Supreme Court of Ohio Clerk of Court - Filed April 23, 2015 - Case No. 2014-0423

IN THE SUPREME COURT OF OHIO

CLYDE A. HUPP, et al., Plaintiffs-Appellants, v. BECK ENERGY CORPORATION, Defendant-Appellee, and XTO ENERGY INC., Proposed Intervenor-Appellee. and STATE OF OHIO EX REL. CLAUGUS FAMILY FARM, L.P., Relator, v. SEVENTH DISTRICT COURT OF APPEALS, et al., Respondents.	Case Number 14-1933 On Appeal from the Monroe County Court of Appeals, Seventh Appellate District Court of Appeals Case Numbers 12 MO 6 13 MO 2 13 MO 3 13 MO 11 Case Number 2014-423 Original Action in Prohibition and Mandamus

---

MERIT BRIEF OF APPELLEE XTO ENERGY INC.
OR, ALTERNATIVELY,
MERIT BRIEF OF AMICUS CURIAE XTO ENERGY INC.

Kevin C. Abbott (0091504)
Reed Smith LLP
Reed Smith Centre
225 Fifth Avenue
Pittsburgh, PA 15222-2716
Phone: 412-288-3131
Facsimile: 412-288-3063
kabbott@reedsmith.com

Clair E. Dickinson (0018198)
Counsel of Record
BROUSE McDOWELL, L.P.A.
388 South Main Street, Suite 500
Akron, OH 44311
Phone: 330-535-5711
Facsimile: 330-253-8601
cdickinson@brouse.com

Counsel for Appellee XTO Energy Inc.

Richard V. Zurz Jr. (007978)
Counsel of Record
Mark A. Ropchock (0029823)
SLATER & ZURZ, LLP
One Cascade Plaza, Suite 2210
Akron, OH 44308-1135
rzurz@slaterzurz.com
mropchock@slaterzurz.com

James W. Peters (0009360)
Peters Law Offices
107 West Court Street
Woodsfield, OH 43793
Phone 740-472-1681
Facsimile: 740-472-1718
judgejpl@sbcglobal.net

Counsel for Appellants

Scott M. Zurakowski (0069040)
Counsel of Record
William G. Williams (0013107)
Nathan D. Vaughan (00777113)
Gregory W. Watts (0082127)
Aletha M. Carver (0059157)
KRUGLIAK, WILKINS, GRIFFITHS & DOUGHERTY CO., L.P.A.
4775 Munson St., N.W./P.O. Box 36793
Phone: 330-497-0700
Facsimile: 330-497-4020
szurakowski@kwgd.com
bwilliams@kwgd.com
nvaughan@kwgd.com
gwatts@kwgd.com
acarver@kwgd.com

Daniel H. Plumly (0016936)
Counsel of Record
Andrew P. Lycans (0077230)
CRITCHFIELD, CRITCHFIELD & JOHNSON, LTD.
225 North Market Street, PO Box 599
Wooster, OH 44691
Phone: 330-264-4444
Facsimile: 330-263-9278

Counsel for Relator Claugus Family Farm, L.P.

Counsel for Appellee Beck Energy

Michael DeWine (0009181)
Ohio Attorney General
Sarah Pierce (0082522)
Counsel of Record
Tiffany Carwile (0082522)
Assistant Attorneys General
Constitutional Offices Section
30 East Broad Street, 16th Floor
Columbus, OH 43215

Counsel for Respondents, The Seventh District Court of Appeals, Judge Gene Donofrio, Judge Joseph J. Vukovich, and Judge Mary DeGenaro

TABLE OF CONTENTS

Page

I. STATEMENT OF FACTS AND OF THE CASE 1

II. ARGUMENT 3

Proposition of Law No. 1 3

An oil and gas lease is not a perpetual, no-term lease if, in the absence of development, it expires at the end of a fixed and specific primary term. 3

A. The Seventh District Correctly Interpreted the Habendum Clause In the Leases 6

1. The Seventh District Correctly Held that the Habendum Clause Includes a Primary Term and a Secondary Term. 6

2. The Seventh District Correctly Held that the Delay-Rental Provision Applied Only to the Primary Term. 10

3. The Seventh District Correctly Construed the Secondary Term As Requiring the Lessee's Good-Faith Judgment with Respect to Production Capabilities 14

B. Lessors' Characterizations of the Habendum Clause Are Not Persuasive 16

1. The Law Abhors a Construction that Would Result in a Perpetual Term 17

2. The Leases Contain a Fixed Term — the "Primary Term." 18

3. The Delay-Rental Provision Does Not Apply Beyond the Primary Term. 20

4. The "In the Judgment of the Lessee" Language Does Not Give the Lessee Unlimited Discretion to Continue the Leases Without Development 24

5. Ohio Public Policy Supports Enforcement of Contracts 27

Proposition of Law No. 2 29

There is no implied covenant to develop within a reasonable time under leases that include both a fixed primary term, during which the lessee may defer development by paying delay rental, and an express disclaimer of all implied covenants 29

A. There Is No Implied Covenant to Develop During the Primary Term 30

B. Lessors' Construction of the Development Provisions Lacks Merit. 33

III. CONCLUSION 36

TABLE OF AUTHORITIES

Page

Cases

Am. Energy Serv. v. Lekan, 75 Ohio App.3d 201, N.E.2d 1315 (5th Dist.1992) 5, 10

Anadarko Petroleum Corp. v. Thompson, 94 S.W.3d 550 (Tex. 2002) 17

Andrew v. Power Mktg. Direct, Inc., 10th Dist. Franklin No. 11AP–603, 2012-Ohio-4371, 978 N.E.2d 974 18

Beaverkettle Farms v. Chesapeake Appalachia, L.L.C., N.D. Ohio No. 4:11CV02631, 2013 WL 4679950 (Aug. 30, 2013) 27

Belmont Hills Country Club v. Beck Energy Corp., 7th Dist. Belmont No. 13 BE 18, 2015-Ohio-1332 11

Bentley v. Beck Energy Corp., 7th Dist. Belmont Nos. 13 BE 33, 34, 2015-Ohio-1375 11

Bilbarian Farm, Inc. v. Bakerwell, Inc., 2013-Ohio-2487, 993 N.E.2d 795 (5th Dist.) 38

Bohlen v. Anadarko E&P Onshore, LLC, 4th Dist. Washington No. 14CA13, 2014-Ohio-5819 10

Brown v. Fowler, 65 Ohio St. 507, 63 N.E. 76 (1902) 4

Bushman v. MFC Drilling, Inc., 9th Dist. Medina No. 2403-M, 1995 WL 434409, *2 (July 19, 1995) 38

Cincinnati City School Dist. Bd. of Edn. v. Connors, 132 Ohio St.3d 468, 2012-Ohio-2447, 974 N.E.2d 78 ..... 33, 42

Clifton v. Koontz, 325 S.W.2d 684 (Tex.1959) 19

Cotton v. Upham Gas Co., 5th Dist. Knox No. 86-CA-20, 1987 WL 8741 (Mar. 6, 1987) 18

E. Ohio Gas v. Duncan, 63 Ohio App.2d 163, 410 N.E.2d 769 (9th Dist.1978) 4

Eastham v. Chesapeake Appalachia, L.L.C., 754 F.3d 356 (6th Cir.2014) 42

Ervin v. Garner, 25 Ohio St. 2d 231, 267 N.E.2d 769 (1971) 42

Gardner v. Oxford Oil Co., 7th Dist. Monroe No. 12 MO 7, 2013-Ohio-5885 ..... 10, 24

Hallock v. Kintzler, 142 Ohio St. 287, 51 N.E.2d 905 (1943) 21

Hanna v. Shorts, 163 Ohio St. 44, 125 N.E.2d 338 (1955) 5, 38

Harris v. Ohio Oil Co., 57 Ohio St. 118, 48 N.E. 502 (1897) 35

Holonko v. Collins, 7th Dist. Mahoning No. 87CA120, 1988 WL 70900, *2 (June 29, 1988) 38

Hupp v. Beck Energy Corp., 7th Dist. Monroe Nos. 12 MO 6, 13 MO 2, 13 MO 3, 13 MO 11, 2014-Ohio-4255 2

In re Sorah, 163 F.3d 397 (6th Cir.1998) 23

Ionno v. Glen-Gery Corp., 2 Ohio St.3d 131, 443 N.E.2d 504 (1983) 22

Jacobs v. CNG Transmission Corp., 332 F.Supp.2d 759 (W.D.Pa.2004) 16

Jacobs v. CNG Transmission Corp., 565 Pa. 228, 772 A.2d 445 (2000) 12

Kachelmacher v. Laird, 92 Ohio St. 324, 110 N.E. 933 (1915) 13

Katzin v. Cent. Appalachia Petroluem, 2012 PA Super. 10, 39 A.3d 307 31

Marshall v. Beekay Co., 4th Dist. Washington No. 14 CA 16, 2015-Ohio-238, 27 N.E. 3d 1 11

Mauger v. Positron Energy Resources, Inc., 5th Dist. Morgan No. 14AP0001, 2014-Ohio-4613 4

McCullough Oil v. Rezek, 176 W.Va. 638, 346 S.E.2d 788 (1986) 11

Morrison v. Petro Eval. Servs., Inc., 5th Dist. Morrow No. 2004 CA 0004, 2005-Ohio-5640 17

Myers v. East Ohio Gas, 51 Ohio St.2d 121, 364 N.E.2d 1369 (1977) 22

N. Buckeye Educ. Council Group Health Benefits Plan v. Lawson, 103 Ohio St.3d 188, 2004-Ohio-1210, 814 N.E.2d 1210 42

Northup Properties, Inc. v. Chesapeake Appalachia, L.L.C., 567 F.3d 767 (6th Cir.2009) 25

Pack v. Sante Fe Minerals, 1994 OK 23, 869 P.2d 323 19

Raimonde v. Van Vlerah, 42 Ohio St.2d 21, 325 N.E.2d 544 (1975) 21

Regency Plaza, LLC v. Morantz, 10th Dist. Franklin No. 06AP-837, 2007-Ohio-2594 21

Smith v. N. E. Natural Gas Co., 5th Dist. Tuscarawas No. 86AP30016, 1986 WL 11337 (Sept. 30, 1986) 39

State ex rel. Claugus Family Farm, L.P. v. Seventh Dist. Court of Appeals, Case No. 2014-0423 3

State ex rel. Gordon v. Taylor, 149 Ohio St. 427, 79 N.E.2d 127 (1948) 20

Swallie v. Rousenberg, 190 Ohio App.3d 473, 2010-Ohio-4573, 942 N.E.2d 1109 10

Swallie v. Rousenberg, 7th Dist. Monroe No. 09-MO-2, 2010-Ohio-4573 23

Swiss Oil Corp v. Rigsby, 252 Ky. 374, 67 S.W.2d 31 (1930) 19

T.W. Phillips & Oil Co. v. Jedlicka, 615 Pa. 199, 42 A.3d 261 (2012) 12

Wilgus v. Horvath, 162 Ohio St. 75, 120 N.E.2d 583 (1954) 21

Wolfer Enters. v. Overbrook Devt. Corp., 132 Ohio App.3d 353, 724 N.E.2d 1251 (1st Dist.1999) 15

Yoder v. Artex Oil Co., 2014-Ohio-5130 38

Treatises

Kuntz, *Law of Oil and Gas* (2014) 3, 10

William & Meyers, *Manual of Oil and Gas Terms* (15th Ed. 2012) 7, 8, 11

Williams Meyers, *Oil and Gas Law* (LexisNexis Matthew Bender 2014) 10, 14

I. STATEMENT OF FACTS AND OF THE CASE

Appellee Beck Energy Corporation entered into hundreds of oil and gas leases with various property owners throughout the State of Ohio on a standard lease form, the Form G&T (83) Oil and Gas Lease. In 2011, XTO Energy Inc. purchased from Beck the right to drill, develop, and explore properties covered by those leases below certain depths greater than 3860 feet.

The plaintiff-appellant lessors ("Lessors") are two married couples and an individual. Each couple and the individual own separate real estate in Monroe County, Ohio, and leased the oil and gas rights for that real estate to Beck on a G&T (83) form. (Second Amended Complaint ("Comp.") at ¶ 2, 3, 5, & 8.) They filed this action against Beck in the Monroe County Court of Common Pleas, seeking a declaratory judgment that their leases were void and also requesting quiet-title relief. (Comp. at ¶ 20-21.) They included class-action allegations in their complaint, seeking to represent other Monroe County real-estate owners having similar leases with Beck. (Comp. at ¶ 22.)

In July 2012, the trial court granted summary judgment to Lessors, declaring their leases void and forfeited. (Decision (On Pending Motions), filed July 12, 2012 ("Summary-Judgment Decision").) Lessors then sought class-action certification. (Plaintiffs' Motion for Class Action Certification, filed July 19, 2012.) After the trial court's Summary-Judgment Decision, but before it ruled on

Lessors' Motion for Class Action Certification, XTO moved to intervene. The trial court granted Lessors' Motion for Class Certification, thereby extending its determination that Lessors' leases were void to the leases of all the members of the class. (Decision and Order (on Plaintiffs' Motion for Class Certification) ("Class-Action Decision"), filed February 8, 2013.) On that same day, it denied XTO's Motion to Intervene. (Decision and Order (on XTO's Motion to Intervene) "Intervention Decision"), filed February 8, 2013.)

Beck appealed the Class-Action and Summary-Judgment Decisions to the Seventh District Court of Appeals, and XTO appealed the Intervention Decision to that same court. The appellate court consolidated Beck's appeals and XTO's appeal. (Seventh District Court of Appeals Judgment Entry Consolidating Appeal Case Nos. 12 MO 06, 13 MO 02, 13 MO 03, and 13 MO 11, filed September 26, 2014.)[1] The appellate court affirmed the Class-Action Decision, reversed the Summary-Judgment Decision, and determined that XTO's appeal of the Intervention Decision was moot. *Hupp v. Beck Energy Corp.*, 7th Dist. Monroe Nos. 12 MO 6, 13 MO 2, 13 MO 3, 13 MO 11, 2014-Ohio-4255, ¶ 76, 104, 122, & 130.

[1] As a party to the consolidated case in the Seventh District Court of Appeals, XTO is an appellee before this Court. Nevertheless, Lessors, in response to XTO's Motion for Further Tolling, took the position that XTO is not a party before this Court. Out of an abundance of caution, therefore, XTO captions its brief as Appellee XTO's Merit Brief or, Alternatively, Amicus Curiae XTO's Merit Brief.

Lessors then sought jurisdiction in this Court, and this Court accepted jurisdiction over their proposed Propositions of Law I and II. It also sua sponte consolidated Lessors' appeal with an original action, *State ex rel. Claugus Family Farm, L.P. v. Seventh Dist. Court of Appeals*, Case No. 2014-0423. As explained below, this Court should affirm the decision of the Seventh District Court of Appeals, reversing the trial court's Summary-Judgment Decision.

II. ARGUMENT

Proposition of Law No. 1

An oil and gas lease is not a perpetual, no-term lease if, in the absence of development, it expires at the end of a fixed and specific primary term.

This case involves the construction of the term provision in oil and gas leases, commonly known as the "habendum clause." Habendum clauses have historically been the subject of dispute because of the underlying tension in the lessor-lessee relationship; the individual lessor wants immediate drilling to accelerate royalty income, but the lessee must prioritize its drilling activities because of the significant cost of drilling across many properties. *See* Kuntz, *Law of Oil and Gas*, Section 26.1 (2014). There is already extensive case law surrounding the interpretation of these clauses; the law in Ohio governing the interpretation of a traditional habendum clause is well settled and conforms with the principles of oil and gas law adopted by other jurisdictions and advocated by scholars.

Those well-settled principles acknowledge that the ordinary habendum clause includes a two-tiered term. *Brown v. Fowler*, 65 Ohio St. 507, 521, 63 N.E. 76 (1902) (explaining two-tiered term in lease with language similar to lease at issue here). The "primary term" is a fixed number of years in which the lessee has the exclusive right to drill for oil and gas. *Mauger v. Positron Energy Resources, Inc.*, 5th Dist. Morgan No. 14AP0001, 2014-Ohio-4613, ¶ 33. During that primary term, the lessor typically receives an annual "delay rental" that provides income to the lessor from the outset of the lease and relieves the lessee of any obligation to drill a well immediately. *E. Ohio Gas v. Duncan*, 63 Ohio App.2d 163, 166, 410 N.E.2d 769 (9th Dist.1978). If the lessee fails to develop the property by the end of the primary term, the lease ends. *Am. Energy Serv. v. Lekan*, 75 Ohio App.3d 201, 212, 598 N.E.2d 1315 (5th Dist.1992). If, however, the lessee develops the property by drilling a well, pooling the lease with others in a production unit, or conducting other development operations specified in the lease before the end of the primary term, the lease continues into a "secondary term" of indefinite duration that continues so long as the well produces oil or gas in "paying quantities" or is capable of doing so. *Cf. Hanna v. Shorts*, 163 Ohio St. 44, 125 N.E.2d 338 (1955). This type of term provision balances the lessor's legitimate interest in receiving royalties and the lessee's legitimate interest in protecting its investment.

The Seventh District's opinion in *Hupp* applied this well-settled

understanding of the habendum clause to the Form G&T (83) Oil and Gas Lease (widely used in Ohio without controversy since 1983) and reached three salient holdings based on the specific language of that form lease:

1. The lease provides for a primary term of a set period of years, followed by a secondary term of indefinite duration that continues so long as the lessee meets express conditions relating to development.
2. The language of the lease requires the lessee either: (a) to develop the land during the first year of the primary term; *or* (b) to pay delay rentals that defer the lessee's development obligation during the primary term.
3. The language of the secondary term — specifying that it continues so long as a well is "capable of producing in paying quantities" — requires the lessee to exercise good faith in determining that capability.

Each of these holdings focused on the specific lease language and construed that language in keeping with commonly understood and accepted meanings of oil and gas law.

Dissatisfied with these holdings, Lessors attempt to foist absurd constructions on the leases, none of which has ever been advanced by Beck or XTO, and then urge that their own constructions produce results that violate Ohio

public policy and therefore void their contracts *ab initio*. Lessors are setting up and then knocking down these extreme interpretations of the leases in an attempt to cash in on changed market conditions since the time that they entered into their leases. Lessors' arguments boil down to two assertions: (1) that the leases do not use the actual labels "primary term" and "secondary term," so the delay-rental provision impermissibly permits indefinite delay of development; and (2) that the secondary term contains language that impermissibly permits the lessor to extend the leases indefinitely without development based on the lessor's subjective belief that development is possible in the future. Both arguments ignore the plain language of the leases and the governing law, including well-accepted, mainstream constructions of terminology commonly used in oil and gas leases.

A. The Seventh District Correctly Interpreted the Habendum Clause In the Leases.

Each of the Seventh District's three holdings with respect to the habendum clause was correct.

1. The Seventh District Correctly Held that the Habendum Clause Includes a Primary Term and a Secondary Term.

The Seventh District's threshold determination — that the habendum clause in the leases provides for a primary term and a secondary term — was based on the plain language of the leases and is simply unassailable.

The Seventh District's construction of the term provision of the leases correctly began in paragraph 2 of the leases:

> 2. This Lease shall continue in force and the rights granted hereunder be quietly enjoyed by the Lessee for a term of ten years and so much longer thereafter as oil and gas or their constituents are produced or are capable of being produced in paying quantities, or the premises shall be operated by the Lessee in the search for oil or gas and as provided in Paragraph 7 [the dry hole clause].[2]

The language in paragraph 2 is a traditional "habendum clause" that is common to nearly all modern oil and gas leases. Its purpose is to establish the term or duration of the lease. *See* Williams & Meyers, *Manual of Oil and Gas Terms*, 461 (15th Ed.2012) (defining the habendum clause as "[t]he clause in a deed or lease setting forth the duration of the grantee's or lessee's interest in the premise.").

As the Seventh District correctly recognized, the habendum clause in paragraph 2 is two-tiered. *See Hupp*, 2014-Ohio-4255, at ¶ 86. The initial phrase —

"for a term of ten years"

[2] The majority of the leases at issue have primary terms of ten years, although some have different primary terms. For ease of discussion, ten years is used to refer to the primary terms throughout this brief.

— is commonly referred to in the oil and gas industry as the "primary term." *See* Williams & Meyers, *Manual of Oil and Gas Terms*, 807 (defining "primary term" as "[t]he period of time during which a lease may be kept alive by a lessee even though there is no production in paying quantities"). And the next phrase —

> *"and so much longer thereafter as * * *"*

— is commonly referred to as the "secondary term." *See id.* at 949 (defining "secondary term" as "[t]he period subsequent to the expiration of the primary term during which the lease or deed is continued in force by operation of the THEREAFTER CLAUSE of the lease or deed").

A long line of Ohio cases supports the Seventh District's construction of the habendum clause at issue here. These cases date back at least as far as the Court's 1902 decision in *Brown*, where the Court construed language strikingly similar to the language in the Beck leases: " 'for the term of two years from the date hereof, and as long thereafter as oil or gas is found in paying quantities thereon, * * *.' " *See* 65 Ohio St. at 521, 63 N.E. 76. The Court did not use the phrases "primary term" and "secondary term," but it recognized the concepts; it held that "[t]his clause means that the term of the lease is limited to two years, but that if, within the two years, oil or gas shall be found, then the lease shall run as much longer

thereafter as oil or gas shall be found in paying quantities * * *."[3] *Id.*; *see also Mauger*, 2014-Ohio-4613, at ¶ 33; *Gardner v. Oxford Oil Co.*, 7th Dist. Monroe No. 12 MO 7, 2013-Ohio-5885, ¶ 27; *Swallie v. Rousenberg*, 190 Ohio App.3d 473, 2010-Ohio-4573, 942 N.E.2d 1109, ¶ 63 (7th Dist.); *Am. Energy Serv.*, 75 Ohio App.3d at 212, 598 N.E.2d 1315. And subsequent decisions from the Seventh District and other districts have followed the reasoning of *Hupp*. *See, e.g.*, *Bohlen v. Anadarko E&P Onshore, LLC*, 4th Dist. Washington No. 14CA13, 2014-Ohio-5819, ¶ 19 ("the duration of an oil and gas lease is determined by the habendum clause, which includes a primary term of definite duration and a secondary term of indefinite duration."); *Marshall v. Beekay Co.*, 4th Dist. Washington No. 14 CA 16, 2015-Ohio-238, ¶ 12, 27 N.E. 3d 1 (noting that habendum clauses in the two leases at issue contain primary and secondary terms); *Belmont Hills Country Club v. Beck Energy Corp.*, 7th Dist. Belmont No. 13 BE 18, 2015-Ohio-1332; *Bentley v. Beck Energy Corp.*, 7th Dist. Belmont Nos. 13 BE 33, 34, 2015-Ohio-1375.

Other oil and gas-producing states in the Appalachian region have adopted an identical construction of two-tiered habendum clauses. *See McCullough Oil v.*

---

[3] The secondary term in *Brown* was not indefinite; it was capped at 25 years. *See* 65 Ohio St. at 521, 63 N.E. 76. But that cap had no bearing on the Court's recognition of the functional distinction between the primary and secondary terms, and the Lessors here do not suggest that the Beck leases are invalid because of the indefinite duration of the *secondary* term.

Rezek, 176 W.Va. 638, 642-643, 346 S.E.2d 788 (1986) ("The habendum clause of virtually all contemporary oil and gas leases provides for a relatively short 'primary' term, consisting of a fixed period of time from a few months to five or ten years, at the end of which period there must be production (or in some leases, the prosecution of drilling operations); the habendum clause also provides that the lease may be preserved for an indefinite period of time beyond the expiration of the primary term 'as long thereafter' as oil or gas is produced in paying quantities."); *Jacobs v. CNG Transmission Corp.*, 565 Pa. 228, 232-233, 772 A.2d 445 (2000); *T.W. Phillips & Oil Co. v. Jedlicka*, 615 Pa. 199, 209-210, 42 A.3d 261 (2012); Williams & Meyers, *Oil and Gas Law*, Sections 603.1-603.4; 2-26 Kuntz, *Law of Oil and Gas*, Section 26.4.

Thus, the Seventh District correctly interpreted paragraph 2 of the leases to provide for a ten-year primary term followed by a secondary term of indefinite duration.

2. The Seventh District Correctly Held that the Delay-Rental Provision Applied Only to the Primary Term.

Having correctly found that the leases contain the ordinary habendum clause with two distinct terms, *Hupp*, 2014-Ohio-4255, at ¶ 90, the Seventh District properly construed the delay-rental provision to permit the lessee to defer its obligation to develop the leases only during the primary term of the leases. *See id.* at ¶ 83, 91. The delay-rental provision in paragraph 3 of the leases provides:

> 3. This lease, however, shall be null and void * * * unless within ___ months from the date hereof, a well shall be commenced on the premises, or unless the Lessee shall thereafter pay a delay rental of ___ Dollars each year * * * until commencement of a well. A well shall be deemed commenced when preparations for drilling have been commenced.

Pursuant to paragraph 3, the leases will terminate after the first year of the primary term unless the lessee takes one of two actions: (1) "commence[s]" a well; or (2) "pay[s] a delay rental." As a practical matter, the lessee's need to prioritize its drilling activities will often make it impractical to drill a well in the first year. Thus, the delay-rental payments become the lessee's avenue for keeping the lease obligations alive during the *primary* term. *See, e.g., Kachelmacher v. Laird*, 92 Ohio St. 324, 332, 110 N.E. 933 (1915) ("Under the clearly expressed terms of the lease, if the lessee does not drill, he may still continue the lease in force by payment of the stipulated rental.").

Indeed, the very purpose of a "delay rental" is to defer drilling obligations "*during the primary term of the lease.*" (Emphasis added.) Williams & Meyers, *Manual of Oil and Gas Terms*, 250-251. As the Seventh District explained, delay-rental clauses were developed to "offset the harsh requirement that development had to occur immediately upon the signing of the lease." *See Hupp* at ¶ 98. Other

Ohio appellate courts have adopted the same interpretation of delay-rental provisions. *See Bohlen*, 2014-Ohio-5819, at ¶ 20 ("Under established case law, once the primary term of the Lease expires, the delay rental provision is no longer applicable.").

It would make no sense to construe the delay-rental provision as having any application beyond the primary term. The entirety of paragraph 3 demonstrates that that paragraph serves as an added *protection* to the lessor, because it requires the lessee either to drill during the first year or to make delay-rental payments in order to continue the leases during the primary term. The payment of delay rentals is thus the lessee's avenue to avoid an early lapse of its rights if drilling during the first year is not feasible. But nothing in paragraph 3 changes the requirement, found in paragraph 2, that oil and gas be "produced or [be] capable of being produced in paying quantities" before the lease extends into the secondary term. And any argument that would allow the delay-rental provision of paragraph 3 to override the secondary-term requirements of paragraph 2 would render the contract "internally inconsistent, [would] not harmonize all of its provisions, and [would] allow for the absurd result" of a no-term lease. *See Wolfer Enters. v. Overbrook Devt. Corp.*, 132 Ohio App.3d 353, 356-57, 724 N.E.2d 1251 (1st Dist.1999). Such a construction would undermine the very purpose for having a two-tiered habendum clause.

The Seventh District also drew support for its plain-language approach from the history of case law construing similar delay-rental clauses. As it explained, the purpose of the secondary term of a habendum clause — the term that requires development to continue the lease beyond the initial fixed term — would be undermined to the point of being moot if delay rentals could be employed to extend a lease without development. In fact, when *lessees* have urged such a construction, courts have routinely rejected it:

> When a fixed term lease came into general use in the 1890s * * * lessees argued that such leases could be extended beyond the fixed term by the mere payment of the fixed rental referenced in the drilling clause. * * * The courts * * * rejected such a construction as being "contrary to the intentions of the parties to so word a habendum clause that the lease must terminate within a definite time in the absence of production, and then in the next clause destroy that provision by another permitting the lease to run indefinitely [without production] by the payment of a nominal delay rental."

Hupp at ¶ 94, quoting *Jacobs v. CNG Transmission Corp.*, 332 F.Supp.2d 759 (W.D.Pa.2004), quoting 2 Summers, *The Law of Oil and Gas*, Section 290.

Thus, the Seventh District correctly interpreted paragraph 3 to allow for the payment of delay rentals in lieu of production during only the primary term.

3. The Seventh District Correctly Construed the Secondary Term As Requiring the Lessee's Good-Faith Judgment with Respect to Production Capabilities.

The Seventh District also correctly held that the secondary term of the leases was not void based on the lessee's ability to exercise subjective judgment as to whether a well was capable of producing in paying quantities. The Seventh District was correct in requiring that the lessee exercise good faith in determining the production capacity of that well.

As a threshold matter, the Seventh District was correct in holding that the phrase "capable of production in paying quantities" means "a well that will produce in paying quantities if the well is turned 'on' and it begins flowing, without additional equipment or repair." *See* Williams & Meyers, *Oil and Gas Law*, Section 603 (LexisNexis Matthew Bender 2014), quoting *Anadarko Petroleum Corp. v. Thompson*, 94 S.W.3d 550, 558 (Tex. 2002); *see also Morrison v. Petro Eval. Servs., Inc.*, 5th Dist. Morrow No. 2004 CA 0004, 2005-Ohio-5640, ¶ 34-35, 39-40 (adopting the *Anadarko* definition). The phrase "capable of production in paying quantities" assumes that a well actually exists on the property or on property that is unitized with the leases.[4] As the Seventh District reasoned,

[4] "Unitization" is a voluntary agreement between the lessor and lessee that the leased property may be joined with other leases in a single production unit. Such clauses typically provide that any well drilled in the unit will be treated as if drilled on each lease and that production from such wells will be shared pro rata among

"oil and gas is not capable of being produced if no well exists." *Hupp* at ¶ 100. The Seventh District's reasoning — that the secondary-term language in paragraph 2 of the leases necessarily requires the development of a well in order to maintain the leases — follows mainstream oil and gas jurisprudence and is consistent with the general purpose of a secondary term, which is the continuation of the term of the lease, or unitized leases, so long as the property is productive.

The Seventh District also correctly concluded that the "in the judgment of the Lessee" language is consistent with Ohio law that the assessment of the economics of a well is ordinarily made from the lessee's viewpoint but is subject to a good-faith standard. *See Hupp* at ¶ 102-103. As explained in *Hupp*, Ohio courts previously recognized that the determination of whether a well is producing in "paying quantities" must be made "from the standpoint of the lessee and his good faith judgment that production in paying quantities must prevail." *Hupp* at ¶ 103, quoting *Cotton v. Upham Gas Co.*, 5th Dist. Knox No. 86-CA-20, 1987 WL 8741 (Mar. 6, 1987). It is a well-settled principle of contract construction that a party's "discretionary authority to determine certain terms of the contract" triggers a "duty of good faith." *Andrew v. Power Mktg. Direct, Inc.*, 10th Dist. Franklin No. 11AP–603, 2012-Ohio-4371, 978 N.E.2d 974, ¶ 31.

This reasoning follows the approach taken by a number of other jurisdictions

---

the leases. *See Yoder v. Artex Oil Co.*, 5th Dist. Guernsey, No. 14 CA 4, 2014-Ohio-5130, ¶ 54-55.

in oil and gas cases, including Pennsylvania, Texas, Oklahoma and Kentucky; cases in these jurisdictions impose an obligation of good faith on a lessee in assessing whether a well is producing in "paying quantities." *T.W. Phillips*, 615 Pa. at 224, 42 A.3d 261; *Clifton v. Koontz*, 325 S.W.2d 684, 691 (Tex.1959); *Pack v. Sante Fe Minerals*, 1994 OK 23, 869 P.2d 323, 326-327; *Swiss Oil Corp v. Rigsby*, 252 Ky. 374, 377-378, 67 S.W.2d 31 (1930). The language in paragraph 2, providing that this assessment of "paying quantities" is made in the "judgment of the lessee," accurately reflects what Ohio law would otherwise impose — the lessee's good-faith judgment is controlling. It does not mean that the lessee has unbridled discretion to declare a well capable of production if the well is in fact not economical, as such a judgment would not be made in good faith. And it certainly does not permit a lessee to hold undeveloped property indefinitely, beyond the primary term, based on a subjective belief that someday production in paying quantities may occur. The Seventh District's construction of the secondary term in the leases comports with settled Ohio law and oil and gas law developed in other jurisdictions. Consistent with the purpose of a secondary term, the leases here require development to maintain the validity of the leases beyond the primary term, and the only parties suggesting the opposite are Lessors themselves.

B. Lessors' Characterizations of the Habendum Clause Are Not Persuasive.

In support of their claim that the leases are void *ab initio*, Lessors

characterize the habendum clause as allowing the lessee to extend the lease perpetually without development, a result they claim is contrary to Ohio public policy. Ohio law does not support their position.

1. The Law Abhors a Construction that Would Result in a Perpetual Term.

Ohio rules of construction provide that the approach taken by Lessors — imposing an interpretation that renders a contract perpetual and unenforceable — is wrong as a matter of course. Ohio law instructs that courts must construe contracts in a way that upholds them, not nullifies them. *See State ex rel. Gordon v. Taylor*, 149 Ohio St. 427, 437, 79 N.E.2d 127 (1948).[5] Further, a court should not construe a contract as having a perpetual term unless the language of the contract clearly provides for it. *Hallock v. Kintzler*, 142 Ohio St. 287, 51 N.E.2d 905 (1943), paragraph one of the syllabus; *Wilgus v. Horvath*, 162 Ohio St. 75, 84-85, 120 N.E.2d 583 (1954); *Regency Plaza, LLC v. Morantz*, 10th Dist. Franklin No. 06AP-837, 2007-Ohio-2594, ¶ 18. As discussed in the *Hupp* opinion and cases following it, there is a reasonable reading of the leases that would avoid a construction of the term as perpetual. *See Hupp*, 2014-Ohio-4255, at ¶ 86-90;

---

[5] Even if the Court could find that the Beck leases contain provisions that offend public policy (which, as explained herein, they do not), the remedy would not be to deem the leases void *ab initio*, as the trial court did. Rather, the remedy would be to modify the offending portion of the leases. *See, e.g., Raimonde v. Van Vlerah*, 42 Ohio St.2d 21, 24-25, 325 N.E.2d 544 (1975) (adopting "a rule of 'reasonableness,' which permits courts to * * * fashion a contract reasonable between the parties, in accord with their intention at the time of contracting").

Bohlen, 2014-Ohio-5819, at ¶ 19. Ohio law requires the Court to endorse any reasonable reading of the leases that results in an enforceable contract with a fixed term in which development must occur.

Lessors' reliance on *Ionno v. Glen-Gery Corp.*, 2 Ohio St.3d 131, 443 N.E.2d 504 (1983), to support their no-term construction is misplaced. As this Court recognized, there was no term provision in the lease at issue in *Ionno*: "The lease in question contains no time period in which mining operations are required to commence." *Id.* at 132. Because there was no express fixed term during which development had to occur, the only reasonable interpretation of the lease was that it was perpetual. But unlike the lease at issue in *Ionno*, the language of the habendum clause in paragraph 2 of the Beck lease contains a fixed primary term of 10 years and a conditional secondary term.[6]

2. **The Leases Contain a Fixed Term — the "Primary Term."**

Lessors argue that the fixed term in the leases is not a primary term because the leases do not explicitly label it as a primary term. As Lessors would have it, even though it has all of the characteristics of a primary term, it fails merely due to

---

[6] Even accepting Appellant's view that paragraph 2 of the leases is not a term provision, the leases would survive, because Ohio courts uphold no-term leases. *Hupp*, 2014-Ohio-4255, at ¶ 82; *Bohlen*, 2014-Ohio-5819, at ¶ 18; *Myers v. East Ohio Gas*, 51 Ohio St.2d 121, 127, 364 N.E.2d 1369 (1977). This Court's decision in *Ionno* provides no support for voiding the leases, because it did not hold that a no-term lease is *void ab initio*. Rather, it found that the lessee's failure to develop for 18 years constituted a breach of an implied duty of development that might support the remedy of equitable forfeiture *if* money damages were inadequate.

the lack of a label. According to Lessors, all of the case law involving leases with primary terms is therefore inapplicable, including the case law that delay-rental provisions permit a lessee to defer development only during the primary term. This argument borders on the frivolous. "There is a saying that if something looks like a duck, walks like a duck, and quacks like a duck, then it is probably a duck." *In re Sorah*, 163 F.3d 397, 401 (6th Cir.1998). As the Court's decision in *Brown* illustrates, the language of a two-tiered habendum clause need not contain the words "primary term" and "secondary term" in order to function as such. *See Brown*, 65 Ohio St. at 521, 63 N.E. 76.

A primary term is defined as the part of the habendum clause that provides for a definite period of time to develop the lease. Lessors cite no case for the proposition that the fixed term portion of the habendum clause is not a "primary term" without that explicit label. And several of their cited cases construed leases as having primary terms even when, as here, the lease language did not use the label. *See Swallie v. Rousenberg*, 7th Dist. Monroe No. 09-MO-2, 2010-Ohio-4573, ¶ 5, 63; *Gardner v. Oxford Oil Co.*, 7th Dist. Monroe No. 12-MO-7, 2013-Ohio-5885, ¶ 4, 27. The characteristics of the term provision, providing for a fixed period of time in which to develop the property, are what make it a "primary term." There is also no traction to Lessors' argument that the absence of a label somehow misled them; there is no evidence in the record to suggest that any of them was

misled or that a "primary term" label would have been any more comprehensible to them than the plain language already found in paragraph 2.

Lessors also root through the leases and cite language that they contend would support continuing the leases beyond the primary term without development. The legal significance of the provisions they cite is unclear, as the conduct required to transition the leases beyond the primary term is relevant to the construction of the *secondary* term, not the primary term. None of these provisions casts any doubt that the words "[t]his Lease shall continue in force * * * for a term of ten years and so much longer" plainly mean that the leases have a ten-year primary term. Furthermore, the provisions they rely upon implicitly assume development. For example, they cite the dry-hole provision in paragraph 7 and the shut-in provision in paragraph 8 as support for the proposition that the lessees can indefinitely extend the leases without development. But both of these provisions necessarily assume that development occurred and that wells were drilled; in one case, the wells fail to produce (the dry hole), and in the other case, there is no current market for the production (the shut-in well). Neither provision has any bearing on the primary term, during which no production is required at all.

3. The Delay-Rental Provision Does Not Apply Beyond the Primary Term.

Lessors also ask the Court to disregard settled law that the delay-rental provision permits a lessee to defer its obligation to commence development during

the primary term of the leases. They instead urge that the leases permit delay rentals to defer commencement of a well indefinitely. This construction is contrary to the very definition of a delay rental. *See Hupp*, 2014-Ohio-4255, at ¶ 99; *Bohlen*, 2014-Ohio-5819, at ¶ 20. The only cases they cite for this argument are a Sixth Circuit decision applying Kentucky law and an interlocutory federal-district-court decision denying motions for summary judgment, both of which involve very different lease provisions that unequivocally provided for a payment of delay rentals beyond the primary term.

In *Northup Properties, Inc. v. Chesapeake Appalachia, L.L.C.*, 567 F.3d 767 (6th Cir.2009), there was a dispute regarding whether delay rentals extended a lease beyond its primary term, under a habendum clause that read as follows:

> It is agreed that this lease shall remain in force for the term of ten (10) years from this date *and* as long thereafter as the said land is operated by the Lessee in the search for or production of oil or gas, with an *extended term* by *payment of rentals* as hereinafter set forth.

(Emphasis in original.) *Id.* at 772. The Sixth Circuit began its analysis by noting the "uniqueness of the Lease's terms" and the fact that the lease did not follow the typical form. *Id.* at 771. The Court stated that "ordinarily, the primary term involved a definite number of years for exploration and development of the minerals, while the secondary term included an 'as long as' or 'so long as clause'"

that would extend the lease while oil and gas was being produced, and further, that the usual lease would require that a delay rental be paid or a well be commenced during the primary term. *Id.* at 772. With respect to the Chesapeake lease at issue in that case, however, the Court stated that "its very language confirms that delay rentals extended the Lease." *Id.* The Court held that unlike the typical lease, "[t]he Lease's discussion of a secondary term held by delay rentals does not include any language equivalent to the typical 'as long as' or 'so long as' production phrases." *Id.* This kind of express language is not present in the leases here.[7]

In Lessors' other case, a federal district court denied in part the parties' cross-motions for summary judgment. *See Beaverkettle Farms v. Chesapeake Appalachia, L.L.C.*, N.D. Ohio No. 4:11CV02631, 2013 WL 4679950 (Aug. 30, 2013). That decision is equally off point, as the district court there considered whether the lessee validly extended the lease beyond its primary term based upon its operations in a unit containing a portion of the leased premises. *Id.* at *1. The district court actually distinguished *Northup* because the case did not involve any claim that the term of the lease "may be extended by the payment of delay rentals."

---

[7] This case still cuts against the relief sought by Lessors. The Sixth Circuit concluded that based on this language, the lease was validly extended by the payment of delay rentals beyond the primary term, and the court affirmed dismissal of the lawsuit seeking to invalidate the lease for failure to develop during the primary term.

See id. at *14. Instead, the lessors were claiming that the lessee was obligated to continue to pay delay rentals for any *undeveloped* acreage after the expiration of the primary term, pursuant to the second paragraph of the delay-rental provision, which stated "[o]nce a well is drilled on the Lease, said Lease shall be held by production *and Lessee shall be entitled to maintain all undrilled acreage under this Lease by paying delay rentals as provided above.*" *See id.* at *11. The lessee argued that after the primary term expired, it did not have to pay delay rentals for any part of the property. The district court denied summary judgment on this issue for both parties, reasoning that the express language in the second paragraph of the delay-rental paragraph could be read either way. Because it could be read to continue to require the payment of delay rentals as to undeveloped property, even though the lessee had already timely developed a portion of the property pursuant to the habendum clause, the unique provision at issue had to be tried. *See id.* at *13. The case was dismissed prior to trial.

Both *Northup* and *Beaverkettle* involved express and unique lease provisions that could be read as requiring payment of delay rentals beyond the primary term of the lease in certain circumstances. Lessors point to no language in the leases here that is remotely similar to that in *Northup* or *Beaverkettle.* Neither of these cases supports Lessors' construction that an ordinary delay-rental provision, like that found in the Beck leases, permits an indefinite extension of the lease without

development, and neither case supports Lessors' sought-after relief of invalidating the leases. The Sixth Circuit in *Northup* affirmed the validity of the lease as written. And in *Beaverkettle*, the district court ordered a trial on the issue of whether the payment of delay rentals was necessary to continue the lease as to undeveloped property beyond the primary term — and that trial never occurred. Accordingly, these non-binding and non-precedential cases, involving vastly different lease language, provide no basis to deviate from the Seventh District's application of settled Ohio law.

4. The "In the Judgment of the Lessee" Language Does Not Give the Lessee Unlimited Discretion to Continue the Leases Without Development.

Lessors argue that the secondary term of the leases could be read to allow the lessee to decide to continue the leases without ever drilling a producing well. They rest their argument on the phrase "in the judgment of the lessee," which Lessors claim cancels out the rest of the habendum clause relating to the secondary term, and results in leases that do not require actual development in order to indefinitely maintain the leases. The Seventh District correctly rejected this forced construction of the secondary term as illogical.

As the Seventh District correctly noted, the habendum clause in paragraph 2 of the leases states that the leases continue "so much longer thereafter as oil or gas or their constituents are produced or are capable of being produced on the premises

in paying quantities, in the judgment of the lessee * * *." The Seventh District linked the "in the judgment of the lessee" to the determination of "paying quantities," because as noted above, Ohio law traditionally assesses whether a well is producing in paying quantities through the good-faith judgment of the lessee. Lessors argue, once again to their own detriment, that "in the judgment of the lessee" actually applies to whether the property is even capable of being produced, and based on this construction, they argue the lessee could indefinitely extend the leases based on the subjective belief that the property might be capable of being produced without ever drilling a well.

Lessors' construction runs counter to over a century of case law interpreting habendum clauses in oil and gas leases. Having no case law that supports such an illogical construction that the secondary term can be continued indefinitely without development, Lessors resort to distinguishing the cases cited by the Seventh District and arguing that the lease form here is different. The Seventh District cited both *Morrison*, 2005-Ohio-5640, and *Anadarko*, 94 S.W.3d 550, for the proposition that the lessee's assessment whether the land was capable of production in paying quantities requires good faith. The leases in these cases used similar "produced or capable of being produced" language to describe the conditions under which the secondary term would continue but did not have the express "in the judgment of the lessee" language. The Seventh District's

interpretation of the leases is consistent with the result reached in those cases.

Lessors also distinguish both cases on the grounds that they involved instances where development occurred, the lease transitioned into the secondary term, and then there was a cessation of production. However, the leases at issue here were still in their primary terms when Lessors sought to invalidate them; the time for development had not yet even expired. If anything, this goes to show the prematurity of Lessors' argument on the secondary term. Even without knowing what development might timely occur on the leases, they seek to invalidate them based on the premise that the lessee will assert the illogical construction that it can indefinitely delay development beyond the primary term. The *only* parties that have ever asserted this construction of the secondary term are Lessors themselves, and they are advancing it only to try to get out of their contracts before the primary term has even expired.[8] Beck and XTO agree with the Seventh District's interpretation of the leases that they cannot extend the leases into the secondary term without development or without something else that would otherwise extend

---

[8] Other courts have rejected similar straw-man arguments by lessors seeking to invalidate their oil and gas leases by arguing a construction that would violate governing law. In *Katzin v. Cent. Appalachia Petroluem*, 2012 PA Super. 10, 39 A.3d 307, the Pennsylvania Superior Court rejected a claim by lessors that the lessee might not pay royalties to them in compliance with Pennsylvania's Guaranteed Minimum Royalty Act. The court refused to assume that the lessees would act in a manner contrary to Pennsylvania law. Neither Beck nor XTO contends that it could hold the leases perpetually without development based on a subjective belief that the property covered by the leases may be developed.

the lease under its terms (for example, force majeure).

Finally, Lessors' reading of the secondary term as permitting a lessee to extend the lease indefinitely without development violates settled rules of contract construction because it creates a conflict within the habendum clause. The Seventh District correctly held that the language "so much longer thereafter as oil or gas or their constituents are produced or are capable of being produced on the premises in paying quantities" presupposes that a well that is capable of producing is drilled, and Lessors do not challenge that construction on appeal. Property cannot produce oil and gas in paying quantities without the drilling of a well. Lessors' argument — that the language "in the judgment of the lessee" cancels out the requirement that a well must be drilled — creates an irreconcilable conflict and would make the inclusion of all of the other language regarding production or capable of production superfluous. Such an interpretation is disfavored, and the Court should reject it. *See Wolfer Enters.*, 132 Ohio App.3d at 356-57, 724 N.E.2d 1251. The Seventh District harmonized the language in the habendum clause to reach a result that was consistent with the purpose of a secondary term in an oil and gas lease: the continuation of the lease so long as a well was drilled that was capable of producing oil and gas in paying quantities.

5. Ohio Public Policy Supports Enforcement of Contracts.

Lessors argue that enforcing the leases would violate public policy. Their

argument presupposes that the leases are no-term contracts that can be held indefinitely without development of the oil and gas. Because Lessors are wrong on the construction of the leases, the sole underpinning for their public policy argument falls away. It fails to overcome the bedrock principle that "[t]he freedom to contract is a deep-seated right that is given deference by the courts." *See Cincinnati City School Dist. Bd. of Edn. v. Connors*, 132 Ohio St.3d 468, 2012-Ohio-2447, 974 N.E.2d 78, ¶ 15.

Further, Lessors' sole support for this public-policy argument is the Court's decision in *Ionno*, which did not involve a public-policy claim at all. Rather, in *Ionno*, this Court found that a lessee breached an implied duty to develop where the lease contained no primary term and the lessee had not made any effort to develop the lease for an 18-year period. In reasoning that an implied duty to develop the lease existed, this Court held that the lessor's expectation of receiving royalties based upon production was a material inducement for entering into the leases. Upon concluding that the lessee breached this implied duty after nearly two decades of no effort to develop, the Court determined that equitable forfeiture might be an appropriate remedy. By contrast, there is no legitimate expectation of development during the primary term of the leases here, because the leases do not require development during the primary term; rather, they explicitly authorize payment of delay rentals as a substitute for production. *See Hupp*, 2014-Ohio-

4255, at ¶ 114. The Seventh District correctly applied settled Ohio law and rules of contract construction, in line with mainstream oil and gas jurisprudence, and enforced the term of the leases as written: a fixed primary term and an indefinite secondary term conditioned upon development. This Court should affirm.

Proposition of Law No. 2

There is no implied covenant to develop within a reasonable time under leases that include both a fixed primary term, during which the lessee may defer development by paying delay rental, and an express disclaimer of all implied covenants.

Lessors seek to impose on the leases an implied covenant to develop. This proposition fails for the same reason as their first proposition: it is contrary to the contractual language to which Lessors assented. It disregards the habendum clause, providing for a fixed primary term and a conditional secondary term. And it disregards the express language in the leases disclaiming all implied covenants.

Much like their arguments on the first proposition, Lessors rest their case on *Ionno*, which is no more relevant to this second proposition, as it involved a lease with no term and no express disclaimer of implied covenants. Unlike the lease at issue in *Ionno*, the leases here are not no-term leases, and the lessees here have not failed to undertake any development for 18 years. These leases are (or, at the time of Lessors' suit, were) still within the primary term, and the only parties in this case arguing the leases could be extended beyond that primary term without development are Lessors themselves. Enforcing the habendum clause as written

undermines the sole underpinning for this argument, which is that these leases continue forever without development. Enforcing the express disclaimer of implied covenants is fully consistent with the habendum clause and the delay-rental provision. Lessors' last-ditch argument — that the disclaimer is ambiguous or so buried in the two-page leases that it could catch a lessor unaware — has no merit. Every Ohio case they cite supports enforcement of the disclaimer, just as the Seventh District did. This Court should affirm.

A. There Is No Implied Covenant to Develop During the Primary Term.

The Seventh District correctly held that an implied covenant to develop oil and gas could not be imposed under the Beck lease during the primary term, because it would conflict with the express terms of the lease that govern development.

"An implied covenant can arise only when there is no expression on the subject." *Kachelmacher*, 92 Ohio St. at 332, 110 N.E. 933; *see also Harris v. Ohio Oil Co.*, 57 Ohio St. 118, 128, 48 N.E. 502 (1897) ("The implied covenant arises only when the lease is silent on the subject."). If an oil and gas lease contains an express definition as to the timing of development under the lease, no implied covenant regarding development can be read into the lease. *See, e.g. Harris* at 128 ("When the extent of the development * * * is provided for in the lease, there can be no implied covenant for further development."). In *Kachelmacher*, this Court

held that "where a lease of land for ten years for oil and gas provides that the lease shall be void if no well is drilled within four months of the date thereof unless the lessee shall pay lessor the sum of fifty dollars for each and every year that the drilling of such well is delayed," the lessee's payment of that amount of money "continues the lease in force during the year for which such payment is made." *Kachelmacher* at paragraph 3 of the syllabus. Thus, "[u]nder the clearly expressed terms of the lease, if the lessee does not drill he may still continue the lease in force by payment of the stipulated rental. Such matter being covered by the express terms of the written contract, no implication can arise in relation thereto inconsistent with, or in opposition to, such plain provision of the written contract." *Id.* at 332.

This Court should endorse the Seventh District's straightforward application of these settled principles to the Beck leases. The habendum clause in paragraph 2 requires development of a well capable of production in paying quantities, or else the leases expire at the end of the primary term. In that context, an implied covenant makes no sense. It would undercut the express rights and obligations set forth in the habendum clause, because it would effectively require development earlier in the life of the lease than the parties bargained for.

Like the lease in *Kachelmacher*, the Beck leases also contain an express provision governing development during the primary term. Paragraph 3 states that

"this lease, however, shall become null and void and all rights of either party hereunder shall cease and terminate unless, within 12 months from the date hereof, a well shall be commenced on the premises, or unless the Lessee shall thereafter pay a delay rental of ___ each year, payments to be made quarterly until the commencement of a well." As held in *Kachelmacher*, this is a "stipulation for the payment of rental in lieu of drilling, and the option is thus given the lessee to drill or pay rental in accordance with the terms of the contract." *Kachelmacher* at 332. "Under the clearly expressed terms of the lease, if the lessee does not drill he may continue the lease in force by the payment of the stipulated rental." *Id.* Having contractually agreed to this development timeline during the primary term of the lease, "no implication can arise * * * inconsistent with, or in opposition to, such a plain provision of the written contract." *Id.* No implied covenant to develop can be imposed during the primary term because the leases expressly contemplate the payment of a delay rental as a substitute for development during the primary term.

Moreover, the Seventh District also correctly upheld the disclaimer of implied covenants in paragraph 19 of the leases. Paragraph 19 states each lease "contains and expresses all the agreements and understandings of the parties in regard to the subject matter thereof, and no implied covenant, agreement or obligation shall be read into this agreement or imposes upon the parties or either of them." Other Ohio courts have enforced the same or nearly the same disclaimer of

implied covenants in oil and gas leases. *See Yoder v. Artex Oil Co.*, 2014-Ohio-5130, ¶ 46-47; *Bilbarian Farm, Inc. v. Bakerwell, Inc.*, 2013-Ohio-2487, 993 N.E.2d 795, ¶ 19-21 (5th Dist.); *Bushman v. MFC Drilling, Inc.*, 9th Dist. Medina No. 2403-M, 1995 WL 434409, *2 (July 19, 1995); *Taylor v. MFC Drilling, Inc.*, 4th Dist. Hocking No. 94CA14, 1995 WL 89710, *2 (Feb. 27, 1995); *Holonko v. Collins*, 7th Dist. Mahoning No. 87CA120, 1988 WL 70900, *2 (June 29, 1988); *Smith v. N. E. Natural Gas Co.*, 5th Dist. Tuscarawas No. 86AP30016, 1986 WL 11337, *2-3 (Sept. 30, 1986). The Seventh District correctly applied settled Ohio law to conclude that the express language of the leases precluded an implied covenant to develop during the primary term of the leases.

B. Lessors' Construction of the Development Provisions Lacks Merit.

Lessors argue that the Seventh District erred in finding that the leases were not subject to an implied covenant to develop during the primary term because the development timelines in the leases are actually "illusory" and a "mere expression of a time table." This argument assumes their construction of the lease as a no-term perpetual lease has merit, which it does not. Lessors fall back on the Court's decision in *Ionno*, arguing that delay rentals paid during the primary term of the leases are just like the advanced royalties paid to extend the term of the no-term lease in *Ionno*. Because this is not a no-term lease like the one at issue in *Ionno*, the Court's decision in *Kachelmacher* is dispositive of this argument.

The remainder of Lessors' arguments take aim at the clear disclaimer of all implied covenants in paragraph 19 of the leases. Because paragraphs 2 and 3 of the leases establish an express timeline for development, there is no basis for reading an implied covenant to develop into these leases. The disclaimer of implied covenants simply reinforces what the clear language of the leases already provides. *See Hupp*, 2014-Ohio-4255, at ¶ 120. While acknowledging that the plain language of paragraph 19 is a "general disclaimer of all implied covenants," Lessors argue that this clear disclaimer is made ambiguous because paragraph 17 of the leases requires that the lessor give notice to the lessee if it believes any obligations under the lease were breached, whether "express or implied." Lessors contend that the notice provision in paragraph 17 could be read as authorizing a cause of action for breach of implied covenants, and that this makes the disclaimer of implied covenants in paragraph 19 ambiguous. The Seventh District correctly rejected this argument, *see Hupp* at ¶ 120, and Lessors advance no new argument showing the Seventh District erred in this construction. As the Seventh District reasoned, the fact that the lessor must give "notice of lessor's belief that an implied covenant was breached does not necessarily *create* implied obligations." *See id.* This was a logical construction that harmonized the language in the leases. Lessors' attempt to distinguish the many Ohio appellate cases enforcing disclaimers of implied covenants — because the leases in those cases did not

contain language similar to paragraph 17 — is unpersuasive for the same reason. Lessors' familiar resort to *Ionno* is equally unavailing, as that case did not involve a disclaimer of implied covenants at all.

The remainder of Lessors' argument seems to be that the enforcement of the disclaimer of implied covenants is unfair. Lessors characterize it as "buried in the text" and "embedded in fine print," and they claim that "lessors are probably unaware" and that enforcement of the implied disclaimer "eviscerates the essence of the parties' agreement as well as the policy giving rise to the implied covenant to develop." (Merit Brief of Appellants Clyde A. Hupp, et al., 38.) These emotional arguments (which lack record support) provide no basis for this Court to re-write the parties' contract so that Lessors have a way to escape their contract when market conditions change and they no longer wish to be bound by an agreement whose terms they now regret:

> "Cases of contractual interpretation should not be decided on the basis of what is 'just' or equitable. This concept is applicable even where a party has made a bad bargain, contracted away all his rights, and has been left in the position of doing the work while another may benefit from the work. Where various written documents exist, it is the court's duty to interpret their meaning, and reach a decision by using the usual tools of contractual interpretation (e.g., the written

documents, the intent of the parties, and the acts of the parties) and not by a determination of what is fair, equitable, or just."

N. Buckeye Educ. Council Group Health Benefits Plan v. Lawson, 103 Ohio St.3d 188, 2004-Ohio-1210, 814 N.E.2d 1210, ¶ 20, quoting *Ervin v. Garner*, 25 Ohio St. 2d 231, 239-240, 267 N.E.2d 769 (1971). "The presumption under Ohio law is the freedom to contract." *Eastham v. Chesapeake Appalachia, L.L.C.*, 754 F.3d 356, 365 (6th Cir.2014), citing *Cincinnati City Sch. Dist. Bd.*, 132 Ohio St.3d 468, 2012-Ohio-2447, 974 N.E.2d 78, ¶ 15. The Seventh District did not err in enforcing the leases as written.

III. CONCLUSION

The Seventh District's decision in this case applied principles of oil and gas law that are well established in Ohio. In asking this Court to reverse that decision, Lessors invite this Court to disregard those well-established principles. The Court should decline that invitation and instead should reaffirm those principles by affirming the decision of the Seventh District Court of Appeals.

Respectfully submitted,

/s/Clair E. Dickinson

Clair E. Dickinson (0018198)
Counsel of Record
Brouse McDowell, L.P.A.
388 South Main Street, Suite 500
Akron, OH 44311

Kevin C. Abbott (0091504)
Reed Smith LLP
Reed Smith Centre
225 Fifth Avenue
Pittsburgh, PA 15222-2716

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing Merit Brief of Appellee XTO Energy Inc. or Alternatively, Merit Brief of Amicus Curiae XTO Energy Inc. were served via ordinary U.S. mail this 22nd day of April 2015 to the following:

Richard V. Zurz Jr.
Slater & Zurz, LLP
One Cascade Plaza, Suite 2210
Akron, OH 44308

Counsel for Plaintiffs-Appellants

Daniel H. Plumly
Critchfield & Critchfield & Johnson,
225 North Market Street, PO Box 599
Wooster, OH 44691

Counsel for Relator Claugus Family Farm, L.P

Michael DeWine
Ohio Attorney General
Sarah Pierce
Assistant Attorney General
Constitutional Offices Section
30 East Broad Street, 16th Floor
Columbus, OH 43215

Counsel for Respondents, Seventh District Court Court of Appeals, Judge Gene Donofrio, Judge Joseph J. Vukkovich, and Judge Mary DeGenaro

Scott M. Zurakowski
Krugliak, Wilkins, Griffiths &
& Dougherty Co., L.P.A.
4775 Munson Street, N.W.
P.O. Box 36963
Canton, OH 44735-6963

Counsel for Appellee Beck Energy Corporation

/s/Clair E. Dickinson
Clair E. Dickinson (0018198)
Brouse McDowell
388 S. Main Street, Ste. 500
Akron, OH 44311
Phone: 330-535-5711
cdickinson@brouse.com

932674