Elemental Principles of the Modern Oil and Gas Lease

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By EARL A. BROWN, JR.*

My subject today is certainly all-inclusive and encompasses much of the field of oil and gas law. The limitation of my discussion has been more difficult than the statement of it; lack of time has required the omission of many interesting and fascinating derivative problems arising out of the present-day oil and gas lease and the so-called lessor-lessee relationship created by it. It has also been necessary to omit any discussion of the history and evolution of the lease form, and to limit my remarks to the point that I will only indicate certain elemental principles of the modern oil and gas lease on non-government land.

The oil and gas lease represents the agreement between the owner of the land, or the mineral rights and interests therein, and another party called a lessee for the granting of certain rights and interests so that the lessee can drill for and produce oil and gas. Naturally, all oil and gas lease forms do not contain the same words and provisions; likewise, the nature of the interests and the legal relationships so created vary with the laws of the different states. Depending on the jurisdiction, this interest has been held to be "a profit a prendre, a corporeal hereditament, an incorporeal hereditament, an estate in land, not an estate in land, an estate in oil and gas, not an estate in oil and gas, a servitude, a chattel real, real estate, interest in land, not an interest in land, personal property, a freehold, a tenancy at will, property interest, and the relation of landlord and tenant." Whatever the legal definition of the interest may be, however, there is not too much practical difference in these interests or rights as between states, and to a large extent, we find that actual operations under standard oil and gas leases do not substantially differ in any of the oil producing states of this country. While the technical wording and phraseology of the lease form are not identical in every instance, experience has demonstrated that it should contain the following parts:

1. The lease must have two parties, a lessor and a lessee, and provide for the payment of a consideration.

2. The lease must be dated and ordinarily provides that it shall remain in force for a definite term of years (called the primary

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1 SUMMERS, THE LAW OF OIL AND GAS, § 152, pp. 372-76 (2nd Ed. 1938). However, without regard to the nature or classification of leasehold interests, it appears that in the event of a sale or assignment of these interests through the mails, such assigned interests may be "securities" within the meaning of that term as defined in the Securities Act of 1933, 15 U.S.C. 77b(1) (1952), and the seller should file his registration statement with the Securities and Exchange Commission and otherwise comply with the provisions of the Act. See Securities & Exch. Com. v. C. M. Joiner Leasing Corp., 320 U.S. 344, 64 Sup. Ct. 120, 88 L.Ed. 88 (1943); Wall v. Wagner, 125 F. Supp. 854 (O. D. Neb. 1954); Note, 163 A.L.R. 1060 (1946). For a summary of authorities and articles regarding the application of various state Blue Sky Laws to such transactions, see Discussion Notes, 3 Oil and Gas Reporter 1747 and 4 Oil and Gas Reporter 369. In this connection, North Dakota in 1953 adopted an act requiring oil and gas brokers to register and file a surety bond. N. Dak. Rev. Code, c. 45-22 (1953 Supp.).
term) and as long thereafter as oil or gas is produced from the leased land.

(3) The lease must contain a granting clause and a description of the leased land.

(4) The lease should contain royalty provisions under which the lessee pays the lessor certain royalties in the event of production. By reason of the increasing importance of natural gas production, it is now also important to provide for the payment of so-called shut-in gas royalties.

(5) The lease should contain a provision allowing the lessee to perpetuate the lease by payment of annual rentals during the primary term absent production.

(6) The lease should contain provisions defining the rights of assignment and surrender.

(7) The lease should contain provisions for drilling or reworking operations on the leased land.

(8) In addition to the other royalty provisions, the lease should contain a provision for the reduction of the rentals and royalties payable under the lease where the lessor owns less than the entire fee simple estate therein.

(9) The lease should contain a force majeure clause.

(10) Depending upon the agreement of the parties, the lease may contain a provision for pooling and unitization, an entirety clause, and other miscellaneous provisions.

In discussing these various clauses and provisions, reference will be hereafter made to representative clauses and provisions generally accepted in this country.

I. PARTIES

As in deeds and other conveyances, there are two parties to an oil and gas lease. The grantor, or the granting party, is referred to as “lessor” throughout the lease, regardless of whether or not more than one person joins in and executes the lease as a lessor. The grantee, or the party to whom the grant is made, is referred to as the lessee.

It appears to be industry practice, wherever practicable, to name all of the owners of the mineral fee interest in the land as lessors in one lease rather than have each owner of an undivided mineral interest execute a separate lease covering only his interest. If this is done, provision should be made for the execution of the lease in counterpart; this expedites the execution and delivery of the lease to the lessee, thereby commencing its operative effect and the running of the primary term of the lease. In the absence of agreement to the contrary, it is also desirable to provide that if any one or more of the parties named as lessors fail to execute the lease, it will nevertheless be enforceable as a lease contract between the lessee and those lessors who do execute it.  

*This should result without an express provision. However, in Watson v. Cloud, 225 S.W. 807 (Tex. Civ. App. 1920), which was an action to cancel an oil and gas lease, the court admitted parol evidence of lessees that the lease was not intended to be effective until executed by all of the lessors named in the lease. While such an intention does not usually exist in this type of lease situation, it is
Before the owners of separate tracts of land join in the execution of one lease covering all of such tracts of land, it is important to determine that each owner realizes the legal effect of this joint execution. For example, John Jones owns Tract A and Henry Smith owns Tract B, and they join in the execution of one lease covering both tracts of land. In the absence of an express provision in the lease to the contrary, it appears to be the settled rule that where two or more separately owned tracts are included in a single lease, all of such tracts of land will be treated as pooled, and the lease royalties will be paid to the respective lessors on the basis of their acreage ownership, regardless of the tract or tracts from which the oil and gas may be produced. A further refinement of this principle of legal construction was recently announced by the Oklahoma Supreme Court in a case where the owners of separate tracts of land executed separate identical leases describing lands owned by all of them. The Oklahoma court said:

The fact that here, instead of all owners signing one lease, all owners signed separate identical instruments, makes no difference. As in the Peerless case, supra, the signing of the instruments covering the entire tract bespoke an intention on the part of each lessor that the tract would be developed as a unit. Plaintiff made no proof of any agreement or expressed intention between the lessors to the contrary. The judgment of the trial court that the entire tract should be communitized is therefore correct.

Where there is a life estate interest in the land, the general rule is that both the life tenant and the remainderman should join in the execution of a lease. While this may not be required where the open mine doctrine is desirable to resolve any question on this point. In the absence of contrary intention on the part of the lessors, the following clause is sometimes used:

Should any one or more of the parties named above as lessors fail to execute this lease, it shall nevertheless be binding upon the party or parties executing the same.


Parker v. Parker, 144 S.W.2d 308 (Tex. Civ. App. 1940, err. ref. N.R.E.); French v. George, 159 S.W.2d 506 (Tex. Civ. App. 1942, err. ref. N.R.E.); Lynch v. Davis, 79 W.Va. 437, 92 S.E. 427 (1917); Hamilton v. McCull Drilling Co., 131 W.Va. 750, 50 S.E.2d 482, 484 (1948); Higgens v. California Petroleum and Asphalt Co., 109 Cal. 304, 41 Pac. 1087 (1895); Clark v. ELSINORE Oil Co., 138 Cal. App. 6, 31 P.2d 476, 478 (1934); Peerless Oil & Gas Co. v. Tipken, 190 Okla. 396, 124 P.2d 418 (1942); Shell Petroleum Corporation v. Calcasieu Real Estate & Oil Co., 185 La. 751, 170 So. 785 (1936); Louisiana Canal Company v. Heyd, 189 La. 903, 181 So. 439, 116 A.L.R. 1260 (1938). In Southland Royalty Co. v. Humble Oil and Refining Co., 249 S.W.2d 914 (Tex. Sup. Ct. 1952), it was held that a 20-year term mineral interest, which was so pooled and unitized with other lands, was extended beyond the 20-year term by production on one of the other leased tracts of land.

Parker v. Parker, supra; French v. George, supra; Peerless Oil & Gas Co. v. Tipken, supra, Lynch v. Davis, supra.


Summers, supra, §§ 223, 224, 225; Annot., 43 A.L.R. 811. In a recently reported case, Welborn v. Tidewater Assoc. Oil Co., 217 F. 2d 509 (10th Cir. 1954), the lessee had acquired a lease only from a remainderman. The court opinion reads in part:

It is well settled that a remainderman may not make an oil and gas lease to permit immediate exploration and production without the consent of the life tenant. (citing authorities) Likewise, a life tenant cannot drill new oil or gas wells, or lease the land to others for that purpose. (citing authorities) A life tenant and the remainderman may lease the land by a joint lease (citing authorities) ... and they may agree as to the division of the rents and royalties. In the absence of such agreement, the life tenant is not entitled to any part of the royalties, but is entitled only to the income from such royalties. (citing authorities).
applicable, it is desirable, as a practical matter, even in that situation that the life tenant and remainderman join in executing the lease. Further, where the life tenant and remainders join in executing one lease, express provision should be made in the lease designating the manner of payment and to whom the delay rentals, royalties and other lease considerations should be paid.

II. GRANTING CLAUSE

The granting clause creates and defines the purposes, rights, and interests granted by the lessor to the lessee, and while its wording may not be identical in different forms of oil and gas leases, its meaning, except for minor variations, has been held to be essentially the same. As is clearly evidenced by the clause itself, the grant by the lessor is for the purpose of enabling the lessee to explore, drill for, and produce oil and gas, and all other purposes incidental thereto.

A key word in the granting clause is the word "exclusively." Some leases use the word—it is not found in other lease forms. Much has been written about its effect in defining the extent of the rights and interests granted the lessee; one writer has summarized this point as follows:

More than half the granting clauses studied use the word "exclusively" immediately following the words of grant and lease, while some use the same word or 'exclusive' as many as three times in specifying particular types of rights and privileges, all showing the intent of the parties, or at least of the lessee, that the rights conferred on the lessee be safeguarded against interference. The full effect of these expressions of exclusiveness has not been adjudicated, but experience shows that some of the lessee’s rights and privileges are accepted as exclusive even without being so granted, while exclusiveness, though specified as part of the grant, is not extended to all of the lessee’s enumerated and implied rights.

While not conclusive, it appears that the exclusiveness of the rights granted the lessee has been construed as follows:

(1) The right of the lessee to drill and produce has been affirmed as an exclusive right within the strict sense of the word, whether

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"Also, if the life tenant does not own the full undivided life interest in all of the land, i.e., if he owns only an undivided one-third life estate interest, the rule would not apply against a remainderman or cotenant owning an undivided mineral fee interest in the land. Davis v. Atlantic Oil Producing Co., 87 F.2d 75 (5th Cir. 1936).

See Welborn v. Tidewater Assoc. Oil Co., supra.

McRae, Granting Clauses In Oil and Gas Leases, Second Annual Inst., Southwestern Legal Foundation, pp. 43 et seq.

A representative clause reads:

Lessor . . . grants, leases and lets exclusively unto lessee for the purposes of investigating, exploring by geophysical and other methods, prospecting, drilling, mining and operating for and producing oil, liquid hydrocarbons, all gases (including, without limitation, hydrogen sulfide gas), and their respective constituent products, injecting gas, water, other fluids, and air into subsurface strata and conducting secondary recovery operations, laying pipe lines, storing oil, building tanks, power stations, roads, telephone lines, and other structures and things thereon to produce, save, take care of, treat, manufacture, process, store and transport said oil, liquid hydrocarbons, gases, and their respective constituent products and other products manufactured therefrom, and housing and otherwise caring for its employees.

McRae, supra, at p. 52.
or not the word "exclusive" is used in the granting clause of the lease."

(2) With respect to the surface rights or privileges granted by the lease as laying pipelines, erecting telephone and telegraph lines and transporting oil, such rights and privileges have been held to be exclusive in the lessee only for the purposes of the lease; the lessor retains the right to use the land in any way not inconsistent with the lessee's rights."

(3) The question has been raised as to whether or not the right of the lessee to prospect, investigate and explore, such as is done in the case of geophysical exploration operations, is exclusive to him. One writer, after presenting the arguments both for and against the exclusiveness of these exploration rights, has indicated that such rights should be non-exclusive because any other rule would retard exploration, discovery, and production in the development of oil and gas resources;" however, there is reasoning to the contrary."

Trespass without permit or consent is the principle of law which most often arises in connection with geophysical explorations," and it is possible that there will be future litigation involving this question of exclusiveness in an action for trespass."

There is no problem peculiar to the oil and gas lease with reference to the description of the leased land; the legal description of the land, such as is sufficient for conveyancing in deeds and other instruments, should also be used in the lease. However, a problem may arise when the lessor owns only an undivided interest in the land and the land description expressly recites that the lease covers only such undivided interest. For example, in Texas Co. v. Parks, 247 S.W. 2d 179, (Tex. Civ. App. 1952, err. ref. N.R.E.), the lessors leased their undivided one-half interest in a designated tract of land under an oil and gas lease containing the usual proportionate ownership clause (sometimes called a reduction of rentals and

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13 Summers, supra, § 532 and cases cited. See also Hull, Oil and Gas Lessee v. Seismograph Licensee, 21 Okla. Bar Journal 1509, and McRae, supra, at p. 53.

14 A Summers, supra, § 652, pp. 2 et seq., and cases cited; Hull, supra, at p. 1509.

15 McRae, supra, at pages 65-80. While recognizing that there is a problem in the absence of lease provision, Mr. McRae expresses the opinion that "when the exploratory right is expressed as exclusive, necessarily no such right remains in the landowner." There is one Texas case which supports this view. Wilson v. Texas Co., 237 S.W. 2d 640 (Tex. Civ. App. 1951, err. ref. N.R.E.).


17 In such actions, however, the plaintiff is faced with the difficulty of establishing a satisfactory measure of damages. Nearly all of the few geophysical cases which have reached the appellate courts have dealt not with the question of trespass but with the measure and proof of damages. Thomas v. Texas Co., 12 S.W. 2d 597 (Tex. Civ. App. 1928); LeBleau v. Vacuum Oil Co., 15 La. App. 689, 132 So. 233 (1931); Shell Petroleum Corporation v. Scully, 71 F. 2d 772 (5th Cir. 1934); Angeloz v. Humble Oil & Refining Co., 196 La. 604, 199 So. 655 (1940); Layne Louisiana Co. v. Superior Oil Co., 209 La. 1014, 26 So. 2d 20 (1946); Iberville Land Co. v. Amerada Petroleum Corporation, 141 F.2d 384 (5th Cir. 1944); Kennedy v. General Geophysical Co., 213 S.W. 2d 707 (Tex. Civ. App., writ ref. N.R.E. 1948); Franklin v. Arkansas Fuel Oil Co., 233 La. 957, 51 So. 2d 600 (1951); Wilson v. Texas Co., supra. A recent case in New Mexico, allowing recovery of actual damages by owner of grazing leases on state land, is Tidewater Assoc. Oil Co. v. Shipp, N.M.......

royalties clause)," and providing for the payment of a delay rental of $160.00. In accordance with the proportionate ownership clause, the lessee reduced the rental stipulated in the lease and paid the lessors the sum of $80.00 as the first delay rental payment. The lessors brought an action to have the lease removed as a cloud upon their title. The court upheld judgment for lessors, stating that the proportionate ownership clause referred to the fractional interest described in the lease and not the entire tract and that, therefore, there should have been no reduction in the rental stated in the lease. However, the decision in this case may well be limited to the fact situation there involved, and it is doubtful if it will receive general application. In the discussion notes following the Parks case which are reported in 1 Oil and Gas Reporter 559, it is stated:

Where a lease by its terms purports to cover the full mineral interest, then clearly the lessee can rely upon the proportionate reduction clause if in fact the lessor owns only a partial interest. However, if the lease expressly sets forth that it covers only a partial interest, as, for example, an undivided one-half interest, then the question is presented of whether the reference to land in the partial ownership clause is a reference to the interest set forth (one-half in the example) or to the full fee simple title to the land. The principal case, which is believed one of the first impression, holds that the reference is to the interest designated. It is respectfully submitted that this holding is in error, and it is hoped that the case will not be followed. It is the writer's opinion that the reference to land in the proportionate reduction clause is intended as a reference to the full fee simple interest therein, and that this is true regardless of whether a fraction is set forth in the lease. It is important, however, to watch for this question in every instance, unless and until the principal case is overruled.

In the event the lease contains a proportionate ownership clause, it is suggested that in drafting the land description for the lease, any reference to an undivided interest of a lessor should be omitted in the land description." This will obviate the necessity for making changes in the delay rental and other provisions of the lease, changes which sometimes result in creating ambiguities with respect to the lease and the lessor-lessee intention.

III. MOTHER HUBBARD CLAUSE

A representative Mother Hubbard clause, which normally follows the description of the land in the lease, reads as follows:

Notwithstanding the above description and/or any error therein, it is nevertheless the intention of lessor to include within this lease and lessee does hereby lease any and all other land owned or claimed by lessee in the herein named section or sections and in ad-

This type of clause usually reads:

"Without impairment of lessee's rights under the warranty in the event of failure of title, it is agreed that, if lessor owns an interest in said land less than the entire fee simple estate, then the royalties and rentals to be paid lessee shall be reduced proportionately."

Because of the warranty clause in the lease, some lessors insist on describing their exact interest. In view of the reduction clause and other considerations, it is doubtful if concern on this point is justified. However, if the reduction clause is omitted from a lease covering only an undivided interest, care should be taken to spell out the intention of the parties as to payment of lease bonus, delay rentals and royalties. See Gibson v. Turner, 278 S.W.2d 916 (Tex. Civ. App. 1955, err. pend.)
joining sections, and lands adjoining the herein described land up

to the boundaries of the abutting landowners, together with any

and all lessor’s lands underlying lakes, streams, roads, easements,

and rights of way which cross or adjoin said lands. For the pur-

pose of calculating the rental payments hereinafter specified, said

lands leased herein are estimated to comprise ....... acres, whether

they actually comprise more or less.

This clause, also sometimes called a coverall clause, is intended as an aid in

perfecting the description of the leased land so as to accomplish the inten-

tion of the parties to lease all of a tract of land, regardless of the legal
description or errors and omissions therein. In some instances, the result

is that it saves defective lease descriptions and avoids the necessity for litiga-
tion to reform the lease. In addition, one writer has stated that its purpose

is to pick up strips of land to which the lessor has acquired limitation title.  

However, it is doubtful if this is the principal purpose of this clause; in

fact, there may be doubt as to the efficacy of the Mother Hubbard clause to

accomplish this purpose in the absence of such intention on the part of the

lesser and lessee.

Objection is sometimes made to this clause where the lessee takes a lease

which does not cover all of the lessor’s land, the ground for the objection

being that the Mother Hubbard clause clouds the title to the unleased land.  

In all situations of this type which I have known, the lessor has had no

problem in obtaining a release of the lease insofar as the unleased acreage

is affected. Nevertheless, when not all of a lessor’s land is leased, care

should be taken in properly drafting the lease so that a release will not be

necessary.

IV. TERM CLAUSE

A representative clause of this type reads:

Subject to the other provisions herein contained, this lease shall

remain in force for a term of ten (10) years from this date (called

‘primary term’), and as long thereafter as oil, liquid hydrocarbons,

Masterson, A Survey of Basic Oil and Gas Law, Fourth Annual Inst., South-

western Legal Foundation, p. 248.

This question is discussed in 3 Oil and Gas Reporter 1951, as follows:

“For example, there may be a row of trees three hundred feet east of the actual

east boundary line, which trees make convenient substitutes for fence posts.

Thereafter the landowner culminates title to the strip by adverse possession.

Still later the landowner executes an oil and gas lease which carries forward

the description in the deed, and thus usually fails to pick up the strip to which

landowner has acquired title by adverse possession. It may be possible for

such a description to include the strip under the doctrine of agreed boundary

[ Gulf Oil Corporation v. Marathon Oil Co., 137 Tex. 59, 152 S.W.2d 711 (1941) ]

or the doctrine of boundary by acquiescence [Anderson v. Atlantic Oil Producing

Co., 83 S.W.2d 418 (Tex. Civ. App. 1935) ], however, it is never safe to assume

that either doctrine applies where the problem before the attorney is preparation

of instruments, or advising as to the construction thereof, short of lawsuit

sage.”


McRae, supra, pp. 83 et seq.

However, see Masterson, supra, at p. 263 where Professor Masterson states that

though there is an unwritten law in the oil and gas industry that tracts “inadver-
tently caught” by this clause will be released, this unwritten law is not always

complied with, citing United Gas Public Service Co. v. Mitchell, 188 La. 561, 177 So.

697 (1937) ; Cummings v. Midstates Oil Corp., 193 Miss. 675, 9 So.2d 645 (1942) ;

Sun Oil Co. v. Burns, 125 Tex. 549, 84 S.W.2d 442 (1935).
or any of them, is produced from said land or land with which said land is pooled.\(^5\)

Because of time, I will not discuss the nature of the lessee's interest under the lease, or the related questions of determinable fee, condition subsequent or words of limitation which usually attend a consideration of this clause.\(^6\) Further, only brief reference can be made to the proposition that, under the majority rule in this country, the condition that the lease shall remain in force as long as oil, etc. "is produced from said land or land with which said land is pooled" means production in paying quantities. A leading case announcing this rule is \textit{Berthelote v. Loy Oil Company,}\(^1\) decided by the Montana Supreme Court in 1933. In that case, though the lease did not provide that production necessary to continue the lease should be in paying quantities, the court nevertheless held that to perpetuate the lease, the production must be in paying quantities.\(^2\) This rule has been criticized,\(^3\) and some oil and gas producing jurisdictions have refused to follow it.\(^4\) Nevertheless, it has a reasonable basis and will probably be adopted by more courts with the passage of time.

When the agreement between the lessor and lessee provides for the drilling of test wells, careful drafting is required to resolve the conflict which may exist between the drilling obligation and the lease provisions for terminating the term of the lease. Otherwise, it is possible that the lessee may freely avoid his drilling obligation by surrendering the lease, even though the drilling obligation is the consideration for the lease.\(^5\) Again, if the lease is not intended to authorize pooling or unitization, care should be taken to delete the pooling reference in this clause.

\(^5\)See also Williams, \textit{Primary Term and Delay Rental Provisions, Second Annual Inst., Southwestern Legal Foundation, pp. 93 et seq where the suggestion is made that the thereafter clause should be redrafted so that it may be clearly understood to operate by way of condition subsequent rather than by way of special limitation.

\(^6\)In holding that "paying quantities" means such an amount of production as would pay a small profit over the cost of operating the well (excluding the initial cost of bringing the well into production), the Montana Court, at 28 P.2d 191, said:

"Frequently oil and gas leases in the 'thereafter' clause provide that the lease is to continue after the fixed term so long as oil or gas is produced in 'paying quantities.' Most courts hold the legal effect of that clause and of the one 'so long as oil or gas is produced' to be the same; and to extend the lease under a clause such as is before us, the production must be in paying quantities. \textit{Summers on Oil and Gas,} § 98, pp. 315, 316; \textit{South Penn Oil Co. v. Snodgrass,} 71 W. Va., 438, 76 S.E. 961, 43 L.R.A. (N.S.) 848; \textit{Gypsy Oil v. Marsh,} 121 Okl. 135, 248 Pac. 329, 48 A.L.A. 876; Parks v. Sinai Oil & Gas Co., 83 Okl. 295, 201 Pac. 517. We prefer to follow the majority rule."

See also Garcia v. King, 139 Tex. 578, 164 S.W. 2d 509 (Tex. Sup. Ct. 1942), and cases there cited.

\(^7\)Williams, \textit{ supra,} pp. 107 et seq. Professor Williams suggests that the lease should terminate, where there is some production but not in paying quantities, only when the equities are equal and that the condition of termination should be treated in the manner of a condition subsequent. \textit{Cf., Reynolds v. McNell,} 218 Ark. 453, 236 S.W. 2d 728 (1951). But see, for the Texas rule, \textit{Walker, The Nature of the Property Interests Created by an Oil and Gas Lease in Texas,} 8 Texas L. Rev. 483, 515 (1930).


\(^9\)Joyce v. Wyant, 202 F.2d 683 (6th Cir. 1953). However it should be noted that the court here based its decision in part on the fact that an "unless" lease, as distinguished from an "or" lease, was involved in this case. While this basis for the opinion in the Wyant case is questionable, this case does indicate the conflict which exists between a covenant to drill a test well and other lease provisions which per-
when a new lease, or a renewal lease, is taken on a tract of land on which an old well has already been drilled, reported decisions indicate that the parties should make express provision evidencing their intention as to whether or not production from the oil well under the new lease will continue such lease in force. Further, other problems are presented where the oil and gas lease provides for development of separate tracts of land covered by the lease.

V. ROYALTY CLAUSE

As is reflected by the representative clause shown below, there are no complicated provisions for payment of the customary one-eighth royalty on oil and gas production. With respect to oil, there is normally a posted market price by which lessee may terminate the lease at will. See also Brightwell v. Norris, 242 S.W. 2d 201 (Tex. Civ. App. 1951, err. ref. N.R.E.) ; Superior Oil Co. v. Dabney, 147 Tex. 51, 211 S.W.2d 563 (1948) ; Terrell v. Munger Farm Co., 129 S.W.2d 407 (Tex. Civ. App. 1939, err. dism. J.C.) ; Matheson v. Ploud Oil Co., 212 La. 807, 33 So.2d 527 (1947) ; Subutler v. Canal Oil Co., 202 La. 639, 12 So.2d 665 (1942) ; Lavery v. Mid-Continent Oil Development Co., 62 Okla. 206, 162 Pac. 737 (1917) ; Paraffine Oil Co. v. Cruce, 63 Okla. 95, 162 Pac. 716 (1916) ; 2 SUMMERS, supra, § 392.

West v. Continental Oil Company, 194 F.2d 893 (5th Cir. 1952) ; Ryan v. Kent, 36 S.W.2d 1007 (Tex. Comm. App. 1931).

Kidd v. Hickey, 237 S.W.2d 389 (Tex. Civ. App. 1950, err. ref. N.R.E.) (this case illustrates the need for careful lease drafting in this type of situation) ; see Note, Termination of Lease by Failure to Produce or Pay Delay Rentals, 30 TEXAS L. Rev. 378 (1952).

The royalties to be paid by lessee are: (a) on oil, and on other liquid hydrocarbons saved at the well, one-eighth of that produced and saved from said land, same to be delivered at the wells or to the credit of lessor in the pipeline to which the wells may be connected, or lessee, at its option, may pay to lessor for such one-eighth royalty, the market price at the well for oil of like grade and gravity prevailing at the time of production; (b) on gas, including casinghead gas and all gaseous substances, produced from said land and sold or used off the premises or in the manufacture of gasoline or other products therefrom, the market value at the mouth of the well of one-eighth of the gas so sold or used, provided that on gas sold at the wells the royalty shall be one-eighth of the amount realized from such sale; and (c) at any time, either before or after the expiration of the primary term of this lease, if there is a gas well or wells on the above land (and for the purposes of this clause, (c), the term 'gas well' shall include wells capable of producing natural gas, condensate, distillate or any gaseous substance and wells classified as gas wells by any governmental authority) and such well or wells are shut in before or after production therefrom, lessee and any assignee hereunder may pay or tender an advance annual royalty equal to the amount of delay rentals provided for in this lease for the acreage then held under this lease by the party making such payment or tender, and if such payment or tender is made, it shall be considered under all provisions of this lease that gas is being produced from the leased premises in paying quantities during any annual period for which such royalty is paid or tendered. Such advance royalty may be paid or tendered in the same manner as provided herein for the payment or tender of delay rentals. Royalty accruing to the owners thereof on any production from the leased premises during any annual period for which advance royalty is paid may be credited against such advance payment. When there is a shut-in gas well or wells on the leased premises, if this lease is not continued in force under some other provision hereof, it shall nevertheless continue in force for a period of ninety (90) days from the last date on which a gas well located on the leased premises is shut in, or for ninety (90) days following the date to which this lease is continued in force by some other provisions hereof, as the case may be, within which ninety-day period lessee or any assignee hereunder may commence or resume the payment or tender of the advance royalty as herein provided.”
ket price in the field, and ordinarily, the lessor is paid this market price for the oil. This relieves the lessor of the burden of selling his royalty oil. The situation with respect to gas production is somewhat different. As has been pointed out, due to differences in the production of oil and gas and different marketing conditions, care should be used in drafting the standards which will control the payment of gas royalties. This matter is further complicated by the fact that the lessee may have to market the gas under a long term gas purchase contract with some interstate pipeline company, but that is a separate subject.

It is also important for obvious reasons to recognize the basic differences between the oil royalty clause and the gas royalty clause. Under the oil royalty clause, the payment of such royalty to the lessor may be in kind, that is, by delivery to the lessor or his credit of one-eighth of the oil produced and saved from the leased land, and, therefore, the lessor is said to have reserved a vested royalty interest in the oil which is excepted from the grant. However, under the customary gas royalty clause, the full eight-eighths interest in the gas produced under the lease vests in the lessee, and the royalty interest of the lessor is payable only in money. The nature of this gas royalty interest is well stated in Tide Water Associated Oil Co. v. Clemens, 123 S.W. 2d 780, 783, (Tex. Civ. App. 1938). The court there said:

Appellee concedes that by the grant in the lease ownership and title to all the gas produced from the land passed to appellant. Stephens County v. Mid-Kansas Oil & Gas Co., 113 Tex. 160, 254 S.W. 290, 29 A.L.R. 566. Appellee further concedes that appellant’s agreement to pay the rentals stipulated in the royalty provisions of the lease is a personal obligation on the part of appellant, a promise to pay a specific price for a thing—gas—already conveyed to and owned by appellant. Reynolds v. McMan Oil & Gas Co., Tex. Comm. App., 11 S.W. 2d 778. And it is not disputed but


[b]Brown, supra, pp. 9-12.


[d]Some royalty clauses provide that the lessor must take his interest in kind.

[e]A leading case, cited numerous times with approval by the State and Federal courts, is Hager v. Stakes, 116 Tex. 453, 294 S.W. 853 (1927). See also Comment, Sneed, supra. No reported decision has been found on the question of whether the nature of this interest is changed where the lessee is granted the option to purchase the oil.

[f]Wall v. United Gas Public Service Co., 178 La. 908, 152 So. 561 (1934); Humble Oil & Refining Co. v. Poe, 29 S.W.2d 1010 (Tex. Comm. App. 1930); Magnolia Petroleum Co. v. Stroud, 3 S.W.2d 462 (Tex. Civ. App. 1927, err. dism.); Comment, supra, note 1, at 641, and numerous other authorities. See also Magnolia Petroleum Co. v. Connellee, 11 S.W.2d 158 (Tex. Comm. App. 1928): wherein the court held that under an oil and gas lease, which expressly provided for the payment of a fixed sum per gas well per year, all of the casinghead gas or dry gas produced under the lease was conveyed to and became the property of the lessee.

[g]It should be noted that many of the cited references and authorities come from Texas sources, but the rules and principles of law stated therein are general rules of construction and should receive universal application. I have made a diligent search and have been unable to find any authorities announced by the courts in this area to the contrary.
that appellant's ownership of all the gas comprehends ownership of every constituent element thereof and that he had the right to sell same or any part thereof, charged only with appellee's right to demand and appellant's corresponding obligation to pay the agreed rental on the gas sold which in this case is '1/4th of the market price at the wells of the amount sold.' Magnolia Petroleum Co. v. Connellee, Tex. Comm. App., 11 S.W. 2d 158.

The shut-in gas royalty clause, shown as clause (c) under previous reference, appears at first blush to be rather complicated and involved; actually, its purpose is simple, and its involved wording has resulted only because of changes due to litigation in recent years which has involved its construction and operation. As one writer has stated, this clause 'was necessitated by the problem, recurring frequently in the oil world, posed when a well capable of producing gas in paying quantities was completed successfully at a time when there was no market or demand for its product. Often there still would be no market for the gas and no actual production from the lease, as the gas could not be stored, at the expiration of the primary term of the lease, with the result that the lessor would then contend that the lease had terminated by virtue of the automatic operation of the habendum clause—which clause operated as a clause of special limitation. Many of the courts having before them this problem, in the course of holding that a lease had terminated because of such failure of production at, or subsequent to, the expiration of its primary term, mentioned, some apparently with regret, that the lease contract did not provide for the contingency that gas wells might be developed which would be unproductive for want of a market (citing Elliott v. Crystal Springs Oil Co., (1920) 106 Kan. 248, 187 P. 692; Cox v. Miller (Tex. Civ. App. 1944, err. ref.) 184 S.W. 2d 323; Stanolind Oil & Gas Co. v. Barnhill, (Tex. Civ. App. 1937, err. ref.) 107 S.W. 2d 746); while courts in other jurisdictions [citing McGraw Oil and Gas Co. v. Kennedy, (1909) 28 L.R.A. NS, 65 W.Va. 595, 64 S.E. 1027; Strange v. Hicks, (1920) 78 Okla. 1, 188 P. 347; Eggleson v. McCasland (D.C. Okla. 1951) 98 F.Supp. 693] avoided that result by rewriting, in effect, the lease contracts or by giving such a strained construction to the language of the leases that their judgments were incompatible with the actual terms of the lease.'

This clause has been developed to resolve this situation and is considered desirable both from the standpoint of the lessor and the lessee. Some lease forms today provide for the payment of a fixed shut-in royalty to the lessor, such as a payment of $50.00 per well per year, but it is suggested that the computation of the shut-in royalty, on the same basis as that provided in the lease for delay rental payments, is fairer to the lessor and results in a more equitable lessor-lessee relationship if the lease is held during or after the primary term by shut-in royalty payments. Articles and papers have been written on this clause, and I will not elaborate on it. It is important,
however, to note that these shut-in payments have been construed as being in the nature of royalty, as distinguished from the lease delay rentals, and should be paid to the royalty owner.

VI. DELAY RENTAL CLAUSE

The delay rental clause of an oil and gas lease is an important part of the lease, and several of its provisions should be considered. Basically, in the absence of other stated conditions, this clause allows the lessee to perpetuate the lease during the primary term by payment of the annual rental to the lessor or to a bank which is designated as the depository for payment. Since it is usually desirable from the standpoint of both the lessor and the lessee, these annual rentals are customarily paid to the bank named by the lessor.

Under this clause, the delay rentals may be paid by check or draft mailed or delivered to the bank or to the lessor on or before the rental paying date. This provision is not intended to give the lessee any additional time within which to make the rental payment; however, it does serve to protect the lessee if the rental is timely mailed in good faith and is lost in the mails. If this happens, I doubt that very many lessors would feel that the lessee should be penalized. In addition, this provision for mailing resolves the problem of date of payment and otherwise simplifies the payment of the rental for the lessor.

Much has been written on the question of the extent to which there should be equitable construction of this clause, and numerous cases have

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Gas Royalty Provision in Oil and Gas Leases, 23 Tulane L. Rev. 374; Comment, Walker, Clauses in Oil and Gas Leases Providing for the Payment of an Annual Sum as Royalty on a Nonproducing Gas Well, 24 Texas L. Rev. 478 (1946).


"A representative clause reads:

"If operations for drilling or mining are not commenced on said land or on land pooled therewith on or before one (1) year from date hereof, this lease shall terminate as to both parties, unless on or before one (1) year from date hereof, lessee shall pay or tender to the lessor a rental of ...................................................... Dollars ($....................) which shall cover the privilege of deferring commencement of such operations for a period of twelve (12) months. In like manner and upon like payments or tenders, annually, the commencement of said operations may be further deferred for successive periods of the same number of months, each during the primary term. Payment or tender may be made to the lessor or to the................................., which bank, or any successor thereof, is hereby designated as the depository and agent of lessor and lessee's successors, heirs and assigns. If such bank (or any successor bank) shall fail, liquidate, or be succeeded by another bank, or for any reason fail or refuse to accept rental, lessee shall not be held in default until thirty (30) days after lessor delivers to lessee a recordable instrument making provision for another method of payment or tender, and any depository charge is a liability of the lessor. The payment or tender of rental may be made by check or draft of lessee, mailed or delivered to said bank or lessor, or either lessor if more than one, on or before the rental paying date. Notwithstanding the death of the lessor or his successors in interest, the payment or tender of rentals in the manner provided herein shall be binding on the heirs, devisees, executors and administrators of the lessor and his successors in interest."

In Burbidge v. Noe, 69 N.W.2d 280 (N. Dak. Sup. Ct. 1955), the court held that payment by the lessee of the lease delay rental to the depository bank was sufficient compliance with the lease, although the credit was not made to the transferee's account until after the date for paying the delay rental.
been decided on this point. Reference can only be made to one or two instances. In *Gloyd v. Mid-West Refining Company*, 62 F. 2d 483, (10th Cir. 1933), the lessee mailed the delay rentals to the lessor in sufficient time to reach him in the normal course of the mail, but the letter was lost and never delivered to the lessor. After the due date for payment, the lessee tendered a duplicat check which the lessor refused. In holding that the lease, covering land located in New Mexico, had not terminated, the Circuit Court (p. 486) said:

> When the lessee in an "unless" lease in good faith manifests his intention to continue the lease by undertaking to pay such rental through a method and means customarily used in such transactions, in ample time for the payment to reach the lessor or the agreed depository on or before the due date, but due to accident or mistake such payment fails to reach the lessor in time, the lease is not, because of such failure, automatically terminated. This is true because the acts of the lessee manifest an intention not to terminate the lease.

For a good discussion of this and other related matters, see an article entitled "Primary Term and Delay Rental Provisions" by Professor Howard R. Williams of Texas University. Professor Williams points out that the opinion in the Gloyd case is based on the proposition that equity will not permit the termination of the estate of the lessee where the delay rental payment is not delivered through accident or mistake, and also for the reason that there was implied authority for the lessee to use the mails for payment.

Another case involving the construction of the delay rental clause is the Texas Supreme Court decision in *Humble Oil & Refining Co. v. Harrison*. This case was decided after the shutin royalty opinion of the same court in *Freeman v. Magnolia Petroleum Co.* and was interpreted by some attorneys as a relaxation of the strict construction principle of the Freeman case. In the *Harrison* case, the lessee in good faith made a mistaken construction of the lessors' partial conveyance of their interest to another person and made delay rental payments accordingly. In holding that the lease had not terminated because of insufficient delay rental payments made under these circumstances, the court said (pp. 360-361) in part:

> It is well settled in this state that the lessee under "unless" leases, . . . has a determinable fee, and that if he fails to drill or to pay delay rentals his lease is terminated . . . In applying this rule, some cases have required a strict compliance by the lessee with the terms of the lease relating to the payment of delay rentals, holding that a small deficiency in the amount of the payment or a failure to make payment until a short time after its due date terminates the lease . . . The application of the rule has been relaxed in some cases, however. In *Perkins v. Magnolia Petroleum Co.*, Tex. Civ. App., 148 S.W. 2d 266, writ dismissed, judgment correct, it was held that a lessee sufficiently complied with the requirement of the payment of delay rentals by making a joint deposit in the depository.
bank of the total amount due under separate leases to different lessors where the lessors were disputing as to the extent of their respective interests. In Miller v. Hodges, Tex. Comm. App., 260 S.W. 168, it was held that the lease continued in effect and that the lessee was excused from making payments of delay rentals after the lessor brought suit to cancel the lease, during the pendency of the suit. In Mitchell v. Simms, Tex. Comm. App., 63 S.W. 2d 371, it was held that where the lessees received a payment of the delay rental after its due date, the lessors became estopped to assert that the lease had terminated because of delay in the payment.

Where, as in this case, the lessee has in good faith made a mistaken construction of the lessors’ partial conveyance of their interests and lessee has made a payment in accordance with such construction, of which the assignee has notice, the duty rests on the assignee to notify the lessee of its mistake so that the lessee will have an opportunity to make a proper payment of the delay rentals. Where the assignee, instead of giving the lessee such notice, remains silent, we hold that the assignee is estopped to assert that the lease has terminated as to his interest on the ground that the lessee has failed to pay to him a sufficiently large share of the delay rentals.

VII. POOLING OR UNITIZATION CLAUSE

The purpose of this clause is to enable the lessee to join in the pooling of separate tracts of land held under different leases so as to form a drilling or production unit. After the formation of the unit, production from any one of the tracts of the land included in the unit is deemed to be production from each tract of land within the unit, and each owner of an interest in the unit lands receives his proportionate part of the royalty from the unit production in lieu of other royalties payable under his lease.

I am sure that all of you are familiar with the Phillips litigation in

A representative clause reads:

"Lessee is hereby given the power and right, as to all or any part of the land described herein and as to any one or more of the formations thereunder, at its option and without lessor's joinder or further consent, to at any time as a recurring right, either before or after production but within twenty (20) years from date hereof, pool and unitize the leasehold estate and the lessor's royalty estate created by this lease with the rights of any third parties, if any, in all or any part of the land described herein and with any other land, lands, lease, leases, mineral and royalty rights, or any of them, adjacent, adjoining or located within the immediate vicinity of this lease, whether owned by lessee or some other person, firm, corporation or governmental authority, so as to create one or more drilling or production units. Lessee shall file written unit designations for record in the County in which such unit is located. In lieu of the royalties hereinafter provided, lessor shall receive on production from such unit (except units subject to the Secretary of Interior of the United States), only such portion of the royalties (shut-in or other kind) elsewhere herein specified as the amount of his acreage hereunder which is pooled in any such unit, or his royalty interest therein on an acreage basis, bears to the total acreage pooled in such unit. The commencement, drilling, completion of or production from a well on any portion of a unit created hereunder shall have the same effect upon the terms of this lease as if a well were commenced, drilled, completed or producing on the land embraced by this lease."

Scott v. Pure Oil Co., 194 F.2d 393 (5th Cir. 1952). For authorities where there is compulsory unitization or pooling under state agency order, cf. Hunter Co. v. Shell Oil Co., 211 La. 583, 31 So.2d 10 (1947) ; Texas Gulf Producing Co. v. Griffith, 218 Miss. 109, 65 So.2d 447 (1953). With respect to the effect of the lease provisions for drilling or reworking operations during, at or after the date of expiration of the primary term, see McClain v. Harper, 206 Okla. 437, 244 P.2d 301 (1952) ; Buchanan v. Sinclair Oil & Gas Co., 126 F. Supp. 950 (D.C. Tex. 1955) affd. 218 F.2d 436 (5th Cir. 1955).
Utah which involved the validity of this clause. In addition to other questions, the issues of uncertainty and the application of the rule against perpetuities were considered by the court. In upholding the validity of the unitization clause in that case, the Tenth Circuit Court said:

Section 12 does not violate the rule against perpetuities, unless the unitization or pooling agreement accomplishes transfers of interests in real property, or, otherwise stated, effects cross-transfers of property interests among the parties to the agreement. Thus, it appears that the effect of unitization was to be only with respect to allocation of production and the computation of royalties and was not to effect cross-transfers of royalty interests. The Unitization Agreement clearly so provided.

While there is a contrariety of authority on the effect of the pooling agreement with respect to whether a cross-transfer of royalty interests results, we are of the opinion the conclusion we have reached is supported by well-reasoned and more persuasive authority.

Finally, there being no time fixed within which unitization was to be effected, it must be implied that the parties intended it to take place within a reasonable time, and a reasonable time, under the facts and circumstances, would be well within the limitation of the rule against perpetuities. Hence, had there been cross-assignments, the rule against perpetuities would not have been violated. (Emphasis supplied).

Provisions in oil and gas leases for unitization have become a practical necessity in the oil and gas industry, because of governmental rules and regulations imposing strict requirements for the proper spacing of wells and the granting of production allowables on the basis of formulae predicated in whole or in part on the quantity of acreage from which the oil and gas can be efficiently recovered by one well completed in the reservoir involved. Permeability, porosity, and other information relating to the producing zone can be scientifically analyzed and a reasonably accurate determination made of the area from which the oil can be efficiently recovered by a well in that zone for the purpose of fixing the appropriate size of the pooled units for developing such zone. See Hoffman, Voluntary Pooling and Unitization, pp. 87, 88. Moreover, limiting the number of wells to be drilled to those that will efficiently recover the oil and the elimination of the drilling of unnecessary wells will prevent underground waste and the loss of oil which would result if unnecessary wells were drilled.

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 lessee, and is vital to the oil and gas industry in the interests of the 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.

A complete book or paper could be written on this subject. The cases

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55 Hoffman, Voluntary Pooling and Unitization, supra; Shank, Some Legal Problems Presented by the Pooling Provisions of the Modern Oil and Gas Leases, 23 Texas L. Rev. 150 (1945); Shank, Pooling Problems, 28 Texas L. Rev. 662 (1950).
are sometimes in conflict, and while this has resulted in part from the different concepts of the nature of the interest created by the oil and gas lease, these conflicts can not be always so explained. It is for that reason that the right to pool and unitize has been limited, in the representative clause hereinbefore mentioned, to a period of twenty years from the date of the lease. Otherwise, the clause does not substantially differ from the customary pooling clause found in many oil and gas leases.

VIII. DRILLING OR REWORKING CLAUSE

The drilling or reworking clause has been supplemented and changed over the years so as to resolve the ambiguities and problems raised by reported cases where it has been construed. Under the earlier lease forms, if during the primary term, the lessee drilled a dry hole or if production was obtained and the well ceased to produce, there was no certainty that payment of delay rentals thereafter would maintain the lease in force; if subsequent wells were not drilled or production obtained, the lease, depending on its terms, was terminated during the primary term regardless of rental payments. To meet this problem, several different types of clauses are employed in the modern lease form as, for example, a provision that if a second well is not commenced on the land within twelve (12) months from the expiration of the last rental period for which rental has been paid, the lease shall terminate. While these clauses have been upheld, there are still certain fact situations where difficulties may be encountered. Thus, it is advisable in each dry hole situation to examine the provisions of the lease to determine the exact time within which a new well should be commenced or delay rental payments resumed, since this clause may have the effect of changing the critical date for compliance with the drilling or delay rental provisions.

If the lessee has made no discovery during the primary term of the lease but is diligently prosecuting drilling operations at the expiration of the primary term, the majority rule, where there is no special lease pro-

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**Footnotes:**

67 The questions of uncertainty, rule against perpetuities, etc. have also been raised in connection with other rights under the lease. However, in view of precedent, the Phillips decision, established custom, and the very real consideration of vested interests under oil and gas leases now in force, it is doubtful if these questions present any serious problem. In this connection, the Arkansas Supreme Court has recently held that a conveyance of a non-participating royalty interest under existing and future leases did not violate the rule against perpetuities. Hanson v. Ware, 274 S.W.2d 359, ...Ark..... (1955).
68 With respect to the considerations of conservation and good faith on the part of the lessee, see the recent case of Boone v. Kerr-McGee Oil Industries, 217 F.2d 63 (10th Cir. 1954).
70 Walker, Defects and Ambiguities in Oil and Gas Leases, 28 Texas L. Rev. 895, 903 (1950) ; Note, Oil and Gas—Dry Hole Clause—Resumption of Delay Rental, 30 Texas L. Rev. 780 (1952) ; Kerr, Maintaining the Lease in Effect Other Than by Payment of Delay Rentals and Shut-In Royalties, Fifth Annual Inst., Southwestern Legal Foundation, pp. 337, 344.
71 Superior Oil Company v. Stanolind Oil & Gas Co., 230 S.W.2d 346 (Tex. Civ. App. 1950) aff'd, 240 S.W.2d 281 (Tex. 1951). Also, for the result of pooling with this clause, see McClain v. Harper, supra ; Buchanan v. Sinclair Oil & Gas Co., supra.
vision, is that the lease is terminated. However, several courts have held in this situation that the lessee has the right to drill the well to completion, even in the absence of special lease provision, and if production is obtained, the lease is continued in force. In recent years, many leases have contained a clause expressly providing that the lease will be continued in force where the lessee is diligently prosecuting drilling operations at the end of the primary term. The courts have generally held that where there is such compliance, the lease is continued in force. 

Again, the situation may be that a producing well has ceased to produce after the expiration of the primary term. Since the lease is to continue as long as oil or gas is produced, the lease may terminate if production ceases for an unreasonable time. It is customary to provide that the lease shall not terminate if the lessee commences additional drilling or reworking operations within a specified time after cessation of production. Careful draftsmanship of the drilling and reworking clause to reflect the intention of the parties will prevent any future misunderstanding and possible litigation. A suggested clause of this type reads:

If, prior to discovery of oil, liquid hydrocarbons, gas, or their respective constituent products, or any of them, on said land or on land pooled therewith, lessee should drill and abandon a dry hole or holes thereon, or if, after discovery of oil, liquid hydrocarbons, gas or their respective constituent products, or any of them, the production thereof should cease from any cause, this lease shall not terminate if lessee commences additional drilling or reworking operations within sixty (60) days thereafter, or (if it be within the primary term) commences or resumes the payment or tender of rentals on or before the rental paying date next ensuing after the expiration of three (3) months from date of completion and abandonment of said dry hole or holes or the cessation of production. If, at the expiration of the primary term, oil, liquid hydrocarbons, gas or their respective constituent products, or any of them, is not being produced on said land or land pooled therewith but lessee is then engaged in operations for drilling or reworking of any well or wells thereon, this lease shall remain in force so long as such operations or additional operations are commenced and prosecuted (whether on the same or successive wells) with no cessation of

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Footnotes:
4. 2 Summers, supra, § 305, and cases cited: Kulp, Oil and Gas Rights § 10.32 (1954). For a construction of this clause where a well producing in paying quantities was completed and thereafter ceased to produce, see Continental Oil Co. v. Boston-Texas Land Trust, 221 F. 2d 124 (5th Cir. 1955).
more than sixty (60) consecutive days, and, if they result in produ-
donction, so long thereafter as oil, liquid hydrocarbons, gas or their
respective constituent products, or any of them, is produced from
said land or land pooled therewith.

IX. ENTIRETY CLAUSE

This clause has been developed over the years in an effort to resolve
the uncertainty and confusion created by the controversy sometimes referred
to as the apportionment rule v. non-apportionment rule. Briefly stated, one
variation of the fact situation involved here is present where a lessor ex-
cutes an oil and gas lease covering a specified tract of land, and thereafter,
he executes a conveyance of the mineral interest in only a part of the leased
land, as for example, the E½ of such land. The lessee then drills a well on
the E½ of the leased land, and the question arises as to whether or not the
lessor and his grantee share equally in the royalties from production from
the well, even though the lessor has parted with all of his mineral interest
in the land on which the well is drilled.

In the absence of an express provision such as the entirety clause or
any governmental regulation, the non-apportionment rule is that a deed to
a part of the leased land, or the mineral or royalty interest therein, grants to
the grantee the right to receive royalty on production from wells on the
conveyed tract of land, but not on production from wells located on any
other part of the land covered by the lease. This non-apportionment rule,
as is stated in the leading case of Japhet v. McRae, 276 S.W. 669 (Tex. Com.
App. 1925), appears to be the majority rule followed in most jurisdictions.

A representative clause reads:

"If the leased premises are now owned or shall hereafter be owned in severalty
or in separate tracts, the premises, nevertheless, shall be developed and operated
as one lease, and all royalties accruing hereunder shall be treated as an entirety
and shall be divided among and paid to such separate owners in the proportion
that the acreage owned by each such separate owner bears to the entire leased
acreage. There shall be no obligation on the part of the lessee to offset wells on
separate tracts into which the land covered by this lease may be hereafter
divided by sale, devise, or otherwise, or to furnish separate measuring or re-
cieving tanks."

3 SUMMERS, supra, § 608 and many authorities there cited. For application of this
rule to Texas lands originally leased by the United States, see Memorandum Opin-
on (March 24, 1955) of the Acting Solicitor, Dept. of Interior, M-36289, following
the Texas rule and authorities. In addition, the Supreme Court of Colorado has
recently adopted this rule in a case where there was no entirety clause. Moshiek
App. 1949 err. ref. N.R.E.), where the Court adopted the ap-
portionment rule on the ground that the conveyance was of a royalty interest (dis-
tinguished from a fee interest conveyance) payable under the terms of an existing
French v. George, 159 S.W.2d 566 (Tex. Civ. App. 1942, err. ref.). It should be
noted that time prevents discussion of the apportionment problem and the entirety
clause in connection with pooling clauses in oil and gas leases, pooling effected by
joint execution of a lease by lessors owning different tracts of land, or compulsory
unitization by administrative order under statutory authority; however, where
these considerations are present, they may be determinative of this problem. For
example, see French v. George, supra, where the Court applied the apportionment
rule in a situation where several owners of adjoining tracts of land joined in the
execution of a single lease covering such tracts, or Grelling v. Allen, supra, which
also involved spacing regulations of the Texas Railroad Commission. Another re-
cent case, Ryan Consolidated Pet. Corp. v. Pickens, S.W. 2d (Tex. Sup. Ct. 1955), which involved a spacing permit, has been construed as indicating "a trend away from the doctrine of non-apportionment." Note, 4 OIL AND
GAS REPORTER 724, 726.
However, this rule has been criticized as causing friction and disputes between the lessee and the owners of royalty interests.

Under the apportionment rule, the royalty is paid according to acreage regardless of the tract or tracts of leased land upon which the producing wells are located. This rule, which was adopted by a Pennsylvania court in the first reported case involving this problem, appears to have been adopted only in that state. However, this rule has much to recommend it for, as has been pointed out, it "seeks to avoid disputes, inconveniences, and any increase in the burdens imposed on the lessee, that are inherent in the application of the non-apportionment rule; and to avoid the inequities between owners of segregated tracts or royalty rights in segregated tracts that are possible because of the lessee’s right to develop the leased area as a whole, ignoring lines of tracts segregated after the execution of the lease."

The entirety clause of the modern oil and gas lease form makes the apportionment rule effective as a part of the lease contract. It defines the rights of a lessor and his grantee with respect to royalty on production from any part of the leased land, and it would seem that it is more reasonable and equitable to the lessor, his grantee, and the lessee. Regardless of whether the entirety clause is construed as a personal covenant, a covenant running with the land, or otherwise, it should be binding on all parties to the lease, and their assigns, and should require the consent of all parties to any change in the apportionment effected by it.

X. ASSIGNMENT CLAUSE

This clause allows both lessor and lessee to assign the interests created or held under the lease, provided that the change or division in such interests shall not operate to enlarge the obligations or diminish the rights of the

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An excellent article on this subject has been written by Robert E. Hardwicke and Robert E. Hardwicke, Jr. entitled Apportionment of Royalty to Separate Tracts: The Entitrety Clause and the Community Lease, 32 Texas L. Rev. pp. 660 et seq. (1954).


Hardwicke, supra, p. 671. Also, see an article by Robt. W. Stayton, eminent professor of law of the University of Texas, entitled Apportionment and the Ghost of a Rejected View, 32 Texas L. Rev., pp. 682 et seq. Here, Judge Stayton discusses the novel situation which existed in 1925 in Texas when he was a member of the Texas Commission of Appeals and wrote an opinion in Japhet v. McRae, supra, which adopted the apportionment rule. Thereafter, his term expired, the Texas Supreme Court asked the commission to reconsider the case, and the final opinion adopted by the court reached the opposite result and has become a leading authority.


A representative clause reads:

"The rights of either party hereunder may be assigned in whole or in part, but no change or division in ownership of the land, rentals or royalties, however, accomplished, shall operate to enlarge the obligations or diminish the rights of lessee. No change or division in the ownership of the land, rentals or royalties shall be binding upon lessee for any purpose until forty-five (45) days after such person acquiring any interest has furnished lessee with the instrument or instruments, or certified copies thereof, constituting his chain of title from the
lessee. In the normal situation, this right of assignment is desirable from
the standpoint of both the lessor and lessee, and their assigns.

This clause also provides that no change in ownership of the lessor’s
interest shall be binding upon the lessee until the lessee has been notified by
receipt of the instrument or instruments, or certified copies thereof, whereby
the change of ownership is effected. The lessor, or his grantee, must comply
with this provision before the lessee is required to change the lease records.7

The necessity for so notifying the lessee is often overlooked by persons who
purchase mineral interests in land already subject to oil and gas leases; in
order to insure proper payment of rentals, royalties and other lease con-
siderations to the persons entitled to them, it is important that when a con-
veyance of an interest under a lease is made, the grantee should immedi-
ately notify the lessee in accordance with the provisions of the lease.

XI. SURRENDER CLAUSE

Under this clause,7 the lessee may surrender the lease to the lessor and
so terminate it. Of course, the lessee may terminate the lease by failure to
comply with its terms, but this surrender clause affords a procedure for
voluntary termination whether before or after production is obtained. It
also allows the lessee a reasonable period of time to remedy any failure to
perform the covenants of the lease;8 this provision8 is a recognition of the
generally accepted rule of conditional or alternative decree.9

original lessor. In the event of an assignment of this lease as to a segregated
portion of said land, the rentals payable hereunder shall be apportioned as be-
tween the several leasehold owners ratably according to the surface area of
each, and default in rental payment by one shall not affect the rights of other
leasehold owners hereunder. An assignment of this lease, in whole or in part,
shall, to the extent of such assignment, relieve and discharge lessee of any ob-
ligations hereunder, and, if lessee or assignee of part or parts hereof shall fail
or make default in the payment of the proportionate part of the rentals due
from such lessee or assignee or fail to comply with any other provision of the
lease, such default shall not affect this lease insofar as it covers a part of said
lands upon which lessee or any assignee thereof shall make payment of said
rentals."

"A representative clause reads:

"Lessee, and lessee's successors and assigns, shall have the right at any time to
surrender this lease, in whole or in part, to lessor, or his heirs and assigns, by
delivering or mailing a release thereof to the lessor, or by placing a release
thereof of record in the county in which said land is situated; thereupon lessee
shall be relieved from all obligations, expressed or implied, of this agreement
as to the acreage so surrendered, and thereafter the rentals payable hereunder
shall be reduced in the proportion that the acreage covered hereby is reduced by
said release or releases. This lease shall never be forfeited or cancelled for
failure to perform any covenants hereof until it shall have been finally judicial-
ly determined that such failure exists, and after such determination, lessee
shall have a reasonable period of time to remedy said failure."

"Gulf Refining Co. v. Shatford, 159 F.2d 231 (5th Cir. 1947) ; Cassity v. Smith, 193
S.W.2d 991 (Tex. Civ. App. 1946, err. ref.) ; Benson v. Lacy, 202 S.W.2d 689 (Tex.

recognized the validity of this provision: the same court later held it invalid in
case may now be doubtful authority since the enactment of the Texas Declaratory
Judgment Act. Terry, Miscellaneous Clauses In Oil and Gas Leases, Second An-
nual Inst., Southwestern Legal Foundation, pp. 248-49. Professor Merrill also
strongly criticizes the reasoning in the Meers case. Merrill, Lease Clauses Affect-
ning Implied Covenants, Second Annual Inst., Southwestern Legal Foundation,
pp. 184-86. A later federal decision in a case arising in Texas upheld the validity
of the clause and did not follow the Meers case, Haynes v. Southwest Natural Gas
XII. MISCELLANEOUS CLAUSES

There are several other clauses usually included in the modern oil and gas lease such as the force majeure clause, a clause establishing the rights of lessor and lessee with respect to drilling near a residence or a barn on the leased land, a provision for use by the lessee of oil, gas and water and payment to the lessor of damages to growing crops, and clauses otherwise establishing the lessor-lessee relationship and manner of operation under the lease. Also, the lease usually contains a warranty clause which sometimes gives the lessee the right to make payment of mortgage indebtedness, and to satisfy other liens on the land and be subrogated thereto. The propor-


"It is pointed out that this provision of the oil and gas lease does not apply where the lessee fails to make due payment of the delay rentals provided in the lease, since the delay rental clause is treated as a special limitation rather than as a covenant of the lease. Hill v. Stanolind Oil & Gas Co., 119 Colo. 477, 205 P.2d 643 (1949); Valentine Oil Co. v. Powers, 157 Neb. 71, 59 N.W.2d 150 (1953); Phillips Petroleum Co. v. Curtis, 122 F.2d 122 (10th Cir. 1950). SUMMERS, supra, § 337, p. 217; Williams, supra, pp. 138-140.

"With respect to the doctrine of conditional or alternative decrees, see MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES, supra, §§ 170, 171.

"A representative clause reads:

"When drilling or other operations are delayed or interrupted as a result of cause whatsoever beyond the control of the lessee, the time of such delay or interruption shall not be counted against lessee, anything in this lease to the contrary notwithstanding. All express or implied covenants of this lease shall be subject to all Federal and State laws, Executive orders, rules or regulations and this lease shall not be terminated, in whole or in part, nor lessee held liable in damages for failure to comply therewith if compliance is prevented by, or if such failure is the result of, any such law, order, rule or regulation."

"A representative clause reads:

"Lessee shall have free use of oil, gas and water from said land, except water from lessor's wells and tanks, for all operations hereunder, including repressuring, pressure maintenance, cycling, and secondary recovery operations, and the royalty shall be computed after deducting any so used. Lessee shall have the right at any time during or after the expiration of this lease to remove all property and fixtures placed by lessee on said land, including the right to draw and remove all casing. When required by lessor, lessee will bury all pipelines below ordinary plow depth. Lessee shall pay for damages caused by its operations to growing crops on said land. No well shall be drilled within two hundred feet (200 ft.) of any residence or barn now on said land without lessor's consent. Where it is necessary to treat oil in order to meet pipeline specifications or to render it merchantable, said oil may be treated or dehydrated at lessee's option, and as agreed compensation for treating or dehydrating such oil, lessor shall be charged at the rate of five (5) cents per barrel on lessor's royalty oil which lessee may currently deduct from any payments or settlements due lessor. However, lessee shall never be required or obligated to sell, market or dispose of the oil and gas produced under the terms of this lease."

"An interesting case construing the term "growing crops" in an oil and gas lease is Wohlford v. American Gas Production Company, 218 F.2d 213 (5th Cir. 1955). In another recent case, Holbrook v. Continental Oil Company, ....Wyo......., 278 P.2d 738 (1955); it was held that in the absence of negligent operations, the owners of only the surface interest in certain public land, which land was subject to an oil and gas lease from the United States, could recover only for damages caused by the lessor's operations to agricultural improvements or agricultural crops. See also T. J. McMahon, The Rights and Liabilities With Respect to Surface Users by Mineral Leesees, SIXTH ANNUAL INST., SOUTHWESTERN LEGAL FOUNDATION.

"A representative clause reads:

"Lessor hereby warrants and agrees to defend the title to said land, hereby releasing and waiving all right of homestead, curtesy, dower and other exemption laws, and agrees that lessee, at its option, may pay and discharge any tax, mortgage, contract for deed, or other lien or encumbrance upon said land, and in the event lessee does so, it shall be subrogated to all rights and liens pertain-
tionate ownership clause hereinbefore mentioned is necessarily made a part of the warranty clause. Other clauses and provisions may be included in the lease depending upon the circumstances and the agreement between the parties.

XIII. FEDERAL LEASES

Lack of time necessitates the omission of any extended discussion of oil and gas leases covering land and minerals owned by the United States. The terms and provisions of these leases are controlled by statute and regulation; beginning with the Mineral Leasing Act of 1920, the United States has been authorized to lease its lands for oil and gas development. The Act of 1920 has been amended from time to time, and when federal land is leased, it is important to determine the present status of the law and regulations.

For a good discussion of oil and gas leases covering lands owned by the United States, see a paper by Ross L. Malone, Jr., entitled Oil and Gas Leases on United States Government Land, Second Annual Inst., Southwestern Legal Foundation, pp. 309-350.

XIV. LEASE CONSTRUCTION

Although there have been innumerable decisions interpreting and construing the various lease clauses, there continues to be much litigation of this kind under different fact situations. In this litigation it appears that the rules governing the interpretation of written instruments have generally been followed, and that the courts have endeavored to construe the lease so as to effect the intention of the parties.

Several courts have held that the oil and gas lease should be strictly construed against the lessee and in favor of the lessor. However, this rule has no application unless the lease is ambiguous, and today, some lessors have their attorneys prepare the leases which they execute; in this case, the

ing thereto with the right to enforce same and apply rentals and royalties accruing hereunder toward satisfying same.

See footnote 14, supra.


For example, three important laws affecting federal leasing were enacted by the United States Congress in 1954. Public Law 555, Chap. 644--83rd Cong.; Public Law 561, Chap. 650--83rd Cong.; and Public Law 585, Chap. 730--83rd Cong. (also known as the Multiple Mineral Development Act). In addition, the Secretary of the Interior has recently promulgated regulations changing the form of Offer to Lease and Lease for Oil and Gas used in leasing federal lands. 43 C.F.R. Parts 192, 200. These forms must be used in acquiring future leases of this type.

For example, in Buchanan v. Sinclair Oil & Gas Co., supra, the trial court held that evidence of an oral agreement varying the written terms of the lease was not admissible, and that since the lease in that case was not ambiguous, the court held that the rule of practical construction did not apply.

Sun Oil Co. v. Burns, 125 Tex. 549, 84 S.W.2d 442 (Tex. Comm. App. 1935); Coyle v. North America Oil Consolidated, 201 La. 99, 9 So.2d 473 (1942); Minerva Oil Co. v. Sohio Petroleum Co., 336 Ill. App. 372, 84 N.E.2d 167 (1949); Kirke v. Texas Co., 186 F.2d 453 (7th Cir. 1951). In Producer's Oil Co. v. Snyder, 190 S.W. 514 (Tex. Civ. App. 1919), the court held that where the contract was ambiguous because of apparent inconsistencies between the written or typewritten or printed parts, the written or typewritten words would control.


ambiguous language of the lease should not be construed against the lessee. The construction of an ambiguous provision in a lease may also be affected by the acts of the parties with respect thereto. Disregarding rules of construction, however, every effort should be made to resolve the defects and ambiguities in the lease by careful drafting.

XV. COVENANTS IMPLIED IN OIL AND GAS LEASES

A detailed analysis of the covenants implied in oil and gas leases is not within the scope of this paper, but a discussion of the oil and gas lease is not complete without reference to this important phase of oil and gas law. After pointing out that the customary oil and gas lease does not contain stipulations governing exploration, development and operation, Professor Merrill states that "the courts have sought to decide the disputes arising between lessor and lessee by a doctrine of implied covenants on the part of the lessee, arising out of the nature of the subject-matter of the lease. Frequently the doctrine is stated in general terms to the effect that there is an implied covenant on the part of the lessee to explore and to operate the leased premises with diligence."

This doctrine of implied covenants has been generally recognized in all jurisdictions. A good illustration of its application is an early case, Phillips v. Hamilton, 95 Pac. 846 (Wyo. Sup. Ct. 1908), where the court (p. 848) said:

The lease contains no express covenant or stipulation for diligence in the matter of exploration, or any requirement as to the amount of work to be done or the number of wells to be drilled within any stated period of time or at all. But it is admitted in argument—and we think rightly so—that the lease does contain an implied covenant that the work of prospecting and development should continue, after the expiration of the year within which the lessee was to commence operation, with reasonable diligence. It is evident that the purpose of the lease was to explore the premises, and, if oil or gas was found therein in paying quantities, to produce and market the same for the mutual benefit of both parties. Such being the case, it was the duty of the lessee, under the implied covenant contained in the lease, to proceed with reasonable diligence to prospect and develop the premises, having due regard to his own interest and those of the lessor.

Merrill, supra, § 2, p. 19. And see Berthelote v. Loy Oil Co., 95 Mont. 434, where the Montana Supreme Court, after recognizing that the usual oil and gas lease does not contain these stipulations, said:

"The payment of the royalty is, however, contingent upon production. Where the real purpose is thus disclosed but the lease does not contain in itself express provisions creating duties in the lessee to do such acts as were necessary for the accomplishment of that purpose, the law implies them. Summers on Oil & Gas, 391; Merrill on Implied Covenants, 18-21; Thornton on Oil & Gas (5th Ed.) §§ 154-157."

Merrill, supra, § 3, p. 21.
Again, the United States Supreme Court, in Sauder v. Mid-Continent Petroleum Corp., 292 U.S. 272, 54 Sup. Ct. 671, 78 L.Ed. 1255 (1933), stated (292 U.S. 279) the rule as follows:

It is conceded that a covenant on respondent's part to continue the work of exploration, development and production is to be implied from the relation of the parties and the object of the lease; and that this covenant was not abrogated by the expiration of the primary term of ten years.

Professor Merrill suggests that there are four of these covenants implied in oil and gas leases:

"I. The implied covenant to drill an exploratory well.
II. The implied covenant to drill additional wells.
III. The implied covenant for diligent and proper operation of the wells and for marketing the product, if oil or gas is discovered in paying quantities.
IV. The implied covenant to protect the leased premises against drainage by wells on adjoining land."

With regard to the standard or test of compliance by the lessee with these implied covenants, the courts of this country have generally adopted the standard of the ordinarily prudent operator. A good statement of this standard appears in the early landmark case of Brewster v. Lanyon Zinc Co., 140 Fed. 801 (8th, Cir. 1905), as follows:

In the absence of some stipulation to that effect, we think an oil and gas lease cannot be said to make the lessee the arbiter of the extent to which, or the diligence with which, the exploration and development shall proceed. . . . If they do not proceed with reasonable diligence, and by reason thereof the oil and gas are diminished or exhausted through the operation of wells on adjoining lands, the lessor loses, not only royalties to which he would otherwise be entitled, but also his contingent interest in the oil and gas which thus passes into the control of others. The object of the operations being to obtain a benefit or profit for both lessor and lessee, it seems obvious, in the absence of some stipulation to that effect, that neither is made the arbiter of the extent to which or the diligence with which the operations shall proceed, and that both are bound by the standard of what is reasonable. . . . There can, therefore, be a breach of the covenant for the exercise of reasonable diligence, though the lessee be not guilty of fraud or bad faith.

But, while this is so, no breach can occur save where the absence of such diligence is both certain and substantial in view of the actual circumstances at the time, as distinguished from mere expectations on the part of the lessor and conjecture on the part of mining enthusiasts. The large expense incident to the work of exploration and development, and the fact that the lessee must bear the loss if the operations are not successful, require that he proceed with due regard to his own interests, as well as those of the lessor. No obligation rests on him to carry the operations beyond the point where they will be profitable to him, even if some benefit to the

*Merrill, supra, § 4, p. 23.
*Merrill, supra, § 122, p. 277 et seq. For a discussion of compliance with the implied covenants where there has been pooling or unitization, see Note, Unitization—Effect on Breach of the Implied Covenant to Further Develop and Explore, 32 Texas L. Rev. 133 (1953) and cases there cited.
PRINCIPLES OF OIL AND GAS LEASES

lessee will result from them. It is only to the end that the oil and
gas shall be extracted with benefit or profit to both that reasonable
diligence is required. Whether or not in any particular instance
such diligence is exercised 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 land, 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. Whatever, in the circumstances, would be
reasonably expected of operators of ordinary prudence, having re-
gard to the interests of both lessor and lessee, is what is required.
A plain and substantial disregard of this requirement constitutes a
breach of the covenant for the exercise of reasonable diligence,
which as before shown, is also made a condition of the lease under
consideration. (Emphasis supplied).

This measure of the lessee's compliance is also sometimes referred to as the
reasonably prudent operator rule or standard.

Brief reference only can be made here to the interesting problems relat-
ing to the remedies for the breach of these implied covenants,\(^9\) and the con-
siderations attending a determination of whether an action based on the
breach of an implied covenant should sound in tort or contract.\(^10\)

CONCLUSION

In conclusion, it can be said that in keeping with the subject, this dis-
cussion has been elementary. While several aspects of today's oil and gas
lease have not been fully discussed, the basic principles, on which the lease
has been developed over the last fifty years, have been considered. These
principles have remained basically the same; to borrow a comparison, "The
skeleton is the same, but like many of us, present company not excepted,
after such a long time a lot more additional flesh has been added."\(^11\)

\(^9\)See Merrill, supra, Chapter VII; Jones, Rights and Remedies for Non-Development
and Failure to Offset, FOURTH ANNUAL INST., SOUTHWESTERN LEGAL FOUNDATION,
pp. 57 et seq. In the recent decision of the Court of Appeals for the Fifth Circuit
in Buchanan v. Sinclair Oil & Gas Co., supra, (218 F.2d 436), it was held:

"... while breach of the implied covenant will not authorize forfeiture and
the usual remedy for its breach is an action for damages, in accordance with
the equitable procedure established in state and federal courts, a court will,
under extraordinary circumstances, entertain an action to cancel the lease in
whole or in part."

"Nothing in the district judge's holding or judgment, nothing in our affirmance
of it, justifies, authorizes, or will permit appellee to hold the un-unitedized por-
tion of the lease against well-founded legal claims, of abandonment or for dam-
gages for breach of the implied covenants, or, where there is no other adequate
relief, against well-founded claims, for relief in equity."

\(^10\)Walker, The Nature of the Property Interests Created by an Oil and Gas Lease in
Texas, 11 TEXAS L. REV. 441-45. In this article, Professor Walker points out that
by the use of contract remedies, measure of damages, and statutes of limitation,
the relation of the parties may be materially affected. See also Brown, Implied
Covenant to Use Due Care, 19 TEXAS L. REV. 80, 82-83.

\(^11\)Moses, The Evolution and Development of the Oil and Gas Lease, SECOND ANNUAL
INST., SOUTHWESTERN LEGAL FOUNDATION, p. 37.