DRAFTING TIPS FOR OIL & GAS LEASES AND CONVEYANCES

(Appropriate Contractual and Conveyancing
Provisions to Acknowledge Recent Judicial Developments)

I. Oil and Gas Lease

A. Granting Clause

Problem 1: Who has the right to conduct or authorize seismic tests?

Lead Cases: Phillips Petroleum Co. vs. Cowden, 241 F.2d 586 (5th Cir. Tex. 1957), 7 O&GR 1291, 67 ALR2d 433; Mustang Production Company vs. Texaco, Inc., 549 F. Supp. 432 (D. Kan. 1982), 74 O&GR 462, affirmed at 754 F. 2d 892 (10th Cir. Kan. 1985), 83 O&GR 502; Wilson vs. Texas Company, 237 S.W.2d 649 (Tex. Civ. App. - Fort Worth 1951, writ ref'd, n.r.e.)

Drafting Solution: If the lessee is to have the exclusive right to grant seismic rights, then the granting clause of the lease should contain the word "exclusive" prior to and modifying the granting language. If the mineral owner/lessor desires to retain this right jointly with the lessee, then the word "exclusive" should be omitted from or stricken from the granting clause of the oil and gas lease.

B. Habendum Clause: Maintenance of the lease during the primary term

Problem 2: Maintaining the lease by paying delay rentals - changing a condition into a covenant.

Lead Cases: Humble Oil & Refining Company vs. Mullican, 144 Tex. 609, 192 S.W.2d 770 (1946) discusses how the usual "unless" lease form is interpreted. W. T. Waggoner Estate vs. Sigler Oil Co., 118 Tex. 509, 19 S.W.2d 27 (1929) holds that an "unless" lease will terminate automatically by its own terms in the event the lessee does not strictly comply with the delay rental clause and other clauses which create conditions, not covenants.

Drafting Solution:

1. The most common way to eliminate the delay rental as a condition of the lease is to pay delay rentals in advance, thus making the lease a "paid-up lease". Usually, the amount of the delay rental is $1.00 per acre so the lessee pays the lessor a bonus of an agreed amount per acre plus $1.00 per acre for

each year that a delay rental would be due, in advance. A typical paid-up lease provision would state:

THIS IS A FULLY PAID-UP LEASE, and as such, all delay rentals have been fully paid. The provisions concerning the payment of delay rentals are included only to facilitate the payment of shut-in royalties.

2. Kincaid vs. Gulf Oil Corporation, 675 S.W.2d 250 (Tex. App. - San Antonio 1984, writ ref'd n.r.e.), 83 O&GR 356 holds that the following language effectively changes the delay rental payment from a condition to a covenant:

> If Lessee shall, on or before any anniversary date, make a bona fide attempt to pay or deposit rental to a Lessor entitled thereto according to Lessee's records or to a Lessor who, prior to such attempted payment or deposit, has given Lessee notice, in accordance with subsequent provisions of this lease, of his right to receive rental, and if such payment or deposit shall be ineffective or erroneous in any regard, Lessee shall be unconditionally obligated to pay to such Lessor the rental properly payable for the rental period involved, and this lease shall not terminate but shall be maintained in the same manner as if such erroneous or ineffective rental payments or deposit had been properly made, provided that the erroneous or ineffective rental payment or deposit be corrected within thirty (30) days after receipt by Lessee of written notice from such Lessor or such error accompanied by such instruments as are necessary to enable Lessee to make proper payment.

C. Habendum Clause: Maintaining the lease in the secondary term.

1. Requirement of "Production"

Problem 3: Must there be actual production or is a discovery sufficient?

Lead Cases: Skelly Oil Company vs. Harris, 163 Tex. 92, 352 S.W.2d 950 (1962), 15 O&GR 653 holds that, at the expiration of the primary term, an oil and gas lease terminates as a matter of law unless there is actual production, or a contractual substitute for production such as drilling operations, or payment of shut in gas royalty. One well, producing in paying quantities on the land covered by the lease, or on land pooled with the lease, will continue the lease as to all land covered by the lease and as to all depths, unless the lease itself contains a provision requiring partial termination of the lease even if production is obtained (sometimes called a Pugh clause, a lease

termination clause, or a retained acreage clause). W. T. Waggoner Estate vs. Sigler Oil Co., 118 Tex. 509, 19 S.W.2d 27 (1929) and Rogers vs. Ricane, 772 S.W.2d 76 (Tex. 1989).

Joining Texas in the majority view that "production" requires actual production and marketing are the states of Louisiana, New Mexico, Kansas, Illinois, Michigan and Ohio.

Oklahoma and West Virginia courts have held that a discovery of hydrocarbons capable of commercial production during the primary term of the lease continues the lease into the secondary term. The lessee has an implied covenant to market gas as soon as possible. It is not necessary to make a timely shut-in gas royalty payment, McVicker vs. Horn, Robinson & Nathan, 322 P. 2d 410 (Okla. 1958), 8 O&GR 951, but if the payment is not made the lessee will still owe the shut in gas royalty payment as a debt. Gard vs. Kaiser, 582 P.2d 1311 (Okla. 1978), 61 O&GR 394.

Montana, Wyoming, Kentucky and Tennessee have cases suggesting that discovery of gas will be sufficient to extend the lease to its secondary term, but actual production of oil will be required. These states take a position which is between the two extremes previously identified.

Drafting Solution: If a Texas lessee desires a more liberal result, he should amend the habendum clause as follows:

> This lease will for a term of three years from this date (called "primary term") and as long thereafter as oil, gas, or their respective constituent products, or any of them, *is capable of being produced* in paying quantities from said land... .

2. Changing the duty to pay royalty, which is a covenant, into a condition.

Problem 4: The effect of adding a duty to pay royalty timely into the Habendum Clause.

Lead Cases: In Hitzelberger vs. Samedan Oil Corporation, 948 S.W.2d 947 (Tex. App. - Waco 1997, writ denied, motion for rehearing pending), the Court construed an unusual Habendum Clause such that a producing paid up lease terminated within its primary term.

In 1990, NCNB Texas National Bank signed an oil and gas lease with Massad Oil Company covering a tract of land in Navarro County. Hitzelberger became the successor to the Lessor while Samedan succeeded Massad. Samedan requested Hitzelberger to join the South Karens Unit consisting of almost 1,000 acres of

unitized oil production. Hitzelberger agreed to join the unit if the royalty provisions in his lease survived the unit agreement. Samedan accepted this condition and altered its unit agreement in an attempt to satisfy Hitzelberger's request. Subsequently, Samedan completed a producing oil well and the first sale of oil from this well, located off of Hitzelberger's land, occurred on June 12, 1992. Samedan paid an initial royalty payment to Hitzelberger 120 days later on October 10, 1992. After timely making two subsequent royalty payments, Samedan failed to make the monthly royalty payments due in January and February of 1993 in accordance with the royalty provisions of Hitzelberger's lease. Hitzelberger notified Samedan that the lease terminated because of the late payment of royalties. After Samedan's refusal to release the lease, Hitzelberger brought this action. After a bench trial, the trial court ruled in Samedan's favor holding that the lease did not terminate.

The Habendum Clause in paragraph 2 of Hitzelberger's lease provides:

> Subject to the other provisions hereof, this lease shall be for a term of three years from this date (called "primary term") and as long thereafter as oil and gas, or either of them, is produced in paying quantities from said land or lands with which said is pooled hereunder *and the royalties are paid as provided*.

The critical language in this dispute is contained in paragraph 3, the royalty clause which includes:

> (g) Within 120 days following the first sale of oil or gas produced from the leased premises, settlement shall be made by Lessee or by its agent for royalties due hereunder with respect to such or gas sold off of the premises and such royalty shall be paid monthly thereafter without the necessity of Lessor executing a division order or transfer order. *If said initial royalty payment is not so made under the terms hereof, this lease shall terminate as of 7:00 a.m. the first day of the month following expiration of said 120-day period. After said initial royalty payment, with respect to oil or gas produced during any month, if royalty is not paid hereunder on or before the last day of the second succeeding month, this lease shall terminate at midnight of such last day*.

Paragraph 4 of the lease contains a typewritten sentence which provides:

> "This is a paid up lease and all references to delay rentals shall be disregarded."

Paragraph 5 of the lease grants the Lessee the right to pool or combine the lands covered by the lease or any part thereof. Hitzelberger's consent to join the South Kerens Unit was necessary because paragraph 5 only covered pooling necessary to drill an exploratory well.

The Waco court reversed and rendered the trial court and remanded the issues not resolved by the trial court's judgment. The appellate court dealt with Samedan's main arguments as follows:

1. While Samedan thought that the lease could not terminate within the primary term because it was paid up, the unambiguous paragraph 3(g) was a condition, not a covenant, and breach of the condition results in automatic termination. Rogers vs. Ricane Enterprises, Inc., 772 S.W.2d 76, 79 (Tex. 1989); Parten vs. Cannon, 829 S.W.2d 327, 329-330 (Tex. App. - Waco 1992, writ denied);

2. Samedan claimed that Gulf Oil Corporation vs. Southland Royalty Company, 496 S.W.2d 547 (Tex. 1973) required that the Habendum Clause cannot be modified by a clause, such a paragraph 3(g), which "does not specifically direct itself toward amending the habendum." The Court held that pursuant to its duty to resolve the intention of the parties from the entire lease it was possible to find language elsewhere in the lease that modifies the duration of the lease but does not specifically modify the habendum clause. In this case, the Court felt that the phrases "subject to the other provisions hereof" and "the royalties are paid as provided" contained within this habendum clause indicated an intent that the habendum clause could be modified by paragraph 3(g).

3. The Court apparently considered it important that Samedan had amended the unit agreement to accommodate Hitzelberger's prior request that the royalty provisions in his lease not be amended by the unit agreement because the Court utilized several pages discussing how the unit agreement amended the lease in part.

The curtain finally fell on Samedan when the Court stated "although the law does not favor forfeitures, we apply the unambiguous language of Hitzelberger's lease and the unit agreement to declare that the lease covering Hitzelberger's tracts terminated at midnight on January 31, 1993.[8] Shindler vs. Harris, 673 S.W.2d 600, 609 (Tex. App. Houston [1st Dist.] 1984, writ refused n.r.e.); Pitman vs. Sanditen, 611 S.W.2d 663, 668 (Tex. Civ. App. - San Antonio 1980), *reversed on other grounds, 626 S.W.2d 496 (Tex. 1981)."*

8. We believe the forfeiture of a lease that is included in a pooled unit is especially distasteful to the law. However, we also believe that it is the Lessee's responsibility to comply with lease and unit obligations to keep the lease in effect.

Drafting Solution:

1. DON'T REFER TO ROYALTY PAYMENT IN YOUR HABENDUM CLAUSE.

(Practice Tip) 2. It is incumbent upon the title examiner to identify all lease termination provisions in all title opinions. The examiner should be particularly careful to identify lease termination provisions that are unusual. Having a producing lease terminate because of failure to pay royalty timely is most unusual. The examiner should stress this point with his client and his client should stress this point with all lease maintenance staff.

3. Savings Clauses as substitutes for "production"

a. Shut-in gas royalty clause

Problem 5: Will the lease terminate if the shut in gas payment is paid late, to the wrong person, or in the wrong amount?

Lead Cases: Gulf Oil Corporation vs. Reid, 337 S.W.2d 267 (Tex. 1960), 12 O&GR 1159 holds that a shut in royalty payment must be timely, to the right person and in the right amount or the lease terminates as a matter of law. As noted supra, Oklahoma does not reach this same strict result. McVicker vs. Horn, supra.

In my opinion, the gravest threat to a lessee losing his investment in a producing oil and gas lease is the threat of making an untimely shut-in gas royalty payment. Therefore, I offer several solutions to deal with this potential disaster.

Drafting Solution:

1. Lessee may make the payment a covenant, not a condition, by adding either a paragraph similar to that identified in Kincaid vs. Gulf Oil Corporation, supra, or by adding the following sentence at the end of the shut-in gas royalty paragraph:

> Lessee's failure to pay or tender or to properly or timely pay or tender such sum as royalty shall render lessee liable for the amount due but it shall not operate to terminate this lease.

Taken from Exxon lease Form 062-02222A Producers 88 Rev. Texas (1-69) with 40/640 acres pooling provision. A copy of this lease form is attached as Exhibit C.

2. Most shut-in gas royalties require the first payment be made within 60 or 90 days from the date the well is shut-in. In my opinion, a better option is where the lease gives the lessee a year from the date of shut-in to decide whether or not to make a shut-in payment:

> Where gas from any well or wells capable of producing gas, ... is not sold or used during or after the primary term and this lease is not otherwise maintained in effect, lessee may pay or tender as shut-in royalty to the party or parties shown by lessee's records to be entitled to receive royalties on actual production of gas at the time of such payment ... in the same manner and subject to the same provisions applicable to the payment and tender of rental, *an amount equal to the annual rental hereinafter provided, payable annually on or before the end of each 12-month period* during which such gas is not sold or used and this lease is not otherwise maintained in force, ...

Taken from Form L.B. 88 Revised 2-60 provided by my friends from Crescendo Resources, L.P., which succeeded Midgard Energy Company in 1997, which succeeded Maxus Exploration Corporation in 1995, which succeeded Diamond Shamrock Corporation in 1984, which succeeded The Shamrock Oil & Gas Corporation in 1968.

3. The same Exxon lease form provides for making shut-in gas royalty payments monthly, not in annual payments. The main advantage is that the situation is monitored monthly so you will not make a shut-in gas royalty payment for a month where production was obtained. The obvious disadvantage is that the lessee must maintain a competent lease records department. The language provided by the lease form is:

> If Lessee drills a well on land covered by this lease or on land pooled therewith, which well is capable of producing oil or gas but such well is not being produced and this lease is not being maintained otherwise as provided herein, this lease shall not terminate, whether it be during or after the primary term, (unless released by Lessee) and it shall nevertheless be considered that oil or gas is being produced from the land covered by this lease. When the lease is continued in force in this manner, Lessee shall pay or tender as royalty to the parties who at the time of such payment would be entitled to receive royalty hereunder if the well were producing, or deposit to their credit in the

depository bank as hereinafter provided *a sum equal to 1/12 of the amount of the annual rental payable in lieu of drilling operations* during the primary on the number of acres subject to this lease at the time such payment is made for each calendar month, or portion thereof, thereafter...

4. Many recent leases include a new condition that limits the number of shut-in gas royalty payments that can be made, a typical clause is:

> This lease may not be maintained for more than three years solely by shut-in gas royalty payments.

I have two suggestions how to respond to this common problem:

a. The lessee should negotiate a clause that, instead of saying "no more than three shut-in gas royalty payments" or that the lease may not be maintained for more than three years," speaks in terms of the lease not being maintained for more than 36 months of non-production, so that the Lessee benefits from intermittent production.

b. The lessee could consider using the Exxon type of monthly shut-in gas royalty payment which also gives the lessee the benefit of all intermittent production.

b. Dry hole, reworking or continuous operations, and temporary cessation of production clause (savings clause)

<u>Problem 6</u>: **Is the change in classification of a well from gas to oil or oil to gas considered temporary cessation of production for the savings clause?**

<u>Lead Cases:</u> <u>Rogers vs. Osborne</u>, 152 Tex. 540, 261 S.W.2d 311 (1953), 2 O&GR 304 and 1439 is considered "the mother" of strict construction of oil and gas lease cases, particularly when you consider the vagaries of the savings clause. There have been many cases interpreting the savings clauses of different leases but one common thread in Texas is that the courts consistently apply the terms strictly. As previously mentioned, the entire Exxon lease is included as Exhibit C and the savings clause is paragraph 6. I recommend that you compare the savings clause on your existing lease with the Exxon lease and also keep in mind the following topics that your savings clause needs to address accurately:

1. Some dryhole clauses are drafted so that they apply only during the primary term. Each provision in the savings clause should be drafted so that it applies to both the primary and secondary term.

2. Any clause referring to pooling should refer to pooling upon the leased premises and also upon land pooled therewith. Humble Oil & Refining Co. vs. Kunkel, 366 S.W.2d 236 (Tex. Civ. App. - San Antonio 1963, writ ref'd n.r.e.), 18 O&GR 344 held that reference in a lease maintenance clause only to operations upon the leased premises and not referring to the land pooled therewith proved fatal.

3. Be sure that your savings clause refers to "continuous operations" and not "continuous drilling" as you want the benefit of the more broadly defined term. See Rogers vs. Osborne, supra;

4. The continuous operations and dryhole portions of the savings clause should avoid reference to "abandonment" of operations. The lessee in Gulf Oil Corp. vs. Reid, supra, was unable to avail itself of the continuous operations clause because of the reference to abandonment of the well rather than completion of the well. Both Skelly Oil Co. vs. Harris, 352 S.W.2d 950 (Tex. 1962), 15 O&GR 653 and Duke vs. Sun Oil Co., 320 F.2d 853, *reh'g denied*, 323 F.2d 518 (5th Cir. Tex. 1963), 19 O&GR 221 and 238 distinguish Reid on this basis.

5. It is possible to tack or add together the provisions of different clause, such as the shut-in gas royalty and the cessation of production clauses, for Lessee's benefit. Skelly Oil Co. vs. Harris, supra and Mayers vs. Sanchez-O'Brien Minerals Corp., 670 S.W.2d 704 (Tex. App. - San Antonio 1984, writ ref'd n.r.e.), 81 O&GR 386 where the lessee commenced production within 60 days after the end of the 12 month period following the shut-in gas royalty payment, a 12 month period the court considered the same as actual production, and thus maintained the lease.

For an actual drafting solution I submit another clause from the Exxon lease form that addresses a seldom occurring but potentially fatal event - change in classification of a producing well.

Drafting Solution: The Exxon lease form previously identified contains the following provision in its pooling paragraph:

> If an oil well on an oil unit, which includes all or a portion of the lease premises is reclassified as a gas well, or if a gas well on a gas unit, which includes all or a portion of the leased premises, is

reclassified as an oil well, the date of such of such reclassification shall be considered as the date of cessation of production for purposes of applying the additional drilling and reworking and resumption of delay rental provisions of Paragraph 6 hereof as to all leases any part of which are included in the unit other than the leased premises on which the well is located.

c. Pooling Clause

Problem 7: Non-drillsite leases terminate if pooling instrument recorded late.

Lead Cases: Sauder vs. Frye, 613 S.W.2d 63 (Tex. Civ. App. - Fort Worth 1981, no writ history) 69 O&GR 147, 15 ALR3rd 899 held that a pooling agreement executed by the record owners of all leases was not effective as to non-drillsite leases until recorded. This deadline has caused many frazzled landmen to overnight conform the copies of pooling agreements to multiple leasehold owners demanding overnight return of signed copies so that the instrument can be immediately taken to the county for recording. This is because, in part, the pooling clause of most leases does not state when the pooling becomes effective.

Drafting Solution:

1. The pooling clause should be amended to provide the following:

> Lessee shall file for record in the appropriate records of the county in which the leased premises are situated an instrument describing and designating the pooled acreage as a pooled unit; *the unit shall become effective as provided in said instrument*, or if said instrument makes no such provision, it shall become effective upon the date it is filed for record.

Taken from the same Exxon lease form.

(Practice Tip) 2. Too often I see an operator attempting to pool shortly after he has conveyed to all of his non-operating investors. If the operator would pool when the leases are owned by fewer parties, then he has much less trouble obtaining the signatures of the necessary parties.

(Practice Tip) 3. If prior to pooling all participating parties have executed an operating agreement, the operating agreement can include as a special provision a limited power of attorney from all non-operators to the operator giving the

operator the limited authority to execute any pooling instrument on behalf of all record owners.

Problem 8: Lease terminates when test well completed as oil well after leases pooled for gas.

Lead Cases: Sunac Petroleum Corp. vs. Parkes, 416 S.W.2d 798 (Tex. 1967), 26 O&GR 689 involves the unhappy situation where the operator timely pooled four leases, each lease covering a quarter of a section, for a gas well but then, unexpectedly, completing an oil well. The operator, believing his completed oil well would be considered a "dry hole" for the purpose of his savings clause, skidded his rig over and commenced operations on an adjacent quarter and completed a gas well. The Lessor filed suit claiming that upon completion of the oil well, all non-drillsite leases terminated. The Supreme Court, following its strict construction philosophy, held that the producing oil well was not a dry hole pursuant to the savings clause and thus the three non-drillsite leases terminated upon completion of the oil well.

Drafting Solution: The pooling paragraph should be amended to include the following language, taken from the same Exxon lease:

> Provided that if after creation of a pooled unit, a well or mine is drilled on the unit area, other than on the land covered hereby and included in the unit, *which well is not classified as the type of well for which the unit was created (oil, gas or other mineral as the case may be), such well or mine shall be considered a dry hole for purposes of applying the additional drilling and reworking and resumption of delay rental provisions of Paragraph 6 hereof.*

4. Combining clauses to promote readability

Problem 9: Difficulty in reading together multiple clauses that impact the same topic.

Lead Cases: None found. I frequently have difficulty reading together a savings clause, usually in the form portion of a lease, with a lengthy retained acreage/lease termination/Pugh clause usually located at the end of a lease and reconciling all provisions. I recently examined an oil and gas lease prepared by Texas Commerce Bank that combined these clauses in a way that I consider particularly effective.

One change that I have made in Exhibit A was at the suggestion of Dwight Snell (no relation), a landman, in Simonton, Texas (713) 346-1932. He mentioned that because of the horizontal drilling occurring in East Texas it was important to the Lessee that all pooling clauses contain the phrase *prescribed and/or permitted* as

required by Jones vs. Killingsworth, 403 S.W.2d 325 (1965), 25 O &GR 508. The Texas Commerce Bank form, Texas Commerce Bank being a lessor, contained only the term *prescribed*.

Drafting Solution: See Exhibit A.

D. Royalty Clause: Payments under the lease

1. Market value gas royalty

Problem 10: Pay gas royalty on market value or contract price

Lead Cases: THE MAJORITY RULE - PAY MARKET VALUE

Texas: Exxon Corp. vs. Middleton, 613 S.W.2d 240 (Tex. 1981), 69 O&GR 115, 10 A.L.R.4th 712;
Texas Oil & Gas Corp. vs. Vela, 429 S.W.2d 866 (Tex. 1968), 29 O&GR 121;
Mississippi: Piney Woods Country Life School vs. Shell Oil Co., 726 F.2d 225, 79 O&GR 244 (5th Cir. Miss. 1984), cert. denied, 105 S.Ct. 1868, 85 L.Ed 2d 161 (1985);
Kansas: Lightcap vs. Mobil Oil Corp. 562 P.2d 1, (Kan. 1977), *cert. denied* 434 U.S.876 (1977);
Montana: Montana Power Co. vs. Kravik, 586 P.2d 298, (Mont. 1978);
North Dakota: West vs. Alpar Resources Resp., Inc. 298 N.W.2d 484, (ND 1980);
West Virginia: Imperial Collier Co. vs. OXY USA, Inc., 912 F.2d 696 (4th Cir. W.VA. 1990).

THE MINORITY RULE - PAY THE CONTRACT PRICE

Oklahoma: Tara Petroleum Corp. vs. Hughey, 630 P.2d 1269 (Okla. 1981);
Arkansas: Hillard vs. Stephens, 637 S.W.2d 581 (Ark. 1982);
Louisiana: Henry vs. Ballard & Cordell Corp., 418 So.2d 1334 (La. 1992).

A typical gas royalty clause provides:

The royalties to be paid by Lessee are as follows:

> "On gas, including casinghead gas, condensate or other gaseous substances produced from said land and *sold or used off of the premises* or for the extraction of gasoline or other products therefrom, the *market value at the well* of 1/8 of the gas sold or used *provided*

that on gas sold at the wells the royalty should be 1/8 of the *amounts realized* from such sale."

The above language identifies two methods of calculating gas royalty. The difference in methods used to calculate gas royalty has led to disputes over defining the differences. When gas is sold at the wellhead, the Lessor's royalty is calculated on the actual proceeds received or "amount realized" by the Lessee under the terms of its gas sales contract. However, in Texas and the majority of gas producing states, when gas is not sold at the wellhead and the operator has to transport the gas off lease to a market, royalty is based on the "market value" at the point of delivery or sale and not the actual amount realized. Middleton, et al.

Because the gas royalty provides that for gas sold "off the premises" the royalty be based upon "market value" *at the well*, the operator can "work back" by deducting the cost of transportation and processing from the "market value" *at the time and point of delivery* to determine the "market value" *at the well* necessary to calculate royalties. Piney Woods, 726 F.2d at 241. Thus in the majority of states, it is necessary to determine the "market value" at the point of delivery in order to calculate royalty and to determine whether the amount realized at the point of sale (delivery) actually refers to the "market value".

The decision in Middleton, et al is in contrast to Supreme Court decisions in Oklahoma, Louisiana and Arkansas in which the Courts rejected the arguments that Lessee should pay royalty for natural gas calculated upon values greater than the amounts actually received. Tara, et al. The Court in Tara held that "market price" is equivalent to the price assigned in the sale contract (thus "amount realized") provides that the producer entered into an arms length good faith purchase contract with the best price and term available to the producers at the time. Tara, 630 P.2d at 1273. The Court reasoned that to hold otherwise would be unfair to the Lessee when the gas is committed to a contract such that when the market value rises, the Lessee would be required to pay the Lessor an increasing percentage of the total revenues - over and beyond the stated percentage of the lease. *Id.*

Drafting Solution: In order to reach a minority rule result in a majority rule state, such as Texas, the gas royalty clause should be redrafted as follows:

3. The royalties to be paid by lessee are:

(a) On oil ...

(b) On gas, ... *the market value at the well* of 1/8 of the gas sold or used, provided that on gas sold by lessee *the market value shall not exceed the amount received by lessee* for such gas

computed at the mouth of the well, and *on gas sold at the well, the royalty shall be 1/8 of the amount realized by lessee from such sale*;

Taken from the same Exxon lease form.

2. Post-production costs (PPC)

Problem 11: **May the lessee deduct from the lessor's royalty the royalty owner's proportionate part of expenses incurred after production?**

Lead Cases: AT THE WELL STATES - LESSEE CAN DEDUCT

Texas: Heritage vs. NationsBank, 939 S.W.2d 118 (Tex. 1996);
Louisiana: Wall vs. United Gas Pub. Ser. Co., 178 La. 908, 152 So. 561 (1934);
____________Mississippi: Piney Woods Country Life School vs. Shell Oil Co., 726 F.2d 225 (5th Cir. Miss. 1984), cert. denied, 105 S.Ct. 1868, 85 L.Ed.2d. 161 (1985);
____________Michigan: Schroeder vs. Tarra Energy, Ltd., 223 Mich. App. 176, 565 N.W.2d 887 (1997);
____________North Dakota: West vs. Alpar Resources, Inc., 298 N.W.2d 484 (ND 1980).

THE MARKETABLE PRODUCT STATES - LESSEE CANNOT DEDUCT

______Colorado: Garman vs. Conoco, Inc., 886 P.2d 652 (Colo. 1994);
Oklahoma: Wood vs. TXO Prod. Corp., 854 P.2d 880 (Okla. 1992);
Mittelstaedt vs. Santa Fe Minerals, Inc., No. 84,977, 1998 WL 33920 (Okla., Jan. 20, 1988)
TXO vs. Missioner of the Land Office, 903 P.2d 259 (Ok. 1994)
Johnson vs. Jernigan, 475 P.2d 396 (Ok. 1970)
Kansas: Sternberger vs. Marathon Oil Co., 894 P.2d 788 (Kan. 1995)
Arkansas: Hanna Oil & Gas Co. vs. Taylor 297 Ark. 80, 759 S.W.2d 563 (1988);
Wyoming: Wyoming Statute - 30 - 5 - 304, 305 (1994).

The At the Well States hold that all post-production costs, defined as all costs subsequent to the wellhead, are to be shared proportionately by the working interest owners and the royalty owners. The Marketable Product States take the position that the Lessee is to bear all costs required to transform raw gas into a marketable product. After a marketable product is obtained, any additional cost incurred to enhance the value of the marketable gas may be charged proportionately against the non-working interest owners.

The At the Well States are of the opinion that the end of production occurs when the raw gas comes out of the well. Thus, all post-production costs are to be shared proportionately by the working interest owners and the royalty owners. The Marketable Product States do not consider that production has ended until there is a marketable product, at least with the facilities that are located on the lease. These courts further hold that, upon obtaining a marketable product, any additional costs incurred to enhance the marketable gas may be charged against the non-working interest owners.

The Marketable Products States also rely on the implied covenant to market as their justification for hold working interest liable for all costs incurred in producing a marketable product. In their view, since the implied duty to market imposes upon the Lessee a duty to get the product to the place of sale in a marketable form, the Lessee should bear all of such cost alone. At the other end of the spectrum, the At the Well States recognize that the Lessee has an implied duty to market gas, but it is the view of these courts that the express language of the lease describing how and where royalty will be determined will control over the implied covenant.

At issue in the <u>Heritage vs. NationsBank</u> case was the interpretation of the royalty clause in six different oil and gas leases covering land located in Winkler County, Texas (the "subject lands"). NationsBank or is predecessors were the Lessors and <u>Heritage</u> owned an undivided interest in varying percentages in most, but not all, of the six leases and was the operator of all wells upon the leases. The royalty clauses in each of the leases were almost identical and provided basically as follows:

> 3. Lessee shall pay the following royalty subject to the following provisions:
>
> (b) Lessee shall pay the Lessor 1/4 *of the market value at the well* <u>for all gas</u> (including all substances contained in such gas) produced from the leased premises and sold by the Lessee or used off the leased premises, including sulfur produced in conjunction therewith; <u>provided however that there shall be no deduction from the value of Lessor's royalty by reason of any required</u> processing, <u>cost of</u> dehydration, compression, <u>transportation</u> or other matter to market such gas (emphasis added)

The majority opinion found that applying the trade meaning of the terms "royalty" and the "market value at the well" rendered the post-production clauses in the leases surplusage as a matter of law.

The concurring opinion authored by Justice Owen examined the post-production clauses to determine whether there was language in the leases that reallocates the post-production cost, by stating:

> It is clear certain "deduction" are prohibited. The question that must be answered is from *what* are deductions prohibited. The clause says "from the value of Lessor's royalty." The value of Lessor's royalty is "market value at the well" for gas sold off the leased premises.

Justice Owen then opined that as long as market value at the well is the bench mark for value in the gas, a phrase prohibiting the deduction of post-production costs from that value does not change the meaning of the royalty clause, but merely restates existing law.

Drafting Solution: In order to change this result, John Woodward 214/373-4090, the Dallas attorney who represented Heritage in this case, proposes that either of the following two clauses should accomplish the result evidently intended by NationsBank and change the general rule concerning post-production deductions in the At the Well States:

1. Lessee shall pay the Lessor *1/4 of the market value at the well* for all gas (including all substances contained in such gas) produced from the leased premises and sold by the Lessee or used off the leased premises, including sulfur produced in conjunction therewith; provided, however, notwithstanding the foregoing, in calculating the value of Lessor's royalty, *there shall be no deductions made from the gross proceeds* received from the sale of such gas by reason of the cost of any required processing, dehydration, compression, transportation or other costs of marketing such gas which occur on the leased premises or within one mile outside thereof.

2. Lessee shall pay the Lessor *1/4 of the market value at the well* for all gas (including all substances contained in such gas) produced from the leased premises and sold by the Lessee or used off the leased premises, including sulfur produced in conjunction therewith. *In addition to 1/4 of the market value of the gas at the well, Lessee shall also pay to Lessor 1/4 of all costs* of processing, dehydration, compression, transportation or other costs of marketing such gas which occur on the leased premises or within one mile outside thereof.

In order to change the general rule concerning post-production cost deductions in the Marketable Products States, John suggests using the following clause:

> Lessee shall pay the Lessor *1/4 of the market value at the well* for all gas (including all substances contained in such gas) produced from the leased premises and sold by the Lessee or used off the leased premises, including sulfur produced in conjunction therewith. *In calculating royalty on natural gas produced hereunder, Lessee may deduct Lessor's proportionate part of any* ad valorem, production and excise taxes, and any *cost incurred by Lessee* in processing, dehydrating, compressing, transporting, or otherwise making such gas a marketable product.

Taken from John R. Woodward, Post-Production Deductions - *Heritage vs. Nations Bank* - Review of Oil & Gas XII - Dallas Bar Association, Energy Law Section Seminar (1997).

E. Top Lease - Rule Against Perpetuities (RAP)

Problem 12A: How to avoid RAP by drafting - the top lease

Lead Cases: Peveto vs. Starkey, 645 S.W.2d 770 (Tex. 1982), 75 O&GR 166; Hammon vs. Bright & Co., 924 S.W.2d 188 (Tex. App. - Amarillo 1996) Judgment vacated without reference to the merits, 938 S.W. 2d 718 (Tex. 1997)

____________ The lesson of both cases is that, to avoid the Rule, the top lessee must acquire a present vested property interest, usually accomplished by a specific grant of the lessor's reversionary interest in the mineral estate underlying the bottom lease. I have seen several clauses accomplishing this and offer two different provisions for your consideration:

Drafting Solution: Add the following language to the top lease:

> This lease is granted on Lessor's reversionary interest in said premises and is hereby vested in interest, but is subject to an existing oil and gas lease by ______________, as Lessor, and ______________, as Lessee, dated ________________, recorded in Book ________, Page ________. The interest covered herein shall vest in possession upon the termination of this existing lease. Lessor agrees not to execute any instrument extending or renewing the existing lease. The anniversary date of this lease is __________________.
> (Consider the last sentence of the next paragraph!)

The following was submitted by Dwight Snell:

Lessee's rights are subordinate to and subject to that certain oil and gas lease dated _________________, recorded in Volume _________, Page _________ of the Official Records of ________________ County, Texas (hereinafter referred to as the prior lease). Lessee shall have no right of interest or possession for the purpose of exercising Lessee's rights hereunder to the extent such exercise would interfere with the rights of Lessee under the prior lease. It is understood and agreed that this lease shall immediately, as of the "effective date of the primary term", vest Lessee with all of Lessor's interest, current or future, as well as Lessor's reversionary interest under the prior lease and such other rights and interests as set forth herein subject only to the prior lease. Lessor's represent and warrant that Lessors have not entered into any renewal, agreement to review or amendment of the prior lease to as to extend the primary term set forth therein and Lessors covenant and agree not to extend, amend or modify the prior lease. **In the event this lease has not vested in Lessee herein by or on _______________, then, in that event, this lease shall terminate and be null and void.**

Problem 12B: How to avoid being top leased - the bottom lease.

A Lessee can act in a defensive manner by including language such as the following "anti-top lease clause" provided by John H. Heyer, Attorney at Law, P. O. Box 588604, Exchange National Bank Building, Olean, New York 14760 (716) 372-0395:

The Lessor will not grant an oil and gas lease, or option, for any oil and gas lease on the premises, to any third party during the primary term or secondary term of this lease without first offering a renewal to the Lessee with the same terms and conditions offered by the third party. Lessee shall have three (3) working days to respond to the subsequent offer to lease, or option to lease, after receiving written notification from Lessor.

Another "anti-top lease clause" found in Pound Printing & Stationery Co. Producers 88 (4-89) - Paid Up with 640 Acres Pooling Provision lease form is as follows:

In the event that Lessor, during the primary term of this lease, receives a bona fide offer which Lessor is willing to accept from any party offering to purchase from Lessor a lease covering any or all of the substances covered by this lease and covering all or a portion of

the land described herein, with the lease becoming effective upon expiration of this lease, Lessor hereby agrees to notify Lessee in writing of said offer immediately, including in the notice the name and address of the offeror, the price offered and all other pertinent terms and conditions of the offer. Lessee, for a period of 15 days after receipt of the notice, shall have the prior and preferred right and option to purchase the lease or a part thereof or interest therein, covered by the offer at the price and according to the terms and conditions specified in the offer.

II. The Mineral Deed

A. Over-conveyance

Problem 13: Grantor conveys with reservations such that both the Grantor and the Grantee cannot own as contemplated.

Lead Cases: Texas: Duhig v. Peavy-Moore Lumber Co., 135 Tex. 503, 144 S.W.2d 878 (1940); also see Ellis, Rethinking the Duhig Doctrine, 28 Rocky Mt.Min.L.Inst. 947 (1982); Smith, The Subject To Clause, 30 Rocky Mt.Min.L.Inst. 1, 15-20 (1984).

Alabama: Morgan v. Roberts, 434 So.2d 738 (Ala. 1983) which does not refer to Duhig but reaches the same conclusion citing Brannon v. Varnado, a Mississippi Supreme Court case, see infra.

Arkansas: Peterson v. Simpson, 286 Ark. 117, 690 S.W.2d 720 (Ark. 1985); Arkansas rejected the Duhig Rule as to reservations contained in quitclaim deeds in Hill v. Gilliam, 284 Ark. 383, 682 S.W.2d 737 (1985).

Colorado: Dixon v. Abrams, 145 Colo. 86, 357 P.2d 917 (1960); Brown v. Kirk, 127 Colo. 453, 257 P.2d 1045 (1953); O'Brien v. Village Land Company, 794 P.2d 246 (Colo. 1990).

California: No case; we guess that California courts would interpret the Duhig type deed subjectively, thus rejecting the Duhig Rule.

Louisiana: Continental Oil Co. v. Tate, 211 La. 852, 30 So.2d 858 (1947); Dillon v. Morgan, 362 So.2d 1130 (La. App. 2d Cir. 1978).

Michigan: No case, but would probably follow Oklahoma and/or majority.

Mississippi: Brannon v. Varnado, 234 Miss. 466, 106 So.2d 386 (1958).

Montana: Has not adopted Duhig but Montana follows the doctrine of "estoppel by deed" upon which Duhig is premised; see Hart v. Anaconda Copper Mining Co., 69 Mont. 354, 222 P. 419 (1924).

North Dakota: Kadramas v. Sauvageau, 188 N.W.2d 753 (N.D. 1971) limited by Gilbertson v. Charlson, 301 N.W.2d 144 (N.D. 1981); Siebert v. Kubas, 357 N.W.2d 495 (N.D. 1984); Acoma Oil Corporation v. Wilson, 471 N.W.2d 476 (N.D. 1991).

New Mexico: Atlantic Refining Co. v. Beach, 78 N.M. 634, 436 P.2d 107 (1968);

Oklahoma: Bryan v. Everett, 365 P.2d 146 (Okla. 1960); Birmingham v. McCoy, 358 P.2d 824 (Okla. 1960).

Utah: Hartman v. Potter, 596 P.2d 653 (Utah 1979) rejects the Duhig Rule without referring to the Duhig case.

Wyoming: Body v. McDonald, 79 Wyo. 371, 334 P.2d 513 (Wyo. 1959).

Duhig vs. Peavy-Moore Lumber Co., is the father of the practical doctrine applicable when a deed on its face results in an over-conveyance, a situation where both the Grantor and the Grantee cannot own all of the interest contemplated, usually caused by the Grantor's failure to except from the present conveyance prior reserved interests. The Duhig Rule has been adopted in at least nine oil and gas producing states. While the majority holding in Duhig was based upon an estoppel by deed theory which most courts reviewing Duhig have rejected, the Duhig Rule is actually based upon two well established rules of construction:

1. A warranty deed that does not specify the quantity of interest of minerals being granted purports to convey 100%, or the totality of the ownership of the minerals;

2. If the Grantor of a warranty deed does not own enough interest to fill both the grant and the reservation, the grant must be filled first.

Interestingly, for these two rules to apply, the examiner must completely ignore constructive notice and actual notice rules because the Duhig rule is not intended to uncover the "real" intent of the parties, it is intended to protect bona fide purchasers for value, and the Duhig Rule is the only reasonable rule of construction to apply to the Duhig (over-conveyance) problem.

Duhig involved a warranty deed and the rule is based, at least in part, upon the Grantor's breach of his covenant of warranty. However, the rule in Texas, and in most states adopting the estoppel by deed rationale, is to apply the Duhig Rule in the absence of a warranty as long as the Grantor "purports to convey a definite estate". Lindsay v. Freeman, 18 S.W. 727 (Tex. 1892). Thus the controlling issue is "not whether Grantor actually owned the title to the land it conveyed, but whether, in the deed, it asserted that it did, and undertook to convey it." Blanton v. Bruce, 688 S.W.2d 908 (Tex. App.-Eastland 1985 writ ref'd. n.r.e.), 86 O&GR 138; Thomas v. Southwest Settlement & Development Co., 132 Tex. 413, 123 S.W.2d 290, Greene

v. White, 137 Tex. 361, 153 S.W.2d 575, 136 A.L.R. 626. Texas has not extended Duhig to the point where the estoppel applies through a quitclaim deed, Texas being one of the minority states which does not permit the grantee of a quitclaim deed to be a BFP. Miller vs. Pullman, 72 S.W.2d 379 (Tex. Civ. App. - Galveston 1934, writ ref'd.); Dickenson, The Doctrine of After-Acquired Title, 11 Sw.L.J. 217 (1957); Hemingway, After-Acquired Title in Texas - Part I, 20 Sw.L.J. 97 (1966) and Part II, 20 Sw.L.J. 310 (1966).

Drafting Solution:

1. PREPARE A DEED CONTAINING A GRANT WITHOUT ANY RESERVATION!

2. Assuming the facts of Duhig, if a Grantor intends to reserve ½ of the mineral estate and he is willing for the Grantee to have the remainder of the mineral estate, if any, a provision substantially as follows could be used:

   > Grantor excepts and reserves for the exclusive benefit of Grantor, his heirs and assigns, an undivided ½ mineral interest, this reservation and exception being in addition to any and all other interests in minerals, or part thereof, including royalty interest, not owned by Grantor, this deed conveying to the Grantee only the surface estate and any mineral interest, if any, owned by Grantor in and to the undivided ½ mineral interest not reserved and excepted hereby to the Grantor, his heirs and assigns.

   Benge v. Scharbauer, 152 Tex. 447, 259 S.W.2d 166 (1953); 2 O&GR 1350, 1360.

B. Use of "of" and "out of"

Problem 14: Use of "of" means times while use of "out of" means subtracted from.

Lead Cases: Use of "of" - Gavenda vs. Strata Energy, Inc., 705 S.W.2d 690 (Tex. 1986), 88 O&GR 568; Harriss vs. Ritter, 154 Tex. 474, 270 S.W.2d 845 (1955), 4 O&GR 1033;

Use of "out of" - Minchen vs. Hirsch, 295 S.W.2d 529, 6 O&GR 1364 (Tex. Civ. App. - Beaumont 1956, writ ref'd n.r.e.) 6 O&GR 1364; Black vs. Shell Oil Co., 397 S.W.2d 877 (Tex. Civ. App. - Texarkana 1965, writ ref'd n.r.e.), 23 O&GR 960.

Gavenda represents the title attorney's worst nightmare! In 1967, the Gavenda family conveyed to the Finesteins land in Burrelson County reserving to themselves a 15 year ½ non-participating royalty interest described as:

> ...The Grantors herein except from this conveyance and reserve unto themselves, their heirs and assigns, for a period of 15 years from the date of the conveyance, *an undivided one-half (½) non-participating royalty of all of the oil and gas in*, to and under that produced from the hereinabove described tract of land. ...

In 1976, a subsequent owner executed an oil and gas lease covering the land providing for a 1/8 royalty. Strata Energy, Inc., et al drilled producing wells on the land in July, 1979 and February, 1980 and requested an attorney to prepare a division order title opinion. The title attorney attributed to the Gavenda family a royalty *of* 1/16, ½ of 1/8, not the ½ of 8/8 they actually owned. The Gavendas subsequently discovered the error and, two days before their term interest terminated, revoked their division orders.

The Texas Supreme Court held that Strata Energy, et al owed the Gavendas 7/16 royalty because Strata Energy and its non-operators had individually benefited/were enriched by retaining at least part of the underpayment for themselves.

The lessons gleaned from this case are:

1. The Supreme Court continued the long history of Texas courts construing contracts strictly.
2. The inclusion or omission of the little word "of" prior to the word "royalty" makes a tremendous difference in the result.

For comparison see Harriss vs. Ritter where a reservation of "½ of 1/8 of the oil, gas and other mineral royalty" entitled the owners to a 1/16 x 1/8 or 1/128 of gross production. (Sometimes referred to as the "horror of the double fractions case".)

On the other hand, the phrase "out of" has the same meaning as "subtract from" so that a deed that grants a fraction "out of" the Grantor's fractional interest specifies the source from which the present grant is taken. In Minchen vs. Hirsch, the Beaumont court construed a royalty deed where the granting clause conveyed "a 1/16 fee mineral royalty of our 1/4 interest." A subsequent intention clause provided that "*...It is our intention to convey unto the said S. Minchen,... a perpetual 1/16 fee mineral royalty out of our interest therein.*" The evidence at the trial established that the word "*out*" was inserted with pen and ink by the Grantor. The court held that the grantee received a 1/16 of 8/8 royalty and the grantors retained a 3/16 of 8/8 royalty.

The case of Black vs. Shell Oil Company involved land divided in ownership between the successors to the husband and the successors to the wife of land which was originally community property. The heirs in the husband's chain sought to establish limitations title through adverse possession of the entire land, but failed. A separate controversy was the interpretation of a deed by the successors to the wife conveying ½ of the minerals "out of the interest owned by them". The Texarkana court held that this deed unambiguously conveyed ½ of the minerals, not ½ of ½ or 1/4, so the heirs of the wife lost their mineral title.

Drafting Solution: Both the person drafting the deed and the title examiner should very closely scrutinize the granting language keeping in mind the difference between these two phrases.

C. Distinction between use of the words "conveyed" and "described"

Problem 15: Grantors owns less than all of the land and conveys what he owns, does it make a difference if he reserves part of the interest "conveyed" or "described"?

Lead Cases: In Averyt vs. Grande, Inc. 717 S.W.2d 891 (Tex. 1986), 95 O&GR 350 the Court construed a September 30, 1977 deed whereby Plaintiff, who owned ½ of the minerals in the land identified, excepted ½ of the minerals, conveyed two tracts of land reserving "...all of the oil, *an undivided 1/4 of the royalty covering gas and other minerals... in, to and under or that may be produced from the lands above described* ...". The question was, did the Grantor reserve 1/4 of the royalty in the ½ of the minerals conveyed or ½ of the royalty in the land described? The Court referred to two rules of construction:

1. The Hooks Rule - if the deed reserves a fraction of minerals under the land conveyed, then the deed reserves a fraction of a part of the mineral estate actually owned by the Grantor and conveyed in the deed. Hooks vs. Neill 21 S.W.2d 532 (Tex. Civ. App. - Galveston 1929, writ ref'd);

2. The King Rule - if the deed reserves a fraction of the minerals under the land described, the deed reserves a fraction of the minerals under the entire physical tract, regardless of the part of the mineral estate actually conveyed. King vs. First National Bank of Wichita Falls, 144 Tex. 583, 192 S.W.2d 260 (1946).

In both cases, the Courts focused on the word actually used in the deed in question, either "conveyed" or "described", again confirming the top Court's rule of strict construction.

Drafting Solution: There are no drafting examples as this discussion simply provides a caution.

D. Use of multiple-grant/multiple-fraction deeds

Problem 16: Can the different fractions be harmonized or did the Grantor convey one mineral/royalty interest which, at the expiration of the existing lease, will convert to a different mineral/royalty interest?

Lead Cases: Dils vs. Garrett, 299 S.W.2d 904 (Tex. 1957), 7 O&GR 322; Concord Oil Co. vs. Pennzoil Exploration & Production Co., 40 Tex. Sup. Ct. J. 33 (1996)

This problem began with the case of Caruthers v. Leonard, 54 S.W. 779 (Tex. Comm. App. - 1923, holding approved), which held that when the land conveyed is covered by an effective oil and gas lease, the conveyance by the lessor of a "½ mineral interest" did not convey any of the benefits under the existing lease. The Caruthers court incorrectly held that express language is required to transfer present lease benefits. The "multiple-grant" deed was drafted in response to the holding in Caruthers to provide the express language thought necessary to transfer existing lease benefits. The "multiple-grant" deed utilized three clauses containing blanks and each blank required a fraction:

1. granting clause of the mineral or royalty estate;
2. interest in presently existing lease; and
3. interest in future leases (or percentage of possibility of reverter).

Normally, the parties intended that the grantee receive the same undivided interest in the mineral estate, the present lease and future leases. If so, the "multiple-grant" deed should have the same fraction inserted in each of the three blanks. While this was probably done in most of the cases, the cases discussed below reflect the struggle Texas courts have had resolving this dilemma. Fortunately, Caruthers was expressly overruled by Harris v. Currie, 176 S.W.2d 304, 305-306 (Tex. 1943) which held that a grant of a "½ mineral interest" transfers to the grantee:

1. ½ of the delay rentals and royalty rights under any existing lease; and

2. when the existing lease terminates, a ½ mineral interest, which includes ½ of the executive, bonus, delay rental and royalty rights with respect to any future lease.

Also see Hager vs. Stakes, 294 S.W.2d 835, 838 (Tex. 1927). Unfortunately, even after Harris, forms and variations of the "multiple-grant" deed continue to be used.

There are at least four reasons for the confusion evidenced by the multiple-fraction cases:

1. Laymen and too many lawyers misunderstood the nature of the interest retained upon the execution of an oil and gas lease. This is manifested primarily by inserting 1/16 in the granting clause when it was the parties' intent to convey ½ of the minerals which were then subject to an oil and gas lease. Because a lease with a 1/8 royalty fraction was outstanding, the grantor believed himself to own 1/8 of the oil, gas and other minerals instead of a 1/8 royalty plus the full possibility of reverter. (Laura Burney calls this the "estate misconception".)

2. It was assumed that the royalty fraction reserved in a lease would always be 1/8. So, instead of granting a fraction of the royalty, the parties used specific fractions in some of the blanks.

3. The parties were mistaken regarding the quantity of interest owned by the grantor.

4. The parties would mistakenly use a fraction, i.e., 1/16 of the royalty rather than merely saying a 1/16 royalty.

The following theories have been utilized by Texas courts to construe the "multiple-grant" deed:

1. Two-grant theory - the deed conveys different interests before and after the expiration of the existing lease. Hoffman v. Magnolia, 273 S.W. 828 (Tex. Comm. App. - 1925, holding approved); Woods v. Sims, 273 S.W.2d 617 (Tex. 1954).

2. Repugnant to the grant rule - the granting clause will control when other provisions of the deed conflict with what the granting clause conveys. Alford v. Krum, 671 S.W.2d 870 (Tex. 1984).

3. Deeds construed in favor of the grantee - the grant should be interpreted to transfer the greatest interest to the grantee allowed by the language of the deed and, if there is any doubt about the proper construction, such doubts

should be resolved against the grantor, whose language it is. <u>Davis v. Andrews</u>, 361 S.W.2d 419 (Tex.Civ.App. - Dallas 1962, writ ref'd. n.r.e.).

4. Four corners rule - all portions of a deed are to be harmonized and given effect, if possible. <u>Luckel v. White</u>, 819 S.W.2d 459 (Tex. 1991).

While the holdings of the Texas courts struggling with this problem were inconsistent, probably these four principles could be summarized by saying that the two-grant doctrine, the repugnant to the grant doctrine and the construction in favor of the grantee doctrine were all corollaries of the "four corners rule". Under the four corners rule, the court seeks to determine the intent of the parties as expressed in the instrument by harmonizing all provisions of the instrument. The "four corners - harmonizing rule" was a cornerstone of the more recent Supreme Court cases of <u>French vs. Chevron</u>, 896 S.W.2d 795 (Tex. 1995) and <u>Temple-Inland Forest Production vs. Henderson</u>, 958 S.W.2d 183 (Tex. 1997).

<u>Concord Oil vs. Pennzoil</u>, supra, involved the construction of a mineral deed (the Concord Deed), executed in 1937 by A. B. Crosby as Grantor. The deed covers Survey 64 in Zapata County. The Grantee was Southland Lease and Royalty Corporation, through whom petitioners, Concord Oil Company, and Crenshaw Royalty Corp. claim. Crenshaw acquired Southland's interest and subsequently executed two oil and gas leases to Concord as Lessee. The Concord deed provides in relevant part:

> That I, A. B. Crosby... grant, sell and convey unto Southland... *an undivided 1/96 interest in and to all of the oil, gas and other minerals in and under, and that may be produced from Survey 64*... together with the right... of ingress and egress at all times for the purpose of prospecting, drilling, mining and exploration said lands for oil, gas and other minerals... together with all rights of every kind and character necessary and convenient to the full use and enjoyment of such estate herein conveyed... .
>
> *While the estate hereby conveyed does not depend upon the validity thereof, neither shall it be effected by the termination thereof*, this conveyance is made subject to the terms of any valid subsisting oil, gas and/or mineral lease or mineral lease or leases on above described land or any part thereof, *but covers and includes 1/12 of all rentals and royalty of every kind and character that may be payable by the terms of such lease or leases insofar as the same pertain to the above described land, or any part thereof.*

The Concord deed was executed on August 5, 1937. The day before, the Grantor, Crosby, had acquired an undivided 1/12 mineral interest in the minerals in Survey 64 by virtue of a deed identical to the Concord deed in all respects but one: the fraction

in the granting clause was 1/12 rather than 1/96. The parties stipulated that at the time of the Crosby deed, an oil and gas lease that provided 1/8 royalty was outstanding.

In 1961, Crosby executed another mineral deed covering Survey 64. He purported to convey to John M. Robinson an undivided 7/96 mineral interest in the minerals. Robinson subsequently executed an oil and gas lease in favor of Pennzoil Producing Company, the predecessor in title to Pennzoil, et al. Pennzoil completed producing wells on Survey 64 and this dispute arose when Concord filed suit seeking a determination of its interest and damages equal to the value of past production by Pennzoil.

The trial court found in favor of Pennzoil and entered a take nothing judgment against Concord. In 1994, the San Antonio Court of Appeals affirmed. 878 S.W.2d 91. The basis of the Court of Appeals' holding was that the Concord deed did not convey any interest in future leases. The Court concluded the grant of 1/12 of rentals and royalty was limited to the lease in existence at the time of the conveyance, and that upon expiration of that lease, Concord was left with only a 1/96 interest in the minerals. In so holding, the Court affirmed what has been termed the "two-grant" or "multiple-grant, multiple-fraction" theory in concluding that the deed did not convey a single estate, but instead conveyed a 1/96 mineral interest in addition to a 1/12 interest in the lease existing at the time of the grant. The Supreme Court issued its 5-4 opinion reversing the San Antonio Appellate Court on October 18, 1996. The Motion for Rehearing was granted on November 18, 1997, the case reargued on January 8, 1998 and we are now awaiting the Supreme Court's final decision.

I filed an Amicus Brief on behalf of Concord's position prior to the Supreme Court's issued opinion. Some of my arguments in favor of Concord were as follows:

1. The practice of most title examiners is to not interpret a deed as making two different conveyances unless the deed contains two separate granting clauses.

2. Harmonization of different fractions is possible when the fraction contained in the granting clause in a deed is 1/8 of the fraction subsequently used. Examiners assume that the fraction chosen in the granting clause was chosen because the property presently produced oil or gas pursuant to an oil and gas lease paying a 1/8 royalty. See <u>Caruthers vs. Leonard</u>, supra, reversed by <u>Harris vs. Currie</u>, supra.

3. Applying the Four-Corners Rule to multi-fraction deeds usually results in a conclusion that the greatest estate possible was conveyed, unless a contrary intention was fairly expressed. <u>Garrett vs. Dils</u>, supra.

4. I borrowed from Laura Burney's excellent treatise by suggesting that the court adopt the following guidelines in interpreting multi-fraction deeds:

    a. If the fraction in the granting clause is 1/8 of the fraction in any subsequent clause, then the larger fraction in the subsequent clause identifies the parties' intent as to the quantity conveyed, both presently with the existing lease and in the future upon termination of any then existing lease (apply the Four-Corners/Harmonizing Rule first);

    b. Where multiple fractions are used and where one fraction is 1/8 less than another fraction, then the parties intended to convey an estate consisting of the largest fraction (apply the Greatest Estate Possible Rule second);

    c. A deed should not be interpreted as creating two different grants unless additional evidence of this intent is found, such as two separate granting clauses in the deed itself or other language in the deed itself consistent with the construction of two grants (the Two-Grant Rule is not an option unless and until the examiner concludes that the above two rules should not apply); and,

    d. If the deed cannot be interpreted by harmonizing its provisions pursuant to Rules 1 and 2 and the Two-Grant doctrine is inapplicable because the deed does not contain two separate granting clauses, then the deed should be considered ambiguous and extrinsic evidence should be considered.

In order to provide the Court a simplified historical prospective of the holdings in previous cases interpreting multi-fraction deeds, I attached an Exhibit A to my Amicus Brief which compared in summary form the granting clause, subsequent clauses, Court's holding and my interpretation of the deeds in question. Exhibit A to my Amicus Brief is attached as Exhibit B to this paper. If you are interested, I invite you to read the cases and reach your own conclusion as to the result you believe would be appropriate.

Much of this discussion is a summary of an excellent article prepared by Terry I. Cross, <u>Conveyancing - From Repugnance to Harmony, the Demise of Alford vs. Krum; and the Effect of Accepting a Conveyance "subject to" a Prior Instrument</u>, State Bar of Texas Advance Oil and Gas Law Seminar, September, 1992.

For a more complete discussion of the historical development of the "Four-Corners Rule" and the " Repugnant to the Grant" doctrine, see Tevis Herd, <u>Conveyancing -</u>

The Implications of Alford vs. Krum on the Two-Grant Theory and a Review of the Duhig Doctrine, State Bar of Texas Advanced Oil & Gas Seminar, September, 1989.

For the best discussion of the entire issue, see Laura Burney, The Regrettable Rebirth of the Two-Grant Doctrine in Texas Deed Construction, 34 S. Tex. L. Rev. 73 (1993).

Drafting Solution: It is ironic that, after this lengthy discussion of the problem, the solution can be simply stated. Present conveyancing practice is simpler than that of the 1920-1940s. The quantity of minerals or royalties conveyed would be stated in the granting clause and usually the deed would make no reference to the amount of delay rentals or royalties payable pursuant to any then existing lease or the amount of leasing rights applicable at the cessation of the existing lease. The present deed would be made "subject to" any existing oil and gas lease and other encumbrances.

III. The Royalty Deed

A. Is mineral or royalty conveyed/reserved?

Problem 17: Why after all these years do we have so much trouble figuring this out?

Lead Cases: French vs. Chevron, 896 S.W.2d 795 (Tex. 1995); Temple-Inland Forest Production vs. Henderson, 958 S.W.2d 183 (Tex. 1997).

French vs. Chevron involved an interpretation of a conveyance in 1943 by George Calvert (Grantor), the owner of a 1/32 mineral interest in a 32,808.5 acre tract, deeded a 50 acre, 1/656.17 (50/32,808.5) interest to Capton M. Paul (Grantee). The relevant parts of the instrument, entitled "Mineral Deed" are as follows:

> (¶I) That I, George Calvert,...do grant, bargain, sell, convey, set over, assign and deliver unto Capton M. Paul, an undivided fifty (50) acre interest, being *an undivided 1/656.17th in and to all of the oil, gas and other minerals in, under and that may be produced from* the following described lands...
>
> (¶II) *It is understood and agreed that this conveyance is a royalty interest only*, and that neither the Grantee, nor his heirs or assigns, shall ever have any interest in:
>
> 1. the delay or other rentals; or

2. any revenues or monies received or derived from the leasing of said lands present or future...
3. the leasing of said lands or any part thereof or the renewal or extending of any lease thereon or for the making of any lease contract to develop or prospect the same for oil, gas or other minerals, *which is hereby specifically reserved in the Grantor*.

The Plaintiffs, successors to the Grantee, claimed that the conveyance was of a royalty interest equal to the value of 1/656.17 of all of the oil and gas produced from the land conveyed. The Defendants, successors to the Grantor, contended that the deed conveyed only a 1/656.17 of the royalty to be paid by the lessee. The Supreme Court rejected the Plaintiff's claim that the problem was resolved by the case of Watkins vs. Slaughter, 144 Tex. 179, 189 S.W.2d 699 (1945), in which a deed containing language similar to the Calvert-Paul deed was held to convey a royalty interest. The court held that the issue was resolved by the case of Altman vs. Blake, 712 S.W.2d 117 (Tex. 1986), 91 O&GR 340. Altman vs. Blake holds that a mineral estate consists of five interests:

1. the right to develop;
2. the right to lease;
3. the right to receive bonus payments;
4. the right to receive delay rentals; and
5. the right to receive royalty payments.

Id, 712 S.W.2d at 118. The court's analysis was that ¶I conveyed a mineral estate and ¶II stripped away from the mineral estate conveyed all elements of the mineral estate except for the right to receive royalty. Therefore, the Grantee received a 1/656.17 mineral interest.

Temple-Inland involved the construction of a 1938 mineral deed from J. S. Ashmore et al to D. M. Henderson et al. Temple-Inland et al are the successors to the Grantors and the Hendersons are the successors to the Grantee. Relevant portions of the mineral deed are as follows:

(¶1) Grantors...grant, bargain, sell, convey...an undivided 15/16 interest in, to and of all oil, gas and other minerals...that may be produced from the following described land...

(¶2) ...It is understood and agreed that *said 1/16 interest is and shall always be a royalty interest and shall not be charged with any of the costs* which the grantee may incur in exploring, drilling, mining,...

(¶3) It being agreed that the *grantor shall not be required to join in or ratify any oil and gas mining lease* which the grantee may grant by virtue of his ownership hereunder and that *grantor shall be entitled to none of the bonus money therefor and to no part of the delay rentals* paid thereunder; it being further understood that any change of ownership of the *1/16 royalty* belonging to grantor...shall entitled the respective owners only to their proportionate part of *said royalty*,...

Both the Trial Court and the Court of Appeals held that the reserved interest was a 1/16 mineral interest, apparently following the ruling in <u>French vs. Chevron</u>. The Supreme Court, referring primarily to its decision in <u>Watkins vs. Slaughter</u>, concluded that the reservation was a 1/16 fixed royalty. The court expressly stated that its decision in <u>French vs. Chevron</u> did not overrule <u>Watkins vs. Slaughter</u>. The court concluded by stating that the Court of Appeals in this case was incorrect when it said that the prior Supreme Court decisions in <u>Watkins</u> and <u>French</u> required a reference to "royalty from actual production" to convey or reserve a royalty interest. 911 S.W.2d at 535. The court provided that it had never required any particular word or phrase to be used to create a royalty interest. It's guiding principle has been and is that the quality of the interest conveyed or reserved is determined by reviewing all the provisions of the instrument. See <u>Altman</u>, 712 S.W.2d at 118; <u>Watkins</u>, 189 S.W.2d at 700 and <u>Luckel vs. White</u>, 819 S.W.2d 459, 461 (Tex. 1991).

Where does this leave us who have to make sense of this quandary?

Drafting Solution: With the benefit of our present perspective I submit it is much easier suggesting a drafting solution to this mess than to explain what these 60 year old conveyances mean.

If the grantor in <u>French vs. Chevron</u> intended to convey minerals, the granting clause should state that the grantor conveys "...an undivided 1/656.17 interest in all of the oil, gas and other minerals in and under the following lands...". If the grantor intended to convey a royalty interest, the granting clause should state that the grantor conveyed "...1/656.17 of the royalty payable from the oil, gas and other minerals produced and saved from the following described lands...".

The grantor in the <u>Temple-Inland</u> situation should convey "...all of grantor's oil, gas and other minerals in and under the following described land, SAVE AND EXCEPT grantor reserves to himself, his heirs and assigns, a non-participating royalty interest consisting of 1/16 of 8/8 of the oil, gas produced and saved from the following described lands...".

IV. The Assignment of Oil and Gas Leases

A. An assignment of oil and gas leases contains its own habendum clause separate from the habendum clause contained in the leases.

Problem 18: Would payment of shut in gas royalty to the Lessors continue the term assignment of the oil and gas leases?

Lead Cases: Riley vs. Meriwether, 780 S.W.2d 919 (Tex. App. - El Paso 1989, writ denied) Meriwether assigned to Riley leases in Crockett County for a specific term and so long thereafter as oil and/or gas were produced. The assignment had no shut in royalty clause, but the base leases did. The assignment included the following:

> Reference for all purposes is made to the oil and gas leases described in Exhibit A and incorporated herein by this reference.

Riley obtained gas production, paid shut in gas royalty to the lessors of the base leases and shut in the wells for 13 months. The term of the assignment expired during the shut in period.

The Court held that assignee's interest in the term assignment terminated and the wells belonged to the assignor. The habendum clause of each instrument must stand on its own. The habendum clauses of different instruments can be tied together contractually, but not by implication.

An example of a contractual connection is if the owner of a term mineral interest and the owner of the reversionary interest in said term jointly executed an oil and gas lease. See Southland Royalty Co. vs. Humble Oil & Refining Co.. 151 Tex. 324, 249 S.W.2d 914 (1952), 1 O&GR 1431, where production is from the land in question, or Spradley vs. Finley, 157 Tex. 260, 302 S.W.2d 409 (1957), 7 O&GR 650 where production was from another tract pooled with the land in question.

Drafting Solution: The assignment should contain the following sentence:

> The parties intend that any contractual provision in the leases assigned that extends the habendum clauses in the leases assigned shall extend the habendum clause of this assignment in the same manner.

B. Is there a difference between assigning all of Assignor's "leasehold interest", or all of Assignor's "working interest"? Should there be?

Problem 19: Are these terms words of art or can they be used interchangeably?

Lead Cases: I am disappointed that Miller vs. Schwartz, 354 N.W.2d 685, (N.D. 1984) 84 O&GR 143 is the only case I have yet unearthed that discusses the difference between "leasehold interest" and "working interest". Its specific holding is that an assignment of all Assignors' .4625 working interest in the Solheim #1 and Solheim #2 Wells located on the the SE/4 of Section 19 and NE/4 of Section 20, both in Township 162 North, Range 89 West, Renville County, North Dakota, conveyed all of Assignor's interest in the leases covering said lands. The opinion referred to 8 H. Williams and C. Meyers, Oil and Gas Law, Manual of Terms, pp. 392-393 (1982), which stated that the term "working interest", as commonly used in the oil industry, is generally synonymous with the term "leasehold interest." I also see these terms often used interchangeably.

While these terms can, and sometimes should, be used interchangeably, my preference is to define and use the terms more precisely. I define a "leasehold interest" as ownership of all or part of a specific lease or leases and I use the term whenever I am discussing ownership, such as in a drilling opinion. In contrast, I define the term "working interest" as the percentage ownership a party has in participating in drilling an oil and gas well. A party's leasehold interest (LI) may be the same as a party's working interest (WI) or they may be different.

If a well is drilled on a lease without pooling, then an owner's leasehold interest and his working interest will usually be the same. However, if a well is drilled pooling leases covering different tracts, then a party's ownership in one lease would not be his working interest in the well. The party's WI would be less than his LI and would be calculated by multiplying his LI times a fraction consisting of the net acres contributed to the pooled unit by the party/the total pooled acres. I call this fraction the party's "Tract Factor" (TF). Another example of when a party's LI does not equal his WI is when the Exhibit A to an operating agreement does not attribute to each party the exact legal ownership that party contributes in leases to the joint project. In other words, it is possible that parties in an Exhibit A agree to participate in wells in a different manner than their proportionate ownership of all leases.

Drafting Solution:

1. In my opinion, the clearest way for an assignor to convey his interest in oil and gas leases is for the assignment to state that it conveys "all of assignor's interest (or part of assignor's interest) in the leases attached hereto as Exhibit A". I discourage using a conveyance of "Assignor's working interest". However, it is always helpful if an assignor will also state in the assignment or the Exhibit A the decimal or percentage WI and the NRI he believes he owns in any producing wells.

DIVISION OF INTEREST TO A GAS WELL

1.	Royalty	MI	RI	TF	NRI	Lse #.
	NW/4					
	OPRAH WINFREY	All	3/16	1/4	.04687500	1
	SW/4					
	PAUL ENGLER	½	3/16	1/4	.02343750	2
	TEXAS CATTLE FEEDERS ASSOC.	½	3/16	1/4	.02343750	2
	E/2					
	JUDGE MARY LOU ROBINSON	All	1/4	½	.12500000	3
	Total				.21875000	

2.	Overriding Royalty	ORRI	TF	NRI	Lse. #
	HARPO PRODUCTIONS INC.	6.25%of 8/8	1/4	.01562500	1

3.	Working Interest	LI	WI	GRI	NRI	Lse. #
	BAYLOR U DRILLING CO.	100%	25%	75%	.18750000	1
	WEST TEXAS A & M EXPLORATION CO.	100%	25%	81.25%	.20312500	2
	ABC COMPANY	50%	25%	75%	.18750000	3
	XYZ COMPANY	50%	25%	75%	.18750000	3
	Total		100%		.76562500	

RECAPITULATION - NRI

RI:	.21875000
ORRI:	.01562500
WI:	.76562500
Total:	1.0000000

C. Is there a difference between assigning all of Assignor's "working interest" or all of Assignor's "interest in a named well" as compared to assigning all of Assignor's "wellbore or borehole interest" in a named well? Should there be?

Problem 20: Is it possible to clearly convey a wellbore or borehole?

Lead Cases: In the absence of a statutory or case law supplied definition of "borehole" or "wellbore", I define the terms synonymously as the right to participate in drilling, operating and producing a single well, without the corresponding right to participate in drilling subsequent wells. In my opinion, the creation of a borehole or wellbore interest should arise in connection with a reference to the underlying oil and gas leasehold, however, I have given recognition to assignments of borehole interest that did not refer to the underlying leasehold but did specifically refer to the well by name and identified the well either as being on a specific tract of land, or the well location by feet from lease lines. Contrasting this problem with the previous problem, I would usually interpret an assignment of "all of assignor's WI in the Smith No. 1 well" as an assignment of all of assignor's leasehold, but I would interpret an assignment of "all of assignor's interest in the No. 1 Smith wellbore" as conveying only assignor's right to participate in the Smith No. 1 well. This interpretation is consistent with my experience in interpreting assignments in my part of Texas and Oklahoma.

While I have not identified any Texas cases specifically discussing this issue, I look for support to a seldom mentioned Texas statute which, I assume, establishes Texas public policy that a grantor conveys: "...a fee simple (all he owns) unless the estate is limited by express words or unless a lesser estate is conveyed or devised by construction or operation of law..." Tex. Prop. Code Ann. § 5.001 (Vernon 1984). Applying this concept, I would interpret an assignment as conveying wellbore rights only if the assignment used the term "wellbore or borehole rights" or expressed the same idea in some other manner.

While I have not yet found any out of state statutory or case law authority expressly confirming the appropriateness of conveying borehole rights only, I have observed this phenomena for over 15 years. The idea appeared to originate in Oklahoma when, for some period of years, practitioners believed that Corporation Commission practice allowed force pooling of wells per borehole, not force pooling as to each drilling and spacing unit. The issue was finally settled in Amoco Production Co. vs. Corp. Comm., 1986 Ok. Civ. App. 16, 751 P.2d 203, 97 O&GR 593. My Oklahoma friends acknowledge that the practice of conveying leases as to the borehole only is increasing, and my experience examining assignments in Texas is the same.

One new concept that I believe should be developed in Texas to effectively own and convey a wellbore interest is the concept that a wellbore owner owns sufficient acreage around the wellbore to be able to obtain a full allowable. If special field rules require the designation of proration units, the wellbore interest owner should by implication own the leasehold

equal to the configuration of the proration unit. Since it is possible the configuration of the acreage making up the proration unit of a particular well can change by virtue of the operator filing an amended proration plat with the Railroad Commission, I recommend that it not be necessary for the specific acres attributable to a specific wellbore to be identified by recording in the county records. I admit, however, that many retained acreage clauses requires the operator to identify a proration unit or "producing unit" as defined by an instrument of record. But I believe, from the perspective of the leasehold owner, it is preferable that the wellbore interest not be limited to any configuration identified in the county records.

Drafting Solution: In order to unambiguously convey borehole rights only, the assignment should provide as follows:

> Assignor conveys all (or part of) his interest in the oil and gas leases identified in Exhibit A attached hereto but only insofar as they cover the borehole rights to the Smith #1 Well located 467' FNL & FWL of Section 56, Block 43, H&TC Ry. Co. Survey, Lipscomb County, Texas.

The assignee would not own any right to participate in subsequent wells.

D. How to create horizontal depth limitation.

<u>Problem 21</u>: What is the best way to identify a horizontal depth limitation in an assignment?

Lead Cases: Again, unfortunately, I have not yet discovered any case or statute that provides helpful definitions and guidance. I suspect that all of us who read instruments of conveyances in the oil and gas industry have read instruments creating depth limitations. My concern is that too often the language used to create the depth limitation is not sufficiently precise to avoid a claim of ambiguity. Too often, I see assignments of leases such as the following:

> Assignor conveys all of his interest in the leases attached hereto as Exhibit A...
> from the surface to the base of the Chester Formation; or...
> from the surface to a depth of 12,300'.

While I would not normally require an amended instrument, it is my opinion that this language contains the seeds of an ambiguity claim.

I have found some helpful definitions in 8 H. William and C. Meyers, Oil and Ga Law, Manual of Terms, pp. 1196 (8th Ed. 1991) which provide the following:

1. Stratigraphic interval - The body of strata between two stratigraphic markers. American Geological Institute, *Glossary of Geology* (R. Bates and J. Jackson, eds., 2d 3d 1980); Energy Reserves Group, Inc., 92 IBLA 219, GFS (O&G) 1986-67

2. Stratigraphic equivalent - In cases of horizontal severances of a leasehold, the assignment may seek to account for the nonuniform lay of subsurface structures by assigning down to the stratigraphic equivalent of a stated numerical depth beneath the surface in order to ensure that a productive reservoir is not split by the assignment. Thus the assignment may provide that it extends to the grantor's interest from the surface down to the stratigraphic equivalent of 4,000 feet beneath the surface, as measured in the bore of a designated well. D. Pierce, *Kansas Oil and Gas Handbook* §7.06 (1986).

I agree that reference to the stratigraphic equivalent is necessary to avoid a potential ambiguity claim. However, even more precise language appears possible in that geologists recognize three different meanings for the phrase "stratigraphic equivalent":

1. Time - Stratigraphic equivalents are the sediments deposited and the rocks formed during a specific time; i.e., in a given era, epoch, or age.

2. Bio - Stratigraphic equivalents are rocks that contain similar fossils;

3. Rock - Stratigraphic equivalents are mappable rock layers with distinctive top and bottom boundaries.

Lowe "Analyzing Oil and Gas Farmout Agreements," 41 Sw. L.J. 759, Note 289 at 826 (1987) provides that:

> The most common way to designate an objective depth in a farmout is by naming an objective rock-stratigraphic unit, whether it is a formally designated formation or member (formally designated rock-stratigraphic units are listed in G. Keroher, Lexicon of Geological Names of the United States for 1936-1960 (United States Geological Survey Bulletin No. 1200 (1966) or some other informally designated but locally recognized unit, such as the Red Fork Sandstone in Oklahoma. (The Red Fork Sandstone is informally, but effectively described in L. Jordan, Subsurface Stratigraphic Names of Oklahoma 165 (Oklahoma Geological Survey Guidebook No. 6, 1957). As indicated above, a formation is a rock-stratigraphic unit. See supra note 288. This suggests that the parties intend that "stratigraphic equivalent" in the portion of the agreement limiting what is earned is meant to be "rock-stratigraphic equivalent." If the objective depth is defined as a zone, the inference is that the "stratigraphic equivalent" means "bio-stratigraphic equivalent." No inference arises if the objective depth is stated in fee.

Drafting Solution: An assignment creating or reserving a depth limitation should contain at least language such as the following:

> Assignor conveys all of his interest in the leases attached hereto as Exhibit A from the surface to *the stratigraphic equivalent of 14,200' as identified in the Smith #1 Well located 467' FNL & FWL of Section 56*, Block 43, H&TC Ry. Co. Survey, Lipscomb County, Texas.

SOME ODDS AND ENDS FROM PROFESSOR ED HORNER

A grantor's/assignor's name should always appear exactly as in the deed/assignment received by the party as former grantee/assignee. Any name change between deed/assignments should be explained.

Always show marital status of all parties.

The cheapest title insurance is the wife's signature.

The cheapest malpractice insurance is a dry hole.

You can always remember Duhig if you remember-"get off the plane-oversold!"

SOME FAVORITE THOUGHTS FOR THE DAY:

566. Middle age is when you want to see how long your car will last instead of how fast it will go.

760. Man blames fate for other accidents, but feels personally responsible for a hole-in-one.

690. The real measure of our wealth is how much we'd be worth if we lost our money.
Anonymous

577. The world is too dangerous to live in. Not because of the men who do evil, but because of the men who sit and let it happen.
Albert Einstein

724. Liberty doesn't work as well in practice as it does in speeches.
Will Rogers

V. Discussion Questions - Title Examination

A. O owns a 10% WI with a 75% NRI. O conveys to A all of his interest as identified in Exhibit A. Exhibit A lists the necessary leases and also states that O owns a 10% WI with an 81.25%, or a .8125000 NRI. Has O reserved an ORR by implication or has O conveyed all that he owns? I say he has conveyed all that he owns.

B. Proportionate reduction - I believe it is industry custom that an instrument that creates an ORR is always intended to be proportionately reduced, whether the creating instrument contains a sufficient proportionate reduction clause or not. In my opinion, there are two types of proportionate reduction - first, if the lease does not cover the entire mineral estate in the land described, and second, if the assignor's ownership in the lease is less than 100%. A proper proportionate reduction clause contains both elements. However, I only show an ORR as not being proportionately reduced if the creating instrument clearly states that the parties do not intend for it to be proportionately reduced. Do you agree?

C. Shut-in gas royalty - *Gulf v. Reid* - "Pay $100.00 per well per year" - most recently prepared oil and gas leases allow the lessee 60 to 90 days of non-production before a shut-in gas royalty payment is due. However, some old leases contain a clause, such as the clause interpreted in *Gulf v. Reid*, the example above. If *Gulf v. Reid* is applied strictly then lessees are at risk in losing their lease. Is there are any argument that softens the harsh result of *Gulf v. Reid*?

D. A deed creates a "1/4 non-participating royalty interest" - is this always a percentage of royalty, or could it be interpreted as 1/4 of the oil and gas produced? I never interpret a NPRI as being a fraction of the oil and gas produced unless the creating instrument makes that very clear.

E. WI owner owns 10% WI and ORR of 5% of 8/8.

1. WIO conveys to B a 5% WI in the leases. Does that always convey ½ of the 5% ORR?

2. WIO conveys to A all of his interest in the leases in question. Does this convey all of O's ORR? I believe so.

3. WIO first conveys 3%, then 2% WI to A. WIO subsequently conveys all of his 5% of 8/8 ORR to B. Has O conveyed ½ of his ORR to A or can he convey all of his ORR to B?

EXHIBIT A

5. The pooling clause contains, in part, the following:

"...Units pooled or consolidated for oil or gas hereunder shall not exceed the number of acres specified for producing units set forth in paragraph 6(d) of this lease; provided that if any Federal or state law, or any order, rule or regulation of governmental authority shall <u>prescribe or permit</u> a spacing pattern for the development of the field or allocate a producing allowable in whole or in part based on acreage per well, then any such units may embrace as much additional acreage as may be <u>prescribed or permitted</u> or as may be used in such allocation or allowable...".

The dry hole/cessation of production clause, the retained acreage clause and the continuous drilling clause can be combined as follows:

6. Subject to other provisions of this lease, with respect to drilling operations on, and acreage held by, this lease, during and following expiration of the primary term, the following provisions shall govern:

(a) In the event Lessee at any time drills a dry hole on said land and no oil, liquid hydrocarbons, gas or their respective constituent products (collectively referred to in this paragraph 6 as "oil or gas") is then being produced hereunder, or in the event all production of oil or gas from said land should at any time cease for any cause, this lease shall continue in effect for a period of ninety (90) days from abandonment of such dry hole or cessation of production and may be continued thereafter under the following conditions, to-wit:

(1) If Lessee commences drilling operations on said land within said 90-day period, this lease shall continue in effect, subject to the provisions of subparagraph (d) hereof, as long as drilling operations are prosecuted with reasonable diligence and thereafter as long as oil or gas is produced hereunder, or

(2) If either of the above events set out under this subparagraph (a) occurs during the primary term, Lessee may defer commencement of such drilling operations and resume the payment of delay rental and the first such rental payment period shall begin ninety (90) days after abandonment of dry hole or cessation of production and shall run to the next anniversary date of this lease and the amount of delay rental payable for such period shall be such portion of the annual delay rental payable for the acreage then held by this lease as the number of days in such period bears to 365; and thereafter delay rental shall be payable annually on the anniversary date of this lease; provided that if delay rental has been paid for the aforesaid period, no delay rental shall be payable until said next anniversary date of this lease; provided, further, that Lessee shall not be in default and this lease shall not terminate so long as Lessee resumes the payment of delay rental within ninety (90) days after abandonment of dry hole or cessation of production.

(b) If no oil or gas is being produced hereunder at the expiration of the primary term but Lessee is then engaged in drilling operations, or within the 90-day period specified in subparagraph (a) above commences drilling operations, this lease shall continue in effect in the manner and for the time specified in subparagraphs (d) hereof.

(c.) The term "drilling operations, wherever used in this lease shall mean and include operations for drilling a well; reworking operations; and reconditioning, deepening, plugging back, cleaning out repairing or testing of a well. For all purposes of this lease, drilling operations shall be deemed to be prosecuted with reasonable diligence when prosecuted without cessation of more than thirty (30) consecutive days or when no more than ninety (90) consecutive days elapse between the completion of all (or substantially all) operations at one well or location and the commencement of drilling operations at another well or location.

(d) Anything in this lease to the contrary notwithstanding, it is understood and agreed that this lease shall terminate at the expiration of the primary term as to all lands held under this lease at the expiration of the primary term, except for any producing tracts as described below, unless Lessee is then engaged in drilling operations on this lease or, within the 90 days period preceding the expiration of the primary term, Lessee shall have completed or abandoned a well drilled on this lease. In either of such events, this lease shall continue in force, as to all lands held under this lease at the expiration of such primary term, only so long as Lessee is engaged in continuous drilling operations on said land, and drilling operations shall be deemed continuous if not more than ninety (120) days (commencing on the date of completion or abandonment in the case of a well completed or abandoned within the 120-day period preceding the expiration of the primary term) elapse between the completion or abandonment of one well and the commencement of drilling operations for another well. At the expiration of the primary term unless the continuous drilling provisions specified above in this subparagraph (d) shall then be applicable, or at such later date as Lessee shall fail to continuously drill this lease within the 120-day time periods specified above for continuous drilling operations in effect at the end of the primary term, this lease shall terminate except as follows:

(1) If lessee has completed a well on said land which is classified as an oil well by the appropriate state or other governmental regulatory agency or commission having jurisdiction and is producing, or capable of producing, oil in commercial quantities, then this lease shall continue in effect as to a tract of forty (40) acres around each such well;

(2) If Lessee has completed a well on said land which is classified as a gas well by the appropriate state or other governmental regulatory agency or commission having jurisdiction and is producing, or capable of producing, gas in commercial quantities, then this lease shall continue in effect as to a tract of three hundred twenty (320) acres around each such well; in each case the acreage around such oil and gas well so held to be limited to the strata or stratum for which the production of oil or gas is obtained; provided however, that in the event any Federal or state law, or any order, rule or regulation of

the appropriate state or other governmental regulatory agency or commission having jurisdiction prescribes or permits a spacing pattern for the development of the field, or allocates a producing allowable in whole or in part based on acreage per well, then any producing unit retained hereunder may include as much additional acreage as may be so prescribed or permitted or as may be used in such allocation or allowable.

Thereafter, the leasehold rights so to continue effective as to each such particular tract (that is, the applicable oil spacing unit and the applicable gas allowable unit, as the case may be) shall continue effective as to the particular tract and strata or stratum so long and only as said tract, and strata or stratum continues to produce hereunder and so long thereafter as Lessee may be conducting operations on said particular tract with respect to the particular strata or stratum with a view of developing and/or restoring production therefrom and with no cessation of such operations on a well or wells thereon for more than ninety (90) days until production from such tract and strata or stratum is restored. Each such tract shall be selected by Lessee and shall, as nearly as practicable, be in the form of a square with the well by virtue of which same is held located in the center thereof. It is the intention of the parties hereto that upon the termination of this lease down to producing tracts and strata and stratum thereunder pursuant to this paragraph 6(d), each such tract containing a well producing or capable of producing oil or gas in commercial quantities from each strata or stratum (as provided in subsections (1) and (2) of this subparagraph (d) shall be treated as constituting a separate lease and neither production from nor operations on any such tract shall maintain this lease in force as to any other such tract.

Taken from a Texas Commerce Bank Lease prepared by Paul Pitibone of Andrews & Kurth (713) 220-4101.

EXHIBIT B

The date following the case is the date of the instrument in question.

	ALFORD - 1929 671 S.W.2d 870	LUCKEL - 1935 819 S.W.2d 459	JUPITER - 1918 819 S.W.2d 466
GRANT:	½ OF 1/8 M	1/32 R	1/16 M
SUBSEQ:	1/16 OF R	1/4 OF R	
SUBSEQ:	½ M	1/4 OF R	½ M
COURT HELD:	1/16 M	1/4 OF R	1/16 M now + 7/16 M later
I SAY:	½ M	1/4 OF R	½ M

	RICHARDSON-1931 185 S.W.2d 563
GRANT:	1/16 OF 1/8 M
SUBSEQ:	1/16 OF 1/8 of R
SUBSEQ:	1/16 OF 1/8 M
COURT HELD:	1/128 OF 1/8 R in present lease + 1/128 M
I SAY:	1/16 M

	STAG SALES - 1943 697 S.W.2d 493	HAWKINS - 1930 724 S.W.2d 878
GRANT:	½ OF R	1/4 OF THE 1/8 R
SUBSEQ:	½ OF R	1/4 OF R
SUBSEQ:	1/16 M	1/4 M
COURT HELD:	½ OF R	1/32 R
I SAY:	½ OF R	1/4 M

	GARRETT - 1921 299 S.W.2d 904	CONCORD - 1937 878 S.W.2d 191; 40 Tex. S. Ct. 33;
GRANT:	1/16 OF 1/8 M	1/96 M
SUBSEQ:	1/16 OF 1/8 of R + 1/8 OF DR	1/12 DR & R
SUBSEQ:	1/8 OF LI + DR + 1/8 OF 1/8 M	1/12 M
COURT HELD:	1/8 M	1/96 M; 1/12 M; 1/12 M
I SAY:	1/8 M	1/12 M

EXHIBIT C

062-0222A
PRODUCERS 88 REV. TEXAS (1-69)
WITH 40/640 ACRES POOLING PROVISION

OIL, GAS AND MINERAL LEASE

THIS AGREEMENT made this _______ day of ___________________, 19_____, between Lessor (whether one or more) whose address is: ____ and ______________________ ______________________, Lessee, WITNESSETH: ($_____________) in hand paid, of the royalties herein provided and of the agreements of Lessee herein contained, hereby grants, leases and lets exclusively to Lessee for the purpose of investigating, exploring, prospecting, drilling and mining for and producing oil, gas, sulphur, fissionable materials and all other minerals (whether or not similar to those mentioned), conducting exploration, geologic and geophysical tests and surveys, injecting gas, water and other fluids and air into subsurface strata, laying pipelines, establishing and utilizing facilities for the disposition of salt water, dredging and maintaining canals, building roads, bridges, tanks, telephone lines, power stations and other structures thereon, and on, treat, transport and own said minerals, the following described land in __________ County, Texas, to-wit:

This lease also covers and includes all land and interest in land owned or claimed by Lessor adjacent or contiguous to the land particularly described above, whether the same be in said survey or surveys or in adjacent surveys. For the purpose of calculating rental payments hereunder, said land is estimated to contain ____________________ acres, whether it contains more or less.

2. Unless sooner terminated or longer kept in force under other provisions hereof, this lease shall remain in force for a term of ten (10) years form the date hereof (called "primary term") and as long thereafter as oil, gas, sulphur, fissionable materials or other mineral is produced from said land or land pooled therewith.

3. The royalties to be paid by Lessee are: (a) on oil, _________ of that produced and saved from said land, the same to be delivered at the wells or to the credit of Lessor into the pipelines to which the wells may be connected; Lessee may from time to time purchase any royalty oil in its possession, paying the market price therefor prevailing for the field where produced on the date of purchase, and lessee may sell any royalty oil in its possession and pay Lessor the price received by Lessee for such oil computed at the well; (b) on gas, including casinghead gas or other gaseous substance, produced from sand land and sold or used off the premises or for the extraction of gasoline or other product therefrom, the market value at the well of ________ of the gas so sold or used, provided that on gas sold by Lessee the market value shall not exceed the amount received by Lessee for such gas computed at the mouth of the well, and on gas sold at the well the royalty shall be _________ of the amount realized by Lessee from such sale; and © on fissionable materials and all other minerals mined and marketed, one-tenth either in kind or value at the well or mine, at

Lessee's election, except that on sulphur mined or marketed, the royalty shall be Two Dollars ($2.00) per long ton. If the price of any mineral or substance for the purpose of computing royalty hereunder shall not be in excess of the price which Lessee may received and retain. Lessee shall have free from royalty or other payment the use of water, other than water from Lessor's wells or tanks, and of oil, gas and coal produced from said land in all operations which Lessee may conduct hereunder, including water injection and secondary recovery operations, and the royalty on oil, gas and coal shall be computed after deducting any so used. If Lessee drills a well on land covered by this lease or on land pooled therewith, which well is capable of producing oil or gas but such well is not being produced and this lease is not being maintained otherwise as provided herein, this lease shall not terminate, whether it be during or after the primary term, (unless released by Lessee) and it shall nevertheless be considered that oil or gas is being produced from the land covered by this leased. When the lease is continued in force in this manner, Lessee shall pay or tender as royalty to the parties who at the time of such payment would be entitled to receive royalty hereunder if the well were producing, or deposit to their credit in the depository bank as hereinafter provided a sum equal to 1/12 of the amount of the annual rental payable in lieu of drilling operations during the primary term on the number of acres subject to this lease at the time such payment is made for each calendar month, or portion thereof, thereafter during which said well is situated on said land, or on land pooled therewith, and this lease is not otherwise maintained, or this lease is not released by Lessee as to the land on which or the horizon, zone or formation in which the well is completed. The first payment of such sum shall be made on or before the first day of the calendar month after expiration of ninety (90) days from the date the lease is not otherwise maintained for all accruals to such date, and thereafter on or before the first day of each third calendar month for all accruals to each such date. Lessee's failure to pay or tender or to properly or timely pay or tender such sum as royalty shall render Lessee liable for the amount due but it shall not operate to terminate this lease.

4. If operations for drilling are not commenced on said land or on land pooled therewith on or before one year from the date hereof, this lease shall terminate as to both parties, unless on or before such date Lessee shall pay or tender (or make a bona fide attempt to pay or tender) to Lessor or to the credit of Lessor in ______________________ Bank at ____________________ __________________ the sum of__________________________________ Dollars ($______________) (herein called "rental"), which shall cover the privilege of deferring commencement of drilling operations for a period of twelve (12) months. In like manner and upon like payment or tender annually, the commencement of drilling operations may be further deferred for successive periods of twelve (12) months each during the primary term. The payment or tender of rental under this paragraph and of royalty under this paragraph and of royalty under Paragraph 3 on any well which is not being produced, hereinafter referred to as "shut-in-royalty", may be made by check or draft of Lessee mailed or delivered to the parties entitled thereto or to said bank on or before the date of payment. Such bank and its successors are Lessor's agent and shall continue as depository for all rental and shut-in-royalty payable hereunder regardless of changes in ownership of said land, rental or shut-in royalty. If such bank (or any successor bank) should fail, liquidate or be succeeded by another bank or for any reason fail or refuse to accept rental or shut-in royalty, Lessee shall not be held in default for failure to make such payment or tender of rental or shut-in royalty until thirty (30) days after the party or parties entitled thereto shall deliver to Lessee a property recordable instrument naming another bank as agent to receive such payment or tender. If Lessee shall make a bona fide attempt on or before any payment date to pay or deposit rental to a party or parties entitled thereto, according to Lessee's records, or to a party or parties who, prior to such attempted payment or deposit, have given Lessee notice in accordance with subsequent

provisions of this lease of their right to receive rental, and if such payment or deposit shall be ineffective or erroneous in any regard, Lessee shall be unconditionally obligated to pay to such party or parties entitled thereto the rental properly payable for the rental period involved, and this lease shall not terminate but shall be maintained in the same manner as if such erroneous or ineffective rental payment or deposit had been properly made, provided that the erroneous or ineffective rental payment or deposit be corrected within thirty (30) days after receipt by Lessee of written notice by such party or parties of such error accompanied by such instruments as are necessary to enable Lessee to make property payment. Failure to make proper payment or deposit of delay rental as to any interest in said land shall not affect this lease as to any interest therein as to which proper payment or deposit is made. The down cash payment is consideration for this lease according to its terms and shall not be allocated as rental for a period. Lessee may at any time, and from time to time, execute and deliver to Lessor, or to the depository bank, or file for record a release or releases of this lease as to any part or all of said land or of any mineral or subsurface interval or any depths thereunder and thereby be relieved of all obligations as to the released land, mineral, horizon, zone or formation. If this lease is released as to all minerals, horizons, zones and formations under a portion of said land, the delay rental, shut-in royalty and other payments computed in accordance therewith shall thereupon be reduced in the proportion that the acreage released bears to the acreage which was covered by this lease immediately prior to such date.

5. Lessee, at its option, is hereby given the right and power during or after the primary term while this lease is in effect to pool or combine the land covered by this lease, or any portion thereof, as to oil, gas and other minerals, or any of them with any other land covered by this lease, and/or any other land, lease or leases in the immediate vicinity thereof, when in Lessee's judgment it is necessary or advisable to do so in order properly to explore, or to develop and operate the leased premises in compliance with the spacing rules of the Railroad Commission of Texas, or other lawful authority, or when to do so would, in the judgment of Lessee, promote the conservation of oil gas or other mineral in and under and that may be produced from the premises. Units pooled for oil hereunder shall not substantially exceed in area 80 acres each plus a tolerance of 10% thereof, and units pooled for gas hereunder shall not substantially exceed in area 640 acres each plus a tolerance of 10% thereof, provided that should governmental authority having jurisdiction prescribe or permit the creation of units larger than those specified, units thereafter created may conform substantially in size with those prescribed or permitted by governmental regulations. Lessee may pool or combine land covered by this or any portion thereof, as above provided as to oil in any one or more strata and as to gas in any one or more strata. Units formed by pooling as to any stratum or strata need not conform in size or area with units as to any other stratum or strata, and oil units need not conform as to area with gas units. Pooling in one or more instances shall not exhaust the rights of Lessee to pool this lease or portions thereof into other units. Lessee shall file for record in the appropriate records of the county in which the leased premises are situated an instrument describing and designating the pooled acreage as a pooled unit; the unit shall become effective as provided in said instrument, or if said instrument makes no such provision, it shall become effective upon the date it is filed for record. Each unit shall be effective as to all parties hereto, their heirs, successors and assigns, irrespective of whether or not the unit is likewise effective as to all other owners of surface, mineral, royalty or other rights inland included in such unit or gas well or well or mine for other mineral on the leased premises and the pooled unit may include, but is not required to include, land or leases upon which a well or mine capable of producing oil, gas or other mineral in paying quantities has theretofore been completed or upon which operations for drilling of a well or mine for oil, gas or other mineral have theretofore been commenced. Operations for drilling on, or production

of oil, gas or other mineral from any part of a pooled unit which includes all or a portion of the land covered by this lease, regardless of whether such operations from drilling were commenced or such production was secured before or after the execution of this lease or the instrument designating the pooled unit, shall be considered as operations for drilling or production of oil, gas or other mineral from land covered by this lease whether or not the well or wells or mine be located on land covered by this lease, and the entire acreage constituting such unit or units, as to oil, gas or other minerals, or any of the, as herein provided, shall be treated from all purposes except the payment of royalties on production from the pooled unit, as if the e same were included in this lease; provided that if after creation of a pooled unit, a well or mine is drilled on the unit area, other than on the land covered hereby and included in the unit, which well is not classified as the type of well for which the unit was created (oil, gas or other mineral as the case may be), such well or mine shall be considered a dry hole for purposes of applying the additional drilling and reworking and resumption of delay rental provisions of Paragraph 6 hereof. If an oil well or an oil unit, which includes all or a portion of the leased premises, is reclassified as a gas well, or if a gas well on a gas unit, which includes all or a portion of the leased premises is reclassified as an oil well, the date of such reclassification shall be considered as the date of cessation of production for purposes of applying the additional drilling and reworking and resumption of delay rental provisions of paragraph 6 hereof as to all leases any part of which are included in the unit other than the leased premises on which the well is located. For the purposes of computing royalties to which owners of royalties and payments out of production and each of them shall be entitled on production of oil, gas or other minerals from each pooled unit, there shall be allocated to the land covered by this lease and included in said unit (or to each separate tract within the unit if this lease covers separate tracts within the unit) a pro rata portion of the oil, gas or other minerals produced from the unit after deducting that used for operations on the unit. Such allocation shall be on an acreage basis - that is, there shall be allocated to the acreage covered by this lease and included in the pooled unit (or to each separate tract within the unit if this lease covers separate tracts within the unit) that pro rate portion of the oil, gas or other minerals produced from the unit which the number of surface acres covered by this lease, (or in each separate tract) and included in the unit bears to the total number of surface acres included in the unit. As used in this paragraph, the words "separate tract" mean any tract with royalty ownership differing, now or hereinafter, either as to parties or amounts, from that as to any other part of the leased premises. Royalties hereunder shall be computed on the portion of such production, whether it be oil, gas or other minerals, so allocated to the land covered by this lease and included in the unit just as though such production were from such land. Production from an oil well will be considered as production from the lease or oil pooled unit from which it is producing and not as production from a gas pooled unit; and production from a gas well will be considered as production from the lease or gas pooled unit from which it is producing and not from an oil pooled unit. Any pooled unit designated by Lessee in accordance with the terms hereof may be dissolved by Lessee by instruments filed for record in the appropriate records of the county in which the leased premises are situated at any time after completion of a dry hole or cessation of production of said unit.

6. If lessee shall drill a dry hole or holes on said land, or on acreage pooled therewith, and this lease is not being maintained otherwise as provided herein, or if oil, gas or other mineral is discovered and not produced from any cause, or if the production thereof should cease from any cause, this lease shall not terminate is Lessee commences operations for drilling or reworking within sixty (60) days thereafter and continues drilling or reworking operations on said well or any additional well with no cessation of more than sixty (60) consecutive days, or if it be within the primary term, commences or resumes the payment or tender of rental or commences operations for

drilling or reworking on or before the rental paying date next ensuing after the expiration of sixty (60) from the date of completion of dry hole, or discovery of oil, gas or other mineral, or cessation of production and continues drilling or reworking operations on said well or any additional well with no cessation of more than sixty (60) days. If at any time subsequent to sixty (60) days prior to the beginning of the last year of the primary term and prior to the discovery of oil, gas or other mineral on said land, or on acreage pooled therewith, Lessee should drill a dry hole thereon, no rental payment or operations are necessary in order to keep this lease in force during the remainder of the primary term. If at the expiration of the primary term, oil, gas or other mineral is not being produced on said land, or on acreage pooled therewith, but Lessee is then engaged in drilling or reworking operations thereon or shall have completed a dry hole thereon within sixty (60) days prior to the end of the primary term, this lease shall remain enforce so long as operations on said well or for drilling or reworking of any additional well are prosecuted with no cessation of more than sixty (60) consecutive days, and if they result in the production of oil, gas or other minerals so long thereafter as oil, gas or other mineral is produced from said land or acreage pooled therewith. In the event a well or wells producing oil or gas in paying quantities should be brought in by Lessee or any other operator on adjacent land and within three hundred thirty (330) feet of and draining the leased premises, or acreage pooled therewith, Lessee agrees to drill such offset wells as a reasonably prudent operator would drill under the same or similar circumstances.

7. 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 necessary for utilization of the surface for some intended use by Lessor and upon request of Lessor or when deemed necessary by Lessee for protection of the pipeline, Lessee will bury pipelines below ordinary plow depth, and no well shall be drilled with two hundred (200) feet of any residence or barn now on said land without Lessor's consent.

8. The rights of either party hereunder may be assigned in whole or in part, and the provisions hereof shall extend to the heirs, successors and assigns; 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, including, but not limited to, the location and drilling of wells and the measurement of production; and no change or division in such ownership shall be binding on Lessee until forty-five (45) days after Lessee shall have been furnished by registered U.S. mail at Lessee's principal of business with a certified copy of recorded instrument or instruments evidencing same. In the event of assignment hereof in whole or in part, liability for breach of any obligation hereunder shall rest exclusively upon the owner of this lease or of a portion thereof who commits such breach. In the event of the death of any person entitled to rentals hereunder, Lessee may pay or tender such rentals to the credit of deceased or the estate of the deceased until such time as Lessee is furnished with proper evidence of the appointment and qualifications of an executor or administrator of the estate, or if there be none, until Lessee is furnished with evidence satisfactory to it as to the heirs or devisees of the deceased and that all debts of the estate have been paid. If at any time two or more persons be entitled to participate in rental payable hereunder, Lessee may pay or tender said rental jointly to such persons or to their joint credit in the depository bank; or, at Lessee's option, the proportionate part of rental to which each participant is entitled may be paid or tendered to him separately or to his separate credit in said depository; and payment or tender to any participant of his portion of the rental hereunder shall maintain this lease as to such participant. In event of assignment of this lease as to a segregated portion of said land, rental hereunder shall be apportionable as between 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 the other leasehold owners hereunder. If six or more parties become entitled to royalty hereunder, Lessee may withhold payment thereof unless and until furnished with a recordable instrument executed by all such parties designating an agent to receive payment for all.

9. Breach by Lessee of any obligation hereunder shall not work a forfeiture or termination of this lease nor cause a termination or reversion of the estate created hereby nor be grounds for cancellation hereof in whole or in part. In the event Lessor considers that operations are not at any timer being conducted in compliance with this lease, Lessor shall notify Lessee in writing of the facts relied upon as constituting a breach hereof, and Lessee, if in default, shall have sixty (60) days after receipt of such notice in which to commence compliance with the obligations imposed by this lease. After discovery of oil, gas or other mineral in paying quantities on said premises, Lessee shall develop the acreage retained hereunder as a reasonable prudent operator but in discharging this obligation as to oil and gas it shall in no event be required to drill more than one well per forth (40) acres of the area retained hereunder plus a tolerance of 10% thereof and capable of producing oil in paying quantities and one well per 640 acres plus a tolerance of 10% of 640 acres of the are retained hereunder and capable of producing gas in paying quantities.

10. Lessor hereby warrants and agrees to defend the title to said land and agrees that Lessee at its option may discharge any tax, mortgage or other lien upon said land, either in whole or in part, and if Lessee does so, it shall be subrogated to such lien with right to enforce same and apply rentals and royalties accruing hereunder toward satisfying same. When required by the state, federal or other law, Lessee may withhold taxes with respect to rental, royalty and other payments hereunder and remit the amounts withheld to the applicable taxing authority for the credit of Lessor. Without impairment of Lessee's rights under the warranty in event of failure of title, if Lessor owns an interest in the oil, gas or other minerals on, in or under sand land less than the entire fee simple estate, whether or not this lease purports to cover the whole or a fractional interest, the royalties, shut-in royalties and rentals to be paid Lessor shall be reduced in the proportion that his interest bears to the whole and undivided fee and in accordance with the nature of the estate of which Lessor is seized. Should any one or more of the parties named above as Lessor fail to execute this lease, it shall nevertheless be binding upon the party or parties executing same. Failure of Lessee to reduce rental paid hereunder shall not impair the right of Lessee to reduce royalties.

11. Should Lessee be prevented from complying with any express or implied covenant of this leased, from conducting drilling or reworking operations thereon or on land pooled therewith or from producing oil, gas or other mineral therefrom or from land pooled therewith by reason of scarcity or of inability to obtain or to used equipment or material, or by operation of force majeure, any federal or state law or any order, rule or regulation of governmental authority, then while so prevented, Lessee's obligation to comply with such covenant shall be suspended, and Lessee shall not be liable in damages for failure to comply therewith; and this lease shall be extended while and so long as Lessee is prevented by any such cause from conducting drilling or reworking operations on or from producing oil, gas or other mineral from the leased premises or land pooled therewith, and the time while Lessee is so prevented shall not be counted against Lessee, anything in this lease to the contrary notwithstanding.

12. Each singular pronoun herein shall include the plural whenever applicable.

IN WITNESS WHEREOF, this instrument is executed on the date first above written.

______________________________ ______________________________
LESSOR SOCIAL SECURITY NO. LESSEE SOCIAL SECURITY NO.

STATE OF TEXAS

COUNTY OF _____

This instrument was acknowledged before me on the _____ day of _________, 1992 by
.

My Commission Expires:______________ ______________________________
Notary Public

STATE OF TEXAS)
)
COUNTY OF _____)

This instrument was acknowledged before me on the _____ day of _________, 1992 by
.

My Commission Expires:______________ ______________________________
Notary Public