

HOLLIDAY ENERGY LAW GROUP

PUGH CLAUSE/RETAINED ACREAGE

Kevin Lambert

Holliday Energy Law Group PC

Holliday Energy Law Group, PC is a San Antonio-based transactional energy law firm focused on rendering title opinions and providing operational/regulatory advising to oil and gas operators active across the continental United States. We represent clients throughout all stages of a drilling program – from acquisition through divestiture – in Texas, Oklahoma, North Dakota, Ohio, New Mexico, Montana, and Illinois.

Pugh Clause/Retained Acreage Presentation Overview

- Definition
- Pugh Clauses
- Retained Acreage Clauses
- Examples
- Recent Cases

Definition

- The Pugh Clause – A clause in the Oil and Gas Lease which modifies usual pooling language to provide that drilling operations on or production from a pooled unit will not preserve the whole lease.
- Retained Acreage – A clause that provides that a lease will continue after the expiration of the primary term as to a certain number of acres associated with each of the wells drilled under the lease.

Pugh Clause

- The main purpose of any Pugh clause is to protect the lessor from the anomaly of having the entire property held under a lease by production from a very small portion.

Rogers v. Westhoma Oil Co., 291 F.2d 726 (10th Cir.1961); *Roseberry v. Louisiana Land & Exploration Co.*, 470 So.2d 178 (La.App.1985).

Pugh Clause

- Pugh clauses are governed by contract law and the courts will interpret them based on the express terms of the clause.
- They can be written as "*if/then*" or "*or*" conditional statements.
- These statements should be read carefully, especially when field rules and regulatory language is included in the clause.
- A lease analysis should note any inherent conflicts between the pooling authority, any Pugh clauses, and any retained acreage provisions.

Retained Acreage

- The Retained Acreage clause is used in an oil and gas lease to protect the lessor's interest when a lease is held in force by continuing production or other conditional language.
- They enable the lease to terminate as to any acreage not held by continuing production.
- This protects the lessor from having a lease covering an entire tract held in force by a single well on a small portion of the tract.

Retained Acreage

- Usually used in tandem with continuous development clauses.
- Each retained-acreage clause must be construed on its own, under governing principles of contract interpretation.
- This leads to widely varying terms because parties are free to contract in any way they choose not prohibited by law.

Retained Acreage

- Terms to include in Retained Acreage Clauses:
 - When the first well must be commenced if all acreage is to be maintained by drilling after the end of the primary term.
 - When a well is considered to be completed and commenced in order to ascertain the number of days that have elapsed between the wells.
 - The size and boundaries of the tract of land that may be retained around a producing well.
 - Specifically, how that size is determined

Horizontal vs Vertical

- Traditional Pugh/Retained Acreage Clauses are considered vertical clauses where the lease is terminated to all depths of a tract for any acreage not included in the pooled unit/retained acreage.
- Horizontal: A horizontal Pugh/Retained Acreage clause “holds a lease only to the stratum or level from which production has been secured in the unit during the primary term of the lease and, thus, frees the mineral interests below that depth absent additional development.”

Community Bank of Raymore v. Chesapeake Exploration, L.L.C.,
416 S.W.3d 750 (Tex.App.-El Paso 2013)

Example – Pugh Clause

- Operations on or production from a pooled unit or units shall maintain this lease in force only as to lands included within such unit or units.

Example – Retained Acreage

- At the expiration of the primary term of this lease or at the end of the extended period for continuous development provided below, whichever is later, this lease shall terminate SAVE and EXCEPT for (i) eighty (80) acres of land plus a tolerance of ten percent (10%) surrounding each vertical well, and (ii) six hundred forty (640) acres plus a tolerance of ten percent (10%) around each horizontal well.

Example – Pugh Clause & Retained Acreage

- At the expiration of the primary term of this lease or at the end of the extended period for continuous development provided below, whichever is later, this lease shall terminate SAVE and EXCEPT for (i) eighty (80) acres of land plus a tolerance of ten percent (10%) surrounding each vertical well, (ii) six hundred forty (640) acres plus a tolerance of ten percent (10%) around each horizontal well, and (iii) all lands included in a pooled unit.

Vertical Retained Acreage

Horizontal Retained acreage

Pugh Clause

Recent Cases

- *Endeavor Energy Resources, L.P. v. Discovery Operating, Inc.*
- *XOG Operating, LLC v. Chesapeake Exploration Limited Partnership et al.*

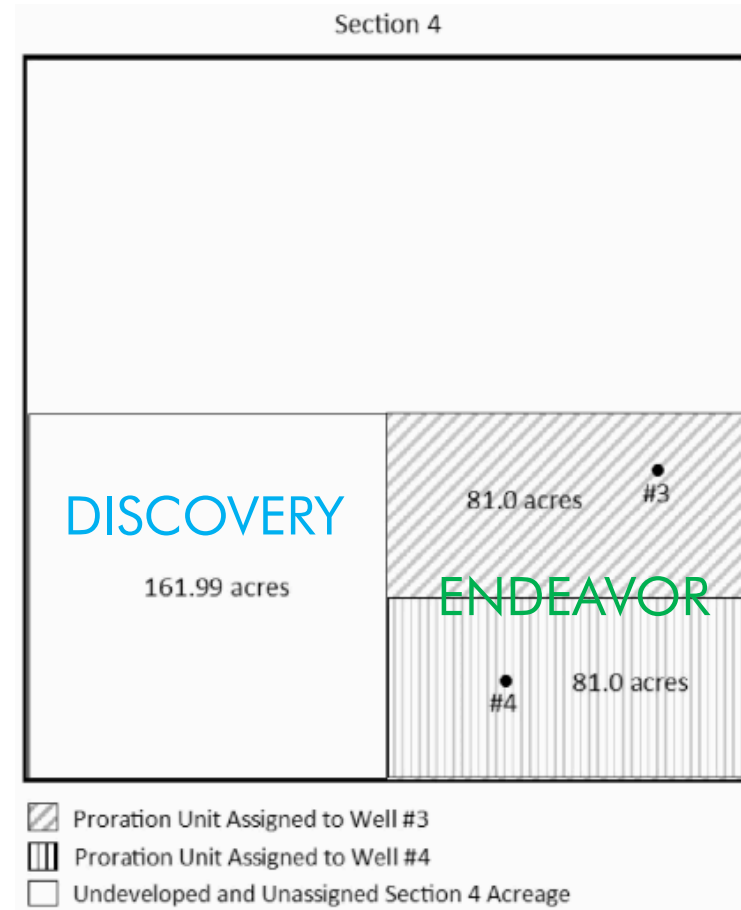
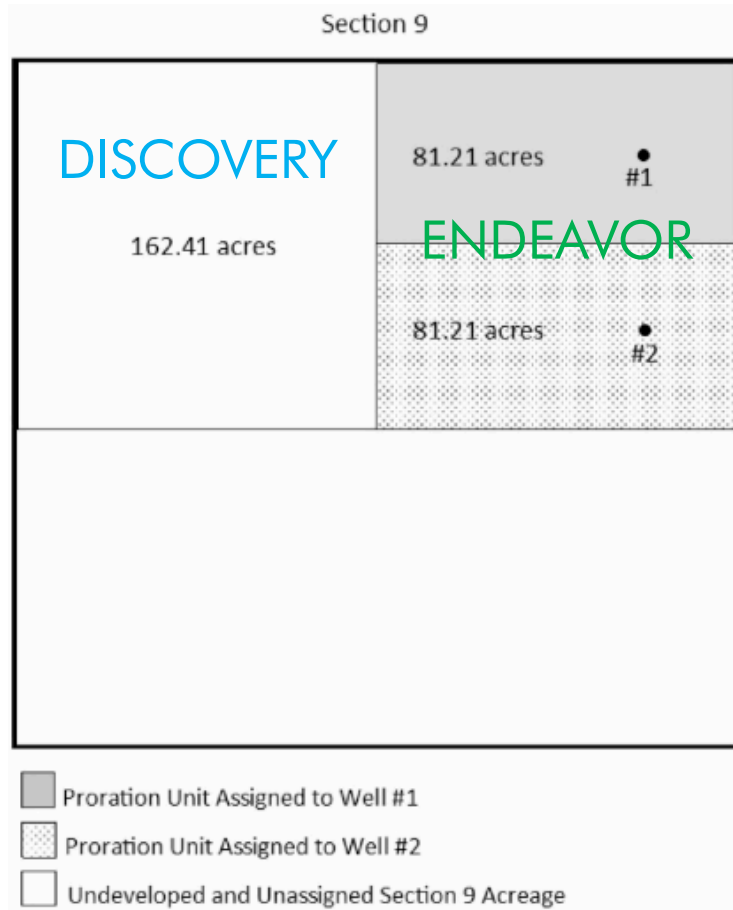
Endeavor Energy Resources, L.P. v. Discovery Operating, Inc.

- **Background:** Operator of oil and gas wells brought trespass to try title action against oil and gas lessee that had maintained drilling operations on various oil and gas leasehold estates, asserting that lessee's leases had automatically terminated and that it had since acquired leasehold interest in the estates.

Endeavor Energy Resources, L.P. v. Discovery Operating, Inc.

- Facts:
- Endeavor had leases initially in the N/2 of Sec. 9 and S/2 of Sec. 4
- 4 wells were drilled, 1 in each of the following locations
 1. N/2 of the NE/4 of Section 9
 2. S/2 of the NE/4 of Section 9
 3. N/2 of the SE/4 of Section 4
 4. S/2 of the SE/4 of Section 4

Endeavor Energy Resources, L.P. v. Discovery Operating, Inc.



Endeavor Energy Resources, L.P. v. Discovery Operating, Inc.

- **Facts (Continued):**

- Endeavor filed certified proration plats with the Texas RR Commission for all 4 wells, designated ~81 acres to each well.
- After the expiration of the primary term, Patriot Royalty and Land, LLC executed leases on the remaining SW/4 of Section 4 and NW/4 of Section 9.
- Patriot then assigned leases to Discovery who drilled wells both sections.

*Endeavor Energy Resources, L.P. v.
Discovery Operating, Inc.*

- **Facts (Continued):**

- Endeavor objected asserting that the applicable governmental proration unit for each of its wells is 160 acres, instead of the ~81 acres as filed in the plats with the RR Commission.

Endeavor Energy Resources, L.P. v. Discovery Operating, Inc.

- **Retained Acreage Clause from Lease:**
- lease shall automatically terminate as to all lands and depths covered herein, *save and except* those lands and depths located within a *governmental proration unit assigned to a well* producing oil or gas in paying quantities and the depths down to and including one hundred feet (100') below the deepest productive perforation(s), with each such governmental proration unit to contain the number of acres required to comply with the applicable rules and regulations of the Railroad Commission of Texas for *obtaining the maximum producing allowable* for the particular well.

Endeavor Energy Resources, L.P. v. Discovery Operating, Inc.

- **Holdings:**

1. Reference to proration unit “assigned” to well in mineral leases' continuous development and retained acreage clauses referred to lessee's assignment of acreage through its regulatory filings, and thus, lessee's assignments of acreage governed the oil and gas leasehold interests that lessee retained after primary term of leases expired;

Endeavor Energy Resources, L.P. v. Discovery Operating, Inc.

- **Holdings:**

2. Retained acreage clauses in mineral leases required lessee to include in its certified plats only the number of acres required to comply with Railroad Commission's rules for obtaining maximum producing allowable for each oil or gas well, and thus, lessee retained only the acreage it had assigned to each well after primary term of leases expired; and
3. Retained acreage clauses in mineral leases operated as special limitations on lessee's oil and gas leasehold interests.

XOG Operating, LLC v. Chesapeake Exploration Limited Partnership et al.

- **Background:** Assignors of oil and gas leases brought action against assignees to interpret “retained acreage” clause of assignment contract.

XOG Operating, LLC v. Chesapeake Exploration Limited Partnership et al.

- **Facts:**

- By a term assignment, XOG conveyed to Chesapeake its rights as lessee under 4 oil-and-gas leases covering approximately 1,625.80 acres in 3 sections of land in Wheeler County.
- The assignment's primary term was 2 years and "as long thereafter as operations"—defined to include "drilling" and "completing"—"are conducted upon said lease with no cessation for more than sixty (60) consecutive days".
- Under the retained-acreage provision, the assigned interest would revert to XOG after the primary term

XOG Operating, LLC v. Chesapeake Exploration Limited Partnership et al.

- **Facts (Continued):**
- Chesapeake completed 6 wells during the primary term of the assignment, all producing or capable of producing gas in paying quantities. Five of the 6 wells are located in the Allison–Britt Field, for which the Railroad Commission has promulgated field rules.
- The 6th well is located in the Stiles Ranch Field, for which there are no field rules.

XOG Operating, LLC v. Chesapeake Exploration Limited Partnership et al.

- **Retained Acreage Clause from Lease:**
- save and except that portion of [the leased acreage] included within the proration or pooled unit of each well drilled under this Assignment and producing or capable of producing oil and/or gas in paying quantities. The term “proration unit” as used herein, shall mean the area within the surface boundaries of the proration unit then established or prescribed by field rules or special order of the appropriate regulatory authority for the reservoir in which each well is completed. In the absence of such field rules or special order, each proration unit shall be deemed to be 320 acres of land in the form of a square as near as practicable surrounding[] a well completed as a gas well producing or capable of production in paying quantities

Endeavor Energy Resources, L.P. v. Discovery Operating, Inc.

- **Retained Acreage Clause from Lease:**
- lease shall automatically terminate as to all lands and depths covered herein, *save and except* those lands and depths located within a *governmental proration unit assigned to a well* producing oil or gas in paying quantities and the depths down to and including one hundred feet (100') below the deepest productive perforation(s), with each such governmental proration unit to contain the number of acres required to comply with the applicable rules and regulations of the Railroad Commission of Texas for *obtaining the maximum producing allowable* for the particular well.

XOG Operating, LLC v. Chesapeake Exploration Limited Partnership et al.

- **Holding:**
- Acreage “included within the proration unit for each well prescribed by field rules” referred to acreage set by field rules, which was 320 acres.

QUESTIONS?

kevin@theenergylawgroup.com