

# Supreme Court ruling says unproductive well can end oil lease

By Neal A. Shipman  
*Farmer Editor*

North Dakota mineral owners who have their minerals tied up in non-paying wells were the winners in a recent North Dakota Supreme Court ruling.

According to Dennis Edward Johnson and Ariston E. Johnson of the Watford City law office of Johnson & Sundeen, who represented McKenzie County landowner Greg Tank in the case, given the great number of old oil wells producing small quantities of oil on leases in western North Dakota, and the advent of the new Bakken and Three Forks wells being drilled on those old leases, the decision in the Tank case could raise significant questions about the validity of some of those old leases.

The case, Tank v. Citation Oil & Gas Corp., 2014 ND 123, concerned the validity of a 1982 oil gas lease where oil wells had been drilled on the lands in the late 1980s. When one of the wells had mechanical issues and failed to produce oil and gas

in paying quantities and the operator of the well failed to fix the well or promptly drill a new well, Tank had demanded that the oil company release the oil and gas lease for his mineral rights. The well operator, Citation Oil & Gas, did not respond to Tank's demand, and he subsequently filed suit in the McKenzie County District Court. Tank was successful in that court and both Citation Oil & Gas and Petro-Hunt appealed to the state Supreme Court to review the decision.

According to Tank's attorneys, the Supreme Court carefully considered the language of the lease and the history of the wells that were drilled on it in reaching its decision, and determined that the lease expired for the portion of the land where there was not paying production.

"There were two core issues that the court had to analyze: the definition of 'production' and the meaning of the Pugh clause in the lease,"

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# Court: Supreme Court ruling could impact older oil leases

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stated Dennis Johnson.

Johnson explained that a Pugh clause is a lease term that protects landowners by releasing undeveloped portions from the lease if a well is not producing oil and gas from those portions. Most oil companies do not include a Pugh clause in their lease forms, but attorneys representing mineral owners routinely demand that some form of Pugh clause be included in the oil and gas lease before it is signed.

According to Johnson, even if a particular lease has a Pugh clause, they are not all the same.

"Our firm has for over three decades not only followed but also, as we did in this case, led developments in oil and gas law so that we can help our clients fully protect their interests for future generations," stated Johnson. "That includes negotiating terms such as a Pugh clause to ensure that the oil company promptly develops the entire leased acreage and keeps its wells producing oil and gas in paying quantities."

According to Johnson, he is aware of at least one lease dating back to 1936, and there are probably many others over the past 80 years that will get closer scrutiny after this court decision.

"Another victory for North Dakota landowners is the part of the decision recognizing that only paying production counts," states Johnson. "Oil companies can no longer hold a lease forever if there is not real, paying production. The production revenue must consistently exceed operating expenses from the well in order to keep the lease in effect."

Johnson said that oil companies sometimes keep unprofitable wells pumping just to hold leases. The majority of courts around the country have ruled against this practice, says Johnson, but North Dakota had never addressed the issue.

"The well on our client's land was

producing very little oil for a long time," stated Johnson. "The operator admitted that it had failed. However, the operator still claimed that the well should hold the lease, even though expenses to operate the well were greater than the sales of oil and gas from the well. North Dakota's courts have now shown that they will not entertain such claims."

The other law firms involved in the case were Fredrikson & Byron of Bismarck for Citation Oil & Gas and Crowley Fleck of Bismarck for Petro-Hunt.