

Question 7 – July 2014 – Selected Answer 1

(1) Yes, Mary can claim that the lease is not effective because it was granted by a non-executive mineral owner. At issue are the rights of a mineral owner and royalty owner when the executive right has been severed. A mineral interest is composed of a number of different rights including the right to develop, right to receive royalty payments, and the executive rights. These all may be severed from one another and transferred to different holders, but they are real property rights in Texas. Therefore, any transfer or conveyance of these rights must comply with the requirements to transfer real property. The executive right is the right to enter into lease agreements of the minerals. Only the person who holds the executive right may validly sign a lease. The executive right holder generally owes a duty of utmost good faith and fair dealing to all other royalty and mineral holders on the interest. In this case, Wally owned the entire mineral interest. But, on his death, the rights were severed. Mary took a royalty interest and the executive rights, while Paula took the rest. This means that Mary was the only person who could validly enter a lease covering Goldacre. That status did not change when Mary expressed intent to give Paula the executive rights. Although Mary stated that she planned to transfer those rights and to have her lawyer prepare a document reflecting the gift, she never actually had that document prepared. The necessary document would be a deed because, as mentioned above, the executive right is part of a real property interest. A deed must be delivered to the grantee and accepted before it is a valid conveyance. No deed was delivered to Paula, so the executive rights were never validly transferred. Therefore, when Paula entered the lease with DOC in October, she was not the holder of the executive right. Mary still held the executive right, so only she could sign an effective lease of Goldacre. DOC may argue that it relied on Paula's statement that Mary owned only a royalty interest, and that it took the lease in good faith. This will not be a successful argument. DOC should have known that Paula had no executive rights because no record of the transfer would have appeared in the real property records. DOC's good faith reliance argument will fail. Consequently, Mary will be able to set aside the Mineral Lease.

(2) John will be able to assert his rights under the Surface Lease to preclude drilling activities on the surface of Goldacre. At issue are the rights of the holder of the surface to prevent development of oil and gas. The general rule in Texas is that the mineral estate is the dominant estate. The owner of the minerals has the right to make reasonable use of the surface for the purpose of development. A lease holder is an "owner" of the minerals because in Texas, a mineral lease is a fee simple determinable in which the lessor has a reversion in the minerals following the lessee's estate. A mineral owner may, however, waive their right to use the surface. At the time that Wally executed the lease to John, Wally owned both the minerals and the surface in fee simple. In the Surface Lease, Wally validly waived his right (as the mineral owner) to use the surface to explore and produce oil, gas, and other minerals. When Wally died, Paula became the owner of the minerals and surface of Goldacre, but subject to Mary's royalty interest and executive rights, and subject to the Surface Lease to John. All the terms of the Surface Lease, including the waiver of the right to use the surface were binding on Paula, and thus on any lessee of her mineral interest. The Surface Lease was recorded in the real property records in the appropriate county, so DOC had notice of this lease prior to taking the Mineral Lease. DOC thus cannot claim that it did not have notice of the Surface Lease and its terms because recordation is constructive notice. Thus, John can assert his right to exclusive use of the surface under the terms of the Surface Lease. Depending on whether John was making a use of the surface prior to when DOC began drilling activities, he may also be able to assert rights under the Accommodation Doctrine. In Texas, even though the mineral estate is dominant, a mineral owner must accommodate the surface owner's use if the surface owner can show (1) a pre-existing use of the surface, (2) the mineral owner has a reasonable alternative to economic development of the minerals, and (3) the reasonable alternative is available on the leased tract. If John had a pre-existing use and could meet the other requirements, he may also be able to assert rights to preclude drilling activities (or at least prevent disruption to his use) under the Accommodation Doctrine.

Question 7 – July 2014 – Selected Answer 2

1. Mary can claim that the Mineral Lease was no effective on the grounds that Paula did not have the authority to enter into the mineral lease since she did not hold the executory interest. The issue is whether Mary can claim that the mineral lease was not effective, and on what grounds would Mary be able to assert the claim. A person who holds the interest in a mineral lease may convey to one person to hold the executive interest as a mineral interest owner. A person who holds the interest in a mineral lease may also convey to another person a non-participating mineral interest ownership in which that person does not receive the right to the executive interest. A person who holds the executive interest in the lease has the sole authority to enter into leases for the production oil, gas, and other mineral underneath the surface of the land. A person who was only conveyed a non-participating mineral owner interest in the mineral estate may not enter in to a lease for the development and production of those minerals. If a person who does not hold the executory interest in executing oil and gas leases, nonetheless, executes an oil and gas lease, such lease will be invalid. A person may convey her mineral interest through a deed. In order to convey the interest, the person must have donative intent, must deliver the deed to the conveyee, and the conveyee must accept the deed that was delivered. Acceptance may be presumed if it is beneficial to the person receiving the conveyance or gift. Absent donative intent, delivery, and acceptance, no valid transfer of the property or interest in the property is conveyed. Here, Wally bequeathed to his sister, Mary, a royalty interest and all executive rights to execute oil and gas leases for Goldacre. Giving Mary the executive rights to execute oil and gas leases constitutes Mary as holding the executory interest in entering into oil and gas leases. No other person may execute oil and gas leases besides Mary. Wally bequeathed to Paula all other interests in Goldacre not bequeathed to Mary. Paula's bequeath did not contain an executive right to enter into oil and gas leases. All other interest would include a non-participating mineral interest as she cannot participate in the lease contracts, but she still maintains an interest in the minerals. Paula might also have an interest in the surface estate of Goldacre since she received all other interest in the Goldacre, but a surface interest owner is not entitled to enter into oil and gas leases, unless the surface owner also has the executory right to enter into leases. Mary had the donative intent to transfer her interest to Paula, but Mary did not complete the necessary steps in order to transfer her interests to Paula. Mary told Paula that she was giving Paula the executive rights in Goldacre that M y received from Wally, and Mary intended to have her lawyer prepare a document that could be recorded. However, no document was ever created nor created nor given to Paula. There was no delivery of the conveyed gift to Paula. Paula might argue that she accepted the gift since it is beneficial to her. However, absent delivery, either by recording it, giving it to Paula, or keeping it in a safe place with the intention that it was constructively delivered to Paula, no delivery occurs. Therefore, since no delivery occurred, Mary's interest was not conveyed to Paula. Mary still holds the executive right to entered into oil and gas leases. Paula does not obtain the executive right to enter into oil and gas leases. Therefore, Paula's lease with Dallas Oil Company (DOC) is invalid. Mary can claim that the lease was not effective since she hold the executive right to lease and she did not executive the mineral lease with DOC, and therefore the lease is not effective. Accordingly, Mary may claim the Mineral Leas was no effective on the grounds that she holds the executory right to enter into leases and that Paula did not have the right to enter into the Mineral Lease, making the lease not effective.

2. John may assert that he has the right under the lease with Wally to preclude DOC from conducting drilling activities on the surface of Goldacre. John also has an action for trespass against DOC. The issue is what rights can John assert to preclude DOC from conducting drilling activities on the surface of Goldacre. When a lessor conveys a lease to a leasee, the terms of the lease may not be disturbed and must be followed. A leasee has a possessory interest in the property leased and obtains rights in the property according to the terms on the lease. Such interest and rights may not unreasonably be disturbed. A lease may state that the leasee will have the exclusive possession of the surface and that the lessor waives any right to use the surface for any purpose during the term of the surface lease, including explore and/or produce oil, gas, or other minerals. Any person who receives that lessor's interest in the property may not interfere with the terms of the lease agreement between the original lessor and the leasee. A lease does not end at the death of the lessor. A recorded lease gives constructive notice to all others of the lease and the terms of the lease. A lease for more than a year

generally needs to be in writing. Additionally, an oil and gas leasee who is not validly on the surface owners land is a trespasser. Here, Wally entered into a valid three-year written lease with John. Under the terms of the lease agreement, Wally granted John the exclusive possession of the surface of Goldacre. Wally waived any right to use the surface for any purpose during the term of the Surface Lease, including any right to explore and/or produce oil, gas or other minerals. The lease was recorded, giving constructive notice to Mary, Paula, and DOC of the terms of the lease. When Wally died in January 2013, the lease was still effective through December 2015 (3 years). John's rights and interest in the surface could still not be disturbed by the people who received Wally's interest in the property. Mary will have to wait until after December 2015 to execute an oil and gas lease. John's right to the recorded lease were first and must be complied with, so any person who took Wally's interest in Goldacre will have to abide by the terms of the lease and wait 3 years (after December 2015) to use the surface to explore and/or produce oil gas or other minerals underneath the land. The lease with DOC was entered into in October 2013. October 2013 falls within John's three-year lease agreement and is therefore not allowed under the terms of the lease. John may assert the rights under his lease agreement to preclude DOC from conducting drilling activities on the surface during the three-year lease term, which October 2013 falls within. Additionally, as mentioned above, DOC did not have a valid lease since Mary did not enter into the lease. A leasee who does not have a valid lease has no rights to enter onto the surface land to develop the oil and gas. If such a leasee does enter the land, it will be a trespasser. Since DOC entered the land, he is deemed a trespasser and John may preclude DOC from entering his land on trespassing grounds, as well. Therefore, John may assert his rights under the lease agreement giving him exclusive control of the surface land for three years to preclude DOC from conducting drilling on the surface of Goldacre. John may also assert a claim of trespass against DOC since DOC did not have a valid lease to be on the land.

Question 7 – July 2014 – Selected Answer 3

1. Yes. Mary can argue that the lease is ineffective: it fails because Paula did not have executive rights; and last, that the lessee cannot enter the property while the Surface Lease is in effect. She will likely prevail for her first claim, and likely will not prevail for her second claim. Under Texas law, the rights associated with land ownership are divisible. Additionally, only the executive interest owner of a mineral estate has the right to enter into an oil and gas lease. Moreover, any interest in land, such as executive rights, must be evidenced by a written document purporting to convey that interest in order to be an effective conveyance. Here, Mary became the executive interest and royalty owner of Goldacre. As the executive interest owner, Mary had the power to enter into an oil and gas lease for the exploration and production of minerals subject to any prior leases and/or ownership claims on the land. Although Mary may have intended to convey the executive interest to Paula, such a conveyance falls within the Statute of Frauds and must be evidenced by a writing that describes the interest being transferred, be signed by the parties, and include intent to convey along with actual delivery of the document. Here, none of the elements are met. There is no signed writing and thus the executive interest never passed to Paula. Therefore, Paula cannot take any action to lease the land to an oil and gas company since that is within the exclusive power of the executive right owner, Mary. DOC, in effect, has no interest in the land because they did not contract with the rightful executive right owner. Mary may also argue that Paula cannot allow a lessee to enter the surface of Goldacre for exploratory and drilling purposes and thus cannot enter into a lease. However, assuming that Paula was the executive right owner (which she is not as discussed above), Paula could indeed enter into an oil and gas lease without any signatures from any royalty owners. The lessee however could not to enter the surface of Goldacre for the duration of the Surface Lease. The oil and gas lease could have a primary term that lasts beyond December 2015, when the Surface Lease expires, and the lessee could enter the surface after that time.

2. John can successfully argue that Wally expressly waived any right to use the surface for ANY purpose during the term of the Surface Lease, INCLUDING any right to explore and/or produce oil, gas or other minerals. Under Texas law, a landowner can waive his right to a reasonable use of the surface to conduct drilling operations (including exploration) despite the fact that the mineral estate is regarded as the dominant estate. Here, Wally did just that. Even though Wally could have conveyed the surface to John without any waivers and could have then still utilized the surface as reasonably necessary to

extract the minerals therein, he decided to waive his right to encroach on the surface all together. When Mary received Wally's executory interest, she effectively stepped into the shoes of Wally and must adhere to the Surface Lease and its terms. Thus, DOC cannot enter the surface DURING the term of the Surface Lease. DOC can, however, enter the surface after the expiration of the Surface Lease. John can also point to the fact that DOC had notice of the lease because the lease was properly recorded and Texas is a pure notice state. Thus, a valid recorded interest will prevail over a later acquired interest even if the interest is valid (here the interest is invalid because DOC did not contract with the executive right owner but rather Paula, as discussed above). Therefore, John can preclude DOC from conducting drilling activities because they did not sign a valid lease and because they were on notice that they could not enter the land during the pendency of the Surface Lease.