

A PRIMER ON OIL, GAS & MINERAL LEASES

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I. Introduction

The purpose of this course is to provide a basic primer on the typical oil, gas and mineral lease as it has been interpreted by Texas courts. The first hurdle to overcome, however, is to identify a “typical” lease. Oil, gas and mineral leases are contracts. As such, they are negotiated between and among parties and they can be as varied as there are people negotiating them. Over the years the industry has developed certain “standard” lease forms which generally serve as the starting point for most lease negotiations. This paper will utilize one of those standard forms, the “Pound Producers 88(7-69) with 640 Acres Pooling Provision” (hereinafter “Sample Lease”) as a “go by” to address the various issues, obligations and rights that derive under an oil, gas and mineral lease in Texas.

II. What is an oil and gas lease?

A. Conveyance of a Determinable Fee Interest

In order to begin our study of the oil, gas and mineral lease, we have to know what we are studying. In Texas, ownership of oil and gas in place is a real property interest. *Texas Co. v. Daugherty*, 176 S.W.2d 17 (Tex. 1915). Oil and gas do not become personal property until they are extracted from the ground. Under Texas law, an oil, gas and mineral lease operates as a conveyance of a determinable fee simple estate in the minerals, vesting the lessee with the exclusive possessory right and ownership interest in the minerals leased. *Texas Co. v. Davis*, 254 S.W. 304, 309 (Texas 1923). *REO Industries Inc. v. Natural Gas Pipeline Co. of America*, 932 F.2d 447, 453 (5th Cir., 1991), see also *Mitchell Energy Corp. v. Sampson Resources Co.*, 80 F. 3d 976, 982 (5th Cir., 1996), *Jupiter Oil Co. v. Snow*, 819 S.W.2d 466, 468 (Tex. 1991); *Mobile*

Pipeline Co. v. Smith, 860 S.W.2d 157, 159 (Tex.App.—El Paso 1993, writ dismissed w.o.j.); *Texas Commerce Bank National Ass’n v. Interpole (‘80) Ltd. Partnership*, 703 S.W.2d 765, 769 (Note 1) Tex.App.—Corpus Christi 1985, no writ). This includes the exclusive right to operate the properties for production of oil and the obligation to pay royalty on production. In turn, the lessor generally reserves a royalty interest, usually defined as the “landowner’s share of production, free of expenses of production,” *Heritage Resources Inc. v. NationsBank*, 939 S.W.2d 118, 121-122 (Tex 1996), the possibility of reverter of the mineral estate and the right to receive delay rentals and bonuses for executing the lease. *Concord Oil Co. v. Pennzoil Production Co.*, 966 S.W.2d 451, 460 (Tex. 1998).

Because the lease creates a fee simple determinable estate, it may continue indefinitely, as long as the lessee uses the land for its intended purpose; i.e. the exploration for and production of minerals. *Texas Co.* 254 S.W. 304 at 306. A lease will automatically terminate if an event by which it is specifically limited occurs. *Gulf Oil Corp. v. Reid*, 337 S.W.2d 267, 269 (Tex. 1960). The limiting events are usually lack of production, lack of operations or lack of some other action required by the lease to keep it in force and effect.

Because an oil and gas lease results in a conveyance of a determinable fee estate, it differs from a “commercial” type lease and in fact the term “lease” is a misnomer. While commercial leases are generally construed against the lessor, an oil and gas lease is generally construed against the lessee because it is presumed the lessee either wrote the lease or had the stronger bargaining power. *Sun Oil v. Whitaker*, 483 S.W.2d 808, 815 (Tex. 1972), citing *Zeppa v. Houston Oil Co.*, 113 S.W.2d 612, 615 (Tex.Civ.App.—Texarkana 1938, writ refused). However, leases are also construed in such a manner as to prohibit forfeiture if possible. *Cambridge Oil Co. v. Huggins*, 765 S.W.2d 540, 543 (Tex.App.—Corpus Christi, 1989, writ denied) (citing *Reilly v. Rang-*

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