

RENDERED: AUGUST 16, 2013; 10:00 A.M.
NOT TO BE PUBLISHED

Commonwealth of Kentucky
Court of Appeals

NO. 2012-CA-001354-MR

JOHN E. STEFFEY

APPELLANT

v. APPEAL FROM BARREN CIRCUIT COURT
HONORABLE PHIL PATTON, JUDGE
ACTION NO. 08-CI-00942

JAMES R. STEFFEY; AND
JOANNE STEFFEY

APPELLEES

OPINION
AFFIRMING

** ** * * * * *

BEFORE: CAPERTON, CLAYTON, AND TAYLOR, JUDGES.

TAYLOR, JUDGE: John E. Steffey brings this appeal from a July 6, 2012,

Findings of Fact, Conclusions of Law and Judgment of the Barren Circuit Court.

We affirm.

Appellant is in the oil and gas business. In the early 1980s, appellant and appellees' predecessors in interest entered into an Oil and Gas Lease (Oil

Lease) concerning 66 acres owned in fee simple by appellees' predecessor in interest. Shortly thereafter, appellant drilled five oil wells on the 66 acres and four proved to be producing wells. Over time, three of the four wells stopped producing oil, and currently only one well produces oil on the 66 acres under the Oil Lease. On December 8, 2008, appellees acquired title to the 66-acre tract. Three days later, appellees sent appellant a letter informing him that they deemed the Oil Lease to be abandoned or to have expired by its own terms. Appellees requested that appellant remove his oil well equipment from their property.

Shortly thereafter, appellant filed a declaration of rights action in the Barren Circuit Court. Therein, appellant claimed that the Oil Lease had not terminated and that he maintained one active producing well on the 66 acres. Appellees filed an answer and asserted that the Oil Lease was either abandoned or terminated under its own terms. By judgment entered July 6, 2012, the circuit court determined that appellant had not abandoned the Oil Lease as one well upon the 66 acres was producing oil in "paying quantities." The circuit court then held that the Oil Lease was valid and continued in full force as to the producing well and the area within 400 feet of property surrounding same. However, as to the "remainder of the 66-acre tract," the court concluded that the Oil Lease terminated under its own terms as no producing wells were maintained thereunder. This appeal follows.

Appellant contends that the circuit court erred by concluding that the Oil Lease had expired except as to the single producing well and the area within

400 feet of property surrounding same. Appellant argues that an oil well had been continuously producing “paying quantities” on the 66 acres, thus precluding termination of the Oil Lease. And, appellant maintains that appellees failed to give proper notice before seeking cancellation of the Oil Lease. We disagree.

To begin, the circuit court heard this matter without a jury pursuant to Kentucky Rules of Civil Procedure (CR) 52.04. Thereunder, the circuit court’s findings of fact will not be disturbed on appeal unless clearly erroneous. A finding of fact is clearly erroneous if not supported by substantial evidence of a probative value. And, we review issue of law *de novo*.

In this case, the material facts are largely undisputed. The parties entered into the Oil Lease in 1980 and currently only a single well is producing oil in paying quantities. The Oil Lease’s original term was for one year and then “as long as thereafter as oil or gas, or either of them, is produced” This latter language extending the original term of the Oil Lease is often referred to as the “thereafter” clause. 38 Am. Jur. 2d *Gas and Oil* § 213 (2013). Under a thereafter clause, an oil and gas lease is extended beyond the original term by the drilling of a producing well in paying quantities. 38 Am. Jur. 2d *Gas and Oil* § 213 (2013).

In this Commonwealth, there are generally three distinct methods to cancel an oil and gas lease: (1) forfeiture, (2) abandonment, and (3) termination by the lease’s own terms. *Hiroc Programs, Inc. v. Robertson*, 40 S.W.3d 373 (Ky. App. 2000). In this case, we are concerned with the third method – termination by its own terms. Under this third method, an oil and gas lease is said to terminate

where neither oil nor gas is produced in paying quantities as required by the thereafter clause in the lease. *Hiroc Programs*, 40 S.W.3d 373. Where the original term of a lease expired and no wells are producing in paying quantities, the lease “will *ipso facto* terminate whenever production or development ceases for an unreasonable period of time” pursuant to the “thereafter” clause. *Hiroc Programs*, 40 S.W.3d at 377. With this third method, notice to the lessee is not required. *Id.*

Pursuant to principles of equity, Kentucky Courts have also recognized the doctrine of partial cancellation or termination of an oil and gas lease. *McMahan v. Boggess*, 302 S.W.2d 592 (Ky. 1957); *American Wholesale Corp. v. F. & S. Oil & Gas Co.*, 242 Ky. 356, 46 S.W.2d 498 (1932); *Ison v. Edra Lee Oil & Gas Co.*, 241 Ky. 754, 45 S.W.2d 3 (1931); *Lawrence Oil Corp. v. Metcalfe*, 241 Ky. 353, 43 S.W.2d 986 (1931), *see also* 3 *Summers Oil and Gas* § 22:23 (3d ed. 2012). Under this doctrine, a court may terminate an oil or gas lease for nonproduction except for a reasonable acreage around a producing well. 3 *Summers Oil and Gas* § 22:23 (3d ed. 2012). In such instance, the oil and gas lease remains in full effect as to the producing well and reasonable acreage surrounding the producing well but terminates as to the remaining acreage.

Herein, we think the circuit court properly applied the facts to the law and did not abuse its discretion. Under the Oil Lease, only one well was producing oil in paying quantities on the 66 acres. The Oil Lease had been in effect for over twenty years with no additional drilling activity. And, the one producing well was only generating royalties between \$800 and \$900 per year. Pursuant to the Oil

Lease's thereafter clause, the lease only remained effective so long as oil was produced thereupon. It was well within the circuit court's discretion to utilize the partial cancellation doctrine and conclude that the Oil Lease terminated by its own terms pursuant to its thereafter clause except for the single producing oil well and the area within 400 feet contiguous thereto. Consequently, we hold that the circuit court's decision that the Oil Lease terminated by its own terms except as to the producing oil well was proper.

For the foregoing reasons, the Findings of Fact, Conclusions of Law and Judgment of the Barren Circuit Court is affirmed.

CLAYTON, JUDGE, CONCURS.

CAPERON, JUDGE, DISSENTS WITHOUT SEPARATE

OPINION.

BRIEF AND ORAL ARGUMENT
FOR APPELLANT:

Danny J. Basil
Glasgow, Kentucky

BRIEF AND ORAL ARGUMENT
FOR APPELLEES:

Thomas W. Davis
Glasgow, Kentucky