

WHO MUST PRODUCE AMONG MULTIPLE LESSEES IN ONE TRACT?

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I. Introduction: Multiple Lessees and Production on One Tract

Under the most commonly encountered drilling clauses found in oil and gas leases, the lessee must drill a well or, as the lease provides, pay delay rentals on or before a particular date, if the lease is to remain in force. At the same time, the minerals within a certain tract can be owned by separate cotenants and subsequently leased out to different lessees. This results in cotenant working interest owner/lessees vying to develop undivided mineral interests within a certain tract, each mindful of its obligations under its particular lease. If drilling operations are conducted by one undivided working interest owner (Company A) on a particular tract, the issue may then arise as to whether such drilling operations are enough to satisfy typical drilling clauses in the lease of a working interest cotenant (Company B).

Texas oil and gas leases most commonly require production in paying quantities after the end of the primary term to keep the lease alive. Texas courts have routinely imposed this production requirement on *each* lessee individually, meaning that production (in paying quantities, usually) from a lessee's cotenant (Company A) will not keep the lease of a non-producing lessee (Company B) going. Under current case law, mere payment of proportionate royalties from the non-producing lessee (Company B, again) to its lessors will fail to keep the typical Texas lease alive past the primary term. Thus, if Company B is not developing the leased premises itself or in some arrangement with Company A, like a joint operating agreement, the all-important question becomes the oldest one facing lessees: what is keeping the lease of Company B going?

Absent pooling of the leases, unusual lease language, or some agreement of co-development between the lessees, the non-drilling working interest owner (again, Company B) under a typical lease cannot rely on the action of a drilling working interest (Company A) to perpetuate Company B's lease, even if Company B pays its lessors the appropriate proportionate royalty. Armed with knowledge of this state of the law, Company A could stiff-arm requests to co-develop a particular tract by Company B while at the same time obtaining top leases from the lessors to Company B and then simply waiting for the bottom leases to expire.

II. Cimarex Energy Co. v. Anadarko Petroleum Corp.

In the case of *Cimarex Energy Co. v. Anadarko Petroleum Corp.* (574 S.W.3d 73 (Tex. App.—El Paso 2019, pet. filed)), the drilling lessee did just that! Simplified, the facts are thus: In Ward County, Texas, Anadarko acquired a 5/6th working interest over the captioned tract from various prior lessees between 2007 and 2010. In December of 2009, Cimarex leased the remaining fractional undivided 1/6th mineral interest. Typical in many ways, the Cimarex lease contained a habendum clause, which provided for a primary term of five years, and a secondary term lasting “as long thereafter as oil or gas is produced from said land or from land with which said land is pooled.” It did not say “produced by lessee.” The Cimarex lease was a “paid-up” lease. The Cimarex lease, like nearly all leases, did place on the lessee “the obligation to pay

royalties on actual production” during that time. Cimarex did not commence operations for the drilling a well on the leased land during the primary term of the lease.

In 2011 and 2012, the Railroad Commission issued permits for Anadarko to drill two wells on the leased land. Later that year in August, the lessors of Cimarex’s lease granted Petro-Land Group, Inc., two top leases covering the leased land. These were acquired by Anadarko in the middle of 2012. Meanwhile, after multiple requests for an accounting by Cimarex, Anadarko sent Cimarex a letter in which it belatedly acknowledged Cimarex’s 1/6th leasehold interest while identifying Cimarex as a “non-participating cotenant” that was entitled to a “net share of proceeds after payout.” Anadarko paid Cimarex from July of 2013 through 2014 for its share of production, minus a 1/6th share of expenses. Cimarex then paid the lessor’s royalties under its lease, calculated back to the first date of production on the wells. After the end of the primary term of Cimarex’s lease Anadarko stopped making payments to Cimarex, claiming (surprise!) that the lease had expired and that Cimarex was no longer entitled to a share of the production or proceeds therefrom. Anadarko asserted that the top lease it has purchased from Petro-Land was in effect, paid the necessary bonus to the lessors to activate the lease, and began royalty payments.

Cimarex sued. In response, Anadarko sought summary dismissal of the action based on its affirmative defense that Cimarex’s lease had terminated at the end of its primary term because Cimarex failed to conduct operations for drilling and production on the leased land. Anadarko argued that Cimarex could not rely on Anadarko’s production to extend Cimarex’s lease and that since the lease had terminated, Anadarko’s top lease took effect.

The trial court and the Court of Appeals of El Paso ruled for Anadarko. The appellate court, citing fairly on-point case law, found that the Cimarex lease expressed an intent and purpose to develop, as the lease was for “investigating, exploring, prospecting, drilling and operating for and producing oil and gas,” as well as seeking to “produce, save, take care of, treat, process, store and transport said minerals[.]” The court therefore concluded that the parties’ intent was for the lessee to “do something to bring about that exploration and production of oil and gas, after the paid-up portion of the lease expired.”

III. Conclusion

While the case has been appealed to the Texas Supreme Court, and while your dear writer does not necessarily agree with the ruling, the result for now seems clear for those dealing with typical leases. If you are a lessee of an undivided fractional interest in a particular tract in which one or more other lessees also have a portion of the working interest under lease, and if there is no agreement between you and the other lessee(s) for co-development, then if the other lessee or lessees produce on the tract and you do not, you cannot count on the other lease production to carry your lease into the secondary term even if you pay your proportionate share of the your lessor’s royalty on production.

A petition has been filed and the Texas Supreme Court might consider this case on appeal. In the meantime, realize that a typical lease contemplates production by the lessee, even if only “production on the tract” is expressly required. Either change the wording of the lease to expressly allow other drilling on the tract to hold your lease, enter into a co-development

agreement with your lessee covenants like a joint operating agreement, or—safest of all—drill your lease yourself.