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THE LAW OF OIL AND GAS*

CHAPTER II

THE OIL AND GAS LEASE

(1) *The Evolution of the Lease.*

The questions heretofore considered are general in their scope, and were treated for the purpose of providing a background for the more intensive study upon which we must now enter. While commentators refer to this branch of jurisprudence as the "Law of Oil and Gas," it is more exact to say that we are dealing with the law pertaining to oil and gas leases. This is true because the oil and gas lease characterizes and distinguishes the subject throughout. For reasons which inhere in the very nature of the business a lease yielding the lessor a royalty on the quantity of oil or gas produced creates the relation between the landowner and the operator which is best adapted to the practical aspects of the enterprise. Accordingly, it is the almost universal custom to develop lands for oil and gas under leases rather than through the ownership of the fee. It follows as a logical consequence that the subject-matter of nearly all of the oil and gas cases is the oil and gas lease. In these circumstances the problem of paramount importance to us is to determine the nature and legal effect of this instrument.

Before coming to close quarters with the specific questions which must be examined, there are certain practical aspects of the oil business which must be taken into account. Broadly speaking, the industry may be divided into two distinct periods of development, each characterized by methods, customs and usages essentially different from the other. Conditions prevailing in the earlier period demanded the prompt development of a lease, or, in lieu thereof, its forfeiture or abandonment. On the other hand, conditions of the later period necessitated the holding of a large portion of the prospective oil territory as a reserve for future development, the time and extent of development depending upon the success of like operations in the vicinity, the lessor being compensated for the delay by periodical money payments. This difference in the underlying methods and practices of the business is clearly reflected in

* This is the second instalment of a series of papers by Mr. Veasey. The first will be found *supra*, p. 445.

the decisions of the two periods. Therefore, to distinguish these cases accurately, and to confine each decision to its proper sphere, it is of the highest importance to consider those contrasts in conditions in detail.

For some years after the pursuit began in Pennsylvania operations were confined to a few counties in that state. Starting with the first discovery, development progressed from one tract of land to another with fairly uniform results. The general tendency then was to restrict exploration to localities which were proven relatively by neighboring production. Moreover, the wells were shallow and the cost of drilling comparatively small. In these circumstances the financial risk incident to a test well was unimportant in contrast with similar conditions today. Aside from this, the speculative spirit was rampant, and the operator of that day was more disposed to incur the hazard of development than is true of the more conservative and businesslike operator of the present. Then again, the leases of those times covered areas of very limited extent. A typical lease would cover an acre of land, or less, and it was seldom the case that a single holding exceeded five acres. Farms, instead of being leased in their entirety, were subdivided for the purpose of development. A lessee of the period ordinarily confined his operations to a single lease until a failure resulted or until it was fully developed, and it was only after this happening that he contemplated another experiment. It was not the practice to pay a bonus or initial cash consideration for a lease, and if paid, the amount was wholly insignificant. Moreover, it was not the custom then to provide for a rental payable to the lessor in default of development. The only consideration moving to the lessor was a royalty entirely dependent upon the success of the venture. The result of these conditions was inevitable. The industry was then stamped as one demanding the early development of all leases. This conclusion finds its absolute justification in the fact that in the period between 1860 and 1874 nearly every oil lease contained a provision for the immediate commencement of operations, "to be pursued until success or abandonment," and to this was added a clause providing for the forfeiture of the lease upon the cessation of operations. In this atmosphere, implying speedy development in whatever circumstances, or, in default thereof, the immediate forfeiture of the lease, the early oil cases were adjudicated. As expressive of the early viewpoint of the courts, the Supreme Court of Pennsylvania said:

> "The discovery of petroleum led to new forms of leasing land. Its fugitive and wandering existence within the limits of a particular tract was uncertain, and assumed certainty only by actual development founded upon experiment. The surface required was often small compared with the results, when attended with success; while these results led to great speculation, by means of leases covering the lands of a neighborhood like a flight of locusts. Hence it was found necessary to guard the rights of the landowner as well as public interest by numerous covenants, some of the most stringent kind, to prevent their lands from being burdened by unexecuted and profitless leases, incompatible with the right of alienation and the use of land. Without these guards, lands would be thatched over with oil-leases by subletting, and a farm riddled with holes and bristled with derricks, or operations would be delayed so long as the speculator would find it hopeful or convenient to himself alone. Hence covenants became necessary to regulate the boring of wells, their number and time of succession, the period of commencement and of completion, and many other matters requiring special regulation. Prominent among these was the clause of forfeiture to compel performance and put an end to the lease in case of injurious delay or a want of success. These leases were not valuable, except by means of development, unlike the ordinary terms for the cultivation of the soil, or for the removal of fixed minerals. A forfeiture for non-development or delay therefore cut off no valuable rights of property, while it was essential for the protection of private and public interest in relation to the use and alienation of property."[1]

Keeping in mind the fixed characteristics of the business in those days, the courts dealing with these questions announced three important legal principles applicable to oil and gas leases. First, by reason of the fugitive tendency of the subject-matter dealt with, great diligence in the development of an oil property was held to be indispensable, and where the lease was silent as to the time and extent of development, covenants or conditions to that effect were implied. Second, urged by the same reason, the settled doctrine that equity abhors a forfeiture gave way to the rule that where an oil lease contained an express forfeiture clause equity would enforce the forfeiture in a proper case. Third, in harmony with the two

[1] *Brown* v. *Vandergrift*, 80 Pa. St. 142 (1875).

principles just stated, the canon of construction that a grant should be construed against the grantor and in favor of the grantee fell before the judicial announcement that an oil and gas lease should be construed in favor of the lessor and against the lessee. While these principles were clearly applicable to the facts involved, much of the confusion of judicial thought upon this subject, which will be made plain as we proceed, is attributable to the utter failure on the part of the courts in the newer oil states to recognize the exact limitations of the earlier holdings. To establish the point of view from which the real or apparent conflict in the cases must be considered, we must place the conditions of the later period of oil development in strong contrast with the situation we have just described.

It is impossible to fix with certainty the advent of the new conditions which thereafter were to characterize the industry. By 1875, however, the oil business in America had attained such proportions that its future as an important industrial enterprise seemed secure. Men of broad vision, identified with the enterprise, began to realize its possibilities. Its rapid growth in the preceding decade had developed a group of operators of wide experience and large capital who were prepared to engage in the pursuit upon a far more extensive scale than formerly. They no longer viewed the venture as a purely speculative one, but regarded it as an established commercial enterprise, and set about to adapt it to such conservative methods as its peculiar nature would permit. The market for oil and oil products was an expanding one, and the serious problem was to provide and maintain a supply of oil fairly equivalent to the current demand. The situation thus presented necessitated prudent measures for the future. Accordingly, the custom of taking up large numbers of leases, not for immediate development but to hold against the necessities of the future, had its inception. Primarily, this plan contemplated the holding of lands under lease to be developed when operations in the vicinity reasonably justified the undertaking, or where the demand for oil warranted wild-catting, regardless of surrounding conditions. To meet the situation of the lessor, accustomed to prompt development, the medium of a rental clause was employed. By virtue of this provision the lessor, in lieu of development, received a money payment at stated intervals until operations were commenced. Usually the rental clause was coupled with a provision for forfeiture upon default in drilling or in the payment of the prescribed rental. Moreover, the fixed duration of the earlier leases, which usually ranged from twenty to ninety-nine years, gave way to a form of lease with a definite term, ordinarily reduced to five years, with a proviso thereto that should production be found within the fixed term the lease would continue in force as long as oil or gas was produced. About 1880 the typical lease of the period contained these important provisions in substance:

Habendum Clause

To have and to hold said lands for the purpose aforesaid for a period of five years from date and as long thereafter as oil or gas shall be produced in paying quantities.

"Drill or Pay" Clause

The lessee agrees to complete a well on said lands within one year from date hereof, or in lieu thereof pay the lessor the sum of One Hundred Dollars per annum until the completion of such well: Provided, should the lessee fail or neglect to drill such well or pay such rental as herein provided, the lessor shall have the right to declare this lease forfeited.

The obvious effect of these provisions, when considered together, was this: The lease terminated at the expiration of the fixed term unless, meanwhile, the lessee had developed the lands and was producing oil or gas therefrom. The lease therefore could not be held for an indefinite period without development. The "drill or pay" clause enabled the lessee to defer drilling operations throughout the fixed term by making the stipulated money payments, and a failure to drill or pay forfeited the lease. Occasionally, where surrounding development justified this course, a lease binding the lessee to immediate operations was entered into, but the vast majority of leases then taken vested the lessee with the alternative privilege of drilling or, instead, paying the prescribed rental. In commenting on this situation the Supreme Court of West Virginia said:

> "These leases are drawn for all sorts of territory, some known to be rich in minerals and others not known to contain any, and their terms are varied to allow for such difference. In territory remote from actual and profitable operation leases are often taken without a reasonable expectation of any immediate advantage to the lessor other than a rental in the form of delay money, and with the expectation of delay in drilling until neighboring lands are shown to contain the minerals, and the consequent establishment of probability of the existence thereof in the leased premises."[2]

[2] *South Penn Oil Co. v. Snodgrass*, 71 W. Va. 438, 76 S. E. 961 (1912).

In another case it is said:

> "For we know, and may lawfully know, as all men know, that vast areas are held by companies or organizations holding these leases for future use."[3]

As a result of the new method of leasing, which involved the payment of a rental, it was soon recognized that the operator could not afford to pay the stipulated rental in any event and after the land covered by the lease was condemned by development in the vicinity. It was necessary to provide the lessee with a means of escaping this obligation when the value of the leasehold no longer justified the payment of rentals. For a number of years after the introduction of the rental clause, coupled with a provision for forfeiture in the event of non-payment, both the lessors and lessees in Pennsylvania were under the impression that a failure to pay the prescribed rental by the lessee *ipso facto* terminated the lease without further obligation on the part of the lessee to pay the remaining rentals which would accrue during the fixed term. In other words, it was then understood that the "drill or pay" clause, supplemented by the forfeiture clause, already quoted here, enabled the lessee to escape further rental payments by defaulting in a single payment. In 1889, however, *Galey* v. *Kellerman*[4] was decided by the Supreme Court of Pennsylvania. It was there held that a provision for forfeiture in a "drill or pay" clause of the character already referred to was for the benefit of the lessor; that the lessor upon default of the lessee to pay could insist upon the forfeiture of the lease as stipulated therein, or waive the forfeiture and maintain assumpsit for all rental thereafter due within the fixed term of the lease. Otherwise stated, the lessee was liable for all rentals falling due within the fixed term of the lease at the option of the lessor. Numerous suits for the recovery of rentals under leases which had slumbered for years were then brought. The importance of the question to the operators of that period is clearly demonstrated when we note that this precise point was before the Supreme Court of Pennsylvania in eighteen different appeals before the question was finally set at rest.[5] The predicament of the operators of that day thus brought about necessitated a new invention to relieve them from the obligation to pay rentals when the value of

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[3] *Bettman* v. *Harness*, 42 W. Va. 433, 26 S. E. 271 (1896).

[4] *Galey* v. *Kellerman*, 123 Pa. 491, 16 Atl. 474 (1889).

[5] *Appeal of Wills*, 130 Pa. 222, 18 Atl. 721 (1889): *Westmoreland Gas Co.* v. *DeWitt*, 130 Penn. St. 235, 18 Atl. 724 (1889); *Ray* v. *Western Penna Gas Co.*, 138 Pa. 576, 20 Atl. 1065 (1891): *Agerter* v. *Vandergrift*, 138 Penn. St. 576, 21 Atl. 202 (1891): *Ogden* v. *Hatry*, 145 Penn. St. 640, 23 Atl. 334 (1892); *Jamestown Ry. Co.* v. *Egbert*,

the property involved no longer justified that action. While some of the leases of the earlier period contained a surrender clause, it now became the universal practice either to insert a clause of this description in the leases, or some equivalent provision. When the "drill or pay" clause was used it then became customary to follow this with a term vesting in the lessee the right to surrender the lease at will. Coincident with this happening, and prompted by the condition just described, the so-called "unless" clause in the oil and gas lease came into existence. Instead of using a "drill or pay" provision qualified by the right to surrender residing in the lessee, the following stipulation was employed:

> "Provided, however, that this lease shall become null and void and all rights hereunder shall cease and determine unless a well shall be completed on the premises within one year from the date hereof, or unless the lessee shall pay at the rate of $100 per year in advance for each additional year until such well shall be completed."[6]

Under this provision the lease terminates *ipso facto* upon the failure to drill or pay, without further liability on the part of the lessee for rentals thereafter accruing.[7] Finally, then, it is to be observed that two methods for the termination of a lease without further liability for rentals were the result of the condition just described. One was the employment of a surrender clause where the affirmative covenant to drill or pay was utilized; the other contemplated the employment of the so-called "unless" clause.

Another practice connected with the taking of oil and gas leases came into importance during this period—namely, the custom of paying the lessor a bonus or initial cash consideration for the execution of the lease. It is manifest that when it was usual to stipulate for early development the payment of bonus was a rare occur-

152 Pa. 53, 25 Atl. 151 (1892); *Letherman* v. *Oliver*, 151 Pa. 646, 25 Atl. 309 (1892); *Wilson* v. *Goldstein*, 152 Pa. 525, 25 Atl. 493 (1893); *Sanders* v. *Sharp*, 153 Pa. 555, 25 Atl. 524 (1893); *Gibson* v. *Oliver*, 158 Pa. 277, 27 Atl. 961 (1893); *Aderhold* v. *Oil Well Supply Co.*, 158 Pa. 401, 28 Atl. 22 (1893); *McMillan* v. *Philadelphia Co.*, 159 Pa. 142, 28 Atl. 220 (1893); *Cochran* v. *Pew*, 159 Pa. 184, 28 Atl. 219 (1893); *Heinouer* v. *Jones*, 159 Pa. 228, 28 Atl. 228 (1893); *Wolf* v. *Guffey*, 161 Pa. 276, 28 Atl. 1117 (1894); *Jackson* v. *O'Hara*, 183 Pa. 233, 38 Atl. 624 (1897).

[6] *Glasgow* v. *Chartiers Oil Co.*, 152 Pa. 48, 25 Atl. 232 (1892); *Snodgrass* v. *South Penn Oil Co.*, 47 W. Va. 509, 35 S. E. 820 (1900).

[7] *Glasgow* v. *Chartiers Gas Co.*, *supra*; *Snodgrass* v. *South Penn Oil Co.*, *supra*; *Butcher* v. *Green*, 50 Ind. App. Ct. Rep. 692, 98 N. E. 876 (1912); *VanEtten* v. *Kelly*, 64 N. E. (Ohio, 1902) 560; *Chapple* v. *Kansas Vitrified Brick Co.*, 70 Kan. 723, 79 Pac. 666 (1905); *Blodgett* v. *Lanyon Zinc Co.*, 120 Fed. 893 (1903); *Deming Investment Co.* v. *Lanham*, 36 Okla. 773, 130 Pac. 260 (1913); *Leonard* v. *Busch-Everett Co.*, 139 La. 1099, 72 So. 749 (1916).

rence. At that time the consideration moving to the lessor was the obligation binding the lessee to operate. When, however, the provision for prompt development was qualified by the rental clause a further inducement to the lessor was necessary. Naturally, this took the form of a money payment sufficient to bring about the execution of the lease, the amount depending upon the prospective value of the land for oil and gas purposes and the degree of competition between operators for leases in the particular vicinity. In the last fifteen years the custom of paying a bonus has been almost universal, and the practice is resorted to even where there is a positive obligation to drill within a stipulated time where the lands are in the immediate neighborhood of development. In wild-cat territory the bonus usually paid is small, while in a district proven or partially proven bonus payments frequently range from one hundred dollars an acre to five thousand dollars an acre, depending upon the possibility of the particular tract and the competition among operators therefor.

Having reviewed the more important considerations which underlie the business and which were incident to the acquiring and developing of oil and gas leases, we are brought to the present. While there are individuals and corporations now engaged in the oil business attracted by the opportunity for great and sudden wealth only, the permanence of the industry is entirely dependent upon that class of operators who make the pursuit their exclusive business. Their activities extend to every known oil field. They maintain highly trained organizations specially adapted to the prosecution of the enterprise under any and all conditions. They have a full appreciation of the utter uncertainty of the venture, and yet devote and will continue to devote their capital and energies thereto. Experience has convinced them that permanent success in the business is possible only when the undertaking is founded upon a lease which involves the following considerations: First, the payment of a cash bonus to the lessor at the time of the execution of the lease, the amount of this depending upon the prospective value of the land involved, determined by competition among lessees for leases in the particular locality. Second, the lease to provide for a royalty payable to the lessor in the event the property is drilled and success attends the operation. On oil the royalty is a share of the production; on gas it is usually a fixed sum for each well where the gas is utilized. Third, where geologic indications are especially favorable, or where the land is in the immediate vicinity of producing wells, the operator will sometimes bind himself to the positive obligation to drill a test well. Occasionally this obligation is supplemented by a stipulation for the drilling of additional wells if the test results in production. Fourth, this positive obligation to drill, however, is exceptional, the typical lease containing a provision for a fixed term of limited duration, the consequence being that unless production is found within that term the lease expires. Fifth, supplementing the provision for a fixed term is a clause by virtue whereof the lessee has the option either to drill a test well or, in lieu thereof, pay a periodical rental within the definite term. Thus, if the obligation to drill or pay rises to the dignity of an affirmative covenant to do one or the other, a surrender clause is annexed. If not, the "unless" clause is employed. In either event the lessee reserves the option to escape all obligation under the lease, whether to drill or to pay, when in his judgment the value of the property no longer justifies either of the alternative stipulations. Seventh, if the affirmative "drill or pay" clause is employed, a provision for forfeiture in favor of the lessor for breach of these conditions is usually added. If, on the other hand, the "unless" clause is utilized, the lease terminates *ipso facto* upon failure to drill or, in the alternative, to pay.

As a result of this situation, the relative rights and obligations of the lessor and the lessee are directly adapted to the peculiar conditions under which the industry must be conducted, if it is to be permanently prosecuted. By this method the lessee obtains the right to explore when explorations are justified, and the right to abandon the enterprise without further liability when prudence dictates that course. The lessor, on the other hand, obtains these advantages: A cash consideration for his lease equivalent to the prospective value of his lands for oil and gas purposes, although in fact they may possess no value whatever to the lessee. The lease terminates within a definite time unless production is realized. Moreover, he receives a periodical money payment for such portion of the fixed term of his lease as the instrument, at the option of the lessee, continues in force. These important considerations must be borne in mind persistently during our consideration of the cases.

(2) *Interpretation of the Lease.*

Nowhere in this inquiry is it more important to persist in the point of view that there is a marked contrast in purpose between the leases of the earlier and later periods just alluded to than when we are called upon to examine the peculiar rules of construction which are applied to oil and gas leases. On principle there is no persuasive reason which demands the interpretation of these grants in a manner essentially different from the interpretation of any other contract. The novel rule of construction which features these instruments is that they should be strictly construed against the lessee and in favor of the lessor. The rule so stated prevails universally.[8] It is sometimes stated thus:

> "Oil and gas leases are construed strongly against the lessee and in favor of the lessor. * * * Ordinarily, oil and gas leases are executed for the purpose of exploration and operation for oil and gas, and where its terms will permit it under the rules of law, such leases will be construed so as to promote development and prevent delay and unproductiveness."[9]

The general doctrine is so deeply imbedded in the authorities that the only course open to us is to ascertain its true limitations.

In a pioneer Pennsylvania case it is said:

> "Perhaps in no other business is prompt performance of contracts so essential to the rights of the parties or delay by one party likely to prove so injurious to the other."[10]

Most of the Pennsylvania decisions involve early leases, and the doctrine of *Munroe* v. *Armstrong* finds constant reiteration in that jurisdiction.[11] In an early Federal case originating in West Virginia it is again said:

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[8] *Kennedy* v. *Crawford*, 138 Pa. 561, 21 Atl. 19 (1891); *Western Penna. Gas Co.* v. *George*, 161 Pa. 47, 28 Atl. 1004 (1894); *Burgan* v. *South Penn Oil Co.*, 243 Pa. 128, 89 Atl. 823 (1914); *Bettman* v. *Harness*, 42 W. Va. 433, 26 S. E. 271 (1896); *Steelsmith* v. *Gartlan*, 45 W. Va. 27, 29 S. E. 978 (1898); *Eclipse Oil Co.* v. *South Penn Oil Co.*, 47 W. Va. 84, 34 S. E. 923 (1899); *Parish Fork Oil Co.* v. *Bridgewater Gas Co.*, 51 W. Va. 583, 42 S. E. 655 (1902); *Erie Crawford Co.* v. *Meeks*, 40 Ind. App. 156, 81 N. E. 518 (1907); *Dittman* v. *Keller*, 55 Ind. App. 448, 104 N. E. 40 (1914); *Ohio Oil Co.* v. *Burch*, 124 N. E. (Ind., 1919) 781; *Rives* v. *Gulf Refining Co.*, 133 La. 178, 62 So. 623 (1913); *Cooke* v. *Gulf Refining Co.*, 135 La. 609, 65 So. 758 (1914); *Rechard* v. *Cowley*, 80 So. (Ala., 1918) 419; *Armitage* v. *Mt. Sterling Oil & Gas Co.*, 25 Ken. L. Rep. 2262, 80 S. W. 177 (1904); *Aycock* v. *Reliance Oil Co.*, 210 S. W. (Tex., 1919) 848; *Superior Oil Co.* v. *Mehlin*, 25 Okla. 809, 108 Pac. 545 (1910); *Kolachny* v. *Galbreath*, 26 Okla. 772, 110 Pac. 902 (1910); *Frank Oil Co.* v. *Belleview Gas Co.*, 29 Okla. 719, 119 Pac. 260 (1911); *Bearman* v. *Dux Oil & Gas Co.*, 166 Pac. (Okla., 1917) 199; *Jameson* v. *Chanslor Oil Co.*, 176 Cal. 1, 167 Pac. 369 (1917).

[9] *Parish Fork Oil Co.* v. *Bridgewater Gas Co.*, 51 W. Va. 583, *supra; Paraffine Oil Co.* v. *Cruce*, 162 Pac. (Okla., 1916) 716; *New State Oil & Gas Co.* v. *Dunn*, 182 Pac. (Okla., 1919) 514; *Curtis* v. *Harris*, 184 Pac. (Okla., 1919) 574.

[10] *Munroe* v. *Armstrong*, 96 Pa. St. 307 (1880).

[11] *Allison's Appeal*, 77 Pa. St. 221 (1874); *Brown* v. *Vandergrift*, 80 Pa. St. 142 (1875); *Galey* v. *Kellerman*, 123 Pa. 491, 16 Atl. 474 (1889); *Brushwood Developing Co.* v. *Hickey*, 16 Atl. (Pa., 1888) 70; *Western Penna. Gas Co.* v. *George*, 161 Pa. 47, 28 Atl. 1004 (1894); *Kleppner* v. *Lemon*, 176 Pa. 502, 35 Atl. (1896) 109.

"There is perhaps no other business in which prompt performance is so essential to the rights of the parties or delay so likely to prove injurious—no other class of contracts in which time is so much of the essence. There is no other branch of mining where greater damage is done by delay. Coal and precious metals lie either in horizontal veins or in pockets. They remain where they are until removed. Oil and gas are the most uncertain, fluctuating, volatile and fugitive of all mining properties."[12]

The reason underlying the rule is thus stated:

"As oil is fugitive, and is not found in all lands, the compensation to the lessor is almost always a royalty. It follows that all of the covenants to be performed by the lessee which relate to the right to drill or explore for oil are construed most strictly in favor of the lessor. Again, the fact that the lessor usually gets nothing out of his lease except the royalty it yields after oil is discovered by the drill, the presumption always is that a lease is made for the purpose of immediate development, unless the contrary appears in the contract of the parties."[13]

The Supreme Court of West Virginia, in an early decision on this subject in that jurisdiction, holds that the controlling object of the lessor in executing an oil and gas lease is to realize production; that is, to obtain the benefit of the royalties which under the early leases was the sole consideration to the lessor.[14] Other expressions to the same effect are these:

"It has been held many times that development is the central purpose of the ordinary oil and gas lease, and that such instruments will be construed in the light of such purpose."[15]

"The real consideration and inducement moving the contracting parties to such contracts has been held to be, on the part of the landowner, prospective rents and royalties, and on the part of the gas company the right to exclude others from the premises and the anticipated profits in vending the products of the wells it should drill."[16]

The Supreme Court of Oklahoma in recent cases firmly adheres to this doctrine:

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[12] *Huggins* v. *Daley*, 99 Fed. 606 (1900).

[13] *Burgan* v. *South Penn Oil Co.*, 243 Pa. 128, 89 Atl. 823 (1914).

[14] *Bettman* v. *Harness*, 42 W. Va. 433, 26 S. E. 271 (1896).

[15] *Dittman* v. *Keller*, 55 Ind. App. 448, 104 N. E. 40 (1914).

[16] *Pittsburgh-Columbia Oil Co.* v. *Broyles*, 46 Ind. App. R. 3, 91 N. E. 754 (1910).

> "Ordinarily, oil and gas leases are executed for the purpose of exploring and operating for oil and gas, and where its terms will permit it, under the rules of law, such lease will be construed so as to promote development and prevent delay and unproductiveness."[17]

Without citing the many cases of similar import, it is plain that the rule is founded on two reasons: first, that because of the fugitive propensity of the subject-matter, prompt development is necessary to protect the lessor against drainage; second, that prompt development is essential in order to yield the lessor the sole or controlling consideration for the grant—namely, the royalties which are contingent on production.

Discussing the reasons which underlie the rule, we must now briefly refer to what was said when the fugacious character of oil and gas was under consideration. It was there pointed out that while oil and gas in their natural state do not migrate, the courts in all the early cases, and in many of the more recent decisions, proceed upon the assumption that oil and gas in a state of nature have the power of self-movement. The quotations from *Munroe* v. *Armstrong* and *Huggins* v. *Daley* are clearly predicated upon that belief. When, however, drainage is possible only when there are operations on adjacent lands, there is no occasion for the application of the rule upon this ground solely in the absence of a showing of drainage by neighboring wells. Even then the principle, as a mere rule of construction, is untenable, because there is a more important and definite principle to protect the lessor; that is, the reading of an implied covenant or condition into the lease, operative at all times and under all conditions, which binds the lessee to protect the land from drainage. Moreover, the application of the rule should be relaxed when it is invoked upon the second ground, that the lessor is entitled to prompt development in order that he may realize the sole or controlling consideration for the lease—namely, the royalties. We say this because, as the business is now conducted and as the leases are now written, no greater importance should be attached to the prospective royalties as the moving consideration for the lease than to the bonus, which represents the value of the leasehold at the time it was created, and which, supplemented by the stipulated rentals, was largely the inducement for its execution.

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[17] *New State Oil & Gas Co.* v. *Dunn*, 182 Pac. (Okla., 1919) 514; *Paraffine Oil Co.* v. *Cruce*, 162 Pac. (Okla., 1916) 716; *Curtis* v. *Harris*, 184 Pac. (Okla., 1919) 574.

In contrast with the early holdings, the courts in their recent decisions are clearly responding to the doctrine that where the parties to the lease in plain terms have fixed the measure of diligence to be exercised by the leasee in the development of the property the contract will be construed as other contracts are construed and in accordance with the plain intent of the parties. In a comparatively recent Kansas case it is said:

> "Courts have no right to declare that, whatever the parties may think, operations for sinking a well must begin at once under an oil and gas lease. If this court had done so prior to the time plaintiffs desired to contract they would have rebelled, without any doubt, with the utmost indignation, against the decision as an infringement of their liberty to contract with reference to their land and the minerals beneath its surface as they pleased. In so doing they would have been justified. If plaintiffs should desire to contract for immediate exploration they must have that right, and if they should desire to give an oil or gas company five years in which to sink a well upon a consideration satisfactory to themselves, and as the result of negotiations free from imposition of fraud, they must have that right; but having deliberately made a contract of the latter description, they have no right to call upon a court to declare that it is of the other kind merely because, generally, it might seem to be better for farmers not to encumber their lands with mineral leases giving a long time for exploration, or because, generally, such leases do contemplate that forfeiture shall follow a violation to explore at once."[18]

When a modern oil lease of the type already alluded to is under consideration this is now the consistent holding of the courts.[19] In a well-considered West Virginia case, where damages were sought

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[18] *Rose v. Lanyon Zinc Co.*, 68 Kans. 126, 74 Pac. 625 (1903).

[19] *Ringle v. Quigg*, 74 Kan. 581, 87 Pac. 724 (1906); *Collier v. Monger*, 75 Kans. 550, 89 Pac. 1011 (1907): *Brewster v. Lanyon Zinc Co.*, 140 Fed. 801 (1905): *Phillips v. Hamilton*, 17 Wyo. 41, 95 Pac. 846 (1908): *Cohn v. Clark*, 48 Okla. 500, 150 Pac. 467 (1915); *Brennan v. Hunter*, 172 Pac. (Okla., 1918) 49: *Northwestern Oil & Gas Co. v. Branine*, 175 Pac. (Okla., 1918) 533: *Rich v. Doneghey*, 177 Pac. (Okla., 1918) 87: *Beatty v. Eastern Oil Co.*, 177 Pac. (Okla., 1918) 104: *Jameson v. Chancellor Oil Co.*, 176 Cal. 1, 167 Pac. 369 (1917): *Stoddard v. Emery*, 128 Pa. 436, 18 Atl. 339 (1889); *McMillan v. Philadelphia Co.*, 159 Pa. 142, 28 Atl. 220 (1893): *Colgan v. Forest Oil Co.*, 194 Pa. 234, 45 Atl. 119 (1899): *Young v. Forest Oil Co.*, 194 Pa. 243, 45 Atl. 121 (1899); *Lowther Oil Co. v. Guffey*, 52 W. Va. 88, 43 S. E. 101 (1903); *South Penn Oil Co. v. Snodgrass*, 71 W. Va. 438, 76 S. E. 961 (1912): *Petty v. United Fuel Gas Co.*, 76 W. Va. 268, 85 S. E. 523 (1915): *Paxton v. Benedum-Trees Oil Co.*,

by a lessor for the alleged breach of a covenant to drill, regardless of the fact that the lease contained a rental clause for deferred drilling, the court said:

> "In so far as right of recovery is asserted in the declaration and evidence, on the ground of duty to drill, merely because the premises are shown to be gas-producing territory, the case is obviously bad. By their written lease, the plaintiffs expressly assented to delay in drilling, and agreed to accept in satisfaction thereof specified pecuniary compensation, which has been paid. In other words, they took a conditional covenant from the lessee to complete a well within a specified period, or pay periodically, in lieu thereof, stipulated sums of money, and provided a like option for the lessee as to subsequent successive periods of like length. The lessee having elected to pay the money instead of drilling, as it was expressly authorized to do, the lessees have accepted it. To permit them now to recover damages for an omission to which they have assented, and for which they have been compensated according to a standard or measure fixed by their own solemn contract, would violate a fundamental principle of the law of contracts. However obvious the adaptability of their land to successful mining operation and mineral production may have become by developments on neighboring lands, they have suffered no denial of right except delay to which they have assented. They still have their gas, and have been compensated for the delay."[20]

While it seems reasonably clear that it is now the settled rule that the measure of diligence to be exercised by an oil lessee should be determined from the express provisions of the lease alone, the latent influence of this earlier principle of construction still abides in some of the jurisdictions. This point may be illustrated by reciting the history of the question in Oklahoma. In one of the first cases decided by the Supreme Court of Oklahoma, after statehood, the rule is laid down that an oil lease should be strictly construed in favor of the lessor and against the lessee.[21] The rule was then

80 W. Va. 187, 94 S. E. 472 (1917); *Poe v. Ulrey*, 233 Ill. 56, 84 N. E. 46 (1908); *Stahl v. Illinois Oil Co.*, 45 Ind. App. 211, 90 N. E. 632 (1910); *Dittman v. Keller*, 55 Ind. App. 448, 104 N. E. 40 (1914); *Grubb v. McAfee*, 212 S. W. (Tex., 1919) 464; *Dunaway v. Galbraith*, 214 S. W. (Ark., 1919) 32; *Rechard v. Cowley*, 80 So. (Ala., 1918) 419.

[20] *Carper v. United Fuel Gas Co.*, 78 W. Va. 433, 89 S. E. 12 (1916).

[21] *Superior Oil Co. v. Mehlin*, 25 Okla. 809, 108 Pac. 545 (1909).

restated in two later cases.[22] In *Brown* v. *Wilson,* and largely under the authority of this principle, an oil and gas lease was canceled which under the overwhelming weight of authority elsewhere would have been upheld.[23] Then in *Bearman* v. *Dux Oil & Gas Company*[24] we find an extreme application of the rule. Here a lease was involved which did not require the payment of the stipulated yearly rental in advance. In such circumstances the overwhelming weight of authority supports the proposition that the rental might be paid at any time during the year. In this case, and by virtue of this far-reaching canon of construction alone, the court held that the rental was payable in advance, and the lease was canceled because the payment was not so made. A mere rule of construction was permitted to overturn the plain and unambiguous language of the contract. The doctrine of *Brown* v. *Wilson* was so vigorously assailed by the bar of the state and so unfounded in both principle and authority that the court in a series of well-reasoned cases overruled *Brown* v. *Wilson* and held in effect that the measure of diligence to be exercised by the lessee should be found in the terms of the lease.[25] Notwithstanding this posture of the cases, which seems to confine the rule to its proper limits, we then find that court in two later cases resurrecting the principle by this declaration:

> "Ordinarily, oil and gas leases are executed for the purpose of exploration and operation for oil and gas, and where its terms will permit it under the rules of law such lease will be construed so as to promote development and prevent delay and unproductiveness."[26]

We have already seen that the courts take judicial notice of the general conditions under which lands are leased for oil.[27] In Oklahoma, as elsewhere in the oil-producing states, oil is produced in comparatively few counties, although the state leads in oil production; but nearly every acre in the state has prospective value for oil purposes, and practically all of the lands of the state are covered by oil and gas leases. These leases are on the "drill or pay" form

[22] *Kolachney* v. *Galbreath,* 26 Okla. 772, 110 Pac. 902 (1910); *Frank Oil Co.* v. *Belleview Gas Co.,* 29 Okla. 719, 119 Pac. 260 (1911).

[23] *Brown* v. *Wilson,* 58 Okla. 392, 160 Pac. 94 (1916).

[24] *Bearman* v. *Dux Oil & Gas Co.,* 166 Pac. (Okla., 1917) 199.

[25] *Brennan* v. *Hunter,* 172 Pac. (Okla., 1918) 49; *Northwestern Oil & Gas Co.* v. *Branine,* 175 Pac. (Okla., 1918) 533; *Rich* v. *Doneghey,* 177 Pac. (Okla., 1918) 87; *Beatty* v. *Eastern Oil Co.,* 177 Pac. (Okla., 1918) 104.

[26] *New State Oil & Gas Co.* v. *Dunn,* 182 Pac. (Okla., 1919) 514; *Curtis* v. *Harris,* 184 Pac. (Okla., 1919) 574.

[27] *Bettman* v. *Harness,* 42 W. Va. 433, 26 S. E. 271 (1896).

and are held to abide neighboring developments in the future. This situation is as clearly understood by the lessors as it is by the lessees. The industry cannot contemplate the drilling of a substantial proportion of the leases taken, not to say every lease. Complete disaster would attend such a course. Not only was the Oklahoma court charged with judicial notice of this state of affairs, but the condition was of such notoriety that the court, in point of fact, was apprised of the situation. Notwithstanding the important practical bearing of the entire matter and the vast property interests involved, we again find these considerations falling before this ancient rule which, in modern oil and gas law, can have little, if any, application.

Finally, then, and although the exact attitude of the cases is somewhat obscured by the inconsistent utterances of the courts, this conclusion is justified: The rule that an oil and gas lease should be construed in favor of the lessor and against the lessee so as to promote development and prevent delay may apply in the early cases, where the courts entertained the notion that a lessor would lose a portion of his oil unless there was speedy development, even though there was no drainage by neighboring wells. Also for the reason that in those cases the only consideration moving to the lessor was a royalty which was not realized unless operations were conducted. Neither of these foundations for the rule obtain with respect to the modern oil lease. The royalty is no longer the sole or even controlling consideration for the lease. The question of impending drainage does not enter into the matter, because, in the absence of adjacent wells, there is no drainage, and when drainage occurs the lessor has his protection not by virtue of this principle of construction but under the implied covenant of the lease. Therefore, the oil lease of today, with respect to the degree of diligence to be exercised by the lessee, is to be interpreted according to the plain import of the terms of the lease which fix this obligation.

As an incident to the question, reference should be made to the rule that prevails in some of the jurisdictions, that where there is an ambiguity in a lease the principle of construction applicable to insurance policies should be applied, because the leases are prepared by lessees experienced in the business, while the lessors are not.[28] To emphasize the limitation on this rule, however, it is held in West Virginia that where the lessor instead of the lessee prepares

[28] *Bettman v. Harness*, 42 W. Va. 433, 26 S. E. 271 (1896); *Ohio Oil Co. v. Burch*, 124 N. E. (Ind., 1919) 781; *Letherman v. Oliver*, 151 Pa. 646, 25 Atl. 309 (1892); *Hopkins v. Zeigler*, 259 Fed. 43 (1919).

the lease the doctrine does not apply.[29] Owing to the fact that grants of this character are frequently ambiguous in their provisions, the familiar rule that the courts will adopt the construction placed upon the instrument by the parties is frequently applied.[30] Then, again, most of the leases taken are on printed forms, and in the negotiations between the parties the printed form is frequently modified or added to by written or typewritten provisions, and in this situation the courts ofttimes have been called upon to announce the rule that where there is a conflict between the written and the printed parts the former controls.[31]

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(To be continued)

[29] *Yoke* v. *Shaw*, 47 W. Va. 40, 34 S. E. 748 (1899).

[30] *Bartley* v. *Phillips*, 165 Pa. 325, 30 Atl. 842 (1895); *Balfour* v. *Russell*, 167 Pa. 287, 31 Atl. 570 (1895); *Gillespie* v. *Iseman*, 210 Pa. 2, 59 Atl. 266 (1904); *McMillan* v. *Titus*, 222 Pa. 500, 72 Atl. 240 (1909); *Collison* v. *Philadelphia Co.*, 233 Pa. 350, 82 Atl. 474 (1912); *Smith* v. *South Penn Oil Co.*, 59 W. Va. 204, 53 S. E. 152 (1906); *Eastern Oil Co.* v. *Coulehan*, 65 W. Va. 531, 64 S. E. 836 (1909); *Lovett* v. *West Virginia Gas Co.*, 73 W. Va. 40, 79 S. E. 1007 (1913); *Kelly* v. *Harris*, 162 Pac. (Okla., 1916) 219; *Jameson* v. *Chancellor Oil Co.*, 176 Cal. 1, 167 Pac. 369 (1917).

[31] *Duffield* v. *Hue*, 129 Pa. 94, 18 Atl. 566 (1889); *Gabbert* v. *William Seymour Edwards Oil Co.*, 76 W. Va. 718, 86 S. E. 671 (1915); *Ft. Orange Oil Co.* v. *Wichman*, 17 Ohio Cir. Ct. Rep. 57 (1898); *Johnson* v. *Shaffer*, 176 Pac. (Okla., 1918) 901; *Producers Oil Co.* v. *Snyder*, 190 S. W. (Tex., 1916) 514; *Perry* v. *Acme Oil Co.*, 80 N. E. (Ind., 1907) 174.