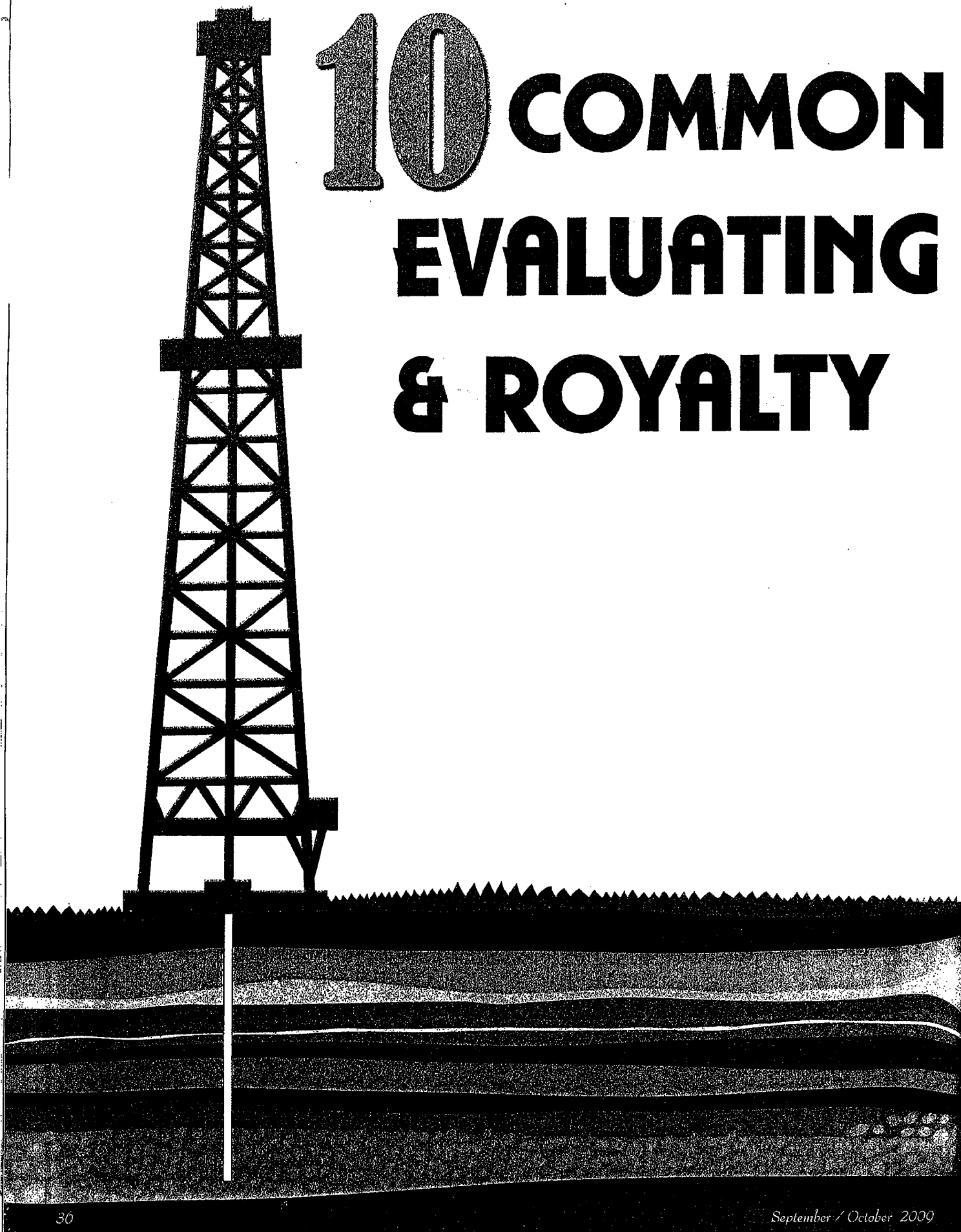


# 10 COMMON EVALUATING & ROYALTY



# PITFALLS IN MINERAL TITLES

By Ronald D. Nickum

A pitfall is more than a mistake made in a transaction. It is a trap. In oil and gas conveyancing there are a number of traps, and they have been around a long time. The legal equivalent of a pitfall is a negligence or malpractice complaint, and no landman wants that. There haven't been a lot of malpractice complaints against landmen and hopefully that will continue to be the case; however, this author has seen at least one situation involving very large tracts of acreage in which landmen out of a reputable office combined serious mistakes with a belligerent attitude, and this did generate litigation. This article is about avoiding pitfalls when drafting or interpreting instruments that convey and reserve minerals and royalty in

Texas. The index to this paper acts as a checklist of these traps. A good resource for landmen is an article on forms of mineral and royalty conveyances presented at the 22nd Annual Oil, Gas & Energy Resources Law Course.<sup>3</sup> This article contains an analysis and discussion of nearly every clause and paragraph used in such instruments, and the paper may be used by a landman to look for clauses and interpret them in light of the case law that might apply to them.<sup>4</sup>

## **Pitfall 1 – Understand what you are looking for and where you should look, and use checklists**

The first opportunity to make a significant mistake is overlooking places and issues that might be important. What are you looking for? Where should you look? Where do you start? You start by being absolutely sure of what the client wants. Is this a lease acquisition situation, a drilling situation or perhaps an acquisition of acreage? What are the exact parameters of your mission? You can have the office manager tell you, or you can read what the client wants. Ask to see the buy-sell agreement, the farmout agreement or the letter agreement. Bone up on what this title search is about. Then go to work. Use this checklist so you don't miss a source of information.

## **Check the Following Records:**

### **Abstract Company**

- Reception Book
- Main Tract Index
- Ask about separate volumes for tax liens, abstracted judgments, other idiosyncrasies

### **County Clerk**

- Reception Book
- Grantor/Grantee Index
- Lessor/Lessee Index for oil and gas leases
- Tax liens
- Abstracted judgments

### **County Tax Assessor/Collector**

- List of record ownership
- Tax delinquencies

### **County Clerk/Secretary of State of Texas**

- UCC filings

Will you need to check all of these sources? That depends on your mission. It might be embarrassing — or costly — if you do not. When checking sources, do not assume that tax liens or judgments will automatically show up in the main tract index at the abstract office or the grantor/grantee index at the county

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clerk's office. These records are sometimes kept in separate books or files and indexed separately. Moreover, some private abstractors have their ways. They may not list all title matters of importance in a tract index, choosing instead to place specific title matters in other books or files. You may look at a tract index and have no clue that there is another book or folder you should look into. Ask the abstractor if there is anything you should look at besides the tract index.

You may want to review financing statements.<sup>5</sup> These were recorded in the county clerk's office prior to 2001, but afterward they were and are required to be filed with the Texas secretary of state. Some of the forms you might want to look at include the *UCC Financing Statement (Form UCC1)* (Rev. 05/22/02), *UCC Financing Statement Addendum (Form UCC1Ad)* (Rev. 05/22/02) and *UCC Financing Statement Additional Party (Form UCC1AP)* (Rev. 05/22/02), which are the prescribed forms by the International Association of Commercial Administrators. The UCC1AP form may only be used in conjunction with the UCC1 form to add multiple debtors or secured parties. The *UCC Financing Statement Amendment (Form UCC3)* (Rev. 05/22/02), *National UCC Financing Statement Amendment Addendum (Form UCC3Ad)* (Rev. 07/29/98), and *UCC Financing Statement Amendment Additional Party (Form UCC3AP)* (Rev. 05/22/02) may only be used in conjunction with the UCC3 form to add multiple debtors or secured parties. UCC5 is the prescribed form to correct a filing. Pursuant to Chapter 9, Subchapter G, Texas Business & Commerce Code, county clerks are to record terminations on financing statements that were recorded in the county clerk's office prior to July 1, 2001. All other types of amendment filings would require the filing of a financing statement in the secretary of state's office. Documents pertaining to real estate records are to be filed in the county clerk's office.<sup>6</sup>

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*What minerals and royalty are being conveyed?*

It is also important to understand the difference between fractions of minerals or royalty and fractional minerals or royalty. If there is a question, use this checklist to make it clear what you are dealing with in a conveyance.

- An undivided  $\frac{1}{n}$  of minerals
- An undivided  $\frac{1}{n}$  of grantor's minerals
- An undivided  $\frac{1}{n}$  of royalty
- An undivided  $\frac{1}{n}$  royalty

*What mineral or royalty rights are being reserved?*

Minerals come with rights. Royalty does not. In reading a deed be aware of the kinds of rights that come with, or may be reserved from, a deed:

- Executive rights
- An undivided  $\frac{1}{n}$  of bonus
- An undivided  $\frac{1}{n}$  of rentals
- An undivided  $\frac{1}{n}$  of shut-in royalty

*Is the land subject to the Relinquishment Act?*

Passed in 1919, the Texas Relinquishment Act applies to permanent school fund lands.<sup>7</sup> Generally, the patent or amended patent will tell you if the lands are subject to the act. The oil and gas underlying these lands belong to the state. The act was an attempt to gain the surface owners' cooperation in the development of the oil and gas, imposing upon the surface owner the duty to act as the agent for the state in leasing the minerals and negotiating not only the bonus but also the terms of the oil and gas lease. The general land office form of lease must be used. Initially, it was thought that the act conveyed 15/16ths of the oil and gas to the surface owners while reserving for the state a share of the delay rentals and an undivided 1/16th of the oil and gas as a royalty.<sup>8</sup> Detractors complained that the act was an unconstitutional donation of assets of the permanent school fund.<sup>9</sup> The court affirmed the constitutionality of the act in *Greene v. Robison*,<sup>10</sup> con-

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cluding that the act did not donate the oil and gas to the surface owners but instead made the surface owners the state's representatives for the purpose of procuring oil and gas leases for act land. Under the act, the state and the surface owner share equally the consideration paid for the lease, with the surface owner's share being compensation for damage to his lands, so that each is entitled to one-half of all bonuses, royalties, rentals or other consideration.<sup>11</sup> While the surface owner is not the state's gen-

## Landman TITLES

eral agent for all purposes, within the scope of the Relinquishment Act, the surface owner is the state's agent to the extent that the state's assets are entrusted to the control of the surface owner, who must not abuse that trust. Agents selling assets for owners — including surface owners under the Relinquishment Act — owe a fiduciary duty to the owners, and agents violate this duty

by acquiring assets for their own benefit.<sup>12</sup> The Relinquishment Act thus also prohibits surface owners from acquiring working interests in the permanent school fund minerals underlying their property.<sup>13</sup> In *State v. Standard*, the surface owner negotiated a Relinquishment Act lease that gave the surface owner (but not the state) an option to acquire a working interest. The court held the lease was invalid because it provided for substantial consideration in which the state could not participate.<sup>14</sup>

### Other burdens

Determine what other burdens you are required to list, including:

- Patent Information
- Applicability of the Relinquishment Act
- Easements
- Mortgages
- Options and Rights of First Refusal
- Working Interest Decimal Before Payout
- Working Interest Decimal After Payout
- APO/BPO Overriding Royalties
- Nonconsent Penalties
- Production Payments

### Pitfall 2 – Don't interpret or construe ambiguous instruments

When oil and gas migrates from reservoirs into deeds it comes "together with all and singular the rights and appurtenances thereto in any wise belonging ..."<sup>15</sup> Those rights and appurtenances are listed in one of the most commonly quoted statements about minerals from *Altman v. Blake*:<sup>16</sup> "A mineral estate consists of the following five rights: (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." It is now a settled rule that pursuant to the "greatest estate rule," a conveyance of minerals carries with it all of these rights unless one or more of them has been previously severed or is being reserved in the deed.<sup>17</sup> Thus, use of the term "minerals," "mineral estate" or "oil, gas and other minerals" incorporates the five appurtenant rights without need

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receive the royalty retained herein only from actual production.”

Is the reservation one of minerals or royalty? The use of the words “... oil, gas and other minerals in and under and that may be produced from ...” indicate minerals, not royalty. But what of the words “... and the grantor ... shall receive the royalty retained herein only from actual production”? That sentence uses the word “royalty.” We know that

## Landman TITLES

when the word “royalty” is used the courts will presume that is what it is. So, what is your conclusion?<sup>27</sup>

Here is another decision example of a deed construction problem involving use of words connoting minerals and use of the term “royalty.”<sup>28</sup> In a 1943 instrument titled “Mineral Deed,” the owner of a 1/32nd mineral interest in a 32,808.5-acre tract deeded a 50-acre,

1/656.17th interest to a grantee which read as follows:

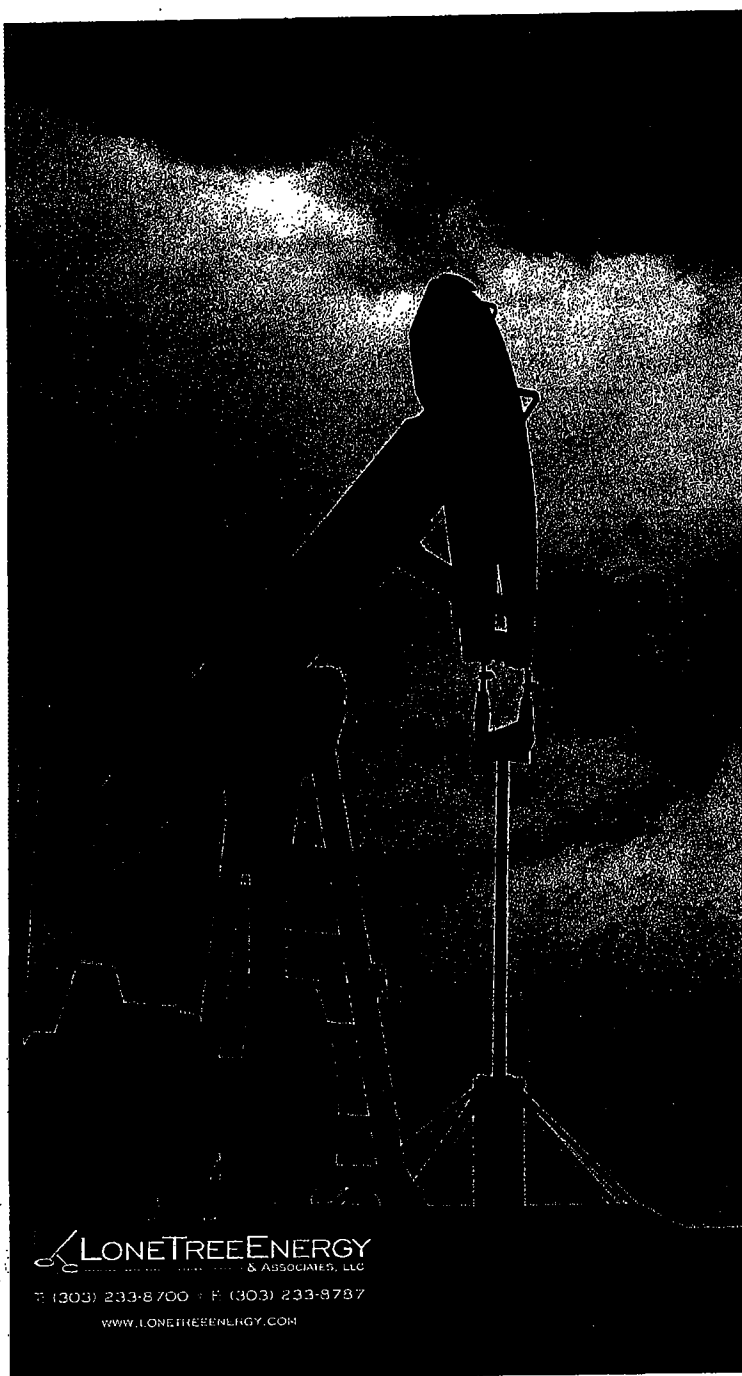
“That I, George Calvert, ... do grant, bargain, sell, convey, set over, assign and deliver unto Capton M. Paul, an undivided Fifty (50) acre interest, being an undivided 1/656.17th interest in and to all of the oil, gas and other minerals, in, under and that may be produced from the following described lands.<sup>29</sup>...

“It is understood and agreed that this conveyance is a royalty interest only, and that neither the Grantee, nor his heirs or assigns shall ever have any interest in the delay or other rentals or any revenues or monies received or derived from the leasing of said lands present or future or any part thereof, or the renewal or extension of any lease or leases now on said lands or any part thereof. Neither the Grantee herein nor his heirs or assigns shall ever have any control over the leasing of said lands or any part thereof or the renewal or extending of any lease thereon or for the making of any lease contract to develop or prospect the same for oil, gas or other minerals, which is hereby specifically reserved in the Grantor.”

Is this a conveyance of a mineral interest or a royalty interest?<sup>30</sup>

When the word “royalty” is used in a document, courts will be most likely to hold the contested interest to be royalty. If this statement seems simplistic, read the majority opinion by the Court of Appeals, the dissent and the opinion of the Texas Supreme Court in *Temple-Inland Forest Products Corp. v. Henderson Family Partnership Ltd.*<sup>31</sup> Here are the excerpts from the deed in that case.

“Grantor[s] grant, bargain, sell, convey an undivided fifteen-sixteenths (15/16ths) interest in, to and of all oil, gas and other minerals that may be produced from the following described land.”



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