The Legal Intelligencer

THE OLDEST LAW JOURNAL IN THE UNITED STATES 1843-2012

PHILADELPHIA, TUESDAY, MAY 15, 2012 VOL 245 • NO. 94 An ALM Publication

ENVIRONMENTAL LAW

'Mineral' Definition Case Could Have Big Impact on Shale

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Special to the Legal

It has been said that possession is nine-tenths of the law. Recently the Pennsylvania Supreme Court agreed to hear the appeal of a case that involves the other one-tenth, which seems unremarkable enough. Except that this one-tenth has the potential to affect hundreds of millions of dollars' worth of oil and gas leases in Pennsylvania.

In 1881, Charles Powers possessed a large tract of land in Susquehanna County. He wanted to sell it, but to keep the right to some of the value hidden below the surface. He executed a deed that forever reserved for himself and his heirs "one half of the minerals and Petroleum Oils on the property."

Now, 130 years later, the state's highest court will convene in *Butler v. Powers* to determine what Powers meant by those words.

There is an important historical context. In 1859, the first oil well was drilled in Titusville, Pa. Soon after that, the Rock Oil Co., later to be known as the Seneca Oil Co. (located in what is now downtown Pittsburgh), developed a method to refine the well's crude oil into kerosene, which was a cheap replacement for the whale oil that until then had powered lamps.

It was big business. No less a figure than John Rockefeller and his Standard Oil Co. would make enormous profits drilling for crude oil in Pennsylvania and using the refined product to, for the first time, bring inexpensive and long burning kerosene lighting to homes and cities.

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When Powers signed his deed in 1881, that was likely the piece of the action he was after. He wanted to sell all portions of his property, except those parts underground that Rockefeller might someday knock on his door and offer to purchase.

He could not have known that a small novelty Thomas Edison invented in his New Jersey laboratory two years before, the electric light bulb, would by the 1890s replace kerosene lamps. A bit of progress, incidentally, that was also due to the industrial ingenuity of a Pennsylvanian, George Westinghouse, who figured out how to generate electrical power on a large scale and distribute it to consumers.

Nor could Powers have known that after a temporary lull in petroleum production because of these innovations, the automobile would revive the industry, which this time would be centered around larger and better deposits of crude oil in Texas, making those fortunate cow herders, instead of Pennsylvania landowners, millionaires.

And, it goes without saying, when he signed his deed Powers had no idea what fracking and horizontal drilling were, or that 130 years later humanity would discover ways to shoot electrons through integrated circuits to perform massive algorithms of the type necessary to do wildly precise things like measure injection profiles, all of which would unlock vast deposits of natural gas from rocks buried thousands of feet below the surface.

In deciding the case, the Pennsylvania Supreme Court will look to its vast body of precedent about subsurface rights in the state. Given the historical context, it is not coincidental that the most important precedent the Supreme Court will confront is one written just about the time Powers was signing his deed.

Dunham v. Kirkpatrick, 101 Pa. 36, 37 (Pa. 1882), involved an 1870 deed that reserved "all minerals" to the grantors. When big money was being made in kerosene in 1881, the grantors "entered upon said land, erected a derrick and engine house, and drilled an oil well thereon" — on the premise that the reservation of "minerals" entitled them to the petroleum products.

The Pennsylvania Supreme Court disagreed, finding the general term "minerals" too broad to suggest such a specific intent. Unstated in the opinion is the bit of common sense that says a property owner should not

be able to take advantage of later-discovered wealth by including a broad catchall word in a conveyance. The court's decision established what was known as the *Dunham* rule, a rebuttable presumption that the word "minerals" does not include petroleum.

A quarter century later, in 1906, the court would extend the *Dunham* rule to natural gas, in the case *Silver v. Bush*, 62 A. 832 (Pa. 1906). The justices stated: "Certainly [natural] gas is a mineral in the broadest sense of the term, but no evidence was given or offered to show that the parties so understood or intended the word 'mineral,' or even that it had acquired a usage in conveyancing which would include gas."

In its *Preston v. South Penn Oil* decision, 86 A. 203, 204 (Pa. 1913), the court gave the *Dunham* rule near dogmatic status when it said the rule had come to define property expectations in Pennsylvania and "will not be disturbed."

In 2010, the heirs of Powers decided to try. They filed a declaratory judgment action staking a claim to the deposits of Marcellus Shale natural gas under the property, making a clever argument.

In 1983, the Pennsylvania Supreme Court decided *U.S. Steel v. Hoge*, 468 A.2d 1380, 1382 (Pa. 1983), a case where a property owner conveyed the right to mine the coal on his property, but reserved the right to "operate through said coal" to drill for gas. Because of advances in the technology of hydrofracturing, it eventually became possible for that property owner to "operate through said coal" to recover the coal bed gas trapped in the coal vein. The property owner claimed that the original conveyance contemplated that he could do just that.

The case did not involve the *Dunham* rule. It did, however, involve the science of hydrofracturing — and the conceptual relationship between gas and the seam in which it is trapped. The court made a hard and fast rule: The owner of the coal bed also owns the gas trapped in it.

Although the case did not involve the *Dunham* rule, it employed the same bit of common sense. In both cases, a party was not permitted to cite a broad catchall word in a conveyance to take advantage of later-discovered wealth unleashed by intervening technology. In 1881, it was the possibility of making kerosene out of crude oil; in 1983, it was hydraulic fracturing of a coal bed to get at the gas trapped inside. In both *Dunham* and *Hoge*, the Pennsylvania Supreme Court basically said to the conveyor of property, "You did not intend to reserve a right to that."

Hundreds of millions of dollars' worth of leases in Pennsylvania have a 'minerals' reservation.

This is essentially what the trial court said to the Powers heirs. The court dismissed their claims to the Marcellus Shale gas, citing the *Dunham* rule, calling it "entrenched." The Superior Court, however, persuaded by the heirs' *Hoge* argument, reversed and remanded for additional factual development on whether: "(1) Marcellus shale constitutes a 'mineral'; (2) Marcellus shale gas constitutes the type of conventional natural gas contemplated in *Dunham*; and (3) Marcellus Shale is similar to the coal to the extent that whoever owns the shale, owns the gas." (See *Butler v. Powers Estate*, 29 A.3d 35, 43 (Pa. Super. 2011), appeal granted, No. 760 MAL 2011, 2012 WL 1087928 (Pa. Apr. 3, 2012).)

The property owners then retained Gregory J. Krock, an oil and gas attorney from Buchanan Ingersoll & Rooney. He prepared a petition for allowance of appeal, arguing that the Superior Court's decision jeopardizes certainty in oil and gas leases, with possible far-reaching implications. Based on that petition, the Pennsylvania Supreme Court decided to hear the case.

From the point of view of the Powers heirs, the case will be one of first impression: whether the natural gas trapped in Marcellus Shale should be treated like the coal bed gas in *Hoge*, such that whoever owns the shale owns the gas — with additional factual finding needed on that point. Krock will likely take the position on behalf of his clients that Powers' intent was long ago decided by the Pennsylvania Supreme Court, with the presumption that the word "minerals" does not include natural gas.

The word "petroleum" from the original Powers deed has not become an issue in the case. The legal analysis has thus far focused on the term "minerals." Although the layman might associate natural gas with petroleum because of similar commercial uses, Pennsylvania long ago determined that natural gas is not a petroleum product, and the parties so far have chosen not to fight on that ground.

The result in *Butler* will have far-reaching consequences. Hundreds of millions of dollars' worth of leases in Pennsylvania have a "minerals" reservation. Some have been conveyed and title has been cleared based on presumptions about the inviolability of the *Dunham* rule.

The good news, for attorneys and landowners alike, is that the system seems to be sensitive to the importance of prompt legal review for Marcellus Shale issues. The Pennsylvania Supreme Court has made itself available to assure certainty, fairness and good policy. Nonpossessory interests in property may only be one-tenth of the law. But, as this case shows, they are a very important one-tenth. •