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Construing Retained-Acreage and Related Clauses After *Endeavor v. Discovery Operating* and *XOG v. Chesapeake*

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II. INTRODUCTION

Retained-acreage clauses have been a relatively common feature of Texas oil and gas leases for decades. *See, e.g., Parten v. Cannon*, 829 S.W.2d 327, 329 (Tex. App.—Waco 1992, writ denied) (interpreting retained-acreage clause contained in oil and gas lease executed in 1976), and *Mayfield v. de Benavides*, 693 S.W.2d 500, 501–02 (Tex. App.—San Antonio 1985, writ ref'd n.r.e.) (interpreting retained-acreage clause included in a 1968 oil and gas lease). Although such clauses have appeared in Texas oil and gas leases for decades, Texas courts had reviewed and interpreted retained-acreage clauses on relatively few occasions—until the last decade. Between 2013 and 2017, Texas appellate courts produced nine opinions centering around retained-acreage clauses. On April 13, 2018, the Texas Supreme Court issued opinions on two of those cases—*XOG Operating, LLC v. Chesapeake Expl. Ltd. P'ship*, 554 S.W.3d 607 (Tex. 2018) and *Endeavor Energy Res., L.P. v. Discovery Operating, Inc.*, 554 S.W.3d 586 (Tex. 2018). This paper will review the facts, issues, and outcomes of those two cases and subsequent Texas cases involving retained-acreage and related clause.

III. RETAINED-ACREAGE CLAUSES: WHAT THEY ARE AND WHAT THEY DO

An extensive analysis of the purpose and history of retained-acreage clauses is beyond the scope of this paper. However, a brief explanation of the meaning, effect, and reasons for the inclusion of retained-acreage clauses in an oil and gas lease is necessary. Simply stated, a retained-acreage clause is a clause in an oil and gas lease that sets out how much acreage a lessee may retain for each well it drills on the leased premises after the balance of the lease automatically terminates.

To understand the reason for inclusion of such clauses in oil and gas leases, one must first understand the nature of the estate granted by an oil and gas lease in Texas, which is a fee simple determinable in the oil, gas and other minerals in place in the property included in the oil and gas lease's property description. *Stephens County v. Mid-Kansas Oil & Gas Co.*, 113 Tex. 160, 176, 254 S.W. 290, 295 (1923). The *duration* of that estate is defined by the oil and gas lease's habendum clause. In Texas, the typical habendum clause divides the lease's duration into two parts: a primary term that is a fixed period of time, and a secondary term that continues the lease after the primary term expires, for "as long thereafter as oil, gas or other mineral is produced." *Endeavor v. Discovery Operating,* 554 S.W.3d at 597. Under this type of habendum clause, the oil and gas leasehold estate will terminate in its entirety in the secondary term if production ceases. But the corollary is also true— "[a]s long as one portion of the leased tract–even a small portion–is producing oil or gas, the lease will continue as to the entire tract, even if the operator elects not to develop other areas within the leased tract." *Id.* (citing *Mathews v. Sun Oil Co.*, 425 S.W.2d 330, 333 (Tex. 1968)). In other words, in the absence of provisions to the contrary (such as continuous development and retained-acreage clauses), a lessee may hold all the acreage described and covered by the oil and gas lease (which may be thousands of acres) with only one producing well after the end of the primary term. This result may put the interests of lessors, who desire more development to maximize royalties, into conflict with the interests of operators, who may desire to maintain their property rights as to the entire leased premises with minimal production and postpone additional development and production based on several factors including market conditions and available resources. *See id.*

To combat the problems associated with the "habendum only" lease, encourage development, and balance these competing interests, lessors and lessees began to include continuous development and retained-acreage clauses in their oil and gas leases. A continuous development clause "permits a lease to be preserved under certain circumstances even though there is no production after the expiration of the primary term during *continuous* drilling operations, whether on the same or different wells." *Id.* at 597–98. Continuous development clauses "have become ubiquitous" in oil and gas leases. *See Endeavor Energy Res., L.P. v. Energen Res. Corp.*, 615 S.W.3d 144, 153–54 (Tex. 2020).

A retained-acreage clause, which typically works in tandem with the continuous development clause "divides the leased acreage such that production or development will preserve the lease only as to a specified portion of the leased acreage." *Endeavor v. Discovery Operating*. 554 S.W.3d at 598. One Texas court has defined a "retained-acreage clause" as: "... a covenant that excludes certain acreage from the automatic termination and reversion provisions contained in an oil and gas lease. Retained-acreage clauses typically provide that at the end of the primary term, each producing well will hold a specified number of acres, with all other (non-producing) acreage being released." *Hardin-Simmons Univ. v. Hunt Cimarron Ltd. P'ship*, No. 07-15-00303-CV, 2017 WL 3197920, at *2 and n. 4 (Tex. App.—Amarillo July 25, 2017, pet. denied). Another way to think of retained-acreage clauses, especially when paired with continuous development provisions, is as a "drill-to-earn" clause. That is because the lessee is essentially earning the right to perpetuate the lease as to a certain number of leasehold acres for each productive well drilled.

As explained above, under a traditional "habendum only" oil and gas lease, commercial production from anywhere on the land covered by the lease will allow the lessee to perpetuate the lease in its entirety. The retained-acreage clause, therefore, changes this rule, and

allows the lessee to maintain only a certain number of acres for each producing well after the terminating event specified in the lease. "Retained-acreage clauses were originally drafted to prevent the lessee from losing those portions of a lease that had productive wells located thereon if the rest of the lease terminated ...[but]...[t]he term has expanded its meaning to include clauses that require the release of all acreage that, at the end of the primary term, is not within a drilling, spacing or proration unit." Bruce M. Kramer, *Oil and Gas Leases and Pooling: A Look Back and A Peek Ahead*, 45 TEX. TECH L. REV. 877, 881 (2013). For leases that contain continuous development clauses, termination of all or part of the leasehold acreage may be extended until the end of the continuous development period, depending on the specific terms of the particular oil and gas leases.

Retained-acreage clauses are "increasingly common" in oil-and-gas leases today. *See* Patrick H. Martin & Bruce M. Kramer, WILLIAMS & MEYERS, OIL & GAS LAW, § 681.3 (LexisNexis Matthew Bender 2015) ("It is becoming increasingly common for leases to include a combination of a continuous operations clause and a retained-acreage clause."). They balance the interests of landowners and operators in the pace of development. Landowners want as much development as possible to maximize royalty payments. Operators share the same development goal, but must also consider development costs, a burden they alone bear. Plummeting oil prices or skyrocketing drilling costs can cause these interests to diverge — landowners wanting more drilling to supplement reduced royalties, and operators wanting less drilling until market conditions improve. Retained-acreage clauses further the interests of the landowners by providing a "use-it-or-lose-it" type of incentive for lessees to fully develop their leased property. Indeed, the Texas Supreme Court recently advised that "if a lessor wants its entire leasehold acreage developed, it should include a retained-acreage clause in its leases." *Endeavor v. Discovery Operating*, 554 S.W.3d at 598. In return, the retained-acreage clause gives lessees certainty that they will retain a certain number of leasehold acres per well drilled and provides them with a road map of the amount of development required to perpetuate the lease in its entirety, or at least as much of it as the lessee desires to hold.

Many retained-acreage clauses specify a fixed number of leasehold acres that each completed, producing well will retain or hold after the terminating event specified in the lease. Alternatively, many retained-acreage clauses tie retained-acreage units to regulatory constructs such as proration units. "Defining the retained-acreage by reference to a Commission designation like a proration unit can provide certainty or clarity regarding the extent of the acreage that remains under lease. But the inclusion of such regulatory principles in a retained-acreage clause may also cause confusion or disappointment, as the contracting parties may not fully understand the ramifications of including a regulatory term in the typical mineral lease." *Id.*

IV. *ENDEAVOR V. DISCOVERY OPERATING* AND *XOG V. CHESAPEAKE*

In *Endeavor v. Discovery Operating*, the Texas Supreme Court observed that:

> [r]etained-acreage clauses come in many different shapes, sizes, and forms. The effect of a particular clause depends on the terms the parties freely chose and like the Commission's implementation of special field rules, there is no "one size fits all" result of their proper construction. Each retained-acreage clause must be construed on its own, under governing provisions of contract interpretation.

Id. This proposition is aptly demonstrated by the results of the disputes in *Endeavor v. Discovery Operating* and its companion case, *XOG v. Chesapeake*. The two cases involved similar retained-acreage and continuous development provisions, similar fact patterns, and similar claims by the opposing parties, but resulted in different outcomes.

A. *Endeavor Energy Res., L.P. v. Discovery Operating, Inc.*, 554 S.W.3d 586 (Tex. 2018)

In this case, Endeavor Energy Resources, L.P. ("Endeavor") owned oil and gas leases covering certain lands located in Martin County, Texas described as the N/2 of Section 9 and the S/2 of Section 4 (both half sections covering approximately 320 acres, more or less). *Id.* at 591. Discovery Operating, Inc. ("Discovery") brought a trespass to try title action against Endeavor over competing claims of title to and ownership of determinable fee interests on two quarter sections of land—the NW/4 of Section 9 and SW/4 of Section 4 (the "Disputed Acreage"). Discovery contended that leases held by Endeavor had partially terminated, that the terminated interests had been released, and that Discovery had subsequently acquired valid leases on the Disputed Acreage. Endeavor claimed that the four oil and gas wells it had drilled under its leases perpetuated both leases as to 320 acres pursuant to the leases' continuous development and retained-acreage clauses. *Endeavor v. Discovery Operating,* 554 S.W.3d at 591-94.

Both leases contained the following retained-acreage clause:

> 18. At the end of the Primary Term or upon the cessation of the continuous development

Title search: Construing Retained-Acreage and Related Clauses after Endeavor v. Discovery Operating and XOG v. Chesapeake

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