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Texas Wesleyan Law Review

Volume 17 | Issue 1 Article 5

10-1-2010

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Recommended Citation
James E. Key, *The Right to Royalty: Pooling and the Capture of Unburdened Interests*, 17 Tex. Wesleyan L. Rev. 69 (2010).
Available at: https://doi.org/10.37419/TWLR.V17.I1.4

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THE RIGHT TO ROYALTY: POOLING AND THE CAPTURE OF UNBURDENED INTERESTS

By James E. Key

DOI: https://doi.org/10.37419/TWLR.V17.I1.4

I. INTRODUCTION

The search for oil and gas involves tremendous expense and, traditionally, a vast element of chance.[1] Because of these factors, Texas follows the rule of capture.[2] Under the rule of capture, the one who captures fugitive oil and gas and brings it to the surface owns it.[3] However, problems can arise where mineral interests are undivided or there are prior reservations that fractionalize the royalty ownership.[4] This paper will examine the law regarding fractionalized royalty interests, how these interests may be captured or burdened by oil and gas leases and other agreements, and the right of the fractionalized royalty owner to receive and share in royalty.

II. METHODS OF POOLING AND PROBLEMS CREATED THEREBY

One reason pooling became so common, besides regulatory issues concerning minimum well spacing, was the judicially created doctrine of non-apportionment.[5] Pooling, either in the traditional sense or through a community lease, can result in the capture of otherwise unburdened interests. Interests may also be captured by including an entirety clause in the lease. Where interests are captured, problems frequently arise with respect to whom is entitled to royalty and in what proportion the royalty should be paid.[6]

A. *The Rule of Non-apportionment*

Where a mineral lessor sells a portion of the land to another, and oil and gas is thereafter produced from the leased premises, the royalty therefrom belongs to the owner of the tract from which the produc-

1. Japhet v. McRae, 276 S.W. 669, 671–72 (Tex. Comm'n App. 1925, judgm't adopted).

2. *Id.* at 671.

3. *Id.*

4. *See generally* Laura H. Burney, *Interpreting Mineral and Royalty Deeds: The Legacy of the One-Eighth Royalty and Other Stories,* 33 ST. MARY'S L.J. 1 (2001).

5. Bruce M. Kramer, *The Nuts and Bolts of Pooling: A Primer for the Uninitiated*, State Bar of Texas 24th Annual Advanced Oil, Gas and Energy Resources Law Course (2006).

6. Burney, *supra* note 4.

tion is obtained.[7] This is the rule of non-apportionment.[8] It is derived from the rule of capture and is illustrated by the following case.[9]

1. *Japhet v. McRae*, 276 S.W. 669 (Tex. Comm'n App. 1925, judgm't adopted).

This case stands for the proposition that absent contractual authority to the contrary, and where there is an oil and gas lease in place and a portion of the leased premises is later sold or partitioned, production belongs to the mineral owner of the tract from which the production is produced.[10]

Fisher signed an oil and gas lease for fifteen (15) acres.[11] Thereafter, Fisher sold five (5) of the 15 acres to Keeble. Keeble sold three (3) undivided acres out of the 5 to McRae.[12] Later, Fisher sold the remaining ten (10) acres to Keeble, who, in turn, and on the very same day, sold them to Japhet.[13] Nothing in the deeds provided for the apportionment of royalty, i.e., an entireties clause.[14] After Japhet bought his 10 acres, he persuaded the lessee to develop his land, which resulted in much oil being discovered on the 10 acres.[15] McRae and Keeble filed suit seeking 5/15 of the 1/8 royalty from the production, although their 5 acres were never developed.[16] The trial court denied recovery and awarded all of the royalty to Japhet, who owned the land where the producing well was drilled.[17] The Court of Appeals reversed and held that the royalty should be apportioned between Japhet, McRae, and Keeble.[18]

The Commission of Appeals reversed and held that McRae and Keeble, owners of the non-drill-site tract, were not entitled to any royalty from the production of oil on the neighboring tract.[19] In reaching its decision, the Commission of Appeals noted that oil and gas is a part of the realty until it is brought to the surface, and that it can be bought and sold in place.[20] Japhet bought the realty in the 10 acres, which included 1/8 of the oil and gas in and under the land.[21] While the lessee bought title to the oil through the oil and gas lease, Japhet

7. *Japhet*, 276 S.W. at 670.
8. *Id.* at 699.
9. *Id.*
10. *Id.*
11. *Id.* at 670.
12. *Id.*
13. *Id.*
14. *Id.*
15. *Id.*
16. *Id.*
17. *Id.*
18. *Id.*
19. *Id.* at 671.
20. *Id.*
21. *Id.*

retained the right to his 1/8 share once it was brought to the surface.[22] The law does not presume that the oil produced from the 10 acres was drained from the 5 acres and absent proof of drainage, Keeble and McRae were not be entitled to share in the production.[23]

Pooling is the bringing together of small tracts sufficient for the granting of a well permit under the applicable spacing rules.[24] The purpose of pooling is to prevent the physical and economic waste that accompanies the drilling of unnecessary wells.[25] A second purpose is to protect the correlative rights of landowners over a particular reservoir.[26] Texas courts have held that pooling effects a cross-conveyance among the owners of minerals under the various tracts, or royalty or minerals in a pool, so that they all own undivided interests under the pooled tract in the proportion their contribution bears to the overall pool.[27] A lease's pooling clause authorizes the lessee to pool the lessor's interests without the further consent of the lessor.

Unitization, on the other hand, is the joint operation of all or some part of a producing reservoir. The purpose is to permit the entire field, or a substantial portion of it, to be operated as a single entity, without regard to surface boundary lines. Therefore, unitization refers to the combination of most, if not all, of the separate tracts in the field into one tract so that the reservoir may be operated without regard to surface property lines.[28]

Absent express authority, a lessee cannot pool the lessor's interests with the interests of others.[29] Therefore, in order for pooling to be valid, it must be done in accordance with the method and purposes specified in the lease.[30] In other words, the lessor's land may be pooled only to the extent stipulated in the lease.[31] Because pooling of oil and gas interests is a matter of contract, an oil and gas lessee has no right to modify those terms through a subsequent, unilateral action unit designation.[32]

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22. *Id.*

23. *Id.* at 671–72.

24. Whelan v. Manziel, 314 S.W.2d 126, 132 (Tex. Civ. App.—Texarkana 1958, writ ref'd n.r.e.).

25. *See, e.g.*, Wagner & Brown, Ltd. v. Sheppard, 282 S.W.3d 419, 420–21 (Tex. 2007).

26. *Id.* at 424.

27. Montgomery v. Rittersbacher, 424 S.W.2d 210, 213 (Tex. 1968); Minchen v. Fields, 345 S.W.2d 282, 285 (Tex. 1961); Brown v. Smith, 174 S.W.2d 43, 46 (Tex. 1943); Veal v. Thomason, 159 S.W.2d 472, 475–76 (Tex. 1942).

28. *Id.*

29. Se. Pipe Line Co. v. Tichacek, 997 S.W.2d 166, 170 (Tex. 1999); Browning Oil Co., v. Luecke, 38 S.W.3d 625, 640 (Tex. App.—Austin 2000, pet. denied).

30. Jones v. Killingsworth, 403 S.W.2d 325, 328 (Tex. 1965).

31. *Id.*

32. Union Gas Corp. v. Gisler, 129 S.W.3d 145, 151 (Tex. App.—Corpus Christi 2003, no pet.).

A typical pooling clause may read as follows: "Lessee, at its option, is hereby given the right and power to pool or combine the acreage covered by this lease or any portion thereof as to oil and gas, or either of them, with any other land covered by this lease or with any other land, lease, or leases in the immediate vicinity thereof . . . ."

Because pooling effects a cross-conveyance of interests and allows the lessee to combine two or more tracts without the further consent of its lessors, pooling can result in the dilution of interests where smaller tracts are joined together to form large units. One way to limit the lessee's power to pool where larger acreage is involved is to include an anti-dilution provision in the lease.[33]

Where the royalty interest is fractionalized through one or more non-executive interests, issues can arise regarding the entitlement to royalty. In many cases, the parties can resolve those issues through ratification as discussed below in Sections III and IV.

B. *Community Leases*

A community lease is a form of voluntary pooling agreement. In essence, a community lease is a single lease that covers two or more tracts executed by the separate landowners as if they were joint owners of the entire leased premises.[34] A community lease may also entail the execution of separate, but identical, leases by the owners of separate tracts individually where each lease covers the entire consolidated acreage.[35]

Executing a community lease normally results in the apportionment of royalties among the several lessors in proportion to their acreage interests in the entire tract and permits the lessee to operate the premises without regard to internal boundary lines.[36] Community leases are not common, but have seen a rise in popularity in urban leasing situations involving homeowners and other associations seeking to lease small tracts in bulk to increase negotiating power.[37]

Absent some form of Pugh clause or continuous development/retained acreage provision, production from any tract within the community lease will extend the lease as to all tracts covered by the lease.[38]

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33. *See e.g.,* Sabre Oil & Gas Corp. v. Gibson, 72 S.W.3d 812, 816–17 (Tex. App.—Eastland 2002, pet. denied).

34. Ruiz v. Martin, 559 S.W.2d 839, 842 (Tex. Civ. App.—San Antonio 1977, writ ref'd n.r.e.).

35. *Id.*

36. French v. George, 159 S.W.2d 566, 569 (Tex. Civ. App.—Amarillo 1942, writ ref'd).

37. *See* Lisa Vaughn, *New Facets of Old Alternatives for Unleased Mineral Interests*, 16 TEX. WESLEYAN L. REV. 113, 114 (2009).

38. Utley v. Marathon Oil Co., 31 S.W.3d 274, 280 (Tex. App.—Waco 2000, no pet.).

The rule of non-apportionment, announced in *Japhet v. McRae*, applies to situations in which a tract out of a community lease is severed, provided that all of the parties to the lease join in or consent to the severance.[39] Thus, in cases where the doctrine applies, production from the severed tract belongs to the owners of the minerals under the producing tract.[40]

C. *The Entirety Clause*

An entirety clause is yet another way to combine or join royalty interests that would otherwise be subject to the non-apportionment rule of *Japhet v. McRae*.[41] An entirety clause typically provides that royalties will be paid based on the ownership of the entire leased premises, and not on who owns the land upon which the minerals are produced.[42] In essence, it is a pooling of the leased premises by the mineral owners for royalty purposes.[43]

Entirety clauses were designed to prevent the need to drill unnecessary wells due to the implied covenant to protect against drainage.[44] Over time, lessors began inserting language regarding the non-apportionment of royalty to ensure that if a partition/severance divided the leased premises, that they would receive their pro rata share of the royalty from a producing well on the other partitioned/severed tract.[45]

There are two basic methods of drafting an entirety clause, as demonstrated below:

- "If the leased premises are hereafter owned in severalty or separate tracts . . . "[46]
- "If the leased premises are now or hereafter owned in separate tracts . . ."[47]

The rest might read ". . . the premises shall be developed and operated as one lease or as an entirety, and royalties accruing thereunder shall be divided among and paid to such separate owners in the proportion that the acreage owned by them bears to the entire leased premises."[48]

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39. *See* Garza v. De Montalvo, 217 S.W.2d 988, 993 (Tex. 1949).

40. *Id.*

41. Montgomery v. Rittersbacher, 410 S.W.2d 925, 928 (Tex. Civ. App.—Corpus Christi 1966), *rev'd on other grounds*, 424 S.W.2d 210, 213 (Tex. 1968).

42. *See* Thomas Gilcrease Found. v. Stanolind Oil & Gas Co., 266 S.W.2d 850, 851 (Tex. 1954).

43. *Compare Montgomery*, 410 S.W.2d at 928, *with* Brown v. Smith, 174 S.W.2d 43, 46 (Tex. 1943).

44. *See* Amoco Prod. Co. v. Alexander, 622 S.W.2d 563, 567 (Tex. 1981).

45. *See Montgomery*, 410 S.W.2d at 927.

46. *See* Turner v. Brookshear, 271 F.2d 761, 762 (10th Cir. 1959).

47. *See* INTERNAL REVENUE SERV., U.S. DEP'T OF THE TREASURY, TRAINING PUBL'N NO. 3149-125, MARKET SEGMENT SPECIALIZATION PROGRAM: OIL & GAS INDUSTRY 1-15, *available at* http://www.irs.gov/pub/irs-mssp/oilgas.pdf.

48. *See Turner*, 271 F.2d at 762; *See also* Stroud v. D-X Sunray Oil Co., 876 P.2d 1015, 1017 (Okla. 1962).

The Texas Supreme Court has held that an "are now" entirety clause applies to minerals held in severalty at the time of the execution of the lease.[49]

Issues can arise where a portion of the land covered by an oil and gas lease is sold and the lease contains an entirety clause and is subject to an outstanding non-participating royalty interest. For instance, what happens where the non-participating royalty interest is in the non-drill-site tract? Does the entirety clause bind the non-participating royalty interest owner's royalty, or does the non-participating royalty owner have to ratify the lease as to the drill-site tract in order to receive royalty? This issue was addressed in *Montgomery v. Rittersbacher* and is discussed in Section IV(E)(1).[50]

III. THE RIGHT TO ROYALTY

As demonstrated above, oil and gas lessees have many tools for joining or combining different mineral interests and acreage in order to drill and produce a prospect. However, joining these interests can create special problems concerning the competing interests involved. For example, it has long been the law in Texas that a lease executed by the owner of the executive right, when there is an outstanding non-participating interest, binds the interest of the non-participating royalty owner.[51] However, can the executive nonetheless dilute the non-participating royalty owner's interest by pooling that interest with other lands or leases?

Texas law is clear: pooling on the part of the executive holder does not bind the non-participating royalty owner's interest in the absence of consent or acquiescence by the royalty owner.[52] The result is no different with respect to an entirety clause. In either case, the consent of the non-participating royalty interest owner must be obtained.[53] This is because, under Texas law, only an owner may convey his or her interest in land,[54] and a non-participating royalty interest is an interest in land.[55] Moreover, the mere reservation of a non-participating royalty interest under a tract does not show that the reserving owner intended to give the holder of the executive right the power to diminish the royalty owner's interest under that tract.

49. Montgomery v. Rittersbacher, 424 S.W.2d 210, 213 (Tex. 1968) (citing Thomas Gilcrease Found. v. Stanolind Oil & Gas Co., 266 S.W.2d 850, 853 (Tex. 1954)).

50. *Id.* at 212.

51. *Id.*

52. *Rittersbacher*, 424 S.W.2d at 213; *Brown v. Smith*, 174 S.W.2d 43, 46 (Tex. 1943).

53. *Rittersbacher*, 424 S.W.2d at 213.

54. Union Pac. Res. Co. v. Hutchison, 990 S.W.2d 368, 370–71 (Tex. App.—Austin 1999, pet. denied)

55. *Brown*, 174 S.W.2d at 46.

A. *The Non-participating Royalty Interest Owner*

As stated, the rule in Texas is that the holder of the executive right has the power to execute oil and gas leases, but cannot pool or unitize an outstanding non-participating royalty interest absent joinder or ratification by the non-participating royalty interest owner.[56] In situations where a royalty reservation predates an oil and gas lease that contains a pooling clause, the lease amounts to a proposal or offer by the lessor to the outstanding non-participating royalty interest owner to effect or create a community lease and to pool or unitize all of the royalties in all of the tracts described in the lease. To successfully ratify the lease, all non-participating royalty owners must ratify.[57] The following cases illustrate these principles.

1. *Ruiz v. Martin*, 559 S.W.2d 839 (Tex. Civ. App.—San Antonio 1977, writ ref'd n.r.e.).

This case stands for two propositions: (i) the holder of the executive interest does not have the power to pool the interest of a non-participating royalty interest owner absent consent or acquiescence, and (ii) a lease by the executive that contains a pooling provision constitutes an offer to lease that the non-participating royalty interest owner can reject or accept by timely ratification.[58]

This oil and gas lease involved three separate tracts totaling 600 acres owned by Ruiz.[59] Martin owned an undivided 1/2 interest in the oil royalties, gas royalties, and royalties in other minerals in a 463.8 acre tract, described as Tract 1 in the lease.[60] The royalty was a perpetual, non-participating royalty interest, and it was outstanding at the time that the oil and gas lease was taken.[61] During the lease term, a producing well was drilled on Tract 2.[62] Ruiz asserted that he was entitled to 100% of the royalty from the producing well on Tract 2.[63] Martin asserted that he was entitled to a share of the royalty from Tract 2.[64] The trial court entered judgment that Martin was entitled to .3865 (1/2 x 463.8/600) of the royalty on all oil, gas, and other minerals produced from the well from and after December 9, 1974, which was the date that Martin alleged to have ratified the lease.[65]

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56. *Rittersbacher*, 424 S.W.2d at 213; *Brown*, 174 S.W.2d at 46.

57. Guar. Nat'l Bank & Trust of Corpus Christi v. May, 395 S.W.2d 80, 82 (Tex. Civ. App.—Waco 1965, writ ref'd n.r.e.).

58. Ruiz v. Martin, 559 S.W.2d 839 (Tex. Civ. App.—San Antonio 1977, writ ref'd n.r.e.).

59. *Id.* at 840.

60. *Id*

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.*

65. *Id.* at 841.

The Court of Appeals affirmed.[66] In support of its holding, the Court of Appeals noted that an ordinary oil and gas lease, when executed by all the owners of different mineral interests in two or more tracts, effectively pools the royalties payable under the lease.[67] The court then stated that the executive holder had the right to execute an oil and gas lease to burden the mineral interest, but did not have the authority or power to pool or unitize the royalty interest of the non-participating royalty interest holder without their joinder or ratification.[68] In essence, the oil and gas lease amounted to a proposal or offer by the executive holder/lessor to the lessee and the non-participating royalty interest owners to pool or unitize all of the royalties in the tracts subject to the lease.[69] Because the non-participating royalty owners timely ratified the lease, they were entitled to receive their proportionate share of the royalty produced from the leased premises.[70]

2. *Guaranty Nat'l Bank & Trust of Corpus Christi v. May*, 395 S.W.2d 80 (Tex. Civ. App.—Waco 1965, writ ref'd n.r.e.).

This case involved an oil and gas lease that covered five separate tracts.[71] May owned the surface and executive right to lease all five tracts.[72] May executed an oil and gas lease that granted the lessee the right and power to pool the acreage under the lease with other acreage to form communitized units.[73] The royalty interests under the five tracts were split between May, Brookshire, Koch, and Hampton.[74] A producing well was drilled on Tract 3, which royalty interest was owned by May and Koch. Brookshire and Hampton ratified May's lease.[75] Koch refused.[76] The trial court held that the lease was not a communitized lease, and that there was no cross-conveyance of interests.[77]

The Court of Appeals affirmed, holding that the parties could not unitize or communitize the respective royalty interest without the joinder or ratification of all of the royalty owners.[78] In other words, ratification by less than all of the owners does not effectuate the pool-

66. *Id.* at 842.
67. *Id.*
68. *Id.* at 842–43.
69. *Id.* at 843.
70. *Id.*
71. Guar. Nat'l Bank & Trust of Corpus Christi v. May, 395 S.W.2d 80 (Tex. Civ. App.—Waco 1965, writ ref'd n.r.e.).
72. *Id.*
73. *Id.* at 80–81.
74. *Id.* at 81.
75. *Id.*
76. *Id.*
77. *Id.* at 82.
78. *Id.*

ing and thus, the law does not recognize a communitization of interests.[79]

B. *Overriding Royalty Interests*

Consider the royalty due, if any, to an overriding royalty interest owner when the lease in which the interest is created out of is pooled and a producing well is drilled on acreage not otherwise subject to the lease. Is the overriding royalty interest owner entitled to any royalty, or does the overriding royalty interest owner have to ratify the pooled unit in order to participate?

Under Texas law, and absent contractual language to the contrary, the owner of the lease can pool an overriding royalty owner's interests without its consent and thus dilute the overriding royalty owner's interest in production.[80] The law treats these interests differently than non-executive interests because they stem from the same instrument that generally allows the lessee to pool the leased premises.[81]

C. *Co-tenancy and the Right to Royalty*

As a general rule, a tenant in common has the absolute right to execute a lease on his undivided interest in the common property, notwithstanding the nonjoinder of his co-tenant.[82] A tenant in common can also pool its interest with other leases and lands.[83] In such situations, what right, if any, does the unleased co-tenant have to royalty? Does that person get to share in production from the pooled unit? The short answer is—it depends.

1. The Unleased Co-tenant

Generally, if production is obtained from a well drilled on the unleased co-tenant's land, and the unleased co-tenant refuses to ratify the lease or designation of pooled unit, the lessee will be required to account to the unleased co-tenant for his or her share of production after the lessee recovers its drilling costs.[84] If, however, production is obtained from a well drilled on land in which the unleased co-tenant does not own an interest, i.e., one of the other pooled tracts, the unleased co-tenant can only share in the production if he or she ratifies

79. *Id.*

80. Union Pac. Res. Co. v. Hutchinson, 990 S.W.2d 368, 371 (Tex. App.—Austin 1999, pet. denied).

81. *Id.*

82. Whelan v. Placid Oil Co., 274 S.W.2d 125, 128 (Tex. Civ. App.—Texarkana 1954, writ ref'd n.r.e.).

83. *Id.*

84. Wagner & Brown, Ltd. v. Sheppard, 282 S.W.3d 419, 426 (Tex. 2007); Cox v. Davison, 397 S.W.2d 200, 201 (Tex. 1965).

the co-tenant's lease, or ratifies the designation of pooled unit.[85] This is essentially the holding from *Superior Oil Co. v. Roberts*.[86]

a. Superior Oil Co. v. Roberts, *398 S.W.2d 276 (Tex. 1966).*

This case stands for the proposition that an unleased co-tenant, who refuses to ratify its co-tenant's lease or the designation of pooled unit, is not entitled to share in production obtained from the pooled unit if the drill site and well bore are located on land other than the unleased co-tenant's.[87]

Superior acquired an oil and gas lease covering 1.5 acres of land consisting of six separate lots out of Block W of the Hawley Addition in Altair, Colorado County, Texas.[88] Superior's lessor owned 1/2 of the minerals under the town lots while the other 1/2 interest was owned by the plaintiffs.[89] The plaintiffs did not seek to ratify or adopt their co-tenant's leases with Superior, nor did they claim to be tenants in common with their co-mineral owners.[90] Rather, their theory was that they were a co-tenant with Superior and that by the pooling of the lots with other lands from which production was obtained, they were entitled to share in the production as if it were actual production from the six town lots.[91] The trial court and the Court of Appeals held that the plaintiffs/unleased co-tenants were entitled to share in production obtained from the pooled unit.[92]

The Texas Supreme Court reversed and rendered, rejecting the plaintiffs' theory.[93] In reaching its holding that the plaintiffs were not entitled to sales proceeds from production, the Court noted that any action taken by Superior concerning its lessors' leases could not operate to place the plaintiffs' property under lease or otherwise make it part of the unitized area without the plaintiffs' consent or acquiescence.[94] The plaintiffs had no contractual relationship with Superior which would give them rights in and to minerals produced from the pooled unit, but not their land.[95] Because the plaintiffs made no attempt to ratify their co-tenants' mineral leases with Superior and because none of the production came from their land, they were not entitled to production from the unit.[96]

85. Sun Exploration & Prod. Co. v. Pitzer, 822 S.W.2d 294 (Tex. App.—Eastland 1991, writ denied); Donnan v. Atl. Richfield, 732 S.W.2d 715, 717 (Tex. App.—Corpus Christi 1987, writ denied).
86. Superior Oil Co. v. Roberts, 398 S.W.2d 276 (Tex. 1966).
87. *Id.*
88. *Id.* at 276–77.
89. *Id.*
90. *Id.* at 277.
91. *Id.*
92. *Id.* at 278.
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.*

2. Pooling and Lease Termination: Who Gets the Royalty?

Consider the following situation and the effect on the right to royalty. Tract 1 consists of sixty acres with X owning 1/8 and Y owning 7/8. X and Y sign separate leases with different lessees. Significantly, however, both leases allow the lessees to pool "the leased premises or interest therein with any other lands or interests."[97] The lessees sign a unit designation and pool the 60 acres with another 120 acres to form a 180 acre unit. A producing well is drilled solely on the 60 acres. Due to special provisions in the X's lease regarding when royalty must be paid, the lease terminates.

Therefore, the question is what is the effect, if any, of X's lease termination in regards to the pooled unit? Does the unit terminate? Is X now an unleased co-tenant, who would otherwise be entitled to 1/8 of the total production after the lessee recovers its drilling costs? The answer is no—X is not entitled to 1/8 of the total production. Rather, X is only entitled to receive her pro rata share of production from the unit multiplied by her 1/8 mineral interest: 1/8 x 60/180 = 4.166%. This essentially is the situation in *Wagner & Brown, Ltd. v. Sheppard.*[98]

a. Wagner & Brown, Ltd. v. Sheppard, *282 S.W.3d 419 (Tex. 2008).*

In *Wagner*, the trial court found that termination of Sheppard's lease also terminated her participation in the unit, and the Court of Appeals affirmed.[99] The Texas Supreme Court reversed and held that termination of Sheppard's lease did not invalidate the pooling agreement and hence, Sheppard was not entitled to an undiluted 1/8 of production.[100] Sheppard's share of production, even though it was obtained from wells drilled on her land, would be allocated based on the acreage in the pooled unit and her 1/8 mineral interest.[101] In reaching its decision, the Texas Supreme Court noted that a lease is not necessarily required for pooling, and that mineral owners can join in pooling even if no lease exists, *i.e.*, they can ratify the unit (ratification was not an issue in *Wagner*. Sheppard asserted a right to 1/8 of the total production from her land as an unleased co-tenant).[102] The Court went on to state that although Sheppard's lease had terminated, the lands themselves did not, and while termination of the lease changed who owned the mineral interests in the unit, it did not cause the unit to terminate because it was a pooling of lands, not just leases.[103] The Court then distinguished *Texaco, Inc. v. Lettermann* on

97. *See* Wagner & Brown, Ltd. v. Sheppard, 282 S.W.3d 419, 422 (Tex. 2008).
98. *Id.* at 419.
99. *Id.* at 422.
100. *Id.*
101. *Id.*
102. *Id.* at 424.
103. *Id.* at 425–27.

the ground that the lease in that case only authorized the pooling of the gas leasehold estate of adjacent lands, while the lease in *Wagner* allowed the pooling of the leased premises or interest therein with any other lands or interests.[104] Finally, the Court noted that Sheppard's possibility of reverter upon lease termination was an interest in the leased premises and that she had granted the lessee the right to pool her interest, including the possibility of reverter, in the leased premises.[105]

IV. RATIFICATION

As shown above, ratification is the key that unlocks the royalty door for non-executive interests owners and owners of undivided, unleased mineral interests. Yet many questions can arise regarding ratification. For instance, when does ratification occur? How do you ratify? Can you ratify part of a lease, but disclaim the pooling clause or the entirety clause? How long do you have to ratify? When do royalties begin accruing for the benefit of the ratifying party?

A. *Ratification in General*

Ratification is the adoption or confirmation by a person, with knowledge of all material facts, of a prior act which did not then legally bind that person and which that person had the right to repudiate.[106]

Ratification has the effect of prior authority.[107] In other words, where ratification is applicable, the effect is the same as execution of the original lease.[108] A party may ratify a lease, as a matter of law, by filing suit to enforce the lease as written.[109]

B. *Ratification by Accepting Royalty Payments*

Ratification can occur through the acceptance of royalty payments even if the payments are accepted under protest or with a reservation of rights.[110]

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104. *Id.* at 423 (citing Texaco, Inc. v. Lettermann, 343 S.W.2d 726 (Tex. Civ. App.—Amarillo 1961, writ ref'd n.r.e.).

105. *Id.* at 424.

106. Vessels v. Anschutz Corp., 823 S.W.2d 762, 764 (Tex. App.—Texarkana 1992, writ denied); Kunkel v. Kunkel, 515 S.W.2d 941, 948 (Tex. Civ. App.—Amarillo 1974, writ ref'd n.r.e.) (op. on reh'g).

107. Yelderman v. McCarthy, 474 S.W.2d 781, 784 (Tex. Civ. App.—Houston [1st Dist.] 1971, writ ref'd n.r.e.).

108. Ruiz v. Martin, 559 S.W.2d 839, 844 (Tex. Civ. App.—San Antonio 1977, writ ref'd n.r.e.).

109. Montgomery v. Rittersbacher, 424 S.W.2d 210, 214 (Tex. 1968).

110. *Yelderman*, 474 S.W.2d at 784.

1. *Yeldeman v. McCarthy*, 474 S.W.2d 781 (Tex. Civ. App.—Houston [1st Dist.] 1971, writ ref'd n.r.e.).

Yeldeman stands for the proposition that a lessor may ratify an otherwise invalid pooled unit by accepting production payments under protest.[111] This was a suit to recover royalties alleged to be due under the terms of an oil and gas lease.[112] The principal issue involved was the validity of a gas unit created under the authority of a unitization provision in an oil and gas lease, which covered the plaintiffs' 3/4 mineral interest in 225.24 acres.[113] The lessee drilled a well on the leased premises and subsequently recorded a unit designation pooling 117.03 acres from the leased premises with adjacent land to form a 346.82 acre unit.[114] The oil and gas lease provided for units not exceeding 640 acres, plus 10% tolerance, unless otherwise allowed by governmental authority.[115] The lease also specified that in creating any unit, the lessee was limited to creating units that would not exceed the minimum size tract upon which a well may be drilled in order to conform to the spacing pattern prescribed in the field by regulatory agencies having jurisdiction.[116] When the well was drilled, the minimum size tract upon which a well could be drilled was forty acres as prescribed by Statewide Rule 37 of the Texas Railroad Commission, but special field rules applicable to this well allowed a minimum drilling unit of 320 acres.[117] Therefore, the unit designation of 346.82 acres was not effective and did not accomplish the pooling of acreage.[118] Even though the unit failed, the lessee tendered royalty payments to the lessors in accordance with the lessors' proportionate share of royalty as if the unit was indeed effective.[119] The lessors cashed those payments with a notation "accepted as partial payment only as per lease agreement."[120] The trial court entered judgment for the defendant/lessee that the plaintiff/lessor take nothing on its claim for additional royalty for unpaid production.[121]

The Court of Appeals affirmed, relying on *Leopard v. Stanolind Oil & Gas Co.*, 220 S.W.2d 259 (Tex. Civ. App.—Dallas 1949, writ ref'd n.r.e.), and held that the acceptance of royalty checks, even under protest, was a ratification of the unit.[122] The Court of Appeals reasoned that the authority in the lease to pool the lessors' interest made the

111. *Id.*
112. *Id.* at 781–82.
113. *Id.* at 782.
114. *Id.*
115. *Id.*
116. *Id.*
117. *Id.* at 782–83.
118. *Id.* at 783.
119. *Id.*
120. *Id.*
121. *Id.* at 784.
122. *Id.*

lessee the lessor's agent and as the agent, the lessee had the ability to convey royalty interests in the subject lease to the owners of other mineral interests.[123] The Court of Appeals then determined that the lessors had ratified the unauthorized action of its agent by accepting the benefits flowing from the unauthorized pooling—cashing the royalty payments, which were based on the allocated acreage in the overall pool.[124]

C. *Ratification by Filing Suit*

A person may ratify an oil and gas lease by filing a pleading in a lawsuit that puts the opposing party on notice that the person intends to ratify and be bound by the terms of the oil and gas lease.[125]

D. *Ratification and Timing*

Issues can arise whether a purported ratification is valid when there has been a long passage of time between the ratifying act and the date that production began or the party seeking to ratify learned of facts sufficient to ratify. At least one case stands for the proposition that a party seeking to ratify must exercise its right without undue delay.[126]

1. *Nugent v. Freeman*, 306 S.W.2d 167 (Tex. Civ. App.—Eastland 1957, writ ref'd n.r.e.).

Nugent involved a royalty suit and stands for the proposition that in order to ratify a pooled unit by filing suit, the party seeking to ratify must act with diligence and not unreasonable delay.[127] It is an issue of laches, not estoppel, as stated in *May v. Cities Serv. Oil Co.*[128]

Nugent conveyed thirty acres to Freeman and reserved a 1/16 non-participating royalty interest in the land.[129] At that time, Freeman

123. *Id.*

124. *Id.*

125. Amoco Prod. Co. v. Wood, 113 S.W.3d 462, 466–67 (Tex. App.—Texarkana 2003, no pet.).

126. Nugent v. Freeman, 306 S.W.2d 167, 170–71 (Tex. Civ. App.—Eastland 1957, writ ref'd n.r.e.). *But see* Montgomery v. Rittersbacher, 424 S.W.2d 210 (Tex. 1968). In that case, a well was drilled in October 1956. *Id.* at 212. Commercial production began in May 1958. *Id.* Suit was not filed, however, until May 1964, some six years later. *Id.* The Texas Supreme Court held that the plaintiff had ratified the lease and thus, was entitled to his share of the royalty as a non-participating royalty interest owner. *Id.* at 215. Importantly, and even though suit was not filed for six years, the record on appeal showed that in January 1959, the plaintiff made a demand upon the operator for his pro-rata share of the royalties due and owing under the lease. *Id.* at 214. Specifically, the plaintiff offered to sign a ratification and sign a division order of interests. *Id.*

127. *Nugent*, 306 S.W.2d at 170–71.

128. See May v. Cities Serv. Oil Co., 444 S.W.2d 822, 826 (Tex. Civ. App.—Beaumont 1969, writ ref'd n.r.e.).

129. *Id.* at 168.

owned another 120 acres that joined the 30 acres.[130] Freeman later executed an oil and gas lease covering the entire 150 acres.[131] The 150 acres was described in the lease under a single description.[132] Three wells were drilled, but none of the wells were on the 30 acres conveyed to Freeman by Nugent.[133] The parties stipulated that Nugent had actual knowledge not later than August 1953 that oil was being produced from the 120 acres.[134] Nugent never signed a lease, never was requested to sign a lease, and never offered to sign a lease.[135] Likewise, Nugent never signed a ratification of the lease and never executed any instrument pertaining to the lease or the pooling of the two tracts involved.[136] There was nothing in the lease to indicate that Nugent was to get less than his 1/16th of the oil produced from the 30 acres or that Nugent was to get any royalty from the 120 acre tract.[137] On December 12, 1955, over three years from the stipulated date of actual awareness, Nugent filed suit claiming a royalty interest in the production from the 120 acre tract.[138] Nugent alleged that by signing the lease with a single property description, Freeman had essentially pooled the 30 acre tract with the 120 acre tract.[139] The trial court entered judgment for Freeman.[140]

The Court of Appeals affirmed and held that Freeman had no authority to pool Nugent's royalty interest in the thirty-acre tract without Nugent's consent.[141] The court then considered if Freeman had no power to pool, when, and in what manner, was the pooling of Nugent's interest in the thirty acres affected.[142] Nugent argued that by filing suit, he ratified the unauthorized act of Freeman.[143] The Court of Appeals rejected that argument.[144] The court reasoned that Nugent waited more than two years to file suit after receiving actual knowledge that oil was being produced from the 120 acre tract.[145] During this time period, all of the royalty was paid to the owners of the 120 acre tract.[146] The court noted that had production been obtained from the thirty-acre tract, Nugent would undoubtedly have

130. *Id.* at 169.
131. *Id.*
132. *Id.*
133. *Id.*
134. *Id.*
135. *Id.*
136. *Id.*
137. *Id.*
138. *Id.*
139. *Id.*
140. *Id.*
141. *Id.*
142. *Id.*
143. *Id.*
144. *Id.* at 170–71.
145. *Id.* at 171.
146. *Id.*

been entitled to his 1/16th royalty.[147] However, because Nugent waited so long to bring suit, the lease had been fully developed and therefore, Nugent could not complain or seek to ratify.[148]

E. *Effect of Ratification: Post Production Royalties Only*

Once ratification occurs, is the ratifying party entitled to pre or post-ratification royalty or both? The prevailing view under Texas law seems to be that a ratifying party is only entitled to post-ratification royalties.[149]

1. *Montgomery v. Rittersbacher*, 424 S.W.2d 210 (Tex. 1968).

Montgomery stands for two propositions: (i) the holder of the executive right cannot enlarge or diminish the rights of a prior non-participating royalty interest owner where he or she executes an oil and gas lease that contains either a pooling clause or an entirety clause, unless the non-participating royalty interest owner ratifies such action; and (ii) a party who ratifies a lease or unit is only entitled to receive royalties that accrue from and after the date of ratification.[150]

In 1945, Montgomery conveyed 80 acres of land and reserved for himself a non-participating royalty interest in the land.[151] Rittersbacher later acquired the 80 acres, which adjoined another 124.19 acres owned by him.[152] Montgomery owned no interest in this other land.[153] In 1953, Rittersbacher recorded an oil and gas lease covering the 80 acres and the 124.19 acres.[154] Montgomery, owning only a non-participating royalty interest, did not join in the execution of the lease.[155] The lease defined the two tracts separately and contained a pooling clause.[156] The lease also contained an entirety clause that stated as follows:

> "If the leased premises are now or shall hereafter be owned in severalty or in separate tracts, the premises, nevertheless, shall be developed and operated as one lease, and all royalties accruing hereunder shall be treated as an entirety and shall be divided among and paid to such separate owners in the proportion that the acreage

147. *Id.*
148. *Id.*
149. Montgomery v. Rittersbacher, 424 S.W.2d 210, 215 (Tex. 1968); May v. Cities Serv. Oil Co., 444 S.W.2d 822, 827 (Tex. Civ. App.—Beaumont 1969, writ ref'd n.r.e.). *But see* Mallett v. Wheat, 709 S.W.2d 768, 772 (Tex. App.—Beaumont 1986, writ ref'd n.r.e.).
150. *Montgomery*, 424 S.W.2d at 213–15.
151. *Id.* at 211.
152. *Id.*
153. *Id.*
154. *Id.*
155. *Id.* at 212.
156. *Id.*

> owned by each such separate owner bears to the entire leased acreage."[157]

A portion of the 124.19 acres was pooled with a tract known as the Crutchfield tract, land not owned by Rittersbacher and not covered by the 1953 lease.[158] Production was obtained from that unit.[159] Montgomery's 80 acres was placed in a unit in which a dry hole was drilled.[160]

Montgomery sued and argued that he was entitled to royalty from the Crutchfield unit by virtue of the entirety clause since a portion of the 124.19 acres was pooled into the unit even though he did not own any royalty interest in the 124.19 acres.[161] Rittersbacher argued that as the executive holder, he did not have the power or authority to bind Montgomery's non-participating royalty interest with an entirety clause.[162] The trial court entered judgment that Montgomery take nothing and the Court of Appeals affirmed.[163]

The Texas Supreme Court reversed and remanded.[164] First, the Texas Supreme Court held that Rittersbacher, being the holder of the executive right, did not have the power to bind Montgomery's non-participating royalty interest by virtue of the entirety clause alone.[165] Second, the Texas Supreme Court held that Montgomery had properly ratified the lease.[166] The Texas Supreme Court went on to state that it was of the opinion that the enlargement or diminishment of the rights of a non-participating royalty interest owner can be accomplished by the holder of the executive right where he or she executes an oil and gas lease that contains either a pooling clause or an entirety clause, provided that the non-participating royalty interest owner ratifies such action.[167]

2. *Mallett v. Wheat*, 709 S.W.2d 768 (Tex. App.—Beaumont 1986, writ ref'd n.r.e.).

Mallett involved a trespass to try title, but it also touches on the issue of royalty allocation and entitlement to royalty.[168] Wheat filed suit claiming title and right to possession of a 1/2 undivided interest in 13.76 acres.[169] The defendants answered and also claimed title to and

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157. *Id.*
158. *Id.*
159. *Id.*
160. *Id.*
161. *Id.*
162. *Id.*
163. *Id.* at 211.
164. *Id.*
165. *Id.* at 213–14.
166. *Id.* at 214–15.
167. *Id.*
168. Mallett v. Wheat, 709 S.W.2d 768 (Tex. App.—Beaumont 1986, writ ref'd n.r.e.).
169. *Id.* at 769.

right to possession of the disputed tract by asserting a defense of limitations and laches.[170] Prior to Wheat filing suit, Mallett signed an oil and gas lease, which allowed the lessee to pool the leased premises with other nearby property.[171] A producing well was drilled within the unit, but outside the boundaries of the disputed tract.[172] Two years after filing suit, Wheat ratified the leases and unitization agreement.[173] At that point, the lessee deposited 1/2 of the royalties due to the owners of the disputed tract from 1980 until the time of trial.[174] The trial court granted a directed verdict for the plaintiff on the title issue and hence, awarded Wheat the royalties that had been paid into the registry of the court.[175] On appeal, Mallett argued that the trial court erred in awarding Wheat royalties accruing prior to Wheat's ratification of the mineral leases.[176]

The Court of Appeals affirmed and held Wheat was entitled to royalties accruing prior to ratification of the leases.[177] In reaching its holding, the Court of Appeals distinguished *Superior Oil Co. v. Roberts*, 398 S.W.2d 276 (Tex. 1966) and *May v. Cities Serv. Oil Co.*, 444 S.W.2d 822 (Tex. Civ. App.—Beaumont 1969, writ ref'd n.r.e.) and said that they did not deal with the situation at hand.[178] Instead, the court reasoned that because Mallett chose to deal with the disputed tract as if he were its sole owner, and since Wheat ratified the leases and unitization agreement, it would unjustly enrich Mallett to allow him to keep any part of their co-tenant's share of the benefits of such agreements.[179] It seems that the better reasoning for allowing the plaintiff to recover pre-ratification royalty is because of the title dispute and the fact that Mallett was held not to own anything and to allow him to keep any royalty would unjustly enrich him.

V. Necessary and Indispensable Parties to Royalty Litigation

The case law on whether the court should join all persons who may have an interest in the pooled/unitized unit is conflicting, but recent cases seem to favor the non-joinder of such persons.

170. *Id.*
171. *Id.* at 771.
172. *Id.*
173. *Id.*
174. *Id.*
175. *Id.* at 769.
176. *Id.* at 771.
177. *Id.* at 772.
178. *Id.*
179. *Id.*

A. Veal v. Thomason, *159 S.W.2d 472 (Tex. 1942).*

Veal stands for the proposition that royalty owners who have unitized their mineral interests together are necessary and indispensable parties in litigation when seeking to remove one of the individual tracts from the unitized block.[180]

Thomason sued to recover title to and possession of land because of certain alleged illegalities in a trustee's sale.[181] The defendants had acquired the property at the sale and had subsequently leased the minerals to the Texas Company.[182] The land was unitized with some 6,000 acres.[183] Thomason refused to name the other parties who had executed leases in the unitized block and the trial court dismissed the case, but the case was reversed on appeal.[184] The Court of Appeals held that the other lessors and royalty owners in the unitized block were not necessary parties to the suit because they did not have a direct interest in the land at issue.[185]

The Texas Supreme Court reversed and held that the other owners were indispensable parties because if the plaintiff's claims are successful, the other royalty owners would have had their royalty interest in the tract at issue cut off and destroyed without having their day in court.[186]

B. Sabre Oil & Gas Corp. v. Gibson, *72 S.W.3d 812 (Tex. App.—Eastland 2002, pet. denied).*

Sabre stands for the proposition that in a suit for bad faith pooling and breach of lease, royalty interest owners whose interests had been pooled were not necessary and indispensable parties such that they would have to be joined in order for the case to proceed.[187]

In 1957, an oil and gas lease covering thirty-eight separate tracts was executed.[188] The plaintiffs owned 100% of the minerals under three of the thirty-eight tracts.[189] The lessee drilled and completed a gas well on one of the plaintiff's three tracts and thereafter, filed a designation of pooled unit that pooled the plaintiff's three tracts with other lands that were not part of the 1957 lease.[190] The plaintiffs sued

180. Veal v. Thomason, 138 Tex. 341, 351, 159 S.W.2d 472, 477 (Tex. 1942), *superseded by rule*, Tex. R. Civ. P. 39(a), *as recognized in* Sabre Oil & Gas Corp. v. Gibson, 72 S.W.3d 812, 814 (Tex. App.—Eastland 2002, pet. denied).

181. *Id.* at 345, 159 S.W.2d at 474.

182. *Id.* at 343, 159 S.W.2d at 473.

183. *Id.* at 345, 159 S.W.2d at 474.

184. *Id.* at 346, 159 S.W.2d at 474.

185. *Id.* at 346, 159 S.W.2d at 474.

186. *Id.* at 351, 159 S.W.2d at 477.

187. Sabre Oil & Gas Corp. v. Gibson, 72 S.W.3d 812, 814 (Tex. App.—Eastland 2002, pet. denied).

188. *Id.*

189. *Id.*

190. *Id.*

seeking a declaration that a lease had terminated as to their land and that the lessee had formed a unit in violation of the lease thus making it void.[191] The plaintiffs refused to join some sixty other royalty interest owners who owned interests in the lands not included under the 1957 lease, but which had been pooled with the plaintiff's three tracts.[192] The trial court found that the gas unit was formed in violation of the lease provisions and was void ab initio.[193] The trial court also denied the lessee's plea in abatement that the case should not go forward until the sixty royalty interest owners were joined.[194]

The Court of Appeals overruled the lessee's argument that the trial court erred in denying the lessee's plea in abatement.[195] In reaching its decision, the Court of Appeals noted that *Veal v. Thomason* was decided prior to the 1971 amendment to Rule 39 of the Texas Rules of Civil Procedure and that the rule no longer talked of "necessary" and "indispensable" parties.[196] Rather, Rule 39, as currently written, is a looser standard that focuses not so much on the trial court's jurisdiction, but on whether the trial court should proceed with the parties already before it.[197] The Court of Appeals reasoned that the trial court was able to provide the requested relief because joinder of the other royalty interest owners was not necessary to determine whether the lessee had pooled in bad faith or breached the terms of the underlying oil and gas lease even though the non-party royalty owners' share of production could be affected if the pooled unit was declared invalid.[198]

191. *Id.*
192. *Id.*
193. *Id.*
194. *Id.*
195. *Id.* at 815.
196. *Id.*
197. *Id.* at 816.
198. *Id.*