Ohio Court Refuses to Apply Statute of Limitations in Lease Validity Dispute

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On October 4, 2018, Ohio's Seventh District Court of Appeals issued an important oil and gas ruling, holding that the statute of limitations did not apply to bar claims brought by landowners to cancel an oil and gas lease that had already expired at the end of its primary term.

In Neuhart v. TransAtlantic Energy Corp., 2018-Ohio-4099, the Court reversed the trial court's ruling, finding that summary judgment in favor of the producers was in error because the language of a letter agreement which amended an oil and gas lease, both of which were signed on June 9, 1991, called for the release of undrilled acreage if three wells were not drilled before the end of the two-year primary lease term. (This type of lease clause is known as a "Pugh" clause.) It was undisputed that only two wells were drilled. Therefore, the Court ruled that, pursuant to the Pugh clause, the lease expired after two years as to all "undrilled acreage" and the oil and gas rights automatically reverted to the landowners. The Court reasoned that the statute of limitations did not apply since the landowners were in possession of the oil and gas. Statutes of limitations typically do not run against parties who are already in possession of property.

The underlying lawsuit was filed on June 22, 2015, more than 22 years after the primary lease term

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expired on June 9, 1993. The trial court, applying Ohio's 15-year statute of limitations applicable to breaches of oil and gas leases, dismissed the landowners' claims because the case was filed after the 15-year deadline. However, the Court of Appeals found the statute of limitations did not apply, since, under the Pugh clause, a reversion of ownership the minerals already occurred when the primary term expired in 1993, without the third well being drilled.

As a matter of background to this ruling, it is helpful to understand how most oil and gas leases may expire over time and why it is important to be able to know if an old lease has expired. Under Ohio law, most oil and gas leases contain a primary term and a secondary term. The primary term is a period of years within which the producer must commence drilling operations in search of oil and gas, in this case, two years. The secondary term of an oil and gas lease is indefinite and extends the producer's rights under the lease, usually for so long as oil and gas are being produced in paying quantities.

If, after the expiration of the primary term, the conditions of the secondary term are not being met, then the lease automatically expires. A secondary term that continues for so long as oil and gas are found in paying quantities requires that oil or gas actually be discovered and produced in paying quantities. In other words, there must be actual production that generates a profit after operating expenses are attributed to the well. An oil and gas lease that is in its secondary term expires on the day the well stops producing in paying quantities. When an oil and gas lease expires, the oil and gas rights revert back to the landowner.

Finally, most oil and gas leases in Ohio cover all geological formations. Therefore, production from one formation typically will indefinitely hold the lease as to all formations, not just the formation that is in production. More specific to the Shale boom, production from a shallow, less productive formation will usually hold the deeper, more productive Shale formations.

While there is no disagreement over the basic principle that an oil and gas lease automatically expires when its lease conditions are not met, there has been much recent debate over whether a statute of limitations applies to bar a landowner from lawsuits to declare leases expired, and if a statute of limitations applies, which statute controls. Which statutes controls is key because that statute sets forth the length of the limitations period that bars these types of cases. Landowners typically argue that there should be no limitations period because leases automatically expire by their own terms, or conversely, that a longer limitations period should apply. Producers have urged courts to apply a shorter limitations period.

The Seventh District Court of Appeals has issued prior rulings that applied various statutes of limitations to bar certain oil and gas cases brought by landowners. In the Neuhart case, the Court was urged to follow some of these cases. However, the Court ultimately found that none of its prior cases involved an oil and gas lease containing a Pugh clause, and "this clause governs the rights and duties of the parties regarding the undrilled property." Thus, "the discussion of any statute of limitations is irrelevant."

The Utica Shale boom has raised the stakes as to the validity of old oil and gas leases. Many of these leases expired long ago and others are held by decades-old wells nearing the end of their productive lives. When leases expire, the landowner stands to benefit from the lucrative signing bonuses and greater royalty payments found in newer Shale lease. Conversely, if a local producer can operate its wells profitably enough to hold its leases in their secondary term, then the local producer may assign the valuable Shale rights covered by those same leases. Thus, there is new, intense scrutiny over whether oil and gas leases have expired over the years. This increased scrutiny has caused a flood of new lawsuits filed by landowners seeking to declare that old oil and gas leases have automatically expired.

This is important to landowners with Shale acreage potentially covered by older lease. A careful review could reveal that the lease has expired. At the very least, a clock could be ticking on the time within which litigation must be filed to challenge the validity of an oil and gas lease based on lack of production. Therefore, landowners should not wait to file their lease validity claims, but instead should timely seek the aid of an experienced oil and gas attorney if they suspect their lease is no longer valid to ensure they do not miss an opportunity to terminate an expired lease and regain ownership of their minerals.