

# Commencement of Operations under Fee Oil and Gas Leases: the End of the Beginning, or the Beginning of the End?

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It's the eleventh hour of the day before your oil and gas lease expires. Will moving drilling equipment onto your leased lands, or lands pooled with those lands, be enough to hold the lease? Will spudding the well do the trick? How can a lessee recognize what counts as "commencement of operations" to keep its lease alive past the primary term?

In the majority of states, actual drilling is unnecessary, but plenty of other activities, "when performed with the bona fide intention to proceed with diligence toward the completion of the well, constitute a commencement or beginning of a well or drilling operations within the meaning of the lease." Courts have held, for example, that the requirement to commence drilling operations within a designated period of time could be satisfied by something less than drilling the wellbore itself. The "commencement of operations" requirement has also been satisfied by erecting a derrick, or by engaging in other work necessary to prepare the well site. In some commentators' view, hauling material onto the leased premises, digging a slush pit, staking out a drilling site and obtaining a drilling permit would probably satisfy the commencement of operations requirement in most states.

In *Wold v. Zavanna, LLC*, North Dakota followed the Eighth Circuit's conclusion that

the location of well sites, hauling lumber on the premises, erection of derricks, providing water supply, moving machinery on the premises and similar acts preliminary to the beginning of the process of drilling, when performed with the bona fide intention to proceed with diligence toward the completion of the well, constitute a commencement or beginning of a well or drilling operations within the meaning of the lease.

*Anderson v. Hess Corp.* *Anderson* followed the United States District Court in *Murphy v. Amoco Production Co.*, where drilling operations were held to commence when (1) work is done preparatory to drilling, (2) the driller has the capability to do the actual drilling and (3) there is a good faith interest to complete the well. In *Anderson*, the lessee surveyed and staked the well, obtained a drilling permit, built the well pad and widened the access road to the pad, drilled the rat hole for the main conductor pipe, moved

equipment to the location and drilled the mouse hole. The court found that that actual penetration by the drilling bit prior to the primary term expiration date was not required because the lessee performed work preparatory to drilling prior to the end of the primary term. Similarly, in *Wold*, the lessee had obtained all of the approvals necessary to commence drilling and had engaged in actual on-site construction activity preparatory to drilling, and since the well was eventually completed the good faith intention to complete the well was clear.

While the North Dakota examples likely represent the majority rule, in any jurisdiction, defining "operations" begins with the specific lease language. For example, if a lease specifically requires "drilling operations" but not "any other operations," some courts have held that actual drilling is required, not just drill site preparation activities. An oil and gas lease might contain a provision defining "drilling operations" specifically to include "placing of material upon the premises for the construction of a derrick and other necessary structures for the drilling of an oil and gas well followed diligently by the construction of such derrick and other structures and by the actual operation of drilling in the ground." In contrast, another lease might define "drilling operations" to be, generally, "any activity conducted on or off the leased premises that is reasonably calculated to obtain or restore production, including without limitation (i) drilling or any act preparatory to drilling (such as obtaining permits, surveying a drill site, staking a drill site, building roads, clearing a drill site, or hauling equipment or supplies); (ii) reworking, plugging back, deepening, treating, stimulating, refitting, installing any artificial lift or production-enhancement equipment or technique; (iii) constructing facilities related to the production, treatment, transportation and marketing of substances produced from the lease premises; (iv) contracting for marketing services and sale of Oil and Gas Substances; and (v) construction of water disposal facilities and the physical movement of water produced from the leased premises." Still other lease offers considerably less guidance, providing that "any operations reasonably calculated to obtain production" will suffice. Thus, a fact-dependent inquiry into whether the requirement has been met becomes one largely based on the court's interpretation of the lease language.

In Wyoming, "commencement of operations" requires a good faith intention to proceed diligently with the work of drilling a well to completion. Good faith can be shown by execution of a surface damage agreement, since it evidences an intention to drill a well. In *Fast v. Whitney*, the court expressed doubt as to any reasonable distinction between commencing operations or commencing drilling operations, under a provision in an oil lease for commencing work within a specified time. Ordinarily, at least, the court reasoned that a lease provision requiring commencing operations would refer to operations for drilling a well; in other words, drilling operations.

Departing from the majority rule, Montana courts have distinguished between "commence operations," held to include preliminary work necessary to actual drilling (when not otherwise defined in the lease), and "commence drilling operations," specifically meaning the spudding in of a well. In *Solberg v. Sunburst Oil & Gas Co.*, the court construed the phrase

"commence drilling operations," concluding that the phrase, properly interpreted, means "the first movement of the drill penetrating the ground." In other words, under *Solberg*, "drilling operations" require more than just spudding in the well and do not begin until the drilling rig bit actually penetrates the ground. Kansas courts, also adhering to a narrower reading of the commencement requirement, offer a more marked exception to the majority rule. In *Hall v. JFW Inc.*, the Kansas Court of Appeals held that a lease requiring the lessee to "commence to drill a well" within the primary term had expired where no drilling rig was in place, in spite of a catalog of preliminary activities performed on the well site prior to the expiration date. Although case law in Kansas "hints that something less than [sic] actual drilling might satisfy a requirement of the 'commencement of drilling,'" Kansas courts nevertheless have refused to apply equity in these cases.

In deciding what activities related to drilling will be important to keep an oil and gas lease alive, it goes without saying that the lease language itself is the critical starting point, followed by a solid understanding of how your state will likely interpret that language. Knowing any particular requirements well in advance of the lease expiration may eliminate a rushed and scrambled drilling setup, possibly insufficient under some leases, before the death knell tolls.

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