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Over the last several months I have received an unusual number of requests pertaining to information involving Pugh Clauses. As a result, it seemed to be a good idea to provide some basic information as to the same. Naturally, this is not intended to be used as specific legal advice to anyone. Instead, this is provided for general education to those that are interested. As always, it is recommended to secure legal counsel familiar with these issues if you are considering incorporating such a clause in your oil and gas lease, or any other document.

PUGH CLAUSE

By Ralph A. Cantafio¹ and Rosanna Slingerland²

A Pugh Clause provides for the severance of the lease into separate tracts whenever less than all of the leased land is included in a single pool or unit. Phrased differently, a Pugh Clause allows the part of the leased property that is part of a pooled unit to be characterized as being placed into the secondary term and held by production, but treat the rest of the leased property not part of the pooled unit as a stranger to the original lease. Hence, the part of the leased premises that is part of the pool is segregated from the rest of the lease. This is referred to as a Horizontal Pugh Clause. Beware; an effective Pugh Clause is difficult to both draft and negotiate. Leasing mineral interests in small tracts is a suitable and much more realistic alternative. A word of caution, the drafting of an effective Pugh Clause is difficult, as too is securing approval of a landman in successfully negotiating the same.

The purpose of a Pugh Clause is to sever the pooled acreage from the remainder of the acreage in a lease so as to provide information to drill or the remainder of the lease will terminate. Generally speaking, the Pugh provision will provide that the production or operation on pooled acreage will maintain the lease only as to the acreage in the lease included in a pooled unit. The clause is said to have been originated by one Lawrence C. Pugh of Crowley Louisiana.

A Pugh Clause is sometimes referred to as a Freestone Rider.

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This clause provides that drilling operations on or production from a pooled unit or units shall maintain the lease only as to land actually included in the pooled unit or units. The acres of a lease not part of the pooled acreage are treated as if the pooled area does not exist.

Delay rentals, if any, paid under a Pugh Clause are typically paid for the land excluded from the pooled unit. Payment of such delay rental is required to preserve the lease as to the acreage excluded from the unit when there is no drilling on such excluded acreage or on a unit which includes such acreage. If the lease in question is a "Paid Up" lease, this payment issue is obviously inapplicable.

Failure to drill on the excluded acreage during the primary term results in the lapsing of the lease at the end of that primary term.

Different forms of Pugh Clauses may be found. While all these forms address the same situation, (pooling of a part of the lease and drilling on the pooled area does not maintain all the lease), there are some differences in these forms. Pugh Clauses are effective in accomplishing vertical or horizontal severances.

Also consider there may be several separate oil reservoirs stacked at different levels under the same surface area. The insertion of a Pugh Clause can also divide the lease into separate producing formations or levels when only one formation is included in a single pool. This is referred to as a Vertical Pugh Clause. However, this type of clause, especially in wildcat rich areas, would be extremely difficult, if not impossible, to negotiate. As before, leasing the surface area in small tracts is a more realistic alternative and should take care of most of the problems a landowner might encounter.