SUPREME COURT, STATE OF COLORADO 2 East 14th Avenue, Denver, Colorado 80203	
Appeal from Court of Appeals, State of Colorado, Opinion Issued by Judge Graham (Tow and Taubaum, JJ., concurring) Case No. 2019CA2040; Boulder County District Court, Colorado, Hon. Thomas F. Mulvahill, District Court Judge, Case No. 2018CV30924	
Petitioner: BOARD OF COUNTY COMMISSIONERS OF BOULDER COUNTY, Colorado; **v.** **Respondent:** CRESTONE PEAK RESOURCES OPERATING, LLC, a Delaware limited liability company	**▲ COURT USE ONLY ▲**
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PETITION FOR WRIT OF CERTIORARI	

CERTIFICATE OF COMPLIANCE

I hereby certify that this Petition complies with all requirements of C.A.R. 28, 32, and 53, including all formatting requirements set forth in those Rules. Specifically, the undersigned certifies that this document contains 3,067 words (including headings and footings but excluding the case caption, Certificate of Compliance, Table of Contents, Table of Authorities, signature blocks, Certificate of Service and the Appendix).

BOULDER COUNTY ATTORNEY

By: */s/ Katherine A. Burke*
David Hughes
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Attorneys for Petitioner, Board of County Commissioners of Boulder County, Colorado.

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I. ADVISORY LISTING OF ISSUES PRESENTED FOR REVIEW

1. Whether the Court of Appeals erred in adopting and applying the minority, disfavored "commercial discovery rule" in interpreting oil and gas leases.

II. ORDER PRESENTED FOR REVIEW; BASIS OF JURISDICTION

The published opinion for review is *Bd. of Cty. Commissioners of Boulder Cty. v. Crestone Peak Res. Operating LLC*, --- P.3d ----, 2021 COA 67 (May 13, 2021) (the "Order") (App. A.)

No motion for rehearing was filed and no extension of time has been granted to petition for writ of certiorari.

Petitioners are not aware of any pending or past case in which the Court has granted certiorari review on the same legal issues presented in this Petition.

III. STATEMENT OF THE CASE

This case presents an issue of first impression critical to mineral owners and oil and gas operators across the state. In an oil and gas lease dispute, the Court of Appeals adopted and applied a minority, disfavored approach to lease interpretation known as the commercial discovery rule or the discovery rule. It holds that "production," as the term is used in oil and gas leases, occurs when commercial amounts of oil or gas are discovered in the ground, irrespective of whether anything is actually extracted. The discovery rule arises in only a handful

of jurisdictions, as opposed to the "great weight of authority" that follows the actual production rule, which holds that the term production means the act of extracting minerals from the ground. *See Tate v. Stanolind Oil, Inc.,* 240 P.2d 465, 468-69 (Kan. 1952). This Court has never considered the validity or application of either rule. However, this Court's most recent case on lease interpretation indicates disagreement with the basis of the discovery rule and support for the actual production rule.

The Order announces that Colorado follows the discovery rule. It sets an unfortunate course by adopting a state-wide rule that conflicts with Colorado jurisprudence.

A. Factual History

Petitioner, the Board of County Commissioners for Boulder County (the "County"), owns mineral interests in and near Boulder County. Some of those interests are leased to Respondent Crestone Peak Resources Operating, LLC ("Crestone"). Two County-Crestone leases are at issue, known as the Haley and Henderson Leases. (CF, pp 610-11; 614-15.) These leases have been in place since 1980 and 1982.

The Haley and Henderson Leases provide for automatic termination if "production" ceases in the secondary term and the operator does not conduct drilling or reworking operations within 60 or 90 days of the production stoppage. (*See* CF, pp 610-11 ¶ 12; pp 614-15 ¶ 1.[1]) In 2017, the County reviewed many of its hundreds of oil and gas leases and discovered that, in 2014, no production took place under either the Haley or Henderson Lease for 122 days and no drilling or reworking operations were conducted. (*See* App. A at 5.)

B. Procedural History

The County initiated suit in 2018 in the Boulder County District Court, requesting an order requiring Crestone to release the Haley and Henderson Leases and for associated trespass damages. The District Court granted summary judgment in Crestone's favor. In the Order, the Court of Appeals affirmed the District Court based on the discovery rule. (App. at 1.)

[1] The cited provisions are called "cessation of production" clauses. Most of the cases and treatises dealing with the commercial discovery and actual production rules address "habendum" clauses. *See* 3 Williams & Meyers, *Oil & Gas Law* § 604.1 (2020). Nonetheless, the term "production" should be read with the same meaning in both clauses. *See Ave. Capital Mgmt. II v. Schaden,* 2017 Colo. Dist. LEXIS 1813, *33. Therefore, the arguments in this petition apply to the term production regardless of where it appears.

The County requests that this Court overturn the Order and remand the case for further analysis applying the actual production rule.

IV. REASONS FOR ISSUING A WRIT OF CERTIORARI

This case merits certiorari review to ensure uniform, predictable lease interpretation consistent with Colorado law, for mineral owners and operators alike. Statewide adoption of the discovery rule would tip the already uneven balance of information and power between operators and mineral owners further in operators' favor, contravening Colorado doctrine favoring lessors and the plain meaning of lease terms, and contrary to reasoning applied by this Court in *Rogers v. Westerman Farm Co.*, 29 P.3d 887, 901 (Colo. 2001).

A. The actual production rule is the well-reasoned, majority rule.

The majority of oil-producing states follow the actual production rule, including our sister states of New Mexico and Kansas. *See, e.g., Smith v. Sun Oil*, 135 So. 15 (La. 1931); *Garcia v. King*, 164 S.W.2d 509 (Tex. 1942); *Gulf Oil v. Reid*, 337 S.W.2d 267 (Tex. 1960); *Continental Oil Co. v. Boston-Texas Land Trust*, 221 F.2d 124 (5th Cir. 1955); *Lamczyk v. Allen*, 134 N.E.2d 753 (Ill. 1956); *Sword v. Rains*, 575 F.2d 810 (10th Cir. 1978); *Tate*, 240 P.2d 465; *Town of Tome Land Grant, Inc. v. Ringle Dev. Co.*, 240 P.2d 850 (N.M. 1952); *Kinne v. Swanson*

Consol., 292 N.W. 472 (Mich. 1940); *Murdock-West Co. v. Logan*, 69 N.E. 984 (Ohio 1904); *Waddle v. Lucky Strike Oil*, 551 S.W.2d 323 (Tenn. 1977).

In contrast, a minority of states follow the discovery rule. *See, e.g., Fey v. A.A. Oil Corp.*, 285 P.2d 578 (Mont. 1955); *Pryor Mt. Oil & Gas Co. v. Cross*, 222 Pac 570 (Wyo. 1924); *Pack v. Santa Fe Minerals*, 869 P.2d 323 (Okla. 1994); *Hutchinson v. Schneeberger*, 374 S.W.2d 483 (Ky. 1964); *S. Penn Oil Co. v. Snodgrass*, 76 S.E. 961 (W. Va. 1912); *see also* 3 Williams & Meyers, § 604.1 ("most of the producing jurisdictions" reject the theory that a lease is satisfied by anything other than actual production).

A corollary to the discovery rule is whether marketing[2] is a necessary part of production. The two formulations are interrelated: if marketing is deemed *not* to be an essential part of production, then "the [lease] is satisfied by discovery in commercial quantities." *Davis v. Cramer*, 837 P.2d 218, 222 (Colo. App. 1992)

[2] Marketing is generally defined as sales to a customer. *See* 3 Williams & Meyers, M Terms. In the case of gas particularly, which cannot easily be stored on site, marketing is synonymous with removal of the gas from the wellhead via pipeline. *See, e.g., Sun Operating P'ship v. Holt*, 984 S.W.2d 277, 285 (Tex. App. 1998).

("*Davis II*"). This Petition refers to the discovery rule, which encompasses the position that marketing is not an essential part of production.[3]

The majority of states have rejected the discovery rule. A leading oil and gas treatise says:

> A construction of the habendum clause providing for the lease to continue in effect while minerals are "produced" as permitting the lease to be held merely by "discovery" during the primary term is contrary to the manifest intent of the parties. Such construction cannot be justified, however great the "inequity" of the requirement of production may be to the lessee.

3 Williams & Meyers § 604; *see also Tate,* 240 P.2d at 468-69 ("the great weight of authority . . . appears to be in harmony with the view that actual production in the primary term is essential to the extension of the lease").

Adoption of the discovery rule in Colorado has grave implications. Not only does it contravene Colorado precedent, discussed below, but it unfairly impairs lessors' rights in several ways. Most leases, like the Haley and Henderson Leases,

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[3] To avoid potential confusion, the County also notes that some of the cited cases and treatises deal with whether wells are producing "in paying quantities," which is sometimes treated as synonymous with the production versus discovery rule issue *See, e.g., Murdock-West Co. v. Logan,* 69 N.E. 984, 517-19 (Ohio 1904). In fact, "in paying quantities" can be applied under either the discovery or actual production rule. *See, e.g., Pack v. Santa Fe Minerals,* 869 P.2d 323, 326 (Okla 1994) (a leading discovery rule case also determining that oil and gas must be found in paying quantities to satisfy the lease). Only the larger context of those cases indicates which rule is applied.

were drafted decades ago, meaning they have out-of-date terms, including royalty allocations well below current market rates. Likewise, the terms for use of the surface lands and the pooling clauses of older leases do not contemplate modern technologies that allow for massive well pads draining minerals from several square miles. Lessees are motivated to maintain older leases with such out-of-date provisions, while lessors are often disadvantaged by them. The discovery rule allows leases to be held open with idle wells, depriving mineral owners of their only real protection against being held hostage to ancient lease terms. It is clear that wells sitting idle do not meet the fundamental purpose of oil and gas leases, to provide for "*mutual benefit* of the lessor and lessee." *Davis v. Cramer*, 808 P.2d 358, 360 (Colo. 1991) ("*Davis I*")(emphasis added); *see also Smith*, 135 So. at 15 (non-producing wells "cannot be said to be a paying proposition"); *Gulf Oil*, 337 S.W.2d at 270 (the mere potential of production does not provide benefit to the parties).

B. The discovery rule contravenes this Court's lease and contract interpretation rules.

Courts review oil and gas leases pursuant to the standard principles of contract law. (App. at 7 (citing *Garman v. Conoco, Inc.*, 886 P.2d 652, 656-57 (Colo. 1994)).) Leases are construed (i) using the plain meaning of their terms in a

harmonious manner, (ii) to determine and effectuate the intent of the parties, and (iii) strictly in the lessor's favor. The Court of Appeals erred on each aspect.

1. Leases must be construed to harmonize the plain meaning of their terms.

There is no standard oil and gas lease; each lease must be construed to give effect to the particular wording chosen by the parties. *Davis I*, 808 P.2d at 359 (*citing* 2 Kuntz, *The Law of Oil & Gas*, at § 18.2 (1989)). The language "must be examined and construed in harmony with the plain and generally accepted meaning of the words employed." *Ad Two, Inc. v. City & Cty of Denver,* 9 P.3d 373, 376 (Colo. 2000).

The plain meaning of "produce" does not encompass mere discovery of minerals, nor idle, shut-in wells. *See* Produce, *American Heritage Dictionary* (Online, last accessed June 21, 2021)[4] (defining "produce" as "to bring forth; yield," and "to create," and "to manufacture."). It is useful to look to the Colorado Oil and Gas Conservation Commission ("COGCC"), which classifies wells based on whether they yield oil and gas. Wells classified as "PR", or producing, are those that report actual extraction from the ground (whether for sale or storage), while "SI", or shut-in, wells do not. *See* Colo. Oil & Gas Conservation Comm'n,

[4] https://www.ahdictionary.com/word/search.html?q=produce

Status Codes (Online, last accessed June 21, 2021)[5]. Two online, industry-generated glossaries define a "producing well" as one "producing fluids (gas, oil or water)," leaving no room for wells only capable of producing. *See* Producing Well, *Schlumberger Oilfield Glossary* (Online, last accessed June 21, 2021)[6]; Producing Well, *Petropedia* (Online, last accessed June 21, 2021)[7].

While these examples demonstrate that produce does not mean discover, neither does discover mean produce. *See Continental Oil*, 221 F.2d at 127 ("The primary meaning of the word 'discover' does not include production, it means merely to find.") (internal citations omitted); Discover, *American Heritage Dictionary* (Online, last accessed June 21, 2021)[8] (defining "discover" as "to notice or learn" and "to be the first . . . to find, learn of, or observe").

Nothing in the Haley and Henderson Leases or the facts of this case requires application of anything other than the plain meaning of the term produce. *See Ad Two, Inc.*, 9 P.3d at 376 (unambiguous contracts "will be enforced according to the plain language").

[5] https://cogcc.state.co.us/documents/about/COGIS_Help/Status_Codes.pdf
[6] https://www.glossary.oilfield.slb.com/en/Terms/p/producing_well.aspx
[7] https://www.petropedia.com/definition/3053/producing-well
[8] https://www.ahdictionary.com/word/search.html?q=discover

Moreover, the plain language of the leases must be harmonized with respect to all of the provisions. *See Copper Mt., Inc. v. Ind. Sys.*, 208 P.3d 692, 700 (Colo. 2009) ("We choose a construction of the contract that harmonizes provisions instead of rendering them superfluous."). The Court of Appeals brushed aside the Haley and Henderson Leases' separate and distinct use of the terms "produce", "discover", and "capable of production" in various clauses. (*Compare* CF, pp 610 ⁋ 4 (using "found," and "capable of producing") *with* ¶ 12 (cessation of production clause using only "production"); *and compare* CF, pp 614 ⁋ 2 (using "discovery") *and* ⁋ 4 ("capable of producing") *with* ¶ 1 (cessation of production clause using only "production").) These usages indicate the drafters knew the difference and chose to use "production" to mean exactly what it says.

2. <u>The parties' intent in signing a lease is paramount.</u>

The courts' primary concern in contract interpretation is finding and enforcing the intent of the parties, which is determined by reference to the plain and unambiguous meaning of the contract terms they chose. *Ad Two, Inc.*, 9 P.3d at 376.

The individuals who originally signed the County's leases, like most mineral owners in the state, would understand the term "produce" according to its plain

meaning as the extraction of oil and gas. Only a complicated legal analysis would uncover the few jurisdictions adopting the legal fiction of the discovery rule. The actual production rule is the only one that aligns with the parties' evident intent.

3. Oil and gas leases must be construed in favor of lessors.

Courts strictly construe oil and gas leases in favor of lessors and against lessees. *Rogers*, 29 P.3d at 901-02 (collecting cases and authorities).

> This rule is generally based on the recognition that . . . lessors are not usually familiar with the law related to oil and gas leases, while lessees, through experience drafting and litigating leases, generally are.

Id. at 902. Contrary to this reasoning, the Order appears to protect against perceived inequities faced by the *operator*. (*See, e.g.,* App. at 16.)

Under these basic and well-established contract interpretation principles, the term produce must be construed to mean actual extraction of oil or gas.

C. The discovery rule is inconsistent with this Court's reasoning in *Rogers*.

1. This Court has determined marketing *is* an aspect of production, which leads directly to the actual production rule.

This Court last gave guidance on oil and gas lease interpretation twenty years ago in *Rogers*, 29 P.3d 887. The reasoning and outcome in *Rogers* show that

Colorado should not adopt the discovery rule as announced by the Court of Appeals.[9]

Rogers was a royalty case, determining the allocation of various costs of producing and processing oil and gas among lessees and lessors. 29 P.3d at 890. Looking at a lease that was silent on cost allocation, this Court found that lessees are obligated to bear all costs to extract oil and gas *and* get the minerals into a marketable condition and to a marketable location. *Id.* at 906.

Although *Rogers* was not focusing on the definition of "production" in a lease, the Court's reasoning makes it clear that production must include both actual extraction and at least some aspects of marketing. Importantly, in dividing costs incurred "at the wellhead" from subsequent costs, as required by the lease at issue, this Court implicitly held that the production phase ends when the minerals have been extracted and made marketable, at which point the post-production period begins. *Id.* at 901-05 (rejecting the reasoning of other states that find production is complete when minerals are "severed from the wellhead," or extracted, instead requiring this *and more*). Secondly, this Court further implied that production

[9] Although the proposition discussed here was cited by the County in briefing to the Court of Appeals, neither party argued the meaning and implications of *Rogers* below. This Court may nonetheless consider these arguments in its de novo review.

means actual extraction when it distinguished "acts which constitute production" from subsequent "processing and refining of gas *extracted by production*." *Id.* at 904-05 (emphasis added). Moreover, *Rogers* recognized that royalty clauses are "the means by which the lessor receives the primary consideration for a productive lease." *Id*. at 898. Of course, royalties are not paid, and therefore there is no primary consideration to the lessor, when minerals have been discovered but not extracted or made marketable. (*See* CF, pp 610 ⁋⁋ 3-4 and pp 614 ⁋ 3) (royalty clauses providing for payment on oil and gas "produced" or "produced and sold," not "discovered").

While *Rogers* arose in a different context from this case, its reasoning points clearly toward the actual production rule and away from the discovery rule.

2. <u>The *Davis II* opinion does not compel adoption of the discovery rule.</u>

The Court of Appeals relied heavily on the ruling in *Davis II*, 837 P.2d 218. *See, e.g.*, App. at 8-10. *Davis II* pre-dates *Rogers* by almost a decade and comes from the Court of Appeals. Therefore, its citation to and application of the discovery rule – finding that marketing is not an essential part of production – may have been implicitly overruled by *Rogers*, a question this Court has not considered.

Additionally, *Davis II* did not analyze the crucial question. It said only this:

> [T]he trial court implicitly ruled that marketing is not an essential part of production, and the habendum clause is satisfied by discovery in commercial quantities. There is nothing in the lease itself or in the relevant case law in Colorado to indicate this finding is not correct.

837 P.2d at 222. The *Davis II* court did not discuss the great weight of authority holding the opposite, nor did it discuss policy or practical reasons for and against the rule.

The determination to adopt the discovery or the actual production rule is a significant one and is deserving of a careful analysis. In this case, the Court of Appeals did more analysis than was done in *Davis II*, but for all the reasons stated above, it reached the wrong conclusion. Canons of construction, the persuasive authority from the majority of jurisdictions, and this Court's reasoning in *Rogers* all militated toward adoption of the actual production rule. *Davis II* did not compel adoption of the discovery rule. Yet, the Court of Appeals joined Colorado to a disfavored minority rule, with negative implications for mineral owners across the state.

V. CONCLUSION

For the foregoing reasons, the Board of County Commissioners of Boulder County respectfully requests that the Court grant this Petition.

Respectfully submitted this 24th day of June 2021.

BOULDER COUNTY ATTORNEY

By: */s/ Katherine A. Burke*
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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on the 24th day of June 2021, a true and correct copy of this **PETITION FOR WRIT OF CERTIORARI** was filed electronically via Colorado Courts E-Filing System, which will serve as notification of such filing to all persons registered in this case.

/s/ Rachel Nelson