

Oil & Gas Law

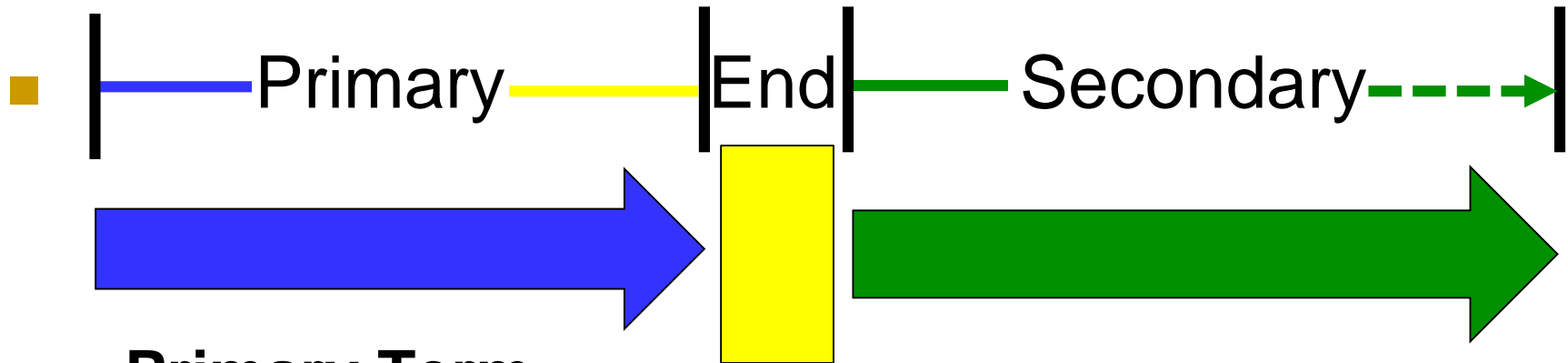
Class 11: OGL (3 / 7) –

Secondary Term [2]

Tonight ...

- ... we're continuing our look at the secondary term of the OGL ...
- ... we're considering the sorts of things that can happen ...
- ... during what the Lessor AND the Lessee hope will be ...
- ... the long-term, indefinite, “so long thereafter” phase in the life of an oil and/or gas well ...
- **BUT ... “stercus accidit”**

OGL – Terms



Primary Term

- Pay Delay Rentals
- Drill

PT→ST:

“PiPQ”

Comm. Drlg Ops

Secondary Term

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

OGL: Secondary Term – Production

■ OGL: Habendum Clause

- Term of a “standard” OGL: “... a term of X years, and so long thereafter as oil or gas is produced from the leased lands.”
- Secondary term
 - 1st method: “production” = production in paying quantities [adopted in virtually all states ... see. p. 235, N1]

Stanolind and Pack

- What's the common issue in these 2 cases?
- What 2 approaches are taken by these 2 cases?
- “Production in paying quantities” – does it mean:
 - a) Actual production? → Stanolind
 - b) Production capability? → Pack
- Which is the majority position? Minority?
 - Which group is Texas in?
- =====
- What is (are) the rationale(s) for each position?
- Does this issue arise for oil? Why / Why not?

Stanolind, Pack and Marketing

- **Oil:** transport alternatives; **Gas:** none – PL only
 - For gas, actual production *implies* that the production must be marketed
 - While “capable of production” suggests L’ee has discretion
 - 3 approaches (p. 248 N1): **Is 2nd approach okay?**
- **Stanolind and Pack – what commodity is the subject of each case?**
 - Stanolind: **“sour gas”** [see pp. 243-4 AND p. 25]
 - Pack: gas (assumption is **sweet gas**)
- **Different result for L’ee who tried to find a market but couldn’t, vs. L’ee who doesn’t try?**

Stanolind, Peck and Marketing

- If in “actual production” state (TX), language in the OGL says that the secondary term runs “... so long thereafter as oil, gas or other hydrocarbons are or can be produced ...” → different result?

[p. 248, N2]

- Parties are free to adopt their own rule ... as long as they are explicit about what they’re agreeing to !!

“Savings Clauses”

■ WHY? What are we saving?

- ❑ Money?
- ❑ Time?
- ❑ A Life?



“Savings Clauses”

- Different focus btwn PT and ST
 - PT – focus is on either drilling or proper / timely payment of Delay Rentals
 - ST – some aspect of production
 - If actual: does the vol. qualify as “paying quantities”?
 - If none: [MIN.] capable? What would reas. operator do?
 - “ [ALL] is there a substitute for production?
- 2 Themes
 - 1: what’s keeping the Lease going?
 - 2:, Courts are likely to construe these “savings clauses” strictly, against the Lessee WHY?

“Savings Clauses”

- What are the different kinds of savings clauses?
- 5 types
 - Shut-in royalty
 - Cessation of production
 - Temporary cessation of production doctrine
 - Dry hole clause
 - Continuous operations
 - Force majeure
- Suggested analytical approach: p. 249, 3rd ¶
 - Does the OGL permit constructive production?
 - If so, have the definitions / requirements be satisfied?

“Savings Clauses”

- Found in the form Leases I’ve posted:
 - TX Form – Paragraph 6
 - KS Form – Paragraphs 5, 7 and 8

Freeman v. Magnolia Pet.

- What is a shut-in-royalty? (“S-I R”)
- Issue in Freeman?
 - This issue makes the S-I R sound a LOT like what other kind of OGL payment?
- In states that follow the minority “PiPQ” rule (i.e., wells that are capable of production), does the L’ee still need to pay a S-I R?
 - after all, well not producing is still capable of producing, and that would qualify as PiPQ)
 - See also p. 255-7 N4

Shut-In Royalty: Questions

- *Does applicability of the S-I Royalty depend on the Lessee's diligence in finding a market?*
- *What if Lessee finds a market but doesn't like it?*
- *Can L'ee shut in well and pay S-I R just to wait for a better price?*
- *When is the payment of the S-I Royalty due?*
 - [see pp. 254-5 N3]

Shut-In Royalty

- Where gas in paying quantities has been discovered, but *before there's production*
- ... and the Lessee is unable to get the gas to market ... e.g.,
 - waiting for a pipeline connection
 - no market available
- ... the Lessee may be able to pay \$X as a substitute for production while that situation exists and continues (assuming that Lessee has been, and continues, to be diligent)

Cessation of Production Clauses

- Cessation of Production
 - Actual production which has stopped ... WHY?
 - Issues to be addressed are
 - Reason for cessation
 - Amount of time that cessation continues
 - Lessee's efforts / diligence to restore production
- Temporary Cessation can be addressed in the OGL; if not ...
- Temporary Cessation of Production Doctrine
 - If OGL is silent, a Cessation of Production result will be implied
 - Originally, a stoppage that was sudden / unexpected / unforeseen --- typically due to a mechanical breakdown
 - Expanded over time to include broader types (incl. voluntary cessations based on maintenance, reworking or even litigation)
 - Whether, under the circumstances, L'ee exercised "diligence to remedy the defect and resumed production in a reasonable time."

Cessation of Production Clauses

- *Could lack of \$\$ support the TCoP Doctrine?*
- *Could depletion of the formation?*
- *What if mechanical breakdown is due to:*
 - *Bad materials?*
 - *Improper maintenance?*
 - *Improper operation?*

Dry Hole Clauses

■ Dry Hole

- Applies to the first well drilled (“If, before discovery, Lessee drills a dry hole ...”)
- Drill dry hole ... you get a 2nd chance; **WHY?**
 - Issues:
 - What constitutes a “dry hole”? [see pp. 264-6 N2]
 - When was the dry hole “completed” (i.e., when does the 60-day clock start)?

Cont. Ops Clauses

- Continuous Operations Clause
 - Either you can finish what you start in the Primary Term, **OR** you can have occasional / temporary stoppages of operations as long as you re-start within ___ days
 - Distinction between the “continuous operations” clause and the “well completion” clause [see pp. 267-9 N4]

CoP / Dry Hole / Cont. Ops Clauses – Questions

- In the Rogers case, why didn't the dry hole clause preserve the lease?
 - NOTE: the clause in Rogers is pretty “standard” and is called a “30-day / 60-day” clause
- You have a gas well producing “sour gas”, and the processing plant where the gas goes to make it meet the PL quality specs) shuts down for 3 mos. for maintenance, causing your well to shut down ...
 - Can your OGL be preserved? If yes, by which mechanisms?

CoP / Dry Hole / Ops Clauses – Questions

- *Can the CoP, Dry Hole and Ops Clauses be used together and cumulatively?*
 - See pp. 269–70 N5
- *Problem – p. 270*
 - *How should the Ct. rule?*

Force Majeure

- Perlman – *Facts?*
- *Ruling?*
- *What do you take from this case?*
- =====
- K language supersedes legal “doctrines”
- Cts enforce FM clauses strictly against the party claiming FM
- FM event has to actually AND materially cause the inability / failure to produce
- Reasonable efforts to remove / fix the FM

Next Week ...

■ **TU Feb. 25 – CL 12**

- Pooling!!! (revisited) – in the context of the OGL
- Ch. 2 Sec. D (pp. 279 – 296)



■ **TH Feb. 27 – CL 13**

- Royalties
- Ch. 2 Sec. E1&2, 5&6 (pp. 298 – 315; 388 – 396)