ENERGY LAW CASES UPDATE

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Thanks again for the warm welcome. I'm going to run through a caselaw update this morning, and so we're just going to walk through a smattering of different issues that hit on the energy industry—largely oil and gas related stuff this morning, although there are some issues that cross over that area of relevance to other areas in the energy industry as well. Hopefully we'll have a little bit of something for everyone. We'll start off by talking about one of the areas that's seen some of the most litigation in the oil and gas sphere in North Dakota over the last few years. One of my favorite topics: the North Dakota prompt pay statute. You can get 18 percent interest on royalties, it's super exciting. We'll walk through those cases and talk about some recent developments there. It's an important area, I think an area of growing interest in North Dakota as the Bakken play matures. Certainly we still continue to see those types of lease validity disputes and quiet title type disputes but those were more pronounced, I think, toward the beginning of the play. And now as time goes on, we're seeing more and more royalty litigation where we have royalty owners and their lessees or their operators getting into disputes about how royalties are calculated, how they're paid or, in some of these cases, the timeliness with which they're paid.

Then, we'll shift gears a little bit and talk about some surface use issues. The case I'm going to talk about relates specifically to competing easement rights in the oil and gas context, but it can also be of relevance to other areas in the industry, especially out in the western part of the state, as many of you are familiar with. If you've dealt with surface use issues or with surface land issues, in a lot of areas where there's been a lot of development, there's a lot of areas with a lot of crisscrossing easements and surface use agreements and that type of thing. So, you can end up in situations, not only in conflicts with the landowner, but also in conflicts between companies. This case is a bit of a case study in how the North Dakota Supreme Court dealt with and resolved one of those issues.

Then, we'll talk a little bit about risk penalties. I'll get into it more when we talk about the case, but as many of you know, in North Dakota, our oil and gas industry operates in the shadow and with the use of a force pooling regime that's overseen by the North Dakota Industrial Commission (NDIC).

* This transcript has been edited and refined for readability.

Meaning that the state, through its police power, can pool and unitize oil and gas interests. Then, you have an operator who's operating a spacing unit, for instance, who may not own all of the leases in that area. Then, when you have non-operating owners who also own interests, other lessees, that's where risk penalties come into play. We'll dive into an interesting example of a situation in which you had a spacing unit which then became part of a larger unitized area and the wells in that unit became unit wells and how the risk penalty works in that type of a scenario.

Then, finally, I'm going to talk a little bit about a cessation of production case that came out of the North Dakota Supreme Court in the last few years. The idea there is you have oil and gas leases that are held by production—a typical oil and gas lease is going to have a primary term, maybe three years, and then it's going to have a secondary term. It will be held for so long thereafter as there's production and paying quantities on the lease. Well, what if production stops for some temporary period of time? How do you know if the lease is still good or not? That's what this last case deals with. It also deals with some arguments that the lessee raised about force majeure type arguments, which, of course, we see in all kinds of different contractual scenarios. We will take a look at how the Supreme Court dealt with the force majeure issue in that case and what we can glean from that about how they might treat force majeure clauses.

So, with that, I'll jump into talking about the prompt pay statute. I have the code provision up here. It provides again for 18 percent interest, which can add up pretty quickly as time goes on. I just want to go through a few background concepts, because these are themes that these cases are going to hit on as we walk through them. So, these are things I want you to keep in mind. First is just the basics of how the statute works. The operator-lessee of the oil and gas well is required to pay oil and gas royalties within 150 days after the production is marketed, and if they fail to do so, absent certain exceptions, that can result in lease cancellation, which is fairly rare—that would be kind of the extreme scenario—or an 18 percent interest award to the mineral owner on unpaid royalties until they're paid. The statute, as I mentioned, has as some exceptions, there are some safe harbor provisions. There are three safe harbor provisions, but the one we're going to talk about today—because it's by far the one that's most commonly litigated—is the dispute of title safe harbor. The idea there is that you can run into scenarios where you have title issues, title disputes where it's unclear who should be paid, and it wouldn't be fair in that scenario to have the operator liable for this high rate of interest. So, there's an exception to the statute in that scenario where you can lawfully suspend royalties where there's a dispute of title that's going to affect payment.

And then last, we've seen litigation, several cases in recent years, on the fee-shifting provision of this statute. It's an interesting fee-shifting provision because it goes both ways and it's mandatory. So, if you're a royalty owner and you bring a claim under this statute, a meritorious claim, and you win, you can recover your attorney's fees, but you have to be careful because you have some skin in the game too. If you lose, the operator-lessee can actually recover their attorney's fees against you if they're the prevailing party.

Let's jump in and talk about a few cases. The first one I want to hit on is *Powell v. Statoil* [*Oil & Gas LP*]. This case involves a couple of different issues that we'll look at. One is statute of limitations and what statute of limitations is going to apply to the statute. It ends up being more complex than you might think. The other issue is sort of a gloss on how that title dispute safe harbor works. The background here is an unusual title issue that affects the validity of the oil and gas lease. It was an unrecorded power of attorney. Powers of attorney generally need to be recorded. There's a title issue flagged on that, the operator in this situation suspends royalties based on that title requirement. When a well starts producing in 2012, the royalties are in suspense and then they remain that way for a number of years. The operator, there's no evidence in the case that they notified the royalty owner that their royalties were being held in suspense, at least not right away. A number of years go by, finally the lessor figures it out, it comes back to the operator's attention. They resolve the issue and release the royalties in 2017. They pay the royalties, but they don't pay interest under this statute. So, a couple of years later, the lessor files an interest claim under the prompt pay statute.

At the district court level, the district court ultimately—if I recall correctly—dismissed the claim based on the statute of limitations. The operator argued that because of the high rate of interest, because this is an 18 percent interest statute, that qualifies as a penalty. North Dakota has a 3-year statute of limitations for statutory penalties, so they argued for that statute of limitations and the district court agreed with them. Well, when the case went up on appeal, the North Dakota Supreme Court went a different direction and they held that the 10-year statute of limitations applied.

Specifically, the 10-year statute of limitations applied for an action upon a contract contained in any conveyance or mortgage of or instrument affecting the title of the real property. Maybe kind of a surprising result for some practitioners, because this statute of limitations relates specifically to contracts affecting the title of the real property. How do they get there in terms of applying that limitations period to a statutory interest provision? What the Supreme Court said was, the important thing to remember is the operator here was also the lessee. There was a lease between the royalty owner and the operator who was being sued.

The Supreme Court, in getting to this statute of limitations, characterized this claim as, at least in part, one for breach of the lease. A lease is a contract that contains a conveyance of a real property interest. So they characterize the claims, at least in part, one for breach of the lease, between the mineral owner and the defendant, the operator here, and that's how they get to this 10-year statute of limitations for contracts containing a conveyance of a real property interest. They also rejected the 3-year limitations period for statutory penalties, and they said the legislature chose to call this interest, not penalty, and we're going to take them at their word. I think another interesting thing about this case though is that both parties did the "go big" thing. The plaintiff went for the 10 years, the operator went for the 3 years, and the Supreme Court didn't consider the 6-year statute of limitations as far as I can tell. The 6-year statute of limitations applies to liabilities created by statute, other than penalties, which would seem like kind of an obvious candidate to me that you might want to consider, but that wasn't raised.

Ultimately, the case comes out and holds a 10-year statute of limitations applies to at least this claim, where there's a contract between the mineral owner and the operator. Of course, this raises some additional questions. It doesn't provide us an answer across the board for this statute because what about situations where you don't have a contract? What if you have an unleashed mineral owner who has no lease at all with anybody? What if you have an operator who's paying a different lessee's royalties? Because remember, in North Dakota, we have these pooled spacing units. It's not uncommon to have an operator who's paying royalties on somebody else's lease, on a minority working interest owner, in the spacing unit. Of course, those owners, those non-operating working interest owners, they could take their production in kind and pay their own royalties, but it often happens that operators will pay royalties to all royalty owners. What happens there if, again, you don't have a contract between the royalty owner and the operator?

The other interesting holding in *Powell* was that they imposed essentially a notice condition, at least in some circumstances, on the ability to claim that dispute of title exception. The operator's backup argument in this case was that even if the statute of limitations doesn't bar the claim, this was a title dispute affecting distribution of royalties if there's a title issue on the lease. The Supreme Court here didn't actually reach whether that factual scenario qualified as a dispute of title within the safe harbor. They raised this issue about a different statute that appears a few sections later in the code as a statute passed in 2013. It's the spacing unit dispute statute and it says that if the mineral owner and mineral developer disagree over the mineral owner's ownership interest in a spacing unit, then the mineral developer has to provide them with certain information. There's no express cross reference between that statute and the dispute of title safe harbor and the prompt pay statute. But, nevertheless, the North Dakota Supreme Court read those statutes together and essentially read the spacing unit dispute statute into the dispute of title safe harbor as imposing a condition. In their words, the notice requirement applies when the dispute is between the mineral developer and the mineral owner, which again was the case here because it's a dispute over the lease between the mineral developer and the mineral owner. They said in that circumstance you have to provide notice under this notice statute before you can assert the dispute of title safe harbor.

That also raises some questions looking forward. What about the more typical scenario where you have a title dispute among mineral owners, where there's multiple mineral owners and fee ownership of the interest is unclear? In that circumstance, it would seem the dispute is probably not between the mineral developer and the mineral owner, but between mineral owners and so, will the notice requirement apply there? It seems like there's an argument to the contrary, but we'll have to see where the Supreme Court goes on that one. It's an issue for oil and gas operators because they're operating these increasingly large spacing units with a lot of different owners and so the administrative burden with these types of notice requirements can be significant.

Let's talk about *Whitetail Wave*[*, LLC v. XTO Energy, Inc.*] and I'll try to move through these next two cases a little quicker. This *Whitetail Wave* case, it's going to involve both the dispute of title exception and then also the fee shifting provision of the statute. The background here was that there was basically a river title dispute—a dispute that arises between Whitetail and the state of North Dakota over the extent of ownership where Whitetail has leased some of its minerals that border the Missouri River—and the State, of course, owns the riverbed in it so it's leased its riverbed minerals. And the question is, who owns what? Where does the ordinary high watermark start and stop? Or where is that line of delineation? Now, Whitetail starts this quiet title and in response, the operator suspends all of their royalties. Then, they go ahead and assert an 18 percent interest claim against the operator.

Ultimately, the district court quieted title to the riverbed and to the tracts under the river, but then they also dismissed that interest claim against the operator. They said this was a dispute of title. Because they dismissed the interest claim, they awarded the operator attorney's fees against the mineral owner. The mineral owner takes that up on appeal—they appealed some other issues too, there are actually two different appeals—but ultimately, the Supreme Court dismissed the owner's takings claim against the State. They said that the state asserting title is not by itself a taking. Something more is required than that for a taking, and that resulted in the case, basically, just being a quiet title where Whitetail is quieted with some of the lands and the State is quieted with title to some of the lands. As to the royalty interest claim, the Supreme Court affirmed the dismissal of the interest claim because they said there was a title dispute. Whitetail's contention was that some of these lands were clearly outside of what was in dispute—nobody was saying that the river went all the way across all of our lands and so you should have at least paid on what wasn't in dispute, but the Supreme Court affirmed it. It stated this position in the past, but it reaffirmed this statute allows suspense of all payments, even though only a portion of the owner's interests are in dispute.

As for the attorney's fees provision, maybe a little bit more interesting argument here. Whitetail argued that we did prevail on some of our claims in this case—we succeeded in having title quieted to us in some of the lands, and, therefore, we prevailed as to part of the case, and the operator wasn't the sole prevailing party in the case so they shouldn't get their attorney's fees. The Supreme Court rejected that argument, and really what they did is they looked at the interest claim as the claim under the prompt pay statute as the relevant unit of measurement to the inquiry there. They said that the district court correctly determined the operator had successfully defended against the interest claim, prevailed on the main issue of whether statutory interest was owing, and had judgment entered in their favor, and so we ended up with a scenario where the mineral owner ends up liable for the operator's attorney's fees as a result.

Last case I want to touch on for this statute is *Dorchester* [*Mins., L.P.*] *v. Hess* [*Bakken Invs. II, LLC*]. We're going to circle back around to that statute of limitations issue that I set up earlier and talk about a different fact pattern there, and then there was also an attorney's fees issue in this case as well. The background in this case is that the mineral owner here, Dorchester, owns unleased minerals in the land. Unlike the *Powell* case, they don't have a lease, they own unleased minerals. They end up suing the operator for 18 percent interest on two different oil and gas wells. The claim on one of the wells is dismissed on a motion to dismiss, dismissed right out of the gate, but the other one is allowed to go forward. The operator here was asserting statute of limitations defenses on both claims.

Ultimately, Dorchester is awarded 18 percent interest on that second well and then moves for its attorney's fees and the district court denies the motion for attorney's fees because the district court says, each of you prevailed on one of the claims to one of the wells. Under this fee shifting statute, the provision talks about a single prevailing party. There is no prevailing party here, because each of you prevailed on one of the issues. So, it denies the motion for attorney's fees and said in that scenario, nobody gets attorney's fees. We then have both parties appealing part of the judgment. The mineral owner appeals that attorney's fees ruling, the denial of their motion for attorney's fees, and the operator appeals the award of interest on that second well. Just to give a little bit more background on what was going on with that second well, this was a situation where, due to some title issues concerning corporate entity issues, royalties weren't paid for a period of time. You can see how far back it goes, 2008 through 2011. In 2013, the mineral owner emailed the operator about missing royalty payments, but then neither they nor the operator took any further action until 2020, when the royalties were ultimately released to the mineral owner without interest. So, the district court in that scenario said that they agreed with the mineral owner's argument that the statute of limitations didn't start to run until the royalties were released, until they were paid in 2020. The operator argues, of course, that the statute of limitations began running much earlier, 2013 at the latest.

On appeal, the operator argues the claim accrued in 2013 at the latest and is time barred because the applicable statute of limitations is 6 years at most, going back to that statute of limitations for statutory liabilities. Dorchester, the mineral owner, argued that the applicable limitations period was 10 years based on that *Powell* case, which came out while this case was pending, or that its claim didn't accrue until payment of royalties in 2020, which is what the district court had held. On appeal, the Supreme Court is then, again, faced with this question of what is the applicable statute of limitations, right on the heels of that *Powell* decision. The Court distinguishes *Powell* and says there's no lease here, so the 10-year statute of limitations can't apply. Again, that 10-year statute only applies to contracts that contain a conveyance of real property. There's no lease here. They then go back to that 6-year statute of limitations for statutory liabilities and hold that's the applicable statute of limitations. They also flag that we can't really tell here what the earliest possible date of accrual is because the royalty statute, the prompt pay statute, says that the 150 days to pay royalties starts to run not from production, but from when production is marketed. Remember, these are quite old claims, so there's nothing in the record that really shows specifically when the marketing occurred relative to production. We know what the production dates are, but there's nothing in the record that says exactly when the marketing occurred. But we don't need to know.

What the Supreme Court ultimately said is that even assuming that the discovery rule applies, which is what the mineral owner argued—that we didn't really know that we were going to have this claim until we were paid the royalties—even assuming that's the case, the Supreme Court said, we're not saying that the discovery rule applies to these types of claims. But assuming that it does, your claim starts to run when you knew or should have known that you had a claim. It doesn't mean you necessarily need to know the full extent of your claim, you just need to know you had a claim. When you sent that email in 2013 complaining that these exact royalties that you're claiming interest on, complaining that they were missing, at that point you clearly knew the facts relevant to your claim, and you had facts sufficient to put you on notice that you had a potential claim. So, the claim starts running in 2013, at the latest, and the 6-year statute of limitations applied, so it's barred.

And then, as a result, the operator has now prevailed on all the claims. So again, that prevailing party statute kicks in, and the mineral owner becomes liable for the operator's attorney's fees. I think *Whitetail* and this case are a bit of a cautionary tale to mineral owners. This can be a powerful tool to ensure that you are timely paid royalties, but you also need to be careful to bring a meritorious claim, because you do have skin in the game when you bring one of these claims and the mineral owner can actually end up liable for attorney's fees.

I'm going to talk a little bit now about surface use disputes, and we're going to do it under the guise of this North Dakota Supreme Court decision from last year, *North Dakota Energy* [*Servs., LLC*] *v. Lime Rock* [*Res., LLC*]. Out in the Bakken, the wells are pretty much all going to be completed with hydraulic fracturing, which requires a lot of fresh water. And so, how do you get that fresh water to the well? You're going to need a lot of water, but it's a temporary period of time. You're going to hydraulically fracture the well over the course of a short period of time, even if there's multiple wells. Maybe you need some water for a few weeks, but you're not going to need that much fresh water for a long enough period of time that it makes a lot of sense to put in a below ground pipeline. You can, of course, truck the water, but that's a lot of trucks. So, in a lot of scenarios, operators have turned to using these lay flat lines. They're just basically gigantic hoses that lay across the ground. If they can get close enough to a fresh water source, then they'll bring in water that way, which, of course, is a surface use. That's what was at issue, interestingly enough, in this case. The case centers on some competing claims to easement rights, specifically with respect to use of those types of lay flat lines across the surface of some property.

The background here is that the operator, Lime Rock, had an existing well site on the property at issue. It also had oil and gas leases. It has oil and gas leases from both the surface owner and severed mineral owners. It operates a couple wells on the property that go back to 2009-2010 on this existing well site, and it holds a surface use agreement. The surface use agreement isn't recorded, but there's a memorandum of it recorded. That becomes important later because this case hits on some issues of how the North Dakota Supreme Court is going to interpret North Dakota's race notice statute in terms of what qualifies as putting you on notice of somebody else's rights.

Fast forward to 2023, the operator is going to come in and drill and complete some new wells on this existing well site. But before they do that, North Dakota Energy comes to the surface owner and takes what they style as a temporary lay flat easement agreement from the surface owner that purports to grant them the exclusive right to transport freshwater across the surface using lay flat hoses. I don't know how well you can see the image up on the screen, but this is the exhibit to that temporary lay flat agreement. You can see it's actually an aerial photograph of the existing well site. North Dakota Energy takes that photograph and they draw in a dark line that crosses that east to west road. It crosses the road and then follows the access road in and goes up to the well site. That's the purported easement area of this exclusive right to lay flat hoses. So, you can see that they came in, they're specifically targeting this well site. Then, when the operator goes to drill its wells, they approach the operator and say, hey, guess what? We have the exclusive right to use lay flat lines on this property. So, do you want to complete your wells? How much are you going to pay us? And the operator says, nice try, we're not paying you, and they go ahead and lay their own lay flat lines to complete the wells. And that's where the dispute begins.

North Dakota Energy sues for interference with contract and willful trespass, asks the district court to enjoin the operator from using lay flat lines on the property, and ultimately, the district court rejects those claims. It grants summary judgment in favor of the operator based on the operator's prior rights to use the surface, both under its oil and gas leases, which can contain certain grants of rights to use the surface as necessary to explore for and develop the minerals, and then also under that surface use agreement, which, remember what we talked about, the surface use agreement the operator had. The surface use agreement isn't recorded but a memorandum of it is. North Dakota Energy takes those rulings up on appeal. And they argue, with respect to the oil and gas leases, that because the oil and gas leases contained certain express easements, including the right to lay pipelines, but they don't contain an express easement to use lay flat hoses, the argument is, "Well, you granted the apple but not the orange, so the lease impliedly excludes the right to use lay flat hoses. It doesn't include that right, and so that right was still laying out there for us to come and grab with our lay flat agreement." That's the argument. As to the surface use agreement, North Dakota Energy argues that, under North Dakota's race notice statute, that agreement is void as to us because it's not recorded. That's nice that you recorded a memorandum, but the memorandum doesn't contain the surface use provisions that you're relying on and so we weren't on notice of those, and so they're void as to us.

Ultimately, the Supreme Court rejects both of those arguments. As to oil and gas leases, the Court kind of reaffirms prior holdings, both from North Dakota and from other places, that oil and gas leases in general are going to grant broad rights to use the property as necessary to develop the mineral estate. This goes back to the idea that the mineral estate is the dominant estate. If you have a severed mineral estate, it's dominant to the surface estate and when you convey an oil and gas lease, absent some specific reservation of the contrary, that oil and gas lease is going to convey those broad surface use rights that are vested in the mineral estate to the lessee to use the surface as reasonably necessary to explore for and develop the minerals. If you didn't have that, the mineral estate would be worthless because the surface owner could just trump your ability to come in and use the surface to get at the minerals. The Supreme Court goes through a discussion of that concept, the fact that not every conceivable use of the surface has to be expressly enumerated under the oil and gas lease—and yes, the oil and gas lease did contain an express right to lay pipelines, but we're not going to infer from that that it was somehow excluding the right to use these lay flat lines across the surface.

As for the surface use memorandum, and this is maybe a more broadly applicable context to those of you who have to deal with looking at title and figuring out what prior rights are out there, the Supreme Court says, no, the memorandum did put you on notice. It might not have contained the precise terms. It might not have contained all the terms of the surface use agreement, might not have contained the surface use terms that the operator's relying on. But when somebody records a memorandum, it at least puts you on inquiry notice. It's notice to the world of the existence of that agreement and so you're on inquiry notice to go out and make reasonable inquiry. If you don't do that, which North Dakota Energy didn't do here, then you're deemed to be on notice of the entire contents of that agreement. So, in the end, North Dakota Energy was not a good faith purchaser and their claim to superior rights on the surface fails.

Next, we're going to talk about risk penalties. As I mentioned at the beginning of the talk, North Dakota's oil and gas industry operates within this statutory and regulatory regime that's administered by the North Dakota Industrial Commission, under which the Industrial Commission, through its orders, can pool oil and gas interests within a defined spacing unit. It can also unitize larger areas for secondary recovery or because of issues with surface access or those types of things. When minerals are pooled or unitized, you end up with a bunch of owners who may not, probably do not, all have contracts with each other, a common contract for development. You can end up with a whole bunch of different owners of oil and gas leases who are then thrown together in that spacing unit or in a unitized area. What happens when an owner comes in and says, “I want to drill a well in this spacing unit,” they invite the other working interest owners, the other lessees to participate? If somebody doesn't want to participate in that well, that's where risk penalties come in. The idea being that if you're not going to participate in the well and bear your share of risk by paying the upfront costs—the large capital costs for drilling and completing an oil and gas well—then you ought not be able to just free ride on the risk the others are taking and have the operator carry your costs and then come back into the well and receive your revenues as soon as your share of the costs is recovered. Instead, you have these risk penalty provisions that provide that if you decline to participate, if you elect to go non-consent in the well, that the operator is going to be able to recover a multiplier of the drilling and completion costs out of your share of production. In North Dakota, under the statutory risk penalty for non-participating lessees, it’s 200 percent of those costs. But you also don't have to write a check for it, because you didn't elect to participate. You don't have a contract obligating you to participate in the well. So, under the risk penalty regime, the risk penalty can only be recovered out of your share of production. This case gets into the issue of what production can it be recovered from.

In North Dakota, we have lots of spacing units where there's more than one well. There was that initial rush to drill and hold oil and gas leases and you had a lot of spacing units with one well holding all the leases and then operators start coming back in and drilling infill wells. What happens if an owner elects to participate in some wells in a spacing unit but doesn't participate in other wells in the spacing unit? Is the risk penalty recovered on a well-by-well basis or can you recover it out of the entire spacing unit? The way the pooling statute reads is that the risk penalty for pooled spacing units can be recovered out of and only out of production from the pooled spacing unit. The unitization statute has a similar provision that says the unitization risk penalty can be recovered out of and only out of production from the unit. The interesting scenario we have in this case, this *Liberty* case, which is an appeal of the North Dakota Industrial Commission order, is kind of a unique scenario.We have wells that were drilled in your typical spacing units but then at a later date an operator comes in and creates a unit and these wells are converted into unit wells.

How does the risk penalty work in that situation is specifically what we're concerned with here. In 2022, the North Dakota Industrial Commission creates the Haystack Butte [(Bakken Pool)] Unit and Liberty objects to the petition. The specific issue is risk penalty because, before unitization, Liberty had elected to participate in seven wells and declined to participate in four wells within the area that became the unit area, and those wells were to become unit wells. Liberty had incurred that risk penalty on those four wells in which they went non-consent, and the issue became, how is that to be recovered, if at all, out of unit production? The unit agreement provided that a working interest owner's pre-unitization payout balance would be satisfied out of proceeds from the sale of unitized substances attributable to the affected tract. So, in English, they're going to continue to bear their risk penalty, and it was going to be recovered out of their unit production once those wells became unit wells. Liberty objected to that provision. They said it would be unfair and inequitable to take revenues from wells it's elected to participate in as spacing unit wells and then apply that risk penalty balances forward in the unit. The NDIC rejected that objection to the unit agreement and concluded that because they had become unit wells, it's no longer being distributed on a spacing unit basis. It's distributed to each tract within the unit area and therefore the balance is to be recovered out of unit production. Ultimately, Liberty appealed this all the way up to the North Dakota Supreme Court on an administrative appeal and argued that the NDIC had exceeded its authority in treating the risk penalty that way.

Ultimately, the North Dakota Supreme Court affirmed and they said that, consistent with the unitization statutes, the unit agreement allowed the risk penalty balances to be satisfied out of the unit production. Basically, what they said is that because these wells have become unit wells, it's fair to treat the unrecovered expense as a unit expense, because these wells did cost money and the cost was not all recouped when they became unit wells. So, that outstanding balance is within the NDIC's remit to treat as a unit expense in creating this unit and so it can be recovered. Liberty's argument, and this part has some broader implications, is that if this had just remained a spacing unit, or if these had just remained the pooled spacing units like they had been, our risk penalty would have been recoverable only on a well-by-well basis. The North Dakota Supreme Court went out of its way to reject that argument. They said, no, under the plain language of the pooling statute, the statute unambiguously allows for recovery of the risk penalty out of production from the pooled spacing unit, not just on a well-by-well basis. That's an interesting holding because it actually runs contrary to some prior precedent from the Industrial Commission.

The Commission has an order where, in a prior case, this issue came up just on a spacing unit basis, no unit issues, and they walk through a list of different policy reasons why the risk penalty really ought to be recoverable only on a well-by-well basis. Including things like, in the industry, the risk is really assessed and the decision to invest is assessed on a well-by-well basis and so that's how the risk penalty ought to work, which might be good and valid arguments. The problem is the statute refers, in its plain language, to the risk penalty being recovered out of the pooled spacing unit. So, the North

Dakota Supreme Court is not going to get into those policy considerations and held that, as the statute stands in this case, the risk penalty can be recovered from the pooled spacing unit.

All right, last case. This one, we're going to talk about cessation of production under an oil and gas lease and what it means to have reworking operations to save that lease, and then also an argument about a force majeure clause. So, the background in this *Zavanna*[*, LLC*] *v. Gadeco*[*, LLC*] case is you have, like I alluded to at the beginning, you have some leases that were initially held by production. So, we're into the secondary term of these oil and gas leases. The oil and gas leases are held for so long as there's production and paying quantities on the leases, essentially. I don't know the exact lease language, but that's the concept. The original leases contain either 90 or 120-day cessation of production clauses that provide, in essence, that if there's a cessation of production on the lease, that the lessee has 90 or 120 days to either restore production or commence drilling or reworking operations in order to save the lease, and if you don't, then the lease terminates. There were at least two cessations of production that occurred. And then another lessee came in later and took some competing leases and filed suit for a determination that the original leases had terminated due to those cessations of production. Ultimately, the district court held a bench trial on some factual issues and held they had terminated. They rejected the original lessee's arguments that reworking operations had saved the lease. They argued, “Hey, we commenced reworking operations within the 90 or 120 days.” They also argued that a force majeure event had saved the leases, and the district court rejected that argument as well.

We'll look at how the Supreme Court dealt with those issues. In terms of the reworking operations argument, I think the Supreme Court looked at what had happened, and they basically affirmed the district court's findings that what the lessee had done is they had maybe taken some initial preparatory steps toward reworking operations. What happened was, concerning the cessation that they were concerned about, there had been a pump failure, the lessee had diagnosed that pump failure, had done some work to design and order a new pump, and the Supreme Court acknowledged those might be initial preparatory steps. Initial preparatory steps can count as commencement of drilling or reworking operations, but in order for those initial preparatory steps to count, the lessee has to pursue the reworking operations with diligence. The problem here was, although it took some of those initial preparatory steps in the 90 to 120 days, it was then months before they got a reworking rig out to the site, and the district court held as a factual finding that the lessee had not acted with diligence.

Therefore, the initial preparatory steps were not going to save the lease, and the Supreme Court looked at that and said that was the district court's factual finding, it's not clearly erroneous, and so they affirmed on that ground. It's a reminder that if you have a lease that needs to be saved in that way to act with diligence, not just in commencing the initial preparatory steps, but then in following through to the on-the-ground operations.

As for the force majeure argument, the lease at issue had a force majeure term, and the lessee argued that this was going to save the lease. Each force majeure term is different, but obviously these appear in all kinds of contracts all over the place. And this one provided, among other things, that a force majeure event could include breakage or failure of machinery or equipment, which is what happened here, and inability to obtain material or equipment, or the authority to use the same. The clause is qualified by the requirement that this has to be beyond the reasonable control of the lessee. As near as I can tell from reading the case, the argument from the original lessee was essentially, "Well, this was 2014, there was an oil boom on, it was really busy, it was really hard to get people to respond and deliver equipment on time, and so that was a force majeure event." The district court rejected that argument and the Supreme Court affirmed. The Supreme Court said the fact there was an oil boom during 2014 and equipment was generally more difficult to obtain does not excuse Gadeco's lack of performance under its leases. Gadeco bore the burden to prove that its ability to comply with its obligations under the leases was actually hindered or prevented by adverse market conditions or inability to obtain materials, not just potentially or hypothetically hindered or prevented.

Insofar as there's a broader implication from this whole thing, it's just a reminder that with force majeure terms, obviously these are bespoke terms. Each one is going to be interpreted according to its plain language, but the burden is certainly going to be on the party who's asserting the force majeure event. So, if you find yourself in a position where you're needing to assert a force majeure event under whatever the contract is, make sure you really marshal that evidence to show that it was the type of occurrence that's anticipated, but also to show how you acted with diligence and in good faith and you have specific evidence showing that you were unable to cure it due to circumstances that were beyond your control. And with that, we're almost up to time for a break.