Question 4 – February 2018 – Selected Answer 1

I. If oil and gas production continues after the Lease, Margaret and Bobby are properly entitled to royalty payments, and Bobby will receive a 1/32nd interest and Margaret will receive the rest of the interest

The first issue is how the royalty payments are to be apportioned between Margaret, John, and Bobby. There are three types royalty interest owners: landowner's or lessor's royalty interest, non-participating royalty rights, and a non-working interest owners. A royalty is a payment free of cost of production, except post-production fees. A landowner's or lessor's royalty interest is determined from the lease to the lessee, an oil and gas company. A division order is a short, one-page document sent by the produciton company to any party who has a right to royalties and specifies the amount of interest each party has as to royalties. If there is an overconveyance of interest, the Duhig rule applies. The Duhig rule states that if there is an overconveyance of interest to a party, the one who overconveyed must make the other party whole as to what they believed they were receving. The party may receive damages if he is not made whole.

In this case, Margaret is the landowner and lessor and has a fee simple interest in Greenacre and is subject only to John's 1/16th non-participating royalty interest. When Margaret signed a lease with Big Oil, the lease provided a royalty of 1/8th of the oil and gas produced. This lease was recorded in Webb County. John then delivered a royalty deed that conveyed to Margaret a 1/32nd interest, leaving John with 1/32nd interest. When Big Oil sent the division order to John reflecting John's ownership as a 1/16th royalty interest, he signed it and returned it. This interest was incorrect because he granted Margaret a 1/32nd interest previously. Then, John conveyed to Bobby a NPRI of 1/16th interest, which he did not have. The Duhig rule applies here because John did not have 1/16th to convey since he only had 1/32nd. John will be liable to Bobby for damages since he only received half of the 1/16th interest.

II.If the current Lease terminates, Bobby does not have the right to negotiate a new lease because the right to lease remains in the mineral estate owner, Margaret.

The second issue is whether a non-participating royalty interest has the right to negotiate a lease for oil and gas production. Under the rules, there are two estates, the surface estate and the mineral estate. The owner of the mineral estate has the right to explore for oil and gas, which a party rarely does because of the expense. Second and most importantly, the mineral estate owner has the executive right to lease the mineral estate to a oil and gas company. Royalty interest owners only have the right to receive payment from production of oil and gas, they do not have the executive right to lease. A party who has a fee simple interest in the property owns both the surface estate and the mineral estate, which allows them to right to lease.

Here, Margaret owns Greenacre in fee simple and John only has a 1/16th non-participating royalty interest in all oil, gas, and other minerals. John does not have the executive right to lease becaus he is only a royalty interest owner, and not the mineral estate owner. John only has the right to receive payment free of production costs, but not including post-production costs, from the oil and gas lessee.

Therefore, Margaret is the only party with the right to lease because she is the mineral estate owner, and Bobby does not have the right.

III. When the Lease terminates, Big Oil has the primary liability and obligation to plug the well.

Under Texas law, plugging a well occurs after the well has been abandoned. The primary liability of plugging a well rests in the oil and gas lessee,or the original operator. The secondary primary liability of plugging the well is in a working interest owner. There is no liability for plugging a well on royalty or land owners. If the lessee or working interest owners are unable to be found or are unable to plug the well, Texas has funds set aside for the purpose of plugging abandoned wells. Therefore, primary liability rests in Big Oil because they are the primary lessee of the oil and gas lease.

Question 4 – February 2018 – Selected Answer 2

(1)

John as a non-participating royalty interest in the oil and gas developed and produced under Greenacre (a 1/16th interest). Margaret retained her interest in the remainder of the oil and gas produced on Greenacre (15/16ths). In April 2017, John sold a portion of his Greenacre royalty to Margaret and delivered a royalty deed that conveyed to Margaret "1/32nd of all oil and gas and other minerals produced on Greenacre." In effect, John sold Margaret one half of his existing royalty interest. John then conveyed to Bobby "a non-participating royalty of 1/16th of all the oil, gas, and other minerals produced from Greenacre." This second conveyance triggers the Duhig Doctrine. The Duhig doctrine provides that in a three party transaction, if one conveys more than his interest in an oil and gas lease to another, he loses his entire interest and the third-party takes the interests the other had. Here, when John made the second conveyance to Bobby, he conveyed twice the royalty interest he had remaining in Greenacre (having already transfered one-half of his 1/16th share earlier to Margaret). Bobby is therefore entitled to take what interest John did have in Greenacre, which is only 1/32nd.

The habendum clause of the Big Oil lease provides that the primary term is two years (no drilling must take place in this period, and if it doesn't - the lease terminates) and that the secondary term is "for so long thereafter as oil and gas is produced in paying quanities." This means that if a producing well is drilled in the two years, the second term triggers and the lease may go on indefinitely (with savings clauses, etc.) so long as there is production in paying quantities. If that occurs, Big Oil must pay the royalties properly allocated among all of the interest holders. Here, as discussed above, that would include Margaret and Bobby.

(2)

A non-participating royalty interest holder does not have any executive right to negotiate a new lease. The NPRI holder is only entitled to a royalty check. A royalty is a cost-free fractional share of the profit from the production of oil and gas from Greenacre. Bobby is not entitled to anything more (such as a bonus check) and does not have an executive interest in Greenacre.

This right is exclusive to Margaret, who has not severed her interest in the mineral estate (having only given up a non-participating royalty interest). Because he does not have the development right or an executive right to Greenacre, Bobby has no rights to negotiate a new lease if the current lease with Big Oil terminates.

Margaret is the owner of the mineral estate and the lessor in the lessor/lesse relationship with Big Oil. As a result, she retains her exclusive executive right to develop the minerals under Greenacre subject to Big Oil's current lease (and use). Margaret did not transfer her mineral estate or sever her executive right interest in any way. Furthermore, even if the conveyance from John to Bobby attempted to convey more than the non-participating royalty interest (which is doubtful because it expressly identified it as a "non-participating royalty"), John did not have any rights in the mineral estate or Margaret's executive rights and therefore could not have transferred this to Bobby. There is therefore no way Bobby has a right to negotiate a new lease. If the well stops producing, he stops receiving a royalty.

(3)

The operator in control of the well at the time or before the termination of the lease--i.e., Big Oil. If the operator (Big Oil) does not plug the well, any working interest holder (e.g., a passive investor with working interst rights) would be responsible to plug the well. In the event the working interest holder is not available, the State of Texas may use funds set aside in every oil and gas transaction to plug the well. The mineral estate owner, Margaret, and any NPRIs or NPMIs (Non-participating mineral interest) holders (i.e., Bobby) are not liable for the failure to plug a well in Texas.