RETAINED ACREAGE CLAUSES – RECENT CASES AND ISSUES

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I. INTRODUCTION

Retained acreage clauses have been a relatively common feature of Texas oil and gas leases for decades. *See, e.g.*, *Parten v. Cannon*, 829 S.W.2d 327, 329 (Tex. App.—Waco 1992, writ denied) (interpreting retained acreage clause contained in oil and gas lease executed in 1976), *and Mayfield v. de Benavides*, 693 S.W.2d 500, 501-02 (Tex. App.—San Antonio 1985, writ ref'd n.r.e) (interpreting retained acreage clause included in a 1968 oil and gas lease). Although such clauses have appeared in Texas oil and gas leases for decades, Texas cases have reviewed and interpreted retained acreage clauses on relatively few occasions. Until recently. Between 2013 and 2017, Texas appellate courts have produced nine opinions centering around retained acreage clauses. This paper will review the facts, issues and outcomes of these recent cases.

II. RETAINED ACREAGE CLAUSES: WHAT THEY ARE AND WHAT THEY DO

An extensive analysis of the purpose and history of retained acreage clauses is beyond the scope of this paper. However, a brief explanation of the meaning, effect and reasons for the inclusion of retained acreage clauses in an oil and gas lease is necessary. Simply stated, a retained acreage clause is a clause in an oil and gas lease that sets out how much acreage a lessee may retain for each well it drills on the leased premises after the balance of the lease automatically terminates. The date of automatic termination is typically the end of the primary term, or, if the lease contains a continuous development clause, at the end of the continuous development period. One Texas court has defined a "retained acreage clause" as: "... a covenant that excludes certain acreage from the automatic termination and reversion provisions contained in an oil and gas lease. Retained acreage clauses typically provide that at the end of the primary term, each producing well will hold a specified number of acres, with all other (non-producing) acreage being released." *Hardin-Simmons University v. Hunt Cimarron Ltd. P'Ship.*, No. 07-15-00303-CV, 2017 WL 3197920 at *2 and n. 4 (Tex. App.—Amarillo July 25, 2017, no pet. h.). Another way to think of retained acreage clauses, especially when paired with continuous development provisions, is as a "drill-to-earn" clause. That is because the lessee is essentially earning the right to perpetuate the lease as to a certain number leasehold acres for each productive well drilled.

Under a traditional oil and gas lease, commercial production from anywhere on the land covered by the lease will allow the lessee to perpetuate the lease in its entirety. *Matthews v. Sun Oil Co.*, 425 S.W.2d 330, 333 (Tex. 1968). In other words, in the absence of provisions to the contrary (such as continuous development and retained acreage clauses), a lessee may hold all the acreage described and covered by the oil and gas lease with only one producing well after the end of the primary term. The retained acreage clause, therefore, changes this rule, and allows the lessee to hold only a certain number of acres for each producing well after the terminating event specified in the lease. "Retained acreage clauses were originally drafted to prevent the lessee from losing those portions of the a lease that had productive wells located thereon if the rest of the lease terminated ...[but]...[t]he term has expanded its meaning to include clauses that require the release of all acreage that, at the end of the primary term, is not within a drilling, spacing or proration unit." Bruce M. Kramer, *Oil and Gas Leases and Pooling: A Look Back and A Peek Ahead*, 45 TEX. TECH. L. REV. 877, 881 n. 28 (2013).

Retained acreage clauses are "increasingly common" in oil-and-gas leases today. *See* Patrick H. Martin & Bruce M. Kramer, WILLIAMS & MEYERS, OIL & GAS LAW, § 681.3 (LexisNexis Matthew Bender 2015) ("It is becoming increasingly common for leases to include a combination of a continuous operations clause and a retained acreage clause."). They balance the interests of landowners and operators in the pace of development. Landowners want as much development as possible to maximize royalty payments. Operators share the same development goal, but must also consider development costs, a burden they alone bear. Plummeting oil prices or skyrocketing drilling costs can cause these interests to diverge — landowners wanting more drilling to supplement reduced royalties, and operators wanting less drilling until market conditions improve. Retained acreage clauses further the interests of the landowners by providing a "use-it-or-or-lose-it" type of incentive for lessees to fully develop their leased property. In return, the retained acreage clause gives lessees certainty that they will retain a certain number of leasehold acres per well drilled, and provides them with a road map of the amount of development required to perpetuate the lease in its entirety, or at least as much of it as the lessee desires to hold.

III. RECENT RETAINED ACREAGE CASES

A. *Community Bank of Raymore v. Chesapeake Expl., L.L.C., 416 S.W. 750* (Tex. App.—El Paso 2013, no pet.)

This case dealt with the interplay and effect of an oil and gas lease's horizontal Pugh, continuous development and retained acreage clauses. In January 2005, Community Bank of Raymore ("CBR"), as lessor, leased approximately 16,000 acres of land located in Loving County, Texas, to Chesapeake, as lessee. The 16,000 acres were dived into four separately identified

blocks. *Id.* at 752. The lease contained a horizontal Pugh clause which stated:

> **G. Horizontal Termination:** At the expiration of the Primary Term or the conclusion of the continuous development program, this Lease shall terminate as to all of the leased Oil and Gas rights in all formations below the depth of 100 feet below the stratigraphic equivalent of the base of the deepest formation from which the Lessee is then producing Oil and/or Gas in paying quantities from a well or wells located on such proration or producing unit.

During the primary term, Chesapeake drilled and completed 13 producing wells on Block Two of the Lease. In January 2010, when the lease's primary term expired, the base of the deepest producing formation in Block Two was 5,672 feet below the surface. CBR then requested that Chesapeake release the lease as to all depths below 5,672 in Block Two. Chesapeake refused, and CBR sued for declaratory judgment that the lease had partially terminated. *Id.* Chesapeake argued that their development under the lease's continuous development clause prevented any partial termination of the lease under the horizontal Pugh clause. *Id.* at 753. That clause provided:

> **F. Continuous Development of Undeveloped Acreage:** This Lease shall terminate as to the undeveloped Leased Land at the expiration of the Primary Term of this Lease unless Lessee commences a continuous development program on the undeveloped Leased Land in accordance with the terms and provisions hereinafter set forth:
>
> (1) If at the expiration of the Primary Term, a producing well or well capable of producing is located on the Leased Land or if Lessee is engaged in the actual drilling of a well in search of Oil and/or Gas and thereafter diligently prosecute drilling of such well ... then Lessee shall thereafter have the option to continuously develop the undeveloped acreage with no cessation of more than one hundred eighty (180) days from the date of the release of the drilling rig from one well until the commencement of actual drilling on the next successive well with the first development well being due within one hundred eighty (180) days from the later of the above to have occurred. Should Lessee not opt to continuously develop the undeveloped acreage as provided for herein above, this Lease shall terminate as to the all undeveloped acreage at such time as Lessee fails [sic] continuously develop as so provided herein.

The lease also contained the following retained acreage clause:

> **D. Producing Acreage:** If this lease is still in full force and effect at the end of the Primary Term because Oil and/or Gas is being produced or capable of being produced at such time in paying quantities from the Leased Land under the terms of this Lease, or because the Lessee is actually drilling an Oil and/or Gas well at the end of the Primary Term, this Lease shall nevertheless terminate as to all land not included within the boundary lines of a proration unit or producing unit designated for a producing Oil well or a producing Gas well or that is not included within the boundary lines of a proration unit on which Lessee is then drilling a well in search of Oil and/or Gas, unless the Lessee continues to develop the Leased Land in accordance with the continuous development provision herein set forth.

After a bench trial, the trial court rendered judgment in favor of Chesapeake, finding that there had been no partial termination of the Lease. *Id.* at 753-54.

On appeal, CBR advanced two arguments. First, CBR argued that the horizontal Pugh clause partially terminated the Block Two acreage below 5,672 feet, despite the fact that Chesapeake had continuously developed the property "with no lapse in the time period required for continuous development." CBR claimed that the horizontal Pugh effected partial termination at both the end of the primary term and at the end of continuous development. CBR based its argument on the contention that the word "or" in the horizontal Pugh clause's first sentence ("At the expiration of the Primary Term *or* the conclusion of the continuous development program.") should be construed to mean "and." *Id.* at 755. The El Paso Court of Appeals rejected this argument because that interpretation would fail to give effect to the lease's continuous development and retained acreage clauses, which control what happens to undeveloped acreage at the end of the primary term. *Id.* at 755-56. The El Paso court also stated that it would make little commercial sense to interpret the clause in that way. That is because part of the horizontal Pugh's purpose is to encourage the lessee to continue to develop the property in order to retain all the leased acreage and depths. That incentive disappears if the lease is interpreted in a manner that allows undeveloped portions to expire even when the lessee is engaged in continuous development. *Id.* at 756.

CBR next argued that after the primary term ended, the terms of the lease were separately applicable to each separate proration unit designated pursuant to the lease's retained acreage clause, such that the continuous development clause applied separately to each proration unit. Therefore, CBR claimed, Chesapeake's continuous development only extended the lease as to the proration units upon which continuous development was occurring, and that the horizontal Pugh applied to partially terminate the deep zones underlying the proration units upon which there were producing wells, but no new development. *Id.* The El Paso court also rejected this argument because under the express terms of the lease, the "separate lease" provision was not applicable until the end of the primary term or until the end of the extension of the primary term allowed by the lease's continuous development clause. *Id.* at 756-57.

B. *Sutton v. SM Energy Co.*, 421 S.W.3d 153 (Tex. App.—San Antonio 2013, no pet.)

In this case, the San Antonio Court of Appeals interpreted a lease's continuous development and retained acreage clauses in the process of determining that an oil gas lease had partially terminated, effectively terminating overriding royalty interests in the lease reserved and owned by previous operators. The lease in question was executed in 1966, and originally covered 40,000 acres of the Briscoe Ranch located in Webb County, Texas. The original lessee, Sutton Producing Corporation, assigned the lease to Kenoil Corporation two months later, reserving a 5.46875% ORRI. In 1978, Kenoil assigned the lease to another operator, reserving a 2.0% ORRI. Both the Sutton and Kenoil assignments contained anti-washout provisions stating that their ORRIs would apply to any amendments, renewals or extensions of the lease executed within 12 months of the lease's termination. *Id.* at 156-57.

In March 2000, the successor lessee, Crimson Operating Company, L.P., released approximately 22,000 acres, and entered into a lease amendment with Briscoe Ranch regarding the remaining 18,000 acres. Crimson's 2000 lease amendment contained both a retained acreage and a continuous development clause, which provided in pertinent part:

> 4. On or before December 31, 2003, each well then capable of production and entitled to perpetuate acreage as a producing well, shall be entitled to perpetuate this lease only as to 160 acres. Not later than December 31, 2003, Lessee shall designate a 160 acre production tract around each well capable of producing oil or gas in paying quantities ... .
>
> 5. Provided Lessee has timely completed all requirements under the foregoing sections 1 through 4, and provided on December 31, 2003, any acreage then covered by this lease has not been perpetuated by and ascribed to a well tract as stated above, and Lessee is then engaged in drilling operations on a well on the lease premises, this lease shall remain in force and effect as to such acreage so long as Lessee shall commence the actual drilling of an additional well within 120 consecutive days after completion of the proceeding [sic] well. Said lease shall remain in full force and effect as to all such acreage during such drilling operations, and as long thereafter as Lessee continues to drill additional wells spudding each well within 120 days after completion of the previous well until all of the acreage covered by the lease premises shall be producing and included in a well tract or well tracts. ...
>
> If at any time after December 31, 2003, Lessee fails to commence the actual drilling operations for any well within the time interval as set forth above, or to diligently prosecute the same, or any other termination or forfeiture of condition or provision become effective under this lease, then this lease shall automatically terminate as to all of the lease premises, save and except only the acreage included within each well tract as defined under this amendment and Lessee shall release all depths below the base of the deepest formation from which Lessee is then currently producing oil or gas under each well tract.

Id. at 159-160. Later, in 2007, SM Energy Corp. ("SM") and Briscoe again amended the lease with the following continuous development provision:

> If at the expiration of the primary term and any extensions thereof, any acreage leased herein has not been perpetuated by and ascribed to a well tract as stated herein, and Lessee is then engaged in drilling operations on a well on the leased premises, or Lessee has done so within ninety (90) days prior to the expiration of the primary term and Lessee shall have notified Lessor by written or electronic form of its intent to conduct continuous development, this lease shall remain in force and effect as to the leased premises so long as Lessee shall commence the actual drilling of an additional well or wells within one-hundred twenty (120) days after completion of the preceding well. ... If any such additional drilling on any well drilled hereunder being continued at the expiration of the primary term or thereafter in

> accordance with the terms of this paragraph results in production, then this lease shall remain in full force and effect as to the well tract ascribed to each well herein according to the appropriate acreage set out in this lease.

Id. at 160. After execution of the 2007 amendment, SM completed the drilling of its last well on the lease on or about October 5, 2008, and did not commence drilling operations on the lease within the following 120 days, due to the steep decline in gas prices at the end of 2008. Therefore, SM and Briscoe took the position that the lease terminated on February 5, 2009 as to the balance of the 18,000 acres not included in any well tract. Subsequently, in late 2009, SM drilled a successful Eagle Ford well in the area, and entered into a new lease on the remaining 18,000 acres with Briscoe on May 1, 2010. *Id.* at 157. Sutton and the other ORRI interest owners later sued SM for its ORRI on production under the 2010 Lease. The trial court entered summary judgment in favor of SM, declaring that the ORRI's had been extinguished and that SM was not required to pay any overriding royalties to Sutton on production from the 2010 Lease. *Id.* at 155.

On appeal, Sutton argued that although the continuous development period ended 120 days after completion of the last well under the 1966 lease, the 2007 amendment to the lease's continuous development clause did not clearly provide that the lease terminated at the end of continuous development, and further, that the 2007 amendment was ambiguous as to the method of determining the size of retained well tracts. Therefore, according to Sutton, nothing happened at the end of the continuous development period, and the 1966 lease was continued under the habendum clause until the new lease was executed in 2010. The San Antonio Court of Appeals disagreed with Sutton, stating: "[h]armonizing all the provisions together, we conclude the consistent, unambiguous intent of the parties beginning with the 1966 lease and continuing through its amendments is that the lease would terminate unless the lessee commenced drilling an additional well or wells within 120 days after completion of the previous well." *Id.* at 161. Therefore, the 1966 Lease had terminated over a year before the 2010 Lease was executed, and Sutton's ORRI expired.

C. ***Chesapeake Exploration, L.L.C. v. Energen Res., Corp.*, 445 S.W.3d 878 (Tex. App.—El Paso 2014, no pet.)**

The lease at issue in this case was executed in 1976 and covered a 640 acre section of land in Ward County, Texas referred to by the court of appeals as Section 25. *Id.* at 879. The lease also contained a continuous development clause that required that in order to perpetuate the lease after the end of the primary term, the lessee must continue development and not allow more than 60 days to elapse between the completion of one well and the commencement of the next well. *Id.* at 880. Further, the retained acreage clause provided that at the end of continuous development, the lease terminates as to all acreage except:

> [E]ach proration unit established under ... [the] rules and regulations [of the RRC...] upon which there exists (either on the above described land or on lands pooled or unitized therewith) a well capable of producing oil and/or gas in commercial quantities ... .

Id. at 879.

In 1978, 80 acres of land located in section 25 were included in a producing, pooled gas unit known as the Cadenhead No. 1 Unit. *Id.* at 880. In 1979, the remaining 560 acres of land located in Section 25 were included in a second producing, pooled gas unit known as the Cadenhead No. 2 Pooled Gas Unit. *Id.* In 1988, the Cadenhead No. 2 Well ceased production and was abandoned. *Id.* The opinion does not explain how either Energen or Chesapeake obtained its respective interests in Section 25, however, Energen drilled a well on the 560 acre portion of Section 25 in 2011, and Chesapeake obtained a permit from the Railroad Commission of Texas to drill a well on that same acreage. At trial, Energen claimed that the lease remained in effect as to all acreage contained in Section 25 and Chesapeake claimed that the lease had terminated as to the 560 acre portion of Section 25 that had been included in the Cadenhead No. 2 Unit. The trial court granted summary judgment in favor of Energen. The issue for the El Paso Court of Appeals was whether the lease's retained acreage clause provided for "rolling" termination of proration units once they ceased to produce, or if the clause operated only once, when continuous development ceased. *Id.* at 881. The El Paso court agreed with Energen, and affirmed the trial court. *Id.* at 880.

The El Paso court began its analysis noting that the lease's pooling clause confirmed production anywhere on the given section, or land pooled with it, was sufficient to maintain the leases as to the entire section, and the lease apparently did not contain a Pugh clause. *Id*. at 880, 882. Nevertheless, Chesapeake claimed that the original lease terminated as to the 560 acres included in the Cadenhead No. 2 Unit when the Cadenhead No. 2 Well ceased producing. *Id.* at 881. The court rejected that argument, noting that the "[t]he plain, grammatical language of the retained acreage clause does not expressly provide for rolling termination of proration units as they cease to exist." *Id.* at 883. Chesapeake argued that the language of the retained acreage clause must be read to require "rolling" termination, because, as soon as production ceased, there could no longer be a "proration unit" for Railroad Commission purposes and

therefore, under the terms of the lease's retained acreage clause, the lease terminated as to 560 acres from Section 25 included in the Cadenhead No. 2 Unit. *Id.* at 883-84. The court rejected this construction, arguing that the lease's reference to the Railroad Commission regulations was to set the size of the retained acreage at the time continuous development ceased. Further, the court pointed out that had the parties wished to provide for "rolling" termination of proration units once production ceased from each proration unit, they could have done so by including express language to that effect in the lease. That language was not in the lease, however, and the El Paso Court of Appeals determined an interpretation that required "rolling" termination would require rewriting the leases. *Id*. Therefore, because there was production from both the Cadenhead No. 1 and No. 2 Units at the end of continuous development, the lease remained in effect as to all of Section 25 even after the Cadenhead No. 2 Unit well was abandoned because the Cadenhead No. 1 well continued to produce in paying quantities.

D. *Endeavor Energy Res., L.P. v. Discovery Operating, Inc.,* 448 S.W.3d 169 (Tex. App.—Eastland 2014, pet. granted)[1]

In this case, Endeavor Energy Resources, L.P. ("Endeavor") owned oil and gas leases covering certain lands located in Martin County, Texas described as the N/2 of Section 9 and the S/2 of Section 4 (both half sections covering approximately 320 acres, more or less). Discovery Operating, Inc. ("Discovery") brought a trespass to try title action against Endeavor over competing claims of title to and ownership of determinable fee interests on two quarter sections of land—the NW/4 of Section 9 and SW/4 of Section 4 (the "Disputed Acreage")—located in Martin County, Texas. Discovery contended that leases held by Endeavor had partially terminated, that the terminated interests had been released, and that Discovery had subsequently acquired valid leases on the Disputed Acreage. Endeavor claimed that the four oil and gas wells it had drilled under its leases perpetuated both leases as to 320 acres pursuant to the leases' continuous development and retained acreage clauses.

Both leases contained the following retained acreage clause:

> 18. At the end of the Primary Term or upon the cessation of the continuous development of the Leased premises required above, whichever is later, this 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.

Id. at 172.

After completing the wells on the leases, Endeavor filed proration plats with the Railroad Commission indicating that each of the Endeavor wells' proration units included approximately 80 acres. *Id.* at 174. Subsequently, Discovery took the position that both leases terminated as to the Disputed Acreage at the end of Endeavor's continuous development, because Endeavor had failed to include the Dispute Acreage in its proration plats filed at the Railroad Commission.

Endeavor argued that Discovery's interpretation was incorrect, and that the section of the retained acreage clause stating "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" established the size of the of the proration units as containing 160 acres under the Railroad Commission's Special Field Rules for the Spraberry (Trend Area) Field. *Id*. at 173, 177 ("A proration unit assigned to a well by an operator must contain the maximum amount of acreage permitted under Rule 3 for the well to be assigned the maximum allowable production. ... Accordingly, the maximum amount of acreage that an operator can include in a proration unit assigned to a well is 160 acres. This amount of acreage is necessary for a well to obtain maximum producing allowable."). Endeavor also contended that its regulatory filings of 80 acreage proration units did not control over the language of the lease allowing for retained proration units of 160 acres.

The trial court granted summary judgment in favor of Discovery and Endeavor appealed. The issue the Eastland Court of Appeals addressed was whether Endeavor had perpetuated the leases as to 160 acres per well, or only the 80 acres per well as specified in the certified proration plats Endeavor filed with the Railroad Commission. *Id*. at 176.

Affirming the trial court's ruling, the court of appeals disagreed with Endeavor, stating that the use of the word "assigned" in the clause, meant that Endeavor must have actually included the Disputed Acreage in the

[1] For purposes of full disclosure, the author of this paper represent Endeavor Energy Resources, L.P. in this case.

proration plats filed with the Railroad Commission. *Id*. at 178.

This case remains pending before the Texas Supreme Court. Endeavor's petition for review was initially denied on March 31, 2017. However, on September 1, 2017, the Court granted Endeavor's Motion for Rehearing and granted Endeavor's petition for review. The case is now set for Oral Argument on January 9, 2018.

E. *ConocoPhillips Co. v. Vaquillas Unproven Minerals, Ltd.,* 04-15-00066-CV, 2015 WL 4638272 (Tex. App.—San Antonio Aug. 5, 2015, pet granted, judgment set aside, remanded by agreement)

ConocoPhillips, as lessee owned two oil and gas leases covering, respectively, 26,622.79 and 6,740 acres of land in Webb, County, Texas. Vaquillas Unproven Minerals, Ltd. ("Vaquillas") was the lessor under both leases. Both leases contained a retained acreage clause which stated:

> ..., Lessee covenants and agrees to execute and deliver to Lessor a written release of any and all portions of this lease which have not been drilled to a density of at least 40 acres for each producing oil well and 640 acres for each producing or shut-in gas well, except that in case any rule adopted by the Railroad Commission of Texas or other regulating authority for any field on this lease provides for a spacing or proration establishing different units of acreage per well, then such established different units shall be held under this lease by such production, in lieu of the 40 and 640–acre units above mentioned....

Id. at *1.

At issue was whether a spacing rule adopted by the Railroad Commission had the effect of establishing different units of acreage per well, reducing the number of acres the allowed for producing or shut-in gas wells from 640 to 40 acres. *Id*. The Railroad Commission adopted field rules for the relevant field which provided:

> Rule 2. No well shall hereafter be drilled nearer than FOUR HUNDRED SIXTY SEVEN (467) feet to any property line, lease line or subdivision line and no well shall be drilled nearer than ONE THOUSAND TWO HUNDRED (1,200) feet to any applied for, permitted or completed well in the same reservoir on the same lease, pooled unit or unitized tract. ....The aforementioned distances in the above rule are minimum distances to allow an operator flexibility in locating a well, and the above spacing rule and the other rules to follow are for the purpose of permitting only one well to each drilling and proration unit.

Id. at *3.

The trial court concluded that the Railroad Commission rule, as referenced in the retained acreage clause, had been adopted, reducing ConocoPhillips' retained acreage to 40 acres around each producing and shut-in gas well and requiring it to release 15,351 acres to Vaquillas. *Id.* at *1.

The San Antonio Court of Appeals concluded that, while that rule did not explicitly provide for different units of acreage per well, Rule 38 of the Statewide Rules provides that if the spacing rule is "467'-1200'," then the acreage requirement is 40 acres per well for both oil and gas wells. *Id*. at *3. Affirming the trial court, the San Antonio Court of Appeals interpreted the rule to establish a standard acreage that is different from that stated in the retained acreage clause, reducing the retained acreage of producing or shut-in gas wells from 640 to 40 acres. *Id*. at 3.

F. *XOG Operating, LLC v. Chesapeake Expl. Ltd. P'ship*, 480 S.W.3d 22 (Tex. App.—Amarillo 2015, pet. denied) order withdrawn and pet. reinstated (Sept. 1, 2017)

In 2003, XOG assigned four oil and gas leases covering 1,625 acres, more or less, in Wheeler County, Texas to Chesapeake's predecessor-in-interest, EOG. The assignment, commonly known as "Term Assignment," was for a primary term of 2 years. The Term Assignment also contained the following retained acreage clause:

> Upon expiration of the Primary Term of this Assignment ... this Assignment and all rights created hereunder shall terminate as to all lands and depths covered hereby. Said lease shall revert to Assignor, *save and except that portion of said lease 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 surroundings [sic] a well completed as a gas well producing or capable of production in paying quantities.... Upon termination or

> partial termination of this Assignment and the rights created hereunder, Assignee shall promptly provide Assignor with a fully executed and recordable release of this Assignment....

Id. at 24-25. At the end of the primary term Chesapeake had drilled gas wells, each of which entitled it to retain 320 acres for a total of up to 1,920 acres (or, at a minimum, all acreage covered by the Term Assignment). However, Chesapeake had not designated 320 acres per well in its form P-15 proration filings at the Railroad Commission. Instead, Chesapeake had designated "fractional proration" units totaling only 802 acres for the 6 wells. *Id.* at 25-26.

XOG brought a trespass to try title case against Chesapeake, seeking an interpretation of the retained acreage clause that would limit the retained portion of Chesapeake's lease to land described in the P-15 forms Chesapeake filed at the Railroad Commission, and that the Term Assignment had terminated as to over 800 acres. *Id*. at 25. The trial court granted summary judgment in favor of Chesapeake, and XOG appealed. The issue the Amarillo Court of Appeals addressed was whether Chesapeake had perpetuated the Term Assignment as to 320 acres per well as provided for in the Term Assignment, or only the smaller amount of acres in the "fractional proration units" Chesapeake included in its Form P-15 proration filings it filed with the Railroad Commission.

XOG argued that under the plain language of the agreement, each drilled well maintained only the acreage described in the P-15 forms filed with the Texas Railroad Commission. *Id*. at 27. XOG further argued that industry practice was to tie retained acreage to "the regulatory framework of the railroad commission." *Id.* at 29. XOG further argued that the because the Railroad Commission does not designate the amount of acres in a proration unit, then the Term Assignment's definition of the proration unit must refer to the acreage designated in the operator's Form P-15 filing. *Id*. at 28-29. Chesapeake argued that by the plain language of the agreement, each well retained the number of acres prescribed by the Railroad Commission's field rules for obtaining maximum production for a well in that particular field, or in the absence of such rules, 320 acres. *Id*. at 27. XOG countered that this interpretation would render meaningless the Term Assignment's language saving from automatic termination acreage "included within the proration." *Id*. at 29.

The Amarillo Court of Appeals rejected XOG's argument and agreed with Chesapeake, affirming the trial court's ruling. The court held that the Term Assignment defined proration unit, as the area within the surface boundaries of the unit prescribed by the applicable field rules. *Id* at 29. Therefore, by the agreement of the parties, a proration unit was 320 acres, as defined by the field rules. *Id*. Based on that interpretation, the language of the Term Assignment controlled over the operator's regulatory filings, and the disputed acreage had not been released from the lease. *Id*.

H. *Mayo Found. for Medical Education v. Courson Oil & Gas, Inc.*, 505 S.W.3d 68 (Tex. App.—Amarillo 2016, pet. denied)

Courson involves an oil and gas lease covering 35,000 acres in Roberts County, Texas. The property was originally leased by Barbara Woodward Lips to Alpar Resources, Inc. in 1994. Lips passed away in 1997, and left her interest in the minerals and lease to the Mayo Foundation ("Mayo"). Courson and another company, Latigo, each subsequently acquired working interests in the Alpar lease. *Id.* at 69.

The dispute between Courson[2] and Mayo was the effect of continuous development on the leasehold acreage after the end of the primary term. Mayo took the position that the lease's atypical habendum clause provided different mechanisms for maintaining developed and undeveloped acreage after the end of the primary term. According to Mayo's interpretation, after the end of the primary term, the lessee could perpetuate the lease as to *only* undeveloped acreage by engaging in continuous development. As to developed acreage, Mayo claimed that, after the end of the primary term, the lessee must designate retained "production units," and such production units must be held by continued production, or, if production ceased, by either reworking those wells or drilling additional wells within 60 days of the cessation of production. *Id.* at 70 - 71.

Courson took the position that after the end of the primary term, continuous drilling of wells every 180 days (or until banked time credits, pursuant to the lease, run out) perpetuates the lease as to all acreage conveyed. Once continuous development ends, Courson argued, the lease expires as to all acreage not in a retained "production unit." At that time, each production unit can be maintained by continuous production, or by reworking or drilling new wells within 60 days after production ceases. *Id.* at 71. The parties filed competing summary judgment motions, and the trial court granted Courson's motion and denied Mayo's. *Id.* at 70.

In determining the issue, the Amarillo Court of Appeals found persuasive language in the lease stating "[i]t was the intent of such lease to provide that after [the] primary term, lessee could continue to develop such lease by drilling a well on the property each 180 days and that the lease would remain effective so long as such drilling by Lessee continued." *Id.* at 71. The court also focused lease language allowing for the

[2] Latigo settled and aligned with Mayo.

designation of retained production units "notwithstanding the termination of this lease as to a portion or portions of acreage covered hereby." Construing these provisions together, the court stated: "These provisions appear to provide that Courson may continue the lease as to *all of the covered property by maintaining continuous drilling or accumulating banked time credits* and, subsequently, it can hold designated production units that are producing in paying quantities ... ." Id. at 71 (emphasis added). Further, in rejecting Mayo's argument, the Amarillo court focused on the retained acreage clause, which provided:

> Lessee shall, *within sixty (60) days after the termination of the lease, ...* execute and file for record ... a written recordable instrument designating and describing all of the lands covered by this lease which, upon such termination, are properly included in a Production Unit ... and *Lessee shall, at such time, further evidence such termination by releasing this lease as to all the lands originally covered hereby not properly included in such unit or units.*

Id. at 72 (emphasis in original). The court noted that in order for there to be a distinction in the way developed and undeveloped lands are maintained, the lease must identify the mechanism by which the "undeveloped" land becomes "developed" land. The mechanism for that was the designation of Production Units pursuant to the above quoted retained acreage clause. The Amarillo court reasoned that since the retained acreage clause requires release of all "undeveloped" acreage at the same time retained Production Units are designated, the only termination that the retained acreage clause could possibly refer to is the termination of the lease at the end of continuous development. Therefore, the Amarillo court affirmed the trial court, concluding that Courson's construction—that continuous development after the end of the primary term maintained the lease as to all land covered by the lease, not just "undeveloped" acreage—was the only reasonable construction.

I. *Hardin-Simmons Univ. v. Hunt Cimarron Ltd. P'ship,* 07-15-00303-CV, 2017 WL 3197920 (Tex. App.—Amarillo July 25, 2017, no pet. h.)

Hardin-Simmons was the lessor, and Hunt Cimarron was the lessee under an oil and gas lease executed on July 31, 2006 covering approximately 4,960 acres of land located in Cochran County, Texas. Much of the property had previously been leased and included in a 13,000 acre waterflood project. Some of the acreage covered under the new lease included wells drilled under the prior lease that continued to produce. The lease provided for a primary term of five years, and a continuous development clause that required commencement of a new well every 150 days to extend the term of the lease. It also included a retained acreage clause that stated:

> 12.b. At the later of the end of the primary term or the cessation of the continuous development program for which provision is above made (herein called the "partial termination date") this lease shall terminate as to all lands and depths covered hereby, save and except as to the acreage and depths included in a production unit which said unit is defined as being: (i) a Unitized Tract formed under the Unitization Statute (which Unitized Tract shall be subject to the Agreement as referenced and described above in paragraph 5); (ii) 40 acres around each producing oil well which is not in a Unitized Tract….

Id. at *3.

In addition, the lease contained the following clause, referred to as a "reworking" clause, which stated:

> [i]f at the expiration of the primary term, oil or gas is not being produced from the land and depths subject to this lease but Lessee is then engaged in ... the reworking of any well on said land, this lease shall remain in force in accordance with its terms so long as ... reworking operations are prosecuted (whether on the same or different wells) with no cessation of more than one hundred twenty (120) consecutive days ....

Id. at *4. After the end of the Primary Term, Hardin-Simmons sued Hunt Cimarron on the following claims:

> (1) breach of the express covenant to explore and develop the leased premises for oil and gas and (2) breach of the implied covenant to (a) drill initial wells, (b) develop the premises, (c) protect the premises from drainage, and/or (d) market the oil or gas produced. Hardin–Simmons also sought a declaratory judgment concerning Hunt's failure to file a written release describing the mineral interests no longer held by production.

Id. at *1. The evidence presented at trial showed that during the primary term of the lease, Hunt Cimarron did not commence drilling any new wells or recomplete any legacy wells in a new production zone. Evidence did show that Hunt Cimarron did commence reworking operations on ten legacy wells in July 2011, days before the end of the primary term. *Id.* at *4. The jury returned a verdict in favor of Hunt Cimarron, resulting in a take

nothing judgment on Hardin-Simmons claims. Hardin-Simmons appealed asserting that the trial court erred in denying its motions for judgment notwithstanding the verdict and motions for new trial.

The issue before the Amarillo Court of Appeals was whether the Hunt Cimarron's reworking operations extended the lease in its entirety or, whether the lease partially terminated when, just prior to the expiration of the primary term, Hunt Cimarron commenced its reworking operations on ten preexisting "legacy" wells. In making its determination, the court was required to interpret the termination clause together with the retained acreage clause, a "reworking" clause and the continuous development clause (included in what the court referred to as the Pugh clause).

Hardin-Simmons argued that the reworking did not extend the primary term of the lease, but only the overall term of the lease as it pertained to "producing acreage." *Id*. at *8. Hunt Cimarron argued that the entire lease was extended under the reworking clause. *Id*. The court agreed with Hardin-Simmons, based on contrasting the terms of the reworking clause with the provisions of the continuous development and retained acreage clauses. *Id*. In particular, the reworking clause stated that the lease would "remain in force in accordance with its terms so long as reworking operations are prosecuted (...) with no cessation of more than one hundred twenty (120) consecutive days …." *Id.* In contrast, the retained acreage clause stated that in the event of continuous development, the lease will be kept in force "as to all lands and depths" covered by the lease agreement. *Id.* The retained acreage clause also defined other acreage exempted from termination, including 40 acres around each producing well. *Id*.

The Amarillo Court of Appeals, reversed the rulings of the trial court, holding that this contrast showed that the continuous development and reworking clauses applied the retained acreage clause's terms exempting only the 40 acres around each producing well and well being reworked from termination, and not the all lands, as would have been retained in the event of continuous development. *Id*. at 8. The court therefore rendered judgment that Hunt Cimarron retained only 40 acres around each well that was producing and/or being reworked at the end of the primary term.

J. *Apache Deepwater, LLC, v. Double Eagle Dev., LLC,* No. 08-16-00038-CV, 2017 WL 3614298 (Tex. App.—El Paso August 23, 2017, no pet.h.)

Apache Deepwater's predecessors leased 640 acres in Reagan County, Texas ("Section 43") from Gladys Clark in 1975 (the "Clark Lease"). The Clark Lease was for a primary term of 3 years, and defined the "leased premises" to contain all 640 acres of Section 43 covered by the lease. The Clark Lease also contained the following continuous development or "drilling operations" clause:

> If Lessee should drill and abandon as a dry hole a well on the *leased premises*, or if after the discovery of oil, gas or other minerals, the production thereof should cease from any cause, and, in either event there are no other producing wells on the *leased premises* or on lands with which they are pooled or unitized, or drilling or reworking operations are not being conducted thereof, this lease shall not terminate if Lessee commences reworking or additional drilling operations on the *leased premises* within sixty (60) days… If , at the expiration of the primary term, oil, gas or other minerals are not being produced from the *leased premises* or from lands with which the *leased premises* are pooled or unitized, but Lessee is then engaged in operations for drilling or reworking of any well, this lease shall remain in force so long as such drilling or reworking operations are prosecuted, or reworking operations on any well or additional drilling operations are conducted on the *leased premises*, or on lands pooled, or unitized therewith, with no cessation of more than sixty (60) consecutive days, and if any such operations result in production then as long thereafter as such production continues.

Id. at *2. Further, the Clark Lease included the following retained acreage clause:

> Notwithstanding anything to the contrary in the foregoing, Lessee covenants to release this lease after the primary term except as to each producing well on said lease, operations for which were commenced prior to or at the end of the primary term and the proration units as may be allocated to said wells under the rules and regulations of the Railroad Commission of Texas or 160 acres, whichever is greater, insofar as said proration units cover from surface to the base of the deepest formation penetrated by the deepest of said wells. The description of said tracts around said well shall be compiled and prepared by the Lessee for the purpose of executing such release.

Id. at *3.

At the end of the primary term, four producing wells has been drilled and completed on Section 43, each on a 160 acre quarter section proration unit. *Id.* at * 1 and n. 3. By 2010, all four original wells had ceased producing, but production continued from the No. A-5TM well, which was drilled, completed and began producing from the southwest proration unit before the Gladys Clark No. A-3 well ceased production. *Id.* at *2. In 2012, the owner of Section 43 executed new leases

with Double Eagle, covering the 480 acres of Section 43 (the north half and the southeast quarter) on which production no longer existed. Double Eagle then asked Apache to release its interest in the Clark Lease as to the disputed 480 acres. Apache refused, claiming that production from the No. A-5TM well maintained the Clark Lease as to all of Section 43. In the ensuing lawsuit, both parties filed motions for summary judgment on the validity of the Clark Lease as to the disputed 480 acres. The trial court granted Double Eagle's motion and denied Apache Deepwater's, effectively declaring that the Clark Lease had terminated as to the disputed 480 acres.

The issue before the El Paso Court of Appeals was whether the No. A-5TM well maintained the Clark Lease as to all of Section 43, or just the 160 acre proration unit in which it was located. Essentially, the court had to determine whether the Clark Lease's habendum, continuous development and retained acreage clauses allowed for "rolling" termination of proration units. In making its determination, the El Paso Court found that the habendum clause clearly and unequivocally established that a single operating well producing in paying quantities could hold the entire leased premises past the primary term. *Id.* at *4. This is especially clear because "leased premises" was a defined term encompassing the entire 640 acres. *Id*.

Given that finding, the question became whether the other clauses demonstrated a clear intent to negate or modify the terms of the habendum clause to allow rolling termination of retained proration units. *See id*. at *4-5. First the court found that the continuous development/drilling operations clause was clearly consistent with the habendum clause, using the defined term "leased premises" to allow work on a single well to hold the entire 640 acres. *Id.* at *4.

Next the court examined the retained acreage clause, finding its precedent in *Chesapeake Exploration., L.L.C. v. Energen Resources Corp*., 445 S.W.3d 878 (Tex.App.—El Paso 2014, no pet.) dispositive. *Id.* at *5. There, the court held that in the absence of clear language providing for the rolling termination of proration units, the retained acreage clause operated once and only once, at the end of continuous development. *Energen*, 445 S.W.2d at 885-886. Applying its reasoning in *Energen* to the Clark Lease, the El Paso Court harmonized the phrase "after the primary term" in the Clark Lease's retained acreage clause with its habendum clause by interpreting the phrase "after the primary term" to accommodate release of acreage being held by wells being drilled or worked on at the end of the primary term that did not "pan out." *Apache Deepwater, LLC*, 2017 WL 3614298 at *6.

Further, the retained acreage clause in the Clark Lease did not express a clear intent to negate the habendum clause and allow for rolling termination. In this regard, the El Paso Court of Appeals found it persuasive that rolling termination clauses are well known in the industry and simple enough to write, when desired, discounting the possibility that the drafter's intent was to create one. *Id*.

Dispensing with the rest of Double Eagle's arguments, the court ruled for Apache, declaring that the Clark Lease was valid as to the entire mineral leasehold interest in Section 43, except for everything below 10,000 feet, which had been released without argument. *Id* at *8.