THE QUICK AND THE DEAD: CESSATION OF PRODUCTION AND SHUT-INS DURING THE SECONDARY TERM OF AN OIL AND GAS LEASE

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ABSTRACT

Historic characterization of the oil and gas leasehold estate developed into two primary views of mineral ownership and the nature of a lessee's interest acquired under an oil and gas lease. Classifications of the leasehold estate are an important foundation in assessing the ongoing viability of maintaining a lease in the secondary term by profitable production. Today, courts and leasing parties employ various equitable and contractual approaches to protect prudent lessees from the potentially harsh consequences of cessations of production in the secondary term. This Article focuses on two such savings concepts – the common law temporary cessation of production doctrine and related lease clauses, and the contractual use of shut-in royalty clauses. For each of these savings concepts, this Article presents a general discussion centered on the law in Texas and Oklahoma, as exemplars of the two primary schools of classification of the interests created by an oil and gas lease, followed by a survey of the law regarding temporary cessation and shut-in clauses in oil- and gas-producing states. Finally, the authors discuss possible directions the law may take in select jurisdictions such as North Dakota where the

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shale revolution shows serious potential, but guiding precedent remains incomplete. This latter discussion is grounded in indications from existing cases as to which school of thought the relevant jurisdiction has favored in the past when considering the oil and gas lease as a property interest.

I. INTRODUCTION

The dramatic and sustained exploration and development of United States shale resources over the past decade inevitably brings with it renewed focus by legal scholars, practitioners, and affected parties, on the "camel"[1] at the heart of the development process: the oil and gas lease. The legal issues associated with oil and gas leases seem endless in their variety, complexity, and resistivity to being reduced to articulate rules of application. When a significant new development play begins to overlap with historic leases operating in their secondary term, renewed attention to the terms and obligations of these leases can be expected, which reopens dormant concerns about the ongoing viability of historic leases. No single article could hope to address all the issues related to operation of oil and gas leases in the secondary term; rather, it is hoped that this Article will provide an adequate discussion of a narrow class of issues related to the preservation of leases in the secondary term, specifically, lease provisions which address continuation in the secondary term due to ongoing production, or the extent to which interruption or temporary cessation of production will be contractually or legally permitted to preserve a lease.

To approach this discussion, this Article will present a treatment of cessation and shut-in clauses based on the law in significant producing states, where long development history has produced a detailed and nuanced jurisprudence, as well as a survey of the related law in other oil and gas producing jurisdictions. Finally, an attempt will be made to analyze the law in jurisdictions with developing shale potential, but with incomplete or nascent case law. The goal is to make useful observations as to the direction those jurisdictions' courts might move as they are faced with consideration of the issues in real world disputes.

1. A camel, it is popularly said, is a horse created by a committee, which seems an appropriate appellation for the unique and wondrous collection of concepts found in contemporary oil and gas leases.

II. CESSATION OF PRODUCTION – GENERAL DISCUSSION OF TEXAS AND OKLAHOMA

It is no surprise that the law regarding cessation of production after the primary term has been most fully developed in two of the largest oil producing states in the United States: Texas and Oklahoma. An examination of these two states readily demonstrates a split in approaches to characterizing the oil and gas leasehold estate created in the various producing states. The distinguishing characteristic between Texas and Oklahoma (with most other jurisdictions taking one approach or the other), which directly impacts their distinctive opinions concerning the effect of production cessation during the secondary term, varies as to the type of estate created by the oil and gas lease by the habendum clause. Traditionally, the habendum clause contains a primary term for an express number of years, and a secondary term of an indeterminate duration such as "for so long thereafter as oil and gas produced in paying quantities."[2] Generally, one of two separate types of estates is deemed to be created by the oil and gas lease: the fee simple determinable or the profit a prendre. The fee simple determinable interest vests the lessee with a perpetual right in and to the oil and gas underlying the leased premises itself; or in place, once oil and gas has been produced from the subject premises in paying quantities, for as long as oil and gas continues to be produced. Conversely, the profit a prendre only conveys a right to explore and develop the leased premises for the purpose of producing oil and gas, if found, and the actual interest in and to the oil and gas only vests once it has been severed from the land by production.

In Texas, the law with regard to the leasehold estate, or the interest transferred by the oil and gas lease, was established by the Texas Supreme Court's rulings in *Texas Co. v. Daugherty*,[3] and *Stephens County v. Mid-Kansas Oil & Gas Co.*[4] In *Texas Co. v. Daugherty*, the court considered whether the interests in the oil and gas transferred to the lessee by several instruments were considered real property interests subject to taxation.[5] The court concluded the instruments transferred "a defeasible title in fee to the oil and gas in the ground, if oil and gas in place are capable of ownership and conveyance."[6] The court further stated, "[i]t is our conclusion that these instruments had the effect to confer upon the plaintiff

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2. *See* BLACK'S LAW DICTIONARY 778-79 (9th ed. 2009).
3. 176 S.W. 717 (Tex. 1915).
4. 254 S.W. 290 (Tex. 1923).
5. *See generally Texas Co.*, 176 S.W. at 717.
6. *Id.* at 719.

in error an interest in the several tracts of land described, the value of which was assessable against it for taxation."[7] Accordingly, the court established the transfers of the oil and gas conveyed defeasible real property interests in the leased premises and that said interests were subject to taxation.[8] The court further stated that said instruments operated to convey a fee simple subject to a condition subsequent.[9]

However, in *Stephens County v. Mid-Kansas Oil & Gas Co.*,[10] the Supreme Court of Texas changed its position with regard to the interest created by the oil and gas lease. In this case, the court once again was confronted with whether an instrument, specifically an oil and gas lease, operated to transfer an interest in property that would be subject to taxation.[11] The court ultimately concluded, the oil and gas lease did in fact convey a taxable interest in the leased premises.[12] However, in its analysis of the issue the court stated, "it was intended by all parties that the lands should be used for no other purpose than the specified mineral exploration and production, and that the grants were to be enjoyed only while such use continued and were to immediately terminate on cessation of the use."[13] The court continued, "[a]t common law, a grant of land for such a term and for such use and purpose-and–no other–created the estate called a base, qualified or determinable, fee. . . ."[14] Accordingly, the court determined that the oil and gas lease created a fee simple determinable that would automatically terminate upon cessation of the intended use of the property.[15] The Supreme Court of Texas has since clarified this position by declaring that a lease automatically terminates upon cessation of production after the primary term.[16]

A detailed discussion of the nature of the leasehold estate as a profit is found in the Wyoming case of *Denver Joint Stock Land Bank of Denver v. Dixon*,[17] which examined the historic legal commentaries of Blackstone, specifically focusing on the nature of hereditaments. According to the

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7. *Id*. at 722.

8. *See id.*

9. *Id*. at 719; *see also* Bruce M. Kramer, *The Temporary Cessation Doctrine: A Practical Response to an Ideological Dilemma*, 43 BAYLOR L. REV. 519, 522-23 (1991).

10. 254 S.W. 290 (Tex. 1923).

11. *Stephens County*, 254 S.W. at 291.

12. *Id*. at 296.

13. *Id*. at 295.

14. *Id*.

15. *See* Kramer, *supra* note 9, at 522-23; *see also* W.T. Waggoner Estate v. Sigler Oil Co., 19 S.W.2d 27, 28-29 (Tex. 1929).

16. Watson v. Rochmill, 155 S.W.2d 783, 784 (Tex. 1941); *see also infra* footnotes 45-53 and accompanying text.

17. 122 P.2d 842 (Wyo. 1942); *see also infra* footnotes 351-53 and accompanying text.

court, Blackstone recognized two separate types of hereditaments, the corporeal and the incorporeal.[18] The court, citing Blackstone, described a corporeal hereditament as being something with a physical embodiment, or manifestation, such that it can be experienced by the senses, or as the court states, "handled by the body."[19] However, the court recognized the incorporeal hereditament as a very different type of interest.[20] It distinguished the incorporeal hereditament as being something of a more abstract nature.[21] In the words of the Supreme Court, "incorporeal [hereditaments] are not the subject of sensation, can neither be seen nor handled, are creatures of the mind, and exist only in contemplation."[22] The court continued, "[a]n incorporeal hereditament is a right issuing out of a thing corporate whether real or personal, or concerning, or annexed to, or exercisable within the same."[23]

After establishing the two distinct categories of hereditaments, the Supreme Court of Wyoming continued its examination of the historical commentaries of Blackstone, focusing on "rights in common," as an example of an incorporeal hereditament.[24] Citing Blackstone, it stated that a right in common "appears from its very definition to be an incorporeal hereditament, being a profit which a man hath in the land of another, as to feed beasts, to catch fish, to dig turf, or cut wood or the like."[25] The court further concluded such rights are commonly referred to as profit a prendre.[26] Although the Supreme Court of Wyoming recognized in the aforementioned case this definition of incorporeal hereditaments does not necessarily seem to define a real property interest, the court relies on the historical authorities that have recognized that a real property interest "consist[s] of lands, tenements and hereditaments."[27] In addition, the court, relying on the analysis of Lord Coke, concluded that a profit a prendre interest is included within the definition of tenements and, as such, would be included in the definition of real property.[28] Therefore, the court stated, "the right to take oil and gas from the land is of the same nature as the

18. *Denver Joint Stock Land Bank*, 122 P.2d at 846.
19. *Id*.
20. *Id.*
21. *Id.*
22. *Id.*
23. *Id*.
24. *Id*. at 847.
25. *Id*.
26. *Id*.
27. *Id*. at 846.
28. *Id*. at 847.

incorporeal hereditament mentioned by Blackstone."[29] In the same vein as Wyoming, the courts in Oklahoma have articulated a different view than Texas with regard to the estate granted by the oil and gas lease. In *Danne v. Texaco Exploration and Production Inc.*,[30] the Court of Appeals held the oil and gas lease does not transfer or convey an actual interest in the leased premises, as the Texas courts concluded, but rather transfers the right to explore and mine the leased premises.[31] As the court stated, "[i]n the primary term, before hydrocarbons are discovered, the lessee has *the right to explore* for a fixed period of time."[32] Therefore, the interest transferred by the oil and gas lease in Oklahoma is much more like an incorporeal hereditament or profit, than a corporeal interest in property, as the Texas courts have viewed the leasehold.[33] The court further held that once oil and gas are produced from the subject tract, thereby extending the lease into the secondary term, "the lessee has proved a valuable asset and has established a right to develop that asset."[34] Accordingly, the court in *Danne* distinguishes the estate vested in the lessee in Oklahoma from that of Texas. While Texas courts hold that a lease conveys a real property interest in the leased premises, the court in Oklahoma concluded that during the primary term the lease only operates to transfer a right to explore and develop the oil and gas underlying the leased premises.[35] The actual right in and to the oil and gas itself does not vest until the lessee has established production.[36]

In *Danne*, the court discussed several issues including whether a lease extended into its secondary term can expire automatically when or if oil and gas cease to be produced in paying quantities.[37] The District Court had concluded that the oil and gas lease can automatically terminate and entered a judgment for the lessors.[38] However, in its consideration of this matter, the Court of Appeals yet again distinguished itself from Texas and other jurisdictions by stating, "Oklahoma does not, however, take the view that habendum clauses are special limitations; rather, Oklahoma views the habendum clause as an estate on condition subsequent creating only a right of entry in the grantor."[39] The court continued, "[w]ith such an estate, the

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29. *Id*.
30. 883 P.2d 210 (Okla. 1994).
31. *Danne*, 883 P.2d at 214.
32. *Id*. (emphasis added).
33. *See id.*
34. *Id.*
35. *Id.*
36. *Id.*; *see infra* footnotes 45-53 and accompanying text.
37. *Id*. at 212.
38. *Id*.
39. *Id*. at 213.

grantor must bring an action to cause forfeiture of the estate."[40] Ultimately, the court established that the habendum clause of an oil and gas lease creates a fee simple subject to condition subsequent that does not automatically terminate upon cessation of production.[41] Therefore, on the issue of whether an oil and gas lease extended into its secondary term can automatically expire, the Court of Appeals determined it could not and overruled the trial court.[42]

In coming to this conclusion, the court in *Danne* relied heavily on the opinion of the Supreme Court of Oklahoma in *Stewart v. Amerada Hess Corp.*[43] In *Stewart*, the court considered whether a cessation of production operated to terminate the lessee's interest in and to the subject lease.[44] The Supreme Court of Oklahoma stated, "[t]he thereafter clause is hence not ever to be regarded as akin in effect to the common law conditional limitation or determinable fee estate."[45] The court continued, "[r]ather, the clause is to be regarded as fixing the life of a lease instead of providing a means of terminating it in advance of the time at which it would otherwise expire."[46] Ultimately, in *Stewart*, the court concluded that cessation of production does not automatically result in the termination of the lessee's interest in the oil and gas lease during the secondary term.[47]

Texas and Oklahoma clearly differ in their approaches with regard to the estate created by the oil and gas lease. However their courts' positions regarding the effect of cessation of production after the primary term have, in some measure, rendered the distinctions between the two states' perspectives on the estate created by the oil and gas lease less significant in application. The following discussion, illustrates this similarity in application, despite the two states divergent views on the nature of the interest created by an oil and gas lease.

Traditionally, it is well established that a fee simple determinable estate includes a limiting event, the occurrence of which will result in the automatic termination of the estate. It is further established by the court in *Stephens County v. Mid-Kansas Oil & Gas Co.*,[48] that the state of Texas views the lessee's estate as a fee simple determinable estate,[49] as to which

40. *Id*.
41. *Id.* at 214.
42. *Id*.
43. 604 P.2d 854 (Okla. 1979).
44. *Stewart*, 604 P.2d at 856.
45. *Id.* at 858.
46. *Id*.
47. *Id*.
48. 254 S.W. 290 (Tex. 1923).
49. *See supra* footnotes 5-13 and accompanying text.

the Texas courts have concluded that the oil and gas lease will terminate when oil or gas ceases to be produced in paying quantities.[50] Acknowledging the potential harshness of this rule, the Texas Court of Civil Appeals in *Scarborough v. New Domain Oil and Gas Co.*,[51] recognized the inequity that could result from automatic termination upon cessation of production under the fee simple determinable estate.[52] Accordingly, the court established what has developed into the equitable principle known as the temporary cessation of production doctrine.[53] In this case, the issue was whether temporary cessation of production from the premises would result in the termination of the oil and gas lease.[54] Specifically, the issue was whether a lease would terminate when a producing gas well became inoperable and ceased production in March 1920, but the lessee was able to drill and establish production from an oil well by July 1920.[55] The court held that a temporary cessation of production should not result in a forfeiture, or termination, of the lease, if the cessation of production were "unforeseen and unavoidable" and if "the lessees in good faith used reasonable diligence to resume production, and at great outlay of money, and did, within a reasonable time . . . resume production."[56]

In *Watson v. Rochmill*,[57] the Supreme Court of Texas further explained its position with regard to the temporary cessation of production doctrine. The issue in this case was whether the oil and gas lease could be preserved under the temporary cessation of production doctrine when the cessation of production was due to the lack of a market for the oil being produced therefrom.[58] The court concluded that the oil and gas lease terminated due to the cessation of production, because said cessation was not temporary or caused by "mechanical breakdown or other condition in connection with the well or the equipment used in connection therewith."[59] Accordingly, the court established that a lease would not automatically terminate if "[the] temporary cessation of production [was] due to *sudden stoppage* of the well

50. *See* Watson v. Rochmill, 155 S.W. 783, 784 (Tex. 1941); *see also supra* footnotes 42-45 and accompanying text.
51. 276 S.W. 331 (Tex. Civ. App. 1925).
52. *Scarborough*, 276 S.W. at 336.
53. *See id.* at 335.
54. *Id*.
55. *Id.* at 334-35.
56. *Id*. at 336.
57. 155 S.W.2d 783 (Tex. 1941).
58. *Watson*, 155 S.W.2d at 784.
59. *Id.*

or some *mechanical breakdown* of the equipment used in connection therewith, or the like."[60]

In *Midwest Oil Corp v. Winsauer*,[61] the Supreme Court of Texas applied the temporary cessation of production doctrine to a term royalty deed. In so doing, it concluded that the determinable interest created by the deed would not automatically terminate, provided the "operator in good faith exercises diligence."[62] In this case, the court was forced to consider whether a cessation of production from a well, due to mechanical breakdown, and litigation, would result in an automatic termination of the term royalty deed.[63] The Texas Supreme Court concluded the cessation of production was temporary, and therefore did not result in automatic termination of the interest therein.[64] In its analysis of this case, the court seems to imply that temporary cessation of production provisions will be implied in all instruments purporting to convey an interest in the oil and gas for a term of years and as long thereafter as oil or gas is produced in paying quantities.[65] The Supreme Court of Texas suggests that a court should consider all the "surrounding facts and circumstances" in determining whether production was abandoned or temporary.[66]

Similarly, the courts in Oklahoma have adopted the doctrine of temporary cessation of production.[67] In 1958, the Supreme Court of Oklahoma, in *Cotner v. Warren*,[68] adopted the temporary cessation of production rule established by the courts in Kentucky in *Lamb v. Vansyckle*.[69] In *Cotner*, the court quoted the holding in the Kentucky case, which stated "the lease continues in force unless the period of cessation, viewed in the light of all the circumstances is for an unreasonable time."[70] The issue in *Cotner* was whether an oil and gas lease terminated when the owner of the property and well operator voluntarily shut the well down in an effort to terminate the lease such that the plaintiff would be precluded

60. *Id*. (emphasis added).
61. 323 S.W.2d 944 (Tex. 1959).
62. *Midwest Oil Corp.*, 323 S.W. at 948.
63. *Id*. at 945.
64. *Id.* at 948.
65. *See generally id.*
66. *Id.* at 947-48.
67. *See* Fisher v. Grace Petroleum Corp., 830 P.2d 1380, 1386-87 (Okla. Civ. App. 1991).
68. 330 P.2d 217 (Okla. 1958).
69. 266 S.W. 253 (Ky. 1924).
70. *Cotner*, 330 P.2d at 219 (quoting Lamb v. Vansyckle, 266 S.W. 253, 254 (Ky. 1924)); *see also* Hunter v. Clarkson, 428 P.2d 210, 212 (Okla. 1967) (determining that voluntary cessation of production resulted in a termination of the oil and gas lease because under the circumstances there were no reasons justifying the continuation of the lease); Pack v. Santa Fe Minerals, 869 P.2d 323, 326 (Okla. 1994).

from operating the well.[71] The court established that they must consider "the surrounding facts in each case" in determining whether a lease or mineral estate was terminated.[72] In its analysis, the court stated that the "controlling factual finding is whether the temporary stoppage in production was for an unreasonable length of time."[73] In addition, in *Townsend v. Creekmore-Rooney Co.*,[74] the Supreme Court of Oklahoma stated "[t]he lease terminates by its own provisions when oil or gas are no longer produced after the primary term, except where there are equitable considerations which justify a temporary cessation of production."[75] In *Townsend*, the court addressed whether an oil and gas lease terminates when production of oil and gas ceases without explanation for a period of seventeen months.[76] The court concluded that "the unexplained cessation of marketing of oil or gas from the leases for an extended period of several months is prima facie sufficient to justify cancellation."[77]

Accordingly, both Texas and Oklahoma recognize a similar rule with regard to temporary cessation of production. In addition, both states agree that when considering a case involving a possible temporary cessation of production, the courts must look at all the circumstances surrounding the cessation to determine whether the cessation should be considered permanent or temporary. As a result, both states courts will make this decision on an ad hoc basis. However, Oklahoma courts seems to emphasize the duration of the cessation rather than the actual cause, while Texas weighs heavily on the actual cause of the cessation of production. Ultimately, by adopting the common law rule of temporary cessation of production, both states have limited the effects of cessation of production with regard to the respective leasehold estates created therein. Despite their distinctions, both Texas and Oklahoma courts agree that upon a determination that the cessation of production is permanent, the oil and gas lease is forfeit or terminated under its terms.

Additionally, the two states agree that when a lease contains a cessation of production clause, the terms of the oil and gas lease clause will control over the general rule discussed above. As the Supreme Court of Texas stated in *Samano v. Sun Oil Co.*,[78] "[t]he sixty day provision is an integral

71. *See generally Cotner*, 330 P.2d at 219.
72. *Cotner*, 330 P.2d at 219 (citing Beatty v. Baxter, 258 P.2d 626 (Okla. 1953)).
73. *Id*.
74. 332 P.2d 35 (Okla. 1958).
75. *Townsend*, 332 P.2d at 37 (citing Brown v. Shafer, 325 P.2d 743 (Okla. 1958)).
76. *Id.*
77. *Id*. at 37-38.
78. 621 S.W.2d 580, 584 (Tex. 1981).

part of the drilling or reworking operations while the contract is in effect during the secondary period. Neither precedent nor sound reason exists for striking down that agreement."[79] In this case, the issue was whether a sixty day drilling or reworking clause was intended to apply to both the primary term and the secondary term of the lease, such that it would define the period for temporary cessation under the oil and gas lease.[80] In discussing whether the temporary cessation of production doctrine would apply, the court also stated, "under the lease here the parties agreed and stipulated what would constitute temporary cessation."[81] Applying the terms of the contract, the court held that when production stopped in the secondary term of the lease, the lessee had an express period of time to reestablish production and the lessee's failure to resume production during that period of time resulted in the termination of the oil and gas lease.[82]

In *Hoyt v. Continental Oil Co.*,[83] the Supreme Court of Oklahoma stated, "[w]here the parties have bargained for and agreed on a time period for a temporary cessation clause that provision will control over the common law doctrine of temporary cessation allowing a 'reasonable time' for resumption of drilling operations."[84] In *Hoyt*, the issue was whether the cessation of production clause would preserve the oil and gas lease if the well still produces but fails to produce in paying quantities. In its analysis, the court stated, "[a]fter the primary term, the effect of the cessation of production clause is to modify the habendum clause and to extend or preserve the lease while the lessee resumes operations . . . ."[85] The court explained that if the lessee fails to reestablish production during this period of time, the oil and gas lease will cease to be preserved by the clause at the expiration of said time and will terminate based on a failure to satisfy the habendum clause.[86] Both Texas and Oklahoma are in accord that the terms of the cessation of production clause will prevent the courts from applying the equitably remedy known as the temporary cessation of production doctrine and, instead, the parties will be bound to their agreement. This means that, although a cessation of production clause may ensure a period of preservation in the event of a cessation of production, it also provides an absolute end to the period of preservation if production is not restored, and

79. *Samono*, 621 S.W.2d. at 584.
80. *Id.*
81. *Id.* (quoting Woodson Oil Co. v. Pruett, 281 S.W.2d 159, 164 (Tex. App. 1955).
82. *Id.*
83. 606 P.2d 560 (Okla. 1980).
84. *Hoyt*, 606 P.2d at 563.
85. *Id.*
86. *Id.*

may result in a briefer period cure than might be allowed where the terms of the lease do not address temporary cessation.

III. TEMPORARY CESSATION OF PRODUCTION – A MULTI-STATE ANALYSIS

Various producing states take varying approaches to evaluating the issue of temporary cessation of production. Most however, tend to generally follow either the Texas or Oklahoma model in their treatment of the issue. This Part analyzes various court opinions to provide a sense of the approach taken in these jurisdictions and the extent to which they can be characterized as being aligned with either the Texas model or the Oklahoma model. The states include: New York, Pennsylvania, West Virginia, Kentucky, Virginia, Louisiana, Alabama, Mississippi, Tennessee, Illinois, Indiana, Michigan, Ohio, Kansas, Arkansas, Nebraska, Arizona, New Mexico, Utah, Arizona, Montana, Wyoming, Colorado, California, and Alaska. They are presented in this Article grouped by geographic proximity to one another.

A. NEW YORK

In New York, the law is unclear as to what interest an oil and gas lease conveys. In *Caflisch v. Crotty*,[87] the court noted New York adheres to the rule of capture. "[U]nder New York's 'rule of capture[,]' title to subsurface oil and gas vests in the party which first brings it to the surface and reduces it to possession."[88]

At least one case, *Wagner v. Mallory*,[89] has held an oil and gas lease is an incorporeal hereditament.[90] By comparison, in *Buck v. Cleveland*,[91] the court held an agreement apparently dealing with hard minerals granting an "exclusive right to prospect for, mine, quarry and take away all kinds of minerals," did not grant any "title to the lands or the minerals dissevered therefrom, but only a corporeal hereditament which did not pass to his heirs

87. 774 N.Y.S.2d 653 (N.Y. 2003).

88. *Caflisch*, 774 N.Y.S.2d at 657 (quoting *In re* Envirogas, Inc. v. Chu, 497 N.Y.S.2d 503, 505 (N.Y. App. Div. 1986)), *aff'd*, 503 N.E.2d 693 (N.Y. 1986).

89. 62 N.E. 584 (N.Y. 1902).

90. *Wagner*, 62 N.E. at 586; *see also* Jones Cut Stone Co., v. New York, 166 N.Y.S.2d 742 (N.Y. Ct. Cl. 1957) (dealing with quarrying and not oil and gas leases, but which held that a lease giving the right to quarry stone "gave to claimant an incorporeal hereditament, a right to quarry and take stone from the area involved. This stone became the property of claimant only upon its actual severance.").

91. 128 N.Y.S. 864 (N.Y. App. Div. 1911).

but to his administrator . . . ."[92] Finally, in *Banach v. Home Gas Co.*,[93] the court found a reservation of mineral rights is a profit a prendre.[94]

New York has little case law regarding cessation of production during the secondary term of an oil and gas lease. However, two New York appellate division court decisions indicate New York courts would apply the temporary cessation of production doctrine in certain circumstances. In the case of *Hill v. Trenkle*,[95] "market conditions" and the refusal of bank financing resulted in a lessee being unable to produce.[96] The duration of the failure to produce is not known.[97] The New York court refused to hold that the lease had terminated for failure to produce, and found the lessee had been prevented from proceeding with production by circumstances outside of their control (e.g. market conditions and inability to obtain financing) and that the cessation was temporary.[98] This decision suggests that New York, unlike Texas, acknowledges inability to market as acceptable grounds for a temporary cessation.

In the subsequent case of *Peckham v. Dunning*,[99] a lessee failed to produce in paying quantities for multiple years during the secondary term of an oil and gas lease as required under the habendum clause.[100] As a result, the lessor sought termination of the lease.[101] In its decision, the *Peckham* court cited *Hill v. Trenkle*[102] for the rule that a "temporary cessation of production does not terminate [a] lease."[103] Nonetheless, the court did not find a temporary cessation, and held the lessee's failures to produce in paying quantities for multiple years during the secondary term of the lease was not "from causes not within the control of the [lessee]."[104]

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92. *Buck*, 128 N.Y.S at 865.

93. 199 N.Y.S.2d 858 (N.Y. 1960), *aff'd*, 211 N.Y.S.2d 443 (N.Y. App. Div. 1961).

94. *Banach*, 199 N.Y.S.2d at 865.

95. 297 N.Y.S. 1020 (N.Y. App. Div. 1937).

96. *See* 2 W.L. SUMMERS, THE LAW OF OIL AND GAS § 14-7 (3d ed. 2012); *Hill*, 297 N.Y.S. at 1022. Note, only a memorandum opinion of the case is available from the reporting services, and so the full facts of the case are not known including the nature of the "market conditions" that resulted in application of the doctrine.

97. As previously indicated, only a memorandum opinion is available from the reporting services, so the known facts are limited to those recited in secondary materials such as Summers Oil and Gas and American Law Reports.

98. SUMMERS, *supra* note 96, § 14-7.

99. 125 N.Y.S.2d 895 (N.Y. App. Div. 1953).

100. *Peckham*, 125 N.Y.S.2d at 898.

101. *Id.* at 897.

102. *Hill*, 297 N.Y.S. at 1022.

103. *Peckham*, 125 N.Y.S.2d at 898-99.

104. *Id.* at 899.

B. PENNSYLVANIA

In Pennsylvania, the nature of a mineral interest depends on the language used to create it. In *Snyder Brothers, Inc. v. Peoples Natural Gas Co.*,[105] Appellants, fee simple owners of the land, granted a mineral lease to the Plaintiff. According to the court:

> a lease of minerals in the ground is a sale of an estate in fee simple until all the available minerals are removed; this leaves the lessor with only an interest in the royalties to be paid under the lease, which are personal property. . . . Specifically, the interest granted to lessee is a fee simple determinable; the lessor retains a reversionary interest. The interest reverts to the grantor upon the occurrence of a specified event.[106]

Yet, in *Kelly v. Keys*,[107] the court held that *Funk v. Haldeman*[108] and its progeny had consistently recognized that "a grant of exclusive rights to explore for oil and gas did not create an estate in land or in the oil but was an incorporeal hereditament."[109]

As was observed by the court in *United States Steel Corp. v. Hoge*,[110] minerals, like gas, are part of the property in which they are held and, while in the ground, belong to the property owner. Ownership of minerals can be transferred only through a grant by the property owner, or by the minerals migrating from below the property onto the property of another.[111]

The Pennsylvania Supreme Court has addressed the temporary cessation of production issue on one occasion.[112] In an action by a landowner claiming a royalty payment owed to him by a lessee, the court rejected the lessee's argument that the lease was abandoned and thus payment excused as a result of lessee disconnecting the well from the pipeline for a "brief" period.[113] Citing the fact that "a temporary cessation of production is not sufficient to terminate a lease," the court found the

105. 676 A.2d 1226 (Pa. Super. Ct. 1996).

106. *Snyder Bros. Inc*., 676 A.2d. at 1230 (citing Smith v. Glen Alden Coal Co., 32 A.2d 227 (Pa. 1943); Higbee Corp. v. Kennedy, 428 A.2d 592 (Pa. Super. Ct. 1981)).

107. 62 A. 911 (Pa. 1906).

108. 53 Pa. 229 (1867).

109. *Kelly*, 62 A. at 912.

110. 468 A.2d 1380 (Pa. 1983).

111. *United States Steel Corp*., 68 A.2d at 1383 (internal citations omitted).

112. "A temporary cessation of production is not sufficient to terminate a lease." Cole v. Phila. Co., 26 A.2d 920 (Pa. 1942) (citing 2 W.L. SUMMERS, THE LAW OF OIL AND GAS § 305 (3d Ed. 2012)).

113. *Cole*, 26 A.2d. at 923.

lease had not been terminated and therefore the royalty payment was due.[114] The court in dicta observed:

> The cost of developing an oil or gas territory so as to make it yield a profit is ordinarily very heavy. It requires both time and money. A cessation of operations for a short time does not signify the same intention as the abandonment of a place of residence or mercantile room. The time of abandonment or cessation of operations has important bearing on the question of intention, but it is obviously not controlling; for abandonment of the premises for a very short time, accompanied by other acts showing unequivocal intention not to return to the property or to do further work thereon, would amply justify [terminating the lease] FalseOn the other hand, the circumstances and conditions may be such as clearly to negative intention to give up the premises when operations have been suspended for a considerable time.[115]

C. WEST VIRGINIA

In an early West Virginia case, *Sult v. Hochstetter Oil Co.*,[116] the West Virginia Supreme Court of Appeals addressed an intricate mineral title dispute over an oil and gas leasehold allegedly passed through a web of deed reservations, lease assignments, intestate succession, and corporate dissolution. The details of this ownership morass can be left aside to focus on three relevant discussion points in the decision: (1) a description of the oil and gas lessee's interest; (2) a common law of "minerals" under a deed reservation; and (3) an explanation of lease abandonment.

1. *Nature of Lessee's Interest*

The court affirmed equity jurisdiction to settle the competing rights of two lessees claiming rights under separate leases from the same party. The court clarified that an oil and gas lessee acquires a mere "license, conferred by the contract of lease, an incident of which is the right to sever, and carry away, the minerals, a part of the corpus of the land."[117] This interest, "peculiar in both nature and subject matter," is a unique right fit for equity jurisdiction.[118]

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114. *Id.*
115. *Id.* (quoting Sult v. A. Hochstetter Oil Co., 61 S.E. 307, 313 (W.Va. 1908)).
116. *See* Sult v. A. Hochstetter Oil Co., 61 S.E. 307, 308-10 (W.Va. 1908).
117. *Id.* at 310.
118. *Id.*

2. *"Minerals" Defined*

The court addressed the critical dispute of whether deed language reserving "all minerals in and under" specified acreage included a reservation of all oil and gas to be produced therefrom.[119] After contrasting the traditional "English rule" with the then-developing "American rule,"[120] the court adopted the former's broad construction of "minerals" to include oil, gas, and all other minerals generally extracted for profit absent contrary language in the contract.[121]

3. *Oil and Gas Lease Abandonment*

Most relevant to issues of temporary cessation, the court laid down key comments in deciding whether an oil and gas lease expired by virtue of nonproduction. Put simply, the court explained "[t]hough a lease, so terminated [by abandonment] is said to have come to its end by operation of law, the legal result arises from the acts of the parties" expressing the intent of both lessor and lessee.[122] The court further explained that the unique aspects of oil and gas production mean that "acts tending to show abandonment . . . differ in their nature and probative weight" from other lease relationships.[123] As such, the court held that lapses in production and their duration are facts relevant to, but not determinative of, lease termination:

> The time of abandonment or cessation of operations has important bearing on the question of intention, but it is obviously not controlling; for abandonment of the premises for a very short time, accompanied by other acts, showing unequivocal intention not to return to the property or to do further work thereon, would amply justify resumption of possession by the lessor and the execution of a new lease to another party. On the other hand, the circumstances and conditions may be such as clearly to negative intention to give up the premises when operations have been suspended for a considerable period of time.[124]

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119. *Id.*

120. *Id.* at 310-11 (finding English decisions consistently held "that mineral will, *prima facie*, include every substance which can be got from underneath the surface of the earth for the purpose of profit," while "some American decisions say the parties to a contract are presumed not to have intended, by the use of the term, anything other than solid substances. . . .").

121. *Id.* at 311.

122. *Id.* at 329.

123. *Id.* at 330 ("A cessation of operations for a short time does not signify the same intention as abandonment of a place of residence or a mercantile room.").

124. *Id.*

In sum, the court articulated an early formulation of the temporary cessation of production doctrine and its underlying principles – no period of nonproduction will terminate a lease automatically if such would contradict the intent of the leasing parties as evidenced by their conduct.[125]

According to the West Virginia Supreme Court in *Bryan v. Big Two Mile Gas Co.*,[126] factors to be considered in determining whether the cessation is "temporary" include the length of time without production, the cause of the delay, and whether the lessee exercised reasonable diligence to resume production.[127] In *Bryan*, the plaintiff lessor sued the lessee, asserting that the lessee had lost its right to operate a gas well due to two periods of cessation of production.[128] The lease was a fixed rate lease providing for a royalty of one cent per Mcf.[129] The lessee paid no royalty during the periods of nonproduction.[130] The court found in favor of the lessor and awarded the lessor "reasonable royalty" (determined to be 1/8th) on the gas produced from the well.[131] Both parties appealed.[132] On appeal, the court found a cessation of mineral production will automatically terminate a lease unless it is excused under the "temporary cessation of production" doctrine.[133] The court held a "temporary" cessation of production is excusable if it is (1) not unreasonably protracted, (2) incidental to the normal operation of the lease, and (3) if it can be said that the possibility of such a period of cessation would be contemplated by objectively reasonable parties to such a lease.[134] The court found that there was sufficient evidence that the cessation from 1979-80 was an excusable cessation, but that the period from 1987-90 was inexcusable, creating a forfeiture of the lease.[135]

A cessation of production clause in a West Virginia oil and gas lease provides a grace period during which production may stop and restart, and the lease will not terminate.[136] If the lease includes a cessation of production clause, the length of time stipulated in the lease will control. If the lease does not include a cessation of production clause, then cessation of

125. *Id.*
126. 577 S.E.2d 258 (W.Va. 2001).
127. *Bryan*, 577 S.E.2d at 266.
128. *Id.* at 263.
129. *Id.*
130. *Id.*
131. *Id.* at 264.
132. *Id.*
133. *Id.* at 269-70.
134. *Id.*
135. *Id.* at 266.
136. McCullough Oil, Inc. v. Rezek, 346 S.E.2d 788, 795 (W.Va. 1986).

production during the secondary term of the lease typically will result in the automatic termination of the lease.[137] However, courts have held that a mere "temporary" cessation of production does not terminate the lease.[138] Typical events that qualify as "temporary" include the types of delays that are not normally protracted and which are incidental to the normal operation of the lease, such as repair or technical problems, and reworking operations.[139]

In *McCullough*, the original lessee (McCullough) brought an action against its assignees and the new lessor, claiming that the surrender of the lease by its assignees constituted abandonment that should have triggered a reversion of the lease to McCollough.[140] The trial court granted summary judgment for the new lessor, holding that the oil and gas lease was not abandoned, but was automatically terminated when the lessee failed to resume operations within sixty days after production ceased during the secondary term of the lease.[141] The court affirmed.[142] The lease provided that if, after the primary term of the lease, production ceased for any reason, "this Lease shall not terminate, provided Lessee resumes operations within sixty (60) days from such cessation."[143] The lease also provided that no default of payment or performance, and thus no forfeiture, could be declared without giving notice to the lessee and allowing ten days to cure the default.[144] The lessee admitted that there was no activity or effort to produce oil or gas, and no payment of royalties or rentals, for a period of six years.[145] The court held that the self-executing terms of the habendum clause terminated the lease automatically.[146] As the lessor argued for automatic termination and not forfeiture, the court concluded that the original lessee was not entitled to notice under the "notice and demand" clause.[147] The court noted many leases contain a "savings" clause called a "cessation of production" clause, which extends a grace period to the lessee if there is a cessation of production during the secondary term of the lease.[148] Absent a cessation of production clause, courts have developed a

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137. *Id.*
138. *Id.*
139. *Id.*
140. *Id.* at 792.
141. *Id.*
142. *Id.* at 798.
143. *Id.* at 791.
144. *Id.* at 797.
145. *Id.* at 792.
146. *Id.* at 795.
147. *Id.* at 796.
148. *Id.* at 793-94.

"temporary" cessation of production doctrine, where a mere "temporary" break in production during the secondary term does not result in automatic termination.[149] The lease involved in *McCullough* did not contain a savings clause but provided for automatic termination if production ceased for sixty days.[150]

D. KENTUCKY

In Kentucky, the courts were early adopters of the cessation of production doctrine. The Kentucky Court of Appeals held in *Lamb v. Vanscykle*,[151] an oil and gas lease remained intact despite a fifty-six-day period of nonproduction in the secondary term.[152] After first achieving production sufficient to survive a two-year primary term, the lessee experienced financial trouble and ceased production for fifty-six days in the wake of creditor litigation.[153] The court, holding that the circumstances were such that the lease did not terminate,[154] provided a fact-based approach that mirrors today's temporary cessation of production doctrine:

> [W]e [are not] willing to adopt the rule that a lease which is to continue for a definite period, and so long as oil or gas is produced in paying quantities, *ipso facto* terminates whenever production or development ceases for a brief period of time. On the contrary, we have reached the conclusion that the 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 an unreasonable time.[155]

The issue of what is an unreasonable time must be determined by the facts and circumstances surrounding each case.[156] Where wells had not been producing profitably for ten years and where it had become necessary to water flood if any production were to occur, the court found that no actual production in over two years was sufficiently unreasonable to

149. *Id.* at 795.
150. *Id.* at 792.
151. 266 S.W. 253 (Ky. 1924).
152. *Lamb*, 266 S.W. at 254.
153. *See id.*
154. *See id.* at 254 ("Here, there was a delay of only fifty-six days . . . at a time when the rights of creditors had intervened . . . [and] no one [was] willing to undertake further operation of the lease until the rights of the parties were adjusted. In view of these circumstances we conclude that the delay in development or production was not so unreasonable as to put an end to the lease.").
155. *Id.*
156. *Id.*

terminate the lease under the provisions of the habendum clause.[157] The court noted a strong public policy against a lessee holding land for an unreasonable length of time simply for speculative purposes, or because of a lack of due diligence, where the lessor's only revenue results from royalty payments received from continued production.[158]

In evaluating what is reasonable, the court is influenced by the actions and intentions of the parties. Where a well had minimal production for a period of years, and no actual production after 1945, the court nevertheless found that the well had not ceased production until that time that both the lessor and the lessee agreed that it had,[159] indicating:

> Notwithstanding lack of actual production . . . it appears that the lessor and the lessee both considered this well as one of some continuing prospect and some remaining possibility right on up until the fall of 1946 or the early part of 1947, when these parties met and thereupon definitely discussed a final cessation of production. The well, uncapped and unsealed, seems to have remained ready, until late 1946, for productive efforts, just like a fertile field waiting for a plow under the springtime sun.[160]

The court found that until the parties met and agreed that production from the well would cease, the well was still potentially – albeit marginally – productive.[161] "[T]he uncapped, unpumped well of this lease remained in production until the judgment of these parties was pronounced against it in late 1946 or early 1947. Production, in a broad sense, is not a continuing usage. Rather, it is a continuing possibility, we believe . . . ."[162]

E. VIRGINIA

Virginia oil and gas jurisprudence is quite underdeveloped, and no Virginia court has addressed the issue of temporary cessation of production directly. Perhaps the best indication of how Virginia courts are likely to treat temporary cessation is provided by a recent decision of the U.S. District Court for the Western District of Virginia.[163] In this case, the court looked to Colorado case law as persuasive on a number of other oil and gas lease issues, including whether a lessee is permitted to deduct post-

157. *Id.*
158. *Id.*
159. Locke v. Palmore, 215 S.W.2d 544, 545 (Ky. Ct. App. 1948).
160. *Id.*
161. *Id.*
162. *Id.*
163. *See generally* Legard v. EQT Prod. Co., No. 1:10cv00041, 2011 U.S Dist. LEXIS 2943 (W.D. Va. Jan. 11, 2011).

production costs from royalty payments and what duties are implied in oil and gas leases.[164] The district court held that Virginia would likely recognize an implied duty on the part of lessees "to operate diligently and prudently, including a duty to market the gas produced."[165] "Without recognizing an implied duty on the part of the operator to act diligently and prudently, royalty owners would have no assurance of ever receiving any benefit of their bargain."[166] In that spirit, Virginia would likely require lessees to act prudently in regaining production as the circumstances allowed. Virginia has also determined that "an implied duty cannot be used to override or modify any explicit contractual term or right."[167] Therefore, the contract negotiated by the parties will generally control, suggesting that an express contract term would be considered controlling over a general doctrine regarding cessation.

F. LOUISIANA

As a general rule, leases that contain the typical "thereafter" clause will terminate if no production is obtained at the end of the primary term, as the clause is construed as a special limitation.[168] Although Louisiana courts have not formally adopted the temporary cessation of production doctrine, they have addressed the issue of whether a lease should terminate for failure of production. In an action by a lessor to cancel an oil and gas lease because no oil or gas had been produced for six months, the lessee defended its failure to produce by invoking a force majeure provision.[169] The court determined that seasonal rains were to be expected, and the defendant had not established that he used due diligence in attempting to dispose of the

164. *Id.*

165. *Id.* at *38-39.

166. *Id.* at *38.

167. *Id.* at *35 (citing Ward's Equip., Inc. v. New Holland N. Am., Inc., 493 S.E.2d 516, 520 (Va. 1997); Riggs Nat'l Bank of Wash., D.C. v. Linch, 36 F.3d 370, 373 (4th Cir. 1994)).

168. *See* 3-6 HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL AND GAS LAW § 604.1 (1991); Taylor v. Kimbell, 54 So. 2d 1, 2 (La. 1951) ("Under the plain terms of the lease contract, the primary term having expired, all rights granted the lessee under the lease have terminated unless the record shows that the gas well drilled on the premises can be classed as a producer in paying quantities and was shut in because of no market or demand for the gas.").

169. Logan v. Blaxton, 71 So. 2d 675, 676 (La. Ct. App. 1954) ("Defendant further alleged that oil was produced . . . until the month of November, 1951, at which time it was necessary to temporarily discontinue operations for the production of oil, due to the fact that the storage tanks located on said lease were full, and that the condition of the road over which said oil had to be transported to market was impassable due to excessive rains, . . . and that, therefore, he had been . . . prevented from selling, marketing and delivering such crude oil by Force Majeure . . . .").

production.[170] For that reason, the court determined the force majeure clause did not save the lease.[171]

However, the court went on to apply a separate provision in the lease that provided as follows:

> [I]n the event lessor considers that operations are not being conducted in compliance with this contract, lessee shall be notified in writing of the facts relied upon as constituting a breach hereof and lessee shall have sixty (60) days after receipt of such notice to comply with the obligations imposed by virtue of this instrument.[172]

Because the contract is "law between the parties," the plaintiff lessor must give the required notice in order to bring suit for termination.[173]

The court further stated that without the foregoing provision in the contract, "it would appear that a putting in default would be necessary before bringing an action for the dissolution of the contract."[174] This conclusion was based on the court's analysis that where a time period is not express, but is a reasonable time, or work is to be done with reasonable diligence, that the issue of default is one of fact and not as a matter of law, so that an express notice of default was required.[175] Based on the foregoing analysis, in the absence of a clause requiring additional drilling or reworking within a specified time after cessation of production, the lessee is held to a "due and reasonable diligence" standard, and the lessor may be required to put the lessee in default prior to bringing suit.

The more common set of facts includes a provision similar to the one at issue in *Trinidad Petroleum Corp. v. Pioneer Natural Gas. Co.*:[176]

> If prior to discovery of oil, gas, sulfur or other minerals on said land, lessee should drill a dry hole or holes, thereon, or if after discovery of oil, gas, sulfur or other mineral, the production thereof should cease from any cause, this lease shall not terminate if lessee commences operations for additional drilling or reworking within sixty days thereafter.[177]

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170. *Id.* at 677 (acknowledging that it would not have been economical to connect the well with any pipe lines in the area, but noting the "defendant made only one effort to produce transportation for the oil").

171. *Id.*

172. *Id.* at 678.

173. *Id.*

174. *Id.*

175. *Id.* (citing Temple v. Lindsay, 161 So. 8, 12 (La. 1935)) (emphasis added).

176. 416 So. 2d 290 (La. Ct. App. 1982).

177. *Trinidad Petrol. Corp.*, 416 So. 2d at 296.

Louisiana courts have construed such a provision as creating an express resolutory condition, *i.e.*, the cessation of production for a period of sixty days, the occurrence of which will effectively terminate the lease.[178] In *Trinidad Petroleum*, the plaintiff lessee sought to confirm that its lease was still effective under a force majeure clause and to determine that the defendant lessor's purported new lease to a third party was void.[179] The court noted that Louisiana jurisprudence "has strictly limited the application of force majeure as an excuse for performance." Rejecting force majeure defenses, the court rejected both arguments, stating that the lessee had "the right either to continue the lease in effect by commencing drilling or reworking operations within [sixty] days or the right to allow the lease to expire."[180] Because the failure to commence such operations within sixty days worked a termination of the lease, the lessor need not place the lessee in default prior to bringing judicial proceedings to cancel the lease.[181] In other words, the lessee was put in default pursuant to the express resolutory condition contained in the lease, with no additional actions needed on the part of lessor. Several cases have covered the issue of what constitutes "reworking" sufficient to maintain the lease pursuant to a savings clause. This issue commonly arises when a lessor seeks to terminate a lease, arguing work done was "maintenance" that does not qualify as "reworking."[182]

When a lessor files suit questioning the validity of a lease or to terminate a lease, an issue may arise as to the extension of the lease term due to the litigation. The lessor, by bringing such action, deprives the lessee of "the exercise of the rights granted to him by the lease" and he should be granted an extension beyond the primary term equal to the length

178. *Id.* at 298; *see also* Amoco Prod. Co. v. Carruth, 512 So. 2d 571, 574 (La. Ct. App. 1987) ("'[N]o cessation' clauses can state resolutory conditions."). The court in *Carruth* looked to *Talley v. Lawhon*, 90 So. 427 (La. 1922), and *Woods v. Ratliff*, 417 So. 2d 1375 (La. Ct. App. 1981) for the proposition that "no cessation" clauses *can* state resolutory conditions. *Id.* The leases in those cases contained language explicitly causing the lease to terminate upon failure to meet the condition (*e.g.*, "lease payments . . . waived . . . *as long as* . . . no cessation of work of over 60 days" and "lease could be maintained only *so long as* the lessee either . . ."). *Id.* (emphasis added). The lease in *Carruth* did not contain such durational language, but the court stated that "the lease as a whole indicates that failure to pay rentals or conduct operations as defined by paragraph six will result in termination of the lease." *Id.*

179. *Trinidad Petrol. Corp.*, 416 So. 2d at 291.

180. *Id.* at 300.

181. *Id.* at 296. Note that in a dissent, Judge Doucet determined that the force majeure provision did save the lease, and, as such, the lessor was not required to put the lessee in default. *Id.* at 303-07. Interestingly, Judge Doucet wrote the majority opinion for *Acquisitions, Inc. v. Frontier Explorations, Inc.*, 432 So. 2d 1095 (App. La. 1983), the following year, which focused heavily on the need to place lessee in default for failure to properly pay shut-in payments if classified as royalties.

182. *See generally* House v. Tidewater Oil Co., 219 So. 2d 616 (App. La. 1969).

of the litigation.[183] However, if the challenge comes subsequent to the expiration of the primary term, the lease will either be found viable or not, without regard to the litigation itself affecting the term. But, if the lessor brings a suit for termination for a reason other than cessation of production in paying quantities, a lessor may not "complain thereafter when production drops below paying quantities because of the lessee's decision not to expend the funds necessary to maintain the lease during the pendency of the lawsuit."[184]

In the foregoing cases, the courts of Louisiana have shown little tolerance for continued cessation of production.[185] If production or reworking activities can resume through any means, the courts will typically require the operators to diligently pursue those other avenues. On the other hand, the Louisiana courts show a willingness to withhold a remedy to a lessor who does not put his lessee in default prior to bringing suit for termination of the lease if the lease has not yet expired by its own terms; for example, the time of an express contract provision has not run.[186] If the provision has expired, the lease will terminate, unless the lessee can demonstrate that it has commenced "reworking" or drilling operations sufficient to maintain the lease.[187]

G. ALABAMA

In Alabama, cases have come to varied conclusions on the nature of a mineral interest. Some have held a mineral lease is a corporeal hereditament,[188] whereas others have said that an oil and gas lease creates an incorporeal hereditament, with title remaining in the lessor.[189] However, the court in *NCNB Texas National Bank, N.A., v. West*[190] stated the Alabama rule most clearly:

> Alabama determines ownership of oil and gas under the nonownership theory, which recognizes the migratory nature of oil and gas and requires actual possession to establish ownership. The owner of property containing gas has the right to reduce the gas to

183. *Id.* (citing Hanszen v. Cocke, 246 So. 2d 200, 203 (La. Ct. App. 1971)).
184. Noel v. Amoco Prod. Co., 826 F. Supp. 1000, 1014 (W.D. La. 1993).
185. *See supra* footnote 178 and accompanying text.
186. *Id.*
187. *Id.*
188. *See* Willcutt v. Union Oil Co., 432 So. 2d 1217, 1221 (Ala. 1983). *See generally* Williams v. Kitchens, 74 So. 2d. 457 (Ala. 1954).
189. Moorer v. Bethlehem Baptist Church, 130 So. 2d 367, 371-72 (Ala. 1961); Lake v. Sealy, 165 So. 399, 401 (Ala. 1936); Louisville & N.R. Co. v. Massey, 33 So. 896, 897 (Ala. 1902).
190. 631 So. 2d 212 (Ala. 1993).

> possession or to sever the gas rights by conveyance. The nonownership theory of gas ownership, because it recognizes the migratory nature of oil and gas, requires actual possession to establish ownership of the resource, and the right held by the landowner is "the right to reduce the oil and gas to possession or to sever this right for economic consideration."[191]

In *Griffen v. Crutcher-Tufts Corp.*,[192] the court was presented with the question of whether an oil and gas lease is held open by production of a well drilled outside of the primary term of the lease.[193] The relevant facts in *Griffen* were that an oil and gas well that had been producing for several years during the primary term of the lease was shut down for workover operations shortly before the January 15, 1980 expiration of the primary term.[194] Those workover operations were unsuccessful and the well was abandoned on April 10, 1980.[195] In May of 1980, a new well was drilled at a different location.[196] Griffin claimed that the lease had expired at the end of the primary term, because there was no production.[197] Crutcher-tufts Corp. argued that a "drilling operations clause" in the lease extended the lease while the second well was being drilled and produced.[198] The drilling operations clause provided in part, that if the lessee is engaged in drilling or reworking operations within sixty days of the expiration of the primary term, the lease would remain in effect "so long as operations are prosecuted with no cessation of more than sixty (60) consecutive days, and if they result in the production of oil or gas or other mineral . . . ."[199] The *Griffen* court agreed with Griffin and held that under the drilling operations clause in the lease, it was necessary for production to have been obtained as a result of the reworking operations that were occurring at the end of the primary term.[200] Drilling a second well in April, which was more than sixty days after the end of the primary term, could not maintain the lease.[201] *Griffen* stands for the proposition that Alabama considers an oil and gas

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191. *NCNB Tx. Nat'l Bank*, 631 So. 2d at 223 (citing Sun Oil Co. v. Oswell, 62 So. 2d 783, 787 (1953)).
192. 500 So. 2d 1008 (Ala. 1986).
193. *Griffin*, 500 So. 2d at 1012.
194. *Id.* at 1009.
195. *Id.*
196. *Id.*
197. *Id.*
198. *Id.* at 1009-10.
199. *Id.* at 1010.
200. *Id.* at 1011.
201. *Id.* at 1010. The court noted that the Defendants could have included a "*continuous* drilling operations clause," which would have allowed the second well to have maintained the lease. *Id.*

lease to be a fee simple determinable because the court treated the lease as expired once the producing well holding the lease was abandoned and the primary lease had expired.[202]

In *Sheffield v. Exxon Corp.*,[203] the Supreme Court of Alabama recognized that many oil and gas leases contain cessation of production clauses that generally provide for termination of the lease "in the event that certain time periods expire without the operator or lessees having prosecuted 'drilling' or 'reworking' operations."[204] As a result, the court set out to define, generally, what operations constitute "drilling" or "reworking," noting that each case will be fact specific.[205] Looking favorably to Oklahoma law, in particular, *Hoyt v. Continental Oil Co.*,[206] the court noted the key factor for evaluating drilling or reworking operations, where a lease does not expressly dictate what operations will defeat a cessation of production clause, is that the operations be associated with the physical site of the well or unit.[207] Negotiations or other non-site efforts that do nothing to make the well capable of production are not sufficient activities to constitute "drilling or reworking."[208] Furthermore, in Alabama, a well generally must be capable of producing in paying quantities to be considered "producing."[209] The *Sheffield* court did not reach the question of what period of time it takes to trigger cessation of production as the court appears to be assuming that leases will generally contain time triggers with regard to cessation of production.[210]

H. MISSISSIPPI

As a general rule in Mississippi, an oil and gas lease will terminate if no production is obtained at the end of the primary term.[211] However, Mississippi has formally adopted the temporary cessation of production

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202. *Id.* at 1011.

203. 424 So. 2d 1297 (Ala. 1982).

204. *Sheffield*, 424 So. 2d at 1302.

205. *Id.*

206. 606 P.2d 560 (Okla. 1980).

207. *Sheffield*, 424 So. 2d at 305.

208. *Id.* at 1302-03.

209. *Id.* at 1303 ("We emphasize that our treatment of the 'capable well' issue—a well capable of producing oil or gas in paying quantities—is limited to the context of the instant case and is not necessarily to be given the same treatment in other contexts.").

210. *Id.* at 1305.

211. Mississippi has not expressly stated whether actual production is required to extend a lease beyond the primary term. However, a federal district court opinion upholding Mississippi law has held that the drilling of a discovery well prior to the expiration of the primary term was enough to hold past the primary term, especially because the "actual drilling thereafter proceeded with diligence until the well was spudded." D'Lo Royalties, Inc. v. Shell Oil Co., 389 F. Supp. 538, 549 (S.D. Miss. 1975).

doctrine in the case of *Frost v. Gulf Oil Corp*.[212] In this case, the Supreme Court of Mississippi, decided a lease dispute in which lessors argued that the lessee's cessation of production terminated the lease.[213] The court initially declared that mineral leases are to be construed against the lessee and in favor of the lessor and that general rules of construction are to be used.[214] The court went on to state:

> The authorities agree that temporary cessation of production after the expiration of the primary term does not terminate the lease, ipso facto. A reading of the numerous cases cited by the parties clearly indicate that the courts have generally applied the rule of reasonable construction to the question of when and under what circumstances cessation of production after the expiration of the primary term will terminate a mineral lease. Consideration must be given to the contract itself and the circumstances attending the cessation and whether the cessation is a reasonable incident to the continued production of minerals.[215]

The most important factor for a court to consider is "whether or not the temporary stoppage in production was for an unreasonable length of time," with five to six months being considered acceptable though no maximum time period was set.[216] In *Frost*, the court stated that after the lessee had expended considerable resources for the well and because production was only on hold for four months while the lessee could obtain a required permit, "such cessation of production pending these administrative procedures was an incident to the proper production of gas . . . and was therefore not an unreasonable delay . . . ."[217]

In many cases, the general cessation of production doctrine will not be applicable because the lease will expressly provide a set period of time in which the lessee must undertake reworking operations or drill a new well in order to maintain the lease. In those situations, reasonableness will no longer be the test. Rather, the question will be whether the lessee has in fact resumed the required operations within the time period specified by the lease agreement.[218]

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212. 119 So. 2d 759 (Miss. 1960).
213. *Frost*, 119 So. 2d at 761.
214. *Id.*
215. *Id.* 761-62.
216. *Id.* at 762.
217. *Id.* at 764.
218. Lone Star Prod. Co. v. Walker, 257 So. 2d 496, 501 (Miss. 1971) (indicating the rule developed in *Frost* should be applied). "The *Frost* case had under consideration a lease which did not contain the sixty (60) day clause which is in appellants' leases and held that temporary cessation of production after expiration of the primary term of a mineral lease does not terminate

If a well is shut-in, it is a "producing well that has been closed down temporarily for repairs, cleaning out, building up pressure, lack of a market, etc.,"[219] and a cessation of production clause may have a different effect. In Mississippi, if a well subject to a cessation clause is shut-in, the cessation clause does not take effect in situations where the well is under constructive production because the lessee is tendering shut-in royalties. The lease will not be terminated if the lessee did not undertake reworking or drilling operations in line with the cessation clause (unless the terms of the lease so require), because the shut-in clause is applicable.

One issue encountered in interpreting cessation of production clauses is how to handle declines in production. If production is originally found in paying quantities, but then declines to something less than that, though still nominal production, is the cessation of production clause triggered? In a Mississippi case, the lease at issue used the word "production" as follows: "[i]f prior to the discovery of oil, gas or other mineral on said land or on acreage pooled therewith, [l]essee should drill a dry hole or holes thereon, or if after the discovery of oil, gas or other mineral, the *production* thereof should cease from any cause."[220] The court determined that because "production" is an unambiguous word, the court should interpret it by its plain meaning; if the parties had meant "production in paying quantities," those are the words they should have used.[221] Therefore, the production will not be considered to have "ceased" until no *actual* production is had from the well.

Additionally, cessation clauses commonly identify "reworking operations" as one of the actions that will maintain the lease. Yet, an exact definition of the term "reworking operations" has eluded the court, as it is difficult to formulate with exactness considering "the problems of capturing and producing oil and gas located thousands of feet below the surface of the earth are many and varied."[222] Generally, reworking includes "testing, evaluation and other acts performed necessary to reworking a given well, and each case will have to be considered in light of facts peculiar to that

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the lease, ipso facto." *Id.* "Appellants' leases contained provisions that if production ceased for sixty (60) days and drilling or reworking operations were not conducted without cessation for more than sixty (60) days, the leases would terminate; therefore, the rule in *Frost* has no application to this case." *Id.*

219. Cavanaugh v. O'Connell, 732 So. 2d 912, 915 (Miss. 1999) (citing 8 HOWARD R. WILLIAMS & CHARLES J. MEYERS, MANUAL OF OIL & GAS TERMS ANNOTATED 1026 (1996)).

220. Roberts v. Corum, 112 So. 2d 550, 553 (Miss. 1959) (emphasis added).

221. *Id.* at 554-55.

222. *Lone Star Prod.*, 257 So. 2d at 500.

operation. One of the prime requirements is that the acts of the operator constitute a bona fide effort to rework a given well."[223]

I. TENNESSEE

In Tennessee, a lease will terminate upon the expiration of the primary term if no production is obtained. "Production" is defined in Tennessee to mean production "in paying quantities."[224] Tennessee has not formally adopted the temporary cessation of production doctrine. Based on Tennessee case law, a lessee whose production temporarily lapsed will be held to the highest standards of prudence and diligence in order for a court to find that the lease had not permanently lapsed. Tennessee has determined the purpose for granting an oil and gas lease is for the development of the leased property, therefore, the terms of the oil and gas lease, specifically those dealing with production, or the lack thereof, should be interpreted in favor of the lessor.[225] However, such inquiries are fact-based and depend on the totality of the circumstances.

Tennessee has recognized that the "purpose of the cessation of production clause is to 'describe the rights of the lessee to resume operations if production should cease.'"[226] In *P.M. Drilling, Inc. v. Groce*,[227] the lease at issue contained a habendum clause allowing shut-in payments to constitute production, and a cessation of production clause that required operations to be commenced within ninety days after production ceased for any cause.[228] The court determined the meaning of "production" in the habendum clause included constructive production by the payment of royalties, while the meaning of "production" in the cessation of production clause was the definition traditionally given to the word in Tennessee – production "in paying quantities."[229] When actual production ceased, the lessee paid shut-in payments but did not resume operations for the drilling of a new well within the ninety days provided.[230] Therefore, although the lease did not lapse under the habendum clause, it lapsed under the cessation

223. *Id.*
224. P.M. Drilling, Inc. v. Groce, 792 S.W.2d 717, 721 (Tenn. Ct. App. 1990).
225. Waddle v. Lucky Strike Oil Co., 551 S.W.2d 323, 326 (Tenn. 1977) (citing Mountain States Oil Corp. v. Sandoval, 125 P.2d 964, 967 (Col. 1942)).
226. *P.M. Drilling, Inc.*, 792 S.W.2d at 721 (citing 4 EUGENE KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 47.3 (1972)).
227. 792 S.W.2d 717 (Tenn. Ct. App. 1990).
228. *P.M. Drilling, Inc.*, 792 S.W.2d at 719.
229. *Id.* at 721-22.
230. *Id.* at 723.

of production clause.[231] The court in *P.M. Drilling* acknowledged that these facts produced "a strange result."[232]

A common term used in cessation of production clauses is "reworking":

> If at the expiration of the primary term oil or gas is not being produced on said land but lessee is then engaged in drilling or *reworking* operations thereon, this lease shall remain in force so long as operations are prosecuted with no cessation of more than sixty days, and if they result in production of oil or gas so long thereafter as oil or gas is produced from said land.[233]

Tennessee has defined reworking operations to include "work performed on a well after its completion, in an effort to secure production where there has been none, restore production that has ceased, or increase production."[234] Reworking can include "testing, evaluation, and all acts necessary to reworking a given well."[235] Therefore, the lessee should have great flexibility in meeting the requirements of such clause, although a court will still likely hold it to a high standard of prudence and diligence.

J. ILLINOIS

Due to the "fugacious qualities" of oil and gas, Illinois law establishes that oil and gas cannot be separately owned until it is severed or extracted from the ground, at which point the possessory interest in the oil and gas becomes vested in the producer.[236] In *Transcontinental Oil Co. v. Emmerson*,[237] the court undertook a review of the various types of property interests, ultimately concluding that the instrument at issue in that case:

> A form of oil and gas lease . . . conveys a freehold interest in the real estate to which it applies, and is, in effect, a sale of a part of

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231. *Id.* at 722.

232. *Id.* ("Here, production ceased because of a lack of market for the gas. The drilling of a new well and discovery of more gas would not have an effect on the marketability of the gas. The only practical effect of the cessation of production clause under the facts of this case would be if the new well produced a discovery of oil and, if that oil proved to be marketable as opposed to the unmarketable gas. Although such a result appears unlikely, we must give effect to the plain language of the lease.").

233. Cali-Ken Petroleum Co. v. Slaven, 754 S.W.2d 64, 66 n.3 (Tenn. Ct. App. 1988) (emphasis added).

234. *Id.* at 66 (citing 8 HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL AND GAS LAW MANUAL OF TERMS 758 (1986)).

235. *Id.* (citing Lone Star Prod. Co. v. Walker, 257 So. 2d 496, 500 (Miss. 1971)).

236. Triger v. Carter Oil Co., 23 N.E.2d. 55, 56 (Ill. 1939) (citing Daughetee v. Ohio Oil Co., 105 N.E. 308, 311 (Ill. 1914); Ohio Oil Co. v. Daughetee, 88 N.E. 818, 820 (Ill. 1909); Watford Oil and Gas Co. v. Shipman, 84 N.E. 53, 54 (Ill. 1908)).

237. 131 N.E. 645 (Ill. 1921).

> the land. Oil and gas in the earth cannot be the subject of an ownership distinct from the soil. They belong to the owner of the land only so long as they remain under the land, and his grant of them to another is a grant only of such oil and gas as the grantee may find, and no title to it vests in the grantee until it is actually found. The conveyance, however, of the right to enter upon the land for the purpose of prospecting and operating for oil and gas, laying pipe lines, and building powers, stations, and structures to produce, save, and care for the products is a conveyance of an interest in the land itself, which, if of indefinite duration, is a freehold estate in the land.[238]

Illinois law follows the view that an oil and gas lease containing a typical "thereafter" habendum clause conveys to the lessee a freehold estate subject to the special limitations regarding commencement of production in the primary term and continued production thereafter.[239] The Illinois Supreme Court has expressly stated that despite the nature of the lessee's estate, "such freehold interests are [not] always subject to a condition subsequent."[240] Rather, in construing the habendum clause as one of limitation, it follows that the lessee's interest will terminate automatically upon nonproduction at the end of the primary term or cessation of production during the secondary term.[241] The lessor is not required to notify the lessee for termination to be effective.[242]

The leading case on temporary cessation of production in Illinois, *Gillespie v. Wagoner*,[243] holds:

> We believe the proper rule to be that temporary cessation of production after the expiration of the primary term is not a cessation of production within the contemplation and meaning of the "thereafter" clause if, in the light of all surrounding circumstances, reasonable diligence is being exercised by the lessee to continue production of oil or gas under the lease.[244]

In *Gillespie*, a well was shut down for over two years, and the motor was removed from the pump jack without any explanation.[245] The only reasons

238. *Transcon. Oil Co.*, 191 N.E. at 649.

239. *See* Dethloff v. Zeigler Coal Co., 412 N.E.2d 526, 530 (Ill. 1980).

240. *Id.* at 531.

241. *See id.* (citing HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL AND GAS LAW § 604 (1977)).

242. *See generally* Gillespie v. Wagoner, 190 N.E.2d 765 (Ill. 1963).

243. 190 N.E.2d 765 (Ill. 1963).

244. *Id.* at 767 (citing Lamb v. Vansyckle, 266 S.W. 253, 254 (Ky. 1924)).

245. *Id.* at 765.

given for failure to produce were that the operators were in financial trouble, it took time to contact the numerous working-interest owners, and the weather was bad at times.[246] According to the appellate court, these circumstances failed to show reasonable diligence in producing the well and the trial court was entirely justified in holding that the lease had terminated.[247] Once the lease had terminated, it could not be revived by commencing production almost simultaneously with plaintiff's action to declare the lease void.[248] Other Illinois cases have similarly held that failure to run pumps because oil prices are depressed does not constitute reasonable diligence to continue to produce oil.[249]

Reasonable diligence *was* found to exist where production of oil had ceased, temporarily, due to a number of circumstances beyond the control of the lessee.[250] In that case, the lessee testified that he had trouble with the motor on the well and with access to the well site due to poor weather. There was also testimony that the lessor may have tampered with the pump, hampering the lessee's efforts to restart production. The court concluded that while no actual production had occurred for two years, "the failure to produce commercial quantities of oil was beyond [lessee's] control, where the uncontroverted evidence showed that they suffered continual problems with the well machinery."[251] According to the court, the lessee had made good faith efforts to keep the motor running so that production could continue, even if those efforts had not succeeded.[252] However, where water flooding was allowing production to occur elsewhere in a unit, merely examining programs to change the pattern of water flooding, performing dye tests, and converting some wells into injection wells in an effort to obtain production from a well that was not located in the unit, did not constitute reasonable diligence to maintain production from that well and was insufficient to negate seven years of nonproduction.[253]

Normally, to extend a lease beyond the fixed term by production, the oil or gas must be produced from the land in question. An exception to this rule exists when a valid unitization agreement is entered into.[254] Several Illinois cases have evaluated whether production from a pooled or unitized

246. *Id.* at 767.
247. *Id.*
248. *Id.*
249. *See generally* Dart v. Leavell, 795 N.E.2d 310 (Ill. App. Ct. 2003); Smith v. Duncan, 595 N.E.2d 645 (Ill. App. Ct. 1992).
250. *Duncan*, 595 N.E.2d at 648.
251. *Id.* at 647-48.
252. *Id.* at 648.
253. Belden v. Tri-Star Producing, Inc., 435 N.E.2d 927, 936-37 (Ill. App. Ct. 1982).
254. *Id.*

tract is sufficient to maintain a lease when production from the leased tract itself has ceased.[255] In one leading case, a conveyance of one-half interest in the oil and gas under two separate tracts was made in one deed.[256] The conveyance was for a stated term and "as long thereafter as oil or gas or both shall be produced therefrom."[257] Within the stated primary term, both tracts yielded production.[258] However, after the expiration of the primary term, production ceased on one tract (the North 40) but continued on the other (the South 40).[259] The case considered the issue of whether the continuous production on the second tract served to extend the grantee's ownership on one-half interest of the oil and gas in the first tract. The Illinois Supreme Court held that it did:

> Arising first in decisions relating to oil-and-gas leases, it is the rule of the vast majority that where a number of land owners demise their lands in a single lease, whether contiguous or not, and provide that after a designated period the interest covered by the said instrument will continue for as long as there is production upon said land, production which is sufficient to continue the interest as to any of the land described is sufficient to continue the interest as to all of the land described.[260]

The courts have extended this logic to term mineral deeds holding that production from one tract will maintain the lease into the secondary term as to another tract covered by the same instrument regardless of whether they are contiguous or not.[261] Citing cases from Kansas, another Illinois court similarly held that in a single lease of multiple tracts for a term of twenty years and as long thereafter as oil and gas are being produced from "said land," the words "said land" refer to the entire acreage. As a result, production on any tract is sufficient to extend the lease as to all tracts.[262]

Where wells on a leased tract are shut in, production from an adjoining tract that is unitized with the lease, but that is outside of the unit, has no bearing on the validity of the lease and cannot be relied upon to maintain

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255. Dickerson v. Ray, 169 N.E.2d 341, 345 (Ill. 1960).

256. *Id.*

257. *Id.*

258. *Id.*

259. *Id.*

260. *Id.* at 344 (citing A. Veeder Co. v. Pan Am. Prod. Co., 17 So. 2d 891, 896 (La. 1944); Lynch v. Davis, 92 S.E. 427, 428-29 (W.Va. 1917); Southland Royalty Co. v. O'Daniel 287 S.W.2d 182, 186-87 (Tex. App. 1956); Hunt Prod. Co. v. Dickerson, 135 S.W.2d 597, 601 (Tex. App. 1939); Lusk v. Green, 245 Pac. 636, 637 (Okla. 1926)); *see also* 2 W.L. SUMMERS, THE LAW OF OIL & GAS § 295 (Perm. ed. 1927).

261. *Dickerson*, 169 N.E.2d at 345.

262. Baker v. Hugoton Prod. Co., 320 P.2d 772, 794 (Kan. 1958) (citing Cowman v. Phillips Petrol. Co., 51 P.2d 988, 991 (Kan. 1935); Wilson v. Holm, 188 P.2d 899, 905 (Kan. 1948)).

the lease.[263] A statutory provision, however, provides that when multiple tracts are pooled and developed as a unit, production from any tract in the unit is considered to be production from all of the tracts.[264] As a result, unitized production from wells off an eighty acre leased tract constituted continuous production from the eighty acre tract so as to keep the lease alive.[265] Because the statute expressly states that production from any tract shall be regarded as production from each tract, the court found that the production from a well located on a different parcel of land that was part of the same unitized pool was sufficient to sustain the lease.

In *Belden v. Tri-Star Producing, Inc.*, the court held that where a holder of the working interest or royalty refuses to sign a unit agreement, the pre-existing oil and gas leases and other contracts of the non-signers remain in effect and unmodified by the unit agreements.[266] As a result, a lessor who does not sign a unitization agreement is due royalties only from that produced on his leasehold.[267] Additionally, a lessor and lessee relationship is enumerated in the original lease.[268] Therefore, to extend a lease under its habendum clause when the lease is within a unit not joined by the lessor, production cannot be from anywhere but the leasehold.[269]

K. INDIANA

The Indiana Supreme Court has held a "title to natural gas does not vest in any private owner until it is reduced to actual possession."[270] According to *Halbert v. Hendrix*,[271] "the owner of lands does not have an absolute title to the oil and gas in place as corporeal real property, but rather has the 'exclusive right' to explore for oil and gas and reduce it to possession and to a consequent absolute ownership."[272]

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263. Edwards v. Dhom, 507 N.E.2d 1253, 1257 (Ill. App. Ct. 1987).

264. 225 ILL. COMP. STAT. 725/23.2(a) (2012); *see also id.* 725/22.2(d) (2012) ("All operations, including, but not limited to, the commencement, drilling, or operation of a well upon any portion of a drilling unit shall be deemed for all purposes the conduct of such operations upon each separately owned tract in the drilling unit by the several owners thereof. That portion of the production allocated to a separately owned tract included in a drilling unit shall, when produced, be deemed, for all purposes, to have been actually produced from such tract by a well drilled thereon.").

265. Shelton v. Andres, 462 N.E.2d 549, 554 (Ill. App. Ct. 1984).

266. Belden v. Tri-Star Producing, Inc., 435 N.E.2d 927, 933-36 (Ill. App. Ct. 1982).

267. *Id.*

268. *Id.*

269. *Id.*

270. State v. Ohio Oil Co., 49 N.E. 809, 812 (Ind. 1898).

271. 95 N.E.2d 221 (Ind. Ct. App. 1950).

272. *Id.* at 223 (citing Monon Coal Co. v. Riggs, 56 N.E.2d 672, 663 (Ind. 1944); Campbell v. Smith, 101 N.E. 89, 95 (Ind. 1913); Fairbanks v. Warrum, 104 N.E. 983, 986 (Ind. Ct. App. 1914); Rupel v. Ohio Oil Co., 95 N.E. 225, 226 (Ind. 1911)); *see also* Callihan v. Bander, 73

Indiana is somewhat unique in that its temporary cessation of production doctrine is codified as a matter of statute. Of the four cases in Indiana that give any discussion to the concept of cessation of production and whether an oil or gas lease in the secondary or "thereafter" phase survives temporary cessation of production, three cases relied heavily on that statute, Indiana Code provision, section 32-5-8-1,which provided (at the time those cases were decided), in relevant part:

> All leases for oil and gas heretofore and hereafter entered of record in this state shall become null and void after a period of one (1) year has elapsed since the last payment of rentals thereon as stipulated for in such lease or contract, or since operation for oil or gas has ceased, both by the nonproduction of oil or gas and the nondevelopment of said lease . . . .[273]

In 2002, the Indiana Code was recodified, section 32-5-8-1 was repealed and a virtually identical provision is now found in section 32-23-8-1[274]:

> (a) Leases for oil and gas that are recorded in Indiana are void:
>
> (1) after a period of one (1) year has elapsed since:
>
> (A) the last payment of rentals on the oil and gas lease as stipulated in the lease or contract; or
>
> (B) operation for oil or gas has ceased, both by the nonproduction of oil or gas and the nondevelopment of the lease; and
>
> (2) upon the written request of the owner of the land, accompanied by the affidavit of the owner stating that:
>
> (A) no rentals have been paid to or received by the owner or any person, bank, or corporation in the owner's behalf for a period of one (1) year after they have become due; and
>
> (B) the leases and contracts have not been operated for the production of oil or gas for one (1) year.

In *Wilson v. Elliott*,[275] the lessor argued the lessee's failure to sell any oil between August 1987 and April 1989 caused the lease to terminate.[276]

N.E.2d 360, 361 (Ind. 1947) (citing Heller v. Dailey, 63 N.E. 490, 493 (Ind. Ct. App. 1902). *Accord* Heeter v. Hardy, 76 N.E.2d 590, 594 (Ind. Ct. App. 1948) ("Oil and gas leases create an interest in real estate known to the law as an incorporeal hereditament.").

273. Text of repealed statute quoted from references in cases, including *Wilson v. Elliott*, 589 N.E.2d 259, 262-63 (Ind. Ct. App. 1992).

274. To date, no cases have interpreted the new statutory provision.

275. 589 N.E.2d 259 (Ind. Ct. App. 1992).

276. *Wilson*, 589 N.E.2d at 261.

The record showed that the lessee had pumped the wells and produced oil continuously from 1973 until the end of 1987.[277] "In 1986, prices for crude oil dropped and many oil and gas lease operators slowed production pending a rebound in crude oil prices."[278] Oil not sold was stored in tanks.[279] During 1987, the lessee engaged the services of a geologist to evaluate the future production potential of the lease.[280] The lessee also replaced two bottom-hole pumps on the wells.[281] Oil was pumped and produced in October and November of 1988, and in January and April of 1989.[282] "Oil was sold in May and August of 1987, and oil from storage was sold in April and May of 1989."[283]

According to the appellate court, the evidence was more than sufficient to support the trial court's judgment that there was no one-year period between August of 1987 and April of 1989 when there was both nonproduction and nondevelopment of the lease.[284] Quoting the former Indiana Code section 32-5-8-1, the court observed:

> The Indiana legislature has codified rules to determine when cessation of production after the primary term of the lease expires causes a lease to terminate. Under IND. CODE 32-5-8-1, a landowner may claim cancellation of the lease when a one-year period has elapsed and the lessee has not paid rentals as stipulated for in the lease or contract, or the operator has not conducted operations, both by not producing oil, and by not developing the lease.[285]

Because there had been ongoing efforts to develop the lease, even while production was temporarily ceased, the lease remained in effect.[286]

> Neither the statute nor the parties' contract provides for cancellation of the lease solely because of [lessee's] failure to pay [lessor] for more than a one-year period. . . . Because a payment provision is not a term of the contract and the statute does not provide for cancellation based on failure to pay unless the provision is in the contract or lease, the trial court did not err when

277. *Id.* at 260.
278. *Id.* at 261.
279. *Id.*
280. *Id.*
281. *Id.*
282. *Id.*
283. *Id.*
284. *Id.* at 264.
285. *Id.*
286. *Id.*

> it concluded the lease did not terminate when [lessee] did not pay [lessor] for over a one-year period.[287]

In *Plymouth Fertilizer Co. v. Balmer*,[288] Plymouth failed to pay the rent, made no effort to physically maintain the wells, and invested no money to maintain the wells for more than a one-year period.[289] Furthermore, between 1963 and 1979, Plymouth made no serious attempts to find a market for the gas that was discovered on the property.[290] The trial court held that Plymouth's oil and gas lease could be cancelled by filing an affidavit pursuant to the now-repealed section 32-5-8-1.[291]

The lessor in *Plymouth Fertilizer Co.* had used gas from the well for domestic purposes during the time in question, and had argued that such use was tantamount to rent.[292] The court disagreed. Quoting from an Illinois Appellate Court case,[293] the *Plymouth Fertilizer Co.* court stated:

> From a reading of the entire instrument it is evident that the royalty provision is a primary matter, while the provision for free gas, like the provision for burying lines below plow depth, is a secondary matter. Nor does the acceptance of free gas constitute an estoppel. Under the terms of the lease, lessor was entitled to free gas and to have the lease terminate at the end of the primary term unless there was production. These rights are not in the alternative.[294]

Adopting the Illinois reasoning, the court concluded that mere provision of free gas was not sufficient to preserve the lease."[295]

In *Barr v. Sun Exploration Co.*,[296] the court again relied on then-existing Indiana Code section 32-5-8-1, finding the legislature intended that both the nonproduction of oil and gas, *and* the nondevelopment of the lease together be shown to prove a cessation of operations for oil and gas.[297] While Sun produced no oil in 1979, there were activities to repair, maintain, and operate the oil well geared toward the eventual production or attempted

287. *Id.*
288. 488 N.E.2d 1129 (Ind. Ct. App. 1986).
289. *Plymouth Fertilizer Co.*, 488 N.E.2d at 1132.
290. *Id.* at 1137.
291. *Id.* at 1135.
292. *Id.*
293. Metz v. Doss, 252 N.E.2d 410, 412-13 (Ill Ct. App. 1969); *see also* Pieszchalski v. Oslager, 470 N.E.2d 1083, 1090 (Ill. Ct. App. 1984).
294. *Plymouth Fertilizer Co.*, 488 N.E.2d at 1136.
295. *Id.*
296. 436 N.E.2d 821 (Ind. Ct. App. 1982).
297. *Barr*, 436 N.E.2d at 825.

production of oil.[298] "Several times during 1979, Sun attended the well and worked on the pump."[299] Testimony revealed that the pump had been struck by lightning and shut down by floods during severe thunderstorms in the spring and summer of 1979.[300] Moreover, Sun paid a pumper monthly wages from January 1979 through and including January 31, 1980.[301] According to the court, these activities constituted operation sufficient to maintain the lease.[302]

In *Barrett v. Dorr*,[303] the appellant argued the temporary cessation of production over a one year period rendered the lease void, and that appellee's failure to pump the well was indicative of intent to abandon the well.[304] Appellee argued failure to pump was due to conditions beyond its control, including weather.[305] In particular, there had been only intermittent production between March of 1960 and March 1961, due to rain and floods.[306] In 1961, appellee hired a new operator, who made certain repairs and increased production from the well from six barrels per day to twenty-one barrels per day.[307] In light of the evidence, the *Barrett* court found that the temporary cessation of oil production did not terminate the lease.[308] The court stated:

> We believe the proper rule to be that temporary cessation of production after the expiration of the primary term is not a cessation of production within the contemplation and meaning of the 'thereafter' clause if, in the light of all surrounding circumstances, reasonable diligence is being exercised by the lessee to continue production of oil or gas under the lease.[309]

L. MICHIGAN

The Michigan Court of Appeals gave a detailed discussion of mineral interests in *Stevens Mineral Co. v. State*.[310] In that case, the court noted:

298. *Id.* at 825-26.
299. *Id.* at 826.
300. *Id.*
301. *Id.*
302. *Id.* at 825-26.
303. 212 N.E.2d 29 (Ind. Ct. App. 1965).
304. *Barrett*, 212 N.E.2d at 30.
305. *Id.*
306. *Id.*
307. *Id.*
308. *Id.* at 36.
309. *Id.* at 34 (citing Gillespie v. Wagoner, 190 N.E.2d 765, 767 (1963)).
310. 418 N.W.2d 130 (Mich. Ct. App. 1987).

> The owner of the land surface owns the minerals beneath his land. . . . Ordinarily, a deed of land conveys the soil and all which it contains within the boundaries of the description in the deed. . . . However, ownership of minerals in place may be severed from the remainder of the land by the proper conveyances. . . . If the grantor retains title to the mineral interests described in a deed, it is an exception . . . . At common law, this created a fee estate in the minerals, a corporeal hereditament. . . . The deed conveyed no interest in the excepted part to the grantee. Therefore, when the grantor excepted all mineral rights, there was no need to expressly state that the right to sever or remove the minerals was an incident of ownership. . . . On the other hand, a reservation is generally seen as the creation of a new right or interest in the grantor. A reservation is really a legal fiction which treats the grantor's reservation as an implied grant from the grantee back to the grantor. Normally, a reservation is an incorporal hereditament, like rent or a profit a prendre . . . .[311]

In the *Stevens Mineral Co.* case, the court found that a reservation of the "right to operate, produce and remove" minerals from the land was a profit a prendre.[312] A profit a prendre is "the right to acquire, by severance or removal from another's land, something previously constituting part of the land, such as minerals. . . . A profit a prendre in the form of a right to carry on mining operations transfers no present interest in the minerals in place."[313]

There is virtually no case law in Michigan that considers temporary cessation of production in the secondary term of an oil and gas lease. In *Michigan Wisconsin Pipeline Co. v. Michigan Nat'l Bank*,[314] a public utility had obtained a certificate of necessity as a prerequisite to filing a condemnation action and made plans to convert producing wells to storage wells. The court found a curtailment of production by the operator in anticipation of the impending condemnation did not constitute a cessation of production so as to terminate the lease.[315] Rather:

311. *Id.* at 133 (citing Mfr. Nat'l Bank of Detroit v. Dep't of Natural Res., 362 N.W.2d 572, 577 (Mich. 1984); Pellow v. Arctic Iron Co., 128 N.W. 918, 925 (Mich. 1910); Rathbun v. State, 280 N.W. 35, 40 (Mich. 1938); Negaunee Iron Co. v. Iron Cliffs Co., 96 N.W. 468, 4 (Mich. 1903); Van Slooten v. Larsen, 299 N.W.2d 704, 705 (Mich. 1980)).

312. *Stevens Mineral Co.*, 919 N.W.2d at 133.

313. *Id.* at 134 (citing VanAlstine v. Swanson, 417 N.W.2d 516, 520 (Mich. Ct. App. 1987); Evans v. Holloway Sand & Gravel, Inc., 308 N.W.2d 440, 443 (Mich. Ct. App. 1981)).

314. 324 N.W.2d 541 (Mich. Ct. App. 1982).

315. *Mich. Wis. Pipeline Co.*, 324 N.W.2d at 545.

> [T]he sale of the field for purposes of storage appeared to represent the optimum form of development for both the holders of the lessee and lessor interests. . . . [W]hile normally leaving gas in place does not promote its production or marketing, in the present case, the gas "in place" constituted the most marketable and productive form. Thus, the decision not to produce the gas . . . by severing it from the ground but rather to "produce" it by leaving it in its more valuable state served the interests of all who had interests in the field.[316]

The court noted that "a lessee-operator need only make payments under a shut-in royalty clause if production has ceased," but where wells were shut in pending condemnation, the court, applying the reasonable and prudent operator standard, found that the lessee-operator continued "production" by "wisely working to market the remaining gas in the field by leaving it in its most valuable state, to-wit: in place."[317]

M. OHIO

Ohio's position regarding the nature of the interest created by an oil and gas lease is unsettled. Early Ohio cases viewed oil and gas in place as part of the realty, capable of separate reservation or conveyance.[318] However, a 1953 Ohio Supreme Court case, *Back v. Ohio Fuel Gas Co.*,[319] found that an instrument of conveyance that granted "oil and gas rights" had "the earmarks of a license."[320] Whether the *Back* decision represents the law of Ohio on the nature of an oil and gas interest has been questioned in more recent decisions. The appellate court noted as recently as 2000:

> Although the Supreme Court [in *Back*] concluded that the "instrument in question is a license rather than a deed of conveyance," . . . , only the syllabus law is binding on this court. . . . The syllabus in *Back* do not address the issue of whether a grant or reservation of "oil and gas rights" constitutes a grant or reservation of a license or of the mineral estate. Furthermore, in an opinion issued after *Back*, the Supreme Court

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316. *Id.* at 545-46.
317. *Id.*
318. Pure Oil Co. v. Kindall, 156 N.E. 119, 123 (Ohio 1927); Kelley v. Ohio Oil Co., 49 N.E. 399, 400 (Ohio 1897).
319. 113 N.E.2d 865 (1953).
320. *Back*, 113 N.E.2d at 867.

> has itself presumed that a person may own "the fee of mineral rights in the property.[321]

Stocker & Sitler, Inc. v. Metzger,[322] also noted several cases have "recognize[ed] that mineral rights in place may be corporeal and subject to exception or reservation in fee simple, [but] have never been overruled by the Supreme Court of Ohio."[323]

The Ohio courts follow the prevailing view that a cessation of production in and of itself will not terminate an oil and gas lease either under the terms of the lease or by forfeiture. The Ohio Supreme Court in *Wagner v. Smith*[324] states:

> Courts universally recognize the proposition that a mere temporary cessation in the production of a gas or oil well will not terminate the lease under a habendum clause of an oil and gas lease where the owner of the lease exercises reasonable diligence and good faith in attempting to resume production of the well. . . . A critical factor in determining the reasonableness of the operator's conduct is the length of time the well is out of production. . . . Additionally, in determining the reasonableness of the lease owner's conduct, all attendant circumstances must be taken into account.[325]

The key legal issue to be determined is what constitutes a temporary cessation of production. In Ohio, is a case by case evaluation depending not only on the lease language, but on the totality of circumstances, including subsequent production or efforts to get the well producing, duration of the cessation of production, and the subsequent acceptance by the lessor of royalty or shut in royalties, all may be considered in determining what constitutes a temporary cessation that does not result in lease termination.

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321. Bath Twp. v. Raymond C. Firestone, Co., 747 N.E.2d 262, 266 (Ohio Ct. App. 2000) (citing Ohio Sand & Gravel Co., v. Masheter, 199 N.E.2d 573, 573 (Ohio 1964).

322. 250 N.E.2d 269 (Ohio 1969) (referring to Sloan v. Lawrence Furnace Co., 29 Ohio St. 568 (1876), Gill v. Fletcher, 78 N.E. 433 (Ohio 1906), Moore v. Indian Camp Coal Co., 80 N.E. 6 (Ohio 1907)).

323. *Stocker*, 250 N.E.2d at 272-73.

324. 456 N.E.2d 523 (Ohio Ct. App. 1982).

325. *Wagner*, 456 N.E.2d at 525-26; *see also* Am. Energy Serv., Inc. v. Lekan, 598 N.E.2d 1315, 1321 (Ohio Ct. App. 1992) ("[C]ourts have recognized that lessees can still have valid lease rights after a reasonable period of non-production for certain valid purposes."); Litton v. Geisler, 76 N.E.2d 741, 744 (Ohio Ct. App. 1945) ("The mere fact that a lessee under such a lease has failed to operate the wells for some time, will not be ground for vacating such lease, where such lessee shows good and sufficient reason why it has been impracticable for him to do so.").

In *Wagner*, the lessee became aware of water problems with the well in 1978, yet did not undertake repairs until 1981, after the lawsuit was initiated.[326] The court noted:

> [W]e are not persuaded that justifiable reasons existed for the delay in restoring the well to production. Discovery of the well defect and its effect on production occurred in 1978. It was not until approximately six months later that the existence of the defect was confirmed. Thereafter, another year passed until the abortive "mudding" repair was started in the summer of 1980, but not done because of the nature of the water flow. While the four-inch pipe [to repair the well] was contracted for after suit was filed in January 1981, . . . it was not installed at time of trial. Accordingly, we hold, in the light of the totality of circumstances, that appellee did not proceed with the diligence required in respect to the rights of the lessors and that the cessation of production was for an unreasonable length of time and, thus, was more than a "temporary" cessation of production.[327]

In *Wagner*, the lessee had argued that the delay in repairing the well was partly due to a disagreement with the other fractional interest owners as to the proper approach.[328] The court deemed that to be insufficient justification, especially in light of the length of the delay, noting that delays of two years or more are typically not considered temporary.[329]

While Ohio law does not have a formula for evaluating duration, it is fair to say that they accept what they believe is the general view that a temporary cessation must be fairly short; the longer the cessation the less likely a court will find the appropriate level of diligence by the operator. In *Wagner,* two years was considered too long a period to permit the lease to stay in force, whereas in *Barrett v. Dorr*,[330] cited favorably by the *Wagner* court on the general law, a one-year cessation with some activity toward bringing the well into production was considered reasonable.[331] The *Wagner* court, in dicta, seems to recognize that the issue can be affected by the subsequent return of a well to production and acceptance of royalties by the lessor.[332]

326. *Wagner,* 456 N.E.2d at 527.
327. *Id.*
328. *Id.* at 526.
329. *Id.* at 527.
330. 212 N.E.2d 29 (Ind. Ct. App. 1965).
331. *Barrett*, 212 N.E.2d at 306-08.
332. *See generally Wagner*, 456 N.E.2d at 527.

However, the issue of whether subsequent production and acceptance of royalties or shut-in royalties will balance the equities to preserve the lease, must be approached with caution. While Ohio courts will consider these factors in the totality of circumstances, the tardy payment of shut-in royalties after an extended cessation of production will not prevent termination of a lease. For example, in *Moore v. Adams*,[333] the court noted that a number of implied covenants have been generally recognized in oil and gas leases, including covenants to market the product and to conduct all operations with reasonable care and due diligence.[334]

The evidence in *Moore* demonstrated that the well did not operate for more than six years and that the equipment was in disrepair. Moreover, the appellant did not attempt to market the gas until the lawsuit was filed. The court noted "[w]hen interruptions occur, the lessee is obligated to exercise reasonable diligence to place the well back into production. . . . Critical to this evaluation is how long the well is out of production."[335] The court also noted cessation of production has been deemed temporary when the time periods are short, but where the cessation exists for two years or more, the lessees have been found not to have proceeded diligently.[336]

In *Tisdale v. Walla*,[337] the lease in question provided that it would remain in effect as long as oil or gas was being produced or being stored on the premises. An annual royalty was to be paid for each well where gas was found but was not sold or marketed, and payment of such a royalty would cause that well to be considered a producing well.[338] Another provision of the lease provided that the lease not be forfeited unless it was first judicially determined that there has been a failure to perform any of the express or implied covenants.[339] The lessee argued the lease did not terminate due to a lack of production, because the lessor had not sought or obtained a judicial determination that the lessee had forfeited the lease.[340] The court disagreed,[341] noting:

> The terminology utilized in the habendum clause ("and as long thereafter as") is generally construed to create a determinable fee interest, such that the lessee's interest automatically terminates

333. No. 2007AP090066, 2008 WL 4907590 (Ohio Ct. App. Nov. 17, 2008).
334. *Moore*, 2008 WL 4907590, at *5.
335. *Id.* (citing Wagner v. Smith, 456 N.E.2d 523, 526 (Ohio Ct. App. 1982)).
336. *Id.*
337. No. 94-A-0008, 1994 WL 738744 (Ohio Ct. App. Dec. 23, 1994).
338. *Tisdale*, 1994 WL 738774, at *5.
339. *Id.* at *6.
340. *Id.* at *10.
341. *Id.* (citing 4 HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL AND GAS LAW §§ 354.6-356, 682.2 (1993)).

> upon lessee's failure to satisfy any of the listed provisions which would serve to extend the term of the lease. In such a case, no affirmative action on the part of a lessor is required to formally terminate the lease; it expires on its own terms.[342]

The court went on to note that the judicial ascertainment clause did not modify the limitation provision of the habendum clause.[343] "Thus, having determined that the lease expired by its own terms, it is unnecessary for appellant to seek a judicial determination of whether the lessee has forfeited the lease."[344]

Interestingly, in *Whitmer v. Mack*,[345] the court held a three-year period with no production was fatal to a lease, even though the lessee resumed operation after that time.[346] The lease terminated automatically, by its own terms, when production ceased.[347] This suggests that at least in some circumstances, a lessor cannot assert an equitable or estoppel defense, based upon subsequent production and payment of royalties, where the lease has terminated by its own terms due to lack of production.

N. KANSAS

The Kansas Supreme Court has consistently held that where the primary term of an oil and gas lease has expired and its terms are being continued pursuant to the "thereafter clause" by continued production of oil or gas, all rights under it terminate when production in paying quantities ceases.[348] Specifically:

> If there is a halt in production at an oil leasehold, the burden is upon the lessee to prove that the cessation is temporary and not permanent. . . . Whether the cessation of production is temporary or permanent is a question of fact to be determined by the trial court, and such finding will not be disturbed on appeal if it is supported by substantial competent evidence.[349]

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342. *Id.* at *9-10.

343. *Id.* at *11.

344. *Id.*

345. No. 5538, 1981WL 6348 (Ohio Ct. App. June 30, 1981).

346. *Whitmer*, 1981WL 6348, at *3.

347. *Id.*

348. *See, e.g.*, Brack v. McDowell, 320 P.2d 1056, 1061 (Kan. 1958); Wagner v. Sunray Mid-Continent Oil Co., 318 P.2d 1039, 1049 (Kan. 1957); Baker v. Huffman, 271 P.2d 276, 276 (Kan. 1954); Tate v. Stanolind Oil & Gas Co., 240 P.2d 465, 465 (Kan. 1952); Wilson v. Holm, 188 P.2d 899, 905-08 (Kan. 1948); Warner v. Kulp, 217 P. 288, 288 (Kan. 1923); Kahm v. Ark. River Gas Co., 253 P. 563, 563 (Kan. 1927); Caylor v. Bankers' Oil Co., 203 P. 735, 735 (Kan. 1922).

349. Eichman v. Leavell Res. Corp., 876 P.2d 171, 174 (Kan. Ct. App. 1994).

> There are three factors relevant to whether a cessation is temporary or permanent: (1) the period of time cessation has persisted; (2) the intent of the operator; and (3) the cause of cessation. In general, no one of these elements can be isolated and held to be decisive.[350]

Courts that have examined the length of a cessation have not established a bright line test, as to how long is too long for cessation to be temporary. Rather, they look to whether the cessation was for "reasonable time, under the circumstances."[351] "Where renewed production depends, if at all, upon various prospective but unassured projects and possibilities, termination is appropriate."[352]

Where water broke through the casing of a well and caused production to stop for more than a year and no effort was made to put the well back in production, the Kansas Supreme Court held that the cessation in production was permanent, and that the well was shut down for an unreasonable time, terminating the lease.[353] In *Reese Enterprises, Inc. v. Lawson*,[354] the court noted that while it found an eighteen month period of unprofitable operation sufficient to terminate an oil and gas lease under a "thereafter" clause that provided that continuation of the lease was dependent upon production in paying quantities, the time factor was case specific and was a question left open.[355]

In *Wagner v. Sunray Mid-Continent Oil Co.*,[356] the court considered the intent of the parties in determining whether cessation of production had been temporary or permanent.[357] The question before the court was whether the lease remained in effect despite a cessation of production of oil in paying quantities for a period of eight months, between September of 1953 and April of 1954.[358] In their discussion, the court, quoting *Wilson*, stated:

> We believe proper construction of such an instrument requires the conclusion that if for any reason there is a cessation of production of oil in paying quantities on the land covered by its terms the owners of the minerals in place are required to move promptly and

350. *Id.*
351. Wrestler v. Colt, 644 P.2d 1342, 1347 (Kan. Ct. App. 1982).
352. *Id.* (internal quotation marks omitted).
353. *Wilson*, 188 P.2d at 908.
354. 553 P.2d 885 (Kan. 1976).
355. *Reese Enters., Inc.*, 553 P.2d at 899.
356. 318 P.2d 1039 (Kan. 1957).
357. *Wagner*, 318 P.2d at 1039.
358. *Id.* at 1041.

> by their efforts actually establish that such cessation, regardless of its cause, is temporary, not permanent. In the event of their failure to do so, it is our view production as contemplated by the parties is to be regarded as having ceased, their conveyance terminates and any estate theretofore held by them under and by virtue of its terms reverts to the grantors.[359]

The court noted the defendants had not taken prompt action to establish that the cessation was only temporary.[360] Therefore, the court concluded the parties had intended the cessation to be permanent and had treated the cessation accordingly.[361]

The third factor the courts look to in evaluating whether cessation is temporary is the cause of the cessation. In *Kahm v. Arkansas River Gas Co.*,[362] a well that had produced large quantities of gas for several years saw its flow decrease and ultimately cease altogether. In that case, the court found that cessation of production was permanent, not temporary, despite the fact that the defendant alleged that production had ceased; because the only pipeline in the vicinity was a high pressure pipeline into which gas from the well could no longer be delivered without compression.[363]

In another case, where the operator of a lease ceased production due to financial difficulties, the court held that a six to seven month cessation of production was not a reasonable time for the lessee to reach an agreement with a new operator and for production to commence again.[364] Although recognizing a temporary cessation of production doctrine, Kansas courts routinely hold that express contract terms control, so that there can be no extension or reviver contrary to the express terms of a lease or a mineral deed."[365] In *Welsch v. Trivestco Energy Co.*,[366] the court held an express contractual provision that addresses temporary cessation supersedes any generally applicable doctrines, and thus, a lessee "cannot invoke the doctrine of temporary cessation to avoid complying with a specific provision in the lease that addresses temporary cessation of production and requires the lessee to recommence production within a specified period of time."[367] The court further noted that some authorities have suggested a

359. *Id.* at 1046-47 (citing Wilson v. Holm, 188 P.2d 899, 907 (Kan. 1948)).
360. *Id.* at 1049.
361. *Id.*
362. 253 P. 563 (Kan. 1927).
363. *Kahm*, 253 P. at 564, 566.
364. Clubine v. Mega Oil Co., No. 56, 687, 1985 Kan. App. LEXIS 774, at *1-2 (1985).
365. Dewell v. Fed. Land Bank of Wichita, 380 P.2d 379, 382 (Kan. 1963) (internal citations omitted). This case is discussed in further detail under shut-in clauses.
366. 221 P.3d 609 (Kan. Ct. App. 2009).
367. *Welsch*, 221 P.3d at 611.

temporary cessation of production clause does not save a lease where the cessation could have been saved by the shut-in royalty provisions of the same lease.[368] *Welsch* favorably cited a Texas case, *Marifarms Oil & Gas, Inc. v. Westhoff*,[369] which held that if a lease contains both a cessation of production clause and a shut-in royalty provision, then to preserve the lease it is required to make the shut-in royalty payment within the time period stated in the cessation of production clause.[370]

In *Baker v. Hugoton Production Company*,[371] the Kansas court considered the effect of pooling on cessation issues. Ten gas-drilling units included all of the land covered by the lease.[372] Gas was being produced from seven of those units, containing 2950 acres, but not the other three, which contained 680 acres.[373] According to the court, the production on the seven units, or any one of them, perpetuated the lease on all of the units where the lease had granted an interest in the entire 3630 acres and the habendum clause indicated the lease was "for a term of twenty years and as long thereafter as oil, gas, or either of them, are being produced from *said land*."[374] According to the court, "[t]he words 'said land' refer to the 3,630 acres described in the granting clause. Production on any part of that acreage was production from *said land*, the legal effect of which was that the mineral interest was perpetuated and extended as to the *entire* acreage."[375]

In *Rook v. James E. Russell Petroleum, Inc.*,[376] the leases at issue contained clauses that extended the term of the interest beyond the primary term for as long thereafter as (1) oil or gas is produced on the property and/or (2) the gas storage rights are exercised and/or (3) the storage rentals are being paid.[377]

The court noted that while leases contain an implied covenant of diligent and prudent operation, which requires a lessee to produce and market oil or gas after discovery, the covenant is rarely invoked.[378] The

368 *Id.* at 616-17 (citing 4 EUGENE KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 47.3(f)(2) (1990)).

369. 802 S.W.2d 123 (Tex. App. 1991).

370. *Marifarms Oil & Gas, Inc.,* 802 S.W.2d at 125-26.

371. 320 P.2d 772 (Kan. 1958).

372. *Baker*, 320 P.2d at 773.

373. *Id.* at 774.

374. *Id.*

375. *Id.* (citing Cowman v. Phillips Petrol. Co., 51 P. 2d 988, 988 (Kan. 1935); Wilson v. Holm, 188 P.2d 899, 905 (Kan. 1948)).

376. 679 P.2d 158 (Kan. 1984).

377. *Rook*, 679 P.2d at 165.

378. *Id.* at 166. Kansas has codified this implied covenant:

reason is because, ordinarily, a failure to produce after the primary term will result in termination of the lease.[379] The court pointed out, however, that the leases in question contained an express provision in the habendum clause relative to gas storage rights, so that the lease remained in effect through that clause, even without diligent and prudent operation.[380] The court went on to review the facts, which showed that there had been no production from any of the wells on the leases in question for fifteen years and the operator had not physically been at the site for many years.[381] As a result, the court determined that the oil and gas production portion of these leases had been abandoned and could be severed from the gas storage rights, which remained intact.[382]

In *Short v. Cline*,[383] the plaintiff landowner sought to quiet title to the oil and gas under his 160-acre parcel of property. He alleged that the defendants' interest had terminated by nonproduction from the 160 acres.[384] The defendants were the royalty interest holders who claimed that a pooling agreement kept the lease alive, despite the lack of production from the plaintiff's land.[385] The court sided with the defendants on equitable principles.[386]

The ownership of the various interests is convoluted but integral to the court's analysis. The key facts are that in 1973, the plaintiff landowner acquired the working interest in oil and gas leases that had originally been granted in 1923.[387] In 1977, the plaintiff acquired the real property on which those leases had been granted, subject to the original lessors' reservation of a royalty right in one stratum of the land; this stratum reverted to the landowner in the event that production ceased.[388] In 1956, before the landowner had acquired any interests in the leases or the land, a pooling agreement had been signed by the then-existing royalty interest

> As a matter of Kansas public policy, all oil and gas leases and subleases for the exploration, development and production of oil, gas or other minerals, or any combination thereof, which are held by production shall be presumed to contain, in addition to any expressed covenants therein, an implied covenant to reasonably explore and to develop the minerals which are the subject of such lease. Such implied covenant shall be a burden upon the lessee and any successor in interest.

KAN. STAT. ANN. § 55-223 (2011).

379. *Rook*, 679 P.2d at 166.

380. *Id.*

381. *Id.* at 167.

382. *Id.*

383. 676 P.2d 76 (Kan. 1984).

384. *Short*, 676 P.2d at 77.

385. *Id.*

386. *Id.* at 84.

387. *Id.* at 78-79.

388. *Id.*

holders, but not the landowner.[389] At the time the lawsuit commenced, production from the landowner's one hundred sixty acres had ceased, but production was ongoing on adjacent property pursuant to the pooling agreement.[390] The royalty interest holders argued that the pooling agreement extended their interests as long as any land covered by the agreement was producing, even though the land in which they originally had an interest ceased producing.[391] The landowner argued that the pooling agreement did not apply to him, because his predecessor in interest did not sign it.[392] The court found that equity precluded the relief sought by the the landowner.[393] The plaintiff was wearing two hats: he was the lessee who had purchased the lease subject to the pooling agreement and the royalty interests, and he owned the surface land and other strata of the land and would become vested in another stratum if production ceased. As lessee, he was obligated to continue production for the benefit of all; as the owner of the reversion, he wished to exterminate the royalty interests.

O. ARKANSAS

In *Arrington v. United Royalty Co.*,[394] the Supreme Court of Arkansas considered the issue of whether a royalty interest in an oil and gas lease would take priority over a mortgage interest on the property when the mortgagee failed to bring suit prior to the passing of the statute of limitations.[395] The court's discussion was focused on whether the royalty interest in the oil and gas lease was a real property interest or a personal property interest.[396] Ultimately, the court held that "royalties in gas or oil, until brought to the surface and reduced to possession, are interests in real estate and not personal property."[397] The court therefore affirmed the trial court's judgment that the royalty interest would take priority over the mortgaged interest.[398] However, in their consideration of this matter, the court also defined Arkansas' understanding of the oil and gas estate.[399] Specifically, the court stated "where the lease may endure for an indeterminable period, it creates an estate in that nature of a *qualified*

389. *Id.* at 78.
390. *Id.* at 79.
391. *Id.* at 80-81.
392. *Id.* at 80.
393. *Id.* at 81.
394. 65 S.W.2d 36 (Ark. 1933).
395. *Arrington*, 65 S.W.2d at 37.
396. *Id.*
397. *Id.* at 38.
398. *Id.*
399. *Id.*

fee . . . ."[400] As a "qualified fee"[401] has long been considered the same as a fee simple determinable interest, the court established that if the lease contains a traditional habendum clause, one that provides for a primary term for years and an indefinite secondary term conditioned on the production of oil and gas in paying quantities, the oil and gas lease will terminate upon the occurrence of the limiting event, or the cessation of production from the lease premises.[402]

However, in *Reynolds v. McNeill*,[403] the Supreme Court of Arkansas seemingly sets its self apart from other determinable estate states by providing that the estate does not vest in the lessee until oil and/or gas are produced in paying quantities. In the court's words, "[t]he lessee and his assignees had spent large sums in successfully attaining production within the primary term of six months. When that event occurred a valuable estate vested in the lessee. . . ."[404] Although, there are no cases decided by the Arkansas courts that appear to address this discrepancy, an examination of the interests created by the traditional habendum clause might offer an explanation. In other determinable estate jurisdictions, the traditional habendum clause conveys an actual interest in the oil and gas in place. However, this interest is only guaranteed for a term of years. On the other hand, the secondary term of an oil and gas lease is not guaranteed at all. In order to preserve their interest into the secondary term, the lessee must establish production in paying quantities. Otherwise, their interest in the oil and gas will terminate at the end of the primary term.

Only after the lessee has established production in paying quantities that continues beyond the primary term will his interest become a fee simple determinable interest. Accordingly, the fee simple determinable interest is an interest created in the secondary term. As Bruce Kramer explained in his discussion of Texas's temporary cessation of production doctrine, "[i]t has been well ingrained in Texas oil and gas law that the typical habendum clause in a lease creates a fee simple determinable estate insofar as the *secondary term* is concerned."[405] Accordingly, in *Reynolds*, as the court states, a valuable estate vested when they established production in paying quantities, because their short six month interest in the oil and gas became a determinable fee interest once they established

400. *Id.*
401. *See* BLACK'S LAW DICTIONARY 1036 (9th ed. 2009).
402. *Arrington*, 65 S.W.2d at 78.
403. 236 S.W.2d 723 (Ark. 1951).
404. *Reynolds*, 236 S.W.2d at 725.
405. Kramer, *supra* note 9, at 519.

production during the primary term.[406] Therefore, although it seems the state of Arkansas has set itself apart from the other determinable estate jurisdictions, the reality is that the courts likely were not addressing the interest initially transferred by the lease. Rather it is much more likely that the court was addressing the change of the estate from a term of years interest to a fee simple determinable interest which would remedy the apparent contradiction.

Reynolds also addressed another issue important to the discussion of cessation of production. As the court stated, "when the lessee's estate has vested it does not automatically terminate upon a temporary cessation of production."[407] The court further provided that a lessee has a reasonable period of time to reestablish production of oil and gas in paying quantities.[408] In *Reynolds*, the plaintiff made several arguments to the Chancery Court with regard to why the oil and gas lease should be canceled, including that the defendant had abandoned the well which had been completed.[409] The Chancery Court entered a judgment that the defendants had sixty days in which to produce oil and gas in paying quantities from the premises.[410] The Supreme Court affirmed.[411] Herein, the court establishes that the state of Arkansas recognizes the temporary cessation of production doctrine.[412]

Although the courts of Arkansas have adopted a determinable interest subject to the temporary cessation of production doctrine, as stated above, the lessee must first establish production in paying quantities to create said interest. *Reynolds* states, "[t]he lessee and his assignees had spent large sums in successfully attaining production within the primary term of six months. When that event occurred, a valuable estate vested in the lessee, to continue as long as oil or gas was produced in paying quantities."[413] The Supreme Court of Arkansas has defined production in paying quantities as "production which is profitable to the lessee."[414] Accordingly, the lessee must be able to realize a profit from the proceeds of the oil and/or gas

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406. *Reynolds*, 236 S.W.2d at 725.
407. *Id.*
408. *Id.*
409. *See generally id.*
410. *Id.* at 724.
411. *Id.* at 725.
412. *See id.*
413. *Id.*
414. *See* Turner v. Reynolds Metal Co., 721 S.W. 2d 626, 627 (Ark. 1986) (referencing W.L. SUMMERS, THE LAW OF OIL AND GAS § 307; 3 HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL AND GAS LAW §604.6(a) (1985)); *see also* Ross Explorations, Inc. v. Freedom Energy, Inc., 8 S.W.3d 511, 514 (Ark. 2000) (citing Turner v. Reynolds Metals Co., 721 S.W.2d 626 (Ark. 1986)).

production from a well drilled under the lease before they are vested with a determinable interest that will preserve the lease during the secondary term.[415]

P. NEBRASKA

In general, Nebraska recognizes that an oil and gas lease consists of a definite term and an indefinite term. Where production is established during the primary, definite term, the lease may be continued indefinitely as long as production continues. "When . . . continuous production ceases, the lease automatically terminates unless there is some other provision which would prevent termination. A cessation of production clause . . . may make it possible for the lessee to preserve the lease beyond the primary term by resumption of operations if production should cease."[416] "Where the parties have bargained for and agreed on a time period for a temporary cessation clause, the agreed-on time period will control over the common-law doctrine of temporary cessation allowing a 'reasonable time' for resumption of drilling operations."[417] Similarly, the court will not rewrite a contract to include or change the language that the parties agreed to.[418]

In *Bedore v. Ranch Oil Co.*,[419] the lease at issue provided that "[i]f after the expiration of the primary term, production on the leased premises shall cease from any cause, . . . [the] lease shall not terminate provided lessee commences operations for drilling a well within sixty (60) days from such cessation. . . ."[420] The lessee argued its efforts to rework a plugged well saved the lease from termination, while the lessor argued that removing plugs did not constitute "operations for drilling a well" sufficient to keep the lease alive.[421] The court sided with the lessor, noting that the weight of authority agrees that general reworking operations, which do not involve making a new hole, are not "operations for drilling a well."[422] The court pointed out that the lease could have used more general language that would have allowed reworking operations to save the lease, but because the lease specifically required "operations for drilling a well," the court found the lease had lapsed due to nonproduction.[423]

415. WILLIAMS & MEYERS, *supra* note 414, § 604.6(a).

416. Bedore v. Ranch Oil Co., 805 N.W.2d 68, 81 (Neb. 2011) (citing 4 EUGENE KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 47.3, at 98 (1990 & Cum. Supp. 2009)).

417. *Id.* at 82 (citing Hoyt v. Cont'l Oil Co., 606 P.2d 560, 564 (Okla. 1980)).

418. *Id.* at 85.

419. 805 N.W.2d 68 (Neb. 2011).

420. *Id.* at 74.

421. *Id.* at 77.

422. *Id.* at 84.

423. *Id.* at 85.

The Nebraska Supreme Court noted in 1982 it had not had occasion to define the term "production" as it is used in the habendum clause, but that in prior cases, in dicta, it had stated that "after the primary term has expired, 'production' means production in paying quantities."[424] Thus, according to the court, any production is sufficient to keep the lease alive during the primary, exploratory portion of a lease.[425] After that time, however, if production is not in paying quantities, the lease expires. In the *Kirby* case, the court found that there had been a cessation of production for 31 months and that as a result, the lease had terminated.[426]

Finally, in *Long v. Magnolia Petroleum Co.*,[427] the court clarified the distinction between a "drill or pay" lease and an "unless" lease. Under a "drill or pay" lease, the court noted that the lessee expressly promises to either drill by a certain date or pay a delay rental in order to keep the lease alive.[428] Under an "unless" lease, the lease language provides that the lease will terminate if drilling is not commenced within one year, "unless" a rental is paid on or before a certain date.[429] According to the court, the difference is that with a drill or pay lease, the lessor is entitled to payment if the lessee doesn't drill.[430] Under an "unless" lease, there is no obligation to pay anything. The lessee can simply not drill and at the end of the stated term, the lease will expire. "The provision for payment is looked upon as merely stating a condition upon which, in absence of drilling, the lease may be continued or terminated."[431]

Q. ARIZONA

In *Arizona State Real Estate Dept. v. American Standard Gas & Oil Leasing Services, Inc.*,[432] the court established that a leasehold interest in oil and gas for a period of "10 years and so long as oil and gas is produced in paying quantities" created an interest in land known as a qualified or determinable fee.[433] Based on this case, it can be assumed that a court of competent jurisdiction in Arizona would hold, like many other states have held, that the determinable fee (or fee simple determinable) interest created

424. Kirby v. Holland, 316 N.W.2d 746, 750 (Neb. 1982) (citing Long v. Magnolia Petrol. Co., 89 N.W.2d 245, 251-52 (Neb. 1958)).
425. *Id.*
426. *Id.*
427. 89 N.W.2d 245 (Neb. 1958).
428. *Long*, 89 N.W.2d at 253.
429. *Id.*
430. *Id.*
431. *Id.*
432. 580 P.2d 15 (Ariz. Ct. App. 1978).
433. *Az. State Real Estate Dep't*, 580 P.2d at 17-18.

by an oil and gas lease automatically terminates upon the cessation of production, absent a contractual provision to the contrary. Arizona Revised Statutes Annotated sections 27-555 and 27-556 dealing with leases on state lands provide that when production ceases after the primary term or after extension of said primary term of an oil and gas lease, "the lease shall not terminate if the lessee commences, drilling, completion or reworking operations on the land within ninety days from cessation of production."[434] The statutes continue, "the lease shall remain in force as long thereafter as such drilling, completion or reworking operations are conducted or as long thereafter as oil or gas is produced in paying quantities from the leased lands, but in no event to extend beyond two years if production is not restoredFalse"[435] Accordingly, the legislature has established the duration of permissible cessation of production. To fully understand the conduct necessary to preserve the oil and gas lease during a period of cessation, it is necessary to know how the legislature has defined completion operations, drilling operations, and reworking operations.

In Arizona Revised Statutes Annotated § 27-551, the legislature defines completion operations as, "work performed in an oil or gas well after the well has been drilled to the point where the production string of casing is set . . . prior to the commencement of the actual production of oil or gas in paying quantities."[436] Drilling operations are defined as "any work or actual physical or mechanical operations undertaken or commenced in good faith for the purpose of bringing about the production of oil or gas in paying quantities."[437] Finally, reworking operations are defined as "work performed at any depth on a well after its initial completion in and effort to secure production where there has been none, or to restore production that has been ceased or to increase production."[438] Therefore, if production ceases under an oil and gas lease upon state lands and the lessee takes any of the actions defined above before the expiration of the ninety day period, the lease will be preserved thereafter in accordance with the statute.[439]

It must be stressed, however, that the aforementioned legislation only preserves oil and gas leases on state lands. The state of Arizona has not promulgated similar laws concerning oil and gas leases on private lands. Given the state's view of a leasehold estate as a fee simple determinable, it

434. ARIZ. REV. STAT. ANN. §§ 27-555, -556 (2011).
435. *Id.*
436. *Id.* § 27-551.
437. *Id.* § 27-551(4).
438. *Id.* § 27-551(10).
439. *See id.*

seems likely that a court would consider the statutory provisions for state lands in evaluating cessation questions arising as to leases on private lands.

R. NEW MEXICO

In *Maralex Resources, Inc. v. Gilbreath*,[440] the court stated, "[t]he typical oil and gas lease grants the lessee a fee simple determinable interest in the subsurface minerals within a designated area."[441] The court continued, "if the lessee fails to produce oil or gas in paying quantities before the end of the primary term, or if production ceases after the primary term, the lease will automatically terminate."[442] In *Maralex*, Norman and Loretta Gilbreath were successors in interest to an oil and gas lease covering two sections of land situated in San Juan County, New Mexico.[443] The lease's habendum clause provided "[t]his lease remains in force for a term of five years and as long thereafter as oil, gas, casinghead gas, or other mineral or any of them is or can be produced."[444] The lessees drilled a producing oil and gas well during the primary term that produced gas without interruption until it stopped in December 1990.[445] After attempting to close off the valve to the pipeline and treating the well with foam to increase pressure inside the well, the well resumed production in March 1991.[446] Shortly thereafter, the Gilbreaths attempted to negotiate a farmout agreement with Maralex Resources, Inc.[447] However, during negotiations, Maralex obtained a title opinion from a law firm that concluded the lease had terminated under the terms of the habendum clause because the Gilbreaths failed to pay shut-in royalty payments.[448] Maralex brought suit seeking a declaratory judgment that the 1959 lease expired under its own terms when the Gilbreaths failed to tender shut in royalties in early 1991.[449] The district court granted summary judgment for Maralex and the Court of Appeals and Supreme Court of New Mexico affirmed.[450]

The court stated in *Maralex* that "production must be in paying quantities, such that the income generated from oil and gas production

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440. 76 P.3d 626 (2003).
441. *Maralex Res., Inc.*, 76 P.3d at 630.
442. *Id.*; *see also* Greer v. Salmon, 479 P.2d 294, 297 (N.M. 1970) (discussed *infra* footnotes 299-312 and accompanying text).
443. *Maralex Res., Inc.*, 76 P.3d at 628.
444. *Id.*
445. *Id.*
446. *Id.* at 629.
447. *Id.*
448. *Id.*
449. *Id.*
450. *Id.*

exceeds the operating costs."[451] Therefore, under *Maralex*, any production is not sufficient to maintain a lease. If oil and gas production falls below the level of production that would result in proceeds exceeding the operational costs of production, the lease would terminate unless saved by other terms of the lease.

It appears New Mexico has not adopted or does not recognize a general doctrine with regard to temporary cessation of production. Rather, the New Mexico courts have observed that, in order to avoid the harsh consequences of the determinable estate created by the oil and gas lease, lessees sought to create contractual remedies by including savings clauses, such as the cessation of production clauses and shut-in royalty clauses, in their leases.[452] As the court stated in *Greer v. Salmon*,[453] "the 'cessation of production' and 'shut-in royalty' clauses are designed to give the lessee some protection from automatic termination. . . ."[454] In *Greer*, an oil and gas lease covering a tract of land containing 40 acres was granted to the lessee, Greer, on September 1, 1950.[455] The lessee obtained commercial gas production from the Pictured Cliff formation prior to the expiration of the five year primary term and production continued through September 1956.[456] However, because of a leak in the flow line between the well-head and the meter, from October 1956 to June 1960, no gas was produced from the well except for 7 MCF produced in May 1958.[457] The leak was discovered and fixed in May 1960, and production began again in June 1960 and continued thereafter.[458] During the period of cessation, no drilling operations were conducted on the lease within a period of ninety days from September 1956, and no oil or gas was sold or used during the period from October 1956 to May 1960.[459]

The lessors conveyed all mineral rights below the base of the Pictured Cliff formation to Evan C. Salmon and his wife, who leased the land to some of the defendants.[460] Thereafter, Evan C. Salmon requested a release be executed by the Greers releasing the land from the September 1, 1950 lease due to the fact that there had not been any production from said lands

451. *Id.* at 631; *see also* Greer v. Salmon, 479 P.2d 294, 296 (N.M. 1979); Town of Tome Land Grant v. Ringle Dev. Co., 240 P.2d 850, 852-53 (N.M. 1952).

452. *See Greer*, 479 P.2d at 296.

453. 479 P.2d 294 (N.M. 1979).

454. *Id.*

455. *Id.* at 295.

456. *Id.*

457. *Id.*

458. *Id.*

459. *Id.*

460. *Id.*

since September 1956.[461] The Greers filed an action to quiet title to the oil and gas lease covering the property.[462] The defendants, Evan C. Salmon, et al., argued the lease had terminated in accordance with its terms.[463] The district court ordered that the plaintiff's complaint be dismissed with prejudice and granted judgment for the defendants on their counter claim for compensatory damages and reasonable attorney fees. The Supreme Court of New Mexico affirmed this judgment.[464]

In making this judgment, the court in *Greer* rationalized that the cessation of production clause operates to preserve the lease by granting the lessee the right to resume operations to secure further production from the lease within a fixed period of time.[465] However, the court stressed in *Greer* that the opportunity to preserve the lease under the cessation of production clauses was in fact a right and not a duty.[466] As the lessee had not attempted to secure or resume further production from the leased premises and had not paid shut-in royalties, the lease had terminated.[467]

In *Greer*, the lessee had argued that the cessation of production had been sudden and only temporary – and that they were entitled to a reasonable time in which to resume production.[468] Upon considering this issue, the court held that "this may be true under the terms of some leases. . . ."[469] However, in the lease therein the parties had agreed to what would constitute temporary cessation by including a cessation of production clause.[470] As the cessation of production was longer than allowed by the clause, it could not be considered temporary.[471]

S. UTAH

In *Benton v. Division of State Lands and Forestry*,[472] the Supreme Court of Utah held that the language of the mineral lease created an incorporeal hereditament, meaning the lease only granted lessee possession of the minerals mined and removed from the land within the terms of the

461. *Id.*
462. *Id.*
463. *Id.*
464. *Id.* at 300.
465. *Id.* at 296.
466. *Id.* at 297.
467. *Id.* at 299.
468. *Id.* at 297.
469. *Id.*
470. *Id.*
471. *Id.*
472. 709 P.2d 362 (Utah 1985).

lease.[473] The remainder of minerals thereunder remained in the possession of the property owner.[474] This case involved three leases, including one to Professional United Development, in 1970.[475] This lease was for a term of ten years, "and so long as said minerals may be produced in commercial quantities from said land."[476]

At no time did United Development conduct mining operations on the property during the primary term of the lease.[477] However, during this time Portland Cement Company of Utah extracted limestone from the property pursuant to federal mining claims that were declared invalid in an earlier federal court action.[478] Professional United Development sought to recover the value of the limestone removed by Portland.[479] The district court ruled that Professional United Development could not maintain an action against Portland for the wrongful removal of the limestone.[480]

The Utah Supreme Court agreed and affirmed the decision of the District Court and granted the defendant's summary judgment motion.[481] In making this determination, the court cites several cases from the state of New York, which interpreted leasehold provisions similar to that included in the subject lease as only transferring "a right to quarry and take stone from the area involved."[482] The court further stated that "[t]his stone [becomes] the property of [the lessees] only upon its actual severance."[483] Since Professional United Development never began mining operations on the subject property, they never reduced any of the minerals therein to their possession.[484] Therefore, they did not have any fee interests in minerals that would permit them to recover for the wrongful removal of the minerals.[485]

Although this decision did not involve an oil and gas lease, it indicates that courts in Utah have viewed mineral leases as incorporeal hereditaments. However, before making this conclusion, it is necessary to point out the law with regard to the estate created by a lease has not been

473. *Benton*, 709 P.2d at 366 (citing Baker v. Hart, 25 N.E. 948, 948 (N.Y. 1890)).
474. *Id*.
475. *Id*. at 364.
476. *Id*.
477. *Id*.
478. *Id*.
479. *Id*.
480. *Id*. at 365.
481. *Id*. at 369.
482. *Id.* at 366 (citing Jones Cut Stone Co. v. New York, 166 N.Y.S.2d 742, 746 (N.Y. Ct. Cl. 1957)).
483. *Id*.
484. *Id*.
485. *Id.*

conclusively established in the State of Utah. In *Commonwealth Coal Services, Inc. v. Rushton*,[486] a federal district court held that, for purposes of a bankruptcy proceeding, the interest created in a leasehold estate may be considered a real property interest for purposes of maintaining a turnover action against parties that violate the automatic stay.[487]

To find that the interest created in a leasehold estate may be considered a real property interest for purposes of maintaining a turnover action against parties that violate the automatic stay, the court agreed with the Trustee's argument that there were legal and equitable rights supporting an action for turnover of the purchased coal or its value.[488] Namely, the Trustee distinguished the lease from a mineral lease, stating the lease provided C.W. with a true lease of the property.[489] Furthermore, the Trustee stated Hiawatha knowingly violated the automatic stay; the coal was mined under C.W.'s; and the coal must be determined to be the property of the Bankruptcy estate because C.W. was the operator of the mine when the coal was mined.[490] Furthermore, it is important to note the court identified that the scope of the lease, as interpreted by its language, could impact the interest transferred.[491]

Accordingly, it seems established that a mineral lease will only transfer an incorporeal hereditament.[492] However, the language of the lease itself, specifically with regard to its scope, may impact how the lease is interpreted with respect to the interest actually created. In the absence of oil and gas related cases in Utah addressing cessation of production, one is left only to observe that other jurisdictions that treat an oil and gas lease as being in the nature of a profit rather than a fee simple determinable have recognized the temporary cessation doctrine in some form.

T. NORTH DAKOTA

North Dakota adheres to the general rule that, where the lease has been extended beyond its primary term by production, a temporary cessation of production will not automatically terminate an oil and gas lease.[493] The *Feland* Court reasoned: "since there are various justifiable causes for the

486. No. 2:10-MC-0017DAK, 2010 WL 596317 (D. Utah Feb. 16, 2010).
487. *Commonwealth Coal Serv., Inc.*, 2010 WL 596317, at *5.
488. *Id.*
489. *Id.*
490. *Id.*
491. *Id.*
492. *See generally id.*
493. Greenfield v. Thill, 521 N.W.2d 87, 92 (N.D. 1994); Feland v. Placid Oil Co., 171 N.W.2d 829, 835 (N.D. 1969).

slowing up, or temporary cessation, of production, it would be harsh and inequitable to automatically terminate a lease in all cases of cessation."[494] This rule holds true whether the habendum clause creates a defeasible-term interest or not.[495]

Whether the cessation is temporary or permanent is a question of fact. In making that determination, the court should consider the following factors as adopted by the North Dakota Supreme Court in *Greenfield v. Thill,* from a decision of a Kansas court in *Wagner v. Sunray Mid-Continent Oil Co.*[496]: (1) the period of time cessation has persisted; (2) the intent of the operator; (3) the cause of cessation; and (4) the totality of the circumstances.[497] *Thill* dealt specifically with cessation in the secondary term of a term royalty deed, ultimately adopting the Texas and Kansas view applying the temporary cessation doctrine to such deeds, and rejecting the narrower Oklahoma view as to the application of the cessation doctrine to determinable deeds.[498]

If the court determines cessation is temporary, the court must decide whether the operator fulfilled his obligation to exercise reasonable diligence and good faith in restoring production within a reasonable period of time.[499] In *Feland*, the court held the determination of reasonableness "must be decided in light of the particular fact situation, keeping in mind the legitimate interests of both lessor and lessee."[500] Ultimately, the court in *Feland* adopted the Texas approach to issues of temporary cessation, which states, "it is only to the end that the oil and gas shall be extracted with benefit or profit to both that reasonable diligence is required."[501]

As such, subsequent decisions have held that an operator be allowed a reasonable time to bring the well or wells back into production.[502] What is considered "reasonable" is dependent upon the particular circumstances of each case.[503] The court has also held that "production" for the secondary term of an oil and gas lease means "production in paying quantities."[504]

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494. *Feland*, 171 N.W.2d at 836.

495. *Greenfield*, 521 N.W.2d at 92.

496. 318 P.2d 1039 (Kan. 1957).

497. *Greenfield*, 521 N.W.2d at 89.

498. *See generally Greenfield*, 521 N.W.2d at 91 (stating as to determinable deeds, "[w]hatever the true state of the law in Oklahoma, we conclude that the Texas and Kansas approach is more rational and equitable. The rule . . . that any cessation of production, regardless of cause or duration, will terminate the interest – is too harsh and inflexible").

499. *See Feland*, 171 N.W.2d at 832-33.

500. *Id.* at 835.

501. *Id.* at 836.

502. *See generally* Sorum v. Schwartz, 344 N.W.2d 73 (N.D. 1984).

503. *See generally Feland*, 171 N.W.2d 829.

504. Greenfield v. Thill, 521 N.W.2d 87, 90 (N.D. 1994).

It appears North Dakota bases its view of temporary cessation as an application of equitable principles. The court in *Feland* held that, as a result of "the large expense incident to the work of exploration and development, and the fact that the lessee must bear the loss if the operations are not successful," it would be "harsh and inequitable to automatically terminate the lease in all cases of cessation.[505]

U. MONTANA

In *Krutzfeld v. Stevenson*,[506] the Supreme Court of Montana stated that a mineral lease conveys the lessee an interest in the minerals for the expressed term of the lease and the lessor retains a reversionary interest therein, thus establishing that in Montana, mineral leases create a fee simple determinable estate.[507] Therefore, in Montana, the leasehold will terminate automatically upon the occurrence of a stated event or upon the breach of the terms of the oil and gas lease.[508] In an attempt to avoid the draconian impact of the determinable estate, the court in *Somont Oil Co. v. A&G Drilling, Inc.*,[509] officially adopted the temporary cessation of production doctrine, stating "[a] temporary cessation in production will not trigger an automatic termination of the lease as contemplated in the habendum clause."[510]

In *Somont*, C-W purchased several oil and gas leases in the Kevin-Sunburst oil field in Toole County, Montana, that were preserved into their secondary terms by production on the leased premises.[511] Subsequently, Somont offered to purchase several of these leases and C-W declined.[512] Somont then acquired new leases from those parties owning property in the Kevin-Sunburst oil field and demanded C-W execute releases on the properties.[513] Somont maintained these leases had terminated due to a lack of production.[514] Following C-W's refusal to execute the releases, Somont filed suit in the district court to compel C-W's execution of the releases.[515]

505. *Feland*, 171 N.W.2d at 836 (citing Clifton v. Koontz, 325 S.W.2d 684, 695 (Tex. 1959)).

506. 284 P. 553 (Mont. 1930); *see also* Somont Oil Co., Inc. v. A&G Drilling, Inc., 49 P.3d 598, 604 (Mont. 2002).

507. *Krutzfeld*, 284 P. at 556.

508. *See* Berthelote v. Loy Oil Co., 28 P.2d 187, 191 (Mont. 1933); *see also Somont Oil Co.*, 49 P.3d at 604.

509. 49 P.3d 598 (Mont. 2002).

510. *Id.* at 604.

511. *Id.* at 600.

512. *Id.* at 601.

513. *Id.*

514. *Id.*

515. *Id.*

The jury rendered a special verdict in favor of C-W.[516] The Supreme Court of Montana reversed and remanded for a new trial.[517]

In evaluating what would be considered a temporary cessation of production, the court relied on the Supreme Court of Texas' conclusion that "cessation must be due to a sudden stoppage of the well or some mechanical breakdown of the equipment used in connection therewith, or the like."[518] Accordingly, if the cessation of production was the result of something other than a sudden stoppage of the well or a mechanical breakdown of the equipment, it would be considered a permanent cessation of production and would not be saved by the temporary cessation of production doctrine.[519] The courts in Montana have not elaborated on other circumstances that would fall under the temporary cessation of production doctrine. However, in *Somont*, the court determined financial conditions of the producer or economic considerations, i.e., market demand, cannot be considered temporary causes of cessation of production.[520]

Although Montana courts have held that economic conditions or financial conditions of the producers cannot be considered justification to establish temporary cessation of production, they will consider such factors in determining whether the lease is producing in paying quantities.[521] In distinguishing *Somont* from the facts of another case, the court stated, "if there is a lack of market; if the lease is capable of producing in paying quantities; and if the lessee is using reasonable diligence to market the product, Montana law will deem the lease as one which is 'producing in paying quantities.'"[522]

In *Christian v. A.A. Oil Corp.*,[523] the court declared the test for determining whether the lessee was acting with reasonable diligence to secure production in paying quantities is whether the lessee was exercising "the diligence which would be exercised by the ordinary prudent operator having regard to the interests of both lessor and lessee."[524] Plaintiffs gave notice that the lease was declared forfeited because A.A. Oil had not paid

516. *Id.*
517. *Id*. at 606.
518. *Id*. at 605 (citing Watson v. Rochmill, 155 S.W.2d 783, 784 (Tex. 1941)).
519. *See id.*
520. *Id*. at 606.
521. *Id*.
522. *Id*. In *Berthelote v. Loy Oil Co.*, the Supreme Court of Montana stated that paying quantities meant "such an amount of production as would pay a small profit over the cost of operation of the well, excluding from consideration the initial cost of bringing the well into production." 28 P.2d 187, 191 (Mont. 1933).
523. 506 P.2d 1369 (Mont. 1973).
524. *Christian*, 506 P.2d at 1373.

royalties or rentals and failed to conduct exploration.[525] On August 19, 1963, plaintiffs executed an oil and gas lease to Robert Byrne on the same land covered by the aforementioned lease to A.A. Oil.[526] Subsequently, plaintiffs commenced a quiet title action on the tract in question against both A.A. Oil and Robert Byrne.[527] The district court found the lease owned by A.A. was a valid lease and that Robert E. Byrne's lease was a top lease.[528] The Supreme Court of Montana affirmed the judgment of the district court.[529] In making this decision, the court concluded that the discovery of gas in commercial quantities during the primary term satisfied the habendum clause of a period of time and extended the lease into the secondary term. In the secondary term, the lessee is "required to use reasonable diligence in operating the well and marketing the product within a reasonable time. Failure to do so will result in a termination of the lease."[530] The court found that Byrne had the burden of proving the well was incapable of producing gas in paying quantities.[531] Because he failed to meet his burden of proof, the A.A. Oil lease continued in full force and effect.[532]

Finally, in *Miami Oil Producers, Inc., v. Larson*,[533] the Montana Supreme Court considered a case in which the oil and gas lease contained a cessation of production clause. In October 1965, plaintiffs executed an oil and gas lease to Sun Oil Company on a tract of land containing 520 acres.[534] On March 2, 1968, Sun Oil Company assigned an interest in 320 acres of that lease to Miami Oil Producers.[535] Miami began drilling operations on the property sometime later that year.[536] In November, they completed a well that produced enough oil and gas to allow payment of royalties to the lessors.[537] Production from that well and royalty payments continued through October 1978, at which time, royalty payments stopped.[538] Subsequently, after several attempts to have Miami execute a release of the oil and gas lease, the plaintiffs filed an action to quiet title and

525. *Id.* at 1371.
526. *Id.*
527. *Id.*
528. *Id.* at 1370.
529. *Id.* at 1375.
530. *Id.* at 1374.
531. *Id.*
532. *Id.*
533. 661 P.2d 1260 (Mont. 1983).
534. *Miami Oil*, 661 P.2d at 1261.
535. *Id.*
536. *Id.*
537. *Id.*
538. *Id.*

to compel the defendants to execute a release of the oil and gas lease, claiming that no oil or gas had been produced since 1979 and that no drilling or reworking operations had been conducted that would meet the requirements of the cessation of production clause in the lease.[539] The district court entered a judgment against Miami.[540] The Supreme Court of Montana affirmed.[541]

The lease at issue in *Miami Oil* contained a cessation of production clause and a notice provision.[542] The cessation of production clause clearly stated that if cessation occurred within ninety days prior to the expiration of the primary term, or at any time in the secondary term, the lease remains in effect if production or operations for drilling or reworking are commenced within ninety days.[543] The notice provision, in paragraph ten, provided that any breach by lessee shall not result in a forfeiture or termination of the lease unless lessor first notifies the lessee in writing and affords the lessee an opportunity to remedy the breach.[544] The lessee, Miami, argued that because the lessor had not provided notice pursuant to paragraph ten, the cessation of production provision did not work to terminate the lease.[545] The court disagreed.[546]

Noting that under the terms of the lease, termination may result from one of three contingencies: (1) failure to commence drilling operations within the specified time, absent timely rental payments; (2) failure to resume or commence drilling or reworking operations or production within ninety days of a cessation after the primary term has expired; or (3) failure to remedy a break within sixty days of receiving written notice, the court held that the failure to meet the second contingency was sufficient to terminate the lease.[547] The court noted the notice provision cannot be engrafted onto the cessation of production clause, because the continuation or resumption of operations during the secondary term, once production has ceased, is the lessee's option and not an obligation.[548] Additionally, it should be noted *Somont* made it clear the producer must be diligent in reestablishing production in order to preserve their lease under the

539. *Id.*
540. *Id.* at 1260.
541. *Id.* at 1265.
542. *Id.* at 1263-64.
543. *Id.* at 1262.
544. *Id.*
545. *Id.* at 1263.
546. *Id.* at 1263-64.
547. *Id.* at 1263.
548. *Id.* at 1263-64.

temporary cessation of production doctrine.[549] A producer's voluntary cessation of production or self-serving delay in reestablishing production may prevent the lease from being preserved under the temporary cessation of production doctrine.[550]

V. WYOMING

In *Denver Joint Stock Land Bank of Denver v. Dixon*,[551] the court examined the language of the lease and historical understandings of property law in order to determine the nature of the interest granted to the lessee by the oil and gas lease.[552] The issue in this case was whether a reservation of an oil and gas interest in a conveyance was a real property interest that would be included in a conveyance by Sheriff's deed.[553] In its consideration of this issue, the Supreme Court of Wyoming concluded an oil and gas lessee is not vested with an actual interest in the oil and gas until the interest is severed and extracted from the land.[554] In the court's words, "the right to the mineral in place is not absolute, but may be said to be inchoate, to attach definitely when the dormant state is disturbed and the oil and gas is on its way to the surface."[555] Therefore, until the lessee actually reduces the oil and gas to their actual possession, by bringing it to the surface, they are only vested with an incorporeal right to explore and develop the leased premises.[556]

Additionally, in *Boatman v. Andre*[557] and three other cases, the Supreme Court of Wyoming stated the language of the oil and gas leases considered therein created a profit a prendre. As the Wyoming court stated, "[t]hat right, created by the lease, is merely to search for oil and gas and if either is found, to remove it from the land leased."[558] The court continued, "[t]his would appear to make it a profit a prendre and hence an incorporeal hereditament, which may be lost by abandonment."[559] In *Boatman*, the issue presented was whether an extensive delay by the lessee in developing the leased premises would operate as an abandonment of the oil and gas

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549. Somont Oil Co. v. A & G Drilling, Inc., 49 P.3d 598, 605 (Mont. 2002).
550. *Id.* at 605-06.
551. 122 P.2d 842 (Wyo. 1942).
552. *See id.* at 844.
553. *See Dixon*, 122 P.2d at 843-48.
554. *Id.* at 847.
555. *Id.*
556. *See id.*
557. 12 P.2d 370, 373 (Wyo. 1932); *see also* State v. Pennzoil, 752 P.2d 975, 980 (Wyo. 1988); *Dixon*, 122 P.2d at 847.
558. *Boatman*, 12 P.2d at 373.
559. *Id.*

leases under the laws of Wyoming. The trial court entered judgments for the plaintiffs and quieted titled to the lands that were subject to the defendant's leases.[560] On appeal, Wyoming Supreme Court affirmed, stating, "there is an implied obligation on the lessee to proceed with exploration and development of the land with reasonable diligence, according to the usual course of business, and a failure to do so amounts to an abandonment which will sustain a reentry by the lessor."[561]

However, Wyoming courts have also concluded a lease will not be cancelled due to a temporary cessation of production.[562] In *Deadwood-Osage Oil Co. v. Walker*,[563] the court considered whether an eight month cessation of production under an oil and gas lease resulted in a termination of the lessee's interest therein.[564] In their analysis, the court cited *Adams v. Bennet*,[565] a case heard before the Court of Civil Appeals of Texas, El Paso. In this case, the Texas court also considered whether an eight month cessation of production resulted in a termination of the oil and gas lease.[566] Despite stating the general rule of Texas, that a temporary cessation of development or production will not result in the termination of the oil and gas lease, the court in *Adams* concluded that a cessation of operations and production for a period of eight months was not considered temporary and, therefore, due to this extended period of cessation, the oil and gas lease terminated.[567] Relying on this analysis, the court in *Deadwood-Osage* concluded that the oil and gas lease terminated and affirmed the judgment of the trial court.[568] Accordingly, it appears Wyoming, like Texas, would conclude that a temporary cessation of production will not warrant a cancellation of the oil and gas lease.[569] However, under the facts of both of these cases, the courts determined that the period of cessation was too long to be considered temporary.

W. COLORADO

Colorado cases acknowledge the requirements of lessees to satisfy the production requirement of a habendum clause, whether it is actual production in paying quantities or merely commercial discovery, varies by

560. *Id.* at 371.
561. *Id.* at 374.
562. *See* Deadwood-Osage Oil Co. v. Walker, 28 P.2d 482, 486 (Wyo. 1934).
563. 28 P.2d 482 (Wyo. 1934).
564. *Deadwood-Osage*, 282 P.2d at 486.
565. 282 S.W. 909 (Tex. Civ. App. 1926).
566. *Adams*, 282 S.W. at 911.
567. *Id*. at 911-12
568. *Deadwood-Osage Oil Co. v. Walker*, 28 P.2d 482, 486.
569. *See id.*

jurisdiction.[570] The Colorado Court of Appeals has addressed this issue, and drew the distinction based upon whether marketing is considered an essential part of production:

> Jurisdictions vary as to what is required to satisfy an habendum clause. If marketing is not an essential part of production, the habendum clause is satisfied by commercial discovery of the product. . . . In jurisdictions in which marketing is an essential part of production, the habendum clause requires that the product be removed from the earth, which necessarily involves marketing where the product is gas, and reduced to possession for use in commerce.[571]

The court stated that neither the lease at issue in the case nor Colorado case law indicated marketing as an essential part of production.[572] Therefore, the habendum clause is satisfied by discovery in commercial quantities.[573]

Although a lease may extend into the secondary term without production, a lessee is not free to let a well capable of production sit idle indefinitely. In the absence of specific lease provisions to the contrary, Colorado recognizes four implied covenants: the duty to explore, to develop, to produce (including to market), and to protect against drainage.[574] Lessees must diligently comply with these obligations in order to maintain their leases.[575]

Understanding Colorado's treatment of the habendum clause informs the question on how Colorado treats production lapses. Although Colorado has not explicitly adopted the "temporary cessation of production doctrine," it has addressed the issue of whether a lease should terminate for failure of production.[576] The determination turns on the relevant lease provisions, the circumstances of the individual case, and considerations of equity.[577]

570. *See* Davis v. Cramer, 837 P.2d 218, 222 (Colo. 1992).

571. *Id.*

572. *Id.*; *see also id.* at 221 ("The habendum clause to the lease provides for a primary term of 10 years and 'as long thereafter as oil or gas or other minerals are produced from said land by lessee.'"); Hoff v. Girdler Corp., 88 P.2d 100, 102 (Colo. 1939) ("When, as here, a producing gas well has been developed within the primary term of the lease but the product is not marketed, that fact alone does not authorize the lessor to declare an abandonment of the lease unless the failure to market has been continued for an unreasonably long period of time.").

573. *See Davis*, 837 P.2d at 222. Of course, if the lease required production "in paying quantities," actual production would presumably be required. *See* N. York Land Assocs. v. Byron Oil Indus., Inc., 695 P.2d 1188, 1192 (Colo. App. 1984).

574. *See Davis*, 808 P.2d at 361.

575. *Id.*

576. *See* Mountain States Oil Corp. v. Sandoval, 125 P.2d 964, 967 (Colo. 1942).

577. *Id.* (observing that leases are to be construed most favorably to development, that time is of the essence, and that the real motive for the giving of leases is the development of the

In *Hoff v. Girdler Corp.*,[578] lessee diligently began drilling under an oil and gas lease with a five-year primary term.[579] He successfully produced helium gas and sold it to the federal government until the government later cancelled the contract.[580] Lessee was then prevented from exporting to Europe and no domestic market existed for helium.[581] However, because he maintained the pipeline and facilities and diligently researched and attempted to market the product, the court found in lessee's favor in an action by lessor to quiet title.[582] The *Hoff* decision appears to rest somewhat on the fact that the action was fashioned as one to quiet title, alleging abandonment, rather than an action for termination of the lease.[583] A later decision by the Colorado Court of Appeals further supports this interpretation.

In *North York Land Associates v. Byron Oil Industries, Inc.*,[584] the court was called upon to determine whether a lease should be cancelled.[585] The leased acreage was considered as two separate portions, the pooled area and the non-pooled area.[586] Although a well was producing on the pooled area, the non-pooled area had not been produced or explored for a number of years, and the court stated that it must use the "prudent operator standard" to determine if the obligation to explore and develop had been breached.[587] Because the trial court had found that a prudent operator would not have explored or developed the land within any foreseeable period, the lessee was not under an obligation to do so.[588] Nevertheless, the court determined the lease should be cancelled as to the non-pooled area.[589] This decision was based on the following reasoning: "Production of oil on a small portion of the leased tract cannot justify the lessee's holding the balance indefinitely and depriving the lessor not only of the expected royalty from production pursuant to the lease, but of the privilege of making

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property; therefore, they are properly construed strongly against the lessee to ensure prompt development).

578. 88 P.2d 100 (Colo. 1939).

579. *Hoff*, 88 P.2d at 101.

580. *Id.* at 101-02.

581. *Id.* at 102.

582. *Id.* at 102-03.

583. *Id.* at 101.

584. 695 P.2d 1188 (Colo. App. 1984).

585. *N. York Land Assocs.*, 695 P.2d at 1190.

586. *Id.*

587. *Id.*

588. *Id.* at 1191.

589. *Id.*

some other arrangement for availing himself of the mineral content of the land."[590]

This decision, with its equity driven result, seems consistent with other relatively flexible decisions of Colorado courts in which conditional decrees are given.[591] The *North York* decision noted a conditional decree, which would give lessee time to resume development, was inappropriate because no further plans to develop existed, further development on the land was not economically justified, and no forfeiture of any well had taken place which lessee could reasonably request time to cure.[592] It appears, then, the facts which caused the jury to decide the lessee had not breached the implied covenant to further develop the land were the facts upon which the court based its decision to terminate the lease – that further development was not justified. In *Graefe & Graefe, Inc. v. Beaver Mesa Exploration Co.*,[593] the lessee was given 120 days to restore production to a well that had ceased producing roughly six weeks before trial, although the lessee's breaches of implied covenants terminated the rest of the lease.[594] Apparently, determining the lessee had not yet breached any implied covenants relating to the forty acres surrounding the well, and that the area could potentially still produce, the cancellation was thus structured as a conditional order.

In *Gillette v. Pepper Tank Co.*,[595] just three years later, the Colorado Court of Appeals granted another conditional decree. The lessee had abandoned all wells except for one marginal producer.[596] This performance combined with the lessee's failure to clear title, his speculative holding, and the finding that third parties were interested in drilling and developing the leasehold, caused the court to conclude that lessee had violated the implied covenant to drill and develop.[597] The remedy was conditional cancellation such that lessee had sixty days to file a plan of development for the non-producing area; if he failed to do so, in order for the cancellation to become effective, lessor was required to submit his own plan for development.[598] As to the producing area, lessee would be able to maintain that section so

590. *Id.* (quoting Sauder v. Mid-Continent Petrol. Corp., 292 U.S. 272, 279 (1934)).

591. *See generally* Gillette v. Pepper Tank Co., 694 P.2d 369 (Colo. App. 1984); Graefe & Graefe, Inc. v. Beaver Mesa Exploration Co., 635 P.2d 900 (Colo. App. 1981).

592. *N. York Land Assocs.*, 645 P.2d at 1192.

593. 635 P.2d 900 (Colo. App. 1981).

594. *Gillette*, 694 P.2d at 902-03 (noting that lessees had not undertaken further exploration or development for many years). Interestingly, the opinion does not give any indication of whether the lease terms indicated that the lease could be cancelled either in whole or in part; this appears to be an equitable remedy of the court. *See id.*

595. 694 P.2d 369 (Colo. App. 1984).

596. *Id.* at 371.

597. *Id.* at 372.

598. *Id.*

long as he made necessary repairs and filed an engineer's report confirming the repairs had been made.[599] Here, the court addressed its use of conditional orders by stating that breach of implied covenants leaves no adequate remedy at law, and therefore the district court is able to grant cancellation either in whole or in part.[600]

X. CALIFORNIA

California law follows the view that an oil and gas lease containing a typical "thereafter" habendum clause grants the lessee a determinable incorporeal interest in the nature of a profit a prendre.[601] In theory, this interpretation dictates that insufficient production during the secondary term will terminate the lease automatically with no need for the lessor to notify the lessee or re-enter the premises.[602] California courts consistently interpret term "production" in a habendum clause as production in paying quantities, even where such quantifying language is absent from the lease.[603] Courts define "paying quantities" as that amount of production "sufficient to yield a return in excess of operating costs, even though drilling and equipment costs may never be repaid and the undertaking as a whole may ultimately result in a loss."[604] Such operating costs may include cleaning and servicing of wells, labor costs, taxes, electricity and other utilities, and lessor's royalties.[605]

As this definition suggests, courts will consider a sufficient degree of profitable production with respect to a habendum clause "so long as the lessor receives royalties and the lessee operates at a profit."[606] Understandably, this has led to litigated disputes over the lessee's proper characterization of expenses in showing the financial status of the operations.[607]

599. *Id.*

600. *Id.* at 373-74.

601. *See generally* Dabney v. Edwards, 53 P.2d 962 (Cal. 1935) (explaining that the duration of the primary right to produce oil or gas for an indefinite period gives character to the instrument as providing for a term of indefinite duration).

602. *See* Renner v. Huntington-Hawthorne Oil & Gas Co., 244 P.2d 895, 897-98 (Cal. 1952); *see also* Lough v. Coal Oil, Inc., 266 Cal. Rptr. 611, 615 (Cal. Ct. App. 1990); Montana-Fresno Oil Co. v. Powell, 33 Cal. Rptr. 401, 404 (Cal. Ct. App. 1963).

603. *See Lough*, 217 266 Cal. Rptr. at 617 n.1 (citing Barnard v. Gibson, 224 P.2d 90, 94-95 (1950)).

604. *Renner*, 244 P.2d at 899.

605. *See Lough*, 266 Cal. Rptr. at 617.

606. West v. Russell, 90 Cal. Rptr. 772, 775 (1970).

607. For a good discussion of disputed operations expenses, *see Lough v. Coal Oil, Inc.*, at 616-19.

In *Renner v. Hunington-Hawthorne Oil & Gas Co.*,[608] the California Supreme Court found the lease, with no additional provision calling for delay or shut-in rentals as an appropriate substitute, terminated automatically after non-production in the secondary term.[609] Thereafter, the lessee remained in possession of the premises and resumed profitable operations, for which the lessor continued to accept royalty payments in accordance with the now-defunct lease.[610] The lessor then filed a quiet title action without notifying the lessor that the lease had terminated.[611]

The California Supreme Court did not find that waiver or estoppel applied, but reversed the lower court's ruling that the lessee maintained no legal right to the property.[612] The court borrowed from traditional landlord-tenant law and held "[i]f a lessee holds over after the expiration of his term and his lessor accepts monthly rental payments in the amount of the payments which the lessee had been making under the lease, the lessee becomes a tenant from month to month."[613] While this decision seems unusual, a court in at least one other jurisdiction, Pennsylvania, has found a tenancy at will is created in similar circumstances.[614] As the lessor had not notified the lessee of termination, the court held that the lessee, now a month-to-month tenant, had a possessory interest in the property since notice was required to end a periodic tenancy.[615]

Courts have not formally adopted a temporary cessation of production doctrine in California. Rather, courts will look to evidence of the lessee's operational expenses and returns to determine whether nonproduction rendered the lease uneconomic and thus effectuated automatic termination.[616] Unlike states that focus on the actual cause of cessation like Texas, California focuses primarily on the profitability of the enterprise and moreover the appropriate time period by which such profitability should be measured.[617]

There is no definitive standard to determine the time period over which a paying quantities analysis is made.[618] Despite no formal adoption of the

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608. 244 P.2d 895 (Cal. 1952).

609. *See Renner*, 244 P.2d at 898.

610. *See id.*

611. *Id.* at 897.

612. *Id.* at 901.

613. *Id.*

614. Derrickheim Co. v. Brown, 451 A.2d 477, 480 (Pa. Super Ct. 1982) (quoting White v. Young, 186 A.2d 919, 920 (Pa. 1963)).

615. *Id.*

616. *See, e.g.*, Lough v. Coal Oil Inc., 266 Cal. Rptr. 611, 617 (1990); Transport Oil Co. v. Exeter Oil Co., 191 P.2d 129, 134 (Cal. Ct. App. 1948).

617. *Transport Oil*, 191 P.2d at 134.

618. *See Lough*, 266 Cal. Rptr. at 617.

temporary cessation doctrine, California courts seem to consider reasonableness factors, often articulated in a temporary cessation analysis, when determining whether production was sufficiently profitable. For example, in discussing the applicable period to assess profitable operations, one court noted:

> Obviously, the period cannot be unreasonably short (i.e., a few days or even weeks) or else a lessor could claim that lease had terminated when in fact it was merely shut-in for repairs or maintenance. On the other hand, using an excessively long period of many years could keep a lease "alive" long after it had become uneconomic and was no longer producing in "paying quantities" by using high initial and very short-lived production rates to claim an artificial 'profit' years later through averaging.[619]

Again, courts acknowledge the absence of any "hard and fast rule for determining over what period the paying quantities analysis must be made."[620] While no prior holding is dispositive on this issue, courts have generally ranged between six months and two years.[621] In *Transport Oil Co. v. Exeter Oil Co., Ltd.*,[622] the court based its decision on the lessee's financial records over one calendar year after first finding a single month "inadequate to provide a reasonably accurate financial picture as to the profitability of production."[623] In so holding, the court expressly promoted a lessor-friendly view that "the profitability of a lease should, where possible, be determined over a relatively long-term period, so that expenses subject to wide fluctuations may be exposed to leveling influences of time."[624]

Both the length and context of non-production sufficient to terminate a lease will depend on facts relevant to the case at hand. For example, a court has considered profitability of a single well over its entire 527-day productive life.[625] Alternatively, another case presented instances of non-production among eight wells under a single lease, where the court considered respective lapses ranging from six to eighteen months in finding termination.[626] Due to the more protracted lease term in the latter case, the court expressly refused to consider the entire operations under the life of the

619. *Id.*
620. *Id.*
621. *See id.*
622. 191 P.2d 129 (Cal. Ct. App. 1948).
623. *Transport Oil Co.*, 191 P.2d at 134.
624. *Id.*
625. *See* Barnard v. Gibson, 224 P.2d 90, 94 (Cal. Ct. App. 1950).
626. *See* Montana-Fresno v. Powell, 33 Cal. Rptr. 401, 402-04, 409-10 (1963).

lease "to determine whether the totality of operations resulted in a loss."[627] Rather, the court rejected that "total cessations of production for the long periods of time shown by the evidence should be overlooked or averaged down."[628]

More recently, in considering the above-cited cases, *Lough v. Coal Oil, Inc.*[629] looked to the financial condition of the lease over the final fifty-one months prior to trial and held that an eighteen-month period of unprofitable production during that time terminated the lease.[630] While these cases offer insight into the courts' analysis in factual context, it is crucial to note "the final decision of an appropriate period is left to the sound discretion of the trial court taking into account all the existing facts."[631]

IV. SHUT-IN CLAUSES AND PAYMENTS – A GENERAL DISCUSSION OF TEXAS AND OKLAHOMA

The shut-in royalty clause is another savings clause that will permit the lessee to preserve the oil and gas lease during the secondary term.[632] Specifically, both Texas and Oklahoma agree that a shut in royalty clause or the payment of shut in royalties can operate to preserve the oil and gas lease when the lessee is unable to find a market for the oil or gas or when an existing market for oil and gas begins to decline.[633] As the Texas Court of Appeals stated in *Amber Oil and Gas Co. v. Bratton*,[634] shut in royalties are, "periodic payments for the privilege of deferring exploration and production after the primary term."[635] Or as the Supreme Court of Oklahoma stated in *Gard v. Kaiser*,[636] a shut in royalty clause "allows the continuance of the lease, without actual production and marketing of the shut-in product by the *substitution* of the stipulated payment for the royalties which would accrue to the lessor from actual production and marketing."[637] In this case, the Supreme Court of Oklahoma was confronted with the issue of whether a failure to pay shut-in royalty

627. *Id.* at 410.
628. *Id.*
629. 217 Cal.App.3d 1518 (1990).
630. 266 Cal.Rptr. 611, 617-19 (1990).
631. *Lough*, 266 Cal.Rptr. at 617.
632. 3 HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL AND GAS LAW § 631 (2010).
633. *See* Amber Oil & Gas Co. v. Bratton, 711 S.W.2d 741, 743 (Tex. App. 1986); Gard v. Kaiser, 582 P.2d 1311, 1314 (Okla. 1978).
634. 711 S.W.2d 741 (Tex. App. 1986).
635. *Amber Oil & Gas Co.*, 711 S.W.2d at 743.
636. 582 P.2d 1311 (Okla. 1978).
637. *Gard*, 582 P.2d at 1314 (emphasis added).

payments to a lessor would result in termination of the oil and gas lease.[638] The Court of Appeals determined that the lease could only be kept alive by production, actual or *constructive*, i.e., the payment of shut-in royalties.[639] However, on appeal, the Supreme Court concluded "shut-in gas provisions are not to be construed as limitations or conditions which would affect termination of the leases."[640]

The Court of Appeals of Oklahoma reiterated this position in *Roye Realty & Developing, Inc., v. Watson*.[641] In *Watson*, the court was again confronted with the issue of whether an oil and gas lease would terminate if the shut-in royalty payments were not paid properly.[642] The district court granted a temporary injunction to the lessee preventing the lessor from interfering with the lessee's operations in building a pipeline.[643] On appeal, the appellate court concluded that the oil and gas lease had not terminated due to the lessee's failure to promptly pay the first shut in royalty payment as the lessor alleged.[644] In the words of the Court of Appeals, "[n]either nonpayment of shut-in royalty after the end of the primary term, nor the failure to secure actual production prior to the end of the shut-in royalty period will terminate the lease if the lessee is acting as a reasonably prudent lessee under the circumstances in securing actual production."[645]

It is well established in the State of Oklahoma that a failure to make shut-in royalty payments will not necessarily terminate the oil and gas lease, provided the lessee exercises the effort that a reasonably prudent operator would exercise in finding a market for the oil and/or gas that could be produced by the shut-in well. The courts in the State of Oklahoma have further held that a lessor's only remedy for failure to pay the shut-in royalty is to file an action for breach of contract.[646] This might explain why courts in Oklahoma have not established, or defined, a period within which shut-in royalty payments must be paid in order to preserve the lease into the secondary term. Oklahoma focuses more on the actions of the lessee and the lessee's implied duty to market the oil or gas, rather than the passing of

638. *Id.* at 1312.
639. *Id.* at 1314 (emphasis added).
640. *Id.* at 1314-15.
641. 791 P.2d 821, 823 (Okla. Civ. App. 1990).
642. *Roye Realty & Dev., Inc.*, 791 P.2d at 823.
643. *Id.* at 822-23.
644. *Id.* at 824.
645. *Id.* at 823 (quoting HEMINGWAY, THE LAW OF OIL AND GAS § 6.5, at 310 (2d ed. 1983)).
646. *E.g.*, Danne v. Texaco Exp. & Prod. Inc., 883 P.2d 210, 215 (Okla. Civ. App. 1994).

a specific date without payment or production in determining whether an oil and gas lease terminates.[647]

However, Texas does focus on the payment of shut-in royalties or the actual production of oil and gas in paying quantities prior to the end of the primary term (or the anniversary of the shut-in payment date).[648] In *Amber Oil and Gas Co.*,[649] the Court of Appeals of, considered whether timely shut-in royalty payments to the wrong person would operate to preserve an oil and gas lease when the lessee had been put on notice that a portion of the leasehold interest had been assigned.[650] The court concluded that a "[f]ailure to make either of these payments properly usually results in automatic termination of the lease."[651] As the court explained, "[b]ecause payment of a shut-in royalty is a *substitute for production* which keeps the lease in effect, failure to make a timely shut in payment is the equivalent of cessation of production and the lease automatically terminates."[652] The Texas courts have also discussed shut-in royalty payments by referring to them as "constructive production."[653]

However, the Supreme Court of Texas has demonstrated some flexibility in what is considered timely payment. The general rule, established in *Freeman v. Magnolia Petroleum Co.*,[654] was that shut-in payments must be paid on or before the date that the well was going to be shut-in.[655] In this case, the court considered whether payments of the shut-in royalty four months after the beginning of the shut-in period would operate to preserve the oil and gas lease.[656] The Texas Supreme Court overruled the trial court and court of appeals, stating, "the provision for the payment of the $50 [shut-in royalty] to declare a potential well a 'producing well' was an absolute and unconditional agreement on the part of the lessee, rather than an option."[657] The court continued, "[this option] had to be timely exercised, to-wit, before the expiration of the Primary Term, in order to keep the lease in force and effect."[658]

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647. *See* McVicker v. Horn, Robinson & Nathan, 322 P.2d 410 (Okla. 1958) (discussing the implied nature of the duty to market in an oil and gas lease).

648. *See* discussion Part II.

649. 711 S.W.2d 741 (Tex. App. 1986).

650. *Amber Oil & Gas Co.*, 711 S.2d at 743-44.

651. *Id*. at 743.

652. *Id*. (emphasis added).

653. *E.g*., Mayers v. Sanchez-O'Brien Minerals Corp., 670 S.W.2d 704, 709 (Tex. App. 1984).

654. 171 S.W.2d 339 (Tex. 1943).

655. *Freeman*, 171 S.W.2d at 342.

656. *Id.* at 341.

657. *Id*.

658. *Id.*

On the other hand, *Gulf Oil Corp. v. Reid*[659] alludes to the fact that if the oil and gas well was producing in paying quantities prior to the expiration of the primary term and the lease was extended into the secondary term as a result, a cessation of production clause could "delay the tender of the royalty payment" until the end of the cessation of production period expressed in the lease.[660] In this case, the court addressed several issues, including whether the shut-in royalty payments tendered after a well capable of production in paying quantities had been capped was considered timely payment of the royalties such that the lease continued after the primary term expired.[661] Ultimately, the court concluded since the oil and gas well in question had never produced oil and gas in paying quantities, the cessation of production clause did not apply.[662] Therefore, the oil and gas lease terminated upon the lessee's failure to pay the shut-in royalty prior to (or on) the date the well was capped.[663]

In *Blackmon v. XTO Energy*,[664] the Texas Court of Appeals established yet another exception to the general rule of Texas that a failure to pay shut-in royalty payments in a timely manner will result in the termination of the lease. Specifically, the court held "if the constructive production defined by the clause is the existence of a well on the premises capable of production in paying quantities, then the lease should not terminate at the end of the primary term even if the shut-in royalties are never paid."[665] Here the court considered whether a lease terminated ninety days after a well drilled thereunder was shut in because XTO failed to pay shut-in royalties to all parties entitled under the lease.[666] After examining the terms of the oil and gas lease, the court concluded the failure to pay shut-in royalties under the lease is a covenant best enforced by a suit for money damages.[667]

Despite general agreement as to the role of the shut-in royalty clause in preserving the oil and gas lease, Texas and Oklahoma disagree on the impact of a failure to make payments pursuant to the terms of the shut in clause. This disagreement is likely the result of each state's treatment of the leasehold estate itself. As stated previously, the Supreme Court of Texas has interpreted the leasehold estate as a fee simple determinable that

659. 337 S.W.2d 267 (Tex. 1960).
660. *Gulf of Oil Corp.*, 337 S.W.2d at 271.
661. *Id.* at 268.
662. *Id.*
663. *Id.*
664. 276 S.W.3d 600 (Tex. App. 2008).
665. *Blackmon*, 276 S.W.3d at 607.
666. *Id.* at 605.
667. *Id.* at 606 (quoting OWEN L. ANDERSON ET AL., HEMINGWAY OIL AND GAS LAW AND TAXATION § 6.5, at 278 (4th ed. 2004)).

automatically terminates upon the occurrence of the limiting condition.[668] However, the Supreme Court of Oklahoma has interpreted the estate created by the habendum clause of the oil and gas lease as an estate on condition subsequent that does not automatically terminate upon a cessation of production or the occurrence of a condition.[669] In fact, in *Roye Realty & Developing, Inc., v. Watson*,[670] the Court of Appeals of Oklahoma expressly limited its conclusion that failure to make shut in payments does not terminate the lease on the condition that the lessee act reasonably and prudently in restoring production.[671] Consequently, in Oklahoma, if shut-in royalty payments are not made and the lessor wishes to declare the lease forfeit, the lessor must bring an action before the court.[672] The court must then determine whether under the facts the lessee acted reasonably and prudently in establishing a market.[673]

Nevertheless, Oklahoma and Texas both agree that in order for shut-in royalty payments to preserve the oil and gas lease, there must be a well capable of producing oil and gas in paying quantities. As the Texas Court of Appeals, stated in *Hydrocarbon Management v. Tracker Exploration, Inc.*,[674] "for a well to be maintained by the payment of shut-in royalties, it must be capable of producing gas in paying quantities at the time it is shut-in."[675] In this case, the issue before the court was whether the trial court erred in determining that the leases had terminated due to a failure of the lessee to establish production or satisfy the terms of one of the savings clauses included in the oil and gas lease.[676] In its discussion, the court analyzed whether the lessee had properly 'shut in' the well.[677] In so doing, it explained "that the phrase capable of production in paying quantities means a well that will produce in paying quantities if the well is turned "on," and it begins flowing, without additional equipment or repair."[678] The court concluded, based on this understanding, that the well was not capable of production and ultimately affirmed the judgment of the trial

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668. Stephens County v. Mid-Kansas Oil & Gas Co., 254 S.W. 290, 295 (Tex. 1923); *see also* Watson v. Rochmill, 155 S.W.2d 783, 784 (Tex. 1941).

669. Danne v. Texaco Exp. & Prod., Inc., 883 P.2d 210, 213 (Okla. 1994).

670. *Roye Realty & Dev., Inc.*, 791 P.2d at 823.

671. *Id.*

672. *Danne*, 883 P.2d at 213.

673. Hydrocabon Mgmt. v. Tracker Exp., Inc. 861 S.W.2d 427, 430-31 (Tex. App. 1993).

674. 861 S.W.2d 427 (Tex. App. 1993).

675. *Id.* at 432-33.

676. *Id.* at 431.

677. *Id.* at 433-34.

678. *Id.*

court holding that the lessees failed to establish that the oil and gas lease was preserved by the savings clauses included in the lease.[679]

Likewise, courts in Oklahoma have concluded a well cannot be shut-in or a lease preserved by the shut-in royalty provision unless the well is actually capable of production in paying quantities.[680] Like the Supreme Court of Ohio, in *James Energy Co. v. HCG Energy Corp.*,[681] the Supreme Court of Oklahoma, has defined the phrase "capable of producing paying quantities" as, "capable of producing quantities sufficient to yield a return, however, small, in excess of 'lifting expenses,' even though well drilling and completion costs might never be repaid."[682] In this case, the court considered several issues, including whether the leases held by the defendants expired under the terms of the habendum clauses. The court held that since the wells were capable of production in paying quantities, the leases were held by production.[683]

V. SHUT-IN CLAUSES AND PAYMENTS – A MULTI-STATE ANALYSIS

The approach regarding shut-in clauses and payments vary dramatically throughout different states nationwide. In order to provide a better understanding of how each state approaches the issue of shut-in clauses and payments, this section will provide a state by state analysis of relevant case law. States discussed include: New York, Pennsylvania, West Virginia, Kentucky, Virginia, Alabama, Mississippi, Tennessee, Illinois, Indiana, Michigan, Ohio, Kansas, Arkansas, Arizona, New Mexico, Utah, Montana, and Colorado.

A. NEW YORK

It appears New York would treat a lease in its secondary term as a fee simple subject to condition. However, New York has little case law regarding cessations of production during the secondary term of an oil and gas lease. One appellate decision does indicate that New York follows the general rule that shut-in royalties need not be paid to prevent termination of a lease if the lease is preserved by operation of another clause. In *Oag v. Desert Gas Exploration Co.*,[684] landowners brought an action for damages

679. *Id*. at 435; *see also* Blackmon v. XTO Energy, 276 S.W.3d 600, 603 (Tex. App. 2008).
680. *See* Fisher v. Grace Petrol. Corp., 830 P. 2d 1380, 1388 (Okla. Civ. App. 1991); *see also* Bixler v. Lamar Exp. Co., 733 P.2d 410 (Okla. 1987).
681. 847 P.2d 333 (Okla. 1992).
682. *Id.* at 339.
683. *Id.*
684. 659 N.Y.S.2d 654 (N.Y. Div. 1997).

against the assignee of a portion of an oil and gas lease for failure to pay shut-in royalties for that portion of the lease.[685] In rejecting the landowner's argument, the court stated "the habendum clause, and modifying clauses of the habendum clause such as the well completion, continuous drilling, *shut-in royalty*, and dry hole clauses, are treated as indivisible."[686] As such, shut-in royalties were not owed by the assignee because the lease was held by producing wells on the acreage retained by the assignor pursuant to the habendum clause.[687]

The Federal District Court for the Northern District of New York dealt with the issue of whether an oil and gas lease was automatically terminated for failure to pay delay rentals during the primary term of a lease.[688] In *Wiser v. Enervest Operating L.L.C.*, a lessee ceased payment of delay rentals during the primary term of an oil and gas lease upon the issuance of an allegedly "de facto" moratorium on fracking by the governor of New York in 2008.[689] As a result, landowners sought a declaration that the leases were null and void.[690] The leases were still within their primary term and no wells had been drilled or operations commenced.[691] Recognizing the "dearth" of New York oil and gas law, the federal court was forced to look entirely to other jurisdictions crafting its decision.[692] In examining the provisions of the lease, the court deemed the lease was an "unless" lease, and such clauses impose a "special limitation" that will automatically terminate the lease in the event the enumerated acts were not performed.[693] As such, the court held the lease was automatically terminated upon the failure of lessee to pay delay rentals as provided for in the "unless" clause.[694]

The court, however, was careful to limit application of its holding that a lease automatically terminates for failure to pay rentals to the *primary* term of a lease, noting that some courts "distinguish [] between occurrences of limiting conditions in the primary term and those that happen in the

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685. In addition, the landowners alternatively sought declaration that the lease was terminated for failure to pay shut-in royalties. 559 N.Y.S.2d at 654.

686. *Id.* (quoting HEMINGWAY, THE LAW OF OIL AND GAS § 9.10 (3d Ed. 1991)) (emphasis added.).

687. *Id.*

688. Wiser v. Enervest Operating, L.L.C., 803 F. Supp. 2d 109, 115 (N.D.N.Y. 2011).

689. *Id.* at 114.

690. *Id.* at 112.

691. *Id.*

692. *Id.* at 117-19.

693. *Id.* at 119.

694. *Id.* at 126.

secondary lease term[.]"[695] For this rationale, the court cited *Danne v. Texaco Exploration and Prod., Inc.*, an Oklahoma Appellate court case, for the proposition that a lessee becomes "vested" with an estate after drilling and proving hydrocarbons into the secondary term, the loss of which can only be effected through an action for forfeiture.[696] In limiting the applicability of its holding to the primary term, the court stated that this "same concern does not exist here where defendants never conducted drilling operations on the property. . . ."[697] As such, it can be said *Wiser v. Enervest* does not foreclose the possibility that a court following precedent would view a lessee's leasehold estate as a fee simple subject to condition subsequent – at least during the secondary term of a lease.

B. PENNSYLVANIA

Pennsylvania takes an unusual view of the ongoing preservation of a lease where a well is not producing in paying quantities upon or after expiration of the primary lease term. Specifically, the Pennsylvania Supreme Court has held:

> in cases involving oil and gas leases containing lease terms of a period of years and "as much longer as oil and gas is produced" or similar language, that when oil and gas is no longer being produced, the lessee becomes a tenant at will and the tenancy can be terminated by either party upon notice being given.[698]

These decisions have permitted terminations of leases where operators have failed to either produce in "paying quantities" or make payments due in lieu of production where the leases permitted such.[699] In addition, in two more recent decisions, the courts refused to equitably extend leases where lessees *voluntarily* suspended operations pending litigation over title to the subject property[700] and pending an action over the validity of the lease agreement itself.[701]

695. *Id.* at 124 n.15 (citing Danne v. Texaco Exp. & Prod., Inc., 883 P.2d 210, 214 (Okla. App. 1994)).

696. *Id.* at 124.

697. *Id.*

698. Derrickheim Co. v. Brown, 451 A.2d 477, 480 (Pa. Super. Ct. 1982) (quoting White v. Young, 186 A.2d 919, 920 (Pa. 1963)).

699. *See, e.g.*, *White*, 186 A.2d at 922; Clark v. Wright, 166 A. 775, 778 (Pa. 1933); Cassell v. Crothers, 44 A. 446, 447-48 (Pa. 1899).

700. *See Derrickheim*, 451 A.2d 479-80 (allowing a tenant to terminate a lease after the primary term where the lessee suspended production after discovering a "cloud on title" over the subject property and awaited judicial resolution of the issue).

701. *See* Lauchle v. Keeton Group L.L.C., 768 F. Supp. 2d 757, 759-62 (M.D. Pa. 2011) (declining to equitably extend a lease where a lessee forewent drilling operations pending

None of the Pennsylvania cases have addressed the issue of lease termination where a producing well is shut-in in the absence of a shut-in provision. However, courts have found termination of a lease for failure to produce or maintain production in "paying quantities" during the secondary term, where lessees were not justified in suspending operations pending the outcome of litigation,[702] and where the courts, in reviewing the facts, found indications of "abandonment" of the operations or clear inactivity on the part of lessees.[703] Additionally, Pennsylvania courts will place special emphasis on a lessee's efforts to "produce" during the secondary term where the landowner's sole compensation under the lease is royalty payments. The Pennsylvania Supreme Court reiterated this doctrine in recognizing an implied covenant to develop and produce under oil and gas leases.[704]

C. WEST VIRGINIA

West Virginia has not generated any cases dealing with the interpretation of shut in clauses. However, in *Howell v. Appalachian Energy, Inc.*,[705] the West Virginia Supreme Court of Appeals considered a tender of a shut-in payment that was not expressly provided for in the lease.[706] In that case, wells had been non-producing for at least eight years, while the leased properties were subject to bankruptcy proceedings and ownership changed hands.[707] Prior to filing suit, plaintiffs sent a letter asserting abandonment by the lessee, who responded by tendering a check

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litigation with the lessor despite the fact that the lessor had initiated the action seeking to invalidate the lease over the royalty terms).

702. *Derrickheim*, 451 A.2d at 480.

703. Though the inquiry into abandonment is a fact-sensitive one, the case law is as follows: Babb v. Clemensen, 687 A.2d 1120, 1122-23 (Pa. Super. Ct. 1996) (finding the lease was no longer maintained where the wells had not produced in five years and had become in disrepair, no delay rentals were paid during that time, and no gas was stored on the premises in accordance with the lease terms); *White*, 186 A.2d at 922 (terminating a lease where no oil or gas was found in paying quantities and thus no royalties had been paid in over 3 years past the primary term); *Clark*, 166 A. at 778 (finding termination of the lease due to surrender by the lessee where the lessee had shut-in the wells, disconnected the pipeline, withdrew from the premises, and failed to pay any delay rentals or take any other action with respect to the property for 22 months); *Cassell*, 44 A. at 447-48 (finding termination where a well, which was no longer producing in paying quantities, was shut-down while other wells in the area were not, and there was no activity by the lessee's employees for a period of five months).

704. "An implied covenant to develop the underground resources appropriately exists where the only compensation to the landowner contemplated in the lease is royalty payments resulting from the extraction of that underground resource." Jacobs v. CNG Transmission Corp., 772 A.2d 445, 455 (Pa. 2001).

705. 519 S.E.2d 423 (W.Va. 1991).

706. *Howell*, 510 S.E.2d at 431.

707. *Id.* at 426-27.

for a shut-in payment.[708] Although there was no shut-in clause in the lease, lessee argued that its effort to offer a shut-in payment along with other actions showed intent not to abandon.[709] Under the facts of the case, the court rejected the argument, finding the eight years of nonproduction and nonpayment, is determinative.[710] Implicit in the decision is the prospect that West Virginia courts would be prepared to evaluate the application of a shut-in clause to preserve a lease in the secondary term by appropriate payment under a shut in clause.

D. KENTUCKY

Whether payments pursuant to a shut-in clause are considered rents or royalties in Kentucky is unclear. In one case, the Kentucky Court of Appeals held payments pursuant to a shut-in clause are considered royalties, not rent, in accordance with the law in other jurisdictions, including Oklahoma, California, and Louisiana.[711] In that case, the court distinguished between payments made under leases to mine coal or other "hard" minerals and payments made for "migratory" minerals such as oil and gas, as follows:

> In dealing with coal this court in *Saylor v. Howard*, 229 Ky. 826, 18 S. W. (2d) 279, held that royalty to be paid on coal mined is regarded as rent. And in *Saulsberry v. Saulsberry*, 162 Ky. 486, 172 S. W. 932, Ann. Cas. 1916 E., 223, when we had under consideration coal and clay, it was written that as the result of usage and custom the terms "rent" and "royalty" are often used interchangeably. In *Crain v. West*, 191 Ky. 1, 229 S.W. 51, it was said that oil and gas royalties are "profits" if not "rents" under KS § 2138, which provides that one-third of the rents and profits of the husband's land shall go to the widow until dower is assigned. It will be noted that the three cases just referred to deal with "hard" minerals and not oil and gas, which are considered migratory. In 2 Thornton Oil & Gas, Sec. 363, p. 644, "rent" in an oil and gas lease is defined as money paid for delay in starting drilling operations, while "royalty" is defined as a certain proportion of the oil found or so much per well where gas is developed. This distinction between "rent" and "royalty" appears to us to be sound when dealing with migratory minerals such as oil and gas and it is

708. *Id.* at 430.
709. *Id.*
710. *Id.* at 432.
711. Maynard v. Ratliff, 179 S.W.2d 200, 200-02 (Ky. Ct. App. 1944).

supported by courts of foreign jurisdictions where the question has been raised.[712]

But, in an earlier case, the court treated shut-in royalty payments like rent, at least for purposes of apportioning them among the heirs of the original lessor.[713] In that case, the court held that where land is partitioned among heirs of a lessor, royalties must be apportioned among the heirs in accordance with the principle of apportionment of rents, because the royalty is a rental payment not only for the oil taken out but also for the holding of the rest of the lands.[714] The court noted Pennsylvania courts had reached the same result, but Arkansas, Oklahoma, Indiana and Ohio reached different results.[715]

E. VIRGINIA

Virginia would likely uphold a shut-in royalty provision in an oil and gas lease, because parties are generally free to contract as they please. The more uncertain issue is whether the lease automatically terminates upon failure to pay shut-in royalties. The answer turns on which position Virginia would take in interpreting the "production" requirement in the habendum clause.[716] The majority of jurisdictions find the term "production" in the habendum clause requires actual production in paying quantities.[717] In that case, failure to pay the shut-in royalty means failure to "constructively" produce; therefore, the lease should terminate automatically. In a jurisdiction that follows the minority position, resembling West Virginia and Oklahoma, "production" means only discovery or a capability of production.[718] Assuming the recent *LeGard v. EQT Prod. Co.*[719] opinion fairly represents the leanings of Virginia courts, it might be expected that Virginia would look to Colorado for guidance on shuts-ins as set out in *Davis v. Cramer*.[720]

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712. *Id.* at 201.

713. McIntire's Adm'r v. Bond, 13 S.W.2d 772, 773-74 (Ky. Ct. App. 1929).

714. *Id.* at 774.

715. *Id.*

716. *See, e.g.*, Fox v. Thoreson, 398 S.W.2d 88, 90 (Tex. 1966), (as an example of the use of the term "production" in a habendum clause: "'If . . . production is obtained, then this lease will remain in force for as long thereafter as oil, gas . . . is produced'").

717. 3-6 HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL AND GAS LAW § 604.1 (3d ed. 2012); *see, e.g.*, Baldwin v. Blue Stem Oil Co., 189 P. 920, 921-22 (Kan. 1920); Natural Gas Pipeline Co. of Am. v. Pool, 124 S.W.3d 188 (Tex. 2003).

718. WILLIAMS & MEYERS, *supra* note 717, § 604.1; *see, e.g.*, South Penn Oil Co. v. Snodgrass, 76 S.E. 961, 966-67 (W.Va. 1912); Cox v. Gulf Corp., 301 F.2d 122, 124 (10th Cir. 1962); Christian v. A.A. Oil Corp., 506 P.2d 1369, 1373 (Mont. 1973).

719. No. 1:10CV00041, 2011 WL 86598 (W.D. Va. Jan. 11, 2011).

720. 808 P.2d 358, 360 (Colo. 1991).

F. ALABAMA

The Alabama Supreme Court, in *Jones v. Bronco Oil & Gas Co.*,[721] held shut-in royalties paid on lands pooled with an oil and gas lease served to extend the lease beyond its primary term, when the lease itself is silent on the issue of pooled lands severing from non-pooled lands.[722] Conversely, in *Federal Land Bank of New Orleans v. Terra Resources*,[723] the court declined to apply the shut-in royalty clause as having been triggered by the facts at issue.[724] In *Jones,* the Supreme Court of Alabama addressed the question of whether an oil and gas lease was extended into its secondary term by payment of shut-in royalties for a well on lands not subject to the instant lease but pooled with a portion of lands from that lease.[725] The facts relevant to the court's analysis are as follows: a portion of an oil and gas lease was pooled with lands not subject to the lease and a well was drilled and shut-in on the non-leased property; following the expiration of the primary term, additional lands were added to the pooling unit and a well was drilled on and subsequently shut-in on those lands; shut-in royalty payments were made to the lessors of the non-leased lands.[726] The court found "proper payment of the shut-in gas royalty preserved the validity of the lease beyond the primary term as to those leased lands outside, as well as within, the unit."[727] In *Jones*, the Court expounded that an oil and gas lease could be written such to sever lands subject to lease but not pooled from those that were pooled and that such a clause would affect its outcome.[728]

In *Federal Land Bank of New Orleans*, the court was presented the question of the effect of failure to pay shut-in royalties on the validity of an oil and gas lease.[729] The court rejected the premise that shut-in royalties were due under the facts at issue and found the oil and gas lease in question was valid.[730] In that case, an oil and gas lease was entered into and subsequently delay rental payments were made. Following the rental payments, the lease was pooled with other lands on which a well was completed and shut-in, and shut-in royalties were paid only to the lessor

721. 446 So. 2d 611 (Ala. 1984).
722. *Jones*, 446 So. 2d at 614-15.
723. 373 So. 2d 314 (Ala. 1979).
724. *Fed. Land Bank of New Orleans*, 373 So. 2d at 318-20.
725. *Jones*, 446 So. 2d at 612-15.
726. *Id.*
727. *Id.*
728. *Id.*
729. *Fed. Land Bank of New Orleans*, 272 So. 2d at 314.
730. *Id.* at 315-20.

owning the property on which the well was located. A producing well was then drilled on the lands subject to the lease at issue.[731] The court held the shut-in royalty clause was not triggered, because no shut-in well was on the leased lands and actual production held the oil and gas lease valid.[732]

G. MISSISSIPPI

Because Mississippi has not expressly held that actual production is required to hold a lease past the primary term, it may be more flexible in allowing a lease to continue in such a situation. The District Court for the Southern District of Mississippi has in fact held that a discovery well drilled during the primary term and diligently pursued after its expiration was enough to hold the lease.[733] The general view of the lease construction expressed as construing leases in favor of a lessor where prepared by a lessee,[734] and certainly imply the terms of a shut-in clause would need to be strictly observed to prevent lease termination.

H. TENNESSEE

Tennessee courts have repeatedly noted one of the "purposes of an oil and gas lease is to encourage the diligent operation of the well."[735] In light of that purpose, traditionally, leases required production to survive past their primary terms. In fact, Tennessee has found that "the standard habendum clause[736] requires either discovery or actual production of oil and gas to cause the lease to remain in effect beyond the primary term . . . ."[737] In that state, the term "production" means "production in paying quantities."[738] Therefore, questions naturally arise as to the survivability of a lease being maintained by a shut-in well.

Tennessee courts recognize the validity of shut-in clauses, which generally allow for a payment in lieu of actual production to take the place of production royalties.[739] Such payments act to keep the well in

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731. *Id.*

732. *Id.*

733. D'Lo Royalties, Inc. v. Shell Oil Co., 389 F. Supp. 538, 548-49 (S.D. Miss. 1975).

734. *See generally* Frost v. Gulf Oil Corp., 119 So. 2d 759, 761 (Miss. 1960).

735. Cali-Ken Petrol. Co. v. Slaven, 754 S.W.2d 64, 65 (Tenn. Ct. App. 1988); Lone Star Oil & Gas, Inc. v. Howard, No. E2009-00428-CA-R3-CV, 2010 Tenn. App. LEXIS 111, *9 (Tenn. Ct. App. Feb., 12, 2010).

736. A typical habendum clause includes the following language: "If . . . production is obtained, then this lease will remain in force for as long thereafter as oil, gas, . . . is produced." Fox v. Thoreson, 398 S.W.2d 88, 90 (Tex. 1966).

737. P.M. Drilling, Inc. v. Groce, 792 S.W.2d 717, 720 (Tenn. Ct. App. 1990).

738. *Lone Star Oil & Gas*, 2010 Tenn. App. LEXIS, at *13; *P.M. Drilling*, 792 S.W.2d at 721.

739. *P.M. Drilling*, 792 S.W.2d at 723.

constructive production. When a shut-in clause exists, it must be considered in light of the whole lease, which will be interpreted by using the rules of construction.[740] Not only will the shut-in clause work to extend the lease as to the portion of the land from which production is obtained, but it will extend the lease as to the entire leased acreage. This proposition has been decided in Tennessee:

> Where a part of a leased tract is included within a pooled or unitized area, a majority of jurisdictions have held that drilling or production within the unitized area during the primary term of the lease, which prevents the termination of the lease at the end of the primary term, prevents its termination as to the portion of the lease excluded from the unitized area as well as to that portion included. This is, of course, consistent with the express language of the provision.[741]

One question relevant to shut-in clauses is whether failure to pay automatically terminates the lease held by constructive production. Tennessee has addressed this question, and held that the failure to pay shut-in royalties terminates the lease automatically by its own terms.[742] In that particular case, a lease provided for a one month primary term and "for so long thereafter as oil, gas, or either of them is produced from the leased premises."[743] While the lease was held past its primary term by production, the Lessee shut-in a well; thereafter, if Lessee wanted to maintain its well, the lease required Lessee to make shut-in royalty payments to lessor. The court determined that if Lessee did not pay delay rental or produce in paying quantities, the lease would terminate by its own terms,[744] which it did after lessee failed to make payments for four months. Because the lease terminated by its own terms, the lessor was under no duty to notify lessee that the lease had terminated.[745]

The court held such inquiries to be heavily based on the facts of the situation. It "is appropriate for courts to consider the 'good faith effort[s] by the lessee' and other 'equitable considerations'" construing the lease.[746] Lessees will be held to higher standards, however, especially in light of

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740. *Lone Star Oil & Gas*, 2010 Tenn. App. LEXIS, at *7.

741. Asberry v. St. Joseph Petrol., 653 S.W.2d 412 (Tenn. Ct. App. 1983) (citations omitted).

742. *Lone Star Oil & Gas, Inc.*, 2010 Tenn. App. LEXIS 111, *17.

743. *Id.* at *2.

744. *Id.* at *8.

745. *Id.* at *10 ("Lessee's failure to produce oil or gas from the well or tender rental or royalty payments to Lessor for four months led to the termination of the Lease by its own terms. Lessee's right to notice of default expired once the lease lapsed.").

746. *Id.* at *16 (quoting Waddle v. Lucky Strike Oil Co., 551 S.W.2d 323, 326 (Tenn. 1977)).

their generally "superior position of knowledge," related to their undertakings to drill or tender timely payments.[747]

A unique consideration in Tennessee is found in Tennessee Code Annotated § 66-7-103.[748] As it has been interpreted, this statute results in complete nullification of any lease provisions allowing a primary term of more than ten years if it is not held by production (with the possibility that shut-in payments may be able to extend a lease for only one additional year).[749] Section 66-7-103 states:

> (a)(1) Any lease of oil or natural gas rights or any other conveyance of any kind separating such rights from the freehold estate of land shall expire at the end of ten (10) years from the date executed, unless, at the end of such ten (10) years, natural gas or oil is being produced from such land for commercial purposes. If, at any time after the ten-year period, commercial production of oil or natural gas is terminated for a period of six (6) months, all such rights shall revert to the owner of the estate out of which the leasehold estate was carved. *No* assignment or *agreement to waive the provisions of this subsection shall be valid or enforceable*. . . .
>
> (b)(1) For a period of one (1) year after the ten-year period provided for in subsection (a) has expired, "production," as used in subsection (a), includes the actual production of minerals under any lease hereof or by the owner of any mineral interest, or when operations are being conducted by any owner of a lease or mineral interest for injection, withdrawal, storage, or disposal of water, gas, or other fluid substances, or when rentals or royalties are being paid by the owner of such lease for the purpose of delaying or enjoying the use of exercise of the rights thereunder or when the same is being carried out on any tract with which such leasehold interest may be unitized or pooled for production purposes. During the one-year period provided for herein, any act by the owner of any leasehold or mineral interest pursuant to or authorized by the instrument creating such interest shall be effective to continue in force all rights granted by such instrument, notwithstanding the provisions of subsection (a). . . .[750]

747. *Id.*

748. TENN. CODE. ANN. § 66-7-103 (2012).

749. Tengasco, Inc. v. E. Am. Energy Corp., No. 03A01-703-CV-00081, 1997 Tenn. App. LEXIS 555, at *15 (Tenn. Ct. App. Aug. 1, 1997).

750. TENN. CODE ANN. § 66-7-103 (emphasis added).

In the relevant case, the lessors leased the premises in 1979 for a primary term of ten years and included a broadly drafted thereafter clause.[751] The lessee drilled a well on the property that was capable of producing gas, but no market existed, so the lessees paid and the lessors accepted shut-in rental payments during and after the primary term.[752] In 1995, the lessors executed a new lease to Tengasco.[753]

The court determined that "production" in section 66-7-103(a)(1) meant actual production of minerals from the ground, not to include constructive production based on shut-in royalties.[754] This decision was rendered in spite of the fact that the parties defined production more broadly in their lease. This holding was based on the court's interpretation of legislative intent, which was "to encourage a lessee to diligently pursue actual, commercial production of oil or gas; . . . [and to] discourage[] a lessee from allowing a well to lie dormant beyond a period of ten years."[755]

Furthermore, the court did not accept the lessee's argument that the lessor's acceptance of shut-in royalties after the expiration of the primary term created a holdover tenancy.[756] "To adopt [this argument], we would have to find that shut-in payments made *after* the lease expired could achieve a result that the same kind of payments *during* the lease could not achieve–the continued long-term viability of the lease."[757] Rather, the court determined such payments could only work to extend the lease for one more year as provided in section 66-7-103(b)(1), although in that case, the one-year period had expired.[758] This provision requires lessees to be exceedingly diligent in maintaining production after the ten-year term has expired. It is questionable whether it is applicable to leases with a primary term of less than ten years or in which production was had within ten years.

I. ILLINOIS

The Illinois Supreme Court has addressed the impact of non-payment of shut-in royalties. In *Lamczyk v. Allen*,[759] the court rejected the lessee's argument that because it capped the well in question during the secondary term for lack of market, which was justifiable under one provision, the lease

751. *Tengasco*, 1997 Tenn. App. LEXIS, at *4-5.
752. *Id.* at *6.
753. *Id.*
754. *Id.* at *12-13.
755. *Id.* at *12.
756. *Id.* at *20.
757. *Id.* (emphasis in original).
758. *Id.*
759. 134 N.E.2d 753 (Ill. 1956).

remained intact despite the lessee's failure to pay shut-in royalties required under a separate provision.[760] The court found the language and intent clear that these provisions were essentially exclusive. Under the lease, paying shut-in royalties served to "keep the lease alive where gas is found . . . [and] . . . not sold (and) to consider the well as a producing well[;]"[761] however, reliance on the clause allowing suspension of operations for want of market "contemplates a condition where there has been production of gas together with its delivery and sale but that, due to certain conditions after production, suspension of operations is caused by no reasonable market being available."[762]

An intermediate appellate decision presented a more unique issue concerning the timeliness of the shut-in itself rather than royalty payments. In *Doty v. Key Oil, Inc.*,[763] the lessee tendered shut-in payments to extend the lease beyond the expiration date of the primary term, but did not actually shut-in the well until a year later.[764] The court found that this crucial fact reframed the issue to one of first impression: "whether the lease was extended under the shut-in clause prior to the actual shutting in by the mere existence of a well capable of producing gas."[765] Relying on *Lamczyk*, the court answered in the negative and held that a well capable of production "is not enough to extend the lease until such time as the lessee should choose to comply fully with the requirements of the shut-in clause."[766] Because the primary term under the Doty lease expired between shut-in payment and the physical act of shutting in, the lease automatically terminated at the closing date of the primary term.[767]

J. INDIANA

There is limited judicial authority in Indiana on shut-in clauses. In *Plymouth Fertilizer Co. v. Balmer*,[768] the lease included the following provision:

> In the event Lessee should encounter gas, and gas only, on said premises prior to the expiration of the primary terms, or any extension thereof, then Lessee may cap said gas well and continue

760. *Lamczyk*, 134 N.E.2d at 755.
761. *Id.*
762. *See id.*
763. 404 N.E.2d 346 (Ill. App. Ct. 1980).
764. *Doty*, 404 N.E.2d at 349.
765. *Id.* at 348.
766. *Id.* at 349.
767. *See id.*
768. 488 N.E.2d 1129 (Ind. Ct. App. 1986).

> this lease by the payment of $50.00 per year as a rental until a market can be found for such production.[769]

Thus, the lessee could continue the lease, which was executed in 1962, by paying rent even though there was no market for the gas.[770] The lessees, however, did not take advantage of this provision and failed to make shut-in rental payments except for four years – 1963, 1967, 1968, and 1969.[771] A lawsuit was brought in 1984 to quiet title and to recover the value of gas that defendants allegedly converted by beginning to operate the well in 1983.[772] In finding that the lease had expired [whether for nonpayment of shut in royalties or on an alternative theory of abandonment], the court noted that "[c]ertainly the lessees were aware of the above cited [shut-in] provision in the lease, since shut-in rentals were paid for certain years; and it follows that they knew that if rent was not paid the lease would expire."[773]

K. MICHIGAN

In Michigan, one court has held that, pursuant to the terms of a lease agreement, a shut-in well on pooled land is considered a producing well, and the existence of a producing well holds a lease open past its expiration.[774] However, a payment of shut-in royalties that is tendered more than a year after a well was shut in, near the expiration of the primary term, does not serve to extend the lease beyond its primary term where the lease requires payment within 90 days of shut in.[775] In the latter case, the defendants also claimed that "constructive production" occurred by payment of the shut-in royalty. "However the definition of constructive production requires timely payment in accordance with explicit lease provisions. . . . As previously noted, the payment was not timely and thus no constructive production occurred."[776]

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769. *Plymouth Fertilizer Co*., 48 N.E.2d at 1136.

770. *Id.*

771. *Id.*

772. *Id.*

773. *Id.*

774. SHR, LP v. N. Lakes Petrol., Inc., No. 225484, 2002 Mich. App. LEXIS 1341, at *5 (Mich. Ct. App. Sep. 24, 2002).

775. West Bay Exploration Co. v. Amoco Prod. Co., 384 N.W.2d 407 (Mich. Ct. App. 1986), *vacated* and *remanded* for reasons not related to shut in royalties by Amoco Prod. Co. v. Ct. App., 289 N.W. 2d 865 (Mich. 1986), *decision on remand*, West bay Exp. Co. v. Amoco Prod. Co., 399 N.W.2d 549 (Mich. Ct. App. 1986), *affirming* the trial court's judgment.

776. *Id.* at 410.

L. OHIO

There are only a few cases in Ohio that address shut-in royalties and how they work to maintain a lease after the primary term. As a general matter, the courts have held that "[a] shut-in royalty clause modifies the habendum clause so that the lease may be preserved between the time of discovery of product and marketing of the same. It is a savings clause, but it certainly does not negate the duty to use due diligence to sell the production."[777]

In *Wuenschel v. Northwood Energy Corp.*,[778] the appellants attempted to declare a forfeiture of a lease for two oil and gas wells on their property, alleging that the wells were not productive, and that they had not received royalty payments.[779] It was undisputed that gas production had stopped for a period of time to allow for repairs to a leaking pipeline.[780] During that time, oil production had continued.[781] In light of the evidence adduced at trial, the appellate court agreed that the wells had not been shut in.[782] The court noted:

> [A]t no time were the wells 'shut-in' for nonproduction as would have been required by the state of Ohio of a nonproducing well because the problem was not with the wells themselves, but rather, with the leaky pipelines, which were fixed . . . . Thus, while the wells were not producing gas in 2000, they were not 'shut-in' for the purpose of closing the wells and stopping production, but rather production of gas was halted for reasonable repairs . . . . During that time period, oil was being produced in 'paying quantities.'[783]

Because the wells were not shut in, the appellees' failure to pay shut-in royalties was not a breach of the lease, and did not trigger forfeiture.[784] "[A]s the wells were never 'shut-in,' there is no reason why they would be owed a shut-in royalty."[785]

In *Moore v. Adams*,[786] a well was shut-in in late 2000 or early 2001.[787] No shut-in royalties were paid from 2001 to 2006.[788] In 2006, the appellant

777. Am. Energy Serv., Inc. v. Lekan, 598 N.E.2d 1315, 1322 (Ohio Ct. App. 1992).
778. No. 20008-A-0039, 2008 Ohio App. LEXIS 5749 (Dec. 26, 2008).
779. *Id.* at **1.
780. *Id.*
781. *Id.* at **2.
782. *Id.*
783. *Id.* at **18.
784. *Id.* at **19.
785. *Id.* at **28.
786. No., 2007AP090066, 2007 WL 4907590 (Ohio Ct. App. Nov. 17, 2008).

sent appellee a check for shut-in royalties for January 2001 to January 2006, which appellee did not cash.[789] A second check was sent to appellee in December of 2006 for shut in royalties for January 2006 through December 2006.[790] Appellee likewise did not cash that check either.[791] Instead, appellee filed a complaint seeking forfeiture of the lease, due to appellant's failure to produce or maintain operations over that time, together with the failure to pay shut-in royalties.[792] Appellant argued that the lease should not be terminated because he had paid – or attempted to pay – shut-in royalties.[793] The court found attempted payment to be too little, too late, as it was "contrary to the express language of the shut-in clause of the lease. The lease states the royalty payment should be paid before the end of each calendar year during which the well is shut-in."[794] Because appellant failed to comply with this requirement, the attempted payment of shut-in royalties did not work to preserve the lease.[795]

In *Morrison v. Petro Evaluations Services, Inc.*,[796] appellees filed a complaint alleging that a well drilled in 1987 was capable of producing oil and gas but had been shut-in in 1988 and was not producing.[797] Appellees claimed that they had not been paid shut-in royalty payments since 1988, as required by the terms of the lease.[798] The appellant, Petro Evaluation Services, Inc., argued the well was neither a producing well nor a well capable of production because all that it produced was sour gas.[799] Because the well was not capable of production, appellant argued that the lease was not valid and no shut-in royalties were due; instead, the lease had expired by its own terms.[800]

The court, having reviewed the evidence from the trial, concluded that contrary to appellant's assertions, the well was capable of producing gas in paying quantities, because "[e]ven sour gas is marketable."[801] The fact that the appellant did not have ready access to a scrubbing facility to remove the

787. *Moore*, 2007 WL 4907590, at *1.
788. *Id.*
789. *Id.*
790. *Id.*
791. *Id.*
792. *Id.* at *2.
793. *Id.*
794. *Id.* at *4.
795. *Id.*
796. No. 2004CA0004, 2005 WL 2715578 (Ohio Ct. App. Oct. 21, 2005).
797. *Morrison*, 2005 WL 2715578, at *5-6
798. *Id.*
799. *Id.* at *6.
800. *Id.* at *3.
801. *Id.* at *15.

sulfur did not mean access was not available or possible.[802] Moreover, the court was influenced by the appellant's arguments to the Ohio Department of Natural Resources in 1991 that the well should not be plugged, because it was capable of production in commercial quantities and that pipeline rights were being negotiated.[803] The court, in finding that the well was shut-in, held:

> If the well was capable of production in 1991, and in 2002, appellant was preparing to transport the sour gas for scrubbing, appellant has failed to demonstrate why it could not have made the well capable of production in 1988. Because the well was capable of production, the lease did not terminate in September, 1988, and appellees were entitled to the shut-in royalties after such time.[804]

M. KANSAS

Under Kansas law, a well is shut-in when it is both complete and capable of producing, regardless of whether it previously achieved actual production. As discussed herein, this definition holds true whether or not the well is connected to a pipeline, subject to dewatering and repairs, or open to a limited market for sale of its production. The key factors considered by the courts are physical in nature, or "those factors that affect the properties and potential of the well itself."[805]

Kansas decisions focus heavily on fact related issues in oil and gas lease disputes, especially with regard to interpreting shut-in provisions.[806] Nonetheless, the Kansas Supreme Court has established "certain general characteristics" of shut-in royalty clauses to guide courts through this ad hoc determination.[807] According to the court, the purpose of a shut-in royalty clause "is to enable a lessee, under appropriate circumstances, to keep a nonproducing lease in force by the payment of the shut-in royalty and that such a clause by agreement of the parties creates constructive production."[808] Depending on the lease language, a shut-in clause "can modify and become an integral part of the habendum clause, or extension clause, of the lease."[809]

802. *Id.*
803. *Id.*
804. *Id.* at *16.
805. *See* Levin v. Maw Oil & Gas, LLC, 234 P.3d 805, 819 (Kan. 2010).
806. *See id.* at 809 (quoting Welsch v. Trivestco Energy Co., 221 P.3d 609 (Kan. Ct. App. 2009)).
807. *See id.*
808. *See id.* (quoting Welsch v. Trivestco Energy Co., 221 P.3d 609, 614 (Kan. Ct. App. 2009).
809. *Id.*

The Kansas Supreme Court's opinion in *Levin v. Maw Oil & Gas*[810] provides a detailed overview of the state of Kansas law regarding shut-in royalty provisions. In *Levin*, the Kansas Supreme Court considered whether shut-in royalty clauses extended a group of leases beyond their respective primary terms.[811] The leases contained similar shut-in royalty provisions, which provided:

> If, at any time, while there is a gas well or wells on the above land . . . and such well or wells are shut in, and if this lease is not continued in force by some other provisions hereof or if a well has been completed and dewatering operations have commenced, then it shall, nevertheless, continue in force as long as said well or wells are shut in and it shall be considered that gas is being produced from the leased premises in paying quantities within the meaning of this lease by the LESSEE paying or tendering to LESSOR annually, in advance a substitute or shut-in gas royalty . . . .[812]

The lessee drilled a gas well on each leased premises within the applicable primary term; however, with no pipeline in place to economically bring the gas to market, the lessee did not produce any oil or gas from these wells.[813] Instead, relying on the above provision, the lessee tendered shut-in and advance royalty payments to each lessor as a means to keep the leases intact.[814]

The district court found the shut-in clause unclear, but interpreted its language to apply only to a well that is *both* shut-in and subject to dewatering operations.[815] Because the absence of dewatering activities was undisputed, the court granted summary judgment in the lessors' favor.[816] Based on a wealth of Kansas precedent construing shut-in clauses, the Supreme Court of Kansas reversed and found this interpretation inaccurate under the circumstances.[817]

In the Kansas Supreme Court's view, this shut-in clause unambiguously established three conditions that must be met to allow the shut-in royalty payments to extend the lease: (1) "the existence of a gas

810. 234 P.3d 805 (Kan. 2010).

811. *See Levin*, 234 P.3d at 814.

812. *Id.* at 810.

813. *See id.* at 810-12.

814. *See id.*

815. *See id.* at 813 (quoting the district court's finding the shut-in clause language to be "at best confusing and ambiguous and at worst nonsensical").

816. *See id.*

817. *Id.* at 814-15; *see also* Classon v. Fed. Land Bank of Wichita, 617 P.2d 1255, 1262-63 (Kan. 1988); Dewell v. Fed. Land Bank, 380 P.2d 379, 383 (Kan. 1963); Friesen v. Fed. Land Bank of Wichita, 608 P.2d 915, 930 (Kan. 1908).

well or wells on the subject land;" (2) that such well(s) qualify as shut-in under state precedent;[818] and, (3) "*[e]ither* the leases must not be continued in force by some other provision[,] *or* the well or wells must be 'completed' and dewatering operations commenced."[819] The second of these conditions – whether the wells qualified as shut-in – was a crucial issue in *Levin*, prompting a detailed explanation of relevant Kansas precedent.[820] The court discussed six prior cases concerning shut-in clause construction, which shaped the *Levin* holding.[821]

After summarizing these six cases, the *Levin* court crafted the following description of shut-in clause construction: "a well generally qualifies as shut-in under Kansas law when it is physically complete and capable of producing in paying quantities, even if it has not actually produced in paying quantities in the past."[822] The court further stated, [t]he fact that [a well] has not yet been connected to a pipeline does not necessarily make it incomplete or prevent it from being accurately described as shut-in," nor is the "definition of shut-in entirely dependent upon whether dewatering has begun or upon whether equipment or repairs are still needed."[823] The court concluded that determining whether a well is shut-in is a question of fact and therefore, reversed and remanded.[824] The court further instructed that the factors to be considered "are those that affect the properties and potential of the well itself, rather than the likely success of any processing or transport of product that remains to be attempted or accomplished."[825] The Supreme Court's holding in Levin was

818. *See id.* at 815.

819. *See id.* at 815 (emphasis added).

820. *See id.* at 815-20.

821. *Id.*; *see also* Robbins v. Chevron U.S.A., Inc., 785 P.2d 1010, 1015 (Kan. 1990) (distinguishing non-payment of shut-in royalties from a breach of the covenant of diligent development); Pray v. Premier Petrol., Inc., 662 P.2d 255, 258-59 (Kan. 1983) (finding a well shut in despite no connection to marketing or transport facilities); Martin v. Kostner, 644 P.2d 430, 433 (Kan. 1980) (clarifying that a well need not connected to a pipeline or turned on before qualifying as shut-in); *Dewell*, 380 P.2d at 381-82 (holding that a lease's shut-in clause is "a privilege granted the *lessee* in lieu of production" but does not "make the payment of shut-in royalties the equivalent of production" under other contracts) (emphasis added); Welsh v. Trivestco Energy Co., 221 P.3d 609, 614-15 (Kan. Ct. App. 2009) (finding a lease expressly kept alive by shut-in royalties in lieu of production implies that the lessee's failure to tender such payments causes the lease to expire absent actual production"). *Contra* Tucker v. Hugoton Energy Corp., 855 P.2d 929, 936 (Kan. 1993) (narrowly ruling that a shut-in clause may only be invoked in response to a total absence of a market).

822. *Levin*, 234 P.3d at 819.

823. *See id.*

824. *See id.* at 820.

825. *Id.* at 819.

followed by the Kansas Court of Appeals in *Palmer v. Bill Gallagher Enterprises*[826] and *RAMA Operating Co. v. Barker*.[827]

In *Dewell v. Federal Land Bank*,[828] one of the cases relied on in *Levin,* the Kansas Supreme Court draws an important distinction between the effect of timely shut-in payments on the subject lease and similar production-contingent interests, such as term mineral interests, held by third parties.[829] In *Dewell*, the shut-in clause stated the lease would survive with annual shut-in payments from the date that "the well was *completed* as a gas well *capable of producing* natural gas in paying quantities."[830] The third-party plaintiff held a reversionary interest under a separate mineral deed that continued under the grant's own condition – "so long thereafter as" production from the leased acreage continues.[831] When the lessee exercised its option to shut-in wells and pay royalties, the plaintiff argued her reversion likewise survived actual cessation by virtue of the lessee's payments.[832]

The *Dewell* court explained that the lease's shut-in royalty clause, did not extend the rights of any unnamed parties "nor make the payment of shut-in royalties the equivalent of production" under any other contract.[833] The plaintiff's interest expired while the lessee's remained intact under the court's distinction between the shut-in clause's applicability to any well "capable of producing" and the grant's unsupported habendum language requiring "a well actually producing."[834] Accordingly, *Levin* defined shut-in as: "[a] well is shut-in when it is *completed and capable of producing* natural gas in paying quantities."[835]

N. ARKANSAS

In *L&L Energy Company v. Chesapeake Exploration, LLC*,[836] the court considered a case involving multiple oil and gas leases that had been produced into their secondary term, after which production ceased for a period of seven months and the lessor had accepted shut-in royalty

826. 240 P.3d 592 (Kan. Ct. App. 2010).
827. 286 P.3d 1138 (Kan. App. Ct. 2012).
828. 380 P.2d 379 (Kan. 1963).
829. *See id.* at 382-83.
830. *Id.* at 380 (emphasis added).
831. *Id.*
832. *Id.* at 380-81.
833. *Id.* at 381-82.
834. *Id* at 382-83.
835. Levin v. Maw Oil & Gas, LLC, 234 P.3d 805, 816 (Kan. 2010).
836. 379 S.W.2d 42 (Ark. Ct. App. 2010).

payments during that period.[837] The court ruled the acceptance of the shut-in royalty payments did not serve to extend the leases as they had expired prior to the acceptance.[838] Furthermore, the payments could not act to renew the lease because the leases were terminated by the time the shut-in payments were made.[839]

In *Hurley Enterprises Inc., v. Sun Gas Company*,[840] the court addressed an oil and gas lease covering lands within multiple sections, where the land covered by all but one section contained producing wells or were pooled with land containing producing wells.[841] The court found the shut-in royalty clause of the lease was never triggered because the entire lease was held by the production of any portion of lease, stating: "the Court is convinced that the lease agreement did not call for the lessee to make a shut-in royalty payment so long as gas is being produced in paying quantities from other lands covered by the lease."[842]

O. ARIZONA

Arizona has a statutory program in place for oil and gas leasing of state owned lands that is primarily contained in Arizona Revised Statutes sections 27-555 and 27-556.[843] Shut in royalties are addressed in section 27-555.01.[844] To take advantage of the provisions in the statute regarding shut in royalties, a lessee must first hold a qualifying lease. This means "the owner of an oil and gas lease issued pursuant to this chapter has discovered oil or gas on the leased premises or on lands joined therewith in a cooperative or pooled unit."[845] Further, there must be a completed well on the leased premises or those lands pooled with the premises that is capable of production in paying quantities but that is unable to so produce for "lack of transportation or processing facilities or a market for the oil or gas that would support production in paying quantities."[846] Production in paying quantities exists where "the monthly proceeds of the well would be expected to exceed the well's monthly operating expenses, if transportation and processing facilities were present and a market existed."[847] The statute

837. *Id.* at 46.
838. *Id.* at 46-47.
839. *Id.*
840. 543 F. Supp. 359 (W.D. Ark. 1982).
841. *Id.* at 360.
842. *Id.* at 362.
843. ARIZ. REV. STAT. § 27-555, -556 (2011).
844. ARIZ. REV. STAT. § 27-555.01 (2011).
845. *Id.* § 27-555.01 A.
846. *Id.* § 27-555.01 A, B(1).
847. *Id.* § 27-555.01 B(3)(a).

also requires that a notice of well completion be filed with the Arizona State Land Department, which is the same department that determines if a lease on state lands will qualify for shut-in status.[848]

P. NEW MEXICO

The New Mexico Supreme Court has examined shut-in royalties in *Maralex Resources Inc. v. Gilbreath*[849] and *Greer v. Salmon.*[850] The analysis in *Maralex* holds that shut-in royalties cannot extend an oil and gas lease when a well is not capable of actual production.[851] The *Greer* case held the reverse – namely, that when a well is capable of actual production, shut-in royalties can serve to save a lease from termination when there is no actual production.[852]

In *Maralex,* the court, presented with an oil and gas leasehold with a producing well on the premises that over time had become a non-producing well, was asked whether shut-in royalties payments could save the lease from expiring under its terms.[853] The *Maralex* court held that the lessee "could only rely on the shut-in royalty clause if the well in this case were capable of production. There is no evidence in the record to support a claim that the well was capable of production."[854] The court dismissed the notion that it should consider the question of shut-in royalties further.[855]

The *Greer* court was presented with an oil and gas leasehold upon which a well capable of actual production had been drilled but was not actually producing oil and/or gas.[856] In *Greer,* the court held a shut-in royalty payment can extend the term of the lease in question where the well is capable of production.[857] The *Greer* court also held the shut-in royalty clause in that case was a covenant not a condition or that it created in the lessee a right not a duty.[858]

Q. NEVADA

In at least one case, Nevada has upheld a delay rental provision in an oil and gas lease, citing the rights of all parties to freely contract according

848. *Id.* § 27-555.01 B(2).
849. 76 P.3d 626 (N.M. 2003).
850. 479 P.2d 294 (N.M. 1970).
851. *Maralex*, 76 P.2d at 632.
852. *Greer*, 479 P.2d at 297-98.
853. *Maralex*, 76 P.3d at 630.
854. *Id.* at 634.
855. *Id.* at 634-35.
856. *Greer*, 479 P.2d at 295.
857. *Id.* at 299.
858. *Id.*

to their wishes.[859] In that case, the parties expressly contracted that in the event the lessee did not drill, it could pay an agreed-upon price-per-acre for each twelve-month extension.[860] In fact, the contract set the price to be paid for the first ten years.[861] The lessee chose to extend the contract and raised the price for extensions in years eleven through twenty-five.[862] In year eleven, the lessee had not drilled but had paid to extend the lease; the lessor sued for termination of the lease, alleging the lessee violated an implied covenant to act with due diligence.[863] The Supreme Court of Nevada reviewed a minority position held by some states that reads an implied covenant of due diligence into contracts, which "would directly contradict an express provision allowing delay in development upon payment of rent."[864] Nevada agreed with the majority that this minority approach "appears 'violative of all settled interpretation and construction of contracts, and an unjustifiable interference with the privilege and power to contract.'"[865] The court explicitly adopted the majority rule, refusing to imply a covenant to act with due diligence that would "defeat the express agreement of the parties."[866]

R. UTAH

There are no Utah cases dealing directly with shutting in a well during the secondary term. The state courts have produced little relevant case law in this area despite consistent production within Utah borders. This absence of authority is largely because the majority of the state's oil and gas is owned and leased by the government and thus subject to lease controls by federal statute.

The only identified case with particular relevance is *Resource Management Co. v. Weston Ranch & Livestock, Co.*.[867] In *Weston*, the Utah Supreme Court found adequate consideration in a lease clause allowing only the lessee to terminate in its "sole discretion" and opinion of profitability.[868] The court rejected the lessor's arguments regarding illusory promises on the express grounds that the lessee owes the traditional

859. Warm Springs Dev. Co. v. McAulay, 576 P.2d 1120, 1120-21 (Nev. 1978).
860. *Id.*
861. *Id.*
862. *Id.*
863. *Id.*
864. *Id.*
865. *Id.* at 1121 (citing 2 W.L. SUMMERS, THE LAW OF OIL AND GAS §§ 397, at 547 (1959)).
866. *Id.*
867. 706 P.2d 1028 (Utah 1985).
868. *Sandtana, Inc.*, 706 P.2d at 1034-38.

contractual duties of good faith in exercising this termination power.[869] The court held:

> [R]eservation by a promisor of a power to cancel upon the occurrence of some event not wholly controlled by the promisor himself does not render his promise illusory or the contract invalid. "Even if the promisor is himself to be the judge of the cause or condition, he must use good faith and an honest judgment."[870]

S. MONTANA

The Montana Supreme Court has interpreted shut royalties in *Sandtana, Inc. v. Wallin Ranch Co.*[871] In *Sandtana,* the court was presented with oil and gas leasehold where a producing well was completed and shut-in on the final day of the primary term, after which shut-in royalty payments were made.[872] The lease contained lands in multiple governmental sections with only one section containing a well.[873] The lease in *Sandtana* contained a "Pugh clause" that functioned to segment the lease by governmental sections once the primary term had expired, further segmenting the lease depending on whether there was a productive well present.[874] The court in that case held "[a] shut-in royalty clause provides for 'constructive production,' typically in the form of shut-in royalty payments. The effect of the shut-in royalty clause is to provide for a substitute for production under the habendum clause."[875] The court considered the question as whether the well at issue was a "'producing well' or 'production'" had been satisfied such to extend the lease term for the whole leasehold upon the payment of shut-in royalties.[876] The court ruled Montana is a minority jurisdiction with regard to the definition of production requiring only that oil or gas be discovered and "'discovery' requires completion and capability of extraction and the lessee must make diligent efforts to market.'"[877] Thus, the court held the well in *Sandtana* was producing under the language of the lease and could sustain the

869. *Id.*
870. *See id.* at 1038 (quoting 1A CORBIN ON CONTRACTS § 165, at 86-87 (1963)).
871. 80 P.3d 1224 (Mont. 2003).
872. *Id.* at 1229-31.
873. *Id.* at 1231.
874. *Id.*
875. *Id.*
876. *Id.* at 1231.
877. *Id.* at 1230.

payment of shut-in royalties.[878] Finally, the court held absent the 'Pugh clause,' the shut-royalty payments in this context would have extended all lands subject to the lease into the secondary term.[879]

T. COLORADO

The "fundamental purpose" of an oil and gas lease is the "exploration, development, production, and operation of the property for the mutual benefit of the lessor and lessee."[880] Often, lessees diligently pursue these objectives by drilling a well capable of production, but the surrounding infrastructure may not have kept pace. Because of the nature of gas (*i.e.*, it cannot be stored), it must be marketed directly upon production; consequently, if no market exists, or if the facilities do not exist to transport it to a market, a producing well must be shut-in. Therefore, a "shut-in" well is one that is capable of production but which is currently not in production, usually due to lack of market.

In recognition of the overriding purpose of oil and gas leases, parties are free to set out express provisions that obligate lessee to carry out acts to accomplish that purpose. If the lease fails to provide these provisions, the law implies them.[881] Settled Colorado case law identifies four such implied covenants: "exploration, development, production (including marketing), and protection against drainage."[882] The implied duty to produce, *i.e.*, to market, is the most relevant for a discussion of shut-in royalties. After completion of a well, lessee has a reasonable time to comply with the implied covenant to market, absent express lease terms to the contrary.[883] The shut-in royalty clause, then, is an example of an express provision which alters the effect of failing to comply with the obligation to market implied into the lease.[884]

Understanding the function of the shut-in royalty clause as interpreted in Colorado is aided by understanding the purpose of the habendum clause.[885] A habendum clause is "[t]he clause in a deed or lease setting forth the duration of the grantee's or lessee's interest in the premises."[886] In

878. *Id.* at 1232.
879. *Id.*
880. Davis v. Cramer, 808 P.2d 358, 360 (Colo. 1991).
881. *Id.* at 361.
882. *Id.*
883. *Id.*
884. *See* Davis v. Cramer, 837 P.2d 218, 223 (Colo. App. 1992).
885. *See generally id.*
886. Bledsoe Land Co. v. Forest Oil Corp., 277 P.3d 838, 840 n.2 (Colo. App. 2011).

order for an "unless" lease to extend a lease beyond the primary term, the lessee must satisfy the production requirement of the habendum clause.[887]

The Colorado Court of Appeals has addressed this issue, and drew a distinction based upon whether marketing is considered an essential part of production, finding:

> Jurisdictions vary as to what is required to satisfy a habendum clause. If marketing is not an essential part of production, the habendum clause is satisfied by commercial discovery of the product. . . . In jurisdictions in which marketing is an essential part of production, the habendum clause requires that the product be removed from the earth, which necessarily involves marketing where the product is gas, and reduced to possession for use in commerce.[888]

The court went on to state that neither the lease at issue in that case nor Colorado case law indicated that marketing is an essential part of production.[889] Indeed, this position is reinforced by relevant Colorado case law.[890] Therefore, the habendum clause is satisfied by discovery in commercial quantities.[891]

The position taken in Colorado that a habendum clause is satisfied by mere discovery of paying quantities has implications in the analysis of shut-in royalty clauses. Once a lessee has successfully drilled a well capable of production in commercial quantities, he has fulfilled his obligation to drill, and his lease will be carried past its primary term.[892] This raises the question of what would induce a lessee to include a shut-in royalty clause. The answer to this question revolves around the implied duties that Colorado case law applies to all lessees.

Colorado implies four covenants into leases that lack contrary provisions. They include: to drill or explore, to develop after discovery in paying quantities, to diligently and prudently operate, and to protect against

887. *See, e.g.*, Davis v. Cramer, 808 P.2d 358, 359 (Colo. 1991).

888. *Davis*, 837 P.2d at 222.

889. *Id.* Note that the lease at issue was for a primary term of ten years and "as long thereafter as oil or gas or other minerals are produced from said land by lessee." *Id.* at 221. Therefore, in the absence of the requirement that minerals be produced from land "in paying quantities," Colorado does not imply such a requirement.

890. *See* Hoff v. Girdler Corp., 88 P.2d 100, 102 (Colo. App. 1939).

891. *See Davis*, 837 P.2d at 222. Parties remain free to draft the habendum clause to require production in commercial quantities, and in that instance mere discovery would presumably be insufficient. *See* N. York Land Assoc. v. Byron Oil Indus., Inc., 695 P.2d 1188, 1192 (Colo. App. 1984).

892. *Davis*, 837 P.2d at 222.

drainage.[893] The covenant to prudently operate entails the further duty to market the product, which requires the lessee to diligently market the product so that lessor will realize a return on his royalty interest.[894]

The performance of a lessee in complying with the duty to market will be judged under the prudent operator standard; that is, lessee must exercise reasonable diligence, having regard for the interests of lessor and lessee, in commencing marketing within a reasonable time after completion of the well.[895] Marketing includes the sale of the product and payment of royalties owing to lessor.[896] A finding of compliance with the duty depends upon equitable consideration applied to the facts of each case. Whether proper diligence was exercised is determined by answering the question, "whatever, in the circumstances, would be reasonably expected of all operators of ordinary prudence, having regard to the interests of both lessor and lessee."[897]

A shut-in royalty effectively provides "constructive production" by allowing the lessee to extend his lease past the primary term without marketing product, and by allowing the lessor to collect royalties in the absence of a market.[898] Where commercial discovery has been made during the primary term, thereby satisfying the habendum clause, the shut-in clause is not *necessary* to extend the lease beyond its primary term and does not operate as a special limitation to extend the term of the lease.[899] The lease will be extended with or without the shut-in clause subject only to forfeiture for failure to comply with the implied covenant to market.[900] However, parties may choose to insert a shut-in royalty clause to provide "an additional special limitation," requiring payment of the shut-in royalty if gas is not marketed.[901] Essentially, it is an avenue through which parties draft around the implied covenant to market.[902]

The following shut-in royalty clause was found to be optional and not the exclusive method for maintaining the lease in force when production lapsed during the secondary term: "[W]hen no reasonable or convenient

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893. *Id.* *See* Davis v. Cramer, 808 P.2d 358, 361 (Colo. 1991) (setting out the implied covenants of exploration, development, production (including marketing), and protection against drainage); *see also* Gillette v. Pepper Tank Co., 694 P.2d 369 (Colo. App. 1984).

894. *See Davis*, 837 P.2d at 222. Note that this duty applies during both the primary and secondary terms. *See generally Davis*, 808 P.2d at 358.

895. *Davis*, 837 P.2d at 222.

896. *Id.*

897. *Id.* at 222-23.

898. *Id.* at 223.

899. *Id.*

900. *Id.*

901. *Id.*

902. *See id.*

gas market is available, lessee may pay $1 per acre per annum for the total acres allotted to each while held as a shut-in well."[903] The Colorado Court of Appeals held failure to pay the shut-in did not terminate the lease, although the lessee was not excused from the duty to search for a market or to otherwise conduct himself as a reasonably prudent operator; it was on the latter ground that the lease was terminated.[904] It is important to note the court found the duty to market to have applied and to have been breached during the primary term.[905] Therefore, payment of shut-in royalties, if used as a saving mechanism, may be necessary both before and after the primary term expires if a well capable of production is shut-in.

Colorado also has had occasion to determine how shut-in royalty payments affect wells shut-in on pooled acreage.[906] In *O'Hara v. Coltrin*,[907] the lease allowed acreage to be pooled with other lands and also provided that a well on pooled acreage but not physically located on the leased land was sufficient to maintain the lease as to the entire leased premises.[908] Two wells were thus drilled on landed pooled with the leasehold, but not on the leasehold, and were subsequently shut-in.[909] The lessee paid shut-in royalties in order to maintain the lease.[910] The lessee challenged the payments because the shut-in clause spoke in terms of the "leased premises."[911] The court found that the shut-in clause should be combined with the pooling clause, such that the payments continued the lease in full force and effect.[912]

VI. FILLING THE GAPS, FURTHER CONSIDERATIONS IN SELECTED SHALE STATES

The states selected here for further discussion, beyond a survey of their existing case law regarding temporary cessation and shut-in clauses have in common ongoing or anticipated new development, to exploit substantial shale horizons using horizontal drilling. In most of these states, the technology of horizontal drilling means a per well investment an order of magnitude, or more, greater than the investment in the wells and leases on which the existing jurisprudence is based. While the shale revolution in

903. *Id.* at 223-24.
904. *Id.* at 224.
905. *Id.*
906. *See generally* O'Hara v. Coltrin, 637 P.2d 398, 401 (Colo. App. 1981).
907. 637 P.2d 398 (Colo. App. 1981).
908. *O'hara*, 637 P.2d at 400.
909. *Id.* at 400-01.
910. *Id.* at 400.
911. *Id.* at 401.
912. *Id.*

Texas or Louisiana will likely not create substantial new developments in case law, at least in regard to the topic of this article, a different result should be expected in the states here visited.

Because both Texas and Oklahoma can be viewed as very supportive of oil and gas development, it may be somewhat misleading to suggest that the differing approaches of these two leading states, demonstrate different biases toward development. Nevertheless, it does appear that Texas, with its view of a lease as a fee simple determinable, which is automatically terminated by a cessation of production, leans toward protecting lessors by eliminating leases that are not producing or being assertively developed. Oklahoma, on the other hand, seems to lean toward a development policy which weighs more heavily toward the risk and investment represented by the lessee or producers efforts. This provides greater leeway in the evaluation of whether a lessee has acted appropriately in performing under the lease, in order to extend and preserve it into the secondary term. It may be expected that in jurisdictions whose jurisprudence is incomplete, the current courts, may lean toward one model or the other based on a contemporary view of which development model, lessor leaning or lessee leaning, most closely reflects the economic and public policies of their respective states, without reference to century old efforts to describe or redefine property interests or contract rights which were last analyzed when the oil industry was in its infancy. If this is the case, many of the states discussed in this section might be expected to take a restrictive, rather than expansive, view of the application of the legal doctrines or contractual provisions discussed in this Article.

A. NEW YORK

In the current context, it is fair to say that the relative absence of judicial decisions on savings clauses in New York is not the proverbial wrench in the works, holding up development of the state's shale resources. Indeed, the ongoing assessment of what ought to be the appropriate New York policy for energy development suggests that any effort to evaluate New York's treatment of saving clauses going forward may be somewhat premature.

The federal district court decision in *Wiser v. Enervest Operating L.L.C.*,[913] discussed in more detail earlier,[914] is instructive in that the court, acknowledging an absence of New York precedent, looked to Oklahoma and the *Danne* decision, to conclude that an oil and gas lease creates an

913. 803 F. Supp. 2d 109 (N.D.N.Y. 2011).
914. *See* footnote 715-24 and accompanying text.

estate subject to a condition, which vests in the lessee upon production.[915] This, in turn, may indicate that New York would characterize itself as a "discovery" state in evaluating the application and effect of shut-in royalty payments in a manner similar to Oklahoma. This approach seems to strike a more reasonable balance of equitable consideration of the risk and economic investment associated with horizontal development, protecting a lessee from the harsher requirements of actual production in the primary term but requiring a quid pro quo, diligent compliance with the payment obligations of a shut-in provision, and like diligence in proceeding to obtain and connect new wells to market.

B. PENNSYLVANIA

Pennsylvania law related to savings clauses in the secondary term is sparse, and as with some other aspects of Pennsylvania oil and gas law and mineral property law,[916] the peculiar uniqueness of the case law makes analysis all the harder. As an ownership-in-place state, it might be expected that Pennsylvania would take a firm position similar to Texas on the general effect of the cessation of production in the secondary term being termination of the lease. Yet, the few cases all seem to support a different approach. It is somewhat akin to Oklahoma or other "discovery" states, but seeming to come from a different set of considerations. The *Cole v. Philadelphia Co.*[917] case sets out a general proposition that a temporary cessation of production of short duration will not result in termination of a lease.[918] However, this case, as it was presented to the court, was uniquely postured with the lessee asserting that the cessation caused a termination and the lessor arguing for continuation and enforcement of payment obligations under the lease.[919] One wonders as to the applicability of this decision in the typical case where the lessor seeks to show that the cessation should result in lease termination. Likewise, the Pennsylvania conclusion that upon cessation of production in the secondary term the lease creates a tenancy at will seems at odds to the majority view that automatic termination results, and more in line with the views of courts in Oklahoma or West Virginia as expressed in *Derrickheim Co. v. Brown*.[920] And

915. *Wiser*, 803 F. Supp. 2d at 133-34 (citing Danne v. Texaco Exp. & Prod., Inc., 833 S.W.2d 210 (Okla. Ct. App. 1994)).

916. *See, e.g.*, Dunham v. Kirkpatrick, 101 Pa. 36, 40 (1882) (creating a presumption that a reservation of "minerals" does not include oil absent clear contrary intention within the terms of a lease).

917. 26 A.2d 920 (Pa. 1942).

918. *See generally Cole*, 26 A.2d at 920.

919. *See id.* at 921-22.

920. 451 A.2d 477 (Pa. Super. Ct. 1982).

California, the other state that finds a holdover tenancy upon a cessation of production, can be classified as a discovery state.[921]

Certainly, if presented with a typical cessation case, the existing case law suggests that Pennsylvania courts would favor some version of a temporary cessation of production doctrine, wherein the court would consider all the related facts, including: duration of the cessation; the effort of the lessee to return to production or acts which infer abandonment; the inclusion of a cessation clause in the lease; and where there is a clause, appropriate and timely performance by the lessee. In the absence of a clause, the tenancy-at-will approach of *Derrickheim* suggests strongly that the duration of a temporary cessation would be brief, perhaps a few months at most, before a lessor might be expected to give notice that the tenancy at will was terminated.

Likewise, the application of the reasoning in *Derrickheim* to shut-in royalty provisions suggests that, in the absence of very clear and specific language as to when payments should commence within the contractual agreement of the parties, Pennsylvania courts would require payment as of the time of shut-in to avoid opening a gap during which the lessor could declare the tenancy at will to be over. In addition, a lessee would almost certainly expect to be required to use diligence in connecting the well to market or returning it to economic production, even while shut-in payments were being made. The extent to which current Pennsylvania courts lean toward either the lessor or lessee, in balancing the equities of a case, may suggest whether Oklahoma or Colorado would be a better guide. As indicated elsewhere in this Article, the authors see as the better view the lessee-leaning approach of Oklahoma. This is because of the economic stakes, the relative risk to the parties, and the potential benefit to both the lessee and lessor from production, assuming the lessee, in its actions, has acted reasonably and prudently in the operation of the well and in meeting its lease performance obligation, including timely payment of required shut-in royalties.

C. WEST VIRGINIA

As stated in *Bryan v. Big Two Mile Gas Company*,[922] West Virginia has adopted a temporary cessation doctrine, which is fact-specific, but is comprehensible and reasonable in evaluating the facts.[923] Coupled with the West Virginia view that "discovery" of productive quantities in the primary

921. *See* Renner v. Huntington-Hawthorne Oil & Gas Co., 244 P.2d 895, 901 (Cal. 1952).
922. 577 S.E.2d 258 (W.Va. 2001).
923. *Bryan*, 577 S.E.2d at 266.

term is sufficient to hold the lease into the secondary term, there is some prospect that West Virginia would follow the Oklahoma model in interpreting shut-in clauses and their effect in preserving a lease in the secondary term. The limited case law on this subject speaks only to the point that preservation by operation of a shut-in payment must be express in the lease and will not be implied in the absence of express language.

In a recent case involving proper payment of royalty, *Estate of Tawney v. Columbia Natural Resources*,[924] the West Virginia Supreme Court of Appeals looked to Colorado as a model for its holding. Colorado, as discussed previously, does take the view that there is a duty to market in the primary term.[925] While early West Virginia precedent like *South Penn Oil Co. v. Snodgrass*,[926] stands for the proposition that discovery of oil or gas in paying quantities is sufficient to hold the lease into the secondary term, the Supreme Court might find an obligation to pay the shut-in royalty in the primary term to be required where a lease provided for such payments, as is the case in many contemporary leases used in West Virginia, even though this would not have been the practice in early 20th century leases in Appalachia. However, given Colorado's view that a well capable of producing will hold a lease into the secondary term, and West Virginia's long-standing similar view, West Virginia could very well adopt some version of a Colorado or Oklahoma model.

D. ALABAMA

As indicated in the survey materials of this Article, Alabama has had opportunity to consider both temporary cessation issues and shut-in clauses in the context of specific contractual clauses in specific leases. It appears Alabama accepts the majority position, as exemplified by Texas law, that a lease will expire at the end of the primary term in the absence of actual production, based on the *Griffen* decision.[927] Likewise from that case, it appears that Alabama would ameliorate that result by the express terms of a lease savings clause on the same reasoning as its analysis of the drilling operations clause considered in that case. It can be reasonably assumed that Alabama would likewise consider adoption of a temporary cessation doctrine, as a matter of equity, in the Texas vein demonstrated by the *Scarborough* decision[928] and *Watson v. Rochmill*.[929] And it may be

924. 633 S.E.2d 22 (W. Va. 2006).

925. *See, e.g.*, Davis v. Cramer, 808 P.2d 358, 363 (Colo. 1991) (suggesting that the shut-in payment needs to be made in the primary term to preserve the lease into the secondary term).

926. 76 S.E. 961 (W. Va. 1912).

927. *See* Griffin v. Crutcher-Tufts Corp., 500 So. 2d 1008, 1011(Ala. 1986).

928. *See* Scarborough v. New Domain Oil & Gas Co., 276 S.W. 331, 336 (Tex. App. 1925).

expected that Alabama would view an express contract provision to be controlling as to the condition and duration of a temporary shut-in, since both Texas and Oklahoma are in accord on that view, as reflected in *Hoyt v. Continental Oil Co.*,[930] which Alabama looked to favorably in evaluating what constituted "reworking" in the *Sheffield* decision.[931]

Further extrapolating the Alabama court view of shut-in clauses, as reflected in *Griffen,* suggests that Alabama would follow the Texas approach on questions of timely payment of shut-in royalties and with regard to treatment of shut-in payments as substitute production. This seems likely, in cases where production had carried the lease into the secondary term, at which point, the well was shut in for some period, if timely shut-in payments were correctly made, following the reasoning in the *Amber Oil* decision.[932]

Alabama has indicated a willingness to consider the relationship of various lease clauses to each other in evaluating the ongoing validity of a lease in the secondary term, as indicated in the *Federal Land Bank of New Orleans* case.[933] In this regard, Alabama could be expected to consider the applicability and timing of the shut-in payments in conjunction with any drilling operations provisions or cessation provisions found in a lease in keeping with *Gulf Oil Corp. v. Reid.*[934]

E. OHIO

While Ohio historically lacks the extensive body of oil and gas law of Texas or Oklahoma, on many issues its case law on temporary cessation is reasonably well developed. Certainly, based on cases, which appear to treat a lease as a profit or incorporeal heriditament, rather than a fee simple determinable,[935] recognition of a fact-based, equity-driven doctrine on temporary cessation is rational in the context of the survival of a lease in the secondary term. However, in evaluating further legal developments on saving clauses in Ohio, it is worthwhile to note recent oil and gas cases at the appellate court level, expressing the view that in Ohio oil and gas leases create a fee simple determinable estate, rather than a profit or

929. *See* Watson v. Rochmill, 155 S.W.2d 783, 784 (Tex. 1941).

930. *See* Hoyt v. Cont'l Oil Co., 606 P.2d 560, 563 (Okla. 1980).

931. *See* Sheffield v. Exxon Corp., 424 So. 2d 1297, 1302 (Ala. 1982).

932. *See* Amber Oil & Gas Co., v. Bratton, 711 S.W.2d 741, 743 (Tex. Ct. App. 1986).

933. *See* Fed. Land Bank of New Orleans v. Terra Res., Inc., 373 So. 2d 14, 319-20 (Ala. 1979).

934. *See* Gulf Oil Corp. v. Reid, 337 S.W.2d 267, 271 (Tex. 1960).

935. *See, e.g.*, *In re* Estate of Faulkner, 64 Ohio Law Abs. 420 (Ohio C.P. 1952); Jones v. Wood, 9 Ohio C.C. 560, 568 (1895).

hereditament.[936] While not controlling, the rationale of the *Tisdale* court is informative where the court states that the typical habendum clause language is "generally construed to create a determinable fee interest."[937] This case suggests a possible movement toward Ohio following Texas precedents going forward. In any event, it seems unlikely that the temporary cessation doctrine in Ohio will see any expansion as a defense by lessees. Rather, it could be expected that case law developments will likely narrow the rule, particularly if the cessations are associated with long-lived marginal wells, where, in attempting to balance the equities between lessor and lessee, a fact finder is more likely to conclude that the lessee has received substantial prior economic benefit over a long period.

With the new intense leasing and drilling activity and a very large number of old held by production leases kept alive by marginally producing wells, one would expect to see the temporary cessation doctrine in Ohio revisited. And if Ohio courts are moving toward a more clearly defined view of leases as fee simple determinable estates, no expansion of the doctrine is likely, insofar as what constitutes "temporary cessation" with long-producing historic wells. Lessees seeking to preserve leases from claims by lessors regarding cessation of production are likely to have an uphill climb where the facts show a lack of economic production for a period much in excess of a year.

A recent statutory change in Ohio could impact a court's view of this issue. Section 1509.062(A)(1) of the Ohio Revised Code, enacted in 2010, permits an owner of a well with no reported production for two years or longer to obtain from the state, approval for the well to be treated as temporarily inactive for up to a year, with the ability to apply for additional renewals.[938] The application must include a plan to utilize the well within a reasonable time. This procedure, if followed, could be weighed by a court as part of its consideration both as to diligence of the lessee to return to production, and as to what constitutes reasonable duration of a temporary cessation. However, such an approach would go considerably beyond the logical extension of any current Ohio cases on the subject.

With regard to the applications of shut-in clauses, early Ohio law clearly requires that there must be actual production at the end of the

936. *See, e.g.*, Tisdale v. Walla, No. 94-A-0008, 1994 Ohio App. LEXIS 5941, at *9-10 (Ohio Ct. App. Dec. 23, 1994); *see also* Stocker & Sitler, Inc. v. Metzger, 250 N.E.2d 269, 276 (Ohio Ct. App. 1969).

936. *See, e.g.*, Kramer v. PAC Drilling Oil & Gas, LLC, 968 N.E.2d 64, 68 (Ohio Ct. App. 2011).

937. *Tisdale*, 1994 Ohio App. LEXIS 5941, at *10.

938. *See* OHIO REV. CODE ANN. § 1509.062(A)(1) (2010).

primary term, consistent with the law in Texas. Thus, it should be expected that Ohio would adhere to this rule regarding current shale development. This, in turn, suggests that where a producible well exists prior to the end of the primary term, but cannot be produced, shut-in payments should be initiated prior to the end of the primary term. Nevertheless, with regard to gas wells, given the substantial investment represented by each horizontal well and current constraints on infrastructure, the Oklahoma approach seems the better rule. Particularly where a well is drilled and completed near the end of the primary term and capable of production in paying quantities, but production is delayed due to pipeline to market availability issues ultimately controlled by third parties, the payment of shut-in royalties pursuant to the terms of a lease should preserve the lease into the secondary term for a reasonable period of time. Such an approach is entirely consistent with the equity-driven origins, from which the temporary cessation doctrine developed in Ohio. *Moore v. Adams*[939] addresses timely payments of shut-in royalty. While *Moore* is not a holding from the Ohio Supreme Court, it speaks to the current view of Ohio courts, which will likely expect diligence by lessees on being in compliance with the clear terms of a savings clause in order to have the court give the clause effect to preserve the lease.[940]

F. MICHIGAN

While Michigan has not considered temporary cessation of production issues in the typical circumstances, *Michigan Wisconsin*[941] indicates a willingness to consider the circumstance of a temporary cessation in an equitable sense.[942] Moreover, the fairly developed law on the temporary cessation doctrine found in Ohio, Illinois, and Indiana, with similar legal histories and similarities in the development of each state's historic oil and gas fields, suggests that Michigan would adopt a version of temporary cessation in the appropriate factual circumstances. This is consistent with *Barrett v. Dorr*,[943] and would follow Ohio and Texas to find that lease termination is otherwise automatic in the secondary term if the cessation is unduly long or if the lessee fails to show prudence and diligence in restoring production. With regard to shut-in clauses, Michigan's limited case law appears to be fully in accord with Texas law, both with regard to

939. No. 2007AP0900662008, Ohio App. LEXIS 4998 (Ohio Ct. App. Nov. 17, 2008).
940. *Moore*, 2008 Ohio App. LEXIS 4998, at **13.
941. 324 N.W.2d 541 (Mich. Ct. App. 1982).
942. *Mich. Wis. Pipeline Co.*, 324 N.W.2d at 546.
943. 212 N.E.2d 29 (Ind. Ct. App. 1965).

timeliness of payments and the effect of payments as constructive production if timely made.[944]

G. NORTH DAKOTA

As indicated in the survey materials, North Dakota appears to have adopted a lessee-oriented approach to temporary cessation of production, which seems to place North Dakota closer to Oklahoma's view regarding oil and gas leases.[945] However as indicated previously, the *Greenfield* decision looks to a Kansas case, *Wagner v. Sunray Mid-Continent Oil Co.*,[946] to identify the factors which a trier of fact should consider in evaluating whether a cessation is temporary or permanent, and distinguishes North Dakota from Oklahoma, on the issue of applying the temporary cessation doctrine to determinable mineral interests.[947]

Although no reported cases dealing with shut-in clauses were noted in North Dakota, *Feland's* holding that a cessation of production does not automatically terminate a lease in the secondary term, seems in accord Oklahoma's approach to the secondary term of a lease. This suggests that North Dakota would view, the similar analysis applied to shut-in clauses reflected in *Roye Realty* and other Oklahoma cases, as persuasive on the application and interpretation of shut-in clauses,[948] including issues of timely payments or non-payment and looking at the facts on a case by case basis. Where Texas and Oklahoma are in accord, as in requiring a well capable of producing in paying quantities, in order to permit application of a shut-in clause, accord in North Dakota seems likely.[949]

VII. CONCLUSION

The issue of when a cessation of production is sufficient to terminate a lease is fact specific and grounded in principals of equity. This in turn suggests that new jurisprudence in the various states will not likely expand the duration of "temporary cessation." As a result, developers seeking to rely on held by production leases to build a land position, will be wise to focus attention on lease production histories. Developers should seek to

944. *See generally* SHR, LP v. N. Lakes Petrol., Inc., No. 225484, 2002 Mich. App. LEXIS 1341 (Mich. Ct. App. Sep. 24, 2002).

945. *See generally* Feland v. Placid Oil Co., 171 N.W.2d 829 (N.D. 1969).

946. 318 P.2d 1039 (Kan. 1957).

947. *See* Greenfield v. Thill, 521 N.W.2d 87, 89-91 (N.D. 1994).

948. *See, e.g.*, Roye Realty & Developing, Inc. v. Watson, 791 P.2d 821, 823 (Okla. Ct. App. 1990).

949. *See* James Energy Co. v. HCG Energy Co., 847 P.2d 333, 338-39 (Okla. 1992); Fisher v. Grace Petrol. Corp., 830 P.2d 1380, 1387 (Okla. Ct. App. 1991).

manage land assets by careful and thorough drafting of lease instruments and amendments and by diligence in performance to the standard of a "reasonably prudent operator" in operating producing wells.

Historic leases should be evaluated carefully as to the extent and meaning of shut in provisions, as well as to past and current performance under the terms of such clauses. Indifferent compliance to the obligations of shut in clauses is likely to result in unfortunate outcomes for the producer. Certainly it can be expected that lessors and attorneys representing them will be exercising diligence in their review of both obligation and performance, given the current market value of prospective shale development lands.

Without question, the shale boom states discussed herein will see significant developments in their substantive oil and gas law in the next five to eight years. Hopefully individual trial and appellate courts, in jurisdictions lacking fully developed jurisprudence, will be as attentive in their review of the facts and in consideration of applicable law as lessors, lessees, and their advocates are now becoming.