



MASSIVE MINERALS

# Top Leases

# Presentation Overview

- Top and Bottom Leasing Basics
- Applicable law
- Unique problems
  - RAP
  - Protections of the bottom lease
  - Determining termination of bottom lease
  - Issues with attacking validity of bottom lease
- Tips for successful top leasing

# Leasing Basics

- Primary term
- Secondary term
- Expiration of a lease:
  - During primary term
    - Examples: failure to pay royalty or commence drilling operations
  - During secondary term
    - Examples: lease is not being perpetuated in accordance with its terms

# Top Leases: Defined

- A top lease is a lease granted by a mineral interest owner during the existence of a recorded mineral lease that becomes effective if and when the existing lease expires or is terminated.
- Two forms of top leasing:
  - Primary term top leasing
  - Secondary term top leasing

# Primary Term Top Leasing

- Generally: Tends to involve fewer complications than secondary term top leasing
- Most common ways top lease becomes effective during primary term:
  - Preexisting lessee makes no effort to preserve the lease
  - Operations were not undertaken in a timely basis

# Secondary Term Top Leasing

- **Generally:** More complex than primary term top leasing because determining whether a secondary term has ended is heavily disputed.
- Taking advantage of lease expiration during the secondary term:
  - Complete cessation of production, OR
  - Production continues but in less than paying quantities
    - Two prong test

# Pugh Clauses

- A top lease may only apply to a portion of lands covered by bottom lease if and when a Pugh clause partially severs the lease
  - The top lease will come into effect as to the part of the bottom lease that expired
  - The top lease remains a top lease as to the non-expired portions of the bottom lease

# Regulation of Top Leases

- Section 26 of Art. I, Texas Constitution:
  - PERPETUITIES AND MONOPOLIES; PRIMOGENITURE OR ENTAILMENTS.
    - Perpetuities and monopolies are contrary to the genius of a free government, and shall never be allowed, nor shall the law of primogeniture or entailments ever be in force in this state.

This is the Texas Rule Against Perpetuities (RAP).



# The Rule Against Perpetuities (RAP)

- An interest is not valid unless it must vest, if at all, within 21 years after the death of some life or lives in being at the time of the creation of the interest.

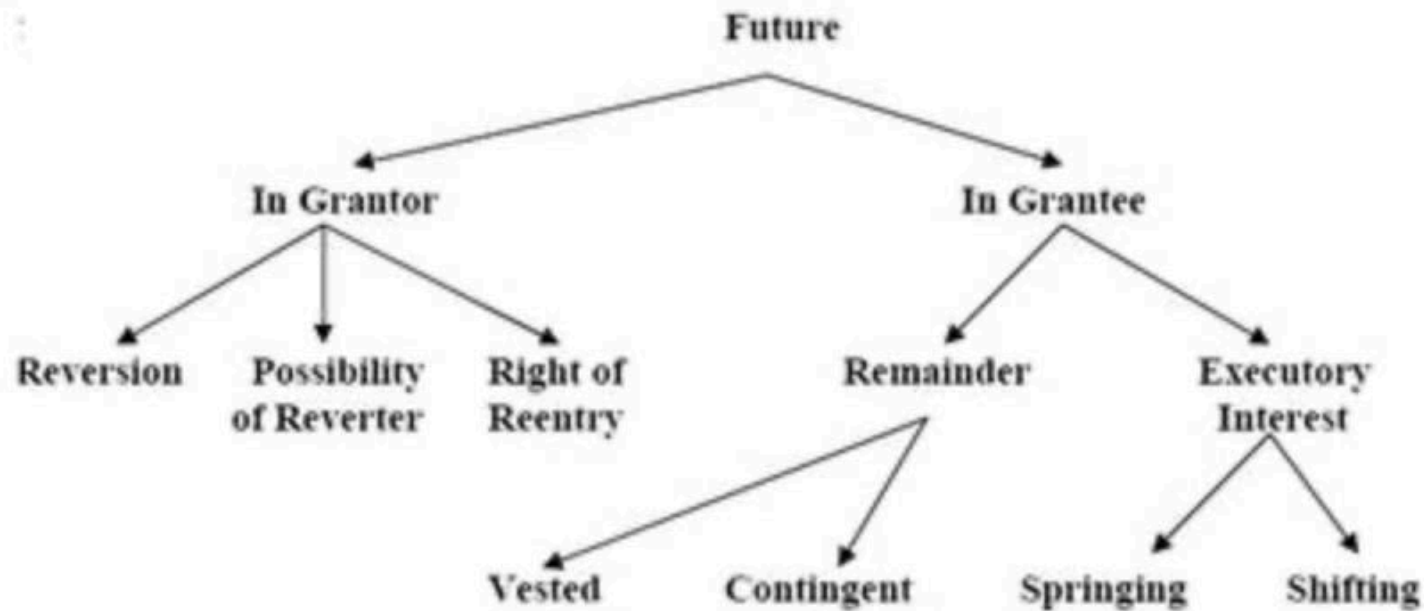
# The Rule Against Perpetuities (RAP)

- Must have all of the following for RAP to apply:
  1. Future interest;
  2. Partially or totally contingent; and
  3. Held by a non-charitable transferee

# RAP — Future Interest

- A future interest is an interest in an estate that will or may become possessory at a future time
- Future interests held by a grantee:
  - Remainder – vested or contingent (life estate)
  - Executory interest – shifting or springing (fee simple subject to executory limitation)
- Future interests held by a grantor:
  - Reversion (fee tail)
  - Possibility of reverter (fee simple determinable)
  - Right of reentry (fee simple subject to condition subsequent)

# RAP — Future Interest



# RAP — Contingent Interest

- A level of uncertainty exists as to whether the interest will vest
  - Holder is unborn or unascertained, OR
  - A condition precedent must occur before the holder of the interest can obtain possession.
- Example: A grants 100 acres to B IF B adopts 5 dogs this year.
  - B owns a future interest in 100 acres from A, contingent on B adopting 5 dogs this year
  - Although B owns the future interest, B lacks the “stick” of possession until the contingency is met

# RAP — Non-Charitable Transferee

- In order to promote charitable intent, Texas law says RAP does not apply to a charitable grantee
- For purposes of RAP analysis, it will not matter if you have a contingent future interest if the grantee of the interest is a charitable organization or entity.

# Triggering RAP in a Top Lease

1. Lessor executes a top lease with top lessee
2. Top lease vests in the top lessee only upon the expiration of the bottom lease
  - Top lessee holds a future interest (springing executory interest)
  - Top lessee's ownership is contingent on expiration of bottom lease
  - Top lessee is not a charitable entity
3. It is possible that the original lease could last longer than the twenty-one years provided for by RAP, so RAP is violated

# Case Law

- ***BP Am. Prod. Co. v. Laddex, Ltd.*, 458 S.W.3d 683 (Tex. App. 2015), aff'd, 513 S.W.3d 476 (Tex. 2017).**
  - Lessor's possibility of reverter is a presently vested right to future possession of the mineral estate upon termination of the lease. This interest is NOT subject to RAP.
- ***Hamman v. Bright & Co.*, 924 S.W.2d 168 (Tex. App. 1996), writ granted (Feb. 13, 1997), vacated pursuant to settlement, 938 S.W.2d 718 (Tex. 1997).**
  - A top lease is void when the lease only vests upon expiration of the bottom lease and it is possible that that original lease could last longer than the period provided for by RAP.



# The Doctrine of Cy Pres

- Public policy favors the exploration and production of oil
- *Cy pres* is applied to reformulate the top lease so that it fits within the confines of RAP
  - NOTE: *cy pres* may not be applied in cases of extreme misconduct, where top lessee acts in bad faith

# Contractual Protections for Bottom Lessees

- Savings clauses
  - Shut-in royalty
  - Operations clause (dry hole, operations, cessation of production)
  - Force majeure
  - Pooling
- Right of First Refusal
  - Lessor must provide notice to original lessee of a potential top lease offer so that the original lessee has the right to choose whether or not to buy those rights

# Attacking the Validity of a Bottom Lease

- Requires joinder of property parties and filing of proper action
  - Almost always trespass to try title
- Top lessee could open itself up to claims by bottom lessee:
  - Tortious interference with contractual relations
  - Champerty and maintenance
  - Slander of title
- **Key for top lessees:** avoid direct challenge to preexisting lease

# Tips for Successful Top Leasing

- Term of years for lease to take effect
- Timing of delay rental obligation
- Include a rider to the lease that subordinates the top lessee's rights to the bottom lessee's rights
- Include language that protects the top lease from actions by lessor to extend bottom lease's primary term
- Make a good faith effort to determine when prior lease terminated or if primary term has been extended before entering the leased premises to explore or drill



# QUESTIONS?

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