

EXECUTIVE RIGHTS & SELF- DEVELOPMENT RIGHT OF MINERAL CO-TENANTS

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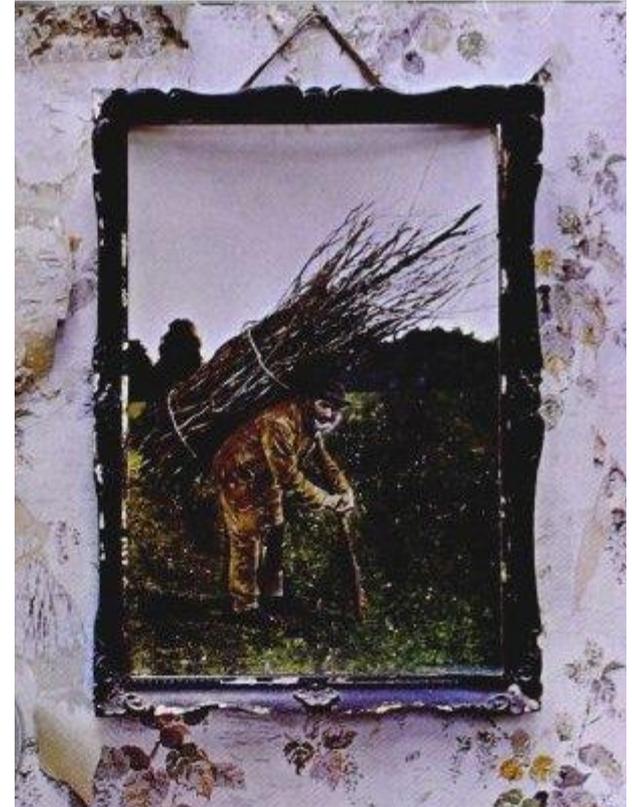
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Setting precedent.



Mineral Estate

- The sticks:
 - Right to Receive Royalty
 - Right to Receive Rentals
 - Right to Receive Bonus
 - Right to Self-Development
 - aka “Right of Ingress and Egress”
 - Executive Right to Lease
- These sticks can be “fused together” in certain instances



Executive Right – History and Effects

- Murky history—fractionalization most likely
 - One party with all leasing rights increases value
 - One party may be more savvy than all the others
 - Surface owner may want executive right
- First several cases entangled the executive right with other mineral rights like bonus and rentals
 - One example is *Klein*: “[g]rantors...reserve...one-eighth (1/8) of all mineral rights... [but] grantors herein are not to participate in any oil lease or rental bonuses that may be paid on any lease...”
 - Grantors told they are left with a mineral interest that changed to a royalty interest under any future lease

Executive Right – Power or Property Right?

- In *Pan American Petroleum Corp.*, grantor conveyed one-fourth (1/4) of the entire mineral estate while reserving the “stripped” executive right. What is the interest?
- Texas Supreme Court: “*It is not an estate in the property, and its scope and extent is governed by the instrument creating it.*”
- But then—*Altman v. Blake*: recognized that “*a mineral interest shorn of the executive right and the right to received delay rentals remains an interest in the mineral fee.*”

The Modern Executive Right

- The executive right is a real property interest in Texas.
Not a contract right!
 - Freely assignable
 - Perpetual
 - Irrevocable
 - Believed to not violate Rule Against Perpetuities
- Comes, however, with a duty to non-executive:
 - First mentioned in *Schlittler*: “that self-interest on the part of the grantee may be trusted to protect the grantor as to the amount of royalty reserved. Of course, there should be the *utmost fair dealing on the part of the grantee* in this regard.”
 - Needed to protect non-executive from executive shenanigans

Manges v. Guerra

673 S.W.2d 180 (Tex. 1984)

- Manges owned all executive rights and a portion of the minerals. Guerra owned non-executive portion of the minerals.
- Manges enters into an “option contract” with producer GPE to develop the minerals.
 - Provided no bonus or delay rentals to Guerra
 - Did not obligate producer to drill
 - Manges borrowed money from GPE
- Manges also (a) refused leases, and (b) issued deeds of trust on all the mineral estate, pushing away other potential lessees.

Manges v. Guerra

673 S.W.2d 180 (Tex. 1984)

- Trial Court, Court of Appeals, and Supreme Court all find for Guerras. Supreme Court:
 - “*[fiduciary] duty requires the holder of the executive right...to acquire for the non-executive every benefit that he exacts for himself.*”
- A “fiduciary duty-lite” has evolved so executive does not have to subordinate his own interests to that of non-executives. Richard Hemingway:
 - Did executive act like prudent non-executives might?
 - Did executive seek any unique advantage or benefit?

Standards of Care

- **TRUE FIDUCIARY**

- trustee duty—highest duty one can owe another
- must act in best interests of beneficiary, regardless of fiduciary's interest

- **UTMOST GOOD FAITH AND FAIR DEALING** (prevailing view in executive-rights litigation)

Executive must obtain for a non-executive:

- Every benefit that executive gets
- Must get what executive would have negotiated for itself as if there were no non-executive interest

- **GOOD FAITH** – without bad faith

- Objective standard: reasonable and prudent under the circumstances
- Subjective (“pure heart”)

Mims v. Beall

810 S.W.2d 876 (Tex. App. 1991, no writ)

- Bealls –deed of 200 acres to Mims reserving “undivided 1/4 nonparticipating interest in the royalties obtained through leasing”
- Mims –og| → to Angus Mims Jr. for 1/8 royalty & no bonus.
- Angus Mims Jr. –assign → Henderson for 1/16 ORR
- Bealls claim that 1/8 royalty is a “sweetheart” deal and claim ¼ share of Mims JR.’s 1/16 overriding royalty interest as well.
- Held:
 - Breach of duty of good faith and fair dealing, citing *Manges*
 - Court imposed “constructive trust” on Mims (and on Mims, Jr. because he knowingly participated in and induced this breach of duty)
 - Angus Mims did not owe the duty to the Bealls (non-executives) BUT a lessee who participates in the breach of the executive is also potentially liable.
 - Also awarded exemplary damages!

Mims v. Beall

810 S.W.2d 876 (Tex. App. 1991, no writ)

- Evidence supported a conclusion that the Mims had failed to negotiate for current market terms and had leased to their son for a lower-than-market royalty.
 - Son also benefited by assigning the lease to an oil company
 - While son didn't himself owe Bealls any kind of duty, he is a relation to the executive and the court opines that such a relationship invite close scrutiny.

In re Bass

113 S.W.3d 735 (Tex. 2003)

- Ps owned portion of 1/12 NPRI on 22k acre ranch. Ds owned rest of minerals and surface.
- Mineral owner hired Exxon to conduct a seismic reflection survey on the tract but did not lease.
- Due to this lack of leasing, NPRI owner sued, arguing that the mineral owner had violated its executive duty to them by not leasing.
 - NPRI owner also sought disclosure of the seismic data as proof that tract would be profitable to lease

In re Bass

113 S.W.3d 735 (Tex. 2003)

- Texas Supreme Court reverses lower court, holding:
 - Executive’s duty comes from agency jurisprudence arising from a special position between parties, not from a covenant to develop read into gaps in lease language
 - No duty by executive rights owner when there is no lease. No evidence of self-dealing—no evidence that they had refused to lease or otherwise made the minerals unleaseable.
- Finally, most importantly: “*What differentiates this case from Manges, however, is that no evidence of self-dealing exists here.*”

*Betty Yvon Lesley, et al. v. Veterans
Land Board of the State of Texas, et al.*

352 S.W.3d 479 (Tex. 2011)

- Executive owns 25% minerals, all of surface
- Non-executive owns 75% minerals
- Self-Dealing? Executive wants to build on surface and prevent drilling.
 - Promises of no drilling = higher land values
 - Promises enforced by anti-drilling covenants
- Wanting to take advantage of a favorable leasing climate but finding themselves unable to get their minerals leased, the owners of the majority share non-executive, non-surface, mineral interest sue.

Lesley v. Veterans Land Board

352 S.W.3d 479 (Tex. 2011)

Texas Supreme Court reverses Eastland Appeals Court:

- To the non-executives: the self-dealing in *Manges* resulted in the breach of the fiduciary duty, not simply the lack of leasing. *In re Bass* had no self-dealing
- To the executives: “*we do not agree with [executives] that Bass can be read to shield the executive from liability for all inaction. It may be that an executive cannot be liable to the non-executive for failing to lease minerals when never requested to do so, but an executive’s refusal to lease must be examined more carefully. If the refusal is arbitrary or motivated by self-interest to the non-executive’s detriment, the executive may have breached his duty.*”

Lesley v. Veterans Land Board

352 S.W.3d 479 (Tex. 2011)

What about self-development by non-executives?

- *Lesley*: cites its prior language in *French v. Chevron U.S.A., Inc.*, reciting that, “*the right to develop is a correlative right and passes with the executive rights.*”
- Your speaker, the GLO of Texas, and Professor Emeritus Bruce Kramer all disagree with this.
 - Self-development is a separate mineral property “stick” for which parties presumably paid value.

More on Self-Development

- Modern self-development is not just a matter of drilling wells, however.
 - assessing future borehole geometry and surveying pad sites.
 - surficial geological mapping and seismic surveys
 - What about “passive source” geophysical testing?
 - logging of existing wells and offsite research of logs, seismic data, surficial geologic maps, and drill core.
- All of these activities are commonly thought to be included in the right of self-development—*are these now proscribed by non-executives?*

Problem

- Rodriquez owns BA subject to a “1/2 of all royalty in oil, gas and other minerals” non-executive interest in Camarillo
- Rodriquez needs cash *now*
- Lease offers:
 - Black Dirt Oil Co. offers \$200/acre; 1/8 royalty
 - Uvalde Oil Co. offers \$50/acre; 3/16 royalty
- What should Rodriquez do?
- Apply “utmost good faith and fair dealing” standard to all his activities!
 - Get every benefit that executive gets
 - Must get what executive would have negotiated for itself as if there were no non-executive interest
 - Consistent with local market?

The Poison Pill and more...

Executive Hi-Jinks

So “activation” of duty is not always post-lease but at any point when executive (in)action hurts non-executives...

- What if the executive places covenants on the surface purchasers which disallow drilling?
 - *Lesley*: exercising executive right—could be struck
- What if executive refuses offered commercially reasonable lease over non-executive?
 - *Lesley*: exercising executive right—could be actionable
- What if the executive says that he will lease the non-executive but not himself?
 - Still unclear. Force someone to lease his own minerals?

Friddle v. Fisher

378 S.W.3d 475 (Tex.App.—Texarkana, 2012 pet. denied)

- Questions considered:
 - What duty is owed an NPRI owner?
 - Who pays the money to non-executives?
- Background
 - Non-tract well brought it on pooled acreage
 - Lessee pays all to executive, none to NPRI owner
 - NPRI owner sues, claiming that he should have been notified of lease, pooling, and production
 - And that Statute of Limitations had been tolled

Friddle v. Fisher

378 S.W.3d 475 (Tex.App.—Texarkana, 2012 pet. denied)

- **Fisher:** cites *Montgomery v. Rittersbacher*¹—a similar case except that lessee paid into a court trust
- **Court of Appeals:**
 - Differentiates *Montgomery v. Rittersbacher*
 - Citing the recent case of *Lesley v. Veterans Land Bd.*,² NPRI owners are held to be owed the same “utmost fair dealing” standard as non-executive mineral owners
 - Where executive accepts all the money, he is chargeable in equity as constructive trustee
 - Lease in OPR doesn’t prevent the discovery rule from tolling SoL

¹ 424 S.W.2d 210 (Tex. 1968)

² 352 S.W.3d 479, 480-81 (Tex. 2011)

Trying to get around the fiduciary duty owed by executives

- Executive right holders (and their lawyers) are prohibited from getting anything more than the non-executives get
- Therefore, offering them individual special incentives in return for signing a favorable (to lessee) lease is poor form
 - Includes individual ORIs specifically carved out by lessee to be awarded to executive for signing
 - Do not go around executive's lawyer, either

Bradshaw v. Steadfast Financial, L.L.C.

395 S.W.3d 348 (Tex.App.—Fort Worth, 2013, pet. granted)

Bonuses are rising and NPRI owners are noticing

- NPRI owners sues claiming executive lessor breached fiduciary duty by leasing for only 1/8
 - Very high bonus
 - Allegedly, royalties in the area were 1/4
- Court:
 - Executive rights owner owed fiduciary duty to NPRI holder
 - Issues of material fact existed
 - Estoppel by deed does not disallow NPRI owner from arguing that executive breached its duty to NPRI owner

Bradshaw v. Steadfast Financial, L.L.C.

395 S.W.3d 348 (Tex.App.—Fort Worth, 2013, pet. granted)

- Court: the measure of control of the executive over the NPRI is important in determining whether the duty has been violated
 - Example: “1/16 fixed royalty” vs. “1/2 of royalty” —which gives the executive more control?
 - Bill Burford: *“The executive will be held to a high standard of duty...when the quantum of oil and gas production due the nonparticipating royalty owner is within the executive’s control.”*

Mineral Owner v. NPRI Owner

Is there a different in the duty owed?

- Mineral interest owners are not the only non-executives out there. NPRIs, ORIs, etc.
- In *Friddle*, the court cited *Lesley* for the proposition that the executive owed an NPRI owner a fiduciary duty of “**utmost fair dealing.**”
- Remember this duty when leasing minerals encumbered by significant NPRIs! Ramping up bonus or other incentives and lowering royalty could be seen as a violation of the executive right!

Who gets the bonus?

- Some people think that the executive rights owner automatically earns the bonus—*wrong*
 - Bonus used to be a small portion of profit
- if a conveyance expressly retains/grants a mineral estate, severing the executive right alone *does not* change the resultant non-executive mineral estate to a royalty so that that non-executive grantor is entitled bonus¹
 - Unless bonus is specifically retained by the executive, the non-executives get their share of bonus

¹ *Burns v. Andus*, 312 S.W.2d 417 (Tex. Civ. App.—Eastland 1958, no writ)

How to pay the bonus?

Logistics of paying the bonus money

- *Bass*: suggests that the agency relationship between the executive and non-executive is strictly for the negotiation and execution period of the lease
- *Lesley*: generally extends duty to any activity by the executive that affects the non-executives interest
- *Fridde*: Where executive accepts all the money, he is chargeable in equity as constructive trustee

Rule of Construction

Greatest Possible Estate Rule

- A Grant or Reservation that is not limited is construed to mean the greatest possible estate
- *E.g.*, a grant or reservation of “Blackacre” will be interpreted to mean all surface and minerals of Blackacre in the largest estate possible given the language of the grant or reservation—even though Grantor may not own that much.

Day & Co. v. Texland Petroleum

786 S.W.2d 667 (Tex. 1990)

- K&Y –deed→ 80 acres to Day, reserving 1/2 MI, but expressly conveying all executive rights to Day
- Day –deed → 10 (of 80) acres to Shoafs, excepting the 1/2 MI previously reserved to K&Y and reserving 1/4 MI. No mention of executive right
- **Issue:** Who has the executive rights in 10 acres deeded to Shoafs?
- Court holds that executive right interest passed to Shoafs in the 10 acres
 - Largest possible estate rule
 - Executive right is assignable and divisible
 - It can also be made inheritable and devisable
 - It is not “personal” unless expressly so made

Separated Executive Right Sold to Multiple Undivided Grantees

- **Example:** 50% minerals owned by non-executive Joe, 50% by executive Mary
- **Next:** Mary sells all her interest in equal undivided shares to Adam, Bob, Carol & David
- **Next:** Bob, who now owns $\frac{1}{4}$ of the undivided executive right to lease Joe's minerals, along with $\frac{1}{4}$ of $\frac{1}{2}$ of Mary's minerals, wants to lease all his interest.
- **Question:** What is the effect of Bob's lease?

Separated Executive Right Sold to Multiple Undivided Grantees

- *Day*: when an undivided mineral interest is received, the grantee is presumed to have acquired all the attributes of the undivided mineral interest—including executive right
- Therefore, if multiple grantees receive undivided shares of a “stand alone” executive right such as that portion of the executive right that covers Joe’s minerals—the undivided portion received by Bob would only cover that fractional portion of the entire undivided interest received by Bob—and later his lessee!
- This suggests Bob’s lease would cover $\frac{1}{4}$ of Joe’s $\frac{1}{2}$ mineral interest and would leave the other $\frac{3}{4}$ of Joe’s $\frac{1}{2}$ mineral interest unleased.

THANKS FOR LISTENING!

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