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STATE OF NORTH DAKOTA

IN THE SUPREME COURT
STATE OF NORTH DAKOTA

Robert Post Johnson, and A.V.M. Inc.,
Plaintiffs and
Appellants,

vs.

Statoil Oil & Gas LP, formerly known as Brigham Oil & Gas LP, Missouri Basin Well Service, Inc., MBI Oil and Gas, LLC, Northern Energy Corporation, Sunshine Pacific Corp., Stewart Geological, Inc., Brent Clum, Earthstone Energy, Inc., Vincent Melashenko, Hill L.P., LGFE-J L.P., Reef 2011 Private Drilling Fund, L.P., Missouri River Royalty Corporation, Rainbow Energy Marketing Corporation, United Energy Trading, LLC, Abaco Energy, L.L.C., Wolfe Exploration LLC, Joe Wolfe, Global Gas & Oil, L.L.C., SourceRock Exploration, LLC, Cody Oil & Gas Corporation, David Peterson, Slawson Exploration Company, Inc., Hess Bakken Investments II, LLC, and LGFE-M L.P.,
Defendants and
Appellees.

Supreme Court Case No. 20180050

McKenzie County District Court Case No. 27-2014-CV-00286

Appeal from Judgment Entered on December 7, 2017
Case No. 27-2014-CV-00286
County of McKenzie, Northwest Judicial District
The Honorable Robin A. Schmidt, Presiding

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I. STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

[¶ 1] This case involves a dispute over the interpretation of a provision contained in two oil and gas leases. Since *Egeland v. Continental Resources, Inc.*, 2000 ND 169, 616 N.W.2d 861, drafters have been on notice of several background principles of lease interpretation. First, the "general rule" is that "an oil and gas lease is indivisible by its nature." *Id.* at ¶ 16. Second, a lease will "[o]rdinarily" remain in force as to all the land covered by the lease in the event of (a) "production" or (b) "other operations." *Id.* Third, the parties to the lease may modify the general rule of indivisibility by saying so "clearly and explicitly." *Id.* at ¶ 17.

[¶ 2] Relying on *Egeland*, the District Court ruled that the subject leases clearly and explicitly modify the general rule of indivisibility for production, but not operations. The District Court ruled correctly.

II. STATEMENT OF THE CASE

[¶ 3] This is a dispute over whether this Court's reasoning in *Egeland v. Continental Resources, Inc.*, 2000 ND 169, 616 N.W.2d 861, ensures that the oil and gas leases at issue remain in effect. The leases provide that continuous drilling operations extend the leases, but the mineral estate lessors contend that the Pugh clause—which does not mention continuous drilling operations as *Egeland* requires—ended the leases in April 2011.

[¶ 4] Two mineral estate lessors sued the mineral estates lessees, the company that negotiated the lease, the well operator, and several assignees of the leases. The lessors sought to have the lessees release five sections of property from the leases under N.D.C.C. § 47-16-37, App. 24, and to quiet title for those five sections under N.D.C.C. ch. 32-17, App. 25.

[¶ 5] The parties filed cross-summary judgment motions to determine the effect of the Pugh clause and the continuous drilling operations clause on the lease. Doc. ID# 126–27, Doc. ID# 116, Doc. ID# 124. The Court granted the defendants' summary judgment motion and denied the plaintiffs' summary judgment motion. App. 389–97. The lessors then dismissed their remaining, pending claims with prejudice. App. 399. The trial court then entered a final judgment declaring the leases at issue "remain valid and in effect and quieting title in and to [the defendants'] leasehold interests." App. 404.

III. STATEMENT OF THE FACTS

[¶ 6] This case involves two oil and gas leases that were executed in April 2008. The drafting took place against the background principles of lease interpretation found in *Egeland v. Continental Resources, Inc.*, 2000 ND 169, 616 N.W.2d 861, a decision that discussed an oil and gas lease provision known as a Pugh clause. *See id.* at ¶4 n.4 ("A Pugh clause is 'a type of pooling clause which provides that drilling operations on or production from a pooled unit or units shall maintain the lease in force only as to lands included within such unit or units.'").

[¶ 7] Under the "general rule," an oil and gas lease is indivisible. *Id.* at ¶ 16. Parties can override this general rule by providing "for a severance of the lease where less than all of the leasehold is included in a single unit . . . ." *Id.* at ¶ 17. To do so, however, the parties must speak "clearly and explicitly." *Id.*

[¶ 8] Many modern leases provide for the lease to remain in force beyond the primary term if either of two situations exist: (a) production or (b) specified operations. Parties can draft a Pugh clause to override the rule of indivisibility for each such scenario, but to do so, they must speak with the required clarity. *Id.* at ¶ 17. If the Pugh clause only modifies the provision governing production, that will not prevent the lease from being extended by operations. *Id.* at ¶ 19.

A. Eight years after *Egeland*, the parties execute the subject leases.

[¶ 9] Appellants are Robert Post Johnson and A.V.M. Inc. In April 2008, they entered into the subject leases with Missouri Basin Well Service. Missouri Basin is one Appellee, but there are other Appellees as well, because of various transactions that took place after Missouri Basin originally took the leases.

[¶ 10] Each lease is entitled OIL AND GAS LEASE. App. 368, 370. Each lease begins with a language of conveyance, which indicates that the lessor grants the lessee the exclusive right to produce minerals from "the land hereinafter described." *Id.* The leases then describe land comprised of eight governmental sections. App. 368 (Johnson), 370 (AVM).

[¶ 11] Paragraph 1 of the leases contains several provisions. First, it provides for a 3-year primary term starting in April 2008. App. 368, 370. The parties all agree that the 3-year primary term expired in April 2011. *Id.*; App. 391.

[¶ 12] Second, paragraph 1 provides for lease maintenance after the primary term. It indicates that the leases survive after the primary term for as long as one of two facts exists: (1) "as long thereafter as oil or gas of whatsoever nature or kind is produced from said leased premises or on acreage pooled therewith," and (2) "as long thereafter as [certain] operations are continued as hereinafter provided." App. 368, 370.

[¶ 13] For three of the eight sections of land covered by the leases, the leases are indisputably held by production because each of those three sections have producing wells. Br. ¶ 13, App. 20 ¶ 36, 28–367. The other five sections do not yet have producing wells. App. 31–367. After some initial clashing, the parties are not currently disputing whether continuous drilling operations exist; the dispute is over whether such operations are a basis for holding the lease in force. App. 399 ¶¶ 3–4.

[¶ 14] Under the provisions of paragraph 1 relating to drilling operations, such operations on any part of the lease will hold the lease in force. App. 368, 370 (The lease continues as long "thereafter as . . . drilling operations are continued as hereinafter

provided."); *cf. Egeland*, 2000 ND 169, ¶27, 616 N.W.2d 861 (the entire lease is "extended by continuous drilling operations.").

[¶ 15] Finally, after the land description and before paragraph 1, the parties added three more sentences. The second sentence, a Pugh clause, mentions production but does not mention operations:

> Notwithstanding anything to the contrary, on expiration of the primary term of the lease, the lease shall terminate as to any part of the property not included within a well unit or units, as established by the appropriate regulating authority, from which oil or gas is being produced in paying quantities and shall also terminate as to 100' below geologic strata or formations from which production has not occurred during the primary term.

App. 368, 370.

B. A dispute exists as to the effect of operations.

[¶ 16] Appellants Robert Post Johnson and AVM filed this lawsuit against (1) the lessee, Missouri Basin Well Services, Inc., App. 17 ¶ 11, (2) the company that negotiated the leases, Cody Oil and Gas, *id.*, (3) the operator, Statoil Oil & Gas LP (previously Brigham Oil & Gas, LP), App. 20, ¶¶ 37–39, and (4) several assignees of the lease, App. 22–24 ¶¶ 53–59 (listing each of the other parties to this case).

[¶ 17] Appellants alleged termination of the leases with respect to the five sections of land referenced above. They sought a judgment releasing those five sections from the leases under N.D.C.C. § 47-16-37, which allows the owner of a mineral lease to "sue in any court of competent jurisdiction to obtain such release," App. 24, ¶¶ 60–66, and they sought a judgment quieting title under N.D.C.C. ch. 32-17, App. 25, ¶¶ 67–70. To resolve the disagreement about interpretation of the leases, both Appellants and Appellees filed competing motions for summary judgment. App. 399 ¶¶ 3–4.

[¶ 18] Appellants Robert Post Johnson and AVM emphasized the Pugh clause. They urged that it "directs a division of the lease" and requires the court to release the lease for the five sections in which production does not exist. Doc. ID# 127, ¶ 24, ¶ 42. They acknowledged *Egeland* but sought to distinguish it. *See id.* at ¶¶ 14–42.

[¶ 19] Appellees countered that *Egeland* applies and is dispositive. They argued that the habendum clause in paragraph 1 of the leases provides for extension beyond the primary term through either (1) production or (2) continuous drilling operations. Doc. ID# 124, ¶ 6. Appellees agreed that the Pugh clause refers to production, but they noted that it does not refer to operations. Accordingly, when it comes to operations, the Pugh clause does not satisfy the "clearly and explicitly" standard from *Egeland*.

C. The District Court grants summary judgment on authority of *Egeland*.

[¶ 20] The District Court ruled for Appellees and against Appellants and signed a memorandum opinion explaining its reasoning. App. 389–97. The court noted the general rule that leases are indivisible. App. 393–95 ¶¶ 8–12. It noted that, to overcome that general rule, "a Pugh clause must . . . specifically direct that production, drilling operations, or both are treated differently on the several parts of a lease to limit extension of the lease in its entirety." App. 395 ¶ 11.

[¶ 21] Applying these standards, the court noted that the Pugh clauses are silent about operations and about how operations on one section impact the other sections of the lease. App. 395 ¶ 12. Accordingly, under *Egeland*, "the Pugh Clauses permit extension of the Subject Leases *in their entirety* by drilling operations continuously prosecuted on any part of the Subject Lands at and after the end of the Subject Leases['] primary terms." *Id.* (emphasis added).

[¶ 22] The court rejected Appellants' view because their view would nullify the continuous drilling operations clauses found in paragraph 1: "Plaintiffs' interpretation is inappropriate, however, because it would render irrelevant significant portions of the Habendum Clause and Continuous Drilling Operations Clauses." App. 396 ¶ 13.

[¶ 23] Although some claims remained pending, the parties agreed to dismiss the remaining claims with prejudice. App. 398–99, 402. Accordingly, the court entered a final judgment declaring that the leases remain valid. App. 403–06.

IV. STANDARD OF REVIEW

[¶ 24] Summary judgment exists for the prompt resolution of a controversy on the merits without a trial if there are no genuine issues of material fact or inferences that can reasonably be drawn from undisputed facts, or if the only issues to be resolved are questions of law. *Hild v. Robert Post Johnson*, 2006 ND 217, ¶ 6, 723 N.W.2d 389.

[¶ 25] The goal of contract interpretation is "to give effect to the mutual intention of the parties as it existed at the time of contracting so far as the same is ascertainable and lawful." N.D.C.C. § 9-07-03; *see Fleck v. Missouri River Royalty Corp.*, 2015 ND 287, ¶ 8, 872 N.W.2d 329. "[I]f possible," when a contract is in writing, "the intention of the parties is to be ascertained from the writing alone." N.D.C.C. § 9-07-04. "The whole of a contract is to be taken together so as to give effect to every part if reasonably practicable." N.D.C.C. § 9-07-06. "When the language of a deed is plain and unambiguous and the parties' intentions can be ascertained from the writing alone, extrinsic evidence is inadmissible to alter, vary, explain, or change the deed." *Goodall v. Monson*, 2017 ND 92, ¶ 7, 893 N.W.2d 774.

[¶ 26] Contracts are read in light of existing law. *Egeland*, 2000 ND 169, ¶ 10, 616 N.W.2d 861. Parties "enter into their contract in reference to existing law, and all relevant existing law at the time of the contract becomes a part of the contract and must be read into it." *Giese v. Engelhardt*, 175 N.W.2d 578, 586 (N.D. 1970). "Thus the contract . . . is not to be determined solely by the provisions of the [contract], but by the law in force at the time the contract was entered into." *Lillethun v. Tri-Cty. Elec. Co-op., Inc.*, 152 N.W.2d 147, 150 (N.D. 1967).

[¶ 27] Summary judgments are reviewed de novo. *Robert Post Johnson*, 2006 ND 217, ¶ 6, 723 N.W.2d 389.

V. SUMMARY OF THE ARGUMENT

[¶ 28] As the District Court correctly held, this case comes within the teachings of *Egeland v. Continental Resources, Inc*, 2000 ND 169, 616 N.W.2d 861. First, under the general rule, oil and gas leases are indivisible. Second, a lease will ordinarily remain in force as to all the land covered by the lease in the event of either production or specified operations. Third, the parties to the lease may modify the general rule of indivisibility by saying so "clearly and explicitly." *Id.* at ¶ 17.

[¶ 29] In the District Court's words, because a lease may ordinarily be extended by production or by drilling operations, "a Pugh clause must therefore specifically direct that production, drilling operations, or both are treated differently on the several parts of a lease to limit extension of the lease in its entirety under the habendum clause." App. 395.

[¶ 30] Here the Pugh clause language addresses production, but not operations. "In fact, the Pugh Clauses are silent about drilling operations." *Id.* Under *Egeland*, then, "the Pugh Clauses permit extension of the Subject Leases in their entirety by drilling operations continuously prosecuted on any part of the Subject Lands." *Id.* Ever since the decision in *Egeland*, lease drafters have had fair notice that the way to alter the rule of indivisibility and to modify a continuous drilling operations clause is simply to address the effect of such operations. The drafters did not do so here.

[¶ 31] Tellingly, the parties knew how to strike through language in the lease. They struck through the warranty of title in paragraph 14. They did not strike through the continuous drilling operations clause which makes up the second sentence of paragraph 1. Yet Appellants now want that sentence treated as though it were completely deleted. The District Court correctly declined to strike through that sentence by judicial decree.

VI. ARGUMENT

[¶ 32] A continuous drilling operations clause allows drilling operations on any location of the lease to extend the lease in its entirety. A Pugh clause can, theoretically, amend that basic rule of North Dakota oil and gas law, but it must do so clearly and explicitly.

[¶ 33] The Pugh clause here does not. It does not even mention continuous drilling operations. Under *Egeland*, the continuous drilling operations clause was, therefore, not modified. Appellants' other fallback arguments regarding ambiguity and the so-called "trigger" contradict North Dakota law and the plain meaning of the lease.

A. The continuous drilling operations clause provides that drilling operations anywhere on the lease extends the lease in its entirety.

[¶ 34] North Dakota law begins with the "general rule" that an "oil and gas lease is indivisible by its nature." *Egeland*, 2000 ND 169, ¶ 16, 616 N.W.2d 861; *see Tank v. Citation Oil & Gas Corp.*, 2014 ND 123, ¶ 12, 848 N.W.2d 691. Accordingly, "production or other operations on any part of the land will generally maintain the lease beyond the primary term for all of the land covered by the lease." *Tank*, 2014 ND 123, ¶ 12, 848 N.W.2d 691; *Egeland*, 2000 ND 169, ¶ 16, 616 N.W.2d 861.

[¶ 35] Indivisibility constitutes the norm in American oil and gas doctrine. *See, e.g.*, *Rogers v. Ricane Enterps., Inc.*, 884 S.W.2d 763 (Tex. 1994); *Bibler Bros. Timber Corp. v. Tojac Minerals Inc.*, 281 Ark. 431, 664 S.W.2d 472 (1984); *Rook v. James E. Russell Petroleum, Inc.*, 235 Kan. 6, 679 P.2d 158 (1984); *Humble Oil & Ref. Co. v. Mullican*, 144 Tex. 609, 192 S.W.2d 770 (1946); *W.T. Waggoner Estate v. Sigler Oil Co.*, 118 Tex. 509, 19 S.W.2d 27 (1929).

[¶ 36] The leases at issue here fit with this principle of North Dakota law. Pursuant to the habendum clause in paragraph 1, the leases remain in force as long as "operations are continued as hereinafter provided." App. 368, 370. The only question is whether a Pugh clause has effectively overridden this rule with respect to such operations. The answer is "No."

i. A Pugh clause must explicitly address drilling operations.

[¶ 37] Parties can modify the general rule of indivisibility. Specifically, in a case with a continuous drilling operations clause, the parties can alter the normal understanding that such operations in one part of the lease will keep the lease in force with respect to all the lands that it covers. One way to alter that understanding is with a Pugh clause.

[¶ 38] The Pugh clause, however, must do so clearly and explicitly to be effective. "A Pugh clause cannot arise by implication." *Egeland*, 2000 ND 169, ¶ 17, 616 N.W.2d 861. "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, and direct that production on the pooled portion does not constitute production on the part not pooled." *Id.* Crucially, when the lease provides that drilling operations will hold the lease in force, the Pugh clause must "negate the additional language in the leases allowing the leases to be extended by continuous drilling operations." *Id.* at ¶ 19.

[¶ 39] This Court has considered this point in its opinions in *Tank* and *Egeland*. To understand why *Tank* and *Egeland* had different outcomes, it is helpful to compare the Pugh clause language. Note that, just as in *Egeland*, the leases in this case have no language addressing continuous drilling operations, whereas the lease in *Tank* speaks expressly to such operations:

	Egeland	***Tank***	***Johnson***
Production	Notwithstanding anything contained herein to the contrary . . . . [a] producing well, or well capable of production, will perpetuate this lease beyond its Primary Term ONLY as to those lands as are located within, or committed to, a producing or spacing unit established by Government authority having jurisdiction.	Notwithstanding any provision in this lease to the contrary, if, at the end of the one year period from 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 as to all that part of said lands not included in a producing unit	Notwithstanding anything to the contrary, on expiration of the primary term of the lease, the lease shall terminate as to any part of the property not included within a well unit or units, as established by the appropriate regulating agency, from which oil or gas is being produced in paying quantities . . . .
Drilling Operations	None	. . . . unless operations for the drilling of a well have been conducted during such one-year period. Lessee may continue to hold this lease in full force and effect as to all of said lands . . . by conducing [sic] additional drilling operations on undeveloped portions of said lands during each preceding one-year period. Should Lessee fail to conduct drilling operations during any such one-year period, then this lease shall expire as to said lands not included in producing units at the end of the one-year period during which no drilling operations were conducted.	None

[¶ 40] The contrast between *Egeland* and *Tank* is decisive. In *Egeland*, this Court held that no conflict existed between the Pugh clause and the continuous drilling operations clause because the Pugh clause was "silent about continuous drilling operations." *Egeland*, 2000 ND 169, ¶ 27, 616 N.W.2d 861. Because the Pugh clause did not explicitly modify the default interpretation of the continuous drilling operations clause—that continuous drilling operations on one part of the lease extend the entire lease—the leases in their entirety "could still be extended by continuous drilling operations." *Id.*; *see id.* at ¶¶ 28–29 (the Court agreed with the argument "that the continuous drilling operations clause continues to operate lease-wide, even though the Pugh clause limits the operation and effect of the habendum clause to the confines of each spacing unit.").

[¶ 41] Contrast that holding to *Tank*, a case that shows the proper way to construct a Pugh clause to modify a continuous drilling clause. In *Tank*, the Pugh clause explicitly addressed continuous drilling operations (as quoted above). *Tank*, 2014 ND 123, ¶ 15, 848 N.W.2d 691. This Court analyzed the provisions governing continuous drilling operations at length. *Id.* at ¶¶ 15–25. The Pugh clause specifically required "drilling operations" to be conducted "on undeveloped portions of" the land. *Id.* at ¶ 15. After examining these provisions, the Court concluded that the Pugh clause terminated part of the lease; "[t]he lease will expire on portions of the property that are not included in a producing unit when additional drilling operations on undeveloped land are not conducted during the one-year term." *Id.* at ¶ 19, ¶ 34.

[¶ 42] The defendant claimed that such a holding would contradict *Egeland*, but this Court explained it did not. It specifically distinguished *Tank* from *Egeland* by explaining that "unlike the Pugh clause in *Egeland*, [the clause in *Tank*] *also addresses drilling*

operations and provides that the lease on all of the property is maintained if additional drilling operations are conducted on undeveloped land during each one-year term." *Id.* at ¶ 32 (emphasis added). Thus, by addressing both, the Pugh clause in *Tank* modified *both* the production clause *and* the continuous drilling operations clause. *Id.*; *see* Jesse Liebe, Case Comment, *Contracts—Mines and Minerals: North Dakota Rejects Extensions of Oil Production Contracts on Unused Land*, 90 N.D. L. REV. 427, 436 (2014).

ii. This Pugh clause does not explicitly and clearly modify the continuous drilling operations clause.

[¶ 43] The Pugh clause here does not mention continuous drilling operations. It only addresses production: "the lease shall terminate as to any part of the property not included within a well unit or units, as established by the appropriate regulating agency, from which oil or gas is being produced in paying quantities . . . ." App. 368, 370. Under *Egeland* and *Tank*, it does not modify the continuous drilling operations clause. Continuous drilling operations on any part of the lease extends the lease in its entirety.

[¶ 44] Appellants contend the Pugh clause modifies the plain meaning of the continuous drilling operations clause, directs a division of the lease into several parts, and requires continuous drilling operations or production *on each section*. Br. ¶¶ 26–31. But Appellants' approach requests the Court "to add additional language" to modify the continuous drilling clause, as this Court held was improper. *See Krenz v. XTO Energy, Inc.*, 2017 ND 19, ¶ 50, 890 N.W.2d 222.

[¶ 45] Appellants cite *Tank* and *Egeland*, but without quoting the Pugh clause language from either. Nor do Appellants address the extensive discussion in either case concerning the need for a Pugh clause to explicitly address continuous drilling operations to modify such a clause.

[¶ 46] Instead, Appellants center their argument around the "notwithstanding" prefix to the Pugh clause. Br. ¶¶ 32–33. But "notwithstanding" means the clause controls over a conflicting clause. *Notwithstanding*, BLACK'S LAW DICTIONARY (10th ed. 2014) ("Despite; in spite; not opposing; not availing to the contrary"). The word "notwithstanding" is insufficient to satisfy the *Egeland* standard, because the Pugh clause does not contradict the continuous drilling clause.

[¶ 47] This conclusion is confirmed by *Egeland*. There the Pugh clause also contained the word "notwithstanding," but that did not allow its silence to modify the continuous drilling clause. *Egeland*, 2000 ND 169, ¶ 4, 616 N.W.2d 861. As in *Egeland*, the Pugh clause here "is silent about continuous drilling operations" and, the default interpretation prevails: continuous drilling operations in one part of the lease extends the lease in its entirety. *Id.* at ¶ 27.

iii. The plethora of Pugh clause examples that explicitly modify continuous drilling operations clauses demonstrates that this lease's silence was intentional.

[¶ 48] Nor is drafting a Pugh clause that explicitly addresses continuous drilling operations a novelty. As discussed above, this Court recently gave an example in *Tank*. *See Tank*, 2014 ND 123, ¶ 15, 848 N.W.2d 691 ("Should Lessee fail to conduct drilling operations during any such one-year period, then this lease shall expire as to said lands not included in producing units at the end of the one-year period during which no drilling operations were conducted.").

[¶ 49] *Tank* is not the only example. The very first example of a Pugh clause provided by this Court addressed continuous drilling operations. *See Olson v. Schwartz*, 345 N.W.2d 33, 41 n.3 (N.D. 1984) ("[T]his lease shall terminate at the end of the primary term as to all of the leased land except those within a production or spacing unit prescribed by law or

administrative authority . . . on which lessee is engaged in drilling or reworking operations.").

[¶ 50] As recently as last year, this Court saw a similar Pugh clause. That clause expressly addressed continuous drilling operations. *See Krenz*, 2017 ND 19, ¶ 48, 890 N.W.2d 222 ("Notwithstanding the provisions of this lease to the contrary this lease shall terminate at the end of the primary term as to all of the leased land except those tracts within a production or a spacing unit prescribed by law or administrative authority . . . on which Lessee is engaged in drilling or reworking operations.").

[¶ 51] The lessons from this Court have not been lost on practitioners. An article in the North Dakota Law Review recently suggested practitioners explicitly provide that continuous drilling operations do not operate lease-wide:

> To draft a Pugh clause that is effective in light of a continuous drilling operations clause, the *Tank* decision indicates that a lessor should ensure that the Pugh clause allows the lease to be continued *only* if production or drilling occurs on the non-pooled land. The Pugh clause should explicitly indicate that the continuous drilling operations clause will not operate lease-wide, but will be segregated into a pool-by-pool basis. This stands in contrast to the *Egeland* Pugh clause, which only required the lessee to fulfill the continuous drilling operations clause on a lease-wide basis. Since the Pugh clause in *Egeland* was not clear about whether the lease could be extended by other means, the court was unwilling to uphold it. Lessor drafters should pay particular attention to the limiting language of the Pugh clause and consider something similar to the provision in *Tank*, which indicated that "[s]hould Lessee fail to conduct drilling operations during any such one-year period, then this lease shall expire as to said lands not included in producing units at the end of the one-year period during which no drilling operations were conducted."

Liebe, *Contracts—Mines and Minerals: North Dakota Rejects Extensions of Oil Production Contracts on Unused Land*, *supra*, at 438–39; *see also* Leah Kelley Kopseng, Case Comment, *Oil and Gas-Leases*, 74 N.D. L. REV. 799, 818 n.84 (1998) (making similar recommendation).

[¶ 52] Considering the mandate that Pugh clauses should speak clearly and explicitly, and considering that third parties have found it easy to do so, the failure to address the continuous drilling operations clause here is significant. *See Egeland*, 2000 ND 169, ¶ 10, 616 N.W.2d 861; *Giese*, 175 N.W.2d at 586; *Lillethun*, 152 N.W.2d at 150.

iv. No "trigger" exists in the continuous drilling clause.

[¶ 53] Appellants speak of the continuous drilling clause not being "triggered." Br. ¶¶ 34–40. This "trigger" argument is unpersuasive.

[¶ 54] First, it is open to question whether Appellants preserved this argument, in that they did not raise the trigger argument below. *See* Doc. ID# 127, Doc. ID# 168, Doc. ID# 175. "It is fundamentally unfair to fault the trial court for failing to rule correctly on an issue it was never given the opportunity to consider. Accordingly, issues or contentions not raised in the district court cannot be raised for the first time on appeal." *Working Capital #1, LLC v. Quality Auto Body, Inc.*, 2012 ND 115, ¶ 13, 817 N.W.2d 346 (quoting *Paulson v. Paulson*, 2011 ND 159, ¶ 9, 801 N.W.2d 746). This preservation requirement covers arguments based on "the terms of [an] agreement" made in the summary judgment setting. *Beeter v. Sawyer Disposal LLC*, 2009 ND 153, ¶¶ 19–21, 771 N.W.2d 282; *see Heng v. Rotech Med. Corp.*, 2006 ND 176, ¶¶ 8–10, 720 N.W.2d 54 (refusing to review question of law applicable to the trial court's summary judgment ruling because it was not raised to the trial court).

[¶ 55] Second, the argument is unsound. Appellants quote one sentence as creating a condition that must be met to trigger the continuous drilling clause. To Appellants, the sentence following the continuous drilling operations clause phrase means that the continuous drilling operations clause cannot extend the lease if "oil and gas were being

produced from the leased premises at the expiration of the primary term." Br. ¶ 37 (quoting App. 368, 370).

[¶ 56] The continuous drilling clause does not contain what Appellants refer to as a trigger. Instead, the trigger is really those provisions that define how continuous drilling operations are to be conducted:

> If, at the expiration of the primary term of this lease, *oil or gas is not being produced* on the leased premises or on acreage pooled therewith but Lessee is then engaged in drilling or reworking operations thereon, then this lease shall continue in force so long as operations are being continuously prosecuted on the leased premises or on acreage pooled therewith, and operations shall be considered to be continuously prosecuted if not more than ninety (90) days shall elapse between the completion or abandonment of one well and the beginning of operations for the drilling of a subsequent well.
>
> If after discovery of oil or gas on said land or on acreage pooled therewith, *the production thereof should cease from any cause* after the primary term, this lease shall not terminate if Lessee commences additional drilling or re-working operations within ninety (90) days from date of cessation of production or from date of completion of dry hole.
>
> If oil or gas shall be discovered and produced as a result of such operations at or after the expiration of the primary term of this lease, this lease shall continue in force so long as oil or gas is produced from the leased premises or on acreage pooled therewith.

App. 368, 370 (emphasis added).

[¶ 57] As shown, continuous drilling operations will extend the lease. The next two sentences merely provide how long the producer has to continue drilling operations if (1) "oil or gas is not being produced" or (2) "the production thereof should cease from any cause." Neither creates a "trigger" for the continuous drilling operations clause.

[¶ 58] Here again, *Egeland*'s lease language is directly on point. First, the "if" clauses following the continuous drilling operations clause are equivalent:

> It is agreed that this lease shall remain in force . . . as long thereafter as . . . drilling operations are continued as hereinafter provided.

> If, at the expiration of the primary term of this lease, oil or gas is not being produced on the leased premises but lessee is then engaged in drilling operations, then this lease shall continue in force so long as drilling operations are being continuously prosecuted on the leased premises; and drilling operations shall be considered to be continuously prosecuted if not more than sixty days shall elapse between the completion or abandonment of one well and the beginning of operations for the drilling of a subsequent well.
>
> If oil or gas shall be discovered and produced from any such well or wells drilled or being drilled at or after the expiration of the primary term of this lease, this lease shall continue in force so long as oil or gas shall be produced from the leased premises.

Egeland, 2000 ND 169, ¶ 3, 616 N.W.2d 861.

[¶ 59] Second, like this case, the *Egeland* lease contained a producing well on one section of the lease. *Id.* at ¶ 6, ¶ 18. Third, like here, drilling operations also were occurring on other parts of the leased lands. *Id.* at ¶ 22. Yet, the Court did not read the language "[i]f, at the expiration of the primary term of this lease, oil or gas is not being produced on the leased premises," as creating a "trigger" that prevents the continuous drilling operations clause from extending the lease if production is occurring on one section. *See id.*

[¶ 60] In short, there is no "trigger." If "drilling operations are continued" on any part of the leases, the leases are extended in their entirety.

v. Appellants' argument conflicts with precedent.

[¶ 61] Requiring a Pugh clause to explicitly modify the continuous drilling clause follows naturally from a proper understanding of oil and gas production. If a Pugh clause required an operator to engage in drilling operations on all sections of an oil and gas lease, that would undermine the careful balancing of policy interests that this Court has conducted over the past several decades.

[¶ 62] It is rarely economic to drill on all sections of an oil and gas lease simultaneously. Oil and gas producers will, accordingly, develop a drilling plan, drilling

wells on some parts of the lease, then using the knowledge gained from those wells to determine where to most efficiently drill next. Hence, the continuous drilling operations clause.

[¶ 63] This Court has noted such efficiencies for decades. In the 1980s, the Court relied on expert testimony regarding a lessee's drilling plans. At first, the expert testified, the producer found there was only "productive potential" from one section of a lease. *Johnson v. Hamill*, 392 N.W.2d 55, 59 (N.D. 1986). Recognizing that reality, a prudent operator would drill on that section but "could not reasonably attempt to exploit additional reserves from" another section. *Id.* After that first well was drilled, however, "production data from those zones tested by a currently producing well" would allow the operator to determine where to drill the next well. *Id.* at 60.

[¶ 64] Requiring simultaneous drilling on all sections of the lease would have undermined this efficiency. "[O]nly one of the wells drilled in the area was a good producer, several were dry holes, and the others were marginal producers." *Id.* In short, the continuous drilling operations clause allowed efficient drilling on the lease.

[¶ 65] Commentators have also recognized this efficiency:

> After all, sound policy demands exploration and development now, does it not? Yes, but accepting this does not tell us where and at what rate exploration and development should take place. . . . From a policy standpoint, slow development of known formations may be preferable to a more rapid rate of development that would return the maximum short-term benefits to the lessor. . . . The corporate lessee with limited capital and materials and with national responsibilities must view the matter from a different perspective . . . .

Patrick H. Martin, *A Modern Look at Implied Covenants to Explore, Develop, and Market Under Mineral Leases*, 3 OIL & GAS, NAT. RES., & ENERGY J. 401, 425–26 (2017),

available at https://digitalcommons.law.ou.edu/cgi/viewcontent.cgi?article=1092&context=onej (reprinting the 1976 article); *see Olson v. Schwartz*, 345 N.W.2d 33, 40 (N.D. 1984) (citing the 1976 article favorably).

[¶ 66] These efficiencies are important with the increase of oil and gas exploration activities in North Dakota to explore and develop the Bakken Petroleum System (the "Bakken"). As the Court is aware, the Bakken has resulted in "North Dakota becom[ing] the talk of the nation when it comes to domestic energy production." Joshua A. Swanson, *The Fine Print Matters: Negotiating an Oil and Gas Lease in North Dakota*, 87 N.D. L. REV. 703 (2011). "The Bakken formation in North Dakota is credited with 'spur[ring] a U.S. energy renaissance,' helping increase U.S. production to 7.56 million barrels per day during one week in July 2013." Alexandra B. Klass & Danielle Meinhardt, *Transporting Oil and Gas: U.S. Infrastructure Challenges*, 100 IOWA L. REV. 947, 966–67 (2015).

[¶ 67] The North American Shale Magazine noted that, after a lease is secure, like many leases now in the Bakken, "[p]roducers are now concerned about economics, focusing more on drilling efficiencies and resource price reduction." Luke Geiver, *Drilling for the Future*, N. AM. SHALE MAGAZINE (2013), *available at* http://northamericanshalemagazine.com/articles/110/drilling-for-the-future. "[P]roducers are transforming their drilling strategies, taking the elements and successful approaches used to drill one well and applying them to help drill multiple wells from a single pad, or reduce costs and improve efficiencies related to extraction, gathering or transport of crude and associated gas from the wells they already have. Their efforts mean drilling sequences will be different now than in the past . . . ." *Id.* "[T]he landscape that once seemed to be

sprinkled with randomly placed rigs, pumping units and storage tanks has begun to appear more ordered." *Id.*

[¶ 68] Recognizing the important policy interests at stake, and the necessity for encouraging efficient production, North Dakota imposes a "reasonably prudent operator" standard to the drilling operations rather than requiring immediate production on all sections of a lease. *See Johnson*, 392 N.W.2d at 57 (lessee must "prosecute drilling operations with reasonable diligence" "having regard to the interests of both lessor and lessee"). The lessor "has an implied obligation to the lessor to do everything that a reasonably prudent operator would do in operating, developing, and protecting the property . . . ." *Id.* (internal citations omitted).

[¶ 69] Typically, the operator "need only bring one of the wells into production to hold the entire lease," but "[t]he remainder of the premises continues to be subject to the implied covenants for reasonable development." *Sorum v. Schwartz*, 344 N.W.2d 73, 77 (N.D. 1984). Because particular leases differ, "[i]t is impossible to state a formula by which a court can determine whether a particular lessee has developed a particular lease in conformity with the prudent operator standard." *Johnson*, 392 N.W.2d at 57–58. Accordingly, "[e]ach case must be decided on the facts peculiar to it" and North Dakota courts consider a variety of factors to judge reasonableness. *Id.* (outlining eleven factors).

[¶ 70] In *Egeland*, this Court addressed the policy rationale for requiring a Pugh clause to explicitly modify a continuous drilling operations clause. The Court noted that applying a Pugh clause to require drilling operations on every section of the lease "would have a chilling effect on the covenant of reasonable development implied in every lease, a covenant recognized by this Court at least as far back as 1949":

> If the lessee is required to reasonably develop the premises but, once having drilled a well to production on one spacing unit, is faced with the prospect of having the Pugh clause terminate the lease as to any other lands except those on which the lessee might be drilling when the primary term expires, the lessee is faced with either drilling on all possible spacing units at one time or forfeiting the lease on those spacing units on which drilling is not commenced at the expiration of the primary term. Presumably a lessee will be disinclined to continue to develop a lease if the non-drilled portion of the lease will expire regardless of development during the extended primary term.

Egeland, 2000 ND 169, ¶ 29, 616 N.W.2d 861.

[¶ 71] Considering the manner in which oil and gas leases are developed, it is not surprising this Court found "no case in this state holding the covenant of reasonable development requires drilling on every spacing unit in a lease simultaneously." *Id.* at ¶ 30.

[¶ 72] Yet the lessors request that the Court issue its first opinion requiring simultaneous development in every section of a lease. Under the lessors' interpretation, a general Pugh clause—without mention of drilling operations—modifies decades of this Court's careful balancing of various policy concerns by requiring simultaneous drilling in all sections of the lease.

[¶ 73] No doubt, parties could choose to include a clause modifying the general rule—if they so desired. But considering the efficiency interests at stake, the Court was wise to require parties to do so clearly and explicitly. This case should not be the first to allow such efficiencies to be disregarded without clear language to the contrary, especially in consideration of the industry's practice in the bustle of activity in the Bakken.

B. Adopting Appellants' position would expunge the second sentence of paragraph 1, without ever mentioning it or striking it out.

[¶ 74] The District Court correctly stated that Appellants' view would "render irrelevant significant portions of the Habendum Clauses and Continuous Drilling Operations Clauses." How significant? Very. The entire second sentence of paragraph 1

would vanish without a trace and without any reason to believe anyone thought about that outcome.

[¶ 75] The parties knew how to strike out language that they did not like. They struck out parts of the sentence immediately after the Pugh clause (changing 3 to 2). They struck out the warranty of title in paragraph 14. But they did not strike out any part of paragraph 1, which deals with drilling operations. The obvious inference is that the parties did not intend to abrogate the effect of continuous drilling operations.

[¶ 76] Appellants see significance in the five words, "Notwithstanding anything to the contrary . . . ." Again, however, they beg the question by assuming that the Pugh clause (which mentions production but not operations) is somehow "contrary" to paragraph 1 (which mentions both). The lesson of *Egeland* is that drafters should speak clearly. That lesson had been on the books for eight years when these leases were drafted. By 2008, anyone savvy enough to insert a Pugh clause into a North Dakota lease surely knew or should have known to mention operations expressly if the intent was to override the continuous drilling operations clause.

C. Ambiguity defeats a Pugh clause.

[¶ 77] In a fallback argument, Appellants refer to ambiguity. Quoting from Johnson's affidavit and citing the general rule that typewritten provisions should control over printed ones, they suggest "any ambiguity" should be resolved in their favor. Br. ¶ 7, ¶¶ 42–43. Those arguments are unsound.

[¶ 78] First, as Appellants recognize, the affidavit and the canon about typewriting come into play only if the document contains conflicting language. Br. ¶ 41. After all, contract interpretation normally looks to the language of the contract, not a litigant's self-serving affidavit. N.D.C.C. § 9-07-02.

[¶ 79] Second, if there is any ambiguity or internal conflict, that would necessarily mean Appellants fail the *Egeland* test. The lesson of *Egeland* is that the only way to override indivisibility is with clear and explicit language. After a document is deemed to suffer from conflicting or ambiguous language, it necessarily fails that test. *See Egeland*, 2000 ND 169, ¶ 17, 616 N.W.2d 861; *Tank*, 2014 ND 123, ¶ 14, 848 N.W.2d 691; *Krenz*, 2017 ND 19, ¶ 44, 890 N.W.2d 222.

[¶ 80] This conclusion draws support from considerations of sound public policy. Just as a tie goes to the runner in baseball, the *Egeland* principle favors maintenance of oil and gas leases. Courts have traditionally favored the preservation of property rights, while preferring to avoid forfeitures. *See Abell v. GADECO, LLC*, 2017 ND 163, ¶13, 897 N.W.2d 914, 919 ("Forfeitures of oil and gas leases are not favored"); *Sorum v. Schwartz*, 411 N.W.2d 652, 654 (N.D. 1987) ("Forfeitures are not favored and the burden of proof is on the party claiming forfeiture of the lease") (internal citations omitted); *Helm Bros. v. Trauger*, 389 N.W.2d 600, 603 (N.D. 1986) (similar); *see also* N.D.C.C. § 9-01-15 ("A condition involving a forfeiture must be interpreted strictly against the party for whose benefit it is created."). This purpose is served by clear-statement rules like the one in *Egeland*.

[¶ 81] Conversely, the purpose of a Pugh clause is to keep a producer from using modest production on a single well to hold a large tract for speculative purposes, instead of investing money to develop the land fully. *See Egeland*, 2000 ND 169, ¶ 17, 616 N.W.2d 861; *Sandefer Oil & Gas, Inc. v. Duhon*, 961 F.2d 1207, 1211 (5th Cir. 1991). But the leases here already protect against that concern. Under the reading advocated here and adopted below, the leases cannot be held fully by production on a single well here or there.

To maintain the lease on the parts of the land that do not (yet) have production, Appellees must invest money to develop the land with continuous drilling operations. That means drillings rigs, drilling crews, and everything that goes with drilling—none of which comes for free.

VII. CONCLUSION

[¶ 82] The District Court faithfully followed this Court's directive that Pugh clauses must be clear and explicit and address all events that extend an oil and gas lease. Drafting a Pugh clause that addresses continuous drilling operations is not difficult. Examples of several such clauses have been the subject of opinions by this Court. The District Court correctly applied the precedents established by this Court by holding continuous drilling operations on one part of the leased premises extend the lease as to the entire leased premises. That decision should be affirmed.

DATED this 25th day of May, 2018.

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IN THE SUPREME COURT
STATE OF NORTH DAKOTA

Robert Post Johnson, and A.V.M. Inc., Appellants, vs. Statoil Oil & Gas LP, formerly known as Brigham Oil & Gas LP, Missouri Basin Well Service, Inc., MBI Oil and Gas, LLC, Northern Energy Corporation, Sunshine Pacific Corp., Stewart Geological, Inc., Brent Clum, Earthstone Energy, Inc., Vincent Melashenko, Hill L.P., LGFE-J L.P., Reef 2011 Private Drilling Fund, L.P., Missouri River Royalty Corporation, Rainbow Energy Marketing Corporation, United Energy Trading, LLC, Abaco Energy, L.L.C., Wolfe Exploration LLC, Joe Wolfe, Global Gas & Oil, L.L.C., SourceRock Exploration, LLC, Cody Oil & Gas Corporation, David Peterson, Slawson Exploration Company, Inc., Hess Bakken Investments II, LLC, and LGFE-M L.P., Appellees.	)	Supreme Court Case No. 20180050 McKenzie County District Court Case No. 27-2014-CV-00286

Appeal from Judgment Entered on December 7, 2017
Case No. 27-2014-CV-00286
County of McKenzie, Northwest Judicial District
The Honorable Robin A. Schmidt, Presiding

CERTIFICATE OF SERVICE

I hereby certify that on May 25, 2018, I electronically filed with the Clerk of the North Dakota Supreme Court, the following:

Brief of Appellee Statoil Oil & Gas LP

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