

PRESENTED AT

Fundamentals of Oil, Gas and Mineral Law

April 13, 2023
Houston, TX

The Oil & Gas Lease, Part III: Implied Covenants

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IMPLIED COVENANTS¹

Implied covenants are obligations that are not expressly imposed by a contract, but which courts nevertheless find are binding on one or more parties to the contract.² Courts in Texas and other states routinely hold that oil and gas lessees are bound by several implied covenants. This paper begins by discussing the reason that implied covenants exist, then it reviews the various implied covenants that courts have recognized, as well as a number of issues that can arise in implied covenant disputes, such as the elements necessary to establish a breach of an implied covenant, defenses, and remedies that are available. The paper emphasizes Texas law, but is not limited to it.

I. History of and justifications for implied covenants

For more than 100 years, courts in Texas and elsewhere have held that mineral leases contain various implied covenants—that is, obligations that are not expressly stated in a lease, but which are nevertheless binding on lessees. For example, in 1891, the Texas Supreme Court declared that a person holding a mining lease had an implied duty to reasonably develop the leased premises.³ In 1904, a Texas appellate court stated that an oil and gas lessee had an implied duty “to explore and develop the land with diligence.”⁴ And in 1919 the Texas Supreme Court recognized that oil and gas leaseholders are bound by implied covenants.⁵

¹ Portions of this paper are adapted from the author’s prior papers and articles on implied covenants, including papers prepared in connection with Rocky Mountain Mineral Law Foundation events. *See also* Keith B. Hall, *Implied Covenants and Changing Technology*, Proceedings of the 60th Annual Mineral Law Institute (2013); Keith B. Hall, *The Application of Oil & Gas Lease Implied Covenants in Shale Plays: Old Meets New*, Proceedings of the 32nd Annual Energy and Mineral Law Institute (2011); Keith B. Hall, *Implied Covenants: Claims Under Mineral Code Article 122*, Proceedings of the 57th Annual Mineral Law Institute (2010); Keith B. Hall, *The Continuing Role of Implied Covenants in Developing Leased Lands*, 49 Washburn L.J. 313 (2010).

² Black’s Law Dictionary (6th edition 1990) defines “covenant” as an agreement or promise, and an “implied covenant” as one which may reasonably “be inferred from the whole agreement and conduct of the parties.” *See also* Johnson v. Gurley, 52 Tex. 222, 226 (1879) (“A covenant is an agreement duly made between the parties to do or not to do a particular act.”); Landscape Design and Const., Inc. v. Harold Thomas Excavating, Inc., 604 S.W.2d 374, 376 (Tex. App.—Dallas 1980) (“A covenant ... is an agreement to act or refrain from acting in a certain way.”).

³ Benavides v. Hunt, 15 S.W. 396, 401 (Tex. 1891).

⁴ J.M. Guffey Petroleum Co. v. Oliver, 79 S.W. 884, 888 (Tex. Ct. Civ. App. 1904). *See also* J.M. Guffey Petroleum Co. v. Jeff Chaisson Townsite Co., 107 S.W. 609, 612 (Tex. Civ. App. 1907) (lessee had implied obligation “to use reasonable diligence and care to develop and protect the property, and this obligation required it to sink as many wells as the exercise of such diligence and care would suggest under the circumstances”).

Guffey Petroleum, whose first operations were conducted in south Texas, would later become Gulf Oil. *See* Anthony Sampson, THE SEVEN SISTERS: THE GREAT OIL COMPANIES & THE WORLD THEY SHAPED 37-40 (1975); Daniel Yergin, THE PRIZE: THE EPIC QUEST FOR OIL, MONEY & POWER 71-6 (1991)

⁵ Grubb v. McAfee, 212 S.W.2d 464, 465-6 (Tex. 1919).

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First appeared as part of the conference materials for the
2023 Fundamentals of Oil, Gas and Mineral Law session

"The Oil and Gas Lease, Part III: Implied Covenants"