STATE OF KANSAS

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January 24, 1977

ATTORNEY GENERAL OPINION NO. 77-29

The Honorable E. Richard Brewster
State Representative
Chairman, Judiciary Committee
3rd Floor - State Capitol Building
Topeka, Kansas 66612

Re: Oil and Gas--Leases--Conditions

Synopsis: The effect of section 1 of 1977 House Bill 2002 is to impose upon lessees a duty to develop every subsurface zone of a producing leasehold as a condition of the implied covenant of reasonable development, a condition which does not now exist, and to create a presumption of breach of that covenant as a ground for partial termination of the lease upon the showing prescribed in section 1 thereof, and thus operates to impair contractual rights and obligations of lessees under existing leases, in violation of Article I, § 10 of the United States Constitution.

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Dear Representative Brewster:

Article I, § 10 of the United States Constitution provides, inter alia, that "No State shall . . . pass any Law impairing the Obligation of Contracts." [Emphasis supplied.] You inquire whether 1977 House Bill 2002 is such a law. In my judgment, it is a contrived and ill-disguised attempt to abridge the rights of parties to existing oil, gas and oil and gas leases, which is subject to precisely the same objections which were recited in Opinion No. 76-342 regarding 1976 House Bill 3038.

Section 1 of the bill provides that in an action for relief based upon an alleged breach by a lessee of an implied or express covenant

of reasonable exploration or development of lands covered by an oil, gas, or oil and gas lease which is held by production, a presumption of breach by the lessee arises upon a showing that 1) production on the lease commenced at least 15 years prior to commencement of the action, and 2) that at the time the action was commenced there was no wellhead production from any "subsurface part or parts" of the leasehold as to which relief is sought.

The bill seeks to avoid the prohibition of Article I, § 10 by the recital in section 4 that "[e]xcept as expressly required hereby, this act shall not alter or affect substantive rights or remedies under any such leases. . . ," and by denominating the presumption merely "evidentiary."

If it is presumed that a lessee has breached an express or implied covenant of reasonable development by failure to develop every subsurface zone or horizon of a leasehold on which production has been maintained for 15 years, then it is also presumed that production from every subsurface zone is a condition of the implied covenant, and that the lessee has an affirmative duty to commence production from every such subsurface zone or horizon. There can be no breach without a condition to be breached, or a duty to be met. If a presumption of breach arises, it may do so only because there exists a duty or condition to be breached.

Clearly, there is no such condition implied today in this state. In Opinion No. 76-342, we referred to Stamper v. Jones, 188 Kan. 626, 364 P.2d 972 (1961), in which the court outlined the scope of the implied covenant of prudent development:

> "There is an implied covenant . . . that the tract will be prudently developed, and where the existence of oil in paying quantities is made apparent, it is the duty of the lessee to continue the development of the property and to put down as many wells as may be reasonably necessary to secure the oil for the common advantage of both the lessor and the lessee.
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> A lessee, under the implied covenant to develop an oil and gas lease, is required to use reasonable diligence in doing what would be expected of an operator of ordinary prudence, in the furtherance of the interests of both the lessor and lessee. Under this rule neither the lessor nor the lessee of an oil and gas lease is the sole judge of what constitutes prudent development of the tract.

> A lessor who alleges breach of the implied covenant to develop has the burden of showing, by substantial evidence, that the covenant has been breached. He must prove that the lessee has not acted with reasonable diligence under the facts and circumstances of the particular situation at the time." 188 Kan. at 631. [Citations omitted.]

The diligence with which the lessee must proceed is measured by a number of considerations. In Fischer v. Magnolia Petroleum Co., 156 Kan. 367, 133 P.2d 95, (1943), the court stated thus:

> "It has generally been recognized that in determining whether there is a prudent development under the lease there are various pertinent factors to be considered -- all the facts and circumstances which would affect the reasonableness of an ordinarily prudent operator's position in connection with development of the particular tract involved. . . . In Brewster v. Lanyon Zinc Co., . . . [140 Fed. 801], the circuit court of appeals said:
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> 'Whether or not in any particular instance such diligence is expressed depends upon a variety of circumstances, such as the quantity of oil and gas capable of being produced from the premises, as indicated by prior exploration and development, the local market or demand therefor or the means of transporting them to market, the extent and results of the operations, if any, on adjacent lands, the character of the natural reservoir -- whether such as to permit the drainage of a large area by each well -- and the usages of the business.'" [Citations omitted.]

In no case has the Kansas Supreme Court yet held that a lessee has an affiramtive duty to commence production from every subsurface zone of a leasehold, and under existing statutory and case law, it clearly appears that a lessor could not obtain judicial relief terminating a lease as to one or more subsurface zones merely by showing production from other zones of the leasehold

for fifteen years and no wellhead production from those as to which relief is sought. The effect of the statutory presumption is to permit lessors to obtain such relief on precisely such a showing; i.e., that showing alone raises a presumption that a condition of the implied covenant to develop has been breached. If the condition has been breached, it is necessarily a condition of the covenant in the first instance, and clearly, it is a condition which attaches only as a result of section one of 1977 House Bill 2002, in order to give effect to the presumption raised by that section. If the legislature were forthrightly to enact legislation requiring a lessee to have commenced production from every single subsurface zone of a leasehold which had been held by production for fifteen years, and entitling the lessor to judicial termination as to those zones from which production had not been commenced, clearly such legislation would be void as an attempt to impair existing contractual obligations.

Section 1 of House Bill 2002 seeks to accomplish the same object but only covertly, through the use of a so-called "evidentiary presumption" which has no other operative effect but to permit a lessor to terminate a lease as to one or more subsurface zones on grounds which would not support that relief prior to enactment of the bill.

It may be argued, of course, that the presumption is rebuttable and that the lessee may dispel or overcome it by showing that development of the leasehold has in fact been reasonable, prudent and diligent despite lack of production of a particular subsurface zone. The United States Supreme Court has held "more than once that a statute creating a presumption which operates to deny a fair opportunity to rebut it violates the due process clause of the Fourteenth Amendment." Heiner v. Donnan, 285 U.S. 312 at 329, 76 L. Ed. 772, 52 S. Ct. 358 (1932). However, under the bill, the lessee is called upon to justify failure to commence production from every subsurface zone not in production at the time the action is commenced, notwithstanding prior to its enactment, the lessee had no legal duty under the implied covenant of reasonable development, as outlined by the Kansas Supreme Court, to develop every such zone, in the first instance.

In Opinion No. 76-342, we quoted from Oil-Fork Development Co. v. Huddleston, 202 Ky. 261, 259 S.W. 334 (1924) thus, which remains as pertinent to this bill as it was to the last:

> "The obligation of contracts is impaired by a statute which alters its terms by imposing new conditions, or dispensing with

> conditions, or which adds new duties or rights, or releases or lessens any part of the contract obligation, or substantially defeats its end. . . ."

In my opinion, the effect of section 1 of 1977 House Bill 2002 is to impose upon lessees a duty to develop every subsurface zone of a leasehold as a condition of the covenant, either express or implied, of reasonable development, a condition which did not exist prior to enactment of the bill, and to create a presumption of breach of that covenant upon the factual showing prescribed in section 1. Clearly, in my judgment, the bill operates to impair contractual rights and obligations of lessees under existing leases, which is prohibited by Article I, § 10 of the United States Constitution.

Yours very truly,

Curt T. Schneider

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