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558 Castle Pines Parkway, Ste B4-207  
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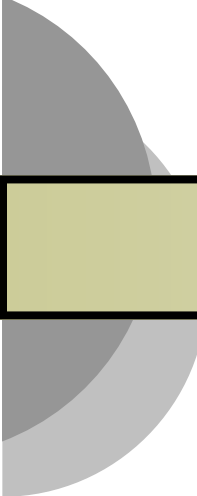
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1 (303) 663-0397



# 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.

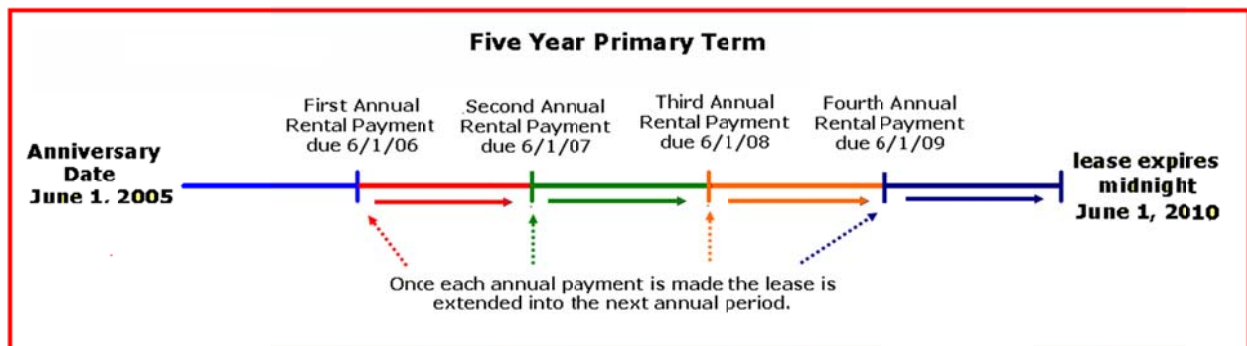
One might argue that the *production* from a great discovery well is a far greater asset than an oil and gas lease. Someone might even argue that the geologic *knowledge* gained from a multi-million dollar seismic shoot is a much greater asset than a simple piece of paper called an oil and gas lease. 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.

# The Delay Rental Clause

Most mineral owners who sign an oil and gas lease want the oil company to drill a well. For most, the sooner the well is drilled the better. Oil companies, on the other hand, may not be ready to begin operations within the first, second or third year of the lease. Although oil companies want to drill wells they must be strategic about the venture. So, in an attempt to accommodate both lessor and lessee, today's non-paid up leases are segregated into equal annual periods. Each of these periods begins on the anniversary date of the lease. During each of the annual periods, the oil company has the right, but not the obligation to begin the drilling of a well.

In those cases where operations have not begun, a delay rental payment must be made to the lessor either on or before the anniversary date of the lease. This payment is the only vehicle that can perpetuate the lease into the next annual period. This payment also allows the company another year in which they have the right but not the obligation to begin drilling.



## A Condition of Title

The language in the delay rental clause has created a *condition of title*. Therefore, the condition must be met or the lease terminates.

An Oklahoma District Court in *Latham v. Continental Oil Co* stated,

"Intention, good faith, or a mistake on the part of the lessee generally are not material and will not excuse the lessee's failure to strictly comply with said lease condition."

Which of the following excuses might a court allow if the rental payment was late?

- The late payment can be shown to be an "honest" mistake.

- The late payment was made in good faith and with right intentions.
- The rental payment was made on time but sent to the wrong payee.
- The rental payment was lost in the mail.

(**Answer:** Generally, the only excuse allowed would be that the rental payment was lost in the mail.)

## Can the Lease be Revived Once an Error is Made?

In answering this question, much caution should be used. As already expressed, courts have not allowed a great deal of latitude when errors have been made.

- 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.
- In cases where the lessor desires to have the lease revived, the only cure for making a faulty delay rental payment is through a ratification, more correctly called reviving the expired lease. A ratification or reviver must be signed by the Lessor.

- If the delay rental clause has 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 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 ...”

**Issue 1:** Your company has a very important oil and gas lease with a rental obligation due in sixty days. Your lease administrator reviewed the obligation last month and received the approval for the payment last week. The check, in the amount of \$640.00 was sent yesterday to the 1<sup>st</sup> National Bank of Oklahoma City, Oklahoma for the account of Jackson Wilson. The problem is the payment should have been sent to the 1<sup>st</sup> National Bank of Tulsa, Oklahoma for the account of Jackson Wilson. The good news is that the check was forwarded to the 1<sup>st</sup> National Bank of Tulsa, Oklahoma and

deposited into Jackson Wilson's account. However, the check arrived 2 days late. What is the status of the lease?

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Does the fact that the check was deposited change the status?

What if Jackson Wilson had deposited his check?

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**Issue 2:** Your company has a very large rental obligation due on March 12<sup>th</sup> for \$1,112.58. Your lease administrator reviewed the obligation ninety (90) days prior to the due date and had the payment approved sixty (60) days prior to the due date. The check request was submitted but the accounting department made a typographical error and the check printed in the amount of \$1,111.58. There was a \$1 error which was not caught prior to the mailing of the check. What is the status of the lease?

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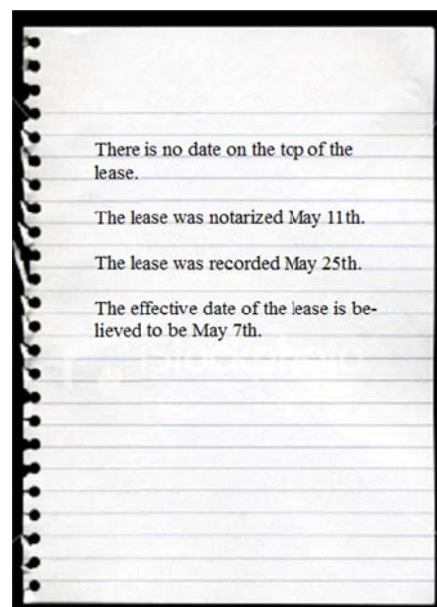
**Issue 3:** The landman who acquired your lease failed to enter a lease date at the top of the lease.

The lease was not notarized until May 11th and was not recorded until May 25th.

A rental payment is due.

On May 8th your lease administrator found the following hand written note in the files that stated.

A rental check was mailed May 8th.



**Did the lease terminate?**

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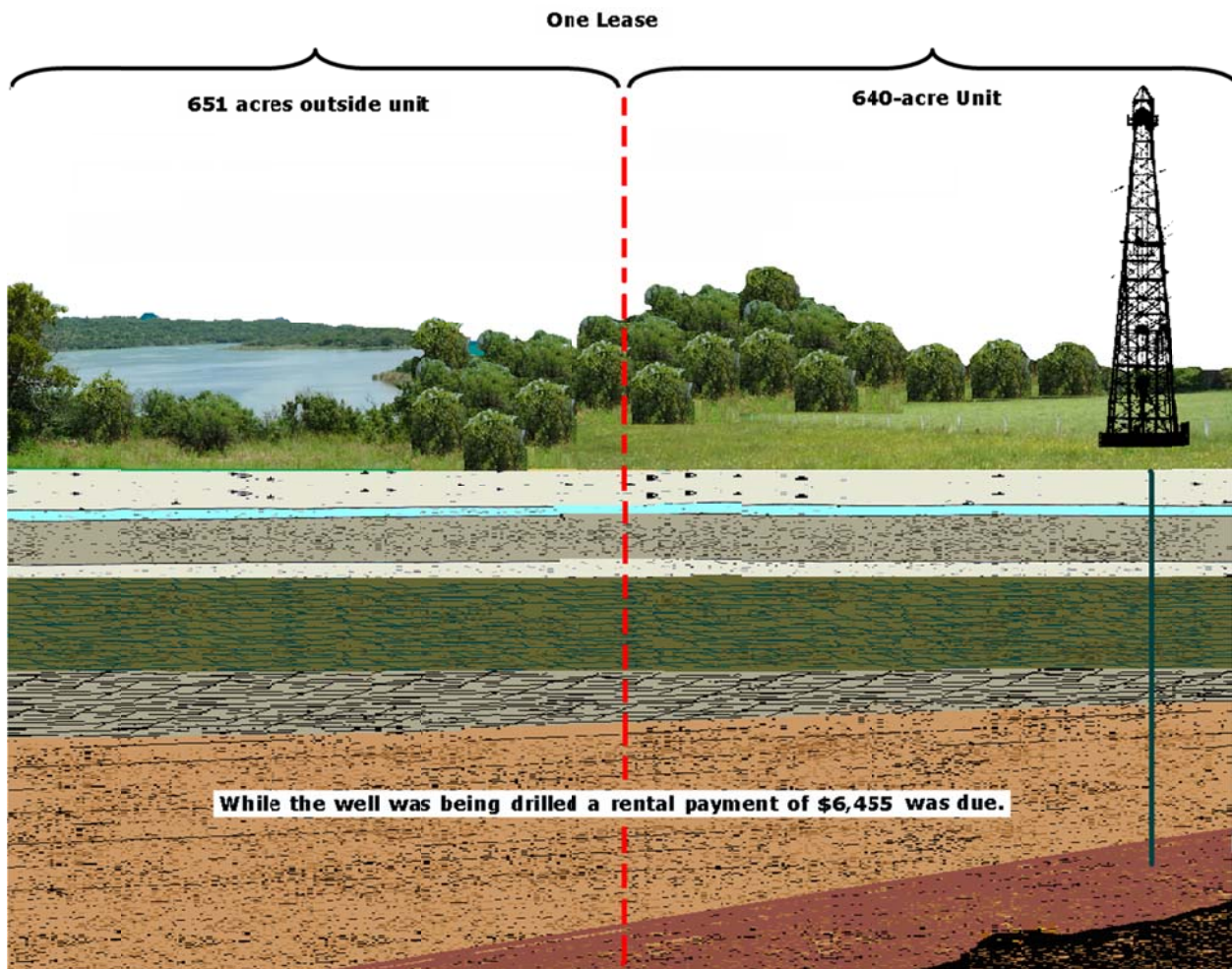
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**Issue 4:** Your company owns a lease that covers 1,291 acres. A 640 acre spacing unit has been formed on the E/2 of the lease and drilling of a well took place inside this unit boundary during the primary term of the lease.

While the well was being drilled, a rental payment of \$6,455 was due. Your company chooses not to make the payment because of the current operation on the lease.



The mineral owner complained, stating that you had violated the terms of the lease; that only half of the lease is inside the unit

**boundary and that a rental payment should have been made. Is the lessor correct? What is the status of your lease?**

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### **Answers to delay rental questions:**

**Issue 1:** Since most states enforce a stringent compliance with the contract language of the lease, they would permit few excuses, if any for this lease to be saved. They would not allow “honest” mistakes or an inadvertent error made on the part of the lease administrator. Because the language in this lease contract created a *condition*, the conditions must be met or the lease will terminate. When contract language is ambiguous or has more than one meaning, circumstantial evidence will be allowed; however, such circumstantial evidence would not be admissible in order to contradict the clear terms of the contract.

Since it appears that the files contained the appropriate bank address and location, if the error is not corrected prior to the anniversary date, the lease will terminate. On the other hand, if the check was addressed to the proper bank but the mail service delivered the check to the wrong bank, in Oklahoma, the lease would not be terminated. Excuses that might be allowed and may not cause the termination of the lease vary to some degree from state to state:

- Confusion or ambiguity caused by the lessor
- Repudiation of the lease by the lessor
- Lessor is attacking the lessee
- Payment sent on time but lost in mail
- Checks mailed on or before the anniversary date but delivered after the date
- 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

**What would be the outcome if Jackson Wilson had deposited the check?** \_\_\_\_\_

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.

For three years a company inadvertently underpaid the delay rentals to a lessor. The payment should have been \$80 for 80 net acres owned but the payment was sent in the amount of \$60. The lessor cashed each of the three checks. Ultimately, the lessor demanded the termination of the lease on the grounds that underpayment had been made. The North Dakota Supreme Court found that the acceptance by the lessor of the partial payment “validated the lease as to the 60 acres...and invalidated the lease as to the 20 acres.” *Borth v. Gulf Oil Exploration and Production Co.*, 313 N.W.2d 706 (N.D. 1981)

**Issue 2:** Even a \$1.00 error will cause the lease to be terminated.

**Issue 3:** If the rental clause specifically stated that the lease would terminate on May 7th then the payment would be late and the lease is terminated. In cases where the date is missing at the top of the lease and no date appears in the rental clause, the rental due date becomes the date of execution or acknowledgment. In this case the lease would not have terminated.

**Issue 4:** The answer will depend on two issues. First, did the lease contain Pugh Clause language that would necessitate a rental payment on the 651 acres outside the unit? If there was no such language, the drilling of the well on the west 640 acres would hold all lands covered in the lease and no payment should be made.

Secondly, was it determined that the well was capable of producing in paying quantities during the lease year. If the well turned out to be a dry hole, your company would most likely be obligated to make a rental payment on the remaining days in the lease year. If a situation like this occurs and it becomes unclear on how to pay the rental, the best rule of thumb is always to overpay rather than risk underpayment.

# A Defective Acknowledgment

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## An acknowledgment

The certificate of acknowledgment must be completely filled out at the time the notary public's signature and seal are affixed. Documents requiring acknowledgments do not need to be signed in the Notary's presence in most states. However, the signer must *appear before* the Notary at the time of notarization to acknowledge that he or she freely signed for the purposes stated in the document.

## What defects are fatal to an acknowledgment?

- failure to include acknowledging party's name in Certificate of Acknowledgment;
- significant variance in acknowledging party's name in the Certificate versus the instrument being acknowledged;
- omission of the word "acknowledged" in the Certificate;
- failure of officer taking acknowledgment to sign the Certificate;
- absence of the officer's official seal when its use is applicable; or,
- officer taking acknowledgment was disqualified, and his/her disqualification is evident on the face of the instrument.

## The effect of a missing or defective acknowledgment

The General Rule is...

- The validity of the instrument, as between the parties, is not affected by the absence of or defect in the acknowledgment.
- However, as against third parties, unacknowledged or defectively acknowledged instruments do not serve as constructive notice to third parties. Thus the instrument can be denied the benefit of recordation.

In other words, even though the instrument physically appears in the real estate records, it will, as a matter of law, be treated as unrecorded.

Some states, such as Oklahoma, now have placed a statute of limitation upon the invalidating effect of defective acknowledgment. In Oklahoma, if an instrument which contains a defective acknowledgment has been recorded for a period of five (5) years, the instrument is considered valid notwithstanding the omission or defect and will not impact marketability.

## **How to manage the missing or defective acknowledgment**

First, one must ask; does the acknowledgment really need to be fixed?

There are three primary instances when a missing or defective acknowledgment does not need to be cured.

1. If the instrument does not convey title, such as a Transfer of Lien, Assignment of Lien, Corporate Resolution, etc.
2. If the instrument no longer effects title. Example; a recorded Deed of Trust that has been paid off and released.
3. A sufficient amount of time has passed and the defect has been fixed by statute.

Otherwise, a fatally defective acknowledgment must be cured.

There are generally three options available when an acknowledgment must be cured. They are:

1. The correction of the acknowledgment is made by the original notary public, followed by the re-filing of original instrument.
2. The Grantor re-acknowledges the original instrument before a different notary public, followed by the re-filing of original instrument.
3. A new acknowledgment if provided by a different notary.

# **SCENARIO #4**

## **DEFECTIVE ACKNOWLEDGMENT AND THE BETTY B. BLACK CONVEYANCE**

Assume that your company leases Betty B. Black, a married woman dealing with her sole and separate property. Her tract of land may be a drill site. You examine the lease and the acknowledgment as seen below.

Locate as many defects as you can find in this acknowledgment? First, circle the defect then list it below. Next, determine what affect these defects would have on the conveyance.

**State of Oklahoma )**  
**)**  
**County of Payne )**

**On this 22nd day of March, 1995, before me personally appeared Betty B. Black, who, being by me duly sworn, deposes and says that she resides at 1974 East 44<sup>th</sup> street, Carmi, Illinois 62114, that she is President for Alright Reality Corp., the corporation described in and which executed the foregoing instrument; that she knows the seal of said corporation; that the seal is affixed to said instrument is such corporate seal; and that she signed her name thereto and affixed the corporate seal by order of the Board of Directors of said corporation and the said instrument is the act and deed of such corporation.**

**In witness whereof, I have hereunto set my hand and affixed my official seal, at**

\_\_\_\_\_  
**Notary Public**

**(SEAL)**

**My Commission Expires: 1/1/2017**

I found the following defects in this acknowledgement

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_
4. \_\_\_\_\_
5. \_\_\_\_\_

## **Answer to scenario #4 - Defective Acknowledgment and the Betty B. Black Conveyance:**

There are several defects found in this acknowledgment including the following:

1. The word "Acknowledged" is missing from the acknowledgment.
2. Betty B. Black signed the lease as a married woman dealing with her sole and separate property and notarized the document as President of Alright Reality Corp.
3. The Notary signature is missing.
4. The seal is missing.
5. The dates seem suspect. The acknowledgment was signed in 1995 and the commission expires in 2017. There appear to be a typo with the 1995 date since most notaries' commission only last a few years.

# The Mother Hubbard Clause

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Picture the dresses worn by the ladies in the “Little House on the Prairie” television series. They covered everything from the neck of the woman to the base of her ankles – thus the term *Mother Hubbard*. Her dress covered everything.

For oil and gas purposes, it was often necessary to rely on such a concept when property was being described. Early survey methods were often inaccurate. Where metes and bounds descriptions were used, precise ownership was often confusing. Where tracts of land bordering rivers or streams were being leased, the riverbed could change. Oil companies needed a lease that would cover everything including the lands described on the lease and any other acreage that was identified later through resurvey, or the small bits and pieces of land contiguous and adjacent to the land described in the lease.

For example, a lease might describe 432.16 acres more or less. When a title opinion is rendered, it might be discovered that the tract of land actually contained 432.46 acres.

## Granting Clause

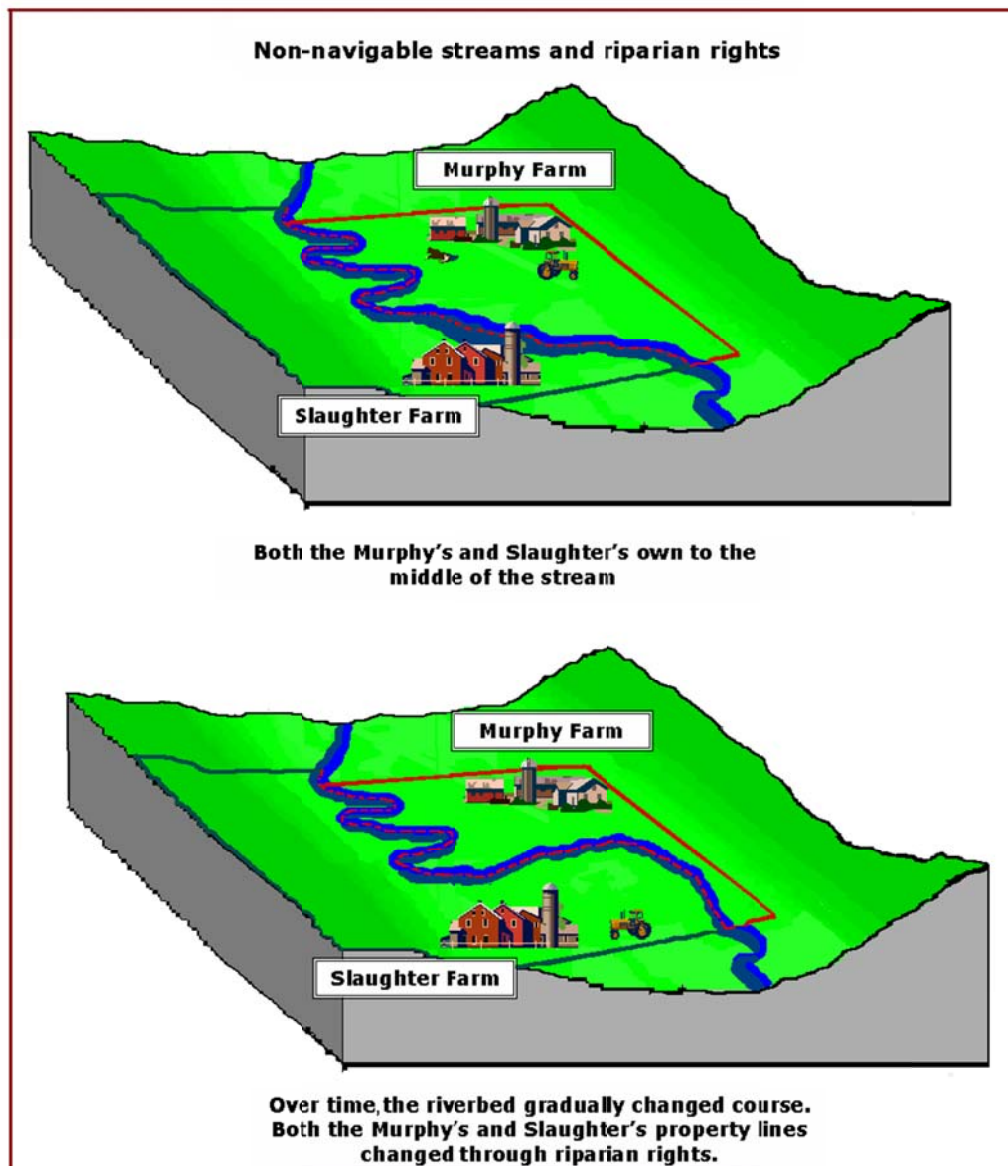
together with all strips, parcels of land, accretion and riparian rights adjoining or contiguous to the above described tract of land, attaching to and forming a part of said land whether properly or specifically described or not and owned or claimed by Lessor.

## Mother Hubbard Clause

Generally when this occurs, the oil company is not obligated to go back and pay the lessor an additional bonus for the non-described acreage.

## Mother Hubbard and Riparian Rights

Generally, non-navigable streams or rivers are owned by the adjacent property owners – each owning to the middle of the stream or river. Over time, riverbeds gradually change as the natural flow of the water changes its course. When this happens, the property owner's rights to the river change with the natural flow of the water. This is called riparian rights.



If your company had taken a lease on the Slaughter farm lands, because of the change in the riverbed, your company's acreage position would have changed dramatically.

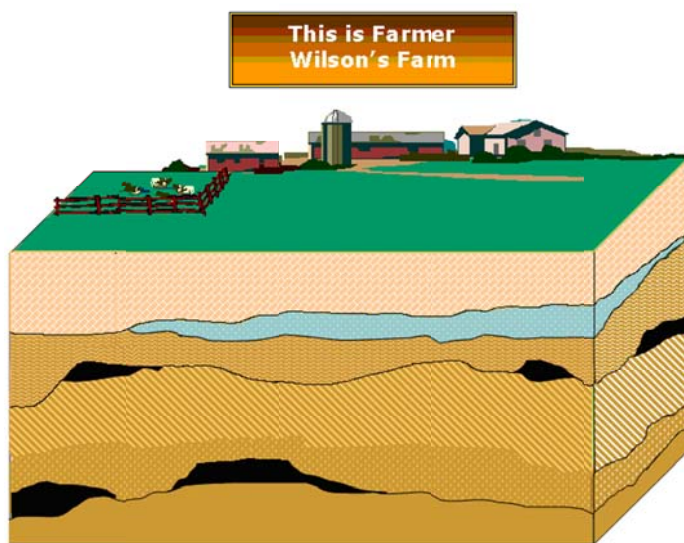
## Avulsion Rights

Avulsion is the sudden change in the course of a river or stream caused by such things as a flood or by man. Generally, avulsion will not change the ownership to the land and the original boundary ownership remains the same.

## Some Limitations for the Mother Hubbard Clause

Some courts have limited the scope of the Mother Hubbard Clause to cover only strips of land that were *unknown* at the time of the oil and gas lease.

Courts have also ruled that certain errors made on the part of the lessor cannot be resolved through the Mother Hubbard Clause.



**Issue 1:** Farmer Wilson leased all of the lands shown to your company *excluding the fenced lands*. These lands are contiguous and adjacent to the tract of land found on the lease. Would they qualify under the terms of the Mother Hubbard Clause shown on the previous page?

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**Issue 2:** Barry White leased with your company. Together, the lands on both sides of the stream contain 240-acres. The lease referenced all 240-acres but the legal description only referenced those lands south of the stream. Using the Mother Hubbard Clause, would all 240-acres be covered under the lease terms? \_\_\_\_\_

## Answers to Mother Hubbard Issues:

**Issue 1:** If, at the time of the lease, all of the lands were *known* but only a portion of the land was described on the lease, then the non-described tract of land would be considered to be a separate tract of land and not covered under the clause.

**Issue 2:** In cases like this where an obvious mistake has taken place on the lease form, courts generally will not allow the Mother Hubbard Clause to remedy the error.