

11/12/2015 | Articles

## Read Carefully: When the royalty language of an oil and gas lease and an operator's failure to strictly comply will lead to forfeiture

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Two Ohio Appellate Court decisions issued this summer about failure to pay leasehold royalties highlight the need for oil and gas operators to carefully write, read, and comply with the terms in their leases — or risk forfeiture of the same.

In *Armstrong v. Chesapeake Exploration, L.L.C.*, the Court of Appeals of Ohio, Fifth Appellate District, Tuscarawas County, declined to overrule a trial court's refusal to terminate a lease for non-payment of royalties. 2015-Ohio-3310 (Aug. 14, 2015). The lease required a 1/8 royalty be paid by the lessee for all oil and or gas produced from the leased property. *Id.* at 4. The property was unitized, but no well was drilled, and no royalties were ever paid under the lease. *Id.* at 5–7. The Court pointed out that the lease lacked an express forfeiture provision for non-payment of royalties and held that “absent specific language in the lease, non-payment of royalties is not grounds for cancellation of an oil and gas lease.” *Id.* at 19–20. The Court indicated that the proper remedy was an action for damages, not forfeiture or cancellation, and that its holding was supported by several precedential cases. *Id.* at 19–20, and 21, citing *Black Diamond Coal Co., v. Buckeye Petroleum Co.*, 4th Dist. Athens App. No. CA-1271, 1986 WL 12952 at \*3 (1986).

Conversely, the Court of Appeals of Ohio, Fourth Appellate District, Washington County, held earlier this summer that non-payment of the minimum royalty required by the lease was sufficient to cause forfeiture. *Sims v. Anderson*, 2015-Ohio-2727 (June 30, 2015). The lease at issue stated that a well must be drilled and the lease must be producing oil or gas in paying quantities by July 1, 1977. *Id.* at 3. The lease defined “paying quantities” as “production sufficient to net the Lessors a minimum of \$400 royalty per year ...” *Id.* The Lessee paid the minimum annual royalty until 2012, when only partial payment was made. *Id.* at 3–4. In the spring of 2013, the Lessors informed the Lessee that the lease had terminated and filed an Affidavit of Forfeiture to which the Lessee responded by filing an Affidavit of Non-Forfeiture. *Id.* at 5. The trial court held that forfeiture, a remedy in equity, was unnecessary given that sufficient legal remedies were available and given that the Lessee failed to pay only \$8.55 of the minimum royalty. *Sims v. Anderson*, 2015-Ohio-2727, at 6.

On appeal, the District Court reversed, holding that when a lease contains an express forfeiture clause, as in this case, the failure to perform a contractual duty triggers said clause. *Id.* at 14. While the Lessee argued that he substantially complied with the royalty term of the lease, the Court stated that “where the performance of a term is essential to the purpose of the contract, a default of that term is not excusable no matter how trifling.” *Id.* at 17. Further, though the Court pointed out that affirmative defenses, including estoppel, may apply in certain cases, the Lessors acceptance of payment in this case did not estop them from terminating the lease, as they were entitled to the payment. *Id.* at 27–28.

Though the holdings in these two cases seem to contradict each other, they actually illuminate an important factual distinction. The *Armstrong* Court pointed out that the distinguishing feature of the lease at issue in *Sims* was that it contained an express forfeiture provision, while the lease in *Armstrong* did not. *Armstrong v. Chesapeake Exploration, L.L.C.*, 2015-Ohio-3310, at 21. These cases illustrate when Ohio courts will find that forfeiture of an oil and gas lease is an appropriate remedy for a Lessee's failure to pay royalties. In determining whether forfeiture is

appropriate, a court will carefully read and rely on the plain language of the lease in question and strictly enforce the terms contained therein. Accordingly, operators should draft their leases with particularity and carefully read the leases which they acquire to ensure that their attempts at compliance are sufficient to avoid triggering any forfeiture clause contained therein.

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