



THE NATURE OF THE MINERAL ESTATE

Bruce M. Kramer
CAIL Institute of Energy Law
Texas Mineral Title Course

INTRODUCTORY PRINCIPLES

- Nature of the Mineral Estate

- Unified Estate

- Severance

- “Separation of a mineral or royalty interest from other interests in the land by grant or reservation. A mineral or royalty deed or a grant of the land reserving a mineral or royalty interest, by the landowner, before leasing, accomplishes a severance as does the execution of an oil and gas lease.”
- Martin & Kramer, 8 Williams & Meyers Oil and Gas Law 960-61 (2012) [hereinafter Manual of Terms]



INTRODUCTORY PRINCIPLES (Cont.)

- Endless possibilities (aka title headaches)
 - Phase severance
 - Oil owned by Able, natural gas owned by Baker
 - Panhandle Field
 - Amarillo Oil Co. v. Energy Agri-Products, 794 S.W.2d 20, 109 O.&G.R. 524 (Tex. 1990)
 - REO Industries, Inc. v. Natural Gas Pipeline Co., 932 F.2d 447, 115 O.&G.R. 322 (5th Cir. 1991)



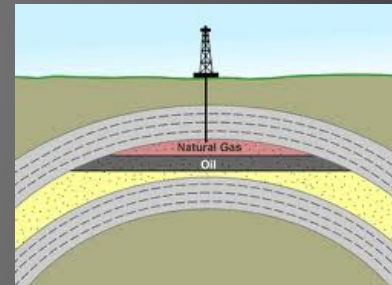
INTRODUCTORY PRINCIPLES (Cont.)

- Endless possibilities
 - Phase severance
 - Coal or other hard rock minerals separately owned
 - Appalachian Basin
 - Statutory solutions



INTRODUCTORY PRINCIPLES (Cont.)

- Endless possibilities
 - Horizontal severances
 - By formation (Marcellus, Ellenburger, Bakken)
 - Rife with problems
 - Conservation agency labels
 - 100 feet below deepest depth drilled
 - Producing formation or deepest point reached by drill stem
 - Sandefer Oil & Gas, Inc. v. Duhon, 961 F.2d 1207, 120 O.&G.R. 22 (5th Cir. 1992) (depth from which lessee is producing)



INTRODUCTORY PRINCIPLES (Cont.)

- BASIC DEFINITIONS

- Mineral Estate/Mineral Interest

- “the rights, privileges, powers and immunities with regard to the minerals held by the owner of minerals which by grant or reservation have been severed from the surface estate.” Manual of Terms, at 606
 - Bundle of sticks concept – same as surface ownership or unified estate ownership



INTRODUCTORY PRINCIPLES (Cont.)

- Mineral estate
 - Duration – Common law estates
 - Fee simple absolute – potentially infinite duration
 - longest estate possible
 - Fee simple determinable/possibility of reverter – O to A so long as price of oil is less than \$200.00/barrel
 - Fee simple determinable/right of entry (power of termination)



INTRODUCTORY PRINCIPLES (Cont.)

- Mineral estate (Duration)
 - Life estate/reversion/remainder – T dies and his will leaves Blackacre (mineral estate) to A for her life
 - Open Mine Doctrine -
 - Term for years/reversion/remainder – O to A for 15 years and then to B and her heirs



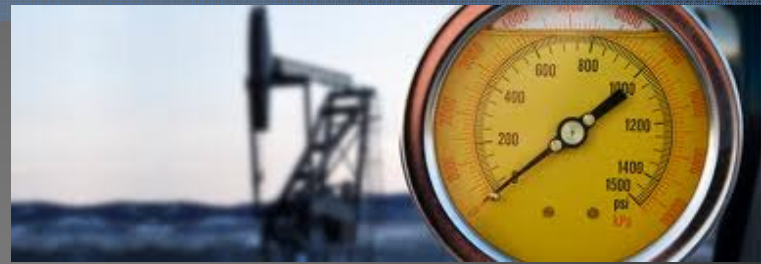
INTRODUCTORY PRINCIPLES (Cont.)

- Present/Future Interests – Successive Interests
 - Power to lease – Neither present interest owner nor future interest owner by themselves can lease
 - Common law doctrine of waste – Present interest
 - Lack of a present possessory interest – Future interest
 - Swayne v. Lone Acre Oil Co., 86 S.W. 740 (1905)
 - BUT instrument (will, deed) can give owner of life estate the power to execute leases or self-develop – Glass v. Skelly Oil Co., 469 S.W.2d 237, 39 O.&G.R. 307 (Tex.Civ.App.—El Paso 1971, error ref'd n.r.e.)



INTRODUCTORY PRINCIPLES (Cont.)

- Defeasible Term Interests
- Either Mineral or Royalty
- “A mineral, royalty or nonexecutive mineral interest for a fixed term of years and for an indefinite period of time thereafter, usually so long as oil or gas is produced.” Manual of Terms at 244.
- Language of deed important – Williamson v. Federal Land Bank, 326 S.W.2d 560 (Tex.Civ.App.—Texarkana 1959, writ ref/d n.r.e.)



INTRODUCTORY PRINCIPLES (Cont.)

- Non-durational divisions
- Oil and Gas Lease
 - Lessee owns fee simple determinable estate in the minerals
 - Lessor owns possibility of reverter
 - Working interest/leasehold interest – Preference is for working interest
 - Key attribute of working interest – Cost-bearing interest



INTRODUCTORY PRINCIPLES (Cont.)

- Oil and Gas Lease
- Working Interest Transfers
 - Assignment or Sublease – All or partial
 - Production Payment a/k/a Oil Payment
 - “an interest created out of the lessee’s estate which is a share of the minerals produced from described premises, free of the costs of production at the surface. . . . But a production payment terminates when the lease expires, or sooner if the owner of the interest has received an agreed quantum of production or dollar amount from the sale of production.” Manual of Terms, at 824.1



INTRODUCTORY PRINCIPLES

- Production/Oil Payment
- Can be created by lessor at time of lease or by lessee who conveys working interest
- Net Profits Interests
 - “A share of gross production from a property, measured by net profits from operations of the property.” Manual of Terms, at 646
 - Different than a royalty interest which is an interest in production, not profits



INTRODUCTORY PRINCIPLES (Cont.)

- Net Profits Interests

- Difficulty in characterization –
Property or contract



- PYR Energy Corp. v. Samson Resources Co., 456 F.Supp.2d 786, 164 O.&G.R. 19 (E.D.Tex. 2006);
Lyle v. Jane Guinn Revocable Trust, 365 S.W.3d 341 (Tex.App.—Houston [1st. Dist.] 2010, pet. denied)
- Language creating NPI critical to its characterization and how it is to be calculated

INTRODUCTORY PRINCIPLES (Cont.)

- “Carried interest”
- “A fractional interest in oil and gas property, usually a lease, the holder of which has no personal obligation for operating costs, which are to be paid by the owner or owners of the remaining fraction, who reimburse themselves therefore out of production, if any. The person advancing the costs is the carrying party and the other is a carried party.” Manual of Terms, at 126



INTRODUCTORY PRINCIPLES (Cont.)

- Carried Interest
 - Similar to, but clearly not the same as a NPI
 - NPI's typically last for life of lease but Carried interests typically last for a shorter period of time such as “carried to the tanks”
 - AAPL JOA Forms create carried interests where working interest owners go “non-consent” to a proposed drilling operation



INTRODUCTORY PRINCIPLES (Cont.)

- Royalty or Royalty Interest
- Three “labels” – Not consistently used by courts or industry
- Landowner or Lessor Royalty
 - Created in an oil and gas lease
 - Reserved by lessor
 - Language critical to payment obligation in Texas



INTRODUCTORY PRINCIPLES (Cont.)

- Royalty or Royalty Interest
- Overriding Royalty Interest (ORRI)
 - Created by owner or working/leasehold estate who transfers all or a portion of said estate
 - Original use of ORRI was any royalty in excess of $1/8^{\text{th}}$ – In addition to Landowner royalty
 - As with all interests carved out of working interest, when working interest terminates so does ORRI



INTRODUCTORY PRINCIPLES (Cont.)

- Royalty or Royalty Interest
- Freestanding Royalty a/k/a/ Non-participating Royalty Interest (NPRI)
- Dislike NPRI label since both Landowner Royalty and ORRI are non-participating
- Created by deed
- Language critical as to whether interest is mineral or royalty and if royalty what fraction



INTRODUCTORY PRINCIPLES (Cont.)

- Royalty or Royalty Interest
 - Not all royalty is a share of production, free of the costs of production
 - Shut-in gas royalty – Contractual (lease) based payment triggered by any of a number of conditions precedent which has the effect of maintaining the lease in the secondary term without actual production



INTRODUCTORY PRINCIPLES (Cont.)

- Production payments and ORRI's – Similar but not identical – Non-possessory property interests – Subject to ad valorem tax – Covered by Statute of Frauds
- Non-executive Interest – Any interest that does not have the power to execute leases – All royalties are non-executive interests but you can have a non-executive mineral interest



FIVE-FOOTED MINERAL INTEREST

- Altman v. Blake, 712 S.W.2d 117, 91 O.&G.R. 346 (Tex. 1986)
- Five “essential attributes” of severed mineral estate
 - 1. Right to develop (right of ingress and egress)
 - 2. Right to lease (the executive right)
 - 3. Right to receive bonus payments
 - 4. Right to receive delay rental payments
 - 5. Right to receive royalty payments



FIVE-FOOTED MINERAL INTEREST (Cont.)

- Not really “essential attributes” but sticks in the bundle of sticks



- Right to develop
 - Gives owner possessory or corporeal estate in Texas
 - Subject to ad valorem tax on real property
 - Estate to which implied easement of surface use attaches

FIVE-FOOTED MINERAL INTEREST (Cont.)

- Right to Executive Leases
 - Executive Power not a Right
 - Interest in Real Property – Day & Co. v. Texland Petroleum, Inc., 786 S.W.2d 667, 105 O.&G.R. 590 (Tex. 1990)
 - Right to develop is correlative to executive power
 - Day & Co.
 - Conveyancing document silent on who owns right to develop, it is owned by owner of executive power



FIVE-FOOTED MINERAL INTEREST (Cont.)

- Right to Receive Bonus (Last Three Sticks relate to traditional economic benefits that flow from a lease)
 - Bonus – “. . . the cash consideration paid by the lessee for the execution of an oil and gas lease by a landowner . . . Bonus is usually figured on a per acre basis.” Manual of Terms at 96
 - No requirement that there be a bonus



FIVE-FOOTED MINERAL INTEREST (Cont.)

- Right to Receive Delay Rentals
 - Delay rental – “A sum of money payable to the lessor by the lessee for the privilege of deferring the commencement of drilling operations or the commencement of production during the primary term of the lease.”
 - Movement to paid-up leases
 - What does the upfront payment constitute – Bonus or delay rental or both?
 - Separate ownership of bonus and delay rentals



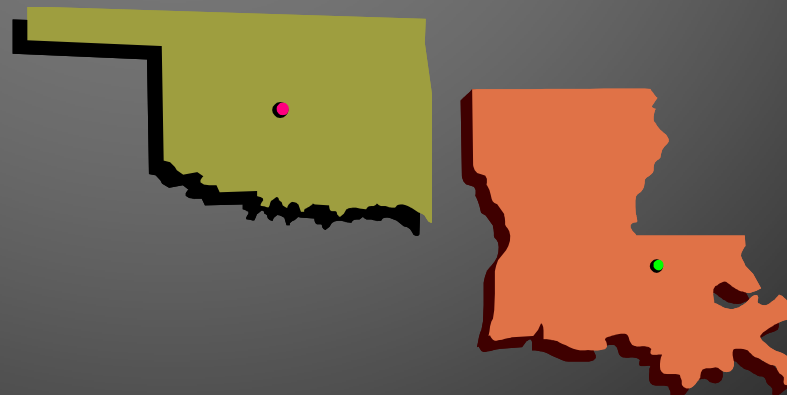
FIVE-FOOTED MINERAL INTERESTS (Cont.)

- Right to receive royalty payments (interests)
 - Lessors/lessees free to agree on any type of economic benefit payable to the lessor
 - Calculation methodology set forth in the express terms of lease – Texas
 - Different language may mean different results – net proceeds/
amount realized, market value,
at the well, in the field, at the pipeline



FEE SIMPLE DETERMINABLE/ AUTOMATIC TERMINATION RULE

- Texas – Absolute Ownership or Ownership in Place Jurisdiction
 - Possessory/corporeal interest in real property
 - Stephens County v. Mid-Kansas Oil & Gas Co., 113 Tex. 160, 254 S.W. 290 (1923)
 - Majority rule but OK and LA are non-ownership jurisdictions



FEE SIMPLE DETERMINABLE/ AUTOMATIC TERMINATION RULE (Cont.)

- Oil and Gas Lease
 - Treated as conveyance of a fee simple determinable estate with lessor retaining possibility of reverter – Stephens County
 - FSD rule applies to secondary term and “unless” drilling and delay rental clause
 - Automatic termination upon occurrence or non-occurrence of the limitation, e.g. production




FSD/AUTOMATIC TERMINATION RULE (Cont.)

- Ramifications of Absolute Ownership Doctrine
 - Mineral or leasehold estates may not be abandoned
 - BUT, devotional limitation doctrine appears to be exception to general rule – Texas Co. v. Davis, 254 S.W.304 (1923)
 - Equitable defenses “normally” not available –
Action by lessor is not a forfeiture action
 - “Day late dollar short” delay rental cases



FSD/AUTOMATIC TERMINATION RULE (Cont.)

- 
- Exceptions to rule that equitable considerations not relevant
 - Bank as agent of lessor/receipt by bank equals receipt by lessor
 - Mailbox rule/receipt by USPS deemed receipt by lessor
 - Revivor doctrine – Acceptance of late payments
 - Estoppel doctrine – Lessor creates uncertainty as to payment obligation

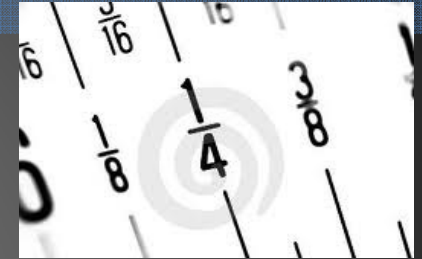
FSD/AUTOMATIC TERMINATION RULE (Cont.)

- Temporary Cessation of Production Doctrine (TCOP)
 - Prevents termination of lease in secondary term upon cessation of production
 - Two elements – 1. Condition precedent, 2. Steps taken to overcome cessation of production
 - Originally limited to cessations caused by “sudden stoppage or mechanical breakdown” but *Ridge Oil Co. v. Guinn Investments*, 148 S.AW.3d 143, 161 O.&G.R. 1135 (Tex. 2004) broadened scope



SOME PROBLEM AREAS

- Fraction of versus Fractional Royalty
 - $1/8^{\text{th}}$ of royalty or a $1/8^{\text{th}}$ royalty
 - Occurs with freestanding royalty and unclear language in the conveyancing document
 - Texas courts look to the written document first and foremost but also may apply “canons of construction”
 - Debate among the Courts of Appeals as to whether canons may be relied on if document is unambiguous.



SOME PROBLEM AREAS (Cont.)

- Fraction of versus fractional royalty (Cont.)
 - Brown v. Havard, 593 S.W.2d 939, 65 O.&G.R. 249 (Tex. 1980)



- “an undivided one-half nonparticipating royalty (Being equal to, not less than $1/16^{\text{th}}$) of all the oil, gas and other minerals, in, to and under or that may be produced from said land.”
- Issue is whether deed reserved $\frac{1}{2}$ of the lease royalty or a fixed $1/16^{\text{th}}$ royalty since subsequent lease had royalty in excess of $1/8^{\text{th}}$

SOME PROBLEM AREAS (Cont.)

- Fraction of versus fractional royalty (Cont.)
 - Texas Supreme Court found language was ambiguous
 - Concluded that intent of parties was to reserve a 1/16th fractional royalty
 - Most Texas courts do not find deed language ambiguous



SOME PROBLEM AREAS (Cont.)

- Fraction of versus fractional royalty
 - Luckel v. White, 819 S.W.2d 459, 116 O.&G.R. 121 (Tex. 1991)
 - Pre-Luckel cases relied on canon that language of granting clause prevails when inconsistent with subject to and/or the future lease clause
 - Issue was whether grantee received a fix $1/32^{\text{nd}}$ royalty of $1/4$ of the lessor's royalty
 - Relies on harmonizing canon of construction
 - Finds that reference in future lease clause to $1/4$ of royalty reflects intent of parties



SOME PROBLEM AREAS (Cont.)

- Fraction of versus fractional royalty (Cont.)
 - Post-Luckel cases rely on harmonizing and four corners canons – May lead to inconsistent results
 - Multiple fraction deeds
 - Granting clause and future lease clause basically describe the same interest
 - Two-grant approach inconsistent with intent of parties – Law of common sense



SOME PROBLEM AREAS (Cont.)

- Fraction of versus fractional royalty (Cont.)
- Hausser v. Cuellar, 345 S.W.3d 462 (Tex.App.—San Antonio 2011)
 - Granting clause – $\frac{1}{2}$ in and to the royalty
 - Subject-to clause - $\frac{1}{2}$ of the royalty
 - Future lease clause – $\frac{1}{16^{\text{th}}}$ part of oil, gas and other minerals taken
 - Applying harmonizing and four corners canons court finds that $\frac{1}{2}$ of royalty granted – Almost no analysis



SOME PROBLEM AREAS (Cont.)

- Fraction of versus fractional royalty (Cont.)
 - Hausser overrules Neel v. Killam Oil Co., 88 S.W.3d 334, 156 O.&G.R. 85 (Tex.App.—San Antonio 2002, pet. denied) which held that with a similar type of conflict between the various clauses that a fractional royalty (1/16th) was conveyed



SOME PROBLEM AREAS (Cont.)

- Mineral/Royalty Dichotomy
 - Did the parties intend to grant or reserve a mineral interest or a royalty interest
 - Altman v. Blake was a mineral/royalty case
 - Basis for dispute – Fractional mineral owner gets fraction of royalty while fractional royalty owner gets that fraction
 - Because owner of mineral estate may grant or reserve any or all of the 5 sticks problems arise as to whether party owns mineral or royalty interest



SOME PROBLEM AREAS (Cont.)

- Mineral/Royalty Dichotomy
- Watkins v. Slaughter, 144 Tex. 179, 189 S.W.2d 699 (1945)
 - “grantor retains title to a 1/16 interest in and too all of the oil, gas and other minerals in and under and that may be produced from said land; . . . the grantor . . . shall not receive any part of the money rental paid on any future lease; and the grantee . . . shall have authority to lease said land and receive the cash bonus and rental; and the grantor . . . Shall receive the royalty retained herein only from actual production. . . .”



SOME PROBLEM AREAS (Cont.)

- Mineral/Royalty Dichotomy

- Watkins

- Applies four corners/harmonizing canons
 - Grantor conveyed executive power, right to receive delay rentals and right to receive bonus
 - Therefore royalty interest was reserved
 - Court does not emphasize the language “only from actual production” although later decisions treat that s decisive



SOME PROBLEM AREAS (Cont.)



- Mineral/Royalty Dichotomy
 - Altman approach – Five sticks approach
 - Even though owner was stripped of four of the five sticks, leaving only the royalty stick, owner had a non-executive mineral interest
 - Key element – Description of interest granted or reserved uses terms of art to describe mineral interest – Fact that 4 of the 5 sticks are not granted or reserved not determinative

SOME PROBLEM AREAS (Cont.)

- Mineral/Royalty Dichotomy
 - French v. Chevron USA, Inc., 896 S.W.2d 796, 134 O.&G.R. 111 (Tex. 1995)
 - Similar language to Altman deed but added the phrase “this conveyance is a royalty interest only”
 - Notwithstanding that seemingly clear construction, French court finds interest is a non-executive mineral interest



Contact Information



Bruce M. Kramer

McGinnis Lochridge & Kilgore, LLP

1111 Louisiana, Ste 4500

Houston, Texas 77002-5250

(713) 615-8500

bkramer@mcginnislaw.com

Website: www.mcginnislaw.com