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Relief from Express Drilling Obligations in an Uneconomic Market: The Federal Response and the Doctrines of Force Majeure, Impracticability, and the Prudent Operator

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RELIEF FROM EXPRESS DRILLING OBLIGATIONS IN AN UNECONOMIC MARKET: THE FEDERAL RESPONSE AND THE DOCTRINES OF FORCE MAJEURE, IMPRACTICABILITY, AND THE PRUDENT OPERATOR

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I. INTRODUCTION

Current price levels for both oil and gas have led some within the industry to view drilling proposals once thought to be attractive as now unwise to pursue. Therefore, oil and gas lessees might desire to seek relief from lease drilling obligations. Similarly, unit operators might desire to retain acreage within their units without complying with a duty to further develop or explore the committed acreage. The federal government, as a lessor of oil and gas acreage, has been forced to respond to these pressures from its lessees and operators of units containing federal leases.

The Bureau of Land Management (BLM), the agency charged with the administration of federal oil and gas leases, has promulgated an agency-wide policy in response to operators seeking relief from the drilling obligations imposed by unit agreements for unproven fields to which federal oil and gas leases have been committed. On July 9, 1985, the Director of the BLM issued an Instruction Memorandum referred to as I.M. No. 85-537. In this Memorandum, the Director concluded that the total lack of a market outlet could be deemed an occurrence that would discharge drilling obligations pursuant to the unit's force majeure clause. This would toll the operator's duty to continue drilling in order to avoid "automatic elimination" of unexplored acreage from the unit. Moreover,

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if a sufficient number of working interest holders and nonfederal royalty owners concur, the term of the unit could be extended. However, the Director concluded that the mere economic nonfeasibility of drilling could not have such an effect unless an unreasonably low return to the government in royalties *vis-a-vis* sales from comparable leases would result. Hence, a distinction was drawn between a total lack of a market and the presence of a market that would be uneconomical to pursue from the operator's perspective.

The oil and gas operators, not surprisingly, maintain that this distinction is "illusory" arguing that a market price that will not return a profit to the lessee should be deemed to have the same excusing effect as a total absence of a market.[1] However, the distinction is valid. Assuming, for the sake of argument, that the BLM appropriately found that a total lack of market could excuse the operator from fulfilling its express drilling obligations, the mere unprofitability of drilling should not mandate the same result.[2] It would be inappropriate to force the BLM to forego the benefits of its contract under a force majeure clause in this manner.

The first step in appreciating why it would be erroneous to discharge the operators' drilling obligations is to recognize the nature of the performance they seek to avoid. The unit agreement states that lands shall be automatically removed from the unit *unless* diligent drilling operations are in progress. The obligation to drill, therefore, is a special limitation on the ability to retain acreage in the unit. In other words, drilling is a material condition precedent to the unit agreement's continued viability.

The BLM was correct in concluding that the operators should not be relieved of their obligations because of the market downturn. This conclusion is based on an analysis of the problem from the following three perspectives:

1. whether or not prior interpretations of force majeure clauses by

1. Arguments of the operators are derived from briefs filed by Koch Exploration Company. Koch Exploration Co., 86-367 (appeal filed Feb. 11, 1986); Sierra Club, No. 86-151 (appeal filed Oct. 31, 1985); Koch Exploration Co., No. 86-13 (appeal filed Sept. 21, 1986). The Interior Board of Land Appeals (IBLA) has been delegated the authority of the Secretary of Interior to review decisions of subordinate officials that concern, among other areas, mineral leasing. *See* 43 C.F.R. § 4.1 (1986).

2. If no market exists, presumably no pipelines or collection facilities would exist. These factors are traditionally included as elements that could excuse delay. The factors are similar to "uncontrollable delays in transportation," an enumerated factor in § 25 of the Model Unit Agreement. 43 C.F.R. § 3186.1 (1986). Additionally, if absolutely no market exists, the lessor is not foregoing any royalties by consenting to a delay in drilling. Even if a well would be drilled, it could only be shut-in.

courts indicate that difficulties arising from foreseeable price fluctuations would be normally encompassed within similar relief provisions;

2. whether or not courts would be likely to discharge performance of a material condition on the basis of commercial impracticability, a doctrine of contractual law that is related to that of force majeure; and
3. whether or not courts would compel a lessee to drill an oil and gas well when it cannot be proven that the lessee would be likely to profit from such drilling activity based on private oil gas precedence, which reveal distinctions between exploratory and developmental duties and between express and implied obligations.

Before analyzing this case law, however, it is important to review the legal milieu of federal unit agreements and the factual background of three units to which the Instruction Memorandum has been applied. Additionally, whether relief for unit operators might be available under other authority reserved to the BLM and possible implications for private agreements must be examined.

II. THE LEGAL AND FACTUAL BACKGROUND OF THE CONTROVERSY

A. *The Nature of a Federal Oil and Gas Unit*

An oil and gas unit agreement has been defined as a "plan of development and operation for the recovery of oil and gas made subject thereto as a single consolidated unit without regard to separate ownerships and for the allocation of costs and benefits."[3] Although units may be formed to promote secondary or tertiary recovery of oil from a field, the focus of concern of this article is the exploratory unit.[4] The purpose of an exploratory unit is to provide for the orderly drilling and subsequent operation of an unproven area.[5] Authority for exploratory units embracing federally owned oil and gas resources is found in the Mineral Leasing Act of 1920, as amended.[6]

Federal statutes authorize the Secretary of Interior to approve unit

3. H. WILLIAMS & C. MEYERS, MANUAL OF OIL AND GAS TERMS 936 (6th ed. 1984).

4. For an informative treatment of problems that can arise in units designed for enhanced recovery, see Anderson, *Mutiny: The Revolt Against Unsuccessful Unit Operations*, 30 ROCKY MTN. MIN. L. INST. 13-1 (1984).

5. *See* 43 C.F.R. § 3186.1 (1986), §§ 9 & 10 of the Model Onshore Unit Agreement for Unproven Areas.

6. 30 U.S.C. §§ 181-287 (1982 & Supp. III 1985). For the particular granting of authority, see *id.* § 226.

plans of development if the plans are "in the public interest."[7] Discretion as to the terms of these plans resides with the Secretary of Interior. The statutes only mandate a limited number of provisions. These provisions prescribe the effect unitization will have on the underlying leases committed to the unit. Of primary interest, the Mineral Leasing Act provides that leases shall be extended for two years if diligent drilling operations are begun anywhere upon the unit and will be extended for so long as production, either actual or constructive, is maintained anywhere within the unit.[8] At the termination of a unit agreement, or in the event a lease is eliminated from an ongoing unit, the Mineral Leasing Act further provides that all leases so released from a unit be extended (if the primary term has either run or has a shorter time to run) for two years and so long thereafter as oil and gas is produced therefrom.[9] As is to be suspected, regulations have been promulgated to supplement the bare framework of the statute.[10]

Surprisingly, however, although these regulations define certain of the terms normally contained in federal exploratory unit agreements,[11] they do not mandate what provisions must be included in a unit agreement. While the regulations contain a Model Unit Agreement, the authorized officer of the BLM is not forbidden from approving a unit agreement with different provisions or from approving modifications after an agreement is executed.[12] Therefore, except for various matters contained in the relevant statute and terms defined in the relevant regula-

7. *Id.* § 226(e), (j). This authority has been delegated to the Director of the Bureau of Land Management, who has further delegated the authority to the State Directors. Currently, each State Director has redelegated such authority to District Managers. The regulations refer to approval by the "authorized officer" as a catchall to provide for potential changes in delegated authority. 43 C.F.R. § 3000.0-5(e) (1986); *see also id.* pt. 3180 note. *See generally* Kutchins, *The Benefits and Risks of Federal Onshore Exploratory Units*, 29 ROCKY MTN. MIN. L. INST. 785 (1983).

8. 30 U.S.C. § 226(e) (1982); *see also* Burton/Hawks, Inc. v. United States, 553 F. Supp. 86 (D. Utah 1982). If a well is deemed capable of production in paying quantities, it is deemed "production" so as to extend leases committed to a unit. No two-year drilling extension is allowed for leases that have already been extended beyond their primary terms. Production must be achieved prior to the revised expiration date of such leases. 30 U.S.C. § 226(f) (1982).

9. 30 U.S.C. § 226(j) (1982). Additional provisions include: If a lease is partially committed to a unit, it will be segregated into two separate leases. The uncommitted portion is extended for two years if the primary term of the base lease would sooner expire. Importantly, if leases are committed to a unit, the acreage contained therein will not be chargeable against the acreage limitations of a lessee or operator. *Id.* For a generalized study of federal unitization and the history of the statutory framework, see Coffield, *Selected Problems with Federal Exploratory Units*, 31 ROCKY MTN. MIN. L. INST. 13-1 (1985).

10. 30 U.S.C. § 189 (1982) (authorizing the Secretary to promulgate regulations).

11. 43 C.F.R. § 3180 (1986).

12. *Id.* §§ 3181.1, 3183.3-1. The Model Onshore Unit Agreement for Unproven Areas is found at *id.* § 3186.1 [hereinafter the Model Unit Agreement].

tions, unitization involving federal oil and gas leases is actually a consensual agreement among various private parties which the Secretary of Interior must approve.[13]

In addition to the government, the parties that must consent to the unit agreement include a sufficient number of owners of interests in the oil or gas deposits so as "to provide reasonably effective control of operations."[14] Despite the nonbinding nature of the Model Unit Agreement, most unit agreements do follow its provisions.[15] The terms relevant to the issue at hand, which are contained in the agreements governing the three situations examined in this article, are summarized below with references to the section numbers of the Model Unit Agreement as published in the Code of Federal Regulations.[16]

The first important area to examine is the agreement's temporal framework. A unit agreement's effective date is the date it is approved by the BLM. The term of each unit is five years, unless a valuable discovery of unitized substances is made. Pursuant to section 20, the unit agreement will continue if a valuable discovery is made as long as unitized substances can be produced in quantities sufficient to pay the cost of production.[17] However, the Model Unit Agreement provides for the automatic elimination of certain acreage from the unit. Acreage that has not been placed within a "participating area" by a certain date, namely on or before the fifth anniversary date of when the first participating area for the unit was established, cannot remain in the unit according to section 2(e). A "participating area" is acreage that has been deemed "reasonably proven to be productive in paying quantities" by exploratory drilling and shares in royalty distribution.[18] Therefore, a unit operator has five years after its first successful well to *explore* the remaining acreage before control may be lost.[19]

13. California Co. v. Udall, 296 F.2d 384 (D.C. Cir. 1961), *aff'g* California Co. v. Seaton, 187 F. Supp. 445 (D.C. Cir. 1960); Marathon Oil Co. v. Kleppe, 407 F. Supp. 1301 (D. Wyo. 1975), *aff'd*, 556 F.2d 982 (10th Cir. 1977).

14. 43 C.F.R. § 3183.3-1 (1986).

15. Kutchins, *supra* note 7, at 785.

16. 43 C.F.R. § 3186.1 (1986).

17. If a well is capable of production in paying quantities but shut-in, the unit agreement will also continue. The Mineral Leasing Act provides that no lease will expire if a well capable of production is on or within a unit to which the lease has been committed, unless the operator fails to produce from the well after receipt of a request to produce. 30 U.S.C. § 226(e) (1982).

18. 43 C.F.R. § 3180.0-5 (1986). Lands necessary for unit operations may also be placed in a participating area.

19. Because the unit is exploratory in nature and lands outside the participating area have not been proven capable of production, the operator's relevant duty is exploration, not development. *See infra* notes 116-58 and accompanying text.

However, the unit operator may retain control over all of the committed acreage in certain circumstances. If the operator is engaged in diligent drilling operations on the relevant fifth anniversary date, no contraction will occur. Instead, all acreage will remain committed to the unit and be held by unit production. So long as the operator continues diligent drilling operation without a lapse of more than ninety days before completion of one well and the commencement of another, the unit will remain intact for an additional five years pursuant to section 2(e). At the end of this five-year period, provided ninety percent of the working interest owners and sixty percent of nonfederal royalty interest owners of nonparticipating acreage agree, the unit operator can receive two more years for exploratory operations by continuing to diligently drill.

The agreement thus anticipates the following schedule:

1. Within five years of the effective date of the unit agreement, unitized substances must be discovered in paying quantities or the unit will terminate.
2. Five years after the date on which the first participating area is established, the unit will be fully explored. Any acreage not so explored or, to use the regulatory term, not reasonably proven to be productive, shall be eliminated from the unit.
3. For the time period extending from the fifth anniversary date to the tenth anniversary date of the establishment of the first participating area, the operator may retain the unit boundaries and forestall acreage elimination by diligently drilling.
4. The unit operator can gain an eleventh and twelfth year for exploration only with the agreement of affected parties combined with diligent drilling.

At most, therefore, a unit operator can have seventeen years to fully explore the unit, assuming that no discovery of unitized substances in paying quantities is made until the fifth year of the unit's term,[20] and further assuming that the operator is diligently drilling for the last twelve of those seventeen years without a break of more than ninety days between well-drilling efforts. If diligent drilling operations cease during these years, acreage not proven to be productive is eliminated from the unit on the ninety-first day after the cessation. Each lease embracing nonparticipating acreage is returned to an individual development status with at least two years being granted for initial development.[21] In contrast, an

20. The unit agreement requires drilling to begin by the sixth month. 43 C.F.R. § 3186.1(9) (1986). Presumably, only dry holes or extreme drilling difficulties would lead to such a last minute discovery.

21. A lease eliminated from a unit that is beyond its primary term or that has less than two

individual lease has at most seven or twelve years to be brought into production, depending on whether the lease was issued competitively or noncompetitively.[22]

Clearly, drilling obligations pursuant to a federal exploratory unit are express requirements. The agreement does have one relief provision:

> 25. UNAVOIDABLE DELAY. All obligations under this agreement requiring the Unit Operator to commence or continue drilling, or to operate on, or produce unitized substances from any of the lands covered by this agreement, shall be suspended while the Unit Operator, despite the exercise of due care and diligence, is prevented from complying with such obligations, in whole or in part, by strikes, acts of God, Federal, State, or municipal law or agencies, unavoidable accidents, uncontrollable delays in transportation, inability to obtain necessary materials or equipment in the open market, or other matters beyond the reasonable control of the Unit Operator, whether similar to matters herein enumerated or not.[23]

This provision of the agreement tempers the express obligations of the unit operator.

The interpretation of this clause has created controversy because it provides that if an occurrence within its compass causes unavoidable delay for the operator, drilling obligations "shall be suspended." The effect of the provision is nondiscretionary, and the BLM must credit such time against unit operational requirements if the time is essential to unit survival.[24] As described above, the BLM interpreted a total lack of a market outlet to be an unavoidable delay situation, but stated that a market in which the operator does not foresee a pay-out would not be such a triggering factor.

This provision, as is generally the case with the terms of federal contractual agreements, is to be interpreted pursuant to normal contractual law,[25] with one caveat. If a statute exists, its provisions and policies may be considered in interpreting a federal contract.[26] In this regard, it

years to run on its primary term is extended for two years following its elimination. 30 U.S.C. § 226(j) (1982).

22. A competitive lease has a five-year term and a noncompetitive lease has a 10-year term with only a single two-year extension available for diligent drilling over the termination date. *Id.* § 226(e).

23. 43 C.F.R. § 3186.1(25) (1986).

24. *See, e.g.*, Exxon Co. U.S.A., 41 I.B.L.A. 118 (June 13, 1979).

25. *California Co.*, 296 F.2d at 387; *Marathon Oil*, 407 F. Supp. at 1306; *see generally* Pasley, *The Interpretation of Government Contracts: A Plea for Better Understanding*, 25 FORDHAM L. REV. 211 (1956).

26. *See supra* note 25; *see also* Vass, *A Comparison of American and British Offshore Oil Development During the Reagan and Thatcher Administrations Part I*, 21 TULSA L.J. 23, 26-33 (1985).

should be noted that the BLM, pursuant to section 21 of the Model Unit Agreement, retained the following authority:

> to alter or modify from time to time, in his discretion, the rate of prospecting and development and the quantity and rate of production . . . when such alteration or modification is in the interest of attaining the conservation objectives stated in this agreement and is not in violation of any applicable Federal or state law.[27]

This provision was anticipated by Congress; the Mineral Leasing Act states that the Secretary of Interior *may* include such a provision in any unit agreement encompassing federal lands.[28]

B. *Factual Background of Three Exploratory Units*

Three units, all operated by the Koch Exploration Company, have been examined by the BLM in response to the operators' requests for relief from drilling requirements.[29] In two of the three situations, no unavoidable delay was found. In the third situation, relief was granted and the Sierra Club has appealed the decision to the Interior Board of Land Appeals (IBLA).[30] The three units are named the Monument Valley Unit, the Adobe Town Unit, and the Winter Flats Unit.

The Monument Valley Unit is in Wyoming and encompasses 24,965.95 committed acres.[31] It was effective August 28, 1979. Over ninety-two percent of the unit area is subject to federal leases. Because a unitized substance has been discovered, the unit agreement's term will continue, and all leases committed to the unit will be held by production in the event their primary terms have run. The first participating area for the Monument Valley Unit was established on February 28, 1980. Hence, automatic contraction should have occurred February 28, 1985. This would have eliminated approximately 24,000 acres. Only one factor could prevent this contraction: the operator must have been conducting diligent drilling operations on the unit acreage on February 28, 1985, and

27. 43 C.F.R. § 3186.1(21) (1986).

28. 30 U.S.C. § 226(j) (1982).

29. A fourth unit, the Hancock Gulch Unit, was considered by the Director in I.M. No. 85-537 and was deemed suitable for relief. No appeal of the determination is pending.

30. According to Departmental regulations, any person may "protest" any decision the BLM intends to make. 43 C.F.R. § 4.450-1 (1986). The Sierra Club and Colorado Open Space Council made a timely protest to the BLM. They asked that the BLM deny Koch's application to suspend drilling requirements for the Winter Flats Unit. When the BLM dismissed their protest and decided to recognize the suspension, the Sierra Club Legal Defense Fund appealed on its behalf and on behalf of the Colorado Open Space Council. *Id.* § 4.410. The Sierra Club, however, might have no standing to appeal. *See infra* note 40.

31. All facts are derived from the briefs and administrative record submitted to the IBLA in Koch Exploration Co., No. 86-13.

thereafter for five more years.[32]

However, there was no drilling activity whatsoever on the unit on February 28, 1985. No drilling whatsoever had occurred since early 1981.[33] In fact, only two wells have been drilled at all. The Twin Forks Number 1 well was drilled prior to February 28, 1980. Other than this well, the Monument Valley Number 1 well was spudded on February 14, 1980, and completed on March 25, 1981. Both of these wells are producing gas wells, connected to pipelines, and gas is being sold. Clearly, two wells are insufficient to test the 24,965.95 acres that are committed to the unit. Only approximately four percent of the unit is deemed to have been proven reasonably capable of production.

In its request for relief, the operator provided evidence that the gas purchaser for the production, pursuant to "economic out" provisions in the sales contracts, reduced the purchase price for gas in August of 1985.[34] Based on the current price and costs to drill another deep well to potentially productive zones, the operator maintained that a well would not "pay-out." The operator further maintained that to drill and then shut-in such a well would be damaging to the formation.

The operator presented similar evidence as to the practicality of drilling on the Adobe Town Unit, a second unit in Wyoming considered by the BLM.[35] This unit was effective June 23, 1978. It encompasses 39,602.66 acres, of which 37,729.47 acres are subject to federal oil and

32. 43 C.F.R. § 3186.1(2)(e) (1986).

33. The BLM granted a suspension of the drilling requirement in order to consider the application for unavoidable delay time credit. Nevertheless, this request was not made until Dec. 24, 1984, after three years and nine months without drilling.

34. The gas had been produced from two wells drilled to depths below 15,000 feet. Thus, the gas was deemed "high cost" gas and was allowed to receive an unregulated price even prior to Dec. 31, 1984. National Gas Policy Act of 1978 §§ 107, 121, 15 U.S.C. §§ 3317, 3331 (1982). During the period of tight regulation, the deregulated gas price tended to be higher than the regulated prices (reaching heights of $9 per million BTU). *See generally* Morgan & Patterson, *The Natural Gas Policy Act of 1978: Four Years of Practice and Two Years to Make Perfect*, 71 KY. L.J. 105 (1982-83); Pannill, *Reform of the Natural Gas Policy Act of 1978*, 17 TULSA L.J. 54 (1981); Pierce, *Producer Regulation under the Natural Gas Policy Act*, 31 INST. ON OIL & GAS L. & TAX'N 99 (1980). So long as "cheap" regulated gas was available, pipelines readily bought the expensive gas because they could "blend it" to reach a relatively reasonable price overall. Quite early, it was recognized that when most gas was to be deregulated, however, the pipelines would be less willing to purchase such high cost gas because of the inability to "blend." *See generally* AM. ENTER. INST. FOR PUBLIC POLICY RESEARCH, THE DEREGULATION OF NATURAL GAS 12-20, 62-69, 132-41 (E. Mitchell ed. 1983). Therefore, pipeline companies began to insert "economic out" or "market out" clauses in their gas purchase agreements. The typical clause enables the purchaser to offer a lower price for the contract price if the company is unable to market the gas because of its contract price. If the seller refuses to sell at that price, the purchaser could refuse to take the gas. T. JOHNSON, HANDBOOK ON GAS CONTRACTS 50-51, 99, 130-31 (1982); Morgan & Patterson, *supra* this note, at 147-50.

35. All facts are drawn from the briefs and administrative record submitted in Koch Exploration Co., No. 86-367.

gas leases. All but two of the federal leases are being held by unit production because their primary terms have ended. The first participating area for the unit was established on November 29, 1980. Hence, automatic elimination should have occurred November 29, 1985. This would have eliminated approximately 38,355 acres. Again, only diligent drilling operations could prevent this contraction.

However, there was no drilling activity whatsoever on the unit on November 29, 1985, nor is the operator drilling today.[36] Only two wells have been drilled. The Adobe Town Number 1 well was drilled by January 14, 1979, and completed for production on November 29, 1980. Other than this well, the Adobe Town Number 1-30 well was spudded on December 25, 1980. It was completed for abandonment on January 4, 1981. The Adobe Town Number 1 well, however, is a producing gas well. It is connected to a pipeline and gas is being sold, although the purchaser has reduced its prices.[37] The two wells drilled are geologically insufficient to test the 39,602.66 acres that are committed to the unit. Only approximately three percent of the unit is deemed to be reasonably capable of production.

The BLM did not concur that the situation justified suspending the drilling obligations for either the Adobe Town Unit or the Monument Valley Unit. By contrast, the BLM did conclude that "unavoidable delay" had prevented further exploration of the Winter Flats Unit, which is located in Colorado. Its history provides a definite contrast to that detailed above for the other two units.[38]

The Winter Flats Unit was approved effective October 25, 1978. It encompasses 31,177.64 acres with forty-four federal oil and gas leases committed to it. Development began promptly. Two wells were completed by May of 1979. The first participating area of 640 acres was

36. The BLM granted a suspension of the drilling requirement in order to consider the application for unavoidable delay time credit. Nevertheless, this request was not made until Dec. 20, 1985, after almost five years without drilling.

37. The Adobe Town No. 1 well was drilled to a depth of 18,000 feet, but production was obtained only from depths of 13,152 to 14,067 feet. Therefore, it did not qualify as high cost gas. It was marketed from Apr., 1981 until Dec. 31, 1984, as "Section 102 new gas." The price was set by the Natural Gas Policy Act of 1978 §§ 107, 121, 15 U.S.C. § 3313 (1982). Although this price was an intermediate price, higher than many regulated prices, it was neither the highest regulated price nor as high as the deregulated price achievable for § 107 gas. Deregulation occurred on Jan. 1, 1985. *Id.* On Aug. 23, 1985, the gas purchaser informed the operator that it would pay $2.50/MMBTU, rather than the price of $7.09/MMBTU, which would be the deregulated price pursuant to the terms of the 1981 contract. The purchaser acted pursuant to the "economic out" provisions contained in the original contract. *See supra* note 34 for an explanation of an "economic out" clause.

38. All facts are drawn from the briefs and administrative record submitted in Sierra Club, No. 86-151.

effective May 8, 1979, which marked the initial five-year development period.

By May 8, 1984, the fifth year, the participating acreage had been increased to 7,155.80 acres, or 22.95 percent of the unit. Another well was completed in June of 1985, increasing the participating areas to 7,715.80 acres, or 24.74 percent of the unit area. In order to avoid contraction of the unit, an additional well would have been due to be commenced on September 11, 1985.

However, Koch Exploration Company, as operator of the unit, noted that twelve wells were already drilled on the unit. The BLM concurred that each of these wells was capable of production in paying quantities. No production was occurring, however, because all wells were shut-in. Koch could find absolutely no market for the gas. The high carbon dioxide content of the gas was partially the cause, although the so-called "gas glut" could have influenced the situation. Therefore, it applied to the BLM for its concurrence that a matter beyond its control existed that was equivalent to unavoidable delay. The BLM agreed. Hence, drilling obligations were deemed suspended. Because the relevant numbers of signatories to the unit agreement assented, the second five-year exploratory period of the unit also was tolled. Therefore, when the unavoidable delay situation is remedied, the operator would have three years and eight months to further explore the unit by diligent drilling operations before contraction would be mandated.[39]

As was noted above, the Sierra Club and the Colorado Open Space Council appealed this decision. Thus, a test case exists as to whether or not the BLM was correct in granting any relief to operators.[40] These

39. The operator's first five-year period began on May 8, 1984, and had run for one year and four months to Sept. 11, 1985, when a suspension was granted.

40. The environmentalists may lack standing to pursue the appeal. The appellants allege that the BLM action affects their "rights to use these lands in their pristine state and to work for their designation as wilderness." Statement of Reasons at 3, Sierra Club, No. 86-151 (filed Dec. 12, 1985). However, the BLM's decision does not affect the manageability of these lands for wilderness. Most of the wilderness study area is covered by oil and gas leases which existed prior to the passage of the Federal Land Policy and Management Act of 1976, 43 U.S.C. § 1701 (1982) [hereinafter the FLPMA]. These valid existing rights enable the development of oil and gas even if the development might impair an area's suitability for inclusion in a wilderness area. *See* The Bureau of Land Management Wilderness Review & Valid Existing Rights, 88 I.D. 909 (1981). As was stated above, these rights would continue even if the BLM's decision was overturned because the leases would be extended for two years and so long thereafter as oil and gas was produced. *But see* Rocky Mountain Oil & Gas Ass'n v. Watt, 696 F.2d 734 (10th Cir. 1982) (nonimpairment of wilderness standard may be applied to control activity not actually occurring on Oct. 21, 1976; interpretation of § 603 of FLPMA's "grandfather" clause, not § 701, which was relied upon by the Interior Department in the cited opinion).

Therefore, it could be impossible for the appellants to show an injury arising out of the BLM's environmental groups have objected to the suspension because the Winter Flats Unit embraces lands contained in either the Little Bookcliffs Wild Horse Range or Little Bookcliffs Wilderness Study Area or both. Hence, the groups believe the decision ignores the special attributes of the area and could prolong the area's subjugation to oil and gas development.[41]

III. PRIOR INTERPRETATIONS OF FORCE MAJEURE CLAUSES WOULD NOT EXCUSE CONTRACTUAL OBLIGATIONS IF ONE PARTY FINDS IT UNPROFITABLE TO PERFORM

The clause at issue in the Model Unit Agreement provides that express obligations of the operator to commence or continue drilling or other operations upon the unit "shall be suspended" if the operator has been "unavoidably delayed" by certain enumerated happenings or other events beyond the operator's control despite the exercise of due diligence to avoid such delay. The provisions of section 25 of the Model Unit Agreement can best be described as contractual provisions that relieve the unit operator from its obligations if its duties are impossible to perform. Accurately or not, most lawyers will be comfortable and familiar with applying the label "force majeure" to these clauses.[42]

The concept of excusing contractual obligations based on impossibility of performance ran counter to the original position of common law

decision. Development of the area for oil and gas could occur regardless of the BLM's action in this case. Moreover, the presence of a unit enabled the BLM to more greatly regulate development than if none existed. Without a unit, more development might occur as each lease is developed independently. Although the Sierra Club might believe it unlikely that individual development will occur, speculation as to whether the lessees will exercise their rights may not rise to the status of an injury caused by the decision to toll automatic contraction of the unit. Speculative injury is not cognizable as injury. Smith, 85 I.B.L.A. 237 (1985); Lone Star Steel, 77 I.B.L.A. 96 (1983). Standing might not exist unless the appellant can show that it has an injury in fact that the Board could remedy by granting it the relief it desires. Geosearch v. Andrus, 508 F. Supp. 839, 845 (D. Wyo. 1981); Pullman v. Chorney, 509 F. Supp. 162, 166-67 (D. Colo. 1981), *aff'd*, 712 F.2d 447 (10th Cir. 1983). *But see* Duke Power Co. v. Carolina Envtl. Study Group, 438 U.S. 59, 75-78 (1978) (only a "substantial likelihood" that the relief requested will redress the injury is needed); Pacific Coast Molybdenum Co., 68 I.B.L.A. 325 (1982).

41. The Wild Horse Range was designated pursuant to the Wild Free-Roaming Horses and Burros Act, 16 U.S.C. § 1331 (1982). The Wilderness Study Area was designated pursuant to the Federal Land Policy and Management Act, 43 U.S.C. § 1782 (1982). For additional decisions involving oil and gas development in the same area, see Animal Protection Inst. of America, 79 I.B.L.A. 94 (1984); Colorado Open Space Council, 73 I.B.L.A. 226 (1983).

42. *See supra* text accompanying note 23 for the text of § 25 of the Model Unit Agreement. For a concise history of the origin of the concept of force majeure, see Squillante & Congalton, *Force Majeure*, 80 COM. L.J. 4 (1975); Trakman, *Winner Take Some: Loss Sharing and Commercial Impracticality*, 69 MINN. L. REV. 471 (1984); Kirkham, *Force Majeure—Does it Really Work*, 31 ROCKY MTN. MIN. L. INST. 6 (1984).

courts. The position is often summarized by the following quotation from a seventeenth-century case:

> When the law creates a duty or charge, and the party is disable to perform it without any default in him, and hath no remedy over, there the law will excuse him .... But when the party by his own contract creates a duty or charge upon himself, he is bound to make it good, if he may, not withstanding any accident by inevitable necessity. . . .[43]

Although this early denial of impossibility as a defense to an express promise has since been softened, a contractual provision excusing performance because of conditions arising subsequent to contract formation is in derogation of the common law.[44] Hence, courts have strictly construed such provisions.[45]

The unit operators seeking relief from their drilling obligations develop the following argument. First, the current price of gas obtainable from purchasers does not justify the expenditures of drilling. The low price is due to general market conditions, not a local vagary of the market. The market collapse, being beyond the control of the operator, has created an "unavoidable delay." Therefore, the operator should be excused from drilling until the market would enable him to profit from drilling.[46]

Fluctuations of the market, however, are generally not considered as within the excusing provisions of a force majeure clause in mineral leases. Often, the rejection is based on the general rule of contract construction known as ejusdem generis. The Latin phrase may be simply defined as "of the same kind, class, or nature."[47] As a rule of construction, ejusdem

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43. Paradine v. Jane, 82 Eng. Rep. 897 (K.B. 1647). This case is traditionally viewed as a contract case although it involved a lease. The result might have been colored by the concept that a lease is a conveyance of an interest in property. *See* Robertson, *Frustrated Leases: No to Never—But Rarely if Ever*, 60 CAN. B. REV. 619 (1982).

44. 6 CORBIN ON CONTRACTS §§ 1320-72 (2d ed. 1962); 18 WILLISTON ON CONTRACTS §§ 1931-79 (3d ed. 1978); Page, *The Development of the Doctrine of Impossibility*, 18 MICH. L. REV. 588 (1920); Annot., *Modern Status of the Rules Regarding Impossibility of Performance*, 84 A.L.R.2d 12 (1962).

45. Squillante & Congalton, *supra* note 42, at 6 nn.31-34; *see also* Trakman, *Nonperformance of Oil Contracts*, 29 OIL & GAS TAX Q. 716 (1981) (empirical study found common law trained lawyers less willing to accept contractual excuse provisions than lawyers trained in the civil law).

46. Additional arguments are noted in *infra* text accompanying notes 159-75. The operators at issue, however, did have problems that were not shared by *all* natural gas producers. The problems were, nevertheless, shared by producers of § 102 and § 107 gas and were definitely foreseeable. *See supra* notes 34 & 37; *infra* notes 93-103 and accompanying text. The operators also claim that the purchasers are unconscionably breaching contractual obligations. Because the "economic out clause" was included in the purchase agreement, however, one must question whether or not these actions, even if they could be deemed breaches, were foreseeable. *Cf.* American Exploration Co. v. Columbia Gas Transmission Co., 779 F.2d 310 (6th Cir. 1985).

47. BLACK'S LAW DICTIONARY 464 (5th ed. 1979); Williams, *Coping with Acts of God, Strikes,*

generis states that where general words follow an enumeration of specific items, the general words will not be construed to include everything within the broadest possible reach of their meaning, but will be limited to apply to only those things of the same general class or kind as was specifically listed.

Therefore, if a force majeure clause lists various excusing occurrences that do not include general economic hardships, this doctrine of construction could prevent poor market conditions from excusing performance. For example, in construing a clause excusing minimum royalty payments if the lessee was prevented from mining "by unforeseen faults in the strata, difficulties in the mines, strikes, scarcity in car supply, or other unavoidable causes," a Pennsylvania court found that an inability to market coal at a profit was not an "unavoidable cause."[48] Similarly, a Kentucky court found that bad market conditions would not relieve a lessee under a clause excusing performance on account of "car supply, strikes, or causes beyond control."[49] The court noted that the clause referred to delays in mining the coal and getting it to market, not to troubles encountered in selling it.

An examination of the clause in the present situation reveals that the enumerated factors, as in the cases discussed above, deal with restrictions on the physical ability to produce. Interferences due to labor, mechanical, and supply dislocations, as well as from natural forces and governmental actions, are noted. The clause does, however, attempt to eschew the concept of ejusdem generis by including as excuses "other matters beyond the reasonable control of the Unit Operator, whether similar to matters enumerated herein or not."[50] However, most courts interpreting similar clauses have refused to recognize that such a clause

and Other Delights: The Use of Force Majeure Provisions in Mining Contracts, 21 ROCKY MTN. MIN. L. INST. 433 (1976).

48. Troxell v. Beacon Coal Co., 50 Pa. D. & C. 128, 131 (1943). The court defined unavoidable as "not avoidable; incapable of being shunned or prevented; inevitable" and stated that a total inability to market coal in any manner, even at a loss, might relieve the lessee as an "unavoidable cause." *Id.* at 129. *See also* Corona Coal & Coke Co. v. Dickinson, 261 Pa. 589, 104 A. 741 (1918) (narrowly construing the phrase, "a general labor strike or other causes beyond the control of the lessee").

49. Elkhorn Star Coal Co. v. Hall, 222 Ky. 345, ___, 300 S.W. 864, 865 (1927); *see also* Wilson v. Big Joe Block Coal Co., 134 Iowa 594, 112 N.W. 89 (1907) (general market fluctuations were not to be taken into account as an excuse for performance, but the practical impossibility of operating the mine due to factors unknown at the time of leasing could be a matter that the lessee could not avoid); Giver's Ex'rs v. Providence Coal Co., 22 Ky. 1217, 60 S.W. 304 (1901) (considered a different construction of the lessee's duties when performing on a profitable property than when on a geologically difficult property pursuant to the parties' own practice).

50. 43 C.F.R. § 3186.1(25) (1986).

could be an "escape for bad economic projections."[51]

Nevertheless, even if the operators prevail on this argument, general market fluctuations do not meet the threshold criterion for being a force majeure event: they are not unforeseeable. The oil and gas industry, like many other mining activities, has long been characterized by boom and bust with each individual producer having little or no control over the market price. Generally, it is the lessee, not the lessor, of mineral property that takes the risk of the market in a mineral lease.[52] If market condition fluctuations are considered "foreseeable," they should not be considered as within the application of a force majeure provision.

The requirement that an event be an abnormal unforeseeable occurrence in order to negate a contractual obligation has long been incorporated into case law interpreting oil and gas leases.[53] Weather conditions create a vivid example. Heavy rains that were seasonal were not unexpected floods or acts of God within a force majeure clause employing such terms, although a downpour in the desert would be.[54] Courts have not directly considered whether a general market downturn should be viewed as unforeseeable within the context of an oil and gas lease's force majeure clause, but they have viewed fluctuations in commodity prices, including oil and gas, as foreseeable due to events such as the Arab oil embargo, war time constraints, and regulatory changes in other contexts.[55] Due to this precedent, discussed in detail below, it is unlikely that courts will be receptive to a claim of force majeure due to general market conditions. Moreover, the particular circumstances of an operator seeking relief from its drilling operations would have to be examined even if the general fall in market prices could be viewed as within section 25 of the Model Unit Agreement.

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51. Northern Ind. Pub. Serv. Co. v. Carbon County Coal Co., 799 F.2d 265, 275 (7th Cir. 1986); Monolith Portland Cement Co. v. Douglas Oil Co., 303 F.2d 176, 180 (9th Cir. 1982). *But see* Continental Oil Co. v. Crutcher, 434 F. Supp. 464 (E.D. La. 1977) (producer likely to succeed on merits to prove that 500% rise in natural gas prices in three years was within such a force majeure clause and would enable producer to renegotiate or cancel a sales contract), *withdrawn on other grounds*, 465 F. Supp. 118 (1979) (joint stipulation that no force majeure event occurred).

52. *Elkhorn*, 222 Ky. at __, 300 S.W. at 865; *see also* Vandalia Coal Co. v. Underwood, 55 Ind. App. 91, 101 N.E. 1047 (1913); *infra* text accompanying notes 116-38 for a discussion of the "prudent operator" rule, a modern refinement of risk allocation.

53. For the general requirement of unforeseeability for force majeure to be operative, see Kirkham, *supra* note 42; Young, *Construction and Enforcement of Long Term Coal Supply Agreements—Coping with Conditions Arising from Foreseeable and Unforeseeable Events*, 27 ROCKY MTN. MIN. L. INST. 127 (1982); Sheinberg, *The Force Majeure Clause: A Tool for Mitigating the Effect of the Determinable Fee Concept of the Modern Oil and Gas Lease*, 6 UCLA L. REV. 269 (1959).

54. *Compare* Logan v. Blaxton, 71 So. 2d 675 (La. App. 1954) *with* Dougherty v. California Pac. Util. Co., 546 P.2d 880 (Utah 1976).

55. *See infra* notes 89 & 91 and accompanying text.

An individual examination of circumstances is necessary because courts have strictly construed force majeure clauses to require that the claimed excusing condition be the sole proximate cause of the failure to perform. One element of this requirement is that the lessee must use any alternative means of performance available to counter the problem purportedly blocking performance, even if other modes of performance would increase costs.[56] Multiplying drilling partners through farm-outs and other methods could spread the risk of well-drilling and enable test wells to be drilled even in difficult times. An operator who did not pursue such avenues might not be in a position to claim that the low prevailing price of gas foreclosed any and all development. This element of the proximate cause rule has been incorporated into section 25 of the Model Unit Agreement; the operator can only have obligations suspended if the operator could not perform "despite the exercise of due diligence."

Moreover, even if the depressed market is considered an excusing occurrence "beyond the control" of the operator, the general market price drop must be the sole reason for the operator's inability to perform. Because drilling operations have not totally ceased in this country, the operator should have to show that its current inability to fund drilling was not caused by a lack of business acumen. Overextension, high leveraging, imprudent dispersals of income during boom times, or other elements of fiscal improvidence could have created or exacerbated the operator's plight.[57]

Although this requirement might seem unsympathetic to an industry undoubtedly buffeted by falling prices, precedent dealing with force majeure clauses apparently requires such proof. For example, a coal mining company was not able to avail itself of a force majeure clause

56. Wheeling Valley Coal Corp. v. Mead, 186 F.2d 219, 221 (4th Cir. 1950); Wilson v. Talbert, 259 Ark. 535, 535 S.W.2d 807 (1976) (even if force majeure triggered by equipment breakdown, lease will terminate if repairs not made in a reasonable time); Butler v. Nepple, 54 Cal. 2d 589, 354 P.2d 239, 6 Cal. Rptr. 767 (1960) (even with a force majeure clause, increased expense in operating through alternative means will not *generally* relieve performance unless the alternative requires "extreme and unreasonable difficulty, expense, injury, or loss"); Trinidad Petroleum Corp. v. Pioneer Natural Gas Co., 416 So. 2d 290 (La. App. 1981) (blowouts on three wells would not rescue lease where operations ceased based on force majeure because lessee could have drilled on other portions of the lease); Woods v. Ratcliff, 407 So. 2d 1375 (La. App. 1981) (lessee could have obtained temporary part while awaiting permanent part for pumping unit); *Logan*, 71 So. 2d at 677 (lessee could have improved roads or used smaller transport trucks).

57. Even if an occurrence is directly listed in a force majeure clause, it will not be deemed beyond the control of a party if it could have been avoided. In an extreme application of this doctrine, an oil company was not relieved of its contractual obligations due to an embargo by Libya because it could have avoided the embargo by paying $117 million. Nissho-Iwai Co. v. Occidental Crude Sales, 729 F.2d 1530 (5th Cir. 1984).

excusing performance for "acts of the government" or "other causes beyond the control of the lessee" despite actions that appeared to have been directly within the provision's purview. Although the United States government had seized its mine, ordered increased wages, and set a maximum price for coal, these actions were considered but "mere aggravating circumstances of a bad financial condition arising out of lack of sufficient operating capital and high operating costs, brought to a head by the lawsuit . . . [filed by one of its customers] and the loss of customers to whom the product of the mines were being sold."[58] However, it might be argued that section 25 attempts to avoid such result by stating that a suspension could occur if delay was caused "in whole or part" by an occurrence beyond the operator's control. Courts, however, have required the excusing condition to be the "sole cause" of nonperformance despite such language.[59]

This strict construction of force majeure clauses indicates that the BLM was correct in finding that an uneconomic market, one in which the operator cannot predict a profit, should not be viewed *carte blanche* as a factor excusing performance of express drilling requirements within the meaning of section 25 of the Model Unit Agreement. Additional support for this position can be found by examining case law dealing with situations when contractual obligations may be discharged due to "impossibility" of performance and situations when profitability to a lessee is deemed relevant to an oil and gas lessee's drilling obligations in private oil and gas leases and units. This case law provides the best available guidance in interpreting the phrase "other matters beyond the reasonable control of the operator."[60]

58. *Wheeling Valley*, 186 F.2d at 221; *see also* Hixon v. Parker, 228 Ark. 317, 307 S.W.2d 210 (1957) (lessee who had operated at a loss for several years and had unsuccessfully attempted to negotiate with employees to work on a "wages from receipts" basis was not prevented from performing by a strike or boycott).

59. International Minerals & Chemical Corp. v. Llanno, Inc., 770 F.2d 879, 885-87 (10th Cir. 1985) (an environmental protection agency's order to lower pollution would not relieve a party from fulfilling an obligation to "pay" under a "take or pay" contract despite a force majeure clause reading "in whole or part"); *Northern Ind.*, 799 F.2d at 274-76; *Butler*, 54 Cal. 2d at __, 354 P.2d at 244-45, 6 Cal. Rptr. at 772-73. The court in *Northern Ind.* noted that the party seeking relief had included the words "partly prevent" in its force majeure clause. The inclusion was an apparent attempt to broaden the clause's scope, which directly referred to actions by governmental agencies. Nevertheless, the court found that the orders of the Public Service Commission relied upon by the utility did not prevent it from purchasing coal at all. Instead, the orders only prevented the utility from passing through to its consumers the added costs of its coal purchases under the subject contract. In the situation at hand, one could similarly say that the probability of not recovering drilling costs in today's market does not "prevent" drilling, but, as in *Northern Ind.*, merely makes it unattractive.

60. As recognized by the courts, the defense of impracticability, as well as the related doctrine

IV. Doctrines of Impossibility of Performance or "Commercial Impracticabilty" do not Support Relief from Performing a Material Condition

The operators, by insisting that the uneconomic market was an occurrence beyond their control that should excuse performance of their drilling obligations, are in effect claiming that events external to their own corporate situations have rendered performance, if not actually impossible, "commercially impracticable." Common law courts and statutory revisionists have long struggled with the concept of when impossibility or extreme impracticability will enable a party to discharge or revise its contractual obligations.[61] Although it is beyond the scope of this article to exhaustively review this field of law, an attempt will be made to predict how a court would treat a generalized market downturn in oil and gas prices based on previous situations that have engendered either much case law or commentary, namely the increase in the market price of uranium and the fluctuations in the production costs and market price of coal.[62] These situations, as will be discussed below, involved allegations by the parties as to the effect changes in the price of oil would have on their performances. Before proceeding to these analyses, however, a brief account of the positions taken in the Restatement (Second)

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of frustration of purpose, are quite similar to force majeure. *Northern Ind.*, 799 F.2d at 278. For a concise delineation of these principles that developed to justify the nonperformance of contractual obligations, see Trakman, *supra* note 42, at 473-74 nn.7-9.

61. Good generalized studies of this topic are found in CORBIN ON CONTRACTS, *supra* note 44, at ch. 74-78; WILLISTON ON CONTRACTS, *supra* note 44, at ch. 58; Page, *supra* note 44; Sirianni, *The Developing Law of Contractual Impracticability and Impossibility: Part I*, 14 U.C.C. L.J. 30 (1981); Sirianni, *The Developing Law of Contractual Impracticability and Impossibility: Part II*, 14 U.C.C. L.J. 146 (1981); Schmitt & Wollschlager, *Section 2-615 "Commercial Impracticability": Making the Impractical Practicable*, 81 COM. L.J. 9 (1976).

62. For a discussion of "typical" classifications of cases in which the doctrines emerge, see Bruce, *An Economic Evaluation of the Impossibility Doctrine*, 11 J. LEGAL STUD. 310 (1982); Posner & Rosenfield, *Impossibility and Related Doctrines in Contract Law*, 6 J. LEGAL STUD. 83 (1977). For a treatment of the doctrine in government defense contracts, see Cuneo & Crowell, *Impossibility of Performance: Assumption of Risk or Act of Submission?*, 29 LAW & CONTEMP. PROBS. 531 (1964). For treatment of the doctrine in the milieu of federal timber contracts, see Comment, *Impracticability as Excuse from Performance on Contracts for the Sale of Forest Service Timber*, 20 WILLAMETTE L.J. 43 (1984), in which the author concludes that relief should be granted. Congress, however, provided relief and no court was called upon to rule. See also the cases and commentaries arising out of the increased shipping costs resulting from the closing of the Suez Canal, such as Transatlantic Fin. Corp. v. United States, 363 F.2d 312 (2d Cir. 1966); Berman, *Excuse for Nonperformance in the Light of Contract Practices in International Trade*, 63 COLUM. L. REV. 1413 (1963); Birmingham, *A Second Look at the Suez Canal Cases: Excuse for Nonperformance of Contractual Obligations in the Light of Economic Theory*, 20 HASTINGS L.J. 1393 (1969); Schlegel, *Of Nuts, and Ships, and Sealing Wax, Suez, and Frustrating Things—The Doctrine of Impossibility of Performance*, 23 RUTGERS L. REV. 419 (1969).

of Contracts (Restatement) and Uniform Commercial Code (UCC), together with a comment on the few cases directly dealing with oil and gas price fluctuations in leases is helpful.

A. *Positions of the UCC and Restatement*

The UCC, in examining what could excuse performance by a seller, provided an impetus to move away from strict requirements of impossibility of performance. Rather than refer to impossibility, it referred to "impracticability" as a trigger point:

> § **2-615. Excuse by Failure of Presupposed Conditions**
>
> Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:
>
> (a) Delay in delivery or non-delivery in whole or in part by a seller who complies with [certain requirements] is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid . . . .[63]

The section is limited to occurrences affecting a seller's performance, but its approach has been adopted more broadly.[64]

The official comments to the section make two important points. First, general market fluctuations normally should not be viewed as relieving a seller's obligations:

> Increased cost alone does not excuse performance unless the rise in cost is due to some *unforeseen contingency* which alters the essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover. But a *severe shortage* of raw materials or of supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance is within the contemplation of this section.[65]

63. U.C.C. § 2-615 (1972).

64. See discussion of the Restatement synthesis *infra* notes 68-75 and accompanying text; *see also* Nora Springs Coop. v. Brandau, 247 N.W.2d 744 (Iowa 1976) (extending coverage to buyers); Northern Ill. Gas Co. v. Energy Coop., 122 Ill. App. 3d 940, 461 N.E.2d 1049 (1984) (considered section but rejected relief for a purchaser of naptha for conversion to synthetic natural gas).

65. U.C.C. § 2-615 comment 4 (1972) (citations omitted) (emphasis added).

It is extreme fluctuations in price due to unforeseeable contingencies, not from foreseeable market vagaries, which come within the normal import of the section.

The second major point made by the comments is that a seller may by agreement be required to perform despite impracticability. Liability may be expressly assumed or be placed upon the obligor "as a matter of reasonable, commercial interpretation from the circumstances."[66] The peculiar nature of the relationship between an oil and gas lessee and lessor, which is examined in more detail below, could militate against excusing the operator from its drilling obligations. Trade usage may have allocated the risk of market downturns.

Article two of the UCC, however, is a specialized statute governing sales contracts. The Restatement is more generalized and deals with what it terms "impracticability of performance" in Chapter 11.[67] The introductory note to the chapter reveals the influence of the UCC on its formulation and suggests that "impracticability" is a more accurate label for circumstances that will excuse performance even in the absence of a contractual force majeure provision.

The approach of the Restatement synthesis is not that courts should imply a term in contracts to the effect that an extraordinary circumstance will not occur, but that the non-occurrence of the circumstance was a

66. *Id.* comment 8. The comment reads:

> The provisions of this section are made subject to assumption of greater liability by agreement and such agreement is to be found not only in the expressed terms of the contract but in the circumstances surrounding the contracting, in trade usage and the like. Thus the exemptions of this section do not apply when the contingency in question is sufficiently foreshadowed at the time of contracting to be included among the business risks which are fairly to be regarded as part of the dickered terms, either consciously or as a matter of reasonable, commercial interpretation from the circumstances.

Id. (citations omitted).

See Hawkland, *The Energy Crisis and Section 2-615 of the Uniform Commercial Code*, 79 COM. L.J. 75 (1974) for a discussion of the evolution of this comment.

67. Although this discussion will focus on the definition of "commercial impracticability," the chapter also includes the related concept of "frustration of purpose":

> 265. Discharge by Supervening Frustration. Where, after a contract is made, a party's principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his remaining duties to render performance are discharged, unless the language or the circumstances indicate the contrary.

RESTATEMENT (SECOND) OF CONTRACTS § 265 (1979).

The operators might prefer to argue that performance is excused because they now cannot envision a profit, their primary purpose in entering into the unit agreement. However, profits are rarely viewed to be a "primary purpose" that could be "frustrated." *See* cases cited *infra* note 109. Moreover, relief pursuant to this section is subject to the same limitations as applied to discharge by impracticability. RESTATEMENT (SECOND) OF CONTRACTS § 265 comment a (1979).

"basic assumption on which the contract was made."[68] Therefore, the contract should not be viewed as covering a situation that actually exists. The basic statement of the law parallels the UCC formulation.[69] Like the UCC, the Restatement recognizes that parties can provide for a non-release of obligations, even in the face of a theoretically excusing situation, by an express allocation of risk. Hence, failure to perform would be a breach of the contract regardless of the impracticability of performance.[70] An examination of which, if any, party to the contract assumed the risk of the occurrence of an event is crucial to determining whether or not the non-occurrence of an event was a basic assumption of the contract.

The Restatement's comments provide guidance in such an analysis. The first exposition of its approach is as follows:

> Determining whether the non-occurrence of a particular event was or was not a basic assumption involves a judgment as to which party assumed the risk of its occurrence. In contracting for the manufacture and delivery of goods at a price fixed in the contract, for example, the seller assumes the risk of increased costs within the normal range. If, however, a disaster results in an abrupt tenfold increase in cost to the seller, a court might determine that the seller did not assume this risk by concluding that the non-occurrence of the disaster was a 'basic assumption' on which the contract was made. In making such determinations, a court will look at all circumstances, including the terms of the contract. The fact that the event was unforeseeable is significant as suggesting that its non-occurrence was a basic assumption. However, the fact that it was foreseeable, or even foreseen, does not, of itself, argue for a contrary conclusion, since the parties may not have thought it sufficiently important a risk to have made it a subject of their bargaining. Another significant factor may be the relative bargaining positions of the parties and the relative ease with which either party could have included a clause. Another may be the effectiveness of the market in spreading such risks as, for example, where the obligor is a middleman who has an opportunity to adjust his prices to cover them.[71]

The hesitancy of the drafters to allow relief for foreseeable price fluctuations is bolstered by the more detailed examination of the phrase "basic

68. *Id.* introductory note on ch. 11.

69. 261. Discharge by Supervening Impracticability. Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.

Id. § 261.

70. *Id.* introductory note on ch. 11.

71. *Id.*

assumption" that they provided. They note that while the foreseeability of the occurrence might not be fatal to a claim for relief, "the continuation of existing market conditions is "ordinarily not such [a basic] asumption [of the parties]."[72]

Similarly, while refusing to exhaustively list events that might render performance impracticable, the commentators state that " 'impracticability' means more than 'impracticality.' "[73] The comments provide but slight hope that an operator could be relieved of express contractual obligations simply because of generalized market conditions, because price fluctuations are normally risks borne by the obligor. Only disastrous price changes could even begin to meet the criterion.[74]

Other points made in the above discussions could be seized upon by the operators. For instance, the introductory note states that the relative bargaining power of the parties and the obligor's resultant opportunity or lack of opportunity to define assumable risks might be relevant to an analysis of whether or not obligations should be discharged. The consideration is also raised by the language dealing with whether or not the parties had indicated an intention that the obligor perform regardless of

72. *Id.* § 261 comment b.

> Its application is simple enough in the cases of the death of a person or destruction of a specific thing necessary for performance. The continued existence of the person or thing (the non-occurrence of the death of (sic) destruction) is ordinarily a basic assumption on which the contract was made, so that death or destruction effects a discharge. Its application is also simple enough in the cases of market shifts or the financial inability of one of the parties. The continuation of existing market conditions and of the financial situation of the parties are ordinarily not such assumptions, so that mere market shifts or financial inability do not usually effect discharge under the rule stated in this Section. In borderline cases this criterion is sufficiently flexible to take account of factors that bear on a just allocation of risk. The fact that the event was foreseeable, or even foreseen, does not necessarily compel a conclusion that its non-occurrence was not a basic asumption.

Id.

73. *Id.* comment d.

> Performance may be impracticable because extreme and unreasonable difficulty, expense, injury, or loss to one of the parties will be involved. A severe shortage of raw materials or of supplies due to war, embargo, local crop failure, unforeseen shutdown of major sources of supply, or the like, which either causes a marked increase in cost or prevents performance altogether may bring the case within the rule stated in this Section.... However, "impracticability" means more than "impracticality." A mere change in the degree of difficulty or expense due to such causes as increased wages, prices of raw materials, or costs of construction, unless well beyond the normal range, does not amount to impracticability since it is this sort of risk that a fixed-price contract is intended to cover. Furthermore, a party is expected to use reasonable efforts to surmount obstacles to performance (see § 205), and a performance is impracticable only if it is so in spite of such efforts.

Id.

74. Examples of cost increases that have or have not met the criterion have been summarized by one commentator as "less than 100% increases, no, but 1000% increases yes; the middle ground is in flux and unpredictable." Note, *U.C.C. § 2-615: Defining Impracticability Due to Increased Expense*, 32 U. FLA. L. REV. 516, 535 (1980).

impracticability.[75] Although it is true that most federal exploratory unit agreements follow the Model Unit Agreement form provided in the Code of Federal Regulations, this fact is irrelevant in determining whether or not the unit operator had or had not assumed the risk of market price fluctuations.

In perhaps all oil and gas leases, whether involving public or private lands, it is the lessee, that is, the oil and gas developer, who assumes the risks inherent in development costs. This fact, which is explored more fully later in this article, counters any possible contention that the BLM "overreached" in failing to provide express relief to the operator from drilling requirements if the operator could not foresee a profit. Moreover, this customary assumption of risk counters any claim that increased costs or depressed prices should be viewed as a discharging event in light of the Restatement's proviso that no discharge may occur if the "circumstances indicate the contrary."[76] That is, the contract itself should negate the applicability of this particular impracticability defense.[77] Even if the operators could overcome this initial hurdle, the comments on market fluctuation also undercut their argument.

B. *Positions of the Courts and Commentators*

The preceding discussion examines the operators' claims based on a purely theoretical examination of the Restatement and UCC approach without the benefit of input by the courts. Courts have looked at the defense of commercial impracticability raised by oil and gas lessees in situations other than drilling obligations. Although the decisions did not discuss the approaches just examined, their reasoning is informative. In

75. RESTATEMENT (SECOND) OF CONTRACTS § 261 comment c.

76. *Id.*

77. *See, e.g.*, Gulf Oil Corp. v. FPC, 563 F.2d 588 (3d Cir. 1977) (warranty required delivery of gas regardless of reserve failure), *cert. denied*, 434 U.S. 1062 (1978); Sunflower Elec. Coop. v. Tomlinson Oil Co., 7 Kan. App. 2d 131, 638 P.2d 963 (1981) (gas producer held to a gas sales contract despite insufficient reserves, because lack of reserves was foreseeable and the oil or gas producer assumed that risk). *But see* Carr v. Whitebreast Fuel Co., 88 Iowa 136, __, 55 N.W. 205, 209-11 (1893) (defendant coal company was released from its obligation to pay royalties on the ground that the contract was based on a mutual mistake of fact); Fritzler v. Robinson, 70 Iowa 500, __, 31 N.W. 61, 63 (1886) (defendant coal company released on grounds that the absence of coal on the premises constituted a failure of the consideration "arising out of mutual mistake"); Virginia Iron, Coal & Coke Co. v. Graham, 124 Va. 692, 98 S.E. 659 (1918) (defendant iron company was released on the grounds of impossibility of performance because the subject matter of the contract had been destroyed when the iron ore ran out and on the alternate ground of mutual mistake of fact). These latter cases may be harmonized in that the mineral lessors were seeking minimum royalties when inadequate reserves existed. Therefore, they were seeking compensation for what they never had owned. In the former cases, the purchasers of gas were seeking to obtain a steady supply of natural gas from others.

one case, the oil and gas lessee had entered into a long-term gas sales agreement that, at the time of execution, appeared to give the lessee and lessor a better price and "take" provision than that prevailing in the market. Several years later, however, the prices received under the contract were less than the market price specified in the lease for purposes of computing the lessor's royalty. The court held that royalties must be computed on the basis of the higher price despite the fact that the lessee acted prudently when the contract was made, could not have drafted and included a sufficient escalation clause in its gas sales agreement, and would be financially burdened if forced to pay higher royalties. Because the lease obligations were clear and unambiguous, impossibility of performance was no excuse.[78] Cases dealing with whether or not lessors' royalties could be computed on hypothetical values of gas in excess of what is "possible" for the lessee to realize under federal rate-setting rules could raise similar claims.[79]

Although the cases noted above did not expressly consider the rationale of the UCC and Restatement drafters, the commercial impracticability standard has been considered when extreme market fluctuations were cited by sellers or buyers seeking to avoid or amend long-term sales agreements for other minerals.[80] The "Westinghouse" cases, which arose out of Westinghouse Electric Corporation's contracts to supply uranium at fixed prices to utilities purchasing its reactors, present this argument. Uranium prices soared, making the fulfillment of contractual obligations extremely burdensome to Westinghouse. Based on an estimated two billion dollar loss, Westinghouse announced that it was rejecting its con-

78. Foster v. Atlantic Refining Co., 329 F.2d 485 (5th Cir. 1964); *see also* J.M. Huber Corp. v. Denman, 367 F.2d 104 (5th Cir. 1966); Lightcap v. Mobil Oil Corp., 221 Kan. 448, 562 P.2d 1, *cert. denied*, 434 U.S. 876 (1977); Montana Power Co. v. Kravik, 179 Mont. 87, 586 P.2d 298 (1978); Texas Oil & Gas Corp. v. Vela, 429 S.W.2d 866 (Tex. 1968). *But see* Henry v. Ballard & Cordell Corp., 418 So. 2d 1334 (La. 1982); Tara Petroleum Corp. v. Hughey, 630 P.2d 1269 (Okla. 1981) (Louisiana and Oklahoma freeze "market value" to price set in good faith situations). *See generally* Morris, *The Gas Royalty Clause—What is Market Value?*, 25TH INST. ON OIL & GAS L. & TAX'N 63 (1974); Wote, *Market Value and Long-term Purchase Contracts*, 17 TULSA L.J. 566 (1982).

79. FERC v. Penzoil Producing Co., 439 U.S. 508 (1979) (in setting "just and reasonable rates" for producers, FERC may consider the increased royalty costs and thus provide prospective relief); Placid Oil v. FPC, 483 F.2d 880 (5th Cir. 1973), *aff'd sub nom.*, Mobil Oil Corp. v. FPC, 417 U.S. 283 (1974); Mobil Oil Corp. v. FPC, 463 F.2d 256 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 976 (1972); Agurs v. Amoco Prod. Co., 480 F. Supp. 737 (W.D. La. 1979).

80. The standard was also considered when a lessor sought to reform an oil and gas lease issued in 1893. At that time, gas was viewed as a nuisance. The lease provided for a royalty on oil, but only a flat fee of $100 a year if gas was recovered. The West Virginia court reformed the contract on a "mutual mistake theory." The concurring opinion concluded that commercial impracticability would not relieve the lessor but argued for a general "equitable reformation" process. McGinnis v. Cayton, 312 S.E.2d 765 (W. Va. 1984).

tracts citing commercial impracticability under section 2-615 of the UCC.[81] Although the numerous law suits filed by utilities against Westinghouse were ultimately settled, commentators had not predicted success for Westinghouse.[82]

Westinghouse initially argued that uranium prices had escalated substantially, from an average contractual delivery price of ten dollars a pound to twenty-six dollars a pound, due to unforeseeable events, specifically the Arab oil embargo and subsequent increases in oil prices.[83] In essence, it argued that the contract assumed that dramatic increases in oil prices, which in turn would lead to uranium price increases, would not occur. Westinghouse would have had difficulty prevailing on this theory because it most likely could not prove that the oil price increase caused the uranium price rise. Westinghouse's own unrevealed short position, contracting to deliver 60,000 tons of uranium but only having 20,000 tons available, could have greatly affected the market price. Producers had no idea of the true demand.[84] Moreover, even ignoring the complication of Westinghouse's own behavior, Westinghouse had implicitly assumed the risk of price fluctuations. It was in a superior position to foresee uranium price fluctuations due to its large market position and could have avoided risk by contracting to "cover" amounts of uranium.[85] Hence, given the hesitancy of courts to release parties from contractual agreements simply because of the increased costs to one party, many commentators concluded that relief should not be available under section 2-615 of the UCC.[86] As will be seen below, courts viewing long-term coal supply agreements adopted a similar view.

Westinghouse later asserted an additional theory of why uranium prices rose. The theory was that an international cartel existed to manipulate prices and to "freeze" Westinghouse out. At first glance, this argument appeared helpful to Westinghouse. However, Westinghouse's

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81. *See generally*, Eagan, *The Westinghouse Uranium Contracts: Commercial Impracticability and Related Matters*, 18 AM. BUS. L.J. 281 (1980); Joskow, *Commercial Impossibility, the Uranium Market and the Westinghouse Case*, 6 J. LEGAL STUD. 119 (1979).

82. *See supra* note 81; *see also In re* Westinghouse Elec. Corp., 517 F. Supp. 440 (E.D. Va. 1981) (no commercial impracticability if Westinghouse could not reprocess fuel as anticipated); Iowa Elec. Light & Power Co. v. Atlas Corp., 467 F. Supp. 129 (N.D. Iowa 1978) (rejecting a claim for relief by a uranium supplier due to increased costs, partially because the supplier could have protected itself), *rev'd on other grounds*, 603 F.2d 1301 (8th Cir. 1979), *cert. denied*, 445 U.S. 911 (1980).

83. Joskow, *supra* note 81, at 164.

84. *Id.* at 172-74; Posner & Rosenfield, *supra* note 62, at 94-95; Eagan, *supra* note 81, at 284-89.

85. Joskow, *supra* note 81, at 16; Eagan, *supra* note 81, at 290; Posner & Rosenfield, *supra* note 62, at 94-95.

86. Eagan, *supra* note 81, at 290.

knowledge of the cartel's existence and the cartel's questionable ability to actually control prices tended to undercut the usefulness of the argument. Westinghouse's antitrust suits ultimately were settled.[87]

Nevertheless, the operators of federal units might argue that it was a prior manipulation of the supply of oil by a different cartel, the Organization of Petroleum Exporting Countries (OPEC), and its later failure to control supply that led to the current depression in energy fuel prices.[88] However, numerous courts looked at the reverse side of this argument, whether or not increases in the price of oil due to OPEC actions could have provided an excuse for parties in long-term contracts burdened by increased costs. At least for contracts entered into after the first price increase of 1971, courts refused to grant relief, partly because these price increases were foreseeable.[89] Although debate may continue about whether or not the oil and gas industry should have foreseen OPEC's increased production and thus the depressed price of oil, once the existence of a cartel is known, then general market fluctuations in response to its activities should be within the realm of foreseeable possibilities.[90]

The effect of conserted activity on the price of oil was the linchpin of another often cited commercial impracticability case. A coal supplier faced increased costs in mining its coal. It alleged that the increases arose at least in part from the Arab oil embargo of 1973, which increased the cost of oil in a manner that was not adequately reflected by the index employed in the long-term sales agreement to escalate prices. The court denied the adjustment:

> The other claim made by Peabody alleged to bring it within the doctrine of 'commercial impracticability,' is the Arab oil embargo. Such a possibility was common knowledge and had been thoroughly discussed and recognized for many years by our government, media

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87. Note, *The Uranium Cartel Saga—Yellowcake and the Act of State: What Will be Their Eventual Fate?*, 12 CASE W. RES. J. INT'L L. 591 (1980); Joskow, *supra* note 81, at 167-71; Eagan, *supra* note 81, at 290-96; *see also* Westinghouse v. Rio Algom, 617 F.2d 1248 (7th Cir. 1980); United Nuclear Corp. v. General Atomic, 96 N.M. 155, 629 P.2d 231 (1980).

88. Because the units presently before the IBLA were designed to explore for natural gas, the argument is more attenuated than stated herein.

89. *Cf.* Eastern Airlines, Inc. v. Gulf Oil Corp., 415 F. Supp. 429 (S.D. Fla. 1975) (jet fuel contract for the period of June 1972 until January 31, 1977); Helms Constr. & Dev. Co. v. State, 97 Nev. 500, 634 P.2d 1224 (1981) (increased petroleum costs on highway construction contract); Publicker Indus. v. Union Carbide Corp., 17 U.C.C. REP. SERV. 989 (E.D. Pa. 1975) (increased costs of ethanol would lead to a $5.8 million dollar loss on a contract entered into in 1972). *But see* Aluminum Co. of America v. Essex Group, Inc., 499 F. Supp. 53, 73-76 (W.D. Pa. 1980) (readjusted a 1967 contract to prevent a $60 million dollar loss, appeal dismissed as moot in light of settlement).

90. *See* B. HUGHES & R. RYCROFT, ENERGY IN THE GLOBAL ARENA: ACTORS, VALUES, POLICIES AND FUTURES 17-20 (1985) (detailing the internal problems of various OPEC members as well as increased conservation by oil consumers as presaging a price fall in the early 1980's).

> economists and business, and the fact that the embargo was imposed during the term of the contract here involved was foreseeable. Peabody failed to demonstrate that this embargo affected its ability to secure oil or petroleum products necessary to its mining production albeit at inflated cost. In fact, as previously stated, this embargo can reasonably be said to have, at least indirectly, contributed to the marked appreciation to the value of Peabody's coal reserves by forcing the market value of that alternative source of energy upward in this country.[91]

To some commentators, this rationale would be an improper application of the concept of foreseeability. It fails to examine commercial practices. Simply because a reasonably prudent person might have foreseen the contingency does not mean that the failure to provide for the contingency in a contract indicates the obligor assumed the risk of its occurrence.[92]

Nevertheless, courts do consider foreseeability. In this instance, the operators could not show that the downturn in prices was an unforeseeable occurrence. On November 8, 1978, natural gas had been subjected to varying levels of price controls under the Natural Gas Policy Act of 1978.[93] High cost gas from deep wells was unregulated in price as of November, 1979.[94] The rationale behind this action was that a higher price for such gas would spur development.[95] "New gas" also would receive a higher price, albeit a regulated one.[96] However, the price regulations expressly were not to continue ad infinitum. Much, although not

91. Missouri Pub. Serv. Co. v. Peabody Coal, 583 S.W.2d 721, 728, (Mo. Ct. App.), *cert. denied*, 444 U.S. 865 (1979). *Compare* Berline v. Waldschmidt, 159 Kan. 585, 156 P.2d 865 (1945) (relief from drilling requirement in a 1939 deed was denied although wartime regulations forbade drilling because United States participation in a war was foreseeable in 1939, as were wartime spacing regulations to conserve oil and gas).

92. Hurst, *Freedom of Contract in an Unstable Economy: Judicial Reallocation of Risks Under U.C.C. Section 2-615*, 54 N.C.L. REV. 545 (1976); Trakman, *supra* note 45, at 726-30; Young, *supra* note 53, at 136-39; Note, *The Doctrine of Impossibility of Performance and the Foreseeability Test*, 6 LOY. U. CHI. L.J. 575, 577 (1975); *see also* Transatlantic Fin. Corp. v. United States, 363 F.2d 312, 318 (D.C. Cir. 1966) (recognized the problem but did not provide relief to a shipper when the Suez Canal was closed). The comments to the UCC, unlike those accompanying the Restatement, *see supra* note 71 and accompanying text, do not expressly state that the foreseeability of the occurrence would not necessarily preclude the occurrence from being a "contingency the non-occurrence of which was a basic assumption on which the contract was made . . . ." U.C.C. § 2-615 (1972). However, other provisions of the UCC might give rise to this conclusion. *See infra* note 108.

93. Pub. L. No. 95-621, 92 Stat. 3351 (1978) (codified at 15 U.S.C. §§ 3301-3432 (1982)) [hereinafter NGPA]. *See generally* Ringleb, *Natural Gas Producer Price Regulation under the NGPA: Regulatory Failure, Alternatives, and Reform*, 20 HOUS. L. REV. 709 (1983); authorities cited *supra* notes 34 & 37.

94. *See generally* NGPA, §§ 101-123, 121, 15 U.S.C. §§ 3311-3334, 3031 (1982).

95. Ringleb, *supra* note 93, at 720-45.

96. NGPA, §§ 102(c), 102(d), 903(c), 15 U.S.C. §§ 3312(c), 3312(d), 3313(c) (1982).

all, of these price controls were to be removed on December 31, 1984.[97] These facts were obviously known to the operators.

It is true, however, that no one was able to predict precisely the price that gas would market for after regulation ceased.[98] However, courts have often stated that relief will not be granted to a party simply because it failed to accurately forecast future prices.[99] Regulatory changes and resultant price fluctuations are viewed as part and parcel of the normal risks of the oil and gas business.[100] More importantly, in regard to the operators currently seeking relief, it was predicted by many that "high cost" gas would no longer be attractive to purchasers after deregulation.[101] Utilities and pipelines might have paid a premium to secure a supply in the late 1970's and early 1980's, but when the purchasers no longer had cheap regulated gas to "blend" in their total supplies, it was predicted that they would be less eager to purchase the gas at the earlier contracted terms.[102] In the situations considered by the BLM, the foreseeability of a less favorable market for the gas was directly presaged by the inclusion of an "economic out" clause in the gas purchase agreement.[103] Because the changes in market prices were foreseeable, precedent indicates that a claim of commercial impracticability will not prevail.

This view is reinforced by a recent case, *Northern Indiana Public Service v. Carbon County Coal*,[104] which examined the "flip-side" of the

97. *Id.* § 121, 15 U.S.C. § 3331. All "new gas," except certain offshore gas, was deregulated. *Id.* § 121(a)(1), 15 U.S.C. § 3331(a)(1).

98. Various predictions stated that demand would greatly exceed the supply of natural gas on December 31, 1984, the price of natural gas would be low compared to that of petroleum, and Congress would reapply regulatory controls due to upward market trends after January 1, 1985. Ringleb, *supra* note 93. *See also* Judge Scalia's summary in Maryland People's Counsel v. FERC, 761 F.2d 768, 770-71 (D.C. Cir. 1985).

99. *Iowa Elec.*, 467 F. Supp. at 135; Hancock Paper Co. v. Champion Int'l Corp., 424 F. Supp. 285 (E.D. Pa. 1976) (even if depressed market was caused by seller's marketing of another product, buyer must purchase and no relief under UCC § 2-615), *aff'd*, 565 F.2d 151 (1977); *Northern Ill.*, 122 Ill. App. 3d at __, 461 N.E.2d at 1059; Lawrence v. Elmore Bean Warehouse, Inc., 108 Idaho 892, 702 P.2d 930 (1985) (price change would only justify relief if failure to relieve would create an unreasonable and severe loss; assertion that compliance would "bankrupt" seller insufficient).

100. *Eastern Airlines*, 415 F. Supp. at 439 (two-tier oil price regulations foreseeable); *see also* Neal-Cooper Grain Co. v. Texas Gulf Sulphur Co., 508 F.2d 283, 294 (7th Cir. 1974) (regulations by Canadian provinces on potash mine); *Westinghouse Elec.*, 517 F. Supp. at 454 (government regulations altering proposed nuclear recycling); *Iowa Elec.*, 467 F. Supp. at 135 (federal environmental and occupational safety regulations).

101. Ringleb, *supra* note 93, at 743-45, 751, 752; Pierce, *Natural-Gas Rate Design: A Neglected Issue*, 31 VAND. L. REV. 1089 (1978).

102. Pierce, *supra* note 101.

103. *See supra* notes 34 & 37 and accompanying text.

104. 799 F.2d 265 (7th Cir. 1986).

problem present in the *Missouri Public Service* case.[105] A coal supplier negotiated a favorable long-term sales contract with only an upward price adjustment. When alternative fuel and energy sources became less costly, the Indiana Public Service Commission refused to allow the purchasing utility to include this higher cost coal in its rate base. Nevertheless, the court, per Judge Posner, firmly rejected claims for relief based on impracticability or frustration of purpose:

> Since impossibility and related doctrines are devices for shifting risk in accordance with the parties' presumed intentions, which are to minimize the costs of contract performance, one of which is the disutility created by risk, they have no place when the contract explicitly assigns a particular risk to one party or the other. As we have already noted, a fixed-price contract is an explicit assignment of the risk of market price increases to the seller and the risk of market price decreases to the buyer, and the assignment of the latter risk to the buyer is even clearer where, as in this case, the contract places a floor under price but allows for escalation. If, as is also the case here, the buyer forecasts the market incorrectly and therefore finds himself locked into a disadvantageous contract, he has only himself to blame and so cannot shift the risk back to the seller by invoking impossibility or related doctrines. It does not matter that it is an act of government that may have made the contract less advantageous to one party. Government these days is a pervasive factor in the economy and among the risks that a fixed-price contract allocates between the parties is that of a price change induced by one of government's manifold interventions in the economy.[106]

Courts historically tend to place the burden on the obligor for difficulties arising out of general market conditions despite great increases in costs of performance that lessen profits or even create a loss.[107] Commentators have claimed that this rigidity eviscerates the standards of the UCC and Restatement, which were meant to temper common law views of impossibility, and violates the general principles of good faith in the

105. *See supra* note 91 and accompanying text.

106. *Northern Ind.*, 799 F.2d at 278 (citations omitted). See also the court's restrictive treatment of the contract's force majeure clause discussed in *supra* note 59. Compare the decision to Judge Posner's earlier article, Posner & Rosenfield, *supra* note 62.

107. *But see* Mineral Park Land Co. v. Howard, 172 Cal. 289, 156 P. 458 (1916). The case allowed extreme cost increases of 10-12 times the anticipated cost to relieve the obligor on a theory of impracticability due to excessive costs. This early case is distinguishable from the situation at hand because the cost increases were caused by unanticipated water existent on the particular tract from which the gravel was to be extracted, rather than general market conditions. *See* Tannenbaum, *Commercial Impracticability Under the Commercial Code: Natural Gas Distributors, Vehicle for Excusing Long Term Requirements Contracts?*, 20 HOUS. L. REV. 771 (1983) (concluding relief from burdensom "take or pay" contracts not likely).

UCC.[108] Despite these criticisms, courts would be hesitant to provide the relief requested by the operators based on past interpretations of commercial impracticability. If increased costs for raw materials due to market conditions will not excuse performance, a lowering of the price receivable by the operators also should not excuse performance.

C. *Additional Requirement for Discharge of Material Conditions*

Even if the operators could convince a court to reverse this trend, an additional obstacle exists: the nature of the relief requested. The unit operators desire to maintain control over all committed acreage despite their failure to comply with drilling obligations. In the typical case, a seller is seeking either to avoid performance altogether and walk away from the contract or to adjust the price to be paid.[109] In the one case that allowed a commercial impracticability defense when increased oil prices greatly inflated production costs, a modified price was imposed to lessen the losses and profits that would have occurred absent modification.[110] Here, however, the operators want to retain all benefits of unitization without expending any effort. This request is contrary to the contractual intent because it ignores the fact that continued drilling is a necessary precondition to the boundaries of the unit remaining intact.

108. *See* U.C.C. § 2-615 comment 6 (calling for adjustment "[I]n situations in which neither sense nor justice is served by either answer when the issue is posed in flat terms of 'excuse' or 'no excuse' "). *See also* Wallach, *The Excuse Defense in the Law of Contracts, Judicial Frustration of the U.C.C. Attempt to Liberalize the Law of Commercial Impracticability*, 55 NOTRE DAME LAW 203 (1979); Schmitt & Wollschlager, *supra* note 61. *But see* Sirianni, *supra* note 61, at 160.

109. *See* RESTATEMENT (SECOND) OF CONTRACTS § 272 (1979) (equitable readjustment and restitutional relief may be available). Examples where leases are involved also show a desire to change the reserved rent or cancel. *See also* Essex-Lincoln Garage, Inc. v. City of Boston, 342 Mass. 719, 175 N.E.2d 466 (1961) (lessened traffic on street due to change of regulations "foreseeable" and no relief even if less profitable); Wood v. Bartolino, 48 N.M. 175, 146 P.2d 883 (1944) (duty to pay rent for filling station unaffected by government rationing of petroleum and tires that made business more unprofitable); Perry v. Champlin Oil Co., 101 N.H. 97, 134 A.2d 65 (1957) (landlord could not rescind lease where rent was a percentage of sales simply because sales have decreased and thus landlord's bargain was poor); North American Capital Corp. v. McCants, 510 S.W.2d 901 (Tenn. 1974) (refusal of Federal Home Loan Bank Board to approve site for savings and loan association would not enable lessee to avoid lease). For an examination of the frustration doctrine as applied to leases in Britain, see Robertson, *supra* note 43 (status of a lease as a conveyance of property as well as being a contract retards growth of the doctrine).

110. *Aluminum Co.*, 499 F. Supp. at 92. See also the attitude of the judges in the various Westinghouse cases seeking to compel settlement. Eagan, *supra* note 81, at 298-301; Comment, *Equitable Reformation of Long-Term Contracts the "New Spirit" of ALCOA*, 1982 UTAH L. REV. 985; Trakman, *supra* note 42. *But see* Posner & Rosenfield, *supra* note 62, at 113 (to split the loss may defer the more efficient risk bearer from adopting "cost-justified risk avoidance or risk-minimization techniques"); Gillette, *Commercial Rationality and the Duty to Adjust Long-Term Contracts*, 69 MINN. L. REV. 521 (1985) (adjustments are not in accord with commercial reality, social utility, or individual right).

The Model Unit Agreement provides that acreage, not within a participating area, shall be eliminated from the unit on a certain date *unless diligent drilling operations are in progress.* The operators claim that the lack of prospective profit from drilling should excuse their performance because they have no control over general market prices. Even if a general market fluctuation could give rise to a "commercial impracticability" defense, it could not excuse performance of a condition that was *material* to the contract.

The discharge of conditions material to a contract are treated in a special manner. The Restatement provides: "Impracticability excuses the non-occurrence of a condition if the occurrence of the condition is not a material part of the agreed exchange and forfeiture would otherwise result."[111] The example given to illustrate this proposition concerned a contract of whole life insurance. Even if the insured was imprisoned in a foreign country and unable to pay premiums for five years, the Restatement drafters maintain that the insurance company need not accept a tender of past premiums upon the insured's release because annual payments were a material part of the agreed upon exchange. The non-occurrence of the payments could not be excused because of impracticability even though forfeiture of the policy would result.[112]

In the present situation, the condition required to prevent contraction of the unit is drilling. Although a technical "forfeiture" would not occur if drilling is not pursued, the definition of "forfeiture" in the Restatement would be broad enough to cover the situation.[113] Nevertheless, drilling of an exploratory well is material to the agreement because oil and gas lessors do not receive any royalities unless development occurs. The fact that the lessor will receive future royalties not only rescues oil and gas leases from claims of lack of mutuality,[114] but also is the impetus for the judicial imposition of responsibilities on lessees to develop the leasehold.[115] Under two rationales of the Restatement, the non-occurrence of diligent drilling could not be excused due to impracti-

111. RESATEMENT (SECOND) OF CONTRACTS § 271 (1979).

112. *Id.* illustration 3.

113. Because drilling was a special limitation on the estate, no "forfeiture" would occur. *See infra* note 157 and accompanying text. The Restatement, however, defined a forfeiture broadly. " 'Forfeiture' is used to refer to the denial of compensation that results when the obligee loses his right to the agreed exchange, after he has relied substantially on the expectation of that exchange, as by preparation or performance." RESTATEMENT (SECOND) OF CONTRACTS § 271 comment a (1979).

114. *See infra* note 123 and accompanying text.

115. *See infra* note 132 and accompanying text.

cability despite the loss of the operators' investment-backed expectations. First, the discharge could not occur because the obligation is a material condition to the lease. Secondly, the allocation of risk between the parties in this particular commercial setting renders discharge inappropriate.

V. Private Oil and Gas Precedents Preclude Conditioning Express Drilling Requirements on Profit Potential for Lessees

The oil and gas operators seek relief from express drilling requirements contained in their unit agreements.[116] The convenant to drill conditions the ability to apply the unit agreement to lands that have not been proven reasonably capable of production and therefore have not been included in a participating area.[117] In essence, this is a requirement to continue to explore the unit acreage because development can only occur after oil or gas is known to exist throughout the unit.[118] The drilling requirement is also a condition precedent to retention of acreage. The unit will automatically contract and lands not within a participating area "shall no longer be part of the unit area and shall no longer be subject to this agreement, *unless* diligent drilling operations are in progress *on unitized lands not entitled to participation* . . . ."[119] By claiming that generally low market prices should excuse performance, the operators are attempting to graft upon an express exploration covenant a "prudent operator" standard, which includes a requirement of profitability for the lessee before drilling can be compelled. An examination of the history of

116. The covenant is express because a contractual provision, namely § 2 of the Model Unit Agreement, provides the drilling requirements. Absent such a provision, courts have implied such duties in the private arena. BLM regulations, incorporated by reference into all leases, also require protection from drainage as well as reasonable development. 43 C.F.R. §§ 3100.2, 3162.2, 3180.0-1 (1986). The last regulation cited emphasizes that federal regulations apply to operations within a federal unit. These provisions may be analogized to private "implied" covenants.

117. This is not a completely accurate summation of the extent of a participating area. Acreage could also be retained by including it in a participating area if it is necessary for unit operations (for example, by containing an injection well) and allocating production to the lands. 43 C.F.R. § 3180.0-5 (1986). However, for the purposes of this article, this additional provision is not relevant. The lands included, although not necessarily proven to be productive, would share in royalties and therefore provide a return to the lessor.

118. Professor Kuntz identified five circumstances in which duties to drill should be classified as exploratory duties: when production has declined from all fully developed known productive formations; when intense interest in another formation exists in the area; when the lease covers distinct minerals some of which are undeveloped; when the lease covers noncontiguous tracts that have not all been developed; and when the lease covers a large area compared to the developed acreage. 5 E. KUNTZ, A TREATISE ON THE LAW OF OIL & GAS § 62.1 (1978) [hereinater KUNTZ]. Because the units at issue are quite large and only developed as to three to four percent of their acreage, the last circumstance listed is clearly applicable.

119. 43 C.F.R. § 3186.1(2)(3) (1986) (emphasis added).

exploration and development requirements on private oil and gas leases and units will clearly show the impropriety of this attempt.

The analysis begins with a most basic premise. An oil and gas lease is granted in order for the lessor to obtain production of oil and gas without the expenditure of the lessor's funds. Unitization occurs in order to increase the efficiency of recovery of oil or gas.[120] Due to the fugacious nature of the oil and gas, a pure rule of capture enables and encourages each owner of oil and gas rights in lands overlying a pool to "race" to drain as much of the pool as possible before neighboring owners do the same.[121] To prevent wasteful practices arising out of such races, the concept of unitization developed whereby owners of oil and gas rights join together to share costs and proceeds from joint development of the geological pool. Nevertheless, the essential relationship between an oil and gas lessor and its lessee remains the same. The lessor desires development because production results in receipt of a primary consideration for the grant of oil and gas rights.

The requirement that oil and gas be developed in order to compensate the grantor of oil and gas rights is one of the hallmarks that distinguishes an oil and gas lease from a grant in fee of mineral rights. If a grantor has not received or will not receive any substantial compensation other than through participation in oil or gas to be produced, courts will consider the transaction to be an oil and gas lease, especially if the terms of the transfer expressly anticipate development.[122] Moreover, if the agreement does not require development, thereby granting the lessee total control over whether or not to drill and enabling the lessee to preserve the interest forever based on an initial small consideration, the contract could be deemed unenforceable.[123] The true consideration for the execu-

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120. *Id.* § 3180.0-1; Kaveler, *The Engineering Basis for and the Results From the Unit Operation of Oil Pools*, 23 TULSA L.J. 331 (1949).

121. *Cf.* Demetz, *Towards a Theory of Property Rights*, 57 AM. ECON. REV. 347 (1967); Friedman, *The Economics of the Common Pool: Property Rights in Exhaustible Resources*, 18 UCLA L. REV. 855 (1971); Williams, *Running Out: The Problem of Exhaustible Resources*, 7 J. LEGAL STUD. 165 (1978); Williams, *Implied Covenants for Development and Exploration in Oil and Gas Leases—the Determination of Profitability*, 27 U. KAN. L. REV. 443 (1979).

122. West v. Commissioner, 150 F.2d 723 (5th Cir. 1945), *cert. denied*, 326 U.S. 795 (1946); Crain v. Pure Oil Co., 25 F.2d 824 (8th Cir. 1928); Eggleston v. Sinclair Oil & Gas Co., 132 Okla. 81, 269 P. 306 (1928); Danciger Oil & Ref. Co. of Texas v. Powell, 137 Tex. 484, 154 S.W.2d 632 (1941); *see generally* HEMINGWAY, THE LAW OF OIL AND GAS § 6.1 (2d ed. 1983) [hereinafter HEMINGWAY].

123. *See, e.g.*, Federal Oil Co. v. Western Oil Co., 112 F. 373, 376 (D. Ind.), *aff'd*, 121 F. 674 (7th Cir. 1902).

> The cash payment, if actually made, was merely nominal, and it is quite apparent from a consideration of the terms of the whole lease that the lessors would not have executed it for any such paltry consideration. If there was no further consideration which the lessee was

tion of an oil and gas lease is the expectation of royalty income. Early decisions held that absent an attempt to produce within a reasonable time, the lease may fail for lack of consideration before the end of its primary term.[124]

In response to these judicial concerns, oil and gas lessees introduced the concept of "delay rental" payments, so-named because they were designed to provide consideration for a postponement of the lessee's drilling obligations. Lease provisions would require drilling within a year but enable the operator to gain an additional year or years of exploratory time by payment of a specified sum. Initially, the clauses were phrased to give the lessee the option to "drill or pay." When courts interpreted this formulation to require lessees to pay rentals throughout the primary term even if they desired to abandon the lease, the clauses were modified to the now familiar "unless" provision.[125] As now employed, the clause generally states that the lease shall terminate if drilling operations are not begun within one year, unless on or before the anniversary date, the lessor pays a certain sum denominated as rent to cover the privilege of deferring drilling for twelve months. Similar rights are retained for each year of the primary term.[126]

The delay rental payment under the "unless" provision countered

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> bound to yield to the lessors, a court of equity would be bound to refuse the enforcement of the lease. The consideration would be so trifling, compared with the value of the leasehold interest, as to shock the moral sense.... Oil leases stand upon quite different grounds from leases of other immovable property. The governing principle in gas and oil leases of the character in question is that the discovery and production of gas or oil is a condition precedent to the existence and continuance of any vested estate in the demised premises. Where, as in this case, the only consideration is prospective royalties to arise from exploration and development, failure to properly explore and develop the demised premises renders the agreement nudum pactum, and works a forfeiture of the lease, for it is of the essence of such a lease that the work of exploration shall be commenced and prosecuted with promptness.

Id. at 375.

The consideration in that case was one dollar. For federal noncompetitive leases, which leases in unproven areas would most likely be, currently only a $75 filing fee and an initial rental of one dollar per acre would be required for issuance. 43 C.F.R. §§ 3103.2-2, 3111.1-1, 3112.2-2 (1986). Rates historically were lower.

124. *Federal Oil Co.*, 112 F. at 375; *see also* Cameron v. Lebow, 338 S.W.2d 399 (Ky. 1960) (recounting rule in Kentucky), other aspects of case considered, 338 S.W.2d 399 (lease not abandoned), 394 S.W.2d (1965) (nature of trespass); Texas Co. v. Davis, 113 Tex. 321, 254 S.W. 304 (1923).

125. *See Butler*, 54 Cal. 2d 589, 354 P.2d 239, 6 Cal. Rptr. 770; Sugg v. Williams, 191 Ky. 188, 229 S.W. 72 (1921); Jackson v. Twin State Oil Co., 95 Okla. 96, 218 P. 324 (1923). See also cases discussing the variants of allowing the lessor to forfeit the lease or the lessee to surrender it. *Federal Oil Co.*, 112 F. 373; Rich v. Doneghey, 71 Okla. 204, 177 P. 86 (1918); Galey v. Kellerman, 123 Pa. 491, 16 A. 474 (1889); Eclipse Oil Co. v. South Penn Oil Co., 47 W. Va. 84, 34 S.E. 923 (1899).

126. *See generally* McElroy, *Unless vs. Or: An Appraisal*, 6 BAYLOR L. REV. 415 (1954); HEMINGWAY, *supra* note 122, at § 6.2.

the necessity of providing consideration for lease operations throughout the primary term. Oil and gas lessees, however, then had to face another variant of the judicial recognition that prospective royalty is the material impetus for a grant of a lease.[127] Most oil and gas leases do not specify that more than one well must be drilled. Production from one well could hold the entire lease area for the entire productive life of the well, frustrating a lessor's desire to maximize return by negating any incentive for the lessee to drill additional wells. A Pennsylvania court first raised the spectre of a duty to be imposed on a lessee to further the lessor's purposes as dicta. In the subject case, express drilling requirements eliminated a need to imply further duties. Absent this provision, however, the court would have had no difficulty in finding "an implication that the property should be developed reasonably."[128] In fact, the courts did impose on a lessee an implied covenant to diligently develop a leasehold.[129]

This duty has been referred to as the implied covenant of further development.[130] To paraphrase the late Professor Merrill, the "prudent operator" joined the legal stage quite early in a crucial supporting role to the development duty.[131] The Court of Appeals for the Eighth Circuit in *Brewster v. Lanyon Zinc Co.*, explained the lessee's duty succinctly:

> The object of the operations [on an oil and gas lease] being to obtain a benefit for both lessor and lessee, it seems obvious, *in the absence of some stipulation to that effect*, that neither is made the arbiter of the extent to which or the diligence with which the operations shall proceed, and both are bound by the standard of what is reasonable . . . .

127. Most courts quickly accepted that the delay rental provision either countered any implied covenant to drill the exploratory well expeditiously or defined the reasonable period allowable for drilling. Rose v. Lanyon Zinc Co., 68 Kan. 126, 74 P. 625 (1903); Lloyd's Estate v. Mullen Tractor & Equip. Co., 192 Miss. 62, 4 So. 2d 282 (1941); Warm Springs Dev. Co. v. McAulay, 94 Nev. 194, 576 P.2d 1120 (1978) (citing existing authorities); Southwestern Oil Co. v. McDaniel, 71 Okla. 142, 175 P. 920 (1918); Newbert v. Messer, 15 Tenn. App. 210 (1932); Campbell v. Schrock, 50 S.W.2d 788 (Tex. 1932) (prepaid rentals); Simms Oil Co. v. Colquitt, 2 S.W.2d 421 (Tex. 1928); Carper v. United Fuel Gas Trust Co., 78 W. Va. 433, 89 S.E. 12 (1916) (protection if drainage occurring). *But see* Consumers' Gas Trust Co. v. Littler, 162 Ind. 320, 70 N.E. 63 (1904); *Cameron*, 338 S.W.2d 399 (implied obligations to develop still exist upon a lessor's demand and refusal to accept rentals); *see generally* Merrill, *Implied Covenants in Oil and Gas Leases*; U. ILL. L. F. 584, 587 (1959).

128. Stoddard v. Emery, 128 Pa. 436, 18 A. 339 (1889).

129. Brewster v. Lanyon Zinc Co., 140 F. 801 (8th Cir. 1905); Harris v. Ohio Oil Co., 57 Ohio St. 118, 48 N.E. 502 (1897). For a history of the development of the concept, see M. MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES §§ 122-23 (1945).

130. It also has been called a covenant of diligent or reasonable development. The federal equivalent is found in a regulation applying generally to oil and gas leaseholds: "After notice in writing, the lessee shall promptly drill and produce such other wells as the authorized officer may reasonably require in order that the lease may be properly and timely developed and produced in accordance with good economic operation practices." 43 C.F.R. § 3162.2(c) (1986).

131. Merrill, *The Modern Image of the Prudent Operator*, 10 ROCKY MTN. MIN. L. INST. 107 (1965).

> Whatever, in the circumstances, would be reasonably expected of operators of ordinary prudence, having regard to the interests of both lessor and lessee, is what is required.[132]

Inquiry into potential profits for the lessee is appropriate, therefore, in situations where the lessor is asserting that an implied covenant of development has been breached. An operator may not be forced to elevate the lessor's concerns above his own.[133]

However, the implied covenant of further development only applies to increasing production in proven fields or formations.[134] In the situation at hand, the operators are seeking to avoid drilling in areas that have not yet been proven reasonably capable of production. They are, in essence, seeking to avoid obligations to explore the extensive acreage committed to the units.

Certain commentators have found a distinct implied covenant of further exploration for unproven strata or fields after some production exists on a leasehold. The implied covenant may be breached even if the lessor is unable to prove that drilling would be potentially profitable for the lessee.[135] Not all commentators agree with this formulation.[136] Some courts, however, do recognize a distinct implied covenant to ex-

132. *Brewster*, 140 F. at 814 (emphasis added); *see also Harris*, 57 Ohio at __, 48 N.E. at 505 (also referred to "an ordinarily prudent man"). The time honored standard used to determine the validity of a mining claim under the Mining Law of 1872, 30 U.S.C. § 21 (1982), should be compared to the "prudent man" standard. In order to qualify as "valuable mineral deposits," the deposits must be of such quality and quantity that "a person of ordinary prudence would be justified in the further expenditure of his labor and means, with a reasonable prospect of success, in developing a valuable mine . . . ." Castle v. Womble, 19 L.D. 455, 457 (1894). *See also supra* note 130 for the text of the federal regulation dealing with non-specified drilling operations. It, too, requires additional drilling to be "in accordance with good economic operating practices."

133. In fact, the lessor bears the burden of proving that the drilling would likely be profitable. Profitability in this instance includes recovery not only of production costs, but drilling costs as well. Trust Co. of Chicago v. Samedan Oil Corp., 192 F.2d 282 (10th Cir.1951) (general rule in Oklahoma absent proof of unreasonable delay); Sanders v. Birmingham, 214 Kan. 769, 522 P.2d 959 (1974) (summarizes the type of evidence necessary).

134. This is the terminology applied in 5 H. WILLIAMS & C. MEYERS, OIL & GAS LAW § 841 (1985) [hereinafter WILLIAMS & MEYERS]. *But see* Doss Oil Royalty Co. v. Texas Co., 192 Okla. 359, 137 P.2d 934 (1943) (referring to the "implied covenant to fully develop" in reference to an unproven field); KUNTZ, *supra* note 118, at § 62.1 (view that exploration is interrelated to and part of developmental duties but arises in special circumstances).

135. The first formulation of the covenant was in Meyers, *The Implied Covenant of Further Exploration*, 34 TEX. L. REV. 553 (1956). It triggered the following exchanges: Brown, *The Implied Covenant for Additional Development*, 13 S.W. L.J. 149 (1959); Meyers, *The Covenant of Further Exploration: A Comment*, 37 TEX. L. REV. 179 (1958); Brown, *Proposed New Covenant of Further Exploration: Reply to Comment*, 37 TEX. L. REV. 303 (1959). Additional objections to the covenant may be found in Merrill, *The Implied Covenant for Further Exploration*, 4 ROCKY MTN. MIN. L. INST. 205 (1958) (unnecessary); Martin, *A Modern Look at Implied Covenants to Explore, Develop and Market under Mineral Leases*, 27 INST. ON OIL & GAS L. & TAX'N 177 (1976); HEMINGWAY, *supra* note 122, at § 8.3 (analysis of cases reveals that courts hesitate to adopt the covenant).

136. *See supra* note 135.

plore or order exploration explicitly, and some states have adopted the covenant statutorily.[137] Moreover, whether or not a court labels the covenant as one of exploration, various courts have refused to allow a lessee to retain large acreage after unreasonable lapses of time without drilling, even if the lessor could not prove an additional well would be profitable. The impetus for these holdings was apparently the *Sauder v. Mid-Continent Petroleum* case.[138]

This case construed development obligations on a lease executed in 1916. The lease encompassed two tracts of land, one of 320 acres and one of 40 acres. No wells were ever drilled on the larger tract. Only two offset wells were drilled on the 40 acre tract in 1920 and 1921. Suit for partial cancellation of the lease or to compel development of the 320 acre tract was brought in 1930. The operator based its defense on the lack of proof that an additional well would return a profit to it. The operator desired, however, to hold the lease pending receipt of additional geological information. The Supreme Court reacted strongly:

> The respondent's officers state that they desire to hold this tract because it may contain oil; but they assert that they have no present intention of drilling at any time in the near or remote future. This attitude does not comport with the obligation to prosecute development with due regard to the interests of the lessor. 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.
>
> The decisions on which the Circuit Court of Appeals relied recognize and apply the rule of *Brewster v. Lanyon Zinc Co. supra*, but are distinguishable because of a difference in the circumstances in which the rule was applied. * * * In none of them was there a neglect to explore or develop for any such period as is here shown, or an ex-

137. *See* 31 LA. REV. STAT. ANN. § 122 (West 1975); Humble Oil & Ref. Co. v. Romero, 194 F.2d 383 (5th Cir. 1952) (conditionally cancelled lease to allow third party to actually begin drilling for exploratory purposes); Nolan v. Thomas, 228 Ark. 572, 309 S.W.2d 727 (1958); *Cameron*, 338 S.W.2d 399; Lake v. Ohio Fuel Gas Co., 2 Ohio App. 2d 227, 207 N.E.2d 659 (1965) (required an "exploratory well" be drilled); *see also* 55 KAN. STAT. ANN. § 224 (West 1983) (lapse of 15 years in drilling creates a presumption of breach of implied covenants which, by preceding section, include exploration); Clovis v. Pac. N.W. Pipeline Corp., 140 Colo. 552, 345 P.2d 729 (1959); Gillete v. Pepper Tank Co., 694 P.2d 369 (Colo. App. 1984) (citing WILLIAMS & MEYERS); *see generally* 5 WILLIAMS & MEYERS, *supra* note 134, at §§ 845-45.9.

138. 292 U.S. 272 (1934). *But see* Note, *Oil and Gas Speculation: Anatomy of an Oil Dispute*, 36 OKLA. L. REV. 141 (1986) (the lessee's failure to have any interest in developing the lease in itself negated the prudent operator standard; therefore, lack of proven profitability was irrelevant to resolving the *Sauder* case).

pressed intention not to do so, in a comparable situation.[139]

This renunciation of speculative holding as violative of a lessor's expectations has been echoed by many courts.[140] Kansas considered a similar situation in 1936. On a portion of a lease of 200 acres issued in 1925, only one well had been drilled, and it had run into production difficulties. The lessee alleged that it would be unprofitable to drill until oil sold for $1.50 a barrel but wanted to retain the lease for its future value. The court cancelled 150 acres of the lease. Its decision rested on the fact that there was a market for oil, and profitability to the lessee was not the sole criterion to judge compliance with developmental duties.[141] Oklahoma, although stating that a covenant of exploration does not exist in the state, has been one of the more active proponents of the proposition that after an unreasonable period of time has elapsed without drilling, proof of the profitability to the lessee from drilling dims in importance.[142]

The cases that have been discussed deal with implied exploration and developmental duties on leaseholds. They are not, however, irrelevant to unit operations. Duties to develop reasonably have been found to

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139. *Sauder*, 292 U.S. at 280-81.

140. *See* Sinclair Oil & Gas v. Masterson, 271 F.2d 310 (5th Cir. 1959), *cert. denied*, 362 U.S. 952 (1960); *see also* Clifton v. Koontz, 160 Tex. 82, 325 S.W.2d 684 (1959). *Clifton* is often cited for the proposition that Texas rejects the implied covenant of exploration. It involved a 350 acre lease on which one well had been drilled. The Texas Supreme Court, however, stated the following:

> However, it should be noted that we do not have a factual situation where the lease covers several thousand acres and an effort is being made to hold such vast acreage by showing production from a comparatively small area. Neither are we confronted with a situation where an unreasonably long length of time has elapsed since the last development of the leased premises. Therefore, we do not pass upon these questions.

Clifton, 160 Tex. at 90, 325 S.W.2d at 696.

Two later cases, both purportedly interpreting Texas law in large acreage situations, have split in result and neither are comprehensive precedents. *Sinclair Oil*, 271 F.2d 310 (conditional cancellation of lease despite lack of proof of profitability); Felmont Oil Corp. v. Pan American Petroleum Corp., 334 S.W.2d 449 (Tex. Civ. App. 1960) (*writ refused, n.r.e.*) (not cancelling a lease of 31,260 acres; however, lessee had conducted extensive geophysical testing, perhaps complying with duty to "explore"); *see also*, 5 WILLIAMS & MEYERS, *supra* note 134, at §§ 842.1, 842.3.

141. Harris v. Morris Plan Co., 144 Kan. 501, 61 P.2d 901 (1936).

142. Mitchell v. Amerada Hess Corp., 638 P.2d 441 (Okla. 1981) (rejecting covenant to further explore in a situation where numerous lessors joined in to seek cancellation; no proof of "speculative" holding of a large lease was made). *But see* Magnolia Petroleum Co. v. Wilson, 215 F.2d 317 (10th Cir. 1954); Trust Co. of Chicago v. Samedan Oil Corp., 192 F.2d 282 (10th Cir. 1951); Carter v. U.S. Smelting, Ref. & Mining Co., 485 P.2d 748 (Okla. 1971) (distinguishes cancellation for failure to develop, which was granted, from damage claims for purported drainage; latter claim did require proof that lessee would profit from drilling an offset well); Crocker v. Humble Oil & Ref. Co., 419 P.2d 265 (Okla. 1965); Sands Springs Home v. Clemens, 276 P.2d 262 (Okla. 1954); McKenna v. Nichols, 193 Okla. 526, 145 P.2d 957 (1944); Skelly Oil Co. v. Boles, 193 Okla. 308, 142 P.2d 969 (1943); Magnolia Petroleum Co. v. Rockhold, 192 Okla. 628, 138 P.2d 809 (1943); *Doss Oil*, 192 Okla. 359, 137 P.2d 934 (finding a breach of development requirements after a lapse of drilling for 14 years without proof of profitability and declaring an abhorrence on speculative holding); Note, *Oil and Gas: The Implied Covenant for Further Exploration—Does it Exist in Oklahoma?* 36 OKLA. L. REV. 164 (1983); Note, *supra* note 138.

exist and apply to acreage embraced by unit agreements.[143] In one case, only a portion of the lessor's lands was included in the unit's "productive limit" and thus entitled to share in revenues. The Fifth Circuit, in recognizing an obligation to reasonably develop the unit area, noted that unitization's "release from the obligations to develop 'each tract separately' and to 'prevent drainage' does not extend to acreage outside the revenue sharing unit or, as it is referred to in this case, the productive limit."[144] By statute, Oklahoma has recognized a similar developmental duty when only a portion of a leasehold is in a spacing unit of more than 160 acres. Production on the unit will not hold the uncommitted acreage more than ninety days beyond the lease's primary term.[145] Lands outside a participating area established under a federal exploratory unit agreement do not share in revenues. Therefore, to indefinitely hold the outside land based on production elsewhere and without any plans to explore appears contrary to the developmental intent of the unit and the lessor, even if the lessee might not profit from drilling.

Professor Meyers, the chief exponent of the concept of an implied covenant to further explore, provides three rationales why profitability to the lessee should not control enforcement of the duty. One rationale is that the duty to explore or surrender prevents holding of unexplored acreage for speculative purposes, thereby frustrating the lessor's desire to explore the minerals. A second is that public policy is to encourage development of domestic oil and gas reserves. Lastly, he notes that the remedy provided a lessor for a breach of the covenant is surrender of the unexplored acreage of the leasehold. A breach does not compel the lessee to make out-of-pocket expenditures.[146] Cogent arguments against these propositions have been made. Especially in times of potentially increasing oil or gas prices, speculation and deferral of development might be viewed as beneficial to society.[147] Nevertheless, in the present situation, the operators desire to maintain control over 25,000 to 40,000 acres

143. Christmas v. Riley, 260 Ark. 150, 539 S.W.2d 405 (1976); Parkin v. State Corp. Comm'n, 234 Kan. 994, 677 P.2d 991 (1984); Samson Resources Co. v. Corporation Comm'n, 702 P.2d 19 (Okla. 1985); *Gillette*, 694 P.2d 369.

144. Mize v. Exxon Corp., 640 F.2d 637, 641 (5th Cir. 1981).

145. OKLA. STAT. tit. 52, § 87.1(b) (1981). The application of this statute is discussed in Wickham v. Gulf Oil Corp., 623 P.2d 613 (Okla. 1981) (not to be applied retroactively); Kuntz, *Statutory Well Spacing and Drilling Units*, 31 OKLA. L. REV. 344 (1978).

146. 5 WILLIAMS & MEYERS, *supra* note 134, at § 847; *see also* KUNTZ, *supra* note 118, at § 62.5.

147. *See* Martin, *supra* note 135, at 205; Pickerell, *Is There a New Covenant of Explorvelopment?*, 31 INST. ON OIL & GAS 245, 288-92 (1980); Weaver, *Implied Covenants in Oil and Gas Under Federal Energy Regulation*, 34 VAND. L. REV. 1473, 1499 (1981) (even if profitability could be shown, lessee should be able to defer if prevailing market conditions indicate better future profits);

in each unit based on one or two wells. In the event relief is not granted, the underlying leases outside the redefined unit will not expire but will be extended for two years and so long thereafter as oil and gas may be produced. The lessor will not necessarily recapture the developmental rights, and the lessees will retain the right to drill the acreage. This effect supports a retreat from the prudent operator rule with its requirement of profitability in purely developmental situations.

The arguments for and against requiring proof of potential profitability on leaseholds could be relevant to the issue of unit exploration. The critique of abandoning profitability and the prudent operator standard when exploration is being considered would appear to aid the operators, but this is not the case. Arguments for retaining the prudent operator formula in full regalia were addressed to interpretations of *implied* exploratory covenants, that is, covenants created judicially to conform to the unstated expectations and agreements of the parties.[148] The prudent operator rule was never applied to express drilling agreements, whether for exploration or development.[149]

Therefore, it is unnecessary to resolve the question of whether or not profitability for the lessee should be abandoned as a standard for implied exploratory duties. Nor is it necessary to decide whether the duties are derived from an implied independent "covenant" or as subspecies of implied developmental covenants.[150] However, by recognizing that the duty the operators seek to avoid is exploratory in nature, the above discussion shows that profitability to the lessee should be less determinative of its obligations than if development was at issue. The treatment of express drilling obligations further underscores the fact that the operators should be required to perform or surrender acreage.

If a private lease had express requirements to drill or rework a well as a condition precedent to the lease's continued existence, failure to perform would make the lease subject to defeasance. For example, leases often provide that the lease will not terminate upon cessation of production if the lessee shall commence or resume drilling or reworking opera-

Williams, *Implied Covenants in Oil and Gas Leases: Some General Principles*, 29 KAN. L. REV. 153 (1981); Williams, *supra* note 121.

148. *See supra* note 147.

149. Brown, *Proposed New Covenant of Further Exploration: Reply to Comment*, *supra* note 135, at 308-09; *see also supra* text accompanying note 132.

150. Hence, for the purposes of this paper, the author adopts Professor Kuntz's "compromise" of recognizing that a separate "duty" of exploration exists that is treated differently than pure developmental duties. KUNTZ, *supra* note 118, at § 62.1.

tions within a specified time.[151] If this clause is present, it will override any implied right that a lessee will have a "reasonable" time to resume drilling because the terms of the contract will rule.[152] Even if the delay is caused by necessary contracting activity, the lease will terminate.[153] As one court noted, it is immaterial that additional drilling is not necessary to drain the acreage and would be wasteful. The same court also deemed it irrelevant that the gas was currently unmarketable and the lessee was building a treatment facility. The unambiguous lease term required drilling.[154] The fact that a prudent operator might not drill an additional well "is inapplicable to operations necessary to keep a lease alive under a special limitation or condition."[155]

The unit provision at issue clearly creates a "special limitation" on the continued commitment of acreage to the unit if it is not in a participating area on the relevant date. It provides that the unit will automatically contract *unless* diligent drilling operations are prosecuted without lapses of more than ninety days.[156] The provision is analogous to the "unless" clause in an oil and gas lease, which states that a lease will terminate unless either drilling is in progress or delay rentals are paid. This clause has been construed as a special limitation in which termination occurs "ipso facto" and not by forfeiture.[157] The automatic nature of such a termination mandates that not even the protections granted to debtors under bankruptcy law could revive a lease on which a failure to drill or pay occurred.[158] Therefore, the unit should not be able to remain

151. *See generally id.* ch. 47, at 74-137; 5 WILLIAMS & MEYERS, *supra* note 134, at §§ 883-885.5.

152. Hoyt v. Continental Oil Co., 606 P.2d 560 (Okla. 1980). By analogy, because the unit agreement provides a definite schedule for additional drilling, failure to drill pursuant to that schedule would be a holding of the unit acreage for an "unreasonable" length of time without further drilling. *See* Chandler v. Drummet, 557 S.W.2d 313 (Tex. Civ. App. 1977) (60 day redrilling clause was not a "special limitation" on the estate, but defined the outer limits of the time frame allowable for reasonable development).

153. *Hoyt*, 606 P.2d 560; *see also* Texas Co. v. Leach, 219 La. 613, 53 So. 2d 786 (1951) (contrasting a lease with a reworking provision to a royalty interest without one).

154. Francis v. Pritchett, 278 S.W.2d 288 (Tex. Civ. App. 1955); *see also* Haby v. Stanolind Oil & Gas Co., 228 F.2d 298, 306 (5th Cir. 1955) (economic impracticability of additional drilling is no excuse).

155. Trinidad Petroleum Corp. v. Pioneer Natural Gas Co., 416 So. 2d 290, 300 (La. Ct. App. 1982); *see also* Endicott v. De Barbieri, 189 Kan. 301, 369 P.2d 241 (1962).

156. 43 C.F.R. § 3186.1(2)(e) (1986).

157. *See generally* KUNTZ, *supra* note 118, at § 29.2(b)-(c); *see also* Powers v. Bridgeport Oil Co., 238 Ill. 397, 87 N.E. 381 (1909) (express covenant to drill six wells).

158. Bankruptcy Act of 1898, § 11(e), 11 U.S.C. § 29(e), *amended by* Pub. L. No. 98-353, 98 Stat. 369 (1984). The section provided for a sixty day grace period "to take any . . . action or do any act" required to preserve the debtor's rights. The grace period was immaterial because the lease automatically terminated. *See, e.g.*, Trigg v. United States, 630 F.2d 1370 (10th Cir. 1980) (automatic stay provisions of current Bankruptcy Code and prior Bankruptcy Rules would not prevent

intact without drilling simply because the operator would not profit from the additional drilling. Concerns as to unprofitability would be immaterial in the private arena.

VI. Conclusion and Suggestions for Alternative Relief

The operators cannot compel the BLM to grant them a suspension of their express drilling requirements pursuant to section 25 of the Model Unit Agreement simply because it would be unprofitable for them to drill additional wells. A generalized market downturn in the price receivable for the product of drilling might not be the sole cause of their present desire to not drill. Additionally, the market downturn is not sufficiently related to the section's enumerated excusing factors, which envision direct governmental or physical restraints on drilling. These facts would prevent bringing the operator's plight within a conventional force majeure clause. Section 25, however, is drafted in a manner that might avoid these objections. It requires an occurrence that is beyond the control of the operator to merely have affected performance "in part" and notes that the condition need not be similar to those enumerated. Nevertheless, the radical departure from prior case law interpreting force majeure clauses might not be so easily overcome. Moreover, the operators could not prove that the downturn in market prices was unforeseeable. The treatment of commercial impossibility or impracticability when a subsequent event prevents the performance of a material condition in a contract, as well as the treatment of profitability in regard to express drilling requirements in private oil and gas leases, underscore the impropriety of viewing potential economic losses as a situation "beyond the control of the operator" that would mandate a discharge of contractual obligations.

This is not to say, however, that economic concerns may not be considered by the BLM in granting discretionary relief. As was noted above, a unit agreement is essentially a contract that may be modified by the parties, and the BLM retained the authority to modify the drilling requirements in a specified situation.[159] The BLM may alter the require-

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automatic termination of federal oil and gas lease for failure to pay rentals); Good Hope Refineries, Inc. v. Benavides, 602 F.2d 998 (1st Cir.), *cert. denied*, 444 U.S. 992 (1979). Although some courts provide limited equitable relief from the consequences of automatic termination under a private lease, and Congress provides for reinstatement of terminated federal leases in certain circumstances, neither case law nor Congress would include financial hardship as an excusing occurrence. *See* 30 U.S.C. § 188(c) (1982); KUNTZ, *supra* note 118, at §§ 36.3-36.5.

159. *See supra* text accompanying notes 3-28.

ments if an alteration in the rate of prospecting and development "is in the interest of attaining the conservation objectives stated in [the] agreement and is not in violation of any applicable Federal or State law."[160] The conservation objectives of a unit are phrased as follows: "Operations hereunder and production of unitized substances shall be conducted to provide for the most economical and efficient recovery of said substances without waste, as defined by or pursuant to State or Federal law or regulation."[161] Although the definition of waste contained in the Mineral Leasing Act regulations appears to be directed to physical waste only, this provision is broad enough to cover economic waste if economic waste is recognized elsewhere in federal or state law.[162]

Economic waste may be defined as allowing resources to be disposed of at less than their absolute worth.[163] Some states define waste to include economic waste in this sense.[164] The Supreme Court has recognized that regulation to prevent economic waste is a valid exercise of the states' police powers, at least when the subject has not been preempted by federal statutes.[165] More importantly, Congress also has indicated that

160. 43 C.F.R. § 3186.1(21) (1986).

161. *Id.* § 3186.1(16). Also, the "whereas clause" of the Model Unit Agreement provides, "the purpose[s] of the parties hereto [are] to conserve natural resources, prevent waste, and secure other benefits obtainable through development and operation of the area subject to this agreement." *Id.* § 3186.1. A unit agreement will be approved if it is "necessary or advisable in the public interest and is for the purpose of more properly conserving natural resources." *Id.* § 3183.3-1. Also, 30 U.S.C. § 226(j) (1982) authorizes unitization "[f]or the purpose of more properly conserving the natural resources of any oil or gas pool, field, or like area." *Id.*

162. 43 C.F.R. § 3160.0-5 (1986) defines waste as:

> Any act or failure to act by the lessee that is not sanctioned by the . . . [BLM] as necessary for proper development and production and which results in (1) a reduction in the quantity or quality of oil and gas ultimately producible from a reservoir under prudent and proper operations, or (2) avoidable surface loss of oil or gas.

Id.

163. *Cf.* Cities Serv. Gas Co. v. Peerless Oil & Gas Co., 203 Okla. 35, 220 P.2d 279, *aff'd*, 340 U.S. 179 (1950).

> Natural gas being exhaustible and of various valuable usage, the public interest extends to its conservation. Undoubtedly the price at which gas may be obtained has an influence upon the ultimate purpose for which gas may be taken and used, and when the price for gas is substantially lower than its intrinsic value or lower than the market price of products of similar usage, a wasteful use of the gas is apt to occur.

Id. at 43, 220 P.2d at 287-88.

A different definition of economic waste, that of unnecessarily increasing production costs, has been deemed to not apply to Wyoming's definition of waste. *See* Larsen v. Oil & Gas Conservation Comm'n, 569 P.2d 87, 92-93 (Wyo. 1977).

164. Oklahoma statutorily defines "waste" as including "waste incident to the production of [oil or gas] in excess of transportation and marketing facilities or reasonable market demands." OKLA. STAT. tit. 52, §§ 86.2, 86.3 (1981); *see also id.* § 238.

165. Transcontinental Gas Pipeline Corp. v. State Oil & Gas Bd. of Mississippi, 106 S. Ct. 709 (1986); Northern Natural Gas Co. v. State Corp. Comm'n, 372 U.S. 84 (1963); Champlin Ref. Co. v. Corporation Comm'n, 286 U.S. 210 (1932); *Cities Serv.*, 203 Okla. 35, 220 P.2d 279.

in times of overproduction of oil and gas, suspension of drilling and production requirements on federal leases might be in the public interest. In 1933, Congress passed section 39 of the Mineral Leasing Act, enabling lessees to forego rental payments and to receive lease extensions when the Secretary of Interior "in the interest of conservation, shall direct or shall assent to the suspension of operations and production [of oil and/or gas] under any [federal] lease."[166]

Therefore, the BLM may consider the inability of its lessee to obtain a profit due to general market conditions in setting revised drilling schedules pursuant to section 21 of the Model Unit Agreement.[167] This revision would not in itself toll the automatic elimination provisions of the unit agreement but could be viewed as a governmental order preventing the operator from drilling. Therefore, the revision would be unavoidable delay under section 25 of the Model Unit Agreement.

Although the BLM has the authority to provide relief, the BLM should not necessarily exercise this authority. Countervailing public in-

166. 30 U.S.C. § 209 (1982). The legislative history reveals that economic waste was at issue. The Senate Committee on Public Lands and Surveys explained the situaton:

> With regard to production of petroleum and natural gas, it is also a matter of public knowledge that there has existed for some time past, and still exists, a condition of overproduction. This condition has resulted in the adoption by the Interior Department of an administrative policy of conservation of oil and gas . . . .
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> . . . .
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> In other cases, by mutual assent of the lessee and of the department, drilling operations or production have been suspended . . . .

S. REP. No. 812, 72d Cong., 1st Sess. 3 (1932).

See also FEDERAL OIL CONSERVATION BOARD TO THE PRESIDENT OF THE UNITED STATES, REPORT III (Feb. 25, 1929) which states:

> The committee is advised that under this authority [regulations adopted under the Mineral Leasing Act of 1920] during the present period of overproduction the Secretary of the Interior, on the application of lessees, has shut in more than 50 per cent of the possible production from existing wells on the public domain, and has also relieved from the necessity of drilling additional wells in cases where lessees have requested such relief and where it is determined by the Secretary that the cessation of drilling will not result in loss to the United States through drainage from wells on adjoining lands.

Id. at 16.

See also Copper Valley Machine Works, Inc. v. Andrus, 653 F.2d 595 (D.C. Cir. 1981) (discusses the historical context of the statute and also interprets "in the interest of conservation" to include attempts to conserve all natural resources, not just oil and gas).

167. This statement, however, does not mean that the BLM must consider oversupply as a mandatory trigger of suspension of obligations under § 25 of the Model Unit Agreement as alleged by the operators. The definition provides the boundary of BLM's authority under § 21 of the Model Unit Agreement. Additionally, the fact that Congress provided for leases to continue if wells are "shut-in" due to the inability to market gas and for reduction of rental and royalty payments when leases cannot be operated at a profit does not supercede any additional discretionary authority as alleged by the Sierra Club. The provisions alluded to are found at 30 U.S.C. §§ 209, 226(e) (1982). Modification of the rate of prospecting and development is supplemental, discretionary authority retained by the BLM in the Model Unit Agreement. It is a provision authorized expressly by statute to be included in the Agreement.

terests might exist. These include increasing short-term revenues by requiring drilling now, promoting low-cost natural gas for consumers, allowing the market to freely operate, or enabling the public to gain additional revenues from leasing the lands at a later date if the leases lapse. Although the BLM will be responsible for balancing these interests and arriving at a policy determination, certain guidelines may be provided.

It is the opinion of this author that *carte blanche* relief would be inappropriate. The BLM should consider the particular situation of each unit operation from the viewpoint of past diligence. It also should ascertain whether or not conflicting demands for multiple use of the affected lands might render them more valuable if removed from oil and gas production.

On the first issue, it would be appropriate to examine the good faith of the unit operator.[168] Factors relevant to this determination would include the extent of acreage being held relative to the amount of production and the status of the underlying leases. If numerous leases were committed to the unit late in their primary terms simply to avoid expiration, the unit operator and lessees might not have created the unit in a good faith effort to maximize production.[169] Additionally, if the operator had been less than diligent in pursuing development during the initial five years without good cause, this could render relief inappropriate.[170] While the fact-finding might be injurious to an operator's position, the discretionary nature of the relief could also enable the BLM to examine factors that would normally be irrelevant under section 2(e) of the agreement, which requires continual drilling regardless of the relative cost of various wells. If the operator had drilled to depths heretofore unexplored in the area or under extreme difficulties, the expenditure of funds and increase in geological knowledge could influence a good faith determination.[171]

168. This section was crystalized by Handlan & Sykes, *Pooling and Unitization: Legal and Ethical Considerations,* 19 TULSA L.J. 309 (1984).

169. *Cf.* Southwest Gas Producing Co. v. Seale, 191 So. 2d 115 (Miss. 1966); Amoco Prod. Co. v. Underwood, 558 S.W.2d 509 (Tex. Civ. App. 1977).

170. The Sierra Club inappropriately attempted to graft the requirements of "diligent drilling" for an extension of a lease onto the requirement under § 25 that the operator exercise "due care and diligence" to comply with its drilling obligations despite the presence of a "delaying" factor. *Compare* 30 U.S.C. § 226(e) (1982) *with* § 25 of the Model Unit Agreement, 43 C.F.R. § 3186.1 (1986).

171. Koch Exploration Company made the argument that the BLM was ignoring the fact that it could have drilled 10 shallow wells for the cost of its two Monument Valley wells. Koch Exploration Co., No. 86-13. Although this fact would be irrelevant in determining whether Koch had complied with a *continuous* drilling requirement, it could influence discretionary relief. Additionally, Koch argued that in comparing revenues from "similar" leases, as required by the instruction memorandum, the BLM should not simply consider simlarity of BTU content, but should examine the cost

However, oil and gas development is not the sole concern of the BLM. Pursuant to its organic act, the BLM is to consider conflicting uses of the public lands and is not bound to prioritize oil and gas development in all instances.[172] If the BLM is exercising discretion under the Mineral Leasing Act, it can and must examine environmental concerns.[173] Approval may be conditioned on compliance with environmental stipulations or be denied outright, so long as it was not the fault of the BLM that placed the operator or lessee in peril of losing its rights.[174] Moreover, the BLM will be required to analyze its proposed action and any alternatives thereto pursuant to the National Environmental Policy Act.[175]

Although avenues for relief from express drilling obligations do exist for federal operators, these avenues are more tenuous than reliance on the contractual force majeure clause. The BLM will have the right to exercise its discretion not only on a broad policy issue, but also in regard to particular lands. For private operators, unless similar orders are rendered by applicable state regulatory agencies, the force majeure clause may be their only out if express drilling clauses are denominated as special limitations on their leaseholds. Oil producers might have an easier

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to produce the gas. In other words, a suspension would be appropriate if the operator was getting less for its high cost, deep gas than other operators of deep gas wells were receiving. This comparison would be inappropriate in ascertaining whether or not a mandatory suspension is necessary because the BLM was to look at *royalty* revenue. Royalty revenue is free and clear of costs. However, a divergency such as suggested by Koch could be a factor to be considered in granting discretionary relief.

172. 43 U.S.C. § 1701(a)(8) (1982). This section requires that:

> the public lands be managed in a manner that will protect the quality of scientific, scenic, historical, ecological, environmental, air and atmospheric, water resource, and archeological values; that, where appropriate, will preserve and protect certain public lands in their natural condition; that will provide food and habitat for fish and wildlife and domestic animals; and that will provide for outdoor recreation and human occupancy and use.

Id.

The statute also requires that "the public lands be managed in a manner which recognizes the Nation's need for domestic sources of minerals, food, timber, and fiber from the public lands including implementation of the Mining and Minerals Policy Act of 1970. . . ." *Id.* § 1701(a)(12). Naturally, not all goals can be met on each parcel of land. *Id.*; *see also* State v. Andrus, 486 F. Supp. 995 (D. Utah 1979).

The arguments of the Sierra Club and Colorado Open Space Council, while not relevant to a suspension *mandated* by the contract, are exceedingly relevant to any discretionary action. *Compare* Getty Oil Co. v. Clark, 614 F. Supp. 904 (D.C. Wyo. 1985) (appeal pending) (which deals with a discretionary lease suspension) *with* South Dakota v. Andrus, 614 F.2d 1190 (8th Cir.) (no environmental impact statement necessary before patenting a Mining Claim because the BLM has no discretion in patenting the lands if requirements of the Mining Law of 1872 have been met), *cert. denied*, 449 U.S. 822 (1980).

173. Gulf Oil Corp. v. Morton, 493 F.2d 141 (9th Cir. 1973).

174. *Getty Oil*, 614 F. Supp. 904.

175. 42 U.S.C. § 4321 (1982).

time of convincing a court that their difficulties were "unforeseeable" than natural gas producers such as those considered here would have. Naturally, renegotiation with their private lessors might be pursued and drilling requirements altered by offering consideration for an amendment of the lease.