BASIC CONVEYANCING RULES FOR MINERAL DEEDS AND ASSIGNMENTS OF OIL AND GAS LEASES

Part 1:
Conveyances and Reservations of Mineral and Royalty Interests
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Part 2:
Understanding Assignments of Oil and Gas Leases
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PART 1

CONVEYANCES AND RESERVATIONS OF MINERAL AND ROYALTY INTERESTS

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CONVEYANCES AND RESERVATIONS OF MINERAL AND ROYALTY INTERESTS

I. INTRODUCTION

A major purpose of this presentation is to identify potential pitfalls to title examiners and others engaged in the interpretation and drafting of mineral conveyances. Mineral and royalty deeds, of course, are subject to the innumerable and sometimes contradictory rules of deed and contract construction that fill multi-volume treatises. We cannot hope to address every problem area or each applicable rule of construction even if we concentrate on those particularly applicable to mineral conveyances and recommend, for example, Professor Kramer's comprehensive analysis. Bruce M. Kramer, *The Sisyphean Task of Interpreting Mineral Deeds and Leases: An Encyclopedia of Canons of Construction*, 24 Tex. Tech L. Rev. 1 (1993). Discussion of some of the more frequent sources of difficulty, though, should help to guide those who deal with conveyancing issues only occasionally and to remind the experienced.

II. LAND DESCRIPTIONS

A. Necessity of Adequate Description

Perhaps the most fundamental rule in the construction of all deeds, including mineral and royalty deeds, is that the deed must identify the land being conveyed with reasonable certainty. If a description is insufficient to identify the land, it is unenforceable as a violation of the Statute of Frauds, now embodied in Tex. Prop. Code Ann. § 5.021 (West 2004). Conveyances that depend on inadequate land descriptions are void. *Republic Nat'l Bank v. Stetson*, 390 S.W.2d 257, 261 (Tex. 1965); *Greer v. Greer*, 144 Tex. 528, 530, 191 S.W.2d 848, 849 (1946). Although land descriptions are not always given the attention they deserve, a defective description of the land intended to be conveyed is one of the most frequent instances of title failure in Texas. Fred A. Lange and Aloysius A. Leopold, *Land Titles and Examination* § 811 (2d ed., Texas Practice Series 1992).

1. Specific

It is not essential for a deed to contain a metes and bounds description or such a full description as will enable the land to be ascertained without extrinsic evidence. *Williams v. Ellison*, 493 S.W.2d 734 (Tex. 1973). However, the instrument must furnish, within itself or by reference to some other existing writing, the means or data by which the land can be identified. *Morrow v. Shotwell*, 477 S.W.2d 538 (Tex. 1972). This is true even if it is clear the parties knew and understood what property was intended to be conveyed. *Id.*

A description is satisfactory, for example, if it refers to an earlier instrument in which the land was particularly described. A description of all the land owned by a grantor in a particular locale is valid. This reference gives the means by which the land can be identified: extrinsic evidence can be admitted to show what land the grantor owned. *Texas Consolidated Oils v. Bartels*, 270 S.W.2d 708 (Tex. Civ. App.—Eastland 1954, writ ref'd). But the essential elements may never be supplied by parol. The framework or skeleton must be contained in the writing. Extrinsic evidence is not for the purpose of supplying the location or description of the land, but only for identifying it with reasonable certainty *from the data in the memorandum. Wilson v. Fisher*, 144 Tex. 53, 188 S.W.2d 150 (1945). Descriptions are given liberal construction so that conveyances may be upheld if capable of explanation, though there must be a "nucleus" of a description affording the necessary clue or key. *Gates v. Asher*, 154 Tex. 538, 280 S.W.2d 247, 248 (1955); *Siegert v. Seneca Resources Corp.*, 28 S.W.3d 680, 682-83 (Tex. App.—Corpus Christi 2000, no pet.).

Texas courts adhere to a number of rules that aid in interpreting land descriptions that might otherwise be too imprecise. Land titles and title examination benefit immensely from the rule that if there is an evident mistake in the description, the courts should attempt to correct errors so as to give effect to the deed. For example, where a call was made for the southeast corner of a survey but the northeast corner was obviously intended, the description is to be given effect according to the parties' intention notwithstanding the literal call. *Turner v. Sawyer*, 271 S.W.2d 119 (Tex. Civ. App.—Eastland 1954, writ ref'd n.r.e.). Likewise, when a deed's reference to another instrument for descriptive purposes gives an incorrect volume or page reference, the conveyance will be upheld if it is clear what instrument the parties intended to refer to. *Overand v. Menczer*, 82 Tex. 122, 18 S.W. 301 (1892). Even if one of the calls in a metes and bounds description is missing, the deed is not void if the missing call can be supplied by reference to the other calls and other instruments in the chain of title. *Montgomery v. Carlton*, 56 Tex. 431 (1882).

A reference to a map or plat may form the basis of a valid land description. *See*, *e.g.*, *Lewis v. E. Tex. Fin. Co.*, 136 Tex. 149, 146 S.W.2d 977 (1941). Indeed, descriptions of land within platted subdivisions almost always depend upon reference to the recorded plat. For a description that relies on a map or plat to be

a valid one, nevertheless, the drawing must contain enough information that the land intended can be located. *River Road Neighborhood Ass'n v. S. Tex. Sports*, 720 S.W.2d 551, 558 (Tex. App.—San Antonio 1986, writ dism'd w.o.j.). Title examiners and drafters should exercise caution in relying on a description that refers to an outline on a map, for example, unless the location of the depicted boundary is very clear and there is no question of the area the map shows, although the courts have exhibited surprising liberality in upholding such descriptions. *See*, *e.g.*, *Coe v. Chesapeake Expl., L.L.C.*, 695 F.3d 311 (5th Cir. 2012); *Dixon v. Amoco Prod. Co.*, 150 S.W.3d 191 (Tex. App.—Tyler 2004, pet. denied).

2. General/Global

Often a conveyance will describe specific property the grantor intends to convey, followed by a clause expressing the intent to convey all the grantor owns in a specified city, county, etc. *See*, *e.g.*, *Holloway's Unknown Heirs v. Whatley*, 133 Tex. 608, 131 S.W.2d 89 (1939); *Cook v. Smith*, 107 Tex. 119, 174 S.W.1094 (1915). However, if the specific description is subsequently found to be incorrect, a subsequent general/global clause will not cure the mistake and the conveyance will not be sustained. *J. Hiram Moore, Ltd. v. Greer*, 172 S.W.3d 609 (Tex. 2005).

3. Irregular

A grantor sometimes utilizes a description obtained from his lessee, tax assessor, or even the Railroad Commission, rather than a legal description derived from a survey. These irregular descriptions may not meet the standard of the Statute of Frauds, rendering the conveyance void. A classic example appears in *Hanzel v. Herring*, 80 S.W.3d 167 (Tex. App.—Ft. Worth 2003, no pet.), where a sheriff's deed included descriptions like the following:

> Tract 1 - .025000 overriding royalty interest, Crumption - Williams wells, Lease 1404, Texas Railroad Commission No. 19281, T. H. Wooley Survey, Abstract 1634 and James Carcher Survey, Abstract 276, Palo Pinto County, Texas (Tax accounts nos. 140420007515, 140420007151.)

A Railroad Commission witness identified the file documents connecting the Railroad Commission numbers and the property descriptions. However, the lease that the Railroad Commission number represented was not a part of the trial record. On that basis the court of appeals affirmed the trial court's decision that the property descriptions in the sheriff's deed were inadequate, so that the instruments were void under the Statute of Frauds. *See also Long Trusts v. Griffin*, 222 S.W.3d 412 (Tex. 2006) (per curiam).

B. Unspecified Acreage "Out Of" a Tract

One of the most frequently encountered instances of fatally defective land descriptions is the reference to a certain number of acres or a tract of a certain size "out of" or "being a part of" some larger described tract, without any reference to a more particular description or other guide to the location of the tract. A conveyance with such a description is void. *See Republic Nat'l Bank v. Stetson*, 390 S.W.2d (Tex. 1965); *Granato v. Bravo*, 498 S.W.2d 499 (Tex. Civ. App.—San Antonio 1973, no writ). (Descriptions giving no guidance as to the location should be contrasted with those defining the land being conveyed as a specified number of acres out of a side or corner of a tract, which the courts have upheld by using a presumption that the parties intended boundaries parallel to the sides of the larger tract. *See Woods v. Selby Oil & Gas Co.*, 2 S.W.2d 895 (Tex. Civ. App.—Austin 1927), *aff'd*, 12 S.W.2d 994 (Tex. Comm'n App. 1929, judgm't adopted); *Scott v. Washburn*, 324 S.W.2d 957 (Tex. Civ. App.—Waco 1959, writ ref'd n.r.e.).) Title examiners must be cautious before passing descriptions such as "40 acres in the form of a square around the Smith No. 1 Well," especially if the precise well location is not given.

It may be tempting to think that a description of a certain number of acres out of a larger tract is sufficient where earlier deeds in the chain of title describe a tract of just such size. Bear in mind, again, that the deed must furnish *within itself* the means or data by which the land can be identified. Thus, in *Pickett v. Bishop*, 148 Tex. 207, 223 S.W.2d 222 (1949), a deed was given effect that described "my property of 20.709 acres out of the John Stephen 640 acre Survey in Tarrant County, Texas." Without the words "my property" the deed would have provided no means to identify what 20.709 acres it referred to and would have been void.

Care must be taken with descriptions of tracts of specified acreage even if the intention is clear that the acreage is to be taken off one side or out of a corner of a survey. Note that the "East 320 acres" of a section of land is not the same as the East half unless the section contains precisely 640 acres. If parties in the chain of title have used the two different descriptions interchangeably and it develops that the actual acreage is not as had been assumed, serious confusion over the correct boundary may result.

C. "More or Less" as Part of Description

Use of the words "more or less" in relation to a tract's acreage is common and ordinarily good practice, but it can lead to a void deed where acreage is part of

the description itself. In a well-known but often overlooked case, *Wooten v. State*, 142 Tex. 238, 177 S.W.2d 56 (1944), the supreme court held, in effect, that a description of "North 60 acres, more or less," of a tract was rendered indefinite and thus void by inclusion of the words "more or less." Because the words were not merely inserted after the land description as part of a recital of the estimated quantity conveyed but instead formed part of the description itself, it became impossible to identify the boundaries of the tract.

Finally with respect to land descriptions, a defect or uncertainty in the description of a tract excepted or excluded from a larger tract being conveyed affects only the excluded tract. *Hornsby v. Bartz*, 230 S.W.2d 360 (Tex. Civ. App.—El Paso 1950, no writ); *Connor v. Brown*, 226 S.W.2d 229 (Tex. Civ. App.—Texarkana 1950, writ ref'd n.r.e.). If the description of the tract intended to be excepted is void for uncertainty, title to the entire larger tract passes to the grantee.

D. Land Bounded by Narrow Strip

Ownership of even a very small tract can become very important if it is found, or believed, to contain a large volume of oil or gas. Practitioners should be aware of some conveyancing rules that may affect ownership of narrow but potentially valuable strips.

The general rule can be stated that if a deed conveys an interest in land bounded by a stream or by the right-of-way of a street, alley, highway or railroad in which the grantor owns the fee, the grantee will take title to the center line of the stream or right-of-way strip, unless the deed expressly provides otherwise. *Muller v. Landa*, 31 Tex. 265 (1868); see *Welder v. State*, 196 S.W. 868 (Tex. Civ. App.—Austin 1917, writ ref'd) (streams); *Texas Bitulithic Co. v. Warwick*, 293 S.W. 160 (Tex. Comm'n App. 1927, judgm't adopted) (city streets); *Weiss v. Goodhue*, 102 S.W. 793, 796-97 (Tex. Civ. App. 1907, writ ref'd) (alleys); *Mitchell v. Bass*, 26 Tex. 372, 379-80 (1862) (highways); *Rio Bravo Oil Co. v. Weed*, 121 Tex. 427, 50 S.W.2d 1080 (1932) (railroads). (Note, however, that the rule cannot apply to navigable streams, statutorily defined as those averaging thirty feet in width from the mouth up under Tex. Nat. Res. Code Ann. § 21.001(3) (West 2011), the ownership of whose beds is retained by the state.) The rule holds true even if the metes and bounds description stops at the side line of the right-of-way, *Cox v. Campbell*, 135 Tex. 428, 143 S.W.2d 361 (1940), or if the calls for the meander lines of a boundary stream follow its bank or cross the stream. *Stover v. Gilbert*, 112 Tex. 429, 247 S.W. 841 (1923).

There are some significant exceptions to the rule that a conveyance of land bounded by the line of a right-of-way extends to the center line. If the grantor owns the fee title to the entire width of a right-of-way strip lying on the margin of the conveyed tract, but not the land on the other side, a deed bounded by the right-of-way will convey the entire strip. *Cantley v. Gulf Production Co.*, 135 Tex. 339, 143 S.W.2d 912, 915-16 (1940). And if the land within an adjacent right-of-way strip is "larger and perhaps more valuable" than the tract described in the deed, the grantor will not be presumed to have intended to convey the adjoining right-of-way tract. *Angelo v. Biscamp*, 441 S.W.2d 524, 527 (Tex. 1969).

There seems to be some question how far Texas courts will go in applying the so-called "strip and gore" doctrine, that a grantor will be presumed to have intended to convey a narrow adjoining strip. In *Goldsmith v. Humble Oil & Ref'g Co.*, 145 Tex. 549, 199 S.W.2d 773 (1947), the court held that a deed did not include any part of an adjoining strip only 7-1/2 varas (about 21 feet) wide, because it made no reference to an adjoining highway, street or passageway and, in fact, there was no existing easement in the strip. A showing of an existing easement was required, the court held, even though it acknowledged that the general rule does not require that the deed expressly mention the easement. The court in *Strayhorn v. Jones*, 157 Tex. 136, 300 S.W.2d 623 (1957), a case involving a stream boundary, nevertheless declared it to be "against public policy to leave title of a long narrow strip of land in a grantor conveying a larger tract adjoining or surrounding this strip," citing *Haines v. McLean*, 154 Tex. 272, 276 S.W.2d 777, 782 (1955), a right-of-way case that illustrates well the potential complexity of the issues considered here. The rule will apparently be applied to "relatively narrow strips of land, small in size and value in comparison to the adjoining tract conveyed by the grantor . . . when it is apparent that the narrow strip has ceased to be of benefit or importance to the grantor of the larger tract," but not, again, when the right-of-way tract is larger and possibly more valuable than the tract actually described. *Angelo v. Biscamp*, 441 S.W.2d 524, 526-27 (Tex. 1969). Whether an adjoining strip is relatively small enough or of low enough value to fall within the strip-and-gore doctrine may be a question of fact for jury determination. *See Haby v. Howard*, 757 S.W.2d 34 (Tex. Civ. App.—San Antonio 1988, writ denied).

Application of the strip-and-gore doctrine to a small strip or tract adjoining a larger tract specifically conveyed may or may not depend on whether the small tract contains a road or easement. At least one court applied it to a small non-road tract, stating the rule to be that the tract must be small in comparison to the land specifically conveyed, must be adjacent to or surrounded by the land conveyed, and must be, by itself, of no apparent benefit or importance to the grantor at the time of the conveyance. *Alkas v. United Sav. Ass'n*,

672 S.W.2d 852, 857 (Tex. App.—Corpus Christi 1984, writ ref'd n.r.e.).

Before any of the foregoing is addressed, it is of course often necessary to determine whether a conveyance relative to a narrow strip of land has conveyed the fee title to the land or merely a right-of-way. If the deed, according to its terms, purports to grant a right-of-way over the land, rather than the land itself, it conveys only an easement and not the fee title. *Right of Way Oil Co. v. Gladys City Oil, Gas & Mfg. Co.*, 106 Tex. 94, 157 S.W. 737 (1913). Conversely, if a deed's granting clause conveys the land itself, it carries the fee even if subsequent clauses define its purpose as being right-of-way or purport to limit its use. *Texas Electric Ry. Co. v. Neale*, 151 Tex. 526, 252 S.W.2d 451 (1952).

III. CONVEYANCES OF FRACTIONAL MINERAL INTERESTS

A. Describing the Interest Being Conveyed

If anything less than the entire fee simple interest in the land is being conveyed, a deed's proper and adequate identification of that interest is just as important as the description of the land itself. This paper focuses on the effect of some of the innumerable different ways that conveyances may describe and define interests in the oil, gas and other minerals within a tract. It is beyond our scope to discuss how the courts have defined minerals, as distinguished from the surface estate, and how drafters might go about expressing their clients' intentions regarding the respective rights of surface and mineral ownership upon severance. We will, later in the paper, touch on such topics as the ways in which conveyances of mineral interests may be distinguished from those conveying only royalty. We will first examine some of the ways fractional mineral interests may be described and misdescribed and some of the pitfalls awaiting the unwary examiner or drafter.

1. Conveyances of Mineral Acres

Problems can arise from even the most straightforward kinds of mineral conveyances, those intended to convey a simple fractional interest in the oil, gas and other minerals. Frequently the price of a mineral interest is based on the number of mineral acres being sold. In order to make certain that the buyer is conveyed no more and no less than he has paid for, mineral deeds are sometimes drafted to describe an undivided specified number of acres out of a particular tract. Special problems can arise from this form of deed. Very commonly the parties do not know the exact acreage of the tract out of which the undivided acreage interest is conveyed (which may be why the device of describing an undivided acreage interest was used to begin with). Until the tract has been surveyed and its acreage precisely determined, the relative allocation of royalty and other lease benefits between the grantor and grantee remains subject to some conjecture. *See* 1 Patrick H. Martin and Bruce M. Kramer, *Williams & Meyers Oil and Gas Law*, § 320.2 (2012); *see also Daniel v. Allen*, 129 S.W.2d 392 (Tex. Civ. App.—Texarkana 1939, no writ). Moreover, if it develops that the grantors have previously conveyed their interests in part of the land and so are left with a smaller tract than the one described, the grantee of an undivided acreage interest will be entitled to the full complement of acreage spread over the smaller tract (i.e., a fractional interest whose numerator is the specified number of mineral acres and whose denominator is the size of the grantor's remaining land). *Crayton v. Phillips*, 297 S.W. 888 (Tex. Civ. App.—Austin 1927), *aff'd*, 4 S.W.2d 961 (Tex. Comm'n App. 1928, judgm't adopted). Unless it is particularly important to the parties that the grantee receive no more or less acreage than paid for, the interest of certainty will be served by a conveyance expressed as a numerical fraction or percentage rather than acreage.

The problem is exacerbated where, as occurs not infrequently, a deed conveys, in its granting clause, a specified fraction of the minerals but thereafter expresses the intention to convey a specified number of mineral acres that turns out to be inconsistent with the fractional interest. Which interest should be given precedence? The question seems not to have been definitely answered in Texas. Williams and Meyers prefer a construction in favor of the number of acres as reflecting the probability that the purchase price was paid on that basis but cite authority from other states not only supporting that construction but also favoring the stated fractional mineral interest or finding the conflict to create an ambiguity, requiring resolution by parol evidence. 1 Patrick H. Martin and Bruce M. Kramer, *Williams & Meyers Oil and Gas Law* § 320.2, at 670-74 (2012).

2. Unspecified Undivided Interest

Another frequent source of difficulty is the careless conveyance of "an undivided interest" in a tract of land, without any indication of the interest intended to be conveyed. Undoubtedly most cases of this nature stem from the use of forms with a blank between "an undivided" and "interest," where the parties have, inadvertently or failing to realize its importance, failed to complete the blank. Texas courts unequivocally hold that such a conveyance of an undivided but unspecified mineral interest is void. *Dahlberg v. Holden*, 150 Tex. 179, 238 S.W.2d 699 (1951); *W. T. Carter & Bro. v. Ewers*, 133 Tex. 616, 131 S.W.2d 86 (1939). In both of those cases the courts rejected arguments that the deeds should be construed to convey "our" or "my" undivided interest, which would have validated them. Where a

deed includes an initial description in a similar form, it may be made effective by a subsequent specific description if the parties' intention to have conveyed the specified interest is manifest from the four corners of the deed. *Pan American Petroleum Corp. v. Texas Pacific Coal & Oil Co.,* 340 S.W.2d 548 (Tex. Civ. App.—El Paso 1960, writ ref'd n.r.e.). (In *Templeton v. Dreiss*, 961 S.W.2d 645 (Tex. App.—San Antonio 1998, pet. denied), which probably must be considered confined to its facts but which the interested practitioner may nevertheless desire to review, the court rather unpersuasively purported to distinguish the doctrine of *Carter v. Ewers* in holding a conveyance of "an undivided interest" in a strip of land used for an access road to have conveyed the entire fee simple.)

3. Term Interests

Occasionally mineral or royalty deeds are made for a limited term, typically, like the usual form of oil and gas lease, for a stated term and so long thereafter as oil or gas is produced from the land included in the deed. Often the grantee under such a deed fails, however, to negotiate provisions for extension of the term, like those found in typical oil and gas leases, by means other than oil and gas production. Extension of the term may be accomplished only by actual production under such circumstances, and this is not modified by the subsequent execution of an oil and gas lease whose term may be extended, for example, by the completion of a shut-in gas well and payment of shut-in royalty. *Archer County v. Webb*, 161 Tex. 210, 338 S.W.2d 435 (1960). A term mineral or royalty interest might be saved in the absence of a saving clause by application of the temporary cessation of production doctrine, in the same manner as an oil and gas lease might under similar circumstances, *DeBenavides v. Warren*, 674 S.W.2d 353 (Tex. App.—San Antonio 1984, writ ref'd n.r.e.), but it will expire on permanent cessation unless some provision of the deed itself applies to save it. Further, merely making the deed subject to existing oil and gas leases, without clearly expressing the intent to incorporate the leases' saving clauses, will not permit the extension of the term interest by virtue of operations or some other substitute for production that extends the term of the lease. *Riley v. Meriwether*, 780 S.W.2d 919 (Tex. App.—El Paso 1989, writ denied). A drafter on behalf of a grantee of a term mineral or royalty interest or on behalf of a grantor reserving such an interest must therefore bear in mind the same considerations that are important to oil and gas lessees with respect to extension of the term.

B. Problems with Outstanding Interests and Burdens

The most difficult problems of mineral deed construction generally revolve around the allocation of interests between grantor and grantee when mineral, royalty or leasehold interests already outstanding in others must be taken into consideration. These may result from imprecision in describing the interest intended to be conveyed, similarly to the issues already addressed, a misunderstanding of the quantity or nature of outstanding interests, lack of knowledge of the legal effect of words appearing in deeds or simple carelessness regarding their use, or some combination of these.

1. Double Fractions and Similar Sources of Confusion

Imprecise descriptive language may lead to uncertainty about the interest being conveyed when a grantor, owning less than the entire mineral interest in a tract, conveys or reserves a fractional part of his interest but leaves some doubt whether the portion is a fraction of the whole or a fraction of the interest otherwise being conveyed. Two classic examples of the difficulty, resolved in opposite directions, are represented by *King v. First National Bank*, 144 Tex. 583, 192 S.W.2d 260 (1946), and *Hooks v. Neill*, 21 S.W.2d 532 (Tex. Civ. App.—Galveston 1929, writ ref'd).

In *Hooks* the court construed a deed conveying an undivided 1/2 mineral interest, with reservation to the grantor of "one thirty-second part of all oil on and under the land and premises herein described and conveyed." The court, emphasizing that the grantors reserved only the stated 1/32 of the oil on and under the land and premises that the deed "conveyed," held that the grantor reserved only 1/2 of 1/32, or 1/64, of the oil. 21 S.W.2d at 538. Following *Hooks*, the court in *Dowda v. Hayman*, 221 S.W.2d 1016 (Tex. Civ. App.—Fort Worth 1949, writ ref'd), construing a reservation from a deed conveying a 7/8 mineral interest, held that the grantor's "one half of the oil, gas and minerals of whatever kind on and under the premises herein conveyed" was only 1/2 of 7/8, not 1/2, of the mineral estate.

The court in *King* concluded otherwise in construing a deed conveying the grantor's ½ mineral interest with reservation of "an undivided one-eighth (1/8) of the usual and customary one-eighth royalty interest reserved by the land-owner in oil and gas and other minerals that may be produced from the hereinabove described land." The court held that the grantor's reserved royalty was to be calculated on the entire interest in the tract, there being no language limiting the reservation to a royalty on the land described "and conveyed." 192 S.W.2d at 262. Similarly, the court in *Averyt v. Grande, Inc.*, 717 S.W.2d 891 (Tex. 1986), considered a reservation of 1/4 of the royalty on oil, gas and other minerals "in, to and under or that may be produced from the lands above described . . . . " The land description in the deed was

followed by an exception: "LESS, HOWEVER, AND SUBJECT TO an undivided 1/2 interest in the oil, gas and all other minerals" described in a certain prior deed. Pointing out that the "subject to" clause was a limitation of the estate granted and not part of the land description, the court followed *King* and held that the grantors reserved a full 1/4 of the royalty. 717 S.W.2d at 895.

Middleton v. Broussard, 504 S.W.2d 839 (Tex. 1974), construed a deed conveying a 1/64 royalty interest in certain "tracts of land . . . being particularly described as follows," which language was followed by a description of various undivided interests in nine different tracts. The deed did not limit the royalty to the land "conveyed," the court pointed out; instead, the granting clause and several other references in the deed expressed the interest as applying to the "tracts" or to the "lands." The grantors were therefore held to have conveyed the full 1/64 royalty in all of the lands described. 504 S.W.2d at 842-43. The courts have established a rule now well entrenched in oil and gas law, declared the *Middleton* court, which it quoted from Will G. Barber, *Duhig to Date: Problems in the Conveyancing of Fractional Mineral Interests*, 13 Sw. L. J. 320, 322-23 (1959), as follows: "Where a fraction designated in a deed is stated to be a mineral interest in land described in a deed, the fraction is to be calculated upon the entire mineral interest," whereas, "[W]here a fraction designated in a reservation clause is stated to be a mineral interest in land conveyed by the deed, the fraction is to be calculated upon the grantor's *fractional* mineral interest . . . . " 594 S.W.2d at 842. (Emphasis in original.)

The distinction made by the courts, then, is that between the land described and the land conveyed. The rule is helpful in many cases that might otherwise be hopelessly ambiguous but will not resolve all possible uncertainties. The result may not be clear if a deed purports to reserve or convey an undivided interest in certain described "property," where undivided interests are described with one or more tracts of land, or where "interests" referred to in an instrument may refer to the land or to particular fractional interests somewhere referred to in the deed. A drafter using only the slightest care can easily avoid confusion, of course, but anyone considering conveyances and reservations involving fractional interests must decide whether a deed in which this problem occurs is clear in referring either to the land described or the land conveyed.

2. Fractional Interest "Out Of" a Larger Interest

A somewhat similar construction problem may arise from a deed conveying a fractional interest "out of" the grantor's interest. Texas courts have held that the phrase "out of" indicates only the source out of which the interest is to be taken, whereas the use of the word "of" alone would require reduction of the interest conveyed. *Minchen v. Hirsch*, 295 S.W.2d 529, 532 (Tex. Civ. App.—Beaumont 1956, writ ref'd n.r.e.). Thus, a "one sixteenth (1/16) royalty out of our [1/4] interest" in the land is a full 1/16 interest, not 1/64. 295 S.W.2d at 532-33. Likewise, a deed describing an undivided 1/2 of the minerals "out of the interest owned by" the grantors conveyed an undiminished 1/2 mineral interest. *Black v. Shell Oil Co*., 397 S.W.2d 877, 884-87 (Tex. Civ. App.—Texarkana 1965, writ ref'd n.r.e.). The court in *Winegar v. Martin*, 304 S.W.3d 661 (Tex. App.—Fort Worth 2010, no pet.), however, seems to have ignored the distinction observed here, holding that the reservation of 1/3 of royalty in a tract "out of" the grantor's undivided 1/3 interest in the land conveyed in the deed was only 1/3 of the grantor's 1/3 of the royalty.

3. Overconveyances: The *Duhig* Doctrine

When a grantor who owns an undivided mineral interest executes a deed that cannot be given full effect because the interest conveyed to the grantee and that reserved to the grantor amount to more than the grantor owned, how should the grantor's interest be allocated between grantor and grantee? The situation, not altogether unusual, is the one addressed in *Duhig v. Peavy-Moore Lumber Co*., 135 Tex. 503, 144 S.W.2d 878 (1940). In *Duhig*, the grantor of a 1912 deed owning one-half the minerals in a tract of land, executed a warranty deed in which he purported to convey the land to the grantee with the reservation of one-half the minerals to himself. Given that one-half the minerals were unquestionably in a prior owner, the question was who, grantor or grantee, became entitled to the other half. The court held that the grantee acquired half the minerals, leaving the grantor with nothing. According to the majority opinion of the commission of appeals, adopted by the supreme court, the grantor was estopped by his warranty from claiming the 1/2 mineral interest he purported to convey, thus vesting the reserved interest, by operation of the after-acquired title doctrine, in the grantee.

Despite the *Duhig* court's somewhat strained reliance on the warranty to estop the grantor from claiming the interest he purported to reserve, what has been called the "real" *Duhig* rule appears to be much more straightforward. See Willis H. Ellis, *Rethinking the Duhig Doctrine*, 28 Rocky Mtn. Min. L. Inst. 947, 954 (1982). As suggested by Judge Smedley, the author of the *Duhig* opinion, the manifest intention of the parties to the deed, after applying established rules of construction, was to invest the grantee with title to the surface and one-half the minerals, withholding only the one-half already outstanding in others. 144 S.W.2d at 879-80. Thus considered, no resort to the principle of estoppel arising from the warranty is necessary.

Blanton v. Bruce, 688 S.W.2d 908 (Tex. App.—Eastland 1985, writ ref'd n.r.e.), supports the

proposition that a warranty is unnecessary to application of the *Duhig* rule. In *Blanton* the court considered a 1934 deed, without warranty, in which the grantor, owning 3/4 of the minerals, conveyed the tract with reservation of 1/2 the minerals. The court held, despite the lack of a warranty, that the grantee became entitled to 1/2 the minerals and that the outstanding 1/4 must be deducted from the grantor's reservation. What is important is not the grantor's covenant of warranty, the court reasoned, but whether the deed purports to convey a definite interest in the property. 688 S.W.2d at 913-14.

Texas courts, explained *Blanton*, have applied the after-acquired title doctrine relied upon by the Duhig court regardless of the presence of a warranty, *Lindsay v. Freeman*, 83 Tex. 259, 18 S.W. 727 (1892), and the estoppel against the grantor arises from his assertion of the interest, not the warranty of it. 688 S.W.2d at 911-14. Additional support for application of the *Duhig* rule regardless of the presence of a title warranty on the basis that it arises instead from the grantor's assertion of title and his undertaking to convey it, is found, *Blanton* further notes, in *American Republics Corp. v. Houston Oil Co.*, 173 F.2d 728 (5th Cir. 1949), in which the court applied Texas law, and in the works of leading authorities. *See, e.g.*, Richard W. Hemingway, *The Law of Oil and Gas* § 3.2(D), at 129 (3d ed. 1991), 1 Patrick H. Martin and Bruce M. Kramer, *Williams & Meyers Oil and Gas Law* § 311.1, at 584.2 (2012).

Where a deed conveys a tract of land without exception or reservation, it purports to include the entire mineral estate. *Schlittler v. Smith*, 128 Tex. 628, 101 S.W.2d 543 (1937). It follows that unless a deed is limited to whatever interest the grantor owns, it purports to convey all interests except those that are specifically excepted or reserved. *Cockrell v. Texas Gulf Sulphur Co.*, 157 Tex. 10, 299 S.W.2d 672 (1956). Properly considered, therefore, the *Duhig* rule requires that a deed be construed from the viewpoint of the grantee, to ascertain the interest the instrument purports on its face to convey. If the grantor has that interest at the moment of the deed, the grantee receives it; any other outstanding interest must be absorbed by, or deducted from, whatever interest the grantor may have purported to reserve.

By logic the *Duhig* rule applies whether the interest outstanding and the interest purportedly reserved are mineral interests or royalty interests. Thus, for example, where a 1943 deed purports to grant a particular mineral interest and reserve the remainder, without mentioning an outstanding nonparticipating royalty, the outstanding interest is borne entirely by the grantor, not proportionately by both grantor and grantee. *Selman v. Bristow*, 402 S.W.2d 520 (Tex. Civ. App.—Tyler), *writ ref'd n.r.e. per curiam*, 406 S.W.2d 896 (Tex. 1966). And where a 1930 deed conveys a tract, purporting to reserve a 1/64 nonparticipating royalty interest to the grantor without mentioning an identical 1/64 royalty interest reserved by a prior grantor, the grantor has retained nothing. *Jackson v. McKenney*, 602 S.W.2d 124 (Tex. Civ. App.—Eastland 1980, writ ref'd n.r.e.).

4. The "Subject To" Clause

a. Use of the words "subject to"

The ordinary use of the words "subject to" in a deed is to limit or qualify the description of the estate being conveyed, not to create affirmative rights. *Kokernot v. Caldwell*, 231 S.W.2d 528 (Tex. Civ. App.—Dallas 1950, writ ref'd). The words will not, in and of themselves, reserve an interest to the grantor unless that intention is clearly expressed. *Monroe v. Scott*, 707 S.W.2d 132 (Tex. App.—Corpus Christi 1986, writ ref'd n.r.e.).

Much difficulty and confusion has nevertheless been generated by careless and inappropriate use of clauses making mineral conveyances "subject to" outstanding oil and gas leases or prior reservations. *See* Ernest E. Smith, *The "Subject To" Clause*, 30 Rocky Mtn. Min. L. Inst. ch. 15 (1984), for a more thorough treatment of the issues that commonly arise than can be presented here.

b. Deeds subject to existing lease

Problems with construction of mineral conveyances made subject to existing oil and gas leases date at least to the early case of *Caruthers v. Leonard*, 254 S.W. 779 (Tex. Comm'n App. 1923, judgm't adopted). In that case the court held that a conveyance of a fractional mineral interest did not carry with it the right to receive a proportionate share of delay rentals. Under the reasoning of the case, presumably the grantee of a mineral interest would nevertheless receive none of the lease benefits unless they were specifically mentioned and conveyed. To avoid this result drafters of mineral deeds began using forms that practically universally included provisions that the conveyance was made "subject to" the existing lease, but "covers and includes" the specified fraction of rentals, royalties and other benefits of the lease. *Caruthers* was overruled in *Harris v. Currie*, 142 Tex. 93, 176 S.W.2d 302 (1943), but the form of deed devised in its wake, without much change, is in general use to this day. Its use has generated more than a few controversies.

One of the first cases to construe a deed containing the "subject to . . . but covers and includes" language was *Hoffman v. Magnolia Petroleum Co.*, 273 S.W. 828 (Tex. Comm'n App. 1925, holding approved). In *Hoffman* the grantor had conveyed an undivided 1/2 mineral interest in 90 acres out of a 320-acre leased tract with a deed providing that the sale was made "subject to said lease but covers and includes one-half of all the oil

royalty and gas rental or royalty due to be paid under the terms of said lease." The court held that the grantee became entitled to one-half the royalty on production not only from the 90 acres described in the deed but from all 320 acres included in the lease. Although the granting clause only conveyed the 90 acres, the "subject to" clause, explained the court, operated as a second grant which operated on "all" royalty under the lease, i.e., the entire 320 acres.

What if a deed conveys only a portion of a larger tract and is made subject to a lease covering the entire tract, like the *Hoffman* deed, but it does not contain the language construed in *Hoffman* to pass the royalty under the lease, as to all of the leased premises, to the grantee? Might a landowner claim that the royalty under the lease should be apportioned on an acreage basis between grantor and grantee? The court in *Japhet v. McRae*, 276 S.W. 669 (Tex. Comm'n App. 1925, judgm't adopted), considered just such a contention by the owner of the lessor's interest in one of two tracts segregated from each other by deed after the execution of a lease, upon the discovery of "much oil" on the other tract. The court held that only the owner of the land where the well was located was entitled to the royalty, announcing the "non-apportionment" rule followed in Texas ever since. The court pointed out that the situation was unlike that in *Hoffman* in that the parties had not contracted for apportionment. 276 S.W. at 670.

Although much criticized, *Hoffman* remains good law. Its result is typically avoided by provisions within the deed's "subject to" clause making it clear that the grantee's rights in the royalty and other lease benefits are limited to the land included in the deed and the oil and gas produced from it. The examiner must nevertheless be alert to the possibility that the language of a "subject to" clause might be broad enough to encompass, under *Hoffman v. Magnolia*, production from other land. It should be pointed out as well that the possible existence of a deed in this form undoubtedly increases the risk of limiting title examination to less than all the premises covered by an existing oil and gas lease.

c. Inconsistent fractions

The "two-grant" theory applied in *Hoffman v. Magnolia* has sometimes been used in courts' many attempts to construe deeds in which the fractional interest stated in the granting clause is inconsistent with the fractions of lease benefits that the "subject to" clause states the conveyance to "cover and include." This presentation will not attempt to go much beyond a description of this complex problem, which is illustrated by the provisions of the deed construed in the Texas Supreme Court's most recent pronouncement on the issue, *Concord Oil Co. v. Pennzoil Expl. & Prod. Co.*, 966 S.W.2d 451 (Tex. 1998). In the 1937 deed the owner of a 1/12 mineral interest conveyed, in the granting clause, an undivided 1/96 interest in and to all of the oil, gas and other minerals. The conveyance was made subject to any existing lease and was stated to cover and include 1/12 of all rentals and royalty payable under such lease, insofar as the same pertained to the tract described. The lease that had been in effect at the time of the deed was long expired, and the deed contained no guidance, beyond the granting clause, specifically concerning ownership of future lease benefits. The court presumably would have had no difficulty, under the existing precedent of *Jupiter Oil Co. v. Snow*, 819 S.W.2d 466 (Tex. 1991), and *Luckel v. White*, 819 S.W.2d 459 (Tex. 1991), in holding unequivocally that the grantee was entitled to 1/12 of the minerals, if the "subject to" clause had included 1/12 of benefits under future leases or specified that the grantee would own 1/12 after the expiration of any existing lease. The "subject to" clause of this deed included no reference to future leases or to ownership after expiration of the existing lease, however, and the court split 5-4. In perhaps the most expansive reliance on the "subject to" clause yet, the court held that the deed conveyed 1/12 of the minerals. All justices would apply the "four corners" doctrine, but the four-justice plurality sought to harmonize the different fractions (although the "subject to" clause, again, did not expressly apply to future leases) on the basis that the prevailing royalty rate at the time was 1/8 and that both fractions evinced an intent to convey all the grantor's interest. The plurality expressly disavowed the *Hoffman v. Magnolia* style of "two-grant" analysis.

Forms of mineral deeds in general use today usually avoid the problem, although many still include a "subject to" clause very similar to that of the old forms and, by leaving a blank, invite misuse. In counties where there has historically been significant oil and gas activity, there are deeds that raise the potential issue of inconsistent fractions. Title examiners must still be alert. It seems reasonably clear after *Concord v. Pennzoil* that deeds made subject to an existing lease, with inconsistent fractions in the granting clause and the "subject to" clause, will be construed under the four-corners doctrine, with the court attempting to harmonize all provisions to arrive at the parties' true intent. *See, e.g., Hausser v. Cuellar*, 345 S.W.3d 462 (Tex. App.—San Antonio 2011, pet. denied). It seems also fairly clear that if the larger fraction expressed in the "subject to" clause is stated to apply to future leases or to mineral ownership, the grantee will be entitled to it and will not be confined to the smaller interest conveyed in the granting clause. Given the split in the *Concord* court, however, the question of ownership under such a deed, at least where there is no reference to benefits under future leases, must be considered still in doubt. Much

more thorough treatments of the history and legal reasoning behind the construction of mineral deeds of the sort discussed here may be found in 1 Ernest E. Smith and Jacqueline Lang Weaver, *Texas Law of Oil and Gas*, § 3.8(A)(3), at 3-59-67 (2d ed. 1998), and David E. Pierce, *Developments in Nonregulatory Oil and Gas Law: The Continuing Search for Analytical Foundations*, 47 Inst. on Oil & Gas L. & Tax'n § 1.01, §§ 1.05-1.06 (1996).

d. Limitation of grant

A "subject to" clause is routinely used to limit a grant or reservation, and careless use of such a clause may lead to unexpected results. In *Bass v. Harper*, 441 S.W.2d 825 (Tex. 1969), the grantor conveyed an undivided one-half interest in a tract of land, followed by the statement, "This Grant is subject to the Mineral Reservation contained in the following Deed[s] : . . . . " The deed thereafter listed several prior deeds in which the grantors had reserved a total of 3/7 of the royalty. The grantee's successor in interest contended, and the court of appeals had held, that the grantor conveyed one-half of his remaining 4/7 interest in the royalty, the "subject to" clause merely having been inserted to protect the grantor on his warranty. Reversing the lower court, the supreme court pointed out that the grant was quite plain, that there were no words limiting it to whatever interest the grantor owned, and that the grant itself was subject to the mineral reservations in the recited prior deeds. The instrument did not relate the outstanding royalty interest to the warranty, as it could have done. Thus, the entire outstanding 3/7 of the royalty must be deducted from the grantee's interest, so that the deed conveyed only 1/14 of the royalty.

Where a grantor's interest is subject to prior burdens, therefore, a prudent grantee of a fractional portion must not accept a deed in which his interest is simply made "subject to" such burdens unless he is willing to bear the entire recited burden. If the burden is to be borne proportionately, the deed should so state. Conversely, the grantor of a partial interest must take care to make the conveyance subject to a proportionate part of any existing burdens, or otherwise provide for their allocation, unless he intends to bear them entirely out of his own retained interest.

5. Other Rules in Construction of Reservations

Among the longstanding rules to which Texas courts continue to adhere is that a grantor may not reserve an interest to a stranger. A may not convey to B, reserving an interest in C, without first reserving the interest to A herself and then expressly conveying to C. *See Joiner v. Sullivan*, 260 S.W.2d 439 (Tex. Civ. App.—Texarkana 1953, writ ref'd). This may seem unduly mechanical, but its purpose is to prevent interests from becoming vested in third parties unless that is the parties' clear intention.

The rule and its purpose are illustrated by *Canter v. Lindsey*, 575 S.W.2d 331 (Tex. Civ. App.—El Paso 1978, writ ref'd n.r.e.), in which Roberts, who had previously conveyed a 1/32 nonparticipating royalty to Lindsey, conveyed a 3/4 mineral interest to Mabee, excepting an interest identified as 1/4 of the royalty in Lindsey. After the land was leased for 3/16 royalty, Lindsey claimed to be entitled to 1/4 of the 3/16, not just 1/32 of production. The court rejected the argument, pointing out that the exception from the Roberts-Mabee deed did not purport to create any new interest in Lindsey and that even if it had, it would have been ineffective under the doctrine prohibiting exceptions or reservations in favor of third parties. 575 S.W.2d at 335. Similarly, the court in *Little v. Linder*, 651 S.W.2d 895 (Tex. App.—Tyler 1983 writ ref'd n.r.e.), held that a mineral interest reserved from a deed joined by both husband and wife, conveying the wife's separate property, did not vest any of the reserved interest in the husband.

Another rule of some importance is that against implied reservations, relied on in, among other cases, *Sharp v. Fowler*, 151 Tex. 490, 252 S.W.2d 153 (1952). In that case the court construed a deed conveying 50 acres in which the grantor owned the surface and 1/4 of the minerals, "being the same land described in" a certain earlier deed. The prior deed had reserved all the minerals, and the grantor's successor in interest claimed that the reference to it had, in effect, qualified the grant and excepted the minerals. The supreme court rejected this argument, pointing out that a reservation of minerals must be in clear language. 252 S.W.2d at 154. To the same effect are *Chambers v. Huggins*, 709 S.W.2d 219 (Tex. App.—Houston [14th Dist.] 1986, no writ), and *Ladd v. DuBose*, 344 S.W.2d 476 (Tex. Civ. App.—Amarillo 1961, no writ), in both of which the courts held that a clause making the deed subject to an outstanding term interest did not impliedly reserve to the grantor the reversionary estate upon expiration of the term. Beware, though, that one court's rejected reservation by implication may be another's clear reservation. The supreme court in *Harris v. Windsor*, 156 Tex. 324, 294 S.W.2d 798 (1956), construed a deed very similar to the one involved in *Sharp v. Fowler*, except that the description of the prior deed was followed by "reference to which is made for all purposes." Without explicitly distinguishing *Sharp v. Fowler*, the court held that since reference was made to the prior deed "for all purposes" and not just description, the parties had intended to except from the grant a 1/2 mineral interest that had been reserved in the prior deed. 294 S.W.2d 800.

The rule against implied reservations is undoubtedly related to the more general rule that

language in a deed will be construed against the grantor as passing the greatest possible estate. *E.g., Allen v. Creighton*, 131 S.W.2d 47 (Tex. Civ. App.—Beaumont 1939, writ ref'd); *Clemmens v. Kennedy*, 68 S.W.2d 321 (Tex. Civ. App.—Texarkana 1934, writ ref'd). This has sometimes been held to be true even if the deed was prepared by the grantee's attorney. *McGuire v. Bruce*, 3332 S.W.2d 110, 113 (Tex. Civ. App.—Beaumont 1959, writ ref'd).

IV. DEFINING AND CONSTRUING CONVEYANCES OF ROYALTY AND OTHER INTERESTS LESS THAN ALL OF MINERAL FEE

A. The Unbundled Mineral Estate

The mineral estate in a tract of land, as distinct from the surface, includes five essential attributes, (1) the right to develop (the right of ingress and egress), (2) the right to lease (the executive right), (3) the right to receive bonus payments, (4) the right to receive delay rentals, and (5) the right to receive royalty payments. *Altman v. Blake*, 712 S.W.2d 117, 118 (Tex. 1986); Richard W. Hemingway, *The Law of Oil and Gas*, §§ 2.1-2.7 (3d ed. 1991). These various components can be separately conveyed or reserved. *E.g., French v. Chevron U.S.A., Inc.,* 896 S.W.2d 795, 797 (Tex. 1995). All of these are real property interests and are capable of ownership entirely separate from the others or in any combination. *Day & Co. v. Texland Petroleum, Inc.*, 786 S.W.2d 667 (Tex. 1990).

When a mineral interest is conveyed or reserved, however, it is presumed that all attributes remain with the mineral interest unless a contrary intention is expressed. *Day & Co. v. Texland Petroleum, Inc.,* 786 S.W.2d 667, 669 n.1 (Tex. 1990). Thus, the conveyance or reservation of a fractional interest in the oil, gas and other minerals in and under and that may be produced from a tract of land carries with it a like undivided fraction of the royalty reserved in any lease, *Delta Drilling Co. v. Simmons*, 161 Tex. 122, 338 S.W.2d 143 (1960), as well as bonus and delay rental rights. If a grantee acquires a 1/16 mineral interest and the land is leased at a royalty rate of 3/16, the grantee becomes entitled to 1/16 of 3/16 of production.

B. Royalty Alone

By contrast, a bare royalty interest is generally considered to consist of a specified interest in all production from the land (that is, 100%, not just the royalty fraction payable under a lease). Thus, a "1/16 royalty" interest in the oil, gas and other minerals produced from a tract of land entitles the grantee receiving it or the grantor reserving it to 1/16 of total production, not just 1/16 of the 3/16 (or whatever fraction) of production reserved as lease royalty. *Caraway v. Owens*, 254 S.W.2d 425 (Tex. Civ. App.—Texarkana 1953, writ ref'd). A royalty owner typically has no right to execute oil and gas leases or to develop the land himself. *Klein v. Humble Oil & Refining Co.*, 126 Tex. 450, 86 S.W.2d 1072, 1079 (1935); *Hawkins v. Texas Oil & Gas Corp.*, 724 S.W.2d 878, 888 (Tex. App.—Waco 1987, writ ref'd n.r.e.).

C. Mineral or Royalty?

Problems have developed in the construction of deeds that convey or reserve a specified fraction of the oil, gas and other minerals in and under a tract in the manner of a typical mineral deed but then, with limiting language or reservations, strip the interest of some or all of the usual attributes, often the right to execute leases and to receive bonuses and delay rentals. Is a mineral interest thus denuded of most or all of the bundle of rights making up the mineral estate except the right to receive royalty still a "mineral" interest, so that the owner receives only the specified fraction of *royalty* production, or has it become a "royalty" interest, entitling its owner to such fraction of *total* production? *See* Richard C. Maxwell*, Mineral or Royalty - The French Percentage*, 49 SMU L. Rev. 543 (1996).

Where the description of a reserved or conveyed mineral interest has left the owner with any of the attributes of the mineral estate other than the right to receive royalty, such as the executive right without the right to bonus or delay rentals, as in *Diamond Shamrock Corp. v. Cone*, 673 S.W.2d 310 (Tex. Civ. App.—Amarillo 1984, writ ref'd n.r.e.), or the right to receive delay rentals, as in *Buffalo Ranch Co. v. Thomason*, 727 S.W.2d 331 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.), the courts have usually had little difficulty in holding that the interest is a mineral interest, not a royalty. Conversely, key phrases have been held sufficiently indicative of royalty, as in *Barker v. Levy*, 507 S.W.2d 613 (Tex. Civ. App.—Houston [14th Dist.] 1974, writ ref'd n.r.e.), in which the deed granted a fraction of the minerals "produced and saved," while omitting "in and under" or any other indication that the owner was to have any interest except upon production (i.e., no right to develop).

The courts have had the most trouble with cases in which the grant or reservation of the minerals has been stripped altogether of any apparent interest other than the right to receive royalty. In an early leading case, *Watkins v. Slaughter*, 144 Tex. 179, 189 S.W.2d 699 (1955), the deed in question reserved to the grantor a 1/16 interest in and to all of the oil, gas and other minerals in and under and that may be produced from the land but provided that the grantee would have the right to execute leases and to receive all bonus and delay rentals. Finally, the grantor would "receive the royalty retained herein only from actual production." Because the grantor parted with essentially all mineral

rights except the right to royalty and because the concluding statement identified the reserved interest as royalty, the court held that it entitled the grantor to 1/16 of total production.

Subsequent cases, while never overruling *Watkins v. Slaughter*, have appeared to call it into serious question. Emphasizing that the granting clause conveyed an interest on its face a mineral interest "in and to all of the oil, gas and other minerals in and under and that may be produced from" the land, the court in *Altman v. Blake*, 712 S.W.2d 117 (Tex. 1986), pointed out that the mineral interest described in the granting clause would not have its essential character altered by the removal, in later clauses, of the right to lease and to receive delay rentals. This approach was carried to its extreme in *French v. Chevron U.S.A. Inc.*, 896 S.W.2d 795 (Tex. 1995). In that case the granting clause to a 1943 deed created what clearly would be a mineral interest if not for any qualifying language, but it went on to provide not only that the mineral grantee would have no control of the leasing and would receive no leasing revenue or rentals but that "this conveyance is a royalty interest only." Following *Altman v. Blake*, the court held that the mineral character of the interest indicated by the phrasing of the granting clause was not altered by the subsequent removal of the other attributes of the mineral estate, leaving only royalty remaining. If the parties had intended the conveyance of only royalty, the court reasoned, the mention of the leasing, rental and bonus rights retained by the grantor would have been redundant. 896 S.W.2d at 798. The identification of the conveyed interest as a "royalty interest only" did not sway the court, which mentioned that the court of appeals had distinguished *Watkins v. Slaughter*, unconvincingly, on the basis that the French deed did not provide for the grantee to receive the interest only out of "actual production." 896 S.W.2d at 797.

Watkins v. Slaughter appeared to be all but dead until the appearance of *Temple-Inland Forest Products Corp. v. Henderson Family Partnership, Ltd.*, 958 S.W.2d 183 (Tex. 1997). The two 1938 deeds at issue there each conveyed an undivided 15/16 interest in, to and of all oil, gas and other minerals on, in, under and that may be produced from the tracts covered, providing with respect to the grantor's reserved 1/16 that it "shall always be a royalty interest," would not bear any of the cost of exploration, development and production, and that "Grantor's one-sixteenth (1/16) royalty interest" was to be delivered free of cost. The grantor would not have leasing rights or share in bonus or delay rentals. Considering the language of the deed in its entirety, and particularly noting the numerous times the deeds referred to the reserved interest as a royalty, the court concluded that the grantor was entitled to a royalty interest of a full 1/16 of total production. In doing so the court noted that *Watkins v. Slaughter* had not been overruled and, indeed, explicitly relied on it. 958 S.W.2d at 185.

In *Temple-Inland* the mechanical approach of *Altman v. Blake* and *French v. Chevron* seems to have given way to a more decidedly four-corners one. *See Luckel v. White*, 819 S.W.2d 459 (Tex. 1991). The seemingly redundant use of the word "royalty" appears to have been the court's key to divining the parties' intent. The result seems correct, but certainty in construing deeds of this kind remains elusive. One use of the word "royalty," according to *French*, is not enough to show intent to distinguish a royalty interest from a mineral interest, but several more will be, per *Temple-Inland*. The cautious will not presume to know which kind of interest a deed creates except where the language is unequivocal or nearly identical to a deed construed in one of the decided cases.

D. Fractional "Royalty Interest" or "Of Royalty"

It is well known to oil and gas title examiners, but may come as a surprise to many others, including professionals in the oil and gas industry and attorneys specializing in other fields, that the law makes a major distinction between a fractional "royalty interest" and the same fraction "of royalty." That the word "of" should make such a crucial difference may seem incongruous to some, but numerous cases illustrate the point.

Where a conveyance or reservation is phrased as a fractional royalty interest, for example a "1/32 royalty interest" in oil and gas produced, the owner is entitled to the stated fraction of total production of the oil and gas produced from the land. *Brown v. Smith*, 141 Tex. 425, 174 S.W.2d 43 (1943). This interest in production is fixed and does not vary with the fractional royalty that may be payable under a particular lease. 2 Patrick H. Martin and Bruce M. Kramer, *Williams & Meyers Oil and Gas Law* § 327.1 (2012), and cases cited therein. Thus, an interest stated to be 1/4 of 1/8, or 1/4 of the "usual" 1/8, royalty interest in production amounts to a fixed 1/32 of total production. *Helms v. Guthrie*, 573 S.W.2d 855 (Tex. Civ. App.—Fort Worth 1978, writ ref'd n.r.e.); *Allen v. Creighton*, 131 S.W.2d 47 (Tex. Civ. App.—Beaumont 1939, writ ref'd). The rule holds even if the stipulated fractional royalty interest is exceptionally high. See *White v. White*, 830 S.W.2d 767 (Tex. App.—Houston [1st Dist.] 1992, writ denied), in which the deed at issue conveyed a 3/8 royalty interest applied to the grantor's 1/7 mineral interest, and *Arnold v. Ashbel Smith Land Co.*, 307 S.W.2d 818 (Tex. Civ. App.—Houston 1957, writ ref'd n.r.e.), in which the deed reserved a 1/4 royalty interest. The reservation of an undivided 1/2 nonparticipating royalty entitling the grantor to 1/2 of all production is

not even questioned in *Gavenda v. Strata Energy, Inc.*, 705 S.W.2d 690 (Tex. 1986).

Conversely, a conveyance or reservation of a fractional portion "of" or "in and to" the royalty consists of the stated fraction of whatever royalty may be provided for in the lease covering the land. *Harriss v. Ritter*, 154 Tex. 474, 279 S.W.2d 845 (1955). The owner's interest in production will thus depend on the amount of royalty payable to the lessor under the current oil and gas lease. *Luckel v. White*, 819 S.W.2d 459 (Tex. 1991); 2 Patrick H. Martin and Bruce M. Kramer, *Williams & Meyers Oil and Gas Law* § 327.2 (2012), and cases cited therein.

Of course, the rules are not always as easy to apply as they are to state. The Texas Supreme Court in *Brown v. Havard*, 593 S.W.2d 939 (Tex. 1980), was faced with a reservation of "an undivided one-half non-participating royalty (being equal to, not less than an undivided 1/16)" of all oil, gas and other minerals. Ambiguity arose both from the infusion of the parenthetical phrase and within the parenthetical, and the trial court had properly admitted extrinsic evidence of the parties' intent. 593 S.W.2d at 942.

Although the courts seem to have seldom been called upon to address them, title examiners encounter with some frequency circumstances in which an owner of a fractional royalty interest has conveyed royalty interests consisting of fractions of the royalty, or vice versa. Ordinarily not much difficulty is presented by a conveyance of a fixed fractional royalty interest out of a fraction of royalty. Usually the fractional royalty conveyed is based on the assumption that the royalty is 1/8, so that the total conveyance is no more than the grantor's fraction of the royalty multiplied by 1/8. If lease royalty is more than 1/8, the grantor has simply retained the difference between the 1/2 of royalty he owned, for example, and the 1/16 royalty interest he conveyed. Where, on the other hand, a grantor owning a 1/16 royalty interest purports to convey 1/2 of the royalty, the grantor has over-conveyed whenever the lease royalty exceeds 1/8. Certainly the grantee or grantees cannot collectively own more than their grantor did. If the overconveyances resulted from successive deeds purportedly totaling 1/2 of the royalty, then the rules discussed here presumably would require that the earliest in time and recordation be given effect. *See Hunley v. Bulowski*, 256 S.W.2d 932 (Tex. Civ. App.—Texarkana 1953, writ ref'd n.r.e.) Possibly the last of them, if the grantor's stated royalty interest has become exhausted, will not be effective at all under such circumstances.

E. Sharing of Extraordinary Interests in Production

Some discussion is in order concerning the nature and extent of interests that will be regarded as "royalty" so that owners of undivided interests in the royalty may claim their respective shares. Clearly, any non-expense bearing interest that continues for the life of the lease is royalty, so that any mineral or royalty owner entitled to a share of the royalty must receive his proportionate part, regardless of any characterization of the interest by the parties to the lease as a "bonus royalty" or "overriding royalty" over and above the royalty appearing elsewhere in the lease. *Griffith v. Taylor*, 156 Tex. 1, 291 S.W.2d 673 (1956); *Lane v. Elkins*, 441 S.W.2d 871 (Tex. Civ. App.—Eastland 1969, writ ref'd n.r.e.).

More controversial is whether the same rule applies to an interest substituting for actual production or payable out of production but not necessarily extending for the life of the lease. Texas courts have held that compensatory royalty and minimum royalty payments are subject to sharing with owners of nonparticipating royalty interests. *Andretta v. West*, 415 S.W.2d 638 (Tex. 1967) (compensatory royalty); *Morriss v. First Nat'l Bank*, 249 S.W.2d 269 (Tex. Civ. App.—San Antonio 1952, writ ref'd n.r.e.) (minimum royalty).

On the other hand, in *State Nat'l Bank v. Morgan*, 135 Tex. 509, 143 S.W.2d 757 (1940), the commission of appeals characterized a production payment of $600 per acre out of 1/8 of 7/8 of oil and gas production, in addition to the usual 1/8 royalty, as being in the nature of bonus and therefore not subject to the claim of the owner of 1/2 of the royalty. The case has never been overruled, but it would be a mistake to read it as granting carte blanche to a lessor to deprive nonparticipating royalty owners of whatever interest the lessor desires (at least any interest over 1/8) by structuring it as a production payment. The court in *Morgan* seems to have relied, at least in part, on the fact that the production payment was out of production over and above the "usual" 1/8 royalty. 143 S.W.2d at 761-62. Today, of course, there probably is no "usual" royalty; or, if it can be said there is, it varies widely according to locale. Given the high standards now imposed on owners of executive rights with respect to non-executives, *see Manges v. Guerra*, 673 S.W.2d 180 (Tex. 1984), *Bradshaw v. Steadfast Financial, L.L.C.*, No. 02-10-00369-CV, 2013 WL 530969 (Tex. App. — Fort Worth Feb. 14, 2013, no pet. h.), any lessor seeking advantage for himself in the reservation of a production payment would certainly face possible damage claims and serious difficulty in proving that the reserved interest is not merely a substitute for higher royalty that could have been obtained from the lessee. The *Morgan* holding itself seems vulnerable in today's climate.

V. CONCLUSION

It would be practically impossible, for a presentation such as this one, to compile a complete

guide to the conveyancing rules applicable to mineral and royalty deeds and their application by Texas courts. We hope this paper will serve to highlight some of the conveyancing issues the practitioner is most likely to encounter in title examination and drafting, and to remind and alert the audience to both helpful rules and hidden dangers.

PART 2

UNDERSTANDING ASSIGNMENTS OF OIL AND GAS LEASES

TABLE OF CONTENTS

I. Introduction

As Bill has shown, an examiner must understand the legal definition of many industry wide words and phrases in order to interpret mineral deeds. Interpreting an assignment of oil and gas leases does not require the examiner to know the legal meaning of so many words and phrases, but it instead requires the examiner to determine the effect of many different clauses upon the assignment. So, the purpose of this portion of the article is to discuss the primary components of an assignment and to assist the examiner in understanding the effect upon the parties of the different components discussed.

The following articles are worth reading on this subject: Earl A. Brown, *Assignments of Interests in Oil and Gas Leases, Farmout Agreements, Bottomhole Letters, Reservations of Overrides and Oil Payments*, 5 S.W. Legal Fdn. Oil & Gas Inst. 25 (1954) (Brown I);Earl A. Brown, *The Law of Oil and Gas Leases*, (2d ed. 1984)(Brown (II); Maurice H. Merrill, *The Partial Assignee – Done in Oil*, 20 Tex. L. Rev. 298; Terry I. Cross, *The Ties That Bind - Preemptive Rights and Restraints on Alienation that Commonly Burden Oil and Gas Properties*, Review of Oil and Gas Law XIII (Dallas Bar - 1968); 42); Frank W. R. Hubert, Jr. & James A. Taylor, *Creation and Conveyance of Oil and Gas Leasehold Burdens*, 31 Rocky Mtn. Min. L. Inst. 14-1 (1985); John S. Lowe, *Analyzing Oil and Gas Farmout Agreements*, 41 Sw. L.J. 759, (1987); David E. Pierce, *An Analytical Approach to Drafting Assignments*, 44 Sw. LJ 943 (1990)(Pierce I); David E. Pierce, *The Art, Science, and Law of Drafting Assignments*, Adv. O. G. & Min. L. Course (1998) (Pierce II); Lawrence P. Terrell, *Limited Assignments - Who Gets What?*, 35 Rocky Mtn. Min. L. Inst. 17-1 (1989)(Terrell I); Lawrence P. Terrell, *Overriding Royalties and Like Interests - Review of Non-Operating Lease Interests*, Rocky Mtn. Min. L. Special Inst. (1993) (Terrell II); Robert P. Hill, *Fundamentals of Oil and Gas Conveyancing*, 34 Rocky Mtn. Min. L. Inst. 17-1 (1988); A. W. Walker, Jr., *Fee Simple Ownership of Oil and Gas in Texas*, 6 Tex. L. Rev. 125 (1928)(Walker I); A. W. Walker, Jr. *The Nature of the Interest created by an Oil and Gas Lease in Texas*, 11 Tex. L. Rev. 399 (1933) (Walker II); William D. Warren, *Transfer of the Oil and Gas Lessee's Interest*, 34 Tex. L. Rev. 386 (1956).

II. The Property Being Transferred

A. Classification of the Leasehold Interest

The primary purpose of the assignment of oil and gas lease is to change the ownership of the lease. In Texas, an oil and gas lease is considered real property as Texas follows the ownership-in-place theory, which considers the owner of the mineral estate as owning the minerals situated within the surface boundaries of the land. *Texas Co. v. Daugherty*, 107 Tex. 226, 176 S.W. 717, 721 (1915). *See also* Walker I, *supra* at page 127-130 (examining Texas law regarding ownership of oil and gas); and *Cherokee Water Co. v. Forderhaus*, 641 S.W.2d 522, 525 (Tex. 1982), 75 O&GR 602. Some other states consider an oil and gas lease as personal property. *Gerhard v. Stephens*, 68 Cal. 2d 864, 69 Cal. Rptr. 612, 442 P.2d 692 (1968); *Rook v. Russell Petro., Inc*., 235 Kan. 61, 679 P.2d 158 (1984), 80 O&GR 471.

B. Description of the Interests Assigned

1. Leasehold

The granting clause of an assignment of an oil and gas lease will convey to the assignee one of the following:

a. All of assignor's interest; or
b. A specified percentage of assignor's interest in the oil and gas lease, such as ½ of assignor's interest; or
c. A specified amount of the oil and gas lease, such as 1/4 of the oil and gas lease.

The examiner's perspective in determining the interest conveyed is based upon the immutable effect of Tex. Prop. Code Ann. §5.001 (a) (West 2004), entitled *Fee Simple* which provides:

> An estate in land that is conveyed or devised is a fee simple *unless the estate is limited by express words* or unless a lesser estate is conveyed or devised by construction of law. Words previously necessary at common law to transfer a fee simple estate are not necessary. (Emphasis added.)

Most assignments include both an assignment of rights and a delegation of duties. For example, A assigns to B all of A's rights in an oil and gas lease, and states nothing else. This simple transaction has at least two important consequences, that B obtain A's rights in the lease, and B also assumes A's obligations to the lessor, and perhaps the previous assignees of the lease. The extent of this liability of B depends upon the underlying lease, previous assignments, and the present assignment. See further discussion at IV. *Effect of Assignment upon Liability, infra*.

For another example, A assigns to B all of A's rights in a lease but reserves the right to receive 1/16 of all of the oil and gas produced from the lease. In this

situation, B receives the property burdened by the obligation to pay royalty to the lessor and to pay A 1/16 of all oil and gas produced. The scope of B's obligation to pay will be discussed at VI. *Problems Associated With Non-operated Interests, infra.*

In the absence of a definition in the assignment itself, the primary terms used in an assignment of an oil and gas lease, which are "oil", "gas" and "other minerals", are already well defined. See Tex. Nat. Res. Code Ann. §86.002 (West 2011). *See also Amarillo Oil Co. v. Energy-Agri Prod.*, 794 S.W.2d 20, 22-25 (Tex. 1990), 109 O&GR 524; *Raw Hide Oil & Gas, Inc. v. Maxus Exploration Co.*, 766 S.W.2d 264, 271 (Tex. App. - Amarillo, 1988, writ denied), 105 O&GR 389. (discussing terms such as "gas rights", "oil rights", and "casinghead gas rights"; *Moser v. United States Steel Corp.*, 676 S.W.2d 99, 101-103 (Tex. 1984), 82 O&GR 143 (defining "other minerals").

Within the industry, however, there is some confusion between the term "leasehold interest" and "working interest". Many industry persons consider the terms synonymous. This author respectfully dissents. In writing title or drilling opinions, this author tries to consistently use the term "leasehold interest" when talking about leasehold ownership, while the author will use the term "working interest" in drilling or division order title opinions when discussing the manner in which the different leasehold owners will participate in drilling the test well. If there is only one tract of land and one or more leases owned by the same parties, then "leasehold interest" and "working interest" are the same. However, if a prospect consists of a tract of land covered by leases owned by different parties or different tracts of land owned by different parties, the "leasehold interest" of the leases cannot be the same as the "working interest" for drilling the test well. Adding to the confusion, some industry persons use the term "working interest" when referring to a lessee's share of gross production, or net revenue, not the lessee's percentage of participation in the cost of drilling. R. Hemingway, *Law of Oil and Gas* § 9.8, at 623 (3d ed. 1991). Usually, an assignor conveys his "interest in the oil and gas leases" or his "leasehold interest", as distinguished from a conveyance of "working interest".

The only case this author could find distinguishing between the terms "working interest" and "leasehold interest" is the case of *Miller v. Schwartz*, 354 N.W.2d 685 (N.D. 1984). In the *Miller* case, the Supreme Court of North Dakota interpreted two documents, one entitled "Assignment of Oil and Gas Lease" and one entitled "Assignment of Working Interest". The "Assignment of Working Interest" provided, in part, that:

> WHEREAS, the undersigned, Earl Schwartz Company is the owner of an undivided .4625000 Working Interest in the following described oil well, to wit:
> . . . assigns and transfers to: (name of assignee) all his right, title and interest in and to the aforementioned Working Interest in said real property, an undivided .4625000 Working Interest.
> . . .

Interpreting the unambiguous assignment, the court held that:

> . . . it is clear that the use of the term "working interest" does not, in itself, limit the interest conveyed to only a share of the oil and gas produced by the two wells in existence at the time the assignment was executed."; and
>
> Thus, it appears that the term "working interest", as commonly used in the oil industry, is generally synonymous with the term "leasehold interest."

As illustrated by the *Miller* case, there is an argument that an assignment of the assignor's "Working Interest", without reference to a conveyance of the underlying leases, could make the assignment ambiguous, especially if the surface acreage covered by the assignor's leasehold exceeds the surface acreage attributable to the assignor's producing wells being conveyed.

2. Surface and Sub-Surface Descriptions

If the assignment is limited to depth, the different operators can utilize the surface use rights expressed and implied from their leases. However, since there is a potential for conflict as to both surface and sub-surface activities, the parties' assignment should reflect their negotiated conclusions, I provide some initial language. For example, if A conveys to B only the leasehold rights to the Upper Morrow formation in Section 17, the assignment should also indicate:

> "B is also conveyed, to the extent necessary to reasonably explore, develop, and operate the interest assigned, the right to enter and use the surface of the leased land and to drill and operate through formations excepted by A from this assignment."

At the same time, A should retain the right to drill and operate through the Upper Morrow. For example:

> "A reserves from this assignment, to the extent necessary to reasonably explore, develop, and

operate A's maintained leasehold interest, the right to drill and operate through the interest assigned to B."

To the extent that the assignment might result in surface use beyond that contemplated by the lease, the parties should be familiar with the express easement rights contained in the granting clauses of the leases in question and any implied easement rights derived therefrom. *Gregg v. Caldwell—Guadalupe Pick-Up Stations*, 286 S.W. 1083 (Tex. Comm'n App. 1926, holding approved). If the mineral and surface estate were severed before creation of the lease, the surface use issue must be determined under the Implied Easements/Reasonable Use Doctrine, unless the deed severing the minerals specifically addresses this issue. *Brown v. Lundell*, 162 Tex. 84, 344 S.W.2d 863, 865-866 (1961), 14 O&GR 611 (operator held liable for negligence in disposing of saltwater).

a. Surface Description Problems

(1) Assignment of Production Site Only/Retained Acreage

If A owned an oil and gas lease covering all of a section, there is no problem if A conveys all of the lease or all of the N/2 of the lease to B. However, if A only intends to convey to B the lease rights in the drill site for a particular well, then there may be serious description problems. The term "drill site" by itself is not a legally adequate description. Identifying the "drill site" as a particular "drilling unit" may be initially accurate but subsequently inaccurate, for example if an oil well is deepened and gas is discovered requiring a larger proration unit. A legal description is probably insufficient if it is contingent upon subsequent reversions and revesting in response to new drilling and future Railroad Commission decisions. See generally Terrell I, *supra* at pages 17-6 and 17-7.

In the author's experience, assignments of drill sites are not as common as tracts created by retained acreage clauses in leases, which provide that leases terminate outside of the area attributed to producing wells. In Texas, these tracts are usually described as "drilling units" or "proration units", depending upon whether or not Special Field Rules are in place. Since this article is limited to assignments of oil and gas leases, see Tevis Herd, *Continuous Drilling and Retained Acreage*, 6th Adv. O. G. & Min. Law Course (State Bar of Texas - 1988), for a thorough discussion of the interpretation and effect of retained acreage clauses.

(2) Assignment or reservation of borehole rights.

PetroPro, Ltd. v. Upland Resources, Inc. 279 S.W.3d 743 (Tex. App. - Amarillo 2007, pet denied) is the first opinion in the country to discuss the rights of an assignee in a wellbore only assignment. In *PetroPro*, the assignor assigned:

> All of seller's right, title and interest in and to the oil and gas leases described in Exhibit "A" attached hereto and made a part hereof ("Subject Leases") *insofar and only insofar as said leases cover rights in the wellbore of the King "F" No. 2 well*. (Emphasis added.)

The King "F" No. 2. well was producing gas from the Cleveland formation at approximately 6,500' to 6,600'. The Plaintiff/wellbore owner desired to drill a horizontal well in the Brown Dolomite formation, approximately 3,400' to 3,600', and sued the leasehold owner who had already drilled his own horizontal wells at that depth, claiming that the leasehold owner's wells prevented Plaintiff from drilling its well. The Court concluded that:

1. The wellbore owner has the exclusive right to produce oil and gas from the wellbore it owns.
2. The wellbore owner owned only the wellbore and the space within the wellbore, no leasehold interest and thus no acreage/space outside the wellbore.
3. The wellbore owner owned no right to deepen the wellbore.
4. The wellbore owner owned no right to drill a horizontal well from the wellbore.
5. The wellbore owner could go up the wellbore, perforate, and obtain new production from an uphole formation.

The dissenting opinion noted that perforating up the wellbore and obtaining new production would probably cause the wellbore owner to trespass into the space owned by the leasehold owner around the wellbore, arguing that the wellbore owner's right to produce should be limited to the Cleveland formation.

Responding to the issue raised by the dissent, my friend Flip Whitworth, an Austin attorney, recommends that a wellbore owner obtain language, such as his suggestion below, in the wellbore assignment clarifying the rights between the wellbore owner and the leasehold owner:

> For regulatory purposes only, assignee shall have the right to use and assign as much as ____ acres around such borehole for permitting and allowable purposes, provided the use or assignment of such acreage does not impede, impair or curtail

assignor's rights to acquire drilling permits or to maximize allowables for assignor's wells, including wells assignor may drill on acreage otherwise assigned to said borehole by assignee.

b. Sub-Surface Description problems

The problem with dividing a lease by depth, usually called a "horizontal severance," is that the parties often are not certain of precise sub-surface depths and configurations. My concern is that too often the language used to create the depth limitation is not sufficiently precise to avoid a claim of ambiguity. Too often, I see assignments of leases such as the following:

> Assignor conveys all of his interest in the leases attached hereto as Exhibit A . . .
>
> from the surface to the base of the Chester Formation; or . . .
>
> from the surface to a depth of 12,300'.

While I would not normally require an amended instrument, it is my opinion that this language contains the seeds of an ambiguity claim.

An example is the recent case of *EOG Resources, Inc. v. Wagner & Brown, Ltd*., 202 S.W.3d 338 (Tex. App. - Corpus Christi 2006, pet. denied). EOG, the farmoutee from Wagner & Brown, completed a well in the Norris Sand producing from perforations between 9,679' and 9,729'. Wagner and Brown's assignment conveyed all of its interest from the surface to "*100' below the deepest producing interval*." EOG's second well was completed in the Norris Sand producing between 10,230' and 10,266'. Wagner & Brown filed a declaration judgment seeking construction of the farmout agreement and the assignment claiming that EOG was only entitled to rights from the surface to 100' below the depth of the deepest producing interval in the #1 well, being 9,729' plus 100', or 9,829'. EOG contended that the term "deepest producing interval" was not limited to the specific vertical depth at which the Norris Sand was found in the #1 well, but to the interval from which the #1 well produced, at whatever depth that might be, arguing that the term applied to the Norris Sand as a formation. In sustaining the Trial Court's summary judgment in favor of Wagner & Brown, the Court of Appeals stated "we do not look to what the parties contend was their intent, but rather to that intent as it was expressed in the final correction assignment", i.d. at page 345. (emphasis added)

I have found some helpful definitions in 8 H. William and C. Meyers, *Oil and Gas Law, Manual of Terms*, pp. 1038 (11th Ed. 2000) which provide the following:

> (1) Stratigraphic interval - The body of strata between two stratigraphic markers. American Geological Institute, *Glossary of Geology,* R. Bates and J. Jackson, eds., 2d ed. 1980); *Energy Reserves Group, Inc*., 92 IBLA 219, GFS (O&G) 1986-67.
>
> (2) Stratigraphic equivalent - In cases of horizontal severances of a leasehold, the assignment may seek to account for the nonuniform lay of subsurface structures by assigning down to the stratigraphic equivalent of a stated numerical depth beneath the surface in order to ensure that a productive reservoir is not split by the assignment. Thus the assignment may provide that it extends to the grantor's interest from the surface down to the stratigraphic equivalent of 4,000 feet beneath the surface, as measured in the bore of a designated well. D. Pierce, *Kansas Oil and Gas Handbook* §7.06 (1986).

I agree that reference to the stratigraphic equivalent is necessary to avoid a potential ambiguity claim. However, even more precise language appears possible in that geologists recognize three different meanings for the phrase "stratigraphic equivalent":

> (1) Time - Stratigraphic equivalents are the sediments deposited and the rocks formed during a specific time; i.e., in a given era, epoch, or age.
> (2) Bio - Stratigraphic equivalents are rocks that contain similar fossils;
> (3) Rock - Stratigraphic equivalents are MapPable rock layers with distinctive top and bottom boundaries.

Lowe, *supra*, Note 289 at 826 provides that:

> The most common way to designate an objective depth in a farmout is by naming an objective rock-stratigraphic unit, whether it is a formally designated formation or member (formally designated rock-stratigraphic units are listed in G. Keroher, *Lexicon of Geological Names of the United States for 1936-1960* (United States Geological Survey Bulletin No. 1200 (1966) or some other informally designated but locally recognized unit, such as the Red Fork Sandstone in Oklahoma. (The Red Fork Sandstone is informally but effectively described in L. Jordan, *Subsurface*

> *Stratigraphic Names of Oklahoma* 165 (Oklahoma Geological Survey Guidebook No. 6, 1957). As indicated above, a formation is a rock-stratigraphic unit. *See supra* note 288. This suggests that the parties intend that "stratigraphic equivalent" in the portion of the agreement limiting what is earned is meant to be "rock-stratigraphic equivalent." If the objective depth is defined as a zone, the inference is that the "stratigraphic equivalent" means "bio-stratigraphic equivalent." No inference arises if the objective depth is stated in feet.

In my opinion, an assignment creating or reserving a depth limitation should contain at least language such as the following:

> Assignor conveys all of his interest in the leases attached hereto as Exhibit A from the surface *to the stratigraphic equivalent of 14,200' as identified in the Exxon-Smith No. 1 well located 467' FNL & FWL of Section 56*, Block 43, H&TC Ry. Co. Survey, Lipscomb County, Texas.

3. Personal Property Rights Transferred With the Leasehold

Assignments of leasehold interests do not necessarily convey lease equipment and fixtures. *Fike v. Riddle*, 677 S.W.2d 722, 727 (Tex. App. - Houston [1st Dist.] 1984, writ ref'd n.r.e.), 82 O&GR 630 (casing held to be trade fixtures, thus personal property and not conveyed); *OTC Petroleum Corp. v. Brock Expl. Corp*., 835 S.W.2d 792 (Tex. App. - Amarillo 1992, writ denied), 120 O&GR 376 (identified 23 specific types of contracts). To specifically convey such items, the assignment should, at a minimum, provide:

> "A also conveys to B all fixtures, equipment and other property located on, and used in conjunction with, the interest assigned."

If the bill of sale is not combined with the assignment so that a separate bill of sale is contemplated that conveys the personal property, the assignment can incorporate the bill of sale for descriptive purposes. For example, the assignment could state:

> "By Bill of Sale between the parties of this same date, A also conveys to B all fixtures, equipment and other personal property located on, and used in conjunction with, the assigned interest."

Even if the bill of sale is not recordable, the reference in the recorded assignment places third parties on notice of the assignee's rights. *Westland Oil Dev. Corp. v. Gulf Oil Corp.*, 637 S.W.2d 903, 907-10 (Tex. 1982), 73 O&GR 359 ("inquiry notice"); *Mbank Abilene, N.A. v. Westwood Energy, Inc.,* 723 S.W.2d 246, 248 (Tex. App. - Eastland 1986, no writ) (bank's lien subordinate to operator's lien identified in operating agreement referred to in prior assignment).

a. Tangible Personal Property

In addition to transferring the mineral estate covered by the oil and gas lease in question, an assignment may also transfer rights to tangible personal property associated with the lease such as pump jacks, compressors, tanks, oil in tanks, casing and tubing. Other examples of personal property relating to the lease are logs, files, title opinions and abstracts obtained in connection with the lease. An assignment could cover as many as three types of tangible personal property:

(1) titled personal property, such as a motor vehicle;
(2) fixtures, such as casing and tubing; and
(3) other goods, such as leasehold equipment and oil in tanks.

Usually language conveying the personal property used in connection with producing wells, or a separate "bill of sale", will transfer these items. However, an assignment will likely be ineffective as to titled property until the appropriate registration documents are executed and processed.

Normally, the sale of tangible personal property is a sale of goods under the UCC. U.C.C.§2-105(1) (1994) provides, in part:

> "'Goods' means all things... which are movable at the time of identification to the contract for sale... 'goods' also includes... other identified things attached to realty (§2-107)."

U.C.C. § 2-107(2) (1994) provides, in part:

> "A contract for the sale apart from the land of . . . things attached to realty and capable of severance without material harm thereto... is a contract for the sale of goods within this article . . . ."

Having the UCC impact a conveyance of real property often requires real property/oil and gas lawyers to review the UCC to determine if there are other unintended consequences. For example, UCC §2-316 (1994) requires language that excludes or modifies the implied Warranty of merchantability to be "conspicuous", which is usually accomplished by using all capitalization for the disclaiming language.

b. Intangible Personal Property/Contract Rights.

Rights in many undeveloped leases are subject to exploration and development agreements. Rights in most developed oil and gas leases are subject to contracts which facilitate development. Examples of such contracts are pooling agreements, operating agreements, gas balancing agreements, gas purchase agreements, and division orders. Transferring title to an oil and gas lease requires the concurrent transfer of these contracts rights associated with the lease. *OTC Petroleum*, 835 S.W.2d at 793-95.

In most instances, the assignee only reviews the contracts identified in order to determine their impact upon the value of the property conveyed. In some cases, however, the parties must conduct an audit to determine the accrued benefits and liabilities. For example, the seller may be subject to a gas imbalance that would require balancing prior to completing the transaction or an offset against the purchase price. As a minimum, these contracts should be excepted from the warranty against encumbrances of the leases assigned.

4. Exhibit A

I refer you to Bill Burford's discussion in his Section II *Land Descriptions* for the applicable rules concerning legal descriptions, specifically applied to mineral deeds. There are few cases that focus upon legal descriptions in assignments.

The court in *Tenneco Oil Co. v. Alvord*, 416 S.W.2d 385, 387-88 (1967), 26 O&GR 710, interpreted an assignment of oil and gas leases, supported by letter agreement, wherein the assignor expressly reserved producing wells, but subsequently argued that he reserved the leases from the surface to the base of the deepest formation. The court held that the instruments were not ambiguous and that assignor conveyed all of his rights not specifically reserved (a Sec. 5.001 moment!). Thus the assignee could drill a new well to the already producing shallow depths.

While the case of *Westland Oil Development Corp. v. Gulf Oil Corp.*, 637 S.W.2d 903 (Tex. 1982), 73 O&GR 359, has several important holdings that are relevant to conveyances, I focus on the issue of whether or not a paragraph of the November 15, 1966 letter agreement supplied a legally sufficient description of the property covered thereby. An agreement to assign an interest in and oil and gas lease is subject to the requirements to the Statutes of Fraud as set out in Tex. Bus. & Com. Code Ann. §26.01 (West 2009); *Consolidated Gas & Equipment Co. v. Thompson*, 405 S.W.2d 333 (Tex. 1966), 25 O&GR 68. The court construed two descriptions from paragraph 5 of the letter agreement. The first description read as follows:

> If any of the parties hereto, their representatives or assigns, acquire *any additional leasehold interest affecting any of the lands covered by said farmout agreement*, . . . such shall be subject to the terms and provisions of this agreement . . . . (Emphasis added.)

Westland contended that the above constituted sufficient description of the specific sections covered by the farmout agreement, thus rendering the area of mutual interest agreement enforceable as to those sections. The second description read as follows:

> If any of the parties hereto, their representatives, or assigns, acquire . . . any additional interest from Mobil Oil Corporation *under lands in the area of the farmout acreage*, such shall be subject to the terms and provisions of this agreement . . . . (Emphasis added.)

Westland contended that this second description also was sufficient.

The court concluded that the first description was legally sufficient but the second description was not legally sufficient to satisfy the Statute of Frauds. The court pointed to the operative words as "leasehold interest affecting any of the lands covered by said farmout." In *Wilson v. Fisher*, 144 Tex. 53, 188 S.W.2d 150, 152 (1945), the Supreme Court stated:

> In so far as the description of the property is concerned the writing must furnish within itself, or *by reference to some other existing writing*, the means or data by which the particular land to be conveyed may be identified with reasonable certainty. (Emphasis added.)

See also *Kmiec v. Reagan*, 566 S.W.2d 567 (Tex. 1977); *Morrow v. Shotwell*, 477 S.W.2d 538 (Tex. 1968); *Pickett v. Bishop*, 148 Tex. 107, 223 S.W.2d 222 (1949). This has been referred to the "nucleus of description" theory. *Gates v. Asher*, 154 Tex. 538, 280 S.W.2d 247 (1955). The court in *Westland* believed that the words "said farmout" sufficiently provided the nucleus of description.

The court reached a different conclusion with respect to the second description because the phrase "land in the area of the farmout acreage" did not meet this test.

In *Long Trusts v. Griffin*, 222 S.W.3d 412 (Tex. 2006), the Court unraveled a long relationship between investors and operators because the Exhibit A's description of the oil and gas leases was insufficient to satisfy the Statute of Frauds. For over 20 years the plaintiffs/investors had received assignments on a "project by project or well by well basis" based upon 1978 and 1982 letter agreements. Plaintiffs filed suit against the defendants/operators to enforce 1992 letter agreements obligating them to pay their proportionate part of legal expenses to Long Trusts so that plaintiffs could participate in any "take or pay" settlement defendants obtained against Tejas Gas Company, who was the gas purchaser from the wells in question. (The defendants ultimately obtained an 11 million dollar settlement from Tejas.) The defendants responded by calling into question the basic agreements that created their relationship.

The 1978 letter agreement stated that the subject leases were located:

> "in the Northeast portion of Rusk County, Texas, and consist[ed] of 50+ leases covering approximately 2100 + net mineral acres in the Dirgin and Oak Hill Fields area" as "described in the attached Exhibit 'A'".

Exhibit A provided the lessor name, the survey name, the term, and the net acreage for each lease at issue. The Exhibit A did not supply the date, recording, or the name of the lessee.

The Court held the information was insufficient to identify the exact location of the lease with reasonable certainty. It described land only by quantity as part of a larger tract, with nothing to identify what specific portion was intended to be conveyed. Therefore, it was voidable for uncertainty of description, citing *Smith v. Sorelle* and *Matney v. Odom*, see *infra*.

The 1982 letter agreement stated that the subject leases were:

> ". . . located in the Northcentral portion of Rusk County, Texas, in the North Henderson Field Area, and consist[ed] of 143 leases covering approximately 2100 net mineral acres" as "described in the attached Exhibit 'A'", and "[a]ll of the acreage as shown on Exhibit 'A' (attached) is dedicated to a Gas Contract with Tejas Gas Corporation."

No Exhibit A was attached to the 1982 agreement.

The Tejas gas contract referred to in the agreement was in the appellate record, but the court determined that it failed to sufficiently identify the leases, even assuming that was the reference's purpose. The Tejas gas contract defined the term "contract acreage" as "all of the leases and lands described in Exhibit 'A' and outlined on Exhibit 'B'. Exhibit "A" to the gas contract stated the leases were "more fully described as follows" and contained (only) headings for items like leases name, description, and acreage, and was blank below the headings. Exhibit B provided a plat. Another document, also entitled "Exhibit 'A'," was attached at the end of the contract and provided the name and legal description of each lease, but stated that it was "attached to and made a part of" a separate seemingly unrelated agreement.

The court concluded that Exhibit A and B to the Tejas gas contract were insufficient to identify the leases at issue. Exhibit A identified no leases and Exhibit B alone (the plat) was insufficient. In the court's view, the Tejas gas contract only provided confusion, not reasonable certainty, as to the identity of each lease in the 1982 agreement. Thus, the court deemed the 1982 agreement unenforceable under the Statute of Frauds.

Because of the lack of a definitive case describing the minimum elements of an oil and gas lease that should be included in the Exhibit A to an assignment, I offer the following:

1. Date of the lease.
2. Recording.
3. Name of lessor.
4. Name of lessee.
5. Property covered, or if less than all, property conveyed.

If the Assignment conveyed all of the land covered by the lease, item 5 above could be omitted.

5. <u>Quantifying the Assigned Interest/ Proportionate Reduction</u>

Where the leases contributed to drilling a test well are burdened only by royalty, there is seldom any confusion when calculating the net revenue of the parties, on both the working interest and the royalty sides. However, when one or more leasehold owners create overriding royalties or production payments, non-operating interests that burden only the assignor creating them, the ultimate calculation of net revenue is complicated by determining the amount of net revenue burdening the operating interest and its subsequent owners. For example, if A intends to create an

overriding royalty of 1/16, this interest could be expressed as 1/16 of 7/8 (an historical example), 1/16 of 8/8, or 1/16 of A's net revenue (NRI).

If A owns an undivided 50% leasehold interest in Section 17 and conveys to B 1/16 of 7/8 of 8/8 of production, the express terms of the assignment will entitle B to 7/128ths of production, as opposed to 7/256ths. *First Nat'l Bank v. Kinabrew*, 589 S.W.2d 137, 149 (Tex. Civ. App. - Tyler 1979, writ ref'd n.r.e.), 65 O&GR 545 (assignment creating overriding royalty contained no proportionate reduction clause so court interpreted assignment to create overriding royalty of 1/8 of 8/8 without reduction). If A desires to reduce the interest assigned to reflect his 50% ownership in the leasehold, A would include a proportionate reduction clause in the assignment. The purpose of a proportionate reduction clause is to reduce the interest assigned to coincide with the assignor's actual leasehold ownership, in the event the assignor owns less than the entire leasehold interest. A properly drafted proportionate reduction clause could include the following instances of reduction:

a. If the leases cover less than the entire mineral estate in the lands described in the leases;
b. If the assignor owns less than 100% of the leases assigned; and
c. If the leases assigned are subsequently pooled with other leases (not usually included).

A sample of a complete proportionate reduction clause is:

> The overriding royalty interest assigned herein shall be proportionately reduced to the extent that the lease covers less than the full interest in the land covered thereby, to the extent that assignor's interest in the lease is less than 100% and, on a surface acreage basis, to the extent that the lease is now or hereafter pooled or unitized by Assignor with other lands or leases.

Typically, an overriding royalty or production payment owner does not bear any part of the drilling, production, or operating expenses from its share of production, the same as a royalty owner, but the overriding royalty owner does agree to pay its proportionate part of taxes levied against its share of production. Language to this effect is usually contained within the assignment. A sample clause is:

> Said overriding royalty shall be delivered or paid free of cost or expense of development or operations, although said overriding royalty shall bear its proportionate share of any production or severance taxes.

III. Conditions

A. In the Lease

Since the leasehold interest the assignee has contracted to receive depends upon the continuing validity of the lease, the assignment sometimes addresses specific issues concerning the status of the lease; for example, the assignor's failure to properly pay delay rentals, see *Young v. Jones*, 222 S.W. 691, 692 (Tex. Civ. App. - El Paso 1920, no writ)(wrong amount); *Gillespie v. Bobo*, 271 F. 641, 643, (5th Cir. 1921)(wrong address); or shut-in royalty, see *Gulf Oil Corp. v. Reed*, 161 Tex. 51, 337 S.W.2d 267 (1960), 12 O&GR 1159, may have terminated the lease. The lease may be subject to termination because the assignor has failed to operate and develop it prudently. *Slaughter v. Cities Service Oil Co*., 660 S.W.2d 860, 862 (Tex. App. - Amarillo, 1983, no writ)(lessor lost because he stubbornly refused conditional cancellation as a possible remedy). An interruption in production during the secondary term may have terminated the lease as a matter of law even though the lease is presently producing in paying quantities. *Samano v. Sun Oil Co*., 621 S.W.2d 580, 582-84 (Tex. 1981), 70 O&GR 64 (lease terminated where 60 day savings clause violated by 73 days of no reworking, drilling or production). Therefore, if B purchases an interest in A's lease, B may require A to specifically warrant/covenant that the lease is in effect, that all rental, shut-in royalty, royalty, and other payments required by the terms of the lease have been properly made, and that A has the right to convey the interest. (See long form warranty, *supra*.) Prior to closing, B's attorney, or other agents, should independently investigate the status of the lease by examining state records, delay rental receipts, shut-in royalty receipts, affidavits of production, lessors' demands, surface occupancy, and any additional sources necessary to satisfy B that A has complied with all leasehold terms.

B. In Assignments

Due diligence requires that B examine the prior assignments to confirm that all conditions stated in the prior assignments have been satisfied. Assignments and leases may contain both conditions and covenants. The examiner should remember that the difference is the remedy for their breach. Breach of a condition results in automatic termination of the leasehold estate, upon the happening of the stipulated event. Breach of a covenant does not automatically terminate the estate, but instead subjects the breaching party to liability for monetary

damages or, in extraordinary circumstances, the remedy of a conditional decree of cancellation. *See Rogers v. Ricane Enterprises, Inc*., 772 S.W. 2d 76 (Tex. 1989), 108 O&GR 331 (Rogers I); *see also Freeman v. Magnolia Petroleum Co*., 141 Tex. 274, 171 S.W.2d 339, 342 (1943); *Shuttle Oil Corp. v. Hamon*, 477 S.W.2d 701, 704 (Tex. Civ. App. - Beaumont 1972, writ ref'd n.r.e.).

If the assignee accepts a term assignment, he should determine if the savings clauses of the base leases are contractually connected to his habendum clause. The case of *Riley v. Meriwether*, 780 S.W.2d 919 (Tex. App. - El Paso 1989, writ denied), 111 O&GR 336, illustrates this potential shipwreck. Meriwether assigned to Riley leases in Crockett County for a specific term, and so long thereafter as oil and/or gas were produced. The assignment had no shut-in royalty clause, but the base leases did. The assignment included the following:

> Reference for all purposes is made to the oil and gas leases described in Exhibit A and incorporated herein by this reference.

Riley obtained gas production, paid shut-in gas royalty to the lessors of the base leases, and shut in the wells for 13 months. The term of the assignment expired during the shut-in period. The court held that, since the assignment itself did not provide for payment of shut-in royalty in lieu of actual production, the assignee's rights terminated automatically when the production condition was not met. The reference to an incorporation of the base leases was not sufficient to incorporate the shut-in royalty clause in the base leases into the separate habendum clause of the assignment. *Riley*, 780 S.W.2d at 924-925.

The lesson was that the habendum clause of each instrument must stand on its own. The habendum clauses of different instruments can be tied together contractually, but not by implication. An example of a contractual connection is if the owner of a term mineral interest and the owner of the reversionary interest in the term jointly execute an oil and gas lease. *See Southland Royalty Co. v. Humble Oil & Refining Co.,* 151 Tex. 324, 249 S.W.2d 914 (1952), 1 O&GR 1431, where production is from the land in question, or *Spradley v. Finley,* 157 Tex. 260, 302 S.W.2d 409 (1957), 7 O&GR 650, where production was from another tract pooled with the land in question.

Lastly, the rules governing the construction of an assignment are well established and are well stated in *Rogers v. Ricane Enterprises, Inc*., 852 S.W.2d 751, 756-57 (Tex. App. – Amarillo 1993), rev'd, 884 S.W.2d 763 (Tex. 1994)(Rogers II):

> In construing an instrument of this type we should ascertain, and give effect to, the intention of the parties as gathered from the entire instrument, together with the surrounding circumstances, unless that intention is in conflict with some unbending canon of construction or is repugnant to the terms of the grant. *Coker v. Coker*, 650 S.W.2d 391, 393 (Tex. 1983); . . . . The instrument must be considered as an entirety and each paragraph must be considered with reference to every other paragraph so that the effect of one on the other may be determined. See *Coker v. Coker*, 650 S.W.2d at 393. It must be presumed that each provision was placed in it for a particular purpose and a construction which would render any provision meaningless should be avoided. Coker v. Coker, 650 S.W.2d at 393. Provisions which are in apparent conflict must be reconciled and harmonized whenever possible so that the instrument as a whole may be given effect . . . .

IV. Warranties - or lack thereof

A. Warranties

An assignment of an oil and gas lease may contain a general or special warranty, disclaim all warranties, or quitclaim the assignor's interest. If the assignment contains a warranty, general or special, the assignor should carefully except all existing encumbrances, including overriding royalties, operating agreements, gas purchase contracts, gas balancing contracts, and other rights burdening the leasehold created by prior assignments. Examples of warranty language touching both extremes are:

> TO HAVE AND TO HOLD the above described oil, gas and mineral lease, and oil, gas and mineral leasehold estate, insofar as it covers the above described land, unto the said assignee, together with all and singular the rights and appurtenances thereto in anywise belonging, forever, and assignor does hereby bind himself, his heirs, administrators, executors and assigns, to warrant and forever defend, all and singular, the said oil, gas and mineral lease, and oil, gas and mineral leasehold estate, insofar as it covers the above described land, unto the said assignee, his heirs and assigns, against every person whomsoever lawfully claiming or to claim the same or any part thereof, and, without limitation on the foregoing, assignor warrants that he is the lawful owner of the above described oil, gas and mineral lease, and oil, gas and mineral leasehold estate, and all of the rights, titles, and

interests thereunder, insofar as it covers the above described land; that all rentals and royalties payable under said lease have been paid; that the said lease is in full force and effect, and is a valid and subsisting oil, gas and mineral lease against the said land, above described; that the assignor has good right and authority to sell and convey the same; and, that the said oil, gas and mineral lease, and oil, gas and mineral leasehold estate therein described is free from any overriding royalties, production payments, liens, encumbrances, claims, indebtedness, charge or tax of any type or character.

This assignment is made with warranty of title by, through and under assignor, but no further.

Assignor hereby warrants and agrees to defend the title to the leases described above.

Where a general warranty is contained in a deed or assignment, the grantor promises that he has not previously conveyed the property interest to any other person than the grantee, and that the property is free from encumbrances. The warranty does not constitute a part of the conveyance, and it extends only to the property interest granted by the deed or assignment, not what is reserved. The warranty does not strengthen, enlarge or limit the title conveyed, but rather it is a separate contract on the part of the grantor to pay damages in the event of a failure of title. The warranty does not operate by estoppel to confer on the grantee any title greater than the title described in the grant contained in the deed itself. However, if the grantor does not own the entire property interest expressly granted, then the doctrine of after-acquired title may subsequently apply to vest the grantee with the full interest intended. A general warranty warrants title from the sovereignty to the present while a special warranty warrants title only during the period of time owned by the grantor. Fred A. Lange & Aloysius A. Leopold, *Texas Practice: Land Titles and Title Examination* §§792-795 (1992 & Supp. 2001), and the cases cited therein.

In states such as Texas that classify the oil and gas lease as real property, the use of common words of conveyance, such as "convey" or "grant" imply certain warranties in conjunction with the assignment. Tex. Prop. Code, Ann. §5.023 (West 2004), entitled Implied Covenants, provides :

a. Unless the conveyance expressly provides otherwise, the use of "grant" or "convey" in a conveyance of an estate of inheritance or fee simple implies only that the grantor and the grantor's heirs covenant to the grantee and the grantee's heirs or assigns:
   (1) prior to the execution of the conveyance the grantor has not conveyed the estate or any interest in the estate to a person other than the grantee; and
   (2) that at the time of the execution of the conveyance the estate is free from encumbrances.
b. An implied covenant under this section may be the basis for a lawsuit as if it had been expressed in a conveyance.

If an assignor desires to not be bound by any warranties, express or implied, he should include in the assignment a statement such as:

This assignment is without warranty of title, either express or implied.

B. Quitclaim

The traditional definition of a quitclaim deed is:

A quitclaim is a deed/assignment of conveyance intending to pass any title, interest or claim of grantor, but not professing that such title is valid, nor containing any warranty or covenants of title.

Black's Law Dictionary 1126 (5th Ed. 1979); *Porter v. Wilson*, 389 S.W.2d 650, 655-656 (Tex. 1965); *Cook v. Smith*, 107 Tex. 119, 174 S.W. 1094, 1095 (1915); *Rogers v. Ricane Enterprises, Inc.*, 884 S.W.2d 763 (Tex. 1994), 130 O&GR 415 (Rogers II). The penalty for accepting or having a quitclaim deed in your title is severe. One who is the grantee in a quitclaim deed is not an innocent purchaser without notice, but must take notice of all defects in the title of his grantor. *Woodward v. Ortiz*, 150 Tex. 75, 237 S.W.2d 286 (1951).

Furthermore, it appears that Texas may have pushed this burden further than most states when the court in *Houston Oil Co. v. Niles*, 255 S.W. 604, 609-11 (Tex. Comm'n. App. 1923, holding approved) held that all subsequent grantees in the chain of title are also burdened by any unknown and unrecorded interests that were outstanding at the time of the quitclaim. Therefore, a Texas title relying upon a quitclaim deed anywhere in the chain is not marketable since the possibility remains that it could be defeated by some unknown claimant.

Today many assignments of leases contain quitclaim type granting language, such as "all assignor's right, title and interest". Also, many assignments have disclaimed all warranties. Are these assignment

quitclaims or not? The answer, fortunately, is found in the case of *Bryan v. Thomas*, 365 S.W.2d 628 (Tex. 1963) which construed a conveyance of "all of our undivided interest" in and to the minerals in a described tract of land, together with the general warranty. The court held that the conveyance was not a quitclaim because it conveyed the land itself. The court stated its conclusion at Id. at 630:

> To remove the question from speculation and doubt we now hold that the grantee in a deed *which purports to convey all of the grantor's undivided interest in a particular tract of land*, if otherwise entitled, will be accorded the protection of a bona fide purchaser.

One of the cases the *Bryan* court relied upon is the case of *Cook v. Smith*, 107 Tex. 119, 174 S.W. 1094 (1915), 3 A.L.R. 940, wherein the granting clause of the instrument in question was of "all my right, title and interest" in certain described property, while, following the description of the property, the deed stated:

> ". . . and it is my intention to convey to the said . . . all the real estate that I own in said town . . . whether it is set out above or not."

The court concluded that this language was sufficient to constitute the instrument a conveyance of land rather than conveyance of a mere chance of title. Thus, the grantor was a bona fide purchaser for value who took title free of an earlier executed but later recorded deed in favor of a third party. The *Cook* court described its test at *Id*., page 109:

> "The character of an instrument, as constituting a deed to land or merely a quitclaim deed, is to be determined according to *whether it assumes to convey the property described and upon its face has that effect, or merely professes to convey the grantor's title to the property*." If, according to the face of the instrument, its operation is to convey the property itself, it is a deed. If, on the other hand, it purports to convey no more than the title of the grantor, it is only a quitclaim deed." (Emphasis added.)

Thus, it appears that an assignment of all of assignor's "right, title and interest" in the leases described in Exhibit A should pass the *Bryan* test and allow its assignee to be a bona fide purchaser for value, if otherwise qualified.

The relatively recent case of *Enerlex, Inc. v. Amerada Hess, Inc*., 302 S.W.3d 351 (Tex. App. - Eastland 2009, no pet.) unfortunately raises unnecessary concerns as to the sustainability of the *Bryan v. Thomas* qualification to the Texas quitclaim rule. The mineral deed in *Enerlex*, conveyed "all right, title and interest" in the described *and*, as opposed to "my right, title and interest" or "all right, title and interest that I may own", and contained a general warranty. The Eastland Court of Appeals construed the deed as a quitclaim, depriving the grantee of bona fide purchaser status, because it did not purport to convey any specific percentage interest, such as 1/4 or 1/2, in the tracts, without even discussing *Bryan v. Thomas* or *Cook v. Smith*. It is interesting to note that the cases the court cited for its conclusion did not involve the question of whether the grantee could claim to be a bona fide purchaser for value.

The consequence of having a quitclaim assignment in title was most recently confirmed by the Texas Supreme Court in *Geodyne Energy Income Production Partnership I-E v. Newton Corp*., 161 S.W.3d 482 (Tex. 2005) wherein the Court determined that an assignment which conveyed "all of assignor's right, title and interest" in the described lease "AS IS AND WHERE IS, WITHOUT WARRANTY OF MERCHANTABILITY," was a quitclaim assignment as a matter of law.

V. Effect of Assignment Upon Liability

A. Assignment v. sub-lease distinction

According to generally accepted rules of landlord-tenant law, a transfer by a lessee of all of his interest in a lease for the balance of the remaining lease term is an assignment of the lease, while a transfer of less than the full interest, or a transfer of the full interest for less than the entire remaining term, is called a sub-lease. In the absence of express lease terms to the contrary, neither an assignment nor a sub-lease relieves the original lessee of his obligations to the lessor. An assignee of the lease is said to be in "privity of estate" with the original lessor, permitting the lessor to pursue either the lessee, the assignee or both for breaches of lease terms. A sub-lessee, on the other hand, has no privity with the lessor, and the lessor is generally required to look only to the lessee/sub-lessor for performance of the lease terms. *Hill, supra*, §17.11(1); Brown I, *supra*, at pages 26-39. An oil and gas lease is a different type of conveyance than a conventional real estate lease, and ordinary real property classifications of assignments and sub-leases do not apply to oil and gas leases in most states. Only the states of California and Louisiana presently apply sub-lease principles to assignments of oil and gas leases. *Broussard v. Hassie Hunt Trust*, 231 La. 747, 91 S.2d 762 (1956), 7 O&GR 6. *See also Warren, supra*, at pages 391-412, and *Moore v. Campbell*, 267 F. Supp. 126 (N.D. Tex. 1967),

27 O&GR 111. (In an income tax context, the court held an assignment of overriding royalty to be an assignment and not a sublease.)

B. Liability to Lessor

The original lessee remains liable to the lessor for a breach of an express covenant of the lease occurring after his assignment, unless the lease contains a clause excusing him from further liability after assignment. *Skeeters v. Granger*, 314 S.W.2d 364 (Tex. Civ. App.– Texarkana 1958, writ ref'd n.r.e.), 9 O&GR 771. An example of a clause that will release the lessee of future liability is:

> An assignment of this lease, in whole or in part, shall, to the extent of such assignment, relieve and discharge lessee of any obligation hereunder.

The continued liability of the original lessee to the lessor for the breach of an implied covenant occurring after an assignment of the lease is determined by the classification of the covenant as being either "implied in fact" or "implied in law." If the assignment is implied in fact, the original lessee will continue liable, just as he is liable for an express covenant, despite his assignment of the interest. *Danciger Oil & Refining Co. v. Powell*, 137 Tex. 484, 154 S.W.2d 632 (1941). However, if the covenant is treated as implied in law, the leasehold owner is liable only for breaches of the covenant as may occur during the period of his ownership. See *Merrill, supra* at 317 and Walker II, *supra* at 402-8, 450-1. Liability of the assignee for breach of his assignor's covenants is based on the theory of covenants running with the land. *Hinson v. State*, 245 S.W.2d 755 (Tex. Civ. App. – Austin 1951, no writ), 1 O&GR 491; See Annot., *Covenants in Oil and Gas Leases as Running with the Land*, 79 A.L.R. 496 (1932); Warren, *supra*, at pages 392-99.

However, the parties themselves may allocate liability through express provisions in the lease and in the assignments. As an example, in an assignment from A to B, A might require the following clause:

> B assumes and agrees to comply with, from the date of this assignment, the express and implied covenants created by the oil and gas lease. B agrees to indemnify A against any liability, claim, demand, damage or cost, including litigation costs and attorney's fees, associated with the oil and gas lease and the interest assigned to B that arises on or after the date of this assignment.

In this instance, B should insist upon a reciprocal indemnity from A.

A lessee who desires to obtain release from the lessor for future liability could attempt to have the assignee substituted for the lessee of the lease itself. This is called a "novation" and would require the consent of the lessor. *Mandell v. Hamman Oil & Ref. Co.*, 822 S.W.2d 153 (Tex. App. – Houston [1st Dist.] 1991, writ denied), 118 O&GR 287. To accomplish this same goal without obtaining the lessor's consent, most oil and gas lease forms contain language such as the following:

> In the event of assignments hereof, in whole or in part, liability for breach of any obligation issued hereunder shall rest exclusively upon the owner of this lease, or any portion thereof, who commits such breach.

A more detailed clause addressing the same issue is:

> If lessee assigns all or part of this lease, lessee shall be discharged, as to the assigned portion of the lease, from further liability, whether created by expressed or implied covenant, relating to lease obligations and acts or omissions occurring from and after the effective date of this assignment. Lessee shall remain liable to lessor for any breach of lease obligations, or any other actionable act or omission occurring during, and to the extent of, lessee's ownership of the lease. In the event lessee's assignment fails to bind its assignee to perform lessee's obligations under this lease, lessee's liability to lessor will continue.

A simple clause that the lessor would probably prefer is:

> No assignment nor reassignment shall operate to relieve lessee or its assignees from any liability or responsibility hereunder.

This type of clause makes the lessee a guarantor for the performance of all subsequent assignees. This places the burden upon the present lessee to avoid liability by choosing only responsible assignees, obtaining indemnities from assignees, or obtaining a release from the lessor prior to a subsequent assignment.

C. Liability between Assignors and Assignees

As previously discussed, the liability for express lease covenants is assumed by the ultimate assignee because of the doctrine of covenants running with the land. *Gould v. Schlacher*, 443 S.W.2d 765 (Tex. Civ. App. - Eastland 1969 no writ), 33 O&GR

691. The more difficult question is whether the initial and intermediate assignees are also liable for performance of covenants to the lessor or new covenants to third parties.

Texas Courts have not used consistent theories when they interpret assignments of oil and gas leases. In *Short Expl. & Prod. Corp. v. Exxon Corp*., 796 F. Supp. 514 (N.D. Tex. 1997) the court applied standard landlord/tenant law in determining the liability of the present leasehold owner who failed to give notice to a prior leasehold owner that delay rentals would not be paid to maintain leases. Texaco was both an initial assignee and an intermediate assignee of different leases. The Court held Texaco liable for non-performance of the notice covenant by the present owner where Texaco was the initial assignee, but held Texaco not liable in the instance where Texaco was a remote assignee and subsequently reassigned to a third party.

Applying general contract law, the Texas Supreme Court held both the present leasehold owner, and its assignor Seagull, liable for plugging costs pursuant to standard form offshore JOAs. *Seagull Energy E&P, Inc. v. Eland Energy, Inc*. 207 S.W.3d 342 (Tex 2006). The simple rule of contract law was that an assignor remains liable after an assignment unless the assignment contains a contrary agreement. A simple clause intended to protect an assignor from liability for his assignee's subsequent conduct is:

> Assignee agrees to be solely liable for the breach of any obligation, covenant or promise occurring while Assignee owns the leasehold estate assigned.

A particular assignor and assignee cannot alter their liability to the original lessor or to previous leasehold owners without the consent of these parties. However, an assignor and assignee can agree within the assignment how their individual liabilities can be shared. This is usually done utilizing mutual indemnities.

D. Allocating Leasehold Burdens

To illustrate the allocation of leasehold burdens among the parties to an assignment, we consider the following illustration:

> Lessor A leases to B and retains a 3/16 royalty. B assigns a 1/16 of 8/8 overriding royalty in the lease to X. B next assigns an undivided interest in the lease to C. B and C determine the allocation of X's overriding royalty by agreement. Normally, the parties bear existing burdens proportionately. In the absence of an agreement, the allocation of X's burden between A and B depends on A's warranty and X's recordation.

If X records his assignment creating the overriding royalty, all subsequent assignees will take with notice of and be subject to X's interest. If A gave a warranty, and failed to except X's interest from the warranty, C could claim a breach of warranty against B and claim that his revenue should not be reduced by X's interest. If the assignment to B simply conveys an interest in the lease without warranty against outstanding interests, it is not legally clear how the burden of X's interest will be shared. Hemingway, *supra*, at 9.8. However, as previously stated, it is the industry custom that leasehold owners will bear their proportionate share of all burdens created at or prior to the time each acquires its leasehold interest.

E. How Failure to Record Timely Affects Liability

Since an assignment of an oil and gas lease is a transfer of an interest in land, recording the assignment in the county real property records provides notice to the world of the change in ownership. Tex. Prop. Code Ann. §13.001(a) (West 2004) provides in part:

> A conveyance of real property or an interest in real property... is void as to a creditor or to a subsequent purchaser for valuable consideration without notice unless the instrument has been acknowledged, sworn to, or proved and filed of record as required by law.

If the assignment is given as security, additional filing may be necessary to perfect the security interest in personal property. U.C.C. 9-302 (1997) and 9-305 (1999). Satisfying the recording requirements is crucial because subsequent purchasers or lenders without notice can defeat the unrecorded assignment. Sec. 13.001(a) *supra.*

Another reason an assignment should be recorded quickly is that if an assignor files a petition for bankruptcy prior to the assignee's recording the assignment, the bankruptcy trustee will have the rights of a bona fide purchaser of real property. 11 U.S.C. §544(a)(3). The trustee will be able to assert rights in the assigned property superior to the assignee's. *Id*.

Another common instance where delivering an assignment or recording an assignment may be delayed, is where B agrees to participate with A in drilling a well and A is reluctant to give B an assignment until B has paid its share of the drilling costs. Before A delivers to

B a recordable assignment, A mortgages the oil and gas lease to C and conveys a portion of the lease to D. If C and D lack actual notice of the prior intention to assign to B, then the rights of C and D will be superior to those of B. See Tex. Prop. Code Ann. §13.001(a) (West 2004). The only way B can protect the leasehold interest he expects to receive from A is to promptly record his assignment from A before A conveys or mortgages his interest in a manner that reduces what B is entitled to receive. However, before an assignment can be recorded, it must be duly executed and acknowledged or sworn. See Tex. Prop. Code Ann.§12.001 (West 2004).

VI. Restrictions on Assignments

Absent an express limitation on assigning, a lessee can freely assign rights in an oil and gas lease. *Heffington v. Hellums*, 212 S.W.2d 245 (Tex. Civ. App. - San Antonio 1948, writ ref'd n.r.e.). Most modern leases contain explicit language providing for free assignment, such as:

> The interest of either lessor or lessee hereunder may be assigned, devised or otherwise transferred, in whole or in part, by area and/or by depth or horizon, and the rights and obligations of the parties hereunder shall extend to their respective heirs, devisees, executors, administrators, successors and assigns.

The estate of either party hereto may be assigned in whole or in part.

Terrell v. Munger Farm Co., 129 S.W.2d 407 (Tex. Civ. App. - Fort Worth 1939, writ denied).

Standard "form" oil and gas leases did not contain restrictions on assignments. However, with the advent of word processor-generated lease forms, it is becoming increasingly common that oil and gas lessors require some form of "consent" or "notice" prior to their lease being assigned. The following examples of contract language, rewritten as if contained in an oil and gas lease, have been utilized to create consent-notice requirement:

1. "The rights of lessee shall not be assigned without the written consent of lessor."
2. "The rights of lessee shall not be assigned without the written consent of lessor, which consent shall not be unreasonably withheld."
3. "No conveyance or assignment of any of the rights granted to lessee hereunder shall ever be made unless such conveyance or assignment transfers all of the rights granted to lessee hereunder. Any transfer of less than the entire interest of lessee shall result in a forfeiture of all rights granted hereunder."
4. "The rights of lessee are not assignable without the prior written consent of lessor, and any attempted transfer without prior written consent of lessor shall be void ab initio and without any effect."
5. "Upon the failure of lessee, its successors and assigns, to give lessor notice within 30 days of the name and address of any assignee, then lessee, its successors and assigns, shall jointly and severally forfeit and pay to the lessor the sum of $1,000.00 per assignment as liquidated damages.

The cases discussing these clauses, identified as clauses 1-5, are discussed below. *Cross*, at pp 23-27.

Clause 1 is essentially the language contained in the deed at issue in the case of *Haskins v. First City Nat'l Bank*, 698 S.W.2d 754 (Tex. Civ. App. - Beaumont 1985, no writ). In *Haskins*, parents conveyed a tract of land to their son, reserving to themselves a life estate for their joint lives, also reserving the right to approve of a subsequent sale of the land by their son. After the deaths, the son could transfer freely. The son granted a deed of trust lien which was foreclosed by the defendant bank while the parents were alive. The restraint language was construed by the court as a covenant which was breached by the foreclosure, but the covenant was not a prohibition to the foreclosure. *Id.* at 756. The court held that the parents' only available remedy was cause of action for breach against their son. Id. The bank acquired the land free of the consent requirement but subject to the outstanding life estate. *Id.* at 757.

Clause 2 was at issue in the case of *Palmer v. Liles*, 677 S.W.2d 661 (Tex. App. - Houston [1st Dist] 1984, writ ref'd n.r.e.). This restrictive language was contained in instruments between co-owners of an oil and gas lease. The court held that the transfer of the leasehold interest without the plaintiff's approval breached the agreement, but that the plaintiff must show damages from the transfer. Thus, like *Haskins*, the court allowed the seller to ignore the consent requirement with impunity.

In the case of *Mitchell's Inc. v. Nelms*, 454 S.W.2d 809 (Tex. Civ. App. - Dallas 1970, writ ref'd n.r.e.), also involving language similar to that of Clause 2, the seller attempted to obtain the required consent. In this commercial lease case, the lessee requested approval of a sub-lease from the landlord and the landlord refused. The sub-lease was not consummated and the lessee sued for damages. The landlord prevailed

in a non-jury trial, and the judgment was affirmed on appeal. The appellate court held that the trial court's findings of fact and conclusions of law supported the landlord's reasonable refusal. The prospective sub-lessee did not have a cause of action against the landlord who withheld consent because the prospective sub-lessee was not a party to the lease/contract in question. *See Oliver Resources P.L.C. v. Int'l Finance Corp*., 62 F.3d 128, 131 (5th Cir. 1995).

Consent provisions that establish forfeiture as a penalty for a breach will not generally be enforced. The language in *Clause 3* above resembles the language contained in a deed conveying a ½ mineral interest in *Outlaw v. Bowen*, 285 S.W.2d 280 (Tex. Civ. App. - Amarillo 1955, writ ref'd n.r.e.). The restriction contained in the *Outlaw* deed was held to be void because there was not an enforceable penalty provided in the event the consent requirement was ignored. *Id*. at 283. While forfeiture is in fact a penalty, the court must have considered forfeiture as too extreme a penalty to be considered.

An automatic termination provision, such as Clause 3, was not given effect in *Knight v. Chicago Corp*; 183 S.W.2d 666 (Tex. Civ. App - San Antonio 1944), *aff'd*, 188 S.W.2d 564 (Tex. 1945), where the court interpreted the following language in an oil and gas lease:

> In the event lessee, its successor or assigns should attempt to assign any undivided interest, overriding royalty or oil payments without the written consent of lessors... this lease shall ipso facto terminate as to the interest so assigned, as well as all of the remaining interest owned by the person or corporation making such assignment.

Knight, 183 S.W.2d at 668.

The Court of Civil Appeals rejected the "ipso facto" concept and decided that a consent provision that makes the grantor's consent a pre-condition to an assignment will always be a condition subsequent, requiring a re-entry or termination action by the grantor, rather than a limitation resulting in automatic reversion or forfeiture. *Id*. at 671. The Court of Civil Appeals also held that any restraint that purports to prohibit "attempts" or "offers" to sell is void for vagueness. *Id*.

Since there are problems in connection with consent requirements and forfeiture penalties, the lessor/assignor who wants to restrict assignability of an oil and gas lease may choose the "non-assignability" option for a lease by using language similar to *Clause 4*. *Clause 4* is a rendition of the language in the deed at issue in *Soper v. Medford*, 258 S.W. 2d 118, 120 (Tex. Civ. App. - Eastland 1953, no writ), where the deed provided that the conveyed land was "never to be sold or traded off." The court held the provision void saying:

> Since it was a conveyance of the fee simple title to the lots, the provision that they were "never to be sold or traded off" is repugnant to the grant and should be disregarded.

Id. at 112.

The plaintiff was more successful suing to enforce a clause like *Clause 5* in *Trafalgar House Oil & Gas Inc. v. De Hinojosa*, 773 S.W.2d 797 (Tex. App. - San Antonio 1989, no writ). The test for determining if liquidated damages are enforceable is:

> ". . . if the amount provided for is a reasonable estimate of harm that would be caused by a future breach, and the anticipated damages resulting from a breach are difficult to ascertain. *Rio Grande Valley Sugar Growers, Inc. v. Campesi*, 592 S.W.2d 340, 342 n.2 (Tex. 1979) . . . . If, however, the clause for liquidated damages, is merely a penalty to induce performance of a contract, it is unenforceable. *See Campesi*, 592 S.W.2d at 343. . . ."

The court enforced the liquidated damage provision of $1,000 for each assignment as to 20 assignments. The court acknowledged the lessor's legitimate interest in knowing, at all times, who owned the leasehold estate covering his land, and it acknowledged the difficulty in determining actual damages from a breach of this clause.

Summarizing from the above, it appears that courts will only enforce reasonable, not absolute, restrictions upon assigning leases and the only remedy for breach appears to be damages which are reasonable and ascertainable.

VII. Problems Associated with Non-Operating Interests

Non-operating interests, such as overriding royalty, production payments, net profits interests, and carried interests, all depend upon the continued validity of the underlying oil and gas lease. Termination of the lease terminates the non-operating interest. *Keese v. Continental Pipeline Co*., 235 F.2d 386, 388 (5th Cir. 1956), 6 O&GR 364.

The most common types of non-operating interests are defined as follows:

1. Overriding royalty - an interest in oil and gas produced at the surface, free of the expense of production, and carved from the working interest held under an oil and gas lease. *T-Vestco Litt-Vada v. Lu-Cal 1 Oil Co*., 651 S.W.2d 284 (Tex. Civ. App. - Austin, 1983, no writ);
2. Production payment (or oil payment) - an interest created out of the lessee's estate which is a share of the minerals produced from the described premises, free of the cost of production at the surface, terminating when a given volume of production has been paid or when a specified sum from the sale of production has been realized. Oil payments may be reserved by a lessor, by an assignor of a lease, or carved out by the owner of a working interest or royalty interest. *Tennant v. Dunn*, 130 Tex. 285, 110 S.W.2d 53 (1937);
3. Net profits interest - a share of gross production carved out of the working interest, measured by net profits from operation of the property. 2 *Williams & Meyers*, supra at §424; and
4. Carried interest - a fractional interest in oil and gas property, usually a lease, the holder of which (the carried party) has no personal obligation for operating costs, which are to be paid by the owners of the remaining fraction (the carrying party), who reimburse themselves therefor out of production, if any. *Ashland Oil & Ref. Co. v. Beal*, 224 F.2d 731 (5th Cir. 1955), 5 O&GR 387.

Brown I, *supra*, at pages 50-67 and Terrell II, supra, at pages 4-1 to 4-27.

In addition to all of the above being carved out of the leasehold interest, they have the following additional common characteristics:

1. Each is payable only out of production under the applicable lease - no absolute obligation to pay money exists;
2. Each is a non-possessory interest, and therefore the owner of each has no right to operate the applicable property - instead, his right is only to receive his share of minerals or income therefrom when they are produced; and
3. The owner of each has no obligation to bear the costs of developing and operating the applicable lands.

Byrd v. Smyth, 590 S.W.2d 772 (Tex. Civ. App. - El Paso 1979, no writ).

A. Accidental Termination

The primary conditions in an oil and gas lease are the payments of delay rental, shut-in royalty, and production in paying quantities pursuant to the habendum clause. Thus, it is possible that a lease burdened by a non-operating interest can terminate accidentally by failure to make a delay rental or shut-in royalty payment properly, or failure to commence operations within the time period of the savings clause. If the lease terminates accidentally, courts generally deny recovery by a non-operating interest owner, unless liability is imposed by contract, *McLaughlin v. Ball*, 431 S.W.2d 305, 305-306 (Tex. 1968), 30 O&GR 393, *Gould v. Schlachter*, 443 S.W.2d 764 (Tex. Civ. App. - Eastland 1969, no writ), or by custom and usage, *Energen Resources MAQ, Inc. v. Dalbosco*, 23 S.W.3d 551 (Tex. App. - Houston [lst Dist.] 2000, pet. denied). Since mere drafting cannot prevent the working interest owner from making mistakes, the parties should specify the consequences of accidental termination by providing for indemnity in the event of accidental termination.

B. Intentional Termination

There are two different categories of intentional termination. First, a lessee can, for legitimate business reasons, surrender a lease or allow it to expire. Second, a lessee can terminate a lease in order to eliminate a non-operating interest. Unless there is limiting language in the assignment, the lessee can terminate the lease for legitimate business reasons without consulting non-operating interest owners. *In re GHR Energy Corp.*, 972 F.2d 96 (5th Cir. 1992); s*ee also McCormick v. Krueger*, 593 S.W.2d 729 (Tex. Civ. App. – Houston [1st Dist.] 1979, writ ref'd n.r.e.), 66 O&GR 372. In order to avoid a subsequent dispute, the working interest owner should state, in the assignment, that he has the right to surrender or terminate the lease. On the other hand, a non-operating interest owner could insist upon an opportunity to acquire the lease before reversion. A clause such as the following could protect the non-operator's interests:

> Assignor will not surrender, abandon, or otherwise permit or cause the lease to terminate without offering to reassign the lease to assignee at lease thirty days prior to any action or inaction by assignor which would terminate the lease.

The operator could insist upon amending the clause to provide an exception in the event of the lessee's negligence, such as not paying a delay rental properly. The operator could also seek to limit the measure of damages in the event the lease terminates without the lessee complying with this duty/covenant.

Without such a limitation as to the measure of damages, the loss appears to be the value of the entire unassigned lease, not the value of the pre-existing non-operating interest. *McLaughlin*, 431 S.W.2d at 306-307 (non-operating interest owner entitled to damages equal to the value of the unassigned leasehold interest).

An operator may intentionally terminate the lease and obtain a new lease on the same property in order to destroy the non-operating interests. This is called a "washout". An assignment may attempt to limit a "washout", where the assignment reserves an overriding royalty, by including a statement such as:

> This reservation shall apply as to all modifications, renewals of such lease, or extensions that the assignee, his successor or assigns may secure.

In the event the lessee obtains a new lease upon the property while the prior lease was still in effect, courts in states like Oklahoma and Kansas, which consider the working interest owner and overriding royalty owner as having a fiduciary relationship, would likely impose the overriding royalty burden of the old lease upon the new lease. *Probst v. Hughes*, 143 Okla. 11, 286 P. 875 (1930); *Howell v. Cooperative Refining Assoc.*, 176 Kan. 572, 271 P.2d 271 (1954). The court in *Probst*, 286 P. at 877, in discussing the relationship of overriding royalty owner and the lessee, held that the lessee occupied a "position of trustee" and was "duty bound to act in the utmost good faith" for the non-operating interest owner's benefit. See Brown II, supra, §11.05. An example of a clause that creates a fiduciary relationship is:

> Assignee owes assignor a fiduciary duty to deal with the leased property in a manner that will protect and enhance the assignor's overriding royalty interest from any action or inaction by assignee, its successors and assigns, that could impair or terminate the assignor's interest in, and right to receive, overriding royalty from the leased land.

Pierce II, *supra* at J-12.

Texas courts have not held that the relationship between the working interest owner and an overriding royalty owner is fiduciary. In the often cited case of *Sunac Petroleum Corp. v. Parkes*, 416 S.W.2d 789 (Tex. 1967), 26 O&GR 689, the Supreme Court held that the assignment creating the overriding royalty was not binding upon a "renewal or extension" of the lease. The lessee formed a pooled gas unit, drilled a well on the pooled acreage but completed an oil well after the primary term of the non-drillsite leases had expired. Believing the non-drillsite leases were held by the production from the oil well, the lessee drilled a second well upon an adjacent pooled tract. Later, the lessor claimed that the lease upon which the second well was drilled had terminated because the pooling for gas was ineffective because the first well was completed as an oil well. The lessee purchased a new lease from the lessor and then stopped paying the overriding royalty owner who burdened the old lease. The overriding royalty owner claimed the renewal or extension clause encompassed the new lease.

The court first concluded that the non- drill site lease had terminated due to the improper pooling. Id. at 802. Therefore, at the time the new lease was obtained, no lease existed between the landowner and the lessee. The court held that the new lease was not an extension or renewal of the old lease by stating:

> ". . . The new lease was executed under different circumstances, for a new consideration, upon different terms, and over a year after the expiration of the old lease. . . ." *Id*. at 803.

While acknowledging the Kansas and Oklahoma cases, the Texas court stated that the existence of a fiduciary relationship would depend upon the facts of each case. *Id*. at 805.

The assignment in the *Sunac* case contained the following provision:

> There shall be no obligation, express or implied, on the part of assignee, its successors or assigns, to keep said lease in force by paying the rentals or drilling or development operations, and assignee shall have the right to surrender all or any part of such leased acreage without the consent of assignor. *Id*. at 804.

The court found that this clause relieved the lessee of any duty to develop the land or to continue the lease in force. *Id.* at 804. It is this writer's experience that this type of clause, negating a duty of the working interest owner to maintain or develop, is rarely contained in an assignment creating an overriding royalty.

An example of a renewal and extension clause that might have required a different result in the Sunac case, because it covers any new lease obtained within a stated period of time after termination, is:

> The obligation to pay the overriding royalty required by this assignment will exist for the life of the oil and gas lease, plus any extension or

> renewals of the lease. For purposes of this section, any leasehold interest acquired by Assignee within _____ years following the termination, cancellation or surrender of the oil and gas lease will be deemed an "extension or renewal". Pierce I, at 969. However, the rights created by this extension or renewal clause will only apply to any leasehold interest or other development right acquired by assignee within 21 years from the date of this assignment.

Pierce II, *supra* at J-12.

If the Texas non-operating interest owner desires to create a fiduciary relationship with its working interest owner, language like the following could be used:

> Lessee owes overriding royalty owner a fiduciary duty to deal with the leased property in a manner that will protect the overriding royalty owner's interest against any action or inaction by the lessee, or its successors and assigns, that could impair or terminate the overriding royalty owner's rights under this assignment.

Pierce I, *supra* at 970.

Such a provision would constitute the basis to impose a constructive trust against any interest the lessee may subsequently obtain in the property which tends to defeat or diminish the non-operator's interest. This provision would also become a defense in the event the working interest owner claimed the renewal and extension clause violated the rule against perpetuities. *Independent Gas & Oil Producers, Inc. v. Union Oil Co.*, 669 F.2d 624, 628 (10th Cir. 1982); *Cities Service Co. v. Ohio Petroleum Co*., 345 F. Supp. 28 (W.D. Okla 1972). The lessee, however, should be reluctant to agree to such a broad clause creating the fiduciary duty because it could also imply additional obligations, such as a duty to develop or a duty to protect against drainage.

C. Implied Covenants

If the assignment is silent concerning the lessee's obligation to develop the leased land, or to protect the leased land from drainage, the non-operating interest owners could claim that they benefit from the same type of implied covenant that protects lessors. The Texas Supreme Court, *Bolton v. Coats*, 533 S.W.2d 914 (Tex. 1976), 53 O&GR 379, recognized an implied covenant by the lessee to protect an overriding royalty owner against drainage. The court acknowledged that the situations of the lessor and the non-operating owner are analogous, and stated:

> Unless the assignment provides to the contrary, the assignee of an oil and gas lease impliedly covenants to protect the premises against drainage when the assignor reserves an overriding royalty. *Id*. at 916.

The extent to which the non-operating interest owner is the beneficiary of all the implied covenants available to lessors in still unclear. Williams & Meyers at §355-56.

Many assignments creating overriding royalties contain express language whereby the creating party retains the right to pool the overriding royalty owner without its consent. However, the assignment involved in the following case did not address the power to pool. In a case of first impression in Texas, the court in Union *Pacific Resources Co. v. Hutchison*, 990 S.W.2d 368 (Tex. App. - Austin 1999, no writ), 141 O&GR 622, held that a lessee/assignee has the right to pool an overriding royalty owner without the consent of the overriding royalty owner. The court's reasoning was that, absent restrictive language, the present leasehold owner receives all of the rights originally granted to the lessee in the base lease, including the right to pool an overriding royalty owner without its consent.

VIII. Conclusion

It is the author's hope that he has included enough sample clauses, for both assignments and oil and gas leases, that the reader will find some language that he can use to improve his daily practice.