Ohio's Seventh Appellate District reverses Monroe County Trial Court, holds form lease valid

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Ohio's Seventh District Court of Appeals issued a long-awaited decision in Hupp v. Beck Energy Corporation, 2014-Ohio-4255 (7th Dist.), on Friday, September 26. The appellate court's decision upheld the validity of the class action, but overturned the Monroe County Court of Common Pleas' substantive holding that the producer's "form" oil and gas leases were invalid. The Seventh District explained that the trial court misconstrued the effect of the leases' primary and secondary terms, improperly held that the leases were subject to an implied covenant and, thus, reversed the trial court's conclusion that the leases were "perpetual," "no-term" leases that should be voided on policy grounds.

The case centered on a group of landowner-lessors who were dissatisfied with the form oil and gas leases they executed with producer-lessee Beck Energy Corporation ("Beck"). The landowners brought a class-action suit to invalidate the leases, which were substantially the same. The trial court's decision in favor of the landowners found that the leases were "perpetual" in nature and, thus, void as a matter of public policy. Beck appealed the decision.

Rulings On Class Action Issues

From a class action perspective, the court of appeals made some notable procedural rulings in upholding the class action, but ultimately denied the substantive claims underlying the lawsuit. First, citing Civil Rule 23(B)(2), the court held that the rule against one-way intervention, which typically prohibits plaintiffs from joining a class-action suit after a favorable ruling on the merits, did not apply in this lawsuit where the plaintiffs seek only declaratory judgment and no monetary damages. Second, the court held that the trial court did not err in certifying the class of plaintiffs without holding a hearing first, primarily because certification was straightforward and neither party requested a hearing. Finally, the court held that, given its broad discretion over class action issues, the trial court did not err in defining the class more broadly than the plaintiffs sought.

Oil and Gas Holdings

On appeal, the Seventh District opened its decision with an analysis of whether the leases were "perpetual," or "no-term" leases. Broadly speaking, according to the court, the leases were not "no-term lease[s]" because they had "two distinct terms" that did not operate in unison to extend the term indefinitely. More specifically, the court focused on a line of Ohio cases defining the two-tiered structure of the habendum clause. The first tier (the primary term) involves a fixed period of time (in this case 10 years) during which the producer-lessee must drill a well or pay annual delay rental payments. The court also took the important step of explaining that the leases' delay rental provision (whereby the lessee could pay to extend the lease) only applied during the primary term of the lease. "In other words," the court said, "the delay rental payment cannot extend the lease beyond the primary term."

The second tier (the secondary term) extends the life of the leases (i) "so long" as, "in the judgment of the Lessee," "oil and gas or their constituents are produced or are capable of being produced on the premises in paying quantities," or (ii) so long as the lessee operated the premises "in the search for oil or gas." In essence, after the primary term, the leases only extended into the secondary term if one of the two conditions referenced above were satisfied. Limiting the scope of the lease language, the court explained that the phrase "capable of being produced" required more than that the land be capable of producing oil; rather, it "presupposes that a well was drilled and began producing during the primary term of the lease." Further, the court noted that courts impose a good-faith standard to guide the "judgment of the Lessee" in determining whether a well is "produc[ing] . . . in paying quantities." Together, these holdings prevented a finding that the leases were perpetual in nature.

Finally, the court reaffirmed Ohio's implied covenant to reasonably develop the land, but deemed it inapplicable in this case, primarily because the lease contained certain provisions expressly limiting the implied covenant (e.g., a disclaimer).

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