

Oil & Gas Law

Class 16:

Lessor Title Issues (1 of 6) – Mineral Interests & Royalty Interests

Changing Focus ...

■ 1 Lessor → → Many Lessors



■ 1 Lessee → → Many Lessees

Mineral Estate ...

- *What is it / What rights and obligations does it include?*
- *Where does it come from?*

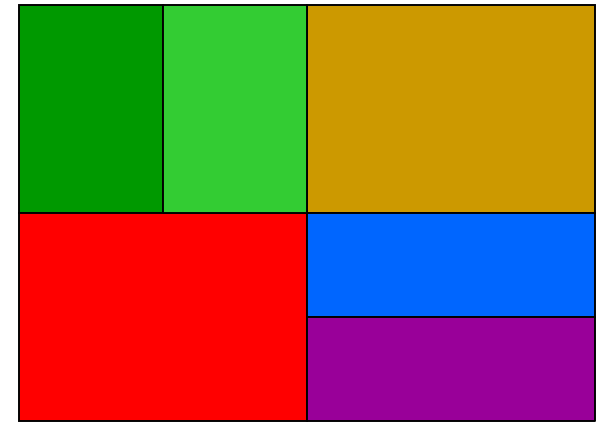
Conveying Mineral Title: Principle #1

- “Slicing and Dicing the Mineral Estate”
- Mineral rights in many different things can be conveyed
 - ... percentage / fraction of the entire tract
 - ... horizontally
 - ... vertically / depth
 - ... limited subsets:
 - -- specified rights
 - -- specified duration
 - -- specified minerals
- These are **NOT mutually exclusive !!!**

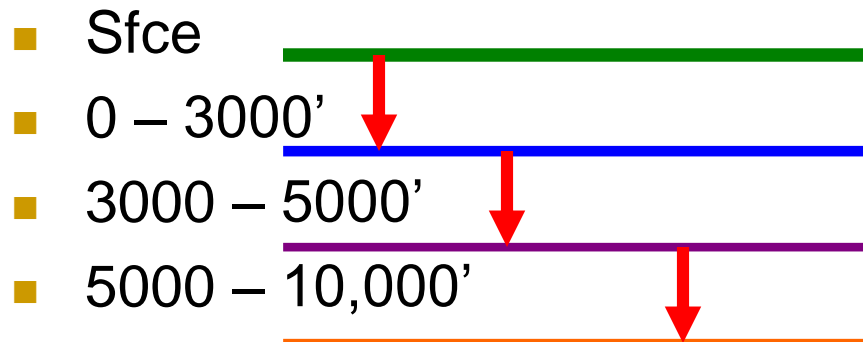
Mineral and Surface Estates:

“Slicing and Dicing the Min. Estate” (from CL 9)

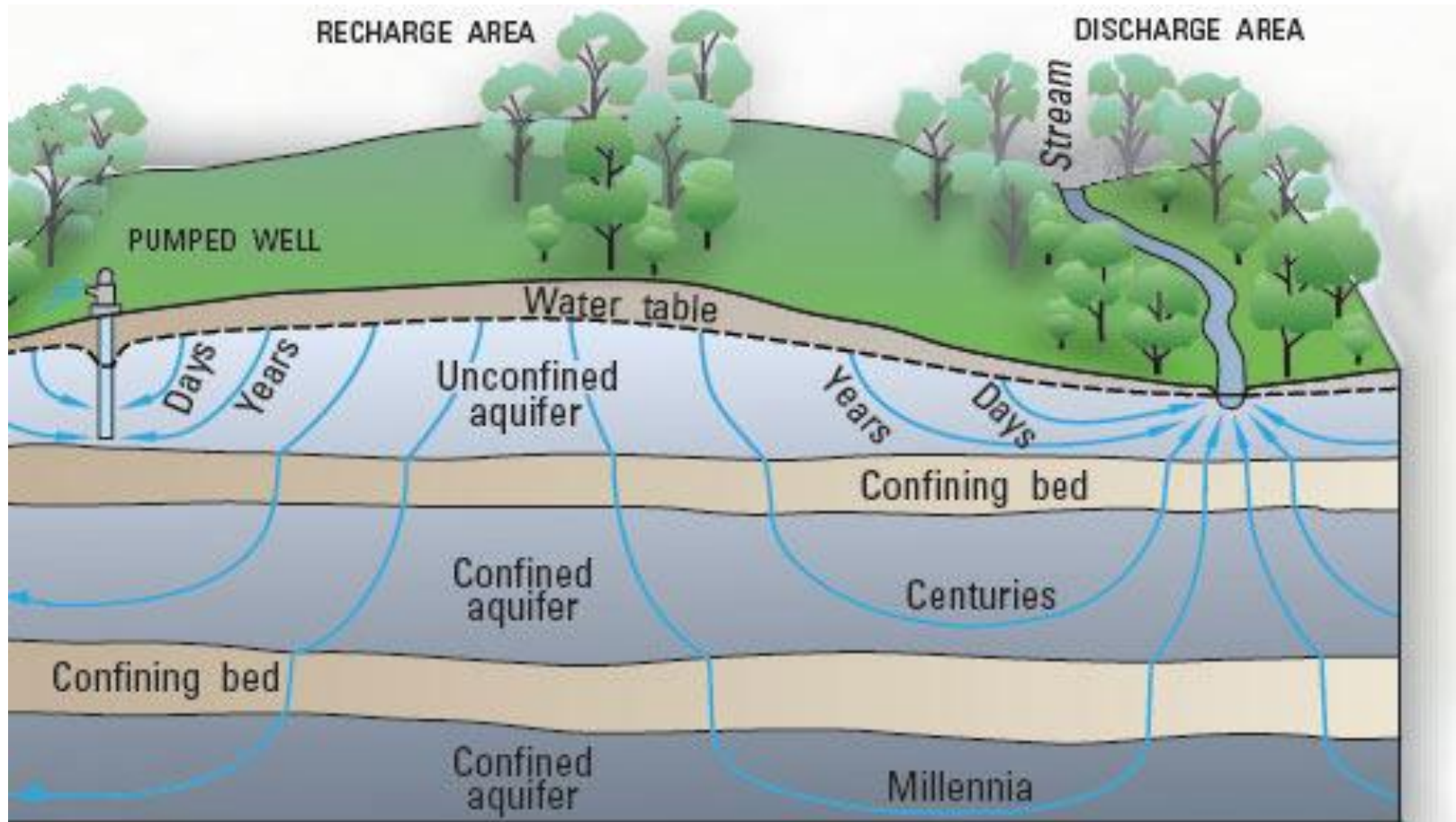
- The surface



- The mineral depths



Mineral and Surface Estates: “Slicing and Dicing the Min. Estate”



Mineral and Surface Estates:

“Slicing and Dicing the Min. Estate – Example”

<u>100% WI</u>	<u>6.7% ORR</u>
<u>9.5% ORR</u>	<u>85.5% WI</u>

Conveying Mineral Title: Principle #2

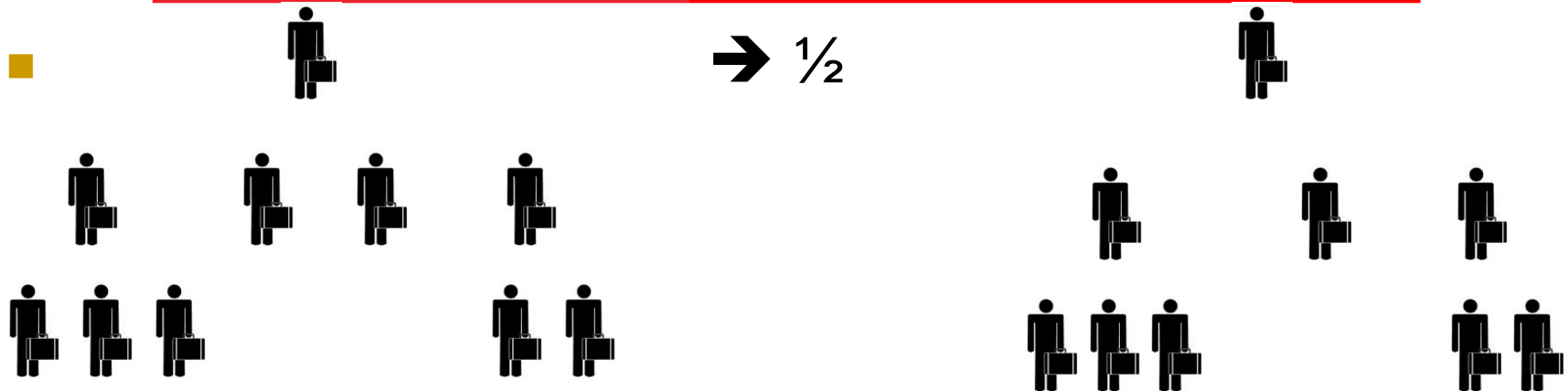
- (a/k/a the “Pie Principle”)
- No matter how many times or how many different ways ...
- ... you slice / dice the “mineral estate” pie ...



Conveying Mineral Title: Principle #2

(a/k/a the “Pie Principle”)

- ... **ALL THE PIECES MUST ADD UP TO 1 !!!**



- $\frac{3}{24} + \frac{1}{8} + \frac{1}{8} + \frac{2}{16} \dots + \frac{3}{18} + \frac{1}{6} + \frac{2}{12}$
- All minerals in $E/2 + SW/4 + N/2NW/4 + S/2NW/4$
- But **NOT** John owns $\frac{3}{8}$ and Sarah owns $\frac{13}{16}$

General Parameters

- P. 398 (top) – interesting questions
 - Grantor → Grantee fee simple interest in O&G
 - *Q: what did Grantee really get?*
 - *Q: does Grantee have a cause of action vs. RoC Capturer? vs. the Grantor?*
- O&G interests are types of real property
 - t/f, O&G conveyances must comply w/ legal requirements/formalities applying to real property
- Instead ... “legal and practical uncertainties that result when a mineral interest is divided” (p. 398, 1st ¶)

Background

- 4 ways to create and transfer some lesser rights in oil and gas
 - ❑ conveyance (a transaction = sale; assignment; deed)
 - ❑ inheritance
 - ❑ “legal transfer” (e.g., [bankruptcy](#); [foreclosure](#); [tax sale](#); [forced pooling](#))
 - ❑ adverse possession
 - 3-step process of K analysis → really 4 steps
 - ❑ Language of the exact clause
 - ❑ 4 corners of the document
 - ❑ “Rules” of construction
 - ❑ -----
 - ❑ Extrinsic / parol evidence
- Diagram illustrating the scope of the 3-step process of K analysis:
- Language of the exact clause → “inside the doc.”
 - 4 corners of the document → “inside the doc.”
 - “Rules” of construction → “inside the doc.”
 - Extrinsic / parol evidence → “outside the doc.”

1. Diff. Btwn. Min. Int. & Roy. Int.

Bodcaw Lumber

- “Quiet Title” Action
- Re-introduces “severance” → creates 2+ separate vertical estates
- *Can sfce. owner obtain title to minerals by adv. possession?*
- *Does conclusion change depending on ownership theory adopted in the applicable jurisdiction?*
- “Ownership in place” vs. “Non-ownership” theories
 - OiP: can have a property int./ownership of minerals (“corporeal” interest) – CANNOT be abandoned
 - Non-O: right to develop / non-possessory interest (“incorporeal” interest) – CAN be abandoned
 - But even Cts. in Non-O States rarely find abandonment
 - Need to show non-use for long time + intent to abandon
 - O&G rights a type of prop. interest that an owner might hold w/o developing them and development is the only way to use them
- Methods of Conveyance
 - Express grant
 - Reservation / retention

McSweyn

- 1933 contract: reserves 2½ % mineral int.
1944 deed: reserves 2½ % royalty int.
- *What's the difference?*
- *What are the differences between a mineral interest and a royalty interest?*
- ... see p. 406, middle ¶

Mineral Int. vs. Royalty Int.

■ Mineral Int. – Right to ...

- ❑ enter property
- ❑ explore / drill / produce
- ❑ participate in dev. / leasing decisions
- ❑ use “reasonable amount” of surface
- ❑ convey all of part of the mineral interest
- ❑ enter into OGL as Lessor / receive benefits
- ❑ =====
- ❑ Obligation to pay share of costs AND liabilities

■ Royalty

- ❑ No right ...
- ❑ No right ...
- ❑ No right ...
- ❑ No right ...
- ❑ No right ...
- ❑ No right ...
- ❑ =====
- ❑ No obligation to pay costs or liabilities
- ❑ =====
- ❑ **RIGHT** to receive share of the value / proceeds of production, **“free” of costs (except post-prod. costs)**

Mineral Int. vs. Royalty Int.

- Between the mineral interest and the royalty interest ...
- **WHICH IS MORE VALUABLE ???**
- McSweyn Court:
 - “... all things being equal, a mineral interest is more valuable than a royalty interest.”
- ***DO YOU THINK THIS IS TRUE? WHY / WHY NOT?***

Mineral vs. Royalty Int. – Value

■ Before production:

- ... royalty interest has no value ...
- ... whereas mineral interest has the right to lease and to collect rentals / bonuses / delay rentals

■ When there's production:

- Assume 1,000 MMBtu/d well
- Gas sells at \$5.33 / MMBtu
- t/f, monthly rev. = \$160,000
- =====
- 1. if op. costs = \$200,000
 - 1/8 min. int. = (\$5,000)
 - 1/8 roy. int. = \$20,000
- 2. if op. costs = \$100,000
 - 1/8 min. int. = \$7,500
 - 1/8 roy. int. = \$20,000

McSweyn – Other Points

- **N6:** Non-Participating Royalty Int. (NPRI)
 - *royalty carved from min. est. before OGL*
- : landowner's royalty → CL 13
- : Overriding Royalty (ORR)
 - *taken from L'ee's interest after OGL*
- **N6:** ORR – same formalities as OGL
- **N6:** “of” = multiplication
 - → 1/8 royalty vs. 1/8 of royalty
 - → 1/8 vs. $1/8 \times 1/8 = 1/64$
- **N4:** royalty on production; t/f, ≠ bonuses & rentals

Problem: pp. 410-412

- Harris → Smith 1,000 acres, reserving $\frac{1}{2}$ of all the royalty
- Smith → (OGL) XYZ
 - Intro: \$500 / acre bonus
 - Intro: \$2.50 / acre delay rental
 - ¶ 3: Reservation of $\frac{1}{10}$ of $\frac{1}{5}$ of O&G
 - ¶ 4: Royalty of $\frac{1}{5}$
 - ¶ 4: \$2,500 shut-in royalty
 - ¶ 5: Reservation of $\frac{1}{10}$ of $\frac{4}{5}$ of O&G, until Lessors receive \$64,000
 - ¶ 6: If $\frac{1}{5}$ royalty < \$2,500, Lessors get [\$2,500 – actual royalty]
- Which (if any) of these would Harris share?

Other Vocab. Terms

- **P. 413, Note 3:**
 - *Production Payment*
 - *Minimum Royalty*

- **PP. 413-4, Note 4:**
 - *Net Profits Interest*
 - *Carried Interest*

2. Creating Mineral and Royalty Interests

- When creating a mineral interest or a royalty interest ...
- Language is very important
- Try to avoid ambiguity ...
 - ... but if it's unavoidable, try and make sure the parties' intentions and actions give some indication of what (or IF) they were thinking

Barker v. Levy

- Grant of “... 1/160 part of all oil, gas ... that may be **produced and saved** from ...” leased lands
 - P. 415: both parties “content that the deed is unambiguous” ... then reach opposite conclusions
- ***Mineral interest OR royalty interest?***
What is the \$ impact of the distinction?
- ***Items considered by the Court?***
 - whether an OGL exists at the time of grant
 - include / exclude “in or under”
 - O-i-P vs. Rt. to Produce Jurisdictions: whether “produced and saved” suggests royalty

The OK Approach & Other Exceptions

■ Pp. 419-422, N3

- grant of a fractional royalty (or a fraction OF a royalty) usually indicates a grant of a royalty interest ... **BUT there are exceptions**

■ pp. 420-1, N3(b): the OK cases

- “royalty” doesn’t necessarily mean a royalty int.
 - “royalty” often used to mean a mineral interest
- was an OGL in existence at the time?
 - FLB v. Nicholson: grant w/ reservation of ½ interest in “all royalties received from any oil and gas leases” → construed to be mineral int. since no OGLs existed at the time

The OK Approach & Other Exceptions

- pp. 420-1, N3(b): the OK cases (cont'd)
 - who has the rt. to grant OGLs and receive rentals and bonuses?
 - rts of exploration, and ingress / egress, granted?
 - **BUT SEE** p. 427 N3: ingress / egress are not conclusive, if royalty holder can take in kind
- p. 422, N3(d): the unusually large NPRI
- p. 422, N3(e): royalty lang. + attributes of min. int.
- p. 422, N4: min. int. language less certain attributes

French & Anderson

■ French

- ❑ Grant of mineral interest
- ❑ Followed by stripping out of certain rights
 - no interest in delay or other rentals
 - no interest in revenues from leasing the lands
 - no control over leasing

■ Anderson

- ❑ Reservation of mineral interest that was “nonparticipating in bonus and rental rights”
 - Grantor: not bound by OGL entered into by his Grantee
 - Ct.: “nonparticipating” = no rt. to enter into his own OGL

Language, Language, Language

- ***What kind of interest is created?***
- Grant of “an interest in oil and gas in and under, and produced and saved from, the Leased Lands”
- Grant of “an ___% interest in oil and gas that might be produced, together with the right of ingress and egress for the purpose of developing the same”
 - -- reverse of French case
- Grant of “1/3 of the royalty in the oil, gas and other minerals in and under the Leased Lands” when no OGL existed

Next Class ...

- **TH 3/20:**
- CL 17 – Shared Ownership of Mineral Estate
 - Ch. 3, Sec. B
 - Text, pp. 429 – 464