

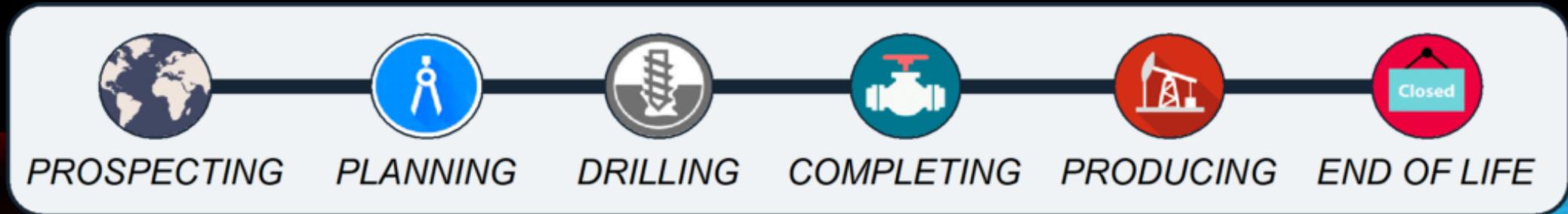
**TIME FOR A WORKOVER:
OIL & GAS IN ESTATE PLANNING
(AND PROBATE)
OR DEALING WITH WHAT COMES OUT OF THE
GROUND BEFORE (AND AFTER) THEY GO IN**

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Estate Planning Council of North Texas

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BASICS OF OIL & GAS



OWNERSHIP AND SEVERANCE

- Minerals are real property prior to extraction.
 - Minerals are subject to the ownership-in-place doctrine, whereby minerals are treated as possessory subparts of the fee simple estate.
 - Under the rule of capture, a landowner vested with full fee simple title to the land may extract and capture migratory minerals such as oil and gas.
- Upon extraction minerals become personal property once produced.
- Ownership, upon original conveyance from the sovereign, extends from the surface down to the core and out to the atmosphere, but interests can be severed and conveyed.
 - The Surface Estate
 - Entering a lease is not a severance that changes the individual holding the possibility of reverter, absent other language.
 - The Mineral Estate
 - Dominant Estate
 - Accommodation Doctrine

TYPES OF OWNERSHIP INTERESTS

Mineral interests

- A mineral interest is an interest in oil, gas and other minerals (the mineral estate), and is a possessory interest which exists prior and continues beyond a lease.
- The mineral estate is comprised of five severable rights:
 - the right to develop,
 - the executive right,
 - the right to receive bonus,
 - the right to receive delay rentals and
 - the right to receive royalty payments.

Leasehold interests

- A leasehold interest is an interest held under a lease and is contingent upon the continuation of the lease.
 - Working Interest
 - Overriding Royalty Interests.

CLASSIFICATIONS CONTINUED

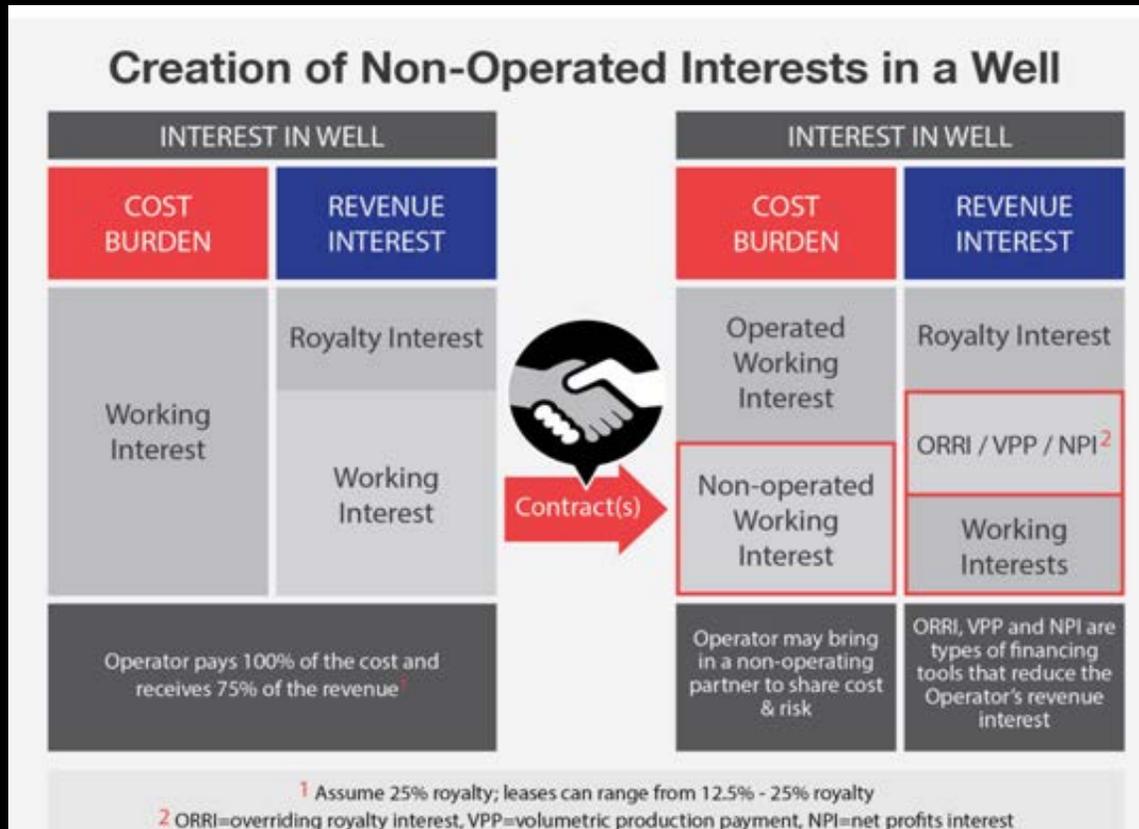
Mineral Interests



Leasehold Interests



DIFFERENCE IN INTERESTS COST BEARING AND NON-COST BEARING

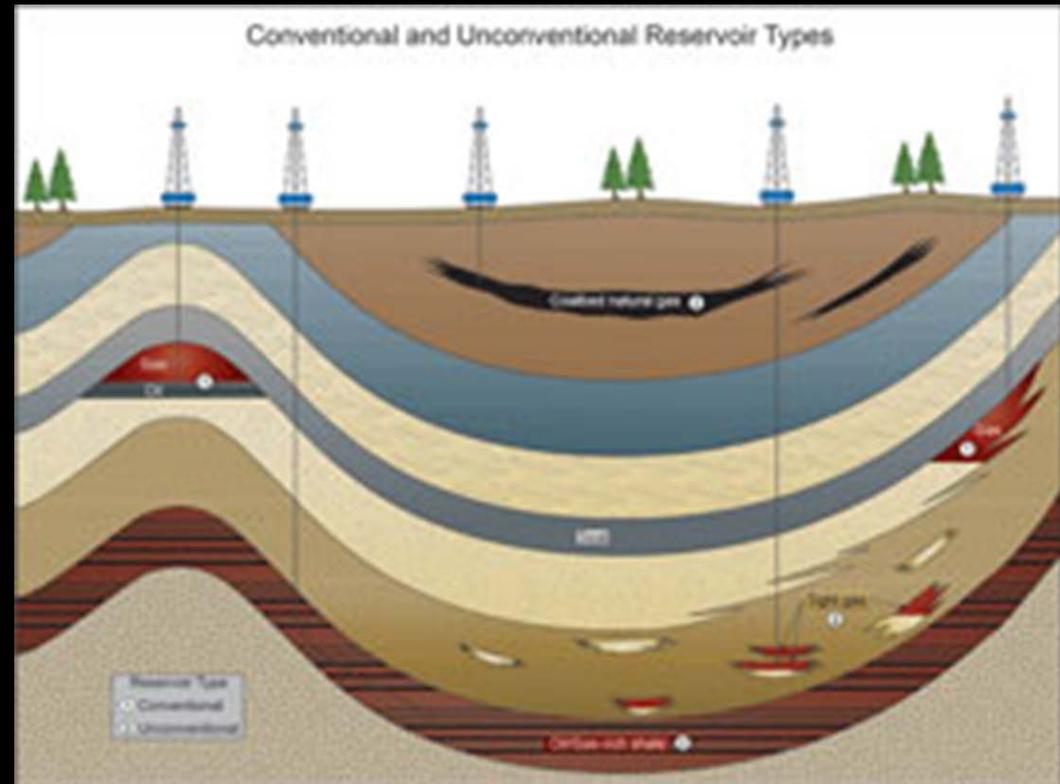
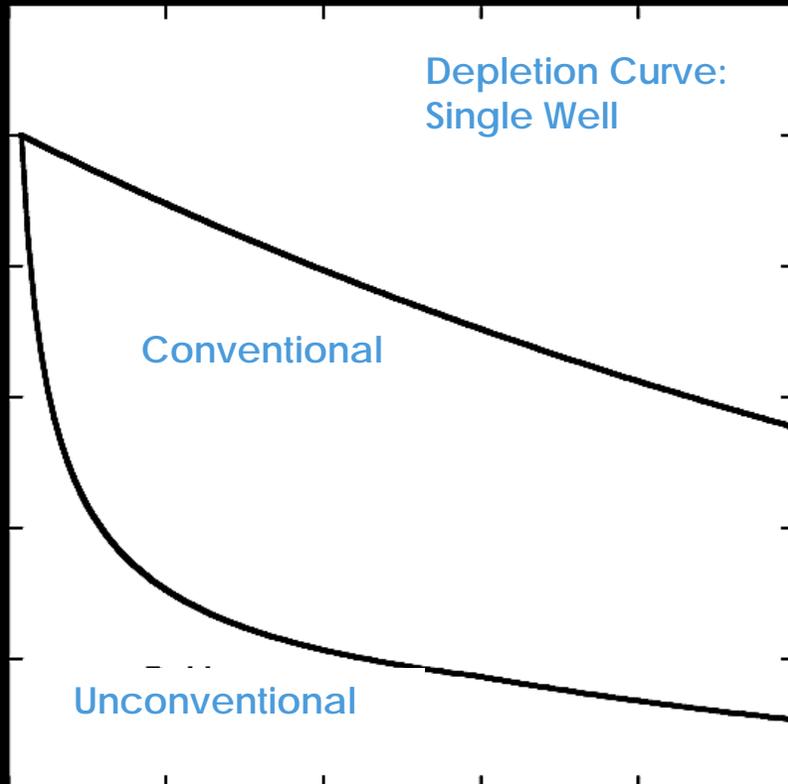


- Non-cost Bearing Interests
 - Mineral Interest
 - Royalty Interest
 - Certain Leasehold Interests
 - Overriding Royalty Interest
 - Production Payments
- Cost Bearing Interest
 - Working Interest
 - Carried Interest

MINERALS AND MARITAL PROPERTY

- Community property consists of any property, other than separate property, acquired by either or both spouses during the marriage.
 - Separate property consists of:
 - (i) any property owned or claimed by one spouse prior to the marriage;
 - (ii) any property acquired by a spouse during the marriage by gift, devise, or descent; and
 - (iii) personal injury recoveries sustained during marriage, except for loss of earning capacity during marriage.
- Inception of Title Rule
- Law of Matrimonial Domicile
- Minerals Interests as part of Homestead
- Production and sale of oil and gas a piecemeal sale of the corpus of the separate estate, and funds acquired through a sale of separate corpus remain separate property.
- Therefore, the following payments are considered a sale of separate property:
 - Royalty Payments
 - Bonus Payments
 - Working Interests
 - Potential claim of reimbursement if community funds are used to pay JIBs
- However, the following payments are not considered a sale and are community property:
 - Delay Rentals

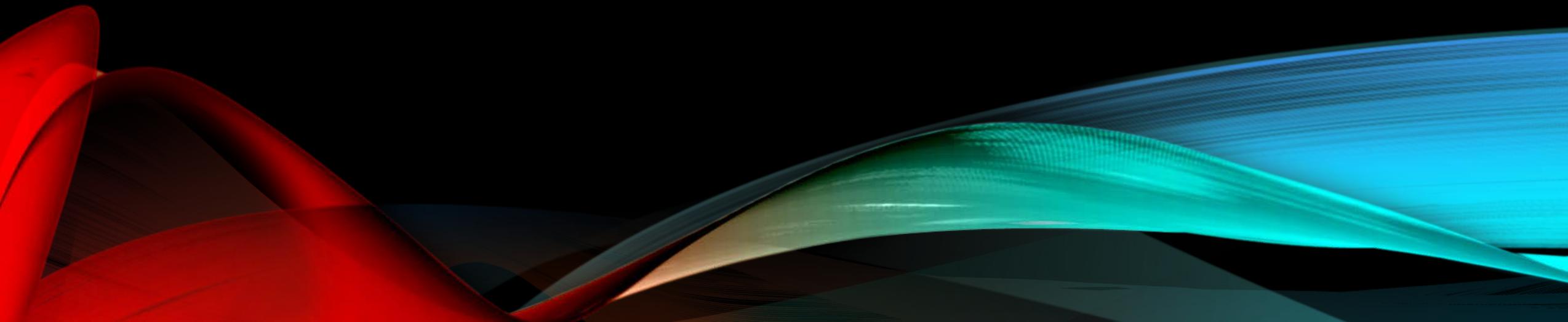
EVOLUTION OF THE DEPLETION CURVE



VALUATION OF MINERAL INTERESTS

- Informal Valuation Methods
 - Industry "Rule of Thumb":
 - 36-60 months income for non-cost bearing interests
 - Common appropriate uses:
 - Probate Inventory
 - Distribution calculations:
 - Adjustments
 - Non-pro rata distributions
 - Evaluation an offer
 - Fails to capture value of any non-producing minerals
- Formal Valuations using a Qualified Appraiser
 - Report should include
 - Relevant dates;
 - the purpose of the appraisal;
 - a description of the property;
 - a description of the appraisal process employed
 - a description of the assumptions; and
 - the information considered in determining the appraised value
 - Allows for the inclusion of proven non-producing minerals

ESTATE PLANNING WITH OIL & GAS



ESTATE PLANNING WITH REVOCABLE TRUSTS

- Outright Ownership
 - Ease of management
- Revocable Trusts
 - Will substitute
 - Posthumous Tax Planning
 - Guardianship Prevention
 - Privacy
 - Decreased Fractionalization
 - Decreased title work at death
 - Avoidance of Ancillary Probate

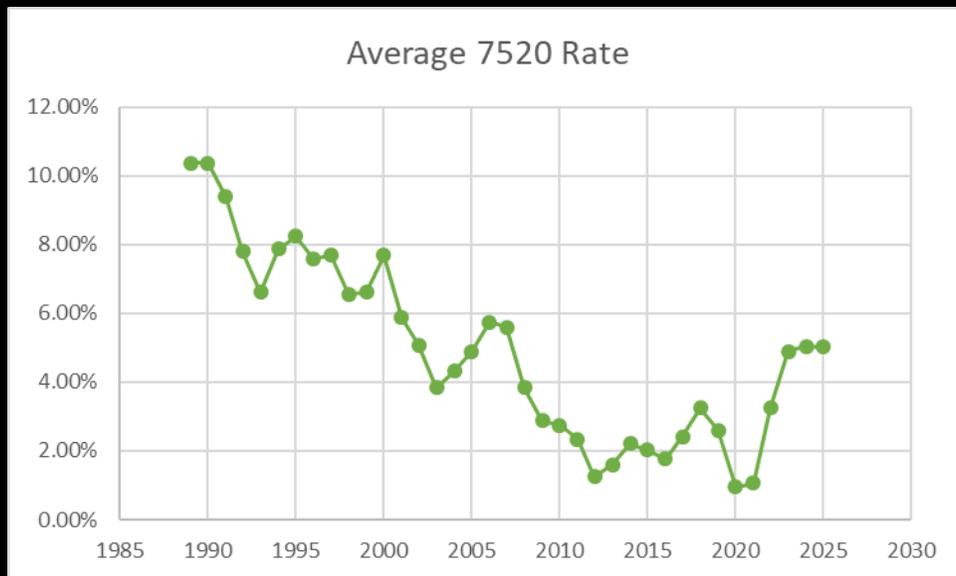


ESTATE PLANNING WITH IRREVOCABLE TRUSTS

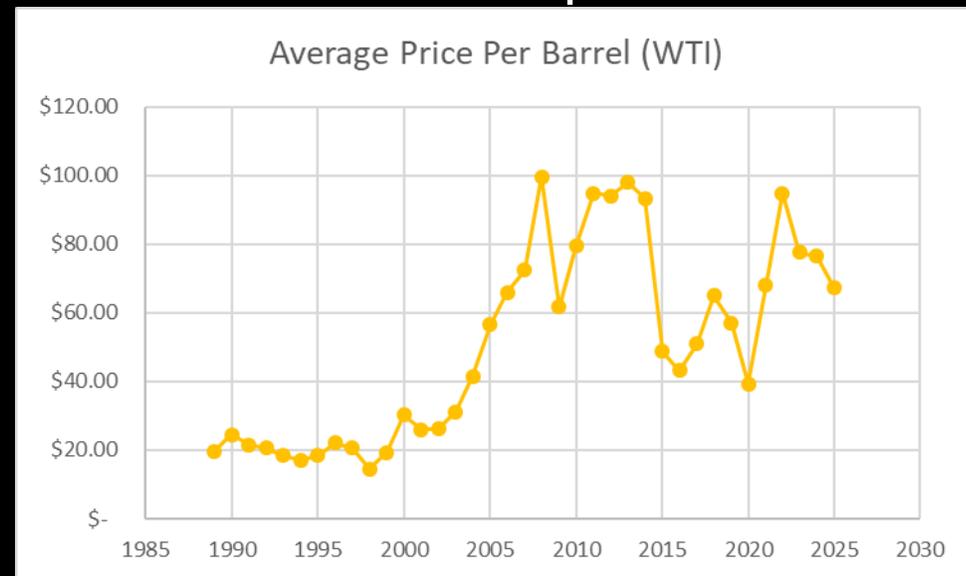


- Benefits of Irrevocable Trusts
 - Removal from the Gross Estate
 - Use of disappearing lifetime exemption
 - Use of annual exclusion gifting
 - Certain creditor protection
 - Potential use of continued rights in the Grantor
- Options
 - "Gift" (GST) Trust
 - IDGT
 - GRAT (GRIT)
 - SLAT
- Thoughtfully use techniques tied to rates

Historic Section 7520 Rate



Historic WTI Spot Price



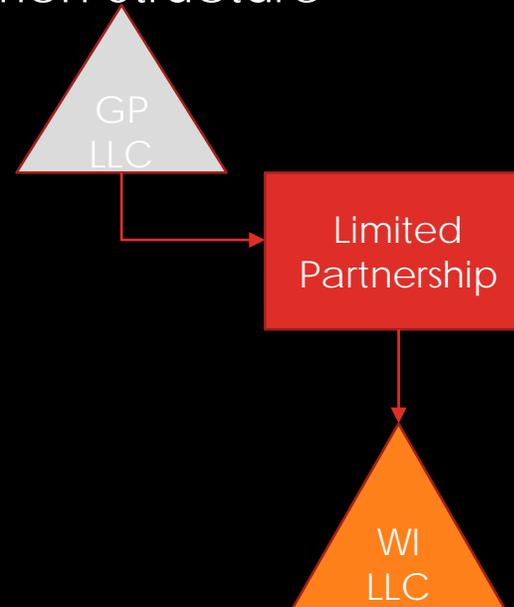
TRUST INCOME ACCOUNTING AND MINERALS

- The Uniform Principal and Income Act governs the allocation of receipts from mineral interests absent a contrary provision in the trust or will.
- It essentially abolished the “open mine doctrine” under common law with respect to a beneficiary’s interest in mineral interests, wherein the consumption and depletion of the natural resources by the income beneficiary would not constitute waste if the land was used for the activity before the life estate began.
- If the trust owned the mineral interest before January 1, 2004, the trustee may allocate receipts in accordance with Chapter 116 or in any lawful manner used by the trustee before January 1, 2004.
- Otherwise, a receipt for a delay rental or annual rent on a lease of a mineral or similar interest is allocated to income.
- A receipt from a production payment is allocated to income to the extent the agreement creating the production payment provides a factor for interest, with the remainder of the receipt allocated to principal.
- A receipt that is a royalty, shut-in-well, take-or-pay payment, or bonus is allocated “equitably” between principal and income.
- A receipt or allocation is presumed to be equitable if the amount allocated to principal is equal to the amount allowed as a deduction for depletion of the interest for federal income tax purposes.

ESTATE PLANNING WITH ENTITIES

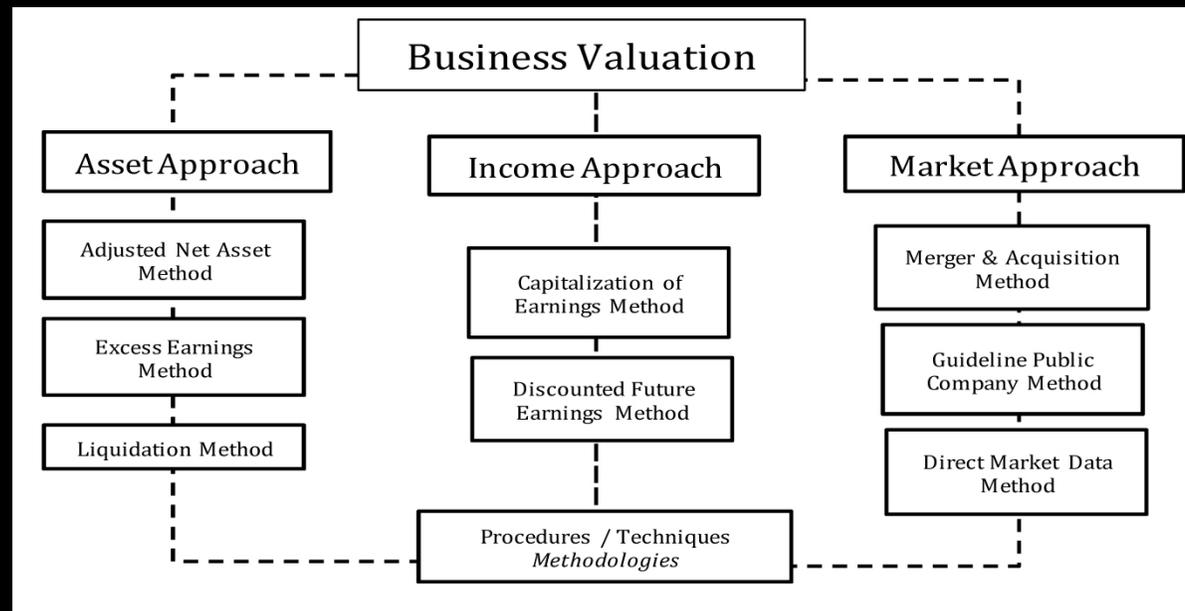
- Advantages and Purposes
 - Asset protection
 - Segregation of non-cost bearing and cost bearing interests
 - Centralized Management
 - Management retained in knowledgeable parties
 - Decreased fractionalization
 - Minimized title requirements over successive generations
 - Additional compression of value
- Common Structure
 - Limited Partnership wherein:
 - General Partner is an LLC and
 - Limited Partners are intended beneficiaries (or trusts)
 - Cost bearing interests are in separate LLC

- Common Structure



VALUATION OF ENTITY INTERESTS

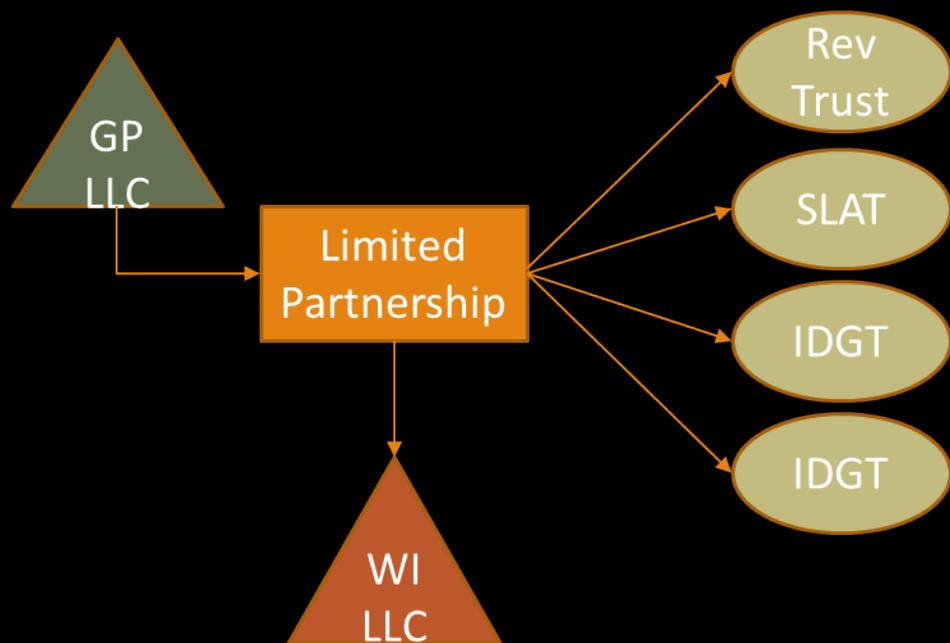
- Standard
 - Discount for Lack of Control
 - Discount for Lack of Marketability
- Layered Asset Valuations
- Undervaluation Penalties
 - Substantial Valuation Understatement
 - Gross Valuation Understatement



ESTATE PLANNING: GIFTS OR SALES

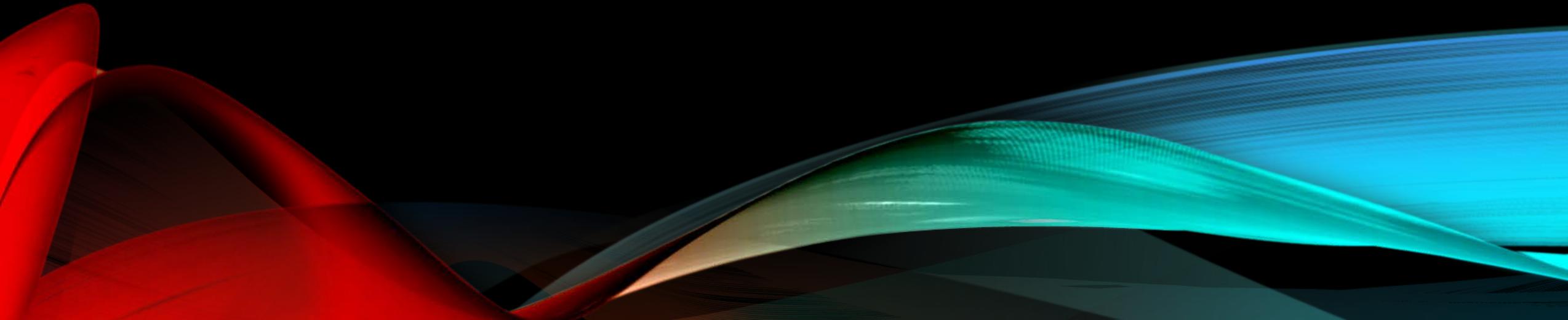
- Gifting
- Intentional gratuitous transfer of an asset to another
 - Includes transfers for less than full and adequate consideration
- Types of Gifts
 - Annual Exclusion Gifts
 - Gift splitting
 - Taxable Gifts
 - Lifetime exemption application
 - Gift Tax Return (Form 709)
 - Generation Skipping Tax
 - Defined Value Gifts
- Sales
- Transfer of assets for full and adequate consideration
- Types of Sales
 - Cash
 - Financed
- Often choose to report sales in estate planning on a Gift Tax Return to start the tolling of the statute of limitations

COMBINING TECHNIQUES



- Entity Structure:
 - Crude LP was funded with royalty interests.
 - Crude Management, LLC is the General Partner of Crude LP
 - Crude Oil & Gas, LLC is funding with working interests
- Ownership of Crude LP:
 - Owner retains $\frac{1}{4}$
 - Owner gifts $\frac{1}{4}$ to SLAT for Spouse
 - Owner and Spouse gift seed money to IDGTs, (one per child), which each then purchases a $\frac{1}{4}$ interests in Crude LP

ESTATE ADMINISTRATION WITH OIL & GAS



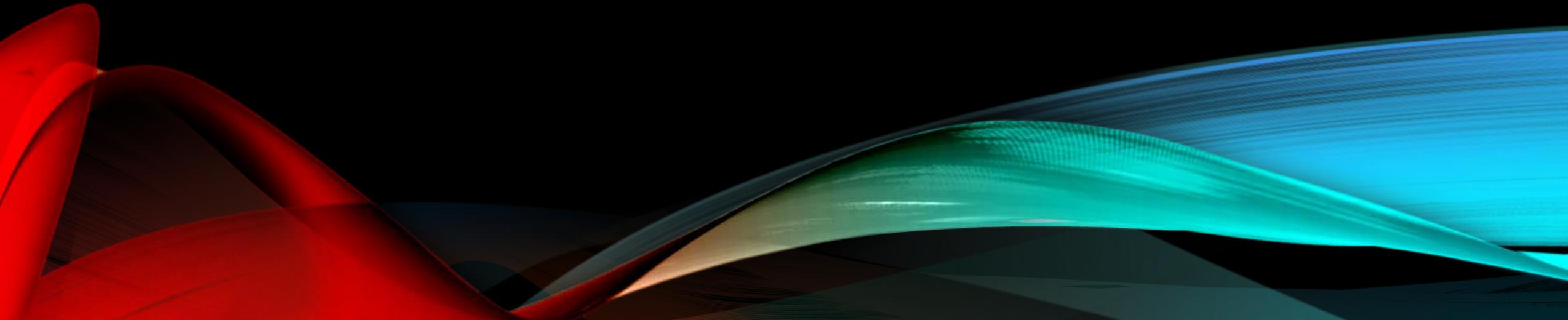
MANAGEMENT AUTHORITY IN ADMINISTRATION

- Routine Administrative Actions
 - Right to Receive Payments
 - Right to Execute Administrative Documents
 - Division Orders
 - Transfer Orders
 - Other Requested Documentation
 - Right to Pay Reasonable Expenses
 - Lease Operating Expenses
 - Repair
 - Workover
 - Other Routine Expenses
- Extraordinary Expenses
 - Drilling Expenses
 - May be essential for preservation of a lease
 - But can be very costly and with a high degree of risk
 - Look to the will for further powers of the executor
 - Otherwise, it is recommended to obtain the consent of beneficiaries or seek declaratory judgment pursuant to the Estates Code

MANAGEMENT AUTHORITY IN ADMINISTRATION

- Authority of Executor to Execute a Mineral Lease
- Fee simple determinable, therefore, the Estates Code provision related to a one year lease is inapplicable.
- Additionally it is a sale of real property interests requiring either:
 - (i) power of sale under a will, or
 - (ii) a court order.
- While often advantageous to the estate and beneficiaries to enter a lease if presented with an offer, it is important to negotiate the terms for the benefit of the future beneficiaries of the assets.
 - Additionally, it may be prudent to seek the consent of the ultimate takers of the interest; or,
 - Seek declaratory judgment.

PERFECTING TITLE



BASICS OF CONVEYANCING

- As an interest in real property, oil & gas interests are conveyed and recorded in the real property records of the county in which the property lies.
 - Mineral or royalty interests should be transferred by deed as they are rights in the minerals held in the ground.
 - Leasehold interests should be transferred by an assignment as they run with the lease and terminate if the lease terminates.
- A clean date of distribution is often highly preferred by the operator.
 - The last or first day of the month or quarter if possible
- As with other real property, the conveyancing instrument may be done via:
 - General Warranty
 - Special Warranty
 - Deed without Warrant
 - Quitclaim

Similarly, it is useful to remember the community property rules which may apply to the ownership of the property and inclusion of a spousal signature or clear language indicating ownership as either sole-management community property or sole and separate property.

INFORMATION REQUIRED IN A CONVEYANCE

- Statute of Frauds
 - In writing;
 - Signed by the Grantor;
 - Properly acknowledged;
 - Adequately describe the property; and,
 - To be valid, a conveyance of real property must contain a sufficient description of the property to be conveyed either in the writing itself, or by reference to some other existing writing, the means or data by which the property may be identified with reasonable certainty.
 - May use blanket conveyancing language.
 - The instrument must be delivered.
 - Delivery is required, but it need not be actual or immediate.
- Recitals are particularly helpful to the title examiner.

PERFECTING TITLE IN ESTATE PLANNING

- Whether it's the funding of a trust or an entity the use of blanket conveyances is highly recommended.

- Use limiting language to prevent catching unintended property.

Proper party to the conveyance:

- J.D. Clampett, Trustee of the Jethro Bodine Mineral Trust
 - Clampett Royalty, LLC, by J.D. Clampett, Member

- If planning in an entity and then to trust(s), while record title to the underlying assets may be properly held by the entity, it is important to properly update minute books and ownership ledgers to reflect gifts and sales.

PERFECTING TITLE FOLLOWING ADMINISTRATION

- A distribution deed from the fiduciary helps the title attorney navigate the transaction quickly and with greater clarity.
- Instances with increased importance:
 - Sale of property during administration
 - Particularly in intestate administration
 - Or will failed to provide a power of sale
 - Non-pro rata distributions
 - Upon application of formula clauses
 - Upon agreement of the parties
 - Upon the discretion of the fiduciary
 - Latent ambiguity in takers
- Use blanket conveyance out of estate!
- Necessity of Recording the 'Probate Transcript'
 - Sufficient to perfect title in beneficiaries in certain instances
 - Includes:
 - Application for probate of will
 - Decedent's will
 - Order admitting will to probate
 - Citation and return of service
 - Any disclaimer's by a devisees
 - Letters testamentary

ADDITIONAL INFORMATION FOR OPERATOR



MM

Division Order

Reference:
 MIRA MAY COMPANY
 479 TRAVIS ST.
 HOUSTON, TX 77002

Analysis Initials: BSC
Division Order: 12000
Date Issued: 04.29.11
Date Effective:

Well Reference Number:
Well Name: 20101
Plant: NORTHWEST TEXAS GAS PLANT
Property Name: BLUE INLET - TIGER
Product: ALL ASSOCIATED PRODUCTS
Operator: ACME PRODUCTION
County and State: TRAVIS, TX

Owner No.	Owner	Percent Interest & Type
11794	ACME PRODUCTION	80.00000000% NI
1754	ROD & MARTHA SMITH	10.00000000% RI
17487	RYAN TRUST	1.00000000% RI
17540	NUAN SMITH	1.00000000% RI

The undersigned certifies: (1) the accuracy of the above percent interest in production or proceeds, and the right to receive the above percent interest in production or proceeds, or (2) the right to receive the above percent interest in production or proceeds, and authorize MIRA MAY COMPANY to distribute such production or proceeds to the undersigned in accordance therewith.

The undersigned agrees to indemnify and hold harmless MIRA MAY COMPANY any amount attributable to an interest erroneously claimed herein by the undersigned.

MIRA MAY COMPANY is authorized to withhold payment pending resolution of a title dispute or adverse claim asserted regarding an interest claimed herein by the undersigned.

MIRA MAY COMPANY may receive proceeds semi-annually or until the total amount received equals \$100.00, whichever occurs first, or as required by applicable state statute.

The undersigned, or their authorized representative, shall notify MIRA MAY COMPANY in writing of any change in ownership, percent interest, or payment address. All such changes shall be effective the first day of the month following receipt of such notice.

- Letter in Lieu of Division Order
- Provides notice to operator on change of ownership and information for new Payees.
- Should include:
 - Operators information
 - Known well information
 - Prior ownership
 - Reason for transfer of ownership
 - Name and Contact for new owners
 - W-9 for new Payees

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