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Updates in Arkansas Oil & Gas Law

Thomas A. Daily

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FOUR ACTS OF THE 2013 ARKANSAS GENERAL ASSEMBLY ARE OF INTEREST

In our last report, the 2013 Arkansas Legislative Session was about to expire, though it was then too early to assess the damage. Now that the dust has fully settled, let us review:

Act No. 1062 made certain amendments to existing statutes concerning the timing and method of the payment of royalties. Most importantly, the act increased from $100 to $150 the amount of royalty which may be accumulated over a period not exceeding twelve months. A royalty owner may decrease that amount to $50, upon written demand. Royalty up to $10 may be accumulated indefinitely except that it must be paid upon cessation of production or upon the payor's relinquishment of responsibility for making the royalty payment. Also, the act expressly authorizes electronic payment of royalties and provides that required “check stub” information may be “made accessible in electronic form,” as an alternative to paper form.

Act No. 1299, titled the “Landowner Notification Act,” amended Arkansas Code § 15-72-203 to require a lengthy list of information to be provided to a surface owner prior

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1 Member, Daily & Woods, P.L.L.C., Fort Smith, Arkansas; Adjunct Professor, University of Arkansas (Fayetteville) School of Law.
to conducting “shale operations”\(^3\) upon that owner’s land. The Act requires the Arkansas Oil and Gas Commission to promulgate rules implementing the Act. The Commission did just that in amendments to its General Rule B-1, which now mirrors the Notification Act.

Act No. 1520 requires that ad valorem tax reappraisals of producing mineral interests occur annually, rather than every five years as under previous law. This act was inspired by the manner in which county tax assessors value producing minerals based upon previous production multiplied by an assumed price. Assessors were refusing to change the assumed price in the formula, even though the gas prices had fallen drastically, and relied upon the five-year reappraisal rule in the previous statute as authority for taking that somewhat unconscionable position.\(^4\)

Act No. 262 was sponsored by Senator Maloch. That act amended ACA § 15-72-103(a)(1) to authorize a civil penalty of up to $100,000 per violation for illegally dumping or disposing of unauthorized fluids or substances into a well or upon a well site. The Oil and Gas Commission then amended its General Rule A-5 to reflect its new fining authority under the Act.

I come from relatively crime-free North Arkansas. I was unaware that illegal dumping into wells was a problem in the South-woods. Moreover, I am totally unfamiliar with whatever incident(s) inspired this legislation. However, I know Senator Maloch to be one of the very best members of the General Assembly, particularly when oil and

\(^3\) As defined by the Act.

\(^4\) Apparently at the direction of the state’s Department of Finance and Administration, Assessment Coordination Division.
gas issues are involved, so I do not intend to argue with him.

I hope the 100-grand fine is an effective deterrent. If not, perhaps the 2015 Legislature can pass another law, authorizing pumpers to pack heat and placing a bounty upon dumpers brought in by pumpers, whether dead or alive.

Arkansas Supreme Court Holds that Possession Under Unrecorded Contract of Sale Constitutes "Actual Notice" to Oil and Gas Lessee

Walls v. Humphries\(^5\) surprised me, to say the very least. Walls is the named Appellant, but the case is really about Hernandez, who was the purchaser of a tract of land under an unrecorded contract of sale. Hernandez alleged that he and his family were in possession of the land covered by that contract. However, the record owner of the land was one Humphries, who had sold it under the unrecorded contract. SEECO, Inc, which acted without actual knowledge of Hernandez' interest, secured an oil and gas lease from Humphries. Paraclifta, also without knowledge of Hernandez' interest, secured a mineral deed from Humphries.

The litigation which ensued involved Ark. Code Ann. § 14-15-404, which provides, in part:

No deed ...shall be good...against a subsequent purchaser of the real estate for a valuable consideration without actual notice thereof...unless the deed...is filed for record...\(^6\)

Relying upon that statutory language, the trial court granted summary judgment, holding that SEECO and Paraclifta were innocent purchasers, not bound by Hernandez' unrecorded interest. The Arkansas Court of Appeals affirmed in Walls v.

\(^5\) 2013 Ark 286, 2013 WL 3239042.
\(^6\) Emphasis Added.
I applauded that decision in this presentation to the 2012 Natural Resources Law Institute, concluding that it indicated a judicial limitation of the Arkansas Supreme Court's holding in *Killam v. Texas Oil and Gas Corp.* You may recall that in *Killam*, a mineral deed necessary to the Killams' title was unrecorded, but another recorded deed, as well as tax assessments, provided clues to the existence of the Killams' interest. The court held in that case that Texas Oil and Gas had a duty, having seen those instruments, to discover the Killams' interest. My reaction to the Court of Appeals opinion in *Walls v. Humphries* was that perhaps this duty to inquire was only triggered by other recorded instruments. While we would still have to live with *Killam*, nothing worse had happened.

But wait!! Remember what Yogi said about "when it's over." The Arkansas Supreme Court accepted review of *Walls v. Humphries* on a totally unrelated issue and then proceeded to reverse the case's principal holding. The Supreme Court ruled that the summary judgment was improper. If Hernandez' possession was open, exclusive and notorious, it constituted "actual notice" under the recording act, trumping SEECO's lease and Paracifita's mineral deed, even though neither SEECO nor Paracifita had any knowledge about Hernandez. Whether Hernandez' possession met that standard was an issue of fact.

I was amazed and disappointed by the court's decision. I even commented on the Natural Resources Section's listserv that the court was clearly wrong. I was quickly

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8 303 Ark. 547, 298 S.W.2d 419 (1990).
corrected by Professors Norvell and Foster,\(^9\) who explained that I should have learned in law school that possession of land was notice to all the world—always had been. Research proved the professors to be right, although most of the case law on this issue is pretty ancient.\(^{10}\)

In its opinion, the court dealt with the issue as though it was determining whether SEECO and Paraclifta qualified as Bona Fide Purchasers for Value (BFP’s) of their interests. We know that BFP’s are purchasers for value, without notice of adverse interests. This is not really a BFP issue, because it involves the interpretation of a statute. Being inquisitive, I wondered if the word “actual” before “notice” in the statute, changed anything. Alas, it apparently does not.

For example, Black’s Law Dictionary contains a listing for the term “Actual Notice.” However, Black’s definition of “Actual Notice” is simply “See Notice.”\(^{11}\) Moreover, the overwhelming weight of cases defining or explaining what is meant by “actual notice” of a fact explain that the term means either knowing that the fact exists or having available the tools to learn that the fact exists. In other words, “actual” preceding “notice” is as useless as the “p” in psoriasis.\(^{12}\) Then, to make matters worse, I learned that the *Walls v. Humphries* holding is not even unique to Arkansas. For example, in the Mississippi case of *Gulf Refining Co. v. Travis*\(^{13}\) an owner whose interest was unrecorded and whose “possession” was only through her tenant, prevailed over an oil

\(^9\) Real property law professors teaching at UAF and UALR Law Schools, respectively.  
\(^{10}\) The most recent Arkansas case cited by the court for the premise that possession equals actual notice were decided in 1948. Most were decided before 1900.  
\(^{11}\) *Black’s Law Dictionary* (9th ed. 2009).  
\(^{12}\) A condition which is likewise not particularly useful for much of anything except, perhaps, heartbreak.  
\(^{13}\) 201 Miss. 336, 29 So. 2d 100 (1947).
Still, the fact remains that oil and gas companies, leasing in the middle of a lease play, have need to rely upon record title and seldom have the time or resources to check on possession. As you know, mineral owners do not even own the surface above. In those cases possession is clearly immaterial. Indeed, to those who drill in 640 acre units for gas, all of the surface is immaterial, except that needed for well sites or pipelines.

How, as a practical matter, do you check possession in this day and age? Our society has become far more mobile. People do not just stay put any more. What if the owner is not home. How long must you wait for his return? Can you rely upon what the babysitter tells you? Perhaps it is time to understand that possession is not what it used to be when court houses were days away by horseback and conveyances were by livery of seisin.14

Understand, it is not the Supreme Court's job to change the law to keep up with the times. That is a job for the Legislature. If this rule is to change, it will require a change to the recording act. Merely substituting “actual knowledge” for “actual notice” would solve much of the oil and gas industry's problem. Perhaps, that could be further

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14 The seisin, as representing the freehold interest of the tenant, was at common law made use of for the purpose of a conveyance of such interest, the latter being in fact transferable only by a delivery of the possession of the land, called “livery of seisin.” This livery of seisin was effected by the delivery on the land, “in name of seisin of the land,” of a turf or twig (livery in deed), or by a statement made in view of the land to the effect that possession was given, followed by entry by the alienee (livery in law). This ceremony was usually accompanied by a deed or charter “of feoffment,” as it was called, attesting the livery of seisin, and stating the purpose, nature, and extent of the transfer, the whole transaction being known as a “feoffment.” (1 Tiffany Real Prop. § 22 (3d ed.) (citations omitted).
improved by placing the burden of proving actual knowledge upon the party claiming through the unrecorded interest. Before we jump on that wagon we need to consider whether we might be creating more problems than we solve, but that is for another discussion. The bottom line here is that the decision in Walls v. Humphries, while practically difficult to stomach, is based upon solid case precedent and unlikely to change except through legislation.

ARKANSAS SUPREME COURT INTERPRETS A MINERAL DEED CONVEYING AN UNDIVIDED _____ INTEREST AS EFFECTIVELY CONVEYING ALL OF GRANTOR’S MINERAL INTEREST

Back in BC\textsuperscript{15} many conveyances were accomplished by fill-in-the-blanks forms. A mineral buyer would simply tear a form from his pad, use a pen to fill in each blank in the form, procure the grantor’s signature, get that signature acknowledged, and record the deed. Barton Land Services, Inc. v. SEECO, Inc.\textsuperscript{16} dealt with one of those transactions, obviously left incomplete in haste. At issue was a 1929 mineral deed, left partially uncompleted as follows:

[R.F. Thomas and Amy Thomas] ... do hereby grant, bargain, sell and convey unto the said J.S. Martin Trustee and to his heirs and assigns forever, an undivided _____ interest in and to all the oil, gas and other minerals, in, under and upon the following described lands lying within the County of Van Buren and State of Arkansas, to-wit: [description of the three tracts] containing 221.35 acres, more or less.

The Thomases had owned 100\% of the minerals beneath the lands described in the deed. The question for the court: What, if anything, goes into the open blank? Successors in interest to the grantor, including Barton Land Services, argued that leaving an essential term\textsuperscript{17} of the contract uncompleted caused the deed to be void for

\textsuperscript{15}Before computers.
\textsuperscript{17}The quantity of interest conveyed.
vagueness. The Arkansas Supreme Court disagreed. Applying the presumption that a
grantor who deeds without exception or reservation conveys his entire interest, the
Court ruled that the uncompleted deed conveyed the grantors' entire 100% interest to
the deed's grantee.

**TWO 2013 ARKANSAS COURT OF APPEALS DECISIONS
VOID MINERAL QUIET TITLE DECREES**

Those of us who examine title are frequently confronted by quiet title decrees
purporting to confirm title to previously severed mineral interests in persons who never
owned them. The claims of those mineral claimants are often based upon void tax
deeds, and nearly always include a bogus allegation that the plaintiff has adversely
possessed the severed interest.\(^{18}\) We have long treated these quiet title decrees as
essentially worthless, much to the annoyance of the “winners” in those lawsuits and
their attorneys, who had charged good money to obtain the worthless court orders.
Now we have a couple of decisions of Arkansas’ Court of Appeals to back us up.

*Wright v. Viele\(^{19}\)* involved a 1991 decree purporting to quiet title to 100% of the
minerals beneath a subject tract. The successors to a person named E. Graves, who
were the owners 50% of that mineral interest, were not personally served in connection
with the quiet title suit. Rather, they were “served” constructively, by published warning
order. That warning order incorrectly referred to their predecessor's name as “E. Crow.”

\(^{18}\) In Arkansas, as in most jurisdictions, adverse possession of a severed mineral
interest can only be accomplished by actual production of the severed mineral, contrary
to the rights of the true owner. (See Daily, Thomas A. and Barrier, W. Christopher,
*Well, Now, Ain't that Just Fugacious!: A Basic Primer on Arkansas Oil and Gas Law.*
(hereinafter “Fugacious I”) Ch. VIII, 29 U. Ark. Little Rock L. Rev. 211 at 222-224.

Noting that constructive service is in derogation of the common law, the Court of Appeals stated that "statutory service requirements are strictly construed and compliance with them must be exact." Hence, the appeals court affirmed the trial court's decree voiding the 1991 decree.

In a similar holding in the second case, the Arkansas Court of Appeals reversed a trial court order upholding a 2009 quiet title decree. That case was Heirs of Duncan v. Alfred T. Williams Living Trust.20 Mancil and Sylvia Duncan were residents of Tyler, Texas who owned land in Arkansas. When they sold that land to the predecessors of the Williams Trust in 1963, Mancil and Sylvia reserved a one-half mineral interest. In 2009 the Williams Trust brought suit to quiet title to the Duncans' mineral interest. By then, both Mancil and Sylvia were deceased, but their heirs resided in the same family house in Tyler. The appeals court determined that counsel for the Williams Living Trust had not conducted the statutorily required diligent inquiry to locate the Duncan Heirs prior to attempting to constructively serve them by publication of a warning order. Had such an inquiry been conducted, the Duncan Heirs likely could have been located and personally served with process. These decisions indicate that Arkansas' appeals courts are willing to go behind the decrees in such suits to confirm compliance with statutory service requirements and fundamental due process.

### Reasonable Surface Use by Oil and Gas Lessee is Not Wrongful and Therefore is Not Compensable

Pollard v. Seeco, Inc.21 was a surface damage case. SEECO, Inc. was the owner of an oil and gas lease executed by Pollard. Pollard had also executed a

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surface-use agreement with SEECO, for separate consideration.

However, after SEECO constructed a drilling pad upon lands which Pollard alleged were “part of the future development activity which had already been commenced...,” Pollard sued for damages. The Arkansas Court of Appeals affirmed a summary judgment for SEECO, based, in part, upon an affidavit of a SEECO geologist stating that the well was drilled in conformance with industry standards, that it used an area of normal and reasonable size and that it was at a geologically desirable location. A mineral lessee who conducts surface operations is liable only if those operations are conducted unreasonably.

Pollard should not be interpreted as giving oil and gas companies license to run roughshod over surface owners. Arkansas follows the Reasonable Accommodation Doctrine with respect to conflicts between the surface and mineral estates. That doctrine concedes that the mineral owner (lessee)’s right of surface ingress exists, but requires it to be exercised with “due regard” to the interests of the surface owner. In Pollard, SEECO presented uncontroverted proof that it had complied with its duty to accommodate Pollard, and thus was not liable to him.

UNITED STATES DISTRICT COURT GRANTS SUMMARY JUDGMENT TO LESSEE IN LEASE CANCELLATION SUIT—LESSORS FAILED TO GIVE NOTICE OF BREACH

In Lewis v. Enerquest Oil and Gas, LLC the lessors sued Enerquest, the operator of the Chalybeat Springs Fieldwide Unit in Columbia County, seeking cancellation of their oil and gas leases, outside of producing formations based upon alleged violation of the Implied Covenant to Develop. The lessors’ primary contention

22 See Fugacious I, supra, at 224-228.
23 USDC (W.D. Ark., El Dorado Division) Case No. 12-CV-1067.
was that Enerquest had failed to develop the Lower Smackover (Brown Dense) Formation. The United States District Court\textsuperscript{24} granted Summary Judgment to Enerquest, holding the oil and gas leases required the lessors to give Enerquest notice of any alleged breach, together with an opportunity to cure the breach, prior to bringing suit. The lessors had contended that a prior request which some of them had made to the Arkansas Oil and Gas Commission, seeking dissolution of the unit, constituted the required notice. However, the court ruled that the request to the Commission was not made on behalf of all Plaintiffs, and, at any rate, was insufficient, because it requested dissolution of the unit, not development of the Brown Dense Formation.

Enerquest also attached a geologist's affidavit to its summary judgment motion. In that affidavit, Enerquest's witness opined that a prudent operator in Enerquest's position would not have explored the Brown Dense Formation, and that Enerquest had acted as a prudent operator as to other zones. The court declined to rule on that basis, however, stating that it was unnecessary for her to do so, given the summary judgment on the notice issue.

In case you are wondering, the district court's decision on the notice issue does not conflict with Arkansas' decision in \textit{Byrd v. Bradham}.\textsuperscript{25} The cases are distinguishable. In \textit{Byrd}, it was contended by the defendant/lessee that principles of equity precluded lease cancellation without notice and the chance to cure. The Arkansas Supreme Court recognized that principal, in theory, but concluded that the non-development had gone on so long as to constitute abandonment of the leased

\textsuperscript{24} Hon. Susan Hickey.
\textsuperscript{25} 280 Ark. 11, 329 S.W.2d 252 (1983).
acreage by the lessee. Thus, notice was excused under the circumstances. In Lewis, on the other hand, the notice was required by an express lease provision, and Enerquest had done considerable work in the unit, so a finding of abandonment was improbable.

THIS JUST IN: COURT OF APPEALS SAVES CHESAPEAKE'S GOOSE (PARTIALLY)

In a brand new decision, Chesapeake Exploration, LLC v. Whillock26 the Arkansas Court of Appeals partially reversed a summary judgment entered by a trial court27 which would have allowed the Whillocks to retain a lease bonus paid by Chesapeake on a mineral interest which they never owned. Here is what happened.

The Whillocks owned the surface of 80 acres in Van Buren County. They knew that they did not own the mineral rights. When a landman representing Chesapeake approached them for a lease on the tract, the Whillocks told him they owned no minerals, but, according to the Whillocks, the landman insisted, so eventually they executed a five-year lease and took his check for $120,000. The paid income taxes on the $120,000 bonus and spent the rest.

Fourteen months later Chesapeake saw a drilling title opinion which indicated that the Whillocks, indeed, owned only surface. Thus Chesapeake wrote to the Whillocks requesting refund of the bonus. That letter enclosed a release of the lease, which Chesapeake then recorded.

When the Whillocks failed to refund the bonus, Chesapeake sued, relying upon

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27 Hon. Michael Maggio.
the warranty in the lease. There was just one problem. The lease had been released. Fortunately for Chesapeake, it alternatively sued for unjust enrichment. The Circuit Court granted the Whillocks' motion for summary judgment, ruling that the release of the lease was a general release of all claims.

On appeal, the Court of Appeals reversed, but only in part. The appeals court affirmed the summary judgment as to the breach-of-warranty claim. It reversed the judgment dismissing Chesapeake's unjust enrichment claim, and remanded that part of the case for trial.

Chesapeake is far from home free. As the court observed, unjust enrichment is an equitable cause of action, subject to equitable defenses. Since the Whillocks claimed that Chesapeake should be barred by the equitable defenses of estoppel and misrepresentation the case was remanded to circuit court for trial on those issues. The Whillocks may have a home-field advantage there, considering that they spent the money in reliance upon the landman's insistence.