BRACEWELL

INSIGHTS

Recent Legal Developments in the Roaring Utica Shale

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Ohio's Utica Shale has been one of the hottest shale plays in the nation over the past six to nine months and in the midst of the impressive amount of activity (both from a transactional and operational standpoint) practitioners (and their clients) are dealing with several recent court decisions that have had and will continue to have impacts on the development of this play. American Energy Partners LP, ("AEP") the company led by Aubrey McClendon, the former Chesapeake Energy Corp. Chief Executive Officer, has led the way in acquiring acreage in the Utica over this period. With purchases from Hess Corp. ("Hess") (74,000 acres) and Exxon Mobil Corp. / Paloma Partners LLC (56,000 acres), it is estimated that AEP has close to 300,000 acres in the region.***[1]*** These acquisitions are just the latest in a series of purchases AEP has making in the area over the past two years. Further AEP has stated that it plans to drill about 2,700 gross wells / 1,600 net wells during the region over the next decade. Further, Hess Corp., despite its offloading of the above mentioned, 74,000 acres to AEP, recently affirmed its faith in the future of the Utica by announcing its plans to drill and additional 35 wells in the region in 2014, an investment estimated to around $550 million.***[2]*** If AEP's and Hess' drilling plans include results similar to the recent discovery announced by Carrizo Oil & Gas, Inc. for its Rector 1H well in Guernsey County, Ohio which tested at 1,680 Bbl/d of condensate, 5.2 MMcf/d of residue gas and 266Bbl/d of NGLs,***[3]*** AEP's investments should pay off nicely. On the midstream side there have been multiple announcements by major players to develop pipelines, processing and fractionation facilities to move Utica production both within the region and south to the Gulf Coast area. MarkWest Energy recently announced multiple projects with its partner Energy & Minerals Group to develop processing plants in the region.***[4]*** Further Kinder Morgan Energy Partners, L.P. has proposed a pipeline known as the Utica Marcellus Texas Pipeline that will span over 1,000 miles and connect services from Mercer, Pennsylvania to Natchitoches, Louisiana.***[5]*** As activity in the Utica has ramped up more and more focus is being placed on the evolution of Ohio law with respect to this development. Two cases decided in 2013 are examples of this renewed focus on oil and gas legal issues and represent evolutions in Ohio oil and gas jurisprudence that will have impacts on future activities in the Utica. In *State ex rel. Morrison v. Beck Energy Corp.*[6] the Ninth District Court of Appeals reversed and remanded a judgment of the Summit County Court

of Common Pleas that had held that the City of Munroe Falls (the "Munroe") could obtain injunctive relief against an operator, Beck Energy Corporation ("Beck"), for failing to comply with the city's oil and gas drilling ordinances. Beck had obtained a lease within the city limits of Munroe and had obtained a well permit from the Ohio Department of Natural Resources (the " ODNR") to drill a well on that property. Upon commencement of operations to drill the permitted well, Munroe issued a Stop Work Order which alleged that Beck had failed to comply with certain city ordinances that required Beck to obtain the necessary permits, certificates and approvals from Munroe officials and pay certain fees associated therewith. Beck argued that since it had already complied with Ohio State law (through its permit with the ODNR) it could proceed with the well because State Law preempted Munroe's ordinances. In reversing the lower court, the Court of Appeals relied on the "home rule analysis" in the prior Supreme Court of Ohio case *Ohioans for Concealed Carry, Inc. v. City of Clyde*[7] to hold that because the Munroe drilling ordinances were established under the local police power of the city of Munroe and that the oil and gas drilling statute of the State of Ohio providing ODNR exclusive authority to issue drilling permits was a general law (i.e. a law that applies uniformly statewide and sets forth police, sanitary or similar regulations), the inconsistency between those regulations allowed State Law to preempt the Munroe city ordinances. While, this case stands for the proposition that ODNR has the exclusive authority to issue oil and gas well permits in the State of Ohio, we anticipate that there will continued litigation and continued local legislation that attempts to wrestle some of that authority away from the ODNR. Another case which has already impacted several transactions we have been involved in *Jack Harding, et. al. v. Viking International Resources Company, Inc.*[8] In *Viking*, the Fourth District Court of Appeals affirmed a judgment rendered by the Washington County Common Court of Pleas which strictly construed the language of the anti-assignment clauses in several oil and gas leases and invalidated the assignments of such leases which were made in contravention of such provisions. Jack and Ryan Harding (collectively the "Hardings") were successors in interest to the lessors under three separate oil and gas leases, each of which contained the following anti-assignment provision: "The rights of the Lessor may be assigned in whole or in part and shall be binding upon their heirs, executors and assigns. The rights and responsibilities of the Lessee may not be assigned without the mutual agreement of the parties in writing." The leases in question were transferred from the original lessee to Viking International Resources Company, Inc. ("Viking") through assignments that were made in writing and were executed and recorded as between the prior lessee and Viking; however, the Hardings were not party to the assignments and the record indicates that the Hardings ever provided written consent for the assignments. Notwithstanding the fact that the Hardings executed a W-9 sent from Viking and cashed checks for eight months until objecting to the assignment and filing suit, the lower court held that *because the assignments in question were made without the required written consent they were therefore void*. In upholding the lower court's decision, the court in *Viking* concluded that the anti-assignment provisions noted above provided "clear contractual language prohibiting assignment"[9] which met one of the three permissible restrictions on the assignment of contract rights recognized by Ohio Law as stated in a recent ruling by the Supreme Court of Ohio.[10] Since the anti-assignment provisions in the leases clearly prohibited the attempted assignments at issue, those assignments were void. Interestingly, the court also affirmed the lower court's decision not to

address Viking's equitable argument that the Hardings had ratified the assignments by their conduct and were therefore estopped from denying the validity of the assignments. In the mind of the court, the principal issue in the case was whether the assignments in question were void and thus the court felt that the lower court's approach not to consider Viking's equitable arguments regarding ratification, waiver and estoppel was correct. In making such determination the court also distinguished the situation in *Viking* (which sought invalidation of an *assignment* of leases) from other cases cited by Viking (which sought to declare a forfeiture or assert a breach or the expiration of an oil and gas lease) where consideration of such equitable arguments was appropriate. The *Viking* case has been interpreted to stand for the proposition that under Ohio law "clear contractual language prohibiting assignment" will be given full effect. The impact of this case to date has been the general opinion that provisions requiring prior written consent to assign a lease will be given effect notwithstanding any language limiting the circumstances under which such consents must be given (i.e. "without the prior written consent of Lessor, such consent not to be unreasonably withheld, conditioned or delayed"). After the Viking case, it may be necessary for a lessee subject to language of this nature to seek a declaratory judgment ordering the holder of such consent to grant its written consent (or provide justification for withholding such consent) before a valid assignment of the underlying lease can be made. While activity in the Utica continues to churn up headlines regarding transaction purchase prices and well performance results, practitioners and industry participants should also pay attention to the accompanying legal developments that this increased level of activity creates. While the *Morrison* and *Viking* cases show important developments in Ohio oil and gas law, there are (and we believe will continue to be) many other cases which will have material impacts on the rights of landowners, operators and other industry participants in the Utica.

[1] See ***http://www.bloomberg.com/news/2014-02-03/mcclendon-s-american-energy-acquires-utica-shale-acreage.html***
[2] See ***http://www.ogj.com/articles/2014/01/hess-reports-5-8-billion-capital-budget-for-2014.html***
[3] See ***http://globenewswire.com/news-release/2014/01/16/602840/10064451/en/Carrizo-Oil-Gas-Reports-Initial-Utica-Shale-Well-Results.html***
[4] See ***http://www.ogj.com/articles/uogr/print/volume-2/issue-1/marcellus/wealth-of-gas-processing-pipeline-projects-planned-for-marcellus-utica-region.html***
[5] See ***http://www.ogj.com/articles/uogr/print/volume-2/issue-1/marcellus/wealth-of-gas-processing-pipeline-projects-planned-for-marcellus-utica-region.html***
[6] Opinion No. 25953, 2013-Ohio-356, 989 N.E.2d 85 (Ohio Ct. App. 9th Dist. Summit County 2013), 2013 WL 461023, 2013 Ohio App. LEXIS 312, appeal allowed, 135 Ohio St. 3d 1469, 2013-Ohio-2512, 989 N.E.2d 70 (2013), 2013 WL 3067574, 2013 Ohio LEXIS 1507.
[7] 120 Ohio St.3d 96, 2008-Ohio-4605, 896 N.E.2d 967

[8] 2013""Ohio""5236; 1 N.E.3d 872 (Ohio Ct. App. 4th Dist. Washington County 2013)
[9] *Id*. at 4 (citing ***J.G. Wentworth, LLC v. Otisha Christian, et al., 7th Dist. Mahoning No. 07MA113, 2008-Ohio-3089, 2008 WL 2486552, ¶ 40***).
[10]Pilkington N. Am., Inc. v. Travelers Cas. & Sur. Co., 112 Ohio St.3d 482, 488, 861 N.E.2d 121 [(2006)] (internal citations omitted)" (Emphasis added).