

(1) The primary term of the lease is 5 years.

Under an oil and gas lease under Texas law, the initial term of the lease by the end of which the lessee must be operating an oil and/or gas which is producing quantities is referred to as the primary term. Here, the primary term is 5 years according to the express language of the oil and gas lease.

(2) The secondary term of the lease is the time period beyond the primary term in which any oil and/or gas well is producing in paying quantities on the leased premises.

Under an oil and gas lease under Texas law, the secondary term is the terms following the primary terms under which the lessee may have a valid lease for as long as any oil and/or gas well on the leased premises is producing in paying quantities. Here, the secondary term is expressly stated in the lease as "...and as long thereafter as oil and gas is produced in paying quantities."

(3) Nick is not entitled to 1/16th of the delay rental received by Jack from Oilco for Whiteacre.

Under Texas law, a non-participating royalty interest holder has a royalty interest, but not a mineral interest, which is carved out of the royalty interest but not the landowner's mineral interest. Therefore, a non-participating royalty interest holder has a profit interest but may not collect delay rentals as available under the terms of an applicable lease and paid by the lessor. However, this non-participating royalty interest is free from the costs of production.

Here, Nick has a 1/16th non-participating royalty interest which he purchased from Jack for \$20,000. Although he has a royalty interest, Nick only has a non-participating royalty interest which does not include a mineral interest, and therefore Nick is not entitled to any delay rental received by Jack from Oilco for Whiteacre.

(4) Jack should not accept the March 1, 2015 delay rental payment because Oilco has been paying delay rental payments for the first four years of the lease.

Under an oil and gas lease under Texas law, a delay rental provision is a provision in an oil and gas lease providing for extension of the primary term in the event that a well is not producing under the lease in paying quantities by the end of the primary term. Failure to pay the delay rental results in automatic termination of the lease where the delay rental provision is a condition and a breach of the lease if the delay rental provision is a covenant. An operations clause in an oil and gas lease allows for extension of an oil and gas lease, in conjunction with the payment of a delay rental, in the event that drilling operations have begun by the end of the primary term, but no well has been drilled.

Here, the lease contains both an operations clause and a delay rental clause. Therefore, Oilco is allowed under the lease to extend the primary term of the lease, ending on March 1, 2015, by virtue of the operations clause of the lease and payment of the delay rental payment, because on February 3, 2015 Oilco began drilling operations, although no well has actually been drilled. However, Jack should not accept the payment because Oilco has already paid the delay rental payment in years when the delay rental payment was not due. Oilco had no obligation to make the delay rental payments in years 1-4 because the delay rental was not due before the end of the primary term. Therefore, because the delay rental has already been paid, Jack should not accept Oilco's March 1, 2015 delay rental payment.

1. Pursuant to the lease, the primary term is 5 years. At issue is what constitutes a primary term in an oil and gas lease. An habendum clause is the traditional clause in an oil and gas lease which contains the time constraints of the lease. It usually includes a primary term, which comes first, and a possible secondary term. The primary term is for a term of years, at the conclusion of which, if there is no production of oil/gas, the lease will terminate. If there is production, the lease will extend into the secondary term which is indefinite. Because of this, the lease represents a fee simple determinable interest in real estate. Here, the primary term is evidenced by the language in the lease which states that the beginning term will be for a set term of 5 years. Therefore, the primary term is for 5 years.

2. Pursuant to the lease, the secondary term is "as long thereafter as oil and gas is produced in paying quantities." At issue is what constitutes a secondary term in an oil and gas lease. An habendum clause is the traditional clause in an oil and gas lease which contains the time constraints of the lease. The secondary term follows the primary term (if circumstances warrant) and is usually for an indefinite period of time, while the primary term is set for a term of years. If there is no satisfactory production produced in paying quantities (i.e., revenue exceeds costs) of oil/gas at the conclusion of the primary term, the lease will terminate and not extend into the secondary term. Because of this, the lease represents a fee simple determinable interest in real estate. Here, the secondary term and its indefinite nature is evidenced by the language "and as long thereafter as oil and gas is produced in paying quantities."

3. Nick is not entitled to 1/16th of the delay rental received by Jack because his non-participating royalty interest only gives him a right to cost-free share of actual production (carved out from Jack's interest). At issue is whether a non-participating royalty interest includes a right to a share in the delay rentals when there is no production of oil. A royalty interest, in general, shares cost-free in a share of actual production. The non-participating (i.e., cost-free) royalty interest is carved from the lessor's share of any production of oil/gas. If there is no production, no payment to royalty interest holders is necessary. A non-participating royalty interest does not include a share of ALL payments made to the lessor, just a share of production of oil/gas. Delay rentals are not based on production. They are based on lack of it; the fact that it has drilling has not been commenced. Here, there was no production, but in any case, delay rentals are not included in "production" for purposes of royalty interest payments. Jack's delay rentals are not reachable. Therefore, Nick is not entitled to 1/16th of the delay rentals received by Jack.

4. Jack should accept Oilco's March 1, 2015 delay rental payment based on the operations clause. At issue is whether the primary term ended and the lease terminated because of the lack of production or whether the operations clause in the lease operates to extend the time period under the lease to obtain production and extend the lease to the secondary term. In Texas, an oil and gas lease can contain an operations clause. Normally, where there is no production in in paying quantities at the end of the primary term, the lease will terminate and not extend into the (possibly lucrative) secondary term. An operations clause is one of several oil and gas lease clauses that parties use to slightly extend the primary term and prevent the lease from terminating when certain circumstances exist. An operations clause will usually state that where production has not been obtained to satisfy an extension into the secondary term (when the primary term is set to expire) but good faith geological and drilling operations are currently underway, the primary term will be temporarily extended to allow the lessee to pursue the operations to obtain production of oil/gas and to hopefully, extend the lease into the second term. In the meantime, the lease operates as if it is still under the primary term and delay rentals are paid until current operations obtain or fail to obtain production. It should be noted that there is a duty to perform the lease in good faith, and neither party should use such clauses (e.g., an operations clause, shut-in royalty clause) as a bad faith excuse to extend or deny the extension of the primary term into the secondary term. Here, there was an operations clause in the lease. Although the primary term of five years was set to expire on March 1, 2015 (and therefore terminate the lease), Oilco began drilling operations prior to expiration on February 3, 2015. The operations clause would cover such drilling operations. Assuming Oilco's operations were not commenced at such a date in bad faith simply to invoke the operations clause, the primary term will be temporarily extended to allow Oilco an opportunity via the current operations to obtain production in paying quantities in order to extend the lease to the second, indefinite term. Therefore, when Oilco properly made a delay rental payment to the lessor, Jack, he should have accepted it.

1) The lease, according to its Habendum Clause, has a primary term of five years.

The lease has a primary term of five years. In an oil and gas lease a Habendum Clause establishes two terms: primary leasing term and the secondary leasing term. The primary leasing term is a defined duration while the secondary leasing term is limited by conditional durational language. Here, the lease expressly establishes that the primary leasing term is 5 years and that the secondary term begins at the expiration of the 5 years and continues on "so long thereafter as oil and gas is produced in paying quantities". In other words, the oil and gas lease will remain in full effect after the expiration of the primary five year term so long as the oil and gas company is operating a well with producing quantities.

2) The lease, according to its Habendum Clause, has a secondary term as determined by conditional durational language.

As established above, the primary term for the lease in question is five years. The secondary term begins at the expiration of the 5 years and continues on "so long thereafter as oil and gas is produced in paying quantities". In other words, the oil and gas lease will remain in full effect after the expiration of the primary five year term so long as the oil and gas company is operating a well with producing quantities.

3) Nick does not have a claim to a share of the delay rental payments.

A non-participating royalty interest is an interest in the production under a lease free from production costs that is carved out of the mineral interest holder's royalty interest under the lease. Here, Jack conveyed a 1/16th non-participating royalty interest to Nick, which was carved out of his interest and left him with 15/16th of the royalty interest. In order for a royalty interest to be paid, it must come from the funds derived from the production of the well. Here, delay rental payments are not a share in the production free from the production costs as there is no production. Nick does not have an interest in a share of the delay rental payments.

4) Jack should not accept the delay rental payment from OilCo, but is entitled to accept any payment, if applicable, specified in the Operations Clause.

Jack should not accept the delay rental payment. A Delay Rental payment is made by an oil and gas company to the other parties to the lease when, during the primary term of the lease, there are no operations being conducted under the lease. Here, OilCo failed to conduct operations until Feb. of 2015 and promptly paid the proper delay rental payments up until that date. However, the primary term expired as of March 1, 2015 and Oil Co attempted to send a delay rental payment on March 1, 2015, when the primary term expired and they had engaged in operations. Although the delay rental payment was not proper, the lease does contain an operations clause which would save the lease.

An operations clause acts as a savings provision that allows for an oil and gas company to continue work under a lease, after the expiration of designated primary and secondary terms, if they are diligently and in good faith engaged in operations under the lease before the terms expired. Here, Oil Co engaged in operations on Feb. 3, 2015 which was before the expiration of the primary term and is entitled, under the operations clause, to maintain those operations in good faith for a reasonable period of time.