Brief Introduction:

Welcome. Petroleum Education Workshops is proud to offer this practical on-line class which has been designed to broaden your job skills and enhance your knowledge base of the oil and gas lease, lease obligations and lease clauses. We believe that you will find this course not only valuable but also comprehensive and convenient. The course has been designed to take you on a journey that is not only worth while but also enjoyable and can help you succeed in your career. Good luck. We wish you well!

A Word of Caution:

Because of the subject matter covered in this course it is important to know that the material covered is designed to help identify the prevailing guidelines that surround the disposition of the oil and gas lease. This course, however, is not intended to substitute for any specific legal advice or opinion. Since state rulings in the matter of law are defined by the courts and can change at any time with court decisions, no portion of this course is a substitute for legal advice. Since state statues are voluminous and vary from state to state, this course does not purport to be a complete or definitive volume on the subject. In many cases lease related issues and the subjects surrounding the lease have been summarized in order to relate to the layman. As with all condensed statements, they are incomplete in their substance. Where these statements are expressed, they are designed only as a guideline and not as a legal opinion on any one specific matter. Because the authors of this course are not licensed attorneys, they do not purport to offer any legal opinion on any one specific matter.

Chapter 1

INTRODUCTION

The Early Days of the Oil and Gas Industry

and

The Early Days of the Oil and Gas Lease

THE EARLY DAYS OF THE OIL AND GAS INDUSTRY

It is generally believed that the beginning of commercial oil and gas production in the United States began in 1859 when Edwin Drake, a former train conductor, drilled the first successful oil well in Titusville, Pennsylvania. The well was drilled to a depth of 69 feet and took two months to complete.[1]

Prior to that time, oil and gas was used for medicinal purposes, as a lubricant or as an adhesive. There were several other uses but the demand was not substantial. The private or commercial use of either oil or gas generally came from marsh gas or oil seeping through the surface of the earth.

During the late 1800's it was not uncommon for someone to find oil while drilling for water. Because of the developmental costs, low demand and low prices offered for oil, the drillers would often ignore the discovery. In 1894 the city of Corsicana, Texas was drilling one such water well when they hit a significant reserve of oil. They walked away from and abandoned the well because they were not looking for oil, only water.[2]

During the early developmental days of the oil and gas industry, pioneers were working blind. Seismic data was only science fiction and men would often use divining rods or clairvoyants as their tools for locating drill sites. Knowledge of deep reserves was unknown and often a discovery was the result of stumbling rather than intention. The earliest wells were drilled by hammering a cable tool into the earth rather than the use of a rotary drill. Well casing technology did not exist and water from shallower zones would often flow into the wells preventing the deeper oil from being produced.

In 1870, a night watchman at an ice plant in Shreveport, Louisiana stumbled upon natural gas that was escaping from a water well. He heard the sound, lit a match and the rest was history. The owners of the plant piped the gas to the facility in order to provide light for their operations. Thirty-one years would pass; however, before the first commercial producing well was completed in the state of Louisiana.[3]

In the early 1860's, there were enough wells drilled in an area of Illinois that the town was named "Oilfield". Because of unknown or poor technology the ability to produce these wells in any type of commercial quantity was marginal at best. It took forty years for that to happen.[4]

In 1866, the first producing oil well in Texas was drilled in, Nacogdoches County, by Lyne T. Barret. The following year, a producing well was drilled

near Oil Springs by Amory Reily Starr and Peyton F. Edwards. Other wells followed, making Nacogdoches County the site of Texas' first commercial oil field.

Even though several thousand barrels of oil were produced, the price of oil was so low that continued drilling operations ceased. Nearly thirty years passed before the Texas oil and gas industry began to boom. Drilling near Beaumont, Texas had begun in 1892 and several dry holes were drilled. Then on January 10, 1901 a plume of oil roared upward some 150 feet. The fountain of black ore could be seen for miles and marked the beginning of a historic event in the history of oil and gas. The derrick was near Beaumont, Texas in what was to become the Spindletop oil field. By 1902 close to 300 additional wells had been drilled by 600 different oil companies.

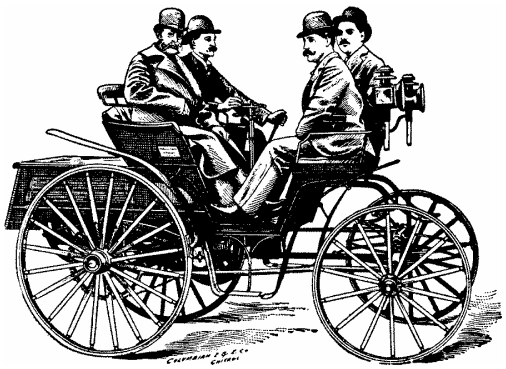
The well was named the Lucas No. 1 and produced more than an estimated 75,000 barrels of oil a day. In 1902, the field produced over 17.5 million barrels of oil.[5]

The oil boom that resulted from this discovery resembled the finding of gold in California in 1849. This California gold find resulted in a rush of gold seekers, known as Forty-Niners, who poured into California's Sacramento River basin from every part of the United States and from all over the world.

Spindletop brought in hundreds of the same types of people, only this time they were called wildcatters. The area was also flooded with thousands of others looking for jobs. Close behind came a "feeding frenzy of human sharks: scores of speculators sniffing out a quick buck; scam artists peddling worthless leases; and prostitutes, gamblers and liquor dealers, all looking for a chunk of the workers' paychecks".[6]

NPR website

In September 1902, one of the workers tossed a cigar from his hand. As a result debris was ignited which spread to the top of a derrick that was gushing oil at the time. The oil ignited and it took over a week to control the blaze. This was perhaps the first of countless environmental issues raised from the exploration of oil and gas.



A significant invention occurred during this same time period that would greatly increase the demand for oil production. In 1889, the first automobile was built. Powered by a 1.5 hp, two-cylinder gasoline engine; it had a four-speed transmission and traveled at 10

mph. The gasoline-powered automobile remained largely a curiosity for the rest of the nineteenth century, with only a handful being manufactured in Europe and the United States.

In 1901, Ransom E. Olds began to produce the first United State's automobile in quantity and all of a sudden the demand for oil in the United States took on a whole new meaning. Modern automobile mass production is credited to Henry Ford. Ford began producing his Model T in 1908, and by 1927, over *18 million* cars had rolled off the assembly line.

By 1910, the United States was quickly turning to oil for its primary energy resource. The demand and profits made way for innovations that would create newer and faster ways to retrieve the oil. Whereas rope had previously been used for drilling, now, steel cable was used. In 1919, the first diamond drill bit was used. By 1926, seismology was being used.

HISTORY OF OFFSHORE DEVELOPMENT

Thirty-eight years after the Titusville, Pennsylvanian well, the first offshore oil well was drilled off the Californian coast near Summerland. Neither this well nor any of the first offshore wells was drilled in open water. They were built from wharfs or piers and extended not more than 300-500 feet into the ocean. Before long, wharfs lengthened. The longest pier stretched 1,200 feet in the ocean. Some of these wells were even drilled to a depth of 600 feet below sea level.[7]

Several years would pass before the industry would see its first successful offshore platform. It was a 100-300 foot wooden base secured to timber pilings and was constructed in 1938. The well was only drilled in 13-14 feet of water but marked the industry's first venture into open water. Nine years later in 1947, 12 miles south of Terrebonne Parish, Louisiana, a well was drilled from a platform that was almost out of sight of land. This well, drilled by Kerr-McGee Oil Company, produced 600 barrels of oil a day and became a model for offshore platforms. From that point on, offshore development and exploration opened. Within 5 years, over thirty offshore fields had been found, several of which contained over 100 million barrels of oil and/or one trillion cubic feet of gas. [8]

THE EARLY DAYS OF THE OIL AND GAS LEASE

In many ways, the development of the oil and gas industry evolved slowly. The oil and gas lease evolved in much the same way. Early leases were adopted from leases used to mine salt, were much shorter than today's leases and failed to make provisions for many of the issues known today.

The very early oil and gas lease contained no royalty clause. The lessor's only compensation out of production was a stated sum of money per well completed.[9]

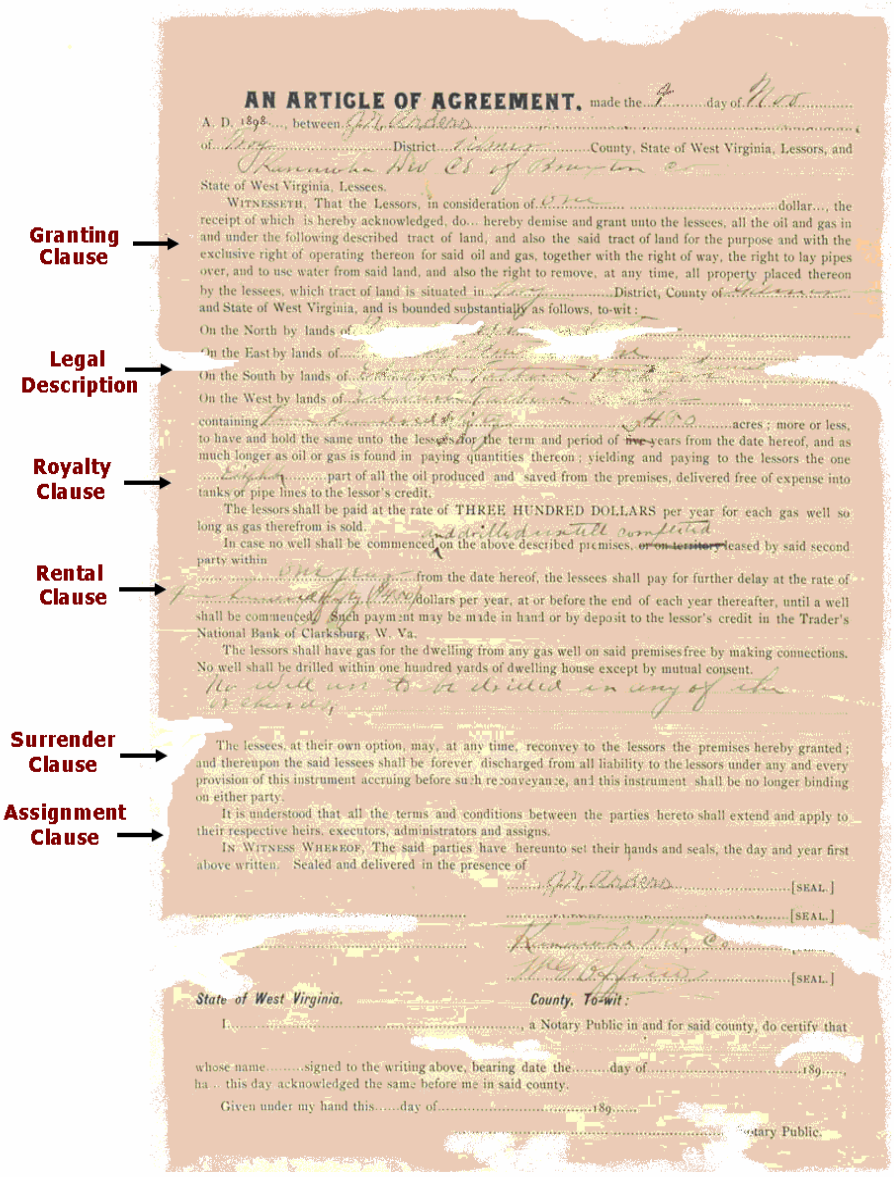
Early leases contained only a fixed primary term. There was no secondary term mentioned even in the light of production, nor did these leases provide for any type of renewal or right to extend the lease.[10]

As the industry evolved, lessor and lessee alike began to see the need for a more mature oil and gas lease.

If a modern oil and gas lease were placed alongside the following 1898 oil and gas lease, one might see some similarities, but also see many stark differences.

The 1898 lease wasn't even called an oil and gas lease, rather an *Article of Agreement*. Notice that several lease clauses that are found on today's leases are missing from this lease:

1898 Oil and Gas Lease



- The Mother Hubbard Clause
- The Shut-in Royalty Clause
- The Dry Hole, Cessation of Production and Continuous Drilling Clause
- The Pooling and Unitization Clause
- Proportionate Reduction Clause
- Damage Clause
- Warranty Clause
- Force Majeure Clause

This 1898 royalty clause grants the lessor one-eighth part of any oil found, but only a fixed dollar amount of $300 per year per gas well completed (if the gas is sold).

TODAY'S OIL & GAS LEASE

The date: An undated lease generally takes effect on the date it was executed.

The Parties: All parties involved in the oil & gas lease must be properly listed. Some states (Louisiana) requires indication of the parties' martial status

Consideration: In order for a contract to be valid, some sort of benefit or consideration is required. The benefit to the lessor can be either cash or payment in kind.

Granting Clause: The granting clause sets out the rights being granted to the lessee and would include the right to search for, drill for and produce oil and gas. The clause also specifies what types of minerals the lease covers.

Legal Description: The legal description is a necessary part of the lease.

Mother Hubbard Clause: The intention of this clause is to complete the description by including any small piece of land that is "contiguous with," "adjoining," or "adjacent to" the described tract.

Habendum Clause: Sometimes called the *term clause* and determines the length of time the lease will remain valid. The *Primary Term* is set out for a precise number of months or years. The *Secondary Term* is conditional and can last forever if production in "paying quantities" lasts forever.

Royalty Clause: The royalty is the percentage of production paid to the royalty owner.

Shut-In Royalty Clause: When gas wells have been shut in, shut-in payments substitute for production and allow the lessee to hold the lease until a market or until a pipeline becomes available to get the product to market.

FORM 88-394 (Prod. Pooling)
Rev. 5-60, No. 2

OIL, GAS AND MINERAL LEASE

AGREEMENT, Made and entered into the 1st day of May 2005, by and between James McDougal and Martha McDougal, husband and wife hereinafter called Lessors (whether one or more). And Your Oil Company, HEREINAFTER CALLED Lessee, whose post office address is 123 Main Street, Tulsa, Oklhoma.

WITNESSETH, That the said lessor, for and in consideration of *****Ten and More******* DOLLARS, cash in hand paid, receipt of which is hereby acknowledged and of the covenants and agreements hereinafter contained on the part of lessee to be paid, kept and performed, has granted, demised, leased and let and by these presents does grant, demise, lease and let unto the said lessee, for the sole and only purpose of exploring by geophysical and other methods, mining and operating for oil (including but not limited to distillate and condensate), gas (including casinghead gas and all other constituents), and all other hydrocarbons, and for laying pipe lines, and building tanks, power stations and structures thereon, to produce, save and take care of said products, all that certain tract of land, together with any reversionary rights therein, situated in the County of Dewey, State of Montana, described as follows, to-wit:

Township 16 South, Range 16 West
Section 14: SW/4NW/4, W/2SW/4

of Section 14, Township 16 South, Range 16 West, and containing 120.00 acres, more or less.

together with all strips, parcels of land, accretion and riparian rights adjoining or contiguous to the above described tract of land, attaching to and forming a part of said land whether properly or specifically described or not and owned or claimed by Lessor.

It is agreed that this lease shall remain in force for a period of 5 years (herein called primary term) and as long thereafter as oil or gas, or either of them, is produced from said land by the lessee.

In consideration of the premises the said lessee covenants and agrees:

1st. To deliver to the credit of lessor free of cost, in the pipe line to which it may connect its wells, the one-eighth (1/8) part of all oil produced and saved from the leased premises.

2nd. On gas including casinghead gas or other gaseous substance, produced from said land and sold or used in the manufacture of products therefrom the market value at the well of three-sixteenths (3/16) of the gas so sold or used, such proceeds to be less severance and other excise taxes, said payments to be made monthly.

During any period (whether before or after expiration of the primary term hereof) when gas from any well or wells on the premises capable of producing gas in commercial quantities is not sold or used and the well or wells are shut in and there is no current production of oil or operations on said leased premises sufficient to keep this lease in force, lessee shall pay or tender a royalty of One Dollar ($1.00) per year per net royalty acre retained hereunder, such payment or tender to be made, on or before the anniversary date of this lease next ensuing after the expiration of ninety (90) days from the date such well is shut in and thereafter on the anniversary date of this lease during the period such well is shut in, to the royalty owners. When such payment or tender is made it will be considered that gas is being produced within the meaning of the entire lease.

Delay Rental Clause: When a lessee uses the "Unless" form, the lessee has two choices during the primary term, 1) commence drilling 2) pay a delay rentals on non-paid up leases. Unless either of these is done the will automatically terminate.

This lease shall terminate on ___May 1st 20 _06_ unless on or before said date the Lessee either (1) commences operations for the drilling of a well on the land, or on acreage pooled therewith, in search of oil, gas or other minerals and thereafter continues such operation and drilling to completion or abandonment; or (2) pays to the lessor a rental of _One_ Dollars ($ 1.00) per acre for all or that part of the land which Lessee elects to continue to hold hereunder, which payment shall maintain Lessee's right in effect as to such land without drilling operations for one year from the date last above mentioned; and Lessee may continue to maintain the right granted without drilling operations for successive twelve month's periods (during the primary term) by paying Lessor, on or before the beginning of such respective periods __One_Dollars ($ 1.00) per acre for all or that part of the land held hereunder. If the lessee shall commence to drill a well or commence reworking operations on an existing well within the term of this lease or any extension thereof, or on acreage pooled therewith, the lessee shall have the right to drill such well to completion or complete reworking operations with reasonable diligence and dispatch, and if oil or gas, or either of them, be found in paying quantities, this lease shall continue and be in force with like effect as if such well had been completed within the term of years first mentioned.

Dry Hole, Cessation of Production, and Continuous Drilling Clause: When production ceases to occur or a well is a dry hole, the lease provides for non-termination if, during a set out period of time, drilling operations or reworking of a current well begins.

After the discovery and production of oil, gas or any other minerals in paying quantities, either on the leased premises or on lands pooled therewith, the rights granted shall be maintained in effect during and after the primary term and without the payment of the rentals hereinabove provided for so long as oil, gas or some other mineral is being produced in paying quantities, or Lessee is carrying on operations with reasonable diligence looking for the production thereof. It is provided, however, that if, after the discovery and production of oil, gas or other minerals in paying quantities, the production thereof should cease from any cause this lease shall terminate unless Lessee resumes or restores such production, or commences additional drilling, reworking or mining operations within ninety (90) days thereafter and continues such operations without the lapse of more than ninety (90) days between abandonment of work on one well and commencement of reworking operations or operations for the drilling of another, in an effort to restore production of oil, gas or other minerals, or (if during the primary term) resumes the payment of rentals in the manner hereinabove provided for in connection with the abandonment of wells drilled.

Pooling Clause: When a company pools leased land, they are usually combining small or irregular tracts into a unit big enough to meet state spacing regulations. The unit size required will vary from state to state and often from one field to another.

To keep a producing well from holding portions of the leased land outside the unit, owners sometimes add a Pugh Clause. Such a clause provides for the release of non-producing acreage and strata at a specified date or in the absence of specified development.

Lessee is hereby granted the right at any time and from time to time to unitize the leased premises or any portion or portions thereof, as to all strata or any stratum or strata, with any other lands as to all strata or any stratum or strata, for the production primarily of oil or primarily of gas with or without distillate. However, no unit for the production primarily of oil shall embrace more than 80 acres, or for the production primarily of gas with or without distillate more than 320 acres; provided that if any governmental regulation shall prescribe a spacing pattern for the development of the field or allocate a producing allowable based on acreage per well, then any such unit may embrace as much additional acreage as may be so prescribed or as may be used in such allocation of allowable. Lessee shall file written unit designations in the county in which the leased premises are located. Operations upon and production from the unit shall be treated as if such operations were upon or such production were from the leased premises whether or not the well or wells are located thereon. The entire acreage within a unit shall be treated for all purposes as if it were covered by and included in this lease except that the royalty on production from the unit shall be as below provided, and except that in calculating the amount of any shut in gas royalties, only the part of the acreage originally leased and then actually embraced by this lease shall be counted. In respect to production from the unit, Lessee shall pay Lessor, in lieu of other royalties thereon, only such proportion of the royalties stipulated herein as the amount of his acreage placed in the unit, or his royalty interest therein on an acreage basis bears to the total acreage in the unit.

Proportionate Reduction Clause: Since many mineral owners own an undivided mineral interest in the lands set out in the legal description, the lease provides for a reduction in payment based on the owners proportionate share of the tract of land.

If said lessor owns a less interest in the above described land than the entire and undivided fee simple estate therein, then the royalties herein provided shall be paid to the lessor only in the proportion which his interest bears to the whole and undivided fee.

Lessee shall have the right to use, free of cost, gas, oil and water produced on said land for its operations thereon, except water from wells of lessor.

When requested by the lessor, lessee shall bury his pipelines below plow depth.

No well shall be drilled nearer than 200 feet to the house or barn now on said premises, without the written consent of the lessor.

Damage Clause: Most leases include language setting out the lessee liability to the surface owner for damage to all growing crops and other items listed. Some leases include special considerations such as trees, pasture or other items the lessor wishes to protect.

Lessee shall pay for all damages caused by its operations to growing crops on said land.

Lessee shall have the right at any time to remove all machinery and fixtures placed on said premises, including the right to draw and remove casing. During the term of this lease, Lessee shall have the exclusive right to conduct exploration by geophysical or other methods upon the lands covered hereby.

Assignment Clause: Both lessor and lessee can assign the lease, usually without the other's permission. This clause usually says that such changes in ownership are not binding on the lessee until they have received notice.

If the estate of either party hereto is assigned, and the privilege of assigning in whole or in part is expressly allowed, the covenants hereof shall extend to their heirs, executors, administrators, successors or assigns. However, no change or division in ownership of the land or royalties shall enlarge the obligations or diminish the rights of Lessee. No change in the ownership of the land or royalties shall be binding on the lessee until after the lessee has been furnished with a written transfer or assignment or a true copy thereof. In case lessee assigns this lease, in whole or in part, lessee shall be relieved of all obligations with respect to the assigned portion or portions arising subsequent to the date of assignment.

Surrender Clause: The lessee, through this clause, can voluntary surrender all or part of the lease.

Lessee may at any time execute and deliver to lessor or place of record a release or releases covering any portion or portions of the above described premises and thereby surrender this lease as to such portion or portions and be relieved of all obligations as to the acreage surrendered.

Warranty Clause: This clause guarantees that the lessor is providing clear title to the lessee. Many lessors refuse to provide this title guarantee and strike out the clause.

Lessor hereby warrants and agrees to defend the title to the lands herein described, and agrees that the lessee shall have the right at any time to redeem for lessor by payment any mortgages, taxes or other liens on the above described lands, in the event of default of payment by lessor, and be subrogated to the rights of the holder thereof. If Lessor owns less than the entire undivided interest in all or any portion of the lands or mineral rights relating thereto (whether such interest is herein specified or not) rentals and royalties as to the land in which an interest is outstanding in others shall be reduced proportionately to the interest of the Lessor therein, but the failure of Lessee to reduce rentals shall not affect Lessee's right to reduce royalties; and all outstanding royalty rights shall be deducted from the royalties herein provided for.

Force Majeure Clause: This clause usually establishes that the lease is subject to state and federal laws. It also relieves the lessee from any lease obligations if certain kinds of events should occur. Such events tend to be catastrophic or at least highly unpleasant. Examples are acts of war, fire, flood, and other disasters known as "acts of God."

All express or implied covenants of this lease shall be subject to all Federal and State Laws. Executive Orders. Rules and Regulations. and this lease shall not be terminated, in whole or in part, nor lessee held liable in damages, for failure to comply therewith, if compliance is prevented by, or such failure is the result of any such Law, Order, Rule or Regulation or acts of God.

This lease shall be effective as to each lessor on execution hereof as to his or her interest and shall be binding on those signing, notwithstanding some of the lessor's above named may not join in the execution hereof. The word "Lessor" as used in this lease means the party or parties who execute this lease as Lessor, although not named above.

Legal Effect Clause and Lessor's Signature: This clause binds the parties and declares the lease effective. The lessor's signatures are dated and need to be styled in the same fashion as title was acquired.

IN TESTIMONY WHEREOF, we sign this the _____day of _____, 2005.

X_____ X_____

James McDougal Martha McDougal

There is a similar construction to most modern leases

Today's oil and gas lease has evolved over the years. Clauses in today's leases address issues that were not thought of when the first leases were signed. For instance, the following clauses found in most modern leases were missing from the 1894 lease example:

> The Mother Hubbard Clause, the Shut-in Royalty Clause, the Dry Hole Cessation of Production and Continuous Drilling Clause, the Pooling and Unitization Clause, the Proportionate Reduction Clause, the Damage Clause, the Assignment Clause, the Surrender Clause, the Warranty Clause, the Force Majeure Clause, and the Legal Effect Clause.

As you can imagine, each of these clauses made their way into the lease because of unforeseen problems rearing their heads as the industry grew. Many or perhaps all of them were added because of legal disputes being resolved by the courts.

As the industry matured so did the oil and gas lease. There is no real standard oil and gas lease today, because every lease can be modified. However, today's modern leases contain a similar construction. People often refer to what has been known as the Producer's 88 oil and gas lease form; however, these words, which might appear at the top of a lease, are meaningless. The wording *Producer's 88* originated from a printing company that placed the term at the top of their first oil and gas lease as a way of identifying the print job.

Leases designated as Producer's 88 might contain a multitude of different lease language. Depending on specific needs, company landmen and/or attorneys will change the wording or strike entire clauses on the lease. There is; however, a basic structure and design in our modern oil and gas leases that can be broken down into a grouping of a handful of lease clauses. They are:

1. The Granting Portion of the Lease
2. The Habendum Clause or Term Clause
3. The Royalty Clause of the Lease
4. The Termination Clauses of the Lease
5. The Pooling Clause of the Lease
6. The Damage, Assignment, Surrender, Warranty, Force Majeure and Legal Effect Clauses

TYPES OF MINERAL OWNERSHIP PERTAINING TO TODAY'S LEASE

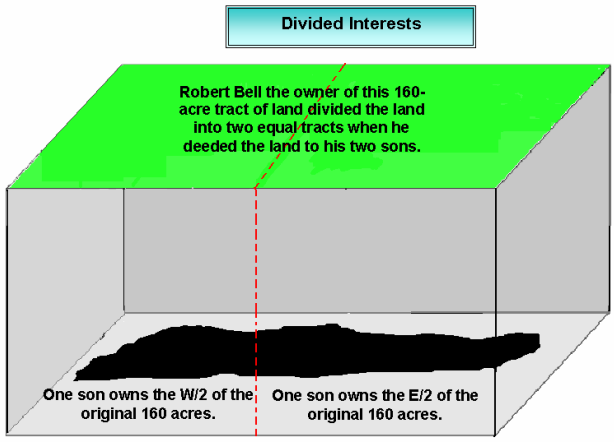
Just as the oil and gas lease has evolved over the years so too has different types of mineral ownership. Many of these were established long before the first lease was signed but some as a direct result of the industry. Since different types of ownership can affect the lease in different ways, one should be aware of the differing types of mineral or royalty ownerships that can be created.

In the beginning, the owner of the surface estate was also the owner of the subsurface estate – from the surface of the earth to the center of the earth. Such an owner can be referred to as a "Fee Simple Owner". Understanding ownership in a tract of land where this is true becomes simple. However, the ownership in many tracts of land today is not this simplistic.

Mineral estates can be grouped into several categories including:

1. Divided Interests

Both surface and mineral estates can become divided in nature. Divided interests are created when a party owning a certain tract of land either conveys away a portion of the land or divides the land into smaller tracts. In the illustration, Robert Bell, the owner of all 160 acres, has divided the land into two equal tracts when he deeded the land to his two sons.

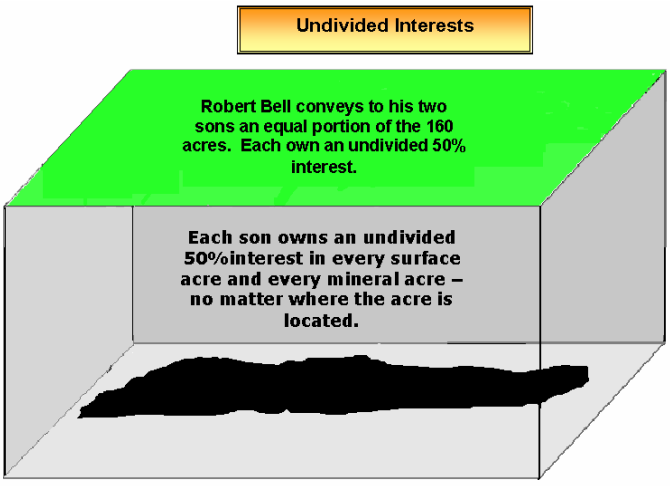


Since Robert Bell owned both the surface and minerals at the time of the conveyance, unless stipulated otherwise, both would became divided estates.

2. Undivided Interests

On the other hand, Robert Bell could have chosen not to divide the land into two tracts of land, but rather convey equal portions of the whole tract to his two sons. In this case the deed would create an undivided ownership.

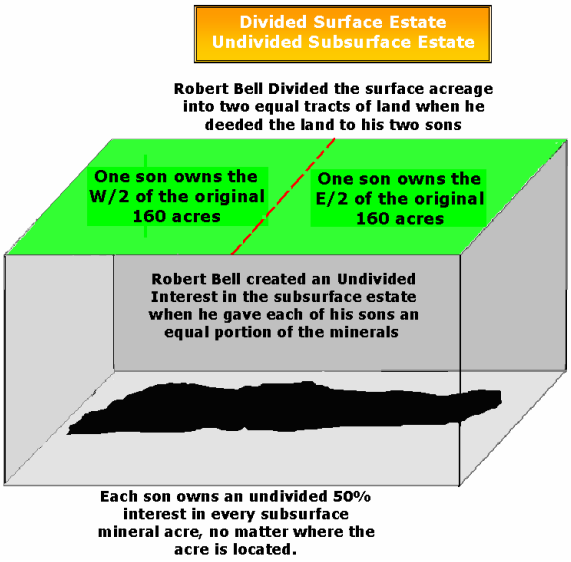
When more than one party owns and interest in the same tract of land or minerals they are said to



Since Robert Bell owned both the surface and minerals at the time of the conveyance, unless stipulated otherwise, both would became undivided estates.

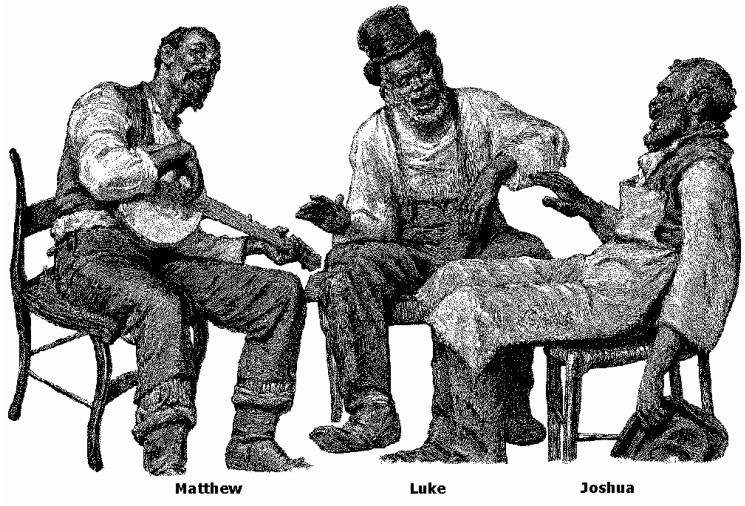
be an undivided owner of the land or minerals.

A third scenario could be that Robert Bell *divided* the surface estate into two equal tracts of land by conveying them to his sons and created an *undivided* interest in the subsurface estate when he conveyed to each of his sons equal portions of the entire subsurface acreage. In this scenario, the surface has become divided and the subsurface has become undivided.



EXAMPLE:

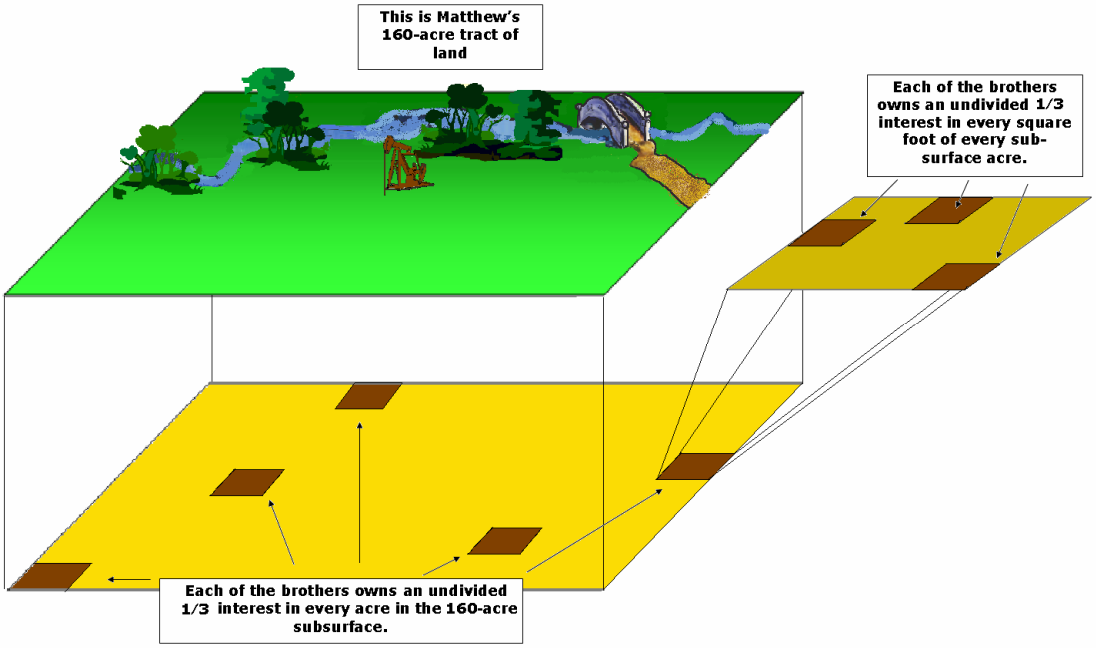
A father divided his 480-acre farm into three equal tracts of land when he deeded them to his three sons, Matthew, Luke and Joshua. At the same time, the father deeded each of the sons an undivided 1/3rd interest in and to all of the oil and gas minerals under the entire tract of land.



Your company has leased each of the brothers. Matthew leased for a 1/8th royalty. Luke leased for a 3/16th royalty and Joshua leased for a 1/6th royalty. If the only well drilled was on Matthew's tract of land how would you calculate each of the brother's royalty?

Since each brother owns an undivided 1/3rd interest in the oil and gas minerals under Matthew's tract of land, when it comes time to make royalty payments on the production, each should receive the following:

Matthew	160 x 1/3 x 1/8th
Luke	160 x 1/3 x 3/16th
Joshua	160 x 1/3 x 1/6th



3. Term mineral interests

Term mineral or term royalty conveyances or reservations can often pose problems to oil and gas personnel. Since statutes differ from state to state, one should consult with an attorney or a particular state legal source when specific questions arise.

Term mineral or term royalty conveyances or reservations simply convey or reserve minerals or royalty for a specified period of time.

Conveying or reserving minerals and or royalty can be done in one of three manners:

First, both minerals and royalties can be conveyed or reserved without any specified term attached to the conveyance.

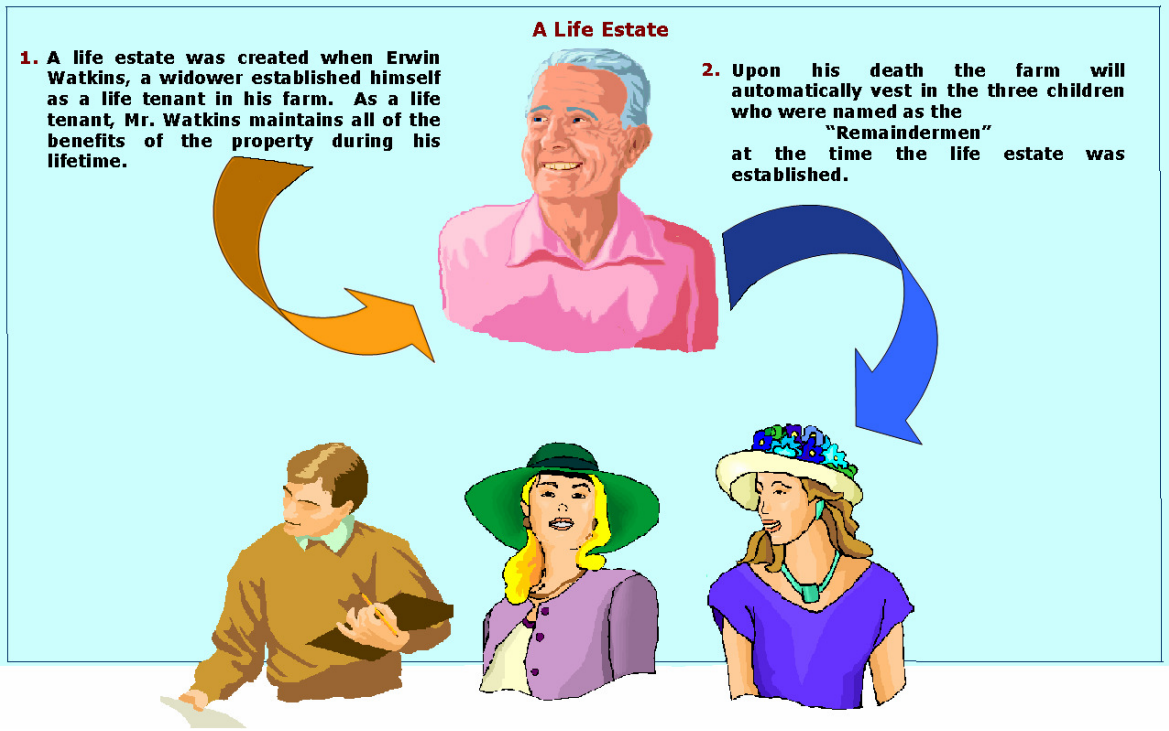
Second, both minerals and royalties can be conveyed or reserved for a specified time period. This is called a *term-mineral* or *term-royalty interest.* In this case, upon the expiration of the specified term, the minerals or royalty will revert back to the other party. Generally, the holder of a term interest can sign an oil and gas lease, but that lease or portions thereof, *will not continue* beyond the expiration date of the term mineral interest. This issue can create a challenge. Unless the conveying document provides for the continuation of the lease past the expiration date, a lease will not transfer to the reversionary mineral owner and two leases should be taken - one from the holder of the term interest and the other from the holder of the reversionary interest.

Third, both minerals and royalties can be conveyed with the following language: conveyed or reserved for a *fixed term* and "as long thereafter as oil or gas is produced."

In order for this option to take effect and move the term mineral into a "secondary term" there must be either oil or gas production in paying quantities not only during the term of the deed but at the date of expiration of the term or there must be diligent operations in place. If not, the minerals or royalty will revert back to the other party.

4. Future interests

Future interests are generally produced when a life estate is created. At the time the life estate is established the life tenant is named. This party receives the rights of possession to the property during his or her lifetime. At the same time, remaindermen are established. They are the parties who will vest in the property upon the death of the life tenant. As long as the life tenant is alive the remaindermen do not have the right of possession to the property. Generally, a life tenant does not have the



authority to enter into any oil and gas lease without signatures of the remaindermen. A general rule is to have the life tenant, remaindermen and their respective spouse sign any oil and gas lease. For land administration purposes, those receiving bonus, annual delay rentals or royalty payments must be clearly established.

5. Interests limited to certain depths

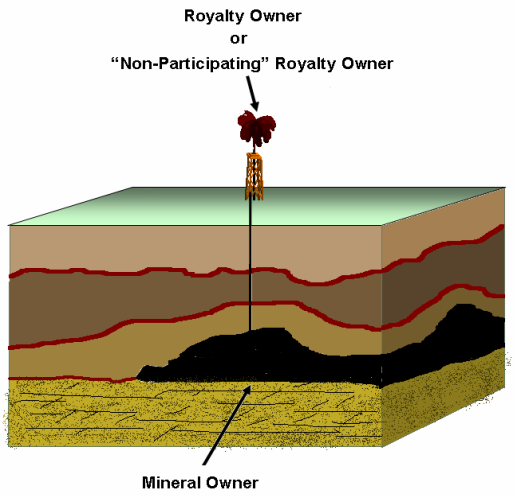
In the early days, the oil and gas lease would cover the minerals from the surface of the earth to the center of the earth. In such a case, any and all reservoirs were covered under the oil and gas lease. If the company taking the lease only wanted to drill shallow wells at a depth of 3,000 feet, any reserves deeper than 3,000 feet would sit for decades without any attempt to produce the oil and gas minerals.

This issue produced oil and gas leases that contained depth limitations. These depth restrictions would limit the company from producing any reservoirs either above or below the depths covered in the oil and gas lease.

6. Interests limited to certain substances

Unless otherwise stipulated, a conveyance will convey all substances owned by the grantor at the time to granting. However, conveyances can limit the substances being granted. Deeds can limit or convey any or all of the following: oil, condensate, gas, casinghead gas, nitrogen, carbon dioxide, helium, all hydrocarbons, other liquid semi-sold and solid minerals, coal, coalbed methane, all hard minerals, potash, sulfur or any other substance.

7. Non-participating royalty interests



The person owning *royalty* can often be different from the person who owns the *minerals.* In most cases they are the same person. When they are different, the royalty can be referred to as *"non-participating royalty"*. Since such a royalty owner would own no minerals they would not have the right or would *not be able to participate* in the execution of leases, receive bonus or rental payments.

Royalty can be defined as the monetary benefit that one would receive out of the production of a commercial oil and gas well.

FOOTNOTES

[1]Man and energy: A brief history of oil and gas, www.wintershall.com/77

[2]Texas Almanac, sesquicentennial Edition 1857-2007, www.texasalmanac.com/history/highlights/oil

[3]Historical Highlights for the LA Oil & Gas Industry, A Remarkable Past -- An Exciting Future, www.lmoga.com/history

[4]History of Oil and Gas Production in Illinois, The early days—Accidents and seeps, www.isgs.uiuc.edu/servs/pubsgeobits-pub/geobit8/geobit8

[5]Texas Almanac, sesquicentennial Edition 1857-2007, www.texasalmanac.com/history/highlights/oil

[6]Ibid.

[7]Leasing Oil and Gas Natural Resources, Outer Continental Shelf, U.S. Department of the Interior, Minerals Management Service, www.mms.gov/ld/PDFs/GreenBook-LeasingDocument

[8]Ibid.

[9] Exploring the Origins of Royalty Disputes, Pierce, David E, Petroleum Accounting and Financial Management Journal, 2004

[10] Petroleum Land Practices: Oil & Gas Leases, Lewis G. Mosburg, Jr., Internet Oil & Gas Primer, 1996.