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The Oil and Gas Lease, Part IV: Other Clauses

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Introduction

In drafting and negotiating oil and gas leases, much attention is deservedly given to direct economic provisions, such as bonus, royalty, and cost sharing, and perhaps to the length of the primary term. However, the lease is a much more complex document than just that. This article will briefly discuss some of the “boilerplate” provisions found in many leases. As you will see, these are really anything but “boilerplate.” Even though many oil and gas leases follow common forms, each is its own contract, the provisions of which the parties are free to include, exclude or custom design.

The Operations Clause

Virtually all oil and gas leases are structured to begin with a primary term, within which a lessee must satisfy a condition in order to extend the lease beyond that primary term into what is called the lease’s “secondary term.” The lease then continues in the secondary term for so long as the condition remains satisfied. The condition is satisfied if oil and/or gas is produced in paying quantities from the leased lands, or from lands pooled therewith, and remains satisfied as long as that production continues. Certain other lease clauses recognize alternate ways that a lessee might satisfy the “production” condition and thus maintain the lease in force. The Operations Clause does just that. A well written Operations Clause covers two situations. First, it extends the primary term if, at the end of that term, the lessee is engaged in “operations.” Second, it extends the secondary term when actual production ceases. If the lessee then timely commences “operations,” for the duration that such operations continue, if production results from the operations, that production then continues the lease for as long as it lasts. The language of the Operations Clause may be included within the lease’s Habendum Clause or may stand

alone as a separate provision. Here are a couple of examples:

Example No. 1:

If prior to discovery of oil, gas or other hydrocarbons on this land, or on acreage pooled therewith, Lessee should drill a dry hole or holes thereon, or if after the discovery of oil, gas or other hydrocarbons, the production thereof should cease from any cause, this Lease shall not terminate if Lessee commences additional drilling or re-working operations within sixty (60) days thereafter, or if it be within the primary term, commences or resumes the payment or tender of rentals or commences operations for drilling or re-working on or before the rental paying date next ensuing after the expiration of sixty (60) days from the date of completion of the dry hole, or cessation of production. If at any time after sixty (60) days prior to the beginning of the last year of the primary term, and prior to the discovery of oil, gas or other hydrocarbons on said land, or on acreage pooled therewith, Lessee should drill a dry hole thereon, no rental payment or operations are necessary to keep the Lease in force during the remainder of the primary term. If at the expiration of the primary term, oil, gas or other hydrocarbons are not being produced on said land, or on acreage pooled therewith, but Lessee is then engaged in drilling or re-working operations thereon, or shall have completed a dry hole thereon within sixty (60) days prior to the end of the primary term, the Lease shall remain in force so long as operations are prosecuted with no cessation of more than sixty (60) consecutive days, and if they result in the production of oil, gas or other hydrocarbons, so long thereafter as oil, gas or other hydrocarbons are produced from said land, or acreage pooled therewith. In the event a well or wells producing oil or gas in paying quantities shall be brought in on adjacent land and draining the leased premises, or acreage pooled therewith, Lessee agrees to drill such offset wells as a reasonably prudent operator would drill under the same or similar circumstances.¹

Example No. 2:

If, at the expiration of the primary term of this lease, oil or gas is not being produced from the above described land but lessee is then engaged in drilling operations, this lease shall continue in force so long as drilling operations are continuously prosecuted, and if production of oil or gas results from any such drilling operations, this lease shall continue in force so long as oil or gas shall be produced. If, after the expiration of the primary term of this lease, production from the above described land should cease, this lease shall not terminate if lessee is then prosecuting drilling operations, or within 180 days after each such cessation of production commences drilling operations, and this lease shall remain in force so long as such operations are continuously prosecuted, and if production results therefrom, then as long thereafter as oil or gas is produced from the above

¹AAPL Form 675 Oil and Gas Lease; Texas Form-Shut-In Clause, Pooling Clause (referred to hereinafter as “Texas AAPL 675 Lease”).

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