Chapter 4

The

Habendum Clause

also known as

The

Term Clause

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HABENDUM CLAUSE OR TERM CLAUSE

The habendum clause follows the legal description clause and appears not only in oil and gas leases but also in conveyances or deeds. This clause is that part of the contract which sets out the period of time for which the grant is extended.

Habendum Clause or Term Clause

It is agreed that this lease shall remain in force for a term of ___*five*___ years from date (herein called the primary term) and as long thereafter as oil or gas, or either of them, is produced from said land by the lessee.

The word *habendum* is Latin in origin and is derived from the phrase *"habendum et tenendum",* meaning "to have and to hold."

In a conveyance the habendum language might read:

Habendum Language in a Deed

TO HAVE AND TO HOLD,* the above quit claimed premises thereunto belonging or in any way appertaining to the said party of the second part, his successors, heirs and assigns, *FOREVER.

The language in this deed states that the grantee is *to have and to hold* title to the premises *forever*. In another case, the clause might read, "To have and to hold said strip of land unto said Railway for a right of way, its successors and assigns forever." In many cases, the grant *limits* the term of the conveyance. This would be true in a deed creating a life estate or in a term mineral deed.

The habendum language in a deed conveying a life estate might read:

Habendum Language Limiting the Grant

TO HAVE AND TO HOLD, the above premises thereunto belonging or in any way appertaining to the said party of the second part FOR AND DURING HIS NATURAL LIFETIME.

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Oil and gas leases contain this special limiting language.

> It is agreed that this lease shall remain in force for a term of ___*five*___ years from this date (herein called the primary term) and as long thereafter as oil or gas, or either of them, is produced from said land by the lessee.

The language in this lease limits the grant for a period of five years (primary term) unless certain conditions are met. If these conditions are met the lease is automatically extended into what is known as the secondary term. If these conditions are not met, the lease will automatically terminate at the end of the primary term (five years from the date of the lease).

In dissecting this clause we will look at five items:

1. The Language in the Clause
2. The Primary Term
3. The Secondary Term
4. The Doctrine of Indivisibility
5. Pugh Clauses

THE LANGUAGE IN THE CLAUSE

The wording of the habendum clause becomes important because it defines exactly, to the second, how much time a company has before the lease expires.

Many leases contain the following words:

"for a term of _five_ years from this date".

Other leases contain the following words:

"for a term of _five_ years".

Notice the difference in the wording?

Habendum Clause or Term Clause

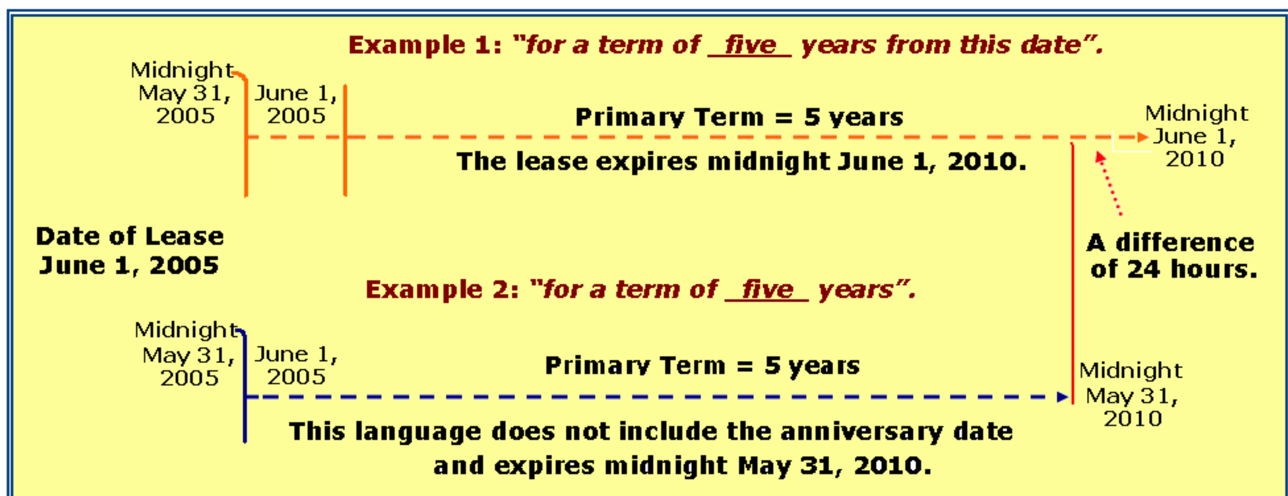
It is agreed that this lease shall remain in force 1. for a term of __five__ years from this date

The language in the clause

If your company had a lease dated June, 1, 2005 and the lease read, ***"for a term of __five__ years from this date"***, when would the lease expire? _______________

If your company had another lease dated June, 1 2005 and the lease read, ***"for a term of _five_ years"***, when would this lease expire? ____________

Answer: In the first case, the lease would terminate at midnight June 1, 2010. In the second case, since the lease does not say five years "from this date," rather, "for a term of five years", it does not include the anniversary date. This lease would terminate at midnight on May 31, 2010.



One might think that the exclusion of the word *from,* in the second case, would not make any significant difference and in most cases this twenty-four hour difference becomes a non-issue. However, if your company held a lease that was going to expire within the next few days and your company needed to know the exact second of termination in order to save the lease, every last second on the primary term might mean a great deal of difference.

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PRIMARY TERM

The habendum clause will establish what is known as the *primary term* of the lease. This term is a fixed number of years and can vary from lease to lease. Older leases often had a primary term of ten years. Except for federal oil and gas leases, today a ten-year term is a thing of the past. For modern leases the lessor might be offered a five-year term but might negotiate a three-year or two-year term. Leases can have terms as little as one-year or six-months.

Habendum Clause or Term Clause

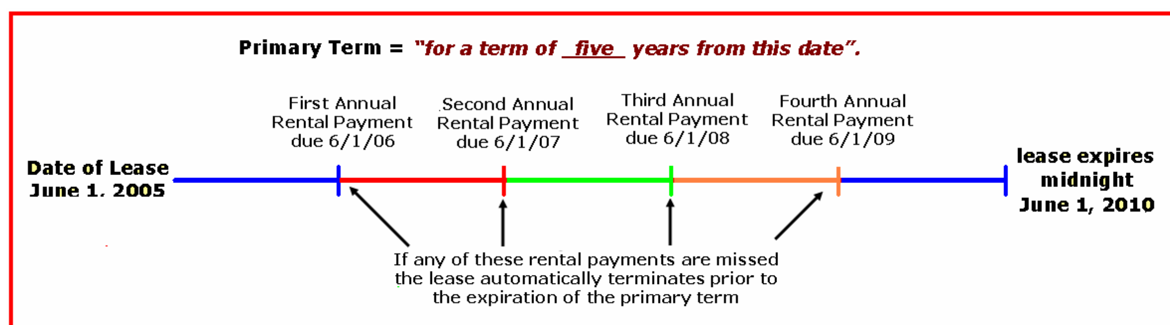
It is agreed that this lease shall remain in force for a term of __five__ years from this date 2. (herein called the primary term)

The Primary Term

During this primary term, unless otherwise stated in the lease, the lessee has the right, but does not have any obligation to begin any type of drilling operations on the lands. Production or drilling operations are not necessary to maintain the lease during the primary term.

Language found in many of the lease clauses must be interpreted alongside language found elsewhere in the lease. This is true for the habendum clause. Many leases require an annual delay rental payment during the primary term of the lease. If this payment is missed or not paid, in the fashion as set out in the *Delay Rental Clause*, the lease will automatically terminate prior to the end of the primary term.

At the expiration date of the primary term, the lease will automatically terminate unless there is actual production from a well, a payment of shut-in royalty for a gas well or some sort of contractual substitute[1] for production allowing for such things as drilling operations.[1]



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SECONDARY TERM

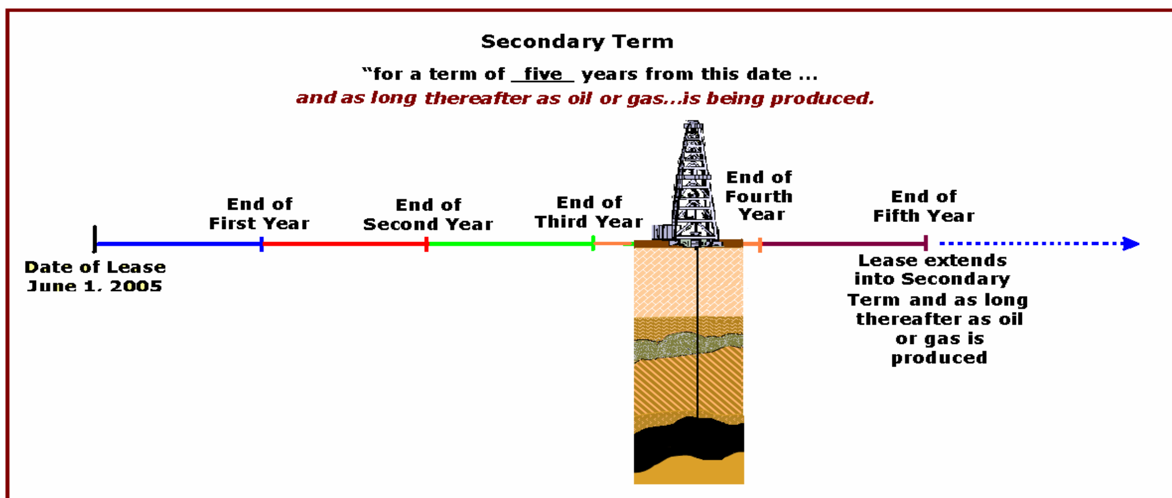
The secondary term can also be referred to as the *"thereafter term"*, meaning that as long as certain conditions have been met, the lease will be extended and continue for an indefinite period of time.

Habendum Clause or Term Clause

It is agreed that this lease shall remain in force for a term of __five__ years from this date (herein called the primary term) 3. and as long thereafter as oil or gas, or either of them, is produced from said land by the lessee.

The Secondary Term

Notice the language, *"and as long thereafter as oil or gas, or either of them is produced from said land".* Leases entering this secondary term will be extended, in some cases, for decades and potentially forever, as long as oil or gas is being produced from the land.



Certain questions should be asked when dealing with the secondary term:

- "Does actual production need to be in place in order for the secondary term of the lease to take place?"
- "If a well was commenced during the primary term but not completed until the term had expired, has the lease terminated?"
- "If a gas well capable of producing in paying quantities was competed within the primary term but was not able to be produced because of marketing or pipeline issues until after the primary term, has the lease terminated?"

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The answer to these questions differs from state to state or from court to court.

In 1932, an Oklahoma court held that if a lessee began drilling a well on the last day of the primary term, they were allowed to finish drilling the well, even though the primary term had expired. The court stated:

> "...we hold that the grant to lessee plaintiff of the right to commence a well at any time within the term fixed by the lease contract, by necessary legal implication, carried with it the right to complete the well after the period fixed for commencement had expired, subject, however, to abandonment of that right by failure to proceed in good faith and with diligence." [2]

However, most courts since that time have differed in their findings stating such things as this:

> "This court has steadfastly held to the rule that an oil and gas mining lease having a definite and fixed term limited with a 'thereafter' clause 'as long as oil or gas or either of them is produced upon said lease by the lessee' terminates not by forfeiture, *but by its own terms, at the end of the fixed period unless oil or gas is found or produced there from*, in the absence of the lessee having specifically provided against such contingency by an appropriate term in his lease contract."[3]

Today, most states hold that in order for the lease to pass into the secondary term actual *production* must be in place prior to the last day of the primary term. Apart from an express contractual agreement allowing for drilling beyond the primary term or a well completion clause, states such as Texas, Louisiana, New Mexico, Mississippi, North Dakota, Michigan, Ohio and Illinois would not permit a company to begin drilling on the last day of the lease.[4]

For leases in Oklahoma and West Virginia, as long as discovery and completion of either *oil* or *gas* has occurred termination will not occur at the end of the primary term. Production does not need to be in place – only a good faith effort to produce.[1] [1]Ibid.

Other states embrace only a portion of this view. For leases in Montana, Minnesota, Wyoming, Kentucky and Tennessee, termination will not occur at the end of the primary term as long as discovery and completion of *gas* has occurred. Production of gas does not need to be in place – only a good faith effort to produce. Oil wells fall into a separate category and must be producing during the primary term.[5]

- Texas – The oil and gas lease will expire at the end of the primary term unless a producing well in paying quantities has been completed prior to the expiration of the primary term. [6] In cases where a well has not been

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completed during the primary term, these leases can be saved with express contractual arraignments allowing for the lessee to complete the well which was commenced. [7] A payment of shut-in gas royalty will hold the lease past the primary term.

- Oklahoma – The oil and gas lease will expire at the end of the primary term unless there is the capability of commercial production.

  Oklahoma allows for a reasonable time past the primary term in order to market production.[8]

- Arkansas – same as Texas[9]
- New Mexico – same as Texas [10]
- Mississippi – same as Texas [11]
- North Dakota – same as Texas [12]
- Kansas – Actual production must be in place by the end of the primary term in order for the lease to extend into the secondary term.

  Unless the substances are produced and marketed on the date the primary term ends, the lease will terminate. In Kansas, a company completed several productive gas wells but were unable to get them hooked up to a pipeline prior to the end of the primary term. The court ruled in Elliott v. Oil Co., 106Kan. 248, 187 P. 692 (1920) that the lease had terminated.[13]

- Montana – Depending on the lease terms, a lease will expire at the end of the primary term unless a well has been commenced and completed.

  Reasonable diligence in marketing gas will hold only gas wells beyond the primary term. A payment of shut-in gas royalty will hold leases where marketing or pipeline issues occur.[14]

THE DOCTRINE OF INDIVISIBILITY

We have seen that the secondary term of a lease will automatically take place once a well, capable of producing in commercial quantities, is completed. With this in mind, one should ask, "Does this secondary term apply to any and all lands covered in the lease?"

The *Doctrine of Indivisibility* addresses this issue. Indivisible simply means not-divisible or not divided and states that a single well, which is capable of producing in commercial quantities, will continue the entire lease into the secondary term "as to all land covered by the lease and as to all depths, unless the lease itself contains a provision requiring partial termination of the lease . . . (sometimes called a Pugh Clause)". [15] In other words, unless

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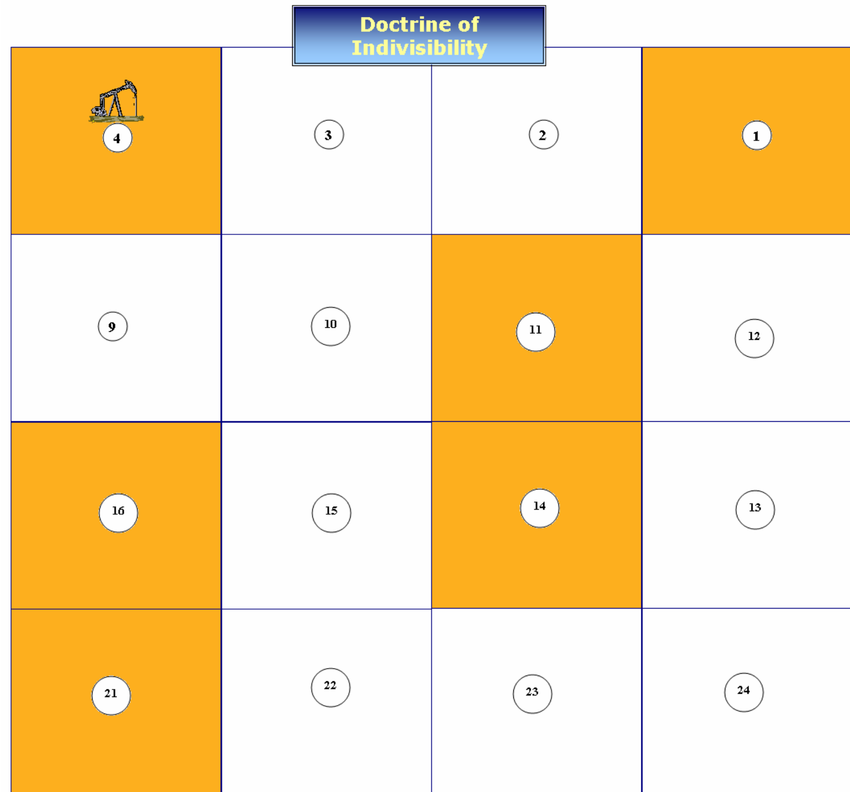
the lease itself contains a provision for dividing the lands, they remain whole (indivisible) during the secondary term. [16]

Not too many years ago, lessors, who owned large tracts of land, might lease their entire ranch or farm on the same lease. Under the doctrine of indivisibility, a single well, capable of commercial production, would hold the entire acreage by production (HBP). This concept became more than an irritant to many land owners who unknowingly placed these large tracts of land on the same lease.



Pugh Clause

During the later part of the twentieth century and into the twenty-first century, the oil and gas industry witnessed a vast increase in leases containing *divisible* language. As land owners broadened their knowledge, more and more leases contained added language requiring a partial termination (Pugh Clause) of lands located outside a formed unit. Such added language might provide for either a *horizontal* or *vertical* termination or severance of the lands.

Today, there exists some confusion over the definition of either a horizontal or a vertical pugh clause or severance. It appears that different organizations in the industry define these differently.

The following illustrations have been adapted from the definitions as set out by the National Association of Royalty Owners and the Schlumberger Oilfiled Glossary.

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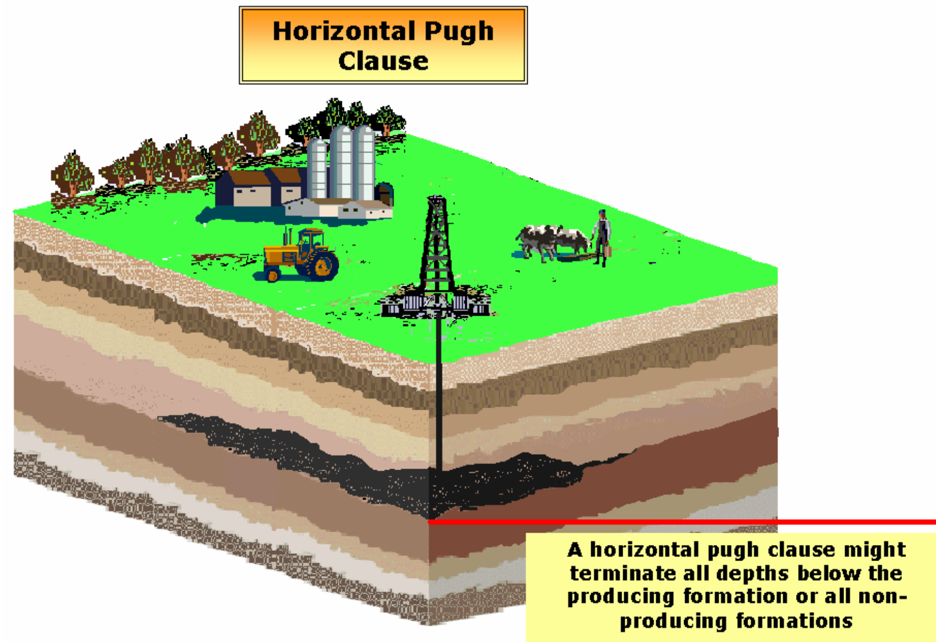
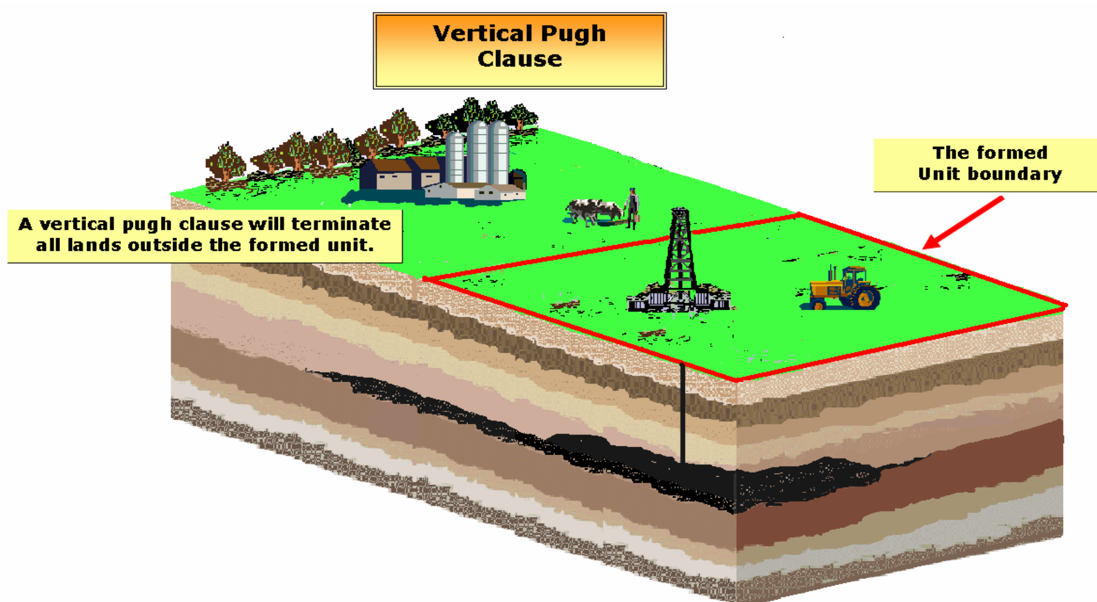
- Horizontal Pugh Clause – refers to depths, geologic horizons or structures beneath the surface of the earth that will be terminated. A horizontal severance happens between two subsurface strata.



- Vertical Pugh Clause – refers to a defined portion of lands located outside a formed unit, such as the Northwest quarter of the lease or any of those lands being outside of the producing unit boundary.



A typical Pugh clause might read:

> "If, . . . a drilling and/or production unit be created and established, pooling and combining a portion of the lands covered by this lease with other lands, lease or leases in the vicinity thereof, then drilling operations . . . shall continue this lease in force and effect during or after the primary term only as to the lands covered hereby which are included in such unit, . . . it being expressly agreed that drilling operations . . . shall not maintain this lease . . . as to any of the land covered hereby which are not included in such unit."

STATUTORY PUGH CLAUSE

A hand full of states, including Oklahoma, North Dakota, Mississippi and Arkansas, have established what is knows as *statutory pugh clause* rulings.

- The Oklahoma statutory pugh clause applies to leases that were executed after May 25, 1977 and only apply to leases that have been included in a spacing unit containing 160 acres or more. In such a case, those lands falling outside the drilling and spacing unit will, by state statute, automatically expire 90 days after the primary term of the lease.
- The North Dakota statutory pugh clause applies to leases that have been committed to a compulsory unit that have lands inside the unit boundary and lands outside the unit boundary. "After two years from the effective date of the order of the commission creating and approving the unit or the expiration of the primary term of the lease, whichever is the later date…lands outside the unit area may be maintained in force and effect only in accordance with the terms and provisions contained in the lease."[17]
- Mississippi provides that if an oil and gas lease contains lands partially within and partly outside a compulsory field-wide unit, production from the unit shall not hold the lands outside the unit. The exception to the rule applies if the lessee commences drilling activities on the land outside the unit within one year from the date of the determination of the unit or before the end of the primary term of the lease, whichever is a longer period of time.[18]
- The Arkansas pugh clause statute applies to oil and gas leases that were executed on or after July 4, 1983. Drilling operations or production from lands falling within a pooled unit shall maintain the lease only as to the lands where the production occurs. Those leased lands falling outside the sections or pooling unit will not be extended into the secondary term of the lease. There is an exception to this rule also. The rule does "not

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apply when drilling operations have commenced on any part or lands in sections or pooling units under the lease within one year after the expiration of the primary term, or within one year after the completion of a well on any part of lands in sections or pooling units under the lease." [19]

- Louisiana does not have a statutory pugh clause. They do require, however, that all state leases, which have been executed after August 1, 1991, contain a type of pugh clause. The language in this clause permits the lessee to maintain lands outside a unit for two additional years past the primary term of the lease, if the lessee submits rental payments during the two year term.[20]

FOOTNOTES:

[1]Oil and Gas Law 2001, Nationwide Comparison of Laws on Leasing, Exploration and Production, George A. Snell, III.

[2] Simons v. McDaniel, 154 Okla 168, 7 P2d 419, (1932) discussed in 10 TEX L REV 518 (1932).

[3] Production During the Primary Term or to Maintain Production Thereafter, Richard C. Maxwell, 3 Rocky Mountain Mineral Law Institute (1957)

[4]South Texas College of Law, Student Bar Association, Oil and Gas Outline, Professor Strausser, 2004 www.stcl.edu/students/sba/outlines.

[5]Ibid.

[6]A Comparative Review of Oil and Gas Law in Texas, Oklahoma, Arkansas, New Mexico, Mississippi & Louisiana, Landman Oil & Gas law, Special Section, December 2002, George Snell, Timothy Dowd, Tom Daily, Gregory Nibert, John McDonald and Richard Revels

[7]An Introduction to Kansas Oil & Gas Law, David E. Pierce, University School of Law, 1988.

[8]An Introduction to Kansas Oil & Gas Law, David E. Pierce, University School of Law, 1988.

[9]A Comparative Review of Oil and Gas Law in Texas, Oklahoma, Arkansas, New Mexico, Mississippi & Louisiana, Landman Oil & Gas law, Special Section, December 2002, George Snell, Timothy Dowd, Tom Daily, Gregory Nibert, John McDonald and Richard Revels

[10] Ibid.

[11] Ibid.

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[12] Ibid.

[13] An Introduction to Kansas Oil & Gas Law, David E. Pierce, University School of Law, 1988.

[14]Comparison of Laws of Texas with North Dakota and Montana on Leasing, Exploration and Production, Craig C. Smith, www.landman.org/content/NorthDakotaPaper.

[15] W.T. Waggoner Estate v. Sigler Oil Co., 118 Tex. 509, 19 S.W.2d 27 (1929) and Rogers v. Ricane I, 772 S.W.2d 76 (Tex. 1989) and Rogers v. Ricane II, 884 S.W.2d 763 (Tex. 1994).

[16] Oil and Gas Law 2001: Nationwide Comparison of Laws on Leasing, Exploration and Production, George A. Snell, III.

[17]Comparison of Laws of Texas with North Dakota and Montana on Leasing, Exploration and Production, Craig C. Smith, www.landman.org/content/NorthDakotaPaper.doc

[18] A Comparative Review of Oil and Gas Law in Texas, Oklahoma, Arkansas, New Mexico, Mississippi & Louisiana, Landman Oil & Gas law, Special Section, December 2002, George Snell, Timothy Dowd, Tom Daily, Gregory Nibert, John McDonald and Richard Revels.

[19]The Arkansas Leasing Manual, Charles A. Morgan, p. 36.

[20]A Comparative Review of Oil and Gas Law in Texas, Oklahoma, Arkansas, New Mexico, Mississippi & Louisiana, Landman Oil & Gas law, Special Section, December 2002, George Snell, Timothy Dowd, Tom Daily, Gregory Nibert, John McDonald and Richard Revels, p. 89-91.

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