

ONE J

Oil and Gas, Natural Resources, and Energy Journal

VOLUME 8

NUMBER 2

KANSAS



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I. Introduction

The following is an update on Kansas legislative activity and case law relating to oil, gas and mineral law from August 1, 2021, to July 31, 2022.

II. Legislative and Regulatory Developments

There have not been any significant Legislative or Regulatory Developments affecting Kansas Oil and Gas Law from August 1, 2021, to July 31, 2022.

III. Judicial Developments

A. Supreme Court Cases

1. L. Ruth Fawcett Trust v. Oil Producers, Inc. of Kansas¹

In *L. Ruth Fawcett v. Oil Producers, Inc. of Kansas*, the Supreme Court of Kansas (“the Court”) held that Kansas mineral rights owners cannot amend a class-action suit to relitigate facts conceded in prior proceedings in an action seeking damages for alleged underpayment of natural gas royalties.

The Kansas Supreme Court held that the royalty owner class failed to justify departing from the “law of the case” doctrine, which bars reconsideration of matters resolved in previous rulings.

a) Facts and Procedural History

This is the second appeal in a class action case alleging a breach of the implied duty to market gas and underpaid royalties.

In 2011, the L. Ruth Fawcett Trust filed a class-action suit on behalf of 2,300 royalty owners (the “Class”) in Seward County, Kansas, alleging well operator Oil Producers, Inc. of Kansas (the “Operator”) had been unlawfully deducting from royalty payments the cost to process raw gas for downstream sale.²

The suit accused the Operator of breaching the marketable condition rule, a corollary to the duty to reasonably market minerals which requires well operators to use their own funds to process gas into a marketable product.

1. *L. Ruth Fawcett Trust v. Oil Producers, Inc. of Kansas*, 315 Kan. 259, 507 P.3d 1124 (2022).

2. *Id.*

After the district court granted summary judgment to the Class, the question of when gas reaches a marketable condition ended up before the Kansas Supreme Court.

In *Fawcett v. Oil Producers, Inc. of Kansas*,³ 302 Kan. 350 (2015) (*Fawcett I*), the Supreme Court held that a well operator may satisfy its duty to market raw gas production if the oil and gas leases provide that raw gas may be sold at the wellhead, the gas is actually sold at the wellhead to a third-party purchaser in a good faith transaction, and the gas is in a condition acceptable to the third-party purchaser at the time of the sale.

The Court thereby held that the Operator properly deducted post-sale processing costs from the royalties owed to the Class. The Supreme Court noted that the leases at issue allowed wellhead sales and the Class did not dispute the well Operator's good faith in executing the purchase agreements.

That case was remanded to the district court.

On remand, the Class moved to amend the petition to clarify that the sole claim in its original petition – breach of implied duty to market – now implicated the implied duty of good faith and fair dealing. Asserting that the Supreme Court had created a new requirement by incorporating a duty of good faith into the marketable condition rule, the Class sought to amend its suit to allege the Operator breached the duty by selling gas that required further processing.

The Class argued that *Fawcett I* significantly altered the landscape of Kansas oil and gas law by introducing the concept of an implied duty of good faith and fair dealing, a factual question, into the marketability determination.

3. Background facts: The original *Fawcett* case was a class action against an operator of natural gas wells alleging breach of implied duty to market gas. The Class sought recovery of underpaid royalties under 25 oil and gas leases entered into between 1944 and 1991, of which Oil Producers, Inc. was the lessee-operator. The royalty provisions in the leases called for the royalty calculations to be made based on a sale of gas at the well or on the market value at the well. Natural gas coming from the ground in its raw condition must be processed before it is suitable for interstate pipelines. The Operator lacked the means to independently process the raw natural gas and make it suitable for transport, so it entered into third-party purchase agreements where the purchaser did the processing of the raw natural gas. The expense of processing the raw natural gas was deducted from the purchase price the third-party purchaser paid to the Operator. The Operator had been paying the class of lessors' royalties based on the sale price after deducting the expense of processing the raw natural gas.

The Operator opposed the motion to amend. It argued that *Fawcett I* already resolved the marketable condition issue when it found that the Operator satisfied its implied duty to market.

The district court sided with the Operator.

The Court of Appeals affirmed.

b) Analysis

Under Kansas law, all gas leases impose an implied duty on well operators to market any minerals produced. To satisfy this duty, the operator must market its production at reasonable terms within a reasonable time following production.⁴

An effect of the duty to market is the marketable condition rule that requires well operators to make gas marketable at their own expense, meaning they cannot deduct the expenses to make gas marketable from royalty payments to the landowners.⁵

In *Fawcett I*, the Court held that when a lease provides for royalties based on a share of proceeds from the sale of gas at the well, and the gas is sold at the well, the operator's duty to make gas marketable is satisfied when the operator, through a good faith transaction, delivers the gas to the purchaser in a condition acceptable to the purchaser.

Relying on the undisputed facts presented by the parties, the Court further held that as a matter of law, the leases at issue did not impose on the Operator the responsibility to perform the post-production, post-sale gathering, compressing, dehydrating, treating, or processing that may be necessary to convert the gas sold at the wellhead into gas capable of transmission into interstate pipelines.

The Court discussed that the law of the case doctrine provides that when a second trial or appeal is pursued in a case, the first decision is the settled law of the case on all questions addressed in a first appeal and reconsideration will not be given to such questions. The law of the case doctrine is a creature of common law with limited exceptions, one of which allows the court to deviate from the law of the case when a controlling authority has made a contrary decision regarding the law applicable to the issues.

Pre-*Fawcett I* caselaw makes clear that the implied duty of good faith and fair dealing in oil and gas sales transactions is part and parcel of the implied duty to market, which requires operators to market the gas on

4. *Fawcett I*, 302 Kan. at 352.

5. *Id.*

reasonable terms as determined by what an experienced operator of ordinary prudence would do, having due regard for the interests of both the lessor and lessee.

Fawcett I did not change existing law by introducing for the first time an implied duty of good faith and fair dealing into the marketable condition component of the duty to market.

The Court pointed out that a court can deviate from the law-of-the-case doctrine when the applicable law has changed.⁶ In the new appeal, the Court rejected the Class's argument that the prior decision had changed the law and for the first time imposed an implied good faith duty on the marketable condition rule. Instead, the Court held that this duty has existed for at least 45 years.

In the underlying case, despite existing case law and the Operator raising the issue of their ability to challenge the prudence of the purchase contracts, the Class chose not to question whether the contracts were unreasonable or made in bad faith. The Court held that, “To allow the Class now to put facts in dispute that it previously deemed admitted would give the Class an impermissible second bite at the apple on the marketable condition question when it was fully litigated in *Fawcett I*.”⁷

The Supreme Court affirmed the district court and appellate court. It held that in *Fawcett I*, the Court held that under the leases at issue the Operator satisfied its duty to market the gas when the gas was sold at the wellhead. The Court went on to conclude that the law of the case doctrine precludes the Class from now relitigating its claim that the Operator breached its implied duty of good faith and fair dealing as alleged in the motion to amend the petition.

c) Conclusion

The Supreme Court held that the Court’s opinion in the prior appeal did not reflect a change of existing law that would allow for an exception to the law of the case doctrine. That doctrine precludes the Class from relitigating the claim that the Operator breached the implied duty to market. The Court further held that the law of the case doctrine precluded the Class from raising a good faith argument based on an intended market theory.

6. *State v. Kleypas*, 305 Kan. 224, 382 P.3d 373 (2016).

7. *L. Ruth Fawcett Trust v. Oil Producers, Inc. of Kansas*, 315 Kan. 259, 282, 507 P.3d 1124 (2022).

B. Appellate Activity

None reported.

C. Trial Activity

None reported.