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INSIGHTS

Adverse Possession in the Oil Patch

December 2, 2016

By: ***Austin T. Lee*** ***William A. Moss***

The most basic example of adverse possession is when a landowner fences in land that belongs to a neighbor. This is trespassing, but if a long enough period of time passes without the neighbor bringing a trespass claim, the trespasser can acquire title by adverse possession. Texas law complicates things a bit by having four separate adverse possession statutes – depending on various factors, the time period is 3 years, 5 years, 10 years, or 25 years. Tex. Civ. Prac. & Rem. Code 16.024-16.028.

In the oil and gas industry, adverse possession can be even trickier. A property owner can have title to both the surface and mineral estates in a given tract of land, or these estates might be severed and owned separately. Further, a number of different property interests can be created from the mineral estate—working interests, royalty interests, overriding royalty interests, non-participating royalty interests, among others, each of which can be owned in various undivided percentages by multiple owners. Some of these interests can be adversely possessed, and some cannot. A brief discussion of each is below.

Surface and mineral estate, not severed – This one is easy. If the surface and mineral estate have not been severed, then they can be adversely possessed together. Possession of the surface of an unsevered estate for the requisite period of time vests title in both the surface and mineral estates. *Carminati v. Fenoglio*, 267 S.W.2d 449, 453 (Tex. Civ. App.—Fort Worth 1954, writ ref'd n.r.e.) ("Where there has been no severance of mineral estate from the surface, the ordinary rules of adverse possession apply.").

Surface estate, severed from the mineral estate – The surface estate can be adversely possessed (as in the example above where land gets fenced in). Importantly, if the mineral estate has been severed from the surface estate, possession of the surface alone will not constitute adverse possession of mineral estate. *Natural Gas Pipeline Co. of Am. v. Pool*, 124 S.W.3d 188, 193 (Tex. 2003).

Mineral estate – A mineral estate can be adversely possessed. "Generally, courts across the country, including Texas courts, have said that in order to mature title by limitations [i.e. adverse possession] to a mineral estate, actual possession of the minerals must occur. In the case of oil and gas, that means drilling and production of oil or gas." *Pool*, 124 S.W.3d at 192-93. Interests in the mineral estate are typically characterized as either working interests or leasehold interests, each of which consist of the right to produce the minerals under a given tract and the obligation to bear the costs of exploring for and developing such minerals. As such, the "title" obtained to the mineral estate via adverse possession is discussed below with

respect to the various types of "Working Interests" and "Leasehold Interests."

Royalty Interest – Royalty interests, in their simplest form, are cost-free interests in production from the mineral estate under a given tract of land and, once created, are owned separate from, and are carved out of, the mineral estate that they burden. Assume that a producer pays royalties to an individual for a number of years under the belief that the individual had a royalty interest in the mineral estate in a given tract of land. The producer then learns that the individual actually owns no royalty interest in that tract. When the producer stops paying the individual, the individual claims that she has title to the royalty via adverse possession—is she correct? Nope. Because a royalty interest is ***non-possessory*** (i.e. the royalty interest entitles you to a cost-free share of production *when and if* it is produced from the subject tract, but gives the holder thereof nothing to possess until that production is obtained, nor does it entitle the holder to any right to go onto the subject tract and cause that production to occur, the rules of adverse possession do not apply as nothing is being possessed, adversely or otherwise. *Sun Oil Co. v. Madeley*, 626 S.W.2d 726 n.6 (Tex. 1982); *Coates Energy Trust v. Frost Nat'l Bank*, 2012 Tex. App. LEXIS 9718 at *26-27 (Tex. App.—San Antonio Nov. 28, 2012, pet. denied); *Saunders v. Hornsby*, 173 S.W.2d 795, 797 (Tex. App.—Amarillo 1943, no writ). It should be noted that this is the case even in the circumstance where the owner of the royalty interest has the right to take its royalty share of production "in kind" because the royalty owner's right to that production is still inherently void of the right to go onto the tract and cause that production to occur (and thus is still non-possessory). *See Saunders*, 173 S.W.2d at 797 (holding that a plaintiff who had wrongfully received royalty payments could not adversely possess a royalty interest, stating "appellant merely converted to his own use the oil and gas that had already been produced by the Gulf Production Company and did not affect that which remained in the ground….").

Non-Participating Royalty Interest (NPRI) – An NPRI is a royalty interest carved out of the mineral estate but it is differentiated from other royalty interests in that it lacks certain rights, such as the executive right to lease the subject mineral estate and the right to collect bonus and delay payments from any such lease. Just like a royalty, an NPRI cannot be adversely possessed because it is non-possessory.

Overriding Royalty Interest (ORRI) – An overriding royalty interest is a royalty interest that is carved out of a leasehold interest (and thus only survives as long as the underlying lease is in effect), and a leasehold interest can be adversely possessed (see below). That said, an ORRI is not possessory—it is a type of royalty interest and is void of the right to go onto the tract in question and cause production to occur. There is no Texas case law specifically discussing if an ORRI can be adversely possessed, but it seems likely that adverse possession does not apply. *See generally Portwood v. Buckalew*, 521 S.W.2d 904, 919 (Tex. Civ. App.—Tyler 1975, writ ref'd n.r.e.) (finding that claim of adverse possession of overriding royalty interests failed because there was no actual possession of the mineral estate). Other states considering the issue reached this conclusion. *See Connaghan v. Eighty-Eight Oil Co*., 750 P.2d 1321, 1324 (Wyo. 1988) (holding that an ORRI cannot be adversely possessed and citing Texas cases—including *Portwood* —holding that receipt of royalty payments is not a basis for adverse possession of a royalty).

Leasehold Interest/Operated Working Interest – Unlike a royalty, a working interest (whether occurring through ownership of the mineral estate or through ownership of a lease of the mineral estate) is a **possessory interest** (i.e. the owner of that interest has the right to enter onto the subject tract and cause production to occur) and can be adversely possessed. For

example, assume a lease has a cessation-of-production clause and expires due to production from the lease ceasing without additional operations being conducted or delay rentals being paid for the requisite period stated in the lease. What if the (now former) lessee drills new wells and pays royalties on the same terms as the lease after the lease terminated? The lessee is clearly trespassing on the mineral estate by taking minerals it has no right to take. If enough time passes without complaint, the lessee can acquire title to the mineral estate through adverse possession. The scope of this title is limited: "The lessees acquired the same interest that they adversely and peaceably possessed, that is, the oil and gas leasehold estates as defined by the original leases." *Pool,* 124 S.W.3d at 199.

Non-operating working interest – Where there are multiple working interest owners that are all entitled to produce minerals on a given tract, the parties typically enter into a joint operating agreement (JOA) that designates one working interest owner as the operator and the rest as non-operators of the area covered by the JOA (Contract Area). The operator drills and maintains the wells while the non-operators share in the costs and revenues based on the percentage interest each non-operator owns in the Contract Area. Assume, for example, that a non-operator is believed to own a 10% working interest. What if, after 10 years of this non-operator receiving and paying joint interest billings under the JOA and receiving revenue based on a 10% working interest, the operator determines that the non-operator actually owns only an 8% working interest? Has the non-operator adversely possessed the extra 2%? This is a difficult question. As seen above, the Texas Supreme Court made clear in the *Pool* case that a working interest owner can acquire title to a mineral estate (working interest or leasehold interest) by adverse possession by taking oil and gas out of the ground. But a non-operating working interest is not taking oil and gas out of the ground—it is not possessing anything. A non-possessory interest such as a royalty interest is not subject to adverse possession, and a non-operating working interest is similar to a royalty interest because it is non-possessory. On the other hand, although the non-operating working interest holder is not taking the minerals from the ground, he/she is paying the costs of the operator to do so unlike a royalty owner, and the designation of another working interest owner as the "operator" under the JOA simply allows for a coordinated arrangement for developing the Contract Area. There is no Texas case law directly on point as to whether a non-operator can adversely possess a non-operated working interest or leasehold interest, so it's hard to be certain how a court would rule on an adverse possession claim made by a non-operating working interest owner.