ASSIGNING OIL AND GAS LEASES

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CHAPTER 20
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ASSIGNING OIL AND GAS LEASES

I. INTRODUCTION

Leases are assigned for any number of reasons, whether to bring in more capitalized investors to assist with the financial burden of operating the lease, or by a lessee who does not have the means or desire to drill a well. Whatever the purpose, all lease assignments serve to transfer ownership in the lease. An assignment accomplishes three acts: 1) it assigns rights and delegates duties between the assignor and assignee, 2) it allocates liabilities between the assignor and assignee and may create obligations in addition to those imposed by the oil and gas lease, and 3) upon recordation, it provides notice to the world that a transfer of an interest in the lease has taken place. David E. Pierce, An Analytical Approach to Drafting Assignments, 44 Sw. L. J. 943, 946 (1990). The assignee of an oil and gas lease owns a working interest in the leasehold, a share of gross production coupled with equal liabilities for the costs of exploration and production. In conjunction with the leasehold interest, those drafting oil and gas lease assignments should be careful to include any tangible or intangible property that the parties may need in order to develop the leases. It should be clear that the right to the leases includes the right to use pumpjacks, tanks, lines and other fixtures if necessary.

An overriding royalty interest is a non-operating interest that burdens only the interest of the assignor creating and transferring the overriding royalty. George A. Snell, III, Understanding Assignments of Oil and Gas Leases, 19th Adv. O. G. & Min. Law Course (State Bar of Texas – 2001). An overriding royalty interest, like conventional royalty interests, is a share of production free of the costs of production. The overriding royalty assignment may create other obligations upon the assignee or subject the interest to certain costs, such as severance taxes. An overriding royalty interest will expire upon termination of the underlying leasehold interest. Keese v. Continental Pipeline Co., 235 F.2d 386, 388 (5th Cir. 1956), 6 O&GR 364. The overriding royalty is an interest in the oil and gas produced at the surface and carved from the working interest held under and oil and gas lease. T-Vestco Litt-Vada v. Lu-Cal I Oil Co., 651 S.W.2d 284 (Tex. Civ. App. – Austin, 1983, no writ). It is a non-possessory interest in which the owner has no right to operate the property. Byrd v. Smyth, 590 S.W.2d 772 (Tex. Civ. App. – El Paso 1979, no writ).

Under the ownership-in-place theory that is the law in Texas, the mineral estate is a real property interest and covers the minerals situated within the surface boundaries of the land. Texas Co. v. Daugherty, 107 Tex. 226, 176 S.W. 717, 721 (1915). The oil and gas lease creates an interest in real property and any assignment thereof is subject to the rules governing conveyances of real property. Cherokee Water Co. v. Forderhause, 641 S.W.2d 522, 525 (Tex. 1982). As George A. Snell, III, notes, care should be taken to distinguish between a working interest and a leasehold interest. Understanding Assignments of Oil and Gas Leases, 19th Adv. O. G. & Min. Law Course (State Bar of Texas – 2001). The leasehold interest refers to a specific lease or specific part of a lease, whereas the working interest is a share of gross production and concurrent liability for the costs of exploration and production. When discussing a single oil and gas lease, the working interest and leasehold may be the same. However, a working interest may refer to several leases or lands, and would be separate and distinct from the individual leasehold interests. Snell draws attention to Miller v. Schwartz, 354 N.W.2d 685 (N.D. 1984), in which the court leaves room to argue that an assignment of working interest made without reference to underlying leases would result in an ambiguous conveyance, especially if the leasehold acreage exceeds the acreage attributable to the assignor’s producing wells. Understanding Assignments of Oil and Gas Leases, 19th Adv. O. G. & Min. Law Course (State Bar of Texas – 2001). As a real property conveyance, oil and gas lease assignments may be subject to implied warranties of title, that the grantor has not conveyed the estate or any interest in the estate to a person other than the grantee; and that at the time of the execution of the conveyance the estate is free from encumbrances. Tex. Prop. Code Ann. § 5.023 (Vernon 1984). Although quitclaim-like language is often used in assignments, such as “all of assignor’s right, title, and interest,” it is not considered a quitclaim under Texas law. A deed (or assignment) which purports to convey all of the grantor’s undivided interest in a particular tract of land will afford the grantee the protection of a bona fide purchaser. Bryan v. Thomas, 365 S.W.2d 628, 630 (Tex. 1963). The Bryan court relied in part upon an earlier decision in Cook v. Smith, 107 Tex. 119, 174 S.W. 1094 (1915), in which the Cook court concluded an instrument granting “all my right, title and interest”, coupled with a statement indicating the grantor wished to convey all of the property in owned by the grantor in town, whether set out in the deed or not, conveyed the property itself, not only the title of the grantor. Id. at 1095. An assignment of an oil and gas lease is void as to third parties without notice unless recorded as required by law. Tex. Prop. Code Ann. §13.001 (Vernon 1984).

The rules of construction applied to assignments are stated clearly in Rogers v. Ricane Enterprises, Inc., 852 S.W.2d 751, 756-57 (Tex. App. – Amarillo 1993), rev’d, 884 S.W.2d 763 (Tex. 1994). The Rogers court found: In construing an instrument of this type we should ascertain, and give effect to, the intention of the parties as gathered from the entire instrument, together...
with the surrounding circumstances, unless that intention is in conflict with some unbending canon of construction or is repugnant to the terms of the grant. Coker v. Coker, 650 S.W.2d 391, 393 (Tex. 1983);… The instrument must be considered as an entirety and each paragraph must be considered with reference to every other paragraph so that the effect of one on the other may be determined. See Coker v. Coker, 650 S.W.2d at 393. It must be presumed that each provision was placed in it for a particular purpose and a construction which would render any provision meaningless should be avoided. Coker v. Coker, 650 S.W.2d at 393. Provisions which are in apparent conflict must be reconciled and harmonized whenever possible so that the instrument as a whole may be given effect.…. 

Upon this basis of Texas law regarding oil and gas conveyances generally, and assignments of leases and overriding royalty interests specifically, this paper discusses typical drafting problems associated with the description of interests assigned, the application of the Duhig rule to assignments, problems associated with proportionate reduction and overriding royalty assignments, and the complexity of horizontal severance. A number of model lease clauses are included in order to better illustrate how these problems can be overcome.

II. DESCRIBING THE INTEREST ASSIGNED

A. Descriptions of Land

A typical assignment of oil and gas leases will grant all of the assignor’s interest in a lease, a specified percentage of assignor’s interest in a lease, or a specified amount of the oil and gas lease. George A. Snell, III, Understanding Assignments of Oil and Gas Leases, 19th Adv. O. G. & Min. Law Course (State Bar of Texas – 2001). As discussed herein, the assignment of an oil and gas lease is a conveyance of a real property interest, and is thus controlled by Tex. Prop. Code Ann. §5.001 (a) (Vernon 1984):

An estate in land that is conveyed or devised is a fee simple unless the estate is limited by express words or unless a lesser estate is conveyed or devised by construction of law. Words previously necessary at common law to transfer a fee simple estate are not necessary.

Any assignment must first accurately define the area, lands or leases being assigned, and then describe the rights and liabilities associated with the assignment. In order to comply with the Statute of Frauds as it exists in Texas, the description must identify the lands with reasonable certainty. Tex. Prop. Code Ann. §5.021 (Vernon 1984). This does not mean the description must be by metes and bounds, it merely needs to describe the land sufficiently to avoid the use of extrinsic evidence. Williams v. Ellison, 493 S.W.2d 734 (Tex. 1973). Extrinsic evidence can be used to identify the land with reasonable certainty from the data in the memorandum, but not to supply the location or the description of the lands. Wilson v. Fisher, 144 Tex. 53, 188 S.W.2d. 150 (1945). If the lack of reasonable certainty applies to lands excluded or specifically excepted from the grant, then that defect will only apply to the excluded lands. Hornsby v. Bartz, 230 S.W.2d 360 (Tex. Civ. App. – El Paso 1950, no writ). Title to the excluded tract would then pass with the larger tract to the grantee.

The Chain of Title Rule applies to an assignment of a leasehold interest, as explained in Westland Oil Development Corp. v. Gulf Oil Corporation, 637 S.W.2d 903 (Tex. 1982):

[A] purchaser is bound by every recital, reference and reservation contained in or fairly disclosed by any instrument which forms an essential link in the chain of title under which he claims… The rationale of the rule is that any description, recital of fact, or reference to other documents puts the purchaser upon inquiry, step by step, from one discovery to another and from one instrument to another, until the whole series of title deeds is exhausted and a complete knowledge of all the matters referred to and affecting the estate is obtained. This Rule works in conjunction with the “nucleus of description” theory, wherein insofar as the description of the property is concerned, the writing must furnish within itself, or by reference to some other existing writing, the means or data by which the particular land to be conveyed may be identified with reasonable certainty. Wilson v. Fisher, 144 Tex. 53, 188 S.W.2d 150, 152 (1945); Gates v. Asher, 154 Tex. 538, 280 S.W.2d 247 (1955). The key is that the deed itself contains the data identifying the land. For example, a grant of all the land owned by the grantor in XYZ County would be upheld, as extrinsic evidence can now be used to show what the grantor owned in that area. Texas Consolidated Oils v. Bartels, 270 S.W.2d 708 (Tex. Civ. App. – Eastland 1954, writ ref’d).

Minor discrepancies generally will not cause failure in the description of the conveyance. In Turner v. Sawyer, the court gave effect to the parties intent to describe a call to the northeast corner of a survey, rather than the call t the southeast corner as stated in the deed. 271 S.W.2d 119 (Tex. Civ. App. – Eastland 1954, writ ref’d n.r.e.). Courts may also overlook errors in the volume or page number of referenced instruments. Overand v.
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Assignor conveys all (or a specified part of) his interest in the oil and gas leases identified in Exhibit A attached hereto but insofar as they cover the borehole rights in the Exxon – Smith No. 1 well located 467” FNL and FWL of Section 56, Block 43, H&TC Ry. Co. Survey, Lipscomb County, Texas.

Specific problems cited by George A Snell, III, include:

(a) If the number of acres covered by the assignment is not clear, it may be difficult to determine what share of production should be allocated to the assignee in the event of a subsequent pooling that allocates production on an acreage ratio;

(b) It may be uncertain what surface area the assignee may use for future facilities, such as tanks, flow lines, and treatment equipment. If the borehole assignment were interpreted to include the area that may be drained by multiple formations, the shape of the surface acreage covered by the assignment could be nearly impossible to determine, because of future expanding or contracting depending upon the particular

Slight changes to the language used, or subtle calls to an identifying description can make valid an otherwise void conveyance. The inclusion of the identifying phrase “my property” in the description “my property of 20.709 acres out of the John Stephen 640 acres Survey in Tarrant County, Texas” transformed such an otherwise void conveyance into an enforceable one in Pickett v. Bishop, 148 Tex. 207, 223 S.W. 2d 222 (1949). The phrase “subject to”, when used to limit a grant or provide for a reservation must be clearly drafted in order to avoid confusion. In some cases, the grantee may be forced to bear the entire “subject to” burden, rather than a proportionate part.

Bass v. Harper, 441 S.W.2d 825 (Tex. 1969). The Bass court concluded that a grant of an undivided 1/2 interest made subject to prior deeds reserving 3/7 of the royalty did not limit the grant to what the grantor owned; rather the grant itself was subject to the prior reservations and the grantee was left with 1/14 of the royalty. Bass v. Harper, 441 S.W.2d 825 (Tex. 1969).

A common problem in assignments of oil and gas leases is the assignment of a drill site. The term drill site itself is generally too vague, while identifying the drill site as a specific proration unit subjects the conveyance to the actions of a regulatory agency. George A. Snell, III, Understanding Assignments of Oil and Gas Leases, 19th Adv. O. G. & Min. Law Course (State Bar of Texas – 2001). A similar problem is the attempted assignment of the well itself, rather than a right to the underlying leasehold, often referred to as a “borehole” or “wellbore” assignment. The intent may be for the assignee to gain a right to production and share in the costs related to a specified well, but may prevent the assignee from entering the land to use the surface, deepening or reworking the well should production cease, and certainly drilling a replacement well. David E. Pierce, An Analytical Approach to Drafting Assignments, 44 Sw. L. J. 943, 955 (1990). Even with a well drafted assignment, such as this one provided by George A. Snell, III, other problems arise:

Menczer, 82 Tex. 122, 18 S.W. 301 (1892). Omission of a call in a metes and bounds description will also not lead to failure of the description when the missing call is found in other instruments in the chain of title. Montgomery v. Carlton, 56 Tex. 431 (1882).

Descriptions which may seem vague may nevertheless be valid. Use of the phrase “more or less” is commonly used, especially in reference to other identified instruments which may contain a more specific description. However, if the “more or less” modifier forms part of the description itself, rendering it impossible to identify the boundaries of the tract, is indefinite and void. Wooten v. State, 142 Tex. 238, 177 S.W.2d 56 (1944). Likewise, when a tract of land is described as “out of” a larger tract, without further reference or clarification, the conveyance is void. Republic National Bank v. Stetson, 390 S.W.2d (Tex. 1965). William B. Burford notes that this issue can raise serious problems when the description is “40 acres in the form of a square around the Smith No. 1 Well” when the location of the well itself is not specified. Conveyances and Reservations of Mineral and Royalty Interests, 19th Adv. O. G. & Min. Law Course (State Bar of Texas – 2001). As noted in Smith v. Sorelle, if the subject-matter sought to be conveyed is not described sufficiently to identify same, the requirements of the statute of frauds have not been met, and the instrument is void. 126 Tex. 353, 87 S.W.2d 703, 705 (1935). Yet the descriptive words in an instrument should be given liberal construction, in order that the writing may be upheld, and parol evidence is admitted to explain the descriptive words and to identify the land. Id at 705. In fact, although the description is uncertain and ambiguous, if the land intended to be conveyed can be identified by the aid of extrinsic testimony, the deed is not void. Kuklies v. Reinert, 256 S.W.2d 435, 443 (Tex. Civ. App. – Waco 1953, writ ref’d n.r.e.). In order to identify the land conveyed, in cases where the meaning of the descriptive language is ambiguous and susceptible of more than one construction, it is proper for the court to look to the circumstances surrounding the transaction to determine the intention of the parties. Texas Osage Co-op Royalty Pool v. Thomas, 270 S.W.2d 450, 454 (Tex. Civ. App. – Eastland 1954, writ ref’d n.r.e.).
formation from which oil or gas is produced at any given time;

(c) If the borehole assignment is construed to transfer the assignor’s leasehold rights with respect to the area that can be drained by the borehole drilled, then the question arises whether such area means:

1. The area that can be drained as to the formation in which the well is currently or initially producing;
2. The area that can be drained with respect to formations in the wellbore which are known to be productive, whether or not currently producing;
3. The area that can be drained from any formation in the wellbore as it currently exists;
4. The area that can be drained from any formation by the existing well or any deepening thereof;

(d) If the assignment were interpreted to include all the acreage in a drilling unit or proration unit but the assignment does not grant the right to the assignee to drill an additional well, would a strict interpretation of the assignment be that neither assignor nor assignee would have the right to drill an infill well;

(e) If the borehole assignment refers to an existing well, may the assignee deepen the well to produce from deeper formations? If not, does the assignor have access to the wellbore to extend the well to the deeper formations;

(f) If the existing well is ruined as a result of an accident or other problem, is there any right on the part of the assignee to drill and produce from a replacement well?

Understanding Assignments of Oil and Gas Leases, 19th Adv. O. G. & Min. Law Course (State Bar of Texas – 2001).

In order to somewhat mitigate these issues, the following language could be added:

For regulatory purposes only, assignee shall have the right to use and assign as much as ____ acres around such borehole for permitting and allowable purposes, provided the use or assignment of such acreage does not impede, impair or curtail assignor’s rights to acquire drilling permits or to maximize allowables for assignor’s wells, including wells assignor may drill on acreage otherwise assigned to said borehole by assignee. Understanding Assignments of Oil and Gas Leases, 19th Adv. O. G. & Min. Law Course (State Bar of Texas – 2001).

Most cases of record concerning errors in land descriptions discuss mineral or royalty deeds. However, a few cases directly address assignments of oil and gas leases and help illustrate the principles discussed above. In Tenneco Oil Co. v. Alvord, 416 S.W.2d 385, 387-388 (1967), 26 O&GR 710, the assignor assigned all of its right, title and interest in certain oil and gas leases subject to an unrecorded letter agreement wherein title to each of the currently producing wells remained with the assignor. The successor in title to the assignor argued that this exception was a reservation of the mineral estate to the base of the deepest well at the time of the assignment. The court disagreed and found that the assignor conveyed all of his interest in the leases and that title to the excepted wells did not reserve a particular depth, horizon or formation.

Westland Oil Development Corp. v. Gulf Oil Corporation, 637 S.W.2d 903 (Tex. 1982), referenced above, showcases the importance of the chain-of-title doctrine and nucleus of description theory. Westland argued that a letter agreement provided two descriptions of lands with enough certainty to be valid. The first description – “[a] leasehold interest affecting any of the lands covered by said farmout” – was upheld by the Supreme Court, although the second, “under lands in the area of the farmout acreage” did not identify the property with reasonable certainty. While referenced documents may aid in the description of land conveyed, their terms and benefits are not necessarily binding on an assignee. In Riley v. Meriwether, 780 S.W.2d 919 (Tex. App.- El Paso 1989, writ denied), 111 O&GR 336, an assignment of leases was made for a specified term and so long thereafter as oil and/or gas is produced. The assignments made reference for all purposes to oil and gas leases described in an attached exhibit, and the referenced oil and gas leases contained shut-in royalty clauses. Production was obtained, the wells were shut-in, and shut-in royalty was paid to the lessors. During the period the wells were shut-in, the term of the assignment came to an end. The court found that payment of shut-in royalty, which maintained the leases, did not maintain the assignment itself. Referencing the base leases did not incorporate the shut-in royalty clause into the separate habendum clause of the assignment. Riley, 780 S.W.2d at 924-925. These terms could have been tied together contractually, as seen in Southland Royalty Co. v. Humble Oil & Refining Co., 151 Tex. 324, 249 S.W.2d 914 (1952), 1 O&GR 1431.

B. Descriptions of Quantity

Many leasehold and overriding royalty assignments rely on fractions or percentages to describe the quantity transferred, and errors in drafting can lead to unexpected results. Double fractions and over conveyances may lead to either assignor or assignee failing to attain their intended outcome.
Making a grant of an undivided or fractional interest of oil and gas leases, coupled with a fractional reservation of overriding royalty, can lead to problematic construction of the instrument by the courts. In *Hooks v. Neill*, 21 S.W.2d 532 (Tex. Civ. App. – Galveston 1929, writ ref’d), the grantor conveyed an undivided ½ mineral interest while reserving “one-thirty-second part of all oil on and under the land and premises herein described and conveyed.” The inclusion of the word conveyed, the court found, meant that the reservation was of 1/32 of the oil of the undivided ½ mineral interest, or 1/64 part of all oil. 21 S.W.2d at 538. Other courts have come to similar conclusions. See *Dowda v. Hayman*, 221 S.W.2d 1016 (Tex. Civ. App. – Fort Worth 1949, writ ref’d). Subtle decisions in word choice may be able to preserve the intended reservation of the grantor, as seen in *King v. First National Bank*, 144 Tex. 583, 192 S.W.2d 260 (1946). In *King*, the questionable reservation read: “an undivided one-eighth (1/8) of the usual and customary one-eighth royalty interest reserved by the land-owner in oil and gas and other minerals that may be produced from the hereinabove described land”. Since this reservation was tied to the land described, rather than conveyed, the court construed it to be a reservation against the entirety of the land described. 192 S.W.2d at 262. The court in *Middleton v. Broussard*, 504 S.W.2d 839, 842 (Tex. 1974) described the ruling regarding double fractions thsly:

> Where a fraction designated in a deed is stated to be a mineral interest in land described in a deed, the fraction is to be calculated upon the entire mineral interest… where a fraction designated in a reservation clause is stated to be a mineral interest in land conveyed by the deed, the fraction is to be calculated upon the grantor’s fractional mineral interest.

It is important to note that when discussing reservations, the reservation must be made in clear language and not solely by reference to another conveyance. *Sharp v. Fowler*, 151 Tex. 490, 252 S.W.2d 153 (1952). However, references made “for all purposes” may accomplish a reservation as described in a prior conveyance. *Harris v. Windsor*, 156 Tex. 324, 294 S.W.2d 798 (1956). Double fractions often occur outside of a reservation, as in the creation of an overriding royalty interest. A leasehold interest will also receive a share of gross production less than the full estate, in order to account for the royalty given the landowner. Any assignment of overriding royalty interest from the leasehold should be clear to state whether that overriding royalty is a share of the entirety of the gross production, or a share of the assignor’s share of gross production. See David E. Pierce, *An Analytical Approach to Drafting Assignments*, 44 Sw. L. J. 943 (1990).

The *Duhig* doctrine is applied when a conveyance and reservation amount to an interest greater than that owned by the grantor. In these cases, it is the grantor who will suffer a reduction or diminution of the reserved portion. A conveyance of land without reservation includes all of the minerals and mineral rights. *Schittler v. Smith*, 128 Tex. 628, 101 S.W.2d 543, 544 (1937). In *Duhig*, the grantor owned ½ of the minerals in the land, and executed a warranty deed in which he reserved ½ of the minerals. The court relied on the general warranty to estop the grantor from claiming the ½ mineral interest the deed presumably conveyed. Title vested in the grantee through the after-acquired title doctrine. The intention of the parties was to grant ½ of the minerals to the grantee. 144 S.W.2d at 879-80. However, it is not necessary to resort to the warranty to make use of the *Duhig* Doctrine. In *Blanton v. Bruce*, 688 S.W.2d 908 (Tex. App. – Eastland 1985, writ ref’d n.r.e.), the conveyance in question, lacking warranty, conveyed a tract and reserved ½ of the minerals. The grantor owned ¼ of the minerals. The court concluded that if the deed intends to convey a definite interest in the property, the excess must be deducted from the grantor’s reservation. 688 S.W.2d at 913-14. Thus the grantor’s portion was reduced by the previously reserved ¼. The *Duhig* Doctrine applies whether discussing a mineral or royalty interest. See *Selman v. Bristow*, 402 S.W.2d 520 (Tex. Civ. App. – Tyler), writ ref’d n.r.e. per curiam, 406 S.W.2d 896 (Tex. 1966); *Jackson v. McKenney*, 602 S.W.2d 124 (Tex. Civ. App. – Eastland 1980, writ ref’d n.r.e.). It seems clear that the *Duhig* Doctrine could also then be applied to assignments of oil and gas leases, a real property conveyance, especially when reserving overriding royalties to the grantor.

### III. OVERRIDING ROYALTY INTERESTS: PROTECTION THROUGH PROPORTIONATE REDUCTION

An overriding royalty interest is a non-operating interest burdening the assignor or assignor’s successors who created the interest. When the assignor creates the interest, they will want to avoid confusion and insure that the interest created is not more than intended. As discussed above when referencing double fractions, an assignor of overriding royalty may intend to grant 1% of their share of production and unintentionally grant 1% of all production in the lease. A proportionate reduction clause serves to reduce the amount granted by the assignor to coincide with their interest in the leasehold, as in:

To the extent A’s leasehold interest in the assigned property covers less than 100% (8/8ths) of the mineral interest, B’s overriding royalty interest will be reduced in the proportion that A’s interest bears to 100% (8/8ths) of the mineral interest. In the event all or part of the assigned property is pooled or unitized with other
leasehold interests to form a drilling, spacing, or proration unit, or to effect field wide unitization, B’s overriding royalty interest shall be further reduced in the proportion of surface acreage covered by the assigned property included within the unit bears to the total acreage within such unit. Allocation of unit production on some basis other than surface acreage will require incorporation of the appropriate formula into the assignment. David E. Pierce, An Analytical Approach to Drafting Assignments, 44 Sw. L. J. 943, 960 (1990).

Lack of a proportionate reduction clause in an overriding royalty assignment has forced courts to interpret the assignment as being a percentage of the whole rather than a percentage of the assignor’s interest. First Nat’l Bank v. Kinabrew, 589 S.W.2d 137, 149 (Tex. Civ. App. – Tyler 1979, writ ref’d n.r.e.). Like the example used above, a well drafted proportionate reduction clause protects the assignor when: 1) the leases cover less than the entire mineral estate in the lands described in the leases; 2) the assignor owns less than 100% of the leases assigned; and 3) the leases assigned are subsequently pooled with other leases not included in the grant. George A. Snell, III, Understanding Assignments of Oil and Gas Leases, 19th Adv. O. G. & Min. Law Course (State Bar of Texas – 2001).

Aside from inclusion of a proportionate reduction clause in overriding royalty assignments, one must further decide how such an assignment will be shared if the original grantor of an overriding royalty interest assigns a portion of the leasehold to another. Normally the subsequent leasehold assignee and the original assignor will share the burden of the overriding royalty interest proportionately, but this may be upset if the overriding royalty interest has not been disclosed and the assignor gave warranty. The subsequent leasehold assignee may make a breach of warranty claim against the original assignor and seek an escape from the burden of the overriding royalty interest. See George A. Snell, III, Understanding Assignments of Oil and Gas Leases, 19th Adv. O. G. & Min. Law Course (State Bar of Texas – 2001). To prevent confusion, the parties may allocate burdens in advance:

Assignee agrees to bear its share of burdens created by any overriding royalty, production payment, or other third party rights to production, carved out of the lease and which were created, and properly recorded, prior to the date of this assignment (or a specified date to correspond with assignee’s examination of title). Assignee’s share of any burden will be proportional to its working interest ownership in the oil and gas lease from which the burden was created. David E. Pierce, An Analytical Approach to Drafting Assignments, 44 Sw. L. J. 943, 964 (1990).

IV. ISSUES RAISED BY HORIZONTAL SEVERANCE

The subsurface descriptions used in oil and gas lease assignment are rarely precise enough to determine with certainty where the depth severance exists. Horizontal severance clauses are intended by the parties to an oil and gas lease assignment to sever the rights to the mineral estate by some designated subsurface demarcation. It can be both a problem of language and a problem of geology. Typically, these clauses divide the subsurface by formation or by a call to a certain depth, as in 5,000 feet below the surface.

When dividing the subsurface by a call to a specific depth, the parties may not agree upon how to measure that depth. Is the depth stated from the rig floor, see level, or the surface? Is the depth stated measured by true vertical depth or through the borehole? As David E. Pierce notes, although measuring through the drill pipe always exceeds the true vertical depth as the drill pipe deviates from the vertical, it nevertheless is the preferred industry standard. An Analytical Approach to Drafting Assignments, 44 Sw. L. J. 943, 964 (1990). Confusion can also arise when the parties contend that a certain producing formation is divided by the horizontal severance. Parties may avoid this confusion by reference to the stratigraphic equivalent of the stated depth, but even that term is open to debate. As George A. Snell, III, describes, there are three different meanings for stratigraphic equivalent:

1. Time-Stratigraphic equivalents are the sediments deposited and the rocks formed during a specific time; i.e., in a given era, epoch, or age;
2. Bio-Stratigraphic equivalents are rocks that contain similar fossils;
3. Rock-Stratigraphic equivalents are mappable rock layers with distinctive top and bottom boundaries.

Understanding Assignments of Oil and Gas Leases, 19th Adv. O. G. & Min. Law Course (State Bar of Texas – 2001).

Despite these inconsistencies, the use of a stratigraphic equivalent is encouraged in drafting horizontal severance clauses:

Assignor conveys all of his interest in the leases attached hereto as Exhibit A from the surface to the stratigraphic equivalent of 14,200’ as identified in the Exxon-Smith No. 1 well located 467’ FNL & FWL of Section 56, Block 43, H&TC Ry. Co. Survey,
Lipscomb County, Texas. Understanding Assignments of Oil and Gas Leases, 19th Adv. O. G. & Min. Law Course (State Bar of Texas – 2001).

Once agreement as to the depth of the horizontal severance is made, the parties to an oil and gas lease assignment should reference the tangible and intangible property associated with the lease that may be affected by the horizontal severance. May the grantee enter boreholes traversing depths above the horizontal severance? To avoid confusion, David E. Pierce provides other model provisions clarifying the rights of the parties:

B. is also conveyed, to the extent necessary to reasonably explore, develop and operate the assigned interest, the right to enter and use the surface of the leased land and to drill and operate through [the mineral estate above the horizontal severance].... An Analytical Approach to Drafting Assignments, 44 Sw. L. J. 943, 964 (1990).

Should the assignment not be severed by a horizontal severance, and instead grant the rights to a specific formation, he adds:

A reserves from this assignment, to the extent necessary to reasonably explore, develop, and operate A’s retained leasehold interest, the right to drill and operate through the interest assigned to B. An Analytical Approach to Drafting Assignments, 44 Sw. L. J. 943, 964 (1990).

V. CONCLUSION

As real property interests, assignments of oil and gas leases and overriding royalty interests offer many opportunities to trap drafters of these instruments. Care should be taken to avoid common problems related to descriptions of land and quantity, problems associated with proportionate reduction clauses, and issues arising under a horizontal severance of the mineral estate. Sample clauses within this paper offer guidance to the oil and gas practitioner, but a close reading of the cases cited herein is recommended. Any oil and gas practitioner must apply local law and the specific circumstances at play when drafting an assignment of oil and gas leasehold, however David E. Pierce again provides a model assignment that can guide any drafter a copy of which is attached as Exhibit “A.”
EXHIBIT “A”

ASSIGNMENT

Big Oil Company (“Big”), for valuable consideration, conveys to XYZ Petroleum Corporation (“XYZ”), subject to the terms of this ASSIGNMENT, an UNDIVIDED 50% INTEREST in the following property:

a. Oil and Gas Lease between John Doe and Mary Doe as lessor and Larry Landman as lessee, dated September 15, 2002, recorded in Book 135, Page 152, of the Miscellaneous Records of Eureka County, Texas, covering the North Half of Section 30, Township 36 South, Range 10 East, in Eureka County, Texas (“Lease”).

b. All personal property, to include fixtures, currently located on the Lease and used or useable in connection with oil and gas exploration and production activities (“Personal Property”) [could itemize in assignment or incorporate an itemized list from a Bill of Sale].

The Lease and Personal Property are collectively referred to as the “Assigned Property.”

ASSIGNMENT terms:

1. NO WARRANTY. Big makes this ASSIGNMENT without any warranty, express, implied, or statutory. XYZ accepts the Personal Property AS IS, WITH ALL FAULTS. 2. ADMINISTRATION OF DELAY RENTAL, Big will pay 100% of the delay rental necessary to keep the Lease in effect. If Big fails to properly pay delay rental, thereby resulting in Lease termination, Big will pay to XYZ an amount equal to the greater of: (1) the price paid by XYZ as consideration for this ASSIGNMENT, or (2) the fair market value of XYZ’s interest in the Lease as of the date immediately prior to termination.

3. INDEMNITY. Big agrees to indemnify XYZ against any liability, claim, demand, damage, or cost arising out of a failure, prior to the date of this ASSIGNMENT, to fulfill the express or implied covenants created by the Lease. XYZ’s indemnity rights include reasonable attorney fees and litigation costs necessary to defend any matter covered by Big’s indemnity or to enforce Big’s obligation to indemnify.

4. ALLOCATING EXISTING BURDENS. In addition to lessor’s royalty rights created by the Lease, production from the Lease is subject to an overriding royalty retained by Larry Landman in an assignment by Larry Landman to Big dated September 20, 1988 and filed for record in Book 106, Page 24, of the Miscellaneous Records of Eureka County, Texas (“Landman Override”). To the extent the Landman Override continues in effect, and relates to production from the Lease, XYZ agrees to share in satisfying the Landman Override up to, but not exceeding, an amount equal to 50% of 1/16ths of 7/8ths of 8/8ths of production from the Lease. To the extent this is not sufficient to meet the requirements of the Landman Override, Big will pay or deliver the balance.

5. BINDING EFFECT. This ASSIGNMENT, and all related terms and conditions, are binding upon the successors and assigns of Big and XYZ.


Mary Smith, President
Big Oil Company
123 Mineral Lane
Oiltown, Texas 75275
SIGNED AND ACCEPTED 29 September 2002.

_________________________________
Betty Doe, President
XYZ Petroleum Corporation
456 Gusher Street
Oiltown, Texas 66762

ACKNOWLEDGMENT CERTIFICATE

Eureka County, Texas

This ASSIGNMENT was acknowledged before me on September 2002 by Mary Smith as President of Big Oil Company, a Texas corporation, and Betty Doe as President of XYZ Petroleum Corporation, a Texas corporation.

(Seal, if any)

_________________________________
John Thomas, Notary Public
My commission expires:_____