THE IMPLIED COVENANTS AND THEIR ROLE IN OHIO OIL AND GAS LAW

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I. INTRODUCTION

The oil and gas industry in Ohio, as well as surrounding states like West Virginia, New York, and Pennsylvania, is in the early stages of what is expected to be a lengthy boom in production due to extraction of natural gas from the Marcellus and Utica Shale regions.[1] This boom will expand an industry[2] that has been economically valuable to the Buckeye State since the middle of the 19th century.[3] Hydraulic fracturing (or "fracking")–the method being utilized to tap into the Marcellus and Utica–has been used in Ohio for more than 40 years,[4] but recent advances have combined the process of fracking with horizontal drilling[5] to lead to a large increase in the ability to cost-effectively extract oil and gas industry in the state. Fracking has

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[1] "The evidence in Pennsylvania and other Appalachian states is too striking to ignore: Our region is approaching a decades-long resurgence of growth in energy, manufacturing and industrial output that will be the envy of states around the nation." Louis D'Amico et al. Editorial, *Natural gas drives energy, manufacturing rebirth in Pennsylvania*, THE ERIE TIMES-NEWS, Oct. 11, 2012.

[2] The first oil well in Ohio was drilled in 1814, although this was done by accident. Sheila Nolan Gartland, *Crude Awakening: Anticipated oil and gas production in Ohio*, 25 OHIO LAW. 10, 11 (2011).

[3] Since 1860, Ohio has produced over 8.5 trillion cubic feet of natural gas and 1.14 billion barrels of crude oil, totaling an approximate worth of 124.4 billion dollars. KLEINHENZ & ASSOCIATES, OHIO'S NATURAL GAS AND CRUDE OIL EXPLORATION AND PRODUCTION INDUSTRY AND THE EMERGING UTICA GAS FORMATION - ECONOMIC STUDY IMPACT, 5 (2011), *available at* http://heartland.org/sites/default/files/Ohio%20Natural%20Gas%20and%20Crude%20Oil%20Industry%20Economic%20Impact%20Study%20September%202011.pdf.

[4] OHIO DEPARTMENT OF NATURAL RESOURCES, THE FACTS ABOUT HYDRAULIC FRACTURING, *available at* http://ohiodnr.com/Portals/11/pdf/fracking-fact-sheet.pdf.

[5] American Petroleum Institute, *Hydraulic Fracturing: Unlocking America's Natural Gas Resources* (2000), http://www.api.org/policy/exploration/hydraulicfracturing/upload/hydraulic_fracturing_primer.pdf.

already had a large impact on the economy of states like North Dakota[6] and Texas,[7] and the focus of the industry has begun to shift to the Marcellus and Utica formations.[8]

The Marcellus Shale is considered by some to be "the most significant opportunit[y] for domestic natural gas development in many years."[9] In the past, this formation was seen as "an infeasible option" for natural gas drilling, but the advancements in fracking technology have opened up an opportunity to obtain the vast resources[10] available in the Marcellus.[11] The Utica Shale, like the Marcellus, holds a vast amount of natural gas and possibly oil, and may actually be more vital to the state's oil and gas industry than the Marcellus, because a large portion of Ohio sits atop the Utica formation.[12] It is probable that the Utica formation will soon be the third largest shale producer of oil and natural gas in the entire country.[13] Nevertheless, for the

[6] The rise of fracking on private land in North Dakota due to the Bakken Shale formation has lowered the unemployment rate in that state to about three percent. James M. Taylor, *Backgrounder: Hydraulic Fracturing*, THE HEARTLAND INSTITUTE (March 6, 2012), http://heartland.org/policy-documents/backgrounder-hydraulic-fracturing-0. In addition, a "recent high school graduate can [a] earn six-figure incomes in the oil fields" of North Dakota. *Id.*

[7] The country's top producer of oil and gas, Texas, has also begun to rely heavily on fracking over the past few years. "More than 40 percent of the jobs created during the national recession" were generated in The Lone Star State, thanks in large part to the rise in fracking. *Id.*

[8] Russ Mitchell, *Ohio's stake in the oil and gas industry*, WKYC, (Nov. 1, 2012), http://www.wkyc.com/news/state/article/267087/23/Ohios-stake-in-the-oil-and-gas-industry

[9] George A. Bibikos & Jeffrey C. King, *A Primer on Oil and Gas Law in the Marcellus Shale States*, 4 TEX. J. OIL GAS & ENERGY L. 155, 156 (2009).

[10] "Researchers estimate the Marcellus Shale alone could contain as much as 363 trillion cubic feet of natural gas, enough to satisfy U.S. energy demands for about 14 years." *Drilling for Natural Gas in the Marcellus and Utica Shales: Environmental Regulatory Basics*, OHIO ENVIRONMENTAL PROTECTION AGENCY (July 2011), *available at* http://www.ohiomemory.org/cdm/singleitem/collection/p267401ccp2/id/7850/rec/20.

[11] Bibikos & King, *supra* note 9, at 156.

[12] The Marcellus Share is thinner along its western edge, the portion of the Marcellus that is located in Ohio. Ohio Environmental Protection Agency, OHIO EPA, *supra* note 10.

[13] The Bakken shale in North Dakota and Eagle ford shale in Texas will likely be first and second, respectively. *Id.*

anticipated oil and gas extraction[14] to be made possible, leases will need to be negotiated with Ohio landowners.

A multitude of landowners in Ohio have already signed oil and gas leases with operators[15] as oil companies have invested billions of dollars in the state to mine the Utica.[16] To drill a horizontal well, about 620 acres are needed, which typically results in competition among companies looking to acquire the necessary acreage.[17] However, even with this intense competition, it may still be a challenge for many landowners to get favorable lease terms—or even understand what the terms of the instrument actually are—when negotiating a lease with an oil and gas company.[18] Even so, the duration of an oil and gas lease is usually not set in stone, and, as such, is typically subject to challenge, especially if oil or gas is not being produced in paying quantities.[19] Because of this, much litigation between lessors and lessees will arise in the future over the development of land leased both prior to and during this fracking boom, and it

[14] Together "the Marcellus and Utica shale formations have the potential to become one of the biggest producers of natural gas" in the entire nation. Jeff Bell, *Utica, Marcellus shale plays could represent more than $10 trillion in new economic activity*, COLUMBUS BUSINESS FIRST, Jan 17, 2013. In 2011, Chesapeake Energy Corp. CEO Aubrey McClendon went as far as to estimate that the Utica may be worth as much as $500 billion and, in addition, remarked that the formation is the "biggest thing economically to hit Ohio, since maybe the plow." *McClendon Values Utica Shale at Half a Trillion Dollars, NGI Reports.* BUSINESS WIRE (Sept. 21, 2011), http://www.businesswire.com/news/home/20110921006942/en/McClendon-Values-Utica-Shale-Trillion-Dollars-NGI.

[15] Bibikos & King, *supra* note 9, at 156.

[16] Edward McAllister & Selam Gebrekidan, *Insight: Is Ohio's"secret" energy boom going bust?* REUTERS, (Oct. 22, 2012), http://www.reuters.com/article/2012/10/22/us-ohio-shale-idUSBRE89L04H20121022.

[17] For shallower formations, such as traditional vertical wells, 20-80 acres is typically enough. Lee Morrison, *Horizontal drilling nets record signing bonuses*, THE TIMES-REPORTER (February 13, 2012), http://www.timesreporter.com/topstories/x2112946157/Horizontal-drilling-nets-record-signing-bonuses.

[18] "[L]andowners should take time to review what's involved and consult with an attorney experienced in oil and gas matters before signing a lease." *Id.*

[19] John K. Keller & Gregory D. Russell, *Ohio's Dormant Mineral Act*, 25 OHIO LAW. 10, 13 (2011).

will be necessary for lawyers to be prepared to litigate the various issues surrounding these leases.[20]

This comment will focus on implied covenants, an area of oil and gas leases which will play a major role in this future litigation.[21] When no express clause has been violated by a lessee, a landowner may still have recourse against the lessee if he is able to find a breach of an implied covenant.[22] These covenants and their sometimes broad application[23] could be an extremely valuable tool for landowners looking to gain from the current fracking boom in Ohio.[24] Rather than allow idle or inexperienced lessees to continue burdening the lessor's land because the terms of the lease do not provide the lessor a way to void the lease or, at a minimum, the ability to force the lessee to become more productive, a lessor can instead look for a remedy through one or more of the implied covenants.[25] However, these covenants will be of little use if

[20] *See* Gartland, *supra* note 2 ("As energy companies, geologists, petroleum engineers and landmen ready the landscape for operations in the Utica and begin tasks toward oil and gas production, lawyers need to be ready to service clients for countless legal issues relating to oil and gas production.").

[21] See, e.g., Chris Baronzzi, *Implied Covenants May Require Mineral Lessees to Develop Deep Rights*, OIL AND GAS LAW REPORT (Aug. 1, 2012) http://www.oilandgaslawreport.com/2012/08/01/implied-covenants-may-require-mineral-lessees-to-develop-deep-rights/.

[22] "In the absence of an express covenant, courts have filled some of the gaps by including certain implied covenants in leases." Bibikos & King, *supra* note 9, at 161.

[23] The implied covenant of diligent and prudent operation can address issues "from how to drill the well to how to operate it after drilling is complete." Gary B. Conine, *Speculation, Prudent Operation and the Economics of Oil and Gas*, 33 WASHBURN L.J. 670, 689 (1994).

[24] *See* Mhari Saito, *Land Rush In Eastern Ohio A Boon For The Economy*, NPR (Oct. 14, 2011), http://www.npr.org/2011/10/14/141322449/land-rush-in-eastern-ohio-a-boon-for-the-economy (stating that "the market for Ohio landowners with mineral rights is booming").

[25] "The implied covenants in the oil and gas lease have been judicially created in order to counteract the potential for opportunistic behavior available to lessees because of the relational nature of the lease." Jeff Nehring, *The Modern Reasonable and Prudent Operator Standard in North Dakota Oil and Gas Leases*, 1 GREAT PLAINS NAT. RESOURCES J. 443, 445-46 (1996).

landowners, attorneys, and judges are unsure of their application under Ohio law, which is currently the case.[26]

Prior to the recent rise of fracking in the state, there had been little reason for the Ohio Supreme Court to provide a framework for the implied covenants as they were sparingly utilized in litigation by landowners.[27] However, the high courts in states such as Texas and North Dakota, two states which have been large oil and gas producers for years,[28] have thoroughly addressed most issues concerning the oil and gas industry in recent years,[29] including the area of implied covenants. Therefore, using the case law that these states and other similarly situated states have developed as a guide, the Ohio Supreme Court should clearly define which implied covenants are recognized by Ohio law, what the scope of these covenants are, how these covenants can be disclaimed in the language, and when breach of these covenants can work as a forfeiture of the lease in question. First, the Supreme Court should recognize four implied covenants, namely, the covenant to market; the covenant to reasonably develop; the covenant to protect the lease from drainage; and the covenant to operate the premises with reasonable care

[26] "Unlike Pennsylvania and West Virginia, the law of oil and gas in Ohio is largely undeveloped except for a few cases discussing the nature of the lessee's interest in oil and gas leases and some discussion of implied covenants." Bibikos & King, *supra* note 9, at 189.

[27] The Ohio Supreme Court has directly addressed these implied covenants in just four decisions, none of which were decided in the past 30 years. *See* Harris v. Ohio Oil Co., 57 Ohio St. 118 (1897); Kachelmacher v. Laird, 92 Ohio St. 324 (1915); Beer v. Griffith, 399 N.E.2d 1227 (Ohio 1980); Ionno v. Glen-Gerry Corp, 443 N.E.2d 505 (Ohio 1983).

[28] Texas and North Dakota are currently first and second, respectively, in terms of crude oil production. Matthew Rocco, *North Dakota Oil Boom Driving Economic Development*, FOX BUSINESS (Feb. 11, 2013), http://www.foxbusiness.com/economy/2013/02/11/north-dakota-oil-boom-driving-economic-development/.

[29] "The 2010-2011 term of the Texas Supreme Court was particularly active in deciding oil and gas cases or cases that have a direct impact on oil and gas operations. One has to look back to 1923, when the Texas Supreme Court issued several significant oil and gas decisions on the same day, to find a year in which more oil and gas decisions were handed down." Bruce M. Kramer, A Renaissance Year for Oil and Gas Jurisprudence: the Texas Supreme Court, 18 TEX. WESLEYAN L. REV. 627, 628 (2012).

"Activity in North Dakota's oil and gas industry has increased significantly in the last several years. The increased oil and gas activity has created an increase in North Dakota case law regarding oil and gas related issues." Christopher D. Friez, *North Dakota*, 18 TEX. WESLEYAN L. REV. 563, 563 (2012).

and due diligence. Secondly, the Court should state that explicit clauses which disclaim the implied covenants will be enforced. Lastly, the Court should allow for the remedy of forfeiture as long as a lessee is provided notice prior to the filing of a suit for breach of one of the covenants. Once this structure concerning the implied covenants is in place, lessors and lessees will have a more astute understanding of how the covenants will affect their rights and duties under Ohio law with regard to leases drafted both prior to and in the midst of this recent fracking boom.[30]

II. BACKGROUND

A. The policy behind implied covenants.

The first reference to implied covenants in oil and gas leases can be found in the Pennsylvania Supreme Court case of *Stoddard v. Emery*.[31] The lease in *Stoddard* stated how many wells "should be put down," but if there had been no express provision in the contract covering the number of wells to be drilled, the Court stated that a covenant of reasonable development would have been implied because such development is to be presumed.[32] Since this late 19th century decision, the number of state and federal courts holding that implied covenants exist in oil and gas leases has grown considerably.[33] At this point in time, nearly all, if not all, states recognize implied covenants, although to varied extents.[34]

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[30] Implied covenants have played a major part in defining responsibilities under oil and gas leases since near the time of the industry's beginning. Jacqueline Lang Weaver, *When Express Clauses Bar Implied Covenants, Especially in Natural Gas Marketing Scenarios*, 37 NAT. RESOURCES J. 491, 492 (1997).

[31] Keith B. Hall, *The Continuing Role of Implied Covenants in Developing Leased Lands*, 49 WASHBURN L.J. 313, 314 (2010).

[32] Stoddard v. Emery, 18 A. 339 (Pa. 1889).

[33] Hall, *supra* note 31, at 314.

[34] *Id.* ("the specific implied covenants that various jurisdictions recognize in oil and gas leases sometimes differ from one state to the next").

The strongest reasoning for implying these covenants and thereby forcing the lessee to comply with them is to "encourage diligent production" by the lessee.[35] It is to the advantage of both parties that the lessee be attentive to the extraction and selling of oil and gas.[36] In many leases, the only consideration received by the lessor under the terms of the lease is royalty payments.[37] Therefore, just as the lessee gains economically from more production of oil and gas, so does the lessor.[38] Still, there may be valid reasons why a lessee would wish to hold off on production for a period of time, although this typically will not be in the interests of the lessor, who will want to begin receiving royalties as quickly as possible.[39] A lessee generally must pay a delay rental fee if they wish to put off–for whatever reason–development of the oil and gas rights, but these payments are usually minimal in comparison to the royalties received from a producing well.[40] Because of these conflicts, certain measures can help to facilitate the mutual benefit of both parties, including the recognition of implied covenants.[41]

To understand why implied covenants can be so invaluable, it is pertinent to look at the contrast in business and negotiation experience that exists between lessors and lessees.[42] It is of consequence that there is no standard oil and gas lease, meaning each instrument will likely be different and will, therefore, need to be examined closely to discern what the rights of each party

[35] Bibikos & King, *supra* note 9, at 163

[36] *Id.*

[37] *See* Nesbit v. Martin, 1887 WL 5026 (Pa. Com. Pl. 1887) *aff'd sub nom.* App. of Forest Oil Co., 12 A. 442 (Pa. 1888). Delay rental, signing bonuses and shut-in-rental payments are typically considered to be royalty payments. Michael A. Ogline, *Black Gold: An Oil and Gas Primer for Estate Planners* 20 OHIO PROB. L.J. 31 (2009).

[38] Bibikos & King, *supra* note 9, at 163

[39] *Id.*

[40] Joe H. Munster, Jr., *Implied Covenants in Oil and Gas Leases in Ohio*, 26 OHIO ST. L.J. 404, 404 (1965).

[41] *Id.* ("[t]his conflict of interest has resulted in a variety of clauses in leases involving oil and gas as well as the development of new lease forms").

[42] A. W. Walker, Jr., *The Nature of the Property Interests Created by an Oil and Gas Lease in Texas*, 11 TEX. L. REV. 399, 400-01 (1933).

will be under the instrument's language.[43] "Oil and gas leases are usually prepared by the lessees, men experienced in the oil and gas business," and "the lessors, frequently lacking in similar experience, often sign the lease forms proffered without adequate information upon which to predicate a demand even for proper protective clauses of a general nature."[44] Implying these covenants can help to promote fairness in the performance of the lease.[45]

In addition, an oil and gas lease is a contract, and, therefore, the laws governing contracts are applicable to these leases.[46] The parties' rights and responsibilities under the contract should be embodied in the document, and if the words the parties used in the agreement are clear and unambiguous, there is no need to look outside the contract's express language.[47] However, when the words used in the written document are unclear and open to interpretation, all such ambiguities should be construed against the lessee, who is typically more experienced in such transactions.[48] The lessee is also normally the drafter of the document, and when ambiguities exist, a contract is always to be construed against its drafter.[49]

As stated by the Supreme Court of Ohio in *Doe v. Roman*, if this principle of construing against the drafter was not held to oil and gas leases, "the [lessor] may ultimately forfeit far more than he or she reasonably contemplated at the time the agreement was signed."[50] For example,

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[43] Ogline, *supra* note 37.

[44] *Id.*

[45] Hall, *supra* note 31, at 315.

[46] Jacobs v. CNG Transmission Corp., 332 F. Supp. 2d 759, 772 (W.D. Pa. 2004).

[47] *Id.* at 772; *See also* Kachelmacher v. Laird, 92 Ohio St. 324, 332 (1915) ("The rights of the parties must be determined from their own contract.").

[48] Jacobs, 332 F. Supp.2d at 773 (the traditional understanding is that the lessee is more familiar with the oil and gas industry).

[49] Doe v. Ronan, 937 N.E.2d 556, 567 (Ohio 2010).

[50] *Id.*

there is a presumption in the oil and gas industry that a contracted lease is made for the purpose of immediate development.[51] Therefore, unless the lease indicates otherwise, the implied covenant to reasonably develop the lease can be enforced.[52] This performs the function of filling the supposed gaps that exist in a typical oil and gas lease.[53] The existence of gaps in the lease must exist because, as the Texas Supreme Court has remarked, a court cannot imply covenants in order to accomplish "what it believes to be a fair contract or to remedy an unwise or improvident contract."[54] "It is not enough to say that an implied covenant is necessary in order to make the contract fair, or that without such a covenant it would be improvident or unwise, or that the contract would operate unjustly."[55] The implication must come about by discovering the "presumed intention" of the parties through the language of the lease.[56]

The importance of implying covenants in oil and gas leases also rings true from a public policy standpoint. The Ohio Supreme Court has defined public policy as "the community common sense and common conscience extended and applied throughout the state to matters of public morals, public health, public safety, public welfare, and the like.[57] In essence, the principle is that a person or group cannot do something which has a propensity to injure the public or is against the public good.[58] "Accordingly, contracts which bring about results which

[51] *See Jacobs* 332 F. Supp.2d at 779.

[52] *Id.*

[53] Hall, *supra* note 31, at 314.

[54] HECI Exploration Co. v. Neel, 982 S.W.2d 881, 888-89 (Tex. 1998).

[55] *Id.* at 889

[56] *Id.*

[57] Pittsburgh, Cincinnati, Chicago & St. Louis Ry. Co. v. Kinney, 95 Ohio St. 64, 64 (1916). It is of note that the Ohio Supreme Court has also stated that, at its best, public policy is "an uncertain and indefinite term." Lamont Bldg. Co. v. Court, 147 Ohio St. 183, 185 (1946).

[58] Eagle v. Fred Martin Motor Co., 809 N.E.2d 1161, 1180 (Ohio App. 9th Dist. 2004) The same case also states that "[p]ublic policy is the community common sense and common conscience, extended and applied throughout the state to matters of public morals, health, safety, welfare, and the like." *Id.*

the law seeks to prevent are unenforceable as against public policy."[59] If the language of a lease does not cover or disclaim an implied covenant, it would seem to be against the public good to construe the uncovered situation against the non-drafter when the situation may not have been in the mind of either party when the lease was negotiated.[60] In addition, it is against the public interest for land—especially land that may produce oil—to be left undeveloped and out of the free market system.[61] Consequently, if a lessee's ineptitude or negligence causes the land's resource to go idle, covenants to force quality performance of the contract become a necessary implication.[62]

Although implied covenants exist in virtually every state in the Union, there is opposition to their implication. Specifically, former North Dakota District Judge Dennis A. Schneider[63] was among those opposed to these covenants. In a concurring opinion[64] in the case of *Olson v. Schwartz*,[65] Schneider set out his hostility to the existence of implied covenants in North Dakota law. He defined a lease as "a contract between the parties which contract contains certain bargained-for-promises."[66] Therefore, because these covenants do not explicitly exist anywhere

[59] *Id.*

[60] See Munster, *supra* note 40, at 406.

[61] Romero v. Humble Oil & Ref. Co., 93 F. Supp. 117, 120 (E.D. La. 1950) *modified*, 194 F.2d 383 (5th Cir. 1952).

[62] "There seems to be general agreement that implied covenants are necessary in oil and gas law to protect lessors from negligent and incompetent lessees, from lessees who speculate, and from lessees who self-deal." Jacqueline Lang Weaver, *supra* note 30, at 494.

[63] Schneider was a District Court Judge in North Dakota from 1979-1998. https://www.ndcourts.gov/court/bios/schneider.d.htm

[64] Schneider concurred, rather than dissented, because "although I have a problem with the implied covenant, 'the river has flowed too long and is too deep for me to believe it can be changed now.'" Olson v. Schwartz, 345 N.W.2d 33, 41 (N.D. 1984).

[65] *Id.*

[66] *Id.* at 41.

in the lease, their implication changes the bargain that the parties clearly agreed to.[67] These covenants, specifically the covenant to reasonably develop, are "nothing more than a judge-made decision in equity which the judges then call a rule of law."

Schneider further noted that the legislature would likely violate the state constitution if it passed a law implying a covenant to "do everything that a reasonably prudent operator would do in operating, developing[,] and protecting the property[,]" because of the existence of the Impairment of Contract provision in the North Dakota Constitution."[68] If such a statute would be unconstitutional, it would have to follow that a similar judge-made law would have to also be unconstitutional.[69] Although Schenider's constitutional interpretation may have some footing in North Dakota law, the same can likely not be said under the Ohio Constitution.[70]

Article II, Section 28 of the Ohio Constitution states:

> The general assembly shall have no power to pass retroactive laws, or laws impairing the obligation of contracts; *but may, by general laws, authorize courts to carry into effect, upon such terms as shall be just and equitable, the manifest intention of parties, and officers, by curing omissions, defects, and errors, in instruments and proceedings, arising out of their want of conformity with the laws of this state.*[71]

Although the first clause of the section is very similar to Article I, Section 18 of the North Dakota Constitution, the rest of Article II, Section 28 does not appear in the North Dakota Constitution. It can certainly be reasoned that the phrase "[t]he general assembly… may

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[67] *See Id.* at 42 ("It is reasonably safe to conclude that a promise of reasonable development or to further explore was not part of the original contract or consideration. … "The judge-made rule of equity called the implied covenant of reasonable development" alters the bargain that the parties came to.).

[68] The Impairment of Contracts provision of the North Dakota Constitution is Article I, Section 18, which states that "[n]o bill of attainder, ex post facto law, or law impairing the obligations of contracts shall ever be passed." *Id.*

[69] *Id.* ("If such a statute would be constitutionally infirm, can it not be such that an identical judge-made rule of law is equally infirm?").

[70] *See* OHIO CONST. ART. II, § 28.

[71] *Id.* (emphasis added).

authorize courts to carry into effect … the manifest intention of parties … by curing omissions, defects, and errors, in instruments"[72] allows for the implication of covenants in oil and gas leases when the subject is not broached in the lease. Therefore, although Schneider's argument that implied covenants impair the actual intentions of the parties may have some weight, these covenants do not violate the Ohio Constitution. In addition, even Schneider acknowledged that implied covenants are "too ingrained to judicially change now" and, therefore, should continue to be applied where applicable.[73]

B. The Supreme Court of Ohio has previously recognized the existence of implied covenants.

Even though the Ohio case law on the implied covenants is thin, there is no question that the Supreme Court of Ohio does recognize them as existing under Ohio to oil and gas leases.[74] The Ohio courts have justified these implications in mining leases for much of the same public policy reasons expressed by other states.[75] Most notably, the purpose for which a lessor and lessee typically come together is to explore, develop, and operate the lessor's property "for the mutual profit and advantage of both the lessor and the lessee."[76] Because of this fundamental purpose, implied covenants are a necessary part of Ohio law.[77]

[72] *Id.*

[73] *Olson*, 456 N.W.2d at 42.

[74] *See, e.g.,* Am. Energy Serv. v. Lekan, 598 N.E.2d 1315, 1321 (Ohio App. 5 Dist. 1992). ("Ohio courts have recognized that certain obligations are imposed upon the parties to an oil and gas lease not only by the terms of the lease itself but also by operation of law. These obligations are referred to as 'implied covenants.').

[75] *See, e.g.,* Karas v. The State of Ohio, 79AP-37, 1979 WL 209304 (Ohio Ct. App. Sept. 11, 1979) (A state can justifiably use its governmental authority "to control the production of oil and gas for the benefit of its citizens.").

[76] Streck v. Reed, 1983 WL 4132, at*3 (Ohio Ct. App. June 8, 1983).

[77] *Id.*

The first Ohio decision to identify these covenants was *Harris v. Ohio Oil Co.,* an 1897 Supreme Court opinion.[78] In *Harris,* the lease—which covered 159 acres—stated that the lessee was obligated to complete one well before six months passed.[79] If this was not accomplished, the lessee had to pay $100 for each three months of delay past the initial six months or else the lease would become void.[80] Although the lease stated that an initial well was required, there was nothing express in the lease about further development on the land.[81] Multiple wells were drilled on the property; however, an area of five acres was never developed at all, which resulted in the lessor filing a lawsuit claiming the lease was not reasonably developed.[82] The Court came to the conclusion that because the lease was silent as to how many wells should be drilled, there was an implied covenant to reasonably develop the land.[83] The Court reasoned that when a contract does not state a time for the performance of said contract, the implication is that a reasonable time is given for performance.[84]

In 1983, the Supreme Court of Ohio decided *Ionno v. Glen-Gerry Corp.*, a case in which the lessee had failed to do any mining on the land.[85] The court largely reaffirmed what the *Harris* decision stated concerning implied covenants,[86] but it did provide some further reasoning

[78] Harris v. Ohio Oil Co., 57 Ohio St. 118 (1897).

[79] *Id.*

[80] *Id.*

[81] *Id.*

[82] *Id.*

[83] *Id.* at 127.

[84] *Id.* The court also used two other examples, including that when a contract to build a house does not state the quality of the materials to be used, it is implied that the materials should be of reasonable quality.

[85] Ionno v. Glen-Gerry Corp, 443 N.E.2d 505 (Ohio 1983).

[86] See *Harris*, 57 Ohio St. at 506 ("[t]his court has long adhered to the general principle that absent express provisions to the contrary, a mineral lease includes an implied covenant to reasonably develop the land").

behind the Court's recognition of implied covenants.[87] The Court stated that although the lease provided for minimum royalty payments in the absence of mining, "the real consideration for the lease is the expected return derived from the actual mining of the land."[88] It would do a disservice to the true essence of the lease if the lessee were allowed to hold the land for a lengthy amount of time without ever having to make any sort of effort to produce oil.[89]

Ohio's Fifth District Court of Appeals has stated that there are six possible implied covenants,[90] although there is not much, if any, Ohio case law on several of the covenants. The six covenants the Fifth District has recognized are 1) the covenant to drill an initial exploratory well; 2) the covenant to protect the lease from drainage; 3) the covenant of reasonable development; 4) the covenant to explore further; 5) the covenant to market the product; and 6) the covenant to conduct all operations that affect the lessor's royalty interest with reasonable care and due diligence.[91] How many implied covenants exist largely depends on the authority being consulted, although it is almost universally agreed that the number ranges from three to six.[92]

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[87] *See Id.*

[88] *Id* at 507.

[89] *Id*.

[90] *See* Am. Energy Serv. v. Lekan, 598 N.E.2d 1315, 1321 (Ohio App. 5 Dist. 1992); Moore v. Adams, Tuscarawas App. No.2007AP090066, 2008 WL 4907590 (Ohio App. 5 Dist. 2008).

[91] *Lekan*, 598 N.E.2d at 1321. However, I have been unable to find any Ohio cases which apply the implied covenant to drill an initial exploratory well or the implied covenant to explore further.

[92] "However, the differences are largely organizational rather than substantive." *Amoco v. Alexander: Common Lessee's Duty to Protect Against Field-Wide Drainage is Within the Reasonably Prudent Operator Standard*, 17 Tulsa L.J. 527, 554 n.22 (1981-1982).

III. ANALYSIS

A. The Four Implied Covenants.[93]

Although some of the states surrounding Ohio have an extensive amount of case law on the subject of oil and gas leases,[94] this area has remained largely untouched by the Ohio court system,[95] especially concerning the application of implied covenants.[96] Several decisions from the Ohio Court of Appeals shed some light on the subject,[97] but the inclusion of various decisions by surrounding states will help in deciding how the Ohio courts may apply implied covenants in the future.

1. Covenant to Market

A late 19th century decision by the Ohio Supreme Court, *Ohio Oil Co. v. Lane*,[98] seemed to deny that any implied covenant to market existed, and the Court has not covered the subject of the covenant to market since.[99] However, a recent decision by the Fifth District came to the conclusion that a lessee had breached the covenant to market the product.[100] In that decision, the Court of Appeals propounded that "[t]he covenant to market the product places an obligation

[93] Although the Fifth District has listed six implied covenants, there is no Ohio case law applying the covenant to drill an exploratory well and the covenant to explore further. Even if these two covenants do exist, they fit neatly under the broad implied covenant to conduct all operations that affect the lessor's royalty interest with reasonable care and due diligence. Therefore, I will only examine the area of implied covenants under the four remaining covenants.

[94] These states include Pennsylvania and West Virginia. *See* Bibikos & King, *supra* note 9.

[95] Bibikos & King, *supra* note 9, at 189-190.

[96] The last Ohio Supreme Court case to consider the subject of implied covenants in oil and leases was *Ionno v. Glen-Gery*, a case that was decided about 20 years ago. 443 N.E.2d 504 (Ohio 1983).

[97] *See e.g.*, Bushman v MFC Drilling Inc., 1995 WL 434409 (Ohio App. 9 Dist. July 19, 1995); Taylor v. MFC Drilling, Inc., 1995 WL 89710 (Ohio App. 4 Dist. Feb. 27, 1995).

[98] Ohio Oil Co. v. Lane, 59 Ohio St. 307 (1898).

[99] Munster, *supra* note 40, at 415.

[100] Moore v. Adams, Tuscarawas App. No.2007AP090066, 2008 WL 4907590, ¶40 (Ohio App. 5 Dist. 2008). The Fifth District also recognized the covenant to market in a 1992 decision. *See* Am. Energy Serv. v. Lekan, 598 N.E.2d 1315 (Ohio App. 5 Dist. 1992).

upon a lessee to use due diligence to market the gas and/or oil produced from a well."[101] In *Moore v. Adams*, the pipeline that made it possible to get the extracted gas to the sales line was damaged in 2000.[102] Because the lessee felt the cost to repair the damage was too high,[103] the pipeline was not fixed and the well—which had been producing in paying quantities—was shut-in and production and marketing of the well stopped.[104] The lease did contain a shut-in royalty clause,[105] but the court noted that these clauses are only "a savings clause" and do not rid the lessee of his duty to use due diligence to sell the oil or gas.[106] Therefore, by shutting-in a well that had been producing, rather than fixing the damaged pipeline, the lessee failed to use reasonable care and due diligence in conducting operations and marketing the product.[107]

The Fifth District's application of the covenant to market was in conjunction with the need to use due diligence and reasonable care in operations under the lease.[108] Because of this rational application, the covenant to market could conceivably be included under the covenant to conduct all operations that affect the lessor's royalty interest with reasonable care and due diligence.[109] The state of Colorado has taken this approach.[110]

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[101] *Moore*, 2008 WL 4907590 at ¶38.

[102] *Id.* at ¶8.

[103] It would have cost about $2000 to fix the pipeline. *Id.*

[104] The lessee did not attempt to market the well's gas again until the lessor's lawsuit was filed. *Id.*

[105] The clause stated: "Notwithstanding anything herein to the contrary, this lease shall continue in full force for so long as there is a well or wells on the leased premises capable of producing oil or gas, but in the event all such wells are shut-in for any reason, then on or before the end of each calendar year during which the well or wells are shut-in, Lessee shall pay to Lessor a shut-in royalty equal to the delay rental provided herein." *Id.* at ¶5.

[106] *Id.* at ¶38 ("A shut-in royalty clause modifies the habendum clause so that the lease may be preserved between the time of discovery of product and marketing of the same.").

[107] *Id.* at ¶40.

[108] *See Id* ("we find the trial court's decision that appellant failed to conduct operations and market the product with reasonable care and due diligence was supported by competent and credible evidence").

[109] This covenant—to use due diligence in all operations—will be discussed later in the Analysis section.

Colorado courts have identified four implied covenants, namely, "to conduct exploratory drilling; to develop after discovering resources that can be profitably developed; to operate diligently and prudently; and to protect the leased premises against draining."[111] The covenant to operate diligently and prudently has been recognized as including within it the implied covenant to market.[112] Under this covenant, the lessee must make marketing efforts which "would be reasonably expected of all operators of ordinary prudence, having regard to the interests of both lessors and lessee."[113] The approach taken by Colorado concerning the duty to market seems to largely coincide with how the Fifth District has attacked it,[114] and, therefore, there would be some in-state and out-of-state support for a decision by the Ohio Supreme Court which treated the covenant to market as existing within the duty to operate diligently and prudently.[115]

No matter how Ohio courts decide to apply the covenant to market in the future, it is vital that this implied pledge be plainly recognized in the state because "[t]he parties to a lease cannot prescribe the exact duties of the lessee respecting the marketing of the oil or gas produced, nor the time and manner of their performance."[116] When applying this covenant, though, it is important to avoid placing too large of an onerous on lessees so as not to deter the major oil

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[110] *See* Legard v. EQT Production, 2011 WL 86598 at *12 (W.D. Va. 2011). However, because the covenant to market contains several "special issues," some courts prefer to treat the covenant to market as its own separate covenant. Conine, *supra* note 23, at 690.

[111] Whitham Farms, LLC v. City of Longmont, 97 P.3d 135, 137 (Colo. App. 2003).

[112] Garman v. Conoco, Inc., 886 P.2d 652, 659 (Colo. 1994).

[113] *Id*.

[114] *See* Moore v. Adams, Tuscarawas App. No.2007AP090066, 2008 WL 4907590, ¶40 (Ohio App. 5 Dist. 2008) ("we find the trial court's decision that appellant failed to conduct operations and market the product with reasonable care and due diligence was supported by competent and credible evidence").

[115] Even a mid-western state may be taking the approach that Colorado and the Ohio Fifth District Court of Appeals have taken. A recent decision by the Federal District Court for the Western District of Virginia held that "Virginia Courts would recognize an implied duty on the part of oil and gas lessees to operate diligently and prudently, including a duty to market the gas produced." Legard v. EQT Production, 2011 WL 86598 at *12.

[116] 2 SUMMERS OIL AND GAS § 18:10 (3d ed.).

companies from continuing to pursue leases with landowners in Ohio.[117] As such, the lessee should have to use "reasonable diligence," or, in other words, the burden of marketing should be no more than that which would be expected of "an ordinarily prudent and diligent operator."[118] It would be unjust to require a lessee to market the product to the point where the process is not even profitable for him.[119] Although it is important that the process of extraction of oil and gas be profitable for the lessor, the same must be said with regard to the lessee.[120] The prudent operator standard,[121] therefore, strives to balance the interests of the two parties by forcing the operator to only reasonably and diligently perform its implied duty.[122]

2. Covenant to Reasonably Develop

The requirement to reasonably develop is the most openly acknowledged implied covenant under Ohio law oil and gas law.[123] In *Harris*, the court recognized that a lessee has a duty to reasonably develop the property.[124] The lease at issue in this case did not specifically address to what degree the lessee had to cultivate the land.[125] As such, the court was faced with

[117] Two major oil companies, "Chesapeake and EnerVest[,] formed a joint venture recently to explore the Utica." BUSINESS WIRE, *supra* note 15.

[118] Rhoads Drilling Co. v. Allred, 123 Tex. 229, 246 (Comm'n App. 1934).

[119] *Id.*

[120] *See Id.* (An operator "is not required to continue in their performance unless continuance will be profitable, not only to his lessor, but also to him.").

[121] The Supreme Court of Mississippi has stated the logic behind the prudent operator standard: "In the oil business, and in determining the rights of the people, there must be some guide by which to go. The guide developed through the years is the prudent operator rule. It is essential as a standard, just as the conduct of a reasonably prudent man is essential in negligence cases." Continental Oil Co. v. Blair, 397 So. 2d 538, 540 (Miss. 1981). The Supreme Court of North Dakota has stated a similar definition for the prudent operator, stating that "[h]e is a hypothetical oil operator who does what he ought to do not what he ought not to do with respect to operations on the leasehold." Johnson v. Hamill, 392 N.W.2d 55, 58 (N.D. 1986).

[122] *See* Bibikos & King, *supra* note 9, at 162 (analyzing the prudent-operator standard in general).

[123] *See* Harris v. Ohio Oil Co., 57 Ohio St. 118 (1897); Ionno v. Glen-Gerry Corp, 443 N.E.2d 504 (Ohio 1983).

[124] *Harris* at 127.

[125] *Id.* at 126-27.

the question of whether to imply that a condition existed with regard to this subject, to which it answered in the affirmative.[126]

> On principle, it would seem that there is such implied covenant in the written instrument. When no time is fixed for the performance of a contract, a reasonable time is implied. When a contract for the erection of a house or other structure is silent as to the quality of the materials or workmanship, it is implied that the same should be of reasonable quality. In a lease of a farm for tillage on shares, it is implied that the tenant shall cultivate the farm in the manner usually done by reasonably good farmers. So, under an oil lease which is silent as to the number of wells to be drilled, there is an implied covenant that the lessee shall reasonably develop the lands, and reasonably protect the lines.[127]

Over 80 years after the *Harris* decision, the Ohio Supreme Court reaffirmed the existence of the covenant to reasonably develop in *Beer v. Griffith.*[128] At least four wells had been drilled on the leased land at issue in *Beer*, but—at the time of trial—no work had been performed on the property for more than a year, and, as such, only one of the four wells was currently producing.[129] There were a number of reasons for this lack of development. Drilling on one of the wells had stopped because the lessee made an error on its permit application and, subsequently, failed to reapply for the permit.[130] A second well was alleged to have potential for oil, but one of the lessee's creditors[131] had removed casing[132] from the well, leaving it unable to produce.[133] Because the lessee had failed to make necessary efforts to secure the permit and had

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[126] *Id.* at 127.

[127] *Id.*

[128] Beer v. Griffith, 399 N.E.2d 1227, 1230 (1980) ("while lessee did not violate an express provision of the lease did breach an implied covenant to reasonably develop the lands").

[129] *Id.*

[130] *Id.* at 1229.

[131] About 25 judgment liens had been filed against the lessee. *Id.* at 1230.

[132] Casing is pipe usually larger in diameter and longer than drill pipe and is used to line the hole. http://www.osha.gov/SLTC/etools/oilandgas/drilling/casing.html.

[133] *Beer*, 61 Ohio St.2d at 1230.

not replaced the removed casing, the court found a breach of the covenant to reasonably develop.[134]

Three years after *Beer*, the court once again found that a lessee had breached the implied covenant to reasonably develop when it decided *Ionno*.[135] The lessee, Glen-Gery Corporation, and its assignor[136] had made annual royalty payments for over 18 years in lieu of mining the land.[137] The court explained that it would be contrary "to the nature and spirit of the lease to allow the lessees to continue to hold the land for a considerable length of time without making any effort to mine."[138] Therefore, the lessee's royalty payments did not act "as a substitute for timely development."[139] The real consideration under an oil and gas lease is the anticipated monetary benefit that actual mining of the property will bring to the lessor,[140] the court explained, which necessitates the need to infer a duty to reasonably develop the land.[141]

In 1983, the Fifth District Court of Appeals offered a succinct reasoning behind the need for reasonable development by lessees in *Anderson v. Chef Drilling*.[142] In that case, the court came to the conclusion that although the lessee had drilled a number of wells on the leased

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[134] *Id.*

[135] Ionno v. Glen-Gerry Corp, 443 N.E.2d 504 (Ohio 1983).

[136] Glen-Gery Corporation, which was formerly known as Glen-Gery Shale Brick Corporation, was assigned the lease by NATCO Coporation, the original lessee. *Id*. at 505.

[137] The court stated that, under the lease, the lessee "was obligated to pay lessors a royalty on the product mined or $300 per year for the first two years and $600 per years thereafter as 'minimum rent or royalty' which payments would be 'credited against the amount or amounts that shall thereafter become due for on account of the removal, mining or hauling of coal and/or clay…'" *Id*.

[138] *Id.* at 507.

[139] *Id*.

[140] *Id.* at 507 ("Clearly, we are not dealing with a contract which exacts a non-refundable annual payment of rent to the lessor as separate and independent consideration.").

[141] *Id.* at 506.

[142] Anderson v. Chief Drilling, Inc., 82-CA-15, 1983 WL 6351 (Ohio Ct. App. Jan. 14, 1983).

property through the years, the portion of the land owned by the plaintiffs[143] had not been developed for over 30 years, and, as such, the plaintiffs were entitled to relief for the lessee's breach of the covenant to reasonably develop the plaintiffs' land.[144] In addition to making this ruling, the court explicated in a clear, concise manner why such an implication is necessary by declaring that "[t]he sole purpose of such an implied covenant is to assure that the land is developed and that the lessor's interest is protected. Why would anyone tie up his land forever without a reasonable expectation that a lessee in a mineral lease would develop the land to the mutual benefit of both the lessor and the lessee within a reasonable time?"[145]

A similar outcome—that the lessee failed to reasonably develop—was reached by the Ninth District in *Streck v. Reed*.[146] In that case, a lease was signed in 1952, but since that time only one of the three leased parcels had a well drilled on it.[147] The well was completed in 1955, and, although it was successful in producing paying quantities of gas, the lessees never made any developments on the other two parcels.[148] The Court of Appeals affirmed the trial court's ruling in favor of the plaintiffs,[149] writing that "the lessees breached the implied covenant of development with respect to Lease Parcel #2 since from the inception of the lease in 1952, the lessees undertook no development whatsoever on that tract of land."[150]

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[143] The Plaintiffs, who were not the original lessors, owned two of three tracts described under the lease. The other tract, which had producing wells, was owned by a relative. *Id.* at *1.

[144] *Id.* at *4.

[145] *Id.* at *2.

[146] Streck v. Reed, 1983 WL 4132 (Ohio App. 9 Dist. June 8, 1983).

[147] The lease was operative for a period of roughly three decades. *Id.* at *1.

[148] *Id.* at *1.

[149] The Plaintiffs', the Strecks, owned two of the three parcels under the lease.

[150] *Id.* at *4.

Although decisions like *Streck* and *Anderson* provide fact scenarios which will be helpful to Ohio courts in determining whether the covenant to reasonably develop has been breached, the North Dakota Supreme Court has put forth a list of factors to aid in determining whether an operator has met the "prudent-operator standard" under this implied covenant [151] which could be of some use to the Buckeye State in the future, although North Dakota has recognized that there is no rigid procedure to apply to determine whether a lessee has failed to reasonably develop the land.[152] The factors articulated by North Dakota include:

> (1) the quantity of oil and gas capable of being produced as indicated by prior exploration and development; (2) the local market and demand therefor; (3) the extent and results of the operations, if any, on adjacent lands; (4) the character of the natural reservoir-whether such as to permit the drainage of a large area by each well; (5) the usages of the business; (6) the cost of drilling, equipment, and operation of wells; (7) the cost of transportation, storage, and the prevailing price ... (8) general market conditions as influenced by supply and demand or by regulation of production through governmental agencies ... (9) evidence of the willingness of another operator to drill on the tract in question; (10) the attitude of the lessee toward further development; and (11) the elapsed time since drilling operations were last conducted.[153]

Although these factors constitute a "nonexhaustive list,"[154] they could serve as an appropriate guide to Ohio courts in future situations where a lessee's inability to develop is not as cut-and-dry as cases like *Anderson*.[155] A number of these factors are especially related to the current oil and gas situation in Ohio, especially "the willingness of another operator to drill on the track in

[151] *See* Olson v. Schwartz, 345 N.W.2d 33 (N.D. 1984); Johnson v. Hamill, 392 N.W.2d 55 (N.D. 1986).

[152] *Olson*, 345 N.W.2d at 39 (It's "impossible to state a formula by which a court can determine whether a particular lessee has developed a particular lease in conformity with the prudent operator standard. Each case must be decided on the facts peculiar to it and the burden of proving a breach of the implied covenant is on the party asserting it.").

[153] *Hamill*, 392 N.W.2d at 57-58.

[154] *Id.* at 57.

[155] In *Anderson*, no development of the land occurred for over 30 years. *See* Anderson v. Chief Drilling, Inc, 82-CA-15, 1983 WL 6351 (Ohio App. 5 Dist. Jan. 14, 1983).

question" and "the attitude of the lessee toward further development."[156] These factors are forward looking and would allow those with property in the Utica or Marcellus formations to point to the interest companies such as Chesapeake Energy have shown in drilling on Ohio lands if a current lessee has failed to develop the property.[157] Performing this type of inquiry would go a long way towards honoring the main reason the covenants are implied in the first place–to "encourage diligent production"[158]–as lessors could use the interest they have garnered from outside companies to force lessees to become more productive or risk losing their rights under the lease.

3. Covenant to Protect the Lease from Drainage

The implied covenant to protect against drainage, which has been recognized in the United States since the late nineteenth century,[159] is meant to deal with the problem that exists when wells are located near property lines.[160] Because of the fleeting nature of oil and gas[161] and the fact that a well drains from its nearby ground, an operating well may end up taking a neighboring landowner's resources.[162] The rule of capture, which states that "title to oil and gas belongs to the owner of the mineral rights to the land from which the oil and gas were extracted, even though the minerals may have been drained from beneath an adjacent lease,"[163] prevents a landowner from bringing a claim against the neighboring property owner who "captures" his oil

[156] *Hamill*, 392 N.W.2d at 57-58.

[157] Cheapeake has stated that it "plans to drill as many as 12,500 wells in the Utica" and may be "investing as much as $200 billion in Ohio over the next 20 years. BUSINESS WIRE, *supra* note 15.

[158] Bibikos & King, *supra* note 9, at 163.

[159] *See* Kleppner v. Lemon, 35 A. 109, 109 (Pa. 1896).

[160] Hall, *supra* note 31, at 320.

[161] *Amoco v. Alexander*, *supra* note 92, at 554.

[162] Hall, *supra* note 31, at 320-21

[163] *Amoco v. Alexander*, *supra* note 92, at 555, n.24.

and gas.[164] Therefore, "a lessee has a duty to protect the leased premises from drainage by wells located on neighboring properties."[165] The common way operators exercise this duty is to drill additional offset wells.[166]

There is not a large assortment of Ohio case law on this covenant, but the Supreme Court has recognized its existence in several decisions.[167] When determining whether to find a breach of this covenant, the plaintiff "has the burden of establishing the affirmative of the following questions: 'Was there productive gas, of sufficient quantity to warrant operations, under the lands of the lessor?' and 'Was the same drained into the wells on adjoining lands by reason of the failure of the lessee to drill wells for the protection of the lessor's lines?'"[168] When concluding whether these questions are answered in the affirmative or the negative, the standard is that "usually found in the same business of an ordinary prudent man, neither the highest nor lowest, but about medium or average."[169] In other words, the court applies the reasonably prudent operator standard.[170] To prove that they were damaged because of drainage, the Ohio Supreme Court has stated that testimony must be brought forth demonstrating that oil or gas

[164] *Id.* at 555.

[165] Hall, *supra* note 31, at 321.

[166] *Amoco v. Alexander*, *supra* note 92, at 555.

[167] *See* Bucher v. Plymouth Oil & Gas Co., 140 N.E. 940, 940 (Ohio 1923); Ohio Fuel Supply Co. v. Shilling, 127 N.E. 873 (Ohio 1920).

[168] Williams v. Samuel J. Brendel Oil & Gas, Inc., 1937 WL 4335 (Ohio App. 9 Dist. April 2, 1937) (stating the rule the Ohio Supreme Court has abided by in its previous decisions).

[169] Weisant v. Follett, 17 Ohio App. 371, 375 (Ohio App. 7 Dist. 1922).

[170] *See Id.*

previously existed under the lessor's land in an amount adequate to warrant drilling and marketing of the same.[171]

In *Bucher v. Plymouth Oil & Gas Co*, the Court affirmed judgment of the lower court which found that the plaintiff had failed to show that the defendant had violated the covenant to protect her lines from drainage.[172] The lessor failed to provide evidence that "that there was productive gas under her property of sufficient quantity to warrant operations, and there was no evidence showing the cost of drilling a well on her property so as to determine whether, even if gas was found there, it would be in sufficient quantities to warrant the expense of operations."[173] This requirement that the preventative drilling would have been cost-effective for the operator goes along with the general oil and gas law principle that performance by a lessee can only be required when it would not have been unprofitable for the lessee to do so.[174] In addition to the above-stated Ohio case law on the implied covenant to protect against drainage, Texas' treatment of the covenant should be considered in future Ohio cases.

Texas does not treat protection from drainage as its own covenant, but instead includes it underneath the broader "implied covenant to protect the leasehold."[175] It would be prudent of Ohio to do something similar and expressly include protection from drainage under the expansive covenant to conduct all operations that affect the lessor's royalty interest with

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[171] Evidence which may show that sufficient oil or gas previously existed may include "the location and productivity of wells on adjoining territory, the transitory nature of gas, [and] the direction of its flow." *Shilling*, 101 Ohio St. at 874.

[172] *Bucher*, 108 Ohio St. at 940.

[173] *Id.* at 941.

[174] *See* Rhoads Drilling Co. v. Allred, 123 Tex. 229, 246 (Comm'n App. 1934) (An operator "is not required to continue in their performance unless continuance will be profitable, not only to his lessor, but also to him."). *See also*, Rush v. King Oil Co., 220 Kan. 616, 619 (1976) ("A lessee is under no duty to undertake development which is unprofitable to him just because it might result in some profit to the lessor").

[175] Amoco Production Co. v. Alexander, 622 S.W.2d 563, 568 (Tex. 1981).

reasonable care and due diligence. Certainly the loss of oil or gas due to the lessee's inability to keep neighboring wells from draining the lessor's resources would affect the lessor's royalty interest.[176] And because the lessor has temporarily given up his mineral rights to the lessee, he has no measures to take against drainage other than to rely on the knowledge and attentiveness of the lessee in preventing such a problem.[177] Thus, if it can be shown that a reasonably prudent operator would have protected the lines,[178] a breach of the covenant to conduct all operations with reasonable care and due diligence would exist.

In *Amoco Production Co. v. Alexander*,[179] the Texas Supreme Court stated that protecting against drainage "is not limited to local drainage."[180] "It extends to field-wide drainage."[181] While local drainage refers to "the migration away from a lease which occurs because a producing well on an adjacent lease lowers the pressure within the deposit in the vicinity of the well's bore," field-wide drainage "is unidirectional and bears no relation to the location of producing wells."[182] The Court explained that the duty to protect against drainage was broad enough to include field-wide drainage because any oil or gas stolen from beneath the lessor's property is lost, whether it occurs through local drainage or field-wide drainage.[183] The opinion noted that the intricacies of the oil and gas industry preclude an all-inclusive list of the duties of a

[176] Munster, *supra* note 40, at 416 ("A landowner may be deprived of oil and gas underlying his property by drainage to adjoining lands. This loss may permanently deprive the landowner of substantial royalty.").

[177] *Id.* at 416 ("Since the lessor by leasing has deprived himself of the right to take protective action by drilling off-set wells himself, such action must be taken by the lessee.").

[178] Weisant v. Follett, 17 Ohio App. 371, 375 (Ohio App. 7 Dist. 1922).

[179] *Alexander*, 622 S.W.2d at 563.

[180] *Id.* at 568.

[181] *Id*.

[182] *Amoco v. Alexander*, *supra* note 92, at 555.

[183] *Alexander*, 622 S.W.2d at 568.

reasonably prudent operator under this covenant.[184] However, seven duties were listed which may—depending on the circumstances of a particular case—be representative of a reasonably prudent operator's efforts to protect the lessor's property from field-wide drainage, including "drilling replacement wells, re-working existing wells, drilling additional wells," and "seeking field-wide regulatory action."[185] Although Ohio courts should, like the Texas Supreme Court, not consider this an all-encompassing list, these listed duties provide a firm base of what the courts should focus their attention on when determining whether a lessee has been a reasonably prudent operator.

4. Covenant to operate the premises with reasonable care and due diligence

The implied covenant of diligent operation is perhaps the most important covenant existing under oil and gas law because of its broad reach.[186] Depending on how just how far-reaching a court decides to extend this covenant, a lessee

> may be required to determine whether it will use new processes developed in the industry, make the proper decision on which formations to produce, select the proper rate of production, and ascertain whether it should install additional equipment, commence secondary recovery, employ safety measures to avoid fire hazards, and represent the interest of the mineral estate before administration bodies.[187] Because of these broad strokes, the failure of a state to imply this covenant under oil and gas leases could leave lessors with no assurance of ever receiving any benefit of their bargain.[188]

[184] *Id.* at 568 ("[T]he courts cannot list each obligation of a reasonably prudent operator which may arise. The lessee must perform any act which a reasonably prudent operator would perform to protect from substantial drainage.").

[185] *Id*.

[186] *See* Conine, *supra* note 23, at 689 (Issues under the implied covenant of diligent and prudent operation "will range from how to drill the well to how to operate it after drilling is complete. Questions will arise in connection with all aspects of operations, including testing, completing, operating, reconditioning, and plugging the well.").

[187] *Id.* at 689-90.

[188] *See* Legard v. EQT Production, 2011 WL 86598 at *12 (W.D. Va. 2011).

The far-reaching possibilities of this covenant could be especially vital in Ohio over the next several years as landowners look to find a way out of lease agreements they signed under less favorable conditions to cash in on the large signing bonuses lessors are currently getting with the major oil companies.[189]

The Ohio Supreme Court, in *Ionno,* mentioned the duty of a lessee to operate with reasonable diligence; however, the court did not seem to distinguish this covenant from the implied covenant to reasonably develop the land,[190] thereby failing to indicate whether the covenant to operate with diligence is its own covenant. More than 50 years before the Supreme Court's decision in *Ionno*, Ohio's Fourth District Court of Appeals recognized that "[t]here is an implied condition in the usual and ordinary oil and gas leases, if none is so expressed, to operate the premises with due diligence."[191] In *Tedrow v. Shaffer*, the covenant was breached when the property produced only about 36 barrels over the final 8 years under the lease.[192] In fact, although the well produced a few gallons of oil the day the lease ended, that was the first oil obtained from the well in more than 7 years.[193] The court found that, based upon these facts, the lessee had failed to make an effort "to exhaust the oil or gas under the premises leased," constituting a breach of the covenant to operate the premises with due diligence.[194]

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[189] *See, e.g.,* Lee Morrison, *supra* note 18 (stating that "[c]ompetition from oil and gas drilling companies scrambling to put together 620-acre units or bigger before beginning horizontal exploration is generating record-high signing bonuses for Ohio property owners").

[190] *See* Ionno v. Glen-Gerry Corp, 443 N.E.2d 504, 507 (Ohio 1983) ("This court has long adhered to the general principle that absent express provisions to the contrary, a mineral lease includes an implied covenant to reasonably develop the land. Thus, where a lease fails to contain any specific reference to the timeliness of development, the law will infer a duty to operate with reasonable diligence.").

[191] Tedrow v. Shaffer, 23 Ohio App. 343, 346 (Ohio App. 4 Dist. 1926).

[192] *Id*.

[193] *Id*.

[194] *Id*. at 347.

The Fifth District Court of Appeals has also applied the covenant to operate with reasonable care and due diligence.[195] In its analysis of this covenant, the Fifth District has bundled it with the implied covenant to market,[196] although the District has also indicated that the covenant's reach also includes a duty to not unreasonably delay operations under the lease.[197] However, the Seventh District seems to have summed up this covenant more sensibly than the Ohio Supreme Court or any of state's other Districts, stating that a "lessee has an implied duty to use diligence in making his wells productive and marketing the product."[198] As indicated earlier in this Comment,[199] as well as by the above-quoted language from the Seventh District, there seems to be no need for a separate covenant to market as it fits neatly under this covenant to operate with diligence. Consequently, it would be practical for the Ohio Supreme Court to adopt the Seventh District's succinct statement on the covenant to operate with due diligence, as well as flesh out the extent of the phrase "making his wells productive."[200] At a minimum, though, the Supreme Court should explicitly state that this covenant can be asserted by lessors so that landowners are not limited to asserting one of the other, less expansive, covenants.[201] With this

[195] Am. Energy Serv. v. Lekan, 598 N.E.2d 1315, 1321(Ohio App. 5 Dist. 1992) ("in every lease, unless it is specifically excluded, there is an implied condition that the lessee will operate the covenant with due diligence").

[196] *Id.* (stating that "[t]he covenant to market the product places an obligation upon a lessee to use due diligence to market the gas and/or oil produced from a well").

[197] *See* Snyder v. Glen Gery Corp, CA 5490, 1981 WL 6203 at *3 (Ohio App. 5 Dist. Mar. 31, 1981) ("There is no question but that in Ohio a mineral lease is made upon the implied condition that the lessee will proceed with due diligence since it would be unjust and unreasonable to permit a lessee to hold mineral land for any length of time without making a reasonable effort to operate in accordance with the purpose of the lease. Even where a land owner gives a mineral lease which provides that the lessee shall make an annual payment for every year he fails to operate thereunder, it is nevertheless the duty of the lessee not to delay the development and operations thereunder for any unreasonable length of time, unless the obligation of or unreasonable delay by the lessee in such respect is waived.").

[198] Christman v. Holmes, 512, 1978 WL 214845 at *2 (Ohio App. 7 Dist. Feb. 16, 1978).

[199] *See* Section(A)(1).

[200] *See Christman*, 1978 WL 214845 at *2.

[201] *See* Conine, *supra* note 23, at 689 (Issues under the implied covenant of diligent and prudent operation "will range from how to drill the well to how to operate it after drilling is complete. Questions will arise in connection with all aspects of operations, including testing, completing, operating, reconditioning, and plugging the well.").

covenant and others at their disposal, it will be less likely to see lessors left with no recourse when a lessee is inexperienced or unproductive.[202]

B. The ability to disclaim implied covenants in a lease.

Although oil and gas leases contain implied covenants by default, most states, including Ohio, have ruled that these covenants only apply if they are not referenced or disclaimed in the lease.[203] Therefore, if the parties to a lease do not wish for any implied covenants to exist in their agreement, they can take steps to avoid their implication. The general policy behind allowing parties to avoid implied covenants is that ultimately the parties have a right to determine what their rights and duties will be under the agreement.[204] The parties may "enlarge, restrict, or entirely abrogate the duties that otherwise would be imposed upon the lessee by implication."[205] This policy is wholly logical because it would contravene the intent of the parties to not honor matters unambiguously expressed in the lease.[206] This altering of the explicit language of the lease would create a contract different than that which was specifically adopted by the parties.[207] In addition, these covenants are not implied to create a "fair contract,"[208] but rather, as the Texas Supreme Court has stated, because the lease does not address the issues the

[202] "Implied covenants can "protect lessors from negligent and incompetent lessees." Jacqueline Lang Weaver, *supra* note 30, at 494.

[203] *E.g.,* Holonko v. Collins, 87 C.A. 120, 1988 WL 70900 (Ohio App. 7 Dist. June 29, 1988) (stating that "[t]he law seems to be well settled in Ohio that there can be no implied covenant in a contract in relation to any matter that is specifically covered by the written terms of the contract itself").

[204] *See* Walker, Jr., *supra* note 42, at 407.

[205] *Id.*

[206] Kachelmacher v. Laird, 110 N.E. 933, 935 (Ohio 1915) (stating that "[t]he rights of the parties must be determined from their own contract").

[207] Hutchison v. Sunbeam Coal Corp., 519 A.2d 385, 388 (Pa. 1986) ("The law will not imply a different contract than that which the parties have expressly adopted.").

[208] Robert O. Stapel, *Unmasking the Implied Covenant to Further Explore in Oil and Gas Leases*, 11 OHIO N.U. L. REV. 109, 110 (1984) (asserting that courts "will not imply a covenant simply because it will make a fair contract; the court must feel that without the covenant the contract operates unjustly").

implied covenants cover.[209] Thus, "unless expressly negated," the implied covenants define the lessee's duties under the lease.[210]

As long as the provision in question clearly expresses the specific subject covered by the implied covenant and the provision was "entered into without fraud or mutual mistake," the general rule is that the covenant cannot be implied.[211] This is consistent with the principle of "freedom of contract," which says that parties to a contract have the right to determine the terms by which their relationship will abide by.[212] This is because, "[i]n general, parties have complete freedom to enter into a contract."[213] The main approach behind the freedom of contract is that, presumably, "parties are in the best position to make decisions in their own interest,"[214] and if they feel implication of these duties is not in their best interest, it should be their right to do so.[215] It is not within the power of the court system to create a contrary agreement; "contracts voluntarily and fairly made should be held valid and enforced in the courts."[216] As such, the Ohio Supreme Court has long allowed parties to disclaim implied covenants if they explicitly state intent to do so in the lease.[217]

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[209] *See* HECI Exploration Co. v. Neel, 982 S.W.2d 881, 889 (Tex. 1998).

[210] Smith v. N.E. Natural Gas, Tuscarawas App. No. 86AP30016, 1986 WL 11337 at *3 (Ohio App. 5 Dist. Sept. 30, 1986).

[211] Brimmer v. Union Oil Co. of California, 81 F.2d 437, 440 (10th Cir. 1936).

[212] Greene v. Oliver Realty, Inc., 363 Pa. Super. 534, 545, 526 A.2d 1192, 1197 (1987).

[213] Jones v. Centex Homes, 939 N.E.2d 1294, 1299 (Ohio App. 10 Dist. 2010) (quoting Brandon/Wiant Co. v. Teamor, 708 N.E.2d 1024, 1028 (Ohio App. 8 Dist. 1998)).

[214] Arrowhead Sch. Dist. No. 75, Park County v. Klyap, 79 P.3d 250, 256 (Mont. 2003).

[215] *See* Walker, Jr., *supra* note 42, at 407.

[216] The state of Connecticut recognizes that freedom contract is favored by public policy. "It is established well beyond the need for citation that parties are free to contract for whatever terms on which they may agree." Gray v. T.C. Healthcare I, LLC, CV106012126, 2012 WL 3064527 (Conn. Super. 2012).

[217] *See, e.g.*, Beer v. Griffith, 399 N.E.2d 1227 (1980).

In *Ionno*, the Supreme Court of Ohio indicated the general rule is "that absent provisions to the contrary, a mineral lease includes an implied covenant to reasonably develop the land."[218] Therefore, when the lease at issue does not "contain any specific reference to the timeliness of development, the law will infer a duty to operate with reasonable diligence."[219] While *Ionno* only dealt with the covenant to reasonably develop,[220] the same principle can be applied to any of the other possible implied covenants. As such, express lease provisions which reject the implied covenants have been consistently enforced by Ohio courts."[221]

Although any language which clearly expresses the desire of the parties to disclaim implied covenants would presumably be ruled effective in Ohio, a specific provision which has definitely been ruled operative by several Ohio appellate courts is:

> It is mutually agreed that this instrument contains and expresses all of 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 imposed upon the parties or either of them.[222]

In *Bushman v. MFC Drilling, Inc.*, the lessor argued that "public policy prohibits a general disclaimer of the implied covenant to develop the leased property."[223] According to the lessor, the lease needed to contain specific language addressing the implied covenant to develop.[224] However, the Ninth District Court of Appeals found the lessor's argument unpersuasive and

[218] Ionno v. Glen-Gerry Corp, 443 N.E.2d 504 (1983).

[219] *Id.* at 506.

[220] *Id.* (the "lease in question contains no express disclaimer of the covenant to develop within a reasonable time").

[221] Bushman v. MFC Drilling Inc., 2403-M, 1995 WL 434409 (Ohio App. 9 Dist. July 19, 1995) (stating that "Ohio courts have consistently enforced express provisions in such leases that disclaim the implied covenant").

[222] Taylor v. MFC Drilling, Inc., 1995 WL 89710 (Ohio App. 4 Dist. Feb. 27, 1995); Smith v. N.E. Natural Gas, Tuscarawas App. No. 86AP30016, 1986 WL 11337 (Ohio App. 5 Dist. Sept. 30, 1986); Holonko v. Collins, 87 C.A. 120, 1988 WL 70900 (Ohio App. 7 Dist. June 29, 1988)

[223] *Bushman*, 1995 WL 434409.

[224] In other words, simply stating that "no implied covenants, agreement, or obligation shall be read into this agreement or imposed upon the parties" should not be sufficient to disclaim specific covenants. *Id.*

ruled that "a general disclaimer of implied covenants effectively [disclaims] the implied covenant to reasonably develop the leased property."[225] This is a reasonable approach, especially considering the aforementioned lack of clarity in Ohio law concerning what implied covenants are actually operative.[226] Until the Ohio Supreme Court provides a breakdown of which implied covenants the state recognizes, it would be irrational to expect those drafting oil and gas leases to disclaim specific implied covenants which may not even exist under Ohio law.[227]

The Ninth District's ruling can also be understood as consistent with the abovementioned principle of the right to contract.[228] Although public policy concerns can override the freedom of contract, such policy fears must be "overwhelming" because the concept "is considered to be fundamental to our society."[229] A general disclaimer like the clause used in the *Bushman*[230] lease is fairly broad, but such a clause clearly states the parties' intent to not include any of the implied covenants within their agreement. If Ohio courts are truly careful not to infringe on the parties' right to make a contract of their own choosing,[231] such a clause should be enforced because an unambiguous disclaimer of the implied covenants does not appear to be against Ohio public

[225] In addition, the court stated that it was "unable to conclude that public policy requires anything more than a general waiver of implied covenants." *Id.*

[226] See Section III(A).

[227] However, an example of a provision which would likely be clear enough to disclaim the specific implied covenant to reasonably develop: "No covenant or condition regarding the measure of diligence to be exercised by lessee in the drilling or development of the leased premises shall be read in to this lease, the parties having agreed that the provisions of this instrument set forth the exclusive conditions under which lessee shall hold this lease." 9 Am. Jur. Legal Forms 2d § 129:115.

[228] *See* Jones v. Centex Homes, 939 N.E.2d 1294, 1299 (Ohio App. 10 Dist. 2010) ("[i]n general, 'parties have complete freedom to enter into a contract'").

[229] *Id.*

[230] Bushman v. MFC Drilling Inc., 2403-M, 1995 WL 434409 (Ohio App. 9 Dist. July 19, 1995)

[231] *See Centex Homes*, 939 N.E.2d at 1299 (Courts "must apply the doctrine of public policy with caution so as not to infringe on the parties' right to make contracts that are not clearly opposed to some principle or policy of law."); *See also* Brandon/Wiant Co. v. Teamor, 708 N.E.2d 1024, 1028 (Ohio App. 8 Dist. 1998).

policy.[232] The Supreme Court of Ohio, in discussing the importance of the freedom to contract, has stated that the right of parties to contract "with the expectation that the contract shall endure according to its terms is as fundamental to our society as the right to write and to speak without restraint."[233] To hold that general disclaimers of implied covenants in oil and gas leases are invalid would be in contravention of the deference the Supreme Court has previously given to parties in the area of contract drafting.[234]

Thus, Ohio's highest court should take a page from the Texas Supreme Court, which has continually stressed that courts cannot make the parties' contract for them.[235] In *HECI Exploration Co. v. Neel*, that Court ruled that "[c]ontractual implications 'are justified only on the ground of necessity.'"[236] Necessity does not contemplate reforming a contract through the use of implied covenants so that the contract becomes more balanced in the eyes of the court.[237] Therefore, to ensure that lower courts do not overstep their judicial bounds, the Ohio Supreme Court should definitively rule that any express provisions which attempt to negate the implied covenants will be accepted as sufficient.[238] With the high number of leases which are currently being negotiated and drafted within the state,[239] this clarification is particularly crucial in

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[232] In *Centex*, the court reasoned that there is "no Ohio authority for the proposition that a clearly disclosed disclaimer of the implied warranty [of good workmanship] is against the public policy of this state." *Centex Homes*, 939 N.E.2d at 1299. A similar analysis would seem to apply as to the implied covenants contained in oil and gas leases.

[233] Lake Ridge Academy v. Carney, 613 N.E.2d 183, 187 (Ohio 1993).

[234] Cincinnati City Sch. Dist. Bd. of Edn. v. Conners, 974 N.E.2d 78, 82-83 (Ohio 2012) (affirming that "[t]he freedom to contact is a deep-seated right that is given deference by the courts").

[235] HECI Exploration Co. v. Neel, 982 S.W.2d 881, 888 (Tex. 1998) ("[o]ur decisions have repeatedly emphasized that courts 'cannot make contracts for [the] parties'").

[236] *Id.* at 889 (quoting W.T. Waggoner Estate v. Sigler Oil Co., 118 Tex. 509, 519 (1929)).

[237] *HECI Exploration Co.*, 982 S.W.2d at 889.

[238] *See Id.* ("[w]e have imposed implied covenants only when they are fundamental to the purposes of a mineral lease and when the lease does not expressly address the subject matter o the covenant sought to be implied").

[239] In Stark County, more than four times as many leases were filed with the recorder's office in 2011 than the previous year. Cantonrep.com Staff Reports, *Oil, gas lease filing more than quadruples in 2011*, THE CANTON

ensuring that the parties to these negotiations know what language they should employ in their lease if they wish to remove the implied covenants.

C. Forfeiture of a lease upon breach of an implied covenant.

As Ohio's fracking boom continues to take shape, many landowners will be looking to terminate decades old leases in order to obtain a new lease with larger bonus payments.[240] However, forfeiture is typically disfavored by Ohio courts,[241] and, thus, the courts have been reluctant in the past to forfeit a lease upon finding that a lessee breached an implied covenant.[242] Instead, the Ohio Supreme Court has held that damages are the default award for a breach of an implied covenant.[243] Because forfeiture is an equitable remedy, it will not be granted unless a lessor can show that damages are insufficient.[244]

In *Harris*, the express language of the lease in question allowed for forfeiture upon "failure to comply with the conditions, or to pay the cash consideration in the lease mentioned, at the time and in the manner agreed."[245] But the implied covenant to reasonably develop—which was not mentioned in the lease—was not stated as a cause for forfeiture and, consequently, the court ruled that "[s]ome causes of forfeiture being expressly mentioned, none other can be

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REPOSITORY (Jan. 9, 2012, 7:00 AM), http://www.cantonrep.com/news/x735289224/Oil-gas-lease-filing-more-than-quadruples-in-2011.

[240] *See* Keller & Russell, *supra* note 20, at 13.

[241] Munster, *supra* note 40, at 418 (stating that "forfeitures usually are looked upon with disfavor").

[242] *See, e.g.*, Harris v. Ohio Oil Co., 57 Ohio St. 118, 131 (1897) ("[s]ome cause of forfeiture being expressly mentioned, none other can be implied"); Kachelmacher v. Laird, 110 N.E. 933, 935 (Ohio 1915) ("[s]uch cause of forfeiture being expressly mentioned, none other can be implied").

[243] Ionno v. Glen-Gery Corp., 443 N.E.2d 504, 505 (1983).

[244] *Id.*

[245] *Harris*, 57 Ohio St. at 131.

implied."[246] In its next two cases concerning the implied covenants—*Kachelmacher* and *Beer*—the Ohio Supreme Court held true to this ruling as both decisions quoted or paraphrased this language.[247] However, in *Ionno* the majority of the Court moved, at least slightly, towards making forfeiture a more likely remedy for breach of an implied covenant.[248]

After stating the rule that causes of forfeiture cannot be implied where others are stated,[249] the court quoted from the syllabus of the *Beer* decision for an exception to the rule. Paragraph four of *Beer*'s syllabus stated that "[w]here legal remedies are inadequate, forfeiture or cancellation of an oil and gas lease, in whole or in part, is an appropriate remedy for a lessee's violation of an implied covenant."[250] Using this language, the majority stated in *Ionno* that the Court's *Beer* opinion "does not stand for the proposition that forfeiture can never be imposed where there is a breach of an implied covenant."[251] Even though explicit grounds for forfeiture may be identified in the lease, others may be permitted if necessary "to do justice to the parties."[252] The majority did state that for this exception to apply, there would need to be a "strong showing of a violation of a clear right[,]" because of the "extreme" nature of the measure,[253] but nonetheless the decision clearly made forfeiture a more readily available

[246] *Id.*

[247] *Kachelmacher*, 92 Ohio St. at 935 (1915) ("[s]uch cause of forfeiture being expressly mentioned, none other can be implied"); Beer v. Griffith, 399 N.E.2d 1227, 1230 (Ohio 1980) ("[s]ince 'certain causes of forfeiture … [are] specified in the lease, other cannot be implied").

[248] *See Ionno*, 443 N.E.2d 504.

[249] *Id.* at 508.

[250] *Beer*, 399 N.E.2d at 1229.

[251] *Ionno*, 443 N.E.2d at 508.

[252] *Id.*

[253] *Id.*

remedy.[254] Since *Ionno*, several lower courts have found fact scenarios which necessitate the granting of forfeiture.[255]

The Ninth District Court of Appeals decided *Streck v. Reed* later that year.[256] After finding that the trial court had correctly found that a breach of the implied covenant to reasonably develop,[257] the appellate court was confronted with whether forfeiture was an appropriate remedy for said breach. Since the lease at issue did not contain an express forfeiture clause, the court was able to use "its equitable power to 'assure the development of the land and the protection of the lessor's interest.'"[258] Because the lessee had abandoned Parcel #2 under the lease, forfeiture of that parcel was an appropriate remedy.[259] The Ninth District is not alone in finding cancellation of a lease to be an appropriate remedy in some circumstances.[260]

In *American Energy Services, Inc. v. Lekan*, the Fifth District affirmed the decision of a Court of Common Pleas to grant a motion for summary judgment.[261] The motion had been granted on several issues, including violation of the implied covenant to use due diligence for which the court granted forfeiture.[262] A number of facts played into the court's decision that

[254] In the end, the majority found that the lessor had not met the standards for the exception to apply. The only relief sought in the lessor's complaint was forfeiture and "the lessor has the burden of proving damages are inadequate before such forfeiture may be declared." *Id.*

[255] *See* Streck v. Reed, 1983 WL 4132 (Ohio App. 9 Dist. June 8, 1983); Am. Energy Serv. v. Lekan, 598 N.E.2d 1315 (Ohio App. 5 Dist. 1992).

[256] *Streck*, 1983 WL 4132.

[257] *Id.* at *4.

[258] *Id.* (quoting Beer v. Griffith, 61 Ohio St.2d 119, 122 (1980)).

[259] *Streck*, 1983 WL 4132 at *4.

[260] *See Lekan*, 598 N.E.2d 1315.

[261] *Id.* at 1316.

[262] *Id*.

forfeiture was an appropriate remedy.[263] The lessee had drilled just one well on the property, Moyers No. 1, which had never been placed into production[264] even though the well had been drilled more than 17 years prior to the lessor filling its complaint.[265] The lessee also had very little experience in the oil and gas industry as he had drilled just three other wells in his life.[266] Lastly, and most importantly to the issue of forfeiture, the equipment on the well site was used and in very poor condition.[267] A petroleum engineer stated that any attempt to repair the equipment would be unsuccessful and that "any attempts to produce or test the well without dismantling, reconditioning or replacing the surface equipment as necessary would create a safety hazard and expose anyone on the leasehold to the potential for serious personal injury."[268] As such, for justice to be done to the parties and "to protect the lessor's interest," the court declared that forfeiture, and not damages, was the correct remedy.[269]

The decisions in *Streck* and *Lekan* appear to make sense from a policy standpoint as they assure that the land in question will be developed and that the lessor's interest will be protected.[270] When a lessor enters into an oil and gas lease, he expects income from the lessee's drilling on the leased land.[271] A lessor wants to see their property's resources extracted by the lessee.[272] But if courts are reluctant to allow forfeiture, it could "allow a lessee to encumber a

[263] *Id.* at 1322-23.

[264] *Id.* at 1320 ("Q: Has the well actually ever been placed in production? A: Never.").

[265] The well was drilled on October 8, 1972 and the lessor filed its complaint on February 5, 1990. *Id.* at 1318.

[266] *Id.* at 1322-23.

[267] *Id.* at 1323 (describing "the dilapidated condition of the equipment").

[268] *Id*.

[269] *Id*.

[270] *See id.* at 1322 ("[i]n forfeiting a portion of the undeveloped acreage, the court noted that it was doing so in order to assure the development of the land and the protection of the lessor's interest").

[271] Barkacs v. Perkins, 847 N.E.2d 481, 484 (Ohio App. 6 Dist. 2006).

[272] Cyril A. Fox & Mary J. Hackett, *Implied Obligations to Mine*, 7 E. MIN. LAW INST. 4-1, 4-28 (1986).

lessor's property in perpetuity, without any return of income to the lessor."[273] Thus, although Ohio courts are certainly not overtly hostile to applying the remedy of forfeiture,[274] the Ohio Supreme Court should move even further and treat forfeiture the way the neighboring state of Kentucky does so that lessors are provided more protection against unproductive lessees.

In Kentucky, forfeiture is a favored remedy for breach of the implied covenants.[275] The only requirement for the remedy to be available is that the lessee be given notice.[276] If a lessor plans to seek forfeiture, he must "provide notice and demand due diligence prior to filing suit" against the lessee for breach of an implied covenant.[277] The notice provided must be "unequivocal and so certain and definite as to advise the lessee what is demanded and expected of him."[278] This way, the lessee is alerted that unless his operations on the lessor's land improve in the specified area—whether it be marketing, development or one of the other covenants—he risks losing his rights to mine the property.[279]

Kentucky's treatment of forfeiture is consistent with the purpose for which a lessor and lessee come together through an oil and gas lease, that is, for the joint benefit and profit of both parties.[280] If the lessee is provided notice, he is given a chance to correct his mistake through

[273] *Barkacs*, 847 N.E. at 484.

[274] Ionno v. Glen-Gery Corp., 443 N.E.2d 504, 508 (Ohio 1983) (stating that forfeiture can be applied "to do justice to the parties").

[275] *See* Monarch Oil, Gas & Coal Co. v. Richardson, 99 S.W. 668 (Ky. 1907) ("forfeitures which arise in gas and oil leases by reason of the neglect of the lessee to develop or operate the leased premises are rather favored").

[276] Hiroc Programs, Inc. v. Robertson, 40 S.W.3d 373, 377 (Ky. App. 2000).

[277] *Id*.

[278] Lawrence Oil Corp. v. Metcalfe, 43 S.W.2d 986, 989 (Ky. 1931).

[279] *Robertson*, 40 S.W.3d at 378.

[280] Streck v. Reed, 1983 WL 4132 at *3 (Ohio App. 9 Dist. June 8, 1983).

development of the land the way the parties intended when they entered into a contract.[281] As stated by the Kentucky Court of Appeals, making forfeiture an attainable remedy is "essential to private and public interest in relation to the use and alienation of property."[282] With the current state of fracking in Ohio, permitting landowners to execute new leases when lessees neglect to develop a property's minerals is not only in the interest of the lessor, but the Ohio economy as a whole.[283] Further, the uncertainty that exists in the oil and gas industry[284] makes the timing of development of mineral rights of the upmost importance and, as such, continued delay only serves to lessen the chances that a lessor can cash in on new technologies in the industry.

At the same time, Kentucky's rule is not excessively harsh towards lessees because of the notice requirement that exists[285] and the fact that the rule only permits forfeiture of undeveloped portions of the lease, thus "preserving all the rights of the lessee in the developed portion" of the lease, if any such portion exists.[286] Rather than give judges and juries the power to decide whether forfeiture is necessary "to do justice to the parties,"[287] Ohio should provide lessors the right to forfeiture of a lease if they fulfill the notice requirement and are able to prove breach of one of the implied covenants.[288] This would further the public interest as lands which contain

[281] *See Metcalfe*, 43 S.W.2d at 989 (stating that the notice alerts the "the lessee [to] what is demanded and expected of him" by the lessor).

[282] Monarch Oil, Gas & Coal Co. v. Richardson, 99 S.W. 668 (Ky. 1907).

[283] In few other industries is "prompt performance of contracts so essential to the rights of the parties, or delay by one party likely to prove so injurious to the other." *Id.* at 669.

[284] *See, e.g.*, Dan Gearino, *Utica-shale estimate doubted*, THE COLUMBUS DISPATCH, Oct. 13, 2012.

[285] *See Robertson*, 40 S.W.3d at 378 ("he is entitled to notice that he must improve his operations, and should he fail to heed the notice, suit will be brought to cancel the lease").

[286] *Metcalfe*, 43 S.W.2d 986, 989.

[287] Ionno v. Glen-Gerry Corp, 443 N.E.2d 504, 508 (Ohio 1983).

[288] *See Robertson*, 40 S.W.3d at 377.

resources like oil and gas would not be permitted to go undeveloped[289] because of idle or financially strapped lessees.

IV. CONCLUSION

As demonstrated in this Comment, the Ohio courts have yet to fully flesh out the role of implied covenants in oil and gas leases.[290] Oil companies will continue to look to exploit the resources contained in the Utica and Marcellus formations,[291] and, consequently, landowners will look for ways out of old leases so they can sign new leases with these interested companies. In both instances, a more complete analysis of the covenants by the Supreme Court of Ohio would go a long way in helping both lessors and lessees to know how these covenants can be used by themselves and opposing parties.[292] As shown throughout this Comment, there are a number of states which have more fully explored the implied covenants. These states should serve as a template for the Supreme Court as it looks to provide the lower courts with a framework in this area. As a starting point, though, the Court should recognize four implied covenants, namely, the covenant to market; the covenant to reasonably develop; the covenant to protect the lease from drainage; and the covenant to operate the premises with reasonable care and due diligence. Secondly, it should explicitly rule that if an unambiguous clause in a lease states that the parties disclaim the implied covenants, it will be enforced by the Ohio courts. Finally, the Court should make forfeiture a more readily available remedy for breach of the implied covenants by making notice the only requirement for a lessor to have the option of forfeiture.

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[289] Romero v. Humble Oil & Ref. Co., 93 F. Supp. 117, 120 (E.D. La. 1950) modified, 194 F.2d 383 (5th Cir. 1952).

[290] Bibikos & King, *supra* note 9, at 189.

[291] *See, e.g.*, Jeff Bell, *Utica, Marcellus shale plays could represent more than $10 trillion in new economic activity*, COLUMBUS BUSINESS FIRST, Jan 17, 2013.

[292] *See* Bibikos & King, *supra* note 9, at 157 (asking the question "how does one comply with the law of a state when it has very limited oil and gas jurisprudence?").