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NOTES

OIL AND GAS LEASES—THE HABENDUM CLAUSE—SUFFICIENCY OF SHUT IN WELLS FOR EXTENSION BEYOND THE PRIMARY TERM

BY DWIGHT D. MURPHEY

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Until the 1890's it was common for oil and gas leases to run for a specified duration, after which they would terminate if not continued by renewal. Ordinarily such leases were for long periods, perhaps for fifteen, twenty or twenty-five years.[1] Since the turn of the century, however, leases of shorter duration have become customary in the oil and gas industry.[2] The craracteristic present day lease runs for from sixty days[3] to ten years and is perpetuated under the habendum clause for an indefinite length of time thereafter if either oil or gas is "found in paying quantities,"[4] "produced,"[5] or "produced in paying quantities"[6] during the initial period. The opening period specified by the lease is called the "fixed," "definite," "initial" or "primary" term.

The courts are not at all uniform in their declarations of what the lessee must do to continue his lease beyond the primary term. It is common for authorities on gas law to tell us that in order to extend the lease "there must be production."[7] However simple this may appear, a student of the subject will not find it helpful. The

[1] 2 Summers, Oil and Gas § 288, p. 115 (Perm. ed. 1938); Veasey, *The Law of Oil and Gas, IV. The Habendum Clause*, 19 Mich. L. Rev. 161, 162 (1921).
[2] *Ibid.*
[3] *E.g.*, Murdock-West Co. v. Logan, 69 Ohio St. 514, 69 N.E. 984 (1904).
[4] Union Gas & Oil Co. v. Adkins, 278 Fed. 854 (6th Cir. 1922); Alford v. Dennis, 102 Kan. 403, 170 Pac. 1005 (1918); Murdock-West Co. v. Logan, 69 Ohio St. 514, 69 N.E. 984 (1904); Roach v. Junction Oil & Gas Co., 72 Okla. 213, 179 Pac. 934 (1919).
[5] Anthis v. Sullivan Oil & Gas Co., 83 Okla. 86, 203 Pac. 187 (1921); Strange v. Hicks, 78 Okla. 1, 188 Pac. 347 (1920).
[6] Cadillac Oil & Gas Co. v. Harrison, 196 Ky. 290, 244 S.W. 669 (1922); Walden v. Potts, 194 Okla. 453, 152 P.2d 923 (1944).
[7] See 2 Summers, Oil & Gas § 298 at 133 (Perm. ed. 1938), "courts generally hold that production within the definite term is necessary to extend the lease beyond it."

habendum itself usually calls for "production" before extension, or else the courts will often construe such words as "found" and "discovered," when they are used in the habendum in place of the word "produced," as being synonymous with "produced."[8] Therefore, we know from the beginning that "production" is required. The problem remains. The student still must determine what constitutes "production" under the law of different states. He has yet to understand which operations will, and which will not, extend the lease after the specified term comes to an end.

It is our purpose here to examine this problem in relation to "shut in wells." A "shut in well" is one which is capable of giving up oil or gas, but which is not being operated, often because there is no pipe line or other market. Will the presence of such a well on leased property at the end of the primary term qualify as "production" under the habendum clause so as to carry on the lease? If so, how long may this extension continue without the actual marketing of oil or gas from the property? What are the rights and duties of the parties while the lease is extended in this manner?

For a simpler analysis, we may distinguish four distinct circumstances under which shut in wells may play a part in the continuation of a lease. They are (a) where oil or gas is marketed during the definite term and the wells are subsequently shut in; (b) where oil or gas is discovered but not marketed during the primary term; (c) where unusual circumstances or lease terms extend the lease and oil or gas is later discovered but not marketed; and (d) where the primary term ends and, although there in nothing else to maintain the lease, discovery is made later. Let us consider these categories one at a time.

I. EXTENSION

A. Where Marketing Precedes the Shutting In

A Texas case has held that where active operations are followed by a decline in well pressure such that the high-pressure pipe line being used cannot carry the gas, a well may be shut in until a new market is found if the parties have included shut in royalties in their lease.[9] In the absence of shut in royalties, another Texas case[10] ruled that a temporary and unavoidable cessation of marketing, as where a well's casing collapses and several months pass before substitute wells are brought in, will not cause a forfeiture of the lease. While the issue in such a case is not strictly one of forfeiture, but rather is one of expiration under the habendum, the decision nevertheless indicates that under such conditions the lease will continue. The court, however, followed reasoning derived from West Virginia authorities, and, as we shall see, Texas has not generally adopted this view.

In *Holchak v. Clark*[11] Texas has maintained its view that only marketing will qualify as "production" for the perpetuation of a

[8] Union Gas & Oil Co. v. Adkins, 278 Fed. 854 (6th Cir. 1922); Murdock-West Co. v. Logan, 69 Ohio St. 514, 69 N.E. 984, 985 (1904): "the lessees must actually find oil in paying quantities, and this is the same as obtaining and producing it in paying quantities." Walker, *The Nature of Property Interests Created by an Oil and Gas Lease in Texas,* 8 Texas L. Rev. 483, 514 (1930). Contra, Texas Pac. Coal & Oil Co. v. Bratton, 239 S.W. 688 (Tex. Civ. App. 1921).

[9] Shell Oil Co. v. Goodroe, 197 S.W.2d 395 (Tex. Civ. App. 1946).

[10] Scarborough v. New Domain Oil & Gas Co., 276 S.W. 331 (Tex. Civ. App. 1925).

[11] 284 S.W.2d 399 (Tex. Civ. App. 1955).

lease. The *Holchak* criticism of Texas cases deviating[12] from this strictness implies that a temporary cessation of marketing will terminate a lease in Texas if it occurs after the definite term. The point is not entirely settled, however. The criticism in *Holchak* is dictum, and the fact situation there is to be distinguished from that in the case just cited.

Kahm v. Arkansas River Gas Co.[13] stated the Kansas position. Here again a gradual depletion of well pressure after several months of successful operations made it necessary to disconnect the well from the only available pipe line, which carried gas only under high presure. Although the Kansas Supreme Court intimated that a temporary cessation of production would not terminate the lease, it held that the lease must expire where further marketing would require the prior development of new wells of sufficient capability as to attract a new, low-pressure pipe line. From the court's language, it would seem that the reasoning in this case is analagous to that in an Oklahoma decision terminating a lease where the only producing well was "plugged and abandoned." Even though the circumstances were not identical, *Kahm* appears based on the view that the permanence of the cessation is material. In so holding, it is consistent with still another Kansas case, which terminated a lease where a well became depleted and the sole hope of future profitability lay in further drilling and discovery.[14]

When wells ceased to surrender oil, but remained capable of producing gas, although no market was available a 1931 Louisiana decision terminated the lease involved.[15]

On the other hand, a lease in Kentucky was held to have remained in force for two years after the only active well had been shut in.[16] The closing of the well followed seven years of operation. Lack of labor and materials during World War II had forced the cessation. "Production," the Kentucky Supreme Court said, " . . . is not a continuing usage. Rather, it is a continuing possibility . . . in a situation of this kind."[17]

It is clear that in West Virginia a lease will not expire if the wells are shut in after marketing has occurred unless it can be shown that the lessee has not acted with due diligence. In *Hutchinson v. McCue*[18] it was said, "the lessee is entitled to an extension of the term for 'as long as the premises are diligently and efficiently operated, provided minerals shall have been discovered within the fixed term.' "[19] Even though the court refused to extend the lease in this case, it clearly did so by reason of its finding that the lessee had not actively sought a new market.

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[12] Scarborough v. New Domain Oil & Gas Co., 276 S.W. 331 (Tex. Civ. App. 1925); Texas Pac. Coal & Oil Co. v. Bratton, 239 S.W. 688 (Tex. Civ. App. 1921).

[13] 122 Kan. 786, 253 Pac. 563 (1927).

[14] Jewett v. Coffeyville Vitrified Brick & Tile Co., 122 Kan. 287, 251 Pac. 1110, 1111 (1927): "When the term had expired and the wells had become unprofitable, the lease was at an end. Defendant was not entitled to hold it thereafter upon a possibility that they might find a deep gas at some later time when they chose to drill for it."

[15] Smith v. Sun Oil Co., 172 La. 655, 135 So. 15 (1931): "where a well has ceased to be a paying proposition for anyone concerned, it has clearly ceased to produce gas in paying quantities."

[16] Locke v. Palmore, 308 Ky. 637, 215 S.W.2d 544 (1948).

[17] 215 S.W.2d at 545.

[18] 101 F.2d 111 (4th Cir. 1939).

[19] *Id.* at 118.

B. Where There Is Discovery, But No Marketing During the Primary Term

Two strong lines of authority differently interpret the habendum clause. Under the following section of this note, we will see that Oklahoma, West Virginia, Pennsylvania and Tennessee construe the clause broadly.[20] Texas, Kansas and Louisiana have given it a narrower construction.

The Broad Construction

Oklahoma. The two views may be found directly opposed in the majority and dissenting opinions in *Bristol v. Colorado Oil and Gas Corp.*,[21] decided by the United States Court of Appeals for the Tenth Circuit. In this case, gas in paying plantities was discovered during the primary term. For nine years thereafter, and seven and two-thirds years after the end of the fixed term, the lessee was unable to market the gas. A pipe line was at last obtained and the gas marketed. The lessor brought action claiming the lease had expired. Although shut in royalties had been paid each year according to agreements made annually, they were not an issue in the case because the lessor had refused to receive them for the last year. The question was precisely whether the condition stipulated in the habendum had been performed. The majority reasoned, consistently with well established Oklahoma law, that no forfeiture results where gas has been discovered in paying quantities during the primary term and the lessee has acted with due diligence in obtaining a market within a reasonable time. It was held that nine years was a reasonable time. Although this may be seriously questioned, the decision clearly illustrates the legal principles espoused by those courts which broadly construe the habendum.

Circuit Judge Huxman, in his dissent to *Bristol*,[22] emphasized that oil or gas must be brought to the surface and sold during the fixed term. The only exception under which the lease may continue without the active operation of at least one well, he said, is where marketing has occurred during the definite term but has been temporarily suspended to allow additional exploration. Only in this event will "due diligence" and "reasonable time" become elements.

It would seem the majority were corrct in their statement of Oklahoma law. In *Parks v. Sinai Oil & Gas Co.*,[23] the Oklahoma court had cited the West Virginia case of *Eastern Oil Co. v. Coulehan*[24] to support a holding that a lease would continue beyond the primary term if gas were discovered and cased off while drilling continued to a lower sand. *Parks* stated that discovery in paying quantities vests the lessee with a limited estate,[25] which could not be lost by the failure to market within the fixed term. It is interesting that the court here cited the earlier case of *Roach v. Junction Oil & Gas*

[20] This line of authority has received unfavorable treatment from some commentators. Summers, *supra* note 1, § 300 at 144-48, has stated that these cases are probably based on equitable considerations, but that it may be objected that conditions precedent to prolonging a lease must be literally performed. Walker, *supra* note 8, at 518 makes substantially the same objection.
[21] 225 F.2d 894 (10th Cir. 1955).
[22] 225 F.2d at 898, 901.
[23] 83 Okla. 295, 201 Pac. 517 (1921).
[24] 65 W. Va. 531, 64 S.E. 836 (1904).
[25] This view is criticized in Summers, supra note 1, at 144, where it is argued that courts have long held that the lessee gets a vested interest upon the very execution of the lease, and that therefore the West Virginia "vested interest upon discovery" doctrine offers no greater basis for extending a lease than is present in other states, including those which narrowly construe the habendum.

Co.,[26] which possibly could have been distinguished on the ground that in that case the habendum called only for the "finding" of gas in paying quantities and provided for a $100.00 royalty, which was tendered by the lessee.

What is significant about the Oklahoma cases is that they have followed the language of the West Virginia decisions. Nearly every case in this area of oil and gas law may be distinguished from other closely related cases on the facts and consequently the authority in most states is incomplete since all conceivable fact problems have not been adjudicated in each jurisdiction. It is often difficult to find authority directly in point. It follows, therefore, that an adequate appraisal of each state's law requires an understanding of the reasoning used the the few cases decided. When a court such as the Oklahoma Supreme Court cites West Virginia authorities,[27] one may feel reasonably sure that the habendum will more or less consistently receive a broad construction. Those citing the weight of authority in Texas, however, will adhere to the stricter interpretation.

West Virginia. In the West Virginia case of *Barbour, Stedman & Co. v. Tompkins*,[28] the court used the words "discovered in paying quantities" interchangeably with "produced in paying quantities." The good faith opinion of the lessee that he had discovered gas in profitable amounts was considered sufficient to extend the lease, even though no gas had been removed from the ground and marketed. Perhaps the broadest statement of the West Virginia doctrine is to be found in *South Penn Oil Co. v. Snodgrass.*[29] Here it was asked "may we not, therefore, say the qualifying clause 'as oil or gas is produced' really means 'as long as the premises are diligently and efficiently operated, provided minerals shall have been discovered within the fixed term?' "[30] The West Virginia court stated that a strict construction of the habendum would "inflict disastrous losses upon diligent and honest lessees in many instances—a consequence plainly not within the intent of either party."[31] Still other opinions by the same court have made it clear that discovery during the primary term will extend the lease unless the lessee clearly abandons the property or forfeits by failure to develop it.[32]

Pennsylvania. In Pennsylvania, a dictum in *Summerville v. Apollo Gas Co.*[33] states that discovery and production are synonymous in that state. Although gas had never been sold from the property, but a well had been completed during the primary term, the court said "we do not find any denial that the well *produced* 1,000,000 feet of gas a day . . . ."[34] The payment of shut in royalties

[26] 72 Okla. 213, 179 Pac. 934 (1919).

[27] West Virginia authorities were cited in: Parks v. Sinai Oil & Gas Co., 83 Okla. 295, 201 Pac. 517, 519 (1921); Roach v. Junction Oil & Gas Co., 72 Okla. 213, 179 Pac. 934, 936 (1919).

[28] 81 W. Va. 116, 93 S.E. 1038 (1917).

[29] 71 W. Va. 438, 76 S.E. 961 (1912).

[30] 76 S.E. at 967.

[31] *Ibid.*

[32] Eastern Oil Co. v. Coulehan, 65 W. Va. 531, 64 S.E. 836, 840 (1909): "Our cases seem clearly to hold that discovery of oil or gas is alone sufficient to vest the right—a right, it is true, which may be lost by abandonment, manifested by neglect to produce, or pursue the work of production and further development." Parish Fork Oil Co. v. Bridgewater Gas Co., 51 W. Va. 583, 42 S.E. 655 (1902).

[33] 207 Pa. 334, 56 Atl. 876 (1904).

[34] 56 Atl. at 878 (emphasis added).

had kept the lease alive, and so this statement is dictum, but it may be considered some indication of the Pennsylvania position.

Tennessee. Benedum-Trees Oil Co. v. Davis[35] is a federal court decision interpreting Tennessee law. It terminated a lease where nine years had passed since completion of a well and all efforts to obtain a pipe line had failed, with no future prospect. The court's rationale, however, was that a reasonable time had passed. From this we may infer that the lease might not have expired if gas in paying quantities had been successfully marketed within some time less than nine years. We may note, also, that the court applied the West Virginia rationale that discovery grants the lessee a vested, though limited, estate in the property, whereas his rights are inchoate before discovery.

Wyoming. The present writer has found scant authority for the Wyoming position. In a 1924 decision,[36] the Wyoming court extended a lease covering property upon which gas had merely been discovered, and not marketed, during the definite term. The lease contained independent "marketing" and "producing" clauses, and from this the court inferred that the parties had intended the habendum clause, which required "production," to demand merely discovery, but not the actual selling of gas. While discussing whether the lease had been forfeited, as a separate problem from whether it had expired by its own terms, the court stated that discovery grants the lessee a vested interest. This is most compatible with the West Virginia law.

Montana. Where gas is found within the primary term in what would be commercial quantities if a market were present, and yet no market is even prospectively available, an operator who has shown diligence in his attempt to find a market is entitled to retain his lease on that portion of the land on which the well is located. The Montana court, in a 1936 case, ruled that under such circumstances the "gas well was 'producing' within the meaning of the lease.[37] According to the reasoning given, the well "producing" in "legal contemplation" from the day the well was completed. The Montana court criticized *Elliott v. Crystal Springs*,[38] a Kansas decision terminating a lease in its entirety under virtually identical circumstances, saying that it "is not in accord with the authorities generally."[39]

The recent case of *Fey v. A. A. Oil Corp.*[40] definitively places Montana in line with the West Virginia authorities.

> To say that they (the lessees) shall be declared in default and to forfeit their lease if they do not market their product, when there is at the time no profitable market, would be contrary to *equitable principles* and to any *express terms* of the lease. It would amount to saying, the defendants have drilled a *producing well* which furnishes gas in marketable quantities, but as there is no market the well is not

[35] 107 F.2d 981 (6th Cir. 1939).
[36] Pryor Mountain Oil & Gas Co. v. Gross, 31 Wyo. 9, 222 Pac. 570 (1924).
[37] Severson v. Barstow, 103 Mont. 526, 63 P.2d 1022, 1024 (1936).
[38] 106 Kan. 248, 187 Pac. 692 (1920).
[39] 63 P.2d at 1024.
[40] 126 Mont. 552, 285 P.2d 578 (1955).

> producing. The contract is not reasonably susceptible to any such interpretation.[41]

In this case marketing arrangements were made after the fixed term had ended.

As we shall see, those states which narrowly construe the habendum clause would have held that the lease expired in each of these cases.

Kentucky. Although interpreting the "unless" clause rather than the habendum, *Unity Oil Co. v. Hill*[42] indicates the Kentucky alignment. The drilling of a well, without "shooting it," was held to meet the requirement under this clause. A dictum, however, says that "it (the well) was not . . . a producing well; that is, one from which oil in profitable quantities *could be taken*.[43] This tells us, though admittedly without great force, that a well capable of giving up commercial quantities is considered a producing well in Kentucky.

We may rely with greater assurance, however, upon *Pennagrade Oil & Gas Co. v. Martin*.[44] Here a well was completed during the primary term but was shut in for two and one half years until a pipe line was obtained. The Kentucky court held that the lease had not expired, arguing that the lessee must be given a reasonable time to market gas after its discovery.

Colorado. No authority is available for the Colorado position on these matters.

(2) *The Narrow Construction*

Texas. The Texas line of authority, giving a narrow construction to the habendum, has been called the majority American rule.[45]

Certainly this is not clear from the case-law. Nevertheless, this construction does have substantial backing. Perhaps it has received its clearest expression in the following remarks from *Stanolind Oil & Gas Co. v. Barnhill*:

> Appellants did not contract for a term which would depend upon the possibility of procuring a market for the product at some date subsequent to its express date of expiration. The lease did not provide that it should remain in force and effect for five years, and as long thereafter as there may be prospects of a market for the product . . .[46]

The facts in this case had shown discovery in paying quantities during the primary term, followed by extensive efforts to find a market. About one year after the fixed term ended, a market was obtained. In such a case, the West Virginia court would have continued the lease.[47] The Texas court did not.

Holchak v. Clark,[48] another Texas decision, criticized the West Virginia rule and two Texas cases following it.[49] The court canceled

[41] 285 P.2d at 587-88 (emphasis added).
[42] 200 Ky. 577, 255 S.W. 151 (1923).
[43] 255 S.W. at 152 (emphasis added).
[44] 211 Ky. 137, 277 S.W. 302 (1925).
[45] See note 7 *supra*; see alsc, Walker, *supra* note 8 at 517 where the West Virginia rule is evaluated as being "a minority group of cases which have placed a lbieral construction upon the habendum clause . . . ."
[46] 107 S.W.2d 746 (Tex. Civ. App. 1937).
[47] See South Penn Oil Co. v. Snodgrass, 71 W. Va. 438, 76 S.E. 961 (1912).
[48] 284 S.W.2d 399 (Tex. Civ. App. 1955).
[49] See note 12 *supra*.

a lease where a favorable drill stem test had shown oil in paying amounts and an active well had been completed after the primary term. "One cannot say that discovery of oil followed by diligent operations is the equivalent to production of oil and gas in paying quantities, without doing violence to the plain meaning of words in common use . . . Production has a commercial connotation."[50] *Holchak* is careful to add, however, that the parties could, by special provision, provide for such a circumstance. Later in this note, in the section dealing with shut in royalties, we will discuss how this might be done.

Dicta in *Morrison v. Swaim*[51] further support the Texas rule. Oil had been discovered during the primary term. Just the same, the Texas court said "the well in question did not occupy the status of a producing oil well . . . "[52] The lease would have expired had not drilling extended it under a special form of the habendum clause, which provided for extension for as long as good faith drilling operations continued.

A very recent case, *Sellers v. Breidenbach*,[53] has reaffirmed these Texas interpretations. *Sellers* repeated the rule that in Texas a shut gas well will not extend a lease in the absence of a shut in royalty provision. It also distinguished the West Virginia rule from that which is predominant in Texas.

Only oversimplification, however, would lead us to state that the Texas position has been clearcut. There has been considerable difference of opinion in that state. Primarily because of the *Sellers* decision, which is the most recent, Texas' position appears clearly defined. The cases to the contrary, although too common to be insignificant, are not the weight of authority there. One of the contrary cases, *Cox v. Miller*,[54] argued that the gas must be marketed *within a reasonable time* and that there must have been "a reasonable expectation and probability of a market for the gas at the time the well was completed"[55] in order for the lease to extend. Since the facts indicated that no market was even prospectively available, the lease expired. The *Cox* reasoning would clearly have extended the lease if a market had been fairly well assured. A narrow construction of the habendum clause would not have led to this implication, nor has it done so.[56]

In *Mitchell v. Perkins*[57] a lessee was given a reasonable time to market the product of a well even if the fixed term expired before the time had elapsed. "It is elementary," the court said, "that where gas or oil is discovered within the primary term, the lessee is entitled to a reasonable time within which to market the same."[58]

A 1955 Texas case from the Court of Civil Appeals also held that where a lease does not provide for shut in royalties and gas is discovered in paying quantities during the fixed term "the lessee

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[50] 284 S.W.2d at 401.
[51] 220 S.W.2d 493 (Tex. Civ. App. 1949).
[52] *Id.* at 495.
[53] 300 S.W.2d 178 (Tex. Civ. App. 1957).
[54] 184 S.W.2d 323 (Tex. Civ. App. 1944).
[55] *Id.* at 327.
[56] See Home Royalty Ass'n v. Stone, 199 F.2d 650 (10th Cir. 1952) (Kansas law held to terminate lease even though the parties stipulated that gas had been marketed within a reasonable time after the primary term).
[57] 266 S.W.2d 451 (Tex. Civ. App. 1953), *rev'd on other grounds*, Perkins v. Mitchell, 153 Tex. 368, 268 S.W.2d 907 (1954).
[58] *Id.* at 454.

should have a reasonable time to market the gas, even though the time required should extend beyond the primary term,"[59] if a market is readily available. The lease expired when due diligence was not shown by the lessee. This case, *Union Oil Co. v. Ogden,*[60] is in line with *Mitchell v. Perkins* and *Cox v. Miller.* These three cases would seem clearly to establish an exception to the severity of the "Texas rule." They may well be established Texas law over the long run. Decisions in other states accustomed to construing the habendum narrowly are in opposition, however.[61]

Holchak v. Clark, supra, has criticized the language in *Texas Pacific Coal & Oil Co. v. Bratton,*[62] where an habendum calling for both discovery and production was interpreted to require only discovery in paying quantities, and not marketing, in order to extend the lease. Since "discovered," "found," and "produced" are generally held to mean the same thing[63] the *Bratton* case may possibly offer some authority, though slight, for cases arising under differently worded habendum clauses. It should be noted, however, that the court seeed to assign a separate meaning to the word "discovered," thereby vitiating somewhat *Bratton's* usefulness for analogy. In any event, the case is in direct alignment with those decisions which have broadly construed the habendum, and as such is contrary to the main course of Texas rulings.

Other states which have narrowly construed the habendum where gas has been discovered but not marketed during the primary term are Kansas and Louisiana. In some states, such as New Mexico, there is little basis for distinct classification, if in fact classification of them is possible.

Kansas. In 1920, the Kansas Supreme Court[64] held a lease to have expired where paying quantities were found during the definite term but where there was no prospect of obtaining a pipe line of the necessary pressure. Twelve years later, *Ratcliff v. Gouinlock*[65] terminated a lease for the mining of clay. Although clay of the proper sort had been discovered within the primary term, it had not been mined until one month afterward. Reasoning by analogy from oil and gas lease problems, the court overrode the lessee's contention that where a well or mine is substantially completed during the fixed term, equity maintains the lease. Rather, it is stated that in oil and gas law it is, "necessary that there should be actual production of oil and gas, not merely exploratory activities in order to extend the term of the lease."[66] While the words "actual production" are ambigious, it is clear that the lessee could have gained an extension only by taking clay from the mine during the initial period of the lease.

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[59] 278 S.W|2d at 249.

[60] 278 S.W.2d 246 (Tex. Civ. App. 1955).

[61] See note 56 *supra;* Ratcliff v. Gouinlock, 136 Kan. 149, 12 P.2d 798 (1932) (terminated mining lease where active extraction of clay began a month and a half after the primary term ended).

[62] 239 S.W. 688 (Tex. Civ. App. 1921).

[63] In Union Gas & Oil Co. v. Adkins, 278 Fed. 854, 856 (6th Cir. 1922), the court held that "found" means "discovered and produced in paying quantities within the term named in the lease." It was said in Murdock-West Co. v. Logan, 69 Ohio St. 514, 69 N.E. 984, 985 (1904), that even though the habendum speaks only of finding oil, "the lessees must actually find oil in paying quantities, and this is the same as obtaining and producing it in paying quantities." See Walker, *supra* note 8 at 514-15.

[64] Elliott v. Crystal Springs Oil Co., 106 Kan. 248, 187 Pac. 692 (1920).

[65] 136 Kan. 149, 12 P.2d 798 (1932).

[66] 12 P.2d at 800.

Two 1952 cases clearly express the Kansas law. Extensive dicta in *Tate v. Stanolind Oil & Gas Co.*[67] review the opposing constructions of the habendum. The court concedes that, "there is a respectable contrary minority view in West Virginia, Texas, Oklahoma, Kentucky, Wyoming, and perhaps in a few other states."[68] But it goes on to say that in its opinion "the great weight ou authority . . . appears to be in harmony with the view that actual production during the primary term is essential to the extension of the lease beyond the fixed term."[69] Although the present writer has found it impossible to substantiate this view of the weight of authority, the court's emphasis, once again, on "actual production" (by which it apparently meant "marketing") 'is clear.

The *Tate* decision is cited in the other 1952 case, *Home Royalty Ass'n. v. Stone.*[70] The issue, upon both fact and law, is here crystal

[67] 172 Kan. 351, 240 P.2d 465 (1952).
[68] 240 P.2d at 469.
[69] *Ibid.*
[70] 199 F.2d 650 (10th Cir. 1952).

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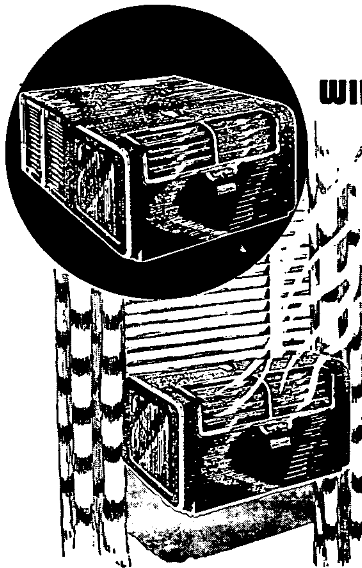

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clear. Four days before the end of the primary term, a gas well was completed with a daily potential of 10,514,000 cubic feet. The gas was successfully marketed three months later, and the parties stipulated that this was a reasonable length of time. The issue raised was whether a lessee has a reasonable time to market gas after completion of a well with high potential even though the time might extend past the expiration of the fixed term. The court held that in Kansas no such opportunity is given. "There must be actual production," it said, "as distinguished from exploration and discovery . . . . "[71]

Louisiana. A lease was held to have expired by its own terms in a 1933 case where the Louisiana Supreme Court reasoned that "gas must be produced within the required time; that is, withdrawn and reduced to possession for use in commerce."[72]

New Mexico. The case of *Town of Tome Land Grant v. Ringle Development Co.*[73] offers an obscure guide to New Mexican law on this subject. It does, however, give us some dicta. The New Mexico court distinguished between leases which provide shut in royalty and those which do not. Where there is no set consideration for the lease, but merely a promise to develop with a hope of future royalties "a lessee cannot be permitted to fail in development and hold the lease for speculative purposes . . . [74] This view would seem compatible with both the West Virginia and Texas rules. Under the particular facts of the case, the lease was terminated by reason of the lessee's lack of diligence during the primary term.

Summary. The preceding review of the case-law in several states warrants the following generalizations, although strictly speaking each state must be considered individually. In certain states discovery of gas during the primary term will usually suffice to extend the lease under the habendum clause if the gas is discovered in paying quantities, the lessee shows due dligence in finding a market, a reasonable time has not elapsed, and there is at least a prospective market. Several other states will generally not extend the lease under such conditions, but instead will require the actual taking and marketing of gas from the well during the definite term. Colorado has no authority and the New Mexico authority is obscure.

C. *Where Unusual Terms or Circumstances Extend the Lease, and Oil or Gas is Later Discovered But Not Marketed*

Even though oil or gas has not been sold in commercial quantities during the fixed term, unusual clauses or circumstances[75] may extend the lease. This may occur, regardless of the state's tendency to follow either the West Virginia or Texas rule. For example, where habendums have provided that a lease is to remain in effect so long as oil or gas is produced or good faith drilling operations are continued, courts interpreting Kansas[76] and Texas[77] law have extended

[71] 199 F.2d at 652.
[72] Pace Lake Gas Co. v. United Carbon Co., 177 La. 529, 148 So. 699, 701 (1933).
[73] 56 N.M. 101, 240 P.2d 850 (1952).
[74] 240 P.2d at 852.
[75] See Strange v. Hicks, 78 Okla. 1, 188 Pac. 347 (1920), where the conduct of the parties was held to be such as to show that they did not consider the lease terminated by failure to market the gas within the primary term.
[76] Christianson v. Champlin Refining Co., 169 F.2d 207 (10th Cir. 1948).
[77] Morrison v. Swaim, 220 S.W.2d 493 (Tex. Civ. App. 1949).

the lease even though there has been a mere discovery of oil, if drilling operations have continued beyond the fixed term. A Wyoming decision[78] extended a lease on the ground that separate "marketing" and "producing" clauses indicated that the parties intended to restrict the word "producing" in the habendum clause to mean discovery in paying quantities. In Montana, a lease which provided that no royalty was to be paid on shut in wells which were closed due to lack of a profitable market was extended on the ground that this language had shown that the parties "contemplated the possibility of a well capable of producing . . . and the possibility that there would be a market for it."[79] In another Kansas case,[80] a separate drilling clause, which allowed extension if drilling were diligently carried through to paying production, was held to have sufficiently modified the habendum as to allow extension.

The parties may agree to an extension of the primary term beyond the date they have originally set. By so doing, the entire lease may be kept in force even though gas has merely been discovered, and not marketed, during the original lease term, according to a Texas decision.[81] A lessee lost his lease to a subsequent good faith lessee in such a case in Ohio,[82] however, where he failed to record the renewal agreement. The Ohio court ruled that the renewal was in fact a new lease, and as such would have to be recorded as provided by Ohio statute.

Estoppel will sometimes be present to keep the lease in force. A lessor in Kentucky[83] was precluded from claiming the expiration of a lease after he had knowingly acquiesced in the lessee's good faith drilling of wells following the end of the definite term. The estoppel doctrine has also been asserted in this connection in Louisiana.[84]

Stipulated rentals. There have been a number of cases in which a lease has continued where only a shut in well has been present and the lessor has been paid a stipulated rental or fixed royalty in accordance with lease provisions to that effect. If such a rental is the only royalty provided for in the agreement, the lessor has in fact very little interest in whether a well is shut in or is active.[85] The rule is different, however, where the lessor is entitled to royalties in excess of the fixed rental.[86] In this event, the rules discussed at length in the previous sections of this note apply.

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[78] Pryor Mountain Oil & Gas Co. v. Cross, 31 Wyo. 9, 222 Pac. 570 (1924).
[79] Steven v. Potlatch Oil & Refining Co., 80 Mont. 239, 260 Pac. 119, 122 (1927).
[80] Tate v. Stanolind Oil & Gas Co., 172 Kan. 351, 240 P.2d 465 (1952).
[81] Masterson v. Amarillo Oil Co., 253 S.W. 908 (Tex. Civ. App. 1923).
[82] Northwestern Ohio Natural Gas Co. v. City of Tiffin, 59 Ohio St. 420, 54 N.E. 77 (1899).
[83] Cadillac Oil & Gas Co. v. Harrison, 196 Ky. 290, 244 S.W. 669 (1922).
[84] Caldwell v. Alton Oil Co., 161 La. 139, 108 So. 314 (1926). Although the lease was canceled on other grounds, the lessor was held to be estopped from claiming forfeiture due to the lessee's failure to drill during the twelve month initial period where the lessor had acquiesced in drilling after this time had elapsed.
[85] Union Gas & Oil Co. v. Adkins, 278 F. 854 (6th Cir. 1922); Summerville v. Apollo Gas Co., 207 Pa. 334, 56 Atl. 876, 878 (1904): "It may be that for some time the lessee was not able to find a purchaser for the gas, but that was not the affair of the lessors. They were not interested in the proceeds of the sale of the gas. Their rights under the agreement extended only to the receipt of a stipulated annual rental for each well, and the free use of gas for domestic purposes. Beyond this, the question of whether or not the quantity of gas was profitable was for the decision of the lessee." McCutcheon v. Enon Oil & Gas Co., 102 W. Va. 345, 135 S.E. 238 (1926); see also dicta in Town of Tome Land Grant v. Ringle Development Co., 56 N.M. 101, 240 P.2d 850 (1952) and Cox v. Miller, 184 S.W.2d 323 (Tex. Civ. App. 1944).
[86] Lowry v. Philadelphia Optical & Watch Co., 161 Pa. 47, 28 Atl. 1004 (1894); accord, Benedum-Trees Oil Co. v. Davis, 107 F.2d 981 (6th Cir. 1939); Smith v. Sun Oil Co. 172 La. 655, 135 So. 15 (1931); Caldwell v. Alton Oil Co., 161 La. 139, 108 So. 314 (1926).

Shut in Royalty Clauses. While terminating a lease in accordance with the Texas construction of the habendum clause, the Texas court in *Sellers v. Breidenbach*[87] mentioned that the parties could have kept the lease alive had they made explicit provision for shut in wells. How might they have done so? What sort of provision would have this effect?

A relatively new type of clause now in common use[88] is the "shut in royalty clause." One form is:

> If while this lease is in effect, oil or gas be discovered on said land which cannot be profitably produced for lack of a market at the well or wells, lessee may pay lessor (a stipulated sum) as royalty for each such well . . . and while such royalty is so paid, such well or wells shall be considered as producing in commercial quantities for all purposes hereunder.[89]

At least one form does not provide, as this one does, that the payment of the royalty will suffice to class the well as a producer of paying quantities. Under this type of provision, it may be necessary to show that the well has a paying potential.[90]

Several Texas decisions have extended leases under such clauses.[91] The leases would have expired otherwise. In *Freeman v. Magnolia Petroleum Co.,*[92] however, the presence of the clause did not achieve extension of the lease where the royalty was tendered four months after the primary term had ended. The royalty must be paid during the primary term if the lease is to be extended. The clause gives the lessee an option: he may pay the royalty and gain extension, or not pay it and see the lease expire.[93] It creates no obligation.

D. Where the Primary Term Ends with Nothing to Sustain the Lease and Oil or Gas is Discovered Thereafter

In *Eastern Oil Co. v. Coulehan,*[94] a West Virginia case, a lease continued in force when gas was found in paying quantities during the fixed term and the lessee drilled deeper, finding a great quantity of gas in the lower sand shortly after the fixed term ended. The

[87] 300 S.W.2d 178 (Tex. Civ. App. 1957).
[88] Scurlock, *Practical and Legal Problems in Delay Rental and Shut-in Royalty Payments,* Fourth Annual Institute on Oil and Gas Law and Taxation 17, 37 (Southwestern Legal Foundation 1953).
[89] Union Oil Co. v. Ogden, 278 S.W.2d 246 (Tex. Civ. App. 1955).
[90] Scurlock, *supra* note 88 at 45.
[91] Union Oil Co. v. Ogden, 278 S.W.2d 246 (Tex. Civ. App. 1955); Moriss v. First Nat'l Bank, 249 S.W.2d 269 (Tex. Civ. App. 1952); Shell Oil Co. v. Goodroe, 197 S.W.2d 395 (Tex. Civ .App. 1946).
[92] 141 Tex. 274, 171 S.W.2d 339 (1943).
[93] Union Oil Co. v. Ogden, 278 S.W.2d 246 (Tex. Civ. App. 1955).
[94] 65 W. Va. 531, 64 S.E. 836 (1909).

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extension was explicitly attributed to the first of the two discoveries. Just the same, the court remarked that equity would have kept the lease alive even if the only discovery had been after the lease period had elapsed. A lessee who makes a good faith effort to complete a well during the primary term will, according to this dictum, be protected in West Virginia. Whether the other states broadly construing the habendum will follow this precedent is, of course, conjectural. It is clear that Kansas, Texas and Louisiana will not.

II. RIGHTS AND DUTIES OF THE PARTIES UNDER AN EXTENDED LEASE

It has been stated that extension of a lease has the same effect upon covenants to develop as would a new lease with immediate possession.[95] The implied covenants to develop the property continue as before.[96] These covenants are, however, just as the primary term, subject to the "reasonably prudent operator" test, which demands only that the lessee develop the land where it would be prudent to do so. He need not extend drilling where there is insufficient indication that such activity would be profitable,[97] although in *Cosden Oil Co. v. Scarborough*[98] the court cautioned that development may not be postponed indefinitely. *McCutcheon v. Enon Oil & Gas Co.*[99] excused a lessee from drilling more than one well while no market was available. But *Severson v. Barstow*[100] emphasized that the lessee must be reasonably diligent in his efforts to obtain a market.

III. CONCLUSION

A shut in gas well will extend a lease beyond the primary term if a shut in royalty clause so stipulates, the lessor is estopped from denying extension, unusual terms are present to modify the habendum clause, or the habendum as such is given a broad interpretation. While the overwhelming majority of cases require "production" to satisfy the ordinary habendum clause,[101] there is a split among the states as to what constitutes "production." The weight of authority in cases directly in point would seem to be that discovery in paying quantities during the fixed term is sufficient. This is the West Virginia rule, which is followed by a number of other states, as related in detail above. On the other hand, some states narrowly construe the habendum and will not extend a lease in most cases unless either oil or gas has been taken from the ground and sold in commercial quantities. There is no Colorado authority on this subject. When a lease is extended, the usual implied covenants to develop continue, but are subject, as during the fixed term, to the "reasonably prudent operator" test, which may limit the lessee's obligation if no market is available.

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[95] Tibbeus v. Clayton, 288 Fed. 393, 400 (E.D. Okla. 1923): "It is immaterial whether you call it an extension or renewal."

[96] In Sander v. Mid-Continent Corp., 292 U.S. 272, 279 (1934), the Court said: "It is conceded that a covenant on respondent's part to continue the work of exploration, development and production is to be implied (sic) from the relation of the parties and the object of the lease; and that *this covenant was not abrogated by the expiration of the primary term* of ten years." (emphasis added). Robinson v. Miracle, 146 Okla. 31, 293 Pac. 211 (1930); Eastern Oil Co. v. Coulehan, 65 W. Va. 531, 64 S.E. 836 (1909). See also, Cosden Oil Co. v. Scarborough, 55 F.2d 634 (5th Cir. 1932) (dictum).

[97] Cosden Oil Co. v. Scarborough, *supra* note 96; Pelham Petroleum Co. v. North, 78 Okla. 39, 188 Pac. 1069 (1920).

[98] See note 96 *supra*.

[99] 102 W. Va. 345, 135 S.E. 238 (1926).

[100] 103 Mont. 526, 63 P.2d 1022 (1936).

[101] See note 7 *supra*.