
Lisa S. McCalmont

Follow this and additional works at: https://digitalcommons.law.utulsa.edu/tlr

Part of the Law Commons

Recommended Citation

Available at: https://digitalcommons.law.utulsa.edu/tlr/vol30/iss4/4

This Casenote/Comment is brought to you for free and open access by TU Law Digital Commons. It has been accepted for inclusion in Tulsa Law Review by an authorized editor of TU Law Digital Commons. For more information, please contact megan-donald@utulsa.edu.
I. Introduction

Oklahoma has long held that a mineral lessee who discovers oil and gas on real property earns a leasehold estate in that property, and his right to develop and produce the discovered asset is protected by a public policy against forfeiture of estates. The lessor's rights are implicitly presumed protected because the mineral lessee's development and marketing strategy should ultimately provide benefits for the lessee as well as the lessee. Although this presumption of mutuality of benefit can be valid, circumstances inevitably arise in which the interests of lessee and lessor diverge. In such circumstances, lessors frequently seek to regain control of leases through enforcement of lease termination clauses. Almost as frequently, they are surprised by the lack of legal vigor enjoyed by those clauses.

For years, the Oklahoma Supreme Court has appeared reluctant to formulate a general rule construing mineral lease termination clauses. In Pack v. Santa Fe Minerals, however, the court has finally provided much needed clarification of its perspective on mineral lease terminations. The Pack court concluded that, when a lease has the capability to produce and hydrocarbons have been reduced to the capture and control of the lessee, a lease cannot be terminated, even when express terms of the lease might have been violated. In such circumstances, a lease can only be terminated when the lessees have failed to market their product with due diligence.

3. For example, the interests of lessee and lessor diverge when production levels decrease late in the life of a producing field or when the profitability of a field fluctuates with product price. See Pack v. Santa Fe Minerals, 869 P.2d 323 (Okla. 1994).
4. See discussion infra part IV.
5. See discussion infra part IV.
6. See discussion infra part IV (concluding that no consistent policy was formulated until Pack).
8. Id. at 329.
9. Id.
now interpreted so liberally that it virtually precludes lease termination when the lessee asserts an effort to market the product. As a result, the lessor has been stripped of almost all rights to control the manner of lease termination, which renders lease termination clauses impotent and powerless to provide the protection purportedly offered by their clear and plain language.

The Pack court has treated oil and gas leases not only in a manner which strongly favors the interests of oil and gas companies, but also in a manner which is decidedly different from the treatment typically accorded other property interests and contracts. To evaluate the apparent special construction of oil and gas leases in Oklahoma, this case note will consider the evolution of mineral lease clause construction in Oklahoma, the reasons for the form it has taken, and the impact of the underlying ownership theory. Finally, this case note will consider the direction in which the Oklahoma Supreme Court has moved Oklahoma law with the decision in Pack.

II. Statement of the Case

A. Facts

Pack and others (the Pack lessors) brought this action to quiet title, alleging that Santa Fe Minerals and others (Santa Fe Minerals) allowed their mineral lease agreements to expire by failing to fulfill express terms of the lease, which required the lessees to produce, commence drilling operations, or pay shut-in royalties.

The Pack lessors signed typical oil and gas exploration and production lease agreements with Santa Fe Minerals. The lease agreements provided three mechanisms for maintaining the leases in full force and effect. First, the habendum clause of each lease provided that an extension past the primary (fixed) lease term would be granted as long thereafter as production was maintained on the lease. Second, if production was not maintained, a cessation of production clause provided that the lease could remain in full force and effect if

10. Id. at 331.
11. For coverage regarding the treatment of other property interests, see discussion infra part IV.A.1.a. For coverage of other contracts, see discussion infra part VI.
13. Id. at 325.
14. Id.
15. Id.
drilling operations began within sixty days of the cessation of production.\textsuperscript{16} Finally, if neither production was maintained nor drilling operations begun, a shut-in royalty clause provided that, if shut-in payments were tendered, a lease would be deemed producing within the meaning of the habendum clause and held in full force and effect.\textsuperscript{17}

In \textit{Pack}, the primary term of the leases expired, and the leases were held by production of gas.\textsuperscript{18} To maximize the gas sales price, Santa Fe Minerals chose to shut-in the wells during the summer months and re-open the wells in the winter, when gas prices were higher.\textsuperscript{19} Though both the Pack lessors and Santa Fe Minerals agreed that the wells were capable of production during the summer, there were periods in excess of 60 days in which there were no hydrocarbons produced, no drilling operations commenced, and no shut-in royalties paid.\textsuperscript{20}

\textbf{B. Issues}

The Pack lessors asserted that Santa Fe Minerals' unilateral decision to cease production caused the leases to terminate by their express terms.\textsuperscript{21} The trial court and the Oklahoma Court of Appeals agreed.\textsuperscript{22} The Oklahoma Supreme Court granted certiorari to decide whether Santa Fe Minerals' failure to market gas for more than sixty days constituted a violation of either express or implied lease terms sufficient to merit lease forfeiture.\textsuperscript{23}

\begin{flushleft}
\textsuperscript{16} Pack, 869 P.2d at 327.
\textsuperscript{17} Id. at 325.
\textsuperscript{18} Id. Gas production from Pack leases are subject to production regulation by the Oklahoma Corporation Commission. The Corporation Commission sets annual allowable limits for production from wells in Oklahoma. Allowable limits have historically been set at “fifty percent (50%) of the daily natural flow of any gas well.” \textsc{Okla. Stat. tit. 52, § 29} (1991) (current version at \textsc{Okla. Stat. tit. 52, § 29} (Supp. 1994)). This rule was amended in 1992, and variable rates of production are now allowed. \textsc{Okla. Stat. tit. 52, § 29} (Supp. 1994).

Specifically, between March and October, when gas prices are lower, a gas well may be produced at a rate of “seven hundred fifty thousand (750,000) cubic feet of natural gas per day, or . . . twenty-five percent (25%) of the daily natural [gas] flow.” \textsc{Okla. Stat. tit. 52, § 29} (A)(1)(a)-(b) (Supp. 1994). Whereas, between November and February, during the higher market price winter months, production may be increased to up to “one million (1,000,000) cubic feet of natural gas per day, or . . . forty percent (40%) of the daily natural [gas] flow.” \textsc{Okla. Stat. tit. 52, § 29} (A)(2)(a)-(b) (Supp. 1994).

\textsuperscript{19} Pack, 869 P.2d at 325-26.
\textsuperscript{20} Id.
\textsuperscript{21} Id. at 325.
\textsuperscript{22} Id.
\textsuperscript{23} Pack, 869 P.2d at 325.
\end{flushleft}
The Oklahoma Supreme Court overturned the decisions of the lower courts, holding that, in the secondary lease term, lessees with a well capable of production would not automatically forfeit their estate merely by failing to produce hydrocarbons, begin drilling operations, or pay shut-in royalties. The court further held that the Santa Fe Minerals’ marketing decision to shut-in the wells for more than sixty days (but less than one year) did not violate the covenant to market with due diligence implied in all oil and gas leases.

III. STANDARD PROVISIONS IN OIL AND GAS LEASES

A. Primary and Secondary Lease Terms

Oil and gas leases, which specify the rights and duties of mineral owners (lessors) and exploration/production companies (lessees), are typically divided into primary and secondary lease terms. The primary term is an initial, fixed period for which the lessee is given an exclusive right to explore for oil and gas. If the lessee discovers hydrocarbons as a result of exploration efforts undertaken in the primary term, the lease is extended past the primary term into a secondary term. This secondary term lasts throughout the life of the mineral asset, subject only to the lessee’s compliance with the express and implied terms and covenants in the lease. The primary analysis of this note, however, will focus only on those lease clauses (both express and implied) which govern lease termination during the secondary portion of a lease. They are the clauses which have been the subject of the greatest controversy in Oklahoma law and which have been most strongly impacted by the ruling in Pack.

24. Id. at 331.
25. Id.
26. Williston H. Symonds, The Michelangelo of the Oklahoma Oil & Gas Industry: The Cessation of Production Clause, Spontaneous Lease Terminations, and Cyclical or Marginal Production Problems, 17 OKLA. CITY U. L. REV. 413, 415 (1992) (noting that since mineral interests are rarely owned by those who have the financial capacity to explore for oil and gas, a contract dictating the terms of exploration and production, called an oil and gas lease, is signed between the mineral owner and the lessee).
27. The primary lease term in an oil and gas lease is usually for a period of five or ten years. 8 HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL AND GAS LAW, MANUAL OF OIL AND GAS TERMS 948 (1993). A lease may remain valid if there is no production in paying quantities through drilling operations or by the payment of rentals. Id. At the expiration of the primary term, the lease will remain valid only by fulfillment of the conditions of the habendum clause of the lease. Id.
28. The secondary lease term is described as “[t]he period subsequent to the expiration of the primary term during which the lease or deed is continued in force by operation of the [habendum clause] . . . of the lease or deed.” Id. at 1125.
29. In the secondary portion of the lease, the potentially indefinite duration of the lease period adds complexity to the analysis of lease termination.
B. Clauses of Lease Termination in the Secondary Lease Term

1. Express Clauses

Three expressly enumerated clauses govern the process of lease termination in the secondary lease term. The three kinds of express clauses are the habendum clause, the cessation of production clause, and the shut-in royalty clause.30

The habendum clause describes the general conditions which must be fulfilled to allow a lease to continue in full force and effect.31 Typically, such clauses permit the lease to remain in full force and effect after the primary term only so long thereafter as hydrocarbon production is maintained.32

The cessation of production clause is included in most oil and gas leases to provide a means for continuing the lease in the event that there is a cessation of production resulting from an inability of the well to produce hydrocarbons.33 In the event of such a cessation, this clause provides that the lease may remain in full force and effect but only if the lessee begins drilling operations to generate new production or to restore production within some stated period of time.34

The shut-in royalty clause35 is included in a lease to insure that the lease will not terminate during the secondary term for failure to produce hydrocarbons during a temporary cessation of production because of market unavailability.36 This clause is particularly important

30. See infra notes 32, 34-35 and accompanying text.
31. The habendum clause is defined as: "usually follow[s] the granting part of the premises of a deed, which defines the extent of the ownership in the thing granted to be held and enjoyed by the grantee." BLACK'S LAW DICTIONARY 710 (6th ed. 1990).
32. 8 WILLIAMS & MEYERS, supra note 27, at 1270. A "thereafter clause" in an oil and gas lease is defined as a "clause providing for continued validity of the lessee's interest... subse-
quent to the expiration of the primary term 'so long as' a specified state of affairs continues, e.g., so long as there is production in paying quantities, or so long as drilling operations are prose-
cuted." 8 WILLIAMS & MEYERS, supra note 27, at 1270. For example, a typical habendum clause provides that "this lease shall remain in force for a term of ten years from date [the primary
term] and as long thereafter as oil, or gas, of whatsoever nature or kind, or either of them is produced from said land or drilling operations are continued as hereinafter provided." 8 Wil-
liams & Meyers, supra note 27, at 1270.
33. See sources cited infra note 34.
34. 8 WILLIAMS & MEYERS, supra note 27, at 169 (describing that cessation of production clauses provide for lease continuation when a well holding the lease by its production ceases operation, either temporarily or permanently); see also 4 EUGENE KUNTZ, A TREATISE ON THE
LAW OF OIL AND GAS § 47.3, at 101 (1990) (describing the theories underlying court rulings regarding what constitutes cessation of production within the meaning of the lease clause).
35. 8 WILLIAMS & MEYERS, supra note 27, at 1151. The operation of a shut-in gas royalty clause is particularly important in Oklahoma. In 1990, Oklahoma ranked as the state with the fifth largest volume of natural gas reserves, with 16,151 billion cubic feet of gas. ENERGY STATIS-
36. 8 WILLIAMS & MEYERS, supra note 27, at 1151.
in gas production because gas cannot be stored above ground like liq-
uid petroleum products. Therefore, if the pipeline connection to
a producing gas well is lost for any reason, it can become impossible
for the lessee to market the product. The shut-in royalty clause pro-
vides that the lease may be held in full force and effect and considered
"producing," within the meaning of the habendum clause, if shut-in
royalty payments are tendered by the lessee to the lessor in lieu of the
royalty payments the lessor would receive if the wells were on-line.

2. Implied Clauses

In addition to express covenants controlling lease continuation/ter-
mination in the secondary lease period, covenants are also implied
in every oil and gas lease agreement, the breach of which can also
result in lease termination. The implied covenant most relevant to
the Pack case is the implied covenant to market the product with due
diligence. This covenant is usually interpreted to mean that the
lessee has an obligation "to use due diligence to market products ca-
ble of being produced from the leasehold once they have been
discovered." [42]

IV. Legal Effect Given to Express and Implied Terms in
Oil and Gas Leases

At first glance, the legal interpretation of express and implied
terms appears as though it should be straightforward. However, many
terms that have established meanings in other areas of property law
are interpreted quite differently when applied to oil and gas leases. [43]

that special consideration must be given to gas production because, above ground, "gas . . .
storage is not yet a practical, accepted, or perhaps possible procedure").
38. Nancy J. Forbis, The Shut-In Royalty Clause: Balancing the Interests of Lessors and Les-
sees, 67 Tex. L. Rev. 1129, 1131 (1989) (commenting that "natural gas is difficult, if not im-
possible, to store outside a reservoir, and thus producers must either transport gas to a pipeline as it
is produced or retain it at the wellhead until they can locate a willing purchaser").
39. Id. at 1133-34 (identifying three basic types of shut-in royalty clauses: the first type al-
ows the lessee to shut-in the well if it tenders the appropriate payment when "gas is not sold or
used," the second type allows the lessee to shut-in the well when "no market from a major gas
line is available" or when a "market does not exist," the third type allows the well to be shut-in
for "lack of a market").
40. 5 Howard R. Williams & Charles J. Meyers, Oil and Gas Law, Manual of Oil
42. Roger D. Williams, Lessee Duties and Lessor Rights in Gas Contracting Under The Im-
43. See discussion infra parts IV.A.1.a-c.
Understanding how these terms have evolved and have been construed in Oklahoma is the key to understanding the court’s position in Pack. The most beneficial method to comprehend the various constructions applied to the terms of oil and gas leases is to look at each term individually; once understood in isolation, the effect of the terms interacting together, as a gestalt, can be better understood.

A. Habendum Clause

As noted above, a typical habendum clause in an oil and gas lease contains the express statement that the lease shall remain in full force and effect so long thereafter as production is maintained. The two operable terms in the habendum clause are: (1) “so long thereafter as;” and (2) “production.”

1. “So Long Thereafter As”

“So long thereafter as” will be recognized by many as a term of art, used in many types of conveyances. To understand the unusual construction given these words in oil and gas leases, this note will first illustrate how these words are construed in deeds, in general. Next, this note will review the use of these words in mineral deeds and analyze their construction in oil and gas leases.

a. “So Long Thereafter As” Constrained in Deeds

Non-oil and gas specialists will be most familiar with the language “so long thereafter as” as it is commonly used in a deed. In that context, these words denote the granting of a fee simple determinable estate. Such an estate is one that automatically re-vests an estate in the grantor upon the occurrence of some specified condition. Indeed, Oklahoma courts have long upheld this meaning in conveyances of deeds.

In Frensley v. White, the Oklahoma Supreme Court outlined the formation of, and enumerated the rights and duties associated with,

---

44. See supra note 32 and accompanying text.
45. See infra note 47 and accompanying text.
46. “A ‘fee simple determinable’ is created by conveyance which contains words effective to create a fee simple and, in addition, a provision for automatic expiration of estate on occurrence of stated event.” Black’s Law Dictionary 615-16 (6th ed. 1990).
47. Oklahoma City v. Local Fed. Sav. & Loan Ass’n, 134 P.2d 565, 570 (Okla. 1943) (confirming that in Oklahoma the phrase “so long as” used in a conveyance connotes the granting of a fee simple determinable estate); see also Ludwig v. William K. Warren Found., 809 P.2d 660, 661 (Okla. 1991).
estates granted on condition. The court explained that there are two types of estates granted on condition, the fee simple determinable and a fee simple on condition subsequent. The difference between these estates is the effect created by the occurrence of the conditional event. If a fee simple determinable estate has been granted, the estate automatically re-vests in the grantor upon occurrence of the conditional event. Whereas, the grantor is limited to the power of reentry in a fee simple on condition subsequent.

In Frensley, the court recognized that the type of estate conveyed is indicated by specific language used in the conveyance and the expressed intent of the grantor. A conveyance of a fee simple determinable is denoted by "the use of the words 'so long as' . . . creat[ing] an estate upon conditional limitation rather than upon condition subsequent." Oklahoma's view of the "so long as" language applied to conveyances on condition is fairly common and is similar to the interpretation of the words used in many other jurisdictions.

b. "So Long Thereafter As" Construed in Mineral Deeds

Though Oklahoma courts interpret the language "so long thereafter as," when used in a deed, as creating a fee simple determinable estate, Oklahoma does not take that view for all conveyances using such language. In fact, with regard to mineral interests, Oklahoma accepts this construction only when applied to mineral deeds, not when applied to mineral leases.

49. Id. at 984.
50. Id.
51. The determinable fee upon conditional limitation is a fee simple, "except that it is immediately terminated by the happening of some possible event, subsequently." Id. In Pack, for example, the consequence of finding that a fee simple determinable had been created through the use of the language "so long as" in the lease would be the automatic forfeiture of the lease for violation of any of the express lease terms.
52. The fee simple on condition subsequent is a fee simple, "except that it may be terminated by the grantor by reentry upon the happening of some possible event, subsequently." Frensley, 254 P.2d at 984.
53. Id. at 985.
54. Id. at 984.
56. See supra note 47 and accompanying text.
57. 1 Eugene Kuntz, A TREATISE ON THE LAW OF OIL AND GAS § 15.8, at 457 (1987) (stating that "[i]n Oklahoma, the court has observed that the grantee under a terminable interest
The type of interest conveyed by a mineral deed, and the nature of the termination of such an interest, was considered by the Oklahoma Supreme Court in *Fransen v. Eckhardt*.58 Fransen was the grantee of a warranty deed from Eckhardt, dated January 22, 1952.59 The deed expressly reserved mineral interests to Eckhardt for thirty years and *as long thereafter as* production was maintained.60 Though no hydrocarbons were originally produced, gas was ultimately produced to the pipeline on May 5, 1982, some thirty years and two and one-half months after the original warranty deed grant.61 Fransen brought an action to quiet title, asserting that Eckhardt’s mineral interest had terminated for failure to produce hydrocarbons within the stated thirty year period.62 The Oklahoma court considered both whether the deed reserving the mineral interests created a fee simple determinable estate and whether the mere discovery of hydrocarbons could satisfy the meaning of “production” within the habendum clause.63

The court determined that the estate had terminated automatically during the primary term upon the occurrence of an explicitly stated condition (failure to produce hydrocarbons within thirty years).64 The court reasoned that a mineral deed reversion will be treated strictly because:

> [j]n a terminable mineral interest, the parties do not contemplate activity by the grantee to produce the minerals for the mutual benefit of grantee and the reversioner. The owner of the terminable mineral interest has the right of ingress and egress but this right is for his/her own benefit. The continuation of the fixed term of the terminable interest may be set by whim, . . . or by references to purposes other than that of stimulating discovery of oil and gas.65

---

58. 711 P.2d 926 (Okla. 1985).
59. Id. at 927.
60. Id. (reserving in the grantors an “undivided one-fourth (1/4) interest”).
61. Id. (noting the well was “shut-in to await connection to a gas pipeline”).
63. Id. at 927.
64. Id. at 930-31. One commentator describes the attributes and classifications of a terminable interest as follows:

> A common type of terminable interest is one which is designed to endure for a fixed period of time and so long thereafter as there is production. Because such an interest is capable of enduring indefinitely, it may be classified as a fee; but because it may not endure indefinitely, but is capable of termination at the happening of a certain event, it may be classified as a determinable fee.

Kuartz, supra note 57, § 15.8, at 454.
Because there is no mutuality of benefit between the actions of the grantor and grantee of such an estate, the construction of the deed is construed as automatically terminating on the occurrence of the conditional event.

Similarly, in *Ludwig v. William K. Warren Found.*, the court held that the conveyance of a mineral deed, subject to a condition "so long as production was maintained" was the conveyance of a fee simple determinable estate. Specifically, the court stated that "[w]hen a mineral deed is given for a term and so long thereafter as oil and gas is produced, the conveyance transfers an estate determinable upon a conditional limitation." In holding that the estate had automatically terminated (and re-vested in grantors) upon the occurrence of the conditional event, the court reasoned that the normal policy against forfeiture of estates recognized in oil and gas leases must be distinguished from deeds of mineral interest because the mineral deed concerns the underlying ownership of the minerals and not the right to produce.

The court further commented that, in oil and gas leases, the prohibition against forfeiture is both "warranted and commendable." Due to the lessee’s large expenditure in acquiring production, the court reasoned that his right to produce should not be canceled because "he should be allowed every chance to profit from what is, at the best of times, a risk and oftentimes simply a gamble." However, where the underlying fee is concerned, the policy must be different because, "[p]roperly analyzed, this case concerns a reversion, not a forfeiture;" which requires the terms of the mineral deed to be strictly enforced.

---

66. *Id.*
67. *Id.*
69. *Id.*
70. *Id.*
71. *Id.* at 663 (affirming both the trial and appellate court rulings).
73. *Id.*
74. *Id.*
75. *Id.* But see Beatty v. Baxter, 258 P.2d 626, 627-29 (Okla. 1953) (holding that, when the cessation of production was reasonable under the particular facts and circumstances, the grantee's estate would not automatically re-vest in the grantor as a result of the mineral lessee's failure to produce).
c. "So Long Thereafter As" Constrained in Oil and Gas Leases

Oklahoma decisions clearly draw a distinction between oil and gas leases and mineral deeds.\textsuperscript{76} A recent Oklahoma Court of Appeals decision, \textit{Danne v. Texaco Exploration and Prod. Inc.},\textsuperscript{77} considered whether a lease in the secondary lease term could ever terminate automatically.\textsuperscript{78} The court discussed the different treatment between primary and secondary lease terms as follows:

\begin{quote}
[i]n the primary term, before hydrocarbons are discovered, the lessee [only] has the right to explore for a fixed period of time. If he fails to discover hydrocarbons within the enumerated period, he must either buy more time (through payment of something like a delay rental) or lose the lease when the term has expired. When the time runs out on the primary term, the estate is not forfeited, it simply ceases to exist by its own terms, a simple terminable estate. Automatic termination of the lease at this stage of exploration does not divest the lessee of valuable assets, since no assets have yet been proved.\textsuperscript{79}
\end{quote}

Once the lessee discovers hydrocarbons and has the capability to produce, the equities of lease termination are governed by different considerations.\textsuperscript{80} After the lessee discovers hydrocarbons, the manner of lease termination is governed, not by elapse of the primary term, but rather by the conditions in the secondary lease term,\textsuperscript{81} particularly the habendum clause.

Other jurisdictions have construed such habendum clauses (those using a "thereafter" provision) as conveyances of conventional determinable fee estates in both primary and secondary lease terms.\textsuperscript{82} Oklahoma does not take this view for the secondary period of the lease term.\textsuperscript{83} In \textit{Stewart v. Amerada Hess Corp.},\textsuperscript{84} the Oklahoma...
Supreme Court held that "[t]he occurrence of the limiting event or condition does not automatically effect an end to the right."\(^{85}\) Because of Oklahoma's strong policy against forfeiture of estates,\(^ {86}\) the court followed the firmly settled law that the result in each case must depend upon the circumstances that surround cessation.\(^ {87}\)

As a result, Oklahoma follows the rule that the term "so long thereafter as," when used in a mineral lease habendum clause, will not be construed in the secondary portion of the lease as a term of special limitation which would permit automatic lease termination.\(^ {88}\) However, even though use of the classic determinable fee language does not mandate automatic forfeiture, a lessee holding a lease in the secondary term does have other duties and obligations to the lessor.\(^ {89}\)

2. "Production"

Initially, early Oklahoma oil and gas leases stated that a lease could remain in full force and effect only if production in paying quantities was established.\(^ {90}\) However, as described in *Pine v. Webster*,\(^ {91}\) production in paying quantities requires more than mere discovery of hydrocarbons.\(^ {92}\) Although this early decision made clear that merely encountering a show of hydrocarbons with an exploratory well could not constitute production in paying quantities, it declined to enumerate the requisite qualities of such production.\(^ {93}\) The meaning of "production" was further clarified in *Walden v. Potts*.\(^ {94}\) In *Walden*, the court found that Oklahoma is "committed to the rule that the clause in an oil and gas lease continuing the lease in force as long as oil or gas is produced in 'paying quantities' means . . . produc[tion] in such quantities as will pay a profit to the lessee over operation expenses."\(^ {95}\)

---

85. *Id.* at 858. (noting further that, though the express language used in an oil and gas lease habendum clause looked like the language used to create a fee simple determinable estate, such estates were not created. "The 'thereafter' clause is . . . not ever to be regarded as akin in effect to the common-law conditional limitation or determinable fee estate").


87. *Id.*

88. See supra notes 84-87 and accompanying text; see also discussion infra part V.

89. For example, the lessee must still maintain "production" within the meaning of the habendum clause. See discussion infra part IV.A.2. The meaning of "production" remains the subject of much controversy.

90. See infra notes 91-103 and accompanying text.

91. 246 P. 429 (Okla. 1926).

92. *Id.* at 430-31.

93. *Id.* at 429-31.

94. 152 P.2d 923 (Okla. 1944).

95. *Id.* at 924.
Production in excess of lifting costs will satisfy the meaning of “produced in paying quantities, though it may never repay the cost of drilling and equipping the well or wells.”96 Similarly, in Henry v. Clay,97 the court held that “production,” when used in an oil and gas lease habendum clause, means “producing” when used in an oil and gas lease habendum clause, means “producing” within the meaning of the habendum clause.100 The court concluded that “[t]he term ‘produced,’ when used in a ‘thereafter’ provision of the habendum clause, denotes in law production in paying quantities.”101 Paying quantities were further defined as production “in quantities sufficient to yield a return . . . in excess of ‘lifting expenses,’ even though well drilling and completion costs might never be repaid.”102 Though these cases established the rule that a lessee could only hold a lease that was economically viable,103 it was still not clear whether actual production had to be achieved or whether mere capability to profitably produce was sufficient to hold a lease.

In an important step in the evolution of oil and gas law, the Oklahoma Supreme Court broadened the definition of “production” in a mineral lease to encompass “capability to produce.”104 In State ex rel. Commissioners of the Land Office v. Carter Oil Co.,105 a well, capable of production, was drilled and completed on the lease within the 5 year primary term.106 However, due to the unavailability of a pipeline, gas from the well was not marketed within the primary lease term.107 The question before the court was whether such a well (namely, one that has discovered gas and is capable of production in paying quantities but is not yet producing) can satisfy the meaning of

---

96. Id.
97. 274 P.2d 545 (Okla. 1954).
98. Id. at 546 (stating that “[i]f the well pays a profit even though small, over operating expenses, it produces in paying quantities, though it may never repay its costs, and the operation as a whole may prove unprofitable”).
100. Id. at 856.
101. Id. at 857.
102. Id.
103. See supra text accompanying notes 90-102.
104. See infra notes 105-10 and accompanying text.
106. Id. at 1091.
107. Id. at 1093.
production in the primary term of an oil and gas lease. The court held "capability to produce" sufficient to satisfy the requirements of the habendum clause:

provided that within a reasonable time... a market is obtained and oil or gas is produced and sold from such well. In such event if the producing and marketing thereof in such quantities from the well so completed is continued, the lease will extend until the economic exhaustion of the product.

Though the decision in Carter can arguably be said to affect only the primary lease term, the definition of production as "capability to produce" has been applied to production in the secondary term of the lease as well.

B. Cessation of Production Clause

A typical cessation of production clause can be found in Hoyt v. Continental Oil Co. Hoyt (the lessor) brought an action to cancel a lease, claiming that the lessees had violated the express terms of the "cessation of production" clause. That clause required the lessees to resume drilling operations within sixty days in the event of any cessation of production in the secondary lease term. After production ceased from the primary producing horizon, Hoyt demanded, in writing, either lease cancellation or lease development. The lessees responded that they were attempting to negotiate a gas sale contract from a secondary horizon that had not been tested or completed. Indeed, six months later, a contract was successfully negotiated. Hoyt nevertheless claimed that, under its own terms, the lease had expired because of the lessees' failure to satisfy the terms of the cessation of production clause. He demanded release from the lease and sought damages for lost income during the period in which the well

108. Id.
111. 606 P.2d 560 (Okla. 1980).
112. Id. at 561.
113. Id.
114. Id. at 562.
115. Hoyt, 606 P.2d at 562.
116. Id.
117. Id.
was not active. The trial court granted Hoyt partial summary judgment, canceling the lease because of the lessees’ failure to resume drilling within the sixty day period. The Oklahoma Supreme Court affirmed the trial court judgment and ruled that, where the “cessation of production clause” modifies the habendum clause and the parties have expressly negotiated for a specific period of time during which cessation of production can be allowed, the negotiated provision “will control over the common law doctrine of temporary cessation allowing a ‘reasonable time’ for resumption of drilling operations.” The common law doctrine is only applicable when the cessation of production is purely temporary, not, as in this case, when the cessation of production exceeded the bargained-for sixty day period.

Commentators have criticized the apparent literal interpretation of the cessation of production clause in Hoyt. It should be noted, however, that the circumstances under which the Hoyt ruling was issued are narrow. After holding that a bargained-for cessation of production clause controls over the common law doctrine of a reasonable time, the Hoyt court emphasized that the operator had curtailed production from the primary producing horizon (the horizon which originally held the lease) and was making no attempt to re-initiate that production. The operator contended that a newly identified secondary horizon (known to contain gas, but untested) could hold the lease by its potential for production. The court held that the protection offered under the implied covenant to market (a reasonable time in which to seek a market for the product) is extended only when the operator has reduced the gas to his “dominion and control.” Without completions or tests to establish its viability, the potential of

118. Id.
119. Hoyt, 606 P.2d at 564.
120. Id. at 563.
121. Id.
122. John S. Lowe, The Meaning of Cessation of Production: Hoyt v. Continental Oil, 52 Okla. B.J. 980, 982 (1981) (rejecting interpretation by the Oklahoma court and arguing that reference to cessation of “production” in Hoyt should have been interpreted to mean total cessation); Keith F. Sellers, Note, Oil and Gas: The Cessation of Production Clause in the Oklahoma Lease, 33 Okla. L. Rev. 645, 661, 663-64 (1980) (noting that most commentators interpreted Hoyt as indicating that “cessation of production clause[s] in . . . Oklahoma oil and gas lease[s] will be strictly construed”).
123. See infra notes 124-27 and accompanying text.
125. Id. at 563.
126. Id. at 564.
the secondary horizon was inchoate, and could not serve to protect the lease.\textsuperscript{127}

Similarly, in \textit{French v. Tenneco Oil Co.},\textsuperscript{128} the lessors alleged that a lease, held in its secondary term by production from a single well, expired because of the lessee's failure to commence drilling operations as specified by the cessation of production clause.\textsuperscript{129} The cessation of production clause required the lessee to resume operations for drilling a well within sixty days from cessation and permitted the lease to remain in full force and effect during the prosecution of such operations.\textsuperscript{130}

Though the lessees began operations to condition the well within the sixty day period, no production was restored and no drilling operations were commenced.\textsuperscript{131} Because the lessees failed to adhere to the expressly bargained-for terms of the lease, the Oklahoma Supreme Court, relying on \textit{Hoyt}, affirmed the trial court's cancellation of the leases.\textsuperscript{132} As with the \textit{Hoyt} ruling, the underlying factual circumstances in \textit{French} require careful analysis. Because swabbing, injecting, reperforating and fracturing the well failed to reestablish production, it was evident that the \textit{French} lease was incapable of further production.\textsuperscript{133} In this limited circumstance, the court held that cessation of production clause must be interpreted literally;\textsuperscript{134} failure to fulfill the lease conditions will result in forfeiture.\textsuperscript{135}

A careful reading of the \textit{Hoyt} and \textit{French} rulings reveals that those holdings do not extend a literal interpretation of the cessation of production clause to circumstances where the lease has the capability to produce.\textsuperscript{136} In fact, when differentiating \textit{Hoyt} and \textit{French} from \textit{Pack}, the Oklahoma Supreme Court relies on the distinction that the \textit{Hoyt} and \textit{French} wells were "not capable of production in paying quantities."\textsuperscript{137}

\textsuperscript{127} Id. (inferring conclusion from the analysis in \textit{Hoyt}).
\textsuperscript{128} 725 P.2d 275 (Okla. 1986).
\textsuperscript{129} Id. at 276.
\textsuperscript{130} Id. at 275-76.
\textsuperscript{131} Id. at 276.
\textsuperscript{132} French, 725 P.2d at 277-8.
\textsuperscript{133} Id. at 276-77.
\textsuperscript{134} Id.
\textsuperscript{135} Id.
\textsuperscript{137} Id.
C. Shut-in Royalty Clause

The last type of express clause which can govern lease continu-ation/termination is the shut-in royalty clause. It is envisaged that, in the normal course of gas well operations, a well may need to be temporarily shut-in when there is no market available for the gas.\textsuperscript{138} The shut-in royalty clause provides that, if shut-in royalty payments are made by the lessee to the lessor in lieu of the royalty payments the lessor would otherwise receive, the lease may be held in full force and effect and considered “producing” within the meaning of the habendum clause,\textsuperscript{139} the effect of which is preventing lease termination.\textsuperscript{140}

As with other clauses considered above, the fundamental question concerning shut-in royalty clauses is whether failure to honor their terms results in automatic forfeiture of the lease. This issue was considered in \textit{Gard v. Kaiser}.\textsuperscript{141} where lessors sought to cancel a mineral lease for the lessee’s failure to pay shut-in royalties.\textsuperscript{142} In \textit{Gard}, a well was completed and production commenced within the primary term of the leases.\textsuperscript{143} Gas was produced into the secondary lease term until the pressure became too low to move gas into a pipeline.\textsuperscript{144} Although the well was shut-in for three years, no shut-in royalty payments were made to the lessor (even though such payments were required by the express terms of the lease);\textsuperscript{145} the lessee did, however, attempt to find an alternative market for its product during this period.\textsuperscript{146}

Though it was clear that the lessee violated an express term of the lease, the trial court held that the lessee’s failure was not sufficient to cause lease forfeiture because the lessee was diligently searching out a market for its product.\textsuperscript{147} The Oklahoma Supreme Court upheld the trial court’s ruling, finding that it was not “against the clear weight of the evidence.”\textsuperscript{148} Ultimately, the court concluded that when a lessee diligently attempts to secure a market for its gas (evidenced in this

\begin{itemize}
\item \textsuperscript{138} 8 WILLIAMS & MEYERS, supra note 27, at 1151.
\item \textsuperscript{139} 8 WILLIAMS & MEYERS, supra note 27, at 1151.
\item \textsuperscript{140} 8 WILLIAMS & MEYERS, supra note 27, at 1151.
\item \textsuperscript{141} 582 P.2d 1311 (Okla. 1978).
\item \textsuperscript{142} Id.
\item \textsuperscript{143} Id. at 1312.
\item \textsuperscript{144} Id.
\item \textsuperscript{145} \textit{Gard}, 582 P.2d at 1312 (noting the shut-in royalty clause of these leases provided that, if gas from a producing well is not sold or used, the lessee could satisfy the habendum clause by paying a royalty at a fixed amount per net royalty acre retained).
\item \textsuperscript{146} Id.
\item \textsuperscript{147} Id. at 1311.
\item \textsuperscript{148} Id. at 1315.
\end{itemize}
case by the trial court’s finding that the lessee had successfully acquired a market in 1975), the “shut-in gas provisions are not to be construed as limitations or conditions which would affect termination of the leases.”

D. **Implied Covenant To Market**

Though the Oklahoma Supreme Court has held that, once a lease has the capability to produce, none of the express clauses of lease termination can be treated so literally that a breach would result in automatic forfeiture, most standard leases are nonetheless subject to an implicit requirement that the lessee must market the product with due diligence.

One of the first cases in Oklahoma to consider the interplay between express lease terms and the implied covenant to market was *Cotner v. Warren.* In this case, a mineral lessee, Warren, brought an action to quiet title to an oil and gas leasehold estate against the mineral lessor, Cotner. Warren had purchased a leasehold estate from another mineral lessee, who had been holding the lease in its secondary term with production coming from a single well. Five months prior to Warren’s purchase of the leasehold, his predecessor in interest had shut-in the well’s production. The Cotners asserted that this voluntary cessation of production from the well caused the lease to terminate according to the terms of the lease’s habendum clause. The Oklahoma Supreme Court held that where a lease’s termination is governed solely by a standard habendum clause, it cannot be automatically terminated by a voluntary cessation of production without a review of the facts and circumstances of the cessation. Lease termination can only be granted when the cessation of production was unreasonable.

---

152. *Id.* at 218.
153. *Id.*
154. *Id.* at 219.
155. *Cotner,* 330 P.2d at 219. The terms of the lease habendum clause provided that the lease should remain in full force and effect “for a term of one year from date, and as long thereafter as oil or gas or either of them, is produced from said land by the lessee.” *Id.* at 218.
156. *Id.* at 219. “[T]he only fair and just rule is to hold that the lease continues in force unless the period of cessation, viewed in the light of all the circumstances is for a unreasonable time.” *Id.* (quoting *Lamb v. Vansyckle,* 266 S.W. 253, 254 (Ky. 1924)).
157. *Id.*
The Oklahoma Supreme Court further considered the implied covenant to market in *McVicker v. Horn, Robinson & Nathan.* In affirming a trial court judgment for the defendant lessees, the court stated that, absent an express clause directing the lessee to market the product, a lease could only be viewed as having, at most, an implied covenant to market. Failure to market the product might, therefore, not result in automatic lease termination; a lessor must allow a reasonable period for marketing the product. In this case, though gas was never marketed or sold, the lessees did attempt to market the product. Despite the well's gas pressure, which was too low to permit connection to a local pipeline, the lessees persisted in their efforts to alternatively market their product. These efforts continued from the time the well was completed throughout the pendency of the lawsuit. Under these facts and circumstances, the court confirmed the trial court's finding that the defendant lessees fulfilled their obligation to market the product and should not now be deprived of the benefit of their efforts to secure a market. The court did clarify, however, that a lessee cannot hold a lease in perpetuity with only a good faith effort to market. Where "there is no reasonable probability [that the lessee's efforts] will be successful, or it appears that others, with less effort, would succeed where they have failed," lease termination can be justified.

Following the reasoning set out in *McVicker,* the Oklahoma Supreme Court reversed a trial court grant of summary judgment to a defendant oil company and remanded for a finding of fact relative to the circumstances of the defendant's failure to market in *Townsend v. Creekmore-Rooney Co.* The court explained that, in addition to discovering hydrocarbons and completing a well, the "lessee has the

---

158. 322 P.2d 410 (Okla. 1958).
159. Id. at 413-14.
160. Id. at 414 (holding that "[i]t therefore follows that [the lease] cannot be held to have terminated ipso facto, or by its express terms, ... [i]t also follows that the defendant lessees had a reasonable time after completion of the well to start marketing its product").
161. Id. at 415.
163. Id. at 415.
164. Id. at 415-16.
165. Id. at 416.
166. *McVicker,* 322 P.2d at 416 (holding that leases cannot be held indefinitely) (citing *Bristol v. Colorado Oil & Gas Corp.*, 225 F.2d 894, 897 (10th Cir. 1955)).
167. Id.
additional duty to market the oil and gas produced." The court suggested that when the failure to market results in spite of "reasonably diligent efforts [and other circumstances which could] excus[e] the lessees' default," cancellation of the lease will not be considered appropriate.

In *State ex rel. Commissioners of the Land Office v. Carter Oil Co.*, the court considered whether Carter Oil exercised due diligence to find a market after discovering and completing a gas well within the primary lease term. Since the operators diligently sought a pipeline contract after the well was completed (and secured the contract within one year of the completion of the gas well), the court concluded that "due diligence was exercised in the seeking and obtaining of a market as required by the practical exigencies of the situation . . . and that such market was found within a reasonable period of time under [the] circumstances."

As strongly as the aforementioned cases stand against automatic termination of a lease for failure to produce hydrocarbons, there are Oklahoma cases where the lessor has quieted title because the lessee failed to develop or produce the product. For example, in *Hunter v. Clarkson*, the Oklahoma Supreme Court quieted title in the lessor because the lessee ceased to regularly produce a well in the secondary lease term. The court held that the lessee had a duty to produce, not just to lessee's advantage, but also to the advantage of the lessor. The court explained that the landowner's interest will be protected "when the operator ceases production for an unreasonable time, without cause, after the expiration of the primary term."

In considering the interaction of the implied covenant to market and the shut-in royalty clause, the court in *Gard v. Kaiser*, ruled that failure to pay shut-in royalty payments according to the terms of

169. *Id.* at 38.
170. *Id.*
171. *Id.*
172. 336 P.2d 1086 (Okla. 1958); *see supra* notes 104-10 and accompanying text.
174. *Id.*
175. See discussion *supra* parts IV.A-C.
176. *See infra* notes 177-80 and accompanying text.
177. 428 P.2d 210 (Okla. 1967).
178. *Id.* at 211.
179. *Id.* at 213.
180. *Id.*
181. 582 P.2d 1311 (Okla. 1978); *see also supra* notes 141-49.
the lease cannot cause lease termination as long as the lessee is diligently searching out a market for the product.\textsuperscript{182} In \textit{Gard}, the lessees initially marketed gas from the well, but stopped production without making shut-in royalty payments when the gas pressure became too low to move gas into a pipeline.\textsuperscript{183} The lessee first attempted to reduce the pipeline pressure,\textsuperscript{184} then requested release from its gas take contract,\textsuperscript{185} and ultimately signed a new contract resulting in re-initiation of production.\textsuperscript{186} The court found these efforts sufficiently diligent, in spite of the lessee’s failure to pay shut-in royalties as required in the lease.\textsuperscript{187}

Similarly, in \textit{Stewart v. Amerada Hess Corp.},\textsuperscript{188} the court held that a lease would not automatically terminate for failure to produce hydrocarbons in paying quantities within the meaning of the habendum clause.\textsuperscript{189} However, the court stated that the effect of failure to produce must be analyzed according to the facts and circumstances of each case.\textsuperscript{190} If the circumstances surrounding the failure to produce indicated that the cessation of production was unreasonable or unjustifiable and there were “no compelling equitable considerations to justify continued production,” the lease may be terminated.\textsuperscript{191}

Since the \textit{McVicker} ruling, Oklahoma has recognized implied covenants in oil and gas leases, particularly the implied covenant to market.\textsuperscript{192} The implied covenant to market can be fulfilled by a diligent effort to seek out a market,\textsuperscript{193} the required diligence proven by

\begin{enumerate}
\item [182] \textit{Gard}, 582 P.2d at 1313-14.
\item [183] \textit{Id.} at 1312.
\item [184] \textit{Id.}
\item [185] \textit{Id.}
\item [186] \textit{Gard}, 582 P.2d at 1312.
\item [187] \textit{Id.} at 1315. \textit{See generally State ex rel. Commissioners of the Land Office v. Amoco Prod. Co.,} 645 P.2d 468, 471 (Okla. 1982) (holding that when a cessation of production is caused by mechanical difficulties, the lease can be maintained by the lessee’s diligent efforts to drill a replacement well. Diligence in operations can be likened to diligence in seeking out a market, where equitable considerations will govern the lease termination) (citing Durkee v. Hazan, 452 P.2d 803 (Okla. 1968); Kerr v. Hillenberg, 373 P.2d 66 (Okla. 1962); Cotner v. Warren, 330 P.2d 217 (Okla. 1958)).
\item [188] 604 P.2d 854, 858 (Okla. 1979).
\item [189] \textit{Id.}
\item [190] \textit{Id.}
\item [191] \textit{Id.; see also Barby v. Cabot Corp.,} 550 F.Supp. 188, 190 (W.D. Okla. 1981) (stating that “[u]nder Oklahoma law a producer has a duty to market the gas produced from a well and to obtain the best price and terms available. . . . The burden of proving that a producer has violated this duty is upon the lessor”) (citations omitted); Tara Petroleum Corp. v. Hughey, 630 P.2d 1269, 1274 (Okla. 1981) (holding that “[t]he burden of proving that a gas purchase contract was unfair or unreasonable at the time it was entered into is on the lessor seeking additional royalty”).
\item [193] \textit{See} cases cited \textit{supra} note 187.
\end{enumerate}
an active and continuous solicitation of a market for the product.\textsuperscript{194} However, in no case has the court held that a lessee may wait indefinitely to find a market price capable of generating a specific profit margin without risking lease termination.\textsuperscript{195} It is also clear that a lessee who relies on his diligent solicitation of a market to hold a lease must actually have a well that has the present capability to flow any time a market is found.\textsuperscript{196}

V. Decision in Pack

In presenting the Pack decision, the Oklahoma Supreme Court reviewed the operation of each of the express lease clauses and also the implied covenant to market.\textsuperscript{197} First, the court held that Santa Fe Minerals' lease did not terminate for failure to produce within the meaning of the habendum clause because a well capable of production at all times satisfies the meaning of "production."\textsuperscript{198} Affirming the court's ruling in Stewart, the Pack court commented that Oklahoma "reject[s] . . . a literal construction of the habendum clause" and refused to hold that voluntary cessation of production automatically causes lease termination.\textsuperscript{199}

The court next reviewed the operation of the cessation of production clause.\textsuperscript{200} Though the Pack lessors argued that the term "cessation of production" literally means any interruption in production for a period longer than the sixty days specified in the clause, the court disagreed.\textsuperscript{201} The court concluded that the cessation of production clause cannot be interpreted in isolation, but rather, it must be viewed in context with the entire lease agreement.\textsuperscript{202} Viewed in this fashion,
the cessation of production clause must be construed with a meaning that is consistent and complimentary with the meaning of the habendum clause.\textsuperscript{203} The court reasoned that since "production" used in the habendum clause means "capability of production," "production" used in the cessation of production clause must also mean "capability of production."\textsuperscript{204} The court further asserted that the cessation of production clause is not meant to take effect in the event of a temporary failure to market the product or a temporary mechanical difficulty, but rather, the clause contemplates the complete and irretrievable failure of the ability to produce from the well.\textsuperscript{205} Finally, the court distinguished the facts in \textit{Pack} from those in \textit{Hoyt, French, and Hamilton v. Amwar Petroleum Co.},\textsuperscript{206} suggesting that the subject wells in those cases all failed to be "capable of production;"\textsuperscript{207} therefore, termination of their leases was appropriate.\textsuperscript{208}

Thus, the court concluded that the failure Santa Fe Minerals to either produce or prosecute drilling operations for a period greater than sixty days (in clear violation of the express terms of the plain language of the cessation of production clause) did not terminate the lease because the cessation of production was voluntary and the well was at all times capable of production.\textsuperscript{209}

The court next turned to the meaning of the shut-in royalty clause. The court explained that the shut-in royalty clause is only intended to take effect in the case of a temporary cessation of production, as opposed to the permanent cessation of production addressed by the "cessation of production" clause.\textsuperscript{210} Thus, this clause relates

\textsuperscript{203} \textit{Id.}; see also \textit{Kuntz, supra} note 34, \$ 47.3, at 105-06 (stating that "if the effect of the cessation of production clause is to modify the habendum clause . . . the 'production' required for the cessation of production clause should be the same as the production required to satisfy the habendum clause").

\textsuperscript{204} \textit{Pack}, 869 P.2d at 328 (commenting that "[a]ny other conclusion would render the habendum clause useless after the primary term expires, a conclusion clearly not intended by the parties to the lease").

\textsuperscript{205} "[T]he cessation of production clause . . . [is] intended to come into play in the event that \textit{production} from the well shall cease, i.e., the well becomes incapable of producing in paying quantities." \textit{Id.}; see also \textit{Eichman v. Leavell Resources Corp.}, 876 P.2d 171, 174 (Kan. Ct. App. 1994) (holding that cessation of production must be permanent); \textit{Greenfield v. Thrill}, 521 N.W.2d 87, 89 (N.D. 1994); \textit{De Benavides v. Warren}, 874 S.W.2d 353, 357 (Tex. Ct. App. 1984).

\textsuperscript{206} 769 P.2d 146 (Okla. 1989).

\textsuperscript{207} \textit{Pack}, 869 P.2d at 329.

\textsuperscript{208} \textit{Id.}

\textsuperscript{209} \textit{Id. But cf.} \textit{Kuntz, supra} note 34, \$ 47.3, at 107-08 (stating that some jurisdictions view a voluntary cessation of production for longer than the prescribed period sufficient justification to warrant lease termination).

\textsuperscript{210} \textit{Pack}, 869 P.2d at 330.
strictly to occurrences, like temporary disruptions in market availability, rather than capability to produce.\footnote{211} Therefore, the court found that “failure to pay shut-in royalties in and of itself does not operate to cause a termination of the lease. Rather, it is the failure to comply with the implied covenant to market which results in lease cancellation.”\footnote{212} Further, the clause contemplates royalty payments where the lease is shut-in for periods of one year or more, not for temporary cessations of production of less than one year.\footnote{213} Accordingly, mineral lessors are due payment only in the event of a shut-in for a year or longer.\footnote{214} In this case, since the well was shut-in for a period considerably less than one year, Santa Fe Minerals was not in breach of this lease clause.\footnote{215}

The court concluded the discussion of the shut-in royalty provision by contrasting the function of this clause with that of the cessation in production clause.\footnote{216} Reiterating that the shut-in royalty clause addresses market unavailability, the court commented that the cessation of production clause does not require marketing, only the capability to produce.\footnote{217} The court refused to construe these clauses as having duplicative or overlapping function.\footnote{218} Rather, each is viewed as fulfilling a separate function under the lease.\footnote{219} To construe these clauses otherwise would cause one clause of the lease to “nullify” another.\footnote{220}

Finally, the court reviewed Santa Fe Minerals’ obligations under the implied covenant to market.\footnote{221} The court stated that “typical oil and gas leases contain an implied covenant to market oil and gas from the subject wells.”\footnote{222} In affirming the rule set out in \textit{Cotner} and

\begin{itemize}
  \item \footnote{211} Id.
  \item \footnote{212} Id.
  \item \footnote{213} Id.
  \item \footnote{214} \textit{Pack}, 869 P.2d at 330.
  \item \footnote{215} Id. at 331. \textit{See generally} Danne v. Texaco Exploration and Prod. Inc., 883 P.2d 210, 215 (Okla. Ct. App. 1994) (holding that “[u]nless a lease clearly provides for forfeiture of the lessee’s estate upon failure to make timely payment, the lessor’s grounds for relief lay only in contract law”).
  \item \footnote{216} \textit{Pack}, 869 P.2d at 330.
  \item \footnote{217} Id.
  \item \footnote{218} Id.
  \item \footnote{219} Id.
  \item \footnote{220} \textit{Pack}, 869 P.2d at 330; \textit{see also} Postier v. Postier, 296 P.2d 138, 139-40 (Okla. 1956) (holding that “every provision must be construed so as to be consistent with every other provision if possible”) (quoting Colonial Royalties Co. v. Keener, 266 P.2d 467, 470 (Okla. 1953)).
  \item \footnote{221} \textit{Pack}, 869 P.2d at 330.
  \item \footnote{222} Id.
\end{itemize}

https://digitalcommons.law.utulsa.edu/tlr/vol30/iss4/4
Carter, the court reiterated that disputes involving the implied covenant to market are questions of equitable cognizance, which must be considered under the facts and circumstances of each case.223 The court concluded that “the lessees in the case at bar may voluntarily cease removal and marketing of gas from the subject wells for a reasonable time.”224 The court found that, unlike the lessees in Hunter, who had no reason other than their own convenience for failing to produce,225 Santa Fe Minerals’ voluntary cessation of production for marketing considerations appeared reasonable.226 The court concluded that, in such a circumstance, the burden is on the Pack lessors to show that the cessation of production was unreasonable, and they failed to meet that burden.227

As a result of the foregoing analysis, the Oklahoma Supreme Court remanded the case with directions to quiet title in favor of Santa Fe Minerals, the lessees of the real estate in question.228

VI. Analysis

In the Pack decision, the Oklahoma Supreme Court offered more clarification than ever before about the interpretation of termination clauses in oil and gas leases. Pack makes it clear that, once a lease is in its secondary term and is held by production, a lessee will not automatically forfeit his estate if there is a well on the leased estate that is capable of production.229 Capability to produce will earn the lessee the right to attempt to market the product.230 If the lessee markets the product with due diligence, the lessee can avoid forfeiture.231

Most importantly, the Pack ruling clarifies that the use of the term “production” in a cessation of production clause, which modifies the habendum clause of the lease, will be interpreted as “capability to produce,”232 thereby restricting the operation of the cessation of production clause to circumstances of complete inability to produce.233 Consequently, absent a failure on the part of the lessee to use due

223. Id.
224. Id. at 331.
227. Id.
228. Id.
229. Id.
231. Id.
232. Id. at 328.
233. Id.
diligence to market the product, a lease that has the capability to produce (i.e. hydrocarbons reduced to the dominion and control of the lessee) will not be forfeited for failure to produce.\textsuperscript{234} Forfeiture for violation of the implied covenants of the lease will be a matter of equitable cognizance, resolved according to the facts and circumstances of each case.\textsuperscript{235} While the court declined to articulate a general rule regarding failure to market with due diligence,\textsuperscript{236} it is evident from the facts in \textit{Pack} that a voluntary curtailment of production for less than one year (with an ostensibly good faith reason, e.g., maximization of product prices), even when accompanied by a failure to pay shut-in royalties or begin new drilling operations, will not work a forfeiture.\textsuperscript{237}

After the ruling in \textit{Pack}, the oil industry now realizes the rights of the lessee with regard to lease terminations in Oklahoma.\textsuperscript{238} Perhaps as interesting as the actual lessee/lessor rights established in \textit{Pack} are the reasons underlying the view expressed in \textit{Pack} concerning the relative rights of the parties to an oil and gas lease agreement. When agreements are not accorded their plain meanings, one is forced to investigate the principles that form the foundation for the interpretation of those agreements.\textsuperscript{239} The meanings which are imputed to the lease agreement clauses reflect Oklahoma’s fundamental view of the nature of the estate held by a mineral interest owner.\textsuperscript{240} It is this underlying view of mineral ownership that ultimately acts to control the interpretation of the terms of a lease agreement.\textsuperscript{241}

As one commentator explains, there are two dominant theories of mineral ownership: the exclusive-right-to-take theory and the ownership-in-place theory.\textsuperscript{242} Though the theory of ownership followed in a given jurisdiction is rarely discussed, if at all, and usually has no particular impact on the routine practice of oil and gas law, it can have

\begin{itemize}
  \item\textsuperscript{234} \textit{Pack}, 869 P.2d at 331.
  \item\textsuperscript{235} \textit{Id.}
  \item\textsuperscript{236} \textit{Id.}
  \item\textsuperscript{237} \textit{Id.}
  \item\textsuperscript{238} \textit{Pack}, 869 P.2d at 331.
  \item\textsuperscript{239} ERNEST HEMINGWAY, THE SNOWS OF KILIMANJARO 28 (Penguin Books 1972) (1939).
  \item\textsuperscript{240} Rich v. Doneghey, 177 P. 86 (Okla. 1918).
  \item\textsuperscript{241} \textit{Id.}
  \item\textsuperscript{242} 1 KUNTZ, \textit{supra} note 57, § 2.4, at 65 (describing the ownership-in-place theory, which states that the landowner owns all substances, including oil and gas, which underlie his land. Ownership is qualified by the law of capture. If the oil and gas depart from beneath the owned land, ownership in such substances is lost. The exclusive-right-to-take theory states that the landowner does not own the oil and gas which underlie his land. He merely has the exclusive right to capture such substances by operations on his land. Once reduced to dominion and control, such substances become the object of absolute ownership).
a profound impact on questions of lease termination, the very problem presented in Pack. The Pack decision is a manifestation of the exclusive-right-to-take theory of mineral ownership.

A. Exclusive-Right-to-Take Theory

The exclusive-right-to-take theory defines the lessor’s mineral ownership as constituting only the right to take and capture minerals. Though one commentator, Kuntz, points out that the exclusive-right-to-take or “non-ownership” theory of mineral interest does not mean “the absence of property rights” for the lessor; such rights are, however, severely constricted. Upon lease of the exclusive right to remove minerals to a lessee, the mineral lessor may retain titular ownership of mineral rights, but he is no longer, in any legally significant way, in control of the development or termination of the mineral interest. He merely controls access to the minerals; he is, in effect, reduced to the status of a gatekeeper — a gatekeeper who, upon opening the gate, loses virtually all opportunity to close it again. The true estate in minerals, in Oklahoma, lies in the one who has captured and reduced the minerals to his possession. Consequently, at law, the general policy against forfeiture of estates protects the lessee from losing his estate, thus captured, through any kind of automatic termination.

Though it is not always easy to tell whether a jurisdiction has adopted an exclusive-right-to-take or an ownership-in-place theory of ownership, it appears that, from the language used in early Oklahoma decisions and the position of the court in Pack, Oklahoma is an exclusive-right-to-take jurisdiction.

243. 1 Kuntz, supra note 57, § 2.4, at 65.
244. 1 Kuntz, supra note 57, § 2.4, at 65.
245. 1 Kuntz, supra note 57, § 2.4, at 65.
246. 1 Kuntz, supra note 57, § 2.4, at 65.
247. 1 Kuntz, supra note 57, § 2.4, at 65.
248. 1 Kuntz, supra note 57, § 2.4, at 65.
250. Rich v. Doneghey, 177 P. 86, 89-90 (Okla. 1918) (stating that the lessors have rights designated “as a qualified ownership thereof, but which may be more accurately stated as exclusive right . . . to erect structures . . . and explore therefor by drilling wells through the underlying strata, and to take therefrom and reduce to possession, and thus acquire absolute title as personal property”); see Bezi v. Hocker, 370 F.2d 533, 535 (10th Cir. 1966) (holding that “the owner of land has a qualified title to the oil and gas in and under his land with the exclusive right to produce it, but has no absolute title thereto”); see also Lough v. Coal Oil Inc., 266 Cal. Rptr. 611, 615 (Cal. Ct. App. 1990) (holding that where “one entity has fee simple ownership of the property to all depths, that owner has the exclusive right to drill and produce oil and gas on that property”); Miller v. Ridgley, 117 N.E.2d 759, 763 (Ill. 1954) (holding that “the ownership of the surface determines the extent of ownership of oil underlying the surface”); Sinclair Oil & Gas
B. Ownership-in-Place Theory

In contrast, an ownership-in-place jurisdiction takes the view that a mineral lessor owns not just the right of access and the right to remove minerals, but also actually owns the minerals.\(^\text{251}\) In such a jurisdiction, the mineral interest owner, whether joined or severed from the surface ownership, has the same kind of interests as does any other holder of an estate in land.\(^\text{252}\) As Hemingway points out, "[t]he great advantage of [this view of ownership] is [that it results in] a property interest whose attributes are more or less predictable and which fits into the pre-existing rules and laws applying to other corporeal interests in realty."\(^\text{253}\)

Consequently, in an ownership-in-place jurisdiction, the convoluted constructions of oil and gas leases applied in exclusive-right-to-take jurisdictions, like Oklahoma, are not necessary.\(^\text{254}\) In Texas, for example, clauses within oil and gas leases are interpreted literally, according to their plain meanings.\(^\text{255}\) Texas courts have consistently interpreted cessation of production clauses that mandate lease forfeiture when production ceases literally; forfeiture of the estate results from failure to comply with the lease terms.\(^\text{256}\) The typical terms of habendum clauses are also interpreted strictly, indicating the conveyance of a fee simple determinable estate, which automatically vests in the grantor upon occurrence of the stated condition.\(^\text{257}\)

C. Implications for the Lessor and Lessee

The full impact of Oklahoma's view of mineral ownership on the construction of lease clauses is illustrated from the Pack ruling. In

---

Co. v. Corporation Comm'n, 378 P.2d 847, 851 (Okla. 1963) (holding "that the owner of land has only a qualified ownership in the oil and gas beneath it, and that his right to reduce said migratory mineral possession by drilling and producing, is subject to legislative control").

\(^\text{251}\) Kuntz, supra note 57, § 2.4, at 65.


\(^\text{253}\) Id. at 15.

\(^\text{254}\) See cases cited infra note 256.

\(^\text{255}\) Harry Cohen, Property Theories Affecting The Landowner in a New Oil and Gas Producing State, 10 Ala. L. Rev. 323, 341 (1958).

\(^\text{256}\) Wainwright v. Wainwright, 359 S.W.2d 628, 630 (Tex. Civ. App. 1962) (stating that a lease will terminate in the secondary lease term when the operator voluntarily shut-in wells that were capable of production and failed to resume production or commence drilling operations within the period stated in the cessation of production clause); see Exploracion De La Estrella Solotaria Inc. v. Birdwell, 858 S.W.2d 549, 551, 557 (Tex. Ct. App. 1993); Bachler v. Rosenthal, 798 S.W.2d 646, 649-50 (Tex. Ct. App. 1990); see also Samano v. Sun Oil Co., 621 S.W.2d 580, 584 (Tex. 1981).

\(^\text{257}\) Stanolind Oil & Gas Co. v. Barnhill, 107 S.W.2d 746, 748 (Tex. Civ. App. 1937) (holding that an oil and gas lease invests the lessee with a determinable fee, i.e., title to oil and gas in place).
holding that a well "capable of production" (i.e., where the asset has been reduced to the dominion and control of the lessee) in the secondary lease term will not suffer automatic forfeiture, the court has given legal consequence to the exclusive-right-to-take theory of ownership.258 As the court stated in Hoyt, "the condition precedent to the vesting of a limited estate in the land covered by the leases is the completion of an oil and gas well in paying quantities."259 When hydrocarbons are reduced to the dominion and control of the lessee, all the equitable protections against forfeiture of estate will attach.260 When the lessee has such dominion and control, the lessee will "retain his estate while he makes a diligent effort to obtain a market."261 In an action brought by a lessor, it is the lessor's burden to show that the lessee has been unreasonable in his failure to market the product.262

Given the large investment a lessee usually makes in developing and producing an oil and gas lease,263 Oklahoma's interpretation of lessee rights is not without a certain fairness. But when the terms of the lease agreement are not accorded their plain meanings, the lease agreement cannot be clear to the lessor. A lessor, untutored in the intricacies of oil and gas leasing, probably assumes that a lease agreement means what it says.264 If the lease states that "if production ceases for any reason and the lessee fails to commence drilling operations the lease will terminate," the lessor assumes that the parties actually contemplate lease termination in the event of the lessee's failure to produce for any reason.265 Lessors are surely surprised, as the lessoes in Pack undoubtedly were, when lease termination does not result.266

261. Hoyt, 606 P.2d at 564.
263. In 1990 the average drilling cost per well in the United States was $383,596; the average drilling cost per well in Oklahoma was $384,090. ENERGY STATISTICS SOURCEBOOK, supra note 35, at 61. The average drilling cost for each foot of well drilled averaged $76.07 in the United States and $67.57 in Oklahoma. ENERGY STATISTICS SOURCEBOOK, supra note 35, at 64. The net investment ratio from drilling in the United States has been declining through time. For example, in 1990, the investment ratio in the United States was estimated at 13.1% (down from 33.2% in 1982), with total drilling expenditures at 11 billion dollars, and total wellhead revenues at 85 billion dollars. ENERGY STATISTICS SOURCEBOOK, supra note 35, at 377.
265. Id. at 549-50.
266. Id.
Special concerns arise when the court reaches the conclusion that an oil and gas lease should not be construed according to the plain meaning of its terms; specifically, these types of leases contain many attributes of an adhesion contract.267 Like a classic adhesion contract, the oil and gas lease is drafted unilaterally.268 Further, a gross inequity in bargaining power exists between the lessor and lessee.269 While a lessor is not totally without the ability to effect a termination, that ability is greatly impaired by the construction the court now gives to the lease agreement.270 Though courts are generally viewed as having a special duty to the weaker party in an adhesion contract (i.e. making the rights and duties of the parties clear and construing such contracts strictly against the drafter), clearly this is not the case with an oil and gas lease.271 This author suggests that many of the lease termination disputes between lessor and lessee arising in an exclusive-right-to-take jurisdiction could easily be avoided if the lease agreement made it clear that, absent proof that the lessee failed to use reasonable diligence and sound commercial judgment in developing and marketing the product, oil and gas leases in the secondary term held by a well capable of production are incapable of termination in the lessor's favor.

VII. CONCLUSION

Though we can surmise that Oklahoma's strong preference for interpreting lease agreements against forfeiture is intended to support an ailing industry in a state where industrial activity is strongly

267. Rodgers v. Tecumseh Bank, 756 P.2d 1223, 1226 (Okla. 1988) (defining an "adhesion contract" as one that is "prepared entirely by one party ... must be accepted or rejected ... on a 'take it or leave it' basis, without opportunity for bargaining") (quoting Steven v. Fidelity and Cas. Co., 377 P.2d 284, 297 (Cal. 1963)).


269. Id.

270. Pack v. Santa Fe Minerals, 869 P.2d 323, 549-50, 555-56 (Okla. 1994) (discussing the view that the implied covenants contained within oil and gas leases are the tool through which balance is restored between the lessee and the lessor); see Tara Petroleum Corp. v. Hughey, 630 P.2d 1269, 1275 (Okla. 1981) (stating that the lessor's rights should be protected from illusory or collusive assignments or gas purchase contracts).

needed, it must be recognized that the individual lessor is disadvantaged by the construction now placed on mineral lease agreements. The lessor clearly needs assistance, if not protection. Some will undoubtedly suggest that responsible companies might be persuaded to draft their agreements more clearly. However, history demonstrates that the fox is a poor guard for the hen house, and it is unlikely that oil companies will voluntarily alter lease agreements that are clearly in their favor. When the court refuses to accord critical lease terms their literal meanings, free and open bargaining between parties in contract negotiations is precluded. With the court clearly standing against the lessor, perhaps only some kind of "truth-in-leasing" legislation can protect the vanishing rights of the lessor.

Lisa S. McCalmont

272. In 1991, the United States oil and gas industry employed some 392,000 people in oil and gas extraction, and some 120,000 people in refining, making it one of the largest employment industries in the United States. ENERGY STATISTICS SOURCEBOOK, supra note 35, at 449.