

Ratification: Beware!

M. Ryan Kirby

J. Brian Davis

Kirby, Mathews & Walrath, PLLC

Ratification

An agreement ratifying and confirming a lease executed by a concurrent owner other than the original lessor, or conduct by such person which by implication ratifies and confirms the lease.

Williams & Meyers, Oil and Gas Law § 505.2

Five Basic Attributes of Mineral Interests

1. Execute oil and gas leases.
2. Develop (ingress and egress).
3. Receive royalty.
4. Receive bonus payments.
5. Receive delay rentals.

Severability

Each attribute of a Mineral Interest is capable of being severed from the others, through conveyance or reservation.

Non-Executive Mineral Interest (“NEMI”)

- Bonus and delay rentals: YES.
- Executive right: NO.
- Right to develop: ???

Non-Participating Royalty Interest (“NPRI”)

- An expense free interest in O&G.
- No bonus, delay rentals, executive right, or the right to develop.

Creation of a Non-Executive Interest

- Express Grant.
 - *White v. White*, 830 S.W.2d 767 (Tex. App. 1992).
- Reservation.
 - *In Re Bass*, 113 S.W.3d 735 (Tex. 2003).

Reasons for Obtaining a Ratification

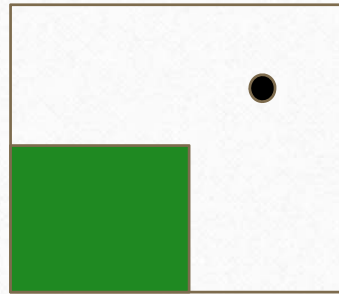
- Unleased Party.
- Adopting Document/Unit.
- Confirming an Instrument.
- Pooling.

Example: Facts

- Lyle: 100% MI on WA, 300 acres & GA, a 100 acres.
- Nancy: 1/8th floating NPRI on GA.
- Lyle executes lease with Supreme Oil Company covering both GA & WA.
 - 25% royalty and a pooling clause.

Example #1: No Ratification, Non-Drillsite

- Nancy does not ratify.
- A vertical well is drilled on WA.
- Nancy's entitlement?



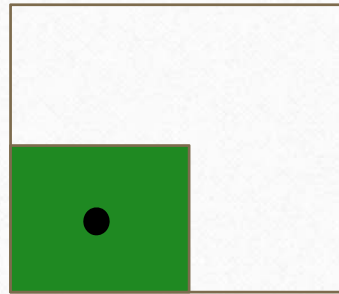
Example #1: No Ratification, Non-Drillsite

0

Absent ratification of the lease, a non-executive owner is only entitled to a share of production when the drillsite is located on the lands burdened by the non-executive interest.

Example #2: No Ratification, Drillsite

- Nancy does not ratify.
- A vertical well is drilled on GA.
- Nancy's entitlement?



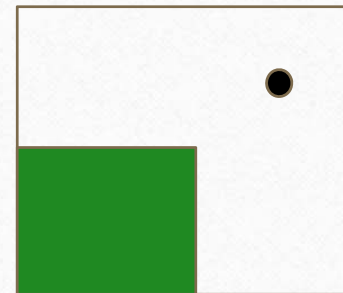
Example #2: No Ratification, Drillsite

$1/8$ of 25%

Absent ratification of the lease, a non-executive owner is entitled to its full share of production when the drillsite is located on the lands burdened by the non-executive interest.

Example #3: Ratification, Non-Drillsite

- Nancy ratifies.
- A vertical well is drilled on WA.
- Nancy's entitlement?



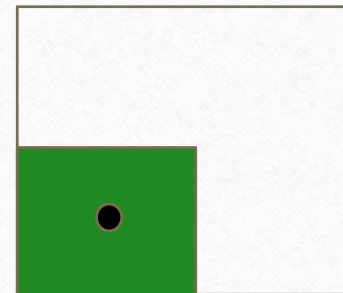
Example #3: Ratification, Non-Drillsite

1/8 of 100/400 of 25%

Ratification of a lease which covers separate tracts effectively communitizes the non-executive's interest across all of the tracts covered by the lease. As a result, the non-executive owner is entitled to a proportionate share of production, even if the drillsite is not located on the tract in which the non-executive owns an interest.

Example #4: Ratification, Drillsite

- Nancy ratifies.
- A vertical well is drilled on GA.
- Nancy's entitlement?



Example #4: Ratification Drillsite

$1/8$ of $100/400$ of 25%

When a lease covers separate tracts, including lands burdened by a non-executive interest, and said lease includes pooling provisions, the effect of a non-executive interest owner ratifying said lease is the same as if they had executed the original lease, and thereafter the non-executive royalty owner would be entitled to their proportionate royalty on all lands covered by the lease. Accordingly, the interest of the non-executive owner is diluted even though their interest burdens the drillsite tract.

Pooling

- Pooling is a cross-conveyance.
- Granting power to pool w/o consent = Conveying interest w/o consent.
 - *Brown v. Smith*, 174 S.W.2d 43 (Tex. 1943).

Pooling Non-executives

- No pooling of non-executive interests unless:
 - Right reserved in instrument, OR
 - Consent obtained.
 - Diminish non-executive's interest w/o consent.
 - *Montgomery v. Rittersbacher*, 424 S.W.2d 210 (Tex. 1968).

Who is Responsible for Obtaining a Ratification?

- Lessor:
 - Duty to notify, AND
 - Give option to ratify.
 - *De Benavides v. Warren*, 674 S.W.2d 353 (Tex. App.—San Antonio 1984).
- Lessee:
 - May be obligated to notify, OR
 - Potential argument participated in Lessor's breach.
 - Fiduciary Obligations Under Oil and Gas Leases: The Standard of Conduct Owed by Executives and Lessees, Ernest Smith, 9/1985.

To Ratify or Not Ratify – The Non-Executive’s Decision

- Up to non-executive owner.
- Potential benefits and risks, regardless of ratification.
- Make a “timely” ratification.
 - When: open to interpretation.

Ratification and Communitization

- Separate tract owners jointly execute lease.
 - Covering both tracts of land.
- Both entitled to proportionate royalty.
 - Regardless of producing well location.

Ratification and Communitization (Cont.)

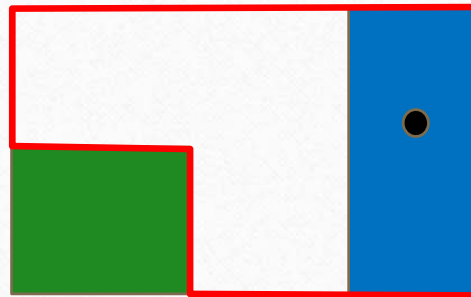
- Lease covers separate tracts.
 - Lands burdened by a non-executive interest, AND
 - Lease includes pooling provisions.
- Ratifying lease = Executing original lease.
 - Entitled to proportionate royalty on all lands covered by the lease.
 - Even O&G produced from well on another tract.

Example: Facts

- Lyle: 100% MI on WA, 300 acres & GA, a 100 acres.
- Anthony: 100% MI on BA, 200 acres.
- Nancy: 1/8th floating NPRI on GA.
- Lyle and Anthony execute a lease with Supreme Oil Company covering GA, WA, & BA.
 - 25% royalty and a pooling clause.

Example #5: Ratification, Lands Outside of Pooled Unit

- Nancy ratifies.
- Supreme Oil forms a Unit that consists of only WA and BA.
- Drillsite is located on BA.
- Nancy's entitlement?



Example #5: Ratification, Lands Outside of Pooled Unit

$1/8$ of $100/400$ of $300/500$ of 25%

When a lease covers separate tracts, including lands burdened by a non-executive interest, and said lease includes pooling provisions, the effect of a non-executive interest owner ratifying said lease is the same as if they had executed the original lease, and thereafter the non-executive royalty owner would be entitled to their proportionate royalty on all lands covered by the lease or pooled therewith.

Ratification and Communitization: Anti-Communitization Clause

If this lease now or hereafter covers separate tracts, no pooling or unitization of royalty interest as between any such separate tracts is intended or shall be implied or result merely from the inclusion of such separate tracts within this lease but Lessee shall nevertheless have the right to pool as provided above with consequent allocation of production as provided. The phrase “separate tract” means any tract with royalty ownership differing, now or hereafter, either as to parties or amounts, from that as to any other part of the leased premises.

Ratification and Communitization: Anti-Communitization Clause (Cont.)

- *London v. Merriman* - “anti-communitization clause” did not prohibit the non-participating royalty owner from ratifying the lease.
- The pooling of the royalties resulted from the lessor’s attempted authorization for the lessee to pool the non-participating royalty interest without their consent (by including a pooling provision in the lease), enabling the non-participating royalty interest owners to ratify the unauthorized pooling provision contained in the lease.

Limits of Ratification

- Revivor –
 - Requires document that takes effect as conveyance; AND
 - Expressly recognizes validity of expired instrument.
- Void Instruments –
 - Ratification does not validate a void instrument.
 - Whether a lease that was void at inception may be ratified once the reason for invalidity has been removed is uncertain in Texas.

Alternative to Ratification: The Consent to Pooling Agreement

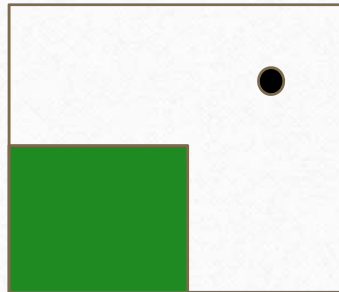
- Eliminates Communitization issue.
- Should include Non-Appportionment Clause.
- May be limited in scope (unit by unit basis).
 - May consent when not burdened.
 - May not consent when burdened.

Non-Appportionment Clause

- Royalties paid only to owner of producing tract.
- Neighbors get nothing.
- Language to protect against non-apportionment.
 - “royalties shall be paid to each separate owner in the proportion that the acreage owned by him bears to the entire leased area.”

Example #6: Consent to Pool, Non-Drillsite

- Nancy executes a consent to pool.
- Supreme Oil Company drills a lease well on WA.
- Nancy's entitlement?



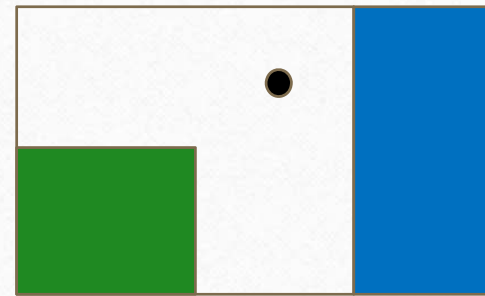
Example #6: Consent to Pool Non-Drillsite

0

Absent ratification of the lease, a non-executive owner is only entitled to a share of production when the drillsite is located on the lands burdened by the non-executive interest.

Example #7: Consent to Pool, Non-Drillsite

- Nancy executes a consent to pool.
- Supreme Oil Company forms a Unit which consists of GA, WA and BA, a 200 acre tract adjacent to WA.
- Supreme Oil Company drills a well on WA.
- Nancy's entitlement?



Example #7: Consent to Pool, Non-Drillsite

$1/8$ of 100/600 of 25%

When a non-executive interest owner executes a consent to pool, the non-executive royalty owner is entitled to their proportionate royalty on all lands included in the Unit. Nancy would be entitled to her same proportionate share of royalty regardless of where the drillsite is located in the Unit.

Conclusion

- Ratifications can easily lead to Communitization.
- Consent to Pool is a viable option to obtaining a ratification.

Questions or Comments?

- Ryan Kirby
 - rkirby@kmwenergylaw.com
- Brian Davis
 - bdavis@kmwenergylaw.com



**KIRBY, MATHEWS
& WALRATH**