

SOUTHEAST TEXAS LAND, MINERAL & ROYALTY OWNERS SEMINAR

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Know Your Rights

- Oil companies are not always looking out for their royalty owners.
- Oil company's primary goal is to maximize its own profits.
- Important for land and royalty owners to understand their rights.
- Don't Just Treat it Like "Mailbox Money" – hold the lessee to its obligations

Implied Covenants of Oil and Gas Lessee

- Covenant to Develop
- Covenant to Protect Against Drainage
- Covenant to Market
- Applicable Standard is Reasonably Prudent Operator (“RPO”)

Implied Covenant to Develop

- Triggered after a well is drilled and production is obtained
- Must drill additional wells to exploit and produce the lease as an RPO would under same or similar circumstances
 - Take into consideration interests of lessor and lessee
 - There is no duty to drill unless the amount of oil or gas expected to be recovered would cover the costs of recovering such production and would also yield to lessee a reasonable profit.

Implied Covenant to Develop (cont.)

- A number of considerations to drilling
 - Dry hole risk (3D seismic)
 - Current and future oil and gas prices
 - Drilling and production costs (horizontal well much more expensive than vertical well)
 - Existing overrides

Implied Covenant to Develop (cont.)

- Lessee may sign lease to hold and prevent competitor from leasing
 - Raises the question of whether there is a duty to explore and drill an initial well in Texas
 - Payment of delay rentals postpones obligation to drill, unless you can show RPO would drill.
 - Can attempt to negotiate an express requirement that at least one well be drilled within the primary term

Implied Covenant to Develop (cont.)

■ What can I Do?

- Look around at your neighbor's property
 - Are wells being drilled or produced?
 - Is it the same lessee?
- Do some quick research into publicly available information – websites
- Request information from your lessee

Implied Covenant to Protect Against Drainage

- Rule of capture treats production of oil and gas similar to “ownership” of wild animals – must drill a well to offset production from neighboring leases
- The drainage must be substantial before lessor can maintain a cause of action.
- Drill replacement wells, rework existing wells, drill additional wells, or seek administrative relief from the RRC

Implied Covenant to Market

- Requires lessee to actively seek a market for production and obtain market price for oil or gas produced.
- “Proceeds” Royalty Clause – royalty based on amount realized by lessee from sale of oil or gas
 - Marketing affiliate transactions are not always based on market price
- “Market Value” royalty clause – royalty is based off the market value of oil or gas at the wellhead
 - Look to comparable “arms-length” sales in the field
- Royalties are free of drilling and production costs
 - Lessee may deduct post-production costs (transportation, compression, processing, etc.), but such costs must be reasonable

Remedies for Breach of Implied Covenants

- Typically, No termination of lease
- Cause of action for breach of contract
- Damages are lost royalties would have been paid, calculated differently depending on which covenant dealing with
- The 4-year Clock is Always Ticking - Be Vigilant

Royalty Reporting Statute

Texas Natural Resources Code § 91.502.

- Check stub must include:

- (1) Identity of lease, property, or well and location;
- (2) Owner's decimal interest;
- (3) The month and year of sale;
- (4) Volume (bbls or mcf) sold
- (5) Price per bbl or mcf
- (6) Severance and any other taxes
- (7) Deductions (transportation, compression, processing, etc..)
- (8) Gross value of sale, and Owner's share of gross value;
- (9) Net value of sale, and Owner's share of net value; and
- (10) Royalty Owner hotline for information.

Royalty Reporting Statute (cont.)

Texas Natural Resources Code § 91.504

- Royalty owner may make request for additional information by certified mail, and lessee must respond by certified mail within 60 days:
 - (1) Deductions
 - (2) Heating value of gas produced or sold
 - (3) Railroad Commission I.D. Numbers for Lease and Wells

Royalty Reporting Statute (cont.)

Texas Natural Resources Code § 91.507

- If the lessee fails to provide the information requested under [Section 91.504](#) within the 60-day period, the royalty owner may bring a civil action to enforce the provisions of [Section 91.504](#).
- The prevailing party is entitled to recover reasonable court costs and attorney's fees.

Surface Use & Damages

- Mineral Estate is Dominant over Surface
- “Reasonable Use”
 - Lessee can use the surface as is reasonably necessary to develop the minerals, giving due regard to rights of surface owner
 - Fact that use is a nuisance or diminishes the value of the surface estate does not make the use unreasonable
 - Negligent use of surface is unreasonable

Surface Use & Damages (cont.)

■ Reasonable Accommodation Doctrine

- (1) Surface owner's use preexisted lessee's proposed use
- (2) Lessee's proposed use interferes with surface use
- (3) Preexisting use is only reasonable means available to use and develop surface
- (4) Lessee has other options that:
 - (a) do not interfere;
 - (b) are reasonable;
 - (c) are practiced in the industry; and
 - (d) are available on the premises.

■ Examples of Unreasonable Use

- Repeated spills; use of more surface than necessary; injury to livestock

Surface Use & Damages (cont.)

- Remedies & Damages
 - (1) Seek injunction of lessee's use;
and/or
 - (2) Monetary damages

Surface Use & Damages (cont.)

- **Provide for Use Restrictions & Damages in the Lease**
- If the lessor owns the surface estate, consider what provisions need to be included to protect the surface estate.
 - Address any particular concerns regarding surface use that are unique to your property.
 - Provide that surface owner will be compensated for all uses of and damages to the surface estate for all operations by lessee.
 - Consider providing agreed liquidated amounts for specific uses: Agreed amounts for well locations, roads, pipeline easements, tank batteries, etc. (adjust annually based on Consumer Price Index to account for inflation)
 - Provide that lessee must consult with lessor in the location of all roads and other facilities, and locate same so as to minimize interference with use of the surface.

Publicly Available Resources

Texas Railroad Commission - <http://www.rrc.state.tx.us/>

- Available Maps – Public GIS Map Viewer for O&G Data
 - <http://www.rrc.state.tx.us/forms/maps/index.php>
- Drilling Permits and Production Data
 - <http://www.rrc.state.tx.us/data/online/index.php>

Tyler Morning Telegraph's East TX Drilling Reports

<http://www.tylerpaper.com/section/BUSINESS03>

Texas Land & Mineral Owner's Association

<http://www.tlma.org/index.htm>



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