

Entireties Clauses in Oil and Gas Leases: Are Mineral Owners Outside Your Unit Entitled to Proceeds?

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Most oil and gas leases, with certain conditions, permit the lessee to develop the leasehold as a whole, so that drilling one well on one tract covered by the lease will satisfy drilling obligations for all tracts covered by the lease. The language typically reads as follows: "if the leased premises are now or hereafter owned in severalty or in separate tracts, the tracts, nevertheless, may be developed and operated as an entirety." Known fittingly as the "entireties clause," by treating the lease as a whole, even if certain tracts are later carved off and sold to others, the clause relieves the lessee of the obligation to drill offset wells to protect owners of the other non-producing tracts from internal drainage.

How are royalty payments treated? Early court decisions developed what is known as the *non-apportionment rule*, which holds that if the tracts covered by a lease were owned by different parties, and a producing well was drilled, for example, in Bob's tract, then Jill, who owns a neighboring tract, is not entitled to any proceeds from production from the well on Bob's tract. The basic principle is that each separate owner is entitled to production from his or her own tract, free from the claims of the others. The non-apportionment rule was soon recognized as unfair, especially if the lessee was under no obligation to drill offset wells. The rule left landowners like Jill receiving no benefits from production on the leasehold. To avoid the unfair result, language was inserted into the entireties clause to allow for the apportionment of royalty payments. Typical language reads as follows: "royalties shall be paid to each separate owner in the proportion that the acreage owned by him bears to the entire leased area." Thus a balance was introduced: lessees were allowed to develop the leased premises as a whole while all lessors benefited from production from anywhere within the whole.

Entireties clauses can take any variety of forms, but the form of concern here contains royalty apportionment language. For example:

If the leased premises are now or hereafter owned in severalty or in separate tracts, the premises, nevertheless, may be developed and operated as an entirety, *and the royalties shall be paid to each separate owner in the proportion that the acreage owned by him bears to the entire leased area.* There shall be no obligation on the part of the lessee to offset wells on separate tracts into which the

land covered by this lease may hereafter be divided by sale, devise, or otherwise, or to furnish separate measuring or receiving tanks for the oil produced from such separate tracts.

Now suppose that Bob owned an undivided fractional mineral interest in two 640-acre sections of land, and that he leased his interest in both sections to XYZ Oil in 1985. The lease included the entireties clause above. In 1990, just before the lease expired, XYZ Oil drilled a prolific well (the Titan I well) in the north section, and the well continues to produce today. The lease did not have a Pugh clause, and thus the Titan I well held both the north section and the south section by continuous production. Meanwhile, in 1995, Bob conveyed all of his interest in the south section to his sister Jill by mineral deed. In accordance with the entireties clause, Bob and Jill updated ownership of the lease with XYZ Oil, and Jill thereafter enjoyed her apportioned royalty proceeds from the Titan I well.

To continue the story, in 2014, ABC Oil leased up the remaining undivided mineral owners in the south section, and drilled the Minerva I well on a 640-acre unit basis. XYZ Oil, as lessee of Bob's and Jill's lease, participates in the well. A title examination is ordered for the south section, and the examiner confirms not only that Bob's and Jill's lease is held by production from the Titan I well, but also that the entireties clause in the lease provides for the apportionment of royalties. At this point the examiner alerts ABC Oil that title to the north section covered by the lease will need to be examined in order to confirm the party or parties entitled to royalty proceeds from the Minerva I well. Perhaps Bob conveyed his interest in the north section to his children and grandchildren. By virtue of the entireties clause, such new owners will be entitled to their apportioned share of royalties, even though production is from a well located in the south section of the lease. Confirming such ownership will require a potentially burdensome title examination of land outside of the subject drilling unit. The title examination problem intensifies when a lease containing an entireties clause covers multiple tracts spread across multiple sections.

Entireties clauses with the type of royalty apportionment language discussed here are not ordinarily found in leases of recent vintage (their use having fallen out of favor), and appear most often in leases dating from the 1950s to 1970s. Importantly, such leases often contain no Pugh clause. Thus, particular care should be taken when reviewing the provisions of leases that have been held by production for multiple decades. Even when certain tracts of leases with royalty apportionment clauses have been released, some have argued that the lessors of released tracts remain entitled to proceeds from actively producing tracts. The entireties clause should also be carefully reviewed in the context of the other lease provisions, which may impact the application of the entireties clause. Further, any lease amendments should be carefully scrutinized because in some instances entireties clauses will have been deleted and replaced with a form of Pugh clause.

The entireties clause deserves the attention of operators, especially considering the many different forms in which the clause is drafted. The royalty apportionment-type clause treated here is just one variant with critical implications for the proper distribution of proceeds, but each lease

needs to be examined in its own right with attention paid to the particular language used, in order to determine what issues might arise out of its application beyond royalty apportionment.

Sources:

1-7 Law of Pooling and Unitization § 7.04 (3d ed.).

4-6 Williams & Meyers, Oil and Gas Law § 678.

1-XII The Law of Oil and Gas Leases § 12.01 (2d ed.).

Gene L. McCoy, The Entirety Clause—Its Current Use and Interpretation, 12 Rocky Mt. Min. L. Inst. 10 (1967).

William S. Livingston, The Entirety Clause and the Drafting of Division Orders, 5 Rocky Mt. Min. L. Inst. 12 (1960).

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