

Question 6 – July 2013 – Selected Answer 1

1. Gigantic Oil's lease on Blueacre is terminated. If an oil and gas lease contains a delay rental clause, the oil company must follow it. A delay rental clause allows an oil company to suspend drilling operations during the primary term of the lease by paying a specified sum (in this case \$3,000). In addition, the words used in the delay rental clause can have different impacts, if it is an "unless" delay rental clause, then the lease terminates automatically, but if it's an "or" delay rental clause, then lease does not terminate automatically and the lessor can sue for breach and obtain damages. Also, a lease may be "revived" by the actions of a lessor. Late payments acceptance by a lessor may be construed as reinstating the lease. However, the lessor must accept the payment, must perform some action (such as cash the check) and the lessee must rely on these actions.

Since the lease required a well of at least 2,000 feet is not underway from one year from the date of the lease (Feb. 1) then the lease would be terminated. The well drilled by Gigantic was to a depth of only 750 feet which did not produce an amount sufficient to put the lease into a secondary term. Gigantic shut-in the well, which is was within its right to do. However, since the one year anniversary was approaching and no well was drilled or even commenced at that time, Gigantic was required to pay the delay rental payments in order to extend the primary term. In this case, the delay rental payment was due to Maggie on or before February 1, 2012. In addition, the delay rentals clause in her lease contained an "unless" statement, meaning that if the delay rental payment was not mad on time, the lease would automatically be terminated. However, due to an accident of a Gigantic Oil employee, the payment was not made until February 22nd. Gigantic claims this falls under the force majeure clause because it was an accident beyond its control. However, the force majeure clause does not help Gigantic in this situation. The force majeure applies to drilling or other operations, the payment of a delay rental would likely not fall under that. In addition, the accident was the direct result of its employee so gigantic did have a role in the accident so it was not entirely out of its control. The main issue deals with the late payment by Gigantic on February 22nd. Gigantic will claim that Maggie accepted the late payment therefore reviving the lease because she did not object to the payment and accepted it. However, the facts indicate that Maggie returned the check to Gigantic within two weeks. Since Maggie did not accept the payment, did not perform some action such as cash it, the late payment exception would not fit into this situation.

Since the delay rental payment was late and late payment was not accepted, but returned, the lease on Blueacre has been terminated.

2. Gigantic Oil's lease on Goldacre has not been terminated. The issue is whether a stop or delay in production is sufficient to terminate a lease.

In Texas oil and gas leases, there are several savings clauses that will help an oil company in the event of any problems. In this situation the temporary cessation of production comes into play. In Texas, if production stops, a lessor may be able to terminate the lease because the lease is no longer producing in paying quantities. However, this is excused if the cessation is due to a problem outside the control of the oil company, the company diligently attempts to fix the problem within a reasonable amount of time, and the cessation is only temporary. In addition, a force majeure clause, which the Goldacre lease contains, may prevent a lease from being terminated due to an event specified in the clause.

In this case, Goldacre's lease would fall under the temporary cessation of production, and possibly the force majeure clause. Since the cessation of production was due to an event outside its control and not its fault, i.e. lightning strike, this would bring force majeure and the temporary cessation of production. The force majeure clause states that when drilling or other operations are interrupted by or storm, such delay or interruption shall not be counted against Gigantic. Since the fire was due to a lightning strike, this would fall under the force majeure clause and any delay would not be counted against Gigantic. In addition to the force majeure clause, Gigantic meets the requirements of temporary cessation because stoppage was due to an event outside its control, and they diligently and quickly fixed the problem. The fire was on February 5th and the facts indicate that repairs were immediately begun and the problems were fixed within 10 days. 10 days is likely a reasonable amount of time. In addition, on February 15th the well was back to producing in paying quantities.

Because Gigantic Oil is protected by the force majeure clause and the temporary cessation of production, its lease has not been terminated.

Question 6 – July 2013 – Selected Answer 2

1. Gigantic's lease of Blueacre is terminated for its failure to timely tender the delay rental payment. An oil and gas lease is really a conveyance of land under a fee simple determinable. The duration of the lease or conveyance is determined by the habendum clause in the lease. The habendum clause typically divides the lease into two terms. The primary term exists for a set period of time and the lease will remain open until the date. After the expiration of the primary term the secondary term begins at which point the lease will remain open only if the lessee or developer is producing oil in paying quantities. If the lessee is not producing in paying quantities, other savings provisions in the lease may prevent the reversion of the mineral interest. For Blueacre the primary term continued through February 1, 2012. After that date Gigantic could only maintain the lease by following the express terms in the lease: either 1) drilling to a depth of 2,000 feet and producing in paying quantities, or 2) tendering the payment of the delay rental by February 1, 2012. Gigantic failed to satisfy either of the conditions to the lease so the lease will terminate and revert back to Maggie. Gigantic failed to drill to the necessary depth and failed to secure paying production. Even if it had drilled to 2,000 feet, the continuation of the lease would still be based on production in paying quantities. In either case, Gigantic failed because it drilled only to 750 feet and failed to produce in paying quantities. Because Gigantic did not satisfy its drilling requirements under the lease, the only way for it to maintain the lease would be to pay the \$3,000 delay rental by February 1. A force majeure clause protects the driller/lessee from delays in production due to "acts of God" which are beyond the lessee's control. Thus, if production is delayed to a force of nature, the lease will remain open assuming the lessee is able to resume production within a reasonable time. The Blueacre lease contained a valid force majeure clause which protected Gigantic from delays of "drilling or other operations". Thus, this would only temporarily excuse the condition of drilling. This does not excuse the failure to timely pay the delay rental. Because the lease provisions only excuse cessation of operations due to acts of god and not the failure to pay delay rentals, the force majeure clause will not prevent the lease's termination. Gigantic has failed to maintain the lease past the primary term by either proper drilling and production or paying the delay rentals, therefore, the lease will terminate.

2. The Goldacre lease is not terminated because it was maintained by paying quantities of production and protected by the force majeure clause. The Goldacre lease had a similar habendum clause but lacked the provision for delay rentals. Thus, this lease would only be maintained past February 1, 2012 by Gigantic producing in paying quantities. Gigantic properly drilled and completed a well on October 19, 2011, well within the time of the primary term. Thus, as long as the well was continuing in paying

quantities, the lease would remain open, even past the expiration of the primary term on February 1, 2012. Production continued early into the secondary term and was only halted by a lightning strike. Whereas, the force majeure clause failed to prevent termination of the Blueacre lease's fail to pay the delay rental, it effectively maintains the Goldacre lease. The force majeure clause specifically states that delays caused by fire, storm, etc. shall not count as an interruption against Gigantic. The storm was a natural act of God, beyond the control of Gigantic and thus covered under this clause. Because the delay was only temporary and Gigantic immediately began repairs and soon after resumed drilling, the force majeure clause maintained the lease, at least as long as while production is ongoing. Even in the absence of such a clause, the lease would probably remain under the doctrine of temporary cessation of production. Texas law favors the drillers and will often excuse brief pauses in production so long as the operator takes reasonable efforts to resume drilling in paying quantities. In either case, the Goldacre lease will remain open.

Question 6 – July 2013 – Selected Answer 3

1. The lease as to Blueacre is terminated. The issue is whether the lease of Blueacre is terminated. Under the Habendum Clause the primary term, Gigantic Oil has no obligation to begin drilling or operations for 3 years from the date of the lease, and the lease will extend beyond that "as long as" they produce paying quantities. However, the lease expressly includes a Commencement Clause requiring operations for drilling "at least 2,000 feet" within 1 year from February 1, 2011. The work they began, in drilling, ended with a well with a depth of 750 feet which was subsequently shut in on October 19. There is no evidence that they intended in good faith to continue drilling that hole or that it would establish a sufficient well to hold the lease open because it only produced a "small amount" of oil. Further, the lease does not contain a "shut in" clause that would maintain the lease for a period of time if certain amounts were paid as shut-in royalties. As a condition of the commencement clause, the lease states it will terminate automatically if they do not pay delay rentals. Delay rentals are a stipulated amount intended to keep the lease alive while there is no production in paying quantities or on the basis of a condition in the lease. Here, the condition is commencement within 1 year. Delay rentals were required as of February 1, 2012, however, they were not paid until February 22, 2012. Gigantic oil claims that the force majeure clause covers the accident that the employee encountered because it was "out of their control." However, the clause only applies to drilling and operations, not the delivery of delay rentals. Maggie returned the check, thus there is no evidence she accepted the delay rental which would keep the lease alive. Thus, the Blueacre lease was terminated on February 1, 2012 when Gigantic Oil failed to pay the delay rentals.

2. The lease on Goldacre is not terminated. The issue is whether the lease of Goldacre is terminated. The Habendum clause on Goldacre has a primary term of 1 year. Gigantic Oil has no obligation to begin drilling or operations until Feb. 1, 2012. On October 9, 2011, Gigantic oil completed a well producing paying quantities sufficient to keep the lease alive beyond that of the primary term. However, a small fire caused by lightning shut down the well on February 5, 2012. Thus, Gigantic Oil must fall under the force majeure clause or defend based on the common law doctrine of temporary cessation in order to prevent the lease from terminating. Under the force majeure clause, this would constitute a delay in operations due to a "storm" beyond the control of Gigantic Oil. Thus, the delay would be covered by that saving clause, and the fact that the well is not producing paying quantities on February 5, 2012 would not terminate the lease. Additionally, under the common law doctrine of temporary cessation, the lease can be saved even in light of the delay. Under that doctrine, any temporary delay due to a mechanical breakdown, which the lessee acts diligently to repair, will not terminate the lease. Here, the fire caused production to shut down on February 5, 2012. However, Gigantic Oil acted as a reasonably

prudent operator and diligently attempted to repair the well. In fact, the lessee had the well up and running only 10 days later, and the well was again producing paying quantities of oil that would hold the lease for an indefinite period of time. Thus, the lease is not terminated as to Goldacre, and Gigantic Oil may continue their work developing and producing under the lease as long as it produces paying quantities.