Ohio Appellate Court Ruling Highlights

Interplay Between Oil and Gas Leases and Ohio's Unitization Statute

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On June 19, 2019, the Ohio Court of Appeals for the Seventh Appellate District issued a ruling that addressed important unanswered questions involving the interplay between an existing oil and gas lease whose unitization clause was deleted and Ohio's unitization statute found at R.C. Chapter 1509. A producer's ability to "force unitize" acreage that is covered by an existing oil and gas lease that does not authorize unitization has been the subject of debate in recent years. In *Paczewski v. Antero Resources Corp.*, 2019-Ohio-2621, the court of appeals held that when an oil and gas lease agreement is silent as to voluntary unitization, a producer who applies for a statutory unitization order, without the landowner's consent, cannot be held to be in breach of the lease agreement.

At issue in the *Paczewski* case was an oil and gas lease originally signed in 1975 covering more than 700 acres in Monroe County, Ohio. The lease contained a unitization clause authorizing the lessee to form drilling units of no more than 640 acres that was struck (or crossed out) when the lease was signed. Antero Resources subsequently acquired the lease to the deep rights to the portion of the leased acreage owned by the Paczewskis and was unable to obtain a lease amendment that would allow Antero to voluntarily unitize the Paczewskis' property with other lands to form a drilling unit called the "Peters Unit."

Thereafter, Antero applied for a mandatory unitization order from

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the Chief of the Ohio Division of Oil and Gas ("ODNR") under R.C. 1509.28, Ohio's unitization statute, to force the Paczewskis' property into the Peters Unit without their consent. After an administrative hearing, the ODNR issued its Order on November 27, 2017, granting Antero's unitization application and allocating a proportionate share of the production from the Peters Unit to the Paczewskis' property.

On April 16, 2018, the Paczewskis filed a complaint against Antero, G-R Contracting, the shallow rights owner, and the ODNR, claiming, among other things, that Antero breached the lease when it obtained its statutory unitization order. On August 22, 2018, the trial court dismissed all claims in the case, based on motions to dismiss filed by Antero, G-R and the ODNR. In its order, the lower court rejected the Paczewskis' arguments that the Antero's unitization order breached the lease. Noting that the original parties' deletion of the pooling clause from the lease, the court concluded that, because the lease was silent on the issue of unitization, the lessee (Antero) was able to properly pursue its statutory right of unitization.

On appeal, the court of appeals affirmed the trial court's judgment. In doing so, the court reviewed its prior decisions regarding the interpretation of oil and gas leases and reiterated its long-held view that oil and gas leases are contracts and are subject to the rules governing contract interpretation. Applying these rules, the court adopted the rule that a striken (or deleted) lease clause renders the lease silent as to the subject matter of the struck clause. Thus, the Paczewskis' lease was silent on the issue of unitization because the unitization clause had been struck. Because of this, the court of appeals found that voluntary unitization was neither allowed nor prohibited, and the lease could not have been breached when Antero applied for and obtained a pooling order from the ODNR.

The court also analyzed a recent ruling from Ohio's Fifth Appellate District known as *Am. Energy-Utica, LLC v. Fuller,* 2018-Ohio-3250, in which a court of appeals in another appellate district held that when an oil and gas lease expressly prohibits unitization, a producer who applies for a forced unitization order, without the landowner's consent, is in breach of the lease agreement. At issue in the *Fuller* case was an oil and gas lease that contained a hand-written provision where the unitization clause was crossed out and in its place was written: "UNITIZATION BY WRITTEN AGREEMENT ONLY!" Although the Paczewskis urged the court to follow the *Fuller* case, the court of appeals distinguished *Fuller* because the *Fuller* lease in expressly prohibited unitization under the lease, whereas the *Paczewski* lease was silent on unitization.

In reviewing these decisions, several important observations are clear. First, Shale producers routinely seek lease amendments from landowners that contain unitization clauses when the existing lease does not authorize unitization. Often, these negotiations are unsuccessful, usually because the landowner is seeking more compensation than the producer is willing to pay. Producers frequently argue that development of the property for oil and gas is enough benefit alone to justify a lease amendment allowing for unitization, without additional compensation. Many landowners believe that, because their lease does not contain a unitization clause, they can hold out for additional compensation and potential block development until their demands are met. With the *Paczewski* decision, producers are now free to pursue unitization orders from the ODNR to force unitize property covered by leases that do not contain unitization clauses. Although the statutory unitization process is time-consuming and costly, it gives producers an alternative to being held hostage by landowners seeking excessive compensation for lease amendments that would permit unitization.

Also, landowners should also be mindful of the *Fuller* case. Landowners with leases that expressly prohibit unitization are potentially in a better position to demand compensation for unitization clauses or, in the alternative, pursue breach of contract claims against producers who attempt to statutorily unitize their acreage in violation of the lease. Additionally, producers who attempt to force unitize acreage risk liability to the landowners with leases that specifically prohibit unitization.

The legal issues before Ohio courts concerning leasing and development rights are ongoing and new decisions that affect these rights are issued frequently. Thus, landowners are confronted with a wide array of legal hurdles over their valuable oil and gas rights, even though their property is already leased. The *Paczewski* and *Fuller* decisions illustrate the complexity of the legal issues. Based the *Paczewski* ruling, landowners must have leases that expressly prohibit unitization, rather than simply strike or delete the unitization clause, in order to bring claims based on the *Fuller* decision. These issues underscore the importance of retaining experienced oil and gas counsel to advise clients as to the leasing and development of their oil and gas interests.

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