44TH ANNUAL ERNEST E. SMITH
OIL, GAS AND MINERAL LAW
FUNDAMENTALS AND INSTITUTE
HOUSTON
April 19-20, 2018
Royal Sonesta Hotel • Houston, Texas

DIVISION ORDERS

The uses and abuses of the Division Order.
Neither a contract nor a conveyance,
a shield but not a sword.

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I. Introduction

An oil and gas well has been drilled on a lease or unit. The well has been completed and sales have begun. As will be discussed in this paper, as soon as sales begin, a legislatively mandated "clock" begins ticking. This "clock" concerns the time limits within which payment of royalty, overriding royalty and working interest payments must be made.

These payments are the contractually required payments imposed on the operator by the oil and gas lease, joint operating agreement, farm-out agreement, joint development agreement or other agreement incident to the drilling of the producing oil and/or gas well. The operator is receiving the proceeds of production, i.e. the money for the sale of the oil and/or gas. It is undoubtedly tempting to keep all of the proceeds, but the contractual obligation to make payment must be satisfied.

In some situations, the payment obligation is simple. The Lessor under the oil and gas lease is the only owner of the mineral estate. The oil and gas lease is solely owned by the Lessee/operator. The division of the proceeds in this situation is generally a simple task. But this is rarely the case.

The oil and gas lessee or operator should have a drilling title opinion on the drill site tract, at the least, in its possession. The drilling title opinion has given the lessee/operator the confidence and assurance that the lessee/operator has the right to drill the well on the drill site tract. All of the interest owners have been accounted for and permission has been obtained to drill the well. Any title issues should have been cured before the well was drilled. The drilling title opinion can be supplemented as a Division Order Title Opinion in our simple situation.

As you might expect, matters can become much more complicated. The lessee/operator may have intended to form a pooled unit all along or this decision may be an afterthought. The lessee/operator may not have title opinions on the remaining tracts to be included in the pooled unit.

Further, the title to the drill site tract and the title to the proceeds of production from the drill site tract may have changed between the time the drilling title opinion was prepared and the well has been turned to sales. The lessee/operator is receiving revenue from the well and the lessee/operator recognizes its obligations to make payment of a portion of those proceeds to various interest owners. In order to fulfill these obligations, the lessee/operator generally requests a Division Order Title Opinion ("DOTO") from an attorney to identify those interest owners and to specify the portion of the proceeds payable to those interest owners.

Based upon the DOTO, a written form is produced and sent to the various interest owners. This written form is the Division Order. Although prepared by the lessee/operator, the Division Order is a communication from the various interest owners to the lessee/operator. This communication in its simplest form specifies the property, the decimal interest in the proceeds, and the identity of the payee. However, the Division Order, in its more complex forms, has been used to communicate much more information to the lessee/operator. This paper will illustrate two general fact situations to demonstrate the uses and abuses of division orders and will discuss the case law concerning division orders as well as the 1991 division order statute as amended.

II. Illustration of uses and abuses of the Division Order

A. Uses of the Division Order.

Larry Landman acquires an oil and gas lease ("OGL") on property in LaSalle County, Texas for Reed Oil Company ("ROC"). Landman takes the lease in his name as the Lessee. The property is a 583 acre tract. Landman has checked the Official Public Records of LaSalle County, Texas and determined that John and Mary Wilson own the 583 acre tract. The OGL provides for a 1/5th royalty. Landman assigns the OGL to ROC and reserves a ½ of 1% ORRI as previously agreed with ROC. The OGL is recorded.

ROC requests Alex Attorney ("Attorney") to prepare a Drilling Title Opinion so that ROC can drill a well. Attorney concludes that John and Mary Wilson own title to the surface and one half of the mineral estate. Attorney identifies the other owners of the mineral estate as George, Louis and Omar Garcia. ROC employs Landman to perform the curative requirement of getting OGLs from George, Louis and Omar Garcia. ROC also demands Landman to re-assign one half of his ORRI for causing ROC to incur additional bonus costs. Landman contacts George, Louis and Omar Garcia and takes OGLs from each of them, but does not secure signatures from George's wife, Louis' wife or Omar's wife because George, Louis and Omar claim this mineral interest to be their separate property. In addition, George, Louis and Omar know that the Wilsons signed an OGL and they demand a 1/4th royalty. Landman agrees. Landman assigns the OGLs to ROC and assigns one half of his ½ of 1% ORRI back to ROC. ROC records the OGLs but neglects to file the Assignment from Landman.

ROC assigns the OGLs to Bigger Oil Company ("BOC") and reserves an ORRI equal to the amount between existing lease burdens and 75% so that BOC receives at least a 75% NRI. BOC drills a well and completes it as a commercial producer. BOC employs Carl Counsel ("Counsel") to prepare a Division Order Title Opinion ("DOTO") based upon the record title. Counsel advises BOC to pay the proceeds of production in the following amounts:

Title search: Division Orders

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First appeared as part of the conference materials for the
2018 Fundamentals of Oil, Gas and Mineral Law session
"Division Orders"