POOLING THE NON-EXECUTIVE INTEREST -

HAVE YOU HAD YOUR CONSENT TODAY

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HAPL SATURDAY FALL SEMINAR
October 28, 2000

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Frank Rosie was born in Trenton, New Jersey. He graduated from Fairleigh Dickinson University in 1976, with a BA in History and Political Science. He moved to Texas in 1977 to attend law school, graduating from South Texas College of Law in 1980. He became licensed by the State Bar of Texas in May, 1981. He began his career as an associate with the law firm of Byrnes, Myers, Adair, Campbell & Sinex, becoming a partner in 1986. Frank practiced in the firm's oil and gas section, with emphasis on all aspects of title examination and producing property acquisitions. Since March of 1993, he has been the senior partner in the law firm of Rosie & Flanagan, P.C., and has continued to concentrate his practice in the area of oil and gas law. Frank is an avid golfer, and since 1997, has been a court appointed advocate for Child Advocates, Inc. Frank and his wife Monica reside in Kingwood with their two wonderful children, Krystal, age 8, and Michael, age 14 months. His golf game has suffered some since the birth of Michael, but he hopes to get his game back with the help of his new golfing buddy.

POOLING THE NON-EXECUTIVE INTEREST

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I. INTRODUCTION

Much has been written in the past decade regarding the authority of the owner of the executive right or exclusive right to execute oil and gas leases, to pool the interest of a non-executive interest owner by the execution of a lease containing a pooling provision. Much of the discussion has been generated by legal "authorities" questioning the rationale of a line of cases beginning with the 1943 Supreme Court decision in *Brown v. Smith*, 141 Tex. 425, 174 S.W.2d 43 (1943), and culminating with the case of *London v. Merriman*, 756 S.W.2d 736 (Tex. App. - Corpus Christi 1988, writ den'd). It is interesting to note that, while many of the legal "authorities" couched their discussion in terms of the right to pool a "non-executive interest", the reported cases expressly deal with non-participating royalty interests. To date, none of the cases have dealt with the right of the executive interest owner to pool a non-executive mineral interest. Although it was initially my intention to deal strictly with the issue of pooling a non-executive mineral interest, since the terms "non-executive mineral interest" and "non-participating royalty interest" have become so intertwined, and are often generically referred to as a "non-executive interest", some discussion regarding pooling of a non-participating royalty interest is necessary.

This paper with attempt to discuss the distinctions between a non-participating royalty interest and a non-executive mineral interest, and whether the nature of the interest would make a difference as to the authority of the owner of the executive rights to pool these interests.

II. ATTRIBUTES OF MINERAL INTEREST OWNERSHIP

In order to understand the distinctions between a non-participating royalty interest and a non-executive mineral interest, it would first be helpful to understand the attributes of mineral interest ownership. In the case of *Temple Inland Forest Products Corp. v. Henderson*, 911 S.W.2d 531 (Tex. App. - Beaumont), rev'd on other grounds, 958 S.W.2d 183 (Tex. 1997), the Court identified the five attributes of mineral ownership. These include: (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. The Court further stated that each of the five attributes of mineral ownership is a separate and distinct interest that may be conveyed or reserved in connection with the conveyance of a mineral interest.

A. THE EXECUTIVE RIGHT

As noted above, two of the attributes of mineral ownership are the right to develop and the right to lease. These rights are often referred to together as the "executive right". In its broadest sense, the executive right includes the right to take or authorize all actions that affect the exploration and development of the mineral estate. Texas courts, however, have rarely used the term in this broad sense. The vast majority of opinions define the executive right as the exclusive right to execute oil and gas leases. See 1 E. Smith and J. Weaver, *Texas Law of Oil and Gas* §2.6 (2d ed. 1998); see also *Altman v. Blake*, 712 S.W.2d 717 (Tex. 1986). In 1990, the Texas Supreme Court confirmed that

the executive right, when severed from the other rights or attributes of mineral ownership, is an interest in property, subject to the principles of property law. *Day & Co. v. Texland Petroleum, Inc.*, 786 S.W.2d 667 (Tex. 1990). As a property interest, the executive right is capable of being severed by either a grant or a reservation, and is freely assignable.

III. RIGHTS AND DUTIES OF THE EXECUTIVE

It is clear that the owner of the executive right has the exclusive right to execute leases binding upon the non-executive or non-participating interest. Because owners of non-executive interests have no right to participate in leasing, they are dependent upon the actions of the executive in realizing any income from their interest. We will here take a brief look at the duties owed by the executive to the non-executive, as well as the right of the executive to authorize pooling of the non-executive or non-participating interest by executing an oil and gas lease which contains a pooling provision.

A. DUTY OF UTMOST GOOD FAITH AND FAIR DEALING

The most commonly accepted standard, and the one which has clearly been adopted in Texas, is that the executive owes to the non-executive, be it a non-executive mineral interest or non-participating royalty interest, a duty of utmost fair dealing. This duty requires the holder of the executive right to execute the same type of oil and gas lease on the same terms as he would have done in the absence of an outstanding non-participating/non-executive interest in a third party. It requires more concern for the interests of the non-executive owners than ordinary good faith; but unlike a fiduciary obligation, it does not require the holder of the executive right to subordinate its own interest to that of the owners of non-executive interests.

The case of *Manges v. Guerra*, 673 S.W.2d 180 (Tex. 1984), appeared to go perhaps one step further, by equating the standard of utmost good faith and fair dealing with that of a fiduciary obligation. In this case, Manges owned the surface of a large South Texas ranch, an undivided 1/2 interest in the minerals therein, and the exclusive right to execute leases covering the entire ranch property. The Guerra family owned a 1/2 interest in the minerals as a non-executive interest. The facts, as somewhat simplified, are that Manges executed an oil and gas lease to himself covering a portion of the ranch acreage. The lease, which was quite favorable to the lessee, provided for a ten year primary term, a 1/8 royalty, and a $2.00 per acre delay rental. A bonus of $5.00 was paid for the entire 26,000 acres covered by the lease. Additionally, shortly after executing the lease, Manges farmed out a portion of the lease and reserved a 50% back-in (working) interest in himself. Three producing wells and several non-producing wells were drilled under the lease. As a result of this lease, the Guerra family filed suit alleging that Manges had breached the duty owed them in the exercise of his executive right.

The Opinion of the Texas Supreme Court comes close to making the executive a full fiduciary. The standard of "utmost good faith" was specifically equated with fiduciary obligations. The court stated that the conduct of Manges amounted to a breach of his "fiduciary" duty. The Court's judgment

included several remedies normally granted in cases involving breach of fiduciary duty, suggesting that such penalties were appropriate because Manges violated a fiduciary obligation to the Guerras. The Court canceled the "Manges-to-Manges Lease" because it provided Manges with special benefits, including a working interest in the lease itself, which was not shared with the non-executives. The Court also sustained an award of exemplary damages because the suit "was based upon a breach of an executive's fiduciary duty, and not the breach of an implied covenant." *Id.*

Although the *Manges* case suggests that the holder of the executive right may be subject to a fiduciary duty, subsequent cases have refused to construe *Manges* as imposing a strict fiduciary standard upon the executive owner absent some elements of overreaching, self-dealing, or refusal to share benefits with the non-executive.

The *Manges* case and subsequent cases clearly stand for the proposition that the duty of utmost good faith and fair dealing owed by the holder of the executive right, requires the executive to acquire for the non-executive every benefit that he exacts for himself. It should be noted, however, that all of the reported cases deal with the duty to execute leases and the monetary terms and monetary benefits under the lease. None of the reported cases address the issue of utmost good faith and fair dealing in light of the pooling authority of the executive. Based upon the holding in *Manges*, it would seem that the executive owner would have the right to bind the non-executive interest to a lease which contains a pooling provision as long as the executive owner is not overreaching or self-dealing, and is obtaining for the non-executive every benefit which he has obtained for himself.

B. RIGHT OF THE EXECUTIVE TO AUTHORIZE POOLING

Relying solely upon *Manges v. Guerra*, it would appear that the executive owner has the authority to bind the non-executive interest to an oil and gas lease which contains a pooling provision, as long as the non-executive owner benefits equally from the pooling provision as the executive. There is another equally established rule of law, however, that the owner of the executive right, absent consent, has no power to authorize pooling of a non-participating royalty interest. A lease which purports to pool the non-executive interest is essentially an offer by the lessor to the non-executive owner to create a community lease by ratifying the lease. The owner of the non-executive interest has the option to either ratify the pooling or not, depending on which alternative is best for him. If the non-executive does ratify the lease, the lease effects a cross-conveyance of interests and a pooling of royalty interests. The non-participating royalty owner receives a proportionate share of the royalty based upon the percentage that the lease acreage which includes his non-participating royalty interest bears to the total acreage included in the unit. If the non-executive refuses to ratify the lease, then the non-executive is entitled to his full undiluted interest in any production from his land, and the non-executive is not entitled to share in production from pooled or communitized lands. (Emphasis added.) It should be noted here that the term "non-executive" interest has been generically used to describe both a non-executive mineral interest and a non-participating royalty interest. Both interests are "non-executive" in that the owners of such interests have no right to execute leases or authorize other action regarding the exploration and development of the mineral estate.

The case of *Brown v. Smith*, 174 S.W.2d 43 (Tex. 1943), was the first case which held that the execution of an oil and gas lease by the executive does not authorize pooling of the non-participating interest without the consent of the owner thereof. *Brown v. Smith* dealt with the pooling of a non-participating royalty interest reserved by a prior grantor, which was subsequently covered by an oil and gas lease which was included in a pooled unit. The Court stated that "When a grantor reserved to himself a royalty interest, he contemplates the leasing of the land for production, and that if he reserves to himself no right of leasing, the grantee possesses that right. But it does not follow that (the grantor's) deed invested her grantee with the right or authority to pool her royalties with royalties from other land that might thereafter be included with it in a lease." 174 S.W.2d 46.

Subsequent cases have followed the holding in *Brown v. Smith*, including *Montgomery v. Rittersbacher*, 424 S.W.2d 210 (Tex. 1968), *Verble v. Coffman*, 680 S.W.2d 69 (Tex. App. - Austin 1984, no writ), and *London v. Merriman*, 756 S.W.2d 736 (Tex. App. - Corpus Christi 1988, writ den'd). These cases which dealt with pooling and apportionment of royalties, arose subsequent to the Rule of Non-Apportionment established in *Japhet v. McRae*, 276 S.W. 669 (Tex. Comm. App. 1925, judgment adopted). The Rule of Non-Apportionment states that, where a lessor, subsequent to the execution of an oil and gas lease, but prior to the production of oil or gas under the lease, sells a portion or portions of the land to others, and oil or gas are thereafter produced under the lease from some portion of the leased premises, the royalties therefrom belong to the owner of the particular tract upon which the well is located, and the owner or owners of other portions of the leased premises have no interest in such production.

In response to the Rule of Non-Apportionment established in *Japhet*, the "entireties clause" was created, which would result in the apportionment of royalties throughout a multi-tract lease. A typical entireties clause states that, if the leased premises are now or hereafter owned in severalty or in separate tracts, the premises shall nevertheless be developed and operated as one lease, and all royalties accruing thereunder shall be treated as an entirety and shall be divided among the separate owners in the proportion that the acreage owned by each such separate owner bears to the entire leased acreage.

The lease involved in *Montgomery v. Rittersbacher* contained an entireties clause. The lease covered two tracts of land, one of which was burdened by a non-participating royalty. A portion of the tract not encumbered by the non-participating royalty was included in a pooled unit with an adjacent lease. Montgomery, the owner of the non-participating royalty interest, filed suit claiming that he was entitled to a portion of the unit production due to the fact that the lease contained an entireties clause, and a portion of the lease was included in the producing unit. The Court agreed, stating that, since, by virtue of the entireties clause, royalties accruing under the lease were to be treated as an entirety and were to be divided among and paid to the separate owners under the lease, and since a portion of the leasehold acreage was included in a pooled unit, the non-participating royalty owner who had ratified the lease was entitled to a pro rata share of production from the producing unit. (Emphasis added.)

The Court was quick to point out that the holder of the executive right did not have the power to bind the non-participating royalty interest by virtue of the entireties clause alone. The Court stated that the enlargement or diminishment of the rights of a non-participating royalty owner can be accomplished by the holder of the executive right executing an oil and gas lease which includes either a pooling clause or an entireties clause, provided the non-participating royalty owner ratifies such action. The Court further stated that the mere reservation of a non-participating royalty under a tract "does not show that the royalty owner intended to give the holder of the executive rights the power to diminish the royalty owner's interest under that tract. Consequently, pooling on the part of the holder of the executive rights cannot be binding upon the non-participating royalty owner in the absence of his consent." 424 S.W.2d 213. The Court also saw no distinction between the pooling clause, insofar as it has the effect of changing the aggregate ownership of the non-participating royalty owner, and the entireties clause, which, in effect, would allow the holder of the executive right to either diminish or enlarge the non-participating royalty interest. The Court stated that in either case, the consent of the owner must be obtained.

The subsequent cases of *Verble v. Coffman*, and *London v. Merriman* also involved a non-participating royalty owner under non-pooled/non-drillsite acreage. These cases differed from *Montgomery* in one seemingly important respect, however, in that these leases did not contain an entireties clause, but rather, contained a clause now referred to as a "non-entireties" or "separate tracts" clause. This clause negates the effect of an entireties clause and follows the rule of non-apportionment. The separate tracts clause states that, if the lease now or subsequently covers separate tracts, no pooling of royalty interests as between such separate tracts is intended or shall be implied or result merely from the inclusion of such separate tracts in the lease. The words "separate tracts" mean any tract with royalty ownership differing either as to parties or amounts from that as to any other part of the leased premises.

In both of these cases, the non-participating royalty owners ratified the lease, thereby effectuating a pooling of production. In both cases, the Court again reasoned that a lease which purported to authorize the lessee to pool the royalty rights of a non-participating royalty owner was essentially an offer by the lessor to the other royalty owners to create a community lease. By ratifying the lease, the non-participating royalty owner effectuated a ratification of the unauthorized act of the lessor in purporting to pool the royalty rights. If the non-participating royalty owner ratifies the lease, the lease effectuates a cross-conveyance of interests and a communitization of royalties.

It is interesting to note, however, that the Courts in both *Verble v. Coffman* and *London v. Merriman* dismissed the "non-entireties" language as being insignificant. It appears that the determining factor of the Courts' decision was the ratification by the non-participating royalty owners which constituted an acceptance of the lessor's offer to pool. In *London*, the Court dismissed the lessor's contention that the plain language of the non-entireties clause negated any intent to pool or unitize the royalties. The Court stated instead, that the pooling and unitization resulted from the lease provisions that authorized pooling of the royalties should the lessee pool the tracts of land in any fashion. The Court dismissed the non-entireties language stating that the "purported non-unitization clause" expressly does not detract from the authorization to pool. The Court stated that "pooling of the royalties

resulted from (the lessor's) attempted authorization for the lessee to pool the (non-participating royalty interest) without their consent, enabling the (non-participating royalty interest) to ratify the unauthorized act." 756 S.W.2d at 740.

In essence, the Court is implying that ratification of a lease by the non-participating royalty owner will bind the non-participating royalty interest to the pooling provision contained in the lease, however, it will not bind such non-participating royalty interest to the "separate tracts" clause which may be contained within the pooling provision itself. (Emphasis added.) Regardless of exact terms of the pooling provision, throughout all of these cases, the Courts have continued to apply the general rule that the owner of the executive right cannot pool the non-participating royalty interest without the consent/ratification of the non-participating royalty owner.

Obviously, this has created much confusion and debate. Many legal authorities have questioned the logic of these cases, in particular, the cases in which the lease specifically included a non-entireties clause. One of the primary Rules of Construction in interpreting any instrument is that the instrument should be read so as to give effect to all of its provisions. Generally, the parties to an instrument intend every clause to have some effect. Some meaning should be given to every word, if it can be reasonably done and it is not inconsistent with the general intent of the whole instrument. The "separate tracts" clause was obviously included in the lease contract to negate any intent to communitize royalty interests. The parties intend it to have this effect. To ratify a lease and the pooling provision contained therein, must necessarily include ratification of the "separate tracts" language. If the non-participating royalty interest owner wishes to ratify the act of pooling, but wishes not to be bound by the separate tracts language, his intent should be clearly expressed. Otherwise ratification of the pooling provision should necessarily include ratification of the separate tracts clause included within the pooling provision itself.

One legal scholar, as early as 1968, well before *Verble v. Coffman* and *London v. Merriman,* urged that the result reached in *Brown v. Smith* was unsound in holding that the owner of the executive right lacked authority to pool a non-executive interest. This scholar has indicated that the Supreme Court of Texas should rule that both royalty and non-executive mineral interests may be pooled by the executive, unless the instrument creating such interest clearly expresses a contrary intent. See *H. Williams, Stare Decisis and the Pooling of Non-Executive Interests in Oil and Gas*, 46 Texas L. Rev. 1013 (1968).

IV. CONCLUSION

A. MINERAL/ROYALTY DISTINCTION

It is interesting to note that all of the reported cases which stand for the proposition that the owner of the execute right does not have the authority to pool a "non-executive" interest without consent, involve pooling of a non-participating royalty interest. None of the cases appear to distinguish between a non-participating royalty interest and a non-executive mineral interest. At times, the two

terms have been haphazardly interchanged. It is important to note, however, that these are two distinct types of interests.

The non-executive mineral interest is similar to a royalty in that the non-executive mineral owner has no right to participate in exploration, development or leasing decisions. It differs from a royalty in that the owner of the non-executive mineral interest is normally entitled to a proportionate share of all benefits attributable to the mineral estate. Thus, where the owner of a non-participating royalty interest receives only a fraction of the gross production, the owner of a non-executive mineral interest also receives a proportionate share of the bonus, delay rentals, and any other lease benefits attributable to the mineral estate. In addition, a mineral fee owner has a possessory interest in land, whereas, a non-participating royalty owner has no possessory estate in land. More importantly, the non-executive mineral interest is made non-executive by the express language of the deed, whereby the grant or reservation of the specific authority to execute leases on behalf of the non-executive is made. A non-participating royalty interest, however, is non-executive by the very nature of the interest itself. It automatically creates an executive right in the mineral interest owner. It grants or reserves a fractional share of gross production only, and does not carry with it any other incidence of ownership.

Perhaps that explains the rational for the rule which does not allow the executive owner to pool a non-participating royalty interest without the consent of the owner thereof. As stated, the non-participating royalty owner is only entitled to a fractional share of gross production. It is his only incidence of ownership. By allowing the executive to pool the non-participating royalty interest, the executive owner is diluting the fractional share of production which the non-participating royalty owner will receive. But what about the executive's duty of utmost good faith? Seemingly, it is met since he is also diluting his own interest by pooling. He is not obtaining an additional benefit to the exclusion of the non-participating royalty interest owner. Regardless, in order to protect the non-participating royalty interest, the courts have indicated that the non-participating royalty interest cannot be pooled without the consent of the owner thereof. Such protection is not necessary for the non-executive mineral interest owner, whose share of production will be determined by the fractional royalty, pooling, proportionate reduction, and other lease terms, which will affect the quantum of his interest. 1 E. Smith and J. Weaver, *supra*, §2.6(A).

B. OBTAINING THE NECESSARY CONSENT

Regardless of whether we are dealing with a non-participating royalty interest or a non-executive mineral interest, it is clear, based upon the existing case law, that consent for pooling must be obtained. This consent can be obtained in essentially two ways. First, by express consent within the instrument creating the non-executive interest, which expressly authorizes the owner of the executive right to pool or unitize the non-executive interest with other lands or leases. Consider the following scenario which this author encountered some years ago. By Warranty Deed dated December 15, 1945 (Volume 86, Page 490), Newton County Lumber Company conveyed various tracts of land in Orange County, Texas, to the Champion Paper and Fibre Company. According to the terms of the Deed, the grantor excepted and reserved an undivided 1/2 interest in and to all of the oil, gas and

other minerals under the lands conveyed, along with the exclusive right to execute leases upon the whole of such minerals for a period of fifteen (15) years from December 15, 1945. At the expiration of such fifteen (15) year period, the exclusive right to execute oil and gas leases would vest in the grantee. Accordingly, on December 15, 1960, the Champion Paper and Fibre Company became vested with the exclusive right to execute oil and gas leases covering the lands conveyed. The non-executive mineral interest reserved by Newton County Lumber Company is now vested in perhaps as many as 100 individuals or other entities. Champion International Corporation (successor to Champion Paper and Fibre Company), executed an oil and gas lease in favor of "XYZ Corp.", covering a portion of the lands conveyed by the referenced deed, which lease authorizes XYZ to pool said lands with other lands or leases.

The question which arises is, does the owner of the executive right have the authority to pool the non-executive mineral interest by the execution of the lease containing an express pooling provision. In this situation, it is important to note the terms of the deed which created the non-executive interest.

The Deed in question from Newton County Lumber Company to the Champion Paper and Fibre Company reserved to the grantor an undivided 1/2 interest in all of the oil, gas and other minerals, and further reflected that grantor was reserving "the exclusive right to execute oil, gas and mineral leases upon the whole of such minerals, including the interest therein which is herein conveyed to grantee for a period of fifteen (15) years from the date hereof, it being understood that for and during such 15-year period from the date of the execution hereof, the grantor shall have the exclusive right to execute oil, gas and mineral leases covering all of such mineral interests, containing such provisions, for such terms ... for such consideration and providing for such royalties ... as it may consider proper, and that the joinder of grantee in any such lease shall never be required ... After the expiration of said 15-year period from the date of the execution hereof, the exclusive right to execute oil, gas and mineral leases upon the whole of such minerals, including the interest therein excepted and reserved by grantor, shall pass to and vest in grantee without the execution of any further instrument affecting the same ...".

As noted above, the grant or reservation of a non-executive mineral interest requires express language creating same. The language contained in the deed in question indicates that the grantor (Newton County Lumber Company) was reserving an undivided 1/2 interest in the oil, gas and other minerals, along with the exclusive right to execute oil and gas leases for a 15-year period. The language further stated that, during the 15-year period, the grantor shall have the exclusive right to execute leases "<u>containing such provisions, for such terms</u> ... for such consideration and providing for such royalties ... <u>as it may consider proper</u> ...". (Emphasis added.) Upon expiration of such 15-year period, the exclusive right to execute leases, including the interest excepted and reserved by the grantor shall pass to and vest in grantee (the Champion Paper and Fibre Company).

It appears by the express terms of the instrument, that the rights of the executive owner, during and arguably after the 15-year term, would include the right to execute oil and gas leases containing a pooling provision. It is thus arguable that the executive owner would have the express authority to pool the non-executive mineral interest. In keeping with the duty of utmost good faith and fair

dealing, as established by *Manges v. Guerra*, it appears that the exercise of pooling authority by the executive owner would be proper provided that the executive acquires for the non-executive every benefit that he exacts for himself. As a result, it can be argued that the non-executive mineral interests in question may be pooled without obtaining ratifications from the numerous owners thereof.

It is also arguable, however, that, based upon the rule of law established by *Brown v. Smith* and all of the related cases cited above, that the owner of the executive right does not have the authority to pool a non-executive interest without the consent of the owner thereof. Although the cases cited above deal strictly with a non-participating royalty interest, several legal authorities have indicated that a non-executive interest would include both a non-executive mineral interest and a non-participating royalty interest. How would you decide?

The second method of obtaining consent to pool the non-executive interest, as was reflected in the above discussed cases, is by lease ratification. Although ratification can take several shapes, including the filing of a lawsuit to share in lease benefits, as was done in *Montgomery v. Rittersbacher*, our focus here will be on the written ratification. Attached as Appendix A to this paper is a "plain vanilla" ratification form. The terms of this ratification instrument provide that the executing party does hereby "adopt, ratify and confirm said lease in all of its terms and provisions, and (does) hereby lease, grant, demise and let said land and premises ... subject to and in accordance with all of the terms and provisions of said lease ... (and does) hereby agree and declare that said lease in all of its terms and provisions is binding on me/us and is a valid and subsisting oil and gas mineral lease."

This ratification form, when executed by a non-participating royalty interest owner, would obviously authorize the pooling of its non-participating royalty interest. Will this form, however, also ratify the "separate tracts" or "non-entireties" clause included within the lease pooling provision? Can I emphasize enough that the executing party, in several places, has ratified and agreed to be bound by all of the terms and provisions of the lease. Clearly this language should include the separate tracts clause. *London v. Merriman*, however, holds otherwise. Compare this generic ratification form with that attached as Appendix B to this paper. This form, which is now in common usage, not only ratifies "all of the terms and provisions" of the lease, but specifically ratifies the separate tracts clause, thereby expressly negating any intent to communitize royalty interests. As long as *London v. Merriman* remains controlling, this is the preferred form to be used.

Based upon the existing case law, unless the pooling of the non-executive interest, be it a non-executive mineral interest or a non-participating royalty interest, is clearly contained in the terms of the instrument creating the non-executive interest, the ratification of the non-executive interest owner should be obtained in order to authorize the pooling of his interest.

C. TO RATIFY OR NOT TO RATIFY

When is obtaining a ratification from the non-executive interest owner critical? When does his consent become less important? As long as *London v. Merriman* remains controlling, utilize the Rule of Non-Apportionment. If the non-executive interest encumbers the tract upon which the well is

located, or in the case of a horizontal well, each tract through which the wellbore and lateral pass, it is essential to obtain a ratification from the non-executive interest owner. Absent his ratification, there is no authority to pool his interest. Thus, he is entitled to receive his full undiluted royalty interest in any production obtained regardless of the size of his tract in relation to the total size of the unit. In this situation, the lessee may become liable for excess royalty due to the unauthorized act of pooling. Obtaining a ratification from the non-executive interest becomes less critical where such interest burdens a non-drillsite or non-wellbore tract. In this instance, while his tract may be included in the unit, the non-executive interest owner is not entitled to any share of production until he ratifies the lease and thus consents to the pooling of his interest.

While this paper certainly does not qualify as an exhaustive treatise on the subject, I hope that it will be helpful in identifying some of the concerns which arise when dealing with a non-executive interest owner, be it a non-executive mineral interest or a non-participating royalty interest.

THE STATE OF_____
COUNTY OF_____

KNOW ALL MEN BY THESE PRESENTS:

THAT WHEREAS, heretofore, under date of_____, _____,

_____

as lessor, did execute and deliver to_____, as lessee, an oil and gas mineral lease, recorded in Volume_____ at Page_____ of the _____ Records of_____ County, covering certain land situated in_____ Survey_____, in_____ County, _____, briefly described as follows, to-wit:

said land being more fully described in said lease, reference to said lease and to the record thereof being here made for all purposes; and,

WHEREAS, said lease and all rights and privileges thereunder are now owned and held by_____

_____; and,

WHEREAS, it is the desire of the undersigned parties hereto to adopt, ratify and confirm said lease;

NOW, THEREFORE, in consideration of the premises and One Dollar ($1.00) and other valuable considerations all cash to us in hand paid by_____, the receipt of which is hereby acknowledged and confessed, I/we_____

_____

lessor (whether one or more), do hereby adopt, ratify and confirm said lease in all of its terms and provisions, and do hereby lease, grant, demise and let said land and premises unto the said _____ subject to and in accordance with all of the terms and provisions of said lease as fully and completely as if we had originally been named as lessor in said lease and had executed, acknowledged and delivered the same in our own proper person; provided, however, the undersigned shall not be paid any portion of the rentals payable under said lease, but such rentals shall be paid to the Lessor therein named, his heirs, legal representatives, or assigns. And I/we do hereby agree and declare that said lease in all of its terms and provisions is binding on me/us and is a valid and subsisting oil and gas mineral lease.

WITNESS our hands and seals this the_____ day of _____, A. D. 19 ____

APPENDIX A

_____

_____

_____

_____

Lessor

RATIFICATION OF OIL AND GAS LEASE
WITH SEPARATE TRACT CLAUSE

THE STATE OF _____ §
§ KNOW ALL MEN BY THESES PRESENTS:
COUNTY OF _____ §

WHEREAS, under date of_____, _____, _____, whose address is_____, Lessor(s), executed an Oil and Gas Lease (hereinafter said "Lease") in favor of_____, as Lessee, which Lease is recorded in Volume _____, at Page _____, of the Oil and Gas Lease Records of the County and State aforesaid; and

WHEREAS, said Lease covers and affects_____ acres of land, more or less, out of the _____ League, Abstract No. _____, _____ County, Texas, all as more fully described in said Lease;

WHEREAS, the undersigned is the owner of a royalty interest in some or all of the land covered by the said Lease and desires to ratify and confirm said Lease and all of the terms and provisions thereof, including the pooling provisions in Paragraph 4 and the provisions set forth in the last two (2) sentences of Paragraph 4 which is customarily known as a "Separate Tract Clause";

NOW THEREFORE, for and in consideration of the premises and One Dollar ($1.00) and other valuable consideration in hand paid, the receipt of which is hereby acknowledged and confessed, the undersigned does hereby adopt, ratify and confirm the said Lease as to all of the terms and provisions therein, and does hereby lease, grant, demise and let the interest of the undersigned in all of the land covered by the said Lease unto the Lessee, its successors and assigns, in accordance with all of the terms and provisions of the said Lease as fully and completely as if the undersigned had originally been named in said Lease as Lessor and had executed, acknowledged and delivered the same to the Lessee; provided, however, that if the interest of the undersigned is a non-participating royalty interest then the undersigned shall not be entitled to any portion of the rentals payable under said Lease, but such rentals shall be paid to the owner or owners of the oil and gas mineral estate, their heirs, legal representatives and assigns.

The undersigned further acknowledges and agrees that it is the intention of the undersigned that the said Lease and this instrument shall not be construed to pool or unitize the royalty interest of the undersigned in any one tract covered by the said Lease with any other tract covered by the Lease which has a different royalty ownership, now or hereafter, whether such difference relates to the ownership or the percentage of the royalties. If the said Lease, now or hereafter, covers separate tracts in which the royalty ownership is different, the Lessee shall have the right, in its discretion, to pool or unitize the interest of the undersigned in any such tract with any other tract covered by the said Lease in the same manner as the Lessee is authorized by the terms of the said Lease to pool or unitize land covered by this Lease with any other land or leases. In such event, the royalty interest of the undersigned in such unit shall be determined on a surface acreage basis, in the proportion that the number of acres in which the undersigned owns a royalty interest bears to the total number of surface acres included in any such unit.

APPENDIX B

The undersigned hereby further declares that the said Lease in all of its terms and provisions is a valid and subsisting oil, gas and mineral lease, and declares that said Lease is binding upon the undersigned, and the undersigned's successors and assigns.

This instrument may be executed in counterparts with the same effect as though all parties had executed the same document. The provisions hereof shall extend to and be binding upon the heirs, successors, legal representatives and assigns of the parties that executed this instrument even though it is executed by fewer than all parties executing as Lessor.

IN WITNESS WHEREOF, this Ratification is executed on the day as it appears in the respective acknowledgments herein.

_____

_____

_____

_____

THE STATE OF _____ §
§
COUNTY OF _____ §

BEFORE ME, the undersigned authority, on this day personally appeared _____, known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that he executed the same for purposes and consideration therein expressed.

GIVEN UNDER MY HAND AND SEAL OF OFFICE, this_____day of_____, 199__.

_____
Notary Public in and for
_____ County, State
of _____

THE STATE OF _____ §
§
COUNTY OF _____ §

BEFORE ME, the undersigned authority, on this day personally appeared _____, known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that he executed the same for purposes and consideration therein expressed.

GIVEN UNDER MY HAND AND SEAL OF OFFICE, this_____day of_____, 199__.

_____
Notary Public in and for
_____ County, State
of _____