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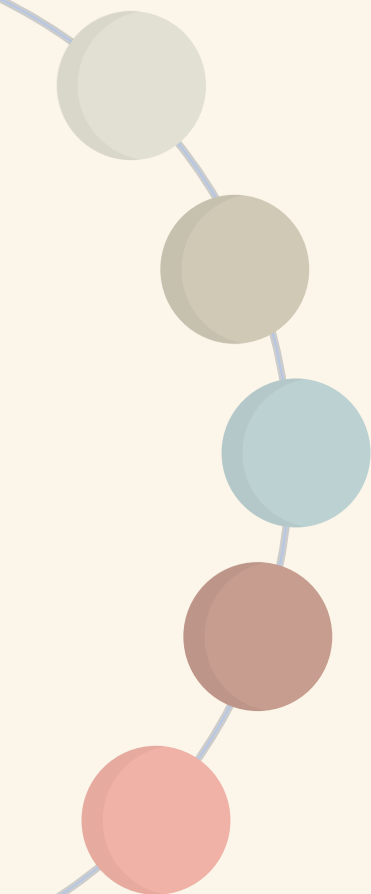
Retained Acreage Provisions



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Topics for Discussion

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- I. In the Beginning
 - II. The Pugh Clause
 - III. Retained Acreage Provisions
 - IV. “Prescribed” versus “Permitted”
 - V. Continuous Development Clauses
 - VI. “Snapshot” versus “Rolling”
 - VII. Depth Termination Provisions

In the Beginning...

- ❖ The rule of indivisibility requires that production from a lease, or from any land pooled with the leased land, maintains the lease in its entirety.
 - *Mathews v. Sun Oil Co.*, 425 S.W. 2d 330 (Tex. 1968)
- ❖ The normal lease with a pooling clause provides that the entire lease tract will be considered held by production, whether that production is on the pooled area or on some area of the tract that has not been unitized.
 - *Shown v. Getty Oil Company*, 645 S.W. 2d 174 (Tex App. 1975)

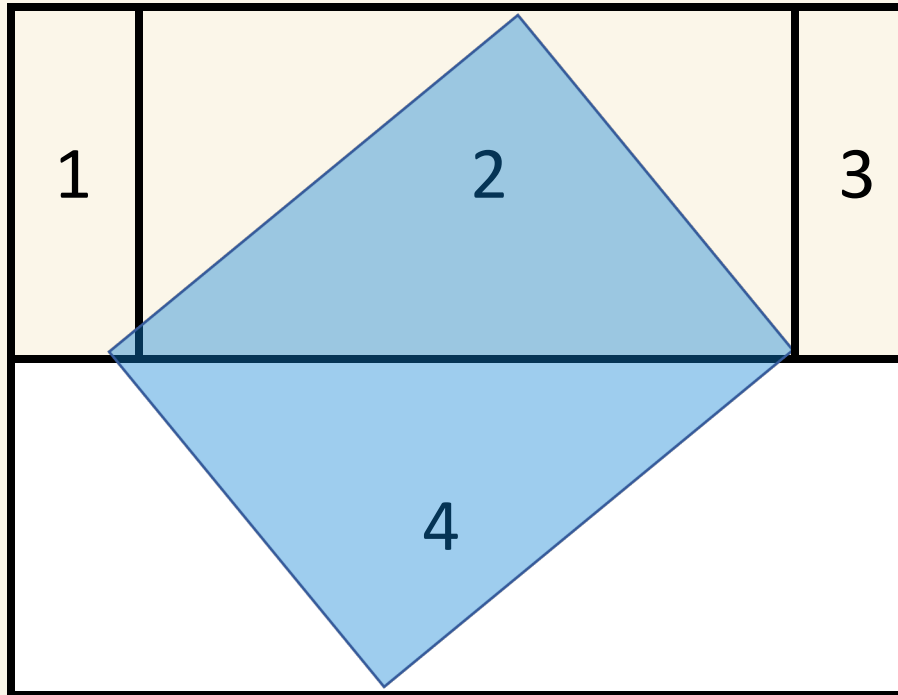
Implied Covenant to Develop

- ❖ Under the implied covenant to develop, a Lessee is generally obligated to drill a well or wells on a lease that a reasonably prudent operator would drill.
- ❖ A **reasonably prudent operator** is not required to drill unless there is a reasonable expectation of profit.
- ❖ The duty to drill covers already producing formations and could extend to other formation(s), from which, in reasonable probability, are capable of production.

The Pugh Clause

- ❖ Lawrence G. Pugh, Crowley Louisiana, 1947
 - Lessor-friendly outcome in *Broussard v. Phillips Petroleum Co.*, 160 F. Supp. 905 (W.D.La. 1958)
- ❖ Also, the “Freestone Rider” clause, Freestone County, Texas
 - *Shown v. Getty Oil Company*, 645 S.W. 2d 174 (Tex App. 1975)
- ❖ Example:
 - “It is expressly understood that if any portion of the leased premises is included into a pool or unit for production of gas or oil, then production from the unit shall only maintain this lease as to the land included in such unit or units.”

The Pugh Clause



1. After the primary term ends, what happens to 1's land (**Pugh Clause**)?
2. After the primary term ends, what happens to 1's land (**no Pugh Clause**)?

Pugh or Retained Acreage?

❖ Pugh Clause

- Provides that production from the pooled unit will not maintain the lease as to lands outside of the unit

❖ Retained Acreage Clause

- Do not involve pooling
- Usually work in connection with a continuous development clause
- Typically divides a lease so as to preserve the lease only as to a specified portion of the leased acreage

Retained Acreage Provisions

- ❖ “Retained-acreage clauses come in many different shapes, sizes, and forms. The effect of a particular retained-acreage clause depends on the terms the parties freely chose and . . . there is no ‘one size fits all’ result of their proper construction. Each retained-acreage clause must be construed on its own, under governing principles of contract interpretation.”
- ❖ *Endeavor Energy Res., L.P. v. Discovery Operating, Inc.*, 554 S.W.3d 586, 598 (Tex. 2018).

What Acreage is Retained?

- ❖ Retained acreage clauses vary widely in determining the acreage that is retained.
- ❖ Retained Acreage clauses may define the acreage as:
 - A set number of acres around a well or other definition in the clause
 - Acreage assigned to proration unit
 - Acreage defined by reliance on field rules or RRC regulations

Jones v. Killingsworth

- ❖ *Jones v. Killingsworth*, 403 S.W.2d 325 (Tex. 1965)
- ❖ The lease authorized the lessee to form pooled units up to 40 acres for oil wells, “provided that should governmental authority having jurisdiction prescribe or permit the creation of larger units than those specified, units thereafter created may conform substantially in size with those prescribed by governmental regulations.” (emphasis in original)
- ❖ The field rules provided for a standard unit of 80 acres and an additional 80 acres for additional allowable credit

Jones v. Killingsworth (Cont.)

- ❖ The lessee attempted to pool part of the lease into a 172.85-acre unit
- ❖ Court interpreted the meaning of prescribed and permitted and concluded that because the 172.85-acre pooled unit exceeded the effective 80-acre maximum authorized under the pooling provision, the lease terminated for a lack of production.
- ❖ The result was that leases were drafted with prescribed or permitted language in the pooling provision instead of only using prescribed.

Endeavor Energy Res., L.P. v. Discovery Operating, Inc.

- ❖ *Endeavor Energy Res., L.P. v. Discovery Operating, Inc.*, 554 S.W.3d 586 (Tex. 2018)
- ❖ The retained acreage clause provided:
 - The “lease shall terminate as to all lands and depths covered herein, save and except those lands and depths located within a governmental proration unit assigned to a well producing oil or gas in paying quantities...”
 - Each proration unit must “contain the number of acres required to comply with the applicable rules ... for obtaining the maximum producing allowable for a particular well.”
- ❖ The Spraberry Trend Area field rules provided for standard drilling and proration units of 80 acres and allowed for assignment of optional additional 80 acres

Endeavor Energy Res., L.P. v. Discovery Operating, Inc. (Cont.)

- ❖ Endeavor assigned 80 acres to its wells instead of utilizing the additional 80 acres, which were optional under the field rules
- ❖ What is the result of “assigned to a well”?
- ❖ Who “assigns” acreage to a well? Does the Railroad Commission “assign” through special field rules?
- ❖ The Court concluded that Endeavor only retained the acreage assigned to the proration units, being 80 acres per well.
- ❖ Endeavor’s leases terminated as to the acreage covered by Discovery’s leases, which was the acreage Endeavor did not assign to a producing well.

XOG Operating, LLC v. Chesapeake Expl. Ltd. P'Ship

- ❖ *XOG Operating, LLC v. Chesapeake Expl. Ltd. P'Ship*, 554 S.W.3d 607 (Tex. 2018)
- ❖ XOG term assignment to Chesapeake included a retained acreage provision that provided:
 - “save and except that portion of [the leased acreage] included within the proration or pooled unit of each well.... The term ‘proration unit’ as used herein, shall mean the area within the surface boundaries of the proration unit then established or prescribed by field rules... In the absence of such field rules or special field or special order, each proration unit shall be deemed to be 320 acres....”

XOG Operating, LLC v. Chesapeake Expl. Ltd. P'Ship (Cont.)

- ❖ Chesapeake completed 6 wells. 5 of 6 wells were located in the Allison-Britt Field, which has field rules. The 6th well was in the Stiles Ranch Field, which had no established field rules.
- ❖ Chesapeake assigned a total of 821.80 acres for the 6 wells, but claimed that it retained 320 acres per well for a total of 1,920 acres
- ❖ Court concluded that Chesapeake retained the 1,920 acres despite the assigned fewer acres to the proration units because the clause deemed each proration unit to contain 320 acres.

ConocoPhillips Company v. Vaquillas Unproven Minerals

- ❖ *ConocoPhillips Company v. Vaquillas Unproven Minerals*, 2015 Tex. App. LEXIS 8194 (Tex. App. – San Antonio Aug. 5, 2015)
- ❖ The lease provided that the lease would be released as to all portions of the lease not drilled to a density of 40 acres for each oil well and 640 acres for each gas well, “except that in case any rule adopted by the [RRC] or other regulating authority for any field on this lease provides for a spacing or proration establishing different units of acreage per well, then such established different units shall be held under this lease by such production, in lieu of the 40 and 640 acre units mentioned above ...”
- ❖ The field rules provided for well spacing but did not contain any proration-based acreages for density purposes

ConocoPhillips Company v. Vaquillas Unproven Minerals (Cont.)

- ❖ Rule 38 of the Statewide Rules provides that if the spacing rule is “467’-1200’”, then the acreage requirement is 40 acres per well for both oil and gas wells.
- ❖ Resulted in the standard unit being 40 acres (and not 640 acres).
- ❖ The court agreed with the lessor and ordered the release of the disputed acreage

Continuous Development

- ❖ The **continuous development clause** modifies the lease habendum clause to address undeveloped acreage.
- ❖ Some leases now specifically address continuous development during the primary term as well.
- ❖ Such provisions can extend the lease into the Secondary Term if the operations are continuous and comply with the time requirements of the lease.
- ❖ A common clause will require operations to be continuous without a lapse of more than a set amount of days.

Sundown Energy Ltd. P'ship v. HJSA No. 3, Ltd. P'ship

- ❖ *Sundown Energy Ltd. P'ship v. HJSA No. 3, Ltd. P'ship*, 622 S.W.3d 884 (Tex. 2021)
- ❖ Continuous development clause:
 - “...so long as Lessee is engaged in a continuous drilling program on that part of the Leased Premises outside of the Producing Areas. The first such continuous development well shall be spudded-in on or before the sixth anniversary of the Effective Date, with no more than 120 days to elapse between completion or abandonment of operations on one well and commencement of drilling operations on the next ensuing well.”

Sundown Energy Ltd. P'ship v. HJSA No. 3, Ltd. P'ship (Cont.)

❖ “Drilling operations” shall mean:

- “[1] actual operations for drilling, testing, completing and equipping a well (spud in with equipment capable of drilling to Lessee's object depth); [2] reworking operations, including fracturing and acidizing; and [3] reconditioning, deepening, plugging back, cleaning out, repairing or testing of a well.”

❖ Do “drilling operations” include activities other than “spudding-in” a well?

- In this case, yes. But the analysis is always specific to individual leases!

When is a Retained Acreage Clause Triggered?

- ❖ Generally, the retained-acreage clause should define the triggering event, which is usually at the expiration of the primary term or continuous development, whichever is later
- ❖ Triggers fall into two categories:
 - Snapshot
 - Rolling

Chesapeake Expl., LLC v. Energen Res. Corp.

- ❖ *Chesapeake Expl., LLC v. Energen Res. Corp.*, 445 S.W.3d 878 (Tex. App. – El Paso 2014)
- ❖ The retained acreage provision provided that the lease would terminate as to all acreage except for:
 - “[E]ach proration unit established under ... [the] rules and regulations [of the RRC ...] upon which there exists (either on the above-described land or on lands pooled or unitized therewith) a well capable of producing oil and/or gas in commercial quantities...”
- ❖ The dispute focused on whether the lease remained in effect for the entire section or only an 80-acre portion.
- ❖ The Court concluded that the retained acreage provision was a snapshot provision.

Apache Deepwater, LLC v. Double Eagle., LLC

- ❖ *Apache Deepwater, LLC v. Double Eagle., LLC*, 557 S.W.3d 650 (Tex. App. – El Paso Aug. 23, 2017)
- ❖ The retained-acreage clause provided:
 - “Notwithstanding anything to the contrary in the foregoing, Lessee covenants to release this lease after the primary term 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 may be allocated to said wells under the rules and regulations of the [RRC] or 160 acres, whichever is greater, insofar as said proration units cover from surface to the base of the deepest formation penetrated by the deepest of said wells.”
- ❖ “Snapshot” or “rolling”?

Apache Deepwater, LLC v. Double Eagle., LLC (Cont.)

- ❖ The dispute focused on whether the Lessee must release the lease as to:
 - Each proration unit without a producing well, or well in development, at the end of the primary term (snapshot) or
 - Each proration with no operating well, or well in development, at any time after the end of the primary term (rolling).
- ❖ The Court concluded that the retained acreage clause did not express a clear intent to negate the habendum clause and that the clause applied once (instead of on a rolling basis)

PPC Acquisition Co. LLC v. Del. Basin Res., LLC

- ❖ *PPC Acquisition Co. LLC v. Del. Basin Res., LLC*, 619 S.W.3d 338 (Tex. App.—El Paso 2021)
- ❖ 2 leases covering land in Reeves County, Texas: Northern Trust Lease and Colt Lease (both found to be snapshot)
- ❖ 1 lease covering the same land (the Lowe Lease), which contained the following retained acreage provision (and a continuous development clause):
 - “40 acres around each such well which is classified as an oil well and 160 acres around each such well which is classified as a gas well or, in each case, *such larger area as may be prescribed by the Railroad Commission of Texas* (or such Governmental Agency having jurisdiction) as the proration unit for such well 'Well Production Unit.’”
 - “any Well Production Unit will perpetuate this lease only as to that Well Production Unit. This lease shall terminate as to each Well Production Unit, respectively, sixty (60) days after the date that production from and operations with respect to such Unit cease . . .”

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

- ❖ Court found the following to be “clearly intended for the lease's retained-acreage clause to be ‘rolling’ in nature”:
 - This lease shall terminate as to each Well Production Unit, respectively, sixty (60) days after the date that production from and operations with respect to such Unit cease ...”

Other Rolling Retained Acreage Provision Cases

- ❖ *Parten v. Cannon*, 829 S.W.2d 327 (Tex. App. – Waco 1992)
 - “Production or operations on said allotted area by the Lessee shall maintain this lease in effect only with regard to the land within the described area. . . . This lease shall terminate as to such part or parts of the leased land lying outside the allotted area unless this lease is perpetuated as to such land outside the allotted area by operations conducted thereon.”

- ❖ *Nafco Oil & Gas, Inc. v. Tartan Resources Corp.*, 522 S.W.2d 703 (Tex. App. – Corpus Christi 1975)
 - “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 gas well.”).

Other Rolling Retained Acreage Provision Cases

- ❖ *Hunt Oil Co. v. Dishman*, 352 S.W.2d 760 (Tex. App. – Beaumont 1961)
 - “Perpetuation of the lease beyond the primary term was conditioned upon operations or production” and that “at any time” the lessor could notify lessee of non-compliance with the development obligation and the lessee would retain only the acreage around operating wells).

Hardin-Simmons Univ. v. Hunt Cimarron Ltd. P'ship

- ❖ *Hardin-Simmons Univ. v. Hunt Cimarron Ltd. P'ship*, No. 07-15-00303-CV, 2017 Tex. App. LEXIS 6934 (Tex. App.—Amarillo Nov. 1, 2017)
- ❖ Lease contained a retained acreage provision, which defined “production unit,” and the following continuous development clause:
 - Lessee shall have the option of maintaining this lease in effect as to all acreage then covered by the commencement of drilling operations on successive wells each of which shall be commenced within 150 days after the completion of the prior well. Such drilling shall constitute a “continuous development program” by which Lessee may keep this lease in force and effect as to **all lands and depths** ...

Hardin-Simmons Univ. v. Hunt Cimarron Ltd. P'ship (Cont.)

❖ Reworking clause:

- [i]f at the expiration of the primary term, oil or gas is not being produced from the land and depths subject to this lease but Lessee is then engaged in ... the reworking of any well on said land, this lease shall remain in force in **accordance with its terms** so long as ... reworking operations are prosecuted (whether on the same or different wells) with no cessation of more than one hundred twenty (120) consecutive days ...”
- ❖ Will a savings clause such as a reworking provision save your entire lease, or just the unit acreage being reworked? If the savings clause is tied to your retained acreage clause, it may just save your unit acreage.

Depth Termination Provisions

- ❖ “At the end of the primary term or the end of continuous operations, whichever is later, this lease will terminate “as to all depths below 100 feet below the stratigraphic equivalent of the deepest **formation** then producing or capable of producing in paying quantities.”
- ❖ “Depth” – True Vertical Depth or Measured Depth?
- ❖ “Deepest depth **drilled**” versus “deepest **producing** depth”
- ❖ Look for a pooling combination – “deepest depth drilled on the leased premises **or lands pooled therewith.**”
- ❖ Separate lease clauses or “as to each unit”

Depth Termination Provisions (Cont.)

❖ Geologic Terms

- Formation

- Interval

- *EOG Resources, Inc. v. Wagner & Brown, Ltd.*, 202 S.W.3d 338, 341 (Tex. App.—Corpus Christi 2006, pet. denied).

- Stratum; Horizon

- *Amarillo Oil Co. v. Energy-Agri Prods, Inc.*, 794 S.W.2d 20 (Tex. 1990).

❖ Use “stratigraphic equivalent” and tie to a formation in a specific well log

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