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Oil and Gas Alert: Supreme Court of Ohio Rejects Implied Covenant to Explore Further in Oil and Gas Leases

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In a January 3, 2018 decision, the Supreme Court of Ohio held that Ohio does not recognize an implied covenant to explore further as a distinct implied covenant in oil and gas leases. See *Alford v. Collins-McGregor Operating Co.*, Slip Opinion No. 2018-Ohio-8.

Background

The appellant-landowners were subject to an oil and gas lease executed by their predecessors in favor of the appellee-lessee in 1980. The landowners' lease contained a one-year primary term and a standard habendum clause. The lease did not require the lessee to drill a specific number of wells or produce from a particular depth. It also did not disclaim implied covenants. One well was drilled under the lease in 1981, which produced from the Gordon Sand formation. In 2015, the landowners filed suit, alleging that while deeper formations like the Utica and Marcellus shales were being developed near their property, their lessee had not explored for oil and gas on their property from any depths below the Gordon Sand. The landowners claimed that this failure violated an implied covenant to explore further, and they asked the court to forfeit the lease as to the deeper depths.

The lessee successfully moved to dismiss the suit, arguing that Ohio law does not recognize the remedy of horizontal forfeiture, and the court of appeals affirmed. On appeal to the Supreme Court of Ohio, the landowners claimed that lower courts were wrong in dismissing their suit, as they stated a claim for the breach of the implied covenant to explore further, and that such a claim could be remedied through horizontal forfeiture of the unexplored depths.

Decision

The implied covenant to explore further proposed by the landowners would have required a lessee to engage in the exploration of unproven formations and new areas after the lease was already producing, potentially without regard to cost or profit. The Court declined the landowners' invitation to recognize this new covenant, finding it was

unnecessary because the long-recognized implied covenant of reasonable development, which obligates the lessee to act as a reasonably prudent operator, was itself sufficient to protect the landowners' interest in the development of their land.

The Court stated that “‘the profit motive [is] an instrumental force in oil and gas leases on behalf of both lessee and lessor,’ and to fail to recognize the profit motive ‘is to ignore the very essence of the contract.’” The Court found that the covenant of reasonable development encompassed “all facts and circumstances relevant to development, whether they relate to exploration—for example, the costs of exploration and likelihood that exploration will result in production at or above a particular level—or to some other aspect of development.” Because the proposed covenant to explore further does not take into account the reasonable expectation of profit as the motivating force underlying the lease, the Court declined to adopt it.

While it found that the implied covenant of reasonable development applied, the Court affirmed the dismissal of the suit because the landowners did not rely on that covenant as a basis for their suit in their appeal.

[Disclosure: Vorys attorneys [Timothy B. McGranor](#) and [Gregory D. Russell](#) represented amici curiae Ohio Oil and Gas Association and Southeastern Ohio Oil and Gas Association in this case.]