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# Continuous Drilling Provisions and Horizontal and Vertical Severances

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# CONTINUOUS DRILLING PROVISIONS AND HORIZONTAL AND VERTICAL SEVERANCES

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## I. Introduction:

In Texas, an oil and gas lease is a grant of a fee simple determinable, which results from the language in the habendum clause of the oil and gas lease providing for a primary term and a secondary term. The primary term is a set period of time during which lessee has the ability to evaluate the prospect and commence operations in an effort to obtain production of leased substances. The secondary term allows the lessee to retain its investment and maintain the lease valid so long thereafter as he produces leased substances. In the event the lessee is unable to produce such substances either through not fault of his own or because he is conducting operations, most leases provide for savings clauses which have the effect perpetuating the lease during such periods of non-production. However, if production ceases and the lessee is unable to rely on the savings clauses, then the lease will terminate and all rights originally granted by the lease will automatically revert to the mineral owner. Continuous drilling provisions and partial termination provisions are founded on the same principles as the habendum clause. The purpose of including these clauses in oil and gas leases is to provide to the lessee an opportunity to develop the entire lease and make sure that the mineral owner's lands are released from the lease in the event the lessee is not able or willing to continue to develop the lease. Once the lands are released from the lease, the mineral owner is free to lease its minerals to a third party and thereby obtain a new bonus and execute a lease that is up to date with the current market. As such, these clauses will prevent a lessee from holding the entire lease with a single or very few wells. As discussed below, there are many factors to consider in drafting and negotiating these provisions.

## II. The Pugh Clause and Partial Termination:

### a. Pugh Clause:

One of the first clauses to result in the partial termination of an oil and gas lease thereby affecting the language in the habendum clause is what is now known as the "Pugh Clause". This clause was drafted on or about 1947 by Lawrence G. Pugh, a lawyer from Crowley Louisiana, who intended to prevent the holding of non-pooled acreage in his client's lease while the pooled portions of the lease were maintained by and through operations and production from wells within the pooled unit. *Shown v. Getty Oil Company*, 645 S.W.2d 555, 560 (Tex.App.-San Antonio Dec 01, 1982). On or about 1958, in the case of *Broussard v. Phillips Petroleum Co*, 160 F.Supp 905 (W.D.La.1958) the intent of the clause drafted by Mr. Pugh was upheld as it was decided that a lease had terminated with respect to the non-unitized portions thereof by

the lessee's failure to pay delay rentals on such non-unitized portions of the lease at issue. There are no Texas Supreme Court decisions discussing the Pugh Clause and only a handful of Appellate decisions on point. A brief review of such decisions is helpful in understanding the issues that have been raised in Texas with respect to the "Pugh Clause". The following is a brief summary of such decisions:

*1. W. Friedrich v. Amoco Production Company*

The mineral owner filed suit against the lessee of two (2) oil and gas leases alleging that the oil and gas lease had terminated as to non-producing unitized strata for which delay rentals had not been paid. Both oil and gas leases at issue were dated February 6, 1981, the primary term of which expired on February 6, 1984. The leases also contained the following provisions:

> In the event a portion or portions of the *land* herein leased is pooled or unitized with other land so as to form a pooled unit or units, operations on, completion of a well upon, or production from such unit or units will not maintain this lease in force as to the *land* not included in such unit or units. *The lease may be maintained in force as to any land covered hereby and not included in such unit or units in any manner provided for herein; provided that if it be by rental payments, rentals shall be reduced in proportion to the number of acres covered hereby and included in such unit or units.*

One of the lessees, who claimed an interest in the lease only from the surface to 1,298 feet beneath the surface (the "Shallow Lessee") created a unit covering 320 acres from both of the leases. Because the Shallow Lessee only claimed an interest down to 1,298 feet beneath the surface, the pooled unit only was created to cover only depths from the surface of the earth down to 1,298 feet beneath the surface. The Shallow Lessee paid the delay rentals as to all of the acreage within the unit. The lessee who claimed the deep rights beneath the unitized acreage and depths (the "Deep Lessee" or "Appellee") was sued by the mineral owner ("Appellant") for failure to pay delay rentals as to the rights beneath the pooled unit. The Deep Lessee successfully moved for summary judgment claiming that the Pugh Clause did not impose a duty upon Appellee to make annual delay rental payments as to non-unitized depths. The mineral owners appealed contending that (1) The Pugh Clauses in the leases effected a vertical as well as a horizontal severance of the leasehold estate; and (2) that the leases were ambiguous. The Corpus Christi Court of Appeals focused on the first contention and because there was no Texas decision on this point at the time, looked to Kansas Law and found two conflicting decisions on point. In *Rogers v. Westhoma Oil Company*, 291 F.2d 726 (10th Cir1961), the United States 10th Circuit applied Kansa Law and found that the Pugh clause in the subject leases effected both a vertical and a horizontal severance of the leasehold. In reaching its conclusion, the Rogers Court focused on the intent of the Pugh Clause, which is to prevent the continuation of the lease as to non-unitized portions thereof and found that nothing in the Pugh Clause confined the application thereof only to surface acreage. For this reason, the Rogers Court found that the Pugh Clause effected to sever the leasehold not only vertically but horizontally

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