Mineral Leasing 101

What to do1st, 2nd, 3rd & 4th

The layman's guide to the questions to ask and get answered.

Lydia Quarles, J.D.
Senior Policy Analyst
Stennis Institute of Government

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So you've heard that they are beginning to drill for oil in your neighborhood. And you want to get in on the action?

The 1st question to ask: *Do you own land?*

If you do not own land, it is very likely that you have no reason to be involved in considering mineral rights. Generally, mineral ownership is associated with land, either surface rights or mineral rights. So if you do not own any land, it is very likely that you own no mineral rights either.

Exception: Occasionally, someone in your family who has owned land before you has reserved mineral rights in property that you might have possibly inherited.

Exception: Occasionally, if you have a long term land lease, such as for timber production, you might also have obtained rights to the underlying minerals, although that is highly unlikely.

The 2nd question to ask: *What is the nature of my ownership?*

There are mineral rights and there are surface rights. Surface rights are what we usually think of when we think of real property. We think of what's on top – where our houses sit, where our tomato plants grow, etc. Surface rights are what we see, and they are specifically described in the deed to our property – either as a lot in a subdivision plat, a lot and block in a city, or a metes and bounds description.

Originally mineral rights traveled with surface rights, so that when we purchased property, we purchased not only the surface area but also the ownership of minerals below the surface of the land. And they still do, unless they have been severed from the land. Shortly after the Civil War, severance of minerals from surface rights began.

So you need to figure out if you own any mineral rights associated with the property you own. There are a couple of ways that this can be done.

Find your deed.

As an initial proposition, if possible, find a copy of your deed and read it. It might say something about mineral rights and you want to know what it says.

Visit your Chancery Clerk's Office.

After you find your deed, go to the chancery clerk's office in your county and look around yourself. There are land record books which record deeds and deeds of trust, among other things, and there are, in some counties, mineral record books that are separate from the land records that contain the deeds and deeds of trust (mortgages). What you are looking for is *whether the mineral rights on your property have been severed sometime in the past*. They could have been partially severed, with a prior fee

holder having sold a portion but having retained a portion for himself. In that case, you purchased whatever mineral interest he retained when you purchased the property.

Not to disillusion you, but doing this yourself is not as easy as you might think, although it doesn't hurt to try and you might find some very helpful clerk, deputy clerk, or even land man in the vault where the records are kept who is willing to help you. Often, if a land man is not extremely busy, he will be happy to help you because you are a potential lessor of any mineral rights you may own.

Hire an attorney and get a title opinion.

At this point, my suggestion is that you hire an attorney to verify your ownership to mineral rights. If you decide to do this, ask whether the attorney will do it for a set fee or whether he will do it for an hourly fee. It doesn't matter which; just get the fee matter settled in some sort of way up front.

There are many different types of title opinions that deal with minerals. What I am suggesting first is that you hire your regular attorney or someone that a friend recommends and ask that the attorney provide you a title opinion. This title opinion will be similar to the one that your bank might have requested when you borrowed money, securing the debt by the land you owned. This title opinion will (1) confirm ownership; (2) define the property owned by description; and (3) provide you with a list of any problems with your ownership. For example, a title opinion will list any un-cancelled mortgages existing on the property (anticipated if you are still paying for the property), as well as any liens, including tax liens or materialmans liens, any judgments which have attached, any rights of ingress and egress that have been reserved by a governmental agency or another landowner, any easements for utilities or the like. The opinion might also reflect prior mineral leases that, on their faces, appear to have expired, but have never been cancelled. It should also provide you with any issues that arise in your chain of title – usually discovered in a title abstract, rather than a title opinion (e.g., someone with homestead rights did not sign a deed somewhere along the line) or any descriptions from other, possibly adjacent properties, that impinge upon the description of your land.

What is the difference between an abstract and an opinion? Abstracts produce chain-of-title summaries. Title opinions are those opinions that include not only a chain-of-title, but significant inquiry into the conveyances and discrepancies in ownership or

land records, liens, judgments, covenants that run with the land and the whole panoply of what makes up the title to your property, for good or ill.

There are other problems that may occur that require a simple “cure”. For example:

1. Possession: The owner of the real property may not be in possession. Moreover, there may be an issue of adverse possession on the property in question.

2. Heirship Issues: The death of a record property owner may result in confusing title issues. If a record owner dies intestate (without a will), the property passes under the laws of descent and distribution. If the record property owner dies with a valid will, then the ownership passes according to the decedent’s devisees, assuming that the will is properly probated. All of this generally occurs under the probate law in the state that the property is located. Beware: intestate succession is normally judicially determined (in court).

3. Capacity: Often there are issues concerning whether the individuals who executed instruments in the chain of title are competent to and have capacity to execute the instruments. For example, if an agent or attorney, a guardian, trustee, corporate officer, or executor executes an instrument of title, there must be a legal determination that the individual had the capacity and authority to do so. Without that, the instrument is worthless.

4. Name discrepancies: Often name discrepancies occur. These can be as insignificant as the spelling of a name, or as significant as a complete disruption in the chain of title. For example, Louise M. Majors (grantee) may be deeded property. The next time the property is deeded, the grantor may be Marjorie M. Sullivan. Are Louise M. Majors and Marjorie M. Sullivan one and the same? They could be. Louise Marjorie Sullivan, nee Majors, are one in the same, but that will have to be established by an affidavit or other method.

5. Tenants and remaindermen: Often individuals will deed property to one individual, but will retain a life estate for themselves, or leave a remainderman

who will have use of the property after the death of the individual retaining the life estate. These issues raise questions about waste, possession, as well as the allocations of royalties, bonuses and delay rentals.

When you receive a title opinion from your regular attorney, if there are unanticipated problems, he will tell you what they are and he will tell you how to "cure" them. Often it requires only something like an "affidavit of heirship" in order to ensure that your chain of title is complete. Curative work is often simple. However, sometimes it will require litigation.

If there are problems, you will want to cure them whether you are interested in leasing any mineral rights that you own or not. If your attorney reveals items that require cure, and there is a mortgage on your property, ask him to notify your lender and to find out whether your lender required title insurance. If the lender did require title insurance, the lender may handle the curative work for you. It is in the lender's interest, as well as yours, to cure any title defects.

Lawyers do not CREATE COMPLICATIONS. The complications are there! COMPLICATIONS EXIST, with or without lawyers. Lawyers find them…and the sooner the better. You need to have complications identified, title defects cured, and your interest in surface and mineral rights assured before you begin to negotiate with mineral exploration and production companies.

Remember: while few titles are perfect, very few flaws in titles are fatal.

Also remember: the title opinions associated with mineral leases will be done with more care than the title opinion required by your bank in the case of a title opinion required for the obtaining of a loan, so *do not be surprised* if a flaw appears in the mineral title opinion that did not appear in the title opinion that your bank required.

Dr. David B. Schweikhardt, who also has a law degree, is a professor in the Department of Agricultural, Food and Resource Economics at Michigan State University. He has developed a checklist for whether you should consult an attorney before entering into a mineral lease.

You do NOT need to consult an attorney about a mineral lease if you can answer YES to any of the following:

My children are raising my grandchildren to be brats and I look forward to haunting them all from beyond the grave. Yes or no?

My business and personal philosophy has always been: "Ignorance is bliss." Yes or no?

I love the smell of fresh courtrooms in the morning. Yes or no?

If you can answer YES to any of these questions, then do not bother consulting an attorney. Otherwise, run…don't walk…to your attorney's office.

In addition to a general title opinion, there are specific mineral title opinions. These are title opinions that your attorney may or may not be able to render, as they are technical in nature and require specific skills that are not shared by all attorneys.

A mineral title opinion will reveal whether a given tract of land is marketable (or has a marketable mineral interest). If there is a problem with the mineral interest, the title examiner will be able to tell you the problems (objections) to the title and will tell you if there is any way that you can "cure" the objections. Because a mineral title opinion is specialized, it should be rendered from a recognized oil and gas title lawyer. Theoretically a mineral title opinion will be supported by extensive research as to the rightful owners of minerals on a certain piece of property. Often this is costly because older deeds may be unclear or insufficient to support your title to the minerals and

various documents besides the land documents recorded in the chancery clerk's office may be relied upon. Find someone who is experienced in the field.

This mineral title opinion will generally be referred to as the "original" title opinion. Subsequent opinions rendered on the same property prior to drilling will be called a "supplement" to the original title opinion or a "supplemental" opinion. As a general principal, companies that desire to explore and produce rely on property record checks made by landmen at the leasing stage and do not secure formal title opinions at that time. Thus, the company will procure the "original" opinion prior to drilling.

If drilling results in production, a "division order" title opinion will be prepared. This opinion sets out the percentage of ownership that all parties have in the production from the well and the land. An original drilling opinion and a division order opinion are the two most common types of title opinions associated with mineral leases and they are frequently supplemented by the lessee. Supplements are required for a number of reasons, including new information obtained, curative matters which occur, changes in size or composition of the drilling unit.

There are fundamental differences between original drilling opinions and division order opinions. First drilling opinions trace title back a relatively long way in time – often to sovereignty, while division order opinions trace the title back only to the closing date of the original drilling opinion or the most recent supplemental drilling opinion. Second, original drilling opinions cover all the leased property, whereas division orders cover only the property allocated to the unit established for the particular well.

The 3rd question to ask: *Do you want to be prepared?*

In order to prepare yourself for issues associated with mineral exploration and production, a vocabulary would be good.

PRIMARY TERM: The number of years the mineral exploration and production company has to begin drilling a well and keep the lease in effect.

SECONDARY TERM: The secondary term of the lease begins when drilling begins and continues (generally) "so long as oil and gas are produced in paying quantities", or "so long as operations are conducted" or "so long as a well is capable of production."

GRANTING CLAUSE: This clause in the lease describes the extent of property rights granted to the company. For example, this clause will specify the rights for activities to explore and evaluate resources, produce, remove and sell resources, and construct other facilities and structures necessary for production (this can include facilities and structures on the surface or in the subsurface). The granting clause usually specifies the natural resource(s) that the company is permitted to remove and sell.

ASSIGNMENT CLAUSE: An assignment clause permits the company to sell or transfer its lease and rights under it to a third party.

LAND USE RESTRICTIONS: A land use restriction restricts the landowner's use of the leased area for other purposes (e.g., hunting).

CHOICE OF LAW (OR VENUE): A choice of law clause or restriction in a lease requires that any lawsuit between the lessor and lessee be heard in a particular state, usually the state that the lessee chooses. For example, if the company is from Texas, the clause may require that any litigation be filed in the state of Texas and adjudicated under Texas law, even if the lease is on Mississippi soil and the other parties to the lease are residents of Mississippi.

TITLE: Title is technically defined as a bundle of rights which constitute ownership in property. The word "title" is also used to designate the means by which a property ownership may evidence his title or ownership (the acts, instruments or records which prove ownership, e.g., a deed).

STAND UP and SIT DOWN TITLE EXAMINATIONS: STAND UP examinations are title examinations that are obtained from direct examinations of the county records. SIT DOWN examinations are title examinations that are obtained from an examination of abstracts.

TITLE OPINION: A title opinion reveals an attorney's conclusions concerning the ownership of a tract of land and its underlying minerals. They generally express who owns the property (surface) and underlying minerals, and contains reservations, qualifications and exceptions. Faulty title opinions can expose a title attorney to

malpractice liability for material errors and omissions. Most attorneys will have malpractice insurance which will cover any errors.

The LANDMAN, ABSTRACTOR and the TITLE ATTORNEY: The landman will generally conduct a STAND UP examination by searching the indices in the land record books in the Chancery Clerk's office, and run a chain of title. His search is not extensive (and he is often not an attorney). The landman will also often perform a SIT DOWN examination as well, from an abstract which has already been developed. Due to his expertise, the landman can often "cure" title defects, investigate "breaks" in the chain of title, and develop other facts from which some cures can be made that might require judicial intervention. The title attorney will examine the instruments which are located in the land records and prepare a title opinion which sets forth his opinion of the owners of the surface and minerals. This opinion will note the issues and irregularities set forth above. The abstractor searches records and files pertaining to a specific property in order to find its *history.* This is generally referred to as a "chain". Abstractors will generally chain a title back at least 10 years, but more often 31 years. In abstracting for oil companies, the abstractor will usually go back to the sovereign (when the title was obtained from the state).

MARKETABLE TITLE: A marketable title is a title that is free from reasonable doubt, such that a prudent person, with knowledge of all salient facts and circumstances and their legal significance, would be willing to accept it. Title is generally NOT considered marketable if:

1. A reasonable chance exists that a 3rd party could challenge the validity of the title against the record owner;

2. Parol evidence (extraneous evidence such as oral testimony that is not included in a relevant written document) is necessary to remove doubt as to the validity and sufficiency of the owner's title;

3. The title rests on a presumption of fact that would probably become a fact issue to be decided by a jury in the event of a lawsuit;

4. The record discloses outstanding interests in the property that could reasonably subject the property owner to litigation or compel the owner to result to parol evidence to defend his title against outstanding claims; and/or

5. The property is unreasonably encumbered.

The 4th question to ask: *Do I really want to do this?*

Assuming that everything is favorable thus far, you want to consider whether you really do want to lease minerals that you may own. While $$ dollar $$ signs may dance in your eyes, you also need to realize that a mineral lease to a mineral exploration and production company does not just result in a check. Because exploring for minerals, and if they exist, getting them out of the ground, is a hands-on task, things will go on at the surface level of your property that you must anticipate. For example, if you live on the plot of land that you are leasing, or if you farm it, run cattle, or cultivate timber, there will be people other than you on the property. Their interests will, in many ways, not be your interests. They will have an obligation to protect, and not waste, your property, but their idea of "protection" and yours may diverge. For example, it is highly unlikely that they will worry about damage to your award-winning rosebushes unless that is brought to their attention and written into the contract.

Remember that the $$ dollar $$ signs may be just that: only visions. Royalties depend on the value of production. Not only are royalties unreliable (they go up and down – unsteadily - and generally decrease after time) and there is a chance that the leasing company does not plan to drill at all during the lease period. Moreover, if and when your assets in the well are depleted, your mineral rights are worthless, you will receive no more royalties, and no other company will purchase your rights.

The leasing of mineral rights may involve complicated legal procedures, disputes and disagreements during extraction and production. If you have not taken into consideration everything you needed to during the negotiation sage, you cannot stop the operator, even if you want to. You must endure.

Most income from a mineral rights sale is taxed at the capital gains rate, but income from royalty and bonus payments from a lease is charged at ordinary income rates. It may be beneficial to sell the mineral rights rather than lease them, for tax purposes. Talk with your tax professional.

There are extensive accounting hassles which accrue with monitoring the drilling process, payments and pending payments, as well as checking the accuracy of the accountings that the company will provide you. You may or may not have the capacity to attend to this yourself; if you do not, this will be an additional expense, because you will have to rely on your tax professional. But you cannot afford not to monitor this information.

There are often unanticipated impacts on the surface owner's property. For example:

1. There may be a diminution in the quality and/or quantity of the surface owner's water supply.

2. While all environmental laws may be complied with, there can always be unanticipated environmental damage.

3. Disagreements which are significant will result in litigation, arbitration, or some other means of dispute resolution (the nature of which is usually established in the lease). Dispute resolution of any nature is time consuming and expensive.

4. Are you providing authority for underground storage of gas, oil or brine, or any other matter? Are you informed about risks?

5. Is production going to be going on at varying depths? What impact will that have on the surface areas of the property?

6. Do you have free access to books, records and drilling data related to operations on your premises?

7. What will happen to the casings in the borehole when the company abandons operations? What value are the casings to you, and why?

8. What remedy do you have if the lessee breaches a covenant contained in the lease? Ensure that you know your remedies and that your lessee pays reasonable attorneys fees and reasonable investigative costs if you bring litigation for the breach and prevail.

9. Do you have an indemnification agreement? You want a lease to require the lessee to hold the lessor (you) harmless from all claims, demands and causes of action stemming from activities undertaken by the lessee or the lessee's assignees, their employees, agents, contractors and subcontractors, during all operations conducted on the lease premises. (As an alternative, require the lessee to post a bond and carry comprehensive liability insurance in a specified amount as added security from such claims, with the lessor named as an additional insured on the lessee's liability insurance.)

10. If you enter into an agricultural lease, hunting lease, or purchase surface rights to land which are void of any mineral interests, make sure that you contact the owners to be assured that there are no pending mineral leases, and/or contract with the owners of mineral interests that will protect you by including a surface damage clause in your favor in the mineral lease. This will ensure any damage to your crops of land usage.

This short analysis is not intended to reflect individualized legal advice of any sort. Its intent is advisory only, Do not rely on this analysis alone when making any legal decisions relative to mineral leases or any other legal decision.

About the author: Lydia Quarles is an attorney and Senior Policy Analyst at the Stennis Institute, Mississippi State University. She received her JD from Cumberland School of Law, Samford University, her MA and BA from Mississippi University for Women, and a graduate certificate in Diversity Training from Mississippi State University. A litigant and former commissioner of the Mississippi Workers' Compensation Commission, as well as an administrative judge in the agency, she resigned in 2006 to join the Stennis Institute. She is a Mississippi Bar Fellow, recipient of the Mississippi Bar's Distinguished Service Award, and has been recognized as a leader in women's issues and participation in the Bar as well as in the field of public administration, having received both the Susie Blue Buchanan Award from the Mississippi Bar, the Mary Lawton Award from the American Bar Association and the Joan Fiss Bishop Award from the American Society of Public Administration. Contact Lydia at lydia@sig.msstate.edu