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ARE WE THERE YET?
THE START AND FINISH OF AN OIL AND GAS LEASE

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ARE WE THERE YET?*

I. COMMENCEMENT OF AN OIL AND GAS LEASE

A. Introduction

In this paper, we will focus on when an oil and gas lease starts and ends. In order to answer these questions, we must know what it is and how it works.

We all know that the oil and gas industry is cyclical, subject to many factors, including the price of hydrocarbons, regulatory changes and the success or failure of drilling operations. This is the reality within which oil and gas leases are negotiated.

Although a lease typically covers all minerals where the granting clause includes "oil, gas and other minerals,"[1] our focus will be upon the operation, production and sale of oil and gas.

The lessor wishes to maximize the value of the bonus, the royalty and its bargaining position with regard to the minerals to be leased, the duration of the lease and the surface to be encumbered (where the lessor is also the surface owner). The lessee prefers to pay no more than the negotiations require, nor to include any more onerous terms in the oil and gas lease than it must. Timing in these negotiations is critical.

It is essential for the parties to the lease to know when the real property rights in the substances covered by the lease become vested in the lessee and when the leasehold interest held by the lessee terminates so that the underlying mineral estate is no longer encumbered by the lease. That which occurs in between will not be covered in this paper, unless such events affect the continuation of the lease.

Our journey begins with the creation of the oil and gas lease through the execution by the lessor of a written document containing the identity of the lessor and the lessee, a description of the leased premises, the essential terms and delivery of the executed instrument to the lessee. The oil and gas lease may last forever. Thus far, none has.

Time does not permit, nor does space allow, a discussion of all of the potential contingencies which could occur. This is not an examination of all of the lease terms which can be created, the breach of which may result in the termination of an oil and gas lease.

The parties to an oil and gas lease should always pay particular attention to the terms and provisions of the lease as written. Although the death of an oil and gas lease may be sudden and without warning, some defenses do exist. Where the lease is held to have expired, these judgments generally do not terminate the lease, but rather confirm that the lease has already expired.

B. The Interest Conveyed by an Oil and Gas Lease

Since the 1920s, the Texas Supreme Court has held that an oil and gas lease conveys a fee simple determinable estate to the

* Many thanks to Brenda Eckert and Eve Searls for their diligence and hard work in the preparation of this paper.

[1] For a discussion of the meaning of "and other minerals" under Texas law, please see this author's article entitled "*Title to Uranium and Other Minerals (Still Crazy After All These Years)*" published in the Oil, Gas and Energy Resources Law Section Report, December 2008.

minerals in place in the acreage described as a result of the language of the habendum clause of the typical lease.[2] Although the document is called a "lease," it does not create a landlord-tenant relationship. A fee simple determinable estate is subject to a special limitation, the duration of which may be perpetual if the special limitation never occurs. However, the estate will automatically terminate by operation of law upon the occurrence of the breach of the special limitation.

1. The Fee Simple Determinable Estate

Under the common law, a special limitation creates a fee simple determinable estate in which A conveys Blackacre to B, "for so long as" B shall use Blackacre for a particular purpose. The instant that Blackacre is no longer used for such purpose, by operation of law the estate terminates and vests in the grantor, or grantor's successors, as a result of the limitation of the grant. The automatic reversion to the grantor of the title to the estate granted is not a forfeiture, but is the result of the "possibility of reverter" retained by the grantor upon the execution and delivery of the fee simple determinable conveyance.[3]

The fee simple determinable estate is distinguished from the fee simple absolute estate in that the determinable estate is subject to defeasance. The fee simple determinable estate is an exception to the common law rule requiring as a prerequisite, the filing of an action to recover land. A determinable fee estate is also distinguishable from the fee simple estate subject to a condition subsequent.[4] The conveyance of a fee simple estate subject to a condition subsequent requires the grantor to take an affirmative action, or to make an actual re-entry in order to terminate the granted estate. The termination of a fee simple estate subject to a condition subsequent is not automatic, but vests in the grantor the power of termination or a right of entry. Today the grantor would bring an action to recover the land without the need for actual prior entry.[5]

In the case of a fee simple estate subject to a condition subsequent, the grantor must know of the termination of the estate in order to bring an action for the recovery of the fee simple title. In the case of a fee simple determinable interest, the grantor need not know of the termination of the estate as a result of the occurrence of the breach of the special limitation in order to become vested with fee simple absolute. Moreover, since the estate reverts to the grantor instantaneously upon the occurrence of the limitation by operation of law, the grantor may not waive its right to terminate the fee simple determinable estate.[6] The fee simple determinable estate terminates upon the terms of the grant through the habendum clause as a consequence of the limitation of the estate granted. The fee simple estate

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[2] Stephens County v. Mid-Kansas Oil & Gas Co., 113 Tex. 160, 173, 254 S.W. 290, 295 (1923). S*ee generally*, A.W. Walker, Jr., *Fee Simple Ownership of Oil and Gas in Texas,* 6 TEX. L. REV. 125 (1928); A.W. Walker, Jr., *The Nature of the Property Interests Created by an Oil and Gas Lease in Texas*, 8 TEX. L. REV. 483 (1930).

[3] FRED A. LANGE & ALOYSIUS A. LEOPOLD, 3 TEXAS PRACTICE: LAND TITLES AND TITLE EXAMINATION § 331, at 602–03 (2d ed. 1992).

[4] However, see Section II.E, *infra*, discussing conditions subsequent contained in provisions other than the granting clause.

[5] FRED A. LANGE & ALOYSIUS A. LEOPOLD, 3 TEXAS PRACTICE: LAND TITLES AND TITLE EXAMINATION § 341, at 702–13 (2d ed. 1992).

[6] However, see Section II.F, *infra*, discussing Texas courts' application of defenses to termination claims.

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