CHAPTER 9: Basic Overview of Texas Laws and Regulations Affecting Oil & Gas

By
Timothy P. Lester
Attorney-at-Law
Please send all questions to me via email or call me after the Webinar

For questions or any assistance please contact:
Timothy P. Lester, Attorney-at-Law
Telephone: (903) 935-2393
E-mail: tim@thelesterfirm.com
Texas has a long and rich history of oil & gas development, along with the case law to back it up. Often, many O&G producing states will cite Texas Case Law when making up their own. Even Texas’ Constitution is written to heavily favor economic development.
Types of Ownership

- The Rule of Capture
- Surface Estate vs. Mineral Estate (Dominant)
- “Bundle of Sticks”
  - Right of ingress and egress
  - Right to sign a lease (Executive right)
  - Right to receive bonus
  - Right to receive delay rentals
  - Right to produce minerals
  - Right to receive royalties

RULE OF CAPTURE
English hunting law
Oil & gas are migratory in nature, too.

SURFACE ESTATE vs. MINERAL ESTATE
In Texas, the surface estate can be severed from the mineral estate. Severance became common after finding oil & gas. Once severed, always severed unless merger of title.

Commonly clay, sand, gravel, caliche

Mineral estate is dominant; use as much of surface as reasonably necessary to produce O&G without compensation.
Discuss Surface Damages

BUNDLE OF STICKS
Discuss
Types of Ownership
(continued)

- Fee Simple
- Fee Simple Determinable
- Reversionary Interests
- Life Estates
  - Life estate holder and remainderman
  - Cannot create “waste”
  - Open Mine Doctrine

FEE SIMPLE
Outright ownership

FEE SIMPLE DETERMINABLE
Ownership until an event occurs. “To Sally Smith for ten years, then to Jeff Doe.”

REVERSIONARY INTERESTS
Similar to FSD. Reverts back to original grantor, or his or her heirs. “To Nesbitt Baptist Church for so long as it is used for church purposes.”

LIFE ESTATES
Pre-testamentary conveyance.
Creates a life estate holder (called the life tenant) and a remainderman.
Freely conveyable.
In oil & gas context, must get life tenant and remainderman to both sign lease. Remainderman usually by ratification. A lease without the other is VOID.
Life tenant gets the “use of the fruits.” Usufruct. Latin. Cannot use the corpus or body of the fruit.
Life tenant cannot commit waste. Usually when signing a lease, life tenant and remaindermen agree how to split proceeds; but without agreement, Delay rentals to life tenant; Bonus and royalty to remaindermen. However, these amounts payable to remainderman go into suspense and life tenant get interest.
Open Mine Doctrine
COTENANCY
Undivided Ownership of the whole by more than one person.
Usually occurs by effect of intestate inheritance.
I usually describe it to people as ...

Timber Deeds

HOWEVER, as to foreign pipelines or other easements, 100% of co-tenants necessary.
Trespasser as a matter of law. Different rules exist for eminent domain proceedings.
SEPARATE PROPERTY
Gift, inheritance, Makes one whole – personal injury lawsuit. Separate funds can be converted to community by agreement or commingling. Whole area of law dedicated to Characterization and Tracing—usually used in divorces.

COMMUNITY PROPERTY
Presumption is anything purchased while married, regardless of who’s signature. Separate funds can be used to by property which is separate.

Examples.

Trick: if property is purchased in one spouse’s name, that spouse is presumed to have control over it and may sell the whole. HOWEVER, if the property is homestead, any sale requires both spouses to sign.

Also, if a spouse conveys his or her community interest to his or her spouse, this creates separate property for the spouse.

HOMESTEAD
Marital residence. Entitled to one homestead in Texas.
Types of Ownership
(continued)

- Mineral Interests
  - Royalty
    - What the mineral owner gets
  - Net Revenue
    - What the Lessee gets after deducting all types of royalties
  - Overriding Royalty
    - A royalty provided by the Lessee to someone who provided value
  - Non-Participating Royalty
    - A royalty provided by mineral owner to someone
The Deed

- **Elements**
  - Competent parties
  - Consideration
  - Words of grant
  - Sufficient description
  - Proper execution
  - Delivery and acceptance

- **General Warranty**
- **Special Warranty**
- **No Warranty**
- **Quitclaim**
- **Gift**

**ELEMENTS**

**GENERAL WARRANTY DEED**
Includes a warranty that the title is good and there exists a right of subrogation of all the warranties in the chain of title.

**SPECIAL WARRANTY**
Warrants only that the seller has not encumbered the titled.

**NO WARRANTY**
Title is good, but no warranties given.

**QUITCLAIM**
Not really a deed at all. Simply an instrument that says grantor will not claim any interest and that if any interest is owned, it is sold to grantee. It releases interests and does not grant interests.

**GIFT**
Separate property. No consideration need be given. Usually love and affection. No warranties presumed.
The Legal Description

- Statute of Frauds
- Reasonable Certainty
  - Survey
    - Metes and Bounds vs. Township and Range
  - Referencing other courthouse instruments

STATUTE OF FRAUDS
All dealings in real property must be evidenced in writing signed by grantor.

LEGAL DESCRIPTION
What describes to land therein dealt with.
Survey
Texas uses metes and bounds, like the original colonies and Britain. The exception is West Texas.
The rest of the U.S. uses the Township and Range
Townships are made up of 32 one-acre square sections forming a 6 mile square Township.
The Legal Description

BEGINNING at a 1/2 inch iron pipe found at the SEC of said 42.99 acre tract from which a 10 inch sweet gum (found marked) bears N 86 deg. 28' E 15.26 feet;

THENCE N 89 deg. 05' 41" W along NBL of a called 75.80 acre tract described as "First Tract" in Partition Deed to Gilbert Gene Griffith and recorded in Volume 1264, Page 476 of said Deed Records, 849.89 feet to a steel spike set in County Road No. 368;

THENCE N 01 deg. 08' 41"E across said 42.99 acre tract at 17.86 feet a 1/2 inch iron rod set and continuing in all 1,316.90 feet to a 1/2 inch rod set on the NBL of said 42.99 acre tract from which a 28 inch Shumard Oak (marked by T. Truitt) bears S 55 deg. 47' E 26.32 feet and a 36 inch Shumard Oak (marked by T. Truitt) bears S 60 deg. 44' W 8.93 feet;

THENCE S 89 deg. 13' 54" E along SBL of a called 100 acre tract described in Deed to Faye Saxon Brady and recorded in Volume 733, Page 294, of said Deed Records, 850.03 feet to a inch iron pipe found at the NEC of said 42.99 acre tract from which a 3 inch dogwood tree (marked by T. Truitt) bears S 38 deg. E 11.90 feet and a 7 inch Post Oak (marked by T. Truitt) bears N 47 deg. W 19.25 feet;

THENCE S 01 deg. 09' 02" W along the EBL of said 42.99 acre tract, 1,318.93 feet to the beginning and CONTAINING 25.72 acres.
The Legal Description (continued)

Tract One: 339.24 acres of land, more or less, out of the A. Nunley Survey, A-176, in Madison County, Texas, and being more particularly described in that certain Warranty Deed from John M. Wallace and Ruby Nell Wallace to John Watson and Gladys Watson, dated August 2, 1990, and recorded at Volume 370, Page 169, of the Deed Records of Madison County, Texas.
The Legal Description (continued)

N/2 Section 6, T3N, R3N, Deaf Smith County, Texas, containing 318.57 acres, more or less.
The Legal Description (continued)

Township & Range vs. Metes & Bounds
Does not work with the language “all my right, title and interest...”
Courts effectively write in “... that I currently own...”
Discuss Getty

Where there is an existing use by the surface owner which would otherwise be precluded or impaired, and where under the established practices in the industry there are alternatives available to the lessee whereby the minerals can be recovered, the rules of reasonable usage of the surface may require the adoption of an alternative by the minerals owner. Nonetheless, where there is only one way the minerals can be produced from the surface, the mineral estate owner has the right to pursue that action regardless of surface damage.

Most things people complain about are found to be not reasonable to accommodate for.
Doctrines Affecting Oil & Gas
(continued)

- Fraction of a Fraction
  - Usually hinges on the word “of”
  - $\frac{1}{2}$ royalty vs. $\frac{1}{2}$ of royalty
  - You don’t see this distinction very often, usually in older leases
If the grantor overconveys by warranty deed, the overconveyance comes out of the grantor’s interest. So, in this example applying the Duhig Rule, the court would leave John with \( \frac{3}{4} \), Andrew with \( \frac{3}{4} \), and Brent with \( \frac{1}{2} \).
John conveys Blackacre to Andrew but reserves 1/4 of the minerals. Andrew later conveys Blackacre to Brent, but reserves ½ of the minerals without reciting anything about prior conveyances. What fraction of the minerals does each own? John gets ¼, Andrew gets ½ and Brent gets ½, totaling 1 ¼. Of course, this is impossible. So, the court has interpreted this style of conveyance to mean that where full effect cannot be given to both the interest granted and the interest reserved, priority will be given to the interest granted. If the grantor overconveys by warranty deed, the overconveyance comes out of the grantor's interest. So, in this example applying the Duhig Rule, the court would leave John with ¼, Andrew with ½, and Brent with ½.
Adverse Possession

- **Surface**
  - Four different time periods may apply
    - 3, 5, 10, 25 years
  - **Requirements**
    - Adverse
    - Hostile
    - Open
    - Peaceable
    - Continuous

Broken down into Surface and Minerals

3 year statute never used
Color of Title
5 appellate cases.

10 year most common. Can use a forged deed or quitclaim deed as basis for title.
Adverse Possession
(continued)

- Minerals
  - All of the above + actual production of minerals
  - A “holdover lessee” doesn’t gain adverse possession
    - Constructive Lease

- Cotenants
  - All of the above + actual or constructive notice
Conditions broken result in breach; covenants broken result in damages

Describe process for receiver’s lease
Landowner is unknown or cannot be found, have not paid taxes in the last 5 years. Plaintiff must execute affidavit regarding due diligence in finding landowner and state that there will be substantial damage if the receiver is not appointed. Plaintiff must serve notice to land owner, usually by publication in the local newspaper.
All proceeds are paid into the registry of the court, where eventually, they will escheat to the state
What is an implied covenant? Cannot be drafted around by stating “no implied covenants exist” because Texas courts have found this unconscionable.

REASONABLY PRUDENT OPERATOR: Most covenants hover around the idea of the reasonably prudent operator.

TO DRILL: There is no implied covenant to drill an initial or test well; however, once a well is drilled, the Lessee is obligated to continue to develop the leases once they enter the secondary term.

DRAINAGE: Lessee may be required to drill additional wells or re-work existing well to prevent drainage of Lessor’s land from surrounding wells. Lessor is entitled to recover damages from a Lessee for field-wide drainage upon proof of substantial drainage of the Lessor’s land with additional facts that support the reasoning that a reasonably prudent operator would have acted to prevent substantial drainage from the Lessor’s land.

MARKET: Requires Lessee to market the production obtained within a reasonable time and at a reasonable price.

OPERATE DILIGENTLY AND PROPERLY: Every operator is required to industriously explore for minerals and diligently operate any producing well. This notion includes performing such incidental or subsidiary acts as may be reasonably necessary to accomplish the major
purpose. Obtaining a drilling permit when an exception may be called for, or obtaining necessary environmental permits, or operating the well in a safe manner would fall under this covenant.
Texas is a notice state; that means the statute protects a subsequent purchaser who has paid value and has no notice of the prior grant—otherwise known as a bona fide purchaser (BFP). To gain the benefit of the recording statute in a notice jurisdiction, an earlier grantee must record before the completion of the conveyance to a subsequent BFP.

Not recorded is still good between grantor and grantee, but not third-parties without notice.
Death of A Mineral Owner
(with a will)

- Last Will and Testament
  - Testator must have capacity
  - Must have testamentary intent
  - Must be signed by testator and witnessed by two witnesses unless holographic
  - Should be self-proved to ease probate
  - Must be probated within 4 years of death
- Probate
- Muniment of Title
- Affidavit not to Probate Will

Also known as Succession.

Testator may dispose of his or her property any way he or she sees fit.
Before we talk about options for dying without a will, we need to talk about the Rules of Intestacy. AKA Descent and Distribution.

I'm going to cover what happens for Real Property. Separate Property descends using different rules.

- Per Stirpes = by branch
- Per Capita = by head
Rules of Intestacy
(Separate Property)

- Per Stirpes vs. Per Capita
- John dies leaving the following heirs:
  - Fred Barney Wilma
  - Jim Kim

- Under Per Stirpes, Fred and Wilma 1/3 each
  - Jim and Kim get ½ of 1/3 each
- Under Per Capita, each gets 1/5
Separate vs. Community are inherited differently.

We use what’s called characterization and tracing to determine if property is separate or community. Same used by family law for divorces. We spoke earlier about commingling. Here, it is usually easy to trace real property. But what happens if separate funds are used to purchase raw land? Then then that land is used as collateral to build a house with a mortgage and that mortgage is paid by both spouses? Has it converted to community property? It is very difficult to tell. Consult a divorce lawyer.
There are other distributions made for times when the decedent has no spouse or descendants, whereby property can devolve to surviving parents, siblings, nieces and nephews, etc. If there is no one to inherit the property, it will escheat to the state.
An administration is the same as procedure use for Probating a will in the courts, but for someone who dies intestate who’s estate is big enough to require some judicial oversight.

Final Notes:
Under intestacy, Adopted Children inherit the same a natural born children. Half-bloods (step-siblings) inherit half shares.
Pooling and Unitization

- One pools leases
- One unitizes land
  - Voluntarily Pooled Gas Units in Texas are limited to 640 acres +/- 10% tolerance = 704 acres
  - Unless special field rules apply
Commonly Referenced Drilling Regulations

- Rule 37
  - Minimum well spacing
    - 467’ from lease, property, or subdivision line
    - 1,200’ between wells
- Rule 38
  - Minimum spacing density
    - 40 acres
- Rule 11
  - Vertical Wells
- Exceptions may be granted after a hearing
Mineral Interest Pooling Act (MIPA)

- Used to force unleased tracts into a unit
- Rules
  - Field discovered after March 8, 1961
  - Not a wildcat well
  - Must be special field rules in place
  - Must be two or more separately owned tracts
  - Will must have been drilled or proposed
  - Units limited to 160 acres for oil; 640 for gas; +10% tolerance
  - State-owned lands excluded
  - Must result in avoidance of unnecessary well, protection of correlative rights, or prevention of wastes
  - Prior to applying, must be a fair and reasonable offer
Statutory Law Applicable to Division Orders

- Payment of Proceeds (Tex. Nat. Res. Code)
  - First Payment
    - For both Oil and Gas; 120 days after the end of the month of first sale
  - Remaining Payments
    - Oil – 60 days after the end of the calendar month in which produced
    - Gas – 90 days after the end of the calendar month in which produced

- How can monies get into “Suspense”?
- Division order may not change terms of the lease
- Statutory Form for D.O.s shown in the Texas Natural Resources Code, Subchapter J.
Statutory Law Applicable to Division Orders
(continued)

- Cannot withhold payment if payee refuses to sign because objection to additional provisions
- Payment may be remitted annually if owed less than $100 from all wells
- D.O. may be terminated by either party with 30 days notice
- Penalties for failure to make timely payments
Statutory Law Applicable to Division Orders
(continued)

- Required reporting with each payment
- Payment of Interest on late payments
- Nonpayment of proceeds or interest
- Notice of change of payor
That concludes this webinar.

I appreciate you giving up your lunchtime to participate. If you have any questions, be sure to contact me. My contact information is listed above.

Also, I’d like to thank the National Association of Division Order Analysts for inviting me to present this webinar. Specifically, I’d like to thank Linda Barry, Luann Johnson, and Brenda Pirrozolo.