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Audrey W. Taylor, Et Al. And Joseph Fazzio v. Phillips Petroleum Company, A Delaware Corporation, Et Al. : Reply Brief of Appellants

IN THE SUPREME COURT

OF THE STATE OF UTAH

AUDREY W. TAYLOR, et al.,

Plaintiffs-Appellants,

vs.

PHILLIPS PETROLEUM COMPANY, a Delaware corporation, et al.,

Defendants-Respondents.

JOSEPH FAZZIO, et al.,

Plaintiffs-Appellants,

vs.

PHILLIPS PETROLEUM COMPANY, a Delaware corporation, et al.,

Defendants-Respondents.

Consolidated Cases

No. 19160

and

No. 19161

REPLY BRIEF OF APPELLANTS

Appeal from the Judgment of the
Seventh Judicial District Court,
Uintah County, State of Utah,
The Honorable Richard C. Davidson, Judge

HUGH C. GARNER
NICHOLAS F. McKEAN
RANDY K. JOHNSON
HUGH C. GARNER & ASSOCIATES, P.C.
310 South Main Street, Suite 1400
Salt Lake City, Utah 84101
Attorneys for Plaintiffs-Appellants

DAN L. SULLIVAN
VAN COTT, BAGLEY, CORNWALL & McCARTHY
50 South Main Street, Suite 1600
Salt Lake City, Utah 84144
Attorneys for Defendant-Respondent
Phillips Petroleum Company

IN THE SUPREME COURT

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W. TAYLOR, et al., Plaintiffs-Appellants, v. PHILLIPS PETROLEUM COMPANY, a Delaware corporation, et al., Defendants-Respondents.	Consolidated Cases No. 19160 and No. 19161
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HUGH C. GARNER & ASSOCIATES, P.C.
510 South Main Street, Suite 1400
Salt Lake City, Utah 84101
Attorneys for Plaintiffs-Appellants

[illegible] McNEILL & McCARTHY
[illegible] Street, Suite 1400
[illegible], Utah 84144
[illegible] Defendant-Respondent
[illegible] Petroleum Company

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IN THE SUPREME COURT

OF THE STATE OF UTAH

[illegible] W. TAYLOR, et al., Plaintiffs-Appellants, v. PHILLIPS PETROLEUM COMPANY, a Delaware corporation, et al., Defendants-Respondents.	Consolidated Cases No. 19160
JOSEPH FAZZIO, et al., Plaintiffs-Appellants, v. PHILLIPS PETROLEUM COMPANY, a Delaware corporation, et al., Defendants-Respondents.	and No. 19161

REPLY BRIEF OF APPELLANTS

I. RESPONDENT'S STATEMENT OF FACTS RAISES FACTUAL ISSUES

From the Statement of Facts of the appellants' brief and in the respondent's brief, it is clear that there is a disparity between the versions of the facts of the respective parties in this case. Since this is an Appeal from a Motion to Dismiss under Rule 12(b)(6) of the Utah Rules of Civil Procedure these factual disputes preclude [illegible] of the appellant-plaintiffs' case as a matter of course.

It is not the nature of this reply brief to review these factual disputes. However, a reply should be made to certain factual misconceptions which are contained in the respondent's brief.

Respondent makes note of, "Appellants' curious decision to make two lawsuits out of this dispute instead of one." Quite simply, two lawsuits were brought because of the facts. Certain lands were leased by the respondent. Part of these lands were excluded from participating in royalties from the Roosevelt Unit. The non-participating lands were subject to a different, superseding lease, which was entered into by the parties more than two years after the lands were excluded from the participating area. Since there is a very different factual situation which concerns only these non-participating lands, a separate action was filed for them in the court below.

Certain statements and matters which are stated in respondent's Statement of Facts indicate that the respondent appears to be laboring under misconceptions of the facts.

Respondent first states that the 1946 lease entered into by the parties is different in the real property which the 1945 leases covered. While this is literally true, it distorts what actually happened. The 1945 leases executed by Wilford L. Whitlock, et ux (R.55) and Leslie B. Taylor, et ux, (R.60) cover lands in [illegible]

... in Township 1 South, Range 1 East and lands in Sections 23 and ... of Township 1 South, Range 1 West all in the Uintah Special Meridian. The 1946 lease only covers those lands in Section 24. Exhibits to the Roosevelt Unit Agreement (which were omitted from the respondent's Exhibit "A" to its Motion to Dismiss but which are verified in one of the agreements of March 11, 1952, R.148) indicate that at the time respondent obtained the 1946 lease on the lands in Section 24 owned by the appellants and their predecessors in interest, it also obtained leases on these other sections contained in the 1945 leases. In effect what it did was consolidate two leases into three leases.

Although it is true that the actual delay rental paid on the 1946 lease is less than what was paid on the 1945 leases, there was no change in the rate at which the delay rental was paid, i.e. 25¢ per acre. Respondent was required to pay that delay rental on all these other lands which it purported to lease in 1945 and attempted to lease again in 1946. Respondent's conclusion that the 1946 lease vastly differs from the 1945 leases just is not true.

Another misconception in respondent's statement of facts is found on page six of its brief, wherein it states that the revision of the initial participating area of the Roosevelt Unit, contracting the ... to exclude the lands in question was effective February 1, 1952, ... six weeks later the appellant, Audrey W. Taylor, her husband ... executed an agreement ratifying the terms of the unit

agreement. This is not entirely correct. The application for approval of the first revised participating area for the Green River Formation (R.122) indicates that the application was not submitted until November 28, 1952, and only approved by the United States Geological Survey on January 13, 1953. At the time the appellant and other lessors entered into the agreement, the application had not even been prepared.

Respondent mentions an agreement dated March 11, 1952, whereby the lessors ratified the unit agreement. However respondent neglects to mention another agreement of that date between the parties which indicates that, "Notwithstanding the provisions of the unit agreement ... unless lessee shall on or before November 12, 1952 commence or cause to be commenced operations for drilling a well ... [on the leased property], the said lease shall terminate." (R.122). Certainly the existence of this second agreement is relevant to the issues raised in the third cause of action of that case (Case No. 19161) which involves the non-participating lands.

This action revolves around the central fact that for over 37 years respondent has failed to develop certain lands it purports to hold under lease. This is in spite of covenants implied in the lease and the second agreement of March 11, 1952, which expressly modified the term of the lease and the unit agreement requiring the development of the property within a few short months.

II. THE ADDITION OF MATTERS OUTSIDE THE PLEADINGS PRESENTED IN A MOTION UNDER THE CIVIL RULE 12(b) DOES NOT ALTER THE BURDEN THAT MUST BE BORNE BY THE RESPONDENT TO PREVAIL ON ITS MOTION TO DISMISS.

In an untitled portion of respondent's argument, respondent appears to imply that because matters outside the pleadings were considered, and requested by the court below in ruling on respondent's Motion to Dismiss, there exists a different burden which the respondent must meet to prevail on its Motion to Dismiss under Rule 12(b). This is just not the case. Questions of fact may not be resolved without a trial in any circumstance. As stated by the United States Supreme Court:

> According to Rule 12(b) and its associated Rule 56, summary judgment may be rendered only if there are no genuine issues of fact to be resolved. The judgment is authorized only where the moving party is entitled to judgment as a matter of law, where it is quite clear what the truth is, and that no genuine issue remains for trial. Sartor v. Arkansas Gas Corporation, 321 U.S. 620, 623, 64 S. Ct. 724, 88 L. Ed. 967. 2A Moore's Federal Practice, Paragraph 12.09 at 2311.

This court, in Holbrook Company v. Adams, 542 P.2d 191 (Utah 1975) has considered this issue in a situation procedurally similar to the present. There, a complaint was filed to recover the value of work and materials supplied to a private liquor club. A verified motion to dismiss was filed whereby the defendant claimed that the defendant did not enter a contract with the plaintiff for the

In response to the motion, plaintiff filed an affidavit signed by its president alleging certain facts which would raise an issue as to whether or not the defendant contracted for the services. The trial court dismissed, but granted the plaintiff ten days to refile its complaint. The plaintiff appealed.

This court was unable to distinguish whether the trial court ruled under Rule 12(b)(6) or Rule 56, but stated that the mere existence of factual issues precluded summary disposition of the case without trial:

> It is not the purpose of summary judgment procedure to judge the credibility of averments of the parties, or witnesses, or the weight of evidence. Neither is it to deny parties the right to a trial to resolve disputed issues of fact. Its purpose is to eliminate the time, trouble and expense of trial when upon any view taken of the facts as asserted by the party ruled against, he would not be entitled to prevail. Only when it so appears, is the court justified in refusing such a party of the opportunity of presenting his evidence and attempting to persuade the fact trier to his views. Conversly, if there is any dispute as to any issue, material to the settlement of the controversy, the summary judgment should not be granted. (At 193)

See also Bekins Bar V Ranch v. Utah Farm Production Credit Association, 587 P.2d 151 (Utah 1978); Harvey v. Sanders, 534 P.2d 905 (Utah 1975)

III. RESPONDENT'S ARGUMENTS DO NOT SUPPORT DISMISSAL OF THOSE CAUSES OF ACTION RELATIVE TO RESPONDENT'S BREACH OF IMPLIED COVENANTS

A. Inconsistent Causes of Action in the Complaint are Acceptable under Utah Rules of Civil Procedure.

In Section IA of respondent's brief, it is stated that

appellants' claims based on the implied covenants are "fundamentally inconsistent" with appellants' other claims that the lease had terminated or was never actually, lawfully in existence. The appellants have no quarrel with the fact that its claims are inconsistent with each other, but questions the relevance respondent's argument at the present stage of the proceedings. The motion brought below was a Motion to Dismiss the complaint. Under the Utah Rules of Civil Procedure, inconsistent pleadings may be made and no election is required between them at the pleading stage of the proceedings.

Rule 8(e)(2) of the Utah Rules of Civil Procedure states:

> A party may set forth two or more statements of a claim or defense alternatively or hypothetically, either in one count or defense or in separate counts or defenses. When two or more statements are made in the alternative and one of them if made independently would be sufficient, the pleading is not made insufficient by the insufficiency of one or more of the alternative statements. A party may also state as many separate claims or defenses as he has regardless of consistency and whether based on legal or equitable grounds or both. All statements shall be made subject to the obligations set forth in Rule 11.

Professor Moore comments, with respect to the Federal Rules of Civil Procedure, upon which the Utah Rules are modeled, "Alternative or hypothetical pleading by its very nature is inconsistent. This, however, is not a valid objection under Rule [illegible]" 2A Moore's Federal Practice paragraph 8.32 at 8-290.

cf Rosander v. Larsen, 14 Ut. 2d 1, 376 P.2d 146 (1962).

B. Notice of Respondent's Breach of Implied Covenants is a Factual Question, not subject to Summary Disposition by the Court Below.

Respondent, by way of a string citation, states a general principle that notice of breach of implied covenants, and opportunity to cure, is required before the termination of any oil and gas lease. Reference is made to the the appellants' brief for the argument that the question before the Court is not the necessity of notice, but the sufficiency of notice, which is a factual issue, not subject to summary dismissal under either Rule 12(b) or Rule 56.

The affidavit of Joseph Fazzio (R.122) indicates the he was in contact with employees of the respondent and that through his communications he notified them that respondents should release any claims to the leased property excluded from the unit because of respondent's failure to develop it.

Referring specifically to the letter of Carl Noel (R.151), Mr. Noel goes through quite a lengthy narrative of the history of the lease to indicate why he feels that Respondent's treatment of appellants was not in good faith. Even in this letter, which the respondent claims gives no notice of its breach of the implied covenants, Mr. Noel closes his letter by stating:

> Three of the original lessors of these lands are now deceased without having the benefit of development which they hoped to see. Their

> heirs deserve better treatment. They deem your course of action to be actionable, outrageous conduct. I doubt that your conduct has been in good faith and fair dealing that the court had in mind in the Peterson case. (Emphasis added). (R.155)

Certainly this statement indicates dissatisfaction with respondent's failure to develop the lands it claims to hold under lease. This responsibility to develop alluded to in the Noel letter is the same responsibility to develop the leasehold premises implied in the lease. Case law cited in the appellants' brief indicates that the specificity which respondent claims is required to put it on notice of its breach of the implied covenants is not necessary if the facts indicate that the breaching party was aware, or should have been aware, of its breach. A failure to develop certain lands which are purported to be held under lease for over thirty years would seem to give respondent, a very large oil company, notice that it may not be meeting its responsibilities implied in the lease. The mere fact that it made delay rental payments for over thirty years on this parcel of land would call attention to the fact that it was purporting to hold these lands not really by production, but by a technical loophole which respondent now claims to be created by certain provisions in the lease as affected by certain other provisions in the unit agreement.

Even without all the evidence outlined above that notice of respondent's breach was given to it, the Federal District Court for District of Kansas has ruled that proof of actual notice in this

type of case is not necessary. Judge Sam A. Crow, in Amoco Produc. Co. v. Douglas Energy Company, et al., Civil No. 82-1865 (filed February 11, 1983) denied Amoco's Motion to Dismiss which is very similar to respondent's in this case. (A copy of the Memorandum and Order filed by the court is attached hereto for the convenience of the court and respondent). In that case Amoco leased many parcels of property from a large number of lessors for over 35 years. It produced natural gas from the property but had failed to drill into deeper strata where there existed proven natural gas reserves. Douglas Energy top-leased many of these parcels. Amoco sued Douglas, and Douglas, together with many land owners, counterclaimed, requesting an adjudication that Amoco had breached its implied covenants for further exploration and requested an order terminating leases as to these deeper strata. There is no allegation on the part of the counterclaimants that notice had been given to Amoco of its breach. Amoco's motion was centered on alleged lack of notice of its breach.

Judge Crow denied Amoco's Motion to Dismiss on the grounds that the land owners' notice would have been futile and that 35 years without exploration was sufficient. The court rejected Amoco's assertation that any production under the lease holds all the lease.

As to the question of notice the court stated:

> A demand for performance, however, may be excused when it appears it would be futile. See 5 Kuntz, A Treatise on the Law of Oil and Gas, §62.4 (1978). See also Howarton v. Kansas Natural Gas Co., 81

> Kansas 553, 106 P.47, (1910, reversed on other grounds, 82 Kan. 367, 108 P.813 (1910)). Memorandum decision at 7-8.

The court concluded:

> Defendants are entitled to the opportunity to trial to satisfy waiver of the demand requirement by showing a manifest intention on the part of Amoco not to undertake further development or exploration. (Memorandum decision at 9).

See also United States v. City of Pawhuska, 502 F.2d 821 (10th Cir. 1974). The affidavit of Joseph Fazzio and all the materials from the file of the Roosevelt Unit, and the actual existence of the release of the 1954 lease indicate that respondent had no intention of developing the property and that any additional requests that respondent perform were futile.

c. The Unitization Clause Contained in the 1946 Lease Does Not Preclude Suit for Breach of Covenants Implied in the Lease.

Respondent asserts a fairly novel position that paragraph 12 of the oil and gas lease executed by the appellants and their predecessors in interest, which is a standard Producers 88 lease form, precludes an action against respondent for its breach of the covenants implied in the lease to develop the known oil and gas producing formations and to explore further others.

Paragraph 12 of the lease states that the terms of the lease will be modified to conform with the terms, conditions and provisions of the unit plan. Paragraph 16 of the unit agreement states:

> The development and operation of the land subject to this agreement under the terms and the continued

> operation of the well or wells now drilled or drilled in the unit area shall be deemed full performance of all obligations for development and operation with respect to each and every part or separately owned tract subject to this agreement.

The land subject to the unit agreement include only "land committed to this agreement." Since the contraction of the unit, the lands covered by Case No. 19161 were not within the unit and therefore not subject to the agreement. Development and operation of lands retained within the unit certainly cannot be seen to be "full performance of all obligations for development and performance" on non-participating lands.

Respondent, by introducing this issue at this time, also raises additional factual questions as to whether or not respondent has met "full performance of all obligations for development and performance" under the unit agreement. If full performance provides respondent with a defense to the action for breach of the implied covenants, then the burden is on respondent to prove full performance has been rendered.

Paragraph 9 of the unit agreement outlines an involved program for unit development. This factual issue cannot be discussed at this point simply because of the difficulty of addressing it at the appellate level. It does not appear that the respondent has filed an affidavit claiming that it, or its successors and assigns, have performed all the requirements for development under the unit

agreement. In a letter obtained from the files of the United States Geological Survey (R.229) dated June 30, 1954, from the USGS to Carter Oil Company, then unit operator for the Roosevelt Unit, it appears that a plan for development was rejected because of a failure to properly develop the unit. As stated in the letter:

> We advised you in approving the temporary plan of January 11 and in our letters of March 5 and 26 that some drilling should be done this year to correct the inequities in the participation and to further develop this large unit area. This has also been mentioned orally and in connection with other unit areas; although, we consider the Roosevelt situation the most noticeable and critical. Hence, I believe you understand the situation. ... .
>
> This Survey has been quite liberal in granting extensions of time for drilling of additional test wells seeking a discovery; also in considering the need for further geologic and engineering studies, market, climatic, and other conditions under which discoveries have been made. However, it becomes more apparent all the time that such benefits are favorable mainly to the working interest owners and usually are detrimental to the royalty and other interests, who are penalized by the slower development. Such parties have sometimes in the past, and may be more inclined in the future to refuse to commit their interest to unit agreements... .
>
> When a unit area is developed to the point where the unit operator feels that further development is not necessary, the area should be contracted to improve the limits of the participating area by reasonable 40-acre subdivisions. There is no justification for keeping all the lands outside the participating area subject to the unit agreement. If the operator does not wish to drill the land, he should surrender those rights within a reasonable time in order that someone else may have an opportunity.

The gist of the fifth and sixth causes of action in Case No. 19161 and the third and fourth causes of action in Case No. 19160 is that respondent has not acted reasonably and responsibly in developing its leasehold interest. No response has been made to these allegations other than to question whether or not notice of respondent's breach of implied covenants has been given. The appellants should be given the opportunity to discover through the means supplied under the rules of civil procedure whether or not the unit operator, who was the agent for the respondent in the development of the unit area, complied with the requirements for unit development. Even under respondent's arguments, without compliance with the unit development plan the implied covenants contained in the lease are still in effect.

The Tenth Circuit Court in Phillips Petroleum Co. v. Peterson, 218 F.2d 926 (10th Cir. 1954) found that these implied covenants still bind this particular respondent, despite the respondent's interpretation of the lease and unit agreement. The court there noted that the potential for abuse by the lessee is enormous when a lease has been joined to a unit. Because of this, the lessee's obligation for reasonable development remains as to the acreage which does not participate in the unit. Somers v. Haines Trust and Savings Bank, 566 P.2d 775, 779 (Kan. App. 1977).

The Tenth Circuit Court has stated:

> The practice of unitization by a power granted the Lessee in advance, if faithfully carried out, will be fair and profitable both to the lessor and the Lessee, and is vital to the oil and gas industry in the interest of conservation of both natural and material resources. It should be upheld, although the grant of power is in general terms, because it is subject to implied terms that will prevent arbitrary and unfair dealing, will require compliance with the implied covenants in the lease for the benefit of the Lessor and will impose a rigid standard of good faith on the part of the Lessee. Peterson, supra. at 933.

Respondent claims that the terms of the lease, as affected by the unit agreement, preclude appellants from bringing any action for breach of implied covenants to develop and further explore. No citation of authority is contained in respondent's argument on this point. It is clear from the cases cited above that the courts differ with respondent on this point. It should be noted that this argument also raises additional issues of fact which must be addressed only by the trier of facts.

2. The Judicial Ascertainment Clause is not Relevant at this Point in the Proceedings.

Another argument introduced by the respondent in its brief is that the judicial ascertainment clause contained in the 1946 lease precludes termination by the court of the lease on account of respondent's breach of the implied lease covenants. First, it should be noted that those causes of action requesting termination and cancellation of the lease on the basis of breach of the implied

covenants also contain a request for damages. The judicial ascertainment clause only affects forfeiture and cancellation.

Secondly, the judicial ascertainment clause requires a fin adjudication as to whether or not there exists a failure to perform the part of the respondent. Judicial economy requires that the determination be made, allowing a reasonable time for cure or forfeiture, in a single proceeding.

Finally, in certain situations, such as the present, where the lessee's breach of its implied covenants is in bad faith, the court should not allow the lessee to shield its inactivity behind the judicial ascertainment clause. As stated by Professor Merrill:

> Particular applications of the judicial ascertainment clauses may be invalid. For instance, they ought not to apply where the lessee has been guilty of such fraudulent or oppressive conduct as to destroy confidence which must be the basis of a proper relationship between the lessor and the lessee. Likewise, they should be invalid in so far as they attempt to relieve the lessee from liability of damages where the alternative decree will not afford the lessor full recompense for the lessee's wrongful conduct. Merrill "Lease Clauses Affecting Implied Covenants," Southwestern Legal Foundation, Second Annual Institute on Oil and Gas Law and Taxation, 141 at 187 (1951) quoted in 4 Williams, Oil and Gas Law, §682.4, n.5 at 366.

Texas courts, which are quite experienced in matters simila to the present one, have rejected judicial ascertainment clauses, stated in Frick-Reid Suuply Corp. v. Meers, 52 S.W.2d 115, 118 (Tex.Civ.App. 1932):

"We think this stipulation is void. If its terms

> were observed, Meers and wife would be required to file a suit in the district court for the purpose of adjudicating the questions as to whether there had been a breach of any implied obligation and whether oil and gas was being produced in paying quantities. By the terms of the stipulation, that would end the suit, even though the facts should be determined against the lessees. The court would be precluded from rendering judgment upon such findings. Except in certain instances prescribed by statute, courts do not try cases by piecemeal ... . Observance by the court of the terms of this stipulation would require a trial in which only the facts named in the stipulation could be judicially ascertained. Upon the determination of such facts, the lessee, according to the stipulation, is given a reasonable time thereafter to comply with his obligations or surrender the lease, reserving any producing well and ten acres surrounding it. This would require at least two trials and two final judgments. It would require, contrary to the provisions of article 2209, a postponement of the rendition and entry of the judgment upon the facts ascertained, subject to the option and caprice of the lessee. Agreements relating to proceedings in civil cases and involving and providing for anything inconsistent with the full and impartial course of judgment therein are illegal ... . While both common-law and statutory arbitrations are favored by the courts, and questions of fact may be conslusively settled in that way, the parties cannot by original contract or otherwise convert the trial and appellate court into mere boards of arbitration."

The judicial ascertainment clause should not be allowed to be used as a device to protect respondent when respondent acts in bad faith. Likewise, it should not be used to wear down the appellants with multiplicity of actions.

IV. DISMISSAL OF THE FIRST CAUSE OF ACTION IN BOTH CASES WAS ERRONEOUS ON THE BASIS OF THE LOWER COURT'S RULING AND RESPONDENT'S SUPPLEMENTING THEORIES.

A. The First Cause of Action Involves Several Factual Issues Unresolvable by Summary Disposition.

In its argument claiming that the first cause of action fails to state a claim against it, respondent ventures into factual issues. Respondent states that the 1945 leases and the 1946 lease were significantly different. According to the respondents, the real reason for entering into the 1946 lease was to enable the parties to strike a different deal. "Appellants predecessors plainly wanted to enter into the 1946 lease, because they did it." (Respondent's Brief at 21. Emphasis in the original). In light of the history surrounding the execution of the 1946 lease contained in the letter of Carl Noel to a vice president of the respondent, (R.151), it appears that agents for the respondent approached the appellants and their predecessors in interest requesting a second lease, claiming that since the seismographic work had been done, which was required under the lease of 1945, respondent wished to obtain a correcting lease omitting this clause.*

Certainly the question of whether or not the appellants and their predecessors wanted to enter into the 1946 lease is a questi-

* The court in Phillips Petroleum Company v. Peterson, supra, substantiates this:

> Phillips completed its seismographic work and having determined that the leaseholds lay within a favorable structure, proceeded to take correction leases where there were minor errors in the original leases.

of fact, not to be summarily disposed of before proper procedural and evidentiary steps had been taken.

Respondent claims that its capacity or lack of capacity to enter into binding leases in the State of Utah in 1945 is far from certain, implying that it was engaged in only "a few isolated transactions". (Respondent's Brief at 23-24). The facts clearly indicate the opposite. Rather than being engaged only in "a few isolated transactions" the respondent was actively involved in leasing a large portion of the mineral interests in the Uintah Basin. Phillips Petroleum v. Peterson, supra at 928-929. By obtaining interests in oil and gas leases respondent was certainly "doing business" in the State of Utah.

However, the relevancy of this issue is questionable. The law enacted and operative at that time states:

> [e] Every contract, agreement and transaction whatsoever made or entered into by or on behalf any corporation [failing to comply with the provisions of Sections 18-8-1 and 18-8-2] or to be executed or performed within this state shall be wholly void on behalf of such corporation and its assignees and every person deriving any interest therefrom ... . (Section 18-8-5 UCA 1933 Emphasis added).

Although stressed in the appellants' brief, it appears it needs to be emphasized again that when a contract is deemed to be void, it is "null, ineffectual, nugatory, having no legal force or binding effect, unable in law to support the purpose for which it was intended". Black's Law Dictionary at 1745.

If the statute states that any contract or transaction entered into by a corporation which has not qualified itself to do business within the state is "wholly void," then that transaction, is a nullity and cannot be ratified. Therefore, the 1946 lease cannot, by itself, revitalize the 1945 leases without the express intention on the part of the lessors that it do so.

Respondent attempts to imply that because the statute was amended in 1961, the legislature has indicated that it had a different intent. As mentioned above, and in the appellants' first brief, the fact that a transaction or contract is void, not voidable, means that breath cannot be blown into it to give it life. It cannot be ratified without an express indication by the legislature of an intention to so. This follows Utah Code Ann. §68-3-3 (1953) which states, "No part of these revised statutes is retroactive, unless expressly so declared." See also, Ferrel v. Pingree, 5 Ut. 443, 16 P. 843 (1888).

B. Failure to Allege a Duty to Speak is not Grounds for Dismissal of the First Cause of Action with Prejudice.

Respondent complains that there was no allegation contained

it with a duty to disclose the fact that it had obtained the 1945 leases while it was not authorized to do business in the State of Utah. According to the respondent's interpretation, the appellants' failure to plead this should result in the dismissal of the cause of action.

Rule 8(e)(1) of the Utah Rules of Civil Procedure states: "each averment of a pleading shall be simple, concise, and direct. No technical forms of pleading or motions are required." Rule 8(f) goes on to state, "all pleadings shall be so construed as to do substantial justice."

In referring to the concept that fraud should be plead with particularity, Professor Moore states:

> There appears a tendency to allow great leniency where issues are complex, or the transactions involved cover a long period of time.
>
> The requirement of particularity does not abrogate Rule 8, and it should be harmonized with the general directives in subdivisions (a) and (e) of Rule 8 that pleadings should contain a "short and plain statement of the defense" and that each averment should be "simple, concise and direct." 2A Moore's Federal Practice, Paragraph 9.03 at 9-28.

If there has in fact been a failure to plead all elements of fraud with particularity, then the proper motion is not a motion to dismiss, but a motion for a more definite statement under Rule

The Appellants have Standing to Maintain a Cause of Action Sounding in Fraud.

Because two of the appellants were not original signors of

the 1945 leases and the 1946 lease, respondent claims that they have no standing. Respondent admits that one of the appellants, Audrey M. Taylor, was an original lessor. Maxine Taylor Fazzio is her daughter and Joseph Fazzio is Maxine's husband. The appellants have actually inherited the property, rather than purchased it.

But respondent's argument of lack of standing indicates a failure to recognize or understand the true basis of the action for fraud. Fraud negated the intent necessary for the appellants and their predecessors to enter into and deliver a new lease in 1946. Bowman v. Cottrell, 15 Ida. 221 96 P. 936 (1908). They were not aware of certain facts, known to the respondent, which were material to the appellants' and their predecessors', decision to execute the 1946 lease. There was no present intent at that time on the part of the appellants and their predecessors in interest to execute a new lease, they merely intended to correct certain "minor errors" as indicated in Phillips Petroleum Co. v. Peterson, supra.

V. THE 1946 LEASE WAS NOT OPERATIVE, INDEPENDANT OF THE VOID 1945 LEASES.

Respondent claims that the 1946 lease, by its terms, clearly indicates the intention of all parties to replace the 1945 leases with the 1946 lease. This is a factual issue. The Peterson case, supra, and the letter of Carl Noel (R.151) raise factual issues about the

parties' intention in executing the 1946 lease. Exactly what the 1946 lease was (that is, whether it was a corrective lease, merely correcting mistakes in the 1945 leases, or was a completely new lease, independent on its own) is unclear from the words contained therein. "Correction" and "in lieu of" together create this ambiguity. Appellants' Brief at 27 and 28).

VI. THE 1946 LEASE WAS ABANDONED OR SURRENDERED BY RESPONDENT'S ACCEPTANCE OF THE 1954 LEASE AND ITS SUBSEQUENT RELEASE.

The amended complaint, in the Third Cause of Action in Case No. 19161, alleges that respondent's interest in the lands excluded from participating in the Roosevelt Unit were merged into a 1954 lease which was released a year later by the respondent. The respondent questions why, if this in fact happened, was no action brought from 1955 until the present challenging respondent's claim. As is evident from the affidavit of Joseph Fazzio, the appellants were not aware that the respondent claimed an interest in the non-participating lands covered by Case No. 19161. (R.122, paragraph 2). It is obvious that appellants believed that the 1955 release released respondent's interest in these non-participating lands.

Respondent goes on to raise questions concerning appellants [illegible] of rental checks on these parcels. Again, this is a [illegible] of fact. Were appellants aware from these rental checks that rental checks covered the non-participating lands?

The respondent claims that the law "will not compel mer... of the estates or it is not in the interests of the party unless t... is an intention on the part of the parties that merger exists." (Respondent's Brief at p.31). As indicated in the appellants' brie... (at 33) this is a question of fact.

At no time in the entire proceedings has the respondent attempted to explain the existence of the 1954 lease. If respondent held an interest in the non-participating lands, why did it feel compelled to enter into a fairly restrictive lease with the lessors If there is any question of intent, it should be fairly clear that parties intended that any leasehold interest the respondent held in the non-participating lands was merged into the 1954 lease, and that this lease evidenced the rights and obligations of the parties as t... these non-participating lands.

The issue of surrender is not even addressed by the respondent. Respondent merely states that since this is a "new" theory, the court is precluded from addressing it. Respondent itself has raised in its brief for the first time its theories concerning ... judicial ascertainment clause and the preclusion of an action for breach of the implied covenants by reason of paragraph 12 of the ... and operation of the unit agreement.

The issue of surrender is certainly not new to this ... Abandonment and surrender of the lease were ... in ... of the appellants in response to the original Motion to Dismiss.

Attention should again be drawn to the fact that this jurisdiction employs rules of civil procedure which provide for notice pleading. The situation before this court is not one where the battle lines have been clearly drawn by the adversarial proceedings. There has been no answer to the amended complaint, no discovery has been made, and no trial has been allowed to the appellants on this matter. As such, respondent's claim that this court cannot consider the question of whether or not the 1946 lease was surrendered by virtue of respondent's acceptance of the 1954 lease, even though those facts were contained in the amended complaint, is not in accordance with underlying principles and rules governing civil procedure in this state.

Referring to the federal rules which are identical to the Utah Rules of Civil Procedure in this matter, it has been said:

> The federal rules have avoided one of the sore spots of code pleading. The federal courts are not hampered by the morass of decisions as to whether a particular allegation is one of fact, evidence or law. All that is required is a "short plain statement of the claim showing that the pleader is entitled to relief." This requirement should be observed. And pursuant to Rule 8(e), "each averment of a pleading shall be simple, concise and direct." ...
>
> * * *
>
> The courts have recognized the function of pleadings under the federal rules is to give <u>fair notice</u> of the claim asserted so as to enable the adverse party to answer and prepare for trial, to allow for the application of the doctrine of

> res judicata, and to show the type of case brought, so that it might be assigned to the proper form of trial. 2A Moore's Federal Practice, paragraph 8.13 at 8-97 to 8-103. (Emphasis in original).

Liberality is afforded pleadings because the rules provide for discovery of facts and formulation of issues. The court below did not allow sufficient time for this formulation of issues through the use of discovery and pretrial conferences. What is required is that the opposing party be put on notice of the facts underlying the theories, not specifically the theories themselves.

This Court has addressed this issue in Rich v. McGovern, 5[illegible] P.2d 1266, 1268 (Utah 1976), stating:

> Defendants also contend that the plaintiffs raised in their brief in this court for the first time matters which were not presented to the District Court, and hence should not be considered here. The principle is correct. But its application here is not. Upon examination we find that, though the pleadings and submission speak in generality, the critical matters recited above pertaining to plaintiffs' claims of fraud were sufficiently set forth in the pleadings, affidavits and depositions.

Here, the record below, through allegations contained in [illegible] amended complaint, the letter of Carl Noel (R.151), the affidavit of Joseph Fazzio and exhibits thereto (R.122) and the exhibits obtained from the records of the United States Geological Surveys filed on [illegible] Roosevelt Unit (R.122) indicate that there may have been a surrend[illegible]

abandonment of respondent's interest in the non-participating lands by its acquisition of the 1954 lease covering those lands.

These facts also raise the issue of whether Phillips intended to abandon its claims under the 1946 lease when it released the 1954 lease and failed to further develop the non-participating lands. Abandonment is the voluntary or intentional release of a known right. Rook v. James E. Russell Petroleum, Inc, 658 P.2d 1059, 1061 (Kan. App.1983). When a lessee holds a lease but does not exercise its rights for development for a significant period of time the lease may be deemed to be abandoned. Rook, supra at 1061. See also Crocker v. Humble Oil and Refining Co., 419 P.2d 265 (Okla. 1966); Kunc v. Harper-Turner, 297 P.2d 371 (Okla. 1956).

The abandonment, as pointed out in the appellants' brief, may not be just abandonment of the rights under the lease, but also an abandonment of the purposes for which the lease was granted by lessor. As stated in Dross Oil Royalty Co. v. Texas Co., 137 P.2d 934 (Okla. 1943) to permit the lessee to hold the lease for an unreasonable length of time for merely speculative purposes, is to allow it to protect its own interest and to disregard the interest of the lessor. If conditions do not indicate to it that further development will be profitable, it is only fair that, after reasonable time has expired, it surrender the undeveloped portion of the lease and allow lessor to secure the development by others.

Once a lease is abandoned it completely terminates the leasehold interest and the former lessee cannot reacquire mineral rights without obtaining a new lease. Superior Oil Co. v. Devon, 6[illegible] F.2d 1063, 1070 (8th Cir. 1979). Because the action (or more aptly inaction) by the lessor, notice is not necessary and irrelevant. Cameron v. Lebow, 388 S.W. 2d 399 (Ky. 1960); Smyth v. Kaplin, 294 S.W.2d 525 (Ky. 1956).

Respondent also objects to the appellants' discussion of novation because, according to the respondents, it is either repetitive of the questions of merger or inaccurately characterizes the theory of novation. Respondent contends that novation is limited to transactions in which the substitute contract contains a new party. This is too narrow a definition. Referring to Black's Law Dictionary (at 1212), novation is the "substitution of a new contract between the same or different parties." This Court, in Robison v. Hansen, 594 P.2d 867 (Utah 1979) has termed a substitute contract between the same parties also as a novation.

If novation is, as respondent claims, merely another name for the merger theory, then respondent's whole objection to the introduction of surrender is baseless. These theories rely upon, basically, the same facts which were plead in the amended complaint. They all lead to the same conclusion; that is, that respondent and appellants by entering into the agreement of March 11, 1952, and [illegible]

lease modified the terms of the lease and the unit agreement and changed the nature of the interest claimed by respondent in the non-participating lands. When respondent failed to comply with the terms of this new contractual relationship and released its property interest, respondent no longer had claim to the non-participating lands under the 1946 lease.

VII. THE TERMS OF THE UNIT AGREEMENT IMPLY THAT NON-PARTICIPATING LANDS MUST BE RELEASED.

In refuting appellants' argument that language contained in the unit agreement and the leases in question lead to the conclusion that non-participating lands must be released, repondent replies only with general statements of the law. Respondent's general position is that non-participating lands may be held by production on the unit if the unit lands and the non-participating lands are in the same lease. However, the language in the unit agreement and the lease, and the facts indicate that the circumstances in the instant case are quite different. In none of the cases cited by the respondent is there a situation similar to this where the lessee is required to pay delay rentals on lands excluded from participation in production royalties. If production itself holds those lands, then why did the parties require the lessee to pay delay rentals?

Respondent appears to agree that if it did not pay these rentals it would lose all rights it purports to claim in the lands. Therefore, respondent is holding the

non-participating lands, not by production, but by the payment of delay rentals. The result is that the lease covering these non-participating lands becomes a no-term lease, i.e. a lease with a primary term which may be held in perpetuity by the lessee, not through production, but by payment of delay rentals above. No-term leases have long been disfavored by the courts because of their inherent unfairness allowing speculation on the part of the lessee without requiring the lessee to meet its side of the bargain, that is to produce oil and gas from the leasehold. 2 Summers Oil & Gas, Sec.

Either the lessee's rights to the excluded property are preserved by payment of delay rentals for a specific term, or its payment of delay rentals was intended to preserve its rights indefinitely. If the latter is the case, then it is so inherently unfair and one-sided that the unit agreement, as it pertains to the non-participating lands, is unenforceable. Federal Oil Co. v. Weste Oil Co., 111 F. 373, aff'd 121 F. 674 (7th Cir. 1902); Lannam v. Jones, 268 P. 521 (Colo. 1928); National Oil & Pipeline Co. v. Teale, 67 S.W. 545 (Tex. Civ. App. 1902).

CONCLUSION.

If nothing else, respondent's brief clearly indicates that there are several unresolved factual issues relating to appellants' causes of action which preclude their dismissal under Rule 12 of the Utah Rules of Civil Procedure. Appellants should be allowed develop the evidence, offer proof on the unresolved factual and to exercise their right to confront the respondent in a trial.

DATED this 27th day of October, 1983.

Respectfully submitted,

HUGH C. GARNER & ASSOCIATES, P.C.

By: _____
Hugh C. Garner

By: _____
Nicholas F. McKean

By: _____
Randy K. Johnson

ATTORNEYS FOR PLAINTIFFS-APPELLANTS

CERTIFICATE OF MAILING

I hereby certify that on the 27th day of October, 1983, a true and correct copy of the foregoing Reply Brief of Appellants was mailed, postage pre-paid, by United States Mail, to the following:

Alan L. Sullivan, Esq.
VAN COTT, BAGLEY, CORNWALL & McCARTHY
Attorney for the Defendant-Respondent
Phillips Petroleum Co.
50 South Main Street
Suite 1600
Salt Lake City, Utah 84144

J. Rand Hirschi, Esq.
VAN COTT, BAGLEY, CORNWALL & McCARTHY
Attorney for the Defendant-Respondent
Roosevelt Unit, Inc.
50 South Main Street
Suite 1600
Salt Lake City, Utah 84144

Merlin O. Baker
RAY, QUINNEY & NEBEKER
Attorney for the Defendant David Monnich
79 South Main Street
Suite 400
Salt Lake City, Utah 84111

Nicholas J. McKean

IN THE UNITED STATES DISTRICT COURT FOR THE
DISTRICT OF KANSAS

AMOCO PRODUCTION COMPANY, a corporation Plaintiff	)	
Vs.	)	No. 82 1865
DOUGLAS ENERGY COMPANY, INC. et al Defendants	)	

MEMORANDUM AND ORDER

This matter comes before the court on plaintiff Amoco Production Company's (Amoco) motion to dismiss counterclaims of Defendant Douglas Energy Company (Douglas) and individual lessor defendants for failure to state a claim pursuant to Rule 12(b)(6), Fed.R.Civ.P. Amoco also moves for judgment on the pleadings and a stay of discovery pending resolution of these motions. The court, having heard oral arguments and having reviewed the briefs submitted by the parties, is now prepared to rule on all pending motions.

Amoco filed this suit seeking a declaration that top leases granted Douglas by lessor defendants covering nonproducing formations constitute an obstruction of Amoco's leasehold rights (claim 1), a declaration that it is presently under no obligation to release of record any nonproducing

formations (claim 2), an order enjoining Douglas from acquiring further top leases or otherwise interferring with Amoco's contractual rights under its leases (claim 3), damages for tortious interference with its contractual relations with lessors (claim 4), an order directing Douglas to release of record its top leases (claim 5), and damages for slander of title (claim 6). Amoco's motion for judgment on the pleadings is directed to claims 1, 2, 3, and 5. Accompanying its answer, Douglas asserts as a counterclaim a request for declaratory judgment that Amoco has breached an implied covenant for further exploration. Douglas also has counterclaim for damages for slander of title. Individual lessors assert a single counterclaim of breach of implied covenants for further exploration and development and request, as does Douglas, partial cancellation of Amoco's leases.

At the outset, the court notes that Amoco has filed no replies to the counterclaims of Douglas and the individual lessor defendants. Rule 12(c), Fed.R.Civ.P., states in pertinent part: "After the pleadings are closed, but within such time as not to delay the trial, any party may move for judgment on the pleadings." Rule 7(a), Fed.R.Civ. indicates that where a counterclaim is asserted a reply is required before the pleadings are closed. See 5 Wright &

Miller, Federal Practice and Procedure, §1367 at page 687. Therefore, absent replies to defendant's counterclaims, the court may consider Amoco's Rule 12(c) motion only if it first dismisses the counterclaims. Since the court denies in part Amoco's motions to dismiss, the motion for judgment on the pleadings is not properly before the court at this time and is dismissed without prejudice. Of course the court realizes, as do the parties, that the motions to dismiss address substantially the same issues that are raised in the motion for judgment on the pleadings.

As to Amoco's motions to dismiss for failure to state a claim, the applicable rule is that a claim should not be dismissed pursuant to Rule 12(b)(6) unless it appears beyond a doubt that a pleader can prove no set of facts in support of his claim which would entitle him to relief. Conley v. Gibson, 355 U.S. 41, 45-46 (1957). The factual allegations of the pleading must be taken as true and all reasonable inferences must be indulged in favor of the pleader. Mitchell v. King, 537 F.2d 385 (10th Cir. 1976). Furthermore, pleadings are to be liberally construed to determine if there is any possibility of recovery. Gast-A-Car, Inc. v. American Petrofina, Inc., 484 F.2d 1102 (10th Cir. 1973). Motions to dismiss for failure to state a claim are viewed with disfavor and are rarely granted. 5 Wright &

Miller, Federal Practice and Procedure, §1357 at 598.

Amoco contends that defendants are prevented from obtaining relief on their counterclaims for breach of implied covenants for essentially three reasons. First, it is contended that the top leases are presently invalid since they purport to be effective as of the time of their executio Second, it is argued that the top leases constitute an obstruction relieving Amoco of further responsibility for performance under any implied covenants. Third, it is argued that defendants are prevented from asserting a claim for lease forfeiture because of absence of prior demand for performance of implied covenants, and because the counterclai do not allege a legally sufficient excuse for failure to make such a demand.

The proposition that Douglas' leases are presently invalid rests on Amoco's argument that its leases remain valid as to all formations since production in paying quantit has been established. Amoco contends that this is the test the court should apply in view of defendants' prior actions and the assertion in their counterclaims that Amoco's leases have already terminated as to nonproducing formations. The prior actions referred to are the execution of top leases granting Douglas the right to make demand on any existing

oil and gas lessee to release of record nonproducing zones, and Douglas' actual demand for release made prior to the institution of this lawsuit. These actions, it is argued, evidenced an intention to challenge the existing leases as having already terminated. Moreover, in view of the principle that breach of an implied covenant never results in automatic termination or forfeiture, see Christiansen v. Virginia Drilling Co., Inc., 170 Kan. 355, 226 P.2d 263 (1951), Amoco argues that its leases could have previously terminated only by breach of their express terms. Therefore, Amoco contends that defendants' actions and allegations in effect confine the issue to whether the habendum clause of its leases has been satisfied, rather than whether a breach of implied covenant has occurred.

The court finds this to be an unduly restrictive characterization of defendants' theory of recovery. Neither the counterclaims, nor Douglas' previous demand for release, nor the top leases themselves disclose an intent to attack Amoco's leases on the basis of cessation of production. Douglas' demand for release could more accurately be characterize as premature and hence ineffective, but the court does not believe this action alone frames the issues now before the court and renders the top leases necessarily invalid. The

mere conferring of the right to demand release is not determinative where, as here, the leases were expressly granted subject to all valid preexisting oil and gas leases. A reasonable interpretation is that the top leases would become effective only to the extent any existing leases were determined invalid. A request for such a determination has been made in the form of defendants' counterclaims for partial lease cancellation. Though the counterclaims express a legal conclusion that Amoco's leases have terminated as to nonproducing formations, defendants clearly seek a judicial determination of termination and request partial cancellation based on prior breach of implied covenants. Defendants' claims for relief are not insufficient merely because they request a present determination of a prior breach. See Superior Oil Co. v. Devon Corp., 458 F.Supp. 1063 (D.Neb. 1978), reversed on other grounds 604 F.2d 1063 (8th Cir. 1979); Robinson v. Continental Oil Co., 255 F.Supp. 61 (D.Kan. 1966). Such a judicial determination would not constitute the legal equivalent of automatic termination under express lease terms.

The issues raised by defendants' counterclaims are whether Amoco, prior to the execution of the Douglas leases, failed to satisfy an implied covenant to explore (asserted

by both Douglas and the individual lessors) or an implied covenant to develop (asserted by individual lessors). The counterclaims are not subject to dismissal under the theory that Amoco's leases are perpetuated by production. Similarly, the proposition must fail that dismissal is appropriate since the top leases, and Douglas' demand, constitute an obstruction. The claims that Amoco has breached its implied covenants focuses on events prior to execution of the top leases.

Amoco's third basis for challenging defendants' counterclaims for cancellation is the more serious from the vantage point of defendants' ultimate ability to prevail on the merits. Normally, a demand for performance of an implied covenant is necessary before a court will grant a claim for lease forfeiture. Robinson v. Continental Oil Co., supra, at 64; Cowman v. Phillips Petroleum Co., 142 Kan. 762, 51 Pac.2d 988 (1935). The purpose of such a demand is to put the lessee on notice that he has breached an implied covenant and provide him the opportunity to perform and avoid the harsh remedy of forfeiture. Superior Oil Co., 603 F.2d at 1069. A demand for performance, however, may be excused where it appears that it would be futile. See 5 Kuntz, a Treatise on the Law of Oil and Gas, § 62.4 (1978). See also

Howerton v. Kansas Natural Gas Co., 81 Kan. 553, 106 Pac. 47 (1910), reversed on other grounds, 82 Kan. 367, 108 Pac. 813 (1910).

As to the claims of breach of an implied covenant to explore, defendants allege that a prior demand for performa was unnecessary, and in effect would have been futile, in view of an extended period of inactivity despite Amoco's knowledge of the production potential of the unexplored formations. It is alleged that Amoco was aware of its obligations to explore the leases in question as a result of its production from deep formations in the area, as well as on the basis of available test data indicating the commercial production potential of the nonproducing formations. It is not alleged that any individual lessors ever demanded performance of implied covenants to explore or develop prior to granting the top leases. However, during oral presentation counsel for defendants argued that discovery might be helpful in revealing relevant communications between Amoco and lessor defendants.

Amoco refers the court to the recent Eighth Circuit decision of Superior Oil Co. v. Devon Corp., supra, wherein the court held that the notice and demand requirement is not waived by the mere passage of what is deemed to be an unreasonable period of time. At trial defendants may well have to show more than a mere passage of time to satisfy

waiver of the notice and demand requirement. As to a threshold motion to dismiss, however, it is sufficient the defendants allege futility based on Amoco's inactivity and its knowledge of production potential of the deeper formations. Defendants are entitled to the opportunity at trial to satisfy waiver of the demand requirement by showing a manifested intention on the part of Amoco not to undertake further development or exploration.

While the counterclaims for partial cancellation sufficiently state a claim for relief, Douglas' individual claim for damages must be dismissed. Douglas has indicated that it is proceeding on the theory that Amoco's leases should be declared invalid as to the deeper formations because of a prior breach of an implied covenant to explore. Douglas does not contend that Amoco's leases expired under any express lease provisions. However, the counterclaim for damages is premised upon Amoco's failure upon demand to release of record the deep formations.

The court notes that in Kansas there are statutory provisions for obtaining release of terminated or forfeited oil and gas leases. See K.S.A. 55-201, et. seq.. These statutes provide the basis for recovery of damages for failure upon demand to release of record a lease that has

terminated by express terms or has been judicially determined to be forfeited. Christiansen v. Virginia Drilling Co., supra. While Douglas states it does not rely upon the statutory scheme as the basis for its damage claim, it is clear that any claim for damages resulting from a failure to release titles of record requires an obligation to do so at the time the demand is made.

Douglas' claim for damages for slander of its titles is inconsistent with its claim for cancellation of its leases as to the deep formations. Under the latter claim, Amoco's leases remain valid unless, and until, declared invalid. To prevail on the former claim, it must be shown that Amoco had a prior obligation to release formations of record. Amoco could have been placed under such an obligation only if its leases had been rendered invalid by their express terms or by a prior judicial finding of forfeiture. If the leases are presently capable of coexisting, as the court has herein found, it follows that neither party may be required to release its leases of record until the court has made a final determination of the issues presented in this case.

The court has already indicated during oral argument that discovery will be stayed pending resolution of the motions now under consideration. However, the court now

deems it appropriate to enter a further discovery order consistent with its decision to bifurcate trial of this action. Having considered prior representations of the parties concerning bifurcation as to the issues of liability and damages, the court believes that bifurcation pursuant to Rule 42(b), Fed.R.Civ.P., represents an expeditious and economical procedure for resolution of this action. Accordingly, discovery will be restricted to the issue of liablity. The court recognizes there may be instances where discovery might appropriately overlap issues of liability and damages. If and when this occurs, discovery need not be restricted as herein ordered if the parties can agree.

IT IS THEREFORE ORDERED that pliantiff's motion for judgment on the pleadings is hereby dismissed without prejudice.

IT IS FURTHER ORDERED that plaintiff's motion to dismiss defendants' counterclaims requesting lease cancellation are denied, and that plaintiff's motion to dismiss defendant Douglas' counterclaim for damages is granted.

IT IS FURTHER ORDERED that this action be bifurcated for separate trials of the issues of liability and damages, and that discovery be restricted to the issue of liability except where the parties can agree otherwise.

Dated this 11th day of February, 1983, at Wichita, Kansas.

Sam A. Crow
U. S. District Judge