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ENERGY LAW—NOT BALANCING WELL INTERESTS WELL: HOW THE SUPREME COURT OF PENNSYLVANIA MISMANAGED OIL AND GAS LEASE POLICY IN *T.W. PHILLIPS GAS & OIL CO. V. JEDLICKA*

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INTRODUCTION

A. *The Real-Life Implications and Interests at Stake in Litigation Over the Proper Interpretation of In Paying Quantities*

The interests at odds in oil and gas lease law are several and intricate. To better understand the sundry perspectives, I offer a hypothetical: envision Will, a college graduate from a small farming community in north-central Pennsylvania.¹ After months of looking for work after graduation, Will found a position as a “landsman”² for Good-Faith Oil and Gas Co. Will has been extremely successful working for Good-Faith because he empathizes with the hardships facing the farming communities he negotiates with.

Now picture Jim, a farmer with two-hundred acres of underperforming corn, wheat, and pumpkin fields. Until the local coal-plant closed two years ago, Jim worked in the coal industry to subsidize his meager income. Afraid of losing his family farm, Jim was looking for any opportunity available to make extra money.

By lucky coincidence, Will and Jim met. Will brought the standard-form lease he gives to landowners to sign when he believes Good-Faith Oil and Gas Co. would benefit from the property. The lease provides the usual wording, including the term of the lease being set for five years “and as long thereafter as oil or gas . . . are produced *in paying quantities*.”³ Such language is standard for a *habendum* clause⁴ in oil and gas leases. Most lessors do not question Will when he reads the

1. This hypothetical bares some inspiration from the movie *Promised Land* written by and starring Matt Damon and John Krasinski. *PROMISED LAND*, FOCUS FEATURES, http://www.focusfeatures.com/promised_land (last visited Feb. 16, 2014).

2. David Levdansky, *Oil and Gas Leases: A Guide for Pennsylvania Landowners*, PA HOUSE, http://www.pahouse.com/pr/039-Leasing_NL.pdf (last visited Feb. 16, 2014) (using industry jargon to describe an employee for an oil and gas company who negotiates leases with landowners).

3. See, e.g., *Multi-State Lease Form*, KANES FORMS, <http://kanesforms.com/forms-programs/sample-forms-field-landman.html> (follow “Pennsylvania Rental” hyperlink) (last visited Feb. 16, 2014). *In paying quantities* is the pseudo-ambiguous phrase, the meaning of which is discussed in this Note.

4. See generally JOHN S. LOWE, *OIL AND GAS LAW IN A NUT SHELL* 191 (4th ed. 2003) (“The habendum clause of an oil and gas lease, sometimes called the ‘term’ clause, sets the period of time for which the rights given in the granting clause will extend.”).

Modern lease habendum clauses provide for a primary term and a secondary term. The *primary term* of an oil and gas lease is a fixed term of years during which the lessee has the right, without any obligation, to operate on the premises. The *secondary term* is the extended period of time for which rights are granted to the lessee once production is obtained.

Id.

lease to them. After all, Will explains to the landowners how much money they stand to make in the lease and the landowner, understandably, wants the money to come in for as long as possible. Will explained to Jim that Good-Faith could offer him five dollars an acre-per-year rental fee plus a one-eighth royalty fee on all oil and gas produced from his land.⁵

Two years after signing, no drilling, or oil or gas production had occurred on Jim's land. While he had not received any royalty payments, the rental fee alone helped him keep his farm out of the bank's hands. In the third year of the definite term of the lease, Good-Faith drilled four traditional oil and gas wells. Further, the company was able to produce a significant amount of natural gas in the first five years of drilling, providing Jim with nearly two million dollars in royalty payments. Jim was thrilled with the money, going from a down-on-his-luck farmer to an affluent landowner. With the new money, Jim was able to fulfill his dream of buying dairy cows to show in competitions.

After ten years, the wells on Jim's land slowed in production, prompting Good-Faith Oil and Gas Co. to fracture the wells to boost output. Jim was unhappy about the hydraulic fracturing. He had grown skeptical about the unknown effects that the chemicals in the hydraulic solutions may have on his farm. The fracturing continued, apparently, without incident.

Unfortunately, Jim's prized show cow died after drinking water from a field near the farm's fractured sites.⁶ Jim is not positive, but he believes his cow died from drinking a chemical in the fracturing solution on his land. Compounding disappointment, the fourteenth year of production was an unsuccessful one for Good-Faith Oil and Gas Co., failing to produce a profit over their operating expenses. After the first half of the fifteenth year, and an eighteen-month net loss, Good-Faith Oil and Gas Co. wanted to re-fracture the wells on Jim's land and drill two new wells. Jim—fearing for the lives of his show cows—opposed

5. 58 PA. STAT. ANN. § 33 (West 1979) (repealed 2013) (“A lease or other such agreement conveying the right to remove or recover oil, natural gas or gas of any other designation from lessor to lessee shall not be valid if such lease does not guarantee the lessor at lease [sic] one-eighth royalty of all oil, natural gas or gas of other designations removed or recovered from the subject real property.”). The numbers used in the hypothetical are strictly fictitious but do represent an accurate example of the profit potential in a large tract of land in rural Pennsylvania. *See generally Oil and Gas Investing FAQ*, BLACKBEARD DATA SERVICES, <http://blackbearddata.com/oil-and-gas-royalties-what-they-are> (last visited Feb. 16, 2014).

6. *See* Barry Estabrook, *Fracking with Our Food: How Gas Drilling Affects Farming*, GRIST (May 20, 2011, 12:48 AM), <http://grist.org/natural-gas/2011-05-19-fracking-with-our-food-how-gas-drilling-affects-farming/> (telling the story of Ken Jaffe, a cattle farmer from the Catskills in New York, with much hyperbole and fear mongering against “fracking”).

the most recent hydraulic fracturing. He filed an injunction and an action to quiet title against Good-Faith Oil and Gas Co. Alleging the lease terminated after the fourteenth year's failure to produce oil and gas in paying quantities, Jim believes Good-Faith Oil and Gas Co. no longer has a right to produce oil and gas on his land.

Good-Faith Oil and Gas Co. believed the lease was still in effect because there were several successful months within the generally unprofitable last eighteen months. They argue the land was producing marginally, and the lease, therefore, continues based only on their own subjective good faith. There is no evidence indicating that Good-Faith is holding Jim's lease just for speculation. Further, Good-Faith alleges Jim only wants out of the original lease so he can renegotiate a higher rental fee to support his new lavish lifestyle.

The jurisdiction that such a hypothetical is heard in may be determinative of the outcome. The hypothetical interests at odds must all be properly factored into decisions relating to oil and gas law in Pennsylvania.⁷ The Supreme Court of Pennsylvania failed to properly value the landowners' interests in favor of protecting those of the oil and gas industry in the majority opinion of *T.W. Phillips Gas and Oil Co. v. Jedlicka*.⁸ The imbalance will be shown through the lens of Jim versus Good-Faith.

In 2012, the Supreme Court of Pennsylvania endeavored to bring the 1899 decision in *Young v Forest Oil Co.*⁹ into the twenty-first century via *T.W. Phillips Oil & Gas Co. v. Jedlicka*.¹⁰ By implementing the good faith business judgment standard as the criterion for determining whether an oil and gas lease is producing "in paying quantities," the court failed to heed guidance from oil and gas law developments in other producing states.¹¹ The business judgment standard states that so long as an oil and gas company subjectively

7. Jim, as the farm owner, and Good-Faith Oil and Gas Co., as the company trying to extract as much money as possible from the land while employing good people like Will, have serious interests in the proper handling of oil and gas litigation.

8. 42 A.3d 261, 263 (Pa. 2012). See Dale A. Tice, *Opening Pandora's Box? Calling Shale Gas Rights into Question*, THE PA. LAW., Mar.-Apr. 2012, at 24, 24 ("As a general rule, lawyers like predictability and consistency in the law. While there may be instances where ambiguity can create opportunities for creative lawyering, when it comes to black-letter property law, uncertainty is anathema for attorneys. This is particularly true when lawyers are counseling clients regarding property as valuable as Marcellus Shale gas rights."); see also State Natural Gas Act, S. 3437, 112th Cong. (as sponsored by Sen. Robert Casey Jr. [D-PA], referred to committee, July 25, 2012) (promoting natural gas production and development).

9. 45 A. 121 (Pa. 1899). *Young* was the first case to interpret the meaning of *in paying quantities* and has been the key authority on the subject since it was decided. See *infra* Part. I.

10. 42 A.3d 261 (Pa. 2012).

11. See *id.* at 276.

believes that it is continuing production activities for a profit, the lease will continue.¹² Furthermore, the standard places an excessive burden of proof on a landowner attempting to terminate a lease due to unprofitable production.¹³ By enforcing such stringent requirements for terminating a lease, and incorporating a subjective good faith component, the Supreme Court of Pennsylvania encourages a significant imbalance among various interests at odds in oil and gas lease litigation. A test, like the “reasonably prudent operator standard,”¹⁴ would be more appropriate for regulating production quantities, and henceforth, promoting impartiality in assessment of oil and gas lease litigation.¹⁵ The reasonably prudent operator standard is utilized in other states, which have found persuasive value in *Young v Forest Oil Co.*¹⁶

This Note will examine how courts interpreted the term *in paying quantities* prior to *Jedlicka*. It will further argue that the good faith business judgment standard was inappropriately included in the test for determining when an oil and gas lease is producing in paying quantities and thereby created indefinite terms in oil and gas leases.¹⁷ Part I describes the opinion of *Young v. Forest Oil Co.*, which first decided the

12. *Id.*

13. *Id.* at 272 (“[I]n assessing whether a lease is producing in paying quantities, *Young* places the principal focus on the good faith judgment of the operator.”).

14. *See, e.g., Clifton v. Koontz*, 325 S.W.2d 684, 691 (Tex. 1959) (“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.”).

15. The applicability of the term in paying quantities is imperative because Pennsylvania has a statutorily mandated minimum royalty clause. 58 PA. STAT. ANN. §§ 33-34 (West 2012). As all Pennsylvania oil and gas leases must have a royalty clause, the cessation of production in the indeterminate period of a lease will result in termination. *See Jacobs v. CNG Transmission Corp.*, 332 F. Supp. 2d 759, 793 (W.D. Pa. 2004). “If any provisions in the lease make the value of the lease increase with production, then the duration of the lease during the secondary term is to be construed as contingent on production in paying quantities unless a clear intent to the contrary is expressed in the lease.” *Id.* (citing *Clark v Wright*, 166 A. 775, 776 (Pa. 1935) (“[L]ease obligating lessee to \$300 per annum for each gas well from which gas is marketed made value of lease dependent upon marketing of gas and properly was interpreted by rules governing royalty-based leases.”)).

16. 45 A. 121 (Pa. 1899). *See, e.g., Koontz*, 325 S.W.2d at 691 (holding if a well produces a profit over operating expenses it is producing in paying quantities, but in the case of a marginal well the reasonably prudent operator standard applies).

17. Note that an oil and gas lease subject to an indefinite term such as so “long thereafter as oil or gas is produced in paying quantities,” are in the nature of a fee simple determinable. *Jedlicka*, 42 A.3d at 264. Therefore, while the reversionary event may or may not happen within twenty-one years, a fee simple determinable is not subject to the rule against perpetuities in Pennsylvania. 20 PA. CONS. STAT. ANN. § 6104(b) (West 2006) (“Upon the expiration of the period allowed by the common law rule against perpetuities as measured by actual rather than possible events, any interest not then vested and any interest in members of a class the membership of which is then subject to increase shall be void.”).

test for determining when a lease was producing in paying quantities. Part I.B is a case study of the language used in *Young* through decisions by other states in developing the reasonably prudent operator standard—which this Note will argue is the proper test to analyze whether a well is producing in paying quantities. Part II proposes that the good faith business judgment standard, imputed by the *Jedlicka* majority, makes the indefinite term in a *habendum* clause nearly impossible to terminate, creating an unwarranted and unfair balance among the interested parties.

B. *Oil, Gas, and the Importance of Marcellus Shale*

Oil and gas leases are integral cogs in transitioning energy from an untapped resource in the ground to a fuel source heating Americans' homes during cold winters. Without proper law governing oil and gas leases the system cannot work efficiently. While renewable energy is the likely future of the energy field, oil and natural gas are the champions of the present.¹⁸ The exponential growth of natural gas production can be seen in Pennsylvania thanks to the improved viability of Marcellus Shale.¹⁹ The increased production is significantly lowering the price of natural gas.²⁰ These lower gas prices benefit homeowners who rely on natural gas to heat their homes.²¹ However, a by-product of the increased abundance of natural gas is an increased number of oil and gas leases. This increase has, not surprisingly, led to a profusion of

18. Tiffany Hsu, *US to Become World's Largest Oil Producer by 2020*, *IEA Says*, L. A. TIMES (Nov. 12, 2012, 9:20 AM), <http://www.latimes.com/business/money/la-fi-mo-u.s.-oil-producer-saudi-arabia-iea-20121112.0.6181922.story> (“Recently . . . an ‘energy renaissance’ in the U.S. has caused a boost in oil, shale gas and bio-energy production due to new technologies such as hydraulic fracturing, or fracking. Fuel efficiency has improved in the transportation sector. The clean energy industry has seen an influx of solar and wind efforts.”).

19. *Horizontal Drilling Boosts Pennsylvania's Natural Gas Production*, U.S ENERGY INFO. ADMIN. (May 23, 2012), <http://www.eia.gov/todayinenergy/detail.cfm?id=6390> (“Between 2009 and 2011, Pennsylvania's natural gas production more than quadrupled due to expanded horizontal drilling combined with hydraulic fracturing.”). Moreover,

[t]he Marcellus Shale gas formation is rich in natural gas resources. It is one of the largest shale regions in the United States; Marcellus shale and [sic] is estimated to be the second largest natural gas find in the world. Stretching across New York, Pennsylvania, West Virginia, Ohio and Maryland, the United States Geological Survey (USGS) estimates the formation's total area to be around 95,000 square miles, ranging in depth from 4,000 to 8,000 feet. The 400 year-old rock Marcellus shale formation is estimated to contain more than 410 trillion cubic feet of natural gas and could supply U.S. consumers' energy needs for hundreds of years.

Marcellus Shale, ENERGYFROMSHAPE (June 30, 2012), <http://www.energyfromshale.org/hydraulic-fracturing/marcellus-shale-gas#sthash.L2Qx7KYM.dpuf>.

20. U.S ENERGY INFO. ADMIN., *supra* note 19.

21. *Id.*

litigation.²² Until recently, oil and gas case law has remained stagnant in Pennsylvania, the first state with an oil well.²³ Recent litigation over the leases in the state will further develop common law in oil and gas's original home.

While there are serious environmental concerns, hydraulic fracturing has significantly advanced drilling potential and gas production.²⁴

As a result of the growing use of hydraulic fracturing, natural gas production in the United States reached 21,577 billion cubic feet in 2010, a level not achieved since a period of high natural gas production between 1970 and 1974. Overall, the Energy Information Administration now projects that the United States possesses 2,552 trillion cubic feet of potential natural gas resources, enough to supply the United States for approximately 110 years.²⁵

Further, the method of hydraulic fracturing requires injecting fluid solutions into hard-to-reach domestic energy sources "to increase the permeability of the shale formation so that gas is able to migrate towards the well."²⁶ Of significant economic importance, the development of natural gas production within the Marcellus Shale formation may provide "employment gains [to more than] 280 thousand [workers] in 2020."²⁷ The myriad interests at stake in oil and gas law must *all* be factored into decisions arising out of, and affecting, Marcellus Shale development.

Oil and gas law in natural-gas-rich Pennsylvania cannot be discussed without addressing the serious environmental concerns

22. See, e.g., *Jedlicka*, 42 A.3d at 277 (warning of lessees abusing the justice system in order to renegotiate lease terms).

23. See 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 L. 47, 48 (2011) ("Despite early contributions to the national body of oil and gas law, the development of Pennsylvania oil and gas case law slowed considerably throughout the twentieth century, reflecting the relative decline of the industry in the state.").

24. See H.R. COMM. ON ENERGY AND COMMERCE, 112TH CONG., CHEMICALS USED IN HYDRAULIC FRACTURING 2 (Minority Staff) (April 2011), available at <http://democrats.energycommerce.house.gov/sites/default/files/documents/Hydraulic-Fracturing-Chemicals-2011-4-18.pdf> (last visited Feb. 16, 2014).

25. *Id.*

26. *How Hydraulic Fracturing Works*, SWARTHMORE C., <http://www.swarthmore.edu/academics/environmental-studies-capstone-/how-hydraulic-fracturing-works.xml> (last visited Feb. 16, 2014).

27. TIMOTHY J. CONSIDINE, THE ECONOMIC IMPACTS OF THE MARCELLUS SHALE: IMPLICATIONS FOR NEW YORK, PENNSYLVANIA, AND WEST VIRGINIA: A REPORT TO THE AMERICAN PETROLEUM INSTITUTE 33 (2010), available at <http://www.api.org/~media/Files/Policy/Exploration/API-Economic-Impacts-Marcellus-Shale.ashx> (last visited Feb. 16, 2014).

surrounding hydraulic fracturing. Hydraulic fracturing, or “fracking,” is the process by which oil and gas companies pump pressurized liquid solutions into shale formations to free trapped natural gas.²⁸ The process has increased the viability of shale formations such as the Marcellus Shale in Pennsylvania and neighboring states.²⁹ The environmental impact from hydraulic fracturing is not fully known, but criticisms of what is known are abundant and popular.³⁰ The facts oil and gas companies leave ambiguous about hydraulic fracturing are often the most worrisome.³¹ The House of Representatives Committee on Energy and Commerce Minority Staff reported,

[i]n many instances, the oil and gas service companies were unable to provide . . . a complete chemical makeup of the hydraulic fracturing fluids they used. Between 2005 and 2009, the companies used 94 million gallons of 279 products that contained at least one chemical or component that the manufacturers deemed proprietary or a trade secret. Committee staff requested that these companies disclose this proprietary information. Although some companies did provide information about these proprietary fluids, in most cases the companies stated that they did not have access to proprietary information about products they purchased “off the shelf” from chemical suppliers. In these cases, the companies are injecting fluids containing chemicals that they themselves cannot identify.³²

The impact of hydraulic fracturing on water supplies has also inspired legislators to propose new laws hoping to limit harmful consequences.³³ Understandably, anxieties over hydrofracking may justify a landowner trying to terminate an oil and gas lease. In an effort to find a way out of such a lease, a landowner may look to a lack of production on the land as an avenue to get out of a now unfavorable agreement.

The *habendum clause*'s inclusion of the term *in paying quantities*

28. *Hydraulic Fracturing-The State of the Science*, U.S. GEOLOGICAL SURV., http://www.usgs.gov/solutions/2012_june8.html (last visited Feb. 16, 2014).

29. *Id.*

30. Even celebrities have taken to the media in order to expound their critiques of the contentious practice. See, e.g., Alec Baldwin, *Fracking: What Cuomo Won't (or Can't) Tell You*, HUFFINGTON POST: THE BLOG (July 25, 2012, 2:53 PM), http://www.huffingtonpost.com/alec-baldwin/fracking-natural-gas_b_1703190.html?utm_hp_ref=homepage (Alec Baldwin is an outspoken opponent of the fracking industry).

31. See generally H.R. COMM. ON ENERGY AND COMMERCE, *supra* note 24.

32. *Id.*

33. FRAC Act, S. 587 and H.R. 1084, 112th Cong. (referred to committee, March 15, 2012) (while unlikely to be passed, the “Fracturing Responsibility and Awareness of Chemicals Act of 2011 - Amends the Safe Drinking Water Act to repeal the exemption from restrictions on underground injection of fluids”).

requires definition in order for a landowner and oil and gas company to properly understand the contracts around which they act. Courts in Pennsylvania and other states have tried to come up with a working definition of *in paying quantities*.³⁴ Pennsylvania has failed to follow the beneficial guidance of other states.

I. THE DEVELOPMENT OF CASE LAW SURROUNDING THE PROPER INTERPRETATION OF WHEN OIL AND GAS IS PRODUCED *IN PAYING QUANTITIES*

Analysis of the contractual phrase “in paying quantities” began in 1899 with the Supreme Court of Pennsylvania’s opinion in *Young v. Forest Oil Co.*³⁵ After discussing *Young* itself, Part I shows how sister states have utilized the language in *Young* to interpret “in paying quantities” to contain both an objective test and, in the case of marginal wells, a reasonably prudent operator standard.³⁶ Finally, Part I offers a brief background to the 2012 Supreme Court of Pennsylvania decision in *T.W. Phillips Gas and Oil Co. v. Jedlicka*. Understanding the three opinions in the decision is critical to fathom the complexity of what *in paying quantities* means in an oil and gas lease. The majority opinion, by Justice Todd, the concurring opinion, by Justice Eakin, and the dissenting opinion, by Justice Saylor, demonstrate the myriad of issues at stake when trying to calculate what it means for oil and gas to be produced in paying quantities.³⁷

A. *The Language in Young v. Forest Oil Co. Supports the Application of Joint Objective and Subjective Test to Determine if Land is Producing “In Paying Quantities”*

The 1899 decision in *Young v. Forest Oil Co.* provided an early opportunity for interpreting the term “in paying quantities,” as it relates to oil and gas leases in the United States.³⁸ The terminology used by the court lends support to both the proponents of the objective and subjective tests. For example, the court’s favor of unambiguous plain language in contracts supports implementing a purely objective test.³⁹

34. See, e.g., *T.W. Phillips Gas and Oil Co. v. Jedlicka*, 42 A.3d 261 (Pa. 2012).

35. 45 A. 121 (Pa. 1899).

36. See *infra* Part. I.B.

37. Ironically, the majority opinion noted that the leases are in the nature of a contract and must be interpreted based on the plain meaning of the terms, yet three opinions of the same court provided different meanings. See *Jedlicka*, 42 A.3d at 267.

38. *Young*, 45 A. at 121-22.

39. *Jedlicka*, 42 A.3d at 267 (internal quotation marks omitted) (citing *J.K. Willison v. Consol. Coal Co.*, 637 A.2d 979, 982 (Pa. 1994)) (A contract “must be construed in accordance with the terms of the agreement as manifestly expressed, and [t]he accepted and

The factual background in *Young* is an effective example of litigation over *habendum* clauses in oil and gas leases. The lessor, Andrew B. Young, sought declaratory relief for forfeiture of an oil and gas lease alleging Forest Oil Company failed to develop land in accordance with the lease provisions.⁴⁰ The oil and gas company developed and successfully produced oil from the western portion of the Young tract, but only perfunctorily tested the other sections to see if they too would produce in paying quantities.⁴¹ In deciding whether the failure to dig wells on the other portions of the land was a fraudulent act amounting to forfeiture of the lease, the court established the test for whether an oil and gas lease is producing “in paying quantities.”⁴²

The language of the test, which has also been popularly adopted in other states,⁴³ prescribes, “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.”⁴⁴ Otherwise stated, the first component of the *Young* test operates as a conditional, mathematical test to see if a well is producing a profit over its operating expenses. The second *Young* component is bi-conditional: if and only if, in the case of marginal wells, a well is producing a profit over operating expenses, a court must decide whether a reasonably prudent operator would continue to produce for a profit.

Notably, “operating expenses” refers to costs separate from the discovery, drilling, and beginning stages of an oil well.⁴⁵ Operating expenses, therefore, are a fairly definite, or at least calculable, sum that can be factored into an algorithm establishing an objective test for whether a well is producing in paying quantities.⁴⁶ Ambiguity naturally remains over the length of time necessary to compare operating expenses against the profits paid by a well. For example, a well may be unprofitable in January and February and then have substantial profits in March and April; if the algorithm were to set the time variable at one month the lease would lapse, if longer then the lease would continue.

plain meaning of the language used, rather than the silent intentions of the contracting parties, determines the construction to be given the agreement”).

40. *Young*, 45 A. at 122.

41. *Id.*

42. *Id.*

43. *Swiss Oil Corp. v. Riggsby*, 67 S.W.2d 30, 31 (Ky. 1931); *Henry v. Clay*, 274 P.2d 545, 546 (Okla. 1954); *Clifton v. Koontz*, 325 S.W.2d 684, 690-91 (Tex. 1959).

44. *Young*, 45 A. at 122-23.

45. HOWARD R. WILLIAMS ET AL., *MANUAL OF OIL AND GAS TERMS* 657 (14th ed. 2009) (referring instead to the “[e]xpenses incurred in the operation of a producing property”).

46. *Young*, 45 A. at 122-23; *Lowther Oil Co. v. Miller-Sibley Oil Co.*, 44 S.E. 433, 436 (W. Va. 1903).

To reconcile the court's disfavor with setting a bright-line time frame within the objective test,⁴⁷ the court inserted language that appears to support principles favorable to parties who believe in a purely subjective test.⁴⁸ Not all wells will produce as steadily *in paying quantities* as those at issue in *Young*. Therefore it stands to reason, in the case of marginal wells that do not continuously and instantaneously produce above operating expenses, that it is proper to defer to a lessee's better judgment.⁴⁹ In *Young*, the production of the wells by the lessees never failed to produce "in paying quantities" over the period of one year.⁵⁰ Arguably, while courts still disfavor a bright-line rule for the reasonable time over which to weigh the objective test, the subjective test should only be used in marginal cases when a reasonable time is untenable.⁵¹ In certain circumstances, a lessee may be willing to take a short-term loss in favor of an average net profit. As seen in *Young* and *Jedlicka*, a few months of loss should not negate a profitable oil and gas lease.⁵²

Further, the pragmatic and market-focused reasoning of the *Young* court supports the subsequent reasoning used by Pennsylvania courts when interpreting oil and gas leases. Recognizing the risks, investment, and long-term nature of oil and gas production, the court supported its conclusion with dicta, opining,

[f]ew wells, except the very largest, repay cost under a considerable

47. See *Cassell v. Crothers*, 44 A. 446, 446 (Pa. 1899) (refusing to use one-year as the bright-line, dispositive time frame); *Texaco, Inc. v. Fox*, 618 P.2d 844, 848 (Kan. 1980) ("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.").

48. *T.W. Phillips Gas & Oil Co. v. Jedlicka*, 42 A.3d 261, 275 (Pa. 2012) ("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.").

49. *Young*, 45 A. at 122.

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.

50. *Id.*

51. See *Jedlicka*, 42 A.3d at 264.

52. See *id.* at 276-77.

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.⁵³

The *Young* court understood that the realities of oil and gas production require some understanding that not all wells, even the most productive, are productive all the time. This understanding led to a decision favoring objectivity but appreciating the need for flexibility with marginal wells.

The two-step analysis outlined in *Young* limits the applicability of a subjective test, whenever possible, in favor of an objective test. The *Young* court did not address what the subjective analysis should be in the case of a marginal well. Other oil and gas producing states have added to Pennsylvania's *Young* doctrine.⁵⁴

B. *Other Oil and Gas Producing States Have Adopted Young, Advanced Young's Reasoning, and Have Adopted the More Appropriate Reasonably Prudent Operator Standard*

Oil and gas law began in Pennsylvania after the first oil well was drilled on August 27, 1859.⁵⁵ However, shortly after the *Young* decision,⁵⁶ oil and gas law shifted its forum of development from Pennsylvania to twentieth century oil and gas powerhouses such as Texas, Oklahoma, and Kentucky.⁵⁷ Despite the shift, and its nature as merely persuasive authority, *Young* remains effectively controlling to the extent that it is the analytical starting point for oil and gas law of the various states.⁵⁸ Reaching a climax in the landmark case *Clifton v. Koontz*,⁵⁹ *Young*'s progeny have retained the two-step process of a primary objective test, which, if met, triggers a subjective analysis for deciding whether a well is producing "in paying quantities."⁶⁰

53. *Young*, 45 A. at 122-23; *Jedlicka*, 42 A.3d at 277-78.

54. *E.g.*, *Garcia v. King*, 164 S.W.2d 509 (Tex. 1942).

55. *Pifer*, *supra* note 23, at 48 ("On August 27, 1859, Colonel Edwin L. Drake drilled the first commercially successful oil well near Titusville, Pennsylvania.").

56. The Supreme Court of Pennsylvania also decided another case in 1899 pertaining to oil and gas law. *See Cassel v. Crothers*, 44 A. 446 (Pa. 1899).

57. *See Pifer*, *supra* note 23, at 48 ("Despite early contributions to the national body of oil and gas law, the development of Pennsylvania oil and gas case law slowed considerably throughout the twentieth century, reflecting the relative decline of the industry in the state.").

58. *See T.W. Phillips Gas & Oil Co. v. Jedlicka*, 42 A.3d 261, 263 (Pa. 2012); *Lowther Oil Co. v. Miller-Sibley Oil Co.*, 44 S.E. 433, 436 (W. Va. 1903).

59. 325 S.W.2d 684 (Tex. 1959).

60. *See id.* at 691; *Swiss Oil Corp. v. Riggsby*, 67 S.W.2d 30, 31 (Ky. 1933) ("The term 'paying quantities' is usually defined as being such quantities as will pay a profit, but at least

The language in *Young* has been used by a number of states⁶¹ before finally culminating in the language's inclusion in *Koontz*. The notable language first appeared in *Gypsy Oil Co. v. Marsh*,

[i]t has been generally held that "paying quantities," when used in this connection, means paying quantities to the lessee. 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 is to be construed with reference to the operator, and by his judgment when exercised in good faith.⁶²

In *Marsh*, the Supreme Court of Oklahoma calculated the profits and operating expenses of the Gypsy Oil Company to conclude that the Gypsy Oil Company was operating at a loss and therefore not acting in good faith by continuing to operate.⁶³

In determining the proper interpretation of what it was to produce in sufficient quantity, the court relied heavily on *Young* and its progeny.⁶⁴ As seen earlier in *Young*, here, too, the court utilized the term "good faith" in its decision, but only in regards to the objective numbers, which proved the Gypsy Oil Company was not producing a profit over operating expenses.⁶⁵ The language of *Young* survived in

the cost of operating the well. . . . 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."); *Pack v. Santa Fe Minerals, a Div. of Santa Fe Int'l Corp.*, 869 P.2d 323, 327 (Okla. 1994) (reaffirming *Stewart v. Amerada Hess Corp.*, 604 P.2d 854 (Okla. 1979) ("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."); *Henry v. Clay*, 274 P.2d 545, 548 (Okla. 1954) ("We further held that the standard by which the judgment and good faith of the lessee is measured is whether the lease is producing, or by the exercise of reasonable skill and diligence could be made to produce, sufficient oil and gas to justify a reasonable and prudent operator in continuing the operation thereof."); *Garcia v. King*, 164 S.W.2d 509, 511-12 (Tex. 1942); *see also Lowther*, 44 S.E. at 436 ("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.") (citing *Young*).

61. *See Riggsby*, 67 S.W.2d at 31; *Clay*, 274 P.2d at 546; *Clifton v. Koontz*, 325 S.W.2d 684 at 690-91 (Tx. 1959).

62. 248 P. 329, 334 (Okla. 1926) (citing, *inter alia*, *Young v. Forest Oil Co.*, 45 A. 121 (Pa. 1899)).

63. *Id.* The facts of *Marsh* pitted a landowner against an oil and gas company over a lease originally signed in 1919. *Marsh*, who bought a right to the lease from the original lessor, claimed the lessee had failed to produce in sufficient quantity to continue the lease. *Id.* at 330-31.

64. *Id.* at 334.

65. *Id.*

Marsh, showing other courts' respect for the standard as laid out by the Supreme Court of Pennsylvania.⁶⁶

Extensively quoting *Marsh* and *Young*, *Garcia v. King* added a number of arguments in favor of the practical, even objective, interpretation of the term "in paying quantities."⁶⁷ First, in *Garcia*, the unprofitability of the wells during the secondary period of the lease was not marginal.⁶⁸ *Garcia* involved a 7,500-acre tract that only paid the lessor royalty payments on production.⁶⁹ The lease originally involved payment by rent until the lessee was unable to afford the original deal.⁷⁰ A court allowed the lease to continue via royalty payments, but after an eight month period of failed production the lessor sought to terminate the lease.⁷¹

The Supreme Court of Texas found for the lessor.⁷² First, the court held that when the difference between the profits and operating expenses are substantial, there is no reason to utilize a subjective test to determine whether the wells were not producing in paying quantities.⁷³ Second, the court added support to the argument that oil and gas lease disputes were to be interpreted practically for the purpose of securing the development of property to "the mutual benefit of" the land owner and the oil and gas company.⁷⁴ Finally, "[t]he 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."⁷⁵ Under a purely subjective test, continuing a lease for speculation purposes would be considered bad faith. *Garcia*, however, did not prescribe a precedent doing away with the objective element outlined in *Young* but in fact proved the utility of a two-step procedure in determining if a well is producing in paying quantities.⁷⁶

66. While nearly nine decades old, *Marsh* is still good law.

67. 164 S.W.2d 509 (Tex. 1942).

68. Compare *id.* at 512 ("[A]ll of the producing wells on the lease in question at the time of the termination of the primary period were not producing enough oil or gas to pay a profit over and above the cost of operating the wells. . . ."), with *T.W. Phillips Gas & Oil Co. v. Jedlicka*, 42 A.3d 261, 264 (Pa. 2012) ("[I]n 1959, T.W. Phillips suffered a loss of approximately \$40 as a result of operations under the Findley lease.").

69. *Garcia*, 164 S.W.2d at 509-10.

70. *Id.*

71. *Id.*

72. *Id.* at 512-13.

73. *Id.* at 512. Again, it is always important to reaffirm that "in paying quantities" is a contentious term because so long as a well is producing in paying quantities an oil and gas lease will continue. See *Jedlicka*, 42 A.3d at 267 (Pa. 2012) (citing *Jacobs v. CNG Transmission Corp.*, 332 F. Supp. 2d 759, 764 (D. Pa. 2004)).

74. *Garcia*, 164 S.W.2d at 512.

75. *Id.* at 513 (in dicta).

76. When a well does not even marginally produce at a profit greater than operating

The factual circumstances in *Clifton v. Koontz*⁷⁷ parallel the difficulties of interpreting *Young* later faced in *Jedlicka*.⁷⁸ In both *Koontz* and *Jedlicka*, a party challenged a marginal well and the reasonable time over which to weigh the profits and operating expenses was not readily apparent.⁷⁹ Building on *Garcia*, the court in *Koontz* stated,

[t]he underlying reason for [the *Young* definition of in paying quantities] appears to be that when a lessee is making a profit over the actual cash he must expend to produce the lease, he is entitled to continue operating in order to recover the expense of drilling and equipping, although he may never make a profit on the over-all operation.⁸⁰

The *Koontz* court looked at the purpose of the definition supplied in *Young* in order to provide the subjective second step that *Young* left ambiguous.⁸¹

After weighing the interests of the lessor and lessee, the court confirmed that in the case of a marginal well the objective test necessitates a secondary subjective analysis.⁸² Naturally, the lessee should be entitled to seek a profit, but only in the case of a well producing, or marginally close to producing, in paying quantities. Therefore, to conclude that a well is in fact marginally close to producing in paying quantities, the *Koontz* court supplied the reasonably prudent operator standard to satisfy the subjective element alluded to by *Young*.⁸³

The reasonably prudent operator standard keeps the burden of proof with the party seeking to end the lease. Moreover, under the reasonably prudent operator standard, “the standard by which paying quantities is

expenses, there is no utility in looking at the subjective character of the lessee. *See Young v. Forest Oil Co.*, 45 A. 121, 122-23 (Pa. 1899).

77. 325 S.W.2d 684 (Tex. 1959).

78. 42 A.3d at 271-72.

79. *Koontz*, 325 S.W.2d. at 688-89 (“Petitioners base their contention that the well had ceased to produce in paying quantities upon the showing that for the period of time from June, 1955 through September, 1956, the income from the lease was \$3,250 and that the total expense of operations during the same period was \$3,466.16—thus, a loss of \$216.16 for the sixteen months’ period selected by petitioners. During the period of time indicated, some months showed a gain and some a loss.”).

80. *Id.* at 692.

81. *Id.*

82. *Id.* at 691.

83. *Id.* (“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.”).

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.”⁸⁴ Therefore, to prove a reasonably prudent operator would not continue to produce a marginal well, a lessor may supply experts and expert testimony.⁸⁵

Starting with the same precedent at issue in *Jedlicka* and *Young*, sister states, including Texas and Oklahoma, have advanced oil and gas law throughout the twentieth century by creating the reasonably prudent operator standard.⁸⁶ With an appreciation for the ambiguities left by *Young*, in the case of a marginal well, the reasonably prudent operator standard emerged naturally during the twentieth century.⁸⁷ The resulting standard allows landowners to use the court system to their benefit and does not insulate corporations from legitimate claims. The reasonably prudent operator standard would also support a landowner like Jim in his litigation against Good-Faith Oil and Gas Co.⁸⁸

Indeed, the language supporting the objective test, described as the primary step in determining if a well is producing in paying quantities in *Koontz*, was directly traceable to *Young*, via *Marsh* and *Garcia*.⁸⁹ Logically, then, there is great support for the argument that *Young* prescribed a two-step analysis in determining whether or not a well is producing “in paying quantities”—rather than a test only focused on subjective good faith.⁹⁰ *Young*’s progeny, especially *Garcia* and *Koontz*, filled in the ambiguity left by *Young* in 1899. The objective test should be applied when the well either clearly produced a profit greater than operating expenses or clearly produced a profit short of operating expenses.⁹¹ When the objective test is inconclusive or there is not a reasonable time over which to weigh the profits and costs—a marginal well—the reasonably prudent operator standard governs.⁹²

Contrary to other states’ development of oil and gas lease law

84. *Id.*

85. *Id.*

86. *See id.*; *Henry v. Clay*, 274 P.2d 545, 548 (Okla. 1954) (“We further held that the standard by which the judgment and good faith of the lessee is measured is whether the lease is producing, or by the exercise of reasonable skill and diligence could be made to produce, sufficient oil and gas to justify a reasonable and prudent operator in continuing the operation thereof.”); *Garcia v. King*, 67 S.W.2d 509, 511-12 (Tex. 1942).

87. *See* cases cited *supra* note 86.

88. *See supra* Introduction, A.

89. *See Gypsy Oil Co. v. Marsh*, 248 P. 329, 334 (Okla. 1926); *Garcia*, 164 S.W.2d at 513.

90. *Young v. Forest Oil Co.*, 45 A. 121, 123 (Pa. 1899).

91. *See Garcia*, 164 S.W.2d at 513.

92. *See Koontz*, 325 S.W.2d at 691.

during the twentieth century, the Supreme Court of Pennsylvania developed a purely subjective test and, in effect, insulated oil and gas companies from unwanted lease termination based on lack of production.⁹³

C. *The Jedlicka Court Instilled a Good Faith Business Judgment Standard but not Without Confusion and Dissent*

In *Jedlicka*, the lessor, Jedlicka, owned a tract of land within a larger tract conveyed to T.W. Phillips Gas and Oil Company by a 1928 oil and gas lease (the “Findley Lease”).⁹⁴ Along with an explanation of royalty payment clauses, the Findley Lease contained a *habendum* clause.⁹⁵ The *habendum* clause provided,

[t]o 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*. . .⁹⁶

The term “in paying quantities” is not outlined or defined within the Findley Lease, but it was written in accordance with *Young*.⁹⁷ One year after signing, the Lessee drilled four gas wells on the Lessor’s expanse, followed by four more wells after the original four were fractured.⁹⁸ The second set of four wells was drilled subsequent to a conveyance by T.W. Phillips Gas & Oil Co. (“T.W. Phillips”) to PC Exploration in 2004.⁹⁹ PC Exploration wanted to drill four more wells on the Jedlicka tract after the 2004 wells were completed.¹⁰⁰ Jedlicka objected to the final set of four wells opining the Findley Lease was no longer valid because T.W. Phillips failed to produce oil or gas *in paying quantities* in 1959.¹⁰¹ Specifically, Jedlicka maintained Lessee suffered a forty-dollar loss in 1959, terminating the lease and creating a tenancy at will.¹⁰²

On April 16, 2007, the case was heard before a trial court that found for the lessees based on the oil and gas company's good faith in continuing to produce oil and gas before, throughout, and subsequent to

93. See *infra* Part II.C-D.

94. T.W. Phillips Gas & Oil Co. v. Jedlicka, 42 A.3d 261, 263-64 (Pa. 2012).

95. *Id.*

96. *Id.* at 264 (emphasis added).

97. 45 A. 121 (Pa. 1899); see *Jedlicka*, 42 A.3d at 264.

98. *Jedlicka*, 42 A.3d at 264.

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.* at 267.

1959.¹⁰³ On appeal, the Superior Court affirmed.¹⁰⁴ Jedlicka appealed, and in 2009 the Supreme Court of Pennsylvania agreed to review *de novo* the question: “[d]id the Superior Court misapply the decision of this Court in *Young v. Forest Oil Co.*,¹⁰⁵ by holding that Pennsylvania employs a purely subjective test to determine whether an oil or gas lease has produced in paying quantities.”¹⁰⁶

The majority¹⁰⁷ affirmed, deciding that the purely subjective test applied by the trial court was the correct interpretation of *Young*.¹⁰⁸ The majority outlined the legal arguments of both sides in order to show the clear divide in the interpretations applied by each party, respectively.¹⁰⁹ Then, citing several decisions from other jurisdictions, the majority concluded that a purely objective test, as Jedlicka argued for, is not workable without a set and reasonable time period within which to measure production.¹¹⁰ Finally, the court claimed to create a two-step interpretation of *Young* while actually creating an entirely new good faith business judgment standard.¹¹¹ First, this new interpretation requires a determination of whether the lessee produces a profit, no matter how small, over the operating expenses. It then requires a determination of whether the well objectively produces “in paying quantities.”¹¹² Second, if the well does not produce a profit over operating expenses, then the court must look to the subjective good faith management of the lessee in operating the well at a loss.¹¹³ The majority acknowledged that interpreting the *habendum* clause to protect the lessee is contrary to the original purpose of such clauses but found the new interpretation in line with *Young* and an unambiguous reading of the language.¹¹⁴

103. *Id.* at 265 (“[N]otwithstanding the \$40 loss suffered in 1959, Appellees had produced gas on their leasehold in paying quantities, and, therefore, [] 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.”).

104. *Id.* at 266.

105. 45 A. 121 (Pa. 1899).

106. *Jedlicka*, 42 A.3d at 266 (internal quotations omitted). *See also* T.W. Phillips Gas and Oil Co. v. *Jedlicka*, 978 A.2d 347 (Pa. Super. Ct. 2009).

107. The Majority opinion was written by Justice Todd, joined by Chief Justice Castille and Justices Baer and McAffrey.

108. *Jedlicka*, 42 A.3d at 274-75.

109. *Id.* at 270-71.

110. *Id.* at 275.

111. *Id.* at 276.

112. *Id.*

113. *Id.*

114. *Id.* at 271 (noting *habendum* clauses were originally meant to protect lessors).

In an exceptionally short concurring opinion, Justice Eakin highlighted the shortsightedness of the majority opinion. Justice Eakin iterated that a *habendum* clause may be "a shield or a sword," for the parties entering into an oil and gas lease.¹¹⁵ The majority opinion, however, only allows a *habendum* clause to be used as a shield by the lessee.¹¹⁶ Further, underscored throughout the opinions in *Jedlicka* is the real difference between the uses of *habendum* clauses now and when *Young* was decided in 1899.¹¹⁷ Rather than supporting the majority's mistaken harmonization of the good faith standard and the reasonably prudent operator standard, Justice Eakin found discussion of the reasonably prudent operator standard "inapposite to this lease."¹¹⁸ Justice Eakin saw through the pretense of Lessors' claims but was unable to prevent the misbalancing applied by the majority.¹¹⁹

Justice Saylor, the lone dissenter, argued that the majority and the trial court misapplied the *Young* decision and created a purely subjective test.¹²⁰ He opined that *Young* prescribed a hybrid two-pronged test, but the proper analysis is hinged on the threshold objective question of whether the lessee was producing a profit over the operating expenses.¹²¹ Only if the critical first prong is met should the court analyze the subjective good faith of the operating lessee.¹²² This argument hinges, importantly, on the original purpose of the *habendum* clause in 1928—to protect the lessor from unfair speculation by the lessee.¹²³ Justice Saylor stated that the proper interpretation of the language in *Young* allows for reference to a lessee's good faith because there are wells that, while producing at a very small profit, will never cover their original expenses.¹²⁴ Contrary to the *Jedlicka* majority's opinion, *Young* conceivably created narrower circumstances through which a lease may extend indefinitely.¹²⁵ Justice Saylor, in effect, argued the reference to

115. *Id.* at 278 (Eakin, J., concurring).

116. *Id.* at 271 (majority opinion).

117. *Id.*

118. *Id.* at 278 (Eakin, J., concurring).

119. *Id.*

120. *Id.* at 278-79 (Saylor, J., dissenting).

121. *Id.* at 279.

122. *Id.*

123. *Id.* *But cf. id.* at 277 (noting that, currently, *habendum* clauses are being used by lessors to end otherwise profitable wells).

124. *Id.* at 282 (Saylor, J., dissenting).

125. Justice Saylor believes *Young* created a narrower interpretation of "in paying quantities," rather than the expanded one used by the majority in *Jedlicka*. *Id.* at 279 ("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

good faith comes into play if a well is producing *in paying quantities* over operating expenses, but the lessee in good faith could allow a lease to terminate.¹²⁶ According to Justice Saylor, the reference to good faith was meant to allow a lessee to terminate a productive lease more easily rather than retain an unproductive agreement.¹²⁷

Further, Justice Saylor argued that the reasonably prudent operator standard implemented in other states was incorporated into the majority decision.¹²⁸ Justice Saylor seemed to imply that the majority might have tried, and failed, to implement the reasonably prudent operator standard from other jurisdictions.¹²⁹ While Justice Saylor believed the reasonably prudent operator standard might be appropriate for Pennsylvania, he acknowledged that the narrow issue on appeal was whether the trial court interpreted *Young* correctly.¹³⁰ Finally, Justice Saylor differed from the majority's belief that the subjective good faith standard applied in the present case was harmonious with the reasonably prudent operator standard as applied in other jurisdictions.¹³¹

The Supreme Court of Pennsylvania read, cited to, and appreciated the value of other states' development of the test to determine when a well is producing in paying quantities.¹³² Despite this, the justices misinterpreted the delicate differences between the good faith business judgment standard and the reasonably prudent operator standard designed in other states.¹³³ The reasonably prudent operator standard created an avenue for landowners to terminate unproductive leases held onto by speculating oil and gas lease companies. The good faith business judgment standard insulates oil and gas companies from termination so long as they maintain the appearance of good faith. The result of *Jedlicka*, therefore, is an unfair burden on landowners when trying to end an unproductive or even harmful lease.

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.'").

126. *Id.* at 278-79.

127. *Id.*

128. *Id.* at 282 (Saylor, J., dissenting). This Note refutes this premise based on affect. In reality, the Majority Justices may have contemplated other states' persuasive authority. If they did, they misinterpreted the reasonably prudent operator standard.

129. *Jedlicka*, 42 A.3d at 282.

130. *Id.* See also *id.* at 270 n.11 ("Jedlicka emphasizes she is not suggesting that *Young* be overruled. Indeed, she states: [t]o 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.").

131. *Id.* at 285 (Saylor, J., dissenting).

132. See *id.* at 268-76.

133. See *id.*

II. THE PURELY SUBJECTIVE GOOD FAITH BUSINESS JUDGMENT STANDARD TEST CREATED BY THE *JEDLICKA* MAJORITY IMPROPERLY BALANCES THE INTERESTS INVOLVED IN AN OIL AND GAS LEASE

Under the good faith business judgment standard for determining whether a well is producing “in paying quantities,” a landowner may only be released from an unprofitable lease by proving a lessee’s bad faith.¹³⁴ With the burden on the landowner, lessees are essentially shielded from petitions alleging unprofitable production. If a landowner brings a petition against a lessee alleging bad faith, the landowner will not be able to present evidence to a jury since bad faith is nearly impossible to prove outside hypothetical realms.¹³⁵

While the standard used in *Jedlicka* places a substantial burden on plaintiffs, an argument in favor of the *Jedlicka* test may be that keeping juries from deciding when a lease is producing in paying quantities is a protection from local bias leading to arbitrary findings for local landowners. Such an argument overestimates the likelihood of abuse under the reasonably prudent operator standard. When the potential worst-case scenarios of the good faith business judgment standard and the reasonably prudent operator standard are compared, the reasonably prudent operator standard is superior.

This Part proposes that the good faith business judgment standard imputed by the *Jedlicka* majority makes the indefinite term in a *habendum* clause nearly impossible to terminate, and notes that the good faith business judgment standard prevents juries from deciding when a well is profitably producing oil and/or natural gas. This Part then extrapolates from the procedural problems that *Jedlicka* creates for lessors, and weighs the reasonably prudent operator standard and the good faith business judgment standard, finding the former to be the lesser of two evils. Finally, this Part lays out a framework that applies to landowners considering their options before entering into an oil and gas lease in this post-*Jedlicka* era.

A. *The Landowner’s New Obligation to Prove Bad Faith*

The shift in the burden of proof from the reasonably prudent operator to the good faith business judgment standard changes the procedural posture of potential future litigation. The common law definition of bad faith will likely be enough to prove a lessee was not continuing production in good faith.¹³⁶ Therefore, plaintiffs may be

134. *See id.* at 276.

135. *See generally* Elizabeth A. Nowicki, *A Director’s Good Faith*, 55 *BUFF. L. REV.* 457, 462 (2007).

136. *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 64 (Del. 2006).

entitled to relief if they are able to prove that an oil and gas company purposely continued production with an actual intent to do harm to the agreement or land. Proving bad faith requires direct evidence of malice or incredibly culpable negligence.¹³⁷

As a result of the high burden of proof necessary to find bad faith, circumstantial evidence is not enough to find liability or even get to a jury.¹³⁸ Even with a team of experienced lawyers and favorable discovery decisions, to be successful, a plaintiff would have to find the metaphorical “smoking gun” or present candid testimony, which amounts to a confession of intentional bad faith.¹³⁹ Moreover, a plaintiff would have to find sufficient evidence to survive a motion for summary judgment prior to contemplating trial.¹⁴⁰

The only realistic way for a landowner to successfully prove a lessee’s bad faith would be to find evidence of the oil and gas company continuing a lease solely for speculation purposes.¹⁴¹ The purpose of an oil and gas lease is to provide an opportunity for two parties to exploit a resource that would not be reachable without the cooperative agreement.¹⁴² If a lessee continues a lease for the purpose of speculation, i.e. in order to prevent a competitor from benefitting, he or

137. *Id.*

138. See *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (“Two working principles underlie our decision in *Twombly*. First, the tenet that a court must accept as true all of the allegations contained in a complaint is inapplicable to legal conclusions. Threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice.”) (citing *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007)).

139. See *id.*

140. PA. R. CIV. P. § 1035.2 (2012).

141. See *Clifton v. Koontz*, 325 S.W.2d 684, 691 (Tex. 1959) (“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.”); *Garcia v. King*, 164 S.W.2d 509, 513 (Tex. 1942) (“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.”); see also 3-6 WILLIAMS & MEYERS, OIL AND GAS LAW § 604.5 (2001) (“Pennsylvania has reaffirmed its commitment to the subjective ‘good faith’ standard in determining whether or not there is production in paying quantities. The lessor bears the burden of establishing a lack of good faith and the mere showing that there was a monetary loss in one year will not survive a motion for summary judgment requested by the lessee.”).

142. See *T.W. Phillips Gas & Oil Co. v. Jedlicka*, 42 A.3d 261, 264 (Pa. 2012) (“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.”) (citing *Lease*, July 2, 1928, at 1 (R.R. at 13a–14a)); Rachel L. Allen & Scotland M. Duncan, *The Standard Oil and Gas Lease - and Why it is Not*, 13 DUQ. BUS. L.J. 155, 166 (2011) (“The granting of an oil and gas lease carries with it the implied right to use as much of the surface area as is reasonably necessary for the purposes specified in the lease.” (emphasis added)).

she would be acting contrary to the purpose of the original oil and gas lease. It would be nonsensical for a marginal oil and gas lease to continue indefinitely, based on producing “in paying quantities,” for a purpose other than for the mutual benefit of both parties. Evidencing bad faith requires a party proving the intent of the other party in continuing production. Logically, the intentions of a lessee can only be established from the words or writings of the lessee.

A pro-industry argument may be that an oil and gas company has no interest in continuing a lease that is not producing in paying quantities. However, such an argument fails to factor in the value of speculation. When weighing the shortcomings of a purely subjective interpretation of in paying quantities, the Supreme Court of Kansas noted, a lessee:

may consider it to be to his economic advantage to continue a marginal or losing operation in order to take advantage of possible [sic] discoveries in formations other than the formation from which he is producing. He may also anticipate a change in marketing conditions or market prices of oil or gas. There may also be other circumstances which indicate to him that a current operating loss may eventually be turned into a profit in the long run.¹⁴³

The increased supply of natural gas has significantly lowered natural gas prices; as a result some producers are holding back on their production rates in order to control the supply.¹⁴⁴ A lessee, in his or her business judgment, may benefit from the continuation of a lease for purely speculative purposes.¹⁴⁵ The benefit, however, is not in the best interest of the landowner.

If a lessee continues production for speculation purposes the lease is not continuing for the benefit of both parties. Therefore, if a lessee is purely speculating during the indeterminate period of the lease, he or she is continuing production in bad faith. Accordingly, even under the good faith business judgment standard imputed by the *Jedlicka* majority,¹⁴⁶ a lessee’s continued production for speculative purposes would terminate the indefinite term of an oil and gas lease. Unfortunately, the opportunity to prove the bad faith may be illusory.

143. *Reese Enter., Inc. v. Lawson*, 553 P.2d 885, 897 (Kan. 1976).

144. Marc Levy, Associated Press, *Fracking for Natural Gas Being Powered by it, Too*, YAHOO NEWS (Jan. 20, 2013, 2:58 PM), <http://news.yahoo.com/fracking-natural-gas-being-powered-170628804.html> (“Production has increased so much that natural gas has flooded the market, dragging down prices and forcing companies to pull back on their plans to expand drilling while looking for new ways to use gas.”).

145. *Reese*, 553 P.2d at 897.

146. *Jedlicka*, 42 A.3d at 266-67.

B. *Landowners Lack Access to the Jury on Questions of Bad Faith*

A landowner must prove bad faith to be relieved from an oil and gas lease with a term clause similar to “for as long as oil or gas is produced in paying quantities.” As established *supra*, only with clear proof can a landowner prove bad faith. In the unlikely event a lessor has sufficient proof to win at trial, he or she would win on summary judgment without the need for a jury.¹⁴⁷ What the *Jedlicka* majority has essentially created is a system where, in the case of a marginal well, the lessee is protected from termination so long as production continues and no outward evidence of bad faith exists. The burden of proof is so high that for a landowner to be successful in defeating summary judgment he or she must prove bad faith, and any proof of bad faith would be sufficient for the landowner to win on his or her own motion for summary judgment. In Pennsylvania there is currently no discretion for a jury to decide when an oil and gas company is continuing production of a marginal lease in good faith.¹⁴⁸

Returning to the hypothetical of Jim’s lease with Good-Faith Oil and Gas Co., the difficulty created by *Jedlicka* is apparent. If Jim lives in Pennsylvania and believes Good-Faith Oil and Gas Co. is continuing to produce oil and gas from his land even though the company knows its operating expenses will be greater than the profits produced, Jim’s burden of proof is exceptionally high. Jim may find multiple experts in the oil and gas producing field who strongly believe that Good-Faith is holding on to Jim’s lease in order to use improved technology and higher prices in the future to make Jim’s land profitable. However, in Pennsylvania, they cannot testify to a jury to that effect absent separate evidence of bad faith. In Pennsylvania, the court will defer to the good faith business judgment of the lessee that Good-Faith is continuing

147. In a recent 2013 motion for dismissal with prejudice pursuant to FED. R. CIV. P. 12(b)(6), the Middle District of Pennsylvania both extended and limited the good faith standard outlined in *Jedlicka*. *Stewart v. SWEPI, LP*, No. 4:11-CV-2241, 2013 WL 170181 (D. Pa. Jan. 16, 2013). In *Stewart*, the lessor is seeking to terminate his lease alleging that the lessee built a well for the sole purpose of continuing a lease for speculation purposes. *Id.* The federal court found that the well being built very recently before the lease was due to expire was constructed “solely for the purpose of extending the lease,” that the lessee had done nothing to produce oil or gas since, and that there were facts sufficient to deny the lessee’s motion to dismiss. *Id.* At least in one federal court obvious facts of speculation have been sufficient to aver the bad faith requirement imputed by the Supreme Court of Pennsylvania in *Jedlicka*. *Id.* Also, the court in *Stewart* applied the good faith standard outside the factual confines of a lease containing the production in paying quantities language and in effect extended the applicability of *Jedlicka*. *Id.* Most importantly for the purposes of this Note, the plaintiffs in *Stewart* were able to plead sufficient circumstantial inferences of bad faith; there is no reference to whether the plaintiffs would be able to *prove* the alleged bad faith.

148. *Jedlicka*, 42 A.3d at 266-67.

production for present profit.¹⁴⁹ Therefore, unless Will provided Jim with evidence that Good-Faith was continuing production at a loss strictly for speculation purposes, which is highly unlikely, Jim will be unable to prove bad faith.

Also, note that if Will was able to provide Jim with sufficient evidence to successfully allege bad faith, such evidence would be sufficient to win on summary judgment.¹⁵⁰ It is important to remember, however, that oil and gas companies are sophisticated business organizations, likely with expensive and talented lawyers, rendering the discovery of evidence establishing bad faith incredibly unlikely. In sum, *Jedlicka* has ultimately created an inequitable system where a lease will continue until the oil and gas company wants it to end.

C. *Hindering Landowner Rights to Avoid Local Bias?*

Jedlicka is illustrative of the typical way that a landowner will bring suit against a lessee.¹⁵¹ Petitioner, *Jedlicka*, brought the action, which was originally decided by the court of proper jurisdiction in the county where *Jedlicka*'s tract was located.¹⁵² A charge against the reasonably prudent operator standard might be that it puts too much power in the hands of juries in deciding valuable leases. The fear is compounded by lease disputes being decided in the jurisdiction containing the leased property.¹⁵³ Many of the counties in Northern and Central Pennsylvania, which are regions within the Marcellus Shale formation, are less populated than the Pittsburgh and Philadelphia areas.¹⁵⁴ Critics of the reasonably prudent operator standard, and the *Jedlicka* majority, may fear small town juries arbitrarily supporting their

149. *Id.* at 276-77 (“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 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.”).

150. PA. R. CIV. P. 1035.2 (2012).

151. *Jedlicka*, 42 A.3d at 264-66.

152. *Id.*

153. *Id.*

154. Law firms have interpreted *Jedlicka* on their websites. See, e.g., Nathaniel I. Holland, *Know How: PA Supreme Court Affirms Good Faith Test of Production in Paying Quantities*, STEPTOE & JOHNSON (Mar. 30, 2012), <http://www.steptoeh-johnson.com/content/pa-supreme-court-affirms-good-faith-test-production-paying-quantities> (“[The *Jedlicka*] opinion is notable for a number of reasons: 1) it reaffirms the longstanding rule that the lessee is in the best position to make business decisions regarding its leases, which should not be second guessed absent evidence of an illicit intent.”) (last visited Feb. 16, 2014).

neighbors, or purposely injuring large corporate lessees.¹⁵⁵

Those who support the *Jedlicka* good faith business judgment rule will argue that the good faith standard still allows a potential process for relief.¹⁵⁶ If a landowner has actual proof of bad faith through motives of pure speculation then he or she is entitled to re-lease. Therefore, it can be argued that it was not worth lowering the burden of proof for a landowner to end a lease if there is the potential risk of an arbitrary judgment.

A jury may rely on any evidence or expert testimony presented at trial when making decisions of fact. Further, understanding what a jury chooses to believe is an exercise for mystics. Fear of arbitrary judgment against an oil and gas company is a legitimate interest that must be balanced in establishing a test for whether a lease is producing in paying quantities. When compared to the problems that arise from the good faith business judgment standard—however—the concerns with the reasonably prudent operator standard are trivial.

D. *The Reasonably Prudent Operator Standard is the Lesser of Two Evils*

Both the good faith business judgment and the reasonably prudent operator standards fail to completely insulate the lessor and lessee from abuse by the other party. Under the reasonably prudent operator standard, a lessee may suffer an arbitrary decision by a locally biased jury ending a long-term profitable lease.¹⁵⁷ Under the good faith business judgment standard, a lessor may be trapped in an unprofitable lease simply because there is not sufficient evidence to allege bad faith.¹⁵⁸ In properly balancing the interests of the lessor and lessee, the good faith business judgment standard is more harmful than the reasonably prudent operator standard, based on both the likelihood and scale of potential detriment.

Recall the difficulty Jim faced under the good faith business judgment standard hypothetical. In Pennsylvania, the court will defer to the good faith business judgment of the lessee that Good-Faith Oil and

155. David Bowen, *Gunned Down – By the Law: Foreign Firms Can Be Soft Targets in the ‘Jackpot’ Mentality of US Litigation*, INDEPENDENT (Feb. 16, 1997), <http://www.independent.co.uk/news/business/gunned-down--by-the-law-1278866.html> (“It is perhaps too easy to drum up an image of xenophobic rednecks determined to kick foreign butt, but it is undoubtedly true that small-town juries will give the home team an advantage [m]y advice is to avoid a jury trial, especially if you’re a foreigner going up against a local company.”).

156. See generally *Jedlicka*, 42 A.3d at 275-77.

157. Bowen, *supra* note 155.

158. See *Jedlicka*, 42 A.3d at 276-77.

Gas Co. is continuing production for present profit.¹⁵⁹ Therefore, unless an unlikely situation occurs, like Will providing Jim with evidence that Good-Faith was continuing production at a loss strictly for speculation purposes, Jim will be unable to demonstrate bad faith. Further, oil and gas companies are sophisticated business organizations, and finding evidence of bad faith is incredibly unlikely. Good-Faith Oil and Gas Co. is essentially allowed to continue an oil and gas lease indefinitely so long as they continue production under the pretense of good faith profit seeking.

Jim believes his prized show cows are dying from the run-off of the hydraulic fracturing solution containing toxic chemicals. He does not have strict evidentiary support for his allegation so he cannot sue for damages or end the lease based on waste.¹⁶⁰ Thinking he could take advantage of the sporadic unprofitability of the wells on his land, Jim attempted to assert that the indefinite term of the lease had ended because it was no longer producing “in paying quantities.” In Pennsylvania, with deference to Good-Faith Oil and Gas Co.’s alleged good faith, Jim cannot terminate his lease. Even with a number of experts supporting Jim’s position—that the oil and gas in his land has been extracted to the point it is no longer profitable to continue production—potentially harmful hydraulic fracturing will endure.

The prospective shortcomings of the good faith business judgment standard trap a landowner in an indefinite lease subject to the whims of the oil and gas-producing lessee. Such a result is contrary to the originally agreed upon purposes of the lease.¹⁶¹ Further, the *Jedlicka* majority acknowledged that interpreting the *habendum* clause to protect the lessee is contrary to the original purpose of such clauses.¹⁶²

When compared to the harms of the good faith business judgment standard, the deficiencies of the reasonably prudent operator standard appear trivial. Suppose Jim’s real purpose for trying to assert his lease

159. *Id.* (“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 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.”).

160. H.R. COMM. ON ENERGY AND COMMERCE, *supra* note 24, at 2 (“Although some companies did provide information about these proprietary fluids, in most cases the companies stated that they did not have access to proprietary information about products they purchased ‘off the shelf’ from chemical suppliers.”).

161. Allen & Duncan, *supra* note 142, at 166.

162. *Jedlicka*, 42 A.3d at 271 (noting *habendum* clauses were originally meant to protect lessors).

with Good-Faith Oil and Gas Co. is not to protect his prized show cows. Jim has met other farmers whose leases are more financially favorable to the lessor. Perhaps, as Good-Faith would likely argue, the reason for Jim's suit is really an attempt to renegotiate for a more favorable lease. Indeed, the justices hearing the *Jedlicka* appeal acknowledged that many landowners in Pennsylvania are trying to get out of their original leases to renegotiate for more favorable terms.¹⁶³ Compounding potential harm of the reasonably prudent operator standard is a possibility when local juries might arbitrarily find in favor of local landowners based on local-bias.¹⁶⁴ Plainly, there is a potential tangible impairment created by using the reasonably prudent operator standard as the test for when a marginal well is producing in paying quantities. The test inevitably devolves into a question of which is worse: for a large oil and gas corporation to renegotiate, or a landowner to be trapped in an unfavorable, or even harmful, oil and gas lease.

While this Note argues that the disadvantages of the good faith business judgment standard are more detrimental than the reasonably prudent operator standard, it still acknowledges the fear of arbitrary jury findings as a legitimate concern. The likely prevalence of each respective harm should prove that the reasonably prudent operator standard is the more beneficial outlet. The likelihood of a jury actually shirking its duties and arbitrarily finding for its members' neighbors is slight.¹⁶⁵ Further, while appellate courts are likely to give findings of fact due deference, they still provide corporations with an avenue of redress for legal errors.¹⁶⁶ The more prudent justice system will shift the difficult burden of proof from the farmer to the wealthy corporation capable of affording the best lawyers money can buy.

Further, the underlying purpose of oil and gas leases—mutual gain from untapped resources—must shape the outcome of all litigation arising from such leases. Under the reasonably prudent operator

163. *Id.* at 277 (“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.”).

164. Bowen, *supra* note 155.

165. See Newton N. Minow, *Who Is an Impartial Juror in an Age of Mass Media?*, 40 AM. U. L. REV. 631, 633 (1991) (“Courts employ a variety of techniques in their attempt to minimize the partiality problem. The technique most heavily relied upon is the *voir dire* process, by which lawyers and judges question potential jurors to determine bias.”); see also *Irvin v. Dowd*, 366 U.S. 717, 723 (1961) (“[I]t is sufficient if the juror can lay aside his impression or opinion and render a verdict based on the evidence presented in court.”) (citing *Holt v. United States*, 218 U.S. 245 (1910)).

166. See generally *Jedlicka*, 42 A.3d at 263-64 (the procedural history of *Jedlicka* shows the appellate courts' willingness to review findings of oil and gas leases).

standard, if a well were only marginally producing and a reasonably prudent operator standard would continue production for a profit, the lease would continue to the honest benefit of both parties. On the other hand, if a reasonably prudent operator would only hold onto a tract of land for speculation purposes, then the mutual benefit that served as consideration for the original lease would be terminated. The lease, too, should then terminate. Should the parties come to an appropriate arrangement recognizing the speculation, then a new lease may be drafted based on the new purpose. An oil and gas lease is in the nature of a contract.¹⁶⁷ Without sufficient consideration, a contract for the use of land should not be equitably enforced.¹⁶⁸ An indefinite lease subject to a “thereafter” term in a *habendum* clause is arguably similar to an employment-at-will where agreement for the next day’s work is based on appropriate ongoing consideration.¹⁶⁹

When balancing the interests involved in an oil and gas lease, the addition of a subjective element necessarily leaves the door open for abuse by one party or another. Under the reasonably prudent operator standard, the abuse likely feared is that a landowner will take advantage of technical language and a favorable jury makeup to end a lease prematurely. This is a realistic fear because of the favorable possibilities renegotiation provides for a lessor.¹⁷⁰ However, the tools still available to an oil and gas company under the reasonably prudent operator standard—sophisticated lawyers, *voir dire* of juries, and appeals—completely mitigate the risk of abuse. On the other hand, a landowner pitted against a large corporation faces an uphill battle; the implementation of the good faith business judgment standard exacerbates the very difficult burden for a landowner. Therefore, the

167. *Id.* at 267.

168. *McKinnon v. Benedict*, 157 N.W.2d 665, 672 (Wis. 1968) (“Considering all the factors—the inadequacy of the consideration, the small benefit that would be accorded [the non-landholders], and the oppressive conditions imposed upon the [landholder]—we conclude that this contract failed to meet the test of reasonableness that is the *sine qua non* of the enforcement of rights in an action in equity.”). In *McKinnon*, the court found an agreement between neighbors unenforceable based on a very small benefit to a landowner that bound him to an oppressive land use restriction. *Id.* The principals upheld in *McKinnon* are comparable to those at issue here; landowners receiving very little benefit in exchange for an economically harmful use or restriction of their land.

169. See generally 3-6 WILLIAMS & MEYERS, OIL AND GAS LAW § 604 (2001) (prior to 1975, Louisiana added another factor to the paying quantities doctrine. The rule here not only demanded that production be in paying quantities to the lessee, but that it also furnishes an adequate consideration to the lessor).

170. *Jedlicka*, 42 A.3d at 277 (“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.”).

more appropriate interest balancing in a disputed oil and gas lease necessitates the application of the reasonably prudent operator standard.

E. *Landowners Must Take Steps to Prevent Oil and Gas Companies from Abusing Leases*

While advocating for the reasonably prudent operator standard, this Note recognizes the Supreme Court of Pennsylvania's decision in favor of the good faith business judgment standard as part of the test for determining when a lease is producing oil and gas in paying quantities. Accordingly, this Note attempts to set forth a framework for lawyers and landowners to consider their options moving forward under the good faith business judgment standard.¹⁷¹ The most important reality is that oil and gas companies want to consummate and perform their obligations under leases. Without land rich in oil and gas reserves, producing companies cannot fulfill their main function: producing oil and gas. Fittingly, if an oil and gas landsman approaches a landowner with a lease, the landowner has significant power in deciding the conditions and terms of the lease.¹⁷²

The first and most important thing a landowner should do after being approached by a landsman¹⁷³ is consult a lawyer who practices oil and gas law. A lawyer may be able to understand the intricacies of an oil and gas lease, including the implications of the *habendum* clause usage of "in paying quantities."¹⁷⁴ Further, as this Note has established, oil and gas companies have sophisticated lawyers at their disposal, so too should landowners. A lessor ought to protect his or her self with representation as early in the leasing process as possible in order to hedge his or her potential future interests. The most important service a lawyer will provide for a landowner is advising, and potentially mediating, the negotiations between the landowner and landsman.

An oil and gas company wants land to develop oil and gas wells and to make money. Landowners, by definition, have land that an oil

171. Unfortunately, landowners already subject to leases with an indeterminate *habendum* clause cannot benefit from advice on their negotiation power.

172. See Pennsylvania Department of Environmental Protection, *Landowners and Oil and Gas Leases in Pennsylvania*, COMMONWEALTH OF PENNSYLVANIA, <http://www.elibrary.dep.state.pa.us/dsweb/Get/Document-91369/8000-FS-DEP2834.pdf> (last visited Feb. 16, 2014) (responding to the hypothetical query of what to do when first being approached with a lease by recommending talking to an attorney and negotiating for what a lessor wants).

173. "Landsman" or "landman" is the name for a person who contracts with landowners to form an oil and gas lease. HOWARD R. WILLIAMS ET AL., *MANUAL OF OIL AND GAS TERMS* (14th ed. 2009). A landsman is often the first person a landowner comes in contact with from the oil and gas industry.

174. Law firms have interpreted *Jedlicka* on their websites. See Holland, *supra* note 154.

and gas company would want to lease. Therefore, even though a landowner stands to make significant money from a lease, they have a lucrative bargaining chip. A landowner should negotiate for the interests most important to him or her before entering into an oil and gas lease. Understandably, the indefinite realities of the language, “and as long thereafter as oil and gas is produced in paying quantities,” should worry landowners after *Jedlicka*. Consequently, a landowner ought to negotiate for a definite term of a lease, or negotiate reparation procedures should the production go unfavorably in the eyes of the lessor. While an oil and gas company would prefer an indefinite and ongoing lease, the company's desire for more holdings may make definite terms a reality. Ironically, the pro-business imports of *Jedlicka* may shift future leases toward more definite terms as landowners become more sophisticated in negotiating with oil and gas companies. More definite terms will only become a reality if landowners consult attorneys and negotiate for their interests.

CONCLUSION

Hydraulic fracturing is a contentious industry practice with many legitimate environmental concerns.¹⁷⁵ Understandably, landowners may disapprove of hydraulic fracturing and want to protect their land from potential pollution. Even still, landowners have entered into binding contracts with oil and gas companies for the joint purpose of making money from hard-to-reach resources. To gain the financial benefits of natural gas, occasional environmental risks are signed away; however, this should not be for an indefinite term. When the joint purposes of an oil and gas lease are ignored an oil and gas lease should be terminable. The term *in paying quantities* should therefore be read with reference to the good faith of all the parties and interests of an oil and gas lease. The reasonably prudent operator standard more appropriately balances the many interests. Under the reasonably prudent operator standard, a landowner may only terminate a lease if oil and gas is not objectively being produced in paying quantities and production is not continuing for purely speculative purposes. *Jedlicka* ignored landowners’ interests and eliminated lessors’ ability to terminate a harmful or purely speculative lease.

Most oil and gas leases contain the indefinite duration of *as long thereafter as oil and gas are produced in paying quantities*.¹⁷⁶ Courts in other states such as Texas, as seen in *Koontz*, have implemented a

175. See generally H.R. COMM. ON ENERGY AND COMMERCE, *supra* note 24.

176. The exact order of the wording may differ, but *habendum* clauses containing an indefinite term such as this are common.

reasonably prudent operator standard to fill the gap left open in the *Young* test. Under the *Jedlicka* decision, there is no need to weigh the objective balance between the profits paid by a well and the operating expenses needed to raise that profit because the burden of proof under *Jedlicka* is so extreme.¹⁷⁷ *Jedlicka* does not necessitate that the subjective test only be used in the case of a marginal well, but rather the good faith of the lessee is the only important factor in judging whether a well is producing in paying quantities.¹⁷⁸ As such, unless a landowner is capable of proving bad faith on the part of the lessee, an oil and gas lease will continue indefinitely at the whim of a lessee. While protecting oil and gas corporations from arbitrary jury decisions, the good faith business judgment standard goes too far in eliminating landowners' opportunities for relief.

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177. Compare *Young v. Forest Oil Co.*, 45 A. 121, 122-23 (Pa. 1899) (“[I]f a well, being down, pays a profit,—even a small one, over the operating expenses,—it is producing in ‘paying quantities’ . . .”), with *T.W. Phillips Gas & Oil Co. v. Jedlicka*, 42 A.3d 261, 272 (Pa. 2012) (“[I]n assessing whether a lease is producing in paying quantities, *Young* places the principal focus on the good faith judgment of the operator.”).

178. *Jedlicka*, 42 A.3d at 277 (“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.”).

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