

Oil & Gas Law

Class 15: OGL (7 / 7) –

Implied Covenants 2: Production/Operations – Oriented I/Cs

OGL: Implied Covenants

- Market
- =====
- *Protect Against Drainage*
- *Drill*
- *Operate Diligently*

I/C to Protect Against Drainage

- Easiest of the I/C's
- Goal: protect L'or against loss of royalty due to loss of production
- [in theory ...] L'ee's interest is same as L'or's
- ***Why wouldn't L'ee act to prevent drainage?***
- Possible Reasons:
 - ❑ Better royalty on OGL with Lessor A than with Lessor B
 - ❑ Better "other" OGL terms (e.g., more flexible "savings" clauses in the secondary term)
 - ❑ Drilling efficiency / dictated by geology → easier / cheaper to produce from OGL A lands than OGL B lands
 - ❑ Shorter deadline in 1 OGL (i.e., end of PT)

Amoco v. Alexander

- ***What do the L'ors want? Did they get it?***
- **Significant facts / issues**
 - ❑ Different royalty percentages (p. 349 – top ¶)
 - ❑ “Field-wide drainage” (p. 348) vs. drainage on lease basis (p. 351 ¶s 1 & 2)
 - ❑ Duty to apply for regulatory exceptions or other administrative relief? (pp. 352-354; also p. 359 N5 (b))
 - ❑ Exemplary damages (p. 355 – top ¶)
- **In a case of “field-wide drainage,” L'ee will owe duty to many L'ors (sometimes conflicting ones) ... *Does L'ee's duty to other parties affect its duty to Alexanders? p. 355 N1 (+ p. 353)***

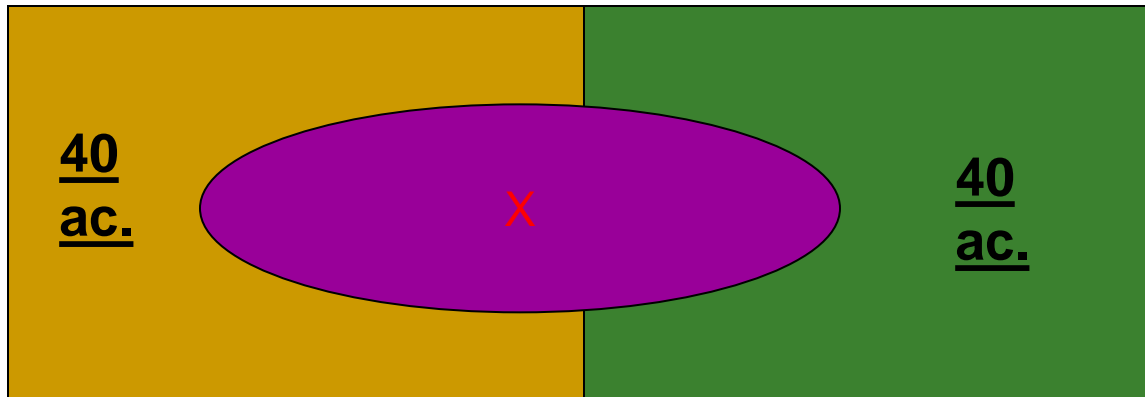
Amoco v. Alexander

- ***What would a “reasonably prudent Lessee” do to avoid liability?***
 - ***Drill a well? Even if not “profitable”?***
 - ***Pay a delay rental?***
 - ***Drill then shut-in and pay a shut-in royalty?***
 - ***If Lessee doesn’t want to drill, are they obligated to assign their rights to someone who WILL drill?***
- The “common lessee” problem (p. 356 N4) – a variety of opinions that range from no relevance to L’ee being a guarantor

I/C to Protect Against Drainage

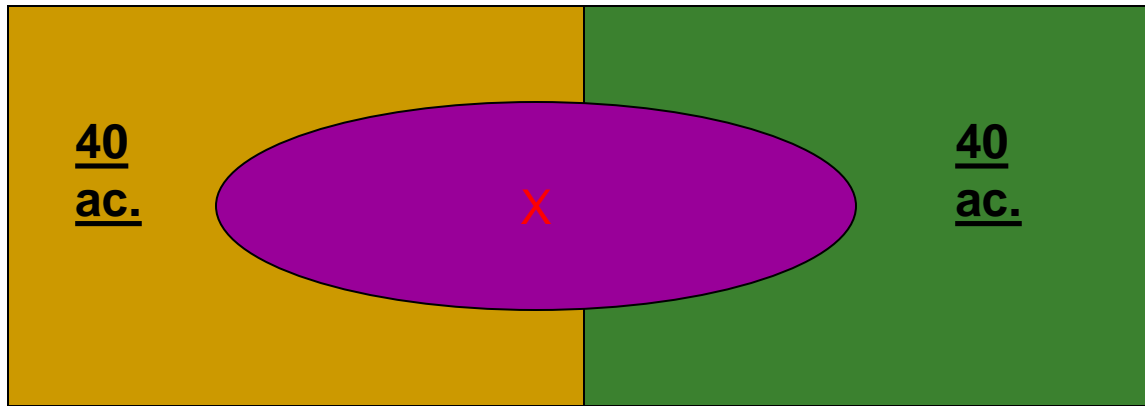
- *Will L'ee's payment of delay rentals satisfy the I/C to protect vs drainage? (p. 359 N5(d))*
- *Are punitive damages available / appropriate for a malicious / intentional breach of K? (p. 360 N 6(b))*
- Forfeiture requires notice / chance to cure (p. 359 N 5(a))

I/C to Protect Against Drainage



- Lessor **A** [diff] Lessor **B**
- Lessee **Z** [same] Lessee **Z**
- =====
- ***Claims of B vs. Z? ... of B vs. A?***
- ***Defenses of Z vs. B? ... of A vs. B?***
- ***Remedies / damages available to B?***

I/C to Protect Against Drainage



- Lessor **A** [diff] Lessor **B**
- Lessee **W** [diff] Lessee **Z**
- =====
- **Claims of B vs. Z? ... B vs. W? ... B vs. A?**
- **Defenses vs. B ... of Z? of W? of A?**
- **If B wins, what remedies / damages available?**

I/C to Drill

- 3 pieces (sometimes referred to as separate I/Cs)
 - Test
 - Develop
 - Explore Further
- Test
 - Obviated by delay rental cl. In OGL → CL 10
- Explore Further
 - *Does this I/C really exist, or is it (as Prof. Weaver suggests, p. 373, 2nd ¶) included within I/C to Develop?*
 - Different from developing the reservoir ... this I/C (to the extent it exists) would require L'ee to explore undeveloped parts of the reservoir → prudence vs higher risk
 - “Retained acreage” clause (p. 375, 3rd ¶)
 - States split (pp. 373-74)

I/C to Develop

- ***What is this and why is it needed?***
- ***What are the elements of the I/C to Develop?***
- **Elements** (see p. 364)
 - *After production has occurred*
 - *In the secondary term of the OGL*
 - *L'ee has “reasonable expectation of profit”*
- ***3 possible rationales?*** (see p. 368 N1)
- *KS Ct in Temple v. Continental Oil (see p. 368 N1) – even though 1 well might ultimately drain the entire reservoir given unlimited time, the I/C to Develop could require L'ee to drill more wells and produce faster ... ***Why so important to produce NOW?****

Superior Oil v. Devon Corp.

■ ***Facts?***

- ❑ 3,440 acres
- ❑ Oil discovered in 1958; no add'l drilling after 1961
- ❑ Subsequent assignments 1961-76
- ❑ “Top lease” → new well drilled successfully 1977

■ ***What does Ct. say about I/C to Develop?***

■ **P. 365, top ¶**

■ ***What should L'or's remedy be?***

■ ***Are notice and demand required as prerequisites for OGL termination?***

I/C to Develop

- *Does L'or have to prove drainage for L'ee to be in breach of the I/C to Develop?*
- *Is the profitability obligation to drill / develop the same as “produce in paying quantities”?*
- *If OGL has clause that states that Lessee is not required to drill more than one well, can Lessor still use the I/C to Develop?*
- 3 measures of damages – see p. 370 N 6(a)
- *Does the I/C to Develop obligate L'ee to use new drilling/recovery technologies or new enhanced recovery methods?*

I/C to Operate Diligently

- Hard to articulate as a separate I/C; overlaps the other I/Cs
- Hard to differentiate from the “reasonably diligent operator” standard applied to other I/Cs
- Something of a “catch-all” covenant
- **BUT ...**
- It is used in those situations where L’or wants L’ee to do something other than what is required by the other I/Cs (e.g., operate / maintain / repair well)

I/C to Operate Diligently

- **Baldwin v. Kubetz**
- *What were L'ee's alleged failures?*
- *Compare this case to the Amoco case ... what did L'ors want L'ee to do in each case?*

A Question to Ponder ...

- L'or and L'ee sign an OGL
- L'ee violates one or more I/Cs
 - **REMEMBER** that I/Cs are not written down anywhere, so they cannot be easily discovered by due diligence review by Assignee ...
- L'ee assigns the OGL to Assignee
- L'or sues Assignee for termination of the OGL, due to L'ee's breach of the I/Cs
- ***What are Assignee's rights / remedies / courses of action?***

NEXT ...



■ **SPRING BREAK !!!!**



- After Break, we begin our next topic ...
 - L'or/Min. Owner transfers, conveyances, title issues
- **TU 3/18: CL 16**
 - Ch. 3, Sec. A /// pp. 397 – 429
- **TH 3/20: CL 17**
 - Ch. 3, Sec. B /// pp. 429 – 464