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“UNLESS” PROVISIONS OIL AND GAS LEASES STRICTLY CONSTRUED – A REMINDER FROM THE SUPREME COURT OF NORTH DAKOTA

By Ralph A. Cantafio¹ and Rosanna Slingerland²

When administering oil and gas leases, it is important to make certain that where an agreement includes the use of “unless” clauses that payments be timely made or work be timely performed. Otherwise, even where the Lessee acts in good faith or engages in simple mistake, the Lease automatically terminates.

An “unless” clause provides that the oil and gas lease in question shall terminate unless the Lessee does some specific act, typically the payment of money or the commencing of the drilling of a well, within a prescribed period of time. See 3 Howard R. Williams and Charles J. Meyers, *Oil and Gas Laws* §606(21). Application of the “unless” clause results in consequences of a significant nature as failure to abide by the “unless” term will be unusually strict and harsh. A breach of these terms triggers automatic termination of oil and gas leases as such are found to act for the benefit of the Lessee. The recent decision of the Supreme Court of North Dakota in the case of Beaudoin v. JB Mineral Services, LLC, 808 N.W.2d 671 (North Dakota, 2011) is a reminder of this. In this instance, the North Dakota Supreme Court upheld the Order Granting Motion for Summary Judgment as entered by the underlying District Court terminating that Oil and Gas Lease because of inadequate performances by the Lessee.

A close examination of Beaudoin, *supra* is appropriate. JB Mineral Services, LLC (“JB”) leased certain oil and gas interests located in Stark County, North Dakota from Beaudoin. In July 2009, JB delivered to the Beaudoin’s an Oil and Gas Lease, a Supplemental Agreement and a site draft in the amount of \$165,000.00. The documents included use of language whereby the Lease would terminate 120 business days from the date of “notarized signature” unless JB paid or tendered to Beaudoin an additional \$45 per net mineral acre as a “supplemental bonus payment” before that termination date. The Agreement included: “...if such sum is not timely paid or tendered then said Lease shall terminate and be of no further force or effect as of the Termination Date”. One can say this is a traditional type of “unless” clause. The Beaudoin’s signed the Lease and the Supplemental Agreement submitting notarizing signatures. The Beaudoin’s calculated that the “Termination Date” under the Supplemental

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Agreement was January 12, 2010. As of that January 12th date the site draft had not been made good by JB and no \$45.00 per acre supplemental payment was made to Beaudoin. As a result, on January 19, 2010, legal counsel of the Beaudoin's faxed a correspondence to JB advising that entity that the Beaudoin's were taking the position that the Oil and Gas Lease had now terminated and was thereafter invalid. The following day, legal counsel for JB replied advising that the Beaudoin's calculation of the date as to the Lease Termination Date was inaccurate. On January 20, 2010, legal counsel for the Beaudoins communicated again continuing to maintain that the Lease had terminated and was thereafter invalid. Despite the same, JB recorded the Lease on January 20, 2010.

Thereafter, the Beaudoins sued JB so as to have the Oil and Gas Lease declared invalid, among other things. The Beaudoins' file a Motion for Summary Judgment asking that the District Court determine that there existed no issues of fact and that as a matter of law Judgment should enter. Ultimately, the District Court granted Summary Judgment to the Beaudoins and against JB determining that the parties Agreement unambiguously provided for an "unless treatment" and that the Lease terminated consistent with the interpretation of the Beaudoins as a result of JB failing to make the required bonus payment by that termination date. The North Dakota Supreme Court agreed that the Oil and Gas Lease terminated by its own terms because of the failure of JB to make timely payment based upon the utilization of an "unless" clause. As mentioned above, the "unless" clause provided that the Oil and Gas Lease in question would terminate unless Lessee did some specific act. Here, JB did not make timely payment. The North Dakota Supreme Court observed:

... [an] "unless" clause does not obligate the Lessee to do an act but provides that the Lease shall terminate unless the Lessee does some act. The "unless" clause does not state a condition subsequent upon which the Lease may be forfeited, but it is construed as a clause of special limitation and if delay rental payments required by the Lease are deficient in either time or the amount of payment, the Lease terminated automatically without any requirement of notice or demand on the part of the Lessor...

The Supreme Court of North Dakota further noted that the language utilized by the parties was clear and unambiguous and that the Agreement between these parties specifically stated that the Lease would terminate 120 business days from date of notarization unless JB paid to the Beaudoins the \$45.00 per net mineral acre on or before that termination date. The Court further noted that the Agreement clearly outlined that: "[I]f such sum is not timely paid or tendered, then said Lease shall terminate". The Supreme Court of North Dakota stated:

...This Court has recognized that the "unless" clause was developed for the benefit of the Lessee, and is strictly construed against the Lessee even though harsh results may occur:

The "unless" clause was developed to allow the Lessee under an oil and gas lease to terminate the obligation to drill or pay delay rentals where no oil and gas were found on the property subject to the Lease. The policy of strictly construing the "unless" clause has been followed even though harsh results may occur. Similarly, the Rule of Automatic Termination containing an "unless" clause has been applied with equally harsh results. [Cite omitted]

The Supreme Court of North Dakota went on to recognize even where a Lessee has both the intent and the ability to perform conditions necessary to hold an Oil and Gas Lease, failure to timely and fully act as prescribed under the Lease resulted in the Lease terminating. This termination resulted even if it was true that the Lessor was not injured by the failure of Lessee to timely and fully act and even in the case where a Lessor was willing to make the Lessee whole by tendering a late payment with appropriate legal interest.

Because the Lease automatically terminates as a result of a failure to timely make payments or act otherwise an “unless” clause has been determined to be a clause of limitation, not one of covenant. The Lessee has no further liability under the Lease by simply failing to commence operations or paying rentals during the primary term. A Lessee who benefits from such treatment as to not being subject to any award of damages as a result of not performing a contractual term is instead subject to automatic termination of the Lease. This is all the more true as it is the Lessee who is responsible for the failure to make a timely payment or otherwise act.

While the decision of the Supreme Court of North Dakota may appear to be very inflexible, this holding is in accord with long established law in virtually every jurisdiction. As one would imagine, it is important to recognize at the onset of Lease administration as to whether or not such Lease contains any “unless” clause. If a clause is of an “unless” nature or is suspected being of an “unless” nature, the most conservative course of action is to make sure that full and timely payment is made so that any failure to make full and timely payment does not trigger an “unless” clause. Likewise, to the extent such “unless” clause is triggered by failure to make actual performance of other obligations that is such performance is actively and timely performed as well as documented strict compliance is required to hold the Oil and Gas Lease. Otherwise, it is the inaction of Lessee that results in the immediate.

The use of these “unless” clauses have been upheld for almost a century now. The use of the same essentially creates a fee simple determinable by the Lessee and a possibility of reversion to the Lessor. This negotiated term whereby an Oil and Gas Lease automatically terminates upon failure, inadvertent or otherwise, of the Lessee to commence the drilling of a well or to make full, complete and timely payments is not new. Particularly because the language in question is typically advanced by the Lessee in drafting Oil and Gas Leases, *Beaudoin* is a clear reminder of what Professor Bruce M. Kramer identifies as the “gotcha implications” of the “unless” clause.

Before concluding, it is important to remind the reader of the difference between a lease covenant and a lease condition. The breach of a covenant permits a claim for damages. A breach of a condition results in automatic termination of the lease, but nothing worse. Today, most forms of lease contain conditions, but not covenants. This is true of *Beaudoin*.

When administering Oil and Gas Leases it is important upon receipt and initial review to identify all “unless clauses”. If one is not sure whether a clause is of an “unless” variety, ask legal counsel. However, be mindful that once any “unless” clause is violated, there is thereafter no right to cure. The Oil and Gas Lease is terminated as a matter of law at the time of said failure to pay or otherwise act.