RECENT COURT OF APPEALS DECISION GUTS FORCE MAJEURE CLAUSES IN MOST OIL AND GAS LEASES

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On March 31, 2015, the New York State Court of Appeals issued an opinion in the case of *Walter R. Beardslee, et al. v. Inflection Energy, LLC, et al.*, interpreting the applicability of *force majeure* clauses to extend the primary term of oil and gas leases where lessees were prevented from drilling due to the moratorium on high-volume hydraulic fracturing in New York. The Court of Appeals, which is New York's highest court, held that a typical *force majeure* clause in the oil and gas leases in question did not modify the habendum clause of the leases, and therefore cannot extend the primary terms of the leases. The habendum clause establishes the term of an oil and gas lease, broken down into a primary term, a fixed period of time during which the lessee must commence a specific activity – usually the drilling of a well, and a secondary term, which only comes into play if the lessee timely commenced the specified activity during the primary term and which continues while the subject property is operated for the production of oil and/or gas, subject to permissible interruptions in production as specified in the lease. The *Beardslee* decision means that the leases expired at the end of their primary terms, even though the failure of the Lessees to commence drilling at, or produce oil or gas from, the leased premises was entirely due to the moratorium.

Inflection Energy, LLC had advised landowners, who were lessors of oil and gas leases it controlled, that the moratorium was a *force majeure* event which would extend the primary term of their leases. A group of Tioga County landowners commenced an action in federal court (the U.S. District Court for the Northern District of New York) against Inflection and two other companies that had interests in the leases, seeking a declaratory judgment that the leases had expired. The District Court granted summary judgment in favor of the landowners, ruling that even if the moratorium constituted a *force majeure* event (a contention that the landowners opposed and that the district court did not decide), it would have no effect on the habendum clause and the lease terms because the energy companies did not have an obligation to drill. The energy companies appealed to the U.S. Court of Appeals for the Second Circuit. The Second Circuit observed that the case involved previously unanswered questions of New York law relating to the interpretation of oil and gas leases and turned to New York's highest court for answers to those questions. The Court of Appeals was asked by the Second Circuit to interpret two questions: (1)

under New York law, and in the context of an oil and gas lease, did the moratorium amount to a *force majeure* event, and (2) if so, did the *force majeure* event modify the habendum clause and extend the primary terms of the leases?

The Court of Appeals focused its analysis on the second question, and decided that even if there was a *force majeure* event it could not modify the habendum clause and thus would not extend the primary terms of the leases involved. Because the Court of Appeals answered the second question in the negative, it determined the first question to be academic and not necessary to answer. The court provided several reasons for its conclusion with respect to the second question, including:

The habendum clause in the leases does not incorporate the *force majeure* clause by reference or contain any language expressly subjecting it to other lease terms nor does the language in the *force majeure* clause, which states that "the time of such delay or interruption shall not be counted against Lessee," refer to the habendum clause with specificity; accordingly, the habendum clause is not expressly modified or enlarged by the *force majeure* clause;

The language in the *force majeure* provision does not supersede all other clauses in the leases, only those with which it is in conflict, and the *force majeure* clause is not in conflict with the provisions of the primary term of the habendum clause, because the Lessee is not obligated to drill for or produce oil or gas during the primary term;

The words "anything in this lease to the contrary notwithstanding" alone are insufficient to compel the conclusion that the *force majeure* clause modifies the primary term, as compared to the secondary term, of the habendum clause;

Because the *force majeure* clause expressly refers to a delay or interruption in drilling or production, the clause only conflicts with and only modifies the secondary term of the habendum clause, in which the Lessee has the obligation to operate in the production of oil or gas or the lease terminates;

The sentence of the *force majeure* clause that deals with governmental regulations pertains only to the energy companies' express or implied covenants (i.e. the Lessee's obligations); since there are no express or implied covenants applicable to the primary term other than the payment of delay rentals, the *force majeure* clause must relate only to continuous drilling/ production operations during the secondary term;

The clause in the *force majeure* provision relating to governmental laws, orders, rules, or regulations dealt with lease termination not lease expiration, and the corresponding habendum clause provision is the secondary term, which addresses the conditions under which the leases would terminate, whereas the primary term deals with lease expiration;

The court interpreted the "notwithstanding" language of the *force majeure* clause as excusing only performance during the secondary term during which operations in the production of oil and gas would be necessary for leases to remain viable and concluded that to read the *force majeure* clause as applying to the primary term would be to interpret the leases in a manner contrary to the plain intent of the parties;

Finally, the Court of Appeals stated that its position was consistent with out-of-state "oil" jurisdictions, which have held that similar *force majeure* clauses cannot extend the primary terms set forth in the habendum clause, and pointed out that if the energy companies intended for the habendum clause to be subject to other provisions of the lease they could have expressly so indicated.

The decision in *Beardslee* essentially makes the *force majeure* clause in most existing oil and gas leases inapplicable to the primary term of the lease. Most oil and gas companies will be surprised by the Court's conclusion that this is what they intended when they entered into the leases. While the *Beardslee* case focused on the moratorium initiated by Governor Paterson, the result of the Court's decision is that any event that may constitute *force majeure* will not result in an extension of the primary term of an oil and gas lease unless the lease expressly provides to the contrary. While it is unreasonable to expect that existing lessors will execute amendments to their leases making the *force majeure* clause applicable to the primary term, companies wishing to execute new leases in New York should revise their lease forms to include this language.

Companies taking leases in other states should also consider revising their lease forms in light of the *Beardslee* decision. The Court of Appeals cited previous holdings by courts in California and Texas that ruled similar *force majeure* clauses could not extend the primary term of a habendum clause in oil and gas leases. The *Beardslee* decision will be added to that list of cases and used as precedent to challenge the application of *force majeure* clauses wherever leases are affected by the increasingly frequent delays resulting from the efforts of anti-drilling/anti-fraccing activists.