20130375
FILED
IN THE OFFICE OF THE
CLERK OF SUPREME COURT
MARCH 3, 3014
STATE OF NORTH DAKOTA

IN THE SUPREME COURT
STATE OF NORTH DAKOTA

Greggory G. Tank,	)	
	)	
	)	
Plaintiff/Appellee,	)	Supreme Court No. 20130375
	)	
v.	)	
	)	
Citation Oil & Gas Corp., et al.,	)	
	)	
	)	
Defendants/Appellants.	)	

Appeal from Order Denying Motions for Summary Judgment entered
on April 17, 2013 and Judgment entered on September 19, 2013
Civil No. 27-2011-CV-00154
County of McKenzie, Northwest Judicial District
Honorable Joshua B. Rustad, Presiding

REPLY BRIEF OF DEFENDANTS/APPELLANTS CITATION OIL & GAS CORP., ET AL.

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[¶ 1] Citation et al. and Tank agree that whether the Subject Lease terminated depends on the resolution of two primary issues. The first is whether the Pugh Clause was effective at any point in time following the one-year period after the expiration of the primary term. *See* Tank Brief, ¶¶ 18–19. The second is whether the language of the Pugh Clause caused a severance of the Subject Lease. *See id.* Contrary to Tank's assertions, the Pugh Clause was applicable at one point in time—at the end of the one-year period following the expiration of the primary term. Moreover, even if that were not the case, the Pugh Clause did not contain the language necessary to sever the Subject Lease. The district court's conclusions to the contrary are incorrect, and its decision should be reversed by this Court.

I. Citation, et al.'s Interpretation of the Subject Lease Gives Meaning to Every Clause in the Lease.

[¶ 2] Tank asserts that Citation, et al. fail to consider the entirety of the Pugh Clause in their analysis. This is patently false as Citation, et al.'s principal brief addressed the entire Pugh Clause and other relevant provisions of the Subject Lease. *See* Appellants' Brief, ¶¶ 21–32. However, to fully counter Tank's argument, Citation, et al. will again address the proper interpretation of this particular Pugh Clause and discuss below each line of the clause within the Subject Lease. The first sentence of the Paragraph 16 states:

> Notwithstanding any provision in this lease to the contrary, if, at the end of the one year period following the end of the primary term hereof, this lease is maintained in full force and effect by virtue of production of oil and/or gas, this lease shall nevertheless expire to all parts of said lands not included in a producing unit unless operations for the drilling of a well have been conducted during such one year period.

(App. 18 (emphasis added).) Even the district court found that this first sentence applied only at the end of the one-year period following the expiration of the primary term. (*See* App. 392.) It is undisputed there was oil and gas production on both the NW/4 and the SW/4 of the Subject Lands at the end of the one-year period following the expiration of the primary term. Moreover, Tank does not claim that the SW/4 of the Subject Lease expired at the end of the one-year period following the expiration of the primary term, but rather in 2009, nearly twenty years later. Thus, the Pugh Clause does not cause the cancellation of the SW/4, nor does Tank rely on it for this purpose. Rather, the Pugh Clause sets forth a method by which portions of Subject Lease could potentially expire or be extended at the end of the one-year period following the expiration of the primary term.

> [¶ 3] The second sentence of Paragraph 16 states:
>
> > Lessee may continue to hold this lease in full force and effect as to all of said lands for subsequent and successive periods of one year by conduc[t]ing additional drilling operations on undeveloped portions of said lands during each preceding one year period.

(App.18 (emphasis added).) As discussed in Citation, et al.'s principal brief, this provision is inapplicable to the facts of this case because the SW/4 was not an "undeveloped portion" of the Subject Lease in 2009, the time at which Tank claims the SW/4 of the Subject Lease expired. *See* Appellants' Brief, ¶ 30. Tank purports to own an interest in the SW/4 of the Subject Lands. (App. 10.) At the time Tank claims the Pugh Clause caused the Subject Lease to terminate, the lessee had drilled oil and gas wells on and developed both the SW/4 and the NW/4 of the Subject Lease, and the SW/4 was therefore not an "undeveloped portion" on which Citation, et al. could have drilled new oil and gas wells to sustain the Subject Lease.

[¶ 4] Moreover, as also discussed in Citation, et al.'s principal brief, the second sentence of Paragraph 16 simply provides a method by which the lessee can prevent the Pugh Clause from terminating the Subject Lease if certain conditions are met. *See* Appellants' Brief, ¶ 29. In other words, the second sentence is a savings provision that prevents the first sentence from causing a termination of the Subject Lease. This is made clear by the use of the phrase "continue to hold this lease." (App. 18.) Tank's interpretation erroneously states that the Subject Lease expired as to the SW/4 one year after the Tank 13-10 Well ceased paying production. Nowhere, however, in the Pugh Clause does the one-year period begin at the point of a cessation in paying production. Rather, the "subsequent and successive periods of one year" began to run following the expiration of the primary term, which was many years prior to any lack of paying production from the Tank 13-10 Well. For these reasons, the second sentence of Paragraph 16 is also inapplicable to this case.

[¶ 5] The third and final sentence of Paragraph 16 states:

> Should Lessee fail to conduct operations during such one year period, then this lease shall expire as to lands not included in producing units at the end of the one-year period during which no drilling operations were conducted.

(App. 18 (emphasis added).) The "during such one year period" language in the third sentence refers to the "subsequent and successive periods of one year" during which Citation, et al. could drill oil and gas wells on undeveloped portions of the Subject Lands to maintain the Subject Lease as to such undeveloped portions. The SW/4 was developed and continues to intermittently produce oil. (*See* App. 277–88.) Thus, the third sentence of Paragraph 16 is likewise inapplicable.

[¶ 6] Further, it would be nonsensical for the above provisions to apply at all times, regardless of the state of drilling or production operations on the Subject Lands. The language states that the Subject Lease may be maintained for a further year by drilling operations in the preceding year. (*See* App. 18.) If the drilling operations requirement applied to developed portions of the Subject Lands, the language would require that an operator conduct drilling operations, *i.e.* drill a new oil and gas well, each year on each spacing unit within the Subject Lands, regardless of the existence and productivity of existing oil and gas wells on the Lease or regardless of any prior operations that established production. Not only is this interpretation contrary to the express language of the Subject Lease, this type of drilling activity would result in unsustainable, rapid depletion of oil and gas from the Subject Lands and would violate state spacing regulations.

[¶ 7] In sum, Citation, et al.'s interpretation of Paragraph 16 gives meaning to each sentence and word therein. Conversely, Tank's and the district court's interpretations do not address the "undeveloped portions," "subsequent and successive periods of one year," or "during such one year period" language, nor consider the practical effect of their incorrect interpretation.[1]

[1] The district court also misinterpreted the Pugh Clause in holding that the Pugh Clause "directed that production on pooled portions wouldn't apply to non-pooled non-producing portions." (App. 393.) There is no evidence in the record to suggest that any of the spacing units were pooled in this case. There is also no language in the Pugh Clause to suggest that pooling would cause a severance of the Subject Lease. The district court's analysis was therefore incorrect.

II. The Pugh Clause in the Subject Lease, like the Pugh Clause in *Egeland*, does not Sever the Lease.

[¶ 8] As discussed in detail in Citation, et al.'s principal brief, *Egeland v. Continental Resources, Inc.*, 2000 ND 169, 616 N.W.2d 861, the only North Dakota Supreme Court case directly on point, applies to the facts of this case and directs that the Pugh Clause did not sever the Subject Lease. *See* Appellants' Brief, ¶¶ 33-40. The *Egeland* Court held: "To bring about a result contrary to the general rule of indivisibility, a Pugh clause must clearly and explicitly direct a division of the lease into several parts . . . ." *Egeland*, 2000 ND 169, ¶ 17, 616 N.W.2d at 867 (emphasis added). Moreover, "[a] Pugh clause cannot arise by implication." *Id.* Tank attempts to refute this, stating that "the decision in *Egeland* did not reach this point." Tank Brief, ¶ 31. This is incorrect. First, the issue of whether the Pugh Clause severed the subject oil and gas lease was the core issue of the *Egeland* case. *See Egeland*, 2000 ND 169, ¶¶ 17–19, 616 N.W.2d at 866–67 (setting forth the rules for interpretation of the Pugh Clause, and analyzing the clause at issue in that case to determine whether it severed the habendum and continuous operations clause). Second, the Supreme Court in *Egeland* explicitly held that the Pugh Clause in the oil and gas lease at issue did not conflict with or affect the continuous operations clause. *See id.* at ¶ 27, p. 870 (holding that the Pugh Clause did not affect the continuous operations clause and "the leases could still be extended by continuous drilling operations clause"). Tank's contention that *Egeland* does not apply to extend the Subject Lease is patently false.

[¶ 9] Tank further asserts that the Pugh Clause severs the Subject Lease as a whole. To this end, Tank cites the following definition of "producing unit" in the Pugh Clause: "[t]he number of acres in the drilling and spacing unit allocated to each well as

determined by" the North Dakota Industrial Commission. Tank Brief, ¶ 27. However, Tank offers no explanation as to why this definition of a spacing unit would in any way cause the Pugh Clause to cause a severance of the Lease or apply to other clauses in the Subject Lease. The terms "spacing unit" and "producing unit" are not referenced anywhere in the continuous operations clause, and there is no language in the Subject Lease suggesting they should be incorporated therein. (*Id.*) Moreover, Tank ignores the fact that the continuous operations clause begins with the phrase, "Notwithstanding anything in this lease to the contrary . . ." and therefore cannot be overridden by other lease provisions. (*See* App. 18.) In short, Tank's reliance on the definition of a "spacing unit" does nothing to further his cause that the Pugh Clause severs the entire lease.[2]

III. The Continuous Operations Clause Sustained the Subject Lease.

[¶ 10] Finally, regardless of the operation of the Pugh Clause and in accordance with this Court's holding in *Egeland*, the Subject Lease was sustained by the continuous operations clause. Tank claims Citation, et al. incorrectly interpret the continuous operations clause because they "omit the words 'completion or' and focus only on 'abandonment' of wells." Tank Brief, ¶ 43. The word "or" is disjunctive and means an alternative between different things or actions. *See Christl v. Swanson*, 2000 ND 74, ¶ 12, 609 N.W.2d 70 (N.D. 2000). Thus, the requirement that new operations commence after the "completion or abandonment" of a well means that new operations must commence either following completion of a well, *i.e.*, following the end of drilling operations, or following the abandonment of a well, *i.e.*, following the end of a well's

[2] Tank also ignores that fact that, even if there were a severance of the Subject Lease, it was between developed and undeveloped portions, and the entire W/2 was developed.

productive life. Citation, et al., unlike Tank, account for and give meaning to each term in the continuous operations clause and their interpretation thereof should be adopted by this Court.

CONCLUSION

[¶ 11] Citation, et al. respectfully request this Court reverse the district court's decision and grant summary judgment in favor of Citation, et al.

DATED this 3rd day of March, 2014.

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STATE OF NORTH DAKOTA)
) ss.
COUNTY OF BURLEIGH)

I hereby certify that on March 3, 2014, I electronically filed with the Clerk of the North Dakota Supreme Court the REPLY BRIEF OF DEFENDANTS/APPELLANTS CITATION OIL & GAS CORP., ET AL. and served the same electronically as follows:

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