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AMOCO v. ALEXANDER: COMMON LESSEE'S DUTY TO PROTECT AGAINST FIELD-WIDE DRAINAGE IS WITHIN THE REASONABLY PRUDENT OPERATOR STANDARD

I. INTRODUCTION

The typical oil and gas lease is a very detailed instrument which, to the unsophisticated, appears to provide for nearly every imaginable contingency. It establishes the relationship between lessor and lessee and defines many of the precise rights and obligations of each party. Yet, regardless of the number of duties imposed on the lessee by the terms of the lease, there is always room for a court to add to those specified duties. This is done by holding that a particular duty, although unspecified, is implied by the standard imposed on all lessees; the reasonably prudent operator standard.

This process of finding implied duties was utilized by the Texas Supreme Court in *Amoco Production Co. v. Alexander*[1] where it held that Amoco (the lessee) had violated its obligation to Alexander (the lessor) by not protecting against field-wide drainage[2] and not seeking administrative relief from spacing regulations.[3] The court emphasized, however, that although these two duties had never before been imposed upon lessees in Texas,[4] they should not be considered additional burdens.[5] Rather, the court indicated that these duties were merely specific applications of the previously existing obligation to protect the leasehold and emanated from the reasonably prudent operator standard.[6]

1. 622 S.W.2d 563 (Tex. 1981).
2. *Id.* at 568.
3. *Id.* at 570. There was some dispute as to how many leases Alexander had. Amoco Prod. Co. v. Alexander, 594 S.W.2d 467, 470 (Tex. Civ. App. 1979). For the purposes of this Note, it will be assumed that Alexander held leases on one contiguous tract, and that tract will be referred to as "Alexander's lease."
4. 622 S.W.2d at 567 ("duty to protect . . . from field-wide drainage . . . has not been considered by the Texas courts").
5. *Id.* at 568, 570.
6. *Id.*

II. BACKGROUND

The standard of reasonable prudence is a guiding principle for resolving disputes between the parties to oil and gas leases. It imposes on the lessee the obligation to conduct all exploratory, drilling, and production operations in the same manner as would a hypothetical reasonably prudent operator under the same facts and circumstances.[7] Implicit in this standard is that a reasonably prudent operator considers his own interests as well as those of his lessor. Thus, a lessee must protect the interests of his lessor only to the extent that he can do so while developing the lease in a profitable manner.[8]

The standard is intentionally general,[9] and encompasses nearly all aspects of the duties a lessee owes his lessor.[10] As a result, it has generated many implied duties[11] and there is a temptation to compile a list of these duties as they arise and apply them to every lease. However, this impulse should be resisted because, while the more general implied

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7. 5 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 806.3, at 41 (1980).

8. Profitability as a limitation on the lessee's duty was recognized early in oil and gas lease jurisprudence. Brewster v. Lanyon Zinc Co., 140 F. 801, 814 (8th Cir. 1905) (lessee not obligated to "carry the operations beyond the point where they will be profitable to him, even if some benefit to the lessor will result from them"); Colgan v. Forest Oil Co., 194 Pa. 234, 241, 45 A. 119, 121 (1899) (lessee "not bound to work at his own loss for his lessor's profit"). This limitation was also recognized by the *Amoco* court, see *infra* note 64. *See generally* Williams, *Implied Covenants for Development and Exploration In Oil and Gas Leases—The Determination of Profitability*, 27 KAN. L. REV. 443 (1979) (profitability as the basis for implied covenants).

9. 622 S.W.2d at 568 ("The lessee is required generally to do what a prudent operator would do.").

10. *Id.* "The reasonably prudent operator concept is an essential part of every implied covenant. Every claim of improper operation by a lessor against a lessee should be tested against the general duty of the lessee to conduct operations as a reasonably prudent operator . . . ." *Contra, e.g.*, Cook v. El Paso Natural Gas Co., 560 F.2d 978, 984-85 (10th Cir. 1977) (reasonably prudent operator rule inapplicable when a common lessee is causing drainage from lessor's tract); Geary v. Adams Oil & Gas Co., 31 F. Supp. 830, 834-35 (D. Ill. 1940) (duty to drill offset wells despite assumption that to do so "would not have been a prudent operation"); R.R. Bush Oil Co. v. Beverly-Lincoln Land Co., 158 P.2d 754, 758 (Cal. Dist. Ct. App. 1945) (ordinarily prudent operator standard not applicable to common lessee situation).

11. The practice of imposing upon lessees duties that had not been specified in the lease is not a recent development in oil and gas law. In 1926 an entire treatise was written on the topic of implied covenants. *See* M. MERRILL, THE LAW RELATING TO COVENANTS IMPLIED IN OIL AND GAS LEASES (1st ed. 1926). As the developing industry confronted new problems, the need arose to recognize additional lessee duties. For example, it became more common to use geophysical or seismographic tests to determine the nature of oil and gas deposits. Geophysical or seismic testing consists of sending sound waves into the earth which, when reflected back to the surface, can be interpreted to indicate the nature of the underlying strata. One court suggested that a lessee may actually have a duty to perform these tests. Felmont Oil Corp. v. Pan Am. Petroleum Corp., 334 S.W.2d 449, 457 (Tex. Civ. App. 1960) (lessee's duty to explore could be satisfied by performing geophysical tests). If this manner of testing for oil and gas deposits becomes the industry's accepted "best" method of discovery, then exploration may not be complete until geophysical tests are conducted.

covenants will apply to all leases, many of the specific duties will not, due to differing fact situations.[12] Ultimately, no duty will be imposed upon the lessee unless it falls within the reasonably prudent operator standard.[13] It is, therefore, more useful to evaluate the validity of a proposed duty by determining whether it derives from that standard rather than simply deciding whether some other court has held that particular duty to exist under a similar set of circumstances.

With the number of duties increasing, it is important to recognize the difference between a specific *duty* and a more general *obligation*. Unfortunately, the words "duty" and "obligation" are often used interchangeably. The distinction to be made is that a duty is a judicial conclusion that is derived from a previously established obligation. For example, a lessee is generally *obligated* to protect his lessor from loss due to drainage,[14] but this obligation may be fulfilled in several ways.[15] It is the function of the court to determine, based on the particular facts of the case, which of these remedial measures the lessee has a *duty* to perform. Thus, a duty imposed upon a lessee is not considered an additional burden, but a mere application of the existing obligation. Or, more general yet, a duty may be considered an application of the reasonably prudent operator standard.

The relationship between duties and obligations has been the subject of various classification schemes.[16] While there are some extensively debated differences between the various schemes,[17] a basic four-level hierarchy seems to be common to all. At the top of the hierarchy is a contract principle rarely dealt with directly in modern oil and gas law, but which is probably the basis for the guiding standard of reasonable prudence.[18] This concept, which applies to all contracts, imposes

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12. For example, the *Amoco* court emphasized that its finding of a duty to seek administrative relief would not have unlimited application: "There may be facts where the prudent operator would not seek administrative relief." 622 S.W.2d at 570. *See also* Sunray DX Oil Co. v. Crews, 448 P.2d 840 (Okla. 1968), discussed *infra* note 57.

13. *But see* cases cited *supra* note 10. For a critique of the *Cook* case, see *infra* note 63.

14. See *infra* note 22 and accompanying text.

15. For example, a lessee may protect from drainage by drilling offset wells, pooling with other leases, reworking existing wells, or some combination thereof.

16. See *infra* note 22.

17. *Compare, e.g.*, Walker, *The Nature of the Property Interests Created by an Oil and Gas Lease in Texas*, 11 TEX. L. REV. 399, 402-06 (1933) (covenants are implied in fact), *with, e.g.*, M. MERRILL, THE LAW RELATING TO COVENANTS IMPLIED IN OIL AND GAS LEASES § 220 (2d ed. 1940) (covenants are implied in law).

18. 5 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 802.1, at 8 (1980) ("broad ground on which implied covenants are properly rested is believed to be the contract principle of cooperation").

on the parties to the contract the duty to cooperate toward the accomplishment of the contract's purpose.[19] Immediately beneath this contract principle is the standard of reasonable prudence.[20] The third level in this hierarchy is the implied covenants which are derived from the objective standard.[21] The implied covenants are:

1. to diligently explore the lease;
2. to diligently drill and develop the lease;
3. to diligently produce and market the oil or gas or both;
4. to protect the lease from drainage.[22]

The final level in the hierarchy is the specific duties imposed upon lessees by court decision based on the particular facts of each case and derived from the four implied covenants.

Of the four implied covenants listed above, the *Amoco* case dealt with the covenant to protect the lease from drainage.[23] Due to their fugacious nature, oil and gas are subject to migration within the reservoir. When this migration occurs laterally, away from a particular lease, that lease is said to be suffering drainage. The implied covenant to protect against drainage is based on the assumption that both the lessor and the lessee enter into a lease with the intention of making a profit. If the oil and gas are subsequently drained from the premises,

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19. *Id.* This principle was stated by Judge Cardozo in Wood v. Lucy, Lady Duff-Gordon, 222 N.Y. 88, 118 N.E. 214 (1917). In that case, Wood had an exclusive contract to market Lucy's products. Lucy contended that Wood had not marketed the products with due diligence. Holding that there was a duty to market the goods with diligence, the court stated: "It is true that [Wood] does not promise in so many words that he will use reasonable efforts to place [Lucy's] indorsements and market her designs. We think, however, that such a promise is fairly to be implied." *Id.* at 90-91, 118 N.E. at 214.

20. See *supra* note 7 and accompanying text.

21. In terms of the preceding duty-obligation distinction, the top three levels of the hierarchy are properly considered obligations. That is, in every oil and gas lease, the lessor is *obligated* to diligently work towards achievement of the lease's purpose, to behave as a reasonably prudent operator, and to do whatever is necessary to fulfill the implied covenants.

22. The number of established implied covenants ranges from three to six, depending upon which author is consulted. However, the differences are largely organizational rather than substantive.

This group of four covenants was compiled from the following five publications: R. HEMINGWAY, THE LAW OF OIL AND GAS § 8.1, at 365 (1971) (implied covenants to (1) develop; (2) protect; (3) manage and administer); M. MERRILL, THE LAW RELATING TO COVENANTS IMPLIED IN OIL AND GAS LEASES § 4, at 23 (1940) (implied covenants to (1) explore; (2) drill additional wells; (3) operate and market; (4) protect); 2 W. SUMMERS, OIL AND GAS LAW § 395 (perm. ed.) (implied covenants to (1) drill test wells within a reasonable time; (2) drill test wells after notice; (3) develop; (4) protect; (5) market); 5 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 804, at 26-27 (1980) (implied covenants to (1) drill exploratory wells; (2) protect; (3) develop; (4) explore further; (5) market; (6) use reasonable care and due diligence); Walker, *The Nature of the Property Interests Created by an Oil and Gas Lease in Texas*, 11 TEX. L. REV. 399, 401 (1933) (implied covenants to (1) develop; (2) protect; (3) produce and market; (4) use reasonable care).

23. 622 S.W.2d at 567.

the purpose of the lease will be precluded and the lessor's rights will be rendered worthless. The lessor will normally have no cause of action against the parties to the adjacent lease due to the rule of capture.[24] However, since the lessor has surrendered to the lessee the rights to drill on the tract, the lessee is the only one who can act to protect against the drainage and is therefore obligated to do so. Typically this would be done by drilling additional "offset wells"[25] which "capture" the oil and gas before it is drained away.

III. STATEMENT OF THE CASE

A. *Facts*

The problem in *Amoco* dealt with drainage, but of a type less frequently encountered. "Drainage" usually refers to "local" drainage but in *Amoco*, the lessors were complaining of "field-wide" drainage.[26] Local drainage is the migration away from a lease which occurs because a producing well on an adjacent lease lowers the pressure within the deposit in the vicinity of the well's bore. This lower pressure draws oil and gas from the surrounding higher-pressure regions, resulting in a multidirectional migration towards the producing well.[27] In contrast, field-wide drainage is unidirectional and bears no relation to the location of producing wells. This so-called "regional migration" is caused not by a pressure imbalance, as is local drainage, but is due to the geologic characteristics of the deposit as a whole.[28]

The deposit underlying the Alexander lease, located in the Hastings West Field, was a water-drive field. This is a type of reservoir containing both oil and water, but because water is heavier, the oil rises to the top. As oil is removed through wells, water moves in from underneath to displace the oil.[29]

An additional characteristic of the Hastings West Field was that, rather than being roughly parallel to the surface plane, it tilted so that the southeast portion was higher than the northwest portion. Thus, the

24. Under the rule of capture, title to oil and gas belongs to the owner of the mineral rights to the land from which the oil and gas were extracted, even though the minerals may have been drained from beneath an adjacent lease. R. HEMINGWAY, *supra* note 22, § 4.2, at 153.

25. An offset well is "drilled on one tract of land to prevent the drainage of oil or gas to an adjoining tract of land, on which a well is being drilled or is already in production." 8 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW 485 (1981).

26. 622 S.W.2d at 565.

27. 8 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW 202-03 (1981).

28. *See id.* at 271.

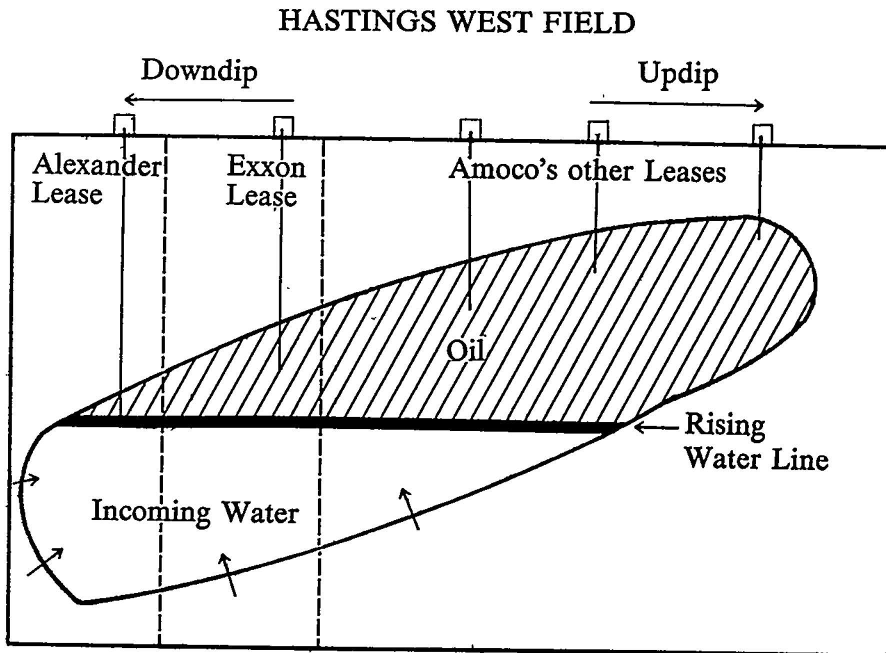
29. *See id.* at 820.

deposit dipped downward to the northwest. Alexander's lease was in the northwest portion and was referred to as a "downdip" lease. Leases towards the southeast were the "updip" leases.[30]

Illustration

The foregoing discussion of the geological circumstances can be best summarized by the following cross sectional, schematic diagram:

HASTINGS WEST FIELD



The combination of these two characteristics dictated that as oil was removed from the field, regardless of well location, incoming water forced the remaining oil towards the updip leases.[31] This regional migration toward the southeast resulted in the field-wide drainage of oil from beneath Alexander's land so that the wells on that lease would eventually produce only water.

Under simpler circumstances, Amoco, as lessee, would have a strong incentive to produce from the Alexander lease because oil was being drained to the southeast by production on the adjacent updip

30. 622 S.W.2d at 565-66.

31. *See* 8 H. Williams & C. Meyers, Oil and Gas Law 820 (1981).

leases.[32] The lease's value was declining with respect to Amoco as well as to Alexander. However, there were readily apparent reasons why Amoco began plugging the Alexander wells and refused to drill any additional wells.

The most significant reason for Amoco's lack of enthusiasm with the Alexander lease was that Amoco held leases on eighty percent of the entire Hastings West Field, including most of the updip leases.[33] This uniquely advantageous position meant that any oil not recovered from the Alexander lease would eventually migrate updip towards Amoco's other leases. Considering Amoco's interest in Hastings West Field as a whole, it would be economically foolish for Amoco to invest resources in Alexander's lease when it could recover nearly the same quantity of oil by developing and producing only on its updip leases.[34] Moreover, the Alexander lease provided for royalty payments payable to Alexander equal to one-sixth of the production, whereas Amoco's updip leases provided for only one-eighth royalties.[35] This additional economic disincentive contributed to Amoco's reluctance to actively produce on Alexander's lease.

From Alexander's perspective, the economic realities were much different. At the time the lease was created, Alexander's land had a substantial quantity of oil and gas beneath it. It was for the purpose of realizing those minerals' value that Alexander entered into the lease agreement. In sharp contrast to Amoco's increased profits on its updip leases, Alexander's expectation of profit was being destroyed as the oil and gas were drained away from under his land.

As the production on Alexander's lease began to decline dramatically, Alexander wrote to Amoco requesting immediate corrective measures.[36] In response to Alexander's request, Amoco stated, "We have reviewed all of our wells for possible corrective work and economics do not justify the additional expenditures."[37] Alexander then

32. Exxon, Amoco's major competitor in the region, was producing oil and gas on leases immediately to the southeast of the Alexander lease. Amoco Prod. Co. v. Alexander, 594 S.W.2d 467, 470 (Tex. Civ. App. 1979).

33. *Id.*

34. The court considered Amoco's advantageous position in making its decision, see *infra* note 62.

35. 622 S.W.2d at 566.

36. 594 S.W.2d at 470. The corrective measures requested probably included drilling offset wells, see *supra* note 25, reworking the wells, or both. Reworking means, in general, any work on an existing well intended to secure or increase production. 8 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW 646-48 (1981).

37. 594 S.W.2d at 470.

exercised his remaining option to remedy the drainage problem by bringing suit in the Texas District Court alleging a violation of the covenant to protect against drainage.

The trial court held that Amoco had violated its duty to protect against field-wide drainage and, further, that included therein was a duty to apply for exceptions to the Texas Railroad Commission's spacing rule. Alexander was awarded $3,916,659.00 in actual and exemplary damages.[38] This judgment was reformed and affirmed by the Texas Court of Civil Appeals.[39]

B. *Issues Before the Texas Supreme Court*

On appeal, the issues before the Texas Supreme Court were fundamentally the same as those before the lower courts and were stated in the opinion:

> We must determine whether:
> (1) Amoco had a duty to protect from field-wide drainage, or a duty not to drain the Alexander downdip leases by its operations updip.
> (2) Amoco had a legal duty under the Alexander leases to apply to the Railroad Commission for permits to drill additional wells at irregular locations, to obtain the permits and drill the wells.[40]

C. *Decision of the Texas Supreme Court*

Amoco argued that the duty to protect against field-wide drainage should not be imposed because it amounted to "a new implied obligation never previously held to exist."[41] In response to this charge, the court reiterated the parameters of the reasonably prudent operator

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38. *Id.* at 469.

39. The appeals court deducted Alexander's share of occupation tax, reducing the award to $3,826,077.76. *Id.* at 481.

40. 622 S.W.2d at 566. Note, the second issue would be of no consequence without the finding of a duty to prevent field-wide drainage since seeking administrative relief is merely a refinement of that duty. *But cf.* R. HEMINGWAY, *supra* note 22, § 8.1 (duty to seek administrative relief is derived from the implied covenant to manage and administer the lease).

The court also considered whether the trial court's admission of testimony that the Railroad Commission would have granted exception permits to allow Amoco to drill additional wells on the Alexander lease was erroneous and whether the Alexanders were entitled to recover exemplary damages. 622 S.W.2d at 566. The court found that the trial court had not erred in admitting the testimony, but held that a lease is essentially a contract, and exemplary damages were not available in contract actions. *Id.* at 571.

41. *Id.* at 567. Amoco contended that the court should not add to a lessee's burden and enforce it retroactively.

standard and found that the duty to prevent field-wide drainage was within the scope of that standard. Therefore, no additional burden was being imposed upon Amoco; the court was merely enforcing a specific duty that emanated from the previously existing obligation.[42]

Next Amoco argued that the imposition of the duty to protect against field-wide drainage was "beyond the point of fairness and workability."[43] The unfairness argument was based on the fact that field-wide drainage is more difficult to prevent than local drainage. Indeed, the drilling of offset wells does not slow field-wide migration; it expedites it.[44] Moreover, Amoco argued, offset wells would prompt adjacent lessees to drill additional wells, resulting in even more rapid field-wide drainage.[45]

The court recognized that while "protecting from local drainage may be easier"[46] than protecting from field-wide drainage, that did not excuse Amoco's failure to act as a reasonably prudent operator with respect to the Alexander lease. Seven ways were listed in which Amoco might have acted to protect Alexander from drainage.[47] The court again emphasized that it was relying on the basic standard: "The Court of Civil Appeals has not imposed a new obligation upon Amoco. The jury, in finding that Amoco failed to operate the Alexander leases as a reasonably prudent operator, has determined that Amoco failed in its duties under the implied covenants to protect the leasehold [from drainage]."[48]

Amoco's final attempt to avoid the duty to protect against field-wide drainage was to argue that such a duty would be in conflict with the duties it owed to its updip lessors.[49] In response, the court recog-

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42. *Id.* at 568-69.

43. *Id.*

44. Recall that in an active water-drive field, migration of minerals is instigated by the removal of oil and gas through wells. Therefore, the speed at which the minerals migrate is directly related to the number of wells drilled into the reservoir, regardless of whether they are drilled updip or downdip. See *supra* note 31 and accompanying text.

45. 622 S.W.2d at 568.

46. *Id.*

47. The duties of a reasonably prudent operator to protect from field-wide drainage may include (1) drilling replacement wells, (2) re-working existing wells, (3) drilling additional wells, (4) seeking field-wide regulatory action, (5) seeking Rule 37 exceptions from the Railroad Commission, (6) seeking voluntary unitization, and (7) seeking other available administrative relief.

Id.

48. *Id.*

49. *Id.* at 569. The court paraphrased Amoco's argument: "If [as part of its duty to protect Alexander's lease] Amoco fails to maintain or increase updip production, it is exposed to liability from the updip lessors." *Id.* The court rejected this argument with ease, even while overlooking

nized Amoco's predicament as a common lessee,[50] but held that a lessee's obligations to his lessors are not alleviated by having more than one lessor in the same field.[51] Because Alexander was not a party to the agreements with the updip lessors, those agreements did not lessen his rights.

The second part of the duty imposed upon Amoco was to seek administrative exceptions to the Railroad Commission spacing rules. Given the geologic situation of Alexander's lease,[52] the way to maximize production would be to drill several wells on the extreme updip portion. Specifically, Alexander proposed that Amoco drill wells at 200 foot intervals and only 50 feet from the lease boundary.[53] These wells would capture most of the oil and gas under Alexander's lease as it migrated updip. Amoco refused to drill these wells on the basis that the Railroad Commission rules required 660 feet between wells and 330 feet between any well and the lease boundary.[54] But the Commission rules also provided for exceptions to be granted under such circumstances where it would be necessary to allow shorter distances between wells in order "to prevent waste or to prevent confiscation of property."[55] Amoco, however, did not attempt to obtain these exception permits.[56]

Because of Amoco's failure to apply for the exception permits, the

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the fact that Amoco was reading more into the lower court's holding than actually existed. The trial court had found that Amoco had a duty to protect Alexander's lease, but this ruling carried no implication that Amoco must decrease production on its updip leases. Amoco's responsibilities to its updip lessors were, therefore, unaffected by its duties to Alexander.

50. *Id.* A lessee does not usually have much difficulty in complying with the implied covenants because his interests in developing, producing, and marketing oil and gas are the same interests held by the lessor. However, a common lessee views the field as a whole (as in this case) which may cause his interests to diverge from those of his lessors. See *supra* notes 33-35 and accompanying text.

51. 622 S.W.2d at 569.

52. *See* illustration *supra* p. 556.

53. 622 S.W.2d at 569.

54. *Id. See* TEX. R.R. COMM'N RULE 051.02.02.037 (1981). This rule has been amended and currently requires 1200 feet between wells and 467 feet between the wells and the lease boundary.

55. TEX. R.R. COMM'N RULE 051.02.02.037 (1981). The pertinent language of rule 37 provides:

> [T]he Commission, in order to prevent waste or to prevent the confiscation of property, may grant exceptions to permit drilling within shorter distances than above prescribed when the Commission shall determine that such exceptions are necessary either to prevent waste or to prevent the confiscation of property.

Id.

56. 622 S.W.2d at 569. Amoco could hardly have made a good faith claim that it was either unaware of the exception provisions or believed that to apply for them would have been fruitless. Exxon had applied for and obtained rule 37 permits for drilling on the lease immediately updip from Alexander and Amoco itself had obtained exception permits for drilling on leases further updip. *Id.* at 570-71.

trial court allowed Alexander to present testimony to the effect that the permits would have been granted if applications had been made. Amoco argued that this holding amounted to a duty to seek administrative relief and that there was no authority in Texas case law to support such a duty.[57] Although the Texas Supreme Court did not comment on whether there was any precedent for the duty to seek administrative relief, it had no difficulty in upholding the duty. Reiterating that "Amoco owed the Alexanders the duty to do whatever a reasonably prudent operator would do," the court held that "an operator, who fails to act as a reasonably prudent operator by not seeking [well spacing exception] permits, is liable for loss caused by the failure to drill the wells."[58] The court stated clearly, however, that this was not an absolute duty, or a new implied covenant, but was merely a judicial conclusion based on the particular facts involved.[59]

IV. Analysis

The most noticeable aspect of the *Amoco* decision is the Texas Supreme Court's adherence to the reasonably prudent operator standard. The court found the duties to protect against field-wide drainage and to seek administrative relief inherent in this objective standard and

57. *Id.* at 569-70. Although Amoco may be correct that there is no Texas decision supporting a duty to seek administrative relief, the idea is not new to the oil and gas industry or the courts of other states. *E.g.*, Baldwin v. Kubetz, 148 Cal. App. 2d 937, 307 P.2d 1005 (Dist. Ct. App. 1957) (duty to seek zoning exception to permit drilling additional wells); Sinclair Oil & Gas Co. v. Bishop, 441 P.2d 436 (Okla. 1968) (duty to seek relief from Corporation Commission to prevent drainage); R. Hemingway, *supra* note 22, § 8.10, at 395 (duty to seek favorable administrative action in aid of the other obligations of the lessee); Merrill, *Fulfilling Implied Covenant Obligations Administratively*, 9 Okla. L. Rev. 125 (1956) (duty to present to regulatory agencies facts and arguments to procure orders favorable to interests of lessor); Meyers, *The Effect on Implied Covenants of Conservation Laws and Practices*, 4 Rocky Mtn. Min. L. Inst. 463, 486 (1958) (duty to fulfill implied covenants administratively).

See generally Sunray DX Oil Co. v. Crews, 448 P.2d 840 (Okla. 1968). In this case, the court stated, "Our determination of the matter herein involved precludes our reaching the question of whether defendant had an obligation to plaintiffs to comply with an alleged implied covenant [to seek favorable regulatory action]." *Id.* at 845. The court found that the lessee had reasonably determined that nothing could be gained by seeking administrative relief, therefore the lessee should not be penalized for failing to do so. *Id.* at 845-46. The author of this Note suggests that the Oklahoma Supreme Court could have clarified this case by phrasing the issue as whether the lessee had a *duty* to seek administrative relief rather than whether there existed an *implied covenant* to seek administrative relief. The *Sunray* court's discussion of whether to create an additional implied covenant was unnecessary because a duty to seek administrative relief could have been derived from the existing implied covenant to protect against drainage had the court wanted to impose such a duty.

58. 622 S.W.2d at 570.

59. *Id.* "We do not agree . . . that in every case of field-wide drainage the lessee must seek [well spacing rule] exceptions."

emphasized that these duties were merely applications of that standard.[60] This faithful adherence to the reasonably prudent operator standard is in contrast to the rationale used by the Tenth Circuit in *Cook v. El Paso Natural Gas Co.*[61] The *Cook* decision, like *Amoco*, held the common lessee liable for failure to protect against drainage, despite the fact that drilling offset wells would have been unprofitable.[62] Noting that the standard of reasonable prudence limits a lessee's duties to those which can be performed profitably, the *Cook* court reached its result by simply holding the standard inapplicable.[63] The *Amoco* court demonstrated that it was not necessary to discard the time-tested standard in order to protect the lessor's rights in an unusual situation.

In order to reconcile the reasonably prudent operator standard with the unprofitability of the duty it was imposing on Amoco, the Texas Supreme Court narrowed its scope to exclude consideration of Amoco's activities updip. Alexander's rights to be protected from drainage were properly viewed as independent of Amoco's updip interests. Alexander entered the agreement with the expectation that Amoco was bound to protect the leasehold. This right to protection could not be lessened by leases to which he was not a party. That it was *more* profitable to refrain from actively developing Alexander's lease is not to say it would have been *unprofitable* to develop it.

It is submitted, therefore, that the profitability limitation on the standard of reasonable prudence should be imposed only within the context of the disputed lease. Thus a lessee would not be relieved of his duty to drill offset wells, for example, unless those wells would not pro-

60. *Id.* at 568-70.

61. 560 F.2d 978 (10th Cir. 1977).

62. *Id.* at 982-84. The *Amoco* court recognized that it would be economically advantageous for Amoco to cease operations on the Alexander leases:

> The Alexander leases provided for 1/6th royalty while Amoco's updip leases provided for 1/8th royalty. There is no economic incentive for Amoco to increase production on the Alexander lease because it will eventually recover the Alexander's oil updip. Money invested in the Hastings, West Field, will have a longer productive life if invested updip.

622 S.W.2d at 569.

63. 560 F.2d at 982-84. The *Cook* court held that the reasonably prudent operator standard's profitability limitation was in conflict with the implied covenant to refrain from depletory acts, *see* Seed, *infra* note 74, and in this case, was subordinated thereto. By rejecting the reasonably prudent operator standard, *Cook* was, *a fortiori*, rejecting the previously suggested hierarchy. See *supra* text accompanying notes 18-22. It has been submitted herein that all implied covenants emanate from the reasonably prudent operator standard. Thus it is impossible, by definition, that any one of the covenants be in conflict with the basic standard; the implied covenants are all branches of the same tree. "The reasonably prudent operator concept is an essential part of every implied covenant." 622 S.W.2d at 568. The Tenth Circuit's apparent preference for an ad hoc system of determining duties is unfortunate in that it sacrifices the predictability of the reasonably prudent operator standard without any discernable justification.

duce enough to pay for themselves.[64] It should be no defense for a common lessee to state that development of a particular tract would be unprofitable based on his field-wide production plans. Although the *Amoco* court did not expressly state this proposition, it clearly and correctly refused to be influenced by Amoco's overall profits in the region.[65] It is no more fair to defend the degradation of a lessor's rights based on his lessee's activities updip than on the lessee's operations in some oil field hundreds of miles away. A lessee is obligated to each one of his lessors to behave as a reasonably prudent operator, and the *Amoco* court recognized that this standard can continue to protect lessor's interests, even in the more complex common lessee situations.

By arguing against the imposition of the duties to protect against field-wide drainage and to seek administrative relief, Amoco was implicitly critical of the court's adherence to the reasonably prudent operator standard. Amoco claimed that because no Texas court had previously found a duty to prevent field-wide drainage, such a duty should not be found in this instance.[66] The same argument was used against the finding of a duty to seek administrative relief.[67] But this reasoning disregards a valuable attribute of the reasonably prudent operator standard—its dynamism. This standard retains its vitality despite changes in technology and industry practice,[68] and without regard to the infinitely varying factual situations of oil and gas leases.[69] For Amoco to argue that the finding of a particular duty requires a specific precedent is to contend that the reasonably prudent operator standard is static. This argument is illogical in view of the process by which

64. Relying on its holding in Clifton v. Koontz, 160 Tex. 82, 96-97, 325 S.W.2d 684, 695-96 (1959), the *Amoco* court stated: "There is no duty unless such an amount of oil can be recovered to equal the cost of administrative expenses, drilling or re-working and equipping a protection well, producing and marketing the oil, *and yield to the lessee a reasonable expectation of profit*." 622 S.W.2d at 568 (emphasis added).

Professor Kuntz would modify this proposition somewhat by stating that while an absolute duty to drill offset wells should not be imposed automatically on common lessees, there are some situations in which it is appropriate to find a duty to drill an unprofitable well. 5 E. KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 61.1, at 140 (1978). "[I]f a prudent operator would not drill the [offset] well because it would not be profitable, it is appropriate to inquire into whether or not the lack of profitability is attributable to the [common] lessee's drainage from the adjoining tract." *Id.*

65. 622 S.W.2d at 569.

66. *Id.* at 567.

67. *Id.* at 569.

68. See *supra* note 11 and accompanying text.

69. *See* 622 S.W.2d at 568: "[B]ecause of the complexity of the oil and gas industry and changes in technology, the courts cannot list each obligation [duty] of a reasonably prudent operator which may arise. The lessee must perform any act which a reasonably prudent operator would perform to protect from substantial drainage."

duties have been historically imposed.[70]

Another of Amoco's arguments is equally feeble. With the premise that Alexander was claiming damages due to drainage, Amoco argued that it should not be required to drill offset wells because these would not halt but would in fact hasten the drainage.[71] While it is true that additional wells would hasten drainage, this argument overlooks the purpose of the implied covenant to protect against drainage. The protection covenant exists to assure that lessors realize the value of oil and gas beneath their land. In the context of local drainage, this protection is often achieved through the drilling of offset wells which slow or halt local drainage. But *preventing* drainage by drilling offset wells is only one way of *protecting against* drainage.[72] There is no inherent value to a lessor in preventing drainage except to the extent that prevention may be the best manner of protection. Alexander did not care how fast the oil was migrating updip. His only concern was that it be withdrawn before it drained to the adjacent lease. So while it was true that the additional wells would have hastened the field-wide drainage, it was also true that those wells would have been the best way for Alexander to realize his interest in the oil and gas beneath his land. Therefore, Amoco could not validly deny that it was in Alexander's best interest to increase production on his lease by drilling offset wells.

Although the court reached the correct result, it made its opinion more confusing by framing the first question as whether "Amoco had a duty to protect from field-wide drainage, or a duty not to drain the Alexander downdip leases by its operations updip."[73] But the court never considered the duty-not-to-drain issue.[74] Instead, it focused

70. The faulty logic of Amoco's reasoning can be exposed by summarizing the argument:

1. Finding a duty requires specific precedent.
2. There is no precedent for the duties to protect against field-wide drainage and to seek administrative relief.
3. Therefore, these duties cannot be imposed upon a lessee.

This argument fails because its basic premise is erroneous. If specific precedent is required in order to find a duty initially, no duties could ever have been found. Since a number of duties have been judicially imposed, they must have originated somewhere. Logically, the courts have derived them from the implied covenants.

71. 622 S.W.2d at 568.

72. A lessee might protect his lessor by either pooling or unitizing the lease with other leases on the same reservoir. By combining efforts with neighboring lessees, the recovery of marginal quantities of oil and gas may become profitable. *See generally* 6 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW §§ 900-999 (1980).

73. 622 S.W.2d at 566.

74. The duty-not-to-drain issue arises when a lessee holds leases on two adjacent tracts of land and his activity on one lease is draining oil and gas from beneath the other lease. One commentator believes that this problem calls for an additional implied covenant, *i.e.*, the implied

solely on whether Amoco had a duty to protect against drainage. In resolving this issue, the court recognized, but was not influenced by, Amoco's other activities within the field. The Texas Supreme Court correctly believed that the lessor's interest could be adequately protected without imposing a higher standard on common lessees and, indeed, without looking beyond the boundaries of the lease.

V. CONCLUSION

Amoco v. Alexander is a case marked by consistent reliance on the reasonably prudent operator standard as the basis for all implied covenants and duties imposed upon oil and gas lessees. The Texas Supreme Court held that Amoco had violated its duties to protect against field-wide drainage and to seek administrative relief from spacing regulations. More significant than the actual finding of these duties was the process by which they were derived. The *Amoco* court could have followed the Tenth Circuit's *Cook v. El Paso* rationale by abandoning the reasonably prudent operator standard and simply creating new duties on an ad hoc basis. Instead, the supreme court strengthened the standard and enhanced the predictability of oil and gas law by carefully tracing these new duties back to the existing implied covenants. Because this was a common lessee situation, adherence to the reasonably prudent operator standard was made more difficult due to its emphasis on profitability. But the *Amoco* court surmounted this difficulty, thereby encouraging other courts to be less hasty in abandoning this versatile standard.

Gregory Noble Fiske

covenant to refrain from depletory acts. Seed, *The Implied Covenant in Oil and Gas Leases to Refrain from Depletory Acts*, 3 U.C.L.A. L. REV. 508 (1956). But this additional covenant is only necessary if the protection covenant is stated as "the implied covenant to drill offset wells." If instead, this covenant is phrased "the implied covenant to protect against drainage," it would include protection against so-called depletory acts. *See* 5 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW §§ 824-824.1 (1980) (discussing fraudulent drainage and the higher duty sometimes imposed upon common lessees).