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Oil and Gas: Preservation of Leaseholds Following Well Failure

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Oil and Gas: Preservation of Leaseholds Following Well Failure

Along with the increased oil and gas drilling activity in Oklahoma over the past decade has come a corresponding expansion in the problems experienced by oil and gas interest holders. Inherent in this intensified exploration is that technological capabilities, or the lack thereof, affect property interests in these oil and gas ventures. Over the past few years, as oil and gas well depths continue to increase,[1] the likelihood of experiencing mechanical difficulty has become greater. To protect these multimillion-dollar oil and gas operations, responsibility is frequently placed upon the attorney to prevent or to remedy problems caused by technological shortcomings.

Assume the following situation were to arise in Oklahoma: Crude Oil Company procures leases covering a 640-acre tract of land; it enters the land a few days before the end of the primary terms of the leases and in good faith commences operations sufficient to satisfy the prudent operator standard.[2] After the primary term has expired, and before total depth is reached, Crude Oil Company Well Number One experiences mechanical difficulty; the casing collapses, rendering the well inoperable. There has been no show of production, nor are the operators close to total depth. Before reaching the depth at which the breakdown occurred, the operator did not drill through any known producing sands. Crude Oil Company has expended a great deal of money and wishes to salvage its operation if possible. Obviously, the most secure route would be to obtain an extension or to execute another oil and gas lease with the lessors. The situation may arise, however, where the lessors are not willing to allow Crude Oil Company to continue drilling, but instead contend the leases have terminated. The problem experienced by Crude Oil Company is not uncommon, and its resolution depends upon the content of the oil and gas lease. An oil and gas practitioner must be able to identify various "saving" clauses which appear in oil and gas leases, using them to the best advantage of the client. A saving clause contained in an oil and gas lease allows operations past the primary term in the absence of production, and is essential to the maintenance of a drilling operation.

This note will discuss the various types of saving clauses used today, pointing out the strengths and weaknesses of each. Particular attention will be paid

1. In 1960 the average footage of completed wells in Oklahoma was 3,630 feet. AM. PETROLEUM INST., PETROLEUM FACTS AND FIGURES (1961). By the fourth quarter of 1981, the average well depth had increased to 4,674 feet. AM. PETROLEUM INST. (1981).

2. In Ramsey Pet. Corp. v. Davis, 184 Okla. 155, 85 P.2d 427 (1938), lessors attempted to cancel an undeveloped portion of an oil and gas lease for breach of implied covenants to further develop. The court stated that the duty imposed by the implied covenants is to use reasonable diligence and care to develop and protect the entire lease premises. Holding that the lessees had complied with the implied covenants, the court indicated that this duty is measured by the prudent operator test. The prudent operator test requires the lessee to do whatever in the circumstances would be reasonably expected of operators of ordinary prudence, with regard to the interests of both lessor and lessee.

to the well completion clause, the most commonly used saving clause. Even though the well completion clause is widely used, it is the most restrictive of these clauses and can present numerous problems, especially in a situation such as that faced by Crude Oil Company in the posed hypothetical. Along with an analysis of Oklahoma case law construing the well completion clause, the note will advocate a liberal construction of this provision. The scope of this note is limited to that situation where the operator is in the process of drilling, having realized no show of production nor having reached total depth. Case law in Oklahoma is fairly clear when dealing with a dry hole or, conversely, a producing well.

"Saving" Clauses Contained in Oil and Gas Leases

Absent the discovery of a well capable of production[3] in paying quantities,[4] an oil and gas lease must normally contain a saving clause that will allow the operator to continue operations, other than completion of the well in process, past the primary term.[5] Allowing the operator to continue to drill or

3. The Texas courts follow a strict standard when determining the degree of production that will perpetuate the lease. In Gulf Oil Corp. v. Reid, 337 S.W.2d 267 (Tex. 1960), an action was brought against the lessee to determine whether an oil and gas lease had lapsed for failure of the lessee to market the product within the term of the lease. The Texas court held that the term "operations" contained in the lease allowing for operations past the term of the lease did not include the search to procure a purchaser for the product.

4. McVicker v. Horn, Robinson & Nathan, 322 P.2d 410 (Okla. 1958). The Oklahoma courts have continued to uphold the *McVicker* doctrine that a well capable of production in paying quantities is sufficient to preserve the term of the lease. In Hoyt v. Continental Oil Co., 606 P.2d 560 (Okla. 1980), an action was brought to cancel an oil and gas lease based upon the fact that production in paying quantities had never been realized from the completion of a gas well. In *Hoyt*, the supreme court, citing *McVicker*, held that in the absence of an express provision in the lease to market, any requirement on the part of the lessee is an implied covenant, which allows a reasonable time after completion of the well to procure a market. 322 P.2d at 564. Similarly, in State *ex rel.* Comm'rs of Land Office v. Amoco Prod. Co., 645 P.2d 468 (Okla. 1982), plaintiff sought to quiet title to a leasehold interest after Amoco Production had drilled a second well following mechanical difficulty and cessation of production on Well Number One. The supreme court found that the ability to produce oil or gas was the most important factor determining the duration of the lease, rather than the actual marketing of the product. The court further held that where production ceased because of mechanical problems, prompt and diligent efforts to restore production preserved the term of the lease.

After the ability of a well to produce oil or gas is established, thus preserving the term of the lease, the Oklahoma courts utilize a liberal definiton of production in paying quantities. In Stewart v. Amerada Hess Corp, 604 P.2d 854 (Okla. 1979), owners of certain interests brought an action to terminate a lease based on the fact that oil and gas were no longer produced in paying quantities. The supreme court held that the term "produced" means production in paying quantities. *Id.* at 857. That term required that there be production in quantities sufficient to yield a return, however small, in excess of lifting expenses, even though drilling and completion costs might never be repaid.

5. Simons v. McDaniel, 154 Okla. 168, 7 P.2d 419 (1932). An exception to the general rule, the Oklahoma courts have granted the implied right to complete a well that was begun during the primary term of a "commencement"-type lease.

A distinction must be drawn between a "commencement"-type lease and a "completion" lease. In State *ex rel.* Comm'rs of Land Office v. Carter Oil Co., 336 P.2d 1086 (Okla. 1958),

pursue other activities past the primary term may be accomplished in a number of different ways. Although the language contained in these saving clauses may differ, there are basically four separate groupings of provisions that allow further operations at the end of the primary term.

The first, and one of the oldest saving clauses, involves a modification of the "thereafter" provision contained in the habendum clause: "To have and to hold the same for and during the term of three years from the date hereof, and as much longer thereafter as oil and gas is found therein, or said premises developed or operated."[6]

The term "developed or operated" allows a wide variety of on-site operations to preserve the term of the lease. In *Moore Oil v. Snakard*,[7] the United States District Court for the Western District of Oklahoma was presented with a habendum clause containing similar language. The lessor contended that the oil and gas lease had expired by virtue of the fact that the well was not completed by the end of the primary term. The court found in favor of the lessee and determined that the lease would be extended as long as operations were maintained on the lease, but that such operations must be maintained diligently and continuously, as a condition limiting the extension of the lease.[8] Although the courts are fairly liberal when construing which operations will preserve the term of the lease, the diligence requirement is strictly applied. In *Statex Petroleum v. Petroleum, Inc.*,[9] the Tenth Circuit Court

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the state of Oklahoma sought to quiet title based on the fact that certain oil and gas leases had expired. A completion lease, like those used by the state in this case, requires that the well be "completed" prior to the expiration of the primary term. A commencement lease requires that the well merely be started during the primary term. The supreme court in *Carter* held that although the well must have been completed during the primary term, the operator had a reasonable time thereafter to find a market for the production.

6. Prowant v. Sealy, 77 Okla. 244, 187 P. 235 (1919). When construing the term "developed or operated," the supreme court found the clause to mean that if drilling operations were commenced on the premises within the three years for the purpose of discovering oil and gas and were still being prosecuted in good faith at the expiration of the three-year period, the term was thereby enlarged or extended during the continuance of such drilling operations.

A modern variation of the modified habendum clause contained in *Prowant* reads: "This lease will remain in force for a term of ____ years and as long thereafter as oil or gas or any of the products covered by this lease is or can be produced from said land, or from land with which said land is pooled, or operations are being continued."

7. 150 F. Supp. 250 (W.D. Okla. 1957). "It is agreed that this lease shall remain in full force for a term of one year from this date, and as long thereafter as oil or gas, or either of them, is produced from said land by the lessee, or the premises are being developed or operated." *Id.* at 254. The lease in question also contained a clause that allows a well to be completed that was begun during the primary term. The court found no conflict between the habendum and the well completion clauses, by holding the lease was extended by either production in paying quantities or diligent and continuous operations by the lessee, provided a well was commenced before the end of the primary term.

8. *See also* Pardue v. Mark, 279 S.W.2d 594 (Tex. Civ. App. 1955), in which the Texas court found that a modified habendum clause containing the phrase "for as long as operations are being carried on" excused the necessity of actual production at the end of the primary term, where drilling had been pursued with reasonable diligence, allowing operations including, but not limited to, the well commenced during the primary term.

9. 308 F.2d 815 (10th Cir. 1962). The Tenth Circuit recently used the *Statex* decision to

of Appeals further defined the holding in *Moore Oil* by stating that when operating under a modified habendum clause, a second well commenced after the primary term did not preserve the term of the lease where there was an unexplained delay between the completion of the first well and the commencement of the second well. The court held that continuous and diligent operations after work was completed on the first well were required to perpetuate the lease. The term "premises developed or operated," although somewhat vague, enables the operator to continue operations on a single well, or on subsequent wells, as long as there is no break in the continuity of such operations.

A second type of saving clause that permits operations after the primary term involves the use of a 30/60/90-day cessation of operations provision. A typical clause reads as follows:

> If at the expiration of the primary term oil, gas or other minerals is not being produced on said land but lessee is then engaged in drilling or reworking operations thereon, the lease shall remain in force so long as operations are prosecuted with no cessation of more than thirty (30) consecutive days, and if they result in the production of oil, gas, or other minerals so long thereafter as oil, gas, or other minerals is produced from said land.[10]

The period of cessation of operations is an arbitrary figure, designed to compensate for mechanical failure or other delays. In *McClain v. Harper*,[11] lessors sought cancellation of an oil and gas lease contending that the lease had expired because of the failure of the lessees to complete the well during the primary term. Even though the lease mentioned "drilling or reworking" operations without reference to a particular well, the Oklahoma Supreme Court severely restricted the operations that could be pursued under this clause, and interpreted the provision as one allowing completion only of the well begun during the primary term.[12] Basically, the 30-day provision (or 60-day or 90-day)

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further a definition of the term "production in commercial quantities." In True Oil Co. v. Federal Energy Reg. Comm'n, 663 F.2d 75 (10th Cir. 1981), True Oil petitioned the Tenth Circuit to review a decision of the FERC. The Tenth Circuit found that "production in commercial quantities" requires a means of transportation of the product from the producer to the consumer. The court noted that to construe the term otherwise would be to ignore the "plain sense" meaning of the word "commercial."

10. McClain v. Harper, 206 Okla. 437, 438, 244 P.2d 301, 302 (1952). A more expansive 30/60/90-day cessation of operations clause currently in use in Oklahoma lease forms reads:

> If lessee shall commence operations for drilling on land above described, or on any acreage pooled therewith, at any time while this lease is in force, this lease shall remain in force and its terms shall continue as long as such operations are prosecuted whether on the same or different wells with no cessation of said operations of more than ninety (90) days, and if production results therefrom, then as long as production continues.

11. 206 Okla. 437, 244 P.2d 301 (1952).

12. In Rogers v. Osborn, 152 Tex. 540, 261 S.W.2d 311 (1953), the Texas Supreme Court construed a cessation of operations clause strictly against the lessee and held that because a well commenced during the primary term was neither a dry hole nor a producer, the lessees could

merely extends the right to complete a well commenced during the primary term, and may be seen as a temporary waiver of the requirement of diligent operation for the duration of the stated period. When such a clause does not contain a stated period during which drilling operations may be delayed, the test of reasonableness and diligent operation is used.[13]

A third type of saving clause that enables the operator to drill past the primary term involves the use of a special, separate provision. An example of such a provision is a well completion clause that provides:

> If the lessee shall commence to drill a well within the term of this lease or any extension thereof, the lessee shall have the right to drill such well to completion with reasonable diligence and dispatch, and if oil or gas, or either of them, be found in paying quantities, this lease shall continue and be in force with like effect as if such well had been completed within the term of years first herein mentioned.[14]

A fourth type of saving clause, similar in appearance but quite different in effect, involves the use of a continuous operations clause:

> Notwithstanding anything contained in this lease to the contrary, it is expressly agreed that if the lessee shall commence drilling operations at any time while this lease is in force, this lease shall remain in full force and its terms shall continue so long as such operations are prosecuted, and if production results therefrom, then as long as production continues.[15]

The important distinction that courts and authors have made between a well completion clause and a continuous drilling clause is that the former extends the lease for the purpose of allowing the lessee to complete only the well in process.[16] Conversely, a continuous operations clause allows the lessee

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not tack those operations to a subsequent well commenced after the primary term. The Texas court reasoned that the word "operates" as used in the cessation of operations clause does not include additional wells commenced after the expiration of the primary term. *Rogers* has become known as the "wet hole" case. *See* R. HEMINGWAY, OIL AND GAS LAW § 6.9 (1971).

13. Jones v. Moore, 338 P.2d 872 (Okla. 1959); Ramsey Pet. Corp. v. Davis, 184 Okla. 155, 85 P.2d 427 (1938).

In *Jones v. Moore*, lessors sought to quiet title and declare void an oil and gas lease they contended had expired because the lessees had allowed 47 days to expire after resuming drilling activity. The court ruled in favor of the lessees, finding that although the 47-day period did pass without further drilling, the lessees were nevertheless diligent in attempting to resume drilling negotiations. The test of reasonable and diligent operations may be satisfied by preparatory drilling activity as well as on-site operations.

14. Skelly Oil v. Wickham, 202 F.2d 442, 443 (10th Cir. 1953).

15. Simpson v. Stanolind Oil and Gas Co., 210 F.2d 640 (10th Cir. 1954).

16. 4 E. KUNTZ, OIL AND GAS § 47.4 (4th ed. 1972); R. HEMINGWAY, OIL AND GAS LAW, § 6.6 (1971). Professor Kuntz indicates that a well completion clause may be used in conjunction with some other clause, giving it the same effect as a more expansive saving clause. A well completion clause may be combined with a dry hole clause, allowing resumption of operations after the primary term, and upon completion of the well as a dry hole.

to complete any drilling activities begun during the primary term, whether on a single well or other wells on that leasehold. In *Simpson v. Stanolind Oil & Gas Co.*,[17] the operator drilled a producing well on leased property, but the well was located in violation of an Oklahoma Corporation Commission spacing order.[18] However, the drilling of the well was later authorized by an order of the Corporation Commission. The lessors contended that the off-pattern drilling was a breach of the lease. When construing the continuous operations clause contained in the lease, the Tenth Circuit held that, by the terms of the lease, the lessees were entitled to proceed with any drilling operations if the well was commenced during the primary term. Therefore, even if the lessees had terminated drilling activities and attempted to procure an exception order from the Corporation Commission, the lease would not have lapsed because such activity would have constituted completing the well with reasonable diligence.

It is evident, then, that there is some authority that indicates that a wide variety of operations may be prosecuted under the continuous operations clause, some of which may even consist of off-premises preparatory activity. However, Professor Kuntz, in his treatise, indicates that the literal provisions of the clause in question will govern what type of operations must be resumed or commenced. The clause may be limited in application to a resumption or commencement of drilling, or it may be less restrictive and apply to reworking and other operations. If the clause specifically provides for the resumption or commencement of drilling, no other operation will satisfy the clause.[19]

All of the clauses outlined above are somewhat deficient, especially when drafted to cover the most narrow of situations or in an attempt at brevity. There are a multitude of operational problems that may arise during drilling activity, most of which cannot be overcome by using the phrases "developed or operated," or "so long as operations are prosecuted." Even though the continuous operations clause appears to be the broadest of these saving clauses, it is too poorly worded to safeguard a drilling venture adequately. The continuous operations clause contained herein only intimates at the problem found in many jurisdictions; a statement that the clause takes effect "notwithstanding anything to the contrary" is in direct conflict with the habendum clause, leaving room for judicial ascertainment of the effect of the provision. Professor Kuntz opines that the most desirable method of enabling an operator to pursue opera-

17. 210 F.2d 640 (10th Cir. 1954). The lessors sued for breach of an oil and gas lease that covered a producing tract of land. The remedy sought, however, would have been equivalent to a termination of the leasehold, vesting the entire production in the lessors. The court held that they could not seek to recover the equivalent of cancellation in money damages and at the same time retain the benefits of the developed lease, with a producing well thereon.

18. *See also* Stoltz, Wagner & Brown v. Duncan, 417 F. Supp. 552 (W.D. Okla. 1976), in which plaintiffs alleged that an order of the Corporation Commission naming the operator had been violated. The United States District Court for the Western District of Oklahoma, relying on Simpson v. Stanolind Oil & Gas Co., 210 F.2d 640 (10th Cir. 1954), held that a well commenced by one not the operator named in the Corporation Commission order will continue the lease in effect, especially if the driller had a leasehold interest in the property.

19. 4 KUNTZ, *supra* note 16, at § 47.5.

tions past the primary term is to insert a special, separate clause, together with a modified habendum clause. He indicates that this method removes the possibility that the special clause will be construed to be repugnant to the habendum clause and therefore possibly ineffective.[20] It is important to define which operations will in fact perpetuate the lease. More particularly, as draftsman, the attorney should make it clear that all drilling operations on that well or wells in process will keep the lease alive. The modified habendum clause should not be considered alone to limit further operations to only those contained therein, but should coordinate with the separate special provision to allow the desired operations. A proposed example of this provision reads:

> This lease shall remain in force for a term of ____ years, and as long thereafter as oil, gas, casinghead gas or other hydrocarbons may be produced from the leased premises, or operations for the drilling or production thereof are continued as hereafter provided.
>
> It is expressly agreed that if lessee shall commence operations for the drilling of a well (or wells) at any time while this lease is in force, this lease shall remain in force and effect and its terms shall continue for so long as such operations are prosecuted and, if production results therefrom, then so long as production may continue. Said operations for the production of oil, gas and other hydrocarbons may consist of, but are not limited to, the commencement, completion, redrilling, reworking (equipping, repairing, secondary recovery, etc.) on any well commenced during the primary term and any wells drilled thereafter pursuant to this lease.

Conflicts Created By the Well Completion Clause

The necessity for well completion clauses in oil and gas leases was eliminated by the Oklahoma Supreme Court in *Simons v. McDaniel*,[21] where drilling activity proceeded past the primary term of the commencement-type lease. The court there stated:

> We hold that the grant to the lessee of the right to commence a well at any time within the term fixed by the lease contract, by necessary legal implication, carried with it the right to complete the well after the period fixed for commencement had expired, subject, however, to abandonment of that right by failure to proceed in good faith and with diligence. . . . Our conclusion is favorable to development, for it permits completion of a well rightfully commenced.[22]

Even though a well completion clause is not necessary, the majority of lease forms now used contain such a provision. The courts have inconsistently interpreted the effect of the well completion clause and many times employ

20. *Id.* § 47.4.
21. 154 Okla. 168, 7 P.2d 419 (1932).
22. *Id.* at 170-71, 7 P.2d at 420-21.

the *Simons* case, notwithstanding express provisions dealing with operations after the primary term contained in the lease. For example, in *Vincent v. Tideway Oil Programs, Inc.*,[23] the trial court canceled an oil and gas lease for failure to comply with implied covenants to further develop, and upon a theory of abandonment. The Oklahoma Court of Appeals supported the holding in *Simons* and reversed the lower court, finding that where an oil and gas lease was a "commencement"-type lease, the well need only have been commenced before the end of the primary term and completed thereafter with due diligence, regardless of any language contained in the lease.[24]

The hypothetical situation faced by Crude Oil Company discussed earlier may be either a major problem or a minor inconvenience, depending on the type of saving clause present in the oil and gas lease. If the leases contain a continuous operations clause or some other provision specifically allowing operations past the primary term, and contain no reference to the well in process, then resumption of operations merely involves skidding the rig and redrilling, or utilizing some form of directional drilling.[25] However, the right to pursue such operations usually is not expressly granted in a well completion clause. If the oil and gas leases acquired by Crude Oil contain only a well completion clause, the operator faces the possibility of losing the privilege to redrill. A strict construction of such a clause, in the event of a mechanical failure rendering the well inoperable, would result in termination of the leases in the absence of some other saving provision. This result would not only be expensive for the lessee but would be grossly inequitable to a prudent operator who in good faith attempts to complete a well rightfully commenced.

The Oklahoma Supreme Court stated in *Simons*, "[I]n every private grant there passes by implication that which is reasonably necessary to the enjoyment of the thing granted."[26] As in the case of Crude Oil Company, there should be, by analogy, some recourse when a good faith drilling operation is threatened with termination by matters outside the scope of diligent drill-

23. 620 P.2d 910 (Okla. Ct. App. 1980). Another basis for the cancellation was that the lessee failed to properly tender delay rentals. However, the portion of the lease providing for payment of delay rentals was left blank. The Oklahoma Court of Appeals held that failure of the parties to provide for the payment of delay rentals did not alter the rule that under a "commencement" lease all that is required of a lessee is commencement within the primary term and completion with due diligence thereafter.

24. The Texas courts have not expressly followed the *Simons* doctrine. However, in Deflores v. Smith, 236 S.W. 505 (Tex. Civ. App. 1922), lessees entered the land and began operations that continued past the term of the lease. The lessor claimed that the lease expired because no oil or gas was discovered within the term of the lease. The Texas court held that the lessees had the right to complete the contract if the operator was doing everything necessary to comply with the terms of the lease.

25. Pardue v. Mark, 279 S.W.2d 594 (Tex. Civ. App. 1955). The modified habendum clause contained in *Pardue* was construed to allow the operator to skid the rig and redrill, following mechanical difficulties encountered after the primary term. However, in Prowant v. Sealy, 77 Okla. 244, 187 P. 235 (1920), a similar clause only allowed completion of the well commenced during the primary term.

26. Simons v. McDaniel, 154 Okla. 168, 170, 7 P.2d 419, 420 (1932).

ing activity. In *Bain v. Portable Drilling Corp.*,[27] the lessors contended that a lease had expired because the operator had failed to produce gas within the term of the lease, such discovery coming after the primary term. The lease in *Bain* contained the following well completion clause: "[A]nd if the lessee shall commence to drill a well within the term of this lease or any extension thereof, the lessee shall have the right to drill such well to completion with reasonable diligence and dispatch. . . ."[28] In reference to this provision and the right to operate thereunder, the court indicated that it was a saving clause whereby the lessee, who had attempted to develop the lease in an effort to produce oil and gas, was protected in such an endeavor so long as he continued diligently to complete a well commenced in good faith prior to the expiration of the lease. The court further stated that it would be unjust and inequitable to hold that a lessee who is required to commence a well within a specified time after the execution of a lease, and who commenced the well within such time, should be deprived of the right to complete a well after the expiration of the term of the lease, in the absence of an express provision in the lease to that effect. The holding in *Bain* did not specifically refer to the right only to complete the well commenced during the primary term. Rather, *Bain* discussed the important need of the courts to promote development, and, consequently, to protect the right to complete a well rightfully commenced.[29]

In *Skelly Oil v. Wickham*,[30] the Court of Appeals for the Tenth Circuit implied that the *Bain* decision did not apply to a second well commenced after the primary term. Defendant Skelly Oil completed its first well as a dry hole after the primary term. At another location on the leasehold, it began a second well and completed it as an oil producer after the primary term. When discussing the rights of Skelly Oil under a well completion clause substantially similar to that contained in *Bain*, the court stated:

> [T]he only unconditional right Skelly had under the lease, after the expiration of the primary term, was to complete the well it had commenced before such expiration; that any further rights Skelly might acquire under the lease were contingent and conditional, in that they were dependent upon completion of the well

27. 200 Okla. 569, 198 P.2d 207 (1948).

28. *Id.* at 571, 198 P.2d at 209.

29. *Id.* The Court in *Bain* allowed completion of the well notwithstanding the fact that the delay rental provision in the lease was left blank. In the *Bain* case, however, the lease was to be commenced within 120 days after execution of the lease. The failure to complete the delay rental provision takes on greater significance when the lessee has the privilege of commencing drilling operations any time within the primary term of the lease. In Vincent v. Tideway Oil Programs, Inc., 620 P.2d 910 (Okla. Ct. App. 1980), the trial court decreed cancellation of an oil and gas lease for failure to pay delay rentals during the three-year term of the lease. The Oklahoma Court of Appeals reversed and found that the failure of the parties to provide for the payment of delay rentals did not alter the rule that under a "commencement" lease, the lessee must only commence the well during the primary term and complete it thereafter with due diligence.

30. 202 F.2d 442 (10th Cir. 1953).

> as a commercial producer; and that when the well was completed as a dry hole Skelly's rights under the lease wholly terminated.
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> That gives effect to what we think was the manifest intent of the parties to the lease. To hold otherwise would give to a simple conditional well completion clause the meaning and effect of a continuous drilling or development clause sometimes employed in oil and gas leases in Oklahoma.[31]

The court in *Skelly* placed great emphasis on the fact that Skelly Oil Company attempted to complete a second well at a location different from the first, which had resulted in a dry hole, rather than merely redrilling or reworking the first well. Would an attempt by Crude Oil Company to rework or redrill Well Number One come within the prohibition set forth in *Skelly*? Crude Oil Company has not drilled a dry hole, nor does it propose a second drilling operation at a completely different site. Crude Oil Company merely seeks to reestablish the status of its original well as an operable well. The confusion surrounding the well completion clause should be resolved in favor of the operator who in good faith attempts to produce oil and gas.

In light of the widespread use of the well completion clause, the Oklahoma courts should allow the completion of drilling operations based upon literal interpretation of the clause itself, and upon the Oklahoma courts' precedent of giving weight to the intent of the parties to the oil and gas lease: that intent which leads to the financial benefit of all parties through the production of oil and gas. The following arguments should be persuasive in adopting a standard application of the well completion clause.

Definition of a Completed Well for Purposes of the Well Completion Clause

To ascertain the rights of Crude Oil Company to operate past the primary term of its lease, the meaning of a well completion clause must be defined to determine that point at which a well is considered "completed." Although the Oklahoma courts have not specifically addressed this problem, the Oklahoma Supreme Court adopted the Michigan definition of a completed well as set forth in *Howard v. Hughes*.[32] In *Edwards v. Hardwick*,[33] pursuant to a contention that an oil well was not a "completed well," the Oklahoma Supreme Court held that, in relation to drilling clauses or contracts, a reference to a completed well means a well drilled to a specified sand or depth and prepared for the various methods of treatment to obtain production of oil and gas.[34] The court stated further that if the term is used to determine the

31. *Id.* at 446.

32. 294 Mich. 533, 293 N.W. 740 (1940).

33. 350 P.2d 495 (Okla. 1960). The supreme court also found that where a well has been drilled and tested according to the directions of its owners (lessees), and necessary equipment and machinery are installed to maintain continuous production of oil or gas, the installation of such equipment and machinery is referred to as "completing the well," expenses so incurred are called "completion costs," and a well so equipped is a "completed well." *Id.* at 500.

34. An early Texas case, Chapman v. Ellis, 254 S.W. 615 (Tex. Civ. App. 1923), held that

commencement of a period of time in which an act is to be performed or a right is to be exercised, the word "completion" means a well drilled to the specified sand or depth, and for which such means known to the industry have been employed to produce oil or gas "to the extent that a reasonably experienced driller would use" to make a producing well of a nonproducer.

The lack of cases citing *Edwards* makes it difficult to determine the extent to which the Oklahoma courts will follow the Michigan doctrine. However, in *JRHOP, Inc. v. Burchardt*,[35] a persuasive but unpublished Oklahoma Court of Appeals decision, the lessors appealed the decision of the trial court denying the cancellation of certain oil and gas leases. Lessee JRHOP acquired the leases, which contained a six-month primary term, with the stipulation that a second well be commenced within six months after completion of the first well. The lessee completed actual drilling of the first well in February 1979, but experienced numerous problems and was not able to achieve continuous production until July 1979. Late in December 1979, the lessee began the second drilling operation. Lessors contended that the well was "completed" in February 1979, and therefore the second well was commenced past the six-month primary term of the lease. The basis of the lessor's suit centered around the definition of a completed well as adopted by the Oklahoma Corporation Commission:

> Oil well: Date of completion of an oil well shall mean the date that the well first produces oil into a leased tank, through permanent wellhead connections.
>
> Gas well: Date of completion of a gas well shall mean the date that gas is capable of being delivered to a pipeline purchaser.[36]

The Oklahoma Court of Appeals found little merit in the lessor's contention that these definitions should control. It held that these definitions of completed wells are binding only for the purpose of interpreting the rules and regulations of the Oklahoma Corporation Commission and do not have the effect of controlling contractual rights of parties, nor are they superior to legislative or judicial pronouncements. Rather, the court, citing *Edwards v. Hardwick*,[37] found that the actions of the lessee were diligent and continuous from the time the borehole was drilled in February 1979, until July 1979, when the well finally became a constant producer. The JRHOP well

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a well was completed when such a depth was reached at which oil was expected to be found and below which no oil had ever been discovered. Some of the ambiguity surrounding the "completion" of a well was noted in Barrett v. Ferrell, 550 S.W.2d 138 (Tex. Civ. App. 1977). There the lessor contended that payment need not be made to the driller of a well that was a dry hole. The Texas court found that an obligation to complete a well does not require that well to produce oil or gas, but rather, a driller will be held to have completed a well when he has drilled to a depth sufficient to produce oil or gas, regardless of whether actual production occurs.

35. No. 56,269 (Okla. Ct. App. Feb. 23, 1982) (unpublished).

36. 1982 Okla. Corporation Comm'n, General Rules of Practice § 1-100(13)(a) (oil well); (13)(b) (gas well).

37. 350 P.2d 495 (Okla. 1960).

was completed, therefore, upon being drilled to the specified formation or depth contemplated by the parties and when such means known to the oil industry were employed to produce oil or gas to the extent that a reasonably experienced driller would use to make a producing well.

Applying the Oklahoma definition of a completed well to the situation faced by Crude Oil Company, operations would be deemed completed, as in *Edwards* and *JRHOP*, when the drillers reached a contemplated depth and proceeded to prepare the well for production of oil or gas. Here, however, Crude Oil Company faces the possibility of losing a drilling operation that has neither reached a depth sufficient to test for production nor has resulted in a dry hole. The status of this drilling activity is not only repugnant to the definition of a completed well but is also in opposition to the long-held idea that "in every grant there passes by implication the right to enjoy the thing granted."[38]

The Oklahoma courts should look to the intent of the parties in light of the *Edwards* decision. To disallow further drilling operations at this point, where the well is not close to total depth, would result in a situation not within the intent of the parties at the time of making the contract. When the lease was created, both parties realized there were certain risks associated with the venture. However, an operation that is neither completed as a producing well nor a dry hole is not an outcome anticipated when the lease was created. Rather, the courts should give effect to the content of the well completion clause, and in conjunction with the following equitable argument, find that the well will only be completed under the clause when total depth is reached and methods for the production of oil and gas are then employed.

Propensity of Oklahoma Courts To Promote Development

The Oklahoma courts have long held that, subject to the intent of the parties, oil and gas instruments should be construed in such a way as to promote the development of natural resources. For example, many jurisdictions strictly interpret the definition of production to include actual discovery and marketing.[39] However, in *McVicker v. Horn, Robinson & Nathan*,[40] the Oklahoma Supreme Court realized the practicalities of oil and gas exploration and held that the Oklahoma operator need only have discovered a well capable of production in paying quantities, rejecting the requirement of ac-

38. Simons v. McDaniel, 154 Okla. 168, 170, 7 P.2d 419, 420 (1932).

39. An operator in Texas does not have the advantage of the lenient attitude the Oklahoma courts have taken toward the term of the oil and gas lease. In Morgan v. Fox, 536 S.W.2d 644 (Tex. Civ. App. 1976), the lessor contended that the operator of the well did not comply with the production terms of the agreement, thus causing the lease to lapse. The Texas court stated that absent any other provisions in the lease that will keep the lease alive, there must be an available market at the time of production to perpetuate the lease.

40. 322 P.2d 410 (Okla. 1958). The decision of the court was based upon the fact that the lease was silent on the matter of marketing the discovery, finding that in the absence of an express provision to the contrary, the duty to market will be governed by the standards of reasonableness and diligence.

tual production and marketing. Similarly, in *Gard v. Kaiser*,[41] lessors brought an action against lessees to cancel oil and gas leases for failure of the lessees to pay shut-in royalty payments after the expiration of the primary terms of the leases. There the court held, citing Professor Kuntz,[42] that the shut-in gas royalty clause is not required as an additional special limitation to extend the term of the lease. The lease is extended without the shut-in gas royalty clause, subject to forfeiture for failure to comply with the implied obligation to market the product.[43]

It is evident that the Oklahoma courts have adopted a policy favoring the production of oil and gas where all parties act in good faith and would mutually benefit from such a result. By analogy, then, the Oklahoma courts should not punish a good faith operator who diligently attempts to complete a well, but is precluded from doing so by a mechanical failure that is outside the scope of prudent operations. If the courts look to the holdings in *McVicker* and *Gard* in conjunction with the implied right to complete a well rightfully commenced espoused in *Simons v. McDaniel*,[44] they should allow the intent of the parties, as evidenced by the oil and gas lease, to be fulfilled, that is, to begin and fully complete the contemplated drilling operation.

Conclusion

Crude Oil Company began drilling operations fully expecting to complete that venture, whether the outcome be a producing well or a dry hole. It procured oil and gas leases giving it the specific right to complete a well commenced in good faith during the primary term. Through no fault of its own, the well was lost because of a mechanical failure. At the time the casing collapsed, Crude Oil was operating in good faith utilizing prudent drilling techniques. If this question were to be litigated, the courts of Oklahoma should examine the intent of the parties at the time the lease was created, looking to see if all express provisions of the instrument in question have been fulfilled in a prudent and diligent manner. At that point, if the court is convinced that all obligations have been fulfilled, it should rule that the operator does have the right to complete a well properly commenced. That decision should be based upon a literal interpretation of the well completion clause, in view of the Oklahoma definition of a completed well. A completed well occurs when the total contemplated depth has been reached and when adequate procedures have been followed for the production of oil or gas. At that time,

41. 582 P.2d 1311 (Okla. 1978).

42. 4 KUNTZ, *supra* note 16, at § 46.3.

43. The courts will not liberally apply the holding in *Gard* unless the shut-in gas well has actually been tested at a specified formation. In Hoyt v. Continental Oil Co., 606 P.2d 560 (Okla. 1980), defendant lessee contended that the Cottage Grove formation was included within the shut-in gas well, thus preserving the lease. The court disallowed recovery because the Cottage Grove formation was never tested, holding that the ability to postpone actual marketing after discovery of a well capable of production in paying quantities is based on the assumption that the producing formation has been reduced to the lessee's dominion and control.

44. 154 Okla. 168, 7 P.2d 419 (1932).