



## Chapter 11

# The Proportionate Reduction, Damage, Assignment, Surrender, Warranty, and Force Majeure Clauses

## THE PROPORTIONATE REDUCTION CLAUSE

The proportionate reduction clause can also be called the lesser interest clause and will permit the lessee to proportionately reduce the payment of royalty or rentals when the lessor owns less than 100% of the mineral interest as set out on the lease.

The purpose of the language in this clause is different from the purpose of the language in the pooling clause whereby it establishes that the lessor will receive his or her proportionate part of royalty based on their acreage contribution to the total acreage in the unit. The *proportionate reduction clause* is not dealing with the lessor's acreage in comparison to the total unit acreage – rather their net acreage in the tract of land they leased.

Compare the language in each.

### Proportionate Reduction Clause

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

**Vs.**

### Pooling Clause

**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.**

Generally, if the person signing the lease owns less than a full 100% of the described tract of land, this lesser interest is not set out in the body of the lease as you can see in the following example:

WITNESSETH, That the said lessor,...leases...unto said lessee...all that certain tract of land... 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, W2SW/4

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

The wording in this lease describes the total acreage of the tract of land being leased (120 acres) and does not give any hint as to how much of the tract of the land the lessor actually owns. From the face of the lease it would appear that the lessor owns all 120 acres. However, the lessor may only own a fractional part (an undivided interest) of the tract of land.



For example, the lessor, along with other siblings, could have inherited this tract of land from their parent's estate. Together all of the children own the whole tract of land but separately they each own a fractional piece of the pie or an undivided interest. If there were 10 children and they inherited equal portions of the 120 acres, they each would own a 1/10 interest in the tract.

If your lessor signed a lease that offered to pay a 1/8<sup>th</sup> royalty from production, should the lessor be entitled to receive a full 1/8 royalty

based on the entire 120 acre tract of land? The answer is, "No". The lessor should only be entitled to receive his full 1/8 royalty based on his proportionate interest in the 120 acre tract (which is 12 acres or  $120 \times 1/10^{\text{th}} = 12$  net acres).

The royalty calculation should look like this --  $120 \times 1/10^{\text{th}} \times 1/8^{\text{th}} = 1.5\%$  royalty.

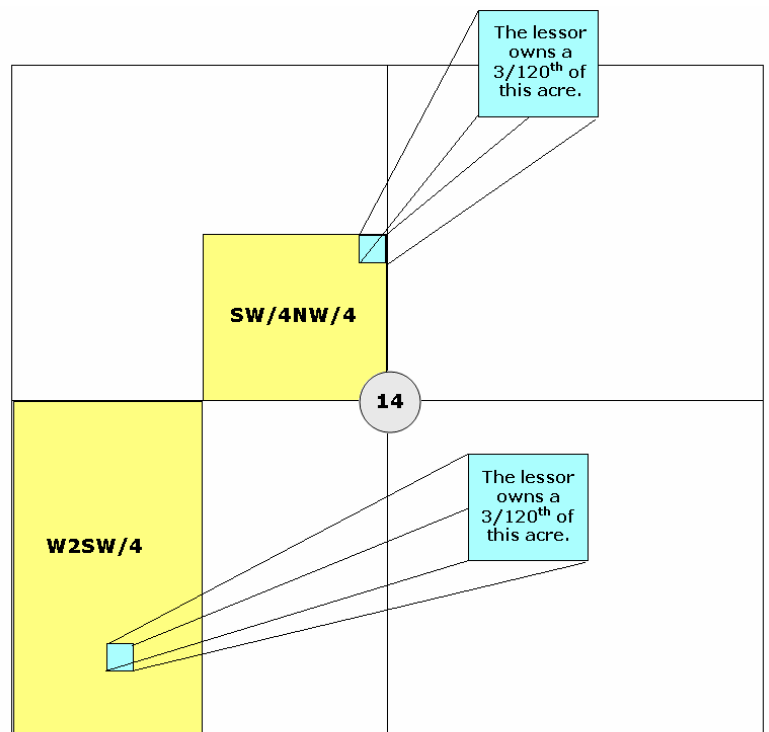
Without this clause in the lease, your company would be obligated to pay the lessor a full 1/8<sup>th</sup> royalty on the entire tract of land. If your company had leased all of the siblings under the same conditions, the royalty obligation your company would have to pay would equal 10/8ths. This obviously would leave them in a bit of a hole.

It is possible that instead of a 1/10<sup>th</sup> interest in the tract of land the lessor owns only a 3/120<sup>th</sup> interest in the tract of land. If that were true, the lessor would own only 3 net acres out of the 120 acres.  $3/120 \times 120$  gross acres = 3 net acres.

Keep in mind that an undivided interest means that the lessor owns, in this case, a 3/120<sup>th</sup> interest in *every* acre. It does not mean that he or she owns 3 net acres somewhere in the middle of the tract of land.

If your company owned this lease and the lessor owned an undivided 3/120<sup>th</sup> interest in the tract of land, according to the proportionate reduction clause your company's rental obligation to the lessor would be a \$3.00 per year rental payment. Your company's royalty obligation to the lessor would be  $3/120^{\text{th}} \times 1/8^{\text{th}} = .3125\%$ .

On the other hand, the lessor could have owned a 100% interest in 3 acres. If this were the case the legal description on the lease would be different than in the example. The description would only describe where the 3 acres are located in the section of land.



**If the lessor owned an undivided 3/120<sup>th</sup> interest in these lands, he or she would own at total of 3 net mineral acres – or  $3/120 \times 120$  gross acres. These 3 acres are derived from a 3/120<sup>th</sup> interest in every acre – no matter where the acre lies.**

## DAMAGE CLAUSE

Although it is a routine practice to pay the surface owner for damages incurred to the land from drilling operations, many states do not have any laws in place that require an operator to pay for such damages. And many states do not have laws that require the surface to be restored to its prior

### Damage Clause

**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.**

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

condition after operations have ceased.

Consequently, most leases today contain damage clause language. This clause is generally brief in scope and deals with the burying of pipelines below plow depth, the distance drilling must take place from houses or barns and damages to growing crops. Often other items that are of concern to the lessor will be added to this language. Such concerns might address:

- Damages to roads, fences, improvements, timber, and livestock
- Pits and mounds must be filled or leveled
- Ruts must be filled and the surface restored to as near its original conditions as is reasonably practical
- The location of roads, drill sites, storage tanks, and treatment facilities
- No hunting and fishing of the premises by the lessees employees

Damages can be placed in one of two categories – permanent and temporary damages.

Temporary damages are considered any damages that can be remedied. Usually the costs for such damages are simply the costs of restoration of the land. On occasions this cost may exceed the market value of the land. In a situation like this is the operator responsible to pay more for the restoration costs than the land is actually worth? The Arkansas Supreme Court addressed this issue in the case of *Benton Gravel Co. v. Wright*, 206 Ark.

930, 175 S.W.2d 208 (1943) and determined that the true measure of the liability costs should be the value of the land.<sup>1</sup>

On occasions damages will occur that are considered permanent. Let's say when drilling a well your company penetrated a reservoir of water that contained toxic minerals. The water made its way to the surface and permanently contaminated several acres of farm land.

When something of this nature occurs the lessee is generally required to pay the difference between the fair market value of the land before the damage occurred and the value of the land after the damage.<sup>2</sup>

## **ASSIGNMENT CLAUSE**

The assignment clause establishes whether or not the lessor and/or lessee have the right to transfer or assign their interest to another party. Generally oil and gas leases contain such language.

A lessee who assigns their operating rights to another party remains liable for any future breaches of the lease contract even though they were not directly involved in the breach. Therefore, the assignment clause will often contain specific language that will obligate the assignee to indemnify the lessee from any such claims.

The clause also protects the lessee from any claims that may be filed against them, until such time as they are given notice of the assignment that was filed by the lessor.

### **Assignment Clause**

**If the estate of either party hereto is assigned, and the privilege of assigning in whole or in part is hereby expressly allowed, the covenants hereof shall extend to their heirs, executors, administrators, successors or assigns, but no change in the ownership of the land or the minerals in and under the same or assignment of royalties shall be binding on Lessee unless Lessee shall have been furnished ninety (90) days before payment hereunder of such royalties, with certified copies of recorded instruments showing evidence of title.**

## **WARRANTY CLAUSE**

This warranty clause guarantees that the lessor owns the propertied interest in and to the lands and minerals as set out in the oil and gas lease. Because this clause warrants any such title ownership, lessors or their attorneys will often strike this clause from the lease.

### **Warranty Clause**

**Lessor hereby warrants and agrees to defend the title to the land herein described and agrees that the Lessee, at its option, may pay or discharge in whole or in part any taxes, encumbrances, or other liens existing, levied or assessed against the above described lands, and in the event Lessee exercises such option, it shall be surrogated to the rights of any holder or holders thereof and may reimburse itself by applying any royalty accruing hereunder to the amount of any such encumbrance, tax or other lien paid by Lessee.**

## **SURRENDER CLAUSE**

This surrender clause allows the lessee to surrender a part of or all of the leased acreage and be relieved of all obligations associated with the acreage in which they want to surrender.

### **Surrender Clause**

**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.**

## FORCE MAJEURE CLAUSE

Your company owns a lease covering lands in North Dakota. Since the lease was going to expire in December the intent was to begin drilling operations in early October. However, an early winter moved into the northern states and North Dakota began experiencing one blizzard after another. Snow drifts several feet high stopped excavation for months. Did the lease expire upon the expiration date or was there language within the body of the lease that would prevent such expiration?

Your company owns a lease in Wyoming that will expire within eighteen months. Your exploration department has scheduled the drilling of a well on the lease within the next six months; however the Federal government recently ordered the termination of all drilling activities in the area pending the result of the "Long Tailed Field Mouse Study". If the study lasts for two years, have you lost your lease?

Your company owns a lease in Utah that will expire in four months. The intent is to begin drilling operations as soon as possible. The problem is the availability of rigs. You found out yesterday that one might be available in three months; however, you also found out that rig workers had recently formed a union and are threatening to walk off the job in every Utah location. Is there language within the body of the lease that would prevent the expiration of the lease if you could not begin drilling operations within four months?

*Force majeure* literally means "greater force – forces greater than the abilities of the either the lessor or lessee. Such forces would be the state

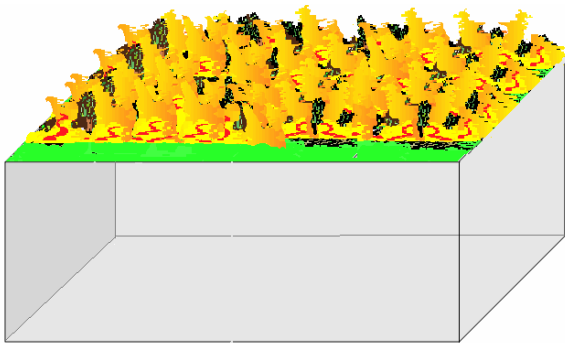
### Force Majeure Clause

**If lessee is required, or ordered or directed by any federal, state or municipal law, executive order, rule, regulation or request enacted or promulgated under color of authority to cease drilling operations, reworking operations or producing operations on the land covered by this lease or if lessee by force majeure is prevented from conducting drilling operations, reworking operations or producing operations, then until such time as law, order, rule, regulation, request or force majeure is terminated and for a period of ninety (90) days after such termination each and every provision of this lease that might operate to terminate it or the estate conveyed by it shall be suspended and inoperative and this lease shall continue in full force. If any period of suspension occurs during the primary term, the time thereof shall be added to such term.**

and federal governments, and certain acts of nature. This clause relieves the lessee from their lease obligations if certain "*greater force*" events happen that are beyond the lessee's control and are catastrophic in nature. Examples of events that would qualify under the force majeure clause are: acts of war; fire; storm; landslides; flood; blockades; riots; strikes; epidemics; laws or requests of the federal, state, municipal or other governments or governmental agents; unavailability or delays in materials, products or services and other disasters commonly referred to as acts of God.

#### Example 1:

Your company owns a lease that covers a large rural tract of land covered with trees. They drilled one well but determined that the well was not capable of producing in paying quantities. According to the terms of the lease, your company has ninety days in which to commence additional operations or the lease will terminate.

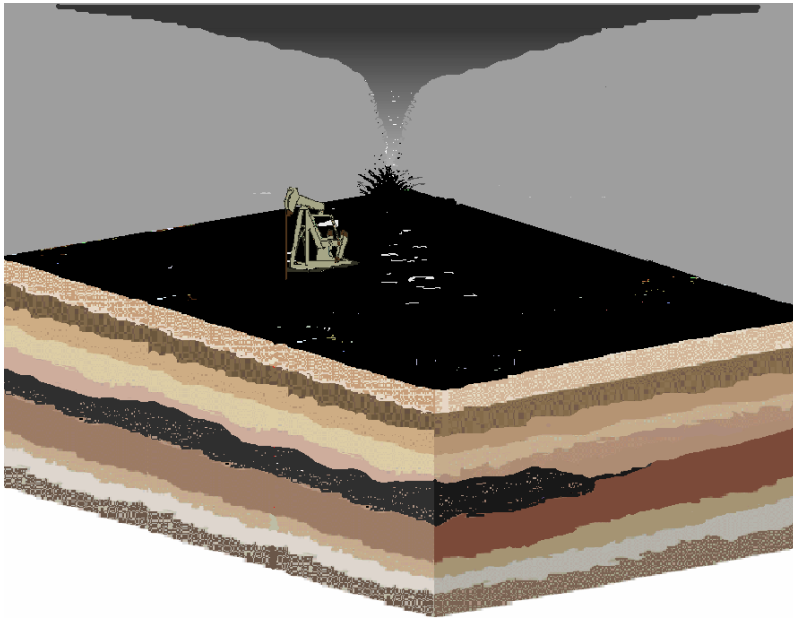


A wild fire recently broke out and raged for two months, destroying everything in its path. Your company was unable to commence operations within the ninety day period. Have they lost the lease?

In a case like this, the lease obligation to commence additional operations within ninety days will be extended by the term of the force majeure.

#### Example 2:

Your grandparents live in an area of Texas that is known historically for having many tornadoes. A few years ago they signed a three year lease with a nearby oil and gas company. The company drilled a well capable of producing gas in commercial quantities but production had been delayed pending the construction of a pipeline connection to the well. The well was shut-in with a shut-in payment due within thirty days. Prior to the payment being mailed one of the largest tornadoes in this area's history completely destroyed the location of the well. Is your company still responsible to make the shut-in payment?



This is an example of an event that is beyond the lessee's control or is often referred to an "Act of God". In an event where the force majeure clause is legitimate, such an event would relieve the lessee from making a delay rental payment, a shut-in payment or commencing operations. Such an event would, normally, pause the term of the lease until the force majeure has ended. The operative effect is that the lease is extended.

In the force majeure language shown, obligations would cease during the force majeure period and would be extended an additional ninety days from the date the force majeure period is terminated. Under a typical force majeure clause, once the clause has terminated and for a period of ninety days (or whatever the lease clause reads) after such termination, all of the provisions of the lease, that might terminate the lease shall continue in full force. If any suspension of operations occurs, during the primary term, the length of time in which the suspension occurred shall be added to the term.<sup>3</sup>

In addition, the lessee is not responsible for the damages that may be caused due to the event or events that may have occurred.<sup>4</sup>

Even though natural disasters are a regular occurrence, there are other things that may not happen as frequently. For example, if the United States declared war and parts of the battlefield are on the leased land or lands and prevents operations & production of the well or wells - this is an unforeseeable event that would be applicable to the force majeure clause.<sup>5</sup>

While this clause protects the lessee from losing the lease, it does not prevent them against termination of the lease due to failure to comply with other lease provisions such as failure to produce, failure to pay, or any other obligation that may be outlined in the lease.<sup>6</sup>

## ROYALTY PAYMENTS AND THE FORCE MAJEURE CLAUSE

A lessee must fully understand the terms of the provisions within the lease itself in order to prevent losing the lease. For example, in the case of *Maralex Resources, Inc. vs. Gilbreath*, 76 P.3d 626 (N.M. 2003), New Mexico Supreme Court, the lessee relied on the shut-in royalty clause, which would allow the lease to remain in effect. However, the clause explained that the well in question had to be capable of producing gas. The issue was the well did not have enough pressure to produce gas into the pipeline. The company shut the well in and began making shut-in payments.

The lack of pressure made the well non-capable of producing gas in paying quantities and the lessor took the lessee to court with the belief that the lease had terminated on its own terms. The company maintained that the shut-in payments held the lease. As a result of this, the court ruled that the shut-in provision was not satisfied and that the lessee could not save this lease by making shut-in payments.

When the lessee realized this, they argued that the decrease in pressure was beyond their control and tried to enforce the force majeure clause. The court ruled that the problem with the pressure of the well was actually the well itself and not the result of an external event that would cause the force majeure clause to take effect.<sup>7</sup>

### FOOTNOTES:

<sup>1</sup>The Arkansas Leasing Manual, Charles A. Morgan, Dunn Nutter & Morgan, LLP, [www.dnmlawfirm.com](http://www.dnmlawfirm.com).

<sup>2</sup>Ibid.

<sup>3</sup>An Introduction to Kansas Oil & Gas Law, David E. Pierce, Washburn University School of Law, 1988, Paragraph 9.

<sup>4</sup> South Texas College of Law, Student Bar Association, Oil & Gas Outline, Topic 5. Force Majeure Clause, 1. *Perlman vs. Pioneer*, Professor Strausser, 2004.

<sup>5</sup> South Texas College of Law, Student Bar Association, Oil & Gas Outline, Force Majeure Clause (Savings) – (iii) a. & b., Professor Strausser, 2004.

<sup>6</sup> South Texas College of Law, Student Bar Association, Oil & Gas Outline, Topic 5. Force Majeure Clause, 1. *Perlman vs. Pioneer*, 2.), Professor Strausser, 2004.

<sup>7</sup>Rocky Mountain Mineral Law Foundation, Mineral Law Newsletter – Volume XXIV, Number 3, 2002, Federal – Mining, Daniel A. Jensen, Reporter.