

This brochure is designed for homeowners who have been approached by someone wanting to lease their mineral estate. This brochure is not meant to be a substitute for legal counsel, but to provide homeowners with basic knowledge of some of the most common terms used in many residential oil and gas leases so homeowners are more educated when making decisions regarding their mineral estates. It is based on Texas law, which is different from many other states and how other states treat mineral leasing.

Common Lease Terms

Bonus – An initial, one-time payment by the lessee to the mineral estate owner (or lessor) for the execution of an oil and gas lease by the mineral estate owner.

Estates – There is a mineral estate and a surface estate in Texas. These estates are considered “one estate” unless they have been severed by you or a previous owner. For example, you may sell your home and the surface estate on which it sits, but retain ownership of the mineral estate underneath your home and surface. This causes a severance of the two estates. If you do not specifically exclude the mineral estate from the sale of your home (by “reserving” or “excepting” the mineral estate in the deed you execute), it will be sold with your home.

Force Majeure Clause – States that if the production of oil or gas fails due to one or more of the events specifically listed in the lease (such as an “act of God”) or other events beyond the reasonable control of the lessee, the lease will not automatically terminate because the performance of the lessee’s obligations will be excused due to these causes. Sometimes the lessee’s performance is excused until the “event” ends, but the lease may also limit the “force majeure event” to a certain time period, such as not more than one consecutive year.

Habendum Clause – Provides the duration of the lessee’s interest by setting the length of the primary term and defining the secondary term.

Lessee – Person or entity who obtains the rights and obligations of mineral development under the executed lease.

Lessor – Person or entity executing a lease in favor of the lessee. For the purposes of this brochure, the lessor is typically the “homeowner” and/or “mineral owner.”

Mineral Estate – In Texas, the mineral estate is comprised of five separate and distinct parts, which are referred to generally as the mineral owner’s “bundle of sticks.” This bundle of sticks includes: (1) the right to develop; (2) the right to lease; (3) the right to receive bonus payments; (4) the right to receive delay rentals; and (5) the right to receive royalty payments. By executing a mineral lease, the mineral owner is “leasing” its right to develop the minerals to the lessee/oil and gas company in exchange for the payment of a bonus, delay rentals, and/or royalties.

Pooling – Consolidation of leased land with adjoining leased land to form a “unit.” When this occurs, each lessor in the unit receives a proportional share of royalties paid for any well drilled on land included in the unit.

Primary Term – The specific period of time, typically three to five years, during which a lease may be kept in force even though there is no production of minerals.

Royalty – The mineral estate owner’s/lessor’s share of production.

Rule of Capture – This Rule allows the owner of a mineral estate to drain oil or gas from under his neighbor’s land (his neighbor’s mineral estate) without liability. A person who extracts oil and/or gas from beneath his land acquires ownership of the extracted oil and/or gas even though they may have been drained the minerals from beneath the surface estate of their neighbor.

Savings Clause – Clause(s) in the lease that operate to hold the lease despite the lack of production of oil or gas.

Secondary Term – The term of the lease after the primary term ends, usually continuing for as long as minerals are being produced.

Shut-in Clause – A clause allowing a lessee to continue the lease after expiration of the primary term when the well is capable of producing oil or gas in paying quantities, but is not producing due to a lack of a suitable market.

Shut-in Royalty – Payment to the lessor in order to maintain the lease after the primary term when the well is capable of producing oil or gas in paying quantities, but is not producing due to a lack of a suitable market.

Surface Estate – The land on which your home is built (and everything other than the minerals that have been reserved).

Warranty Clause – A warranty is a guarantee. This clause permits the lessee to seek and possibly recover damages (such as return of any lease bonus payment the homeowner has received) if there is a failure in the title regarding the mineral estate. In many cases, the lessee wants the homeowner to provide a “general warranty deed,” meaning the homeowner is warranting that she owns the mineral estate. Sometimes a quitclaim deed is included instead of a general warranty. A quitclaim deed does not warrant anything. Through a quitclaim deed, the homeowner is merely conveying the mineral estate to the lessee if she owns the mineral estate. (Most likely, the title work performed when you purchased your home does not warrant that you own the mineral estate.)

Frequently Asked Questions and Answers

Can I sign a lease with more than one company?

No, leasing your mineral rights is exclusive, so you cannot sign with more than one company.

What does it mean when the lease states a 3-year primary term with 2-year option?

The company will pay you the bonus for the first 3 years. If the company cannot keep the lease in force through production of minerals or a savings clause, then the company has the option to pay you another bonus to hold the lease for another two-year primary term.

When will the lease expire?

The lease will expire at the end of the primary term (unless there is an option which the company exercises) unless oil or gas is being produced. Once oil or gas is being produced, the lease will continue so long as oil or gas is being produced in paying quantities (enough to make a profit).

Will I need to get a legal release (called subordination agreement) from my mortgage company?

Your mortgage holder or the oil and gas company may require a subordination or non-disturbance agreement. (A subordination agreement is a written agreement between holders of liens on a property that changes the priority of mortgage, leases, judgment and other liens under certain circumstances.)

Who regulates the oil and gas companies?

Currently, the Texas Railroad Commission regulates the oil and gas industry in Texas. However, at the time of printing the Texas Legislature had a bill pending to abolish the TRC, create the Oil and Gas Commission, and transfer all the powers and duties of the TRC to the Oil and Gas Commission. In addition, your municipality may also enact specific ordinances regarding the drilling sites.

What should I do if I decide to sell my house — can I keep the mineral estate?

If you decide to sell your property after you have signed the oil and gas lease, you have the option to sever your mineral estate from your surface estate. You can sell your house, which is part of the surface estate, and retain the mineral estate or vice versa. Be sure to tell your realtor whether you wish to retain the mineral rights. If you are selling the property yourself, consult an attorney for the proper language to retain the mineral estate.

How will the oil and gas lease affect my taxes, if at all?

Income from oil and gas leases is considered income for federal taxation purposes. All bonuses and royalties should be included on your income tax returns.

Are there any sales scams?

Yes. You should always verify that you are leasing your mineral estate and not selling it (unless you intend to sell the mineral estate). There have been reports of purchase agreements that were written to “appear” as a lease.

Helpful Websites

Texas General Land Office – www.glo.texas.gov

Texas Railroad Commission – www.rrc.state.tx.us

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For Additional Copies Please Contact:

Public Information Department

State Bar of Texas

P.O. Box 12487

Austin, Texas 78711-2487

(800) 204-2222, Ext. 1800

www.texasbar.com



OIL & GAS BASICS FOR HOMEOWNERS

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