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Evaluating the Validity of Oil and Gas Form Leases in Ohio

In a slip opinion published January 21, 2016,[1] the Supreme Court of Ohio upheld the validity of form leases executed in favor of Beck Energy Corporation ("Beck") affirming a 2014 decision issued by the Seventh District Court of Appeals in *Hustack v. Beck Energy Corp.*[2] The Court also denied a separate appeal to invalidate the tolling of a certain group of the form leases, in the consolidated case of *State ex rel. Claugus Family Farm, L.P. v. Seventh Dist. Court of Appeals,*[3] and refused to grant Beck's motion to toll hundreds of the form leases executed by all certified class members.

Some background is required to unpack the Court's thrifty 13-page decision. The original dispute concerning the form leases began in the Monroe County Court of Common Pleas in 2011, where Larry and Lori Hustack, together with several other plaintiff landowners, filed a complaint alleging that the Form G&T (83) leases ("Form Leases") they had signed in favor of Beck were void *ab initio* as against public policy.[4] Ohio law prohibits the execution of long-term leases under which no development is specifically required (referred to as "perpetual leases"),[5] and the plaintiffs in *Hustack* alleged that because the Form Leases did not require Beck to develop the leaseholds within any particular time period they were invalid as perpetual leases.

Although the Form Leases did not include terms specifically labeled as "primary" and "secondary" terms, they did include language familiar to industry professionals, permitting the leasehold to be "quietly enjoyed by the Lessee for the term of ten years" and extending the leases "so much longer thereafter" as the Lessee produced or operated for oil or gas.[6] If the Lessee was unable to conduct operations during the "primary" term, they were also required under the terms of the lease to pay a delay rental to the landowners every 12 months until the 10-year term expired.[7]

The trial court found that the Form Leases were, as the *Hustack* plaintiffs suggested, void *ab initio* as against public policy, and in 2013, granted summary judgment to the plaintiffs. The court also granted plaintiff class certification to *all* landowners in Ohio who had signed the Form G&T (83) lease and "upon whose land no preparations for drilling had occurred."[8] The trial court granted Beck's motion to toll the terms of all Form G&T (83) leases as to said class of plaintiffs during further resolution of the dispute at the Seventh District Court of Appeals.[9]

Upon appeal, the Seventh District modified the trial court's tolling order to only include leases signed by any class members as of October 1, 2012.[10] However, the Seventh District's ultimate opinion in the case, issued in 2014, reversed the trial court's determination that the Form Leases were invalid. The Seventh District held that because the leases required Beck to pay a delay rental in lieu of drilling during the primary term said leases were not void *ab initio* as against public policy.[11]

Both plaintiffs and defendants subsequently agreed that the tolling of said leases would continue as previously ordered while the Seventh District's decision was appealed to the Ohio Supreme Court. Meanwhile, back in Monroe County, the Claugus Family owned property subject to a Form G&T (83) lease, which had been executed by their predecessors-in-ownership in favor of Beck back in 2004; ergo, the Claugus Family ("the Family") expected the 10-year term of said lease to expire in early 2014.[12] However, because the trial court in *Hustack* had recertified the plaintiff class to include unnamed class members, the Claugus Family was not directly provided with notice of the suit, and was unaware of its effect on their lease.[13] When the Claugus Family unsuccessfully attempted to execute a new lease with a second operator just prior to the expiration of their Form Lease, they were informed that the

Hustack tolling order held their Form Leases during the dispute, which was consequently a title defect.

The Claugus Family therefore filed a complaint directly to the Ohio Supreme Court, challenging the Seventh District's tolling order in *Hustack* as a violation of their rights as landowners and as a breach of due process.[14] The *Hustack* and *Claugus* cases were consolidated by the Supreme Court of Ohio on February 3, 2015, and oral arguments were held thereafter.[15]

In a short majority opinion issued January 21, 2016, authored by Justice French and joined by Chief Justice O'Connor and Justices Lanzinger, Kennedy, and O'Neill, the Court briefly reviewed the Seventh District's decision in *Hustack,* and even more briefly discussed the Claugus Family's challenge to the tolling order. The Court affirmed the Seventh District's decision to uphold the Form G&T (83) leases as valid, stating that the leases required Beck Energy Corporation to take *some* activity during the primary term of the lease, even if only to pay delay rentals, and that the leases could only be extended thereafter by drilling or other operations: the instruments were therefore not void *ab initio* as perpetual leases.[16]

The Court also upheld the Seventh District's decision to toll the terms of said leases as to named plaintiffs during the resolution of the dispute and agreed with the Seventh District's decision to toll said leases as to all members of the class as they existed on October 1, 2012, and not merely as to named plaintiffs.[17] Furthermore, due to the validity of the leases, the Court denied the *Claugus* plaintiffs' motion challenging the enforcement of the trial court's tolling order.[18]

Although at first blush the Ohio Supreme Court's determination in this case favors Beck Energy Corporation as the holder of the valid Form Leases, the reality is that Beck and its successors will essentially have as much time to meet their obligations under their Form G&T (83) leases as they had on October 1, 2012, or they risk losing their interests. Operators should also consider the case to be a warning sign that if a landowner decides to litigate the validity of a lease prior to the expiration of its primary term, the Court cannot be relied upon to grant the operator additional time in which to commence operations.

On the other hand, as pointed out in a spirited partial dissent written by Justice Pfeifer and joined by Justice O'Donnell, the interests of landowners who belong to the certified class of unnamed plaintiffs may not have been aligned with the interests of the named plaintiffs. After all, the Hustacks wanted their Form Leases to be declared invalid *ab initio*, but the Claugus Family and similar parties would have preferred that the Form Leases be considered valid and therefore expired under their own terms. The unnamed class of landowners who executed Form Leases prior to October 1, 2012, now find themselves in the highly unfavorable position of being stuck with leases tolled to remain within the 10-year primary term, even though they (as unnamed members of the class) did not intervene in the original suit in time to protect their own interests.

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[1]*State ex rel. Claugus Family Farm, L.P. v. Seventh Dist. Court of Appeals,* No. 2016-Ohio-178 (Ohio Jan. 21, 2016).
[2]No. 2014-1933; decision of Seventh District originally published at No. 2014-Ohio-4255, 20 N.E.3d 732 (Ohio App. 7th Dist. 2014).
[3]No. 2014-0423 (Ohio App. 7th Dist. 2014).
[4]*State ex rel. Claugus,* at 3.
[5]*Ionno v. Glen-Gery Corp.,* 2 Ohio St.3d 131, 443 N.E.2d 504 (Ohio 1983).
[6]*State ex rel. Claugus,* at 7-8.
[7]*Id.*
[8]*Id. at 3.* Original class certification was any landowners who had signed the Form G&T (83) lease.
[9]*Id. at 4.*
[10]*Id.*

[11]*State ex rel. Claugus,* at 4.
[12]*Id.* at 5.
[13]*Id.* at 6.
[14]*Id.* at 5-6.
[15]*Id.* at 6.
[16]*State ex rel. Claugus,* at 9-10.
[17]*Id.* at 12.
[18]*Id.*

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