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LEASING FOR OIL AND GAS:
The Legal Perspective*

J. Hovey Kemp**

INTRODUCTION

Top leasing, whereby a lessee acquires a lease on a mineral estate currently under a valid, existing lease, is not a new phenomenon in the oil and gas industry. The legal issues surrounding top leasing have been the subject of reported cases for more than fifty years.

It has been during the last decade, however, that the practice of top leasing for oil and gas has increased dramatically. During the late 1970's, highly competitive leasing areas such as the Williston Basin in North Dakota and Montana became fertile ground for this proliferation of top leasing. The major factors that combined to spur the growth of top leasing in those areas include the shortage of drilling rigs, an increasing number of brokers and independent oil and gas exploration companies hungry for leasehold positions and, perhaps, increasingly sophisticated mineral owners. Ethical and moral concerns regarding the practice of top leasing, which led one court in 1960 to state that "[t]op leasing has the same invidious characteristics as claim jumping,"1 have seemingly ebbed in the face of strident competition for leasehold positions.

Although courts in many jurisdictions have upheld the validity of a properly drafted top lease, concerns regarding the legal ramifications of the art and practice of top leasing for oil and gas persist. The aim of this article is to outline those concerns in an understandable manner and offer a few suggestions as to how an oil and gas company engaged in top leasing might be able to avoid litigation.

I. DEFINITION OF A TOP LEASE

A top lease is an oil and gas lease covering a mineral estate that is currently under a valid, existing oil and gas lease. The top lease has been described as a "partial alienation of a possibility of reverter"3 and as a "present grant of a future interest."4 In oil and gas terms, the prior lease is frequently referred to as the "bottom lease." In most cases, the bottom lease will still be within its primary term when the top lease is executed. However, when a

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1. For other legal periodical articles on this subject, see Brown, Effect of Top Leases: Obstruction of Title and Related Considerations, 30 Baylor L. Rev. 213 (1978); Ernest, Top Leasing—Legality v. Morality, 26 Rocky Mt. Min. L. Inst. 957 (1980).
2. Frankfort Oil Co. v. Snakard, 279 F.2d 436, 445 n.23 (10th Cir. 1960).
3. Brown, supra note 1, at 239.
mineral estate is burdened by an oil and gas lease in its secondary term (for example, where the lessee has established production from the leased lands, or from lands with which the leased lands have been pooled or unitized, prior to expiration of the primary term), a second lease that is executed before the prior lease expires can be properly classified as a “top lease” as well.

In general, there are two basic types of top leases. First, a two-party top leasing situation can be described as follows: B (lessee) owns an oil and gas lease covering the mineral estate of A (lessor). The lease is dated January 1, 1972, with a primary term of ten years and so long thereafter as oil or gas is produced. Some months before the primary term of his lease expires, B secures another lease from A, dated September 1, 1981, but with a primary term of ten years commencing January 1, 1982 (the day after B’s prior lease expires). B might top lease his own bottom lease for a variety of reasons. Drilling rigs may be scarce in the last year of the bottom lease’s primary term, threatening B’s ability to extend the lease into a secondary term. More likely, B may be concerned that he will lose his leasehold position if he doesn’t get to A before his competitors arrive, armed with offers of an increased bonus and a greater landowner’s royalty.

The second basic type of top lease involves a three-party situation, which can be pictured as follows: The owner of the mineral estate, A (lessor), leases to B (lessee), by an oil and gas lease dated January 1, 1972, with a primary term of ten years and so long thereafter as oil or gas is produced. Some months before the primary term of B’s lease expires, C, a third party, secures another lease from A covering the same lands, dated September 1, 1981, but with a primary term of ten years from January 1, 1982 (the day after the primary term of the prior lease expires). C may have been able to secure his top lease with an offer of an increased royalty, promises of imminent drilling operations, and payment of a portion of the bonus consideration at signing, the remainder to be paid if the top lease actually takes effect upon expiration of the bottom lease.

II. APPROACHES TO TOP LEASE LITIGATION

Top leases come under the scrutiny of courts most frequently in disputes between the bottom lessee and the top lessee over the exclusive possession of

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5. The two-party top lease diagrammed above should be distinguished from the situation where B’s top lease is not subject to B’s bottom lease (that is, where B’s top lease is dated and “effective” September 1, 1981, and makes no mention of his prior lease). If B is wise, he will avoid any overlap of the two leases, thereby avoiding questions of which lease terms apply if there is production during the overlap period. For a thorough discussion of the applicability of the doctrine of “novation,” as applied to the two-party top lease situation, see Brown, supra note 1, at 231-37.

6. The three-party lease pictured above should be distinguished from the situation where C’s top lease is not subject to the rights of B under the bottom lease (that is, where C’s top lease is dated and effective September 1, 1981, and makes no mention of B’s prior lease). As discussed in the text, C will avoid creating any such overlap of the two leases while B’s lease is still in effect, thereby steering clear of some of the legal pitfalls described herein.

7. One method by which a bottom lessee could have an option to prevent his lease from being top leased by a third party would be for him to include in his bottom lease a preferential right to purchase a top lease on the same terms as any top lease offer that the lessor receives.
the leasehold estate. Resolution of these disputes generally turns on the issue of whether the bottom lease has expired or whether it has been extended. The litigation is usually in the form of a quiet title action by either the top lessee or the bottom lessee. Sometimes, however, a lessor who has executed a top lease will sue on his own or will join in an action with the top lessee to cancel the bottom lease. Ultimately, however, the central question to be determined by the court is the same: Whose lease is valid?

When the litigation is instigated by the top lessee, he will generally claim that his top lease is the only valid lease covering the subject mineral estate and will ask the court to quiet his title or, perhaps, he may request that the court find the bottom lessee in trespass. In general, when the bottom lessee brings such an action he will typically assert that his bottom lease is still valid, and will request 1) that the court quiet his title to the exclusion of the top lessee or 2) that the court find the top lessee in trespass. If the facts warrant, the bottom lessee may also sue his lessor, claiming that the lessor has obstructed or otherwise interfered with his rights under his bottom lease by executing the top lease.

State courts in Kentucky, Louisiana, Mississippi, Montana, Nebraska, North Dakota, Oklahoma, and Texas, and several federal courts have considered such claims. It should be noted that most cases involving top leases do not turn on the validity or invalidity of top leasing. Because courts generally have accepted the proposition that a properly drafted top lease creates a valid interest in favor of the top lessee, the bulk of the discussion below examines those cases that are concerned with the more problematic legal aspects of top leasing for oil and gas.

A. Recognition of the Top Lease

In 1923, in Rorex v. Karcher the Oklahoma Supreme Court held that a

8. See, e.g., Joyce v. Zachary, 434 S.W.2d 659 (Ky. 1968); Wheeler & LeMaster Oil & Gas Co. v. Henley, 398 S.W.2d 475 (Ky. 1965); Lebow v. Cameron, 394 S.W.2d 773 (Ky. 1965); Swiss Oil Corp. v. Hupp, 223 Ky. 552, 69 S.W.2d 1037 (1934); Union Gas & Oil Co. v. Gillam, 221 Ky. 293, 279 S.W. 626 (1926).


10. See, e.g., Barnett v. Getty Oil Co., 266 So. 2d 581 (Miss. 1972); Lone Star Producing Co. v. Walker, 237 So. 2d 496 (Miss. 1971).


17. 101 Okla. 195, 224 P. 696 (1923).
top lease is valid. Plaintiff, the top lessee, acquired a top lease from the mineral owners while a valid oil and gas lease already covered the lessors’ lands. Roughly a month before the prior lease was to expire, the lessors executed an extension agreement with defendants, the prior lessees, to extend the prior lease. The prior lessees then commenced drilling some three months after the primary term of their lease expired. Plaintiffs sued when the defendants refused to stop drilling. During the trial, the defendants called into question the validity of the top lease. In reviewing the trial court’s decision for defendants, the Oklahoma Supreme Court stated:

[It is the contention of the defendants that the lease to the plaintiff, having been executed while there was a valid lease on the property, was void. No authority is cited to sustain this proposition, and we have been unable to find any which tends to support the same. The lessors were the owners of the fee-simple title to the property, and the same was not restricted in any manner whatever. Such being the condition of the title, there was no reason why the owners of the fee could not carve out as many estates as they saw fit. There was no reason why the [lessors] could not execute a second oil and gas lease during the existence of the first lease. Of course, the holders of the second lease would take same subject to the rights of the holders of the first lease . . . . We are therefore of the opinion that the lease to the plaintiff was valid, and that judgment should have been rendered for the plaintiff.18

The Oklahoma Supreme Court again confronted a case involving a top lease in Jennings v. Elliott,19 and upheld the right of a landowner to execute an oil and gas lease covering land subject to an unexpired prior lease. The plaintiff landowners in Jennings sought to cancel defendants’ prior lease and to enjoin defendants from entering and trespassing on the leasehold premises. As defendants, the bottom lessees sought to restrain or enjoin plaintiffs from alienating or disposing of the oil and gas rights conveyed under their prior lease (that is, from executing a top lease), while their prior lease was still in force.20 Concerning the top lease, the court stated:

In Gypsy Oil Co. v. Marsh,21 the right of a land owner to execute an oil and gas lease covering land that is already subject to an unexpired prior lease was before the court and upheld. However, the second lessee does not acquire the right to explore, develop for, and produce oil from the premises as against the prior lessee until the prior lease had terminated. If plaintiffs should execute such a

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18. Id. at 196, 224 P.2d at 697-98.
20. Id. at 287, 97 P.2d at 70.
21. 121 Okla. 135, 248 P. 329 (1926). The Supreme Court of Oklahoma considered a top lease in the context of a lawsuit on the question of whether the bottom lease had expired at the end of its primary term. The plaintiff in Gypsy Oil, the top lessee, brought an action to cancel the prior lease, for possession of the leased premises and to enjoin the defendant, the prior lessee, from asserting any right, title, or interest in the premises. Despite the above-cited statement in the later decision in Jennings about the holding of the Gypsy Oil court, the Oklahoma Supreme Court in that latter case did not specifically discuss the issue of the legality of the top lease or its existence as a defense, and affirmed the trial court’s decision to cancel the bottom lease because the prior lessee had failed to discover oil or gas in paying quantities before the primary term of the bottom lease had expired. The legality of the top lease seems to be presumed.
lease it would in no way interfere with defendants in whatever rights they may eventually be adjudged to have under the lease they claim to be still in force.²²

Other jurisdictions have similarly upheld the practice of top leasing for oil and gas. For example, in the case of Barnett v. Getty Oil Co.,²³ the Mississippi Supreme Court considered a bottom lessee’s contention that the particular top lease involved was not a valid and subsisting oil, gas and mineral lease. The court rejected that contention as follows:

Whether you consider the lease a present grant of a future interest or otherwise, the fact that the primary term was not to commence until a date in the future does not alter the fact that the said lease was valid, subsisting and in effect according to its terms from the moment of its execution . . . .²⁴

B. Rejection of the Top Lease

The Oklahoma case of Simons v. McDaniel²⁵ has been noted as one of the few cases in which the bare existence of a top lease was held to constitute an obstruction of the bottom lessee’s title.²⁶ However, the decision can be distinguished on its facts and has been correctly classified as an “anomaly” in this area.²⁷

In Simons, the lessor granted plaintiffs, the bottom lessees, a lease with a term of five years; the lease provided that “if no well be commenced” on or before the end of the primary term, the lease was to terminate, subject to the lessees’ right to make delay rental payments. Four months before the primary term expired, the lessor’s successors granted defendants top leases covering the same lands. The top leases became effective two weeks after the prior lease’s primary term expired. The bottom lessees commenced a well, however, just before the term expired. And, prior to the expiration date, the bottom lessees brought a quiet title action to eliminate the top leases as a cloud on their title. They also sought a court order that would permit them to cease drilling operations under the bottom lease pending resolution of the dispute.

The court held that the right to commence a well within the primary term carried with it the right, after the term expired, to complete the well begun within the term when the lessee acted in good faith.²⁸ Regarding the top leases, the court stated:

The acts of the [lessors], in executing and delivering ‘top leases,’ was an election to declare the first lease at an end [citations omitted] . . . .

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²². 186 Okla. at 288, 97 P.2d at 70-71. The court went on to state: “Particularly is this true in the instant case for any person who might purchase a second lease after this action had been commenced, would be a purchaser pendente lite, and would of necessity take subject to any judgment or decree that might thereafter be rendered or entered in defendants’ favor.” Id.
²³. 266 So. 2d 581 (Miss. 1972).
²⁴. Id. at 585.
²⁵. 154 Okla. 168, 7 P.2d 419 (1932).
²⁶. See Brown, supra note 1, at 218; Ernest, supra note 1, at 958-59.
²⁷. Brown, supra note 1, at 220.
²⁸. 154 Okla. at 170, 7 P.2d at 420-21.
These acts obstructed the exercise of the rights of the original lessees under the terms of their lease. Their title was clouded. Had they produced oil or gas as a result of commenced development, ownership thereof would have been in litigation and the value of production impounded, so that a real obstacle was imposed by lessors upon the right of lessee plaintiffs. 29

The court in Simons found that the bottom lessees were acting in good faith and permitted them to suspend operations pending resolution of the proceedings to remove obstructions imposed by the lessors. 30

The court's decision in Simons that the top leases constituted "clouds on title" is difficult to understand in the context of other decisions in this area, including prior Oklahoma cases. 31 The fact that the practice of top leasing has been condoned by the Oklahoma Supreme Court in decisions before and after Simons makes the latter decision puzzling in light of the fact that the top leases involved in Simons were prospective (that is, they were to take effect two weeks after the end of the bottom lease's primary term).

A 1966 case, Robinson v. Continental Oil Co., 32 is consistent with Simons in holding that a top lease not "subject to" a bottom lease is a cloud on the bottom lessee's title. 33 The Robinson case involved a suit by a lessor to cancel an oil and gas lease on the ground that it expired by its own terms or by the lessee's breach of the implied covenant to develop. In holding for the oil and gas lessee, the court found that the lessee had established a commercial gas well within the primary term, that the lessee was entitled to reasonable time in which to locate a market for the well, and that the lessee had not obligated to tender shut-in payments while lessee's title was under attack by lessor. 34

While considering the lessee's obligation to tender shut-in payments, the court in Robinson discussed the fact that the lessor had executed top leases covering the same lands as the lease in question. The court stated:

Further, we conclude that while Continental made a timely tender of shut-in payments, it was under no obligation to make such tender because defendant's title was at the time under attack by plaintiff as lessor. The execution of top leases by plaintiff . . . was in our opinion a challenge of Continental's title (citations omitted). 35

29. Id., 7 P.2d at 420.
30. Id. at 170-71, 7 P.2d at 421.
31. For an articulate discussion as to the rather puzzling holding of Simons, see Brown, supra note 1, at 218-19.
33. See also Berry v. Tide Water Associated Oil Co., 188 F.2d 820, 822 n.4 (5th Cir. 1951). This latter decision cites the Texas case of Shell Oil Co. v. Goodroe, 197 S.W.2d 395 (Tex. Civ. App. 1946), for the proposition that a lessor's execution of a top lease constitutes a declaration of forfeiture, thus forbidding drilling operations by the bottom lessee. A close reading of the Shell Oil decision reveals that it is weak authority for the proposition cited by the Fifth Circuit. In Shell Oil, the lessor not only executed top leases, but repudiated the bottom leases and demanded their release by the bottom lessee prior to expiration of their primary term. See Brown, supra note 1, at 229-30.
34. 255 F. Supp. at 63-64.
35. Id. at 63.
As judicial precedent, the quoted statement of the court in *Robinson* is questionable. As pointed out by one commentator, the court’s reliance on cited authority appears to be misplaced.\(^\text{36}\) Furthermore, the holding of the *Robinson* court was based on alternative grounds, namely that the lessor “attacked” the bottom lessee’s title through litigation to cancel the bottom lease before the first shut-in royalty was due.\(^\text{37}\)

The decisions, even though they seem to be against the weight of authority in this area, should not be taken lightly. To be safe, a top lease should state expressly that it is taken subject to the rights of prior lessees under the terms of any valid and subsisting bottom lease in existence at the time the top lease is executed.

### III. PROBLEMATIC ASPECTS OF TOP LEASING

#### A. The Two-Party Top Lease

As stated above, a two-party top lease situation is one in which, for one reason or another, the bottom lessee secures another lease from the lessor before the primary term of his prior lease expires, with the top lease to take effect at the expiration of the earlier lease. In many instances, such a situation would not cause great concern to an oil and gas lawyer or landman. However, there are certain circumstances in which the bottom lessee’s actions may result in litigation. Two such circumstances involve the issues of whether the top lessee may avoid overriding royalty and gas purchase contract obligations created under or burdening his bottom lease.

1. Extinguishing Overriding Royalty Obligations

One of the questions that may arise in the two-party top lease situation is whether overriding royalty obligations, created during the term of the bottom lease, survive the execution of a top lease. Cases indicate that the answer depends on the facts surrounding the creation of the overriding royalty. Where the lessee obtains his bottom lease by assignment, and the assignor’s sole consideration for making the assignment is the reservation of the override, the override will likely burden the lessee’s top lease. Conversely, where other additional consideration is involved in the assignment of the bottom lease, the lessee may be found to take his top lease free from the previously created overriding royalty burden.

*Brannan v. Sohio Petroleum Co.*\(^\text{38}\) involved a suit to establish and enforce an assignor’s right to an overriding royalty interest in an oil and gas leasehold. Plaintiffs had assigned to defendant two oil and gas leases covering lands in Oklahoma. The leases were for a primary term of five years, terminating October 25, 1954. Each assignment reserved to the assignors an overriding royalty of one-sixteenth of seven-eighths of all oil and gas produced on the premises. Shortly before the primary lease terms expired, defendant obtained a top lease covering both tracts from the mineral owners. The top

\(^{36}\) Brown, supra note 1, at 220 n.56.

\(^{37}\) 255 F. Supp. at 63. See Brown, supra note 1, at 220.

\(^{38}\) 260 F.2d 621 (10th Cir. 1958).
lease provided that it was subject to existing leases and should not go into effect until the existing leases terminated. Defendant did nothing to develop the premises during the life of the original leases. Then, after the original leases expired and the top lease became effective, defendant developed the premises and obtained production. Plaintiffs claimed an overriding royalty interest in the oil and gas produced, but defendant successfully resisted the claim.39

The plaintiffs in Brannan contended that a fiduciary relationship existed between them and defendant, and that after defendant's top lease became effective, they were entitled to a constructive trust upon the leasehold estate for the undivided portion of production reserved in the earlier lease assignments. The court stated:

In ordinary circumstances, the mere reserving of an overriding royalty interest in the assignment of an oil and gas lease-alone and without more—does not create a confidential or fiduciary relationship between the assignor and the assignee which denies to the assignee the right to obtain from the owner of the land a top lease to take effect after the expiration of the assigned lease free of the burden of the overriding royalty, either in the form of a constructive trust or otherwise.40

The court distinguished the Brannan decision from that in Rees v. Briscoe,41 where the Oklahoma Supreme Court had held that a fiduciary relationship existed between an assignee and an assignor. The Rees court had determined that where the assignor had received no consideration for the leases except the overriding royalty interest and the assignee's express agreement that a well would be drilled, the assignee took renewal leases impressed with a trust in favor of the assignors and respecting their overriding royalty interest reserved in the original lease assignments. The court in Rees had said it was unreasonable to assume that the assignor would assign the leases for no present consideration unless he felt he could depend upon the assignee to undertake development of the leases.

In contrast, the assignors in Brannan not only reserved the overriding royalty, but also were paid a cash bonus of fifty dollars per acre for the land covered by the assigned leases, and nothing was said about drilling a well on that land. The Brannan court held that the assignment created no fiduciary relationship impinging upon the assignee's right to obtain a top lease that would become effective on termination of the assigned leases, "free of any burden either in the form of a constructive trust or otherwise concerning the share in the production reserved in the assignment."42

A recent decision of the Eighth Circuit Court of Appeals, St. Clair v. Exeter Exploration Co.,43 involved the question of whether plaintiff, pursuant to a turnkey agreement by which plaintiff had sold a number of properties (including a farmout of the bottom lease) to defendant, was entitled to re-

39. Id. at 621-23.
40. Id. at 622.
41. 315 P.2d 758 (Okla. 1957).
42. 260 F.2d at 623.
43. 671 F.2d 1091 (8th Cir. 1982).
ceive an assignment of an overriding royalty under a top lease acquired by defendant. In brief, the primary term of one of the leases subject to the turnkey agreement expired; the defendant, however, secured a top lease on those lands prior to the expiration date. Defendant refused plaintiff's request that defendant assign plaintiff an override under the top lease pursuant to the turnkey agreement. In a decision that turns largely on the language of the particular contracts involved, the Eighth Circuit affirmed the lower court decision which required the defendant to assign the override.44

2. Extinguishing Gas Purchase Contract Obligations

A recent federal decision, Amarex, Inc. v. Federal Energy Regulatory Commission,45 concerned a two-party top lease situation involving a gas purchase contract. Amarex had acquired by assignment the bottom lease, which commenced in 1967, with a primary term ending in 1972, covering a quarter-section of land. That lease was included in a 1970 contract for the sale of natural gas to the Arkansas Louisiana Gas Company (Arkla) for a primary period of twenty years. By virtue of a Federal Energy Regulatory Commission (FERC) order regarding small producers, Amarex was granted a certificate of convenience and necessity of unlimited duration covering all Amarex sales and services in interstate commerce.

Amarex's service under the 1970 gas purchase contract began with initial deliveries to Arkla in 1971 of gas from acreage included in the contract, but not from the quarter-section covered by the 1967 bottom lease. Amarex's leasehold interest in the lands covered by the 1967 lease expired in September, 1976. Some five months earlier, however, the lessors executed a top lease with Amarex covering the same quarter-section of land, with a primary term of five years beginning on the date the 1967 lease expired.

Before executing the 1972 top lease, Amarex requested a title opinion, which advised that any gas produced from the premises would be subject to the 1970 gas purchase contract. Despite that advice, Amarex refused to comply with Arkla's request that gas attributable to Amarex's interest in the subject quarter-section be delivered to Arkla when production began under the 1972 top lease.

Both parties commenced proceedings before FERC. Arkla first filed a complaint asking FERC to direct Amarex to deliver the natural gas attributable to Amarex's oil and gas leasehold in the lands covered by the 1972 top lease. Amarex, in turn, filed a petition for a declaratory order that Arkla was not entitled to the gas from Amarex's 1972 leasehold.46

FERC held that the public service obligation, imposed by Amarex's small producer certificate of public convenience and necessity and the terms of the 1970 gas purchase contract between Amarex and Arkla, applied to Amarex's leasehold interest under the 1972 top lease, and directed Amarex

44. Id. at 1097.
45. 603 F.2d 127 (10th Cir.), cert. denied, 444 U.S. 1102 (1979).
46. Id. at 128-29.
to deliver to Arkla any gas produced from or attributable to Amarex's interest in the subject quarter-section for interstate transportation and sale.\textsuperscript{47} Amarex appealed FERC's order.

The Tenth Circuit Court of Appeals affirmed the order, following the Supreme Court's holding in \textit{California v. Southland Royalty Co.}\textsuperscript{48} In \textit{Southland}, the Supreme Court examined FERC's interpretation of the relevant portion of the Natural Gas Act,\textsuperscript{49} which provides that, once gas has begun to flow in interstate commerce from a field subject to a certificate of unlimited duration, a service obligation is imposed, and the expiration of a lease on the field does not affect the obligation to continue the flow of gas; the service obligation cannot be terminated unless FERC authorizes abandonment of service.\textsuperscript{50}

Relying on \textit{Southland}, the Tenth Circuit found that Amarex was in an even less favorable position than was Southland Royalty Company. Southland Royalty Company was a stranger to the gas purchase contract and the certificate involved in the \textit{Southland} case.\textsuperscript{51} Such was not the case in \textit{Amarex}, where the top lessee was a party to the contract and had been delivering gas pursuant to its certificate of unlimited duration.

The teaching of the \textit{Amarex} decision, when read in light of \textit{Southland}, is that a top lessee will not be able to "top" his own bottom lease to avoid the obligations of a gas purchase contract burdening the bottom lease where interstate deliveries have been made pursuant to a certificate of public convenience and necessity of unlimited duration.

It is crucial that the \textit{Amarex} and \textit{Southland} decisions, read jointly, not only control in a two-party top lease situation, but also in a three-party top lease situation. Therefore, where a third party top leases an existing lease that is subject to a gas purchase contract, and the bottom lease is included in a field from which gas is being delivered in interstate commerce pursuant to the contract and to a certificate of public convenience and necessity of unlimited duration, the top lessee may not avoid the obligations of the gas purchase contract.

\textbf{B. The Three-Party Top Lease}

In a three-party top lease situation, most disputes arise between the top lessee and the bottom lessee over whose lease is valid. Therefore, questions of whether the bottom lessee has extended his lease into its secondary term by

\textsuperscript{47} Id. at 129 (citing Commission Opinion No. 798). FERC denied Amarex's application for rehearing in Opinion 798-A, but permitted Amarex to deliver gas to Arkla under a protective order, pending the outcome of judicial review.

\textsuperscript{48} 436 U.S. 519 (1978). Judge McWilliams' Tenth Circuit opinion was written after the opinion of the Supreme Court in United Gas Pipe Line Co. v. McCombs, 442 U.S. 529 (1978). Although Judge McWilliams stated in his opinion that the court believed the \textit{McCombs} decision fully supported the result reached in the \textit{Amarex} case, Judge Barrett's concurring opinion raises some doubt. Judge Barrett's concern is not relevant here, however, as it deals with whether \textit{Southland} should be broadened beyond \textit{McCombs} to include dedications of all "fields" subject to the certificate.


\textsuperscript{50} 436 U.S. at 525.

\textsuperscript{51} 603 F.2d at 131.
production, pooling, payment of shut-in royalties or otherwise, dominate. Central to three-party top lease situations is the risk involved in top leasing should the bottom lease be extended. By entering into a top lease, a lessee gambles that he may lose the portion of the bonus he pays the mineral owner upon execution of the top lease if the bottom lease does not expire at the end of its primary term.

In most cases, the top lessee should be able to avoid litigation by verifying conclusively, prior to taking possession of the leased premises, that the bottom lease has in fact expired by its terms. Such a factual determination is not always easy, however, and disputes may ensue even though the top lessee has satisfied himself that the bottom lease expired prior to his entry. The result is often an action in trespass.

1. Trespass

Several courts have found a top lessee in trespass where the top lessee has entered onto the leased premises and started drilling operations after the end of the bottom lease’s primary term. In general, these cases involve situations where, for one reason or another, the top lessee believes that the prior lease has expired but in fact the bottom lease has been extended into its secondary term, either by pooling, by commencement of drilling operations, by production prior to expiration, or otherwise. However, where the bottom lessee does not relinquish his leasehold when his lease has expired, the top lessee might recover damages for the bottom lessee’s trespass as well.

The first case to consider trespass by a top lessee, Swiss Oil Corp. v. Hupp, involved an action for damages by a bottom lessee against a top lessee whose lease had been adjudicated invalid and who had been found in trespass in an earlier decision.

The issue in Swiss Oil—and central to any case concerned with assessing damages where a top lessee has trespassed—was whether the top lessee was a “willful” or “innocent” trespasser. As stated by the court in Swiss Oil, that distinction generally is made using the following test:

The conditions and behavior are usually such that the court can determine whether the trespass was perpetrated in a spirit of wrongdoing, with a knowledge that it was wrong, or whether it was done under a bona fide mistake, as where the circumstances were calculated to induce or justify the reasonably prudent man, acting with a proper sense of the rights of others, to go in and to continue along the way.

Included among the factors the Swiss Oil court considered as evidencing the good faith of the top lessee were: 1) at least reasonable doubt existed as to the bottom lessee’s exclusive or dominant right; and 2) the top lessee acted

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52. See, e.g., Joyce v. Zachary, 434 S.W.2d 659 (Ky. 1968); Lebow v. Cameron, 394 S.W.2d 773 (Ky. 1965); Swiss Oil Corp. v. Hupp, 253 Ky. 552, 69 S.W.2d 1037 (1934); Lone Star Producing Co. v. Walker, 257 So. 2d 496 (Miss. 1971). See also Superior Oil Co. v. Devon Corp., 604 F.2d 1063, 1072-73 (8th Cir. 1979).

53. See, e.g., Lone Star Producing Co. v. Walker, 257 So. 2d 496 (Miss. 1971).

54. 253 Ky. 552, 69 S.W.2d 1037 (1934).

55. Id. at 560, 69 S.W.2d at 1041.
upon the advice of counsel, to whom all the facts had been fairly submitted. Using these factors and considering the specific facts presented, the court affirmed the trial court's finding that the top lessee was an innocent trespasser.

The court then turned to the question of damages. The bottom lessee sought to recover the "gross" receipts of the oil produced by the top lessee, based on the contention that the top lessee was a willful trespasser. As stated, however, the court found that the top lessee was an innocent trespasser. The court considered the weight of authority regarding the measure of damages for a good faith trespass or appropriation, and found it to be the value of the oil at the mouth of the well, less the amount reasonably expended in producing it.56

The top lessee urged the court to employ the exception to the general rule, recognized in Kentucky, that establishes the damage or compensation as the customary royalty paid in the community.57 The court distinguished that rule, stating that it was only a fair measure of damages as between a mineral owner and a trespasser who has removed the mineral. As between two oil and gas lessees, the court noted that in the usual contractual relation a lessee is entitled to seven-eighths of the oil produced and not, as in the case of the landowner, one-eighth of the oil produced.58 The top lessee also urged the court to allow it to return the same quantity of oil it took from the lease. The court termed this a "novel proposition" and rejected it, noting that the decrease in the value of oil since the top lessee had removed it from the premises was a matter of common knowledge.59

The court in Swiss Oil followed the weight of authority and concluded that the bottom lessee was entitled to the top lessee's net profits, that is, to the value of the oil at the mouth of the well as established by the sale price, less reasonable costs and expenses of production.60 The court considered several contested deductions by the top lessee. It rejected the top lessee's attempt to deduct the value of improvements, income taxes and legal fees.61 The court also refused to disturb the trial court's discretionary ruling that the bottom lessee was not entitled to recover interest.62

Subsequent cases in Kentucky further illuminate the question of measuring damages owed by the top lessee who is an innocent trespasser. For example, in the case of Joyce v. Zachary,63 Kentucky's highest court again held that the top lessee was liable to the bottom lessee for his net profits. In Joyce, the top lessee was entitled to take the following deductions: 1) waterflooding

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56. Id. at 564, 69 S.W.2d at 1043 (citing Barnes v. Winona Oil Co., 83 Okla. 253, 200 P. 985 (1921); L. Mills & J. Willingham, Law of Oil and Gas § 22 (1926); 1 S. Willis, Thornton on Oil and Gas § 59 (5th ed. 1932)).
57. The court seemed to indicate that the Kentucky law in this regard stemmed from coal cases. See, e.g., Kentucky Harlan Coal Co. v. Harlan Gas Coal Co., 245 Ky. 234, 53 S.W.2d 538 (1932); New Domain Oil & Gas Co. v. McKinney, 188 Ky. 183, 221 S.W. 245 (1920).
58. Swiss Oil Corp. v. Hupp, 253 Ky. 552, 563, 69 S.W.2d 1037, 1044 (1934).
59. Id. at 567, 69 S.W.2d at 1044-45.
60. Id. at 567, 69 S.W.2d at 1044.
61. Id. at 567-69, 69 S.W.2d at 1045.
62. Id. at 569, 69 S.W.2d at 1046.
63. 434 S.W.2d 659 (Ky. 1968).
expenses; 2) ad valorem taxes; 3) overpayment of landowner's royalties; 4) operating expenses after suit was filed; and 5) expenses for drilling a dry hole. The court rejected the top lessee's attempt to deduct "supervisory" expenses of one of its non-participating partners.

Superior Oil Co. v. Devon Corp. is a recent federal decision consistent with the Kentucky cases discussed above. The Superior Oil facts were as follows: in 1949, the mineral owners executed an oil and gas lease to Superior Oil Company covering 3,440 acres of land in Banner County, Nebraska. The lease had a primary term of ten years and "as long thereafter as oil, gas, . . . or any of the products covered by this lease is or can be produced." Oil was discovered and produced within the primary term, and in 1961, that part of the Superior leasehold on which oil was being produced was unitized into the Willson Ranch Field "J" Sand Unit.

After 1961, neither Superior nor its subsequent assignees conducted further drilling on the tracts covered by the Superior lease. In February 1976, the successors in interest to the original lessors executed oil and gas top leases to Chris L. Christensen, Jr., on certain tracts that were subject to the prior Superior lease, and an oil well was successfully completed in February 1977.

In June 1977, Superior and its assignees filed an action naming as defendants the lessors, and the lessee and assignees under the 1976 top leases. Plaintiffs alleged in part that the lessors breached their contract with plaintiffs by executing the top leases, thereby creating a cloud on title, and that the top lessee and his assignees were guilty of trespass and conversion. Plaintiffs sought injunctive relief, an accounting, and a decree quieting title to the leasehold. In turn, the lessors sought cancellation of the Superior lease for plaintiffs' breach of the implied covenant of further development, which covenant, apparently, had not previously been recognized under Nebraska law.

The district court concluded that it had to find the lessors liable for the execution of the top leases unless the bottom lessee, Superior, and its assignees had violated the implied covenant to further develop prior to February of 1976. The court then found that Superior had failed to meet the standards required of a prudent operator and that prior to February 1976 it had breached the implied covenant to further develop. The court dismissed

64. Id. at 661-63.
65. Id. at 662.
66. 604 F.2d 1063 (8th Cir. 1979).
67. Id. at 1066.
68. Id.
69. See Note, Oil and Gas, 13 Creighton L. Rev. 1429-35 (1980).
70. Superior Oil Co. v. Devon Corp., 458 F. Supp. 1063, 1071 (D. Neb. 1978), rev'd, 604 F.2d 1063 (8th Cir. 1979). The decision of the lower court held that, as between Superior and the lessors, the express terms of the 1949 lease had not been breached and that neither the failure to file an affidavit of production (required by Nebraska law) nor the subsequent unitization agreement altered the lessor-lessee contractual relationship between those parties.
71. 458 F. Supp. at 1075. The court held that an adjudication of breach of the implied covenant to further develop was not barred by the failure of the lessors to demand further drilling, and ordered that portion of the Superior lease outside the Willson Ranch Field "J"
plaintiffs' claim against the top lessee and his assignees.\textsuperscript{72}

The Eighth Circuit Court of Appeals reversed, finding that the Superior lease should not have been cancelled because the lessee had not been served with notice or demand before the lessor executed the top leases.\textsuperscript{73} The court held that the lack of notice and an opportunity for redemption protected the lease against allegations of a breach of implied covenant to further develop; consequently, the district court erred in dismissing the action. However, the court of appeals' decision did not rest upon a finding of insufficient notice to the plaintiffs; the court also considered the question of notice to the defendants:

The fact that the Superior lease was valid and prior to the [top] lease does not \textit{ipso facto} make the [top lessee and his assignees] trespassers and converters . . . . Although the Superior lease, as between Superior and its lessors, was held by production after expiration of the primary term in 1959, no affidavit of production was filed under Neb. Rev. Stat. § 57-208 . . . . Section 57-208 is a notice statute to the public . . . . The 1949 lease did not provide notice to subsequent purchasers of its existence after the expiration of the primary term. A purchaser after August 1, 1959, who relied upon the public records and who did not otherwise have actual or constructive notice of the Superior lease would therefore be a subsequent good faith purchaser for value, and his leasehold interest would be prior to that of the lessees under the Superior lease.\textsuperscript{74}

The Eighth Circuit concluded that if the top lessee and his assignees did not have actual or constructive notice of oil production under the Superior lease, they would be bona fide purchasers for value and the bottom lessee's only recourse would be against the lessors.\textsuperscript{75} The court continued, “[i]f, however, the [top lessee or his assignees] had actual or constructive notice of plaintiffs' interests, \textit{they would be trespassers and converters and would be liable to plaintiffs for damages and such other relief as may be appropriate}.”\textsuperscript{76}

In a significant footnote,\textsuperscript{77} the court stated that the top lessee may have made a good faith but mistaken determination that the Superior lease was not held by production. The appellate court pointed to the lower court’s finding that the top lessee had conducted a title search, obtained an attorney’s title opinion and concluded that Superior’s lease was not held by production. The court noted that if the lower court upon reconsideration found the top lessee had actual or constructive notice of production from the Super-

\textsuperscript{72} Id. at 1080.

\textsuperscript{73} The Eighth Circuit grounded its reversal on the principle that an oil and gas lease is a recognized and protected property interest, that a cancellation of an oil and gas lease effects a forfeiture of that interest and that the law abhors a forfeiture. Accordingly, the court concluded that an oil and gas lease will not be cancelled for breach of an implied covenant without the lessor having first given the lessee notice of the breach and demanding that the terms of the implied covenant be complied with within a reasonable time. 604 F.2d at 1069.

\textsuperscript{74} Id. at 1072 (citing Cities Serv. Oil Co. v. Adair, 273 F.2d 673, 677 (10th Cir. 1959); Grand Island Hotel Corp. v. Second Island Dev. Co., 191 Neb. 98, 214 N.W.2d 253 (1974)).

\textsuperscript{75} 604 F.2d at 1072.

\textsuperscript{76} Id. at 1072-73 (emphasis added).

\textsuperscript{77} Id. at 1073 n.13.
rior leasehold, "under the circumstances of the case equity may require that they recover their drilling and production costs." The court, therefore, implicitly recognized the willful-innocent distinction in damages for trespass in a case where the top lessee was found liable for trespass against the bottom lessee's leasehold.

In sum, the Superior Oil decision is instructive for top lessees who execute a top lease on a bottom lease that is within its secondary term. If the lands are within a jurisdiction, such as Colorado or Nebraska, that requires an affidavit of production to be placed of record as constructive notice that a lease has been extended by production into its secondary term, and no such affidavit is of record under the bottom lease, the top lessee who does not otherwise have actual or constructive notice of the continued effectiveness of the bottom lease may be elevated to the status of a bona fide purchaser. As such, his lease may be insulated from liability. The bottom lessee's only legal recourse in such an event would lie against the lessor.

A decision by the Mississippi Supreme Court, Lone Star Producing Co. v. Walker, presents the reverse side of the top lessee-as-trespasser case. In Lone Star, the top lessee recovered damages from a bottom lessee who was adjudged to have an invalid lease after production ceased for an unreasonable time during the bottom lease's secondary term. The bottom lessee in Lone Star had extended his lease past its primary term by production. The top lease was entered into during the sixty-day window period allowed for beginning drilling or reworking operations after production ceased. In fact, production under the bottom lease ceased for more than sixty days before reworking operations began.

The Mississippi Supreme Court affirmed the trial court's holding that the delay invalidated the bottom lease and that the top lessee's lease was therefore valid. The top lessee was able to clear the cloud on his title created by the bottom lessee's continued possession under the terminated prior lease. Further, the court held that the top lessee was entitled to damages in the amount of the value of production from the date of the bottom lessee's completion of reworking operations, less the bottom lessee's reasonable costs of production.

2. Protecting Against Last-Minute Bottom Lease Extensions

One of the most difficult issues in the three-party top lease situation arises in the following factual situation: A, the mineral owner, leases the oil and gas leasehold estate to B, the bottom lessee. Before the primary term of

78. Id.
81. 257 So. 2d 496 (Miss. 1971). It might be noted that the top leases involved in Lone Star were executed two years after the expiration of the primary term of the bottom lease; however, the "top lease" classification was correct because at the time of their execution the bottom lease was still alive by virtue of the clause in the bottom lease granting the lessee 60 days to engage in drilling or reworking operations after cessation of production.
82. Id. at 500-01.
83. Id. at 501.
that lease expires, A enters into a top lease with C, and then executes an extension agreement with B, extending the bottom lease. Do A's actions in extending the bottom lease render C's top lease ineffective?

The Oklahoma Supreme Court's decision in *Rorex v. Karcher*, 84 discussed above, is authority for the proposition that the bottom lessee's rights under such an extension agreement would be subject to the superior rights of the top lessee. For this to be the case, however, the court in *Rorex* made the following point:

It is insisted by the defendants, that one of the rights of the lessees under the first lease was to procure an extension of time during the lifetime of the first lease. There was no provision in the lease contract granting an extension or right of extension to the lessees, and any extension procured by the lessees was subject to the rights of intervening third persons. Prior to the time the extension was procured, the rights of the plaintiff intervened by reason of his lease, and any extension granted after the execution of the lease to the plaintiff was taken subject to the rights of the plaintiff under his lease. 85

At least in Oklahoma, therefore, it appears that so long as the bottom lease does not expressly grant an extension or create a right of extension in the lessee, any extension procured by the bottom lessee would be subject to the rights of an intervening third-party top lessee.

The Nebraska Supreme Court addressed a related situation in *Willan v. Farrar* 86 and found that, having entered into a top lease, the lessor owes a duty to the top lessee not to render the provisions of the top lease ineffective. In *Willan*, Willan's oil and gas leases, which provided for termination unless delay rentals were paid by a specified date, burdened the lessor's mineral estate. Before delay rentals became due under Willan's bottom leases, the lessor executed top leases that apparently were to be effective only if the bottom leases terminated for failure to pay the rentals. Although there was some dispute as to whether the lessor extended the time for rental payment and whether he actually accepted the payment, the bottom lessee tendered delay rental payment after the due date. The bottom lessee then brought an action to quiet its title in the leasehold.

The question before the court was whether the bottom lessee paid his delay rentals before the due date. The court concluded, "[t]he evidence is plain he did not and the top leases thereupon fell into place according to their terms." 87

In a well-reasoned opinion, the *Willan* court cited favorably to *Rorex v. Karcher*, discussed above, and held:

The top leases were expressly given to be in force on the termination of the prior ones because of nonpayment of the rentals. The [lessors] evidently desired that their premises remain under lease if Willan's delay rentals were not paid. Though [the bottom lessee]
had an option by which he could continue the leases by paying the rentals when they became due, he was under no obligation to do so. (The lessors) having given the top leases to [the top lessee] owed a duty not to render their provisions ineffective. The purpose of [the top] leases should not be permitted to be defeated by the actions of the lessors at will.88

The Rorex and the Willan cases indicate that the top lessee may be able to prevent the lessor or bottom lessee from defeating the top lessee's rights as an intervening purchaser. One important caveat should be remembered, however: the top lessee's rights are always subject to the bottom lessee's rights under the terms of the latter's lease. Therefore, if the bottom lease expressly grants the right to an extension or the right to pool, and the lands are pooled or an extension agreement is entered into after the top lease is executed but before the bottom lease expires, the top lease would not take effect.

Riders might be employed by a top lessee who wants to avoid the situation litigated in Rorex.89

IV. SUMMARY OF LEGAL THEORIES THAT MAY INVALIDATE A TOP LEASE

A bottom lessee who has been "topped" may assert a number of different theories of liability against the lessor and/or the top lessee. Although many but not all of these theories have been touched upon, several deserve special summary treatment. The theories that might invalidate a top lease include: 1) violation of the Rule Against Perpetuities; 2) cloud on title; 3) obstruction of the prior lessee's interest; 4) tortious interference with the prior lessee's contractual rights; and 5) trespass by the top lessee.

A. Violation of the Rule Against Perpetuities

Although this theory of liability will arise only in the rarest of circumstances, an improperly drafted top lease may be invalid if it does not meet the test imposed by the Rule Against Perpetuities. The Rule Against Perpetuities stems from the common law of England, and was developed as a legal mechanism to prevent the creation of remote future interests in real property that might never vest. Despite its archaic roots, the Rule is still recognized in many jurisdictions. The Rule, as commonly phrased, states that "no interest is good unless it must vest, if at all, not later than 21 years after some

88. Id. at 6, 124 N.W.2d at 704 (emphasis added).
89. The following are examples of riders that might be used to protect the top lessee from prior lease extensions:

Example 1: Lessor agrees to execute no agreements, the effect of which would be to extend the primary term of the said prior lease.

Example 2: Lessor represents and warrants that lessor has not entered into any renewal or agreement to renew said prior lease or amended said prior lease so as to extend the primary term as set forth or recorded therein. Further, lessor covenants and agrees not to extend, amend or modify said existing lease.

The riders probably would be effective only where the bottom lease is silent on the right to extension, however, because the top lessee's rights should always be subject to the rights of the bottom lessee as set forth by the express terms of the latter's lease. See also Ernest, supra note 1, at 978-79.
life in being at the time of creation of the interest.\textsuperscript{90}

Simply stated, if a lessor purports to grant a top lease that is to vest at the time the existing lease terminates, the top lease might be held to be void under the Rule because there is no assurance that the bottom lease will terminate or that the top lessee’s leasehold interest will vest within the perpetuity period.\textsuperscript{91}

The likelihood of such an improperly drafted top lease running afoul of the Rule Against Perpetuities is confirmed by case law.\textsuperscript{92} In a recent case, \textit{Stoltz, Wagner & Brown v. Duncan},\textsuperscript{93} the top lessees sought to quiet title in their leasehold estates. Defendants were the assignees under the prior leases. Plaintiffs contended that defendants’ leases had expired at the end of their primary term. The defendants in their counterclaim asserted that plaintiffs’ top leases violated the Rule Against Perpetuities and were void.

The top leases in issue in \textit{Stoltz} provided:

\[\text{[F]or a term of one (1) year from and after the 8th day of August, 1975, or from and after the expiration of the existing lease, whichever is the later, hereafter called ‘primary term’ and as long thereafter as oil, gas . . . may be produced.}\textsuperscript{94}

The court held that under Oklahoma law, a party cannot maintain an action to quiet title unless he has a title or an interest in the land. As stated, the top leases provided that their effective date was August 8, 1975, or “at the expiration of the existing oil and gas lease, whichever is the later.” The court found that the top leases appeared to violate the Rule Against Perpetuities.\textsuperscript{95} However, the court maintained that the plaintiffs’ top leases could be reformed under the “cy pres” provision of the Oklahoma statutes,\textsuperscript{96} which would act to delete the provision for bringing the top lease into effect at the expiration of the existing lease. The court held that, once reformed, it would be possible for the plaintiffs’ top leases to vest on August 8, 1975, or within the one-year primary term provided for in the top leases, if the owner of the existing leases failed to extend the primary term of his leases.

The court held that the plaintiffs had valid top leases as reformed and could maintain an action to quiet title. However, the court held for the defendants. It found that they had commenced drilling work on August 6, 1975, which was within the primary term of their leases, and that they had continued in good faith and with due diligence so as to comply with the extension terms of their leases. Therefore, the bottom lessees continued their leases beyond their primary terms and, as stated by the court, the top lessees “lost their gamble and must lose their quest to quiet their title to the leases

\textsuperscript{90} J. Gray, \textit{The Rule Against Perpetuities} § 201 (4th ed. 1942).

\textsuperscript{91} I E. Kuntz, \textit{Law of Oil and Gas} § 17.2 (13th ed. 1962 & Supp. 1981); see also Ernest, \textit{supra} note 1, at 961-62.


\textsuperscript{93} 417 F. Supp. 552 (W.D. Okla. 1976).

\textsuperscript{94} Id. at 556.

\textsuperscript{95} Id.

\textsuperscript{96} Okla. Stat. Ann. §§ 75-77 (1971). The cy pres doctrine acts as a liberal rule of construction to allow the fulfillment of an underlying intent to be carried out where the instrument would not permit the intended grant. Thus, the Oklahoma statutes allow an instrument to be reformed to meet the intent of the parties where the Rule is violated.
they topped.\textsuperscript{97}

B. Cloud on Title

If there is a valid non-producing oil and gas lease outstanding, and the primary term is about to expire, the lessor cannot grant a "naked" top lease (one which does not recognize the existence and priority of any outstanding lease and appears to be effective as of the date of execution). Such a grant arguably would cloud the title of the lessee's outstanding lease. \textit{Simons} and \textit{Robinson} illustrate this point.\textsuperscript{98}

C. Obstruction

Under the equitable doctrine of obstruction, the lessor of an oil and gas lease is not permitted to assert that the lease has terminated or otherwise come to an end for the lessee's failure to produce oil or gas or otherwise to comply with the terms of the lease if the lessor has obstructed the operations of the lessee, and such obstruction accounts for the failure of the lessee to comply with the terms of the lease.\textsuperscript{99}

Again, absent language subordinating the top lease to an existing lease, the lessor cannot grant a presently effective "naked" top lease while the prior lease remains in effect; such a grant may serve to obstruct operations under the existing lease and thereby to perpetuate the bottom lease during the period of obstruction.\textsuperscript{100} The granting of a top lease, when combined with other acts by the lessor in which he attempts to repudiate the bottom lease, would obstruct the rights of the bottom lessee. However, so long as the top lease recognizes the existence of the bottom lease and so long as the top lessee and the lessor do not otherwise assert that the top lessee's rights are superior to the bottom lessee's rights while his bottom lease is still in effect, there should be no finding of obstruction from the mere existence of a top lease.

D. Interference with Contractual Rights

Where a top lessee has notice of an existing lease and the top lessee begins exploration and drilling activities before it is certain that the prior lease has terminated, the prior lessee could bring suit against the top lessee for interference with his contractual rights. To avoid such a claim the top lease should specifically recognize outstanding leases or option agreements and should verify the termination of the prior lease before commencing operations under the top lease.

\textsuperscript{97} 417 F. Supp. at 556.

\textsuperscript{98} See supra text accompanying notes 25-37.


\textsuperscript{100} Id.; \textit{Simons} v. McDaniel, 134 Okla. 168, 7 P.2d 419 (1932); \textit{Shell Oil Co.} v. \textit{Goodroe}, 197 S.W.2d 395 (Tex. Civ. App. 1946) (lessor's execution of top leases in conjunction with lessor's notice repudiating bottom lease and demand by lessor that bottom lessee execute a release while bottom lease was still in effect relieved bottom lessee of operating gas well pending resolution of the title dispute).
E. Trespass

Where exploration or drilling operations are conducted under a top lease that is invalid because of the continued validity of a prior lease, a court may find the top lessee in trespass where the top lessee had actual or constructive notice of the prior interest. The cases discussed above stand for the principle that, where the top lessee is found in trespass, he would be liable to the prior lessee for damages and such other relief as may be appropriate. The critical question for trespass damages is whether the top lessee is a willful trespasser, or a good faith trespasser. A willful trespasser who extracts minerals must make complete restitution without credit for expenses incurred. When, however, the trespasser inadvertently, or under a bona fide belief or claim of right, invades the bottom lessee's property and extracts minerals, he is allowed credit for proper expenditures in obtaining or producing the minerals, but is not allowed a profit.

Where the bottom lease grants to the lessee the exclusive right to explore, the top lessee has no right to conduct geophysical exploration on the lands covered by the bottom lease before that lease expires, absent authorization from the bottom lessee. Any such exploration activity could subject the top lessee to liability for seismic trespass.

IV. Checklist for the Top Lessee

In considering the top lessee's potential liability under various theories that might invalidate a top lease, the following checklist is recommended for the potential top lessee:

A. The top lease should be dated the day it is executed.
B. The habendum clause should contain a term of years to begin one day after the bottom lease expires. For example, if the bottom lease expires on at midnight on March 31, 1982, insert "... this lease shall remain in effect for a term of X years from April 1, 1982" (to allow for the situation where the bottom lessee releases his lease prior to the expiration of the primary term, the top lessee might use a clause which states that the primary term of the top lease is for a term of X years from the date that the bottom lease is terminated or released, if such termination or release occurs prior to the expiration of the primary term of the bottom lease, or April 1, 1982, whichever is

102. See supra text accompanying notes 52-81.
103. Swiss Oil v. Hupp, 253 Ky. 552, 69 S.W.2d 1037 (1934). The footnote in Superior Oil, 604 F.2d at 1073 n.13, is consistent with this view.
104. Although no "seismic trespass" cases could be found which involved the geophysical trespass of a top lessee, it is extremely doubtful that the fact that the top lessee had a valid future interest in the oil and gas leasehold would be of concern to a court where the bottom lease provides for the exclusive right of exploration. For cases in the area of seismic trespass, see generally Phillips Petroleum Co. v. Cowden, 241 F.2d 586 (5th Cir. 1957) (applying Texas law); Franklin v. Arkansas Fuel Oil Co., 218 La. 987, 51 So. 2d 600 (1951) (applying Louisiana law); see also, Ohio Oil Co. v. Sharp, 135 F.2d 303 (10th Cir. 1943); Kennedy v. General Geophysical Co., 213 S.W.2d 707 (Tex. Civ. App. 1948); (these last two decisions indicate that liability may be imposed for deliberate and unauthorized off-site exploration, presumably for trespass).
105. See also Ernest, supra note 1, at 978-79.
C. The delay rental obligation under the top lease should commence with a date one year from the day after the date upon which the existing lease's primary term expires.

D. One or more riders should be attached to the top lease, subordinating the top lease to the prior lessee's rights and protecting the top lease from actions by the lessor that would extend the prior lease's primary term.

E. A portion of the bonus due for the top lease should be paid to the mineral owner when the top lease is executed (the percentage of the total to be paid will vary according to the facts involved, that is, depending on the area, the period remaining in the primary term of the prior lease, etc.); the balance due should be payable when and if the lease becomes effective. In addition, if a rider is used to subordinate the top lease to the prior outstanding lease, the top lessee should be in a position to pay the remainder of the bonus for unreleased lands covered by the top lease to the mineral owner within thirty days of receiving notice that the bottom lease has expired.

F. A clause which allows for postponement of the second payment in case of a dispute or litigation as to whether the bottom lease has expired should be included.

G. Record the top lease as soon as possible after execution.

H. If the bottom lease grants the lessee the exclusive right to explore, do not enter upon the leased premises to conduct geophysical or other exploration activities before the prior lease terms permit.

106. Where, for example, the primary term of a top lease is to run three years from its "effective date," rather than three years from the day after expiration of the bottom lease, a court could find that the top lease expires three years from the date of its execution, rather than three years from the date upon which the top lease received any actual rights to the mineral leasehold. A Texas court so found in Oblegoner v. Oblegoner, 526 S.W.2d 790 (Tex. Civ. App. 1975).

107. The following rider might be used to subordinate a top lease:

The lessee's rights hereunder are subordinate to that certain oil and gas lease dated -------, 19 ---, recorded in Book ---, at --- and lessee shall have no right of entry or possession for the purpose of exercising lessee's rights hereunder to the extent such exercise may be adverse to the right of the prior lessee, during the term of such prior lease. After termination of such existing lease, lessor shall give lessee notice and demand stating that said existing lease has expired. Thirty (30) days after receipt of such demand by the lessee this lease shall become null and void, unless on or before the end of said thirty (30) day period, lessee pays to lessor the amount equal to $ --- per net mineral acre owned by lessor in the lands described above as to which lessee has not theretofore (or within said 30-day period) recorded a release of this lease. Payment shall be made direct to lessor at the address shown in this lease, or at the option of lessee, to the depository bank to which the annual delay rentals are to be paid, as provided for in Paragraph --- herein. The commencement of drilling or mining operations by the lessee herein, upon any part of the lands described herein, or upon acreage with which this property has been pooled, shall not relieve said lessee, his successors or assigns, of the obligation to pay the amount set forth above.

The rider contemplates that the top lessee will pay a portion of the bonus due upon execution of the top lease. It subordinates the top lease to the rights of the bottom lessee under the terms of the latter's lease. It provides for written notice and demand by the lessor upon termination of the bottom lease. The rider then gives the top lessee a thirty-day option period to lease those lands described in the lease that the top lessee has not previously (or during the option period) released, by paying the remaining portion of the bonus due on a net mineral acre basis.

108. See supra note 89.

109. Thus, if the bottom lessee drilled a dry hole on a portion of his lease, the top lessee could, in effect, carve out the nonproductive acreage.
I. Make a good faith effort to determine whether the prior lease has terminated or whether the primary term has been extended by production or otherwise before entering onto the leased premises to explore or drill under the top lease. Such effort should include the following steps:

1. Title search, including, prior to drilling, an attorney's title opinion; and,
2. A release from the prior lessee or, at least before drilling, conclusive evidence that the prior lease has expired, which will usually require proof of nondevelopment as to all of the lands in the prior lease and any lands with which any of such lands have been pooled or unitized.

CONCLUSION

Legal authorities illuminate several features of top leases that are of significant import to an oil and gas company engaged in the practice of top leasing. The top lease must expressly recognize the existence of the prior lease and be subject to it. Prior to entrance onto or possession of the leased premises, the top lessee must be absolutely certain that the prior lease has not been extended past its primary term by production, pooling, or otherwise. Even if the primary term of the prior lease should have terminated some years before the execution of the top lease, a top lessee may be a trespasser if he has actual or constructive notice that the prior lease is being held by production.

In this regard, it is of paramount importance that the top lessee make a good faith effort to determine whether the prior lease has in fact terminated, whether the leased lands have been pooled with other lands, or whether the prior lease is being held by production or otherwise. The top lessee should conduct an independent title search and obtain an attorney's title opinion before drilling. The top lessee should also conduct a surface examination. The top lessee should obtain releases or, alternatively, assurances from the lessor that the lessor has given notice and demand to the lessees or assignees of any prior unreleased oil and gas leases. These would constitute the steps that the top lessee must take to ensure the safety of his investment and to shield him from liability to a bottom lessee.

In sum, an examination of the judicial decisions involving top leases reveals that litigation can arise in a number of different circumstances. From the legal perspective, there is much to be learned from the authority in this area. As the practice of top leasing for oil and gas continues to proliferate, the top lessee who knows the law will stand a much better chance of avoiding litigation.