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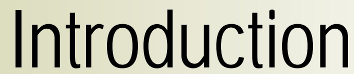

Introduction

The oil and gas lease is, without question, the foundation of every oil and gas exploration and production company. It can be said, with a great deal of certainty, that these simple pieces of paper are, indeed, the greatest assets a company can own.

One might argue that the *production* from a great discovery well is a far greater asset than an oil and gas lease. Someone might even argue that the geologic *knowledge* gained from a multi-million dollar seismic shoot is a much greater asset than a simple piece of paper called an oil and gas lease. The argument might suggest that the discovery well is projected to produce millions of dollars and the seismic data has revealed a field worth tens of millions of dollars. However, both are worthless to a company unless that company has gained the *leasehold right* to the tracts of land. This process takes place through the oil and gas lease.

With this in mind, the role of the oil and gas personnel who oversee and manage these simple pieces of paper becomes paramount for the success of the oil and gas company. These people have been hired not as data input personnel but rather as the *guardians of the company assets*. Their responsibility goes far beyond shuffling paper and capturing information into a computer system. Their job is as an analyst, overseer, maintainer, and guardian of these assets. For the company to realize its maximum success those who oversee the leases must also succeed. A part of that success will come as a result of mastering the oil and gas lease.

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The Essence of a Contract

According to the American Law Institute and their restatement of the Law of Contracts, a contract is a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty.

Contracts are legally enforceable agreements between two or more parties that contain specific actions and/or promises that must be fulfilled or actions and/or promises that must remain undone. The failure to perform any such duty is referred to as a breach of the contract and the law provides remedies for such a breach.

Contracts can be either written or oral, but oral contracts are more difficult to prove thus the old saying, "An oral contact is not worth the paper it is written upon!" All states require contracts that involve the sale or transfer of real property to be in writing and be signed by the grantor.

The law has established that contracts are only valid if the parties involved have the "legal capacity" to enter into the agreement. Individuals that would not fall within the *legal capacity* range would be:

1. Minor children
2. The insane
3. Those who are mentally ill or senile at the time of entering into a contract
4. Those under the influence of alcohol or drugs at the time of entering into a contract
5. Deceased parties

Since contracts lie at the heart and soul of most oil and gas business activities, almost all items found in the lease administrator's inbox is connected directly with or indirectly with some sort of a contract. It is; therefore, imperative that contract law and the contracts themselves be studied by the lease administrator.

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The Rules for Contract Interpretation

When courts become involved in contract disputes, they are called upon to determine the validity of either certain terms of the contract or the validity of the contract itself. Certain principles will guide the courts in their ultimate determination. They are:

1. The Statute of Frauds
2. The Four Corners Rule
3. The Parol Evidence Rule
4. Breach of the Contract

The Statute of Frauds

In 1920 William Payson Richardson professor at the Brooklyn Law School, St. Lawrence University authored the "Principles of Law of Contract." Herein he wrote, "The most important statute every promulgated, either in England or in this country, is the celebrated Statute of Frauds." The statute originated in England in 1677 and was originally entitled "An act for Prevention of Frauds and Perjuries."

The purpose of the statute was to prevent loss caused from fraudulent behavior, particularly associated with false testimony (perjury) regarding the sale or transfer of lands or property wherein no written deed was ever secured. In an attempt to reduce this type of fraud, England enacted a statute that required certain contracts be in writing.

Generally, the statute requires the following:

1. The contract must identity the parties involved.
2. The contract must detail the provisions, terms and conditions of the agreement.
3. The contract must adequately state the purposes and subject matter of the agreement.
4. The contract must have a legally sufficient legal description.

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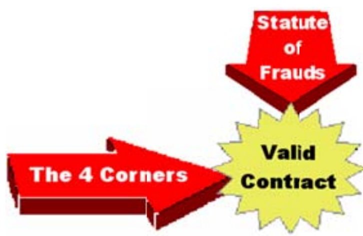
Additionally, oil and gas contracts that involve the transfer of real property must be in writing or they may be voidable.



The Four Corners Rule

If a court is called upon to determine the validity or meaning of certain terms or conditions in a contract, they will refer to the "four corners rule." In other words, they will examine the entire contract (the four corners) in an attempt to understand the meaning and outcome of a particular term or condition.

It is as if the entire written agreement were contained in a square box. The meaning of certain conditions that appear in one corner of the box will be influenced by statements and conditions contained in other corners of the box.

Additionally, if it is determined that, on its face, the contract is complete no external evidence can influence the meaning of the condition. Courts are required to interpret the meaning and conditions of a provision based solely on the overall meaning and intention of the entire agreement.

When examining one lease obligation the terms and obligations of the entire lease must be understood. This concept becomes a critical piece of mastering lease obligations.

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Example 1 – The Four Corners and The Granting Clause

The first paragraph of most oil and gas leases contains the *granting clause*. It is here where the lessor sets out and defines what exactly is being granted to the lessee.

Granting Clause

... 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,

In this lease, the language specifies *"oil (including but not limited to distillate and condensate), gas (including casinghead gas and all other constituents), and all other hydrocarbons"*.

Not all leases have this particular granting language. Many leases simply state, *"all oil and gas"* or *"all oil, gas and other minerals."* That type of granting language is very *general* in nature. Often courts have been asked to step in and interpret what constitutes *"other minerals"*. To add to the confusion, states differ on their interpretation of what constitutes *"oil, gas or other minerals"*.

If the lease uses this general language but later describes specific substances, the general statement becomes limited in nature to the specific substances described.

Examine the following granting clause. This language does not even mention "other minerals"...

OIL, GAS AND MINERAL LEASE

(PAID UP)

AGREEMENT, Made and entered into this 3rd day of July, 2008, by and between VENITA BENTLY, a single woman dealing with her sole and separate property, Party of the first part, hereinafter called Lessor (whether one or more), whose post office address is PO Box 44, Sayre, Oklahoma 73662, and A COMPETITOR Oil Company, Party of the second part, hereinafter called Lessee, whose post office address is 123 Main St Denver, CO 80222

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 all oil and gas 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 Van Zandt, State of Texas, described as follows, to-wit:

The North 134.77 acres of the west 277 acres of Block A-2, Section 77, Abstract #75,
Southern Union Railroad Company Survey, in Van Zandt County, Texas

together with all strips 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 term of three years from date (herein call 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 three-sixteenth (3/16) part of all oil (including but not limited to condensate and distillate) produced and saved from the leased premises.

2nd. To pay lessor for gas of whatsoever nature or kind (with all of its constituents) produced and sold or used off the leased premises, or used in the manufacture of products therefrom, three-sixteenth (3/16) of the net proceeds realized by Lessee for the gas sold, used off the premises, or in the manufacture of products therefrom, such net proceeds to be less a proportionate part of the production, severance and other excise taxes and the cost incurred by Lessee in delivering, processing, compressing or otherwise making such gas merchantable, said payments to be made monthly.

3rd. To deliver to the credit of lessor the one-eighth (1/8th) part of all other substances including coal, potash, and sulfur produced from the leased premises.

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.

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 640 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. 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.

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.

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.

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, if lessee is required, ordered or directed by such to cease drilling operations, reworking operations or production 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 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.

IN TESTIMONY WHEREOF, we sign this the ________ day of ________, 2008.

X________________________ X________________________

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Question: Would this lease cover coal?
____
____

Using the Four Corners Rule, examine the wording found in the royalty clause of the lease and determine if coal would be covered by the terms of this lease.

Royalty Clause

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.

3rd. To deliver to the credit of lessor the one-eight (1/8) part of all other substances; including coal, potash or sulfur produced from the leased premises.

The royalty clause may make specific references to the types of minerals being granted.

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Example 2: The Four Corners and the Delay Rental Clause

Assume your company has a delay rental lease that says the following:

Delay Rental Clause

This lease shall terminate on _______July 1st_________ 20 __10__ unless on or before said date the Lessee either (a) 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 (b) 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,

What does commencing operations really mean?

____

____

In another portion of the lease you read this language:

This lease shall terminate on __July 1, 2010__ unless on or before said date Lessee completes drilling operations for the drilling of a well on the land, or on acreage pooled therewith, in search of oil, gas or other minerals.

Now, what does commencing operation mean?

____

____

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Example 3: The Four Corners and the Royalty Clause

The royalty clause is that portion of the lease which sets out the fractional amount of production due the lessor. This can also be referred to as "leasehold royalty".

In the example language, the lessor negotiated a different fractional amount of oil (1/8th) than for gas (3/16th). This interest is cost free to the lessor meaning that the lessor bears no costs associated with the drilling of any well. Those risks and costs are borne entirely by the lessee.

Royalty Clause

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 (including but not limited to condensate and distillate) 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.

Sal Small owns an undivided 1/32 mineral interest in a 54.3 acre tract of land. He has 31 other siblings and cousins that each own an undivided 1/32 interest in the same tract of land. Assume your company leased each of the 32 parties granting each a 3/16th or 18.75% royalty (assume the royalty clause above represents each of the leases). According to the royalty clause your company has entered into a *COVENANT* to pay Sal and everyone else 3/16th of all the gas sold even though they only own a 1/32nd interest. This can become a significant issue. If you pay each of the lessors 3/16th or 18.75% of production your company would have to pay out 600% of all production to the lessors.

Sal Small, et al

The importance of the four corners rule would clearly apply here. The drafters of the lease would have added additional language elsewhere to take care of this problem. What other language in the lease could address this major issue?

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Example 4: How the Four Corner's Rule is impacted when language is deleted from the lease

Assume your Company has taken a 160 acre lease that has been pooled into a 640-acre unit. This is the only lease your company owns in the unit. At signing, the lessor negotiated a 18.75% royalty and also deleted the following language. What could be the result if your company drilled on this tract of land?

~~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.~~

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Answers to the Four Corners example:

Example 1: If a lease uses general granting language such as "oil and gas" and then later describes specific substances, the general statement becomes limited in nature to the specific substances described. In this example, the royalty clause in the lease stated that the mineral owner would be entitled to a fractional percent of all coal; therefore, this lease would cover coal.

Example 2: In this example, one clause mentions the term "commencing operations" but because another clause defines the term. Courts would hold the oil company to be in strict compliance with the definition found in the lease.

Example 3: This is a prime example of the absolute importance of the four corners rule. The royalty clause states categorically that the lessee will pay the lessor the exact fractional percentage of the royalty as stated in the clause. However, another clause, the proportionate reduction clause, states that this percentage is to be based only to the proportionate part of the tract of land that is owned by the owner. If the proportionate production clause had been deleted, the oil and gas company would never be able to make a penny on this well.

Example 4: This is another example of the absolute importance of the four corners rule. If the cited lease had the pooling clause deleted, the oil company would have only one course of action in how they were going to pay the lessor. Even if the lease had become a part of a unit that comprised other tracts of land, the oil company must pay the lessor the full royalty amount not proportionately reduced by the size of the unit.

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SCENARIO #1

THE FOUR CORNERS RULE

AND

THE VENITA BENTLY LEASE

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Assume that a "Competitor Oil Company" has acquired a lease from Venita Bently. The lands are in a very productive but competitive area. The bonus amount paid to the lessor by the competitor company was $500 per acre. It is a three year lease with an effective date of July 3, 2008.

Your company's land broker was checking ownership records in the same county and did not see this lease filed of record. (The competitor company had not yet recorded the lease.)

Your field landman made contact with Venita Bently. Explaining that no current oil and gas leases appeared in the court house records, the landman offered to pay MS Bently $750 an acre on a 1 year lease. She said nothing about the competitor's lease and agreed to the terms and signed a lease with your company dated January 1, 2011.

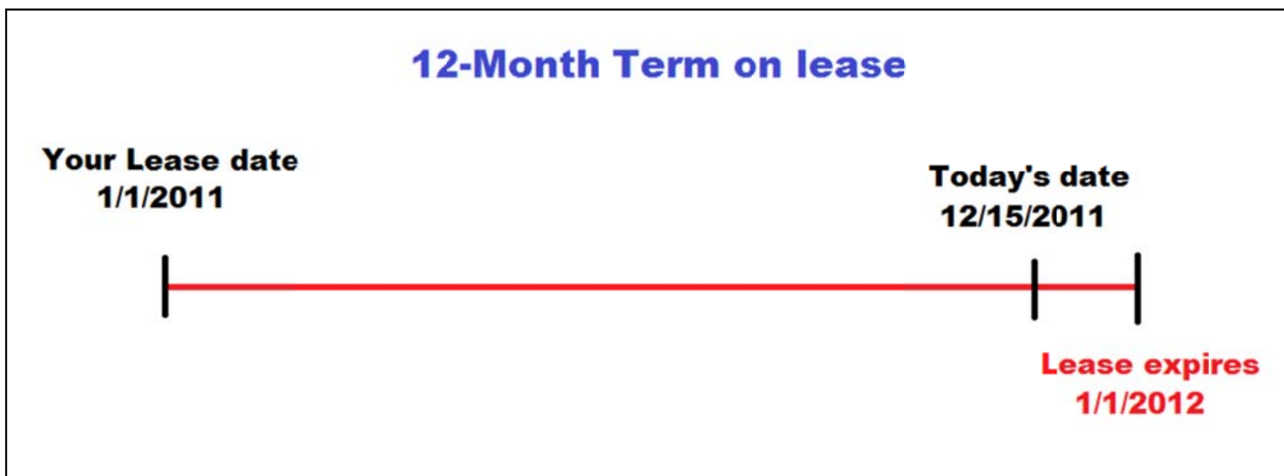
Your lease was immediately filed of record (see lease on next page).

Notice that the broker used a delay rental form lease. Because the lease was going to be a 1-year lease, the broker deleted the delay rental clause and typed "Paid Up" in the right-hand corner.

Upon finding out about your company's lease, the competitor company was furious. Their Bently lease covered a proposed drill site location. Upon approaching MS Bently, she simply replied, "I thought I had leased one tract of land to your company and another tract of land to another company. I'll give your bonus money back, if you want!"

The competitor company wanted the lease rather than their bonus back. So, they offered to top lease the Bently land with an effective date of January 2, 2012.

Assume that today's date is December 15, 2011, two weeks before your company's lease expires. You plan to begin commencing operations by building a location in three days.



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OIL, GAS AND MINERAL LEASE

V.B. Paid Up

AGREEMENT, Made and entered into this 1st day of January, 2011, by and between VENITA BENTLY, a single woman dealing with her sole and separate property, Party of the first part, hereinafter called Lessor (whether one or more), whose post office address is PO Box 44, Sayre, Oklahoma 73662, and YOUR Oil Company, Party of the second part, hereinafter called Lessee, whose post office address is 124 Main St Denver, CO 80222

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, gas, 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 Van Zandt, State of Texas, described as follows, to-wit:

The North 134.77 acres of the west 277 acres of Block A-2, Section 77, Abstract #75,
Southern Union Railroad Company Survey, in Van Zandt County, Texas

together with all strips 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 term of ~~three years~~ from date (herein call primary term) and as long thereafter as oil or gas, or either of them, is produced from said land by the lessee. one year V.B.

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 three-sixteenth (3/16) part of all oil (including but not limited to condensate and distillate) produced and saved from the leased premises.

2nd. To pay lessor for gas of whatsoever nature or kind (with all of its constituents) produced and sold or used off the leased premises, or used in the manufacture of products therefrom, three-sixteenth (3/16) of the net proceeds realized by Lessee for the gas sold, used off the premises, or in the manufacture of products therefrom, such net proceeds to be less a proportionate part of the production, severance and other excise taxes and the cost incurred by Lessee in delivering, processing, compressing or otherwise making such gas merchantable, said payments to be made monthly.

V.B.

~~This lease shall terminate on ______ 20___ unless on or before said date the Lessee either (1) commences operations (and operations shall be defined as building a wellsite location) for the drilling of a well on the land, or on acreage pooled therewith, in search of oil, gas and other minerals and thereafter continues such operation and drilling to completion or abandonment; or (2) pays to the lessor a rental of ____ 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.~~

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 640 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. 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.

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.

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.

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, if lessee is required, ordered or directed by such to cease drilling operations, reworking operations or production 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 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.

IN TESTIMONY WHEREOF, we sign this the 1 st day of January, 2011

X Venita Bently X __________

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Today, December 15, 2011, in an attempt to stall your operations, the competitor company filed a Temporary Restraining Order against your company. The Restraining Order has caused a judge to limit all operations until the matter has been reviewed. Because of this event your operations cannot begin prior to January 1, 2012, the expiration date of your lease.

By using the Four Corner's Rule, examine your lease and determine what options are available for your company. HINT: look at the bottom portion of the lease and find the Force Majeure Clause.

All express or implied covenants of this lease shall be subject to all Federal and State Laws...and this lease shall not be terminated, in whole or in part, if lessee is required, ordered or directed by such to cease drilling operation ... on the land covered by this lease *or if lessee by force majeure is prevented from conducting drilling operations* ...,

then

until such time as law, order, rule, regulation, request or force majeure is terminated and for a period of 90 days after such termination each and every provision of this lease that might operate to terminate 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 lease.

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How would this language affect the circumstances surrounding your ability to drill a well?

____
____
____

In essence, with this language, the competitor did your company a favor.

How many days after the end of the force majeure would your company have in order to begin operations?

____
____

Assume that 85 days after the force majeure ended, your company did commence operations and completed a very successful oil well. The completion date was 160 days after the force majeure.

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Ninety days after the completion of the well, Venita Bently sent the following "Demand Letter" to your land manager.

Venita Bently

PO Box 44

Sayre, Oklahoma 73662

YOUR Oil Company

124 Main Street

Denver, Colorado 80222

RE: Demand for a Release of Oil and Gas Lease

Dated: January 1, 2011

To whom it may concern,

Referencing the above captioned oil and gas lease executed by Venita Bently, lessor and YOUR Oil Company, Lessee, dated January 1, 2011 and recorded in Van Zandt, Texas, please be advised that said lessor demands a release of said oil and gas lease.

Examine the Habendum Clause in your lease. What is she getting at? Why would she feel that your lease was terminated?

____

____

____

____

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Habendum Clause or Term Clause

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

This is standard language found in many leases.

List the *thereafter* conditions in the Habendum Clause:

____

According to the conditions, does actual production need to be in place by the end of the primary term in order for the secondary term of the lease to take place?

- ☐ Yes
- ☐ No

If a well was commenced during the primary term but not completed until after the primary term, has the lease terminated?

- ☐ Yes
- ☐ No

The answer to these questions differs from state to state or from court to court. Most courts have found as follows (Oklahoma Court):

> "This court has steadfastly held to the rule that an oil and gas mining lease having a definite and fixed term limited with a 'thereafter' clause 'as long as oil or gas or either of them is produced upon said lease by the lessee' terminates not by forfeiture, *but by its own terms, at the end of the fixed period* *unless oil or gas is found or produced there from*, in the absence of the lessee having specifically provided against such contingency by an appropriate term in his lease contract."

For leases in Oklahoma and West Virginia, as long as discovery and completion of either *oil* or *gas* has occurred, termination will not occur at the end of the primary term. Production does not need to be in place – only a good faith effort to produce.

Other states embrace only a portion of this view. For leases in Montana,

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Minnesota, Wyoming, Kentucky and Tennessee, termination will not occur at the end of the primary term as long as discovery and completion of *gas* has occurred. Production of gas does not need to be in place – only a good faith effort to produce. Oil wells fall into a separate category and must be producing during the primary term.

Texas – in Skelly Oil Company vs. Harris, 163 Tex. 92, 352 S.W.2d 950 (1962), 15 O&GR 653 at the expiration of the primary term, an oil and gas lease terminates as a matter of law unless there is actual production, or a contractual substitute for production such as drilling operations, or payment of shut in gas royalty. Joining Texas in this similar view is Louisiana, New Mexico, Kansas, Illinois, Michigan, Ohio, Arkansas, Mississippi and North Dakota. A payment of shut-in gas royalty will hold these leases past the primary term.

Shut-in gas payments will not perpetuate a lease if a shut-in well is not capable of production. So to, a minimum royalty payment will not serve to perpetuate a lease if the lease is not otherwise producing. Minimum royalty payments are not a substitute for production. While shut in gas royalty payments will be considered as substitute production under certain circumstances, the law of each state where the property is located must be consulted to determine the lessee's rights in this regard.

Today, most states hold that in order for the lease to pass into the secondary term, *actual production* must be in place prior to the last day of the primary term.

Apart from an express contractual agreement allowing for drilling beyond the primary term or a well completion clause, states such as Texas, Louisiana, New Mexico, Mississippi, North Dakota, Michigan, Ohio and Illinois would not permit a company to begin drilling on the last day of the lease.

Thankfully, most all leases contain additional language in other clauses that will allow the company to begin drilling during the primary term and continue drilling past the expiration date until the well is completed.

Using the Four Corner's rule, examine all parts of the Vanita Bently lease. Can you find such language in your Company's lease? If not, what is the outcome? If you were the Lease and Title Analyst, what advice would you give your field broker? What lessons have you learned?

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Answer to scenario #1: The Four Corners Rule and the Venita Bently Lease:

Under the terms of the lease, this lease would have terminated due to the absence of production from the well during the Primary Term of the lease. Most all leases will make a provision for this so that a company could begin drilling during the primary term and continue to drill past the primary term. This lease contained that provision but it was deleted by the field landman when he struck the delay rental clause.

This exercise demonstrates three important elements of lease administration. First, it demonstrates the impact of language in one part of the lease and how it can impact language in another part of the lease. Secondly, it demonstrates the need to examine all clauses of the lease that have been deleted or altered. Lastly, it highlights the importance of NOT altering a lease electronically, printing it out with altered and omitted language and having it signed that way. For those who become the guardians of the leases, they must be able to spot any potential issue with altered language in the lease.

In this example, the "Force Majeure Clause" did extend the Primary Term by 90 days + 2 weeks; however, the well was not completed until 160 days after the end of Force Majeure; therefore, failing to comply with the "Habendum Clause", which requires that there be production associated with the well during the Primary Term to perpetuate the lease into the Secondary Term.

Essentially, your company is in the same situation as they were before the Temporary Restraining Order was filed. They still do not have a completed well that was producing oil or gas during the Primary Term of the lease. Had they completed the well before the 90 days + 2 weeks period ended and the well was a producing well, they would have met the terms of the lease and the lease would have been Held by Production (HBP).

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Scenario #2

The Four Corners Rule

and

The Elmer Berchard Lease

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Assume Elmer and Emily Berchard are your grandparents. Fifteen years ago they leased a large tract of land to Sunrise Oil & Gas.

Elmer asked Sunrise to keep drilling activities east of the stream. Nothing to that effect was written in the lease. There was no Pugh Clause language added to the lease nor is this land in a Statutory Pugh Clause State.

Three years into the primary term, Sunrise began drilling deep wells on lands east of the stream. The wells are producing in the secondary term of the lease and the average royalty check sent to the Berchard does exceed $20,000 per month.

Boundary of the Berchard Lands

Stream

Neighboring Tract of land

Deep wells

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The following is the oil and gas lease that Elmer Berchard signed with Sunrise Oil and Gas.

OIL, GAS AND MINERAL LEASE

(PAID UP)

AGREEMENT, Made and entered into this 3rd day of July 1995 by and between Elmer and Emily Berchard, a married couple, Party of the first part, hereinafter called Lessor (whether one or more), whose post office address is PO Box 44, Sayre, Oklahoma 73662, and Sunrise Oil Company, Party of the second part, hereinafter called Lessee, whose post office address is 123 Main St Denver, CO 80222

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 all oil and gas 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 Van Zandt, State of Oklahoma, described as follows, to-wit:

Township 131 North, Range 55 West, 6th P.M.

Sections 10, 11, 12, 13,14, 15 containing 3,840

together with all strips 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 term of five years from date (herein call 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 three-sixteenth (3/16) part of all oil (including but not limited to condensate and distillate) produced and saved from the leased premises.

2nd. To pay lessor for gas of whatsoever nature or kind (with all of its constituents) produced and sold or used off the leased premises, or used in the manufacture of products therefrom, three-sixteenth (3/16) of the net proceeds realized by Lessee for the gas sold, used off the premises, or in the manufacture of products therefrom, such net proceeds to be less a proportionate part of the production, severance and other excise taxes and the cost incurred by Lessee in delivering, processing, compressing or otherwise making such gas merchantable, 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 no 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 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.

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 640 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. 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.

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.

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, if lessee is required, ordered or directed by such to cease drilling operations, reworking operations or production 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 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.

IN TESTIMONY WHEREOF, we sign this the 3rd day of July, 2008.

X Elmer Berchard X Emily Berchard

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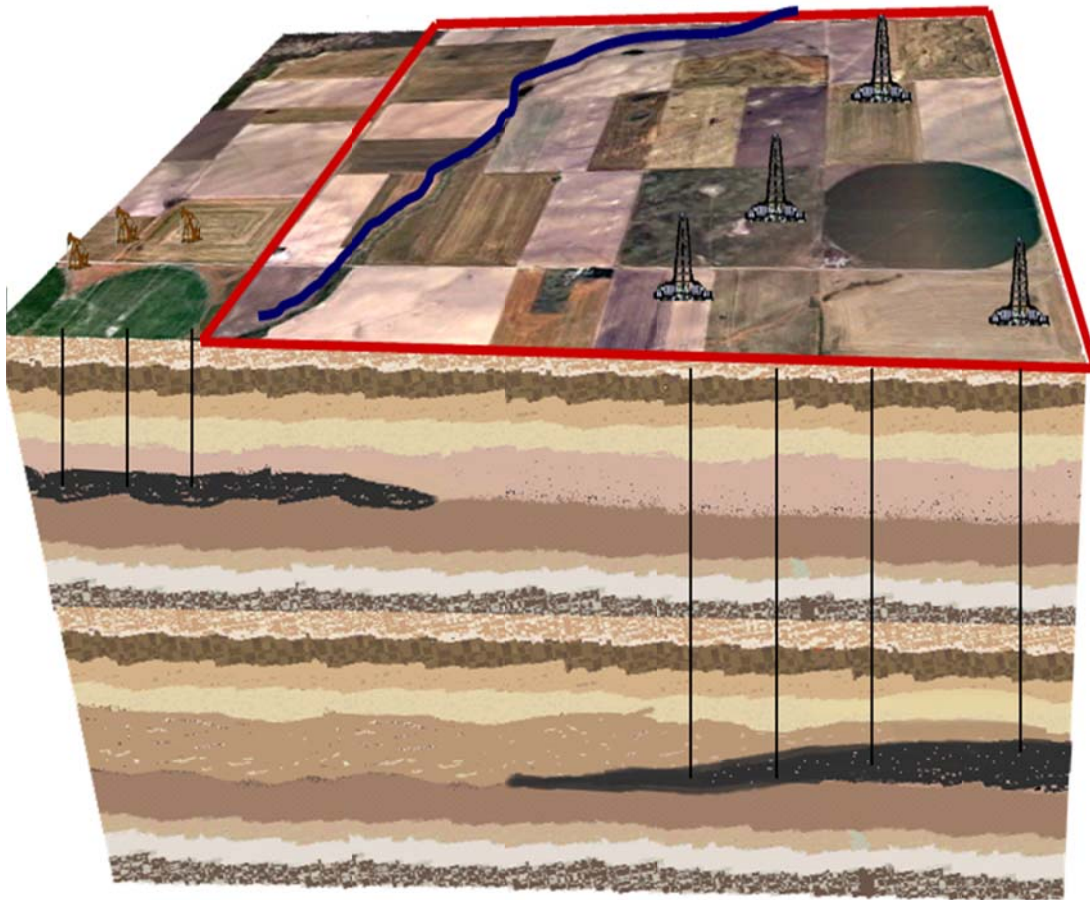
Two years ago, Provision Petroleum, a competitor company, began drilling shallow wells west of the fence on a neighbor's tract of land.



Sometime ago, Mr. Berchard met Sunrise's pumper and asked him when Sunrise was going to begin drilling shallow wells on his land.

The pumper replied, "I'm not sure. You should call Sunrise's land manager."

Mr. Berchard said, "If you want, you can drill shallow wells on the lands west of the stream."

Elmer Berchard did call the land manager. When his phone calls were not returned…he wrote a letter asking the same question.

On more than one occasion, Provision Petroleum has asked Sunrise to farmout their shallow rights as to the lands west of the stream. Sunrise has rejected such farmout attempts and their land manager has written the following memo to upper management:

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MEMO: Upper Management
RE: Farmout offer of Berchard Lease shallow rights

"Our geologists and engineers believe that the economic terms of such farmouts are not favorable and I do not think it wise to divide the ownership on stratigraphic grounds since there is no pressing need to farmout any of the lease. The lands are HBP."

Last month, a Provision Petroleum Landman offered to top lease the Berchard lands west of the stream. After the meeting, Elmer called you. He was confused. He wants to know your opinion. Should he, can he sign this new lease?

If Elmer were your grandfather, what advice would you give him? Is Sunrise in jeopardy of losing the lease? It does not seem that the current production on your grandfather's land is going away any time soon, so what is Provision Petroleum up to? If he signs a top lease with them, can they drill wells west of the stream? Is Sunrise acting as a prudent operator? What does that mean? If your grandfather really wanted shallow wells drilled on his land, what options are available to him? If drainage of your grandfather's minerals is taking place, what does that mean? If drainage is taking place, what responsibility would Sunrise have to your grandfather?

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The Difference between a Condition and a Covenant

It is important that the lease administrator understand the difference between a *lease condition* and a *lease covenant*. Although both are similar in nature, to breach a *condition* would mean a definite automatic termination of the lease but to breach a *covenant* might simply give rise to a suite for damages.

A ***condition*** will set forth a *condition of fact* or action that must exist or not exist before another essential provision in the contract takes place. An example would be found in the habendum clause in the Vanita Bently lease.

> "It is agreed that this lease shall remain in force for a term of 1 year and as long thereafter as oil and gas is produced."

In this case, if production was occurring at the end of the 1st year (*the condition of fact*) the lease would continue "as long thereafter" (the other essential provision.)

Another example of *conditional* language is found in the delay rental clause.

> "This lease shall terminate on July 1 unless on or before said date the Lessee either commences operations for the drilling of a well or pays to the lessor a rental of $1 per acre..."

The *condition of fact* is either operations or a rental payment. This *condition of fact* is tied to the continuation of the lease which is the other essential provision.

Another example can be found in the following Pugh Clause:

> "If a drilling and production unit be created and established, pooling and combining a portion of the lands covered by this lease with other lands, lease or leases in the vicinity thereof, then drilling or production operations shall continue this lease in force and effect after the primary term only as to the lands covered hereby which are included in such unit."

The *conditions of fact* follow the word "If." The other essential provision follows the word "then."

A ***covenant*** in the lease is a promise or an obligation made on the part of the lessee who makes a pledge that certain things will be done or will not be done.

> "Lessee agrees not to drill a well closer than 500 feet from any structure"

> "Lessee agrees to pay surface damages, to clean up the well site and repair all roads"

> "Lessee *covenants* and agrees to pay lessor 3/16ths of all oil..."

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If the promise or obligation is not met, the lessee is in breach of the contract; however, this breach does not automatically terminate the lease. Rather, lessee is liable for damages. Usually, these damages are tied to the amount of money or action required to put the lessor in the same situation it would have been in if the *covenant* had not been broken. The breach of a *covenant* is not grounds for termination. The contract remains binding and only damages are recoverable for the breach.

As seen above, the royalty clause is an example of a *covenant* in the lease. Most leases even use the word *covenant* as it sets out the negotiated royalty rate.

> "In consideration of the premises the said lessee *covenants* and agrees: to deliver to the credit of lessor free of cost, in the pipe line, the 3/16th part of all oil…"

This language creates a promise to pay royalties in the stated amount. If the operator paid these royalties differently, the *covenant* would have been breached but the lease would not have been lost.

With that being said, in Waggoner Estate v. Sigler Oil Co, 19 S.W.2d 27, the court said, "The usual remedy for breach of the lessee's *implied covenant* for reasonable development of oil and gas is an action for damages, though, under extraordinary circumstances – where there can be no other adequate relief – a court of equity will entertain an action to cancel the lease in whole or in part."

From time to time, the shut-in royalty clause can be written as either a condition of title or a covenant of title. Consider the following language:

> "When gas from a well capable of producing gas is not sold or used, Lessee shall pay a royalty to the royalty owner of $1 per year per net mineral acre hereunder. If such payment or tender is made, it will be considered that gas is being produced within the meaning of this lease."

In this case, the *conditions of facts* are that a gas well has been shut-in and that the shut-in royalty has been paid. These facts are tied to the next essential provision which is that making the payment is considered the same as if gas is being produced. If gas was not produced, the lease would not continue into the "thereafter" phase found in the habendum clause and the lease would terminate.

Consider the following shut-in language and determine if it sets forth a condition or a covenant.

> "Lessee shall be obligated to pay or to tender to Lessor, on or before the anniversary date of this lease following the shutting-in of such well, and annually thereafter, while such well is so shut-in, a royalty payment in the sum of $100 per well."

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This clause states that the lessee "shall be obligated to pay" the shut-in payment; however, this is more of an obligation or promise. There is nothing in the language that connects the lack of payment to any other provision or to termination if the payment is not made. In other words, the lessee is obligated to pay and if the payment is missed, the lessee is in breach of the contract; however, this breach does not automatically terminate the lease. Rather, lessee is liable for damages. Usually, these damages are tied to the amount of money or action required to put the lessor in the same situation it would have been in if the *covenant* had not been broken.

Implied Covenants

As the phrase *implied covenants* suggests, the covenants are not written within the body of the lease, rather they are *implied* by the lease itself. Therefore, courts have found that oil companies are bound and obligated to the lessor by these covenants, as if they *had* been written within the four corners of the lease. As would make sense, these covenants are weighted more heavily in the favor of the mineral owner than the oil company.

Courts found that the very act of signing a lease established a statement of cooperation between both the lessor and the lessee. This principle of cooperation exits in all contracts and basically states that both parties have joined into a venture in order to accomplish the purpose of the agreement. This principle of cooperation also establishes the belief that each party agrees to do whatever is "reasonably" necessary to create financial success from the mineral lands. For the oil company, that means making a reasonable attempt to develop and produce the lease in order for the lessee to receive benefits from such development. It was this belief that gave way to the covenants as we know them today.

Since this principle of cooperation establishes the belief that both parties agree to do whatever is reasonably necessary, courts, when called upon to rule in these matters, attempt to find an outcome that is fair to both parties.

An Early Landmark Case

In Brewster v. Lanyon Zinc Co., one of the early cases dealing with implied covenants, the court stated:

> "It is conceded, as indeed it must be, that the lease contains no express stipulation as to what, if anything, should be done in the way of searching for and producing oil or gas after the first five years; but it does not follow from this that it is silent on the subject, or that the matter is left absolutely to the will of the

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lessee. Whatever is implied in a contract is as effectual as what is expressed. Implication is but another name for intention, and if it arises from the language of the contract…it is controlling."

The Implied Covenants in the Oil and Gas Lease

The Implied Covenant to Develop the Leasehold

The oil and gas lease implies an obligation on the part of the lessee to finish the job they first began. Once a discovery well has been located, there exists an implied duty to continue the development of the exploration for the oil or gas underlying the leased premises. Stopping short of that, the oil company could be found in breach of the lease.

One of the standards by which the courts will make its ruling is the "Prudent Operator Standard". And the courts will ask this question, "Given these circumstances what action or inaction would a prudent operator normally take?"

The three-fold obligations defining a prudent operator are:

- A prudent operator will act in good faith
- A prudent operator will act competently
- A prudent operator will take into account the legitimate interests of the lessor.

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The Implied Covenant to Protect the Leasehold from Drainage

Another implied covenant requires that the Lessee act appropriately when drainage is occurring from their lessor's lands. The guidelines used to determine this fact are:

- Can it be shown that substantial drainage is occurring?
- Can it be determined that an offset well would most likely be profitable?
- Under the same circumstances would a reasonable prudent operator drill an offset well?

If it can be determined that (1) drainage is occurring; that (2) an offset well would be profitable and that (3) a prudent operator would drill such a well, then the Lessee could be required to drill a well in order to stop the drainage. Apart from drilling another well, other options might include compensating the lessor for lost revenue or pooling the lessor's lease with other leases.

Burden of Proof

In order to establish the three facts as set out above, the burden of proof rests entirely on the shoulders of the lessor. Such proof must be in the form of technical evidence.

In a case where demands are made to drill another well but the operator still fails to stop the drainage by drilling, the courts might grant the operator a conditional cancellation of the lease and give them one last chance to drill a well. Apart from that, three decisions might follow:

1. The lease will no longer cover undeveloped acreage.
2. The lessor could be awarded damages.
3. The lessor could be awarded damages combined with the loss of acreage.

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Answer to scenario #2 - The Four Corners Rule and the Elmer Berchard Lease:

First, Mr. Berchard needs to understand his legal position. In addition to the terms explicitly stated in the lease with Sunrise Oil and Gas, Sunrise is obligated to perform under implied covenants that courts have established. Primarily, the implied covenants were established to protect the lessor's rights, and they were weighted toward the lessor rather than the lessee. Generally, courts will interpret a document more favorably toward the party that did not draft the document as that non-drafting party is seen as holding the weaker position.

When Mr. Berchard and Sunrise signed the lease, both parties entered into the lease in a spirit of cooperation. This spirit of cooperation existed because both parties contracted to accomplish the purpose of the contract. In this case, both agreed to do what was reasonably necessary to derive financial success from the mineral rights that were leased.

Courts have established only a handful of implied covenants in oil and gas leases. Three of them are, (1) to develop the leasehold; (2) to protect the leasehold from drainage; and (3) to market the product.

The lessee has a duty to continue the development of the lease and continue to explore for oil and gas even after a well has been drilled and is producing. The oil and gas lease implies an obligation on the lessee to finish the job that the lessee began. If not, the lessee may be found in default. Because of this, a court may not take a favorabe view of the land manager's memo stating that ". . . there is no pressing need to farmout any of the lease." If the lessee does not continue development, the courts could find that the lessee is in default on the lease. Courts judge the lessee on the "Prudent Operator Standard." A prudent operator acts in good faith, acts competently, and takes the lessor's legitimate interests into account.

Another of the implied covenants is protection of the leasehold from drainage. The lessee must act appropriately when drainage is occurring from the lessor's land. If the lessor believes that the lessee is not acting appropriately, the lessor could file a lawsuit and attempt to prove that substantial drainage is occurring, that an offset well would most likely be profitable, and that a reasonable operator under the same circumstances would drill an offset well. The court might order the lessee to drill an additional well to stop drainage, compensate the lessor for lost revenue from the drainage, or pool the lessor's lease.

Alternatively, the landowner who wants to protect land from drainage must develop their own land through drilling their own well. In this case, Mr. Berchard has leased the minerals to Sunrise and does not have the option of drilling his own well.

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Also, Mr. Berchard needs to understand the concept of a top lease. A top lease is a lease that is signed after a valid lease is in effect. The lease would become effective the moment that the first lease expired or was terminated. At this time, Mr. Berchard and Sunrise Oil and Gas have an effective lease. If he signs a top lease with Provision Petroleum, the top lease would only be effective when the Sunrise lease was no longer effective. The existence of the top lease might help Sunrise to understand Mr. Berchard's seriousness about additional wells in the shallow horizon.

Mr. Berchard asked Sunrise to keep drilling east of the stream, but the lease did not have a clause detailing that Sunrise could only drill east of the stream. If Mr. Berchard filed a lawsuit against Sunrise, Sunrise could not use Berchard's request as a reason why they have not drilled west of the stream. The request would be parol evidence that the court would probably not consider since the court would confine themselves to the four corners of the lease. Unfortunately, for Mr. Berchard, the lease does not have a Pugh Clause that would release depths that were not drilled and producing.

If he signed a top lease with Provision Petroleum, then Provision Petroleum would probably provide the expert witness testimony that Mr. Berchard would need to show that Sunrise was not meeting the implied covenant to develop the lease or the implied covenant to prevent drainage. Of course, the court might also view the testimony by the Provision Petroleum experts to be not as credible since Provision Petroleum would have a financial stake in the court's ruling.

Sunrise would produce testimony in an attempt to prove that the economic terms of the farmout proposed by Provision Petroleum were not favorable to Sunrise and that Sunrise was acting as a prudent operator in developing the lease.

Lastly, Mr. Berchard should know that there would be no downside to signing the top lease with Provision Petroleum. It is legal, and it would not affect the existing lease. Even if he signed the top lease, Provision Petroleum would not have a right to drill on the lease until the Provision Petroleum lease was effective. It appears that the motivation of Provision Petroleum is to help Mr. Berchard. They want him to take Sunrise to court. If the court found in Mr. Berchard's favor and released the shallow lands, the Provision Petroleum lease would automatically become effective.

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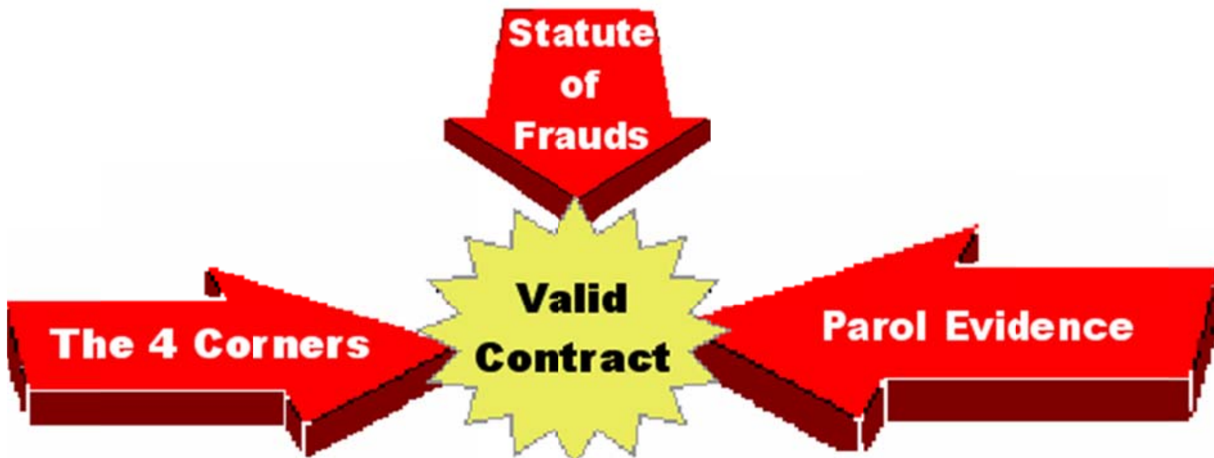
The Parol Evidence Rule



One of the basic rules of contract law is that if the court is attempting to determine the meaning and effect of a contract they must restrict themselves to the document itself. If it is determined that the contract was indeed a clear and complete statement of the terms and conditions as between the parties, the restriction does not allow the court to look at other extrinsic evidence such as prior agreements, side agreements, or verbal interactions either before or after the creation of the contract.

During the negotiation period of a contract, both parties will often make statements or promises that do not ultimately end up in the written contract. The "parol evidence rule" may exclude these oral statements as evidence that would have the effect of adding to or taking away from the terms of the written contract.

If terms or conditions in the contract appear to be clear and unambiguous, the court must accept the "plain meaning" of the terms and will not be influenced by outside evidence.

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SCENARIO #3

PAROL EVIDENCE
AND THE
EDWARD MATTHEWS LEASE

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Scenario 3: The Edward Matthews Lease

Assume a newly hired lease administrator had the responsibility of making a rental payment on a delay rental oil and gas lease. The rental terms of the lease state,

Delay Rental Clause

"This lease shall terminate on March 15, 2010 unless on or before said date Lessee either (a) commences operations for the drilling of a well on the land, or (b) pays the lessor a rental payment of $10 per acre for all or that part of the land the Lessee elects to continue to hold hereunder..."

On January 15, 2010 the lease administrator examined the Edward Matthews Lease. This is a very important lease because the company intends to drill on this lease within 18 months.

The lease administrator realized that a delay rental payment was due and requested a check in the correct amount. Thirty days later, on February 15, 2010, the accounting department cut the check and delivered it to the lease administrator for delivery.

That same day, the lease administrator called the lessor and explained that the payment was being mailed on that day. Immediately after the call, the lease administrator gathered up the rental payment along with several of her personal bills and drove them to the post office. While in her car, the rental payment fell unnoticed beneath the passenger seat of the car. Although the lease administrator believed the check was mailed, it is still sitting unnoticed between the seats in her car.

On March 17, 2010 Edward Matthews, the lessor, having not received the rental payment, believed the oil company was in breach of the lease contract and demanded a release of the lease.

Since this lease was a drill site location, the oil and gas company has taken the matter to court and asked the lease administrator to testify establishing proof that the check was issued; that a phone call was made, that the check was personally handed to the post office official and that a "good faith" effort was made to make the payment.

What would you consider to be the outcome of this scenario?

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Assume you had been the lease administrator; that you had been asked to testify in court in order to provide convincing evidence so that the lease was not lost. What would you say in court and what evidence you would provide? What could you prove? Lastly, determine the probable outcome of the case.

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Scenario 3a:

If the delay rental clause had included the following language, what would be the outcome?

> "If Lessee shall, on or before any anniversary date, make a bona fide attempt to pay or deposit rental to a Lessor entitled thereto according to Lessee's records or to a Lessor who, prior to such attempted payment or deposit, has given Lessee notice, in accordance with subsequent provisions of this lease, of his right to receive rental, and if such payment or deposit shall be ineffective or erroneous in any regard, Lessee shall be unconditionally obligated to pay to such Lessor the rental properly payable for the rental period involved, and this lease shall not terminate but shall be maintained in the same manner as if such erroneous or ineffective rental payment or deposit had been properly made, provided that the erroneous or ineffective rental payment or deposit be corrected within thirty (30) days after receipt by Lessee of written notice from such Lessor"

If the delay rental clause in the lease had contained this language, what would be the outcome?

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Answer to scenario #3 - Parol Evidence and the Edward Matthews Lease:

As already expressed, courts have not allowed a great deal of latitude when errors have been made on the part of the lessee. Because the delay rental clause expresses a conditional element that must be fulfilled, if the condition is not met, the lease will terminate automatically.

If the lessor accepts a late payment or payment less than the full amount, courts have viewed this as "inconsistent" with having the lease terminate and, therefore, might allow the lease to continue.

This was not the case with Edward Matthews, however, and everything that the lease administrator can prove in court would be considered parol evidence. It would appear that the lease has terminated.

The outcome would be different if the delay rental clause had been modified to include language such as, "If Lessee shall, on or before any anniversary date, make a bona fide attempt to pay or deposit rental to a Lessor entitled thereto according to Lessor's records or to a Lessor who, prior to such attempted payment or deposit, has given Lessee notice, in accordance with subsequent provisions of this lease, of his right to receive rental, and if such payment or deposit shall be ineffective or erroneous in any regard, Lessee shall be unconditionally obligated to pay to such Lessor the rental properly payable for the rental period involved, and this lease shall not terminate but shall be maintained in the same manner as if such erroneous or ineffective rental payment or deposit had been properly made, provided that the erroneous or ineffective rental payment or deposit be corrected within thirty (30) days after receipt by Lessee of written notice from such Lessor of such error accompanied by such instruments as are necessary to enable Lessee to make proper payment to Lessor."

Excuses that might be allowed and may not cause the termination of the lease vary to some degree from state to state:

Texas courts have permitted the following excuses:

- Confusion or ambiguity caused by the lessor
- Repudiation of the lease by the lessor

Kansas courts have permitted the following excuses:

- Lessor is attacking the lessee
- Payment sent on time but lost in mail

Oklahoma courts have permitted the following excuses:

- Checks mailed on or before the anniversary date but delivered after the date

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- A clerical error on behalf of a depository bank
- An improper payment made by an independent party over which the lessee has no control
- The mail service delivering check to the wrong bank

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