AVOIDING THE UNINTENDED CONSEQUENCE WHEN DRAFTING MINERAL RESERVATIONS

CELIA C. FLOWERS AND MELANIE S. REYES
FLOWERS DAVIS, P.L.L.C
TYLER, TEXAS

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TYPICAL SCENARIO
YIKES!!!!!!!!!!!!!!!!!!!!

Who are they going to call?
“We got a great deal on the house, but unfortunately, it didn’t include the mineral rights.”
MOTIVATIONS OF THE SELLERS AND BUYERS

SELLERS WANT ...

BUYERS WANT ...

To protect the surface of the property just purchased.....

And...
WHAT IS THE MINERAL ESTATE?

- **Minerals include:**
  - Oil, gas, uranium, coal, lignite,
  - Sand, water, and gravel

- The minerals and surface: one estate in fee simple

- Upon Severance, minerals divided as follows:
  - **Mineral estate:** oil, gas, uranium, coal, and lignite
  - **Surface estate:** water, sand, gravel, and “shallow” coal or lignite
MINERALS VS. ROYALTY

- **FEE SIMPLE**
  - **SURFACE ESTATE**
    - Trees, grass
    - Improvements
    - Minerals that belong to the surface estate according to case law
  - **MINERAL ESTATE**
    - Right to execute the lease
    - Right of ingress and egress to explore and produce
    - Right to receive lease bonus
    - Right to receive delay rentals
    - **ROYALTY** - right to receive the income from a producing well
      - no right of ingress and egress
THE MINERAL ESTATE IS THE DOMINANT ESTATE

Rights of Mineral owner:

- Right to develop & produce
- Rights to use surface/ingress and egress
- Use as much of surface as reasonably necessary

Limitations:

- Not use more land than is reasonably necessary
- Non-negligent use
- Due regard/accommodation
- Waivers
- Express lease language
- City ordinances
CONVEYANCE

- If seller fails to reserve minerals when selling the property, seller’s mineral estate passes to buyer.
- If seller does not own minerals, buyer receives no mineral interests, even if seller purports to convey minerals, because seller had no interest to convey.
Rights under the lease and case law

Can a lessee/mineral owner build a road? Does Lessee pay damages?

Can lessee use gravel/caliche from the land?

Can lessee locate the well anywhere they want to?

Can lessee drill the opening weekend of deer season?
Rights of the Typical Lessee
(The Myths)

- Can lessee conduct seismic operations on the land without further permission?
- Does Lessee have to pay damages? Even to crops? Improvements?
- Any duty to fence? Any duty to restore?
- Can Lessee use the water from a lake, drill a well?
Drafting attorney presented with executed real estate contract

Contract sets out parties’ proposed reservations and exceptions.
Mineral Conveyances, Reservations, and Exceptions in Conjunction with Modern “Forms”

- Attorney’s drafting challenge:
  - Reservation/exception that comports with the sales contract;
  - Reservation/exception that comports with Oil and Gas case law; and
  - Incorporating the reservation/exception into today’s short form warranty deed.

- Considerations:
  - “subject to” clause to protect a reservation itself;
  - the warranty created in the conveyance;
  - and properly drafting necessary exceptions to the warranty.
EXCEPTIONS vs. RESERVATIONS

- **EXCEPTIONS:**
  - excludes an interest from the grant;
  - excluded interest does not pass to the grantee;
  - operates to grantor’s benefit only to the extent that ownership in the excepted interest is vested in the grantor and is not outstanding in another person.

- **RESERVATIONS:**
  - the grantor retains an interest in the property;
  - operates for the benefit of the grantor;
  - retains in ownership of a carved out interest to the extent stated;
  - creates a new right in the thing granted that did not exist as an independent right prior to the grant.
OVER-CONVEYANCE AND DUHIG

- **Over-conveyance**
  - grantor reserves only what is already reserved by prior chain of title reservations, and the law the presume that the reservation is included solely to protect warranty.
  - **Effect:** grantee acquires balance and grantor retains nothing.
  - **Referred to as the “Duhig” rule** -- originates from a Texas Supreme Court case: *Duhig v. Peavy-Moore Lumber Co.*, 144 S.W.2d 878 (Tex. 1940).
  - Based on *Estoppel by Deed*, which arises due to warranty clause;
  - Doesn’t apply to quitclaim deeds.
DUHIG EXAMPLE

- Joe owns 100% (surface and minerals) of Whiteacre.
- Joe conveys Whiteacre to Mary; reserves ½ of the minerals.
- Mary conveys Whiteacre to Sally; reserves ½ of the minerals.
- Mary fails to mention Joe’s outstanding ½ mineral interest.
- Mary intended to convey the surface to Sally and retain her ½ mineral interest.
- Under Duhig, however, priority is given to the granted interest.
  - Joe owns an undivided ½ interest in Whiteacre’s mineral estate’
  - Sally owns an undivided ½ interest in Whiteacre’s mineral estate and all of Whiteacre’s surface estate;
  - Mary owns nothing.
Prior version of form grouped Reservations and Exceptions together:

“RESERVATIONS FROM AND EXCEPTIONS TO CONVEYANCE AND WARRANTY”

- Grouped heading used
- Any and all easements, rights of way, and prescriptive rights, whether of record or not; all presently recorded restrictions, reservations, covenants, conditions, oil and gas leases, mineral severances, and other instruments, other than liens and conveyances, that affect the property, rights of adjoining owners in any walls and fences situated on a common boundary; any discrepancies, conflicts or shortages in area or boundary line; any encroachments or overlapping of improvements; taxes for 2004 . . .
- Court held list of items under grouped headed constituted only exceptions to the grant and not reservations therefrom
Johnson case raises bigger question:

Whether a more specific listing of items intended to be reserved under a group heading would effectuate a reservation despite the grouped “exceptions/reservations” form heading?
EXAMPLE: “RESERVATIONS FROM AND EXCEPTIONS TO CONVEYANCE AND WARRANTY”

1. Estate created in Lease to Joe Dirt, dated __, recorded in Volume __ Page 3__, of the Oil & Gas Records of Burleson County, Texas.

2. Right of Way Easement dated ___ from Joe Dirt to Pipeline X. recorded in Volume __, Page __, Deed Records of Burleson County, Texas.

3. Mineral Reservation as set out in Deed from Daisy Dirt to Jack Dirt dated __ recorded in Volume __, Page __, of the Deed Records of Burleson County, Texas.

4. Mineral Reservation as set out in Deed from Daisy Dirt, dated __, recorded in Volume __, Page __ of the Deed Records of Burleson County, Texas.

5. Lease Agreement from Daisy Dirt to Pipeline X, dated __, recorded in Volume __, Page 1__, Deed Records of Burleson County, Texas.

5. All valid and subsisting easements, restrictions, right-of-way conditions, exception, reservations, and covenants of whatsoever nature of record, if any, and also to the zoning laws and other restrictions, regulations, ordinances and statutes of municipal or other governmental authorities applicable to and enforceable against the described premises.

WHICH OF THESE ARE EXCEPTIONS AND WHICH ARE RESERVATIONS?
General Warranty Deed Form

General Warranty Deed

Notice of confidentiality rights: If you are a natural person, you may remove or strike any or all of the following information from any instrument that transfers an interest in real property before it is filed for record in the public records: your Social Security number or your driver’s license number.

Date:

Grantor:

Grantee’s Mailing Address: [include county]

Grantee:

Grantee’s Mailing Address: [include county]

Consideration:

See form 8-6 for consideration clauses.

Property (including any improvements):

If the conveyance includes personal property, include the description from clause 9-6-13.

Reservations from Conveyance:

State “None” or to create reservations of title, include the appropriate clauses from form 9-7.

Exceptions to Conveyance and Warranty:

State “None” or to create exceptions to conveyance and warranty, include the appropriate clauses from form 9-8.
• Reservation should be clearly set out under Reservation heading.

• State that the grantor is reserving a mineral interest for himself, his heirs and assigns.

• As noted recently by the Eastland court of appeals: “a deed should have a reservation by the grantor and a “subject to” clause to protect the reservation.”

• The drafter of a mineral reservation should consider putting both of these elements of the reservation under the heading “Reservation” in the short form warranty deed.
• Simply reserve “oil, gas and other minerals”.

• “minerals” in that phrase means any minerals that are produced in association with the oil and gas.

• “Minerals” in that phrase does not include surface estate minerals.

• Unless expressly stripped from the reservation, “minerals” include all rights appurtenant thereto.

• It is not necessary for the reservation of all (or a part of) the oil, gas, and other minerals to contain further definition.

• If the practitioner drafts a clear reservation and then lists of items that are to be conveyed (or reserved) the court may determine the parties mean to convey or reserve something different than case law defines.
PROMULGATED BY THE TEXAS REAL ESTATE COMMISSION (TREC) 12-05-2011

ADDITION FOR RESERVATION OF OIL, GAS, AND OTHER MINERALS

ADDITION TO CONTRACT CONCERNING THE PROPERTY AT

(Street Address and City)

NOTICE: For use only if Seller reserves all or a portion of the Mineral Estate.

A. "Mineral Estate" means all oil, gas, and other minerals in or under the Property, any royalty under any existing or future lease covering any part of the Property, surface rights (including rights of ingress and egress), production and drilling rights, lease payments, and all related benefits.

B. The Mineral Estate owned by Seller, if any, will be conveyed unless reserved as follows (check one box only):
   □ (1) Seller reserves all of the Mineral Estate owned by Seller.
   □ (2) Seller reserves an undivided % interest in the Mineral Estate owned by Seller. NOTE: If Seller does not own all of the Mineral Estate, Seller reserves only this percentage of Seller's interest.

C. Seller □ waives □ does not waive Seller's surface rights (including rights of ingress and egress). NOTE: Any waiver of surface rights by Seller does not affect any surface rights that may be held by others.

D. If B(2) applies, Seller shall, on or before the Closing Date, provide Buyer contact information known to Seller for any existing lessee.

If either party is concerned about the legal rights or impact of the above provisions, that party is advised to consult an attorney BEFORE signing.

TREC rules prohibit real estate licensees from giving legal advice.
ISSUES REGARDING ADDENDUM

- “Mineral Estate” definition
- Use of phrase “surface rights”
- Fraction of the whole vs. percentages
Title: “Addendum for the Reservation of Oil, Gas and Other Minerals”

Definition: “’Mineral Estate’ means all oil, gas and other minerals in or under the Property, any royalty under existing or future lease covering any part of the Property, surface rights (including rights of ingress and egress), production and drilling rights, lease payments, and all related benefits.”

“Minerals has broader meaning than just “oil, gas, and other minerals” but when used in that phrase, courts have limited “minerals” to those not belonging to the surface.

Had the Addendum stuck with the title, “oil, gas, and other minerals”, as a definition, it would have comported with oil and gas law.

The most problematic part of the definition is the use of the phrase “surface rights.”
The reservation

Historically, oil and gas interests are set out as fractions of the whole mineral estate or fractions of royalty.

Addendum B uses percentages, but many parties inadvertently place a fraction in the blank on the form.

This creates a fraction of a percentage, which is generally not what the parties intend to reserve.

Because language used is “interest owned by Seller,” if the seller does not own the entire mineral estate, this form can only be used to reserve a fraction of what seller owns and not a fractional interest of the whole because a fractional interest is part of the whole mineral estate as owned by seller and other parts outstanding in third persons.
“Surface Rights”

“in an instrument conveying ‘surface rights' the term means the entire surface of the land, reserving the minerals to the grantor.” -- *Fleming Foundation v. Texaco, Inc.*, 337 S.W.2d 846, 850 (Tex. App.---Amarillo 1960, writ ref’d n.r.e.).

If the Grantor reserves the mineral estate, and does not waive his surface rights, then what is he selling?

If he waives his surface rights, then how can he develop his mineral estate if “surface rights” includes ingress and egress?
CONCLUSION

- Texas oil and gas law is complex and highly nuanced.

- Understanding these complexities is crucial when working with TREC and the State Bar of promulgating forms upon which real estate practitioners are expected to rely.

- Drafting the proper mineral reservation requires the drafting attorney to be sure his clients understand the reservation they want to make.

- The TREC mineral addendum makes the expression of the client’s intent in their contract difficult.

- Use of “Exceptions” and “Reservations” headings in the short form Warranty Deed further complicates the problem.

- Once the drafting attorney understands the reservation agreed to in the contract as intended by the parties, the attorney faces expressing that reservation in the deed in such a way to protect the reservation from being diluted by prior reservations.

- A basic understanding of the issues presented by Texas oil and gas case law will hopefully help guide the drafting attorney and enable him to utilize the streamlined forms, while at the same time ensuring that correct legalese, capturing the clients’ needs, is incorporated into the final documents.