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HAUNTED LEASEHOLD TALES



October 16



12:00 PM - 1:00 PM CST

Speaker:

Brad Gibbs | Co-Owner



About the Speaker



MEMBER AND FREQUENT PRESENTER



HOUSTON BAR ASSOCIATION



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Topics Covered



Introduction

Retained Acreage Provisions Generally

The Regulatory Framework

The Continuous Development Clause

Depth Termination Provisions

Recent Cases Construing Retained Acreage Provisions

General Curative Approaches





Based on the article **“This is Not Your Father’s Producers 88: A Practical Guide to Retained Acreage, Depth Terminations, Continuous Development, and Other Pitfalls In the Modern Oil and Gas Lease,”** Section Report of the State Bar of Texas Oil, Gas & Energy Resources Law Section, Vol. 48, No. 4 (Fall 2024).

Complimentary copy with this webinar!

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



II. Retained Acreage Provisions, Generally

- Retained acreage provisions generally result in a loss of lease acreage if drilling or production 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.



**Fully
Developed
Lease**

**Operational
Flexibility**



Retained Acreage Provisions: Moving Parts

Habendum Clause

Creates a right for the Lessee

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

State Government

Limits the right of the Lessee

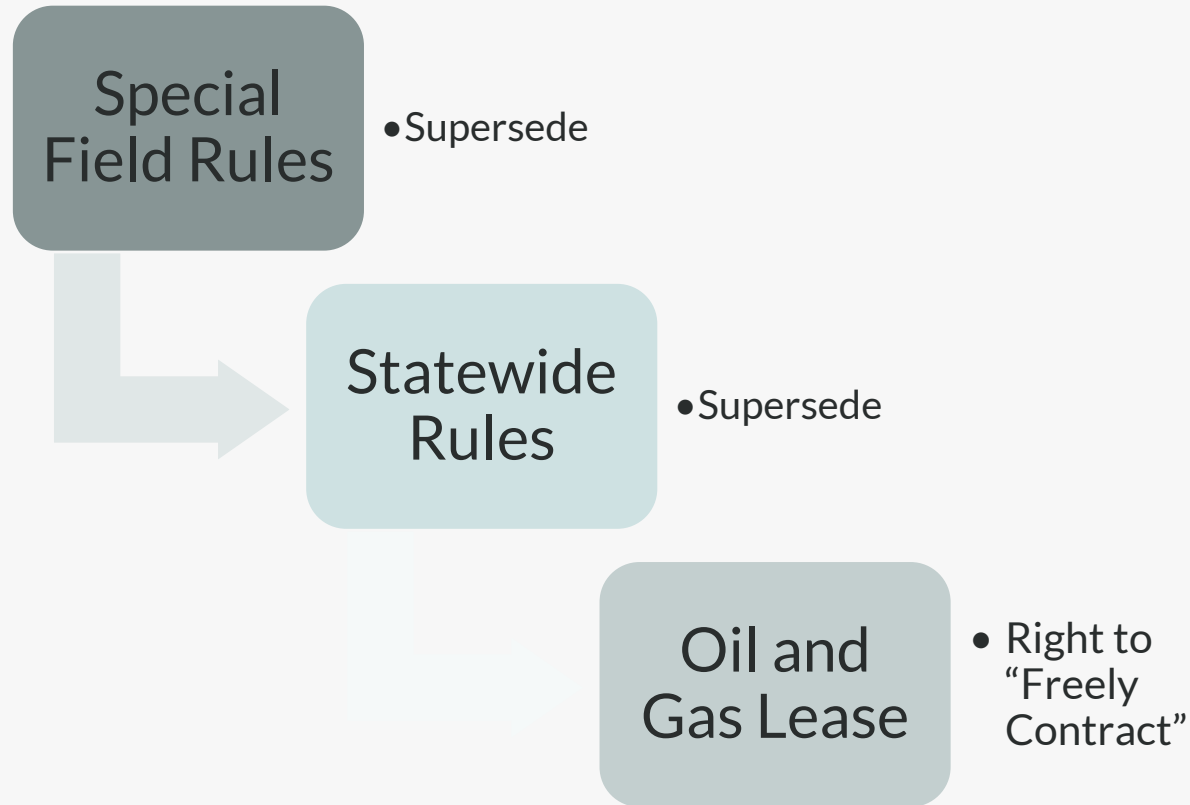
- Regulation
- Courts (Common Law)
 - Interpret the Four Corners
 - Implied covenant to fully develop a leasehold...
 - Plus, incorporation of regulatory rules when the agreement calls for it.

Lessor

Limits the right of the Lessee

- Instead of trusting in the benevolent operator, wary landowners may wish to insert a special limitation 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 spacing, density, and production allowables

A. The Statewide Rules – Rule 38



- If the oil and gas lease incorporates regulations to determine what acreages remain operative after the primary term or continuous development, then it behooves one to know what those Government regulations are. Rule 38 will generally be the starting point.



A. The Statewide Rules – Rule 38 & Rule 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 = establish well density

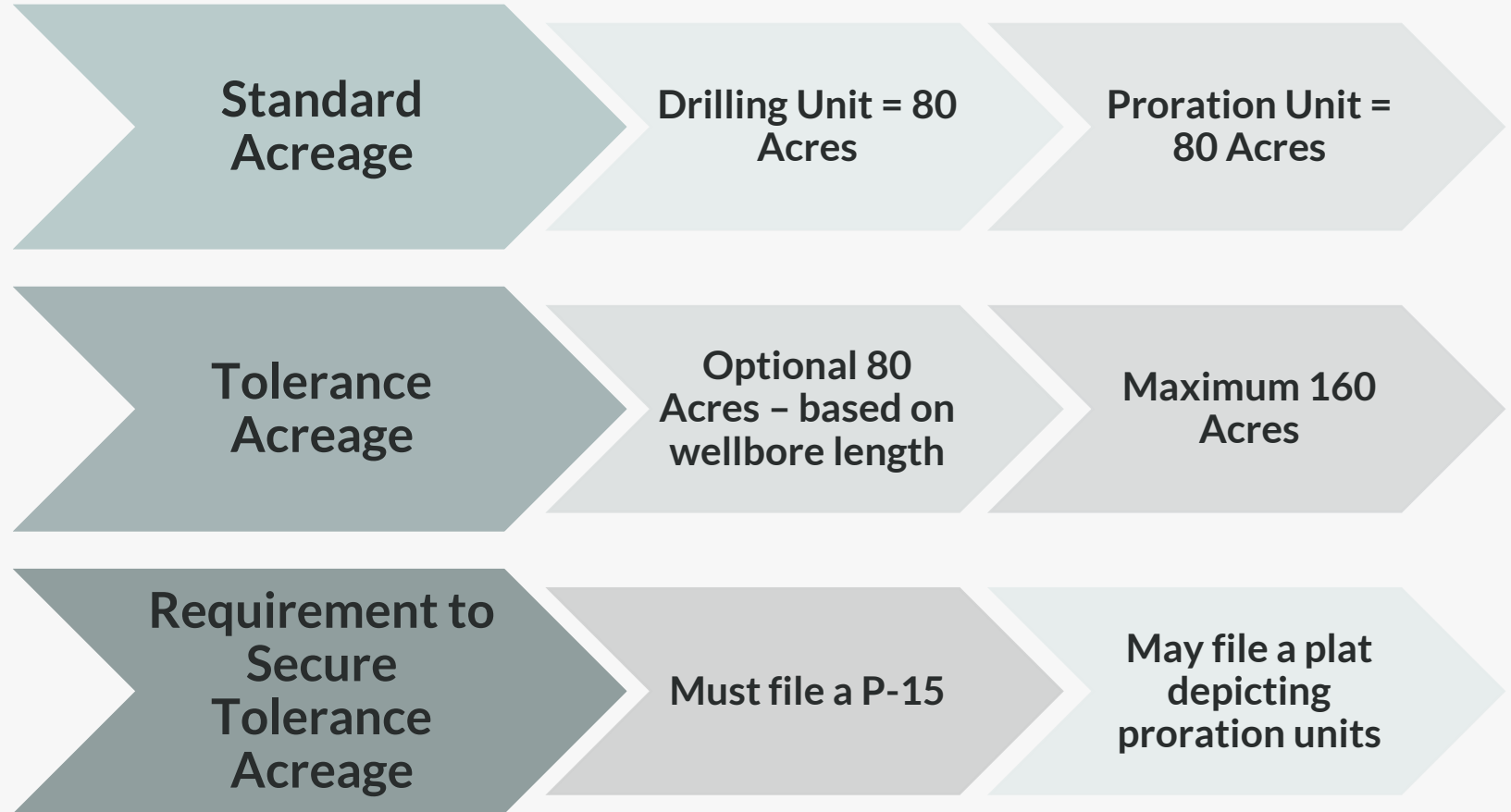
Rule 86

- Horizontal Drain Holes
- Establishes process and defines **Tolerance Acreage**
 - Acreage added to Proration unit based on the lateral length of the Horizontal Drain Hole
- Purpose = density and production allowables

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)

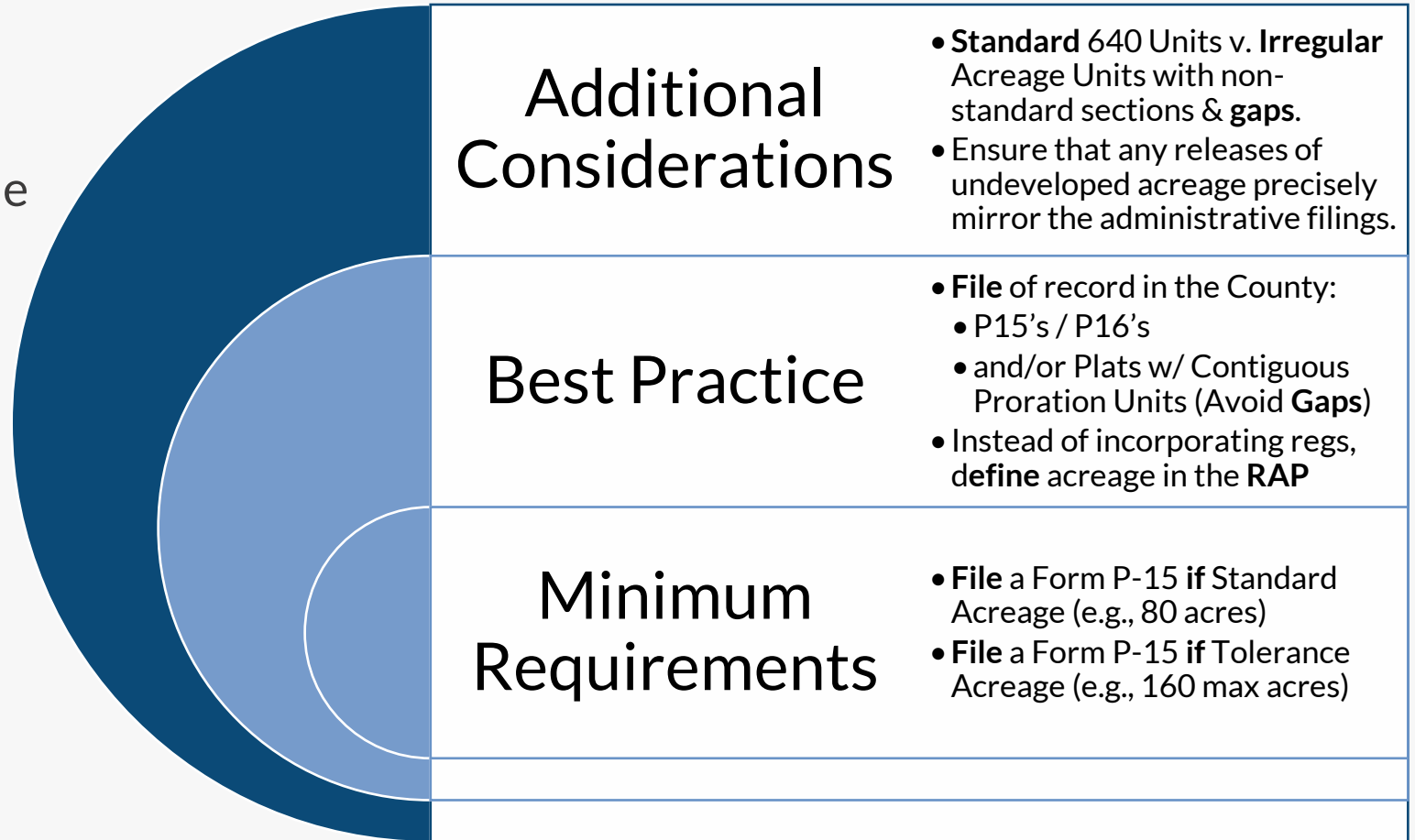


C. Putting It All Together



Avoid losing acreage by:

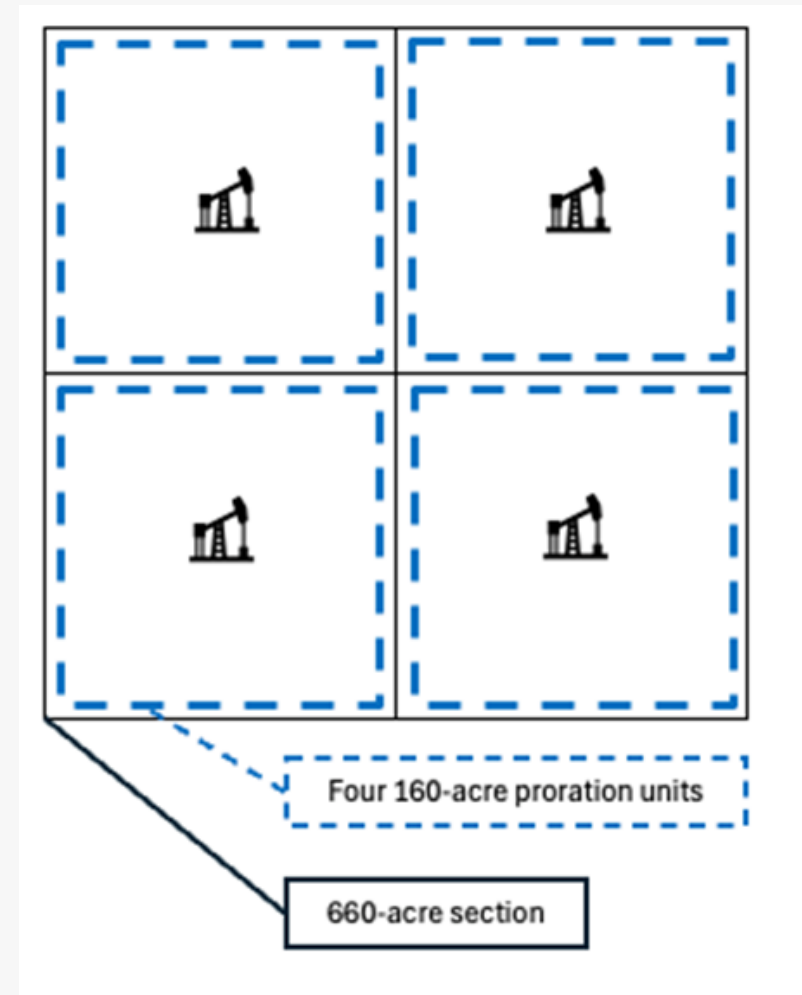
1. a close reading of the lease;
2. an in-depth understanding of the applicable statewide or special field rules, including any amendments thereto; and
3. a strict adherence to the filing requirements for designating tolerance acreage.



Example: Irregular Sections



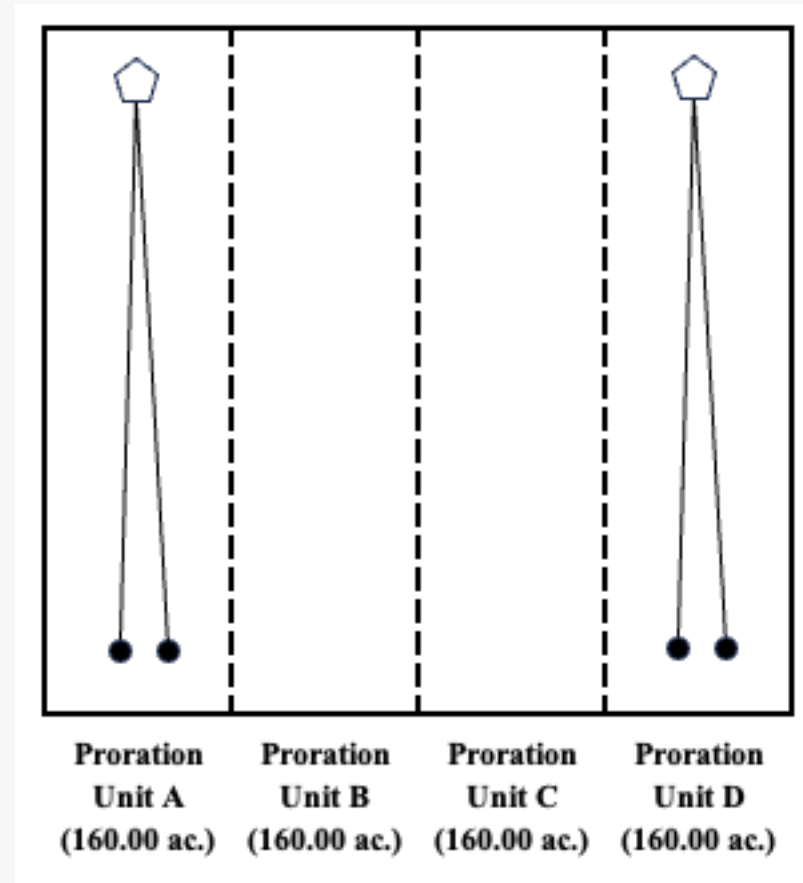
- Lease covered 660 acres
- Four wells drilled, one on each quarter section
- RAP: After drilling program 160-acre proration units around each well “in as close to a square as possible.”
- Top lease taken
- Bottom lease operator now wants to drill horizontally...



D. Assigning Non-Productive Acreage



- Intent was to assign all 640 acres to wells
- However, separate 160-acre proration units assigned to each of the four wells in the filings
- No plat filed. Where are these four proration units?
- Some leases expressly prevent this
 - › Ex: A lease that defines a “production unit” as an area of land and depths “around a well only.”
 - › Lease that prohibits designating a production unit that does not “physically contain” the appropriate well within in boundaries.
 - › A separate lease provision may also preclude extending a nonproducing proration unit



E. 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:

1. **Mirroring Approach** = the retained acreage provision should attempt to mirror the acreage provided in the pooling provision.
2. **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 producing 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 may set forth a certain number of wells per year to maintain full lease.



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** = After the expiration of the PT or CD, 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. Reclassifying a Gas Well and an Oil Well

- In *PPC Acquisition Co. LLC v. Del Basin Res. LLC*, a gas well with a 640-acre proration unit was reclassified as an oil well with a 160-acre proration unit. The three leases were past the trigger date for their retained acreage provisions. The leases were not identical.
- At issue was whether this reclassification reduced the acreage held from 640 to 160.
- The court treated this as any other rolling vs. snapshot analysis
 - › Two of the leases did not include clear language for rolling termination. Still held as to all 640 acres.
 - › Third lease stated that “operations on or production from . . . 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.” Court found this created rolling termination.
- *See also* farmouts or term assignments with a retained acreage provision.

D. 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
 - › Use it or lose it, or cumulative? (*Endeavor v. Energen*)
 - › Can it be tolled under force majeure? Probably not for poor rig scheduling (*Point Energy v. MRC*)

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



Sever 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



- When 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.” Court found this was less than full formation.



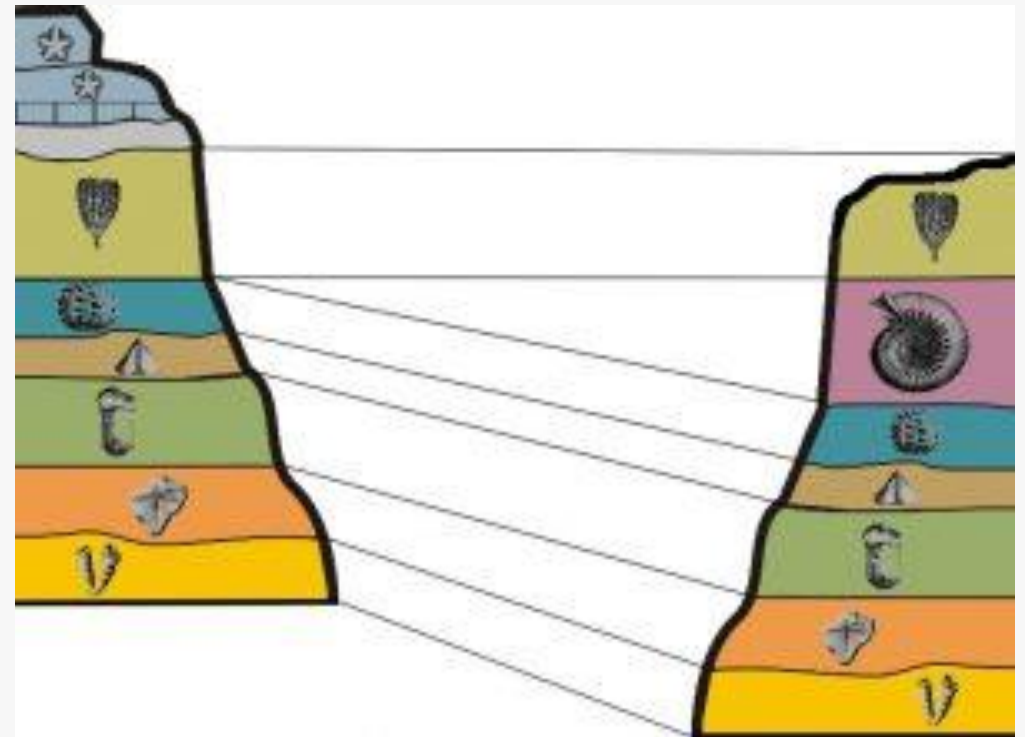
Caution when using geological terms!



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
 - › Reference the stratigraphic equivalents as found in a particular well log, including the date, well name and API number.



C. Double Assignment of Acreage



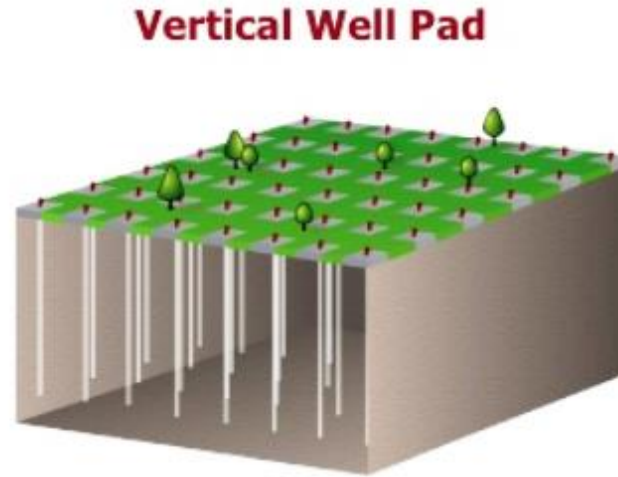
- **Double Assignments of Acreage** occur when a single tract of land has been assigned to two or more different wells in the same field. Caused problems when operators originally permitted horizontal wells on acreage HBP from vertical wells
- Rule 40 now broadens operators' ability to make multiple assignments of acreage, and expressly supersedes prior UFT field rules. However, note this does not extend to non-UFT fields. 16 Tex. Admin. Code § 3.40(e)(2)(f).
- You can tailor a depth severance provision to retain all depths within a particular *field*.



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



Frac Hits – Perhaps 100 feet below the deepest producing depth is no longer enough.



•Source: ERCB 2011

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.

E. Hacking Up Your Lease



A Note on Use of the Terms “Horizontal Pugh Clause” and “Vertical Pugh Clause”

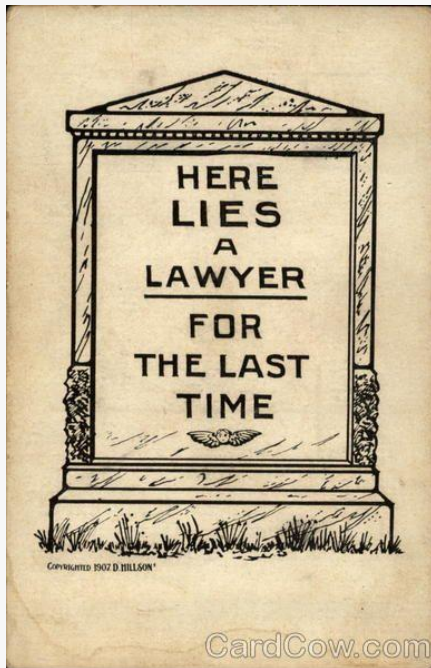
- These terms “Horizontal Pugh Clause” and “Vertical Pugh Clause” are sometimes used interchangeably.
- “Most courts, when referring to a “horizontal Pugh clause,” define it as releasing certain depths on the basis of a horizontal plane, and a “vertical Pugh clause” as a release of surface area on the 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 Unintended Texas Cases



- Knowing the Applicable Field Rules
 - › *ConocoPhillips Co. v. Vaquillas Unproven Minerals*
- Effect of Referencing the Acreage “Prescribed” by the Field Rules
 - › *XOG Operating, LLC v. Chesapeake Expl. Ltd. P’Ship*
- Failure to “Assign” Acreage to a Proration Unit
 - › *Endeavor Energy Res., L.P. v. Discovery Operating, Inc*

In some instances, it may be advisable . . .utilize “self-contained” retained acreage provisions that do not incorporate outside rules.

A. Knowing the Applicable Field Rules



ConocoPhillips Co. v. Vaquillas Unproven Minerals – 40 or 640 acres?

Facts

- COP's lease incorporated regulatory authority. Field rules provided for *spacing* (Rule 37) but not *density* (Rule 38)
- Rule 38 was incorporated by reference and provides for 40 acres minimum around each well
- COP kept 40 acres instead of 640 around each well. Released 15K acres from a 20K+ acre lease.

Takeaway

- If one decides to incorporate State regulation into one's Oil and Gas Lease, then at least know what one is agreeing to.
- Court: ConocoPhillips may not have "fully anticipated the consequences" of tying the retained acreage clause to field rules

B. Effect of Referencing the Acreage “Prescribed” by the Field Rules



XOG Operating, LLC v. Chesapeake Expl. Ltd. P'Ship – Prescribed vs. Actually Assigned

Facts

- XOG's lease incorporated governmental authority.
- CHK designated proration units less than those “prescribed” under the field rules.

Takeaway

- In this case, things worked out in CHK's favor because the field rules prescribed greater acreage than was designated.
- Don't count on this happening

C. Failure to “Assign” Acreage to a Proration Unit

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

Facts

- Endeavor’s lease incorporated governmental authority.
- The provisions required that Endeavor “Assign” acreage to a proration Unit
- Endeavor failed to Assign full acreage to a proration Unit

Takeaway

- Because Endeavor only assigned 81 acres, instead of the maximum 160, per proration unit, Endeavor was only allowed to hold those originally filed 81 acres per well.
- An operator, and not the RRC “assigns” acreage

VII. General Curative Approaches



Popular Costume in 2010

A. An Example



Scenario to Solve:

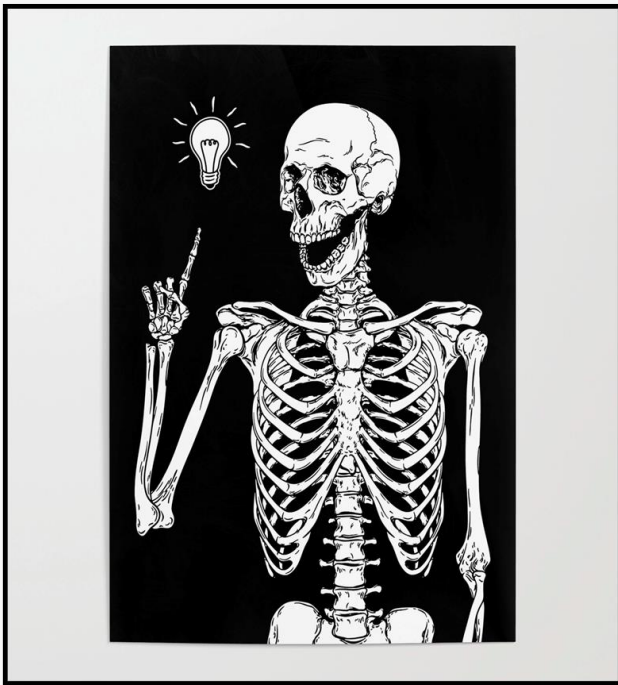


- Multiple leases authorize 640-acre pooled units.
- Addendum to each lease provides that lease will terminate at the end of the continuous development term except as to acreage dedicated to proration units, and only as to those depths from the surface to the deepest producing formation.
- Leases are pooled but smaller proration units are assigned for various wells. Also, only shallower depths are developed
- The leases all have different primary terms and conflicting continuous development programs
- What acreage and depths are now held if operator wants to drill deeper wells?

A. An Example



Possible Approach:



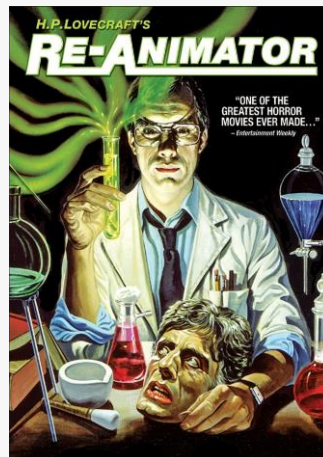
- Amendment will likely include new retained acreage and depth provision language that is subordinated to a new pooling clause
- “Reset” the continuous development period (Amendment)
- “Revivor” of the lease for any lost depths and/or acreage
- Lease “Tolling Agreement?”

B. Ratification vs. Revivor

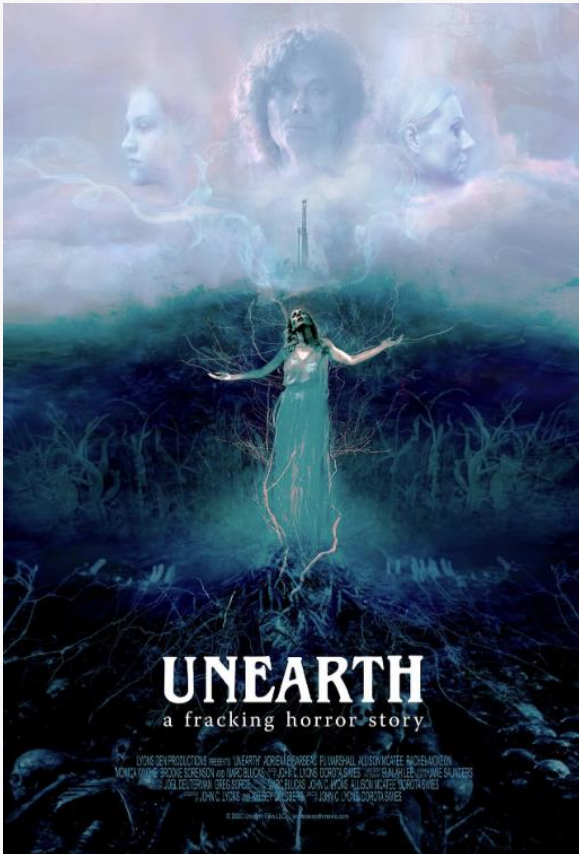


- **Ratification** is generally defined as an agreement confirming a lease by the original lessor. Ratification does not effect a present conveyance of a terminated lease, but binds a mineral owner to an otherwise defective, voidable lease which was previously executed.
 - › Howard R. Williams & Charles 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.
- **Halloween Homework:** Watch *Unearth: A Fracking Horror Story* (2020) for some fair and balanced industry commentary.



71%

Tomatometer
17 Reviews



32%

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Fewer than 50 Ratings

Eric L

It's a rancid piece of crap and that is its good point. It goes down hill from there.

About the Speaker



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