



Seller Beware

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A recently released opinion from the Wyoming Supreme Court sends a grave message to companies looking to sell their oil and gas properties: ***Seller Beware***. The case of [Pennaco Energy, Inc. v. KC Co. LLC, 2015 WY 152](#) (Wyo. 2015) (“*Pennaco Energy*”), is the latest legal precedent in the fallout from the acquisition by High Plains Gas, Inc. (“High Plains”) of several thousand coalbed natural gas wells in Wyoming’s Powder River Basin. After acquiring the wells from various companies, High Plains proceeded to default on numerous financial and other obligations under its leases and surface use agreements. The *Pennaco Energy* opinion sends a significant message to all sellers that a sale of assets does not necessarily mean a divorce from the associated liabilities.

Background & Judgment

In the *Pennaco Energy* opinion, the Wyoming Supreme Court upheld a District Court decision finding Pennaco Energy, Inc. (“Pennaco”) liable to landowners for the defaults of High Plains under certain surface use agreements associated with properties Pennaco sold to High Plains in July 2010. After receiving assignment of the assets, High Plains did not make any payments to the landowners under the governing surface use agreements and failed to make payments under related water well and water storage agreements. In 2012 and 2013, the landowner plaintiffs gave notice of the default to High Plains and Pennaco, then subsequently filed two separate suits against the companies. High Plains did not answer the complaints, thus defaulting in the lawsuits. Pennaco and the landowners filed cross motions for summary judgment, and the District Court entered a decision finding Pennaco liable to the landowners for High Plains’ defaults under the agreements. The Court ordered Pennaco to pay landowners over \$130,000 (plus interest) as compensation for surface use by High Plains after the sale; and further ordered Pennaco to perform required reclamation under the surface use agreements, which High Plains failed to perform when it ceased operations.

Legal Issue – Contract or Servitude?

The primary legal issue in the case was whether the obligations under the agreements with the landowners constituted contractual agreements, or covenants/servitudes running with the land. If

the Court found them to be contractual agreements, Pennaco could not assign its duties without a novation/consent from the landowner/lessor. If the Court found them to be covenants/servitudes running with the land, then Pennaco's liability ceased when it transferred its rights to the use of the land. After a review of contract law, property law, and oil and gas law, the court found the obligations were contractual agreements which Pennaco could not transfer through a simple assignment. The Court determined that Pennaco retained all duties under the agreements, absent a release or novation from the landowners.

In reaching its decision, the Wyoming Supreme Court looked to the language of the contracts to discern the parties' intent. The Court determined the language did not indicate the parties intended the original operator/lessee under the agreements be allowed to freely transfer the duties under the contracts. The Court made this finding despite the fact that there were no express requirements in the contracts that the operator obtain approval from the lessor/landowner to assignment of the agreements. The Court also found the agreements indicated the creditworthiness of the original lessee, Pennaco, was a motivating factor for the landowner/lessors to enter into the agreements. In short, the court found, "***Absent an express provision [in the contract between the original party and the landowner] stating a party's obligations end upon assignment of a surface use agreement...or a release by the surface owner, the party originally obligated under the agreement remains liable.***" *Pennaco Energy* at ¶45 (emphasis added).

Precedential Impact

While *Pennaco Energy* only involved surface use agreements, the Court's analysis left an opening to carry its holding beyond ancillary agreements, potentially applying the determinations to underlying oil and gas lease terms. Consequently, the case may lead to claims for other holdover liabilities, such as payment of royalties or delay rentals. In addition, the decision provides no guidance as to when a seller/assignor's liability may end for assets that have already been transferred, absent a novation from the landowner/lessor.

Recognizing this potential impact, both the Petroleum Association of Wyoming ("PAW") and the Texas Oil and Gas Association ("TOGA") filed *amicus curiae* briefs in the Wyoming Supreme Court appeal. The associations argued the District Court exposed oil and gas operators "to unpredictable and indeterminate liability for duties respecting the use of lands (1) to which they have no access and (2) based on the acts of successors over which they have no control." *Pennaco Energy* at ¶73. However, the Court rejected the pleas of PAW and TOGA, noting that Pennaco was a sophisticated party, knowledgeable in the oil and gas business, who could have acted to protect its interests by bargaining for language excusing it from liability, or by obtaining the landowner's consent to transfer its duties to the purchaser. The Court found that because Pennaco failed to protect itself, it would not "depart from firmly established rules of law to insulate Pennaco from its lack of care." *Pennaco Energy* at ¶74.

Conclusion

Companies looking to dispose of assets must closely consider the ruling in *Pennaco Energy* when evaluating properties for sale and when evaluating their potential purchasers. The financial capabilities of the purchaser will necessarily be a more significant consideration for the seller, including whether the purchaser has the resources to operate the properties, make required annual payments, and perform reclamation obligations. Seller companies should also evaluate options for terminating their liability to third parties for periods after the assets are sold. Some of these options may be obtaining, at the time of the sale, consents or novations from lessors and landowners under significant oil and gas leases and other agreements for which there will be ongoing obligations after the sale. In the event landowner/lessor consent cannot be obtained, sellers may also consider structuring other financial assurances under the purchase and sale agreements, such as escrowed funds or additional bonding posted by the purchaser.

Finally, *Pennaco Energy* also compels companies to more carefully craft assignment provisions in leases and other agreements that it executes in the future. Assignment provisions should expressly define when the assigning lessee will be released after the sale of an asset or assignment of agreement.

For more information on the implications of the *Pennaco Energy* case, please contact [Nicol Kramer](#).