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## Does a Provision That an Oil and Gas Lease Shall be Void Unless the Leasee Drills or Pays Rental Create A Condition?

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consumers. Of course a natural gas company may be, and often is, a public utility as to industrial consumers, but whether in a given case a particular natural gas company is supplying its industrial consumers on a public basis or on a private basis, depends, it would seem, upon the facts of the particular case, *viz.*, whether the gas company has held itself out to serve industrial consumers generally, *i. e.*, depends upon the existence of a *public profession* to serve that class of applicants. But how far a classification is permissible is a point that is not free from doubt, and, in justice to the decision it should be said that it is perhaps possible to sustain the actual conclusion reached in the principal case on the ground that there was probably present the requisite public profession, but the Court, apparently taking the view that a public profession as to one class of applicants is a public profession as to the other class, does not throw much light upon the point herein suggested.

—T. P. H.

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DOES A PROVISION THAT AN OIL AND GAS LEASE SHALL BE VOID UNLESS THE LESSEE DRILLS OR PAYS RENTAL CREATE A CONDITION?—An important class of oil and gas leases has been termed by some courts “unless” leases. As an example of the provision which distinguishes “unless” leases we may take the following clause from a lease involved in a well known case<sup>1</sup> in which the term was five years and as long thereafter as oil or gas should be found in paying quantities. The provision is as follows:

“Provided, however, that this lease shall become null and void and all rights thereunder shall cease and determine *unless* a well shall be completed on said premises within three months from date hereof, or in lieu thereof thereafter the parties of the second part shall pay to the parties of the first part fifteen dollars for each three months delay, payable in advance, until a well is completed.”

Thus the essential feature of an “unless” lease is a provision to the effect that the lease shall become null and void (or shall terminate) unless the lessee drills a well within a fixed period or pays a certain sum for the privilege of delaying such drilling dur-

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<sup>1</sup>*Pyle v. Henderson*, 65 W. Va. 39, 66 S. E. 10 (1909). A statement as to the characteristics of an “unless” lease will be found in *Northwestern Oil & Gas Co. v. Branine*, 175 Pac. 533 (Okla. 1918). The term may not be a desirable one but it is short and the meaning is now well known to lawyers familiar with oil and gas litigation.

ing such period. The lessee, however, does not covenant to do anything. He does not bind himself to drill a well or to pay the delay rental.<sup>2</sup> In two recent cases<sup>3</sup> it was assumed without discussion that this sort of a provision in an oil and gas lease amounts only to a condition subsequent so that if the lessee fails to drill a well or to pay the delay rental within the period fixed this is a breach of the condition and gives to the lessor only a right to declare a forfeiture of the lease. Consequently in each of these cases the Court held that equity should relieve from the forfeiture by the lessor where the lessee intended to pay the delay rentals but failed to make payment within the time fixed.

In one of these cases<sup>4</sup> the leased premises had been conveyed to the plaintiff by the original oil and gas lessor more than a year before the delay rental in question became due and the lessee was duly notified of this conveyance. The lessee's clerk negligently failed to note the conveyance to the plaintiff in the proper place on the lessee's books and as a result the rental was deposited in the proper bank to the credit of the original lessor instead of to the credit of the plaintiff. The error was not discovered until over two months after the delay rental was due, at which time the rental was tendered to the plaintiff who refused it. No well had ever been started by the lessee. The plaintiff brought suit apparently to remove the lease as a cloud on his title. He based his suit on the theory that the lease terminated on non-payment of the delay rental. The lessee admitted its failure to pay the delay rental was due to the negligence of its clerk. The Court held that the attempt of the plaintiff to terminate the lease was in the nature of a forfeiture and under Sec. 2844 of the Revised Statutes of Oklahoma equity would relieve from such forfeiture.<sup>5</sup>

<sup>2</sup>Glasgow v. Chartiers Oil Co., 152 Pa. St. 48, 25 Atl. 232 (1892); Snodgrass v. South Penn Oil Co., 47 W. Va. 509, 35 S. E. 820 (1900); Weaver v. Akin, 48 W. Va. 456, 37 S. E. 600 (1900); Smith v. South Penn Oil Co., 59 W. Va. 204, 53 S. E. 152 (1906).

<sup>3</sup>Brunson v. Carter Oil Co., 259 Fed. 656 (D. C., E. D. Okla. 1919) and Kays v. Little, 103 Kan. 461, 175 Pac. 149 (1918). Some support has been given such construction by dicta in certain cases in which the lessor tried to recover delay rental in an action at law. Such dicta are of little value. In most of these cases the courts evidently considered the lease involved as an ordinary lease and consequently considered themselves bound by the established law of landlord and tenant. For cases of this sort see O'Neill v. Risinger, 77 Kan. 63, 93 Pac. 340 (1908); Glasgow v. Chartiers Oil Co., 152 Pa. St. 48, 25 Atl. 252 (1892); Snodgrass v. South Penn Oil Co., 59 W. Va. 204, 53 S. E. 152 (1900).

<sup>4</sup>Brunson v. Carter Oil Co., *supra*.

<sup>5</sup>The Supreme Court of Oklahoma has since correctly decided that an "unless" lease terminates on failure of the lessee to drill a well or to pay the delay rental. It stated there is no forfeiture in such a case. See Curtis v. Harris, 184 Pac. 574 (Okla. 1919). See also Mitchell v. Probst, 152 Pac. 597 (Okla. 1915).

In the other case<sup>6</sup> the lessee five days before the delay rental was due sent a check for the amount due by registered mail to his agent in the county in which the land was located. On the day the rental was payable the agent called up the lessee on the telephone and told him the check had not arrived, whereupon the lessee immediately sent another check to his agent by registered mail. Both letters arrived three days after the money was due and one of the checks was then deposited in the proper bank to the lessor's credit. The Court approved the conclusion of the trial judge "that a state of facts is presented which, in the interest of justice, requires that a court of equity should relieve against the forfeiture attempted to be enforced by the plaintiff in this action." It does not appear why the lessee did not have his agent deposit the twenty dollars delay rental due after the latter called the lessee on the telephone. Apparently the sum could easily have been paid on the day due, hence the lessee seems to have been guilty of negligence. In the report of this case the theory on which, the plaintiff based his suit does not appear. It is true the lessee was engaged in drilling a well on which about \$15,000 had been spent before the rental was due but no oil had been discovered.

In the latter case the effect of the decision was to allow the lessee three days more time in which to exercise his option to pay the delay rental, for it is evident that the lessee could have decided not to make the payment at any time before the check was actually deposited, and the lessor would have had no remedy. In the former case the lessee was given over two months extra time in which to decide whether to make the payment. In the meantime if developments on nearby land had shown the leasehold in question was valueless the lessee would probably not have paid this sum of money at all but would have rejoiced in the fortunate mistake of its clerk. Any oil and gas lessee might be pleased to have extra time within which to exercise such an option at a contingent expense equal to interest at the legal rate on the sum due for the extra time allowed. What does the lessor get in return for this favor to the lessee? He finds that he has no right to take advantage of the apparent termination of the lease as provided by its express language. He finds that, instead, the option of the lessee is extended by judicial construction. The fact that the lessee may have intended to exercise the option is of no

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<sup>6</sup>Kays v. Little, *supra*.

value to the lessor. Such intentions give rise to no liability enforceable against the lessee.

Is the provision in an "unless" lease a condition subsequent as assumed by these courts or is it a special limitation? According to the usual meaning of the language used it seems to be a special limitation since the lease provides it shall become null and void (or shall terminate) if the lessee does not drill a well or pay the delay rental within the time fixed. The distinction between a condition subsequent and a special limitation has been stated as follows:<sup>7</sup>

"The principal difference between a *condition* and a *limitation* is, that a *condition* does not defeat the estate when broken, until it is avoided by an act of the grantor or his heirs; but a *limitation* marks the period which is to determine the estate, without entry or claim, and no act is necessary to vest the right in him who has the next expectant interest. Whether the particular form made use of amounts to a condition, a limitation, or a covenant merely, is a matter of construction depending upon the true intent and meaning of the contract."

According to this statement whether a provision amounts to a condition or a special limitation must be determined from the intent of the parties as expressed in the instrument.

There are early English cases holding that where an ordinary lease provides that on default of the tenant in the performance of some covenant the lease shall become void or shall terminate, this is a special limitation and the lease ends *ipso facto* on a breach of the covenant. These cases have been overruled in England and such a provision has since been construed as a condition inserted in the lease for the benefit of the lessor. The law of most of the jurisdictions in this country is in accord with the latter construction.<sup>8</sup> One reason the courts abandoned the original construction and adopted this new one (which may seem somewhat inconsistent with the language used) was that the former construction enabled the tenant to terminate the lease at any time he desired by making a breach of the covenant, thus enabling him to take advantage of his own wrong. Undoubtedly this construction is fully justified wherever the provision is inserted with the purpose of preventing

<sup>7</sup>TAYLOR, LANDLORD AND TENANT, 8 ed., § 273.

<sup>8</sup>See LEAKE, PROPERTY IN LAND, 2 ed., 170 and TIFFANY, LANDLORD AND TENANT, 1369.

the breach of covenants by the lessee. This appears to be the purpose wherever a breach of a covenant by the lessee is the event stipulated as making the lease void. The courts in the two cases under consideration, probably as a matter of course, applied this well-known construction to an "unless" oil and gas lease disregarding the fact that the situation was not analogous. The same construction ought not be given in case the event stipulated is one which is entirely beyond the control of the lessor and does not amount to a wrong by the lessee.

If an oil and gas lessee should covenant to drill a well within a stated time or to pay delay rental in lieu thereof and the lease further provided that if the lessee broke such covenant, then the lease should terminate, a situation would be presented which would be analogous to the one mentioned above. In other words, had the leases involved in the two cases under consideration been what has been termed "or"<sup>9</sup> leases and had each contained a further provision that it should terminate on breach of the covenant to drill a well or to pay delay rental, then, on failure of the lessee to do either, the lessor could treat it as a breach of condition and declare a forfeiture, or he could treat the lease as still existing and enforce the covenant to pay the delay rental against the lessee,<sup>10</sup> just as a landlord in an ordinary lease with a provision that it shall terminate on breach of a covenant by the tenant may on breach of condition waive the forfeiture and enforce the covenant against the lessee. When this provision is construed as a condition in such a lease the construction is plainly beneficial to the lessor. According to familiar rules equity will in proper cases

<sup>9</sup>Oil and gas leases in which the lessor affirmatively covenants either to drill a well or to pay delay rental from time to time in lieu of drilling have been termed "or" leases. If the lessee in such lease fails to pay the delay rental the lessor may sue and recover such rental in an action at law. See *Leatherman v. Oliver*, 151 Pa. St. 646, 25 Atl. 309 (1892); *Cohn v. Clark*, 150 Pac. 467 (Okla. 1915); *Roberts v. Bettman*, 45 W. Va. 143, 30 S. E. 95 (1898).

<sup>10</sup>Authorities to this effect are quite numerous. See *Ray v. Natural Gas Co.*, 138 Pa. St. 576, 20 Atl. 1065 (1891) and *Galey v. Kellerman*, 123 Pa. St. 491, 16 Atl. 474 (1889) for a statement of the law. For further cases see the collection in a note in 2 ANN. CAS. 447.

Oil and gas leases create profits and are not true leases. However, as has heretofore been pointed out in 25 W. VA. L. Q. 322-5, courts have been trying to treat them as true leases and have been slow to recognize the fact that they are not true leases. Since there is no considerable body of law in regard to profits (aside from so-called mineral leases) in dealing with oil and gas leases courts ought to apply the law of landlord and tenant when closely analogous but should at all times feel free to depart from it in situations where not closely analogous. On the point involved in the above-mentioned cases the analogy is almost perfect and the same rule ought to apply as is applied in the case of true leases. It does not follow that this rule ought to apply to an "unless" lease.

relieve from a forfeiture for condition broken.<sup>11</sup> But in the case of an "unless" oil and gas lease the reason for construing the provision as a condition instead of the special limitation which its language indicates it was intended to be, fails entirely, for, on failure by the lessee to drill a well or to pay delay rental, the lessor has no election to keep the lease alive or to declare a forfeiture. He has no control over the matter at all and has no right which he can enforce against the lessee. He can declare a forfeiture but the court of equity may relieve against the forfeiture for mere non-payment of money at the suit of the lessee with the result that the only effect of this construction is to extend the lessee's option to drill or to pay. Thus the lessee gets a substantial benefit from such a construction but the construction is detrimental to the lessor.

It is submitted that an "unless" lease gives to the lessee the right to choose any one of three courses. He may drill a well within the time limited, or he may pay the delay rental from time to time in lieu of drilling, or he may do neither and allow the lease to terminate by its own terms.<sup>12</sup> He has an option to elect any one of these three courses. His right neither to drill a well nor to pay delay rental is as much an option as his right to drill a well or to pay a sum in lieu of drilling. Ordinarily one having a definite time within which to exercise an option is not excused because by his own negligence he failed to exercise his option within the time fixed,<sup>13</sup> so here the lessee should not be excused because he negligently fails to give notice of his election to exercise the option to pay. Here the lessee by his express language made the failure to drill a well or to pay delay rental in lieu thereof an exercise of his option to allow the lease to terminate

<sup>11</sup>See *TIFFANY, LANDLORD AND TENANT*, 1412.

<sup>12</sup>*O'Neill v. Risinger*, 77 Kan. 63, 93 Pac. 340 (1908); *Curtis v. Harris*, 184 Pac. 574 (Okla. 1919); *Mitchell v. Probst*, 152 Pac. 597 (Okla. 1915).

<sup>13</sup>An election to exercise an option must be within the time stipulated. Time is of the essence of an option contract. *McConkey v. Peach Bottom Slate Co.*, 68 Fed. 830 (1895); *Smith v. Howard*, 105 S. W. 411 (Ky. 1907); *Sage v. Hazard*, 6 Barb. 179 (N. Y. 1849); *Mitchell v. Probst*, 152 Pac. 597 (Okla. 1915); *Olsen v. Northern S. S. Co.*, 70 Wash. 493, 127 Pac. 112 (1912); *Dyer v. Duffey*, 39 W. Va. 148, 19 S. E. 540 (1894). The court in *Brunson v. Carter Oil Co.*, cited and relied on a statement in *JAMES, OPTION CONTRACTS*, § 862, to the effect that the general rule that options must be exercised within the time fixed is subject to qualifications and that equity will grant relief to an optionee where "there is mistake or some other equitable ground for involving its jurisdiction." None of the cases cited by the author involve the exercise of options or even have dicta in them on the subject with one exception and the decision in that case is flatly contra to the author's statement. It is doubtful if this statement in this text has any foundation whatever.

without the necessity of giving further notice. The lessee loses nothing for which he has contracted and ought to be compelled to comply with his obligation. He has paid for the privilege of keeping the lease alive without drilling for a fixed time and has the right to pay for a like privilege for an additional period. When the time paid for has expired the lessee has gotten all he bargained for, namely, the right to elect which course to take for a fixed period. He bound himself as to the mode in which he was to make this election. He made his failure to drill or to pay in itself an exercise of his option to terminate the lease without the necessity of giving the lessor notice of his election. Oil and gas lessees originated "unless" leases so that this very provision would give them this right to terminate the lease without a corresponding liability such as is imposed by the so-called "or" type of lease. Courts have frequently considered such a lease unfair to the lessor. Hence it is surprising to find two courts by construction making such a lease still more unfair to the lessor under pretense of doing equity to the lessee.

In order to reach the result in the cases under consideration these courts have violated the well-established rule that an oil and gas lease is to be construed most strongly against the lessee and in favor of the lessor.<sup>14</sup> As shown above, the construction adopted in these two cases is a strained construction in favor of the lessee and against the interest of the lessor and is practically unsupported by authority. If a lessee expressly provides that delay rental must be paid by a certain day in order to extend the lease without binding himself to pay it, why should he be given by a kind and indulgent court more time in which to watch developments and decide what to do? He has not provided for more time in the instrument he has had prepared by his own attorneys and has persuaded the lessor to sign. It is submitted that both of the decisions are wrong on principle in so far as the facts appear in the reports.<sup>15</sup> The provision which these courts treat as a condition is intended by the parties to be a special limitation. No facts upon which an estoppel might be based appear in the

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<sup>14</sup>*Schaffer v. Marks*, 241 Fed. 139 (D. C., E. D. Okla., 1917); *Curtis v. Harris*, *supra*; *Parraline Oil Co. v. Cruce*, 162 Pac. 716 (Okla. 1917); *Bettman v. Harness*, 42 W. Va. 433, 26 S. E. 271 (1896).

<sup>15</sup>Attention might be called to a note in the last issue of this publication where cases were discussed in which a court extended the term of an oil and gas lease after a well had been started, by a seemingly strained construction of the language of the lease. This construction was also in favor of the lessee. See 26 W. VA. L. Q. 79.

report of either case. It is submitted that in an "unless" oil and gas lease nothing should excuse the lessee's failure to pay the delay rental within the time fixed except some representation or act of the lessee of a nature to give rise to estoppel. Furthermore, the lessee has an option to terminate the lease by failure to pay the delay rental and his failure to exercise his option to pay delay rental is an exercise of the option to terminate and may be treated as such by the lessor. The history of the oil and gas business indicates that the lessee does not require a court of equity to protect him from the effect of disadvantageous leases.

—J. W. S.

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QUESTIONS AND ANSWERS OF COMMITTEE ON PROFESSIONAL ETHICS OF NEW YORK COUNTY LAWYERS ASSOCIATION<sup>1</sup>

QUESTION NO. 180

DIVISION OF FEES WITH ATTORNEYS FORWARDING COLLECTIONS—PROPER BASIS INDICATED—RETENTION OF SHARE OF FEE BY FORWARDING ATTORNEY WITHOUT ACCOUNTING TO CLIENT—NOT NECESSARILY IMPROPER.—1. An attorney in the course of litigation is required to engage the services of an out-of-town attorney. This out-of-town attorney in due course renders his bill for the services rendered, upon the prior understanding that the forwarding attorney is to receive the customary one-third of the fee. The client could not have procured the services to be rendered by an out-of-town attorney for a less price than the amount charged. Is the forwarding attorney entitled to retain for his own use the share of the fee he receives from his out-of-town corresponding attorney? 2. Under a similar arrangement for the payment of a share of the fee to a forwarding attorney, the latter attorney arranges with his client to conduct the entire litigation, including disbursements, for a fixed amount. In the latter case, would he

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<sup>1</sup>In answering questions this Committee acts by virtue of the following provisions of the by-laws of the Association, Article XVI, Section III:

"This Committee shall be empowered when consulted to advise inquirers respecting questions of proper professional conduct, reporting its action to the Board of Directors from time to time."

It is understood that this Committee acts on specific questions submitted *ex parte*, and in its answers bases its opinion on such facts only as are set forth in the questions.