



**Oil and Water
(or conflicting clauses in an oil and gas lease)
Don't Mix**

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A recent North Dakota case illustrates how the insertion of a fairly common clause into a pre-printed oil and gas form may have unintended consequences.

In *Johnson v. Statoil Oil & Gas LP*, 2018 ND 227 (October 3, 2018), the North Dakota Supreme Court found that a typed Pugh clause inserted into a pre-printed lease form trumped a conflicting habendum and continuous drilling operations clause. In general, a habendum clause establishes the term of a lease and a Pugh clause allows the lessor to sever non-producing lands from the lease.

In *Johnson*, the mineral estate lessors claimed that the subject leases had terminated as to certain lands upon the expiration of their primary terms. The leases were on pre-printed forms that contained identical habendum and continuous drilling operations clauses. Each of the leases also included an identical typewritten Pugh clause that was inserted into the oil and gas lease form by the lessors.

The habendum clause provided that the lease may be extended beyond the initial three-year primary term by production *or drilling operations* (as set forth in the continuous drilling operations clause that followed).

The Pugh clause provided that “[n]otwithstanding anything to the contrary, on expiration of the primary term of the lease, the lease shall terminate as to any part of the property not included within a well unit or units, as established by appropriate regulating authority, from which oil or gas is being produced in paying quantities”

The lessors claimed that the Pugh clause operated to terminate the leases at the expiration of their primary terms as to those lands lying outside of any producing units because oil or gas was not being produced in paying quantities.

Because oil and gas leases are generally indivisible, the lessees claimed that the leases were extended by drilling operations anywhere on the lease. The lessees cited to prior North Dakota case law holding that “[t]o make a lease divisible, the Pugh clause must be clear and explicit.” Because the Pugh clause only referenced production, the lessees argued that the Pugh clause did not modify the drilling operations method for extending the lease as set forth in the habendum clause.

In concluding that the Pugh clause operated to limit the lease extension as to both the production and drilling operations provided for in the habendum clause, the court distinguished its prior holdings based on the facts at issue and noted that the Pugh clause specifically stated “[n]otwithstanding anything to the contrary.” Consequently, the court held that the Pugh clause operated to limit the lease extension as to both production *and* the drilling operations provided for in the habendum clause.

As a result, the court found the habendum and continuous drilling operations clauses, permitting lease extension for production or drilling operation, to be irreconcilable with the Pugh clause, permitting lease extension for production only.

Because the court could not harmonize the disputed provisions, the court relied on N.D.C.C. § 9-07-16, which provides that the parts of the contract that are purely original control those parts which are copied from a form, in concluding that the typewritten Pugh clause controlled over the pre-printed habendum and continuous drilling operations clauses included in the lease form. Consequently, the court held that drilling operations could not extend the leases as provided for in the habendum and continuous drilling operations provisions of the lease.

While the case appears to involve, in part, the court’s application of a specific North Dakota statute, its applicability may not be so limited. The statute cited by the court appears to codify the canon of construction in contract interpretation that handwritten or typed provisions prevail over printed. Consequently, a court employing canons of construction in construing contractual provisions may arrive at a similar conclusion even in the absence of a similar statute.

For more information, please contact [Deana Allen](#).