

2008 Barnett Shale Royalty & Landowner Symposium

Presented by

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Parties to a Lease



Mineral Owner/Lessor



Lessee

What happens when an oil and gas lease is made?



Mineral Owner

Fee Simple

(w/right of possession)

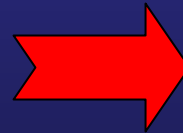
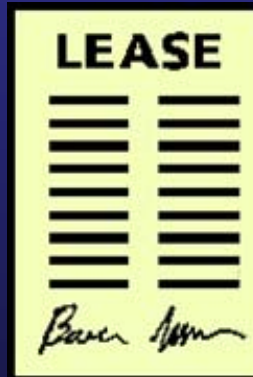
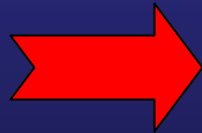
**Full Ownership of Entire
Mineral Estate**

(8/8^{ths})



Mineral Owner

Fee Simple
(w/right of
possession)



Lessee



Title to ALL
Oil & Gas in Place
Determinable Fee
in full mineral
estate (w/right of
possession).

Determinable Fee

Determinable Fee

An estate with a special limitation which “contains within itself the seeds of its own termination.”

B. Kramer, *The Temporary Cessation Doctrine: A Practical Response to an Ideological Dilemma*, 43 *Baylor L. Rev.* 519, 521 (1991).

Lease Habendum Clause

¶ 2. Subject to the other provisions herein contained, this lease shall remain in force for a term of 5 years from this date (hereinafter called “primary term”), *and as long thereafter* as oil, gas, condensate, sulphur or any other mineral *is produced* hereunder or from the land above described, or any operations (as hereinafter defined) are conducted, any payment is made, or any condition exists, which as hereinafter provided continues this lease in force.



Mineral
Owner/Lessor

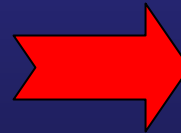
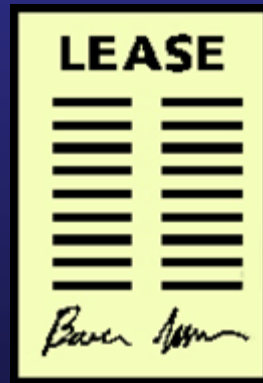
Right of Reverter

+

Contractual
Royalties

(non-possessory)

(1/8^{ths})



Lessee

Determinable Fee
(w/right of possession)
In full mineral estate.

(7/8^{ths})

Right of Reverter

Right of Reverter

“The owner of the possibility of reverter may not waive his right to reclaim the possessory interest. It occurs instantaneously upon the happening of the limitation by operation of law.”

B. Kramer, 43 Baylor L. Rev. at 522.

**What happens in the event of
unexcused lack or cessation of
production?**

“The operative effect of the occurrence of the event named in the clause of . . . special limitation is . . . : the estate granted automatically terminates without the necessity of any affirmative action on the part of the grantor, or lessor, and, in fact, even without his knowledge or against his express wishes.”

Walker, *The Nature of the Property Interests Created by an Oil and Gas Lease in Texas*,
8 Texas L. Rev. 483, 484-85 (1930).



Mineral
Owner/Lessor

Right of Reverter

+

Contractual Royalties

(non-possessory)

(1/8th)



Lessee

Determinable Fee

(w/right of possession)

(7/8^{ths})



Mineral Owner/Lessor

Right of Reverter
+
Contractual Royalties
(non-possessory)



“The owner of the of the possibility of reverter may not waive his right to reclaim the possessory interest. It occurs instantaneously upon the happening of the limitation by operation of law.”

Kramer, 43 Baylor L. Rev. at 522



**Entire Leasehold Estate
Reverts**
(all ownership and rights)



Mineral Owner

Fee Simple
(w/right of possession)

(8/8^{ths})

**What if exploration and production
continue thereafter?**

- Adverse Possession -

Natural Gas Pipeline Co. of America v. Pool, 124
S.W.3d 188 (Tex. 2003).



Mineral Owner

Fee Simple

(w/right of possession)

Exercises Possession

- Drilling, production, etc.
- Thinks it is pursuant to lease



Possessor

. . . years later . . .



Mineral Owner

Right of Reverter

+

Royalties

All pursuant to lease terms

(1/8th)



Possessor/Lessee

Determinable Fee in full mineral estate
(w/possession)

All pursuant to lease

(7/8^{ths})

Overriding Royalty Interest

Overriding Royalty Interest

“It is an interest which is carved out of, and constitutes a part of, the working interest created by an oil and gas lease.”

Gruss v. Cummins, 329 S.W.2d 496, 501
(Tex. Civ. App. – El Paso 1959, rnre)



Mineral
Owner/Lessor

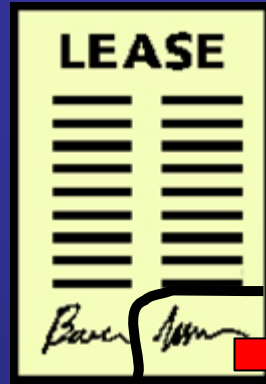
Right of Reverter

+

Contractual Royalties

(non-possessory)

(1/8th)



Assignor/Lessee

Overriding Royalty
Interest

(non-possessory)

(1/8th)



Assignee/Lessee

Determinable Fee

(w/right of possession)

full ownership of oil & gas in place

(6/8ths)

Overriding Royalty Interest

“An overriding royalty interest, because it is carved out of a leasehold interest, is limited in duration to the leasehold interest’s life, and the termination of that leasehold estate extinguishes the overriding royalty.”

In re GHR Energy Corp., 972 F.2d 96, 99 (5th Cir. 1992) citing *Sunac Petroleum Corp. v. Parkes*, 416 S.W.2d 798, 804 (Tex. 1967).

**What happens to an overriding
royalty interest in the event of
unexcused lack or
cessation of production?**

“The operative effect of the occurrence of the event named in the clause of . . . special limitation is . . . : the estate granted automatically terminates without the necessity of any affirmative action on the part of the grantor, or lessor, and, in fact, even without his knowledge or against his express wishes.”

Walker, *The Nature of the Property Interests Created by an Oil and Gas Lease in Texas*,
8 Texas L. Rev. 483, 484-85 (1930).



Mineral Owner/Lessor

Right of Reverter
+
Contractual Royalties
(non-possessory)

(1/8th)



Assignor/Lessee

Overriding Royalty Interest
(non-possessory)

(1/8th)



Assignee/Lessee

Determinable Fee
(w/right of possession)

(6/8ths)



Mineral Owner/Lessor

Right of Reverter
+
Contractual Royalties
(non-possessory)

(1/8th)



Assignor/Lessee

Overriding Royalty Interest
(non-possessory)

(1/8th)





Mineral Owner/Lessor

Right of Reverter

+

Contractual Royalties
(non-possessory)

(1/8th)



Right of Reverter

“The owner of the possibility of reverter may not waive his right to reclaim the possessory interest. It occurs instantaneously upon the happening of the limitation by operation of law.”

B. Kramer, 43 Baylor L. Rev. at 522.



BIG OIL

**Entire
Leasehold
Estate Reverts**



**Little
OIL**



Mineral Owner

**Fee Simple
(w/right of possession)**

(8/8^{ths})

**What if exploration and production
continue thereafter?**

-Adverse Possession –

Of What?

Natural Gas Pipeline Co. of America v. Pool, 124
S.W.3d 188 (Tex. 2003).



Mineral Owner

Fee Simple

(w/right of possession)

Exercises Possession

- Drilling, production, etc.
- Thinks it is pursuant to lease



Possessor

- **The override was non-possessory.**
- **The override vanished with the lease.**
- **The overriding royalty owner owned nothing to be possessed.**
- **The overriding royalty owner did not exercise possession.**

Scenario One

.. . years later .. .



Mineral Owner

Right of Reverter

+

Royalties

All pursuant to lease terms

(1/8th)



Possessor/Lessee

Determinable Fee in full mineral estate
(w/possession)

All pursuant to lease

(7/8^{ths})



Scenario Two

... years later ...

Mineral Owner

Right of Reverter

+

Royalties

All pursuant to lease terms

(1/8th)

+

Previous Override

(1/8th)



Possessor/Lessee

Determinable Fee in full mineral estate
(w/possession)

All pursuant to lease - only

(6/8^{ths})

“Temporary Cessation”

The temporary cessation of production doctrine prevents termination by excusing non-production when the cessation was involuntary, was necessarily unforeseeable and unavoidable, and where the lessee, during the period of cessation, used diligence to successfully resume production within a reasonable time.

“Temporary Cessation”

“The strictness of the above rule [automatic termination of the determinable fee upon cessation of production] has been modified where there is only a temporary cessation of production due to sudden stoppage of the well or some mechanical breakdown of the equipment used in connection therewith, or the like.”

“Temporary Cessation”

The lessee has the burden to prove that it exercised diligence to regain production.

“Temporary Cessation”

Does not apply if there is a cessation of production clause.

Savings Provisions

Lease Habendum Clause

¶ 2. Subject to the other provisions herein contained, this lease shall remain in force for a term of 5 years from this date (hereinafter called “primary term”), and as long thereafter as oil, gas, condensate, sulphur or any other mineral is produced hereunder or from the land above described, *or any operations (as hereinafter defined) are conducted, any payment is made, or any condition exists, which as hereinafter provided continues this lease in force.*

Cessation of Production Clause

¶ 5. . . . If after the discovery of any mineral or any two or more of them the production thereof should cease from any cause, this lease shall not be terminated thereby if within sixty (60) days thereafter production of any mineral or minerals is restored or Lessee commences additional operations

Where there is a cessation of production clause, the time period specified to restore production or commence operations strictly applies, and the lease will terminate after that period has run.

Samano v. Sun Oil Co., 621 S.W.2d 580, 584
(Tex. 1981)

Sun Operating Ltd. Ptnshp. v. Holt, 984 S.W.2d 277,
282 (Tex. App. – Amarillo 1998, pet. denied)

Shut-In

**For a shut-in royalty to preserve
a lease, there must be a well
that is “capable of production.”**

Unless the well will produce in paying quantities if it is turned “on,” and it begins flowing without additional equipment or repair, it is not “capable of production.”

Anadarko Petroleum, Inc. v. Thompson, 94 S.W.3d 550, 558-59 (Tex. 2002)

Hydrocarbon Mgmt., Inc. v. Tracker, 861 S.W.2d 427 (Tex. App. – Amarillo 1993, writ denied)

Operations

¶ 5. . . . If at the expiration of the primary term no mineral is being produced on the leased premises but Lessee is engaged in operations thereon, or shall have completed a dry hole (or other operations) thereon within sixty (60) days prior to the end of the primary term, this lease shall remain in force *so long as operations* (whether on the same well or mine or on different wells or mines successively) are continuously prosecuted and, if they result in the production of a mineral, so long thereafter as any mineral is produced hereunder from the leased premises. All operations hereunder shall be deemed to be continuously prosecuted if not more than sixty (60) days shall elapse between the completion of operations on any well or mine and the commencement or resumption of operations on the same or another well or mine.

Force Majeure

A force majeure clause will excuse the lessee from non-performance when the non-performance is caused by circumstances beyond the reasonable control of the lessee.

Ratification & Revivor

BEWARE

of what you sign!

Production in Paying Quantities

- Does the production yield a profit over operating and marketing costs?
- If so, would a reasonably prudent operator continue, for profit and not for speculation, to operate the well as it has been operated?

Breach of Implied Covenants

- Reasonable Development
- Maximize Production
- Protect Against Drainage
- Administrative Action

Breach of Implied Covenants

- Remedy is damages, not termination

Improper Deductions

- “Lifting”
- Compression
- Treating
- Gathering
- Processing
- Marketing

Improper Deductions

- Depends on terms of lease
- “Market Value” at the well
- Proceeds

Improper Deductions

NationsBank v. Heritage Resources

- Lease may not mean what it says.

Pricing

- “Market Value” or “Proceeds”
- Insider or “Sweetheart” Pricing

Statute of Limitations

- 2 years
- 4 years
- *HECI v. Neel* – No Discovery Rule
- Lessor has obligation to keep up with what the lessee is doing.

**You must investigate and
monitor the lessee's
activities.**

You must act diligently.

Questions

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