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Comparing Apples and Oranges - The New Mexico Supreme Court's Modification of the Habendum Clause in an Oil and Gas Lease by the Implied Covenant of Development: *M.H. Clark v. Benson-Montin-Greer Drilling Corp.*

Rebecca Dickerson

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COMPARING APPLES AND ORANGES—THE NEW MEXICO SUPREME COURT'S MODIFICATION OF THE HABENDUM CLAUSE IN AN OIL AND GAS LEASE BY THE IMPLIED COVENANT OF DEVELOPMENT: *M. H. Clark v. Benson-Montin-Greer Drilling Corp.*

M. H. Clark v. Benson-Montin-Greer Drilling Corp.,¹ a recent decision by the New Mexico Supreme Court, could have a major effect on the oil and gas industry in New Mexico. In the past, the New Mexico Supreme Court has ruled with the vast majority of jurisdictions and has treated a "thereafter" clause² in the habendum clause³ of an oil and gas lease as a special limitation.⁴ Due to this limitation, a lease containing a "thereafter" clause *automatically terminated*⁵ if no oil or gas were being produced on the lease at the end of the primary term.⁶

Today's oil and gas lease evolved from the conflicting interests of the landowner (lessor) and the oil and gas operator (lessee).⁷ The lessee wants a lease which will maximize his profits by providing for a small initial investment which allows the lessee to hold the lease as long as it has speculative value or produces oil or gas. The lessee also wants the option of terminating the lease without his being liable to the lessor when the lease becomes unprofitable.⁸ The lease is only

1. 20 N.M. St. B. Bull. 367 (March 26, 1981). [Editors' note: Between the writing and publication of this Casenote, the New Mexico Supreme Court notified the parties that the opinion in *M. H. Clark v. Benson-Montin-Greer Drilling Corp.* had been withdrawn. The case is under advisement at this time.]

2. The clause which provides extension of the lease's primary term for "as long thereafter" as oil or gas is produced.

3. The habendum clause establishes the duration of the lessee's interest in the premises.

4. "A vast majority of the courts have construed such habendum clauses as conveying an interest subject to a special limitation. . . ." 3 Williams & Meyers, *Oil and Gas Law*, §604, at 36 (1980). See also, *Greer v. Salmon*, 82 N.M. 245, 479 P.2d 294 (1970); *Town of Tome Land Grant v. Ringle Development Co.*, 56 N.M. 101, 240 P.2d 850 (1952).

5. "The consequences of this conceptual classification of the habendum clause as a clause of limitation is that lack of production at the end of the primary term or cessation of production after the expiration of the primary term results in an *automatic termination* of the lessee's interest." 3 Williams & Meyers, *Oil and Gas Law* §604 at 38 (emphasis added).

6. *Greer v. Salmon*, 82 N.M. 245, 479 P.2d 294 (1970). In *Clark v. Benson-Montin-Greer* the New Mexico Supreme Court cited *Salmon* for the proposition that ". . . once production ceases under a lease with an 'as long thereafter' limitation clause, as in this case, the lease is automatically *terminable*." 20 N.M. St. B. Bull. 370 (March 26, 1981) at 370 (emphasis added). The *Salmon* court actually said, "The habendum clause . . . is a typical clause of limitation with a relatively short primary term and its 'thereafter' provision designed for *automatic termination*." 82 N.M. at 247, 479 P.2d at 296 (emphasis added).

7. 3 Williams & Meyers, *Oil and Gas Law* §601.1 (1980).

8. *Id.*

profitable to the lessor if he is receiving royalties from the production of oil and gas under the lease. The lessor must, therefore, require prompt drilling and development of the leased lands or exact a rental from the lessee for the privilege of postponing drilling. The lessor needs a lease that expires at the end of a short fixed term so he may recover his mineral interests if the lessee fails to obtain production and pay royalties.⁹ The modern habendum clause evolved to protect these conflicting interests.¹⁰

The habendum clause in a typical oil and gas lease provides: "It is agreed that this lease shall remain in force for a term of [five] years from date and *as long thereafter* as oil, or gas, of whatsoever nature or kind, or either of them is produced from said land or drilling operations are continued as hereinafter provided."¹¹ The primary term of the lease is the original five year period, but the lease may be extended indefinitely by the production of oil and gas.¹²

This clause assures the lessor that his land will be put into production during the primary term or the lease will expire at the end of the primary term. At the same time, the lessee is assured of a definite time in which to obtain production and the extension of the lease as long as his production continues.¹³

For the first time, the New Mexico Supreme Court has modified the habendum clause in an oil and gas lease by imposing upon the clause a requirement associated with the implied covenant of reasonable development.¹⁴ The implied covenant of development, however, is considered a condition and courts may require the lessor to give notice and demand before the lease may be cancelled for breach of this covenant.¹⁵

9. *Id.*

10. 3 Williams & Meyers, Oil and Gas Law § 603 (1980).

11. Manual of Terms, Williams & Meyers, Oil and Gas Law 267 (1980).

12. See 3 Williams & Meyers, Oil and Gas Law § 603 (1980).

13. *Id.* at § 604.

14. This obligation is imposed by courts on an oil and gas lessee. The lessee must drill a sufficient number of wells in a producing formation to provide for the most beneficial removal of the oil or gas. The lessee is obligated to his lessor to prevent the permanent loss of hydrocarbons under the lessor's land and to prevent delay in the lessor's collection of royalty payments on the hydrocarbons that can be produced from his land. See 5 Williams & Meyers, Oil and Gas Law § 831 (1980).

15. *E.g.*, Robinson v. Continental Oil Co., 255 F. Supp. 61 (D. Kan. 1966) (holding that equity required notice and demand before a court will order forfeiture); Savoy v. Tidewater Oil Company, 218 F. Supp. 607 (W.D. La. 1963), *aff'd* 326 F.2d 757 (5th Cir. 1964) (holding notice and demand is a condition precedent to suit for rescission or cancellation of oil and gas lease); Vincent v. Tidewater Oil Programs, Inc., 620 P.2d 910 (Okla. App. 1980) (required notice and demand); Superior Oil Company v. Devon Corporation, 604 F.2d 1063 (8th Cir. 1979) (oil and gas lease will not be cancelled for breach of implied covenants without notice and demand).

The automatic termination of an oil and gas lease, by the express limitation of the habendum clause, on which New Mexico oil and gas lessors and lessees have so long depended, is now questionable.¹⁶ The *Clark* decision reopens the questions:

- a) When does an oil and gas lease automatically terminate by the lease's express terms?¹⁷
- b) What circumstances require a lessor to give notice and demand to his lessee before the lease is terminated by its habendum clause?¹⁸

These questions were settled in the past by New Mexico's acceptance of the majority construction of the habendum clause.¹⁹ In New Mexico, future litigation will probably be necessary to re-establish the rights and obligations of the parties to an oil and gas lease containing a typical habendum clause.

STATEMENT OF THE CASE

During the primary term of a fee oil and gas lease,²⁰ Benson-Montin-Greer Drilling Corp. (hereinafter "Original Lessee"), under authority granted by the terms of the unit agreement ratified by the lessors and the Original Lessee, committed all 931 acres covered by the lease to a unit.²¹ Prior to the end of the primary term of the lease, production was obtained from lands within the unit, but not upon

16. The automatic termination of a lease by express limitation in the habendum clause has been recognized in New Mexico since 1952. *Town of Tome Land Grant v. Ringle Development Co.*, 56 N.M. 101, 240 P.2d 850 (1952).

17. 20 N.M. St. B. Bull. at 371.

18. *Id.*

19. See note 4 *supra*.

20. A fee mineral lease is considered real property in New Mexico. *Sachs v. Board of Trustees*, 89 N.M. 712, 557 P.2d 209 (1976); *Terry v. Humphreys*, 27 N.M. 564, 203 P. 539 (1922). The typical fee lease provides that the lease creates an indivisible estate. Paragraph 11 of the original leases provided "[i]f the leased premises are now or if same shall hereafter be owned in severalty or in separate tracts, the premises, nevertheless, shall be developed and operated as one lease. . . ." Exhibits A and B to the Stipulation of Facts, Transcript of Record Proper, *M. H. Clark v. Benson-Montin-Greer Drilling Corp.*, 20 N.M. St. B. Bull. 367 at 17-20. Different problems are presented with Federal or State oil and gas leases. N.M. Stat. Ann. §19-10-47 (1978) governs New Mexico State oil and gas leases in circumstances similar to those presented by the *Clark* case. See also, *Hickman v. Mylander*, 68 N.M. 340, 362 P.2d 500 (1961). For a discussion of federal statutes governing the questions raised in the *Clark* case, but involving federal leases, see *Status of Oil and Gas Leases Upon Partial Commitment to or Partial Elimination From a Unit Plan*, M-36592, *Gowers Federal Reporter* SO-1960-39 (January 21, 1960).

21. A "unit" is the area included under a unit agreement providing a plan of development and operation for recovery of oil and gas, consolidating the area without regard to separate ownership and further providing for the allocation of cost and benefits according to the agreement. 6 *Williams & Meyers, Oil and Gas Law* §910 (1980).

lands covered by the lease. This production continued beyond the primary term, thereby extending the lease. At no time, however, was there any production on the lease itself. Long after the end of the primary term, 891 acres of the leased lands were eliminated from the unit.²² On September 19, 1977, before the contraction was approved and retroactively applied, Clark (hereinafter "Subsequent Lessee") took a lease to the 891 acres that were later excluded.²³ The Subsequent Lessee then brought suit to quiet title to his leasehold interest in the disputed acreage.

The decision of the supreme court reversed a judgment in favor of the Subsequent Lessee and recognized the general rule that production from a unit ordinarily serves to extend a lease beyond its primary term, as to all lands covered by the lease, including the land not within the unit.²⁴ The court then held that Paragraph 18(g) of the Original Lessee's unit agreement²⁵ segregated²⁶ the lease as to the 891 acres in dispute, effective upon the elimination of the 891 acres from the unit. The court further held that due to this segregation, production from the unit no longer extended the lease as to the 891 acres.²⁷ A discussion of the implied covenant of reasonable development followed these holdings.²⁸ In this discussion, the court explained why notice and demand are necessary, prior to the forfeiture of a lease, for breach of the implied covenant of development. The court then found that no notice of breach or demand for development had been given the Original Lessee, that the conduct of the Subsequent Lessee in taking its lease prior to the approval of the contraction of the unit

22. The original lessee acquired its leases on January 16, 1953, and shortly thereafter agreed with the operator of a unit to submit the entire 931 acres to the unit. In December 1977, the unit operator contracted the size of the unit thereby excluding the disputed 891 acres. In February 1978, the United States Geological Survey and the New Mexico Commissioner of Public Lands approved the contraction and made it retroactive to September 1, 1977. 20 N.M. St. B. Bull. at 368.

23. *Id.*

24. 20 N.M. St. B. Bull. at 369, citing 2 W. Summers, *The Law of Oil and Gas Leases* §302.1 (1959); *Clovis v. Pacific Northwest Pipeline Corporation*, 140 Colo. 552, 345 P.2d 729 (1959); *Wells v. Continental Oil Company*, 244 Miss. 509, 142 So.2d 215 (1962).

25. Paragraph 18(g) of the unit agreement provided:

Any lease having only a portion of its lands committed hereto shall be segregated as to the portion committed and the portion not committed, and the terms of such lease shall apply separately to such segregated portions commencing as of the effective date hereof. In the event any such lease provides for a lump sum rental payment, such payment shall be prorated between the portions so segregated in proportion to the acreage of the respective tracts.

20 N.M. St. B. Bull. at 370.

26. Segregation has the effect of removing a portion of the land from the unit agreement. See 6 Williams & Meyers, *Oil and Gas Law* §920.5 Art 15 (1980).

27. 20 N.M. St. B. Bull. at 370.

28. *Id.* at 370-71.

was not equitable, and that this failure to "do equity" justified the court's refusal to forfeit the original lease²⁹ for lack of reasonable development. Finally, the supreme court reversed the trial court's judgment and ordered that judgment be entered quieting title to the disputed lease interest in the Original Lessee.

ANALYSIS OF THE DECISION

According to the facts which were stipulated to by the parties,³⁰ the New Mexico Supreme Court expressly set forth its perception of the issues as:

First, whether the continued inclusion of the 40 acres in the participating area³¹ following the exclusion of the 891 acres from the unit is sufficient to maintain the defendants' [original lessees] leases to the 891 acres. Second, if we hold defendants' leases were not so extended, are the defendants' lessors³² barred from forfeiting the leases because of their failure to comply with the judicial ascertainment provision of the lease³³ or their failure to give the defendants notice and demand for reasonable development.³⁴

In its resolution of the first question, the court noted that the Original Lessee had satisfactorily met the production requirements to extend the original lease from 1953 until 1977. Paragraph 7(1) of the original lease provided that production on any land in a unit to which the leased land was committed, was sufficient production to extend the lease beyond its primary term.³⁵ The court then stated:

The real issue in controversy is whether, after the contraction of the unit in 1977, the inclusion of the 40 acres in the participating

29. The court's statement of the facts of the case reflected that the original lessee had "acquired its leases on January 16, 1953." 20 N.M. St. B. Bull. at 368 (emphasis added). There were two leases executed to the Original Lessee on January 16, 1953. Each of the leases covered the same 931-acre tract and together the two leases covered the entire mineral interests in the 931-acre tract. Transcript of Record Proper at 10. These two leases are called the original lease for purposes of this article because they each cover a portion of the mineral interest in the entire 931 acres and together convey 100% of the mineral interests in the 931 acres.

30. 20 N.M. St. B. Bull. at 368.

31. The participating area is that part of a unit to which production has been allocated according to the unit agreement and pursuant to 30 C.F.R. § 226.2(i) (1970). Manual of Terms, Williams & Meyers, Oil and Gas Law 417 (1980).

32. The lessors were apparently not parties before the court.

33. A typical judicial ascertainment clause will provide that an oil and gas "lease shall not terminate, be cancelled or forfeited for failure to perform implied covenants, conditions or obligations until it is judicially determined that such failure exists." Manual of Terms, William & Meyers, Oil and Gas Law 304 (1980).

34. 20 N.M. St. B. Bull. at 368 (footnotes added).

35. *Id.*

area could satisfy the production requirement of the excluded 891 acres, and thus maintain the defendants' leases.³⁶

The issue, thus framed, together with the court's construction of paragraph 18(g), forced the court into the conclusion that unit production could no longer extend the original lease as to the 891 segregated acres.³⁷ The court accepted the rule followed by courts in the majority of petroleum producing states, which provides that continuing production anywhere within the unitized area prevents termination of the lease, *absent specific contractual agreements to the contrary*.³⁸ Paragraph 18(g) was then construed by the court to be such a contrary contractual agreement, which prevented the court's application of the majority rule.³⁹

At this point in the opinion, the court would have been forced to find that the original lease had automatically terminated upon the segregation of the 891 acres, if it followed the rule established in *Greer v. Salmon*.⁴⁰ Under that rule, the original lease might have been saved only if it complied with specific "savings clauses"⁴¹ in the lease. The court, however, did not mention whether the original lease contained any "savings clauses" or whether the lease might be extended due to such clauses.

The court did not hold that the original lease automatically terminated, but that the lease became automatically terminable because it was no longer extended by the unit production.⁴² The court then discussed the manner in which the failure of notice and demand affected the termination of the original lease.⁴³ Although purporting to recognize the ruling in *Greer v. Salmon*,⁴⁴ that the permanent cessation of production after expiration of the primary term results

36. *Id.*

37. If Paragraph 18(g) does not apply in a case like *Clark* where all of the original lease is initially committed to the unit, it would be necessary to determine whether the elimination of lands from a unit, of itself, effects a segregation of the lease. A noted authority describes this question as one that has never been the subject of any court decision. 6 Williams & Meyers, Oil and Gas Law §980.9. The New Mexico Supreme Court made no mention of the question, as posed in this note, and evidently missed its opportunity to decide the issue inadvertently, rather than intentionally.

38. 20 N.M. St. B. Bull. at 370 (emphasis added). "Therefore, absent specific contractual agreements to the contrary, under the majority rule, the defendants' leases would remain in effect." *Id.*

40. 82 N.M. 245, 479 P.2d 294 (1970). The *Salmon* court ruled that the typical habendum clause with a "thereafter" provision was a clause of limitation, which resulted in automatic termination of a lease due to a permanent failure of production during the extended term of the lease.

41. See, e.g., the discussion of the "cessation of production" clause, and its application, in *Greer v. Salmon*, 82 N.M. 245, 247-48, 479 P.2d 294, 296-97 (1970).

42. 20 N.M. St. B. Bull. at 370.

43. *Id.*

44. 82 N.M. 245, 479 P.2d 294 (1970).

in automatic termination under the habendum clause (a clause of limitation), the court concluded:

Subsection (g) of Paragraph 18 . . . was inapplicable until September of 1977, because prior to that time all, not a portion, of the leased land was included in the unit. However, once the 891 acres were excluded from the unit the segregation clause of Paragraph 18 took effect and the production from the rest of the unit no longer maintained the defendants' [original] leases to the 891 acres. Under New Mexico law once production ceases under a lease with an "as long thereafter" limitation clause, as in this case, the lease is automatically *terminable*. *Greer v. Salmon*, 82 N.M. 245, 479 P.2d 294 (1970). Therefore, as of September 1, 1977, the defendants' leases . . . were *terminable* for lack of reasonable development but, as shown below, *lessors*⁴⁵ failed to take the requisite steps to terminate the leases.⁴⁶

This holding reflects that the members of the court erroneously related the implied covenant of reasonable development to the habendum clause of the lease by requiring the lessors to take affirmative action to terminate a lease which should have terminated automatically.

The second holding in *Clark* is based on modification of the original lease's habendum clause by either the judicial ascertainment clause,⁴⁷ the implied covenant of reasonable development, or both.⁴⁸ A modification of this sort is considered incongruous by the authorities on oil and gas law,⁴⁹ based on the sort of reasoning which follows. An implied covenant imposes a duty on the lessee. The implied covenant of reasonable development requires a lessee to develop the land under his lease sufficiently to protect his lessor's royalty interest.⁵⁰ Neglect of that duty results in a breach of the covenant, for which the lessor may seek damages or compel specific

45. It should be noted that, so far as appears from the style of the case, and the opinion, the lessor (*i.e.*, the mineral owner) was not even a party to the suit. The court clearly stated, however, that it was the *lessor's* duty to give such notice and demand as the court deemed required. Then stating that the plaintiff (Subsequent Lessee) had failed to "do equity," the court apparently imputed this duty of the lessor, and his failure to comply with the duty, to the Subsequent Lessee. 20 N.M. St. B. Bull. at 371.

46. *Id.* at 370 (emphasis added) (footnotes added).

47. In its statement of the issues, the court refers to the judicial ascertainment clause, *see* note 33, *supra*, contained in the original lease, as having some bearing on the second question posed by the court. The subsequent discussion and decision on the second issue, however, make no further mention of the judicial ascertainment clause, nor do they indicate whether the clause affected the court's decision in any way.

48. See the discussion in the opinion in 20 N.M. St. B. Bull. at 370-71.

49. 4 Williams & Meyers, Oil and Gas Law § 682.2 (1980).

50. *See* note 14 *supra*.

action or a forfeiture.⁵¹ In contrast, the habendum clause never involves a duty.⁵² The "thereafter" provision in a habendum clause gives the lessee a *right* to extend the term of a profitable lease. The extension, however, is limited by the production requirement.⁵³ The lessee may not be compelled by notice and demand to exercise a right, nor should the presence of notice and demand negate the express limitation provided by the habendum clause.⁵⁴

The fallacy of relating a notice and demand clause or a judicial ascertainment clause to the limitation provided by the habendum clause has been expressed by the authorities on oil and gas law and recognized in several jurisdictions.⁵⁵ William & Meyers in their treatise on Oil and Gas Law⁵⁶ explain that:

In view of the clear language of limitation in the habendum clause . . . of the typical lease, a notice and demand or judicial ascertainment clause . . . should not be construed as modifying the limitation provisions of the lease. It has long been understood that a leasehold created by an unless lease⁵⁷ terminates

51. 20 N.M. St. B. Bull at 370-71.

52. This clause merely provides for a primary term. The lease terminates at the end of this term unless it is extended by production. See note 3, *supra*.

53. See note 2 *supra*.

54. Professor Masterson in his Discussion Notes at 1 O&GR 23-24, explains the incongruity as follows, "If the lease terminated by its own terms, . . . the lease provision requiring notice by lessors of an intent to terminate would seem inapplicable."

Another writer explains:

Anything that the grantee, or lessee, is under a *duty* to do, or to refrain from doing, cannot constitute the subject matter of a special limitation. A limitation cannot in its very nature impose a duty because the happening of the event named in the limitation clause automatically terminates the estate, and the law will not countenance the absurdity of holding that a man may be discharged of a duty by his very act of breaching it.

Walker, *The Nature of the Property Interests Created by an Oil and Gas Lease in Texas*, 8 Tex. L. Rev. 483, 488 (1930).

The California Supreme Court's explanation is:

The oil lease, with its "and so long thereafter" phrase in the habendum clause, created a determinable fee interest. . . . A determinable fee terminates upon the happening of the event named in the terms of the instrument which created the estate; no notice is required for, and no forfeiture results from, such termination.

Renner v. Huntington-Hawthorne Oil & Gas Co., 39 Cal.2d 93, 98, 244 P.2d 895, 898-99 (1952).

55. See, e.g., *Waggoner Zeller Oil Company v. Deike*, 508 S.W.2d 163 (Tex. Civ. App. 1974); *Taylor v. Buttram*, 111 So.2d 576 (La. App. 1959); *Eitel v. Alford*, 127 Colo. 341, 257 P.2d 955 (1953); *Renner v. Huntington-Hawthorne Oil and Gas Company*, 39 Cal.2d 93, 244 P.2d 895 (1952), *error ref'd n.r.e.*

56. 4 Williams & Meyers, *Oil and Gas Law*.

57. The "unless" lease is the form most widely used in this country. It contains a special clause of limitation generally providing that *unless* the lessee pays the lessor a rental fee by a specified date or commences drilling a well during the allotted time, the lease will automatically terminate. This clause is generally construed in favor of the lessor and even failures due to accident or mistake will terminate the lease. 3 Williams & Meyers, *Oil and Gas Law* § 606 (1980).

automatically without any requirement of notice or judicial ascertainment in the event of failure of production at or after the end of the primary term. . . . Under such circumstances it is unreasonable to conclude that the parties, by including in the lease a vaguely phrased notice and demand, or judicial ascertainment clause, intended to modify the operation of [the] limitation clauses.⁵⁸

The second holding of the *Clark* case, thus, relies on the misapplication of the holding in *Greer v. Salmon*⁵⁹ as well as a misapplication of the principles espoused by the authorities and adhered to by the courts of other jurisdictions.⁶⁰

The result in this case probably arose from the court's feelings that the Lessor and Subsequent Lessee acted improperly by executing the subsequent lease while the original lease was still valid and in full force. In trying to obtain an equitable result under the facts in *Clark*, the New Mexico Supreme Court has created confusion and cast serious doubt on the validity of firmly entrenched rights under oil and gas leases.⁶¹ The court could have extended the original lease based on at least two alternative theories which would have been consistent with overwhelmingly accepted legal precedents.⁶²

The court could have construed Paragraph 18(g) of the unit agreement as inapplicable, held the elimination of 891 acres insufficient to segregate the lease, and applied the majority rule that production from any land in a unit is sufficient to hold all the land in leases committed to that unit. Courts generally have held that the express provisions of a lease or unit agreement will govern the effect of production from the unit at the expiration of the primary term of the lease of a tract, all or part of which is included in the unit.⁶³ A court's decision in a particular case will then turn on the construction of ex-

58. 4 Williams & Meyers, Oil and Gas Law §682.2 at 354 (footnotes added). The second holding of the *Clark* case, that the lessor must have given notice, demand and opportunity to cure before he could rightfully terminate the lease, is very peculiar in light of the court's recognition of those instances where notice and demand are not required. The court stated, "We recognize there are instances when such demand, notice, and opportunity to cure is not required. For example, . . . to terminate a lease under one of the clauses of special limitation." 20 N.M. St. B. Bull. at 371 (emphasis added). The authority cited for this statement is none other than 4 Williams & Meyers at §682. The court further stated, "[n]one of these exceptions are applicable to the instant case." 20 N.M. St. B. Bull. at 371 (emphasis added).

59. 82 N.M. 245, 479 P.2d 294 (1970).

60. See notes 40, 54, 55, and 58 *supra*.

61. The impact of the *Clark* decision may be limited greatly, however, by the fact that it turned entirely on the court's construction of the provision in the unit agreement as dictating a segregation of the lease as to the lands within the unit and those eliminated from the unit.

62. See note 4 *supra*.

63. 6 Williams & Meyers, Oil and Gas Law §953 (1980); see, e.g., *Scott v. Pure Oil Co.*, 194 F.2d 393 (5th Cir. 1952); *Beck v. Norbeck Co.*, 116 Mont. 345, 151 P.2d 1014 (1944).

press provisions governing unit production as to excluded acreage.⁶⁴ The New Mexico Supreme Court adopted this approach and based its first holding in *Clark* on its construction of Paragraph 18(g).

Paragraph 18(g) certainly governed leased land which was *initially* only partially committed to the unit. The wording of 18(g), "as of the date *hereof*" (emphasis added), however, lends itself to the argument that 18(g) *only* covers leased lands partially committed *as of the date of the unit agreement*. If 18(g) had not been applied in the *Clark* case, the court could have decided this case only on the question of whether the elimination of the 891 acres itself created a segregation. This would have allowed the court to avoid its second holding entirely, thus preserving the sound, established decisions of the past.⁶⁵

Alternatively, the court might have held that application of Paragraph 18(g) of the unit agreement created a "cessation of production" thus activating one or more of the "savings" clauses that were in the original lease.⁶⁶ A "cessation of production" clause modifies the limitation of the habendum clause by providing that the lessee has a short, fixed period of time, usually 60 or 90 days, in which to resume operations on the leased land if production ceases during the extended term. The lease does not automatically terminate for the period in which the lessee diligently pursues operations to obtain production. If the lessee does obtain production, the lease is again extended for so long thereafter as the production lasts. In *Greer v. Salmon*,⁶⁷ the court noted that such clauses were designed "to relieve the lessee from some of the harsh consequences of *automatic termination* by granting the lessee a period of 90 days to resume operations to secure further protection."⁶⁸ The original lease in *Clark* contained a similar provision.⁶⁹

Perhaps the court felt that "fair play" required allowing the Original Lessee a short period in which to obtain production on the excluded acreage, because the contraction and subsequent elimination of the acreage were circumstances over which the Original Lessee had no control. The *Clark* court might have applied the "savings" clause and reasoned that the elimination of the 891 acres from

64. *Id.*

65. See, *Greer v. Salmon*, 82 N.M. 245, 479 P.2d 294 (1970); *Town of Tome Land Grant v. Ringle Development Co.*, 56 N.M. 101, 240 P.2d 850 (1952).

66. Exhibits A and B to the Stipulation of Facts, Transcript of Record Proper, *M. H. Clark v. Benson-Montin-Greer Drilling Corp.*, 20 N.M. St. B. Bull. 367 at 17-20.

67. 82 N.M. 245, 479 P.2d 294 (1970).

68. *Greer v. Salmon*, 82 N.M. 245, 247-48, 479 P.2d 295, 296-97 (1970).

69. See note 66 and accompanying text *supra*.

the unit effected a "cessation of production" as to those acres. The Original Lessee would then have had the right under the "savings" clause to retain the lease while it attempted to obtain production on the excluded acres.

Either of the suggested holdings would have been consistent with the law as it stood in New Mexico before the *Clark* decision⁷⁰ and would have preserved the original lease. If the court's decision were truly based on a feeling that the Lessor and Subsequent Lessee acted in bad faith, the court should have set this basis out in the opinion and employed an analysis similar to one of the two outlined above to reach an "equitable" result.

CONCLUSION

This is an important decision, regardless of the holdings, in that it recognized the following general rules:

(a) unit production holds all lands covered by a fee lease, including those outside the unit; and

(b) notice and demand are prerequisites to enforcement of the implied covenant of further development, and, by implication, other covenants.

The opinion of the court, however, does violence to the generally accepted concept of automatic termination of oil and gas leases when a limitation of the habendum clause is involved. The decision of the court may have resulted because the court deemed it unfair to terminate the original lease under the circumstances of this case. The court could have avoided future confusion of the application of this decision to other specific situations, by being more explicit, logical, and careful in its analysis. Unfortunately, the court with its opinion in *Clark* has provided a classic example of how "hard cases make bad law."

REBECCA DICKERSON

70. See note 4 *supra*.