



Oil and Gas Leases and Liens: Savings Clauses and Lien Procedures

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Force Majeure

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Force Majeure

- “An irresistible force . . . [a]n event which cannot be definitely foreseen or controlled.”
 - 46 ALR 4th 976 § 2(a).
- “Force majeure” is not a fixed rule of law that regulates the content of all force majeure clauses, but instead is a term that describes a particular type of event, i.e., an “Act of God” which may excuse performance under the contract.
 - *Perlman v. Pioneer Ltd. P'ship*, 918 F.2d 1244, 1248 (5th Cir. 1990).

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Force Majeure

- “Doctrine of force majeure” requires that the event complained of be:
 - **Outside the party’s control**; and
 - Entirely **unforeseeable**.
- Many courts also require the lessee exercise **due diligence** to overcome the condition alleged to be force majeure.
- Doctrine of force majeure should not supersede the specific terms bargained for in the contract. When the terms of a contract are unambiguous, the courts must give effect to the intentions of the parties expressed by the language they employ.
 - *Perlman v. Pioneer Ltd. P'ship*, 918 F.2d 1244, 1248 (5th Cir. 1990).

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Force Majeure

- Conditions typically included in a force majeure clause:
 - Acts of God, strikes, lockouts, other industrial disturbances, acts of a public enemy, war, blockades, riots, epidemics, earthquakes, explosions, accidents, or repairs to machinery or pipes, the delays of carriers, inability by reason of governmental regulation to obtain materials, acts of public authorities, other causes not within the control of the party claiming suspension, federal, state, county, or municipal laws, rules, regulations or executive orders.
- Economic or financial conditions generally do **not** constitute force majeure.
 - *Kaiser-Francis Oil Co. v. Producer's Gas Co.*, 870 F.2d 563, 566 (10th Cir. 1989).

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Force Majeure

- Force majeure clauses generally apply to circumstances that involve governmental orders or regulations or to relieve the lessee of its obligations or covenants.
- A well-drafted force majeure clause will provide constructive production to maintain an oil and gas lease if:
 - (1) the event complained of is defined as a force majeure event by the language of the clause,
 - (2) production is excused by the event defined as force majeure,
 - (3) there is a causal relationship between the event defined as force majeure and the failure of production, and
 - (4) the lessee gives timely notice, if the clause requires it.
 - 28A West's Legal Forms, Specialized Forms § 22:23.

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Force Majeure

- **Practice Pointers – Drafting:**
 - Determine which of the lessee's or lessor's obligations, conditions, or covenants will be affected by force majeure.
 - Determine which events will qualify as force majeure.
 - Include language that the list of events is not exclusive.
 - Consider including a judicial ascertainment clause.
 - Specify the period of time within which the affected party must resume its obligations following the end of the event claimed to be force majeure.

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Force Majeure

- **Practice Pointers – Pleading:**
 - Allege the party claiming force majeure exercised due diligence in attempting to overcome the condition claimed to be force majeure.
 - Be prepared to prove facts that will support the claim of due diligence.
 - Burden of proof is on the party claiming force majeure.
 - Admission by a party claiming force majeure that it could have overcome the force majeure event by paying a premium is likely fatal.

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Force Majeure

- **Sample Force Majeure Clause**
- Lessee's obligations under this lease, whether express or implied, shall be subject to all applicable laws, rules, regulations and orders of any governmental authority having jurisdiction, including restrictions on the drilling and production of wells, and regulation of the price or transportation of oil, gas and other substances covered hereby. When drilling, reworking, production or other operations are prevented or delayed by such laws, rules, regulations or orders, or by inability to obtain necessary permits, equipment, services, material, water, electricity, fuel, access or easements, or by fire, flood, adverse weather conditions, war, sabotage, rebellion, insurrection, riot, strike or labor disputes, or by inability to obtain a satisfactory market for production or failure of purchasers or carriers to take or transport such production, or by any other cause not reasonably within lessee's control, 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. Lessee shall not be liable for breach of any provisions or implied covenants of this lease when drilling, production or other operations are so prevented or delayed.
 - 6 West's Tex. Forms, Minerals, Oil & Gas § 3:3 (4th ed.)

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Cessation of Production/ Continuous Production

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Cessation of Production

- What is it?
- What does it do?
- Examples
- Case Law

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Cessation of Production

- What is it?
 - Savings Clause
 - Perpetuates a lease when production stops
 - Secondary Term
 - Defined period of time

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Cessation of Production

- Why?
 - Common Law – A temporary cessation does not terminate lease, provided the operator attempts to re-establish production in a reasonable time.
 - Provides clarity and certainty to both parties to oil and gas lease by defining what is considered temporary cessation.
 - Avoid litigation.

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Cessation of Production

- Example 1
 - If, after the expiration of the primary term of this lease and after oil, gas, or other mineral is produced from said land, or from land pooled therewith, the production should cease **from any cause**, this lease shall not terminate if Lessee commences operations for drilling or reworking **within 60 days** after the cessation of production, but shall remain in force and effect so long as such operations are prosecuted with **no cessation of more than 60 consecutive days**, and if they result in production of oil, gas, or other mineral, so long thereafter as oil, gas, or other mineral is produced from said land or land pooled therewith.

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Cessation of Production

- Example 2
 - If, If Lessee is engaged in actual drilling or reworking operations on the leased premises or land pooled with the leased premises upon or within 90 days prior to expiration of the primary term hereof, the termination provision set forth above will be suspended for so long as there is **no cessation of more than 90 consecutive days** in such operations on a single well, and **no cessation of more than 180 consecutive days between the completion of drilling or reworking operations on one well (completion being defined as the date of the completion rig release) and the commencement of actual drilling or reworking operations on another well.** The term "**drilling operations**" means actual drilling operations with a drilling rig capable of drilling to a depth at which it can be reasonably expected to encounter commercial quantities of hydrocarbons in a good faith effort to secure production where there has been none, plugging back operations, and deepening operations, and the term "**reworking operations**" includes work performed on a well after its completion, in good faith effort to secure production where there has been none, restore production that has ceased, or increase production.

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Cessation of Production

- Example 3 – Wyoming State Lease
 - Provided, however, if drilling, completion, testing or reworking operations are being **diligently conducted**, either during the primary term or during any extension thereof, this lease shall continue in full force and effect so long as such operations are being conducted and so long thereafter as oil or gas may be produced in paying quantities. This lease may be relinquished or terminated at an earlier date as provided herein.

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Cessation of Production

- BLM
 - If a Federal lease is in its extended term, and the AO has determined that there are no wells on the lease capable of producing oil or gas in paying quantities, the lease will terminate upon cessation of production unless within 60 days thereafter, reworking or drilling operations on the lease are commenced and are conducted with reasonable diligence and the lease resumes production in paying quantities. The 60-day period commences upon receipt of a determination from the AO that the lease is not capable of producing oil or gas in paying quantities.
 - 43 CFR § 3107.2-2 - Cessation of production

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Cessation of Production

- Case Law
 - *Osage Oil Co. v. Walker* 28 P.2d 482 (Wyo. 1934)
 - The Wyoming Supreme court, citing a Texas case with similar facts, applied the common law rule that a temporary cessation of development or production will not result in the termination of the oil and gas lease.
 - In the facts of the *Osage* case, the cessation of production lasted 8 months without any production or efforts to continue operations, despite demand from the lessor.
 - The trial court terminated the oil and gas lease at issue and was affirmed by the Wyoming Supreme Court.

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Cessation of Production

- Case Law
 - No Wyoming cases which directly address a cessation clause.
 - An oil and gas lease is a contract and is interpreted using the doctrines applicable to contracts. *State v. Moncrief*, 720 P.2d 470, 473 (Wyo.1986).
 - Operator's conduct will be measured by the prudent operator standard.

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Cessation of Production

- Sources:
 - R. Neal Pierce, et. al., *The Quick and the Dead: Cessation of Production and Shut-Ins During the Secondary Term of an Oil and Gas Lease*, 88 N.D. L. Rev. 727 (2012).
 - EXTENDED OIL & GAS LEASES: AND SO LONG THEREAFTER... HAPPILY EVER AFTER?, 2014 NO. 1 RMMLF-INST PAPER NO. 4, 4-1
 - CONTINUING THE LEASE: SUBSTITUTES FOR PRODUCTION AND THE MEANING OF CONTINUOUS OPERATIONS, 2018 NO. 3 RMMLF-INST 5, 5-1.

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Shut-In Clauses

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Origin and Definition

- The Shut-In clause is the original remedy to the harshness of lease habendum clauses requiring *actual* production
- Recognizes the pragmatic realities that a well, although capable, can't be produced effectively without infrastructure and/or markets
- Simultaneously balances the interests of landowners reasonably expecting the benefits of a lease
- The Wyoming Supreme Court recognized the WOGCC definition of "Shut-in Well" in the Pennaco Energy, Inc. v. Sorenson case.
 - **WOGCC Rules, Chapter 1, Section 2, (vv):** Shut-In Well shall mean a well not currently considered active in which the completion interval has not been isolated from the wellbore above and where the wellbore condition is such that its utility may be restored by opening valves or by energizing equipment involved in operating the well.

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Example

If at any time while there is a gas well or wells on said land or land pooled therewith and such well or wells are shut-in, and this lease is not being maintained otherwise as provided herein, this lease shall nevertheless remain in force and effect following the shutting-in of the well(s), whether it be during or after the primary term, and it shall be considered that gas is being produced from the land covered by this lease. When the lease is continued in force in this manner and the well or wells are shut-in for a period of at least ninety (90) consecutive days, Lessee shall pay or tender as royalty to the parties who at the time of such payment would be entitled to receive royalty hereunder if the well were producing \$ ___ per net acre for the acreage then held under this lease by the party making such payment or tender.

SPINNING STRAW INTO GOLD: REFINING AND REDEFINING LEASE PROVISIONS FOR THE REALITIES OF RESOURCE PLAY OPERATIONS, 57 RMMLF-INST 26-1 (2011), 26-7

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Common Pitfalls

- Condition v. Covenant
 - The significance between the two can result in unwanted automatic termination of the lease
 - “If the shut-in payment is timely made”
- “Capable of Production” and “Paying Quantities”
 - “will produce in paying quantities if the well is turned “on,” and it begins flowing, without additional equipment or repair. Conversely, a well would not be capable of producing in paying quantities if the well switch were turned “on,” and the well did not flow, because of mechanical problems or because the well needs rods, tubing, or pumping equipment.”
 - Anadarko Petroleum Corp. v. Thompson 94 S.W.3d 550 (Tex. 2002).
 - However, rejected by Kansas Court in *Levin v. Maw Oil & Gas, LLC*, 234 P.3d 805 (Kan. 2010).
- Well, what does it cover?

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Production in Paying Quantities

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Production Paying Quantities

- Originates from the habendum clause
 - Generally an oil and gas lease may be kept alive after the primary term by production in paying quantities or a savings clause.
 - "Produced" = "produced in paying quantities"
 - *Roberts v. Corum*, 236 Miss. 809, 112 (So. 2d 550 (1959)).
- Generating a profit in excess of operating expenses over a reasonable period of time
 - ² Eugene Kuntz, *A Treatise on the Law of Oil and Gas* § 26.7(d)(2015)

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Production in Paying Quantities

- Two-step analysis:
 - Did the well yield a profit over operating costs over a reasonable period of time?
 - Would a reasonable and prudent operator continue to operate a well in the manner in which the well was operated under the relevant facts and circumstances?
 - *Clifton v. Koontz*, 235 S.W.2d 684, 690-91 (Tex. 1959).
- What is a “reasonable period of time”?
 - No bright line
 - Fact-intensive
 - Expert testimony

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Production in Paying Quantities

“The true criterion for determining whether a well is a commercial producer is: Will it pay for a profit to the lessee, over operating expenses, for its operation? If so, the well may be said to produce in paying quantities, even though the profit is small and the costs of development may never be recovered.”

Champion Ventures, Inc. v. Dunn, 567 P.2d 724, 728 (1977).

Drilling and equipment costs not included in calculation

- *Tank v. Citation Oil & Gas Corp.*, 2014 ND 123, ¶ 12, 848 N.W.2d 691, 696 (quoting 8 Patrick H. Martin & Bruce M. Kramer, *Williams & Meyers Oil and Gas Law Manual of Terms* 816 (2013)); *Somont Oil Co. v. A & G Drilling, Inc.*, 2002 Mont. 141, ¶ 27, 49 P.3d 598, 604.

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Production in Paying Quantities

- Automatic
- Burden is on the Lessor or challenging party, not the operator/lessee
 - *Somont Oil Co. v. A & G Drilling, Inc.*, 2002 Mont. 141, ¶ 28, 49 P.3d 598, 604; *Sorum v. Schwartz*, 411 N.W.2d 652, 654 (N.D. 1987); *Champion Ventures, Inc. v. Dunn*, 567 P.2d 724, 729 (1977).
- Affect of acceptance of royalties on a claim by lessor to cancel a lease
 - *West v. Alpar*, 298 N.W.2d 484 (N.D.1980); *Corey v. Sunburst Oil & Gas Co.*, 72 Mont. 383, 233 P. 909, 912 (1925).

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Federal Leases

Lease Suspensions

- Not based up on an economic analysis of producing from the lease.

Royalty Reductions

- What royalty rate allows the lease to be economic?

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Oil and Gas Liens

Wyo. Stat. §§29-3-101 – 29-3-111

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1) What type of work qualifies for a lien?

“Every person who works upon or furnishes material, whether incorporated into the real property or not, *under contract* with the owner of any interest in real estate . . . has a lien to secure payment for:

- Constructing, altering, digging, drilling, driving, boring, operating, completing or repairing any wells, mines or quarries;
- Altering, repairing or constructing any oil derrick, oil tank or any pipelines; and
- Transportation and related mileage charges plus interest from the date due.”

“Material” means “casing, tanks, pipelines, fuel, machinery, equipment, appliances, buildings, structures, tools, bits or supplies” but “does not include drilling rigs or hoists or their integral component parts except wire lines.”

- Note: Materialman and subcontractors have the same lien rights as the general contractor, but only to the extent the general contractor had an agreement with the owner for the materials and services provided by the sub.

Wyo. Stat. § 29-3-103(a) (emphasis added).

Wyo. Stat. § 29-3-101(a).

Wyo. Stat. § 29-3-104.

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2) What is the deadline for filing a lien (\$750 min.)?

180 days:

- (i) After the last day materials were delivered or work was performed under contract;
- (ii) From the date the work was substantially completed as determined by the facts in each case; or
- (iii) With respect to a subcontractor, after the last day it performs work at the direction of its contractor.

If more than one of the events applies, assume that the earliest one controls.

Wyo. Stat. § 29-3-106(b).

Wyoming's mechanic's lien statute contains a similar list of events that start the clock ticking. Like Wyo. Stat. § 29-3-106(b) here, that statute does not specify what event controls if multiple events apply to a situation, but the Wyoming Supreme Court has held that the earliest applicable event controls in that mechanic's lien statute. Bates v. Chi. Lumber Co., 375 P.3d 732, 734 (Wyo. 2016).

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3) How is the lien perfected?

- A lien is perfected by recording a proper lien statement with the county clerk. Wyoming's lien statutes contain a form lien statement, and to be effective, a lien statement must "be in substantially the same format and contain the same information" as that form.
- Among other things, the lien statement must include "the name and address of the record owner against whose property the lien is filed" and "the legal description of the property." One may not always have this information, but the Wyoming Oil and Gas Commission maintains searchable databases that can help in addition to the county real estate records. See the attached link:

<http://pipeline.wyo.gov/legacywogccea.cfm>

Wyo. Stat. § 29-1-312(f). The form is found at Wyo. Stat. § 29-10-104.

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4) What does the lien cover?

- A lien attaches to the following:
 - All the production of oil, gas and ore and minerals in solid form attributable to the interest subject to the lien (only effective against purchaser if notice is sent);
 - The proceeds of production attaching to the working interest as the working interest existed on the date labor was first performed or materials were first furnished (only effective against purchaser if notice is sent);
 - Any well;
 - Oil derricks;
 - Oil tanks;
 - Any pipelines including rights-of-way;
 - Any mine or quarry;
 - All materials furnished for use with work done; and;
 - The whole of the land or leasehold (or, in the case of validly pooled or unitized lands, leases or interests, the lands, leases or interests so pooled or unitized) and including all other wells, buildings, property and appurtenances, including water rights, located on the land or leasehold (or pooled or unitized lands, leases or interests) where work was performed or materials furnished.

Wyo. Stat. § 29-3-105(a)-(d).

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5) How long does the lien last?

- The statutes gives a lien claimant 180 days after the filing of the lien statement to commence an action to recover amounts due, and the lien continues during the pendency of that action. In practice, actions to recover amounts due often include a claim to foreclose the lien.
- To be sure of the rights of a subcontractor, it is best to have access to the contract between the contractor and the owner if possible. If the contractor would have no right to file a lien for the services provided, then the subcontractor has no right. Wyo. Stat. Ann. § 29-3-109(a).

The statutes relating to lien foreclosure are found at Wyo. Stat. §§ 29-1-401 *et seq.*

Adobe Oil & Gas Corp. v. Getter Trucking, Inc., 676 P.2d 560 (Wyo. 1984).

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6. Other Remedies

Payment Directly to Subcontractor

- Parties who perform services or furnish material under a contract whose demand for payment is ignored must serve the owner via certified mail a notarized accounting of the amount and value of work performed or materials furnished for which payment is outstanding.
- If the contractor fails to dispute the claim of the subcontractor within 10 days of receipt of the claim from the owner, the owner is authorized to withhold later payments to be made to the contractor to pay all claims when they become do.

Mechanic's Lien Statutes

- Wyoming's Contractors and Materialmen Lien statutes have also been used to claim liens arising in the oil and gas context, although not often utilized.

Wyo. Stat. Ann. § 29-3-111.

Wyo. Stat. Ann. § 29-2-101 et seq. (Contractor and Materialmen Lien Statutes).

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