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Mines and Minerals--Extent of Implied Obligation of Development in Oil and Gas Lease

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OIL AND GAS

MINES AND MINERALS — EXTENT OF IMPLIED OBLIGATION OF DEVELOPMENT IN OIL AND GAS LEASE

Lessor executed in 1916 a term "unless" oil and gas lease covering a half section and an adjoining one-sixteenth section, or 360 acres in all. During the ten-year primary term, the lessee drilled two small paying wells on the adjoining one-sixteenth section. These were later claimed to keep the entire lease alive as long as there was production in paying quantities. No further drilling occurred anywhere on the property. Then lessee and subsequent assignees asserted that neighborhood dry holes indicated further drilling in either the Bartlesville sand or the Mississippi lime throughout the rest of the estate would prove unprofitable. With the half section wholly untouched and no indication of immediate activity on the part of the lessee, lessor in 1929 sued for cancellation of the lease as to the undeveloped portion thereof. Upon removal on diversity grounds by the lessee's assignee, the trial Federal court decreed cancellation except as to a small tract surrounding the two producers. An appeal was taken to the Circuit Court of Appeals. *Held*: (one judge dissenting) There was no breach of the implied obligation to develop where the geological information at hand tended to indicate that the half section could not be operated profitably. Judgment reversed. (Petition for writ of certiorari pending). *Mid-Continent Petroleum Corp. v. Sauder, et al.*[1]

The implied obligation to develop is a reasonable relational incident imposed by law.[2] It is made a covenant or condition by necessary implication where royalty is the chief consideration which induced the contract[3] and such implication is as effectually one of the terms of the lease as if it had been expressed.[4] Drilling and/or developing is especially to be inferred to be the chief consideration for the lease when the initial down-payment is small.[5] The implied obligation to reasonably develop exists without regard

[1] 67 F. (2d) 9 (C. C. A. 10th, 1933).
[2] Peoples Gas Co. v. Dean, 193 Fed. 938, 113 C. C. A. 566 (1911); Allen v. Colonial Oil Co., 92 W. Va. 689, 115 S. E. 842 (1923).
[3] Mills v. Hartz, 77 Kan. 218, 94 Pac. 142 (1908); Brewster v. Lanyon Zinc Co., 140 Fed. 801 (C. C. A. 8th, 1905).
[4] Brewster v. Lanyon Zinc Co., *supra* n. 3.
[5] Day v. Kansas City Pipe Line Co., 87 Kan. 617, 125 Pac. 43 (1912).

to whether the lessee's interest may be a fee simple determinable,[6] a *profit à prendre*,[7] or an incorporeal right.[8] The leading case dealing with partial cancellation of oil and gas leases for the failure to reasonably develop is *Brewster v. Lanyon Zinc Co.*,[9] which holds that neither of the parties is the arbiter of reasonableness in development[10] but that the development must be that of a reasonable and prudent man. The other view is that the good faith of the lessee is the test, based on prevailing economic circumstances.[11]

Because each case is of necessity determined on its own factual situation, the rules of one case may not be applicable to the facts of another: thus, the hopeless diversity of decisions on, seemingly, similar facts. In a recent Circuit Court of Appeals decision[12] it was held that twelve wells scattered over a 10,000 acre tract constituted reasonable development where the evidence showed no threat of drainage, that further development of it would result in loss, and the absence of proof that a reasonable man would develop it; yet the lessee also asserted that the property had production possibilities and that he would develop on change of conditions. On the other hand, in an earlier Circuit Court of Appeals decision[13] it was held that two producing gas wells on a tract of 900 acres were not reasonable development, even though the

[6] In Texas after oil or gas has been produced in paying quantities under an habendum clause the lessee's right in the land is a fee simple determinable, termination on failure to extract oil or gas.
Mon-Tex Corp. v. Poteet, 118 Tex. 546, 19 S. W. (2d) 32, 33 (1929); Cosden Oil Co. v. Scarborough, 55 F. (2d) 634 (C. C. A. 5th, 1932).

[7] In Kansas when the lessee has fulfilled the requirement of the "habendum" clause his interest is a 'profit a prendre'. Brinkman v. Empire Gas & Fuel Co., 120 Kan. 602, 245 Pac. 107 (1926).

[8] In West Virginia it is held that the lessee has after oil or gas has been produced an incorporeal interest in the land. State v. South Penn Oil Co., 42 W. Va. 80, 24 S. E. 688 (1896).

[9] *Supra* n. 3.

[10] The West Virginia court has adopted the test in the case, Brewster v. Lanyon Zinc Co., *supra* n. 3. In Hays v. Bowser, 110 W. Va. 323, 325, 158 S. E. 169, 170, the court says "we are committed to the view that the implied duty of the defendant to sink additional wells in this case depended on whether (a) the plaintiff's land needed protection from drainage of oil and gas through adjoining tracts, or (b) operators of oil and gas of ordinary prudence and experience in the same neighborhood and under similar conditions had been proceeding successfully with the further development of their lands or leases; and whether such additional wells would likely have been to the mutual profit of both lessors and lessee."

[11] Note (1929) 7 TEX. L. REV. 438, 443, "i. e. prevailing market conditions, storage costs saved by leaving the mineral in situ, policy of discovery rather than producing, holding up for further development to effect advantageous purchases in the region."

[12] Cosden Oil Co. v. Scarborough, *supra* n. 6.

[13] White *et. al.* v. Green River Gas Co., 8 F. (2d) 261 (C. C. A. 6, 1925).

lessee's assignee alleged that the pressure was too low to transport it to a distant market. A more difficult problem arises where adjoining tracts of heterogeneous nature are held under a single lease, and where it is contended that drilling of wells on one tract of the lease is development of all the leased tracts.[14]

The principal case, seemingly, has gone far in permitting the lessee to be the arbiter in determining what is reasonable diligence. So long as mineral is not drained away and lessee has a producing well, he may hold all of the tract for speculative purposes and prevent development, by merely asserting that geological inferences lead to the conclusion that there is not sufficient underlying mineral to warrant drilling. This assertion the court approves, despite knowledge that geological inferences are fallible, and though the effort of the lessee's assignee in court to prevent cancellation is inconsistent with the stand that minerals do not exist in such quantities as to warrant further developing.

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MINES AND MINERALS — PARTIAL CANCELLATION OF OIL AND GAS LEASE

Suit in equity was brought against the lessee holding under a renewal term "or" oil and gas lease, either to obtain cancellation by reason of alleged fraudulent drainage or to compel further development of the property, in addition to the well already drilled by lessee. The trial chancellor, on testimony offered by the heirs of the lessor, decreed the drilling of an additional well, with the possibility of a second, or payment of royalty therefore, — and, in default thereof, that there be cancellation, (R., p. 324), as to all *except* 37 1/3 *acres around the present producing well.* Lessee appealed. *Held*: Where allegations and proof establish with reasonable certainty fraudulent drainage, lessee may be compelled to sink an offset well (and here but one), or "submit to a forfeiture of all, except an acreage around the well theretofore drilled under the lease." Accordingly, lower court decree modified and affirmed. *Adkins v. Huntington Development & Gas Co.*[1]

The instant decision as to partial cancellation must be dis-

[14] Gypsy Oil Co. v. Cover, 78 Okla. 158, 189 Pac. 540 (1920); *cf.* Pierce Oil Corp. v. Schacht, 75 Okla. 101, 181 Pac. 731 (1919).

[1] 168 S. E. 366 (W. Va. 1933).