

January 2017

OIL AND GAS LAW—Owning Liability Without Ownership Rights: Harmonizing Property, Contracts, and Oil and Gas Principles in the Assignment of Surface Use Agreements; Pennaco Energy, Inc. v. Sorenson, 2016 WY 34, 371 P.3d 120 (Wyo. 2016)

Megan Romano

Follow this and additional works at: <https://scholarship.law.uwyo.edu/wlr>

Recommended Citation

Romano, Megan (2017) "OIL AND GAS LAW—Owning Liability Without Ownership Rights: Harmonizing Property, Contracts, and Oil and Gas Principles in the Assignment of Surface Use Agreements; Pennaco Energy, Inc. v. Sorenson, 2016 WY 34, 371 P.3d 120 (Wyo. 2016)," *Wyoming Law Review*. Vol. 17: No. 2, Article 8.

Available at: <https://scholarship.law.uwyo.edu/wlr/vol17/iss2/8>

This Case Notes is brought to you for free and open access by the UW College of Law Reviews at Law Archive of Wyoming Scholarship. It has been accepted for inclusion in Wyoming Law Review by an authorized editor of Law Archive of Wyoming Scholarship.

CASE NOTE

**OIL AND GAS LAW—Owning Liability Without Ownership Rights:
Harmonizing Property, Contracts, and Oil and Gas Principles in
the Assignment of Surface Use Agreements; *Pennaco Energy, Inc. v.
Sorenson*, 2016 WY 34, 371 P.3d 120 (Wyo. 2016)**

Megan Romano *

I.	INTRODUCTION	391
II.	BACKGROUND	393
	A. <i>Transferring Liability Pursuant to Contract Principles and Oil and Gas Law</i>	393
	B. <i>Determining Ongoing Liability Under Property Law</i>	395
	C. <i>Governing Law to Establish Liability After Assignment in Wyoming and Other Jurisdictions</i>	398
	D. <i>Split Estate Act</i>	399
III.	PRINCIPAL CASE	400
	A. <i>Background</i>	400
	B. <i>Controlling Law to Determine Ongoing Liability Under Surface Use Agreements</i>	401
IV.	ANALYSIS	403
	A. <i>Missing the Mark: The Contract Approach</i>	403
	B. <i>Misdirection: Servitude or Landlord-Tenant Law</i>	405
	C. <i>The Property Question Refocused: Intention of the Parties and Character of the Promise</i>	407
	D. <i>Legislative Policy: The Split Estate Act</i>	411
	E. <i>Aftermath and Remedies</i>	412
V.	CONCLUSION	414

I. INTRODUCTION

The first known oil lease dates back to 1853, located in Pennsylvania’s Oil Creek region.¹ Although theories of oil and gas ownership vary by jurisdiction today,² courts have long-recognized for a landowner, “the right to explore for these

* J.D. candidate, University of Wyoming College of Law, Class of 2018. Thank you to Professor Alan Romero for his expertise and guidance, the *Wyoming Law Review* Board for its attentiveness and edits, my friends and family for all the support, and most of all, to my husband Eric for his encouragement throughout this process.

¹ EUGENE KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 1.32 (Matthew Bender, rev. ed. 2015).

² 1 PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS, OIL AND GAS LAW, § 203 (LexisNexis ed. 2016).

substances, and to reduce them to possession if found, is a valuable part of his property.”³ Mineral interests may be reserved or created by deed.⁴ Alternatively, landowners may grant operators mineral exploration rights under an oil and gas lease.⁵ These intricate transactions and relationships occasionally led to tensions between landowners and operators, shaping the contemporary oil and gas lease.⁶

To complicate matters, numerous landowners may be involved with an operator-lessee, where past conveyances severed minerals from the surface estate, creating two separate estates.⁷ In 2005, the Wyoming Legislature enacted the Split Estate Act to enhance protections for surface owners and balance power between the parties.⁸ By encouraging good faith negotiations for surface use agreements, the Act aims to guarantee operators perform surface reclamation and reimburse surface owners for damages resulting from mineral exploration and production.⁹ In *Pennaco Energy, Inc. v. Sorenson*, the Wyoming Supreme Court held the operator remained liable under a surface use agreement because it failed to include an exculpatory clause in the original agreement or obtain a subsequent novation prior to assignment.¹⁰

Although the *Pennaco* court arrived at the correct conclusion, its narrow contract-based analysis results in lingering property questions, and conceivably undesired implications for surface owners and operators alike.¹¹ The Background section of this Case Note first details ongoing liability under agreements pursuant to contract, oil and gas, and property law, jurisdictional applications, and the Split Estate Act.¹² A description of the case, the court’s analysis, and holding in *Pennaco* follows in the Principal Case section.¹³ Finally, the Analysis provides the appropriate legal approach and policy to determine liability in this case, the practical consequences of the *Pennaco* decision, and recommendations for parties to reconcile the court’s reasoning.¹⁴

³ Gray-Mellon Oil Co. v. Fairchild, 292 S.W. 743, 745 (1927).

⁴ 1 MARTIN & KRAMER, *supra* note 2, § 301.

⁵ 1 MARTIN & KRAMER, *supra* note 2, § 601.

⁶ *Id.*

⁷ See 1 MARTIN & KRAMER, *supra* note 2, § 218.

⁸ See Randall T. Cox, *Analysis of the Wyoming Split Estate Act, W.S. 30-5-401, et seq.*, THE WYOMING LAWYER, February 2014, at 39, http://digitaleditions.walsworthprintgroup.com/publication/?i=197015&article_id=1633994&view=articleBrowser&ver=html5#%22issue_id%22:197015,%22view%22:%22articleBrowser%22,%22article_id%22:%221633994%22.

⁹ See WYO. STAT. ANN. §§ 30-5-401–410 (2016).

¹⁰ *Pennaco Energy, Inc. v. Sorenson*, 2016 WY 34, ¶ 46, 371 P.3d 120, 131 (Wyo. 2016).

¹¹ See *infra* notes 213–42 and accompanying text.

¹² See *infra* notes 213–42 and accompanying text.

¹³ See *infra* notes 15–117 and accompanying text.

¹⁴ See *infra* notes 118–242 and accompanying text.

II. BACKGROUND

A. Transferring Liability Pursuant to Contract Principles and Oil and Gas Law

Contract law “attempts the realization of reasonable expectations that have been induced by the making of a promise.”¹⁵ Freedom to contract is a coveted policy woven into the fabric of contract doctrine.¹⁶ These fundamental objectives manifest in the court’s review of contract construction and enforcement.¹⁷ Provided the contract language is clear and unambiguous, the court looks only within the four corners of the agreement,¹⁸ giving the words their plain and ordinary everyday meaning.¹⁹ The court also analyzes the contract in its entirety, considering the words and language used to interpret the parties’ intent.²⁰ If the court finds the language is ambiguous or inconsistent, it may consider parol evidence.²¹ However, if parties adopt a contract and demonstrate their intent that the writing includes a complete statement of the agreed upon terms, parol evidence does not govern.²² The parties’ relationship, transaction type, preliminary negotiations, and commercially reasonable trade usage influence the determined meaning.²³ Finally, the court construes ambiguous contract terms against the drafter.²⁴

Understanding the implications of foundational contract interpretation rules is vital in complex, multi-party transactions common to the energy industry, and requires hypervigilance in drafting assignment terms with potential impacts

¹⁵ CORBIN ON CONTRACTS § 1.1 (LexisNexis Matthew Bender 2016).

¹⁶ See CORBIN ON CONTRACTS § 79.01 (LexisNexis Matthew Bender 2014).

¹⁷ See *infra* notes 18–24 and accompanying text.

¹⁸ *N. Fork Land & Cattle, LLLP v. First Am. Title Ins. Co.*, 2015 WY 150, ¶ 10, 362 P.3d 341, 345–46 (Wyo. 2015) (citing *Prudential Preferred Properties v. J and J Ventures, Inc.*, 859 P.2d 1267, 1271 (Wyo. 1993)).

¹⁹ *Felix Felicis, LLC v. Riva Ridge Owners Ass’n*, 2016 WY 67, ¶ 18, 375 P.3d 769, 775 (Wyo. 2016) (citations omitted).

²⁰ See *N. Fork Land & Cattle, LLLP*, ¶ 14, 362 P.3d at 346 (citing *Doctors’ Co. v. Ins. Corp. of America*, 864 P.2d 1018, 1023–24 (Wyo. 1993)).

²¹ RESTATEMENT (SECOND) OF CONTRACTS § 213 cmt. a–b (AM. LAW INST. 1981) (explaining the parol evidence rule “defines the subject matter of interpretation” and “renders inoperative prior written agreements as well as prior oral agreements”).

²² *Id.* § 213 cmt. c.

²³ *Id.* § 212 cmt. b.

²⁴ *Mountain View/Evergreen Improvement & Serv. Dist. v. Casper Concrete Co.*, 912 P.2d 529, 532 (Wyo. 1996) (citing *Prudential Preferred Properties v. Underwood Ranch Co.*, 873 P.2d 598, 600 (Wyo. 1994)).

on operations for years ahead.²⁵ Oil and gas leases generally contain a clause authorizing assignment of mineral interests and a similar reference in the common language about “running of the covenants of the lease to assignees.”²⁶

Contract principles address liability when a party assigns agreement rights.²⁷ *Restatement (Second) of Contracts* states, “[u]nless the obligee agrees otherwise, neither delegation of performance nor a contract to assume the duty made with the obligor by the person delegated discharges any duty or liability of the delegating obligor.”²⁸ Thus, even if a party assigns its contractual rights and interests, any duties under the contract are generally delegated and assignor retains its obligation under the original agreement, unless the assignment is coupled with express novation.²⁹ A novation³⁰ “discharges the original duty, just as any other substituted contract does, so that breach of the new duty gives no right of action on the old duty.”³¹

Parties may also include exculpatory clauses in agreements to shift liability.³² To illustrate, lessees typically include language in oil and gas leases discharging their liability and holding any successor in interest fully responsible for breaches occurring after assignment.³³ However, if the assignor fails to include an explicit exculpatory clause, oil and gas law holds the original lessee liable for any breach of lease covenant arising subsequent to assignment.³⁴

In addition, oil and gas leases commonly include some provisions also addressed under a separate surface use agreement.³⁵ Frequently overlapping terms benefitting the lessee under an oil and gas lease include surface easements for well

²⁵ See *infra* notes 213–42 and accompanying text.

²⁶ 2 PATRICK H. MARTIN & BRUCE M. KRAMER, *WILLIAMS & MEYERS, OIL AND GAS LAW*, § 402 (LexisNexis Matthew Bender 2016).

²⁷ See *infra* notes 28–34 and accompanying text.

²⁸ RESTATEMENT (SECOND) OF CONTRACTS § 318 (AM. LAW INST. 1981).

²⁹ JOSEPH M. PERILLO, *CONTRACTS §18-25* (West Academic Publishing 7th ed. 2014).

³⁰ RESTATEMENT (SECOND) OF CONTRACTS § 280 (defining novation as “a substituted contract that includes as a party one who was neither the obligor nor the obligee of the original duty.”).

³¹ *Id.* § 280 illus. 1 (“A owes B \$1,000. B promises A that he will discharge the debt immediately if C will promise B to pay B \$1,000. C so promises. There is a novation under which B’s and C’s promises are consideration for each other and A is discharged.”).

³² *Exculpatory Clause*, *THE WOLTERS KLUWER BOUVIER LAW DICTIONARY* (desk ed. 2012) (“[A] contract provision by which one party expressly agrees not to hold the other party liable for some past or future conduct.”).

³³ 5 EUGENE KUNTZ, *A TREATISE ON THE LAW OF OIL AND GAS* § 64.6 (Matthew Bender, rev. ed. 2015).

³⁴ 2 MARTIN & KRAMER, *supra* note 26 § 403.1.

³⁵ See 1 MARTIN & KRAMER, *supra* note 2, § 218.

locations, equipment, access roads, and pipelines.³⁶ While “all writings which are part of the same transaction are interpreted together,”³⁷ the parties must include express language demonstrating their intent to incorporate the writings.³⁸

B. Determining Ongoing Liability Under Property Law

Property principles are pertinent to oil and gas transactions because exploration and production relate to both the surface and mineral estates.³⁹ While many parties create land use promises by contract, property doctrine is imbedded in these easements and covenants.⁴⁰ The *Restatement (Third) of Property: Servitudes* describes these principles and its scope as follows:

- (1) A servitude is a legal device that creates a right or an obligation that runs with land or an interest in land.⁴¹

...

- (2) The servitudes covered by this Restatement are easements, profits, and covenants. To the extent that special rules and considerations apply to the following servitudes, *they are not within the scope of this Restatement*:

- (a) covenants in *leases*;

...

- (c) *profits for the removal of timber, oil, gas, and minerals*.⁴²

Easements create “a nonpossessory right to enter and use land in the possession of another and obligates the possessor not to interfere with the uses authorized

³⁶ *Id.*

³⁷ WILLISTON ON CONTRACTS § 30:25 (3d ed.).

³⁸ *Id.*

³⁹ See 5 KUNTZ, *supra* note 33 § 3.1.

⁴⁰ RESTATEMENT (FIRST) OF PROP. § SCOPE (AM. LAW INST. 1936).

⁴¹ RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 1.1 (AM. LAW INST. 2000) (further describing servitudes: “(a) Running with land means that the right or obligation passes automatically to successive owners or occupiers of the land or the interest in land with which the right or obligation runs. (b) A right that runs with land is called a “benefit” and the interest in land with which it runs may be called the “benefited” or “dominant” estate. (c) An obligation that runs with land is called a “burden” and the interest in land with which it runs may be called the “burdened” or “servient” estate.”).

⁴² *Id.* (emphasis added).

by the easement.”⁴³ If parties create an easement by conveyance, nothing additional is required to form the intended easement.⁴⁴ Further, “[a] covenant is a servitude if either the benefit or the burden runs with land. A covenant that is a servitude ‘runs with land.’”⁴⁵

The *Restatement* identifies circumstances when an assignor’s liability under a covenant continues, dependent upon the parties’ intent and expectations.⁴⁶ Where a servitude in gross exists, contract principles are determinative.⁴⁷ If a servitude lasts for indefinite or perpetual periods, any servitude burden arising after an original party transfers burdened property rights to a third party is no longer binding on assignor.⁴⁸ Conversely, where duration of the servitude is limited, the principles governing a landlord-tenant relationship apply.⁴⁹ A lessee cannot terminate its duties by assignment, based on privity of contract or estate.⁵⁰ Further, a lessee must generally restore the premises at the landlord’s

⁴³ *Id.* § 1.2 (further describing easements: “(2) A profit a prendre is an easement that confers the right to enter and remove timber, *minerals, oil, gas, game, or other substances from land in the possession of another. It is referred to as a “profit” in this Restatement. (3) The burden of an easement or profit is always appurtenant. The benefit may be either appurtenant or in gross.”).*

⁴⁴ RESTATEMENT (FIRST) OF PROP. § SCOPE.

⁴⁵ RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 1.3.

⁴⁶ *Id.* § 4.4 cmt. a (“a. Application. The rules stated in this section apply only as an aid to determining the intent or expectations of the parties . . . in creating a servitude. . . . [T]he parties are free to determine the duration of their rights and obligations under a servitude. If their intent to do so is ascertained, it should be given effect.”).

⁴⁷ *Id.* § 4.4(3).

⁴⁸ *Id.* § 4.4(1).

⁴⁹ *Id.* § 4.4 cmt. b (“b. . . . This rule is different from that which obtains in the law of landlord and tenant where the original tenant generally remains liable on the covenants in the lease after assignment of the term. The difference results from the likely difference in the expectations of parties to leases and parties to covenants among fee owners. In the lease transaction, the duration of the tenant’s liability is limited by the duration of the lease term, and the landlord is thought to have relied on the tenant’s creditworthiness in determining to enter into the lease. By contrast, servitudes created by fee owners generally have an indeterminate or perpetual duration (see § 4.3(4) and (5)), and neither party is likely to have expected the other to be liable after transfer of the burdened interest. . . .”).

⁵⁰ RESTATEMENT (SECOND) OF PROP.: LANDLORD & TENANT § 16.1(1)(a)–(b) (AM. LAW INST. 1997) (“(1) A transferor of an interest in leased property, who immediately before the transfer is obligated to perform an express promise contained in the lease that touches and concerns the transferred interest, continues to be obligated after the transfer if: (a) the obligation rests on privity of contract, and he is not relieved of the obligation by the person entitled to enforce it; or (b) the obligation rests solely on privity of estate and the transfer does not terminate his privity of estate with the person entitled to enforce the obligation, and that person does not relieve him of the obligation.”).

request, and a landlord may recoup damages if lessee fails to satisfy this duty.⁵¹ Oil and gas law incorporates these landlord-tenant principles.⁵²

As noted, oil and gas leases generally include express language creating easements on the servient surface estate to benefit the dominant mineral estate.⁵³ Pursuant to oil and gas law, a surface easement of this nature typically creates a “mutual and simultaneous” property interest to provide the required privity of estate for covenants running with the land.⁵⁴ Therefore, when a party grants or reserves a mineral interest, any associated surface easement is appurtenant.⁵⁵

Though infrequent, some historic oil and gas leases appeared to grant fee simple absolute mineral interests.⁵⁶ In these cases, some courts concluded these fee interests could be terminated where abandoned.⁵⁷ Leases conveying mineral interests in fee absolute no longer exist because lessors opposed a lessee’s ability to hold a lease for an extended duration, with no requirement to develop the minerals or periodically compensate lessors.⁵⁸ Inclusion of a primary term and surrender clauses help distinguish a lease from a deed.⁵⁹ Today, the habendum clause of an oil and gas lease typically permits the lease to effectively continue following the primary term, as long as commercial production subsists.⁶⁰ Essentially, an oil and gas lease terminates after expiration of the primary term or following cessation of production.⁶¹

⁵¹ *Id.* § 12.2(3).

⁵² *Pennaco Energy, Inc. v. Sorenson*, 2016 WY 34, ¶ 30, 371 P.3d 120, 127 (Wyo. 2016) (quoting 5 EUGENE KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 64.6 (Matthew Bender, rev. ed. 2015) (“Under traditional landlord-tenant law, a landlord can hold both the original tenant and the tenant’s assignee liable for breach of a lease covenant that runs with the estate. The original tenant is liable under the initial contractual agreement (privity of contract) with the lessor, and the assignee is liable because it has accepted the benefit of the leasehold estate and must accept its attached burdens as well (privity of estate).”)).

⁵³ *See* 1 MARTIN, *supra* note 2, § 218.

⁵⁴ 2 MARTIN & KRAMER, *supra* note 26, § 324.

⁵⁵ 1 MARTIN & KRAMER, *supra* note 2, § 218.

⁵⁶ 3 PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS, OIL AND GAS LAW, § 601 (LexisNexis ed. 2016).

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *See* 1 MARTIN & KRAMER, *supra* note 2, § 206(13), (15).

⁶⁰ 2-26 EUGENE KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 26.1 (Matthew Bender, rev. ed. 2015).

⁶¹ *See id.*

C. *Governing Law to Establish Liability After Assignment in Wyoming and Other Jurisdictions*

In a recent and related case, *Pennaco Energy, Inc. v. KD Co. LLC*, the Wyoming Supreme Court considered whether the assignor remained liable under a surface use agreement after assigning the agreement to a third party.⁶² The court declined to apply property law in reaching its decision, and instead analyzed the issue from a contract perspective.⁶³ The court has also applied contract law in other cases involving the assignment of oil and gas interests.⁶⁴ For example, in *Ultra Res., Inc. v. Hartman*, the court found the assignor liable for payments to the assignee's successor based on explicit obligations in the contract, and because the assignor could not delegate the duty under the applicable statute.⁶⁵ Similarly, the Supreme Court of Texas applied contract principles and held an assignor liable for duties under a joint operating agreement following assignment.⁶⁶

When deciding issues according to property tenets, the Wyoming Supreme Court accepted the *Restatement (Third) of Property: Servitudes* as persuasive law.⁶⁷ Further, the court concluded that “when the covenant inures to the benefit of, or must be fulfilled by, whatever party holds the land at the time when fulfillment is due,” that is determinative of whether covenants run with the land.⁶⁸ To resolve whether covenants run with the land, the court provided a four-part test: “1) the original covenant is enforceable; 2) the parties to the original covenant intended that the covenant run with the land; 3) the covenant touches and concerns the land; and 4) there is privity of estate between the parties to the dispute.”⁶⁹ The court distinguished ongoing liability under a landlord-tenant lease from that in a fee absolute conveyance.⁷⁰ To determine whether liability continues and a covenant is enforceable following assignment, the court examines the type of covenant and the associated estate.⁷¹ Even after assignment of property in fee

⁶² *Pennaco Energy, Inc. v. KD Co. LLC*, 2015 WY 152, ¶ 4, 363 P.3d 18, 20.

⁶³ *Id.* at ¶ 25, 363 P.3d at 25.

⁶⁴ See *infra* note 65 and accompanying text.

⁶⁵ *Ultra Res., Inc. v. Hartman*, 2010 WY 36, ¶ 100, 107, 226 P.3d 889, 924–25.

⁶⁶ *Seagull Energy E&P, Inc. v. Eland Energy, Inc.*, 207 S.W.3d 342, 345 (Tex. 2006).

⁶⁷ *Hasvold v. Park Cnty. Sch. Dist. No. 6*, 2002 WY 65, ¶ 14, 45 P.3d 635, 638 (reversing and remanding a finding that two adjacent dominant estates had valid easements across the servient estate).

⁶⁸ *Lingle Water Users' Ass'n v. Occidental Bldg. & Loan Ass'n*, 297 P. 385, 387 (Wyo. 1931).

⁶⁹ *Mathisen v. Thunder Basin Coal Co., LLC*, 2007 WY 161, ¶ 14, 169 P.3d 61, 65–66 (Wyo. 2007) (quoting *Jackson Hole Racquet Club Resort v. Teton Pines Ltd. Partnership*, 839 P.2d 951, 956 (Wyo. 1992)).

⁷⁰ *Lingle*, 297 P. at 389 (quoting *West Virginia Transp. Co. v. Pipe Line Co.*, 22 W. Va. 600, 632, 46 Am. Rep. 527 (1883)).

⁷¹ *Id.* 297 P. at 389, 392.

absolute, courts have found an assignor can remain liable for covenants it is able to perform even if the assignor no longer owns the property rights.⁷²

D. Split Estate Act

Responding to increasing oil and gas development and ensuing friction between surface owner and operator interests, the Wyoming Legislature drafted the Split Estate Act (the Act) to broaden surface owners' rights and available tools.⁷³ The governor signed the Act into effect in 2005.⁷⁴ Under the Act, a "Surface owner" is any party owning an interest in the surface estate upon which oil and gas development occurs, and this definition excludes mineral ownership.⁷⁵

Operators seeking to perform oil and gas operations impacting the surface estate must provide notice and negotiate with the surface owner in good faith to acquire permission to enter their land.⁷⁶ Alternatively, the operator must execute a bond or guaranty for surface reclamation in an amount equal to or greater than "two thousand dollars (\$2,000.00) per well site on the land."⁷⁷ The Wyoming Oil & Gas Conservation Commission will release the bond or guaranty only after the operator pays the surface owner damages and the surface owner signs a release.⁷⁸

The Act includes payments "intended to compensate the surface owner for damage and disruption" and states, "[n]o person shall sever from the land surface the right to receive surface damage payments."⁷⁹ If operators fail to pay surface

⁷² RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 4.4 (listing several cases in the Reporter's Note demonstrating ongoing liability following fee absolute assignment: "City of Glendale v. Barclay, 94 Ariz. 358, 385 P.2d 230 (1963) (in the absence of express terms of assignment, developer's promise to city to build sewage facilities was a personal real covenant; developer's obligation was thus contractual and developer remained liable after conveyance of property)"; "Indian Lake Maintenance, Inc. v. Oxford First Corp., 572 So.2d 536 (Fla. Dist. Ct. App. 1990) (developer's liability to pay maintenance assessments for upkeep of streets, golf course, and clubhouse not terminated by unrecorded agreements for deeds)"; "Associated Grocers of Iowa Coop., Inc. v. West, 297 N.W.2d 103 (Iowa 1980) (developer sold an option on lots in a commercial development, promising in the contract to build rail spurs and pave streets upon exercise of the option; obligation was personal and enforceable by purchaser after developer lost remainder of parcel in foreclosure).").

⁷³ See Cox, *supra* note 8, at 39, http://digitaleditions.walsworthprintgroup.com/publication/?i=197015&article_id=1633994&view=articleBrowser&ver=html5#%22issue_id%22:197015,%22view%22:%22articleBrowser%22,%22article_id%22:%221633994%22.

⁷⁴ 2005 Wyo. Sess. Laws 81.

⁷⁵ WYO. STAT. ANN. § 30-5-401 (2016).

⁷⁶ *Id.* § 30-5-402(c)(i)-(iii).

⁷⁷ *Id.* §§ 30-5-402(c)(iv), 30-5-404(b).

⁷⁸ *Id.* § 30-5-404(e)(i)-(ii).

⁷⁹ *Id.* § 30-5-405(a)(iii).

owners pursuant to the Act, surface owners may bring suit, subject to a two-year statute of limitations.⁸⁰ Rights granted to surface owners under the Act are in addition to those provided by law or contract.⁸¹ The Wyoming Constitution also limits the court's discretion related to statutory enforcement and construction, prohibiting application of "statutes contrary to legislative intent once that intent has been ascertained."⁸²

III. PRINCIPAL CASE

A. Background

Pennaco Energy Inc. ("Pennaco") purchased oil and gas leases in the Powder River Basin and Brett L. Sorenson owned the surface above some of the underlying mineral leases, granted by multiple third-party owners.⁸³ Sorenson granted Pennaco a surface use agreement in 2001 to accommodate drilling operations across his land.⁸⁴ The surface use agreement included obligations requiring the grantee, Pennaco, to make annual payments and maintain and reclaim the surface.⁸⁵ Pursuant to its surface use agreement and oil and gas leases, Pennaco drilled shallow coal bed methane wells and utilized Sorenson's surface estate for operations.⁸⁶

Pennaco sold its rights under various oil and gas leases and surface use agreements, including Sorenson's, in a 2010 purchase and sale agreement and associated assignments to CEP-M Purchase, LLC ("CEP-M").⁸⁷ CEP-M later assigned these same rights to High Plains.⁸⁸ Pennaco properly made the annual payments due under the Sorenson surface use agreement prior to its sale to CEP-M.⁸⁹ Following the 2010 assignment from Pennaco to CEP-M, neither CEP-M nor High Plains made the required annual payments or reclaimed the surface.⁹⁰

Sorenson brought suit against High Plains, CEP-M, and Pennaco for default under the surface use agreement, seeking the outstanding annual payments and

⁸⁰ *Id.* §§ 30-5-406, 409.

⁸¹ *Id.* § 30-5-407.

⁸² *Allied-Signal v. Wyo. State Bd. of Equalization*, 813 P.2d 214, 219 (Wyo. 1991).

⁸³ *Pennaco Energy, Inc. v. Sorenson*, 2016 WY 34, ¶ 7, 371 P.3d 120, 122 (Wyo. 2016).

⁸⁴ *Id.* at ¶ 6-7, 371 P.3d at 122.

⁸⁵ *Id.* at ¶ 8, 371 P.3d at 123.

⁸⁶ *Id.* at ¶ 10, 371 P.3d at 123.

⁸⁷ *Id.* at ¶ 12, 371 P.3d at 123-124.

⁸⁸ *Id.* at ¶ 12, 371 P.3d at 124.

⁸⁹ *Id.* at ¶ 11, 371 P.3d at 123.

⁹⁰ *Id.* at ¶ 13, 371 P.3d at 124.

damages for unperformed reclamation.⁹¹ CEP-M and High Plains failed to respond to the complaint.⁹² Pennaco motioned for summary judgment, alleging the 2010 assignment extinguished its duties.⁹³ The district court denied Pennaco's motion, finding as a matter of law Pennaco was liable under the surface use agreement, and put only the issue of damages before the jury.⁹⁴ Pennaco motioned for judgment as a matter of law regarding the claim for damages after Sorenson presented his case, and the court also denied this motion.⁹⁵ The jury awarded Sorenson damages totaling \$1,055,982.62.⁹⁶ In Pennaco's renewed motion for judgment as a matter of law, it again opposed ongoing liability under the surface use agreement.⁹⁷ The court denied this motion and granted Sorenson's subsequent motion, awarding him attorney fees.⁹⁸

Pennaco appealed the district court's decision and the Wyoming Supreme Court considered the matter of attorney fees.⁹⁹ The court also examined the issue of significance to this Case Note: whether the district court erred in finding as a matter of law that Pennaco's liability under the surface use agreement continued after assignment to a third party.¹⁰⁰

B. Controlling Law to Determine Ongoing Liability Under Surface Use Agreements

Pennaco contended the court should apply property law to resolve liability under the surface use agreement.¹⁰¹ Relying on the *Restatement (Third) of Property: Servitudes*, Pennaco argued the obligations under the agreement were covenants running with the land.¹⁰² Pennaco posited that because the covenants ran with the mineral estate, it was not liable for obligations accruing after assigning the surface use agreement and oil and gas leases to a successor.¹⁰³

⁹¹ *Id.* at ¶ 13–14, 371 P.3d at 124.

⁹² *Id.* at ¶ 14, 371 P.3d at 124.

⁹³ *Id.* at ¶ 15, 371 P.3d at 124.

⁹⁴ *Id.* at ¶ 16, 371 P.3d at 124.

⁹⁵ *Id.* at ¶ 17, 371 P.3d at 124.

⁹⁶ *Id.* at ¶ 19, 371 P.3d at 125.

⁹⁷ *Id.*

⁹⁸ *Id.* at ¶ 20, 371 P.3d at 125.

⁹⁹ *Id.* at ¶ 5, 371 P.3d at 122.

¹⁰⁰ *Id.*

¹⁰¹ *Id.* at ¶ 27, 371 P.3d at 126.

¹⁰² *Id.*

¹⁰³ *Id.*

The Wyoming Supreme Court looked to its recent decision in *Pennaco Energy, Inc. v. KD Co. LLC*.¹⁰⁴ In that case, the court held contract law, and not property principles, resolves liability disputes under a surface use agreement.¹⁰⁵ Expanding on contract doctrine, the court discussed an obligor's ability to assign rights and simultaneously only delegate duties, without express novation.¹⁰⁶ If an obligor-delegant did not remain liable, "every solvent person could obtain freedom from debts by delegating them to an insolvent."¹⁰⁷ The court applied the delegation principle to the subject surface use agreement.¹⁰⁸ In doing so, the court noted Pennaco's oil and gas lease included an exculpatory clause, whereas its surface use agreement did not.¹⁰⁹ The court also observed the related Pennaco oil and gas lease did not include language integrating the surface use agreement.¹¹⁰ As a result, "absent an express exculpatory clause, a lessee continues to remain liable to the lessor for a breach of an express covenant in the oil and gas lease after assignment, even if the express covenants run with the land."¹¹¹

After deciding contract law governed the liability issue, the *Pennaco* court analyzed the language of the surface use agreement *de novo*.¹¹² The court stated it would not read in terms or rewrite an unambiguous contract.¹¹³ In examining the ordinary meaning and plain language within the four corners of the surface use agreement, the court found the parties' intent was clear and the agreement did not create any servitudes to justify the application of property law.¹¹⁴ The court likened oil and gas leases to surface use agreements, both requiring an exculpatory clause or novation to relieve an assignor of ongoing liability.¹¹⁵ Without an exculpatory clause in the surface use agreement or novation from Sorenson to demonstrate intent otherwise, the court found Pennaco's liability continued under the surface use agreement pursuant to contract principles.¹¹⁶ For these reasons, the court

¹⁰⁴ *Id.* at ¶ 28, 371 P.3d at 126.

¹⁰⁵ *Pennaco Energy, Inc. v. KD Co. LLC*, 2015 WY 152, ¶ 87, 363 P.3d 18, 40 (Wyo. 2015).

¹⁰⁶ *Pennaco Energy, Inc. v. Sorenson*, 2016 WY 34, ¶ 29, 371 P.3d 120, 127 (Wyo. 2016).

¹⁰⁷ *Id.* at ¶ 29, 371 P.3d at 127.

¹⁰⁸ *Id.* at ¶ 30, 371 P.3d at 127.

¹⁰⁹ *Id.* at ¶ 31, 33, 371 P.3d at 127–128.

¹¹⁰ *Id.* at ¶ 32, 371 P.3d at 128.

¹¹¹ *Id.* at ¶ 30, 371 P.3d at 127.

¹¹² *Id.* at ¶ 41, 371 P.3d at 129.

¹¹³ *Id.* at ¶¶ 38, 41, 371 P.3d at 130.

¹¹⁴ *Id.* at ¶¶ 41–42, 44, 371 P.3d at 129–130 (stating "[t]he contract contains nothing indicating that the parties intended servitudes to be created under property law principles so that Pennaco would be able to relieve itself of these obligations merely by assigning them to a third party.").

¹¹⁵ *Id.* at ¶ 45, 371 P.3d at 130.

¹¹⁶ *Id.*

affirmed the conclusion of the district court, holding Pennaco liable under the surface use agreement following assignment.¹¹⁷

IV. ANALYSIS

The *Pennaco* court properly held the operator remained liable following assignment of a surface use agreement, absent an exculpatory clause or novation.¹¹⁸ However, the court incorrectly confined its analysis to contract law, resulting in unsettled property questions and unanticipated practical implications for both surface owners and operators.¹¹⁹ Additional harm to both parties may stem from miscalculating the significance of the *Pennaco* decision; in effect, a landscape where surface owners would have no recourse for unpaid surface damages and unperformed reclamation, and operators might face unsurmountable costs and financial crisis.¹²⁰

A. Missing the Mark: The Contract Approach

The *Pennaco* court correctly held where the operator failed to include an exculpatory clause in the surface use agreement or obtain a novation, its liability continued after assignment to a third party.¹²¹ Examining the contract on its face and within its four corners, the plain language of the surface use agreement did not include an exculpatory clause.¹²² Ideally as part of its original transaction with Sorenson, Pennaco could have protected against ongoing liability by including an exculpatory clause in its surface use agreement, holding any assignee-successor in interest wholly liable for any breach arising after assignment.¹²³ Absent an exculpatory clause, Pennaco could have subsequently negotiated an agreement with Sorenson to terminate Pennaco's liability.¹²⁴ If the assignee expressly agreed to assume all liability and Sorenson authorized the release, Pennaco would have been concurrently discharged of its duties when it assigned its rights.¹²⁵ However, Pennaco did not acquire any such novation.¹²⁶

The clear and unambiguous language, and absence of any associated novation, indicated the parties' apparent intent that Pennaco remain liable

¹¹⁷ *Id.* at ¶ 46, 371 P.3d at 131.

¹¹⁸ *See id.*

¹¹⁹ *See infra* notes 213–42 and accompanying text.

¹²⁰ *See infra* notes 221–26 and accompanying text.

¹²¹ *Pennaco Energy, Inc. v. Sorenson*, 2016 WY 34, ¶ 46, 371 P.3d 120, 131 (Wyo. 2016).

¹²² *Id.*

¹²³ *See KUNTZ, supra* note 56, § 64.6.

¹²⁴ *See* RESTATEMENT (SECOND) OF CONTRACTS § 280.

¹²⁵ *See id.* § 280, illus. 1.

¹²⁶ *Pennaco Energy, Inc. v. Sorenson*, 2016 WY 34, ¶ 46, 371 P.3d 120, 131 (Wyo. 2016).

under the surface use agreement, including for any breach after assignment.¹²⁷ If the agreement terms had been ambiguous, the results may have differed with two unsophisticated parties.¹²⁸ However, in this case, the agreement would be construed against Pennaco as the drafter and a sophisticated business party to the transaction.¹²⁹

Alternatively, since the oil and gas lease associated with the minerals underlying Sorenson's surface included an exculpatory clause,¹³⁰ Pennaco could have integrated the oil and gas lease into the surface use agreement to serve as a functional equivalent of including this clause in the surface use agreement itself.¹³¹ Insertion of an exculpatory clause in the oil and gas lease provides evidence of Pennaco's awareness of this type of language, as a repeat-player in the industry.¹³² The surface use agreement referenced the oil and gas lease, stating the "rights-of-way [granted by the surface use agreement] shall be a covenant running with the lease."¹³³ Nonetheless, the parties did not expressly incorporate the language of the oil and gas lease into the surface use agreement.¹³⁴ Notwithstanding terms in the oil and gas lease creating surface easements, the surface use agreement granted Pennaco broader surface rights and simultaneously increased its obligations.¹³⁵ Although the surface estate interrelates to the underlying mineral estate by nature, absent explicit incorporation by reference in the surface use agreement and/or oil and gas lease, the two contracts cannot be read together.¹³⁶ Therefore, the court properly concluded the surface use agreement could not implicitly integrate the exculpatory clause of the oil and gas lease, and the two contracts were to be construed separately.¹³⁷

Expanding its contract analysis, the court recognized the oil and gas lease and surface use agreement as "allied contracts" and "yoked together" because mineral operations necessitate surface use.¹³⁸ While the latter supposition is

¹²⁷ See PERILLO, *supra* note 29, §18–25 (7th ed. 2014); 2 MARTIN *supra* note 26, § 403.1.

¹²⁸ RESTATEMENT (SECOND) OF CONTRACTS § 212 cmt. b.

¹²⁹ See *id.*; Mountain View/Evergreen Improvement & Serv. Dist. v. Casper Concrete Co., 912 P.2d 529, 532 (Wyo. 1996) (citing Prudential Preferred Properties v. Underwood Ranch Co., 873 P.2d 598, 600 (Wyo. 1994)).

¹³⁰ *Sorenson*, ¶ 15 n. 8, 371 P.3d at 124.

¹³¹ See WILLISTON ON CONTRACTS § 30:25 (3d ed.).

¹³² See RESTATEMENT (SECOND) OF CONTRACTS § 212 cmt. b.

¹³³ Brief for Appellant at 27, *Pennaco Energy, Inc. v. Sorenson*, 2016 WY 34, 371 P.3d 120 (Wyo. 2016) (No. S-15-0210) [hereinafter Brief for Appellant].

¹³⁴ *Sorenson*, ¶ 32, 371 P.3d at 127.

¹³⁵ See *id.* at ¶ 7, 371 P.3d at 123.

¹³⁶ See WILLISTON ON CONTRACTS § 30:25 (3d ed.).

¹³⁷ *Sorenson*, ¶¶ 32, 41, 371 P.3d at 127.

¹³⁸ *Id.* at ¶¶ 33–34, 371 P.3d 120, 128.

accurate, the court's dicta did little to support its decision to utilize a contract-centric methodology.¹³⁹ By highlighting the inherent union between developing the surface estate while producing from the underlying mineral estate, even where no contract language incorporated the oil and gas lease into the surface use agreement, the court inadvertently alluded to the prevailing property principles demanding further examination.¹⁴⁰

In continuing its trend to attempt restricting the surface use agreement liability to a question of contract law, the court haphazardly discarded Pennaco's foundational real property argument.¹⁴¹ While some courts have relied on contract principles alone to analyze assignment liability in the realm of oil and gas operations, those courts were not faced with the same property disputes posed in the instant case.¹⁴² Although contract law is relevant to this case, the *Pennaco* court should have expanded its limited analysis and incorporated property principles to provide a fully informed decision.¹⁴³ The *Pennaco* court's evasion and circular reasoning left unclear whether Pennaco's argument could have prevailed and what property theory applies.¹⁴⁴

B. *Misdirection: Servitude or Landlord-Tenant Law*

Pennaco misconstrued the crucial property principles, arguing the *Restatement (Third) of Property: Servitudes* establishes the subject surface use agreement created an easement, the covenants ran with the mineral estate, and by assigning the underlying oil and gas lease, Pennaco was no longer liable under the surface use agreement.¹⁴⁵ Pennaco urged finding otherwise would create

¹³⁹ See *infra* notes 155–56 and accompanying text.

¹⁴⁰ See *Sorenson*, ¶ 33, 371 P.3d at 128.

¹⁴¹ *Pennaco Energy, Inc. v. KD Co. LLC* was somewhat analogous to the current case and Pennaco was a common denominator. While *KD Co. LLC* was a step in the right direction, at least recognizing the crucial property principles, the *KD Co. LLC* court still erroneously found the surface use agreement did not create a servitude and the court muddled the applicable property theory. *KD Co. LLC* misdirected its narrow analysis to rest solely on contract law, while improperly characterizing property principles. The instant case relies on *KD Co. LLC* to establish contract law controls, but unlike *KD Co. LLC*, this case regresses and omits all but a superficial property analysis. See *id.* at ¶ 27, 371 P.3d at 126; *Pennaco Energy, Inc. v. KD Co. LLC*, 2015 WY 152, ¶ 87, 363 P.3d 18, 40 (Wyo. 2015).

¹⁴² See *e.g.* *Seagull Energy E&P, Inc. v. Eland Energy, Inc.*, 207 S.W.3d 342, 345 (Tex. 2006) (holding seller and assignee of oil and gas leases remained liable under an operating agreement where Appellant and Appellee both offered arguments regarding contract principles); *Ultra Res., Inc. v. Hartman*, 2010 WY 36, ¶ 100, 107, 226 P.3d 889, 924–25 (concluding operators were liable to successors in interest under an assignment of leases including a clause for Net Profit Interest payable to leaseholder, based on the parties' allegations under statutory provisions and contract law).

¹⁴³ See *infra* notes 145–99 and accompanying text.

¹⁴⁴ See *infra* notes 148–50 and accompanying text.

¹⁴⁵ Brief for Appellant, *supra* note 133, at 19–32.

an absurd result, holding a predecessor mineral owner perpetually liable.¹⁴⁶ In opposition, Sorenson created a false dichotomy, alleging even if property law was determinative, *Restatement (Third) of Property: Servitudes* was inapplicable and *Restatement (Second) of Property: Landlord & Tenant* applied instead to hold lessee liable after assignment.¹⁴⁷

Given the unavoidable property roots in this case, the *Pennaco* court superficially brushed on easements, covenants, and servitudes generally.¹⁴⁸ Nevertheless, the court expressly stated its analysis relied solely on contract law.¹⁴⁹ For some onlookers, the court's silence may fallaciously suggest disavowing the single rule under both *Restatements*, requiring continued liability of the burdened assigning party where a servitude exists between a landlord and tenant.¹⁵⁰

The definition and scope of the *Restatement (Third) of Property: Servitudes* immediately calls into question whether the doctrine would govern in this case, because where special rules or considerations pertain to “covenants in leases” or “profits for the removal of . . . oil, gas, and minerals,” the *Restatement* does not apply.¹⁵¹ While the court acknowledged the interdependent nature of the surface use agreement and oil and gas lease, *Pennaco* contended the two agreements were categorically distinct.¹⁵² *Pennaco* asserted the surface use agreement related to the surface only (and not the minerals for this isolated analysis), and accordingly the presumption that an assigning party is relieved of liability applied.¹⁵³ Yet, to arrive at its conclusion of extinguished liability, *Pennaco* argued the surface and minerals are tied closely together and the surface use agreement creates an easement appurtenant to the oil and gas lease.¹⁵⁴ This mirrors the juxtaposed reasoning of the *Pennaco* court, suggesting the two agreements be analyzed independently, but also underscoring the associated rights unified by their singular purpose of oil and gas operations.¹⁵⁵ The *Pennaco* court could have clarified what seems to be a revolving argument by directly confronting the looming property issue for bewildered bystanders.¹⁵⁶

¹⁴⁶ Brief for Appellant, *supra* note 133, at 41–53.

¹⁴⁷ Brief for Appellee at 33, *Pennaco Energy, Inc. v. Sorenson*, 2016 WY 34, 371 P.3d 120 (Wyo. 2016) (No. S-15-0210) [hereinafter Brief for Appellee].

¹⁴⁸ *Pennaco Energy, Inc. v. Sorenson*, 2016 WY 34, ¶ 29, 371 P.3d 120, 127–130 (Wyo. 2016).

¹⁴⁹ *See Sorenson*, ¶ 28, 371 P.3d at 126.

¹⁵⁰ *See infra* notes 187–88.

¹⁵¹ RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 1.1(a), (c).

¹⁵² *Sorenson*, ¶ 34, 371 P.3d at 128–29.

¹⁵³ Brief for Appellant, *supra* note 133, at 44.

¹⁵⁴ Brief for Appellant, *supra* note 133, at 19, 21.

¹⁵⁵ *Sorenson*, ¶ 34, 371 P.3d at 129.

¹⁵⁶ *See id.*

Even if the covenants created by the surface use agreement are of the type proving problematic, the special rules defined in *Restatement (Third) of Property: Servitudes*, § 4.4 hold a party liable for servitude burdens only if those obligations accrue when the party owns the burdened property interest.¹⁵⁷ Pennaco claims the breached annual payment and reclamation obligations did not accrue until after Pennaco assigned its interest in the surface use agreement and oil and gas leases.¹⁵⁸ On the other hand, Sorenson argued Pennaco became liable when it impacted the surface by drilling wells pursuant to its rights under the surface use agreement.¹⁵⁹

Furthermore, § 4.4 states contract law governs a party's liability for a servitude in gross.¹⁶⁰ These property principles are not rigid applications, but instead serve to achieve the overarching goal of enforcing the parties' intentions if they elect to define the "duration of their rights and obligations under a servitude."¹⁶¹ Treating the covenants under the agreement as a servitude burden in gross requires individually examining the assigned surface use agreement under the principles of contract law.¹⁶² Pennaco remains liable under the surface use agreement pursuant to the aforementioned contract analysis.¹⁶³ Although assessing a servitude in gross requires returning to the contract question, it still acknowledges the surface use agreement is grounded in property law to a greater extent than the *Pennaco* court was willing to concede.¹⁶⁴

C. *The Property Question Refocused: Intention of the Parties and Character of the Promise*

Unfortunately, the court and parties relied on artificial and formalistic reasoning in applying the *Restatement (Third) of Property: Servitudes*.¹⁶⁵ The court's reliance on *Pennaco Energy, Inc. v. KD Co. LLC* and its transitory comments in the current case improperly suggest the surface use agreement did not create a servitude.¹⁶⁶ However, the duties created under the surface use agreement are undeniably a servitude (covenant) running with the land, because the promise

¹⁵⁷ RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 4.4(1).

¹⁵⁸ Brief for Appellant, *supra* note 133, at 33.

¹⁵⁹ Brief for Appellee, *supra* note 147, at 52.

¹⁶⁰ RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 4.4(3).

¹⁶¹ *Id.* § 4.4 cmt. a.

¹⁶² *Id.* § 4.4(3).

¹⁶³ *See supra* notes 121–37.

¹⁶⁴ *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 4.4(3).

¹⁶⁵ *See infra* notes 166–200 and accompanying text.

¹⁶⁶ *Id.* at ¶ 44, 371 P.3d at 130; *Pennaco Energy, Inc. v. KD Co. LLC*, 2015 WY 152, ¶ 68, 363 P.3d 18, 36 (Wyo. 2015) (“The parties’ relationship here is much more similar to a lease or standard contract than it is to unending covenants based on land ownership.”)

to make annual payments and reclaim the surface was made with the intent to bind, touches and concerns the land, and satisfies horizontal and vertical privity.¹⁶⁷

In spite of this, the servitude question is not dispositive of whether a party is relieved of liability.¹⁶⁸ By applying this misleading and false distinction and not correcting course, the *Pennaco* court opens the possibility for future mistakes if parties believe liability would be extinguished by the existence of a servitude, though this is not remotely what § 4.4 suggests.¹⁶⁹

Instead of framing the determinative property issue as a covenant question, § 4.4 hinges on the parties' intentions and character of the promise to determine liability.¹⁷⁰ The *Restatement* addresses situations in which parties may be relieved of liability and also recognizes covenants between landlord and tenant.¹⁷¹ It is presumed covenants may not be extinguished by assignment in a landlord-tenant relationship because of the expectations tied to the nature of the promise.¹⁷² A fundamental policy at the core of leaseholds is the landlord's reliance on the original tenant's ability to perform its duties under the lease.¹⁷³ Another quintessential characteristic of a lease is the limited duration of the estate.¹⁷⁴ In contrast, an assignment in fee absolute differs from the character of a promise under a lease because the duration of a fee estate is indeterminate and the expectation is that upon assignment, the assignor's duty to perform a covenant terminates.¹⁷⁵

As noted, the *Pennaco* surface use agreement is independent of the oil and gas lease.¹⁷⁶ Without explicit incorporation, that the two contracts are closely related is not enough to import one into the other.¹⁷⁷ The surface use agreement instead creates an affirmative covenant ancillary to the leasehold because of Sorenson's expectancy of returning to possession, the limited duration of the oil and gas lease and related surface use agreement, and the payment and restoration obligation on the benefitted land as a central purpose of the surface use agreement.¹⁷⁸

¹⁶⁷ *Mathisen v. Thunder Basin Coal Co., LLC*, 2007 WY 161, ¶ 14, 169 P.3d 61, 65-66 (Wyo. 2007) (quoting *Jackson Hole Racquet Club Resort v. Teton Pines Ltd. Partnership*, 839 P.2d 951, 956 (Wyo. 1992)).

¹⁶⁸ RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 4.4 cmt. b.

¹⁶⁹ *See id.*

¹⁷⁰ *Id.*

¹⁷¹ *Id.* § 4.4.

¹⁷² *Id.* § 4.4 cmt. b.

¹⁷³ *Id.*

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ *See supra* notes 134–37.

¹⁷⁷ *See id.*

¹⁷⁸ *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 4.4 cmt. b.

The subject oil and gas lease explicitly labeled the contract as a “lease” and included a five-year term.¹⁷⁹ While the oil and gas lease continued until ninety days following cessation of production, the expectation was clear the lease term (and the appurtenant surface use agreement lasting for the life of the oil and gas lease) was limited and not a mineral deed in fee.¹⁸⁰ Thus, as leasehold tenant, Pennaco’s ancillary obligations under the surface use agreement were not released after assignment.¹⁸¹ Although wells may produce for decades and hold a lease, that does not change the expectation of eventually returning the property to the landlord-lessor.¹⁸²

The objective under the surface use agreement is apparent, requiring annual payments until reclamation occurs on the surface, in conjunction with oil and gas operations.¹⁸³ Landlord-tenant law elaborates and notes the duty of restoration inherent in leaseholds, akin to those covenants under the surface use agreement.¹⁸⁴ According to landlord-tenant law, Pennaco as lessee-tenant remains liable for non-performance of obligations under the surface use agreement, even after assignment.¹⁸⁵ Sorenson entered into the surface use agreement relying on Pennaco to be financially responsible for performance, and with the expectation Pennaco would return its interests in the lease to Sorenson, as landlord fee owner.¹⁸⁶

While both parties and the court oscillated in attempt to draw a line between the *Restatements*, the underlying principle is identical and they are not discrete bodies of law.¹⁸⁷ The *Restatements* describe the context of a servitude between landlord and tenant, expecting the assignor, as original tenant, to remain liable for covenants under a leasehold estate.¹⁸⁸ Regrettably, the court’s perfunctory property analysis does not follow from this central principle in the *Restatements*, and does not implement any policy other than contract law.¹⁸⁹

¹⁷⁹ Brief for Appellant at 54.

¹⁸⁰ See MARTIN & KRAMER, *supra* note 2, § 206(13), (15).

¹⁸¹ See *Id.*

¹⁸² See KUNTZ, *supra* note 60, § 26.1 (Matthew Bender, rev. ed. 2015); MARTIN & KRAMER, *supra* note 56, § 601.

¹⁸³ See Pennaco Energy, Inc. v. Sorenson, 2016 WY 34, ¶ 8, 371 P.3d 120, 123 (Wyo. 2016).

¹⁸⁴ *Id.* at ¶ 8, 371 P.3d at 123; RESTATEMENT (SECOND) OF PROP.: LANDLORD & TENANT § 12.2(3).

¹⁸⁵ See Sorenson at ¶ 30, 371 P.3d 120, 127 (quoting KUNTZ, *supra* note 33, § 64.6).

¹⁸⁶ *Id.* at ¶ 7, 371 P.3d at 122; 3 MARTIN & KRAMER, *supra* note 2, § 601.

¹⁸⁷ See RESTATEMENT (SECOND) OF PROP.: LANDLORD & TENANT § 12.2(3); RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 4.4 cmt. b.

¹⁸⁸ *Id.*

¹⁸⁹ Sorenson, ¶ 28, 371 P.3d 120, 126.

Furthermore, it is equally true under oil and gas law that lessees are not released from liability simply by assigning a lease.¹⁹⁰ Whether an oil and gas lease or appurtenant surface use agreement is labeled as a lease or given an alternate title, the expectations of the parties and character of the covenant remain the predominant principles to determine ongoing liability.¹⁹¹ The reclamation obligation itself manifests the intention Pennaco remain liable.¹⁹² The very fact duties traveled with the surface use agreement because Pennaco drilled wells and impacted the surface, the covenant is appurtenant to an interest intended to end, and that Sorenson ultimately expected reclamation, relying on Pennaco's creditworthiness to perform as party to the contract, all indicate intended ongoing liability.¹⁹³ Pursuant to oil and gas law, the character of the promise governing the lessor-lessee relationship under the *Pennaco* surface use agreement is the type in which parties intend lessee-assignor's liability to continue.¹⁹⁴

Pennaco mischaracterizes its argument, focusing on the unfairness of perpetual liability and the assignor's inability to perform obligations following a fee assignment.¹⁹⁵ Despite the surface use agreement's "right-of-way and easement" grant language, the covenant was appurtenant to the mineral estate, effective as long as the oil and gas lease was in force.¹⁹⁶ Thus, Pennaco was not a fee mineral owner and cannot be treated as such.¹⁹⁷ Additionally, courts have held an assignor may remain liable for covenants under fee assignments where it does not need to maintain ownership to perform the covenant.¹⁹⁸ Likewise, Pennaco's affirmative covenant did not require retaining ownership rights to perform reclamation on Sorenson's surface.¹⁹⁹ Pennaco's reservation of reclamation rights under the surface use agreement, indicated in its Purchase and Sale Agreement with assignee, further supports the latter supposition.²⁰⁰

¹⁹⁰ *Id.* at ¶ 30, 371 P.3d at 127 (quoting KUNTZ, *supra* note 33, § 64.6).

¹⁹¹ RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 4.4.

¹⁹² *See id.*; *Sorenson*, ¶ 30, 371 P.3d at 127 (quoting KUNTZ, *supra* note 33, § 64.6).

¹⁹³ *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 4.4 cmt. b.

¹⁹⁴ *See id.*

¹⁹⁵ *See* *Lingle Water Users' Ass'n v. Occidental Bldg. & Loan Ass'n*, 43 Wyo. 41, 49, 297 P. 385, 387 (Wyo. 1931); *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 4.4 cmt. b, illus. 2.

¹⁹⁶ *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 4.4.

¹⁹⁷ *See* *Pennaco Energy, Inc. v. Sorenson*, 2016 WY 34, ¶¶ 34, 42, 371 P.3d 120, 128, 130 (Wyo. 2016).

¹⁹⁸ *See supra* note 72.

¹⁹⁹ *See supra* note 72.

²⁰⁰ Brief for Appellee, *supra* note 147, at 54.

D. Legislative Policy: The Split Estate Act

Adhering to legislative authority and purpose is equally significant to the application of property law in this case.²⁰¹ The Split Estate Act reflects the underlying public policy objective to ensure operators reclaim surface owners' property.²⁰² Instead of tying oil and gas leases and surface use agreements together, the Act articulates the surface owner is distinctly separate from the mineral owner.²⁰³ The Wyoming Legislature makes apparent its goal to safeguard surface owners and make them whole by not relieving operators' liability until they pay surface owners a mutually agreeable sum.²⁰⁴ While the Act does not expressly address assignment of operator interests, the Act makes clear the surface owner's right to receive surface damages is not severable and a surface owner may sue for such damages if the operator neglects to make payment.²⁰⁵ In fairness to operators, the Act requires a surface owner bring suit "within two (2) years after the damage has been discovered, or should have been discovered through due diligence, by the surface owner."²⁰⁶

Construing this case by misapplying contrary formalism could possibly support a finding Sorenson had no recourse.²⁰⁷ Doing so would promote opposition to the established rule and policy expressed by the Legislature, granting surface owners explicit rights to surface damage compensation.²⁰⁸ Analyzing this case with the Act's policy in mind and in light of what is fair and just, calls attention to the significant timeline: Pennaco conducted drilling operations in 2001, shut down operations in 2009, and assigned its operating interests in 2010.²⁰⁹ The successors in interest to Pennaco did not conduct any drilling operations following assignment.²¹⁰ Thus, any surface impacts to Sorenson's land resulted from Pennaco's operations.²¹¹ While ongoing liability is not one Pennaco, or any similarly situated operator, would desire after assigning its interest in oil and gas leases and surface use agreements, without an exculpatory clause in the surface use agreement or subsequent novation, continued liability is exactly what property, contract, oil and gas law, and the Wyoming Legislature dictate.²¹²

²⁰¹ See *Allied-Signal v. Wyo. State Bd. of Equalization*, 813 P.2d 214, 219 (Wyo. 1991).

²⁰² WYO. STAT. ANN. § 30-5-401–410 (2016).

²⁰³ *Id.* § 30-5-401.

²⁰⁴ *Id.* § 30-5-404(e)(i)–(ii).

²⁰⁵ *Id.* §§ 30-5-405(iii), 30-5-406(c).

²⁰⁶ *Id.* § 30-5-409.

²⁰⁷ See *infra* note 216–19 and accompanying text.

²⁰⁸ See WYO. STAT. ANN. § 30-5-405(a)(iii) (2016).

²⁰⁹ Brief for Appellee at 52.

²¹⁰ Brief for Appellee at 11.

²¹¹ See *supra* notes 209–10.

²¹² See *supra* notes 121–208.

E. *Aftermath and Remedies*

The property issue in this case is weighty, and a holistic analysis by the court addressing Pennaco's argument could have resolved practitioner, surface owner, and operator inquiries moving forward.²¹³ Instead, the *Pennaco* court strategically dodged the property question and treated the dispute in this case as a contract delegation issue to reach the desired outcome.²¹⁴ Although the court arrived at the correct conclusion, the framework applied was flawed.²¹⁵

Coupling the reasoning in this case with its predecessor, *Pennaco Energy, Inc. v. KD Co. LLC*, sends a dangerous message.²¹⁶ In any other context, if a court had to decide if the sort of promise under the surface use agreement in this case was a servitude, it would affirmatively find the parties created a covenant.²¹⁷ Misuse of the *Pennaco* cases may result if the court misleads parties to absurdly think promises like those under the surface use agreement are not covenants.²¹⁸ Further, if the *Pennaco* decision misguides parties to believe determining whether a promise is a covenant establishes an assignor's liability, various unforeseen property disputes may ensue.²¹⁹

Energy is often synonymous with Wyoming's economy, serving as an essential source of revenue for the state.²²⁰ Practical implications abound for surface owners impacted by oil and gas operations if the *Pennaco* case misleads naïve operators to assume they are relieved of liability after assignment of a surface use agreement containing a servitude but not an exculpatory clause, or equally catastrophic, believe no covenant exists.²²¹ Additionally, unscrupulous operators could collude to cheat surface owners in circumstances where assignor and assignee recognize assignee is on the brink of bankruptcy.²²² Either situation results in a surface owner fighting to collect damage payments, and with land

²¹³ See *infra* notes 221–26 and accompanying text.

²¹⁴ *Pennaco Energy, Inc. v. Sorenson*, 2016 WY 34, ¶¶ 28–29, 371 P.3d 120, 127 (Wyo. 2016).

²¹⁵ See *infra* notes 216–19 and accompanying text.

²¹⁶ *Pennaco Energy, Inc. v. KD Co. LLC*, 2015 WY 152, ¶ 70, 363 P.3d 18, 37 (Wyo. 2015) (“There is no language in the agreements between the landowner and Pennaco stating the parties intended to create servitudes.”)

²¹⁷ See *supra* note 167.

²¹⁸ See *infra* notes 221–26 and accompanying text.

²¹⁹ See *id.*

²²⁰ See OFFICE OF THE GOVERNOR, OFFICE OF GOVERNOR MATT MEAD, WYOMING'S ACTION PLAN FOR ENERGY, ENVIRONMENT AND ECONOMY (2016), <https://drive.google.com/file/d/0BxgGvgRMOUrURE53czl3ZkhPaU0/view>.

²²¹ See *infra* note 223 and accompanying text.

²²² *Pennaco Energy, Inc. v. Sorenson*, 2016 WY 34, ¶ 29, 371 P.3d 120, 127 (Wyo. 2016).

impacted by exploration activities that operators may never reclaim; the very outcome the *Pennaco* court sought to avoid.²²³

The *Pennaco* decision could also provide a false sense of optimism for operators, mistakenly believing liability terminates by assigning agreements without exculpatory clauses if a servitude exists.²²⁴ Consequently, operators may not allocate budget funds for exposure to possible financial risks where successors in interest to surface use agreements become insolvent or simply breach the contract, and the assignor must fulfill the monetary obligations.²²⁵ Sudden significant costs could blindside unsuspecting operators, and their error and oversight could result in their own demise when operating budgets are constricted or during market downturns.²²⁶

The Wyoming Legislature manifested the underlying policy favoring surface reclamation in the Split Estate Act.²²⁷ Even so, with liability disputes like those in *Pennaco*, the public may believe lawmakers could do more.²²⁸ In this case, the surface damages far exceeded the allocated “two thousand dollars (\$ 2,000.00) per well site” provided for under the Act.²²⁹ This case could serve as a call to the Legislature to increase the required bond amount to align more closely with the realities of actual drilling surface impacts.²³⁰ Yet, the existing reclamation figure is presumed to be sufficient for the majority of cases if the legislature assigned that amount.²³¹ Furthermore, while increased bond amounts could heighten the deference the few questionable operators give to surface damage obligations, an increase could also penalize and discourage responsible and ethical operators and be proportionally more burdensome on smaller companies.

Alternatively, the Legislature could further adjust bonding requirements for assignees, requiring any successor in interest to an oil and gas lease and/or surface use agreement to execute a bond or guaranty under the Split Estate Act.²³² Functionally, the latter may be achieved under the current statutes if an assignee submits a permit to drill where no surface use agreement exists.²³³

²²³ See *id.* ¶ 44, 371 P.3d at 130.

²²⁴ See *supra* notes 145, 166, 216.

²²⁵ See *Pennaco Energy, Inc. v. Sorenson*, 2016 WY 34, ¶ 29, 371 P.3d 120, 127 (Wyo. 2016).

²²⁶ See *id.* ¶ 3, 371 P.3d at 122.

²²⁷ WYO. STAT. ANN. § 30-5-404(e) (i)–(ii) (2016).

²²⁸ See *Sorenson*, ¶ 3, 371 P.3d at 122.

²²⁹ WYO. STAT. ANN. § 30-5-404(b) (2016).

²³⁰ See *Sorenson*, ¶ 19, 371 P.3d at 125.

²³¹ See *Allied-Signal v. Wyo. State Bd. of Equalization*, 813 P.2d 214, 219 (Wyo. 1991).

²³² See WYO. STAT. ANN. § 30-5-404(b) (2016).

²³³ *Id.*

However, currently if an oil and gas lease and associated surface use agreement is assigned with no further action by an assignee to drill, the successor does not need to supply any new bond or guaranty.²³⁴ Unfortunately, additional bonding requirements for every assignment of oil and gas lease or surface use agreement could put a substantial administrative burden on the state.

Instead, the *Pennaco* court puts operators on notice to evidence clear contract intent by including an exculpatory clause or obtaining a subsequent novation to extinguish assignor's liability under a surface use agreement.²³⁵ This demands operators' due diligence in drafting future contracts and revisiting previous conveyances.²³⁶ Operators must also examine practical considerations accompanying operations and unforeseen repercussions, effects of downturned markets, and bankruptcies.²³⁷ If past agreements lack exculpatory clauses or an operator failed to obtain a novation at the time of assignment, the informed operator-assignor may find it worth its time to contact assignees and surface owners alike to mitigate risks by seeking grants of additional language terminating assignor's future liability.²³⁸

With increasing scrutiny on the fossil fuel industry, companies should operate their business and conduct transactions conscientiously to avoid missteps that could possibly cost millions of dollars.²³⁹ Without decisive guidance from the *Pennaco* court, operators must acknowledge the nature of leasehold covenants and risks of ongoing liability.²⁴⁰ An exculpatory clause in agreements or novation is the best solution to terminate liability upon assignment.²⁴¹ Failure to obtain such protections may result in surface owner claims against an assignor, and negotiations or simply performing the reclamation may outweigh the operator's costs to litigate. There will likely be more hard lessons learned looking ahead if operators neglect curative measures and vigilance.²⁴²

V. CONCLUSION

Whether *Pennaco* remained liable under the surface use agreement should not have been resolved as an isolated contract delegation question and the *Pennaco* court erroneously omitted the property analysis of servitudes in a

²³⁴ *Id.*

²³⁵ *Sorenson*, ¶¶ 45-46, 371 P.3d at 130-31.

²³⁶ *See Sorenson*, ¶ 45, 371 P.3d at 130.

²³⁷ *See supra* notes 221-26.

²³⁸ *See Sorenson*, ¶ 19, 371 P.3d at 125.

²³⁹ *See Sorenson*, ¶ 3, 371 P.3d at 122.

²⁴⁰ *See supra* notes 221-26.

²⁴¹ *See Sorenson*, ¶ 46, 371 P.3d at 131.

²⁴² *See supra* notes 224-26.

landlord-tenant relationship.²⁴³ Both characterizations of the liability dispute, in the context of oil and gas law, lead conclusively to the same finding that Pennaco's liability continued.²⁴⁴ However, the foregoing analysis demonstrates directly addressing the property law central to this case is a more fitting approach to resolve the contrary outcomes of the hyper-formalistic arguments proposed.²⁴⁵ Well settled servitude principles establish Pennaco's ongoing liability under the surface use agreement, based on the parties' intent and the character of the promise, creating an affirmative covenant ancillary to the mineral leasehold.²⁴⁶ Yet, by punting the property inquiry, the court missed the opportunity to elucidate its confounded application of servitudes in this case for both surface owners and operators, now perhaps exposed to greater potential impacts and risks.²⁴⁷

²⁴³ See *supra* notes 141–200.

²⁴⁴ See *supra* notes 121–200.

²⁴⁵ See *supra* notes 121–200.

²⁴⁶ See RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 4.4(a).

²⁴⁷ See *supra* notes 221–26.