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The Courts: Recent Developments and Looming Challenges

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The Courts: Recent Developments and Looming Challenges

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Bonus Payments and Royalties

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Bonus Cases

December 2007 – Spring 2008

- Market booming
- Bonus payments went from $25/acre to $2,500/acre or more
- Landowners wanted out of existing leases so they tried to invalidate/terminate leases in order to negotiate new leases on more favorable terms, including more favorable bonus payments

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Fall 2008

- Market collapsed
- Landowners want to enforce proposed leases negotiated before collapse to collect favorable bonuses

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Facts

- Producer provided landowner with lease and other documents stating that gas company would pay landowner bonus of $2,500/acre “subject to approval of title and management lease review.”
- Landowner signed and returned lease to producer
- Producer did not sign lease, but instead, rejected and returned lease to landowner and did not pay bonus
- Landowner sued producer for breach of contract for failing to make bonus payment

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Plaintiffs' Basic Contention:

- A contract is formed at the moment a landowner signs an oil and gas lease
- As a result, any bonus payments are due to the landowner if they sign the lease, even if it subsequently turns out that the lease is rejected by the gas company because of title, geology, location, or any other reason

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Response to Plaintiffs' theory:

- A contract is not formed at the moment the landowner signs the lease
- Rather, the landowner signing the lease constitutes an offer to the gas company that the gas company can accept or reject
- Bonus payments are not due until and unless gas company accepts the landowner's offer
- Producer filed motion to dismiss complaint on several grounds, including that no contract was ever formed

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- **4 federal judges (3 in Pennsylvania, 1 in West Virginia) have ruled no contract was ever formed even though landowner signed and returned lease to producer and GRANTED MOTIONS TO DISMISS**
  - Lease and other documents provided to landowner did not constitute an offer from producer to landowner because further manifestation of assent by producer was required
  - Landowner signing lease and returning it to producer constituted an offer from landowner to producer
  - By not approving/rejecting/voiding the lease and returning it to the landowner, the producer rejected the landowner's offer
  - As a result, no contract was formed and, therefore, no bonus was due

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- **Despite favorable decisions for producers, landowners still suing and even adding new claims, including antitrust claims**
  - Bid Rigging/Monopoly
  - Treble damages, attorney fees, onerous discovery
- **Federal judge in West Virginia has granted motions to dismiss the antitrust claims**

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Whether Signature of Gas Company on Lease Required

General Rule: Signature is not required unless expressly required by law or by the intent of the parties

- Intent of Parties:
  - "[T]he mere presence of signature lines does not determine whether the parties intended to be bound only upon the execution of the document by all the signatories."
  - "The inquiry is properly directed to whether the parties agreed to the terms in question and intended to be bound by the terms of the contract."

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Whether Signature of Gas Company On Lease Required (cont.)

- Law: Statute of Frauds
  - General Rule: Only requires party conveying the property, i.e., the lessor, to sign the lease
  - But a court in a bonus payment case has stated that it has failed to find "a single case in Pennsylvania where the party seeking to enforce the agreement or lease was the lessor or the seller and had filed a cause of action against the lessee or buyer who never signed the writing."
  - As a result, the court stated that it may be required to revisit the Statute of Frauds issue in the future

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Lesson

- If you want to prevent formation of contract before you sign lease, you should include more than just a signature line
- You should also include express term/provision that makes clear that an enforceable contract does not exist until all signatures are affixed to the contract

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Royalty Cases

Kilmer – Landowners' attempt to invalidate leases pursuant to Minimum Royalty Act unsuccessful when Pennsylvania Supreme Court held that the deduction of post-production costs did not violate the Minimum Royalty Act

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- **Despite favorable decision for producers, landowners still suing and again adding new claims**
- **Landowners not challenging *legality* of deduction of post-production costs but instead challenging the propriety of the *types* and *amounts* of the post-production costs being deducted**

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Challenged Deductions

Volume – point of sale vs. wellhead
Volume – temperature and pressure adjustments
Gathering
Dehydration
Compression
Treatment
Processing
Transportation
Marketing
Management

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Why do these bonus payment and royalty cases matter to the oil-and-gas industry?

- Numerous individual and class action lawsuits pending in federal and state trial courts throughout Pennsylvania and West Virginia in which landowners are seeking millions of dollars in bonuses/royalties that they claim are due to them
- A number of plaintiffs' lawyers have entered into this arena, and some have sent letters to landowners to enlist them as plaintiffs for individual lawsuits/class actions
- Depending on the specific language used in a proposed lease and accompanying documents, producers may have legal defenses that could result in early dismissal of cases on motions to dismiss or preliminary objections

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Water Well Contamination Cases

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Common Features of Factual Allegations

Conclusory allegations

Multiple defendants treated collectively

Allegations that “defendants” drilled, constructed, and operated natural gas wells in manner that caused groundwater contamination

Groundwater source alleged to be relatively close to gas well operations

Alleged contaminants include methane, minerals, and “hazardous substances”

Alleged injuries include personal injury, lost property value, “annoyance and discomfort,” costs of remediation, costs of future health monitoring, emotional distress

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Commonly-Asserted Claims

Hazardous Sites Cleanup Act (Sections 702, 1101, 1115)

Negligence (including negligence *per se*)

Private nuisance

Strict liability for abnormally dangerous activities

Trespass

Medical monitoring

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Elements of "Core" Claims

Negligence

- Duty of care
- Breach of duty
- Causation (actual and proximate)
- Damages

Strict Liability

- "Abnormally dangerous" activity. Restatement Section 520 factors:
  - Existence of high degree of risk of harm
  - Likelihood that harm will be great
  - Inability to eliminate the risk by exercise of reasonable care
  - Extent to which activity is not a matter of common usage
  - Inappropriateness of activity to the area
  - Extent to which activity's value to community is outweighed by dangerous attributes
- Causation
- Harm of the kind the possibility of which makes activity dangerous

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Potential Pleading Defects

Global

- Lumping of defendants, “shotgun” pleading

HSCA Section 1115

- Pre-complaint notice, prosecutorial inaction on part of PaDEP

HSCA Sections 702 and 1101

- “Hazardous substance,” “release,” causation

Negligence

- Breach of duty of care, causation

Private nuisance

- Causation, culpability, “neighboring” properties, mere residents

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Potential Pleading Defects (cont’d)

Strict liability

- “Abnormally dangerous” (specificity relative to Section 520 factors), causation

Trespass

- Intent, mere residents

Medical monitoring

- Negligence predicate, specificity (*e.g.*, significantly increased risk of contracting serious latent disease)

Punitive damages

- Scienter (more than gross negligence)

Emotional distress

- Physical manifestation

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Statutory and Regulatory Overlay

Oil and Gas Act

- Section 208 and implementing regulations
  - 25 Pa. Code 78.51 (protection of water supplies – restore or replace)
  - 25 Pa. Code 78.52 (pre-drilling surveys)
- Role of "Section 208 letter"
  - EHB appeals
- 25 Pa. Code 78.73(b) (prevent groundwater pollution)
- 25 Pa. Code 78.81(a) (casing and cementing to prevent gas migration and groundwater pollution)
- 25 Pa. Code 78.89 (gas migration response protocol)

Clean Streams Law

- Section 401

Viable basis for negligence *per se,* given structure and features of the statutes?

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Evidentiary Issues and Discovery

Well site selection (geologic investigation)

Well design (company/industry standards and well-specific)

Well construction (drilling, casing, cementing, materials/chemicals)

Chemical and isotopic analyses

Background conditions

Property valuation

Physical injury (nature and extent, pre-existing conditions)

Causation (pathways)

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Requested Remedies – Major Categories

Compensation for injury to property

- Reparable injury: cost of repairs up to pre-injury value of property
  - Stigma damages where repairs will not restore land to its prior value?
- Permanent injury: decrease in fair market value of property
- Inconvenience/discomfort damages – jury question

Compensation for personal injury

Costs of future health monitoring

Punitive damages

- Scienter (more than gross negligence)

Compensation for emotional distress

- Physical manifestation

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Forum

Arbitration

- Arbitration provision in oil and gas lease. Scope issues:
  - Meaning of "Lessee's operations" (on-site vs. off-site operations)
  - Plaintiffs or defendants who are non-parties to the lease
- One or more arbitrators preside, no jury trial, limited discovery, relaxed procedures, relatively speedy, limited right to appeal award

Court

- Judge presides, right to jury trial, extensive discovery, formal procedures, relatively drawn-out, right to meaningful appeal

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Some Recent Developments

Lipsky v. Durant, Carter, Coleman LLC, No. CV11-0798 (Parker Co. TX)

- Plaintiffs' claims against well operator dismissed in light of unappealed Texas Railroad Commission determination that well operations did not cause alleged contamination of groundwater supply.
- Motion to dismiss operator's multi-million dollar defamation counterclaim denied. According to court, owner of groundwater supply, under advice or direction of consultant, created a "deceptive video" that was "calculated to alarm the public into believing the water was burning."

Study by Energy Institute at University of Texas at Austin

- Conclusion: no direct link between hydraulic fracturing and groundwater contamination
- Surface spills of fracturing fluids pose greater risk to groundwater than fracturing itself
- Presence of background methane in groundwater

EPA Sampling Efforts in Dimock, Pennsylvania

- First round of groundwater sampling for first eleven (of approx. 60) homes did not show levels of contamination that could present health concern.
- All contaminant levels in all samples within safe range for drinking water.

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On the Horizon?

"Above ground" mass-nuisance cases

- Focus on dust, noise, air emissions, light, truck traffic
- Class actions vs. large number of individually-named plaintiffs
- Potential defenses

Issues in Ohio

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Avoiding Lease Termination

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Termination of Lease Agreements

Lessors' theories to avoid lease obligations:

- Initial wave of cases challenging formation and validity at the outset of relationship
- Now seeing cases seeking to terminate lease based on
  - failure to commence operations within lease term

    and
  - failure to produce in paying quantities (*Jedlicka*)

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Commencement of Operations

Henderson v. Ferrell (Pa. 1898)

- Lessee required to commence operations on leasehold within 30 days or lease would be "null and void."
- 30th Day: Drove stake to indicate where well would be drilled and where lumber should be deposited
- Employee began to unload lumber, and lessor stopped him.
- Activity was "commencement of operations" sufficient to perpetuate lease.

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Commencement of Operations

Pemco Gas, Inc. v. Bernardi (Armstrong Co. 1977)

- Lease term = 10 years "and so long after commencement of operations as said land is operated for the production of gas and oil"
- Applied and extended *Henderson*

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Commencement of Operations

Pemco Gas, Inc. v. Bernardi (Armstrong Co. 1977)

Significant Holdings:

(1) Actual drilling is not necessary.

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Commencement of Operations

Pemco Gas, Inc. v. Bernardi (Armstrong Co. 1977)

(2) Lease will be perpetuated where lessee performs "preliminary acts" before expiration of lease and then proceeds with diligence to complete well.

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Commencement of Operations

Pemco Gas, Inc. v. Bernardi (Armstrong Co. 1977)

- Preliminary acts may include:
  - Choosing well location
  - Hauling lumber on premises
  - Erecting derricks
  - Providing water supply
  - Moving machinery onto premises

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Commencement of Operations

Pemco Gas, Inc. v. Bernardi (Armstrong Co. 1977)

- Lessee took the following steps:
  - Surveying property
  - Negotiating with landowner re: location of well, ROW and damages for tree removal
  - Hiring excavation and drilling contractors
  - Obtaining a drilling permit
  - Placing conductor pipe on property

with intent to continue until well completed (good faith)

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Commencement of Operations

Kaszar v. Meridian Oil & Gas (Ohio Ct. App. 1985)

- Lease language: If lessee shall begin operations for commencement of a well during lease term, lessee shall then have right to complete drilling of such wells…

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Commencement of Operations

Kaszar v. Meridian Oil & Gas (Ohio Ct. App. 1985)

- During lease term, lessee took following action:
  - Had site surveyed and staked
  - Filed necessary papers with SEC
- Same result – sufficient to avoid termination of lease.

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Commencement of Operations

Consistent with courts in other jurisdictions

Summers, “Oil & Gas”

- There are acts sufficient to constitute beginning of operations when
  - lessee performs, in good faith, acts preliminary to actual drilling and
  - actually completes well with due diligence

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Commencement of Operations

Unitization

- For parcels properly included in unit, can look to activity anywhere on the unit
- Most leases expressly provide for that

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Commencement of Operations

Potential issues

- What is required to show due diligence, good faith?
- Nature and scope of preliminary activities?
- Title disputes or issues out of lessee's control that prevent preliminary activities?
- Does it matter if all preliminary activities are internal or not visible to lessor?

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Commencement of Operations

Bottom line: Strong argument that actual drilling is not necessary

Courts look for preliminary activity with diligence to actually complete well.

Practical Tips

- Timing
- Documentation
- Continuing activity
- Drafting/lease language

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Commencement of Operations

What constitutes preliminary activity will be an issue as lessors' challenges are tested.

An area to watch for developing case law

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Producing "in paying quantities"

- After term of X years, lease continues "as long thereafter as oil or gas is produced in paying quantities…."
- March 26 victory in Pa. Supreme Court:

T.W. Phillips Gas & Oil Co. v. Jedlicka (Pa. 2012)

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Producing "in paying quantities"

T.W. Phillips Gas & Oil Co. v. Jedlicka (Pa. 2012)

- Lease signed in 1928
- Lessor sought to cancel it in 2005 for failure to produce "in paying quantities" over life of lease because wells recorded a loss in one year ($40 loss in 1959).
- Lessees prevailed.

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Producing "in paying quantities"

T.W. Phillips Gas & Oil Co. v. Jedlicka (Pa. 2012)

Held:

- If well consistently pays a profit, however small, over operating expenses, that suffices to hold lease.
- Even if well has periods of unprofitability, producer's subjective good faith judgment in operating well suffices to hold the lease.

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Producing "in paying quantities"

T.W. Phillips Gas & Oil Co. v. Jedlicka (Pa. 2012)

- Open question: Over what period of time should profitability be judged?
- Court said must determine on case-by-case basis.

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Producing "in paying quantities"

T.W. Phillips Gas & Oil Co. v. Jedlicka (Pa. 2012)

- Court found that lessor failed to establish lessees' lack of good faith.
- Court also suggested that trial court could have found one year was not reasonable period for assessing profitability (which would have made good faith analysis unnecessary).

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Producing "in paying quantities"

T.W. Phillips Gas & Oil Co. v. Jedlicka (Pa. 2012)

- Court did not adopt the objective "prudent-operator" standard from other jurisdictions
- Instead, kept the subjective good faith standard under longstanding Pa. precedent (1899 *Young* decision).

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Producing "in paying quantities"

T.W. Phillips Gas & Oil Co. v. Jedlicka (Pa. 2012)

- Significant for older leases that have been held for decades by continuous, but low-level production.

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The Evolution of Marcellus Shale Litigation in Pennsylvania: What's Past Is Prologue

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This presentation is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

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Types of Litigation

- Individual lease litigation
- Mass litigation related to drilling and hydrofracturing operations
- Regulatory/Statutory litigation

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Litigation Through the Life Cycle of a Lease

- First, litigation to have leases declared invalid by landowners who entered into leases before market drove up bonus payments and royalties.
  - Minimum Royalty Act
  - Fraudulent inducement
- Simultaneously, or just a short while later, litigation to require producers to consummate leases with landowners where negotiations occurred but producer ultimately decided not to conclude deal. The number of these sorts of cases increased as natural-gas prices decreased and offering prices for leases decreased.

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Litigation Through the Life Cycle of a Lease

- We are mostly through the first wave of lease litigation. MRA cases withered after *Kilmer.* Many, but not all, fraudulent-inducement cases dropped off because they would have been more expensive to prosecute.
- We are now in the second wave of lease litigation. As many leases have reached the ends of their primary terms, many landowners are eager to have the change to renegotiate their leases or take them back on the market.

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Litigation Through the Life Cycle of a Lease

- There are a variety of claims here. First, as you have heard, are the "commencement-of-operations" cases. Second, there are the cases that allege that delay-rental payments were not made. Third, we may see cases alleging that units were not properly created (*i.e.,* that properties were included in bad faith).
- There will be some important legal decisions on the first sort of claim: commencement-of-operations claims. There is a strong argument that the Pennsylvania Supreme Court laid down the law 114 years ago in *Henderson:* any activity on the leasehold will suffice so long as it is accompanied by a *bona-fide* intention to continue activity until there is a completed well.
- However, landowners likely will argue that *Henderson* did not include a lengthy analysis and that it has not been cited more than once or twice in 114 years.
- This is a significant issue to watch, and there are now cases in the federal district court in the M.D. Pa. They could make their way to the Pennsylvania Supreme Court by certification.

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Litigation Through the Life Cycle of a Lease

- There are also ongoing one-off lease cases: allegations of property damage, “misplaced” well pads, *et cetera.*

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Litigation Through the Life Cycle of a Lease

- What is the future of lease litigation?
  - More lease-termination allegations, particularly if the market picks up and bonus payments increase.
  - Royalty-calculation litigation, again particularly if the market picks up and development and production increases.
  - Failure-to-produce litigation, particularly if the market stays where it is.

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Mass Litigation

- Mass litigation: Class actions or multi-plaintiff suits
- Hallmarks: Common legal and factual issues
- Examples:
  - MRA: Same or similar lease language and statutory provision
  - Alleged water-well contamination: Same natural-gas well and multiple, allegedly affected properties
- Why attractive to plaintiffs' bar?
  - Less work and financial investment
  - More potential recovery
  - High ROI

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Mass Litigation

- Where should we be looking for the next mass litigation?
  - More water-well cases as hydraulic fracturing is discussed more in the news
  - Surface-contamination claims
  - Royalty-calculation claims

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Statutory/Regulatory Claims

- Statutory/Regulatory Claims: Claims challenging local ordinances or Act 13
  - In the past, we saw some litigation reach the Pennsylvania Supreme Court regarding the preemptive reach of the Oil and Gas Act with respect to local ordinances and zoning.
  - Already a full-bore attack on Act 13 with respect to
    - Breadth of new preemption provision
    - Trade-secret protection
    - Advisory opinions from Pa PUC
  - Potential for industry claims regarding features of Act 13's impact fee

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Mr. Feczko is a partner in the Commercial Litigation and Energy, Infrastructure and Resources practice groups. His practice is concentrated in complex litigation in oil and gas and other disputes. He has represented natural gas producers and pipeline companies in litigation involving lease disputes, development obligations, disposal and storage rights, migration, royalty class actions and zoning and land use. He has extensive litigation experience in all aspects of discovery, trial preparation and trial, and he has handled numerous arguments, hearings, mediations, arbitrations, non-jury and jury trials and appeals in federal and state courts throughout the country.

PUBLICATIONS

- Co-Author, "DEP Officials Personally Hit With $6.5 Million Verdict," *Independent Oil & Gas Association of Pennsylvania (IOGA) Newsletter*, Volume 229, March 2010

COURT ADMISSIONS

- All Pennsylvania courts
- U.S. Court of Appeals for the First Circuit
- U.S. Court of Appeals for the Second Circuit
- U.S. Court of Appeals for the Third Circuit
- U.S. Court of Appeals for the Fourth Circuit
- U.S. District Court for the Western District of Pennsylvania
- *Pro hac vice* admissions in various federal and state courts

BAR MEMBERSHIP

Pennsylvania

EDUCATION

J.D., University of Notre Dame, 1994 (*summa cum laude*; Colonel William J. Hoynes Award; Lead Note Editor, *Notre Dame Law Review*)

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FOCUS AREAS

Mr. Holtzman's practice concentrates on appellate, constitutional, and governmental litigation, gaming law, and environmental law.

Mr. Holtzman has represented national and international clients in a variety of matters before federal and state courts and state administrative agencies. He regularly practices before the U.S. Court of Appeals for the Third Circuit, the U.S. District Court for the Middle District of Pennsylvania, Pennsylvania's appellate courts, and the Pennsylvania Environmental Hearing Board. Known for his creative problem solving and analytical skills, Mr. Holtzman specializes in matters that involve complex issues of first impression, including issues of constitutional law (federal and state) and the interpretation and application of gaming and environmental statutes and regulations.

PROFESSIONAL BACKGROUND

Prior to joining K&L Gates, Mr. Holtzman served as a law clerk at the Pennsylvania Higher Education Assistance Agency.

PROFESSIONAL/CIVIC ACTIVITIES

- American Bar Association
- Pennsylvania Bar Association
- Dauphin County Bar Association
- Messiah College President's Leadership Council

COURT ADMISSIONS

- Pennsylvania Supreme Court
- U.S. Court of Appeals for the Third Circuit
- U.S. District Court for the Middle District of Pennsylvania

BAR ADMISSIONS

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EDUCATION

J.D., Dickinson School of Law of the Pennsylvania State University, 2005 (*summa cum laude*; John Maher Scholarship; Thomas A. Beckley Prize for Legal Writing; Board of Governors' Awards; Woolsack Society; *Penn State Law Review*)

B.A., Messiah College, 2002 (*summa cum laude*)

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Ms. Groff's practice focuses on employment law, general civil and commercial litigation, and appellate work. She represents employers in a variety of industries, including the energy sector.

Her employment law practice involves representing employers before administrative agencies, defending litigation in state and federal courts, advising employers, and drafting policies and procedures. The substantive areas of employment law she has handled include discrimination and retaliation claims, ERISA denial-of-benefits claims, OSHA compliance, non-compete covenants, wage and hour law, and the Family and Medical Leave Act.

For clients in the energy sector, Ms. Groff has handled oil and gas lease challenges and other litigation in state and federal trial courts, as well as the Pennsylvania Supreme Court and U.S. Court of Appeals for the Third Circuit.

She also has jury-trial experience in federal court, has argued cases before the Third Circuit, and participated on a team that successfully defended a constitutional challenge in the U.S. Supreme Court.

PROFESSIONAL BACKGROUND

Ms. Groff worked as an investigator for the U.S. Department of Labor, Wage and Hour Division from 1997 to 2003. In that role, she enforced federal laws such as the Family and Medical Leave Act, Fair Labor Standards Act, Migrant and Seasonal Agricultural Worker Protection Act, and prevailing wage statutes for government contracts. Ms. Groff participated in several national and joint-agency initiatives and received the Secretary of Labor's Exceptional Achievement Award for that work.

PROFESSIONAL/CIVIC ACTIVITIES

- Pennsylvania Bar Association, Civil Litigation Section (council member, 2007-present; treasurer, 2008-2009; secretary, 2009-2010; vice chair, 2010-2011; chair-elect, present)
- *Civil Litigation Update*, Pennsylvania case notes editor
- Dauphin County Bar Association
- Widener University School of Law Mentoring Program
- Hon. William W. Lipsitt Inn of Court - founding member

PRESENTATIONS

Ms. Groff lectures on various employment law topics and has participated in seminars sponsored by Lorman and the Council on Education in Management.

COURT ADMISSIONS

- Supreme Court of Pennsylvania
- U.S. Court of Appeals for the Third Circuit
- U.S. District Court for the Middle District of Pennsylvania

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J.D., Widener University School of Law, Harrisburg (2004) (Valedictorian; Internal Managing Editor, *Widener Law Journal*)
B.A., Indiana University (1997) (with distinction; Phi Beta Kappa)

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Mr. Fine focuses on civil litigation with an emphasis on federal practice and appellate representation. His practice includes commercial litigation involving contract claims, unfair-competition claims, oil-and-gas litigation, ERISA claims, employment claims, consumer-law claims, products-liability claims, personal-injury claims, class-action claims, regulatory issues and motor-vehicle franchise issues.

PROFESSIONAL BACKGROUND

From 1992 to 1994, Mr. Fine served as a law clerk for the Honorable William W. Caldwell of the U.S. District Court for the Middle District of Pennsylvania. Prior to attending law school, Mr. Fine worked as a broadcast reporter.

PUBLICATIONS/PRESENTATIONS

- Co-author, *The Middle District Manual* (PBI Press, 7th ed., 2009)
- Contributing author, *Third Circuit Appellate Practice Manual* (PBI Press, 2d ed., 2010)
- Frequent lecturer on federal-practice and civil-litigation matters in continuing legal education courses
- Published articles in The Washington Post, The San Francisco Chronicle, The Philadelphia Inquirer, The ABA Journal, The National Law Journal, The American Lawyer, Findlaw's Writ, Exceptional Parent Magazine, The Pennsylvania Lawyer and several law reviews.

PROFESSIONAL/CIVIC ACTIVITIES

- Dauphin County Bar Association
- Pennsylvania Bar Association
- Pennsylvania Bar Association, Civil Litigation Section (council member, 2003-present; chair, 2008-2009)
- Lawyers' Advisory Committee of the U.S. Court of Appeals for the Third Circuit (appointed member, 2006-2009)
- Pennsylvania Supreme Court Appellate Court Procedural Rules Committee (appointed member, 2008-)
- Federal Bar Association
- Federal Bar Association (Middle District of Pennsylvania Chapter, President, 2001-2002)
- Lawyers' Advisory Committee of the U.S. District Court for the Middle District of Pennsylvania (appointed member, 1999-2005; committee chair, 2003-2005)
- Central Pennsylvania Autism Education and Resource Center (The Vista School) (director and corporate secretary, 1999-)
- Pennsylvania Special Education Advisory Panel (gubernatorially appointed member 2004-present; vice-chair, 2007-present)
- Pennsylvania Autism Task Force (appointed member, 2003-2011)
- Merit Selection Panel for Magistrate Judge Retention, U.S. District Court for the Middle District of Pennsylvania (chair, 2005)

David R. Fine

COURT ADMISSIONS

- Supreme Court of Pennsylvania
- Supreme Court of the United States
- United States Court of Appeals for the Third, Sixth, Seventh, Ninth and Eleventh Circuits
- United States Court of Appeals for Veterans Claims
- United States District Court for the District of New Jersey (*pro hac vice*)
- United States District Court for the Eastern, Middle, and Western Districts of Pennsylvania
- Circuit Court of Monangalia County, WV (*pro hac vice*)
- Maryland Court of Appeals (*pro hac vice*)

BAR MEMBERSHIP

Pennsylvania

EDUCATION

J.D., University of Toledo College of Law, 1992 (*cum laude*)
M.S., Northwestern University, 1988 (*with distinction*)
B.S., Cornell University, 1987

ACHIEVEMENTS

- Listed among the "Best Lawyers in America" in appellate practice by U.S. News & World Report.
- Awarded Outstanding Service Award by the United States District Court for the Middle District of Pennsylvania (2008).
- Named by American Lawyer Media as one of 30 Pennsylvania "Lawyers on the Fast Track," 2004.
- Named a Pennsylvania "Super Lawyer" by Philadelphia Magazine and Law & Politics Magazine, 2004, 2005, 2006, 2007, 2008, 2009, 2010, and 2011.

REPRESENTATIVE MATTERS

- *Kilmer v. Elexco Land Services, Inc.*, 990 A.2d 1147 (Pa. 2010)). (Pennsylvania Supreme Court holding in a case of first impression that thousands of natural-gas leases are permissible under Pennsylvania's Minimum Royalty Act).
- *Donlin v. Philips Lighting N. Am. Corp.*, 564 F.3d 207 (3d Cir. 2009) (holding that it was error for trial judge to allow plaintiff to testify to prospective damages under the label of "lay-opinion" testimony).
- *Hodge v. United States*, 554 F.3d 372 (3d Cir. 2009) (holding that inmate was unconstitutionally deprived of his right to effective counsel when his lawyer failed to file a notice of appeal when directed to do so by his client).
- *Urcinoli v. Cathel*, 546 F.3d 269 (3d Cir. 2008) (reinstating habeas corpus petition and revisiting proper procedure for district courts confronting "mixed" habeas petitions).
- *United States v. Wecht*, 541 F.3d 493 (3d Cir. 2008) (defining standard for declaring mistrial in criminal trial with allegedly deadlocked jury and disqualifying district judge).

David R. Fine

- *Gay v. CreditInform*, 511 F.3d 369 (3d Cir. 2007) (enforcing arbitration provision with class-action waiver in case of first impression in circuit)
- *United States v. Wall*, 456 F.3d 316 (3d Cir. 2006) (establishing rule for calculating deadline for taking appeal)
- *OSRAM Sylvania Products, Inc. v. Comsup Commodities, Inc.* 845 A.2d 846 (Pa. Super. 2004).
- *Central Dauphin Sch. Dist. v. Central Dauphin Educ. Ass'n*, 767 A.2d 16 (Pa. Cmwlth. 2001).
- *Syncsort Incorporated v. Innovative Routines International, Inc.*, 04-3623, 2008 U.S. Dist. LEXIS 35364 (D.N.J. April 30, 2008) (holding that use of the competitor's name in an Internet metatag is fair use under the Lanham Act where no indication of endorsement or sponsorship by competitor).
- *Hall v. Glenn O. Hawbaker, Inc.*, 39 Employee Benefits Cas. (BNA) 1417 (M.D. Pa. 2006) (interpreting COBRA notice provisions in ERISA case); 2007 U.S. Dist. LEXIS 8669 (M.D. Pa. 2007) (denying preliminary injunction in ERISA case); and 42 Employee Benefits Cas. (BNA) 1662 (M.D. Pa. 2007) (granting summary judgment in ERISA case).
- *Rea v. The Hershey Company 2005 Enhanced Mutual Separation Plan*, 40 Employee Benefits Cas. (BNA) 2142 (M.D. Pa. 2007) (dismissing claim for interference with ERISA benefits).
- *Flow International Corp. v. Hydrojet Services, Inc.*, 2004 U.S. Dist. LEXIS 4376 (E.D. Pa. 2004) (favorable verdict in contract dispute bench trial).
- *Shadle v. Central Dauphin School District*, No. 00-541, 2003 U.S. Dist. LEXIS 5475 (M.D. Pa. 2003) (granting summary judgment for defense in claim of discrimination under Americans with Disabilities Act).
- *Reilly Foam Corp. v. Rubbermaid Corp.*, 206 F. Supp.2d 643 (E.D. Pa. 2002) (favorable application of Section 2-207 of the Uniform Commercial Code on issue of first impression).

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

LYCO BETTER HOMES INC. c/o CONFAIR COMPANY and CONFAIR COMPANY INC.	:	4:09-CV-00249
Plaintiffs,	:	(Judge McClure)
v.	:	
RANGE RESOURCES - APPALACHIA, LLC	:	
Defendant.	:	

MEMORANDUM

May 21, 2009

BACKGROUND:

On January 8, 2009, plaintiffs, Lyco Better Homes Inc. c/o Confair Company and Confair Company Inc. (hereinafter "Lyco Homes"), commenced this civil action against defendant, Range Resources-Appalachia (Hereinafter "Range Resources"), by filing a complaint in the Court of Common Pleas of Lycoming County. On February 6, 2009, Range Resources filed a Notice of Removal removing the action from the Court of Common Pleas to the Middle District of Pennsylvania. The basis for removal is diversity jurisdiction, which has not been challenged by plaintiffs. In its complaint, Lyco Homes alleges Range Resources should be subjected to specific performance (Count I) and alleges breach of

contract (Count II).

On February 12, 2009, Range Resources filed a Motion to Dismiss, along with its supporting brief.[1] (Rec. Doc. Nos. 7 and 8). Lyco Homes filed its opposing brief February 27, and Range Resources filed its reply brief March 13. (Rec. Doc. Nos. 12 and 13). The matter is ripe for disposition.

Now, for the following reasons, we will grant defendant's motion to dismiss.

DISCUSSION:

I. Motion to Dismiss Standard

When considering a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6), the court must view all allegations stated in the complaint as true and construe all inferences in the light most favorable to plaintiff. Hishon v. King & Spaulding, 467 U.S. 69, 73 (1984); Kost v. Kozakiewicz, 1 F.3d 176, 183 (3d Cir. 1993). "The tenet that a court must accept as true all of the [factual] allegations contained in the complaint is inapplicable to legal conclusions." Ashcroft v. Iqbal, __ U.S. __ , 2009 U.S. Lexis 3472, *29 (internal citations omitted). In ruling on such a motion, the court primarily considers the allegations of the pleading, but is not required to consider legal conclusions alleged in the

[1]Defendant is directed to Middle District Local Rule 5.1(c) and is advised to use 14 point font in future filings in the Middle District.

complaint. Kost, 1 F.3d at 183. "Threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice." Iqbal, __ U.S. at *29. At the motion to dismiss stage, the court considers whether plaintiff is entitled to offer evidence to support the allegations in the complaint. Maio v. Aetna, Inc., 221 F.3d 472, 482 (3d Cir. 2000).

A complaint should only be dismissed if, accepting as true all of the allegations in the complaint, plaintiff has not pled enough facts to state a claim to relief that is plausible on its face. Bell Atlantic Corp. v. Twombly, 127 S.Ct. 1955, 1960 (2007). "Determining wether a complaint states a plausible claim for relief will . . . be a context-specific task that requires the reviewing court to draw on its judicial experience and common sense." Iqbal, __ U.S. at *30. In considering a Rule 12(b)(6) motion, we must be mindful that federal courts require notice pleading, as opposed to the heightened standard of fact pleading. Hellmann v. Kercher, 2008 U.S. Dist. LEXIS 54882, 4 (W.D. Pa. 2008). Federal Rule of Civil Procedure 8 "'requires only a short and plain statement of the claim showing that the pleader is entitled to relief,' in order to 'give the defendant fair notice of what the...claim is and the grounds on which it rests,'" Bell Atlantic Corp. v. Twombly, 127 S.Ct. 1955, 1964, (2007) (citing Conley v. Gibson, 355 U.S. 41, 47, 78 S. Ct. 99, (1957)). However, even under this lower notice pleading standard, a plaintiff

must do more than recite the elements of a cause of action, and then make a blanket assertion of an entitlement to relief under it. Hellmann, 2008 U.S. Dist. LEXIS at 4-5. Instead, a plaintiff must make a factual showing of his entitlement to relief by alleging sufficient facts that, when taken as true, suggest the required elements of a particular legal theory. Twombly, 127 S.Ct. at 1965. "[W]here the well-pleaded facts do not permit the court to infer more than the mere possibility of misconduct, the complaint has alleged - - but it has not "shown" - - "that the pleader is entitled to relief." Iqbal, __ U.S. at *29, citing Fed. R. Civ. P. 8(a). The failure-to-state-a-claim standard of Rule 12(b)(6) "streamlines litigation by dispensing with needless discovery and factfinding." Neitzke v. Williams, 490 U.S. 319, 326-27 (1989). A court may dismiss a claim under Rule 12(b)(6) where there is a "dispositive issue of law." Id. at 326. If it is beyond a doubt that the non-moving party can prove no set of facts in support of its allegations, then a claim must be dismissed "without regard to whether it is based on an outlandish legal theory or on a close but ultimately unavailing one." Id. at 327

II. Allegations in the Complaint

Taking as true all of the allegations in the complaint, the facts are as follows. Range Resources discussed with Lyco Homes an Oil and Gas Lease for several of plaintiffs' properties. On May 29, 2008, Lyco Homes signed a Lease,

Memorandum of Lease, and Approved Addendum. These documents are attached to the complaint as exhibits 1-6. Lyco Homes alleges that there was to be an up-front payment of $2,400.00 per acre. As a result of choosing to contract with Range Resources, Lyco Homes refused other gas lease offers.

The documents were executed in the presence of Range Resources "Landman," Randy Hoffman. At that May 29, 2008 meeting, Hoffman produced two "Dear Property Owner" letters (hereinafter "DPO" letters). These letters specified the allegedly previously negotiated and agreed-upon upfront payments for each of the two leases. These documents are attached to the complaint as exhibits 7 and 8. Hoffman took the executed documents. Both leases were signed by Mark A. Acree, Vice-President-Land, on behalf of Range Resources. One of the two leases, marked as exhibit 10 for the 192.24 acre parcel, was notarized as to Mark A. Acree's signature on September 22, 2008. The other lease, exhibit 9 for the 36.41 acre parcel, was not notarized as to Mark A. Acree's signature. On October 14, 2008, Lyco Homes was notified by telephone call of Range Resource's approval of the leases.

Lyco Homes asserts that both conditions in the DPO letters were met - the title searches found good title and management approved the leases, as evidenced by the signature of Mark A. Acree on the two leases.

On November 11, 2008, defendant notified plaintiff that the leases were not approved by Range Resource's senior management and were returned, marked "void," to Lyco Homes without payment.

III. Analysis

In its motion to dismiss, Range Resources argues that both counts of the complaint should be dismissed. As to the breach of contract claim, it argues the bonus payments sought are not part of the lease agreement between the parties, but even if the court finds the bonus payments are part of the agreement, Range Resources exercised its right to surrender the leases which cancelled all liabilities under the leases. Additionally, Range Resources argues that Count I should be dismissed because the complaint demands specific performance in the form of money damages.

As a preliminary matter, Lyco Homes concedes that specific performance is not appropriate, and is relying on the breach of contract claim only. Thus, Count I of the complaint is dismissed. Therefore, our analysis only focuses on the breach of contract claim in Count II.

In Pennsylvania, "a lease is in the nature of a contract and is controlled by principles of contract law. Amoco Oil Co. v. Snyder, 478 A.2d 795, 798 (Pa.

1984). "To support a claim for breach of contract, a plaintiff must allege: 1) the existence of a contract, including its essential terms; 2) a breach of a duty imposed by the contract; and 3) resultant damage." Church v. Tentarelli, 953 A.2d 804, 808 (Pa. Super. Ct. 2008).

There is no contract here. Plaintiffs, the land owners, each made an offer when they signed the documents. The offereree, defendant, could have accepted or rejected the offers. Defendant communicated a rejection of the offers by returning the documents to plaintiffs marked with the "void" stamp.

Although plaintiffs contend that defendant informed plaintiffs of the lease approval via a telephone call on October 14, 2008, in Pennsylvania, leases which will exceed three years must be in writing in order to be enforceable. See Blumer v. Dorfman, 289 A.2d 463, 466 (Pa. 1972). Both leases at issue here were intended to last for a term of five years.

Therefore, we will grant defendant's motion to dismiss, as no contract existed between the parties.

CONCLUSION:

Count I of the complaint seeking specific performance has been voluntarily dismissed by plaintiff.

Count II of the complaint alleging breach of contract will be dismissed.

s/ James F. McClure, Jr.
James F. McClure, Jr.
United States District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

LYCO BETTER HOMES INC. c/o CONFAIR COMPANY and CONFAIR COMPANY INC.	:	4:09-CV-00249
Plaintiffs,	:	(Judge McClure)
v.	:	
RANGE RESOURCES - APPALACHIA, LLC	:	
Defendant.	:	

ORDER

May 21, 2009

In accordance with the accompanying Memorandum, **IT IS HEREBY ORDERED THAT:**

1. Defendant's Motion to Dismiss (Rec. Doc. No. 7) is GRANTED.

2. Count I of the complaint is voluntarily withdrawn.

3. Count II of the complaint is dismissed pursuant to Federal Rule of Civil Procedure 12(b)(6).

4. Defendants request for oral argument is denied.

5. The clerk is directed to close the case file.

s/ James F. McClure, Jr.
James F. McClure, Jr.
United States District Judge

UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

JOHN P. HOLLINGSWORTH, et al.,	:	
	:	CIVIL ACTION NO. **3:CV-09-0838**
	:	
Plaintiffs,	:	
	:	(Judge Munley)
v.	:	(Magistrate Judge Blewitt)
	:	
RANGE RESOURCES-APPALACHIA, LLC	:	
	:	
Defendant	:	

REPORT AND RECOMMENDATION

I. Background.

This breach of contract (Count I) and declaratory judgment (Count II) action was commenced on March 30, 2009, in the Court of Common Pleas of Bradford County, Pennsylvania, by Plaintiffs John, James and Kenneth Hollingsworth against Defendant Range Resources-Appalachia, LLC ("RRA"). (Doc. 1, Ex. A). Defendant filed a Notice of Removal of this action to this Court, pursuant to 28 U.S.C. § 1441, based on diversity jurisdiction. 28 U.S.C. § 1332. (Doc. 1, pp. 2-3).[1] This case has been assigned to the undersigned Magistrate Judge for pre-trial matters pursuant to 28 U.S.C. § 636(b).

In response to the Complaint, on May 11, 2009, Defendant RRA filed a Motion to Dismiss pursuant to Fed. R. Civ. P. 12 (b)(6). **(Doc. 6).** Defendant simultaneously filed its support Brief with exhibits (Exs. A-D). (Doc. 7). The Plaintiffs filed their opposition Brief on May 22, 2009. (Doc. 8). Defendant then filed a Reply Brief with an exhibit, *i.e.* a copy of the Court's decision in *Lyco v. RRA*,

[1]Plaintiffs are all residents of Pennsylvania and Defendant is a Delaware corporation with its principle place of business not in Pennsylvania. Plaintiffs did not move to remand the case back to state court.

Civil No. 09-249, M.D. Pa., on June 8, 2009. (Doc. 12). Upon request of Defendant, we hear oral argument, on the record, regarding their pending Motion on June 30, 2009. (Doc. 13).

Presently before the Court is Defendant's Motion to Dismiss pursuant to Federal Rule of Ci Procedure 12(b)(6). **(Doc. 6)**. The Motion is ripe for disposition.

II. Allegations Giving Rise to the Complaint.

The Complaint contains two counts. Count I is for Breach of Contract and Count II is fc Declaratory Judgment. (Doc. 1, Ex. A, pp. 4-5).

The following factual allegations are extracted from the Complaint:

> 5. Plaintiffs own 66 acres of real property located in Lichfield Township, Bradford County, Pennsylvania at tax parcel number 23-34-53 and more particularly described by deed at Book 191, Page 596 of the Bradford County Record of Deeds, (hereinafter "Property").
>
> 6. On or about June 8, 2008, Defendant offered to enter into a paid-up oil and gas lease with plaintiffs for a term of five (5) years on sixty-six (66) acres of real property as described above for the payment of a lease bonus and delay rental in a lump sum amount of $165,000.00. A copy of the Lease tendered and signed by plaintiffs is attached hereto and incorporated by reference as Exhibit "A".
>
> 7. The lease was delivered by mail sent to the Plaintiff J.P. Hollingsworth by Kenny Gunter, field land man Range Resources, along with an undated letter, a copy of which is attached hereto and incorporated by reference as Exhibit "B".
>
> 8. The lease was accepted by plaintiffs and signed before a notary on July 28, 2008 and forwarded by mail to defendant on August 13, 2008.
>
> 9. The defendant returned the lease to plaintiffs marked "Void" by letter dated December 16, 2008 stating that the lease was not approved by management.

(Doc. 1, Ex. A, ¶s' 5.-9.).[2]

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[2]A copy of Plaintiffs' Complaint with its attached exhibits is also found at Doc. 7-2.

Essentially, Plaintiffs allege that they formed a contract with Defendant that included a bonus and delay rental payment, and that all contingencies required for the payment was met.[3] According to Plaintiffs, "the parties agreed that when the Plaintiffs delivered the lease to the Defendants (sic) the bonus payment was due." (*Id.*, ¶ 26.). Plaintiffs aver that despite the contract which required Defendant to make the lease bonus and delay rental payment within 90 days of the lease date, Defendant failed to make the required $165,000.00 payment pursuant to the contact, *i.e.* lease agreement.

Plaintiffs claim in Count I that Defendant breached the lease agreement it entered into with them by voiding the lease and by failing to pay them the bonus and delay rental payment. In Count II, Plaintiffs seek the Court to declare the lease with Defendant was formed and was valid, and that the bonus and delay rental payment is due and payable by Defendant to them.[4]

III. Motion to Dismiss Standard.

The Court in *Williams v. Hull,* 2009 WL 1586832, *2-*3 (W.D. Pa. 2009), set forth the Motion to Dismiss standard of review, as annunciated by the Supreme Court in *Bell Atlantic Corp. v. Twombly*, 550 U.S. –, 127 S. Ct. 1955 (2007), and as refined in *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009), as follows:

> The issue is not whether the plaintiff will prevail at the end but only whether he should be entitled to offer evidence to support his claim. *Neitzke; Scheuer v. Rhodes*, 419 U.S. 232 (1974). A complaint must be dismissed pursuant to Rule

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[3]The parties refer to the bonus and delay rental payment collectively as the "bonus payment".

[4]Plaintiffs attached a copy of the lease agreement they allege was accepted and agreed to by Defendant as Ex. A to their Complaint, Doc. 7-2, Ex. A.

12(b)(6) if it does not allege "enough facts to state a claim to relief that is plausible on its face." *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007) (rejecting the traditional 12(b)(6) standard set forth in *Conley v. Gibson*, 355 U.S. 41, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957)). See also *Ashcroft v. Iqbal*, --- U.S. ----, ----, 129 S.Ct. 1937, ----, --- L.Ed.2d ----, ----, 2009 WL 1361536 (May 18, 2009) (specifically applying *Twombly* analysis beyond the context of the Sherman Act). The court must accept as true all allegations of the complaint and all reasonable factual inferences must be viewed in the light most favorable to plaintiff. *Angelastro v. Prudential-Bache Securities, Inc.*, 764 F.2d 939, 944 (3d Cir.1985). The Court, however, need not accept inferences drawn by plaintiff if they are unsupported by the facts as set forth in the complaint. See *California Pub. Employee Ret. Sys. v. The Chubb Corp.*, 394 F.3d 126, 143 (3d Cir.2004) citing *Morse v. Lower Merion School Dist.*, 132 F.3d 902, 906 (3d Cir.1997). Nor must the court accept legal conclusions set forth as factual allegations. *Twombly*, 550 U.S. at 556, citing *Papasan v. Allain*, 478 U.S. 265, 286, 106 S.Ct. 2932, 92 L.Ed.2d 209 (1986). "Factual allegations must be enough to raise a right to relief above the speculative level." *Twombly*, 550 U.S. at 556. Although the United States Supreme Court does "not require heightened fact pleading of specifics, [the Court does require] enough facts to state a claim to relief that is plausible on its face." *Id.* at 570.

In other words, at the motion to dismiss stage, a plaintiff is "required to make a 'showing' rather than a blanket assertion of an entitlement to relief." *Smith v. Sullivan*, 2008 WL 482469, at *1 (D.Del. February 22, 2008) quoting *Phillips v. County of Allegheny*, 515 F.3d 224, 231 (3d Cir.2008). "This does not impose a probability requirement at the pleading stage, but instead simply calls for enough facts to raise a reasonable expectation that discovery will reveal evidence of the necessary element." *Phillips*, 515 F.3d at 232, quoting *Twombly*, 550 U.S. at 556 n. 3.

IV. Discussion.

Initially, we note that during oral argument (as well as in its Briefs), Defendant relied upo the correct motion to dismiss standard under *Bell Atlantic Corp. v. Twombly* and *Ashcroft v. Iqba* but Plaintiffs did not. (See also Doc. 7, pp. 4-5 and Doc. 12, p. 2). Rather, at oral argumen Plaintiffs relied upon an outdated motion to dismiss standard, insisting that they only were require to make a general assertion that a contract existed, that Defendant breached it, and that they wer

entitled to relief. Plaintiffs argued they were entitled to discovery regarding their claims and that Defendant's arguments were properly suited for a summary judgment motion after discovery. We agree with Defendant that its Motion to Dismiss should be granted at this early stage of the case since Plaintiffs have failed to state sufficient "facts to raise a reasonable expectation that discovery will reveal evidence of the necessary element." *Twombly*, 550 U.S. at 556 n. 3; *Lyco Better Homes, Inc. v. Range Resources-Appalachia, LLC*, Civil No. 09-0249, M.D. Pa., 5-21-09 Memorandum, slip op. pp. 2-4.[5]

As this is a case based upon diversity jurisdiction of this Court, 28 U.S.C. § 1332, we apply Pennsylvania law. *See Moore v. Kulicke & Soffa Industries, Inc.*, 318 F.3d 561, 563 (3d Cir. 2003).[6] We agree with Defendant that Plaintiffs have not sufficiently plead a breach of contract claim and that its Motion to Dismiss should be granted since no contract which included a bonus and rental delay payment was ever formed between it and Plaintiffs. (Doc. 7, pp. 5-11). "[C]ontract law protects the expectation interests of contracting parties based on a voluntary agreement that defines their relationship. Protection is limited to those individuals specifically named in the contract, and enforcement is based on the manifestation of the intent between the parties." *Hahn v. Atlantic Richfield Co.*, 625 F.2d 1095, 1104 (3d Cir. 1980).

In *WP 851 Associates, L.P. v. Wachovia Bank, N.A.*, 2008 WL 114992, *3 (E.D. Pa. 2008)(footnote omitted), the Court stated:

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[5]Defendant attached a copy of the *Lyco* Court's May 21, 2009 Memorandum to its Reply Brief, Doc. 12-2.

[6]Both parties recognize that Pennsylvania substantive law applies to this case.

> To state a claim for breach of contract under Pennsylvania law, a plaintiff must allege (1) the existence of a contract, including its essential terms, (2) a breach of a duty imposed by the contract, and (3) resultant damages. *Ware v. Rodale Press, Inc.*, 322 F.3d 218, 225 (3d Cir.2003) (*quoting CoreStates Bank, N.A. v. Cutillo*, 723 A.2d 1053, 1058 (Pa.Super.Ct.1999)). The important inquiry is whether the parties "manifested an intention to be bound by [a document's] terms and whether the terms are sufficiently definite to be specifically enforced." *ATACS Corp. v. Trans World Commc'ns., Inc.*, 155 F.3d 659, 665 (3d Cir.1998). "Whether the parties are merely negotiating a contract, or entering into a present contract, is purely a question of intention." *Windsor Mfg. Co. v. S. Makransky & Sons*, 472,322 Pa. 466, 186 A. 84, 86 (Pa.1936).

See also Gundlach v. Reinsrien, 924 F.Supp. 684, 688 (E.D. Pa. 1996).

We agree with Defendant that Plaintiffs' pleading does not meet the stated elemen required for a breach of contract action under Pennsylvania law. We also find futility of allowir Plaintiffs leave to amend their Complaint since no contract was ever formed with Defenda because it did not manifest an interest to be bound by the terms of the lease agreement witho its management's approval.

In *County of Dauphin, Pennsylvania, v. Fidelity and Deposit Company of Maryland*, 770 Supp. 248, 251 (M.D. Pa. 1991), this Court stated:

> Under Pennsylvania law, the interpretation of a contract requires an initial determination by the court of whether the contract language is ambiguous, or is clear and unambiguous. *Polish Amer. Machinery Corp. v. R.D. & D. Corp.*, 760 F.2d 507, 512 (3d Cir. 1985). If the language is ambiguous, the court must turn the interpretation of the contract over to the jury. If the language is clear, however, the court must interpret the agreement. *Id.* Contractual language is ambiguous when it is "reasonably susceptible of different construction, is obscure in meaning through indefiniteness of expression or has a double meaning." *Commonwealth, Dept. Of Trans. v. Mosites Constr. Co.*, 90 Pa.Commw. 33, 36, 494 A.2d 41, 43 (1985). A contract is not ambiguous by the mere fact that the parties disagree on the proper interpretation to be given the

> language. *Commonwealth State Highway & Br. Authority v. E.J. Albrecht Co.*, 59 Pa. Commw. 246, 251, 430 A.2d 328, 330 (1981).
>
> We are mindful of the fact that Pennsylvania courts apply the "plain meaning" rule of interpretation of contracts, an approach to contract interpretation that assumes that "the intent of the parties to a written contract is . . . embodied in the writing itself, and when the words are clear and unambiguous the intent is to be discovered only from the express language of the agreement." *Steuart v. McChesney*, 498 Pa. 45, 48-49, 444 A.2d 659 (1982). This approach is found to "enhance the extent to which contracts may be relied upon by contributing to the security of belief that the final expression of *consensus ad idem* will not later be construed to import a meaning other than that clearly expressed." *Id.* at 52, 444 A.2d at 663.

In construing a contract to determine if it is ambiguous under Pennsylvania law, the court looks to the four corners of the document. *See Glenn Distribs. Corp. v. Carlisle Plastics, Inc.*, 297 F. 3d 294, 300 (3d Cir. 2002).

In *Benchmark Group, Inc. v. Penn Tank Lines, Inc.*, 612 F. Supp. 2d 562, 574 (E.D. Pa. 2009), the Court stated:

> "[t]he task of interpreting a contract is generally performed by a court, rather than by a jury.... [t]he goal of that task is, of course, to ascertain the intent of the parties as manifested by the language of the written instrument." *Standard Venetian Blind Co. v. Am. Empire Ins. Co.*, 503 Pa. 300, 469 A.2d 563, 566 (1983) (internal citations omitted). "The intent of the parties is to be ascertained from the document itself when the terms are clear and unambiguous." *Hutchison v. Sunbeam Coal Corp.*, 513 Pa. 192, 519 A.2d 385, 390 (1986). Thus, "a contract that is unambiguous on its face must be interpreted according to the natural meaning of its terms, unless the contract contains a latent ambiguity, whereupon extrinsic evidence may be admitted to establish the correct interpretation." *Bohler-Uddeholm Am., Inc. v. Ellwood Group, Inc.*, 247 F.3d 79, 96 (3d Cir.2001).

We agree with Defendant and its first argument that no contract was ever formed between it and Plaintiffs since Plaintiffs offered the oil and gas lease to Defendant and Defendant rejected the lease agreement when its senior management did not approve of it, and marked it "Void."

Plaintiffs signed the "Dear Property Owner" ("DPO") letter which initially stated, "Thank you fc entering into an oil and gas lease with our firm." (Doc. 7-2, Ex. C).[7] Plaintiffs also executed th lease agreement dated July 28, 2008. (*Id.*, Ex. A). However, as Defendant points out, the DP(letter significantly also stated, "RANGE RESOURCES - APPALACHIA, LLC hereby agrees to pay th following oil and gas owner the amount below set forth subject to approval of title and managemer lease review." (*Id.*) (emphasis original). Further, the DPO was not signed and dated by Defendant representative, its Landman (Kenny Gunter). Defendant then returned the lease to Plaintiffs, *sar* any bonus payment, with a letter to them dated December 16, 2008, which stated as follows:

> The above referenced oil and gas lease that you offered to Range Resources - Appalachia, LLC ("Range") has been reviewed by Range's senior management and was not approved. Factors considered in Range's decision included the drastic drop in oil and gas prices, the downturn of the U.S. economy and the resulting effects on the credit markets. It is unfortunate that circumstances beyond Range's control have caused us to come to this decision. Accordingly, the proposed lease is being returned to you with this correspondence.

(*Id.*, Ex. D).

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[7]As noted by the Court in *White v. Probation Office*, 2008 WL 3837045, *1, n. 3 (M.D. Pa.),

> "[t]he court may consider documents of record and exhibits submitted by the parties when evaluating a motion to dismiss. *See Tilbury v. Aames Home Loan*, 199 F. App'x 122, 125 (3d Cir.2006) (quoting *Oshiver v. Levin, Fishbein, Sedran & Berman*, 38 F.3d 1380, 1384-85 n. 2 (3d Cir.1994)) (observing that a court may consider exhibits submitted by the parties when ruling on a motion to dismiss)."

We find, as Defendant argued, that no contract was ever formed in this case since both parties did not show an intent to be bound unless the least offer of Plaintiffs was approved by Defendant's management. We concur with Defendant and find that the very recent *Lyco* case is directly on point with our case, and that the *Lyco* Court properly found that no contract existed between RRA and Plaintiffs under very similar facts to our case. Further, during the oral argument in our case Plaintiffs' counsel failed to distinguish the *Lyco* case upon which Defendant RRA relied.

The *Lyco* Court stated:

> In its motion to dismiss, Range Resources argues that both counts of the complaint should be dismissed. As to the breach of contract claim, it argues that bonus payments sought are not part of the lease agreement between the parties, but even if the court finds the bonus payments are part of the agreement, Range Resources exercised its right to surrender the leases which cancelled all liabilities under the leases.

(Doc. 12-2, p. 6).

The *Lyco* Court concluded as follows:

> In Pennsylvania, "a lease is in the nature of a contract and is controlled by principles of contract law. Amoco Oil Co. v. Snyder, 478 A.2d 795, 798 (Pa. 1984). "To support a claim for breach of contract, a plaintiff must allege: 1) the existence of a contract, including its essential terms; 2) a breach of a duty imposed by the contact; and 3) resultant damage." Church v. Tentarelli, 953 A.2d 804, 808 (Pa. Super. Ct. 2008).
>
> There is no contract here. Plaintiffs, the land owners, each made an offer when they signed the documents. The offeree, defendant, could have accepted or rejected the offers. Defendant communicated a rejection of the offers by returning the documents to plaintiffs marked with the "void" stamp.

(*Id.*, pp. 6-7).

The Court in *Lyco* then granted Defendant RRA's motion to dismiss the Complaint and i remaining breach of contract claim since it found that no contract existed between the parties. (*Id* pp. 7-8).[8] The lease agreement and DPO letter which Plaintiffs signed, *i.e.* Plaintiffs' offer, and sei to Defendant clearly required approval by Defendant's management before it was intended t become effective. The lease Plaintiffs offered to Defendant was not approved by Defendant management which was a condition precedent of the lease, and Plaintiffs' offer was rejected Thus, no contract was ever formed. Therefore, Defendant was not obligated to pay Plaintiffs th bonus payment at issue herein.

Even though the DPO letter began by thanking Plaintiffs for entering into a lease wit Defendant, we agree with Defendant that the lease, in order to become a binding contract, was st subject to approval of both Plaintiffs' title to the land and to approval by Defendant's managemen As Defendant argued, the Court must give effect to the language of the document, and it cann simply ignore the stated conditions. Thus, reading the DPO letter as a whole, it is apparent th Defendant's intent was not to accept Plaintiffs' lease offer without good title and without i management's approval. Also, just because the title to Plaintiff's property was found acceptable b Defendant, this did not satisfy both conditions required for a contract to be formed. The DP letter was clearly written in the conjunctive, and the Plaintiffs' lease offer required both titl approval and approval by Defendant's management. In fact, at oral argument, Plaintiffs' couns

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[8]We note that in *Lyco*, Plaintiff filed a Notice of Appeal with the Third Circuit on June 2, 2009, and that this appeal, docketed to USCA Case Number 09-2645, is still pending. Thus, in the alternative, it will be recommended that the present case be stayed until the Third Circuit decides the appeal in *Lyco*.

conceded that if Plaintiffs did not have a valid title to the subject property, Defendant did not owe them the bonus payment. Likewise, if Defendant's management did not approve of Plaintiffs' lease offer, no contract with Plaintiffs was formed, and Defendant was not obliged to give Plaintiffs the bonus payment. Further, we do not find, as Plaintiffs suggested, that the approval language in the DPO letter was ambiguous.

Moreover, we do not find that the cases cited by Plaintiffs during oral argument are on point with our case and are controlling, including the one hundred sixteen-year-old case of *McMillan v. Phila. Co.*, 159 Pa. 142, 28 A. 200 (1893). We agree with Defendant and its rationale (Doc. 12, pp. 6-7) and we do not find that the *McMillan* case lends support to Plaintiffs' position that there was an offer and acceptance between the parties in our case, particularly since the DPO letter in our case explicitly required approval of Defendant's management before a contract was formed. As Defendant states, *McMillan* did not deal with a document which had language similar to the language of the DPO letter in our case. Rather, as stated, we find that Defendant is correct (Doc. 12, pp. 3-4, 8) and that the *Lyco* case is directly on point with our case and is persuasive. We also find that based, in part, on the *Reed v. Pittsburgh Bd. of Public Educ.*, 862 A. 2d 131 (Pa. Commw. 2004), case cited by Defendant (Doc. 12, p. 4), the DPO letter Defendant sent to Plaintiffs was not an offer of Defendant to Plaintiffs as a matter of law since it clearly required further approval, not yet given, by Defendant's management. In fact, as stated, Defendant's representative did not sign the DPO letter since he had to wait for management approval. (Doc. 7-2, Ex. C).

Simply stated, since the DPO letter clearly required further approval by Defendant's management, it was not sufficiently definite to constitute an offer by Defendant as a matter of law

regardless of how specific the terms were in the lease agreement and the DPO letter. Defendai made it quite apparent that it did not intend to form a contract with Plaintiffs simply upon the execution of the lease agreement and DPO letter; rather, Defendant clearly indicated that it d not intend to form a contract with Plaintiffs until it obtained a further manifestation of assent, *i.* approval by its management.

As mentioned, we also disagree with Plaintiffs that there were any ambiguities in the DP letter regarding the requirement that Defendant had to get management approval before accepted Plaintiffs' offer. Nor do we find Plaintiffs are correct in arguing that when they signed tl documents (*i.e.* the lease agreement and DPO letter) and sent them back to Defendant, there w a conveyance and Defendant had the right to mine natural gas under their land and they wei entitled to the bonus payment.

As discussed, we find no contract existed between Plaintiffs and Defendant, and based c *Lyco*, the DPO letter and lease agreement Plaintiffs signed was their offer to Defendan Defendant's management was required to approve of the lease, and Defendant clearly did n intend on entering into the lease without its management's approval. Thus, no contract was ev formed between Plaintiffs and Defendant.

Plaintiffs also argued that the DPO letter in our case and in the *Lyco* case were differen In *Lyco*, the DPO letter stated that "management approval of the lease" was required. In our cas as indicated above, the DPO letter stated that Defendant agreed to pay Plaintiffs the lease paymei of $165,000.00 "subject to approval of title and management lease review." (Doc. 7-2, Ex. C Plaintiffs argue that they have alleged that management lease review occurred in our cas

However, as discussed, and similar to the *Lyco* case, the management lease review was not complete since Defendant advised Plaintiffs on December 16, 2008, that the lease Plaintiffs offered to it was reviewed by its senior management and it was not approved. (*Id.*, Ex. D). The proposed lease, including the lease payment of $165,000.00 by Defendant to Plaintiffs, was specifically subject to approval by Defendant's management, and this approval was never given. Defendant did not intend to form a contract with Plaintiffs without the approval of the lease by management.

Accordingly, we will recommend that Defendant's Motion to Dismiss be granted and that Plaintiffs' Complaint be dismissed pursuant to Rule 12(b)(6). We also find futility with respect to Plaintiffs' request at oral argument that they be permitted leave to amend their Complaint. We agree with Defendant that, regardless of any amendment, the DPO letter, with its requirement of management approval of the lease, was not Defendant's offer of a contract. Rather, the DPO letter Plaintiffs signed it was Plaintiffs' offer to Defendant which was not accepted by Defendant because it was not approved by Defendant's management. Therefore, no valid contract was ever formed between Plaintiffs and Defendant in this case. Defendant did not manifest an intent to be bound by the terms of the lease and DPO letter, including the bonus payment, until Plaintiffs' title was approved and the lease was approved by its management.[9] *See Conway v. King Pharmaceuticals, Inc.*, 2008 WL 4128088, *2 (M.D. Pa.)("a complaint that sets forth facts which affirmatively

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[9]In *WP 851 Associates, L.P. v. Wachovia Bank, N.A.*, 2008 WL 114992, *4, n. 15, the Court noted, "[g]enerally, when the letters of intent contained language explicitly stating that the document was not binding or containing a condition precedent, Pennsylvania courts have held that such letters did not manifest a mutual intent to be bound and were, therefore, not enforceable contracts."

demonstrate that the plaintiff has no right to recovery is properly dismissed without leave t amend.")(citing *Grayson v. Mayview State Hosp.*, 293 F.3d 103, 108 (3d Cir.2002)).

V. Recommendation.

It is respectfully recommended that Defendant 's Motion to Dismiss **(Doc. 6)** be granted ar that Plaintiffs' Complaint be dismissed pursuant to Rule 12(b)(6). Alternatively, it is recommende that the Court stay this case and administratively close it until the Third Circuit Court of Appea decides the appeal in the *Lyco* case.

s/ Thomas M. Blewitt
THOMAS M. BLEWITT
United States Magistrate Judge

Dated: July 29, 2009

UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

JOHN P. HOLLINGSWORTH, et al.,	:	
	:	CIVIL ACTION NO. **3:CV-09-0838**
	:	
Plaintiffs,	:	
	:	(Judge Munley)
v.	:	(Magistrate Judge Blewitt)
	:	
RANGE RESOURCES-APPALACHIA, LLC	:	
	:	
Defendant	:	

NOTICE

NOTICE IS HEREBY GIVEN that the undersigned has entered the foregoing **Report and Recommendation** dated **July 29, 2009.**

Any party may obtain a review of the Report and Recommendation pursuant to Rule 72.3, which provides:

> Any party may object to a magistrate judge's proposed findings, recommendations or report addressing a motion or matter described in 28 U.S.C. § 636 (b)(1)(B) or making a recommendation for the disposition of a prisoner case or a habeas corpus petition within ten (10) days after being served with a copy thereof. Such party shall file with the clerk of court, and serve on the magistrate judge and all parties, written objections which shall specifically identify the portions of the proposed findings, recommendations or report to which objection is made and the basis for such objections. The briefing requirements set forth in Local Rule 72.2 shall apply. A judge shall make a *de novo* determination of those portions of the report or specified proposed findings or recommendations to which objection is made and may accept, reject, or modify, in whole or in part, the findings or recommendations made by the magistrate judge. The judge, however, need conduct a new hearing only in his or her discretion or where required by law, and may consider the record developed before the magistrate judge, making his or her own determination on the basis

of that record. The judge may also receive further evidence, recall witnesses or recommit the matter to the magistrate judge with instructions.

s/ Thomas M. Blewitt
THOMAS M. BLEWITT
United States Magistrate Judge

Dated: July 29, 2009

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

JOHN P. HOLLINGSWORTH, JAMES A. HOLLINGSWORTH, and KENNETH E. HOLLINGSWORTH, **Plaintiffs**	**No. 3:09cv838**
v.	**(Judge Munley)**
RANGE RESOURCES–APPALACHIA, LLC, **Defendant**	

MEMORANDUM

Before the court are plaintiffs' objections (Doc. 18) to the report and recommendation of Magistrate Judge Thomas M. Blewitt (Doc. 17) that defendant's motion to dismiss (Doc. 6) be granted and that plaintiffs' complaint be dismissed pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure. The matter is fully briefed and ripe for disposition.

BACKGROUND

Plaintiffs John P. Hollingsworth, James A. Hollingsworth, and Kenneth E. Hollingsworth own sixty-six acres of land (the "land") in Lichfield Township. (Compl. at ¶ 5 (Doc. 1 at 2)). On or about June 8, 2008, Defendant Range Resources-Appalachia, LLC ("Range") mailed plaintiffs a five-year "paid-up oil and gas lease" for their signature. (Id. at ¶¶ 6, 7). Along with the lease, Range mailed plaintiffs a "Dear Property Owner" letter ("DPO letter"). (Id. at ¶ 19; DPO Letter (Doc. 1-3 at 20)). The lease states the terms under which Range would be allowed to drill on plaintiffs' land for oil and gas in return for consideration of one dollar and potential royalties. (Lease (Doc. 1-3 at 10)). The DPO letter thanks plaintiffs for "entering into an oil and gas lease" with Range and explains that Range pays a bonus payment to property owners "as consideration for executing the lease." (DPO Letter (Doc 1-3 at 20)). Significantly, the DPO letter states that Range "hereby agrees to pay the following oil and gas

owner the amount below set forth subject to approval of title and management lease review. . . ." (Id.) The DPO letter recites plaintiffs' lease payment amount as $165,000.00, to be paid ninety days from the lease date. (Id.) Neither the lease nor the DPO letter was ever signed by a representative of Range, though Range prepared each document.

Following Range's instructions, plaintiffs each signed the lease before a notary public on July 28, 2008. (Compl. at ¶¶ 7, 8; Lease (Doc 1-3 at 10)). On August 13, 2008, plaintiffs mailed the lease containing their signatures to defendant. (Id. at ¶ 8). Range Vice President Jeffery Bynum sent plaintiffs a letter on December 16, 2008, stating that plaintiffs' lease was not approved and returning the lease stamped 'void.' (Id. at ¶ 9; Bynum Letter (Doc. 1-3 at 22)). Range made no payment to plaintiffs and plaintiffs filed suit in the Court of Common Pleas of Bradford County on March 30, 2009 for breach of contract and declaratory relief. (Compl. at ¶¶ 22 to 30 (Doc. 1-3)).

Range removed the action to this court pursuant to 28 U.S.C. § 1441 based on diversity jurisdiction. 28 U.S.C. § 1332. On May 11, 2009, Range filed the instant motion to dismiss, which Magistrate Judge Thomas M. Blewitt recommends granting. (Doc. 17). Plaintiffs filed their objections to the magistrate judge's recommendation, bringing the case to its present posture.

JURISDICTION

The court has diversity jurisdiction over this action pursuant to 28 U.S.C. §§ 1332 where the plaintiffs are citizens of Pennsylvania and Range is a Delaware corporation with a principal place of business not in Pennsylvania. (Notice of Removal (Doc. 1)).

LEGAL STANDARD

In disposing of objections to a magistrate judge's report and

recommendation, we make a *de novo* determination of those portions of the report to which objections are made. 28 U.S.C. § 636 (b)(1)(C); see also Henderson v. Carlson, 812 F.2d 874, 877 (3d Cir. 1987). This court may accept, reject, or modify, in whole or in part, the findings or recommendations made by the magistrate judge. We may also receive further evidence or recommit the matter to the magistrate judge with instructions. Id.

Before the court is the magistrate judge's recommendation that we grant defendant's motion to dismiss for failure to state a claim upon which relief can be granted. FED. R. CIV. P. 12(b)(6). When a 12(b)(6) motion is filed, the sufficiency of the allegations in the complaint is tested. Granting the motion is appropriate if, accepting as true all the facts alleged in the complaint, the plaintiff has not pleaded "enough facts to state a claim to relief that is plausible on its face," or put another way, "nudged [his or her] claims across the line from conceivable to plausible." Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 570 (2007). The Third Circuit interprets Twombly to require the plaintiff to describe "enough facts to raise a reasonable expectation that discovery will reveal evidence of" each necessary element of the claims alleged in the complaints. Phillips v. County of Allegheny, 515 F.3d 224, 234 (3d Cir. 2008) (quoting Twombly, 550 U.S. at 556). Moreover, the plaintiff must allege facts that "justify moving the case beyond the pleadings to the next stage of litigation." Id. at 234-35.

In relation to Federal Rule of Civil Procedure 8(a)(2), the complaint need only provide "'a short and plain statement of the claim showing that the pleader is entitled to relief,' in order to 'give the defendant fair notice of what the . . . claim is and the grounds upon which it rests,'" Twombly, 550 U.S. at 555 (citation omitted). "[T]he factual detail in a complaint [cannot be] so undeveloped that it does not provide a defendant the type of notice

of claim which is contemplated by Rule 8." Phillips, 515 F.3d at 232 (citation omitted). "Rule 8(a)(2) requires a 'showing' rather than a blanket assertion of an entitlement to relief." Id.

The issue is whether the facts alleged in the complaint, if true, support a claim upon which relief can be granted. In deciding a 12(b)(6) motion, the court must accept as true all factual allegations in the complaint and give the pleader the benefit of all reasonable inferences that can fairly be drawn therefrom, and view them in the light most favorable to the plaintiff. Morse v. Lower Merion Sch. Dist., 132 F.3d 902, 906 (3d Cir. 1997). However, "we are not bound to accept as true a legal conclusion couched as a factual allegation." Ashcroft v. Iqbal, – U.S. –, 129 S. Ct. 1937, 1949-50 (2009) (internal quotations omitted). The Supreme Court has counseled that a court examining a motion to dismiss should, "begin by identifying pleadings that, because they are no more than conclusions, are not entitled to the assumption of truth." Iqbal, 129 S. Ct. at 1950. Next, the court should make a context-specific inquiry into the "factual allegations in [the] complaint to determine if they plausibly suggest an entitlement to relief." Id. at 1950-51.

To decide a motion to dismiss, a court generally should consider only the allegations in the complaint, exhibits attached to the complaint, matters of public record, and documents that form the basis of a claim. See In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1426 (3d Cir. 1997); Pension Benefit Guar. Corp. v. White Consol. Indus., Inc., 998 F.2d 1192, 1196 (3d Cir. 1993).

DISCUSSION

Plaintiffs make seven objections to the magistrate judge's report and recommendation. The court will examine each in turn.

1. Application of 12(b)(6) Standard to Plaintiffs' Complaint

Plaintiffs' first objection is that the magistrate judge "did not accept as true allegations of fact contained in the complaint and did not identify allegations that were rejected as legal conclusions or lacking in specificity as required by Supreme Court precedent." (Doc. 18 at 1). Specifically, plaintiffs argue that "the complaint alleges the following facts that the court must accept as true. 'On or about June 8, 2008, defendant offered to enter into a paid up oil & gas lease . . . . The lease was accepted by plaintiffs and signed by a notary on July 28, 2008 . . . .'" (Plaintiffs' Br. in Supp. at 5 to 6 (Doc. 19)). We disagree with the plaintiffs. First, these are not allegations of facts, but rather legal conclusions which we need not presume true. Iqbal, 129 S. Ct. at 1950. Second, it is apparent which portions of the complaint the magistrate judge considered conclusory--plaintiffs' characterization of what constituted an offer and acceptance, and therefore the existence of a contract. (Doc. 17 at 7). This court agrees with the magistrate that it was the plaintiffs who were making an offer to lease, which defendant subsequently rejected.

2. Plausibility of Plaintiff's Breach of Contract Claim

Plaintiffs' second objection is that the magistrate judge's report "is in err because the breach of contract claim is plausible." (Doc. 18 at 1). In essence, plaintiffs argue that, even after discounting conclusions of law found in the complaint, they still prevail under the second prong of Iqbal because their well-pleaded factual allegations "plausibly suggest an entitlement to relief." 129 S. Ct. at 1951; (Br. in Supp. at 6 to 7 (Doc. 19)) ("the Court must still conclude that the defendant gave the plaintiff (sic) an oil and gas lease, that they had prepared, it was mailed to one of the plaintiffs by defendant's landman, signed by the plaintiffs and returned to the defendant, ninety days lapsed . . . and the defendant returned the lease marked void . . . .").

This court, based on its judicial experience and common sense, determines that these admittedly well-pleaded facts "do not permit the court to infer more than the mere possibility of misconduct, the complaint has alleged– but it has not 'show[n]'– 'that the pleader is entitled to relief." Iqbal, 129 S. Ct. at 1950 (quoting Fed. Rule Civ. Proc. 8(a)(2)). Under Pennsylvania law, which governs this case, "a plaintiff must allege (1) the existence of a contract, including its essential terms, (2) a breach of a duty imposed by the contract, and (3) resultant damages. Ware v. Rodale Press, Inc., 322 F.3d 218, 225 (3d Cir. 2003). The court finds that, upon the facts just recited, no contract exists. See Reed v. Pittsburgh Bd. of Public Educ., 862 A.2d 131, 134 (Pa. Commw. 2004) (elements of a valid contract are offer, acceptance, and consideration).

Here, plaintiffs have not established the first element– the existence of a contract. No contract could be formed absent defendant's manifestation of an intent to be bound. See Restatement (Second) of Contracts § 26 (1979) ("A manifestation of willingness to enter into a bargain is not an offer if the person to whom it is addressed knows or has reason to know that the person making it does not intend to conclude a bargain until he has made a further manifestation of assent."). Preparing a lease and giving it to plaintiffs for their signature is not plausibly an offer where the defendant did not sign the lease and stated that plaintiffs' signed lease would be subject to review. Rather, as the magistrate found, the only offer made was by the plaintiffs, when they signed the lease and mailed it to defendant.

3. Sufficiency of Plaintiffs' Pleading

Plaintiffs' argue that the magistrate judge's "finding that Plaintiff[s] did not sufficiently plead a breach of contract claim (Doc. 17 [at] 5) is in err because the well pled facts in the complaint applied to the law of contracts

properly sets forth a breach of contract cause of action." (Doc. 18 at 1). As stated above, plaintiffs have not stated a claim for breach of contract because they cannot establish the existence of a contract.

4. Lack of Contract Formation

Plaintiffs' fourth objection is that "[t]he Magistrate Judge's finding that 'no contract which included a bonus and rental delay payment was ever formed between it and Plaintiff' (Doc. 17 [at] 5) is a legal conclusion without basis in all well pleaded facts that the court must accept as true." (Doc. 18 at 2). The court does not agree, as explained above. Rather, as a matter of law, plaintiffs' allegations and documentary evidence show that no contract was formed.

5. Delivery of a Lease

Plaintiffs object that the magistrate judge "failed to recognize that a delivery of a lease is a conveyance of real property." (Doc. 18 at 2). Plaintiffs cite Stonehedge Square Ltd. P'ship v. Movie Merchs., Inc., 715 A.2d 1082 (1998) for the proposition that principles of property law govern whether or not a landlord in a commercial lease has a duty to mitigate damages. (Pls. Br. in Supp. at 14 (Doc. 19)). While that proposition demonstrates that property law may be applicable to some issues relating to a lease, it does not establish that property law governs the instant lease. Because plaintiffs cannot show that anything other than the law of contracts governs this case, delivery is irrelevant.

6. Applicability of Lyco Better Homes, Inc. v. Range Resources–Appalachia, LLC

Plaintiffs argue that the magistrate judge "should not have followed Lyco Better Homes, Inc. v. Range Resources-Appalachia, LLC, 4:09-CV-00249-JFM, May 21, 2009 where the cases have significant differences in the pleadings and the language in the Dear Property Owner

letter." (Doc. 18 at 2). This court has reviewed plaintiffs' arguments against dismissal *de novo*, without reliance on Lyco, therefore this objection is moot.

7. Opportunity to Amend the Complaint

Finally, plaintiffs object that the magistrate judge "erred in refusing to permit the Plaintiff to amend the complaint since the courts are reluctant to refuse a party an opportunity to amend a pleading." (Doc. 18 at 2). In certain circumstances it is appropriate to dismiss the case provisionally and allow the plaintiffs to file an amended complaint. Lorenz v. CSX Corp., 1 F.3d 1406, 1413 (3d Cir. 1993). We do not provide the opportunity to amend, however, where such amendment would be futile. Shane v. Fauver, 213 F.3d 113, 115 (3d Cir. 2000); In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1434 (3d Cir. 1997). "'Futility' means that the complaint, as amended, would fail to state a claim upon which relief could be granted." Shane, 213 F.3d at 113. The court applies the same dismissal standard in assessing futility as it does under Rule 12(b)(6). Id.

The plaintiffs' proposed amended complaint continues to label defendant's preparation and mailing of the lease as an offer and the plaintiffs' signature and return of the lease as an acceptance. (Proposed Am. Compl. (Doc. 19-2)). However, plaintiffs propose to add a promissory estoppel claim against Range, based on the same allegations and documents which underlie their breach of contract and declaratory judgment causes of action. (Id. at ¶¶ 33 to 38).

Promissory estoppel allows a court to enforce a promise against a promisor despite the fact that he received no consideration for his promise. See Cardmone v. Univ. of Pittsburgh, 384 A.2d 1228, 1233 (Pa. Super. Ct. 1978). The doctrine is applicable where "(1) the promisor makes a promise that he reasonably expects to induce action or forbearance by the

promisee, (2) the promise does induce action or forbearance by the promisee, (3) and injustice can only be avoided by enforcing the promise." Carlson v. Arnot-Ogden Mem'l Hosp., 918 F.2d 411 (3d Cir. 1990).

Plaintiffs claim fails, however, because they have alleged no further facts indicating an unconditional promise by Range. Thus, for the same reason that plaintiffs breach of contract claim is ripe for dismissal, plaintiffs' request to amend their complaint is futile– Range conditioned their entrance into any agreement upon management review.

CONCLUSION

For these reasons, each of plaintiffs' objections to Magistrate Judge Thomas M. Blewitt's report and recommendation are overruled. Defendant's motion to dismiss will be granted in a following order without granting plaintiffs leave to amend their complaint.

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

JOHN P. HOLLINGSWORTH, JAMES A. HOLLINGSWORTH, and KENNETH E. HOLLINGSWORTH, **Plaintiffs**	**No. 3:09cv838**
v.	**(Judge Munley)**
RANGE RESOURCES–APPALACHIA, LLC, **Defendant**	

ORDER

AND NOW, to wit, this 28th day of October 2009:

1. The plaintiffs' objections (Doc. 18) to the report and recommendation of Magistrate Judge Thomas M. Blewitt are hereby **OVERRULED.**

2. Judge Blewitt's report and recommendation (Doc. 17) is hereby **ADOPTED**.

3. The defendant's motion to dismiss (Doc. 6) is hereby **GRANTED**.

4. Plaintiffs' request for leave to amend the complaint is hereby **DENIED**. And,

5. The Clerk of Court is directed to close the case.

BY THE COURT:

s/ James M. Munley

JUDGE JAMES M. MUNLEY
United States District Court

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF WEST VIRGINIA

RALPH O. KERNS and
MARY JANE KERNS,

Plaintiffs,

v. // **CIVIL ACTION NO. 1:10CV23**
(Judge Keeley)

RANGE RESOURCES -
APPALACHIA, LLC,

Defendant.

MEMORANDUM OPINION AND ORDER GRANTING DEFENDANT'S MOTION TO DISMISS [DKT. NO. 13]

I. INTRODUCTION

Pending before the Court is the motion to dismiss of the defendant, Range Resources - Appalachia LLC ("Range"). For the reasons that follow, the Court concludes that no contract was formed between Range and the plaintiffs and **GRANTS** Range's motion to dismiss (dkt. no. 13).

II. FACTUAL BACKGROUND

This case arises from oil and gas leasing negotiations between the plaintiffs, Ralph O. Kerns and Mary Jane Kerns ("the plaintiffs"), who own approximately 207 acres of land in fee simple in Monongalia County, West Virginia, and Range. As part of these negotiations, which occurred in 2008, Range provided the plaintiffs with unsigned copies of an Oil and Gas Lease, an Addendum to the Lease, a Memorandum of Oil and Gas Lease, a "Dear Property Owner"

letter ("DPO letter"), and a Request for Taxpayer Identification Number.[1] On September 5, 2008, the plaintiffs signed and returned these documents to Range. They now assert that by signing these documents they made a contractual offer to Range. See Pl.'s Compl. at p. 2.

On November 11, 2008, Range wrote to the plaintiffs ("the November 11th letter") advising that, due to "the drastic drop in oil and gas prices, the downturn of the U.S. economy and the resulting effects on the credit markets," Range's senior management had not approved the plaintiffs' proposal. See November 11th letter (dkt. no. 3-1 at 33). In pertinent part, however, Range also stated:

> As an alternative, if you remain interested in leasing your property:
>
> - Range would consider entering into a five (5) year term delay rental lease with a lease date commencing in early 2009.
> - Upon your execution of such a lease, Range would tender 20% of the consideration provided for in the Proposed Lease.

[1] The plaintiffs attached these documents to their complaint. Accordingly, the Court may consider them without converting Range's motion to dismiss to a motion for summary judgment. See Sec'y of State For Defence v. Trimble Navigation Ltd., 484 F.3d 700, 705 (4th Cir. 2007).

> - The lease would provide for four (4) annual delay rental payments with each payment equaling 20% of the consideration provided for in the Proposed Lease.
> - Range would still need to verify your title to the oil and gas rights under the lands described in the lease, which Range would expect to complete by the lease date.
>
> This alternative offers you the potential of realizing the same total consideration that you would have been paid if the Proposed Lease had been accepted, does not alter the other terms and provisions of the Proposed Lease, and allows Range the opportunity to develop your oil and gas resources. . . .
> If you are interested in leasing your property to Range under the above terms, please sign and return one copy of this letter to Range in the enclosed pre-paid envelope. If you have any questions concerning Range's proposal, please contact us at (412) 697-2643. **This proposal will remain open until December 31, 2008.**

Id. (emphasis in original).

After they received the November 11th letter, the plaintiffs signed it and returned it to Range. They contend that the letter was an "alternative proposal counteroffer" from Range which they accepted, thus forming a contract. See Pl.'s Compl. at ¶ 6.

Months later, on June 4, 2009, Range sent a letter to the plaintiffs' attorney, Samuel Spencer Stone, stating:

> Range has suspended leasing activity in West Virginia for the foreseeable future and will not be interested in pursuing a lease with the plaintiffs at the present time.

June 4th Letter (dkt. no. 13-2, at 2). According to the plaintiffs, this letter breached the leasing contract formed when they signed the November 11th letter. Range, however, argues that the November 11th letter was not a counteroffer and that the parties never formed a contract.

III. DEFENDANT'S MOTION TO DISMISS

To survive a motion to dismiss filed pursuant to Fed. R. Civ. P. 12(b)(6), a complaint must contain factual allegations sufficient to state a plausible claim for relief. Ashcroft v. Iqbal, 129 S. Ct. 1937, 1949 (2009); Bell Atlantic Corp. V. Twombly, 550 U.S. 544, 557 (2007). "The plausibility standard requires a plaintiff to demonstrate more than a sheer possibility that a defendant has acted unlawfully. It requires the plaintiff to articulate facts, when adopted as true, that show that the plaintiff has stated a claim entitling him to relief, i.e., the plausibility of entitlement to relief." Francis v. Giacomelli, 588 F.3d 186, 193 (internal quotations omitted).

Although the Court must accept factual allegations in a complaint as true, this "tenet . . . is inapplicable to legal

conclusions." Id. at 1950. Thus, a complaint may be dismissed when the facts alleged clearly demonstrate that the plaintiff has not stated a claim and is not entitled to relief. 5B Charles Alan Wright & Arthur R. Miller, Federal Practice and Procedure § 1357 at 344-45 (3d ed. 2007). "Determining whether a complaint states a plausible claim for relief will . . . be a context-specific task that requires the reviewing court to draw on its judicial experience and common sense." Iqbal, 129 S. Ct. at 1949 (citation omitted).

A. The Plaintiffs' Breach of Contract Claim

Range contends that the plaintiffs' claim for breach of contract fails because Range and the plaintiffs never formed a contract. Even if a contract was formed, however, Range further contends that conditions precedent to performance have not yet taken place. The Court need not address the latter issue because, as discussed below, it concludes that no contract was formed under West Virginia law.

1. West Virginia Law Governs the Question of Contract Formation

Pursuant to Erie R. Co. v. Tompkins, 304 U.S. 64, 78 (1938), the applicable law in a diversity case such as this is determined by the substantive law of the state in which a district court sits.

This includes the forum state's prevailing choice of law rules. See Klaxon Co. v. Stentor Electic Mfg. Co., 313 U.S. 487, 496-97 (1941). In West Virginia, "[t]he law of the state in which a contract is made and to be performed governs the construction of a contract when it is involved in litigation in the courts of this state." See Syl. Pt. 3, Howe v. Howe, 625 S.E.2d 716, 717 (W. Va. 2005) (internal citations and quotation marks omitted). The parties, however, may defeat this general rule "by making a choice of law in the contract." Nadler v. Liberty Mut. Fire Ins. Co., 424 S.E.2d 256, 261 (W. Va. 1992).

In this case, the negotiations between the plaintiffs and Range took place in West Virginia. Additionally, the parties contemplated contract performance in West Virginia. Moreover, no choice of law provisions are at issue in this case. Thus, the substantive law of West Virginia governs whether the parties formed a contract. See Syl. Pt. 3, Howe, 625 S.E.2d at 717.

2. The Law of Contract Formation in West Virginia

Under West Virginia law, contract formation requires an offer, acceptance of the offer, and consideration supporting the agreement. See First National Bank v, Marietta Mfg. Co., 153 S.E.2d 172 (1967). "[M]utuality of assent is an essential element

of all contracts." Id. (citing Wheeling Downs Racing Ass'n v. West Virginia Sportservice, Inc., 216 S.E.2d 234 (W. Va. 1975)). "In order for this mutuality to exist, it is necessary that there be a proposal or offer on the part of one party and an acceptance on the part of the other." Id. In other words, contract formation requires "a complete meeting of the minds on all material matters, leaving nothing for future negotiations." Allen v. Simmons, 125 S.E. 86, 88 (W. Va. 1924).

Section 24 of the Second Restatement of Contracts defines an offer as "'the manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to that bargain is invited and will conclude it.'" Verizon West Virginia, Inc. v. West Virginia Bureau of Employment Programs, 586 S.E.2d 170, 205 n.11 (W. Va. 2003) (Davis, J., dissenting) (quoting National Educ. Association-Rhode Island by Scigulinsky v. Retirement Bd. of Rhode Island Employees' Retirement System, 890 F. Supp. 1143, 1157 (D.R.I. 1995) (quoting Restatement (Second) of Contracts, § 24 (1981))(internal quotation marks omitted)); see also 1 Corbin on Contracts, § 11 at 23 (1963) (defining an offer as "an expression by one party of his assent to certain definite terms provided that the other party involved in

the bargaining transaction will likewise express his assent to the identical same terms."). "An offer must be certain in its essential terms to create a power of acceptance." Charbonnages de France v. Smith, 597 F.2d 406, 417 (4th Cir. 1979) (construing West Virginia law).

In contrast, "a manifestation of willingness to enter into a bargain" will not constitute an offer if the person receiving the communication "knows or has reason to know" that the party manifesting a willingness to bargain "does not intend to conclude [the] bargain until he has made a further manifestation of assent." Restatement (Second) of Contracts, § 26 (1981). Such communications will constitute preliminary negotiations. See id.

"'Generally, the existence of a contract is a question of fact for the jury.'" Ruckdeschel v. Falcon Drilling Co., L.L.C., 693 S.E.2d 815, 820 (W. Va. 2010) (quoting Syl. Pt. 4, Cook v. Heck's Inc., 342 S.E.2d 453, 457 (W. Va. 1986). The determination of what constitutes a contract, and the application of an unambiguous writing, however, present questions of law. See Croft v. TBR, Inc., 664 S.E.2d 109, 111 (W. Va. 2008) (citations omitted); Williams v. Precision Coil, Inc., 459 S.E.2d 329, 339 n. 18 (W. Va. 1995).

Whether a writing is ambiguous also presents a question of law. Fraternal Order of Police, Lodge No. 69 v. City of Fairmont, 468 S.E.2d 712, 715 (W. Va. 1996). Contract language will usually be ambiguous "where an agreement's terms are inconsistent on their face or where the phraseology can support reasonable differences of opinion as to the meaning of words employed and obligations undertaken." Id. at 716. Disagreement among parties over the construction of a contract, however, will not render its terms ambiguous. Id. at 717. A court must apply an unambiguous writing according to the "'plain and ordinary meaning'" of its terms. Dan's Carworld, LLC v. Serian, 223 W.Va. 478, 483, 677 S.E.2d 914, 919 (W. Va. 2009) (citing Supervalu Operations, Inc. v. Center Design, Inc., 524 S.E.2d 666, 670 (W. Va. 1999) (per curiam) (internal citation omitted)).

Pursuant to these legal principles, the November 11th letter is an unambiguous writing ripe for applying the plain and ordinary meaning of its terms. It is not, however, an offer.

3. The November 11th Letter was Not an Offer

In determining whether the November 11th letter was an "offer" or a continuation of the parties' "preliminary negotiations," the case of Fleming Co. Of Nebraska, Inc. v. Michals, 433 N.W.2d 505

(Neb. 1988), is instructive.[2] In Fleming, an individual named Forrest R. Michals ("Michals") served as a guarantor for the debts Beer Mart, Inc. and Mike's IGA, Inc. owed to the Fleming Company of Nebraska, Inc. ("Fleming"). On September 6, 1984, Michals's attorney wrote to Fleming, stating:

> I am enclosing a copy of a Complaint that our office will file on behalf of Mike's IGA, Beer Mart, Inc., Forrest R. Michals, Sr., and Forrest R. Michals, Jr., against The Fleming Company of Nebraska, Inc. Our clients **would consider** not filing this action and giving release of the claims noted therein if they, in return, are given a complete release of all claims of The Fleming Company of Nebraska, or any related companies, who may have a claim against them.

Id. at 506-07 (emphasis added).

On September 27, 1984, Fleming's attorney responded to the lawyer for Michals, stating:

> This will respond to your letter of September 6, 1984 regarding the above matter. Fleming Companies, Inc. and the Fleming Co. of Nebraska, Inc. hereby accept the settlement proposal set forth in your letter. . . .
> . . .
> I will contact you early next week so that we can begin to prepare releases and any other documentation necessary to formalize the settlement.

---

[2] Fleming's holding and reasoning are in accord with the common law of West Virginia and rely on well-established principles of the common law of contracts.

Id. at 507. No additional correspondence occurred between the parties until October 17, 1984, when Fleming's attorney wrote:

> Fleming Companies, Inc. and the Fleming Co. of Nebraska, Inc., hereby withdraw their counterproposal set forth in my letter to you of September 27, 1984, to settle the disputes between the parties with regard to the above matter. I have been directed by my clients to proceed to file an action against Mr. Michals on his Guaranty as soon as possible, and you should proceed accordingly.

Id.

Fleming then filed suit against Michals in Nebraska state court on October 29, 1984. Michals answered by denying default on any corporate debts, alleging antitrust violations against Fleming, and asserting that the parties had a valid settlement agreement. Id.

The trial court agreed with Michals and concluded that his letter was an offer to enter into a settlement agreement, and that Fleming had accepted that offer. It further concluded that Fleming's acceptance of this offer had resulted in the formation of a binding contract which precluded its suit against Michals. Id. at 506.

On appeal, the Nebraska Supreme Court reversed, holding that the September 6th letter was not an offer but rather an invitation

from Michals for Fleming to make an offer. In reaching this conclusion, the court relied on an example from the official commentary to the Second Restatement of Contracts:

> A writes B, "I am eager to sell my house. I **would consider** $20,000 for it." B promptly answers, "I will buy your house for $20,000 cash." There is no contract. A's letter is a request or suggestion that an offer be made to him. B has made an offer.

Id. at 508 (quoting Restatement (Second) of Contracts § 26, cmt. d. (1981) (emphasis added). Because Michals's letter stated that he "would consider" settling his claims against Fleming if Fleming would do the same, the court reasoned that the letter failed to place "an actual and definitive promise or obligation on Michals." Id. Inasmuch as the letter lacked a definitive promise, "Fleming could not accept a nonexistent offer," and its response to Michals therefore did not result in the formation of a contract. Id. In other words, the letter Michals wrote was not an offer, but rather an "invitation for Fleming's submission of an offer." Id.; see also Ferrero Const. Co. v. Dennis Rourke Corp., 536 A.2d 1137, 1145 (Md. 1988) (recognizing that "[a]n invitation to submit an offer is not itself an offer; the submission of an offer, pursuant to the invitation, is not an acceptance.").

In the case at bar, Range's November 11th letter stated that if the plaintiffs "[remained] interested in leasing [their] property[] Range **would consider** entering into a five (5) year term delay rental lease with a lease date commencing in early 2009." November 11th letter (dkt. no. 3-1 at 33) (emphasis added). Those words contain no "actual and definitive promise or obligation" by which Range agreed to be bound. See Fleming, 433 N.W. at 508. The letter also lacks any definitive promises or obligations from Range. Under West Virginia law, therefore, the lack of a definitive promise from Range in the November 11th letter precludes the letter from qualifying as an offer. See id.

It follows from this that when the plaintiffs received the November 11th letter from Range they could not reasonably have understood that, merely by signing and returning the letter, they could conclude any bargain. Compare Restatement (Second) of Contracts § 26, comment d. (invitation to bargain) with Restatement (Second) of Contracts, § 24 (offer). At most, Range's willingness to "consider" entering into a leasing agreement with them invited the plaintiffs to submit an offer of their own and signaled to them that further negotiations, or at least a further manifestation of assent from Range, would be necessary to conclude any agreement.

Accord Allen, 125 S.E. at 88 (holding that contract formation requires "a complete meeting of the minds on all material matters, leaving nothing for future negotiations."). The allegations in the plaintiffs' complaint therefore fail to state a plausible claim for breach of contract. Iqbal, 129 S.Ct. at 1949.

B. The Plaintiffs' Remaining Claims

The plaintiffs also assert claims against Range for breach of the covenant of good faith and fair dealing, fraudulent misrepresentation, negligent misrepresentation, and punitive damages. These claims, however, fail as a matter of law.

1. Breach of the Covenant of Good Faith and Fair Dealing

It is well settled that West Virginia does not recognize a claim for breach of the covenant of good faith and fair dealing independent of a claim for breach of contract. See, e.g., Unum Life Ins. Co. of America v. Wilson, No. 2:08CV73, 2009 WL 3617747, at *7-*8 (N.D.W. Va. Oct. 29, 2009) (Bailey, C.J.) (unpublished) (recognizing that, "[u]nder West Virginia law, a claim for breach of the duty of good faith and fair dealing is not an independent cause of action, but rather is subsumed in the claim for breach of contract."). Accordingly, because the Court has concluded that they had no contract with Range, it also concludes that the

plaintiffs have no independent claim for breach of the covenant of good faith and fair dealing.

2. Fraudulent Misrepresentation

The plaintiffs allege that Range made fraudulent misrepresentations to them regarding the work it intended to perform as well as the work that it "actually performed under the terms of the parties' contract." Pl.'s Compl. at ¶¶ 15-17. To survive a motion to dismiss, however, such a fraud claim must "state with particularity the circumstances constituting fraud or mistake." Fed. R. Civ. P. 9(b). "[T]he 'circumstances' required to be pled with particularity under Rule 9(b) are 'the time, place, and contents of the false representations, as well as the identity of the person making the misrepresentation and what he obtained thereby.'" Harrison v. Westinghouse Savannah River Co., 176 F.3d 776, 784 (4th Cir. 1999) (quoting 5 Charles Alan Wright and Arthur R. Miller, Federal Practice and Procedure: Civil § 1297, at 590 (2d ed. 1990)).

Notwithstanding that the plaintiffs' claim for fraudulent misrepresentation fatally relies on the existence of a contract, their pleading of that claim also fails to satisfy the requirements of Rule 9(b). Rather than plead their fraud claim with

particularity, the plaintiffs have merely listed the elements of such a claim without providing any factual support for it. For example, they allege that Range "made certain representations," but they never specify the nature of those representations or state what was said. Moreover, they provide no information about when these representations were made, where they were made, or who made them. Such bare allegations fail to satisfy the pleading requirements of Rule 9(b). See Harrison, 176 F.3d at 784.

3. **Negligent Misrepresentation**

The plaintiffs' claim of negligent misrepresentation, see Pl.'s Compl. at ¶¶ 23-29, which closely mirrors their claim of fraudulent misrepresentation, fails because a non-fraud claim, including one of negligent misrepresentation, must satisfy the pleading requirements of Federal Rule of Civil Procedure 8(a). See Baltimore County v. Cigna Healthcare, 238 Fed. App'x 914, 922 (4th Cir. 2007) (unpublished). Rule 8(a) requires "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a). A claim consisting only of "threadbare recitals of the elements of a cause of action, supported by mere conclusory statements" fails to satisfy the pleading requirements of Rule 8(a). Igbal, 129 S. Ct. at 1949.

Here, the plaintiffs' claim of negligent misrepresentation consists of mere legal conclusions. For example, their complaint alleges that Range negligently misrepresented the work it intended to perform, and the work that it "actually performed under the terms of the parties' contract." Pl.'s Compl. at ¶¶ 23-26. But there is no description in the complaint of the circumstances or details concerning how Range made such negligent misrepresentations. Because the plaintiffs have failed to provide any factual basis for their claim of negligent misrepresentation, their complaint does not satisfy the pleading requirements of Rule 8(a). See id.

4. Punitive Damages

Finally, in light of the fact that all of the plaintiffs' substantive claims fail as a matter of law, it follows that their claim for punitive damages also fails because punitive damages are a form of relief rather than an independent claim. See, e.g., Miller v. Carelink Health Plans, Inc., 82 F. Supp.2d 574, 579 n.6 (S.D.W. Va. 2000) (Haden, C.J.). In Miller, the court recognized that "punitive damages" are a "a form of relief," not a cause of action. See also Berry v. Nationwide Mut. Fire Ins. Co., 381 S.E.2d 367, 373-74 (W. Va. 1989), which held that, "[g]enerally, absent

an independent, intentional tort committed by the defendant, punitive damages are not available in an action for breach of contract."

IV. CONCLUSION

For the reasons discussed, the Court **GRANTS** the motion of the defendant, Range Resources - Appalachia, LLC, to dismiss the complaint (dkt. no. 13), **DIRECTS** the Clerk not to enter a judgment order, and further **DIRECTS** that the case be left open on the docket so that the Court may address the plaintiffs' pending motion to amend the complaint (dkt. no. 31). It further **DIRECTS** the Clerk to transmit copies of this order to counsel of record.

It is so **ORDERED.**

DATED: January 18, 2011.

/s/ Irene M. Keeley
IRENE M. KEELEY
UNITED STATES DISTRICT JUDGE

183 Pa. 547
Supreme Court of Pennsylvania.

HENDERSON et al.
v.
FERRELL et al.

Jan. 3, 1898.

Appeal from court of common pleas, Washington county.

Ejectment by T. O. Henderson and others against Thomas Ferrell and others. Judgment for plaintiffs. Defendants. Defendants appeal. Affirmed.

West Headnotes (5)

1 **Landlord and Tenant**
Trial
Mines and Minerals

Disputed facts as to whether lessee suffered the forfeiture clause of the lease are for the jury.

2 **Mines and Minerals**
Assignment or Sublease

Assignees of one who takes a lease with knowledge of a prior lease, and of the facts on which depends the question of forfeiture thereof have no greater rights against the prior lessee than their assignor.

3 **Mines and Minerals**

A lessee of land for oil and gas purposes, required by his lease to commence operations on the premises within 30 days, on penalty of the lease being void, does not forfeit his rights if on the last day of the period allowed he in good faith enters and commences operations on the premises preparatory to drilling a well, and is prevented by the lessor from proceeding therewith.

11 Cases that cite this headnote

4 **Mines and Minerals**

Where the lessee was to begin operations under an oil and gas lease within thirty days, there is no forfeiture if on the afternoon of the thirtieth day he began unloading lumber upon the land with the bona fide intention of sinking a well, but was prevented from so doing by the action of the lessor, his delay in beginning operations being caused by inability to secure necessary machinery and labor.

1 Cases that cite this headnote

5 **Mines and Minerals**

It is for the jury to determine whether the lessee began operations within the required time so as not to forfeit his rights under the lease.

1 Cases that cite this headnote

Attorneys and Law Firms

*552 R. W. Cummins, David Sterrett, and Chas. C. Sterrett, for appellants.

Andrew M. Linn and T. F. Birch, for appellees.

Opinion

McCOLLUM, J.

On the 4th of February, 1896, Albert Behling, being then the owner of the land in suit, leased the same to Alexander Adams, 'for the purpose and with the exclusive right of drilling and operating for petroleum and gas.' By the terms of the lease, the lessee was required to commence operations on the premises within 30 days from the date thereof, and, on his failure to do so, the lease was to be considered by the parties as 'null and void.' On the 24th of February, 1896, Adams assigned a half interest in the lease to Henderson. Nothing was done on the premises by the lessees, or by their direction, until the 5th of March, that ***553** being the last day of the period allowed by the lease within which to commence operation. On that day, Henderson drove a stake near the center of the lot, to indicate the location of the proposed well, and the point at which the lumber required in the performance of the work called for by the lease should be deposited. In the afternoon of the same day, and while an employé of the lessees was unloading some lumber upon the lot, in accordance with their instructions, he was met by the lessor, who denied that they had any right to put it there. The ground of the denial was that the time allowed for the commencement of operations expired in the forenoon of that day. The lessor was accompanied by a number of persons, who appeared to be in accord with his manifest purpose to prevent the unloading of the lumber upon the lot and the occupancy of it by the lessees or their workmen. The lessor's insistence that the lumber should not be deposited on the lot resulted in the unloading of the balance of it by the roadside, and in his removal from the lot of the lumber unloaded there. It may be stated in this connection that the stake driven by Henderson as above described had been taken up and carried away by the lessor or some member of his family before any lumber was unloaded upon the lot, and that the lessees were not present when the stake or lumber was removed, or when their employé was forbidden to deposit the lumber where they had directed him to.

The lessees had a clear right to enter and commence operations upon the lot on the 5th of March, and if they did so in good faith, and with a purpose to continue the work in accordance with the provisions of the lease, the resistance of the lessor to their occupancy of the lot furnished no warrant for a forfeiture of the lease. This was the view that was taken of the lessor's action by the learned court below, and which the lessor contests on this appeal.

As the entry of the lessees upon the lot was before the time allowed for the commencement of operations under the lease had expired, it was prima facie, at least, a lawful entry, and the lessor's action was apparently an unlawful interference with it. It would seem, therefore, that the burden was on him to show conduct on their part which justified his action. But the lessees did not rest their suit for the possession of the lot on a bare presumption. They alleged and introduced evidence to prove ***554** that their entry was made in good faith, and with a determination on their part to prosecute with due diligence the work they were authorized by the lease to do. The evidence submitted by them showed the obstructions in the way of an earlier commencement of operations, and the efforts they made to secure the materials, machinery, and labor necessary to the proper performance of the work. It also showed that, when they commenced operations on the lot, they intended and were prepared to continue them, and that their failure to do so was caused by the refusal of the lessor to allow them to proceed. It is true that the defendants introduced evidence inconsistent with and tending to discredit the evidence to which we have referred; but this would not have justified a peremptory instruction from the court to the jury to find for the defendants. Certainly, the court could not say that the lessees had forfeited their right under the lease to enter and commence operations upon the lot when they did, or that their entry was a mere bluff, and they did not intend to comply with the provisions of the lease. Whether they commenced operations in good faith, and whether they intended to proceed with due diligence, were questions for the jury, and so was the question whether their failure to continue them was caused by the ****1019** action of the lessor. These questions were submitted to the jury in a clear and impartial charge, and the result was a verdict based on a finding of facts in accord with the lessees' contention. In other words, it is established by a verdict authorized by the evidence that the lessees entered and commenced operations upon the lot in good faith, and that they were prevented from continuing them by the unlawful interference of their lessor.

The defendants claim under a lease from Behling to Adam A. Welsh, dated March 26, 1896. Welsh saw and examined the Adams lease before he closed his contract with Behling, and, according to the testimony of the latter, was told by him about the occurrences on the 5th of March, and that he would have to be responsible for the lease Adams had. On the 24th of April, Welsh sold and assigned his interest in the lease of March 26th to Gilmor, who on the same day assigned a half interest in it to the Forest Oil Company. The defendants therefore have, as against the plaintiffs, the rights which Welsh acquired by his lease, and nothing more.

***555** We discover no error in the rulings complained of in the first and second assignments, or in the excerpts from the charge on which the third, fourth, and fifth assignments were based; nor do we think that the

defendants have any cause to complain of the answers to their second and fourth points. We are clearly of the opinion that, upon the facts established by the verdict, the action of ejectment is maintainable. The assignments are overruled, and the judgment is affirmed.

End of Document

Parallel Citations

38 A. 1018

5 Pa. D. & C.3d 85
Court of Common Pleas of Pennsylvania, Armstrong County.

Pemco Gas, Inc.
v.
Bernardi

No. 1276 of 1976. | December 30, 1977

Attorneys and Law Firms

Frederick L. John, II, for petitioner.

Blair F. Green, for respondents.

Opinion

HOUSE, P.J.

Petitioner brings this action for a declaratory determination of its rights under an oil and gas lease held on property located in Cowanshannock Township, Armstrong County, Pa.

FINDINGS OF FACT

1. Petitioner, Pemco Gas, Inc. (hereinafter referred to as "Pemco") is a corporation engaged in the exploration and production of natural gas with its principal place of business located at Suite 107, 3930 Fulton Drive, Northwest Canton, Ohio, 44718.

2. Respondents, Frank L. Bernardi and Helen G. Bernardi, his wife (hereinafter referred to as "the Bernardis") are individuals who reside at 173 Temona Drive, Pittsburgh, Pa. 15236.

3. Equitable Gas is a corporation with its principal place of business at 420 Boulevard of the Allies, Pittsburgh, Pa. 15219.

4. Robert W. Nichol is an individual engaged in the coal augering business, residing at R.D. 2, Dayton, Pa. Mr. Nichol also engages in the business of performing bulldozer work for hire.

5. S. J. Jack and Son Drilling Company is engaged in the gas drilling contracting business and is located in Indiana, Pa.

6. The Bernardis acquired title to a certain tract ***87** of land situated in Cowanshannock Township by deed dated May 27, 1976, recorded in Armstrong County Deed Book 569, page 302, more particularly described as follows: . . .

7. The Bernardis' title to said land is not in dispute, and an abstract of the title is set forth in plaintiff's exhibits numbers 2, 3, 4, and 5, and in deed attached to Pemco's petition. A dispute as to the Bernardis' title did arise in late August 1976, when Pemco's attorney, Frederick L. John, II, told Pemco that the names appearing in the chain of title, i.e., Harry Lookhart and Harry Lukehart, might not be the same person. This discrepancy is no longer in dispute.

8. The Bernardis' predecessor in title, John Zenchemko, entered into an oil and gas lease with Equitable Gas on September 3, 1966, recorded in Armstrong County Deed Book 501, page 284.

9. The term clause of said lease reads:

"To have and to hold the said land and privileges for said purposes for and during a period of ten (10) years from *September 1, 1966*, and as long after commencement of operations as said land is operated for the exploration or production of gas and oil, or as gas and oil is found in paying quantities thereon, or stored thereunder, or as long as said land is used for the storage of gas or the protection of gas storage on lands in the general vicinity of said land."

10. Said lease was assigned by Equitable Gas to Pemco as evidenced by a letter dated January 20, 1976.

11. The property was surveyed by Pemco to determine the location of the well as evidenced by survey dated May 18, 1976.

12. Pemco made the initial contact with the ***88** Bernardis concerning the drilling of a well early in July 1976.

13. Negotiations between Pemco and the Bernardis continued throughout July 1976.

14. The parties agreed to the location of the well and the location of a right-of-way to the well.

15. Damages to the trees that were to be removed were set at $700 and an oral agreement was entered into that required Mr. Bernardi to be present at the site when any trees were removed in preparing the site. Pemco did not

honor this agreement and trees were removed without Mr. Bernardi being present.

16. During July 1976, and the early part of August 1976, Pemco negotiated with Kenneth Yagle, an adjoining property owner, and ultimately obtained a right-of-way across his property to the well site.

17. Pemco employed Robert W. Nichol, who lived near the Bernardis' property, to do the excavation work in July 1976. Nichol worked on the property on August 12, 13, 14, 27, 28, 30, and 31, clearing and grading approximately 11,050 feet of right-of-way and a well site 100 feet by 200 feet, removing 25 to 30 trees in the process.

18. Nichol used a cable to pull down the trees in order to reduce the damages that would be caused to the trees.

19. A drilling rig and equipment could be moved to the site as early as August 27, 1976.

20. Pemco contacted S. J. Jack and Son Drilling Company in early August 1976, to drill the well.

21. Because of delays at another site, Jack and Son notified Pemco that a rig would not be available until the end of August 1976.

22. Jack and Son moved three pieces of conductor pipe to the site on August 30, 1976.

***89** 23. A rig was available to move to the site on September 1, 1976, but Jack and Son did not move it to the site because Pemco notified them that the Bernardis had entered into a lease with another party.

24. On August 27, 1976, Pemco received their drilling permit from the State of Pennsylvania.

25. On August 30, 1976, Pemco sent a letter to the Bernardis notifying them of the delays along with a check for $300 for damages caused in clearing the right-of-way and well site. The letter stated that another check for $400 for damages would be on its way.

26. The Bernardis returned the letter and check to Pemco.

27. Pemco did not take any further action regarding operations under the lease after receiving notice from the Bernardis that they had entered into a new lease with Wagner and Wagner on September 1, 1976, and that they regarded the lease assigned to Pemco as having terminated.

28. Pemco would have started drilling a well sometime in August had not certain delays with Jack and Son occurred.

29. Pemco would have continued their operations until a gas well was produced had the Bernardis not leased the property to another party.

30. Pemco did commence operations with the good faith intent to complete a gas producing well.

31. The operations that Pemco did commence prior to the end of the fixed term of the lease were necessary operations conducted in preparation for the actual drilling of a gas well.

ISSUE

The sole issue before the court in this case is ***90** whether the Pemco oil and gas lease terminated at midnight, August 31, 1976, or whether, by its terms, it continued in effect thereafter.

DISCUSSION

This court has jurisdiction under the Uniform Declaratory Judgments Act of June 18, 1923, P.L. 840, to determine the proper construction of a lease: 12 P.S. §831 et seq. See also Girard Trust Co. v. Tremblay Motor Co., 291 Pa. 507, 140 Atl. 506 (1928); County Amusement Company v. Johnstown Schiff's, Inc., 37 Pa. D. & C.2d 290 (1965); Rea & Derick, Inc. v. Lancaster Shopping Center, 42 Pa. D. & C. 2d 271, 60 Lanc. 191 (1966); 6A Standard Pa. Pract. 365, §120 (1960); 11 P.L.E. 379, §9 (1970). A declaratory judgment may be used in the place of a quiet title action: 11 P.L.E. 382, §10 (1970); Zima Estate, 9 Fiduc. Rep. 676, 50 Luz. 39 (1959).

A great many changes have taken place in the oil and gas industry since its inception in the fields of northwestern Pennsylvania in the latter part of the nineteenth century. The law relating to oil and gas has also been changing, although sometimes lagging behind the times, to reflect new attitudes towards production, conservation and ecology.

The termination of oil and gas leases has been a perplexing problem for decades. The cases involving disputes on termination range from complex interpretation of lease provisions to considerations of the more practical aspects of the oil and gas industry. See 67 A.L.R. 526.

Normally, the lease terminates according to the habendum clause of the lease.

"By the great weight of authority, the term clause, which is the habendum clause, dominates ***91** the period for which the lease shall run, so that unless it is properly modified by other provisions, all rights of the lessee cease at the expiration of the fixed time stated in the term clause, except in the one contingency that at the expiration of such time the lessee is actually producing oil and gas on the premises." Fagan and Co. v. Burns, 247 Mich. 674, 226 N.W. 653, 655, 67 A.L.R. 522, 524 (1929).

In Fagan, the term of the lease was for five years "and as long thereafter as oil and gas, or either of them, is produced from said land by the lessee."

In our case at bar, the term of the lease is for ten years "and as long after commencement of operations as said land is operated for the exploration or production of gas and oil, or as gas and oil is found in paying quantities thereon, or stored thereunder, or as long as said land is used for the storage of gas or the protection of gas storage on lands in the general vicinity of said land."

The law has become fairly clear as to what constitutes "commencement of operations" so that the fixed term can be extended. Summers on Oil and Gas discusses the law at length as follows:

"The modifications of the habendum clause and other portions of the lease so as to provide its extension beyond the primary term by drilling and development operations have taken a variety of forms. A first form is limited to a change in the habendum by the addition of such expressions as 'said premises developed and operated', 'operations are continued thereon' or 'as long after the commencement of operations as said premises are being operated for the production of oil or gas.' These clauses have been construed as meaning that if a lessee commences a well within the primary term of a lease and carries on the drilling ***92** operations diligently and in good faith, although he does not actually complete the well and secure production until after the end of the primary term, the lease remains in force until he completes the well, and if he secures production therefrom, as long as production in paying quantities continues." 2 Summers, Oil and Gas, §300.1, p. 252 (1959).

"In a number of cases it has become necessary for the courts to determine what constitutes commencement of a well or the commencement of drilling operations. Similar language is used in the unless drilling clause and in agreements of leases where the lessee or assignee agrees to commence the drilling of a well on or before a certain date. The general rule is that actual drilling is not necessary and that physical acts normally required to be done prior to the commencement of actual drilling are sufficient, if done in good faith, are sufficient to constitute the commencement of a well or drilling operations. This rule has been followed in the cases involving the habendum and the well completion clauses." 2 Summers, Oil and Gas, §300.1, p. 261 (1959).

"The general rule seems to be that actual drilling is unnecessary, but that the location of wells, hauling lumber on the premises, erection of derricks, providing a water supply, moving machinery on the premises and similar acts preliminary to the beginning of the actual work of drilling, when performed with the bona fide intention to proceed thereafter with diligence toward the completion of the well, constitute a commencement of beginning of a well or drilling operations within the meaning of this clause of the lease. If the lessee has performed such preliminary acts within the time limited, and has thereafter actually proceeded with the drilling to ***93** completion of a well, the intent with which he did the preliminary acts are unquestionable, and the court may rule as a matter of law that the well was commenced within the time specified by the lease. On the other hand, where the lessee has taken such preliminary steps within the time limited, but is prevented from continuing the drilling operations by the lessor, then the intent with which these preliminary acts were done becomes material. Where the lessee's good faith in the performance of acts preliminary to the commencement of actual drilling is established by uncontroverted evidence of actual completion of the well with due diligence, or the pleadings of the lessee allege that the preliminary acts were done with the bona fide intent of drilling the well with due diligence, the court may rule as a matter of law that these acts were sufficient to constitute a beginning of operations.

But if there is doubt or controversy as to the intent of the lessee in performing the acts claimed as a commencement of operations, then the question should be submitted to the jury." 2 Summers, Oil and Gas, §349, pp. 459-66 (1959).

From Summers, it seems clear that two questions arise. First, what kind of preliminary acts are necessary to constitute commencement of operations? Second, and more important, did the lessee commence these operations with the good faith intent to drill a gas well?

1. *Commencement of Operations*

The only Pennsylvania case on point seems to be Henderson v. Ferrell, 183 Pa. 547, 38 Atl. 1018 (1898). The Supreme Court upheld the jury's finding that the lessee had commenced operations to drill a well within the 30-day deadline period. On ***94** the last day of the 30-day period, the lessee staked the location of the well and the location of the point where lumber was to be placed. On the same day, the lessee tried to unload lumber on the site but was prevented by the lessor. The court held that this was sufficient to extend the term of the lease.

Although the opinion in Henderson is rather sketchy, we think that the case accurately reflects the law as it is shown by numerous cases in other jurisdictions.

The Michigan case of Walton v. Zatkoff, 372 Mich. 491, 127 N.W. 2d 365 (1964), holds that no actual drilling need be commenced prior to the expiration of the fixed term. There, a lease was entered into for a term of ten years from September 6, 1951. The term was extended if there was a commencement of "operations for the drilling of a well" or "drilling operations." The delay-drilling provision required $40 per year to be paid when drilling was not started.

Several weeks prior to August 31, 1961, a drilling permit was obtained, the site was surveyed and staked, drilling equipment was purchased and a unitization agreement was entered into. On August 31 a bulldozer leveled the site and dug a slush pit. No more operations were conducted until after the fixed term was expired. Then, between September 7 to 13, a drill, derrick and other equipment were moved onto the site. The court said that actual drilling need not start and the above-mentioned activities were sufficient to constitute commencement of drilling operations.

The Texas case of Petersen v. Robinson Oil & Gas Company, 356 S.W. 2d 217 (Tex., 1962), holds that drilling equipment need not be on the premises in order that drilling operations be commenced. In ***95** Petersen, a ten-year lease was entered into on March 27, 1947. A delay-drilling provision provided for twelve month extensions if $244 was paid by the lessee. The lease was to expire on March 27, 1957. Several days prior to the end of the term, the lessee entered into a contract with a driller. On March 26 the site was surveyed. The site was staked and a maintainer was brought in to level the location on March 27. More work was done with the maintainer on March 28 and 29. Between March 30 and April 9 a bulldozer worked at the site and on the road to the site. On April 3 a drilling rig was moved onto the site and work progressed until a well was completed. The court said:

"The record in this case supports the implied findings of the trial court that prior to the end of the primary term of the lease the lessee had set into motion the process of drilling a well, and that such acts preliminary to the actual work of drilling were performed with bona fide intention of proceeding with diligence to the completion of the well." Petersen at 220.

Other similar cases from jurisdictions having substantial drilling activity include: Allen v. Continental Oil Company, 255 So. 2d 842 (La., 1971); Hilliard v. Franz Heim, 180 So. 2d 746 (La., 1965); Jones v. Moore, 338 P. 2d 872 (Okla., 1959); Guleke v. Humble Oil & Refining Co., 126 S.W. 2d 38 (Ky., 1939).

A review of the facts of the case at bar have led us to conclude that Pemco had commenced operations within the generally accepted meaning of that phrase. More than three months prior to the end of the lease, the site was surveyed. This was only a little more than three months after Pemco obtained ***96** assignment of the lease. Almost two months before the end of the lease, Pemco started negotiations with the Bernardis concerning the location of the site, location of the right-of-way and damages. During the same time, negotiations were held with Kenneth Yagle for a right-of-way over his property which adjoined the Bernardis' property. A month before expiration of the lease, Pemco contacted Mr. Nichol to do the excavation work. Shortly after this, Pemco contacted Jack and Son to do the drilling.

The site was prepared during August 1976, and Mr. Nichol testified that a rig could be moved to the site as early as August 27. Jack and Son agreed that a rig would be available in the middle of August, but delays pushed the date to the end of August. A drilling permit was received August 27. Conductor pipe was placed on the site on August 30. The representative of Jack and Son testified a rig would have been moved to the site on September 1 had not Pemco notified them to stop the move. The evidence convinces us that Pemco would have continued with the drilling operations had not the Bernardis leased the property to another party and precluded further entry upon the property.

2. *Good Faith*

The second equally crucial question is whether Pemco conducted these preliminary operations with the good faith intent to proceed until a gas producing well was completed.

Cases in several other jurisdictions hold that where

preliminary activities to drilling were commenced, but not done or pursued in good faith, the lease could not be extended beyond the fixed term.

Thus, where preliminary acts to drilling were conducted, but actual drilling of the well was contingent ***97** upon receiving favorable information from the drilling of a nearby well or upon the making of favorable financial arrangements, the United States District Court in the Eastern District of Texas held that drilling operations were not commenced in good faith: Geier-Jackson, Inc. v. James, 160 F. Supp. 524 (E.D. Texas 1958). Likewise, where preliminary acts were conducted with the hopes that a certain agreement would not be reached, the Supreme Court of Wyoming held that drilling operations did not commence with the good faith intent to drill a well to completion: True Oil Company v. Gibson, 392 P. 2d 795 (Wyo. 1964). Similarly, the Supreme Court of California held that, where completion of the well was conditioned upon buying pipe at a favorable price, no good faith could be found. This was true in light of the fact that the lessee drilled two costly wells just prior to the expiration of the lease in dispute: Butler v. Nepple, 54 Cal. 589, 6 Cal. Rptr. 767, 354 P. 2d 239 (1960). And even when the well had been spudded in, i.e., actual drilling had started, the Court of Appeals of Kentucky held that good faith commencement of operations could not be found where the lessee then abandoned the operations for several months before resuming activities: Flanigan v. Stein, 204 Ky. 814, 265 S.W. 324 (1924).

The Bernardis did not present any evidence to show lack of good faith on the part of Pemco in commencing drilling operations. The only evidence that they did present leads to the possible inferences to be drawn from the facts that Pemco breached its agreement with Mr. Bernardi in that he was to be present at the site when any trees were pulled down and that operations were not commenced until near the end of the ten-year term.

***98** The agreement with Mr. Bernardi was simply an accommodation on the part of Pemco and collateral to the parties' rights and duties under the lease. Pemco had the contractual right to drill a well on the property under the lease and was required to use ordinary and reasonable care in conducting its operations. The evidence shows that the parties had agreed on the location of the right-of-way and the site. Mr. Nichol testified he used special care in pulling down the trees when clearing the right-of-way and site. Mr. Bernardi would not say he was displeased with the job, but he felt that a few trees out of 25 to 30 pulled down were damaged. Even though the Bernardis may have a valid legal claim for damages because of the breach of this collateral agreement, we do not feel that this shows any lack of good faith on the part of Pemco in commencing operations.

The Bernardis argue that the lessee did not start operations with due diligence because it was only near the end of the ten-year lease that the operations started. Both Walton, supra, and Robinson, supra, involved ten-year leases. In both cases, activities did not start until near the end of the ten-year term. And, in both cases, the courts found that the operations then conducted extended the fixed term of the lease.

The lease in this case also has a delay-drilling provision providing for compensation of $5 per quarter if a well is not previously completed. "Where the lease contains either of these provisions [the drill or pay or the 'unless drilling commences' clauses] for delay in drilling, most courts have held that such express provisions preclude the implication of a duty in the lessee to drill within a reasonable time, although in a few jurisdictions it has been held that the lessee is under a duty to drill within a ***99** reasonable time after notice." 2 Summers, Oil and Gas, §413, p. 601 (1959).

The changing nature of the oil and gas industry has brought about a new approach to the old concept that production should be sought with due diligence:

"It was through this formative period of oil and gas law when the policy of production was predominant, that certain so-called rules of construction of oil and gas leases were created. These rules have continued in the language of the decisions, although the policy upon which they were founded has been greatly weakened by the counteracting policies, which may for convenience be termed the policy against over-production, or economic waste, and the policy of conservation of natural resources." 2 Summers, Oil and Gas, §372, p. 483 (1959).

Several factors may have caused some delay in the operations. These include the negotiations with Yagle concerning a right-of-way over his property, the possible title defect in the Bernardis' title, and unforeseen delays in moving the drilling rig. But the evidence shows that none of the factors were regarded as preconditions to completion of a well or to the drilling operators so as to negate Pemco's good faith.

Thus, we cannot see anything that suggests bad faith on the part of the lessee in commencing operations.

The Bernardis allege that a tenancy at will should be created at the end of the ten-year term of the lease, citing the following cases in support of their view: Clark v. Wright, 311 Pa. 69, 166 Atl. 775 (1933); Cassell v. Crothers, 193 Pa. 359, 44 Atl. 446 (1899); ***100** T. W.

Phillips Gas and Oil Company v. Komar, 424 Pa. 322, 227 A. 2d 163 (1967); White v. Young, 409 Pa. 562, 186A. 2d 919 (1963); Brown v. Haight, 435 Pa. 12, 255 A. 2d 508 (1969). In these cases, the fixed term of the lease was extended only if gas or oil was found or produced in paying quantities. Gas or oil was not found or produced in any of the cases cited above. Thus, the courts held that a tenancy at will was created.

However, the case at bar is clearly distinguishable. Here, the lease will be extended beyond the fixed term if operations connected with drilling a well are commenced before the fixed term expired. The very contingency extending the term of the lease which did not take place in the cases cited by the Bernardis did take place in the case at bar.

CONCLUSIONS OF LAW

This court is of the opinion that the lease did not terminate on August 31, 1976, but that it was extended by Pemco's good faith commencement of operations in preparation for the actual drilling of a gas well within the fixed term of the lease.

A few words of caution must be added. The evidence clearly shows that Pemco would have continued operations to drill a gas producing well but for the Bernardis signing a lease with another party. The same good faith and unconditional activity must also persist if Pemco elects to continue operations. Although consideration should be taken of the delays caused by this litigation, Pemco must make a diligent effort to complete a well on the Bernardi property within a reasonable time.

ORDER

And now, December 30, 1977, upon consideration *101 of the petition for declaratory judgment and answer thereto, and upon consideration of the evidence adduced at hearing and the oral and written argument of counsel, and, for the reasons contained in the annexed opinion, it is ordered, adjudged and decreed that the certain gas lease entered into between John Zenchemko, as lessor, and Equitable Gas Company, as lessee, dated September 3, 1966, and recorded in Armstrong County Deed Book Vol. 501, page 284, did not terminate on August 31, 1976, by operation of law or otherwise, but remains in full force and effect so as to bind the parties thereto, their heirs, successors and assigns.

Each party to bear own costs.

Parallel Citations

1977 WL 260 (Pa.Com.Pl.)

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27 Ohio App.3d 6
Court of Appeals of Ohio, Eleventh District,
Ashtabula County.

KASZAR et al., Appellants,
v.
MERIDIAN OIL & GAS ENTERPRISES, INC. et al., Appellees.*
No. 1178. | July 2, 1985.

Lessors filed complaint seeking to enjoin lessees from conducting oil and gas drilling operations on leased property. The Court of Common Pleas, Ashtabula County, dismissed complaint, and appeal was taken. The Court of Appeals, Cook, J., held that: (1) lessees under oil and gas lease, which was to expire by certain date if lessees had not "commenced" operations, commenced operations by that date where they had surveyed site, staked out well, and filed necessary documents with Securities and Exchange Commission, and (2) lessees acted in accordance with lease by consolidating or "unitizing" lessors' property with other leased property, even though they did so after primary term of lease, as lease was still in effect as extended, since lessees had "commenced" operations by conditional expiration date.

Affirmed.

Dahling, P.J., dissented and filed statement.

West Headnotes (4)

[1] **Mines and Minerals**
⇐Time for Development; Commencement, Completion, and Interruptions

Commencement of operations under oil and gas lease may consist of trivial and comparatively insignificant matters.

[2] **Mines and Minerals**
⇐Time for Development; Commencement, Completion, and Interruptions

Any act, the performance of which has tendency to produce desired result, is commencement of operations under oil and gas lease, including staking out location for well, making contract for lumber for a rig and cutting portion of timber.

[3] **Mines and Minerals**
⇐Time for Development; Commencement, Completion, and Interruptions

Lessees under oil and gas lease, which provided lease would expire by certain date if lessees had not "commenced" operations, commenced operations by that date where they had surveyed site, staked out well, and filed necessary documents with Securities and Exchange Commission.

1 Cases that cite this headnote

[4] **Mines and Minerals**
⇐Place or Portion Developed; Pooled or Unitized Tracts

Lessees acted in accordance with oil and gas lease by consolidating or "unitizing" lessors' property with other leased property, even though they did so after primary term of lease, as lease was still in effect as extended, since lessees had "commenced" operations by conditional expiration date.

**4 ***Syllabus by the Court*

*6 The "commencement" of operations, under an oil and

gas lease, may consist of trivial and comparatively insignificant matters. Any act, the performance of which has a tendency to produce the desired result, is a "commencement" of operations. Therefore, surveying the site, staking out the well, clearing the well site, and filing the necessary documents with the Securities and Exchange Commission constitute a commencement of operations, if done in a bona fide manner and prior to the expiration of the initial lease. (*Duffield v. Russell* [1899], 10 Ohio C.D. 472, affirmed [1902], 65 Ohio St. 605, 63 N.E. 1127 followed.)

Attorneys and Law Firms

William P. Bobulsky, Ashtabula, for appellants.

Thomas L. Sartini, Ashtabula, for appellees.

Opinion

COOK, Judge.

In 1978 and 1979, appellants, Ernest and Joyce Kaszar, purchased property which was leased to appellees, Meridian Oil and Gas Enterprises, Inc. and James Drilling Corporation, for the purpose of oil and gas exploration. The lease was to expire July 8, 1980 if appellees failed to begin operations for the commencement of a well prior to that date. Prior to July 8, 1980, appellees surveyed the site for the well and staked it out, cleared the well site, and filed the necessary documents with the Securities and Exchange Commission. Appellees subsequently filed instruments of unitization of appellants' property.

On February 10, 1983, appellants filed a complaint in the Ashtabula County Court of Common Pleas seeking to enjoin appellees from conducting oil and gas drilling operations on their land, to clear title to the property, to void an instrument purporting to unitize the property for drilling purposes, and for damages. The gist of appellants' complaint was that the lease agreement had expired prior to appellees' commencement of operations.

On March 6, 1984, the court found *7 for appellees and dismissed appellants' complaint, reasoning that appellees had "commenced" operations prior to the expiration date of the gas and oil lease, thus extending the lease.

Appellants have appealed the judgment of the trial court and have filed the following assignment of error:

"The trial court erred in overruling plaintiffs' prayer for a permanent injunction and in dismissing plaintiffs' associated claims for relief."

The assigned error is without merit.

Paragraph twelve of the lease agreement provides:

"If the Lessee shall begin operations for the commencement of a well during the term of this lease or any extension thereof, the Lessee shall then have the right to complete the drilling of such wells, and if oil or gas or either of them be found in paying quantities, this lease shall continue and be in force and with like effect as if such well had been completed within the term first herein mentioned."

In *Duffield v. Russell* (1899), 10 Ohio C.D. 472, affirmed (1902), 65 Ohio St. 605, 63 N.E. 1127, the court, as noted in paragraph one of the headnotes, held:

[1] [2] "The 'commencement' of operations, under an oil and gas lease, may consist of trivial and comparatively insignificant matters. Any act, the performance of which has a tendency to produce the desired result, is a 'commencement' of operations; therefore, staking out the location for the well, making the contract for the lumber for [a] rig and cutting a portion of the timber constitutes a 'commencement' of operations, if done *bona fide*."

**5 [3] In the instant cause, appellees surveyed the site, staked out the well, and filed the necessary documents with the Securities and Exchange Commission. Under the *Duffield* decision, these acts constituted a commencement of operations under the parties' oil and gas lease so as to extend the term of the lease pursuant to paragraph twelve.

[4] Appellants also argue that the court erred because appellees filed instruments of unitization of appellants' property and "a unitization of an oil and gas lease may not be effectuated after the primary term thereof."

Paragraph fourteen of the lease agreement provides:

"For the purpose of conserving the interest of the parties hereto and protecting said premises, and the oil and gas field within which the same are comprehended from unnecessary and wasteful drilling and undue depletion of its resources, Lessor further grants to Lessee, its heirs and assigns, the right to consolidate the above described premises or any part thereof at the option of Lessee with others to form a unit not to exceed 640 acres for development * * *."

In the instant cause, appellees consolidated or "unitized" appellants' property with other leased property. The "unitization" took place on August 30, 1980 and March 25, 1982. Although this was after the primary term of the lease, the lease was still in effect since appellees had "commenced" operations as stated above.

The judgment of the trial court is affirmed.

Judgment affirmed.

FORD, J., concurs.

DAHLING, P.J., dissents.

DAHLING, Presiding Judge, dissenting.

In my view, placing a survey stake did not constitute commencement of drilling. I would reverse.

Parallel Citations

499 N.E.2d 3, 27 O.B.R. 6

Footnotes

* A motion to certify the record to the Supreme Court of Ohio was overruled on December 4, 1985 (case No. 85–1371).

End of Document

2012 WL 1033691
Only the Westlaw citation is currently available.
Supreme Court of Pennsylvania.

T.W. PHILLIPS GAS AND OIL CO. and PC Exploration, Inc., Appellees
v.
Ann JEDLICKA, Appellant.

No. 19 WAP 2009. | Argued April 13, 2010. | Decided March 26, 2012.

Synopsis

Background: Oil and gas lessee brought declaratory judgment action against lessor as to respective rights and duties of the parties. Lessor sought forfeiture of lease. The Court of Common Pleas, Indiana County, Civil Division, No. 10362 CD 2005, Martin, J., entered judgment for lessee. Lessor appealed. The Superior Court, No. 1918 WDA 2007,affirmed, 964 A.2d 13, 2008 PA Super 293. Lessor filed petition for allowance of appeal.

Holdings: The Supreme Court, No. 19 WAP 2009, Todd, J., held that:
[1] where production on a well has been marginal or sporadic, the phrase "in paying quantities" in habendum clause in oil or gas lease must be construed with reference to an operator's good faith judgment, and
[2] gas lease produced "in paying quantities," and thus did not terminate, even though lease had once sustained a $40 loss over a one-year period 45-years earlier.

Affirmed.

Eakin, J., concurred and filed opinion.

Saylor, J., dissented and filed opinion.

West Headnotes (13)

[1] **Appeal and Error**
⇐Trial in Equitable Actions
Appeal and Error
⇐Allowance of Remedy and Matters of Procedure in General

When reviewing the findings of a court in equity, an appellate court's review is limited to a determination of whether the chancellor committed an error of law or abused his discretion.

[2] **Appeal and Error**
⇐Trial in Equitable Actions
Appeal and Error
⇐Sufficiency of Evidence in Support

A final decree in equity will not be disturbed unless it is unsupported by the evidence or demonstrably capricious.

[3] **Appeal and Error**
⇐Equitable Proceedings
Appeal and Error
⇐Sufficiency of Evidence in Support

Although facts found by the chancellor, when supported by competent evidence in the record, are binding, no such deference is required for conclusions of law, which appellate court reviews de novo.

[4] **Landlord and Tenant**
⇐Nature of the Contract

A lease is in the nature of a contract and is controlled by principles of contract law.

[5] **Landlord and Tenant**
⇐Application of General Rules of Construction

A lease must be construed in accordance with the terms of the agreement as manifestly expressed, and the accepted and plain meaning of the language used, rather than the silent intentions of the contracting parties, determines the construction to be given the agreement.

[6] **Landlord and Tenant**
⇐Evidence

A party seeking to terminate a lease bears the burden of proof.

[7] **Estates in Property**
⇐Base or Qualified Fee

A fee simple determinable is an estate in fee that automatically reverts to the grantor upon the occurrence of a specific event, and the interest held by the grantor after such a conveyance is termed "a possibility of reverter"; such a fee is a fee simple, because it may last forever in the grantee and his heirs and assigns, the duration depending upon the concurrence of collateral circumstances which qualify and debase the purity of the grant.

[8] **Mines and Minerals**
⇐Extent of Production, Paying Quantities, and Marketing

The determination of what constitutes a reasonable time period by which to evaluate whether a well has produced "in paying quantities," within meaning of habendum clause in oil or gas lease, must be based on the unique circumstances of each individual case, and be driven by consideration of the good faith judgment of the operator.

[9] **Mines and Minerals**
⇐Extent of Production, Paying Quantities, and Marketing

If a well consistently pays a profit, however small, over operating expenses, it will be deemed to have produced "in paying quantities" within meaning of habendum clause in oil or gas lease.

[10] **Mines and Minerals**
⇐Extent of Production, Paying Quantities, and Marketing

Where production on a well has been marginal or sporadic, such that, over some period, the well's profits do not exceed its operating expenses, a determination of whether the well has produced "in paying quantities," within meaning of habendum clause in oil or gas lease, requires consideration of the operator's good faith judgment in maintaining operation of the well.

[11] **Mines and Minerals**
⇐Extent of Production, Paying Quantities, and Marketing

In assessing whether an operator has exercised good faith in his judgment in maintaining operation of a well whose production has been marginal or sporadic, for purposes of determining whether the well has produced "in paying quantities," within meaning of habendum clause in oil or gas lease, the court must consider the reasonableness of the time period during which the operator has continued his operation of the well in an effort to reestablish

the well's profitability.

[12] **Mines and Minerals**
Extent of Production, Paying Quantities, and Marketing

Under habendum clause in oil or gas lease, providing that a lease will remain in effect for as long as oil or gas is produced "in paying quantities," if the well fails to pay a profit over operating expenses, and the evidence establishes that the lessee was not operating the wells for profit in good faith, the lease will terminate.

[13] **Mines and Minerals**
Extent of Production, Paying Quantities, and Marketing

Gas lease produced "in paying quantities," and thus did not terminate under habendum clause, even though, in the context of an nearly 80-year-old lease, there was a $40 loss over a one-year period 45-years earlier, after which the subject wells resumed and continued production at a profit; no evidence suggested that the wells were not being operated in good faith, and lessor's own expert witness, a petroleum geologist, testified he would have continued to operate the well that had sustained the $40 loss because the well "makes money."

Appeal from the Order of the Superior Court entered December 29, 2008 at No. 1918 WDA 2007, affirming the Order of the Court of Common Pleas of Indiana County, entered October 19, 2007 at No. 10362 CD 2005. 964 A.2d 13 (Pa.Super.2008).

CASTILLE, C.J., SAYLOR, EAKIN, BAER, TODD, McCAFFERY, ORIE MELVIN, JJ.

Opinion

OPINION

Justice TODD.

*1 This Court granted allowance of appeal in the instant case to determine the proper test for evaluating whether an oil or gas lease has produced "in paying quantities," as first discussed by this Court in *Young v. Forest Oil Co.*, 194 Pa. 243, 45 A. 1 (1899). After careful consideration, we hold that, where, as here, production on a well has been marginal or sporadic, such that for some period profits did not exceed operating costs, the phrase "in paying quantities" must be construed with reference to an operator's good faith judgment. Furthermore, as we find the lower courts considered the operator's good faith judgment in concluding the oil and gas lease at issue in the instant case has produced in paying quantities, we affirm the order of the Superior Court affirming the judgment entered by the trial court in favor of T.W. Phillips Gas and Oil Co. and PC Exploration, Inc. (collectively, "Appellees").

Appellant, Ann Jedlicka, is the owner of a parcel of land consisting of approximately 70 acres located in North Mahoning Township (the "Jedlicka tract"). Title to the Jedlicka tract was conveyed from James and Anna Jedlicka, husband and wife, to Anna Jedlicka and Ann Jedlicka, mother and daughter, in October 1979. The Jedlicka tract is part of a larger tract of land consisting of approximately 163 acres, which was conveyed to Samuel Findley and David Findley by deed dated February 24, 1925 (the "Findley property"). In 1928, Samuel Findley and David Findley conveyed to T.W. Phillips Gas and Oil Co. ("T.W.Phillips") an oil and gas lease covering all 163 acres of the Findley property (the "Findley lease"), which included the Jedlicka tract. The Findley lease, characterized as a pressure lease, established royalty payments to the lessor based upon the pressure of the well. The lease also contains a habendum clause, which provides:

> To have and to hold the above-described premises for the sole and only purpose of drilling and operating for oil and gas with the exclusive right to operate for same for the term of two years, and as long thereafter as oil or gas is produced in paying quantities, or operations for oil or gas are being conducted thereon,

including the right to drill other wells.

Lease, July 2, 1928, at 1 (R.R. at 13a–14a). Notably, the term "in paying quantities" is not defined in the lease. Subsequently, the Findley property was subdivided and sold—including the Jedlicka tract—subject to the Findley lease.

In 1929, pursuant to the Findley lease, T.W. Phillips drilled four gas wells, identified as Well Nos. 1 through 4. Well No. 4 is situated on what is now the Jedlicka tract. Well No. 2 was temporarily abandoned in 1955, and Well No. 4 was temporarily abandoned in 1953. All four wells were fractured in 1967[1] and eventually assigned to PC Exploration, Inc. ("PC Exploration") on June 15, 2004. Thereafter, PC Exploration drilled four additional wells, identified as Well Nos. 6 through 9.[2] Jedlicka has received royalties and free gas throughout the life of the lease.

*2 Subsequently, PC Exploration made plans to drill four more wells—Well Nos. 10 through 13—on the Jedlicka tract. Jedlicka objected to the construction of these new wells, claiming that T.W. Phillips failed to maintain production "in paying quantities" under the habendum clause of the Findley lease, and, as a result, that the lease lapsed and terminated. Specifically, Jedlicka argued that there has not been continuous production in paying quantities on the wells because, in 1959, T.W. Phillips suffered a loss of approximately $40 as a result of operations under the Findley lease.

In 2005, Appellees filed a declaratory judgment action against Jedlicka to determine their rights with regard to the Jedlicka tract under the Findley lease. Appellees maintained that the Findley lease remains valid; that the wells on the original Findley property have produced gas in paying quantities because they have continued to pay a profit over operating expenses; and that they have operated the wells in good faith to make a profit. Prior to trial, Jedlicka filed a motion *in limine* to exclude evidence of Appellees' post–1974 operating expenses and revenues for Well Nos. 1 through 4 because Appellees did not have any depletion schedules[3] for those wells after 1974. The trial court denied the motion and allowed Appellees to introduce other evidence of expenses, revenue, and production.

Appellees then filed a motion *in limine,* opining that Jedlicka's claims were barred by operation of Rule 1901 of the Pennsylvania Rules of Judicial Administration.[4] Appellees noted that, in 1988, Jedlicka commenced an action by writ of summons challenging the validity of the Findley lease, but that action was dismissed with prejudice as an inactive case pursuant to Pa.R.J.A.1901. Appellees further noted that Jedlicka failed to allege any reasons for such inactivity in a timely petition for permission to reinstate the cause of action. Accordingly, Appellees argued that Jedlicka should be precluded from presenting any evidence or testimony regarding the production or operation of the wells on the Findley property prior to 1988. The trial court heard testimony on Appellees' motion and determined that the lease at issue in the 1988 action was the same as the lease at issue in the case *sub judice;* however, the trial court was unable to conclude that the issues in the two actions were identical, or that Jedlicka was attempting to argue the same claims, and thus denied Appellees' motion.[5]

On April 16, 2007, a bench trial was held before President Judge William J. Martin of the Indiana County Court of Common Pleas. Following trial, President Judge Martin determined that, notwithstanding the $40 loss suffered in 1959, Appellees had produced gas on their leasehold in paying quantities, and, therefore, that the Findley lease remained in effect. In determining that Appellees produced gas in paying quantities, the trial court relied on this Court's 1899 decision in *Young v. Forest Oil,* wherein we held that consideration should be given to a lessee's good faith judgment when determining whether oil was produced in paying quantities. The trial court noted that Appellees "continued efforts in production after 1959 and [the owners of the Jedlicka tract] continued to receive royalty payments per the lease for more than thirty years without asserting that the lease had expired." *T.W. Phillips Gas and Oil Co. and PC Exploration, Inc. v. Jedlicka,* No. 10362 CD 2005, at 5.

*3 Additionally, the trial court rejected Jedlicka's suggestion that, instead of the *Young* test, the court should apply a test utilized by federal and some state courts, under which courts "interpret[ ] gas leases in a more objective manner using a computation of production receipts minus royalty minus expenses including marketing, labor, trucking, repair, taxes, fees and other expenses." *T.W. Phillips Gas and Oil Co. and PC Exploration, Inc.* ., No. 10362 CD 2005, at 5–6. Recognizing that the objective approach favored by Jedlicka incorporates the concern that "lessees should not be allowed to hold land indefinitely for purely speculative purposes," the trial court noted that Pennsylvania has not adopted this objective approach, and nevertheless concluded that "based upon all of the testimony and other evidence presented, the rationale utilized in support of a completely objective test is not applicable herein." *Id.* at 6. The trial court explained, in particular, that the Findley lease "is a pressure lease, not a 1/8 royalty lease," and "[t]he evidence indicates that the lessees were operating the wells in good faith and there was no evidence that they were holding the land for purely speculative purposes." *Id.*[6]

On November 26, 2008, the Superior Court affirmed the

decision of the trial court in an unpublished memorandum opinion, which, upon joint motion of the parties, was subsequently published. *T.W. Phillips Gas and Oil Co. and PC Exploration, Inc. v. Jedlicka,* 964 A.2d 13 (Pa.Super.2008). The Superior Court first concluded that our decision in *Young,* although more than a century old, remains good law. The Superior Court further found that, under *Young,* "the good faith of the lessee is a necessary determination," and held that Jedlicka failed to carry her burden of establishing that Appellees acted in bad faith. *T.W. Phillips Gas and Oil Co. and PC Exploration, Inc.,* 964 A.2d at 19. Jedlicka petitioned for allowance of appeal, and, on July 29, 2009, this Court granted her petition to consider the following issue: "Did the Superior Court misapply the decision of this Court in *Young v. Forest Oil Co.,* 194 Pa. 243, 45 A. 121 (Pa.1899), by holding that Pennsylvania employs a purely subjective test to determine whether an oil or gas lease has produced 'in paying quantities.' " *T.W. Phillips Gas and Oil Co. v. Jedlicka,* 602 Pa. 154, 978 A.2d 347 (2009) (order).7

[1] [2] [3] When reviewing the findings of a court in equity, an appellate court's review "is limited to a determination of whether the chancellor committed an error of law or abused his discretion. A final decree in equity will not be disturbed unless it is unsupported by the evidence or demonstrably capricious." *Kepple v. Fairman Drilling Co.,* 532 Pa. 304, 312, 615 A.2d 1298, 1302 (1992) (internal quotation marks omitted). Although facts found by the chancellor, when supported by competent evidence in the record, are binding, no such deference is required for conclusions of law, which we review *de novo. Id.*

*4 [4] [5] [6] Furthermore, a lease is in the nature of a contract and is controlled by principles of contract law. *J.K. Willison v. Consol. Coal Co.,* 536 Pa. 49, 54, 637 A.2d 979, 982 (1994). It must be construed in accordance with the terms of the agreement as manifestly expressed, and "[t]he accepted and plain meaning of the language used, rather than the silent intentions of the contracting parties, determines the construction to be given the agreement." *Id.* (citations omitted). Further, a party seeking to terminate a lease bears the burden of proof. *See Jefferson County Gas Co. v. United Natural Gas Co.,* 247 Pa. 283, 286, 93 A. 340, 341 (1915).

In order to better assess the parties' arguments in the case *sub judice,* we consider briefly the unique characteristics of an oil and gas lease. As this Court recognized in *Brown v. Haight,* "[t]he traditional oil and gas 'lease' is far from the simplest of property concepts. In the case law oil and gas 'leases' have been described as anything from licenses to grants in fee." 435 Pa. 12, 15, 255 A.2d 508, 510 (1969). Generally, however, the title conveyed in an oil and gas lease is inchoate, and is initially for the purpose of exploration and development. *Calhoon v. Neeley,* 201 Pa. 97, 101, 50 A. 967, 968 (1902); *Burgan v. South Penn Oil Co.,* 243 Pa. 128, 137, 89 A. 823, 826 (1914) ("The title is inchoate, and for purposes of exploration only until oil is found." (internal quotation marks omitted)); *see also Hite v. Falcon Partners,* 2011 WL 9632 (Pa.Super. filed Jan 4, 2011) (same); *Jacobs v. CNG Transmission Corp.,* 332 F.Supp.2d 759, 772 (W.D.Pa.2004) (same).

[7] If development during the agreed upon primary term is unsuccessful, no estate vests in the lessee. If, however, oil or gas is produced, a fee simple determinable is created in the lessee, and the lessee's right to extract the oil or gas becomes vested. *Calhoon,* 201 Pa. at 101, 50 A.2d at 968; *Jacobs,* 332 F.Supp.2d at 772–73. A fee simple determinable is an estate in fee that automatically reverts to the grantor upon the occurrence of a specific event. *Brown,* 435 Pa. at 18, 255 A.2d at 511. The interest held by the grantor after such a conveyance is termed "a possibility of reverter." *Higbee Corp. v. Kennedy,* 286 Pa.Super. 101, 428 A.2d 592, 595 (Pa.Super.1981). Such a fee is a fee simple, because it may last forever in the grantee and his heirs and assigns, "the duration depending upon the concurrence of collateral circumstances which qualify and debase the purity of the grant." *Id.* at 595 n. 4 (quoting *Slegel v. Lauer,* 148 Pa. 236, 241, 23 A. 996, 997 (1892)).

Within the oil and gas industry, oil and gas leases generally contain several key provisions, including the granting clause, which initially conveys to the lessee the right to drill for and produce oil or gas from the property; the habendum clause, which is used to fix the ultimate duration of the lease; the royalty clause; and the terms of surrender. *Jacobs,* 332 F.Supp.2d at 764 (citing 3 Howard R. Williams & Charles J. Meyers, Oil and Gas Law § 601 (2003)). Further,

> *5 A habendum clause is used to fix the ultimate duration of an oil and gas lease. 2 Summers, THE LAW OF OIL AND GAS § 281. "The habendum clause of the modern oil and gas lease is the result of a long process of development, in which many influences have aided in shaping its final form," chief of which have been the [distinct] interests of the lessor and lessee, the peculiar needs of the industry and the interpretation and enforcement of certain phrases by the Courts. *Id.* at § 282 Experimentation in the industry for a suitable durational term progressed from definite term leases, which placed the lessee at a disadvantage if production was only attained late in the term or extended beyond the term, to a definite term with an option to renew, to long term leases with conditional

clauses extending the term through the production life of the land. *Id.* at §§ 283–287.

Jacobs, 332 F.Supp.2d at 765 n. 1.

Typically, as herein, the habendum clause in an oil and gas lease provides that a lease will remain in effect for as long as oil or gas is produced "in paying quantities."[8] Traditionally, use of the term "in paying quantities" in a habendum clause of an oil or gas lease was regarded as for the benefit of the lessee, as a lessee would not want to be obligated to pay rent for premises which have ceased to be productive, or for which the operating expenses exceed the income. *Swiss Oil Corp. v. Riggsby,* 252 Ky. 374, 67 S.W.2d 30, 31 (Ky.1933). More recently, however, and as demonstrated by the instant case, these clauses are relied on by landowners to terminate a lease.
As noted *supra,* the habendum clause contained in the lease at issue provides that Appellee shall have the right to drill for oil and gas for the term of two years "and as long thereafter as oil or gas is produced in paying quantities, or operations for oil or gas are being conducted thereon." Lease, July 2, 1928, at 1 (R.R. at 13a–14a). It is the meaning of the term "in paying quantities," which is not defined in the lease, that is the crux of the dispute between the parties; however, the parties agree that the lease is controlled by our 1899 decision in *Young.*[9]

In *Young v. Forest Oil,* the plaintiff landowner sought a declaration of forfeiture of an oil lease held by the defendant due to the defendant's alleged failure to develop the land. The trial court found that the defendant had "sufficiently developed" the west end of the plaintiffs farm. However, the court determined that the drilling of a single well on the north and east portions of the plaintiff's farm, which admittedly revealed no oil or gas, did not support the defendant's refusal to drill additional wells on the remainder of the farm, because "[t]here remains a large portion of plaintiff's farm which ... ought to produce oil in paying quantities, with a reasonable degree of certainty." *Id.* at 248–49, 45 A. at 122. As a result, the trial court determined, "under the circumstances of this case the defendant's refusal to sink additional wells on plaintiff's farm is a wrongful act, amounting to a fraudulent use of the lease, to plaintiff's injury." *Id.* at 249, 45 A. 121, 45 Pa. at 122.

***6** On appeal, this Court reversed, noting that the trial court's conclusion "proceed[ed] from an erroneous view of the law,"[10] and stating:

> In the present case the conclusion of the court rests on nothing else than such a difference of judgment. There is not a scintilla of evidence for any other basis. The lessee contracted to put down one paying well. He did in fact put down five, four of which produced oil for a time. Even considering the plaintiffs side alone, the weight of the evidence in favor of the court's conclusion is exceedingly light. Passing over the plaintiffs extraordinary reasoning, that, because one well put down in the alleged insufficiently tested part of the farm proved to be a dry hole, therefore another hole in the same portion would produce a paying well, we have looked in vain for any testimony that even the experts are willing to stake their judgments on any such result. Not a single witness says so.... Even if [a witness] had said so, with sufficient positiveness to convince the court as a matter of judgment, it would not have been enough.... The operator, who has assumed the obligations of the lease, has put his money and labor into the undertaking, and is now called upon to determine whether it will pay to spend some thousands of dollars more in sinking another well to increase the production of the tract, is entitled to follow his own judgment. If that is exercised in good faith, a different opinion by the lessor, or the experts, or the court, or all combined, is of no consequence, and will not authorize a decree interfering with him.

Id. at 249–50, 45 A. at 122.

With regard to the plaintiff's argument to this Court that the lease had expired because oil was no longer produced in paying quantities, we noted that, despite declining to grant the plaintiff relief on this ground, the trial judge found it unnecessary to determine the exact meaning of the phrase "in paying quantities." However, we nevertheless agreed the trial court was correct not to grant relief on this ground, explaining:

> The phrase 'found or produced in paying quantities' means paying quantities to the lessee or operator. If oil has not been found and the prospects are not such that the lessee is willing to incur the expense of a well (or a subsequent or second well, as the case may be), the stipulated condition for the termination of the lease has occurred. So, also, if oil has been found, but no longer pays the expenses of production. But if a well, being down, pays a profit,—even a small one, over the

> operating expenses,—it is producing in 'paying quantities,' though it may never repay its cost, and the operation as a whole may result in a loss. Few wells, except the very largest, repay cost under a considerable time; many never do; but that is no reason why the first loss should not be reduced by profits, however small, in continuing to operate. The phrase 'paying quantities,' therefore, is to be construed with reference to the operator, and by his judgment when exercised in good faith.

*7 *Id.* at 250–51, 45 A. 121, 45 A. at 122–23.

In *Colgan v. Forest Oil Co.*, 194 Pa. 234, 45 A. 119 (Pa.1899), which we issued on the same day as our opinion in *Young*, we elaborated on the concept of good faith judgment. Therein, the owner of land (lessor) filed a bill in equity against the lessee for specific performance of convenants contained in an oil lease, or, alternatively, forforfeiture of the lease. The lessee challenged the number of wells put down by the lessor, as well as the location of the wells. Concerning the lessee's good faith judgment, we stated:

> So long as the lessee is acting in good faith on business judgment, he is not bound to take any other party's, but may stand on his own. Every man who invests his money and labor in a business does it on the confidence he has in being able to conduct it in his own way. No court has any power to impose a different judgment on him, however erroneous it may deem his to be. Its right to interfere does not arise *until it has been shown clearly that he is not acting in good faith on his business judgment, but fraudulently, with intent to obtain a dishonest advantage over the other party to the contract.* Nor is the lessee bound, in case of difference of judgment, to surrender his lease, even *pro tanto*, and allow the lessor to experiment. Lessees who have bound themselves by covenant to develop a tract, and have entered and produced oil, have a vested estate in the land, which cannot be taken away on any mere difference of judgment.

Id. at 242, 45 A. 119, 45 A. at 121 (emphasis added).

Jedlicka argues that the lower courts in the instant case erroneously interpreted our decision in *Young* as providing for a "purely subjective," rather than objective, test to determine whether a gas or oil lease is producing in paying guantities.11 Specifically, Jedlicka argues:

> [W]hile there are some subjective factors to consider in the overall analysis, the test is not purely subjective, as the trial court found in the instant case. Rather, the threshold inquiry is whether, objectively, the lease is making a profit, "however small" over its operating expenses. The operating expenses referred to here are the day to day costs of operating the well. Some courts have referred to these expenses as "lifting expenses." The Court in *Young* was clear that if the wells do not pay this minimal cost of production, they will not be deemed to produce in paying guantities.
>
> The subjective element is the second layer of analysis which only enters the determination when the wells have already been found to be producing in paying guantities, but that the profits are insufficient to offset the total expenses incurred in the operation as a whole—particularly those expenses associated with the exploration, drilling and inception of oil or gas extraction. In such case, the Court in *Young* explained, it is necessary to determine whether the lessee is exercising its good faith judgment as to whether the wells are being operated for revenue. Provided that it is, and the wells are producing in paying guantities, the lease will not lapse.

*8 Appellant's Brief at 11–12 (citations omitted).

Based on her interpretation of *Young*, and, because it was "conclusively established that the wells under the Lease incurred a net loss in 1959 when their combined revenues were insufficient to overcome the expenses of their operation," *id.* at 15, 45 A. 121, Jedlicka contends:

> [i]t was unnecessary, unprecedented and, indeed, improper, for the trial court to then inquire as to the subjective good faith of T .W. Phillips and [PC Exploration] in operating under the Lease. Once there failed to be a profit, however small, the Lease lapsed by operation of law into a tenancy at will, terminable by Ms. Jedlicka at any time.

Appellant's Brief at 15 (footnote and citations omitted).

Appellees, conversely, argue that Jedlicka's proposed construction of *Young* is inconsistent with the very language and intent of that decision. Appellees further maintain that, to the extent *Young* requires consideration of an operator's good faith when determining whether a lease has produced in paying quantities, *Young* is

"reflective" of "national authority," in that

> [a] number of the jurisdictions that have embraced what Jedlicka terms an "objective" standard for "paying quantities" have explicitly held that the term to be used in assessing the performance of the lease should be one long enough to "provide the information which a prudent operator would take into account in [deciding] whether to continue or abandon operation."

Appellees' Brief at 16 (citing, *inter alia, Fisher v. Grace Petroleum Corp.*, 830 P.2d 1380, 1386 (Okla.App.1991); *Ross Explorations, Inc. v. Freedom Energy, Inc.*, 340 Ark. 74, 8 S.W.3d 511 (Ark.2000); and *Texaco, Inc. v. Fox, supra*).

Alternatively, Appellees argue that, even if *Young* is not consistent with current prevailing authority, the Findley lease must be interpreted in accordance with the prevailing law at the time the parties entered into the Lease—namely, *Young*. Appellees' Brief at 18 (citing, *inter alia, DePaul v. Kaufmann*, 441 Pa. 386, 398, 272 A.2d 500, 506 (1971) ("[T]he laws in force when a contract is entered into become part of the obligation of [the] contract 'with the same effect as if expressly incorporated in its terms.' ")).

As a preliminary matter, we recognize that our decision in *Young* is more than a century old; thus, there is bound to be uncertainty as to how such precedent applies to disputes involving an industry that has changed rapidly over that same time period. As previously noted, while habendum clauses traditionally were used to protect the interests of lessors, *see Swiss Oil*, 67 S.W.2d at 31, the clauses are now viewed as a protection for lessees. Moreover, *Young* left room for interpretation; although *Young* specifies that whether a lease makes a profit is key to determining if it produces in paying quantities, it does not address over what time period such an assessment is to be made. Further, *Young* broadly focuses on the good faith judgment of the operator, but without specifying precisely when the operator's judgment comes into play. The present case allows us to address these open issues.

*9 Jedlicka casts *Young* as prescribing an objective test—a mathematical calculation of profits—which, if the elements are not met, indicates the lease is not producing in paying quantities. She further contends that the good faith judgment of the operator is relevant only where a lease *is* producing in paying quantities—i .e., making a profit—but yet may not offset its total operational expenses. There are two inherent flaws in this argument. First, by its terms, *Young* requires consideration of the operator's good faith judgment *as part* of the assessment of whether the lease produces in paying quantities. *See Young*, 194 Pa. at 250–51, 45 A. at 122–23 ("The phrase 'paying quantities,' therefore, is to be construed with reference to the operator, and by his judgment when exercised in good faith."). Second, Jedlicka's argument overlooks the fact that profits must be measured over some time period, and, as we discuss below, setting a reasonable time period necessarily implicates the operator's good faith judgment. Thus, in assessing whether a lease is producing in paying quantities, *Young* places the principal focus on the good faith judgment of the operator.

Initially, we note that the courts of many of our sister states have concluded that the determination of whether a lease has produced in paying quantities requires consideration of the operator's good faith judgment. Indeed, some of these courts have relied on *Young*.[12] In the landmark case of *Clifton v. Koontz*, the Texas Supreme Court acknowledged the "generally accepted" definition of production "in paying quantities": "If a well pays a profit, even small, over operating expenses, it produces in paying quantities, though it may never repay its costs, and the enterprise as a whole may prove unprofitable." 160 Tex. 82, 325 S.W.2d 684, 690–91 (Tex.1959) (quoting *Garcia v. King*, 139 Tex. 578, 164 S.W.2d 509, 511 (Tex.1942)).[13] The court, however, continued:

> In the case of a marginal well, such as we have here, the standard by which paying quantities is determined is whether or not under all the relevant circumstances a reasonably prudent operator would, for the purpose of making a profit and not merely for speculation, continue to operate a well in the manner in which the well in question was operated.
>
> In determining paying quantities, in accordance with the above standard, the trial court necessarily must take into consideration all matters which would influence a reasonable and prudent operator. Some of the factors are: The depletion of the reservoir and the price for which the lessee is able to sell his produce, the relative profitableness of other wells in the area, the operating and marketing costs of the lease, his net profit, the lease provisions, a reasonable period of time under the circumstances, and whether or not the lessee is holding the lease merely for speculative purposes.

Clifton, 325 S.W.2d at 691.

Thus, to the extent the "profit over operating expenses" test comprised the entire test for determining whether a well produced in paying quantities under *Garcia*, the *Clifton* court held that such test was but one of several elements a court must consider when determining whether

a reasonably prudent operator would continue to operate a lease for the purpose of making a profit and not for speculation. Another relevant factor in determining whether a well has produced in paying quantities under the reasonable and prudent operator standard is whether the lessee is holding the lease for the purpose of making a profit, and not merely for speculative purposes. *See Clifton,* 325 S.W.2d at 691. This inquiry necessarily implicates the issue of whether a lessee has exercised his judgment in good faith.

***10** In *Pack v. Santa Fe Minerals,* the Oklahoma Supreme Court likewise held that an operator's good faith is a necessary consideration in determining whether a well has produced in paying quantities. The court, in holding that a failure to market oil or gas did not alone operate to terminate a lease under a "cessation or production" clause, explained:

> More recently, in *Stewart v. Amerada Hess Corp.,* 604 P.2d 854 (Okla.1979), we reaffirmed the rule that an oil and gas lease could not be terminated under the habendum clause merely because the subject well ceased production in paying quantities. Rather, the finder of fact must also look into the circumstances surrounding the cessation, including the "[d]uration and cause of the cessation, as well as the diligence or lack of diligence exercised in the resumption of production." 604 P.2d at 858, fn. 18. In so holding we affirmed our rejection of a literal construction of the habendum clause stating:
>
> > "Under a literal or strict interpretation of the 'thereafter' provision in a habendum clause, uninterrupted production—following expiration of primary term—would be indispensable to maintain a lease in force. This would mean, of course, that *any* cessation of production [in the paying-quantities sense of the term], however slight or short, would put an end to the lease. Oklahoma has rejected that literal a view. Our law is firmly settled that the result in each case must depend upon the circumstances that surround cessation. Our view is no doubt influenced in part by the strong policy of our statutory law against forfeiture of estates.

869 P.2d 323, 326–27 (Okla.1994) (alterations and emphasis original). The court concluded "[i]n short, the lease continues in existence so long as the interruption of production in paying quantities does not extend for a period longer than reasonable or justifiable in light of the circumstances involved. *Id.* at 327 (emphasis original).

In *Swiss Oil, supra,* the Supreme Court of Kentucky acknowledged the term "paying quantities":

> is usually defined as being such quantities as will pay a profit, but at least the cost of operating the well. The lessee is not required to market the gas at a loss, but only when there is a reasonable profit, and in determining whether it could be so marketed, the distance to the market, the expense of marketing, and every similar circumstance should be taken into consideration. In determining whether or not a gas or oil well is productive to this extent, the judgment of an experienced operator or lessee, *if exercised in good faith,* will prevail as against that of a lessor without experience.

67 S.W.2d at 31 (emphasis added). Thus, although the court in *Swiss Oil* viewed the phrase "paying quantities" as a measure to protect a lessee from his obligation to continue operations under an unprofitable lease, it too found the good faith judgment of the lessee to be a relevant consideration in determining whether a well has produced in paying quantities.

***11** As the above cases reveal, in determining whether a well that has suffered marginal or sporadic production for some period should be deemed to have failed to produce in paying quantities, "a majority of jurisdictions apply a subjective approach and will look to a number of factors and relevant circumstances to determine whether or not a prudent lessee would continue to operate the lease for profit and not for speculation." Richard W. Hemingway, Law of Oil and Gas 320 (3rd ed.1991).[14]

[8] Regarding Jedlicka's position that, under *Young,* a determination of whether a well has produced in paying quantities must be based on an objective mathematical calculation of profits,[15] we note that the test for determining in paying quantities could never be *purely* objective, absent picking an arbitrary time period.[16] Profits must be measured over some time period and establishing what is a reasonable time period warrants consideration of the particular characteristics of a given leasehold. *See Clifton,* 325 S.W.2d at 691 (one factor to be considered in determining paying quantities is "a reasonable period of time under the circumstances"). An operator, exercising his good faith judgment, may be willing to wait longer for one lease to become "profitable" than he is willing to wait for another well to become profitable, and unless it can be established that he is not acting in good faith on his business judgment, but instead is acting with fraudulent or dishonest intent, he does not forfeit his rights under the lease based on a difference in such judgment. *Colgan,* 194 Pa. at 242, 45 A. at 121.

Thus, with regard to what constitutes a reasonable time period by which to determine whether a well is profitable, we decline to establish a definite rule. Although Jedlicka maintains a one-year period of loss is sufficient to conclude that a well has failed to produce in paying quantities, courts have been disinclined to impose such a rigid term. For example, in *Texaco, Inc. v. Fox, supra,* in addressing an argument that a 13–year period was sufficient to determine the profitability of a lease, the court explained:

> it is generally accepted that profitability on an oil and gas lease should be determined over a relatively long period of time in order to expose the operation to the leveling influences of time. The arbitrary use of a short period of time while a well is down for a workover is obviously untenable. On the other hand, the use of an unreasonably long period would entail using past glories during flush production to determine a lease's present condition, which would give a distorted result not reflective of the current status of the lease. The better rule precludes the use of a rigid fixed term for determination of profitability and uses a reasonable time depending upon the circumstances of each case, taking into consideration sufficient time to reflect the current production status of the lease and thus to "provide the information which a prudent operator would take into account in whether to continue or to abandon the operation."

***12** 618 P.2d at 848 (citation omitted). Ultimately, the court found the 13–year accounting period unreasonably long, but held such finding was irrelevant in light of its determination on a depreciation issue. *See also Ross Explorations,* 8 S.W.3d at 516 (noting that appropriate period for determining profitability depends "upon the facts of the particular case and the specific reasons production waned or ended," and holding that, "[u]nder the facts of the instant case," a 24–month period was reasonable for determining profitability); *Fisher,* 830 P.2d at 1386 ("[t]he appropriate time period for determining profitability is a time appropriate under all the facts and circumstances of each case.").17 Ultimately, under *Young,* we conclude that even the determination of what constitutes a "reasonable time period" by which to evaluate whether a well has produced in paying quantities must be based on the unique circumstances of each individual case, and be driven by consideration of the good faith judgment of the operator.

[9] [10] [11] Accordingly, and for the reasons stated above, we hold that, if a well consistently pays a profit, however small, over operating expenses, it will be deemed to have produced in paying guantities. Where, however, production on a well has been marginal or sporadic, such that, over some period, the well's profits do not exceed its operating expenses, a determination of whether the well has produced in paying quantities requires consideration of the operator's good faith judgment in maintaining operation of the well. In assessing whether an operator has exercised his judgment in good faith in this regard, a court must consider the reasonableness of the time period during which the operator has continued his operation of the well in an effort to reestablish the well's profitability.18

[12] Although Jedlicka suggests that, "if only a subjective standard is used to determine paying quantities, oil and gas companies may choose to hold onto otherwise unprofitable wells for merely speculative, as opposed to productive, purposes," Appellant's Brief at 19, we disagree. Under the standard set forth above, a lessor will be protected from such acts because, if the well fails to pay a profit over operating expenses, and the evidence establishes that the lessee was not operating the wells for profit in good faith, the lease will terminate. Consideration of the operator's good faith judgment in determining whether a well has produced in paying quantities, however, also protects a lessee from lessors who, by exploiting a brief period when a well has not produced a profit, seek to invalidate a lease with the hope of making a more profitable leasing arrangement. In the instant case, for example, Jedlicka seeks to invalidate a nearly 80–year–old lease based on a single-year loss which occurred more than more than 45 years ago, after which the wells resumed and continued production at a profit.

[13] Turning now to the specific circumstances of the instant case, Jedlicka contends that, because there was a $40 loss in 1959, the subject wells failed to produce in paying quantities, resulting in termination of the lease. The trial court, without expressly finding that a one-year period in the context of a nearly 80–year–old lease was not a "reasonable time period" in which to conclude that the wells were not profitable, determined that "[t]he evidence indicates that the lessees were operating the wells in good faith," and, on this basis, that the wells had produced in paying quantities. *T.W. Phillips Gas and Oil Co. and PC Exploration, Inc.* ., No. 10362 CD 2005, at 6. Based on our review of the record, we find no error in this regard.

***13** As explained above, pursuant to *Young,* the operator's good faith judgment is the principal focus in determining whether a lease has produced in paying quantities. Thus, as we have construed *Young,* the trial court properly considered Appellees' good faith judgment in its consideration of whether the wells had produced in paying quantities.

Here, Jedlicka presented no evidence to suggest that Appellees have not operated the wells in good faith. Significantly, as Appellees emphasize, Jedlicka's own expert witness, Wayne Leeper, a petroleum geologist, testified he would have continued to operate the well that had sustained the $40 loss in 1959 because the well "makes money." N.T. Trial, 4/17/07, at 191 (R.R. at 353a). The witness further testified that the other wells on the Jedlicka property, including Well Nos. 6, 7, 8, and 9, are favorably producing. *Id.* at 205–05 (R.R. at 367a–368a). Accordingly, we find the record supports the trial court's conclusion that the lease was being operated in good faith and that Jedlicka failed to sustain her burden of establishing a lack of good faith by Appellees. *See Jefferson County Gas Co., supra.* As a result, we agree she failed to prove that the wells had not produced in paying quantities. For these reasons, we affirm the order of the Superior Court.

Order affirmed.

Justice ORIE MELVIN did not participate in the consideration or decision of this case.

Chief Justice CASTILLE and Justice BAER and McCAFFERY join the opinion.

Justice EAKIN files a concurring opinion.

Justice SAYLOR files a dissenting opinion.

CONCURRING OPINION

Justice EAKIN.

I join the majority in affirming the Superior Court's order. I write separately, however, to expand upon and note my disagreement with portions of the majority's opinion.

Appellant reads *Young v. Forest Oil Co.,* 194 Pa. 243, 45 A. 121 (Pa.1899) to require an objective test for determining if a well is producing in "paying quantities." Appellant's vision for this objective test would require a mathematical calculation of the well's profits, such that if during any 12–month period the well sustains a loss, the lease could be terminated. As the majority correctly determines, "the test for determining in paying quantities could never be *purely* objective, absent picking an arbitrary time period." Majority Slip Op., at 19–21 (emphasis in original). That is because profitability is not measured (under the lease, much less elsewhere) on a calendar year. If Ford loses a billion dollars one year and makes two billion the next, it has sold cars in "paying quantities." Scouring the 80–year history of a well and finding a 12–month period where expenses were greater than revenue is false accounting for lease purposes and cannot be rewarded.

Regarding the term "paying quantities" in the lease habendum clause, the majority properly characterizes it as either a shield or a sword, depending on who is wielding it. At the time the lease was written, this clause was used to release the driller from the lease when the well was no longer profitable. The landowner, on the other hand, typically wanted the lease to remain intact so as to obtain rent from an otherwise unprofitable well. Here, it is Appellant who is the party attempting to terminate the relationship, even though she has received payments and gas throughout the life of the lease. Therefore, this is not a case where a driller, desiring to get out of a lease, slows production in bad faith and causes the well to not produce in "paying quantities." Accordingly, I do not believe a review of whether Appellees acted in good faith is necessary for the disposition of this issue. Similarly, I would refrain from discussing *Clifton v. Koontz,* 160 Tex. 82, 325 S.W.2d 684 (Tex.1959) and its subjective productivity analysis, as it is equally inapposite to this lease; these are questions better left for another day when we are given advocacy on the considerations relevant thereto.

DISSENTING OPINION

Justice SAYLOR.

***14** I differ with the majority's formulation of the "paying quantities" test, as set forth in *Young v. Forest Oil Co.,* 194 Pa. 243, 45 A. 121 (1899). In my view, *Young* provides a two-part, hybrid standard for ascertaining if a well is producing in "paying quantities." The objective and threshold element is that profits must exceed operating expenses, *i.e.,* that the well must be at least marginally profitable. If profits exceed operating expenses, then the subjective component—the lessee's good-faith judgment—comes into play. In those instances, it should be presumed that the lessee is operating the lease in good faith, and unless the lessor rebuts this presumption, the lease is said to be producing in "paying quantities." My reasoning is as follows.

I. Background

At the outset, this appeal is set amid the backdrop of a contract dispute. Briefly, and as noted by the majority, Appellant's predecessors in title and Appellee T.W. Phillips Gas and Oil Company executed an oil-and-gas lease in 1928. In relevant part, the lease states that it remains in effect after the primary term so long as "oil or gas is produced in paying quantities, or operations for oil *or* gas are being conducted thereon." Majority Opinion, *slip. op.* at 2 (emphasis added; citation omitted). Although the lease does not define the phrase "paying quantities," Appellant and Appellees are in agreement that the original parties to the contract incorporated the meaning of the term supplied by the Court's 1899 ruling in *Young. See, e.g.,* Brief for Appellant at 11; Brief for Appellees at 12.

Rather than providing a straightforward definition of the phrase, *Young* sets forth a series of principles to determine when a well is producing in "paying quantities." According to the Court, the phrase means paying quantities to the lessee, not the lessor; a "stipulated condition for the termination of the lease" occurs if either "oil has not been found, and the prospects are not such that the lessee is willing to incur the expense of a well (or second or subsequent well as the case may be)" or "oil has been found but no longer pays the expenses of production"; and a well is producing in "paying quantities" if it pays a profit over operating expenses, even if it never repays its "cost,"1 and the operation as a whole results in a loss. *Young,* 194 Pa. at 250, 45 A. at 122–23. The *Young* Court summed up its judicially-crafted (but apparently industry-accepted) definition of the term along these lines: "The phrase, 'paying quantities,' therefore is to be construed with reference to the operator, and by his judgment when exercised in good faith." *Id.* at 251, 45 A. 121, 45 A. at 123. The Court, however, did not define "good faith" or explain its function for purposes of this inquiry.

II. Marginal Profitability

The majority initially holds that, under *Young,* operating expenses can exceed profits, and yet, a well can still be producing in "paying quantities." *See* Majority Opinion, *slip. op.* at 22–23. In reaching this conclusion, the majority does not rely on the text of *Young,* but rather, on how other courts have interpreted the phrase, finding the rulings in *Clifton v. Koontz,* 160 Tex. 82, 325 S.W.2d 684 (Tex.1959), and *Pack v. Sante Fe Minerals,* 869 P.2d 323 (Okla.1994), particularly instructive on this issue. *See* Majority Opinion, *slip op.* at 15–18. These decisions, posits the majority, are consistent with *Young,* and thus, inform this Court's judgment as to the issue on appeal. *See id.* at 15–16 & n. 12, 45 A. 121.

***15** While arguably reflecting a more modern view of "paying quantities," these cases are in conflict with the plain terms of *Young,* which impose a threshold, marginal profitability requirement. *Young* clearly states that, "if oil has been found but no longer pays the expenses of production," a "stipulated condition for the termination of the lease has occurred." *Young,* 194 Pa. at 250, 45 A. at 122. Despite the fact that the Court did not specifically indicate that such a well is not producing in "paying quantities," it is obvious from the context that such failure is the stipulated condition for terminating the lease. *See Barnsdall v. Boley,* 119 F. 191, 198 (N.D.W.Va.1902) (finding that *Young* expressly held that, "where oil has been found, but no longer pays the expenses of production, that it is not producing in paying quantities"). In this regard, *Young* reflects the prevailing view among courts at that time. Historically, "paying quantities" had to include "an element of profit to the lessee." Anderson, Oil and Gas Law at 252; see Douglas Hale Gross, *Meaning of "Paying Quantities" in Oil and Gas Lease,* 43 A.L.R.3d 8, § 2[a] (1972) ("[T]he requirement that there be a profit is the core around which the meaning of paying quantities is built." (footnote omitted)). The rationale for this rule is perhaps best summarized by the Texas Supreme Court in *Garcia v. King,* 139 Tex. 578, 164 S.W.2d 509 (Tex.1942). There, the Court rejected the argument that, if a well produces any amount of oil or gas that is capable of division, it is producing in "paying quantities," opting instead to adopt the approach followed by the majority of courts that, " '[i]f a well pays a profit, even small, over operating expenses, it produces in paying quantities [.]' " *Id.* at 511–12 (quoting *Gypsy Oil Co. v. Marsh,* 121 Okla. 135, 248 P. 329, 334 (Okla.1926), in turn, quoting, *inter alia, Young,* 194 Pa. at 250, 45 A. at 122–23).

The *Garcia* Court explained its ruling, in relevant part, as follows:

> The object of the contract was to secure development of the property for the mutual benefit of the parties. It was contemplated that this would be done during the primary period of the contract. So far as the lessees were concerned, the object in providing for a continuation of the lease for an indefinite time after the expiration of the primary period was to allow the lessees to reap the full fruits of the investments made by them in developing the

> property. Obviously, if the lease could no longer be operated at a profit, there were no fruits for them to reap. The lessors should not be required to suffer a continuation of the lease after the expiration of the primary period merely for speculation purposes on the part of the lessees. Since the lease was no longer yielding a profit to the lessees at the termination of the primary period, the object sought to be accomplished by the continuation thereof had ceased, and the lease had terminated.

*16 *Id.* at 512–13.2 Thus, as originally conceived and reflected in *Young*, a well had to be marginally profitable to be producing in "paying quantities."

Beginning with the decision in *Henry v. Clay*, 274 P.2d 545 (Okla.1954), however, some courts started construing "paying quantities" so that unprofitable wells could achieve this designation. *See* Anderson, Oil and Gas Law at 254–57 & accompanying footnotes. These approaches apparently developed as a response to the difficulties associated with applying the traditional understanding of "paying quantities" to marginal wells—*i.e.*, wells operating at a loss—because that standard did not account for "the problems of cyclical production or the period over which the well should be tested to determine whether production is profitable." *Id.* at 254. Notably, while implementing a more lenient threshold, these tribunals did not elaborate on the original formulation of the "paying quantities" test, as the majority appears to suggest; instead, they effectively displaced that standard where well production was marginal or sporadic.
In *Clay*, for example, the Oklahoma Supreme Court initially recited the traditional definition of "paying quantities," stating that "[i]f the well pays a profit even though small, over operating expenses, it produces in paying quantities, though it may never repay its costs, and the operation as a whole may prove unprofitable ." *Clay*, 274 P.2d at 546 (citations omitted). The Court then devised a rule in which a lease would not terminate if profits did not surpass lifting expenses, *see id.* at 548,3 thus supplanting the original understanding of "paying quantities" in the case of marginal wells.4

The Texas Supreme Court subsequently followed suit in *Koontz*. Like the *Clay* Court, the *Koontz* Court began by noting that "[t]he generally accepted definition of 'production in paying quantities' is ... '[i]f a well pays a profit, even small, over operating expenses, it produces in paying quantities, though it may never repay its costs, and the enterprise as a whole may prove unprofitable.' " *Koontz*, 325 S.W.2d at 690–91 (quoting *Garcia*, 164 S.W.2d at 511). The *Koontz* Court proceeded to create an exception to this rule similar to the one in *Clay*, concluding that:

> In the case of a marginal well, such as we have here, the standard by which paying quantities is determined is whether or not under all the relevant circumstances a reasonably prudent operator would, for the purpose of making a profit and not merely for speculation, continue to operate a well in the manner in which the well in question was operated.

Id. at 691. In so holding, the Court relegated the *Garcia* test of marginal profitability—the standard patterned after the one in *Young*—to one of the elements a reasonably prudent operator would consider in determining whether to continue to operate the lease. *See* ANDERSON, OIL AND GAS LAW at 256.

*17 Therefore, as illustrated above, neither scheme is consistent with the one outlined in *Young*, since *Young* expressly requires profits to exceed operating expenses for a well to be producing in "paying quantities," *see Young*, 194 Pa. at 250, 45 A. at 122–23, whereas *Clay* and *Koontz* allow for unprofitable wells to attain that designation. *See Clay*, 274 P.2d at 548; *Koontz*, 325 S.W.2d at 691. I thus am unable to support the majority's assertion that those rulings inform this Court's judgment regarding *Young*. Moreover, by relying on such contradictory authority, it appears that the majority is overruling that decision.

I appreciate that more recent developments in this area of the law, at some point, may warrant this Court's consideration of the continued viability of *Young*. Notably, while initially being at the forefront of this field, this Court's jurisprudence has remained largely stagnant for the last 100 years. *See, e.g.*, Ross H. Pifer, *Drake Meets Marcellus: A Review of Pennsylvania Case Law Upon the Sesquicentennial of the United States Oil and Gas Industry*, 6 TEX. J. OIL GAS & ENERGY J. 47, 48 (2010–11). As such, in comparison to other oil and gas producing states, this Court's caselaw is rather antiquated, and thus, the majority opinion could be read as an attempt to modernize Pennsylvania law.

Nevertheless, in the present case, this Court granted allocatur limited to whether the Superior Court misinterpreted *Young*. *See T.W. Phillips Gas & Oil Co. v. Jedlicka*, 602 Pa. 154, 978 A.2d 347 (2009) ("Did the Superior Court misapply the decision of this Court in [*Young*] by holding that Pennsylvania employs a purely

subjective test to determine whether an oil or gas lease has produced 'in paying quantities[?]' "). Furthermore, neither party is advocating for this Court to overrule that decision; instead, both contend that *Young* supplies the definition of "paying quantities" for purposes of this contract dispute. *See, e.g.*, Brief for Appellant at 11; Brief for Appellees at 12. Indeed, Appellees maintain that, "even if this Court were to decide that the *Young* test is undesirable in every way and should no longer be the controlling law of Pennsylvania, it would still be the only proper test to apply here because the parties contracted on its basis." Brief for Appellees at 17.

I agree with Appellees' position on this point. The majority's decision, in effect, to overrule *Young* is particularly troublesome, not only on account of its *sua sponte* character, *see generally Danville Area Sch. Dist. v. Danville Area Educ. Ass'n*, 562 Pa. 238, 247, 754 A.2d 1255, 1259 (2000) (explaining that "[s]ua sponte consideration of issues disturbs the process of orderly judicial decision making"), but also because the parties incorporated *Young's* definition of "paying quantities" into their contract. *See, e.g., Lesko v. Frankford Hosp.-Bucks County*, —— Pa. ——, ——, 15 A.3d 337, 342 (2011) ("The fundamental rule in contract interpretation is to ascertain the intent of the contracting parties[.]" (citation and quotation marks omitted)).5

III. The Lessee's Good–Faith Judgment

***18** The majority also concludes that the good-faith judgment of the lessee need only be considered where profits do not exceed operating expenses. *See* Majority Opinion, *slip op.* at 22. Thus, according to the majority, if profits surpass lifting expenses, a well is producing in "paying quantities." *See id.* Neither position is in agreement with *Young*, however.

First, as explained above, that decision expressly imposes a threshold, marginal profitability requirement. *See Young*, 194 Pa. at 250, 45 A. at 122–23. Consequently, even though the exact meaning of the lessee's good-faith judgment is not apparent from *Young*, it stands to reason that a court must first determine that profits exceed operating expenses before evaluating the lessee's opinion. Stated otherwise, the lessee's good-faith judgment is only assessed once profits have been found to surpass lifting expenses, and therefore, the lessee's opinion, even if held in good faith, cannot save an otherwise unprofitable well, as the majority argues.

Presumably, then, this understanding of "paying quantities" led the original parties to the contract to include the operations provision (*i.e.*, "or operations for oil or gas are being conducted thereon") in the habendum clause of the lease. Since it acts independently of the "paying quantities" phraseology, the operations provision appears to provide the lessee with a means to preserve the lease in the event that profits do not exceed operating expenses, that is, where a lease is not producing in "paying quantities." *Cf.* Lisa S. McCalmont, *Vanishing Rights of the Mineral Lessor: The Pack v. Sante Fe Minerals Ruling*, 30 Tulsa L.J. 695, 699 (1995). The flexibility afforded to the operations provision further suggests against the over-liberalization of the term "paying quantities."

Moreover, to the extent that the majority suggests that *Young* embodies a purely objective standard where profits exceed operating expenses, I question the majority's reading of that case, as *Young* makes clear that the lessee's good-faith judgment must be evaluated when ascertaining if a well is producing in "paying quantities." *See Young*, 194 Pa. at 251, 45 A. at 123 ("The phrase, 'paying quantities,' therefore is to be construed with reference to the operator, and *by his judgment when exercised in good faith*." (emphasis added)). Additionally, while the Court has not revisited that ruling in over a century, a number of other tribunals have applied its reasoning in the interim, concluding that *Young* places a central focus on the good-faith judgment of the lessee.6

The majority further concludes that the reasonably prudent operator standard "necessarily implicates the issue of whether a lessee has exercised his judgment in good faith." Majority Opinion, *slip. op.* at 17. In this regard, the majority evidently believes that the lessee's good-faith judgment test is a component of (or perhaps subsumed within) the reasonably prudent operator standard. *See id.* at 21–23 & n. 18, 45 A. 121. Although the majority makes no attempt to reconcile the reasonably prudent operator standard at large with *Young*, it nonetheless reasons that, to establish good faith under *Young*, a court must consider "the reasonableness of the time period during which the operator has continued his operation of the well in an effort to reestablish the well's profitability," *id.* at 23, 45 A. 121, one of the inquiries traditionally associated with that standard. *See, e.g., Koontz*, 325 S.W.2d at 691.

***19** Preliminarily, it bears noting that the lessee's good-faith judgment test and the reasonably prudent operator standard are two distinct concepts.7 Chief among their differences is the fact that the former is a subjective test, *see, e.g., Brewster v. Lanyon Zinc Co.*, 140 F. 801, 813–15 (8th Cir.1905), whereas the latter is an objective standard. *See, e.g.*, Jared Hall, *Both Eyes Open or One Eye Closed: Does the Reasonable and Prudent Operator Standard Handicap Mineral Lessees in the Prevention of*

Drainage, 7 TEX. TECH ADMIN. L.J. 179, 197 (2006).8 Indeed, a number of courts and observers have understood the reasonably prudent operator standard as a rejection of the lessee's good-faith judgment test,9 since the former does not afford considerable deference to the knowledge and judgment of the lessee, which is the central feature of the latter. *See, e.g.,* Conine, *The Prudent Operator Standard: Applications Beyond the Oil and Gas Lease,* 41 NAT. RESOURCES J. at 32 & n. 32; Gary B. Conine, *Speculation, Prudent Operation, and the Economics of Oil and Gas Law,* 33 WASHBURN L.J. 670, 679 (1994). Therefore, I differ with the majority insofar as it views the lessee's good-faith judgment test and the reasonably prudent operator standard as harmonious approaches.

Nor do I agree with the majority that, under *Young,* the lessee's good-faith judgment entails a subjective, as well as an objective, component. *See* Majority Opinion, *slip op.* at 21 ("[U]nless it can be established that [the operator] is not acting in good faith on his business judgment, ... he does not forfeit his rights under the lease based on a difference in such judgment"); *id.* at 22–23, 45 A. 121 ("In assessing whether an operator has exercised his judgment in good faith ..., a court must consider the reasonableness of the time period during which the operator has continued his operation of the well in an effort to reestablish the well's profitability."). Rather, I believe it involves a purely subjective inquiry, which is consistent with how a companion case construed the term.

As noted by the majority, in *Colgan v. Forest Oil Co.,* 194 Pa. 234, 45 A. 119 (1899), a dispute arose between the lessor and lessee with respect to the former's drilling operations, namely, the lessee's decision to put down wells on the eastern half of the lessor's farm, but not the western half. The lessor filed suit for, *inter alia,* specific performance. The trial court found that the western half of the farm would furnish at least one paying well, and thus, directed the lessee to put down a well in that region.

On appeal, the Court reversed, concluding that there was no evidence to support the trial court's finding. *See id.* at 241–42, 45 A. 119, 45 A. at 121. In addition, and of particular importance here, the *Colgan* Court held that, absent a showing of bad faith, a court will not interfere with the lessee's business judgment with respect to drilling operations. *See id.* at 242, 45 A. 119, 45 A. at 121. Specifically, the Court reasoned that:

> *20 So long as the lessee is acting in good faith, on business judgment, he is not bound to take any other party's, but may stand on his own. Every man who invests his money and labor in a business does it on the confidence he has in being able to conduct it in his own way. No court has any power to impose a different judgment on him, however erroneous it may deem his to be. Its right to interfere does not arise until it has been shown clearly that he is not acting in good faith on his business judgment, but fraudulently, with intent to obtain a dishonest advantage over the other party to the contract.

Id.

As explained earlier, *Young* did not elaborate on the role of the lessee's good-faith judgment for purposes of its "paying quantities" test, even though the Court held that the lessee's opinion must be considered when performing this inquiry. *See Young,* 194 Pa. at 251, 45 A. at 123. It appears that the Court intended for the term to have a similar meaning in *Young* as it did in *Colgan,* since both decisions were issued on the same day, both involved matters relating to wells producing in "paying quantities," and both discussed the good-faith judgment of the lessee in connection with this finding.
Therefore, when reading *Young* in conjunction with *Colgan,* as some courts have done, *see Manhattan Oil Co.,* 73 N.E. at 1086–87; *Tex. Pac. Coal & Oil Co.,* 233 S.W. at 539; *Warfield Natural Gas Co. v. Allen,* 248 Ky. 646, 59 S.W.2d 534, 537 (Ky.Ct.App.1933), it stands to reason that the lessee's good-faith judgment is assessed on purely subjective terms for purposes of *Young's* "paying quantities" test. Under this view, it should be presumed that the lessee is operating the lease in good faith where profits exceed operating expenses. Absent a showing of bad faith on the part of the lessee to rebut the presumption, the lease is deemed to be producing in "paying quantities." *See Young,* 194 Pa. at 250–51, 45 A. at 122–23; *Colgan,* 194 Pa. at 242, 45 A. at 121. While such an interpretation does not supply a strong, independent basis to terminate a lease, given the fact that it allows a lessee to conduct his or her drilling operations up to the limits of bad faith, ostensibly, this is because it acts in concert with the threshold, marginal profitability requirement. In short, *Young's* good-faith inquiry, as explain more fully in *Colgan,* merely acts a final check on the lessee's judgment in those instances where the well's profits have been found to exceed its operating expenses.10

The majority, however, is not of the opinion that *Colgan* confirms the meaning of "good faith" under *Young.* Instead, it plumbs the reasonably prudent operator standard to announce a more objective good-faith inquiry. *See* Majority Opinion, *slip op.* at 21–23 ("In assessing whether an operator has exercised his judgment in good

faith ..., a court must consider the reasonableness of the time period during which the operator has continued his operation of the well in an effort to reestablish the well's profitability."). The many difficulties with this approach include the failure to account for: the stark departure from *Colgan's* subjectivity, manifested in a presumption of good faith in the absence of actual fraud; the need for selective recourse to the prudent-operator factors, since reasonable-time-under-the-circumstances is but one of those factors, *see Koontz,* 325 S.W.2d at 691; and the fundamental disharmony between the reasonably prudent operator standard and the two-part objective/subjective inquiry of *Young* and *Colgan,* as previously discussed.

***21** Further, although there is a rational dispute as to whether, given its cryptic nature, *Young* provides for a two-part, as opposed to a one-part, inquiry (*i.e.,* whether it requires an objective profitability/subjective good-faith analysis or simply a subjective good-faith examination),11 to my knowledge, no court or commentator has gleaned a reasonably prudent operator standard from the four corners of *Young.* Finally, since assessment over a reasonable time period is necessary to the objectively-based inquiry into marginal profitability required under *Young,* it is unclear why it should be overlaid—redundantly—onto the separately stated good-faith inquiry.

Here, the Superior Court panel interpreted *Young* as providing a purely subjective test for ascertaining if a lease is producing in "paying quantities," reasoning, in relevant part, that, "while the lease operated at a loss in 1959, [Appellant] has not established any evidence that [Appellees] acted in bad faith." *T.W. Phillips Gas & Oil Co. v. Jedlicka,* 964 A.2d 13, 19 (Pa.Super.2008). Thus, the panel determined that Appellant failed to carry her burden, under *Young,* of demonstrating a lack of good faith on the part of Appellees. *See id.* Given that *Young* delineates a two-part, hybrid test, as outlined above, I would conclude that the Superior Court erred in this regard.

Finally, although I realize it is not squarely implicated in the present case, it is my considered view that Pennsylvania may be well served to move, prospectively, to the reasonably prudent operator standard in situations in which the parties employ the paying quantities rubric without making their intentions clearer on the face of their lease agreements, in recognition of the cyclical nature of the industry. Again, I emphasize that my position here is predicated upon the fact that *Young* was incorporated into the salient 1928 oil-and-gas lease.

IV. Conclusion

Accordingly, with regard to the limited issue upon which this Court granted allocatur, I would hold that Superior Court erred by concluding that *Young* sets forth a purely subjective test for determining whether an oil or gas lease has produced in "paying quantities." I would thus remand.

In such a remand, the Superior Court might find it appropriate to return the matter to the trial court for additional development. For one, the lease is silent as to the relevant time period to determine if the lease is producing in "paying quantities," and it is not clear from the trial court's opinion what, if any, period it used to perform this analysis. *See T.W. Phillips Gas & Oil Co. v. Jedlicka,* No. 10362 CD 2005, *slip op.* at 5–6 (C.P.Indiana, July 16, 2007). The nature of the loss suffered by the lease in 1959 is also not apparent from that decision. *See id.* at 5.

Moreover, the remand would allow the trial court to address a number of other subsidiary issues raised by the parties, including whether an accounting loss taken by the lessee is a part of a "paying quantities" calculation, and whether the lease continued in existence under the operations provision of the habendum clause.

Footnotes

1 Hydrofracturing, or fracking, is a method used to stimulate production of a well. A specially blended liquid is pumped down the well and into a formation under pressure high enough to cause the formation to crack open, forming passages through which oil or gas can flow into the wellbore. *See, e.g., U.S. Steel Corp. v. Hoge,* 503 Pa. 140, 144 n. 1, 468 A.2d 1380, 1382 n. 1 (1983) ("Hydrofracturing is the forcing of fluids underpressure into the well so as to cause a fracturing of the target stratum.").

2 The parties do not make reference to a Well No. 5.

3 Depletion schedules are used to show the operating expenses and amount of revenue generated by each well.

4 Rule 1901, titled "Prompt Disposition of Matters; Termination of Inactive Cases," permits a court, after giving a minimum of 30 days notice, to enter an order terminating a matter where the matter has been inactive for an unreasonable period of time. Pa.R.J.A.1901(a).

5 Shortly prior to trial, Jedlicka filed a supplemental trial memorandum arguing that Appellees breached the Findley lease by failing to meter Well No. 4 and pay a 1/8 royalty as set forth in 58 P.S. §§ 33–35. Section 33, titled "Guarantee of minimum royalties," provides that an oil or gas lease which does not guarantee the lessor at least 1/8 royalty of all oil, natural gas, or gas removed or recovered from the property is invalid. 58 P.S. § 33. Sections 34 and 35 provide for the metering and escalation of royalties under leases which do not provide for a 1/8 royalty at the time of the April 1985 effective date of the Oil and Gas Act, 58 P.S. §§ 601.101 *et seq.* (the "Act"). Appellees objected to her filing on the basis that they did not have an opportunity to respond to or challenge the Act's constitutionality. Noting that Jedlicka had not previously raised this argument, thus depriving Appellees of an opportunity to argue the constitutionality of the Act, the trial court held that Jedlicka was precluded from raising the issue, "without prejudice to raise it appropriately." *T.W. Phillips Gas and Oil Co. and PC Exploration, Inc. v. Jedlicka,* No. 10362 CD 2005, unpublished memorandum opinion at 4 (Indiana Cty. Common Pleas filed July 16, 2007). This issue is not presently before this Court.

6 We note that, under the habendum clause, the Findley lease remains valid as long as "oil or gas is produced in paying quantities," or as long as "operations for oil or gas are being conducted thereon, including the right to drill other wells." Lease, July 2, 1928, at 1 (R.R. at 13a–14a) Thus, even if gas or oil were not produced in paying quantities, Appellees' rights under the lease would remain intact for as long as "operations" are conducted. The trial court did not address this possibility in its opinion, and, despite Appellees' assertions that "[f]rom the date of the Findley Oil and Gas Lease to the present, ... operations for oil or gas have been conducted," *see* Appellees' Pretrial Memorandum, at 3 (R.R. at 60a), a review of the trial transcript reveals that there was some dispute, not only as to whether Appellees conducted operations for gas during the period of the lease, but also as to what activities constituted "operations" in the first instance. As a result, we are unable to determine whether the Findley lease remains valid under the second part of the habendum clause. Given our disposition of the "in paying quantities" issue, however, such determination is unnecessary.

7 The Pennsylvania Oil and Gas Association and the Independent Oil and Gas Association of Pennsylvania have filed a joint *amicus* brief in support of the position of Appellees, i.e., that this Court's decision in *Young,* requires consideration of an operator's good faith judgment when determining whether a well has produced in paying quantities.

8 In some jurisdictions, the phrase "in commercial quantities," as opposed to "in paying quantities," is used. *See, e.g., Texaco, Inc. v. Fox,* 228 Kan. 589, 618 P.2d 844 (Kan.1980); *Landauer v. Huey,* 143 Colo. 76, 352 P.2d 302 (Colo.1960).

9 Jedlicka argues in her brief to this Court that the trial court improperly held that she waived her right to challenge the validity of the Findley lease by accepting royalties from Appellees. Jedlicka contends such a finding is contrary to established law, particularly, *Brown, supra.* Jedlicka argues that, under *Brown,* when Appellees failed to produce gas in paying quantities in 1959, any interest Appellees had in the land "lapsed as a matter of law into a tenancy at will, terminable by Ms. Jedlicka at any time," and, therefore, "there can be no waiver of any right to challenge the validity of the lease." Appellant's Brief at 16. Contrary to the terminology used by Jedlicka, the trial court in the instant case did not hold that Jedlicka *waived* her challenge to the validity of the lease. The trial court simply noted, in its discussion of the $40 loss suffered by T.W. Phillips in 1959, that Jedlicka "continued to receive royalty payments per the lease for more than thirty years without asserting that the lease had expired," and, thus, received the benefit of the bargain since the inception of the Lease in 1928. *T.W. Phillips Gas and Oil Co. and PC Exploration, Inc.,* No. 10362 CD 2005, at 5. The court then went on to address her arguments under the lease. Thus, we need not address Jedlicka's waiver contention any further.

10 Specifically, this Court concluded the trial court had "misapprehended" the scope of *Kieppner v. Lemon,* 176 Pa. 502, 35 Atl. 109. We explained in *Young* that *Kieppner*

> was not meant to stretch the jurisdiction of equity beyond its regular and established limits, nor to blaze out any new path for proceedings on oil or gas leases, differing from ordinary remedies between lessor and lessee. It rested on fraud alleged and proved, and fraud in fact, not merely inferred from a difference of judgment between the defendant and the court as to the profitable development of the leased premises.

Young, 194 Pa. at 249, 45 A. at 122.

11 Jedlicka emphasizes she is not suggesting that *Young* be overruled. Indeed, she states: "To be abundantly clear, [Jedlicka] is not advocating that this Court overturn *Young* .... It has always been [Jedlicka's] contention that *Young* was properly decided ... and should, therefore, be affirmed and applied to this case." Appellant's Reply Brief at 9 n. 8.

12 The dissent suggests that our interpretation of *Young* is based, not on its plain language, but on how other courts have interpreted *Young,* and avers, "[w]hile arguably reflecting a more modern view of 'paying quantities,' these cases are in conflict with the plain terms of *Young,* which impose a threshold, marginal profitability requirement." *See* Dissenting Opinion, *slip op.* at 3. The dissent further posits that the decisions on which we rely "did not elaborate on the original formulation of the 'paying quantities' test," set forth in *Young,* but rather "effectively displaced that standard where well production was marginal or sporadic." *Id.* at 5–6, 45 A. 121. The *Young* decision is more than 100 years old, and was decided at a time when habendum clauses were used to protect the interests of lessors, not lessees. *See Swiss Oil, supra.* Often, this Court is called upon to interpret established case law against new facts, which is what we do in the case *sub judice.* Moreover, *Young* failed to address the necessary aspect of the time period over

which an assessment of whether a lease has made a profit should be made, and failed to specify at what point an operator's good faith judgment becomes a relevant factor; thus, we merely look to other jurisdictions for guidance in construing language similar to *Young*, and, at times, *Young* itself.

13 We note that this formulation by the Texas Supreme Court in *Clifton* may be traced to this Court's decision in *Young*. *See Clifton*, 325 S.W.2d at 690–91, quoting *Garcia*, 164 S.W.2d at 511; which in turn quotes *Gypsy Oil Co. v. Marsh*, 121 Okla. 135, 248 P. 329, 333 (Okla.1926); which in turn cites, *inter alia*, *Young*, 45 A. at 121.

14 Jedlicka contends, and commentators agree, that Kansas has expressly adopted a purely objective test for determining whether a well has produced in paying quantities, and has held that good faith of the operator is not a factor. Indeed, in *Reese Enterprises, Inc. v. Lawson*, 220 Kan. 300, 553 P.2d 885 (Kan.1976), the Kansas Supreme Court, after expressing concern that the subjective approach, which leaves the matter "to the sole judgment of the lessee," does not adequately protect a lessor from "the very real factor that the lessee may be interested in preserving his interest for speculative purposes," explained:

> In our opinion the better approach is to ... apply an objective test, where the determination of 'paying quantities' turns upon a mathematical computation. This approach recognizes the interest of both the lessor and the lessee, and it gives the lessor some protection when the burdens of the lease far exceed the meager royalty payments, when they fall below the customary delay rental.

Id. at 897 (citations omitted). The court acknowledged, however, that "application of the objective standard to a determination of whether an oil and gas lease is producting [sic] oil in 'paying quantities' under the 'thereafter' clause of the lease is not free from difficulties." *Id.* The court further stated that its opinion "should not be construed as requiring an eighteen month period of unprofitable operation to terminate an oil and gas lease," but that "[t]he time factor in the formula ... is a question we leave open," thus suggesting that a lease may be terminated based on unprofitable operation over a period of less than eighteen months. *Id.* at 899.

15 Jedlicka argues that *Young* is consistent with decisions from other jurisdictions that have adopted an objective test for determining whether a well has produced in paying quantities. Appellant's Brief at 17 (citing, *inter alia*, *Reese Enterprises*, 553 P.2d at 897) (to avoid termination of the lease, a lessee must "produce those quantities of oil or gas which will produce a profit, however small, over operating expenses, after eliminating the initial cost of drilling and equipping the well"); *Sheffield v. Exxon Corp.*, 424 So.2d 1297, 1303 (Ala.1983) ("[p]aying quantities means production in quantities sufficient to yield a return in excess of operating costs, even though drilling and equipment costs may never be repaid and the undertaking considered as a whole may ultimately result in a loss"); *Landauer, supra* (same); *Kerr v. Hillenberg*, 373 P.2d 66 (Okla.1962) (same); *Blausey v. Stein*, 61 Ohio St.2d 264, 400 N.E.2d 408 (Ohio 1980) (same); *Ross Explorations, Inc. supra* (same); *Swiss Oil Co., supra* (same); and *Vance v. Hurley*, 215 La. 805, 41 So.2d 724 (La.1949) (same)). However, simply characterizing *Young* as consistent with the law of other jurisdictions in this regard does not make it so.

Furthermore, in several instances, Jedlicka characterizes certain jurisdictions as having expressly adopted an objective test, when, in fact, the decisions cited by Jedlicka do not support her contention. For example, in *Blausey*, and *Vance*, it was not necessary for the courts to consider the good faith of the operator because the question of whether the leases produced in paying quantities was not seriously at issue; the courts determined, as a preliminary matter, that the wells in question had paid a profit. *See Blausey*, 400 N.E.2d at 410 (holding that the trial court erred in including value of appellee's labor in calculating operating expenses, and thus erred in finding the well was not profitable); *Vance*, 41 So.2d at 728 ("It is our opinion ... that the well drilled on the property of the plaintiffs is producing in paying quantities within the meaning and contemplation of the parties as set out in the terms of their contract of lease."). Interestingly, in *Vance*, the Louisiana Supreme Court took note of an apparent lack of good faith by the plaintiff-lessors:

> The plaintiffs by their own actions showed they never entertained any doubt but that the well was producing in paying quantities, for the record shows although they were not satisfied with the production of the well, they never voiced any serious complaint with respect thereto, but, instead accepted the monthly royalty payments due thereunder during more than two years and that it was only upon the expiration of the third year, and only after they had failed in their effort to collect from their leases personally under the contemporaneous agreement, that they first entertained the idea of cancelling the lease on this ground.

Id. at 727.

In *Ross Explorations*, the Arkansas Supreme Court specifically declined to consider the appellant's assertion that the trial court erred in refusing to apply a "reasonably prudent operator rule" to determine whether a well had produced in paying quantities, noting that the argument had not been raised before the trial court and the absence of the trial court's ruling constituted a procedural bar to the court's review. 8 S.W.3d at 516.

Finally, in *Kerr*, the Oklahoma Supreme Court did not apply an objective test for determining whether a well had produced in paying quantities. Indeed, it did not consider the issue of paying quantities, noting that, if the plaintiffs were entitled to prevail, it was "because of the cessation of actual production." 373 P.2d at 69. The court ultimately concluded the temporary cessation in production did not operate to terminate the lease where the lessee made persistent and good faith efforts to repair the mechanical problems that caused the cessation of production.

16 Kansas is the only jurisdiction that has seemingly established an arbitrary time period over which to measure profits. *See Reese Enterprises, supra* n. 14.

17 Jedlicka also cites *Buehler v. Angle*, 79 P.3d 1093 (Kan.App.2003), for the proposition that nine months is a reasonable period to use in determining paying quantities; however, that decision is unpublished and non-precedential, and, in any event, the court recognized that rigid fixed terms are disfavored, and limited its conclusion to the facts of that case.

18 We note that, in cases which expressly provide for consideration of an operator's good faith judgment, some courts have held the good faith judgment of an operator should be considered as a preliminary factor in determining whether a well has produced in paying quantities, *see Clifton*, 325 S.W.2d at 691 ("In determining paying quantities ... the trial court necessarily must take into consideration all matters which would influence a reasonable and prudent operator."), while others have suggested that a determination that an operator has operated a well in good faith may save a lease from termination following a determination that a well did not produce in paying quantities, *see Pack*, 869 P.2d at 327 ("[T]he lease continues in existence so long as the interruption of production in paying quantities does not extend for a period longer than reasonable or justifiable in light of the circumstances involved."). In Pennsylvania, we find this to be a distinction without a difference. A lease terminates when it ceases to produce in paying quantities, but, as discussed herein, that determination incorporates an operator's good faith judgment.

1 Most courts and commentators have construed "cost," in this sense, to refer to the expenditures associated with drilling, completing, or equipping the well. *See, e.g.*, OWEN L. ANDERSON ET. AL., HEMINGWAY OIL AND GAS LAW AND TAXATION N 253 (4th ed. Thompson West 2004). Operating or "lifting" expenses, in contrast, have generally been understood to include: "labor costs of pumpers and others operating equipment on the lease; day-to-day power and supplies; severance taxes; ad valorem taxes; license and permit fees; replacement and repair of producing equipment, maintenance and repairs of roads, entrances, and gates; and electricity and telephone costs." *Id.* at 258 (footnotes omitted).

2 One commentator has similarly set forth the reasoning behind the marginal profitability requirement, stating that:

> [R]equiring the value of production to exceed only the operating expenses is another way of saying that the lessee might sustain an overall loss on the leased premises and still maintain the lease in full force. The object of providing for a continuation of the lease for an indefinite time during the secondary term after the expiration of the primary term is to allow the lessee to reap the full fruits of the investments made by him in developing the property. This objective is met, in regard to the habendum clause, by defining paying quantities so as to allow a lessee who is making a profit over the actual cash which must be expended to produce the lease (and who is thus reaping rather than speculating) to continue operating in order to recover at least some of the expenses of drilling and equipping, although he may never make a profit on the overall operation. Thus the definition serves to minimize loss.

Gross, *Meaning of "Paying Quantities"*, 43 A.L.R.3d 8 at § 4[b] (footnote omitted).

3 *See Clay*, 274 P.2d at 548 ("Having held that the operator is under a duty to continue production if by the exercise of reasonable skill and diligence the well could be made to produce sufficient oil and gas to justify a reasonable and prudent operator in continuing the operation thereof, we believe the operator should have the right to continue production under the same circumstances.").

4 In later cases, such as *Pack*, the Oklahoma Supreme Court summarized this principle as follows:

> In short, the lease continues in existence so long as the interruption of production in paying quantities does not extend for a period longer than reasonable or justifiable in light of the circumstances involved. But under *no* circumstances will cessation of production in paying quantities *ipso facto* deprive the lessee of his extended-term estate.

Pack, 869 P.2d at 327 (emphasis in original).

5 *See generally* 17A AM.JUR.2D*Contracts* § 358 (2011) ("Words and phrases as used in particular contracts are to be interpreted in accordance with the meaning with which they have been invested by the parties. When, at the time of formation, the parties attach the same meaning to a contract term and each party is aware of the other's intended meaning, or has reason to be so aware, the contract is enforceable in accordance with that meaning." (footnote omitted)).

6 *See, e.g., Manhattan Oil Co. v. Carrell*, 164 Ind. 526, 73 N.E. 1084, 1086–87 (Ind.1905) (holding that an operator is not required to drill additional wells merely because the profits from the first or test well exceeded the operating expenses; rather, under those circumstances, "whether or not oil is found in paying quantities [so as to mandate further drilling] is ... exclusively to be determined by the operator, acting in good faith and upon his honest judgment") (citing, *inter alia, Young*, 194 Pa. at 243, 45 A. at 121); *Barbour, Stedman & Co. v. Tompkins*, 81 W.Va. 116, 93 S.E. 1038, 1040 (W.Va.1917) ("The grantor of a right to explore his land for oil and gas cannot forfeit the lese merely because he thinks the quantity of gas discovered therein was not sufficient to constitute a paying well, where the lessee claims it is such a well and is willing to pay the rent stipulated thereto. It is for [the lessee] to say, when acting in good faith, whether the gas is produced in paying quantities." (citing, among other cases, *Young*, 194 Pa. at 243, 45 A. at 121)); *Tex. Pac. Coal & Oil Co. v. Bruce*, 233 S.W. 535, 538–39 (Tex.Civ.App.1921) ("If the well pays a profit, even small, over operating expenses, it produces in paying quantity, though it may never repay its cost, and the operation as

a whole may result in a loss. The phrase 'paying quantities,' therefore, is to be construed with reference to the operator, and by his judgment, when exercised in good faith." (quotation marks omitted; citing, *inter alia, Young,* 194 Pa. at 243, 45 A. at 121)); *Gypsy Oil Co.*, 248 P. at 334 ("If a well pays a profit, even small, over operating expenses, it produces in paying quantities, though it may never repay its costs, and the enterprise as a whole may prove unprofitable. Ordinarily, the phrase ['paying quantities'] is to be construed with reference to the operator, and by his judgment when exercised in good faith," (citing, among other cases, *Young,* 194 Pa. at 243, 45 A. at 121)).

7 *See, e.g.*, Gross, *Meaning of "Paying Quantities"*, 43 A.L.R.3d 8 at §§ 10–11 (distinguishing between the lessee's good-faith judgment test and the reasonably prudent operator standard); Gary B. Conine, *The Prudent Operator Standard: Applications Beyond the Oil and Gas Lease*, 41 NAT. RESOURCES J. 23, 31 (2001) (same); Jacqueline Lang Weaver, *When Express Clauses Bar Implied Covenants, Especially in Natural Gas Marketing Scenarios*, 37 NAT. RESOURCES J. 491, 500 (1997) (same); Bruce M. Kramer, *The Interaction Between the Common Law Implied Covenants to Prevent Drainage and Market and the Federal Oil and Gas Lease*, 15 J. ENERGY NAT. RESOURCES & ENVTL. L. 1, 6 (1995) (same); Stuart C. Hollimon & Robert E. Vinson, Jr., *Oil, Gas and Mineral Law*, 46 SMU L.REV. 1591, 1600 (1993) (same).

8 Unfortunately, some commentators have referred to the reasonably prudent operator standard as a "subjective approach," *see, e.g.*, ANDERSON, OIL AND GAS LAW at 255, and the majority repeats that language here. *See* Majority Opinion, *slip op.* at 19. Couching the reasonably prudent operator standard in such terms, however, is misleading, if not wholly inaccurate, since courts have almost universally viewed that inquiry as an objective one. *See e.g.*, 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, 161–62 (2008–09) ("The great majority of oil and gas jurisdictions apply the prudent-operator standard.... The standard is an objective one [.]"). *See generally* Kathleen Cooper Lake, *The Prudent Operator Standard and FERC Authority*, 57 TEX. L.REV. 661, 662 n. 8 (1979) (analogizing the prudent operator standard to the reasonable man standard in tort law).

Even so, it does not appear that these observers intended to depart from the traditional meaning of the reasonably prudent operator standard, that is, as a set of non-exclusive, objective criteria to assess if a marginal well is producing in "paying quantities"; rather, by denoting it as a "subjective approach," it seems that they sought to distinguish it from the test (as manifested in *Young*) where the main focus of a paying-quantities inquiry is whether the well's profits exceeded its operating expenses. *See* ANDERSON, OIL AND GAS LAW at 255 (positing that *Koontz* established a "subjective approach" which "allow[ed] a marginal well to continue a lease *even where it is produced at a loss* " (emphasis added)). As such, I do not view this authority as undermining the common understanding of the reasonably prudent operator standard.

9 At least one commentator has posited that *Koontz* provides a ready example of this perspective. *See* Gross, *Meaning of "Paying Quantities"*, 43 A.L.R.3d 8 at § 11 (explaining that that ruling did not elaborate on the lessee's good-faith judgment test, but instead, apparently jettisoned it in favor of the reasonably prudent operator standard).

10 Perhaps one of the most troubling aspects of the majority opinion is the removal of this check upon a mere finding of marginal profitability. *See* Majority Opinion, *slip op.* at 22 ("[I]f a well consistently pays a profit, however small, over operating expenses, it will be deemed to have produced in paying quantities.").

11 *Compare, e.g., Tex. Pac. Coal & Oil Co.*, 233 S.W. at 538–39, *with, e.g., Zeller v. Book*, 1905 WL 1178, at *2 (Ohio Ct .App. Apr. 29, 1905) ("It is presumed of course that he will operate in his own interest, and so long as he is acting in good faith and making an effort to get some production out of the well, he has a right to go forward and decide for himself," (citing *Young*, 194 Pa. at 243, 45 A. at 121)); 2 Summers Oil & Gas § 14:14 & n. 1 (3d. ed.2010) (finding that *Young* is one of the many courts that have expressed the view that whether a well is producing in "paying quantities" "depends solely upon the good-faith judgment of the lessee"); Gross, *Meaning of "Paying Quantities"*, 43 A.L.R.3d 8 at § 10 & n. 12 (same).

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