TEXAS OIL AND GAS LEASING
A PRIMER

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CHAPTER 21.1
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Texas Oil And Gas Leasing A Primer

Chapter 21.1

Texas Oil and Gas Leasing
A Primer

I. INTRODUCTION
A. SCOPE

This paper is written and presented to assist real estate attorneys in representing landowners in oil and gas leasing transactions, especially in rural or undeveloped areas. The intent is to provide a broad overview of issues involved in modern leasing. The paper assumes that the reader has some knowledge of the oil and gas industry and is dealing with property not already in a producing unit. Those without basic knowledge of oil and gas law are advised to study more comprehensive background material such as Oil and Gas in a Nutshell by John S. Low (published by West). Time, space, and this author's writing ability does not allow a thorough examination of the development and current state of oil and gas law. Accordingly, the paper is not heavily annotated.

This paper is written for real estate lawyers representing landowners. Those with several years of experience representing oil and gas producers in drafting leases will likely find the content trite and shallow. Much more in-depth treatment of the subject matter is regularly presented in the State Bar's Oil, Gas and Energy Resources Law Section Report.

In writing this paper, the author attempted to present well-settled legal principals. To the greatest extent possible, no speculative theories are espoused or defended.

B. DISCLAIMER

The leases attached as exhibits represent a cross-section of instruments the author reviewed on behalf of clients in early 2006. They are not presented as being favorable to the lessor; but merely reflect the type of document likely to cross the practitioner's desk. None of the leases represent this author's original work and credit is given to the drafters of such (whoever he, she or they may be).

The author shamelessly plagiarized most of the addendum provisions in this paper from other attorneys' work. Each has been modified so many times that the original text and name of its drafter are now unknown. The provisions are presented as examples or a rough guide to the reader and should be modified to fit the user's situation. There are likely other better provisions to accomplish the same general goals of the presented addendum provisions. To the extent the reader is aware of such, he is encouraged to fax or e-mail them promptly to the author for review and adoption in his own practice. Just as there is no such thing as a "standard Producers 88", there is no group of lease addenda that will fit every situation. There are enumerable other provisions that have been and should be used to address the concerns of the attorney and his/her client.

II. THE BASIC LEASE
A. PREAMBLE / PARTIES

The basic oil gas and mineral lease begins with a header stating that it is a Producer's 88 of some permutation. This can be misleading to landowners. Leasing agents have been known to tell landowners that it is unnecessary to have a lease reviewed by an attorney because it is a standard Producers 88 and the same instrument all his/her neighbors signed. While the format seems to follow a relatively standard convention, the reader is advised that THERE IS NO STANDARD OIL AND GAS LEASE. It is imperative the practitioner read every part of every paragraph of the lease in advising his/her client.

The lease will begin by stating an effective date and naming the parties. The date is important because it determines the dates of other crucial events in the life of the lease. Most importantly, it determines the date that the lease will terminate if it is not held in force by production or otherwise.

The names of the parties can be important. This represents one opportunity for an attorney to avoid malpractice. When more than one lessor is named, the attorney should consider the possibility for conflict. If a husband and wife are named, is the property community property or the separate property of one of them? If two or more lessors are named, are their interests identical? Would one lessor benefit from a larger bonus at the expense of a greater royalty to the detriment of the other(s)? If the lessor is an entity and one or more partners, directors and/or officers, it is imperative that the practitioner identify his/her client(s) and get conflict waivers where applicable.

The attorney is also advised to research the lessee. In this author's area, it is common for the operator or final owner of the lease to take the lease in its own name. Elsewhere, the ultimate lessee will act through a leasing agent. It is also common to find independent lessee's taking a lease with the goal of selling the leases at a profit. When dealing with an unknown lessee, the attorney is advised to investigate his/her reputation with other practitioners in the area. It is not unheard of for a lessee to take a lease with the intent of selling it and then dishonor the bonus money draft when he/she is unable to sell the lease. This author finds that his clients dislike paying attorneys' fees for time spent negotiating leases when the same fails to result in the client receiving money.

B. THE GRANTING CLAUSE

1. ESTATE CREATED

After naming the parties and establishing the effective date, the lease generally proceeds to the granting clause. The usual convention is to recite that
the lessor grants the lease for "$10.00 and other valuable consideration". This does not usually present any problems; however, the author had occasion to witness a potential disaster. The client came to the author's office with an unexecuted (thankfully) lease and a check for ten dollars. The lessee had instructed the lessor to sign the lease, return it to him, and that the lessee would pay the additional bonus money (totaling over twenty thousand dollars) when he sold the lease. Consider the result if the lessee successfully assigned the lease for money and failed to pay the additional bonus money. The lessor would have to honor the lease in the hands of a bona fide purchaser for value and attempt to recover the bonus money from the original lessee, provided he could be found. Accordingly, the practitioner is advised to present the executed lease to the lessee upon receipt of the bonus money. The bonus money is traditionally paid in the form of a bank draft; however, the author finds that some lessees can be convinced to pay by cashier's check, thereby greatly reducing the number of times each succeeding week the lessor calls his / her attorney asking when the draft will be paid.

The general language of the granting clause states that the lessor "grants, lets and leases" the property exclusively to the lessee and follows with a myriad of purposes for which the property is leased. The language "grants, lets and leases" should be used in favor of other language such as "grants, sells and conveys" to clarify the intent that the estate created is in fee simple determinable rather than fee simple absolute.

2. PURPOSES

The granting clause usually sets forth the purpose for which the lessee can use the property. Each lease has a different string of purposes. The standard "exploring for, developing, producing and marketing" may be greatly expanded to such activities as laying pipelines, constructing refining facilities, and drilling injection or salt-water disposal wells. It is imperative that the practitioner carefully consider what is involved in each recited purpose and eliminate by striking or addendum those purposes which the client finds undesirable. Obviously, a client who owns the surface of the property will be more sensitive to issues involving seismic operations, pipelines, and refining operations than will a lessor who does not own the surface. Pipelines, especially larger distribution lines, should be handled in a separate agreement, and reference to them should be eliminated from the granting clause by striking or use of an addendum.

3. SUBSTANCES COVERED

The granting clause also sets forth what substances are covered. In addition to oil and gas, it likely sets forth a list of other substances like sulphur, helium, and nitrogen. The lease may also state that it is for "oil, gas an other minerals" leading to a debate regarding the identity of "other minerals" under Moser v. United States Steel Corp., 676 S.W. 2d 99 (Tex. 1984) and its progeny. To avoid leasing some substance that turns out later to have value separate and apart from oil and gas, the author recommends limiting the lease to oil, gas and other hydrocarbons produced in conjunction with oil and gas through the well bore of an oil and gas well. To the extent the practitioner is willing to expand the scope of covered substances, he / she is nevertheless advised to make clear that coal and lignite are not covered. These substances currently have value separate and apart from oil and gas and can be recovered from the property at the same time that oil and gas are being produced.

4. PROPERTY COVERED

The property covered by the lease is generally described next. As most oil and gas is produced from rural or less developed property, the description will likely include a section, range and township, or a metes and bounds description which, because of its length, will be attached as an exhibit. Care should be taken to be certain the property is described as accurately as possible. Additionally, spending time ascertaining the interest owned by the client at this point will significantly lessen the number of problems once production is had and royalties are paid. First, consider the legal description. Does it describe all the clients land in the area? If not, adjacent and adjoining strips and gores may be covered by the lease even though no bonus is paid for them. Is the description so old or questionable as to cast doubt on the number of acres involved? If so, having a new survey performed could prove useful. Suppose the client reveals that she believes her property is actually 372 acres rather than the 350 acres described in the deed to her grandfather in 1908. If a survey proves she is correct, the bonus will be paid based on the actual acreage. In this case, there was an additional 22 acres. If the bonus is $425.00 per acre, the increase to the client would be $9,350.00. Provided a new survey could be performed for less than $9,350.00, the client will benefit as a result. Most leases state that the bonus, shut-in royalties, and delay rentals are to be paid on the acreage stated, regardless of whether the total acreage is later determined to be more or less. Accordingly, surveying the property prior to executing the lease may be beneficial, especially if the lease cannot be amended to provide for additional bonus moneys to be paid if the property is later determined to be larger than it was thought to be at the time the lease was executed.

At this time, the practitioner should consider the interest owned by the client. The bonus is typically paid as a certain amount per net mineral acre. In other words, if the client owns one-half of the oil, gas and
other minerals under one hundred acres, he or she owns fifty net mineral acres. If the bonus is $300.00 per net mineral acre, the actual payment would be $15,000.00. Of course, the situation can be much more complicated. Suppose the client's property consists of three separate tracts with different fractional mineral or royalty interests reserved at separate dates. The practitioner should inquire as to how the lessee has calculated the number of net mineral acres owned by the client. If possible, the attorney should review the lessee's run sheet, prepare a title run, or purchase a title report, especially if the acreage is quite large. Taking the time to do so may increase the amount of bonus money paid and lessen the incidents of surprises when reviewing division orders when production begins. Discussing these matters with the clients up front usually saves time. Most have a keen sense of exactly what they own and will readily explain how they received it. If the client is uncertain of the interest owned, it is even more imperative to be certain the lessee's calculations are correct. Of course, these points are moot if the lessor owns 100% of the minerals and the bonus calculation reflects such.

5. THE MOTHER HUBBARD CLAUSE
Following the property description, the lease will typically contain a Mother Hubbard clause. It states that if the lessor owns any property contiguous with or adjacent to the leased property, the contiguous or adjacent property is also leased. Its purpose is to bring small strips and gores into the lease under the theory that the lessor and lessee meant to include them and would have done so if they knew of the existence of the additional property. Though this clause could work inequity in any number of occasions, it is well settled that the Mother Hubbard clause cannot be used to make the lease effective as to large adjacent tracts. *Smith v. Allison*, 301 S.W. 2d 608 (Tex. 1956). If the practitioner is aware that the client owns property nearby that he / she does not intend to include in the lease, an addendum can be used to specifically except such property from the lease. Once again, it is important to communicate with the client about such matters.

C. THE HABENDUM CLAUSE
1. TERM
The Habendum Clause is the portion of the lease that makes the instrument a conveyance in fee simple determinable. It states that the lessor has granted the oil and gas to the lessee FOR A NUMBER OF YEARS AND AS LONG THEREAFTER AS (SOME CONDITION EXISTS). The usual language is "for three (3) years and as long thereafter as oil and gas are produced from the property or property pooled therewith". It is this clause, then, that breaks a lease into a primary and secondary term. The primary term is the period, three years in this example, when no action is required on the part of the lessee. The secondary term is the period during which the lease will expire unless some condition, production in paying quantities in this example, exists. The Habendum Clause will usually go on to incorporate some savings clauses that act as substitutes for the existence of the condition. For example, the lease may state that even if there is no production in paying quantities, it will nevertheless be held in force if the lessee pays shut-in royalties.

Most modern Texas leases are "unless" leases. They expire after the primary term unless something happens. "Or" leases, also commonly referred to as "drill or pay" leases, are uncommon in Texas today and not treated herein.

Delay rentals have historically been used to allow the lessee to extend the primary term of a lease and gain additional time to achieve production. The author has seen a noticeable shift away from the mention of delay rentals in the lease. Most modern leases seem to be simple three of five year paid up leases with no provision for the payment of delay rentals. Nevertheless, the practitioner is advised to use caution in determining what conditions can extend the primary term or substitute for production in paying quantities in the secondary term.

To recap, the Habendum Clause essentially states that the lessor grants the oil and gas to the lessee for a term of years and as long thereafter as the lessee produces the minerals in paying quantities. Any departure from language that accomplishes this goal should be analyzed carefully to consider its effect.

2. SAVINGS CLAUSES
Savings clauses in the lease can appear anywhere; however, several are generally grouped together in the Habendum Clause. If the lease is for a term of years (the primary term) and as long thereafter as there is production (the secondary term), the savings clauses identify conditions or activities that act as a substitute for production and hold the lease in force during the secondary term. The most common savings clauses found at this part of the lease are the Shut-in Royalty Clause, the Operations Clause, and the Dry Hole Clause.

a. Shut-in Royalty Clause
The Shut-in Royalty clause may appear in the Habendum Clause, but more commonly appears in the section of the lease involving royalties. It is treated here because it effects the term of the lease, specifically the secondary term. The Shut-in Royalty clause essentially states that if the lessor drills a well during the primary term which is capable of producing covered minerals in paying quantities, and the well is shut-in (usually for lack of a market, for maintenance,
or because no pipeline has yet been constructed to transport the gas), the lease will not expire and will be held in force so long as the lessee makes some nominal payment. In reviewing this clause, the practitioner should look for language that identifies what circumstances will allow the lessee to pay shut-in royalties, how long the payment of shut-in royalties can hold the lease in force, and what diligence is required on behalf of the lessee to produce and market the product. Generally, an addendum can be used to limit the term during which the lessee can hold the lease by paying shut-in royalties. The commonly-used addendum limits the term during which shut-in royalties can be paid by the lessee to two years at any one time and three years in the aggregate. Most leases contemplate the payment of $1.00 per acre per year as shut-in royalties. Most lessees will agree to increase this amount to $25.00, $50.00 or even $100.00 per acre annually as the amount so paid represents a small fraction of the value of the product.

b. Operations Clause

The Operations Clause is a savings clause that generally appears within the Habendum Clause. It states that if, at the end of the primary term, there is no actual production, but the lessee is conducting operations (as that term is defined in the lease), the lease will not expire as long as operations continue. The purpose of the clause is to allow the lessee to complete a well begun in the primary term thereby extending the lease into the secondary term. Caution should be exercised in reviewing the definition of "operations". The definition may be given in this paragraph or elsewhere in the lease. Some leases provide that preliminary site preparation by the lessee constitutes operations. Clearly, such a definition could be abused by the lessee to carry the lease into the secondary term when no meaningful activity is contemplated in the immediate future. A narrower definition of operations would be more beneficial to the lessor. The practitioner is advised to work toward a definition that provides operations have begun only after a drilling rig is located on the property or property pooled with the property and is actually spudded in.

c. Dry-hole Clause

Occasionally, a lessee might drill a well which fails to produce oil or gas in paying quantities, but which produces information sufficient to lead the lessee to believe a producing well could be produced by modifying the drill site or completion method. This is the purpose of the Dry-hole clause. It prevents termination of the lease when the lessee has drilled a dry hole and allows some length of time (usually ninety (90) days) for the lessee to begin drilling another well on the property or property pooled with it. Care should be taken to insure the time period between the completion of the dry hole and commencement of operations for the next well is not too lengthy.

In summary, Habendum Clause states that the lease lasts for (1) the primary term, plus (2) as long thereafter as production continues in paying quantities, provided that (3) it will not expire for lack of production if some savings clause applies. The savings clauses may be set out in the habendum clause or elsewhere in the lease. Some savings clauses such as the Force Majeure Clause typically appear toward the end of the lease and are considered later in this writing.

D. THE ROYALTY CLAUSE

Royalties are the ultimate goal of most lessors. While it is preferable to maximize the bonus money the lessor receives, the greatest amount of money is usually received via royalties. Royalties are essentially the mineral interest owner's share of production free of the cost of production. Historically, lessors were offered a 1/8 royalty. Today, 3/16 or 1/5 royalties are common with some lessors negotiating royalties of 25% or more. The practitioner should inquire as to the standard royalty being paid in his / her area and identify conditions which might substantiate a royalty above the average being paid.

Royalty negotiation and calculation can become quite technical. A detailed discussion of the background and theories involved is beyond the scope of this paper. For a more in-depth analysis, the reader should consult articles such as Gas Royalty Calculation 2005 - An Update, by Michael P. Peterson, which appears in the March 2006 edition of the State Bar of Texas Oil, Gas and Energy Law Section Report. This heavily-annotated report presents an excellent background into royalty calculation and reviews numerous modern cases on the subject.

1. OIL ROYALTIES

In beginning this section of the paper, the author must admit that virtually all of the leasing he has reviewed in the past three years involved leases to produce gas in the Bosier Sand formation. The author originally began this section by stating that royalties on oil were typically payable in kind at the wellhead because that is where oil is stored and sold. A review of recent leases, a cross-section of which are included as exhibits to this paper, reveals that such is no longer the case. Once again, it is imperative to read the entire text of the lease.

Like gas, the royalty on oil may be calculated at the wellhead, or when sold off site. The royalty may be paid on the "market value" or the "amount realized". The lessee will typically deduct from the royalty the lessor's share of taxes and costs of treating the oil and making it marketable.

To the extent the royalty is calculated based on "market value", it is important that the term is defined
in the lease or an addendum. It is common to define market value as the average of the two or three highest prices paid in the same field within the previous year or two. The practitioner should be aware that "market value" may be less than the amount realized from the sale of oil or gas when the lessee successfully obtains a price higher than market value.  

Yzaguirre v. KCS Resources, Inc., 53 S.W. 2d 368 (Tex. 2001).

To the extent the royalty is calculated based on the "amount realized", it is important that the amount is actually realized in an arms-length transaction between non-affiliated entities. If not set out in the royalty clause, this requirement should be treated in an addendum to prevent a situation whereby the lessee sells the product to an affiliated entity for a price less than what the lessee could have obtained in an arms-length transaction.

2. GAS ROYALTIES

Like oil royalties, gas royalties may be calculated at the well or at the point of sale. They may be based on the amount realized or the fair market value. Only by carefully reading the lease will the practitioner be able to determine how the royalty will be calculated, inform the lessor, and negotiate a more advantageous method of calculation.

The most common method of calculating royalties on gas is the fair market value at the well. Gas, by its nature, cannot be economically stored at the well, so it must be transported, usually by means of a pipeline, and treated to render it marketable. Because of the cost associated with such transportation and treatment, the fair market value price at the wellhead will necessarily be less than the price of the gas ultimately sold after transportation and processing. Without explicitly stating so in the lease, a royalty calculated based on the market price at the well makes the lessor's royalty subject to deductions for the lessor's pro-rata share of the costs associated with processing and transportation. See Piney Woods Country Life School v. Shell Oil Co., 726 F.2d 225 (5th Cir. 1984), cert denied, 471 U.S. 1005, 105 S. Ct. 1868 (1985). Not even a clear statement to the effect that the lessee will have free use of the oil or gas produced from the property to use for its operations. It often states that no royalty will be paid on the minerals so used. The author refers to such provisions (somewhat tongue-in-cheek) as mineral theft provisions. No limit is generally placed on this right in the lease such that the value of the minerals so used might be significant. It is recommended that this provision be struck in its entirety, or that some limit be placed on the amount of production that can be extracted and used without compensation to the lessor.

3. SHUT-IN ROYALTIES

The Shut-in Royalty provision in the lease usually appears in the Royalty Clause. As discussed above, the Shut-In Royalty clause is a savings clause that acts to hold the lease in force in the absence of production in paying quantities.

4. MINERAL THEFT PROVISION

Some lease forms end the Royalty Clause with a statement to the effect that the lessee will have free use of the oil or gas produced from the property to use for its operations. It often states that no royalty will be paid on the minerals so used. The author refers to such provisions (somewhat tongue-in-cheek) as mineral theft provisions. No limit is generally placed on this right in the lease such that the value of the minerals so used might be significant. It is recommended that this provision be struck in its entirety, or that some limit be placed on the amount of production that can be extracted and used without compensation to the lessor.

E. THE POOLING CLAUSE

1. PURPOSE

The pooling clause allows the lessee to combine one lessor's acreage or interest with other acreage in order to form a pool. The terms "pool", "unit", and "proration unit" are often used interchangeably. The reasons and purposes of pooling including Railroad Commission spacing rules, field rules, etc. are beyond the scope of this paper. Suffice to say that the vast majority of oil and gas production in Texas is accomplished by way of pooling two or more tracts.

The effect of pooling is such that production on any of the acreage pooled will hold the leases on all pooled interests. Accordingly, if Lessor A's interest in a 100 acre tract is pooled with the interest of Lessor B's 400 acre tract and Lessor C's 204 acre tract, and the lessee completes a well on Lessor C's 204 acres, production from that well will hold the lease on Lessor B's and A's interest as well. All three Lessors will share in the production in the proportion that their interest bears to the total acreage pooled. In this simplified example, Lessor A's share would be 100/704. Assuming the well produced one million dollars worth of gas in a month, and that Lessor A owned all of the minerals on his / her 100 acre tract and had leased the gas for a royalty of one-fifth, the royalty for that month would be calculated at $1,000,000.00 X 100/704 X 1/5 = $28,409.09. This simplistic example excludes factors such taxes and
expenses chargeable to Lessor's share, but should adequately demonstrate the effect of pooling.

Pooling allows the lessor to participate in the royalties by virtue of the fact the lessor is in privity of contract with the lessee. The well need not be drilled on the lessor's land in order for the lessor to receive a share of the royalty.

Caution must be exercised in reviewing the pooling provisions in a lease. Standard pooling provisions state that if any of the lessor's interest is included in a pool from which there is production in paying quantities, then the lease remains in force as to the lessor's entire interest. Without some modification to the pooling provision, the lessee could include a portion of one acre of the lessor's interest in the pool and hold the lease in force as to hundreds of acres on which the lessor received no royalty. To address this problem, the practitioner should be certain to insist upon a Pugh Clause as an addendum to the lease.

2. THE PUGH CLAUSE

The Pugh Clause is used to prevent the lessee from using pooling to hold all of the lessor's interest by production when only a portion of the lessor's interest is included in a pooled unit. The Pugh Clause most commonly appears as an addendum to the lease and is not commonly contained in the Pooling Clause. The basic text of the Pugh Clause is as follows:

Notwithstanding any provision hereof to the contrary, if a part of the Leased Premises is included within a pool or proration units, drilling operations or production from the unitized premises shall maintain this lease only as to that portion of the leased premises within such pool or proration unit regardless of whether such unit is located totally within the acreage covered by this lease or not. As to that portion of the Leased Premises not included in a proration unit or pool, after expiration of the primary term this lease may be maintained only by production or by operation of other provisions herein which pertain to reworking operations, drilling operations or additional drilling operations. After the expiration of the primary term, Lessee agrees to release in recordable form all acreage not held by production in paying quantities.

The Pugh Clause has been used so extensively and for so long that most lessees will have no objection to accepting it as an addendum to the lease. Due to the inequitable situations that can result from failure to use a Pugh Clause, it is in the author that it should appear as an addendum in each and every lease that has a pooling provision.

3. ACREAGE PROVISIONS

It is common for modern leases to allow the lessee to pool up to 80 or more acres for oil wells and up to 640 acres for gas wells, plus a tolerance of up to ten percent. Accordingly, under the common lease form, a gas unit could be up to 704 acres. The practitioner should take note of the effect that increasing the unit has on the lessor's royalty. As explained above, the lessee shares in the production to the proportion that his / her interest bears to the total acreage in the unit.

The larger the unit, the smaller the lessor's proportionate share thereof. The practitioner may find it advantageous to negotiate for a smaller maximum unit size in order to increase the lessor's interest in the unit. Conversely, negotiating such a concession might cause the lessee to include another lessor's interest in the pool in order to maximize the number of acres held by production.

In sum, the Pooling Clause allows the lessee to combine the acreage of several tracts and hold all the acreage in the pool under the leases by production on any of the property in the pool. A more detailed discussion of pooling is beyond the scope of this paper; however, pooling addenda are discussed below.

F. CLAUSES DEFINING OPERATIONS

As discussed above, modern leases are for a term of years (the primary term) and as long thereafter as production continues in paying quantities (the secondary term). Even if the lessee has not completed a well in the primary term, the lease can be held in effect after the expiration of the primary term by "operations". This is a type of savings clause discussed at length above. Following the pooling provision of many leases, the lessee often inserts a provision that defines "operations". To the extent that the lease defines operations as drilling, reworking, completing or repairing the well in a diligent attempt to obtain production, this definition is probably reasonable to the lessor. Conversely, to the degree that the definition includes planning, preparing, or conducting seismic testing, it is probably too broad. Any portion of the definition that contains an unreasonable activity should be struck or a mutually acceptable addendum defining operations should be negotiated.

G. ANCILLARY RIGHTS CLAUSES

Toward the end of the lease, it is not uncommon to find provisions granting the lessor ancillary rights. These may be somewhat harmless such as the right to remove equipment after the lease terminates. On the other hand, this clause may be used to grant the lessee the right to drill saltwater disposal wells, construct treating or refining facilities, or build pipelines. As discussed above, a mineral owner who also owns the surface will be especially sensitive to the sort of rights
granted in such a provision. It is common for such a clause to set forth the minimum distance that operations must be conducted from improvements. It is recommended that even non-surface owners consider this limitation. If the non-surface mineral owner sold the property to the current surface owner and made any representation regarding future surface use, he or she may have some liability to the surface owner who relied upon such a representation. It may be advisable for the non-surface mineral owner to negotiate a larger buffer for the protection of the surface owner if the two ever had a buyer - seller relationship.

H. THE WARRANTY CLAUSE

Most leases contain a clause whereby the lessor warrants title to the mineral estate and further grants the lessee the right to discharge any mortgage or lien and be subrogated to the rights of the lien holder. The real estate practitioner will likely be quite familiar with warranties of title. It is recommended that the sentence warranting title be struck completely on the theory that the lessee has or will research the title and should bear the responsibility for determining the validity of the title to the mineral estate. If the warranty provision cannot be deleted, it should be limited to those matters by through or under lessor, thus creating a special rather than general warranty.

The portion of the Warranty Clause allowing for the discharge of liens and subrogation to the right of the lienholder is probably necessary to protect the lessee's interest. Care should be taken in reviewing the language to be certain it is not overly broad as to what actions the lessee may take.

The final part of the Warranty Clause is usually a "Cut-down Clause". It provides that if the lessor owns less than one hundred percent of the minerals under the property, his / her royalties and shut-in royalties will reduced to correspond with the percentage of the mineral estate owned. This provision is probably not objectionable in most circumstances. If the lessor is concerned about the percentage owned, he / she might attempt to negotiate a stipulation provision as an addendum. Understandable, lessees are usually more than reluctant to do so.

I. MORE SAVINGS CLAUSES

1. NO TERMINATION CLAUSE

There is a strong trend in modern leases to include a provision limiting the lessor's remedies in cases where the lessee breaches the lease. They seem to follow the following form: First, the lessor must notify the lessee of the alleged breach. The lessee then has a time period (usually sixty to ninety days) to remedy or begin to remedy the lease before the lessor files a lawsuit. Finally, even if the lessor is successful in his lawsuit, the lease cannot be terminated. Instead, the lessor's remedy is limited to collecting damages. While the purpose of this clause is clear, the common language offends the sensibilities of even the least litigious attorney. It is recommended that this provision be heavily amended to reduce the time between notification and commencing litigation. The lessee should be allowed to remedy the breach, but not to simply begin to remedy it. Finally, some attempt should be made to strike the limitation on remedies. The author has been successful in negotiating a change to the clause whereby the lease would not be terminated in whole or in part unless so ordered by a Court of competent jurisdiction, thus amending the complete prohibition against termination.

2. FORCE-MAJEURE CLAUSE

The force-majeure clause is the final savings clause typically found in an oil and gas lease. Its purpose is to prevent termination of the lease due to lack of production in paying quantities, when the cessation in production is beyond the control of the lessee. The clause typically sets out a litany of events deemed to be acts of God and, therefore, beyond the lessee's control. Care should be taken to exclude from the list any condition that is not truly beyond the lessee's control. For example, floods and wars are probably beyond the lessee's control, whereas, inability to obtain equipment at the lessee's desired cost is not.

J. CHOICE OF LAW CLAUSES

Most modern leases state that they will be interpreted and governed under the laws of the State of Texas. There appears to be no overwhelming reason to object to such a provision. They often go further in attempting to establish venue in whatever county the lessee is situated. Obviously, it is often advantageous to have venue in the county in which the lessor lives or where the property is located. Most lessees will agree to venue in the county in which the property is located; and the lease should be amended to reflect such if it is advantageous to do so.

III. ADDENDA

A. DISCLAIMER

The terms of the main lease can be amended through attached addendum provisions. Occasionally, the author reviews a lease addendum that was obviously drafted by an attorney who believed in the "more is better" approach. Rather than taking such an approach, the author recommends using only provisions that the reader understands and that are targeted to address specific provisions in the lease or matters of concern to the client.

The addendum provisions set out below represent a collection of items addressing some more commonly encountered situations. They are not by any means exhaustive. The author does not represent that the addendum provisions are the best or only ones
available. The reader should consider when an addendum should be used and craft the addendum to address his/her specific situation.

B. THE PUGH CLAUSE

As discussed in Paragraph II (E) (1) above, the Pugh Clause is used to counter the undesired effect of the standard Pooling Clause. The usual language of the Pooling Clause would allow the lessee to hold all of the lessor's interest under the lease by including any portion of the lessor's interest in a pooled unit. The goal of the Pugh Clause is to limit the interest held by production to only that interest actually included the pool. It is the author's position that a Pugh Clause should be used in every lease that has a standard pooling clause. One example of a Pugh Clause is as follows:

Notwithstanding any provision hereof to the contrary, if a part of the Leased Premises is included within a pool or proration units, drilling operations or production from the unitized premises shall maintain this lease only as to that portion of the leased premises within such pool or proration unit regardless of whether such unit is located totally within the acreage covered by this lease or not. As to that portion of the Leased Premises not included in a proration unit or pool, after expiration of the primary term this lease may be maintained only by production or by operation of other provisions herein which pertain to reworking operations, drilling operations or additional drilling operations. After the expiration of the primary term, Lessee agrees to release in recordable form all acreage not held by production in paying quantities.

The Pugh Clause is included first in this list of addendum provisions solely because of the author's perception of its importance in current oil and gas leases.

C. VERTICAL RELEASE ADDENDUM

The Vertical Release Clause, sometimes referred to as a Vertical Pugh Clause, is used when the lessor believes that, at some time in the future, some party will desire to drill one or more wells to depths other than those contemplated by the current lessee. An example of a vertical release provision follows:

Notwithstanding anything contained herein to the contrary, upon two (2) years after the expiration of the primary term or any continuous drilling operations as provided for in this lease, whichever is the later, this lease shall terminate as to all depths below one hundred feet (100') below the stratigraphic equivalent of the deepest depth from which oil and/or gas is produced on the leased premises or on lands pooled therewith. Then and in that event, Lessor and/or Lessor's assigns shall have the right to drill through all shallower depths to reach the deeper depths hereby released.

Variations of this clause can be used to limit the lease to only certain strata or to release both shallower and deeper strata at the end of some time period.

D. SURFACE USE ADDENDUM

Surface use clauses represent some of the more frequently used and misused addendum provisions. They are of the most use to the surface owner, but can be used by the non-surface mineral owner when there is some reason to limit surface operations.

In drafting, the practitioner is cautioned to be aware of outstanding interests. If the surface owner proposes an addendum stating that his/her lease does not grant the right to make use of the surface, it is still possible for the lessee or another lessee to make use of the surface through the rights granted in a lease from another lessor.

The practitioner should also inquire as to the location of the improvements on the property. There is less advantage in negotiating a provision prohibiting operations on the property when the surface owner's home is located fifty feet from the boundary of the adjoining property, on which the operations will take place.

Below are a few simple examples of surface use clauses:

1. Lessee covenants and agrees not to conduct any operations on the Property described in this lease or on any property adjoining this Property within eight hundred feet (800') of any of any residence or barn on the Property described in this Lease.

2. Notwithstanding anything to the contrary herein, Lessee agrees and obligates itself to conduct its operations upon the leased premises as a reasonable and prudent operator and in such a way as to cause a minimum of damage to the land and improvements thereon, including fences; and that should it become necessary to make any opening in the fences, Lessee will properly brace the fence on each side of the opening to prevent slackening of the wires and shall place substantial pipe gates and cattle guards in such openings, and at all times thereafter they shall be securely closed and locked. Said gates and cattle guards shall be installed before drilling operations commence and said gates and cattle guards shall
forever remain on said property unless otherwise directed by Lessors. Lessee agrees that within ninety (90) days after any operation hereunder, Lessee shall repair the damaged land to the fullest practical extent, including the filling and leveling of all holes, pits, ruts, roads of excavations in the areas no longer to be used by Lessee; and upon termination hereof, to fully repair all damaged land not already repaired to the end that the land will be rendered to as substantially the same condition as it was prior to commencement of such operations. Lessee shall pay for all injury or damage done or caused by Lessee in its operations hereunder to any buildings, fences, roads, roadway easements, culverts, trees, turf lands, growing crops or other improvements on said land or to livestock on said land which is not replaced or repaired by Lessee according to the terms of this Lease.

3. Lessee shall level all pits or other excavations dug by Lessee in its operations hereunder promptly after the termination of Lessee’s use thereof. Lessee shall restore to Lessor’s satisfaction all fences, terraces, access roads, drill sites and all other sites on which operations were conducted to as near the original conditions (prior to operations) of same as possible within ninety (90) days after the termination of operations on the particular area requiring restoration. Lessee agrees to construct and maintain fences capable of turning back cattle and/or other livestock of ordinary demeanor from all drilling sites and pits and other excavations until such pits and other excavations are leveled. Lessee shall not permit well or operations in connection therewith to flow on or over or stand on Lessor’s land, but Lessee shall take all action necessary to confine all such substances to pits adjoining the wells. Lessee also agrees to promptly remove from the premises all drilling mud, oils and/or other debris of every kind and character.

Obviously, Surface Use Clauses can be drafted to address any concerns of the surface owner. Lessors are reluctant to accept complete surface use prohibitions, especially on large tracts. In such instances, the practitioner should consider negotiating reasonable drill site designations or specific areas within the property on which the lessee will not conduct operations.

E. ROYALTY ADDENDUM

The main body of every lease form will contain a Royalty Clause. The practitioner may be able to negotiate an alternative method of calculating the lessor's royalty. Lessees generally object to any substantive amendment in the manner of calculation, but more often agree to definitional changes. Below are some examples of addendums concerning royalty calculation:

1. It is understood that in the event Lessee should for any reason enter into a gas sales contract covering the sale of gas (including casinghead gas and/or other gaseous substances) produced from or attributable to the leased premises to a purchaser which is owned or controlled by Lessee, or which is a subsidiary or affiliate of Lessee, or of which Lessee is a subsidiary or affiliate, then and in that event, the royalties on such gas payable by Lessee as provided elsewhere in this lease shall be calculated and paid on the basis of the market value thereof. The term "market value" as used in the lease and in this paragraph shall mean the average of the two (2) highest prices being paid for gas (on an MCF basis) located in the field in which the leased premises is located under existing contracts of like duration having been entered into within one year of the purchase of gas and/or casinghead gas from a well drilled on the leased premises or on lands pooled therewith.

2. Regardless of language in the lease to the contrary, Lessee shall pay Lessor, as the royalty on natural gas of any kind and nature the greater of (1) one-fifth (1/5) of the "market value" of the gas at the well or (2) one-fifth (1/5) of the amount realized by lessee on the sale of the gas calculated at the point of delivery without deducting Lessor's share of processing or transportation. Lessor's royalty shall be calculated free and clear of all costs, expenses and deductions for exploration, drilling, development, production, treatment, transportation and marketing including but not limited to costs of dehydration, storage, compression, separation by mechanical means, and stabilization of hydrocarbons at the well; but said royalty shall bear its proportionate share of severance and other taxes based upon the production.

Caution should be exercised in amending the royalty provision of any lease. Again, the author does not warrant that either of the above-clauses would be beneficial to the practitioner or his / her client in any particular situation. The clauses presented are simply adaptations of clauses the author has reviewed in other leases.

F. DISCLOSURE ADDENDUM

Disclosure clauses can be useful in a number of situations. When the practitioner believes a controversy might arise regarding ownership of the minerals, he / she might desire a copy of the lessee's
title work or title opinion to assist in determining the
ownership of the minerals or prepare for potential
litigation. When the practitioner believes, because of
reputation or otherwise, there may be reasons to
question the amount of royalty payments, he or she
may desire to review a copy of the lessee's production
reports.

Lessor or his representative shall, at their
own risk and expenses and by written request
have the right to inspect or examine any
driller's log, test, core, electrical log or
record made during the drilling operations.
Lessee agrees to furnish Lessor with one (1)
free copy of each electrical log, MUD log,
daily report, core record, test, or completion
record made. Lessor further reserves the
right to examine any metering device used
for calculating production from the leased
premises, provided, however, no examination
shall be allowed unless there is a company
representative present during any
examination. Lessor may audit any
production records of Lessee related to any
well producing on the leased premises or
lands pooled therewith. Any audit of
Lessee’s records shall be conducted in
Lessee’s principal place of business during
normal business hours.

The addendum above is probably overbroad. The
practitioner is advised to ask for disclosure of only
relevant information for which he / she anticipates
some reasonable use.

G. SHUT-IN ADDENDUM
The practitioner may determine that the lessee's
right to hold the lease in force by paying shut-in
royalties should be limited. This is especially so in the
case of leases where the production of natural gas is
anticipated. The following is a commonly used
 provision for such a purpose:

Lessee’s right to maintain this Lease in full
force after the primary term by shut-in-gas
well payments under Paragraph 3 shall not
continue for any one shut-in period of more
than two (2) years immediately following the
primary term, or in recurring periods after
the primary term not to exceed three (3)
years in aggregate; provided, however, this	right to maintain this Lease for one (1) shut-
in period of two (2) years or in recurring
periods not to exceed three (3) years in the
aggregate shall be a recurring right during
each and every ten (10) year period that this
Lease remains in effect. Whenever a gas well
is shut-in by virtue of the provisions of this
paragraph, Lessee agrees to pay Lessor for
such shut-in well a sum of Twenty-Five
($25.00) Dollars per acre per year for such
shut-in well.

H. POOLING ADDENDUM
In some situations, it may desirable to be certain
the lessee will include all or a certain percentage of the
lessor's interest in a pool. Care should be taken when
considering such a provision. While it would be
advantageous for all the lessor's interest to be included
in a unit with substantial production, it would be
unfortunate if all the interest was included in a unit
with poor production thereby preventing any portion of
the interest from being included in a different unit with
superior production at a later time. For this reason, it is
beneficial to consider a clause providing for not less
than half or one third of the interest to be included in a
pool. By doing so, the practitioner addresses the
concern that only a small portion will be unitized, but
leaves open the possibility that that the lessor's interest
will be included in more than one unit.

Notwithstanding anything contained herein
to the contrary, it is expressly agreed and
understood that in the event that Lessee
elects to pool or unitize any of the Leased
Premises, then not less than one-half (1/2) of
Leased Premises will be included in such
pool or unit.

I. EXTENSION ADDENDUM
It is common for the lessee to desire the right to
extend the primary term of the lease. This is especially
so if the primary term is less than three years. In this
event, the lessee is usually willing to pay some
premium for the option to extend the primary term of
the lease. Following is an example of an extension
clause commonly used as an addendum by lessees:

If, at the expiration of the primary term of
this lease, this lease is not being maintained
in effect in any manner provided for herein,
Lessee is hereby given the option to extend
the primary term of this lease for an
additional one (1) year from the expiration of
the original term. This option may be
exercised by Lessee at any time during the
last year of the original primary term by
paying a one- time sum of Fifteen Thousand
Dollars ($15,000.00) to Lessor or to Lessor's
credit in any depository named in this lease
and set out below and payment or tender to
any participant of his portion of the payment
hereunder shall this lease as to such
participant. Should this option be exercised
as herein provided, it shall be considered as though this lease originally provided for a primary term of three (3) years for the acreage so extended, though to the extent all provisions hereof should be harmonized.

There is no limit on the way the lease can be amended or modified through the use of addendum provisions. Some provisions modify the preprinted lease terms. Others add issues not considered in the body of the lease. The practitioner should use caution in drafting addendum provisions crafted to suit his / her particular purpose rather than copying a laundry list of mostly inapplicable addendum provisions.

IV. CONCLUSION

This paper presented the basic provisions found in modern lease forms and some common addendums used to modify the lease form or address additional matters. The basic oil and gas lease is a conveyance in fee simple determinable for a term of years and as long thereafter as production continues in paying quantities. The terms of the lease can be modified or supplemented through the use of carefully drafted addendum provisions addressing specific concerns of the lessor or his / her attorney.
OIL, GAS, AND MINERAL LEASE

This LEASE is made and entered into to be effective December 20, 2005, and to continue in force for the term and on the conditions therein stated. In Witness whereof, the Lessee, as aforesaid, hath set his hand and affixed his seal on this lease.

This LEASE is a full and complete agreement between the parties hereto and is not subject to any oral or written agreement, except as provided for in this instrument. Any and all rights and covenants contained herein shall be binding on the respective successors and assigns of the parties hereto.

This LEASE shall not be subject to any oral or written agreement, except as provided for in this instrument, and any and all rights and covenants contained herein shall be binding on the respective successors and assigns of the parties hereto.

This LEASE is subject to any and all other leases, riparian, or mineral rights, as well as any and all other agreements, contracts, or concessions, now existing or hereafter entered into by or on behalf of the Lessee.

This LEASE is subject to any and all other leases, riparian, or mineral rights, as well as any and all other agreements, contracts, or concessions, now existing or hereafter entered into by or on behalf of the Lessee.

This LEASE is made and executed this 20th day of December, 2005, at the City of Round Rock, County of Travis, State of Texas.

Texas Oil And Gas Leasing A Primer

Chapter 21.1

Page 101 of the Official Public Records of Robertson County, Texas.

NOTE OF CONFIDENTIALITY RIGHTS: IF YOU ARE A NATURAL PERSON, YOU MAY REMOVE OR STRIKE ANY OF THE FOLLOWING INFORMATION FROM THIS INSTRUMENT BEFORE IT IS FILED FOR RECORD IN THE PUBLIC RECORDS: YOUR SOCIAL SECURITY NUMBER OR YOUR DRIVER'S LICENSE NUMBER.

This lease also covers and includes, in addition to the described leased premises, all lands, mining rights, and other minerals owned or controlled by the Lessee,及其 successors and assigns, in fee simple, for the term and on the conditions herein stated.

This lease also covers and includes, in addition to the described leased premises, all lands, mining rights, and other minerals owned or controlled by the Lessee,及其 successors and assigns, in fee simple, for the term and on the conditions herein stated.

This lease also covers and includes, in addition to the described leased premises, all lands, mining rights, and other minerals owned or controlled by the Lessee,及其 successors and assigns, in fee simple, for the term and on the conditions herein stated.

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This lease also covers and includes, in addition to the described leased premises, all lands, mining rights, and other minerals owned or controlled by the Lessee,及其 successors and assigns, in fee simple, for the term and on the conditions herein stated.

This lease also covers and includes, in addition to the described leased premises, all lands, mining rights, and other minerals owned or controlled by the Lessee,及其 successors and assigns, in fee simple, for the term and on the conditions herein stated.

This lease also covers and includes, in addition to the described leased premises, all lands, mining rights, and other minerals owned or controlled by the Lessee,及其 successors and assigns, in fee simple, for the term and on the conditions herein stated.
Leases may exercise its right to pool at any time and from time to time, while this Lease is in force and effect, whether before or after commencing operations.

For the purpose of computing the royalties to which owners of royalties and payments out of production shall be entitled on production of oil and gas from a pooled unit, there shall be allocated thereto, by this lease, and included in the unit (or to each separate tract within the unit) a pro rata portion of the oil and gas produced from the pooled unit which the reserved surface acres covered by this Lease (or each separate tract covered by this Lease) and included in the pooled unit (or to each separate tract within the unit) that pro rata portion of oil and gas produced from the pooled unit which the number of surface acres covered by this Lease (or each separate tract covered by this Lease) and included in the pooled unit (or to each separate tract within the unit) is an acreage basis; i.e., there shall be allocated to the acreage covered by this lease and included in the pooled unit (or to each separate tract within the unit) that pro rata portion of oil and gas produced from the pooled unit which the number of surface acres covered by this Lease (or each separate tract covered by this Lease) and included in the pooled unit (or to each separate tract within the unit) is an acreage basis.

Leases shall be allocated on the production of the well, whether oil or gas, and shall be calculated on the basis of the entire acreage covered by the lease, and each succeeding lease shall be calculated on the acreage covered by the lease, including the acreage covered by previous leases.

5. If the Leases have any other party to the lease may be assigned from time to time, in whole or in part, and to any mineral, depth, or horizon under the land, and immediately be released of all obligations, as to the released acreage or interest.

6. Whenever used in the lease the word "operations" shall mean operations for any of the following: drill, location, preparation or maintenance, drilling, testing, completing, recompletion, stopping back or repairing of a well in search of or for the purpose of production of oil, gas, or other minerals; or production of oil, gas, or other minerals, whether or not in paying quantities.

7. Leases shall have the same free from royalties, water, salt water, and gas produced from the lease, and to all operations out of the term of this Lease. Leases shall have the right, in its entirety, at any time, to remove all machinery and fixtures placed on the land, including the right to drill and remove casing. No well shall be drilled nearer than 500 feet to the house or barn on the farm. If the surface owner of the Lease shall pay for damage caused by the operation of a new well, the surface owner of the Lease shall have the right to remove the well, and the operator shall have the right to remove the well.

8. The rights and estates of any party to this lease may be assigned from time to time, in whole or in part, and to any mineral, depth, or horizon under the land, and immediately be released of all obligations, as to the released acreage or interest.

9. In the event the Lessee considers the Lessee has not complied with all its obligations under this Lease, either express or implied, the Lessee shall notify the Lessee in writing, setting out specifically how the Lessee is claimed to have breached this Lease. The Lessee shall have sixty (60) days after receipt of the notice to cure any breach of the Lessee.

10. All payments made under this Lease shall be paid in lawful money of the United States of America, with any interest on overdue payments to be paid at the rate of one percent per month until paid, and the Lessee shall be entitled to interest on any overdue payments.

This Lease is executed as of the date of the acknowledgment of the undersigned's signature, and shall be deemed effective for all purposes as of the Effective Date stated above.
Texas Oil And Gas Leasing A Primer

Chapter 21.1

This Lease Agreement is made effective the 10th day of May, 19__.

Oil, Gas & Mineral Lease

as Lessee, (whether one or more), whose address is:

and

Oil Company, Agent, whose address is:

as Lessee, portions of this lease were prepared by Lessee, but all other provisions (including the omission of blank spaces) were prepared jointly by Lessee and Lessee.

1. Description. Lessee, in consideration of Ten and other valuable considerations, Dollars ($10,000.00), in hand paid, of the royalties herein provided and the covenants herein contained, hereby grants, leases and lets to Lessee, or his successors, lessees, assigns, and sub-lessees, the following:

2. Royalty. Royalties on covered minerals produced and saved hereunder shall be paid by Lessee to Lessee as follows: (a) For oil and other liquid hydrocarbon separated at Lessee's field separator facilities, the royalty shall be 1/8 of such production, to be delivered at Lessee's option to Lessee or to Lessee's contractor or to such other person as Lessee shall designate.

3. Term of Lease. This lease shall be in force for a primary term of 5 years, from the effective date hereof, and for as long thereafter as covered minerals is produced in paying quantities from the leased premises or this lease is otherwise maintained in effect pursuant to the provisions hereof.

4. Operations. If, after expiration of the primary term, Lessee drills a dry hole on the leased premises or if all production of covered minerals should permanently cease from any cause either voluntary or involuntary (and if this lease is not otherwise being maintained), this lease shall remain in effect if Lessee commences drilling, reworking or other operations on the leased premises within 30 days thereafter. If, at any time during the primary term, this lease is not otherwise being maintained but Lessee is then engaged in drilling, reworking or other operations calculated to obtain or restore production from the leased premises, this lease shall remain in effect so long as such operations are conducted with no cessation of more than 90 consecutive days and, if such operations result in the production of a covered mineral, as long thereafter as there is production from the leased premises. After production has been established on the leased premises, Lessee shall drill such additional wells as a reasonably prudent operator would drill under the same or similar circumstances to (a) develop the leased premises to formations then capable of producing in paying quantities on the leased premises or (b) prevent the leased premises from uncompensated drainage by a well producing a covered mineral in paying quantities located within 300 feet of and draining the leased premises. There shall be no covenant to drill exploratory wells or any additional wells except as expressly provided herein.

5. Pooling. Lessee shall have the continuing and recurring right, but not the obligation, to pool all or any part of the leased premises or interests therein with any other lands, leases or interests, as to any or all depths or zones, and as to any or all covered minerals, either before or after the commencement of production, whenever Lessee deems it necessary or proper to do so in order to prudently explore, develop or operate the leased premises, whether or not similar pooling authority exists with respect to such other lands, leases or interests. A unit formed by such pooling for oil or gas well which is not a horizontal completion shall be a minimum average area of 50 acres and a maximum average area of 100 acres, and for such oil well which is a horizontal completion or a gas well shall not exceed 50 acres plus 1.5% per acre in excess of 50 acres, and for such oil well which is a horizontal completion or a gas well shall not exceed 100 acres plus 1.5% per acre in excess of 100 acres. The oil well or gas well shall be drilled as soon as practicable after commencement of operations and in accordance with the terms and conditions of this lease.

6. Notice of Leasing. Notice of any leasing or assignment of the premises, shall be given to the Lessee at the time of execution of the pooling agreement or of the assignment of the premises, or at such other time as the Lessee may specify in writing, and such notice shall be deemed to have been given upon the delivery of a written notice to the Lessee.
shall not affect Lessor's pooling right hereunder, and Lessor shall, without the joiner of Lessor, have the remaining right but not the obligation to revive any unit formed hereunder by express or constructive or both, either before or after commencement of production. In order to declare a pooling of the Lessor's rights, the same must be authorized by the governmental authority having jurisdiction, or to confirm to any production acreage determination made by such governmental authority, or court order, or when to do so would, in the judgment of Lessor, promote the conservation of covered minerals in and under and that may be produced from the leased premises. In making such a pooling, Lessor shall file of record a written declaration describing the revised unit and the effective date of such revision shall be the date of filing unless provided otherwise in such declaration. To the extent any portion of the leased premises is included in or excluded from the unit by virtue of such revision, the proportion of unit production on which royalties are payable hereunder shall thereafter be calculated according to such adjustment and such adjustment shall be made effective as of the effective date of the revision. Lessor may at any time dissolve any unit formed hereunder by filing a written declaration dissolving the unit, and the effective date of dissolution shall be the date of filing unless provided otherwise in such declaration.

If this lease now or hereafter covers separate tracts, no pooling or utilization of royalty interests as between any such separate tracts is intended or shall be implied or result merely from the inclusion of such separate tracts within this lease but Lessor shall nevertheless have the right to pool or utilize as provided in this paragraph with consequent allocation of production as herein provided. As used herein the words "separate tract" means any tract with royalty ownership differing, now or hereafter, either as to parties or amounts, from that as to any other part of the leased premises.

6. Ancillary Rights. In exploring for, developing, producing and marketing oil, gas and other substances covered hereby on the leased premises, in primary or enhanced recovery, Lessor hereby grants and conveys to Lessee the right to enter ingress and egress along with the right to conduct such operations on the leased premises as may be reasonably necessary for such purposes, including but not limited to geophysical operations, the drilling of wells, and the construction and use of roads, canals, pipelines, tanks, water wells, disposal wells, injection wells, pits, drill roads and telephone lines, power stations, and other facilities deemed necessary by Lessee to discover, produce, store, treat and transport production. In exploring, developing, producing or marketing from the leased premises, the ancillary rights granted herein shall apply (a) to the entire leased premises described in Paragraph 1 above, (b) to any partial lease or other partial termination of the lease, and (c) to any other lands in which Lessor or hereafter has authority to grant such rights in the vicinity of the leased premises. No surface location for a well shall be located less than 200 feet from any house or barn now on the leased premises or other lands used by Lessor hereunder without Lessor's consent, and Lessee shall pay for actual damages caused by its operations to buildings and other improvements now on the leased premises, or such other lands, and to compensate timber and growing crops thereon. Lessee shall have the right at any time to remove its fences, equipment and materials, including well casing, from the leased premises or such other lands during the term of this lease or within 180 days following the expiration thereof.

7. Ownership Changes. The interest of either Lessor or Lessee hereunder may be assigned, deviser or otherwise transferred in whole or in part, by any or by death or divorce, and the rights and obligations of the parties hereunder shall extend to their respective heirs, devisees, executors, administrators, successors and assigns. No change in Lessor's ownership shall have the effect of reducing the rights or enlarging the obligations of Lessee hereunder, and no change in ownership shall be binding on Lessee until 60 days after Lessor has been furnished the original or certified or duly authorized copies of the documents establishing such change of ownership to the satisfaction of Lessee. In the event of the death of any person entitled to such interests hereunder, Lessor may pay or tender such interest in royalties to the legal or statutory successor or custodian of the deceased's estate. If any time two or more persons are entitled to such interest hereunder, Lessor may pay or tender such interest in equal shares to such persons, either jointly or separately, in proportion to the interest which each owns. If Lessor transfers its interest hereunder to a third party, it shall be relieved of all obligations thereafter arising with respect to the transferred interest, and failure of the transferee to satisfy with respect to the transferred interest shall not affect the rights of Lessee with respect to any interest not so transferred. If Lessee transfers a full undivided interest in all or any portion of the area covered by this lease, the obligation to pay or tender the interest to Lessee hereunder shall be divided between Lessee and the transferee in proportion to the net acreage interest in this lease then held by each.

8. Warranties of Title. Lessor hereby warrants and agrees to defend title to the interest conveyed to Lessee hereunder. Lessee, at its election, may pay or discharge any tax, mortgage or lien existing against the leased premises and, in the event that it does so, Lessee shall be subrogated to any right to whom payment was made. In addition to its other rights, may reimburse itself out of any royalties or shut-in royalties otherwise payable to Lessor hereunder. If Lessor owns less than the full mineral estate in all or any part of the leased premises, payment of royalties and shut-in royalty hereunder shall be reduced proportionately to the amount that Lessor's interest in the leased premises bears to the entire mineral estate in the leased premises.

9. Release of Lessor. Lessee may, at any time and from time to time, deliver to Lessor or file of record a written release of this lease as to a full or undivided interest in all or any part of the leased premises or any depths or zones thereunder, and such release shall be construed as if Lessor had never been a party to this lease. If Lessee releases all or an undivided interest in less than all of the area covered hereunder, Lessor's obligation to pay or tender shut-in royalties shall be proportionately reduced in accordance with the net acreage interest retained hereunder.

10. Regulation and Delay. Lessor's obligations under the lease, whether express or implied, shall be subject to all applicable laws, rules, regulations and orders of any governmental agency exercising jurisdiction including restrictions on the drilling and operation of wells. Notwithstanding the provisions of paragraph 1 above, when drilling, reworking, production or other operations are prevented or delayed by any law, rule, regulation or order, or by inability to obtain necessary permit, equipment, services, materials, water, electricity, fuel, access or equipment, by fire, flood, adverse weather conditions, war, sabotage, rebellion, insurrection, riots, strikes or labor disputes, or by any other cause not reasonably within Lessor's control (commonly referred to as "force majeure"), this lease shall not terminate because of such prevention or delay and, at Lessee's option, the period of such prevention or delay shall be added to the term hereof. Lessor shall not be liable for breach of any express or implied covenant of this lease when drilling, production or other operations are so prevented, delayed or interrupted.

11. Breach or Default. An alleged breach or default by Lessor of any obligation hereunder or the failure of Lessor to satisfy any condition or limitation contained herein shall not work a forfeiture or termination of this lease nor cause a termination or revocation of this lease created hereby nor grounds for cancellation hereof in whole or in part, and no litigation shall be instituted by Lessee with respect to any alleged breach or default by Lessor hereunder, for a period of at least ninety (90) days after Lessor has given Lessor written notice fully describing the breach or default, and then only if Lessee fails to remedy or comply with the prior written notice within such period. In the event the matter is litigation and if in a final judicial determination that a breach or default has occurred, this lease shall not be forfeited or canceled in whole or in part unless Lessor is given a reasonable time after said judicial determination to remedy the breach or default and Lessee fails to do so. Nothing in this instrument or the relationship created hereby shall be construed to establish a fiduciary relationship, a relationship of trust or confidence or a principle agent relationship between Lessor and Lessee for any purpose.

IN WITNESS WHEREOF, this lease is executed effective the date first written above, and upon execution shall be binding upon the signatory whether or not the lease has been executed by all parties named herein as Lessor.
PAID-UP OIL, GAS & MINERAL LEASE

Notice of Confidentiality Rights: If you are a natural person, you may remove or strike any of the following information from this instrument before it is filed for record in the public records: Your social security number or your driver’s license number.

This LEASE AGREEMENT is made effective the 29th day of April, 2006, (the “effective date”), between

A. (insert name of lessee), hereinafter referred to as Lessee (whether as an individual or a corporation, or as a partnership or as a joint venture);

B. (insert name of lessor), hereinafter referred to as Lessor (whether as an individual or a corporation, or as a partnership or as a joint venture);

and

C. (insert name of third party, if any), hereinafter referred to as Third Party (whether as an individual or a corporation, or as a partnership or as a joint venture);

WHEREAS, Lessor, in consideration of the covenants and agreements herein contained, grants, leases and assigns to Lessee, for the period and subject to the terms and conditions hereinafter set forth, the oil, gas and mineral rights to (a) all lands, (b) all salt, (c) all underflow, and (d) all veins, horizons, strata, formations, zones, layers, beds, sands, zones, cavities, caverns, openings, deposits, minerals, ore, and any and all oil, gas, or mineral-bearing substances, on, under, or within the leased premises or lands pooled therewith, for the term and period hereinafter specified.

NOW, THEREFORE, BE IT KNOWN, that the foregoing premises, covenants, conditions, and agreements shall be and remain forever subject to all prior and existing reservations, prescriptive rights, and easements of record, and the same are hereby referred to and incorporated herein by reference; and further, that the rights of third persons, if any, under this lease shall not be affected hereby.

IN WITNESS WHEREOF, the parties hereto have caused this lease to be signed, sealed and delivered this 29th day of April, 2006, at (insert location).
Lease may at any time dissolve any unit formed hereunder by filing a written declaration describing the unit, and the effective date of dissolution shall be the last day of the month in which the notice of dissolution is filed. If the dissolution of any unit results in the termination of this lease or any other Lease, the Rights of either Party to the same interest shall survive the termination of the lease. It is agreed that the Lessee and the Lessor shall have the right to sell, assign, or otherwise dispose of any of their rights, benefits, or obligations under this lease without the consent of the other unless otherwise provided for in this lease.

9. **Expiry Rights.** In exercising for developing, producing, and marketing covered minerals in an area that has been developed to the extent required by this lease, the Lessee shall have the right to develop and produce minerals in such area, so long as the Lessee is in compliance with all terms and conditions of this lease. The Lessee shall have the right to abandon and deliver the wells in such area in a safe and reasonable manner.

10. **Termination of Lease.** The lease shall terminate upon the expiration of the term of this lease or upon the earlier termination of this lease by either party as provided in this lease. If the lease is terminated by either party for any reason, the lessee shall restore the premises to their original condition and make any necessary repairs, at the option of the lessee, the lessee shall fully perform all obligations under this lease and pay all sums due thereunder, and the lessee shall pay all operating and administrative charges during the term of the lease. If the lease is terminated by the lessee for any reason, the lessee shall restore the premises to their original condition and make any necessary repairs, and the lessee shall pay all sums due thereunder, and the lessee shall pay all operating and administrative charges during the term of the lease.

11. **Assignment.** The lessee may assign the lease to any person or entity as provided in the lease. The lessee may assign the lease to any person or entity as provided in the lease. If the lessee assigns the lease, the assignee shall assume all obligations of the lessee under this lease and shall be bound by all terms and conditions of this lease.

12. **Renewal Options.** The lessee may renew the lease for additional terms of the same duration and conditions as provided in the lease, upon the terms and conditions as provided in the lease. The lessee may renew the lease for additional terms of the same duration and conditions as provided in the lease, upon the terms and conditions as provided in the lease. If the lessee elects to renew the lease, the lessee shall pay the renewal option and shall be bound by all terms and conditions of this lease.

13. **Notwithstanding any provisions of this lease, the lessee may, by written notice, terminate the lease and deliver possession of the premises to the lessee. The lessee may, by written notice, terminate the lease and deliver possession of the premises to the lessee.

14. **Exhibit.** At the expiration of the term of this lease, the lessee shall offer to the lessee a renewal of the lease for an additional term of the same duration and conditions as provided in the lease. The lessee shall have the right to renew the lease for an additional term of the same duration and conditions as provided in the lease. If the lessee elects to renew the lease, the lessee shall pay the renewal option and shall be bound by all terms and conditions of this lease.

15. **Anti-Assignments.** Except as otherwise provided in the lease, no provision of this lease shall be assignable by the lessee without the written consent of the lessor. The lessee shall have the right to assign the lease to any person or entity as provided in the lease, upon the terms and conditions as provided in the lease. If the lessee assigns the lease, the assignee shall assume all obligations of the lessee under this lease and shall be bound by all terms and conditions of this lease.
AGREEMENTS AND PROVISIONS
The following agreements and provisions shall supersede the provisions in the printed form text of this lease to the contrary, and shall inure to the benefit of, and be binding upon the parties hereto and their respective heirs, representatives, successors and assigns.

OIL & GAS ONLY/EXCLUDED MINERALS
Notwithstanding anything herein to the contrary, this lease covers only oil and gas of whatsoever nature or kind, including coalbed methane gas and other liquid and gaseous hydrocarbons, and sulphur, as well as such other minerals or substances as may be produced incidental to and as a part of or mixed with oil, gas and other liquid or gaseous hydrocarbons, but this lease does not cover gravel, uranium, fissionable materials, coal, lignite or any hard minerals or substances of any type which shall be produced from the leased premises separate and apart from, or independently of, oil, gas, sulphur, coalbed methane gas or other liquid and gaseous hydrocarbons.

OPTION TO EXTEND
Lessor hereby grants Lessee the option to extend the primary term of this lease for an additional TWO (2) years from the expiration of the original primary term hereof as to all or any portion of the leased premises then held hereunder which would expire unless so extended. This option may be exercised by Lessee, or its successors and assigns, at any time before the expiration of the primary term hereof by paying to Lessor or to Lessor’s credit at the depository bank which may be named herein, the sum of THREE HUNDRED AND NO/100 dollars ($300.00) per net mineral acre for each acre so extended, which payment shall cover the TWO (2) years of the extended term and Lessor acknowledges that there will be no rental payments due for or during the extended term. Payment may be made by check or draft mailed or delivered to Lessor or to said depository bank which may be named herein. Should this option be exercised as herein provided, it is agreed that Lessee may execute and file of record an instrument evidencing the exercise of this option.

PUGH (HORIZONTAL)
Two (2) years following the expiration of the primary term of this lease or the expiration of any extension or renewal of the primary term, whichever occurs last, in the event a portion or portions of the leased premises is pooled with other land so as to form a pooled unit or units, Operations on such unit or units will not maintain this lease in force as to the land not included in such unit or units. This lease may be maintained in force as to any land covered hereby and not included in such unit or units in any manner provided for herein.

SURFACE USE, SURFACE DAMAGES & SURFACE RESTORATION
Lessee agrees to use reasonable care in its operations on the leased premises, and within a reasonable period of time after completion of any drilling operations on the leased premises, Lessee shall proceed with reasonable diligence to endeavor to restore the surface of the leased premises to as near its original condition as reasonably practicable in the sole judgment of Lessee, and shall pay Lessor in full for all actual permanent damages caused by Lessee’s operations to crops, livestock, land or improvements situated on the leased premises. Upon written request by Lessor and prior to installation by Lessee, Lessee shall bury pipelines below ordinary plow depth.