

Publications

Oil and Gas Alert: Ohio Court of Appeals Issues Decision on Scope of Granting Clause, Effect of Well Permit Application on Lease Terms and Lessee's Fiduciary Duties

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On October 26, 2015, the Ohio Fifth District Court of Appeals in *K and D Farms, Ltd, et al. v. EnerVest Operating, L.L.C., et al.* addressed several issues concerning oil and gas leases in Ohio. In its decision, the Court held that: (1) the granting clause of an oil and gas lease that does not contain any limitation as to geological formation grants the oil and gas rights to all depths, (2) a well permit application submitted to the ODNR cannot alter the terms of the parties' contractual agreement regarding the distribution of royalties in a consolidated unit, (3) the use of the word "agent" in an oil and gas lease, standing alone, does not create a fiduciary relationship between a lessor and lessee, and (4) a lessee's obligation to pay royalties in an oil and gas lease is contractual in nature and claims in tort for the recovery of purely economic damages for non-payment of royalties are barred by the economic loss rule.

The Fifth District includes such counties as Coshocton, Guernsey, Holmes, Muskingum, Stark and Tuscarawas.

[Click here](#) to read the decision.

Background

On July 16, 2013, plaintiffs (landowner-lessors) filed suit against defendants (lessees and co-landowners-lessors) asserting claims for declaratory relief, breach of contract, and breach of fiduciary duty. The crux of the lawsuit was plaintiffs' belief that they were entitled to 100% of landowner royalties for certain wells drilled within a voluntary consolidated unit.

The case involved two leases that contained an identical provision authorizing a consolidation of both leases into a single development unit and that, upon consolidation, all royalties produced from the unit shall be divided amongst all lessors proportionally based on their acreage in the consolidation.

The leases were consolidated into single, 228-acre development unit in 1954. Five Clinton Sandstone wells were drilled in the consolidated unit from 1954 through 1980 and two Rose Run wells were drilled in 2007 and 2012. The two Rose Run wells were drilled on the plaintiff-lessors' acreage within the consolidation. The defendant-lessors were not included as royalty owners in the well permit application submitted to the ODNR for the first Rose Run well. As a result, the plaintiffs claimed that the consolidation was abrogated and they were entitled to 100% of the landowner royalties for wells drilled on their acreage. In support of this contention, the plaintiffs argued that the leases and consolidation were limited to the Clinton Sandstone formation.

On February 27, 2015, the trial court granted the defendants' motion for judgment on the pleadings on all claims based on the unambiguous language of the leases, which authorized the consolidation and required the distribution of royalties to all lessors who have an interest in the consolidation. The trial court further held that a well permit application submitted to the ODNR cannot abrogate or modify an oil and gas lease and that the plaintiffs' tort claims based on the lessees' alleged failure to pay royalties were subsumed by their breach of contract claims and barred by the economic loss rule.

The plaintiffs appealed the trial court's decision on March 10, 2015.

THE APPEAL

The Fifth District Court of Appeals affirmed the trial court's ruling on all grounds. In its decision, the Court of Appeals issued several rulings:

- The unambiguous language of an oil and gas lease and consolidation cannot be altered by allegations of parol evidence evidencing a contrary intent;
- If the granting clause of an oil and gas lease does not contain terms limiting the depth or formation, the rights are granted as to all depths;
- The omission of certain royalty owners on a single well permit application does not alter the provisions of the parties' lease or a recorded consolidation;
- The use of the word "agent" in an oil and gas lease does not alone create a fiduciary duty between a lessor and lessee;
- Fiduciary duty claims seeking recovery of contractual royalties are subsumed by a breach of contract claim and are barred by the economic loss rule; and
- A lessee does not "wrongfully unitize" a lessors' acreage where a lease authorizes a consolidation and requires the lessee to distribute royalties to all interest holders.

The lessees were represented by Vorys attorneys John Keller, Thomas Fusonie, and Steven Chang.

QUESTIONS

If you have any questions about the Fifth District Court of Appeals' decision, please contact: Thomas Fusonie (614.464.8261), John Keller (614.464.6389), Greg Russell (614.464.5468), or Steven Chang (614.464.5484).