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PENNSYLVANIA SUPREME COURT RESOLVES MARCELLUS SHALE OWNERSHIP AND LEASE UNCERTAINTY BY REAFFIRMING LONGTIME *DUNHAM RULE*

CONCLUDES THAT NATURAL GAS PRODUCED FROM THE MARCELLUS SHALE FORMATION IS NOT A "MINERAL"

Natural gas producers and landowners alike breathed a sigh of relief on April 24, 2013 as the Pennsylvania Supreme Court (the "Supreme Court" or "Court") overturned a lower court decision that questioned whether subsurface ownership rights of natural gas in shale formations should be treated differently than ownership rights of natural gas in conventional formations. The uncertainty began in 2011, when the Pennsylvania Superior Court (the "Superior Court") suggested that the *Dunham* Rule—a century-old rule creating a rebuttable presumption that reservations of "minerals" in property conveyances do not include oil or natural gas—may not apply to natural gas found in the unconventional Marcellus shale play. *See Butler v. Charles Powers Estate,* 29 A.3d 35 (Pa. Super. 2011). However, the Supreme Court recently held that there is a presumption that property conveyances describing "minerals," without specific reference to natural gas, do not include the natural gas found in the Marcellus shale formation. *Butler v. Charles Powers Estate,* No. 27 MAP 2012. If the *Dunham* Rule ultimately were not applied to unconventional shale plays, the result could have upended thousands of Marcellus shale gas leases signed in the Commonwealth of Pennsylvania. The Supreme Court's decision resolves any uncertainty by extending the *Dunham* Rule to natural gas extracted from the Marcellus shale play.

THE DUNHAM RULE

Pennsylvania allows property owners to sever ownership of the property's surface from ownership rights to the subsurface, which includes the right to extract coal, oil, natural gas, or other minerals. The Supreme Court, in *Dunham & Short v. Kirkpatrick*, 101 Pa. 36 (1882) and *Highland v. Commonwealth,* 161 A.2d 390 (Pa. 1960), held that a reservation or exception in a deed reserving "minerals," without any specific mention of natural gas or oil, creates a rebuttable presumption that the grantor did not intend that the term "minerals" include natural gas or oil. Known as the *Dunham* Rule, this presumption can be rebutted only by presenting clear and convincing evidence that the parties intended otherwise at the time of the conveyance. *See Highland,* 161 A.2d at 398-99.

THE BUTLER CASE

Butler v. Charles Powers Estate arose from a deed recorded in October of 1881 conveying 244 acres of land in Susquehanna County, Pennsylvania, but reserving for the grantor Charles Powers "one half the minerals and Petroleum Oils." In 2009, John and Mary Butler, as owners of the 244 acres and holders of the original deed, sought quiet title to all the "minerals and petroleum oils" on the property in order to lease those rights for Marcellus shale gas drilling. William and Craig Pritchard, as heirs to the Estate of Charles Powers (collectively the "Estate"), objected and claimed the reservation of "minerals" in the 1881 deed included Marcellus shale gas. The trial court rejected the Estate's argument, stating that the *Dunham* Rule presumed the deed's reservation would not include shale gas unless the deed made a specific reference to a reservation of natural gas rights.

On appeal, the Superior Court (an intermediate appellate court) reversed and remanded with instructions for the trial court to address several technical questions. Most importantly, the trial court was to determine whether Marcellus shale gas is considered a "mineral" as that term was contemplated in *Dunham* and *Highland* and the extent to which gas-bearing shale is similar to coal seams. The Superior Court reasoned that the *Dunham* Rule was well-settled for conventional oil and natural gas resources, but it recognized that unconventional shale plays differed geologically from traditional natural gas reservoirs. The court also questioned whether natural gas-bearing shale could be analogized to coalbeds, which contain valuable methane gas. The analogy potentially could be dispositive, as the Supreme Court expressly recognized in *U.S. Steel Corp. v. Hoge,* 468 A.2d 1380 (Pa. 1983), that the coalbed methane contained in a coal vein belongs to the coal owner until that gas is allowed to migrate into the surrounding subsurface. The Superior Court accepted that these technical questions required further fact-finding and expert opinion at the trial level and held accordingly. The Butlers subsequently appealed the decision to the Supreme Court for review.

THE SUPREME COURT'S DECISION

The Supreme Court reaffirmed the *Dunham* Rule and declined to analogize natural gas from shale formations to coalbed methane, instead holding that shale formations and the oil and gas extracted from those formations are not "minerals" and that the *Dunham* Rule applied equally to natural gas from both conventional formations and the Marcellus shale play.

The Butlers argued for the strict application of the *Dunham* Rule to unconventional shale gas, claiming this outcome was supported by the public policy of providing certainty to both the shale industry and landowners who have relied on the century-old presumption. In response, the Estate argued that the parties signed the 1881 deed before the *Dunham* decision, that Marcellus shale gas was likely considered a "mineral" at the time, and that gas-bearing shale formations are analogous to coal veins.

The Court first discussed the history of *Dunham* and the rule's eventual progeny. The Court highlighted *Gibson v. Tyson,* 5 Watts 34 (Pa. 1836) and *Schuylkill Navigation Co. v. Moore,* 2 Whart. 477 (Pa. 1837) as predecessors to the *Dunham* decision. The *Dunham* court relied on these cases

for two overarching principles: (i) that deeds should not be construed by scientific determinations, but merely as they would be understood by ordinary people at the time; and (ii) anything non-metallic in nature would not be considered a mineral by common persons for private deed purposes. *Gibson*, 5 Watts at 41-42; *Moore*, 2 Whart. at 493. The Court then traced *Dunham*'s subsequent progeny, while emphasizing the underlying principle that oil and natural gas are not "minerals" as a common layperson would understand the word in drafting a deed. Based on the 131-year history of the *Dunham* Rule as the settled law in Pennsylvania—177 years when crediting its origins to the *Gibson* decision—the Court roundly reaffirmed the *Dunham* Rule as "the bedrock for innumerable private, real property transactions for nearly two centuries."

Applying the *Dunham* Rule to the case at bar, the Court held that Marcellus shale gas would not be considered a "mineral" by Charles Powers at the time of his 1881 conveyance and therefore his reservation of "one half the minerals and Petroleum Oils" did not include natural gas. The Court reasoned that the common, layperson understanding of a mineral at the time of the lease would not include natural gas extracted from shale because it was non-metallic in nature. The Superior Court therefore erred by seeking expert testimony on the scientific nature of Marcellus shale gas because scientific opinion is irrelevant to the layperson-centric *Dunham* analysis. Further, the Court explained that the mere fact that the 1881 conveyance predated the *Dunham* decision was irrelevant to the analysis because *Gibson* had already established that non-metallic substances were not considered "minerals" in deeds as early as 1836.

The Court then rejected the potential analogy between natural gas from shale and coalbed methane by distinguishing its *Hoge* precedent from the *Dunham* line of cases. First, the Court noted that the *Hoge* decision did not discuss *Dunham* in any detail. The Court then focused on the unique nature of coalbed methane, emphasizing that it was traditionally viewed as a dangerous substance that was legally ventilated by the coal vein owner and generally not recognized as a commercially viable substance at the time the *Hoge* deed was executed. Despite the chemical similarity between traditionally produced natural gas and coalbed methane, the Court noted that the *Hoge* court inherently made a legal distinction between coalbed methane and other natural gas by allowing the surface owners to drill *through* the coal vein to reach natural gas deposits below, but did not allow the surface owner to drill *into* the coal vein to extract the coalbed methane contained therein. Finally, although the extraction of both coalbed methane and Marcellus shale gas involve hydraulic fracturing, the Court emphasized that the *Dunham* analysis concerns the nature of the substance being claimed as a "mineral," not the *situs* of the substance or its method of extraction. Therefore, for purposes of the *Dunham* Rule, the Court placed natural gas contained in the Marcellus shale on the same legal footing as natural gas contained in conventional sandstone formations.

CONCLUSION

The Superior Court's unexpected decision in 2011 left shale exploration and production companies and related businesses questioning the legal validity of thousands of leaseholds that were drafted and signed under the assumption that the *Dunham* Rule would apply to shale-based oil and natural gas rights. With its decision, the Supreme Court ensures that *Dunham*—a product of Pennsylvania's first petroleum revolution more than 130 years ago—will continue to shape the Commonwealth's shale-based energy renaissance into the future.

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