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Modifying Oil & Gas Documents for Horizontal Drilling

H. Martin Gibson

Author contact information:
H. Martin Gibson
Patton Boggs LLP
2000 McKinney Avenue, Suite 1700
Dallas, Texas 75201
Telephone No.: 214-758-1537

mgibson@pattonboggs.com

TABLE OF CONTENTS

I am delighted to acknowledge the able and professional assistance of Mr. Austin Henley at Patton Boggs in the preparation of this paper.

— Martin Gibson

Modifying Oil & Gas Documents for Horizontal Operations

This is a work in progress. If you have thoughts or comments or sample language for an oil and gas document dealing with horizontal wells, your contributions would be most appreciated (and recognized).

Oil & Gas Leases.

1. Date. The date of the lease determines the end date of the primary term. Generally, operations that have commenced off of a lease tract do not preserve the lease past the primary term and a horizontal wellbore that is intended to penetrate the lease will not preserve the un-penetrated lease.

However, the United States District Court for New Mexico reached a different result in a 2001 case.[1] As an oil and gas lease was approaching the end of its primary term, the lessee, Chesapeake, was informed that a drilling zoning variance would not be granted for drilling on the leased tract due to its location near a residential neighborhood. Chesapeake purchased a three-acre parcel adjoining the leased tract to directionally drill a well from the surface of the purchased parcel to a producing formation within the leased tract. The proposed well was spudded on July 27, 1998 on the three-acre purchased parcel. The stated primary term of the lease expired on August 3, 1998. On August 12, 1998, the drill bit penetrated the subsurface of the leased tract.

The court focused on two lease provisions in finding that the lease was extended by the commencement of operations off the leased premises:

> Paragraph five of the Lease provides, in pertinent part, that Defendant, the lessee, is "granted the right . . . to pool or combine this lease, the land covered by it or any part or horizon thereof with any other land, leases, mineral estates or parts thereof for the production of oil or gas." Paragraph five also contains the following language, to wit:
>
> > Drilling operations on or production from any part of any such unit shall be considered for *all purposes*, except the payment of royalty, as operations conducted upon or production from the land described in this lease. (Emphasis supplied.)
>
> Paragraph six of the Lease provides, in pertinent part, that "[i]f at the expiration of the primary term there is no well upon said land capable of producing oil or gas, but lessee has

[1] *Manzano Oil Corp. v. Chesapeake Operating Inc.*, 178 F.Supp.2d 1217 (D.N.M. 2001).

> commenced operations for drilling or reworking thereon this lease shall remain in force so long as operations are prosecuted with no cessation of more than 60 consecutive days . . . ."[2]

It was undisputed that the defendant timely began "drilling operations" on the tract adjacent to the lease. The court went a step further and found that the operations on the off-lease property should be included as "drilling operations" for the purpose of continuing the lease:

> The intent of the parties as manifested in the totality of the Lease provisions and in the actions of the parties would permit the drilling of the horizontal well and would allow for the extension of the Lease under the circumstances here presented. Plaintiffs argue that paragraph 6 of the Lease requires that any drilling actually be on the lands covered by Lease. I do not agree. To so hold would substantially negate the provisions of paragraph 5 of the Lease. *See Owens*, 105 N.M. at 157, 730 P.2d 458 (oil and gas leases must be construed to give effect to all of their provisions so far as possible). Here the Plaintiffs entered into an agreement which allowed the horizontal well to be drilled and later, on the strained rationale that the well had to be solely on the Leased land, they would work a forfeiture on Defendant. Lease provisions providing for forfeiture by the lessee will be strictly construed in lessee's favor. *Stamm v. Buchanan*, 55 N.M. 127, 227 P.2d 633 (1951) (forfeitures are not favored by the Court). Thus, I find that adjacent property and the Lease property were "pooled" or "combined" in such a way as to make the provisions of paragraph five of the Lease applicable "for all purposes" including the provisions of paragraph six of the lease which provided for an extension of time where drilling operation had begun.[3]

The decision essentially implied "pooling" or a "combination" of the off-lease acreage and the leasehold acreage without any actual exercise of the pooling authority in the lease. However, the result might be justified by certain language in the lease. "Lessee has commenced operations for drilling or reworking thereon, this lease shall remain in force so long as operations are prosecuted with no cessation of more than 60 consecutive days . . ." can be interpreted in two ways. The first is that the operations must have been commenced on the lease. The second is that the operations for drilling or reworking on the lease must have been commenced. The question is whether "on the lease" pertains to "commenced operations" or "drilling or

[2] *Id.* at 1219.

[3] *Id*. at 1220.

Title search: Modifying Oil & Gas Documents for Horizontal Drilling

Also available as part of the eCourse
Dealing with Unleased and Uncommitted Cotenants: Legal Risks of Drilling and Operating without Leases; plus, Modifying Oil and Gas Agreements to Accommodate Horizontal Operations

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