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Texas Oil and Gas Leases Contain Separate and Distinct Implied Covenant to Further Explore after Lucrative Production.

E. Joy Jackson Sparks

CASENOTES

OIL AND GAS—Implied Covenants—Texas Oil And Gas Leases Contain Separate And Distinct Implied Covenant To Further Explore After Lucrative Production.

Sun Exploration & Production Co. v. Jackson,
31 Tex. Sup. Ct. J. 604 (July 13, 1988, reh'g granted).

In 1938, Ocie Jackson and interested family members executed an oil, gas, and mineral lease to Sun Oil Company.[1] A producing formation known as the Oyster Bayou Field[2] was discovered in 1941 that extended over 1800 acres of the 10,000 acre lease.[3] In 1979, the Jacksons refused to allow Sun Exploration & Production Company (Sun), successor of Sun Oil Company,[4] to enter the leasehold to conduct seismic tests, alleging that the 8200 acres

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1. Sun Exploration & Prod. Co. v. Jackson, 31 Tex. Sup. Ct. J. 604, 605 (July 13, 1988, reh'g granted). The lease covers acreage on the Jackson Brothers' Ranch located in Chambers County, Texas. *Id.* The majority of the working interest is owned by Sun with Amoco Production Company (Amoco) owning the remaining interest. Brief for Petitioner at 7, Sun Exploration & Prod. Co. v. Jackson, 31 Tex. Sup. Ct. J. 604 (July 13, 1988, reh'g granted)(No. C-6000). The Jacksons own all of the surface interest and hold the majority of the outstanding nonparticipating royalty interest in the minerals. *Jackson*, 31 Tex. Sup. Ct. J. at 605. The lease had a six-year primary term with a $2.00 delay rental per acre. *Id.*

2. *Jackson*, 31 Tex. Sup. Ct. J. at 605. The Oyster Bayou Field was discovered when Sun drilled the Jackson No. 3 well. Sun Exploration & Prod. Co. v. Jackson, 715 S.W.2d 199, 201 (Tex. App.—Houston [1st Dist.] 1986), *rev'd*, 31 Tex. Sup. Ct. J. 604 (July 13, 1988, reh'g granted); *see also* Brief for Petitioner at 8, *Jackson* (No. C-6000)(Oyster Bayou forms west boundary of Jackson lease). Production from the formation during the term of the lease has exceeded 110,600,000 barrels of oil, 110.3 billion cubic feet of gas, and 53,500 barrels of condensate. *Jackson*, 715 S.W.2d at 201. The field production has averaged over $10,000 per day in royalties. *Id.*

3. *Jackson*, 31 Tex. Sup. Ct. J. at 605. Some sources indicate that the Oyster Bayou Field covers only 1,123 acres. *See Jackson*, 715 S.W.2d at 201; Brief for Respondent at 20, Sun Exploration & Prod. Co. v. Jackson, 31 Tex. Sup. Ct. J. 604 (July 13, 1988, reh'g granted)(No. C-6000).

4. *See Jackson*, 31 Tex. Sup. Ct. J. at 605 (Sun Exploration and Production Company succeeded Sun Oil as holder of majority working interest).

outside the producing formation were not being adequately explored.[5] Sun sought to enjoin the Jacksons from denying Sun's right to enter the leased land and to declare the lease valid.[6] The Jacksons counterclaimed alleging that Sun had breached the lease's implied covenant of reasonable development by failing to further explore and develop the premises outside the Oyster Bayou Field.[7] The trial court found that Sun had breached the implied covenant to reasonably develop the land because Sun had failed in its duty to further explore outside the Oyster Bayou.[8] As a result, the trial court cancelled the lease outside the Oyster Bayou and conditionally cancelled the leasehold below 8480 feet of the producing field.[9] The court of appeals af-

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5. Sun Exploration & Prod. Co. v. Jackson, 31 Tex. Sup. Ct. J. 604, 605 (July 13, 1988, reh'g granted). Once successful production is accomplished on a leasehold, an implied covenant to reasonably develop and explore the leasehold arises. *Id.* at 609.

6. *Id.* at 605. Amoco Production joined Sun as a party to this action because of Amoco's minority working interest in the lease. *Id.*

7. *Id.* Sun drilled a total of 66 wells on the Jackson leasehold. Brief for Petitioner at 10, *Jackson* (No. C-6000). Fifty-three of the wells, including the initial exploratory well, were drilled in the Oyster Bayou Field. *Id.* at 11. A total of 16 exploratory wells were drilled on the leasehold, and 14 of those were drilled after the discovery of the Oyster Bayou Field. *Id.* at 10. Prior to litigation, the last exploratory well drilled was the Jackson No. 61 in 1977. *Id.* at 11. Two were drilled in 1981 and 1982 after proceedings in the present case had begun. *Id.*

8. Sun Exploration & Prod. Co. v. Jackson, 715 S.W.2d 199, 201 (Tex. App.—Houston [1st Dist.] 1986), *rev'd*, 31 Tex. Sup. Ct. J. 604 (July 13, 1988, reh'g granted). Two issues were submitted to the jury. *Id.* at 202-03. The jury found that Sun had "failed to reasonably explore the portions of the Jackson Lease which lie outside the Oyster Bayou Field." *Id.* at 202. When asked if Sun had "failed to reasonably develop the Jackson Lease," however, the jury answered that Sun had not. *Id.* When the trial court determined that Sun had not exerted any effort to develop nor entertained any present intent to drill on the leasehold outside the producing formation, the court found this to be an "extraordinary circumstance" warranting the unconditional cancellation of the lease pertaining to this land outside the Oyster Bayou Field. *Id.* at 206. Unconditional cancellation is considered the remedy in a breach of further exploration because money damages are not readily ascertainable. *See* 5 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 844.3 (1964)(cancellation frees land for further exploration). *See generally* R. HEMINGWAY, THE LAW OF OIL AND GAS § 8.10-11 (2d ed. 1983)(discussing remedies available for breach of implied covenants).

9. *Jackson*, 715 S.W.2d at 205; *see also* Sauder v. Mid-Continent Petroleum Corp., 292 U.S. 272, 281 (1934)(cancellation of lease possible for reasonable development breach unless development initiated within reasonable time); Slaughter v. Cities Serv. Oil Co., 660 S.W.2d 860, 862 (Tex. App.—Amarillo 1983, no writ)(conditional cancellation is preferred remedy); Wes-Tex Land Co. v. Simmons, 566 S.W.2d 719, 722 (Tex. Civ. App.—Eastland 1978, writ ref'd n.r.e.)(conditional cancellation preferred remedy for breach of reasonable development covenant to allow opportunity to correct). The conditional cancellation required deeper drilling in the Oyster Bayou Field. *Jackson*, 715 S.W.2d at 206. The primary producing hydrocarbons of Oyster Bayou Field are located in the Seabreeze Sands. *Id.* at 201. The Seabreeze Sands are located at an approximate depth of 8120 feet to 11,000 feet. Brief for Petitioner at 9, *Jackson* (No. C-6000). Money damages are the remedy in a breach of the implied covenant of reasonable development if the money amount can be determined. Texas Pac. Coal & Oil Co. v. Barker, 117 Tex. 418, 427, 6 S.W.2d 1031, 1037-38 (1928)(damages must be proven with rea-

firmed the cancellation of the lease outside this formation.[10] The court reversed and remanded the judgment regarding the conditionally cancelled portion of the lease because it found that the terms imposed on Sun to explore the land below the Oyster Bayou were unreasonable.[11] The Jacksons filed a motion for rehearing claiming the appellate court erred in its reversal of the conditional cancellation.[12] The appellate court denied all motions for

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sonable certainty). The lessor, however, has a difficult burden in trying to prove those damages, and therefore, recovering on the breach. *Id. See generally* R. HEMINGWAY, THE LAW OF OIL AND GAS § 8.10-11 (2d ed. 1983)(discussion of remedies available for breach of implied covenants).

10. *Jackson*, 715 S.W.2d at 203. The court held that contained within the implied covenant to reasonably develop a producing field is an obligation to further explore outside that field by drilling "exploratory" development wells. *Id.* at 203-04. The appellate court classified the wells on the Jackson leasehold into three separate categories: a) "wildcat" wells; b) "additional development" wells; and c) "exploratory development" wells. *Id.* at 202. A "wildcat well" is a speculative well drilled in unproven strata. *Id.*; *see also* 8 H. WILLIAMS & C. MEYERS, MANUAL OF TERMS 834 (4th ed. 1981)(wildcat well drilled in unproven sands where no production in surrounding area). "Additional development" wells are wells drilled to fully develop and exploit the available minerals of a known lucrative producing formation. *Jackson*, 715 S.W.2d at 202. "Exploratory development" wells are drilled based on seismic data and earlier drilling information that indicate a possible mineral producing formation. *Id.* Sun alleged that a "wildcat well" and an "exploratory development" well are the same in that both are considered "wildcat wells" within the oil industry. *Id.* Thus, the court was requiring Sun to drill "wildcat wells" based on speculative data. Brief for Petitioner at 56, *Jackson* (No. C-6000).

11. *Jackson*, 715 S.W.2d at 206. Sun alleged that the part of the judgment conditionally cancelling the lease was not reasonable because the judgment would require them to drill and complete 75 producing wells beneath the Oyster Bayou Field in a relatively short period of time. *Id.*

12. Sun Exploration & Prod. Co. v. Jackson, 729 S.W.2d 310, 311-12 (Tex. App.—Houston [1st Dist.] 1987), *rev'd*, 31 Tex. Sup. Ct. J. 604 (July 13, 1988, reh'g granted). In reply to the Jacksons' motion for rehearing, the appellate court adhered to the decision in its first opinion stating that the conditional cancellation of the lease below the producing formation must be remanded to the lower court so that a condition consistent with the reasonable prudent operator standard could be formulated. *Id.* Sun and Amoco alleged for the first time that the trial judge should have been constitutionally disqualified because he was related to one of the Jacksons' attorneys. *Id.* at 314. The court stated that the trial judge should not be disqualified on this basis because the related attorney was not a "party" to the suit as required by the Texas Constitution. *Id.*; *see also* TEX. CONST. art. V, § 11 (judge shall not preside over case where either party related within degree prohibited by law); TEX. REV. CIV. STAT. ANN. art. 15 (Vernon 1969)(parties may not be related within third degree). Sun also alleged that the trial judge might be biased because he was related to the Jacksons by consanguinity in the fourth degree and, therefore, should have recused himself. *Jackson*, 729 S.W.2d at 312; *see also* TEX. R. CIV. P. 18b (disqualification based on judge's connection with parties while recusal based on judge's ability to be impartial). Since the law prohibited third degree consanguinity, the court held that the judge's relationship to the Jacksons was not constitutional grounds for disqualification. *Jackson*, 729 S.W.2d at 315. The court stated that the judge was not required to recuse himself because recusal was not compulsory but, in effect, left the issue to the judge's discretion. *Id.*; *see also* TEXAS SUPREME COURT, CODE OF JUDICIAL CON-

rehearing.[13] The Texas Supreme Court granted writ of error to determine whether Sun had breached the implied obligation to further explore the leasehold.[14] Held—*Reversed*. Texas oil and gas leases contain a separate and distinct implied covenant to further explore after lucrative production although not breached by Sun.[15]

Under early English common law, a covenant was a legal action used to enforce a sealed promise.[16] The presence of the seal made the promise legally binding and enforceable as a contract.[17] Today, a covenant is a "promise" between two or more parties to perform or not to perform a specific act.[18] A covenant may be expressly stated within a contract or implied by the actions of the parties.[19] Implied covenants are contractual terms with

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DUCT, Canon 3, pt. C(1) (1984)(judge should recuse himself if reasonable question of partiality) (repealed 1987)(current version at TEX. R. CIV. P. 18b(2))(judge shall recuse himself if reasonable possibility of partiality or bias). Because Sun failed to raise the recusal issue in the trial court, the appellate court stated that Sun was barred from raising the issue on appeal. *Jackson*, 729 S.W.2d at 315. The Texas Supreme Court, however, found that because Sun was unaware of the relationship when the case was before the trial court, the disqualification issue was not waived. *Jackson*, 31 Tex. Sup. Ct. J. at 607. Determining that the Jackson's remedy awarded by the trial judge was unusually advantageous, the court found that the judge had an obligation to inform the parties of any possible prejudice. *Id.* The disqualification and recusal issue was considered at length by the court. *See id.* at 605-08.

13. *Jackson*, 729 S.W.2d at 316.

14. *See Jackson*, 31 Tex. Sup. Ct. J. at 604 (writ granted from Chambers County, First District).

15. Sun Exploration & Prod. Co. v. Jackson, 31 Tex. Sup. Ct. J. 604, 610 (July 13, 1988, reh'g granted).

16. *See* Lacey v. Hutchinson, 64 S.E. 105, 106 (Ga. Ct. App. 1909)(formality of execution made sealed promises enforceable at common law); Cochran v. Taylor, 7 N.E.2d 89, 91 (N.Y. 1937)(seal sufficient to validate written instrument at common law); *see also* 1 A. CORBIN, CORBIN ON CONTRACTS § 20 (1963)(action of covenant applied only to sealed promises); 1 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 109 (3d ed. 1957 & Supp. 1988)(common-law action of covenant enforced contracts under seal). *See generally* Farnsworth, *The Past of Promise: An Historical Introduction to Contract*, 69 COLUM. L. REV. 576, 593 (1969)(traces development of modern contract); Holdsworth, *Debt, Assumpsit and Consideration*, 11 MICH. L. REV. 347, 352-55 (1913)(discusses history of consideration).

17. *See, e.g., In re* Brereton's Estate, 130 A.2d 453, 456 (Pa. 1957)(seal denotes consideration); *In re* Killeen's Estate, 165 A. 34, 35 (Pa. 1932)(sealed promise imports consideration); Shinn v. Stemler, 45 A.2d 242, 243 (Pa. Super. Ct. 1946)(additional consideration not necessary for promise under seal); *see also* 1A A. CORBIN, CORBIN ON CONTRACTS § 252 (1963)(sealed promise enforceable before consideration doctrine created); Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799, 800 (1941)(discussing policies underlying common-law consideration).

18. *See* Beall v. Hardie, 279 P.2d 276, 278 (Kan. 1955)(covenant agreement between two or more parties); *see also* BLACK'S LAW DICTIONARY 327-29 (abr. 5th ed. 1983)(defining covenant as agreement, convention, or promise); 3A A. CORBIN, CORBIN ON CONTRACTS § 633 (1960)(covenant synonymous to promise).

19. *See, e.g.*, Sylvan Crest Sand & Gravel Co. v. United States, 150 F.2d 642, 644 (2d Cir. 1945)(conduct of parties evidence of implied promise to receive and pay for merchandise or

binding power equal to express contractual provisions.[20] Implied covenants in leases[21] impose numerous obligations on both the lessor and the lessee.[22]

A lease that grants an interest in oil and gas located beneath the ground surface contains several implied covenants.[23] Once successful production begins on a leasehold, implied covenants arise to encourage cooperation between the lessor and the lessee.[24] Cooperation is necessary to effectuate the

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give reasonable cancellation notice); Brewster v. Lanyon Zinc Co., 140 F. 801, 809 (8th Cir. 1905)(equity effectuates parties' intent by implying covenants if expressed provisions inadequate); Wood v. Lucy, Lady Duff-Gordon, 118 N.E. 214, 214 (N.Y. 1917)(circumstances supported existence of implied promise); Danciger Oil & Ref. Co. of Texas v. Powell, 137 Tex. 484, 490, 154 S.W.2d 632, 635 (1941)(implied covenant based on presumed intentions); *accord* Hill v. Waxberg Constr. Co., 237 F.2d 936, 939 (9th Cir. 1956)(implied promise can be either 'implied at law' or 'implied in fact'). A contract which is 'implied in fact' is based on the parties' intentions as determined from the surrounding facts and circumstances. *See id.* at 939 (court implies contract when parties intended for contract to exist). A contract 'implied at law' (quasi-contract) is not based on promises or intentions but is a duty imposed by law to render justice and to prevent unjust enrichment. *Id.*; *see also* Patterson, *Constructive Conditions in Contracts*, 42 COLUM. L. REV. 903, 934 (1942)(cooperation between parties to contract necessitates additional obligations beyond those specifically expressed). *See generally* 1 A. CORBIN, CORBIN ON CONTRACTS §§ 13, 144 (1963)(discussing express promises and implied promises); M. MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES § 223 (2d ed. 1940)(implied covenants arise from relationship of parties).

20. *See* Freeport Sulphur Co. v. American Sulphur Royalty Co. of Texas, 117 Tex. 439, 451, 6 S.W.2d 1039, 1042 (1928)(implied terms part of contract as though plainly written); McCarter v. Ransom, 473 S.W.2d 235, 238 (Tex. Civ. App.—Corpus Christi 1971, no writ)(implied obligations enforceable as express obligations).

21. *See, e.g.*, Cook v. University Plaza, 427 N.E.2d 405, 407 (Ill. App. Ct. 1981)(lease passes possessory interest in specific property); People v. Chicago Metro Car Rentals, Inc., 391 N.E.2d 42, 45 (Ill. App. Ct. 1979)(lease grants exclusive possession of designated area); Warner v. Fry, 228 S.W.2d 729, 730 (Mo. 1950)(lease identical to sale of premises for lease term at common law). *But see* RESTATEMENT (SECOND) OF PROPERTY § 1.1 (1977)(variation of location within predetermined lease does not preclude landlord-tenant relationship).

22. *See, e.g.*, Dolph v. Barry, 148 S.W. 196, 198 (Mo. Ct. App. 1912)(implied covenant of quiet enjoyment prevents lessor from interfering with lessee's possession); Adrian v. Rabinowitz, 186 A. 29, 30 (N.J. 1936)(implied obligation of lessor to deliver leasehold to lessee at beginning of lease term); Kamarath v. Bennett, 568 S.W.2d 658, 661 (Tex. 1978)(implied warranty of habitability insures fitness of use of premises).

23. *See, e.g.*, Empire Oil & Ref. Co. v. Hoyt, 112 F.2d 356, 360 (6th Cir. 1940)(implied covenant in mineral lease to use reasonable care in methods of operation); Mansfield Gas Co. v. Alexander, 133 S.W. 837, 838 (Ark. 1911)(implied covenant to drill initial exploratory well); Amoco Prod. Co. v. Alexander, 622 S.W.2d 563, 568 (Tex. 1981)(implied covenant to administer obligations of oil and gas lease); Danciger Oil & Ref. Co. of Texas v. Powell, 137 Tex. 484, 490, 154 S.W.2d 632, 635 (1941)(implied covenants based on presumed intentions). *See generally* R. HEMINGWAY, THE LAW OF OIL AND GAS §§ 8.1-.13 (2d ed. 1983)(discusses implied covenants of oil and gas lease); M. MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES §§ 3,4 (2d ed. 1940)(discussion and classifications of implied covenants in oil and gas leases); 5 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW §§ 801-85 (1964)(discusses implied covenants).

24. *See, e.g.*, Gerson v. Anderson-Pritchard Prod. Corp., 149 F.2d 444, 446 (10th Cir.

primary purpose of the lease, which is to exploit the mineral resources of the leasehold with a reasonable profit to both the lessor and the lessee.[25]

Texas recognizes three implied covenants that arise once successful production begins.[26] These include the implied covenant to manage and administer the lease,[27] the implied covenant to protect from drainage,[28] and the implied covenant to reasonably develop the leasehold.[29] To avoid breach of

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1945)(implied covenant to protect lease from drainage arises after production begins); Clifton v. Koontz, 160 Tex. 82, 97, 325 S.W.2d 684, 693 (1959)(implied covenant to develop leasehold imposed on lessor after production); Cole Petroleum Co. v. United States Gas & Oil Co., 121 Tex. 59, 63-64, 41 S.W.2d 414, 416 (1931)(implied covenant to market minerals produced from lease). *See generally* R. HEMINGWAY, THE LAW OF OIL AND GAS §§ 8.1-.13 (2d ed. 1983)(discusses implied covenants of oil and gas lease that arise after production); M. MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES §§ 3,4 (2d ed. 1940)(discussion of implied covenants and application in oil and gas leases); 5 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW §§ 801-85 (1964)(discusses elements and remedies available for breach of implied covenants).

25. *See* Danciger Oil & Ref. Co. of Texas v. Powell, 137 Tex. 484, 491, 154 S.W.2d 632, 635 (1941)(main purpose of oil and gas lease to exploit and develop minerals on leasehold); *see also* Texas Pac. Coal & Oil Co. v. Barker, 117 Tex. 418, 431-32, 6 S.W.2d 1031, 1036 (1928)(reasonable expectation of profit essential to enforcing implied covenant).

26. *See, e.g.*, Amoco Prod. Co. v. Alexander, 622 S.W.2d 563, 568 (Tex. 1981)(implied covenant to protect lease from drainage); Clifton v. Koontz, 160 Tex. 82, 97, 325 S.W.2d 684, 693 (1959)(implied covenant to reasonably develop leasehold after initial production); Cole Petroleum Co. v. United States Gas & Oil Co., 121 Tex. 62, 63-64, 41 S.W.2d 414, 416 (1931)(implied covenant to market minerals produced from lease). *See generally* R. HEMINGWAY, THE LAW OF OIL AND GAS §§ 8.1-.13 (2d ed. 1983)(discusses covenants implied in oil and gas leases); M. MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES § 4 (2d ed. 1940)(classification of implied covenants); 5 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW §§ 801-85 (1964)(discusses policy considerations for implied covenants).

27. *See Cole*, 121 Tex. at 63-64, 41 S.W.2d at 416 (1931)(implied covenant to market minerals with due diligence); Amoco Prod. Co. v. First Baptist Church of Pyote, 579 S.W.2d 280, 285 (Tex. Civ. App.—El Paso 1979, writ ref'd n.r.e.)(good faith effort implied in marketing of gas). The lessee has the duty to sell and market the oil and gas as a reasonable, prudent operator would, resulting in a profit to the lessor and the lessee. 5 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 853 (1964)(discussion of marketing covenant). Hemingway has divided the implied covenant to manage and administer into four subsections: "(1) to produce and market, (2) to operate with reasonable care, (3) to use successful modern methods of production and development, and (4) to seek favorable administrative action." R. HEMINGWAY, THE LAW OF OIL AND GAS § 8.9 (2d ed. 1983)(discussion of management and administration covenant).

28. *See* Amoco Prod. Co. v. Alexander, 622 S.W.2d 563, 568 (Tex. 1981)(implied covenant to protect leasehold from drainage); Shell Oil Co. v. Stansbury, 401 S.W.2d 623, 631 (Tex. Civ. App.—Beaumont 1966, writ ref'd n.r.e.)(offset wells to prevent drainage required if reasonable). The lessee has a duty to protect the lessor's land from oil or gas drainage onto adjoining lands by drilling offset wells if a reasonably prudent operator would do likewise under the same circumstances. R. HEMINGWAY, THE LAW OF OIL AND GAS § 8.5 (2d ed. 1983). *See generally* 5 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW §§ 821-25.2 (1964)(discussion of protection covenant).

29. *See* Clifton v. Koontz, 160 Tex. 82, 96, 325 S.W.2d 684, 693 (1959)(implied covenant

these implied covenants, the lessee's conduct must conform to the behavior of a reasonable, prudent operator under the same or similar circumstances.[30] Implicit in the prudent operator standard is the obligation to drill wells whenever a reasonable expectation of profit to both the lessee and lessor exists.[31]

Texas and other jurisdictions have addressed the possibility of a fourth implied covenant arising after production that requires the lessee to further explore a mineral lease outside a known producing formation.[32] Purporting

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to reasonably develop encompasses additional wells necessary for production in known and unknown formations); W.T. Waggoner Estate v. Sigler Oil Co., 118 Tex. 509, 514, 19 S.W.2d 27, 29 (1929)(implied covenant of development requires due diligence); *see also* Texas Pac. Coal & Oil Co. v. Barker, 117 Tex. 418, 438, 6 S.W.2d 1031, 1038 (1928)(damages for breach of development covenant are royalties actually lost). The implied covenant of reasonable development requires drilling additional wells in a formation already proven to be productive. 5 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW §§ 831-35.4 (1964). This covenant also requires the lessee to act as a prudent operator. *Id. See generally* R. HEMINGWAY, THE LAW OF OIL AND GAS § 8.3 (2d ed. 1983)(discussing covenant of reasonable development).

30. *See* Brewster v. Lanyon Zinc Co., 140 F. 801, 814 (8th Cir. 1905)(lessee's activities must be similar to reasonable, prudent operator); *see also Alexander*, 622 S.W.2d at 568 (reasonable, prudent operator standard inherent in every oil and gas lease implied covenant); *Clifton*, 160 Tex. at 96, 325 S.W.2d at 684 (lessee's obligation measured by reasonable, prudent operator standard); *Stansbury*, 401 S.W.2d at 633 (reasonable, prudent operator would have drilled offset wells to prevent drainage from leasehold). *See generally* 5 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 806.3 (1964)(reasonable, prudent operator standard similar to objective test of tort's reasonable man standard).

31. *See Brewster*, 140 F. at 814 (objective of reasonable standard imposed on lessee is to obtain profit for both lessee and lessor); *see also Clifton*, 160 Tex. at 98, 325 S.W.2d at 697 (requiring exploration without expectation of profit violates reasonable, prudent operator standard); Texas Pac. Coal & Oil Co. v. Barker, 117 Tex. 418, 431-32, 6 S.W.2d 1031, 1036 (1928)(reasonable expectation of profit essential to enforcing implied covenant); Felmont Oil Corp. v. Pan Am. Petroleum Corp., 334 S.W.2d 449, 455 (Tex. Civ. App.—El Paso 1960, writ ref'd n.r.e.)(reasonable, prudent operator standard requires proof of reasonable expectation of profit); *accord* Mitchell v. Amerada Hess Corp., 638 P.2d 441, 447 (Okla. 1981)(profit motive goes to essence of lessee's and lessor's intent to contract). *But see* Meyers, *The Implied Covenant of Further Exploration*, 34 TEX. L. REV. 553, 568 (1956)(no reasonable expectation of profit necessary to enforce duty to explore). *See generally* R. HEMINGWAY, THE LAW OF OIL AND GAS § 8.3(C) (2d ed. 1983)(general discussion of exploration covenant); 5 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 841 (1964)(discussion of further exploration covenant).

32. *See* Sauder v. Mid-Continent Petroleum Corp., 292 U.S. 272, 280 (1934)(Kansas law recognizes covenant of further exploration); Sinclair Oil & Gas Co. v. Masterson, 271 F.2d 310, 320-21 (5th Cir. 1959)(recognizes separate covenant to further explore); Nolan v. Thomas, 309 S.W.2d 727, 730 (Ark. 1958)(Arkansas law interpreted as recognizing further exploration covenant); Cameron v. Lebow, 338 S.W.2d 399, 405 (Ky. Ct. App. 1960)(Kentucky recognizes separate covenant to further explore); Meyers, *The Implied Covenant of Further Exploration*, 34 TEX. L. REV. 553, 557 (1956)(implied covenant to further explore should be recognized); Meyers & Williams, *The Implied Duty to Explore Further: Recent Texas Developments*, 41 TEX. L. REV. 789, 790 (1963)(Texas case law should enforce implied covenant to further explore). *But see* Doss Oil Royalty Co. v. Texas Co., 137 P.2d 934, 938-39 (Okla.

to follow Texas precedent, the United States Court of Appeals for the Fifth Circuit enforced, as a separate covenant, the duty to further explore outside a known producing area.[33] The El Paso Court of Appeals, in contravention to the Fifth Circuit, held that a separate duty to further explore did not exist in Texas.[34] Both courts claimed to follow *Clifton v. Koontz*[35] in which the Texas Supreme Court held that the covenant to further explore outside a producing area did not exist independent of the covenant to reasonably develop within a known producing area.[36]

In *Sun Exploration & Production Co. v. Jackson*,[37] a plurality of the Texas Supreme Court recognized an implied covenant to further explore separate and distinct from the covenant to reasonably develop a lease.[38] Justices Robertson, Wallace, and Culver recognized the fourth implied covenant based on the differences between the technical definitions of "development" wells and "exploratory" wells.[39] The court reasoned that "development"

1943)(recognizes separate covenant to further explore), *rev'd sub nom.*, Mitchell v. Amerada Hess Corp., 638 P.2d 441, 449 (Okla. 1981)(Oklahoma law does not recognize separate covenant to further explore); Clifton v. Koontz, 160 Tex. 82, 98, 325 S.W.2d 684, 696 (1959)(duty to further explore exists as part of covenant to reasonably develop leasehold); Brown, *The Proposed New Covenant of Further Exploration: Reply to Comment*, 37 TEX. L. REV. 303, 305 (1959)(covenant of further exploration should not be recognized as separate from covenant to reasonably develop); Smith, *The Implied Duty to Explore Further: Recent Texas Developments — A Disagreement*, 42 TEX. L. REV. 199, 199 (1963)(Texas case law shows no indication of recognizing further exploration covenant as separate obligation).

33. *See* Sinclair Oil & Gas Co. v. Masterson, 271 F.2d 310, 313-15 (5th Cir. 1959)(court affirmed lower court's finding that duties to develop and explore outside known producing area separate and distinct), *cert. denied*, 362 U.S. 952 (1960).

34. *See* Felmont Oil Co. v. Pan Am. Petroleum Corp., 334 S.W.2d 449, 457 (Tex. Civ. App.—El Paso 1960, writ ref'd n.r.e.)(implied covenant to further explore not distinguishable from implied covenant to reasonably develop).

35. 160 Tex. 82, 325 S.W.2d 684 (1959).

36. *Id.* at 98, 325 S.W.2d at 696. The court in *Clifton* stated that the duty to further explore is part of the implied covenant of reasonable development. *Id.* The court noted that an exception to the rule exists when a lessee attempts to hold a large piece of land by developing a small portion, and a substantial amount of time passes after such development occurs. *Id.* at 97, 325 S.W.2d at 696. The *Masterson* court applied the *Clifton* exception and enforced a duty to explore apart from the duty to reasonably develop. *Masterson*, 271 F.2d at 317. In *Felmont*, however, the court refused to follow the decision of the *Masterson* court. *Felmont*, 334 S.W.2d at 458.

37. 31 Tex. Sup. Ct. J. 604 (July 13, 1988, reh'g granted).

38. *See id.* at 609 (duty to explore leasehold no longer inherent in, but separate from, implied covenant to reasonably develop). The court stated that confusion had existed because the terms "development" and "exploration" were often used interchangeably. *Id.* at 610.

39. *See id.* at 609 (technical definitions used to distinguish activities). "Development" wells are drilled to fully produce and exploit the available minerals of a known productive formation. *Id.* "Exploratory" wells are drilled based on seismic data and earlier drilling information that indicate a possible mineral producing formation. *Id.*

refers to activities occurring within a known producing formation,[40] and "exploration" concerns activities taking place outside a known producing field.[41] The court noted that the leading case of *Clifton v. Koontz*[42] had recognized the duty to further explore, but refused to recognize this duty as a covenant independent of the implied covenant of reasonable development.[43] The court in *Jackson* explained that they were departing from *Clifton* only by separating the activities into two separate covenants, thereby alleviating future confusion in pleadings as to the duty allegedly breached.[44]

To allege breach of the duty to further explore, the plurality stated that the lessor must show that the lessee acted inconsistent with the reasonable, prudent operator standard by failing to further explore unproven areas when a reasonable expectation of profit existed.[45] Applying this standard, the court found that no reasonable expectation of profit existed in areas outside the Oyster Bayou Field and, therefore, Sun had not breached the implied covenant of further exploration.[46]

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40. *See id.* (development requires drilling additional wells in proven formation to prevent waste of minerals).

41. *See id.* (exploration requires drilling wells in unproven stratas which have potential of producing minerals).

42. 160 Tex. 82, 325 S.W.2d 684 (1959).

43. *See* Sun Exploration & Prod. Co. v. Jackson, 31 Tex. Sup. Ct. J. 604, 609 (July 13, 1988, reh'g granted)(court found *Clifton* required drilling in formation different from formation already proven productive); *see also* Clifton v. Koontz, 160 Tex. 82, 96, 325 S.W.2d 684, 695 (1959)(implied covenant to reasonably develop leasehold includes requirement to drill wells in unproven strata).

44. *Jackson*, 31 Tex. Sup. Ct. J. at 610. The court reasoned that clearer pleadings would contribute to more efficient trials. *Id.*

45. *Id.* The court stated that *Clifton* rejected the idea of a separate exploration covenant because the petitioners in *Clifton* asserted that proof of profit should not be a necessary element of the reasonable, prudent operator standard. *Id.* at 609; *see also Clifton*, 160 Tex. at 98, 325 S.W.2d at 695 (requiring exploration without expectation of profit violates reasonable, prudent operator standard); Texas Pac. Coal & Oil Co. v. Barker, 117 Tex. 418, 431-32, 6 S.W.2d 1031, 1036 (1928)(reasonable expectation of profit essential to enforcing implied covenant); Felmont Oil Corp. v. Pan Am. Petroleum Corp., 334 S.W.2d 449, 455 (Tex. Civ. App.—El Paso 1960, writ ref'd n.r.e.)(reasonable, prudent operator standard requires proof of reasonable expectation of profit).

46. *Jackson*, 31 Tex. Sup. Ct. J. at 612. The court conceded that proving a reasonable expectation of profit is a very difficult burden for a complaining plaintiff to meet. *Id.* at 610. Finding no breach of the implied covenant to further explore, the court validated the lease between Sun and Jackson. *Id.* at 612. Justice Wallace concurred in a brief opinion stating that he believed this case should have been decided under the holding of *Clifton v. Koontz* in which the court held that an implied covenant to further explore did exist, but not separate and distinct from the implied covenant to reasonably develop the leasehold. *Id.* (Wallace, J., concurring); *see also* Clifton v. Koontz, 160 Tex. 82, 98, 325 S.W.2d 684, 695 (1959)(duty to further explore exists as part of covenant to reasonably develop leasehold). Justice Kilgarlin also agreed that *Clifton* was dispositive of this case in his concurring opinion. *See Jackson*, 31 Tex. Sup. Ct. J. at 615 (Kilgarlin, J., concurring). Most of Kilgarlin's concurrence, however,

In *Jackson*, the Texas Supreme Court correctly separated the implied covenant to further explore from the implied covenant to reasonably develop the oil and gas lease.[47] The separation of the implied covenants alleviates confusion by distinguishing the causes of action which may be asserted by the lessor and clarifying the duty allegedly breached by the lessee.[48] Because exploration and development involve distinct activities, factual statements in the pleadings will notify the lessee of the duty allegedly breached.[49] This notice clarifies the issues to be tried, resulting in a more efficient trial.[50]

Also, a breach of each duty invokes separate remedies.[51] If a breach of development is proved, money damages is the proper remedy.[52] Conditional cancellation, however, is the remedy usually imposed for breach of the implied covenant of development because of the difficulty faced by the lessor in establishing the monetary value of unproduced minerals below the surface.[53]

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addressed the disqualification and recusal issue. *See id.* at 612-15 (disagreeing with court's discussion of recusal issue). Justice Spears' dissenting opinion deals solely with the disqualification and recusal issue. *See id.* at 615-16 (failure of trial judge to recuse himself was reversible error).

47. *See* Sun Exploration & Prod. Co. v. Jackson, 31 Tex. Sup. Ct. J. 604, 610 (July 13, 1988, reh'g granted)(implied covenant to further explore separate and distinct from implied covenant to reasonably develop).

48. *See id.* (statements in pleadings will clarify breach alleged and cause of action to be tried); *see also* TEX. R. CIV. P. 45 (pleadings must concisely and plainly state plaintiff's cause of action); Bernard Johnson, Inc. v. Continental Constructors, Inc., 630 S.W.2d 365, 367-68 (Tex. App.—Austin 1982, writ ref'd n.r.e.)(must state substantive law because substantive law sets forth right, duty and breach).

49. *See Jackson*, 31 Tex. Sup. Ct. J. at 610 (pleadings will clarify duty allegedly breached); *see also* Roark v. Allen, 633 S.W.2d 804, 810 (Tex. 1982)(notice necessary to allow defendant to prepare defense); TEX. R. CIV. P. 45, 47 (pleadings must give sufficient notice of cause of action and remedy sought).

50. *See Jackson*, 31 Tex. Sup. Ct. J. at 610 (because issues tried are clearer, trials more efficient); Davis v. Quality Pest Control, 641 S.W.2d 324, 328 (Tex. App.—Houston [14th Dist.] 1982, no writ)(notice determines nature of relevant issues and testimony).

51. *Compare* W.T. Waggoner Estate v. Sigler Oil Co., 118 Tex. 509, 518, 19 S.W.2d 27, 29 (1929)(usual remedy for breach of reasonable development is money damages) *and* Wes-Tex Land Co. v. Simmons, 566 S.W.2d 719, 722 (Tex. Civ. App.—Eastland 1978, writ ref'd n.r.e.)(monetary damages difficult to prove, therefore, conditional cancellation preferred remedy for breach of reasonable development covenant) *with* Sauder v. Mid-Continent Petroleum Corp., 292 U.S. 272, 281-82 (1934)(cancellation of leasehold remedy for breach of further exploration).

52. *See W.T. Waggoner Estate*, 118 Tex. at 518, 19 S.W.2d at 29 (remedy for breach of reasonable development is money damages); *see also* Texas Pac. Coal & Oil Co. v. Barker, 117 Tex. 418, 427, 6 S.W.2d 1031, 1037-38 (1928)(damages for breach of covenant of reasonable development must be proven with reasonable certainty).

53. *See Barker*, 117 Tex. at 427, 6 S.W.2d at 1037-38 (monetary damage is remedy for breach of duty to reasonably develop leasehold); *Wes-Tex Land Co.*, 566 S.W.2d at 722 (conditional cancellation preferred remedy for breach of reasonable development covenant because monetary damages difficult to prove).

When a breach of further exploration is successfully proved, relief is limited to the cancellation of the lease, in whole or in part.[54]

Additionally, the release of the undeveloped land as the remedy for breach of the implied covenant of further exploration is in the public's best interest because it releases the land for further exploration and production.[55] Cancellation of a leasehold for breach of the covenant prevents the lessee from holding the land for speculative purposes.[56] By allowing a lessee to retain possession of undeveloped land indefinitely, the lessor is unable to receive the full benefit of the land.[57] If the lessor is able to prove that a substantial possibility exists for locating other producing fields on the leasehold, the lessee has the option to either drill for minerals himself or release the land to another operator so that exploration may be resumed.[58]

The lessor who alleges breach of the implied covenant must overcome a formidable burden of proof.[59] To successfully maintain this action, the lessor must show that a reasonable expectation of profit exists in the undevel-

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54. *See Sauder*, 292 U.S. at 281 (remedy for breach of further exploration is cancellation of leasehold). *See generally* 5 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 844 (1964)(discussion of remedy for further exploration breach).

55. *See Sauder*, 292 U.S. at 280-81 (cancellation of leasehold for breach of further exploration allows lessor to make other arrangements for development of land); Sinclair Oil & Gas Co. v. Masterson, 271 F.2d 310, 320 (5th Cir. 1959)(cancellation of lease allows lessor to make arrangements for drilling of leasehold by other lessee).

56. *See* Sauder v. Mid-Continent Petroleum Corp., 292 U.S. 272, 281 (1934)(production on small piece of land not sufficient justification for holding non-producing land indefinitely); *Masterson*, 271 F.2d at 320 (exploration on any part of lease does not nullify obligation to explore remaining sections of lease), *cert. denied*, 362 U.S. 952 (1960); *accord* Brewster v. Lanyon Zinc Co., 140 F. 801, 810 (8th Cir. 1905)(essence of lease is to extract oil and gas from leasehold). *See generally* 5 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 842.1 (1964)(discussion of rule that lessee may not retain land for speculative purposes); Meyers & Williams, *The Implied Duty to Explore Further: Recent Texas Developments*, 41 TEX. L. REV. 789, 807 (1963)(discussion of reasons for duty to further explore).

57. *See* Danciger Oil & Ref. Co. of Texas v. Powell, 137 Tex. 484, 491, 154 S.W.2d 632, 635 (1941)(purpose of lessor granting lease is to receive royalties from mineral exploitation); Mitchell v. Amerada Hess Corp., 638 P.2d 441, 447 (Okla. 1981)(lessor seeks monetary benefit from resulting sale of minerals produced from land). *See generally* 5 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 842.1 (discusses reason for policy against holding land for speculative purposes).

58. *See Sauder*, 292 U.S. at 281 (if lessee expresses no intent to further explore land, lease will be cancelled); *accord* Wes-Tex Land Co. v. Simmons, 566 S.W.2d, 719, 722 (Tex. Civ. App.—Eastland 1978, writ ref'd n.r.e.)(lessee given opportunity to correct breach before cancellation of lease). *See generally* 5 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 842.1 (1964)(discusses reasons for imposing further exploration covenant).

59. *See* Sun Exploration & Prod. Co. v. Jackson, 31 Tex. Sup. Ct. J. 604, 610 (July 13, 1988, reh'g granted)(nature of exploration of oil and gas makes proof of reasonable expectation of profit for lessor and lessee difficult). *See generally* 5 H. WILLIAMS & C. MEYERS, OIL AND GAS § 841 (1964)(lessor's burden of proving profit makes it difficult for lessor to prove breach of implied covenant to further explore).

oped land.[60] To show that a reasonable expectation of profit exists, the lessor must prove with substantial certainty that a formation worthy of production exists below the surface of the leasehold even though the land has never been explored.[61] The Texas Supreme Court, therefore, has made it very difficult to successfully prove breach of the implied covenant of further exploration so that the risks involved in exploring beyond known producing formations will be effectively balanced.[62]

Separation of the implied covenant to further explore the land from the implied covenant to reasonably develop the land alleviates confusion by clarifying the duties allegedly breached by the lessee and the causes of action to be asserted by the lessor. Furthermore, by recognizing an implied covenant to further explore, *Jackson* prevents the lessee from holding the lessor's land for speculative purposes, thus encouraging the policy of fully exhausting available mineral resources. By placing a heavy burden of proof on the lessor who alleges breach of the implied covenant to further explore, the court effectively balances the risks that the lessee encounters by exploring unproven formations against the mutual benefits that the lessor and lessee reap if exploration proves to be successful.

E. Joy Jackson Sparks

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60. *See, e.g.*, Clifton v. Koontz, 160 Tex. 82, 98, 325 S.W.2d 684, 695 (1959)(requiring exploration without expectation of profit violates reasonable, prudent operator standard); Texas Pac. Coal & Oil Co. v. Barker, 117 Tex. 418, 431-32, 6 S.W.2d 1031, 1036 (1928)(reasonable expectation of profit essential to enforcing implied covenant); Felmont Oil Corp. v. Pan Am. Petroleum Corp., 334 S.W.2d 449, 455 (Tex. Civ. App.—El Paso 1960, writ ref'd n.r.e.)(reasonable, prudent operator standard requires proof of reasonable expectation of profit).

61. *See Jackson*, 31 Tex. Sup. Ct. J. at 610 (lessor must prove breach by proving with substantial certainty profit available); *see also* Mitchell v. Amerada Hess Corp., 638 P.2d 441, 447 (Okla. 1981)(proving profit on unknown formation speculative).

62. *See Jackson*, 31 Tex. Sup. Ct. J. at 610 (mere speculation that profit exists not sufficient for proof of breach of covenant to further develop); *accord Mitchell*, 638 P.2d at 447 (element of chance in successful exploration varies from situation to situation). *See generally* Smith, *The Implied Duty to Explore Further: Recent Texas Developments — A Disagreement*, 42 TEX. L. REV. 199, 202 (1963)(proof of reasonable expectation of profit required to balance risks lessee must face when drilling in unproven formation).