



Oil & Gas Leases - The Habendum Clause

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Habendum clause basics

There is a primary term, a fixed number of years in the lease for the lease's initial term.

But, the lease may not go to the end of the primary term! (You must consider implied covenant to drill an initial test well, delay rentals, etc.)

There is a secondary term, which may or may not be realized. If it is realized, it may continue indefinitely.

Keeping the primary term going

Courts recognize in an oil-and-gas lease an implied covenant to drill an initial test well within a reasonable time of commencing a lease.

To keep a lease going, then, lessees must do one of the following:

- Drill
- Pay delay rentals
- Have a properly drafted “paid up” lease

The hazards for lessees of delay rentals

See CB 2/50-61

An “unless” clause provides that the lease terminates unless the lessee has either made the required payments or commenced drilling operations.

Lessees can therefore be terminated from the lease by failure to pay the proper amount, by the due date, in the proper form, to the proper party.

A majority of jurisdictions hold that failure to pay delay rentals as required automatically terminates the lease as a matter of law.

Lessee “developed elaborate administrative schemes to ensure payments were made properly” (CB 2/55)

The hazards for lessees of delay rentals

See CB 2/50-61

Ways lessees try to get continuation of a lease despite not paying delay rentals under an “unless” clause as required:

- Equitable arguments (CB 2/52-55)
- Revivor - parties act as if lease is still valid (CB 2/55)
- Surrender clause (CB 2/57)
- Express savings clause (CB 2/57-58)
 - *Look at examples in casebook.*

The hazards for lessees of delay rentals

See CB 2/50-61

Lessees often try to avoid the hazards of not paying delay rentals with:

- “Or” clauses, as opposed to “unless” clauses (CB 2/58-59)
 - This makes it such that instead of extending the lease with a payment, the lessee is just incurring an obligation to pay rentals (i.e., maybe racking up debt).
 - Might not work because of state statute.
- Paid-up leases (CB 2/60)

The Secondary Term

See CB 2/-67 et seq.

The primary term allows the lessee to look for oil or gas. It's a fixed term of years (which, as we saw, might expire early if the lessee isn't active).

The secondary term is capable of indefinite duration. The idea is that it extends as long as oil and gas, which was discovered, has yet to all be produced.

Question for thought: Is such a transaction really a "lease"? For instance, as one would understand it in landlord/tenant or the UCC?

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The Secondary Term - Interests of Lessees

Lessees want the secondary term to keep going without having to actually produce oil or gas.

This can allow them to hold on to the lease for speculative purposes (maybe it will be worth something in the future, even if it's worth nothing now).

Lessees want to be able to keep oil/gas in the ground until it's economically favorable to take it out.

This might depend on seasonal fluctuations, market trends, and state regulatory agency limits.

The Secondary Term - Interests of Lessors

Lessors want the secondary term to end unless they are making good money from royalties.

But even if they are making money from royalties, they'd like to have the option to renegotiate.

And they would like their surface back at some point.

They also would like to have a lease end for purposes of being able to find a seller for the land and to fetch a good price.

The Secondary Term - “produced in paying quantities”

Leases generally provide that they continue beyond the primary term so long as oil or gas is being produced in paying quantities.

This phrasing was so common in leases that courts created a jurisprudence construing it as matter of law with reference to policy rationales. (Contrast this to the ordinary contract-interpretation is to give effect to the parties’ intent.)

In large part, this is because of a practice of landmen using form leases (the “Producers’ 88”) which, while not identical, had common boilerplate language.

Return to: **EMER OIL COMPANY** County Recorder
300 10th NW
WILMINGTON DE 19801-1020
COUNTY RECORDER, MCKENZIE COUNTY, ND

McKENZIE COUNTY
COUNTY RECORDER

(Do Not Write Above This Line - For Official Use Only)

PRODUCERS RA-PAID LIP
REV. 5-00, NO. 2

OIL AND GAS LEASE

AGREEMENT, Made and entered into the 14th day of July, 2008 by and between Val M. Holmes and Matt P. Holmes, Individually and as Trustees of the Val M. Holmes and Matt P. Holmes Revocable Living Trust, whose post office address is 3700 Holmes Circle, Helena, MT 59601, hereinafter called Lesor, (whether one or more) and **EMER OIL COMPANY** whose post office address is P. O. Box 1835, Williston, ND 58802-1835, hereinafter called Lessee.

WITNESSETH that the Lessee, for and in consideration of TEN OR MORE DOLLARS cash in hand paid, the receipt of which is hereby acknowledged, and the covenants and agreements hereinafter contained, has granted, devised, leased and let, and by these presents does grant, demise, lease and let exclusively unto the said Lessee, the land hereinafter described, with the exclusive right for the purpose of mining, exploring by geophysical and other methods, and operating for and producing therefrom all and all gas of whatsoever nature or kind, with rights of way and easements for laying pipe lines, and erection of structures thereon to produce, save and take care of said products, all that certain tract of land situated in the County of McKenzie, State of North Dakota, (described as follows, to-wit:

Township 162 North, Range 100 West
Section 08; SE1/4
Section 06; Lot 1-6(3,38), 82NE, 82SW

See Exhibit "A" attached hereto and made apart hereof.

and containing 193.38 acres, more or less.

1. It is agreed that this lease shall remain in force for a term of Five (5) years from this date and as long thereafter as oil or gas of whatsoever nature or kind is produced from said leased premises or on acreage pooled therewith, or drilling operations are continued as hereinafter provided. If, at the expiration of the primary term of this lease, oil or gas is not being produced on the leased premises or on acreage pooled therewith but lease is then engaged in drilling or re-working operations thereon, then this lease shall continue in force so long as operations are being continuously prosecuted on the leased premises or on acreage pooled therewith, and operations shall be considered to be continuously prosecuted if not more than one hundred twenty (120) days shall elapse between the completion or abandonment of one well and the beginning of operations for the drilling of subsequent well; if after discovery of oil or gas on said land or on acreage pooled therewith, the production thereof should cease from any cause after the primary term, this lease shall not terminate if Lessee commences additional drilling or re-working operations within one hundred twenty (120) days from the date of cessation of production or from date of completion of dry hole. If oil or gas shall be discovered and produced as a result of such operations at or after the expiration of the primary term of this lease, this lease shall continue in force so long as oil or gas is produced from the leased premises or on acreage pooled therewith.

2. This is a PAID-UP LEASE. In consideration of the down cash payment, Lessee agrees that Lessee shall not be obligated, except as otherwise provided herein, to commence or continue any operations during the primary term. Lessee may at any time or times during or after the primary term surrender this lease as to all or any portion of said land and as to any such an amount by delivering to Lesor or by filing for record a release or release, and be relieved of all obligations thereafter accruing as to the acreage surrendered.

3. In consideration of the premises the said Lessee covenants and agrees:

Return to:
Empire Oil Company
P.O. Box 1835
Williston, ND 58802-1835



Return to: 385569
EMPIRE OIL COMPANY
BOX 1835
WILLISTON ND 58802-1835
COUNTY RECORDER, MCKENZIE COUNTY, ND
County Recorder
McKenzie County
Watford City ND 58854
Page 1 of 4
I certify that this instrument was filed and recorded. 385569
Ann N. Johnsrud, County Recorder Fee \$19.00
By Ann M. Johnsrud Dec 22, 2008 11:44 AM

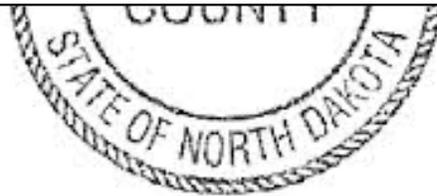
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PRODUCERS 88-PAID UP
Rev. 5-60, No. 2

OIL AND GAS LEASE

AGREEMENT, Made and entered into the 14th day of July, 2008 by and between Val M. Holms and Mari P. Holms, individually and as Trustees of the Val M. Holms and Mari P. Holms Revocable Living Trust, whose post office address is 470 Holms Gulch, Helena, MT 59601, hereinafter called Lessor (whether one or more) and EMPIRE OIL COMPANY whose post office address is P. O. Box 1835, Williston, ND 58802-1835, hereinafter called Lessee:

WITNESSETH, That the Lessor, for and in consideration of TEN OR MORE DOLLARS cash in hand paid, the receipt of which is hereby acknowledged, and the covenants and agreements hereinafter contained, has granted, demised, leased and let, and by these presents does grant, demise, lease and let exclusively unto the said Lessee, the land hereinafter described, with the exclusive right for the purpose of mining, exploring by geophysical and other methods, and



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The “Producer’s 88”

The phrase “Producers’ 88” apparently was chosen by a printing company which provided pads of boilerplate forms for landmen to fill out and tear off.

There never was a single, uniform lease that was the “Producer’s 88.”

While not identical, these forms had enough common boilerplate language that courts treated them like statute, creating binding interpretations.

In the same way, courts created lines of cases finding implied duties, usually for the benefit of landowners/lessors.

The Producer’s 88 era is largely regarded to be over, with parties making up their own new forms.

Theoretically, freedom of contract is not dead, but ...

Today in drafting non-form leases, it is necessary to draft around implied covenants (or knowingly include them by omission) and to use language in a way that is conscious of Producers-88 precedent.

The Secondary Term - Producing

See CB 2/-67 et seq.

Different jurisdictions took differing views of what producing in paying quantities means.

- Some jurisdictions (e.g., Texas) say producing means producing.
- Some jurisdictions (e.g., Oklahoma, W. Va.) say producing means *capable of producing*.

The Secondary Term - In Paying Quantities

See CB 2/-75 et seq.

The requirement that production be in paying quantities is specified in many leases.

Even where not specified in the lease, most courts read “in paying quantities” into the term “produced.”

- Clifton v. Koontz (Tex. 1959) (“While the lease does not expressly use the term ‘paying quantities’, it is well settled that the terms ‘produced’ and ‘produced in paying quantities’ mean substantially the same thing.”)
- West Virginia has the minority view of not reading “in paying quantities” into leases.

The Secondary Term - In Paying Quantities

See CB 2/75 et seq.

At least two things seem clear across jurisdictions in terms of what in paying quantities means:

- The requirement of in paying quantities is meant to exclude situations in which lessees’ interest in holding on to the lease is a speculative one - not that the lease is currently economically feasible, but that it might be someday.
- The question is one of marginal profit, not a question of the well’s total profitability.
 - “If a well pays a profit, even small, over operating expenses, it produces in paying quantities, though it may never repay its costs, and the enterprise as a whole may prove unprofitable.” Clifton v. Koontz (Tex. 1959) (quoting Garcia), CB 2/78.