

Natural Gas Case Law Brief

Jacobs v. CNG Transmission Corp.

No. 108 W.D. Miscellaneous Docket 1999; 772 A.2d 445 (Pa. May 29, 2001)

Summary prepared by Michael Magee on June 16, 2010

This case concerned a disputed lease agreement between Jacobs and CNG Transmission Corp. (CNG). Jacobs purchased land in Armstrong County in 1994, and the land was encumbered by a lease agreement entered into by previous owners. Specifically, the oil and gas rights were leased to CNG and had been with its progeny since 1956. At no point during the lease, however, did CNG or its predecessors drill wells on the property. Once Jacobs took ownership, he demanded that CNG either develop or surrender the gas-bearing sands below the surface. When CNG refused, Jacobs entered into a similar lease with a different company.

Jacobs argued that the lease was terminated due to CNG's failure to develop their subsurface rights. CNG argued that Pennsylvania law does not imply any covenant to develop subsurface rights. The District Court for the Western District of Pennsylvania granted partial summary judgment for the gas company, and Jacobs appealed.

In order to properly decide the case, the United States Court of Appeals for the Third Circuit certified the following two questions to the Pennsylvania Supreme Court: (1) *is it necessary to find that the intent of contracting parties is ambiguous regarding the severability of their contract's provisions before applying the doctrine of severability?*, and (2) *does Pennsylvania recognize an implied covenant to develop the oil or natural gas interests of a parcel when the rights to those interests are leased out?*

The issue of severability was important because the lease agreement had one clause for gas production and another clause for gas storage, each clause with its own consideration. The gas company, wishing to keep the clauses together, argued that the Court could not sever the clauses unless and until it was determined that the parties' intent as to clause severability was ambiguous. The Pennsylvania Supreme Court was unconvinced. In *Heilwood Fuel Co., Inc. v. Manor Real Estate Co.*, the Court recognized that "if the consideration is single, the contract is entire...whatever the number or variety of items embraced...but, if the consideration is apportioned, either expressly or by necessary implication...the contract will generally be held to be severable." 175 A.2d 880, 884 (Pa. 1961). The Court recognized that the ultimate duty of the Court is to effectuate the intent of the parties, but that intent is too intertwined with the terms of

the contract to be able to declare it ambiguous before considering severability in other respects. Consequently, *the Court is not required to make a specific finding of ambiguity in the parties' intent regarding severability before inquiring into the severability of the contract's provisions.*

As to the issue of an implied covenant to develop natural gas interests, the Court noted two types of leases and offered a different answer for each. *For those leases where the only consideration received by the surface owner is royalty payment for the minerals developed, the lessee is obligated to make diligent development efforts to ensure that the lessor receives the benefit of his or her bargain. For leases where there is other consideration, such as bonus payments, there is no implied duty to develop the leased rights.*

Having answered the certified questions, the Pennsylvania Supreme Court directed the matter back to the Third Circuit Court of Appeals.



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