FIVE STEPS FOR IN-HOUSE COUNSEL FACING OIL AND GAS LEASE EXPIRATION CLAIMS

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INTRODUCTION

The typical oil and gas lease has a habendum clause that provides for a fixed primary term within which the lessee/operator must comply with certain requirements and a secondary term that lasts for "so long as" oil or gas operations or production take place on the leased premises or lands pooled therewith.[1] The interests created by the lease may expire if the lessee fails to satisfy conditions or engage in certain activities during either the primary or secondary terms of the lease.[2]

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[1] A "habendum clause" in an oil and gas lease is "[t]he clause in a deed or lease setting forth the duration of the grantee's or lessee's interest in the premises." *See* PATRICK H. MARTIN & BRUCE M. KRAMER, 8 WILLIAMS & MEYERS, OIL AND GAS LAW SCOPE (2019) ("WILLIAMS & MEYERS, MANUAL OF TERMS"); 3 WILLIAMS & MEYERS, OIL AND GAS LAW § 601.4 (2019) ("WILLIAMS & MEYERS") ("The habendum clause of virtually all contemporary leases provides for a short primary term of from one to ten years and provides that the lease may be preserved beyond the expiration of the primary term 'so long thereafter' as oil or gas (or other specified minerals) is produced in paying quantities.").

[2] Hite v. Falcon Partners, 13 A.3d 942 (Pa. Super. 2011) (lease expired for lack of operations or production; payment of delay rentals keep the lease alive for the primary term only, not the secondary (perpetual) term); *see also* Wilson v.

Oil and gas lease expiration issues frequently arise for exploration and production companies and their in-house counsel. But a lease expiration claim is only one of many other problems in-house counsel for E&P companies might face on any given day. In light of that, this article is designed to give busy in-house counsel a five-step approach when facing lease expiration claims. These steps can be summarized as follows:

- ***First***, understand why landowners try to terminate their lease. Knowing their motivations will help in-house counsel evaluate their claims and better recommend business-oriented solutions for the E&P company.

- ***Second***, determine whether the lease matters. This has nothing to do with the law; it has everything to do with prioritizing assets. If the lease is inconsequential, there may be no need to expend time and resources defending against the lease expiration claim (unless there is some other compelling reason to do so).

- ***Third***, if the lease is important to the company, evaluate the claims with outside counsel. Lease expiration claims are like fingerprints – no two are exactly alike. This is where in-house counsel and outside counsel can work closely together to evaluate the law in the relevant jurisdiction and identify strengths and weaknesses of the company's defense.

- ***Fourth***, decide whether to litigate and, if that decision is a "yes," then develop an efficient plan. Unfortunately, most lease expiration cases feel like "all or nothing" propositions – the E&P company says the lease is in full force and effect, the landowner says it is not. There is often no middle ground to work with. However, many lease expiration cases can be decided on the law based on the terms of the agreement, often without the need for any (or very little)

Snyder Bros., Inc., 2020 PA Super 113, 2020 WL 2313813, at *5 (Pa. Super. Ct., May 11, 2020) (lessee maintained lease by making annual delay rental payments for seven years followed by a ratification of the lease before drilling and no facts demonstrating cessation of production during secondary term).

fact development, so counsel should focus intently on pursuing early dismissal opportunities to avoid the burden of discovery and trial.

- ***Fifth***, learn from lease expiration claims. If a lease contains particular language that resulted in a lawsuit (whether successfully defended or not), the company should reconsider that language when drafting future leases. Counsel can provide value to their clients by revisiting bad language and revising lease forms to avoid future litigation expenses.

We explore these steps in more detail below.

I. UNDERSTANDING LEASE EXPIRATION CLAIMS

At the outset, in-house counsel who may be new to the company or unfamiliar with the oil and gas industry should understand why E&P companies often face lease expiration issues.

Most landowners lack the technical and financial capabilities to engage in exploration and production on their properties given the high capital expenditures and technical expertise required to drill wells, particularly in unconventional plays like tight shale or similar oil or gas bearing formations. The way landowners realize value for the natural resources underlying their property is to convey leasehold interests to companies that have sufficient access to capital and the technical expertise to drill expensive wells.

Consequently, landowners who lease their oil and gas interests do so with business purposes in mind. Owners convey their oil and gas rights to E&P companies often for a per-acre payment up front, and always for the opportunity to receive royalties free of the costs of exploration and production if/as/when production occurs.

So why would a landowner ever want out of an oil and gas lease given the significant opportunities for financial gain? Although the reasons may vary, the typical lease expiration claim arises because:

- A landowner believes that he or she got a bad deal to begin with.

- A landowner believes that he or she can get a better deal either from the same company or another company if he/she challenges the lease.

- A landowner already got a better deal through a "top lease" with another company and wants the "base lease" (i.e., the original lease) to expire so the top lease can take effect.

Understanding these motivations may help in-house counsel better evaluate lease expiration claims. Once counsel fully understands the motivation behind lease expiration claims, it will be easier to evaluate the claims and make informed business decisions.

II. PRIORITIZING LEASE EXPIRATION CLAIMS

When in-house counsel receives word that the company faces a lease expiration claim, counsel should ask whether the lease even matters to the company and its future business plans. While oil and gas leases are important and valuable assets that provide opportunities for exploration, development, and even the ability to trade for other leases, some companies lease more acreage than they ultimately need or want, leading to excess leased acreage.

Before evaluating the merits of a lease expiration claim, in-house counsel should discuss the following questions with individuals in the company's land department, including geologists, and others involved in developing drilling plans and schedules:

- Does the company care about this lease?

- Does the lease cover wildcat acreage, unproven acreage, proven but undrilled acreage, or proven and producing acreage?

- Is the lease in a unit, and where is the lease within the unit?

- Does the lease cover a drill-site tract within a unit (perhaps more important and valuable) or a non-drill-site tract within a unit (perhaps less important or valuable)?

- Is there anything special about the lease that inures to the company's benefit for operations or other reasons (i.e., can

it be used as a staging area for access to well sites on a unit or for other unit operations)?

- Is there anything cumbersome about the lease that puts the company at a disadvantage?

- Where does the lease fit within the company's overall objectives of developing the particular unit, field, or play as a whole?

If business considerations dictate that the lease is inconsequential, the company may inform the landowner that the company agrees that the lease expired or does not intend to fight the claim or will agree to execute and record a surrender document. (Some states, like Pennsylvania, require a written and recorded surrender.)[3]

This approach serves as a helpful screening process for in-house counsel facing lease expiration claims (sometimes many of them). In this way, much of the initial evaluation work can be done internally so that resources are not spent on outside counsel when the lease is unimportant from a business standpoint.

III. EVALUATING THE MERITS OF LEASE EXPIRATION CLAIMS

If the lease is important to the company, the next step will be evaluating the claim. Preliminarily, in-house counsel should:

- Identify if the claim is a "primary term" claim or a "secondary term" claim.

- Carefully study the relevant language contained in the oil and gas lease in question and review the laws of the jurisdiction governing the lease to spot preliminary issues and possible defenses.

- Make a preliminary decision about litigation.

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[3] *See* 58 P.S. §§ 901-905.

Some leases are particularly important to the overall drilling plan such that companies are compelled to invest significant resources in their defense rather than risk losing the lease. Others may be important enough to a company to warrant a legal defense but they may not wish to expend significant resources disproportionate to the value of the lease. Outside counsel with experience in lease expiration issues can help by further evaluating the claim with in-house counsel to develop an effective dispute resolution or litigation plan that suits the needs of the company based on the relative importance of the lease.

For reference, the following are among the most common issues associated with lease expiration claims along with brief descriptions of the law governing them.

A. Primary Term Claims

For "primary term" claims, the most common issues include: (1) whether the lessee has properly paid "delay rentals" or other preliminary payments to maintain the lease for the first fixed period; (2) whether the lessee has "commenced operations" during the primary term sufficient to keep the lease from expiring; and (3) whether there are other ways to extend the primary term.

(1) Delay Rentals or Extension Payments

Delay rentals are payments in lieu of operations that maintain the lease for the duration of the primary term.[4] The payment creates an option to keep the lease alive for the primary term so the operator may, if it chooses, drill a well during that time.[5] Some leases require annual delay rental payments, while others are "paid up," meaning that the lessee pays all delay rentals required to keep the lease alive during the primary term at the time of executing the lease rather than making annual payments. Once the lessee makes or tenders full payment, the primary term should last for that fixed amount of time.

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[4] *See, e.g.*, Glasgow v. Chartiers Oil Co., 25 A. 232 (Pa. 1892); Bertani v. Beck, 479 A.2d 534 (Pa. Super. 1985); In re Estate of Slaughter, 305 S.W.3d 804 (Tex. App. 2010).

[5] *Slaughter*, 305 S.W.3d at 804; *see also*, *e.g.*, *Hite*, 13 A.3d at 942.

Delay rental issues include whether the lessee has tendered payment; if so, whether the lessee has tendered payment properly; and if not, whether the lease should expire for non-payment or improper payment.

Courts in many jurisdictions strictly construe delay rental provisions and require timely payment to the proper party in the proper amount and in the manner specified. How strictly the courts construe the delay rental provision depends on the language of the lease. If the delay rental provision is couched as a condition instead of a covenant and the lessee fails to pay or fails to pay properly, that failure puts the lease at risk. If, however, the delay rental provision is couched as a covenant (i.e., a promise) to pay, then there is a possibility that the courts will construe any failure to make payment as a breach entitling the lessor to payment of the rental rather than an order cancelling the lease.[6]

In addition to delay rentals, some leases have clauses authorizing the lessee to extend the primary term of the lease for an additional term of years (usually a term equal to the term of the original primary term). By making or tendering payment, the lessee can extend the primary term of the lease for this additional fixed term. Generally, the same rules that govern delay rentals apply to extension payments.

In light of these general rules, in-house counsel should ask several key questions when facing delay rental claims:

- Has the company tendered payment?
- Were payments made to the right person, at the correct place, in the right amount, and within the time specified by the lease?
- Did the landowner accept payment, such as by cashing the check?

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[6] *See, e.g.*, Hitzelberger v. Samedan Oil Corp., 948 S.W.2d 497 (Tex. App. 1997); Schwartzenberger v. Hunt Trust Estate, 244 N.W.2d 711 (N.D. 1976).

- If there was a problem with payment, is the problem curable in this jurisdiction?

- If the problem can be remedied, how can the company cure the claim based on the language of the lease?

Although lease expiration claims based on the failure to pay delay rentals or extension payments tend to be straightforward, the law in some jurisdictions is not very sympathetic when lessees fail to tender proper payments to satisfy primary term obligations.

(2) Commencement of Operations

"Commencing operations" is another way to maintain the lease in the primary term and in most situations keeps the lease from expiring at the end of that term.

In many (if not all) jurisdictions, "commencing operations" means that, during the primary term, the lessee has engaged in some activity on the leased premises or lands pooled or combined therewith to drill and complete a well. Unless otherwise required by the lease, actual drilling is not required. The test is fact specific: courts evaluate the activities of the lessee, the lessee's good faith in engaging in those activities to establish production (as opposed to holding the lease for speculative purposes), and the lessee's diligence in carrying out those operations.[7]

Many activities short of actual drilling qualify as "commencing operations," including surveying the property, staking the property, mobilizing equipment and materials, clearing the area for the well pad, earthmoving activities, and (of course) drilling and completing a well.[8] Note, however, that the State of Texas requires more than "back office" operations (like negotiations, planning activities, or obtaining well permits) that do not involve any actual physical

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[7] *See, e.g.*, Rippy Interests, LLC v. Nash, 475 S.W.3d 353 (Tex. App. 2014); Breaux v. Apache Oil Corp., 240 So. 2d 589 (La. App. 1970).

[8] *See* Roe v. Chief Exploration & Development, LLC, No. 11-00816, 2013 U.S. Dist. LEXIS 113914 (M.D. Pa., Aug. 13, 2013); Petersen v. Robinson Oil & Gas Co., 356 S.W.2d 217 (Tex. App. 1962).

activity on the leased premises.[9] Nevertheless, although those activities might not be enough standing alone to qualify as commencing operations, they should be relevant when evaluating the good faith of the lessee.

Texas and Pennsylvania courts generally agree that if a lessee commences operations during the primary term and finishes the job after the primary term expires, that is virtually conclusive evidence of the lessee's good faith intention to commence operations during the primary term with the goal of drilling and completing a well as opposed to holding the lease for speculative purposes.[10]

When defending against claims that the lease has expired for failure to commence operations, the key is to develop a detailed timeline of operations and support the timeline with documents to establish the life cycle of the well operations. A timeline will help establish the good faith intention of the lessee to actually drill a well and establish production rather than engaging in minimal activity at the last minute in order to keep the lease alive for merely speculative purposes. Although, standing alone, "back office" operations may be insufficient to establish the commencement of operations, that information should still be included in the timeline because it may be relevant to establish the lessee's good faith.

(3) Equitable Extension of the Primary Term

The final question is whether there are any other ways to extend the primary term's deadline. If a lessor has challenged the validity of the lease during the primary term, the "equitable extension" doctrine recognized by virtually all oil and gas jurisdictions may apply to add time onto the primary term.

The "equitable extension" doctrine provides that a lessor repudiates a lease by challenging its validity; if the lessor is unsuccessful, the lessee is entitled to an extension of the primary term for the same amount of time it took to litigate the unsuccessful lease validity claim. The rationale is that no prudent operator would

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[9] *See* Gulf Oil Corp. v. Reid, 337 S.W.2d 267, 268 (Tex. 1960).
[10] *Petersen*, 356 S.W.2d at 217; *Roe*, 2013 U.S. Dist. LEXIS 113914.

proceed with the significant expense of drilling operations while the validity of the lease hangs in the balance. Although most jurisdictions recognize the doctrine, some (like Pennsylvania) do not.[11]

If a lessor sues during the primary term with a claim that the lease has expired, counsel for the company should consider ways to raise the equitable extension doctrine in the case to assure that, if the company prevails, it gets additional time added to the primary term that it lost pending the outcome of litigation.

B. Secondary Term Claims

For "secondary term" claims, the most common issues include (1) whether the company has established "production" "in paying quantities" and (2) whether there are any substitutes for production that operate to prevent the lease from expiring.

(1) Production in Paying Quantities

Courts in Texas have concluded that "production" means actual production and marketing in order to prevent the lease from expiring.[12] By contrast, some states have concluded that a well "capable" of production is sufficient to prevent the lease from expiring as long as the lessee proceeds with diligence thereafter to market the gas.[13]

Production in "paying quantities" means the well pays or will pay a profit, however small, over operating costs (including labor, trucks, transportation, and other day-to-day costs but generally not including capital costs of the well). The test is relatively straightforward: If a well pays a profit over costs for a reasonable and relevant period of time, the well is producing in paying quantities. If, however, a well is "marginal" (i.e., not producing in paying quantities for a substantial period of time), the test is whether a reasonably prudent operator would continue to operate the well the

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[11] *See* Harrison v. Cabot Oil & Gas Corp., 110 A.3d 178 (Pa. 2015).
[12] Stanolind Oil & Gas Co. v. Barnhill, 107 S.W.2d 746 (Tex. App. 1937).
[13] Pack v. Santa Fe Minerals, 869 P.2d 323 (Okla. 1994).

same way for purposes of making a profit and not merely to hold the well for speculative purposes. To determine whether it is "reasonable" for an operator to continue operating a marginal well, the courts consider (1) other wells in the area; (2) the remaining productivity of the reservoir; (3) market; (4) costs; (5) net profit; and (6) reasonable basis for expecting a profit.[14]

If a lessor claims that the lease has expired for lack of "production in paying quantities" during the secondary term, in-house counsel should collaborate with land and operations departments and get a sense of the answers to the following questions:

- Is there a producing well on the property or on a unit that includes the property?
- If so, on what date did the well first start producing?
- Is the well generating a profit over operating costs and how much?
- If the well is producing but in a marginal or sporadic way, is it reasonable for the company to continue operating the well for purposes of making a profit and why?
- If there is a well that is not producing, is the well capable of production (i.e., drilled and completed but shut-in and waiting on a pipeline)?
- Does the lease require actual production or capability of production?
- If the lease is unclear, do courts in this jurisdiction interpret "production" to mean "actual production" or "capable of production"?

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[14] *See, e.g.*, Clifton v. Koontz, 325 S.W.2d 684, 691 (Tex. 1949); *cf.* T.W. Phillips Gas and Oil Co. v Jedlicka, 42 A.3d 261 (Pa. 2012) (adopting a similar standard but focusing on the subjective "good faith judgment" of the particular operator in question).

These issues often arise in situations where the company has acquired older leases long held by production given that many modern lease forms account for these scenarios to avoid lease expiration. Consequently, older leases – that do not account for these scenarios – present challenges for in-house counsel when facing lease expiration claims particularly in jurisdictions where the law is not as well developed as other jurisdictions.

(2) Substitutes for Production in Paying Quantities

Finally, many leases incorporate a number of substitutes for production that operate to maintain the lease in the absence of actual production. If the company faces a lease expiration claim based on a failure to produce, in-house counsel should scan the lease to determine if there are substitutes for production and if they apply:

- ***Is there a pooling clause?*** Pooling clauses authorize lessees to combine leased properties and operate them all as one unit.[15] Absent contrary language in the lease, operations or production on any property in the unit is treated as if it occurred on every property in the unit.[16] If the lease in question is in a unit and the company otherwise engaged in timely operations to maintain the lease somewhere on that unit, then that activity should be attributed to the property subject to the lease in question.

- ***Is there a Pugh Clause?*** A Pugh clause modifies the pooling clause by giving the lessee the ability to hold only such acreage the lessee includes in the unit and must release the

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[15] WILLIAMS & MEYERS, MANUAL OF TERMS, *supra* n.1, at 784 ("A lease clause authorizing a lessee to 'pool' or join the particular leased premises with other leases for the purpose of aggregating a tract sufficient for a well permit under applicable spacing regulations. Also, a lease clause authorizing the lessee to unitize the leased premises with other parcels."); *see also* WILLIAMS & MEYERS §§ 668-670.8.

[16] *See, e.g.*, Snyder Bros., Inc. v. Yohe, 676 A.2d 1226 (Pa. Super. 1996); Southland Royalty Co. v. Humble Oil & Refining Co., 249 S.W.2d 914 (Tex. 1952).

rest.[17] So, if a lessee pools 50 acres of a 100-acre tract into a unit, the lease expires as to the 50 acres that the lessee omitted from the unit. However, certain operations clauses give lessees the opportunity to "save" the acreage from "Pugh-ing out" if the lessee is engaged in operations at the end of the primary term and finishes a well within a certain time that serves to hold the otherwise Pughed-out acreage.

- ***Is there a shut-in royalty clause and is the company making payments?*** A shut-in royalty clause lets the lessee make a payment on a well that is shut-in and not producing without risking termination under the lease.[18] Typically, lessees rely on shut-in payments when the last producing well on the leased premises or unit must be shut in (for whatever reason). However, if there are other producing wells on the leased premises or pooled or unitized land, there is generally no need for any shut-in payment in order to keep the lease alive unless the lease otherwise provides. As with delay rental payments, the failure to pay shut-in royalties when they are necessary to maintain the lease may have significant consequences. When the lease provides that the lessee covenants or promises to pay shut-in royalties, the failure to pay them promptly may give rise to a claim for payment but should not give rise to a claim for cancellation. However, if the lease is couched in mandatory terms and the lessee fails to properly pay shut-in royalties, that may give rise to a claim for cancellation (assuming no other provisions of the lease

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[17] A Pugh Clause has been defined as: "The name given to a type of pooling clause which provides that drilling operations on or production from a pooled unit or units shall maintain the lease in force only as to lands included within such unit or units. This clause was said to have been originated in 1947 by Lawrence C. Pugh of Crowley, Louisiana, and it take its name from him." *See* WILLIAMS & MEYERS, MANUAL OF TERMS, *supra* n.1, at 848. *See also* Sandefer Oil & Gas v. Duhon, 961 F.2d 1207, 1209 (5th Cir. 1992) ("The main purpose of any Pugh clause is to protect the lessor from the anomaly of having the entire property held under a lease by production from a very small portion.") (citations omitted).

[18] WILLIAMS & MEYERS, MANUAL OF TERMS, *supra* n.1, at 968 ("[A] lease clause which authorizes a lessee to pay a shut-in gas well royalty and thereby keep a lease alive without actual production when and if a well has been drilled which is capable of producing gas in paying quantities but which is shut-in, usually by reason of lack of a market."); Wheeland Family Ltd. Partnership LP v. Rocdkale Marcellus LLC, No. 4:18-CV-01976, 2019 WL 2868937, (M.D. Pa. July 3, 2019).

apply to keep the lease alive).[19] In-house counsel should always ask whether the company has made shut-in payments for any well that is capable of actual production but shut in for whatever reason.

- ***Is there an operations clause that applies?*** An "operations" clause accounts for situations in which the lessee either drills a "dry hole" or does not finish drilling a well that either produces or is capable of producing in paying quantities within the time frames required by the lease.[20] In those circumstances, leases may grant the lessee a right to start drilling a new well and produce oil or gas within some additional period of time specified by the lease (e.g., 60, 90, 120 days) without allowing the lease to expire. If the lease contains an operations clause, in-house counsel should establish a timeline of events showing that the company properly maintained the lease.

- ***Is the company facing a force majeure event that explains the lack of production?*** Sometimes lessees face situations in which they have not established production due to forces beyond their control. In this situation, a force majeure clause may operate as a substitute for production. Force majeure is generally hard to establish and it is often difficult for lessees to invoke the clause successfully absent extraordinary circumstances.[21]

- ***Does the company have and is it exercising any storage rights?*** Some leases, particularly in Appalachia, expressly grant storage rights, and some do not. Those that grant

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[19] *See, e.g.*, Freeman v. Magnolia Petroleum, 171 S.W.2d 339 (Tex. 1943).

[20] There are many variations of operations clauses in oil and gas leases. For a detailed review, *see* WILLIAMS & MEYERS, *supra* n.1, §§ 611-630. For example, a continuous drilling operations clause is "[a] lease clause providing that a lease may be kept alive after the expiration of the primary term and without production by drilling operations of the type specified in the clause continuously pursued." WILLIAMS & MEYERS, MANUAL OF TERMS, *supra* n.1, at 212. *See also* 3 WILLIAMS & MEYERS, *supra* n.1, § 617; Bruce M. Kramer, *Oil and Gas Leases and Pooling: A Look Back and a Peak* Ahead, 45 TEX. TECH L. REV. 877, 881 (2013).

[21] *See, e.g.*, Beardslee v. Inflection Energy, LLC, 798 F.3d 90 (2d Cir. 2015); Sun Operating P'ship v. Holt, 984 S.W.2d 277 (Tex. App. 1998).

storage rights provide another opportunity to maintain the lease without actual production on the leased premises or lands pooled therewith. (If the lease does not grant storage rights, the analysis ends there.)[22] Accordingly, counsel for the company should determine if the lease contains storage rights and whether the company is exercising those rights.

- ***Is there an express "cessation of production" clause?*** Well operators often shut down a well for a variety of reasons. Many leases account for that scenario and include another type of operations clause that says a lease will not expire if the lessee takes the well offline for operational or other reasons.[23] As with other operational issues and related lease provisions, in-house counsel should develop a timeline and identify the circumstances that caused the company to temporarily cease production to be sure that the reasons are consistent with the justifications for stopping production that are expressed in the lease.

- ***Does this jurisdiction recognize the implied "temporary cessation of production" doctrine?*** In the absence of an express cessation of production clause, many oil and gas producing jurisdictions have recognized an implied, "temporary cessation of production" doctrine. Under many court decisions, a temporary cessation of production does not automatically terminate a lease. Courts in Texas evaluate several factors to determine whether the doctrine should apply to save the lease, including (1) the length of cessation of production; (2) the cause of the cessation; (3) the lessee's efforts to restore production. The rationale for the doctrine is that, during its life cycle, a well is bound to stop producing at some point for some reason—*e.g.*, for reworking, stimulation, or repair (to name a few). Courts in Texas presume that the parties contemplated this situation when they entered the lease, so the courts read the temporary cessation of production doctrine into the lease as a practical way to avoid the harsh result of automatic termination for

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[22] *See, e.g.*, Warren v. Equitable Gas Company, LLC, 120 A.3d 369 (Pa. Super. 2015).

[23] *See* WILLIAMS & MEYERS, *supra* n.1, §§ 611-630.

lack of production during the secondary term.[24] If the jurisdiction recognizes this doctrine, the company should take advantage of it to avoid "gotcha" cases where landowners attempt to terminate a lease following a brief legitimate cessation of production.[25]

In addition to any favorable language in the lease, in-house counsel should identify the equities in the company's favor when defending claims that an otherwise valid and subsisting lease has expired for lack of production. Courts tend to abhor a forfeiture, and counsel for the company should assert any available equitable justifications to maintain the lease, particularly when the lease language is favorable and the company risks a forfeiture of property rights that it has acquired and sought to maintain by operations or other activities at very great expense.

IV. LITIGATING LEASE EXPIRATION CLAIMS

As noted above, lease expiration claims often feel like "all or nothing" propositions given that the landowner claims the lease has expired and the E&P company claims the lease continues to exist. That dynamic leaves little room for meaningful negotiation at the outset of the case. Consequently, at least some amount of litigation may be a foregone conclusion. In addition to preliminary matters applicable to all litigation (such as issuing litigation hold notices, identifying persons with knowledge, gathering and preserving evidence, etc.), in-house counsel should take the following steps:

- ***Prepare a response to any demand.*** If a landowner has indicated his or her lease has expired, or has made a formal demand claiming expiration, but has not yet filed suit, the

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[24] *See, e.g.*, Krabbe v. Anadarko Petroleum Corp., 46 S.W.3d 308 (Tex. App. 2001); Landover Production Company, LLC v. Endeavor Energy Resources, L.P., 2014 Tex. App. LEXIS 11990 (Tex. App. 2014).

[25] *See* 72 P.S. § 1610-E (codifying Pennsylvania's version of the temporary cessation of production doctrine); *cf.* SLT Holdings, LLC v. Mitch-Well Energy, Inc., 217 A.3d 1258 (Pa. Super. 2019), *petition for allowance of appeal granted*, --- A.3d ---, No. 6 WAP 2020, 2020 WL 1862111 (losing/abandoning lease for lack of production in paying quantities, failure to pay shut-ins, implied covenant issues, and failure to meet a drilling commitment).

company should prepare and send a response explaining why the lease remains in full force and effect (whether or not the lease requires a response). Sometimes lease expiration disputes go away following an explanation from the company. A formal response gives the landowner the courtesy of a reply and gives the company an opportunity to state its position. In-house counsel can make the judgment call of whether the response should come from the company or from outside counsel (e.g., if the landowner is represented, in-house counsel may want the company's outside lawyer sending the response). The letter should be respectful and provide enough detail so that the landowner (and his or her counsel) can consider the strengths of the defense. Counsel should be mindful that if the response fails to persuade the landowner to drop his or her demand, the letter will most likely end up attached to the landowner's complaint.

- ***Evaluate options for the most beneficial forum.*** Venue is always an important consideration in litigation, and the same is true for lease expiration claims. Counsel should determine whether the lease contains an arbitration provision or any forum-selection clauses, evaluate possible removal options, and decide based on the outcome of the results of this review where best to litigate the case.

- ***Evaluate early dismissal opportunities.*** Many lease expiration cases can be decided on the law based on the terms of the agreement without the need for a trial on the merits. Counsel for the company should therefore focus intently on pursuing early dismissal opportunities to avoid the burden of discovery and trial. The opportunities for early dismissal often present themselves even in seemingly fact-specific cases involving questions about whether the company commenced operations in a timely and sufficient manner, or whether a well is producing "in paying quantities."

V. LEARNING FROM LEASE EXPIRATION CLAIMS

Finally, in-house counsel can provide a valuable service to the E&P company by working with outside counsel to review and modify lease forms. When drafting new leases or revising existing lease forms, in-house counsel should consider:

- ***Avoiding conditional language.*** As noted above, there is a material difference between a condition and a covenant in oil and gas law. If the lessee breaches a condition, its leasehold estate is at risk; if the lessee breaches a covenant, the leasehold estate is not at risk, but the lessee may be liable for damages. Unless otherwise prohibited by law, the lease should include promissory language, not conditional language. For example, counsel should draft the company's performance obligations, particularly payment obligations (like delay rentals, shut-in royalties, and production royalties) as promises to pay such that the failure to make proper payment should be construed as a mere breach of a promise to pay that entitles the lessor to damages as opposed to an order cancelling the lease.

- ***Using broader language for more flexibility.*** Broad language in favor of a lessee provides flexibility that can protect a lessee's interests years down the road. For example, use of the word "tender" in connection with the lessee's payment obligations allows a lessee to satisfy its payment obligations once payment is sent, regardless of whether the payment has been delivered, or whether the lessor has accepted the payment. In addition, defining the term "operations" broadly to include not only physical activity on the leased premises but any activity undertaken by the lessee that is commensurate with or related to the drilling and completion of a well and/or the establishment of production is a way a lessee can protect its interests in a lease expiration scenario. Defining the term "production" as "capable" of production with the "capability" determination left to the discretion of the lessee is another wise revision that may result in the lease being protected from expiration from a lack of "actual" production.

- ***Incorporating as many substitutes for production into the lease as possible***. Oil and gas production is a difficult and expensive endeavor, and there are significant costs and resources devoted to drilling wells. The lease form has evolved over the years to account for that situation. Properly drafted, the lease should incorporate as many layers of security against termination as possible to account for situations where a producing well is marginal or ceases production for legitimate reasons.

These drafting considerations may help avoid future litigation expenses associated with defending a lease that may contain ambiguous or otherwise "bad" language. In short, the lease should be designed to give the company appropriate time to engage in operations if it elects to do so and, once so engaged, to keep the lease for as long as it is profitable to do so.

CONCLUSION

When facing lease-expiration claims, in-house counsel can provide valuable assistance to the E&P companies they serve by first evaluating how (if at all) the challenged lease fits into the company's business plans, then establishing an effective litigation plan to defend leases that are important to the company, and finally revising lease forms with better and more flexible language that may help the company avoid future challenges questioning the validity of its valuable assets.

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