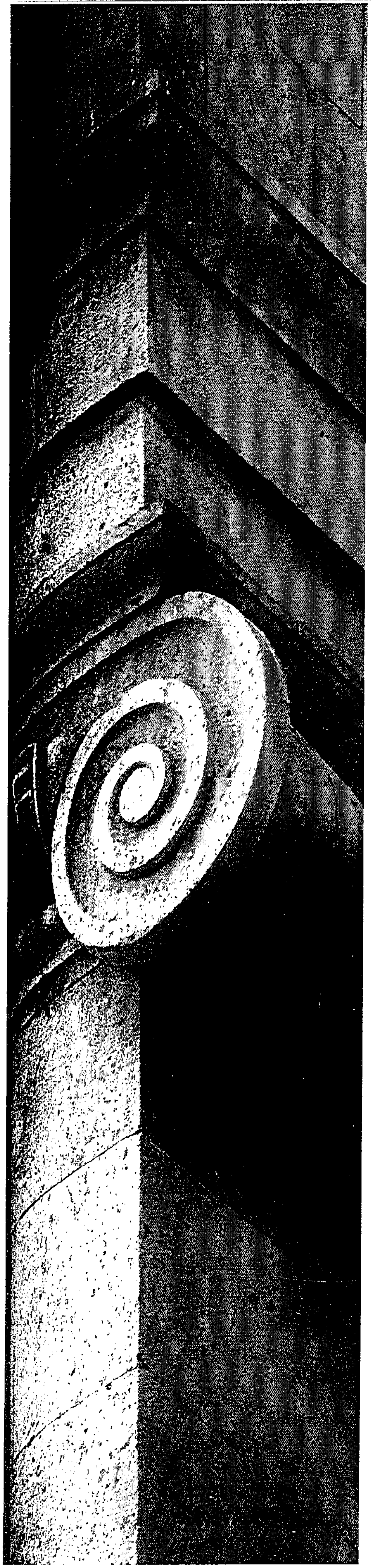

Oil & Gas Law
Nationwide Comparison of Laws on Leasing, Exploration and Production

TEXAS

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TEXAS

I. CHARACTERISTICS OF THE MINERAL AND ROYALTY ESTATE

A. Definition of Oil, Gas and Casinghead Gas

Seldom does a well produce oil only or gas only. Assuming no separate ownership of oil and gas, in the absence of a contract to the contrary, it is the general understanding and commonly accepted custom and practice in the oil and gas industry that gas produced with a well classified as an oil well is called casinghead gas and belongs to the owner of the oil while liquids produced from a well classified as a gas well is gas condensate and belongs to the owner of the gas. If the oil and gas are not owned separately, then the leasehold owner owns both oil and gas and all hydrocarbons products produced therewith. *Reynolds v. McMan Oil & Gas Co.*, 11 S.W.2d 778 (Tex. Comm'n. App. 1928, *holding approved*). If, however, the oil rights are owned separately from the gas rights, then, in the absence of a definition in the instrument creating the separate ownership, the oil and gas rights are as defined in the statute in existence at the time of the instrument of severance. *See Dorchester Gas Producing Co. v. The Harlow Corp.*, 743 S.W.2d 243 (Tex Civ. App.-Amarillo 1987, *no writ* history) and *Amarillo Oil Company v. Energy-Agri Products*, 794 S.W.2d 20 (Tex. 1990), both of which dealt with the "white oil controversy" in the Texas Panhandle field, one of the oldest continuously producing regions in the United States. Both cases applied Article 6008(2)(i), V.A.T.S., now recodified as Sec. 86.002(10) Natural Resources Code, which defines casinghead gas as "gas and/or vapor ***indigenous to an oil stratum*** and produced from such stratum with oil". A restatement of this definition is that casinghead gas is gas which is in solution with oil in the reservoir and is produced with the oil.

B. Elements of a Mineral Interest

The mineral estate consists of the following elements: (1) the right to explore and develop yourself (includes the rights of ingress and egress); (2) the right to execute an oil and gas lease (usually called the leasing right or the executive right); (3) the right to receive bonus; (4) the right to receive delay rental and (5) the right to receive royalty (Texas acknowledges permanent non-participating royalty) *Altman v. Blake*, 712 S.W.2d 117, 118 (1986), 91 O&GR 346.

If a mineral owner drills a well himself or participates himself in the drilling of a well, he is entitled to receive his proportionate part of all production, less his share of expenses, and there is no bonus, delay rental or royalty paid to him. He would be considered a non-leasing co-tenant. *Bullard v. Broadwell*, 588 S.W.2d 398 (Tex. Civ. App.-Eastland 1979, writ ref'd n.r.e.), 64 O&GR 336. Normally however, the party owning the leasing right executes an oil and gas lease, and part of the consideration of granting said lease is the payment of bonus, delay rental and royalty. *Griffith v. Taylor*, 156 Tex. 1, 291 S.W.2d 673 (1956), 5 O&GR 1371.

C. Conveyability

Each element of the mineral estate can be owned, conveyed, reserved or inherited separately from the other elements. The leasing right, however, has been held to be a personal right, not a real property right, and thus not inheritable when it was reserved by the grantor, and not by the grantor, his "heirs and assigns." *Pan American Petroleum Company v. Cain*, 355 S.W.2d 506 (Tex. 1962), 16 O&GR 427. However, the Texas Supreme Court overruled itself in *Cain* and held in *Day & Co., Inc. v. Texland Petroleum, Inc.*, 786 S.W.2d 667 (Tex. 1990), effective on March 7, 1990, that the executive right is a real property right, not a personal or contract right, and that it is treated as any other element of the mineral estate.

D. Mineral or Royalty Interest for a Term of Years

Term-royalty and term-mineral interest are divided into two basic types: A grant or reservation for a fixed term only and a grant or reservation for a fixed term and "as long thereafter as oil or gas is produced" in paying quantities. In the second instance, there must be actual production from the land covered by the term interest at the expiration of the primary term or the term interest ceases. *Minchen v. Fields*, 162 Tex. 73, 345 S.W.2d 282 (1961) 14 O&GR 266. Temporary cessation of production will not terminate the term interest where it is attributable to mechanical breakdown and the operator commences diligent reworking operations. *Midwest Oil Corp. v. Winsauer*, 149 Tex. 560, 323 S.W.2d 1944 (1959), 10 O&GR 1123.

If the owner of the term interest and the owner of the possibility of reverter join together in executing a joint lease, the habendum clause of the term interest is modified thereby so that the term interest is perpetuated by production anywhere on the leased premises, *Southland Royalty Company v. Humble Oil & Refining Co.*, 151 Tex. 324, 249 S.W.2d 914 (1952), 1 O&GR 1431, or on land pooled therewith. *Spradley v. Finley*, 157 Tex. 260, 302 S.W.2d 409 (1957), 7 O&GR 650. Similarly, a shut-in royalty paid pursuant to a base lease did not continue the term assignment owned by the operator of the well when the term expired within the shut-in period. *Riley v. Meriweather*, 780 S.W.2d 919 (Tex. App. - El Paso 1989, *writ denied*).

The payment of a shut-in gas royalty pursuant to a lease will not continue a term mineral interest into its secondary term unless the instrument creating the term mineral interest ties its term contractually into the term of an oil and gas lease covering said land or contains a shut-in gas royalty clause itself. *Archer County v. Webb*, 326 S.W.2d 250 (Tex. Civ. App.-El Paso 1959), *affirmed* 161 Tex. 210, 338 S.W.2d 435 (1960), 13 O&GR 280.

BEWARE – If the phrase "and as long thereafter as..." is omitted, then a term interest can result in a perpetual interest. In *Browning v. Grigsby*, 657 S.W.2d 821 (Civ. App. Texarkana 1983, *no writ* history) 78 O&GR 548, there was a reservation of one-half of the mineral estate with a proviso that: "this mineral exception and reservation shall expire on October 25, 1958, unless at that time the above named minerals or either of them is being produced from said premises in paying quantities." The Court held that production in paying quantities on the date stipulated maintained the Grantor's interest in perpetuity; it did not terminate when production later ceased.

Hemingway - Sec. 2.2-2.6, 3.2(A), 5.1(B), 6.4(B), 6.5(A), 7.13(B), 9.4(A) and 9.11(A)
Kuntz - Sec. 6.9 & 15.8
Summers - Sec. 305, 511, 554, 586, 599, 604, 611, 958, 962,965
W & M - Sec. 323, 327.2, 334.8, 338, 418.2, 633.5, 955, 961.2

E. Leasehold and Overriding Royalty

The term "leasehold interest" means the ownership interest a person has in an oil and gas lease. Typically, an owner would buy or sell a leasehold interest. The term "working interest," while often used in the same manner as the term leasehold interest, should be restricted to discussions of how leasehold owners participate in drilling a well. In *Broesche v. Jacobson*, 218 S.W.3d 367 (Tex. Civ. App. - Houston [14th Dist.} 2007, *no pet.*), a divorce suit between two geologists, the Court held that the Exhibit A to their Property Settlement Agreement, which was intended to identify the oil and gas interests he conveyed to her, was ambiguous because it did not clearly distinguish between identifying the leases involved (leasehold interest) or the working interest in the specific wells identified. The only time a person's working interest would be the same as his leasehold interest is when a well is produced from a single lease. A working interest is a lesser percentage than a leasehold interest because of the proportionate reduction caused by the existence of multiple leases and/or pooling of leases.

Overriding royalty interests are real property interests created out of or reserved in a conveyance of a leasehold and, along with royalty, burdens the leasehold owner. Overriding royalty is non-expense bearing, and it reduces the net revenue available to the leasehold owner. An overriding royalty interest terminates upon the termination of the oil and gas lease it burdens unless the instrument creating the overriding royalty contains language continuing the overriding royalty as to renewals and extensions of the original lease. *MacDonald v. Follett*, 142 Tex. 616, 180 S.W.2d 334 (1944). A leasehold owner burdened by an overriding royalty can pool his leases without obtaining the consent of the overriding royalty owner. *Union Pacific Resources Co. v. Hutchison*, 990 S.W.2d 368 (Tex. App - Austin 1999), 141 O&GR 622. If a leasehold owner elects to be non-consent under his JOA, the overroyalty burdening that leasehold owner will not be paid until the leasehold owner backs-in after payout, as defined in the JOA. *Boldrick v. BTA Oil Producers*, 222 S.W.3d 672 (Tex. App. - Eastland 2007, *no pet.*).

F. Dormant Mineral Act, Marketable Title Act or Title Standards

Texas has adopted neither a Dormant Mineral Act nor a Marketable Title Act. However, the State Bar of Texas has adopted title standards and the Title Examination Standards Joint Editorial Board, sponsored by the Bar's Real Property, Probate and Trust Section and the Oil, Gas and Mineral Law Section, will continue to draft and revise additional standards. Texas Title Standards are referenced where applicable.

The State Bar of Texas first approved Title Standards effective 1997. The Title Standards Joint Editorial Board meets three to six times per year as necessary in order to review the prior standards and add new standards. As of January 1, 2001, the State Bar of Texas has approved 59 standards divided into the following Chapters:

Chapter I	Title Examiner (3)
Chapter II	Marketable Title (1)
Chapter III	Name Variances (7)
Chapter IV	Execution, Acknowledgment and Recordation (3)
Chapter V	Land Descriptions (1)
Chapter VI	Corporate Conveyances (7)
Chapter VII	Conveyances Involving Partnerships, Joint Ventures, and Unincorporated Associations (5)
Chapter VIII	Powers of Attorney (2)
Chapter IX	Conveyances Involving Trustees (2)
Chapter X	Capacity to Convey (2)
Chapter XI	Decedent's Estates (10)
Chapter XII	Bankruptcies.(16)
Chapter XIII	Affidavits and Recitals (4)
Chapter XIV	Marital Interests (10)
Chapter XV	Liens and Lis Pendens (11)
Chapter XVI	Foreclosures (4)

The Title Standards Joint Editorial Board is a committee composed of members from the Real Estate, Probate and Trust Law Section and the Oil, Gas and Mineral Law Section of the State Bar of Texas. The standards can be reviewed on their own Web site, http://west.thomson.com/pdf/texas/PropT2App.pdf or at the section Web sites which are www.reptl.org and www.oilgas.org.

Texas Title Standards are referenced where applicable.
Hemingway - Sec. 1.3, 2.2, 2.5(B), 7.2(B)
Kuntz - Sec. 15.2, 15.3, 15.4, 16.1
Summers - Sec. 62, 136, 554, 586, 589, 595, 597.1, 604, 962
W & M - Sec. 324.2, 334.9, 428.1, 607.7 651.2, 654, 953

II. WHO CAN LEASE?

A. Marital Property

Jointly owned — Community property

Texas has adopted the Spanish-Mexican influenced community property system, not the English common law system, for marital property. Tenancies by the entirety are abolished. Joint tenancies with right of survivorship cannot be created between spouses with existing community property except as discussed hereafter. Spouses using their separate property only, or other persons, can own property as joint tenants with right of survivorship if the creating instrument expressly identifies the grantees as "joint tenants with right of survivorship." Texas Probate Code, Sec. 46.

All property acquired while married, other than separate property, is community property. Texas Family Code, Sec. 5.01(b). Community property is owned equally by both spouses. Where title is joint, both can manage. Where title is in one spouse only, then that spouse alone can manage, lease or sell, except for homestead. Texas Family Code, Sec. 5.22 and Sec. 5.24.

Separate property

Separate property, generally consists of (a) property acquired while single or (b) if married, property acquired by (1) gift or (2) inheritance Texas Family Code, Sec. 5.01.

Normally, both spouses execute oil and gas leases jointly, whether the mineral interest is community property or separate property. However, if the mineral interest is separate property, that spouse alone can execute a binding oil and gas lease, except upon homestead property.

Classification as either separate or marital property — Who must sign

Property owned during marriage takes its status as separate property or community property at the time it is acquired. Such status is fixed by the facts or circumstances existing at that time. This is called the Inception of Title Doctrine. *Smith v. Buss*, 136 Tex. 566, 144 S.W.2d 529 (1940).

Property possessed by either spouse during or on dissolution of the marriage is presumed to be community property. This presumption can be rebutted by "clear and convincing evidence." Texas Family Code Sec. 5.02.

Conversion of type of joint ownership between spouses

Prior to November 3, 1987, spouses could not convey their community property to themselves as joint tenants with right of survivorship without first having a formal partition of said community property into the separate property of each spouse. *Hilley v. Hilley*, 161 Tex. 569, 342 S.W.2d 565 (1961), as explained in *Williams v. McKnight*, 402 S.W.2d 505 (Tex. 1966). After November 3, 1987, spouses can acquire title to a mineral estate as joint tenants with right of survivorship, and spouses can convey community property to themselves as joint tenants with right of survivorship as long as the instrument creating said interest expressly states that the grantees take as "joint tenants with right of survivorship" and said instrument is signed by both parties. Article 16, Sec. 15, Texas Constitution and Sec. 5.52-5.54, Texas Family Code, as amplified by Sec. 451 *et seq.*, Texas Probate Code, effective August 28, 1989.

Individual acknowledgment

Texas has adopted the Uniform Acknowledgment Act. §121.008, Texas Civil Practices & Remedies Code. Included is a Texas short form acknowledgment for an individual, which can be used for more than one person:

THE STATE OF TEXAS)
COUNTY OF)
This instrument was acknowledged before me on (date) by (name or names of person or persons acknowledging).

____
Notary Public - State of Texas
My commission expires:________

Hemingway - Sec. 2.4
Kuntz - Sec. 5.11
W & M - Sec. 5.16

B. Homestead

Definition of homestead rights

In Texas, the homestead right consists, in part, of the following:

a. Homestead property is exempt from forced sale for debts except for purchase money liens, property improvement liens and taxes; Tex. Prop. Code Sec. 41.001(b).
b. Neither spouse may convey or encumber the homestead without the joinder of the other spouse; Tex. Family Code Sec. 5.81.
c. A surviving spouse has the right to possession of the property for life or until abandonment, without regard to how title is then vested; Tex. Probate Code Sec. 283
d. A guardian for minor children has the right to possession of the property during the minority of the children, without regard to how title is then vested; Tex. Probate Code Sec. 284.

The homestead right does not extend to severed minerals.

Types of homestead and whom they benefit

The homestead right extends to a "family" and to a "single adult person, not otherwise entitled to a homestead." Tex. Prop. Code Sec. 41.002(a). The term "family" is not defined by statute.

A rural homestead for a family shall consist of not more than 200 acres of land, which may be in one or more parcels, with the improvements thereon. A rural homestead for a single adult shall consist of not more than 100 acres of land, which may be in one or more parcels, with the improvements thereon. Tex. Prop. Code Sec. 41.002(b). An urban homestead may consist of a lot or lots, with improvements, containing not more than 10 acres of land. An urban homestead may be either the urban home of the single adult person or family or used both as a urban home and as "a place to exercise a calling or business" in the same "urban area," as defined. Tex. Prop. Code Sec. 41.002(a) and ©. Texas is the only state in the Union to recognize an urban business homestead.

Extent of possession necessary

Homestead rights attach to property which is actually occupied as a homestead or property which the owner intends to occupy as a homestead. In the latter situation, the property is not impressed with homestead character until the owner has made some "overt act of preparing" the property for homestead use. *Cheswick v. Freeman*, 155 Tex. 372, 287 S.W.2d 171 (1956).

Leasing homestead

If the mineral estate has not been severed from the surface estate and if the surface estate is a homestead (see II.B. infra), then both spouses must execute an oil and gas lease, or it is inoperative as to the non-joining spouse. Texas Family Code, Sec. 5.81 and 5.82. An oil and gas lease executed by only one spouse or less than all of the persons owning the homestead right is inoperative as to the nonsigning parties as long as the property is homestead or until the homestead is abandoned or the lease is ratified by all owners. Such lease can be set aside if done so before the homestead is abandoned. *Grissom v. Anderson*, 125 Tex. 26, 79 S.W.2d 619 (1935). *Also see* Sec. 5.81 (Note 18) Texas Family Code and Art. 16, Sec. 50 (Note 37), Texas Constitution.

BEWARE – Because of the rules previously set forth, both spouses and all other homestead claimants should always jointly execute an oil and gas lease. The only exception is when there is no possibility that the property covered in the lease could be claimed as homestead property.

Caveat

BEWARE – The homestead right can be utilized to defeat a testator's stated intention. For example, a testator willed all of his producing mineral rights in his homestead to his children from a former marriage. The widow renounced all benefits under the will and claimed her statutory share of the royalties as part of the homestead, in addition to possession of the homestead. Applying the Open Mine Doctrine, it was held that the widow, as life tenant, was entitled to receive all of the royalties, not just the interest from a one-third life estate and that the division order executed by the widow and her husband subsequent to the lease, while vesting title to the oil as produced in the lessee, did not affect her homestead rights as to the oil in place. *Thompson v. Thompson*, 149 Tex. 632, 236 S.W.2d 779 (1951).

Hemingway - Sec. 2.7©, 6.3(B)
Kuntz - Sec. 8.5
Summers - Sec. 452, 583, 613
W & M - Sec. 218, 516, 606.4, 70

C. Business Entities

Corporations

A Texas corporation, or any other business entity, may purchase, lease or otherwise acquire, use or deal in oil, gas or other real property, or any interest therein. Texas Business Organizations Code, V.T.C.A. Bus. Org. Code (TBOC) §10.251. A corporation may convey or lease minerals, with or without a corporate seal, signed by the president, a vice-president or an attorney-in-fact. TBOC §10.251 - 10.253. *See* Title Standards 6.10-6.70.

ACKNOWLEDGMENT

STATE OF TEXAS)
COUNTY OF _________)
This instrument was acknowledged before me on (date) by (name of officer), (title of officer) of (name of corporation acknowledging) a (state of incorporation) corporation, on behalf of said corporation.

____
Notary Public - State of Texas
My commission expires:________

General partnership

TBOC §10.251 and 152.102 provide that a general partnership may acquire and convey real property in the partnership name and that any partner may execute such conveyance in the partnership name. TBOC §152.301-152.302. See Texas Title Standards 7.10-7.40.

ACKNOWLEDGMENT

A Texas short form acknowledgment for a partnership is as follows:

STATE OF TEXAS)
COUNTY OF _________)
This instrument was acknowledged before me on (date) by (name of acknowledging partner or partners), partner(s) on behalf of (name of partnership), a partnership.

____
Notary Public - State of Texas
My commission expires:________

Limited partnerships

TBOC §10.251 and 153.152 provide that a Texas limited partnership may engage in any lawful business and that an oil and gas lease may be executed by the general partner of the limited partnership. *See* Texas Title Standards 7.10-7.40.

ACKNOWLEDGMENT

An acknowledgment for a limited partnership in Texas is as follows:

STATE OF TEXAS)
COUNTY OF _________)
This instrument was acknowledged before me on (date) by)(name of acknowledging general partner or partners, partner(s) on behalf of (name of limited partnership), a limited partnership.

____
Notary Public - State of Texas
My commission expires:________

Limited liability companies and limited liability partnerships (LLCs and LLPs)

The Texas Limited Liability Company Act (TLLCA), Art. 1528n, effective August 26, 1991, which is now codified as the Texas Business Organizations Code (TBOC) effective January 1, 2010, allows the creation of a new business entity creating limited liability for all participants but having most of the characteristics of a corporation. A Limited Liability Company (LLC) has "members," similar to investors, and "managers," similar to officers and directors of a corporation or similar to general partners of a limited partnership. An LLC is identified by the word "limited" or abbreviations "Ltd." or "L.L.C." TBOC §5.056. An oil and gas lease or other conveyance may be executed by a manager, officer or agent vested with actual or apparent authority, or a member, if management is retained by members. TBOC §10.251 and 101.253 - 101.254. *See* Title Standard 7.50.

ACKNOWLEDGMENT

Sec. 121.008 of the Civil Practices & Remedies Code entitled "Short Forms for Certificates of Acknowledgment" does not identify an acknowledgment form for a L.L.C.

The corporation acknowledgment form should be adapted as follows:

STATE OF TEXAS)
COUNTY OF _________)
This instrument was acknowledged before me on (date) by (name of acknowledging manager, officer, agent, or member), (title of executing person) of (name of L.L.C.)

____
Notary Public - State of Texas
My commission expires:________

Hemingway - Sec. 5.7
Kuntz - Sec. 20.6
Summers - Sec. 164, 231, 551
W & M - Sec. 213.4, 214.2, 226.3

D. Attorney-in-Fact

General rules

An attorney-in-fact may execute an oil and gas lease if the power of attorney expressly grants the authority to execute said lease. Powers of attorney that contain a list of authorized actions are to be strictly construed, and a general power to sell land does not authorize the agent to sell and convey minerals under the land by lease or deed. *Bean v. Bean*, 79 S.W.2d 652 (Tex. Civ. App. Texarkana, 1935, *writ ref'd*). However, the Texas Supreme Court has not, and may not, expressly affirm this strict rule.

Universal power of attorney

A universal power of attorney, which gives the attorney-in-fact broad powers, usually stating that the attorney-in-fact has all authority that the principal would have but does not expressly authorize executing an oil and gas lease, has been given effect. *Dockstader v. Brown*, 204 S.W.2d 352 (Tex. Civ. App. - Fort Worth 1947, writ ref'd n.r.e.).

Necessity of recording power of attorney

The power of attorney may be recorded in the county where the land covered by the oil and gas lease is located. Tex. Prop. Code Sec. 12.016.

Curative necessary

A title examiner will require an affidavit from a knowledgeable person stating:

a. That the principal was alive on the date said power was exercised;
b. That the principal was competent on the date said power was exercised; and
c. That the power of attorney has not been revoked.

An exception to the competency requirement exists if the power of attorney expressly states that the power survives the disability of the principal, making it a durable power of attorney. Effective August 28, 1989, a durable power of attorney must be witnessed and signed by two adults and be recorded in the county of the principal's residence. Tex. Prob. Code Sec. 36A.

Durable power of attorney

As of September 1, 1993, the rules stated above, as to durable powers of attorney, are changed because Sec. 36A of the Texas Probate Code was replaced with the "Durable Power of Attorney Act," consisting of Sections 481-506 of the Texas Probate Code. The changes are as follows:

a. A durable power of attorney must be recorded in the Office of the County Clerk of the county in which the property is located. Sec. 489.
b. Instead of obtaining an affidavit, usually after the transaction, confirming that the authority of the attorney-in-fact had not terminated at the time of performance, the act contemplates that the attorney-in-fact will execute an affidavit, contemporaneous with the transaction, confirming that he has no actual knowledge of any terminating event. This affidavit, which should be recorded along with the instrument of conveyance, is conclusive proof that the agent had authority at the time. Sec. 487.
c. Unless otherwise provided in the Durable Act of Attorney itself, a revocation of a durable power of attorney is not effective as to a third party relying on the power until the third party receives actual notice of the revocation. Sec. 488.
d. The statute creates a statutory durable power of attorney form enabling a principal to delegate broad authority but requiring only one or two pages. This is possible because the statute itself contains the many details incorporated by identifying broad categories of authority in the form. Caution is necessary if the principal intends to delegate authority to the agent to execute an oil or gas lease or related instruments. Prior to Sept. 1, 1997, Sec. 492, entitled "Real Property Transactions" did not include the authority to execute conveyances of oil, gas and other minerals. Therefore, the *Bean v. Bean* dilemma continues to exist, even if the statutory form is used, as to conveyances effective from Sept. 1, 1993, to Sept. 1, 1997. Sec. 492.

This is the Texas version of the Uniform Statutory Form Power of Attorney Act. *See* Texas Title Standards 8.10 and 8.20.

Acknowledgement

A Texas short form acknowledgment for an Attorney-in-Fact is as follows:

STATE OF TEXAS)
COUNTY OF _________)
This instrument was acknowledged before me on (date) by (name of Attorney-in-Fact) as Attorney-in-Fact on behalf of (name of principal).

____
(Signature of Officer)
(Title of Officer)
My commission expires:____________

Hemingway - Sec. 5.7(A)
Kuntz - Sec. 20.9

E. Estate of Resident Decedent

Rules of descent and distribution (intestate succession)

The applicable rules of descent and distribution in Texas are summarized as follows:

Intestate - Community property - No children - All to surviving spouse. Texas Probate Code, Sec. 45. (All subsequent references in II-E and II-F are to Secs. of the Texas Probate Code).

Intestate - Community property - Spouse and children - If the decedent died before September 1, 1993. The decedent's share of the community goes to the decedent's children, per stirpes. Sec. 45.

Intestate - Community property - Spouse and children - If the decedent died on or after September 1, 1993.

1. If all of the decedent's children are of the decedent's marriage to the surviving spous, the decedent's share of the community goes to the surviving spouse;
2. If the decedent's children are the result of two or more marriage, the decedent's share of the community goes to all of the decedent's children, per stirpes. Sec. 45.

Intestate - Decedent's separate property - Survived by spouse and children. One-third of the life estate goes to spouse with remainder in children; two-thirds in fee goes to the children (realty only). Sec. 38(b).

Intestate - Decedent's separate real property - Spouse and no children. One-half goes to the spouse, and One-half goes to the "heirs at law." Sec. 38(a). "Heirs at law" are defined as:

1. Surviving parents, one-half each.
2. If only one parent survives, the other one-half to brothers

and sisters, per stirpes. The result is that the surviving spouse becomes a tenant in common with the "heirs at law."

3. If no parents, brothers, sisters, nieces or nephews, then all to surviving spouse.

Lapse doctrine

Texas has adopted the common law lapse doctrine. This doctrine provides that a gift to a devisee who predeceases the testator lapses and passes pursuant to the residuary clause in the will. If the will does not contain a residuary clause, then the gift passes by descent and distribution. In Texas, the common law lapse doctrine is modified by the Texas lapse statute, Sec. 68 of the Texas Probate Code. This section provides that a gift to the testator's "child or other descendant," who predeceases the testator, shall not lapse but shall vest in "the children or descendants of such...devisee in the same manner as if he had survived the testator and died intestate."

Administration of estate of intestate decedent

Some general rules concerning the administration of an intestate decedent's estate are:

a. Formal dependent administration is required if two or more debts or other necessity is determined by the Court. Sec. 178(b). However, informal Affidavits of Death and Heirship are frequently used where the estate is small and where all heirs are adults and are in agreement as to the manner of administration.
b. An oil and gas lease from a dependent administrator obtained by private sale must be approved by the Court, Sec. 368, unless administration is an "independent administration," as permitted in Sec. 145.
c. Heirs should not manage property until dependent administration is closed by court order.

Administration of estate of testate decedent

A will is not effective until it is probated. The heirs' title relates back to the date of death. Sec. 37.

If the will names an independent executor, unless the will states otherwise, the independent executor can execute an oil and gas lease without court approval and without ratification by the heirs for the purpose of preserving and protecting the assets of the estate as long as the estate still has unpaid debts and the estate has not been closed. *Lowrance v. Whitfield*, 752 S.W.2d 129 (Tex. App.-Houston [1st Dist.] 1988, *no writ* history). The *Lowrance* case acknowledges that an independent executor has the authority that an administrator or executor under court order would have in the settlement of an estate. Sec. 367(b) permits courts to issue orders allowing personal representatives to execute oil and gas leases. Sec. 367(c)(7) limits the lease to no more than a five-year primary term and to containing no more than a 60-day cessation of operations clause.

Rules relative to closing estate

Estates are frequently kept open for an indefinite period even though all taxes and debts have been paid, and frequently closing affidavits are not recorded in all counties where the decedent owns property. Independent administration is considered closed for statute of limitations purposes when debts have been paid and all estate property has been distributed. *Estate of McGarr*, 10 S.W.3d 373 (Tex. App. - Corpus Christi 2000, *pet. denied*).

The independent executor closes the estate either by court order or, more commonly, by affidavit. Sec. 151. Sec. 188 provides that if executors are legally qualified and their acts appear from the record to be in conformity with provisions of the will and the powers which executors have under the law, then their acts will be regarded as valid so far as said acts affect the rights of innocent purchasers for value and subsequent purchasers from them. Therefore, such purchasers will be protected against any attack on their title based on a claim of invalidity of the acts of the executors. The following case holds that the actions of an Independent Executor are protected in the same manner as a dependent executor. *Dallas Services for Visually Impaired Children, Inc. v. Broadmoor, II*, 635 S.W.2d 572 (Tex. App.-Dallas 1982, *writ ref'd n.r.e.*). A good faith purchaser may rely upon the apparent regularity of the probate proceedings and the apparent authority of the independent executor to sell property. He need not inquire into matters outside the record that might affect the executor's authority. *American Finance & Investment Vo. v. Herron*, 20 S.W.3d 829 (Tex. App. - El Paso 2000, *no pet*).

F. Estate of Non-Resident Decedent

If ancillary probate of foreign will is not necessary

If ancillary administration of the foreign will is not necessary, and usually it isn't, then an exemplified copy of the foreign will and the order admitting same to probate can be recorded in the Deed Records of the county where the decedent owned real property in Texas. Sec. 96. Such recording has the same force and effect as a Deed of Conveyance as to all property in the state covered by the foreign will. Sec. 98. It is a better practice to also include the application to admit the foreign will and, if the foreign estate is closed, the closing order. Both the application to probate the will and the closing order contain important information, such as the date of the decedent's death and the names and addresses of surviving heirs.

If ancillary probate of foreign will is necessary

It is not necessary to probate the foreign will if the only transaction necessary in Texas is to execute an oil and gas lease. If administration is necessary, pursuant to application, the foreign will and the proceeding admitting same to probate in the other state, exemplified in the manner required by Sec. 95©, are filed in the probate records of a county where the decedent owned real property. No order by the probate court is necessary. Sec. 95.

Conflict of law rules

While property acquires its status as community property or separate property at the time it is acquired, there is a rebuttable presumption that property owned on the date of death is community property.

Title to real property is exclusively subject to the law of the state where the land is located. In other words, where a non-resident dies intestate owning minerals in Texas, the Texas statutes of descent and distribution determine who inherits the Texas minerals. *Colden v. Alexander*, 141 Tex. 134, 171 S.W.2d 328 (1943). Texas courts, because of their ultimate power over lands located within the state, have the jurisdictional authority to change the above rule and apply the law of the domicile of the parties in preference to the law of Texas. *Toledo Society for Crippled Children v. Hickok*, 152

Tex. 578 261 S.W.2d 692 (1953), 43 ALR 2d 553, *cert. denied* 347 U.S. 936, 98 L Ed. 1086.

It has long been the rule in Texas that when a non-resident dies intestate owning minerals in Texas that must be characterized as either separate property or community property for descent and distribution purposes, the presumption of community property status can be rebutted by evidence showing that the law of the state of the matrimonial domicile would hold that the property in question was the decedent's separate property. *Oliver v. Robertson*, 41 Tex. 422 (1874), *confirmed by Estate of Hanau v. Hanau*, 730 S.W.2d 663 (Tex. 1987). *Also see Orr v. Pope*, 400 S.W.2d 614 (Tex. Civ. App. - Amarillo 1966, *no writ*) which declared it to be the law of this state that where a spouse acquires Texas real property while residing in a common law state, the real property is separate property.

CAUTION – Making this determination, and thus rebutting the community property presumption, requires both knowledge of the property law of the state of marital domicile plus "clear and convincing" evidence that the spouses did not intend the property in question to be owned jointly. In the absence of such proof, a stipulation of interest identifying the actual heirs should be executed by all potential heirs.

Use of affidavit of death and heirship

While the statutory procedure for determining heirship, Sec. 48-56, is seldom used because of the time and expense involved, Affidavits of Death and Heirship are frequently recorded in the Deed Records of a county in Texas where the decedent owned real property to verify who the heirs at law were at the time of death. Sec. 37. Said Affidavit is effective for this purpose if it contains all of the information required by Sec. 49, which is:

a. The name(s) of the decedent, the decedent's residence at the time of his death and the time and place of death;
b. The names and residences of the decedent's heirs, the relationship of each heir to the decedent and the true interest of each of said heirs;
c. The decedent's marital history, including the names and addresses of all spouses and children, whether born or adopted, and the date of death and heirs of any predeceased spouse or child;
d. Whether the decedent died testate or intestate and, if testate, the disposition of the decedent's will;
e. At least a general description of the real and personal property belonging to the estate of the decedent located in Texas but, if possible, a legal description of the property in question and a description of how and when the decedent acquired the property; and
f. An explanation for the omission of any of the above information.
g. A statement that all debts are paid or the manner in which all debts will be paid.

BEWARE – An Affidavit of Death and Heirship, like any other affidavit, may contain inaccurate information caused either by the negligence or the intent of the affiant. The benefit of relying upon the statutory proceeding for determining heirship is that all third parties can rely upon the facts confirmed in the court's final order. Sec. 55.

G. Trustee

Power of trustee derived from the trust instrument

A trustee appointed in a written trust instrument has the powers stated therein. If the trustee is expressly given the authority to manage and sell land, then he impliedly has the authority to execute an oil and gas lease and related instruments. Wills and trust instruments are liberally construed. *Avis v. First National Bank of Wichita Falls*, 141 Tex. 489, 174 S.W.2d 255 (1943). Sometimes, a trust instrument or will gives the trustee all powers authorized by statute. *See* Texas Title Standard 9.10.

Power of trustee derived from the trust statute

All trustees have, unless limited as noted below, the statutory powers provided in the Texas Trust Code, which has been recodified as part of the Texas Property Code, Secs. 101.001-115.015. Sec. 113.012 lists the specific actions a trustee may take, which includes negotiating and executing oil and gas leases covering mineral or royalty interests that extend beyond the term of the trust. Sec. 113.002 authorizes a trustee to exercise additional powers that are "necessary or appropriate to carry out the purposes of the trust." The only limitation upon the trustee's powers is contained in Sec. 113.001 which provides that the powers granted in Sec. 113.002 *et seq.* do not apply if the trust instrument, a subsequent court order, or another provision of the trust code "conflicts with or limits the power." Since the Trust Code does not require that the instrument creating the limitation be recorded, a purchaser has the duty to inquire and obtain a copy of the trust agreement from the trustee. *See* Texas Title Standard 9.10.

Title in trust but no trustee named; "blind" trust

Often title is in a named trust but no individual trustee is identified. Examiners usually do not require an amended conveyance but will require to see a copy of the trust agreement prior to acknowledging a subsequent conveyance so that the examiner can confirm the identity of the trustee and the sufficiency of the trustee's powers.

If a trust is created by conveying to, i.e. "Jack Smith, Trustee" and the creating instrument does not identify a trust instrument or the name of any beneficiary, then the trustee may:

> convey, transfer or encumber the title of the property without subsequent question by a person who claims to be a beneficiary under the trust or who claims by, through or under an undisclosed beneficiary" and "the trust property is not liable to satisfy the personal obligations of the trustee. Sec. 101.001.

This situation is frequently referred to as a "blind trust" and permits the trustee to execute an oil and gas lease. However, if the instrument creating the trust, or some other recorded instrument, identifies a trust instrument or the name of a beneficiary of said trust, then you should make inquiry and obtain a copy of said trust instrument to verify that the trust instrument does not limit the power of the trustee as well as to determine that the trust has not terminated.

If there is a question as to the authority of the trustee or the possibility of the trust having terminated, then ratifications of the lease should be obtained from the beneficiaries.

When record title is in a blind trust and the record owner dies, absent evidence of a valid trust, the trust property vests in the heirs of the trustee. *Jordan v. Exxon Corp.*, 801 S.W.2d 880 (Tex. Civ. App. - Texarkana, *no writ*). *See* Texas Title Standard 9.20.

Allocation of proceeds to principal and income

If an instrument creating a trust directs the trustee how to allocate to principal and income the proceeds from oil and gas production, then said direction should be followed. However, in the event the trust instrument does not address the question of allocation, then the trustee shall make said allocation in accordance with Sec. 113.107 of the Texas Trust Code as follows:

a. "Rent or extension payments on a lease" are allocated as income.
b. The proceeds from a production payment "...are income to the extent of any factor for interest or its equivalent provided in the governing instrument, and the balance of the proceeds is principal."
c. The proceeds of "royalty, overriding royalty or limited royalty, or bonus or from a working interest, net profit interest or any other interest in minerals..." are allocated as follows:
    1. 27.5 percent of the gross proceeds, but not to exceed 50 percent of the net, after deducting the expenses and carrying charges on the property, is principal; and
    2. the balance is income.

Section 113.107 provides, as stated below, that the proceeds from oil and gas:

> ...shall be apportioned on a yearly basis in accordance with this subsection whether or not any natural resources were being taken from the land at the time the property was placed in the trust.

McGill v. Johnson, 799 S.W.2d 673 (1990) interprets Sec. 113.107 as not overruling the Open Mine Doctrine so a trustor can specifically give a life tenant/beneficiary the right to receive all income from trust property unburdened by the duty to avoid waste.

Kuntz - Sec. 8.7.

H. Life Tenant/Remainderman and Open Mine Doctrine

General rules

The life tenant, of either a legal life estate or a conventional life estate, has the right to possession of the property with the remainderman obtaining possession upon the death of the life tenant. Neither the life tenant nor the remainderman can execute an effective oil and gas lease without the joinder of the other. *Davis v. Bond*, 158 S.W.2d 297 (Tex. 1942).

The life tenant is entitled to receive the delay rental. In the absence of a written agreement, the bonus and royalty should be paid to the life tenant and remainderman jointly. The life tenant is entitled to the interest produced from the bonus and royalty as set aside in an interest bearing account. This is because bonus and royalty are considered corpus while the delay rental is considered income or rent. *Clyde v. Hamilton*, 414 S.W.2d, 434 (Tex. 1967), 26 O&GR 220.

Open mine doctrine

An exception to the above is the "Open Mine Doctrine." This doctrine states that, if a lease was in effect or if a well was producing at the time the life estate was created, the life tenant can use the land for that purpose and is thus entitled to receive all royalty himself. The theory is that the person creating the life estate must have intended that the life tenant benefit from the activities being conducted at the time the life estate was created. A lease alone will open the mine. *Youngman v. Shular*, 155 Tex. 437, 288 S.W.2d 495 (1956), 5 O&GR 1069. A testator's will may grant authority to his executor or trustee to execute oil and gas leases, and they will also receive the open mine benefit. *McGill v. Johnson*, 799 S.W.2d 673 (Tex. 1990).

Normally, if the lease in effect at the time the life estate was created terminates, then the "mine closes," and the *Davis v. Bond* rule becomes effective. *Moore v. Vines*, 474 S.W.2d 437 (Tex. 1971), 41 O&GR 82.

Hemingway - Sec. 5.2-5.2(D)
Kuntz - Sec. 8.2
Summers - Sec. 32, 36, 76, 223, 572, 581, 583, 586, 613
W & M - Sec. 512.2, 513, 515

I. Minors and Mental Incompetents

Minors

A person is a minor until he becomes 18 years of age, is married or had the disability of minority removed. Tex. Probate Code, Sec. 3(t). An oil and gas lease executed by a minor is voidable by the minor for a reasonable time after the minor becomes 18. *Prudential Bldg. and Loan Assn. v. Shaw*, 119 Tex. 228, 26 S.W.2d 168, *rehearing overruled* at 119 Tex. 240, 27 S.W.2d 157 (1930). An oil and gas lease executed by a guardian can be effective for a period longer than the time the ward is a minor, but said lease cannot be for a primary term in excess of five years. Tex. Prob. Code Sec. 367(c)(7). *See* Texas Title Standard 10.10.

Mental incompetents

A person is not mentally incompetent to execute an oil and gas lease until he has been determined by a court to be mentally incompetent. An oil and gas lease taken from a person who has been judicially declared to be mentally incompetent is voidable at the lessor's election for a reasonable time after the person is judicially declared to be sane. *Neill v. Pure Oil Company*, 101 S.W.2d 402 (Tex. Civ. App.-Dallas 1937, *writ ref'd*), 3 OGR 419. *See* Texas Title Standard 10.20.

Kuntz - Sec. 20.8, 820.9

J. Mineral Owners Who Cannot be Located

Receivership for mineral owner who cannot be located

Texas Civil Practices & Remedies Code (TCP&RC) Sec. 64.091 *et seq*. provides a procedure, with some limitations, for the appointment of a receiver to execute an oil and gas lease covering a mineral interest, royalty interest or leasehold interest owned by a person or company who cannot be located.

The plaintiff must file an application in the District Court in the county where the property is located and cite the defendant either by publication or by some other substituted service. *Gray v. PHI Resources, Ltd.*, 710 S.W.2d 566 (Tex. 1986). The defendant must not have paid taxes on the mineral or leasehold interest or rendered same for taxes within the last five years. The plaintiff must prove:

1. That he has made a diligent but unsuccessful effort to locate the defendant;

2. That the plaintiff will suffer substantial damage if the receiver is not appointed, and
3. That the lease terms offered the receiver are reasonable compared to the lease terms accepted by other mineral owners similarly situated.

The receiver may be a county official, such as the county judge or county clerk, or any other resident of the county in which the land is located. The receiver is not required to post bond.

The receivership can continue as long as the defendant, his heirs or assigns fail to appear and claim the proceeds held by the receiver. Normally, if no production is obtained from the lease executed by the receiver, the proceeds will escheat to the state of Texas in three years pursuant to Texas Property Code, Sec. 72.101. The defendant can still obtain said funds from the state by properly identifying himself to the Texas State Treasurer, Attn: Unclaimed Property Department.

Receivership for contingent future interest

Sec. 64.092 (TCP&RC) provides a procedure for the appointment of a receiver to execute an oil and gas lease covering a mineral interest or a leasehold interest owned by a person or company who may own a contingent future interest, legal or equitable, whether arising by way of remainder, reversion, possibility of reverter, executory devise upon the happening of a condition subsequent or otherwise. The procedure for obtaining said receivership is essentially the same as that briefly described previously.

Effect of force pooling on the above

Texas' limited force pooling statute, the Mineral Interest Pooling Act (MIPA), cannot be used to provide notice by publication to persons who cannot be located and thus bind the unlocated person to a force pooling proceeding. See discussion of MIPA in the pooling topic.

Summers - Sec. 39

K. Public Entities

Cities, towns or other political subdivisions

Sec. 71.001, *et seq.* of the Natural Resources Code (NRC) establishes the following procedure for obtaining an oil and gas lease from such lessor:

a. The lease is obtained from the governing body. Sec. 71.003.
   BEWARE – A "political subdivision" should not be confused with a "department, board or agency of the state," whose lands are usually leased by the Commissioner of the General Land Office (GLO). A "department, board or agency of the state" exercises jurisdiction throughout the state, i.e. - State Highway Department. A "political subdivision," sometimes called a "special purpose district," has jurisdiction over only a portion of the state, i.e. - Brownsville Navigation District. Other examples of commonly created political subdivisions are soil and water conservation districts, school and hospital districts and river authorities. *Guaranty Petroleum Corporation v. Armstrong*, 609 S.W.2d 529 (Tex. 1980), 68 O&GR 715.
b. Notice of the intent to lease must be placed in a newspaper of general circulation in the county once a week for three consecutive weeks. Sec. 71.005. On the date specified in the notice, the governing body at a public hearing shall receive the bids and may award the lease to the "highest and best" bidder. Sec. 71.006. In the alternative, a lease may be made at a public auction. Sec. 71.008.
c. Sec. 253.005 of the Local Government Code provides that a municipality may lease "in the manner and on the terms that the governing body of the municipality determines, for the benefit of the municipality." A municipality may lease a "street, alley or public square if the lease prohibits the lessee from using the surface of the land."
d. Counties and school districts may likewise lease land owned by them for mineral development. Mineral lessees of political subdivisions are nevertheless required to comply with city ordinances regulating mineral developments within its limits, even though the lease was executed before the enactment of the ordinance. Op. Atty. Gen. 1951, no. V-1323.

County and other unincorporated public entities

Land held/owned by counties in trust for the state, such as county owned roads, are subject to oil and gas leasing by the School Land Board. Sec. 32.001(4)(NRC). County land not held in trust for the state can be leased by the Commissioners Court of the county.

Minerals owned by the state

The state of Texas, through its agencies, owns minerals in various capacities. The leasing procedure for each category is as follows:

Permanent school fund lands. (approximately 13 million acres)

Fee Uplands. All surveyed but unsold land, all undedicated land and all unsurveyed public land. Sec. 11.041 (NRC), (approximately 800,000 acres).

Submerged Lands.

> ... the mineral estate in areas within tide water limits, including islands, lakes, bays and the bed of the sea which belongs to the state. . . and the arms and the beds and shores of the Gulf of Mexico within the boundaries of Texas ... Sec. 11.041 (NRC).

River Beds and Streams. See discussion at II.L. infra. Leasing procedure for the above:

a. Leased by sealed bid sales held by the School Land Board (SLB) each year in April and October.
b. Nominations are submitted to the Petroleum and Minerals Division of the General Land Office (GLO) with a $100 fee at least 120 days prior to the sale.
c. A bid package, identifying the tracts to be sold, minimum bids, form of lease and other information is distributed by the GLO 60 days prior to the sale, which is held in Austin, Texas. Anyone may obtain a bid package and be included on the regular mailing list by contacting the Petroleum and Minerals Division.

Relinquishment Act Lands. Sec. 52.171 *et seq.* (NRC) (approximately 7 million acres). This Act applies only to public free school land and asylum land sold with a mineral classification or mineral reservation between September 1, 1895, and August 21, 1931.

The "owner of the soil" (surface owner) is the agent of the state for the purpose of leasing oil, gas and hard minerals. A state lease form, provided by the GLO, must be used, and the lease is not effective until a certified copy of the lease, as recorded in the county or counties in which the property lies, is submitted to and approved by the GLO.

If the surface owner leases Relinquishment Act land, he must share all benefits received equally with the state. *Greene v. Robison*, 117 Tex. 516, 8 S.W.2d 655 (1928). The surface owner cannot drill the property himself and must lease to another party in an arm's length transaction (not to an affiliated company). Any arrangement, whether stated in the lease or not, that gives the surface owner a benefit that is not shared with the state renders the lease void. *State v. Standard*, 414 S.W.2d 914 (Tex. 1967).

The only accurate source for information as to the classification of land sold by the state subsequent to September 1, 1985, is the classification records of the GLO or the classification records of the respective county. This means one cannot rely solely on the fact that the patent contains no mineral reservation in the state.

Although the "owner of the soil" may sell "Relinquishment Act Land" and reserve a royalty interest in production from a lease which he executed, said owner cannot sell the land and reserve a permanent mineral or royalty interest which would be binding upon a subsequent "owner of the soil." *Lewis v. Oates*, 145 Tex. 77, 195 S.W.2d 123 (1946).

"Free Royalty" Lands. Sales Act of 1931 (now Sec. 51.054 NRC). This Act applies after August 21, 1931 (some attorneys argue for May 29, 1931), and supersedes the Relinquishment Act of 1919.

If land is classified as mineral, then the State has reserved a non-participating royalty of: "one-eighth of all sulfur and other mineral substances from which sulfur may be derived or produced and one-sixteenth of all other minerals," including oil and gas.

While the mineral owner can lease land utilizing a form acceptable to him without state approval, the lease is not effective until a copy of same is filed with the GLO. Also, the nonparticipating royalty interest of the state can not be pooled without the written consent of the General Land Office.

Lands Patented, Sold or Traded Subsequent to June 19, 1983. (Sec. 51.054 NRC). The School Land Board has the discretion to set the terms of the sale at "not less than" one-eighth of the sulfur and one-sixteenth of all other minerals. The practice of the School Land Board, with few exceptions, is to reserve all minerals.

i. The mineral reservation will be contained in the patent itself, as there is no mineral classification for lands patented, sold or traded after June 19, 1983.

Permanent University Fund Lands (approximately two million acres). Mineral leasing is administered by the Board for the Lease of University Lands, P.O. Box 553, Midland, Texas 79702.

The leasing procedure is conducted by sealed bid, usually twice a year; leases have a five year primary term and a one-fourth royalty. Sec. 66.62 and 66.63, Texas Education Code.

Texas Department of Corrections and Texas Parks and Wildlife Department. Mineral leasing conducted by the Board of each agency. The Commissioner of the GLO is the chairman of each Board. The GLO staff administers the leases and the leasing procedure, and lease form is parallel to the SLB lease of Permanent School Fund Lands.

Dealing with the General Land Office (GLO). Texas General Land Office, David Dewhurst, Commissioner, 1700 N Congress Ave, Austin, Texas 78701; (512) 463-5001.

The day-to-day interpretation and administration of state leases is conducted by the Petroleum and Minerals Division. For a preliminary determination of boundary and title issues, contact the Survey Division. To obtain a "Certificate of Fact" describing the contents of all GLO records affecting a particular tract, contact the Asset Management Division. To determine the classification of any land in the state, contact Asset Management.

Highway rights of way

If fee title to a public road is in the name of a county or the state, only the state has the right to execute an oil and gas lease covering the same. *Robbins v. Limestone County*, 114 Tex. 345, 268 S.W. 915 (1925)., *State v. Hale*, 136 Tex. 29, 146 S.W.2d 731 (1941), and Attorney General's Opinion No. WW-870 dated July 5, 1960.

However, the state of Texas has permitted wells adjacent to public roads to drain the oil and gas underlying the road without compensation to the state for many years. *Wencker v. Railroad Commission*, 149 S.W.2d 1009 (Tex. Civ. App.-Austin 1941, *writ dism'd)*.

Sec. 32.201-32.205, NRC, effective June 8, 1985, provides the procedure for obtaining an oil and gas lease covering a public road from the General Land Office. A summary of said provisions is as follows:

1. The adjacent mineral owner has a preferential right to obtain the lease. If the adjoining land is covered by a presently effective oil and gas lease, then the royalty, bonus and rental shall be identical to those amounts in said lease. If there is more than one oil and gas lease covering the adjoining land, then the terms of the state lease shall be no less favorable to the state than the most favorable of such leases. Sec. 32.201(b).
2. If the adjacent mineral owner elects not to exercise his preferential right to obtain said lease, then the land may be offered for lease either directly to an applicant or by sealed bid. Such lease must contain a price and terms which are at least as beneficial to the state as those offered to the adjoining mineral owner. Sec. 32.201(g).

The state may not lease a right-of-way tract if, on January 1, 1985, there was a well capable of producing oil and/or gas in paying quantities within 2,500 feet of the state right-of-way. Rule 153.61(a), as adopted by the Board pursuant to Sec. 32.205.

SUGGESTION - If the owner of a lease adjacent to a state right-of-way elects to obtain a lease covering said right-of-way from the state, then said party should obtain from the General Land Office a copy of the rules applicable to said purchase.

Quasi-public land — Cemeteries, churches and other unincorporated associations

Cemetery tracts may be owned by a cemetery association or by a profit or non-profit cemetery corporation. Article 912a-5, V.A.T.S. One who purchases a lot or plot in a cemetery does not acquire an ordinary fee simple title. The property acquired can only be used for burial purposes. *Oak Park Cemetery, Inc. v. Donaldson*, 148 S.W.2d 994 (Tex. Civ. App.-Galveston 1940, *writ dism'd*). Church land may be owned either by an unincorporated association or by a non-profit corporation.

An unincorporated association, as distinguished from a corporation, may not acquire title in the associational name but holds title to real property either in the names of the members, or, more commonly, by elected trustees and their successors. *O.K.C. Corporation v. Allen*, 574 S.W.2d 809 (Tex. Civ. App.-Texarkana 1978, *writ ref'd* *n.r.e.*). An oil and gas lease would be obtained from the trustees and, if an abundance of caution seems necessary, ratified by the members. If the lessor is a corporation, an oil and gas lease would be obtained from the president, vice-president or attorney-in-fact.

Land dedicated for cemetery, church or other specific purposes cannot be used for oil and gas development or for any other purpose which would be considered a desecration or would defeat the use of the land for the dedicated purpose. Any use of said land inconsistent with the specific purpose could be enjoined. However, a tract dedicated for a specific purpose can be leased and be a part of a producing unit as long as there is no surface operation or other activity upon said specially dedicated tract which would impair the dedicated use of the land. *Meadows v. Edwards*, 116 S.W.2d 831 (Tex. Civ. App.-Texarkana 1938, *writ ref'd*) and *Eternal Cemetery Corporation v. Tammen*, 324 S.W. 2d 562 (Tex. Civ. App. - Ft. Worth 1959, *writ ref'd n.r.e.*), 11 O&GR 274.

Kuntz - Sec. 20.10(d), 20.10(f)

L. Riverbeds and Streams

Navigable streams or rivers

The state owns title to the oil and gas underlying the Texas coast of the Gulf of Mexico, all land below tidewater (deemed the "arm of the sea") and all land underlying all river beds, navigable in fact or in law. By law, every river or stream in the state of Texas is a "navigable stream" if it is navigable in fact or if its average width is greater than 30 feet, from cutbank to cutbank (technically referred to as the gradient boundary), from the mouth up. The common law rule was that the sovereign would own only the minerals underlying a stream which was navigable in fact. *See Manry v. Robison*, 122 Tex. 213, 56 S.W.2d 438 (1932) *interpreting Art.* 5302, V.A.T.S., now codified as Section 21.001(3), 21.012 and 21.013 (NRC). The state holds title to the beds and minerals underlying navigable water in trust for the Permanent School Fund. Such land passes by grant or sale only when expressly provided for by patent or statute; there is no presumption of the passing away of such title. *State v. Bradford*, 121 Tex. 515, 50 S.W.2d 1065 (1932).

Usually, the legal description in the state's patent will identify a tract as being up to the cutbank of a navigable stream. If however, a patent crosses part or all of a navigable stream, the patentee and his successors will own the bed and the minerals underlying the stream to the extent that the tract, as patented, does not contain excess acres, Art. 5414a, V.A.T.S., or to the extent the state has conveyed said excess acreage by a Deed of Aquittance, Art. 5414a-1, V.A.T.S. (Both articles being commonly referred to as the "Small Bill").

Where the bed of a navigable river changes gradually by natural processes, the ownership of the adjacent (riparian) land changes with the bed. Where the river bed changes quickly, for either man-made or natural reasons (this is called avulsion), the riparian owner's boundary changes from the cutbanks of the old bed to the cutbank of the new bed, with the state obtaining title to the new riverbed. *Maufrais v. State of Texas*, 142 Tex. 559, 180 S.W.2d 144 (1944).

To obtain a lease from the State covering the river bed under a navigable stream, see II.K., "Minerals owned by the state."

Non-navigable streams or rivers

The adjacent (riparian) owners own the oil and gas underlying said stream, each to the middle of the stream. *Welder v. State*, 196 S.W.868 (Tex. Civ. App.-Austin 1917, *writ ref'd*) adopts this common law rule. If the channel for a stream or river changes as the result of natural flow, then the private ownership changes with the change in the location of the stream. However, if the riverbed or channel changes quickly, as a result of flooding or by artificial or man-made causes, the boundary remains unchanged. *Hancock v. Moore*, 137 S.W.2d 45, (Tex. Civ. App. - El Paso 1939) *affirmed* at 138 Tex. 619, 146 S.W.2d 369 (1941).

For a more complete discussion of this subject, see Chapter 6 of Volume 3 – *Texas Practice - Land Titles and Title Examination - Third Edition*, by Fred A. Lange and Aloysius Leopold, West Publishing Co. - 2005. This four volume set, Volumes 3, 3A, 4 and 5, is the best source available discussing Texas real property law.

III. INTERPRETATION OF PROVISIONS OF THE OIL AND GAS LEASE

A. Habendum Clause – Generally

General nature of the oil and gas lease

Oil and gas is owned in fee simple and an "unless" form oil and gas lease (the most frequently used) is a conveyance of a fee simple determinable in the oil and gas. *Stephens County v. Mid-Kansas Oil & Gas Company*, 113 Tex. 160, 254 S.W. 290 (1923), 29 A.L.R. 566. The Habendum or Term Clause of the lease establishes the period for which the lease rights will extend. Normally the term is divided into two distinct terms: the primary term and the secondary term. The primary term is that fixed term of years in the lease during which the lessee has the option, but not the obligation, to pay delay rentals and/or explore for and produce oil and gas.

At the expiration of the primary term, the lease terminates as a matter of law unless there is actual production, or a contractual substitute for production such as drilling operations, or payment of shut-in gas royalty. *Skelly Oil Company v. Harris*, 163 Tex. 92, 352 S.W.2d 950 (1962), 15 O&GR 653.

Hemingway - Sec. 1.1, 1.3, 6.1, 7.13, 8.10, 8.12
Kuntz - Sec. 26.2
Summers - Sec. 61, 106, 132, 165, 299, 461, 532, 553, 583, 652, 962
W & M - Sec. 203.3, 210, 618, 825, 953

Doctrine of indivisibility

One well, producing in paying quantities on the land covered by the lease, or on land pooled with the lease, will continue the lease as to all land covered by the lease and as to all depths, unless the lease itself contains a provision requiring partial termination of the lease even if production is obtained (sometimes called a Pugh Clause). *W.T. Waggoner Estate v. Sigler Oil Co.*, 118 Tex. 509, 19 S.W.2d 27 (1929) and *Rogers v. Ricane I*, 772 S.W.2d 76 (Tex. 1989) and *Rogers v. Ricane II*, 884 S.W.2d 763 (Tex. 1994).

Many leases now contain special provisions requiring partial termination, either horizontally or vertically, after production has been obtained. Vertical termination describes lands located outside a proration unit. Horizontal termination refers to the lease terminating as to certain depths, usually defined as all depths below the producing formation or total depth, or termination as to all non-producing formations, which leaves the lessee only with the producing formation.

Statutory Pugh (Termination) Clause

Texas has no statute which requires either vertical or horizontal termination. All partial termination of a lease must be created by the terms of the lease itself.

Termination cured by adverse possession by lessee

In the Texas Panhandle during the 1930s, 1940s, 1950s and 1960s, there were many instances of gas wells not actually producing for long periods in excess of any savings clause. No complaint was made by lessors at that time, and the lessees continued to produce the leases and often drilled new wells on the leases. In the mid 1990s, over 100 suits were filed claiming that gas leases had terminated as much as 50 or 60 years earlier, and the mineral owners claimed 100 percent of production subsequent to lease termination. All leases were saved when the Supreme Court reached a decision in *Natural Gas Pipeline Co. v. Pool*, 124 S.W.3d 188 (Tex. 2003) ("The *Pool* Case"). The *Pool* case held that the lessees, by restoring production and continuing operation without complaint for a period exceeding 10 years, adversely possessed the leasehold estates they technically lost by failure to produce years before. The Court did not address the question of whether or not the same result may have been reached under Texas' three- and five-year statutes of limitations.

The Texas Supreme Court reversed the Amarillo Court of Appeals which had denied the adverse possession claim because there was no evidence of an essential element of adverse possession, that there must be some act or declaration of repudiation before possession becomes hostile to the record owner. *Hunt Oil Co. v. Moore*, 656 S.W.2d 634, 641 (Tex. App. - Tyler, 1983, *writ ref'd n.r.e.*). This is the same requirement a cotenant must meet in order to adversely possess another cotenant, *Glover v. Union Pacific Railroad Company*, 187 S.W.3d 201 (Tex. App. - Texarkana 2006, *pet. denied*). The Supreme Court, citing its previous opinion in *Tex-Wis Co. v. Johnson*, 534 S.W.2d 895 (Tex. 1976), stated that "notice of repudiation may be inferred without any change in the use of the land if there has been long-continued use." Here, the lessors had failed to assert a claim to the mineral estate for more than 14 years since the last cessation of production before they filed suit. In other words, the Court charged the lessors with constructive notice that the mineral estate had reverted back to them when the leases terminated for lack of production. The Court pointed out that the lessees continue to produce and sell oil and gas from the lease, paying lessors a royalty in the normal fashion, and lessees also drilled new wells after the time the leases were alleged to have terminated. These acts, according to the court, were open, notorious and hostile to the lessors ownership of the mineral estate. As a result, the Court found that the evidence was sufficient to establish the requisite notice of adverse possession as a matter of law.

B. Production in "Paying Quantities"

General rule

If production of oil or gas is obtained, the lease will continue as long as the well produces in "paying quantities." This term means that the well produces a sufficient amount of oil or gas so that when same is sold, the lessee realizes a profit above the cost of lifting or producing the oil or gas. Since the cost of drilling and completing the well are not considered, it is possible for the well to never pay out the cost of drilling and for the enterprise as a whole to be unprofitable, and yet the well produces in "paying quantities." *Garcia v. King*, 139 Tex. 578, 164 S.W.2d 509 (1942). The case of *Clifton v. Koontz*, 160 Tex. 82, 325 S.W.2d 684 (1959), 10 O&GR 1109, 79 A.L.R.2d 774, and 43 ALR 3rd 8 modified this rule in the case of a marginal well, to be:

> Whether or not, under the relevant circumstances, a reasonable prudent operator would, for the purpose of making a profit and not merely for speculation, continue to operate a well in the manner in which the well in question was operated.

Some of the relevant factors would be:

a. The depletion of the reservoir and the price for which the lessee is able to sell his produce;
b. The relative profitableness of other wells in the area;
c. The operating and marketing cost of the lease;
d. Lessee's net profit;
e. The lease provisions;
f. A reasonable period of time under the circumstances; and
g. Whether or not the lessee is holding the lease merely for speculative purposes.

Thus, the *Garcia v. King* rule (factors c. and d.) was incorporated as part of the *Clifton v. Koontz* rule.

Operating expenses

In Texas, "lessee's net profit" (factor d. above) consists of all income received for the contractual working interest of the original lease. This constitutes all income less only the royalty. To determine the "lessee's operating and marketing cost" (factor c. above), all drilling expenses are excluded as well as all depreciation for all equipment used in drilling. *Clifton v. Koontz, supra.* Lifting and production costs are generally held to include:

> Labor costs of pumpers and others operating equipment on the lease, day-to-day power and supplies; severance taxes; license and permit fees; replacement and repair of producing equipment, maintenance and repair of roads, entrances and gates; and electricity and telephone costs. Hemingway, Sec. 6.4.

In Texas, actual depreciation of producing equipment (not drilling equipment) and administrative expenses attributable to the well in question must also be deducted. *Skelly Oil Company v. Archer*, 356 S.W.2d 774 (Tex. 1962) 16 O&GR 650 and *Bales v. Delhi-Taylor Oil Corporation*, 362 S.W.2d 388 (Tex. Civ. App.-San Antonio 1962, *writ ref'd n.r.e.*), 17 O&GR 811.

Hemingway - Sec. 6.4, 6.4(A), 8.3
Kuntz - Sec. 26.5 and 26.7
Summers - Sec. 293, 298, 306, 395, 433, 512, 955, 993
W & M - Sec. 301, 334.6, 604.6, 815, 845.6, 874.1
Summers - Secs. 299, 306, 400, 411, 412, 604.1

C. Shut-In Gas Clause

General rules

The lease will expire as a matter of law at the end of the primary term unless the lease is actually producing oil or gas in paying quantities, as distinguished from only a discovery of oil and/or gas, *Garcia v. King*, 139 Tex. 578, 164 S.W.2d 509 (1942), or unless the lease contains a "well completion clause" which permits a well commenced during the primary term to be completed after the expiration of the primary term. *Rogers v. Osborne*, 152 Tex. 540, 261 S.W.2d 311 (1953). The lease may contain other contractual substitutes for production for the lease to continue into the secondary term. *Freeman v. Magnolia Petroleum Co.*, 141 Tex. 274, 171 S.W.2d 339 (1943).

One of the contractual substitutes for actual production is the payment of a shut-in gas royalty. A shut-in gas royalty payment is normally due within 60 or 90 days from when the well is completed. If the shut-in gas royalty payment is not paid in the proper amount, within the stated time, or to the proper parties, and the lease is not otherwise maintained by some other provision, then the lease terminates as a matter of law. *Gulf Oil Corporation v. Reid*, 337 S.W.2d 267 (Tex. 1960), 12 O&GR 1159. However, the payment of shut-in gas royalty can be made a covenant to the lease, not a condition. *See* III.B.

Amount of shut-in gas royalty

The amount of the shut-in gas royalty is, historically, $1 per net acre. Shut-in gas royalty, being a substitute for actual production, is paid to the royalty owners if different than the mineral owners. *Morriss v. First National Bank of Mission*, 249 S.W.2d 269, (Tex. Civ. App. - San Antonio 1952, *writ ref'd n.r.e.*), 1 O&GR 1371.

BEWARE – Some old lease forms provide that shut-in royalty may be paid only on wells "producing gas only." However, it is common knowledge within the industry that most gas wells will produce some liquid condensate. For a well to be classified as a "gas well" in Texas, the well must produce "...more than 100,000 cubic feet of gas to each barrel of oil from the same producing horizon...." Section 86.002(5) (NRC). *Vernon v. Union Oil Company of California*, 270 F.2d 441 (5th Cir. Tex., 1959) and at 273 F.2d 178 (5th Cir. Tex., 1960) holds that it would not be proper to maintain a lease by the payment of shut-in royalties if it was reasonable to operate a properly classified gas well solely for the production of liquid components which themselves produced in paying quantities. More recent lease forms avoid this confusion by permitting shut-in royalties to be paid where the well produces gas and gas condensate, or gas liquids.

Hemingway - Sec. 6.4, 6.4(A), 6.5, 6.6-6.9, 7.13(B)
Kuntz - Sec. 4, 5, 6
Summers - Sec. 165, 293, 298, 300, 306, 400, 411, 412, 416, 604, 955
W & M - Sec. 334.6, 604.6, 618.1, 632, 736, 842.1

D. Temporary Cessation of Production

Common law rule

Even if the creating instrument does not provide, if there is a temporary cessation of production due to mechanical problems in the secondary term, the lease or term mineral or royalty interest will not terminate for a reasonable time if the lessee is making reasonable good faith efforts to restore production. Whether a cessation of production is temporary is a question of fact that will depend on the individual circumstances. *Watson v. Rochmill*, 137 Tex. 565, 155 S.W.2d 783 (1941), 137 A.L.R. 1032 and *Amoco Production Co. v. Braslau*, 561 S.W.2d 805 (Tex. 1978).

Lease provision

To avoid this uncertainty, most leases contain a "cessation of production" clause which defines the length of time the lease continues without additional reworking or drilling operations. These clauses are strictly construed against the lessee but usually allow 60 or 90 days within which additional operations must commence. *Samano v. Sun Oil Company*, 621 S.W.2d 580 (Tex. 1981).

Hemingway - Sec. 6.4(B)
Kuntz - Sec. 26.14
Summers - Sec. 226, 301, 305, 306, 349, 470, 599, 955
W & M - Sec. 334.8, 604, 604.7, 615.1

E. Delay Rental Clause

General rule

The usual "unless" lease form is interpreted to mean that the lease will terminate on any anniversary date of the lease "unless" the lessee:

a. Conducts "operations" (as defined infra, III.B.) for the drilling of a well on that date; or
b. Pays a rental payment to the lessor on or before that date; or
c. Is actually producing oil or gas or has paid a shut-in gas royalty payment on or before said date. *Humble Oil & Refining Company v. Mullican*, 144 Tex. 609, 192 S.W.2d 770 (1946).

Permitted excuses for faulty payment

Texas, like a majority of jurisdictions, views the "unless" clause as creating a limitation or condition upon the estate of the lessee, which will terminate automatically by its own terms in the event the lessee does not strictly comply with the delay rental clause and other clauses which create conditions, not covenant. *W. T. Waggoner Estate v. Sigler Oil Co.*, 118 Tex. 509, 19 S.W.2d 27 (1929). Texas permits few excuses for making a faulty delay rental payment. Being cautious, the author lists only:

a. Confusion or ambiguity caused by the lessor. *Humble Oil & Refining Co. v. Harrison*, 146 Tex. 216, 205 S.W.2d 355 (1947); and
b. Repudiation of the lease by lessor, such as filing suit claiming the lease has expired, *NRG Explanatory, Inc. v. Rauch*, 671 S.W.2d 649 (Tex. App. - Austin 1984, *writ ref'd n.r.e.*), 81 O&GR 400, or preventing lessee's entry upon the leased premises, see III.F. infra.

The only cure for making a faulty delay rental payment is ratification, more correctly called reviving the expired lease. *Reserve Petroleum Company v. Hodge*, 147 Tex. 115, 213 S.W.2d 456 (1948), 7 A.L.R. 2d 288.

The practice in Texas, as in many other states, is to pay delay rental in advance with the bonus so that the lessee purchases a "paid-up" lease and has no future delay rental obligation.

Modification of delay rental requirement — Change a condition into a covenant

In order to protect itself against an improper payment of delay rentals when the lessee was attempting in good faith to make a proper payment, lessees have begun to include, within the delay rental clause itself, a specific savings clause such as the following: If lessee shall, on or before any anniversary date, make a bona fide attempt to pay or deposit rental to a lessor entitled thereto according to lessor's records or to a lessor who, prior to such attempted payment or deposit, has given lessee notice, in accordance with subsequent provisions of this lease, of his right to receive rental, and if such payment or deposit shall be ineffective or erroneous in any regard, lessee shall be unconditionally obligated to pay to such lessor the rental properly payable for the rental period involved, and this lease shall not terminate but shall be maintained in the same manner as if such erroneous or ineffective rental payment or deposit had been properly made, provided that the erroneous or ineffective rental payment or deposit be corrected within 30 days after receipt by lessee of written notice from such lessor of such error accompanied by such instruments as are necessary to enable lessee to make proper payment. *Kincaid v. Gulf Oil Corporation*, 675 S.W.2d 250 (Tex. App. - San Antonio 1984, *writ ref'd n.r.e.*) 83 O&GR 356.

Similar language could be utilized to change other leasehold provisions, such as shut-in gas royalty, from conditions to covenants and thus avoid accidental lease termination.

Hemingway - Sec. 2.3, 6.3, 6.3(A)&(B)&(E), 7.8
Kuntz - Sec. 27.4, 29.2, 36.3, 36.4, 36.5
Summers - Sec. 218, 342, 343, 344, 348, 452, 585.1
W & M - Sec. 312, 340.04, 601.3, 606.2, 686.4

F. Definition of Operations

General rule

Unless the term "operations" is defined differently in the lease, "commencement of drilling operations" means, as a minimum, conducting some type of surface operation required for the drilling and completion of the well. This activity can be determined objectively. *Peterson v. Robinson Oil and Gas Co.*, 356 S.W.2d 217 (Tex. Civ App.-Houston [1st Dist.] 1962, *no writ history*), 16 O&GR 440. A subjective requirement is that the lessee has in good faith planned for and is capable of continuing the remaining operations in a reasonable and timely fashion. *Texas Pacific Coal & Oil Co. v. Barker*, 117 Tex. 418, 6 S.W.2d 1031 (1928), 60 A.L.R. 936.

BEWARE – Some lease forms will define "operations" to mean actual drilling with a rig capable of drilling to total depth.

Obstruction doctrine or lockout rule

Sometimes a lessor/surface owner or surface tenant will physically prevent a lessee from gaining entry to the leased property. This problem occurs most often at the end of the primary term and frequently occurs when the lessor/surface owner has agreed to execute another lease when the base lease expires. Such activity by the lessor or surface owner will excuse performance by the lessee and the primary term of the base lease is usually extended for a reasonable time by the court. This rule is called the Obstruction Doctrine or the Lockout Rule. *Gilbert v. Smedley*, 612 S.W.2d 270 (Tex. Civ. App.-Ft. Worth 1981, writ ref'd n.r.e.), 69 O&GR 312.

Hemingway - Sec. 6.7, 8.3(A), 8.4-8.10
Kuntz - Sec. 26.14, 32.3, 36.4
Summers - Sec. 293, 300.1, 301, 349, 996
W & M - Sec. 604.7, 606.1, 618.1, 683.1, 825.2, 885.2

G. Pooling

Reasons for pooling

Pooling is defined as bringing together two or more oil and gas leases covering two or more separately owned tracts of land for the purpose of accumulating sufficient surface acres to enable the drilling parties to create a sufficiently large proration unit so that the Railroad Commission of the state of Texas will grant to them a full allowable for the unit production of oil and/or gas.

Texas has adopted the non-apportionment rule for the payment of royalties. *Japhet v. McRae*, 276 S.W. 669 (Tex. Comm'n. App. - 1925, *judgm't adopted*). The non-apportionment rule is that all royalty is paid only to the drillsite royalty owners. This is true even if the land covered by one lease is subsequently divided into drillsite and non-drillsite tracts. In other words, royalty is paid on a tract basis, not a lease basis, unless there is:

a. pooling;
b. community lease;
c. entirety clause in the lease; or
d. language in deed creating separate tracts that states royalty is to be paid on a lease basis.

In addition to voluntary pooling by lessees, pooling results when parties create a community lease. In Texas, a lease that is executed by owners of separate tracts is considered a community lease. *Parker v. Parker*, 144 S.W.2d 303 (Tex. Civ. App. - Galveston 1940 *writ ref'd.*). The lessee is entitled to treat all tracts covered by the instrument as a single "leased premises" so that drilling operations, production or other activities anywhere on the land are deemed to relate to the entire area. The community lease also negates the non-apportionment rule with respect to the payment of royalty so that all lessors receive their proportionate part of the royalty from any wells drilled upon the community lease or other leases pooled with the community lease. *French v. George*, 159 S.W.2d 566, 569 (Tex. Civ. App. - Amarillo 1942, *writ ref'd*). A community lease is presumed whenever different mineral owners of different tracts execute a single lease. If those lessors intend a different effect, they must make their intention clear within the lease itself. *Phillips Petroleum Co. v. McIlroy*, 178 F. Supp. 107 (N.D. Tex. 1959).

In Texas, when discussing pooling leases and permitting wells, there is much confusion in discussing "units" because there are at least six types of "units." Provided here are over-simplified definitions of these units (references to Rules are to the Rules of the Texas Railroad Commission).

Voluntary pooled unit. Bringing together two or more oil and gas leases covering two or more separately owned tracts of land for the purpose of drilling a well, as discussed at paragraphs 1 and 2 above. The size of the pooled unit may, but is not required to, correspond to the proration unit size for the field. The pooled unit is created by a Designation of Unit, as discussed at paragraph 2 above, but is designated to the Commission with the drilling application and completion papers by Form P-12 which lists the interests that are pooled as well as those tracts which contain non-pooled interests.

Force pooled unit. Formed by an Order of the Railroad Commission pursuant to Sections 102.001-102.112, Natural Resources Code (MIPA) only after notice and hearing. Such units correspond to an individual proration unit and are limited to a specific reservoir.

Fieldwide units. Usually formed to conduct enhanced recovery operations pursuant to Sections 101.002-101.052, Natural Resources Code. Said units can cover an entire field or a portion of a field. There is no forced fieldwide unitization in Texas.

Drilling unit. The area prescribed (means required) by the applicable spacing regulations for the granting of a drilling permit from the Railroad Commission. It is designated by Form W-1 (Application for Drilling Permit) with plat attached. The purpose is to show the Commission that there is sufficient unassigned acreage from the property to satisfy the Density Rule for the applicable reservoir. A drilling unit normally has no title significance. Rule 38, the Statewide Density Rule, is 40 acres.

Spacing unit. Not a geographic area but a requirement that a well be no closer to lease lines, property lines, subdivision lines or other wells than required by the rules. Rule 37, the Statewide Spacing Rule, provides that wells shall be no closer than 467 feet from lease, property or subdivision lines and no nearer than 1,200 feet to any wells completed in or drilling to the same reservoir.

Proration unit. Determined upon completion of well to designate actual acreage assigned to well for proration purposes in order to obtain allowable (the volume of hydrocarbons such well is authorized to produce). It is designated by Form P-15 and plat, which are filed with completion papers when special field rules have been adopted with acreage as a factor in the allocation formula (acreage is a factor in the allocation formula for nearly every well). The well need not be in the center, and proration units need not be square. Proration units can be amended at any time by the filing of an Amended Form P-15.

There are no proration units where there are no special field rules or where the allocation formula does not include acreage as a factor. Absent special provisions in private oil and gas agreements, proration units have no title significance in and of themselves and do not determine the manner in which production is allocated among the mineral interest owners. An obvious exception to this rule is a "proration unit" earned by a farmoutee or lessee pursuant to a retained acreage or a continuous development provision.

If the acreage attributed to a proration unit is not sufficient to obtain a full allowable, then the allowable is proportionately reduced.

The Statewide Rules identified above apply in the absence of Special Field Rules. The issue of obtaining, amending and working within Railroad Commission Rules is a subject much too broad to be covered in this paper.

Voluntary, compulsory or both

Voluntary – Designation of unit. While Texas has the Mineral Interest Pooling Act (MIPA), Natural Resources Code, Sec. 102.001 *et seq.*, which authorizes the Texas Railroad Commission to forcibly pool two or more leases (a detailed discussion of which is beyond the scope of this article), most units are formed by exercising the voluntary pooling clause provided in most oil and gas lease forms. Normally, all leasehold owners of record are required to execute a Designation of Unit and same should be recorded prior to the expiration of the primary term of the first non-drillsite lease to expire. *Sauder v. Frye*, 613 S.W.2d 63 (Tex. Civ. App.-Fort Worth 1981, *no writ* history), 69 O&GR 147, 15 A.L.R.3rd 899. Once properly pooled, drilling operations or production upon one lease will be considered drilling operations or production upon all leases pooled.

Practice Tip - Often the leases to be pooled are about to expire, and the lessees are overnighting copies of the Designation of Unit to each other in an effort to get all necessary signatures prior to recording. If all lessees have executed the Operating Agreement, they could include as a special provision of the Operating Agreement a limited power of attorney whereby the non-operators grant to the operator authority to execute the Designation of Unit on behalf of all lessees.

Mineral Interest Pooling Act (MIPA). Texas has a force pooling statute, the Mineral Interest Pooling Act (MIPA), which is included in the Texas Natural Resources Code, Sec. 102.001 *et seq*. The MIPA has limited application. Two of its limitations are that it covers only "reservoirs discovered and produced" after March 8, 1961, and reservoirs for which the Railroad Commission has already established temporary or permanent field rules. Thus, the MIPA does not apply to old reservoirs, which were discovered and produced prior to March 8, 1961, and to new reservoirs in wildcat areas which are subject to statewide spacing rules. A complete discussion of the MIPA is beyond the scope of this article.

Unleased mineral owner within the pooled unit

If an unleased mineral owner owns an undivided mineral interest in the drillsite tract, then he is entitled to receive his proportionate part of eight-eighths of production after said production has repaid the drilling parties their cost for land work, drilling, testing, completing, equipping and operating the unit well until payout. *Cox v. Davison*, 397 S.W.2d 200 (Tex. 1965), 24 O&GR 128. If the unleased mineral co-tenant is in a non-drillsite tract which has been pooled with the drillsite tract, then the unleased mineral co-tenant is not entitled to any part of production. *Superior Oil Co. v. Roberts*, 398 S.W.2d 276 (Tex. 1966), 24 O&GR 77 and *Hunt Oil Co. v. Moore*, 656 S.W.2d 634 (Tex. Civ. App.-Tyler 1983, *writ ref'd n.r.e.*), 79 O&GR 576. A lessee has no duty to offer an unleased mineral owner a right to participate in a pooled unit. *Donnan v. Atlantic Richfield*, 732 S.W.2d 715 (Tex. App. - Corpus Christi 1987, *writ denied*).

Effect of pooling (or not pooling) non-participating royalty owner

An oil and gas lease executed by the owner of the executive right covers the non-participating royalty in said tract for all purposes except pooling. *Brown v. Smith*, 141 Tex. 425, 174 S.W.2d 43 (1943). A non-participating royalty owner (NPRO) must either ratify the lease covering his interest or ratify the designation of unit for his non-participating royalty interest to be pooled into the unit. *Montgomery v. Rittersbacher*, 424 S.W.2d 210 (Tex. 1968), 27 O&GR 774. If a non-participating royalty owner has ratified neither the lease nor the unit by the time drilling operations commence, then the non-participating royalty owner can wait and determine the location of the drillsite. If the drillsite is on his land, then the non-participating royalty owner can refuse to ratify, and he will be entitled to receive a royalty that is not spread throughout the unit. *Montgomery v. Rittersbacher, supra*. However, if the drillsite is not on his tract, the non-participating royalty owner can, after the well has been drilled and completed, unilaterally ratify his lease or the designation of unit and thus be entitled to receive his proportionate part of the royalty from the unit production from the date of ratification. *Ruiz v. Martin*, 559 S.W.2d 839 (Tex. Civ. App.-San Antonio 1979, *writ ref'd n.r.e.*), 60 O&GR 128.

Texas Courts have treated the NPRO as a favorite citizen. In *DeBenavides v. Warren*, 674 S.W.2d 353 (Tex. App. - San Antonio 1984, *writ refused n.r.e.*), the NPROs did not learn of the lease or the designation of pooling until 10 years after the lease was executed and seven years after production was established in the pooled unit. The NPROs were allowed to retroactively ratify the lease, effective as of the date of first production, and to obtain a judgment against the lessors for their share of production on the grounds that the lessors had violated a duty of "utmost good faith" by failing to notify the NPRO when the lease was first executed. The fact that the lease and the designation of unit were both filed for record was held to be insufficient to discharge the duty to notify the NPRO that they could ratify the leases if they so elected. This holding was based, in part, on the Supreme Court's decision reached the same year that a mineral owner has a fiduciary duty of "utmost fair dealing" in treating the NPRO that burden his mineral interest fairly. *Manges v. Guerra*, 573 S.W.2d 180 (Tex. 1984). Thus the NPRO burden is clearly upon the mineral owner, but the mineral lessee can also be culpable. While the cases of *Verble v. Coffman*, 680 S.W.2d 69 (Tex. App. - Austin 1984, *no writ*) and *London v. Merriman*, 756 S.W.2d 736 (Tex. App. - Corpus Christi 1988, *writ denied*) are, in the author's opinion, confusing and contradictory, they collectively require the lessee to notify any NPRO within the pooled unit or else face a potential argument that the lessee participated in the executor owner's breach of duty in the event the executive/mineral owner fails to notify the NPRO. *See* Ernest E. Smith, *The Standard of Conduct Owed by Executive Right Holders and Operators to the Owners of Non-Participating and Non-Operating Interest*, 32nd Oil & Gas Inst. 241, 252-255 (1981).

Termination/Release

A voluntary pooled unit will terminate when all unit wells cease to produce in paying quantities. Seldom are recorded designations of unit released of record. Therefore, an examiner must usually go outside the record to determine if a recorded designation of unit is still effective.

As acknowledged in the discussion above concerning unleased mineral owners, an unleased mineral owner within a drillsite tract is a tenant in common with the leasehold owners of that tract. In the case of *Wagner & Brown v. Sheppard*, 282 S.W.3d 419 (Tex. 2008), the Supreme Court held that when a drillsite lessor's lease in a pooled unit terminates, that unleased interest is still bound by the effect of the prior pooling so that the unleased mineral owner's mineral interest is still proportionately reduced. The Court supported its decision with two concepts that were previously unknown to Texas Jurisprudence. First, the Court concluded, because of the language in the lease and designation of unit in question, that the lessee pooled the lessor's land in addition to the lessor's lease. Secondly, the Court concluded that the lease conveyed to lessee the lessor's possibility of reverter, so that by pooling the possibility of reverter the mineral interest which reverted to lessor was still bound by the pooling.

Miscellaneous pooling issues

Effect of completing a unit oil well when the unit was pooled for gas production. *Sunac Petroleum Corp. v. Parkes*, 416 S.W. 2d 798, (Tex. 1967), 26 O&GR 689 confirmed the following disaster. Several leases, totaling 640 acres, were timely pooled for a prospective gas well. The unit well, however, was completed as an oil well, not a gas well, after the primary terms of all leases had expired. Within the time frame permitted by the additional drilling clause and by the dry hole clause, the operator commenced additional drilling operations on the 160 acre tract covered by the lease in question and completed same as an oil well. Approximately a year after the completion of the oil well on the 160 acre tract, the lessor questioned whether or not the lease had been maintained in force during the period from the expiration of the primary term until drilling operations were commenced on the 160 acre tract. The Texas Supreme Court held that the additional drilling clause in this lease covered only the well drilling through the primary term of the lease, not additional wells, and that the dry hole clause in the lease did not cover the unit well, which was a producing oil well, not a "dry hole" as normally understood, and not a gas well, as intended. Thus, the lease in question, and inferentially the other non-drillsite leases that were pooled for gas, terminated when the unit well for the gas unit was completed as an oil well.

LESSON - The harsh result caused by the Court's strict construction of the lease in question could be avoided, it appears, only by drafting an additional drilling clause which covers new wells in addition to the well drilling through the primary term and a dry hole clause which covers a completed well which is of a different type than the contemplated well for which the leases were pooled.

Bad faith pooling. Texas Courts have held that a lessee pools in bad faith when he includes within the pooled unit land that was previously condemned. *Amoco Production Co. v. Underwood*, 5587 S.W.2d 509 (Tex. Civ. App. - Amarillo 1977, *writ ref'd n.r.e.*); *Hay v. Shell Oil Co.*, 986 S.W.2d 772 (Tex. App. - Corpus Christi 1999, *pet. den'd.*). Another example of bad faith pooling is where the designation of unit was held to gerrymander the tracts. *See Amoco Production Co. v. Underwood*, 58 S.W.2d 509 (Tex. Civ. App. - Amarillo 1977, *writ ref'd n.r.e.*) (one well held eight leases totaling 2,252.03 acres) and *also see Circle Dot Ranch, Inc. v. Sidwell Oil & Gas, Inc.*, 891 S.W.2d 342 (Tex. App. - Amarillo 1994, *writ den'd*) (The pooled unit was irregular in shape, its diagonal corners being in excess of 11,000 feet apart and containing 668.23 acres). Also, the lessee cannot pool and ignore geology. *Elliott v. Davis*, 553 S.W.2d 223 (Tex. Civ. App. - Amarillo 1977, *writ ref'd n.r.e.*).

Cannot ratify a pooled unit after a successful well has been completed. *Fletcher v. Ricks Exploration*, 905 F.2d 890 (5th Cir. 1990) held that a lessee of a fractional mineral interest in a non-drillsite tract within a pooled unit could not join in the unit by ratifying the unit agreement after a successful well had been drilled. In *Neugent v. Freeman*, 306 S.W.2d 167 (Tex. Civ. App. - Eastland 1957, *writ ref'd n.r.e.*) a mineral owner knowingly waited two years before ratifying a community lease which had been fully developed. The Court held that he waited too long before accepting the pooling offer.

Pugh/Partial termination clause – Triggered by pooling? The rule of indivisibility requires that production from a lease, or from any land pooled with the leased land, maintains the lease in its entirety. *Mathews v. Sun Oil Co.*, 425 S.W.2d 330 (Tex. 1968). In an effort to prevent production from a small portion of leased land maintaining the entire larger lease in 1947, a lawyer in Crowley, La., Lawrence G. Pugh,. drafted a clause providing that, when a portion of the leased land was pooled, the non-pooled portion of the leased land terminated, unless the lessee paid delay rentals for a stated period of time for the unpooled land. This type of clause, requiring partial termination of the lease outside the lands held by production, is now commonly called a "Pugh Clause," even if the division of the lease between producing and non-producing tracts is not caused by pooling. Personally, the author uses a term which he considers to be more descriptive, "partial lease termination." The Court in *Shown v. Getty Oil Company*, 645 S.W.2d 555 at 560 (Tex. App. - San Antonio 1982, *writ refused n.r.e.*) discussed the history of the

"Pugh" clause in a fact situation where only 40 acres were pooled out of a 1,080.95 acre lease.

Courts are conflicted as to whether or not actual pooling is required to trigger the Pugh clause. *SMK Energy Corp. v. Westchester Gas Co.*, 705 S.W.2d 174 (Tex. App. - Texarkana 1975, *writ refused, n.r.e.*) held that a lease partially terminated even though there was no actual pooling. The Court considered the creation of a "drilling unit" as the equivalent of a pooled "unit" in the Pugh Clause. The Court in *Mathis v. Texas Intern. Petroleum Corp.* 628 F.Supp. 759 (WD Tex. 1986) held that, with the same facts, the lease did not partially terminate.

Can the JOA be a pooling agreement? A Joint Operating Agreement has been held to be "in effect a unitization of the tract conveying an interest in realty ... with income to be paid on the basis of each party's acreage contribution to the whole unit." *Gillring Oil Co. v. Hughes*, 618 S.W.2d 874, 875 (Tex. Civ. App. - Beaumont 1981, *no writ*); *See Wheelan v. Pacid Oil Co.*, 198 F.2d 39, 42 (5th Cir. 1952); *Renwar Oil Corp. v. Lancaster*, 154 Tex. 311, 315, 276 S.W.2d 774, 776 (1955). The combining/pooling of leases covering multiple tracts by a JOA is called "working interest unit." A working interest unit does not pool royalty.

Pooling for horizontal wells. *Browning Oil Co. Inc. v. Luecke*, 38 S.W.3d 625 (Tex. Civ. App. - Austin 2000, *pet. denied*), 149 O&GR 127, is the only Texas appellate opinion dealing with the pooling of a horizontal well. The plaintiff's leases covering three tracts, executed in 1979 contemplating the drilling of vertical wells, contained "anti-dilution provisions" which required a lessee when pooling to pool at least 60 percent of plaintiff's leases along with other restrictions, all intended to minimize the possibility of pooling non-plaintiff land. The operator claimed to pool as a reasonably prudent operator by including the tracts necessary, both drillsite and non-drillsite, to create a typical unit around his horizontal well. The appellate court sustained the Trial Court in holding that the pooling was void because lessee did not pool in strict compliance with the pooling restrictions contained in the leases pooled. However, unfortunately, the appellate court did not describe how the royalty from the now unpooled tracts should be paid. In other words, while the appellate court reversed the Trial Court's charge on damages as being improper, the appellate court did not make it clear what the proper damage charge should be. Also, the appellate court did not discuss the plaintiff's theory, that it was entitled to 100 percent of the royalty for each leased tract penetrated by the horizontal wellbore. The theory that the plaintiffs claimed and the Browning Court ignored is called the "Confusion of Good Doctrine." Under the Confusion of Goods Doctrine, where goods similar in nature and value, but owned by different parties, are so confused that the property of each owner cannot be distinguished, then the burden is on the party commingling the goods to properly identify the share of each owner. In an oil and gas context, this means that if the operator cannot determine with reasonable certainty the amount of production coming from each of the tracts penetrated by a horizontal wellbore, then the operator may be required to account to each of the owners of each tract penetrated as if all of the production is allocable to each tract penetrated by the wellbore. *Humble Oil & Refining v. West*, 508 S.W.2d 817, 818 (Tex. 1974). To meet this burden, the operator would have to show by preponderance of evidence and with reasonable certainty the amount of oil and gas produced from each of the tracts penetrated by the horizontal wellbore. *See Exxon Corp. v. West*, 543 S.W.2d 667, 673 (Tex. Civ. App. - Houston [1st Dist.] 1976, *writ refused n.r.e., Cert. denied* 434 U.S. 875). In the absence of such showing, the owners in each of the separate tracts will be entitled to receive their ownership share in production from the total oil and gas produced from the well. *Mooers v. Richardson Petro. Co.*, 146 Tex. 197, 204 S.W.2d 606, 608 (1947).

Hemingway - Sec. 2.2(D), 5.1, 5.1(B)&©, 7.13, 7.13(B)
Kuntz - Sec. 48.3
Summers - Sec. 37, 138, 599, 606.1, 611, 612, 952, 956, 963, 964, 967, 970, 976, 996
W & M - Sec. 224.3, 339.2, 504.1, 505.2, 670.8, 709, 921.16, 925.1

H. Calculation and Payment of Royalties

Meaning of a "market value" gas royalty clause

If the lease contains a "market value" gas royalty clause, the gas royalty is calculated on the "fair market value" of the gas from that field as of the date of production, not the date of the lease or the date lessee executed a gas sales contract. Thus, the fair market price for royalty paid by the lessee may be greater than the contract price received by the lessee for the gas sold pursuant to its gas sales contract. *Texas Oil and Gas Corp. v. Vela*, 429 S.W.2d 866 (Tex. 1968), 29 O&GR 121 and *Exxon Corp. v. Middleton*, 613 S.W.2d 240 (Tex. 1981), 69 O&GR 115, 10 A.L.R. 4th 712.

Items of expense deducted from royalty payment/post-production costs (PPCs)

In the absence of contrary language in a royalty clause, a lease requiring the royalty to be paid "at the well" would permit the paying party to deduct the royalty owner's proportionate part of the following expenses:

a. Gross production and severance taxes, *Hobine v. Austral Oil Co., Inc.*, 609 F.2d 206 (5th Cir. 1980);
b. Transportation expenses, *Amoco Production Company v. First Baptist Church of Peyote*, infra;
c. Treatment and dehydration expenses, *Amoco Production Company v. First Baptist Church of Peyote*, infra;
d. Cost of extracting natural gas liquids, *Danciger Oil & Refineries, Inc. v. Hamil Drilling Company*, 141 Tex. 153, 171 S.W.2d 321 (1943).

It appears that the case of *Heritage vs. NationsBank*, 939 S.W.2d 118 (Tex. 1996), holds that for a lessor to not pay his proportionate part of the expenses incurred subsequent to the wellhead, the royalty clause must make the point at which the royalty is calculated downstream from the wellhead.

Implied covenant to market

The lessee has an implied obligation to obtain a fair market price for the gas sold, whether the royalty is paid pursuant to a "proceeds" royalty clause or a "market value" royalty clause. *Amoco Production Company v. First Baptist Church of Pyote*, 579 S.W.2d 280 (Tex. Civ. App.-El Paso 1979) *writ ref'd n.r.e., per curiam*, at 611 S.W.2d 610 (Tex. 1980), 67 O&GR 590.

Methods by which royalties are calculated

Texas has not adopted the "Blanchard Decision" (See corresponding Oklahoma section.). Thus, in Texas, royalty is paid pursuant to the "tract allocation method." This means that a royalty owner does not receive any royalty unless his lessee is actually marketing gas.

If there is a split stream resulting in different gas prices, a royalty owner's royalty will be based upon the price received by his lessee, *Puckett v. First National Bank of Midland*, 702 S.W.2d 232 (Tex. Civ. App.-Eastland 1985, *writ ref'd n.r.e.*), 90 O&GR 144, unless the lessee has breached its implied duty to market gas in good faith by entering into a gas sales contract which provides for less than a fair market price for the gas sold. *See Amoco Production Company v. First Baptist Church of Pyote, supra*, where the lease contained a "proceeds" type royalty clause, not a "market value" royalty clause.

When royalties are due and penalties for late payment

The duty to pay royalty is a covenant, not a condition of the lease, so typically failure to pay royalty will not cause a lease to terminate. In *Mitchell Energy Corp. v. Samson Resources, Co.*, 80 F.3d 976 (5th Cir. 1996), the Court held that even an intentional failure to pay royalty was not grounds for lease termination. However, lease language can make the duty to timely pay royalty a condition so that the Courts will allow a lease to terminate upon late payment. *Hitzelberger v. Samedan Oil Corp.* 948 S.W.2d 497 (Tex. Civ. App. - Waco 1997, *writ denied*).

By statute, the operator is required to distribute funds to the interest owners within 120 days after the end of the first month of the first sale and subsequently within 60 days after the end of each calendar month where oil is produced or within 90 days after the end of each calendar month in which gas is produced. Failure to timely pay these sums results in interest being due at "the rate charged on loans to depository institutions by the New York Federal Reserve Bank unless a different rate of interest is specified in a written agreement" between the parties. The payment of interest is avoided if the failure to pay is because of a title dispute or title question or requirement. An owner can file suit if he has not been paid and then collect his funds plus interest, costs and attorneys fees if he prevails. Natural Resources Code Sec. 91.401 etc.

Effective August 26, 1991, Sec. 91.401 *et seq.* NRC was expanded to provide:

a. A payor may suspense payment without interest until a payee signs a division order which:
   1. If an oil division order - conforms to the statutory division order form for oil, Sec. 91.402(d);
   2. If a gas division order - contains only the provisions identified in Sec. 91.402©. Sec. 91.402(e).
b. The terms "market value," "market price," "prevailing price in the field" or such other language, when used as a method of valuing royalty payable in an oil and gas lease, shall be defined as the amount realized at the mouth of the well by the seller of such production in an arms-length transaction. Sec. 91.402(i). (Since this provision overturns *Vela* and *Middleton*, it will probably generate future litigation.)
c. Any provision of a division order between "payee and its lessee" is invalid to the extent it contradicts the oil and gas lease. Sec. 91.402(h).

In conclusion, these additions to the Texas Division Order Statute compel the payee (lessor) to (a) Cooperate on title curative and (b) sign a division order containing statutorily required minimum information to protect the payor because the statute permits the payor to withhold funds without interest. The statute now limits the payor's ability to use the division order for purposes other than directing payment.

Are take-or-pay proceeds royalty bearing?

The express language of a typical gas royalty clause requires royalty to be paid only on gas produced. Thus, unless the typical clause is modified, a royalty owner is not entitled to receive his proportionate part of a take-or-pay settlement between his lessee and gas producer where gas was not actually produced. *Killam Oil Co. v. Bruni*, 806 S.W.2d 264 (Tex. App. - San Antonio 1991, *writ den'd*). Also, a lessee has not breached a duty of utmost good faith when it negotiates a take-or-pay settlement because such duty does not ordinarily exist between a lessee and lessor. *Herd Enterprises, Ltd. v. Bruni*, 828 S.W.2d 101 (Tex. App. - San Antonio 1992, *writ den'd*).

Hemingway - Sec. 7.2-7.12, 8.9
Kuntz - Sec. 48.3
Summers - Sec. 398, 399, 400, 415, 416, 589, 590, 761, 962, 973, 1144
W & M - Sec. 334.8, 650.3, 682.4, 705, 856.3, 951

Does the discovery rule apply to royalty payment claims?

The following cases rendered in the last 12 years reflect why the discovery rule is difficult to apply in an oil and gas context.

In *HECI*, the damage was caused by an adjacent lessee violating TRC Orders and overproducing thus draining the plaintiff's tract. The plaintiff's lessee obtained a large judgment from the adjacent lessee for the overproduction/drainage but paid no royalty. The lessees settled the suit and filed a release of judgment in September 1989. The plaintiffs, some of whom were old people in nursing homes, sued HECI, their lessee, in December 1993. In holding that the discovery rule was not applicable, the Supreme Court held that all of the plaintiff's claims accrued at the time the overproduction occurred, the latest date being December, 1988 when the overproduction ceased. The Court held that the injury was not "inherently undiscoverable," pointing out that the plaintiffs could have obtained information about the adjacent lessee's overproduction from the Texas Railroad Commission (TRC) by reading local newspapers and examining the records in the county courts. One of the important consequences of the HECI Opinion was that the discovery rule will apply to any royalty claim categorized as based upon "damage to a common reservoir".

In *Hay v. Shell*, 986 S.W.2d 772 (Tex. App. - Corpus Christi 1999, *pet. denied*), the royalty owners claimed their lessee improperly pooled their acreage with unproductive acreage. On January 20, 1977, Shell filed the designation of unit in question which covered 704 acres, 640 acres plus a 10-percent tolerance. The plaintiffs learned of the formation of the unit in March 1977 when they reviewed their division orders. In 1989 a subsequent lessee obtained approval from the TRC to reduce the unit from 704 to 160 acres by swearing that only 160 acres were reasonably productive of hydrocarbons. The Hays learned for the first time that the unit was reduced in May 1992. On Feb. 21, 1995, the royalty owners sued the subsequent lessee and on Sept. 15, 1996, joined Shell as a defendant. The Court's primary holding in the case was its decision that conflicting expert testimony created a type of swearing match which prevented the discovery rule facts from being "objectively verifiable."

In *Wagner & Brown v. Horwood*, 58 S.W.3d 732 (Tex. 2001), the lessors claimed that the lessee had underpaid royalties by deducting excessive fees for gathering and compressing the gas produced.

In 1983, one of the royalty owners hired a consultant who concluded that a compression fee of 25 to 30 cents per Mcf was excessive. In 1985, the royalty statements showed a reduced fee of 12 cents per Mcf, which prompted a contact with W & B, who confirmed that the charge was in fact 12 cents. While the royalty owner remained suspicious that he was being charged more than 12 cents, the royalty owners did not file suit until April 9, 1996. The Trial Court granted the payors a summary judgment concluding that all claims prior to April 9, 1992, were time barred. The El Paso Court of Appeals reversed the Trial Court and concluded that the discovery rule applied because (1) the royalty owners' injury was inherently undiscoverable; (2) the injury was objectively verifiable since the injury could be proven by expert testimony and by financial records showing standard charges made by other similarly situated producers and gatherers in the area and (3) HECI was not applicable because it only analyzed the discovery rule in the context a claim of damage to a common reservoir.

The Supreme Court reversed the Court of Appeals and held that the discovery rule did not apply to the classic cases for injuries caused by the lessee's excessive or improper charges, which would result in the underpayment of oil and gas royalties payable under oil and gas leases. The Court held that such claims as a class were not "inherently undiscoverable" because royalty owners could (a) contact their lessees and gas purchasers for information and (b) investigate on their own the accuracy of the fees identified in the statements included with the royalty checks.

In *Funk v. Devon Louisiana Corp*, 2005 WL 2560107 (Tex. App. - Corpus Christi 2005 *pet. denied*) (Mem.Op.), the Corpus Christi Court of Appeals, six years after its *Hay v. Shell* decision, again decides another bad faith pooling case. In *Hay*, the Court determined that the injury was not objectively verifiable. In *Funk*, the Court identified the category of injury as the improper pooling of unproductive acreage with productive acreage and included that it was not inherently undiscoverable. This conclusion was based on the fact that TRC records were available to the plaintiffs more than four years from the date they filed suit. *Funk* holds that the royalty owner must exercise diligence to discover the non-existence of a common reservoir through requests for information from the lessee and a review of TRC records.

In *Exxon Corp. v. Emerald Oil & Gas Co.*, 52 Tex. Supp. J. 467, 2009 WL 795668 (Tex. March 27, 2009), Exxon was charged with sabotaging productive wells by plugging them in a way that would not permit reopening. Exxon's leases in the Mary Ellen O'Connor Field in South Texas required the payment of a 50-percent royalty to the royalty owners. In the 1970s, Exxon tried to amend the leases and reduce the royalty requirement because Exxon complained the leases, burdened with a 50-percent royalty, were no longer economic for Exxon to operate. Exxon negotiated with royalty owners over a period of time but ultimately plugged and abandoned the wells by August 16, 1991. Emerald leased a portion of the field previously operated by Exxon and attempted to reenter the wells Exxon had plugged, discovering junk, cut casing and plugs in the wellbores, items that were not identified by Exxon in its W-3 Plugging Reports filed with the TRC. Emerald determined that 80-90 percent of Exxon's W-3s inaccurately described the status of the wells plugged. After Emerald brought suit against Exxon, the royalty owner intervened in August and September of 1996, asserting claims for waste, negligence per se, tortious interference and breach of the implied covenant to develop. The jury found that the royalty owners discovered, or should have discovered in the exercise of reasonable diligence, the waste committed by Exxon on January 24, 1995, the date Emerald informed the royalty owners of the full extent of Exxon's damages to the wells and of Exxon's discrepancies in filing the well plugging reports with the TRC. The Trial Court overruled Exxon's limitations defense and, based upon the jury verdict, awarded the royalty owners in excess of $20 million. The Corpus Christi Court of Appeals sustained the Trial Court by concluding that plaintiff's injury was inherently undiscoverable because the damage to subsurface wellbores could not be confirmed either by visual inspection or review of public available records. The damages were objectively verifiable because there was substantial objective evidence of the injury to the wellbores. The Supreme Court confirmed the appellate court's conclusion that the injury at issue was "waste of hydrocarbons" (a tort) which carried a two-year statute of limitations but reversed and rendered in favor of Exxon concluding, as a matter of law, that both Emerald and the royalty owners had actual knowledge of the claims more than two years before Emerald and the royalty owners filed suit. While the jury determined that the royalty owners discovered Exxon's waste on January 24, 1995, the Supreme Court based its decision on two uncontested letters dated September 12, 1990, and June 8, 1994. The September 12, 1990 letter from the royalty owners to Exxon was a generic demand that bad things would happen to Exxon if it plugged producing wells. In Emerald's June 8, 1994 letter to the royalty owners, Emerald advised that Exxon had cut the casing and dumped junk in the wells that Exxon had plugged. The Supreme Court held that, as a matter of law, the letters "unequivocally and conclusively" established that the royalty owners and Emerald "knew or suspected there was damage to their interest ... in 1990 and 1994."

DDD Exploration, Inc. v. Key Production Co., Inc., 2009 WL 1159154 (N.D. Tex. - Amarillo Div. 2009) was a dispute between an oil operator and the adjacent salt water disposal operator. Key drilled its Nichols wells in 1998 into the Chappel formation in Hardeman County, Texas. The Nichols well was a dry hole so in 2000 Key decided to convert the Nichols well into a commercial salt water well. The TRC on March 23, 2000, granted Key a permit to dispose of up to 15,000 barrels per day of salt water into the well. In its permit application, Key represented to the TRC that the Chappel formation into which Key would inject the salt water was not productive of oil or gas. In May 2006, DDD completed the Evans well, which was located 300' from the Nichols well because DDD had obtained a special exception, in the Chappell formation. The Evans well was unsuccessful because it produced almost entirely salt water. On November 8, 2006, a TRC hearing examiner ordered that Key shut-in the Nichols well because it was injecting water into a productive formation rather than into a non-productive formation. At the time of trial, DDD's Evans well was producing 18 to 20 barrels of oil per month, the same rate of production it achieved after Key ceased injecting salt water into its Nichols well.

DDD filed its action against Key on January 2, 2008, claiming that the Nichols well and Evans well were in pressure communication and that the salt water injected into the Nichols well drowned the reservoir underlying the Evans well.

The Court granted Key's motion for summary judgment based upon its statute of limitations defense. The Court held that DDD's claims were not inherently undiscoverable because DDD should have known, prior to drilling its well, that the adjacent Nichols well was receiving salt water in the Chappel formation. The Court held that DDD failed to act with reasonable diligence. Further, the Court held that the plaintiff's claims were not objectively verifiable. The Court was unimpressed with plaintiff's expert witness because the expert admitted that he could not determine in advance where the oil was located. In this regard, the Court stated that:

> Ultimately, drilling for oil is an inherently speculative enterprise. By its very nature, injuries to a subterranean reservoir are not objectively verifiable for the purposes of the discovery rule.

Thus, the DDD exploration opinion seems to preclude the applicable of the discovery rule in most of the lessor/lessee implied covenant cases of drainage, development, marketing and administrative duties since all such cases depend upon expert testimony as to causation, standard of conduct and damages. Also, in virtually all of such cases, the party's expert witnesses will offer greatly diverse testimony. Thus, it would be a rare oil and gas case in which the expert testimony would be so near consensus, and supported by other undisputed evidence, as would meet the objectively verifiable standard to support the application of the discovery rule.

In conclusion, only an exceptionally diligent Texas mineral/royalty owner can obtain all the facts necessary to support his claim and avoid the limitations defense.

LAWYERS BEWARE – The statue of limitations for legal malpractice claims is two years, the standard limitation for all torts. However, the Texas Supreme Court has already concluded that the discovery rule applies to all attorney malpractice suits. *Willis v. Maverick*, 760 S.W.2d 462 (Tex. 1988).

IV. OTHER TOPICS

A. Seismic Activity

Who has the right to conduct or authorize seismic tests?

An unleased mineral owner, a mineral lessor or a mineral lessee, not the surface owner, owns the right to conduct or to authorize seismic tests for the presence of oil or gas. *Gulf Oil Corporation v. Whitaker*, 252 F.2d 157 (5th Cir. Tex. 1958), 9 O&GR 543.

Does the lease grant the exclusive right to conduct seismic tests?

If the granting clause of a lease conveys the exclusive right to explore to the lessee, then the mineral lessor no longer retains any geophysical rights. *Wilson v. Texas Company*, 237 S.W.2d 649 (Tex. Civ. App.-Fort Worth 1951, *writ ref'd n.r.e.*) but articulated better at *Mustang Production Company v. Texaco*, 549 F.Supp. 432 (D. Kan. 1982) 74 O&GR 462, *affirmed* at 754 F.2d 892 (10th Cir. Kan. 1985) 83 O&GR 502.

Liability for wrongfully condemning land

If a trespasser demonstrates that oil and/or gas is not present in commercial amounts, then the owner(s) of the exploratory rights can sue and recover damages resulting from said disclosure. The measure of damages would be the loss of the value to lease, which would be primarily the lost bonus. *Humble Oil and Refining Company v. Kishi*, 276 S.W.190 (Tex. Comm. App. 1925), set aside on other grounds at 291 S.W.538 (Tex. Comm. App. 1927) and later appealed at 299 S.W.687 (Tex. Civ. App.-Beaumont 1927, *writ ref'd*). The Texas Supreme Court recently held that fracing across lease lines did not constitute a subsurface trespass. *Coastal Oil & Gas Corp. v. Garza Energy Trust*, 268 S.W.3d 1 (Tex. 2008).

Hemingway - Sec. 4.1, 4.1(A)
Kuntz - Sec. 12.10
Summers - Sec. 21, 25, 25.1, 78.1, 652, 659, 660
W & M - Sec. 218.5, 226, 231.1, 316.3, 407.2, 512.2, 613.5

B. Surface Issues

General rule as to payment; Surface Damage Act

There is no common law or statutory duty to pay damages to the surface owner for drilling operations. A person who seeks to recover from the lessee for damages to the surface must prove either specific acts of negligence or that more of the land was used by the lessee than was reasonably necessary. *Humble Oil and Refining Company v. Williams*, 420 S.W.2d 133 (Tex. 1967), 27 O&GR 202. Also, there is no common law duty to restore the surface after drilling operations have terminated to the condition the surface was in prior to drilling operations. *Warren Petroleum Corp. v. Monzingo*, 157 Tex. 479, 304 S.W.2d, 362 (1954), 7 O&GR 1108, 65 A.L.R.2d 1352. However, it is customary to pay the surface owner damages or at least reach an agreement with the surface owner as to the amount of damages prior to entering the property for drilling operations.

Lessee's right to use the surface, water, etc.

An oil and gas lease impliedly conveys to the lessee the right to use all of the oil, gas, water, soil, etc. that is reasonably necessary to carry out the lessee's operations under the lease, including secondary recovery operations such as water flooding, *Sun Oil Company v. Whitaker*, 483 S.W.2d 808 (Tex. 1972), 42 O&GR 256, unless the operations benefit other lands, *Robinson v. Robbins Petroleum Corporation*, 501 S.W.2d 865 (Tex. 1973), 46 O&GR 348.

Obstruction doctrine

If the surface owner of his surface lessee uses force to prevent lessee's agents from entering the property, then the lessee can obtain a temporary restraining order from the district court in that county against the complaining party and thus commence his operations prior to a scheduled hearing before the court. Usually, the court will enter a temporary or permanent injunction against the surface owner or his lessee to prevent him from interfering with drilling operations. The surface owner can also be liable to the lessee for damages. *Ball v. Dillard*, 602 S.W.2d 521 (Tex. 1980), 67 O&GR 69.

Accommodation doctrine

The surface use of a lessee must accommodate, if reasonably possible, the prior use of the surface owner. *Getty Oil Company v. Jones*, 470 S.W.2d 618 (Tex. 1971), 39 O&GR 657, 53 A.L.R. 3rd 1. For example, if the surface owner has a rotating type irrigation unit, the lessee should attempt to install surface equipment for production that would not interfere with the irrigation unit.

Hemingway - Sec. 1.2, 4.1(A)
Kuntz - Sec. 26.14

Summers - Sec. 133, 652, 976
W & M - Sec. 218, 219.6, 656.3, 822.2, 877.3

C. Severance of Title from the State (Patents)

If a patent is issued by the state of Texas before September 1, 1895, the state owns no mineral or royalty interest in said land because the state, through a series of statutory and constitutional relinquishments, has surrendered the minerals to the owners of the lands sold, their successors and assigns.

Relinquishment Act of 1919. (Now Natural Resources Code, Sec. 52.171-52.189.) This act applies only to public free school land and asylum land sold with a mineral classification or mineral reservation between September 1, 1895, and August 21, 1931. The "owner of the soil" is the agent of the state for the purpose of leasing oil and gas. A state lease form must be obtained from the General Land Office. If the surface owner leases land for oil and gas, the surface owner and the state share equally in the bonus, delay rental, royalty and other considerations.

Sales Act of 1931. (now Natural Resources Code Sec. 51.054.) This Act applies after August 21, 1931 (some attorneys argue for May 29, 1931), and supersedes the Relinquishment Act of 1919. If land is classified as mineral, then the state has reserved a nonparticipating royalty of "one-eighth of all sulfur and other mineral substances from which sulfur may be derived or produced and one-sixteenth of all other minerals" including oil and gas.

Effective June 19, 1983, the Sales Act of 1931 was amended to permit the state to reserve "not less than" one-eighth of all sulfur and one-sixteenth of all other minerals. The state usually reserves all minerals.

Patents are not covered by Sec. 13.001 of the Property Code which requires certain instruments to be recorded in the county in order to provide constructive notice. Therefore, a patent recorded in the General Land Office is notice to the world of its existence without recording in the county. *Evitts v. Roth*, 61 Tex. 81 (1884); *Byrne v. Fagan*, 16 Tex. 391 (1956). As a practical matter, most patents are recorded in the county.

See II.K. for the leasing procedure for Relinquishment Act and Sales Act Lands.

Hemingway - Sec. 2.5©, 5.7(E)
Summers - Sec. 165, 860
W & M - Sec. 303.9

D. Recording Acts

Nature of the oil and gas lease for recording purposes

An oil and gas lease is a conveyance of real property, not personal property, and the execution thereof constitutes the conveyance of a fee simple determinable in the oil and gas described therein. *Stephens County v. Mid-Kansas Oil and Gas Company*, 113 Tex. 160, 254 S.W. 290 (1923).

Effect of not recording

An oil and gas lease, an assignment of a lease, or any conveyance of a mineral interest that is not recorded in the county where the minerals are located is void as to (a) a creditor or a subsequent purchaser who, (b) pays a valuable consideration without notice; unless the instrument has been acknowledged or proved and filed for record as required by law. An unrecorded instrument is binding on (a) a party to the instrument, (b) the parties' heirs and (c) a subsequent purchaser who does not pay a valuable consideration or who has notice of the instrument.

The above paragraphs summarize Texas Property Code, Sec. 13.001, which identifies the types of "conveyances" that must be recorded or they will be declared void as to creditors and subsequent purchasers who pay value and do not have "notice."

Doctrine of bona fide purchaser

Because there may be title risks that do not arise from a "conveyance," the protection of Sec. 13.001 is limited. The equitable doctrine of "bona fide purchaser" (hereinafter referred to as BFP) provides greater protection. In order for a grantee to be a BFP and prevail over a prior equitable claim, the grantee must:

a. acquire a recordable interest;
b. pay value;
c. be in good faith; and
d. be without "notice" of the prior claim.

Both Sec. 13.001 and the BFP doctrine require a person claiming their benefit to be "without notice" of the prior claim of the contesting party. There are two kinds of "notice." The notice provided by the County Records, generally called constructive notice, means that a purchaser and creditor have notice imputed to them of every recital, reference, reservation and provision of every instrument in their chain of title, and of every unrecorded instrument that is referred to in their chain of title.

Inquiry notice means that the purchaser or creditor has actual knowledge of facts which would lead a reasonable person to inquire further, the most common example being the possession of the land by an adverse claimant or by his tenant.

An extreme example of "inquiry notice" is *Westland Oil Development Corporation v. Gulf Oil Corporation*, 637 S.W.2d 903 (Tex. 1982), 73 O&GR 359, as expanded in *MBank Abilene, N.A. v. Westwood Energy, Inc.*, 723 S.W.2d 246 (Tex. App.-Eastland 1986, *no writ* history), where the Bank's lien was held to be second in priority to a prior lien contained in an unrecorded operating agreement referred to in an assignment of leases recorded prior to the recording of the Bank's security instruments covering the same leases.

Instruments that are void or voidable even if recorded

Neither Sec. 13.001 nor the BFP doctrine can protect a grantee from void instruments or some voidable instruments.

Forgery. A forged instrument is void and is a nullity, as if it never existed. All persons claiming under a forged instrument own nothing, no matter how innocent they were or how much consideration they paid. *Texas Osage Cooperative Royalty Pool, Inc. v. Cruze*, 191 S.W.2d 47 (Tex. Civ. App.-Austin 1945, *no writ*).

Mistaken identity. The execution of an instrument by grantor having the same name as the owner of the land conveys no interest and is void. *Blocker v. Davis*, 241 S.W.2d 698 (Tex. Civ. App.-Ft. Worth 1951, writ ref'd n.r.e.).

Agent without authority. The Ancient Document Rule is 20 years. *See* Texas Title Standards 4.20 and 13.40.

Minority. An instrument executed by a minor is voidable by him until a reasonable time after the minor reaches majority. *Prudential Building & Loan Assn. v. Shaw*, 26 S.W.2d 168 (Tex. Com. App. 1936) *re-hearing overruled* at 119 Tex. 240, 27 S.W.2d 157 (1930). *See* Texas Title Standard 10.10.

Incapacity. An instrument executed by a person lacking mental capacity to contract is, like that of a minor, voidable. *Neill v. Pure*

Oil Company, 101 S.W.2d 402 (Tex. Civ. App.-Dallas 1937, *writ ref'd*), 3 O&GR 419. *See* Texas Title Standard 10.20.

Priority of recording

Generally, instruments can be made effective at, before or subsequent to the date actually signed. However, in the unusual instance where a grantor conveys the same property twice, then the Texas rule is "first in time, not first recorded, is right" because Sec. 13.001 is a "notice" type statute, as opposed to a "race" statute. In Texas, the first purchaser can protect himself from a subsequent purchaser for value who is without notice only by recording his conveyance or taking possession of the property before the subsequent purchase occurs. A later recording will not assist the first purchaser even if he records before the subsequent purchaser's conveyance is recorded. The statute protects the subsequent purchaser without notice regardless of when he records. *Houston Oil Company v. Kimball*, 103 Tex. 94, 122 S.W. 533 and 124 S.W. 85 (1910). The burden of proof is upon the subsequent purchaser to prove, by evidence outside the recitals in his conveyance, that he purchased for a valuable consideration and without notice of the previous conveyance. *Watkins v. Edwards*, 23 Tex. 443 (1859) and *Turner v. Cochran*, 94 Tex. 480, 61 S.W.923 (1901).

Also, *see* Sec. 881 *et seq.* - *Texas Practice-Land Titles and Title Examination* (Second Edition) by Lange and Leopold, *supra*.

Hemingway - Sec. 1.1, 1.3, 6.1
Kuntz - Sec. 22.6
Summers - Sec. 543, 553, 996
W & M - Sec. 203.3, 210.3, 432.1

E. Important Conveyancing Rules

Duhig Rule (Overconveyance)

If a deed conveys and reserves a specific interest without acknowledging a prior reserved mineral or royalty interest, then, in the event all mineral or royalty owners can not be made whole, the grantee of the deed is made whole at the grantor's expense. *Duhig v. Peavey Moore Lumber Company*, 135 Tex. 503, 144 S.W.2d 878 (1940). The Duhig Rule has been held in most states to apply in the absence of a warranty as long as the grantor "purports to convey a definite estate." *Lindsay v. Freeman*, 18 S.W. 727 (Tex. 1892). Thus the controlling issue is "not whether grantor actually owned the title to the land it conveyed, but whether, in the deed, it asserted that it did and undertook to convey it." *Blanton v. Bruce*, 688 S.W.2d 908 (Tex. App. - Eastland 1985, *writ ref'd n.r.e.*), 86 O&GR 138; *Thomas v. Southwest Settlement & Development Co.* 132 Tex. 413, 123 S.W.2d 290; *Greene v. White*, 137 Tex. 361, 153 S.W.2d 575, 136 A.L.R. 626. Texas has not extended Duhig to the point where the estoppel applies through a quitclaim deed.

If, however, both the grantor and the grantee are mutually mistaken as to the legal effect of the deed in question, as opposed to a mutual mistake of fact, then equity will permit reformation of the deed to correct the mistake of law. *McClung v. Lawrence*, 430 S.W.2d 179 (Tex. 1968).

Reference to "interest conveyed" v. "land described"

"Interest conveyed" or land "described" - If a conveyance reserves an interest in the interest conveyed, the interest reserved is proportionately reduced by the interest conveyed. However, if the interest reserved is in the land described, the reserved interest is not proportionately reduced by the interest conveyed. For example, if a grantor owns a one-half interest in the minerals in a tract, conveys said one-half interest reserving a one-fourth mineral interest in the land ***described***, the grantor has reserved a one-fourth mineral interest. On the other hand, if the deed conveys a one-half mineral interest but reserves a one-fourth mineral interest in the land (or interest) ***conveyed***, then the grantor only reserves one-fourth of one-half or a one-eighth mineral interest. *Averyt v. Grand, Inc.*, 717 S.W.2d 891 (Tex. 1986).

A recent example is *Winegar v. Martin*, 304 S.W.3d 661 (Tex. App. - Ft. Worth 2010, no pet.) wherein the grantor, who owned 1/3 of the tract in fee, conveyed his one-third and reserved: "Out of the undivided mineral interest conveyed, grantor reserves a 1/3 non-participating royalty ... ." The Court held that grantor reserved one-ninth of the leased royalty.

Effect of a large non-participating royalty

It is possible, in creating a nonparticipating royalty interest, to create a very large interest, such as a "one-half royalty interest," which would be one-half of eight-eighths of the gross production of oil and gas. *Gavenda v. Strata Energy, Inc.*, 705 S.W.2d 690 (Tex. 1986) 88 O&GR 586. Usually, the intention is to create a nonparticipating royalty of "one-half of the royalty."

"Strip and Gore" Doctrine and the "Mother Hubbard" Clause

The Strip and Gore Doctrine is a presumption applied where a grantor owns land, adjacent to a strip of land (which could be an easement, road, railroad or non-navigable stream) and conveys all of the land with a description that abuts, but does not include, the adjacent strip. The doctrine answers the question: "Does the grantor retain title to the undescribed easement tract/strip?"

The Strip and Gore Doctrine was first adopted by the Texas Supreme Court in *Mitchell v. Bass*, 26 Tex. 372 (1862). The rule was extended to cover streets and alleys abutting city lots by *Texas Bitulithic Co. v. Warwick*, 293 S.W. 160 (Tex. Comm'n. App., 1927) and was extended to railroad rights of way in *Rio Bravo Oil Company v. Weed*, 121 Tex. 427, 50 S.W.2d 1080 (1932), 85 A.L.R. 391.

A Mother Hubbard Clause is an attempt to create the same result by contract that the Strip and Gore Doctrine creates as a legal presumption. While the Strip and Gore Doctrine applies to strips of land underlying easements etc., the Mother Hubbard language, while including land underlying easements etc., includes small adjacent tracts, particularly those resulting from incorrect surveying, careless location of fences or other mistakes. *Sun Oil C. vs. Burns*, 84 S.W.2d 442 (1935); *Gulf Production Co. v. Spear*, 84 S.W.2d 452 (1935).

Conveyance of mineral acres or royalty acres instead of an undivided interest

A conveyance of mineral acres or royalty acres will be strictly interpreted even if the number of acres in the tract is more or less than originally understood. For example, a conveyance of 25/200 mineral acres where the land actually contained 226.8 acres, not 200 acres, conveyed a 25/200 interest rather than a 25/226.8 interest in the minerals. *Woods v. Simms*, 154 Tex. 59, 273 S.W.2d 617 (1954). However, in Texas it is not common for a conveyance to be exclusively in mineral or royalty acres.

Legal description

Sufficiency of description. For a legal description to be valid, the writing must contain within itself, or by reference to some other existing writing, the means or data by which the land can be identified. It is not necessary that the deed should contain a full description as will enable the land to be determined without extrinsic evidence. *Morrow v. Shotwell*, 477 S.W.2d 538 (Tex. 1972). *See* Texas Title Standard 5.10.

Omnibus/Coverall/Global description. It has long been the rule in Texas that a deed (or an assignment) purporting to convey all lands owned by the grantor/assignor in the state or in a named county is a sufficient description to effect a conveyance and thus, when recorded, constitutes constructive notice to subsequent purchasers. *Texas Consolidated Oils v. Bartels*, 270 S.W.2d 708 (Tex. Civ. App. - Eastland 1954, *writ ref'd.*). This rule was confirmed in *U.S. Enterprises, Inc. v. Dauley*, 535 S.W.2d 623 (Tex. 1976) at page 628.

This type of coverall description is often used when the grantor does not know the full extent of his property ownership. Often this grantor will convey by identifying the property he knows he owns and adding a coverall description. These conveyances have been sustained in Texas. *Holloways Unknown Heirs v. Whatley*, 131 S.W.2d 89 (1939) and *Cook v. Smith*, 107 Tex. 119, 174 S.W. 1094, 3A.L.R. 940. However, if the specific description in the conveyance is deemed to be ambiguous, the Court has held that the entire conveyance is void and not saved by the coverall description. *J. Hiram Moore, Ltd. v. Greer*, 172 S.W.3d 609 (Tex. 2005).

Hemingway - Sec. 3.1(C), 3.2(C)&(E), 7.8, 9.1
Kuntz - Sec. 14.5
Summers - Sec. 133, 134, 590, 601, 606
W & M - Sec. 221.2, 311, 317, 320.2, 340, 505, 704.5

Reservation in favor of third party

An attempted reservation in favor of a third party or a stranger to title is void. For example, if a husband and wife convey their property and reserve all minerals to themselves and their seven children, the reservation in favor of the seven children is void. *Joiner v. Sullivan*, 260 S.W.2nd 439 (Tex. Civ. App. - Texarkana 1953, *writ refused*). The theory is that estoppel does not operate in favor of one whose title is created only by a recital in a deed. Estoppel can operate only to protect the person invoking the estoppel as to property he already owns. *Cone v. Cone*, 153 Tex. 194, 266 S.W.2d 480 (1953).

Unique conveyancing issues (varies by state)

Quitclaim deeds infect entire subsequent chain. A quitclaim deed is a conveyance whereby the grantor does not represent that he owns any interest/title in the property conveyed, but he intends to convey whatever interest he may own. The legal effect of a quitclaim deed is that the grantee is not a bona fide purchaser for value and thus takes whatever title he receives subject to any outstanding equitable interests. In most states, the burden of the quitclaim deed only affects the immediate grantee. In Texas however, a quitclaim deed prevents any subsequent owner of the interest conveyed from being a bona fide purchaser, and thus all subsequent owners are subject to any outstanding equitable interest. *Miller v. Pullman*, 72 S.W.2d 379 Tex. Civ. App. - Galveston 1934, *writ ref'd*). *Enerlex Inc. v. Amerada Hess, Inc.*, 302 S.W.3d 351 (Tex. App. - Eastland 2009, *no pet.*).

Today many assignments of leases contained quitclaim type granting language, such as "all assignor's right, title and interest." Also, many assignments have disclaimed all warranties. Thus, it would appear that many assignments of leases are in fact quitclaims. Fortunately, the case of *Bryan v. Thomas*, 365 S.W.2d 628 (Tex. 1963) construed a conveyance of "all of our undivided interest" in and to the minerals in a described tract of land as not being a quitclaim because it conveyed the land itself. The Court stated its conclusion at *id.* 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 protection of a bona fide purchaser."

See also Chapter 31 of Texas Practice Series - Land Title and Title Examination.

Can a wellbore be a property interest separate from the surrounding leasehold? This question is answered, for the first time in the country, by *PetroPro, Ltd. v. Upland Resources, Inc.*, 279 S.W.3d 743 (Tex. App. - Amarillo 2007, *pet. denied*). The granting language in question (in an auction assignment) did not detail the rights of the assignee when it conveyed:

> 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" #2* well.

The King "F" #2 well was producing gas from the Cleveland formation, approximately 6,500 to 6,600 feet.

The Court held that the wellbore owner had neither the right to deepen the wellbore nor drill a horizontal well from the wellbore. In addition to producing the wellbore from the Cleveland formation, the only right the Court confirmed in the assignee was the right to produce up the wellbore by new perforations. This last right is unclear because the Court also plainly explained that the assignee only owned the wellbore and the space within the wellbore, not any property or right to access the property (leasehold) outside the wellbore. Thus, the assignor retained all leasehold rights, which would include the right to drill subsequent wells upon the lease. The dilemma the Court left unanswered is that the wellbore owner cannot obtain a drilling permit to go up the hole and establish new production unless the wellbore owner can swear to the Texas Railroad Commission that it owns sufficient leasehold to support the operation it proposes. Since the wellbore owner owns no leasehold, it appears that the only way the wellbore owner can obtain new production higher in the wellbore is with the consent of the surrounding leasehold owner.

Practice Tip – A wellbore-only interest should not be created unless the parties detail the rights of the wellbore owner. Part of the agreement should be that the assignor conveys to the assignee, for TRC permitting only, sufficient leasehold around the wellbore to allow the wellbore owner to conduct future operations.

F. "Pore Space" Ownership Issue

The placement of CO_2 into underground storage is currently a popular idea held primarily by the advocates of global warming. Currently, CO_2 is primarily produced and sold for use in enhanced-oil-recover projects (EOR). CO_2 is injected into oil-bearing formations to stimulate oil and gas production, and the CO_2 that is produced with oil can be reinjected. Incentives encourage the use of CO_2 for EOR purposes, including tax credits in Texas, but no incentives presently exist to sequester CO_2 underground. Owen Anderson, Drilling, Production, Processing and Sequestration, Advanced Oil, Gas and Energy Resources Law Course 2009 (State Bar of Texas).

Texas, like most states, does not have a definitive opinion determining who owns the pore space underground. The granting clause of an oil and gas lease frequently conveys the right to store hydrocarbons. *See E. G. Ryan Cons. Petroleum Corp. v. Pickens*, 155 Tex. 221, 204 (1955). Assuming CO_2 sequestration is somewhat analogous to underground gas storage, Texas cases go both ways. *Emeny v. United States*, 412 F.2d 1319 (Ct. Cl. 1969) (which determined title to the Bush Dome, a storage facility for helium located northwest of Amarillo, Texas), applying Texas law, held that the surface owner had title to gas storage rights. In contrast, in *Mapco, Inc. v. Carter*, 808 S.W.2d 262 (Tex. App. - Beaumont 1991), *rev'd* in part on other grounds at 817 S.W.2d 686 (Tex. 1991), the mineral owners ownership claim prevailed. In *Humble Oil & Refining Co. v. West*, 508 S.W.2d 812 (Tex. 1974), the Texas Supreme Court cited Emeny for the proposition that the surface owner retained

> the geological structures beneath the surface, together with any such structure that might be suitable for the underground storage for extraneous gas produced elsewhere.

Ultimately, the answer could be eminent domain. If a party seeking to sequester CO_2 had the power of eminent domain, then neither the surface nor mineral owner could prevent the sequestration project. However, the question still remains: "Who is entitled to compensation for the taking?" Currently, the safest answer is to obtain the approval of, or compensate both, surface and mineral owners.

G. Definition of "Other Minerals" — Coal Development

Texas' natural resources include an appreciable quantity of low to medium grade bituminous coal and a large quantity of average to high grade lignite. Coal deposits are found in all of Texas except the northwest, which the author defines as from Midland north to the Panhandle. Lignite is produced principally for the production of steam-generated electricity. By the 1990s, Texas was the nation's sixth leading coal producing state, and as much as 99 percent of the production was lignite.

A conveyance in Texas of all "oil, gas and other minerals" raises few interpretive issues as to the conveyance of oil and gas, but determining what is meant by "other minerals" has been a problem for many years. After decades of decisions addressing particular substances on a case-by-case basis, a unanimous court in *Acker v. Guinn*, 464 S.W.2d 348, 352 (Tex.1971), identified a new rule, holding a grant or reservation of "minerals" or "mineral rights" should not be construed to include a substance that must be removed by methods that will, in effect, consume or deplete the surface estate. This so called "surface-destruction" test was explained and modified in *Reed v. Wylie*, 554 S.W.2d 169, 172 (Tex. 1977) (Reed I), which held that if substantial quantities of the minerals lie so near the surface that extraction, as of the date of the surface-mineral severance, would necessarily destroy the surface, then the surface owner has title to the mineral. In *Reed v. Wylie*, 597 S.W.2d 743, 747-48 (Tex. 1980) (Reed II), the Court held that a deposit within 200 feet of the surface was held to be "near the surface" as a matter of law and thus a part of the surface estate if it were shown that any reasonable method of production, at the time of the conveyance or thereafter, would consume, deplete or destroy the surface. The Supreme Court, recognizing the uncertainty in mineral titles created by *Acker* and *Reed I* and *Reed II*, changed course again, though only prospectively, in *Moser v. United States Steel Corp.*, 676 S.W.2d 99 (Tex. 1984). Returning to its pre-*Acker* approach, the Court held that a grant or reservation of oil, gas and other minerals includes all substances within the "ordinary and natural meaning" of the word "minerals," whether their presence or value is known at the time of the severance. 676 S.W.2d at 102. In its opinion, the Court held that uranium was a mineral within the ordinary and natural meaning of the word. The opinion expressly reaffirmed earlier decisions holding particular substances to belong to the surface estate as a matter of law, including:

a. Building stone and limestone - *Heinatz v. Allen*, 147 Tex. 152, 217 S.W.2d 994 (1949);
b. Limestone, caliche and surface shale - *Atwood v. Rodman*, 355 S.W.2d 206 (Tex. Civ. App. - El Paso 1962, *writ refused n.r.e.*);
c. Water - *Fleming Foundation v. Texaco, Inc.*, 337 S.W.2d 846 (Tex. Civ. App. - Amarillo 1960, *writ ref'd n.r.e.*);
d. Sand and gravel - *Psencik v. Wessels*, 205 S.W.2d 658 Tex. Civ. App. - Austin 1947, *writ ref'd*); and
e. Near-surface lignite, iron and coal - *Reed v. Wylie*, 597 S.W.2d 743 (Tex. 1980).

The surface destruction test continues to apply to cases involving conveyances severing the surface and mineral estates before June 8, 1983, the date of the Supreme Court's original opinion in *Moser*. This is true of grants or reservations of royalty interests as well as mineral interests, *Plainsman Trading Co. v. Crews*, 898 S.W.2d 786 (Tex. 1995), although the concern for the integrity of the surface estate that generated the surface-destruction test does not seem to apply to royalty interests, whose owners have no right to develop.

Substances identified pre-*Moser* by the Courts as minerals are oil and gas, uranium, sulphur, deep iron ore and salt, deep coal and lignite. Also, substances long considered to have special value, such as gold, silver and most other metallic substances seem clearly to be within the ordinary and natural meaning test.

H. Unique State Issues (Non-Conveyancing)

Statute allowing interest owners to perfect a security interest in proceeds from a well

Sec. 9.319 of the Texas Business and Commerce Code creates a security interest in favor of all interest owners (they become secured parties) to secure the payment to them by the first purchaser of oil or gas to pay the purchase price. A "signed writing" operates to give the interest owner a security agreement, and the security interest is perfected automatically without the filing of a financing statement. This statute is unique to Texas.

In re: Tri-Union Development Corporation, No. 0032498-H4-11, 2000 Bank. LEXIS 1129 (Bankr. SD. Tex. - Houston Division, Oct. 4, 2000) is the first Texas case construing this statute. Its holding is that a Texas royalty owner is a secured creditor and thus in a more beneficial position than a similarly situated California royalty owner.

I. Burdens upon Title/Due Diligence

Mortgages/Deeds of trust

While a mortgage is a two-party instrument between a mortgagor and mortgagee, a deed of trust is a conveyance to a trustee for the benefit of the mortgagee and, in Texas, gives the trustee the power of non-judicial foreclosure and sale. *Johnson v. Snell*, 504 S.W.2d 397, 399 (Tex. 1973). The general practice in Texas is to use a deed of trust; however, lenders and attorneys commonly use the terms "mortgage" and "deed of trust" interchangeably. Any real property interest that can be conveyed can be subject to a deed of trust lien, including a reversionary interest or an interest effective after payout. *David v. Kidd*, 37 S.W. 2d 261 (Tex. Civ. App. - Texarkana 1931, *no writ*). Texas follows the "lien theory" of mortgages and deeds of trust, under which the creditor or the trustee, despite granting language in the instrument, is not regarded as the owner of the property securing the debt. *Taylor v. Brennan*, 621 S.W.2d 592, 593 (Tex. 1981). Legal title does not pass from the mortgagor, and the mortgagee receives only a lien or equitable title. *Flagg-Redfern Oil Co. v. Humble Exploration Co.*, 744 S.W.2d 6, 8 (Tex. 1987).

Unless the mortgage or deed of trust provides otherwise, the property owner generally retains the right to rents, revenues and profits while the property is subject to the lien. However, the deed of trust or a separate instrument commonly includes a provision assigning to the mortgagee the mortgagor's interest in rents or other income accruing after the date of the mortgage as additional security. *NCNB Tex. Nat'l Bank v. Sterling Projects, Inc.*, 789 S.W.2d 358, 360 (Tex. App. - Dallas 1990, *writ dism'd woj*). If an assignment of rents is given as additional security for the debt, the assignment does not become operative until the creditor takes affirmative action, such as obtaining possession of the property, impounding the rents or securing the appointment of a receiver. *Summers v. Consol. Capital Special Trust*, 783 S.W.2d 580, 583 (Tex. 1989). On the other hand, if the assignment of rentals is an "absolute assignment," it does not create a security interest but instead automatically gives the creditor title to the rent on the occurrence of a specified condition, such as default. *NCNB Tex. Nat'l Bank v. Sterling Projects, Inc.*, 789 S.W.2d 358, 360 (Tex. App. - Dallas 1990, *writ dism'd woj*). Absolute assignments are not favored by the Courts. If the assignment agreement or deed of trust states that the assignment of rents is given as "further" security for the debt and permits the creditor on default to enter the premises and collect the rents, the assignment will be construed to be security which must be foreclosed, not an absolute assignment. *Taylor v. Brennan*, 621 S.W.2d 592 (Tex. 1981).

A non-judicial foreclosure, or sale under power of sale in a deed of trust, authorized by Tex. Prop. Code §51.002, represents one of the most expeditious foreclosure procedures available in any state. However, all aspects of the sale will be subject to close scrutiny and strict construction by the Courts. The lien must be foreclosed within four years from the maturity of the debt. Tex. Civ. Prac. & Rem. Code §16.035 (b). Failure to initiate the foreclosure procedure within four years will cause the lien to be "barred of record." Taken from Texas Title Standard 15.10

Judgment liens

If a Court-certified "abstract of judgment" is properly prepared, recorded and indexed, a judgment lien lasting 10 years attaches to the judgment debtor's non-homestead real property, then owned or thereafter acquired, located in the county or counties where the abstract of judgment is of record. Tex. Prop. Code Ann. §§52.001, 52.002. The term "real property" includes any interest in land including any undivided interest. *Robertson v. Scott*, 172 S.W.2d 478 (Tex. 1943); *Stroble v. Tearl*, 221 S.W.2d 56 (Tex. 1949).

Neither the entry of a money judgment nor the recordation of a judgment creates a lien. *White v. FDIC*, 19 F. 3d 249, 251 n. 5 (5th Cir. 1994). Although a judgment may create a separate judicial lien by its expressed language, a certified copy of a judgment does not qualify as an abstract of judgment and does not create a lien by recordation. *City Corp. Real Estate, Inc. v. Banque Arabe Internationale D'Investissement*, 747 S.W.2d 926, 929 (Tex. App. - Dallas 1988) *writ denied*).

While many older Texas cases hold that each and every statutory element, *see* Tex. Prop. Code Ann §52.003, must be met to establish a lien, the standard for establishing a lien is substantial compliance with the statute, *Apostolic Church v. American Honda Motor Co.*, 833 S.W.2d 553, 554 (Tex. App. - Tyler 1992, *writ denied*), or the abstract of judgment contains sufficient facts to put a subsequent purchaser on notice of a lien. *See Thompson v. Clay*, 367 S.W.2d 917, 920 (Tex. Civ. pp. - Amarillo 1963, *writ ref'd n.r.e.*).

The lien comes into existence only when the abstract of judgment has been recorded and indexed as to each plaintiff and each defendant. *J. M. Radford Grocery Co. v. Speck*, 152 S.W.2d 787, 789 (Tex. Civ. App - Amarillo 1941, *writ ref'd*). An abstract of judgment may not be enforced if it is indexed under an incorrect name. *Reynolds v. Kessler*, 669 S.W.2d 801, 805 (Tex. App. - El Paso 1984, *no writ*) ("the names of all of the parties to the judgment must appear alphabetically in the index, direct and reverse"). The judgment creditor has the burden to prove that the abstract of judgment complied with the statute and that it was properly recorded and indexed. *Alkas v. United Sav. Ass'n . of Texas, Inc.*, 672 S.W.2d 852, 859 (Tex. App. - Corpus Christi 1984, *writ ref'd n.r.e.*). The judgment creditor cannot use as a defense the fact that the error was caused by the clerk. *Caruso v. Shropshire*, 954 S.W. 2d 115, 116 (Tex. App. - San Antonio 1997, *no pet.*).

A judgment lien continues for a period of 10 years following the date of recording and indexing the abstract, unless the judgment becomes dormant during this time. Tex. Prop. Code Ann. §52.006. Dormancy of judgments is addressed by Tex. Civ. Prac. & Rem. Code Ann. §34.991. If a judgment becomes dormant, any judgment lien derived therefrom also becomes dormant. *Anthony v. Taylor*, 4 S.W. 531, 532 (Tex. 1887). A dormant judgment may be revived within two years from the date of dormancy by filing a scire facias proceeding. Tex. Civ. Prac. & Rem. Code Ann. §31.006. In addition, dormancy may be prevented by filing suit to foreclose the judgment lien, which is regarded as an action for debt sufficient to preserve the judgment. *Churchill v. Russey*, 692 S.W.2d 596, 597-98 (Tex. App. - Ft. Worth 1985, *no writ*). If a judgment is not dormant, an abstract of judgment can be re-recorded and re-indexed. Each recording and indexing of an abstract of judgment seems to create a new lien with a new priority date. *Burton Lingo Co. v. Warren*, 45 S.W.2d 750 (Tex. Civ. App. - Eastland 1931, *writ ref'd*).

An abstract of judgment creates a judgment lien only if issued by a Texas State Court under Tex. Prop. Code Ann. §§52.001, 52.002 or by a United States District Court located in Texas, as authorized by Tex. Prop. Code Ann. §52.007. *See Reynolds v. Kessler*, 669 S.W.2d 801, 806 (Tex. App. - El Paso 1984, *no writ*); 28 U.S.C. §1962. A foreign judgment must first be domesticated as provided in Tex. Civ. Prac. & Rem. Code Ann. chapter 35 and chapter 36, whereupon an abstract of judgment may be issued and recorded in the same manner as any other Texas judgment. *Hennessy v. Marshall*, 682 S.W.2d 340, 343 (Tex. App. - Dallas 1984 *no writ*). *See* Texas Title Standard 15.30. Taken from Texas Title Standard 15.30.

Involuntary mechanic's liens

Texas law provides for three types of mechanic's liens: constitutional, statutory/general and mineral liens. The Texas Constitution provides that:

> mechanic's, artisans and materialman, of every class, shall have a lien upon the buildings and articles made or repaired by them for the value of the labor does thereon or material furnished therefore; and the legislature shall provide by law for the speedy and efficient enforcement of said liens. Tex. Const. art. XVI, §37.

The constitutional lien is self-executing as between the property owner and the original contractors. Also, one providing labor or materials directly to the owner is not subject to statutory conditions to enforcement, such as the timely filing of an affidavit claiming the lien. *Hayek v. Western Steel Co.*, 478 S.W.2d 786, 790 (Tex. 1972); *Strang v. Pray*, 35 S.W. 1054 (Tex. 1896). While, generally the constitutional lien may be either oral or written for it to be a valid construction or improvement lien on homestead, the contract must be in writing. *Cavazos v. Munoz*, 305 B.R. 661, 680 (SD Tex. 2004). The constitutional lien is not binding on third parties without notice or unless the contractor has followed the statutory lien provisions. *Strang v. Pray*, 35 S.W. at 1056).

The statutory lien is available to one who provides labor or materials, either as an original contractor or as a sub-contractor for the construction of a house, building, or oil, gas or water well pipeline or quarry. Tex. Prop. Code. Ann §§56.001-56.002. The affidavit claiming a lien for labor or materials furnished must be filed in the office of the county clerk in the county in which the property is located not later than the 15th day of the fourth calendar month after the day on which the indebtedness accrues. The indebtedness generally accrues on the last date of the month the contract was completed or terminated for an original contractor and on the last day of the last month labor was performed or material furnished by a sub-contractor or material supplier. Tex. Prop. Code Ann §53.053. The affidavit must be signed and sworn to by the person claiming the lien or another person on the claimant's behalf and contain all items specified in Tex. Prop. Code Ann §53.054.

The mineral contractor's lien allows one who furnishes labor or material for an oil, gas or water well, an oil or gas pipeline or a mine or quarry to file his affidavit in the office of the county clerk of the county where the property is located not later than six months after the day the indebtedness accrues. Tex. Prop. Code Ann. §56.021(a.) The indebtedness for labor performed by the day or week accrues at the end of each week during which the labor is performed. Tex. Prop. Code Ann. §56.005(a.). The indebtedness for material or services otherwise accrues on the date they were last furnished; all material or services furnished by the same person on the same property are considered furnished under a single contract, unless more than six months elapsed between the dates the material or services are furnished. Tex. Prop. Code. Ann. §56.005(b.). The lien attaches to leasehold interest and is not limited to the wells or to the proration units around the producing wells. Thus, the lien claimant for a well will acquire a lien in other wells on the same lease and in nonproductive acreage covered by the lease. *Mercantile Nat'l Bank v. McCullough Tool Co.*, 259 S.W.2d 724 (Tex. 1953). The lien attaches only to the leasehold interest of the owner who contracts with the lien claimant. The lien does not attach to the undivided interest of co-owners who did not contract with the lien claimant unless the lien claimant can establish that the co-owners are mining parties or joint venturers or that an agency relationship exists. *Youngstown Sheet and Tool Co. v. Penn*, 357 S.W.2d 239 (Tex. Civ. App. - Austin 1962), *modified* on other grounds, 363 S.W.2d 230 (Tex. 1962). Typically, the co-owners of a leasehold will designate an operator as an independent contractor under a joint operating agreement so long as the parties conduct is not inconsistent with that characterization; they will not be mining partners or joint venturers, and the operator will not be regarded as an agent of the non-operators. *Ayco Devel. Corp. v. G.E.T. Service Co.*, 616 S.W.2d 184 (Tex. 1981). Taken from Texas Title Standard 15.20.

Tax liens

Ad valorem taxes are assessed as of January 1 of each year. They are due and payable on the following October 1 but are not delinquent if paid before February 1 of the following year. A tax lien attaches on January 1 of each year to secure payment of taxes, penalties and interest ultimately imposed for that year. Tex. Tax Code Ann §32.01. In determining the status of payment of ad valorem taxes, the attorney customarily relies upon a tax certificate issued by a collector for a taxing unit. A tax receipt, as opposed to a tax certificate, is less reliable because it is only prima facia evidence that the tax has been paid. Tex. Tax Code Ann §31.075. The collector for a taxing unit must cancel and remove from the delinquent tax roll a tax that has been delinquent for more than 20 years. Tex. Tax Code Ann. §33.05. For further information on foreclosure, see Texas Title Standard 16.20. Taken from Texas Title Standard 15.70

Various federal tax liens may constitute a claim against a taxpayer's property. These include a general tax lien (26 U.S.C. §6321), a gift tax lien (26 U.S.C. §6324(b.)), an estate tax lien (26 U.S.C. §6324(a.)), a generation-skipping tracer tax lien (26 U.S.C. §2661) and special liens relating to recapture of deferred or reduced taxes such as special use valuation of a farm or closely held business (26 U.S.C. §§6324(a.) and 6324(b.). Most federal tax liens attach to the taxpayer's property following certain statutory notice from the Internal Revenue Service and other procedures involving the taxpayer (26 U.S.C. §6320). No filing is required for perfection of the estate tax lien or gift tax lien. Except for the federal estate tax lien, a lien is not perfected against a purchaser, a holder of a security interest, a holder of a mechanic's lien or a judgment creditor until a notice is filed in the records of the county where the land is located (26 U.S.C. §6323).

Subject to renewal (26 U.S.C. §6323(g)), a notice of federal tax lien is valid for 10 years and 30 days from date of assessment (26 U.S.C §§6322, 6502, and 6503). Taken from Texas Title Standard 15.60.

Lien priority and subordination

All ad valorem tax liens have equal priority. The ad valorem tax lien is superior to a federal tax lien. Tex. Tax Code Ann. §32.04; 26 U.S.C. §6323(b.)(6). A tax lien takes priority over the claim of any holder of a lien on the land encumbered by the tax lien. Tex. Tax Code Ann. §32.05. Texas Title Standard 15.80.

After a senior lien is validly foreclosed, junior liens and junior interests in the same property are extinguished. *Arnold v. Eaton*, 910 S.W.2d 181 (Tex. App. - Eastland 1995, *no writ*). Under common law, the lienholder whose lien first attaches to the property has the right to satisfy the lien against the property before the holders of subsequently attached liens. *Windham v. Citizens Nat'l Bank*, 105 S.W.2d 348 (Tex. Civ. App. - Austin 1937, *writ dism'd.*). However, recording statutes have modified the common law rules of lien priority. A recorded lien may be inferior to a subsequent lien created under an instrument actually recorded before the first lien, such as a deed of trust with a future advance clause because the first lienholder is charged with constructive notice of the lien that may arise in the future. *Coke Lrb. & Mfg. Co. v. First Nat'l Bank*, 529 S.W.2d 612 (Tex. Civ. App. - Dallas 1975, *writ ref'd*). Taken from Texas Title Standard 15.90.

Removal of liens

Regardless of whether a written release is delivered, the lien ceases to exist when the underlying debt is paid; however, the lienholder has a duty to issue a written release. *Knox v. Farmers' State Bank*, 7 S.W.2d 918 (Tex. Civ. App. - Eastland 1928, *writ ref'd*); *Spencer-Sauer Lumber Co. v. Ballard*, 98 S.W.2d 1054 (Tex. Civ. App. - San Antonio 1936, *no writ*) (full release); *Cook v. Leslie*, 59 S.W.2d 302 (Tex. Civ. App. - San Antonio 1933, *no writ*) (partial release). Preferably a written release should be obtained whenever reasonably possible. To give notice to third parties dealing with the property, a written release must be recorded in the county in which the lien was recorded. Tex. Prop. Code Ann §§11.001, 13.002.

Commonly a release of a mortgage or deed of trust may fail to expressly release a related assignment of rents or leases or a separate financing statement which may have been given to the same lender as additional security. If a deed of trust or other mortgage was filed for record at or about the same time as the filing of a financing statement or the recordation of an assignment of rents, leases, production or other collateral to the same lender and appears to be part of the same transaction evidenced by the deed of trust or other mortgage, it is common practice for an examiner to assume that a full release of a deed of trust or other mortgage without specific reference to the financing statement or assignment is sufficient as a release of the financing statement or assignment.

A sale of real property under a power of sale in a mortgage or deed of trust must be made not later than four years after the date the cause of action accrues. Generally, the cause of action accrues on the maturity date of the debt. Upon expiration of the four year limitations period, the real property lien and any power of sale to enforce the lien are void. The running of the statute of limitations is not suspended against a bona fide purchaser. An examiner who does not have notice or knowledge of the suspension of the limitations period (e.g., unrecorded extension agreement) may assume that the lien is unenforceable when a cause of action on an outstanding real property lien has accrued for more than four years, except as provided by the provisions governing suspension in the event of death. Tex. Civ. Prac. & Rem. Code Ann. §§16.035, 16.036, 16.062.

If a promissory note is payable on demand, there are two limitations periods. A promissory note is "payable on demand" if it states that it is payable on demand, payable at site, otherwise indicates that it is payable at the will of the holder or does not state any time for payment. Tex. Bus. & Com. Code Ann. §3.108. If demand for payment is made to the maker, an action to enforce payment must be commenced within six years after the demand; however, if no demand for payment is made, an action to enforce the note is barred if neither principal nor interest on the note has been paid for a continuous period of 10 years. *See* Tex. Bus. & Com. Code Ann. §3.118 (b.). Note, however, that prior to the amendment of §3.118, effective May 22, 2001, Texas case law held that the limitations period for a demand note began to run on the date the note was made. *See e.g. G&R, Inv. v. Nance*, 683 S.W.2d 727 (Tex. App. - Houston [14th Dist.] 1984, *writ ref'd n.r.e.*). Although enforcement of a lien may be barred by the four-year limitations period (under §16.035 Tex. Civ. Prac. & Rem. Code Ann.), payment of the debt may continue to be enforceable as an unsecured debt provided an action to enforce payment is commenced within the limitations periods set forth in Tex. Bus. & Com. Code. Ann. §3.118; *Aguero v. Ramirez*, 70 S.W.3d 372 (Tex. App. - Corpus Christi 2002, *pet. denied*).

If the maturity date of the debt is omitted from the deed of trust, the deed of trust is read together with the underlying note as if the two constituted one instrument. *Cadle Co. v. Butler*, 951 S.W. 2d 901 (Tex. App. - Corpus Christi 1997, *no writ*). An omission of the date of maturity does not toll the statute of limitations for the payment of the debt. The limitations period begins to run on the date the last installment payment is due, even if not stated in the deed of trust. *Swedlund v. Banner*, 970 S.W.2d 107 (Tex. App. - Corpus Christi 1998, *pet. denied*). Taken from Texas Title Standard 15.100.

Lis pendens

Tex. Prop. Code Ann. §13.004 provides:

a. A recorded lis pendens is notice to the world of its contents. The notice is effective from the time it is filed of record, regardless of whether service has been made on the parties to the proceeding.
b. A transfer or encumbrances of a real property involved in a proceeding by a party to the proceeding to a third party who has paid a valuable consideration and who does not have actual or constructive notice of the proceeding if effective, even though the judgment is against the party transferring or encumbering property, unless a notice of the pendency of the proceeding has been recorded under that party's name in each county in which the property is located.

A property filed lis pendens notice effectively prevents a grantee from being an innocent purchaser. The doctrine does not void a conveyance during the pendency of a suit, but the interest of the grantor merely passes subject to the results of the cause. *Cherokee*

Water Co. v. Advance Oil & Gas Co., 843 S.W.2d 132 (Tex. App. - Texarkana 1992, *writ den.*). Taken from Texas Title Standard 15.110.

Foreclosure

Non-judicial. The statute of limitations for foreclosure of a lien runs four years from date of maturity of the obligation, unless otherwise tolled. The trustee's authority expires when a debt is barred; therefore, a sale subsequent to the running of the statute of limitations is void. *Stubbs v. Lowrey's Heirs*, 253 S.W.2d 312 (Tex. Civ. App. - Eastland 1952, *writ ref'd. n.r.e.*). Moreover, the statute of limitations begins to run when a note is accelerated, *Curtis v. Speck*, 130 S.W.2d 348 (Tex. Civ. App. - Galveston 1939, *writ ref'd.*) or, for lien foreclosure purposes, when the note is executed if it is a demand note, *Seaman v. Seaman*, 425 S.W.2d 339 (Tex. 1968), unless demand is specifically required in the instrument. *Loomis v. Republic Nat'l Bank*, 653 S.W.2d 75 (Tex. App. - Dallas 1983, *writ ref'd. n.r.e.*). If the deed of trust itself does not state the maturity date of the note, then the note itself must be examined. An extension of the maturity date of the note extends the period of time for foreclosure. *Southland Life Ins. Co. v. Egan*, 86 S.W.2d 722 (Tex. 1935). Tex. Civ. Prac. & Rem. Code Ann. §16.036 prescribes the requirements for a valid extension. To be effective as to a bona fide purchaser, a lienholder or lessee without actual notice, the extension must be recorded. *Id.* §16.037.

Even though a federal tax lien may be subordinate to the lien of a security instrument being foreclosed, a federal tax lien is not cut off by the foreclosure unless there has been compliance with I.R.C. §7425. Thus, where an unreleased subordinate federal tax lien has been filed or recorded more than 30 days prior to the date of the foreclosure sale, the examiner must determine either that the notice of lien has expired (I.R.C. §6323) or that the Internal Revenue Service was notified in compliance with I.R.C. §7425.

The filing of a petition in bankruptcy generally results in an automatic stay against the enforcement of a lien and any action to obtain possession of property of the bankrupted estate. 11 U.S.C. §§362, 922. An examiner who becomes aware of a bankruptcy filing should require evidence that the stay was lifted. Taken from Texas Title Standard 16.10.

Judicial foreclosure and execution sales. A deed by an officer, typically a sheriff or constable, purporting to convey a judgment debtor's interest in real property may form an essential link in the chain of title under examination. Sheriff's deeds are commonly encountered in two situations: those involving the judicial foreclosure of liens and those resulting from execution on money judgments. To confirm that the sale was conducted properly, an examiner must review three documents: (1) the Court's judgment, (2) the clerk's order of sale or writ of execution and levy and (3) the sheriff's or constable's deed resulting from the sale. Unless the sale is conducted pursuant to the Court's authority, a sheriff's or constable's deed conveys no title. *Mills v. Pitts*, 48 S.W.2d 941 (Tex. 1932). A return by the sheriff or constable following the sale is not essential. It will be presumed from the judgment and the sheriff's deed that the officer did his duty unless this is rebutted by proof to the contrary. *Harris v. Mayfield*, 260 S.W. 835 (Tex. Comm'n App. 1924, *holding approved*). For this reason, a sheriff's deed may be regarded as reliable if regular on its face. But if the record discloses that the officer acted beyond his authority, the sale cannot be given effect. *Mills v. Pitts*, 48 S.W.2d 941 (Tex. 1932); *Howard v. North*, 5 Tex. 290 (1849).

Unlike some other varieties of judicial sales, foreclosure and execution sales do not require an order of confirmation after the sale. In the case of judicial foreclosures, the order of sale itself authorizes the executing officer to place the purchaser in possession. *See* Tex. R. Civ. P. 309 and 310. *Efficient Energy Systems, Inc. v. J. Hoyt Kniveton, Inc.*, 631 S.W.2d 538, 542 (Tex. App. - El Paso 1982, *no writ*); *Darlington v. Allison*, 12 S.W.2d 839 (Tex. Civ. App. - Amarillo 1928, *writ dism'd*). Following an execution sale the officer is required to file a return of the same with the clerk of the court, Tex. R. Civ. P. 654, but it is well established that irregularities in the return, or even the complete absence of a return, do not void the sale. *See Willis v. Smith*, 17 S.W. 247 (Tex. 1886); *Donald v. Davis*, 208 S.W.2d 571, 573 (Tex. Civ. App. - Ft. Worth 1948, *writ ref'd*). *Tiger v. Henderson*, 162 S.W.2d 170, 174-175 (Tex. Civ. App. - Ft Worth 1942, *writ ref'd wom*).

On collateral attack, the rule that recitals in judgments control the rest of the record does not apply to the judgments against non-residents of Texas. *Pellow v. Cade*, 990 S.W.2d 307 Tex. App. - Texarkana 1999, no pet.); *Hicks v. Sias*, 102 S.W.2d 460 (Tex. Civ. App. - Beaumont 1937, *writ ref'd*). Accordingly if the defendant sought to be bound by a proceeding was not a Texas resident, an examiner should review the entire record in the underlying proceeding.

After foreclosure of a real estate tax lien, the prior owner has the right to redeem the property within 180 days; however, if the land is the resident's homestead, is designated for agricultural use or is a mineral interest, the redemption period is two years. The redemption period runs from the date that the purchaser's deed is filed for record. Tex. Tax Code Ann. §34.21. The owner of property sold on foreclosure of a federal tax lien may redeem it within 180 days after the sale. 26 U.S.C. §6337 (b)(1). An action to set aside a tax sale is subject to the limitations periods in Tex. Tax Code Ann. §§33.54, 34.08. Taken from Texas Title Standard 16.20.

J. How to Use County Records

Records in the county

Texas has 254 counties, and there are only 35 counties without any oil and gas production last year. While the maintenance of certain types of records is mandated by law, most county clerks have exercised considerable discretion in how the records are organized and how they are maintained.

Prior to 1980, County Clerks were required to maintain separate volumes of books with corresponding indices for at least:

1. Deed Records (since 1836)
2. Oil and Gas Lease Records (since 1917)
3. Abstract of Judgment Records (since 1879)
4. Deed of Trust Records (since 1879)
5. Federal Tax Lien Records (since 1923)
6. Financing Statements (since 1966)
7. Lis Pendens Records (since 1905)
8. Mechanic's and Materialmen's Lien Records (since 1939)
9. Release Records (since 1836)
10. State Tax Lien Records (since 1961)
11. Utility Security Records (since 1966)
12. Vendor's Lien Records (since 1879)

13. Birth Records and Death Records (since 1903; since August 29, 1929, all county clerks forwarded a copy of Birth Certificates and Death Certificates to the Bureau of Vital Statistics in Austin) (phone)
14. Marriage Records (since 1837)
15. Probate Records (since 1836)

For a detailed discussion of the record keeping requirements for all of the above and the statutory authority therefor, see Volume 1 of the Texas County Records Manual prepared by the Local Records Division of the Texas State Library at Austin, Texas (1987) and maintained by most County Clerks. All of the above described records are accessed by separate (usually) direct/reverse grantor/grantee indices.

Since 1980, to assist in the computerized consolidation of records, most County Clerk's of the more populated counties elected to microfilm their records and to consolidate their books and indices into an "Official Public Records" of:

a. Real Property, etc.
   1. Real property
   2. Personal property and chattels
   3. Governmental, business and personal matters.
b. Courts
   1 Probate
   2. County/civil
   3. Criminal
   4. Commissioner's.

Clerks also have the option, if not microfilming records, to consolidate indices into the same seven categories and maintain hard copies of all records. Sec. 193.008, Texas Government Code.

County Clerks state-wide charge $9 for the first page and $2 for each subsequent page to record an instrument. Effective September 1, 1991, all clerks have the option to charge up to an additional $5, or less per instrument, to go into a fund designated for records management and preservation. Also, if grantees' addresses are not included on the instrument, the Clerk can, and often does, charge an additional $25 to record the instrument. In order to save a phone call, one should enclose $5 plus the state-wide recording fee, and the clerk will refund any amount due.

Since County Clerks in Texas have not been required by law to maintain a tract index, it would be unusual to locate a tract index in the County Clerk's office. (One should not rely on it if found). Most, but not all, abstract companies maintain a tract index.

The District Court has jurisdiction to litigate title to land. If one chooses to check further than the Lis Pendens Records recorded with the County Clerk, the examiner should review the District Clerk's index of litigation.

The Tax Assessor-Collector of each county maintains a current list of all surface owners and owners of producing oil and gas income. Texas does not tax non-producing minerals. The Tax Assessor-Collector's records usually provide a current address for all surface owners and owners of producing minerals and can identify the amount of taxes due, if any.

Records outside the county

Usually, if a state reserves a mineral interest at the time it issues a patent, the reservation is contained in the patent. Unfortunately, Texas is not so straightforward. If the land is patented prior to September 1, 1895, the state had no authority to reserve any mineral interest. For land patented after September 1, 1895, the examiner must determine whether or not the land was classified as mineral or classified in some other manner, such as dry grazing, agricultural, etc. For lands patented subsequent to September 1, 1895, and classified as mineral land, the state reserved the following:

1. For mineral classified land patented between September 1, 1895, and August 21, 1931, the state and the surface owner shares equally in all economic benefits.
2. For land patented with a mineral classification between August 21, 1931, and June 19, 1983, the state reserves a non-participating royalty of "one-eighth of all sulphur and other mineral substances from which sulphur may be derived or produced and one-sixteenth of all other minerals" including oil and gas; and
3. Effective June 19, 1931, the state may reserve "not less than" one-eighth of all sulphur and one-sixteenth of all minerals. The state usually reserves all minerals.

Not all counties contain separate classification records and the recording of a classification by reference to the land classified is infrequent. Therefore, an examiner must contact the General Land Office, (512) 463-5001, in Austin, Texas, and obtain a letter of classification and/or Certificate of Facts (all instruments preceding the issuance of the patent) to provide this information.

Also, in order to obtain the history or current status of land which the examiner believes may be held by production, the examiner must contact the Central Records Division of the Texas Railroad Commission:

Railroad Commission of Texas
ATTN: Central Records Division
PO Box 12967
1701 N Congress Ave
Austin, TX 78711-2967
(512) 463-6882

The examiner should provide the Commission with the Railroad Commission district number and/or the county, the field name, the name of the operator and the name of each well upon which he is requesting information. The following forms are the forms most often requested:

1. Form W-1 – Application for Permit to Drill, Deepen or Plugback
2. Form W-2 – Oil Well Potential Test, Completion of Recompletion Report and Log
3. Form W-9 – Net Gas-Oil Ratios Report
4. Form G-1 – Gas Well Back-Pressure Test, Completion or Recompletion Report and Log
5. Form P-12 – Certificate of Pooling Authority
6. Form P-15 – Statement of Productive Acreage.

Other records topics

An examiner would prepare a run sheet covering the land examined either from the tract index prepared by an abstract company in the county or by utilizing the direct/reverse grantor/grantee, etc., indices provided by the County Clerk. While a landman might be able to examine the tract indices of an abstracter at no charge, most abstracters will charge a title attorney from $50 per hour to $300 per hour if they permit the title attorney to examine the tract indices at all.

Abstract companies charge by the page at a range from $4 to $8 per page. Generally, the abstracter will not limit the instruments included in the abstract or agree not to copy every page of every instrument.

Landmen work with attorneys in two ways: **Standup examination.** The landman works with the attorney in the County Clerk's office with the landman preparing run sheets and delivering them to the attorney who examines the instruments indicated.

Abstract preparation. The landman "builds" an abstract himself from sovereignty to present by compiling a run sheet and copying the pertinent pages of all documents and delivering them to an attorney for examination, usually in the attorney's office. The landman would include all curative instruments that the landman believed would be necessary.

K. Example of Format for Title Opinion

I. Identify prior opinions and instruments examined

II. Fee Simple Title
1. Surface - Interest, acres
2. Minerals - MI, acres, lease number
3. Oil and Gas Leasehold - LI, acres, lease number

III. Liens and Encumbrances
1. Mortgages
   Date:
   Recorded:
   Mortgagor:
   Mortgagee:
   Legal Description:
   Amount Secured:
   Term or Due Date:
   Assn. of Production:
   Present Owner:
2. Oil and Gas Leases
   Date:
   Recorded:
   Lessor:
   Lessee:
   Description:
   Primary Term:
   Present Owner:
3. Rights of Way
   Date:
   Recorded:
   Grantor:
   Grantee:
   Covers:
   Type:
4. Taxes

IV. Patent Information
   Date:
   Recorded:
   Patentor:
   Patentee:
   Description:
   Reservation:

V. Tabulation of Leases and Assignments - See Exhibit A.

VI. Comments and Requirements

VII. Closing

VIII. Exhibit A - Tabulation of Leases and Assignments

Lease 1
   Form:
   Date:
   Recorded:
   Lessor:
   Lessee:
   Description:
   Min. Int. Covered:
   Primary Term:
   Royalty:
   Shut-In Gas Royalty:
   Delay Rental:
   Depository:
   Lesser Interest:
   Entirety:
   Savings Clause:
   Pooling:
   Special Provisions:

Assignment 1
   Date:
   Recorded:
   Assignor:
   Assignee:
   Description:
   Reservation:
   Prop. Reduced:
   Comment: