Catholic University Law Review

Volume 71
Issue 4 *Fall 2022*

Article 10

12-2-2022

The Trouble with Farmouts: The Problem of the Innocent, Nonperforming Farmee

Benjamin Idzik
Benjamin.idzik@gmail.com

Follow this and additional works at: https://scholarship.law.edu/lawreview

Part of the Contracts Commons, Energy and Utilities Law Commons, and the Oil, Gas, and Mineral Law Commons

Recommended Citation

Benjamin Idzik, *The Trouble with Farmouts: The Problem of the Innocent, Nonperforming Farmee*, 71 Cath. U. L. Rev. 823 (2022).
Available at: https://scholarship.law.edu/lawreview/vol71/iss4/10

This Comments is brought to you for free and open access by Catholic Law Scholarship Repository. It has been accepted for inclusion in Catholic University Law Review by an authorized editor of Catholic Law Scholarship Repository. For more information, please contact edinger@law.edu.

The Trouble with Farmouts: The Problem of the Innocent, Nonperforming Farmee

Cover Page Footnote

Few of my experiences during law school rival the positive personal impact of producing this article. The countless hours of research, writing, and meticulous editing fostered my love of legal scholarship and, more importantly, allowed me to discover the wonderful world of energy law. I hope that my professional career will permit me to further study its depths and positively contribute to its present and future challenges. Although mere words cannot do them justice, I want to offer three quick statements of thanks to those who made this article possible: First and foremost, to Professor Joseph A. Schremmer of the New Mexico University School of Law, for his invaluable guidance, encouragement, and good humor throughout the entire writing process. Even though he was two time zones away, he was the best oil and gas law professor that I have ever had. Second, to the excellent staff of the Catholic University Law Review, for their thoughtful feedback and diligent editing. Lastly, I want to thank my beautiful bride, Allie, for her unwaivering support and unrivaled proofreading abilities. It is safe to say that she is among a few nurses in the country who can explain farmout contracts to any audience. I am forever grateful to you all.

This comments is available in Catholic University Law Review: https://scholarship.law.edu/lawreview/vol71/iss4/10

THE TROUBLE WITH FARMOUTS: THE PROBLEM OF THE INNOCENT, NONPERFORMING FARMEE

Benjamin Idzik+

The oil market is a volatile universe. The price of the commodity has a profound impact both on the national and global economies and on the lives of everyday consumers. Consider the high prices of 2022 compared with the record lows seen in 2020, the price of oil affects almost everything. The United States is one of the top oil producing nations in the world. The size and importance of the industry has led to a somewhat unique area of the legal practice known as oil and gas law. Among its many tenants is an instrument known as a farmout contract. Farmout contracts have steadily grow in use by the industry since their inception, supplementing and even replacing the oil and gas lease, which traditionally has been the primary legal mechanism under which oil drilling takes place.

Oil and gas leases generally obligate lessees to drill continually or else face breach liability. In response, many courts eased this requirement of strict performance by way of novel and established legal doctrines when the lessee's nonperformance was caused by circumstances outside of its control. However, even though, farmees—the parties that are obligated to drill under farmout contracts—are generally subject to the same drilling requirements, they do not enjoy the same judicial protections as oil and gas lessees. No current legal doctrine can readily excuse their nonperformance, no matter how blameless the farmee may be. This is the problem of the innocent, nonperformance farmee. The following comment examines the problem's relevant background, analyzes the shortcomings in the current law, and suggests two solutions for future parties and courts to consider.

+Few of my experiences during law school rival the positive personal impact of producing this article. The countless hours of research, writing, and meticulous editing fostered my love of legal scholarship and, more importantly, allowed me to discover the wonderful world of energy law. I hope that my professional career will permit me to further study its depths and positively contribute to its present and future challenges.

Although mere words cannot do them justice, I want to offer three quick statements of thanks to those who made this article possible: First and foremost, to Professor Joseph A. Schremmer of the New Mexico University School of Law, for his invaluable guidance, encouragement, and good humor throughout the entire writing process. Even though he was two time zones away, he was the best oil and gas law professor that I have ever had. Second, to the excellent staff of the *Catholic University Law Review*, for their thoughtful feedback and diligent editing. Lastly, I want to thank my beautiful bride, Allie, for her unwaivering support and unrivaled proofreading abilities. It is safe to say that she is among a few nurses in the country who can explain farmout contracts to any audience. I am forever grateful to you all.

I. INTRODUCTION 824
II. OIL & GAS LAW AND FARMOUTS: A BRIEF OVERVIEW 829
A. *Oil & Gas Transactions Generally* 829
B. *Farmout Contracts* 830
1. *Reasons for Farmout Agreements*...830
2. *Option verses Obligation Farmouts*..831
III. THE TROUBLE WITH FARMOUTS: AN INNOCENT FARMEE'S NONPERFORMANCE CANNOT BE READILY EXCUSED UNDER CURRENT LAW 831
A. *Force Majeure Clauses* 832
B. *Impracticability and Frustration of Purpose Doctrines*....................833
C. *Temporary Cessation of Production Doctrine* 835
IV. ADDRESSING THE PROBLEM OF THE INNOCENT, NONPERFORMING FARMEE 837
A. *Courts Historically Have Deviated From Applying Established Legal Principals in Oil and Gas Law to Promote Fairness and Favorable Public Policy*..838
1. *The Rule Against Perpetuities*...839
2. *Implied Covenants* 840
3. *Privity* 841
B. *Broadening the Temporary Cessation of Production Doctrine*..........842
C. *Liberally Applying the Doctrine of Impracticability and Frustration of Purpose* 843
V. CONCLUSION 844

I. INTRODUCTION

Developments in science and technology have greatly diversified the energy industry.[1] Yet, among all the current ways to produce energy, oil remains king.[2] The commodity's beginnings are well-known; oil is a fossil fuel that is formed when dead and decaying plankton and algae are trapped underground in certain conditions for millions of years.[3] These pools remain untouched until producers discover and, by various means, extract the oil within them.[4] The oil that is extracted is raw, hence the name "crude oil."[5] To be commercially viable, crude oil must be refined into different petroleum products: diesel and heating oil, hydrocarbon gas liquids (such as propane), jet fuel, and the most common being

---

1. *The Diversity of Our Energy Market*, SUSTAINABLE ENERGY FUND BLOG (June 17, 2020), https://www.thesef.org/diversity-of-energy-market/.

2. *See Oil and Petroleum Products Explained: Use of Oil*, U.S. ENERGY INFO. ADMIN., https://www.eia.gov/energyexplained/oil-and-petroleum-products/use-of-oil.php (May 10, 2021).

3. *See Oil and Petroleum Products Explained*, U.S. ENERGY INFO. ADMIN., https://www.eia.gov/energyexplained/oil-and-petroleum-products/ (Apr. 19, 2022).

4. *See id.*

5. *See id.*

motor gasoline.[6] All of these products are used in some way by virtually every individual and industry within every economy.[7] In the United States, petroleum fuel consumption makes up the largest share of the total of the country's energy usage.[8]

Prior to the economic disruption caused by COVID-19, the demand for oil was relatively stable since 2006.[9] Its supply, on the other hand, grew steadily since 2011 and experienced a significant increase by 2018.[10] This surge was prompted by the vast expansion of oil production in the United States and was later amplified by the response of foreign competitors.[11] When American oil production hit record levels by 2019, the Organization of the Petroleum Exporting Countries ("OPEC") responded by flooding the market with oil at "record levels" to push emerging United States producers into bankruptcy.[12] By 2020—a year that impacted far more than the oil market[13]—oil supply was even further inflated by a Russian and Saudi Arabian price war,[14] and perhaps more obviously, by the effects of COVID-19. In response to the coronavirus's rapid spread, travel restrictions and quarantine measures imposed by governments across the world caused global oil demand to plummet.[15] By the late spring, these factors led to a historic oversaturation of the oil market.[16] Although the

---

6. *See id.*

7. *See generally Use of Energy Explained*, U.S. ENERGY INFO. ADMIN., https://www.eia.gov/energyexplained/use-of-energy/ (June 13, 2022).

8. *See id.*

9. *See* N. Sönnichsen, *Daily Global Crude Oil Demand 2006-2026*, Published under *Daily Demand for Crude Oil Worldwide From 2006 to 2020, with a Forecast until 2026**, STATISTA (Jun. 13, 2022), https://www.statista.com/statistics/271823/daily-global-crude-oil-demand-since-2006/ (providing also on this website a chart demonstrating the demand's stability until 2020).

10. *See Oil and Petroleum Products Explained: Where Our Oil Comes From*, U.S. ENERGY INFO. ADMIN. (June 1, 2022), https://www.eia.gov/energyexplained/oil-and-petroleum-products/where-our-oil-comes-from.php (charting the production of the top five crude oil producing countries from 1980 to 2021).

11. *Id.*; Alex Ritchie, *A Reexamination and Reformation of the Habendum Clause Paying Quantities Standard Under Oil and Gas Leases*, 3 OIL & GAS, NAT. RES., & ENERGY J. 977, 978–79 (2017).

12. *U.S. Field Oil Production of Crude Oil*, U.S. ENERGY INFO. ADMIN. (Mar. 7, 2022), https://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=MCRFPUS2&f=A; Ritchie, *supra* note 11, at 978–79.

13. *See generally* Reis Thebault, Tim Meko & Junne Alcantara, *A Pandemic Year: Sorrow and Stamina, Defiance and Despair. It's Been a Year.*, WASH. POST (Mar. 11, 2021), https://www.washingtonpost.com/nation/interactive/2021/coronavirus-timeline/.

14. Natasha Turak, *The Saudi-Russia Oil Price War Was a 'Very Big Mistake,' Qatar Energy Minister Says*, CNBC, https://www.cnbc.com/2020/06/09/saudi-russia-oil-price-war-was-very-big-mistake-qatar-energy-minister.html (June 9, 2020, 9:25 AM).

15. Jeff Desjardin, *How Oil Prices Went Subzero: Explaining the COVID-19 Oil Crash*, VISUALCAPITALIST (Apr. 21, 2020), https://www.visualcapitalist.com/subzero-oil-price-crash-covid-19/.

16. *Crude Oil Prices-70 Year Historical Chart*, MACROTRENDS, https://www.macrotrends.net/1369/crude-oil-price-history-chart (last visited Apr. 6, 2022); Stanley Reed & Clifford Krauss,

oversaturation allowed consumers to enjoy low prices at the pump,[17] it also wreaked havoc on the national oil market, the health and stability of which is essential to the United States' economy and national security.[18]

In countries like Saudi Arabia and Russia, where the oil industry is effectively state-owned, production cuts can be easily coordinated by the national government.[19] In the United States, however, the federal government largely lacks such centralized control to compel large-scale production furloughs. While it enjoys regulatory control over oil production on federal land, most American oil is produced on state land and is subject to state regulation.[20] This means that any significant scale backs of production would have to be directed by the legislatures and executive agencies of oil-producing states.[21] However, political realities and the independence of the states on these matters make any state led furloughs unlikely.[22] While an analysis of this issue is beyond the scope of this comment, the limitations of the federal government and the states in this regard must be noted.

Oil production in the United States has generally occurred by way of leases.[23] These legal creations facilitate the input of oil into the market, and, as such, are of incredible importance. While oil and gas leases have historically been the dominant legal instruments used by the industry,[24] since the 1980s, farmout

---

Too Much Oil: How a Barrel Came to Be Worth Less Than Nothing, N.Y. TIMES, https://www.nytimes.com/2020/04/20/business/oil-prices.html (Sept. 28, 2021).

17. *Id.*

18. *See generally US Oil Needs More Explicit Support from Policymakers: Standard Chartered*, CNBC (Apr. 24, 2020, 1:24 AM), https://www.cnbc.com/video/2020/04/24/us-oil-needs-more-explicit-support-from-policymakers-standard-chartered.html; Charles L. Glaser, *How Oil Influences U.S. National Security*, 38 INT'L. SECS. J. 112, 112–13 (2013).

19. *See generally* Jim Krane, *Energy Governance in Saudi Arabia: An Assessment of the Kingdom's Resources, Policies, and Climate Approach*, CTR. FOR ENERGY STUD. (Jan. 2019), https://www.bakerinstitute.org/media/files/research-document/09666564/ces-pub-saudienergy-011819.pdf; Jennifer Josefson & Alexandra Rotar, *Oil and Gas Regulation in the Russian Federation: Overview*, THOMSON REUTERS: PRACTICAL LAW, https://uk.practicallaw.thomsonreuters.com/0-527-3028 (law stated as at Apr. 1, 2021) (providing "[a] Q&A guide to oil and gas regulation in the Russian Federation").

20. E. Allison & B. Mandler, *U.S Regulation of Oil and Gas Operations*, AM. GEOSCIENCES INST. 1 (2018), https://www.americangeosciences.org/sites/default/files/AGI_PE_Regulations_web_final.pdf; Alexandra B. Klass, *Federalism "Collisions" in Energy Policy*, REG. REV. (Nov. 19, 2018), https://www.theregreview.org/2018/11/19/klass-federalism-collisions-energy-policy/.

21. Allison & Mandler, *supra* note 20, at 1.

22. Klass, *supra* note 20.

23. David E Pierce, *Rethinking the Oil and Gas Lease*, 22 TULSA L.J. 445, 445 (1987).

24. *Id.* at 447–48 ("The four basic oil and gas lease clauses which usually comprise oil and gas leases are the granting clause, habendum clause, drilling/delay rental clause, and royalty clause. The other clauses encountered in lease forms are generally designed to alter in some fashion the four basic clauses. The granting clause states the substances, land, and associated surface rights which are being transferred to the developer. It also specifies the purpose of the transfer—to explore, develop, and produce the granted substances. The habendum clause states the duration of the granted rights. The grant will terminate after a stated period following the grant unless the

contracts have become "nearly as important and commonplace"[25] A farmout is a contract whereby "one who owns drilling rights [(usually the lessee of an oil and gas lease)] assign[s] all or a portion of those rights to another in exchange for drilling and testing" or other consideration.[26] Like in any other contract, each party to a farmout contract is required to perform its end of the bargain generally regardless of whether it is made more diffcult by any external circumstances. This notion of strict performance characterizes the traditional law of contracts. Under it, courts focus on effectuating the intent of the parties at the time of contracting, and rarely excuse a party's nonperformance.[27] But when performance consists of oil production, common sense suggests that the stake of the contract is much higher than when the bargain is for widgets or the like.

This comment considers whether courts should apply the traditional law of contracts, with its insistence on performance and narrow excuse doctrines, to farmout contracts. The answer is no. This argument is not founded solely on pragmatism aimed at decreasing production and supply when economically necessary. Rather, it is rooted in the tradition of oil and gas law under which courts have consistently declined to apply established legal principles to oil and gas transactions when doing so would defy fairness or public policy.[28] Indeed, modern oil and gas law is built on exceptions to longstanding property and contract law principles.[29] And though the oil industry is cyclical in nature, as price spikes and downturns have and will continue to happen, the severity of the 2020 oversupply crisis is useful to illustrate the weak points within the current law and address them in anticipation of future downturns.

To animate the discussion that will follow, this hypothetical illustrates the problem of what will be called "the innocent, nonperforming farmee":

Joe owns Blackacre, a 160-acre plot of land in rural Kansas. He was approached by Big Barrel, a regional oil business, and allowed it to conduct mineral testing on the property. After testing, the company discovered that the ground below Blackacre contains a massive oil pool. As a result, Big Barrel asked Joe to lease to it the mineral estate of the property. Joe agreed, and the two parties entered into a standard oil and gas lease; its habendum clause provides that the lease will continue in duration "for ten years, and as long thereafter as oil and gas are being produced." The two parties executed the lease and Big Barrel promptly began drilling operations. Operations ran smoothy and the company enjoyed a healthy flow of oil from the property. Additionally, Joe

---

developer's efforts result in production of a granted substance, in which case the grant will continue so long as the developer's production income exceeds expenses.").

25. John S. Lowe, *Analyzing Oil and Gas Farmout Agreements*, 2 OIL & GAS, NAT. RES., & ENERGY J. 263, 268 (2017).

26. *Id.*

27. 11 Williston on Contracts § 32:2 (4th ed.).

28. *See infra* Part IV, Section A.

29. *See generally* James W. Coleman, *The Third Age of Oil and Gas Law*, 95 IND. L.J. 389, 391 (2020).

benefited handsomely from resultant royalties. However, Big Barrel could only afford to drill on 80 of the 160 acres of the property. Seeking to maximize its profit from the lease, Big Barrel entered into negotiations with Little Pump, a local oil operator, to farmout the remaining 80 unused acres of Blackacre to it. Little Pump was anxious to take advantage of a high price environment for oil and saw a farmout contract as a low-risk, high-reward opportunity. After some negotiations, the two companies struck a deal. Little Pump agreed to construct a well and begin production within two years as a condition to receive the 80-acre assignment.

After signing the farmout, supply levels rose and decreased the commodity's market price. This prompted Little Pump to hold off on construction with the expectation that the market would balance out and the price rebound. However, its hesitation did not pay off as supply levels continued to rise. Adding to Little Pump's troubles, the COVID-19 Pandemic engulfed the country, prompting authorities to issue quarantine orders and place restrictions on people and businesses, thereby further decimating oil's price. With the two-year deadline quickly approaching, Big Barrel, the farmor, and Joe, the lessor, are demanding that Little Pump proceed with production as planned.

This situation places Little Pump in a precarious position through no fault of its own, one that goes beyond simple inconvenience or even the regular hazards of the oil industry. On a microlevel, it forces Little Pump to decide between two difficult, and seemingly unfair, choices: The company can elect to perform as planned but then be stuck with oil for which there is no meaningful demand, requiring it to either to sell the oil at an undesirable rate (assuming it could find a buyer), or shoulder the significant cost of storing it.[30] Alternatively, Little Pump can refuse to perform as expected but, by not doing so, loose the entire farmout.

On a macrolevel, if Little Pump were to perform as planned, it would be infusing oil into an already oversaturated market, leading to waste and further undermining the stability of the national oil market. The market depends on a healthy balance of supply and demand. When supply is either under or oversaturated, history is filled with examples of the disastrous results that such environments produce.[31] The ultimate fear in this context is that oversaturation can lead to the weakening or collapse of the domestic oil industry, which in turn, would harm the country's economy and national security.

This comment has four parts and three significant subsections. Part I explores the relevant provisions of oil and gas law surrounding farmout contracts. Part II analyzes the established means of excusing nonperformance in the context of oil and gas transactions and details how they are inadequate to address the problem

30. Daniel Tenreiro, *Why Oil Prices Went Negative*, NAT'L REV. (Apr. 21, 2020), https://www.nationalreview.com/2020/04/why-oil-prices-went-negative/ (noting how in 2020 "storing oil [was] more [expensive] than the oil itself").

31. *See generally* Tyler Priest, *The Dilemmas of Oil Empire*, 99 J. AM. HIST. 236 (2012).

of the innocent, nonperforming farmee. Part III (A) discusses how and why courts historically have declined to apply established legal doctrines to oil and gas transactions when doing so would defy fairness or public policy. Part III (B) examines how the problem of the innocent, nonperforming farmee defies both and argues that, to address it, courts must modify the temporary cessation of production doctrine. Alternatively, Part III (C) proposes that the problem may also be resolved by an unconventional application of either the doctrines of impracticability or frustration of purpose. Part IV concludes by arguing that the modification of the temporary cessation of production doctrine is the most attainable and effective solution to the problem of the innocent, nonperforming farmee.

II. OIL & GAS LAW AND FARMOUTS: A BRIEF OVERVIEW

A. Oil & Gas Transactions Generally

As mentioned previously, oil and gas production in the United States has occurred largely under the legal framework of leases.[32] In most jurisdictions, an oil and gas lease is not treated like a traditional lease seen in the landlord-tenant settings; rather, "[i]t is more properly characterized as a deed or conveyance."[33] Some of these jurisdictions find that the lease simply conveys to the lessee an "exclusive right to profit" from minerals that it extracts—known as a "profit à prendre."[34] Others view it as granting the lessee "a fee simple . . . in the minerals themselves."[35] But regardless of how state jurisprudence characterizes the interest that the oil and gas lease conveys, perhaps its most defining quality is its habendum clause. The habendum clause specifies what the conveyance grants the lessee. In a typical oil and gas lease, the habendum clause grants the lessee an interest in oil and gas for a period of time and specifies that after that period, the interest remains with the lessee only if production of oil and gas is in-fact taking place.[36] It is worded something like the following: "from A to B for ten years, and as long thereafter as oil is being produced."[37] For analysis purposes, consider the conveyance to be divided into two terms. The primary term conveys the interest to the lessee for a fixed period—in this case ten years.[38] The secondary term provides that the conveyance will remain with the lessee as

32. Pierce, *supra* note 23, at 445.

33. Ritchie, *supra* note 11, at 981.

34. T. Ray Guy & Jason E. Wright, *The Enforceability of Consent-to-Assign Provisions in Texas Oil and Gas Leases*, 71 SMU L. REV. 477, 481 (2018).

35. *Id.* at 481–82.

36. Ritchie, *supra* note 11, at 981.

37. Lynette S. Wilson, Comment, *The Temporary Cessation of Production Doctrine: Litigating Cessation of Production and Termination of Oil and Gas Leases . . . What the Heck Does "Or the Like" Mean Anyway?*, 35 TEX. TECH L. REV. 311, 317 (2004).

38. Ritchie, *supra* note 11, at 981.

long as it is producing oil.[39] Most jurisdictions allow the lessee to transfer its interest in an oil and gas lease to another, provided the lease contains no express restrictions on alienation.[40] Provided that alienation is permitted and the lease contains a standard habendum clause, the lessee enjoys the ability to transfer its interest during the primary term and throughout the secondary term, as long as production is taking place.

B. Farmout Contracts

A farmout contract is one such transfer of interest. Formally defined, it "is an agreement by one who owns drilling rights to assign all or a portion of those rights to [a third party] in return for drilling or testing" and other consideration, such as money or royalties.[41] The owner of the drilling rights ("the farmor") is most often a lessee of an oil and gas lease, while the third party (known as the "farmee") is an operator ready to drill.[42] The farmee "earns" the right to extract oil from its assigned portion of the farmor's lease upon the happening of a specified event in the farmout contract (e.g., beginning production).[43] This means that upon the occurrence of the specified event, the farmee is assigned the specified portion of the farmor's lease, earning it the right to extract oil and gas subject to the bargained-for lump sum payment or royalties.[44]

1. Reasons for Farmout Agreements

There are various practical reasons for why lessees/farmors enter into farmout contracts. They include: "(a) lease preservation, (b) lease salvage, (c) risk sharing, (d) exploration and evaluation, (e) access to market, (f) obtaining reserves, and (g) drilling an 'obligation well.'"[45] To illustrate, a lessee under a typical oil and gas lease may be at the end of its primary term and may be concerned about its ability to produce during the lease's secondary term.[46] Such a lessee could alleviate its concerns by entering into a farmout contract with an operator that is ready to drill. Upon executing the farmout contract, the operator's production would preserve the lease for the farmor once it enters its secondary term because production would be maintained by the farmee. Additionally, if the farmor's lease contains drilling obligations, such as quantity requirements, a farmout contract would be equally useful to help the farmor meet these obligations. The farmee's reasons for entering into a farmout contract "mirror the motivations of the farmor"; they consist of the following:

---

39. *Id.* at 981–82.
40. Guy & Wright, *supra* note 34, at 480–81.
41. Lowe, *supra* note 25, at 268.
42. *Id.* at 268.
43. *Id.* at 269.
44. *Id.* at 269.
45. *Id.* at 287.
46. For example, the lessee may lack the capital required to drill once the oil and gas lease enters into its secondary term.

(1) the farmout is the quickest or cheapest way to obtain or expand an acreage position or to obtain reserves; (2) the farmee may have cash, or equipment and personnel that it wishes to keep busy; (3) the farmee may highly evaluate a property that the farmor has dismissed as a poor prospect; or (4) the farmee may want to become active in an area, but [may] be unwilling or unable to take the risks alone.[47]

In brief, farmout agreements are an attractive supplement to the oil and gas lease. Farmors benefit by having farmees preserve or expand their production obligations, while farmees are rewarded with additional drilling opportunities.

2. *Option verses Obligation Farmouts*

Farmout contracts fall into two categories: option-based and obligation-based.[48] The distinction between the two has an important implication on the performance requirements of the parties, particularly at the beginning of the farmout contract.[49] In an option-based farmout, the farmee's performance is a *condition*; in an obligation farmout, its performance is a *covenant*.[50] An option-based farmout, similar to any garden-variety option contract, requires the farmee to render performance in order to receive the assignment.[51] If the farmee does not perform, the assignment never takes place, and thus technically, the farmout contract never forms.[52] Conversely, under an obligation-based farmout, the farmee makes "a legally binding promise" to perform.[53] Thus, nonperformance constitutes a breach and subjects the farmee to breach liability.[54]

III. THE TROUBLE WITH FARMOUTS: AN INNOCENT FARMEE'S NONPERFORMANCE CANNOT BE READILY EXCUSED UNDER CURRENT LAW

The question remains how and when a farmee's nonperformance under a farmout contract can be excused. Under the traditional law of contracts, there are two primary means for a party to excuse its nonperformance: First, a party may argue that a force majeure clause in the contract excuses nonperformance.[55] Second, a party may look beyond the contract and argue that nonperformance is excused by virtue of one of the common law excuse doctrines.[56] Additionally,

47. *Id.* at 291–92.

48. *Id.* at 304.

49. *See id.* at 305. Performance requirements at this stage differ in specifics, but generally consist of the farmee being required to build a well and begin drilling within a specified amount of time. *See id.* at 304 n.133, 305 n.136.

50. *Id.* at 304.

51. *Id.*

52. *See generally id.*

53. *Id.*

54. *See id.* at 305.

55. Robin L. Nolan & Adam F. Aldrich, *Navigating Commercial Leases and Real Estate Loans During Covid-19*, 49 COLO. L. 36, 37 (2020).

56. *Id.* at 38.

and specific to only oil and gas law, a lessee under an oil and gas lease may argue that its nonperformance is excused by way of the temporary cessation of production doctrine.[57] Thus, on the surface, there is some law that is applicable to the problem of the innocent, nonperforming farmee. However, these options are either too difficult to trigger in practice or are legally incompatible with farmout contracts.

A. Force Majeure Clauses

A force majeure clause is agreed to by the parties during bargaining; it sets out certain circumstances that, if triggered, excuse nonperformance for one or both of the parties.[58] Typically, force majeure clauses excuse nonperformance when "acts of God or other extraordinary events prevent a party from fulfilling [its] contractual obligations."[59] These acts of God and extraordinary events need to be "caused by circumstances beyond the reasonable control" of the nonperforming party, or "is caused by an event which [was] unforeseeable at the time the parties entered the contract."[60] Additionally, these circumstances generally cannot be caused by the nonperforming party's "fault or negligence."[61]

In the context of the innocent, nonperforming farmee, the first obvious point to make is that many farmout contracts simply do not contain force majeure clauses.[62] These clauses are not required and are only present if the parties specifically agreed to them during bargaining.[63]

However, even if the parties did agree to one, triggering a force majeure clause is often difficult.[64] Courts will focus on the clause's *exact* language to see if the purported force majeure event actually falls within the clause's intended meaning.[65] Broad catch-all phrases like "other events beyond the reasonable

---

57. Wilson, *supra* note 37, at 326.

58. Nolan & Aldrich, *supra* note 55, at 37, 39.

59. *Id.* at 37.

60. Joseph A. Schremmer, *Crystal Gazing: Foretelling the Coming Decade in Oil and Gas Law*, 66 ROCKY MT. MIN. L. INST. 5–1, 5–67 to 5–68 (2020) (quoting Hydrocarbon Mgmt., Inc. v. Tracker Expl., Inc., 861 S.W.2d 427, 435–36 (Tex. App. 1993)).

61. Gulf Oil Corp. v. F.E.R.C., 706 F.2d 444, 452 (3d Cir. 1983).

62. Jay D. Kelley, *So What's Your Excuse? An Analysis of Force Majeure Claims*, 2 TEX. J. OIL GAS & ENERGY L. 91, 92 (2007).

63. *See generally* Nolan & Aldrich, *supra* note 55, at 37.

64. *See id.*

65. 30 WILLISTON ON CONTRACTS § 77:31 (4th ed.) ("A claim of 'force majeure' is equivalent to an affirmative defense. What types of events constitute force majeure depend on the specific language included in the clause itself. . . . A force majeure clause might read as follows: 'The parties' performance under this Agreement is subject to acts of God, war, government regulation, terrorism, disaster, strikes (except those involving [a party's] employees or agents), civil disorder, curtailment of transportation facilities, or any other emergency beyond the parties' control, making it inadvisable, illegal, or impossible to perform their obligations under this Agreement. Either party may cancel this Agreement for any one or more of such reasons upon written notice to the other.'") (quoting OWBR LLC v. Clear Channel Commc'ns, Inc., 266 F. Supp. 2d 1214, 1220 (D. Haw. 2003)).

control of the parties" (which are sometimes used) are interpreted narrowly, thereby offering a nonperforming party a small window to argue on their basis.[66] Course of performance, course of dealing, and usage of trade, in light of *ejusdem generis*, have been employed by those invoking a force majeure clause to make the connection between the clause's wording and the alleged triggering event.[67]

Nonetheless, even with these tools of contractual interpretation, force majeure clauses are diffcult to trigger because courts regularly demand that the purported force majeure event be one within "precise terms" of the clause.[68] For example, in *Kyocera Corp. v. Hemlock Semiconductor*, the court found that a trade war was not precise enough to fall within the force majeure clause's broad language, "acts of the Government."[69] Further, in *TEC Olmos, LLC v. ConocoPhillips Co.*, a farmee attempted to argue that a significant decrease in the market value of oil excused its nonperformance.[70] The terms of the force majeure clause stated that the farmee would be excused from nonperformance if it was caused by "reason of fire, flood, storm, act of God, governmental authority, labor disputes, war or *any other cause not enumerated [] but which [was] beyond the [farmee's] reasonable control*."[71] The court considered whether this catch-all provision excused the farmee's nonperformance and concluded that it did not.[72] The opinion explained that "fluctuations in the oil and gas market are foreseeable as a matter of law, [and thus, such fluctuations] cannot be considered [as] a force majeure event unless *specifically* listed as such in the contract."[73] Therefore, even if a force majeure clause was present in the innocent, nonperforming farmee's farmout contract, it would be a considerable challenge for the farmee to argue convincingly that its nonperformance is excused because of an oversaturated oil market—unless such a circumstance was *specifically* agreed to as an excuse for nonperformance during bargaining.

B. Impracticability and Frustration of Purpose Doctrines

At common law, "contractual covenants [are] considered absolute, subject to no exceptions or excuses . . . even if some intervening circumstance ma[kes] [the covenant] difficult or impossible to accomplish."[74] However, as the common law developed, courts fashioned equitable exceptions to contractual performance requirements if performance would result in undue harshness to

66. Schremmer, *supra* note 56, at 5-68 to 5-69.

67. *Id.*

68. Nolan & Aldrich, *supra* note 51, at 37.

69. Kyocera Corp. v. Hemlock Semiconductor, LLC, 886 N.W.2d 445, 452–53 (2015).

70. TEC Olmos, LLC v. ConocoPhillips Co., 555 S.W.3d 176, 180 (Tex. App. 2018); Schremmer, *supra* note 56, at 5–70.

71. *TEC Olmos, LLC*, 555 S.W.3d at 179 (emphasis added); Schremmer, *supra* note 56, at 5-71.

72. *TEC Olmos, LLC*, 555 S.W.3d at 186.

73. *Id.* at 184 (emphasis added); Schremmer, *supra* note 56, at 5-71.

74. Schremmer, *supra* note 60, at 5–61.

one of the parties.[75] The problem of the innocent, nonperforming farmee can be framed in this light. Most relevant to this context are the doctrines of impracticability and frustration of purpose. For impracticability, the RESTATEMENT (SECOND) OF CONTRACTS states that a party's contractual obligations may be discharged if, "after the contract is made, a party's performance is made impracticable without [the party's] fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made."[76] And for frustration of purpose, the RESTATEMENT (SECOND) OF CONTRACTS provides that a party's contractual obligations may be discharged if, "after the contract is made, a party's principal purpose is substantially frustrated without [the party's] fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made."[77]

The impracticability and frustration of purpose doctrines have a flexible, but limited, application.[78] The key factor in persuading a court to apply either is showing that the event that caused the nonperformance was "unforeseeable" to the parties at the time of contracting.[79] To prove that an event was unforeseeable, the innocent, nonperforming farmee would have to convincingly assert one of the following arguments. For impracticability, the farmee would have to show that an "unanticipated circumstance [] made performance of the promise *vitally* different from what should reasonably have been within the contemplation of both parties when they entered into the contract."[80] For frustration of purpose, the farmee would have to "show total, or near total, destruction of the essential purpose of the transaction."[81]

The farmee could raise either of these doctrines as its excuse for nonperformance. However, the substantial obstacle to invoking either doctrine successfully is that courts have consistently declined to apply these doctrines simply because unfavorable changes in market conditions caused the nonperformance.[82] The courts' reasoning is grounded in the principle that

---

75. *See id.*

76. RESTATEMENT (SECOND) OF CONTRACTS § 261 (AM. L. INST. 1981).

77. RESTATEMENT (SECOND) OF CONTRACTS § 265 (AM. L. INST. 1981).

78. Transatl. Fin. Corp. v. United States, 363 F.2d 312, 315 (D.C. Cir. 1966) ("The doctrine ultimately represents the ever-shifting line, drawn by courts hopefully responsive to commercial practices and mores, at which the community's interest in having contracts enforced according to their terms is outweighed by the commercial senselessness of requiring performance.").

79. Schremmer, *supra* note 60, at 5–62 (emphasis omitted).

80. City of Littleton v. Emps. Fire Ins. Co., 453 P.2d 810, 812 (1969) (emphasis added).

81. Beals v. Tri-B Assocs., 644 P.2d 78, 80–81 (Colo. App. 1982).

82. *See*, *e.g.*, *id.* at 81 (holding that "[t]he risk that economic conditions may change, or that government actions of the type involved here may impair the profitability of a real estate development, are not so unforeseeable that they are outside the risks assumed under the contract"); Hemlock Semiconductor Operations, LLC v. SolarWorld Indus. Sachsen GmbH, 867 F.3d 692, 702 (6th Cir. 2017) ("The expectation that current market conditions will continue for the life of

changes in market conditions are a basic assumption of every contract.[83] Thus, if the farmee were to argue that the oversaturated oil market excuses its nonperformance, its argument falls—at least somewhat—into that category. Additionally, the farmee would be faced with the fact that the nature of its performance and the overall purpose of the farmout contract remain the same, regardless of the state of the oil market.

C. Temporary Cessation of Production Doctrine

Similar to why courts developed the impracticability and frustration of purpose doctrines, the temporary cessation of production doctrine was fashioned to prevent the harsh termination of oil and gas leases.[84] Recall that the habendum clause within the typical oil and gas lease is worded something to this effect: "from A to B for ten years, and as long thereafter as oil is being produced." The lease has two terms within its lifecycle, a "primary term" ("from A to B for ten years") and a "secondary term" ("and as long thereafter as oil is being produced").[85] Under traditional law of contracts, the habendum clause's plain language indicates that if a lessee ceases to produce for any reason while the lease is in its secondary term, it will automatically terminate the whole lease "without regard to the reasonableness of the []lessee's actions."[86] Courts recognized the practical severity of this approach and gradually "soften[ed] the callousness of the automatic termination rule" by creating the temporary cessation of production doctrine.[87] The doctrine was first introduced by name in *Watson v. Rochmill*.[88] There, the court held that the automatic termination rule could be "modified where there is [] a temporary cessation of production due to [a] sudden stoppage of the well or some mechanical breakdown of the equipment . . . or the like."[89] The opinion reasoned that "[u]nder such circumstances . . . the lessee is entitled to a reasonable time in which to remedy the defect and resume production."[90] Courts gradually extended the doctrine's

---

the contract is not such a basic assumption, so shifts in market prices ordinarily do not constitute impracticability."); *TEC Olmos, LLC*, 555 S.W.3d at 184.

83. Nolan & Aldrich, *supra* note 55, at 38; *TEC Olmos, LLC* , 555 S.W.3d at 184.

84. Wilson, *supra* note 37, at 326 ("[T]he rules of property law, as applied to oil and gas leases, cause a lease to terminate automatically upon cessation of production. To reiterate, this merciless consequence has historically resulted no matter what the cause of the cessation. When the leasehold language does not specify otherwise, any cessation, 'be it mechanical failure, force majeure, governmental regulation, loss of market or economic advantage, would terminate the lease.' With this harsh consequence in mind, the courts turned to the [temporary cessation of production] doctrine.").

85. Ritchie, *supra* note 11, at 985.

86. Wilson, *supra* note 37, at 318, 324.

87. Wilson, *supra* note 37, at 326; *see, e.g.*, Scarborough v. New Domain Oil & Gas Co., 276 S.W. 331, 336 (Tex. Civ. App. 1925).

88. Wilson, *supra* note 37, at 328.

89. Watson v. Rochmill, 155 S.W.2d 783, 784 (Tex. 1941).

90. *Id.*

protections beyond the limited circumstances outlined in *Rochmill*.[91] In its modern form, the doctrine temporarily excuses nonperformance during the lease's secondary term, if it was caused by "mechanical failure, lack of a market, a fire, or [a] reworking [of drilling] operations" and gives the lessee a "reasonable [amount of] time to recommence production." [92] To invoke it, courts generally require the lessee to satisfy a two-prong test.[93] The doctrine differs greatly from impracticability and frustration of purpose in that it does not require that the event that caused the nonperformance to be one that was "unforeseeable" to the parties at the time of contracting.[94] Given this lower burden, some courts have specifically held that the doctrine may be triggered to excuse nonperformance as a result of a "total lack of a market" for oil and gas.[95]

For example, in *Hoff v. Girdler Corp.*, the Colorado Supreme Court held that a lack of market for helium gas was a valid excuse for nonperformance, and as such, did not terminate an oil and gas lease in its secondary term.[96] The common thread within the court's reasoning was fairness. The opinion explained that lessee's cessation of production was involuntary, because the market for gas that it was producing "vanished."[97] The court focused on the lessee's ultimate intent to preserve the lease and reasoned that the production stoppage did not disadvantage either the lessor or lessee and thus did not warrant a termination of the lease.[98] In *Stimson v. Tarrant*, the Ninth Circuit held that a lessee's nonperformance does not terminate an oil and gas lease in its secondary term, if '"no profitable market [was] within [the] reach"' of the lessee when production ceased.[99] Like in *Hoff*, this conclusion was grounded in fairness. The court cited the lower court's finding that "the lessee exercised reasonable diligence in attempting to find a[n] [alternative] market."[100] The court ultimately found that the lessee's intention was not to abandon the lease and noted that stopping

91. Wilson, *supra* note 37, at 336.

92. Ritchie, *supra* note 11, at 985–86.

93. Ritchie, *supra* note 11, at 985–86; Wilson, *supra* note 37, at 315 ("The first prong is a determination of whether a legal excuse for the cessation existed. Courts look specifically at the cause of the cessation to make their determination. Under the second prong, the court determines whether, under the circumstances, the lessee exercised diligence in successfully remedying the defect and resuming production within a reasonable amount of time. In other words, the second prong concerns the reasonableness of the time and effort the lessee exhausted in resuming production and determines whether the cessation was truly temporary. Both prongs of this test have given courts much difficulty in application.").

94. Schremmer, *supra* note 60, at 5–66.

95. *Id.*

96. Hoff v. Girdler Corp., 88 P.2d 100, 101–03 (1939).

97. *Id.* at 103.

98. *Id.*

99. Stimson v. Tarrant, 132 F.2d 363, 364–65 (9th Cir. 1942) (quoting Steven v. Potlatch Oil & Refining Co., 80 Mont. 239, 254 (1927)).

100. *Id.* at 363.

production was "obviously more economical[ly]" prudent than continuing at a loss.[101]

The driving principle behind the temporary cessation of production doctrine is fairness. Functionally, the doctrine is an equitable decision by a court to mute a lessee's technical breach of the oil and gas lease in its secondary term to prevent its harsh termination—a termination that would otherwise result under the traditional law of contracts.[102] The equitable principle behind the temporary cessation of production doctrine and the fact patterns that it has been applied to seem analogous to the problem of the innocent, nonperforming farmee. After all, the heart of the farmee's problem—a lack of market for oil—forces it to make a choice that is fundamentally unfair.[103]

However, the doctrine's mechanics are incompatible with farmout contracts. A farmout contract contains no primary or secondary term. Whether it is obligation or option based, a farmout contract is simply a promise that the farmee makes to produce within a specified period of time and thereafter.[104] Thus, unsurprisingly, there are no reported cases where courts have extended the doctrine's protections to farmout contracts. Moreover, in direct contrast with cases such as *Hoff* and *Stimson*, one jurisdiction has declined even to apply the doctrine to situations where a lack of market caused the lessee's nonperformance, reasoning that "lessee[s] could have provided for such a contingency" during drafting.[105]

IV. ADDRESSING THE PROBLEM OF THE INNOCENT, NONPERFORMING FARMEE

The current law offers a limited array of options to address the problem of the innocent, nonperforming farmee. The solution proposed by this comment is that courts should modify the temporary cessation of production doctrine by extending its protection of nonperformance to farmout contracts, or alternatively, by liberally applying the doctrines of impracticability and frustration of purpose to accomplish the same result. Adopting either of these approaches would be a departure from the current law. However, from its inception, oil and gas law has been an unorthodox project.[106] The unique nature

---

101. *Id.* at 365.

102. *See* Wilson, *supra* note 37, at 326, 328; *Scarborough*, 276 S.W. at 336.

103. *See supra* Part I, p. 6 ("Little Pump is in a precarious position through no fault of its own, one that goes beyond simple inconvenience or even the regular hazards of the oil industry. On a microlevel, it forces Little Pump to decide between two difficult, and seemingly unfair, choices: the company can elect to perform as planned but then be stuck with oil for which there is no meaningful demand, requiring it to either to sell the oil at an undesirable rate (assuming it could find a buyer), or shoulder the significant cost of storing it. Alternatively, Little Pump can refuse to perform as expected but, by not doing so, loose the entire farmout.").

104. *See supra* Part II, Section B; Lowe, *supra* note 25, at 269.

105. Schremmer, *supra* note 60, at 5–66; *see, e.g.*, Elliott v. Crystal Springs Oil Co., 187 P. 692, 694 (Kan. 1920); Collins v. Mt. Pleasant Oil & Gas Co., 118 P. 54, 56 (Kan. 1911).

106. *See generally* Coleman, *supra* note 29.

of oil and gas has forced the judiciary to treat the transactions surrounding them in unconventional ways.[107] A survey of the relevant precedent suggests that courts have deviated from applying established legal principles to issues unique to oil and gas transactions when doing so would compromise either fairness or public policy.[108] Fairness, which is most often cited to by courts when deviating, can be defined as the absence of oppression or unfair surprise to the performing party.[109] Public policy, in this context, centers around the broader impact that the production of oil and gas has on the economy and national defense, as well as the public's interest in preventing the waste of oil, a nonrenewable resource.[110]

A. Courts Historically Have Deviated From Applying Established Legal Principals in Oil and Gas Law to Promote Fairness and Favorable Public Policy

The problem of the innocent, nonperforming farmee defies fairness in two ways. First, if a farmee under an option-based farmout, like Little Pump, decides to drill, it will be forced into an undesirable business position. The farmee would either have to suffer the significant cost of storage, or presuming it can find a buyer, sell the oil at a price that reflects the oversaturated market.[111] Second, if the farmee refuses to drill, it will lose the entire expected assignment from the farmout. A farmee under an obligation-based farmout would likewise be placed in similar difficulty as one under an option-based farmout. Drilling would leave the farmee with oil that is not in demand and refusing to drill would thrust the farmor and the farmee into unnecessary litigation surrounding the breach of the farmee's obligation.[112] Either circumstance is oppressive and an unfair surprise to the farmee. The problem also defies public policy. On one hand, forcing the farmee to drill and add oil into an already oversaturated market compromises the economy and national security.[113] On the other, compelling production of a finite resource for no other reason than to abide by the contract is a quintessential

107. *See infra* Part IV, Section A.

108. *Id.*

109. David E. Pierce, *Exploring the Jurisprudential Underpinnings of the Implied Covenant to Market*, 48 ROCKY MT. MIN. L. INST. 10–11, 10–16 (2002); *see infra* Part IV, Section A.

110. *See* Desjardin, *supra* note 15.

111. *See supra* Part I, at 6; Tenreiro, *supra* note 30.

112. See Part II, Section B, Subsection 2; by not performing pursuant to the farmout contract's obligation, the farmee would be in breach. The farmor in this circumstance would have a breach of contract claim against the farmee. If the farmor decided to pursue it, absent a valid excuse, the farmee would be subject to breach liability that could consist of money damages or, worse yet, lead to the termination of the whole contract, if the breach is found to be material.

113. *See generally US Oil Needs More Explicit Support from Policymakers: Standard Chartered*, CNBC (Apr. 24, 2020, 1:24 AM), https://www.cnbc.com/video/2020/04/24/us-oil-needs-more-explicit-support-from-policymakers-standard-chartered.html; Charles L. Glaser, *How Oil Influences U.S. National Security*, 38 INT'L. SECS. J. 112, 112–13 (2013).

illustration of waste.[114] The following subsections discuss examples of when courts have deviated from applying established legal principles to oil and gas transactions when doing so would defy fairness or public policy.

1. The Rule Against Perpetuities

The famous (to many, the infamous) Rule Against Perpetuities "precludes the creation of any future interest in property which does not necessarily vest within twenty-one years after a life or lives presently in being, plus the period of gestation, where gestation is, in fact, taking place."[115] The Rule's reputation in mercilessly invaliding property interests is well-known within the legal community from the time of every lawyer's first-year property class.[116] Yet, a lesser known wrinkle is how the Rule clashes with the conveyance of mineral interests. *Jason Oil Co., LLC v. Littler*, a recent Kansas case, illustrates this "common" problem in the oil and gas industry.[117]

In *Littler*, the Kansas Supreme Court considered the following situation: a fee simple owner conveyed a tract of land to his son, but reserved the mineral interest in the tract "for a period of 20 years or as long thereafter as oil and/or gas . . . [are being] produced."[118] Under the literal wording of the conveyance, the son was granted a fee simple in the surface estate and a springing executory interest in its mineral estate.[119] The executory interest would spring to the son only if oil and gas were no longer produced from the property. A strict application of the Rule to this conveyance would quickly render the entire conveyance invalid, because the executory interest was not guaranteed to vest within twenty-one years of the death of the lives in being—as oil and gas could be produced from the land for well more than that timeframe.[120] However, despite the license to do so under the black letter of the common law, the court declined to apply the Rule and held the conveyance to be valid.[121] The court reasoned that applying the Rule would defy public policy by harming the oil and gas industry,[122] and noted that such a strict application went against the

114. *See generally* John A. Lovett, *Doctrines of Waste in a Landscape of Waste*, 72 MO. L. R. 1209, 1212 (2007).

115. Jason Oil Co., LLC v. Littler, 446 P.3d 1058, 1062 (2019).

116. Bruce M. Kramer, *Modern Applications of the Rule Against Perpetuities to Oil and Gas Transactions: What the Duke of Norfolk Didn't Tell You*, 37 NAT. RES. J. 281, 281 (1997).

117. Littler, 446 P.3d at 1067 ("The Grantees' heirs and the Amici Curiae additionally argue that these transactions are common in the oil and gas industry and application of the Rule will impact many other property owners who received their interest from similarly worded deeds. We recognize that the undisputed facts relied upon by the district court did not address this contention. But . . . Kansas caselaw provides multiple examples of these transactions, and we cannot ignore that reality.").

118. *Id.* at 1060.

119. *Id.* at 1065.

120. *Id.*

121. *Id.* at 1068.

122. *Id.* at 1065.

fundamental purpose of the Rule. Under this rationale, other courts have "simply assumed the validity of these interests without any discussion of the rule against perpetuities."[123]

2. *Implied Covenants*

Courts sometimes will imply covenants to typical contracts under certain circumstances;[124] "[i]n oil and gas leases, however, implied obligations are more commonly enforced . . . [and] play a much larger role than they do in contracts generally."[125] For example, even though the language that sets out the primary term in the typical oil and gas lease coveys the interest for a fixed period, courts will generally "not allow the lessee to remain . . . idle during" that time.[126] Instead, the lessee is held to an implied obligation that, at the very least, test drilling or exploration must be done during the primary term.[127]

There are two theories behind the usage of implied covenants in oil and gas leases. Some courts reason that implied covenants are implied-in-fact.[128] They serve as gap-fillers that collectively direct "lessee[s] to perform [] activities [that are] unexpressed in [the] lease," but are nevertheless consistent with its overall purpose.[129] Under this approach, a court will impose an implied covenant when it is evident from "the common intent of the parties."[130] Other courts posit that implied covenants are implied-in-law, meaning that they will be imposed to ensure an equitable execution of the lease, regardless of whether the implied covenant aligns with the parties' overall purpose in making it.[131]

---

123. *See, e.g.*, Williams v. Watt, 668 P.2d 620, 630 (Wyo. 1983) ("An executory interest, by definition, does not vest so long as it remains a future interest. Consequently, all executory interests are subject to invalidation by the rule against perpetuities. To say that a rule-against-perpetuities result is contrary to the intentions of the parties is of no avail, because the rule against perpetuities always operates to frustrate the parties' intentions. Despite the foregoing conclusion that the exception by the grantor of a determinable fee may subject the granted executory interest to problems with the rule against perpetuities, only a few courts have found such interests to be void."); Rousselot v. Spanier, 60 Cal. App. 3d 238, 244 (Cal. Ct. App. 1976); Traywick v. Transcon. Gas Pipe Line Corp., 170 So. 2d 802, 805 (Ala. 1965).

124. RESTATEMENT (SECOND) OF CONTRACTS § 205 (AM. LAW INST. 1981); *see, e.g.*, Wood v. Lucy, Lady Duff-Gordon, 118 N.E. 214 (1917).

125. Keith B. Hall, *Implied Covenants and the Drafting of Oil and Gas Leases*, 7 LSU J. ENERGY L. & RES. 401, 403 (2019).

126. Ritchie, *supra* note 11, at 982.

127. *Id.*

128. Hall, *supra* note 125, at 406.

129. Alexander Nicolai von Kreisler, Note, *Imposing Implied Covenants in Oil and Gas Leases-Covenant of Further Exploration Tenuously Supported Under Texas Jurisprudence: Sun Exploration and Production Co. v. Jackson, 715 S.W.2d 199 (Tex. App.-Houston (1st Dist.,—Houston [1ST DIST.] 1986, WRIT GRANTED)*, 19 TEX. TECH L. REV. 1231, 1234 (1988); *see, e.g.*, Hartman Ranch Co. v. Associated Oil Co., 73 P.2d 1163, 1166 (Cal. 1937).

130. Hall, *supra* note 125, at 406.

131. Hall, *supra* note 125, at 406; *see, e.g.*, *Jacobs v. CNG Transmission Corp.*, 772 A.2d 445 (2001).

Irrespective of the implied-in-fact and implied-in-law distinction, which is largely academic and beyond the scope of this comment, the use and frequency of implied covenants evidences the unique flexibility that the judiciary affords to oil and gas transactions.[132] Courts are comfortable imposing these unbargained-for obligations because the inherent "complexities and uncertainties" of oil and gas production prevent the parties from fully addressing every aspect of the lease during bargaining.[133] These inherent complexities and uncertainties makes producers within the industry particularly suspectable to oppression and unfair surprise, which in turn, prompts courts to impose measures, like implied covenants, to prevent parties from falling victim to either.

3. Privity

A lessee may sublease to a third-party, barring any express terms in the lease that state otherwise.[134] Subleasing raises the issue of whether the original lessor can sue the sublessee if it breaches the original lease. At common law, for the original lessor to sue a sublessee, it must show that it is in vertical privity with the sublessee.[135] Vertical privity is the requirement that there be a "legal connection" between the two parties.[136] The consensus among courts is that vertical privity exists only when the lessee assigned its *entire* leased interest to the sublessee—it cannot retain a reversion interest or even, in some jurisdictions, the power of termination.[137]

Yet, it is frequent practice in the oil and gas industry for lessees to sublease to third parties while maintaining a reversion interest or an overriding royalty interest.[138] Thus, at common law, if a sublessee is subject to an overriding royalty and also breaches a covenant of the original lease, the lessor has no ability to pursue action directly against it.[139]

The California Supreme Court, in *Ranch Co. v. Associated Oil Co.*, recognized this predicament and reasoned that an exception to the common law

132. *See generally* Hall, *supra* note 125.

133. *See, e.g.*, Hall, *supra* note 125, at 405 (quoting A.W. Walker, Jr., *The Nature of Property Interests Created by an Oil and Gas Lease in Texas*, 11 TEX. L. REV. 399, 399 (1933)) ("It is doubtful if any other character of legal instrument can be found in which one of the parties has so much potentially at stake with so little express contractual protection.").

134. *See generally* Blake A. Watson, *Do I Have to Be Reasonable?: The Right to Arbitrarily Restrict Transfer of Occupancy and Mineral Leases*, 47 CAP. U. L. REV. 27 (2019).

135. Bruce M. Kramer, *Property and Oil and Gas Don't Mix: The Mangling of Common Law Property Concepts*, 33 WASHBURN L.J. 540, 562 (1994) (The original lessor and lessee must "intend the covenant to be binding on [the third party], the promise must touch and concern the estate . . . [and] there must be horizontal privity between the [lessor] and [lessee]").

136. *See generally* Douglas J. Whaley et al., PROBLEMS AND MATERIALS ON THE SALE AND LEASE OF GOODS 215 (8th ed.) (2019).

137. Kramer, *supra* note 135, at 556.

138. Kramer, *supra* note 135, at 562–63.

139. Kramer, *supra* note 135, at 563.

in such situations is warranted.[140] *Ranch Co.* involved an oil and gas lease that was subleased by the lessee.[141] The lessee retained an overriding royalty interest in the oil that was produced by the sublessee.[142] After the execution of the sublease, the lessor demanded that the sublessee pay it the royalties pursuant to the original lease terms.[143] The sublessee refused and argued that, under the common law rule, the lessor could not bring suit against it to enforce the terms of the original lease.[144] While the court permitted the action on other grounds, it explained in dictum, that the sublessee could not make such an argument because of the fairness concerns that it posed.[145] The court reasoned that the "the lessor has a definite property right" in the oil that is produced from the lease, even if a sublessee produces it.[146] It concluded that this right cannot be defeated simply because the lessee subleased while retaining an overriding royalty.[147] This exception, though technical in nature, again illustrates the willingness of courts to deviate from established legal principles in oil and gas transactions to ensure fairness.

B. Broadening the Temporary Cessation of Production Doctrine

As previously discussed, the temporary cessation of production doctrine applies to only oil and gas leases.[148] However, at its core, courts created the doctrine in the spirit of fairness, to alleviate lessees from an "inadvertent and inappropriate termination" of their oil and gas lease.[149] Significantly, the doctrine has been successfully employed to excuse the temporary nonperformance of lessees' caused by a "lack of a market."[150] The innocent, nonperforming farmee is faced with an almost identical problem, one that the temporary cessation of production doctrine seemingly was created to relieve in oil and gas leases.

Drawing back to the hypothetical, Little Pump, the innocent, nonperforming farmee, is under an option-based farmout contract that requires it to drill on Blackacre within a three-year period.[151] Should it fail to do so—no matter the cause or any reasonable steps that the farmee might have taken to perform—it loses its entire potential assignment from the farmor. The farmee would not

---

140. Kramer, *supra* note 135, at 563; Ranch Co. v. Associated Oil Co., 73 P.2d 1163, 1168, 1171 (Cal. 1937).

141. *Ranch Co.*, 73 P.2d at 1165.

142. *Id.*

143. *Id.*

144. *Id.*

145. *Id.* at 1171.

146. *Id.*

147. *Id.*

148. *See supra* Part III, Section C.

149. Wilson, *supra* note 37, at 344.

150. Ritchie, *supra* note 11, at 985–86.

151. *See supra* Part I.

suffer this loss because of its own doing; rather, it would suffer the loss because of something completely beyond its control—a lack of market for oil. A similarly harsh result would occur if the farmee was under an obligation-based farmout contract. In such a case, the farmee would likely be thrust into unnecessary litigation with the farmor, which would likely force it to pay damages or, worse yet, terminate its assignment if the breach was found to be material. Moreover, should the farmee (whether under an option-based or obligation-based farmout) decide to perform, not only would it be forced to suffer the costs associated with producing unwanted oil, it would also be infusing oil into an already oversaturated market. This would contribute to the greater oversaturation problem, which compromises the economy and national security and promotes the waste of a nonrenewable resource.

The problem of the innocent, nonperforming farmee would be resolved by extending the temporary cessation of production doctrine to farmout contracts. Under this approach, nonperforming farmees whose nonperformance was caused by "a lack of a market" for oil would be temporarily excused from performance.[152] Such a modification of the doctrine would further its purpose of preventing "inadvertent and inappropriate termination[s]"; moreover, it would be in line with the judiciary's tradition of ensuring fairness and promoting good public policy in oil and gas transactions.[153]

C. Liberally Applying the Doctrine of Impracticability and Frustration of Purpose

In order to convince a court to excuse nonperformance under the common law excuse doctrines of impracticability and frustration of purpose, a nonperforming farmee would have to establish either impracticability or frustration of purpose. For impracticability, it would have to show that an "unanticipated circumstance [] made performance of the promise *vitally* different from what should reasonably have been within the contemplation of both parties when they entered into the contract."[154] For frustration of purpose, it would have to "show [a] total, or near total, destruction of the essential purpose of the transaction."[155] There is a significant amount of case law that maintains that these doctrines cannot be used to excuse nonperformance caused by unfavorable economic conditions, which presumably includes the farmee's fundamental problem—the lack of a market for oil.[156] Nevertheless, carving out an exception to the established law

152. Ritchie, *supra* note 11, at 985–86.

153. Wilson, *supra* note 37, at 344.

154. *City of Littleton*, 453 P.2d 78 at 812 (emphasis added).

155. *Beals*, 644 P.2d at 81.

156. *See*, *e.g.*, Hemlock Semiconductor Operations, LLC, F.3d 692 at 703 (6th Cir. 2017) ("[T]he simple fact that a contract has become unprofitable for one of the parties is generally insufficient to establish impracticability."); Aluminum Co. of Am. v. Essex Grp., Inc., 499 F. Supp. 53, 74 (W.D. Pa. 1980) (quoting Uniform. Commercial Code § 2-615, cmt. 4) ("Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency

in this area would be consistent with the unique manner in which courts have treated oil and gas transactions.[157] The judiciary's willingness to deviate from established law to ensure fairness and promote good public policy is explained in detail in the previous sections of this comment.[158]

From the fairness perspective, applying the excuse doctrines would protect the farmee from having to drill oil that is expensive to store and not in demand given the oversaturated market. From a public policy perspective, applying these doctrines would prevent oil from flooding an already oversaturated market that puts the American economy and national security at risk. Moreover, as many cases filed in 2020 make their way through court systems, some jurisdictions have indicated that these doctrines can temporarily excuse nonperformance that was caused by circumstances related to the COVID-19 Pandemic.[159] However, this is still a minority attitude—even to nonperformance related to the Pandemic.[160] Thus, to address the problem of the innocent, nonperforming farmee, modifying the temporary cessation of production remains the better alternative.

V. CONCLUSION

Applying the current law to the problem of the innocent, nonperforming farmee compromises both fairness and public policy. It leaves farmees with the harsh reality that should they not be able to perform their duties under farmout contracts—regardless of their blamelessness—they could face monetary damages, or worse, a loss of their farmout assignments. Moreover, it encourages

---

which alters the essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover."); Island Dev. Corp. v. D.C., 933 A.2d 340, 352 (D.C. 2007) (noting that "a party demonstrates that an event 'substantially frustrated' the purpose of a contract by showing that 'changed conditions have rendered the performance bargained from the promisee worthless, not because the promissor's performance has become different or impracticable'") (quoting Seaboard Lumber Co. v. United States, 308 F.3d 1283, 1296 (Fed. Cir. 2002)); *see also supra* Part III, Section C.

157. *See supra* Part III, Section A.

158. *Id.*

159. Bay City Realty, LLC v. Mattress Firm, Inc., No. 20-CV-11498, 2021 U.S. Dist. LEXIS 67054, at *30 (E.D. Mich. Apr. 7, 2021) (holding that the doctrines of impracticability and frustration of purpose temporarily excused a lessee's nonpayment under a commercial lease because of the effects of the COVID-19 Pandemic); Umnv 205-207 Newbury, LLC v. Caffé Nero Ams., Inc., Nos. 145768, 2084CV01493-BLS2, 2021 Mass. Super. LEXIS 12, at *19 (Feb. 8, 2021) (holding that "Defendant's obligation to pay rent under the parties' Lease was discharged under the doctrine of frustration of purpose from March 24 to June 22, 2020, and during any other period when Defendant was barred by government order concerning the COVID-19 pandemic not to allow any consumption of food or beverage within the lease premises.").

160. *See* Wroblesky v. Hughley, 169 N.E.3d 709 (Ohio Ct. App. Mar. 31, 2021) (holding that the doctrines of impracticability and frustration of purpose did not excuse a lessee's nonperformance even if it was caused by the effects of the COVID-19 Pandemic); CAI Rail, Inc. v. Badger Mining Corp., 2021 U.S. Dist. LEXIS 32564, at *27 (S.D.N.Y. Feb. 22, 2021); In re CEC Ent., Inc., 625 B.R. 344, 364 (Bankr. S.D. Tex. 2020).

farmees to drill at all costs, regardless of the negative impact that production has on the economy, national security, and the public's interest in preventing waste. The recent turmoil in oil markets highlights these vulnerabilities and demonstrates to courts that, when such matters ripen into litigation, a solution will be needed. This solution, modifying the temporary cessation of production doctrine or liberally applying the doctrines of impracticability and frustration of purpose, is attainable and is supported by the historical willingness of courts to deviate from established law to ensure fairness and promote favorable public policy. After all, oil and gas law is built on such deviations.