**OIL & GAS OUTLINE**

* Miscellaneous:
  + Early 🡪 Now View of Oil:
    - “Non-Ownership” (Oil underground is not owned by anyone, you can only own the surface and the right to drill) 🡪 “Ownership in Place” (can own the oil under the land)
  + **Parts of an Oil, Gas & Mineral Lease (Clauses)**
    - **Grant**
    - **Habendum (duration of lease)**
    - **Royalty (X% of oil produced, regardless of cost)**
    - **Pool (gives lessee ability to pool tracts & only have 1 well)**
    - **ADR (lease terminates after X period unless lessee drills or pays Annual Delay Rentals to keep lease alive)**
    - **Operations (at end of primary term, lease expires unless lessee is willing to spend money to continue drilling)**
    - **Assign (lessee may assign working interest and may reserve overriding royalty interest, while lessor keeps original royalty interest)**
  + Forfeiture v. Termination
    - Forfeiture = breach of covenant 🡪 of such magnitude that Lessor should be able to terminate the lease (ex. offset wells)
    - Termination = lease ends because the lease says it does if X occurs (ex. no production by end of primary term)
  + Statute of Frauds Requirements for Lease:
    - Must be in writing;
    - Must be signed by the party to be bound;
    - Must sufficiently identify tract of land to be leased;
    - Extent of rights to oil and gas must be stated; and
    - Duration of rights to oil and gas must be stated.
  + Philosophy:
    - Formalism = terms are important, language is standardized, and we assume parties mean what they are saying.
    - Policy/Economics = “law is politics”
      * Early TX law – seemed to favor landowners, tough on oil & gas company (b/c O&G company had drafted the lease)
      * Post 1980s – Court leans in favor of oil companies, but have the “do right rule” (oil company should still treat landowners well)
  + **Illegal Production 🡪 Railroad Commission & Maximum Efficient Recovery Level**
    - **Problem (leading up to 1900) – too much oil produced, so oil was being stored in earthen pits 🡪 caused sick livestock, fire, etc**
    - **Solution – Railroad Commission given regulatory authority:**
      * **Maximum Efficient Recovery Level established – drillers must have PERMITS; a minimum chunk of land was required for an oil well to be built; only X number of barrels could be produced per owner.**
  + **Deed Poll Rule = A grantee in a Deed accepted by him is a party to the deed, even though he does not sign it, and he is bound by recitals in the deed and by reservations contained therein in favor of the grantor, binding him contractually. He is bound by his acceptance.**
* **Basic Interests:**
  + **Surface**
  + **Reservation v. Exception of Interest:**
    - **Reservation = creation of a new right issuing out of the thing granted; retains ownership of the interest in the grantor**
    - **Exception = operates to exclude an interest already created and held in the grantor; excludes from the grant and benefits the grantor only to the extent that the ownership of the interest is already vested in the grantor**
  + **Mineral – see below**
    - **Normal = right to the minerals, including the right to make a lease on the interest (executive rights).**
    - Non-Participating Mineral Interest
      * = you own the minerals, but you don’t have the power to lease your mineral interest (no executive rights); BUT, they can sell the NPMI (in the ordinary case, all other rights are still there).
      * Owner has the right to receive benefits under leases negotiated by the executive right owner.
  + **Royalty Interest:**
    - Royalty Owner is by definition a Non-Participating Royalty Interest – doesn’t come with executor rights (right to convey, etc.)
    - **Historically 1/8 in Texas, but may be anything.**
    - **Royalty is free and clear of the cost of production = fraction of oil produced** (so it is better to have a royalty interest than the same fraction of mineral interest)
  + **Term Interest – allows buyer to ensure that he has the land for as long as O&G is produced.**
    - Example: O 🡪 A for 10 years and as long thereafter as O&G is produced.
  + **Community Interests**
    - **If A and B sign a community lease, A and B share royalties absent any specific language. A and B will share pro rata (based on % ownership of the property) no matter which part of the land the oil is produced from.** (Parker v. Parker)
* **SURFACE v. MINERAL ESTATE**
  + **Parts of the surface estate:**
    - **Basic Rule: Item is part of the surface if any reasonable method for removal of the item will consume, deplete or destroy the surface.** (Reed v. Wylie). **Item is part of the mineral estate if it is a mineral in the “ordinary and natural meaning of the word”.** (Moser v. US Steel Corp.)
    - **Surface Estate Includes:**
      * **The physical surface;**
      * **Water** (Sun Oil v. Whittaker);
      * **Iron, Gravel, Limestone, or other ore deposits** (Acker v. Guinn – b/c the only way to removed would be by strip mining, and that would completely inhibit the surface owner from using his land);
      * **Lignite** (Reed v. Wylie – b/c it is so near the surface);
    - **Does Not Include:**
      * **Uranium** (Moser v. US Steel Corp.)
  + **A mineral interest includes the RIGHT TO USE THE AMOUNT OF LAND (and things like water) REASONABLY NECESSARY to develop the mineral rights.** (Stradley v. Magnolia Petroleum). **If the lessee exceeds this use, he becomes a trespasser.** (Brown v. Lundell).
    - **“Reasonably Necessary” = measured by the individual circumstances (condition and use of the surface by the surface owner) AND measured against the “usual, customary and reasonable practices in the industry”.** (Jones v. Getty Oil)
    - **Lessee CANNOT use the surface/subsurface in a NEGLIGENT manner so as to DAMAGE THE LANDOWNER.** (Brown v. Lundell)
* **What was conveyed?**
  + **Basic Rules:**
    - **“OUT OF” = SUBTRACT + DEFINES THE SOURCE OF THE INTEREST**
    - **“OF” = MULTIPLY**
    - **“UNDER THE LAND CONVEYED” = Deed reserves a fraction of the part of the MINERAL ESTATE ACTUALLY OWNED by the grantor and conveyed in the Deed.**
    - **“UNDER THE LAND DESCRIBED” = Deed reserves a fraction of minerals under the ENTIRE PHYSICAL TRACT, regardless of the mineral estate actually listed as conveyed.**
  + **Mother Hubbard Clause**
    - **What = follows the deed’s description of land granted.**
    - **Purpose = “to prevent the leaving out of small pieces or strips of land which may exist without the knowledge of one/both of the parties by reason of incorrect surveying, or other mistakes.”** (Smith v. Allison)
    - Statute of Frauds concerns:
      * Assumed to be effective against either of the contracting parties even if the land description isn’t technically precise.
      * May not be effective against 3rd parties because they do not have notice of the lessee’s rights to the strip, even though the lease is recorded.
  + **Mineral v. Royalty Interest conveyed?**
    - **WOULD RATHER HAVE ROYALTY INTEREST because mineral interest will give you profit = sale value of oil – cost of production; royalty gives you sale value of oil**
    - **Basic Rules:**
      * **“oil, gas, minerals IN and UNDER” = BELOW ground = MINERAL INTEREST**
      * **“oil, gas, minerals OUT of” = from WELL HEAD = ROYALTY**
      * Ex. of distinctions:
        + A has ½ mineral interest, conveys ¼ of ALL 🡪 B has ¼ of total
        + A has ½ mineral interest, conveys ¼ of HIS 🡪 B has 1/8 of total
        + A has ½ mineral interest, conveys ½ 🡪 B has ½ of total
    - **Mineral Interest:**
      * **5 Essential Attributes of a Mineral Estate:**
        + **The right to develop (right of ingress and egress);**
        + **Right to lease (executive right);**
        + **Right to receive bonus payments;**
        + **Right to receive delay rentals; and**
        + **Right to receive royalty payments.**
      * Phrases that generally mean mineral interest:
        + Says it is a mineral interest;
        + Refers to minerals in, on or under the ground;
        + Refers to the right to receive bonus, rentals, or royalties from leases;
        + Refers to profit-sharing between the parties;
        + Refers to an executive right to lease;
        + Refers to possessory rights of ingress and egress that allow physical possession of leased premises.
    - **Royalty Interest:**
      * Phrases that generally mean royalty interest:
        + Calls the interest “royalty”;
        + Refers to a share of oil/gas produced and marketed, RATHER THAN oil/gas in place under the ground;
        + Excludes any interest in bonus, rentals or profit-sharing;
        + Excludes any interest in executive rights, the right to participate in leasing, or the right to physically occupy premises.
    - **Interpretation by the Court:**
      * **If the language is unambiguous, the court’s primary duty is to ascertain the INTENT OF THE PARTIES from the language of the deed by using the “FOUR CORNERS” RULE.** (French v. Chevron USA)
    - **Over-Conveyancing**
      * **Problem: The mineral interests claimed by A, B and C add up to more than 100%, so someone has to lose title to some or all of the minerals.**
      * **Solution:**
        + **As long as A has recorded, A is first in time and first in right, and will always have title to his reserved interest.**
        + **B, the grantor who drafted the deed to C, will lose all or part of the fractional mineral interest he attempted to reserve to himself.**
        + **C, the grantee, will receive as much of B’s mineral interest as is needed to make C whole. In addition, C may receive damages for failure of title if C cannot be made whole by moving title from B to C.**
        + **B will be estopped to deny the conveyance of C to part of the minerals b/c of warranties contained in the Deed.** [So if deed is quitclaim, no warranty and no remedy for C.]
        + Outcome is different whether B has RESERVED or EXCEPTED his portion, or whether the conveyance is “subject to” prior conveyances. [Duhig v. Peavy Moore]
  + **Participating v. Non-Participating Interest**
    - **Non- Participating = No Executive Interests**
    - **Duty of Good Faith and Fair Dealing**
      * **NPRIs and NPMI’s must depend on the executive right owner to manage the mineral estate and obtain the “best deal” for all parties.**
      * **The executive owner owes a duty of GOOD FAITH AND FAIR DEALING to the nonparticipating interests. He must “exact for the non-participating owners every benefit that he exacts for himself”. (Manges v. Guerra)**
      * Examples of breach:
        + Failure to negotiate for current market terms. (Mims v. Beall)
    - **The executive right owner has no power to pool the non-executive interest owners. When the executive owner leases the land, the Pooling Clause in the lease cannot affect the non-executive interests unless they ratify the pooling act.** (Montgomery v. Rittersbacher)
* **BASIC RULE OF ABSOLUTE OWNERSHIP = THE OWNER OF BLACKACRE OWNS ABSOLUTELY THE OIL & GAS UNDERNEATH THIS UNSEVERED TRACT.**
* **“FAIR SHARE RULE” = ALL OWNERS OF A COMMON RESERVOIR HAVE THE RIGHT TO A FAIR SHARE OF THE OIL IN THE RESERVOIR**
* **RULE OF CAPTURE = you own the oil in the ground, but if your neighbor drills and gets your oil, it becomes his oil.**
  + **Limitations:**
    - **Stored Gas: When oil/gas is removed from the soil, it becomes personal property 🡪 the owner does not lose title by storing the property on another person’s land. (Lone Star Gas Co. v. Murchison; Tex. Amer. Energy Corp. v. Citizens Fidelity Bank & Trust Co.)**
    - **Negligence/Tort Law:**
      * **There is no liability for reasonable and legitimate drainage from a common pool, but the driller is limited to legitimate operations. The driller cannot carry on operations in reckless or lawless irresponsibility, or with negligent waste/destruction. (Eliff v. Texon)**
      * **“The law imposes on all persons the duty to exercise ordinary care to avoid injury or damage to the property of others.” (Eliff v. Texon)**
    - **Illegal Production that violates conservation order or other rules. (Wrongsky v. Sun Oil Co.)**
* **TRESPASS**
  + **Basic Trespass Rule: Trespass occurs when someone either causes, allows or physically himself crosses a boundary**
  + **Trespass in the Oil/Gas Context:**
    - **The right to explore for oil and minerals belongs to the owner of the minerals. Anyone else doing so is a trespasser.** (Phillips Petro. v. Cowden)
    - **The mineral interest owner has the right to explore, etc, for minerals on/under the surface of where his mineral estate lies – he does not have the right to explore under other surfaces.** (Phillips Petro. v. Cowden)
  + **Types of Mineral Estate Trespass:**
    - **Seismic Trespass:**
      * **Trespass may be committed by shooting over the land, by explosions, by throwing inflammable substances, by blasting operations, by discharging soot and carbon, BUT NOT BY MERE VIBRATIONS. There must be injury to the land.** (Kennedy v. General Geo. Co.)
    - **Slantwell Trespass:**
      * **“Whipstocking” is a method of drilling that forces the drill bit to move in a slanted direction rather than straight down. If the drill bit lands in someone else’s property, trespass has occurred.**
      * **Damages – Owner of land will probably not get the well, but can seek compensation for oil obtained and the value of information (that oil is under owner’s land).**
  + **Remedy for Trespass:**
    - **Owner can sue under trespass OR in assumpsit, for the reasonable value of use and occupation.** (Phillips Petro. v. Cowden)
    - **Calculation of Damages in ASSUMPSIT** (Phillips Petro. v. Cowden)**:**
      * **Compensation based on ACTUAL PART OF PROPERTY OCCUPIED.**
      * **Based on the REASONABLE MARKET VALUE OF THE USE of the property – NOT measured by the benefit received from the use.**
  + **Damages may also be calculated as the market value of information gained (the decrease to lease value because the amount of oil is known).**
  + **Damages for Trespass:**
    - **Bad Faith Trespasser:**
      * **Trespasser is responsible for COMPLETE RESTITUTION WITHOUT CREDIT FOR EXPENSES incurred or deduction of costs of production.** (Swiss Oil Corp. v. Hupp). **Mineral owner keeps well.**
    - **Good Faith Trespasser:**
      * **Trespasser is responsible for VALUE OF OIL AT MOUTH OF WELL LESS REASONABLE EXPENSES.** (Swiss Oil Corp. v. Hupp). **Mineral owner keeps the well.**
      * **If the well is dry, the good faith trespasser owes nothing (except arguably value of information).** (Swiss Oil Corp. v. Hupp)
* **SLANDER OF TITLE**
  + **One who sues to remove the cloud of an unreleased oil and gas lease and seeks damages caused by the loss of a subsequent oil & gas lease sale is seeking recovery for slander of title.** (Kidd v. Hoggett)
  + **Basic Elements of Slander of Title:**
    - **The uttering and publishing**
    - **Of statements that are false**
    - **Done with malice**
    - **Causing special damages**
    - **To a person with an estate or interest in the property slandered.**
* **ADVERSE POSSESSION**
  + **REQUIREMENTS FOR ADVERSE POSSESSION: MUST BE EXCLUSIVE, ACTUAL, PEACEABLE, OPEN AND NOTORIOUS, CONTINUOUS AND HOSTILE POSSESSION UNDER A CLAIM OF RIGHT FOR THE STATUTORY PERIOD.**
  + **TX Statutes:**
    - **3 years – title or color of title required**
    - **5 years – Deed (not forged) Recorded, Taxes Paid** (note: the 5 year rule is most often used)
    - **10 years – title acquired by mere possession**
    - **25 years – if record owner of land is disabled/a minority**
  + **An adverse possessor who comes onto the land will get the surface and whatever rights were tied to it at the time of first possession, including any unsevered mineral rights.** (Broughton v. Humble Oil)
  + **If the mineral interests have been severed, the adverse possessor must do more than just use the surface to acquire the mineral interests.** **Such dominion must be exercised over the minerals as will be notice to the owner of the mineral estate that the possessor of the surface is claiming the minerals also.** (Broughton v. Humble Oil)
  + Example: O 🡪 B ½ mineral interest (so O keeps surface rights + ½ mineral interest)
    - AP comes onto land 🡪 AP gets surface + ½ mineral interest 🡪 B & AP now have MINERAL COTENANCY, B has implied easement to come onto land and drill “as is necessary for exploration & production”.
* **MINERAL COTENANCY**
  + **Occurs when two or more individuals own the mineral rights – they have concurrent, nonexclusive rights to possess the interest.**
  + **A tenant in common has the right to make such reasonable use of the common property as necessary to enjoy the benefit and value of his ownership. He has the right to develop and operate the common property for oil and gas, but cannot exclude his cotenant from exercising the same rights and privileges (note: if he does this, he becomes an adverse possessor.** (Prairie Oil & Gas Co.)
  + **ACCOUNTING/SHARING COSTS**
    - **For drilling:**
      * **If A drills and finds nothing, B owes no part of the drilling costs to A.**
      * **If A drills and finds oil, A owes B ½ of net profit (revenue – expenses)**
        + **Expenses DO NOT INCLUDE ROYALTIES.**
        + Note: If A is a trespasser, then B can recover land + oil taken, but A cannot deduct cost of production (b/c A is a trespasser)
    - **For lease by one cotenant:**
      * **The accounting to the other co-tenant should include all money received by the lessor, including bonus money, money from oil and gas rentals, etc, accruing under the lease.** (Texas Pacific Coal & Oil Co. v. Kirtley)
  + **Appointment of Receivers in Cotenancy Situation**
    - **A court may appoint a receiver when two conditions exist** (Byrom v. Pendley):
      * **The plaintiff or the other party has shown a probable right or interest in the property or fund; and**
      * **The property or fund is in danger of being lost, removed or materially injured.**
    - **When the parties are asserting an interest in title to mineral interest, the receivership may be made to apply to the operation, not just the proceeds of oil and gas taken from land.** (Byrom v. Pendley)
  + **PARTITION** (Mosely v. Hearrell)
    - **Any joint owner or claimant of any real estate or any interest therein may compel a partition between the other joint owners or claimants.**
    - **If a partition IN KIND (equitable division of the land or mineral interest itself) cannot be fairly made, the Court will direct partition BY SALE, and the proceeds of the sale will be equitably split between the owners.**
      * Note: The law favors partition in kind.
      * **Known oil v. un-known oil:**
        + **Where oil is not known, the partition will generally be IN KIND – property will be split equitably, and one party may end up with more/less minerals after production begins.**
        + **Where oil is known, partition will usually be BY SALE.**
* **LIFE TENANTS & REMAINDERMEN**
  + **Ex. O 🡪 A for life, remainder to B and heir**
    - **A - has life estate, and he can enjoy the property, but at his death, the property must be in good condition to pass to remaindermen (i.e., he can’t commit waste)**
    - **B and heirs – get estate after death of A**
  + **Oil & Gas Lease** 
    - **Common Law - Neither the life tenant nor the remaindermen can make an oil & gas lease to permit exploration or production without the consent of the other 🡪 lessee must have consent of life tenant AND remaindermen.** (Welborn v. Tidewater)
    - **Open Mine Doctrine – If mines are open at the time the life interest is created, then everything produced is income for the life tenant, and the remaindermen only gets what is left**
    - **Oil Company gets permission for lease from life tenant and remaindermen – who gets what proceeds?**
      * **Life tenant – get income = interest gained on any bonus and royalties in the bank and gets any Annual Delay Rentals**
      * **Remaindermen – gets corpus = bonus (immediately put into bank and interest gained for life tenant) when life tenant dies; gets royalty payments**
* **RULE AGAINST PERPETUITIES**
  + **Rule:**
    - **Exceptions:**
      * **Possibility of Reverter + most interests RETAINED BY GRANTOR are classified as vested from the outset and immune to the Rule.**
    - **Interpretation of Documents where Rule may apply:**
      * **“Within the limits of the Rule, a court shall reform or construe an interest that violates the rule to effect the ascertainable general intent of the creator of the interest.”** (Tex. Prop. Code §5.043)
      * “Where the instrument is capable of two constructions, one of which will give effect to the whole of the instrument, preference is given to the construction that will uphold the instrument.” (Bagby v. Bredthauer)
  + **Examples:**
    - **Ex. O** 🡪 **A for 10 years and as long thereafter as oil, gas, other minerals produced.**
      * **O has possibility of reverter, A has determinable fee.**
      * **B/C O’s interest is by definition vested, it is immune from the Rule Against Perpetuities**
    - **Ex. O 🡪 A for ten years and as long thereafter as oil, gas or other minerals produced, then to B and heirs.**
      * **B has executory interest which is subject to the Rule against Perpetuities. Interest violates Rule b/c is not certain to vest within measuring life (A’s life + 21 years). B’s interest is void 🡪 B gets nothing.**
      * **A has fee simple determinable.**
      * **O has possibility of reverter in the minerals.**
    - **Ex. O 🡪 A for ten years and as long thereafter as oil, gas or other minerals produced. THEN O 🡪 B and heirs.**
      * **If conveyance O 🡪 B considered to be transfer of O’s possibility of reverter, Rule is not violated b/c interest is vested and immune from the Rule.**
      * **If conveyance O 🡪 B has words like “this conveyance to take effect when the interest in A expires”, B takes springing executory interest. This violates Rule and is void.**
    - **Ex. O 🡪 A and heirs, O excepts/reserves all minerals for 10 years and as long thereafter as oil, gas or other minerals produced, and if production ceases, minerals to A and heirs.**
      * **A has springing executory interest, subject to Rule, and is void.**
      * **BUT, if the interest is RESERVED (NOT EXCEPTED) in O, then there is a REGRANT and A has a possibility of reverter, immune to the Rule.**
  + Solutions to avoid the Rule Against Perpetuities Problem:
    - Use 2 instruments of conveyance – Grantor conveys all land to the Grantee, who by a second Deed conveys back to the grantor the defeasible term interest to be retained. Original Grantee has possibility of reverter, original Grantor has fee simple determinable.
    - State that “this lease is granted on lessor’s reversionary interest”
    - State that the top lease will terminate 2 (or any number less than 21) years from the date of its execution.
    - State that top lease is subject to prior lease and is effective upon expiration; however, if the existing lease has not expired within 1 year of primary term, top lease terminates automatically.
* **LEASE CLAUSES**
  + **#2 - HABENDUM CLAUSE**
    - **Standard Text: “Subject to the other provisions herein contained, THIS LEASE SHALL BE FOR A TERM OF TEN YEARS FROM THIS DATE (CALLED “PRIMARY TERM”) AND AS LONG THEREAFTER AS OIL, GAS OR OTHER MINERAL IS PRODUCED from said land or land with which said land is pooled hereunder.”**
    - **Implication: Lease automatically terminates at end of primary term if no production.**
      * **But:** May be an exception if there is only temporary cessation of production due to sudden stoppage of the well or a mechanical breakdown of equipment, etc. (“unforeseen and unavoidable”) (Watson v. Rochmill). 3 factors considered in determining if cessation is just temporary:
        + Cause of production stoppage;
        + How long stoppage lasted; and
        + Lessee’s diligence in restoring production.
    - **Meaning of PRODUCTION?**
      * **Production = oil/gas produced in paying quantities to yield a profit (Stanolind Oil v. Barnhill)**
      * In OKLAHOMA – production = discovery + reasonable diligence in finding a market for the oil/gas
  + **#3 - SHUT-IN ROYALTY CLAUSE**
    - **Standard Text: “while there is a well… but gas is not being sold or used, Lessee may pay as royalty, on or before 90 days after the date on which such well is shut in and thereafter at monthly intervals [a royalty payment], and if such payment is made or tendered, the lease shall not terminated and it will be considered that gas is being produced from this lease in paying quantities.”**
    - **Implication: If there is a shut-in well, Lessee may pay shut-in royalty payments w/in 90 days to keep the well defined as “producing”.**
  + **#4 – POOLING CLAUSE**
    - **Standard Text: “Lessee, at its option, is hereby GIVEN THE RIGHT AND POWER TO POOL OR COMBINE THE ACREAGE COVERED BY THIS LEASE… with OTHER LAND… WHEN IN LESSEE’S JUDGMENT IT IS NECESSARY OR ADVISABLE TO DO SO in order to explore, or to develop and operate said leased premises… operations for drilling on or production of oil or gas commenced from any part of the pooled unit… shall be considered as operations for drilling on or production of oil and gas from land covered by this lease whether or not the well or wells be located on the premises covered by this lease…”**
    - **Implication: Production/drilling on any part of pooled tract satisfy lease requirements 🡪 no termination. (Scott v. Pure Oil Co.)**
    - Language in lease is outer bounds of pooling ability – if less than allowed by law, the lease controls. (Jones v. Killingsworth)
    - Pooling must be done in good faith. (Amoco Production Co. v. Underwood).
    - **Pooling ability of Lessee may be limited by PUGH CLAUSE, requiring that:**
      * **ADRs must be paid for tracts not a part of the pooled land (non-productive acreage); and**
      * **Lease will expire after X period of time for land not included in the pooled tract if no production on the outliers.**
      * And possibly requiring the release of underground non-productive formations (typically formations lower than level from which oil is being produced).
  + **#5 – ANNUAL DELAY RENTALS (NO DRILLING) CLAUSE**
    - **Standard Text: “IF OPERATIONS FOR DRILLING ARE NOT COMMENCED… ON OR BEFORE ONE YEAR FROM THIS DATE, THE LEASE SHALL THEN TERMINATE… UNLESS on or before such anniversary date LESSEE SHALL PAY OR TENDER… the sum of X dollars (ANNUAL DELAY RENTALS)…”**
    - **Implication: If no drilling operations began in first year, then Lessee must pay ADR to keep lease from terminating. (And will then have to pay annually for life of lease while still no drilling.)**
    - Effective Date of Payment = Date payment is delivered to Lessor OR mailed to Lessor/Lessor’s bank.
    - Meaning of “Commencement” = “substantial surface preparations to drill… such as making and clearing a location, delivering equipment to the well site, and the like, provided that such preliminary operations are continued in good faith and with due diligence until the well is actually spudded in.” (Breauz v. Apache Oil Corp.)
  + **#6 - ANNUAL DELAY RENTALS (PRODUCTION CEASES OR DRY HOLE) CLAUSE**
    - **Standard Text: “If PRIOR TO DISCOVERY AND PRODUCTION… Lessee should drill a DRY HOLE, or if AFTER… PRODUCTION… THE PRODUCTION SHOULD CEASE… THIS LEASE SHALL NOT TERMINATE IF LESSEE COMMENCES OPERATIONS FOR DRILLING OR RE-WORKING… within 60 days thereafter or IF IT BE WITHIN THE PRIMARY TERM, COMMENCES OR RESUMES THE PAYMENT… OF RENTALS… within 60 days.”**
    - **Implication:**
      * **If cessation AFTER primary term, Lessee MUST drill within 60 days or lease will terminate.**
      * **If cessation DURING primary term, Lessee MUST pay ADR or lease will terminate.**
    - Relationship to Clause #2 – Temp. cessation does not affect the status of the lease under #2, but #6 says that if there is a cessation of production [fact determination], Lessee must do something within X days 🡪 Clauses #2 + #6 together = not clear if lease really terminates after X days under #6 (but lease may still be alive – Clifton v. Koontz)
  + **#11 – FORCE MAJEURE CLAUSE**
    - **Standard Text: “Should Lessee be prevented from complying with any… covenant of this lease… BY REASON OF SCARCITY OR OF INABILITY TO OBTAIN OR USE EQUIPMENT OR MATERIAL, OR BY OPERATION OF FORCE MAJEURE, ANY FEDERAL OR STATE LAW OR ANY ORDER, RULE OR REGULATION OF GOVERNMENTAL AUTHORITY, then while so prevented, LESSEE’S OBLIGATION TO COMPLY WITH SUCH COVENANT SHALL BE SUSPENDED…”**
    - **Implication: failure to comply with lease b/c of listed reason ≠ termination**
* **PAYMENT OF ROYALTIES**
  + **Royalty payments are determined from the provisions of the oil and gas lease, NOT from any subsequent prices stipulated in contracts.** (Texas Oil and Gas Corp v. Vela)
  + Market value is defined by the price property would bring when it is offered for sale by one who desires, but is not obligated to, sell, and is bought by one who is under no necessity of buying it. The market value of oil/gas can be calculated by using comparable sales (comparable in time, quality, quantity and availability of marketing outlets). **Three tiered approach (Piney Woods Country Life School v. Shell Oil:**
    - **If the product is being sold at the wellhead as it is produced in a contract negotiated at the time of sale, then this price is market value** (unless the sale is not at arms length or unless the lessee has acted unreasonably).
    - **In the absence of such actual sales at the wellhead, comparable sales are strong evidence of market value.**
    - **OR, the “work back” method can be used – The lessor’s gas is traced to the point where it is sold off the lease. These sales proceeds, minus the reasonable costs of processing, transporting and other post-production services, is the amount used for royalty payments.**
  + **“Sold off the premises” v. “Sold at the wells”** (Exxon Corp. v. Middleton)
    - **“Sold off the premises” = gas which is sold outside the leased premises**
    - **“Sold at the wells” = gas sold at the wells within the lease, and not sold at the wells within the fields.**
  + **Division Orders**
    - **Declare the market value at the mouth of the well such that the pipeline purchaser knows the definite amount.**
    - **Does not change the basis for calculating royalty payments from the terms of the lease.** (Amoco Production Co. v. First Baptist Church of Pyote)
    - **They are binding only for the time and to the extent that they have been or are being acted on.** (Exxon Corp. v. Middleton)
* **IMPLIED COVENANTS**
  + **“Whatever is necessary to the accomplishment of production of oil and gas to pay royalties is part and parcel of the contract, though not specified.” (Brewster v. Lanyon Zinc Co.)**
  + General covenants (Brewster v. Lanyon Zinc Co.):
    - Reasonable time for performance implied (if no fixed time).
    - Reasonable quality implied (if no stated requirements).
    - Reasonable exploration and production of lands (if not stated).
    - **3 general implied covenant categories (Sun Oil v. Jackson):**
      * **To develop;**
        + = to drill an initial well + to reasonably develop the lease after production has begun
      * **To protect the leased premises;**
        + = to protect against drainage + not to depreciate the lessor’s interest
      * **To manage and administer the leasehold.**
        + = to produce and market + to operate with reasonable care + to use successful modern methods of production/development + to seek favorable administrative action (when needed).
  + **Implied Covenant to Develop:**
    - **= implied obligation for the Lessee to develop and produce oil/gas WITH REASONABLE DILIGENCE, AS AN ORDINARY AND DILIGENT OPERATOR WOULD DO to the end that SUCH OPERATIONS WOULD RESULT IN BENEFIT/PROFIT FOR BOTH THE LESSOR AND LESSEE. (Clifton v. Koontz)**
    - **There is no implied covenant to explore as distinguished from the implied covenant to conduct additional development after production has already occurred** (i.e. obligation begins when you know oil is there). (Clifton v. Koontz).
  + **Implied Covenant to Protect Against Drainage:**
    - **A Lessee has an implied obligation to protect from local drainage (i.e. oil migration from under one lease to the well bore of a producing well on an adjacent lease) by drilling off-set wells.** (Amoco Production v. Alexander)
  + **Implied Covenant to Administer and Manage the Leasehold**:
    - There is no implied covenant that requires a lessee to give notice of its intent to sue an adjoining operator. (HECI Exploration Co. v. Neel)
    - **Includes the duty to market the oil and gas reasonably.** (Yzaguirre v. KCS Resources). Duty begins when the product is discovered. (Amoco Production Co. v. First Baptist Church of Pyote)
* **LEGAL LIMITS ON PRODUCTION (BY GOVERNMENT)**
  + Principle of Correlative Rights (governing the relationship between different tract owners with a common reservoir) – Each owner has the right to drill and consume the oil, but they should not do so in a manner that harms the other owner’s ability to produce from the same field.
  + **Doctrine of Correlative Rights 🡪 Conservation Legislation**
    - = Action of the police power by the Legislature (Commission) that balances public’s interest in preserving the natural resources with the landowner’s interest in developing and selling the minerals 🡪 **STATE CAN REGULATE TO PREVENT UNNECESSARY LOSS, DESTRUCTION OR WASTE, BUT CANNOT “TAKE” UNDER 5TH AMENDMENT (CONFISCATION). (Champlin Refining Co. v. Corp. Comm. of State of Oklahoma)**
    - **State (Commission) can regulate:**
      * **Flow**
      * **Spacing of Wells**
    - **Exceptions – Granted to prevent a CONFISCATION (taking) from occurring**
      * Court may consider:
        + Economic loss to landowner that will result if no Exception is granted
  + **POOLING ACT**
    - **CURRENT LAW:**
      * **Rule 37 still in effect with 40 acre spacing (regular spacing)**
      * **Rule 37 Exceptions still the law today, BUT, because of proration based on acreage, there is not much small tract drilling 🡪 B/C alternative to POOL is available and would probably give them a higher profit.**
      * **Pooling Act:**
        + **Once there is a FAIR AND REASONABLE OFFER TO POOL:**

**Tract owner can consent to pooling.**

**Forced Pooling 🡪 RR Commission will force if tract owner gets F&R offer and does not consent 🡪 Non-consenting owner will get pay only when well pays out, only as to share and will not receive royalties. Non-consenting owner may be forced to pay their share of drilling costs.**

* Differences between Pound Lease and TX Lease Packet
  + SHUT-IN WELL PROVISIONS: Pound lease makes shut-in wells by definition operations [so the lease extends for primary term and as long as operations are conducted]. In TX Lease, lessee must make shut-in well payments for them to classify as production and keep from expiring.
  + SIGNIFICANT EVENT IN EACH: Pound lease makes OPERATIONS a significant event to keep the lease running, whereas in the TX lease, PRODUCTION is significant.