

OG Energy Education Series

Common Title Issues Encountered When Operating on Federal Lands



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I focus my practice exclusively on oil and gas matters, including **due diligence and title examination.**



LOCATION

Based in Houston, TX



BAR ADMISSION

Texas

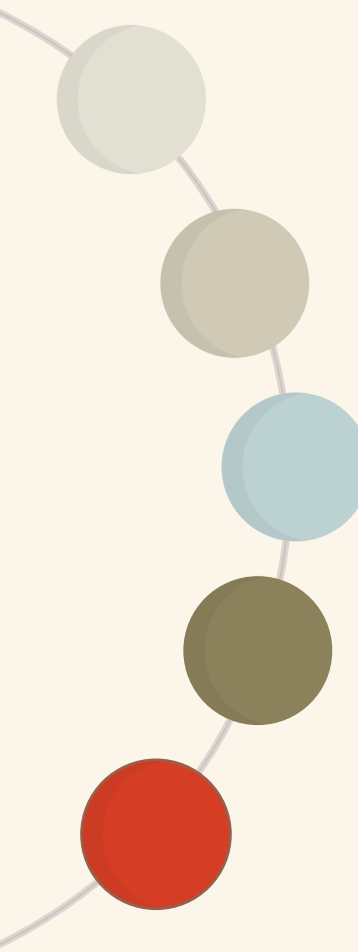


EDUCATION

J.D., South Texas College of Law Houston

B.A. in History, University of Saint Thomas, Houston

What I'm Covering Today

- 
- I. Recording and Constructive Notice
 - II. Record Title vs. Operating Rights
 - III. Right of Way Leasing
 - IV. Lease Segregation
 - V. Communitization vs. Unitization

Recording and Constructive Notice

❖ You Must Search (and File in) Both the County and Federal Records!

Bureau of Land Management

- ❖ Federal lease records maintained by Bureau of Land Management, United States Department of the Interior, in Washington, D.C.
 - Partial sets of duplicate records maintained in BLM State Offices
 - Common practice is to search state office records only, though BLM takes “no responsibility” for incomplete records in state offices
 - Legacy Rehost System (LR2000) provides searchable database, but no docs. In-office examination remains necessary (BLM will provide but federal abstract company is best)
 - Code of Federal Regulations – 43 C.F.R. Parts 3100 through 3180
 - Mineral Leasing Act of 1920 (MLA), U.S.C. Sections 181-263 (amended numerous times)
- ❖ Records regarding operations, well completions, production, unitization, and communitization are maintained in the BLM Field Offices.

County Clerk

- ❖ County records are maintained by the Office of the County Clerk in the county where the property is located.
- ❖ Certain instruments are also filed in the records of the district clerk, probate clerk and in the tax records (if any portion is patented fee lands).

Why Search and File in the Federal Records?

- ❖ **43 CFR § 3106.4-1:** Each transfer of record title or of operating rights (sublease) shall be filed with the proper BLM office on a current form approved by the Director or exact reproductions of the front and back of such form...
- ❖ The rights of any such assignee shall not be recognized by the BLM until such assignment has been approved by an authorized officer thereof.

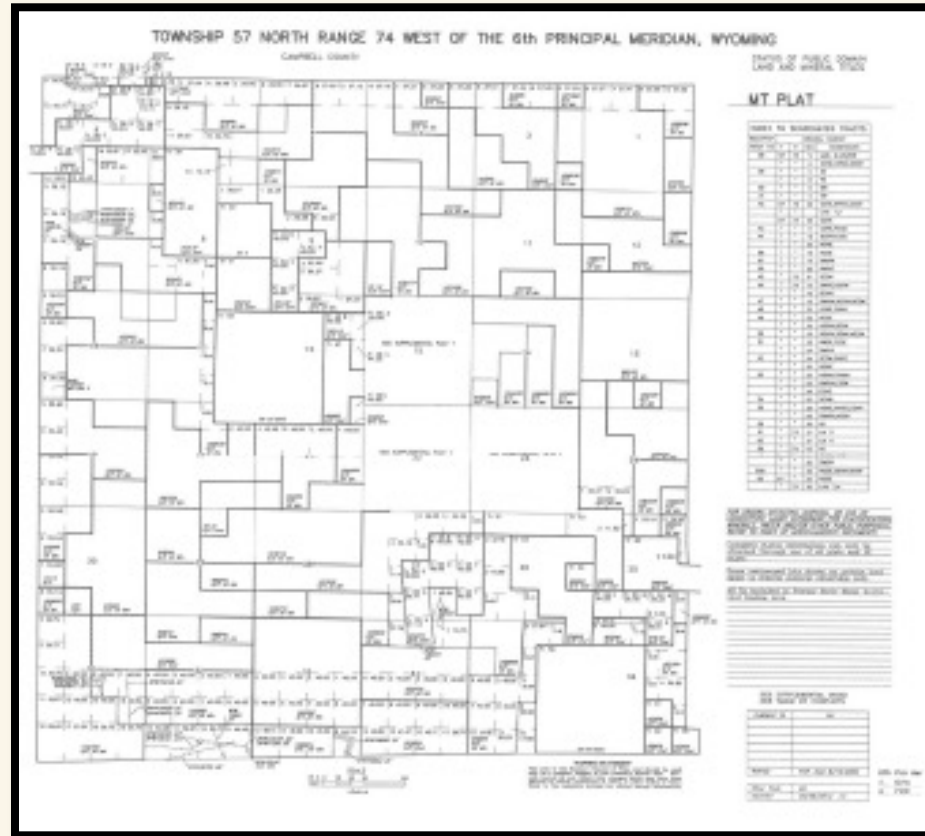
What Needs to Be Recorded with the BLM

- ❖ Assignments of Record Title Interest
- ❖ Transfers of Operating Rights (Sublease)
- ❖ Overriding Royalty Assignments
- ❖ Mass Transfers
- ❖ Corporate Name Changes or Mergers
- ❖ Probate Materials (will or decree of distribution & qualification statement)
- ❖ Divorce Decrees
- ❖ 43 CFR § 3106.1 through 3106.8-3

Why Search or File in the County Records?

- ❖ There is no federal statute providing that the BLM records, either in Washington, D.C. or in the state offices, are actual or constructive notice to persons acquiring interests in federal oil and gas leases.
- ❖ In order to protect your interest from third party bona fide purchasers for value without notice.
- ❖ Many instruments are not, or cannot be, recorded with BLM – i.e. liens, easements, etc.

Examining Federal Titles and Common Title Defects



Master Title Plat

TOWNSHIP 57 NORTH RANGE 74 WEST OF THE 6TH PRINCIPAL MERIDIAN, WYOMING

| SECTION | RANGE | TOWNSHIP | DATE | DESCRIPTION |
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Historical Index

Step 1: Plat Books

- ❖ Organized by township and range.
- ❖ Contain (1) the actual plats, (2) historical indexes and (3) conflict sheets detailing disputes between claimants to rights in federal lands.
- ❖ Master Title Plat and Oil and Gas Plat will reveal surface patents, rights-of-way, leases, etc.
- ❖ Also look to the Historical Index (lands), Serial Registers (for each lease or easement), Patents, Survey Plats, Unpatented Mining Claims.

Step 2: Determine the Proper Leasing Act

- ❖ Most are Mineral Leasing Act of 1920 (as amended) - 30 U.S.C. § 181, et seq.
- ❖ Act provides for Noncompetitive Leases as to lands not within a known geologic structure (KGS) and Competitive Leases for lands within a KGS.
- ❖ If Right-of-Way, then may only be leased under the Right-of-Way Leasing Act.
- ❖ Indian Lands = Bureau of Indian Affairs.



Step 3: Case File for Active Lease

- ❖ Case files exist for every lease.
- ❖ If lease has been segregated, there will be a separate case file (more on segregation later).

Common Title Defects

1. **Dual Recording** – In the county and with the BLM
2. **Parallel Chains**
 - Some lessees may not file with BLM to avoid qualification issues or lease segregation.
 - Net profits interests and other production payments that are not easily shoehorned into federal form.
 - Sometimes different assignments get filed in county and with BLM with intent to have same effect (for example a depth limitation in county only).

Common Title Defects (Cont.)

❖ Rights of Way – More later

❖ 17.5% Clause (Excess Royalty)

- 43 C.F.R. §192.83 used to provide that an agreement creating ORRIs that, when added to previous ORRIs and the lease royalty, aggregating in excess of 17.5% is impermissible, unless the agreement expressly provides that the excess royalty shall be suspended when the average production of oil and gas per well per day averaged less than fifteen barrels on a monthly basis.
- Deleted in 1988 but may still apply between parties if provided for in assignment. See *Burnseed Oil Co. Inc. v. Grynberg*, 2009 U.S. App. LEXIS 6331 (5th Cir. 2009). Stipulation of Interest should be required.

Record Title vs. Operating Rights and How to Transfer

Form 3000-3 (July 2012)

UNITED STATES
DEPARTMENT OF THE INTERIOR
BUREAU OF LAND MANAGEMENT

ASSIGNMENT OF RECORD TITLE INTEREST IN A LEASE FOR OIL AND GAS OR GEOTHERMAL RESOURCES

Mineral Leasing Act of 1920 (30 U.S.C. 181 et seq.)
Act for Acquired Lands of 1947 (30 U.S.C. 351-359)
Geothermal Steam Act of 1970 (30 U.S.C. 1001-1025)
Department of the Interior Appropriations Act, Fiscal Year 1981 (42 U.S.C. 6508)

FORM APPROVED
OMB NO. 1004-0034
Expires: July 31, 2015

Lease Serial No. _____

Lease Effective Date (Anniversary Date) _____

New Serial No. _____

Type or print plainly in ink and sign in ink.

PART A: ASSIGNMENT

1. Assignee*
Street _____
City, State, Zip Code _____

1a. Assignor

*If more than one assignee, check here and list the name(s) and address(es) of all additional assignees on page 2 of this form or on a separate attached sheet of paper.

This record title assignment is for: (Check one) Oil and Gas Lease, or Geothermal Lease

Interest conveyed: (Check one or both, as appropriate) Record Title, Overriding Royalty, payment out of production or other similar interests or payments

2. This assignment conveys the following interest:

| Land Description Additional space on page 2, if needed. Do not submit documents or agreements other than this form, such documents or agreements shall only be referenced herein. | Percent of Interest | | | Percent of Overriding Royalty Similar Interests | |
|--|---------------------|----------|----------|---|---------------------------------|
| | Owned | Conveyed | Retained | Reserved | Previously reserved or conveyed |
| | | | | e | f |
| a | b | c | d | | |

Assignment of Record Title

Form 3000-3a (July 2012)

UNITED STATES
DEPARTMENT OF THE INTERIOR
BUREAU OF LAND MANAGEMENT

TRANSFER OF OPERATING RIGHTS (SUBLEASE) IN A LEASE FOR OIL AND GAS OR GEOTHERMAL RESOURCES

Mineral Leasing Act of 1920 (30 U.S.C. 181 et seq.)
Act for Acquired Lands of 1947 (30 U.S.C. 351-359)
Geothermal Steam Act of 1970 (30 U.S.C. 1001-1025)
Department of the Interior Appropriations Act, Fiscal Year 1981 (42 U.S.C. 6508)

FORM APPROVED
OMB NO. 1004-0034
Expires: July 31, 2015

Lease Serial No. _____

Type or print plainly in ink and sign in ink.

PART A: TRANSFER

1. Transferee (Sublessee)*
Street _____
City, State, Zip Code _____

1a. Transferor

*If more than one transferee, check here and list the name(s) and address(es) of all additional transferees on page 2 of this form or on a separate attached sheet of paper.

This transfer is for: (Check one) Oil and Gas Lease, or Geothermal Lease

Interest conveyed: (Check one or both, as appropriate) Operating Rights (sublease) Overriding Royalty, payment out of production or other similar interests or payments

2. This transfer (sublease) conveys the following interest:

| Land Description Additional space on page 2, if needed. Do not submit documents or agreements other than this form, such documents or agreements shall only be referenced herein. | Percent of Interest | | | Percent of Overriding Royalty Similar Interests | |
|--|---------------------|----------|----------|---|---------------------------------|
| | Owned | Conveyed | Retained | Reserved | Previously reserved or conveyed |
| | | | | e | f |
| a | b | c | d | | |

Assignment of Operating Rights

Record Title vs. Operating Rights

- ❖ **Record Title** – Primary ownership of an interest in an oil and gas lease that includes the obligation to pay rentals, and the rights to assign and relinquish the lease (i.e. must account to BLM).
 - Can't be transferred as to limited horizons, as to part of a 40-acre legal subdivision, or separately as to oil and gas. 30 U.S.C. § 187a; 43 C.F.R. § 3106.1(a).
 - **BLM approval required**

Record Title vs. Operating Rights

- ❖ **Operating Rights/Working Interest** – The interest or contractual obligation created out of the lease (such as a sublease) authorizing the holder of that right to enter the leased lands to conduct drilling and related operations, including production.
 - Operating rights may or may not be transferred through an operating agreement. Can be limited as to certain horizons or zones.
 - **BLM approval required**

Assignments of Record Title

- ❖ **Operating Rights Not Severed:** a record title assignment will convey both operating rights and record title interest.
 - Therefore, it is not necessary to file both a record title assignment and an operating rights transfer when conveying all the interest in a lease.
- ❖ **Operating Rights Severed:** an operating rights transfer must be filed.

Partial Assignments of Record Title

- ❖ Created when an assignor conveys 100% record title interest in a portion of the lands in the lease.
- ❖ Partial assignments segregate the lease into two separate leases.
- ❖ The segregated portion of the lease creates a new lease and is assigned a new lease number.
- ❖ Releases and discharges the assignor from all obligations thereafter accruing with respect to the assigned lands.
 - 30 USCS § 187a

Assignments of Operating Rights

- ❖ Operating Rights transfers must identify the lease formation depths either by zone, formation, or deposit.
- ❖ It is not necessary to file separate operating rights transfers when conveying interest in several sections of land. One transfer can convey various interest percentages at various depths.
 - 43 CFR § 3106.1

Overriding Royalty Assignments

- ❖ Overriding royalty interests may be filed by Assignment of Record Title (Form 3000-3), Transfer of Operating Rights (Sublease) (Form 3000-3a); or other.
- ❖ Only one originally executed copy is required to be filed.
- ❖ BLM approval not required.
- ❖ The ORRI rules also apply to production payments.

Mass Transfers

- ❖ Used when conveying interests of any type in a large number of Federal leases to the same entity (generally 10 leases or more).
- ❖ Filings should be made on the BLM Form with an attached exhibit of all the leases involved.
- ❖ **Each assignment must be adjudicated and approved individually.**
 - **43 CFR § 3106.4-3**

Entity Name Changes and Mergers

For the BLM to recognize a name change or merger, the following must be submitted:

- ❖ A list of serial numbers of all leases, pending assignments and unit and communitization agreements;
- ❖ A copy of the Secretary of State's certificate of name change or merger;
- ❖ A copy of the amendment of the Articles of Incorporation ...
- ❖ If one company buys out the interests of another company, and it is not a merger or name change, record title assignments and/or transfer of operating rights must be filed.
 - 43 CFR § 3106.8-2 and 8-3

MLA Qualification Statements - 43 CFR § 3102

- ❖ Leases or interests may be acquired only by U.S. citizens (or stockholders in a corporation). Aliens can only own through corporate stock.
- ❖ Record title cannot be held by minors (but may be held by legal guardians or trustees of minors).
- ❖ 246,080-acre limitation
 - In any one state.
 - Individual with more than 10% stock charged with a proportionate share of corporation's lease interests.

Right of Way Leasing Act of May 1, 1930

(§§ 30 U.S.C. 301 to 306)

- ❖ Certain federal rights of way can only be leased under the ROWLA if ROW predates lease (you may not realize your lease doesn't cover prior-existing rights of way).
- ❖ The grantee of the ROW may have a “limited fee”, subject to ownership reverting back to the United States.
- ❖ Sometimes the lease may exclude ROWs.
- ❖ In 1983 the Act was amended to apparently limit the 1930 Act ...

Amended Right of Way Leasing Act (1983)

❖ Now only apparently applies with respect to:

1. Railroad ROWs under Act of March 3, 1875 (43 U.S.C. 934, *et seq.*).
2. Reservoir/Irrigation easements issued pursuant to the Act of March 3, 1891 (43 U.S.C. 946, *et seq.*).
3. Also encountered on potential potash deposit lands.

Amended Right of Way Leasing Act (1983) (Cont.)

- ❖ Despite broad language in 1930 Act, the BLM only issues ROW Leases for railroad and reservoir easements.
 1. “other rights of way acquired under any law of the United States, whether the same be a base fee or mere easement.”
 2. Conflicts with 1983 Act?

Right of Way Leasing Act (Cont.)

- ❖ Owner of the right of way has preferential right to lease or may assign right to lease (Adjusted Form 3100-11 Offer to Lease and Lease for Oil and Gas). Notice will be provided to adjacent landowners.
- ❖ Adjacent lessees have a right to submit a bid for compensatory royalty, paid to the U.S. in lieu of issuing a lease to ROW owner or its Assignee (must be at least 12.5%).
- ❖ If adjoining landowners submit compensatory royalty bid, the ROW Lease or Compensatory Royalty Agreement will be awarded to the offer most advantageous to the U.S.

Right of Way Leasing Act (Cont.)

- ❖ Because BLM will not issue leases except as to the RR and Reservoir ROWs, *technically unable to lease prior ROWs(?)*
 - **Best practice** - obtain an assignment of preferential right to lease, or make a bid for compensatory royalty agreement.
 - Possible trespass claim or compensatory royalty bidding war.
- ❖ Note that a Compensatory Royalty Agreement is not a lease and cannot be assigned by assignments of record title or operating rights.
 - Any intent to change operators must be done on a Sundry Notice and Reports on Wells Form 3160-5.

Events Segregating a Federal Lease

- ❖ Record Title Assignment – 100% in a portion of the lands (Base Lease / Segregated Lease).
- ❖ Unitization – only a portion of a federal lease is committed to a unit, the uncommitted portion is segregated into a separate lease. Does not occur when a portion of a committed federal lease is eliminated from a unit.
- ❖ Segregated portion issued a new lease number and treated as a distinct lease.
- ❖ Communitization – does not segregate a lease.

Segregation by Assignment

❖ Fixed Term

- Segregated lease will continue for remainder of fixed term or 2 years (whichever is longer)

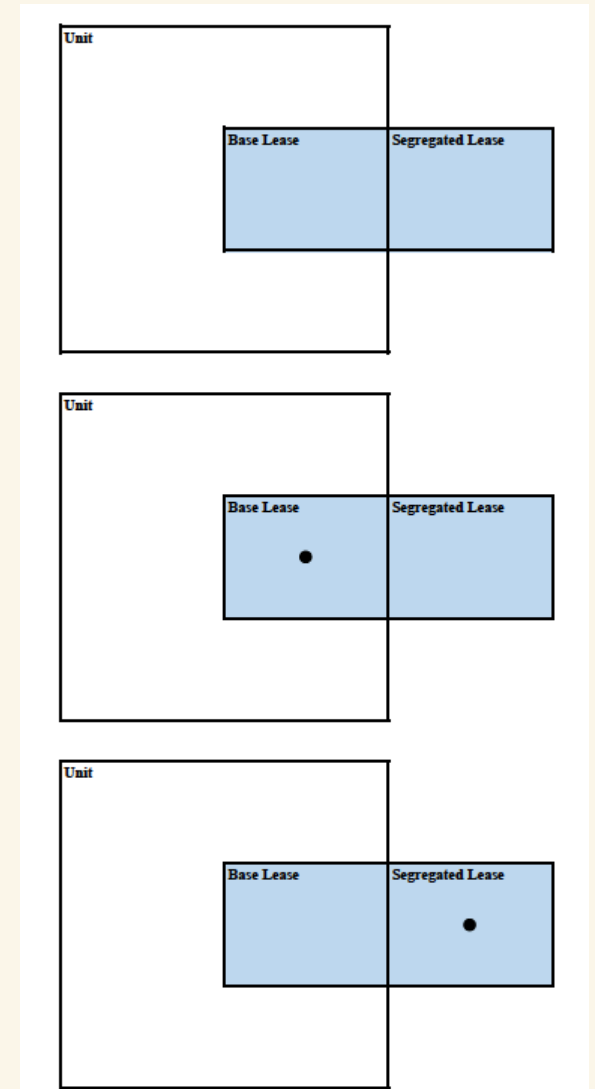
❖ Extended Term

- **Before 9/2/1960* – fixed term or 2 years
- **After 9/2/1960* – extended by production

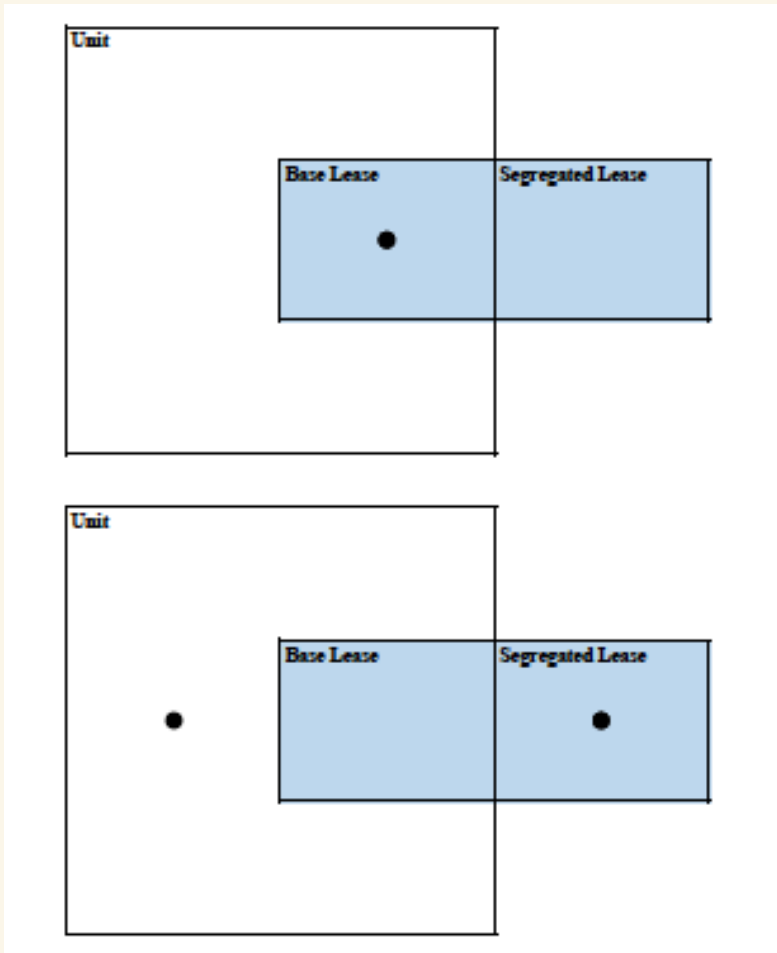


Segregation by Partial Unitization Within Fixed Term

- ❖ **General Rule:** Lease stands on its own!
 - Solicitor's Opinion M-36592, GFS (O&G) SO-1960-39 (1960).
- ❖ Lease effective for two years or remainder of FT (whichever is longer).
- ❖ Production on producing non-unitized portion will not extend unitized portion.
- ❖ Unit production will not extend non-unitized non-producing portion.
- ❖ BLM generally will not approve unitization or specific formations which would result in horizontal segregation.



Segregation by Partial Unitization Within Extended Term



- ❖ Segregated portion extended as long as base lease producing.
- ❖ Exception to general rule:
 - Celcius Energy Co, 99 IBLA 53, GFS (O&G) 82 (1987)
- ❖ Base lease continues for life of non-unitized segregated portion.
- ❖ If unit production obtained before cessation of non-unitized portion, unitized portion will continue for life of unit.

Terminology – Often Used Incorrectly!

- ❖ **Pooling** – combining two or more leases to meet minimum state spacing requirements. Prevents waste and protects correlative rights.
- ❖ **Communitization** – similar to pooling, but involves federal leases.
- ❖ **Unitization** – unified development and operation of an entire geologic prospect or producing reservoir.

Unitization

- ❖ **Purpose is conservation of resources and serving the public interest.**
- ❖ **Unit area operated as single entity without regard to lease boundaries.**
 - **Advantages are cost, recovery, and common facilities to service all wells.**
 - **For exploratory units – BLM Model Onshore Unit Agreement for Unproven Areas. 43 CFR § 3186.1. (No set form for enhanced recovery units).**
 - **Allocation of production made on acreage basis.**
 - **Exploratory units may also be developed in stages, generally by Participating Area surrounding a producing well** (That part of a unit area which is considered reasonably proven to be productive of unitized substances in paying quantities or which is necessary for unit operations and to which production is allocated in the manner prescribed in the unit agreement – CFR § 3180.0-5).

Unitization (Cont.)

- **Two types of Unit Operating Agreements (UOA)**
 - **Form 1 (1954) = Undivided Interests** – Interests do not fluctuate as participating areas expand or contract (extent and uniformity of prospect known).
 - **Form 2 (1994) = Divided Interests** – working interest owner's share in production is determined by its interest in a defined participating area (extent and uniformity of prospect unknown).

Communitization

- ❖ Leases may be voluntarily pooled, and a Designation of Pooling recorded in county.
 - When federal leases involved you must execute a Communitization Agreement (“CA”)
 - Allocation on acreage basis.
 - Model Form of Federal Communitization Agreement (BLM Manual) generally followed.
 - Defines communitized area, depths or formations (typically only one), and substances.
 - Executed or ratified by each royalty, WI, ORRI owner.
 - Defines how production will be allocated among the operators and mineral owners.
 - New streamlined approval process effective August 19, 2015, to help ensure that CAs are approved within 120 days.

Lease Maintenance Comparison

❖ Unitization

- Operations/production anywhere within the unit are considered operations/production on each committed lease.
- Inclusion of only a portion of a lease in the unit effects a lease segregation. Segregated portion outside the unit extended for remainder of fixed term, or two years, whichever is longer.

❖ Communitization

- Operations/production from anywhere on the communitized lands shall be considered operations/production on each tract.
- Inclusion of only a portion of a lease in the unit does not affect a lease segregation.
- If CA terminates, lease continues for fixed term or two years, whichever is longer.

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