



Kentucky Law Journal

Volume 13 | Issue 1

Article 1

1924

Kentucky Law of Oil and Gas

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Recommended Citation

Willis, Simeon S. (1924) "Kentucky Law of Oil and Gas," *Kentucky Law Journal*: Vol. 13 : Iss. 1 , Article 1.
Available at: <https://uknowledge.uky.edu/klj/vol13/iss1/1>

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KENTUCKY LAW JOURNAL

Volume XIII

NOVEMBER, 1924

Number 1

KENTUCKY LAW OF OIL AND GAS.

Mr. Justice Holmes, in his classic work on "The Common Law" (p. 312), keenly observes that "the distinctions of the law are founded on experience, not on logic." No branch of law better illustrates the truth of the observation than that concerned with oil and gas, which has developed almost entirely from experience, and differs from other law because the substances with which it deals are different from every other species of property. There are analogies in the law, but no counterparts.

In recent years there has been a prodigious growth of decisions and legislation in Kentucky so that now there is quite a large volume of relatively new law upon this subject. A review of the principles and policies thus far settled may prove interesting and useful to the profession.

STATUS.

In an early case (1854), *Hail v. Beed*,¹ it was decided that when oil is drawn from a well by a trespasser, the oil thus taken is personal property, and the owner of the well may recover it by action of detinue, or its value in an action of trover.

The legal status of oil and gas, debated for many years, is now established. They are minerals, and a part of the real estate in which they are found, and possess all the incidents of real estate.²

¹ 15 B. Mon. 479.

² *Lovelace v. Southwestern Pet. Co.*, 267 Fed. 504 (D. C.), 267 Fed. 513 (C. C. A.); *Kader v. Shaffer*, 186 Ky. 802; *Scott v. Laws*, 135 Ky. 440; *Wolfe Co. v. Beckett*, 127 Ky. 253; *Beckett-Iseman Oil Co. v. Backer*, 165 Ky. 818; *Kash v. United Star Oil Co.*, 192 Ky. 422; *Kentucky Coke Co. v. Keystone Gas Co.*, 296 Fed. 320.

A contract respecting oil and gas must be in writing and duly signed by the party to be bound, under the statute of frauds, sec. 470.³

Oil and gas wells and leases are taxable estate,⁴ and are subject to the same rules of conveyance, reservation, and exception. A conveyance or reservation of minerals, without qualifying words, includes the oil and gas that may be found therein.⁵ But if the instrument contains qualifying words indicating only minerals of a particular class, it is presumed to intend the class or kind indicated only, and such intention is given effect.⁶

It is upon such distinction only that the cases can be reconciled. The principle seems to be that the intention of the grantor controls; that the term "minerals" alone is not ambiguous, but comprehensive, and ambiguity is only introduced by adding words which seem to limit the things embraced to the kinds of things specified or indicated by the character of privileges coupled with it, and upon which operations for the minerals depend.

STATUTES.

As early as 1900, a law was enacted investing oil and gas companies with the power of eminent domain (sec. 3766-b Ky. Stat.), which power has been frequently exercised.⁷

The Acts of 1891-93 provided for the confinement of gas in wells until utilized, for the proper plugging of abandoned wells, and a means for adjacent owners to protect themselves in the event of failure of the owner to obey and observe the statute. This act was sustained and enforced.⁸

³ *Lowther v. Scheirch*, 195 Ky. 177, 241 S. W. 834.

⁴ *Wolfe County v. Beckett*, 127 Ky. 252; *Associated Producers Co. v. Board of Supervisors*, 202 Ky. 538; *Raydure v. Board of Supervisors*, 183 Ky. 84; *Commonwealth v. Garrett*, 202 Ky. 548.

⁵ *Blackely v. Wilson*, 190 Ky. 697; *Scott v. Laws*, 185 Ky. 440; *Ky. Diamond & Dev. Co. v. Ky. Transvaal Diamond Co.*, 141 Ky. 97; *Lovell v. S. W. Pet. Co.*, 267 Fed. 513

⁶ *McKinney v. Central Ky. Nat. Gas Co.*, 134 Ky. 239; *Hudson, et al. v. McGuire*, 188 Ky. 724.

⁷ *Ky. Heating Co. v. Calor Oil and Gas Co.*, 146 Ky. 414; *Calor Oil & Gas Co. v. Franzell*, 128 Ky. 715; *Cincinnati Gas Co. v. Cartee*, 149 Ky. 89.

⁸ *Commonwealth v. Trent*, 177 Ky. 34.

An adjoining owner will not be allowed to waste with impunity the gas from his own land.⁹

In attacking the law, it was plausibly argued that the owner of the gas had a right to do as he pleased with his own property with which the Legislature was powerless to interfere. But as the rights of others and the public were thereby affected the waste of a valuable public resource was held to be a proper subject for the application of the police power of the state.¹⁰

The subject is now regulated by a statute (Ch. 100. Ky. Stat.) which provides in detail the duties of all persons relating to the care of abandoned wells. By various acts pipe line companies are fully regulated (sec. 3766b-1a to 3766b-6C), and made common carriers.¹¹

Provision has been made for leasing the land of infants and incompetents (sec. 2031a-4), and a rather intricate judicial procedure is outlined. Prior to the passage of this enabling act, guardians could not lease the land of infants for oil and gas development.¹²

In 1918 an oil production tax license law was enacted which has been construed in certain particulars by the Court of Appeals (sec. 4223C Ky. Stat.).¹³

Royalty owners are taxable on the leases as a separate item of real property under secs. 4020, 4022, 4039 Ky. Stat., and Sec. 172 Ky. Const.¹⁴

The Act of March 18, 1920 (Sec. 3766b-2c) undertakes to regulate oil and gas leases, and the construction thereof. It purports to validate existing leases, to abrogate the rule of this State hastening development upon reasonable notice, if rentals are paid or tendered according to the terms of the lease, and to make a rather arbitrary regulation regarding off-set wells applicable throughout the State regardless of the particular facts or conditions.

⁹ *Louisville Gas Co. v. Ky. Heating Co.*, 77 S. W. 368.

¹⁰ *Ohio Oil Co. v. Indiana*, 177 U. S. 190.

¹¹ *Hall v. Cumberland Pipe Line Co.*, 193 Ky. 728.

¹² *York v. Warren Oil & Gas Co.*, 171 Ky. 157, 209 S. W. 19.

¹³ *Raydure v. Board*, 183 Ky. 84; *Associated Producers Co. v. Board*, 202 Ky. 538, 260 S. W. 335.

¹⁴ *Mt. Sterling Oil & Gas Co. v. Ratliff*, 127 Ky. 1; *Com. v. Garrett*, 202 Ky. 548, 260 S. W. 379.

The Court of Appeals held that this Act did not apply to a lease already forfeited when it was passed;¹⁵ or to the assertion of grounds of forfeiture existing prior to its passage;¹⁶ or to suits filed before it became effective, as it was not retroactive;¹⁷ and finally that it did not apply by reason of constitutional objections to any lease executed and outstanding when the Act went into effect.¹⁸

The Court of Appeals of Kentucky has never upheld or enforced the Act, but the United States Circuit Court of Appeals for the Sixth Circuit has held the Act constitutional as applied to leases executed subsequent to the date it became a law.¹⁹ The opinion is an able one, and if the hypothesis upon which it proceeds is accepted, the argument is sound. It is predicated upon the reasoning that the basis of the Act is public policy, the determination of which is a legislative, and not a judicial function. The effect of the Act, if valid, is to overturn a long line of decisions beginning with *Monarch Oil & Gas Co. v. Richardson* (124 Ky. 602), and ending with *Union Gas & Oil Co. v. Indian Tex Petroleum Co.* (203 Ky. 521, 263 S. W. 1) to the effect that failure, after refusal of rentals and upon reasonable notice, to develop the lease terminates all rights thereunder.

In such circumstances, a judicial declaration of the forfeiture is not a prerequisite to a new lease.²⁰ Indeed, the execution of a new lease is itself sufficient avoidance of the old one, when the right to avoid exists.²¹

The foundation of this rule is not public policy, as seems to be assumed by the Federal Court in its opinion in *Roberts v. Atlantic Producing Co.*, 295 Fed. 16, but it is a construction of the terms of the lease itself to effectuate the intention of the parties; it being implied from a lease otherwise silent upon the subject, that it was intended that the property should be developed within a reasonable time.

¹⁵ *Hunt v. Garvin*, 190 Ky. 472, 227 S. W. 811.

¹⁶ *Sugg v. Williams*, 191 Ky. 188, 229 S. W. 72.

¹⁷ *Keystone Gas Co. v. Salisbury*, 192 Ky. 643; *Maverick Oil & Gas Co. v. Howell*, 193 Ky. 433, 237 S. W. 40.

¹⁸ *Union Gas & Oil Co. v. Diles*, 200 Ky. 188; *Oil Fork Dev. Co. v. Huddleston*, 202 Ky. 261, 259 S. W. 334.

¹⁹ *Roberts v. Atlantic Producing Co.*, 295 Fed. 16.

²⁰ *Union Gas & Oil Co. v. Indian Tex. Petr. Co.*, 199 Ky. 334.

²¹ *Brooks v. Day Oil Co.*, 200 Ky. 323, 251 S. W. 1008.

In the pioneer case (*Monarch Oil & Gas Co. v. Richardson*, 124 Ky. 602), it was expressly stated that the lease contract should be so construed as to carry out the intention of the parties at the time it was entered into, and "this contract can be so construed as to effectuate the intention of the parties in a manner that will do justice to the lessor as well as the lessee without arbitrarily cancelling it." It was upon that basis that the Court evolved the now famous doctrine that the lessor must first refuse rentals, demand development, and wait a reasonable period for that purpose. That such was the foundation and reason for the rule is accentuated by the later cases.²²

As an additional emphasis of the fact that it is not public policy, but an implied covenant, upon which the rule rests, the Court of Appeals has held that the lessor may not act arbitrarily,²³ or within a period for which rentals have been paid,²⁴ and that a course of conduct tolerating delay in development and tardy payment of rentals estops the lessor from asserting a forfeiture upon such grounds,²⁵ nor can the lessee forestall the lessor by tendering rent before it is due²⁶ If the rule had been grounded upon public policy, the lessor equally with the lessee would be affected by it, and could not frustrate that policy any more than the lessee; and the view that acceptance of rentals, or any other acts, would estop the lessor, could not have prevailed.

It seems clear that the rule was not founded on public policy, but expressly and consistently upon an implied covenant from the terms of the lease itself. The reference in some of the opinions to public policy is that the construction accepted accords therewith because it promotes development of the natural resources of the State. Public policy served as an argument in support of the rule, but was not the origin of it. This position is well illustrated by the opinion of the Court in *Daven-*

²² *Dinsmoor v. Combs*, 177 Ky. 740; *Bell v. Kilburn*, 192 Ky. 809; *Warren Oil & Gas Co. v. Gilliam*, 182 Ky. 809; *Keystone Gas Co. v. Salisbury*, 192 Ky. 647; *Union Gas & Oil Co. v. Indian Tex Petroleum Co.*, 199 Ky. 384; *Plumber v. Southern Oil Co.*, 185 Ky. 248; *United Fuel Gas Co. v. Adams*, 198 Ky. 283; *Swiss Oil Corp. v. Howell*, 199 Ky. 763.

²³ *Ohio Valley Oil & Gas Co. v. Irvine Development Co.*, 184 Ky. 520.

²⁴ *McNutt v. Whitney*, 192 Ky. 134.

²⁵ *Denniston v. Kenova Oil Co.*, 187 Ky. 831, 220 S. W. 1078.

²⁶ *Satterfield v. Galloway*, 193 Ky. 780, 234 S. W. 448.

port v. Schoenfelt (191 Ky. 234, 229 S. W. 1023) where it is said:

"The lease contract under consideration is in terms much like other oil leases, the principal consideration for the execution of which we have held to be speedy development, and not the nominal sum paid for the lease or the small rental reserved. Our public policy demands progressive development of all our mineral resources, such as oil, gas, coal and other minerals, and long term leases held by persons, who do not in good faith contemplate early development, are not and should not be countenanced by the courts where they hinder or delay the progress of industry. Pursuing this policy and recognizing well established principles of equity, we have held that an oil lease, which provides for speedy development, and which was induced by that condition, may be avoided by the landowner, if, after reasonable time has expired for drilling wells, none have been in good faith commenced and the lessor has refused to accept rentals in lieu of development, and has notified the holder of the oil lease that cancellation of the contract will be demanded, if he does not within a reasonable time thereafter begin in good faith the drilling of a well or wells."

The distinction is a vital one in determining the constitutionality of the Act of March 18, 1920. If the Act is an exertion of the legislative power, it is valid; but if it is the attempted exercise of judicial power, it transcends the authority of the Legislature.

The opinion in *Roberts v. Atlantic Prod. Co.*, 295 Fed. 16, proceeds from the premise that the Kentucky rule first announced in the *Monarch Oil & Gas Co.* case, and since followed in many cases, was founded wholly upon public policy, and as the fixing, declaring, and changing of public policy is a legislative function, the Act of 1920 effectively supplanted the whole body of law in conflict therewith that had grown up in Kentucky from the *Monarch* decision in 1907. But if the rule was not grounded on public policy at all, but upon an implied term of the lease, as it undoubtedly was, then the Act of 1920 is an abortive attempt of the Legislature to control the courts in the construction of private contracts, and the reasoning of the *Roberts* opinion does not apply. The construction of contracts is a judicial function, and the legislative authority is powerless to circumscribe the courts in purely judicial functions, because it is forbidden by the Constitution.²⁷

"Whether a given statute is intended simply to establish a rule of substantive law, and thus to define the duty of the court, or is meant

²⁷ 23 Cyc. 1619-1620; Ky. Constitution, sections 27-28; *U. S. v. Klein*, 13 Wall. 728, 20 L. Ed. 519.

to limit its power, is a question of construction and common sense." *Fauntleroy v. Lunn*, 210 U. S. 230, 52 L. Ed. 1039.

Tested by this rule, the Act of 1920 treads perilously near, if it does not pass, the border line that separates the legislative from the judicial power.

The obvious, if not the declared, purpose of the Act of 1920 is to abrogate the rule of construction adopted in the *Monarch* case. It is a direction by the legislative power to the courts how to exercise the judicial power in particular cases regardless of the facts, and it remains to be seen whether the Court of Appeals will follow the Federal Court in the *Roberts* case or wholly disregard the Act of March 18, 1920 as an unwarranted invasion of the judicial power.

The Federal Courts follow the state supreme courts on these questions,²⁸ and it is regrettable that the question did not reach the State Court before it had to be determined in the Federal Court; yet if the State Court holds the Act void, it will be so treated in the Federal Courts, notwithstanding the *Roberts* decision.

We shall await with lively interest the decision of the Court of Appeals of Kentucky upon this important question; for if the Act should be sustained, it would work radical changes in many ways in the law regulating oil and gas production, especially as to the validity and interpretation of leases, and as to off-set wells required to protect against drainage through adjacent lands.

LEASES.

Development of oil and gas property is seldom attempted by the landowner. The customary method is by lease with covenants, or upon conditions reserving a royalty to the landowner. Out of this practice most of the litigation upon the subject has arisen. There are, of course, many forms of leases, and each lease must be dealt with according to its own peculiar terms. But speaking generally, there are two types most commonly encountered. They are executed and executory leases, and are sometimes characterized as "or" and "unless" leases.

²⁸ *Lyon v. U. G. & O. Co.*, 281 Fed. 674.

In *Hopkins v. Ziegler* (259 Fed. 43) it is said:

"A covenant that the lessee will do one thing or will do another may impose a binding obligation, although in the alternative, and does not import any fatally optional or unilateral character. It is, therefore, held not inappropriate to a lease which grants a vested interest; but a lease which does not continue to be in effect, unless the lessee does a certain act, is only executory, and is inoperative if the condition is not performed."

This classification must be borne in mind in order to understand and harmonize the decisions on the various leases. An executed lease with covenants either to pay rental or to develop the property is universally held to be valid and enforceable.²⁹

In the absence of a forfeiture clause in the lease, failure to perform a covenant, either to drill or pay, does not forfeit the lease or afford grounds therefor.³⁰ But in an executory, or "unless" lease, a failure to observe the terms of the condition automatically ends the lease. Speaking accurately, it is not a forfeiture, but a termination of the lease by its own terms.³¹

It has been held that a covenant to pay rental or drill a well is a good consideration to support a lease,³² while one dollar alone, without covenants, is not good consideration, and a lease so given is unilateral, void, and unenforceable so long as it remains executory.³³

An important practical question is the duration of the lease. It is customary for a lease to fix a definite term of years, and then to provide for a continuance "so long as oil is produced in paying quantities." It is generally held that the lease ends at the period fixed, unless oil or gas is then being produced in paying quantities. Nothing less than the production of oil or gas in paying quantities will prolong such a lease.³⁴

What constitutes production in paying quantities has been

²⁹ *Hughes v. Parsons*, 183 Ky. 584; *Warren O. & G. Co. v. Gilliam*, 182 Ky. 807, 207 S. W. 698.

³⁰ *Trammel Creek Coal Co. v. Sarver*, 197 Ky. 94, 247 S. W. 753; *Kies v. Williams*, 228 S. W. 40, 190 Ky. 596; *Wilson v. Purnell*, 199 Ky. 218, 250 S. W. 850.

³¹ *Brooks v. Day Oil Co.*, 200 Ky. 323; *Union Gas & Oil Co. v. Wright*, 200 Ky. 791, 255 S. W. 697; *Union G. & O. Co. v. Jess Rose, et al.*, 202 Ky. 236, 259 S. W. 57.

³² *Hughes v. Parsons*, *supra*; *Guffey v. Smith*, 237 U. S. 101.

³³ *Berry v. Frisbie*, 120 Ky. 357; *Soaper v. King*, 167 Ky. 121; *Young v. McIlhenny*, 116 S. W. 728; *Kilbrew v. Murray*, 151 Ky. 345.

³⁴ *Union G. & O. Co. v. Adkins*, 278 Fed. 854; *Enfield v. Woods, et al.*, 198 Ky. 328, 248 S. W. 842.

a fruitful subject of dispute. Some courts have held that the operator is the sole judge of that question, but the sounder and better rule is that it is a question of fact of which neither party is the arbiter.³⁵ A mere showing of oil is not sufficient to prolong the lease, but there must be actual production in sufficient quantities to pay the expense of operation and still leave a profit.³⁶ In *Union Gas & Oil Co. v. Adkins* (278 Fed. 854) it was observed that deference was due the operator, especially as to gas development, but if the extension of the term of a lease is made to depend upon a fact, the finding of that fact is a judicial question.

It has been held, however, in one case owing to the peculiar form of the lease, which seems to be a novelty, that it was extended a reasonable time beyond the period fixed for the production of oil, although there was no production, because the right to commence a well was paid for within the life of the lease, which implied a reasonable time to complete it, and if when completed, it was a producer, the lease was extended.³⁷ But as a general principle, at the end of the period fixed, the lease expires unless there is actual production of oil or gas, or there are some peculiar facts which affect the rule; which principle is perfectly sound and inevitable from the terms employed in such leases.

It is sometimes important to determine whether a provision in a lease is a covenant or a condition, for the reason that in the case of a covenant it may be enforced by action,³⁸ and in the absence of a forfeiture clause, the remedy may be exclusive, except as to the proceedings by notice to develop;³⁹ whereas, if it is a condition, the condition must be performed or the lease ends. Failure to perform the condition does not give rise to a right of action, but discharges the obligations of the lease. Failure to keep a covenant requires affirmative action for relief, while breach of a condition automatically ends all rights, and leaves the lessor free to act.⁴⁰

³⁵ *Brewster v. Lanyon Zinc Co.*, 140 Fed. 802.

³⁶ *Reynolds v. White Plains O. & G. Co.*, 199 Ky. 243, 250 S. W. 975.

³⁷ *Lester v. Midsouth Oil Co.*, 296 Fed. 661.

³⁸ *Lockhart v. Atwood*, 248 S. W. 843, 198 Ky. 324; *Central Oil Co. v. Sandlin*, 244 S. W. 882, 196 Ky. 422.

³⁹ *Turner v. Lick Creek O. & G. Co.*, 234 S. W. 191, 192 Ky. 580.

⁴⁰ *Young v. McIlhenny*, 116 S. W. 728; *Hopkins v. Ziegler*, 259 Fed.

The duration of a lease is also affected by development clauses and by implied covenants. The development clause may greatly shorten a lease. It is usual to provide that if development is not commenced or completed within a fixed time, the lease ends; but this is protected against by a promise to pay rental for the delay, or by a condition that payment of a rental may prevent termination of the lease for a certain period. These clauses are strictly construed to promote development.⁴¹

No covenants are ever implied in opposition to the express terms of a lease, but there are many implied covenants consistent with the terms, or where the lease is silent, deduced from the necessary intention of the parties manifested by the lease. There is an implied covenant to develop the leased premises within a reasonable time, unless the lease gives a specific time for development;⁴² and when the presence of oil is demonstrated, there is an implied covenant to continue development to the capacity of the property,⁴³ and if oil is produced from adjoining lands, a covenant to protect by offset wells is implied.⁴⁴ If the implied covenant to continue development with due diligence is disregarded for a substantial period of time, the lease may be treated as abandoned and new contracts made respecting it.⁴⁵

In some jurisdictions abandonment is presumed when the operations have been suspended for three months,⁴⁶ and authorities upon the subject are referred to in the opinion of the Chief Justice in *Hails v. Johnson* (note 45).

In Kentucky, as we have seen, it has been held for many years that there is an implied covenant to develop the land within a reasonable time, but as a condition, the courts have required reasonable notice to be given, demand made, and rentals refused.⁴⁷ The rule imports into every oil and gas lease (at least those made before March 18, 1920) even if for a definite term, a condition that it shall continue for only a reasonable

⁴¹ *Jenkins v. Williams*, 191 Ky. 165, 229 S. W. 84; *Reynolds v. W. P. O. & Gas Co.*, 250 S. W. 975, 199 Ky. 243.

⁴² *Logan Natural Gas Co. v. Great Southern Gas Co.*, 126 Fed. 623.

⁴³ *Penn. Lub. Co. v. Backer*, 121 Ky. 637; *Hails v. Johnson*, 204 Ky. 94.

⁴⁴ *Union G. & O. Co. v. Diles*, 200 Ky. 188.

⁴⁵ *Hails v. Johnson*, 204 Ky. 94.

⁴⁶ *Kennedy v. Crawford*, 138 Pa. 561.

⁴⁷ *Monarch O. & G. Co. v. Richardson*, 124 Ky. 602; *Ocala Oil Co. v. Hughes*, 187 Ky. 486, 219 S. W. 799.

time, unless by the lessor's continuing consent, and applies equally to "or" and "unless" leases.⁴⁸

But as applied to "unless" leases, it is an imperfect remedy involving delay and litigation, which could be avoided by refusing to pay rentals and thus terminating the lease, a result that automatically follows failure to pay, or delayed tender.⁴⁹

In such leases, there is an option to continue the lease by paying rentals, but no obligation to do so. In the absence of an initial consideration sufficient to support the option the lessee would not be obligated to accept a tender of rental, as the mutuality required in contracts would be lacking. In the absence of covenants or actual operations by the lessee, a nominal consideration would not support the option, and the lessor could end the lease by refusing to receive, just as the lessee could by declining to pay rentals. This is the unequivocal effect of the decisions of the Court of Appeals of this State, already mentioned. It is well settled doctrine in Kentucky that one dollar is a nominal, and not a substantial consideration, and insufficient to support an executory contract.⁵⁰

The U. S. Circuit Court of Appeals has refused assent to the proposition that an "unless" lease is void from the beginning.⁵¹ The reasons assigned were that the doctrine of the *Monarch* case removes all features of unfairness that might otherwise obtain, and the previous decision of that Court in *Allegheny Oil Co. v. Snyder* (106 Fed. 7764) which was written upon Ohio Law by a judge who was an Ohio lawyer. It was there held that the initial consideration of one dollar supported both the lease and the option to extend it. But this finding cannot be reconciled with the Kentucky decisions upon the subject; and the doctrine of the *Monarch* case does not help out an

⁴⁸ *Lyon v. Union Gas & Oil Co.*, 281 Fed. 674; *U. G. & O. Co. v. Indian Tex Pet. Co.*, 199 Ky. 384, 251 S. W. 1008.

⁴⁹ *Hopkins v. Ziegler*, 259 Fed. 49; *Union G. & O. Co. v. Wright*, 200 Ky. 791, 255 S. W. 697.

⁵⁰ *Berry v. Frisbie*, 120 Ky. 357; *Murphy v. Reed*, 125 Ky. 885; *Noble v. Mann*, 105 S. W. 152; *Killebrew v. Murray*, 151 Ky. 345; *Stamper v. Combs*, 164 Ky. 733; *Litz v. Goosling*, 93 Ky. 185; *Walton v. Franks*, 191 Ky. 32; *B. K. M. & T. Co. v. Swann-Day*, 148 Ky. 82; *Young v. McElhanny*, 116 S. W. 728.

⁵¹ *Leeper v. Neely*, 293 Fed. 967; *Miller v. Union G. & O. Co.*, 295 Fed. 29.

unilateral lease for reasons well stated by the Circuit Court of Appeals in *Hopkins v. Ziegler*, 259 Fed. 49.

A covenant to pay royalty on oil produced, without any sort of obligation, either express or implied, to produce oil, is illusory, and was apparently first suggested in the Miller case (295 Fed. 29) as an element of consideration to help out the dollar first paid. After operations have been commenced, the option is exercised, and an implied obligation arises to continue work until the lease is fully developed; but in the absence of real consideration, present covenants, or actual operations an "unless" lease cannot be considered valid in Kentucky in the present state of the decisions.

An election to proceed by notice may estop the lessor from asserting any other remedy,⁵² but until the election is actually made, it would seem clear that the lessor in an "unless" lease has available the two recognized remedies for relief.

As to what constitutes a reasonable time for development is a question of fact to be determined from the attending circumstances. It would appear that one year is conclusively presumed to be sufficient.⁵³ Even three or four months may be sufficient.⁵⁴ But twenty-five days have been held to be inadequate.⁵⁵

All the circumstances, including location, roads, weather and markets, must be considered and sufficient time allowed so that with reasonable diligence that which is required may be performed. But an absolute obligation to develop within a fixed time is not affected by such circumstances.⁵⁶

The general rule of equity that forfeitures are not favored does not apply to oil and gas leases, on account of their peculiar nature; and any breach of covenant, if so provided in the lease, will work a forfeiture, because the rule encourages development of mineral resources, and is deemed to be just in practical operation, and promotes a public policy long considered sound.⁵⁷

⁵² *Lyon v. U. G. & O. Co.*, 281 Fed. 674.

⁵³ *Monarch Oil & Gas Co. v. Richardson*, 124 Ky. 602; *Union Gas & Oil Co. v. Indian Tea Pet. Co.*, 199 Ky. 384, 251 S. W. 1008.

⁵⁴ *Maverick Oil & Gas Co. v. Howell*, 193 Ky. 433, 237 S. W. 40; *Key-stone Gas Co. v. Salisbury*, 192 Ky. 647, 234 S. W. 290.

⁵⁵ *Swiss Oil Corp. v. Howell*, 199 Ky. 763, 251 S. W. 1007.

⁵⁶ *Niles v. Meade*, 189 Ky. 243, 224 S. W. 854.

⁵⁷ *Jenkins v. Williams*, 191 Ky. 165; *Kies v. Williams*, 190 Ky. 596.

The notice is not required to be in any particular form, or even written, but must be a sufficient ultimatum to put the lessee on his guard and to advise him of the consequences of failure to proceed.⁵⁸

It is a common practice to insert a so called "surrender clause" in an oil and gas lease for the purpose of enabling the lessee to surrender the lease and escape its burdens. While the Kentucky Court has not expressly dealt with such provisions, many leases containing them have been held valid. The decision in *Guffey v. Smith* (237 U. S. 101, 59 L. Ed. 856) has been regarded as settling any question of legality on that score. The United States Supreme Court there said:

"Some criticism is directed against the reserved option to surrender, but it is difficult to perceive how it could be declared inequitable. If it was not exercised, the lessee would be bound by his covenants, and if exercised, the lessor would be free to deal with the premises as he chose."

Agreements incorporated in a lease will be respected and enforced according to their terms. While a lessor is generally entitled to the payment of rentals, until royalties begin,⁵⁹ nevertheless an agreement that the drilling of a well shall operate as a liquidation of all rentals is valid whether the well turns out to be a producer or a dry hole.⁶⁰

Where the lessor prevents payment of the agreed rentals by absenting himself from the State,⁶¹ or where he procures or causes the lessor to expend money in development,⁶² he is estopped to claim a forfeiture of the lease, whatever grounds therefor he might otherwise have had. The acceptance of rentals by a lessor likewise prevents a forfeiture, but a widow cannot bind the heirs by the acceptance of rentals after the death of her husband who was the lessor, even tho she joined in the lease to release prospective right of dower,⁶³ nor can a designated bank

⁵⁸ *Great Western Petr. Corp. v. Samson*, 192 Ky. 814, 234 S. W. 727; *Lowe v. Brood Bottom M. Co.*, 194 Ky. 88, 238 S. W. 192.

⁵⁹ *Sugg v. Williams*, 191 Ky. 188; *Monarch O. & G. Co. v. Hunt*, 193 Ky. 315, 235 S. W. 772.

⁶⁰ *Bradshaw v. Hurst*, 198 Ky. 38, 247 S. W. 1113; *Stock v. W. Va. Ky. Oil Co.*, 198 Ky. 527, 249 S. W. 751.

⁶¹ *Farrow v. Caudill*, 199 Ky. 290, 250 S. W. 939.

⁶² *Cadillac Oil & Gas Co. v. Harrison*, 196 Ky. 290, 244 S. W. 669.

⁶³ *Jenkins v. Williams*, 191 Ky. 169, 229 S. W. 94.

bind the lessor except in accordance with the precise terms of the lease and while it is in force.⁶⁴

Royalties derived from oil wells opened up on the land after the death of the owner, and not in pursuance of a contract executed by him, usually are considered as part of the corpus of the estate, and not as income therefrom as between life tenants and remaindermen.⁶⁵

Oil wells and other mines which a deceased husband opened on his lands during his life, or which are opened after his death by persons with whom he had made enforceable contracts for that purpose, are real estate of which the widow is dowable.⁶⁶

A life tenant can operate a mine or wells opened or contracted to be opened by the former owner,⁶⁷ but a life tenant alone has no power to lease for oil and gas, and operations under such a lease may be enjoined as waste by the remaindermen.⁶⁸ A lease given by the life tenant and remainderman jointly is valid, and they may agree upon the division of the royalties.⁶⁹

It is held in the case of *York v. Warren Oil & Gas Co.* (191 Ky. 157) that a tenant in common cannot be compelled to lease his lands for oil and gas, against his will, to his cotenant's lessee, but that one cotenant may lease his undivided interest, which lease is valid and binding, and thereby the lessee becomes a cotenant in the mineral; and each can operate for oil and gas, but must respect the prior locations and improvements of the other, and account to the other for his proportion of the minerals according to the rule announced in the case of *New Domain Oil & Gas Co. v. McKinney* (188 Ky. 183).

The application of this decision encounters difficulties in practical operation, because each cotenant must account to the other for one-half of the fruits of the venture, which renders the operation so burdensome on the operator that he cannot take the risk for the reward. It also overlooks Sec. 2332 Ky. Statutes which reads:

⁶⁴ *Brooks v. Day Oil Co.*, 200 Ky. 323.

⁶⁵ *Eager's Gan. v. Pollard*, 194 Ky. 276, 239 S. W. 39.

⁶⁶ *Crain v. West*, 191 Ky. 1., 299 S. W. 51.

⁶⁷ *Goosling v. Pinson*, 198 Ky. 61; *Daniels v. Charles*, 172 Ky. 241.

⁶⁸ *Gerkins v. Ky. Salt Co.*, 100 Ky. 734; *Rose v. U. G. & O. Co.*, 297 Fed. 16.

⁶⁹ *Meredith v. Meredith*, 193 Ky. 192, 235 S. W. 757; *Sparks v. Albin*, 195 Ky. 52, 241 S. W. 321.

"If a tenant in common, joint tenant, or parcener commit waste, he shall be liable to his cotenants jointly or severally for the damage."

And by Section 2334 the damages may be trebled.⁷⁰

The opinion in the York case does not refer to these statutes or prior decisions, apparently in conflict with it, and it would seem clear that one cotenant could prevent by injunction waste committed or threatened by the other.

It has long been held that property removed from a joint estate by one cotenant may be reclaimed by the other in the possession of a purchaser, or the purchaser held liable as for a conversion.⁷¹

It does not seem possible to distinguish the cutting of timber from the extraction of gas, or the removal of oil, and the point was so decided in *Gerkins v. Ky. Salt Co.* (100 Ky. 734), and *New Domain Oil & Gas Co. v. McKinney*, (188 Ky. 183), in which opinions the principle of the Nevells case was recognized and the case cited, along with many others, in support thereof.

It is apparent that further amplification of this question will be required of the Court.

A lease may be assigned in writing, but there is no implied warranty of title,⁷² and an action for damages may be maintained for breach of a contract to reassign leases, even where the original assignor had breached his own warranty as to title and acreage, the damages being confined to the leases which had been originally assigned in full force.⁷³

A person, who enters upon land in good faith and without notice of prior claims, and is dispossessed, is entitled to be reimbursed for his improvements to the extent they have increased the vendible value of the land; but if a person drills upon land for oil and gas with actual or constructive notice of a prior lease, and is dispossessed, he cannot recover for the value of the improvements made, or the expenditures incurred.⁷⁴

It was held in *Wells v. Shadoin* (202 Ky. 456, 260 S. W. 12) that payments of rentals on the basis of a large acreage

⁷⁰ *Winchester v. Watson*, 169 Ky. 213, 183 S. W. 483.

⁷¹ *Nevells v. Ky. Lumber Co.*, 108 Ky. 550.

⁷² *Miles v. United Oil Co.*, 192 Ky. 542, 234 S. W. 209, 19 A. L. R. 602; *Arnett v. Stephens*, 199 Ky. 730, 251 S. W. 947.

⁷³ *Clark v. Cooper*, 197 Ky. 530, 247 S. W. 929.

⁷⁴ *Loeb v. Conley*, 160 Ky. 91, 169 S. W. 575.

could be applied to the actual acreage which was much smaller, and thereby extend the lease; and a purchaser was charged with notice if he was put upon inquiry of the rights of the first lessee.

It was held in *Stark v. Petty Bros.* (195 Ky. 445, 243 S. W. 50) that drillers of oil wells were entitled to a lien for labor and materials under Sec. 2464, Kentucky Statutes, but were limited to the enhancement in value caused by the work. This remedy was illusory, as a dry well would cause as much labor and cost as much money as a productive one, yet would not enhance the value of the lease; but in *Scottsville Oil & Gas Co. v. Dye Bros.* (203 Ky. 496, 262 S. W. 615) the *Stark* case is overruled, and it is held that a driller is entitled to a lien on the leased property for labor and materials used in drilling thereon. By the Act of February 18, 1924, the Legislature has provided a lien for persons who furnish work or supplies in developing oil leases,⁷⁵ and this statute is no doubt exclusive of all other statutes upon the subject, as it is a comprehensive statute on the whole subject.

In *Williams v. McKenzie* (203 Ky. 376, 261 S. W. 598) it is held that oil leases may be executed on school lands under Kentucky Statutes, Sec. 4437, and the oil marketed as by other owners.

In *Wilson v. Purnell* (250 S. W. 850, 199 Ky. 218) it is held that a completion of a well on one of several tracts covered by one lease prevents forfeiture as to the other tracts; but there was no forfeiture clause in the lease there involved, which was a sufficient reason for the conclusion reached. The ruling regarding production on one tract satisfying the demand for development on other tracts was based on a West Virginia case.⁷⁶

The soundness of the principle is not beyond doubt, unless there is a provision in the lease to qualify the usual implication that upon the discovery of oil or gas in paying quantities, full development must be prosecuted with reasonable diligence. But no doubt a lease could be so framed as to delimit the extent to which development could be exacted; and a stipulation that a well on one tract should be sufficient to discharge either an express or an implied obligation to develop several tracts, would

⁷⁵ Acts 1924, page 166.

⁷⁶ *Harness v. Eastern Oil Co.*, 49 W. Va. 232, 38 S. E. 662.

be valid. It is likely that the opinion cited goes no further than this, which accords with the authorities.

It is obviously impracticable, if not wholly impossible, within the compass of a single article of reasonable length to advert to all the decisions of even one state on the important subject of oil and gas, and collateral subjects closely akin, such as titles, contracts, pleading and practice, and damages; but sufficient has been adduced to show that Kentucky now possesses a real and extensive jurisprudence upon the subject, worthy of study and understanding.

The cases cited will be found to contain much valuable information and authority on correlated and collateral questions, not logically embraced within the subject matter of this paper. Our Court of Appeals has displayed great ability and industry in dealing with the many difficult questions that have arisen, and we venture to believe that it has contributed very substantially to the progress and development of the law of oil and gas.

The decisions vindicate entire accuracy of the dictum of Justice Holmes that "The life of the law has not been logic, but experience."

S. S. WILLIS, *Ashland, Kentucky.*