DRAFTING A TEXAS OIL AND GAS LEASE TO ENSURE ENFORCEABILITY OF A CONSENT-TO-ASSIGN CLAUSE: HOW TO MAKE AN OIL AND GAS "LEASE" A LEASE

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The traditional Texas oil and gas lease expressly allowed the operator to freely transfer the working interest in the lease. These transfers, however, have occasionally been made to sketchy operators who are not attentive to the rights of the surface estate owner. Consequently, more and more landowners are now seeking to protect themselves by negotiating for a clause in the lease that requires the landowner's consent before a transfer occurs. This Article advises Texas attorneys as to how to draft the duration clause of the oil and gas lease so as to facilitate judicial acceptance of the consent-to-transfer clause.

I. INTRODUCTION

In a previous article,[1] Professor Rory Ryan and I explained why courts should enforce a clause in an oil and gas lease that requires a landowner's consent before an operator transfers the working interest in a lease.[2] The argument was two-fold.[3]

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1. *See* Luke Meier & Rory Ryan, *The Validity of Restraints on Alienation in an Oil and Gas Lease*, 64 BUFF. L. REV. 305 (2016).
2. *See id.* at 308.
3. *See id.*

First, the reasons that courts universally permit a landlord to restrict a tenant's right to transfer apply with full force to an oil and gas lease.[4] An oil and gas lease, like a typical lease, creates an involved, on-going working relationship between lessor and lessee.[5] In fact, given that the operator of an oil and gas lease will be using the landowner's surface estate, and, given that the landowner trusts that the operator is honestly and accurately accounting for the landowner's royalty payments (that is, rent), the relationship created by an oil and gas lease is even more involved than is the typical landlord-tenant relationship.[6]

Second, the reasons that courts typically invalidate alienation restraints upon a fee estate do not apply to an oil and gas lease.[7] Fee simple absolute estates extend to infinity, which means that an enforceable restraint on a fee would forever restrict alienability of the property.[8] But enforcing a restraint on the working interest in a typical Texas oil and gas lease will not perpetually restrict transfers of that interest.[9] Because almost all Texas oil and gas leases terminate when production is no longer occurring in paying quantities,[10] the duration of the interest itself is inherently limited. The limited quantity of oil and gas that can be produced from any well means that an oil and gas lease will never extend to infinity; production—at some point—will no longer occur in paying quantities.[11] As the interest itself is inherently limited in duration, a restriction on the alienability of that interest is not permanent.[12] Moreover, an operator that wants to rid itself of the working interest in a lease can always surrender this interest back to the landowner.[13] In this sense, then, an operator—unlike the owner of a fee interest subject to a (hypothetically enforceable) restraint on transfer—will never be "stuck" with an estate that he does not desire.[14]

The analysis in our previous paper compels the conclusion that consent-to-transfer clauses in an oil and gas lease should be enforceable, based on the fundamental policies and purposes driving this body of law.[15]

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4. *See id.* at 330.

5. *See id.* at 313–17 (describing the intimate relationship created by an oil and gas lease).

6. *See id.* at 333–36.

7. *See id.* at 337–40.

8. *See id.* at 338 (explaining that the infinite nature of a fee simple absolute explains the legal rule generally prohibiting alienation restraints on this estate).

9. *See id.* at 338–39.

10. *See* ERNEST SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS § 4.4[A] (Michie ed., 1989) ("Although there are other events which may perpetuate an oil and gas lease, the production of oil or gas is usually necessary to extend the lease past the primary term."); *id.* § 4.4[A][1] ("To maintain a lease, a well must not only produce but must produce 'in paying quantities.'").

11. *See* Meier & Ryan, *supra* note 1, at 338–39.

12. *See id.* at 338.

13. *See id.* at 340–45 (explaining that surrender of an oil and gas lease back to the landowner is always possible).

14. *See id.* at 343.

15. *See id.* at 307–08 (discussing how an oil and gas lease straddles contract law and property law).

Despite our plea to resolve this issue based on governing policies and purposes, it is possible that some Texas courts may resort to labels to determine the legality of an oil and gas alienation restraint. Because the typical oil and gas lease is a "fee simple defeasible" estate under existing Texas caselaw,[16] a tempting syllogism is created: (1) oil and gas leases create a fee simple defeasible estate; (2) restrictions on the transfer of a fee are usually determined to be illegal and invalid;[17] and (3) thus, an attempted restriction on the interest created in an oil and gas lease is invalid.[18]

With a simple drafting trick, however, lawyers can protect against this sort of superficial judicial reasoning. Although it is beyond cavil that the typical Texas oil and gas lease involves a fee simple defeasible estate, this conclusion is derived from the standard lease language. The standard Texas oil and gas lease has no definite ending date, with termination of the lease occurring when production is not occurring in paying quantities.[19] Because the fee simple defeasible label derives from the typical lease language, however, a simple change in this lease language will change the type of real property estate that is created.

By inserting fourteen simple words—*fourteen*—into the standard lease agreement, a lawyer can change the property label that applies to the estate that is being transferred to the operator in the lease. By describing a definite ending date to which the lease must terminate, what is transferred to the operator is no longer an indefinite fee simple defeasible estate, but rather a term of years leasehold estate.[20] This drafting trick will destroy the superficial syllogism alluded to above, by which a court concludes that a restraint in an oil and gas lease is illegal because the oil and gas "lease" conveys a fee estate.[21] Instead, a court that was inclined to decide the legality of the restraint with a resort to labels will have a different syllogism to apply: (1) *this* oil and gas lease is a term of years leasehold estate; (2) restraints on the transfer of a

16. *See generally id.* at 312. To be more precise, the type of defeasible fee created by the typical Texas oil and gas lease is a fee simple determinable. *See* NANCY SAINT-PAUL, 1A SUMMERS OIL AND GAS § 9:33 (Thompson West eds., 3d ed. 2016) ("In Texas, an oil and gas lease generally conveys a fee simple determinable in the mineral estate with the possibility of reverter."); *see also* THOMAS W. MERRILL & HENRY E. SMITH, PROPERTY: PRINCIPLES AND POLICIES 510 (3d ed. 2017) (describing the fee simple defeasible as one of the three types of defeasible fees).

17. *See* JOHN P. DWYER & PETER S. MENELL, PROPERTY LAW AND POLICY: A COMPARATIVE INSTITUTIONAL PERSPECTIVE 185 (Foundation Press eds., 1998) (explaining that restraints on a fee are usually invalid). Even for a court inclined to use these labels, however, complications arise because the prohibition on restraining alienation of a fee does not necessarily apply to a *defeasible* fee. *See, e.g.*, RESTATEMENT (FIRST) OF PROP. § 407 cmt. b (AM. LAW INST. 1944) (providing that a restraint on alienability for a fee simple defeasible is more likely to be reasonable, and thus valid, than an identical restraint on a fee simple absolute would be).

18. *See* Meier & Ryan, *supra* note 1, at 312.

19. *See* SMITH & WEAVER, *supra* note 10, at 171–72.

20. *See* Meier & Ryan, *supra* note 1, at 339 n.99 (defining a term of years lease estate).

21. *See id.* at 310.

leasehold estate are always permitted;[22] and (3) thus, the restraint drafted in this lease is legal and enforceable.[23]

Changing the duration clause of a Texas oil and gas lease will have minimal collateral consequences beyond the intended result of judicial acceptance of a consent-to-assign clause.[24] A term of years lease can be made to terminate when production is no longer occurring in paying quantities.[25] And setting the definite ending date of the lease far off into the future (for instance, three hundred years later) avoids the possibility that a lease will end while production in paying quantities is still occurring.[26] Thus, the term of years oil and gas lease will end at exactly the same moment a standard fee simple defeasible oil and gas lease would end—when production is no longer occurring in paying quantities.[27] And, as explained in the last section of this Article, changing an oil and gas "lease" from a fee to a term will have very little effect on other legal issues that might arise between landowner and operator.[28]

The drafting trick described in this Article underscores the lunacy of resolving the validity of an alienation restraint in an oil and gas lease by a simple resort to labels. Because the labels can be manipulated so easily, an important issue such as the legality of a bargained-for consent-to-assign clause should not hinge on these labels. Nevertheless, conscientious attorneys can protect their landowner clients against this potential superficial judicial reasoning by adopting the drafting trick advocated for in this Article.[29]

II. PRESENT POSSESSORY ESTATES IN REAL PROPERTY

The Texas Supreme Court's 1915 decision in *Texas Co. v. Daugherty* was a monumental decision for the burgeoning oil and gas industry.[30] A few questions of fundamental importance regarding the legal treatment of oil and

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22. *See* RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 4.1 intro. note (AM. LAW INST. 1983). "Restraints on the alienation of tenants' interests in the landlord-tenant situation are widely used to give the landlord some additional assurance that the tenant of his choice will stay on the land and perform the obligations of the lease. The validity of these restraints on the tenant is generally recognized . . . ." *Id*.; *see* ERIC T. FREYFOGLE & BRADLEY C. KARKKAINEN, PROPERTY LAW: POWER, GOVERNANCE, AND THE COMMON GOOD 586 (2012) ("[M]any leases, both residential and commercial, provide that a tenant may not sublease or assign without the express consent of the landlord.").

23. *See* RESTATEMENT (FIRST) OF PROP. § 407 (AM. LAW INST. 1944).

24. *See infra* Part IV (discussing the collateral consequences of changing the duration of an oil and gas lease to a term of years).

25. *See* JAMES CHARLES SMITH, THE GLANNON GUIDE TO PROPERTY 182–83 (3d ed. 2015).

26. *See* Meier & Ryan, *supra* note 1, at 339.

27. *See* SMITH, *supra* note 25, at 339.

28. *See infra* Part IV (discussing the legal issues that might arise from changing the duration of an oil and gas lease to a term of years).

29. The text of this Article has been drafted for the attorney negotiating a lease on behalf of a landowner. The subject matter of this Article implicates some theoretical issues of academic interest; the discussion of these theoretical matters will be mainly confined to the footnotes.

30. Tex. Co. v. Daugherty, 176 S.W. 717 (Tex. 1915).

gas were resolved in *Daugherty*,[31] with enormous consequences—both legal and practical—flowing from these decisions.[32] The discussion of these issues in *Daugherty* was somewhat jumbled, and the resolution of these issues was, in some instances, implicit rather than explicit.[33] Nevertheless, the Court's clear conclusion that the oil and gas lease in *Daugherty* involved a fee simple defeasible was only possible after a resolution of the three fundamental questions addressed below.[34]

First, the *Daugherty* Court resolved that oil and gas would be treated as property, even as those minerals remained underground and undeveloped.[35] Other states had used non-property legal constructs in dealing with oil and gas in place.[36] The Supreme Court's decision to treat minerals in place as property resulted in a variety of consequences.[37]

Second, having determined that minerals in place are property, the *Daugherty* Court needed to resolve whether those minerals were real property or personal property.[38] The Court determined that minerals in place were real property, despite the fugitive nature of oil and gas.[39] Again, this conclusion resulted in a variety of legal and industry consequences.[40]

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31. *See* Bruce M. Kramer, *The Temporary Cessation Doctrine: A Practical Response to an Ideological Dilemma*, 43 BAYLOR L. REV. 519, 522 (1991) ("In *Texas Co. v. Daugherty*, the Texas Supreme Court treated both oil and gas in place and the oil and gas leasehold estate as a corporeal or possessory property interest subject to ad valorem taxation.") (footnote omitted).

32. *See* Andrew M. Miller, Comment, *A Journey Through Mineral Estate Dominance, the Accommodation Doctrine, and Beyond: Why Texas Is Ready to Take the Next Step with a Surface Damage Act*, 40 HOUS. L. REV. 461, 466–67 (2003) ("Specifically, ownership-in-place provides predictability for both legislatures and courts because this theory directly correlates with certain aspects of general property law, such as statutes of fraud, taxation statutes, and recording acts."); *see also* Jared C. Bennett, Comment, *Ownership of Transmigratory Minerals, Utah and Zebras: Proof that Oil and Gas Ownership Law Needs Reform*, 21 J. LAND RESOURCES & ENVTL. L. 349, 359 (2001) ("Hence, despite some possible logical inconsistencies with the theory, its ability to fit into existing concepts of real property law coupled with its predictability provide the ownership-in-place theory with substantial policy advantages over nonownership theory.").

33. *See Daugherty*, 176 S.W. at 717.

34. *See infra* text accompanying notes 35, 38, 41 (asking the three fundamental questions).

35. *Daugherty,* 176 S.W. at 721 ("But nevertheless, while they are in the ground, they constitute a property interest.").

36. RICHARD W. HEMINGWAY, THE LAW OF OIL AND GAS 27 (3d ed. 1991) (explaining that several states have rejected the idea that oil and gas can be owned as property while in place).

37. *See infra* Part IV (discussing the resulting consequences).

38. *Compare* George A. Bibikos & Jeffrey C. King, *A Primer on Oil and Gas Law in the Marcellus Shale States*, 4 TEX. J. OIL GAS & ENERGY L. 155, 159 (2009) ("The prevailing view seems to be that a lease conveys an interest in real property."), *with* W. Nat. Gas Co. v. McDonald, 446 P.2d 781, 783 (Kan. 1968) ("The rights created by oil and gas leases covering land in Kansas constitute intangible personal property except when that classification is changed for a specific purpose by statute."). *See also* Backar v. W. States Producing Co., 547 F.2d 876, 881–82 (5th Cir. 1977) ("Under Texas, Oklahoma and New Mexico law, oil and gas leases are real property, but under New York law, oil and gas leases are personal property.") (footnote omitted).

39. *See Daugherty*, 176 S.W. at 720 ("If these minerals are a part of the realty while in place, as undoubtedly they are, upon what principle can the ownership of the property interest, which they constitute while they are beneath or within the land, be other than the ownership of an interest in the realty?").

40. *See infra* Part IV (discussing the resulting consequences).

Third, having determined that the minerals in place were interests in real property, it was necessary to determine whether those interests were "estates."[41] An estate is a property interest in land involving possessory rights.[42] Some interests in land—such as easements, profits, or real covenants—do not give the holder the right to possession.[43] A few states have characterized an oil and gas lease as conveying an interest in real property but not as a possessory interest and, thus, not an estate.[44] The *Daugherty* Court rejected this view.[45]

Having determined that oil and gas in place consisted of a possessory interest in real property, it was then necessary for the Court to label the *Daugherty* conveyance within the estates system.[46] This determination—unlike the three fundamental holdings regarding Texas law discussed above—revolved around the particular language that was used in the conveyance by Daugherty to Texas Company.[47] This language will be

41. *See Daugherty*, 176 S.W. at 720.

42. *See* RESTATEMENT (FIRST) OF PROP. § 9 (AM. LAW INST. 1936) ("The word 'estate,' as it is used in this Restatement, means an interest in land which (a) is or may become possessory; and (b) is ownership measured in terms of duration.").

43. *See* James L. Winokur, *The Mixed Blessings of Promissory Servitudes: Toward Optimizing Economic Utility, Individual Liberty, and Personal Identity*, 1989 WIS. L. REV. 1, 8 (1989) ("Servitudes—easements, real covenants, and equitable servitudes—involve truly nonpossessory rights over the use of land in possession of another."); *see also* Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The* Numerus Clausus *Principle*, 110 YALE L.J. 1, 16 (2000). "Another general category of property rights in land consists of interests that confer only limited rights of use as opposed to general possession. Here, American law recognizes four basic forms: easements, real covenants, equitable servitudes, and profits." Merrill & Smith, *supra*.

44. *See, e.g.*, David E. Pierce, *Incorporating a Century of Oil and Gas Jurisprudence into the "Modern" Oil and Gas Lease*, 33 WASHBURN L.J. 786, 792 n.21 (1994) (noting that Kansas law states that a "lessee's interest is a non-possessory interest"); *see also* Luther L. McDougal III, *Louisiana Mineral Servitudes*, 61 TUL. L. REV. 1097, 1098–99 (1987) ("Any attempt to sell or reserve the ownership of oil and gas [in Louisiana] results in the creation of a mineral servitude.").

45. *See Daugherty*, 176 S.W. at 719 ("The grant amounted to a defeasible title in fee to the oil and gas in the ground, if oil and gas in place are capable of ownership and conveyance.").

46. *See id.* at 719–20. Even after concluding that the minerals in place were (1) real (2) property, classification as an "estate" is only necessary if what is involved is a possessory interest in land. *See id.* Thus, by proceeding to a determination as to the type of estate created by the conveyance, the *Daugherty* Court implicitly held that the real property interest created under the lease was possessory in nature. *See id.* This implicit conclusion was explicitly confirmed in *Stephens County v. Mid-Kansas Oil & Gas Co.* and has subsequently been accepted as gospel within Texas. Stephens County v. Mid-Kan. Oil & Gas Co., 254 S.W. 290 (Tex. 1923); *see* Laura H. Burney, *The Regrettable Rebirth of the Two-Grant Doctrine in Texas Deed Construction*, 34 S. TEX. L. REV. 73, 87–88 (1993). "In *Stephens County v. Mid-Kansas Oil & Gas Co.*, the Texas Supreme Court determined that an oil and gas lease creates a fee simple determinable in the lessee in the mineral estate. The lessee owns this fee in the entire mineral estate. The lessor retains the future interest that accompanies a fee simple determinable, a possibility of reverter, in the whole estate." Burney, *supra* (footnote omitted).

47. *See generally Daugherty*, 176 S.W. 717. Indeed, some have noted that the Court's conclusion in *Daugherty* that oil and gas in place were real property seemed to ignore some of the lease language involved in that case. *See* Adam Walton, Note, Edwards Aquifer Authority v. Day *and the Search for Consistency in the Theory of Groundwater Rights*, 8 LIBERTY U. L. REV. 27, 47 (2013) ("To build its logical argument [that oil and gas were real property capable of ownership in place], the court turned a critical eye to what was actually being conveyed in the oil lease at issue.").

familiar to practicing Texas oil and gas lawyers. The duration of the conveyance was described as follows:

> [T]he sinking of a well or shaft and the discovery of any of the minerals named, within the period of one year or the extension thereof provided for, in each instance renders the instrument effective for [twenty] years and as much longer as such minerals shall be produced in paying quantities.[48]

The task for the *Daugherty* Court was to determine what possessory estate was created by this language.[49]

Under the estates system, there are five present possessory estates for real property; each of these five estates has a different duration.[50] The five present possessory estates are as follows:

Figure A

Fee Simple **Life Estate** **Term of Years** **Period Tenancy** **Tenancy at Will**

That is it.[51] According to the bedrock numerus clauses principle, every present possessory interest in real property must be placed into one of the five present estates recognized under the common law.[52]

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48. *Daugherty*, 176 S.W. at 719. It is somewhat unclear from the *Daugherty* opinion whether this quoted language is a direct quote from the lease or whether the Court is paraphrasing the duration of the lease in *Daugherty*. *Id.* at 717. In other places in the *Daugherty* opinion, the Court was explicit when directly quoting from the lease; it seems likely then that the quoted language in the text is from the Texas Supreme Court rather than the lease in *Daugherty*. *See id.*

49. *See id.* at 720.

50. *See* JOHN E. CRIBBET & CORWIN E. JOHNSON, PRINCIPLES OF THE LAW OF PROPERTY 40–68 (3d ed. 1989); JOHN G. SPRINKLING & RAYMOND R. COLETTA, PROPERTY: A CONTEMPORARY APPROACH 309–48 (2009).

51. In identifying these five estates, I have ignored the fee tail and the tenancy at sufferance. Most jurisdictions, including Texas, have abolished the fee tail. *See* TEX. CONST. art. I, § 26; JOSEPH WILLIAM SINGER, PROPERTY 323 (3d ed. 2010) (describing the abolition, by statute, of the fee tail in most states). The tenancy at sufferance is the term sometimes applied to a tenant who holds over after the end of her lease. *See, e.g.*, Coinmach Corp. v. Aspenwood Apartment Corp., 417 S.W.3d 909, 915 (Tex. 2013) ("By contrast, a tenant at sufferance is '[a] tenant who has been in lawful possession of property and wrongfully remains as a holdover after the tenant's interest has expired' . . . . The defining characteristic of a tenancy at sufferance is the lack of the landlord's consent to the tenant's continued possession of the premises."). Given that the former lessee's possession is without consent or legal justification, the tenancy at sufferance is not typically viewed as being an estate within the common law's classification system. *See* ROGER BERNHARDT & ANN M. BURKHART, PROPERTY 153 (2012) ("[T]he tenancy at sufferance is a tenancy in name only."); R. POWELL & P. ROHAN, POWELL ON REAL PROPERTY § 16.06[2] (1996) ("A tenant at sufferance falls short of being a trespasser only by virtue of having initially been in possession rightfully.").

52. *See* JESSE DUKEMINIER ET AL., PROPERTY 221 (8th ed. 2014) ("The prohibition of new of customized property interests, known in the civil law as the numerus clauses principle, applies not only to estates but to all types of property interests."); Merrill & Smith, *supra* note 43, at 3 ("Every common-law lawyer is schooled in the understanding that property rights exist in a fixed number of forms. The principle is acknowledged—at least by implication—in the 'catalogue of estates' or 'forms of ownership' familiar to anyone who has survived a first-year property course in an American law school."); *see also* D. BENJAMIN BARROS & ANNA P. HEMINGWAY, PROPERTY LAW 163 (2015) ("[W]e have to fit every interest

The Court in *Daugherty* concluded that the mineral conveyance in that case was of a fee simple;[53] the correctness of this conclusion is obvious when one considers the intended duration of the conveyance in that case and the duration of each of the five present estates.

The parties in *Daugherty* intended the conveyance to last for as long as production[54] occurred in paying quantities after the original twenty-year primary term.[55] This precludes characterization as a life estate.[56] A life estate is an estate that lasts for the duration of a person's life,[57] which was obviously not the intended duration of the estate in *Daugherty*.[58]

Similarly, characterization of the *Daugherty* estate as a term of years was not possible.[59] A term of years is an estate that lasts until a fixed, ascertainable date.[60] This was also not the intended duration of the *Daugherty* conveyance.[61] The estate in *Daugherty* was to last so long as there was production in paying quantities, not until a fixed "cut-off" date.[62]

Labeling the estate in *Daugherty* as a periodic tenancy or tenancy at will was also inconsistent with the terms of the estate being transferred.[63] A periodic tenancy is an estate that lasts from one defined period to the next,

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created by a conveyance into one of our established categories of present and future interests."). Under Texas law, this principle is implicitly recognized in the Texas Property Code. *See* TEX. PROP. CODE ANN. § 5.001 (West 2017) (discussing the fee simple estate); *id.* § 5.009 (explaining the duties of a life estate holder); *id.* § 5.021 (stating that term leases for more than one year must be in writing); *id.* § 24.002 (discussing the termination of a tenancy at will); *id.* § 91.001 (outlining the termination of periodic tenancies). Although the Code does not mention the numerus clauses principle, it does recognize the five standard present estates. *See id.* §§ 5.001, 5.021, 24.002, 91.001.

53. *See Daugherty*, 176 S.W. at 719 ("The grant amounted to a defeasible title in fee to the oil and gas in the ground, if oil and gas in place are capable of ownership and conveyance.").

54. *See id.* If a lease requires "production," Texas courts have interpreted this to require production in paying quantities. *See* Clifton v. Koontz, 325 S.W.2d 684, 690 (Tex. 1959) ("While the lease does not expressly use the term 'paying quantities,' it is well settled that the terms 'produced' and 'produced in paying quantities' mean substantially the same thing.").

55. *See Daugherty*, 176 S.W. at 717.

56. *See id.*

57. *See* RESTATEMENT (THIRD) OF PROP.: WILLS & DONATIVE TRANSFERS § 24.5 (AM. LAW INST. 2011) ("The life estate is a present interest that terminates on the death of an individual whose life serves as the governing life."); *see also* Eversole v. Williams, 943 S.W.2d 141, 143 (Tex. App.—Houston [1st Dist.] 1997, no writ) ("Generally, a life estate is created by a deed or will where the language of the instrument manifests an intention on the part of the grantor or testator to pass to a grantee or devisee a right to possess, use, or enjoy property during the period of her life.").

58. *Daugherty*, 176 S.W. at 717.

59. *Id.*

60. *See* Bockelmann v. Marynick, 788 S.W.2d 569, 571 (Tex. 1990) ("The lease created a tenancy for a definite term (a tenancy with a specified beginning and ending date)."); DUKEMINIER ET AL., PROPERTY 443 (8th ed. 2014) ("A term of years is an estate that lasts for some fixed period of time or for a period computable by a formula that results in fixing calendar dates for beginning and ending, once the term is created or becomes possessory.").

61. *See generally Daugherty*, 176 S.W. 717.

62. *Id.*

63. *Id.*

until either party gives an adequate notice of termination.[64] Thus, a periodic tenancy might be "week-to-week" or "month-to-month" or even "year-to-year."[65] This was obviously not the case with the estate being transferred in *Daugherty*.[66] There was no defined period.[67] More importantly, though, the parties to the *Daugherty* transaction did not anticipate that the grantor would be able to terminate the estate while there was production in paying quantities.[68] In this sense, the grantor was "locked-in" to the lease while production was occurring.[69] This is an important concept from the producer's perspective; a producer would not agree to the costs and risks involved in exploration if a landowner was free to terminate the operator's estate once oil and gas had been found (so as to enter into a new lease with higher royalties).[70] By definition, however, either party to a periodic tenancy is capable of terminating the estate by giving adequate notice.[71]

The ability of either party to terminate the estate is also a defining characteristic (indeed, *the* defining characteristic) of a tenancy at will.[72] Under a tenancy at will, either party is free to terminate the estate;[73] thus, neither party is "locked-in" to the conveyance any longer than either desires.[74] Here again, this is simply incompatible with the terms of the *Daugherty* conveyance, which prevented the grantor from terminating the estate once the producer had done the expensive, risky work of finding production in paying quantities.[75]

This leaves a fee simple. A fee simple is defined as a present estate with an unlimited, or potentially unlimited, duration.[76] When the fee estate in

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64. *See* RESTATEMENT (SECOND) OF PROP.: LANDLORD & TENANT § 1.5 (AM. LAW INST. 1977) ("A landlord-tenant relationship may be created to endure until one of the parties has given the required notice to terminate the tenancy at the end of a period."); *see also* Panola Cty. Appraisal Review Bd. v. Pepper, 936 S.W.2d 10, 12 (Tex. App.—Texarkana 1996, no writ) ("Periodic tenancies are those where the agreement provides no fixed term, but is for period to period at the will of the lessor or the lessee.").

65. *See* RESTATEMENT (SECOND) OF PROP.: LANDLORD & TENANT § 1.5 cmt. a (AM. LAW INST. 1977) ("The lease from period to period described in this section traditionally has been referred to as a tenancy from year to year, or a tenancy from month to month, or a tenancy from week to week, depending on the length of the period that is specified.").

66. *Daugherty*, 716 S.W. at 717.

67. *Id.*

68. *Id.*

69. *See id.*

70. *See infra* note 129 (discussing agreement to lease terms by operators).

71. *See* RESTATEMENT (SECOND) OF PROP.: LANDLORD & TENANT § 1.5 (AM. LAW INST. 1977) ("A landlord-tenant relationship may be created to endure until *one of the parties* has given the required notice to terminate the tenancy at the end of a period.") (emphasis added).

72. *See id.* §1.6.

73. *See id.* § 1.6. "A landlord-tenant relationship may be created to endure only so long as both the landlord and the tenant desire. Statutes commonly require some period of notice to terminate the tenancy." *Id.*; Philpot v. Fields, 633 S.W.2d 546, 547 (Tex. App.—Texarkana 1982, no writ) ("A tenancy at will is terminable by either party to a lease.").

74. *See* RESTATEMENT (SECOND) OF PROP.: LANDLORD & TENANT § 1.5 (AM. LAW INST. 1977).

75. Tex. Co. v. Daugherty, 176 S.W. 717 (Tex. 1915).

76. *See* RESTATEMENT (FIRST) OF PROP. § 14 (AM. LAW INST. 1936) ("An estate in fee simple is an estate which (a) has a duration (i) potentially infinite; or (ii) terminable upon an event . . . .").

question is unlimited, this is termed a fee simple absolute.[77] The *Daugherty* conveyance was not a fee simple absolute; the estate granted to the operator did not last until infinity, but only so long as production was occurring in paying quantities.[78] Rather, the conveyance was a fee simple defeasible.[79] A fee simple defeasible is an estate that might last for eternity (theoretically, at least) but could also be cut short at some indeterminate point in the future based on the occurrence of certain events.[80] This was the duration of the estate in *Daugherty*. Although, of course, no well will last forever[81]—it is a theoretical possibility. And more importantly, the event which cuts short the estate is not tied to a person's life (as in a life estate), a fixed ascertainable date (as with a term of years), or the notification by either party that he or she wanted to terminate the estate (as with a periodic tenancy or a tenancy at will).[82] The conveyance in *Daugherty* was a fee simple defeasible, and this conclusion becomes clear when one considers the limited types of real property estates recognized under the common law of property.[83] The *Daugherty* Court had no choice but to reach the conclusion it did.[84]

Having determined that the conveyance involved a fee simple defeasible, it followed that the oil and gas "lease" in *Daugherty* was not technically a legal lease.[85] Under the established estates system, fee simple estates (absolute or defeasible) and life estates are both "freehold estates." The distinction between a freehold estate and a nonfreehold estate is related to the ancient English common law concept of "seisen"—freehold estates carried seisen, while nonfreehold estates did not.[86] Whether an estate carried seisen had important consequences for the feudal hierarchy established by

77. *See* Benjamin D. Barros, *Toward a Model Law of Estates and Future Interests*, 66 WASH. & LEE L. REV. 3, 32 (2009) (defining a fee simple absolute as "a present interest in real property that is unlimited in duration").

78. *Daugherty*, 176 S.W. at 717.

79. *See id.* (providing the text of the conveyance between the parties).

80. JOSEPH W. SINGER, PROPERTY LAW: RULES, POLICIES, AND PRACTICES 506 (4th ed. 2006) ("A fee simple defeasible is a type of property interest in which the fee holder's title is subject to the performance (or non-performance) of a condition specified by the grantor.").

81. *But see* R. Kyle Nuttall, *Oil and Gas Leases Could Last Forever*, NUTTALL LEGAL, LLC, (June 15, 2015), http://www.nuttalllegal.com/2015/06/15/oil-and-gas-leases-could-last-forever/ (telling the story of an active lease that was signed in 1892). As oil and gas production was beginning in Texas, there was some sentiment that production might occur perpetually. *See* Stephens County v. Mid-Kan. Oil & Gas Co., 254 S.W. 290, 295 (Tex. 1923) ("First, that the grants might endure forever, since the lands might never cease the profitable production of oil and gas . . . ."); Tex. Co. v. Davis, 254 S.W. 321, 331 (Tex. 1923) (commenting that "the land might always produce minerals in paying quantities").

82. *See generally* RESTATEMENT (SECOND) OF PROP.: LANDLORD & TENANT § 1.7 (AM. LAW INST. 1977) (defining a fee simple defeasible).

83. *See Daugherty*, 176 S.W. at 717.

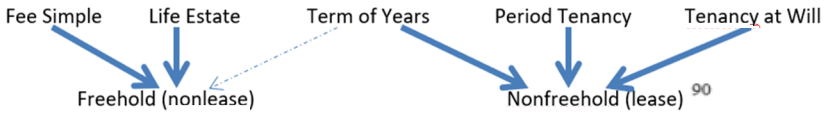
84. *Id.*

85. *Id.*

86. *See* David A. Thomas, *Anglo-American Land Law: Diverging Developments from a Shared History*, 34 REAL PROP. PROB. & TR. J. 143, 187 ("[S]eisin applied only to freehold estates . . . .").

estates in land.[87] The concept of seisen is no longer important,[88] but the distinction between freehold and nonfreehold estates survives in that nonfreehold estates are determined to be leases while freehold estates are determined to be non-leases.[89] This relationship is depicted below:

Figure B



87. *See* RESTATEMENT (FIRST) OF PROP. div. II, intro. note (AM. LAW INST. 1936) ("An 'estate' . . . is a 'freehold estate' when it is one of the types of estate which had importance in the feudal land system and developed its definitive characteristics under the aegis of the feudal hierarchy of England."); W.A. Rhea, *The Destructibility of Contingent Remainders in Texas*, 2 TEX. L. REV. 63, 64 (1923). "Seisin was fundamental in the common law. 'It was so important that we may almost say that the whole system of our land law was law about seisin and its consequences.'" Rhea, *supra* (quoting 2 FREDRICK POLLOCK & FREDRICK WILLIAM MAITLAND, THE HISTORY OF ENGLISH LAW BEFORE THE TIME OF EDWARD I 29 (1895)).

88. Whitehead v. Foley, 28 Tex. 268, 283 (1866) ("Generally in this country, certainly in this state, seizin means merely ownership . . . ."); Rhea, *supra* note 87, at 68 ("[I]deas of seisin . . . were not only never a part of the Texas law, but were foreign to the policy of her law.").

89. Youngjoon Kwon & Yong-Shik Lee, *Legal Analysis of Traditional Leasehold in Korea (Chonsegwon) from a Comparative Legal Perspective*, 29 ARIZ. J. INT'L & COMP. L. 263, 270 (stating that nonfreehold estates are leaseholds).

90. Luke Meier, Figure B (2017) (unpublished table) (on file with author). Some complexity—unnecessary to the topic at hand—has been skirted over in this depiction and in the preceding paragraph in the text. *See supra* text accompanying notes 85–89 (explaining estates system). The discussion in the text would suggest that the determination of the type of estate involved occurs first (based on an analysis of duration), with the conclusion as to whether the estate is a lease (or not), following from this conclusion. *See supra* text accompanying notes 85–89 (explaining estates system).

A different logical relationship is possible, under which the conveyance is *first* characterized as a lease (or not) and then placed into the appropriate estate that best matches the intended duration of the parties. This type of analysis could be depicted as such:

Under this approach, it is necessary to apply criteria (other than the duration of the estate) to distinguish a lease from a non-lease. This sort of analysis would presumably look at the nature of the relationship established between the grantor and grantee. To the extent that the grantor and grantee anticipated and established an ongoing relationship (the payment of periodic rent, the responsibility of the grantor for maintenance and repairs, for example), a lease would exist. The landlord-tenant relationship desired by the grantor and grantee, rather than the duration of the estate being created, would determine that a leasehold estate had been created. Under this approach, if the grantor and grantee expected to go their separate ways after the conveyance (not wanting a landlord-tenant relationship), a non-lease would exist.

These two different approaches can result in dramatically different results. Suppose that a grantor and a grantee both intended to establish a landlord-tenant relationship for a lease that would last as long

as the grantee was alive. Under the approach in the text, the duration of the estate would first be considered. *See supra* text accompanying notes 85–89 (explaining estates system). Because the intended duration of the estate is for the life of the grantee, a life estate is created. But because a life estate is not a leasehold estate, no landlord tenant duties are implicated. Thus, for example, the grantee could not expect the grantor to resolve a rodent infestation on the property. A dramatically different result occurs if the approach considered in this footnote is followed. Under this approach, the conveyance is first determined to be a lease because of the parties' desire to create a landlord-tenant relationship. At that point, however, the estate must be characterized as one of the three types of leasehold estates. *See supra* text accompanying notes 85–89 (explaining estates system). The most likely result under this approach is that the lease is characterized as a periodic tenancy (with a period equivalent to when rent was to be paid) or a tenancy at will; this means, however, that either the grantor or grantee can terminate the lease upon proper notice, because either party to a periodic tenancy is entitled to terminate the lease. *See, e.g.*, Nitschke v. Doggett, 489 S.W.2d 335, 335 (Tex. Civ. App.—Austin 1972, writ ref'd n.r.e.) *vacated for lack of jurisdiction by* Doggett v. Nitschke, 498 S.W.2d 339 (Tex. 1973). "The question is whether a lease for the balance of the life of appellee, as lessee, created an estate for years or a tenancy at will. We hold that the lease established a tenancy at will terminable at any time by either the lessor or the lessee." *Id*.; *see* Kajo Church Square, Inc. v. Walker, No. 12-02-00131-CV, 2003 WL 1848555, at *6 (Tex. App.—Tyler Apr. 19, 2003, no pet.). "[A] leasehold for life is not a recognized property right. Therefore, as a matter of law, the lease constitutes a tenancy at will." *Kajo Church Square, Inc.*, 2003 WL 1848555, at *6; Clear Lake Reg. Med. Ctr. v. DeAsis, No. 01-98-01390-CV, 1999 WL 624533, at *4 (Tex. App.—Houston [1st Dist.] Aug. 12, 1999, pet. denied) ("We hold that the written lease contract between Clear Lake and DeAsis, having no definite duration, created a tenancy at will terminable by either the lessor or the lessee.").

In 99% of actual cases, the theoretical difficulties addressed in this footnote are irrelevant because the estate is either lease or non-lease, regardless of whether the question is first resolved by looking at the duration of the estate or by first considering the type of relationship intended by the parties. When these theoretical issues do matter to the result in a particular case, it is a byproduct of the numerus clauses principle, which precludes the creation of new estates. *See* Anna Di Robilant, *Property and Democratic Deliberation: The* Numerus Clausus *Principle and Democratic Experimentalism in Property Law*, 62 AM. J. COMP. L. 367, 368 (2014). Under the numerus clauses principle, a "lease for life" is problematic because there is no such thing as a lease for life under the common law, meaning that the estate must be crammed into a box that is going to do some violence to the intent of the parties with regard to either (1) the type of relationship they intended or (2) the duration of the estates they desired. Courts (including Texas courts) have occasionally reacted to this scenario (and similar ones) by ignoring the numerus clauses principle and simply enforcing the intent of the parties. *See* Garner v. Gerrish, 473 N.E.2d 223 (N.Y. 1984) (holding that a lease with no fixed term or period, but terminable by the lessee, was a lease for the life of a lessee that the lessee (but not the lessor) was free to terminate); Myers v. E. Ohio Gas Co., 364 N.E.2d 1369, 1372–74 (Ohio 1977) (holding that a lease with no fixed term or period, and terminable by the lessee only, was enforceable as written and was not a tenancy at will terminable by either party); Philpot v. Fields, 633 S.W.2d 546, 547–48 (Tex. App.—Texarkana 1982, no writ) (holding that a lease that was to continue so long as the lessee used it for a particular purpose was enforceable and not a tenancy at will terminable by either party, while avoiding the question as to what type of estate had been created). Commentators, however, have noted the systemic benefits deriving from the principle. *See* Robilant, *supra*, at 368–94.

In any event, the theoretical problems addressed in this footnote can be avoided in this Article because the *Daugherty* Court clearly determined that the oil and gas lease in that case was a defeasible fee because of the duration of the estate that had been created. *See generally Daugherty*, 176 S.W. 717. The Texas Supreme Court in *Daugherty* did not consider the nature of the on-going relationship between landowner and operator. *See generally id.* Had it done so, the Court would have been compelled to determine that the relationship created was leasehold rather than non-leasehold. *See generally id.* Indeed, that is the entire basis of our previous Article regarding the enforceability of consent-to-assign clauses in oil and gas leases. *See generally* Meier & Ryan, *supra* note 1. The reason that alienation restraints are always upheld for land leases is because of the type of relationship created between landlord and tenant. *See generally id.* at 330–37. The relationship between landowner and operator is even more involved and on-going than the typical relationship between landlord and tenant in a typical land-lease; stated differently, the landowner-operator relationship under an oil and gas lease is more "leasey" than is the typical relationship between landlord and tenant. *See id.* There is a reason that the term oil and gas lease persists, despite the holding in *Daugherty*: everyone recognizes that the conveyances function, from a

The reader will note that the term of years estates can be characterized as either a freehold (nonlease) or a nonfreehold (lease).[91] This requires some explanation.

First, it should be noted that there is some ambiguity regarding the correct label for this estate. This Article uses term of years, but this estate is also referred to as a tenancy for years, and estate for years, or other similar terms.[92] The multitude of expressions used to refer to this estate is indicative of some underlying conceptual disorder about this estate.

Commentators and courts usually assume that a term of years is a nonfreehold, leasehold estate.[93] (This result is depicted in Figure B by the

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practical perspective, like a leasehold relationship. Notice, however, that had the *Daugherty* Court first characterized the conveyance in that case as a lease because of the type of relationship created, a problem would have arisen regarding the duration of that lease; there is no leasehold estate that locks that grantor into the lease until production is no longer occurring in paying quantities. *But cf.* Sirtex Oil Indus., Inc. v. Erigan, 403 S.W.2d 784, 788–90 (Tex. 1966) (recognizing the validity of a surface lease with a duration fixed to that of a mineral lease on the same property, but not addressing the argument that the lease could be terminated because it was not a term of years and was thus terminable by either party, instead addressing the lessor's argument that the rent requirement should be construed as a condition terminating the lease when rent was not timely paid rather than a covenant).

Because this Article is simply a response to the reasoning used by the *Daugherty* Court, it will assume (as did the *Daugherty* Court) that the duration of an estate determines whether it is a lease or a non-lease. *See generally Daugherty*, 176 S.W. 717.

Interestingly, the question as to how to determine whether a conveyance is a lease or non-lease arises under the Texas Property Code's provisions that describe the parameters of some of the duties owed by a landlord to a tenant. *See* TEX. PROP. CODE ANN. § 92.001 (West 2017). These issues are essentially ignored through a pattern of circular definitions that provide no real guidance. *See, e.g.*, *id.* (defining a residential lease as "any written or oral agreement between a landlord and tenant that establishes or modifies the terms, conditions, rules or other provisions regarding the use and occupancy of a dwelling"); *id.* § 92.001(2) (defining a landlord as "the owner, lessor, or sublessor of a dwelling"); *id.* § 92.001(6) (defining a tenant as "a person who is authorized by a lease to occupy a dwelling to the exclusion of others and, for the purposes of Subchapters D, E, and F, who is obligated under the lease to pay rent."). These definitions were clearly not created to resolve the theoretical issues identified in this footnote. *See generally id*. And the absence of case law addressing the question as to what is a lease and who is a landlord or tenant under the Code supports the point made above, which is that in 99% of actual cases an estate will either be a lease (or not) regardless of the approach used (duration or relationship) to resolve this distinction.

91. *See* Thomas, *supra* note 86, at 176.

92. *See* SMITH, *supra* note 25, at 182. ("The tenancy for years, also sometimes called an *estate for years* or a *term of years*, is the most important of the . . . leasehold estates."); *see also* Bockelmann v. Marynick, 788 S.W.2d 569, 571 (Tex. 1990) (using the term "tenancy for a definite term"); *Nitschke*, 489 S.W.2d at 337 (using the term "lease for years"); RESTATEMENT (SECOND) OF PROP.: LANDLORD & TENANT § 1.4 (AM. LAW INST. 1977) (using the term "Lease for a Fixed or Computable Period of Time").

93. *See infra* Part III (discussing the process of making an oil and gas lease in Texas). For this reason (and as will be explained in the text), a term of years estate might not be a lease, even though it was clearly a nonfreehold estate with seisen under English common law. *See infra* Part IV (exploring the collateral consequences of creating a term of years estate).

heavy, bold line from the term of years estate to the lease category.[94]) The assumption that a term of years estate is a lease is true in most instances, but not always.[95] On occasion, a term of years is treated like a nonlease rather than a lease, at least for some purposes.[96] This rare result is depicted in Figure B by the light, dashed line from the term of years estate to the nonlease category.[97]

When it becomes necessary to characterize a term of years as either a lease or a nonlease,[98] the specific legal issue involved becomes paramount. The Texas Statute of Conveyances provides a great (statutory) example of this concept.[99] Texas requires that a conveyance of a freehold estate be in

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The confusion arises because of the blanket assumption that the catalog of nonfreehold estates under ancient English common law directly equates to the modern catalog of leasehold estates. *See, e.g.*, JOHN G. SPRANKLING & RAYMOND R. COLETTA, PROPERTY: A CONTEMPORARY APPROACH 449 (2009). In other words, what was a nonfreehold estate under ancient English common law is now a "lease" under modern law, and vice versa. *Id.* This is a common assumption. *See, e.g.*, *id.* ("Our modern system of landlord-tenant estates is based on these early nonfreehold estates."); SMITH, *supra* note 25, at 180 ("[A] lease is classified as a *nonfreehold* estate."); *see also* BARROS & HEMINGWAY, *supra* note 52, at 139 (distinguishing between "freehold and leasehold estates"). The problem, though, is that the concept of seisen no longer has any modern importance, thus rendering irrelevant the distinction between freehold and nonfreehold estates. *See* Barros, *supra* note 77, at 67. Of course, the difference between leases and other possessory interests is still important (as this Article demonstrates), but the purposes served by this modern distinction are different than the purposes served by the ancient delineation between freehold and nonfreehold. *See infra* Part III. For this reason (and as will be explained in the text), a term of years estate might not be a lease, even though it was clearly a nonfreehold estate with seisen under English common law. *See infra* Part IV.

In any event, I have sought to avoid this unnecessary confusion by operating under the same assumption that is common by other commentators (that a nonfreehold estate is a leasehold estate and a freehold estate is a nonlease); thus, the categories of leasehold/nonfreehold and nonlease/freehold are concordant in the text. This does, however, result in a historical inaccuracy: although a term of years might now be treated as something other than a lease for modern purposes, under English common law a term of years was always—and only—a nonfreehold estate. RESTATEMENT (THIRD) OF PROP.: WILLS AND OTHER DONATIVE TRANSFERS § 24.6 (AM. LAW INST. 2011).

From this point forward in the text, I will no longer use the terms nonfreehold/freehold and employ only a lease/nonlease distinction. This should, I believe, have the effect of (1) focusing on the *modern* problems implicated by the lease/nonlease distinction and (2) avoiding the difficulties addressed in this footnote.

94. Meier, *supra* note 90.

95. *See* JERRY L. ANDERSON & DANIEL B. BOGART, PROPERTY LAW: PRACTICE, PROBLEMS, AND PERSPECTIVES 284–87 (2014).

96. *See id.* (explaining that an estate for years can be a lease or nonlease); *cf.* LINDA H. EDWARDS, ESTATES IN LAND AND FUTURE INTERESTS 13 (2009) (grouping a term of years with the fee simple and life estate but acknowledging that the "term of years has less status" than the fee simple or life estate). Sometimes the distinction between an estate for years as a lease/nonlease is addressed by statute. *See also* MASS. GEN. LAWS ANN. ch. 186 § 1A (West 2018) (stating that a term of years estate for 100 years or more will be treated as a nonlease when at least fifty years remain unexpired on the estate); N.J. STAT. ANN. § 46:15-5 (West 2018) (stating that a term of years estate for ninety-nine years or more will be treated as a nonlease).

97. Meier, *supra* note 90.

98. *See, e.g.*, MASS. GEN. LAWS ch. 186 § 1 (recognizing the difference between a lease and nonlease in terms of descent and devises); N.J. STAT. § 46:15-5 (recognizing the difference in recording requirements for leases versus nonleases); MERRILL & SMITH, *supra* note 16, at 549 (explaining that nonleases "tend to be recorded in land registries, but short-term leases are not").

99. TEX. PROP. CODE ANN. § 5.021 (West 2017).

writing.[100] However, the Texas statute also applies the writing requirement to a term of "more than one year," presumably under the theory that the reasons for requiring a writing for the conveyance of a fee or a life estate also apply to a term lasting more than one year.[101] Thus, in Texas, a term of years lease for more than one year is subject to the writing requirement generally applicable to freehold estates.[102]

Other examples of a term of years being treated akin to a freehold estate can be found in other states. In Massachusetts, because homestead protection does not extend to lessees,[103] the normal conclusion that a term of years is a lease would preclude homestead protection for the owner of a long-term term of years estate.[104] Courts, however, have reasoned in this situation that a term of years estate should not be treated like a lease, given the purposes for which the lease/nonlease distinction was made under the homestead laws.[105] In other words, for purposes of homestead eligibility, courts have determined that a term of years functions more like a nonlease than it does a lease.[106] Similar results have occurred in other settings in which the lease/nonlease label might be thought to control the specific legal issue before the court.[107] These results are based on common sense: Although the owner of a nine-month term of years lease might expect to be able to call his landlord in the event of a rodent infestation, the owner of a ninety-year lease might not expect—and probably should not expect—that a rodent infestation is his landlord's problem to resolve.

In any event, the Supreme Court of Texas had no discretion in *Daugherty* as to the type of estate that had been created by the oil and gas lease.[108] Because the estate lasted so long as there was production in paying quantities, the estate was a fee simple defeasible.[109] And a fee simple defeasible estate is not a lease.[110] Thus, the oil and gas lease in *Daugherty*

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100. *Id.* ("A conveyance of an estate of inheritance, a freehold, or an estate for more than one year, in land and tenements, must be in writing . . . .").

101. *Id.*

102. *See id.*

103. *See In re* Dougan, 484 B.R. 529, 533 (D. Mass. 2013) ("A lessee is not among the six enumerated types of owners who may claim an exemption under the Homestead Statute."); *see also* MASS. GEN. LAWS ANN. ch. 188 § 1 (defining an "owner" who is entitled to homestead protection as "a natural person who is a sole owner, joint tenant, tenant by the entirety, tenant in common, life estate holder or holder of a beneficial interest in a trust").

104. *Dougan*, 484 B.R. at 533.

105. *See id.* (holding that the owner of a long-term term of years lease was entitled to claim homestead exemption despite lessee not being among those entitled to claim homestead protection).

106. *See id.*

107. *See* Diversified Golf, LLC v. Hart Cty. Bd. of Tax Assessors, 598 S.E.2d 791, 794–96 (Ga. Ct. App. 2004) (discussing, and applying, the rule that a term of years for five years or more is presumed to be an interest that is taxable to the "lessor" under the ad valorem tax); *see also* Pinnacle Props. V, LLC v. Mainline Supply of Atlanta, LLC, 735 S.E.2d 166 (Ga. Ct. App. 2012) (considering whether a term of years estate is a property interest subject to a mechanics lien, and concluding that it is).

108. Tex. Co. v. Daugherty, 176 S.W. 717 (Tex. 1915).

109. *Id.*

110. *See id.*

was not a lease under the estates system—regardless of the widespread adoption in Texas of the word lease to describe the typical conveyance to an oil and gas producer.[111]

III. MAKING A TEXAS OIL AND GAS LEASE A LEASE

Because a conveyance to a producer for as long as oil and gas production occurs in paying quantities creates a fee simple defeasible estate, a court confronted with a clause that restricts the producer's ability to transfer the lease without the permission of the landowner might be inclined to invalidate that clause.[112] After all, common law generally frowns on attempts to restrict the alienability of a fee estate.[113]

I (along with Professor Ryan) have previously rejected the wisdom of this sort of analysis.[114] Rather than relying upon labels such as "fee" and "lease," a court determining the validity of an alienation restraint in an oil and gas lease should consider *why* restraints are always tolerated in leases and typically invalidated with regard to fee estates, and then consider how those policies apply to an oil and gas lease.[115] This approach, we believe, results in a clear conclusion: Landowners should be able to restrict the alienability rights of a mineral lessee through a consent-to-transfer clause.[116]

An attorney representing a landowner that wants a consent-to-transfer clause in the lease, however, can draft the lease in a way that protects against a Texas judge that is inclined to resolve the issue based on labels. The attorney just needs to change the labels that apply. In other words, the attorney needs to make the oil and gas lease a lease under the estate classification system.

Doing this is really quite simple. Recall that, in *Daugherty*, the Court concluded that the oil and gas lease in that case was a fee simple defeasible based on the duration of the lease.[117] Thus, changing the duration of the oil and gas lease will change the type of estate that is created by the document.[118]

An attorney can do this merely by adding a clause that provides for a definite ending date at which the lease must terminate. Here is an example: "This lease shall terminate on April 16, 2208, if it has not already terminated."

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111. *Id.* at 717–20; *see* Frederick R. Schneider, *A Rule Against Perpetuities for the Twenty-First Century*, 41 REAL PROP. PROB. & TR. J. 743, 791 (2007).

112. *See* Schneider, *supra* note 111.

113. *See id.* ("Most cases hold that the right to alienate property is inherent in fee simple interests.").

114. *See* Meier & Ryan, *supra* note 1, at 309–13 (discussing the problem with using estate labels as the basis of a conclusion as to the validity of an alienation restraint on an oil and gas interest).

115. *See id.* at 323.

116. *See id.* at 308, 329.

117. Tex. Co. v. Daugherty, 176 S.W. 717, 721–22 (Tex. 1915).

118. *See id.*

That is it. By providing a definite, fixed, ascertainable date on which the lease must terminate, the estate has changed from a fee simple to a term of years.[119] By definition, a term of years is an estate that ends on a fixed, ascertainable date.[120]

Indeed, the Court has already recognized the validity of this type of oil and gas lease.[121] In *Gulf Oil Corp. v. Southland Royalty Co.*,[122] the Texas Supreme Court considered an oil and gas lease with a defined term similar to the one proposed above.[123] It read: "Provided, that this lease shall not remain in force longer than fifty (50) years from this date . . . ." In describing the lease as a "fifty year term,"[124] the Court stated that "[i]t is always a question of resolving the intention of the parties from the entire instrument."[125] Confirming the fact that the term was enforceable as written, the Court concluded with the following: "With a plain and certain answer to the question of when the lease terminates, we cannot change that answer with words elsewhere in the lease not certainly directed to the same question."[126]

The *Southland* decision confirms that the parties to an oil and gas lease are free to define the duration of the lease as they see fit, and that Texas courts will enforce the terms of the lease as written.[127] Thus, by providing a fixed, ascertainable date on which the oil and gas lease must end, a term of years estate is created.[128]

Of course, most landowners and operators will prefer that the lease actually end when production is no longer occurring in paying quantities.[129]

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119. *See supra* note 60 and accompanying text (discussing term of years estates).

120. *See supra* note 60 and accompanying text (discussing term of years estates).

121. Gulf Oil Corp. v. Southland Royalty Co., 496 S.W.2d 547, 552 (Tex. 1973).

122. *See generally id.*

123. *Id.* at 552.

124. *Id.* at 548, 552.

125. *Id.* at 552.

126. *Id.*

127. *Cf. In re* Royalco Oil & Gas Corp., 287 S.W.3d 398, 400 (Tex. App.—Waco 2009, no pet.) ("[B]ecause the [salt water disposal] lease at issue provides for a fixed term of 99 years, the lease created a tenancy for years.").

128. *Gulf Oil Corp*., 496 S.W.2d at 552.

129. An operator will not be agreeable to a term lease that might expire while production is still ongoing. *See* NANCY SAINT-PAUL, 2 SUMMERS OIL AND GAS §14:18 (3d ed. 2015) ("Definite term leases were not suitable for the business of oil and gas production. Suppose a lessee had drilled a number of wells at considerable cost and risk, which showed possibilities of producing oil or gas in profitable quantities far beyond the time fixed in the lease for its termination. In the absence of a clause giving him an option of renewing the lease for the productive life of the wells, he was at a great disadvantage in negotiating for a renewal of the lease, since the lessor could insist on a renewal based on the increased value of the land as determined by the conditions at the end of the first term."). This can be negated, however, by extending the term to a date beyond the capacity of even the most productive well. At the time the typical fee Texas oil and gas well was becoming standardized, however, the potential duration of an oil and gas well was largely unknown, with some believing—or perhaps, hoping—that production might last infinitely. *See* Stephens County v. Mid-Kan. Oil & Gas Co., 254 S.W. 290, 294–95 (Tex. 1923) ("First, that the grants might endure forever, since the lands might never cease the profitable production of oil or gas . . . ."); Tex. Co. v. Davis, 254 S.W. 304, 306–07 (Tex. 1923) (commenting that "the land might always produce minerals in paying quantities"). The unknown production duration of oil and gas

This result can still be achieved under a term of years. There is no question that a term of years—like a fee simple—can be made defeasible upon the occurrence of certain events.[130] Thus, the existing clause that terminates the lease when production in paying quantities ceases can still be included in the term of years lease.[131] All that has been changed in our term of years lease is the substitution of one fiction for another: under the fee simple defeasible, the fiction is that the lease could extend (theoretically) for infinity.[132] Under the term of years, the fiction is that the lease could extend until the fixed date set by the lease. Under either one, the *real* date on which the lease will end is when production can no longer be had in paying quantities. The term of years lease would not change this current reality regarding the duration of Texas oil and gas leases.[133]

The lease I propose will thus have no *practical* effect on the duration of oil and gas leases in Texas. But it might have the *legal* effect of making a consent-to-assign clause enforceable. The blackletter law is equivocal: a lessee's right to transfer a lease can be restricted by a clause in the lease.[134]

The astute reader will recall, from above, that although a term of years is usually considered a lease, it has, on occasion, been treated like a nonlease.[135] This is not an impediment, however, to the objective at hand, which is drafting an oil and gas lease so as to make enforceable a restriction on transferring the lease. The type of analysis that would be used to distinguish a term of years lease from a term of years nonlease would result in the conclusion that a term of years oil and gas lease is, in fact, a lease estate. As described in the previous part, courts that occasionally treat a term

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wells during this time probably prompted the defeasible fee lease, so as to completely eliminate the possibility that the lease would end while production was still occurring (even hundreds of years later).

130. *See* Willis v. Thomas, 9 S.W.2d 423, 424–25 (Tex. Civ. App.—Corpus Christi 1928, writ dism'd w.o.j.) ("But an estate may be created by a demise for a definite period, subject to an earlier termination contingent upon the happening of a collateral event . . . .").

131. *See id.*

132. *See supra* note 129 (citing *Stephens County* and *Davis* to illustrate how a lessee could keep a lease forever by never ending production in paying quantities).

133. *See Willis*, 9 S.W.2d at 424–25. For the optimistic landowner (expecting to hit a gusher well), a date into the far distant future could be selected. In the draft clause in the text, I choose April 16, 2108; the ending date could be April 16, 3008, or anywhere in between.

134. TEX. PROP. CODE ANN. § 91.005 (West 2017). Texas adheres to this principle even more than other jurisdictions. *See generally id.* In Texas, a lessor's consent is always required—by statute—before a tenant may transfer the lease, *even without a clause to that effect in the lease*. *See id.* This raises an interesting issue: if an oil and gas lease was made a term of years by a clause providing for a fixed, ascertainable date, would a landowner's consent be required before the operator transferred, even without a restraint clause in the lease? I doubt that the Texas Legislature had this result in mind when it drafted § 91.005. A landowner that desires a restraint on alienation would best be served by expressly including such a clause in a term of years lease, rather than trying to achieve this result—in a somewhat nefarious manner—through § 91.005. *See id.* An operator negotiating an oil and gas lease in which the landowner desires a fixed, ascertainable date (but with no express consent-to-assign clause) should be suspicious that the landowner might be trying to bring the lease under § 91.005 without alerting the operator.

135. *See supra* notes 91–111 (describing court treatment of term of years estates).

of years as a nonlease do so because of a functional analysis.[136] In certain circumstances, a term of years estate functions more like a nonlease, meaning that the policies driving the specific legal issue being determined by the court are better fulfilled through treatment of the estate as a nonlease rather than a lease.[137] In these instances, policies and purposes—rather than labels—guide the courts' conclusion that the term of years should be treated like a nonlease for the particular issue being resolved by the court.[138]

If Texas courts were to take this functional analysis to the question of the validity of a restraint on alienability in an oil and gas lease, they would be forced to conclude that the purposes behind alienability law are better fulfilled through enforcement of these clauses. Thus, a Texas court that was inclined to consider whether a term of years oil and gas lease was a lease or nonlease—to resolve the validity of an alienability restraint—would have to conclude that the term of years was a lease rather than a nonlease. This conclusion is explained more fully in Professor Ryan and my previous scholarship.[139] Suffice to say, however, it is no accident that the term "oil and gas lease" has persisted within Texas, despite the *Daugherty* Court's conclusion that the property estate was actually a fee simple.[140] As the old adage goes: If it walks, talks, and quacks like a duck, it is probably a duck. An oil and gas lease walks, talks, and quacks like a lease, and this reality is reflected in the persistent and ubiquitous use of the lease term over the last century.

To be clear, I do not believe that the drafting trick explained in this Section should determine the validity of an alienation restraint in an oil and gas lease. If anything, this Section demonstrates the folly of tying the legality of a restraint clause to the estate label that happens to be applicable. Surely the legality of an alienation restraint should not hinge on whether the drafting trick explained herein has been employed.

Rather, this Article is for the attorney seeking to insulate against a court that might determine the validity of an alienation restraint in an oil and gas lease by a resort to labels. The drafting trick explained above insulates the landowner from this sort of superficial judicial analysis.[141]

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136. *See supra* text accompanying notes 93–111 (explaining how and why a court would treat a term of years as a nonlease).

137. *See supra* text accompanying notes 93–111 (explaining how and why a court would treat a term of years as a nonlease).

138. *See supra* text accompanying notes 93–111 (explaining how and why a court would treat a term of years as a nonlease).

139. *See* Meier & Ryan, *supra* note 1, at 304–13 (arguing that courts should look to the purpose of a restraint on alienability in determining the validity of that restraint rather than concluding based solely on whether the transaction is labeled lease or fee).

140. Tex. Co. v. Daugherty, 176 S.W. 717, 722 (Tex. 1915) (holding that the characteristics of the instrument conveyed constituted a fee simple estate).

141. *See supra* text accompanying notes 17–23 (describing the application of the drafting trick and its effect on landowners).

Thus, drafting an oil and gas lease as a term of years might help the landowner achieve the goal of enforcement of an alienation-restraint clause. An attorney considering this approach, however, must also be aware of collateral consequences that might result from making the oil and gas lease a defeasible term of years. These issues are explored in the next Part.

IV. COLLATERAL CONSEQUENCES OF CREATING A TERM OF YEARS ESTATE

On first impression, it might seem that creating a term of years oil and gas lease—rather than a fee simple defeasible—would result in dramatic collateral consequences other than the intended objective of ensuring enforceability of a restraint-on-alienability clause. Closer inspection, however, defuses that preliminary impression.

Initially, it is helpful to keep in mind that changing the duration of the oil and gas estate will leave unchanged the most important holdings in *Texas Co. v. Daugherty*.[142] The *Daugherty* decision established that oil and gas would be treated as property, that it would be treated as real (rather than personal) property until it was captured and removed from the ground, and that this interest in real property was possessory (that is, an estate).[143] Changing the duration of the oil and gas lease does not affect any of these conclusions. Indeed, the particular language of an oil and gas lease cannot change these legal conclusions. The decision in *Daugherty* regarding the real property treatment of oil and gas was not just a reaction to, or an interpretation of, the conveyance in that particular case.[144] Rather, it was a fundamental statement from the Texas Supreme Court about the nature of Texas law,[145] which was clearly confirmed in the subsequent case of *Stephens County v. Mid-Kansas Oil & Gas Co*.[146]

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142. *See generally Daugherty*, 176 S.W. 717.

143. *See id.* Previously, the Texas Supreme Court had determined that an oil and gas lease "did 'not pass an interest in land' but was 'a mere contract for an option by which the lessee might acquire such interest.'" *Id.* (citing *Nat'l Oil & Pipeline Co. v. Teel*, 68 S.W. 979, 980 (Tex. 1902)).

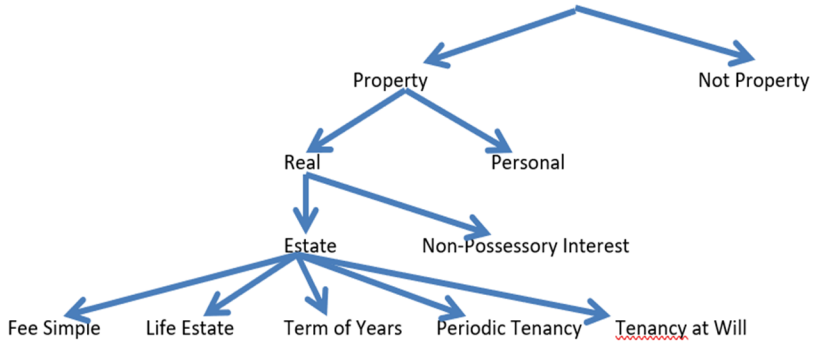
144. *See id.* at 719 (passing over the property treatment of the oil and gas in the conveyance instruments and moving on to the "naked question" of whether oil and gas in place constituted real property under Texas law).

145. A.J. THUSS, JR., TEXAS OIL AND GAS 447 (1929) ("Nothing is more firmly established, in the law of Texas pertaining to oil and gas, than that principle which classes oil and gas leases as realty and makes them subject to taxation as such. No distinction can be made as to the form of the lease . . . .") (footnote omitted).

146. *See* Stephens County v. Mid-Kan. Oil & Gas Co., 254 S.W. 290, 294 (Tex. 1923) ("We find it impossible to reasonably ascribe to the two sets of instruments, disregarding mere form and looking at substance, any different legal effects as regards the transfer of title to the oil and gas in place . . . . Notwithstanding the distinctions attempted to be drawn in the decisions, we cannot conclude otherwise than that there is no real difference in the title conveyed, whether an instrument takes the form of a grant of the exclusive right to mine and appropriate all of a certain mineral (as in Benevides v. Hunt), or takes the form of a demise of the land, for the sole purpose of mining operations, coupled with a grant of the exclusive right to produce and dispose of the mineral (as in this case), or takes the form of a grant of the mineral with the exclusive right to mine for, produce, and dispose thereof (as in Texas Co. v. Daugherty).") (citations omitted).

These bedrock holdings from *Daugherty* about the legal treatment of oil and gas under Texas law precipitate the subsequent question as to the *type* of real property possessory estate granted to the operator. The narrow question regarding the type of estate created by an oil and gas lease is within the confines of the (1) real (2) property (3) possessory estate regime used within Texas.[147] Indeed, a determination regarding the duration of an estate *only comes up* if we are dealing with a possessory interest in real property.[148] This is depicted below in Figure C.

Figure C



Thus, changing an oil and gas lease from a fee to a term lease does not have the dramatic consequences that one might initially assume. The mineral estate will still be treated as a possessory interest in real property.

That said, the shift from a freehold fee to a nonfreehold lease must be carefully scrutinized, even if both of these are possessory estates in real property.[149] There are some legal issues that have traditionally depended upon the freehold/lease distinction. For instance, freehold estates are usually required to be in writing and recorded, while leases are sometimes exempt from the statute of frauds and recording statutes.[150]

The (occasional) distinct legal treatment of freehold estates (such as fee estates) and lease estates is associated with the old common law rule that a nonfreehold estate (that is, a lease) was owned as *personal* property rather than *real* property.[151]

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147. *See generally Daugherty*, 176 S.W. at 718–19.

148. *See generally id.*

149. *See id.* (holding that oil and gas ownership should be viewed as an interest in real property).

150. *See* RESTATEMENT (SECOND) OF PROP.: LANDLORD & TENANT § 2.1 (AM. LAW INST. 1977) ("A landlord-tenant relationship can be created orally if the duration of an oral lease does not exceed the period specified in the controlling Statute of Frauds.").

151. *See* David A. Thomas, *Anglo-American Land Law: Diverging Developments from a Shared History–Part III: British and American Real Property Law and Practice–A Contemporary Approach*, 34 REAL PROP. PROB. & TR. J. 443, 452 (1999) ("Indeed, the law did not even consider nonfreehold estates, such as leaseholds, as real property.").

Before considering the effects of this rule to the oil and gas topic at hand, it is important to appreciate the nuances of it. It is imperative to recognize that calling a lease a personal property interest—and thus a fixed-term oil and gas lease as a personal property interest—is not inconsistent with the holdings in *Daugherty* that oil and gas would be treated as real property.[152] To grasp this slippery distinction, it is helpful to distinguish between the oil and gas themselves and the different types of possessory estates that might be created *in* the oil and gas. In *Daugherty*, the Court clearly held that oil and gas minerals were to be treated as real property.[153] This does not mean, however, that every little slice of ownership of oil and gas (that is, every chunk of the "bundle of rights") would also be treated as real property.

This thorny concept is perhaps most easily appreciated by considering it outside of the oil and gas context. There is no question that surface land—we can call it Blackacre—constitutes real property. Under the common law, however, the owner of a lease in Blackacre owned a personal property—rather than a real property—interest.

The "chattel real" term, which is often applied to leases, nicely captures this concept: the underlying asset or thing is real property, but the particular ownership interest *in* the real property is personal property.[154] Thus, someone with a lease has a chattel—or personal property—interest in a piece of real property.[155]

The chattel real treatment of leases (that is, a personal property interest *in* a piece of real property) derives from the ancient concept of seisin.[156] The concept of seisen has a long history,[157] and its import and function seems to

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152. *See Daugherty*, 176 S.W. at 718–19 (holding oils and gases part of the realty are considered an interest in land when conveyed).

153. *See id.*

154. *See* Citicorp v. Bank of Lansing, 604 F. Supp. 585, 589 (N.D. Ind. 1985) ("A 'chattel real' is an interest having the character of immobility, less than freehold, annexed to, or growing out of, real estate, such as an estate at will and by sufferance, and an estate for years."); Craig H. Averch & Blake L. Berryman, *The Treatment of Net Rents in Bankruptcy—Adequate Protection, Payment of Interest, Return of Collateral, or Reduction of Debt*, 48 U. MIAMI L. REV. 691, 707 (1994). "Historically, nonfreehold estates, like leases, were not well favored by the law. Indeed, nonfreehold estates were called by the 'ambiguous name chattels real and were treated as personal property for various purposes.'" Averch & Berryman, *supra* (quoting JOHN E. CRIBBET, PRINCIPLE OF THE LAW OF PROPERTY 52 (2d ed. 1975)).

155. *See* John V. Orth, *Leases*, 12 GREEN BAG 2d 53, 58 (2008) ("So uncomfortable was the common law, or rather the common law lawyers, with interests that were not somehow property interests that leases were categorized as 'chattels real,' rights derived from land and therefore in some sense real property though passing as personal property on succession at death—in any event property, not contract."); Martha Wach, *Withholding Consent to Alienate: If Your Landlord Is in a Bad Mood, Can He Prevent You from Alienating Your Lease?*, 43 DUKE L.J. 671, 677 (1993) ("Eventually, the courts classified these [leasehold] estates as chattels real because they were personal property in the form of real estate.").

156. *See* POLLOCK & MAITLAND, *supra* note 87, at 29 ("In the history of our law there is no idea more cardinal than that of seisin.").

157. *See* Sydney K. Mitchell, *Book Review*, 36 YALE L.J. 589, 589–90 (1927) ("Seisin is a general legal concept, more especially a concept of real property; at the end of the twelfth and during the thirteenth

have morphed over time.[158] But it was a central idea to the feudal system of estates,[159] from which our current system of estates derives.[160] Under the feudal system of estates, obligations and rights were based on land ownership; more specifically, the obligations and rights were based on the party with seisen.[161] Under this system, it was important that one—and only one—party always be in seisen of the property. The party with seisen was the "true" owner of the land, and was thus, obligated to perform the feudal responsibilities—and entitled to the feudal rights—connected to a particular piece of land.[162]

Because leases did not transfer seisen under the common law, they were conceived of as merely a carve out of the "true" ownership estate.[163] Thus, the lessor retained "true ownership" of the land because he or she retained seisen.[164] As such, the *lessor's* interest in the real property was considered a real property interest; the lessee's interest was simply a personal property interest carved out of real property—a chattel real.[165]

Although the concept of seisen is now irrelevant, the treatment of leases as personal property (chattel real) is still adhered to, although not

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century, as a result of the influence of Roman law, it put into definite shape a traditional and profoundly original notion of the bond which unites man to things.").

158. *See* THOMPSON ON REAL PROPERTY, SECOND THOMAS EDITION § 17.01(b) (David A. Thomas ed., 1995) (describing the historical understanding of seisin and possession and how these concepts changed over time).

159. *See* Percy Bordwell, *Seisin and Disseisin*, 34 HARV. L. REV. 596 (1921) ("And in this feudalized land law, as we have seen, seisin played a most conspicuous part. The complicated structure of the land law was possible only because the ascending series of rights of the feudal hierarchy could be realized in a seisin.").

160. *See generally* THOMAS F. BERGIN & PAUL G. HASKELL, PREFACE TO ESTATES IN LAND AND FUTURE INTERESTS (2d ed. 1984) ("Our purpose is to present just enough of the feudal background to make intelligible to the law student some of the more important doctrines and concepts of our modern law of property.").

161. *See* Mark A. Senn, *English Life and Law in the Time of the Black Death*, 38 REAL PROP. PROB. & TR. J. 507, 518 (2003) ("Seisin was a critically important aspect of feudalism. Because the person seised of the land was responsible for services due from the land, someone was always seised of the land.").

162. *See id.* ("This need to have someone in service explains the medieval refusal to recognize estates that left a gap in possession or seisin.").

163. *See* Michael Madison, *The Real Properties of Contract Law*, 82 B.U. L. REV. 405, 410 (2002) (describing a lease as a "carve-out of the landlord's fee simple ownership"). The way that leases were treated under the common law (as not transferring seisin) is somewhat similar to the modern treatment of subleases of a lease, which are a mere carve out of the master lease and thus do not serve to transfer privity of estate. *See* 1 HON. ROBERT F. DOLAN, RASCH'S LANDLORD AND TENANT § 9:55 (4th ed. 1998) ("[A] sublease is carved out of the paramount lease between his sublessor and the paramount landlord . . . ."); Dayna Ferebee, *Handshakes and Heartaches: Who Owns the Oil After* Rogers v. Ricane*?*, 2 TEX. WESLEYAN L. REV. 129, 169 (1995) ("Traditionally, a sublease is a present possessory interest carved out of the lease. The subtenant is not in privity of estate with the landlord but is in privity with the head tenant.").

164. *See* CRIBBET & JOHNSON, *supra* note 50, at 54 ("[T]he law treated [the lessee] as having only possession of the premises while the seisin remained in the lessor.").

165. Laura B. Bartell, *Revisiting Rejection: Secured Party Interests in Leases and Executory Contracts*, 103 DICK. L. REV. 497, 508 n.33 (1999) ("Even if the leased property is real estate and the leasehold is an interest in land, for historical reasons leasehold interests have always been categorized as personal property ('chattels real').").

uniformly.[166] For purposes of the proposal in this Article, then, the following question must be resolved: If one changes a mineral lease from a freehold fee estate to a term of years lease estate, will the usual treatment of leases as personal property result in unintended (and undesirable) consequences for the landowner? The short answer to this question is "no."

As will be explained below, the Texas Supreme Court has treated *every* interest associated with the mineral estate as real property, in disregard of the old seisen rules that designated one party as the "true owner" of the real property.[167] In other words, Texas has rejected the notion that one might have a personal property interest *in* the mineral estate.[168] *Every* sliver of ownership of the mineral estate—even a non-participating royalty interest—has been treated as real property.[169] The "chattel real" idea has been rejected with regard to oil and gas.[170]

The rejection of the "chattel real" concept in the oil and gas context is important to the proposal made in this Article. Although a lease of *land* might be considered the transfer of a personal property interest, a fixed term of years lease of *the mineral estate* will, nevertheless, be considered real property: Every interest in the mineral estate has been treated as real property.[171] As such, creating a term of years lease should not result in dramatic collateral consequences, other than (perhaps) the intended result of judicial acceptance of a restraint on alienation of the operator's interest.

A. Texas Ad Valorem Taxes

The Texas Supreme Court's approach to ad valorem taxes provides the clearest example of how the Court has treated every interest in oil and gas in place as real, rather than personal, property.

Many of the foundational Texas Supreme Court cases involving oil and gas arose in disputes about the payment of ad valorem taxes.[172] These cases

166. *See* Robertson v. Scott, 712 S.W.2d 478, 478–79 (Tex. 1943) ("This statement and the authorities cited in the text in support thereof are sufficient to show that at common law a leasehold estate, of whatever its duration in years, was personal property.").

167. *See infra* notes and accompanying text 186–197, 201–202 (evidencing Texas's historical treatment of tax responsibility in mineral estates).

168. Of course, once the oil and gas is physically removed from the land, it becomes personal property rather than real property. *See* Phillips Petrol. Co. v. Adams, 513 F.2d 355, 363 (5th Cir. 1975) ("Texas law provides that oil and gas are realty when in place and personalty when severed from the land by production."). This Article, however, is addressed to the legal interests that can be created in minerals-in-place.

169. *See generally* Tex. Co. v. Daugherty, 176 S.W. 717 (Tex. 1915).

170. *Id.*

171. *Id.*

172. *See id.* ("The question presented by the case for decision is whether the interests or rights conferred upon the Texas Company, in virtue of a number of so-called oil leases, constituted property subject to taxation in its hands."); *see also* Stephens County v. Mid-Kan. Oil & Gas Co., 254 S.W. 290, 290 (Tex. 1923) ("Appellee, Mid-Kan. Oil & Gas Company, sued appellants, Stephens county and the tax collector, tax assessor, county judge, and county commissioners of Stephens county, to enjoin the

(including the *Daugherty* case) clearly established that oil and gas in place was real property that was subject to ad valorem taxes[173] and also addressed the tricky question as to *who* would be charged with the payment of these taxes.[174] To be sure, the question of ad valorem taxation has always been a key component of the development of Texas oil and gas law.[175]

Changing an oil and gas lease from a defeasible fee to a term of years requires some consideration as to *who* bears responsibility for payment of the ad valorem taxes on the mineral estate. This question is not, of course, unique to the oil and gas setting. Outside the oil and gas context, when ownership of property is divided across time through the creation of present and future estates, ad valorem taxes are nevertheless assessed against only *one* of the owners.[176] The holder of one of the estates is considered to be the true "owner,"[177] while the owner of the other interest is considered to hold a "carve-out" that is free from tax liability.[178]

The "one-payer" approach to ad valorem taxes is consistent with the ancient feudal notion that only one party had seisen. As explained above, the party with seisen was the true owner of the land.[179] Similarly, under the "one-payer" approach to ad valorem taxes, the "true" owner of a piece of property is always responsible for payment on the full value of the land, even if ownership has been divided across time.[180]

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assessment and collection of taxes on any separate right or interest of appellee as the assignee of the Texas & Pacific Coal Company, under the following instrument.").

173. *See Daugherty*, 176 S.W. at 717–20 (explaining why the oil and gas leases created real property interests subject to ad valorem taxes).

174. *See id.* at 722 (holding that the operator was responsible for paying taxes on the interest conveyed by the lease, but not addressing whether the landowner was also liable on the interests retained in the conveyance).

175. *See generally id.*

176. *See* Cty. of Dall. Tax Collector v. Roman Catholic Diocese, 41 S.W.3d 739, 743–44 (Tex. App.—Dallas 2001, no pet.) ("Generally, tax liability rests with the owner of property encumbered by a leasehold or other interest . . . . When non-exempt property is leased, the lessor, not the lessee, is responsible for the taxes that accrue on the full value of the property.").

177. *See generally id.* The parties to a lease can make private arrangements regarding payment of the tax, but they cannot relieve a party of ultimate responsibility to pay the tax. *See, e.g.*, Bass v. Shell W. E & P, 957 S.W.2d 159, 160 (Tex. App.—San Antonio 1997, no pet.) (interpreting a lease provision providing for the reimbursement by lessee of taxes paid by the lessor).

178. *See generally Roman Catholic Diocese*, 41 S.W.3d at 743–44. This approach to ad valorem taxation, in which there is only one "owner" of property, is similar to the English common law concept of seisin. *See generally* CALVIN MASSEY, PROPERTY LAW: PRINCIPLES, PROBLEMS, AND CASES 119 n.3 (2012). Under feudal English society, the social hierarchy based around land ownership required a determination as to who had seisin, because that was the party on whom the privileges and responsibilities of land ownership incurred. *See id.* ("Seisen meant more than possession; it was also the expression of the tenure holder's personal obligation to his lord to provide the required feudal services. Because those services accompanied any grant of land tenure, it was necessary that someone have seisin—and be obligated for performance of those services—at all times.").

179. *See supra* notes 85–90 and accompanying text (considering historical treatment of lease classification to explain the Court's treatment of the lease is *Daugherty*).

180. *See* MASSEY, *supra* note 178.

Under this "one-payer" approach, the type of estates that have been created will determine who has the tax responsibility. A lease is thought merely to be a "carve-out" of the estate from which it was created (recall that a lease was a personal property "chattel real" under the common law), meaning that the tax burden falls on the landlord-grantor, who retains a reversionary future interest that follows the lease.[181] When the grantor conveys a freehold estate such as a defeasible fee or a life estate, however, the grantee is considered to be the "owner" and is thus responsible for the payment of property taxes (at least until the possessory interest expires).[182] When a defeasible fee or life estate is created, the grantor retains a future interest[183]—just like when the grantor conveyed the lease interest—but in this instance, ownership of that future interest is not ownership for tax purposes, and thus, no tax obligation exists for the future estate holder.[184]

On first impression, then, it might seem that changing an oil and gas lease from a fee simple defeasible estate to a term of years estate would shift the tax responsibility from the grantee (the operator) to the grantor (the landowner). Because lessees *are not* responsible for ad valorem taxes on land, while owners of a defeasible fee *are* responsible for ad valorem taxes, it might be assumed that changing an oil and gas lease from a defeasible fee to a term of years would shift ad valorem tax responsibility from the operator to the landowner.

This conclusion, however, is incorrect. As explained below, Texas courts have rejected the notion that only one party will bear the full tax responsibility regarding the value of the mineral estate.[185] Thus, a

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181. *See* TEX. TAX. CODE ANN. § 25.06(a) (West 2017) ("[P]roperty encumbered by a leasehold . . . shall be listed in the name of the owner of the property so encumbered."); Cherokee Water Co. v. Gregg Cty. Appraisal Dist., 801 S.W.2d 872, 875 (Tex. 1990) ("It has long been the law that the lessor rather than the lessee is responsible for taxes on the full value of the property.").

182. *See* TAX § 25.05 ("Real property owned by a life tenant and remainderman shall be listed in the name of the life tenant."); Trimble v. Farmer, 305 S.W. 2d 157, 161 (Tex. 1957) ("Lucy O. Trimble had a life estate in the whole of the property and it was her duty to render the whole of the property for taxation each year.").

183. *See* DWYER & MENELL, *supra* note 17, at 158. This future interest retained by the grantor might be a possibility of reverter, a right of entry, or a reversion. *See id.* In some instances, the future interest will not be retained by the grantor but, instead, conveyed to a third party; in this instance, the future interest is either a remainder or an executory interest. *See* ERIC T. FREYFOGLE & BRADLEY C. KARKKAINEN, PROPERTY LAW: POWER, GOVERNANCE, AND THE COMMON GOOD 614 (2012). The tax principles discussed herein do not hinge on whether ownership of the future interest is retained by the original grantor or given to a third party. For simplicity, I will assume in the text that the grantor has retained the future interest.

184. *See* Tex. Tpk. Co. v. Dallas County, 271 S.W. 2d 400, 402 (Tex. 1954) ("Thus it is held that a contingent remainder in property is not a taxable title. Neither is a possibility of reverter.") (citations omitted); Cypress-Fairbanks Indep. Sch. Dist. v. Glenn W. Loggins, Inc., 115 S.W.3d 67, 71 (Tex. App.—San Antonio 2003, pet. denied) ("Thus, according to the supreme court, a possibility of reverter interest is a nontaxable interest.").

185. *See infra* notes 194–206 and accompanying text (separating ad valorem tax responsibility based on interest).

landowner's ad valorem tax responsibility will remain the same regardless of whether a fee or term lease has been created.

The Texas Supreme Court first considered the tax implication of an oil and gas lease in *Daugherty*[186] and *Stephens County v. Mid-Kansas Oil and Gas. Co*.[187] In both cases, an operator was seeking to avoid payment of ad valorem taxes on the interest that had been conveyed to it under an oil and gas "lease."[188] The Texas Supreme Court established in *Daugherty* that oil and gas in place was real property that was subject to ad valorem taxation.[189] With regard to *who* was obligated to pay those taxes, the Court held in both *Daugherty* and *Stephens County* that the operator was obligated to pay ad valorem taxes on the interest it had been conveyed under the "lease."[190]

Given that the Texas Supreme Court held in both *Daugherty* and *Stephens County* that the oil and gas "lease" was actually a defeasible fee,[191] the conclusion that the operator was subject to ad valorem taxes was consistent with the general conclusion that the owner of a defeasible fee or life estate was the owner for property tax purposes.[192] Thus, one could read *Daugherty* and *Stephens County* for the proposition that the operator is solely responsible for *all* of the ad valorem taxes on the mineral estate. Recall that this would be the result, under the normal "one-payer" system described above, for the owner of a fee simple defeasible estate outside the oil and gas context.[193]

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186. Tex. Co. v. Daugherty, 176 S.W. 717, 717 (Tex. 1915).

187. Stephens County v. Mid-Kan. Oil & Gas Co., 254 S.W. 290 (Tex. 1923).

188. *See generally Stephens County*, 254 S.W. 290 (both describing the posture of the case); *Daugherty*, 176 S.W. 717.

189. *See Daugherty*, 176 S.W. at 720–21 ("[T]hese minerals are a part of the realty while in place . . . .").

190. *See Stephens County*, 254 S.W. at 296 ("Our answer to the certified question is that the appellee did acquire interests and estates in the lands which were subject to separate taxation."); *Daugherty*, 176 S.W. at 722 ("[T]hese instruments had the effect to confer upon the [operator] . . . an interest in the several tracts of land described, the value of which was assessable against it for taxation.").

191. *See Stephens County*, 254 S.W. 290; *Daugherty*, 176 S.W. 717. The operator in *Stephens County* had attempted to distinguish its case from *Daugherty* based on differences in the documents involved. *See Stephens County*, 254 S.W. at 293–94 (addressing the attempt to distinguish *Daugherty*). Specifically, Mid-Kansas Oil noted that the granting clause in *Daugherty* used the phrase "granted, bargained, sold, and conveyed" while the granting clause involved in *Stephens County* used the phrase "let and leas[ed.]" *See Stephens County*, 254 S.W. at 290; *Daugherty*, 176 S.W. at 717. The Court rejected this distinction, noting that the practical effect of each conveyance was the same and that each estate lasted "only while such [exploration and production] continued and w[as] to immediately terminate on cessation of the use." *Stephens County*, 254 S.W. at 295. As explained above, the *duration of* the interest determined the type of estate that was created, not the technical language used in the granting clause. *See id.* ("[T]he parties usually attach little or no significance to the language in the granting clause.") (quoting ROBERT E. HARDWICKE, INNOCENT PURCHASER OF OIL AND GAS LEASE 11 (2010)).

192. *See* Cty. of Dall. Tax Collector v. Roman Catholic Diocese, 41 S.W.3d 739, 743–44 (Tex. App.—Dallas 2001, no pet.).

193. *See* MASSEY, *supra* note 178 (analyzing the property owner's responsibility to pay taxes of owned land).

The Texas Supreme Court, however, ultimately rejected the one-payer approach to ad valorem taxes when there is a lease in the mineral context.[194] In fact, there were indications as early as *Stephens County* that the tax treatment of the oil and gas defeasible fee might be different than the tax treatment of a similar estate "of land, for purposes of ordinary cultivation or occupancy . . . ."[195] Although the oil and gas lease "create[d] a separately taxable estate in land,"[196] the Court was careful to stress that the conclusions in *Stephens County* were not necessarily applicable to cases outside the oil and gas context requiring a determination as to "whether taxable interests or estates in real estate" had been created.[197]

In a 1927 case, the United States Supreme Court picked up on what the Texas Supreme Court had intimated in *Stephens County*. In *W.T. Waggoner Estate v. Wichita County*,[198] the United States Supreme Court interpreted Texas law as requiring the lessor of a fee simple determinable oil and gas lease to *also* pay ad valorem taxes on the interest retained in the lease.[199] The Court, then, interpreted Texas law as rejecting the one-payer approach that could be traced to the ancient concept that only one party had seisen in the land and was thus the one true owner.[200]

The conclusion the United States Supreme Court reached in *W.T. Waggoner* about Texas law was squarely confirmed by the Texas Supreme Court in its famous opinion in *Sheffield v. Hogg*.[201] In *Sheffield*, the Court held that the interest retained by the landowner in an oil and gas lease was

194. *See* Sheffield v. Hogg, 77 S.W.2d 1021, 1029 (Tex. 1934).

195. *Stephens County*, 254 S.W. at 295–96.

196. *Id.*

197. *Id.*

198. W.T. Waggoner Estate v. Wichita County, 273 U.S. 113 (1927).

199. *See id.* at 119 ("[T]he ownership of the royalty oil remained in the lessor who retained the power of disposition and the right to receive possession, and his interest was properly taxable as realty."). The Supreme Court viewed the conclusion in *W.T. Waggoner Estate* as being in slight tension with the Texas Supreme Court's decision in *Stephens County*. *See id.* at 118 (distinguishing the result in *W.T. Waggoner Estate* with the result in *Stephens County*). This concern was unfounded. In *Stephens County*, the Texas Supreme Court had simply held that the oil and gas lease had created "interests or such estates in land as were subject to separate taxation." *Stephens County*, 254 S.W. at 291–92. This holding established that the operator was obligated to pay at least some ad valorem tax. *Id.* The *Stephens County* decision, however, did not address the separate question as to whether the landowner was *also* obligated for ad valorem taxes on the value of her retained interest. *See id.* at 166 (addressing only whether the interest was subject to separate taxation). This was the question that the United States Supreme Court was wrestling with in *W.T. Waggoner Estate*: was more than one party obligated to pay ad valorem taxes on the interests created by an oil and gas lease? *W.T. Waggoner Estate*, 273 U.S. at 118. Feeling (erroneously) compelled to distinguish its conclusion in *W.T. Waggoner* from the Texas Supreme Court's previous decision in *Stephens County*, the United States Supreme Court noted that the lease in *Stephens County* allowed the producer to pay the royalty "in oil or cash" while the royalty in *W.T. Waggoner* was for "one-eighth of all the oil produced." *Id*. The distinction made by the United States Supreme Court in *W.T. Waggoner Estate* was rejected by the Texas Supreme Court in *Sheffield v. Hogg*. *Sheffield*, 77 S.W.2d 1021.

200. *W.T. Waggoner Estate*, 273 U.S. at 118.

201. *Sheffield*, 77 S.W.2d at 1021.

subject to ad valorem taxes, despite its earlier conclusion that the operator's interest was *also* taxable:

> Despite differences in their phraseology and forms, we have concluded, after careful consultation and deliberation, that the lessor's interest, sought to be taxed in each instance in these cases, . . . was an interest in land, subject to taxation as such in the counties in which the respective tracts of land are situated . . . .
> . . . .
> . . . . We therefore hold that all the property interests of ascertainable value, secured to the lessors or their assigns under the Hogg-Hamman lease, are subject to taxation as real estate in the county wherein the land lies . . . .[202]

The *Sheffield* Court rejected the notion that the particular language used in the lease mattered to the conclusion that the interests retained by the landowner was taxable as real property.[203] Moreover, the Court extolled the virtues of the statute of frauds and recording statutes, which became applicable to the lessor's interests because of the Court's conclusion that the retained interests were an interest in real property.[204]

The combined holdings of *Stephens County* and *Sheffield* mean that the one-payer approach to ad valorem taxes does not apply to interests created by a Texas oil and gas lease.[205] Under *Stephens County*, the operator must pay ad valorem taxes on its working interest, and under *Sheffield* the landowner must pay ad valorem taxes on the interest it retains under the lease.[206] Thus, both grantor *and* grantee to an oil and gas lease have an interest that is taxable as real property. The oil and gas lease essentially splits the taxation atom.

The rejection of the one-payer approach to ad valorem taxes is important—both specifically and generically—to a landowner considering a term oil and gas lease.

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202. *Id.* at 1024.

203. *Id.* ("It logically can make no difference, as may have been intimated, . . . whether the oil is retained by the lessor as oil and gas, readily convertible into cash on the market, or whether the lessee is given a power to sell *all* of the oil and gas, always accounting for a fixed royalty portion to the lessor."). This portion of the *Sheffield* Court's opinion essentially rejects the distinction suggested by the United States Supreme Court in *W.T. Waggoner Estate*. *W.T. Waggoner Estate*, 273 U.S. at 118.

204. *See Sheffield*, 77 S.W.2d at 1024 ("Were the stability furnished by the [statute of frauds and recording statutes] withdrawn and the fundamental contracts, on which the oil business so largely rests, be adjudged by the Supreme Court to create mere rights in personalty at some uncertain date in the future, the structure of the business would be seriously, if not fatally, jeopardized.").

205. *See generally id.*; Stephens County v. Mid-Kan. Oil & Gas Co., 254 S.W. 290 (Tex. 1923). The approach taken by the Texas Supreme Court in *Sheffield* was subsequently endorsed by the Texas Legislature. *See* TEX. TAX CODE ANN. § 25.12(a) (West 2017) ("[E]ach separate interest in minerals in place shall be listed separately from other interests in the minerals in place in the name of the owner of the interest.").

206. *See Sheffield*, 77 S.W.2d at 1029; *Stephens County*, 254 S.W. at 295–96.

Specifically, the Court's rejection of the one-payer approach to ad valorem taxes in the oil and gas context means that a landowner's tax liability will remain the same, regardless of the type of lease conveyed to an operator. Under *Stephens County* and *Sheffield*, each owner is responsible for the market value of the interests created under an oil and gas lease.[207] Because a

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207. *See Sheffield*, 77 S.W.2d at 1029–30; *Stephens County*, 254 S.W. at 295–96. The case of *Pounds v. Jergens* might be thought to contradict the conclusion reached in the text, but the *Pounds* case misinterpreted the Texas Supreme Court's decision in *Sheffield*. Pounds v. Jergens, 296 S.W.3d 100, 107–08 (Tex. App.—Houston [1st Dist.] 2009, pet. denied). The *Pounds* litigation involved a dispute over what interests had been sold in a tax foreclosure sale. *See id.* at 105–06 (describing the litigation). The landowner had previously executed an oil and gas lease and active production continued to occur. *See id.* at 103. The landowner had failed to pay taxes on the surface estate, and a tax foreclosure sale had commenced. *See id.* at 103–04. The buyer at the tax foreclosure claimed that she had purchased not only the surface estate but also (1) the possibility of reverter in the mineral estate following the defeasible fee conveyed in the lease and (2) the royalty interest under the lease. *See id.* at 105. The court first stated that these two interests had never been severed from the surface estate. *See id.* at 108. The court then proceeded to the question of whether taxes had been assessed against these interests, noting that only those interests that had been assessed for tax payment may be sold in a tax foreclosure sale. *See id.* The court acknowledged—citing *Sheffield*—that a royalty interest under a mineral lease was a separate, taxable interest. *See id.* at 107. Because there was no evidence that the landowner had failed to make payments on the royalty interest, the court concluded that the royalty interest was not bundled with the surface estate rights sold at the tax foreclosure sale. *See id.* at 109.

The *Pounds* court then proceeded to a discussion of the possibility of reverter in the minerals that followed the defeasible fee conveyed in the lease. *See id.* at 107–09. The court cited the Texas Supreme Court's decision in *Texas Turnpike Co. v. Dallas County*, 21 S.W.2d 400 (Tex. 1954), for the proposition that a possibility of reverter is not a taxable interest. *See id.* at 109. From this, the court concluded that the possibility of reverter in the mineral interest was sold at the tax foreclosure sale, apparently under the theory that the taxes that had been assessed against the surface estate included the value of the possibility of reverter in the mineral estate. *See id.*

The *Pounds* decision (which was incorrectly decided, as explained below) might be twisted to argue that the royalty interest is the only separate taxable entity retained by the lessor in the usual defeasible fee lease. According to this argument, the possessory rights in the mineral estate are still "bundled" or "tied," meaning that the "one-payer" rule usually applicable for ad valorem taxes still applies. *See generally id.* And finally, because the possessory rights are still "bundled," a switch from a defeasible fee lease to a term of years lease will shift all of the tax liability to the lessor of the term of years lease. *See generally id.*

This argument is wrong on multiple fronts. First, although it is true that *usually* a possibility of reverter is not taxed as a separate interest (this is not true for the mineral context, as explained below), the question then becomes what interest the possibility of reverter should be "bundled" with for tax purposes. *See, e.g.*, *id.* at 109. In other words, if the possibility of reverter is not taxed separately, what interest *does* the holder have to pay taxes on the value (if any) of the possibility of reverter? The *Pounds* court concluded that the possibility of reverter in the mineral estate had been bundled with the surface estate, meaning that the tax assessment for the surface estate had continued to include the value of the possibility of reverter. *See id.* at 111–12. Usually, however, a possibility of reverter would be "bundled" with the possessory interest that it follows. *See id.* at 107. Thus, the owner of the defeasible fee would have to pay taxes on the value (if any) of the possibility of reverter, and the failure to do so would allow for a tax foreclosure sale of a full, fee simple absolute interest. This appears to be the intent of the legislature in adopting § 32.05(b)(3). TEX. TAX CODE ANN. § 32.05(b)(3) (West 2017) (stating that a tax lien takes priority over a "possibility of reverter"). Section 32.05(b)(3) was passed in 2005, apparently in response to *Cypress-Fairbanks Independent School District v. Loggins*, which had held that a possibility of reverter was excluded from a tax foreclosure sale and thus survived as an interest against the foreclosure purchaser. Cypress-Fairbanks Indep. Sch. Dist. v. Loggins, 115 S.W.3d 67, 72–73 (Tex. App.—San Antonio 2003, pet. denied); *see* TAX § 32.05(b)(3). Section 32.05(b)(3) seems to indicate a desire that the tax sale of a defeasible fee will include the possibility of reverter that follows the fee. *See* TAX § 32.05(b)(3). The

term oil and gas lease will function exactly as a fee oil and gas lease (each ending when production in paying quantities ceases), the market value of that interest is the same regardless of whether the "fee" label or "term" label applies to the interest conveyed to the operator.[208] In short, there should be

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Pounds court violated this principle when it assumed that the possibility of reverter should be bundled with the surface estate owner rather than the defeasible fee in the mineral estate. *See Pounds*, 296 S.W.3d at 111. The court cited § 32.05(b)(3) for the proposition that "a tax lien has priority over the possibility of reverter," but the court seemed oblivious to the fact that the possibility of reverter did not exist because of a sequential division of ownership of the surface estate. *See id.* at 109. It is doubtful that the Texas Legislature could have anticipated or desired the result in *Pounds*, in which sequentially divided ownership of the mineral estate is sold at a tax sale; indeed, that seems to be exactly what the legislature was trying to avoid by adopting § 32.05(b)(3). *See id.* at 111–12.

Even if the *Pounds* court was correct in "bundling" the possibility of reverter with the surface estate, such that the surface estate owner has to pay the value (if any) of the possibility of reverter, this undermines the argument that the lessor in a term of years lease must pay all of the ad valorem taxes associated with the lease. As explained in the text, the *Sheffield* case had the effect of "splitting the atom" with regard to ad valorem taxes on the mineral estate. *See supra* text accompanying notes 205–06. The *Pounds* court also split the taxation responsibilities of the mineral estate, albeit in a different way. *See Pounds*, 296 S.W.3d at 109–10. Under *Pounds*, the operator paid taxes on the value of the defeasible fee, and the owner of the surface estate paid value on the value of the possibility of reverter. *See id.* at 107–09. Had the *Pounds* court bundled the possibility of reverter with the defeasible fee, this would have provided better support for the argument that only one taxable, possessory interest is created by an oil and gas lease, but that is not what occurred in *Pounds*. *See id.*

In any event, neither the conclusion reached by the *Pounds* court (to bundle the possibility of reverter with the surface estate) nor the alternative considered above (to bundle the possibility of reverter with the defeasible fee, which might undermine the one-payer approach to ad valorem taxes) are a correct interpretation of Texas law. *See* TAX § 32.05. The *Pounds* Court cited *Texas Turnpike Co.* for the proposition that a possibility of reverter is a non-taxable interest, but that case did not involve an oil and gas lease. *See Pounds*, 296 S.W.3d at 109 (citing *Tex. Tpk. Co*., 271 S.W.2d at 402). The tax treatment of the mineral estate has always been distinct, a point emphasized in the text. *See supra* text accompanying notes 182–84 (discussing mineral estate tax treatment). And in *Sheffield*, the Texas Supreme Court specifically held that a possibility of reverter in a mineral estate was a taxable interest, together with the royalty interest created under the lease: "We therefore hold that *all* the property interests of ascertainable value, secured to the lessors or their assigns under the Hogg-Hamman lease, are subject to taxation as real estate in the county wherein the land lies . . . ." *Sheffield*, 77 S.W.2d at 1024 (emphasis added).

Because, under *Sheffield*, the possibility of reverter was a separate, taxable interest in real property, it could not be sold at a tax foreclosure sale unless taxes has been assessed against that interest. *See id.* at 1029–30. The *Pounds* court correctly applied this concept as it related to the royalty interest created by the oil and gas lease, holding that the royalty interest had not been sold at the tax foreclosure sale. *See Pounds*, 296 S.W.3d at 111–12. The *Pounds* court, however, should have applied this same analysis to the possibility of reverter in the mineral lease. The error by the *Pounds* court was simply failing to appreciate that, under *Sheffield*, "*all* the property interests of ascertainable value, secured to the lessors or their assigns under the Hogg-Hamman lease, are subject to taxation as real estate . . . ." *Sheffield*, 77 S.W.2d at 1024 (emphasis added). Under *Sheffield*, the royalty interest retained by a lessor is an interest in real property, but so is every other interest created by the lease. *Id.* This concept has been repeatedly confirmed by Texas courts. *See, e.g.*, Retamco Operating, Inc. v. Republic Drilling Co., 278 S.W.3d 333, 339 (Tex. 2009); Day & Co. v. Texland Petrol., Inc., 786 S.W.2d 667, 669 (Tex. 1990); Renwar Oil Corp. v. Lancaster, 276 S.W.2d 774, 776 (Tex. 1955); Anadarko Petrol. Corp. v. BNW Prop. Co., 393 S.W.3d 846, 859 (Tex. App.—El Paso 2012, no pet.); Brady v. Sec. Home Ins. Co., 640 S.W.2d 731, 733 (Tex. App.—Houston [14th Dist.] 1982, no writ).

208. *See Retamco Operating, Inc*., 278 S.W.3d at 339; *Texland Petrol., Inc.*, 786 S.W.2d at 669; *Lancaster*, 276 S.W.2d at 776; *Anadarko Petrol. Corp*., 393 S.W.3d at 859; *Brady*, 640 S.W.2d at 733 (discussing how the term of years oil and gas lease will function identically to a defeasible lease).

no change in the ad valorem tax liability of a landowner who drafts a term rather than a fee lease.[209]

Generically, the Texas Supreme Court's rejection of the one-payer approach to ad valorem taxes has significance outside of the narrow tax context. Recall the theoretical basis for the one-payer approach, which was that there was one true owner of property.[210] And recall how this view was wrapped up in (1) the notion that only one party had seisen under feudal common law[211] and (2) the related view that a nonfreehold lease was to be treated as a personal property interest (that is, a chattel real).[212] In the Texas ad valorem cases, the Texas Supreme Court rejected this entire way of thinking as it applied to the separate interests created by an oil and gas lease, and this concept has been repeatedly confirmed by Texas courts.[213] There is not a one true owner of the mineral estate. Instead, every separate interest in minerals in place constitutes ownership (on which taxes are due), and each of those interests is an interest in real property. The ad valorem tax cases provide the best discussion and clearest embrace of this idea.

B. Statute of Frauds

The Texas Supreme Court's conclusion that all interests in the mineral estate are real property[214] has been duplicated in other settings, a couple of which are worth examining specifically. One of these is the statute of frauds.

The writing requirement deriving from the statute of frauds is one of the issues on which the freehold/lease distinction has sometimes mattered. The conveyance of a freehold interest is not valid unless in writing,[215] while

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209. *See supra* text accompanying note 28 (explaining the small impact that would occur in changing an oil and gas lease).

210. *See supra* text accompanying notes 179–80 (discussing that only one party had seisen and that party was the true landowner).

211. *See supra* text accompanying notes 179–80 (explaining one party seisen).

212. *See supra* notes 154–55 and accompanying text (outlining how an interest in real property is personal property).

213. *See, e.g.*, *Retamco Operating Inc.*, 278 S.W.3d at 339 ("Oil and gas interests are real property interests."); *Texland Petrol. Inc.*, 786 S.W.2d at 669 ("We hold that the executive right is an interest in property, an incident and part of the mineral estate like the other attributes such as bonus, royalty and delay rentals . . . . The transfer of executive rights is best governed by principles of real property and oil and gas law, and not by principles of contract law pertaining to agency and powers of attorney."); *Lancaster*, 276 S.W.2d at 776 (holding that a unitization agreement was an interest in real property); *Anadarko Petrol. Corp.*, 393 S.W.3d at 849 ("Like any other mineral interest, the executive right is governed by principles of real property."); *Brady*, 640 S.W.2d at 733 ("It is not disputed that Hawkins' real property interest consisted of a royalty interest and the right to one-half the bonus and delay rentals."); SMITH & WEAVER, *supra* note 10, § 2.4(E) ("All varieties of royalties, overriding royalties, and production payments are nonpossessory interests in land, whether payable in money or payable in kind. The same analysis is usually made of carried interests and net profits interests.").

214. *See* Sheffield v. Hogg, 77 S.W.2d 1021, 1024 (Tex. 1934).

215. *See* John H. Scheid, *Down Labyrinthe Ways: A Recording Acts Guide for First Year Law Students*, 80 U. DET. MERCY L. REV. 91, 97–98 (2002) (describing the historical origins of the writing requirements for the conveyance of a freehold estate).

(some) leases (as chattels real) are valid even without a writing requirement.[216] It might be presumed, then, that the creation of a term of years oil and gas lease would obviate the need for a written document, a result that is contradictory to the Texas Supreme Court's consistent statements extolling the virtues of having any conveyance involving the mineral estate to be in writing.[217]

Drafting an oil and gas lease as a term of years, however, will not excuse the writing requirement of the statute of frauds. The Texas Statute of Frauds[218] requires a writing for the "conveyance of an estate of inheritance, a freehold, *or* an estate for more than one year . . . ."[219] The term of years lease proposed in this Article will be for more than one year, and thus subject to the writing requirement.[220] Oral term of years leases will be ineffective.[221]

The Texas cases, however, relying upon the holding and logic from *Sheffield*, extend the writing requirement beyond what might be assumed from the actual language of the statute.[222] Texas courts have consistently required that *any* conveyance of any interest of the mineral estate be in writing.[223]

The best early example of this principle is perhaps *Stovall v. Poole*,[224] in which a party brought suit on an alleged oral agreement by the defendant to convey a royalty to the plaintiff.[225] The court denied the relief, reasoning that the royalty interest was an interest in land, and thus subject to the writing requirement.[226] In the more recent case of *Quigley v. Bennett*,[227] the Texas Supreme Court clearly confirmed this notion.[228]

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216. *See* MOYNIHAN & KURTZ, *supra* note 93, at 80 ("Most of the state statutes [of fraud], however, allow oral leases for one year or less . . . .").

217. *See, e.g.*, *Sheffield*, 77 S.W.2d at 1024 ("The oil industry in Texas is largely dependent for development, growth, or prosperity, on the doctrine that the interests we are considering—such as the lessee's and the lessor's estates under contracts which are in customary use in Texas—are interests in land; and hence not subject to parol sale, but have the protection of the statute of frauds . . . .").

218. The writing requirement actually derives from two separate sources in Texas. *See* TEX. BUS. & COM. CODE § 26.01 (West 2017); TEX. PROP. CODE § 5.021 (West 2017). These two statutes, one applicable to contracts and the other to conveyances, will be generically referred to as the "Statute of Frauds."

219. PROP. § 5.021 (emphasis added).

220. In any event, a landowner negotiating for the term of years oil and gas lease proposed in this Article will be working with a written document.

221. BUS. & COM. § 26.01. This provides an example of the phenomenon explained earlier in the Article, in which term of years leases are treated as freehold estates for some purposes. *See supra* text accompanying note 95–96 (stating that a term of years is sometimes treated as a nonlease). The Texas Statute of Frauds, by its language, adopts this treatment of a term of years lease. *See* BUS. & COM. § 26.01.

222. *See, e.g.*, Stovall v. Poole, 382 S.W.2d 783, 784 (Tex. Civ. App.—Waco 1964, writ ref'd n.r.e.).

223. *See id.*

224. *See id.*

225. *See id.* at 783–84.

226. *See id.* at 784.

227. Quigley v. Bennett, 227 S.W.3d 51 (Tex. 2007).

228. *See id.* at 54 ("An overriding royalty interest in an oil and gas lease is considered an interest in real estate that falls within the statute of frauds. Absent a writing, an agreement to transfer such an interest is unenforceable.") (citing Consol. Gas & Equip. Co. v. Thompson, 405 S.W.2d 333, 336 (Tex. 1966)).

This result might appear to be at odds with the language of the statute of frauds, which speaks specifically in terms of "freehold" estates or "estate[s] for more than one year . . . ."[229] The result is perfectly consistent with the Supreme Court's decision in *Sheffield*, however, which was cited by the *Stovall* court.[230]

What does the Supreme Court's decision in *Sheffield*, an ad valorem tax case, have to do with the statute of frauds issue in *Stovall*? The *Sheffield* decision held that *all* interests in the mineral estate are interests in real property, rejecting the freehold/lease and real property/personal property distinctions that had been recognized in the common law.[231] Under the *Sheffield* logic, then, it makes no sense to apply the writing requirement to only some of the interests that might be created in the mineral estate. Under *Sheffield*, if you are dealing with an interest in the mineral estate, you are dealing with real property.[232] In *Stovall*, the court reasoned that the statute of frauds must thus be applicable to *every* interest in the mineral estate.[233] Other Texas courts have reached this exact same conclusion.[234]

C. Recording Statutes

The freehold/lease distinction has also sometimes mattered to the question of whether a state's recording statute requires recording of the interest conveyed. In some jurisdictions, nonfreehold leases have been interpreted as being outside the purview of that state's recording statutes.[235]

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229. TEX. PROP. CODE ANN. § 5.021 (West 2017).

230. *See Stovall*, 382 S.W.2d at 784 (citing Sheffield v. Hogg, 77 S.W.2d 1021 (Tex. 1934)).

231. *See Sheffield*, 77 S.W.2d at 1024 ("We therefore hold that all the property interests of ascertainable value, secured to the lessors or their assigns under the Hogg-Hamman lease, are subject to taxation as real estate in the county wherein the land lies . . . .").

232. *See id.*

233. *See Stovall*, 382 S.W.2d at 784.

234. *See* Minchen v. Fields, 345 S.W.2d 282, 288 (Tex. 1961) (holding that a payment out of a share of minerals, if produced, is a real property interest subject to the statute of frauds); Carpenter v. Phelps, 391 S.W.3d 143, 147–48 (Tex. App.—Houston [1st Dist.] 2011, no pet.) (acknowledging that an agreement in which "Phelps and Helms would initially share in a pro rata ownership of 100% of the M.T. Cole 'A' lease until net revenues from the wells equaled the principal and interest due the investors, after which Phelps and Helms would share in a pro rata ownership of 50%" was an interest in real property that was subject to the statute of frauds); Johnson v. Tex. Gulf Coast Corp., 359 S.W.2d 91, 92 (Tex. Civ. App.—San Antonio 1962, no writ) ("An overriding royalty in an oil and gas lease is an interest in land and ordinarily must be conveyed by an instrument in writing . . . ."); Gruss v. Cummins, 329 S.W.2d 496, 500 (Tex. Civ. App.—El Paso 1959, writ ref'd n.r.e.) ("The overriding royalty interest claimed by plaintiffs is an interest in land and, as such, is realty within the meaning of the Statute of Frauds . . . ."); Pantaze v. McDill, 228 S.W. 962, 963 (Tex. Civ. App.—Fort Worth 1921, no writ) (affirming that "a verbal assignment of an interest in an oil lease [is] nonenforceable by reason of the statute of frauds").

235. *See* Hannah J. Wiseman, *Rethinking the Renter/Owner Divide in Private Governance*, 2012 UTAH L. REV. 2067, 2112 (2012) ("Further, leases need not be recorded, nor are landlords typically required to disclose lease rules to prospective renters prior to the stage at which they quickly read and sign the lease."). In some jurisdictions, long-term leases are subject to the recording statute, while shorter-term leases are not. In Louisiana, for example, a lease will be considered invalid against claims by third parties if the lease (in its entirety or in a short form that, in Louisiana, is called a notice of lease) is not recorded.

This conclusion is usually justified by reference to the old common law rule that a lease is merely a personal property interest.[236]

The language of the Texas recording statute, however, is extremely broad, seemingly anticipating—and rejecting—the argument that a personal property interest *in* real property is excluded from coverage of the act.[237] The statute applies to "a conveyance of real property *or* an interest in real property."[238] As such, land leases are frequently recorded in Texas, even though those leases might be considered a chattel real under the old common law rule.[239]

The broad language of the Texas recording statute compels the conclusion that any interest in the mineral estate is subject to the recording scheme, even if those interests (such as a nonfreehold lease estate) might have been considered personal property under the common law. Moreover, recall the Supreme Court's consistent holdings that *all* interests in the mineral estate constitute real property.[240] Between the broad language of the recording statute, and the Texas Supreme Court's consistent treatment of any interest in the mineral estate as real property, it seems abundantly clear that every interest in the mineral estate is subject to recording. The statute rejects the real property/chattel real distinction under the common law; in any event, the Texas Supreme Court says that interests in the mineral estate fall on the "real property" side of that division.[241] In short, the recording scheme will continue

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See LA. REV. STAT. ANN. § 44:104 (2018); LA. CIV. CODE art. 3338 (2018). In Connecticut, an MOL (or the lease itself) must be recorded if the lease has a term of longer than one year. *See* CONN. GEN. STAT. §§ 47-19, 47-20 (2018). In Maine, recordation is required if the term is longer than two years. *See* ME. REV. STAT. ANN. tit. 33, § 201 (2018). Otherwise, the lease is binding only on the parties to the lease and not on innocent third parties who would have otherwise benefited from the recording of such a document. *See id.* In Alabama, a lease with a term of less than twenty years (which includes the initial term and any options to extend) does not need to be recorded to be enforceable against third parties; however, if the lease term is more than twenty years, that portion of the lease that is longer than twenty years is void unless the lease or an MOL is recorded within one year after lease execution. *See* ALA. CODE § 35-4-6 (2018).

236. *See, e.g.*, 1 WITKIN ET AL., SUMMARY OF CALIFORNIA LAW § 393 (Thomson Reuters eds., 11th ed. 2017) ("A lease is technically personal property ('chattel real'), and formerly an agreement to sell a lease or procure a lease did not require a writing.").

237. *See* TEX. PROP. CODE ANN. § 5.002 (West 2017).

238. *Id.* (emphasis added).

239. *See* GERRY BEYER, 15 WEST'S TEXAS FORMS, REAL PROPERTY § 16.17 (2d ed. 2001) ("Frequently, ground leases or leases for a long term are recorded in the real property records in the county in which the leased premises are located. The purpose is to put third parties on notice of the existence of the lease."). Curiously, there is a dearth of caselaw addressing the issue. However, it must be remembered that possession by a tenant will put a third party on either inquiry or actual notice, thus protecting a tenant who had not recorded her lease in a dispute with third party who has subsequently purchased the possessory rights originally conveyed to the tenant. *See* J.B. Glen, Annotation, *Continued Possession of Tenant as Constructive Notice to Third Person of Unrecorded Transfer of Title of Original Lessor*, 1 A.L.R. 2d 322 (1948).

240. *See supra* notes 232–35 and accompanying text (describing cases holding that all mineral interests are real property).

241. *See supra* notes 232–34 and accompanying text (providing cases holding that mineral interests are real property).

to apply to oil and gas interests, even if a landowner drafts a lease as a true term lease rather than a defeasible fee.

D. Miscellaneous Issues

The real property/chattel real distinction can also matter in a few other circumstances, such as (1) the interpretation of a conveyance or devise that disposes of only the grantor's real or personal property;[242] (2) the application of Texas's intestate succession laws, which (in narrow circumstances) distinguish between the decedent's real and personal property;[243] (3) the application of Texas's homestead laws, which apply to real property interests only; (4) the application of mortgage foreclosure or tax foreclosure sales; (5) the existence of personal jurisdiction;[244] (6) the availability of adverse possession; (7) the proper cause of action for resolving disputes regarding the ownership of the mineral interest; and (8) the establishment of proper venue.[245] Here again, though, because the Texas Supreme Court has held that *all* interests associated with the mineral estate are real property interests, the difference between a defeasible fee oil and gas lease and a term lease should be irrelevant.[246] Either mineral lease (fee or term) involves the conveyance of—and retention of—real property interests.

E. Abandonment and Surrender

There are two additional issues that need to be considered in drafting a term, rather than a defeasible fee, oil and gas lease. The first is the question of whether an operator can surrender or abandon their interest under the common law. The second deals with the federal income tax consequences resulting from a term of years lease. Both involve a more detailed explanation.

Under the common law, leases and nonleases are treated differently regarding the issues of abandonment and surrender.[247] Thus, it would seem that changing an oil and gas lease from a fee to a term would result in a difference with regard to abandonment and surrender of the interest. The

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242. *See, e.g.*, San Antonio Area Found. v. Lang, 35 S.W.3d 636 (Tex. 2000).

243. *See* TEX. EST. CODE ANN. § 201.002 (West 2017) (explaining the intestate succession for an intestate with a surviving spouse).

244. Retamco Operating, Inc. v. Republic Drilling Co., 278 S.W.3d 333, 336 (Tex. 2009) (basing a finding of personal jurisdiction on the fact that royalty interest was an interest in real property).

245. *See* Renwar Oil Corp. v. Lancaster, 276 S.W.2d 774, 776 (Tex. 1955) (basing venue on the real property nature of the oil and gas interests involved in the suit).

246. *See Retamco Operating, Inc.*, 278 S.W.3d at 339 ("Oil and gas interests are real property interests.") (citing *Renwar Oil Corp.*, 276 S.W.2d at 776; State v. Quintana Petrol. Co., 133 S.W.2d 112, 115 (Tex. 1939)).

247. *See infra* text accompanying notes 255–65 (explaining the difference in treatment of abandonment and surrender between leases and nonleases).

reality, however, is that there will be minimal consequences from this change.[248]

First, it is necessary to distinguish surrender from abandonment; this is a slippery distinction that commentators and courts often fail to explain clearly. A "surrender" involves a formal offer by a grantee to give her property interest back to her grantor.[249] An "abandonment" involves an intentional relinquishment of property rights.[250] Abandonment, technically speaking, involves an inquiry into the mind of the property owner. For obvious reasons, though (and as will become more clear in the subsequent two paragraphs), it is necessary for the law to infer abandonment from the objective conduct of the property owner.

Perhaps a better way to understand the distinction between a surrender and an abandonment is to consider the type of dispute that necessitates an inquiry into these two respective doctrines. When a grantee desires a surrender of her interest, and the grantor accepts, there is no dispute. A dispute only arises regarding a surrender if the grantor wishes to reject the surrender. In this scenario, the question is whether the grantee can force the grantor to accept the offer of surrender. In other words, a dispute over a surrender involves a situation in which *neither* party—grantor or grantee—wants the property interest involved.

To understand the type of real property[251] dispute that typically arises with regard to an abandonment, it is helpful to have in mind the type of fact pattern in which a grantee might be adjudged to have abandoned her property interest. The most common scenario is with regard to land leases. Tenants occasionally vacate possession of the lease premises and stop paying rent, all without any communication with the landlord. This scenario invites a possible conclusion that a tenant has abandoned her lease interest. This creates an opportunity for a dispute between the landlord and the tenant, with the tenant arguing that she did not intend to abandon her lease interest and the landlord arguing that she did.[252] In this scenario, then, both parties are claiming the disputed interest.[253] Thus, if a surrender dispute involves a

248. *See infra* text accompanying notes 266–68 (discussing how the use of surrender clauses in oil and gas leases render the common law distinction between abandonment and surrender insignificant).

249. Arrington v. Loveless, 486 S.W.2d 604, 606 (Tex. Civ. App.—Fort Worth 1972, no writ) ("[S]urrender of a lease, as that term is used in the law of landlord and tenant, is the yielding up by the tenant of the leasehold estate to the landlord so that the leasehold estate comes to an end by the mutual agreement of the landlord and tenant.").

250. *See* Worsham v. State, 120 S.W. 439, 444 (Tex. Crim. App. 1909) ("It is essential, in order to raise the issue of abandonment, that there must be a concurrence of the intention to abandon and an actual relinquishment of the property, so that it may be appropriated by the next comer.").

251. Abandonment of personal property is encountered much more frequently in the caselaw, for reasons explained below.

252. This is not the only type of dispute that might arise. But the one described in the text is the one most likely to result in litigation.

253. The type of dispute in which an abandonment is typically litigated, then, explains the point alluded in the previous paragraph that an abandonment will need to be inferred from the objective conduct

situation in which *neither* party desires the property interest, an abandonment dispute usually involves a situation in which *both* parties claim the property interest.[254]

The common law has different rules regarding surrender and abandonment for leases and nonleases. First, regarding surrender, it is axiomatic that a tenant can surrender her possessory rights in a lease back to a landlord. If the landlord accepts the surrender, the landlord regains the possessory rights that had been granted under the lease and the tenant is relieved of her obligation to pay rent; the relationship between the parties is over.[255] The consequences of a landlord's rejection of a surrender are a little more complex. If a landlord rejects a tenant's offer of surrender, the tenant's obligation to pay rent continues.[256] The landlord, however, is free to relet the premises to a new tenant.[257] In fact, most jurisdictions (including Texas[258]) now impose on the landlord a duty to "mitigate the [tenant's] damages" by reletting the premises to a new tenant.[259] The ability/duty of the landlord to relet the premises reveals an implicit truth about the surrender of a lease interest: the tenant, by surrendering the lease premises back to the landlord, can compel the landlord to retake the possessory rights that had been transferred in the lease. The landlord is not compelled to let the tenant off the hook with regard to *rent*, but the landlord is not free to reject the tenant's surrender of the lease *possessory rights*.[260] Thus, under the common law, a tenant can surrender her possessory rights back to a landlord, even though the tenant might have continued liability to the landlord for rent.[261]

Although a tenant can surrender a lease back to a landlord, the holder of a nonlease estate is not free to surrender that interest back to her grantor.[262]

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of the property owner. A party arguing that they did not abandon the property will not admit to a subjective intent to abandon the property; resort to objective acts, then, will be necessary to prove an abandonment.

254. *See, e.g.*, City of Grand Prairie v. Sides, 430 S.W.3d 649, (Tex. App.—Dallas 2014, no pet.) (resolving a dispute in which taxing authority and owner of land both argued for the excess process from tax foreclosure sale, with the taxing authority arguing that owner had abandoned its property interest).

255. Southmark Mgmt. Corp. v. Vick, 692 S.W.2d 157, 159 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.) ("A surrendering of the lease held by a tenant and an acceptance of possession by the landlord ordinarily releases the tenant from liability for rent which would thereafter accrue.").

256. *See id.*; Arrington v. Loveless, 486 S.W.2d 604, 606 (Tex. Civ. App.—Fort Worth 1972, no writ).

257. *See* Austin Hill Country Realty, Inc. v. Palisades Plaza, Inc., 948 S.W.2d 293, 299 (Tex. 1997) (stating landlords must relet premises vacated by a lessee in breach of lease to meet their duty to mitigate damages), *superseded in part by statute as stated in In re* Perry, 411 B.R. 368, 377 (Bankr. S.D. Tex. 2009).

258. *See* TEX. PROP. CODE ANN. § 91.006 (West 2017) ("A landlord has a duty to mitigate damages if a tenant abandons the leased premises in violation of the lease.").

259. *Austin Hill Country Realty, Inc.*, 948 S.W.2d at 293.

260. *See id.*

261. *See generally* Robert H. Kelley, *Any Reports of the Death of the Property Law Paradigm for Leases Have Been Greatly Exaggerated*, 41 WAYNE L. REV. 1563, 1581–85 (1995) (describing the options a landlord has when confronted with a surrender).

262. There is almost no general authority for this proposition; the reason for this dearth of authority is explained in the text. There is some sparse authority mentioning the possibility of "surrendering" a life

There are fewer proclamations and applications of this rule than the surrender rule regarding leases, probably because it is much less likely that the holder of a nonlease would want to surrender this type of estate. A lease estate is usually bundled with varying duties and covenants that a tenant often wants to extricate herself from, most notable the covenant to pay rent.[263] A nonlease estate, however, is less likely to be an on-going burden to the owner; nonleases do not usually involve a continuing rent payment, but rather an upfront, one-time payment to the grantor. Nevertheless, there are some scenarios in which the holder of a nonlease might like to surrender that interest back to her grantor. Perhaps the taxes are too burdensome, or maybe there are other liabilities associated with ownership of the estate (such as liability under CERCLA) that the owner would like to surrender back to the grantor.[264] In this (unique) scenario, the nonlease owner's offer of surrender is free to be rejected by the original grantor of that interest, resulting in the grantee still owning the nonlease estate.[265]

The blackletter law discussed above would suggest that changing an oil and gas lease from a fee to a term of years would enable the lessee to surrender its interest back to the landowner.[266] But that is already the existing practice in Texas! The standard oil and gas lease in Texas contains a surrender clause,[267] and it is well-established that this clause is enforceable, even though the typical Texas oil and gas lease creates a fee simple estate.[268]

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estate to the future interest holder. *See* RESTATEMENT (FIRST) OF PROP. § 152 cmt.d (AM. LAW INST. 1936) (discussing surrender of a life estate). What is contemplated here, however, is different than the surrender discussed in the text. As discussed in the text, surrender involves a transfer of possessory rights to an unwilling recipient. *See infra* Section IV.E (discussing surrender). The surrender of a life estate occasionally mentioned in the authorities, however, contemplates a transfer to a willing recipient. *See* RESTATEMENT (FIRST) OF PROP. § 152 (AM. LAW INST. 1936) (speaking of a "transfer"); 28 AM. JUR. 2D *Estates* § 102 (2017) ("The conveyance of property by a life tenant and the joint tenants with right of survivorship effectively destroys the tenant's life estate.").

263. *See* SINGER, *supra* note 51, at 658 (describing a landlord's right to receive rent and other duties imposed upon a tenant).

264. *Cf.* 47 AM. JUR. *Trials* § 5 (1984) (explaining potentially liable parties pay for cleanup under a CERCLA claim).

265. Here again, there is little authority for this basic proposition, which perhaps can be generally attributed to the fact that this concept is so basic that it is not even tested or articulated. Perhaps the best authority can be found in the requirements for the delivery of a deed, which provide that a potential grantee is always free to reject the conveyance. *See* ROGER A. CUNNINGHAM ET AL., LAW OF PROPERTY § 11.3, at 786 (2d ed. 1993) (explaining that acceptance of a deed is required but usually presumed).

266. *See supra* notes 247–61 and accompanying text (explaining rules of real property surrender).

267. *See* SMITH & WEAVER, *supra* note 10, § 4.9[C] ("The surrender clause found in printed form leases permits the lessee to make a unilateral decision that is effective without the consent or even over the objection of the lessor.").

268. *See* Superior Oil Co. v. Dabney, 211 S.W.2d 563, 565–66 (Tex. 1948) ("It follows that the option to surrender in the lease and contract here involved must be held valid and given effect."). This is also the rule—by statute—for mineral leases on federal lands. *See* 30 U.S.C. § 187b (1970) ("Notwithstanding any provision to the contrary in section 187 of this title, a lessee may at any time make and file in the appropriate land office a written relinquishment of all rights under any oil or gas lease issued under the authority of this chapter or of any legal subdivision of the area included within any such lease. Such relinquishment shall be effective as of the date of its filing . . . .").

It is unclear whether an operator would be able to surrender a Texas oil and gas lease back to the operator even without an explicit surrender clause in the lease. Because most oil and gas leases do contain an explicit surrender clause, however, the expectation of parties to typical Texas oil and gas leases—that the lease can be surrendered by the operator—will not be affected by changing the lease from a fee to a term.[269]

What about abandonment? Here, it is helpful to compare the rule of abandonment for real property to that of personal property. The common law recognizes that title to personal property can be lost by abandonment.[270] Thus, if one throws a valuable pearl into the ocean, intending to relinquish title and possession, an abandonment has occurred.[271]

Abandonment is generally not recognized with regard to real property.[272] It is not problematic for a piece of personal property (such as a pearl) to be unowned, with title going to the first party to establish possession,[273] but the law prefers that title to real property be with someone at all times.[274] Allowing abandonment of real property would undermine this goal.

The conclusion that Texas oil and gas leases can be surrendered to the landowner—despite the usual rule that a nonlease estate (such as a fee simple defeasible) cannot be surrendered back to a reluctant grantor—can be perceived as an instance in which Texas courts have looked beyond the "fee simple" label to reach a result they deemed sensible to the oil and gas context. (This is the exact type of analysis that Professor Ryan and I have previously advocated for with regard to the enforceability of an alienation restraint in an oil and gas lease. *See* Meier & Ryan, *supra* note 1, at 308.) This analogy is not perfect, though: while the Texas oil and gas lease has a surrender clause, it is unusual to find this clause in the conveyance of usual nonlease estates. It is unclear whether courts would enforce this clause in a nonlease conveyance outside the oil and gas context. An argument could be made, however, that a surrender clause is simply a defeasible limitation on the estate granted that should be enforceable like any other defeasible limitation. If this argument is to be accepted, the rule that a nonlease cannot be surrendered would have to be qualified as a default rule that applies only when there is no surrender clause in the conveyance. In any event, resolving these issues is unnecessary to the point being made in the text, which is that changing a Texas oil and gas lease from a fee to a term will not have a practical effect on the ability of the lessee to surrender its interest back to the landowner.

269. *See* SMITH & WEAVER, *supra* note 10, § 4.9[C]. Changing the oil and gas lease from a fee to a term would make more palatable the notion that an operator can surrender the lease even without an explicit surrender clause. This, after all, is the result under existing lease law, which allows the lessee to surrender his possessory rights to the lessor even without an express clause to that effect in the lease. *See* 30 U.S.C. § 187b.

270. *See* SINGER, *supra* note 51, at 95 (describing the difference between property that is lost, mislaid, and abandoned).

271. *See* JOHN STEINBECK, THE PEARL 97 (Penguin Books eds., 1976) ("And Kino drew back his arm and flung the pearl with all his might. Kino and Juana watched it go, winking and glimmering under the setting sun. They saw the little splash in the distance, and they stood side by side watching the place for a long time.").

272. *See* Lior Jacob Strahilevitz, *The Right to Abandon*, 158 U. PA. L. REV. 355, 355 (2010) ("The common law prohibits the abandonment of real property.").

273. State v. $281,420 in United States Currency, 312 S.W.3d 547, 552 (Tex. 2010) ("[O]ne who seeks to acquire abandoned property must take possession of the property with an intent to acquire title.").

274. James C. Roberton, *Abandonment of Mineral Rights*, 21 STAN. L. REV. 1227, 1228 n.13 (1969) ("The continuing validity of the policy against voids and gaps in the chain of title may be open to criticism insofar as its only function was to protect a certain political relationship of the feudal system that is no longer in existence. The services, or incidents, that a tenant was required to perform for his lord were not

The preference against abandonment of real property should theoretically apply to all types of estates in property. But it is slightly more complicated than that because courts have recognized that a lease interest can be, in effect, "abandoned" by a lessee.[275] (Recall the previous discussion of how the common law treated leases as chattels real, that is, personal property interests in real property.) When a lessee vacates possession of the lease premises and stops paying rent, courts have treated this abandonment of the premises as an implicit offer of surrender to the lessor.[276] At that point, the lessor can either accept the implicit offer of surrender, at which point the lessee is resolved from liability for future rent, or the lessor can reject the implicit offer of surrender, at which point the lessee's obligation to pay rent continues (subject, in most jurisdictions, to the landlord's duty to mitigate the tenant's damages).[277] In either situation (rejection or acceptance of the implicit offer of surrender), the landlord regains the right to possession of the premises.[278] That the landlord regains the possessory rights in a lease abandonment (which is actually a surrender to the landlord) is important because this avoids the situation in which possessory rights to real property are owned by no one.[279] For this reason, then, courts recognize that a lease interest can be "abandoned"[280] by the lessee.[281]

Texas adheres to the general common law rules distinguishing between abandonment of leases and abandonment of other estates.[282] Thus, although title to real property cannot be abandoned in Texas,[283] the possessory rights

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personal obligations, but obligations that ran with the land. The rule against abandonment . . . was designed to protect the lord by ensuring that he would always have a tenant to whom he could look for performance of the incidents.").

275. *See* SINGER, *supra* note 51, at 661 (describing how when a tenant leaves property and stops paying rent, a landlord may accept the surrender).

276. *Id.*

277. *Id.*

278. *Id.*

279. *Id.* at 662.

280. The abandonment of a lease interest back to the landlord is not a true abandonment in the sense that the lease possessory rights are returned to the lessor rather than to the "first taker." *See* Bright v. Gineste, 284 P.2d 839, 842 (Cal. Ct. App. 1955) ("[T]o constitute an abandonment in the strict legal sense there must be a parting with title that is unilateral, the owner must leave the property free to the acquisition of whoever wishes to claim it, and [be] indifferent as to what may become of it. A transfer of property from one person to another cannot be effected by abandonment, and abandonment cannot be made to a particular individual."). Nevertheless, the term abandonment is frequently used in this context, even though the term "implicit surrender" better captures the notion that the rights in question are being returned to a specific party.

281. *See id.* The modern rule that leases can be abandoned, while nonleases cannot, is similar to the ancient common law rule that required one person to always be seised in the land. *See* MOYNIHAN & KURTZ, *supra* note 93, at 30 ("The concept of seisin was so fundamental to the operation of the feudal system that it was a strict rule that seisin could never be in abeyance or suspended.").

282. *See* Rogers v. Ricane Enters., Inc., 772 S.W.2d 76, 80 (Tex. 1989).

283. *See id.* ("Abandonment of title to real property is not recognized in Texas."). This was not always the case, however. Under Mexican law, applicable before January 20, 1840, abandonment of real property was permissible. *See* Harris v. O'Connor, 185 S.W.2d 993, 1010–12 (Tex. Civ. App.—El Paso 1944, writ

in a lease can be abandoned (an implicit surrender) back to the lessor.[284] The Texas Supreme Court's effort to apply these two rules to the oil and gas lease context, however, has resulted in some confusion and complexity (to put it mildly).[285]

This confusion and complexity need not be untangled herein, however. First, it is crucial to appreciate that an operator who does nothing under a lease will generally lose his interest pursuant to the explicit terms of the lease.[286] The standard Texas mineral lease requires an operator to both explore and produce.[287] Thus, when the operator sits on his hands, the operator's estate defeases under the explicit language of the oil and gas lease; whether there has been a common law "abandonment" in this situation is an irrelevant inquiry. Thus, under the lease proposed in this Article (a term lease that terminates according to the usual provisions requiring an operator to explore and produce in paying quantities), the common law abandonment issue is simply irrelevant.

Moreover, changing a mineral lease to a term from a fee can do nothing but help the landowner in an abandonment dispute with an operator. Recall that the typical abandonment dispute is one in which both parties—here, the landowner and the operator—wish to own the property interest in question.[288] In this case, the landowner will argue that the operator did abandon the interest, with the operator claiming that it did not.[289] Changing an oil and gas

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ref'd n.r.e.) (recognizing that abandonment of property could apply, under Mexican law, before January 20, 1840).

284. Vanity Fair Props. v. Billingsley, 469 S.W.2d 453, 457 n.5 (Tex. Civ. App.—San Antonio 1971, writ ref'd n.r.e.) ("The tenant's abandonment constitutes an offer to terminate which is deemed accepted by the landlord's acts inconsistent with the tenant's continued possession.").

These two concepts—that title to real property cannot be abandoned in Texas, while a tenant can abandon a lease back to a lessor—can be reconciled through a technical definition of the word "title." Under this definition, a tenant does not have title even though she has the current possessory estate in the land. In some instances (such as the tax situations discussed in this section), the determination as to whether the holder of a present possessory interest (such as a landlord's) or a future possessory interest (such as a tenant's) has "title" might be necessary to resolve a particular legal question. A conclusion that a tenant does not have title is similar to the English common law notion that the holder of a nonfreehold estate did not have "seisen." *See* Lynda L. Butler, *The Commons Concept: An Historical Concept with Modern Relevance*, 23 WM. & MARY L. REV. 835, 855 n.90 (1982) ("In contrast to freehold tenants, nonfreehold tenants received only a possessory interest, not an ownership interest, in the land. In other words, the lord did not convey seisin to the tenant who held by unfree tenure.").

285. Ferebee, *supra* note 163, at 163 ("Although the Rogers group and the Texas Supreme Court relied on the tenet that an estate in land cannot be abandoned in Texas, the concept is not as simple as it seems.").

286. *See* HEMINGWAY, *supra* note 36, § 6 (providing various clauses to write into a lease for the operator to keep the lease alive without production).

287. *See id.* § 6.4.

288. *See supra* text accompanying notes 252–53 (explaining a scenario where both parties would claim the disputed interest).

289. *See supra* text accompanying notes 252–53 (discussing when the disputed interest would be claimed by both parties). This was the type of fact pattern involved in the three seminal oil and gas abandonment cases decided by the Texas Supreme Court: *Davis*, *W.T. Waggoner Estate*, and *Rogers II*.

lease from a fee estate to a term estate *strengthens* the argument that a common law abandonment can occur. If Texas courts view the common law abandonment issue as being affected by the shift from a fee to a term lease,[290] it will be in favor of the abandonment conclusion, *which is the exact result that a landowner wants* in a dispute with an operator as to whether there has been a common law abandonment.

Thus, although the common law treats leases and nonleases differently with regard to surrender and abandonment, there is no reason for a landowner to be concerned in changing the duration of a Texas oil and gas lease such that a term—rather than a fee—is created. First, operators will continue to be able to surrender the lease.[291] Second, operators who sit on their hands will continue to lose their interest under the explicit terms of a lease.[292] Third, landowners have a *stronger* argument that an operator has abandoned its interest under the common law.[293]

F. Federal Income Taxation

A landowner contemplating a term oil and gas lease will also want to consider whether there are any federal tax consequences deriving from a lease with a definite, fixed ending date. The short answer is "no": A term oil and gas lease will almost surely be treated like the conventional defeasible fee lease.[294] Should the term lease be treated differently, however, it would be to the *benefit* of the landowner (similar to the common law abandonment question discussed in the previous section[295]).

First, in discussing federal tax consequences of a term oil and gas lease, it is important to remember that a state's classification and treatment of an

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Rogers v. Ricane Enters., Inc., 772 S.W.2d 76, 80 (Tex. 1989); W.T. Waggoner Estate v. Sigler Oil, 19 S.W.2d 27 (Tex. 1929); Tex. Co. v. Davis, 254 S.W. 321, 331 (Tex. 1923).

290. As Professor Ryan and I have argued with regard to the enforceability of alienation restrictions, perhaps the labels a jurisdiction happens to apply to the sui generis oil and gas lease should not determine whether the interest can be abandoned. *See generally* Meier & Ryan, *supra* note 1. Professor Roberton has advanced this argument in favor of his conclusion that mineral interests should be capable of abandonment. *See* Roberton, *supra* note 274, at 1234–35 ("Unfortunately, the usefulness of the abandonment doctrine is blunted by its dependence on the corporeal-incorporeal distinction. Every consideration of public policy demonstrates that dormant mineral interests should be subject to abandonment, and the abstract categorization of such interests as corporeal or incorporeal should be totally irrelevant to the question . . . . There is no reason, either in logic or in policy, for courts to continue adhering to the consequences that follow from these labels. The court's approach, in permitting social and economic consequences of considerable magnitude to turn on considerations no more substantial than metaphysical theories of the nature of ownership, is clearly out of step with an enlightened system of jurisprudence.").

291. *See supra* notes 261–69 and accompanying text (discussing the Court's treatment of surrender and surrender clauses in oil and gas leases).

292. *See supra* notes 270–81 and accompanying text (discussing explicit and implicit surrender).

293. *See supra* notes 270–81 and accompanying text (discussing the lessor's rights in surrender scenarios).

294. *See supra* Part IV (discussing the consequences of a lease with a term of years).

295. *See supra* Section IV.E (explaining the difference between surrender and abandonment).

oil and gas lease is irrelevant.[296] Instead, federal income tax treatment of the mineral estate depends upon an "economic interest" analysis under federal law.[297]

When a taxpayer has an "economic interest" in the minerals in place, income derived solely from the extraction of the minerals is not treated as capital gain, but rather as ordinary income subject to depletion.[298] There is no question that landowners are currently treated as having an economic interest in the minerals in place under the standard oil and gas lease.[299] This legal conclusion derives from two points: First, the landowner acquires an interest in the minerals in place through the creation of the lease.[300] Second, the landowner acquires income from the capital investment by looking solely to the minerals in the ground.[301]

This basic analysis would be unaffected by the shift from a defeasible fee to a term lease. A landowner would still have an interest in the minerals in place in a term lease, and any income from the capital investment would be attributed solely to the minerals in the ground. In fact, the United States Supreme Court has expressly held that the legal form of the investment does not matter.[302] In *Kirby Petroleum Co. v. Commissioner*, the Court held that economic interest does not mean title to the oil in place, but the possibility of *profit* from that economic interest dependent solely upon the extraction and sale of the oil.[303]

Although there is little doubt that a term oil and gas lease would be considered an economic interest under the general test outlined above, it is a

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296. *See* Burnet v. Harmel, 287 U.S. 103, 110 (1932) ("Here we are concerned only with the meaning and application of a statute enacted by Congress, in the exercise of its plenary power under the Constitution, to tax income. The exertion of that power is not subject to state control. It is the will of Congress which controls, and the expression of its will in legislation, in the absence of language evidencing a different purpose, is to be interpreted so as to give a uniform application to a nation-wide scheme of taxation."); OWEN L. ANDERSON ET AL., HEMINGWAY OIL AND GAS LAW AND TAXATION § 11.1 (4th ed. 2004) ("Although state laws vary as to whether the execution of an oil and gas lease results in a sale of the mineral estate, for federal taxation purposes such state laws are not determinative.").

297. Treas. Reg. § 1.611-1(b)(1) (1973); *see also* Palmer v. Bender, 287 U.S. 551, 557 (1933) ("It is enough if by virtue of the leasing transaction he has retained a right to share in the oil produced. If so, he has an economic interest in the oil, in place, which is depleted by production.").

298. *See* Wood v. United States, 377 F.2d 300, 301 (5th Cir. 1967) (holding for the government that the taxpayer had an economic interest "and that the payments received [under the lease were] taxable as ordinary income subject to a . . . depletion allowance").

299. *See id.* at 305 ("Clearly, where a 'typical' mineral lease is entered into by a landowner, there is a retention of an economic interest in the minerals. In any case, therefore, an inquiry into the presence of such an interest need go no further unless it can be shown that some characteristics of the agreement make it atypical.").

300. *See* Anderson v. Helvering, 310 U.S. 404, 409 (1940) (holding that an interest in minerals in place exists if the taxpayer has a right to share and participate in the proceeds derived from the production of minerals).

301. *See id.* at 408–09.

302. *Palmer*, 287 U.S. at 557 ("Similarly, the lessor's right to a depletion allowance does not depend upon his retention of ownership or any other particular form of legal interest in the mineral content of the land.").

303. *See* Kirby Petrol. Co. v. Comm'r, 326 U.S. 599, 604 (1946).

slightly closer question as to whether the "carved-out production payment" exception would apply.[304] If the economic interest in question is a carved-out production payment, it will not be treated as an economic interest, but rather as a mortgage loan on the property.[305] In this scenario, not all of the payments will qualify as income; instead, a portion of the payments will be treated as income, and a portion will be treated as capital gain.[306]

Under Treasury Regulations, an economic interest in minerals in place becomes a carved-out production payment when the payments have an "expected economic life (at the time of its creation) of shorter duration than the economic life of . . . [the burdened property.]"[307] The Regulations specify that "[a] right to mineral in place has an economic life of shorter duration than the economic life of a mineral property burdened thereby only if such right may not reasonably be expected to extend in substantial amounts over the entire productive life of such mineral property."[308]

Because the Regulation specifically mentions a "time limitation" as one of the situations in which an economic interest becomes a carved-out production payment, [309] it is tempting to conclude that a term oil and gas lease—with a definite ending date—would qualify. However, an IRS revenue procedure defining more precisely what is meant by "substantial amounts over the entire productive life" clarifies that the term oil and gas lease contemplated by this Article would not be a carved-out production payment.[310] Under this IRS guidance, an economic interest only becomes a carved-out production payment if it is expected to terminate "upon the production of not more than [90%] of the reserves then known to exist" and if the remaining reserves constitute "[5%] or more of the present value of the entire burdened property . . . ."[311]

As explained earlier in this Article, the term of years lease suggested in this Article will terminate at exactly the same time the common defeasible fee lease ends—when production no longer occurs in paying quantities.[312] Because the end of the term lease will be set at a far-off date (well past when

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304. Treas. Reg. § 1.611-1(b)(1) (1973).

305. *See* 26 U.S.C. § 636(a) (2012) ("A production payment carved out of mineral property shall be treated, for purposes of this subtitle, as if it were a mortgage loan on the property, and shall not qualify as an economic interest in the mineral property."); Treas. Reg. § 1.636-1(a)(1)(i) (1973) ("[A] production payment . . . to which this section applies shall be treated as a loan on the mineral property (or properties) burdened thereby and not as an economic interest in mineral in place . . . .").

306. *See* Anderson et al., *supra* note 296, § 12.2. ("The payments to [the holder of the production payment] are treated as allocable between principal and interest to [the holder of the production payment]. That part allocable to interest is taxable as interest income, with the remainder treated as a nontaxable return of capital to [the holder of the production payment], the creditor.").

307. Treas. Reg. § 1.636-3(a)(1).

308. *See id.*

309. *See id.*

310. *Id.*

311. Rev. Proc. 97-55, 1997-51 I.R.B. 23.

312. *See supra* Part III (discussing the process of making an oil and gas lease in Texas).

production might still be on-going[313]), this precludes treatment as a carved-out production payment under federal tax law.[314] The parties entering into this sort of lease will anticipate that more than 90% of the reserves will be developed under the lease. Moreover, the value of the production expected to remain after the lease terminated will be less than 5% of the value of the lease (indeed, the expectation will be that the value of the remaining production should approach 0%).[315] Indeed, in fact patterns involving fixed-term agreements somewhat analogous to the term oil and gas lease proposed in this Article, both the IRS and the Third Circuit have confirmed that these fixed-term agreement constitute economic interests and are not subject to the carved-out production payment exception.[316]

Thus, under federal tax law, a fixed-term oil and gas lease will almost surely be treated the same as the current defeasible-fee lease. That said, it is worth noting that using this unconventional lease poses no downside risk to the landowner. Even if taxing authorities differentiated the term lease proposed in this Article from the conventional defeasible fee lease, the landowner would actually benefit from this decision. Under the current defeasible fee lease, a taxpayer's royalty payments are treated as ordinary income.[317] If the term lease was determined to be different, it would mean that the taxpayer's royalty payments would be (partially) taxed at the lower rate for capital gains.[318] Thus, in litigation determining the effect of a term oil and gas lease, it would be the landowner asking that the term lease be treated differently than the standard defeasible fee lease. As described above, however, this distinction will almost surely be rejected.

V. CONCLUSION

In some sense, the lessons from the preceding Part bring the discussion full circle.

In Professor Ryan and my previous Article, we encouraged judges to take a practical, functional approach in determining the validity of a restraint

313. *See supra* note 10 and accompanying text (describing how lease duration is generally set). Recall that a producer will not be agreeable to a lease that could end while profitable production is still on-going.

314. *See* Treas. Reg. § 1.636-3(a)(1).

315. *See* Rev. Proc. 97-55, 1997-51 I.R.B. 23.

316. *See* Gulf Oil Corp. v. Comm'r, 914 F.2d 396 (3d Cir. 1990) (holding that an agreement to explore for minerals in Iran, with a maximum time period of forty years, constituted an economic interest that was not subject to the carved-out production payment exception); *see also* Rev. Rul. 76-215, 1976-1 C.B. 194 (determining that a "30 year production sharing contract" for oil and gas production constituted an economic interest that was not subject to the carved-out production payment exception); *cf.* Watnick v. Comm'r, 90 T.C. 326 (1988) (holding that a cap on the amount of money that was payable to the taxpayer under a mineral lease did not create a carved-out production payment when there was no "reasonable prospect or expectation that the oil payment[s]" would be large enough to trigger this cap).

317. *See supra* note 207 (discussing various Texas cases concerning royalty payment tax consequences).

318. *See* 26 U.S.C. § 1254 (1988).

on alienation in an oil and gas lease.[319] Given the realities of the relationship created by an oil and gas lease, a landowner should be able to restrict the operator's ability to transfer the lease to a third party. Lessors in land leases are given this ability, based on the intimate, on-going relationship established by a lease. An oil and gas lease establishes this same type of relationship between landowner and operator, even if some jurisdictions (like Texas) label this "lease" as a fee simple defeasible estate under the real property estates classification system.[320]

This Article provides a drafting trick so that landowners can create a true "lease" under the property estates classification system.[321] But, of course, nothing about the relationship created by a term oil and gas lease will be any different than the relationship created by a defeasible fee oil and gas lease.[322] The drafting trick outlined in this Article simply supplies a different label to the working, on-going relationship created by an oil and gas lease. For judges inclined to decide the validity of a restraint on alienation in an oil and gas lease based on the applicable property label, the term of years lease described in this Article will compel a judge to accept and enforce the landowner's desired restraint on alienation.[323]

In considering the potential collateral consequences of creating a term of years oil and gas lease, however, a reality regarding Texas oil and gas law became apparent: Texas courts have long taken a practical, functional approach to resolving oil and gas disputes.[324] With regard to Texas property taxes, Texas courts have held that each owner of the mineral estate is required to pay taxes, even though traditional property law provides that only the one, true owner is required to pay property taxes.[325] Texas courts have held that a conveyance of any interest of the mineral estate is subject to the statute of frauds, even though the language of the statute suggests that only freehold estates and long-term leases must be in writing.[326] Similarly, Texas courts have held that every interest in the mineral estate is subject to the state's recording statute scheme.[327]

In making these decisions, Texas courts have recognized a very basic fact: oil and gas is different, and the principles, labels, and doctrines of

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319. Meier & Ryan, *supra* note 1, at 313.

320. *See supra* note 16 and accompanying text (explaining the type of interest created by a Texas oil and gas lease).

321. *See supra* Part III (suggesting a change to the duration of language of an oil and gas lease).

322. *See supra* text accompanying notes 130–32 (explaining that the actual duration under a term of years lease would not change).

323. *See supra* notes 20–23, 121–27 and accompanying text (discussing the treatment of the drafting trick and *Gulf Oil Corp. v. Southland Royalty Co.*).

324. *See supra* notes 93–111 and accompanying text (treating term of years leases as freehold estates).

325. *See supra* text accompanying notes 206–08 (discussing the taxable interest of grantor and grantee).

326. *See supra* text accompanying notes 223–31 (showing the application of statute of frauds to mineral interest leases).

327. *See supra* notes 230–34 (providing Texas cases).

property law cannot be taken whole cloth and blindly applied to the nuanced, complex field of oil and gas. Thus, practical realities and a functional analysis—rather than the blind application of labels—have guided Texas courts in this arena.

Because of the functional analysis that Texas courts have taken with regard to the mineral estate—holding that every interest in the mineral estate is an interest in real (rather than personal) property—there should be no collateral consequences of changing an oil and gas lease from the traditional defeasible fee to a fixed term of years.[328] Thus, a landowner who desires a restraint on alienation will be able to achieve this result by drafting a term of years lease, and there should be no collateral consequences from this shift from defeasible fee to term.

The unique Texas oil and gas doctrines discussed in arriving at this conclusion, however, underscore why it should be unnecessary for a landowner to employ this drafting trick to achieve the desired result of an enforceable restraint on alienation.[329] The essence of Texas oil and gas doctrine is that it is a practical body of law designed to achieve common sense results in this unique industry.[330] But this is *exactly* the approach Professor Ryan and I advocated for in our previous article.[331] A Texas court that takes this approach will easily conclude that a restraint on alienation in an oil and gas lease is enforceable, regardless of the property estates label that applies to that particular lease.[332]

In any event, a Texas landowner can ensure that her desired restraint on alienation is enforceable by drafting the term of years lease suggested in this Article. My hope, though, is that Texas courts negate the necessity of this drafting trick by enforcing *all* restraints on alienation that a Texas landowner bargains for in her lease, regardless of the property estate created by the language in her lease.

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328. *See supra* Part IV (exploring the collateral consequences of creating a term of years estate).

329. *See supra* Part III (discussing the process of making an oil and gas lease in Texas).

330. *See supra* notes 135–41 and accompanying text (describing the functionalist approach taken by courts).

331. Meier & Ryan, *supra* note 1, at 313.

332. *See supra* text accompanying notes 121–27 (discussing *Gulf Oil Corp. v. Southland Royalty Co.*).