

Information & Instructions: Explanation and summary of standard oil and gas lease clauses

PREVIEW

1. **Date.**

This sets the time the lease is effected and usually establishes the period for the primary term. It may also determine the date for payment of shut-in clauses and delay rentals. The term of the lease is usually for a certain primary term, such as 10 years, and a secondary term which commences upon the production of oil in paying quantities. A secondary term is unlimited and ceases when the well no longer produces oil in paying quantities.

2. **Parties.**

This section identifies who is bound to the terms of the lease and normally recites the capacity of the parties therein.

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3. **Consideration.**

This section ensures that the lease is legally enforceable. All contracts must recite consideration to be effective; the same is true of oil and gas leases.

4. **Granting Clause.**

This states the purposes for which the property is leased, the rights that the lessee has acquired and describes properties which are subject to the lease. This clause also grants exclusive exploration and drilling rights to the land in question in favor of the lessee. The lessee may have the right under the clause to place buildings and house employees on the land, and to develop the land as is necessary to develop the mineral estate.

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5. **Habendum Clause.**

This clause states the length the lessee's rights will continue. It is often subject to other provisions-including drilling, delay rental, pooling, shut-in, royalty and continuous drilling clauses.

6. **Land Description Clause.**

This clause describes the land in its legal terminology. This is similar to a deed's recitation of the legal description of the property.

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7. **Mother Hubbard Clause.**

The lease may purport to cover all of the lands owned or claimed by the lessor which are contiguous to the property described in the lease even if the boundaries of the land are not described. This clause was originally meant to pick up small or odd-shaped wedges of land inadvertently omitted from the legal description. It is important to note that the Mother

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Hubbard clause should be limited so as not to include all of the land the lessor may own as opposed to the part intended by the parties.

PREVIEW

8. Title Clause.

The title refers to oil and gas and other minerals. If it is to be oil and gas lease only, it is important to make sure that the word minerals is stricken otherwise, a question will arise as to what the lessee is entitled to develop (surface minerals as well as oil and gas).

9. Royalty Clause.

This is perhaps the most important part of the lease. The royalty clause specifies the share of the production proceeds that the lessor will receive. Typically, this has been one-eighth. However, the percentage has changed based on the market, and it is not uncommon for mineral owners to receive one-fourth to one-fifth of the production.

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10. Shut-in Clause.

This clause is applicable to gas and provides that the lessee may shut-in (cease production) a gas well when gas is not being sold or used. This clause gives the lessee the right to cut off a gas well for any reason or for no reason. This clause was intended to protect the lessee when no available market was available to sell the gas.

11. Drilling and Delay Rental Clause.

This clause gives the leasing party a right to defer immediate exploration of the property if he pays a certain amount of delay rentals. Delay rentals keep the lease in effect and full force until the end of the primary term. This is one of the most important clauses in the lease, especially from the lessee's standpoint. It is called the "unless" clause, since the lease may expire unless there is production or delay rental is tendered to the lessor. The delay rental clause, therefore, gives the lessee the option to defer or delay commencement of drilling operations for another year during the primary term. Delay rentals are therefore due once a year unless the lease specifies otherwise. Failure to pay or tender the delay rental will cancel the lease. Once the lease is terminated, the lease is ended forever.

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12. Dry Hole and Offset Clause.

This clause states the rights of the parties in case a dry hole is drilled during the primary term, or if production ceases. The clause may also provide for drilling of an offset well if such a well would be advantageous to the parties.

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13. Pooling Clause.

This allows the lessee to combine leases (one with another) in order to form a single drilling unit. Pooling is a legal device to combine and convey an acreage of interests. It refers to the creation of drilling

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lots of irregularly sized tracts. Unitization refers to the reservoir of an existing discovery and is used in secondary recovering operations.

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14. **Surrender Clause.**

This states the rights of the lessee if he or she is required to surrender the lease.

15. **Assignment Clause.**

This gives either party the right to transfer his or her property rights in the lease and contains a change of ownership provision requiring that notice be given if the lessor transfers his or her interest under the lease. As stated earlier, leases and contract rights are freely assignable by either party without permission of the other. Assignments occur quite frequently in the oil and gas industry.

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16. **Force Majeure Clause.**

This states that the lease is subject to state and national laws. It gives the lessee freedom from nonperformance of obligations implied or specified in the lease if, in certain cases, he or she can prove the contingencies are beyond his or her control.

17. **Damage Clause.**

A damage clause defines the liabilities of the lessee in the event that damage occurs to the surface of the land.

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18. **Warranty Clause.**

This clause states that the lessor owns and guarantees title to the property covered under the lease. It outlines the rights of the lessee if the lessor defaults on taxes, mortgages or other obligations. It also provides for a reduction of payment should the lessor own less interest than the amount indicated on the lease.

19. **Apportionment Clause.**

A provision may be added to provide for apportionment in the event there is a postlease subdivision of the lease property. This provision provides a royalty on subdivided property be paid only if the well is located on that specific land which is in the subdivision or subdivided property.

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20. **Shallow Well Clause.**

This clause allows the lessor to lease his or her land to others for deeper development of his or her minerals, since a shallow well will not, under this clause, stifle full mineral development.

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Information & Instructions: Oil and gas lease formation Implied covenants

PREVIEW

1. In addition to the express lease clauses discussed above, oil and gas leases are subject to various implied covenants or duties. Implied covenants are implied by law as duties and obligations that flow from the presumed intentions of parties as evidenced from the actual terms written in the document.

2. Most of the implied covenants are imposed upon the lessee. Some of the implied covenants are as follows:

a. The lessee is obligated to operate the well in a reasonable and prudent manner so as to benefit the lessor. He or she may be required to drill offset wells or additional wells so as to prevent oil from being taken from the lessor's property by adjoining oil wells in which the lessor has no interest.

b. He or she is under a duty to drill an initial well and to develop the property after the production is discovered.

c. He or she is required to protect against drainage to keep the lessor's interest from being depreciated.

d. He or she is required to produce, market and operate the lease with reasonable care and use successful modern methods of production.

e. He or she is required to seek favorable administrative action.

Oil and gas lease formation conclusion

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1. As is evident, an oil and gas lease is quite different from personal property contracts. The area becomes more complex when one deals with the real property technicalities applicable to land conveyances and state/federal regulations.

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