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Moerman v. Prairie Rose Resources, Inc.

Carolyn A. Sime

University of Montana School of Law, carolysime@gmail.com

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***Moerman v. Prairie Rose Resources, Inc.*, 2013 MT 241, 371 Mont. 338, 308 P.3d 75.**

Carolyn A. Sime

I. ABSTRACT

The Montana Supreme Court affirmed that an oil lease did not terminate during either the primary or secondary terms. Prairie Rose Resources (PRR) fulfilled the primary lease terms when drilling rigs were in place, a pump was turned on, and the operator saw oil one day prior to expiration. Even though production ceased during the secondary term, PRR preserved the lease by its own express terms based on contract law and under the cessation of production doctrine. PRR made reasonable, diligent efforts to obtain a mineral title opinion despite significant delays caused by the backlog of requests in the rapidly expanding Bakken area. PRR showed it acted consistent with the diligence of an ordinary prudent operator to obtain the title, despite delays caused by third parties. The Court affirmed the fee award to PRR, including on appeal.

II. INTRODUCTION

In *Moerman v. Prairie Rose Resources, Inc.*,¹ the Montana Supreme Court affirmed a district court ruling which preserved an oil lease on private land in Wibaux County. Moreman's, the plaintiff-appellant, challenged the lease's validity by arguing the lease expired due to lack of production during the primary term, or alternatively, that cessation of production during the secondary term automatically terminated the lease.² The Court affirmed that sufficient evidence of production during the primary term can be starting up a pump and seeing it produce "some" oil.³ Applying contract law, the Court concluded the express lease term "for any cause" allowed cessation of production for up to 180 days during the secondary term and did not trigger

¹ *Moerman v. Prairie Rose Resources, Inc.*, 2013 MT 241, 371 Mont. 338, 308 P.3d 75.

² *Id.* at ¶ 24.

³ *Id.* at ¶ 25.

forfeiture.⁴ Further, the delay in obtaining the requisite mineral title opinion caused by the backlog of title opinion requests in the busy Bakken area did not thwart appellee–lessee PRR’s required due diligence under the cessation of production doctrine which preserves a lease in the secondary term under *Somont I.*⁵ The lease remained in force, and PRR was awarded fees.

III. FACTUAL AND PROCEDURAL BACKGROUND

The Moerman’s executed a lease with PRR which allowed PRR to rework an abandoned well to recover previously unavailable oil using new technology.⁶ The lease’s primary term was June 1, 2010 through December 1, 2010.⁷ If PRR produced oil or gas by December 1, 2010, the lease would continue into the secondary term. Additionally, if PRR continuously drilled or re-worked the well or started drilling a new well within 180 days of abandoning this well, the lease would not terminate.⁸ Once oil was produced and the lease moved into the secondary term, the lease would not terminate if production ceased “*from any cause*” during the secondary term, so long as PRR commenced additional drilling or re-working operations within 180 days after the cessation date.⁹ PRR assigned Moerman’s lease to PB Oil Company, who contracted with TOI Operating, Inc. (TOI) to bring the well into production.¹⁰

In November 2010, TOI moved a work-over rig to the site.¹¹ After constructing a pad and installing the necessary equipment, TOI started up the well on November 29.¹² However, severe winter weather prevented TOI from further activity at the well until December 9.¹³ The Montana Board of Oil and Gas Conservation documented over seven feet of oil in the storage

⁴ *Id.* at ¶¶ 29-30.

⁵ *Id.* at ¶¶ 29-31; *Somont Oil Co., Inc. v. A. & G. Drilling, Inc.*, 2002 MT 141, 310 Mont. 221, 49 P.3d 598.

⁶ *Moerman*, ¶ 6.

⁷ *Id.* at ¶ 7.

⁸ *Id.*

⁹ *Id.* at ¶ 30. Lease secondary term “*for any cause*” emphasized in the original.

¹⁰ *Moerman*, ¶ 8.

¹¹ *Id.* at ¶ 9.

¹² *Id.*

¹³ *Id.* at ¶¶ 9-10.

tanks during inspections on December 10 and 13.¹⁴ PRR notified John Moerman on December 10 that the well was producing.¹⁵ PRR contracted with Shell Oil to purchase the oil, but the oil could not be sold until a mineral title opinion demonstrated clear title.¹⁶ PRR contacted several attorneys during the latter part of 2010, but did not expect a completed title opinion until February 15, 2012.¹⁷ In a February 18, 2011 letter, Moerman's attorney requested PRR release the leases on behalf of Irene Moerman, who was unaware that oil was being produced.¹⁸ PRR did not respond to the letter, declining to cancel the lease so as to avoid significant financial loss.¹⁹

Moerman's filed for declaratory judgment, claiming the PRR lease had expired. They requested a release, which would allow them to pursue other leasing opportunities.²⁰ PRR counterclaimed for breach of contract and the implied covenant of good faith and fair dealing, alleging the lease was still in force.²¹ After a bench trial, the district court held the lease in full force and awarded PRR attorney's fees and costs.²² Moerman's appealed.

IV. ANALYSIS

On appeal, the Court decided two issues: whether the district court correctly concluded the lease remained in effect and whether the court correctly awarded fees to PRR.²³

In the first instance, the Court reviews a district court's finding of fact for clear error if sitting without a jury and its conclusions of law for correctness.²⁴ The Court concluded the lease

¹⁴ *Moerman*, ¶ 10.

¹⁵ *Id.* at ¶ 11.

¹⁶ *Id.* at ¶ 12.

¹⁷ *Id.*

¹⁸ *Id.* at ¶ 13.

¹⁹ *Id.* at ¶ 14.

²⁰ *Id.* at ¶ 15.

²¹ *Id.*

²² *Id.* at ¶ 16.

²³ *Id.* at ¶¶ 19, 34.

²⁴ *Id.* at ¶ 17.

remained in effect on three grounds. First, the Plaintiff-Moermans had not met their burden of proof to show the well was not producing before the primary term expired on December 1, 2010.²⁵ In contrast, PRR's offered evidence that the drilling operator had started the pump and saw it produce oil on November 29. This was sufficient to establish production during the primary term.²⁶ Second, the lease allowed PRR's re-working efforts preserve the lease as long as they were continuously prosecuted.²⁷ Third, after finding that the lease had not expired on December 1, the Court held that lack of production in the secondary term caused by a delayed mineral title fell within the gambit of the express lease phrase "for any cause" (a condition of the secondary term) and thus preserved the lease.²⁸ Further, the Court noted TOI's diligent efforts to secure the requisite mineral title report within 180 days of the primary term's expiration.²⁹ The Court concluded that PRR demonstrated the requisite diligence of an ordinary prudent operator having regard for the interests of both lessor and lessee by citing to the high demand for mineral title work in the rapidly expanding Bakken and that PRR's effort to obtain a title report began in September, 2010.³⁰ The Court also noted the lease's secondary term allowed for a cessation of production "for any cause" – the scope of which here encompassed a delayed title opinion.³¹

As to the second issue, a trial court's award of fees and costs is reviewed for abuse of discretion.³² By statute, an owner of a leased premises who successfully challenged the validity of an oil and gas lease may recover costs, fees, and any additional damages evidence in the case warrants.³³ But plaintiffs who fail to establish lease forfeiture are statutorily required to pay

²⁵ *Moerman*, ¶ 25.

²⁶ *Id.*

²⁷ *Id.* at ¶ 27.

²⁸ *Id.* at ¶ 30.

²⁹ *Id.* at ¶¶ 31-33.

³⁰ *Id.* at ¶¶ 13, 32.

³¹ *Id.* at ¶ 30.

³² *Id.* at ¶ 18.

³³ *Id.* at ¶ 35; (citing § 82-1-202(1) Mont. Code Ann. (2013)).

fees.³⁴ The Court affirmed the award to PRR, as Moermans did not meet their burden.³⁵ The Court also granted PRR's request for fees on appeal.³⁶

V. CONCLUSION

Due to the highly speculative nature of oil and gas development, leases are typically construed in favor of the lessor, and forfeitures are favored to prevent burdening landowners with unworked leases. A common issue across many oil and gas lease forfeiture cases is whether a well is in production. The Court's affirmation that oil production may be inferred from evidence that drilling equipment was in place, pumps were started and operators saw oil provides a contemporary interpretation of what is required to establish production during the primary term.

However, facts and circumstances determine whether a lease is forfeited when production ceased during the secondary term. Here, express lease terms were scrutinized and interpreted under contract law first. "For any cause" was broadly interpreted to include title delays caused by third parties under the circumstances prevailing in the Bakken. Second, the cessation of production doctrine encompassed title delays attributable to third parties where the operator's reasonable diligence to resume production was found based simply on a title request, given the backlog of requests in the Bakken. Despite public policy favoring lessor's interests, lessors who request declaratory judgment to terminate a lease during the secondary term must provide supporting evidence by citing to express lease terms or by overcoming the cessation of production doctrine by showing a lack of diligence. More importantly, lessors should closely scrutinize all lease terms and clauses to adequately protect their own interests in the face of dynamic circumstances in the oil and gas industry.

³⁴ *Moerman*, ¶¶ 35-36.

³⁵ *Id.* at ¶ 36.

³⁶ *Id.* at ¶ 37.