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Pa. High Court's Oil And Gas Lease Ruling: An Industry Win

On March 29, 2016, in the case captioned *Shedden v. Anadarko E&P Co. LP*, 2016 Pa. LEXIS 689 (Pa. 2016) (Slip Opinion No. J-7-2016, Case No. 103 MAP 2014), the Pennsylvania Supreme Court unanimously affirmed a lower court's application of Pennsylvania's equitable doctrine of "estoppel by deed" (also known as the rule of after-acquired title) to an oil and gas lease holding that an oil and gas lessee is entitled to the subsequently acquired oil and gas interests of the lessor.

Leo and Sandra Shedden own 62 acres in Ward Township, Tioga County, and *thought* they owned all of the underlying oil and gas. However, the Sheddens' ancient predecessors in title, Ezra and Emma Baxter, had previously reserved one-half of the applicable oil and gas in a deed dated February 21, 1894.

In 2006, Anadarko approached the Sheddens to lease the oil and gas underlying the entirety of the 62-acre tract. Negotiations inevitably led to an oil and gas lease covering the entire 62 mineral acres, and Anadarko agreed to issue the Sheddens a bonus payment equal to \$80 per acre, being an upfront payment of \$4,960. However, having conducted preliminary title research, but before tendering the bonus payment, Anadarko discovered that the Sheddens, in fact, were only vested in a one-half interest in the applicable oil and gas. Consequently, Anadarko only issued bonus consideration for 31 net mineral acres, equal to a payment of \$2,480, and the lease was funded on that basis. The form of the oil and gas lease, however, was not amended by the parties to reflect the Sheddens' diminished ownership but remained an oil and gas lease covering their interest in the entire 62 acres.

Subsequently, in 2008, and in furtherance of their general warranty of title as set forth in the lease, the Sheddens successfully quieted title in their favor as to the balance of the acreage, being the remaining 31 acres. In 2011, Anadarko exercised its renewal option to extend the lease for an additional term and tendered an extension payment of \$70 per acre, or \$4,340, covering the full 62 acres. The Sheddens refused the renewal payment and never cashed the check. The Sheddens subsequently sought a judicial determination as to the rights of the parties under the lease and filed a declaratory judgment action claiming that the lease only covers 31 net oil and gas acres, and that the remaining acreage was unleased.

Significantly, between 2008 and 2011, as drilling and leasing activity in the Appalachian Basin steadily increased, so did the market rate to secure valuable oil and gas rights. The Sheddens arguably had every incentive to clear title on what they believed would have been 31 unleased acres. Anadarko, however, defended by arguing that the Sheddens were estopped by both their contractual obligations and the doctrine of estoppel by deed from denying that the lease had *already* granted Anadarko 100 percent of the oil and gas underlying the entire 62-acre tract. Significantly, the trial court, as affirmed by the superior court, determined that the Sheddens "intended to enter into a binding lease exclusively with Anadarko as to all 62 acres." Ultimately, the Supreme Court upheld the lease as to the entire tract.

The court focused on two provisions in the lease: (1) the "proportionate reduction" clause, and (2) the lessors' general warranty of title. The court first focused on the effect of the "proportionate reduction" clause. The Sheddens argued that Anadarko's reduced bonus payment in 2008 and their acceptance constituted a "modification" of the lease contract, which became vested only as to 31 acres. Anadarko responded that the reduced bonus paid was proper consideration for the interest that the Sheddens *actually* conveyed, relying on application of the lease's

“proportionate reduction” clause which provided that “the lessor shall be entitled to only a share of the rentals and royalties equivalent to the proportion of such oil and gas owned by the lessor.”

In this case, at the time of original execution, the Sheddens were only entitled to payment for a one-half net mineral interest in the 62 acres. The court held that Anadarko’s reduced bonus payment was consistent with the intent of the parties as reflected in the proportionate reduction clause and did not constitute a modification of the written contract. The court then focused on application of the “estoppel by deed” doctrine.

In Pennsylvania, the doctrine of estoppel by deed traditionally precludes one who leases property which he does not own, but of which he later acquires ownership, from denying the lease on the basis that he did not have ownership at the time the lease was executed. Additionally, an oil and gas lease is considered a conveyance of a property interest.

Here, the Sheddens gave a general warranty of title to the oil and gas underlying the 62 acres. The Sheddens promised in the lease that they were the owners of the oil and gas underlying the 62 acres, agreeing that “the lessor has full title to the premises and to all the oil and gas therein at the time of granting this lease, and forever warrants title to the leasehold estate hereby conveyed to the lessee.” In order to defend the general warranty in the lease, they were obligated to quiet title to the 31 mineral acres they did not own, but by application of the “proportionate reduction” clause, Anadarko was not obligated to make full payment until such time as the Sheddens acquired full ownership.

The court held that once the Sheddens perfected ownership to the oil and gas as to the remaining unvested 31 mineral acres, the lease became vested in its entirety as to Anadarko.

Consequently, in applying the equitable doctrine of estoppel by deed, the Sheddens could not deny the validity of their initial conveyance to Anadarko, and the court upheld and enforced the lease as covering the entire 62 acres.

The Supreme Court’s application of the doctrine of estoppel by deed to an oil and gas lease represents a significant victory for the industry. First, the court enforced the lessors’ covenant of general warranty as to the entire 62 acres, giving meaning to the promise that “the lessor has full title to the premises.” After the parties’ execution of the contract, but before payment of the bonus, Anadarko was within its rights under the lease to exercise the “proportionate reduction” provision and only pay the Sheddens for exactly the interest they owned.

Secondly, by application of the rule of after-acquired title and the doctrine of estoppel by deed, oil and gas lessees are the only parties under an oil and gas lease who may benefit from a landowner’s subsequent acquisition of the acreage they promised they already owned. When the Sheddens could not deliver “full title” to the 62 acres, they were already obligated to defend their general warranty in the lease and clear title by acquiring the Baxter’s one-half interest.

The court’s ruling gives a clear message that landowners will not be rewarded with an acreage windfall by doing what they were already contractually obligated to do: deliver “full title.” The court further prevents any future claims by landowners that an oil and gas lessee’s reduced bonus payment (or other form of consideration) by exercise of the “proportionate reduction” rights constitutes a contract modification decreasing the size of the original leasehold acreage. The court’s ruling also gives operators reason to review standard oil and gas lease forms to ensure inclusion of unambiguous proportionate reduction and after-acquired property clauses.

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For a full copy of the Slip Opinion described above, or to further discuss how application of the doctrine of estoppel by deed may impact your operations in the Marcellus, please contact **John R. Seeds** or **Jesse J. Zirillo**.



John R. Seeds
412-392-5349
jseeds@dmclaw.com



Jesse J. Zirillo
412-392-5342
jzirillo@dmclaw.com