

OG Energy Education Series

**OLIVA
GIBBS** LLP

Retained Acreage and Pugh Clauses Pitfalls of the Modern Oil and Gas Lease

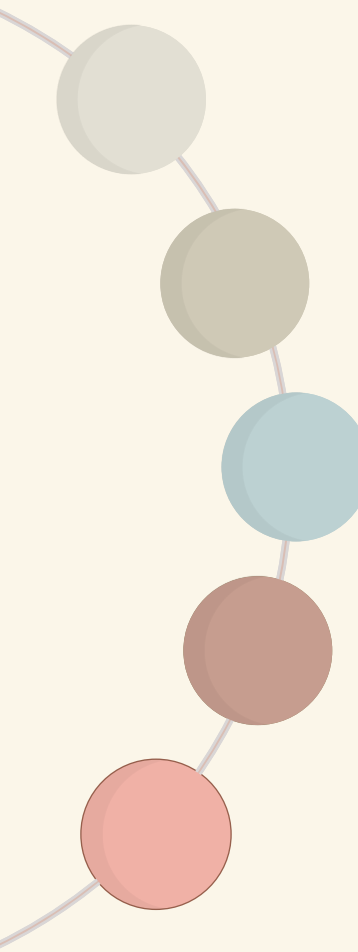
September 27, 2021

Brad Gibbs, Partner

Email: bgibbs@oglawyers.com

www.oglawyers.com

Overview

- 
- I. Introduction
 - II. Retained Acreage Provisions Generally
 - III. The Regulatory Framework
 - IV. The Continuous Development Clause
 - V. Depth Termination Provisions
 - VI. Recent Cases Construing Retained Acreage Provisions
 - VII. General Curative Approaches

I. Introduction

- ❖ This presentation attempts to demystify some common elements found in various retained acreage provisions.
- ❖ Applicability
 - Loss of Acreage Mitigation
 - A & D
 - “Bottom” v. “Top” Lessee
 - Conflicting OGLs



Various Bodies of Law

- ❖ Retained acreage provisions generally result in a loss of lease acreage if certain obligations are not met. [It is a] compromise between a lessor's desire to have his lease fully developed or "drilled to density," and a lessee's desire for operational flexibility.
- ❖ Common law contract interpretation and freedom of contract within regulatory constraints



Fully
Developed
Lease



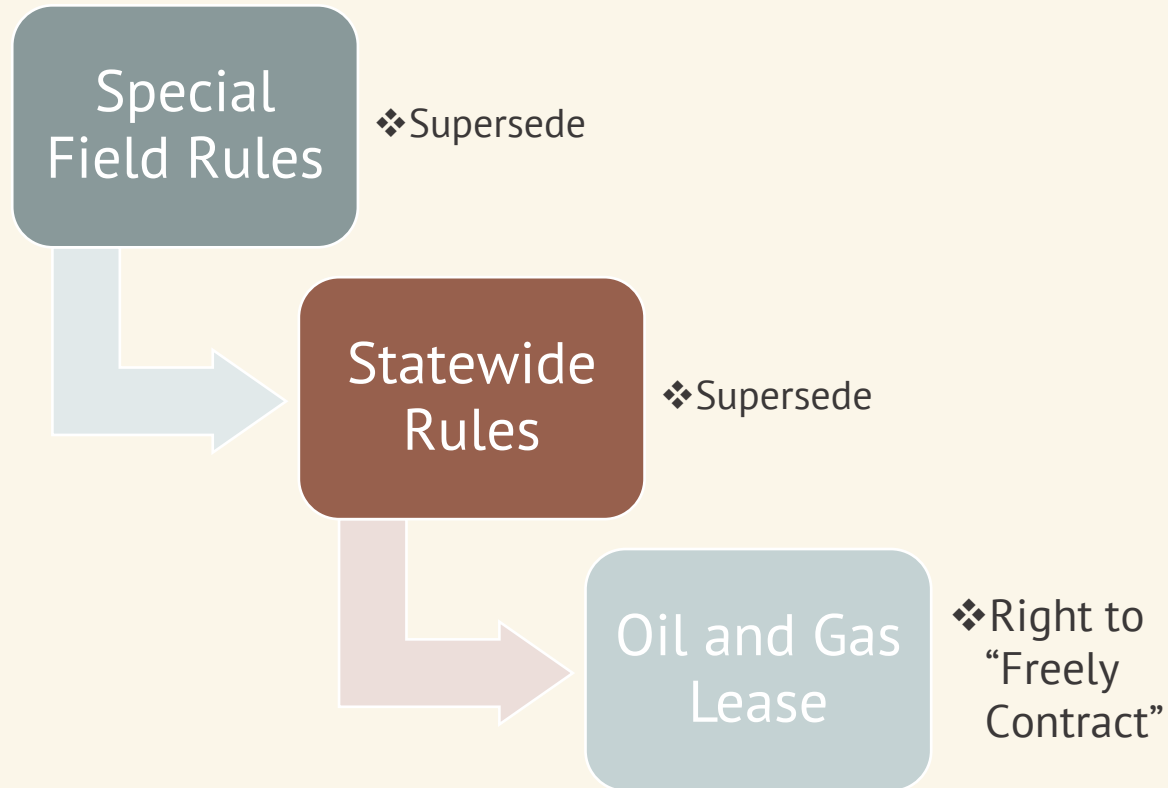
Operational
Flexibility



II. Retained Acreage Provisions, Moving Parts

| Habendum Clause | State Government | Lessor |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Creates a right for the Lessee | Limits the right of the Lessee | Limits the right of the Lessee |
| <ul style="list-style-type: none"> ❖ The habendum clause [in an] oil and gas lease conveys to a lessee the right to develop ... minerals for a fixed number of years. ... and so long thereafter as oil and gas are produced | <ul style="list-style-type: none"> ❖ [I]mplied covenant to fully develop a leasehold ... ❖ Regulation ❖ Courts <ul style="list-style-type: none"> ○ Interpret the Four Corners ○ Plus, Incorporation of State regulation when the agreement calls for it. | <ul style="list-style-type: none"> ❖ [I]nstead of trusting the <i>always reasonable</i> operator, wary landowners may wish to insert a <u>special limitation</u> on the habendum clause. Such an “express development clause” commonly takes the form of a retained acreage provision and may be paired with continuous drilling obligations and/or a depth termination provision. |

III. The Regulatory Framework



- ❖ The rules regulate well density and production allowables



A. The Statewide Rules – Rule 38

- ❖ If the Oil and Gas Lease incorporates regulations from a Governmental body as a determinative factor in shaping what acreages remains operative after the primary period, then it behooves one to know what those Governmental regulation are. Rule 38 will be the starting point.



A. The Statewide Rules – Rule 38 & 86

Rule 38

Vertical Wells

- ❖ Establishes process and defines **Standard Acreage**
 - Drilling Unit = **If** W1 (Permit), **then** Certified Plat + Well Location
 - Proration Unit = **If** W2 (upon completion), **then** P15 **and/or** P16 **and/or** certified plats designating the proration unit
- ❖ Purpose is to establish = Well Density

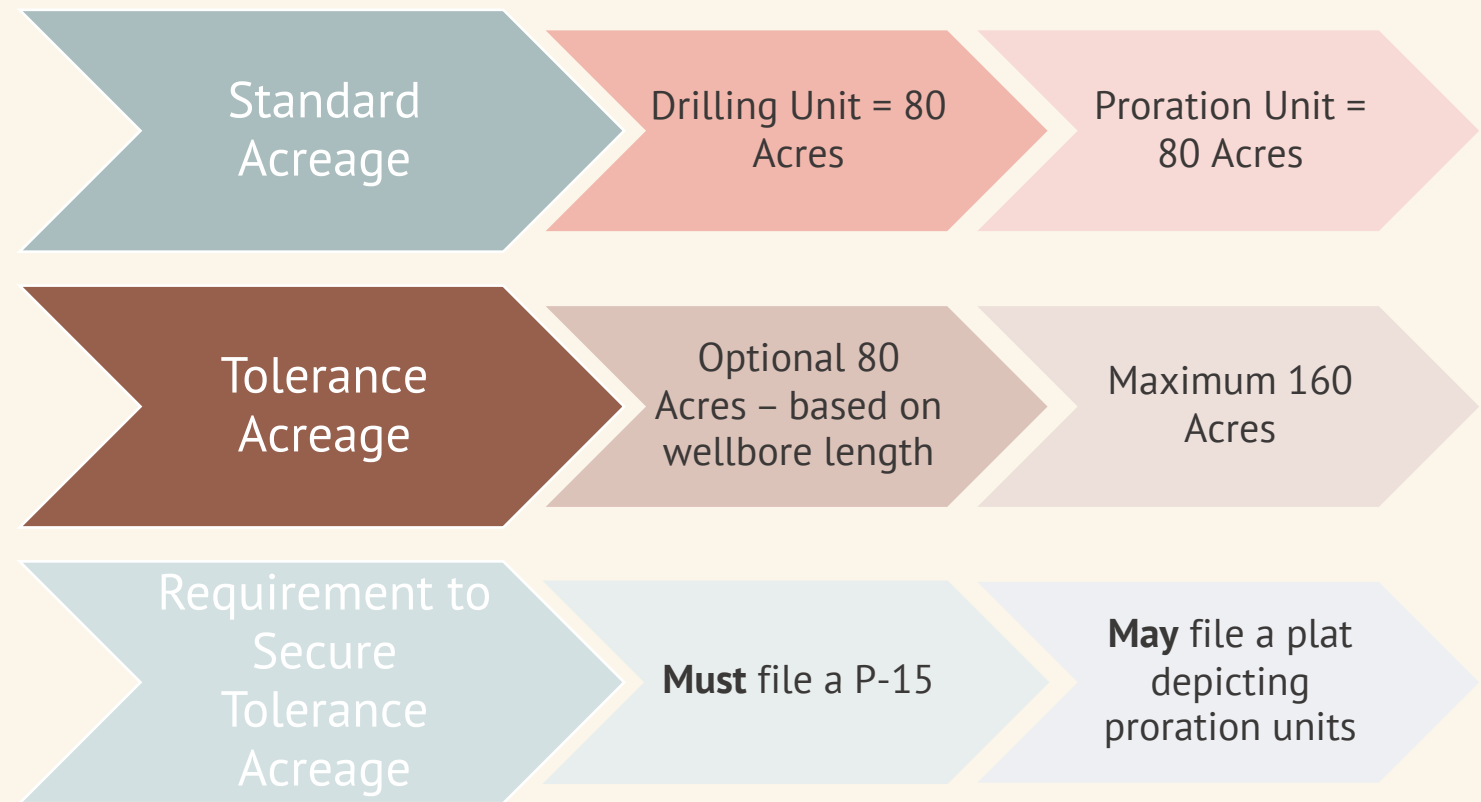
Rule 86

Horizontal Drain Holes

- ❖ Establishes process and defines **Tolerance Acreage**
 - Add acreage added to Proration unit based on the lateral length of the Horizontal Drain Hole
- ❖ Purpose is = Allocating Allowable Production

B. Special Field Rules

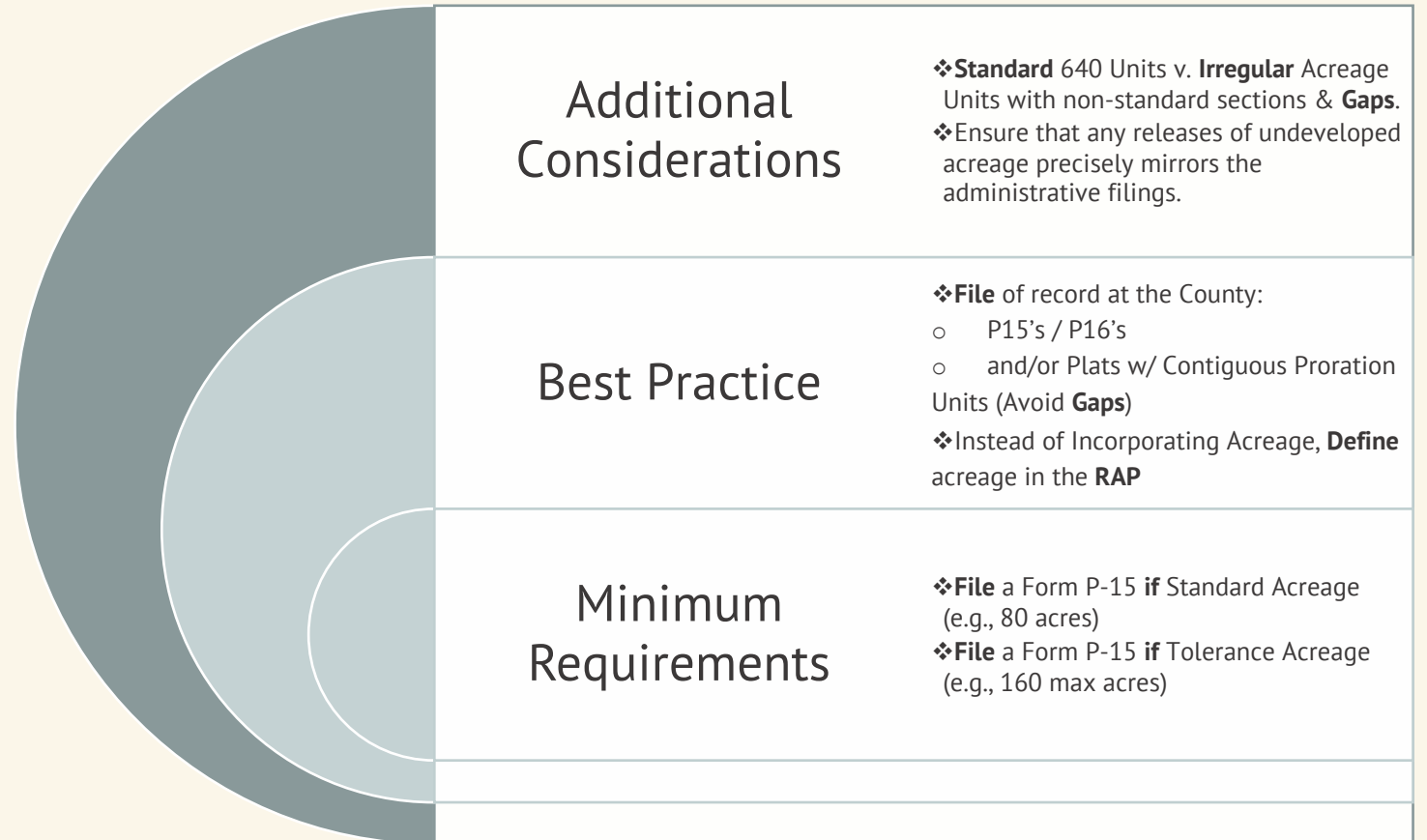
- ❖ **Purpose:** To address the particularities of individual mineral reservoirs.
- ❖ **Example:** “Spraberry Field Rules” adopted in 2013 by the Commission for the Spraberry (Trend Area)



C. Putting It All Together

❖ Avoid losing acreage by:

- A close reading of the lease;
- An in-depth understanding of the applicable statewide or special field rules, including any amendments thereto; and
- A strict adherence to the filing requirements for designating tolerance acreage.



D. Interaction of Retained Acreage Provisions with Pooling Clauses

- ❖ There is a potential for the loss of acreage when a pooling clause conflicts with a retained acreage clause.
- ❖ Two possible solutions are:
 - I. **Mirroring Approach** = the retained acreage provision should attempt to mirror the acreage provided in the pooling provision.
 - II. **Preemptive Approach** = draft a “preemptive” pooling provision such that notwithstanding the retained acreage clause, any portion of the leased premises included within a pooled unit will remain held by unit production and will not be subject to the retained acreage provision (including depths or formations).

IV. Triggering the Retained Acreage Provision – The Continuous Development Clause

- ❖ When is the Retained Acreage Provision Triggered?
 - At the end of the primary term, or
 - During the secondary term, at the expiration of continuous development.
- ❖ How is the Retained Acreage Provision Triggered?
 - If there is an initial producer well, then the Continuous Development Clause requires additional wells with no lapse in time.
 - If operator ceases drilling, then the lease will normally terminate except as to a specified number of “retained” acres around each well.
- ❖ A “Well Based” provision defines a minimum number of wells.

A. Snapshot Termination Provisions

❖ Snapshot vs. Rolling

- A snapshot termination provision in a continuous development clause is one that holds all proration units as long as production is maintained on at least one proration unit.
- Lessors may prefer to negotiate rolling termination language to provide an automatic release of proration units as they become nonproductive.
- Courts neither favor Rolling Termination Clauses nor do they interpret them to exist unless: the continuous development clause [includes]“clear, precise and unequivocal” language to that effect that can be given no other reasonable meaning[.]
 - Chesapeake Exploration, LLC v. Energen Res. Corp.

❖ An effective way of creating Rolling Terminations

- Separate Lease Clause = [U]nits or retained tracts being treated as a single lease in which production or operations on one tract will hold the entire lease, each proration unit or retained tract may be treated as a separate lease.

B. Snapshot vs. Rolling Examples

- ❖ **Snapshot** – Lease terminates at the end of continuous development program as to all acreage except each proration unit established under the rules and records of the RRC upon which there exists ... a well capable of producing oil and or gas.
 - *Chesapeake Exploration, LLC v. Energen Res. Corp.*
- ❖ **Snapshot** - Lessee covenants to release this lease ... except as to each producing well on said lease, operations for which were commenced prior to or at the end of the primary term and the proration units as they may be allocated to said wells under the rules and regulations of the RRC or 160 acres, whichever is greater.
 - *Apache Deepwater, LLC v. Double Eagle Dev. LLC*
- ❖ **Rolling** – Production or operations will maintain this lease in effect only with regard to proration units with producing wells or wells under development, and the lease shall terminate “as to any such part or parts of the leased land lying outside.”
 - *Hunt Oil Co. v. Dishman*
- ❖ **Rolling** – Production of gas on one 160-acre tract will not maintain the lease as to gas rights in another 160-acre tract, because the right to production of gas is limited to a designated 160-acre tract around each well.
 - *NAFCO Oil & Gas, Inc. v. Tartan Resources Corp.*

C. Timing of Continuous Development

- ❖ Timing is everything and clear definitions are paramount.
 - Define “Completion”
 - Define “Commencement”
- ❖ Timing of Continuous Development
 - Generally, a lease will provide that a lessor has a certain number of days (e.g., 60 or 120) to complete one well and **commence** the next.
- ❖ Time Banking
 - Do not wait until the last moment
 - Keep track of the time banked

V. Depth Termination Provisions

- ❖ Special care must be taken in drafting and interpreting depth termination provisions, and the most common pitfall is an imprecise description of the depths retained.
- ❖ As noted by the Amarillo Oil Co. court, these definitions often turn on “particular geological facts”[.]

[D]eep~~e~~est producing well on the leased tract . . . or [the] stratigraphic equivalent” of a specified depth

[S]everal depths above and/or below the deepest producing formation, stratum, substratum, interval, zone, member, horizon, perforation, benchmark, depth drilled, depth completed or plugback depth.

A. Depth Severances, Generally

- ❖ [W]hen a retained acreage and/or continuous development clause is coupled with a depth termination provision.
- ❖ In *EOG Resources, Inc. v. Wagner & Brown, Ltd.*, a dispute arose regarding the phrase “100 feet below the deepest producing interval as obtained in the test well.”
- ❖ EOG argued the provision held all of the Morris Sand, but the Corpus Christi Court of appeals disagreed
- ❖ Another example is the “Bakken Pool”

Caution when using geological terms!



B. Stratigraphic Equivalent

❖ Purpose

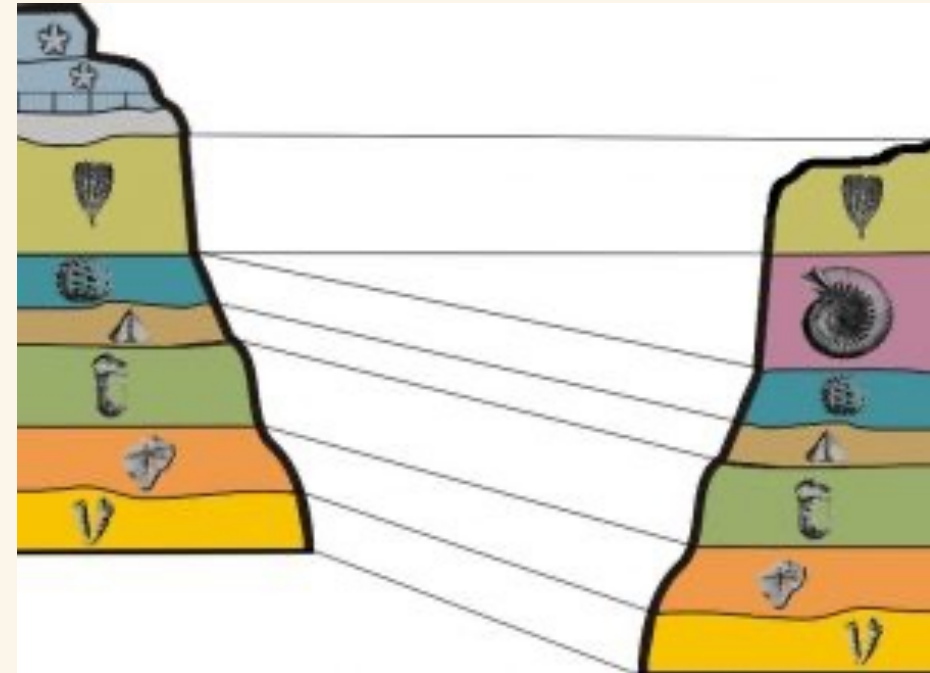
- This is intended to ensure that a productive reservoir is not “split” by an assignment or depth termination.
 - Howard R. Williams & Charles J. Meyers, Manual of Oil and Gas Terms 1007 (2018).

❖ Example

- “Stratigraphic equivalent of the base of the Spraberry Formation.”

❖ Best Practice Tip

- “[R]eference the stratigraphic equivalents as found in a particular well log, including the date, well name and API number.”

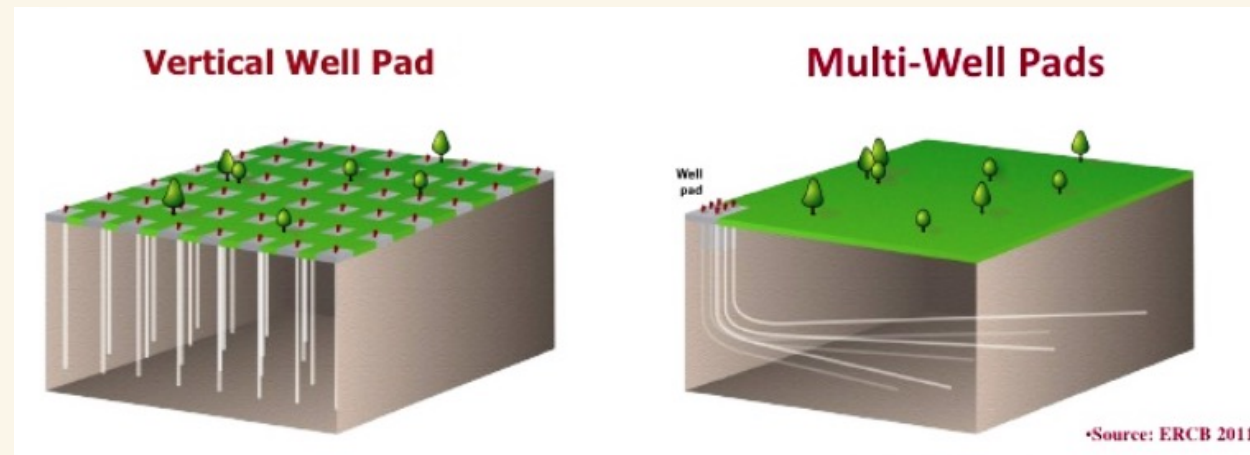


C. Double Assignment of Acreage and 2020 Regulatory Update

- ❖ Double Assignment of Acreage occurs when a single tract of land has been assigned to two or more different wells in the same field
- ❖ These new amendments to Rule 40 substantially broaden operators' ability to make multiple assignments of acreage, and expressly supersede prior UFT field rules. However, note that they do not extend to non-UFT fields. 16 Tex. Admin. Code § 3.40(e)(2)(f).
- ❖ [One may also,] tailor a depth severance provision to retain all depths within a particular field.

D. Some Considerations Regarding Frac Hits and Parent-Child Wells

- ❖ A growing concern in the context of both horizontal and vertical spacing between wells is the danger of frac hits from a child well interfering with production from a parent well.
- ❖ Frac Hits – Perhaps 100 feet below the deepest producing depth is no longer enough.



E. Hacking Up Your Lease - A Note on Use of the Terms “Horizontal Pugh Clause” and “Vertical Pugh Clause”

- ❖ These terms “Horizontal Pugh Clause” and “Vertical Pugh Clause” are sometimes used interchangeably.
- ❖ “Most courts, when referring to a “horizontal Pugh clause,” define it as releasing certain depths on the basis of a horizontal plane, and a “vertical Pugh clause” as a release of surface area on the basis of a vertical plane.”
 - Peironnet v. Matador Resources co., 103 So.3d 445, 459, (La. App. 2 Cir. 2012, rev’d on other grounds); Questar Exploration & Prod. Co. v. Woodard Villa, Inc. 123 So.3d (La. App. 2 Cir. 2013); Sandefer Oil & Gas, Inc. v. Duhon 961 F.2d 1207 (5th Cir. 1992).

VI. Recent Cases Construing Retained Acreage Provisions

Three Texas Cases and One Colorado

- ❖ Applying force majeure
 - *MRC Permian Co. v. Point Energy Partners Permian LLC*
- ❖ Effect of a retained acreage clause when reclassifying wells
 - *PPC Acquisition Co. LLC v. Del. Basin Res., LLC*
- ❖ Construing lease provisions
 - *Endeavor Energy Res., LP v. Energen Res. Corp*
- ❖ What does “completion” mean
 - *Bledsoe Land Co. LLLP v. Forest Oil Corp.*



A. Applying Force Majeure

MRC Permian Co. v. Point Energy Partners Permian LLC (El Paso)

Facts

- ❖ Parties aligned as top lessee and bottom lessee. Bottom lease provided for 180-day spud to spud continuous development.
- ❖ A rig delay was argued to be a force majeure event caused operator to miss a continuous drilling deadline (specialized rig for high pressure area).
- ❖ Operators had 60 days to give notice of “non-economic” force majeure events that occur off-lease. The timeline made it possible for the operator to know of the force majeure event, but a lessor may not have been aware force majeure was triggered.

Takeaway

- ❖ What constitutes an off-lease “non-economic” event is a jury question; be careful of what you agree qualifies as force majeure.
- ❖ If an operator adheres to the notice requirement in the lease, then courts cannot rewrite the lease.

B. Effect of Reclassifying a Well

PPC Acquisition Co. LLC v. Del. Basin Res., LLC (El Paso)

Facts

- Gas well (640 acres) reclassified as an oil well (160 acres). Two lessors subsequently leased the right to drill and explore the parcel. Operator of the oil well filed a petition to quiet title and to bring a trespass suit against the second lessees.
- Essentially a snapshot vs. rolling case and language wasn't clear and unequivocal.

Takeaway

- Just because a retained-acreage clause is triggered does not mean that the lease is automatically terminated.
- The reclassification only affected one of the leases (rolling). The rest retained the original acreage (snapshot).
- This analysis can also sometimes come up with JOAs and term assignments.

C. “Any” and “Next”

Endeavor Energy Res., LP v. Energen Res. Corp

Facts

- Lease contained a time-banking provision that provided “Lessee shall have the right to accumulate unused days in **any** 150-day term during the continuous development program in order to extend the **next** allowed 150-day term between completion of one well and the drilling of a subsequent well”
- Case turns on “any” and “next”

Takeaway

- The court finds that because the clause is ambiguous and not “clear and unequivocal” it cannot be a special limitation that terminates the lease.
- Result of poor draftsmanship

D. Definition of “Completion”

Bledsoe Land Co. LLLP v. Forest Oil Corp. (Colorado)

Facts

- Parties agreed that a continuous operations clause will hold the lease in effect if there is not a lapse of more than 180 days between the completion or abandonment of one well and the beginning of operations of another.
- The question is what counts as “completion”

Takeaway

- As a matter of law, “completion” is not ambiguous in this instance.
- The Court found that the well was not “complete” until it had been hydraulically fractured and was capable of production and **not** at the time of rig release.

VII. General Curative Approaches



Amendment

Ratification

Revivor

New Lease

**There is no
one-size-fits
all solution.**

A. An Example

❖ Scenario to solve

- Multiple leases authorize 640-acre pooled units.
- [A]ddendum to each lease provides that lease will terminate at the end of the continuous development term.
- The leases may all have different primary terms and conflicting continuous development programs
- Conflicting pooling clause.

A. An Example

❖ Possible Approach:

- “[A]mendment will likely include new retained acreage and depth provision language that is subordinated to a new pooling clause
- “Reset” the continuous development period (Amendment)
- “Revivor” of the lease for any lost depths and/or acreage
- Lease “Tolling Agreement?”

B. Ratification vs. Revivor

- ❖ **Ratification** is generally defined as an agreement confirming a lease by the original lessor. Ratification does not effect a present conveyance of a terminated lease, but binds a mineral owner to an otherwise defective, voidable lease which was previously executed.
 - Howard R. Williams & Charles J. Meyers, Manual of Oil and Gas Terms 866 (2018).
- ❖ **Revivor** creates a new grant of the mineral leasehold estate following termination or partial termination of a lease. To be effective, the instrument reviving the lease must specifically reference the revived lease, acknowledge its validity, and include words of present grant and a recital of new consideration paid.

VIII. Conclusion

- ❖ [R]etained acreage provisions remain a powerful tool in ensuring full development of the leasehold
- ❖ It is usually advisable to consult with experienced counsel when faced with a convoluted retained acreage provision.

Brad Gibbs

Partner, Oliva Gibbs LLP



**BOARD
CERTIFIED**
Texas Board of Legal Specialization
OIL, GAS, AND MINERAL LAW

RATED BY
SuperLawyers
Rising Stars
Bradley Gibbs
SuperLawyers.com

I focus my practice on **due diligence, complex mineral titles, pooling issues, lease analysis, joint operating agreements, surface use issues, title curative, regulatory, litigation and general upstream matters.**



LOCATION

Based in Houston, TX



BAR ADMISSIONS

Texas, North Dakota, Kansas, and Wyoming



EDUCATION

J.D., University of Houston Law Center

B.S. in Technology, Texas State University

**OLIVA
GIBBS LLP**

**Continuing land and
legal education at
your fingertips.**

Scan the QR code to register for
upcoming sessions of our OG
Energy Education Series.



www.oglawyers.com/events



<https://oglawyers.com>



[@OlivaGibbsLLP](https://twitter.com/OlivaGibbsLLP)



[Oliva Gibbs LLP](https://www.linkedin.com/company/OlivaGibbsLLP)



[Oliva Gibbs LLP](https://www.youtube.com/OlivaGibbsLLP)