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## Kansas

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# ONE J

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## KANSAS



*Steven Rhodes & Sarah Trainer*\*

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### *I. Introduction*

The following is an update on Kansas legislative activity and case law relating to oil and gas law from August 1, 2019 to July 31, 2020.

### *II. Legislative and Regulatory Developments*

There has not been any significant Legislative or Regulatory Developments affecting Kansas Oil and Gas Law from August 1, 2019, to July 31, 2020.

### *III. Judicial Developments*

#### *A. Supreme Court Cases*

##### *1. Jason Oil Company, LLC v. Littler, et al.*<sup>1</sup>

This was a quiet title action involving the mineral interests in two tracts of land that were conveyed by two separate deeds in which the Grantor excepted the mineral interests for a “period of 20 years or as long thereafter” as minerals may be produced. The Supreme Court determined that the common-law rule against perpetuities, being a rule founded on public policy, should not be applicable here. This was a case of first impression for the Kansas Supreme Court.

##### *a) Facts and Procedural History*

On December 30, 1967, Frank E. Littler (Grantor) executed two deeds conveying two tracts of land situated in the same section in Rush County, Kansas. Both deeds contained the following language:

“EXCEPT AND SUBJECT TO: Grantor saves and excepts all oil, gas and other minerals in and under or that may be produced from said land for a period of 20 years or as long thereafter as oil and/or gas and/or other minerals may be produced therefrom and thereunder.” (the reservation)<sup>2</sup>

In 2016, Jason Oil Company, LLC (“Jason Oil”) filed a petition to quiet title to both tracts claiming to hold valid oil and gas leases. The petition alleged that the successors to the Grantees in both deeds owned all of the minerals in and under each tract. The heirs of the Grantor answered, claiming an interest in the mineral rights, arguing that after the deeds were

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1. *Jason Oil Co. v. Littler.*, 446 P.3d 1058 (Kan. 2019).

2. *Id.* at 1059.

executed and delivered, Grantor was vested with a fee simple determinable in the mineral rights and the Grantees to said deeds held springing executory interests in the minerals which were subject to and invalidated by the Rule Against Perpetuities (the Rule).<sup>3</sup>

Grantees' heirs also answered. They admitted all of the allegations in Jason Oil's petition and cross-claimed against Grantor's heirs alleging that Grantees' heirs owned the minerals. Grantees alternatively asserted that if the Court determined the future interest in minerals conveyed by Grantor violated the Rule, the interests should be reformed under the Uniform Statutory Rule Against Perpetuities (USRAP) specifically under K.S.A. 59-3405(b) to conform with the intent of the parties and avoid violating the Rule.<sup>4</sup>

The district court denied summary judgment to the Grantor's heirs and granted summary judgment to the Grantees' heirs. The court noted that there is no dispute that Grantor conveyed all of his interest in the subject properties to the Grantees, subject only to the express reservation, excepting and saving a term mineral interest. The court found that when construing deeds, all other rules are subordinate to the intention of the Grantor and Grantor's intention in this case "could not be clearer than stated."<sup>5</sup> The court also found that Grantor's reservation had not restricted alienation of the surface and mineral estates of the real property in question.<sup>6</sup> The Supreme Court granted the Grantor's heirs' motion to transfer the appeal from the Court of Appeals.

From the expiration of the 20-year term, December 30, 1987, to the date the district court filed its memorandum decision granting summary judgment to the Grantees' heirs, May 31, 2017, there was no drilling operation conducted on either tract and no oil or gas or other minerals were ever produced from either tract.<sup>7</sup>

*b) Analysis*

The Supreme Court was asked to decide a question of first impression in Kansas that carries the potential of voiding innumerable transfers of mineral interests and creating marketable title problems: Does the common practice of reserving a term mineral interest in minerals that continues so long as

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3. *Id at 1060.*

4. *Id.*

5. *Id.*

6. *Id.*

7. *Id.*

minerals are produced create a springing executory interest that must be invalidated by the Rule?<sup>8</sup>

The Supreme Court exercised unlimited review in making its decision. With regards to the Rule, the Supreme Court agreed that the district court was correct in holding that the Rule did not apply to Grantor's excepted interest, but for a different reason. The interest was not a reversion, but rather it was a present, vested interest to which the Rule is simply inapplicable.<sup>9</sup> The future interest created by the deeds that the district court should have focused on is the interest in the minerals that passed to the Grantees. That interest is the right for Grantees to have full possession and use of the mineral interest following the expiration of the Grantor's reserved defeasible term interest. The Supreme Court acknowledged that a future interest would violate the Rule; but their task was to determine whether the Rule should be applied to *this type of future interest*.<sup>10</sup>

The Court noted that no Kansas case has addressed whether to apply the Rule to a grantee's future interest in minerals following the grantor's reservation of a defeasible term mineral interest. Using the straightforward language in the deeds at issue, the Court determined that the deeds created in the Grantees a springing executory interest.<sup>11</sup> The Court went on to explain that if the Grantees' heirs are to receive what the original parties to the deed obviously intended the Grantees to have, it will be because this Court carves out a narrow exception to the common-law rule against perpetuities in Kansas, making the Rule inapplicable to a reserved (or excepted) defeasible term mineral interest of the kind presented here.<sup>12</sup>

The Court agreed with the Grantees that the application of the Rule in this case would actually impede the alienability of the land because it would result in the Grantor's heirs holding the mineral interests in the real estate in perpetuity.<sup>13</sup> The Court agreed with other courts that have pointed out that applying the Rule to prevent the reuniting of split mineral interests would frustrate the policies behind the Rule. Here, applying the Rule would increase the number of owners of the interest over time when the deed provision actually provides for the reunification of the surface and mineral interest.<sup>14</sup>

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8. *Id.*

9. *Id.* at 1063.

10. *Id.* at 1063.

11. *Id.* at 1064.

12. *Id.* at 1065.

13. *Id.* at 1066.

14. *Id.* at 1067.

*c) Conclusion*

The Supreme Court in this case held that the policies behind the Rule include promoting the alienability of property. Applying the Rule in this case would be counterproductive to the purpose behind the Rule and would create chaos. The Court held that 1) the mineral interest reserved by the Grantor was a defeasible term mineral interest; 2) that such interest is a present interest rather than a future interest, and therefore the rule against perpetuities did not apply; and 3) that Grantees' future interest was a springing executory interest. Finally, the Supreme Court here held that where a grantor creates a defeasible term-plus-production mineral interest by exception, leaving a future interest in an ascertainable grantee, the future interest in minerals is not subject to the Rule. The Court held that the Rule does not apply in this case, affirming the district court's granting of summary judgment to the Grantees' heirs and ordering quiet title to the two tracts.

*2. Northern Natural Gas Company v. OneOK Field Services Company, LLC, et al.*<sup>15</sup>

In this case, a natural gas public utility sued gas buyers who had been wrongfully converting gas that had migrated from the utility's underground injected-gas storage field. The Supreme Court reversed the judgement of the district court granting summary judgment against Northern Natural Gas Company ("Northern"), holding that certification from the Federal Energy Regulatory Commission (FERC) permitting Northern to expand the authorized boundaries of its underground storage field to encompass nearby wells changed the right-to-produce analysis for gas taken before June 2, 2010.

*a) Facts and Procedural History*

Northern Natural Gas Company injects into underground storage reservoirs large quantities of previously produced natural gas acquired from distant locations so it can remove, transport, and resell that gas later during peak market conditions.<sup>16</sup> In this case, some of its storage gas migrated beneath the earth to nearby wells in areas Northern did not control through eminent domain or contract. The wells' operators extracted that gas and sold it. A legal struggle ensued over the disputed right to produce Northern's migrated storage gas.

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15. *Northern Nat. Gas Co. v. OneOK Field Services Co.*, 448 P.3d 383 (Kan. 2019).

16. *Id.* at 386.

In a previous appeal, the Supreme Court applied the common-law rule of capture to rule that the operators lawfully produced and sold Northern's storage gas taken before June 2, 2010, the date when Northern received its certificate from FERC.<sup>17</sup> At issue in this appeal was whether the producers could take Northern's migrated storage gas from wells located within the newly certified boundaries from the storage field after June 2, 2010. The district court ruled on summary judgment that the producers had that right under the common-law rule of capture.<sup>18</sup> The Supreme Court disagreed, holding that once the new boundaries were certified, Northern's identifiable storage gas within that designated area was no longer subject to the rule of capture.<sup>19</sup>

*b) Analysis*

There were no material facts in dispute as to the issue on appeal, so the Supreme Court exercised de novo review as to the legal effect of undisputed facts. The legal question here is how the common-law rule of capture operates during the time between certificate issuance and storage rights acquisition.<sup>20</sup>

The Court relied on *Union Gas System, Inc. v. Carnahan*, 245 Kan. 80 (Kan. 1989), which is part of the body of Kansas capture-law in the unique context of migrated storage gas.<sup>21</sup> This case held the gap-filling rule permitting others to capture and keep an injector's gas, as developed in case law, does not apply after a natural gas public utility obtains certificated authority to use a storage area and its gas within that area is identifiable.<sup>22</sup> The Court held that the *Union Gas* exception to the common-law capture rule should continue.

*c) Conclusion*

The Supreme Court in this case held that 1) landowners and producers did not retain right to capture utility's gas after date of FERC certificate; and 2) cessation of right to capture the gas was not a taking. The Court reversed and remanded the district court's grant of summary judgment holding that the court erred when it granted judgment against Northern.

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17. *Id.*

18. *Id.* at 388.

19. *Id.*

20. *Id.* at 396.

21. *Id.* at 400.

22. *Id.*

*B. Appellate Activity*

*1. Lario Oil & Gas Co. v. Kansas Corp. Com'n*<sup>23</sup>

In *Lario Oil & Gas Co. v. Kansas Corp. Com'n*, the Court of Appeals of Kansas addressed, in part, whether the Kansas Corporation Commission (the “Commission”) improperly applied the Kansas Unitization Act in denying an application by the Lario Oil & Gas Company (“Lario”) to unitize several oil and gas leases on the same set of geological formations for the purpose of operating them as a single unit when the Commission’s decision was based on the ground that the formations did not constitute a single pressure system.<sup>24</sup>

*a) Facts and Proceedings*

Lario applied for unitization and unit operations for the Feiertag Unit “to enhance the ultimate recovery of liquid hydrocarbons” from several wells it owns and operates the working interest in within Shawnee, Lansing, Kansas City, Marmaton, Cherokee, Morrow, Basel Penn, and Mississippian formations in said unit within Scott County.<sup>25</sup>

Lario sought to operate a reservoir described as “the interval between the top of the unitized substances in the Topeka Formation at 3,570 feet through the Oread, Lansing-Kansas City Marmaton, Millrich, Morrow and St. Louis formations at 4,700 feet.”<sup>26</sup> Lario argued said unitization was “economically feasible and reasonably necessary to prevent waste within the reservoir and thereby increasing substantially the ultimate recovery of oil and gas,” estimating the value of additional recovery of oil and gas substantially exceeded the estimated additional costs of conducting the unitized operations.<sup>27</sup> Lario noted that 92.64 percent of the working interest holders and 95.53 percent of the royalty owners had approved said unitization.<sup>28</sup>

Cholla Production, LLC (“Cholla”) is one interest holder who did not approve of the unitization, who filed a protest to Lario’s application, and asked to intervene.<sup>29</sup> Cholla, being an oil and gas exploration company who owned and operated oil and gas producing properties both within and next

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23. *Lario Oil & Gas Co. v. Kansas Corp. Com'n*, 450 P.3d 353 (Kan. Ct. App. 2019).

24. *Id.* at 356.

25. *Id.* at 357.

26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.*

to Lario's proposed unit boundary, alleged that Lario's proposed plan would cut through Cholla's contiguous producing acreage and would take over two of Cholla's wells.<sup>30</sup> It further alleged that Lario's proposed plan did not meet the requirements of K.S.A. 55-1304 because: (1) the plan was flawed geologically; (2) the allocations to property owners were unfair and unequitable; (3) the plan would substantially and irreparably harm Cholla's correlative rights; (4) the plan would cause waste in violation of K.S.A. 55-601; and (5) the plan would unduly violate Cholla's property rights contrary to the Kansas and United States Constitution.<sup>31</sup>

Lario did not object to Cholla's intervention, but denied its allegations. The Commission allowed Cholla to intervene.<sup>32</sup>

In its order denying Lario's application to unitize, the Commission stressed three points: (1) it could approve Lario's request for unitization only upon a showing that the unit constituted a single-pressure system and the unit would contribute to the prevention of waste and the protection of correlative rights; (2) Lario had not met its burden to show that its proposed unit constituted a single-pressure system, largely due to the varied bottom-hole pressures shown across the wells; and (3) that Lario's apparent suggestion that it could artificially cure "the problem" by trying to perforate all the formations to create a single-pressure system would constitute waste in violation of the Kansas Unitization Act.<sup>33</sup>

Lario sought judicial review of the Commission's denial of its application. The district court, 25th Judicial District, affirmed the Commission's denial of Lario's application for unitization. Lario appealed the district court's decision to the Court of Appeals Kansas, in part, on the ground that the Commission misinterpreted the Kansas Unitization Act by using a too narrow definition of the term "pool," which improperly increased what it had to prove in order to show that the leases can be operated as a common unit.<sup>34</sup>

For the purposes of this update, we will only be reporting on the first ground stated above.

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30. *Id.*

31. *Id.* at 357.

32. *Id.*

33. *Id.* at 360.

34. *Id.* at 356.

*b) Rules of Law*

The Kansas Unitization Act, K.S.A. 55-1301 et seq., gives the Kansas Corporation Commission the jurisdiction to regulate and permit the grouping of oil and gas leases into a single unit production unit.<sup>35</sup>

The legislative purpose of the Kansas Unitization Act is to prevent waste, to further the conservation of oil and gas, and to protect the correlative rights of persons entitled to share in the production of oil and gas.<sup>36</sup>

There are four factors which the Commission must consider before it can order unit operations. Under K.S.A. 55-1304, the Commission must look at production, feasibility, costs and fairness to all:

(a)(1) The primary production from a pool or part thereof sought to be unitized has reached a low economic level and, without introduction of artificial energy, abandonment of oil or gas wells is imminent; or (2) the unitized management, operation, and further development of the pool or the part thereof sought to be unitized is economically feasible and reasonably necessary to prevent waste within the reservoir and thereby increase substantially the ultimate recovery of oil or gas;

(b) the value of the estimated additional recovery of oil and gas substantially exceeds the estimated additional cost incident to conducting such operations; and

(c) the proposed operation is fair and equitable to all interest owners.<sup>37</sup>

“Waste” is defined under K.S.A.55-1302(d) as being “both economic and physical waste resulting from the development and operation separately of tracts that can best be operated as a unit.”<sup>38</sup>

A “pool” is defined under K.S.A. 55-1302(b) as being “an underground accumulation of oil and gas in one or more natural reservoirs in communication so as to constitute a single pressure system so that production from one part of the pool affects the pressure throughout its extent.”<sup>39</sup>

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35. *Id.*

36. *Id.*

37. *Id.* at 356.

38. *Id.* at 357 (quoting in part, Kan. Stat. Ann. § 55-1302(d) (2020)).

39. *Id.* (quoting in part, Kan. Stat. Ann. § 55-1302(b) (2020)).

*c) Discussion*

Lario raised the following notable issues on appeal:

(1) that the Commission misinterpreted the Kansas Unitization Act by requiring a “full” or “total”, or even a particular degree or extent of pressure communication;

(2) that the Commission erroneously conflated the two distinct pathways to unitization under the Kansas Unitization Act by not recognizing a different standard for pressure communication for pools that are near the end of their economic life under K.S.A. 55-1304(a)(1) than the standard for pools that are not near the end of their economic life under K.S.A. 55-1304(a)(2). and that the Commission’s order erroneously conflated these two distinct pathways to unitization and rendered entire portions of the Kansas Unitization Act meaningless.<sup>40</sup>

*(1) The Commission did not misinterpret the Kansas Unitization Act to require “full” or “total” pressure communication*

Lario argued that K.S.A. 55-1302(b) does not require “full” or “total”, or even a particular degree or extent of pressure communication, and that Lario had provided sufficient evidence of pressure communication throughout the extent of the proposed unit.<sup>41</sup> Lario alleged the use of such a restrictive test creates physical and economic waste rather than preventing it, and would have a chilling effect on future applications for unitization thereby causing more waste.<sup>42</sup>

The Court of Appeals did not find Lario’s argument to be supported by the record, noting the Commission did not use the terms “full” or “total” in their order, and that the Commission simply required Lario to show that its proposed unit constituted a single-pressure system.<sup>43</sup>

*(2) The Commission did not erroneously conflate the two distinct pathways to unitization*

Lario argued that the Commission erroneously conflated the two distinct pathways to unitization under the Kansas Unitization Act by not recognizing a different standard for pressure communication for pools that are near the end of their economic life under K.S.A. 55-1304(a)(1) than the standard for pools that are not near the end of their economic life under

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40. *Id.* at 363.

41. *Id.* at 361.

42. *Id.* at 361-362.

43. *Id.* at 362.

K.S.A. 55-1304(a)(2), thereby rendering entire portions of the Kansas Unitization Act meaningless.<sup>44</sup>

The Court of Appeals agreed with the district court that Lario's argument was "a distinction without a difference", and stated that nothing in the law requires a different standard to be applied for the two pathways to unitization.<sup>45</sup> All units, regardless of their economic condition, must be single-pressure systems according to K.S.A. 55-1302(b).<sup>46</sup>

*d) Conclusion*

The Court of Appeals held the Commission properly interpreted and applied the Kansas Unitization Act in denying Lario's application, and the district court did not err in affirming the Commission's ruling. The judgment of the district court was affirmed.<sup>47</sup>

*C. Trial Activity*

No relevant trial activity was reported during the survey period.

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44. *Id.* at 363.

45. *Id.*

46. *Id.*

47. *Id.* at 368.