



MASSIVE MINERALS

Division Orders

What is a Division Order?

- An agreement signed by the payee directing the distribution of proceeds from the sale of oil, gas or hydrocarbons.
- Directs and authorizes the payor to make payment for the products taken in accordance with the division order.
- Link to the Title Opinion – generated from information found in title opinions
- Generally, division orders are binding until revoked.

A Division Order is Not a Contract

- There is no consideration.
- There is an obligation to pay the royalty owner independent of any division order.
 - The oil and gas lease imposes the obligation to pay.
 - Generally, leases do not mention or require division orders.
- There is no offer and no acceptance.

Characterization of Division Orders

- A representation of certain facts by the owner to the payor.
- An agreement as to the quantum of interest and the basis of payment until revoked.
- There is no fixed term for a division order.
- Does not amend or modify the oil and gas lease.

Transfer Order

- An agreement signed by a payee and his transferee directing the payor to pay another person a share of production.
- Generally, the same terms will apply to transfer orders that apply to division orders.

Division Orders Promote Proper Payment

- Give owners an opportunity to review interests
- Protects payor from liability
- Binding for payments made until time of revocation

Interaction with Lease

- Terms included in the division order that are different from the oil and gas lease are invalid.
- If the division order contradicts or varies the oil and gas lease, the Payee will not be prevented from asserting a claim for payment with a four-year statute of limitations

Division Order Process

- 1) Division orders are generated based on title opinions and other documents and sent to owners.
- 2) Owners sign and return to payor or don't sign.
- 3) Upon receipt, payor will release funds, subject to any additional reasons for suspending funds.

NOTE: Leases, especially newer ones, commonly contain provisions stating that Lessee may not require execution of a division order as a condition for payment of royalties.

Chicago Corp. v. Wall

- Involved a mistake by the payor and acquiescence of that mistake by the payee in the form of a division order.
- The Walls owned a 79-acre tract, a 10-acre tract, and a 30-acre tract and sold all three tracts to Smith, reserving 1/2 NPRI
- Smith executed a lease covering all three tracts with Chicago Corp. and the lease was pooled into a unit
- Chicago Corp. prepared division orders, but did not credit the Walls for their interest in the 10-acre or 30-acre tracts
- The Walls sued for underpaid royalties and Chicago Corp. defended on the basis of signed division orders

Chicago Corp. v. Wall

- Texas Supreme Court said that once the Walls signed transfer orders, they were not entitled to money they directed Chicago Corp. to pay others and the Walls could not recover from Chicago Corp.
- Otherwise Chicago would suffer the injury of double payment
- Based upon detrimental reliance on the representations in the division orders, the Walls could not recover

Exxon Corp. v. Middleton

- Middleton leases executed between 1933 and 1941
- Lessee paid royalty based on division orders executed in 1952
- Division orders effectively changed the basis of the royalty of the leases from market value to amount realized and stated they would remain in force for the life of the leases
- Supreme Court held that payments made and accepted under an agreement such as the division orders were effective until the agreement was revoked.
- Footnote 8: Execution of DO's does not prevent relief from fraud, accident, mistake, errors in calculations, unfair provisions

Gavenda v. Strata Energy, Inc.

- 1967, Gavendas conveyed a tract of land and reserved a NPRI for 15 years only
 - an undivided $1/2$ NPRI of all of the oil and gas from the land
- Lease providing for $1/8$ royalty executed and wells drilled
- DO's sent out crediting Gavendas with $1/16$
- Royalties paid to Gavendas based on signed DO
- Two days before 15-year term ended, Gavendas revoked DO's and filed suit for $7/16$

Gavenda v. Strata Energy, Inc.

- Supreme Court concluded that Gavendas reserved 1/2 royalty and not 1/2 of royalty and were owed \$2.4 million
- Strata defended based on executed division orders
- Issue: Whether division orders are binding until revoked when an operator who prepares erroneous orders underpays royalty owners, retaining part of the proceeds for itself.

Gavenda v. Strata Energy, Inc.

- The general rule is that DO's bind underpaid royalty owners until revoked and the underlying principle of this rule is detrimental reliance.
- Underpaid royalty owners have a remedy: recovery from the overpaid royalty owners.
- Unlike the previous cases, the operator Strata profited and retained some of the proceeds owed to the royalty owners.
- Court held Strata liable to the Gavendas for the portion of their royalties retained

Gavenda v. Strata Energy, Inc.

Rule: Division orders will not be binding until revoked if unjust enrichment can be demonstrated.

Cabot Corp. v. Brown

- Brown signed division orders in January 1968 which stated that royalties would be based on prices determined by the Federal Power Commission, if the sale was subject to their jurisdiction
- Cabot's production initially subject to FPC jurisdiction (interstate market), but they were later able to get a higher price on a large proportion of the gas (intrastate market)
- Cabot continued to pay Brown at the lower FPC price
- Court said that Brown was bound by the interstate prices

Cabot Corp. v. Brown

- The division orders were not effectively revoked until Brown served Cabot with her pleadings.
- Brown was correctly paid because part of the gas was still regulated by the FPC and her division order specified FPC price
- Since Brown accepted the payments, she was bound
- Cabot was “justly” enriched

Coleman v. State

- Operator failed to pay royalty, underpaid royalty, and issued NSF checks to pay royalty
- Criminal Investigation Revealed: Payor was selling gas to Marketing Company based on and indemnifying DO and the Marketing Company forwarded 100% of the net revenue, including royalties, to Payor and Payor agreed to indemnify Marketing Company.
- Court said Payor was a fiduciary under criminal statute and that this was not a civil matter under the Division Order Statute
 - Misapplication of money contrary to lease and law
 - Not just a failure to pay royalty

Division Order Statute

- TEX. NAT. RES. CODE § 91.401-408
- Governs the payment of proceeds of sale of oil and gas:
 - Timing of payment
 - Statutory form
 - Payment of interest on late payments
 - Nonpayment of proceeds or interest
 - Exemptions
 - Notice of Change of payor

§91.401 Definitions

Payee: any person or persons legally entitled to payment from the proceeds derived from the sale of oil or gas from an oil or gas well located in this state.

§91.401 Definitions

Payor: the party who undertakes to distribute oil and gas proceeds to the payee, whether as purchaser of production, operator of the well, or lessee under the lease.

The payor is the first purchaser of such production of oil or gas from an oil or gas well, unless the owner of the right to produce under an oil or gas lease or pooling order and the first purchaser have entered into arrangements providing that the proceeds derived from the sale of oil or gas are to be paid by the first purchaser to the owner of the right to produce who is thereby deemed to be the payor having the responsibility of paying those proceeds received from the first purchaser to the payee.

Application of Division Order Statute

Concord Oil Co. v. Pennzoil Exploration & Prod. Co.

- The Division Order Statute applies to payors and payees.

Prize Energy, L.P et al. v. Hoskins

- The Division Order Statute may apply even though there are no signed division orders.

Timing of Payment

- TEX. NAT. RES. CODE §91.402
- Payments on oil or gas must be made on or before 120 days after the end of the month of first sale of production
- After this, payments must be made according to lease or other agreement
- If there is no other agreement, payments must be paid no later than:
 - 60 days after end of the month in which subsequent oil is sold; or
 - 90 days after end of the month in which subsequent gas is sold

Timing of Payment

- Statutory deadlines provide a safe harbor for the payor to avoid accrual of interest
- If paying under the lease or other agreement, be mindful of consequences of late payment
 - Interest owed
 - Possible termination, with/without period to cure or notice
- Be cautious of “quick pay” provisions in the lease

Payment of Interest on Late Payments

- TEX. NAT RES. CODE §91.403
- If payments are made outside of the statutory deadlines, interest on the late payments is imposed.
- Payor must pay interest beginning at expiration of time limits at 2% above the percentage rate charged on loans by NY Federal Reserve Bank, unless a different rate specified by agreement.
- Does not apply to situation in §91.402(b) (see next slide)
- Payment of interest terminates upon the delivery of proceeds and accumulated interest.

TEX. NAT RES. CODE §91.402(b)

- Interest does not accrue where:
 - 1) A dispute concerning title that would affect distribution of payments;
 - 2) A reasonable doubt that the payee
 - a) Has sold or authorized the sale of its share of the oil or gas to the purchaser of production;
or
 - b) Has clear title to the interest in the proceeds of production
 - 3) A requirement in a title opinion that places in issue the title, identity, or whereabouts of the payee **and** that has not been satisfied by the payee after a reasonable request for curative information has been made by the payor.

Essentially, good faith title disputes.

Good Faith Title Disputes

- A dispute concerning title that would affect distribution of payments.
 - Example: two parties claiming the same interest
 - Can suspend payments or file an interpleader
- Reasonable doubt that the Payee has sold its share of oil/gas or that the Payee has clear title to the proceeds
 - Example: Recorded liens covering the interest
 - Can suspend payments or get an indemnifying division order

Good Faith Title Disputes

- Requirement in a title opinion
 - Example: Order of Probate missing in chain of title, but nothing else
 - Payor can request information from the Payee or hire a landman to obtain curative documents and can suspend until curative is received

When there is no question of the right to royalty and the amount of royalty calculated on the undisputed interest, suspension of the entire interest is improper and such amounts cannot be withheld without the accrual of interest.

Mistakes

- Voluntary Payment Rule: Money voluntarily paid on a claim of right with full knowledge of all the facts, in the absence of fraud, deception, duress, or compulsion, cannot be recovered back merely because the party at the time of payment was ignorant of or mistook the law as to his liability.
- If the error is made in the preparation of the division order, is returned executed by the Payee, and then payments are made, it is considered a legal mistake and the Payor cannot recover the payments.

Mistakes

- Mistake of fact: an unconscious ignorance or forgetfulness of fact
 - Example: Royalties are based on the number of barrels produced per day, and when production slips below that threshold, unbeknownst to the Payor, an overpayment is made.
 - The Payor may be allowed to recover funds paid under a true mistake of fact.

Non – Payment

- TEX. NAT. RES. CODE §91.404
- Payee must give Payor written notice by mail of failure to pay before beginning judicial action for non-payment
- Payor has 30 days after receipt of notice of non-payment to either pay the proceeds due or respond with a reasonable cause for non-payment.
- Lease or other agreement may state otherwise

Statutory Division Order Provisions

- Effective date
- Property description
- Fractional or decimal interest and type of interest
- Agreement to notify payor of changes and indemnification
- Authorization to suspend until resolution of title dispute
- Name, address, taxpayer identification number
- Valuation and timing of settlements
- Notification of statutory rights available to payee
- Division order does not amend lease or OA

Requirement of a Signed Division Order

- Most leases do not reference division orders
- The obligation to pay royalty is an express covenant of the lease
- TEX. NAT RES. CODE §91.402(c)
- Statutory authorization to demand an executed division order from the Payee, but it can only contain the provisions prescribed by the statute.

Statutory Form of Division Order

- TEX. NAT RES. CODE §91.402(d) – **OIL ONLY**
- Absent any conflicting language in the lease, if the Payor issues this form, the the Payee must execute and return the division order before the Payor is required to distribute the proceeds.
- Remember: the division order cannot amend the lease or other document providing for payment.

Refusal of Payee to Sign Division Order

- TEX. NAT RES. CODE §91.402(e)
- If an owner will not sign a division order because it contains provision in addition to the statutory provisions, the Payor shall not withhold payment solely for such refusal.
- If an owner will not sign a division order which only includes the statutory provisions, the Payor may withhold payment without interest until such division order is signed.
- CAUTION: Be aware of any language in the lease which states that signing a division order shall not be a prerequisite to payment.

Miniscule Payments

- Some owners only accrue pennies each month
- The cost of cutting a check each month may far outweigh the amount owed to the owner
- Division Order statute address this inefficiency
 - Allows the payor to accumulate proceeds to a set amount or time
- TEX. NAT. RES. CODE §91.402(f)

Exemptions

- The Division Order Statute does not apply to royalties payable to:
 - The board of regents of The University of Texas System under a lease of land dedicated to the permanent university fund; or
 - The General Land Office as provided by Subchapter D, Chapter 52, of the Texas Natural Resources Code.
- Essentially, the Division Order Statute does not apply to the Sovereign

Notice of Change of Payor

- TEX. NAT. RES. CODE §91.407
- New Payor must give written notice to each Payee within the time permitted for payment of proceeds and in accordance with TEX. NAT. RES. CODE §91.402
- Notice can be a division order, check stub, or attachment to a payment form.
- Payor can't defend non-payment where notice hasn't been sent
- This section doubles the interest rate on late payments

Owners with No Known Address

- No executed division order due to no known address
 - Payor should make reasonable efforts to locate the owner, but Payor is probably protected by Division Order Statute
 - TEX. PROP. CODE §75.101: where mineral proceeds that remain unclaimed by the owner for longer than three years after they become payable, the owner's right to receive those mineral proceeds are presumed abandoned.



QUESTIONS?

YOUR PARTNER IN CREATING MASSIVE, OUTSIZED VALUE