

IMPLIED COVENANTS IN OIL AND GAS LEASES IN OHIO

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The ordinary oil and gas lease in the United States calls for the payment by the lessee of bonus money, provides for delay rentals, and contains a provision that the lessor shall receive royalty, usually one-eighth of the production or its equivalent in money. Generally, most oil leases are entered into long before there is any production and at a time when the initial down payment, or bonus money, is slight. Similarly, the delay rentals are ordinarily small in amount and the main consideration for the lease, insofar as the lessor is concerned, is the possibility of royalties from production. The lessor land-owner is naturally interested in securing development as rapidly as possible, while the lessee may, and frequently does, desire to delay exploration and development until a time best suited to him. This conflict of interest has resulted in a variety of clauses in leases involving oil and gas as well as the development of new lease forms.

In the early days of oil production, landowners leased land for oil and gas development for a fixed term, much as a farmer might lease a field for the growing of crops. The lease under which the first commercial oil well was drilled was of this type. On the expiration of the fixed term the land, including the well, reverted to the lessor. Because this was entirely unsatisfactory to the lessee, the fixed term oil and gas lease was gradually abandoned. In some instances the landowner conveyed an undivided interest in the oil and gas to the "lessee" in fee with the result that the "lessee" was under no duty to develop. Here again, dissatisfaction—this time on the part of the landowner—resulted in the virtual abandonment of this type of instrument. The next development was the so-called "no-term" lease which, after construction by the courts, was found to be unsatisfactory to both the lessor and the lessee and is not in current use.

The two lease forms currently in use are the "or" lease, in which the lessee is privileged to drill, *i.e.*, develop, *or* to make certain payments to the lessor; and the "unless" lease, under which the lessee must develop within a specified time or suffer termination of the agreement *unless* delay rentals are paid. The former type is

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rarely used outside the State of California with the result that today the "unless" lease is the type most commonly used.¹

The classification of leases has generally been on the basis of the granting or habendum clause, and while "unless" provisions are relatively standard, other provisions vary according to the desires and ingenuity of the draftsman of the instrument.²

It is unusual for any oil and gas lease to contain any provisions delineating the extent either of the lessee's obligation in the areas of exploration, development, operation, marketing, and drainage protection, or of the diligence the lessee must use in fulfilling those obligations. Indeed, where the lease is in wildcat or semi-proven territory it would be extremely difficult to devise specific provisions placing such obligations on the lessee. There may not be any oil and gas under the land involved, or oil and gas may exist under only part of it. The result has been silence in the lease agreement on these matters, and the courts have developed the doctrine of implied covenants to govern disputes between lessor and lessee in these areas.³

This is not to say that a lease cannot contain specific provisions in these areas. Some do, particularly where the lease involves proven territory; and where such specific provisions appear it is said that no implied covenant can arise as to the particular obligation covered. But even where specific provisions may exist, *e.g.*, in development, implied covenants may be involved in other areas, *e.g.*, in drainage protection or marketing. The extent and application of these implied covenants require examination.

As might be expected, the obligations of the lessee vary according to the particular implied covenant involved, as do the remedies afforded the lessor for breach of covenant. Accordingly, the implied covenants generally fall into and are classified under four categories: (1) The implied covenant to drill an exploratory well; (2) The implied covenant to drill additional wells; (3) The implied covenant for diligent and proper operation of the wells, and for marketing the products if oil or gas is discovered in paying quantities; and (4) The implied covenant to protect the leased premises against drainage by wells on adjoining land.⁴

¹ Williams, Maxwell & Myers, *Oil and Gas Cases and Materials* 141 (2d ed. 1964).

² Under usual circumstances the lease is drafted by the lessee. The lease form is normally printed bearing a title such as "Standard Producers 88 Lease."

³ See Merrill, *Covenants Implied in Oil and Gas Leases* §§ 1-3 (2d ed. 1940).

⁴ *Id.* § 4. Merrill notes that, while various writers have listed the number of categories of implied covenants from three to five, the above classification covers all of them, the variation in number being achieved by consolidation or division of the listed four.

Regardless of the category, however, an implied covenant is precisely what its name indicates. The obligation is imposed by operation of law because of the nature and purpose of the agreement and may not have been consciously considered by the parties to the agreement.⁵ Thus, where the agreement contains an express covenant relating to any of the four categories above indicated, courts customarily state that the express covenant excludes the possibility of any obligation arising from an implied covenant on that particular point.⁶ According to Merrill,⁷ a more exact statement is that "An implication cannot stand against an express agreement. Insofar as it is inconsistent with terms of the agreement, it must yield."⁸

THE IMPLIED COVENANT TO DRILL AN EXPLORATORY WELL

Usually, the average landowner of wildcat territory is approached by a leaseholder who offers him a small bonus payment, from five to ten dollars an acre and frequently less; delay rentals of a dollar or two per acre per year, again frequently less; and one-eighth of the production as royalty. The landowner is invariably presented a lease form, prepared by the lessee, which contains language usually not fully understood by the lessor. In any event, the lessor is almost certainly unaware that any implied covenants are involved. He is primarily interested in royalty payments and, therefore, in expeditious development. However, an implied covenant does exist in this area under certain lease provisions. Merrill has adopted a classification of these provisions which I shall follow here.⁹

As previously indicated, leases of the fixed term or no-term types are rarely used today, and where mineral interests are trans-

⁵ *Id.* § 7.

⁶ See, *e.g.*, *Kachelmacher v. Laird*, 92 Ohio St. 324, 332, 110 N.E. 933, 935 (1915), which states that "An implied covenant can arise only when there is no expression on the subject." In *Linn v. Wehrle*, 35 Ohio App. 107, 111, 172 N.E. 288, 289 (1928), it is said that "there can be no implied covenant in a contract in relation to any matter that is specifically covered by the written terms of the contract itself."

⁷ *Op. cit. supra* note 3, § 6.

⁸ *Carper v. United Fuel Gas Co.*, 78 W. Va. 433, 438, 89 S.E. 12, 14 (1916).

⁹ Merrill, *op. cit. supra* note 3, classifies the fact patterns which arise under this covenant as follows:

A. Where the lease contains no express provisions concerning the drilling of an exploratory well and no provisions for delay rental.

B. Where there is an express provision that the lessee is to have all of a specified period in which to commence operations.

C. Where two separate tracts are included in a single lease, but all wells are drilled on one tract.

ferred in fee no duty arises for the grantee to develop in the absence of an express covenant. While there are no Ohio cases squarely in point there is language in parallel cases indicating the courts of this state would hold an implied covenant exists to drill an exploratory well where no provision for exploration appears in the lease and where there is no provision for delay rentals.¹⁰ Thus, in *Landers v. Ohio Oil Co.*,¹¹ the following language appears:

In an oil and gas lease which reserves to the lessor substantial royalties in kind and in money of the oil produced and the gas used off the premises, the promise of these royalties is the controlling inducement to the securing of the lease . . . it necessarily follows that the intention of the parties was that the drilling for oil and gas should be commenced at some time, notwithstanding that no time is mentioned in the lease. . . .¹²

Where there is an express provision that the lessee is to have all of a specified period in which to commence operation, if the expressions in *Kachelmacher v. Laird*¹³ and *Linn v. Wehrle*¹⁴ are to be taken at their face value, it would logically follow that the lessee might take all the time specified in commencing operation even though the period may appear unreasonably long. No Ohio cases directly in point have been found. In other jurisdictions rulings are to the effect that, the time having been fixed by the parties, there is no implied covenant to drill within any other time.¹⁵ As the vast majority of present day leases involve short primary terms and provide for delay rentals, this problem will seldom arise.

D. Where the lease contains a provision that the lessee shall commence or complete a well upon the leased premises, or upon other specified premises, within a specified time, or, in lieu thereof, pay a rental for such delay.

1. Where delay rentals have been paid and accepted by the lessee.
2. Where the lessor refuses to accept payment of delay rentals and demands that the lessee commence operations.
3. Where operations have been carried on upon other lands, as provided for in the lease.

Id. § 14, at 51. (Text italicized in the original.)

¹⁰ The great weight of authority is to this effect. Cases so holding are listed in Merrill, *op. cit. supra* note 3, § 15, at 52.

¹¹ 24 Ohio N.P. (n.s.) 65 (C.P. 1921).

¹² *Id.* at 70.

¹³ 92 Ohio St. 324, 110 N.E. 933 (1915).

¹⁴ 35 Ohio App. 107, 172 N.E. 288 (1928).

¹⁵ See, *e.g.*, *Adkins v. Adams*, 152 F.2d 489 (7th Cir. 1945) (solid minerals and oil production apparently regarded as incidental); *Skinner v. Ajax Portland Cement Co.*, 109 Kan. 72, 197 Pac. 875 (1921) (lease for ninety-nine years, express provision that drilling to be optional within that period); *McKee v. Thornton*, 79 Okla. 138, 192 Pac. 212 (1920) (provision that oil and gas to be prospected for within twenty years). See generally Merrill, *op. cit. supra* note 3, § 18.

The problem which arises where two separate tracts are included in a single lease, but all wells are drilled on one tract was first presented in *Alford v. Dennis*,¹⁶ in which two tracts of land about two miles apart were covered by the same lease. Producing wells were drilled on one tract but none were drilled on the other. The non-producing tract subsequently passed to one of the heirs of the original lessor and suit was brought to cancel the lease as to that particular tract on the basis that the implied covenant to explore had been breached. Cancellation was decreed, the court stating that "since plaintiff's land was burdened with an oil and gas lease he is entitled to have those lands prospected for oil and gas within a reasonable time."¹⁷

In Ohio as early as 1903, *Northwestern Ohio National Gas Co. v. Ullery*¹⁸ held that, where the lessee agrees that the contract or lease should extend to heirs and assignees and the tracts pass to separate owners, the payment for gas production should go to the owner of the tract on which the producing well was located. In this instance the two tracts joined at one corner and the ruling would appear to follow the general rule laid down in *Alford v. Dennis*.¹⁹ *Northwestern Ohio Natural Gas Co. v. Ullery* did, however, contain the statement. "It may be that the payment of the rental of \$150 for this one well would have the effect to hold the lease on both tracts as between the original parties. . . ." ²⁰ This indicates a possible departure from the rule of *Alford v. Dennis* where the non-productive tract had not been transferred. It is difficult to believe the possibility mentioned by the court in *Ullery* would be applied to transfers in view of prior language of the Ohio circuit courts in such cases as *Baumgardner v. Browning*,²¹ where it was stated:

[W]e have held heretofore, that where wells have been sunk under a contract of lease, and found to be productive wells, that it was the duty of the lessee to proceed diligently and make a fair use of the premises in producing the oil, to the end that the lessor might have his royalty and the use of his premises²²

¹⁶ 102 Kan. 403, 170 Pac. 1005 (1918).

¹⁷ *Id.* at 406, 170 Pac. at 1007.

¹⁸ 68 Ohio St. 259, 67 N.E. 494 (1903).

¹⁹ Compare *Ohio Gas Co. v. Davis*, 6 Ohio C.C. Dec. 529, *aff'd*, 59 Ohio St. 591, 54 N.E. 1106 (1898), an even stronger case as a single tract had been subdivided. See generally Merrill, *op. cit. supra* note 3, § 19.

²⁰ 68 Ohio St. at 273, 67 N.E. at 496. (Emphasis added.)

²¹ 5 Ohio C.C. Dec. 394 (1896).

²² *Id.* at 396. Cf. *Kenton Gas & Elec. Co. v. Orwich*, 11 Ohio C.C. Dec. 786 (1900). "If the first well proved a good one . . . there was an implied contract to make a second well and a sufficient number of wells to reasonably develop the whole land . . ." *Id.* at 788.

The action of the Ohio Supreme Court in *Coffinberry v. Sun Oil Co.*,²³ permitting cancellation as to those portions of a leased tract which the lessee had failed to protect against drainage increases this doubt. Of course, the latter case was based on another implied covenant—that of protection against drainage—but it would seem from the reasoning used that the same principle would apply. Despite the dictum in *Ullery*, then, it is believed the rule of *Alford v. Dennis* would be applied in Ohio for it seems to be the better rule.

Where the lease contains a standard delay rental clause, that is, provides for payment in the event of the lessor's delay in exploration, Merrill recognizes three classes of cases: (1) where the delay rentals have been paid by the lessee and accepted by the lessor; (2) where the lessor refuses payment and demands exploration; and (3) where operations have been carried on upon other lands as provided in the lease.²⁴

The early Ohio case of *Venedocia Oil & Gas Co. v. Robinson*²⁵ was one in which delay rentals had been paid. The lease contained a clause reading: "In case no well is completed within ninety days from date hereof, unavoidable delay excepted, then this grant shall become null and void, unless second party shall pay the first parties [delay rentals]. . . ." ²⁶ Despite the use of the term "grant" instead of "lease" the court recognized the instrument to be a lease, and stated that "the lessor, by acceptance of the stipulated rental, has waived performance of the implied engagement to develop the premises, to the end of the last year for which rent was paid."²⁷ The case syllabus does not mention waiver but says that the time within which the implied engagement must be performed is postponed by acceptance of the sum specified. The difference in language appears to be immaterial.²⁸ It thus appears that in this situation Ohio follows the position taken by a majority of jurisdictions.²⁹

Where the lessor refuses to accept payment of delay rentals and demands that the lessee commence operations, difficult questions are raised. It has already been shown that where the lease is silent as to the time of the commencement of a well and does not provide for delay rentals, an implied covenant arises requiring the lessee

²³ 68 Ohio St. 488, 67 N.E. 1069 (1903).

²⁴ Merrill, *op. cit. supra* note 9.

²⁵ 71 Ohio St. 302, 73 N.E. 222 (1905).

²⁶ *Ibid.* This clause is strikingly similar to the modern "unless" clause.

²⁷ *Id.* at 315, 73 N.E. at 224.

²⁸ A similar ruling was made in *Kachelmacher v. Laird*, *supra* note 6, the court stating that payment of the rental in accordance with the terms of the lease keeps the lease in force during the period for which the rent was paid.

²⁹ Cases are collected in Merrill, *op. cit. supra* note 3, § 23, and 2 Summers, *Oil and Gas* § 397 n.57 (perm. ed. 1959).

to commence a well within a reasonable time. Where the lease is an "or" or "unless" type, however, the lease will contain an express agreement that the lessee may, by payment of rental, defer drilling.

It has been suggested that delay rentals are liquidated damages for delay in the performance of the contract, not an alternative obligation representing fulfillment of the contract,³⁰ but this position has not been taken by Ohio courts. Some jurisdictions have held that, if the parties have stipulated that rentals would be payable in lieu of development, then an express provision, as opposed to any implied covenant to develop, would exist.³¹ This would, of course, be consistent with the general rule.³² It should be obvious, however, that such a position might work serious hardship if the leased premises were in proven territory³³ or, as is more likely, territory which became proven after execution of the lease. Further, this application of the general rule might, in the absence of other implied covenants, permit a lessee who had wells on adjoining lands to drain the leased premises.³⁴

Because of the possibility of drainage, the underlying proposition that the main consideration for a lease is royalty, and the additional implied covenant to prevent drainage, some courts, notably those of Indiana³⁵ and Kentucky,³⁶ have held that it would be unfair to the lessor to permit the lessee to delay drilling for extended periods and thereby deprive the lessor of royalties, stating that the lessor might refuse to accept delay rentals and demand development within a reasonable time thereafter. These decisions may have been influenced by the fact that in each case the bonus and rental payments were nominal. Summers expresses the view that such decisions are "violative of all settled rules of interpretation and construction of contracts. . . ." ³⁷

³⁰ *Murray v. Barnhart*, 117 La. 1023, 42 So. 489 (1906).

³¹ *Merrill*, *op. cit. supra* note 3, § 27.

³² See *supra* note 6 and associated text material.

³³ Proven territory is used to mean land under which, from surrounding producing wells, oil or gas or both is known to exist.

³⁴ *Meyers & Williams*, "Implied Covenants in Oil and Gas Leases: Drainage Caused by the Lessee," 40 *Texas L. Rev.* 923 (1962); *cf.* *Comment*, 35 *Miss. L.J.* 280 (1964).

³⁵ *Consumers' Gas Trust Co. v. Littler*, 162 Ind. 320, 70 N.E. 363 (1904).

³⁶ *Monarch Oil, Gas & Coal Co. v. Richardson*, 124 Ky. 602, 99 S.W. 668 (1907). The position established by this case was specifically repudiated by statute where the oil and gas lease contained a delay rental clause. *Ky. Stat.* 376 6b-4a (Carroll 1936) [apparently still the law by virtue of *Ky. Rev. Stat. Ann.* §§ 446.130, .170 (1963)]. See *Ky. Rev. Stat. Ann.* §§ 353.020-.060 (1963). The pros and cons of the rule are discussed in *Veasey*, "The Law of Oil and Gas," 18 *Mich. L. Rev.* 652 (1920).

³⁷ 2 *Summers*, *op. cit. supra* note 25, § 397, at 547. *Quaere* as to contracts of adhesion.

The Ohio Supreme Court seems to have vacillated between the two positions. In *Central Ohio Natural Gas & Fuel Co. v. Eckert*,³⁸ the court declined to permit the lessor to enjoin operations by the lessee on leased premises following the lessor's refusal to accept delay rentals and his notice to the lessee that the lease was terminated. Although the court said the option was to terminate the leases or keep them in force by payment of delay rentals, no mention was made of implied covenants and the decision may have been based on the ground that—assuming an implied covenant to exist—the lessee should have reasonable time to commence operations after refusal to accept delay rentals.

Shortly thereafter, in *Venedocia Oil & Gas Co. v. Robinson*³⁹ the court indicated approval of the Indiana position, discussed *Consumers' Gas Trust Co. v. Littler*⁴⁰ at some length, and, by dictum at least, recognized the existence of an implied covenant to drill within a reasonable time after lessor's refusal to accept delay rentals even though such delay rentals were provided for in the lease. Ten years later, in the *Kachelmacher* case, the court said:

The rights of the parties must be determined from their own contract. Under the clearly expressed terms of the lease, if the lessee does not drill he may still continue the lease in force by payment of the stipulated rental. Such matter being covered by the express terms of the written contract, no implication can arise in relation thereto inconsistent with, or in opposition to, such plain provision of the written contract. An implied covenant can arise only when there is no expression on the subject.⁴¹

In *Kachelmacher* the plaintiff complained of failure to drill during a period for which delay rentals had been paid and accepted and the quoted language is, therefore, dictum, but it strongly indicates a denial of any implied covenant and a rejection of the Indiana position. This appears to be the latest expression by the Ohio Supreme Court and the result is a conflict of dicta.

The only case in which a lower court has discussed the precise point involved is *Landers v. Ohio Oil Co.*⁴² The court, after a review of the cases already noted, distinguished *Kachelmacher* on its facts.⁴³

³⁸ 70 Ohio St. 127, 71 N.E. 281 (1904).

³⁹ *Supra* note 25.

⁴⁰ *Supra* note 35.

⁴¹ *Supra* note 6, at 332, 110 N.E. at 935.

⁴² 24 Ohio N.P. (n.s.) 65 (C.P. 1921).

⁴³ The court observed:

In the *Kachelmacher* case, the customary delay rental in that vicinity was from 25 cents to \$1.00 per acre, but there the lease provided for the payment of about 60 times the customary rental. The territory leased was 8 tenths of

Merrill suggests Ohio would follow the rule denying an implied covenant in delay rental leases, but he makes no mention of the *Landers* case.⁴⁴ Although the present situation is unsettled, the *Landers* case, as the latest judicial expression, would appear to indicate that Ohio courts will infer a covenant when the principal inducement for the lease is royalty and will deny it when such is not the case.

Cases in which the operations have been carried on upon other lands, as provided for in the lease, are infrequent because this form of agreement is relatively rare and, where used at all, applies to wildcat or unproven territory. It is usually in the "unless" or "or" lease form and the stipulation for drilling states that a well must be commenced or completed on the premises or in the vicinity within a specified time, followed by the "unless" or "or" provision. Only two Ohio cases construing such leases appear to exist and both merely construe the meaning of vicinity;⁴⁵ the existence of an implied covenant was not in issue in either case. Determination of the existence or nonexistence of an implied covenant in such cases should follow the same rules and reasons as indicated in the preceding paragraph.

THE IMPLIED COVENANT TO DRILL ADDITIONAL WELLS

If the lease contains no delay rental clause it terminates by its own terms unless production is secured during the named period of the lease. The great weight of authority holds that the lessee, following the drilling of a nonproductive exploratory well, may not continue to hold the leased premises during the fixed term without making further efforts to secure production.⁴⁶ Ohio apparently follows the majority rule, but does not require the lessee to redrill

an acre. Not more than 5 per cent of the oil or gas produced from the well on this lot would come from the land of the lessor. This extraordinary high delay rental, the Supreme Court holds was agreed to by the parties in lieu of an express covenant to drill. From these facts it must be assumed that in that case the primary purpose of the giving of the lease was not necessarily the drilling of a well, like the case at bar and the other cases referred to. For these reasons, to-wit: That the facts are so materially different from the case at bar and the other cases referred to, and the resultant difference in the purpose of the giving of the lease, the court was obliged to hold as it did in that case.

Id. at 77.

⁴⁴ Merrill, *op. cit. supra* note 3, § 32, at 99-100.

⁴⁵ West v. Hall, 23 Ohio C.C.R. (n.s.) 575 (Cir. Ct. 1912) (this land, adjacent or adjoining land); *In re Oil Well Lease*, 9 Ohio C.C. Dec. 860 (1896) (vicinity).

⁴⁶ See cases collected in Merrill, *op. cit. supra* note 3, § 14, at 53 n.7.

at once, *i.e.*, the lessee is permitted a reasonable time to determine whether further operations will be conducted. What a reasonable time is must be determined from the facts of the particular situation, and whether or not the premises leased are in proven or unproven territory should be a material factor. In *Baumgardner v. Browning*⁴⁷ the territory was unproven, and it was held that a six-year delay after the drilling of the initial nonproductive well was not sufficiently long to call for cancellation of the lease or to be considered a breach of the implied covenant. Because modern leases of unproven territory usually contain delay rental provisions this particular problem should seldom arise.

It has already been noted that Ohio appears to follow the position that an implied covenant to explore exists despite the express covenant concerning delay rentals. Such being the case it would logically follow that where the lease provides for the payment of delay rentals the drilling of a dry hole would not destroy the implied covenant. Such drilling would, in view of the holding in *Landers v. Ohio Oil Co.*,⁴⁸ constitute a fact to be considered to determine whether delay in drilling constituted a breach of the covenant. Thus, in the *Baumgardner* case a six-year delay in unproven territory was held not too long a time. This lease was, of course, a fixed-term lease and the conclusion follows only by analogy.⁴⁹

Where the lease provides that the drilling of a nonproductive exploratory well terminates the lessee's obligation to pay delay rentals the nonproductive exploratory well merely converts the delay rental lease into a fixed-term lease and the rule of the *Baumgardner* case would seemingly apply. Although it involves prior productive wells and subsequent further development, one Ohio case states that the lessee is entitled to notice that the lessor will insist on further development and to a reasonable time thereafter in which to perform.⁵⁰ It appears probable that the same rule would apply in the situation under discussion.

The implied covenant to drill additional wells may appear where the exploratory well produces oil or gas in paying quantities, as well as in the situations discussed above, where the exploratory

⁴⁷ *Supra* note 21.

⁴⁸ *Supra* note 42.

⁴⁹ Abandonment of the lease may also result from a dry hole if there is no further development. See *e.g.*, *Tucker v. Watts*, 15 Ohio C.C. Dec. 320, *aff'd*, 72 Ohio St. 632, 76 N.E. 1134 (1905). Abandonment is quite different from a breach of an implied covenant and involves the conscious intent of the lessee, as indicated by the circumstances, to discontinue all operations.

⁵⁰ *Ohio Oil Co. v. Hurlbert*, 7 Ohio C.C. Dec. 321 (1897), *aff'd*, 60 Ohio St. 613, 54 N.E. 1103 (1899).

well proved nonproductive. In 1897, the Supreme Court of Ohio in *Harris v. Ohio Oil Co.*,⁵¹ said:

There is no express covenant, condition, or agreement in the lease as to the extent to which the lands should be developed, nor as to the number of wells that should be drilled after completion of the first well. Is there an implied covenant, condition, or agreement, as to such development, or as to the drilling of a reasonable number of wells?

On principle, it would seem that there is such a covenant. . . .

We therefore hold, both on principle and authority, that there is an implied covenant in this lease to *reasonably develop* the lands by drilling and operating such number of wells as would be ordinarily required for the production of the oil contained in such lands, and afford ordinary protection in the lines.⁵²

This case, in using the "reasonable development" test at least implied that no distinction would be made among any of the following situations: (1) no provision in the lease as to drilling of wells during a fixed term; (2) provision in the lease for drilling of one or more wells during a fixed term; and (3) drilling of wells after expiration of the fixed term.⁵³ The *Harris* case involved drilling after the expiration of the fixed term and included an element of drainage.⁵⁴ Although an express covenant to drill one or two wells during the primary term exists, the *Harris* case suggests that such a covenant might not prevent an implied covenant to drill additional wells. It has already been shown that an express covenant concerning delay rentals may not prevent an implied covenant as to exploration, a somewhat analogous situation. *Ohio Oil Co. v. Hurlbert*⁵⁵ stated that the lessee was entitled to notice from the lessor that further development was demanded and to a reasonable time thereafter to comply with that demand. This would indicate the existence of an implied covenant. The position following implied covenants is the better rule and should be applied by the courts of Ohio. Surely the desire of the lessor to have one or two exploratory wells drilled should not operate to preclude full development of the land, especially where the primary inducement for the lease is the prospect of royalty.

⁵¹ 57 Ohio St. 118, 48 N.E. 502 (1897).

⁵² *Id.* at 126-27, 48 N.E. at 505. (Emphasis added.)

⁵³ The classification follows Merrill, *op. cit. supra* note 3, § 49, at 129-30.

⁵⁴ See *Weisant v. Follett*, 17 Ohio App. 371 (1922). *Linn v. Wehrle*, 35 Ohio App. 107, 172 N.E. 288 (1928), impliedly recognizes the obligation to develop, but only by dictum, since the lease expressly denied the existence of the implied covenant.

⁵⁵ *Supra* note 50.

No Ohio cases have been found involving the fact situation where wells after producing oil and gas in paying quantities cease production during the primary term. In the event that production is not again secured by the end of the primary term the usual lease would terminate by its own terms unless drilling operations were going on at that time.⁵⁶ Where cessation of production occurs after the primary term has expired, the lessee is entitled to a reasonable time in which to drill other wells and seek new production,⁵⁷ even though the lease has expired and no implied covenant placing any obligation on the lessee then exists.⁵⁸

As far as Ohio is concerned, it is probable that the implied covenant for development includes the obligation to explore other strata. If exploration of this nature is carried on by a reasonably prudent operator, the quoted language of the *Harris* case should apply. No Ohio cases directly in point have been found; however, in other jurisdictions there is substantial precedent holding the implied covenant to exist.⁵⁹

THE IMPLIED COVENANT FOR PROPER OPERATION AND MARKETING

Under normal circumstances a lessee who has expended large sums of money in geophysical studies, in drilling, and in equipping a producing well is going to use every effort to make a profit, and no question will arise as to this implied covenant. Special circumstances may make it beneficial to a lessee from a profit standpoint to fail to market the petroleum products, and in these circumstances the courts have generally said an implied covenant exists.⁶⁰

In Ohio the early case of *Ohio Oil Co. v. Lane*⁶¹ denied the existence of any implied covenant to market gas under a lease which required a payment of 300 dollars per year per well where the gas was used off the premises. There are indications in the decisions that the court was of the opinion that the provision was an incidental addition to the lease to cover a product of little value and that the primary interest was in oil. No subsequent rulings on the particular point appear to have been made by the supreme court. One lower court, however, completely disregarded the *Lane* decision and by dictum recognized the existence of an implied

⁵⁶ This assumes the lease contains the usual specific clause to that effect.

⁵⁷ *Blair v. Northwestern Ohio Natural Gas Co.*, 5 Ohio C.C. Dec. 619 (1896).

⁵⁸ The usual lease stipulates that it shall continue in force as long after the primary term as oil and gas is produced in paying quantities.

⁵⁹ The cases are collected in Merrill, *op. cit. supra* note 3, § 69, at 175 n.22.

⁶⁰ Merrill, *op. cit. supra* note 3, § 72; 2 Summers, *op. cit. supra* note 25, § 400.

⁶¹ 59 Ohio St. 307, 52 N.E. 791 (1898).

covenant "to operate the premises with due diligence."⁶² This language would seem to include marketing production as well as operations on the leasehold. Such judicial expression appears in *Litton v. Geisler*.⁶³ That case involved a lease calling for a payment of 300 dollars per well while gas was marketed, a provision very similar to that in the *Lane* case. The court was primarily concerned with the question of when a well is considered to be producing in paying quantities, and laid great stress on the good faith of the operators. No mention was made of the *Lane* case or of any implied covenant to operate, but the opinion's language indicates that the court would require the lessee to operate the premises in good faith, which seemingly would include a good-faith effort to market.

THE IMPLIED COVENANT TO PROTECT AGAINST DRAINAGE

A landowner may be deprived of oil and gas underlying his property by drainage to adjoining lands. This loss may permanently deprive the landowner of substantial royalty. Since the lessor by leasing has deprived himself of the right to take protective action by drilling off-set wells himself, such action must be taken by the lessee. Thus, in the absence of any express covenant on the subject, there is an implied covenant requiring the lessee to protect the premises leased against drainage.⁶⁴ Ohio follows the general rule.⁶⁵

However, complicated problems arise when the lease contains a delay rental clause, or a clause calling for the drilling of a specific number of wells. The early Ohio case of *Harris v. Ohio Oil Co.*⁶⁶ in dictum indicated that a lease specifying the number of wells to be drilled would preclude application of an implied covenant involving the drilling of any additional wells.⁶⁷ There is ample authority in other jurisdictions to support the opposite view—which many believe is the better view—that the lessee by stipulating a minimum number of wells to be drilled does not thereby consent or intend to consent to having his royalty reduced by drainage,⁶⁸ and, there-

⁶² *Tedrow v. Shaffer*, 23 Ohio App. 343, 346, 155 N.E. 510, 511 (1926).

⁶³ 80 Ohio App. 491, 76 N.E.2d 741 (1945).

⁶⁴ See, e.g., *Linn v. Wehrle*, *supra* note 54, where the lease contained an express covenant negating the existence of any implied covenant to protect lines. See also *Merrill*, *op. cit. supra* note 3, § 94, at 236, which states that "the decisions, practically without exception, recognize its existence."

⁶⁵ *Coffinberry v. Sun Oil Co.*, *supra* note 23; *Harris v. Ohio Oil Co.*, *supra* note 51.

⁶⁶ *Supra* note 51.

⁶⁷ *Supra* note 51, at 128, 48 N.E. at 505.

⁶⁸ *Merrill*, *op. cit. supra* note 3, §§ 100-01.

fore, the implied covenant to prevent drainage, *i.e.*, to protect lines, is *not* eliminated by a clause setting the minimum number of wells to be drilled.

Delay rental clauses present a different problem. As previously indicated, acceptance of delay rentals is held to constitute a waiver of the implied covenant to drill an exploratory well, at least for the period for which the rental is paid. If the lessor desires to compel drilling he must refuse the payment and demand performance. There appears to be no reason to make a distinction where the initial well also protects against drainage. No Ohio cases specifically in point have been found, although the *Kachelmacher* case⁶⁹ has been construed both to support and to deny the existence of the implied covenant where delay rentals are accepted.⁷⁰ The turning point of the disagreement is whether acceptance of rentals waives drilling requirements for the rental period or merely waives exploratory drilling. Certainly, where the fact of drainage is known at the time of acceptance the better rule would seem to be in favor of waiver of exploratory drilling only. The difficulty here is to prove knowledge of drainage. Even if there is a producing well adjacent to the property in question there can be no actual assurance that oil is present until drilling occurs. Where the primary term has expired but the lease is to continue until production ceases, the courts of Ohio recognize the existence of an implied covenant to protect against drainage.⁷¹

No distinction has been made in Ohio between situations involving drainage of the leased premises by the lessee as the operator of adjoining leases and drainage by others. There has been dispute as to whether the lessee is under any greater duty to protect lines where he himself owns the adjoining leases. Authorities in the field would impose no greater duty,⁷² but some courts have indicated a greater duty exists.⁷³ The Ohio courts have apparently ignored the problem.⁷⁴

⁶⁹ 92 Ohio St. 324, 110 N.E. 933 (1915).

⁷⁰ Compare Merrill, *op. cit. supra* note 3, § 106, with Brown, "Covenants Implied in Oil and Gas Leases," 1960 A.B.A. Section of Mineral & Natural Resources Law Proceedings 162, 163 & n.47.

⁷¹ Harris v. Ohio Oil Co., *supra* note 51.

⁷² See Seed, "The Implied Covenant in Oil and Gas Leases to Refrain from Depletory Acts," 3 U.C.L.A.L. Rev. 508, 512-13 (1956). (This author disagrees with the authority, however.)

⁷³ See generally Meyers & Williams, "Covenants Implied in Oil and Gas Leases: Drainage Caused by the Lessee," 40 Texas L. Rev. 923 (1962); Comment, 35 Miss. L.J. 324 (1964); Comment, 35 Miss. L.J. 280 (1964).

⁷⁴ See, *e.g.*, Harris v. Ohio Oil Co., *supra* note 51, where the defendant was the lessee by assignment of the Harris tract as well as of the adjoining tracts.

REMEDIES FOR VIOLATION OF IMPLIED COVENANTS

The general rule which is followed in Ohio is that the lessor cannot utilize self-help to protect his interests where implied covenants have been breached by the lessee. In *Harris v. Ohio Oil Co.*,⁷⁵ for example, the lessee was denied the right to self-help (declaration of a forfeiture) and damages were held to be the proper remedy. It may be extremely difficult to prove damages where the breach consists of failure to drill an exploratory well and the premises are in wild-cat territory or in what would be considered step-out territory. Similarly, damages might be difficult to prove in drainage cases⁷⁶ and one Ohio case noted that no adequate remedy at law existed because of the difficulty of showing the amount of damages.⁷⁷

Forfeitures usually are looked upon with disfavor, and Ohio early took the position that a general forfeiture clause, such as one providing for termination of the lease upon failure to pay delay rentals, would preclude forfeiture for any other reason.⁷⁸ This position might be satisfactory where appropriate damages can be shown, as in case of failure to market, or failure to develop a known productive area. Forfeiture might well be appropriate in case of failure to drill an exploratory well where the lease will permit the existence of an implied covenant to do so, or where the lessee has breached the implied covenant against protection of lines. This position is limited to situations where forfeiture could be adjudged as to undrilled portions of the lease and then only after proper demand on the part of the lessor. This was the position taken by *Coffinberry v. Sun Oil Co.*⁷⁹ Thus far the courts of Ohio have declined to order the lessee to drill and develop *or* forfeit.⁸⁰

Certainly, where the lessee has the option during the primary term of drilling or paying delay rentals, there can be no action at all for failure to drill unless for breach of some other covenant, such as the covenant to protect lines, and this covenant appears to be the only one that could be breached in the absence of initial drilling. Granted that there can be no absolute certainty that there is oil or gas under the particular leased property until a well is drilled, the advance in geophysical knowledge permits a much better determination of probabilities than in years past. If in a particular

⁷⁵ *Supra* note 51.

⁷⁶ See generally Merrill, *op. cit. supra* note 3, §§ 148-58; 3 Summers, Oil and Gas §§ 433-36 (perm. ed. 1958).

⁷⁷ *Coffinberry v. Sun Oil Co.*, *supra* note 23.

⁷⁸ *Harris v. Ohio Oil Co.*, *supra* note 51.

⁷⁹ *Supra* note 23.

⁸⁰ See *Kachelmacher v. Laird*, 92 Ohio St. 324, 110 N.E. 933 (1915).

situation a prudent operator would protect lines even though a delay rental clause appears in the lease, then the better practice would call for such protection or for forfeiture of the lease.

CONCLUSION

Ohio appears generally to follow the majority rules. As can be seen, however, the Ohio cases on implied covenants are few, frequently conflicting, and leave much to be desired in clarity. Most of the precedent is from an era of ignorance of geological techniques and reservoir mechanics. One hopes future decisions will be based on the modern technological information then available and on modern precedent then existing in other jurisdictions. The proper development of the petroleum resources of Ohio should recognize the basic proposition that the lessor expects to be compensated through royalty, *i.e.*, drilling and development coupled with proper protection of the petroleum substances under his land. It should likewise be recognized that the lessee is entitled to exercise the rights secured under the lease as a reasonably prudent operator would exercise them. He should be held to no higher standard.