

Ohio Supreme Court Rules in Oil & Gas Lease Interpretation Case



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In yet another case in a long series of rulings brought about by Ohio's shale boom, the Supreme Court of Ohio has interpreted the terms of a certain oil and gas lease in favor of the producer and against the landowner. This case that should be a wake-up call to all landowners about the importance of having oil and gas leases carefully reviewed and revised prior to signing them.

In *Bohlen v. Anadarko E&P Onshore, L.L.C.*, the Supreme Court of Ohio affirmed the long-standing rule that oil and gas leases are contracts and are generally determined by the terms of the written document. Therefore, according to the Court, the landowner could not void the lease at issue because, according to the lease, the delay rental provision did not extend beyond the one-year primary term, and a poorly worded minimum royalty provision in the lease addendum was held to be inapplicable. In general, in Ohio, a producer's failure to pay royalties – as opposed to the failure of a well to produce in paying quantities – does not constitute a legal basis to terminate a lease.

It has been long held in Ohio that oil and gas leases fall under the purview of contract law; thus, leases are interpreted under the same rules as traditional contracts. This means that rights and remedies of parties to an oil and gas lease are determined by the rules governing the interpretation of the written document, i.e., the lease. *Bohlen* restated this law and gave it continued vitality.

The *Bohlen* Court then explained how oil and gas leases typically contain two terms: (1) a primary term, which is a definite term (typically in years) during which the producer must commence drilling a well to avoid expiration of the lease, and (2) a secondary term, which is an indefinite that typically extends the lease "for so much longer thereafter" as oil or gas are produced in paying quantities. The Court also reviewed the purpose of a "delay rental" clause, which serves to extend the primary term upon payment of delay rents to the landowner.

In *Bohlen*, the core of the dispute surrounded the interplay between two lease provisions: the delay rental provision and a minimum royalty provision (unartfully referred to in the lease addendum as an "annual rental") to be once a well was drilled. The problem was that both terms contained the word "rental." It was undisputed that the producer had failed to pay the "annual rental." The landowner therefore argued, among other things, that the producer's failure to pay this "annual rental" during the secondary term entitled the landowner to void the lease under the "delay rental" clause.

The Supreme Court of Ohio rejected this argument, ruling instead that the parties must adhere to the plain, unambiguous language of the agreement, which provided that the lease terminated only if the deferment of a well went beyond the one-year primary term without the payment of "delay rents." Because the producer had already drilled wells within the primary term, the lease was in its secondary term and the delay rental clause did not apply. In addition, the lease did not contain a clause that terminated the lease if the annual rent was not paid. Therefore, it was determined that the lease was still valid and did not expire, even though the annual rent was not paid.

The ruling in *Bohlen* underscores the importance of landowners carefully reviewing and negotiating oil and gas leases before they are signed. Once signed, oil and gas leases bind the parties, like any other contract, and cannot be revised or terminated, without the written consent of both parties to the agreement. Also, oil and gas leases are likely to remain effective for decades. Landowners should never simply sign the initial lease offer from a producer, as these leases are very likely to contain provisions that are much more favorable to the producer and much less favorable to the landowner. Usually, landowners will be able to substantially revise a proposed oil and gas lease by adding landowner-friendly terms in what is known as a lease addendum. This must be done before the lease is signed. The lease addendum will modify the lease and is signed at the same time as the lease.

Given the Shale boom in Ohio, the complexity of the new Shale leases used by producers, and the tremendous financial consequences of signing a bad lease, landowners are strongly encouraged to seek the assistance of experienced legal counsel during lease negotiations and before signing a lease. This will allow the landowner to avoid the unfavorable consequences of a bad lease in which the language is either ambiguous or unfavorable but to which landowners will be forced to adhere for the duration of the lease. The *Bohlen* case is just one example highlighting the complexity of oil and gas leases, and the need for engaging the services of a knowledgeable and experienced oil and gas attorney to be a guide in reviewing and entering into lease agreements for valuable oil and gas interests.

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**Ohio
Gas & Oil**
July 1, 2017 Edition