Guffey Vs. Smith

Guffey Vs. Smith

SooperKanoon Citation : sooperkanoon.com/92170

Court : US Supreme Court

Decided On : Apr-05-1915

Appeal No. : 237 U.S. 101

Appellant : Guffey

Respondent : Smith

Judgement :

Guffey v. Smith - 237 U.S. 101 (1915)
U.S. Supreme Court Guffey v. Smith, 237 U.S. 101 (1915)

Guffey v. Smith

No. 86

Argued December 2, 3, 1914

Decided April 5, 1915

237 U.S. 101

CERTIORARI TO THE CIRCUIT COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

SYLLABUS

Under the settled rule of decision in Illinois, an oil and gas lease like that involved in this suit passes to the lessee, his heirs and assigns, a present vested freehold interest in the premises, and an option on the part of the lessee to surrender does not create a tenancy at will, give the lessor an option to compel surrender or make the lease void as wanting in mutuality.

Decisions of the highest courts of the state in which the property is situated are accepted and applied by tho federal courts as rules of property in passing upon the estate and rights passing by such a lease.

Where, as is the case in Illinois, the holder of such a lease cannot maintain ejectment in the state courts, he cannot, under 721 and 1914, maintain such an action in the federal courts in that state.

Where ejectment cannot be maintained by one holding a gas and oil lease against another claiming under a later lease, and no other action affords an adequate remedy, the earlier lessee may maintain a suit in equity to restrain the later lessee and for accounting and discovery in the federal courts where the requisite amount is involved and diverse citizenship exists, even though such a suit, by reason of the lessee's having an option to surrender, could not be maintained in the courts of the states.

Remedies afforded and modes of procedure pursued in the federal courts sitting as courts of equity are not determined by local laws or rules of decision, but by general principles, rules, and usages of equity having uniform operation in those courts wherever sitting.

According to the general principles and rules of equity enforced in the federal courts, a clause in a lease permitting the lessee to surrender it is not an obstacle to enforcing the lease in equity against those who, under a later lease, are committing waste.

Whether a lease is so unfair and inequitable that it cannot be enforced by the lessee in equity must be determined in view of the circumstances under which it was given, and, in this case, *held* that an oil and gas lease of undeveloped land requiring all expenses to be paid by the lessee and providing for reasonable royalties and fixed rental

Page 237 U. S. 102

during a designated period of delay is not so unfair and inequitable as to require that equitable relief be withheld, even where it contains a provision permitting the lessee to surrender it at any time.

Under the statutes of Illinois, a lessee who omits to pay rent when due may cure his default by payment at any time prior to demand and notice or within the time named in the notice, and if so paid, the lessee's rights are the same as though the default had not occurred. On an accounting for oil and gas taken under color of a lease later than that of plaintiff but without actual knowledge thereof, although the same was recorded, *held* that the later lessees were entitled to be credited with the cost of improvements and operation incurred prior to, but not after, the date on which they were actually notified of the rights of the earlier lessee. The continued taking thereafter was a willful taking and appropriation of the property of another.

202 F. 106 reversed.

The facts are stated in the opinion.

Page 237 U. S. 108

MR. JUSTICE VAN DEVANTER delivered the opinion of the Court.

This was a suit in equity, brought in the Circuit Court of the United States for the Eastern District of Illinois,

Page 237 U. S. 109

by the holders of an oil and gas lease covering a small tract of land in Crawford County, Illinois, to enjoin operations under a later and similar lease and to obtain a discovery and an accounting in respect of the oil and gas produced and sold in the course of operations already had. In due course, the case was referred to a master, who took the evidence, reported the same with his conclusions upon questions of fact and law, and recommended a decree awarding the relief prayed, but taking no account of the gas theretofore used or sold. Exceptions to the report were filed by the defendants, and at the final hearing, the circuit court overruled the exceptions, confirmed the report, and entered a decree as recommended. The decree was reversed by the circuit court of appeals with a direction that the bill be dismissed, the ground of decision being that the complainants were not entitled to relief in equity, and should be remitted to such remedy as they might have at law, because, by the terms of their lease, they had an option to surrender it at any time. 202 F. 106. Other questions in the suit were not considered by that court. The case is now here upon a writ of certiorari.

Both leases were for the same tract, and were given by James A. Smith, who owned it in fee simple. The earlier lease was given to one Walton, May 22, 1905, and by two successive assignments made in November and December following was transferred to Joseph F. Guffey and others, the complainants. It and the assignments were properly recorded June 15, 1906. The later lease was given to one Allison August 9, 1906, was assigned shortly thereafter to one Willett, and was transferred March 25, 1907, to Solley, Johnson, and Hennig, three of the defendants. There was also an intermediate lease to one Wilcox, given March 23, 1906, but, as it was voluntarily surrendered and nothing is claimed thereunder, it suffices to say (a) that it contained a provision whereby the lessee

therein agreed to protect the lessor against any expense or damage that might arise by reason of the earlier lease, (b) that, before surrendering it, Wilcox drilled a well upon the premises in an effort to find oil and gas, but without success, and (c) that the complainants, upon learning of this lease, promptly served upon Wilcox and the lessor a notice asserting the rights conferred by the prior lease.

Allison and his immediate assignee, Willett, took the subsequent lease with actual notice of the earlier one, and with constructive, if not actual, notice of its transfer to the complainants, but made no inquiry of the latter respecting its status or their claim under it. Nothing was done under the subsequent lease by Allison, but after its assignment to Willett, the latter entered upon the premises, with the lessor's sanction, and drilled a well which yielded a flow of gas, but no oil. Upon learning of these drilling operations, the complainants, in a written notice to Willett and the lessor, again asserted their claim under the prior lease, and demanded that the operations cease.

Solley and his associates took the assignment from Willett without actual knowledge of the prior lease, but, under the local law, were constructively charged with notice of it and of its transfer to the complainants, for both were duly recorded. They acted upon the advice of an abstractor who failed to make a proper examination of the records. After receiving the assignment, Solley and his associates, with the lessor's approval, proceeded to drill other wells upon the premises and developed the presence therein of oil in paying quantities. On August 1, 1907, they were actually and fully informed of the prior lease and of the complainants' purpose to insist upon the rights conferred by it and to obtain redress for the invasion of those rights, but they persisted in their drilling operations and produced and sold from the premises large quantities of oil. These operations were being continued when the suit was

Page 237 U. S. 111

brought (March 24, 1908) and when the accounting was had before the master. Most of the oil taken from the premises was extracted and sold after August 1, 1907, the date when Solley and his associates were actually and fully informed of the complainants' claim.

In its terms, the prior lease of May 22, 1905, under which the complainants claim, substantially conforms to one in common use in unexplored territory, as is shown by the evidence in this case and by reported decisions in other cases. It recites that it was given in consideration of $1 paid to the lessor and the covenants and

agreements of the lessee therein set forth. It contains the usual words of grant and demise, runs to the lessee, Walton, his heirs and assigns, describes the purpose for which it was given as that of mining and operating for oil and gas and laying pipelines and building tanks and other structures to take care of those substances when produced, and defines the terms for which it was to endure as five years from its date "and as long thereafter as oil or gas or either of them is produced" from the premises. The lessee covenants and agrees therein first, to deliver to the lessor, free of cost, in the pipeline to which the wells may be connected, the equal one-eighth part of all oil produced and saved from the premises; second, to pay $100 per year for the gas from each gas well the product of which is marketed and used off the premises; third, to locate all wells so as to interfere as little as possible with the cultivated portions of the land, and fourth, to complete a well on the premises within nine months after the date of the lease, or to pay at the rate of twenty-five cents per acre per year, quarterly in advance, for the additional time the completion of a well is delayed beyond the nine months, such payments to be made directly to the lessor, or deposited to his credit in the Exchange Bank at Martinsville, Illinois. There is also a surrender clause to the effect that, "upon the

Page 237 U. S. 112

payment of one dollar at any time," the lessee, his heirs or assigns, "shall have the right to surrender this lease for cancellation, after which all payments and liabilities thereafter to accrue" thereunder "shall cease and determine."

Among the master's findings and conclusions which were approved by the circuit court were the following:

"The master further finds that the complainants have been at all times financially responsible and able to perform the covenants of their lease; that they have not drilled a well on said premises, but that they have paid all the rentals required by the terms of said lease to be paid at the rate of twenty-five cents per acre, and deposited the same in the bank designated in the lease to receive the same, for the owner of the land."

"That, prior to purchasing the Allison lease, Willett made inquiry by telephone of the Exchange Bank at Martinsville whether or not rentals had been paid on the Walton lease by the complainants, and was informed by the bank that no such payments had been made or deposited to the credit of James A. Smith, although, as a matter of fact, the master further finds that, at the time the said bank gave this information, the rental money had in fact been deposited to the credit of the said James A. Smith."

"That the Walton lease, under which complainants claim title, has never been forfeited for failure to comply with the terms thereof, and up to the time of the filing of this suit, no grounds existed whereby such a forfeiture could be declared."

In addition to Solley and his associates, the defendants to the suit included the lessor and the Ohio Oil Company, the latter having purchased the oil with knowledge of the premises from which it was produced and of the complainants' claim under the prior lease.

It is settled by the decisions of the Supreme Court of

Page 237 U. S. 113

Illinois that an oil and gas lease like that of the complainants passes to the lessee, his heirs and assigns, a present vested right -- "a freehold interest" -- in the premises, that this interest is taxable as real property, and that the clause giving the lessee an option to surrender the lease at any time is valid, does not create a tenancy at will or give the lessor an option to compel a surrender, and does not make the lease void as wanting in mutuality. *Bruner v. Hicks,* 230 Ill. 536, 540, 542; *Watford Oil & Gas Co. v. Shipman,* 233 Ill. 9, 13, 14; *Poe v. Ulrey,* 233 Ill. 56, 62, 64; *Ulrey v. Keith,* 237 Ill. 284, 298; *People v. Bell,* 237 Ill. 332, 339; *Daughetee v. Ohio Oil Co.,* 263 Ill. 518, 524. These decisions constitute rules of property, and must be accepted and applied in passing upon the complainants' rights. *McGoon v. Scales,* 9 Wall. 23, 76 U. S. 27 ; *Bucher v. Cheshire Railroad,* 125 U. S. 555 , 125 U. S. 583 ; *Barber v. Pittsburgh &c.; Ry.,* 166 U. S. 83 , 166 U. S. 99 .

It also is settled that in the courts of Illinois the holder of such a lease cannot maintain an action of ejectment thereon (*Watford Oil and Gas Co. v. Shipman, supra,* p. 12; *Gillespie v. Fulton Oil and Gas Co.,* 236 Ill. 188, 206), and, by reason of the legislation of Congress requiring that in actions at law in the federal courts of first instance effect shall be given to the local laws and modes of proceeding (Rev.Stat. 721, 914), it results that the complainants could not have maintained an action of ejectment in the circuit court. An action for damages, of course, would not have afforded a plain, adequate, and complete remedy in the circumstances, and if such a remedy was to be had, it was necessary to resort to a suit in equity for an injunction, discovery, and accounting, as was done. *Joy v. St. Louis,* 138 U. S. 1 , 138 U. S. 46 ; *Coosaw Mining Co. v. South Carolina,* 144 U. S. 550 , 144 U. S. 567 ; *Franklin Telegraph Co. v. Harrison,* 145 U. S. 459 , 145 U. S. 474 . Thus, the principal question for decision is whether such a suit could be successfully maintained in the circuit court,

Page 237 U. S. 114

diverse citizenship and the requisite jurisdictional amount being conceded.

The Supreme Court of Illinois, while fully sustaining the right to maintain such a suit in the courts of the state when the lease contains no clause giving the lessee an option to surrender it (*Gillespie v. Fulton Oil and Gas Co., supra*), holds that the presence of such a clause in the lease operates to prevent the lessee from directly or indirectly enforcing it in equity (*Watford Oil and Gas Co. v. Shipman,* and *Ulrey v. Keith, supra*) the ground of distinction being that the surrender clause, although lawful in itself and not affecting the validity of the lease, renders it so lacking in mutuality that equity will remit the lessee to his remedy at law. These decisions, it is insisted, should have been accepted and applied by the circuit court. To this we cannot assent. By the legislation of Congress and repeated decisions of this Court, it has long been settled that the remedies afforded and modes of proceeding pursued in the federal courts, sitting as courts of equity, are not determined by local laws or rules of decision, but by general principles, rules, and usages of equity having uniform operation in those courts wherever sitting. Rev.Stat. 913, 917; *Neves v. Scott,* 13 How. 268, 54 U. S. 272 ; *Payne v. Hook,*

7 Wall. 425, 74 U. S. 430 ; *Dodge v. Tulleys,* 144 U. S. 451 , 144 U. S. 457 ; *Mississippi Mills v. Cohn,* 150 U. S. 202 , 150 U. S. 204 . As was said in the first of these cases:

"Wherever a case in equity may arise and be determined, under the judicial power of the United States, the same principles of equity must be applied to it, and it is for the courts of the United States, and for this Court in the last resort, to decide what those principles are, and to apply such of them to each particular case as they may find justly applicable."

It next is insisted that, according to the general principles and rules of equity administered in the federal courts, the surrender clause constitutes an insuperable obstacle

Page 237 U. S. 115

to granting the relief sought, the argument being that, as the complainants have a reserved option to surrender the lease at any time, it cannot be specifically enforced against them, and therefore cannot be similarly enforced in their favor. The rule intended to be invoked has to do with the specific performance of executory contracts, is restrained by many exceptions, and has been the subject of divergent opinions on the part of jurists and text writers. Without considering it in other aspects, we think it is without present application. Rightly understood, this is not a suit for specific performance. Its purpose is not to enforce an executory contract to give a lease, or even to enforce an executory promise in a lease already given, but to protect a present vested leasehold, amounting to a freehold interest, from continuing and irreparable injury calculated to accomplish its practical destruction. The complaint is not that performance of some promised act is being withheld or refused, but that complainants' vested freehold right is being wrongfully violated and impaired in a way which calls for preventive relief. In this respect, the case is not materially different from what it would be if the complainants were claiming under an absolute conveyance, rather than a lease. In a practical sense, the suit is one to prevent waste, and it comes with ill grace for the defendants to say that they ought not to be restrained because, perchance, the

complainants may sometime exercise their option to surrender the lease. We think this option, which has not been exercised and may never be, is not an obstacle to the relief sought.

Another contention of the defendants is that the lease is so unfair and inequitable in its terms that relief in equity should be withheld and the complainants left to seek a remedy at law; which is tantamount to saying that they must submit to the practical destruction of their leasehold and accept such reparation as may be obtained through recurring actions for damages. Whether

Page 237 U. S. 116

the lease is unfair and inequitable must be determined in view of the circumstances in which it was given. *Willard v. Tayloe,* 8 Wall. 557, 75 U. S. 570 -571; *Rutland Marble Co. v. Ripley,* 10 Wall. 339, 77 U. S. 357 ; *Franklin Telegraph Co. v. Harrison,* 145 U. S. 459 , 145 U. S. 473 . They were these: whether the leased tract contained oil or gas was not known. It was in an undeveloped district in which there was no oil or gas well and no pipeline leading to a market. Drilling wells was attended with large expense, the cost of each well being upwards of $1,000 according to the testimony of one of the defendants. No fraud, deception, or overreaching was practised in procuring the lease. The parties were competent to contract with each other, and entered into the lease because, in the circumstances, its provisions were satisfactory to them. Under its terms, the cost of the drilling was to be borne by the lessee. If the undertaking was unsuccessful, he alone was to stand the loss, and if it was successful, the lessor was to share in the results by receiving substantial royalties, the reasonableness of which is not questioned. The consideration for the lease, *viz.,* one dollar paid to the lessor and the covenants and agreements of the lessee, cannot be pronounced unreasonable. Similar leases, resting upon a like consideration, often have been sustained in cases not distinguishable from this. * The lease was to remain in force five years and as much longer as oil or gas was being produced from the premises; in other words, it was to expire in five years unless oil or gas was produced within that time. The lessee expressly covenanted to drill a well within nine months or to pay a

rental of twenty-five cents cents per acre per year, quarterly, in advance, for such time as the completion of the well was delayed beyond that period, the delay, of course, not to extend beyond the primary term of five years. The terms of the covenant doubtless were suggested by the undeveloped condition of the district and by the expense and risk incident to exploring for oil and gas. They evidently were satisfactory to the lessor at the time, and the record discloses no reason for holding that, in the circumstances, they were unreasonably liberal to the lessee. Some criticism is directed against the reserved option to surrender, but it is difficult to perceive how it could be declared inequitable. If it was not exercised, the lessee would be bound by his covenants, and if exercised, the lessor would be free to deal with the premises as he chose. A surrender was not to affect any existing liability, but only to avoid those "thereafter to accrue." A like clause is in the subsequent lease, and, according to the evidence and several reported decisions, is of frequent occurrence in such instruments. We conclude that there is nothing in the terms of the lease which requires that equitable relief be withheld.

While the complainants, as found by the master, paid all the rental required by the terms of the lease, and while they paid most of it in advance of the time stipulated, the first two payments were not seasonably made, and this is urged as a ground for refusing equitable relief. The objection is not well taken. The rental was not in arrears when the subsequent lease of August 9, 1906, was given, and there was no attempt at any time to forfeit or put an end to the lease because of the omissions to pay strictly in advance. While there was no provision in the lease for a forfeiture, the subject was covered by an Illinois statute. Hurd's Rev.Stat. of 1905, c. 80, 8. Under it, the lessor could have demanded the rent in arrears and have notified the complainants in writing that, unless

payment was made within a time named in the notice, not less than five days thereafter, the lease would be terminated, and upon a failure to pay within that time, he could have treated the lease as ended. But there was no such demand or

notice, and consequently no failure to comply with either. As interpreted by the supreme court of the state, the statute confers upon a lessee who omits to pay rent at the time it is due a right to cure his default by paying at any time prior to demand and notice or within the time named in the notice. *Chadwick v. Parker,* 44 Ill. 326; *Chapman v. Kirby,* 49 Ill. 211; *Woods v. Soucy,* 166 Ill. 407. Here, the default was cured in advance of any demand or notice, and thereafter the complainants' rights were the same as if the default had not occurred.

In the accounting, Solley and his associates were charged with the value, in the pipeline where the same was sold, of all the oil taken by them from the premises, save the one-eighth part going to the lessor as a royalty, and error is assigned upon this because no deduction was made for the cost of the improvements and operations whereby the oil was taken from the earth and delivered at the pipeline. As respects the cost incurred prior to August 1, 1907, we think the objection is well taken, for, up to that time, Solley and his associates were in actual ignorance of the earlier lease, and were proceeding in the honest belief that the later lease, assigned to them by Willett, was the only one upon the premises. They paid a substantial sum for it, were let into possession by the lessor, and were not conscious that they were invading the rights of others. True, the prior lease had been properly recorded, but, as they consulted an abstracter before consummating the transaction with Willett and were advised that the title was clear, the constructive notice resulting from the recording of the prior lease was not inconsistent with an honest, though mistaken, belief on their part

Page 237 U. S. 119

that they had acquired a perfect right to take and dispose of the oil. But the expenses incurred after August 1, 1907, are upon a different footing. On that date, Solley and his associates were actually and fully informed of the prior lease and of the complainants' purpose to insist upon the rights conferred by it and to obtain redress for the invasion of those rights, so what was done thereafter cannot be regarded as anything less than a willful taking and appropriation of the oil which was subject to the complainants' superior right. These views are amply sustained by our decisions. *Woodenware Co. v. United States,* 106 U. S. 432 ; *Benson*

Mining Co. v. Alta Mining Co., 145 U. S. 428 , 145 U. S. 434 ; *Pine River Logging Co. v. United States,* 186 U. S. 279 ; *United States v. St. Anthony Railroad,* 192 U. S. 524 , 192 U. S. 542 . *See also Central Coal Co. v. Penny,* 173 F. 340; *Bender v. Brooks,* 103 Tex. 329; *Gladys City Oil Co. v. Right of Way Oil Co.,* 137 S.W. 171, 182.

We conclude that the decree in the circuit court was right, save that the accounting should have proceeded along the lines just indicated, and those improvements the cost of which should have been deducted in the accounting -- that is, those made before August 1, 1907 -- should have been awarded to the complainants.

The decrees below are reversed, and the cause is remanded to the district court, as successor to the circuit court, with directions that the accounting and the decree be conformed to the views herein expressed.

Decree reversed.

* *See Allegheny Oil Co v. Snyder,* 106 F. 764; *Brewster v. Lanyon Zinc Co.,* 140 F. 801; *Brown v. Fowler,* 65 Ohio St. 507; *Gas Co. v. Eckert,* 70 Ohio St. 127; *Venedocia Oil Co. v. Robinson,* 71 Ohio St. 302; *Lowther Oil Co. v. Guffey,* 52 W.Va. 88; *Pyle v. Henderson,* 65 W.Va. 39; *Brick Co. v. Bailey,* 76 Kan. 42; *Gillespie v. Fulton Oil Co.,* 236 Ill. 188.