Oil & Gas: Valuation, Surface Rights and Mineral Interests

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Mineral Interests

Created by:
- Grant
- Reservation/Exception
- Mineral Deed
- Conveyance with Exception
- ALL or an undivided interest
Mineral Interests

Rights of Mineral Interest Owner:
- Enter the land to prospect
- Execute oil and gas leases
- Receive bonuses
- Receive delay rentals
- Receive royalties
Mineral Interests

Leasehold Interest:
- Mineral owner creates a leasehold interest in another by executing an oil and gas lease.
- Lessor: The Mineral Owner
- Lessee: The one who has the right to prospect
- Primary term is for a set number of years and thereafter so long as oil and gas is produced in paying quantities.
Mineral Interests

Bonus:

- Cash paid by Lessee to Owner/Lessor for entering into the oil and gas lease
Mineral Interests

Royalty:

The consideration Lessee pays Lessor is a % share of the production, free of costs
Mineral Interests

Hot Tip:
- Lease of minerals is only for term of lease and thereafter if production
- UPON TERMINATION OF LEASE THE MINERAL RIGHTS REVERT TO OWNER/LESSOR
- Always award all mineral rights in Decree even if only one party is awarded rights in the “Lease”.
# Mineral Interests vs. Royalty Interest

<table>
<thead>
<tr>
<th>Right and/or Privilege</th>
<th>Mineral Owner</th>
<th>Royalty Owner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prospect for oil and gas on the land</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Create a leasehold interest, i.e., execute and deliver an oil and gas lease</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Possess a possibility of reverter</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Receive bonus</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Receive delay rentals</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Receive royalty (share or proceeds of product)</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>
## Mineral Interests vs. Surface Interests

<table>
<thead>
<tr>
<th>Right and/or Privilege</th>
<th>Mineral Owner</th>
<th>Surface Owner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Use all necessary land to drill</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Receive compensation for damage to land</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Can negotiate for surface damages</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Enter land for non-production uses</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>
Mineral and Surface Interests

 Married couple buys property – Surface and Minerals
   • Couple lease to XTO
   • Couple negotiates for bonus and royalty of 25%

 10 Years Pass
   • Couple Divorces
   • Husband is awarded royalty interest (income)
   • Wife awarded land

      . . . . . .
Mineral and Surface Interests

5 Years Pass

- XTO stops producing
- Lease terminates
- Husband’s royalty stops and terminates
- Wife now owns all surface and minerals
- Wife re-leases to Devon for mega bucks in the Barnett Shale
Warranty Deed (ex. I)

“Property: Situated in Hidalgo County, Texas, the Property described in Exhibit A, attached and made a part of this Deed;

SAFE AND EXCEPT all of the oil, gas and other minerals in, under and that may be produced from the Property, together with the right of ingress and egress at all times for the purpose of mining, drilling and exploring the lands for oil, gas and other minerals and removing the same from the lands.

Reservations from and Exceptions to Conveyance and Warranty:
- Reservation of all oil, gas and other minerals.
- Subject to valid and subsisting oil, gas and mineral leases and all unit designations of record.

Grantor, for the consideration and subject to the reservations from and exceptions to conveyance and warranty, grants, sells, and conveys to Grantee the property, together with all and singular the rights and appurtenances thereto in any wise belonging, to have and hold it to Grantee, Grantee's heirs, executors, administrators, successors, or assigns forever. Grantor binds Grantor and Grantor's heirs, executors, administrators, and successors to warrant and forever defend all and singular the”

-Severs surface from mineral estate and reserves mineral to Grantor
Warranty Deed (ex. II)

“Property: Situated in Hidalgo County, Texas, the Property described in Exhibit A, attached and made a part of this Deed;

SAFE AND EXCEPT an undivided 1/4 of Grantor's interest in all of the oil, gas and other minerals in, under and that may be produced from the Property, together with the right of ingress and egress at all times for the purpose of mining, drilling and exploring the lands for oil, gas and other minerals and removing the same from the lands.

Reservations from and Exceptions to Conveyance and Warranty:
- Reservation of 1/4 of Grantor's interest in all oil, gas and other minerals.
- Proportionally subject to prior exceptions and reservation of record, of any.
- Subject to valid and subsisting oil, gas and mineral leases and all unit designations of record.

Grantor, for the consideration and subject to the reservations from and exceptions to conveyance and warranty, grants, sells, and conveys to Grantee the property, together with all and singular the

○ Reserves ¼ of Grantor’s minerals (whatever that is)
○ Does Two Things:
  ○ Keeps ¼ for Grantor
  ○ Convey ¾ to Grantee
“Property: Situated in Hidalgo County, Texas, an undivided ½ of Grantor's interest in the oil, gas and other minerals in, on under and that may be produced from Grantors Property described in Exhibit A, attached and made a part of this Deed, together with the right of ingress and egress at all times for the purpose of mining, drilling and exploring the lands for oil, gas and other minerals and removing the same from the lands.

Reservations from and Exceptions to Conveyance and Warranty:

. Proportionally subject to prior exceptions and reservation of record, of any.
. Subject to valid and subsisting oil, gas and mineral leases and all unit designations of record.

Grantor, for the consideration and subject to the reservations from and exceptions to conveyance and warranty, grants, sells, and conveys to Grantee the property, together with all and singular the rights and appurtenances thereto in any wise belonging, to have and hold it to Grantee, Grantee's heirs, executors, administrators, successors, or assigns forever. Grantor binds Grantor and Grantor's”

Grants ½ of Owner’s Interest
Royalty Deed (ex. IV)

"Property: Situated in Hidalgo County, Texas, an undivided 1/4 interest in the oil, gas and mineral royalty or royalties deliverable or payable on production of oil, gas and other minerals, or any one of them, under the terms of any existing or future lease leases insofar as such lease or leases cover the lands, or any portion thereof, described in Exhibit A, attached and made a part of this Deed.

Grantor shall have the power to execute any and all future leases for the development of the lands, or any portion thereof, for oil, gas and other minerals, or any one or more of them, without the joinder of Grantee, but no lease shall be executed which provides for a royalty of less than the following amounts upon any mineral covered by the lease or leases: 1/8 of all oil produced and saved from the lands; 1/8 of the value of all gas produced and sold or used by lessee off the leased premises; 1/8 of the value of any other mineral produced or mined from the premises and sold or used for commercial purposes. Grantee shall have no right to participate in the bonus or bonuses paid or payable for any existing or future lease, nor in the delay rentals payable thereunder for the privilege of deferring the commencement of a well, but, with the exception of the foregoing, shall be entitled to receive an undivided 1/4 in all payments or considerations of every kind and nature, except payments made for the use of or damage to the surface estate, paid or payable to Grantor by any lessee of the premises, or any part thereof, under the terms of the lease, including the following: all royalties (including royalties in excess of the minimum amounts stated above); all payments made in lieu of production from any well or wells that are shut in for want of a market or other cause; and all oil or production payments or other payments or considerations, the accrual of which is contingent upon production, payable under any lease hereafter executed.

Reservations from and Exceptions to Conveyance and Warranty:

Subject to valid and subsisting oil, gas and mineral leases and all unit designations of record.

Grantor, for the consideration and subject to the reservations from and exceptions to conveyance and warranty”

* Gives grantee 1/4 of whatever royalty is negotiated in the future
Term Royalty Deed (ex. V)

“Property: Situated in Hidalgo County, Texas, an undivided 1/4 interest in the oil, gas and mineral royalty or royalties deliverable or payable on production of oil, gas and other minerals, or any one of them, under the terms of any existing or future lease or leases insofar as such lease or leases cover the lands, or any portion thereof, described in Exhibit A, attached and made a part of this Deed.

This grant shall run, and the rights, titles and privileges granted shall extend to Grantee, to Grantee's heirs, administrators, executors and assigns, for a period of twenty (20) years from the date of this deed and as long thereafter as oil, gas or other minerals, or either of them, is produced or mined from the lands in paying or commercial quantities. If at the expiration of twenty (20) years from date hereof, oil, gas or other minerals, or either of them, is not being produced or mined from the land, or any portion thereof in paying or commercial quantities, this contract shall be null and void and Grantee's rights hereunder shall terminate.”

• Gives grantee ¼ of any royalty but for only 20 years and as long as there is production
“Property: Situated in Hidalgo County, Texas, an undivided 1/4 interest in all of the oil, gas and other minerals in, on or under and that may be produced from Grantor's lands described in Exhibit A, attached and made a part of this Deed, together with the right of ingress and egress at all times for the purpose of mining, drilling and exploring the lands for oil, gas and other minerals and removing the same from the lands.

This grant shall run, and the rights, titles and privileges granted shall extend to Grantee, to Grantee's heirs, administrators, executors and assigns, for a period of twenty (20) years from the date of this deed and as long thereafter as oil, gas or other minerals, or either of them, is produced or mined from the lands in paying or commercial quantities. If at the expiration of twenty (20) years from date hereof, oil, gas or other minerals, or either of them, is not being produced or mined from the land, or any portion thereof, in paying or commercial quantities but if there is outstanding a valid lease of oil, gas or other minerals covering all or any part of the land, this grant shall continue as long as the lease remains in effect. If at the expiration of the twenty (20) year period, there is no production and there is no outstanding valid lease in effect, this contract shall be null and void and Grantee's rights hereunder shall terminate.”

• Gives a mineral interest of ¼ for 20 years and as long as there is production
Gift Mineral Deed with Reservation of Life Estate (ex. VII)

“Property: Situated in Hidalgo County, Texas, all of Grantor's undivided interest in and to all oil, gas and other minerals in, under and that may be produced from Grantor's lands described in Exhibit A attached and made a part of this Deed; together with the right of ingress and egress at all times for the purpose of mining, drilling and exploring the lands for oil, gas and other minerals and removing the same from the lands;

SAVE AND EXCEPT, however, Grantor excepts and reserves for Grantor and Grantor's assigns the full possession, benefit and use of the property, as well as the rents, issues and profits from it, for and during Grantor's natural life.”

- Grantor gets benefits of the minerals until she dies then grantee gets mineral interest owned by grantor
Mineral Deed of Life Estate with Remainder Over (ex. VIII)

“Property: For and during Grantee's natural life, with remainder over at Grantee's death to Grantee's heirs at law, situated in Hidalgo County, Texas, all of Grantor's undivided interest in and to all oil, gas and other minerals in, under and that may be produced from Grantor's lands described in Exhibit A attached and made a part of this Deed; together with the right of ingress and egress at all times for the purpose of mining, drilling and exploring the lands for oil, gas and other minerals and removing the same from the lands, full possession, benefit and use of the property, as well as the rents, issues and profits from it, for and during Grantee's natural life.”

- E.G. Grandfather giving daughter a life estate in minerals for her life, but then minerals go to her heirs.
Waiver and Release of Surface Rights (Ex. IX)

“1. Waiver of Surface Rights. The mineral Owner, on behalf of itself and its successors and assigns, as to its mineral ownership and as to all mineral ownership for which it holds exclusive and/or leasing rights, expressly releases and waives all rights to use all or any part of the surface of the Property, including, without limitation, the right to enter upon the surface of the Property for purposes of exploring for, developing, drilling, producing, transporting, mining, treating, storing or any other purposes incident to the development or production of the oil, gas and other minerals in and under the property.”

- Used especially in cities, prohibits mineral owner from entering the land for any purpose.
## Characterization

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<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Royalty Payments on Separate Properties</td>
<td>Separate</td>
</tr>
<tr>
<td>Minerals on Separate Properties</td>
<td>Separate</td>
</tr>
<tr>
<td>Partnership interest in oil and gas business before marriage</td>
<td>Separate</td>
</tr>
<tr>
<td>Salary</td>
<td>Community</td>
</tr>
<tr>
<td>Profits</td>
<td>Community</td>
</tr>
<tr>
<td>Delay rentals on separate property</td>
<td>Community</td>
</tr>
<tr>
<td>Bonus payments on leases on separate property</td>
<td>Separate</td>
</tr>
</tbody>
</table>
Valuation

- Present value of oil and gas properties using discounted future income.

- 3 Techniques for estimating discount rates:
  - Market Surveys
  - Oil and gas sales analysis
  - Weighted average cost of capital (WACC)

- These 3 techniques provide a range for the discount
Discounted Cash Flow method:

1. Projects anticipated net income for each year of well’s economic life.
2. Annual cash flow is discounted to present value.
3. Present values are added to obtain total market value of the property.
Discount Rate Components

- The Inflation Rate
- The Risk-free Component
- General Risk Premium
- Property Specific Risk Premium

= Discount Rate
Valuation Tip

Hire a really good valuation expert!!!