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Clarifying the Duty of Executive Right Holders

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ONE OIL AND GAS RIGHT TO RULE THEM ALL¹

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I. INTRODUCTION

The proverbial “bundle of sticks” is an analogy familiar to real property scholars.² The analogy compares property ownership to a bundle of sticks—that is ownership is composed of separate and individual property rights—where each “stick” represents a right or stream of benefits available to the property owner. Under the centuries-old common law *ad coelum* doctrine, real property contained all lands from the core of the earth to the sky. Although this “heaven-to-hell” doctrine is now limited, oil and gas law still composes that part of subsurface real property, sometimes called the mineral estate. And in oil and gas law, the mineral property bundle is composed of five essential attributes: (1) the right to develop (the right of ingress and egress), (2) the right to make decisions affecting exploration and development of the mineral estate, (3) the right to receive bonus payments, (4) the right to receive delay rentals, and (5) the right to receive royalty payments.³ The right to make decisions affecting exploration and development of the mineral estate is also called the “executive right.”⁴

Commonly, the executive right refers to the right to execute an oil and gas lease,⁵ which is both a contract and conveyance of the subsurface mineral estate. The oil and gas lease not only governs the rights and obligations between the parties; it is also a fee simple determinable. Execution of an oil and gas lease gives the lessee—the party that takes the lease—the mineral property interest in fee simple subject to the condition of continued oil and gas production. If actual or constructive production ceases, the oil and gas lease automatically terminates and the mineral estate reverts to the lessor—the party that granted the lease.

Although the executive right is part of the mineral estate’s bundle of sticks, it is, in fact, the most important property right. Without the right to execute an oil and gas lease or self-develop,

1. A final version of this article will be appearing in 55 Hous. L. Rev. (May 2018). My great thanks to the editors of the Houston Law Review for their editorial support and to the University of Oklahoma College of Law for its research support.

2. See *United States v. Craft*, 535 U.S. 274, 278 (2002) (citations omitted) (stating that a “common idiom describes property as a ‘bundle of sticks’—a collection of individual rights which, in certain combinations, constitutes property. State law determines only which sticks are in a person’s bundle.”).

3. *Altman v. Blake*, 712 S.W.2d 117, 118 (Tex. 1986) (citations omitted).

4. See *Craft*, 535 U.S. at 278 (2002) (citations omitted); see also *Altman*, 712 S.W.2d at 118 (Tex. 1986) (citations omitted) (“There are five essential attributes of a severed mineral estate: (1) the right to develop (the right of ingress and egress), (2) the right to lease (the executive right), (3) the right to receive bonus payments, (4) the right to receive delay rentals, (5) the right to receive royalty payments.”).

5. See *Altman*, 712 S.W.2d at 118.

(1) there is no development of the mineral estate; (2) there is no bonus, which is the amount paid as an incentive to enter into an oil and gas lease; (3) there are no delay rentals, which are the payments made during the primary term of an oil and gas lease that serve as constructive production; and (4) there are no royalty payments, which are a cost-free share of production that arises out of an oil and gas lease. Therefore, the executive right is the most important and governing right of all the mineral property rights. Like the One Ring in Tolkien's *The Lord of the Rings*, the executive right rules them all.

The holder of the executive right (the "executive") obtains the right through a conveyance or deed instrument, which may or may not include an associated mineral or royalty interest.⁶ If the executive holds the right absent any associated mineral or royalty interest, he holds a "naked" right.⁷ At present, there is not a bright-line "for the characterization of sole ownership of the executive right in Texas."⁸ Few cases involve an executive holding only the right without an associated mineral or royalty interest.⁹ In fact, the executive right is commonly coupled with a fractional interest in the minerals or royalty.¹⁰

Challenges arise when the executive right is severed from the subsurface mineral estate. If the intentions of the executive conflict with those of the holder of the associated mineral interest (the "non-executive"), tensions form concerning the owed—whether actual or perceived—obligations or duties. For example, whereas an executive with a real estate surface development may desire prohibiting oil and gas operations to satisfy buyer or lender preferences, the non-executive mineral or royalty interest owner desires oil and gas development and production to acquire potential future revenues. Analogously, the severed executive right is comparable to one person owning the cake (e.g., the mineral interest) and another person owning the right to eat the cake or the right to allow someone else to eat it.

Over the past century, courts have used a standard of conduct approach to review the relationship between the executive and non-executive. These standards have varied, moving

6. See 55 TEX. JUR. 3D Oil and Gas § 97 (2004); *Day & Co. v. Texland Petroleum*, 786 S.W.2d 667, 669 n.1 (Tex. 1990).

7. See Christopher S. Kulander, *Big Money vs. Grand Designs: Revisiting the Executive Right to Lease Oil & Gas Interests*, 42 TEX. TECH L. REV. 33, 39 (2009).

8. J. Robert Beatty & Monika Ehrman, *The Nature of the Severed Executive Right*, 32 ST. B. TEX. OIL, GAS & ENERGY RES. SEC. REP. 21, 23 (2007).

9. Cf. Kulander, *supra* note 7, at 39 (citations omitted) ("No case in Texas, or any surrounding state, suggests that the executive right *cannot* be held exclusively from the rest of the mineral estate.") (emphasis in original).

10. See Ernest E. Smith, *Implications of a Fiduciary Standard of Conduct for the Holder of the Executive Right*, 64 TEX. L. REV. 371, 372 (1985).

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