

## Pennsylvania Supreme Court decision makes operators bear risk of challenged lease's expiration

Should an operator in a lawsuit challenging the validity of its oil and gas lease have to risk having its lease expire during that suit by not commencing operations? Nearly all states whose courts have addressed this issue say, "No." Those states' courts allow operators to extend or "equitably toll" their challenged leases if they prevail in the suit. But not in Pennsylvania, where the Supreme Court has rejected equitable tolling in most situations and forced the operator to bear the risk that its lease will expire during the suit challenging that lease.

On February 17, the Pennsylvania Supreme Court issued a significant opinion in *Harrison v. Cabot Oil & Gas Corp.* in which the court refused to apply equitable tolling principles. Wayne and Mary Harrison filed suit in the United States District Court for the Middle District of Pennsylvania by asserting a declaratory judgment claim that they had been fraudulently induced by Cabot to enter into an oil and gas lease. Cabot counterclaimed seeking its own declaratory judgment that in the event the Harrisons' claims failed, Cabot was entitled to an extension of the lease's primary term under equitable tolling principles for so long as the suit was pending. In fashioning its claim for relief, Cabot suggested that the lease term be extended for the period commencing at the end of the litigation for so long as the case was pending. For instance, if the case took 18 months from start to finish, Cabot advocated that the lease should extend for an additional 18 months once the case ended. Cabot justified its request to extend the lease term by arguing that the Harrisons' suit put a cloud on its lease and prevented it from prudently taking steps to commence operations—which would have tolled the lease's primary term.

The District Court ultimately granted Cabot's motion for summary judgment, thereby disposing of all of the Harrisons' claims. The trial court, however, denied Cabot's counterclaim, holding that Pennsylvania law did not support equitable tolling of a gas lease under these circumstances. The trial court relied on the 1982 case of *Derrickheim Company v. Brown*, 451 A.2d 477. In that case, the Superior Court held that an operator who suspended operations until a title defect was resolved was not

entitled to equitable tolling. The Superior Court held that the operator was not justified in ignoring the lease's express language regarding the lease expiring during a cessation of operations. The trial court believed that the facts of the two cases were significantly similar and that the reasoning of *Derrickheim* controlled.

As a result of the District Court's decision, Cabot appealed to the United States Court of Appeals for the Third Circuit, which then certified the case to the Pennsylvania Supreme Court on the grounds that there was an issue "of first impression and of significant public importance, given that its resolution may affect a large number of oil and gas leases in Pennsylvania." Thus, in somewhat unusual circumstances, the case went from a federal appeals court straight to the Pennsylvania Supreme Court for its determination.

In a unanimous decision, the Supreme Court upheld the trial court's decision not to toll the oil and gas lease. In so ruling, the court noted that a party acts at its own peril if it refuses to perform its contractual duties. In this instance, the court held in essence that Cabot should not have risked expiration of the lease by failing to commence operations. The court also noted that finding for Cabot would require the adoption of a "special approach to repudiation pertaining to oil and gas leases," which it declined to do. The court acknowledged, but ultimately chose to ignore that nearly every other state addressing this issue adopted the equitable tolling rule Cabot advocated. Those other states which have adopted the rule Cabot argued for include Louisiana, Arkansas, Illinois, Texas and Montana.

The Supreme Court explained that the Harrisons' attempt to invalidate the lease did not justify "altering material provisions" of the lease—i.e. the primary term. The court noted as an alternative approach operators are free to negotiate tolling agreements in their leases, particularly since lease challenges are so prevalent. The court also noted that the result of the case may have been different "where there is an affirmative repudiation of the lease." In other words, had the lessors prevented the operator from entering the leasehold property to conduct operations, the court may have been willing to toll the primary term of the lease.

The *Harrison* case is significant in several respects and its lessons should not be ignored. First, the case opens the door for lessors to try to "run out the clock" on leases by filing

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frivolous lease litigation. Although operators might have claims against lessors for bringing frivolous suits, it may tip the scales for lessors in deciding whether to pursue litigation that may “be a close call” where a lease is at risk for expiring during the suit. Secondly, the case clearly imposes on operators both the obligation and the risk to continue operations even in the face of suits challenging the validity of their leases. That risk is obviously great where the operator faces the potential ruling that its lease is invalid. Third, if a lessor files suit to challenge a lease’s validity and simultaneously denies the operator the right to conduct operations, the operator must now consider filing for equitable relief through an injunction before seeking to toll the lease term. In other words, believe it or not, an operator whose lease is being challenged may be in a better position to extend the term of its lease if it is being prevented from operating by the lessor. Lastly, and most importantly, the *Harrison* case makes clear that all future leases entered into in Pennsylvania contain tolling provisions to extend the primary terms of those leases in the event of a validity challenge by the lessor.

If you would like additional information about this important development, contact the author at 412-253-8818 or [ssilverman@babstcalland.com](mailto:ssilverman@babstcalland.com).