

What you need to know about mineral rights

Learn what recently changed in the mineral addendum and how to use it properly, plus get a primer on what mineral rights entail.

by Charles Porter



The typical real estate transaction involving mineral rights issues is complicated. The well-publicized shale oil and gas boom of the past decade caused Texans to realize the value and consequences of mineral rights, leases, and royalties at a level not seen since the oil boom of the 1980s.

Traditionally, negotiations between buyers and sellers of mineral rights occurred over properties located in rural settings. The *Farm and Ranch Contract* (TAR 1701, TREC 25-10) is used for many of these transactions. But now, shale oil and gas drilling is rapidly spreading into or near urban areas, especially those in the Barnett Shale area located around Dallas-Fort Worth. This change has happened for two reasons:

1. Horizontal subsurface drilling in lengths up to one mile opened up drilling in many urban areas, especially in outlying suburbs.
2. The amount of money involved in oil and gas leasing and drilling can be significant.

Negotiations in these new types of single-family residential transactions involve the following issues:

- What, if any, mineral rights are owned by the seller?
- What portion of the mineral rights will transfer to the buyer?
- What portion, if any, of the mineral rights will the seller reserve or retain ownership of?

Last spring, TAR initiated a task force of farm and ranch and residential

brokers, oil and gas attorneys, and TAR staff to clarify the *Addendum for Reservation of Oil, Gas, and Other Minerals* (TAR 1905, TREC 44-2) for the benefit of farm and ranch brokers who consistently use the form and brokers now using the form in residential transactions. The task force made recommendations to TREC on proposed changes to the addendum, which TREC adopted on Nov. 18, 2014. The revised form is now available for voluntary use in zipForm and the *Forms* section of texasrealestate.com. It becomes mandatory on March 1.

The difference between the old and new addendum

The revisions to the *Addendum for Reservation of Oil, Gas, and Other Minerals* add more details to help



parties understand what comprises the mineral estate. The definition of *executive rights* has also been clarified along with other terms to help buyers and sellers better understand a mineral estate.

Section A is now more detailed and clarifies what *mineral estate* means. This revision explains what is and is not included in a mineral estate. The mineral estate does *not* include water, sand, gravel, limestone, building stone, caliche, surface shale, near-surface lignite, and iron. It does include the reasonable use of these surface materials for mining, drilling, exploring, operating, developing, or removing oil, gas, and other minerals from the property. The mineral lessee has the right, pursuant to the terms of the mineral lease executed by the executive

rights holder, to use as much of these surface materials as is “reasonably” needed to explore and develop the minerals. Permission from the surface owner is not necessary, as the mineral estate prevails over the surface estate in Texas. The negotiated terms of the mineral lease, however, could include specific limitations about use of these surface materials.

Section B identifies the choice the seller makes between (1) reserving all the mineral estate or (2) any portion thereof. This section is written to make the seller’s basic choice quickly understandable. The first revision to this section is a reminder that the seller’s chosen option is subject to options taken in Section C. The other revision added “or fraction” to allow the seller to express the reservation in the mineral estate as a percentage (e.g., 25%) or a fraction (e.g., one-quarter).

Section C further clarifies the parties’ negotiated agreement concerning “implied rights of ingress and egress and of reasonable use of the Property,” with details of the typical reasonable uses. The note reminds the parties that *other* parties may have rights that supersede those negotiated between the buyer and seller of the surface real estate in the current transaction. This revision also provides a warning to the parties to be very careful.

Section D requires sellers who do not reserve all of their interest in the mineral estate to provide the buyer, within seven days after the effective date of the contract, the contact information of any existing mineral lessee “known” to the seller. This is a buyer protection mechanism and provides



The basics of mineral rights and oil and gas leases

In Texas, oil and gas are often the only minerals of special focus in real estate negotiations. These negotiations center on ownership of the mineral estate due to the potential of future oil and gas lease payments and royalty checks from production. In most situations, the way future income potential is realized is through a front-end lease payment known as a *bonus payment*, which secures the lease coupled with language in the lease (typically three years long) that confirms a percentage of royalty from the sales of the oil and gas extracted.

The bonus payment can range from a few hundred dollars per acre to, in highly productive shale areas, many thousands of dollars per acre. Royalty payments typically range from 20% to 25% of the gross revenue from the oil and gas produced. The payment is based on the gross revenue, not net revenue after expenses of drilling and extraction are subtracted.

For example, in the Eagle Ford shale area, a landowner owning 100% of the oil and gas mineral estate on a 100-acre tract could have received \$1,000 per acre in the upfront lease bonus (\$100,000), and also received 20% royalties on the gross revenue of a well. Say the well produced 1,000 barrels of oil a day at \$100 per barrel, the annual royalty check would equal \$7,300,000. Even if the well produced 100 barrels a day at \$80 per barrel, the annual royalty check would equal \$584,000.

Wells in the Eagle Ford decline rather quickly, then level off for five to 10 years. Even if the well declines to 10 barrels a day at \$80 a barrel, then the check annually will still be \$58,400 for a number of years.

full disclosure of all commitments on the property in a timely manner. Prior to this revision, this requirement was to be fulfilled “on or before the Closing Date,” which could have been past the option period in the contract and too late for the buyer to cure or object to the information without being subjected to loss of earnest money or other penalty.

The final change is the “Important Notice.” This notice describes TREC’s intent and main message in this form. It is critical to warn the parties yet again that determining the nature and characteristics of any mineral estate is highly complex and necessitates consultation with an attorney if the seller or buyer has any questions about their respective rights and interests. This important paragraph is congruent with the common warning found in all TREC promulgated forms: *Consult an attorney!*

Consulting an attorney is a prudent practice to prevent disagreements between buyers, sellers, and real estate licensees, and hopefully avoid unknown and unintended consequences of the transaction in the future.

When to use the form

Although it’s optional to use this form with the *Farm and Ranch Contract*, it is required when the seller is reserving mineral interests and using the *One to Four Family Residential Contract (Resale)* (TAR 1601, TREC 20-12) or other residential contracts promulgated by TREC. The heading of the form itself makes it clear: “*NOTICE: For use only if Seller reserves all or a portion of the mineral estate.*” If the seller is not reserving any of the mineral estate, don’t use the form. Remember, seek the advice of an attorney if the client has any questions.

Your duties involving mineral rights

With the increase of oil and gas drilling in and near residential areas, Texas REALTORS® who haven’t dealt with issues involving the mineral estate are facing new challenges in their transactions. But what are you required to do, or allowed to do, when it comes to mineral rights?

If a question arises about the ownership of the mineral estate to a property, or who holds a mineral lease, or who holds the executive rights, would these questions be considered something pertinent that must be disclosed? Absolutely.

Since the revenues from shale oil drilling can be lucrative and significantly impact the value of the property in the transaction, licensees who ignore or have no general knowledge about oil and gas activities in their geographical area of practice could be held liable for violations of the standard of care outlined in the Texas Real Estate License Act, TREC rules, and NAR’s Code of Ethics.

Another reason to inform clients about the mineral estate is to help them assess their risk in selling or purchasing the property, especially in cases when all the minerals were severed long ago and the current owner does not hold the executive rights. Keep in mind that the rights of the mineral owners, their lessees, and the holder of the executive rights come first and dominate over the surface owner’s rights. This is important for a new buyer to understand, especially for situations in which those rights are in the exclusive control of someone else.

Extra time in the option period is negotiable between the parties, but it might be a good idea to encourage the parties to agree to a reasonable time period to work out their complete understanding of all the key elements of this complicated transaction.

Don't forget that, as a real estate licensee, you are not allowed to practice law unless you have a license to practice law in Texas. Similarly, real estate licensees cannot practice engineering, geology, or other professions unless they are qualified to do so.

The Code of Ethics also prohibits REALTORS® from acting outside their area of expertise; NAR makes it clear that a REALTOR® should direct clients to professional resources to help them make informed decisions.

The Texas Real Estate License Act and TREC rules additionally outline your responsibility to disclose all *known* information to the client that would impact the client's decision to purchase; provide all *known* information about defects to potential purchasers while they are making their decision to purchase; and avoid misrepresentation by acts of commission or omission, among others.

The increase in oil and gas activity is changing the real estate landscape, but your responsibilities remain the same. By understanding the latest issues surrounding minerals, you'll maintain your significance as part of the real estate transaction. ★

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How to determine who owns mineral rights

A buyer or seller can hire an oil and gas attorney or a representative of the oil and gas drilling company, generally known as a "landman" or "petroleum landman," to attempt to identify all owners of the minerals and holders of the executive rights.

Discovering the true owner of the minerals and holder of the executive rights can be problematic. Why? As long ago as 1742 in Texas, individual water rights were severed from the land, establishing one of the earliest precedents to eventually allow the severance of minerals in Texas. After the famous 1901 Lucas Gusher exploded in the southeast Texas Spindletop oilfield, many severed mineral estates were created, and this practice continues relentlessly today. Many sellers have negotiated to keep the mineral rights for future income, even when they no longer own the surface of the land.

After more than a century of transactions severing the minerals and executive rights in infinite combinations, complicated further by the daily fragmentation of ownership of these rights due to normal inheritance processes, the path to determine today's true and marketable owner of the rights often is convoluted, murky, and difficult to ascertain.



What does ownership of mineral rights mean?

Landowners own the minerals on and under their property unless that ownership has been "severed," or transferred to someone else in a prior transaction. Severing the minerals under Texas law means ownership and control of the mineral estate are separated from the property in the transaction. In Texas, one can own the minerals yet not own any portion of the land surface. Unless severed, a landowner's mineral rights convey automatically with the deed upon sale of the property to the new owner.

According to Judon Fambrough, attorney at the Real Estate Center at Texas A&M University, the five mineral rights are:

1. The right to enter to explore and produce the minerals
2. The right to negotiate and sign a mineral lease (the executive right)
3. The right to receive bonus payments
4. The right to receive delay rentals
5. The right to receive royalty payments.

The two basic questions in oil and gas mineral right negotiations are:

- Who owns the minerals?
- Who has the right to execute a lease of those minerals?

The right to lease the minerals is commonly referred to as the *executive right*. The holder of the executive right can execute a lease of portions of the mineral estate to other parties no matter the holder's ownership percentage of the minerals.