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Oil and Gas--Habendum Clause--Exercise of Due Diligence Extends the Lease Beyond the Primary Term Although the Production Was Not Marketed Owing to the Lack of Pipe Line Facilities

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CASE COMMENTS

Oil and Gas—Habendum Clause—Exercise of Due Diligence Extends the Lease Beyond the Primary Term Although the Production Was Not Marketed Owing to the Lack of Pipe Line Facilities.—An oil and gas “unless” lease provided for a primary term of five years and as long thereafter as oil or gas was produced. P, lessor, brought an action against D, lessee, to cancel the lease contending that the lease expired by its own terms for failure to produce oil or gas during the primary term. Within such term of the lease a well was completed, but because of the unburnable quality of the gas and the lack of a pipe line the well was capped and no gas sold therefrom until seven and two-thirds years after the end of the primary term at which time a pipe line was constructed. The court stated that while under Oklahoma law there is no condition precedent requiring production within the primary term to extend the lease beyond it, there is an implied covenant to operate the lease with reasonable diligence and this includes a duty to market the production. Held, that D had not been guilty of such lack of diligence as would forfeit the lease and there had not been a delay of an unreasonable time in marketing. The dissent stated that it is a matter of “conjecture” as to whether or not the Oklahoma courts would apply the “rule of reason” to extend a lease under these facts, and even if a test of reasonableness were applied, nine and one-half years after the completion of the well and seven and two-thirds years after the expiration of the fixed term was too long a time and therefore unreasonable. Bristol v. Colorado Oil and Gas Corp., 225 F.2d 894 (10th Cir. 1955).

The paramount rule in construing contracts is to ascertain the intent of the parties at the time the contract was formed. In the principal case no provision was made for a delay in securing a market so the duty devolved upon the court to ascertain the mutual intent concerning this question. When oil or gas is produced in paying quantities there is an implied covenant to use due diligence to market the product. Strangé v. Hicks, 78 Okla. 1, 188 Pac. 847 (1920). It has been stated that, “[t]he general rule is . . . where production results from drilling operations and the operator is unable to market the product immediately on account of lack of an available market or of pipe line connections, no forfeiture results if, by the exercise of due diligence on the part of the operator, the well is equipped and a market is obtained within a reasonable time.” Christianson v. Champlin Refining Co., 169 F.2d 207 (10th Cir. 1948). Although the Christianson case stated that fifteen
months was not an unreasonable time, the test laid down was one of reasonableness to be determined by looking at all the facts and circumstances and not one of time alone. The court in the principal case recognizes that an unduly long time has passed but states that the lessee should still be given the opportunity to bring forth any facts that may justify this delay. D in answering showed that it used due diligence in attempting to secure a market, there was good faith, there was a lack of pipe line facilities, the drilling took place in "wildcat" territory, there was no drainage, and although not a waiver the fact that the plaintiff accepted without protest the pro rata share of the rentals or royalties notwithstanding that he refused to execute the annual shut-in royalty agreements which his cotenants signed. That the length of time is an important fact is not disputed, but it should not be controlling. "[O]ne year may be unreasonable in some circumstances, and ten years reasonable in others." Trust Co. v. Samedan Oil Corp., 192 F.2d 282 (10th Cir. 1951). It has been often stated that the principles of equity are to be applied to a suit for the cancellation of a lease and the final determination depends upon the sound discretion of the court. McKenna v. Nichlos, 193 Okla. 526, 145 P.2d 957 (1944).

Although there is authority for the plaintiff's contention that the lease expired by its own terms for failure to produce oil or gas within the primary term, the court was justified in treating this as a forfeiture proceeding. The completion of a well to production within the definite term creates an interest in the land of the lessee. Masterson v. Amarillo Oil Co., 253 S.W. 908 (Tex. Civ. App. 1923). The discovery of oil or gas vests title in the lessee; however, this right may be lost. Eastern Oil Co. v. Coulehan, 65 W. Va. 531, 64 S.E. 836 (1909). There is an ancient equity maxim to the effect that "equity abhors forfeitures." As a result of this maxim a heavy burden is placed on the lessor to show that the lessee was guilty of such acts as would permit a forfeiture to be decreed.

That the court reached an expedient result which was equitable to both parties is strongly supported when we look at the following considerations. The lessee took a tremendous financial risk, over three-fourths of a million dollars in the principal case; and before he can receive any return on his investment his lease may be cancelled. Because the land has been partially developed the lessor could make a new lease on much more favorable terms so that he would be seeking a cancellation at the slightest provocation. However, the courts should be careful not to allow the lessee to tie up the lessor's
land for speculative purposes without the lessor's getting some return. In the principal case the annual shut-in royalty agreements provided for "rental or royalty" so that the lessor was getting some consideration for the use of his land. Most gas leases provide for a flat yearly rental as a result of which the lessor receives a return whether the gas is produced or not and suffers no hardship while the lessee is awaiting a market to develop. Another important factor, mentioned in the principal case, is that while oil may be taken from the ground and stored in tanks the only important storage place for gas is under the ground where it is found. It must remain there until a pipe line is connected to take it to market.

If this question is ever raised in West Virginia, our court would probably reach a result similar to the one in the present case upon the authority of South Penn. Oil Co. v. Snodgrass, 71 W. Va. 498, 76 S.E. 961 (1912). There the lease provided for a term of ten years and as long thereafter as oil or gas or either of them is produced. During the definite term not more than one barrel of oil was produced. However the court extended the lease beyond the fixed term stating that, "as long as oil or gas is produced" means "as long as the premises are diligently and efficiently operated, provided minerals shall have been discovered within the fixed term." This appears to be broad enough to allow the result reached in the present case. Although this case has been severely criticised, 2 Summers, Oil and Gas § 300 (2d ed. 1954), it is law today in West Virginia. In McCutcheon v. Enon Oil & Gas Co., 102 W. Va. 345, 135 S.E. 238 (1926), a lease was continued after the expiration of the fixed term although the well was shut in for want of a market. Here the lessor was receiving payments throughout this time. See Donley, Law of Coal, Oil and Gas in West Virginia and Virginia §§ 70, 72 (1951), for the West Virginia cases touching upon this question.

Although there are situations that cannot be foreseen the problem in the present case has arisen before and could have been easily avoided by including a detailed provision in the lease expressing the intention of the parties as to this contingency. A strong argument may someday be made, as suggested by the dissent in the principal case, to the effect that the omission of such a provision shows that the parties did not intend to extend the lease beyond the fixed term in this factual situation.

It is submitted that the court in the principal case by the application of the "rule of reason" reached the more desirable
result. Instead of harsh, fixed rules of law the court looked to the facts and circumstances of the case to determine where the equities lay.

M. J. P.

Torts—Voluntary Assumption of Duty—Federal Tort Claims Act.—Action by barge charterer and others, under the Federal Tort Claims Act, for damages sustained when a tug went aground and the cargo on a barge towed by it was damaged allegedly because of the negligent operation of a lighthouse by the coast guard. The coast guard personnel failed to check the equipment and to make the necessary repairs, and they failed to give warning that the light was not operating. Held, that the coast guard, having undertaken to provide lighthouse service, had a duty to use due care to make certain that the lighthouse was kept in good working order and to use due care to discover failure of the light, to repair the same, or to give warning that it was not functioning; and if the coast guard failed to do so and damages were thereby caused to the petitioners, the United States was liable under the Tort Claims Act. Indian Towing Co. v. United States, 76 Sup. Ct. 122 (1955) (5-4 decision).

The old common law maxim that the "king could do no wrong" has been disregarded in the United States. Here the sovereign can be sued, but not without consent. In 1946 the Federal Tort Claims Act was enacted. The relevant provisions are: "...the district courts...shall have exclusive jurisdiction of civil actions on claims against the United States, for money damages...for injury or loss...caused by the negligent or wrongful act or omission of any employee of the government while acting within the scope of his office or employment, under circumstances where the United States, if a private person, would be liable to the claimant in accordance with the law of the place where the act or omission occurred." 28 U.S.C. § 1346 (b) (1952). "The United States shall be liable...in the same manner and to the same extent as a private individual under like circumstances, but shall not be liable for interest prior to judgment or for punitive damages." Id. § 2674. Negligence was admitted in the principal case. The question was whether this was a type of negligence for which the government had consented to be sued.

In Feres v. United States, 340 U.S. 135 (1950), it was held that members of the armed services injured through the negligence