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Leading Articles

THE OIL AND GAS LEASE—MAJOR PROBLEMS

Maurice H. Merrill*

I. INTRODUCTION

What is an oil and gas lease? We may start with the proposition that it is not a conventional lease of real property at all.¹ Unlike that document,² it does not create the relation of landlord and tenant between the grantor and the grantee.³ Where the conventional lease "implies an estate in the real property, for the time being, an ownership *pro hac vice*,"⁴ the oil lease "does not constitute a conveyance of lands, tenements, or other realty, or of a freehold or corporeal interest therein."⁵ Whereas, under the ordinary lease, the lessee becomes entitled to the immediate possession of the premises⁶ and may exclude therefrom the world,⁷ including his landlord,⁸ the oil and gas lessee has no

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¹ *Huston v. Cox*, 103 Kan. 73, 172 Pac. 992 (1918); *Staplin v. Vesely*, 41 N.M. 543, 72 P.2d 7 (1937); *Rich v. Doneghey*, 71 Okla. 204, 177 Pac. 86, 3 A.L.R. 352 (1918).

² *Clark v. Harry*, 182 Va. 410, 29 S.E.2d 231 (1944); *Golden v. Mount*, 32 Wash. 2d 653, 203 P.2d 667 (1949).

³ *Concord Oil & Gas Co. v. Thompson*, 248 Mich. 230, 226 N.W. 857 (1929); *Shell Oil Co. v. Howth*, 138 Tex. 357, 159 S.W.2d 483 (1942).

⁴ *Bowley v. Fuller*, 121 Me. 22, 115 Atl. 466, 24 A.L.R. 964 (1921). "A lease of real estate is a hiring or renting of it for a certain time for a named consideration." *Hampton v. Struve*, 160 Neb. 305, 311, 70 N.W.2d 74, 75 (1955).

⁵ *State v. Shamblin*, 185 Okla. 126, 90 P.2d 1053 (1939).

⁶ *Canaday v. Krueger*, 156 Neb. 287, 56 N.W.2d 123 (1952).

⁷ *Gregory v. Pribbeno*, 143 Neb. 379, 9 N.W.2d 485 (1943); *Papadopoulos v. Defabrizio*, 102 Utah 84, 125 P.2d 416 (1942).

⁸ *Wurm v. Allen Cadillac Co.*, 301 Mass. 413, 17 N.E.2d 305 (1938); *Vance v. Henderson*, 141 Neb. 766, 4 N.W.2d 833 (1942); *Golde Clothes*

right to enter except to carry on the mineral operations which are the subject of the lease,⁹ and he may not prevent the use of the demised property by the lessor,¹⁰ unless that use interferes with his own authorized activities.¹¹ While the conventional lease usually is construed most strongly against the landlord,¹² the oil and gas lease is construed most strongly against the lessee.¹³ One court admirably has expressed some of the differences between the two classes of instruments in the following language:

Oil and gas leases differ from the ordinary and well known forms of leases in existence and heretofore construed in this state such as leases on city property and agricultural and grazing lands, in that, in the latter classes of leases valuable property rights are at once acquired by the lessee and immediate possession usually yielded by the lessor, and the occupancy by the lessee either improves, or at least does not materially injure, the leased premises; he gets no right to take away any part of the soil, and during the term of the lease, in the absence of extraordinary circumstances, the value of the property remains reasonably stable, while, on the other hand, no particular value attaches to an oil and gas lease until after development and the production of oil or gas in paying quantities. The holding of a lease for this latter purpose, without prospecting or operating, inures only to the benefit of the lessee as a speculator, and possession of the premises is not usually yielded at once, and, when yielded, the lessor usually retains possession of the larger part of the surface ground. When the lessee finally takes possession and commences operations, the lessor's lands may be riddled with holes and cluttered with derricks and other paraphernalia of the business, to the great detriment of the

Shop v. Loew's Buffalo Theatres, 236 N.Y. 465, 141 N.E. 917, 30 A.L.R. 931 (1923).

⁹ Concord Oil & Gas Co. v. Thompson, 248 Mich. 230, 226 N.W. 857 (1929).

¹⁰ Standard Oil Co. v. Oil Well Salvage Co., 170 Ark. 729, 281 S.W. 360 (1926) (gathering stations); Brookshire Oil Co. v. Casmalia Ranch Oil & Dev. Co., 156 Cal. 211, 103 Pac. 927 (1909) (pipe line); Gulf Pipe Line Co. v. Pawnee-Tulsa Petroleum Co., 34 Okla. 775, 127 Pac. 252, 41 L.R.A. (n.s.) 1108 (1912) (pumping station manifold pit); Cosden Oil & Gas Co. v. Hickman, 114 Okla. 86, 243 Pac. 226 (1925) (townsite development).

¹¹ Conway v. Skelly Oil Co., 54 F.2d 11 (10th Cir. 1931) (buildings and other improvements inconsistent with authorized developmental activities); Cozart v. Crenshaw, 299 S.W. 499 (Tex. Civ. App. 1927) (refinery).

¹² Otting v. Gradsky, 294 Ky. 779, 172 S.W.2d 554, 148 A.L.R. 580 (1943); Golden v. Mount, 32 Wash. 2d 653, 203 P.2d 667 (1949).

¹³ Hill v. Stanolind Oil & Gas Co., 119 Colo. 477, 205 P.2d 643 (1949); Schumacher v. Cole, 131 Mont. 166, 309 P.2d 311 (1957); Fritsche v. Turner, 133 Neb. 633, 276 N.W. 403 (1937); Berton v. Coss, 139 Okla. 42, 280 Pac. 1093 (1929).

lessor and damage to the property, if oil or gas be not discovered. If oil or gas is discovered, the lessee carries away a valuable part of the real estate itself. Thornton on Oil & Gas, p. 152. Again, the value of property declared in such a lease, is subject to violent fluctuations, and any substantial delay, either in commencing drilling operations or in prosecuting such operations thereafter with diligence, may render land, theretofore extremely valuable for its potential oil and gas rights, absolutely valueless.¹⁴

What, then, is this instrument, if it is not a lease? Functionally, it is a document designed to facilitate the development of the petroliferous resources in the described premises, a task which ordinarily the landowner is not in a position to undertake,¹⁵ by granting to the lessee the privilege to enter the premises, to search for these resources, and to produce them and to take them into his possession if they are discovered. In view of the speculative nature of the venture, the major part of the consideration to the lessor neither is paid at the outset nor is its amount fixed definitely. Instead, the chief remuneration is afforded by payments proportionate to the productivity of the premises, termed royalty.¹⁶

Originating from primitively drafted documents,¹⁷ modeled after the conventional lease of real estate¹⁸ or modifications thereof already in use for the exploitation of solid minerals,¹⁹ lease forms have passed through numerous stages. Since the printed forms are prepared by, or for the use of, those seeking to acquire operating rights, most of the changes have been initiated in response to the felt needs of the lessees, seeking either to overcome disappointing judicial decisions²⁰ or to frame

¹⁴ Solberg v. Sunburst Oil & Gas Co., 76 Mont. 254, 246 Pac. 168 (1926).

¹⁵ See MERRILL, *THE PUBLIC'S CONCERN WITH THE FUEL MINERALS* 15 (1960).

¹⁶ Royalty is "a share of the product or proceeds therefrom, reserved to the owner for permitting another to use the property." Carroll v. Bowen, 180 Okla. 215, 217, 68 P.2d 773, 775 (1937). It also has been defined as "the share of oil and gas to be received by the lessor by the operation of the lease." Davis v. Hurst, 150 Kan. 130, 132, 90 P.2d 1100, 1101, 122 A.L.R. 957, 959 (1939).

¹⁷ Examples of early lease forms may be found in BROWN, *OIL AND GAS LEASES* 1 (1958); Moses, *The Evolution and Development of the Oil and Gas Lease*, SOUTHWESTERN LEGAL FOUNDATION 2D ANNUAL INST. ON OIL & GAS L. & TAX 1, 6, 7, 38 (1951).

¹⁸ There is the testimony of contemporary comment: "The discovery of petroleum led to new forms of leasing land." Brown v. Vandergrift, 80 Pa. 142, 145 (1875).

¹⁹ For an early example of a solid mineral arrangement see Barney v. Sutton, 2 Watts 31 (Pa. 1833).

²⁰ See BROWN, *OIL AND GAS LEASES* 112 (1958). Other examples will be found throughout the work cited.

provisions adapted to changes in the oil business.²¹ Occasionally, lessors have sufficient knowledge and bargaining ability to introduce modifications in the forms presented to them. Generally, however, the preservation of lessors' interests has been achieved by judicial interpretation in the course of litigation, often accompanied by anguished protest from the lessee interests that the courts in effect are legislating rather than construing.²² It is difficult, though, to see how the judges could have avoided this task. Long-term interests of landowners and oil operators *may* coincide in general.²³ Specifically and immediately, however, they *are* often in conflict.²⁴ The oil operator, particularly in these days of integrated enterprise, tends to think that he should be able to conduct his activities in the manner of a well-managed industrial operation.²⁵ He forgets that he does not "own" his "factory" and that others possess beneficial interests in the product.²⁶ Conversely, the landowner often feels that maximum return to him should be the lessee's sole objective. Inevitably, the arbitrament of the judges must resolve the conflicts thus engendered and, in the process, must develop a system of law designed to realize, as completely as is possible in consistence with the general welfare, the objectives of all parties.²⁷

Because of the empiric manner in which it has developed, the typical oil and gas lease has little to recommend it, either as a literary composition or as an example of master draftsmanship.²⁸ It is too long, over-wordy, and poorly organized. It is full of inconsistencies and contradictions, thereby multiplying the opportunities for judicial construction or misconstruction. Yet, because so many decisions have given it effect in one way or another, no one bent on reform dares to abandon the past and concoct a simpler, shorter, more logical document. Instead, words

²¹ See Moses, *supra* note 17, at 18 for examples.

²² As in BROWN, *op. cit. supra* note 20, at 80, 168, 243, 301, or in Veasey, *The Law of Oil and Gas*, 18 MICH. L. REV. 652, 660 (1920).

²³ See BROWN, *op. cit. supra* note 20, at 335.

²⁴ See Merrill, Book Review, 12 OKLA. L. REV. 193, 195 (1959).

²⁵ Cf. Veasey, *supra* note 22, at 652, 655, 659.

²⁶ Cf. MERRILL, *THE PUBLIC'S CONCERN WITH THE FUEL MINERALS* 16 (1960).

²⁷ See 3 POUND, *JURISPRUDENCE* § 81 (1959).

²⁸ Lease forms are collected in KULP, *CASES ON OIL AND GAS* 835-48 (3d ed. 1947); WILLIAMS, MAXWELL & MEYERS, *CASES AND MATERIALS ON THE LAW OF OIL AND GAS* 739-49 (1956); DONLEY, *LAW OF COAL, OIL AND GAS IN WEST VIRGINIA AND VIRGINIA* 263-301 (1951); BROWN, *OIL AND GAS LEASES* 417-542 (1958); 7 SUMMERS, *OIL AND GAS* 12-319 (perm. ed. 1939), with others in current pocket supplements.

are altered. New phrases, clauses, sentences or sections are added. The crazy old structure remains, like a house which has been built onto, time and again.²⁹ The result merits a comment similar to that made by a British judge concerning another legal document, to the effect that: "no one, I am sure, by the light of nature ever understood an English mortgage of real estate."³⁰ The judges give a variety of names to the interests created by it.³¹ The most accurate term seems to be "profit à prendre."³² If we may not understand the oil and gas lease by the light of nature, let us try to understand a few of its major features by the light of the decisions.

II. WHO MAY LEASE

We start with the proposition that, in the American property system, the landowner's domain, in its normal condition, extends, in accordance with the old maxim, "ad coelum et ad inferos,"³³ so that "the owner of the surface is an owner downward to the center, until the underlying strata have been severed from the surface by sale."³⁴ Obviously, until such a severance has been effected, whether by sale or otherwise, the surface owner ordinarily is the proper person to make a lease.³⁵

A. GUARDIANS AND TRUSTEES

But the owner may be an infant, insane or otherwise under legal disability. The legal effect of a lease by such a person, who

²⁹ Forms, often differing only in minor particulars, are almost infinite in number. One collection included nearly 200 documents in 1951. See Terry, *Miscellaneous Clauses in Oil and Gas Leases*, SOUTHWESTERN LEGAL FOUNDATION 2D ANNUAL INST. ON OIL & GAS L. & TAX 237 (1951).

³⁰ Lord MacNaghten in *Samuel v. Jarrah Timber & Wood Paving Corp.*, [1904] A.C. 323, 326.

³¹ For an enumeration of the various terms, see KULP, *CASES ON OIL AND GAS* 175 (3rd ed. 1947).

³² *Callahan v. Martin*, 3 Cal. 2d 110, 43 P.2d 788, 101 A.L.R. 871 (1935); *Burden v. Gypsy Oil Co.*, 141 Kan. 147, 40 P.2d 463 (1935); *Williard v. Federal Sur. Co.*, 91 Mont. 465, 8 P.2d 633 (1932); *Rich v. Doneghey*, 71 Okla. 204, 177 Pac. 86, 3 A.L.R. 352 (1918). See Shokes, *Possible Treatment in Nebraska of a Lessee's Interest Under an Oil and Gas Lease*, 31 NEB. L. REV. 374, 398 (1952).

³³ *Doe v. Burt*, 1 T. R. 701, 99 Eng. Rep. 1330 (1787); *Sargent v. Adams*, 69 Mass. (3 Gray) 72, 63 Am. Dec. 718 (1854).

³⁴ *Hague v. Wheeler*, 157 Pa. 324, 27 Atl. 714, 22 L.R.A. 141 (1893).

³⁵ *Gillespie v. Iseman*, 210 Pa. 6, 59 Atl. 266 (1904) (successor in interest may not derogate from the terms); *Knotts v. McGregor*, 47 W. Va. 566, 35 S.E. 899 (1900) (exclusion of lessee by lessor, attempting repudiation).

is not under guardianship, depends upon whether the incapacity is such as to render his contracts void or merely voidable.³⁶ A legally appointed guardian of the estate of such a person, if authorized by statute to sell the ward's real estate, and with appropriate approval by the proper court,³⁷ may execute an oil and gas lease.³⁸ Where the guardian's powers are derived solely from his general authority over the ward's realty, however, there is a division of opinion as to whether the lease which he executes can endure after the ward has achieved capacity. The judges who deny the power stress the interference with a fully capacitated owner's dominion over his estate.³⁹ Those taking the contrary view point out that the established habits of the oil business require the execution of leases which may be of indefinite duration and that the realization of generous bonuses and the effective protection against drainage by neighboring wells may be thwarted if the guardian cannot execute such a lease.⁴⁰ This latter reasoning seems the more convincing. To clear up any doubt, statutes should authorize expressly the execution of leases in the appropriate form. A number have been enacted⁴¹ and there seems no reason to doubt their constitutionality.⁴²

³⁶ See BROWN, OIL AND GAS LEASES §§ 2.04, 2.05 (1958); KULP, OIL AND GAS RIGHTS §§ 10.16, 10.23 (1954), and authorities cited in these works.

³⁷ As to the necessity of court authority: *Ardizzone v. Archer*, 71 Okla. 289, 160 Pac. 446 (1916); *South Penn Oil Co. v. McIntire*, 44 W. Va. 296, 28 S.E. 922 (1898).

³⁸ *Newell v. McMillan*, 139 Kan. 94, 30 P.2d 126 (1934); *Henderson v. Shell Oil Co.*, 202 S.W.2d 492 (Tex. Civ. App. 1947).

³⁹ *York v. Warren Oil & Gas Co.*, 191 Ky. 157, 29 S.W. 114 (1921); *Miles v. Amerada Petroleum Corp.* 241 S.W.2d 822 (Tex. Civ. App. 1950).

⁴⁰ *Cabin Valley Mining Co. v. Hall*, 53 Okla. 760, 155 Pac. 570 (1916), 1916F L.R.A. 493.

⁴¹ See for example NEB. REV. STAT. §§ 57-210 to -212.01 (Reissue 1960); OKLA. STAT. tit. 58, §§ 924-27 (1951); OKLA. STAT. tit. 58, §§ 929.1-5 (Supp. 1959).

⁴² *Jones v. Prairie Oil & Gas Co.*, 273 U.S. 195 (1927). There was a declaration of invalidity as to such a statute under the Kentucky Constitution in *Lawrence E. Tierney Coal Co. v. Smith's Guardian*, 180 Ky. 815, 203 S.W. 735, *modified on rehearing*, 181 Ky. 764, 205 S.W. 951, 4 A.L.R. 1540 (1918). However, on rehearing the decision was confined to coal leases and the question as to oil and gas leases was expressly reserved. The citator indicates no decision since upon the point reserved. All concerned may have assumed the point as disposed of by the federal ruling, or it may be that the state court's reservation of the question has been taken as establishing a distinction. It hardly seems likely that occasions for guardians to execute such leases have ceased in Kentucky.

In the absence of statute, the personal representatives of a deceased owner,⁴³ or trustees⁴⁴ may not lease real estate for oil and gas unless they are acting under an instrument giving them power to do so.⁴⁵ Authority to sell,⁴⁶ particularly where coupled with a general power of management of the property,⁴⁷ usually is construed to give power to lease for mineral exploitation. Because of the difference between the use made of premises by an ordinary tenant and the depletion of the estate caused by oil and gas operations, however, a simple power to lease, not specifying mineral exploitation as the object, is not construed to permit leasing for that purpose.⁴⁸ Often the problems of interpreting wills or trust documents involve vexing uncertainty.⁴⁹ Consequently, it must be a relief to all concerned if the land is located within the borders of a state which has enacted one of those helpful statutes providing for the execution of leases by personal representatives or trustees, acting under judicial sanction and supervision.⁵⁰

Various governmental units may own land which is in the area of active oil play. Whether, by whom, and in what way such land is subject to lease is always a matter of statutory enactment and construction. The subject is too complex for detailed consideration here. It is mentioned as a reminder of the need to

⁴³ *Lanyon Zinc Co. v. Freeman*, 68 Kan. 691, 75 Pac. 995 (1904) (executor); *Allar Co. v. Roeser*, 217 S.W. 442 (Tex. Civ. App. 1919) (administrator); *Smith v. Womack*, 231 S.W. 840 (Tex. Civ. App. 1921) (executor).

⁴⁴ *Ohio Oil Co. v. Daughetee*, 240 Ill. 361, 88 N.E. 818, 36 L.R.A. (n.s.) 1108 (1909); *Lanyon Zinc Co. v. Freeman*, *supra* note 43.

⁴⁵ *First Nat'l Bank v. Magnolia Petroleum Co.*, 144 Kan. 645, 62 P.2d 891 (1936).

⁴⁶ *Layman v. Hodnett*, 205 Ark. 367, 168 S.W.2d 819 (1943); *Heffelfinger v. Scott*, 142 Kan. 395, 47 P.2d 66 (1935); *Ilari v. Ewing*, 314 Ky. 182, 234 S.W.2d 293 (1950); *Franklin v. Margay Oil Corp.*, 194 Okla. 519, 153 P.2d 486 (1944). *But cf. In re Bruner's Will*, 363 Pa. 552, 70 A.2d 222, 18 A.L.R.2d 92 (1950).

⁴⁷ *Oliver v. Culpepper*, 209 Ark. 326, 190 S.W.2d 457 (1945); *Avis v. First Nat'l Bank*, 141 Tex. 489, 174 S.W.2d 255 (1943).

⁴⁸ *Lanyon Zinc Co. v. Freeman*, 68 Kan. 691, 75 Pac. 995 (1904).

⁴⁹ Note the construction in *Robinson v. Barrett*, 142 Kan. 68, 45 P.2d 587 (1935); *Pedroja v. Pedroja*, 152 Kan. 82, 102 P.2d 1012 (1940), in which possibility of drainage and the existence of explosive oil booms, coupled with a broad power to manage the trust estate, were held to justify leasing for oil under permission from the district courts. See also *Shepherd, Execution of Mineral Leases by Trustees*, 16 OKLA. B.A.J. 80 (1945).

⁵⁰ As, for example, the statutes cited in note 41 *supra*.

consult statutes and decisions and to proceed with caution in all instances of doubt.⁵¹

B. DIVIDED OWNERSHIP

So much for the questions posed by single ownership of the whole interest in the land to be leased. Ownership, however, frequently is divided in various ways, and that division creates more problems for the prospective lessor.

(1) *Cotenancy*

The rule that one cotenant may not commit waste upon the commonly owned premises⁵² has led a number of state courts to rule that one cotenant may not, by himself or by his lessee, take oil or gas.⁵³ The only safe way to obtain a lease upon land held in concurrent ownership in those states is to procure execution by all the common proprietors.⁵⁴ Moved by the need for promptitude in the disposition of oil property⁵⁵ and by the problem of protection against drainage,⁵⁶ most courts uphold the propriety of a lease executed by one cotenant.⁵⁷ Since one cotenant may

⁵¹ HOFFMAN, OIL AND GAS LEASING ON THE PUBLIC DOMAIN (1951); McLANE, OIL AND GAS LEASING ON INDIAN LANDS (1955), may be consulted in connection with federally owned or managed lands. For Nebraska lands, consult NEB. REV. STAT. §§ 57-218 to -221 (Reissue 1960); NEB. REV. STAT. §§ 72-901 to -812 (Reissue 1960). *Belgium v. City of Kimball*, 163 Neb. 774, 81 N.W.2d 205 (1957), involves the rights of a municipality leasing its streets and alleys, holding that the city, as the owner of a determinable fee therein, may lease them for the production of oil and gas and receive the royalties therefrom. BROWN, OIL AND GAS LEASES § 2.12 (1958), contains a useful listing of cases on the question of what municipal lands properly may be leased for oil and gas purposes.

⁵² *Amerada Petroleum Corp. v. Reese*, 195 La. 359, 196 So. 558 (1940); *Williamson v. Jones*, 43 W. Va. 562, 27 S.E. 411, 38 L.R.A. 694 (1897).

⁵³ *Zeigler v. Brenneman*, 237 Ill. 15, 86 N.E. 597 (1908); *Gulf Ref. Co. v. Carroll*, 145 La. 299, 82 So. 277 (1919); *Law v. Heck Oil Co.*, 106 W. Va. 296, 145 S.E. 601 (1928) (injunction secured by owner of 1/768 interest against operations under lease in which all other owners joined).

⁵⁴ See *West v. Continental Oil Co.*, 194 F.2d 869 (5th Cir. 1952). Subsequent ratification will do as well, of course. *Sommers v. Bennett*, 68 W. Va. 157, 69 S.E. 690 (1910). In *Zeigler v. Brenneman*, *supra* note 53, the court indicated that if all the interests were leased, the individual lessees could agree among themselves as to the conditions on which operations should be carried on, thereby binding the lessee.

⁵⁵ *Burnham v. Hardy Oil Co.*, 147 S.W. 330 (Tex. Civ. App. 1912), *aff'd*, 108 Tex. 555, 195 S.W. 1139 (1917).

⁵⁶ *Dabney-Johnson Oil Corp. v. Walden*, 4 Cal. 2d 637, 52 P.2d 237 (1935).

⁵⁷ *Prairie Oil & Gas Co. v. Allen*, 2 F.2d 566 (8th Cir. 1924); *Bates v. Rogers*, 178 Okla. 164, 62 P.2d 481 (1936).

not exclude another,⁵⁸ the operator developing under such a lease must account to the non-leasing co-owners or to their lessees,⁵⁹ for their share of the production⁶⁰ less costs.⁶¹ There can be inconvenience in such a situation.⁶² It is much better for the lessee if he can get all the interests to join in the execution of the lease.⁶³ In some jurisdictions statutory procedures exist whereby administrative⁶⁴ or judicial⁶⁵ measures may be invoked to bring together, under a single lease, land held in multiple co-ownership. These provisions are held constitutional as a reasonable regulation in aid of the proper adjustment of correlative interests.⁶⁶

(2) *Life Tenancy*

Another form of divided ownership is presented by the tenancy for life. As between the life tenant and the remainderman, the former usually may not undertake to produce oil or gas from

⁵⁸ *Compton v. People's Gas Co.*, 75 Kan. 572, 89 Pac. 1039, 10 L.R.A. (n.s.) 787 (1907); *Hochsprung v. Stevenson*, 82 Mont. 222, 266 Pac. 406 (1928).

⁵⁹ *Earp v. Mid-Continent Petroleum Corp.*, 167 Okla. 86, 27 P.2d 855, 91 A.L.R. 188 (1933).

⁶⁰ *Johnson v. Kansas Natural Gas Co.*, 90 Kan. 565, 135 Pac. 589 (1913); *Ludey v. Pure Oil Co.*, 157 Okla. 1, 11 P.2d 102 (1931). However, in case of ratification, only royalty may be recovered. *Stephens v. Preston's Heirs*, 300 Ky. 843, 190 S.W.2d 468 (1945).

⁶¹ *Prairie Oil & Gas Co. v. Allen*, 2 F.2d 566 (8th Cir. 1924); *York v. Warren Oil & Gas Co.*, 191 Ky. 157, 229 S.W. 114 (1921); *Marias River Syndicate v. Big W. Oil Co.*, 98 Mont. 254, 38 P.2d 599 (1934); *Naharkey v. Sand Springs Home*, 177 Okla. 371, 59 P.2d 289 (1936); *Williamson v. Jones*, 43 W. Va. 562, 27 S.E. 411 (1897).

⁶² As between two lessees: *Moody v. Wagner*, 167 Okla. 99, 23 P.2d 633 (1933); as to accounting: *Smith v. United Fuel Gas Co.*, 113 W. Va. 178, 166 S.E. 533 (1932); as to problems of development by one lessee only and effect on obligations under other lease: *Mattison v. Trotti*, 262 F.2d 339 (5th Cir. 1959); *Earp v. Mid-Continent Petroleum Corp.*, 167 Okla. 86, 27 P.2d 855 (1933).

⁶³ See BROWN, OIL AND GAS LEASES 5 (1958).

⁶⁴ La. Acts 1952, No. 513, §§ 1-5. As a result of repeal of a portion of this act in 1960, the procedure does not seem available for use in the future, although administration under leases already made apparently continues. See LA. REV. STAT. ANN. §§ 30.186-.188 (Supp. 1961).

⁶⁵ ILL. ANN. STAT. c. 104, §§ 25-33 (Smith-Hurd 1957); KY. REV. STAT. §§ 353.300-.380 (1957); MICH. STAT. ANN. §§ 13.140(1)-(10) (1958); OKLA. STAT. tit. 60, §§ 71-73 (1951).

⁶⁶ *Sun Oil Co. v. State Mineral Bd.*, 231 La. 689, 92 So. 2d 583 (1956), appeal dismissed for want of substantial federal question, 353 U.S. 962 (1957); cf. *Superior Oil Co. v. Oklahoma Corp. Comm'n*, 206 Okla. 213, 242 P.2d 454 (1952).

the premises or execute a lease for such a purpose.⁶⁷ To this there are exceptions, such as the power to lease or to execute dispositive instruments if the land already has been devoted to mineral production at the inception of the life estate;⁶⁸ express authority arising out of the grant of a power of consumption to the life tenant;⁶⁹ the creation of the life estate without impeachment of waste,⁷⁰ or the existence of a threat of loss of the deposit through drainage.⁷¹ Similarly, the remainderman, acting alone, may not grant by lease the authority to exploit the petroliferous resources of the land,⁷² against the objections of the

⁶⁷ *Marlin v. Texas Co.*, 109 F.2d 305 (5th Cir. 1940); *Eide v. Tveter*, 143 F. Supp. 665 (D.N.D. 1956); *Marshall v. Mellon*, 179 Pa. 371, 36 Atl. 201, 35 L.R.A. 816 (1897); *Swayne v. Lone Acre Oil Co.*, 98 Tex. 597, 86 S.W. 740, 69 L.R.A. 986 (1905); *Williamson v. Jones*, 43 W. Va. 562, 27 S.E. 411, 38 L.R.A. 694 (1897). The remainderman may enjoin operations under the lease: *Ohio Oil Co. v. Daughetee*, 240 Ill. 361, 88 N.E. 818, 36 L.R.A. (n.s.) 1108 (1909); *Richmond Natural Gas Co. v. Davenport*, 37 Ind. App. 25, 76 N.E. 525 (1905); *Russell v. Tipton*, 193 Ky. 305, 235 S.W. 763 (1921). He may recover damages for the waste: *Rupel v. Ohio Oil Co.*, 176 Ind. 4, 95 N.E. 225 (1911). He may cancel the lease as a cloud upon his title: *Whitaker v. Surtees*, 248 S.W. 432 (Tex. Civ. App. 1923).

⁶⁸ The "open mine" theory, classically applicable when production exists at the inception of the life estate, *Mills v. Taylor*, 268 S.W.2d 412 (Ky. 1954); *Lawley v. Richardson*, 101 Okla. 40, 223 Pac. 156, 43 A.L.R. 803 (1924), has been applied also to production later obtained under a lease in existence at the beginning of the tenancy. *Andrews v. Andrews*, 31 Ind. App. 189, 67 N.E. 461 (1903); *Benson v. Nyman*, 136 Kan. 455, 16 P.2d 963 (1932); *Youngman v. Shular*, 155 Tex. 437, 288 S.W.2d 495 (1956); *Minner v. Minner*, 84 W. Va. 679, 100 S.E. 509 (1919). It permits the life tenant to execute agreements for the introduction of secondary recovery operations and to receive the royalty therefrom. *In re Shailer's Estate*, 266 P.2d 613 (Okla. 1954), discussed in 8 OKLA. L. REV. 367 (1955).

⁶⁹ *Guest v. Bizzell*, 271 S.W.2d 472 (Tex. Civ. App. 1954). *But cf.* *Woelk v. Woelk*, 174 Kan. 130, 254 P.2d 297 (1953).

⁷⁰ See 2 TIFFANY, REAL PROPERTY § 639 (3d ed. 1939); 2 WILLIAMS & MEYERS, OIL AND GAS LAW § 512.1 (1959). I have not been able to find any cases applying this concept to oil and gas leasing.

⁷¹ *Gerkins v. Kentucky Salt Co.*, 24 Ky. L. Rep. 34, 36 S.W. 1 (Ct. App. 1896). In effect this is sustained by the later decision in the same case, 100 Ky. 734, 39 S.W. 444 (1897). *But cf.* *Richmond Natural Gas Co. v. Davenport*, 37 Ind. App. 25, 76 N.E. 525 (1905). Despite the dearth of authority, the principle seems sound.

⁷² *Welborn v. Tidewater Associated Oil Co.*, 217 F.2d 509 (10th Cir. 1954), discussed in 9 OKLA. L. REV. 83 (1956). *But cf.* *Davis v. Atlantic Oil Producing Co.*, 87 F.2d 75 (5th Cir. 1936), discussed in 16 TEXAS L. REV. 420 (1938).

life tenant,⁷³ so long as the latter lives.⁷⁴ Acting in conjunction, however, by the same instrument,⁷⁵ or by separate instruments,⁷⁶ the life tenant and the remainderman may devote the land to mineral development. These, of course, are the methods the prudent investor will follow in taking leases.⁷⁷ Ratification by one of a lease executed by the other will have the same effect as original joinder.⁷⁸ There are vexing questions concerning the apportionment of royalty, as to which the rule is unsettled,⁷⁹ in the absence of controlling statute.⁸⁰ Statutory provisions also may be found authorizing procedures for the leasing of land where life tenant and remainderman are unable to agree,⁸¹ or where contingent interests are involved, precluding the possibility of effective leasing.⁸²

⁷³ *Carter Oil Co. v. McQuigg*, 112 F.2d 275 (7th Cir. 1940); *Brandenburg v. Petroleum Exploration*, 218 Ky. 557, 291 S.W. 757 (1927) (estoppel).

⁷⁴ See *Welborn v. Tidewater Associated Oil Co.*, 217 F.2d 509 (10 Cir. 1954).

⁷⁵ *Prout v. Hoy Oil Co.*, 263 Ill. 54, 105 N.E. 26 (1914); *Meredith v. Meredith*, 193 Ky. 192, 235 S.W. 757 (1921); *Union Gas & Oil Co. v. Wiedemann Oil Co.*, 211 Ky. 361, 277 S.W. 323 (1924); *Barnes v. Keys*, 36 Okla. 6, 127 Pac. 261, 45 L.R.A. 178 (n.s.) (1912); *Blakely v. Marshall*, 174 Pa. 425, 34 Atl. 564 (1896).

⁷⁶ *Orndoff v. Consumers' Fuel Co.*, 308 Pa. 165, 162 Atl. 431 (1932), discussed in 31 MICH. L. REV. 998 (1933). Query: as to the merger, by assignment, of separate leases executed to different lessees by life tenant and remainderman, see *Rowe v. Bird*, 304 S.W.2d 775 (Ky. 1957).

⁷⁷ *Blakely v. Marshall*, 174 Pa. 425, 428, 34 Atl. 564 (1896) ("[N]o practical oil operator would undertake the development of supposed oil territory on the faith of a lease from life tenants only . . ."). Note, however, that one who takes separate leases may be bound to pay the royalties under each lease cumulatively, so that he is liable for more than the customary amount. *Orndoff v. Consumers' Fuel Co.*, *supra* note 76. But cf. *Weekley v. Weekley*, 126 W. Va. 90, 27 S.E.2d 591, 150 A.L.R. 689 (1943).

⁷⁸ *Mills v. Mills*, 275 Ky. 431, 121 S.W.2d 962 (1938).

⁷⁹ See 2 WILLIAMS & MEYERS, OIL AND GAS LAW § 512.2 (1959).

⁸⁰ Most noteworthy of legislation in this field is the UNIFORM PRINCIPAL AND INCOME ACT, 9B UNIFORM LAWS ANNOTATED 365 (1957), adopted in twenty-three states, but not in Nebraska.

⁸¹ Examples are afforded by ARK. STAT. ANN. §§ 53-302 to -311 (1947), and W. VA. CODE ANN. §§ 3542-54 (1955). The constitutionality of these statutes has been upheld, as against objections stemming from the claims of contingent remaindermen. See *Love v. McDonald*, 201 Ark. 882, 148 S.W.2d 170 (1941); *Geary v. Butts*, 84 W. Va. 348, 99 S.E. 492 (1919). However, the principles applied in *Sun Oil Co. v. State Mineral Bd.*, 231 La. 689, 92 So. 2d 583 (1956), sustain their general validity as to all interests.

⁸² NEB. REV. STAT. §§ 57-222 to -224 (Reissue 1960). As to procedure under such statutes, see *Ellis v. Rudy*, 253 S.W.2d 382 (Ky. 1952).

(3) *Interest in Minerals Only*

Divided interests may take the form of a separation of the surface from ownership of part or all of the subsurface. There may be outright ownership of all or of a fraction of the mineral interests. In the case of the solid minerals this will involve title to the substances themselves, in place.⁸³ Due to the varied theories concerning the extent and nature of property rights to oil and gas in their natural condition,⁸⁴ it is more satisfactory to speak, in respect to them, of a title to the mineral interests,⁸⁵ meaning thereby succession to the legal authority ordinarily inhering in the owner of the surface to prospect for these substances and, if they are found, to reduce them to possession and to dispose of them.⁸⁶ The holder of such a mineral interest, incidental thereto, has full power to execute a lease covering it.⁸⁷ Of course, if he does not own the entire mineral interest in the tract, his position will be that of an owner in common, and the effect of his lease will be governed by principles already discussed with reference to common ownership.⁸⁸

The mineral interest itself may be divided into an assortment of more limited interests: the right to explore and develop; the right to execute leases or other instruments affecting the mineral interest; and the right to receive "bonus" payments for executing a lease, "delay rental" payments or "shut-in" payments for the privilege of delayed drilling or delayed marketing, and "royalty" payments based on production from the premises.⁸⁹ These interests individually may be the subject of bargain and of transfer.⁹⁰ The "executive right"⁹¹ of leasing may be combined

⁸³ *Caldwell v. Fulton*, 31 Pa. 475, 72 Am. Dec. 760 (1858); *Feather v. Baird*, 85 W. Va. 267, 102 S.E. 294 (1919).

⁸⁴ See 1 WILLIAMS & MEYERS, OIL AND GAS LAW §§ 203-04 (1959), for a discussion of various theories.

⁸⁵ *Id.* § 202.2.

⁸⁶ See MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES 15 (2d ed. 1940).

⁸⁷ *McCall v. Nettles*, 251 Ala. 349, 37 So. 2d 635 (1948).

⁸⁸ *Amundson v. Gordon*, 134 Mont. 142, 328 P.2d 630 (1958).

⁸⁹ See 1 WILLIAMS & MEYERS, OIL AND GAS LAW § 301; Morris, *Some Legal Consequences Resulting from a Separation of the Incidents of Ownership of a Mineral Interest*, 7 OKLA. L. REV. 285, 287 (1954).

⁹⁰ See MERRILL, THE PUBLIC'S CONCERN WITH THE FUEL MINERALS 75-76 (1960), for a listing of various forms of divided property interests receiving judicial recognition.

⁹¹ For judicial use of this term see *Morris v. First Nat'l Bank*, 249 S.W.2d 269 (Tex. Civ. App. 1952). The executive right holder is subject to special duties of fairness and good faith in favor of other interest-

with any or all of these other interests. Whoever possesses that right is the person with whom the prospective lessee may deal. It seems sensible that ownership of the executive right could be isolated from any of the other rights.⁹² On the theory that the right is in essence nothing more than a power to deal with the property of others, such an isolation has been held to violate the Rule Against Perpetuities in California.⁹³ Other jurisdictions adopting the better view, that it is a species of property right in itself,⁹⁴ have upheld the propriety of such a grant, expressly⁹⁵ or impliedly.⁹⁶

Ordinarily a grant of "royalty" as distinguished from a grant of "minerals," of "mineral interest," or of specifically named substances does not carry with it the executive right.⁹⁷

In the drafting of instruments covering the separation of oil and gas interests, much depends upon choice of language as to the character and amount of the interest. The necessary limitations upon the scope of this discussion preclude anything more than a reference to the problem and to useful discussion thereof.⁹⁸

The existence of a mortgage upon the premises on which a lease is sought renders the owner unable to give a lease which will bind the security interest.⁹⁹ This is important, not only because foreclosure may cut off the lessee's rights,¹⁰⁰ but also because structures placed on the land by the lessee, which cannot be removed without injury to the premises, inure to the benefit of the security holder.¹⁰¹

III. DURATION OF LEASE

A. HABENDUM CLAUSE

Various clauses affect the duration of the lease. Primarily,

holders. See MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES § 191C (Supp. 1959).

⁹² Cf. *Rudes v. Field*, 146 Tex. 133, 204 S.W.2d 5 (1947).

⁹³ *Dallapi v. Campbell*, 45 Cal. App. 2d 541, 114 P.2d 646 (3d. Dist. 1941).

⁹⁴ See 2 WILLIAMS & MEYERS, OIL AND GAS LAW § 338 (1959).

⁹⁵ *Hanson v. Ware*, 224 Ark. 430, 274 S.W.2d 359 (1955).

⁹⁶ See cases collected in 2 WILLIAMS & MEYERS, OIL AND GAS LAW §§ 21-23 (1959).

⁹⁷ *Davis v. Mann*, 234 F.2d 553 (10th Cir. 1956).

⁹⁸ See 1 WILLIAMS & MEYERS, OIL AND GAS LAW §§ 302-07, 320 (1959); Bowen, *Pitfalls in Mineral Conveyancing in Oklahoma*, 9 OKLA. L. REV. 133 (1956).

⁹⁹ *Ball v. Coyle*, 108 Okla. 30, 233 Pac. 750 (1925).

¹⁰⁰ *Yarg Producing & Ref. Corp. v. Iles Inv. Co.*, 88 Colo. 412, 297 Pac. 1001 (1931); *Breeding v. Ritterhoff*, 126 Okla. 225, 259 Pac. 227 (1927).

¹⁰¹ *Smith v. Bush*, 173 Okla. 172, 44 P.2d 921, 101 A.L.R. 330 (1935).

there is the so-called habendum clause—the term derives from the traditional pattern of common law conveyancing¹⁰²—which, in modern form, specifies a duration for a fixed number¹⁰³ of years, generally referred to as the “primary term,” the “fixed term”¹⁰⁴ or the “exploratory period,”¹⁰⁵ and “so long thereafter as oil or gas are produced from said land” or “are produced in paying quantities.”¹⁰⁶

B. DELAY RENTAL CLAUSE

Another clause which may affect the duration of the lease is the so-called delay rental provision.¹⁰⁷ While the habendum clause, standing alone, appears to give the lessee the entire length of the primary term in which to extend the life of the lease by achieving production, the courts at a comparatively early date gave effect to the lessor's understandable desire for prompt action by raising the implied covenant for diligent exploration of the premises within a reasonable time.¹⁰⁸

(1) “Or” Lease

For the purpose of relieving the lessee from the obligations of this requirement, while giving the lessor something by way of compensation for his wait, a clause was devised whereby the lessee agreed to commence a well before a specified day (usually one year from the execution date) or to pay a fixed sum to the lessor, with provision for further periodic payments in place of drilling and forfeiture upon default of performance.¹⁰⁹ The lessees unquestionably felt that they achieved thereby an option to drill or to pay the “delay rental,” or, if they desired to drop the whole venture, to terminate the affair simply by fail-

¹⁰² The clause, in a typical lease of the traditional form, reads: “To have and to hold unto said lessee and to lessee's successors and assigns for the term of seven (7) years from the date hereof and as much longer thereafter as oil or gas are produced from said land.”

¹⁰³ See WILLIAMS & MEYERS, *MANUAL OF OIL AND GAS TERMS* 189 (1957).

¹⁰⁴ See KULP, *OIL AND GAS RIGHTS* § 10.30 (1954).

¹⁰⁵ See WILLIAMS & MEYERS, *op. cit. supra* note 103, at 90.

¹⁰⁶ A sampling of diverse phrasings of the habendum clause is contained in BROWN, *OIL AND GAS LEASES* § 5.11 (1958).

¹⁰⁷ See WILLIAMS & MEYERS, *op. cit. supra* note 103, at 56.

¹⁰⁸ See MERRILL, *COVENANTS IMPLIED IN OIL AND GAS LEASES* §§ 50, 51 (2d ed. 1940).

¹⁰⁹ See KULP, *OIL AND GAS RIGHTS* 597 (1954).

ing either to drill or to pay. Much to their disappointment, the courts ruled that the option simply was to drill or to pay delay rental throughout the primary term.¹¹⁰ The forfeiture provision was for the lessor's benefit only. Even when a clause giving the lessee the option to surrender the lease at any time was introduced, the operator who absent-mindedly neglected to execute the release found himself stuck with liability for all rentals accruing prior to the time of exercising the option.¹¹¹ Also, some judges came to the conclusion that the presence of the option made the obligations lacking in mutuality so that the lease became unenforcible against the lessor.¹¹²

(2) "Unless" Lease

Accordingly the provision was rephrased to make the lease terminate automatically if no well was commenced within the specified time, *unless* the lessee paid delay rental.¹¹³ This "un-

¹¹⁰ *Woodland Oil Co. v. Crawford*, 55 Ohio St. 161, 44 N.E. 1093 (1896); *Wills v. Manufacturers' Natural Gas Co.*, 130 Pa. 222, 18 Atl. 721 (1889); *Roberts v. Bettman*, 45 W. Va. 143, 30 S.E. 95 (1898). Cf. *Jackson v. Twin State Oil Co.*, 95 Okla. 96, 218 Pac. 324 (1923); *Thompson v. Christie*, 138 Pa. 230, 20 Atl. 934, 11 L.R.A. 236 (1890), holding that under a drill or pay lease without a forfeiture clause, neither party could claim termination.

¹¹¹ *Davis v. Olympic Ref. Co.*, 46 Cal. App. 2d 799, 117 P.2d 9 (2d Dist. 1941); *Healdton Oil & Gas Co. v. Smith*, 80 Okla. 242, 195 Pac. 756 (1921).

¹¹² *Brown v. Wilson*, 58 Okla. 392, 160 Pac. 94 (1916); *Steelsmith v. Gartlan*, 45 W. Va. 27, 29 S.E. 978 (1898).

¹¹³ A typical "unless" clause reads as follows: "If operations for the drilling of a well for oil or gas are not commenced on said land on or before one year from this date, this lease shall terminate as to both parties, unless the lessee shall, on or before one year from this date, pay or tender to the lessor or for the lessor's credit in the _____ Bank at _____, or its successors, which bank and its successors are the lessor's agent and shall continue as the depository of any and all sums payable under this lease, regardless of changes of ownership in said land or in the oil and gas, or in the rentals to accrue thereunder, the sum of _____ Dollars (\$ _____) which shall operate as rental and cover the privilege of deferring the commencement of drilling operations for a period of one year. In like manner and upon like payments or tenders, the commencement of drilling operations may be further deferred for like periods successively. All payments or tenders may be made by check or draft of lessee or any assignee thereof, mailed or delivered on or before the rental paying date. Notwithstanding the death of the lessor, or his successor in interest, the payment or tender of rentals in the manner provided above shall be binding on the heirs, devisees, executors, and administrators of such person."

less" form has proved so much more satisfactory to both lessors and lessees than the "or" form that the latter today is rarely encountered.¹¹⁴

Under the "unless" form, then, the lease terminates before expiration of the primary term, if the lessee neither commences operations nor pays the delay rental by the specified date.¹¹⁵ The termination is absolute, so that the lessor may not recover delay rental.¹¹⁶ Also, in most jurisdictions, time is of the essence,¹¹⁷ so that the lessee may not receive relief for default in payment arising from inadvertence,¹¹⁸ misfeasance of transmission,¹¹⁹ mistake as to persons¹²⁰ or amount¹²¹ and like causes.¹²² Occasionally, if the lessor has contributed to the error,¹²³ or if other

¹¹⁴ See BROWN, OIL AND GAS LEASES 126 (1958).

¹¹⁵ Eitel v. Alford, 127 Colo. 341, 257 P.2d 955 (1953); Morton v. Sutcliffe, 175 Kan. 699, 266 P.2d 734, 5 A.L.R.2d 993 (1954); Schumacher v. Cole, 131 Mont. 166, 309 P.2d 311 (1957); Valentine Oil Co. v. Powers, 157 Neb. 71, 59 N.W.2d 150 (1953); Ellison v. Skelly Oil Co., 206 Okla. 496, 244 P.2d 832 (1952).

¹¹⁶ Union Cent. Life Ins. Co. v. Empire Oil & Ref. Co., 148 Kan. 813, 84 P.2d 911 (1938); Deming Inv. Co. v. Lanham, 36 Okla. 773, 130 Pac. 260, 44 L.R.A. (n.s.) 50 (1913).

¹¹⁷ Epperson v. Helbron, 145 Ark. 566, 225 S.W. 345, 15 A.L.R. 597 (1920); Union Gas & Oil Co. v. Indian-Tex Petroleum Co., 202 Ky. 236, 259 S.W. 57 (1924); McDaniel v. Hager-Stevenson Oil Co., 75 Mont. 356, 243 Pac. 582 (1926).

¹¹⁸ Hill v. Stanolind Oil & Gas Co., 119 Colo. 477, 205 P.2d 643 (1949); Johnson v. Smallenberger, 237 La. 11, 110 So. 2d 119 (1959); Woodside v. Lee, 81 N.W.2d 745 (N.D. 1957).

¹¹⁹ Abell v. Bishop, 86 Mont. 478, 284 Pac. 525 (1930). *But cf.* Oldfield v. Gypsy Oil Co., 123 Okla. 293, 253 Pac. 298 (1926) (postal misdelivery excused). In some instances, the lease is construed as merely requiring mailing of the rental to the lessee, rather than delivery or deposit to his credit. Baker v. Potter, 223 La. 274, 65 So. 2d 598 (1953); Hitz v. Ohio Fuel Gas Co., 43 Ohio App. 484, 183 N.E. 768 (1932).

¹²⁰ LeRosen v. North Cent. Texas Oil Co., 169 La. 973, 126 So. 442 (1930); New England Oil & Pipe Line Co. v. Rogers, 154 Okla. 285, 7 P.2d 638 (1931).

¹²¹ Young v. Jones, 222 S.W. 691 (Tex. Civ. App. 1920).

¹²² Phillips Petroleum Co. v. Curtis, 182 F.2d 122 (10th Cir. 1950) (mistake as to lease being held by production); Vaughan v. Doss, 219 Ark. 963, 245 S.W.2d 826 (1952) (wrong bank); Warner v. Page, 59 Okla. 259, 159 Pac. 264 (1916) (unsigned check); Garfield Oil Co. v. Champlin, 78 Okla. 91, 189 Pac. 514 (1920) (time); Ireland v. Chatman, 87 Okla. 223, 209 Pac. 408 (1922) (banker's failure to make deposit); Humble Oil & Ref. Co. v. Mullican, 144 Tex. 609, 192 S.W.2d 770 (1946) (time).

¹²³ Saling v. Flesch, 85 Mont. 106, 277 Pac. 612 (1929) (delay in presenting check); Superior Oil Co. v. Jackson, 207 Okla. 437, 250 P.2d 23 (1952) (uncertainty as to apportionment of lessor interest). *But cf.* Stady v. Texas Co., 150 Kan. 420, 94 P.2d 322 (1939) (denial of relief,

equitable considerations are present,¹²⁴ relief is granted.

Other difficult problems arise where the commencement of drilling is relied upon to absolve the payment of delay rental as a means of continuing the lease in effect. What constitutes commencement?¹²⁵ If the well is commenced, it is agreed that drilling must be pursued with due diligence.¹²⁶ But, again, what is due diligence?¹²⁷

C. DRILLING A DRY HOLE

If the lessee undertakes to hold the lease by sinking a well and it turns out to be dry, vexing questions again arise. Some courts hold that the drilling of the one well absolves the lessee from further action.¹²⁸ The weight of authority, however, bring the implied covenant for development into play,¹²⁹ in analogy to the rule regarding exploration.¹³⁰ To avoid the necessity of

suggesting lessee should procure appointment of receiver to take delay rental, pending determination of persons entitled).

¹²⁴ *Brunson v. Carter Oil Co.*, 263 Fed. 935 (E.D. Okla. 1919) (change in ownership, bookkeeper's error); *Kays v. Little*, 103 Kan. 461, 175 Pac. 149, 1 A.L.R. 675 (1918) (failure of mail service); *Browning v. Weaver*, 158 Kan. 255, 146 P.2d 390, 5 A.L.R.2d 985 (1944) (lessor's attempt to carry water on both shoulders, awaiting outcome of test well).

¹²⁵ Cases are collected in 2 SUMMERS, OIL AND GAS § 349 (perm. ed. 1958); KULP, OIL AND GAS RIGHTS § 10.34 (1954); BROWN, OIL AND GAS LEASES § 7.04 (1958).

¹²⁶ See MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES § 44 (2d ed. 1940).

¹²⁷ *Geier-Jackson, Inc. v. James*, 160 F. Supp. 524 (E.D. Tex. 1958) (indiligence); *Hughes v. Ford*, 406 Ill. 171, 92 N.E.2d 747 (1950) (indiligence); *Illinois Mid-Continent Co. v. Tennis*, 122 Ind. App. 17, 102 N.E.2d 390 (1951) (indiligence); *Wright v. Hunt*, 190 Ky. 683, 228 S.W. 27 (1921) (fact question); *Robinson v. Gordon Oil Co.*, 258 Mich. 643, 242 N.W. 795 (1932) (diligence); *Keechi Oil & Gas Co. v. Smith*, 81 Okla. 266, 198 Pac. 588 (1921) (diligence); *Karns v. Tanner*, 66 Pa. 297 (1870) (fact question—doubtful decision); *Munroe v. Armstrong*, 96 Pa. 307 (1880) (indiligence); *Bartley v. Phillips*, 165 Pa. 325, 30 Atl. 842 (1895) (fact question); *Cockrum v. Christy*, 223 S.W. 308 (Tex. Civ. App. 1920) (diligence); *Woods v. Bost*, 26 S.W.2d 299 (Tex. Civ. App. 1930) (fact question).

¹²⁸ *Nabors v. Producers' Oil Co.*, 140 La. 985, 74 So. 527 (1917); *Smith v. Tullos*, 195 La. 400, 196 So. 912 (1940).

¹²⁹ *Hill v. Larcon Co.*, 131 F. Supp. 469 (W.D. Ark. 1955); *Ohio Oil Co. v. Detamore*, 165 Ind. 243, 73 N.E. 906 (1905); *Berthelote v. Loy Oil Co.*, 95 Mont. 434, 28 P.2d 187 (1933); *Steelsmith v. Gartlan*, 45 W. Va. 27, 29 S.E. 978 (1898).

¹³⁰ See MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES § 54 (2d ed. 1940).

continuous activity, there have been introduced clauses such as the following:

If at any time prior to the discovery of oil or gas on this land and during the term of this lease, the lessee shall drill a dry hole, or holes, on this land, this lease shall not terminate, provided operations for the drilling of a well shall be commenced within twelve months from the expiration of the last rental period for which rental has been paid, or provided that within said period the lessee begins or resumes the payment of rentals in the manner and amount herein above provided; and in this event the preceding paragraphs hereof governing the payment of rentals and the manner and effect thereof shall continue in force.

These clauses, granting the privilege to resume delay rental payments in lieu of drilling, thereby excluding implied duties to continue drilling,¹³¹ are construed strictly against the lessee both as to the occasion for exercise¹³² and as to the date of payment.¹³³ On the other hand, so long as the conditions alternative to the need for resumption exist, there is no need to pay delay rental.¹³⁴

D. AMOUNT OF RENTAL

Traditionally, through most of the oil country, the rate of delay rental has been one dollar per acre per year. In completely wildcat areas, the oil men have been able to bring this sum down materially. During the Great Depression there was a movement by lessees to secure a lower sum, sometimes by a threat to drop existing leases. This vanished as the crisis lightened. With the depreciation of the dollar over the last twenty years, it may be that the traditional rate no longer can be sustained. Certainly it does not aid the lessor in paying his taxes and other land charges as much as it did in the days when the tradition as to

¹³¹ Cf. *Miles v. Ashby*, 295 Ky. 500, 174 S.W.2d 753 (1943).

¹³² *Niles v. Luttrell*, 61 F. Supp. 778 (W.D. Ky. 1945) (inordinate delay in completing dry test); *Freeland v. Edwards*, 11 Ill. 2d 395, 142 N.E.2d 701 (1957) (resumption clause cannot be used to extend lease beyond primary term).

¹³³ *Sittig v. Dalton*, 195 La. 765, 197 So. 423 (1940).

¹³⁴ *Wilson v. Wakefield*, 146 Kan. 693, 72 P.2d 978 (1937) (dry hole absolves delay rental for year); *Long v. Magnolia Petroleum Co.*, 166 Neb. 410, 89 N.W.2d 245 (1958) (resumption not due so long as production in any quantity continued).

the amount of delay rental originated.¹³⁵ Lawyers advising prospective lessors may be justified in suggesting to their clients that they hold out for a more remunerative delay rental provision.

E. PRODUCTION REQUIREMENTS

Reverting to the habendum clause, we have seen that, after the conclusion of the primary term,¹³⁶ the continued duration of the lease is made to depend upon production,¹³⁷ or upon production in paying quantities.¹³⁸ The general rule is that this requires that actual production be accomplished,¹³⁹ rather than commencing work upon a well,¹⁴⁰ even though accompanied by some reasonable showing of probable success justified by later achievement.¹⁴¹ In a few instances, a result more favorable to the lessee has been justified upon the inclusion in the habendum clause of the phrase "if oil or gas is discovered" or an equivalent wording.¹⁴² In still other cases, the courts, without benefit of such phrasing, have held that the discovery of an apparently profitable sand within the primary term gives the lessee a reasonable time to exercise diligence in the work of testing and completion, even though this extends beyond the fixed term.¹⁴³ Obviously, this requires the taking of substantial liberties with the language employed in the document.¹⁴⁴

If the well is under way, merely, at the close of the exploratory term, the language commonly employed seems to dictate the

¹³⁵ As of the first quarter of the present century, the dollar an acre payment would be a substantial contribution to the annual tax bill on the ordinary farm, if, indeed, it did not exceed that exaction.

¹³⁶ *Kinne v. Swanson Consol. Oil Co.*, 293 Mich. 509, 292 N.W. 472 (1940); *Humphreys v. Fletcher*, 27 N.M. 639, 204 Pac. 70 (1922); *Brown v. Fowler*, 65 Ohio St. 507, 63 N.E. 76 (1902).

¹³⁷ *Sawyer v. Potter*, 223 Ky. 359, 3 S.W.2d 758 (1928); *South Penn Oil Co. v. Snodgrass*, 71 W. Va. 438, 76 S.E. 961, 43 L.R.A. (n.s.) 848 (1913).

¹³⁸ *Moon v. Marker*, 26 Cal. App. 2d 33, 78 P.2d 460 (3d Dist. 1938); *Hanna v. Shorts*, 163 Ohio St. 44, 125 N.E.2d 338 (1955).

¹³⁹ *Baldwin v. Blue Stem Oil Co.*, 106 Kan. 848, 189 Pac. 920 (1920); *Town of Tome Land Grant v. Ringle Dev. Co.*, 56 N.M. 101, 240 P.2d 850 (1952); *Dygas v. Rogers*, 198 Okla. 632, 181 P.2d 253 (1947).

¹⁴⁰ *Perkins v. Saunders*, 109 Kan. 372, 198 Pac. 954 (1921).

¹⁴¹ *Garcia v. King*, 139 Tex. 578, 164 S.W.2d 509 (1942).

¹⁴² *Texas Pac. Coal & Oil Co. v. Bratton*, 239 S.W. 688 (Tex. Civ. App. 1921); *Bouldin v. Gulf Prod. Co.*, 5 S.W.2d 1019 (Tex. Civ. App. 1928). Cf. *Roach v. Junction Oil & Gas Co.*, 72 Okla. 213, 179 Pac. 934 (1919).

¹⁴³ *Bain v. Portable Drilling Co.*, 200 Okla. 569, 198 P.2d 207 (1948); *South Penn Oil Co. v. Snodgrass*, 71 W. Va. 438, 76 S.E. 961 (1913).

¹⁴⁴ See 2 SUMMERS, OIL AND GAS 242 (perm. ed. 1958).

conclusion that the lessee's rights have expired.¹⁴⁵ In some jurisdictions, a line is drawn based on the delay rental provision, however, theorizing that the last delay rental payment secures to the lessee the privilege of deferring the commencement of the well clear up to the end of the primary term. To make this privilege effective, it is considered necessary that the lessee be permitted a reasonable time to complete the well and place it in operation, even if this carries substantially past the fixed term.¹⁴⁶ Here, again, it must be said that substantial violence is done to the plain language of the lease, which is intended to define the limits of the fixed term.¹⁴⁷ The weight of authority, numerical as well as meritorious, clearly is the other way.¹⁴⁸

The same problem arises when production has been achieved during the primary term, but thereafter trouble arises. Here there is considerable justification for the view that a temporary interruption of production does not terminate the lease, if the lessee strives diligently to restore fruitfulness, either by reworking the failing wells,¹⁴⁹ or by drilling anew.¹⁵⁰ The better view is against extending this period over too long a period of time.¹⁵¹ Some decisions stretch it pretty far.¹⁵² Others apply strictly the

¹⁴⁵ *Cooke v. Gulf Ref. Co.*, 127 La. 592, 53 So. 874 (1910); *Morrison v. Swaim*, 220 S.W.2d 493 (Tex. Civ. App. 1949).

¹⁴⁶ *Simpson v. Buckner's Adm'r.*, 247 Ky. 564, 57 S.W.2d 464 (1933); *Simons v. McDaniel*, 154 Okla. 168, 7 P.2d 419 (1932).

¹⁴⁷ 2 SUMMERS, OIL AND GAS 202 (perm. ed. 1958).

¹⁴⁸ *Perkins v. Saunders*, 109 Kan. 372, 198 Pac. 954 (1921); *Murdock-West Co. v. Logan*, 69 Ohio St. 514, 69 N.E. 984 (1904); *Heard v. Nichols*, 293 S.W. 805 (Tex. Com. App. 1927).

¹⁴⁹ *Reynolds v. McNeill*, 218 Ark. 453, 236 S.W.2d 723 (1951); *Brown v. Shafer*, 325 P.2d 743 (Okla. 1958) (dictum).

¹⁵⁰ *Cotner v. Warren*, 330 P.2d 217 (Okla. 1958), discussed in 35 N. DAK. L. REV. 234 (1959).

¹⁵¹ *Anthis v. Sullivan Oil & Gas Co.*, 83 Okla. 86, 203 Pac. 187 (1922); *Townsend v. Creekmore-Rooney Co.*, 332 P.2d 35 (Okla. 1958).

¹⁵² *Saulsberry v. Siegel*, 221 Ark. 152, 252 S.W.2d 834 (1952). Cf. *Frost v. Gulf Oil Corp.*, 238 Miss. 775, 119 So. 2d 759 (1960), in which, after favorable showings at various levels, a well finally was completed as an oil producer in 1945. The primary term expired in 1947. The oil sand ceased to produce in 1955. About a month later, the lessee completed the well as a gas producer in one of the by-passed sands. It was held that the lease continued in effect. This is all very well, so far as diligence in achieving production after the failure of the first sand is concerned, but there is at least a serious question as to whether the lessee was not unduly dilatory in waiting so long to test the productivity of the second stratum, which was known to exist when the well first was completed.

rule that the lease terminates with the failure of production.¹⁵³

We have seen that the leases vary in defining the event which continues the lease in being, sometimes phrasing it as "production" and sometimes as "production in paying quantities." While a few decisions seem to regard the phraseology as significant, holding that the former is satisfied so long as the lessee extracts the least amount of product,¹⁵⁴ the great weight of authority considers that "paying quantities" is to be read into those clauses that do not spell it out.¹⁵⁵ The test of production in paying quantities is whether, over a substantial period of time, not just a few weeks or months,¹⁵⁶ current revenue from the operation of the lease exceeds current expense.¹⁵⁷ Sales may not necessarily reflect the entire production, however, and to this extent allowance should be made for the actual value of the product and deductions should be made if the sales include production from too distant a date.¹⁵⁸ Depreciation charges on investment are not to be considered as an expense in this sense.¹⁵⁹ Overriding royalties or other charges on the working interest are not to be deducted from income.¹⁶⁰

Increasingly, leases include provisions intended to ameliorate the effect of the standard habendum clause. One common provision specifically allows the completion of a test well under way at the close of the primary term, or of any extension thereof,¹⁶¹ with the effect of continuing the lease indefinitely if the well is a producer.¹⁶² However, this period for completion may not

¹⁵³ *Haby v. Stanolind Oil & Gas Co.*, 228 F.2d 298 (5th Cir. 1955); *Warner v. Kulp*, 114 Kan. 118, 217 Pac. 288 (1923); *Cassell v. Crothers*, 193 Pa. 359, 44 Atl. 446 (1899); *Rogers v. Osborn*, 152 Tex. 540, 261 S.W.2d 311 (1953); *Anderson v. Schaffner*, 90 W. Va. 225, 110 S.E. 566 (1922).

¹⁵⁴ *Gillespie v. Ohio Oil Co.*, 260 Ill. 169, 102 N.E. 1043 (1913).

¹⁵⁵ *McLeon v. Wells*, 207 Ark. 303, 180 S.W.2d 325 (1944); *Caldwell v. Alton Oil Co.*, 161 La. 139, 108 So. 314 (1926); *Long v. Magnolia Petroleum Co.*, 166 Neb. 410, 89 N.W.2d 245 (1958); *Brown v. Shafer*, 325 P.2d 743 (Okla. 1958).

¹⁵⁶ *Transport Oil Co. v. Exeter Oil Co.*, 84 Cal. App. 2d 616, 191 P.2d 129 (2d Dist. 1948); *Clifton v. Koontz*, 160 Tex. 82, 325 S.W.2d 684 (1959).

¹⁵⁷ *Dinwiddie v. Mulligan*, 208 Ky. 320, 270 S.W. 774 (1925); *Long v. Magnolia Petroleum Co.*, 166 Neb. 410, 89 N.W.2d 245 (1958); *Brown v. Shafer*, 325 P.2d 743 (Okla. 1958); *Barbour, Stedman & Co. v. Tompkins*, 81 W. Va. 116, 93 S.E. 1038 (1917).

¹⁵⁸ *Sullivan & Garnett v. James*, 308 S.W.2d 891 (Tex. Civ. App. 1957).

¹⁵⁹ *Clifton v. Koontz*, 160 Tex. 82, 325 S.W.2d 684 (1959).

¹⁶⁰ *Vance v. Hurley*, 215 La. 805, 41 So. 2d 724 (1949) (oil payment); *Clifton v. Koontz*, *supra* note 159 (overriding royalty).

¹⁶¹ *Humphreys v. Skelly Oil Co.*, 83 F.2d 989 (5th Cir. 1936).

¹⁶² *Haddock v. McClendon*, 223 Ark. 396, 266 S.W.2d 74 (1954).

itself be regarded as an extension, allowing the lessee to continue his status by starting another well before writing off of the test well as a dry hole.¹⁶³

Another device is to provide that the lease shall not terminate for want of production if the lessee commences additional drilling or reworking operations within a specified time.¹⁶⁴ On failure to comply with the granted option, however, the lease comes to an end.¹⁶⁵ One form of operation cannot be tacked onto another, however, so as to extend the fixed term indefinitely in this way.¹⁶⁶ In determining whether the privilege of drilling

¹⁶³ *Skelly Oil Co. v. Wickham*, 202 F.2d 442 (10th Cir. 1953); *Moore Oil Co. v. Snakard*, 150 F. Supp. 250 (W.D. Okla. 1957).

¹⁶⁴ *St. Louis Royalty Co. v. Continental Oil Co.*, 193 F.2d 778 (5th Cir. 1952).

¹⁶⁵ *Haby v. Stanolind Oil & Gas Co.*, 228 F.2d 298 (5th Cir. 1955); *Browning v. Cavanaugh*, 300 S.W.2d 580 (Ky. 1957); *Seiber v. Ringgold*, 231 La. 983, 93 So. 2d 530 (1957).

¹⁶⁶ *Rogers v. Osborn*, 152 Tex. 540, 261 S.W.2d 311 (1953). *But cf. Stanolind Oil & Gas Co. v. Newman Drilling Co.*, 157 Tex. 489, 305 S.W.2d 169 (1957) and criticism thereof in 56 MICH. L. REV. 823 (1958). A lease form evidently designed to permit "tacking" reads: "If a dry hole is completed on leased premises or if all wells thereon cease to be capable of producing oil, gas or substance covered hereby within less than ninety (90) days before the end of the primary term, this lease, if not otherwise kept in force, shall continue in force and effect for a period of ninety (90) days from and after the date of the completion of such dry hole or the date when such wells ceased to be capable of so producing, and if at the end of the primary term, or at the expiration of said ninety (90) day period, oil, gas or substance covered hereby is not being produced on said leased premises, but Lessee is then engaged in operations for drilling, reworking or producing, this lease shall continue in force so long as any operations for drilling, reworking or producing (including operations for additional drilling or reworking commenced during such continuance) are prosecuted with no cessation of more than ninety (90) days, and if such operations result in the production of oil, gas or substance covered hereby, then so long thereafter as oil, gas or any of them, or any substance covered hereby, is produced from said land.

"Without limiting any provision of this lease, it is expressly agreed that if, during the primary term of this lease or at any time thereafter that this lease is in force, the Lessee shall commence operations for drilling or reworking on leased premises, this lease shall continue in full force and effect and its term shall continue as long as such operations for drilling or reworking (including operations for additional drilling or reworking commenced during such continuance) are prosecuted with no cessation of more than ninety (90) days, and if any such operations for drilling or reworking result in the production of oil, gas or substance covered hereby, then this lease shall be continued so long thereafter as oil or gas, casinghead gas or oil-well gas or liquid hydrocarbons or gaseous hydrocarbons or any substance covered here-

has been carried on with proper diligence, a reasonable time for testing the prospective production is allowed.¹⁶⁷

F. EFFECT OF ADVERSE MARKET CONDITIONS

Adverse market conditions sometime prevent production. Some courts hold that this warrants extension of the lease, so long as the lessee is diligent in his attempts to secure a market.¹⁶⁸ The situation seems to arise typically with respect to gas.¹⁶⁹ Many leases specifically deal with this situation by allowing the payment of so-called shut-in royalty as a substitute for production and the payment of ordinary royalty, as a means of continuing the lease in effect.¹⁷⁰ These provisions are effectual,¹⁷¹ but

by, or any of them, is produced from said land, or operations for drilling or reworking are continued as herein provided."

It has not yet received judicial interpretation.

¹⁶⁷ *Fields v. Stanolind Oil & Gas Co.*, 233 F.2d 625 (5th Cir. 1956).

¹⁶⁸ *Tate v. Stanolind Oil & Gas Co.*, 172 Kan. 351, 240 P.2d 465 (1952); *McVicker v. Horn, Robinson & Nathan*, 322 P.2d 410 (Okla. 1958).

¹⁶⁹ See 2 SUMMERS, OIL AND GAS 220 (perm. ed. 1958).

¹⁷⁰ A somewhat wordy clause of this kind reads: "at any time, either before or after the expiration of the primary term of this lease, if there is a gas well or wells on the above land (and for the purposes of this clause (c) the term 'gas well' shall include wells capable of producing natural gas, condensate, distillate or any gaseous substance and wells classified as gas wells by any governmental authority) and such well or wells are shut in before or after production therefrom, lessee or any assignee hereunder may pay or tender an advance annual royalty equal to the amount of delay rentals provided for in this lease for the acreage then held under this lease by the party making such payment or tender, and if such payment or tender is made, it shall be considered under all provisions of this lease that gas is being produced from the leased premises in paying quantities for one (1) year from the date such payment or tender is made, and in like manner subsequent advance annual royalty payments may be made or tendered and it will be considered under all provisions of this lease that gas is being produced from the leased premises in paying quantities during any annual period for which such royalty is paid or tendered; such advance royalty may be paid or tendered in the same manner as provided herein for the payment or tender of delay rentals; royalty accruing to the owners thereof on any production from the leased premises during any annual period for which advance royalty is paid may be credited against such advance payment; and when there is a shut-in gas well or wells on the leased premises if this lease is not continued in force under some other provision thereof, it shall nevertheless continue in force for a period of ninety (90) days from the last date on which a gas well located on the leased premises is shut in, or for ninety (90) days following the date to which this lease is continued in force by some other provision thereof, as the case may be, within which ninety day period lessee or any assignee hereunder may com-

the lessee must take care to pay the shut-in royalty on time¹⁷² and before the expiration of the fixed term.¹⁷³ It has been argued persuasively that, if the well is not completed until after that date, prompt payment upon completion should suffice.¹⁷⁴ Otherwise there would seem little effectiveness to the extended drilling privilege in such circumstances. Under the shut-in clauses, as commonly drafted,¹⁷⁵ so much ambiguity arises as to just when the payment should be made that the interests of both the lessor and the lessee render desirable more specific delineation in respect to this problem.¹⁷⁶

Lawyers representing prospective lessors may well counsel with their clients concerning the amount to be paid as shut-in royalty. Frequently this is placed at the same amount as the delay rental, one dollar, or less, per acre per year.¹⁷⁷ The logic of

mence or resume the payment or tender of the advance royalty as herein provided."

¹⁷¹ *Morriss v. First Nat'l Bank*, 249 S.W.2d 269 (Tex. Civ. App. 1952).

¹⁷² *Gulf Oil Corp. v. Reid*, 337 S.W.2d 267 (Tex. 1960).

¹⁷³ *Lamczyk v. Allen*, 8 Ill. 2d 547, 134 N.E.2d 753 (1956); *Freeman v. Magnolia Petroleum Co.*, 141 Tex. 274, 171 S.W.2d 339 (1943).

¹⁷⁴ See Huie, *Some Recent Developments in the Law of Oil and Gas*, 1960 A.B.A. PROCEEDINGS, SECTION OF MINERAL AND NATURAL RESOURCES LAW 148, 158, criticizing *Gulf Oil Corp. v. Reid*, 337 S.W.2d 267 (Tex. 1960).

¹⁷⁵ See Moses, *Recent Problems in Connection with Shut-in Royalty Provisions in Oil and Gas Leases*, 10 LOYOLA L. REV. 1 (1960); Masterson, *The Shut-in Royalty Clause in an Oil and Gas Lease*, 12 Sw. L.J. 459 (1958).

¹⁷⁶ One essay at such a clause reads: "The term 'stated date' as used in this paragraph shall mean any rental paying date of this lease or any subsequent anniversary thereof if there be a rental paying date, but if no rental paying date is specified in this lease, then 'stated date' shall mean any anniversary date of this lease. If on any such stated date there be on the above described lands or on lands with which the above described lands or portion thereof are pooled or unitized, one or more such gas wells capable of producing gas only, and no gas has been sold or so used from any of such gas wells at any time during the twelve months period ending with such stated date, Lessee shall, before the expiration of sixty (60) days after such stated date, pay or tender to each owner of the right to receive royalty on the gas produced from any part of the above described lands covered by this lease on such stated date at each such owner's address as last known to Lessee, or to the credit of each such owner in the depository bank named herein, in the manner provided herein for payment of delay rentals, a shut-in gas royalty for such period."

¹⁷⁷ For example, see the following: "The total amount of shut-in gas royalty payable to all such owners shall be determined by multiplying One Dollar (\$1.00) by the total number of acres of land covered by

the situation seems to call for a shut-in payment substantially higher than delay rentals. The latter payment is made simply to continue the lease in being as a speculative option on the part of the lessee. On the other hand, the shut-in royalty comes into effect only when it has been demonstrated that the leased premises are valuably productive. They constitute a partial substitute for the return which the lessor would get from actual production and a payment by the lessee for the privilege of preserving his economically advantageous interest in a proven area. This he does by destruction of the lessor's opportunity to realize upon the established productive capacity of his land. At the same time, the well and its appurtenant structures remain as impediments to the use of the surface, burdens which do not exist if the lease is held undeveloped through the payment of delay rental. Surely these factors justify fixing the shut-in payment at a figure many times in excess of the delay rental.

Lawyers representing lessors should be conscious of a related pitfall in the form of a provision in some lease forms that shut-in royalty payments are to be credited against royalties thereafter accruing.¹⁷⁸ This defeats the object of the shut-in payment as current compensation to the lessor for the legal and physical burden placed currently upon his land by the well and by the continuance of the lease.

Another clause against which the lessor should be warned, if it appears in a lease he is asked to sign, reads as follows:

Provided, however, that if on such stated date this lease is being maintained in force and effect otherwise than by reason of any such shut-in gas well or shut-in gas wells, Lessee shall not be obligated to pay or tender any such sum of money as shut-in royalty.

It is not the law that diligence in operating for and marketing one product is excused because some other product is produced and marketed.¹⁷⁹ There is no reason why a lessor should contract to give up a payment substituted for production and marketing simply because income from another source is realized. These provisions, like some others, exemplify an unjustifiable tendency of integrated industry to consider the premises which

said lease on such stated date, and each such owner shall receive that part thereof which is in the proportion that his royalty acreage interest in said land bears to the total number of acres of land covered by such lease on such stated date."

¹⁷⁸ See the clause set out in note 170 *supra*.

¹⁷⁹ See MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES §§ 69, 79, 80 (2d ed. 1940), 69A (Supp. 1959).

they hold under lease as the equivalent of an industrial plant owned in fee.

G. SURRENDER PROVISIONS

Leases usually contain a clause authorizing surrender by the lessee as to all or part of the premises. One such form reads as follows:

Lessees may at any time and from time to time surrender this lease as to any part or parts of the leased premises by delivering or mailing a release thereof to the lessor, or by placing a release thereof of record in the proper county.

This clause originated in the desire of lessees to have a way of getting out from under continuing liability to pay delay rentals on unwanted leases of the "or" variety.¹⁸⁰ Its change to include the privilege of partial release was to take care of other exigencies. It represents a privilege of the lessee or his assignee.¹⁸¹ It does not afford the lessor an opportunity to require surrender.¹⁸² Surrender may be effectuated only by strict compliance with the specified formalities.¹⁸³ On the other hand, when these are performed, the lessor-lessee relationship effectually is terminated.¹⁸⁴ It has been ruled that matured liability for the payment of delay rentals is not absolved by surrender.¹⁸⁵ This same principle should apply to liabilities for other defaults in the lessee's obligations to his lessor.¹⁸⁶ Unfortunately, there are decisions which seem to allow the lessee to use the partial surrender privilege to escape such liabilities.¹⁸⁷ While these cases are indefensible, a wise lessor will insist that the surrender clause be modified so as expressly to forbid the avoidance of accrued liability by its exercise.

¹⁸⁰ See KULP, OIL AND GAS RIGHTS 597 (1954); 2 SUMMERS, OIL AND GAS 131 (perm. ed. 1958).

¹⁸¹ McKee v. Grimm, 111 Okla. 24, 238 Pac. 835 (1925).

¹⁸² See 2 SUMMERS, OIL AND GAS 383 (perm. ed. 1958). The cases cited in support contain dicta only, but the principle is sound.

¹⁸³ Farlow v. Frankson, 110 Kan. 197, 203 Pac. 299 (1922); Ardizzone v. Archer, 71 Okla. 289, 160 Pac. 446 (1916).

¹⁸⁴ Osburn v. Finkelstein, 189 Ind. 90, 126 N.E. 11 (1920); Superior Oil Co. v. Dabney, 147 Tex. 51, 211 S.W.2d 563 (1948).

¹⁸⁵ Cases are collected in 2 SUMMERS, OIL AND GAS 402 n.70 (perm. ed. 1958).

¹⁸⁶ Central States Prod. Corp. v. Jordan, 184 Okla. 262, 86 P.2d 790 (1939).

¹⁸⁷ Plains Petroleum Corp. v. Fine, 174 Okla. 570, 51 P.2d 284 (1935); Superior Oil Co. v. Dabney, 147 Tex. 51, 211 S.W.2d 563 (1948).

H. REMOVAL OF EQUIPMENT

Upon the termination of the lease, the lessee ordinarily is privileged within a reasonable time¹⁸⁸ to remove his casing and equipment from the premises.¹⁸⁹ Commonly, this is provided in the lease.¹⁹⁰ A comprehensive clause of this sort, contained in one form, reads:

At all times during the life of this lease and for a reasonable time after the expiration of this lease, Lessee shall have the right to remove all machinery, fixtures, houses, buildings and other structures placed on said premises, including the right to draw and remove all casing.

The lessee must, of course, perform any statutory obligation to plug abandoned wells.¹⁹¹ Apart from statute, he owes it to his lessor to plug such wells to the extent necessary to prevent injury to the subterranean strata.¹⁹² Occasionally, there arises a difference of opinion between lessor and lessee as to whether a particular well may be continued in operation profitably. There are cases holding that the lessee may not pull the casing from such a well without giving the lessor opportunity to test it in order to determine whether to undertake its operation.¹⁹³ The logical corollary to this position, requiring the lessee to leave the casing in the well, upon being paid a reasonable rental¹⁹⁴ or other compensation¹⁹⁵ therefor, has been applied in some cases.¹⁹⁶ Other decisions seem to deny it.¹⁹⁷ The first line of decision seems justified, in analogy to the lessee's duty not to destroy a paying well.¹⁹⁸

¹⁸⁸ *Wilson v. Wilson*, 280 Ky. 461, 133 S.W.2d 722 (1939); *Shellar v. Shivers*, 171 Pa. 569, 33 Atl. 95 (1895).

¹⁸⁹ *In re Midland Oil Co.*, 3 F.2d 112 (5th Cir. 1924); *Hammons v. Pure Oil Co.*, 309 Ky. 495, 218 S.W.2d 22 (1949); *Tyler v. Wilhite*, 97 Okla. 159, 222 Pac. 997 (1923).

¹⁹⁰ *Wade v. Lillard*, 201 Okla. 520, 207 P.2d 771 (1949) exemplifies such a provision.

¹⁹¹ *Nisbet v. Van Tuyl*, 224 F.2d 66 (7th Cir. 1955).

¹⁹² *Warner v. Shell Petroleum Corp.*, 132 Kan. 837, 297 Pac. 682 (1931).

¹⁹³ *Warner v. Shell Petroleum Corp.*, *supra* note 192.

¹⁹⁴ *Okmulgee Supply Corp. v. Anthis*, 189 Okla. 139, 114 P.2d 451 (1941).

¹⁹⁵ *Sparks v. Ward*, 322 S.W.2d 461 (Ky. 1959) (agreed compensation).

¹⁹⁶ *Powers v. Bridgeport Oil Co.*, 238 Ill. 397, 87 N.E. 381 (1909); *Okmulgee Supply Corp. v. Anthis*, 189 Okla. 139, 114 P.2d 451 (1941).

¹⁹⁷ *Collins v. Mt. Pleasant Oil & Gas Co.*, 85 Kan. 483, 118 Pac. 54, 38 L.R.A. (N.S.) 134 (1911).

¹⁹⁸ *Warner v. Shell Petroleum Corp.*, 132 Kan. 837, 297 Pac. 682 (1931); *Sunburst Oil & Ref. Co. v. Callender*, 84 Mont. 178, 274 Pac. 834 (1929).

It is held in most jurisdictions that the lessee is under no duty to the lessor to restore the premises to their former condition or to remove his structures at the termination of the lease.¹⁹⁹ Statutes sometimes impose such an obligation.²⁰⁰ Where they do not exist, it would be wise for lessors to insist upon the inclusion of a clause requiring removal and restoration.²⁰¹ Frequently the land is left with incumbering ruins and other conditions impeding its use for other purposes.²⁰²

IV. DEVELOPMENT, OPERATION AND ROYALTY PROVISIONS

A. IMPLIED COVENANTS

The lease usually is silent with respect to developmental and operational obligations, apart from the "drilling clause" already discussed. This results partly from the fact that lessors usually are not in position, economic or knowledgeable, to chaffer effectively with lessees over such matters. Partly, it results from the fact that many leases are taken by brokers or speculators who are in no position to insert special agreements in the standardized forms. Partly, too, and this, perhaps, is the most impelling factor, the parties, no matter how cognizant of the oil business, usually are in no position to determine in advance a specific program of development and operation.²⁰³ Occasionally, a lessor is able to stipulate for a binding promise to drill one or more test wells.²⁰⁴ A generally accepted measure of damages for breach of such a promise is the cost of the agreed-for drilling,²⁰⁵ but

¹⁹⁹ *Duvanel v. Sinclair Ref. Co.*, 170 Kan. 483, 227 P.2d 88 (1951); *Black Gold Petroleum Co. v. Hill*, 188 Okla. 329, 108 P.2d 784 (1940); *Warren Petroleum Corp. v. Monzingo*, 157 Tex. 479, 304 S.W.2d 362, 65 A.L.R.2d 1352 (1957).

²⁰⁰ See ILL. ANN. STAT. c. 38, § 466(12) (Smith-Hurd Supp. 1959); KAN. GEN. STAT. ANN. § 55-132a (Supp. 1959).

²⁰¹ Provisions which have been effective will be found in *Danker v. Lee*, 137 Cal. App. 2d 797, 291 P.2d 73 (4th Dist. 1955); *Oceana Oil Producers v. Portland Silo Co.*, 229 Ind. 656, 100 N.E.2d 895 (1951).

²⁰² As in *Fox v. Cities Serv. Oil Co.*, 201 Okla. 17, 200 P.2d 398 (1948).

²⁰³ See MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES §§ 2, 61 (2d ed. 1940).

²⁰⁴ For instances of such stipulations, see cases cited in MERRILL, *op. cit.* *supra* note 203, at 50 n.8, and in supplements thereto.

²⁰⁵ *Stannard v. Reynolds*, 179 Kan. 394, 295 P.2d 610 (1956); *Brown v. Homestake Exploration Corp.*, 98 Mont. 305, 39 P.2d 168 (1934); *Smith v. Kiouss*, 194 Okla. 17, 147 P.2d 442 (1944).

there are other rules²⁰⁶ and controversy rages as to their respective merits.²⁰⁷ Obviously, any reasonable attempt to stipulate a liquidation measure will be sustained.²⁰⁸

In some instances, chiefly where prior activity has given a basis for assessment of what may be encountered, leases, modifications of existent leases, or renewal leases, contain specific programs for development.²⁰⁹ These must be complied with, even though later knowledge suggests the effort's uselessness.²¹⁰

In that great majority of instances in which the leases contain no provision, the courts decide the controversies arising between the lessors and the lessees over the proper administration of the mineral enterprise by what are called the implied covenants of the lease.²¹¹ There are conflicting decisions as to whether the implications are of fact²¹² or of law.²¹³ The impossibility of ascribing to either party either the mental state or the objective manifestation appropriate to the implied in fact contract²¹⁴ convinces me that the latter alternative is preferable.²¹⁵ The practical significance of this logomachy is very limited. It may have some bearing upon the solution of certain problems under some statutes of limitations.²¹⁶ As we shall see later, it affects certain questions of liability in case of assignment or

²⁰⁶ See 3 SUMMERS, OIL AND GAS § 434 (perm. ed. 1958); MERRILL, *op. cit. supra* note 203, § 153.

²⁰⁷ See the discussion in *Fite v. Miller*, 192 La. 229, 187 So. 650 (1939); Annot., 122 A.L.R. 446 (1939).

²⁰⁸ *Lorraine Petroleum Co. v. Bartlett*, 138 Okla. 8, 280 Pac. 286 (1929).

²⁰⁹ Examples of such stipulations may be found in the cases cited in MERRILL, *op. cit. supra* note 203, at 129 n.1 and supplement thereto.

²¹⁰ *Mollohan v. Patton*, 110 Kan. 663, 205 Pac. 643 (1922).

²¹¹ These are discussed in detail in MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES (2d ed. 1940) and the supplements to that work. A short survey of the field occurs in Merrill, *Implied Covenants in Oil and Gas Leases*, 1959 U. ILL. L.F. 584.

²¹² *Indian Territory Illuminating Oil Co. v. Rosamond*, 190 Okla. 46, 120 P.2d 349, 138 A.L.R. 246 (1941); *Danciger Oil & Ref. Co. of Texas v. Powell*, 137 Tex. 484, 154 S.W.2d 632, 137 A.L.R. 408 (1941).

²¹³ *Sauder v. Mid-Continent Petroleum Corp.*, 292 U.S. 272 (1934); *George v. Franklin*, 219 Ky. 377, 292 S.W. 1093 (1927).

²¹⁴ See 1 CORBIN, CONTRACTS §§ 17-19 (1950); 1 WILLISTON, CONTRACTS § 3 (3d ed. 1957). In these situations, the duty defines the contract rather than the reverse. Cf. *Justice Lowrie in Hertzog v. Hertzog*, 29 Pa. 564 (1857).

²¹⁵ MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES 463 (2d ed. 1940).

²¹⁶ *Indian Territory Illuminating Oil Co. v. Rosamond*, 190 Okla. 46, 120 P.2d 349 (1941); *Texas Pac. Coal & Oil Co. v. Stuard*, 7 S.W.2d 878 (Tex. Civ. App. 1928).

subleasing. Perhaps, too, judges who recognize that the obligations arise out of law may be more resourceful in dealing with the problems than those who think they merely are giving effect to what the parties had in mind. However, in most instances, legal theorizing about the basis of the obligations seems to play no acknowledged or recognizable part in their application. It is noteworthy that the origin of these obligations antedates the oil industry,²¹⁷ and that they still find frequent application to other minerals.²¹⁸

What are these covenants? Opinions differ as to numbers and nomenclature.²¹⁹ Personally, I classify them as four in number: (1) to explore;²²⁰ (2) to develop further after exploring;²²¹ (3) to operate diligently after development (including the obligation to market the product),²²² and (4) to protect the premises against drainage from wells on neighboring land.²²³ While these obligations primarily were applied in favor of lessors as against lessees, the true conception probably is that they run in favor of all those possessing non-working interests dependent for their value upon the diligence with which the working interest is operated.²²⁴ A recent federal case²²⁵ indicates that the principle is applicable to an agent who is compensated from natural gas sales.

(1) *Duty of Exploration*

The covenant for exploration has become of comparatively little significance today, with the prevalence of short fixed term leases permitting delay of exploration upon payment of money. These provisions, with some dissent,²²⁶ are construed generally

²¹⁷ The early cases are collected in Merrill, *Implied Covenants in Oil and Gas Leases*, 1959 U. ILL. L.F. 584 nn.1 & 3.

²¹⁸ The cases involving other than petrolific minerals will be found in MERRILL, *op. cit. supra* note 215, § 218 n.10.

²¹⁹ See MERRILL, *op. cit. supra* note 215, § 4.

²²⁰ MERRILL, *op. cit. supra* note 215, ch. II.

²²¹ MERRILL, *op. cit. supra* note 215, ch. III.

²²² MERRILL, *op. cit. supra* note 215, ch. IV.

²²³ MERRILL, *op. cit. supra* note 215, ch. V.

²²⁴ See MERRILL, *supra* note 217, at 585.

²²⁵ *White v. New York State Natural Gas Corp.*, 191 F. Supp. 38 (W.D. Pa. 1958).

²²⁶ *Huggins v. Daley*, 99 Fed. 606 (4th Cir. 1900); *Allegheny Oil Co. v. Snyder*, 106 Fed. 764 (6th Cir. 1900); *Consumers Gas Trust Co. v. Litterer*, 162 Ind. 320, 70 N.E. 363 (1904); *Monarch Oil, Gas & Coal Co. v. Richardson*, 124 Ky. 602, 99 S.W. 668 (1907).

as superseding the implied covenant for exploration.²²⁷ Occasionally, however, a document drawn after the models of the older day is brought into court, and, if the lawyers and judges are not familiar with the requirements of the covenant for exploration, bizzare results may occur.²²⁸ Also, the covenant assumes importance when widely scattered tracts are incorporated in the same lease. Production from one tract will hold the lease in effect without regard to the payment of delay rentals or the expiry of the fixed term.²²⁹ The implied covenant for exploration, however, requires diligent search for production to be made upon the other tracts.²³⁰ Unfamiliarity with the exploration principle may lead to improper results in a case of this type.²³¹

(2) *Duty of Further Development*

The covenant for further development, simply stated, requires that the lessee, after drilling the exploratory well, shall carry on such further operations as are reasonably necessary to develop the productive capacity of the premises.²³² The duty may be imposed even though the first well is dry,²³³ although the advent of resumption clauses, and the like, of which we have spoken earlier, are likely to supersede it.²³⁴

²²⁷ *Rose v. Lanyon Zinc Co.*, 68 Kan. 126, 74 Pac. 625 (1903); *Lloyd's Estate v. Mullen Tractor & Equip. Co.*, 192 Miss. 62, 4 So. 2d 282 (1941); *Southwestern Oil Co. v. McDaniel*, 71 Okla. 142, 175 Pac. 90 (1918).

²²⁸ As, for example, in *State ex rel. Comm'rs of the Land Office v. Couch*, 298 P.2d 452 (Okla. 1956) (implication of exploratory covenant defeated by cash bonus); *Gay v. Grinnan*, 218 S.W.2d 1021 (Tex. Civ. App. 1949) (no covenant to explore, under ninety-nine year lease on land in wildcat territory).

²²⁹ *Hunt v. McWilliams*, 218 Ark. 922, 240 S.W.2d 865 (1951); *Spikes v. Weller*, 159 Kan. 597, 156 P.2d 540 (1945); *State v. Worden*, 44 N.M. 400, 103 P.2d 124 (1940).

²³⁰ *Drummond v. Alphin*, 176 Ark. 1052, 4 S.W.2d 942 (1928); *Alford v. Dennis*, 102 Kan. 403, 170 Pac. 1005 (1918); *Sohio Petroleum Co. v. Miller*, 237 La. 1013, 12 So. 2d 695 (1959); *Magnolia Petroleum Co. v. Vaughn*, 195 Okla. 662, 161 P.2d 762 (1945).

²³¹ As in *Clayton v. Atlantic Ref. Co.*, 150 F. Supp. 9 (D.N.M. 1957), decided in apparently complete oblivion of *State v. Worden*, 44 N.M. 400, 103 P.2d 124 (1940).

²³² *Mountain States Oil Corp. v. Sandoval*, 109 Colo. 401, 125 P.2d 964 (1942); *Berry v. Wondra*, 173 Kan. 273, 246 P.2d 282 (1952); *Petroleum Producers Co. v. Steffens*, 139 Tex. 257, 162 S.W.2d 698 (1942).

²³³ Cf. *Ohio Oil Co. v. Detamore*, 165 Ind. 243, 73 N.E. 906 (1905); *Steel-smith v. Gartlan*, 45 W. Va. 27, 29 S.E. 978, 44 L.R.A. 107 (1898).

²³⁴ *Miles v. Ashby*, 295 Ky. 500, 174 S.W.2d 753 (1943).

(3) *Duty of Diligent Operation*

When production is achieved, the covenant for diligent operation comes into play. This covenant imposes on the lessee a number of duties. He must complete,²³⁵ properly²³⁶ and within a reasonable time,²³⁷ wells showing favorable prospects²³⁸ of production.²³⁹ He should test all sands from which a yield is likely.²⁴⁰ If production needs to be stimulated, appropriate²⁴¹ and efficient²⁴² means should be used. A profitable well ought not to be abandoned,²⁴³ and we have seen that the lessee may be under a duty to leave casing in a well which he feels worthy of abandonment, if the lessor desires to try his hand.²⁴⁴ A failing well should be restored if possible.²⁴⁵

Since the lessor's return depends upon royalties out of production, the lessee should market the product.²⁴⁶ He must seek markets diligently²⁴⁷ even, perhaps, to installing facilities to get the product to the market,²⁴⁸ and he should realize the best possible price.²⁴⁹ Preparation of the product for the market, if this is necessary, also is the lessee's duty.²⁵⁰

(4) *Duty to Protect Against Drainage*

Since oil or gas may be drained away through operations on neighboring land, the lessee is under obligation to drill such pro-

²³⁵ *Warfield Natural Gas Co. v. Allen*, 248 Ky. 646, 59 S.W.2d 534 (1933).

²³⁶ *Indiana Oil, Gas & Dev. Co. v. McCrory*, 42 Okla. 136, 140 Pac. 610 (1914).

²³⁷ *Slater v. Boyd*, 120 Cal. App. 457, 8 P.2d 182 (3d Dist. 1931).

²³⁸ *Ohio Oil Co. v. Reichert*, 343 Ill. 560, 175 N.E. 790 (1932) (no prospect).

²³⁹ *Empire Oil & Ref. Co. v. Hoyt*, 112 F.2d 356 (6th Cir. 1940).

²⁴⁰ *Donaldson v. Josey Oil Co.*, 106 Okla. 11, 232 Pac. 821 (1925).

²⁴¹ *Unity Oil Co. v. Hill*, 200 Ky. 651, 255 S.W. 151 (1923) (necessity to show appropriateness of method).

²⁴² *Brennan v. Carter*, 296 S.W.2d 728 (Ky. 1956).

²⁴³ *Gallaspy v. Warner*, 324 P.2d 848 (Okla. 1958).

²⁴⁴ See the discussion in the division dealing with duration of the lease.

²⁴⁵ *Smith v. Moody*, 192 Ark. 704, 94 S.W.2d 357 (1936).

²⁴⁶ *Matzen v. Hugoton Prod. Co.*, 182 Kan. 456, 321 P.2d 576 (1958); *Townsend v. Creekmore-Rooney Co.*, 332 P.2d 35 (Okla. 1958). This rule was applied to a gravel lease in *George v. Jones*, 168 Neb. 149, 95 N.W. 2d 609 (1959).

²⁴⁷ *Wolfe v. Texas Co.*, 83 F.2d 425 (10th Cir. 1936).

²⁴⁸ See discussion in MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES § 87 (2d ed. 1940).

²⁴⁹ *Young v. West Edmond Hunton Lime Unit*, 275 P.2d 304 (Okla. 1954).

²⁵⁰ See MERRILL, *op. cit. supra* note 248, § 85.

tection wells as are necessary reasonably to protect against such loss.²⁵¹ Some authority indicates that the obligation is greater if the lessee owns the robber wells,²⁵² but I have never been able to see any sense to this distinction.²⁵³ Some leases contain express provisions for offsetting wells within a certain distance from the boundaries.²⁵⁴ There is a tendency in some jurisdictions to regard these provisions as setting the standard for protection, so that, no matter how much drainage actually may occur through wells more distantly situated, there is no duty to give protection.²⁵⁵ The true purpose of these provisions, and the meaning they are most likely to have for the lessor, is that they set a minimal standard only.²⁵⁶ It is the sounder policy so to regard them.²⁵⁷

B. STANDARDS TESTING IMPLIED COVENANTS

The standards by which to test performance of the implied covenant obligations vary. Where the covenant for exploration exists, it is pretty much an absolute duty, regardless of cost²⁵⁸ or of probable success.²⁵⁹ With respect to the other covenants, two standards have competed for judicial favor: the discretion of the operator, exercised in good faith,²⁶⁰ and the judicially

²⁵¹ *Millette v. Phillips Petroleum Co.*, 209 Miss. 687, 48 So. 2d 344 (1950); *Eastern Oil Co. v. Beatty*, 71 Okla. 275, 177 Pac. 104 (1918).

²⁵² *Hartman Ranch Co. v. Associated Oil Co.*, 10 Cal. 2d 232, 73 P.2d 1163 (1937); *Swope v. Holmes*, 169 La. 17, 124 So. 131 (1929).

²⁵³ See MERRILL, *op. cit. supra* note 248, at 260.

²⁵⁴ A rather typical provision reads: "In the event a well or wells producing oil or gas in paying quantities should be brought in on adjacent land and within three hundred thirty (330) feet of and draining the leased premises, lessee agrees to drill such offset wells as a reasonably prudent operator would drill under the same or similar circumstances. The judgment of the lessee, when not fraudulently exercised, in carrying out the purposes of this lease shall be conclusive."

²⁵⁵ *Coats v. Brown*, 301 S.W.2d 932 (Tex. Civ. App. 1957). Cf. *Millette v. Phillips Petroleum Co.*, 209 Miss. 687, 48 So. 2d 344 (1950).

²⁵⁶ See discussion in Merrill, *Lease Clauses Affecting Implied Covenants*, SOUTHWESTERN LEGAL FOUNDATION 2d ANNUAL INST. ON OIL & GAS L. & TAX 141, 173 (1951).

²⁵⁷ *Hutchins v. Humble Oil & Ref. Co.*, 161 S.W.2d 571 (Tex. Civ. App. 1942). Cf. the sensible discussion in *Sinclair Oil & Gas Co. v. Master-son*, 271 F.2d 310, 323 (5th Cir. 1959), relating to a minimum program for development.

²⁵⁸ *Fox Petroleum Co. v. Booker*, 123 Okla. 276, 253 Pac. 33 (1927).

²⁵⁹ See MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES § 46 (2d ed. 1940).

²⁶⁰ See MERRILL, *op. cit. supra* note 259, §§ 125-33.

interpreted standard of the conduct of the reasonably prudent operator, having regard to the interests of both the lessor and the lessee, in the light of all relevant circumstances.²⁶¹ The latter represents the great weight of authority.²⁶²

Under normal circumstances, great weight is to be given to the probable profitability, to the operator, of the action sought to be imposed upon him under this test.²⁶³ The reasons are obvious. Private business cannot survive if it continually must operate in disregard of cost. But there are numerous instances in which the courts disregard the factor of probable profitability in the light of other factors deemed significant in the particular case. These factors are too diverse for detailed discussion here.²⁶⁴

C. REMEDIES FOR BREACH OF IMPLIED COVENANTS

The remedies for breach of the implied covenants are varied. In some instances the award of damages is deemed appropriate.²⁶⁵ In others, the difficulty of ascertaining damages makes equitable relief by way of cancellation of the lease, wholly²⁶⁶ or partially,²⁶⁷ as to all²⁶⁸ or only as to some strata,²⁶⁹ the appropriate remedy. The alternative decree, by which the lessee is given the opportunity to comply with his judicially determined duty and thereby to avoid cancellation, is coming into judicial favor.²⁷⁰ This form of relief affords opportunity for adjustments so as to accord complete justice.²⁷¹ Mandatory injunctions,²⁷² receiverships²⁷³ and declaratory judgments²⁷⁴ are other forms of relief that have been used in enforcement of the implied covenant obligations.

²⁶¹ See MERRILL, *op. cit. supra* note 259, §§ 122, 123.

²⁶² See MERRILL, *op. cit. supra* note 259, § 136.

²⁶³ See MERRILL, *op. cit. supra* note 259, § 124.

²⁶⁴ For a treatment of the subject, see Merrill, *The Implied Covenant of Further Exploration*, 4 ROCKY MT. MINERAL LAW INST. 205 (1959).

²⁶⁵ See MERRILL, *op. cit. supra* note 259, §§ 148-58.

²⁶⁶ See MERRILL, *op. cit. supra* note 259, §§ 159-66.

²⁶⁷ *Libby v. DeBaca*, 51 N.M. 95, 179 P.2d 263 (1947).

²⁶⁸ *Elliott v. Pure Oil Co.*, 10 Ill. 2d 146, 139 N.E.2d 295 (1956).

²⁶⁹ *Carter Oil Co. v. Mitchell*, 100 F.2d 945 (10th Cir. 1939).

²⁷⁰ See MERRILL, *op. cit. supra* note 259, §§ 168-71.

²⁷¹ See MERRILL, *op. cit. supra* note 259, § 172.

²⁷² See MERRILL, *op. cit. supra* note 259, § 173.

²⁷³ See MERRILL, *op. cit. supra* note 259, § 175.

²⁷⁴ See MERRILL, *op. cit. supra* note 259, § 174.

D. ROYALTIES

Royalties, as we have seen, afford the means through which the lessor receives his return if the land is developed. Customarily, the royalty is set at one-eighth of the oil,²⁷⁵ although larger or smaller fractions sometimes are specified.²⁷⁶ In what now seems like a far-off day, when gas was regarded as more of a liability than as an asset, the usual gas royalty was prescribed as a small cash sum for each well, on a periodic basis.²⁷⁷ Now, with gas perhaps more valuable than oil, lessors insist upon having it put upon a share royalty basis also, and the lease forms reflect this change.²⁷⁸ The terms vary. Sometimes the lessor's share of the gas is to be valued at a fixed price.²⁷⁹ This, of course, is undesirable for him in a time of rising prices. Sometimes the price is fixed in terms of market value,²⁸⁰ which often raises difficult problems when no market exists at the well-head.²⁸¹ Too, a clause giving the lessor one-eighth of the "proceeds" may raise serious doubt concerning its effect on the lessee's duty to get the best price.²⁸² The royalty clause should be so framed as to secure to the lessor his proportionate share of the product of the well, regardless of the conditions under which it is marketed or the processing through which it goes on the way to market. In many instances the gas is laden with extractable "wet" elements. This adds to its value, and complicates the task of writing royalty provisions. Some forms seem drafted with a view to cutting the lessor off from fully sharing in these valuable components of his gas.²⁸³ Probably the ideal clause dealing

²⁷⁵ See 3A SUMMERS, OIL AND GAS 128 (perm. ed. 1958).

²⁷⁶ As in *Alamitos Land Co. v. Shell Oil Co.*, 3 Cal. 2d 396, 44 P.2d 573 (1935).

²⁷⁷ See BROWN, OIL AND GAS LEASES 97 (1958).

²⁷⁸ See 3A SUMMERS, OIL AND GAS 109 (perm. ed. 1958).

²⁷⁹ *O'Neal v. Union Producing Co.*, 153 F.2d 157 (5th Cir. 1946).

²⁸⁰ *Haynes v. Southwest Natural Gas Co.*, 123 F.2d 1011 (5th Cir. 1941); *Continental Oil Co. v. United States*, 184 F.2d 802 (9th Cir. 1950).

²⁸¹ *Sartor v. Arkansas Natural Gas Corp.*, 321 U.S. 620 (1944) (prices paid on other leases evidentiary of market price); *Union Producing Co. v. Pardue*, 117 F.2d 225 (5th Cir. 1941) (effect of controlled market); *Phillips Petroleum Co. v. Bynum*, 155 F.2d 196 (5th Cir. 1946) (evidentiary value of public utility pipe line contracts).

²⁸² *Phillips Petroleum Co. v. Record*, 146 F.2d 485 (5th Cir. 1944).

²⁸³ Example: "If gas, including oil-well or casinghead gas and any gaseous substances produced from any well, is used off of the leased premises by the Lessee for any purposes, or is used on the leased premises by the Lessee for purposes other than the development and operation thereof, then Lessee shall pay Lessor therefor one-eighth (1/8) of the

with these problems is yet to be written. With this problem in mind lawyers, representing prospective lessors should be very careful to inspect the tendered form.²⁸⁴

Royalty payments may become divided, as the result of defects in title, or of the conveyance of undivided interests, or of the subsequent subdivision of the land. Various provisions have been inserted in the common forms to take care of these situations.

(1) "Lesser Interest" Clause

One of these clauses is the so-called "lesser interest" or "proportionate reduction" clause. One such clause reads:

If said lessor own a less interest in the above described land than the entire and undivided fee simple estate therein, then the royalties and rentals herein provided shall be paid the lessor only in the proportion which his interest bears to the whole and undivided fee.

A more sophisticated clause is couched in these terms:

In case said lessor owns a less interest in the above described land than the entire and undivided fee simple estate therein, then the royalties and rentals therein provided for shall be paid the said lessor only in the proportion that his interest bears to the whole and undivided fee; however, such rental shall be increased at the next succeeding rental anniversary after any reversion occurs to cover the interest so acquired, and lessor agrees to notify lessee in writing upon acquisition of any reversionary interest.

Coupled with this may be something in this form:

With respect to the payment of and the right to receive delay rentals and royalties (including shut-in gas royalties), it is agreed that the termination of a life estate, term mineral interest or other precedent estate whereby the Lessor shall come into possession or use of an interest in said land shall, subject to all the provisions of this

market value thereof at the mouth of the well. Such payments shall be received and accepted by Lessor as full compensation for all such gas, oil-well or casinghead gas, helium, hydrogen sulphide and all gaseous substances, whether or not combustible, and any and all products extracted or manufactured therefrom including the residue gas remaining."

²⁸⁴ See MERRILL, COVENANT, IMPLIED IN OIL AND GAS LEASES § 89A (Supp. 1959) for discussion of problems arising where the lessee uses the product.

lease, become effective from and after the date when such Lessor shall have furnished satisfactory evidence to Lessee showing the termination of such life estate, term mineral interest or other precedent estate, but for all other purposes this lease shall cover such interest as and when the Lessor shall so come into the possession or use of it.

There are many variations on this general theme. Serious problems can arise out of the application of such clauses to particular situations.²⁸⁵ The form used should be carefully checked with respect to those events which reasonably may be anticipated, to make sure that unexpected and undesired applications may be avoided.

A problem of frequent occurrence arises where the surface of the land, and the mineral interest pertaining thereto, is subdivided after the execution of the lease. While some authority exists to the contrary,²⁸⁶ the great weight of decision holds that all the royalty from a well drilled on Subdivision I goes to the owner of that tract,²⁸⁷ leaving the owner of Subdivision II without any compensation, although his land continues to be bound by the lease so long as production continues on the other tract.²⁸⁸ Moreover, he may be unable to require a well upon his own tract, because the conditions on which the implied covenant obligation depends are lacking.²⁸⁹

(2) *Entirety Clause*

To avoid such an injustice, the so-called "entirety clause"²⁹⁰ has been fashioned. A common phraseology reads in this wise:

If the leased premises shall hereafter be owned in severalty, or in separate tracts, the premises, nevertheless, shall be developed and operated as one lease, and all

²⁸⁵ See Williams, *The Effect of Concurrent Interests on Oil and Gas Transactions*, 34 TEX. L. REV. 519, 528-34 (1956).

²⁸⁶ *Wettengel v. Gormley*, 160 Pa. 559, 28 Atl. 934 (1894).

²⁸⁷ *Central Pipe Line Co. v. Huston*, 401 Ill. 447, 82 N.E.2d 624 (1948); *Kimbley v. Luckey*, 72 Okla. 217, 179 Pac. 928 (1919); *Japhet v. McRae*, 276 S.W. 669 (Tex. Com. App. 1925). The rule was stated in *Rauner v. Jones*, 159 Neb. 385, 67 N.W.2d 347 (1954).

²⁸⁸ *Republic Natural Gas Co. v. Baker*, 197 F.2d 647 (10th Cir. 1952); *Garza v. de Montalvo*, 147 Tex. 525, 217 S.W.2d 988 (1949).

²⁸⁹ *Cochran v. Gulf Ref. Co.*, 139 La. 1010, 72 So. 718 (1916); *Galt v. Met-scher*, 103 Okla. 271, 229 Pac. 522 (1924).

²⁹⁰ See WILLIAMS & MEYERS, *MANUAL OF OIL AND GAS TERMS* 85 (1957).

royalties accruing hereunder shall be treated as an entirety, and shall be divided among and paid to such separate owners in the proportion that the acreage owned by each such separate owner bears to the entire leased acreage. There shall be no obligation on the part of the lessee to offset wells on separate tracts into which the land covered by this lease may be hereafter divided by sale, devise, or otherwise, or to furnish separate measuring or receiving tanks.

The consequences flowing from the execution of a lease containing an entirety clause are that, in case of subsequent subdivision of the leased premises, the royalties resulting from development are apportioned according to the shares of the acreage of the mineral interest owned by each participant in the title.²⁹¹ There is some authority that this effect does not extend to allowing the subsequent holder of a mere royalty interest in production from a specified portion of the leased premises to share in royalty based on production elsewhere on the land.²⁹² This is a quaint diversity, however, that seems to make no real sense and is not to be commended.²⁹³ Some entirety clauses are so drawn as to be applicable to existing divisions of interest.²⁹⁴ This affords needed relief in situations such as those created where the entire executive right is vested in one who owns the mineral interest as to part, only, of the premises.

The advantages of the entirety clause are, on the one hand, the avoidance of the inequities to holders of subdivided interests under the nonapportionment rule²⁹⁵ and, on the other hand, that the lessee is absolved from the necessity of keeping track of production from the several divisions for the purpose of paying royalties,²⁹⁶ and also is relieved from difficulties arising out of the misconceptions of the various tract owners concerning the

²⁹¹ *Hoffman v. Sohio Petroleum Co.*, 179 Kan. 84, 292 P.2d 1107 (1956); *Rauner v. Jones*, 159 Neb. 385, 67 N.W.2d 347 (1954); *Gypsy Oil Co. v. Schonwald*, 107 Okla. 253, 231 Pac. 864 (1924).

²⁹² *Shell Petroleum Corp. v. Carter*, 187 La. 382, 175 So. 1 (1937). Cf. *Rauner v. Jones*, 159 Neb. 385, 67 N.W.2d 347 (1954).

²⁹³ See 2 WILLIAMS & MEYERS, OIL AND GAS LAW 678 (1959).

²⁹⁴ Such a clause is construed in *Thomas Gilcrease Foundation v. Stanolind Oil & Gas Co.*, 153 Tex. 197, 266 S.W.2d 850 (1954).

²⁹⁵ See 3A SUMMERS, OIL AND GAS 444 (perm. ed. 1958).

²⁹⁶ See Adoue, *Royalty and Pooling Provisions in Oil, Gas and Mineral Leases*, SOUTHWESTERN LEGAL FOUNDATION INST. 2D ANNUAL INST. ON OIL & GAS L. & TAX 195, 225 (1951).

amount of development respectively due them.²⁹⁷ These last advantages probably account for the introduction of the entirety clause into lease forms.

There are situations, however, in which the existence of an entirety clause may redound to the harm of the lessor. One such instance may result if production is achieved from part only of the leased premises or if the wells on part of the land are greatly more productive than those elsewhere. If he has an opportunity to sell the less productive part of the tract, the owner doubtless will wish to free the retained portion from the dilutive effect of the entirety clause. Apparently, in most jurisdictions, he may do this by clearly indicating such an intent in his conveyance²⁹⁸ or in some other effective instrument.²⁹⁹ In a few jurisdictions,³⁰⁰ including Nebraska,³⁰¹ however, this is considered an impermissible unilateral impairment of the lease contract if the lessee does not assent. In such jurisdictions, prospective lessors, before accepting an entirety clause, certainly should consider carefully whether they desire inescapably to bind themselves by the pattern established thereby.

Provisions designed to protect the lessee against liability for royalty payments which are erroneously made because of unknown changes in ownership frequently occur in modern forms. Here is a well-drawn example:

But no change in the ownership of said land or of any rights hereunder shall be binding upon the Lessee until thirty (30) days after the Lessee has been furnished with (1) the original or a certified copy of the recorded transfer or assignment thereof, or (2) in case of the death of the Lessor with (a) a certified copy of letters of administration issued on his estate by the Probate Court having jurisdiction of said land, or (b) with a certified copy of the last Will of Lessor, and the certificate of proof of the same and of the order of the Probate

²⁹⁷ See 2 WILLIAMS & MEYERS, OIL AND GAS LAW 675 (1959); 3A SUMMERS, OIL AND GAS 431 (perm. ed. 1958).

²⁹⁸ *Iskian v. Consolidated Gas Util. Corp.*, 207 Okla. 615, 251 P.2d 1073 (1952).

²⁹⁹ *Alsip's Adm'r v. Onstott*, 283 S.W.2d 711 (Ky. 1955).

³⁰⁰ *Harley v. Magnolia Petroleum Co.*, 378 Ill. 19, 37 N.E.2d 760 (1941) (reservation).

³⁰¹ *Hafeman v. Gem Oil Co.*, 163 Neb. 438, 80 N.W.2d 139 (1956) (mineral deed); *Krone v. Lacy*, 168 Neb. 792, 97 N.W.2d 528 (1959) (mineral deed, assignment of royalties).

Court having jurisdiction of said land admitting said Will to probate, together with a certified copy of letters testamentary issued to the executor or administrator of his estate, or (c) if rentals only are involved, with an instrument in recordable form satisfactory to the Lessee and executed by the Lessor's heirs and devisees, if any, showing the date of death of Lessor and the names, relationship and identity of Lessor's heirs and authorizing and directing to whom the payment, deposit or tender of rentals may be paid hereunder.

Such provisions are eminently reasonable. So far, no litigation concerning their meaning seems to have arisen.

Less defensible, from the lessor's point of view, is a stipulation requiring the appointment of an agent or trustee to receive and distribute payments in the event of substantial multiplication of persons entitled thereto.

If at any time there be as many as four parties entitled to royalties (including shut-in gas royalty) Lessee may withhold payments thereof unless and until all parties furnish to and file with the Lessee a recordable instrument satisfactory to Lessee and appointing a common agent to receive all payments due such parties hereunder, and appointing such common agent to execute division and transfer orders on behalf of said parties, and their respective successors in interest.

To the lessee, these subdivisions may constitute a terrific burden.

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I have seen fractional interests like this: $1/6750$ of $\overline{18,726,912}$ of the usual $1/8$ royalty interest in a 160 acre tract. One cannot blame the lessee for wishing to achieve relief from the task of computing payments and writing checks in such a situation.

On the other hand, multiple division of interests on such a scale creates an almost impossible task of getting in the necessary assents from owners scattered all over the world. Likewise, the inevitable incident of death easily may result in four or more persons entitled to share in royalties under a lease originating in an undivided ownership. There may be one or more recalcitrants in such a group, who will not agree to the agent desired by the others. The prospect of an impasse blocking payment of royalties for a long time lurks in clauses of this sort. Skilled draftsmanship might produce a provision better adapted to reconciling the interests of lessors and lessees, but to date I have seen nothing that seems to accomplish that purpose.

V. TRANSFERABILITY OF LEASE RIGHTS
AND OBLIGATIONS

The obligations owed the lessor under the lease belong to him in his capacity as owner of the estate out of which the lease interest is carved. He can grant them to another or if he conveys his interest generally they pass with it.³⁰² There is no dissent, that I know of, to these propositions. Likewise, the lessee owns a valuable property interest, which is assignable, in all states,³⁰³ unless there is a stipulation against assignment.³⁰⁴ Based on an unfortunate analogy to a supposed principle of the ancient land law,³⁰⁵ however, there was some doubt concerning the validity of a partial assignment of a lease, if the lessee had no estate in the oil and gas³⁰⁶ but merely a right to enter and take.³⁰⁷ From this doubt arose the clause, commonly found in lease forms, stating that "the privilege of assigning in whole or in part is expressly allowed." The consequence today is that the assignability of the lessee's interest, "in whole or in part," is recognized without discussion.³⁰⁸ The assignment carries to the assignee whatever interest his assignor had under the lease, as to the entire tract³⁰⁹ or as to that portion covered by a partial assignment.³¹⁰

The obligations of the express covenants of the lease run with the land, and so are enforceable against the assignee.³¹¹ Certain special problems, however, arise under partial assignments. For instance, it generally is considered that the necessity to pay rentals to keep an "unless" lease alive is indivisible, so that, after a partial assignment, the partial assignee may not preserve the lease as to his acreage by tendering payment of his proportion

³⁰² See 1 WILLIAMS & MEYERS, OIL AND GAS LAW 438 (1959).

³⁰³ *Watts v. England*, 168 Ark. 213, 269 S.W. 585 (1925); *Chandler v. Hart*, 161 Cal. 405, 119 Pac. 516 (1911); *Fischer v. Magnolia Petroleum Co.*, 156 Kan. 367, 133 P.2d 95 (1943).

³⁰⁴ *Stanolind Oil & Gas Co. v. Guertzgen*, 100 F.2d 299 (9th Cir. 1938).

³⁰⁵ See *Merrill, The Partial Assignee—Done in Oil*, 20 TEXAS L. REV. 298, 299 (1942).

³⁰⁶ *Bronson v. Lane*, 91 Pa. 153 (1879).

³⁰⁷ *Funk v. Haldeman*, 53 Pa. 229 (1866).

³⁰⁸ *Mistletoe Oil & Gas Co. v. Revelle*, 117 Okla. 144, 245 Pac. 620 (1926).

³⁰⁹ *Ball v. Coyle*, 108 Okla. 30, 233 Pac. 750 (1925).

³¹⁰ *Bronson v. Lane*, 91 Pa. 153 (1879).

³¹¹ *Hafeman v. Gem Oil Co.*, 163 Neb. 438, 80 N.W.2d 139 (1956). The authorities are fully collected in 3 SUMMERS, OIL AND GAS § 553 (perm. ed. 1958).

of the rentals.³¹² Some cases make a distinction if the lease contains a partial assignment clause.³¹³ This seems inadequately grounded in principle, however.³¹⁴ The partial assignee's privilege to preserve his interest by paying a proportionate rental may be secured, however, by some such stipulation as this:

. . . and it is hereby agreed that in the event this lease shall be assigned as to a part or as to parts of the above described lands and the assignee or assignees of such part or parts shall fail or make default in the payment of the proportionate part of the rental due from him or them, [or in the performance or any of the obligations of this contract,] such default shall not operate to defeat or affect this lease in so far as it covers a part or parts of said lands upon which the said lessee or any assignee[s] thereof shall make due payment of said rental [and due performance of the obligations of this contract].

The words within the brackets are absent in some forms. The effectiveness of this sort of provision stands adjudicated.³¹⁵ If we may judge by the approving citation³¹⁶ accorded to an earlier case relating to the duty of a partial assignee of an agricultural lease,³¹⁷ it is possible that Nebraska will hold the delay rental privilege to be divisible.³¹⁸ It seems certain that, under an "or" lease, the obligation to pay will be so considered.³¹⁹

As to development, drilling a well on one part of the divided lease suffices to absolve the payment of delay rentals on all the tracts.³²⁰ Production on one part will hold the lease in effect as to all.³²¹

³¹² *Cosden Oil Co. v. Scarborough*, 55 F.2d 634 (5th Cir. 1932). Cf. *Kugel v. Young*, 132 Colo. 529, 291 P.2d 695 (1955); *Flanigan v. Stern*, 204 Ky. 814, 265 S.W. 324 (1924); *Phoenix Oil Co. v. Mid-Continent Petroleum Corp.*, 177 Okla. 530, 60 P.2d 1054 (1936).

³¹³ *Armstrong v. McGough*, 157 Ark. 173, 247 S.W. 790, 29 A.L.R. 236 (1923). Cf. *Logan v. California Co.*, 231 Miss. 836, 97 So. 2d 924 (1957); *Hitson v. Gilman*, 220 S.W. 140 (Tex. Civ. App. 1920).

³¹⁴ See Walker, *The Nature of the Property Interests Created by an Oil and Gas Lease in Texas*, 10 TEXAS L. REV. 291, 317 (1932).

³¹⁵ *Dormon Farms Co. v. Stewart*, 157 Ark. 194, 247 S.W. 778 (1923).

³¹⁶ See *Hafeman v. Gem Oil Co.*, 163 Neb. 438, 80 N.W.2d 139 (1956).

³¹⁷ *Hogg v. Reynolds*, 61 Neb. 758, 86 N.W. 479 (1901).

³¹⁸ The decision, of course, is not specifically apt, since it involved an obligation rather than a privilege.

³¹⁹ On the obligation under the "or" lease, see Merrill, *The Partial Assignee—Done in Oil*, 20 TEXAS L. REV. 298, 305 (1942).

³²⁰ *Wilson v. Texas Co.*, 147 Kan. 449, 76 P.2d 779 (1938).

³²¹ *State ex rel. Shell Petroleum Corp. v. Worden*, 44 N.M. 400, 103 P.2d

The implied covenants of the lease, though imposed by law, run with the land in the same way, and the assignee, if of the whole lease, is liable for their performance.³²² The partial assignee is liable for failure to perform as to his part.³²³ But may the leasehold be split, so that adequate performance by the owner of one portion saves his interest, despite default by the owners of other portions?³²⁴ As to this, it has been well said that "the authorities are not harmonious."³²⁵ The cases sustaining divisibility³²⁶ seem more in harmony with concepts of the oil business.³²⁷ It probably does not make much difference in result, however, in the long run.³²⁸

Does the lessee-assignor continue liable for breach of covenants? As to express covenants, the analogy to the law of landlord and tenant³²⁹ has been held to impose continued liability.³³⁰ As to implied covenants, if the implication be regarded as one of law, the want of privity of estate, as distinguished from privity of contract, would absolve the assignor.³³¹ If they are regarded as implied in fact, there is privity of estate, and liability continues.³³² But the practice of the oil business is against this concept, and I venture to suggest that it should not be applied.³³³

124 (1940); *Pierce Oil Corp. v. Schacht*, 75 Okla. 101, 181 Pac. 731 (1919); *Cain v. Neumann*, 316 S.W.2d 915 (Tex. Civ. App. 1958).

³²² *Humphreys Oil Co. v. Tatum*, 26 F.2d 882 (5th Cir. 1928).

³²³ *Swope v. Holmes*, 169 La. 17, 124 So. 131 (1929); *Amerada Petroleum Corp. v. Sledge*, 151 Okla. 160, 3 P.2d 167 (1931); *Cox v. Sinclair Gulf Oil Co.*, 265 S.W. 196 (Tex. Civ. App. 1924).

³²⁴ *Cosden Oil Co. v. Scarborough*, 55 F.2d 634 (5th Cir. 1932). See MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES 401 (2d ed. 1940).

³²⁵ *Drummond v. Alphin*, 176 Ark. 1052, 4 S.W.2d 942 (1928).

³²⁶ Among late decisions are *Sinclair Oil & Gas Co. v. Masterson*, 271 F.2d 310 (5th Cir. 1959); *Reagan v. Murphy*, 235 La. 529, 105 So. 2d 210 (1958).

³²⁷ See Walker, *The Nature of the Property Interests Created by an Oil and Gas Lease in Texas*, 11 TEXAS L. REV. 399, 450 (1933).

³²⁸ This I have discussed in MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES 404 (2d ed. 1940).

³²⁹ See 1 TIFFANY, REAL PROPERTY § 121 (3d ed. 1939).

³³⁰ *Texas Co. v. Mattocks*, 211 Ark. 972, 204 S.W.2d 176 (1947); *Stafford v. Yerge*, 139 Cal. App. 2d 851, 294 P.2d 721 (2d Dist. 1956); *Whale v. Rice*, 173 Okla. 530, 49 P.2d 737 (1935).

³³¹ Cf. *Heller v. Dailey*, 28 Ind. App. 555, 63 N.E. 490 (1902).

³³² *Gillet v. Elmhurst Inv. Co.*, 111 Kan. 755, 207 Pac. 843 (1922) so holds, but the opinion is not well-considered.

³³³ See discussion in MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES 397 (2d ed. 1940).

It is frequent practice to insert in the lease a clause intended to absolve the lessee-assignor from this responsibility.³³⁴

In some states, a great deal of importance is attached to the distinction between an assignment, by which the lessee's whole interest is transferred, and a sublease, by which the lessee creates a new tenancy, retaining in himself some part of the interest vested by the lease.³³⁵ This is thought to have significance with respect to the liabilities of the lessee³³⁶ and his transferee³³⁷ to the lessor. Actually, the distinction has no relation to the realities of the oil business.³³⁸ It should not be applied to oil and gas leases by any court which is not irrevocably bound thereto by controlling decisions.³³⁹

The transfer may take the form of the assignment of the lease as to certain strata³⁴⁰ or as to one substance, that is, a separation of oil rights from gas rights.³⁴¹ The general principles already discussed apply to such transfers.

We have seen that the lessor, by transferring his interest in part, does not thereby increase the lessee's developmental obli-

³³⁴ Two examples follow: "An assignment of this lease, in whole or in part, shall, to the extent of such assignment, relieve and discharge lessee of any obligations hereunder, and, if lessee or assignee of part or parts hereof shall fail or make default in the payment of the proportionate part of the rentals due from such lessee or assignee or fail to comply with any other provisions of the lease, such default shall not affect this lease in so far as it covers a part of said lands upon which lessee or any assignee thereof shall make payment of said rentals."

"Upon each assignment hereof, whether in whole or in part, the assignor thereupon shall be released from any and all liability thereafter arising or accruing hereunder as to the portion assigned and, should the owner of this lease, as to any portion of leased premises, fail or make default in any of the covenants, conditions, or obligations of LESSEE, express or implied, such failure or default shall not operate to defeat or affect this lease in so far as it covers any portion of leased premises upon which the owner thereof shall have complied with the terms and provisions of the lease."

³³⁵ *Hartman Ranch Co. v. Associated Oil Co.*, 10 Cal. 2d 232, 73 P.2d 1163 (1937); *Bond v. Midstates Oil Corp.*, 219 La. 415, 53 So. 2d 149 (1951); *Shearer v. United Carbon Co.*, 143 W. Va. 482, 103 S.E.2d 883 (1958).

³³⁶ See MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES 398 (2d ed. 1940).

³³⁷ See MERRILL, *op. cit. supra* note 336, at 393.

³³⁸ See Merrill, *The Partial Assignee—Done in Oil*, 20 TEXAS L. REV. 298, 332 (1942).

³³⁹ See MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES 394 (2d ed. 1940); 3 SUMMERS, OIL AND GAS 599 (perm. ed. 1958).

³⁴⁰ As in *Carter Oil Co. v. McCasland*, 190 F.2d 887 (10th Cir. 1951).

³⁴¹ As in *Sinclair Oil & Gas Co. v. Masterson*, 271 F.2d 310 (5th Cir. 1959).

gations.³⁴² A few jurisdictions speak of the "divisibility" of the obligation,³⁴³ but they are in the minority. The hope of the lessor in such cases lies in showing the court that the lessee has not adequately performed his obligations with respect to the tract as a whole.³⁴⁴

VI. POOLING AND UNITIZATION

Pooling means the bringing together of small separately owned tracts to form a unit sufficient as a drainage area for a single well.³⁴⁵ It avoids the necessity of drilling wells on each individual tract, in order to realize for the respective owners a return from their mineral interests. Thereby it conduces to the more economic development of oil and gas areas. The most economic and efficient development, and the utmost in conservation, however, can be achieved only through unitized operation of each reservoir as an entity. The legal process by which such a unitized operation of a reservoir underlying lands held in separate ownership is achieved is termed "unitization."³⁴⁶

Pooling and unitization each may be achieved either by private agreement or by legislative compulsion as an exercise of the police power.³⁴⁷ Compulsory merging, of course, overrides lease arrangements, and is in no way dependent upon lease terms. We shall pass it by with no further comment.

Voluntary pooling or unitization may be achieved by the common action of the holders of the working interests, without the consent of their respective lessors.³⁴⁸ Such agreements, however, cannot bind the lessors' interests,³⁴⁹ and the resultant

³⁴² *Fischer v. Magnolia Petroleum Co.*, 156 Kan. 367, 133 P.2d 95 (1943); *Cochran v. Gulf Ref. Co.*, 139 La. 1010, 72 So. 718 (1916); *Magnolia Petroleum Co. v. St. Louis-S.F. Ry.*, 194 Okla. 435, 152 P.2d 367 (1944).

³⁴³ *Compton v. Fisher-McCall*, 298 Mich. 648, 299 N.W. 750 (1941).

³⁴⁴ *Hitt v. Henderson*, 112 Okla. 194, 240 Pac. 745 (1925). Cf. *Republic Natural Gas Co. v. Baker*, 197 F.2d 647 (10th Cir. 1952).

³⁴⁵ See WILLIAMS & MEYERS, *MANUAL OF OIL AND GAS TERMS* 184 (1957).

³⁴⁶ *Id.* 266.

³⁴⁷ *Patterson v. Stanolind Oil & Gas Co.*, 305 U.S. 376 (1939); *Hunter Co. v. McHugh*, 320 U.S. 222 (1943); *Palmer Oil Corp. v. Amerada Petroleum Corp.*, 343 U.S. 390 (1952).

³⁴⁸ *Farrell v. Simms*, 209 La. 1072, 26 So. 2d 143 (1946); *Beck v. Norbeck Co.*, 116 Mont. 345, 151 P.2d 1014 (1944); *Thomas v. Ley*, 177 Okla. 150, 57 P.2d 1186 (1936).

³⁴⁹ *Hunter v. Hussey*, 90 So. 2d 429 (La. App. 1956); *Knight v. Chicago Corp.*, 144 Tex. 98, 188 S.W.2d 564 (1945).

possibility of liability if those interests are harmed by the operations makes this way of achieving merged operation undesirable in most instances.³⁵⁰ Consequently, the search turns toward some method of getting the mineral and royalty owners to assent in a program of merged interests.

Immediately there comes to mind the device of getting all the proprietors of the nonworking interests to join in a contractual assent to pooling or to unitization. This has its drawbacks, however. Ordinarily it is impossible to secure assent in advance of exploration or during the period of "flush" production.³⁵¹ The document must be carefully drawn with a view to all contingencies and in the light of experience.³⁵² The information necessary for proper framing will not be available until the field has been pretty well developed, and too, the time involved may defeat realization of the values sought by the merger.³⁵³

Because of this, it has become common to insert in oil and gas lease forms some provision authorizing the lessee to combine the leased premises with other properties. Forms vary, from succinct and simple statements³⁵⁴ to those which are long, de-

³⁵⁰ See Merrill, *Unitization Problems: The Position of the Lessor*, 1 OKLA. L. REV. 119, 121 (1948); Merrill, *Implied Covenants and Secondary Recovery*, 4 OKLA. L. REV. 177, 182 (1951).

³⁵¹ See Long, *The Pooling Clause in an Oil and Gas Lease*, 11 OKLA. L. REV. 1, 2 (1958). This article, incidentally, is one of the most valuably thoughtful surveys of the legal and practical problems connected with the pooling clauses of oil and gas leases.

³⁵² See Myers, *Spacing, Pooling and Field-Wide Unitization*, 18 MISS. L.J. 267, 274 (1947); King, *Pooling and Unitization of Oil and Gas Leases*, 46 MICH. L. REV. 311, 330 (1948); Williams, *The Negotiation and Preparation of Unitization Agreements*, SOUTHWESTERN LEGAL FOUNDATION 1ST ANNUAL INST. ON OIL & GAS L. & TAX 43 (1949).

³⁵³ See Long, *supra* note 351, at 4.

³⁵⁴ "It is further agreed that lessee may at any time without the consent of lessors, consolidate, jointly operate, and develop this lease and the land covered hereby with any other lease or leases covering any lot, lots or parcels of land embraced within the outer boundary lines of the J. W. Craig's Sub. of Block 19, Fruitland Addition to Oklahoma City, Oklahoma.

"Lessee is hereby granted the right to pool or consolidate this lease, the land covered by it, or any part thereof, with any other land, lease, leases, mineral estates, or parts thereof, but only as to the gas rights hereunder (excluding casinghead gas produced from oil wells) to form one or more gas operating units of not more than 640 acres each. Lessee shall file written unit designations in the county in which the premises are located. Such units may be designated either before or after the completion of wells. Drilling operations and production on any part of the pooled acreage shall be treated as if such drilling

tailed and complex.³⁵⁵ As will be seen from the forms set out in

operations were upon or such production was from the land described in this lease whether the well or wells be located on the land covered by this lease or not. The entire acreage pooled into a gas unit shall be treated for all purposes, except the payment of royalties on production from the pooled unit, as if it were included in this lease. In lieu of the royalties herein provided, lessor shall receive on production from the unit so pooled only such portion of the royalty stipulated herein as the amount of his acreage placed in the unit or his royalty interest therein on an acreage basis bears to the total acreage so pooled in the particular unit involved.

"The lessee is hereby authorized when in its discretion lessee deems it necessary or convenient so to do, to unitize the leased premises, or any part thereof, with neighboring lands as to the production of oil and gas or separately as to the production of either oil or gas. Such unitization may be effected and evidenced: (a) By a contract between lessee and the parties owning or interested in the oil and/or gas or mineral rights in such neighboring lands and/or the oil and gas lessee thereon; or (b) If the lessee herein holds an oil and gas lease, or leases, covering such neighboring lands, by lessee executing and filing of record a declaration of such unitization. If the lands to be unitized fall in both classes above set out, then the lessee may use the method and manner of effecting and evidencing the unitization applicable to the particular lands in each class as above provided. Thereafter the commencement of any well or production of oil or gas on any part of the unitized area shall have the same effect as to keeping this lease in force as though such well were commenced or production had on the premises hereby leased, and the royalty on the oil or gas produced from the unitized area shall be payable to the lessors or their assigns at the rate herein specified, but only in such proportion as the interest or acreage owned by the lessors herein or their assigns in the oil and/or gas or mineral rights in the land covered by this lease shall bear to the entire interest or acreage in the oil and/or gas or mineral rights in the unitized area.

"Lessee may pool and unitize land covered by this lease with any other land, lease or leases lying within the outer boundaries of the . . . acres described as . . . whether such other land, lease or leases are held by lessee or others. The entire acreage so pooled shall be treated for all purposes as if it were included in one lease, and the rental and royalties herein provided shall be shared by the lessors of the pooled acreage in the proportion to which the mineral ownership of each lessor, in acres, bears to the total pooled acreage."

³⁵⁵ "Lessee is hereby granted the right to pool this lease or any portion thereof, the land covered by it or any part, formation or zone thereof, into a unit or units with any other lease or leases, mineral estates, land or formation, zone or portions thereof for the production of oil or gas, or of any liquid or gaseous hydrocarbon or substance covered by this lease. The acreage of any unit so pooled shall not exceed by more than ten per cent (10%) the greater of the following: six hundred and forty acres, or the acreage prescribed by Federal law, State law, order of a regulatory agency, executive order, rule or regulation either as a spacing pattern for the drilling of wells in the field where the leased premises are located, or as a basis for the allocation of a

producing allowable based wholly or partly on acreage per well. Lessee shall file written unit designations, reformations, contractions or enlargements thereof in the office for recording deeds in the county wherein the above land is situated. Such units may with the same effect be formed, designated, reformed, contracted or enlarged either before or after the completion of any producing well or wells.

"The oil or gas or substance covered by this lease and for the production of which the pooled unit was formed, is referred to as Unitized Substance, or Substances. Drilling or reworking operations commenced or performed on the unit shall for all purposes be treated the same as if actually commenced or performed on the herein leased premises. Any well anywhere located upon the acreage pooled in the unit and producing or capable of producing a Unitized Substance and whether drilled before or after the designation of the unit shall for all purposes be treated as if drilled, located on and producing from the herein leased premises. The production of Unitized Substance or Substances from any well or wells located on any lands in the unit (whether or not such well or wells be on herein leased premises and whether or not such well or wells be commenced or drilled before or after the designation of the unit) shall after the effective date of the unit for all purposes be treated as if such Unitized Substance or Substances were actually produced from the herein leased premises and the entire acreage pooled into the unit shall be treated for all purposes as if it were included in this lease, except, however, that in lieu of the royalties elsewhere herein specified Lessor shall be entitled to receive from any unit so pooled only such proportion of the royalty stipulated herein as the amount of Lessor's interest in the acreage placed in such unit bears to the total acreage included in such unit. At any time, when there is not located on the pooled acreage a well capable of producing any Unitized Substance in paying quantities, the Lessee may terminate such unit by filing in such office for recording deeds, a written declaration terminating such pooled unit, whereupon such pooled unit shall cease to exist.

"Lessee, at its option, is hereby given the right and power at any time and from time to time as a recurring right, either before or after production, as to all or any part of the land described herein and as to any one or more of the formations hereunder, to pool or unitize the leasehold estate and the mineral estate covered by this lease with other land, lease or leases in the immediate vicinity for the production of oil and gas, or separately for the production of either, when in lessee's judgment it is necessary or advisable to do so, and irrespective of whether authority similar to this exists with respect to such other land, lease or leases. Likewise, units previously formed to include formations not producing oil or gas, may be reformed to exclude such non-producing formations. The forming or reforming of any unit shall be accomplished by lessee executing and filing for record a declaration of such unitization or reformation, which declaration shall describe the unit. Any unit may include land upon which a well has theretofore been completed or upon which operations for drilling have theretofore been commenced. The entire acreage so pooled and production, drilling or reworking operations anywhere on such acreage shall be treated for all purposes except the payment of royalties as if it were included in and were production, drilling or reworking operations under this lease. In lieu of the royalties else-

where herein specified, including shut-in gas royalties, lessor shall receive on production from the unit so pooled royalties only on the portion of such production allocated to this lease; such allocation shall be that proportion of the unit production that the total number of surface acres covered by this lease and included in the unit bears to the total number of surface acres in such unit. In addition to the foregoing, lessee shall have the right to unitize, pool, or combine all or any part of the above described lands as to one or more of the formations thereunder with other lands in the same general area by entering into a cooperative or unit plan of development or operation approved by any governmental authority and, from time to time, with like approval, to modify, change or terminate any such plan or agreement and, in such event, the terms, conditions, and provisions of this lease shall be deemed modified to conform to the terms, conditions, and provisions of such approved cooperative or unit plan of development or operation and, particularly, all drilling and development requirements of this lease, express or implied, shall be satisfied by compliance with the drilling and development requirements of such plan or agreement, and this lease shall not terminate or expire during the life of such plan or agreement. In the event that said above described lands or any part thereof, shall hereafter be operated under any such cooperative or unit plan of development or operation whereby the production therefrom is allocated to different portions of the land covered by said plan, then the production allocated to any particular tract of land shall, for the purpose of computing the royalties to be paid hereunder to lessor, be regarded as having been produced from the particular tract of land to which it is allocated and not to any other tract of land; and the royalty payments to be made hereunder to lessor shall be based upon production only as so allocated. Lessor shall formally express lessor's consent to any cooperative or unit plan of development or operation by lessee and approved by any governmental agency by executing the same upon request of lessee.

"Lessee is hereby granted the right to pool or unitize this lease, the land covered by it or any part thereof with any other land, lease, leases, mineral estates or parts thereof for the production of oil, liquid hydrocarbons and all gases and their respective constituent products, or any of them. Units pooled for oil hereunder shall not exceed forty (40) acres plus a tolerance of ten per cent (10%) thereof, and units pooled for gas hereunder shall not exceed six hundred forty (640) acres plus a tolerance of ten per cent (10%) thereof, provided that if any federal or state law, Executive order, rule or regulation shall prescribe a spacing pattern for the development of the field or allocate a producing allowable on acreage per well, then any such units may embrace as much additional acreage as may be so prescribed or as may be used in such allocation or allowable. Lessee shall file written unit designations in the county in which the premises are located. Such units may be designated either before or after the completion of wells. Drilling operations and production on any part of the pooled acreage shall be treated as if such drilling operations were upon or such production was from the land described in this lease whether the well or wells be located on the land covered by this lease or not. The entire acreage pooled into a unit shall be treated for all purposes, except the payment of royalties on production from the pooled unit, as if it were included in this lease. In lieu of the royalties

the footnotes, some clauses authorize pooling only,³⁵⁶ while others are phrased broadly enough to permit unitization.³⁵⁷ Despite some early doubts based largely on misconception of the Rule Against Perpetuities,³⁵⁸ the validity of these authorizations seems established³⁵⁹ and properly so.³⁶⁰

The clauses, it will have been noted, often place extremely wide discretion in the lessee.³⁶¹ To the extent that there are express restrictions, an attempted unitization in excess of the authority granted is invalid.³⁶² In addition, there are judge-made restrictions. The power must be exercised within a reasonable time,³⁶³ which, in some jurisdictions,³⁶⁴ though not in all,³⁶⁵ means before production is achieved on any of the tracts concerned. It must be exercised, not alone in the lessee's interest, but, based on implied covenant principles, with due regard to the legitimate concerns of the lessor.³⁶⁶ All the following have been recognized as legitimate considerations in support of an exercise of this authority: economical development and operation

herein provided, lessor shall receive on production from a unit so pooled only such portion of the royalty stipulated herein as the amount of his acreage placed in the unit or his royalty interest therein on an acreage basis bears to the total acreage so pooled in the particular unit involved."

³⁵⁶ Another example of such a clause is set forth in *Diggs v. Cities Serv. Oil Co.*, 241 F.2d 425, 426 (10th Cir. 1957).

³⁵⁷ For a judicially approved type of unitization clause, see *Phillips Petroleum Co. v. Peterson*, 218 F.2d 926, 928 (10th Cir. 1954).

³⁵⁸ Cf. *Carlson v. Tioga Holding Co.*, 72 N.W.2d 236 (N.D. 1955) where an attempted unitization of undivided interests in separately owned tracts was held invalid, principally because the trustee could not alienate until the termination of the trust which would not come about until failure of production throughout the area. Such a holding could well be extended to any power to unitize based on leases with a "thereafter" clause.

³⁵⁹ *Phillips Petroleum Co. v. Peterson*, 218 F.2d 926 (10th Cir. 1954); *Kenoyer v. Magnolia Petroleum Co.*, 173 Kan. 183, 245 P.2d 176 (1952).

³⁶⁰ See Kuntz, *The Rule Against Perpetuities and Mineral Interests*, 8 OKLA. L. REV. 183, 198 (1955).

³⁶¹ It is unnecessary to make detailed specifications concerning the unit to be set up. *Tiller v. Fields*, 310 S.W.2d 185 (Tex. Civ. App. 1957).

³⁶² *Union Oil Co. v. Touchet*, 229 La. 316, 86 So. 2d 50 (1956); *Leopard v. Stanolind Oil & Gas Co.*, 220 S.W.2d 259 (Tex. Civ. App. 1949).

³⁶³ *Phillips Petroleum Co. v. Peterson*, 218 F.2d 926 (10th Cir. 1954).

³⁶⁴ *Mallett v. Union Oil & Gas Corp.*, 232 La. 157, 94 So. 2d 16 (1957).

³⁶⁵ *Gillham v. Jenkins*, 206 Okla. 440, 244 P.2d 291 (1952); *Tiller v. Fields*, 310 S.W.2d 185 (Tex. Civ. App. 1957).

³⁶⁶ *Phillips Petroleum Co. v. Peterson*, 218 F.2d 926 (10th Cir. 1954); *Imes v. Globe Oil & Ref. Co.*, 184 Okla. 79, 84 P.2d 1106 (1938).

of the area,³⁶⁷ wartime regulations,³⁶⁸ the exigencies of a drilling program³⁶⁹ and conservation objectives.³⁷⁰ Apparently, in the absence of express stipulation, the authority is not exhausted by its first exercise,³⁷¹ although serious harm to the lessor's interest may lead a court to disallow the reopening of a unit once set up.³⁷²

The ordinary terms of these provisions, as shown by the samples already set out, make drilling or producing activities anywhere on the created unit the equivalent of such action on the leased tract. As a result, they are operative to extend the lease, not only as to the area embraced within the unit,³⁷³ but also as to portions of the leased premises omitted from the unit.³⁷⁴ The implied covenant obligations, however, continue with respect to the ununitized portions,³⁷⁵ so that the lessor is not left entirely unprotected.

There are statutes authorizing various fiduciaries to enter into agreements for pooling or unitization through proceedings in courts of proper jurisdiction.³⁷⁶ A nice question arises whether, under such statutes, the court is permitted to authorize the execution of a lease containing a power to pool or to unitize, or whether it is limited to the approval or disapproval of a particular unitization or pooling project.³⁷⁷

The desirability of broad pooling or unitizing authority on the part of the lessee is manifest. Should the lessor be advised to grant such an authority? The answer in part depends upon

³⁶⁷ *Boone v. Kerr-McGee Oil Indus.*, 217 F.2d 63 (10th Cir. 1954).

³⁶⁸ *Gillham v. Jenkins*, 206 Okla. 440, 244 P.2d 291 (1952).

³⁶⁹ *Diggs v. Cities Serv. Oil Co.*, 241 F.2d 425 (10th Cir. 1957).

³⁷⁰ *Boone v. Kerr-McGee Oil Indus.*, 217 F.2d 63 (10th Cir. 1954).

³⁷¹ *Trawick v. Castleberry*, 275 P.2d 292 (Okla. 1954).

³⁷² *Imes v. Globe Oil & Ref. Co.*, 184 Okla. 79, 84 P.2d 1106 (1938) (unfair dilution by addition of tracts proved to be barren, apparently with some interest in lessee).

³⁷³ *McClain v. Harper*, 206 Okla. 437, 244 P.2d 301 (1952).

³⁷⁴ *Scott v. Pure Oil Co.*, 194 F.2d 393 (5th Cir. 1952); *Trawick v. Castleberry*, 275 P.2d 292 (Okla. 1954). This effect may be negated by express provisions in the lease. *Broussard v. Phillips Petroleum Co.*, 160 F. Supp. 905 (W.D. La. 1958). The provision is set out in the report of the case.

³⁷⁵ *Gregg v. Harper-Turner Oil Co.*, 199 F.2d 1 (10th Cir. 1952); *Buchanan v. Sinclair Oil & Gas Co.*, 218 F.2d 436 (5th Cir. 1955); *Sunray Mid-Continent Oil Co. v. McDaniel*, 30 OKLA. B.A.J. 1055 (1959).

³⁷⁶ An example is NEB. REV. STAT. §§ 57-210 to -212.01 (Reissue 1960).

³⁷⁷ See Long, *The Pooling Clause in an Oil and Gas Lease*, 11 OKLA. L. REV. 1, 15 (1958).

the jurisdiction. In a state which considers that a pooling or unitization agreement of any kind constitutes a cross conveyance, vesting an interest in each tract in each of the proprietors of every other tract who become parties to the agreement,³⁷⁸ the effect on the titles of the individual proprietors³⁷⁹ and upon their powers to maintain litigation affecting their individual interests³⁸⁰ is so devastating that I would counsel strongly against entering into any voluntary unitization or pooling whatever.³⁸¹ Obviously, I would advise against placing a power to enter into such an agreement into the hands of a lessee who might use it, inadvertently and with good intention, to the lessor's detriment. It is very doubtful whether, in such a jurisdiction, the judge-proclaimed limitations on the exercise of the power can afford an adequate safeguard.³⁸²

In other jurisdictions, where unitization or pooling is regarded merely as a means of administering the development of petrolierous resources and of apportioning returns in aid of an economical and conservative pattern of development,³⁸³ the question is not so easily answered. There are strong reasons which may make the speed and flexibility which the granting of this authority places in the hands of lessees advantageous to the lessors.³⁸⁴ On the other hand, the very speed and flexibility of the power render it subject to arbitrary use, and the judicial safeguards, like all such processes, are cumbersome, dilatory and expensive. Moreover, these clauses usually confine the apportionment of royalty to an acreage basis. If the merging is in advance of production, this is inevitable. The lessor may not wish to enter into such a gamble. He may prefer to be sure that

³⁷⁸ *Tanner v. Title Ins. & Trust Co.*, 20 Cal. 2d 814, 129 P.2d 383 (1942); *Veal v. Thomason*, 138 Tex. 431, 159 S.W.2d 472 (1942).

³⁷⁹ *Renwar Oil Corp. v. Lancaster*, 154 Tex. 311, 276 S.W.2d 774 (1955); *Matthews v. Landowners Oil Ass'n*, 204 S.W.2d 647 (Tex. Civ. App. 1947).

³⁸⁰ *Sharpe v. Landowners Oil Ass'n*, 127 Tex. 147, 92 S.W.2d 435 (1936); *Belt v. Texas Co.*, 175 S.W.2d 622 (Tex. Civ. App. 1943).

³⁸¹ See *Merrill, Recent Unitization Cases*, 6 OKLA. L. REV. 168, 171 (1953).

³⁸² See what has happened to the supposed duty of utmost good faith said to be owed by the executive right holder to his beneficiaries in *Archer County v. Webb*, 338 S.W.2d 435 (Tex. 1960).

³⁸³ *Phillips Petroleum Co. v. Peterson*, 218 F.2d 926 (10th Cir. 1954); *Shell Petroleum Corp. v. Calcasieu Real Estate & Oil Co.*, 185 La. 751, 170 So. 785 (1936); *Sinclair Crude Oil Co. v. Oklahoma Tax Comm'n*, 326 P.2d 1051 (Okla. 1958).

³⁸⁴ See *Long, The Pooling Clause in an Oil and Gas Lease*, 11 OKLA. L. REV. 1, 4 (1958).

unproductive acreage does not share in the return from his land, or that, if he has rich acreage, his return is not divided to increase the yield to those whose land is less productive. If the lessor desires to retain some voice in the extent to which he is caught up into a communized venture, he should not execute a lease with such a provision. In a state having procedures for the compulsory institution of pooling or of unitization, the lessor well may feel that he ought not to give the lessee the power to establish them unilaterally. While there may be delay resulting from resort to the administrative process,³⁸⁵ it also is true that significant concerns of the lessor may be presented and may be recognized as a result of this process.³⁸⁶

VII. REMEDIAL AND JUDICIAL ASCERTAINMENT CLAUSES

A number of clauses have been devoted to relieving the lessee from burdens related to remedies or to regulatory or other activities.

One such provision requires notice to and opportunity for performance by the lessee as a prerequisite to action against him based on a theory of nonperformance of obligations under the lease.³⁸⁷ The extent to which this is required in the absence of stipulation is doubtful.³⁸⁸ The clause probably is intended to remove that doubt. The cases seem generally to give it effect as written.³⁸⁹

³⁸⁵ *Id.*

³⁸⁶ See Merrill, *Recent Unitization Cases*, 6 OKLA. L. REV. 168, 176 (1953).

³⁸⁷ One such form reads: "In the event lessor considers that lessee has not complied with all its obligations hereunder, both express and implied, before production has been secured or after production has been secured, lessor shall notify lessee in writing, setting out specifically in what respects lessee has breached this contract. Lessee shall then have sixty (60) days after receipt of said notice within which to meet or commence to meet all or any part of the breaches alleged by lessor. The service of said notice shall be precedent to the bringing of any action by lessor on said lease for any cause, and no such action shall be brought until the lapse of sixty (60) days after service of such notice on lessee. Neither the service of said notice nor the doing of any acts by lessee aimed to meet all or any of the alleged breaches shall be deemed an admission or presumption that lessee has failed to perform all its obligations hereunder."

³⁸⁸ See MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES ch. X (2d ed. 1940).

³⁸⁹ See the recent discussion in Williams & Meyers, *Forfeiture, Notice and Demand and Judicial Ascertainment Clauses in Oil and Gas*

Allied to this is the so-called judicial ascertainment clause.³⁹⁰ While an early opinion questioned the validity of such a stipulation on the ground that it interfered with the orderly administration of justice by requiring piecemeal trials,³⁹¹ the contention is far fetched,³⁹² and they have been enforced so often that there now seems no reason to question their validity.³⁹³ The judicial ascertainment clause is available only to a lessee who has a respectable, as distinguished from a factitious, ground of controversy.³⁹⁴ Neither do they apply to cases where the contention is that the lease has expired by its own terms.³⁹⁵

The decisions denying effect to various natural calamities³⁹⁶ and governmental afflictions³⁹⁷ as excuses for nonperformance of lessees' obligations have stimulated the drafting of what is commonly referred to as the "force majeure" clause.³⁹⁸ There

Leases, 1 NATURAL RESOURCES J. 41 (1961). *Billeaud Planters, Inc. v. Union Oil Co.*, 245 F.2d 14 (5th Cir. 1957) seems erroneous in applying such a clause to relieve a lessee that must all along have known that it was filching oil from beneath the leased premises through neighboring wells.

³⁹⁰ An example of phraseology: "This lease shall never terminate or be forfeited or canceled in whole or in part, either during or after the primary term hereof, for failure to perform any of its implied covenants, conditions, or obligations until it shall have first been finally judicially determined that such failure exists, and any decree of termination, cancellation or forfeiture shall be in the alternative and shall provide for termination, cancellation, or forfeiture unless Lessee comply with the implied covenants, conditions, or obligations breached within a reasonable time to be determined by the Court."

³⁹¹ *Frick-Reid Supply Corp. v. Meers*, 52 S.W.2d 115 (Tex. Civ. App. 1932).

³⁹² See Merrill, *Lease Clauses Affecting Implied Covenants*, *SOUTHWESTERN LEGAL FOUNDATION 2D ANNUAL INST. ON OIL & GAS L. & TAX* 141, 185 (1951).

³⁹³ *Haynes v. Southwest Natural Gas Co.*, 123 F.2d 1011 (5th Cir. 1941); *Steffes v. Allen*, 295 Mich. 510, 295 N.W. 245 (1940).

³⁹⁴ *Melancon v. Texas Co.*, 230 La. 593, 89 So. 2d 135 (1956).

³⁹⁵ *Eitel v. Alford*, 127 Colo. 341, 257 P.2d 955 (1943).

³⁹⁶ *Baldwin v. Blue Stem Oil Co.*, 106 Kan. 848, 189 Pac. 920 (1920); *Logan v. Blaxton*, 71 So. 2d 675 (La. Ct. App. 1954).

³⁹⁷ *B. & B. Oil Co. v. Lane*, 249 S.W.2d 705 (Ky. 1952) (war).

³⁹⁸ "When drilling, production or other operations are delayed, interrupted or stopped by lack of water, labor material, inability to obtain access to leased premises, fire, flood, war, rebellion, insurrection, riot, strike, differences with workmen, failure of carriers to transport or furnish facilities for transportation of any product produced hereunder, lack of available or satisfactory market, in Lessee's opinion, for the oil or gas produced, or as a result of an order of any govern-

has been little interpretation of the sweeping language of this clause. The decisions have tended toward strict construction, in accordance with a general judicial attitude.³⁹⁹ Thus excessive, but seasonal, rain does not come within the exculpatory provisions of such a clause.⁴⁰⁰ Also, a court has refused to infer, without proof, that the work would have been performed had the weather been good.⁴⁰¹ Governmental interference which the lessee might have removed had he made the attempt is not an excuse for inaction despite a "force majeure" clause.⁴⁰² On the other hand, one court seems to have construed such a clause as permitting the lessee to suspend operations almost at will.⁴⁰³ In view of the possibility of other such decisions, and particularly in view of the tendency of draftsmen to concoct more strongly worded clauses designed to give excuse for complying with every act of government, no matter how illegal,⁴⁰⁴ it is my advice that prospective lessors refuse to execute leases containing clauses excusing the lessee for nonperformance due to acts of government. To the extent that such acts are legally binding, and not cap-

mental agency, (including but not limited to orders restricting production) or as a result of any cause beyond the control of Lessee, the time of such delay, interruption or stoppage shall not be counted against the Lessee under any provision of this lease, and this lease shall not terminate by reason of any such delay, interruption or stoppage, and the period of such delay, interruption or stoppage shall be added to the term of this lease."

³⁹⁹ See MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES § 200 (2d ed. 1940).

⁴⁰⁰ Logan v. Blaxton, 71 So. 2d 675 (La. Ct. App. 1954).

⁴⁰¹ Illinois Mid-Continent Co. v. Tennis, 122 Ind. App. 17, 102 N.E.2d 390 (1951).

⁴⁰² Baldwin v. Kubetz, 148 Cal. App. 2d 937, 307 P.2d 1005 (2d Dist. 1957).

⁴⁰³ Reconstruction Fin. Corp. v. Chromium Prods. Corp. 202 F.2d 664 (9th Cir. 1953).

⁴⁰⁴ "Compliance with any now or hereafter existing law enacted by Federal or State legislative authority, or with orders, judgments, decrees or regulations made or promulgated by State or Federal courts, State or Federal offices, boards, commissions or committees, purporting to be made under authority of law, shall not constitute a violation of the terms of this lease or be considered a breach of any obligation herein, nor shall it constitute a cause for the termination, forfeiture, reversion or reversion of any estate or interest hereby created, nor shall compliance confer any right of entry or become the basis of an action for damages or suit for the forfeiture or cancellation hereof, and while any such purport to be in force and effect they shall, when complied with, to the extent of such compliance, operate as a modification of the terms and conditions of this lease where inconsistent therewith."

able of being modified or removed at the initiative of the lessee, they probably should excuse nonperformance without need to resort to contractual stipulation.⁴⁰⁵ If they are illegal⁴⁰⁶ or are capable of being modified by the lessee's stimulation,⁴⁰⁷ they should not exculpate his inaction. The lessor ought not to make any stipulation capable of being twisted by judicial interpretation into a waiver of this salutary principle.

VIII. CLAUSES DESIGNED TO CURE PROBLEMS ARISING FROM SEPARATION OF THE LEASE BY HORIZONTAL ASSIGNMENTS OR BY PARTIAL POOLING OR UNITIZATION

Frequently production is obtained, or is obtainable, from different subsurface levels, horizons or strata. It therefore may be desirable to provide expressly in the lease that production from one level or horizon during the primary term will not perpetuate the lease as to another level or horizon beyond the primary term. Ordinarily, as we have seen, an oil and gas lease is extended beyond the primary term by a "thereafter" clause if a producing well is obtained at any location on the surface of the leased premises during the primary term.

Leases usually contain no prohibition against the recognized practice of horizontal subsurface separation of formations by partial assignment. Thus one person may have a valid operating right on a designated horizon and another person on another under the same base. Production may be obtained from one horizon while the other horizon is not explored or is permitted to remain nonproductive. This may tend to deny the lessor an opportunity to realize fully upon the productive capacity of his land. While it is true that the implied covenant obligations, heretofore mentioned, may afford the lessor some relief in such a situation,⁴⁰⁸ the exact extent of this relief is not well defined.

⁴⁰⁵ *Gray v. Cameron*, 218 Ark. 142, 234 S.W.2d 769 (1951); *Hunter Co. v. Vaughn*, 217 La. 459, 46 So. 2d 735 (1950); *Superior Oil Co. v. Foote*, 214 Miss. 857, 59 So. 2d 85, 37 A.L.R.2d 415 (1952).

⁴⁰⁶ *Haby v. Stanolind Oil & Gas Co.*, 228 F.2d 298 (5th Cir. 1955); *Union Pac. R.R. v. Oil and Gas Conservation Comm'n*, 131 Colo. 528, 284 P.2d 242 (1955); *Marrs v. Railroad Comm'n*, 142 Tex. 293, 177 S.W.2d 941 (1944).

⁴⁰⁷ See *Merrill, Fulfilling Implied Covenant Obligations Administratively*, 9 OKLA. L. REV. 125 (1956), for an exploration of the lessee's obligations in this respect.

⁴⁰⁸ See MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES § 69 (2d ed. 1940).

Moreover, delay rental payments, and other obligations of the lessee, may be absolved by the fact of production from one horizon, while the other levels are held without development.

The same problems may arise where the leased premises are pooled or unitized with other lands, or where a designated formation under the leased premises is pooled or unitized by agreement or by governmental order, with parts of the same formation in a common source of supply underlying other lands.⁴⁰⁹ In this respect, it is immaterial whether the pooling or unitization is voluntary or is compulsory.

It may be desirable, therefore, to provide expressly in the lease that the subsurface separation or segregation of mineral rights by levels, horizons or formations, or the pooling or unitizing of part of the acreage with other tracts, shall constitute a severance of the basic lease so that each such separated formation or acreage thereafter shall be treated as though covered by a separate lease containing all of the provisions and stipulations of the basic lease. This is believed to constitute a simpler and more effective way of solving the difficult problems arising from the severance of the operating interest as to different levels, or from the inclusion of part, only, of the leased premises in the same unit with lands of other owners, wholly strangers to the lease, than has been achieved by provisions, commonly referred to as "Pugh clauses," which have been employed for that purpose in some states.⁴¹⁰

⁴⁰⁹ See MERRILL, *op. cit. supra* note 408 at 215 (Supp. 1959).

⁴¹⁰ See lease forms set out or summarized in *Broussard v. Phillips Petroleum Co.*, 160 F. Supp. 905, 907 (W.D. La. 1958), *aff'd.* 265 F.2d 221 (5th Cir. 1959); *Rogers v. Westhoma Oil Co.*, 291 F.2d 726, 730 (10th Cir. 1961); *Humble Oil & Ref. Co. v. Hutchins*, 217 Miss. 636, 64 So. 2d 733, 738 (1953).