

A Reprint from *Tierra Grande*

Mineral owners beware — mailboxes bearing large sums of money can mean trouble.

Crude oil and natural gas prices have reached record levels, making ownership of mineral rights and royalties more lucrative than ever. Recently, mineral owners, especially those with producing wells, have been receiving offers through the mail to purchase their mineral or royalty interest. Such offers can trap the unwary into transferring more rights than they realize.

Offers contain a cover letter, a deed and a sight draft, which looks like a check but is not funded until title is verified. To accept an offer, the owner signs the deed before a notary, endorses the sight draft and mails both documents to the purchaser.

Astute mineral and royalty owners must look beyond the amount of money being offered and the wording in the cover letter and focus on the deed.

The cover letter and the deed may contradict each other. Regardless of what the cover letter implies, the deed is the legal instrument that spells out the interest transferred. Most people read the cover letter because it is written in layperson's terms and addresses how to obtain the money. But it is more important that they read and understand the deed or have their attorney read it.

Typically, the cover letter states that the purchaser wants to buy the owner's future income from the current oil and gas lease on the described property. Supposedly, the value of the sight draft reflects the magnitude of the projected income stream. Legally speaking, the purchaser wants the owner to assign his or her royalty interest (right to receive revenue) in the present lease and possibly in all future leases on the property.

To understand the full ramifications of signing such documents, some knowledge of Texas oil and gas law is helpful. Three possible royalty or mineral interests may be conveyed by deed.

Royalty deeds take two different forms. One is an assignment of the right to receive future income (or royalty) from the present lease. When the lease expires, the assigned interests may revert to the owner, depending on the wording of the deed. Reversion is what the royalty owners expect but that is probably not what the deed provides.

The language would read something like, "The royalty owner (possibly the assignor or grantor) grants, sells and conveys

Risky Business Mineral Sales by Mail

By Judon Fambrough



(or assigns) its rights to receive royalty (or the right to receive proceeds from production) under the current Oil, Gas and Mineral Lease recorded at (volume, page number and county)." A legal description of the property may be included instead of referencing the oil and gas lease.

The second type of royalty deed conveys a permanent royalty, which extends beyond the present oil and gas lease. The seller (or royalty owner) forever conveys the right to receive all or a part of his or her royalty from the present and all future leases. Two types of royalty conveyances fall into this category. One is a *fraction of royalty* and the other a *fractional royalty*.

A fraction-of-royalty deed reads something like, "The royalty owner (or grantor) grants, sells and conveys one-half (1/2) of the royalties payable under the existing lease and one-half (1/2) of the royalties paid under all future leases on the following described land (legal description.)"

Under this arrangement, the seller (present royalty owner) retains the right to negotiate

and sign all future oil and gas leases but shares on a 50-50 basis the royalties reserved. If the seller reserves a one-fifth royalty in a lease, the seller receives one-tenth of the production and the purchaser the other one-tenth.

A fractional-royalty deed, on the other hand, reads something like this. "The royalty owner (or grantor) grants, sells and conveys one-half the royalties under the following described property (legal description.) No preposition such as "of" appears between the numerical fraction specified in the deed (here the one-half) and the word "royalties."

Under this arrangement, as before, the seller (present royalty owner) retains the right to negotiate and sign the oil and gas leases on the property. No oil or gas company would lease the property in this situation. The recipient of a fractional-royalty deed has the right to receive the specified amount of production from the property regardless of the size of royalty negotiated in the lease. Here, the purchaser literally gets one-half of the total production from the property.

The grantor (the seller in this case) is entitled to receive a royalty only if he or she is able to negotiate a royalty greater than the one specified in the fractional royalty deed. Suppose, for example, the conveyance was for a one-sixth royalty, not a one-half. The grantor (seller) negotiates a one-fifth royalty in a lease. In this case, the purchaser gets the one-sixth royalty, and

the grantor receives the difference between a one-fifth and a one-sixth (or one-thirtieth of the production).

Most deeds attached to the offers, however, are mineral deeds, not royalty deeds. Although the cover letter describes purchasing some sort of a royalty interest, the deed is for a mineral interest.

Here is the distinction. In Texas, the mineral estate is made up of five separate and distinct interests. They include the:

- executive rights or the right to negotiate and sign a lease,
- right to receive a bonus,
- right to receive delay rentals,
- right to receive a royalty or a share of the production and
- right to enter the property to explore for and produce the minerals.

Royalty deeds involve the purchase and conveyance of all or a part of the royalty interest. The other four rights remain with the seller, assuming the seller owns all the minerals.

A mineral deed has language to the effect that, "The grantor hereby grants, sells and conveys to the grantee (purchaser) all rights, title and interest to the oil, gas and other *minerals* in and under and that may be produced from the following described property (legal description)."

By signing the deed, the owner conveys all the mineral interests owned beneath the described property. This includes the royalty interests as well as the other four interests comprising the mineral estate. The interest never reverts to the present owner(s).

There is another problem. While the cover letter references purchasing the seller's right to receive income or royalty from a lease or property, the mineral deed accompanying the offer letter conveys all the seller's mineral interest in the entire county. There may be a vast difference. A seller who reads only the cover letter and not the deed could be selling interest in properties not referenced in the cover letter.

Distinguishing a royalty deed from a mineral deed is difficult. The *Texas Real Estate Forms Manual* provides no promulgated forms as examples. Instead, the manual states, "Texas mineral law is complex and extensive . . . Attorneys who are not experienced in mineral law are urged to exercise caution and seek appropriate counsel when mineral law issues arise."

If attorneys have difficulty grasping this area of the law, what are laypersons to do?

The Texas legislature recognized the problem and passed a law effective September 1, 1999, giving owners some protection and advice. The law is found in Section 5.151 of the Texas Property Code.

The statute provides, "A person who mails to the owner of a mineral or royalty interest an offer to purchase only the mineral or royalty interest . . . and encloses an instrument of conveyance of only the mineral or royalty interest and a draft . . . providing for payment for that interest, shall include in the offer a conspicuous statement printed in a type style that

is approximately the same size as 14-point type style or larger and is in substantially the following form:

BY EXECUTING AND DELIVERING THIS INSTRUMENT YOU ARE SELLING ALL OR A PORTION OF YOUR MINERAL OR ROYALTY INTEREST IN (DESCRIPTION OF PROPERTY BEING CONVEYED)."

If the purchaser fails to give the prescribed notice in the offer and fails to resolve the matter after receiving a 30-day notice from the seller, the seller may sue for:

- the greater of \$100 or the difference between the price paid for the minerals or royalty and its fair market value at the time of the transaction,
- court costs and
- reasonable attorney's fees.

The lawsuit must be filed within two years after the seller (grantor) signs the deed.

The plaintiff may seek other remedies under existing law as long as they do not include rescinding the transaction or otherwise rendering the conveyance null and void.

The statute does not specify where the notice must be placed. Legislators probably envisioned placing the notice in the cover letter. However, in most cases, the notice appears in the deed.

Another easily overlooked problem deals with the substances conveyed by the deed.

The cover letter addresses purchasing the owner's mineral or royalty interest in oil and gas production. According to the Texas Supreme Court, the term "minerals" includes oil, gas and uranium. It does not include limestone, sand, surface shale, caliche, building stone, gravel and water. Coal, lignite and iron ore are not considered minerals when they lie on the surface or within 200 feet of the surface if any reasonable method of production will destroy or deplete the surface.

A proposed deed in one mailed offer used the following language:

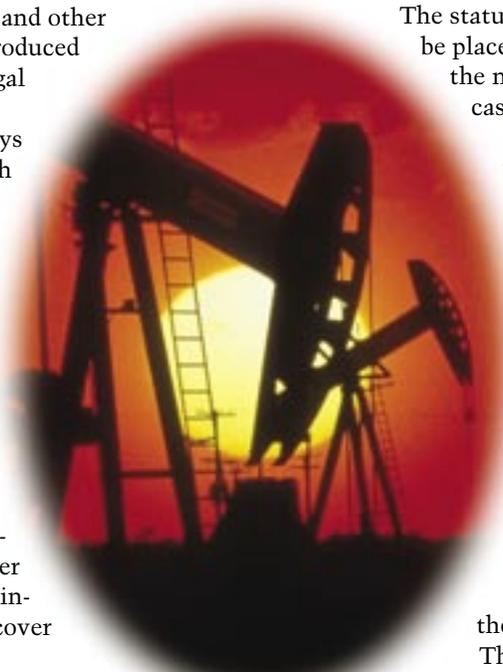
The grantor grants, sells, assigns and delivers to the grantee all of the grantor's rights, titles, claims and interests to the oil, gas and other minerals, in, on and under and that may be produced, saved, marketed from any lands located in (blank) County, Texas.

This is standard language. However the deed goes on to say, "In this instrument, the term 'other minerals' includes coal, lignite, uranium, sulphur, iron ore and every other 'mineral' now or hereafter recognized as such under the laws of the State of Texas."

By signing this deed, the owner conveys not only his or her oil and gas interests but also the interest in coal, lignite, uranium, sulphur, iron ore and any other substances the Texas Supreme Court declares a mineral in the future. Apparently, the language in this deed conveys the coal, lignite and iron ore regardless of their depths or how they are produced.

For more on oil and gas interests, see Volume 10, No. 4 issue of *Law Letter* (recenter.tamu.edu/pubs/1140.html). ♦

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