

THE DEMISE OF THE PRODUCERS 88

For many years in Texas Oil and Gas Leases looked very similar with various versions of the infamous Producers 88. The landscape has changed dramatically over the last few years with the rapid increase in leasing for the Barnett Shale. As leasing moved into a more urban environment there was an increase in competition among Lessees opening the door to negotiating various terms. Besides the traditional issues such as bonus, the percentage of royalty and the length of the primary term, numerous other provisions of the typical Oil and Gas Lease were negotiated creating thousands of leases with custom provisions located within them. This article touches on just a few of those other negotiated items.

1. **Post Production Expenses**. Royalty in Texas is considered free from the costs of production. Such costs include those for drilling, completion and equipping the well. However, once the product reaches the surface, then the general rule is that post production expenses such as costs to gather, compress, dehydrate or treat the product to make it marketable can be passed on in their proportionate share to royalty owners. This can be changed by specific language in the lease. Lessors, with some degree of success, soon began attempting to either eliminate or limit such post production expenses. Since such expenses can constitute anywhere from 10% to 15% of the total amount received, a 25% royalty in which landowners shared in the post production expenses may not be a better deal than a 23% royalty with no such post production expenses.
2. **Pooling Clauses**. Unless you own a large tract, the issue of pooling authority and the size of units to be created continues to be an issue between Lessors and Lessees. Lessees traditionally like permission to create large units giving them significant discretion to pool all or any part of the property. Lessors on the other hand, typically believe smaller units are in their best interest. While smaller units may appear to be more beneficial to a small tract owner, if in fact a Lessee is going to drill numerous wells within the unit, a large unit can allow participation in a greater number of wells. Depending upon the drilling plan in the unit, participation in a smaller number of wells with a greater percentage of interest may provide greater up front cash flow, however, there is concentrated risk. Participation in

a larger number of wells over a larger development may ultimately yield greater results and an extended cash flow stream. There is no simple or single solution on the pooling issue.

3. **Pugh Clauses**. Pugh Clauses which provide for the release of either unused acreage or unused depths or formations have now become common. The majority of negotiated leases and certainly the leases which have been negotiated by various homeowners associations within cities include both vertical and horizontal pugh clauses so that only the acreage contained within producing units is maintained after the expiration of the primary term and only those formations or depths from the surface to the bottom of the producing formations will be retained.

4. **Surface Use**. The most difficult issues deal with those leases which will involve use of the surface as a drillsite location. Due to the high value of the land that is involved, as well as, the potential future real estate development opportunities that may be available to such land, the surface use, access, scheduling and layout all become critical issues. Dealing with the myriad of issues up front so that all parties understand their rights and obligations can slow down the process. However, obtaining a clear agreement can eliminate future misunderstandings. Incorporate the provisions into the lease or obtain a separate Surface Use Agreement.

An Oil and Gas Lease that results in production creates a very long term relationship. Simply signing a form lease without understanding the importance of its terms may very well mean that you did not get the best terms that were available.