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I. LEGISLATIVE UPDATES

Since September 1, 2010, the Tennessee legislature has adopted and amended oil and gas legislation by enacting House Bill No. 628 and House Resolution No. 98. Although not passed and signed into enactment, proposed House Bill 1853 is still in the comment period and, if enacted, would expand the notice requirement for the issuance of permits for drilling oil and natural gas.[2]

A. *House Bill No. 628*

Effective July 1, 2011, House Bill No. 628 ("Bill") amended three separate Tennessee statutes. Section One of the Bill deleted subdivision thirty-three in its entirety from Tennessee Code section 4-29-232(a).[3] Section Two of the Bill amended Tennessee Code section 4-29-237(a) by adding subdivision twenty-one thereto titled "Oil and gas

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2. Act introduced Feb. 23, 2011, 2011 Tenn. Pub. Acts 174, sec. 1, § 60-1-103(b).

3. Act of May 5, 2011, 2011 Tenn. Pub. Acts 172, sec. 1, § 4-29-232(a).

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board, created by section 60-1-201."[4] This amendment extended the termination date of the Tennessee Oil and Gas Board from 2011 to June 30, 2016.[5] Section Three of the Bill amended Tennessee Code section 60-1-201 by deleting the section in its entirety and substituting new language creating and establishing the Tennessee oil and gas board and detailing the appointment process for the board.[6] The amended statute requires the Oil and Gas Board to be composed of six members. The membership shall include the following: (i) the commissioner of environment and conservation or the commissioner's designee, who shall act as chair; (ii) the designee of the commissioner of economic and community development; (iii) the chair of the conservation commission; (iv) a member from the oil and gas industry appointed by the governor; (v) an owner of oil or gas property appointed by the governor; and (vi) a member from the mineral industry appointed by the governor.[7] The members appointed by the governor shall each serve four-year terms.[8] In the absence of the commissioner of environment and conservation or the commissioner's designee, the Oil and Gas Board shall elect one of its members to serve as chair.[9]

B. *House Resolution No. 98*

House Resolution No. 98 ("Resolution") was passed by the 107th General Assembly and relates to the use of hydraulic[10] fracturing or "hydrofracking" as a method of natural gas extraction in Tennessee.[11] Currently, the Tennessee Department of Environment and Conservation ("TDEC") regulates gas well drilling and operations under the regulations adopted by the Oil and Gas Board, and such regulations do not explicitly refer to hydrofracking.[12] The Tennessee legislature recognizes the widespread use of hydrofracking as a means to extract natural gas and encourages the TDEC to be forward thinking in its rules and regulations regarding this natural gas recovery method through the enactment of the Resolution.[13] The Resolution encourages "representatives of the Tennessee Department of Environment and Conservation, the Tennessee Oil and Gas Association

4. *Id.*, sec. 2, § 4-29-232(a).
5. *See* TENN. CODE ANN. § 4-29-237(a)(34) (West, Westlaw through end of 2011 1st Reg. Sess.).
6. 2011 Tenn. Pub. Acts 172, sec. 3; TENN. CODE ANN. § 61-1-201 (West, Westlaw through end of 2011 1st Reg. Sess.).
7. TENN. CODE ANN. § 61-1-201(a).
8. *Id.* § 61-1-201(b).
9. *Id.* § 61-1-201(c).
10. The Resolution references "hydrological" fracturing as the modern method for recovery of natural gas being more widely used to extract gas from shale formations. However, to conform with common oil and gas industry terminology and maintain consistency throughout this article, it will be referred to as "hydraulic" fracturing.
11. H.R. 98, 107th Gen. Assemb., 1st Reg. Sess. (Tenn. 2011).
12. *Id.*
13. *Id.*

("TOGA"), and the public, represented by the League of Women Voters and the Tennessee Conservation Voters, to meet with the purposes of proposing regulations to provide necessary oversight for the use of hydraulic fracturing as a method of modern natural gas extraction in Tennessee."[14] The regulations are to be presented to the Oil and Gas Board for consideration with the goal of protecting Tennessee's groundwater quality and water supplies, protecting the collative rights of the land and mineral owners, and to allow for the development, protection and management of the resource of natural gas deposits.[15] Through the Resolution, the legislature is proactively addressing future concerns associated with the development and expansion of the Chattanooga shale and Conasauga Formation underlying much of Tennessee.

C. *Proposed House Bill 1853*

Not only was the Tennessee legislature successful in adopting and amending certain oil and gas legislation through the adoption of the Bill and the Resolution, the legislature also proposed several bills that are still in the comment period that could potentially affect the oil and gas industry if passed and signed into law. The most substantial of which is proposed House Bill 1853 ("Proposed Bill"). The Proposed Bill would amend T.C.A. section 60-1-103 and T.C.A. section 69-3-105 by expanding upon the notice requirement relating to drilling permits for oil and gas extraction.[16] The present law prohibits a person from drilling any well for oil or gas, or conducting any surface disturbances incidental to or in preparation for such drilling, until a permit application has been submitted to the commissioner of environment and conservation ("Supervisor").[17] The Proposed Bill would require a permit applicant to notify the public of the application by posting a sign, the provisions of which are specified by the Supervisor, near the entrance to the drill site and within view of a public road.[18] The sign must be maintained for at least thirty days following submittal of the application.[19] The Supervisor must ensure that the public is notified that a hearing has been scheduled or an appeal has been granted.[20] Public notices may describe more than one permit or permit actions and notice of a public hearing must be given at least thirty days before the hearing is conducted.[21]

14. *Id.*
15. *Id.*
16. Act introduced Feb. 23, 2011, 2011 Tenn. Pub. Acts 174, sec. 1, § 60-1-103(b).
17. TENN. CODE ANN. § 60-1-103 (2007).
18. 2011 Tenn. Pub. Acts 174, sec. 1, § 60-1-103(b)(1).
19. *Id.*
20. *Id.*, § 60-1-103(b)(2).
21. *Id.*, § 60-1-103(b)(3)–(4).

To inform interested persons of the proposed drilling activities, public notices must be circulated within the geographic area of the proposed drilling by the following means:

> (A) Publishing in local daily or weekly newspapers and periodicals, or, if appropriate, in a daily newspaper of general circulation; (B) Mailing (either electronically or physically) a copy of said notice to the following persons: (i) the applicant; (ii) any other agency which the Supervisor knows has issued or is required to issue other permits for the same activity; (iii) federal and state agencies with jurisdiction over fish and wildlife resources and historic preservation, including, but not limited to, the Tennessee wildlife resources agency and the United States fish and wildlife service; (iv) any affected states and Indian Tribes; (v) persons on a mailing list developed by (a) including those who request in writing to be on the list; (b) soliciting persons for area lists from participants in past permit proceedings in that area; (c) notifying the public of the opportunity to be put on the mailing list through periodic publication in the public press, newsletters, environmental bulletins, or state law journals. The supervisor may update the mailing list from time to time by requesting written indication of continued interest from those listed. The supervisor may delete from the list the name of any person who fails to respond to such a request; (vi) any unit of local government having jurisdiction over the area where the proposed drilling is to occur; (vii) each state agency having any authority under state law with respect to the construction or operation of such drilling; and (viii) division of ground water protection of the department of environment and conservation; and (C) [any other method reasonably calculated to give actual notice of the action in question to the persons potentially affected by it, including press releases, web site postings or any other forum or medium to elicit public participation.][22]

The Proposed Bill allows interested persons to submit written comments on the permit application within either thirty days of public notice or such greater period as the Supervisor allows and such comments must be retained and considered in the final determination.[23] Interested persons may also request in writing that the Supervisor hold a public hearing on any application.[24] The request for a public hearing must be filed within the period allowed for public comment and must indicate the interest of the party filing it and the reasons a hearing is warranted.[25] If there were a significant public interest, the Supervisor would hold a hearing in the geographic area of the proposed drilling activities. Notice of the public hearing must be sent to all persons who received a copy of the notice of the application, any person who submitted comments on the application, all per-

22. *Id.*, § 60-1-103(b)(5).
23. *Id.*, § 60-1-103(b)(8).
24. *Id.*
25. *Id.*

sons who requested the public hearing, and any person who specifically requests a copy of the public hearing notice.[26]

Section Two of the Proposed Bill would effectively amend Tennessee Code section 69-3-105 by designating the existing language of subsection (i) as subdivision (i)(1) and adding the following language as subdivision (i)(2):

> Permits issued under title 60, chapter 1, for the extraction of natural gas shall be subject to review under this section with respect to any term or condition or the lack thereof that may result in a condition of pollution under this part.[27]

II. COMMON LAW UPDATES

Although the Tennessee courts were not as active as the state legislature in the oil and gas industry, the courts did provide a framework for the interpretation of a letter of intent concerning the assignment of oil and gas leases in *CNX Gas Co. v. Miller Petroleum, Inc.* The pertinent issue surrounding the case at bar was the interpretation of a letter of intent ("LOI") between CNX Gas Company L.L.C. ("CNX") and Miller Petroleum, Inc. ("Miller").[28]

On May 29, 2008, Miller and CNX entered into the LOI for the assignment of oil and gas leases ("Leases"), where after the closing scheduled for June 6, 2008 ("Closing"), as set forth in the LOI, CNX was to take possession of the Leases for $13 million in consideration.[29] The LOI created an exclusive option period from the time the parties executed the LOI until 5:00 p.m. on June 6, 2008, where CNX had the exclusive option to enter in the assignment for the Leases with Miller.[30] The terms of the LOI also prohibited Miller from entertaining competing offers from other companies for the Leases.[31] When CNX entered into the LOI it was aware of pending litigation between Miller and Wind City Oil & Gas, LLC ("Wind City") with respect to the Leases.[32] Several provisions contained within the LOI allowed CNX to "opt out" of the Closing if it was unsatisfied with the resolution of the pending litigation.

During CNX's exclusive offer period, Atlas America, LLC ("Atlas") sent an offer to Miller to purchase the Leases. However, Miller's CEO denied having read any emails or offers from Atlas or having

26. *Id.*

27. *Id.*, sect 2, § 69-3-105.

28. CNX Gas Co. v. Miller Petroleum, Inc., No. E2009-00226-COA-R3-CV, 2011 WL 1849082, at *1 (Tenn. Ct. App. May 11, 2011).

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.*

had any communication with Atlas during the exclusive time period that would violate the terms of the LOI.[33]

On June 6, 2008, Miller refused to close the agreement because it did not have possession of the Leases due to the pending litigation, and Miller thought it had the right, within the terms of the LOI, to opt out for this reason.[34] Within days of refusing to close the deal with CNX, Miller began negotiations on a similar deal for the assignment of the Leases with Atlas.[35] On June 12, 2008, the Atlas deal closed for $19 million, which included the Leases and eight additional wells not within the CNX deal.[36] On June 13, 2008, the pending litigation between Miller and Wind City concluded.[37]

CNX brought suit against Miller under a breach of contract theory, claiming Miller breached the terms of the LOI by (1) refusing to close the transaction on June 6, 2008, and (2) entertaining competing offers from Atlas during the exclusive option period.[38] Miller filed a motion for summary judgment that was granted by the Chancery Court.[39] CNX appealed to the Court of Appeals of Tennessee claiming the trial court erred in (i) interpreting the terms of the LOI, and (ii) granting summary judgment by holding that Miller was excused from closing due to a lack of possession of some of the Leases.[40]

The central issue on appeal was whether the trial court properly interpreted the terms of the LOI and whether it provided Miller with such a right to opt out of the contract. Miller argued that paragraph two[41] of the LOI provided CNX with an "out," while paragraph three[42] of the LOI provided Miller with an "out" if pending litigation

33. *Id.* at *2.
34. *Id.* at *1.
35. *Id.* at *2.
36. *Id.*
37. *Id.* at *2.
38. *Id.*
39. *Id.*
40. *Id.* at *2–3.
41. *Id.* at *5 ("2. For a period from the date of Miller Petroleum's execution of this Letter of Intent until 5:00 on Friday, June 6, 2008, (a) Miller Petroleum shall grant CNX the exclusive option and right to enter into the Assignment with Miller Petroleum . . . Provided, however, if during such period any litigation or material defect affecting title to the Leases has not been resolved satisfactorily to CNX, CNX shall not be required to close the transaction but the option period may be extended with the consent of each of the parties hereto. Miller Petroleum shall not during such period solicit or entertain any offers or proposals of, or enter into any agreement with, third parties to acquire an interest in the Leases, nor negotiate or discuss the sale of an interest in the Leases.").
42. *Id.* at *6 ("3. As consideration for this Letter of Intent and the terms and conditions contained herein, including without limitation the exclusive option and right to enter into the Assignment as set forth in paragraph 2, upon receipt by CNX of a copy of this Letter of Intent fully executed by Miller Petroleum, CNX shall pay Miller Petroleum the amount of ONE MILLION DOLLARS ($1,000,000) . . .; *provided, however, that should Miller Petroleum be unable to enter into the Assignment contemplated by this Letter of Intent within the option period set forth in paragraph 2*

with Wind City could not be resolved. Miller claims that its out is provided in the clause stating that Miller must return $1 million paid as consideration by CNX "should Miller Petroleum be unable to enter into the Assignment" because of "unresolved litigation."[43]

To resolve this issue the court provided a comprehensive framework for the interpretation of contracts. The court noted that "[t]he cardinal rule of contract interpretation is that the court must attempt to ascertain and give effect to the intention of the parties."[44] To determine intent, the court assigns each word its "usual, natural and ordinary meaning."[45] The court must determine if any of the language in the contract is ambiguous, which is found when a word is susceptible to multiple interpretations or definitions.[46] If ambiguity is found within the contract, the ambiguity is construed against the drafter of the contract, and if ambiguity is not found within the contract, "the literal interpretation of the language controls the outcome of the contract disputes."[47] The court held that the LOI was not ambiguous and a straightforward reading of the LOI led to the conclusion that "CNX was the only party without any obligation to enter into the Assignment due to the pending litigation."[48] The court went on to state that "when a contract's language is clear and unambiguous, 'the contract is interpreted according to its plain terms as written, and the language used is taken in its plain, ordinary and popular sense.'"[49] The court further stated that "[t]he interpretation should be one that gives reasonable meaning to all of the provisions of the agreement, without rendering portions of it neutralized or without effect."[50]

Based on the foregoing, the court disagreed with Miller's interpretation of the LOI for several reasons. First, the language Miller claimed provided it with a right to opt out is different "from the language used throughout the LOI that reserves CNX's right to opt out of the Closing."[51] The court read "should Miller be unable to enter" to mean that Miller would be unable to close the transaction because CNX *was unsatisfied* with the resolution of the pending litigation, it did not state a condition that would allow Miller to opt out of the agreement.[52] Next, paragraph two, subsection (f), which referred to the clause where Miller must return payment to CNX for the acres

due to unresolved litigation affecting title to the Leases, then within five days after the expiration of the option period Miller Petroleum shall return the ONE MILLION DOLLARS ($1,000,000) to CNX.") (emphasis added).

43. *Id.*
44. *Id.* at *4 (citing Christenberry v. Tipton, 160 S.W.3d 487, 494 (Tenn. 2005)).
45. *Id.* at *4.
46. *Id.*
47. *Id.*
48. *Id.* at *7.
49. *Id.* (quoting Maggart v. Almany Realtors, 259 S.W.3d 700, 704 (Tenn. 2008)).
50. *Id.*
51. *Id.* at *8.
52. *Id.* (emphasis added).

that CNX deemed unsatisfactory due to defects in the title or pending litigation *after* the Closing, demonstrated the parties' intent that they may have closed the transaction without possessing all the Leases.[53] Finally, paragraph four contains conditions precedent that would require CNX to enter the Assignment.[54] One of these conditions expressly states that any litigation affecting the title to the Leases be "resolved satisfactorily to CNX."[55] There is no such provision in the LOI reserving the right to Miller.

In conclusion, the LOI was held by the court not to be ambiguous when read within the plain meaning of the words. The court noted "CNX was the only party to reserve the right to opt out of the Closing if the pending litigation was resolved in a manner unsatisfactorily to it."[56] Therefore, Miller did not reserve any right to opt out of the Closing. The appellate court reversed the trial court's grant of summary judgment in favor of Miller, Atlas, and Wind City and remanded the cause for further proceedings consistent with the court's opinion.

53. *Id.*

54. *Id.* at *6 ("4. *CNX shall have no obligation to enter into the Assignment to acquire the Leases* (or Miller Petroleum's interest therein) unless each of the following condition precedent have been strictly fulfilled: (a) any and all litigation affecting title to the Leases have been resolved satisfactorily to CNX; and (b) Miller Petroleum has provided information reasonably satisfactory to CNX and that Miller Petroleum has the necessary authority to enter into the Assignment.") (emphasis added).

55. *Id.*

56. *Id.* at *9.