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The Right of a Lessee to Discontinue the Payment of Rentals When the Product of a Gas Well Cannot be Utilized Off the Premises

Robert T. Donley
West Virginia University College of Law

OIL AND GAS

THE RIGHT OF A LESSEE TO DISCONTINUE THE PAYMENT OF RENTALS WHEN THE PRODUCT OF A GAS WELL CANNOT BE UTILIZED OFF THE PREMISES

Oil and gas leases commonly provide for the payment of a rental for each gas well, "the product of which is transported or used or marketed off the premises". What are the respective rights of the lessor and the lessee should a situation arise in which the lessee, after diligent effort, is unable to market or otherwise dispose of the gas at a profit? The problem may be subdivided according to time, *i. e.*, whether such failure occurs (a) during the fixed term of the lease, or (b) after that term, when the premises are being held "as long as oil or gas is produced", or "produced in paying quantities",[1] or "the premises are operated for the production of oil or gas".

For purposes of this discussion, questions of forfeiture or cancellation for breach of implied covenants diligently to explore,[2] or to protect from drainage,[3] as well as doctrines of abandonment,[4] are eliminated.

The liability of the lessee for rentals would seem to be referable solely to the language of the lease. If the lease stipulates that the lessee is to pay for each well, the product of which is used or transported or marketed off the premises, the unavoidable implication is that he is not to pay for any well, the product of which is not so utilized. But, since a strictly literal interpretation of the lease would enable the lessee arbitrarily to refuse to market the gas at a small profit (holding for higher prices), and thereby to deprive the lessor of any remuneration, the courts have implied a covenant binding the lessee to use reasonable diligence and good faith in an effort to dispose of the gas at a profit.[5] If

[1] Whether or not the production is in paying quantities is left to the judgment and discretion, in good faith, of the lessee. Lowther Oil Co. v. Miller-Sibley Oil Co., 53 W. Va. 501, 44 S. E. 433 (1903).

[2] *Cf.* Wilson v. Reserve Gas Co., 78 W. Va. 329, 90 S. E. 875 (1916) and Johnson v. Armstrong, 81 W. Va. 399, 94 S. E. 753 (1917) with Carper v. United Fuel Gas Co., 78 W. Va. 433, 89 S. E. 12 (1916); Note (1920) 26 W. VA. L. Q. 248.

[3] *Cf.* Trimble v. Hope Natural Gas Co., 169 S. E. 529 (W. Va. 1933).

[4] To constitute abandonment there must be both intention to abandon and actual relinquishment of the leased premises. Lowther Oil Co. v. Miller-Sibley Oil Co., *supra* n. 1.

[5] "Profit", means over and above the cost of marketing, although the operator may be incurring a loss upon his entire investment.

the lessee has done so, it would seem that he is not liable to the lessor in an action at law for rentals payable for the "quarters" during which no gas was or could be utilized off the premises.[6]

If this situation should arise during the fixed term of the lease, the lessor quite obviously cannot secure cancellation on any theory of expiration. If, however, the non-utilization occurs during the extension period, *i. e.*, "as long as oil or gas is produced" from the premises, the lessor logically may argue that the lease has terminated. The nature of the estate, or its duration, held by the lessee during the extension period is not clear.[7] It would seem that at least in West Virginia, actual production is not necessary in order to extend the lease beyond the fixed term, as long as the lessee is diligently exploring.[8] But, having completed exploration and secured a well capable of producing, it is submitted that the lessee could not continue indefinitely to hold the lease and pay nothing for the privilege, notwithstanding that upon discovery of the gas he acquires a vested interest.[9]

The courts would probably hold that the lessee has a reasonable length of time within which to continue his efforts to utilize the gas. What should constitute a reasonable length of time might well depend upon the particular facts and circumstances in each case.[10] However, it is believed that one year should be the maxi-

[6] Indianapolis Gas Co. v. Teters, 15 Ind. App. 475, 44 N. E. 549 (1896); Ohio Oil Co. v. Lane, 59 Ohio St. 307, 52 N. E. 791 (1898); Roberts v. Fort Wayne Gas Co., 40 Ind. App. 528, 82 N. E. 558 (1907); Indiana Natural Gas Co. v. Wilhelm, 44 Ind. App. 100, 86 N. E. 86 (1908); Pittsburgh-Columbia Oil and Gas Co. v. Broyles, 46 Ind. App. 3, 91 N. E. 754 (1910). The *Roberts* and *Wilhelm* cases are cited with approval in Prichard v. Freeland Oil Co., 75 W. Va. 450, 84 S. E. 945 (1914).

[7] See State v. South Penn Oil Co., 42 W. Va. 80, 24 S. E. 688 (1896), at page 102: "Nor does the addition to the term of years of the clause 'and as long as oil or gas may be found in paying quantities' give it such indefinite duration as makes the interest freehold in quantity; for, after the expiration of the term prescribed (ten years), the lessee, having the option to continue to pump if he can find oil in paying quantities, becomes a tenant at will, which may become a tenancy from year to year on the terms of the lease, but it is not a freehold, because its extension after the end of the term prescribed depends upon his own will; so, according to the terms of the instrument, that is as large an interest as the word will bear."

[8] South Penn Oil Co. v. Snodgrass, 71 W. Va. 438, 76 S. E. 961 (1912) and Ohio Fuel Oil Co. v. Greenleaf, 84 W. Va. 67, 99 S. E. 274 (1919), commented upon in note (1919) 26 W. VA. L. Q. 79.

[9] See Simonton, *The Nature of the Interest of the Grantee Under an Oil and Gas Lease* (1918) 25 W. VA. L. Q. 295.

[10] In Grass v. Big Creek Development Co., 75 W. Va. 719, 84 S. E. 750 (1915), an action at law to recover damages for breach of implied covenants to protect against drainage and to develop with reasonable diligence, it was held (syl. 9): that regard must be had to the "cost of drilling, proximity of market, and facilities for marketing; current prices, whether high or low; location of the lands, etc."

mum period, from either (a) the expiration of the fixed term, assuming that there never has been any utilization, or (b) the date upon which gas was last utilized. This would be particularly true in any case in which the lease provided for an "annual" rental, notwithstanding that it is payable in quarterly instalments. Some consideration might also be given to the acreage embraced in the lease. Recent cases intimate that the lessee may continue to hold the well and sufficient surrounding acreage, but the lessor is entitled to partial cancellation, as to the remainder of the tract.[11]

It may be contended that a lease which in terms provides that the lessee may continue to hold the premises, either during the fixed term or thereafter, without payment to the lessor, is so unfair and inequitable that a court of equity should decree cancellation. The answer to this contention will depend upon whether the lease is regarded primarily as a contract or as a conveyance of an interest in real property.[12] The notion of fairness is referable to theories of consideration and mutuality of obligation. If consideration for the continuance of the lease, in a case in which oil only is produced, is continued operation and the payment of royalties, the lessor, without violence to reason, might argue that payment of rentals is the consideration where gas only is found. Yet, he is confronted by the provision of the lease which negatives such a construction. On the other hand, payment of one dollar is sufficient consideration to support all the covenants of the lease.[13] It would seem, therefore, that during the fixed term, the lessor could not complain simply because he entered into a speculative

[11] White v. Green River Gas Co., 8 F. (2d) 261 (C. C. A. 6th 1925); 18 F. (2d) 471 (C. C. A. 6th 1927), in which the statement is made that if the lessee pays rental when he is not marketing the gas, such payments are purely gratuitous. J. B. Gathright Land Co. v. Kentucky-West Virginia Gas Co., 65 F. (2d) 906 (C. C. A. 6th, 1933).

[12] The oil and gas lease is not strictly a "lease" at all, but is a profit *a prendre*. Upon execution of the lease the lessee gets two estates: (1) a vested right to explore and (2) a right to produce, contingent upon discovery. See Simonton, *op. cit. supra* n. 9. See TIFFANY, LANDLORD AND TENANT (1910) 160: "In view of the fact that the entrance into contractual obligations by means of 'covenants' ordinarily constitutes a most important part of a transaction involving the creation of the relation of landlord and tenant, it is not surprising that quite frequently courts have lost sight of the fact that the really essential part of the transaction is a conveyance, and instead regard it as involving the creation of contractual obligations only, frequently speaking of the 'contract of lease' ". At p. 163: "The fundamental objection to such a definition of a lease is that it entirely ignores the common-law theory of a particular and reversionary estate in the lessee and lessor respectively."

[13] *Cf.* Rich v. Donaghey, 71 Okla. 204, 177 Pac. 86, 3 A. L. R. 352 (1918) and collection of cases, 3 A. L. R. 378.

bargain which the turn of events has rendered displeasing.[14] After the fixed term, it is here suggested that the obligation of the lessee to use diligent efforts to utilize the gas is a detriment suffered, which constitutes sufficient consideration for extension beyond the fixed term, for a reasonable length of time.

Treating the lease as primarily a conveyance eliminates problems of consideration. No consideration is necessary to support the grant of a leasehold estate.[15] If the lessee has once acquired a vested estate he cannot well be deprived of it unless the grant is subject either to a conditional limitation or to a condition subsequent. The former could not operate during the fixed term, and the latter could hardly be implied from non-payment of rentals, since the lessee would thereby be subjected to the penalty of a forfeiture[16] for exercising a privilege which does not render him liable to the lessor in an action at law.

The conclusion, then, here submitted, is that during the fixed term of the lease, the lessee may continue to hold without payment of rentals, so long as he diligently attempts to utilize the gas. During the extension period, in the usual form of lease, he should be permitted to hold, upon the same basis, for a reasonable length of time, as to that part of the acreage necessary to the proper operation of the well, and the lessor should be awarded partial cancellation as to the remainder of the tract.

—ROBERT T. DONLEY.

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[14] As to what constitutes unfairness in a contract, entitling to equitable relief, see note (1924) 30 W. VA. L. Q. 293.

[15] TIFFANY, *op. cit., supra* n. 12, at 164: "So far as by the term 'lease' we refer to a conveyance by way of lease, that is, a conveyance leaving a reversion in the grantor, it is perfectly valid without any consideration moving to the lessor. Even though any of the contractual stipulations were invalid for lack of a consideration, this would not affect the lease so far as it is a conveyance creating a tenancy."

[16] Assuming that a forfeiture could be declared, could the lessee re-enter under the provisions of W. VA. REV. CODE, 1931, ch. 37, art. 6, §§ 19 to 26, inclusive?