Opinion No. 41-3835

July 16, 1941

BY: EDWARD P. CHASE, Attorney General

TO: Mr. George A. Graham General Counsel State Land Office Santa Fe, New Mexico

*{*76}* By your letter dated July 8, 1941, you have requested an opinion from this office as to what the effect of our recent Supreme Court decision in State vs. Worden, 44 N.M. 400 (May 27, 1940) is upon the Attorney General's Opinion No. 1642, dated May 13, 1937, written by Fred J. Federici. You also inquire as to the authority of the Commissioner with respect to so-called implied covenants in oil and gas leases, namely, the covenants to: (1) reasonably develop, (2) adequately test for oil and gas, (3) offset to prevent drainage.

We deem it advisable to discuss at some length the decision in State vs. Worden, 44 N.M. 400. The facts in that case are as follows:

K obtained an oil and gas lease dated December 4, 1933, from the State of New Mexico upon two *{*77}* tracts of land. K assigned his lease on the 40 acre tract to O Company on April 30, 1935, and the O Company discovered oil on September 6, 1936. K, two and one-half months prior to the discovery of oil on the 40 acre tract, had assigned the 280 acre tract to one H, the assignment bearing date June 25, 1936. On March 17, 1937, H assigned his interest in a 40 acre tract of this 280 acre tract to S Company, the relator in this action, after discovery.

The Court refused to grant relator's writ of mandamus to compel the Land Commissioner to accept $ 40.00 cash rental on the ground that from the record before the Court, the relator had not reasonably developed the premises for oil and gas as required by an implied covenant in the original lease. The Court used these words:

"It appears from the record that four years have elapsed since the one well was developed on the lease, and relator has performed no developing work on the tract in suit. We are not apprised whether the Commissioner of Public Land claims that relator's implied covenant to use reasonable diligence to develop the land for oil and gas has been broken; and if so, whether he has given relator notice of his intention to cancel the lease for failure to comply with such implied covenant if the default was not remedied; nor whether such default, if made, has been remedied. We are, therefore, unable to say that relator's assignment of lease is in good standing, and that respondent should be compelled to receive the $ 40 tendered him."

Incident to its decision, however, the Court held that an assignee succeeded to and acquired all the rights and privileges of the assignor subject to express and implied covenants. The Court said:

"Looking to the lease, we find that after oil or gas is obtained from any part of the leased land in paying quantities, the lease continues in force so long as it is so produced, subject to the covenants we have mentioned."

In view of the foregoing we are of the opinion that the former ruling of the Attorney General should be amended to read as follows:

"Where production of oil and gas in paying quantities **in compliance with express and implied covenants of oil and gas lease** is made during the definite term of years upon the acreage retained in the mother lease.

(a) An assignment, which is perfected prior to such production upon the mother lease, **is** continued because of the production upon the mother lease **or upon an assigned portion of the mother lease.**

(b) An assignment perfected after discovery of production upon the mother lease is continued because of such production.

Where production of oil and gas in paying quantities **and compliance with express and implied covenants of oil and gas lease** is made upon the assignment during the definite term of years.

(c) The mother lease **is** continued because of the production upon the assignment.

(d) Such production upon the assignment thereby **continues** other assignments made before such discovery.

(e) Such production upon an assignment thereby continues *{*78}* other assignments from the mother lease made after such discovery."

In Merrill's 1926 Edition of "Covenants Implied in Oil and Gas Leases," the author discusses four obligations which are as follows:

"1. The implied covenant to drill an exploratory well.

2. The implied covenant to drill additional wells.

3. The implied covenant for diligent and proper operation of the wells if oil or gas is discovered in paying quantities.

4. The implied covenant to protect the leased premises against drainage by wells on adjoining land."

This author states that where there is no provision in a lease requiring the drilling of a well for oil and gas that courts will imply into the oil and gas lease a covenant running against the lessee in favor of the lessor, which covenant may be imposed to compel the

reasonable development of the leased premises for oil and gas. This covenant was not considered in the Worden case, supra, but likely would have been if there had not been a producing well upon the leased premises.

I am of the opinion that the Commissioner of Public Lands may impose this covenant under circumstances which reasonably warrant its imposition. If a lessee or his assignee refuses to comply, then the lease may be cancelled.

The next covenant has been read into oil and gas leases so as to put an additional burden on the lessee after a producing well has been obtained on the leased premises. This covenant required the drilling of additional wells or the adequate testing of the leased premises for oil and gas. It is the foregoing covenant which is discussed at length by our Supreme Court in the case of State vs. Worden, supra.

There can be no doubt but that the Commissioner of Public Lands may cancel an oil and gas lease for the lessee's or his assignee's failure to drill additional wells or adequately test the leased premises for oil and gas. This covenant should only be imposed when the situation reasonably warrants that it be imposed. The Court said in this regard, at page 406:

"Klingsmith's implied covenant in the original lease (to develop with reasonable diligence the undeveloped portion of the lease, after the discovery of oil or gas on any part of the leased land in paying quantities) the relator agreed to perform 'insofar as said described lands (land in suit) are affected.'

The relator, therefore, was obliged under the terms of its assignment, to proceed with such reasonable diligence as the facts and circumstances required, to perform the development work on the tract in question after oil and gas were produced in paying quantities in 1936 on another tract covered by the lease, considering the lease as a whole."

The next covenant, called the protection covenant, requires a lessee to protect the leased land by drilling offset wells to prevent drainage by wells on adjoining lands. The majority rule governing this covenant and the additional well covenant is that a lessee may be required to act in a particular situation when action is expected of an "operator of ordinary prudence." When the situation warrants, the Commissioner may cancel a lease when the lessee fails, after due notice, to do that which is expected of an "operator of ordinary prudence."

*{*79}* It is well to point out that the express lease covenant as to three hundred foot offset wells may be imposed in addition to the foregoing protection covenant. The questions of whether a lessee must offset every producing well upon adjoining land, regardless of production, and how close to the line the well must be to require an offset well, are governed by the foregoing text.

Trusting that the foregoing sufficiently answers your inquiries, I am