THE CURIOUS CASE OF THE MODERN NON-PARTICIPATING LEASEHOLD CO-TENANT

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INTRODUCTION TO MINERAL CO-TENANCY

- Co-tenancy: where two or more people own a possessory interest in the mineral estate of a single piece of property
- The value of mineral ownership hinges on the ability to develop the mineral estate
- In Texas, co-tenants have the right to extract minerals from common property without the consent of other co-tenants as long as he accounts to them their share of net revenue
- When leases are executed, operators take the place of mineral owners and assume all rights and duties of the co-tenancy relationship

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INTRODUCTION TO MINERAL CO-TENANCY

When an operator discovers unleased mineral ownership or co-tenants, it generally has three options:

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Execute a joint operating agreement providing who will operate the wells and division of costs and revenue	Negotiate a trade out: farm out agreement, sale of one's interest to the other, etc.	Drill on a co-tenancy basis

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INTRODUCTION TO MINERAL CO-TENANCY

- Unleased mineral co-tenants and non-participating leasehold co-tenants have long been thorns in the side of operators
- Historically, operators rarely developed a piece of land without consent of all mineral owners due to economic uncertainty
  - Non-participating co-tenants bear no risk in mineral development
  - If drilling results in a dry hole or unproductive well, the drilling party bears all financial responsibility
- An operator is entitled to recoup its reasonable and necessary costs of production
- Certainty of horizontal drilling and quicker recovery of drilling expenses have changed how operators view the risk of drilling with consent from less than all owners

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INTRODUCTION TO MINERAL CO-TENANCY

- Accelerated decline curves may make recovery of development expenses during the early "boom" production increasingly important and may offset a lower long-term net revenue interest
- Operators may retain the non-participating co-tenant's lessor's share of royalty to recover development costs quicker
- Aggressive operators may use co-tenancy to force competition out of the oilfield or washout their leases

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ACCOUNTING BETWEEN CO-TENANTS GENERALLY

- Absent an agreement, co-tenants develop minerals at their own risk and expense and must recover costs from production
- If a successful well is drilled, operators are entitled to recoup their necessary and reasonable expenses before they must account to other co-tenants
- Upon payout, each non-producing co-tenant is entitled to receive their share of the revenue, net of expenses
- Lessors may argue that their lessee has a duty to either (1) participate in development or (2) at least pay the lease royalty regardless of participation

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Title search: The Curious Case of the Modern Non-Participating Leasehold Co-Tenant

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