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The Oil and Gas Lease, Part I: Classification, Scope of Grant and Duration

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INTRODUCTION¹

Of all the contracts used in the oil and gas industry, none is as important as the oil and gas lease. It is the foundational instrument in oil and gas and a required prerequisite to development for those who do not own the mineral estate. Its uniqueness arises in that unlike most other oil and gas contracts, it is both a contract and a conveyance of property. Part I of this article begins with an overview of the mineral estate, the predecessor to an oil and gas lease. Part II examines theories of oil and gas rights ownership and oil and gas lease ownership. Part III provides a general overview of the oil and gas lease. Part IV reviews the granting clause, examining its rights of use and the accommodation doctrine; substances granted by the lease; lands and interests granted by the lease, which includes in gross provisions, Mother Hubbard and coverall clauses, after acquired title language, proportionate reduction clauses, subrogation clauses, and warranty clauses. Part V reviews the habendum clause, focusing on the terms of the lease; payment of delay rentals; maintenance by operations; extension of the lease; and the production in paying quantities. Savings clauses, which affect the duration of the lease, are discussed in *The Oil and Gas Lease, Part IV: Other Clauses*. Following the conclusion, an Appendix provides useful granting clause drafting examples.

I. AN OVERVIEW OF THE MINERAL ESTATE

The proverbial “bundle of sticks” is an analogy familiar to real property scholars.² The analogy compares property ownership to a bundle of sticks—that is ownership is composed of separate and individual property rights—where each “stick” represents a right or stream of benefits available to the property owner. Under the centuries-old common law *ad coelum* doctrine, real property contained all lands from the core of the earth to the sky. Although this “heaven-to-hell” doctrine is now limited, oil and gas law still composes that part of subsurface real property, sometimes called the mineral estate. And in oil and gas law, the mineral property bundle is composed of five essential attributes: (1) the right to develop (the right of ingress and egress), (2) the right to make decisions affecting exploration and development of the mineral estate, (3) the right to receive bonus payments, (4) the right to receive delay rentals, and (5) the right to receive royalty payments.³ The right to make decisions affecting exploration and development of the

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¹ This article contains material from Monika U. Ehrman, *The Granting Clause in the Modern Oil and Gas Lease*, SPECIAL INST. ON DRAFTING AND NEGOTIATING THE MODERN OIL & GAS LEASE 1-1, ROCKY MT. MIN. L. FDN. (2018) [conference proceedings] & Monika U. Ehrman, *One Oil and Gas Right to Rule Them All*, 55. HOUS. L. REV. 101 (2018).

² See *United States v. Craft*, 535 U.S. 274, 278 (2002) (citations omitted) (stating that a “common idiom describes property as a ‘bundle of sticks’—a collection of individual rights which, in certain combinations, constitutes property. State law determines only which sticks are in a person’s bundle.”)

³ *Altman v. Blake*, 712 S.W.2d 117, 118 (Tex. 1986) (citations omitted).

mineral estate is also called the *executive right*.⁴ Commonly, the executive right refers to the right to execute an oil and gas lease,⁵ which is both a contract and conveyance of the subsurface mineral estate.

The oil and gas lease not only governs the rights and obligations between the parties; it is also a fee simple determinable. Execution of an oil and gas lease gives the *lessee*—the party that takes the lease—the mineral property interest in fee simple subject to the condition of continued oil and gas production. If actual or constructive production ceases, the oil and gas lease automatically terminates and the mineral estate reverts to the *lessor*—the party that granted the lease.

II. THEORIES OF OIL AND GAS OWNERSHIP

Characterization of the mineral estate is a unique problem in property because of the fugacious nature of oil and gas. Unlike coal and other minerals that are mined, oil and gas hydrocarbons in gaseous and liquid form may migrate within the reservoir, ignoring any artificial delineations of property estates or tracts. The application of the *rule of capture* is another aspect of oil and gas law that creates challenges with respect to ownership. The rule of capture, also known as the “the law of capture,” modifies the common law in *Del Monte Mining & Milling Co. v. Last Chance Mining & Milling Co.*,⁶ which applies a type of *ad coelum* doctrine. Although the *Del Monte* case involves hard rock mining, it is a good descriptor of the doctrine, which provides: *Cujus est solum, ejus est usque ad coelum et ad infernos*—“to whomsoever the soil belongs, he also owns also to the sky and to the depths.”⁷ To promote the doctrine of property use and thereby prevent waste of natural resources, courts adopted the rule of capture as a qualification of the *ad coelum* doctrine.⁸

There are two major theories of oil and gas property ownership, applying to two incidents of oil and gas interests. Beginning with a description of interests, the first interest is the oil and gas mineral estate and the second is the oil and gas lease. But this section begins with a review of the theories of oil and gas property rights ownership.

A. Theories of Oil and Gas Property Rights Ownership

4. See *Craft*, 535 U.S. at 278 (2002) (citations omitted); see also *Altman*, 712 S.W.2d at 118 (Tex. 1986) (citations omitted) (“There are five essential attributes of a severed mineral estate: (1) the right to develop (the right of ingress and egress), (2) the right to lease (the executive right), (3) the right to receive bonus payments, (4) the right to receive delay rentals, (5) the right to receive royalty payments.”).

5. See *Altman*, 712 S.W.2d at 118.

6. 171 U.S. 55 (1898).

7. JOHN S. LOWE ET AL., CASES AND MATERIALS ON OIL AND GAS LAW 57 (Note 1) (West 7th ed. 2018). [JOHN S. LOWE ET AL., CASES AND MATERIALS ON OIL AND GAS LAW (West 7th ed. 2018) is hereinafter LOWE].

8. The *ad coelum* doctrine has been further limited with respect to air and subsurface rights. See e.g., Lora D. Lashbrook, *Ad Coelum Maxim As Applied to Aviation Law*, 21 NOTRE DAME L. REV. 143 (1946).

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