Denver Law Review

Volume 34 | Issue 5 Article 9

May 2021

Mines and Minerals - Implied Covenants in Oil and Gas Leases - Implied Coveneant to Further Explore

Marilyn Cimino

Mines and Minerals—Implied Covenants in Oil and Gas Leases—Implied Covenant to Further Explore

By MARILYN CIMINO

Marilyn Cimino is a student at the University of Denver College of Law.

The heirs of Mary Bryson, deceased lessor of certain oil leases, brought suit against the lessee's assignee, Willingham, to cancel his lease on the ground that the assignee had breached the implied covenant of further reasonable exploration. In the alternative, the lessors asked that Willingham be compelled to explore further under penalty of forfeiture. Of the four wells on the lease, only one was producing oil and gas in very small, but paying, quantities. Evidence established that new production methods clearly would produce oil from deeper sands than those reached by the present wells. The court *held*: the operator had breached the covenant of further reasonable exploration when he refused to drill under such circumstances as would lead a reasonable, prudent operator to drill additional wells with fair expectation of producing oil and gas in paying quantities.

The implied covenant is nothing new to oil and gas leases. Apparently the first case to recognize the covenant to develop after discovering paying oil and gas was *Stoddard v. Emery*.[1] In that 1889 decision the Pennsylvania Supreme Court announced by way of dictum that, in the absence of an express provision to the contrary, an implied duty arises to develop the property reasonably. Since the *Stoddard* case, the doctrine of implied covenants in oil and gas leases has become well settled.[2] By its nature, the oil and gas lease is incapable of containing provisions for all the circumstances that may arise during its term, therefore, the usual lease form merely excludes mention of many situations likely to arise.

Germane to this discussion are only those covenants implied in the drilling clause of one lease. Merrill has recognized three implied drilling obligations: (1) to drill an initial well, (2) to drill an offset well, and (3) to drill additional wells.[3] Though the first two of these doctrines have been generally recognized and followed in most jurisdictions, a conflict marks the third. The majority rule divides the covenant to fit two distinct situations. The more obvious of the two is the duty to develop proven producing territory, and, not so obvious, but equally important—the duty to explore unproven territory. Unproven territory as construed most favorably to the lessee is that containing one or perhaps more wells producing in small, but paying, quantities. The necessity for a covenant to explore becomes paramount after a producing well has been developed. Then the lessee has lost his right to delay drilling by the

[1] 128 Pa. 436, 18 Atl. 339 (1889).
[2] See 2 Summers, Oil and Gas § 395 (Perm. ed. 1938).
[3] Merrill, Covenants Implied in Oil and Gas Leases 23 (2d ed. 1940).

payment of rentals, and the only consideration flowing to the lessor is the payment of royalties.

While jurisdictions surrounding Texas were adhering to the doctrine of the implied covenant to further explore, Texas held out strongly in favor of the lessee and clearly repudiated it. The Texas Court of Civil Appeals recognized in *Waggoner Estate v. Sigler Oil Co.*[4] that where the lease fails to define the lessee's duty regarding development after discovery of paying oil and gas, the law implies an obligation to continue drilling with reasonable diligence. The opinion concluded, however, that the alternative decree of cancellation was an improper remedy and that it would override by judicial interpretation the intent of the parties.

In *Spurlock v. Hinton*[5] the same court found that no such implied equitable doctrine existed, and that the only remedy was an action for damages. Texas followed these decisions,[6] utilizing a variety of reasons without mentioning the implied exploration covenant.

The United States Supreme Court case of *Stauder v. Midcontinent Petroleum Corp.*[7] did little to sway the Texas courts. In *Stauder* the court held the lessor had the duty to prove the lease had been abandoned, or that an offset well was needed, *or* that a reasonably prudent operator under similar circumstances would have drilled a well. While there was some question of drainage in the case, the Court based its decision chiefly on the last issue, stating that it would be inequitable to permit the lessee to hold the undeveloped balance of land for speculation without drilling or having any intent to drill in the near future. An alternative decree was granted to the lessor, i.e., to drill within a specified period or surrender the lease.

Some twenty years after the *Stauder* decision Texas still had not recognized the lessee's obligation to drill additional wells after production in paying quantities. Although in 1954, the Texas Supreme Court in *Perkins v. Mitchell*[8] granted relief to the lessor, the implied obligation of the lessee had little importance in the case. There the lessor brought suit to cancel an oil and gas lease on the ground that the lessee had failed to reasonably develop the property. There was no evidence as to how long the lessee had refrained from drilling. One expert was allowed to testify to the effect that he would drill a well if he were in similar circumstances. A conditional decree to drill an additional well or suffer cancellation was rendered for the first time in Texas. Even though the court talked in terms of reasonable development, the case actually turned upon further exploration of deeper, unproven sands.[9]

In the principal case the primary issue was whether there is an implied covenant to explore as distinguished from the obligation to develop after production. By answering this question in the

[4] 118 Tex. 509, 19 S.W.2d 27 (1929).
[5] 225 S.W.2d 203 (Tex. Civ. App. 1949).
[6] Fort Worth Nat'l Bank v. McLean, 245 S.W.2d 309 (Tex. Civ. App. 1951); Senter v. Shanafelt, 233 S.W.2d 202 (Tex. Civ. App. 1950). (no proof of profitable production); Guleke v. Humble Oil & Ref. Co., 126 S.W.2d 38 (Tex. Civ. App. 1939); Gibson v. Sheldon, 90 S.W.2d 841 (Tex. Civ. App. 1936). (action for damages proper under facts rather than equitable decree of cancellation).
[7] 292 U.S. 272 (1934).
[8] 153 Tex. 368, 268 S.W.2d 907 (1954).
[9] Conflicting answers to specific questions put to the jury were the issues on appeal, but the court found that the answers could be reconciled and passed lightly over the exploration issue.

affirmative, the Texas courts had advanced in only two years from bare recognition[10] to complete approval of the doctrine. Just why Texas was so tardy in applying the implied covenant to explore has been the subject of much conjecture. One writer feels that the willingness to wildcat the Texas fields has, perhaps, minimized litigation by dissatisfied lessors.[11] At any rate, the lessor may now have his remedy in Texas.

Colorado has not yet had to pass on a case involiving precisely the same facts. As early as 1898, however, the Colorado Supreme Court found an implied covenant that the lessee should exercise reasonable diligence in working a mineral lease.[12] Thirty years later in *Florence Oil & Refining Co. v. Orman*[13] a lease which granted the lessee exclusive exploration rights was cancelled without notice to the lessee by the lessor. The lessee had drilled four wells, only one of which produced any oil and gas, and that was not of a paying quantity. Four years after the lessee had pulled the casings and quit the premises, a cancellation was granted on the ground of abandonment. Since no oil and gas had been produced, no estate had vested in the lessee. The court stated: "He (lessee) could not be sued on an implied covenant to search, because no covenant existed."[14]

At first glance this appears to be a direct denial by the Colorado Supreme Court of an implied exploration covenant, *but* here there was no prior production. The court indicated when it cited with approval an Ohio case[15] that an implied covenant to *develop* arises after the lessee has discovered and produced paying oil and gas.

From this conclusion regarding development of a leasehold after production of paying oil and gas, it is but a short step to reach a similar conclusion where further exploration is in issue. With oil production and exploration on the increase in Colorado, the existance of the implied covenant to further explore will surely arise here as an issue before too long. The influence of *Willingham v. Bryson* should be heeded and followed by the Colorado courts.

[10] Perkins v. Mitchell ,153 Tex. 368, 268 S.W.2d 907 (1954).
[11] Meyers, The Implied Covenant of Further Exploration, 34 Tex. L. Rev. 553 (1956).
[12] Colorado Fuel & Iron Corp. v. Pryor, 25 Colo. 540, 57 Pac. 51 (1898).
[13] 19 Colo. App. 79, 73 Pac. 628 (1903).
[14] Id. at 92, Pac. at 632.
[15] Harris v. Ohio Oil Co., 57 Ohio St. 118, 48 N.E. 502 (1897).