

# Oil & Gas Law

---

## Class 10: OGL (2 / 7) –

---

1. Primary Term
2. Secondary Term [1 of 2]

# OGL Topic 2: Habendum Clause

## (a/k/a, Term)

- From OGL Forms posted
  - TX form: Clauses 2, 5 & 6
  - KS form: Clauses 2, 3 & 8
- Term has 2 parts: \_\_\_\_\_ and \_\_\_\_\_

# Last Class ... and this One ...

## ■ OGL

- Why this “Lease” isn’t really a lease

## ■ L’or

- Drill producing wells
- *Drill well(s) sooner rather than later*
- Receive as much \$ as possible

## ■ L’ee

- Drill producing wells
- *Hold the acreage for as long as possible, without drilling*
- Pay as little \$ as possible

# Primary Term – Basics

- **What is the typical PT duration?**
- **PT: “... shall be for a term of \_\_ years ...”**
  - **What does this really mean?**
  - **Why doesn't the Lessee get the entire PT to drill?**
  - **What's the mechanism for extending the PT?**
- **What are the 2 methods used by the L'ee to keep the OGL through the entire PT?**

# Delay Rentals

- 2 kinds of Primary Term Clauses: \_\_\_\_\_ and \_\_\_\_\_
  - *What's the difference between them?*
- Types and Distinction
  - “unless” clause – automatic termination of the Lease **unless** the **delay rental payment** is made
  - “or” clause – lease doesn't terminate, but failure to pay the delay rental is treated as a breach and the remedy is damages
- *Which is the more common? Why?*

# Delay Rental Problems

- **ASSUME:** an OGL with an “unless” delay rental clause ... **does the OGL terminate?**
- 1. L’ee makes out a check and mails it in a timely manner, but the P.O. delivers it to the wrong house, and the recipient tosses it
- 2. L’ee makes out the check, but the person who’s job it is to mail it unexpectedly goes into labor, and the check sits on her desk for 3 months until she returns from maternity leave
- 3. due to a typo, L’ee pays \$1,001.99 instead of \$1,010.99

# Schwartzenberger v. Hunt Trust Estate

- *Which kind of delay rental clause was in the OGL?*
- *What was the mistake and who caused it?*
- Surface acres vs. *“Mineral acres”*
- PP. 215-218 N1 & 3
  - ❑ Proper amount / person / manner
  - ❑ Received on or before the due date
  - ❑ Whether or not equity applies

# Delay Rentals

- A very common practice: do a paid-up lease [ see KS Form, cl. 3 ... & p. 223 N8 ]
- What is a “paid-up lease”?
- What are the benefits ??
- What are the detriments ??



# Savings Clauses (p. 222, N7)

- *Does Clause 1 work?*

- *No*

- *Does Clause 2 work?*

- *It should, but ...*

- *Does Clause 3 work?*

- *Yes it did*

- =====


- **Drafting Pointer**

# Primary Term:

## Another Way to Save the OGL ...

- Drilling!!
- L'ee can drill during the initial part (e.g., 1<sup>st</sup> yr.) of the PT and avoid paying delay rentals
- TX form, CL. 5: *"If operations for drilling are not commenced ... on or before one year from the date hereof, the Lease shall terminate ... unless [pymt of D.R.] ..."*
- Based on that language (and the Breaux case), what constitutes "operations for drilling"?

# Primary Term – Drilling

- **Which of these activities (if any) constitute “operations for drilling”?**
  - ❑ **1. Building a road on the leased lands**
  - ❑ **2. Building a road on lands adjacent to / nearby the leased lands**
  - ❑ **3. Putting up a sign on a stick that says “future home of the Smith #7 well”**
- 
  - ❑ **4. Filing with the applicable state agency an application for a drilling permit**
  - ❑ **5. Ordering equipment that could be used on several wells**
  - ❑ **6. Ordering specialized equipment that could only be used on this well**

# Primary Term – Drilling

- **Which of these activities (if any) constitute “operations for drilling”?**
  - ❑ **7. Staking out the drilling rig’s location**
  - ❑ **8. Contracting for a drilling rig to drill the well**
  - ❑ **9. Using a drilling rig to drill a water well to use in the drilling of the O&G well**
- =====
  - ❑ **10. Obtaining financing**
  - ❑ **11. Wiring the leased lands for electricity**
- =====
- **What if a Lessee waits until 11:57 PM on the last day of the primary term to commence operations for drilling?**

# Primary Term – Drilling

- 3 factors to consider – see N2 p.228
- **Should waiting until the last day (or close to the last day) raise an inference on L'ee's good / bad faith?**
- When it comes to paying delay rental payments, the courts (as we have seen) are **very strict** ... and yet, when it comes to “commencement of operations for drilling”, the courts are **more liberal**; **Why?**
- If a Lessor didn't want to subject itself to the vagueness of “commence for the operation of drilling”, **how should the Lessor modify the Lease form?**

# Primary Term – Drilling

- ***What if L'ee drills during the PT, but it drills a dry hole?***
  - ***Ex: 3-yr PT, from Jan. 1, 2011 → Jan. 1, 2014***
  - ***L'ee drills dry hole during Aug.-Oct. 2012***
- If L'ee does wait until the end of PT, it is given a period of time to complete its “drilling operations”
  - ***SEE: TX OGL Form: Clause 6 (2<sup>nd</sup> half)***
  - ***SEE: KS OGL Form: Clause 8 (1<sup>st</sup> half)***

# Secondary Term

- The trickier (conceptually) of the 2 parts of the term
- Term Clause:
  - Primary Term: “... for a term of \_\_\_\_ years ...”
  - “**and for so long thereafter as [ something occurs ]**”
- There are several ways to maintain the OGL into and through the Secondary Term
  - Tonight: production

## Secondary Term – Clifton v. Koontz

- Will any production extend the OGL Term?
- Does “production” mean the same thing as “production in paying quantities”? (PiPQ)
- What does “PiPQ” mean?
- Is paying quantities = commercial quantities?
- What kinds of deductions did the Petitioners argue should be considered? Ct ruling?
- What about RRC Orders ... should they be considered? What kind of Order was involved here?



# “Production in Paying Quantities”

## ■ Example:

- **Cost to drill and complete:**                    \$5,000,000
- -----
- **Cost of continuing operations:** \$     70,000 /mo.
- **Overhead / G&A:**                                 \$     20,000 /mo.
- **Royalties to L'or (1/8)**                             \$     9,375 /mo.
- -----
- **Sales revenue:**                                         \$     75,000 /mo.
- -----

## ■ *Is this well producing in paying quantities?*

# “Production in Paying Quantities”

- Essentially a 1- or 2-step process [ p. 237 N3 ]
  - First: is there a profit? If yes, the analysis is over
  - Second, if no, then you examine whether or not a reasonably prudent operator would continue
  - What sorts of factors might go into the Lessee’s decision?
- Over what period of time must the well produce “in paying quantities”? Monthly? Quarterly? Annually?
- *Look at N4 pp. 238 – 241 re other kinds of expenses*
- If a Lessor wanted more specificity or clarification, how might they modify the OGL?
- Some possibilities:
  - “production sufficient to continue operations in Lessee’s opinion”
  - “production sufficient to generate a royalty payment to Lessor of at least \$\_\_\_\_ per year”

# “Production in Paying Quantities”

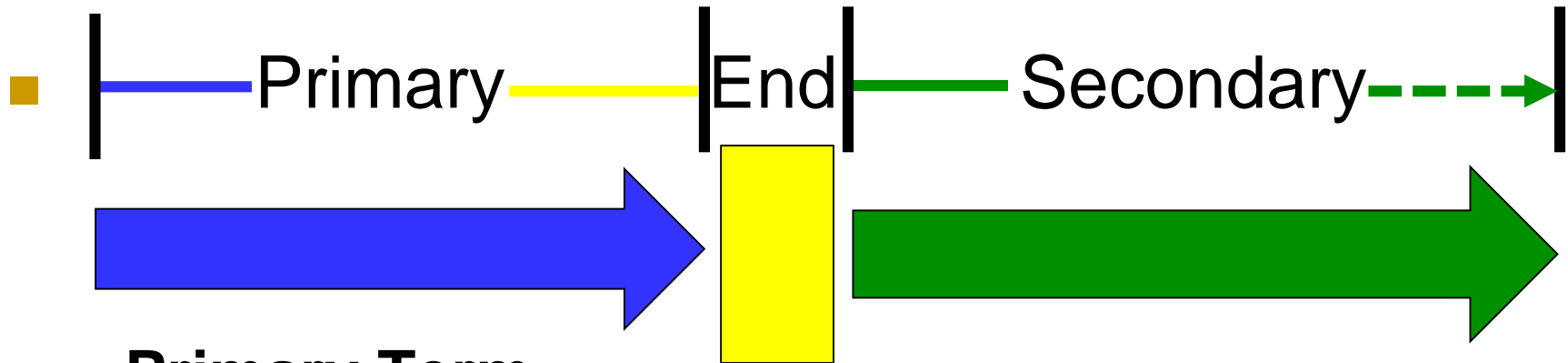
- **An OGL is a business transaction, not an arrangement entered into for political or social objectives; t/f, L’ee MUST BE making \$\$\$**

---

## Post-Termination

- P. 242 N8 – “Equipment Removal” Clause
  - **SEE: TX OGL Form: Clause 7**

# OGL – Terms



## Primary Term

- Pay Delay Rentals
- Drill

## PT→ST:


“PiPQ”

Comm. Drlg Ops

## Secondary Term

Prod. /// Shut-In Royalties  
TCoP /// Imp. Cov.

# Next Class (CL 11) ...

- **Continue Topic 2: Term**
- **The other ways that the secondary term can continue in effect**
- 
- **Ch. 2 Sec. 2 (b) and (c)**
- **PP. 243 – 278**