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I. Legislative and Regulatory Developments

This year's developments included the State of Oklahoma creating the Emission Reduction Technology Incentive Act, and the Oklahoma Corporation Commission adopting final versions of several rules, including new allowables for gas wells.

A. State Legislative Developments

1. Commission May Permit Well Drilling Pending Orders

House Bill 3039 relating to common source of supply and well spacing and drilling units and allowing the drilling of wells prior to the Oklahoma Corporation Commission granting certain orders was enacted on May 20, 2022. It amends 52 O.S. Section 87.1 to provide that the Commission may issue a permit to drill any well for which notice and hearing have occurred for a special order or an order on the merits in any type of case prior to the issuance of any such order. A final order from the Commission is required prior to drilling any well that falls within one (1) mile of the boundary of an underground storage facility except in cases where the underground storage operator does not object.[1]

2. Oklahoma Emission Reduction Technology Incentive Act and Additional Tax Incentives

House Bill 3568, enacted May 26, 2022 and effective July 1, 2022, creates the Oklahoma Emission Reduction Technology Incentive Act to be codified at 68 O.S. Section 55006 et seq. The Act creates a rebate program through July 1, 2027 for a rebate in the amount of up to twenty-five percent (25%) of documented expenditures directly attributable to the implementation of a qualified Emission Reduction Project. The rebate program will be administered by the Department of Environmental Quality and the Oklahoma Tax Commission.

HB 3568 amends 68 O.S. Section 1001 to provide for a gross production tax exemption for a period not to exceed five (5) years for secondary and tertiary recovery projects approved or having an initial project start date on or after July 1, 2022 and for wells drilled which are completed with the use of recycled water on or after July 1, 2022 from the date of first sales for a period of twenty-four (24) months, proportionate to the percentage of the total amount of water used to complete the well that is recycled water. The exemptions shall be administered as a refund to be claimed after the end of

1. 2022 Okla. Sess. Law Serv. ch. 289 (H.B. 3039) (West).

the fiscal year. The amount of refunds is capped and will be proportionate if required to avoid exceeding the maximum amounts authorized for refunds.

HB 3568 also amends 68 O.S. Section 1001.3 to provide for a partial exception from gross production tax as a tax refund for economically at-risk oil or gas leases, defined as any lease with one or more producing wells with an average production volume per well of ten (10) barrels of oil or sixty (60) MCF or less of natural gas per day operated at a net loss or at a net profit which is less than the total gross production tax for such lease during the previous calendar year, and the gross value of the oil falls below Fifty Dollars ($50) per barrel, on an average monthly basis, and the price of gas falls below Three Dollars and fifty cents ($3.50) per MMBtu, on an average monthly basis. Again, the total amount of refunds is capped and will be proportionate if required to avoid exceeding the maximum amounts authorized for refunds.[2]

B. State Regulatory Developments

1. Oil & Gas Conservation Rule Updates

On September 1, 2021, the Oklahoma Corporation Commission published various permanent final adoptions of rules, to be effective October 1, 2021, including: rules to modify allowables for horizontal gas wells, extend the time period to submit initial test results for gas wells to sixty (60) days after the date of first sales of gas, reduce the frequency of gas well tests, and clarify permitted rates of production for unallocated gas wells.[3]

2. Production Rates for Unallocated Gas Wells

On March 3, 2022, by Order No. 723929, in Cause CD No. 202102956, the Oklahoma Corporation Commission entered an order regarding the maximum permitted rates of production for unallocated natural gas wells. The order establishes a proration formula for the period between April 1, 2022 through March 31, 2023 at seventy-five percent (75%) of wellhead calculated absolute open flow potential or 3,000 mcf/d, whichever is greater.[4]

2. 2022 Okla. Sess. Law Serv. ch. 346 (H.B. 3568) (West).
3. 38 Okla. Reg 1739 (Sept. 1, 2021).
4. Okla. Corp. Comm'n, Cause CD No. 202102956, Order No. 723929 (Mar. 3, 2022).

II. Judicial Developments

This year Oklahoma state courts examined the limits of local control over oil and gas operations, and how an order from the Oklahoma Corporation Commission can affect a joint operating agreement. Also, the federal court for the Western District of Oklahoma explained when a pipeline company can acquire property using eminent domain under the Natural Gas Act.

A. Supreme Court Cases

Magnum Energy, Inc. v. Board of Adjustment for City of Norman, 2022 OK 26, 510 P.3d 818

How much authority does a municipality have to regulate oil and gas activities? Magnum Energy, Inc. ("Magnum") applied for a variance from the Board of Adjustment for the City of Norman ("City") for a variance from the City's requirement that oil and gas operators maintain $2 million of umbrella liability coverage.[5] The trial court granted summary judgment for Magnum, holding the coverage requirement conflicted with State law; however, the Court of Civil Appeals ("COCA") reversed.[6] The Oklahoma Supreme Court held the requirement conflicts with 52 O.S. Supp. 2015 § 137.1 ("137.1"), setting forth a municipality's authority to regulate oil and gas operations; therefore, the requirement is unenforceable.[7]

Magnum operates the Patty No. 1 well in Norman, Oklahoma, and on January 2, 2018, it requested a waiver of the umbrella insurance requirement. On January 24, 2018, City denied the waiver, and Magnum appealed to the District Court of Cleveland County.[8] That court granted Magnum's motion for summary judgment, while the COCA reversed, holding the requirement was a valid exercise of City's police power.[9]

The Oklahoma Supreme Court separated the issue into two parts: "(1) what is the scope of municipal authority to regulate the production of oil and gas, and (2) whether [the insurance requirement] falls within the scope of that authority."[10]

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5. Magnum Energy, Inc. v. Bd. of Adjustment for City of Norman, 2022 OK 26, ¶ 1, 510 P.3d 818.
6. *Id.* ¶¶ 2-3.
7. *Id.* ¶ 0.
8. *Id.* ¶ 2.
9. *Id.* ¶ 3.
10. *Id.* ¶ 7.

Magnum argued that 137.1 limits a municipality's authority to regulate oil and gas operations to three categories: (1) road use, traffic, noise, and odors; (2) establishing setbacks and fencing requirements to protect health, safety, and welfare; and (3) enact reasonable ordinances within a 100-year floodplain to maintain flood insurance. Except for those three categories, "all other regulations of oil and gas operations shall be subject to the exclusive jurisdiction of the Corporation Commission."[11]

City responded that 137.1 did not "comprise the full scope of authority to regulate" oil and gas operations. City claimed it also had a general police power to provide for the safety of its citizens, allowing it to enact regulations that go beyond the categories noted above.[12]

The Oklahoma Supreme Court held that when the State Legislature enacted 137.1, it severely limited a municipality's ability to regulate oil and gas operations, instead conferring that authority on the Corporation Commission.[13] In doing so, the Court held City's authority to regulate such operations is limited to those areas specified in 137.1, and City's umbrella insurance requirement does not fall within those areas, rendering it unenforceable.[14]

Crown Energy Company v. Mid-Continent Casualty Co., 511 P.3d 1064, 2022 OK 60

Does a general liability policy apply to damages allegedly caused by waste water disposal wells? Crown Energy Company ("Crown") operates oil and gas wells in Payne County, Oklahoma. In 2015, Crown obtained insurance from Mid-Continent Casualty Co. ("Mid-Continent") to cover those operations. The policy applies to bodily injury or property damage caused by an occurrence, and it includes a Pollution Exclusion.[15]

In December 2016, a group of Payne County residents sued Crown and other operators in a class action lawsuit, claiming the defendants' waste water disposal wells had caused seismic activity which damaged the plaintiffs' property (the "Reid Lawsuit"). Crown submitted a claim to Mid-Continent requesting defense and indemnity pursuant to the insurance policy. Mid-Continent denied Crown's request, claiming the damages were not caused by an "occurrence" as defined in the policy, and citing the

11. *Id.* ¶ 9.
12. *Id.* ¶ 12.
13. *Id.* ¶ 19.
14. *Id.* ¶ 20.
15. Crown Energy Co. v. Mid-Continent Casualty Co., 2022 OK 60, ¶ 1, 511 P.3d 1064.

Pollution Exclusion.[16] Under the Exclusion, the policy does not apply to bodily injury or property damage "arising out of the discharge…of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon the land, the atmosphere or any water course or body of water[.]"[17]

Crown filed suit, and the trial court held Mid-Continent had a duty to defend Crown in the Reid Lawsuit.[18] The Court of Civil Appeals ("COCA") affirmed the trial court, ruling the Pollution Exclusion did not apply. The COCA found the seismic activity was caused by the injection of waste water into the disposal wells at high pressure, and the Pollution Exclusion did not reference the injection of pollutants into the land "under pressure." Mid-Continent appealed to the Oklahoma Supreme Court, claiming the COCA's emphasis on the pressure of the injection amounted to a "new and independent theory of causation" and undermined the effect of the Pollution Exclusion.[19]

The policy defines "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." Mid-Continent argued Crown intentionally injected waste water into its disposal wells, so the injection could not be considered an "accident."[20]

The Oklahoma Supreme Court rejected that argument, finding the seismic activity itself was accidental because it is not a "natural and probable consequence" of Crown's activities. The seismic activity constituted the occurrence as defined by the policy.[21]

In its second argument, Mid-Continent claimed the Pollution Exclusion applied because the Reid Lawsuit concerned claims arising out of the discharge of toxic liquids and waste materials, and the Oklahoma Corporation Commission had identified waste water as a "deleterious substance."[22]

Crown countered the Pollution Exclusion is ambiguous as to whether it applies to the claims arising out of seismic activity, and the court should apply the "reasonable expectations doctrine" to determine whether the

16. *Id.* ¶ 3.
17. *Id.* ¶ 2.
18. *Id.* ¶ 4.
19. *Id.* ¶ 5.
20. *Id.* ¶ 10.
21. *Id.* ¶ 12.
22. *Id.* ¶ 13.

applicability of the policy. Crown argued the pressure of the injection caused the property damage, not the polluting nature of the waste water.[23]

After discussing past holdings, the Oklahoma Supreme Court found the Pollution Exclusion to be ambiguous as to whether it applies to the claims in the Reid Lawsuit. Since the court construes ambiguous provisions in favor of the insured, it held Crown could have reasonably expected the policy to cover the claims in the Reid Lawsuit, and affirmed the trial court's judgment.[24]

B. Appellate Activity

FourPoint Energy, LLC v. BCE-Mach II, LLC, 2021 OK CIV APP 46, 503 P.3d 435

When the Oklahoma Corporation Commission (the "Commission") issues a pooling order and designates an operator, who has the authority to designate a successor operator – a court or only the Commission?

The Commission designated EnerVest Operating, LLC ("EnerVest") as operator of several wells subject to JOAs involving FourPoint Energy ("Energy"), and some of those areas were also subject to force pooling orders. In late 2019, BCE-Mach II, LLC ("BCE") bought EnerVest's interest in those properties, including those subject to force pooling orders.[25]

EnerVest has filed the paperwork to transfer operations to BCE, and the Commission has designated BCE as the bonded operator of the pooled wells. However, the Commission has yet to approve all of BCE's applications to amend the force pooling orders to designate BCE as operator.[26]

Energy filed suit in 2020 in Beckham and Washita Counties, requesting the district court declare them operator under the applicable JOAs, enjoin BCE from operating the properties, and award monetary damages due to BCE's alleged breach of contract for failure to relinquish operations.[27] The trial court granted BCE's motion to dismiss on all pooled properties, citing the court's lack of subject matter jurisdiction.[28]

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23. *Id.* ¶ 14.
24. *Id.* ¶ 25.
25. FourPoint Energy, LLC v. BCE-Mach II, LLC, 2021 OK CIV APP 46, ¶ 3, 503 P.3d 435.
26. *Id.* ¶ 4.
27. *Id.* ¶ 5.
28. *Id.* ¶ 6.

The Court of Civil Appeals ("COCA") upheld the trial court's dismissal of Energy's claims for a declaratory judgment and injunctive relief due to the court's lack of subject matter jurisdiction. However, the COCA found the trial court erred in dismissing Energy's claim for breach of contract; the court should have allowed Energy to amend its complaint to allege BCE breached the JOA for reasons other than failure to turn over operations to Energy.[29]

Energy argued when parties enter into private contracts, the District Court should determine the parties' respective rights and obligations. The COCA disagreed, citing when the Commission has issued a force pooling order, it has exclusive jurisdiction to designate an operator.[30] "Though JOAs, including ones with 'successor operator provisions' (like those at issue here), are used to supplement forced pooling orders…private contract provisions that purport to transfer Commission-conferred power cannot alter a unit operator's legal status."[31]

Regarding Energy's claim for breach of contract, the trial court ruled that claim was not yet at issue because the Commission had not yet designated BCE as operator. If the Commission did not designate BCE as operator under the force pooling orders, then BCE could not have breached the contract.[32]

The COCA reversed the trial court's order in this respect, holding the court does not need to wait for the Commission because the Commission's designation of an operator can be separated from Energy's breach of contract claim. Even if the Commission designates BCE as operator, BCE could still be liable for damages under the JOA, and the question of liability may not be determined by a motion to dismiss.[33]

C. Federal Cases

Kunneman Properties, LLC, et al. v. Marathon Oil Company, 2022 WL 1766925 (N.D. Okla. 2022)

What requirements does a plaintiff have to meet to certify a class action? Kunneman Properties, LLC, et al. ("Kunneman") own royalty interests in wells operated by Marathon Oil Company ("Marathon"). Kunneman claimed Marathon breached leases and underpaid royalties by improperly

29. *Id.* ¶ 19.
30. *Id.* ¶ 11.
31. *Id.* ¶ 12.
32. *Id.* ¶ 17.
33. *Id.*

deducting costs of midstream services required to make the natural gas marketable.[34] This lead Kunneman to move for class certification pursuant to Rule 23 of Federal Civil Procedure ("Rule 23") for the following class: (1) all mineral owners subject to a lease from August 7, 2012 under which they received royalty attributable to Marathon's interest in Oklahoma properties; and (2) those royalty payments were reduced for costs for marketing, gathering, compressing, dehydrating, treating, processing or transporting the natural gas.[35]

Kunneman also offered a subclass: all owners subject to a lease with an express provision stating, "royalty will be paid on gas used off the lease premises (an Off-Lease-Use clause)."[36] The proposed class includes 19,788 leases and 1,336 wells in 21 different counties in Oklahoma.[37] Marathon argued Kunneman did not meet Rule 23's requirements of commonality, typicality, adequacy, or predominance.

Regarding commonality, the court explained there must be "questions of law or fact common to the class."[38] Will the resolution of the issue resolve the issue for all class members? Kunneman argued Marathon breached the implied duty of marketability and there is a common question as to at what point gas becomes marketable.[39]

Kunneman broke the leases down into seven separate categories; however, Marathon argued and the court found inconsistencies in Kunneman's categorization, including the same royalty payment language found in leases in separate categories. Kunneman argued none of the lease provisions eliminate the implied duty of marketability, making all of the leases "the same." The court disagreed, holding there are too many variations of lease language within each category; therefore, Kunneman did not satisfy the commonality requirement.[40]

Second, the court turned to the typicality requirement, or that the claims of the class representative are typical of the claims of the entire class. Since every claim is based on an alleged breaching of a lease, the court held Kunneman satisfied the typicality requirement.[41]

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34. Kunneman Props., LLC v. Marathon Oil Co., 2022 WL 1766925 (N.D. Okla. 2022).
35. *Id.* at *1.
36. *Id.*
37. *Id.*
38. *Id.* at *3.
39. *Id.*
40. *Id.* at *5-9.
41. *Id.* at *9.

Third, Kunneman must establish the class representative will "adequately protect the interests of the class." The court set forth a two-prong test: (1) do the named plaintiffs have any conflicts with the remaining class members, and (2) will the named plaintiffs prosecute the action "vigorously on behalf of the class?"[42]

Marathon argued the named plaintiffs were inadequate because they did not understand the litigation. The court disagreed, finding the named plaintiffs understood why they thought Marathon breached their leases, read the leases provisions and their royalty check stubs, and understood their role as representatives of the class. Therefore, Kunneman satisfied the adequacy requirement.[43]

Next, Kunneman sought class certification pursuant to Rule 23(b)(3), which requires the court to find the common questions of law predominate over any other questions of law affecting only individual class members.[44]

After analyzing the leases, the court explained the proposed class presents as many as 137 legal issues for the court to determine, and adjudicating each issue would be unmanageable. Therefore, Kunneman did not satisfy the predominance requirement.[45]

Finally, the court explained Kunneman must establish a class action is superior to any other method of "fairly and efficiently adjudicating the controversy."[46] Marathon argued individual class members want to control the litigation because they have filed their own lawsuits against Marathon. The court responded that those are only four lawsuits, so they do not defeat the superiority of a class action.[47]

Ultimately, since Kunneman could not meet the requirements for commonality and predominance, the court declined to certify the proposed class or modify the class to certify a partial class. Due to the general inaccuracies in Kunneman's proposed categories of lease royalty payment provisions, the court declined the motion for class certification.[48]

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42. *Id.* at *10.
43. *Id.*
44. *Id.* at *11.
45. *Id.* at *11-12.
46. *Id.* at *12.
47. *Id.*
48. *Id.* at *13.

Panhandle Eastern Pipe Line Company, LP v. Tarralbo, 2022 WL 386099, Util. L. Rep. P 15,208 (W.D. Okla. 2022)

Under what circumstances does the Natural Gas Act ("NGA") authorize a pipeline company to use eminent domain to acquire property? Panhandle Eastern Pipe Line Company, LP ("Panhandle") operates a compressor station in Kingfisher County pursuant to two certificates issued by FERC in 1979 and 1981, declaring the station "necessary and integral" to Panhandle's "ability to transport natural gas through its pipelines in interstate commerce."[49]

From 1979 through April 20, 2020, Panhandle leased the land from the defendants ("Tarralbo"). After the lease expired, Tarralbo rejected several offers by Panhandle to buy the property, leading Panhandle to ask the Court to declare that § 717 of the Natural Gas Act ("NGA") authorizes it to use eminent domain to acquire the property.[50]

The Court explained Federal Rule of Civil Procedure 71.1 sets forth the procedural aspects of NGA condemnation proceedings. Rule 71.1 describes a two-step procedure: (1) determine whether the taking is proper; and (2) determine just compensation.[51]

§ 717f(h) allows natural gas companies holding certificates of public convenience and necessity to acquire real property through eminent domain. The statute sets forth three requirements Panhandle must meet to succeed in the action and establish this court has subject matter jurisdiction: (1) holds the required certificate; (2) unable to agree on compensation to acquire the property; and (3) the property value exceeds $3,000.[52]

The court explained Panhandle meets the first and third requirements, but Tarralbo argued the second requirement has not been met because the lease included a provision evidencing the parties' agreement to extend the lease to 2029. The court rejected the argument, explaining nothing in the lease required an extension, and after the lease expired, Panhandle made several unsuccessful attempts to purchase the property.[53]

Next, Tarralbo argued § 717f(h) limits the use of eminent domain to new pipeline construction or equipment installation. Again, the court rejected the argument, holding the statue authorizes eminent domain to acquire land

49. Panhandle Eastern Pipe Line Co., LP v. Tarralbo, 2022 WL 386099, Util. L. Rep. P 15,208 (W.D. Okla. 2022).

50. *Id.* at *1.

51. *Id.* at *2.

52. *Id.* at *3.

53. *Id.*

necessary to operate and maintain pipelines, even if the pipeline system has already been built. Having met all three requirements, the court held Panhandle had the right to use eminent domain.[54]

Regarding just compensation, the court explained it can only appoint a three-person commission and deny a jury trial in "exceptional cases." The court ordered the parties to submit briefs concerning whether "this is one of those exceptional cases."[55]

54. *Id.* at *4.
55. *Id.* at *5.