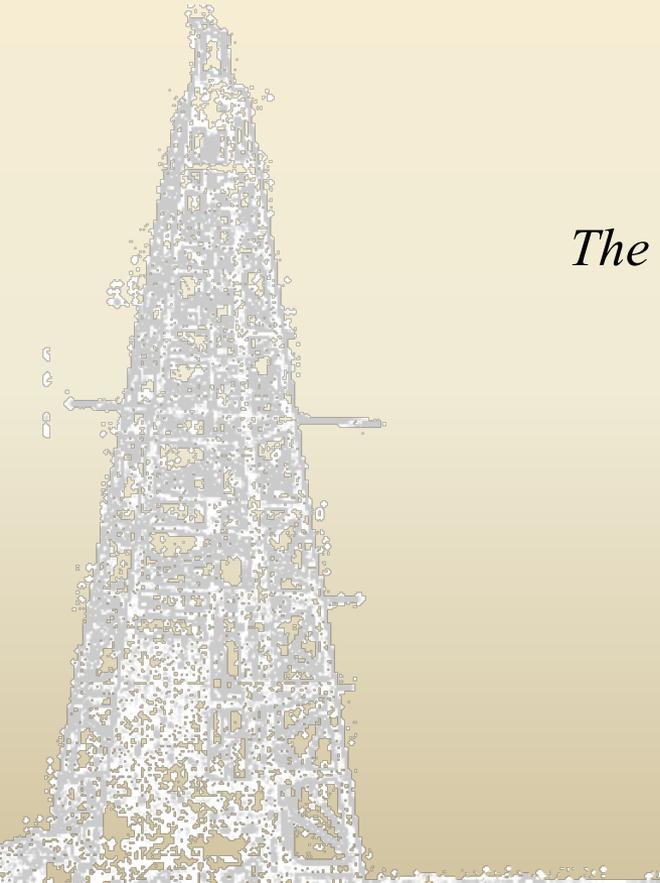


EXECUTIVE RIGHTS AND THE MINERAL ESTATE

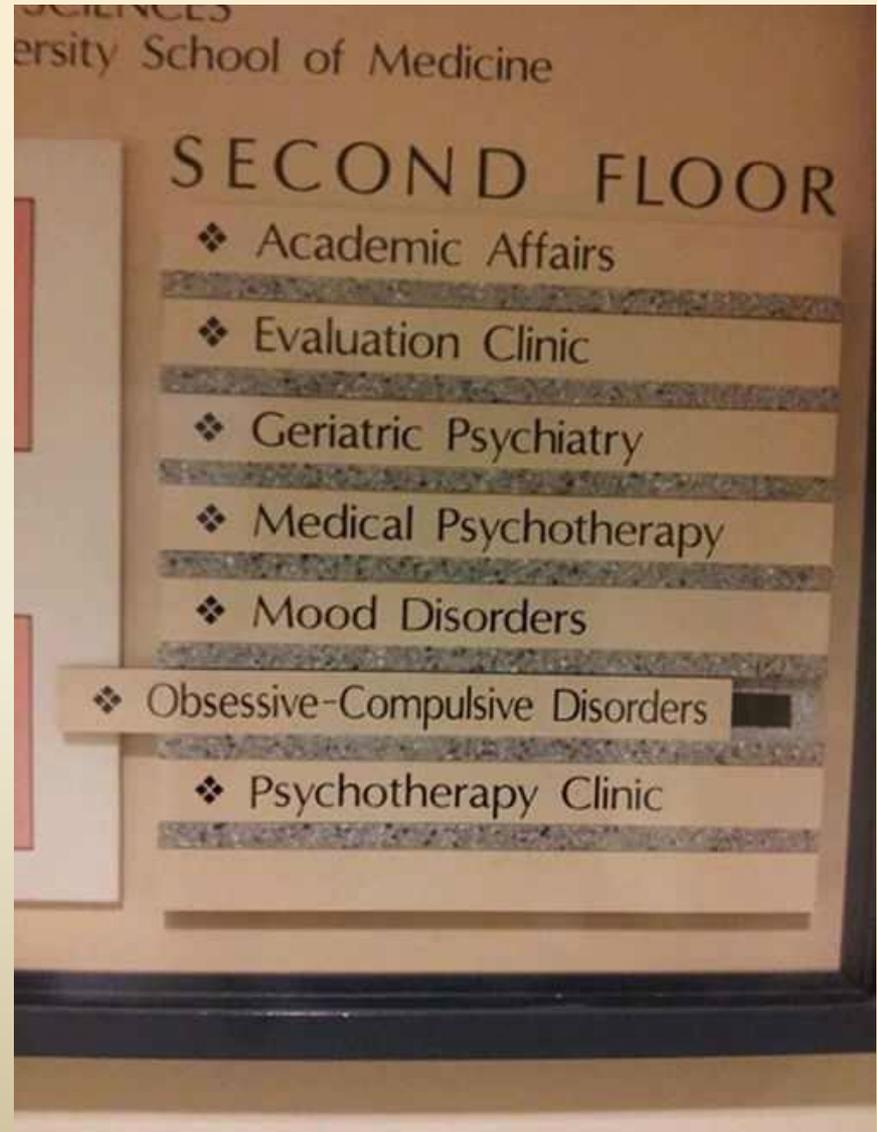
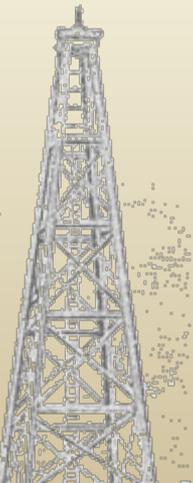
or

*The Obsessive Need By Some People
To Be In Control*



I. Mineral Estate Concepts

- ❖ *Don't we already have a Lease?*
- ❖ *The Lease says what?*
- ❖ *Are you kidding me?*
- ❖ *Does this Lessor have control issues?*



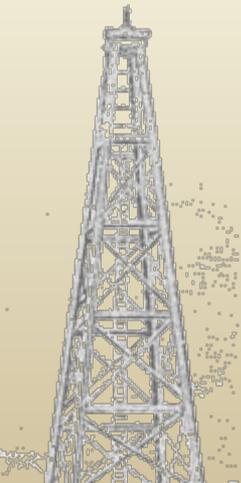
The Mineral Estate

Simplest form of ownership of OGM = Fee Simple Owner

- ❖ *Absent any reservation or conveyance, the owner of the surface of the land owns all the minerals underneath.*

Conveyance or reservation of minerals by grantor= severance

- ❖ *Creates two separate fee simple estates: (1) Surface Estate, and (2) Mineral Estate.*
- ❖ *Initial severance and later conveyances or reservations of the mineral estate are subject to the same formalities as required for any conveyance of real property (Tex. Prop. Code Ann. Sec 5.021).*



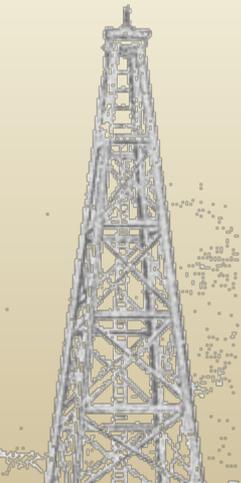
A. Bundling.



B. What's in YOUR Bundle?

Altman v. Blake, 712 S.W. 2d 117 (Tex. 1986)

- ❖ Right to develop;
- ❖ Right to lease;
- ❖ Right to receive bonus payments;
- ❖ Right to receive delay rentals; and,
- ❖ Right to receive royalty payments.

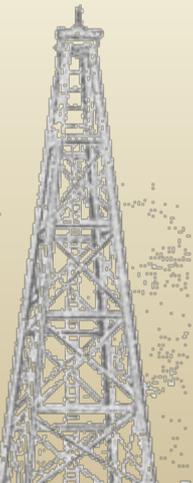


C. *Non-Executive vs. Executive*

1. Non-Executive Rights. The non-executive rights include the *right to royalty, right to bonus* and *right to delay rentals*.

A. Right to Royalty: non-possessory interest where owner gets a certain fraction of production, but does not pay production costs.

- Takes many forms, but courts have held that there must include a set “size” and “value” (i.e., what kind of hydrocarbon it covers, payable in-kind or in revenue, how revenue is computed);
- No right to lease or develop the property;
- No CONTROL “per se” over production of oil and gas;
- Dependent upon terms of the overall lessor royalty to define size and value; and,
- Not entitled to any income unless property is leased and producing.



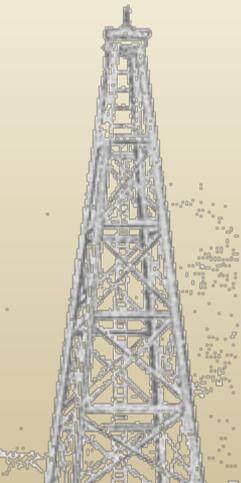
C. *Non-Executive vs. Executive*

B. Right to Bonus: interest where owner gets consideration paid by lessee in exchange for the granting of the lease.

- Vested real property interest in the mineral estate; and,
- The owner has no control over the amount of bonus that is actually received, i.e. the executive right holder determines same.

C. Right to Delay Rental: interest where owner gets payments made by lessee during primary term of lease in order to defer drilling.

- “Vestigial tail of oil and gas law”, and rarely seen in today’s leases.



C. *Non-Executive vs. Executive*

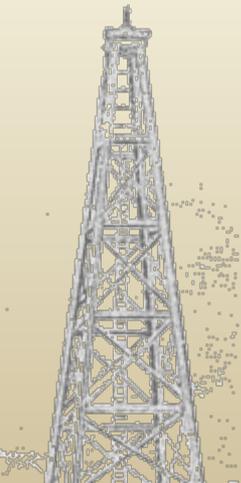
2. Executive Rights. The executive rights include the *right to lease* and the *right to develop*.

A. Right to Lease: traditional “executive” right, inclusive of right to execute a lease for oil, gas and minerals.

- Broadest sense being the right to take and authorize “all actions that affect the exploration and development of the mineral estate”.

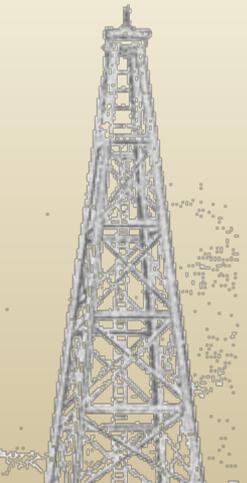
B. Right to Develop: the right of ingress and egress to access the mineral estate, i.e. the right to “penetrate the mineral estate” and remove the hydrocarbons.

- Has been ruled “correlative”, i.e. corresponding to, and therefore “indivisible from” the executive right. See *Lesley v. Veterans Land Bd.*, 352 S.W.3d 479, 492 (Tex. 2011) and *French v. Chevron U.S.A., Inc.*, 896 S.W.2d 795 (Tex. 1995)).



II. Limitations on the Executive Rights

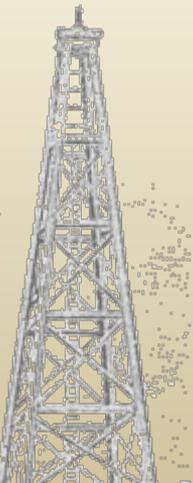
- ❖ Power of the executive rights holder is not absolute!
- ❖ Texas courts have imposed two key limits on executive rights:
 - A. Fiduciary duty of the executive rights holder(s) to the non-executive rights holder(s); and,
 - B. Limitations on the right to pool.



II. Limitations on the Executive Rights

A. “Executive’s Duty”

- The executive rights holder has duties and obligations to the non-executive interests!!!
- Texas courts recognize the executive’s duty to protect non-executive interest from “self-dealing” (*Schlitter v. Smith*, 101 S.W.2d 543 (Tex. 1937)).
- The executive must acquire for the non-executive interest every benefit that he exacts for himself (*Lesley v. Veteran’s Land Board*, 352 S.W.3d 479 (Tex. 2011)).
- “Duty owed by executive rights holder depends on the amount of control placed in his or her hands by the terms of the [non-executive interest] reservation itself” (*Bradshaw v. Steadfast Financial, L.L.C.*, 395 S.W.3d 348 (Tex. App. – Fort Worth 2013)).
- **Not a general rule!** It is case-specific and changes depending upon the amount of control ceded to the executive (*Lesley v. Veteran’s Land Board*, 352 S.W.3d 479 (Tex. 2011)).



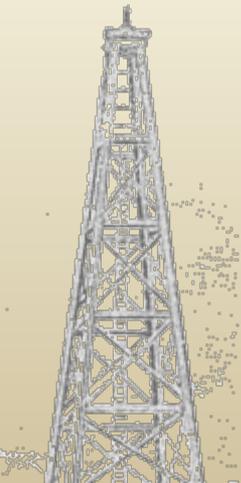
II. Limitations on the Executive Rights

A. “Executive’s Duty” (continued).

Two areas where executive duty is prevalent:

1. Duty to lease.

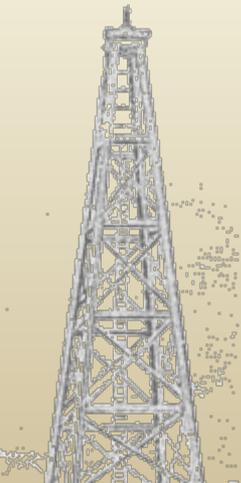
- The duty to lease may be considered a “balancing act”.
- Need to balance exercise of business judgment by executive (for ease of leasing, avoiding squabbles over terms, etc.) with protection for non-executive interests from negligent inaction or unrealistic expectations.
- While there is no hard and fast rule for when executive duty attaches, Texas courts have noted that any affirmative action taken by the executive that restricts ability to lease – including not acting in response to an offer – is considered an exercise of executive right!



II. Limitations on the Executive Rights

2. Duty to secure equal benefits.

- Duty to secure equal benefits attaches when, if at all, the executive executes the lease.
- Executive rights holder needs to secure best terms reasonably possible while refraining from self-dealing.
- However, please note that the executive rights holder has no duty to develop the mineral estate without an oil and gas lease!
- Also, the executive rights holder has no duty to disclose information about lease negotiations because a non-executive rights holder has no right to participate in the lease.



II. *Limitations on the Executive Rights*

B. Restrictions on Pooling.

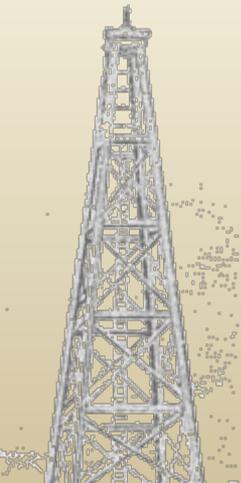
- Executive's power to lease on behalf of non-executive interests does not extend to pooling!!!!

“Pooling ... cannot be binding upon the non-participating royalty owner in the absence of his consent.” (*Montgomery v. Rittersbacher*, 424 S.W.2d 210 (Tex. 1968), citing *Brown v. Smith*, 174 S.W.2d 43 (Tex. 1943))

- Theory: to protect the non-executive from forced dilution.
- Consequence: Non-executive now has quasi-executive power – to either consent to pooling, or to refuse!

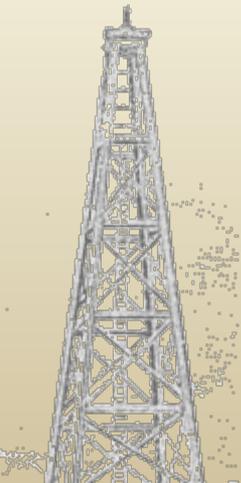
Consent = pooling is effective as to the non-executive's interest.

Refusal = non-executive is entitled to his *unpooled share of production!!*



III. Interpreting Control Issues

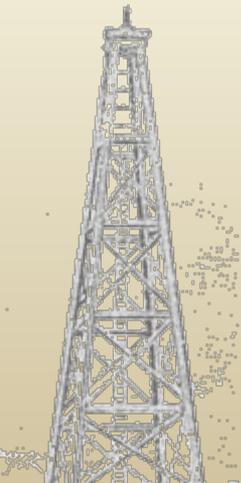
- ❖ Who do we lease?
- ❖ They use both “royalty” and “mineral” in this thing.
- ❖ Is this thing a royalty or a mineral?



III. Interpreting Control Issues

A. Harmonizing All Parts.

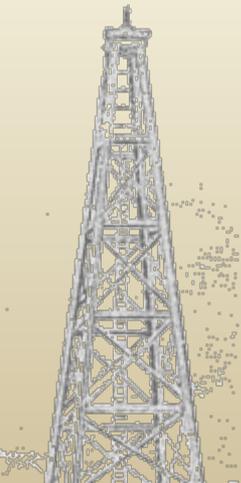
- It is a well-accepted doctrine of Texas mineral law that a grantor can create a mineral fee even though it is stripped of some of the “sticks” (incidents of ownership normally attached to it).
- Key for interpretation – *go with the language of the document and harmonize all its provisions!*
- The Texas Supreme Court said in *Luckel v. White*, 819 S.W.2d 459 (Tex. 1991) that to truly harmonize the deed provisions, one must consider all of the clauses. To do this, it used the “Four Corners Rule.”



III. Interpreting Control Issues

A. Harmonizing All Parts and the “Four Corners Rule”:

- Look within the “four corners” of the document itself to find the intent.
- Look at the “express language” found in all four corners of the document.
- “Even if different parts of the deed appear contradictory or inconsistent, the court must strive to harmonize all of the parts, construing the instrument to give effect to all of its provisions.”
Luckel, at 461.



III. *Interpreting Control Issues*

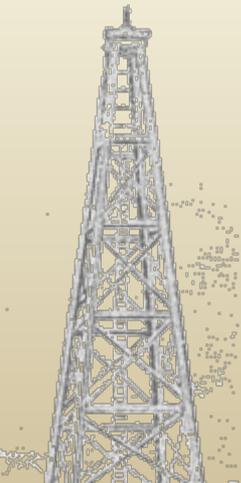
B. Phrases to Watch For as Part of Harmonizing.

1. ***“IN AND UNDER”***

- Instrument that grants/reserves oil, gas, and other minerals “in, on, and under” or “in and under” the described land – without other provisions relating to the minerals – may point towards a mineral interest.
- Very little consistency within Texas courts.

2. ***“PRODUCED AND SAVED”***

- Using “produced and saved” or “that may be produced from” or “produced, saved, and sold” generally point to a royalty interest.
- Logic dictates, however, that you cannot really get a royalty without the oil/gas/minerals having first been produced.

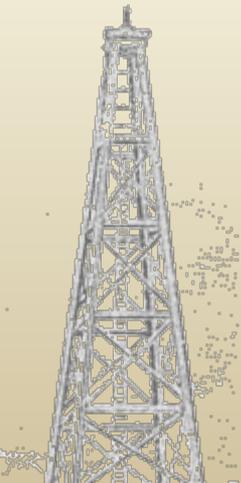


III. Interpreting Control Issues

B. Phrases to Watch For as Part of Harmonizing.

3. “ROYALTY”

- Significant factor to the courts in construing a royalty interest.
- Using the term “royalty” and clauses providing for the payment such as “from actual production” trend towards courts ruling it a royalty interest.
- The *absence* of the term “royalty” often a determinative factor in deciding whether it’s a mineral interest.

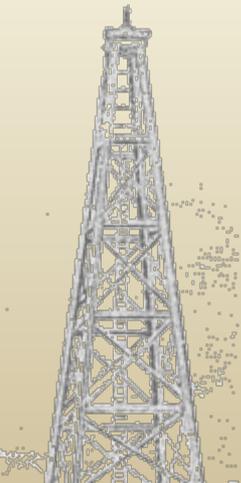


III. Interpreting Control Issues

B. Phrases to Watch For as Part of Harmonizing.

4. Look to your actual **granting** language!!!

- Granting clause often contains the parties' "key expressions of intent".
- The grant, in context of the overall document, should be read with the other provisions, including the habendum, to ascertain the intent within the four corners! Are there additional "privileges" granted?
- Go with the language of the document as a whole. Construe the parties' intent from what was written (or left out!) of the four corners of the document.



IV. Choosing Your Words Carefully

KNOW ALL MEN BY THESE PRESENTS;- That I, Nana D. Newton a widow of the above County and State, for and in consideration of the sum of One Hundred (\$100.00) Dollars cash in hand paid the receipt of which is hereby acknowledged and the performance of all the terms, conditions and stipulations by T.B. Slick hereinafter set forth; do by these presents Grant, Sell Convey, Assign and Deliver unto the said T.B. Slick an undivided one half interest of a one eighth interest in and to all of the oil and gas in and under and that may be produced from the following described blocks of land situated in Brown County, Texas, to-wit:-

"Blocks four (4) five (5) six (6) and seven (7) out of the John Sanders Survey No. 162, Abstract 820, save and except all gas or oil wells that may be located on March 28th, 1923 on any of the above blocks in said Survey, whether producing or not"

As a part of said consideration hereinabove set forth the said T.B. Slick hereby agrees, binds and obligates himself to commence one (1) Well within Ninety (90) days from the signing of this Royalty Deed on some parts of Blocks four (4) five (5) six (6) seven (7) eight (8) nine (9) ten (10) and eleven (11) out of the above described John Sanders Survey

located in Brown County, Texas, and to continue the boring of said well with all possible speed and diligence until said well has reached a depth of three thousand feet (3000) feet, or oil or gas is found in paying quantities.

The said T. B. Slick for the purpose of guaranteeing the boring of the Well hereinabove set out does hereby agree, bind and obligate himself to deposit in the National Bank of Commerce of the City of San Antonio, Bexar County, Texas, a check for three thousand (\$3000.00) Dollars, payable to the order of Nana D. Newton said check shall be held by said Bank for the benefit of the said Nana D. Newton to guarantee the commencement of the above described Well within a period of Ninety (90) days from the signing of this agreement; and in the event that the said T.B. Slick from any cause whatsoever shall fail to commence the boring of a Well, ninety (90) days from signing these presents, and to diligently and continuously prosecute the boring of the same until a depth of three thousand (3000) feet is reached, or oil or gas in paying quantities is discovered then and in that event the said three thousand (\$3000.00) dollars, shall be immediately turned over to the said Nana D. Newton or her order; and the signing of these presents by the said T.B. Slick shall be fully authority for said Bank to turn over said check of three thousand (\$3000.00) dollars and the Royalty Deed to the said Nana D. Newton.

It is further agreed by the parties hereto that this contract and conveyance shall be held in escrow together with said three thousand (\$3000.00) dollars until the completion of the well as hereinabove specified.

And in the event that said T.B. Slick shall perform all the conditions of this contract and oil or gas in paying quantities is discovered on said land or said well is drilled to a depth of not less than three thousand (3000) feet than and in that event only is this Royalty Deed to be turned over to the said T.B. Slick his heirs or assigns.

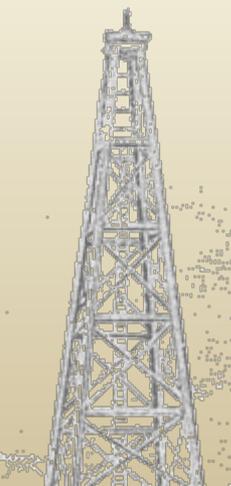
It is distinctly understood that it is the intention of the said Nana D. Newton by these presents to convey to the said T.B. Slick an undivided one half interest of a one eighth interest in and to all the oil and gas that may be discovered by the said T.B. Slick or his Associates, their heirs or assigns or any of the hereinbefore mentioned property.

Said T.B. Slick further agrees to furnish the said Nana D. Newton, during the progress of the above described Well a log of said Well.

In Testimony Whereof, we have hereunto signed our names on this 28th day of March, A.D. 1923.

Nana D. Newton

T.B. Slick



IV. Choosing Your Words Carefully

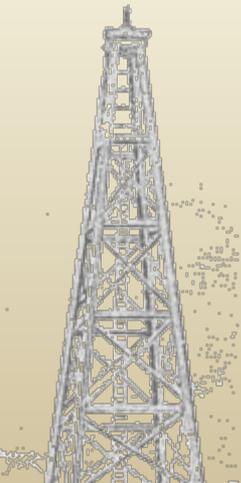
A. The Nana Files.

If you go with the language of the WHOLE document, how do you harmonize this?

- ❖ “Conveyancing Problems” (Ernest E. Smith, Ernest E. Smith Selected Works 152 (2013)):

For the fifty years or more when 1/8th was so typically the landowner’s royalty that courts could take judicial notice of it, a right to “1/4th of royalty” was essentially synonymous with a right to “1/4th of 1/8th,” i.e., a 1/32nd royalty. Thus it was not unusual for the identical royalty to be described in the same or different instruments both in terms of a fraction “of royalty” and a fraction “of 1/8th.” In all probability, then, most deeds which make reference to “1/2 of 1/8th” or “1/4th of 1/8th” do so only because 1/8th was virtually a synonym for “landowner’s royalty.”

- ❖ See *State National Bank v. Morgan*, 143 S.W.2d 757 (Tex. 1940); *Garrett v. Dils*, 299 S.W.2d 904 (Tex. 1957); and *Badger v. King*, 331 S.W.2d 955 (Tex. App. – El Paso, 1959).



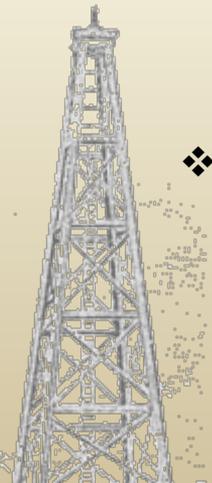
IV. Choosing Your Words Carefully

A. The Nana Files (continued).

- ❖ “Interpreting Mineral and Royalty Deeds: The Legacy of the One-Eighth Royalty and Other Stories”, 33 St. Mary’s L. J. 1, 2 (2001), Laura H. Burney:

“The traditional 1/8 royalty has left a legacy of interpretative problems for land title professionals. Unfortunately, courts have either ignored this legacy or adopted ad hoc approaches to title issues that fail to effectively acknowledge the influence of the 1/8 royalty on drafting mineral and royalty deeds... For land title professionals, the answer is generally to seek stipulations and curative measures. For owners and operators, however, title litigation will continue to loom as the legacy of the 1/8 royalty.”

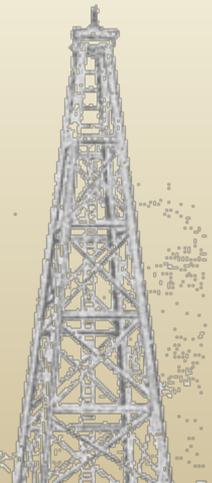
- ❖ Any interest conveyed or reserved is determined from all provisions of the instrument. However, the court does not require particular words or phrases to be used. See *Temple-Inland Forest Prods. Corp. v. Henderson Family Partnership*, 958 SW2d 183, 184 (Tex. 1997).



IV. Choosing Your Words Carefully

B. *French v. Chevron, U.S.A., Inc.*, 896 S.W.2d 795 (Tex. 1995).

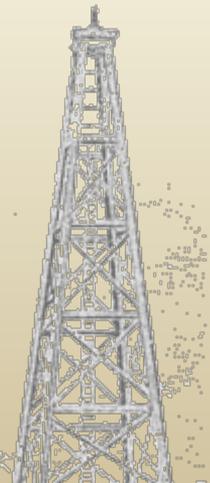
- ❖ In 1943, George Calvert gave Capton M. Paul an undivided “Fifty (50) acre interest, being an undivided 1/656.17th interest in and to all of the oil, gas, and other minerals, in, under and that may be produced from the following described lands....”
- ❖ The second paragraph, however, was a descriptive clause stating that it was understood and agreed “that this conveyance is a royalty interest only” and that Paul would not “ever have any interest in the delay or other rentals or any revenues ... received or derived from the leasing of said lands present or future”
- ❖ Descriptive clause went on to say that “neither the Grantee herein nor his heirs or assigns shall ever have any **control** over the leasing of said lands or any part thereof ... which is hereby specifically reserved in the Grantor.” (emphasis added)



IV. Choosing Your Words Carefully

B. French v. Chevron, U.S.A., Inc. (continued).

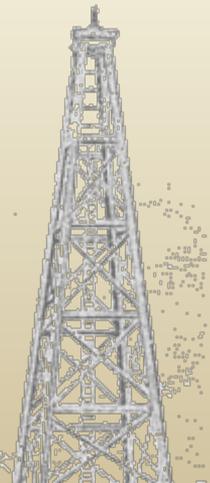
- ❖ Court used the Four Corners Rule by looking at the entirety of the document and by reading the granting clause in light of the rest of the document!
- ❖ Remainder of paragraph explains “the consequences of the ‘royalty only’ description”, which is the reservation of all the other “sticks”.
- ❖ Meaning of the grant is “to convey an interest in the nature of a royalty – a mineral interest stripped of appurtenant rights other than the right to receive royalties.”



IV. Choosing Your Words Carefully

C. *Temple-Inland Forest Products Corporation v. Henderson Family Partnership, Ltd.*, 958 S.W.2d 183 (Tex. 1997).

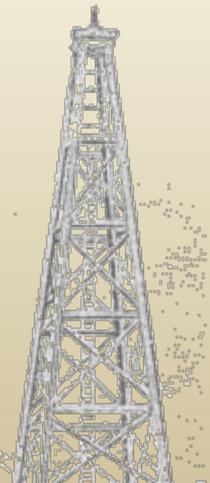
- ❖ In 1938, members of the Ashmore family and one Olar Wells executed a mineral deed to the Hendersons. Temple-Inland was the successor-in-interest to the grantors and the Henderson Family was the successor-in-interest to the grantees.
- ❖ Deed provided that the Grantors “grant, bargain, sell, convey ... an undivided 15/16ths interest in, to, and of all oil, gas and other minerals ... that may be produced from the following described lands....”
- ❖ Grantors also reserved an undivided 1/16th interest in the oil, gas and other minerals, but the deed said it was “understood and agreed that said 1/16th interest is and always shall be a royalty interest.”



IV. Choosing Your Words Carefully

C. Temple-Inland (continued).

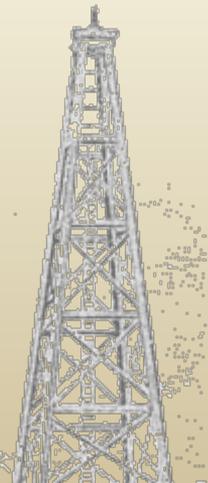
- ❖ Question: Was the 1/16th interest mineral or royalty?
- ❖ Texas Supreme Court opined that it has “never required a particular word or phrase to be used.”
- ❖ Interest conveyed or reserved is to be determined from all provisions of the instrument, and noted that the deed used the word “royalty” at least six times, and that it further excepted the costs of drilling and production.
- ❖ Court said that a mineral conveyance must be considered in its entirety and when considered as a whole, the deed reserved a 1/16th **royalty**.



IV. Choosing Your Words Carefully

D. *Lesley v. Veteran's Land Board*, 352 S.W.3d 479 (Tex. 2011).

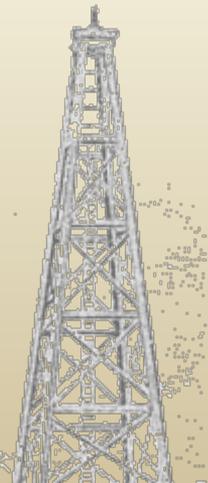
- ❖ In 1998, Bluegreen Southwest One, L.P., acquired 4,100 acres of land southwest of Fort Worth. The land had been conveyed to Bluegreen's predecessor by several landowners, which we collectively refer to as "Lesley".
- ❖ Deeds reserved part of Lesley's undivided half-interest in the minerals; the other half-interest in minerals was owned by the successors of the original landowners, the Hedricks.
- ❖ The "full, complete, and sole right to execute oil, gas, and mineral leases covering all the oil, gas, and other minerals in the following described land" was conveyed to Bluegreen.
- ❖ Bluegreen developed the property into the "Mountain Lakes" subdivision with over 1,200 lots and added restrictive covenants which included a provision forbidding "commercial oil drilling, oil development operations, oil refining, quarrying or mining operation". Covenants could be modified or abrogated by a written agreement or signed ballot of 2/3 of the owners entitled to vote.



IV. Choosing Your Words Carefully

D. Lesley v. Veteran's Land Board (continued).

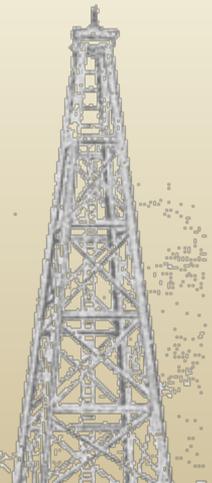
- ❖ Bluegreen conveyed the lots to some 1,700 owners and in the deeds included the mineral interest, excepting only the restrictive covenants and the mineral interests previously reserved to Hedrick and Lesley.
- ❖ Deeds did not mention the executive right.
- ❖ While Bluegreen developed its property, the Barnett Shale was developed as well and evidence indicated that Mountain Lakes was sitting on approximately \$610,000,000 worth of minerals that could not be accessed except through the subdivision.
- ❖ Hedrick and Lesley sued Bluegreen and Mountain Lakes lot owners in 2005, complaining that the restrictive covenants limited mineral development.
- ❖ Court said that when an undivided mineral interest is conveyed, the executive right incident to that interest passes to the grantee unless specifically reserved! Thus, the executive right was conveyed by Bluegreen by each lot owner's deed.



IV. Choosing Your Words Carefully

D. Lesley v. Veteran's Land Board (continued).

- ❖ Principal issue in the case is “the nature of the duty that the owner of the executive right owes to the non-executive interest owner, and whether that duty has been breached”.
- ❖ Court found that if “the refusal is arbitrary or motivated by self-interest to the non-executive’s detriment, the executive may have breached his duty.”
- ❖ Court noted that the accommodation doctrine would protect surface owners from “disruptive activities” related to mineral development.

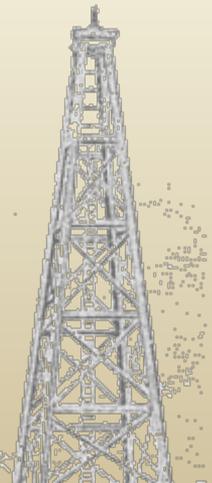


IV. Choosing Your Words Carefully

E. *Altman v. Blake*, 712 S.W.2d 117 (Tex. 1986).

- ❖ In 1938, A granted an “undivided 1/16 interest in and to all of the oil, gas, and other minerals in and under and that may be produced from” the 348-acre subject tract to B.
- ❖ The deed then limited the interest, saying that B “would not participate in any rentals or leases”.
- ❖ Finally the deed conveyed to B “the rights of ingress and egress at all times for the purpose of mining, drilling, exploring, and developing said lands”.
- ❖ Which is it? Royalty or mineral conveyance?

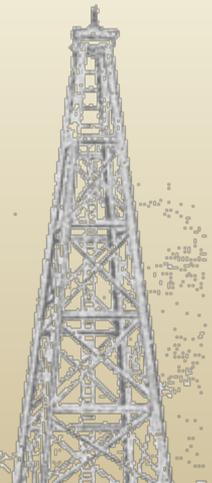
Per the *Altman* court, it is a MINERAL interest. Why?



IV. Choosing Your Words Carefully

E. *Altman v. Blake* (continued).

- ❖ Go with the language of the document! Per the deed, the grantee has an interest in the minerals with the right to develop, but NO executive right and NO right to rentals. The royalty right and bonus right were included.
- ❖ Again, remember the big picture: Texas law says you can take out some of the sticks from the bundle, but it does not change a mineral interest into a royalty.
- ❖ While the executive right was taken out, the grantee has no control over setting the royalty size or value, no control over setting bonuses, and no right to rentals!
- ❖ It takes more than just taking away a couple of sticks to convert a fractional interest in minerals into a royalty in gross production.



Final Thoughts.

Thank you for your time! If you have any questions, please feel free to contact me via e-mail at:

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