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COMMENCEMENT: THE BEGINNING OF THE END OF MINERAL OWNERS' RIGHTS UNDER THE MAJORITY RULE

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STATEMENT OF THE ISSUE

Interpretation of continuous drilling clauses in oil and gas leases, specifically commencement clauses, has been a source of ambiguity in Oklahoma since the beginning of the twentieth century. While many operators and mineral owners have started to address the issues that arise through use of the general definition of commencement by using more specific lease language, less experienced parties continue to overlook the issues, which often become the subject of litigation. One popular express definition of commencement uses the spud date as the date of commencement. The spud date is the date when the drill bit used by the main rig capable of drilling to total depth begins to turn.¹ This Note will

* Juris Doctor Candidate, Oklahoma City University School of Law, May 2021. Thank you to my family for their support throughout law school, and my law professors who challenged me. I hope this Note, written from my perspective as a petroleum engineer by education, serves to be helpful and thought provoking. 1. *Spud*, SCHLUMBERGER | OILFIELD GLOSSARY, <https://www.glossary.oilfield.slb.com/en/terms/s/spud> (last visited Apr. 8, 2021).

explore a variety of cases where oil and gas leases were not cancelled despite the spud date occurring long after the expiration of the primary term under the lease. While these leases would have been cancelled under more specific lease language, Oklahoma courts have allowed the leases to stand under broad circumstances held to satisfy the general definition of commencement.

This Note is concerned only with the broad lease language requiring the operator to commence *to drill* a well, and the language that requires commencement of operations generally in preparation to drill the well. This is distinguishable from the requirement to actually drill the well.² Courts have held that leases that contain habendum clauses with language that only requires commencement to drill may be extended beyond the primary term as long as the premises are being developed or operated or as long thereafter as oil, gas, or both, is being produced.³ In Oklahoma, this interpretation has long been held to be the “only reasonable means of giving force and effect to the unusual provision of the habendum which in the disjunctive expressly provides for extension” as long as the aforementioned requirements are met by the operator.⁴

The goal of this Note is to study the evolution of the majority’s application of the general definition of commencement with a special focus on Oklahoma case law. Throughout the Note an analysis of the illustrative fact patterns and commentary regarding potential pitfalls will be provided. The objective of this Note is to demonstrate the negative impact certain recent holdings by Oklahoma courts could have if applied over a wider range of scenarios.

First, this Note will explore the history of the majority’s broad rule used to interpret the general definition of commencement in the context of drilling and the oil and gas lease in order to provide context for the discussion. Second, this Note will explore the history of the minority’s narrow rule for interpreting commencement and its relationship to the modern trend of oil and gas lease language. Third, this Note will highlight the overarching policy considerations created by Oklahoma’s legislature to balance the interests of mineral owners with the interests of operators while efficiently developing the state’s oil and gas resources. Fourth, this Note will explain the reasonably prudent operator standard as it relates to an operator’s duties to commence to drill in Oklahoma. Additionally, this

2. See *Caltex Oil Venture v. Comm’r*, 138 T.C. 18, 29 (2012).

3. *Moore Oil, Inc. v. Snakard*, 150 F. Supp 250, 255 (W.D. Okla. 1957).

4. *Id.*

section of the Note will compare Oklahoma's standard to a similar, but more specific, standard used by Louisiana and discuss the pros and cons of adopting such a standard in Oklahoma. Fifth, this Note will examine five more recent cases from Oklahoma and suggest that the majority's broad view of commencement has resulted in an evolution of caselaw that diminishes the rights of the mineral owner. Finally, this Note will conclude with a summary of holdings illustrated and relate those holdings to the policy objectives of the Oklahoma legislature. Moreover, this Note will evaluate whether the legislature's policy objectives are properly served by the interpretation of Oklahoma's statutory standards and application of the majority rule regarding commencement to drill by Oklahoma's courts.

THE MAJORITY RULE FOR COMMENCEMENT: A HISTORY

In 1928, the Oklahoma Supreme Court rejected the idea that the operator is required to actually pierce the earth with a drill bit in order to satisfy its obligation to commence a well.⁵ Rather, in *Smith v. Gypsy Oil Co.*, drilling the water well to supply water for drilling the oil well was held to be preparation for drilling sufficient to satisfy the commencement requirement under the lease.⁶ The Oklahoma Supreme Court elaborated on its application of the general definition of commencement in 1932, when it held that if the operator commenced the well before the expiration of the primary term "by necessary legal implication, [the operator has] the right to complete the well after the period fixed for commencement ha[s] expired."⁷ However, the Oklahoma Supreme Court said that the right to complete the well is "subject . . . to [the] abandonment of that right by *failure to proceed in good faith and with diligence.*"⁸ This application of the general definition of commencement is still used by Oklahoma to this day, as well as by a majority of other jurisdictions in the United States.⁹ As one court in Arkansas eloquently stated: "Does 'drilling' commence with the operations for a well, or does it commence only with the piercing of the ground with the drill bit? Does 'baking a cake' begin with the preparation of the dough, or only with the actual placing of the dough in

5. See *Smith v. Gypsy Oil Co.*, 1928 OK 10, 265 P. 647.

6. *Id.*

7. *Simons v. McDaniel*, 1932 OK 34, 7 P.2d 419, 420-21.

8. *Id.* (emphasis added)

9. See *Anderson v. Hess Corp.*, 649 F.3d 891 (8th Cir. 2011); See *Fast v. Whitney*, 187 P. 192 (Wyo. 1920); See *Whelan v. Lacy, Inc.*, 251 S.W.2d 175 (Tex. 1952).

the oven?”¹⁰

Over time, law professors and other commentators articulated a more specific test which was eventually adopted by Oklahoma courts in 1986.¹¹ In *21st Century Inv. Co. v. Pine*, the Oklahoma Civil Court of Appeals referenced Professor Eugene Kuntz’s understanding of the law regarding the general definition of commencement, stating that “Professor Kuntz’s understanding of the law does not differ from that of the trial court or ours.”¹² Since then, the standard for determining whether a lease commenced during the primary term should be extended past the primary term or cancelled comes in the form of the test as articulated by Professor Kuntz. The test, which has since been applied in more recent cases, requires satisfaction of four elements. The elements of commencement of drilling operations under the general rule are as follows: a well has been commenced if (1) operations are conducted on the land (2) in a good faith preparation for the drilling of a well for oil or gas and (3) the operations have continued in good faith and with due diligence (4) with the intention of completing a well.¹³ The plaintiff-mineral owner has the burden to provide evidence that the defendant-operator did not satisfy these elements.¹⁴

Courts in Oklahoma, as well as other states that follow the majority rule, have made a wide variety of holdings that express the breadth of operations that can satisfy the first element of the test, several of which will be examined in more detail in this Note. Additionally, Oklahoma courts have given significant deference to the operators in finding that their actions after the commencement of the well and after the expiration of the primary term were performed in good faith and with due diligence. The result is that operators are almost always found to have proceeded in good faith and due diligence, thus retaining the right to complete the well. This Note will examine several instances where courts held that the operator continued in good faith when the answer is not necessarily clear and could present potential issues for mineral owners’ rights down the road. After the presentation of these cases, this Note will pose the question of whether these holdings are consistent with the intent of some of the oil and gas

10. *Vickers v. Peaker*, 300 S.W.2d 29, 32 (Ark. 1957).

11. *See 21st Century Inv. Co. v. Pine*, 1986 OK CIV APP 27, ¶ 24, 734 P.2d 834, 839-40.

12. *Id.* at 839.

13. *Bays Exploration Inc. v. PenSa, Inc.*, 771 F. Supp. 2d 1289, 1295 (W.D. Okla. 2011) (quoting 3 E. Kuntz, *A Treatise on the Law of Oil and Gas* § 32.3 at 69 (1967)).

14. *Id.*

development policies created by the Oklahoma legislature.

The purpose of the following discussion is to expose pitfalls in the use of the general definition of commencement in an oil and gas lease, namely through reliance on fact-specific inquiries used by the majority of jurisdictions that often favor the lessee. In the majority of jurisdictions, the lessee-operator can almost always point to actions it has performed that satisfy the general definition of commencement. The analysis of case law will demonstrate the potential of the majority's approach to give vast leniency to the operator at the expense of the mineral owner. This Note will also discuss how this approach is potentially harmful to Oklahoma's oil and gas development policies and whether those policies would be better served by the minority rule or some other approach. Although many of the pitfalls could be addressed by including more specific language in the lease regarding the definition of commencement, it is still common to see commence used in its general sense without additional clarification.¹⁵

THE MINORITY RULE FOR COMMENCEMENT

The minority rule, used in Montana and Kansas, defines commencement in a much narrower sense. These jurisdictions have held that commencement of "drilling operations" specifically requires the well to be spud, which requires that a drill bit actually pierce the ground.¹⁶ This definition of spud assigns the same meaning as is commonly known in the oil and gas industry.¹⁷ Kansas courts have held that commence requires a drilling rig to be present on the well site that is capable of reaching total depth.¹⁸ Both of these interpretations by these states that reject the majority's definition of commencement are consistent with the modern trend in lease language. This trend is to address some of the pitfalls created through relying on the general definition of commencement by including more specific lease language. Professor David Pierce, a reputable commentator on oil and gas legal issues, opined that, "[t]he typical oil and

15. See David Pierce, *Rethinking the Oil and Gas Lease*, 22 TULSA L.J. 445, 458 n.60. ("The typical oil and gas lease form leaves too much for factual resolution; matters which often could be easily addressed in the lease. For example, how simple it would be to define the scope of the term 'commence.'").

16. See *Solberg v. Sunburst Oil & Gas Co.*, 235 P. 761, 763 (Mont. 1925).

17. *Id.*; *Spud*, *supra* note 1.

18. See *Hall v. JFW, Inc.*, 893 P.2d 837, 841-42 ("[T]he lessee runs a risk when something less than an appropriate rig is in place on the lease." quoting 1 Pierce, *Kansas Oil and Gas Handbook* § 9.34 (1991)).

gas lease for leaves too much for factual resolution; matter which often could be easily addressed in the lease. For example, how simple it would be to define the scope of the term ‘commence’....”¹⁹ Many parties to oil and gas agreements in jurisdictions that follow the majority rule now include specific lease language to define commencement to the effect of the minority’s interpretation. For example, it is common for a mineral owner-lessor in Oklahoma to specifically define commencement in the habendum clause by including the language: A well is commenced when the operator (lessee) moves a drilling rig onto the well site which is capable of drilling to total depth. This language expressly says what performance the mineral owner expects of the operator before the end of the primary term. Not only does this benefit the operator by helping the operator avoid litigation that might arise if the term commencement remained ambiguous, but it also protects the mineral owner’s interest that the well will be completed as quickly as possible so that the mineral owner may start to collect royalties from the production of the well. Typically, mineral owners who wish to lease their mineral rights to an operator are ready to realize that value—if they were not ready to realize value and wished to speculate, it is unlikely they would enter into a lease at all.

In light of the modern trend toward the minority rule and its benefits, one might wonder why this is still the minority rule. Why not just use the minority rule if most leases in the jurisdictions following the majority rule are going to the trouble to add additional lease language to avoid the majority’s construction of the term commencement anyway? Is it possible that the majority of states want to continue to allow sophisticated operators to leverage the speculative benefits of the general definition of commencement against unwitting mineral owners? Keep these questions in mind as this Note illustrates potential pitfalls of the majority rule as it is applied in Oklahoma today.

OKLAHOMA OIL AND GAS POLICY CONSIDERATIONS

Oklahoma’s legislature created the Oklahoma Corporation Commission Oil and Gas Division to regulate the development of oil and gas throughout the state.²⁰ More specifically, the Oklahoma Corporation Commission seeks to accomplish its regulatory purpose by preventing waste and protecting correlative rights, while at the same time promoting

19. Pierce, *supra* note 15, p. 457, n.60.

20. OKLA. STAT. tit. 52, § 86.4 (2020).

the development of the state's resources.²¹ The mission statement of the Oklahoma Corporation Commission is to “[e]mpower[] Oklahoma by [e]nsuring responsible development of oil and gas resources” while simultaneously “[b]alancing the rights and needs of the people with those of regulated entities through development and enforcement of regulations in an open, transparent, ethical, and just manner.”²² The vision of the Oklahoma Corporation Commission is “[t]o be a trusted, effective agency that works collaboratively to accomplish its Mission in a way that protects people and the environment, conserves natural resources, improves quality of life, promotes continued economic development, and hold both itself and the industries it regulates accountable to the citizens of Oklahoma.”²³

Additionally, Oklahoma courts have recognized several implied covenants that are enforced with the goal of protecting the interests of the mineral owners. These implied covenants include the implied covenant to drill an initial exploratory well or test for oil and gas, reasonably develop the leased premises, protect against drainage, and market the product. The implied covenant to drill an initial exploratory well is the covenant which is questioned the most in this Note. These general policy goals regarding the development of Oklahoma's oil and gas resources will be referenced throughout this Note while commentating on whether Oklahoma courts are promulgating these goals in the context of their holdings. Specifically, this Note will present facts from cases that illustrate scenarios where the operators are given significant leeway at the expense of the mineral owner's interests and ask whether the result is in the best interests of Oklahoma's stated objective to protect people and balance its interests against corporations.

THE REASONABLY PRUDENT OPERATOR STANDARD

In Oklahoma case law, courts' inquiries in whether the operator's actions justify an extension of the lease past its primary term routinely include an analysis of whether the operator continued performance in good faith and with diligence after the well was commenced.²⁴ Whether the

21. OKLA. STAT. tit. 52, § 87.1(a) (2020).

22. OKLAHOMA CORPORATION COMMISSION, <https://oklahoma.gov/occ/about/history/mission-vision.html#:~:text=Our%20Mission%3A&text=Balancing%20the%20rights%20and%20needs,%2C%20ethical%2C%20and%20just%20manner> (last visited on Nov. 13, 2020).

23. *Id.*

24. *Simons v. McDaniel*, 1932 OK 34, 7 P.2d 419, 420-21.

operator has exercised the requisite diligence, like the question of commencement, warrants a fact-specific inquiry. Oklahoma's rules regarding an operator's obligation of diligence are outlined below. Following that is a comparison to the rules used by Louisiana, another state whose economic interests are inextricably intertwined with the oil and gas industry.

The obligation of diligent development comes from the implied covenant to diligently develop, measured by the prudent operator rule. The prudent operator rule is that the designated operator is bound to perform its duties to the standard of a reasonably prudent operator.²⁵ The reasonably prudent operator standard is the "performance which an operator acting reasonably would have undertaken given the circumstances at the time, without being required to subordinate its own business interests, but with due regard to the interests of all affected parties, including [its own]."²⁶

The reasonably prudent operator standard codified in 52 Okla. Stat. §52-902 is similarly articulated by the Louisiana legislature in La. R.S. §31:122.²⁷ Louisiana courts have also added additional clarity to the mushy standard by creating a list of useful factors to consider in the application of the standard. The list is not exclusive, and includes (1) geological data, (2) number and location of wells drilled, (3) productive capacity of wells, (4) cost of drilling operations compared to profits, (5) time interval between completion of the last well and the demand for additional operations, and (6) acreage involved in the disputed lease.²⁸ Louisiana courts tend to further disadvantage the mineral owners' ability to protect their interests by requiring a substantial showing by the lessor that the operator has breached the standard.²⁹

The specificity added to Louisiana's standard through the factors expressed by courts might be helpful to potential litigants in evaluating their position without the need for litigation. Having this additional guidance at their disposal, it is plausible that in many scenarios parties will refrain from litigation, settle disputes amongst themselves, and continue the development of oil and gas resources contemplated in the lease. This

25. OKLA. STAT. tit. 52, § 902 (2020).

26. *Id.* at § 902(1).

27. LA. STAT. ANN. §31:122.

28. *Ferrara v. Questar Expl. & Prod Co.*, 70 So. 3d 974, 983 (La. Ct. App. 2011).

29. *Id.* at 982. ("Cancellation is a harsh remedy that is rarely granted; the breach must be substantial to warrant dissolution.")

is a desirable result, because there is less potential for economic waste, and a more timely completion of oil and gas wells will lead to a more efficient development of a state's resources.

If Oklahoma were to enunciate a more specific test to determine whether an operator has met the reasonably prudent operator standard, the benefits in doing so would yield progress toward the objectives of Oklahoma's legislative and regulatory bodies. For example, one of the primary purposes of the Oklahoma Corporation Commission Oil and Gas Division is to prevent waste.³⁰ Waste can include economic waste caused by inefficient spending in the course of developing oil and gas resources. Waste can also include permanent damage to oil and gas resources that would render those resources incapable of being produced. Economic waste could result from prudent operators taking unnecessary measures at unnecessary expense in an attempt to comply with the broad and ambiguous terms of the general definition of commencement.³¹ These expenses, as well as other undesirable forms of economic waste, could be avoided if Oklahoma's courts and Oklahoma's legislature defined a clearer standard. A clearer standard would enable operators, especially sophisticated operators, to come up with more streamlined development plans that could be implemented across their entire business. These plans could allow operators to anticipate shortcomings that might develop under a more specific reasonably prudent operator standard and enable operators to sort out those issues before they arise.

Bearing in mind the general definition of commencement in an oil and gas lease, under what circumstances can an operator commence the well, then leave for a period of time, then come back and continue? Specifically, can the operator leave the site to commence operations at other locations at the end of its primary terms in order to protect its own interests, as long as it does not harm the interests of the mineral owner? Can this be done in good faith? Is there a difference? In practice, the answers to these questions require a fact-intensive inquiry dependent on the circumstances. The cases illustrated below submit to the reader that the courts' application of the law in recent cases may be more operator friendly in light of the shift toward the reasonably prudent operator standard rather than the good faith requirement. The reasonably prudent operator standard does not require an operator to subordinate its own interests (such as satisfying the

30. OKLA. STAT. tit. 52, § 87.1(a) (2020).

31. *See* Son-Lin Farms, Inc. v. Dycos Petroleum Corp., 589 F. Supp. 1, 2 (W.D. Okla. 1982).

primary term of the lease through meeting minimum requirements of commencement) as long as it exercises due regard for the interests of other parties involved.

EVOLUTION OF THE BREADTH OF COMMENCEMENT THROUGH MODERN
OKLAHOMA CASE LAW

The following cases are illustrated to show some of the consequences of the application of the general definition of commencement in practice. After each case, this Note will propose the potential adverse effects on mineral owners' rights created by the holding. This Note will then relate the adverse effects on those rights of the mineral owners to Oklahoma's oil and gas development policies that have been outlined previously and evaluate whether these holdings tend to support those policies.

Son-Lin Farms, Inc. v. Dyco Petroleum Corp.

An operator may not literally be required to continuously operate machinery onsite if it is making other preparations offsite.³² In *Son-Lin Farms*, the operator formed a good faith intent to drill ten days before the expiration of the primary term of the lease.³³ The good faith intent was formed after the operator saw positive indications from an offset well it was drilling nearby.³⁴ Two days before the expiration of the primary term, the operator slowly drilled a conductor hole.³⁵ The operator continued to drill at a rate of between one and two feet per day because of its good faith belief that operations after commencement should be continuous to satisfy its obligation of diligent development.³⁶ The court said this belief, although in good faith, was "perhaps legally incorrect."³⁷ The court elaborated that if the slow drilling of the conductor hole was done while there was a deep drilling rig available on the market, the operator would have failed to meet the reasonably prudent operator standard.³⁸ Nevertheless, the court credited the operator for continuing the operations at its own expense as to protect the financial interests of the mineral

32. *Id.*

33. *Id.* at 2.

34. *Id.*

35. *Id.* at 2-3.

36. *Id.* at 2.

37. *Id.*

38. *Id.* at 4.

owner.³⁹ The operator eventually completed and produced from the well.⁴⁰ The court held that the operator's conduct was reasonable because of the lack of availability of drillings rigs capable of drilling to total depth at the time.⁴¹ The operator was also not required to have formed a contract for the rental of a deep drilling rig to be used before the end of the primary term—simply beginning to search for an available rig after making its decision to drill was sufficient.⁴² The operator secured a contract for the first available deep drilling rig, which had to be moved from a drilling location in Texas.⁴³ Finally, the court mentioned that if the operator had formed its intent to drill based on an offset well after the primary term expired, the commencement by slowly drilling the well would have been insufficient to hold the lease.⁴⁴

In *Son-Lin Farms*, the court suggested that the operator was not actually required to continuously operate machinery on the well site.⁴⁵ Rather, the court suggested that the operator could satisfy the requirement to continue with good faith and diligence through its activities off site.⁴⁶ This notion by the court is clearly broader than the classic Oklahoma cases that formed the basis for the definition of commencement.⁴⁷ The actions held sufficient to satisfy commencement by the operator are also at odds with the types of “physical activit[ies]” contemplated by oil and gas law scholars as requisite to satisfy commencement.⁴⁸ Now, instead of making tangible progress through delivery of materials to the well site and completion of preparatory field work on location, the court suggests that the operator may satisfy the requirement from the chair in its office. This presents a variety of issues and additional ambiguities. First, under this interpretation the operator can more easily concoct an excuse for why it is not making progress on the well site and justify it with myriad claims based on digital or remote efforts. For example, an operator who wishes to temporarily delay field operations for any reason may claim that it is

39. *Id.* at 2.

40. *Id.*

41. *Id.*

42. *Id.* at 4.

43. *Id.* at 2.

44. *Id.* at 4.

45. *Id.* at 2.

46. *Id.*

47. *Simons v. McDaniel*, 1932 OK 34, 7 P.2d 419, 420-21.

48. *21st Century Inv. Co. v. Pine*, 1986 OK CIV APP 27, 734 P.2d 834, 839-40 (quoting 3 E. Kuntz, *A Treatise on the Law of Oil and Gas* § 32.3 at 70 (1967)).

making continuous efforts to contract a rig, but those efforts are delayed because of the time it may take for drilling contractors to respond to the operator's inquiries by email or telephone.

Another pitfall of the court's application of the rule in *Son-Lin Farms* is that no date was given in the opinion about how long it took to move the rig from Texas to the site in Oklahoma. Although it was clear that the rig made it to the well site in Oklahoma long after the expiration of the primary term, the exact passage of time was not addressed. This may be a sign that Oklahoma courts are willing to allow any passage of time without tangible progress being made on the well site as long as the operator can justify the delay. This is a dangerous precedent that could have adverse effects on the goals of the Oklahoma legislature and the policies it has implemented to allow for the efficient development of oil and gas resources.

Under *Son-Lin Farms*, an operator in the digital age can more readily come up with justifications for delay in tangible progress. Thus, the operator could easily delay tangible operations required for preparing the well site to drill. The operator could use the delay to speculate on whether the project is worth pursuing in its entirety. Speculation by operators is one of the main concerns that conflicts with the efficient development of oil and gas; speculation is essentially the antithesis of development. Speculation is also directly opposed to the interests of mineral owners who want to realize the net present value of their minerals by starting to collect royalty payments from the production of their minerals as soon as possible. This concern would be compounded during times of high oil prices. When oil prices are high, mineral owners' and operators' interests for timely production align where it appears clear from the geological and geophysical data underlying the mineral owners' tract that the well will be productive. However, geological and geophysical data can be extremely expensive to collect and may not fall within the budget of a less sophisticated operator. Thus, operators could obtain leases in hot areas during an oil boom and hold those leases for long periods of time past the expiration of the primary term of the lease. The operator just has to justify these long delays as reasonable, like the operator did in *Son-Lin Farms*, by citing the high demand and lack of availability of drilling rigs capable of drilling to total depth.

*Stoltz, Wagner & Brown v. Duncan*⁴⁹

The operator may start dirt work the day before the expiration of the primary term and take thirty days to complete the dirt work without cancellation of the lease, even though the same dirt work is routinely completed faster by prudent operators.⁵⁰ In *Stoltz, Wagner & Brown v. Duncan*, the operator staked the location for the well site five days before the expiration of the primary term and began dirt work one day before the expiration of the primary term.⁵¹ The operator officially obtained operator rights on the final day of the primary term and began searching for a drilling rig capable of drilling to total depth. The court allowed the operator to hold the lease despite the fact that a contract was not obtained for use of a drilling rig capable of reaching total depth until twenty-six days after the expiration of the primary term.⁵² The drilling rig was moved onto location on the twenty-seventh day after the expiration of the primary term, and the well was spudded on the thirty-second day after the expiration of the primary term.⁵³ The mineral owners claimed that the amount of time it took the operator to contract for an adequate drilling rig was excessive and evidence that the operator did not meet the reasonably prudent standard.⁵⁴

The court rejected the mineral owners' claim citing evidence that drilling rigs adequate to reach the total depth of the well were "scarce and very difficult to obtain" at the time.⁵⁵ Moreover, the court found that the operator acted with "[g]ood faith and diligence" by making a "diligent and reasonable effort to locate and contract for a drilling rig" and in fact contracted the first rig that became available.⁵⁶ The court also rejected the mineral owners' claim that the operator did not complete the dirt work to the standard of a reasonably prudent operator because it took thirty days to complete.⁵⁷ The court reasoned that the operator had acted prudently here because the dirt work began before the expiration of the primary term of the lease, the contractor only had one bulldozer and one operator

49. *Stoltz, Wagner & Brown v. Duncan*, 417 F. Supp. 552 (W.D. Okla. 1982).

50. *See id.* at 563.

51. *Id.* at 562.

52. *Id.*

53. *Id.*

54. *Id.* at 563.

55. *Id.*

56. *Id.*

57. *Id.*

available at the time, the dirt work was performed eight hours per day except Sundays and one holiday, and the dirt work was completed before the drilling rig arrived on location.⁵⁸ Finally, the mineral owners claimed that the operator deliberately delayed the completion of the dirt work and the contracting of an adequate drilling rig in an effort to evaluate the results of an electric well log being taken on an offset well also operated by the operator.⁵⁹ The mineral owners' theory was that the operator had not formed the requisite good faith intent to drill the well prior to the expiration of the primary term of the lease, that the operator's actions were performed in bad faith to disguise its attempt to extend the lease so that it could speculate on the results of the log and that the operator's intent to drill was formed after the log was analyzed after the primary term had expired.⁶⁰ Thus, the mineral owners argued that the operator had not satisfied the elements of commencement, and the lease should be cancelled.⁶¹ The court rejected this argument, because despite the fact that the results of the log were disappointing, the operator continued with its plans to drill the well here at an expense of over one million dollars based on its knowledge of the geology underlying the mineral owners' acreage obtained before the expiration of the primary term.⁶²

The *Stoltz, Wagner & Brown* court's justification regarding the amount of time taken by the operator to complete the dirt work may extend to other circumstances where it may be more economically desirable for an operator, not necessarily a mineral owner, to take longer to prepare a pad.⁶³ A one-month delay, as was the case in *Stoltz, Wagner & Brown*, is at odds with mineral owners' interest in collecting royalty payments in a timely manner. Here, the court further alienated the interests of the mineral owner by allowing the operator to subordinate the mineral owners' interests by broadly applying the requirements for commencement.⁶⁴ The court seems to dilute the reasonably prudent operator standard by evolving it into some sort of *reasonable under the circumstances of failing to be*

58. *Id.*

59. *Id.*

60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.* at 563.

64. See *id.* at 562 ("But on said date [within the primary term of the lease] Defendants [operators] must have had the good faith intention to unqualifiedly drill the well *and* must have commenced drilling the well on said date *and* pursued such drilling as a reasonably prudent operator.") (emphasis added).

prudent standard. The court expressly wrote that the dirt work that took the operator thirty days to complete is routinely completed faster by prudent operators.

Despite the standard for the timely completion of the work set by those prudent operators, the court was lenient with the operator and allowed a longer period for the completion of the dirt work. The court justified its leniency by citing the lack of a drilling rig deadline. Therefore, because the operator was able to finesse itself into a lease that did not specify a time for the rig to be on location, it could take its time contracting for a drilling rig as long as it could justify the low burden of reasonable progress towards contracting a capable drilling rig as the court used in *Son-Lin Farms*.⁶⁵ Not being rushed by a drilling rig deadline also allowed the operator to take longer to complete the dirt work by contracting for less man power and less heavy equipment. The operator in *Stoltz, Wagner & Brown* got away with contracting a single bulldozer and a single operator.⁶⁶ Surely this came with an appreciable amount of savings compared to the cost to complete a drilling pad with multiple bulldozers and operators. The court's holding here rubs against the grain of another layer of protection for the mineral owner—the judicial scrutiny traditionally applied to the lease language that appears to benefit the lessee.⁶⁷ Normally, ambiguities in oil and gas leases are strictly interpreted against the operator-lessee because the lessee is frequently the more sophisticated party and has more control and experience in negotiating the terms of the lease.⁶⁸ This strict judicial scrutiny is not apparent in the decision by the court in *Stoltz, Wagner & Brown* nor is it apparent in other courts interpreting the ambiguous general definition of commencement under the majority rule.

*Jones v. Moore*⁶⁹

Oklahoma courts may favor the operator by presuming good faith and due diligence when there is no evidence to the contrary.⁷⁰ In *Jones*, the operator commenced to drill a well by selecting the drilling location,

65. See *Son-Lin Farms, Inc. v. Dyco Petroleum Corp.*, 589 F. Supp. 1, 2-3 (W.D. Okla. 1982).

66. See *Stoltz, Wagner & Brown*, 417 F. Supp at 563.

67. See *Rook v. James E. Russel Petroleum, Inc.*, 679 P. 2d 158, 164 (Kan. 1984).

68. *Id.*

69. *Jones v. Moore*, 1959 OK 23, 338 P.2d 872 (1959).

70. See *id.* at ¶ 19.

digging disposal pits, and contracting for a drilling rig the day before the end of the primary term of the lease.⁷¹ The court held that this constituted proper commencement and that the operator would have satisfied the general requirements of commencement if it performed the same acts the day that the primary term of the lease was set to expire.⁷² The mineral owner argued that the operator failed to continue its work in good faith and with reasonable diligence because the operator failed to make progress while it was enjoined for thirty-four days by the mineral owner.⁷³ Moreover, the mineral owner argued that the operator subsequently failed to proceed with good faith and reasonable diligence when the operator took forty-seven days to move a rig onto location after the injunction was dismissed.⁷⁴ As to the mineral owner's first complaint, the court held that the operator was not required to continue operations in good faith and with reasonable diligence during the thirty-four days it was prevented from doing so by the court-ordered injunction.⁷⁵ As to the mineral owner's second complaint, the court held that the forty-seven-day delay after the injunction was lifted was justified by the operator's desire to start from scratch in negotiating a new contract for a drilling rig.⁷⁶ Additionally, the court gave the operator the benefit of the doubt that it acted diligently as soon as it received notice that the injunction was lifted.⁷⁷ This was presumed true despite the fact that there was no evidence in the record regarding the notice received by the operator.⁷⁸ The court noted that from the time the operator commenced to drill until the well was spudded almost three months later, the mineral owner made no effort to cooperate with the operator.⁷⁹

In *Jones*, the court seemed to construe the majority's application of the general definition of commencement to favor the operator.⁸⁰ This is another instance where the court's decision went against the grain of the strict standard of judicial scrutiny usually applied against the operator in

71. *Id.* at ¶ 10.

72. *Id.* at ¶ 15.

73. *Id.* at ¶ 17.

74. *Id.* at ¶ 18.

75. *Id.* at ¶ 17.

76. *Id.* at ¶ 19.

77. *Id.*

78. *Id.*

79. *Id.* at ¶ 20.

80. *See id.* at ¶ 17.

oil and gas leases.⁸¹ After weighing the evidence, the court in *Jones* presumed the operator's good faith because the plaintiff-mineral owner failed to provide evidence to the contrary.⁸² One would not expect a court interpreting the ambiguous terms of the lease, such as the definition of the word commencement in a habendum clause, in a way that favors the lessor-mineral owner to place this type of burden on the plaintiff. However, in *Jones* there is a fact that makes it distinguishable from *Stoltz, Wagner & Brown*. The plaintiff in *Jones* applied for an injunction against the operator when it suspected that the operator was not performing up to the standard of a reasonably prudent operator.⁸³ From the facts, it appears that after the injunction was granted, the relationship between the parties deteriorated.⁸⁴

Subsequently, the plaintiff did not make a good faith attempt to cooperate with the operator.⁸⁵ The court appeared to take exception to this lack of good faith by the plaintiff in denying to cancel the lease after a period of over two months without any tangible progress. The court's reasoning points to the fact that the delays were caused by the plaintiff's bad faith and that the delays could not have been caused by the operator's bad faith.⁸⁴ This reasoning creates a dangerous precedent that may allow an operator to evade any burden to justify the reasonableness and diligence exercised in drilling the well where a plaintiff has become so frustrated with the operator's lack of progress that it resorts to the judicial system to help protect its rights. It does not seem like a desirable outcome that in order for a mineral owner to protect its rights, namely the interest in obtaining timely royalty payments, it must resort to litigation and further delay those payments. Moreover, during the litigation the mineral owner must overcome the burden of proof, making it even less likely to prevail and discouraging the pursuit of the protection of its rights in this regard. This result would seem especially unfair in a scenario where the mineral owner did not enjoin the operator, but the operator seemed to be delaying tangible progress on the well site similar to the other cases illustrated in this Note. In that situation, it is foreseeable that the relationship between the parties could deteriorate in the absence of the injunction or any other bad faith by the plaintiff, and a court could still reach the same operator-

81. See *Stoltz, Wagner & Brown v. Duncan*, 417 F. Supp 552, 563 (W.D. Okla. 1976).

82. See *Jones*, 338 P.2d at 872.

83. *Id.* at 874.

84. *Id.*

85. *Id.* at 876.

friendly result that the court did in *Jones*.

*Moore Oil, Inc. v. Snakard*⁸⁶

An operator may have the ability to commence to drill a well in good faith up to the very last minute of the primary term.⁸⁷ In *Moore Oil, Inc. v. Snakard*, the operator discovered that the contractor who was hired to begin dirt work on the last day of the primary term of the lease had not shown up for work that day.⁸⁸ The operator immediately took action to hire a crew who showed up to the well site around ten o'clock that night.⁸⁹ The bulldozer required to complete the work was transported to the well site some time before midnight.⁹⁰ About one week later, the mineral owner arrived to the well site and expressed his dissatisfaction with the lack of progress the operator had made in preparing the site for drilling.⁹¹ The mineral owner filed suit claiming that the operator had failed to operate in a diligent and prudent manner.⁹² Despite the operator's late start and limited progress, the court held that the operator's actions were sufficient to satisfy the requirement to commence in good faith under the habendum clause of the lease.⁹³

The court in *Moore Oil, Inc.* demonstrates that the requirement for the amount of work and preparation for the operator to commence to drill is truly minimal.⁹⁴ The operator waited until the very last day of the lease to check the progress of the preparation of the well site.⁹⁵ Upon arrival, the operator discovered that the dirt work contractor had not even shown up for work.⁹⁶ As a last-ditch effort to preserve the lease past the primary term, the operator hired a makeshift crew of four men and was able to arrange for a bulldozer to be delivered just before the primary term of the lease expired at midnight.⁹⁷ When the mineral owner arrived to the location a week later to evaluate the progress, it was justifiably upset with

86. *Moore Oil, Inc. v. Snakard*, 150 F. Supp. 250 (W.D. Okla. 1957).

87. *See id.*

88. *Id.* at 256.

89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.* at 257.

93. *Id.* at 257-58.

94. *Id.* at 256.

95. *Id.*

96. *Id.*

97. *Id.*

the lack of progress.⁹⁸

In making its decision based on the facts, the court in *Moore Oil, Inc.* never asked whether it was reasonably prudent for the operator not to know the dirt work contractor was missing in action. Such an inquiry may have led to discovery of additional facts that showed disorganization and procrastination on behalf of the operator before commencement, as in the week following the expiration of the primary term. The fact that progress was still difficult to discern when the mineral owner showed up suggests that maybe the operator was not continuing preparations for drilling with good faith and reasonable diligence. Instead, the court once again granted the operator leniency and held that the progress was reasonable under the circumstances—the circumstances being that the operator waited until the last possible hour to commence to drill and was unprepared when he arrived to the well site. It would have been interesting in this case to see whether the court would have held the same if there was not a bulldozer available in the area and the operator's crew had to attempt to prepare the pad with hand shovels because they were the best means that could be obtained. Would the court have used the same justification as the court in *Son-Lin Farms* to allow the primary term to be extended because of the lack of availability of the necessary equipment? It seems plausible that they would, as long as the operator could provide proof that there were no bulldozers available at the time. Or perhaps under *Jones* it would be the plaintiff's burden to establish that there were bulldozers available that could have been reasonably obtained by the operator. Considering the operator-friendly holdings derived from the majority rule in the cases so far analyzed allows one to anticipate the severe disadvantage to the mineral owner if the facts were aggregated. The rights and interests of mineral owners could potentially disintegrate if the effects of these holdings were to be compounded in one single case.

*Bays Exploration Inc. v. PenSa, Inc.*⁹⁹

The eventual completion and production of a well may justify an operator's lack of continuous progress during the drilling phase.¹⁰⁰ In *Bays Exploration, Inc.*, the operator commenced drilling operations by

98. *Id.*

99. *Bays Exploration, Inc. v. PenSa Inc.*, 771 F. Supp. 2d 1289 (W.D. Okla 2011).

100. *See id.* at 1295.

constructing a drilling site in June.¹⁰¹ The lease provided for the expiration of the primary term in August.¹⁰² The operator did not conduct any operations onsite until three months later, when the operator installed the surface casing.¹⁰³ The operator eventually spudded the well in November, and the well was completed in March of the following year.¹⁰⁴ The court held that the operator's lack of continuous progress did not constitute bad faith or lack of diligence, because the well was ultimately completed and produced.¹⁰⁵ In so holding, the court reasoned that the operator's completion of the well was evidence of good faith intention at the time of commencement.¹⁰⁶ Moreover, the mineral owners failed to provide any evidence that the operator did not intend to complete the well when it began constructing the drill site nor did the mineral owner provide evidence that the three-month delay was attributable to the operator's bad faith or lack of diligence.¹⁰⁷

In *Bays Exploration Inc.*, the court strays even further away from the requirement of continuous progress than the court in *Son-Lin Farms*.¹⁰⁸ The court in *Son-Lin Farms* required that the operator make continuous progress towards drilling the well but held that the progress could come in the form of contract negotiations that were conducted offsite.¹⁰⁹ In *Bays Exploration Inc.*, the court does not appear to even require evidence that the operator's progress was in fact continuous.¹¹⁰ Rather, the court held that the fact that the well was eventually completed as a producer was evidence enough that the operator had exercised due diligence and good faith.¹¹¹ But what if the operator had not ceased progress for three months and instead continued to work onsite? It seems reasonable to conclude that the well would have started producing three months earlier, and the mineral owner would have been able to realize the profits from its retained royalty interest over that period of time. The mineral owner, if treated fairly here, would have had been able to invest those proceeds into other

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.* at 1295.

107. *Id.*

108. *See generally* *Son-Lin Farms, Inc. v. Dyco Petroleum Corp.*, 589 F. Supp. 1 (W.D. Okla. 1982).

109. *Id.* at 3.

110. *See Bays Exploration Inc.* 771 F. Supp. 2d at 1295.

111. *Id.*

projects or investments and potentially be better off than it was in this case.

Thus, the court's holding in *Bays Exploration Inc.* fails to adequately protect the interests of the mineral owner. The court should have held that the operator failed to act as a reasonably prudent operator because the three-month hiatus in progress on the well site was a failure to give "due regard to the interests of all affected parties," that is, the mineral owner.¹¹² There are no facts present here that would suggest that in not taking the three-month break the operator would have subordinated its own interests in any way. Perhaps if the court inquired into the facts here instead of so easily finding in favor of the operator, the court could have found facts that indicated the reason for the operator's three-month break. Perhaps those facts would have evidenced bad faith by the operator to stall the project at this site in favor of quickly commencing a well on another site in an attempt to extend its interest in that lease. Instead, the court has not only compromised the rights and interests of the mineral owner in *Bays Exploration Inc.* but has also potentially jeopardized the rights and interests of other mineral owners doing business simultaneously with the same operator by failing to adequately investigate the facts. The analysis of commencement by the operator and subsequent continuous progress by the operator in good faith and due diligence apparently no longer requires the same fact-intensive inquiry based on the circumstances it did when Oklahoma started applying the general rule at the beginning of the twentieth century.¹¹³

The court also appears to dilute the protections offered to the lessor-mineral owner through the implied covenant to drill an exploratory well in favor of placing emphasis on the operator's good faith intent at the time of commencement. Using this kind of reasoning destroys one of the few protections mineral owners have and makes an already ambiguous standard even more exploitable by operators. Now the burden is on the mineral owner to explain how and why a deceptive operator exercised bad faith at the time of commencement. The answers to these questions must be found during the discovery phase of litigation at an enormous expense to the mineral owner. This type of reasoning by the court risks creating a policy that discourages mineral owners from defending the rights—rights that are supposed to be regarded as so vital that they are protected by an *implied* covenant. This goes against the oil and gas policy created by the

112. See OKLA. STAT. tit. 52, § 902(1) (2020).

113. See *Smith v. Gypsy Oil Co.*, 130 OK 135, 265 P. 647 (Okla. 1928); See also *Simons v. McDaniel*, 7 P.2d 419, 420-21 (Okla. 1932).

Oklahoma legislature and represents a step in the wrong direction by Oklahoma courts in their interpretation of continuous drilling clauses.

COMMENCEMENT IN MODERN MULTI-UNIT HORIZONTAL DRILLING
DEVELOPMENT (2020)

A recent decision in *Lawson v. Citizen Energy II* highlighted the breadth of problems that may arise when the general definition of commencement expands even further to include oil and gas development fields utilizing horizontal drilling techniques.¹¹⁴ The issue in *Lawson* is whether commencement of a multi-unit horizontal well in one section satisfies the habendum clause for adjacent unit when the bit has not yet penetrated the ground underlying the adjacent unit.¹¹⁵ The lease in *Lawson* included a commencement clause that invoked the use of the general definition of commencement.¹¹⁶ The Oklahoma Court of Civil Appeals held that commencement of the horizontal well in one unit satisfied the commencement as to the adjacent unit, citing the advancements in drilling technology which have evolved following the legislature's enactment of Oklahoma's drilling and spacing unit rules, as well as relying on its interpretation of 52 Okla.Stat. § 87.8(B)(3).¹¹⁷ The court's interpretation using the "One Unit One Well" principle is arguably contrary to the legislature's intent to consider each section as a separate unit for the purposes of commencement, despite the court's efforts to discern the legislature's intent throughout its opinion in *Lawson*.¹¹⁸

As the *Lawson* case is heard by the Oklahoma Supreme Court on appeal, it may be prudent for the court to consider the implications that commencement issues may have in modern, multi-unit horizontal drilling

114. See *Lawson v. Citizen Energy II*, 2021 OK CIV APP 1, 481 P.3d 287.

115. *Id.* at ¶ 9.

116. *Id.* at ¶ 8 ("The Oklahoma Supreme Court has interpreted 'commence to drill' language in an oil and gas lease to mean something less than actual spudding of a well, absent specific language in the lease to the contrary.")

117. *Id.* at ¶ 15. (OKLA. STAT. tit. 52, § 87.8(B)(3) (2020) provides that a multiunit horizontal well shall be treated as a well in each of the affected units and shall be subject to all of the rules applicable to another well in any of the affected units.)

118. See Stephanie Moser Goins, *Look at this Absolute Unit: Oklahoma Courts Tackle Cross-Unit Commencement Issues*, (Aug. 25, 2020), <https://www.ballmorselowe.com/blog/look-at-this-absolute-unit-oklahoma-courts-tackle-cross-unit-commencement-issues>. (Regarding the legislature's intent that the units be considered separately by writing that a multiunit horizontal well "shall be treated as *a* well in each of the affected units.")

plays. One such issue is that allowing commencement in one unit to satisfy the habendum clause in an adjacent unit will present more opportunities for operators to stall to speculate using some of the tactics discussed previously. However, in the context on multi-unit horizontal wells, the negative impact on mineral owners would be magnified because the operators could be absolved of their duties to mineral owners across larger swaths of land. The magnification of the negative impact on mineral owners will put even more stress on courts who apply the defunct reasonably prudent operator standard as the analysis applied to multi-unit horizontal commencement cases will undoubtedly yield even more absurd results in favor of mineral owners' speculative behavior. The fate of mineral owners in Oklahoma may rest in a court's ability to sleuth around operators' conduct to determine whether they acted in bad faith while performing preparatory work or other commencement type operations. Unfortunately, as the case law stands, evidence of an operator's bad faith will continue to be elusive due to the fact that mineral owners have the burden to prove that an operator did not commence in good faith. This issue should be resolved by putting the burden of proof of good faith on the operator, who would be in a better position to prove that it did commence in good faith.

SUMMARY AND CONCLUSION

Since the majority rule for application of the general definition was developed in the early twentieth century, Oklahoma seems to have evolved its application to become even more operator friendly than the rule formerly was when it allowed commencement to be broadly achieved by the operator before the expiration of the primary term of the lease. Under recent Oklahoma case law, the operator has broad latitude not only to easily satisfy commencement to drill before the expiration of the primary term of the lease but also to continue the lease beyond the primary term by using a variety of justifications. These justifications include: I completed the well eventually and it was even a producer;¹¹⁹ I was doing my best to make continuous progress in preparation of the well site from the comfort

119. See generally *Bays Exploration Inc. v. PenSa, Inc.*, 771 F. Supp. 2d 1289 (W.D. Okla. 2011).

of my office;¹²⁰ You can't prove I didn't have good faith;¹²¹ We commenced the well by kicking around some dirt while we waited for the bulldozer at midnight;¹²² and We weren't as fast as a reasonably prudent operator, but we were fast enough.¹²³

This Note has illustrated the danger of these precedents by posing examples of how an operator's justifications could be compounded to decimate the rights of mineral owners. If courts continue the liberal application of the general definition of commencement, it will be harder to hold operators accountable without more specific legislative action. It is important to Oklahoma's oil and gas development policy to be able to effectively balance the interests of operators and mineral owners. However, utilizing the majority rule to evaluate operators' actions in commencement clause disputes has proven to provide many obstacles and threats to mineral owners' interests. It may also be in the best interests of the Oklahoma legislature to consider revising the standard of the reasonably prudent operator to make it more specific. One of the major contradictions in the current standard as written is that it asks the operator to balance the interests of the parties involved without subordinating its own interests. Any balance of interests requires compromise, and compromise would, in many instances, require subordination of the operator's own interests in some way.

To avoid these issues, mineral owners should insist on defining commencement in their oil and gas leases as *moving a rig onto location that is capable of drilling to total depth*. To mitigate against these issues all together Oklahoma should consider shifting toward the minority rule, which applies the definition of commencement as if the above language was included in the oil and gas lease. Doing so would prevent the mineral owner-lessor from being further disadvantaged in its negotiations of the lease and the eventual drafting of the lease terms in relation to a sophisticated and experienced operator. This would promote the policy of protecting the interests of the lessor by interpreting oil and gas lease language strictly against the lessee, which has become a standard practice in the oil and gas industry. From a legislative policy perspective, it is also

120. See generally *Son-Lin Farms, Inc. v. Dyco Petroleum Corp.*, 589 F. Supp. 1 (W.D. Okla. 1982).

121. See generally *Jones v. Moore*, 338 P.2d 872 (Okla. 1959).

122. See generally *Moore Oil, Inc. v. Snakard*, 150 F. Supp. 250 (W.D. Okla. 1957).

123. See generally *Stoltz, Wagner & Brown v. Duncan*, 417 F. Supp. 552 (W.D. Okla. 1976).

a positive practice not to favor the more powerful party. Not only does it protect the interests of weaker parties and individuals, but it also helps prevent corruption. This could be especially true in Oklahoma, where oil and gas corporations account for an immense percentage of the wealth generated in the state. Rethinking the rules and regulations for the development of oil and gas in Oklahoma to truly prioritize the interest of mineral owners would help temper the power and influence of an already dominant force in Oklahoma's socioeconomic landscape. Moreover, it is unlikely that implementing legislation to help guide courts to more mineral owner friendly decisions would discourage oil and gas corporations from continuing to conduct business in Oklahoma due to the prolificity of the state's reservoirs and the state's well developed oil and gas infrastructure.

Ultimately moving more toward the minority rule for applying commencement principles has the potential to benefit Oklahoma in many ways while presenting few detriments. Until the legislature agrees to expressly adopt a narrower definition of commencement, courts should bear in mind the potential threats to mineral owners' rights discussed throughout this Note and make an attempt to protect them as much as they can.