

Commonwealth of Kentucky
Court of Appeals

NO. 2007-CA-001715-MR

YOST ENERGY, LLC,
a Kentucky Limited Liability Company

APPELLANT

v. APPEAL FROM WARREN CIRCUIT COURT
HONORABLE JOHN R. GRISE, JUDGE
ACTION NO. 06-CI-00610

JERRY “PEANUTS” GAINES AND
MARILYN GAINES

APPELLEES

OPINION
REVERSING AND REMANDING

** ** *

BEFORE: CAPERTON AND VANMETER, JUDGES; GUIDUGLI,¹ SENIOR JUDGE.

GUIDUGLI, SENIOR JUDGE: Yost Energy, LLC, appeals from a judgment of the Warren Circuit Court which terminated an oil and gas lease. Yost Energy presents three arguments: (1) that it was entitled to a directed verdict; (2) that the

¹ Senior Judge Daniel T. Guidugli sitting as Special Judge by assignment of the Chief Justice pursuant to Section 110(5)(b) of the Kentucky Constitution and KRS 21.580.

jury instructions were contrary to the lease and the evidence; and (3) the trial court erred by failing to grant its motion for judgment notwithstanding the verdict. We reverse.

Appellees, Jerry “Peanuts” Gaines and Marilyn Gaines own property in Warren County, Kentucky. The Gaineses and Yost Energy entered into a standard Kentucky 88 oil and gas lease. The lease was executed on August 17, 2004. The lease term provision at issue in this appeal states:

It is agreed that this lease shall remain in force for a term of one year from this date and as long thereafter as oil, gas, casing-head gas, casing-head gasoline or any of them is produced from said leased premises or shut-in royalty or rental is paid for the right to inject, store and remove gas in and from the oil and gas strata underlying said premises, as hereinafter provided: or operations for drilling are continued as hereinafter provided.

Gaines Well Number 1 was drilled on January 5, 2005. Well Number 1 was the only well on the lease. During the drilling process, the well produced between two and three barrels of oil. Subsequently, the well was shut in because of inclement weather. The completion of the well and production resumed on November 18, 2005. Subsequently, the well produced fifteen barrels which were then sold.

In January 2006, Yost Energy sent a royalty check to the Gaineses. The Gaineses returned the check and advised Yost Energy of their belief that the lease had expired. Yost Energy sought a declaratory judgment that the lease remained intact and further requested damages for lost income. The Gaineses counterclaimed for damage to their property. The trial court conducted a three-day

jury trial. The jury, in an eleven to one verdict, found in favor of the Gaineses on the leasehold validity issue and further found unanimously that the operations of Yost Energy did not unreasonably damage the Gaineses' property. This appeal followed.

Yost Energy first argues that it was entitled to a directed verdict because the jury's finding that it had not pursued oil production with reasonable diligence and good faith was flagrantly against the evidence.

The standard of review for directed verdicts is as follows:

when an appellate court is reviewing evidence supporting a judgment entered upon a jury verdict, the role of an appellate court is limited to determining whether the trial court erred in failing to grant the motion for a directed verdict. All evidence which favors the prevailing party must be taken as true and the reviewing court is not at liberty to determine credibility or the weight which should be given to the evidence, these being functions reserved to the trier of fact. The prevailing party is entitled to all reasonable inferences which may be drawn from the evidence.

Upon completion of such an evidentiary review, the appellate court must determine whether the verdict rendered is palpably or flagrantly against the evidence so as to indicate that it was reached as the result of passion or prejudice.

Bierman v. Klaphehe, 967 S.W.2d 16, 17 (Ky. 1998).

Generally, the law applicable to oil and gas leases is the law applicable to land. *Ralston v. Thacker*, 932 S.W.2d 384, 387 (Ky.App. 1996). A lessee may lose his interest in an oil and gas lease on three separate grounds: (1) forfeiture; (2) abandonment; and (3) when the lease expires by its own terms.

Hiroc Programs, Inc. v. Robertson, 40 S.W.3d 373, 377 (Ky.App. 2000). “Where the primary term of an oil and gas lease has run and the lease provides for an extension for so long as oil or gas is produced in paying quantities, the lease will *ipso facto* terminate whenever production or development ceases for an unreasonable period of time.” *Id.* The unreasonableness of delay depends on the facts and circumstances of each case. *Id.* Notice is not required when a lease expires upon its own terms. *Id.* at 378. Further, as a matter of public policy, “a lessee, who in good faith is prosecuting work for development with reasonable diligence, will be protected against cancellation of his lease.” *Little v. Page*, 810 S.W.2d 339, 340 (Ky. 1991). Kentucky also recognizes a strong public policy “... against a lessee holding land for an unreasonable length of time simply for speculative purposes, or because of a lack of due diligence, where the lessor's only revenue results from royalty payments received from continued production.” *Wheeler & Lemaster Oil & Gas Co. v. Henley*, 398 S.W.2d 475, 477 (Ky. 1966).

The well was commenced in late December 2004. The initial drilling produced a quantity of two to three barrels of oil. This oil was not sold. The only activity on the well during the primary lease term was the initial drilling. Because of inclement weather and other delays, the well was not completed until November 2005 after the one year period had expired. A quantity of fifteen barrels of oil was produced between the completion of well in November 2005 and January 2006. The fifteen barrels were sold in December 2005 and Yost Energy sent a royalty

check to the Gaineses. The Gaineses returned the check because they considered the lease expired because of the lack of activity during the primary lease period.

The jury found that the Yost Energy had not pursued production with reasonable diligence and good faith. There was sufficient evidence to support this conclusion. Yost Energy attributed much of the delay during the primary term to inclement weather conditions. However, evidence was presented that Yost Energy operated several wells on adjacent properties. Randy Shields, an employee of Yost Energy, testified that the weather was not inclement for the eleven month period between the initial drilling in late December 2004 and completion in November 2005. There was also evidence that the completion of the well was delayed by financing issues that Yost Energy was experiencing. The delay was also explained by the speculative prospect of the completion of a local gas line that had been defunct for almost twenty years. The evidence presents a close question. However, this Court is mindful of the stringent standard of review for directed verdicts. We cannot conclude that the verdict was so flagrantly against the evidence as to be the result of passion or prejudice.

Next, Yost Energy argues that the jury instructions did not conform to the language of the lease in this case. We agree. The pertinent instruction read as follows:

Under the terms of the Oil and Gas Lease from Defendants, Jerry “Peanuts” Gaines and Marilyn Gaines, to Plaintiff, Yost Energy, LLC, the lease would remain in effect as long as Yost Energy began to drill a well on the defendants’ property between August 17, 2004, and

August 17, 2005, and continued to drill such a well to completion with reasonable diligence and dispatch. After completion of drilling, the lease would continue in effect as long thereafter as Yost Energy pursues, in good faith and with reasonable diligence, the production of oil, gas, casing-head gas, or casing-head gasoline.

Are you satisfied from the evidence that between August 17, 2004, and August 17, 2005, Plaintiff, Yost Energy, LLC, was pursuing, in good faith and with reasonable diligence, the production of oil and gas under the lease from the Defendants, Jerry “Peanuts” Gaines and Marilyn Gaines?

Specifically, Yost Energy argues that the instruction fails to state the lease provision regarding its right of completion if it had commenced the well within the one-year primary term. The right of completion provision in the lease reads as follows:

11. COMPLETION OF DRILLING. If the Lessee shall commence to drill a well within the term of this lease or any extension thereof, the Lessee shall have the right to drill such well to completion with reasonable diligence and dispatch, and if oil and gas, or either of them, be found, this lease shall continue and be in force with like effect as if such well had been completed within the term with Lessee paying rental, royalty, or shut-in royalty payments.

The first paragraph accurately reflected the lease language. In the second paragraph, however, the trial court limited the jury’s consideration to evidence of events that occurred within the primary term. Under the lease, the commencement of the well was the only requirement during the primary term. The issues for the jury were whether Yost Energy commenced the well within the primary term and thereafter continued to drill until completion and whether Yost Energy pursued the

production of oil with reasonable diligence and dispatch. The instructions erroneously confined the issues of the completion of drilling and the pursuit of production to the primary lease term. Therefore, we reverse and remand this matter for a new trial.

Finally, Yost Energy argues that the trial court erred by failing to grant either its motion for judgment notwithstanding the verdict, motion for a new trial, or motion to alter or amend the judgment. The standard of review for directed verdicts and judgments notwithstanding the verdict are the same.

Pritchard v. Bank Josephine, 773 S.W.2d 883, 885 (Ky.App. 1987). As this Court has already determined that a directed verdict was not warranted, we need not address judgment notwithstanding the verdict. The standard of review for a new trial is whether the trial court abused its discretion. *McVey v. Berman*, 836 S.W.2d 445 (Ky.App. 1992). The motion for a new trial was based on arguments regarding the jury instructions. We have addressed this argument above and reversed the judgment. Therefore, any further argument on this issue is rendered moot.

Accordingly, the judgment of the Warren Circuit Court is reversed and remanded for a new trial.

ALL CONCUR.

BRIEFS AND ORAL ARGUMENT
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