Kansas Supreme Court Clarifies the Marketable Condition Rule for Natural Gas Royalties

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Overview

Kansas royalty owners and oil-and-gas producers received important guidance from the Kansas Supreme Court concerning a recurring question in royalty litigation: When does natural gas become "marketable," and who pays the costs incurred to get it to that point? In *Cooper-Clark Foundation v. Scout Energy Management, LLC*,[1] the court rejected competing categorical approaches and held that the answer depends upon the language of the particular oil-and-gas lease and the facts surrounding the marketing of the gas. The decision is particularly significant because the underlying federal litigation involves thousands of Kansas leases and potentially substantial royalty underpayment claims.

The Dispute Over Post-Production Costs

Cooper-Clark Foundation owns royalty interests in Kansas gas wells operated by Scout Energy. Cooper-Clark alleged that Scout improperly deducted certain midstream processing costs before calculating royalty payments. The disputed costs involved services associated with processing natural gas at the Jayhawk Gas Plant in Ulysses, Kansas.

The royalty owners argued that Kansas's implied duty to market and its related marketable condition rule[2] required Scout to bear the costs necessary to place the gas produced in marketable condition. Their position was essentially that the gas was not marketable until it satisfied the specifications of the interstate pipeline market into which the gas ultimately was sold. Scout took a different position. It argued that gas can be marketable at the wellhead even if it ultimately is processed and sold into a larger downstream market. According to Scout, the disputed processing could constitute transportation or value-enhancement costs rather than expenses necessary to make otherwise unmarketable gas marketable.

The federal district court certified the legal question to the Kansas Supreme Court because the issue presented an unsettled question of Kansas law for which neither the Kansas Supreme Court nor the Kansas Court of Appeals had controlling precedent.[3]

[1] Cooper-Clark Foundation v. Scout Energy Management, LLC, No. 128,275, 2026 Kan. LEXIS 404 (Kan. Sup. Ct. Sept. 11, 2026).
[2] *Sternberger v. Marathon Oil Co.*, 257 Kan. 315, 329–30, 894 P.2d 788 (1995); *Fawcett v. Oil Producers, Inc. of Kan.*, 302 Kan. 350, 353–57, 352 P.3d 1032 (2015).
[3] *Cooper-Clark Found. v. Scout Energy Mgmt., LLC*, No. 22-4048-KHV, Memorandum and Order at 2–3 (D. Kan. Sept. 26, 2024) (certifying question pursuant to K.S.A. § 60-3201 because the disposition of the case depended upon an unsettled question of Kansas law and the Kansas Supreme Court and Court of Appeals had no controlling precedent).

The Kansas Supreme Court's Holding

The Kansas Supreme Court declined to establish a categorical definition of when natural gas becomes marketable. Instead, the court established a two-step analytical framework:

- First, courts must examine the express language of the oil-and-gas lease. If the lease expressly allocates particular production, gathering, transportation, processing, or other post-production costs, that contractual language controls.

- Second, if the lease is silent or ambiguous concerning cost allocation, the marketable condition rule may operate as a tool of contract construction to fill the contractual gap. Determining when the gas became marketable then becomes a fact-specific inquiry under the particular lease and circumstances.

The court specifically rejected the proposition that gas necessarily remains unmarketable until it reaches the market in which the lessee actually sells it. But the court also rejected Scout's argument that gas necessarily becomes marketable merely because it theoretically could be sold somewhere at or near the wellhead. Neither approach adequately accounts for the lease terms and factual circumstances.

What Does "Marketable" Mean?

The court identified a number of considerations relevant to determining when gas becomes marketable. They include:

- the lessee's duty to exercise reasonable diligence in finding a market;
- the interests of both the lessor and lessee;
- the location of the sale;
- the condition of the gas when delivered to the purchaser;
- whether the purchaser accepted the gas in a good-faith transaction;
- the terms of applicable purchase agreements;
- whether a market existed at the wellhead;
- whether midstream services were necessary to sell the gas;
- whether those services actually made the gas marketable or merely transported or enhanced already-marketable gas; and
- relevant industry practices and market conditions.

The court emphasized that these factors are illustrative rather than exhaustive. That is important. The decision does not establish a bright-line rule that gas becomes marketable at the wellhead, at the point of processing, at the interstate pipeline, or at the point of actual sale. Instead, marketability is a factual question tied to the particular lease and circumstances.

The Importance of the Royalty Clause

Perhaps the most important practical point for Kansas royalty owners is the court's emphasis on the actual language of the lease's royalty provision. The court stated that provisions using language such as "proceeds if sold at the well" or "market value at the well" must be given their ordinary meaning. The marketable condition rule cannot simply be invoked to override express contractual provisions.

The court's analysis builds upon its earlier decisions, including *Sternberger v. Marathon Oil Co.*,[4] and *Fawcett v. Oil Producers, Inc. of Kansas*.[5] In *Fawcett,* for example, the court concluded that leases providing for royalties based on proceeds from gas sold at the well did not, as a matter of law, require the operator to bear post-sale costs necessary to place the gas into interstate pipeline condition.

At the same time, *Cooper-Clark* makes clear that *Fawcett* does ***not*** establish a universal rule that gas is always marketable at the wellhead. Rather, the circumstances surrounding the particular lease and transaction remain important.

A Significant Consequence for Royalty Owners

For Kansas royalty owners, the practical consequence is that there is no substitute for examining the lease itself. Two royalty owners receiving payments from wells operated by the same producer may potentially have different royalty rights because their leases contain different language.

That issue is particularly important in older leases. A lease might calculate royalty based upon:

- proceeds from gas sold at the well;
- market value at the well;
- proceeds received by the lessee;
- market value of production;
- gross proceeds;
- net proceeds; or
- another specifically negotiated formula.

The presence (or absence) of language addressing gathering, compression, dehydration, treatment, processing and transportation costs can likewise become critical. Thus, royalty owners considering an underpayment claim should not simply ask, "What costs did the producer deduct?" They should first ask, "What does my lease provide concerning the calculation of my royalty?"

[4] *Sternberger v. Marathon Oil Co.,* 257 Kan. 315, 894 P.2d 788 (1995).
[5] *Fawcett v. Oil Producers, Inc. of Kan.,* 302 Kan. 350, 353–57, 352 P.3d 1032 (2015).

Implications Beyond Kansas

Although *Cooper-Clark* is a Kansas decision, its broader significance extends beyond Kansas because disputes over post-production costs and the marketable condition rule occur throughout oil-and-gas producing states. The precise result in another state will depend upon that state's statutes, common law, and lease-construction principles. Consequently, Kansas's approach should not automatically be treated as controlling elsewhere.

Nevertheless, *Cooper-Clark* illustrates a broader principle relevant to royalty litigation nationally: the economics of a royalty obligation often cannot be determined solely by looking at the producer's accounting records. The underlying lease is the starting point.

> **Observation:** The decision also demonstrates why seemingly similar royalty disputes can produce different results when lease language differs.

The decision therefore may be useful persuasive authority in other jurisdictions that recognize some version of the marketable-condition rule, although the effect of the decision elsewhere will depend upon the applicable state's law and the language of the particular lease.

Class Actions May Become More Difficult

There is another important procedural implication. *Cooper-Clark* sought to represent thousands of royalty owners. The proposed class included royalty owners associated with approximately 6,279 leases, but those leases contained variations in their royalty provisions. The Kansas Supreme Court's emphasis upon lease-by-lease and fact-specific analysis potentially complicates efforts to resolve large numbers of royalty claims on a uniform basis. If determining marketability requires consideration of different royalty clauses, sale arrangements, gas characteristics, processing requirements, markets, and industry practices, demonstrating that common questions predominate in a class action may become more difficult.

> **Note:** The Kansas Supreme Court was answering a certified question of Kansas law; it did *not* resolve the ultimate class-certification or royalty-underpayment issues in the federal litigation.

Conclusion

Cooper-Clark provides an important roadmap for Kansas oil-and-gas royalty disputes. First, the lease controls. A court will begin with the parties' express contractual language. Second, the marketable condition rule is not categorical. It is a tool for filling contractual gaps and requires a fact-specific analysis when the lease is silent or ambiguous. Third, “marketable” does not necessarily mean interstate pipeline quality. Nor does the theoretical existence of a wellhead market necessarily end the inquiry. Fourth, royalty owners should examine their individual leases before evaluating whether post-production deductions are permissible. The precise wording of the royalty clause may determine the analysis.

For producers and royalty owners alike, *Cooper-Clark* reinforces a fundamental lesson: in oil-and-gas royalty disputes, the language of the lease and the actual facts surrounding the marketing of the production matter enormously.