PENNSYLVANIA OIL AND GAS LEASES IN BANKRUPTCY: REJECTION SHOULD OCCUR ONLY BEFORE PRODUCTION

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BANKRUPTCY – US Bankruptcy Code 11 U.S.C. § 365 – OIL & GAS LAW – Where state law governs whether an oil and gas lease conveys an estate in real property or only grants a license or easement for extraction of oil and gas, and a recent Pennsylvania Supreme Court decision holds that oil and gas leases convey oil and gas interests in fee simple determinable upon production, rejection of an oil and gas lease in bankruptcy should only occur prior to the production of oil and gas.

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INTRODUCTION

In Pennsylvania, oil and gas leases are instruments used to sell a landowner's interest in oil and gas in fee simple determinable. During the seemingly chaotic growth of the energy industry in light of the development of Marcellus and Utica shale natural gas, some Pennsylvania landowners believe they leased their oil and gas interests far below fair market value. Many landowners may believe they should file bankruptcy to escape these undervalued leases. However, this route appears limited upon review of several federal and state jurisdictions. This comment focuses solely on Pennsylvania oil and gas leases and whether landowners in the Commonwealth may escape their oil and gas leases by filing bankruptcy. Following a recent Pennsylvania Supreme Court decision, it is clear that oil and gas leases convey interests in fee simple determinable.[1] Whether a debtor lessor files bankruptcy before or after such conveyance dictates whether a lease is escapable.

An appealing route for landowner lessors to escape their undervalued leases in bankruptcy is found in section 365 of the Bankruptcy Code.[2] The debtor in possession or the trustee may attempt to categorize oil and gas leases as "executory contracts" or "unexpired leases."[3] Once the bankruptcy petition is filed, the trustee, with court approval, "may assume or reject any executory contract or unexpired leased of the debtor."[4] "Executory contracts" are not defined within the Bankruptcy Code.[5] Nonetheless, the legislative history of this section indicates that the term means "a contract 'on which performance is due on some extent on both sides.'"[6] "Unexpired leases" are addressed more thoroughly in the Code addressing both when the debtor is the lessee and lessor.

Recently, bankruptcy proceedings and state law have merged as debtors attempt to escape what they believe are undervalued oil and gas leases.[7] The issue of whether oil and gas leases are "executory contracts" or "unexpired leases" that the trustee may reject under section 365 has proved difficult to answer, particularly in Pennsylvania where little contemporary oil and gas law exists. This article examines Pennsylvania oil and gas leases, rejection procedures in bankruptcy, and critical points in time that determine whether such leases may be rejected.

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1. *T.W. Phillips Oil and Gas Co. v. Jedlicka*, 42 A.3d 261, 267 (Pa. 2012) (citing *Calhoon v. Neely*, 50 A. 967, 968 (Pa. 1902)).
2. 11 U.S.C. § 365(a) (2012).
3. *Id.*
4. *Id.*
5. *See e.g. N.L.R.B. v. Bildisco and Bildisco*, 465 U.S. 513, 522 n. 6 (1984) (noting the lack of a definition).
6. *Id.* (citing H.R.Rep. No. 95595, p. 347 (1977); S.Rep. 95-989, p. 58 (1977)).
7. *See e.g. In re Powell*, 482 B.R. 873 (Bankr. M.D. Pa. 2012).