

Chapter 4

The Creation of Varying Mineral Interests

Mineral Conveyances or Reservations




It is not uncommon, in a chain of title, to see a land owner sell an interest in the surface estate but reserve either a portion of or all of the minerals beneath the tract of land. The following are general rules of construction that might apply to conveyances that contain mineral reservations.

1. Since it is presumed that the grantor drafted or selected the wording in the deed, when issues arise, the deed is most generally interpreted against the grantor rather than the grantee. *Coley v. Williams*, 98 Okla. 143, 224 P. 345 (1924).
2. If the conveyance is determined to be complete, clear, and unambiguous, the intention of the parties will be determined by an examination of the words in the deed itself and will not rely on external or oral evidence. When a contract is reduced to writing, the intention of the parties is to be ascertained from the writing alone (The four corner's rule).
3. In most states, a reservation or exception made to a third party or stranger in title is not allowed. Example: Abe, a fee simple absolute owner cannot deed the surface lands to Ben and reserve the mineral estate to Carl, a stranger in title.
4. The general rule is that the granting clause in a deed determines the interest conveyed.

When fractional pieces of the mineral estate are being conveyed or reserved

When fractional pieces of the mineral estate are being conveyed or reserved, three different types of approaches can be used to describe the interest either being conveyed or reserved. Assume that Abe, the owner of 100% of the minerals under a 160-acre tract of land, is conveying an undivided

interest to Betty from the lands being described. The grantor can use the "Fractional Approach," the "Percentage Approach," or the "Mineral Acre Approach."

<p>The "Fractional Approach"</p>  <p><i>"Abe hereby conveys...an undivided 1/2 interest in and to all of the oil, gas and other minerals..."</i></p>	<p>The "Percentage Approach"</p>  <p><i>"Abe hereby conveys...an undivided 50% interest in and to all of the oil, gas and other minerals..."</i></p>
<p>The "Mineral Acre Approach"</p>  <p><i>"Abe hereby conveys...80 mineral acres in and to all of the oil, gas and other minerals..."</i></p>	<p>In each of these approaches Betty is granted an undivided 80 net mineral acres.</p>




When the *mineral acre* approach is used, the land professional should understand that *one* mineral acre is the same as 100% of the minerals in *one* acre of land. In other words, Abe would be conveying a net of 80 mineral acres to Betty, but they are located throughout the entire described lands rather than in one quadrant of the land.

If Abe owned 640 acres rather than 160, and conveyed 80 mineral acres to Betty, he would be conveying 1/8th or 12.5% of the minerals under the tract of land.

In many cases, the land professional will see a deed that contains language similar to the following: "Abe hereby conveys...80/640ths interest in and to all of the oil, gas, and other minerals..." It appears that when this language is used, the fraction is directly tied back to the mineral acres being conveyed (the smaller number or numerator) and the gross acres in the described tract of land (the larger number or the denominator).




Owners of large tracts of land very often used such language when conveying or reserving minerals.

Scenario 1: Assume that Abe owns 2,345 gross acres and wishes to convey 5 net mineral acres from the land to Betty. He could use any of the three approaches.

<p>The "Fractional Approach"</p>  <p><i>"Abe hereby conveys 5/2345th interest in and to all of the oil, gas and other minerals..."</i></p>	<p>The "Percentage Approach"</p>  <p><i>"Abe hereby conveys an undivided .213220% interest in and to all of the oil, gas and other minerals..."</i></p>
<p>The "Mineral Acre Approach"</p>  <p><i>"Abe hereby conveys...5 mineral acres in and to all of the oil, gas and other minerals in and under the described lands..."</i></p>	<p>In each of these approaches Betty is granted an undivided 5 net mineral acres.</p>

Scenario 2: From time to time, the land professional may see a fraction like 5/2345 on a deed that does not describe all 2,345 acres. For instance, Abe may convey to Betty a 5/2345th mineral interest on a deed that only describes a 160-acre tract of land. In all likelihood, the 160-acre tract of land was, at one time, a part of the larger 2,345 acreage. In this case, the result would be different and Betty would not receive 5 net mineral acres. Instead, Abe would be conveying 5/2345 of the 160 acres or .3411513 net mineral acres to Betty.

Scenario 3: Read the following and answer the questions.

<p>The "Fractional Approach"</p>  <p>Assume Abe conveys "a 10/4557th interest in and to all of the oil, gas and other minerals..." and the deed describes a 40-acre tract of land.</p>	<p>The "Percentage Approach"</p>  <p>What percent of the tract of land has he conveyed to Betty?</p> <hr/>
<p>The "Mineral Acre Approach"</p>  <p>How many "Mineral Acres" has he conveyed to Betty?</p> <hr/>	<p>Which of the three approaches makes the most sense to you?</p>

ANSWER: Abe has conveyed .219443% of the land to Betty ($10 / 4557 = .00219443$). Abe has conveyed .08777704 net mineral acres to Betty ($40 \times 10 / 4557$).

The Granting or Reserving of "Royalty Acres"

The land professional must make a distinction between the term "royalty acre" and "mineral acre." Because royalty acre is not often used today, when it does appear, confusion may follow. Usually, it can be seen in older instruments when the standard lease royalty was $1/8^{\text{th}}$.







With that being said, there would be a total of 8 royalty acres in one mineral acre. The oil company would receive 7 of them and the landowner would receive 1 of them. Owning a one *net royalty acre* would give a person the right to receive a $1/8^{\text{th}}$ royalty on that one acre with $7/8^{\text{th}}$ going to the oil company.

Scenario 1: Assume Abe owned a 100-acre tract of land under a $1/8^{\text{th}}$ royalty lease. This would equal 800 royalty acres (100×8). The oil company would be entitled to 700 royalty acres and Abe would be entitled to 100 royalty acres. Calculating royalty acres is based on the number of acres

in the tract of land $\times 8$; multiplied by the percentage of royalty in a lease (100 acres $\times 8 \times 1/8^{\text{th}} = 100$ royalty acres).

If Abe had negotiated a $3/16^{\text{th}}$ lease the outcome would be $100 \times 8 \times 3/16 = 150$ royalty acres.

Scenario 2: Assume that Abe owned a second tract of land of 120 acres and he negotiated a $3/16^{\text{th}}$ lease royalty with Provision Petroleum. How many net royalty acres does he own? Also, assume that Abe conveyed "60 royalty acres" to Betty. What percent of production will each owner receive?

<p>Abe negotiated a $3/16^{\text{th}}$ lease royalty on his 120-acre tract of land.</p>    <p>Abe</p>	<p>How many net "royalty acres" does Abe own?</p> <p>$120 \times 8 \times 3/16 = 180$</p> <p>If Abe had leased for a $1/5^{\text{th}}$ royalty, how many net royalty acres would he own?</p> <p>_____</p>
<p>Abe conveyed "60 royalty acres" to Betty</p>    <p>Abe</p> <p>Betty</p>	<p>What percent of production will each owner receive?</p> <p>Provision _____</p> <p>Abe _____</p> <p>Betty _____</p>

NOTE: Betty was conveyed 60 "royalty acres," not 60 mineral acres. If she had been conveyed mineral acres she would have received 50% of the minerals in the 120-acre tract of land. With royalty acres the outcome will be different.

ANSWER: Total royalty acres ($120 \times 8 = 960$)

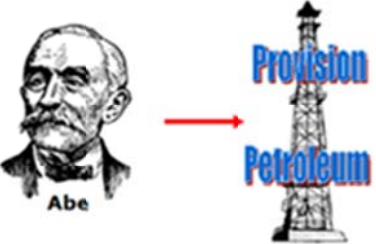

Royalty acres going to Abe and Betty ($120 \times 8 \times 3/16 = 180$)

Royalty acres going to Provision Petroleum ($120 \times 8 \times 13/16 = 780$. This gives Provision an 81.25% of all production $780/960 = 81.25\%$.)

Royalty acres going to Betty ($60 / 180 \times 3/16 = 6.25\%$ royalty from all production).

Royalty acres going to Abe ($120 / 180 \times 3/16 = 12.5\%$ royalty from all production).

Scenario 3: Assume that Abe owned a 210-acre tract of land and negotiated a $1/5^{\text{th}}$ royalty with Provision Petroleum. Subsequent to the lease, he conveyed "a 15 acre royalty interest" to Betty. Answer the following questions:

<p>Abe negotiated a $1/5^{\text{th}}$ lease royalty on his 210-acre tract of land.</p> 	<p>How many net "royalty acres" does Abe own?</p> <p>_____</p>
<p>Abe conveyed "a 15 acre royalty interest" to Betty</p> 	<p>What percent of production will each owner receive?</p> <p>Provision _____</p> <p>Abe _____</p> <p>Betty _____</p>

ANSWER: Total royalty acres ($210 \times 8 = 1680$)

Royalty acres going to Abe and Betty ($210 \times 8 \times 1/5 = 336$)

Royalty acres going to Provision Petroleum ($210 \times 8 \times 4/5 = 1344$. This gives Provision 80% of all production $1344/1680 = 80\%$.)

Royalty acres going to Betty ($15 / 336 \times 1/5 = .89285\%$ royalty from all production).

Royalty acres going to Abe ($321 / 336 \times 1/5 = 19.10715\%$ royalty from all production).

The Granting of “Minerals” or “All other Minerals”

In most states, a grant or a reservation that cites “minerals” or “all other minerals” will include oil, gas, and all component and constituent hydrocarbons. A Colorado Supreme Court case in 2000, ruled that a deed or reservation using the term “other minerals” has been, as a well-established matter of law, interpreted to include oil and gas minerals. *McCormick et.al. v. Union Pacific Resources Company, et. al.*

Some states, however, began to limit and restrict the type of minerals when the conveyance or reservation used the term “all minerals,” especially if the extraction method of the minerals would cause the total destruction of the surface lands.

Because of this, when a grant or reservation intends to include oil, gas, and *all other minerals*, West’s Colorado Practice Series suggests the following language be used:

“all minerals of whatsoever kind or character in, under, and upon or that might be produced from the herein described lands...”

When a grant or reservation intends to include only oil and gas minerals, West’s Colorado Practice Series suggests the following language be used:

“all oil, gas, and all constituents thereof in, under or that might be produced from the herein described lands...”

When a grant or reservation wishes to specify certain minerals without any exclusion of other minerals, C. Elaine Carleton and Lauren Matthews, suggest that the following language could be used:

“all minerals of whatsoever kind or character, including without being limited thereto, oil, gas and their constituents thereof and coal, and..., in, under, and upon or that might be produced from the herein described lands.”

Everything You Wanted to Know About Oil & Gas Interests (But Were Afraid to Ask)

Royalty Ownership

A royalty interest is a “cost free” percentage out of the production from an oil or gas well. Cost free means that royalty owners would not pay any of the costs associated with drilling a well or any of the monthly operating costs associated with the well.

The word “royalty,” as used in connection with oil and gas leases, conveyances, and reservations, has a definite meaning in its popular sense. It means a share of the products, or proceeds therefrom, reserved to the owner of land for permitting another to use the property. *McCullough v. Almach*, 188 Okla. 434 (Okla. 1941).

The Landowner’s Royalty – This royalty is established at the time the mineral owner negotiates the oil and gas lease and becomes the fractional percentage of production that would go to the owner. Just as an author of a bestselling novel would receive royalty checks based on the sales of his or her book, this royalty owner would receive a royalty payment based on the production of a producing well. Originally, the standard royalty rate paid the mineral owner was 1/8th of all production. Over the years, royalty rates have increased. In some parts of the country, many landowners have negotiated very high royalties, some with sophisticated consequences.

The Escalating royalty: With this language, the royalty rate would, at some point, increase. In the following example, the before payout royalty would increase once the well reached payout.

“The royalties payable to the Lessor under this lease shall be on a well by well basis and on a Before Pay Out (BPO) and After Pay Out (APO) basis.” As to each and every well completed as a producer on the leased premises or on lands pooled therewith, the royalties paid to Lessor shall be one-eighth (1/8) BPO and one-fifth (1/5) APO.

The Sliding Scale Royalty: The North Dakota Industrial Commission (NDIC) has approved 640 acre spacing for the minimum size Bakken well. The operator, however, can apply for and receive 1,280 acre spacing for their unit sizes. Some attorneys, representing their mineral owner clients, are insisting on “sliding scale royalty” language when the spacing becomes greater than the minimum 640 permitted by the NDIC.

The result of such added language can be significant. For instance, assume the lessor negotiated a 18.75% royalty with a sliding scale royalty increase of 35% if the unit size increased from 640 acres to 1280 acres. The result would be (18.75% X 1.35% = 25.3125% royalty).

Overriding Royalty – This royalty is a cost free royalty and typically is established by the lessee who agrees to carve out a fractional portion in his

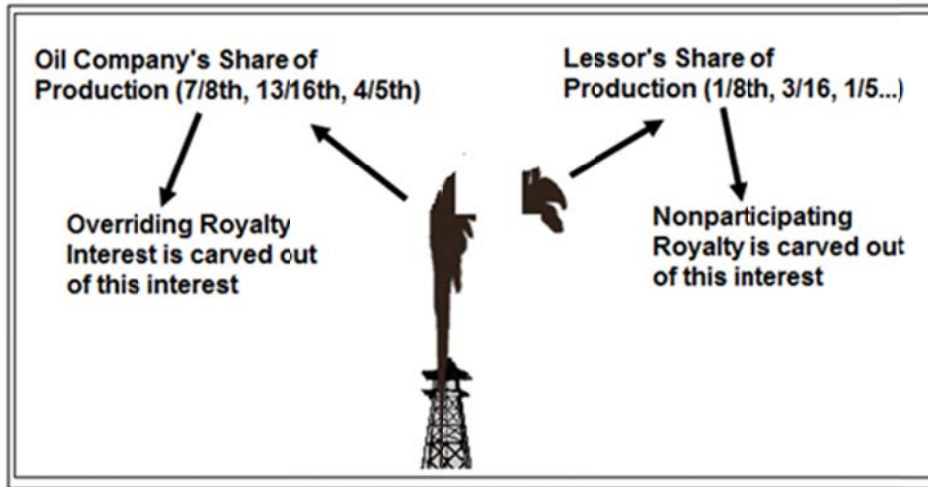
share of the production and give it to a third party. Because it is carved out of the working interest owner's leasehold interest, it will terminate when the lease terminates. An override is often created in order to compensate a party who has helped to develop a drilling project or by an oil company when they assign either all or a portion of their leases to another company.

Nonparticipating Royalty Interest (NPRI) – Mineral owners can convey either all or a part of their *royalty* interest in a tract of land to a non-mineral owner. It is often assumed that this transaction cannot take place prior to the creation of the oil and gas lease since no true “royalty” exists prior to the lease. Most states would reject this thought and allow a conveyance or reservation of royalty to take place before the lease has been executed. An exception to this is seen in Oklahoma courts, where a conveyance of a “royalty” interest prior to a lease is treated as a conveyance of a mineral interest. *Melton v. Sneed*, 188 Okla. 388, 109 P.2d 509 (1940).

Once the royalty is severed from the mineral owner, it can be referred to as a *nonparticipating royalty* and will contain some distinguishing characteristics.

- 1) Nonparticipating owners have no right to explore for or remove the minerals from the land.
- 2) They have no ingress or egress rights.
- 3) They have no right to grant an oil and gas lease.
- 4) They have no right to share in the bonus or delay rental payments.

If the language in all deeds that created a nonparticipating royalty interest described these distinguishing characteristics similarly, there would be no confusion. However, deeds are often difficult to interpret. There have been times that a deed designated as a “mineral deed” actually conveyed royalty, and times when a deed entitled “royalty deed” actually conveyed minerals. Such royalty conveyances or reservations are often deemed to be ambiguous; therefore, the land professional must look to the intent of the parties as found on the face of the deed. *Mitchell v Hannah*, 208 P.2d 812 (MT 1949). *Stokes v Tutvet*, 328 P.2d 1096 at 1101-1104 (MT 1958) and *Proctor v Werk*, 714 P.2d 171, 173 (MT 1986).



What does the language in the deed mean?

"Mineral," "Mineral Interest," or "Mineral Acres"

At first glance, the land professional would assume that words such as "*mineral*," "*mineral interest*," or "*mineral acres*" would be describing a mineral interest. Under the Rules of Construction, if the conveyance or reservation used such words but later referenced other characteristics that would describe a royalty interest, these later characteristics might very well convey or reserve a royalty interest instead of a mineral interest.

"In, on, and under"

When such language is used, courts have most often determined that the interest being conveyed or reserved is still *in, on, and under the land*; and therefore, would be describing a mineral interest.

"In, on, and under and that which may be produced"

This language is often used to create a mineral interest, since it refers to that which is yet to be produced. According to Williams and Meyers, *Oil and Gas Law*, when this phrase stands alone, it will create a mineral interest.

"That which may be produced"

According to Stan T. Ingram and Travis Conner, *Mineral vs. Royalty Distinction*, Arkansas, Kansas, and Oklahoma might see this language as creating a royalty interest.

"Produced and saved"

When these words are used in a conveyance or reservation, they would be describing minerals that have been taken from the land and would, therefore, be considered a royalty interest.

“Royalty,” “Royalty Interest,” or “Royalty Acres”

Generally, such words would be describing a conveyance or reservation of royalty; however, under the Rules of Construction, if the conveyance or reservation used such words but later referenced other characteristics that would describe a mineral interest, these later characteristics might very well convey or reserve a mineral interest instead of a royalty interest.

“The right to share in profits, a portion of all royalty, incomes, rentals”

Most states would see this language as conveying or reserving a mineral interest.

“The right to Nonparticipating in bonus, rentals, and executive rights”

States do not appear to be consistent when such contradictory language is used. Since the royalty owner is the party who has no right to receive bonus, rentals, or executive rights, some courts would see this language as creating a mineral interest.



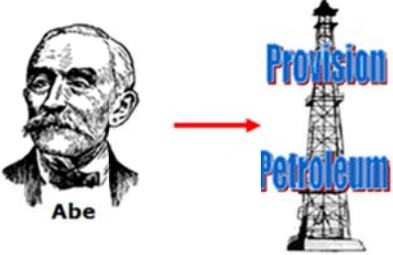
“A 1/24th royalty interest” vs. “a 1/24th of royalty interest”

Would a deed conveying a 1/24th royalty interest convey a full 1/24th of 8/8ths of the royalty under the tract of land or a 1/24th of the royalty rate found in the oil and gas lease?

In most states, a conveyance or reservation of “1/24th royalty interest” without any additional limitation would be a full 1/24th of 8/8ths of the royalty under the tract of land.

On the other hand, a conveyance or reservation that simply added the word “of” would limit the amount being conveyed or reserved by the percentage of royalty negotiated in the lease. If the negotiated lease royalty was 1/8th, the conveyed royalty would be 1/24th of 1/8th.

Scenario 1:

<p>1. Assume that Abe conveyed a 10% royalty to Betty.</p>  <p>Abe Betty</p>	<p>2. Next, assume that Abe conveyed a 1/2 of royalty to David.</p>  <p>Abe David</p>
<p>3. Next, Abe signs a lease with Provision Petroleum. He negotiates a 20% lease royalty.</p>  <p>Abe</p>	<p>4. What royalty should be paid to each of the owners?</p> <p>Abe _____ % royalty</p> <p>Betty _____ % royalty</p> <p>David _____ % royalty</p>

ANSWER: Abe negotiated a great royalty rate of 20%; however, he will receive none of that royalty. He conveyed a full 10% royalty to Betty, leaving him with 10%. When he conveyed 1/2 of royalty to David, David would have received 1/2 of the royalty negotiated in the lease, leaving Abe with nothing.

Oklahoma courts have ruled that any such conveyance made prior to an oil and gas lease, unless the conveyance is stated as a specific percentage of production (1/24th of 3/16th royalty), would create a mineral interest. *John S. Lowe, Oil and Gas Law in a Nutshell* (4th ed. 2003; *H. Williams & C. Meyers, Oil and Gas Law* (13th ed. 2006).

Montana appears to draw a distinction between a royalty conveyed prior to leasing and one that was conveyed subsequent to leasing. The Montana Supreme Court ruled that a royalty conveyed prior to leasing (defined as a “nonparticipating royalty”) is not reducible by a later lease royalty, and a conveyance of royalty after leasing (defined as a “landowners royalty”), is reducible by the lease royalty rate. The prior conveys a much larger share of production than the latter.

A Kentucky court ruled that when a conveyance containing a reservation of royalty, "1/16 royalty interest in all the oil and gas now being produced or which may hereafter be produced," would be a full 1/16th royalty out of 8/8th production and not 1/16th of the lease royalty. They further found that this interest would be consistent on any current or future oil and gas leases. *Kavanaugh v. Clay*, 275 S.W.2d 938, 939 (Ky. Ct. App. 1955).







"A 1/2 of 1/8th royalty interest"

Assume a deed granted "1/2 of 1/8th of the oil, gas, and other mineral royalty that may be produced from said land." Also assume that the negotiated lease royalty rate was 1/8th. What royalty has been conveyed?

- 1/2 of 1/8th, or
- 1/2 of 1/8th of the negotiated 1/8th royalty rate?

Several courts have ruled that the grant was 1/2 of 1/8th of the amount negotiated in the lease or 1/2 of 1/8th of the 20% royalty rate. *Harriss v. Ritter*, 279 S.W.2d 845 (Tex.1955), *Palmer v. Lide*, 567 S.W2d 295 (Ark.1978), *Corbin v. Moser*, 403 P.2d 800 (Kan.1065).

Scenario 2:

<p>1. Assume that Abe conveyed a 1/2 of royalty interest to Betty.</p> <div style="text-align: center;">  →  </div> <p style="text-align: center;">Abe Betty</p>	<p>2. Next, assume that Abe conveyed 1/2 of 1/8th of the oil, gas and other mineral royalty to David.</p> <div style="text-align: center;">  →  </div> <p style="text-align: center;">Abe David</p>
<p>3. Next, Abe signs a lease with Provision Petroleum. He negotiates a 20% lease royalty.</p> <div style="text-align: center;">  →  </div> <p style="text-align: center;">Abe</p>	<p>4. What royalty should be paid to each of the owners?</p> <p style="margin-top: 20px;">Abe _____ % royalty</p> <p style="margin-top: 10px;">Betty _____ % royalty</p> <p style="margin-top: 10px;">David _____ % royalty</p>

ANSWER: Betty would receive a full 10% royalty or 1/2 of the negotiated 20% royalty. David would receive 1/2 of 1/8th (1/16th) of the 20% negotiated royalty or $1/2 \times 1/8 \times 20\% = 1.25\%$ royalty. Abe would receive what is left over or 8.75% royalty.

“A 1/2 nonparticipating royalty interest”

Would this language convey 1/2 of 8/8ths of all production, or 1/2 of the royalty rate found in the oil and gas lease?

Although it is possible to convey 1/2 of all royalty production, such a conveyance would become an almost impossible burden for an oil company to bear. The likelihood that the oil company would walk away is great. In an attempt to determine the intent of the instrument, a number of courts ruled that an abnormally large fraction indicated intent to convey minerals.

A Mississippi Supreme Court examined a conveyance entitled “Non-participating Royalty” but contained the following grant:

“1/2 of the whole of any oil, gas or other minerals, on, under, or that may be produced... the royalty herein described shall be delivered or paid to purchaser out of and deducted from royalty reserved to lessor in said lease.”

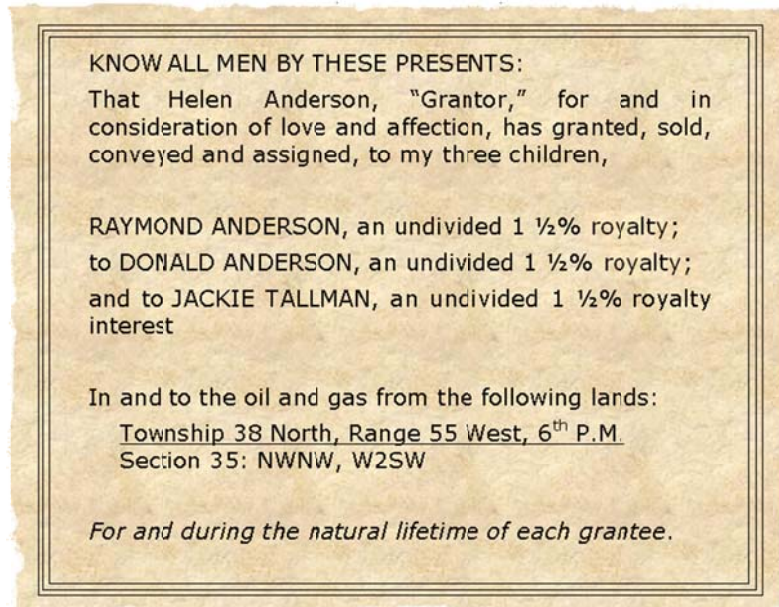
The court determined that the royalty conveyed was 50% of the lease royalty rather than a full 50% of all production. *Payne v. Campbell* 164 So.2d 780 (Miss.1964).

A grant of “royalties, incomes, and rentals”

In West Virginia, such language is interpreted to grant the entire mineral estate, unless the conveyance adds clarifying intent language. *Davis v. Hardman*, 148 W. Va. 82, 133 S.E.2d 77, 81-82 (1963).

The Perpetual or Non-perpetual Nature of the NPRI

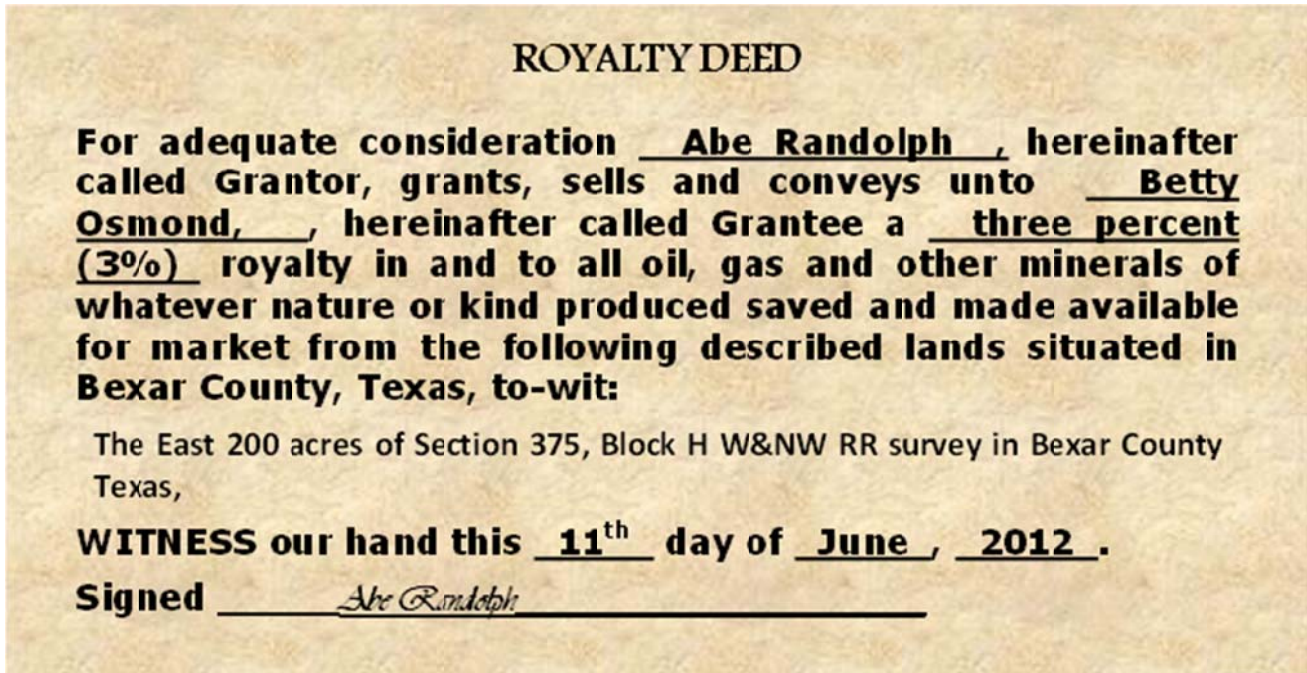
Generally, a nonparticipating royalty can be created for a certain period of time or in a perpetual manner. The following language would create a non-perpetual royalty:



Kansas is a state where it appears impossible to create a perpetual royalty. The courts ruled that royalty "consists of a share in the oil and gas produced *under existing leases*, but a royalty interest does not consist of a perpetual interest in the oil and gas as they lie in the ground. On the expiration of the existing leases the right of the owner of the royalty expires." The court held that a nonparticipating royalty is a "contractual obligation." Once the oil and gas lease terminates, the royalty obligation also terminates. *Bellport v. Harrison*, 255 P.52 (Kan.1951).

Scenario 1:

Assume that Abe Matthews owned an undivided 50% of the minerals in the 200 acre tract of land located in Bexar County, Texas. He leased his mineral interest to Provision Petroleum and negotiated a 3/16th lease royalty. Subsequently, he conveyed an NPRI to Betty Osmond in the following Royalty Deed. After examining the deed determine what interest Betty is receiving?



- a full 3% NPRI
- 3% X 50% (Abe only owned 50% of the minerals in the land)
- 3% X 3/16th lease royalty
- 3% X 50% X 3/16th

ANSWER: Abe gave Betty a 3% royalty interest "from the following described lands." He DID NOT give her a 3% royalty out of his 50% mineral interest. This 3% would not be reduced by his royalty rate; therefore, the answer is a full 3% NPRI. Abe would receive (3/16th X .50) – 3% NPRI = 6.375 Royalty.

Scenario 2:

Assume that after conveying the 3% NPRI to Betty, Abe conveyed a 50% mineral interest to David Davis on the following Mineral Deed. After examining the deed, determine what royalty David should receive out of the 3/16th royalty negotiated in Abe's lease with Provision Petroleum.

MINERAL DEED

KNOW ALL MEN BY THESE PRESENTS THAT

Abe Randolph hereinafter called Grantor, for and in consideration of the sum of One and no/100 -----Dollars each in hand paid and other good and valuable consideration, the receipt of which is hereby acknowledged, do hereby grant, bargain, sell, convey, transfer and deliver unto David Davis, hereinafter called Grantee, an undivided fifty percent (50%) interest in and to all of the oil, gas, casinghead gas, coal, clay, uranium, potash and other minerals, known or unknown, in and under and that may be produced from the following described lands situated in Bexar County, Texas, to-wit:

The East 200 acres of Section 375, Block H W&NW RR survey in Bexar County Texas,

WITNESS our hand this 10th day of August, 2012.

Signed *Abe Randolph*

- 18.75%
- 18.75% X 50% (50% of Abe's royalty)
- 18.75% X an undivided 50% interest in the lands
- 18.75% X an undivided 50% interest less a 3% NPRI

ANSWER: David received a full 50% of the mineral estate because the conveyance was granting the interest from the described lands rather than 50% of Abe's interest. The interest David received is also burdened by the previous NPRI owned by Betty; therefore, his royalty interest would be 18.75% X an undivided 50% interest in the lands less Betty's 3% NPRI.

Scenario 3:

Instead of the language used in Scenario 2, Abe conveyed the following to David from this Mineral Deed. Prior to this deed, Abe had conveyed the 3% NPRI to Betty but HAD NOT negotiated an oil and gas lease. Six months after receiving this interest from Abe, David negotiated his own lease with Provision Petroleum and received a 3/16th royalty rate. What royalty would David be entitled to from the entire tract of land?

MINERAL DEED

KNOW ALL MEN BY THESE PRESENTS THAT

Abe Randolph hereinafter called Grantor, for and in consideration of the sum of One and no/100 -----Dollars each in hand paid and other good and valuable consideration, the receipt of which is hereby acknowledged, do hereby grant, bargain, sell, convey, transfer and deliver unto David Davis, hereinafter called Grantee an undivided twenty-five percent (25%) interest in and to all of the oil, gas, casinghead gas, coal, clay, uranium, potash and other minerals, known or unknown, in and under and that may be produced from the following described lands situated in Bexar County, Texas, to-wit:

The East 200 acres of Section 375, Block H W&NW RR survey in Bexar County Texas,

WITNESS our hand this 10th day of August, 2012.

Signed *Abe Randolph*

- A full 18.75%
- 18.75% X 25%
- 18.75% X 50% X 25%
- 18.75% X 25% less 3%
- 18.75% X 25% less 1.5%

ANSWER: David received a full 25% of the mineral estate. The interest David received is also burdened by the previous NPRI owned by Betty, but since David only received half of Abe's interest he is only burdened by half of the NPRI. The other half of the NPRI burdens Abe. (18.75% X 25% X 1.5%)

Nonparticipating Royalty in Texas

In Texas, a nonparticipating royalty owner's interest is covered by the oil and gas lease for all purposes *except* for pooling. If the lease is pooled with other leases and becomes a part of a pooled unit, the interest is not covered by the pooling language in the lease.

This situation could prove disastrous to an oil and gas company – especially if the drill site location is to be located on the nonparticipating royalty owner's tract of land. The Texas Supreme Court's decision in *Brown v. Smith* states that a mineral owner with executive rights to lease does not have the right to pool any interest owned by the nonparticipating royalty owner without his or her approval. Courts in Texas have consistently upheld this principal in law.

In Texas, if this royalty owner fails to ratify the lease or sign some sort of unit designation, his or her interest cannot be pooled in the unit. There are two different outcomes for this scenario.

1. First, if the drill site is located on this tract of land, the nonparticipating royalty owner will receive his or her royalty in whole and not proportionately reduced by the other acreage in the unit.
2. Secondly, if the drill site is located on another tract of land, the nonparticipating royalty owner is not entitled to receive any royalty benefits from production. This royalty owner does have the right, however, to sign a ratification or unit designation even after the well is drilled and completed. At this point, the royalty payment would be based on his or her proportionate part of the unit.
3. One court allowed a nonparticipating owner to collect royalty payments from a well that was drilled 13 years before he signed the ratification to the lease.
4. Another court granted a nonparticipating royalty owner the right to ratify only portions of a lease. In this case, the lease covered a larger tract of land, and the nonparticipating royalty owner could pick and choose what portions of the lease he wished to ratify. On wells that were not located on lands burdened by his royalty interest, the owner received royalty payments based on his proportionate part of the unit. On wells that were located on lands burdened by his royalty interest, the owner received his full royalty interest.

Scenario #1:

Study the scenario below as it relates to a unit boundary in Texas.

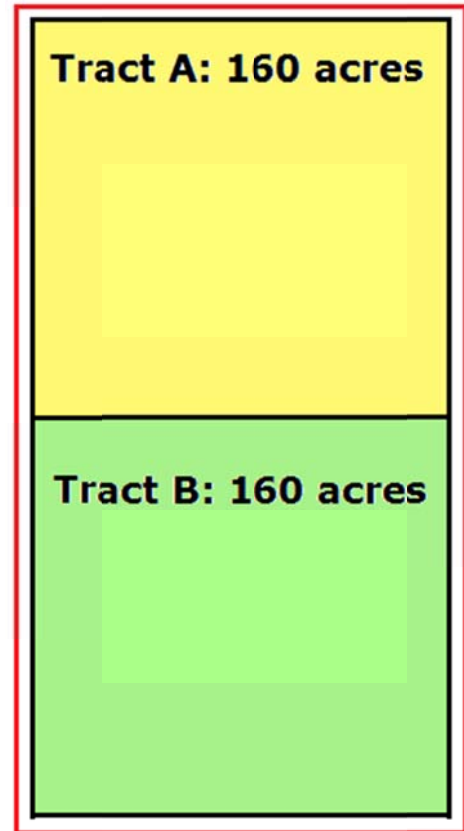
Assume that the mineral owner of "Tract A" conveyed a full 10% NPRI to your mother.

A year later, the mineral owner leased "Tract A" and negotiated a 20% royalty.

A year later, "Tract A" was pooled with "Tract B" to form a 320-acre drilling unit. The well is to be located on Tract A.

Your mother recently called you and asked for advice. She said that a landman called and asked her to ratify the lease in Tract A. She said the landman said he did not care if she did or didn't ratify. Later that day, the mineral owner called. He seemed insistent that she ratify. Your mother was confused as to what is happening.

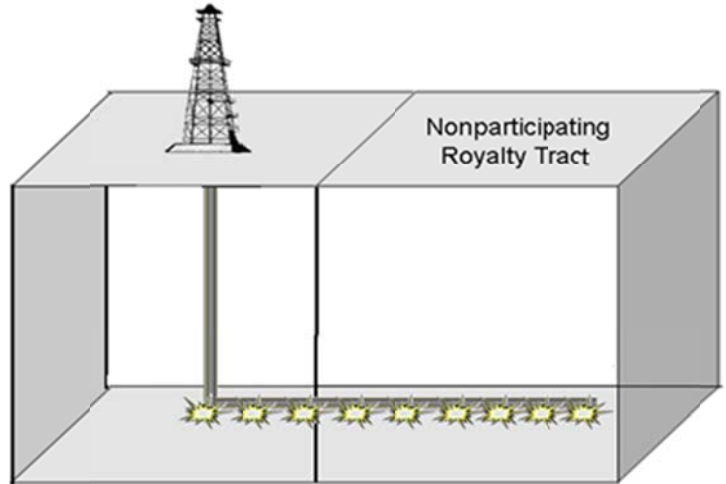
Why did the landman seem more disinterested in your mother's ratification than the mineral owner?



ANSWER: Since the NPRI comes out of the royalty interest negotiated in the lease, the mineral owner has more to lose than the oil company. Since Tract A is pooled with Tract B, the royalty attributed to Tract A would be $160/320 \times 20\%$ royalty or 10%. If the well is located on Tract A and your mother refused to ratify the lease, she would receive a full 10% nonparticipating royalty, leaving nothing left over for the mineral owner.

Scenario #2:

Examine the illustration. Two tracts of land have been pooled in order to form a drilling unit. The well being drilled is a horizontal well. The surface well location is not on the NPRI's tract of land; however, a portion of the horizontal leg to the well does run beneath the NPRI's tract of land. If the NPRI owner had failed to ratify the lease would they be entitled to receive royalty on a unit basis or a leasehold basis?



ANSWER: Simply because the surface location does not fall on the NPRI's tract of land does not change the fact that subsurface drilling has taken place on the NPRI's tract of land. In this case, the NPRI owner should be entitled to receive royalty on a leasehold basis.

Mineral Classified Lands in Texas

After Texas became an independent nation, through various acts, the state set aside more than 42,500,000 acres of unsold land as "public free school land," and provided that the sales of those lands would finance schools. Prior to selling these lands, they were classified as "grazing land," "mineral land," "agricultural land," or "timber land". After 1895, approximately seven million acres of land was set aside as mineral classified lands. When these lands were granted, only surface rights passed in the grant. Texas retained all minerals at the time of patent. A determination of these lands can be found in the records of the General Land Office (GLO) in Austin, Texas. It is important to note that the grant or patent itself may not always note this fact.

RELINQUISHMENT ACT OF 1919: At the turn of the century, Texas was at the epicenter of oil production in the United States. Huge oil fields were discovered. Many of those were in west Texas and located on mineral classified lands. According to state statute, if companies wished to acquire leasing rights on these lands, the surface owner would receive ten cents per acre per year to compensate for surface damages.

Production became prolific in the 1920's and problems arose and tempers shortened when surface owners became upset at all the economic loss they were suffering because 100% of the minerals under their tracts of land belonged to the state. In order to encourage production and cool tempers, the legislature passed what is known as the Relinquishment Act of 1919. The law seemed to relinquish the oil and gas minerals back to the surface owners, with the state only retaining a 1/16th royalty interest.

Many were not happy with the outcome of the act and in 1928 the constitutionality of the act went before the Texas Supreme Court. The court determined that the act did not, in fact, relinquish the oil and gas minerals to the surface owners, but rather made the surface owners agent on behalf of the state. As leasing agents, the surface owners would receive 1/2 of all lease royalty, bonus, delay rentals and other benefits from the lease as an equal partner with the state. The act does not allow for any lease with less than one-eighth royalty and applies only to free public school and asylum lands. Historically, the lease must be on an approved General Land Office form and must be approved and filed by the General Land Office.

1. Assume Tex Walker owned 100 acres of Mineral Classified Lands.



Tex leased the lands to your company on behalf of the state. You drilled a producing well on the land. Since Tex negotiated a $\frac{3}{16}$ royalty, you have been paying him 50% of this or 9.375%.



Carrie

2. Six months later, Tex and his wife Carrie divorced. The Divorce Decree granted 50% of Tex's royalty to Carrie.



Susanne

3. Six months later, Tex married Susanne. Twelve months later, they divorced. The Divorce Decree granted the other 50% of Tex's royalty to Susanne.



4. Six months later, the well drilled up and the lease terminated.



Ginger

5. A year later, Tex married Ginger. Six months later, Tex died.

Your company wants to lease the land once again.

Who should they lease?

Who should receive royalty?

ANSWER: Apart from specific language contained in the divorce decrees, the royalty would follow the lease. Since the first lease terminated, the royalty attributed to Carrie and Susanne would be gone, and either Ginger or the estate of Tex would be the entity to negotiate a new lease and receive royalty.

Mineral Servitude in Louisiana

Louisiana recognizes what is called a *mineral servitude*. Since mineral ownership is not a part of land ownership in the state of Louisiana, the landowner can only convey or reserve what he or she owns. In this case, the landowner only owns the right to produce minerals. When this right is conveyed or reserved, a mineral servitude is created. This is much like a term conveyance.

A mineral servitude can only belong to someone other than the landowner. The owner of the mineral servitude does not own the minerals, but only possesses the exclusive right to explore and develop the property for oil and gas, which can be reduced to ownership only through actual drilling and production. Thus, the owner of the servitude has the right to lease the minerals or drill their own well.

Those owning a usufruct do not have the right to create a mineral servitude.

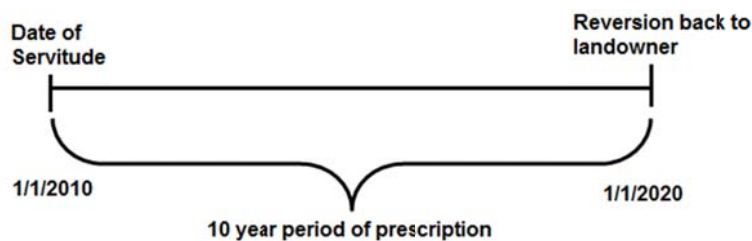
There are certain rights and obligations of a mineral servitude owner including:

1. The owner of a mineral servitude is under no obligation to exercise it.
2. If the owner does exercise this right, then he or she is entitled to use only so much of the land as is reasonably necessary to conduct operations.
3. The owner is obligated, insofar as practicable, to restore the surface to its original condition at the earliest reasonable time.

Prescription in Louisiana

In most states, when an owner of minerals sells the minerals to another party, the term of the conveyance is usually "forever."

In Louisiana, a mineral servitude is subject to what is known as *prescription* resulting from non-use of the minerals for ten (10) years.



If a party owns a mineral servitude for a period of ten years and the minerals have not been used, they will then revert back to the current landowner.

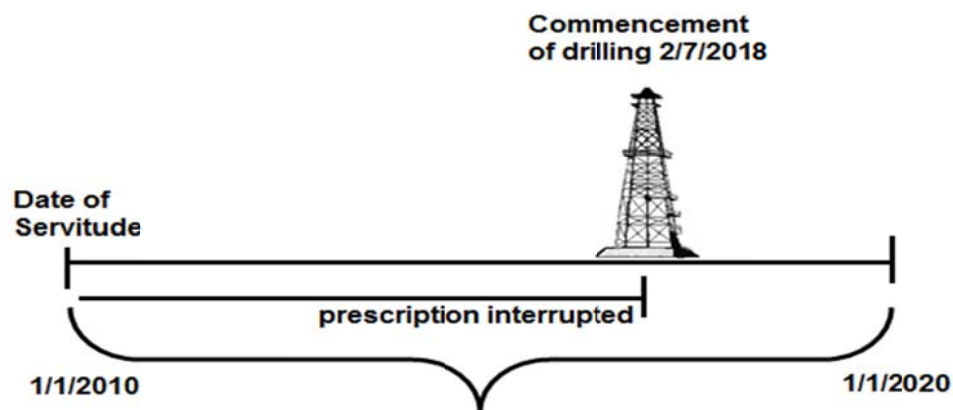
Royalty interests are also subject to prescription and

will be extinguished in 10 years unless the prescription is interrupted by production. Parties creating a mineral servitude have the right to shorten the period of prescription.

According to Louisiana Code - RS 31:115, the interest of a mineral lessee is not subject to the prescription of nonuse. The usufructuary of a *mineral servitude* may grant a mineral lease that extends beyond the term of the usufruct. This lease will bind the naked owner of the servitude to the lease. Louisiana Mineral Code Article 118.

Interruption of Period of Prescription

Assume an oil company is drilling a well on mineral servitude lands or on pooled lands included with the servitude lands. In this case, the 10 year prescription period will be interrupted by the use of the minerals. The interruption takes place on the date actual drilling or "good faith" mining operations are commenced.



Activities that *would not* meet the definition of interruption would be:

1. Geological or geophysical exploration
2. Surveying
3. Building or clearing a well site location
4. The hauling and/or erection of any structures necessary to conduct operations

Scenario:



Karen

Jan 1, 2001



Karen's Grandparents

Jan 1, 2011



Mar 1, 2009 Dec 25, 2010

Karen's grandparents granted her a 10-year mineral servitude in a tract of land that they own. The Prescription period began Jan 1, 2001.

On March 1, 2009, Karen executed a 3-year lease with an oil company.

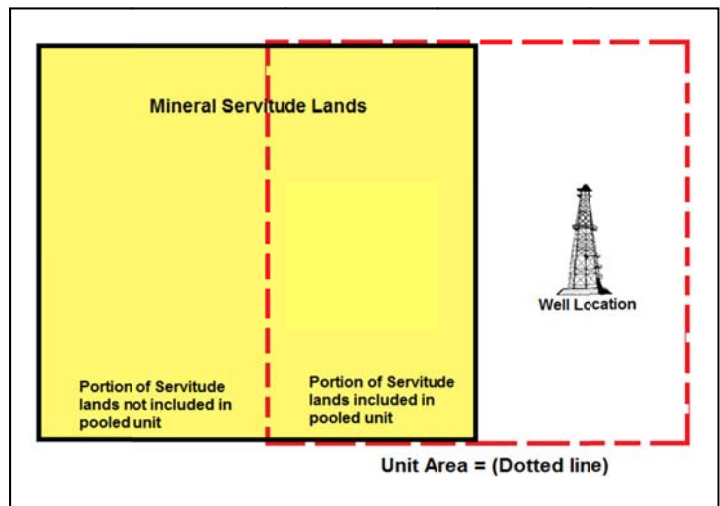
On December 25, 2010, the oil company began building a well site location for a well they intent to spud in early January.

What is the status of the mineral servitude? What is the status of the oil and gas lease?

ANSWER: Karen's 10-year prescription ends January 1, 2011 unless there has been use. Even though there was an oil and gas lease executed by her and a well site location built before that date, these would not constitute use. Therefore, Karen's prescription period is not interrupted and the minerals revert back to her grandparents. As for the status of the lease, keep in mind Louisiana Code - RS 31:115: the interest of a mineral lessee is not subject to the prescription of nonuse.

Assume a well is drilled and is capable of production in paying quantities, but the well is shut in. Prescription will have been interrupted by the commencement of drilling. Prescription will commence anew from the date the well is shut in after testing. The ten-year clock resets.

If only a part of the tract burdened by the servitude is included in a unit and the unit well is on land other than that burdened by the servitude, the interruption of prescription extends only to that portion of the tract burdened by the servitude included in the unit.



The 10 year period of prescription will begin again if the well is a dry hole or when a producer is later plugged.

If production is retrieved from the pooled lands rather than the mineral servitude lands, then any servitude lands not included in the pool are still subject to the 10-year prescription.

Assume a company is attempting to restore production from a well that has ceased to produce, has some type of cessation of production, or is attempting to drill a new well on the lands. The 10 year prescription period will begin once again following the last day operations were conducted in good faith to secure or restore production.

Louisiana's statutes surrounding prescription are one of the most important aspects of mineral law in the state. The land professional must not only have a keen understanding of the laws surrounding servitude and prescription, they must also keep accurate accounting of the servitude expiration dates, the events surrounding the life of the lease, knowledge about which tracts of land are subject to an extended servitude, and be able to pay the correct owners production from the well.

Exceptions to Prescription

- The prescription of minerals does not apply to state owned minerals. These minerals are owned by the state in perpetuity.
- If the state acquires property from a landowner and the landowner reserves his or her mineral rights, the 10-year prescription period would not apply as long as title to the surface is held by the state. Normally, the reserved mineral interest would be subject to the 10-year period of non-use but this does not apply to sales acquired by the state. If the state were to sell the same land to an entity not covered by the statute, the 10-year prescription would begin again where it had left off.
- When the state acquires property from a landowner who only owned surface lands but whose interest had already been burdened by servitude and whose interests are subject to the 10-year prescription of non-use, at the end of 10 years of non-use, the mineral interest would revert back to the landowner. If in the sale of the property to the state the landowner reserves the minerals, prescription will continue to run on the existing servitude.

Since 1921, the Louisiana Constitution provided that all mineral rights on property sold by the state would be reserved to the state. LSA-Const. Art. 9, §4 (formerly LSA-Const.1921. Art. 4, §2).

Sec. 4 (A), "the sale of state lands will automatically effect a reservation of mineral rights." This reservation of minerals takes place even if the conveying document from the State fails to reserve the mineral rights.

Subsection (B) "lands and mineral interests of the state, of a school board, or of a levee district shall not be lost by prescription." The prescription of minerals does not apply to the state owned minerals and are owned by the state perpetually.

