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## Money for Nothing — Shut-In Royalty Clauses in Oil and Gas Leases

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### **§ 15.01. Introduction.**

Shut-in clauses are well known to all parties in the natural gas industry. The typical shut in clause permits the lessee of a gas well to shut in the well in return for making payment of a contractually specified amount to the lessor. The primary purpose of the shut-in clause is to permit the lessee to hold onto its lease despite the fact that the well is not producing in paying quantities.

Although simple in concept, shut-in clauses have been frequently litigated. The issues litigated depend on the language of the specific lease and the facts of each case. Certain issues, however, resurface with regularity. For example, many cases involve claims by lessors seeking to invalidate a lease on a shut-in well based on the claim that the well is not capable of producing in paying quantities. Other frequently litigated issues are whether the acceptance of shut-in payments estops the lessor from seeking termination of the lease; whether failure to make shut-in payments automatically terminates the lease or merely entitles the lessor to recover breach of contract damages; when shut-in payments are required to be made; and who the proper parties are to receive the payments.

The Eastern Mineral Law Foundation last addressed the interpretation and operation of shut-in clauses in 1984.<sup>1</sup> This chapter will focus primarily

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<sup>1</sup> John S. Lowe, "Shut-In Royalty Payments," 5 *E. Min. L. Inst.* 18-1 (1984) [Hereafter cited as Lowe, *Shut-In Royalty Payments* at \_\_\_\_]. A more recent scholarly discussion of the issues arising from shut-in clauses can be found in Robert E. Beck, "Shutting-In: For What Reasons And For How Long?", 33 *Washburn L.J.* 749 (1994).

on the shut-in clause cases litigated since 1984 and suggest drafting solutions to avoid those problems. Because any contract drafter knows that litigants can crawl through the narrowest of cracks in any contract, this article will also discuss current or likely future issues involving the interpretation or operation of shut-in clauses.

**§ 15.02. Typical Shut-In Royalty Clauses.**

There is no uniform shut-in clause and slight differences in language have led to different results in the reported cases. Moreover, the shut-in clause cannot be read in isolation but rather must be read in the context of the entire lease. Those disclaimers aside, the following are examples of typical shut-in clauses:

A. Where gas from any well or wells capable of producing gas, . . . is not sold or used during or after the primary term and this lease is not otherwise maintained in effect, Lessee may pay or tender as shut-in royalty to the party or parties shown by Lessee's records to be entitled to receive royalties on actual production of gas . . . payable annually on or before the end of each twelve-month period during which said gas is not sold or used and this lease is not otherwise maintained in force, and if such shut-in royalty is so paid or tendered and while Lessee's right to pay or tender same is accruing, it shall be considered that gas is being produced in paying quantities, and this lease shall remain in force . . . . During any period while Lessee's right to pay or tender any shut-in royalty is accruing, Lessee may commence or resume operations or production and this lease shall remain in force as though shut-in royalty had been duly paid down to such commencement or resumption.<sup>2</sup>

B. If at any time after the expiration of the primary term of this lease, there is any gas well on land covered hereby, which is capable of producing in paying quantities, but is shut in for

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<sup>2</sup> Hydrocarbon Mgt., Inc. v. Tracker Exploration, Inc., 861 S.W.2d 427, 433 (Tex. Int. App. Ct. 1993).