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THE ARC OF THE IMPLIED COVENANT: AN ANALYSIS OF THE MODERN IMPLIED COVENANT TO REASONABLY DEVELOP THE LEASE PREMISES

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I. Introduction

After drilling one productive well, the operator of an oil and gas lease assumes the implied covenant to maintain an active interest in the lease by reasonably developing the lease premises.[1] However, this implied covenant has largely eroded over the years, with courts generally reluctant to penalize inattentive operators and lessors reluctant to take the issue as a primary cause of action.[2] In 2023, though, with the recent surge in demand for non-Russian hydrocarbons, the implied covenant serves as an increasingly attractive remedy as mineral owners look to revitalize the wells on their land to keep up with modern demand. Nevertheless, the courts, still rarely terminate a lease by finding a violation of the covenant.[3] Although scholarship has explored the implied covenant to develop the lease premises, such research has taken more narrow approaches—such as a specific focus on shale recovery—and some research is now outdated.[4] Renewed analysis of the implied covenant to develop the lease premises in the context of global energy shortages is therefore long overdue.

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1. *See* Superior Oil Co. v. Devon Corp., 604 F.2d 1063, 1069-70 (8th Cir. 1979).

2. *See* Olson v. Schwartz, 345 N.W.2d 33, 41–42 (N.D. 1984) (Schneider, concurring) (criticizing the implied covenant as "a judge-made decision in equity" that would have been unconstitutional had it been created by a legislative body).

3. *Cf.* U.S. Energy Information Administration, *Gasoline and Diesel Fuel Update* (July 31, 2023), https://www.eia.gov/petroleum/gasdiesel/ (last accessed Sept. 7, 2023).

4. *See* George A. Bibikos, *A Review of the Implied Covenant of Development in the Shale Gas Era*, 115 W. Va. L. Rev. 949, 950 (2013); Alexander Nicolai von Kreisler, *Imposing Implied Covenants in Oil and Gas Leases-Covenant of Further Exploration Tenuously Supported Under Texas Jurisprudence: Sun Exploration*; and Production Co. v. Jackson, 715 S.W.2d 199 (Tex. App.-Houston (1st Dist., 19 Tex. Tech L. Rev. 1231 (1988)).

U.S. Regular Gasoline Prices*(dollars per gallon)

				Change from	
	08/21/23	**08/28/23**	**09/04/23**	**week ago**	**year ago**
U.S.	3.868	3.813	3.807	-0.006	0.061
East Coast (PADD1)	3.728	3.678	3.655	-0.023	0.042
New England (PADD1A)	3.783	3.763	3.749	-0.014	-0.068
Central Atlantic (PADD1B)	3.847	3.809	3.774	-0.035	-0.069
Lower Atlantic (PADD1C)	3.636	3.571	3.556	-0.015	0.139
Midwest (PADD2)	3.720	3.637	3.630	-0.007	-0.008
Gulf Coast (PADD3)	3.458	3.378	3.364	-0.014	0.135
Rocky Mountain (PADD4)	4.039	3.975	3.999	0.024	0.059
West Coast (PADD5)	4.866	4.880	4.912	0.032	0.171
West Coast less California	4.609	4.633	4.652	0.019	0.261

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The table above, taken from the US Energy Information Administration, demonstrates the aforementioned rise in demand for domestic hydrocarbons. While prices have begun to decline recently, they still dwarf what they stood

5. *Cf.* U.S. Energy Information Administration, *Gasoline and Diesel Fuel Update* (July 31, 2023), https://www.eia.gov/petroleum/gasdiesel/ (last accessed Sept. 7, 2023).

before Russia's February, 2022 invasion of Ukraine.[6] Therefore, with such prices and increased demand, there remains an avenue of reform with renewed analysis and potential change to the implied covenant.

This comment analyzes the history of the implied covenant to reasonably develop the lease premises of an oil and gas lease. It explores the traditional lack of enforcement of the covenant.[7] It also examines jurisdictional variations such as Colorado, Louisiana, and Kansas' bifurcation between the implied covenant to further develop a known deposit and the implied covenant to explore for other deposits on the premises,[8] as well as Pennsylvania's outright waiver of the covenant where the lease still compensates the lessor even in the absence of production.[9] It also describes common mistakes that lessors make when pursuing a claim that their lessees breached the covenant, including pursuing it as an alternate cause of action, thus failing to give proper notice and demand.[10] Finally, this comment suggests future approaches to the implied covenant. It explores possible changes in the law to better suit modern demand such as a modification of the "reasonable and prudent operator" standard against which lessees accused of a breach are measured.[11]

II. Description of the General Area

Specifically, Oklahoma's "unconscionable delay" exception to the standard might preserve the principle that a party seeking to disrupt the status quo via legal proceeding bears the initial burden to prove grounds for relief.[12] However, it would also relieve such a party where the lessee clearly does not intend to develop the lease premises further.[13] Additionally, some states distinguish the implied covenant to reasonably develop a known mineral deposit from the implied covenant to explore for additional deposits, which

6. *Id.*

7. *See, e.g.,* Union Oil Co. of Cal. v. Jackson, 489 P.2d 1073, 1078; Whitham Farms, LLC v. City of Longmont, 97 P.3d 135, 138 (Colo. App. 2003)

8. *See* Gillette v. Pepper Tank Co., 694 P.2d 369, 372 (Colo. App. 1984) (overruling on other grounds recognized in Davis v. Cramer, 837 P.2d 218, 222 (Colo. App. 1992)); K.S.A §§ 55–224; La. Stat. Ann. § 31:122 (citing Carter v. Arkansas-Louisiana Gas Co., 36 So.2d 26 (1948); Sohio Petroleum Co. v. Miller, 112 So.2d 695 (1959); Middleton v. California Co., 112 So.2d 704 (1959)*;* Nunley v. Shell Oil Co., 76 So.2d 111 (La.App.2d Cir. 1954).

9. *See* Jacobs v. CNG Transmission Corp., 772 A.2d 445, 455 (2001).

10. *See* Superior Oil Co. v. Devon Corp., 604 F.2d 1063 (8th Cir. Neb. 1979); Olson v. Schwartz, 345 N.W.2d 33, 40.

11. *Cf. Jackson*, 489 P.2d at 1077.

12. Skelly Oil Co. v. Boles, 193 Okla. 308, 142 P.2d 969, 971.

13. *Id.*

allows distinct analyses of fact and burdens of proof for each.[14] Other jurisdictions also disallow lessees from pooling their leases and abrogating their duties to develop without the consent of lessors. This prevents lessees from going to the state's regulatory agency to force lessors into much larger premises, containing acreage of which they generally do not own, and having their implied covenant claims analyzed as to how a reasonably prudent lessee would treat the entire tract. Also, Colorado's presumption that a plaintiff bears the burden to prove a prima facie case for a breach of the implied covenant might balance the due process rights of lessees against the difficulty of lessors in proving detailed unreasonableness in a profession in which the lessee naturally has more expertise.[15] Alternatively, courts might enforce the covenant more readily upon the adoption of a less severe remedy than forfeiture of the lease such as expectation damages for lost royalties.

In addition to favored laws in enforcing the implied covenant to further develop, this comment also examines what lessors can do to protect their interests in having their leases developed on a case-by-case basis. For example, if lessors cannot gain relief through changes in their states' caselaw or legislation, said lessors might have more success enforcing the covenant by asserting its breach as their primary causes of action rather than the common practice of listing it as an alternative to abandonment.[16] This would both make lessors more likely to comply with the breach's notice and demand requirements, as well as give lessees the opportunity to comply with the implied covenant, potentially obviating the need for litigation. Additionally, per the suggestion of the Texas Supreme Court, lessors could further develop their premises by including express provisions in their leases such as a Retained Acreage Clause or, in cases of pooling, a Pugh Clause.[17] These clauses encourage lessees to fully develop the lease premises by severing the lease into separate parts: (1) an active lease on sections where the lessee has completed productive wells, and (2) the rest of the lease, in either square acreage or formations below the deepest-producing well, for which the lease terminates.[18]

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14. *See* Davis v. Cramer, 837 P.2d 218, 222 (Colo. App. 1992).

15. *See Whitham Farms,* 97 P.3d at 138.

16. *See* Superior Oil Co. v. Devon Corp., 604 F.2d 1063 (8th Cir. Neb. 1979); Olson v. Schwartz, 345 N.W.2d 33, 40.

17. *See* Endeavor Energy Res., L.P. v. Discovery Operating, Inc., 554 S.W.3d 586, 598 (Tex. 2018) ("… if a lessor wants its entire leasehold acreage developed, it should include a retained acreage clause in its leases.").

18. *See* Sandefer Oil & Gas, Inc. v. Duhon, 961 F.2d 1207, 1209 (5th Cir. 1992); John Lowe et al., CASES AND MATERIALS ON OIL AND GAS LAW (Ed. 7), p. 325.

III. Introduction and Analysis of the Implied Covenant

A. Creation and Requirements of the Implied Covenant to Develop the Lease Premises

Recognized by the United States Supreme Court, the implied covenant to develop the lease premises emerged to protect lessors from lessees who, whether for speculative purposes or otherwise, unreasonably use one productive well to hold on to an exclusive right to develop on much larger tracts.[19] As the Court noted in *Sauder v. Mid-Continent Petroleum Corp.*:

> The production of oil on a small portion of the leased tract cannot justify the lessee's holding the balance indefinitely and depriving the lessor, not only of the expected royalty from production pursuant to the lease, but of the privilege of making some other arrangement for availing himself of the mineral content of the land.[20]

The implied covenant therefore has its roots not only in the principle that consideration for a contract must be more than nominal, but also the principle that in contracts, a party who bargains for an exclusive right must use reasonable efforts to exercise those rights.[21]

B. Historical Disfavor of the Implied Covenant

As noted above, courts traditionally disfavor enforcing the implied covenant to develop the lease premises.[22] They do so by imposing strict notice requirements on the lessor before seeking cancellation,[23] as well as placing the burden of proof on the party claiming a breach, with the standard of evidence varying from a detailed "reasonable and prudent operator" test to a general requirement that the party disrupting the status quo first build a prima facie case.[24] While the latter burden describes the standard for civil cases in general,[25] both burdens have the practical effect of requiring

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19. *See* Sauder v Mid-Continent Petroleum Corp., 202 U.S. 272, 281 (1934).

20. *Id.*

21. *See* Wood v. Lucy, Lady Duff-Gordon, 118 N.E. 214, 215 (1917).

22. *See, e.g., Jackson*, 489 P.2d at 1077; Whitham Farms, LLC v. City of Longmont, 97 P.3d 135, 138 (Colo. App. 2003).

23. *See* Superior Oil Co. v. Devon Corp., 604 F.2d 1063 (8th Cir. Neb. 1979) (holding there was no breach where the lessee had not drilled another well for sixteen years because lessors failed to give lessee notice of the breach and demand its correction).

24. *See Jackson*, 489 P.2d at 1077; *Whitham Farms*, 97 P.3d at 138.

25. *See* Whitham Farms, LLC v. City of Longmont, 97 P.3d 135, 138 (Colo. App. 2003).

lessors—mineral owners who often lack the relevant expertise of the operators they are suing—to provide factfinding beyond their capabilities.[26]

For example, in *Olson v. Schwartz*, the Supreme Court of North Dakota listed the following factors in evaluating whether the implied covenant to develop has been breached:

> (1) the quantity of oil and gas capable of being produced as indicated by prior exploration and development; (2) the local market and demand therefor; (3) the extent and results of the operations, if any, on adjacent lands; (4) the character of the natural reservoir—whether such as to permit the drainage of a large area by each well; (5) the usages of the business; (6) the cost of drilling, equipment, and operation of wells; (7) the cost of transportation, storage, and the prevailing price, and (8) general market conditions as influenced by supply and demand or by regulation of production through governmental agencies.[27]

While the Court noted that courts should consider other factors in favor of the lessor, such as another operator's willingness to drill on the premises, it ultimately declined to find a breach where both parties conceded that there was no development on the tract for twenty-six years, and that the second lessor's consideration for the entire 720 acre lease (two leases were in dispute) was fulfilled by "marginal production" of less than ten barrels per day.[28] The Court did so by noting the strict notice and demand requirements for asserting a breach that were discussed above. Because the primary cause of action in *Olson* was a claim that the lessee had abandoned the lease, the first time either plaintiff gave notice of failure to develop was in two 1981 letters (one from each lessor's attorney) to relinquish the undeveloped acreage of each lease.[29] Neither letter, therefore, demanded the lessee rectify the breach by beginning further development in a reasonable time, so neither letter satisfied the Court's notice and demand requirement.[30]

Even when a lessor gives the lessee notice of a breach and a demand to bring the lease back into compliance, courts still require the lessor to give a

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26. *Cf.* Clifton v. Koontz, 325 S.W.2d 684, 694 (Texas, 1959).

27. Olson v. Schwartz, 345 N.W.2d 33, 39–40 (N.D. 1984) (citing *Sanders v. Birmingham,* 522 P.2d 959, 966 (1974)).

28. *Id*. at 35, 36, 40.

29. *Id*. at 40.

30. *Id*.

"reasonable amount of time" to comply before seeking cancellation.[31] Furthermore, in what courts and commentators call the "repudiation doctrine," a lessee is generally not required to satisfy implied covenants while a suit, in which the lessor seeks cancellation of the lease, is pending.[32] While defenders of the doctrine note the unfairness of expecting an operator to invest substantially in a lease that the lessor is actively trying to terminate, the Supreme Court of Pennsylvania rejected this argument.[33] The Court noted that contracts, in general, do not excuse performance where one party challenges the validity of the contract.[34] Accordingly, the Court held that oil and gas leases should be no different.[35] Therefore, at least historically, courts have disfavored the breach of the implied covenant as a means of developing a ground for cancelling a lease. As the following paragraphs will illustrate, courts do continue to recognize it and sometimes outright encourage lessors to focus on their implied covenant claims.[36] However, until lessors test this encouragement, the present caselaw shows a historical lack of enforcement of the implied covenant to develop.

C. Lease Disclaimers

Another barrier to the enforcement of the implied covenants, especially the implied covenant to develop, includes the manner in which some leases expressly override or disclaim them. In these cases, because express language overrides implied covenants in most contract interpretations, even courts that might otherwise sympathize with lessors stuck under minimally productive leases will refuse to grant the lessors relief.[37] As the Supreme Court of Ohio put it in *Harrison v Cabot Oil & Gas Corp.*:

> Courts have sometimes imposed upon the parties to oil and gas leases an implied covenant to develop in a reasonable period of time, but only when the lease fails to refer specifically to the

31. *Id*.; B&B Buckles Properties, LLC v. Oil Producers Inc. of Kansas, 520 P.3d 392, 402 (citing *James Energy Co. v. HCG Energy Corp.*, 847 P.2d 333).

32. Keith B. Hall, *Implied Covenants and the Drafting of Oil and Gas Leases*, 7 LSU J. Energy L. & Resources 401, 429 (2019).

33. *See* 110 A.3d 178, 185 (2015)

34. *Id.*

35. *Id.* (citing Restatement (Second) of Contracts § 250).

36. *Cf.* Coastal Oil & Gas Corp. v. Garza Energy Tr., 268 S.W.3d 1, 20, 40 (Willett, J, concurring), 47 (Johnson, J, concurring in part and dissenting in part) (Tex. 2008) (all noting how the lessors had a stronger breach of implied covenant claim than their trespass claim).

37. *See* State *ex rel*. Claugus Fam. Farm, L.P. v. Seventh Dist. Ct. of Appeals, 47 N.E.3d 836, 843 (citing *Ianno v. Glen-Gery Corp.,* 443 N.E.2d 504, 506; *Beer v. Griffith,* N.E.2d 1227 (1980); and *Harris v. Ohio Oil Co.,* 48 N.E. 502 (1897)).

> timeliness of development. We will not impose an implied covenant to develop when the lease requires that development must commence within a certain period or when the lease specifies that no implied covenant shall be read into the agreement.[38]

The Court went on to find that the lease at issue contained both an enforceable disclaimer of implied covenants in general, as well as specific language as to when development must commence.[39] Not only did the general disclaimer of implied covenants therefore bar cancellation of the lease based on a failure to further develop a formation; the provision that specified when development would commence showed an agreement between the lessor and lessee that would potentially permit even a development schedule that the lessor could later show was imprudent for an operator. As discussed in IV(e), lessors can also negotiate for lease language that encourages lessees to develop beyond what the implied covenant does. However, disclaimers such as the one in *Claugus* remain another obstacle to the enforcement of the implied covenant to develop.

D. Pooling

An additional hindrance on the implied covenants to develop and explore further is the fact that lessees can sometimes "pool" multiple leases together—in other words, combine the leases so that they are treated as one lease for the sake of satisfying each one's habendum clause.[40] Under a pooled unit, development on one portion of the pooled unit will satisfy the lessees' obligation to develop on all lease premises covered by the pooling order.[41] All lessors under a pooling unit receive a blended royalty even if the producing wells are not on their land, and even though some pooling occurs under the terms of the lease, courts analyze the lessee's use of pooling for "good faith."[42] However, pooling also frequently comes from a lessee going to the relevant state's regulatory body to force a pooling order without the

38. *Id*.

39. Id. at 843.

40. *See* John Lowe, Owen Anderson, Ernest Smith, & David Pierce, CASES AND MATERIALS ON OIL AND GAS LAW (Ed. 7), p. 306.

41. *See id*.

42. *See, e.g.,* Circle Dot Ranch, Inc. v. Sidwell Oil & Gas, Inc., 891 S.W.2d 342, 345 (Tex. App. 1995), writ denied (Aug. 1, 1995); Doran & Assocs., Inc. v. Envirogas, Inc., 492 N.Y.S.2d 504, 505 (1985).

lessors' consent.[43] Furthermore, courts often construe pooling to limit the implied covenant to develop, sometimes abrogating it entirely.[44] Therefore, compulsory pooling orders weaken lessors' protections under the implied covenant without their consent.

For example, in *Whitham Farms*, the Colorado Court of Appeals considered the entire pooled tract in conducting its "reasonably prudent operator" analysis of one lessee, NARCO.[45] Noting a provision in NARCO's lease that permitted voluntary pooling between it and the lessees of surrounding tracts, the court held that NARCO had no duty to develop so long as any of the other pooled lessees had so much as a single well on the pooled unit.[46] While *Whitham Farms* involved a pooling clause rather than a compulsory pooling order, the court used no language to restrict its holding to cases where a unit came from a pooling clause.[47] Furthermore, Colorado does have a forced pooling statute empowering its Oil and Gas Conservation Commission to compel pooling units without the consent of lessors.[48] Consequently, while pooling has its roots in express provisions of leases and the government's police power, it still keeps lessors from prevailing should they claim lessees breached the implied covenant to further develop.

E. Jurisdictional Variations

1. Doss *and Burden Shifting*

As noted above, most courts impose a "reasonable operator" standard on plaintiffs who seek to establish a breach of the implied covenant to develop the lease premises.[49] However, the Supreme Court of Oklahoma has recognized an important exception to that standard in a way that empowers the implied covenant to reasonably develop.[50] Specifically, the Court in *Doss* held that, where the lessee has concluded that further development of the

43. *See, e.g.,* Texaco Inc. v. Indus. Comm'n of State of N. Dakota, 448 N.W.2d 621, 624 (N.D. 1989); Application of Farmers Irr. Dist., 194 N.W.2d 788, 790–91 (Neb. 1972).

44. Whitham Farms, LLC v. City of Longmont, 97 P.3d 135, 139 (Colo. App. 2003).

45. *Id.*

46. *Id.* (citing Clovis v Pacific Northwest Pipeline Corp., 345 P.2d 729 (Colo. 1959); Gillette v. Pepper Tank Co., 694 P.2d 369, 372 (Colo. App. 1984).

47. *Id.*

48. Colo. Rev. Stat. Ann. § 34-60-116 (West).

49. *See*, *e.g.,* Union Oil Co. of Cal. v. Jackson, 489 P.2d 1073, 1078; Clifton, Clifton v. Koontz, 325 S.W.2d 684, 691 (1959).

50. Doss Oil Royalty Co. v. Texas Co., 137 P.2d 934, 938, holding modified by Shell Oil Co. v. Howell, 258 P.2d 661.

premises will not result in profit, that lessee should surrender the undeveloped parts of the lease after a reasonable amount of time.[51]

Other courts have analyzed the *Doss* holding skeptically,[52] and the Oklahoma Supreme Court has since narrowed that exception to allow the lessee to provide evidence that the lessee acted in a reasonably prudent manner even with a long delay in development.[53] The Court further held in later cases that the amount of time required before a lessor can claim the *Doss* exception, an "unconscionable delay," is not a set, measurable amount of time and still requires a case-by-case, factual analysis before application.[54] Nevertheless, *Doss*, which is still valid law, stands in dynamic contrast with the majority rule that a lessor must affirmatively establish that additional development would result in profit to the lessee.[55]

Colorado, for its part, still formally applies the "reasonable and prudent operator" standard.[56] However, the Colorado Supreme Court has explained that the plaintiff merely needs to establish a prima facie case that the lessee is holding onto the lease for speculative purposes, a less exacting burden than how other states apply the "reasonable and prudent standard."[57]

For example, in *Whitham Farms*, the Colorado Supreme Court declined to adopt the *Doss* exception.[58] Citing the general duty in civil actions of the party asserting a cause of action to establish at least a prima facie case, the Court refused to invalidate three pooled leases in which one well secured 310 acres.[59] This is because the plaintiffs, relying not only on *Doss* as a persuasive authority but also a narrower distinction to the "reasonable and prudent operator" rule that the Colorado Supreme Court recognized in *N. York Land Assocs. v. Byron Oil Indus., Inc.,* outright posited that further development of the lease would not be profitable and a reasonable operator therefore would not develop the premises.[60] The Court distinguished its *Byron*

51. Id. at 938.

52. *See* Whitham Farms, LLC v. City of Longmont, 97 P.3d 135, 139 (Colo. App. 2003); Atl. Richfield Co. v. Gruy, 720 S.W.2d 121, 123 (Tex. App. 1986), writ refused NRE (Feb. 25, 1987).

53. *See* Shell Oil Co. v. Howell, 258 P.2d 661 (Oklahoma, 1953).

54. Skelly Oil Co. v. Boles, 142 P.2d 969, 971 (Oklahoma, 1943).

55. *See Doss*, 137 P.2d at 938.

56. *See Whitham Farms*, 97 P.3d at 138.

57. *See* id; Atl. Richfield Co, 720 S.W.2d at 123 (finding no breach of implied covenant or express "due diligence" provision on 640-acre lease where lessors failed to prove the existence of hydrocarbons below 3,750 feet).

58. *Id*. at 139 (citing *Doss*, 137 P.2d 934 (1943)).

59. *Id.* at 136, 138.

60. *Id.*

exception—that the lessor did not need to prove an additional well would create profits where the lessee clearly held onto the lease for speculative purposes[61]—by noting how, in *Byron*, the lessee conceded that the area surrounding the developed area showed "very poor potential for profitable wells," both at the time and for the foreseeable future.[62] This stood in contrast with the fact pattern in *Whitham Farms*, in which no party's experts commented on the potential profitability of future wells on the lease premises.[63] The lessors' failure to comment on future profitability therefore meant they had failed to establish even a prima facie case that the lessee's retention of the undeveloped portions of the lease was purely speculative.[64]

2. Pennsylvania and the Delay Rentals Exception

While these courts still give lessors some credence where the operator has ceased production entirely, Pennsylvania courts have made their own exception for where a lessor is still compensated through something like a delay rental.[65] These courts have reasoned that, while royalties are normally the consideration given to the lessor for the lessee's right to explore, develop, and produce, rental payments provide lessors with an alternative consideration, validating the lease even where the lessee deprives the lessor of royalty payments through actions less than those of a reasonably prudent operator.[66] On the other hand, rental payments often consist of a nominal dollar per acre, and the exclusive nature of an oil and gas lease traps lessors into potentially wasteful leases. Nevertheless, the court in *Jacobs* did not address how such a trap avoids breaching the nonwaivable implied covenant of good faith and fair dealing present in all contracts.[67]

3. Appropriate Remedy

Another jurisdictional split affecting courts' willingness to enforce the implied covenant to develop is the appropriate remedy for a breach. As the Supreme Court of Alabama recognized in *Meaher v. Getty Oil Co.*, courts generally take one of three approaches:

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61. *Id*. at 138 (citing N. York Land Assocs. v. Byron Oil Indus., Inc., 695 P.2d 1188, 1190 (Colo. App. 1984), 139 (citing *Doss*, 137 P.2d 934 (1943).

62. *Whitham Farms*, 97 P.3d at 138 (citing *Byron*, 137 P.2d at 1191).

63. *See id.* at 139.

64. *Id.*

65. *See* Jacobs v. CNG Transmission Corp., 772 A.2d 445, 455 (2001).

66. *Id.*

67. *Id*.; *see also* (CanPro Invs. Ltd. v. United States, 131 Fed. Cl. 528, 531 (2017).

1) Damages as the exclusive remedy: applied in Illinois, Ohio, and West Virginia, these state courts hold that, because the implied covenant to develop is not a condition subsequent, damages and not forfeiture are the only appropriate remedy.[68]

2) Cancellation of the lease where damages are "wholly inadequate": the majority rule, these jurisdictions sometimes terminate the lease upon a breach of the implied covenant.[69] However, as discussed in IV(b), because of property law's presumption against forfeitures, and the "speculative" nature of determining damages from lost royalties caused by an unreasonable, imprudent operator, this often has the effect of denying lessors relief entirely.[70]

3) Cancellation without proving that damages would be inadequate. Another minority rule, this rule likewise invokes the presumption against forfeitures, whereas the Kentucky Court of Appeals case cited in *Meaher* only explained that its plaintiffs' claims for damages had "questionable legal merits" before moving on to the forfeiture issue.[71]

4. Distinct Implied Covenant to Explore

Some jurisdictions that reject the *Doss* exception do not do so because they disagree that lessees should have to justify only developing a small fraction of their premises.[72] Instead, they distinguish the covenant—one that requires development of an already-established deposit of oil and gas—from an additional implied covenant that requires the lessee to explore the premises for other deposits.[73] By separating the duties into two different covenants, these courts emphasize the different factual questions as to what a reasonably prudent operator would do in each situation—a premises with a known,

68. Meaher v. Getty Oil Co., 450 So. 2d 443, 447 (Ala. 1984) (citing *Geary v. Adams Oil & Gas Co.,* 31 F.Supp. 830 (E.D.Ill.1940); Beer v. Griffith, 399 N.E.2d 1227 (1980); and *McCutcheon v. Enon Oil & Gas Co.,* 135 S.E. 238 (1926)).

69. Id. (citing *Southwest Gas Producing Co. v. Seale,* 191 So.2d 115 (Miss.1966); *W.T. Waggoner Estate v. Sigler Oil Co.,* 19 S.W.2d 27 (1929); and *Alford v. Dennis,* 170 P. 1005 (1918)).

70. *See* Clifton v. Koontz, 325 S.W.2d 684, 694 (Texas, 1959).

71. *Meaher*, 450 So. 2d at 447 (citing *Sapp v. Massey,* 358 S.W.2d 490 (Ky.1962)); *Sapp, 358 S.W.2d at 492.*

72. *See* Davis v. Cramer, 837 P.2d 218, 222 (Colo. App. 1992).

73. *See* Gillette v. Pepper Tank Co., 694 P.2d 369, 372 (Colo. App. 1984) (*overruling on other grounds recognized in* Davis v. Cramer, 837 P.2d 218, 222 (Colo. App. 1992)).

established deposit versus an undeveloped premises with potential deposits—in justifying having different burdens of proof for each covenant.[74] As the Colorado Court of Appeals put it in *Gillette v. Pepper Tank Co.*:

> The implied covenant of reasonable development requires a determination that additional development will be profitable. This determination rests on proof that, more probably than not, production of oil or gas will be found in paying quantities. The implied covenant of further exploration does not need such proof, but rather requires the lessor to show unreasonability by the lessee in not exploring further under the circumstances.[75]

This difference in questions of fact also explains why, in jurisdictions like Texas that do not distinguish the duty to explore from the implied covenant to develop, some courts refuse to award damages as a remedy.[76] While a party might prove the benefits of drilling an additional well on a known deposit with some certainty, a court could rightly condemn such calculations as "entirely speculative" where neither party can point to such a deposit, as the Texas Supreme Court did in *Clifton v. Koontz*.[77]

5. Forced Pooling

As noted above, lessees often pool leases together so that development anywhere on the unit satisfies the habendum clause, while courts also analyze compliance with the implied covenants to further develop and explore by asking what a reasonably prudent operator would do to the entire unit.[78] In more extreme examples, courts hold that pooling results in the complete abrogation of the implied covenant to further develop.[79] While lessees sometimes pool their leases by getting their lessors to agree to specific lease provisions that account for pooling, many states also allow a lessee to go to the state's regulatory body to force a pooling order.[80] Other states, however, passed statutes that strictly regulate how much lessees and the government can do to force pooling on lessors who refuse to consent.[81] Because pooling

74. *Id.*

75. *Id.*

76. *See* Clifton v. Koontz, 325 S.W.2d 684 (1959).

77. *Cf. id* at 694.

78. *See* John Lowe, Owen Anderson, Ernest Smith, & David Pierce, CASES AND MATERIALS ON OIL AND GAS LAW (Ed. 7), p. 306.

79. *See* Whitham Farms, LLC v. City of Longmont, 97 P.3d 135, 139 (Colo. App. 2003).

80. *See, e.g.,* Texaco Inc. v. Indus. Comm'n of State of N. Dakota, 448 N.W.2d 621, 624 (N.D. 1989); Application of Farmers Irr. Dist., 194 N.W.2d 788, 790–91 (Neb. 1972).

81. *See* Tex. Nat. Res. Code Ann. §§ 102.001–102.112 (West).

weakens lessees' obligations to further explore and develop their leases, these latter states empower the implied covenants to explore and develop by protecting lessors' rights to insist their lessees treat their leases separately, giving each one the scrutiny of what a reasonably prudent operator would do with the leases on a case-by-case basis.[82]

Texas, for example, has strict requirements over when the Railroad Commission, which governs oil and gas in the state, may issue a pooling order against the wishes of its respective lessees.[83] The state's Mineral Interest Pooling Act provides the following: (1) any applicant for a pooling order must first make an effort to get the mineral owners to voluntarily pool their leases, then present "a fair and reasonable offer to pool voluntarily" to the Texas Railroad Commission;[84] (2) all interested parties must be given notice of a hearing on the application at least thirty days prior to the hearing, given in a manner proscribed by the Railroad Commission and with publication for any unknown owners or owners whose whereabouts are unknown;[85] (3) any "person affected by an order" may appeal to a state court in a manner other than trial de novo;[86] and (4) the pooling unit automatically dissolves two years after commencement of the order if no production begins, six months after completion of a dry hole on the unit, or six months after production ceases.[87] In practice, the Railroad Commission issues involuntary pooling orders sparingly, while courts demand that the fairness and reasonableness of an offer to pool "be adjudged from the standpoint of the offeree."[88] As noted above, Texas enforces the implied covenant to reasonably develop sparingly out of an abhorrence of forfeitures and shuns a distinct implied covenant to further explore.[89] However, through its protections against forced pooling, the state still protects mineral owners' interests in seeing their tracts developed. They do so by ensuring that the owners have the opportunity to negotiate in pooling efforts, strictly

82. *Cf. id.*

83. *See id*.

84. *Id*. § 102.013.

85. *Id*. § 102.016.

86. *Id*. § 102.111.

87. *Id*. § 102.083.

88. R.R. Comm'n of Texas v. Broussard, 755 S.W.2d 951, 956 (Tex. App. 1988), *writ denied* (Feb. 8, 1989) (citing Windsor Gas Corp. v. R.R. Comm'n of Tex., 529 S.W.2d 834 (Tex. Civ. App. 1975).

89. *See* Clifton v. Koontz, 325 S.W.2d 684, 694 (Texas, 1959).

construing lessees' abilities to pool without their consent and guaranteeing a right to judicial review even when lessees manage to do so.[90]

On the other hand, states like Oklahoma force pooling more readily where lessors will not agree to a voluntary offer to pool.[91] Okla. Stat. Ann. tit. 52, § 87.1(e) (West) provides that the Commission "shall . . . require" mineral owners of a common oil or gas deposit spread across multiple tracts to pool and develop their interests in the deposit as a unit when one owner starts drilling or proposes to drill without coming to an agreement with all affected co-owners.[92] Like its Texan equivalent, the statute requires notice and a hearing to affected owners before the Commission issues its order.[93] However, such notice need not come as far in advance of the hearing (fifteen days as opposed to thirty), the statute mandates the order even when no owner has applied to the Commission for one, and the statute contains no guarantee of judicial review.[94]

What varies most from the Texan statute, however, is that Okla. Stat. Ann. tit. 52, § 87.1(e) does not require any showing that the party seeking to commence operations into the shared deposit first make an effort to pool voluntarily, let alone present such an offer that the Commission agrees was "fair and reasonable."[95] Rather, in the interest of "prevent[ing] waste and protect[ing] correlative rights," Oklahoma authorizes and demands that its Corporation Commission force pooling onto mineral owners who share a deposit across different tracts at the first sign that one intends to drill competitively.[96] This may cause drilling that is both more efficient and more consistent with the presumption that one well will adequately deplete one deposit.[97] However, for mineral owners who desire full development of their premises, laws such as Okla. Stat. Ann. tit. 52, § 87.1(e) impede the owners' ability to demand additional production by first combining the owners' interests with their neighbors, then outright barring production on one

90. *See* Tex. Nat. Res. Code Ann. §§ 102.001–102.112 (West).

91. *Cf.*, Okla. Stat. Ann. tit. 52, § 87.1(e) (West).

92. *Id.*

93. *Compare id*. *with* Tex. Nat. Res. Code Ann. § 102.016.

94. *Compare* Okla. Stat. Ann. tit. 52, § 87.1(e) (West) *with* Tex. Nat. Res. Code Ann. §§ 102.012, 102.016, 102.111 (West).

95. *Compare* Okla. Stat. Ann. tit. 52, § 87.1(e) (West) *with* Tex. Nat. Res. Code Ann. § 102.013.

96. Okla. Stat. Ann. tit. 52, § 87.1(e) (West).

97. *See generally* Mont. Code Ann. § 82-11-201(3) (West) (noting that minimum well spacing should be determined by the maximum area one well can "efficiently and economically" drain).

owner's land where it would drill onto the same deposit as another well located on another tract.[98]

Upholding the aforementioned impediment, Oklahoma courts analyze the Corporation Commission's pooling orders for basic due process violations.[99] Noting the Commission's police power to protect correlative rights, the Oklahoma Supreme Court has upheld involuntary pooling in all but the most extreme circumstances.[100] For example, in *Ward v. Corp. Comm'n*, the Court upheld tit. 52, § 87.1(e)'s permitting of only one well on a 640-acre unit.[101] The Commission's actions were held unconstitutional only in that the pooling order did not allow non-drilling lessees and owners to participate in production.[102] This shows a policy in Oklahoma's forced pooling law, upheld by the State Supreme Court, dramatically prioritizing efficient drilling over the individual landowner's interest in profiting from individual, maximally developed leases. Texas's statute, on the other hand, provides for forced pooling on a showing that lessors are being unreasonable.[103] However, because it bars lessees from going to the state's regulatory body without first trying to negotiate with lessors, the Texas statute manages to give lessors a greater degree of protection over their interests in their own leases.

F. Overlap with Abandonment

As discussed above, many suits involving the implied covenant to develop failed because the party asserting a breach failed to provide notice and demand.[104] This is because the lessors in said cases asserted abandonment as their primary cause of action, which does not require notice and demand for relief.[105] However, abandonment does require the following: (1) The lessee intentionally (2) relinquishes a right (3) that the lessee knows he possesses.[106] Because the lessees in *Superior Oil Co.* and *Olson* did not relinquish physical possession of their existing wells, only failed to drill other wells on the

98. Okla. Stat. Ann. tit. 52, § 87.1(e).

99. *See* Ward v. Corp. Comm'n, 501 P.2d 503, 507.

100. *See id*. at 508 (quoting Patterson v. Stanolind Oil & Gas Co., 77 P.2d 83, 89).

101. *See id*. at 504, 507.

102. *See Ward*, 501 P.2d at 507.

103. *See* Tex. Nat. Res. Code Ann. §§ 102.001–102.112 (West).

104. *See* Superior Oil Co. v. Devon Corp., 604 F.2d 1063 (8th Cir. Neb. 1979); Olson v. Schwartz, 345 N.W.2d 33, 40.

105. See Superior Oil Co., 604 F.2d at 1070 (citing B. & B. Oil Co. v. Lane, 249 S.W.2d 705 (Ky.1952); *Olson*, 345 N.W.2d at 34.

106. *See Superior Oil Co.*, 604 F.2d at 1070 (quoting Cameron v. Lebow, 338 S.W.2d 399, 402 (Ky. 1960) (*overruling on other grounds recognized by* Carrs Fork Corp. v. Kodak Min. Co., 809 S.W.2d 699 (Ky. 1991))).

premises, both courts refused to hold that the lessees intentionally relinquished their rights in the lease.[107] Therefore, neither lessee abandoned its respective lease.[108]

This pattern of lessors relying on incomplete abandonment claims because of their more explicit place in property law and less stringent notice and demand requirements has had the effect of sabotaging potentially meritorious claims for breach of the implied covenant to develop by suing over the relevant issue but disguising the claims as abandonment. This mismatch then dooms the claims when the courts properly categorize them but apply the standard notice and demand requirements of breach of implied covenant claims.

IV. Suggested Approaches

While some courts have expressed willingness to reexamine the implied covenant to develop the lease premises, change remains slow.[109] Constrained by the strict requirements of notice and demand, factfinding, and the general disfavor of forfeitures examined above, few courts dramatically differ from their predecessors in their treatment of the covenant.[110] In order to use the covenant to help with modern energy needs, legislatures and courts need to examine changes to these limitations. Additionally, should legislatures and courts fail to change the implied covenant, lessors can make their implied covenant claims more likely to prevail by focusing on such claims as their primary cause of action. This would avoid wasting resources on frivolous abandonment claims, encourage lessors to comply with the covenant's notice and demand requirements, and potentially avoid litigation altogether with said notice and demand. Furthermore, lessees can strengthen their lessees' obligations to explore and develop by negotiating for explicit provisions in their leases such as Retained Acreage Clauses, Horizontal Pugh Clauses, and Vertical Pugh Clauses. This section discusses both the changes that courts and legislatures can make to empower the implied covenant to further

107. *See Superior Oil Co.*, 604 F.2d at 1070; *Olson*, 345 N.W.2d at 38.

108. *Id.*

109. *See generally* In re EP Energy E&P Co., No. 19-35647, 2021 WL 5917771, at *20 (Bankr. S.D. Tex. Dec. 14, 2021), B&B Buckles Properties, LLC, Plaintiff/Appellant, v. Oil Producers Inc., 2022 OK CIV APP 34 (not released for publication) (*citing* Doss Oil Royalty Co. v. Texas Co., 137 P.2d 934; *but see* Diehl v. SWN Prod. Co., LLC, No. 3:19-CV-1303, 2022 WL 3371327, at *1 (M.D. Pa. Aug. 16, 2022).

110. *See* In re EP Energy E&P Co., 2021 WL 5917771 at *20 (holding that cessation of production during Covid was temporary and not a breach of the implied covenant); Diehl, 2022 WL 3371327, at *1 (M.D. Pa. Aug. 16, 2022).

develop, as well as the steps lessors can take to protect their interests should their courts and legislatures prove unsympathetic.

A. Lower Burden for Establishing Breach

As noted above, both Oklahoma and Colorado recognize exceptions to the "reasonable and prudent operator" test. While Colorado requires a mere prima facie test before the burden of proof switches to the lessee, Oklahoma shifts said burden where the lessee fails to develop for an "unconscionable period," even when additional development would not result in profit.[111]

Other states considering one of the aforementioned rules would need to balance due process considerations and more general notions of evidentiary burdens in civil litigation. As the Colorado Supreme Court noted in *Whitham Farms*, the burden of proof in any civil case lies with the party seeking to disrupt the status quo.[112] The Court therefore honored that principle by narrowly applying its *Byron* exception, applying it only after the lessor establishes at least a prima facie case that the lessee retains the undeveloped portions of the lease only for speculative purposes.[113]

The Oklahoma Supreme Court, for its part, dismissed concerns that they empowered an implied covenant too much with its *Doss* exception to the "reasonable and prudent operator" standard by noting that it did not weaken the strict notice and demand requirements for a party alleging a breach of an implied covenant.[114] Furthermore, recognizing equities abhorrence of forfeitures, the Court also held that it would not terminate a lease even under its *Doss* exception where the lessee could demonstrate "special circumstances [that] would make it inequitable to [order a forfeiture]."[115] Should other states desire to give the implied covenant to develop the lease premises more teeth, they should take care to incorporate both Colorado and Oklahoma's limitations on their exceptions to the "reasonable and prudent operator" standard. This would balance general due process concerns with the desperate factfinding abilities of lessees and lessors—the former naturally having more expertise in what a "reasonable and prudent" operator would do.

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111. *See* Whitham Farms, LLC v. City of Longmont, 97 P.3d 135, 139 (Colo. App. 2003); Skelly Oil Co. v. Boles, 142 P.2d 969, 971.

112. *See Whitham Farms*, 97 P.3d at 139.

113. See *id.*; N. York Land Assocs. v. Byron Oil Indus., Inc., 695 P.2d 1188, 1190 (Colo. App. 1984).

114. *Cf.* Doss Oil Royalty Co. v. Texas Co., 137 P.2d 934, 939 (Okla., 1943).

115. *Id.*

B. Adoption of the Implied Covenant to Explore

Alternatively, to avoid the "burden-shifting" problem of adopting the *Doss* exception condemned by the Colorado Supreme Court in *Whitham Farms*, more states could recognize the implied covenant to further explore as distinct from the covenant to reasonably develop.[116] As discussed in both *Gillette* and *Davis*, the Colorado Supreme Court has recognized this duty through court decisions.[117] However, especially for jurisdictions such as Ohio and Texas whose courts have already ruled that "there is no implied covenant to explore further separate and apart from the implied covenant of reasonable development," state legislatures can intervene by creating an implied duty to further explore in addition to the implied covenant to develop.[118]

For example, in 1983, Kansas took this course of action when it passed the "Deep Horizons Act."[119] The Act created a presumption that a lessee has breached the covenant upon failure to develop a producing well at formations deeper than the lessee's deepest producing formation.[120] Rather than going through the traditional "reasonably prudent operator" test, a lessor can shift the burden of proof to the lessee upon a showing that: (1) there is no mineral production from existing formations below the lessee's deepest producing formation; and (2) "initial oil, gas, or other mineral production on the lease commenced at least fifteen years prior to the commencement of such action . . . ."[121]

Louisiana, for its part, has not passed a specific act creating an implied covenant of exploration beyond reasonable development. However, the Comments to Article 122 of the Louisiana Mineral Code provide:

> [T]he obligation of further exploration can be viewed as an evolutionary offshoot of the obligation of reasonable development. Although the jurisprudence does not make a clear distinction between the obligation of further exploration and the

116. *See Whitham Farms*, 97 P.3d at 139.

117. *See* Davis v. Cramer, 837 P.2d 218, 222 (Colo. App. 1992); Gillette v. Pepper Tank Co., 694 P.2d 369, 372 (Colo. App. 1984).

118. Alford v. Collins-McGregor Operating Co., 95 N.E.3d 382, 388; *see also* Clifton v. Koontz, 325 S.W.2d 684 (Texas, 1959).

119. John Lowe, Owen Anderson, Ernest Smith, & David Pierce, CASES AND MATERIALS ON OIL AND GAS LAW (Ed. 7), p. 425 (summarizing K.S.A §§ 55–224).

120. *Id.*

121. *Id.*

> obligation of reasonable development, the distinction nevertheless exists.[122]

Given how Oklahoma initially recognized a pseudo-exploration covenant with *Doss* but gradually weakened it by refusing to "make a clear distinction between" the duties of exploration and development, the Oklahoma Legislature might benefit from recognizing *Doss* and its progeny in a similar manner as Louisiana.[123] Regardless of how the jurisdiction recognizes a distinct, implied covenant to further explore— whether it do so through court decisions, through explicit legislature, or through comments on legislature that positively cite the aforementioned court decisions—states can empower lessors trapped in minimally productive leases by formally adopting the implied covenant to further explore as its own obligation that is distinct from the implied covenant to develop. Given the former covenant's lighter burden to establish a breach, such a separation would incentivize lessees to develop their premises quickly and fully lest they lose their leases.

C. Damages as Opposed to Forfeiture

"The law abhors forfeitures and statutes authorizing forfeiture of private property are to be strictly construed."[124] This abhorrence not only causes courts to burden lessors—irrespective of their expertise in oil and gas production—by establishing that their lessees act unlike reasonably prudent operators;[125] it also causes courts to only grant relief where the lessor gave notice to the lessee of the breach and a demand that the lessee fix it in a reasonable time, even where lessors can establish a breach.[126] Courts might more readily enforce the implied covenant to develop the lease premises, therefore, if lessors sought not the entire forfeiture of the lease, but damages for lost royalties when the lessee remained idle.

For example, in its 1980 decision, *Beer v. Griffith*, the Supreme Court of Ohio held that damages were the only appropriate remedy for a breach of an

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122. La. Stat. Ann. § 31:122 (citing Carter v. Arkansas-Louisiana Gas Co., 36 So.2d 26 (La. 1948); Sohio Petroleum Co. v. Miller, 112 So.2d 695 (1959); Middleton v. California Co., 112 So.2d 704 (La. 1959)*;* Nunley v. Shell Oil Co., 76 So.2d 111 (La.App.2d Cir. 1954).

123. Doss Oil Royalty Co. v. Texas Co., 137 P.2d 934, 938 (Okla., 1943); Shell Oil Co. v. Howell, 258 P.2d 661 (Okla., 1953) (modifying *Doss* by specifying the delay in development must be "unconscionable").

124. State ex rel. Redman v. $122.44, 2010 OK 19, ¶ 16, 231 P.3d 1150, 1155 (citing State ex rel. Dept. of Public Safety v. 1985 GMC Pickup, 898 P.2d 1280, 1282 (Okla., 1995)); *see also* Superior Oil Co. v. Devon Corp., 604 F.2d 1069-70 (8th Cir. 1979); Bibikos, 965.

125. *See* Union Oil Co. of Cal. v. Jackson, 489 P.2d 1073, 1078 (Okla., 1971).

126. *Superior Oil Co.*, 604 F.2d at 1069 (8th Cir. 1979) (internal citations omitted).

implied covenant where the lease states specific causes of forfeiture.[127] As discussed in III(b), Texas follows the majority rule on implied covenant remedies in oil and gas leases.[128] However, in the sixty-three years since *Clifton*'s publication, no courts in Texas or elsewhere have cited its holding—that lost royalties are inherently too speculative to provide an adequate remedy for a breach of the implied covenant to develop the lease premises.[129] For *Beer*, on the other hand, thirty-four cases cite its holding that courts can only remedy implied covenants with damages when express provisions of a lease provide for forfeiture.[130]

On the other hand, in *Clifton*, the Texas Supreme Court declined to impose damages mentioned and explained why lease forfeiture is the current remedy.[131] In that case, the lessors claimed that if the lessees had started to rework their well two years earlier, the lessors would have received $230 per month in royalties for two years.[132] However, the Court rejected this argument.[133] It noted that the record did not show that earlier reworking would have resulted in greater gas production, nor that the lessors would not have recovered all of their interest in the gas reservoir after the delayed reworking.[134] Therefore, a finding that the lessees owed two years' worth of damages in lost royalties would be "entirely speculative."[135] Nevertheless, the Court decided *Clifton* sixty-three years ago.[136] Oil and gas production, as well as seismology in general, have advanced considerably since the 1950s, and not all states since then have agreed with Texas that compensatory damages are an inappropriate remedy by virtue of being "entirely speculative."

In one example, the Supreme Court of Alabama in *Meaher v. Getty Oil Co.,* explained the gravitation towards damages as a remedy, noting that the implied covenant to develop the lease premises is just that: a covenant.[137] It is not a condition subsequent because the lease did not suggest the parties intended for a breach to result in forfeiture. Therefore, courts should not

127. *See* Beer v. Griffith, 399 N.E.2d 1227, 1230 (Ohio, 1980).

128. *See* Meaher v. Getty Oil Co., 450 So. 2d 443, 447 (citing *W.T. Waggoner Estate v. Sigler Oil Co.,* 19 S.W.2d 27 (1929)).

129. Clifton v. Koontz, 325 S.W.2d 684 (Tex., 1959).

130. Beer v. Griffith, 399 N.E.2d 1227 (Ohio, 1980).

131. *See Clifton*, 325 S.W.2d at 694.

132. *Id.*

133. *Id.*

134. *Id.*

135. *Id.*

136. *Id*.

137. *See* Meaher v. Getty Oil Co., 450 So. 2d 433, 447 (Ala., 1984).

remedy its breach with forfeiture unless the party seeking cancellation can demonstrate that damages will prove somehow, or "wholly," by the Court's holding, "inadequate."[138] Although such an exception for when damages prove inadequate reflects Alabama's adoption of the Texas rule—not Ohio's—*Beer* ultimately held that damages were in fact an adequate remedy for a lessee's failure to reasonably develop the premises.[139] This shows Alabama's indirect repudiation (*Beer* did not cite *Clifton*) of the argument that lost royalties as damages are "entirely speculative," and instead suggests that such damages both subvert the law's "abhorrence of forfeitures" and are more consistent with the norms of contract law.[140] Likewise, on a national scale, remedying a breach of the implied covenant to develop with damages as opposed to forfeiture would make courts more likely to both enforce the covenant and make the covenant itself comply with the norms of contracting. Should a lessor intend for a failure to develop to result in the lessee forfeiting the lease, the lessor can negotiate for an explicit lease provision to that effect. Thus, a damages remedy would not frustrate the expressed intent of the parties to the lease. It would only make breaches of implied covenants (which are inherently not expressed in the lease) easier to enforce in court.

D. Protections Against Forced Pooling

As noted above, some states passed statutes that strictly regulate how much lessees and the government can do to force pooling on lessors who refuse to consent.[141] Pooling relaxes lessees' obligations to further explore and develop their leases, treating a whole pooling unit as a tract for the reasonably prudent operator test or sometimes entirely abrogating the implied covenants to further develop and explore. Therefore, states that limit lessees' abilities to force pooling empower the implied covenants by protecting lessors' rights to insist their lessees treat their leases separately, giving each one the scrutiny of what a reasonably prudent operator would do with each lease on an individual basis.[142]

One example of the pro-mineral owner nature of Texas's pooling laws is the Texas Court of Appeals at Austin's decision in *Railroad Comm'n of Texas v. Broussard*.[143] There, the court upheld the Commission's denial of a

138. *Id.*
139. *Id.*
140. *Cf.* Beer v. Griffith, 399 N.E.2d 1227, 1230 (Ohio, 1980).
141. *See* Tex. Nat. Res. Code Ann. §§ 102.001–102.112 (West).
142. *Cf. id.*
143. *See generally* R.R. Comm'n of Texas v. Broussard, 755 S.W.2d 951 (Tex. App. 1988), *writ denied* (Feb. 8, 1989).

pooling order, overturning the lower court's finding that the denial was "arbitrary and capricious."[144] As noted above, Texas requires parties who have standing to make a "fair and reasonable offer to pool voluntarily" with other interest holders before soliciting the Railroad Commission for a pooling order.[145] Here, the court noted that the Mineral Interest Pooling Act does not define "fair and reasonable," but that the Commission must interpret those terms from the perspective of the offeree.[146] Furthermore, the Commission must consider "those relevant facts, existing at the time of the offer, which would be considered important" by a reasonable offeree.[147] Applying this standard, the court found that the Commission acted within its discretion to determine in 1985 that Broussard's 1983 offer to pool was not fair or reasonable because the offeree's well was not at that time causing drainage from Broussard's property.[148]

While the *Broussard* decision did not relate to implied covenants, it shows how much protections against forced pooling can protect the same interests as the implied covenants to further develop and explore. Namely, the case applied the Mineral Interest Pooling Act to hold that a well need not share revenue with its neighboring tracts because, five years before the case resolved, the well did not cause drainage from said neighboring tracts.[149] Therefore, mineral owners who seek to maximize production, the interest protected by the implied covenant to further develop, also benefit in states that protect against forced pooling.

E. Abandoning Abandonment

Even if lessors cannot persuade their legislatures and courts to reasonably develop the implied covenant, lessors could better enforce the covenant if they more commonly relied on it as their primary cause of action. As noted above, several lessors lose suits for breach of the implied covenant to develop because they posit abandonment as their primary cause of action.[150] They then state breach of the implied covenant as an additional claim but fail to provide notice to their lessees and a demand that lessees bring the lease into

144. *See id.* 956.

145. *See* Tex. Nat. Res. Code Ann. § 102.013 (West).

146. *See Broussard*, 755 S.W.2d at 952 citing Windsor Gas Corp. v. R.R. Comm'n of Tex., 529 S.W.2d 834 (Tex. Civ. App. 1975).

147. *Id.* (quoting *Carson v. Railroad Commission,* 669 S.W.2d 315, 318 (Tex.1984)).

148. *See Id.* at 952, 956.

149. *Id.*

150. *See* Superior Oil Co. v. Devon Corp., 604 F.2d 1063 (8th Cir. Neb. 1979); Olson v. Schwartz, 345 N.W.2d 33, 40.

compliance.[151] Because abandonment, for its part, requires some form of intent or physical relinquishment on the part of the lessee, such claims fail even where the lessee drills only one producing well for large premises.[152] By abandoning abandonment in situations where the lessor still produces (albeit minimally) from the premises, lessors can commit to a claim of breach of the implied covenant to develop early on, complying with the implied covenant's notice and demand requirements. This would bolster their claims in court and potentially avoid the need for litigation, as a demand would give the lessee an opportunity to correct the breach.[153]

For example, in *Coastal Oil & Gas Corp. v. Garza Energy Trust*, the Supreme Court of Texas noted how the respondents, the Salinas, originally sued for breach of the implied covenants to develop and to protect against drainage.[154] The case that ended up before the court dealt with whether hydraulic fracturing constituted trespass when it destroyed shale barriers between two tracts of land, causing drainage of oil from one tract into the other.[155] However, this is because the petitioners, the Salinas' lessees and owners of the neighboring tract, began "a flurry of drilling . . ." onto the Salinas' tract in order to bring the lease into compliance.[156] This would suggest that, where the lessee holds onto a lease only through minimal production, even a lessee with real financial incentive to avoid further development might come into compliance with the implied covenant when faced with a demand. Furthermore, although the Salinas lost their trespass case per the rule of capture, the majority, concurrence, and dissent all noted that the Salinas had a much stronger case in their implied covenant claims, with the majority and concurrence indicating that the case may have turned out differently had the Salinas focused on these claims.[157] This indicates that, while modern courts still show caution in penalizing lessors for a breach of implied covenant to develop, especially in Texas where damages for lost royalties is "too speculative," such courts are still willing to enforce a breach

151. *See id*.

152. *Id.*

153. *See Devon Corp.*, 604 F.2d at 1069 ("A lessee . . . should be informed of that breach, and should be given an opportunity to redeem himself by commencing further development within a reasonable time.").

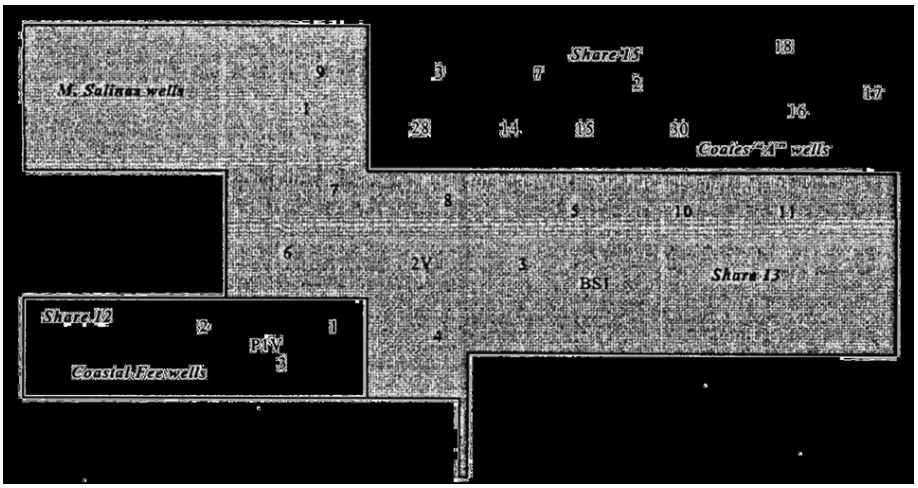
154. *See* Coastal Oil & Gas Corp. v. Garza Energy Tr., 268 S.W.3d 1, 6 (Tex. 2008).

155. *See id.* at 4.

156. *Id.* at 6.

157. *See id*. at 20, 40 (Willett, J, concurring); 47 (Johnson, J, concurring in part and dissenting in part).

where lessors follow the proper procedure.[158] Therefore, lessors can significantly empower the implied covenant to develop by asserting it more often as a primary cause of action, abandoning already-discredited theories like abandonment where the lease still has minimal production or asserting that hydraulic fracturing constitutes trespass.



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The map listed above demonstrates the situation in *Coastal Oil*.[160] Specifically, Share 13, land on which the Salinas had royalty interests, had active wells. As a result, the lessees satisfied their habendum clause, had not abandoned the premises, and were generally safe from lease termination under express terms of the lease.[161] However, by affirmatively causing drainage from Share 13 onto Shares 12 and 14 through fracking on the latter two shares, the lessees actively caused drainage in violation of the implied covenant to protect against drainage.[162] Much like how the lessors in *Superior Oil Co.* and *Olson* sabotaged their implied covenant claims by focusing on abandonment, the Salinas undermined their own implied covenant claims by focusing on an experimental trespass claim.[163] Furthermore, because the

158. *See* Clifton v. Koontz, 325 S.W.2d 684 (1959).

159. *Coastal Oil*, 268 S.W.3d at 5.

160. *See generally id.*

161. *See generally id*.

162. *See* id. at 20, 40 (Willett, J, concurring), 47 (Johnson, J, concurring in part and dissenting in part).

163. *See* Superior Oil Co. v. Devon Corp., 604 F.2d 1063 (8th Cir. Neb. 1979); Olson v. Schwartz, 345 N.W.2d 33, 40; Coastal Oil, 268 S.W.3d at 4.

Salinas sent notice and demand regarding their implied covenant claims, the lessees complied and began "a flurry of drilling . . . ."[164] Meanwhile, all justices—the majority, concurrence, and dissent—agreed that the Salinas' implied covenant claims had more merit than their trespass claim.[165] Therefore, even without changes in legislation or caselaw, lessors could more easily enforce the implied covenant to develop if they made its breach the primary focus of their claims.

F. Express Lease Language

Finally, lessors that cannot empower the implied covenant to develop through legislation or new caselaw have another, more obvious method of enforcing the covenant. Namely, they can negotiate an express provision in their leases as to how much development they expect on their tract, as well as their desired remedy where lessees fail to comply. While the Court in *Beer* used the absence of an express provision to hold that forfeiture was an inappropriate remedy for a breach, that necessarily implies that an express provision regarding a failure to develop additional wells would govern the case.[166] While this approach does not help lessors already bound by leases lacking such a provision unless they negotiate for some sort of addendum, lessees do sometimes agree to provisions enlarging their obligations to develop.[167] Specifically, there are three common provisions that expand a lessee's duty to develop: the Retained Acreage Clause, and, for leases that have been pooled, the Vertical and Horizontal Pugh Clauses. The usefulness of each clause depends on the location of deposits on the individual lease premises, but each clause offers advantages in maximizing development that the implied covenants to explore and develop might not.

1. Retained Acreage Clause

As the Supreme Court of Texas noted in *Endeavor Energy Sources, L.P. v. Discovery Operating, Inc.*, a Retained Acreage Clause terminates a lease after the primary term as to portions of the premises that the lessee did not develop.[168] It does so by dividing the lease into separate drilling units, with

164. *Coastal Oil*, 268 S.W.3d at 6.

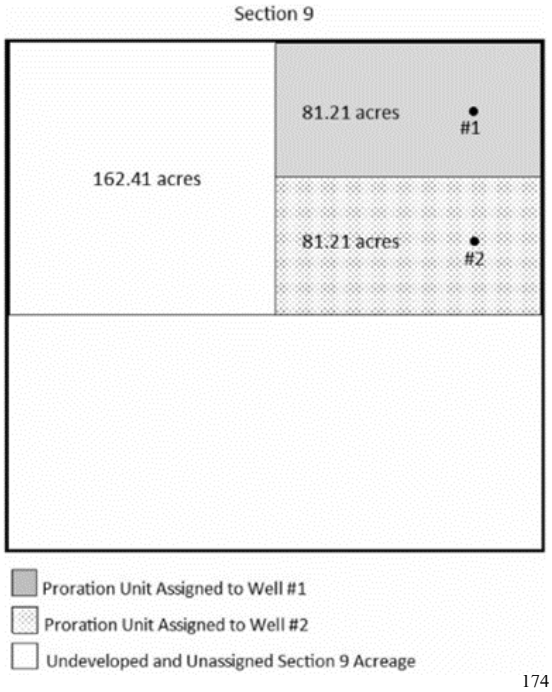
165. *See* id. at 20, 40 (Willett, J, concurring), 47 (Johnson, J, concurring in part and dissenting in part).

166. *Cf.* Beer v. Griffith, 399 N.E.2d 1227, 1230 (1980).

167. *See*, *e.g.,* Endeavor Energy Res., L.P. v. Discovery Operating, Inc., 554 S.W.3d 586, 597 (Tex. 2018); Lester v. Mid-S. Oil Co., 296 F. 661, 662 (6th Cir. 1924).

168. *See* Endeavor Energy Res., L.P. v. Discovery Operating, Inc., 554 S.W.3d 586, 598 (Tex. 2018).

production only extending the secondary term of the lease on the land in the unit.[169] The Court went so far as to say ". . . if a lessor wants its entire leasehold acreage developed, it should include a retained acreage clause in its leases."[170] Nonetheless, the *Endeavor* decision did not involve any implied covenant claims.[171] Rather, it evaluated how a lease's habendum clause related to its continuous development and retained acreage clauses.[172] However, two key phenomena are shown by a state supreme court acting in 2018 to use a minimally productive lease's explicit provisions to grant a lessor relief. First, it shows precedent for binding lessees to more stringent obligations to develop the premises than the implied covenant does. Second, it shows that lessees do sometimes agree to such provisions, if only as compensation for savings clauses like a continuous development clause.[173]



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169. John Lowe, Owen Anderson, Ernest Smith, & David Pierce, CASES AND MATERIALS ON OIL AND GAS LAW (Ed. 7), p. 325.

170. *Endeavor*, 554 S.W.3d at 598.

171. *Id.*

172. *Id.* at 591.

173. *Cf. id.*

174. *Id.* at 592.

The map above illustrates one of the leases at issue in *Endeavor*.[175] Without the retained acreage clause, two wells would have secured the entire 320-acre tract.[176] Thanks to the lease's Continuous Development Clause, the construction of such wells at the end of the primary term and the time following it satisfied the habendum clause.[177] This held true even in Texas, an actual production state.[178] However, because of the lease's retained acreage clause, the Court found the northwest quarter of Section 9, which had no wells on it, severable per the terms of the lease.[179] Should lessors today include this type of clause in their new leases, that clause would not grant total forfeiture or damages like prevailing on an implied covenant to develop claim would. However, it would grant forfeiture on the undeveloped portions of the premises while still giving the lessors royalties and delay rentals on the developed portions. Therefore, should lessors fail to convince legislatures and courts to further empower the implied covenant to further develop, they can negotiate for express provisions like the retained acreage clause on a lease-by-lease basis.

It bears mention, however, that only six cases, all decided by Texan courts, cite *Endeavor*'s holding that lessors "should" include a retained acreage clause if they wish to fully develop their premises.[180] Despite this fact, the case is just under five years old—not enough time for many parties, especially outside of Texas, to negotiate a lease, come to a dispute, and conclude litigation with the *Endeavor* opinion as a key source.[181] The opinion can therefore likely still serve as valuable precedent as lessors draft new leases with a bolstered, express duty to develop the lease premises. Thus, barring pro-lessor changes in legislation or caselaw concerning the implied covenant to develop, lessors can negotiate for more favorable obligations to develop in their own leases.

175. *Id.*
176. *See id*.
177. *See id*. at 600.
178. *See* Amoco Prod. Co. v. Braslau, 561 S.W.2d 805, 807 (Tex. 1978).
179. *Endeavor*, 554 S.W.3d at 607.
180. *See* Endeavor Energy Res., L.P. v. Discovery Operating, Inc., 554 S.W.3d 586, 597 (Tex. 2018)
181. *Cf. id.*

2. Pugh Clause

In the event that a lessee or governmental regulatory authority has pooled a lease into a much larger premises, the lessee needs to develop the original lease premises even less than under the implied covenants to develop and explore further.[182] However, lessors often negotiate for express provisions, called Pugh Clauses, for further protection from minimally productive leases.[183] It is first worth mentioning that courts sometimes define the two types of Pugh Clauses—Vertical and Horizontal—in opposite ways.[184] For clarity, this comment uses the term "Horizontal Pugh Clause" to refer to a provision where after the primary term, a lease terminates as to all minerals more than a set distance below the deepest producing foundation.[185] "Vertical Pugh Clause," for its part, refers to a provision where development of a pooling unit will only satisfy a lease's habendum clause for the acreage of the premises contained in the pooling unit.[186] Regardless, both Pugh clauses serve to protect a lessor's interest in seeing the premises reasonably developed in the event of pooling. Indeed, these clauses are modes of empowerment for lessors' interest beyond the implied covenants to further develop and explore.

a) Horizontal Pugh Clause

The Horizontal Pugh Clause enables lessors to protect their expectation of development in the event of pooling or unitization. Under this clause, development in a pooled premises will only satisfy the relevant leases down to the deepest producing formation.[187] For any possible exploration or development below that formation, mineral owners may then sign separate leases with new lessees.[188] Similar to the Vertical Pugh Clause and Retained Acreage Clause, this clause grants neither the total forfeiture nor possibility of damages that a lessor could gain from successfully claiming a breach of

182. John Lowe, Owen Anderson, Ernest Smith, & David Pierce, CASES AND MATERIALS ON OIL AND GAS LAW (Ed. 7), p. 325.

183. *See id.* 325–26; *Endeavor*, 554 S.W.3d at 598.

184. *Compare* Sandefer Oil & Gas, Inc. v. Duhon, 961 F.2d 1207, 1209 (5th Cir. 1992) (referring to a provision that terminated the lease as to all space 100 feet or more below the deepest producing well as a Horizontal Pugh Clause), *with* Petrohawk Properties, L.P. v. Jones, 455 S.W.3d 753, 778 (Tex. App. 2015) (referring to similar provisions as Vertical Pugh Clauses).

185. *See Duhon*, 961 F.2d at 1209; John Lowe et al., CASES AND MATERIALS ON OIL AND GAS LAW (Ed. 7), p. 325.

186. *See id.*

187. *See id.*

188. *See id.*

the implied covenant to develop. However, such a provision mitigates the damage that pooling can do to a lessors' expectation of development and exploration on their properties and allows them to sign new leases subject to the original implied covenants. Therefore, lessors looking to proactively empower their rights under the implied covenant to develop should consider including a Horizontal Pugh Clause in their leases.

In one instance, the United States Fifth Circuit of Appeals found that parties mean for any Pugh Clause "to protect the lessor from the anomaly of having the entire property held under the lease by production of a very small portion."[189] While this analysis in *Sandefer Oil & Gas, Inc. v. Duhon* applies to all Pugh Clauses, the court specifically ruled on the interpretation of a Horizontal Pugh Clause. The lease provided that it would automatically terminate for any space 100 feet or lower than the deepest depth drilled of a well that produced in paying quantities.[190] Because the deepest producing well on the lease drilled to a total of 17,609 feet below the surface, the lessees did not dispute that the lease terminated as to all space below 17,700 feet of the surface.[191] Instead, the lessees argued that the proper metric for beginning the "100 feet below" measurement was the deepest extension of the drill stem, even if the well ultimately drew from a formation higher than that point.[192] The lessors argued that, as Sandefer's well drew from the Middle Miogypsionoides Sand formation—which extended from 17,100 to 17,250 feet below the surface—the lease terminated as to all horizons below 17,350 feet.[193] The Fifth Circuit agreed, noting that the purpose of a Pugh Clause is to protect lessors from lessees who barely produce.[194] Rather than the lessee-focused analysis of the "reasonably prudent operator" standard that the implied covenant to develop requires, a Horizontal Pugh Clause, and by extension all Pugh Clauses, forces lessees to either "develop [the premises] or let it go."[195]

189. Sandefer Oil & Gas, Inc. v. Duhon, 961 F.2d 1207, 1209 (5th Cir. 1992).
190. *See id*., 1208.
191. *Id*. at 1208–09.
192. *Id*. at 1209.
193. *Id.*
194. *Id.*
195. *Id.* at1210.

b) Vertical Pugh Clause

The Vertical Pugh Clause operates in a similar fashion as the Retained Acreage Clause, and some courts use the two ambiguously.[196] However, a Retained Acreage Clause does not require a pooling order or any form of unitization to take effect.[197] A Vertical Pugh Clause, on the other hand, applies exclusively in the context of pooling and unitization.[198] Under the latter, development on a pooled premises will only secure the original lease to the extent that the original lease premise was pooled.[199] Any land not included in the pool or unit gets severed into its own lease and requires its own development, subject to the implied covenant to further develop, to satisfy the habendum clause.[200] While such a provision only protects a lessor in the event of pooling, it remains one way that lessors can incentivize lessees to further develop the premises, or at least regain the right to lease the undeveloped, non-pooled parts of the premises.

The court in *Duhon*, while interpreting a Horizontal Pugh Clause, claimed that the Vertical Pugh Clause was older and better established.[201] However, caselaw dealing solely with a Vertical Pugh Clause is rare. Additionally, as mentioned above, some courts define the two Pugh Clauses in the opposite manner as did the Fifth Circuit of Appeals in *Duhon*.[202] The lack of clear jurisprudence may come from the fact that many states include Vertical Pugh protections in their forced pooling statutes, obviating the need to include such clauses in the lease.[203] Additionally, leases sometimes use one provision to cover the protections of both Pugh Clauses,[204] and parties often dispute whether a provision is a Pugh Clause or a Retained Acreage Clause.[205] Even

196. *See* John Lowe et al., CASES AND MATERIALS ON OIL AND GAS LAW (Ed. 7), p. 325–26.

197. *See id*. p. 326.

198. *See id.* p. 325.

199. *Id.*

200. *Id.*

201. *See* Sandefer Oil & Gas, Inc. v. Duhon, 961 F.2d 1207, 1209 (5th Cir. 1992).

202. *Compare* id., *with* Petrohawk Properties, L.P. v. Jones, 455 S.W.3d 753, 778 (Tex. App. 2015).

203. *See, e.g.,* Miss. Code § 53–3–111, Okla. Stat. Ann. tit. 52, § 87.1(b).

204. *See* Rogers v. Westhoma Oil Co., 291 F.2d 726, 732 (10th Cir. 1961) (holding that Pugh Clause that did not limit its severance into horizontal or vertical units allowed severance by either metric); *but see* Rist v. Westhoma Oil Co., 385 P.2d 791, 796–97 (holding that terms like "tract," "premises," and "lands" only showed parties' agreement on a Vertical Pugh Clause).

205. *See* SMK Energy Corp. v. Westchester Gas Co., 705 S.W.2d 174, 176 (Tex. App. 1985), writ refused NRE (Jan. 7, 1987);

so, the Vertical Pugh Clause remains an effective means of protecting lessors' interests in seeing their premises developed, beyond what is guaranteed by the implied covenants to further explore and develop.

For example, in *Tank v. Citation Oil & Gas Corp.*, the North Dakota Supreme Court terminated portions of a lease based on the lease's Vertical Pugh Clause.[206] The Court held that the clause superseded the lease's Continuous Development Clause, as to hold otherwise would render the Pugh Clause meaningless.[207] The *Tank* opinion never used the term "Vertical Pugh Clause," instead referring to the lease's provision as a general "Pugh Clause."[208] However, the Court applied the provision to vertically sever the undeveloped portions of a lease from a 1280-acre spacing unit issued by the North Dakota Industrial Commission.[209] Therefore, *Tank* supports the contention that lessors can use Vertical Pugh Clauses—and by extension express lease terms in general—to protect their interests in having fully-developed leases should relief be unavailable through the implied covenants to further develop and explore.

V. Conclusion

In short, modern energy demands have caused a reevaluation of the implied covenant to reasonably develop the lease premises. However, actual court opinions do not yet reflect such a change. Positive changes to this status quo may come from reimagining what a plaintiff must do to show a breach of the covenant, or perhaps a reimagining of how courts penalize a breach. Still, courts will need to balance any such changes against due process concerns and the need for a precise estimation of damages. Alternatively, more courts and legislatures could distinguish between the implied covenant to reasonably develop a known deposit from the implied covenant to further explore the lease premises for other deposits. While not every jurisdiction recognizes the latter implied covenant at all, the stark contrasts in questions of fact of each covenant's alleged breach would justify different burdens of proof depending on which breach the lessor alleges. Additionally, legislatures could adopt measures limiting how much pooling lessees and regulatory bodies can force against the will of lessors. While such laws do not directly empower enforcing implied covenants, they allow lessors to guard their interest in seeing lessees fully develop the lease, whereas pooling,

206. *See* Tank v. Citation Oil & Gas Corp., 848 N.W.2d 691, 701 (N.D. 2014).
207. *See id.* at 700.
208. *See id.* at 694.
209. *See id.* at 694–95, 701.

even forced pooling, weakens the implied covenants to develop and explore, sometimes completely abrogating it.

Even without significant changes in caselaw and legislation, the lessors themselves could more easily enforce implied covenants, especially the implied covenant to reasonably develop, by pursuing such a breach as their primary cause of action instead of a subordinate cause of action to abandonment. Because abandonment usually requires some form of intent or physical relinquishment, such lawsuits do not normally succeed where the lessee still produces from even one well on the premises. By abandoning abandonment in such cases and instead focusing on their implied covenant claims, lessors could comply with court requirements of notice and demand, making their breach claims much more likely to succeed or even cause lessees to meet such demands, obviating the need for trial.

Finally, lessors might be able to negotiate for express provisions in their leases that obligate lessors to develop the premises beyond the protections of the implied covenant. Such provisions, such as the Retained Acreage Clause, Vertical Pugh Clause, and Horizontal Pugh Clause, require some sophistication on the parts of lessors. Even so, the fact that such provisions have been tried and enforced in court shows both that lessees do agree to them and that courts interpret them to protect lessors' interest in further development beyond what implied covenants currently offer. In conclusion, in favorable jurisdictions, the implied covenant to reasonably develop can ameliorate modern energy demands. However, lessors can empower their mineral interests by giving the covenant the proper focus or negotiating even stronger expectations through explicit lease provisions.