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Best Practices for Busy Attorneys: Real Property and Oil and Gas Issues

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Ms. Gartland is a partner of her firm and regularly advises clients in the acquisition, sale, development, leasing and financing of real property. She also represents clients in connection with oil and gas transactions, including acquisitions, dispositions, joint ventures, lending, title matters, and leasing. Ms. Gartland is a fellow of the American College of Real Estate Lawyers and currently serves as chair of the Real Property Law Section Council of the Ohio State Bar Association. Ms. Gartland is also active with the Energy Mineral Law Foundation where she serves on its Board of Trustees, and she actively participates in CREW Columbus. She has authored a variety of articles and is a frequent lecturer on both real property issues and oil and gas related matters. For additional information, please visit www.vorys.com.

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Best Practice for Busy Attorneys: Real Property and Oil and Gas Issues

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I. Approaching Real Property Issues

A. Start with the statutes.

1. Title 53 of the Ohio Rev. Code provides much of the framework for real property transactions, including acknowledgment requirements (§ 5301.01); marketable title requirements, limitations and exceptions (§§ 5301.47 – 5301.56); forms of conveyance (Chapter 5302); lease requirements and the landlord-tenant relationship (Chapter 5321).
2. Real property taxes are governed by Chapter 5713 of the Ohio Rev. Code.
3. Issues relating to state-, county-, township-, and other government-owned lands are addressed in the Ohio Rev. Code chapter governing each respective entity.

B. The Ohio Title Standards also provide guidance as to marketability of title and many common title issues.

1. The Ohio Title Standards do not have the force of law, but do serve as guidelines to best practices.
2. The Ohio Title Standards do not specifically address the unique issues relating to mineral title examination.

C. Know when to ask for help!.

II. Recent Updates to Ohio Real Property Law

A. Ohio Rev. Code § 5301.36.

Requires mortgagees to file a satisfaction of mortgage of record within 90 days after the mortgage has been satisfied. This section previously only applied to residential mortgages, but, as of March 23, 2015, applies to all mortgages. The revised statute also provides a notice procedure, cause for civil action and damages for failure to comply.

B. Ohio Rev. Code § 5301.09:

Requires oil and gas leases and assignments thereof to be filed of record. Effective March 23, 2015, this section now specifically provides that leases and licenses "by which any right is granted to operate or to sink or drill wells thereon for natural gas and petroleum or either, or pertaining thereto" "*create an interest in real estate*."

III. Real Property Basics

A. Ownership of real property.

1. Ownership of real property as a "bundle of sticks" – a collection of rights that can be separated but, together, make up the whole of all possible interests in a certain piece of real property.
2. "Fee" or "fee simple" or "fee simple absolute" – an estate of indefinite or potentially infinite duration. "Fee" generally refers to ownership of the entire bundle of sticks. However, be aware that common usage and meaning may vary by region. In some areas, these terms are used to mean ownership of real property "from heaven to hell." In others, it may be common to refer to ownership "in fee" of the surface estate, oil and gas estate, etc.
3. Co-tenancy in Ohio.
    a. Tenancy in common is the "default" form of ownership by more than one person under Ohio law. Unless the language of a deed (or other instrument of conveyance) specifies otherwise, "if any interest in real property is conveyed or devised to two or more persons, such persons hold title as tenants in common and the joint interest created is a tenancy in common." (Ohio Rev. Code § 5302.19). Tenants in common each have an undivided, fractional share of the real property, which they may use and transfer as a full owner.
    b. Joint tenancy with right of survivorship is a form of ownership created by statute (Ohio Rev. Code § 5302.20). Joint tenants with right of survivorship own their respective shares of the title so long as all are living. Upon the death of any joint tenant, that person's title vests in the surviving joint tenants.
        i. The statutory language for creation of a survivorship tenancy is "to A and B, for their joint lives, remainder to the survivor of them." (Ohio Rev. Code § 5302.17). However, any deed (or other instrument of conveyance) that evidences an intent to create a survivorship tenancy is liberally construed to do so.
        ii. If there are only two joint tenants and they are married to each other, the survivorship tenancy automatically terminates and becomes a tenancy in common upon divorce. If the survivorship tenancy consists of two joint tenants who are married and one or more others, the survivorship tenancy is not affected by the divorce of the married joint tenants.
    c. Tenancy by the entireties no longer exists in Ohio, but was permitted by statute from 1972 to 1984. During that time, a tenancy by the entireties was automatically created when real property was conveyed to a husband and wife. Tenancies by the entireties created during that time are still valid, although new tenancies by the entireties cannot be created.

B. Transfer of ownership interests in real property.

1. By deed.

a. General warranty deed (Ohio Rev. Code § 5302.05).

i. By conveying with general warranty covenants,

> *The grantor covenants with the grantee, his heirs, assigns, and successors, that he is lawfully seized in fee simple of the granted premises; that they are free from all encumbrances; that he has good right to sell and convey the same, and that he does warrant and will defend the same to the grantee and his heirs, assigns, and successors, forever, against the lawful claims and demands of all persons.*

(Ohio Rev. Code § 5302.06.)

ii. General warranty covenants cover all adverse claims, regardless of when they arose.

b. Limited warranty deed (Ohio Rev. Code § 5302.07).

i. By conveying with limited warranty covenants,

> *The grantor covenants with the grantee, his heirs, assigns, and successors, that the granted premises are free from all encumbrances made by the grantor, and that he does warrant and will defend the same to the grantee and his heirs, assigns, and successors, forever, against the lawful claims and demands of all persons claiming by, through, or under the grantor, but against none other.*

ii. Limited warranty covenants cover only adverse claims that arose during the period of the grantor's ownership.

c. *Note*:

In warranty deeds, certain encumbrances are commonly excepted from the conveyance and the warranty contained therein, *e.g.*, "subject to all applicable zoning ordinances, legal highways, taxes and assessments, if any, not yet due and payable, all applicable restrictions, conditions, limitations, rights of way, reservations and easements of record."

d. Quit-claim deed (Ohio Rev. Code § 5302.11).

i. Grant does not include any covenant language; grantor does not warrant against any adverse claims.

ii. Quit-claim deeds are often used to adjust legal descriptions, fix scrivener's errors in prior deeds, and cure title defects.

e. The Ohio Rev. Code also provides statutory forms for fiduciary deeds (§ 5302.09), mortgages (§ 5302.12) and survivorship deeds (§ 5302.17).

2. By inheritance/through probate.

a. Transfer on death designation affidavit (Ohio Rev. Code § 5302.22).

   i. Property owner files an affidavit providing that his or her interest in specified real property transfers to a designated beneficiary or beneficiaries upon his or her death.

   ii. One benefit is that the real property transfer does not require probate; title vests in the beneficiary or beneficiaries immediately upon the property owner's death. In order to evidence the transfer of record, the transfer on death beneficiary or beneficiaries must file an affidavit of confirmation of record in the county in which the real property is located.

   iii. The beneficiary of a transfer on death affidavit has no present interest in the property, and takes only the interest that the deceased owner of the interest held on the date of death, subject to all encumbrances, reservations, and exceptions.

   iv. A transfer on death designation may be revoked during the grantor's lifetime.

b. Affidavit of heir or next of kin by intestacy (Ohio Rev. Code § 317.22(B)).

   i. The real property interests of an owner that dies intestate automatically vest in such owner's heirs upon his or her death, subject to the right of an administrator to sell the property to pay off debts, in accordance with the laws of intestate succession.

   ii. If nothing is filed of record evidencing that title has passed in accordance with the laws of intestate succession, then, prior to conveying their interests to a third party, the heir(s) (or two Ohio residents with personal knowledge of the facts) must present an affidavit to the county auditor, which sets forth information regarding the ancestor's death, intestacy, and heirship. The affidavit must then be recorded in the county recorder's office prior to any deed by which the heir(s) convey their interests.

c. Certificate of transfer (Ohio Rev. Code § 2113.61).

   i. The probate court, typically upon the application of the administrator or executor, issues a certificate of transfer from the estate of a decedent to the grantees, as determined by the will, intestate succession or other probate proceedings. The certificate of transfer is filed in the recorder's offices of the county in which the real property is located, and is effective as of the date of death.

   ii. If there is no probate/administration of an estate, an heir or other successor-in-interest may file an application for a certificate of transfer with the probate court of the county in which the real property is located.

iii. Similarly, if the estate was probated in another jurisdiction, the foreign executor or administrator may file an application for a certificate of transfer with the probate court of the county in which the real property is located.

3. By court order.

a. A court proceeding over a quiet title action, partition action, divorce proceeding or other matter may determine ownership of real property and enter an order or decree to that effect.

b. The court may order the parties to carry out the determination of ownership by executing and recording deeds or other instruments.

c. Alternatively, the court may include in its order instructions for the clerk of court to file the order itself in the county recorder's office, in which case it may have the effect of recording a deed.

C. Lease of real property.

1. Leases for a term of more than three years must be acknowledged in accordance with Ohio Rev. Code § 5301.01. Regardless of the term, a lease that is going to be recorded must be acknowledged.

2. Oftentimes, the parties do not want to record the full lease (for example, because they do not want the rent amount to be made public). Ohio Rev. Code § 5301.251 permits a memorandum of lease executed and acknowledged in accordance with Ohio Rev. Code § 5301.01 to be recorded, instead. A memorandum of lease must contain the names and addresses of the lessor and lessee, a reference to the full lease with its date of execution, a description of the leased property sufficient to identify the property, the term of the lease, any rights of renewal or extension, and the date of commencement or manner of determining the date of commencement.

3. Residential leases are governed by Chapter 5321 and subject to statutory obligations of the landlord (Ohio Rev. Code § 5321.04) and tenant (Ohio Rev. Code § 5321.05). Those obligations cannot be "written out" of the lease terms. Any provisions attempting to circumvent these statutory requirements are deemed invalid.

IV. Common Title Issues

A. Ownership of real property held by a trustee of a trust.

1. A conveyance of real property to a trust is *invalid*. *But*, Ohio has a curative statute to address this (Ohio Rev. Code § 5301.071(E)(1)) – a conveyance to a trust is to be considered as a conveyance to the trustee of the trust if:

a. The trust named as grantor or grantee has been duly created under the laws of the state of its existence at the time of the conveyance, and

b. A memorandum of trust that (1) complies with Ohio Rev. Code § 5301.255 and (2) contains a description of the real property conveyed by that instrument is recorded.

2. A conveyance to a "trustee" of an ***undisclosed trust*** is insufficient to establish that a trust exists. Such a conveyance does not give notice that a trust exists or that there are any beneficiaries other than the grantees.
    a. Subsequent bona fide purchasers, mortgagees, etc. take free of any claims of the undisclosed beneficiaries.
    b. A subsequent conveyance from the grantee, individually, or as "trustee" (with no named trust) is valid.
    c. Example: If the first conveyance is from "A to B, as Trustee", a subsequent conveyance from "B to C" or from "B, as Trustee, to C" is valid.
3. Memorandum of Trust (Ohio Rev. Code § 5301.255): A recorded instrument that complies with this statute evidences the authority of a trustee to act on behalf of the trust.
4. In practice, authority issues are limited by Ohio Rev. Code § 5810.12 – "a person other than a beneficiary who in good faith deals with a trustee is not required to inquire into the extent of the trustee's powers or the propriety of their exercise."
5. In order to avoid future problems, when a real property transaction involves a trust, ***best practice*** is to require that a memorandum of trust is recorded and to confirm that the trustee is either (i) specifically authorized to acquire, transfer and/or encumber real property, as necessary for the transaction at hand, or (ii) authorized to perform the "specific powers" identified in Ohio Rev. Code § 5808.16, which include acquisition, sale, lease and encumbrance of real property.

B. Power of attorney.

1. In Ohio, a power of attorney authorizing the conveyance, mortgage or lease of real property must be recorded in the recorder's office of the county in which the property is located, prior to the recording of any deed, mortgage or lease executed under such power of attorney.
2. A power of attorney may be revoked, and such revocation must also be recorded.
3. Ohio does not limit the responsibility of third parties to inquire into the authority of an attorney-in-fact (as it does with respect to trustees), so ***best practice*** in a real property transaction involving a power of attorney is to confirm that (i) a power of attorney, which specifically authorizes the attorney-in-fact to execute deeds, leases and/or mortgages, has been properly acknowledged and recorded and (ii) the execution by the attorney-in-fact of any instruments relating to real property occurred after the date of execution of the power of attorney and prior to the date of execution of any revocation of the power of attorney.

C. Dower.

1. Ohio is one of the few states that has not abolished dower - Surviving spouse is seized with a life-estate in one-third of the deceased (record owner) spouse's real property. This applies to any property that the deceased spouse held during the marriage.

2. The dower interest terminates upon the death of the record-owner spouse except in two circumstances:
    a. Where the record-owner spouse conveyed the property during the marriage and the surviving spouse did not release dower.
    b. Where the property was affected by a mortgage or other encumbrance and the surviving spouse did not release dower.
3. Otherwise, the surviving spouse's dower interest automatically terminates upon the surviving spouse's death; divorce decree; and certain other occurrences (e.g., adultery, waste)
4. In any real property transaction in which an individual record owner of real property is executing any instrument relating to that property, *best practice* is to determine whether the record owner is married (and to state the same in the instrument) and, if so, ensure that the individual's spouse also executes all instruments relating to real property. If for some reason, the record owner's spouse has not executed all instruments, obtain and record the following:
    a. In the case of a deed that was not signed by a record owner's spouse, either (i) a corrective deed executed by the record owner and his or her spouse, or (ii) a quit-claim deed executed by the record owner's spouse.
    b. In the case of a lease, mortgage or other encumbrance that was not signed by the record owner's spouse, a ratification of the lease, mortgage or other encumbrance by the record owner's spouse.
5. Under Ohio law, an instrument does not need to specifically state that the record owner's spouse is releasing his or her dower in the real property; execution of the instrument by the record owner's spouse is sufficient to release any dower rights.

D. Acknowledgement.

1. Statutory forms of acknowledgement by an individual, on his or her own behalf, on behalf of an entity and as trustee or personal representative are provided in Ohio Rev. Code § 147.55.
2. *Best practice* is to use the statutory forms and to insert the acknowledgement directly below the signature of the person being acknowledged.
3. An unacknowledged (or improperly acknowledged) instrument remains effective between the parties thereto, but does not provide notice to third parties, even if the instrument is recorded.
4. Ohio has curative statutes (Ohio Rev. Code §§ 5301.07 and 5301.071), which validates instruments containing certain defective acknowledgements:
    a. The officer taking the acknowledgment of the instrument having an official seal did not affix that seal to the certificate of acknowledgment.
    b. The certificate of acknowledgment is not on the same sheet of paper as the instrument.

c. The executor, administrator, guardian, assignee, or trustee making the instrument signed or acknowledged the same individually instead of in a representative or official capacity.

d. The instrument has been of record for more than 21 years.

E. Legal descriptions.

1. Under the Ohio Title Standards,

> *[e]rrors, irregularities and deficiencies in property descriptions in the chain of title do not impair marketability unless, after all circumstances of record are taken into account, a substantial uncertainty exists as to the land which is conveyed or intended to be conveyed, or the description falls beneath the minimal requirement of sufficiency and definiteness which is essential to an effective conveyance.*

2. The severity of an error in legal description depends on the circumstances. For example, a typographical error that identifies the wrong unit number in a condominium can result in the conveyance of the wrong property.
3. Be aware (and wary) of copy and paste errors.
4. *Best practice* to avoid potential issues later is to check and re-check legal descriptions. Check them against the prior conveyance of record and the survey, if any.

V. Overview of Oil and Gas Interests

A. Ownership of oil and gas.

1. Unless specified otherwise (or previously severed from the surface), ownership of the oil and gas is transferred along with the surface.
2. The oil and gas interest is one "stick" of the "bundle of sticks" that may be conveyed separately or reserved to the grantor in the conveyance of other of property rights related to a piece of land. NOTE, however, that a reservation cannot be made to a third party.
3. Other incidents of ownership of oil and gas interests include:
   a. The owner of oil and gas interests has the right to develop that interest at its own cost and profit therefrom.
   b. The owner of an oil and gas interest may also grant the right to develop to a third party, i.e., execute an oil and gas lease.
   c. The oil and gas estate is considered "dominant" to the surface estate. The oil and gas owner has the right to reasonably use the surface to explore for, develop and produce the oil and gas.
4. The oil and gas interest may be further divided into fractional interests, or separated by depth/formation.

B. Oil and gas lease.

1. With the revision to Ohio Rev. Code § 5301.09, it is clear that oil and gas leases create an interest in real estate; however, the nature of that interest is unsettled under Ohio law. Oil and gas leases have been characterized as creating leases, licenses, rights, easements, and/or fee interests in real estate.
2. Basic provisions of an oil and gas lease:
    a. Grant: conveys the rights to be enjoyed by the lessee under an oil and gas lease, usually including the right to explore, develop, produce, store, and transport oil, gas and other hydrocarbons.
    b. Term: defines the period during which a lease will be effective. Oil and gas leases typically incorporate primary terms and secondary terms. The primary term is a fixed period (e.g., five years) during which the lessee must drill or pay a delay rental (which are now commonly paid for the entire primary term up front). The secondary term is not a fixed period of time, but typically extends "as long thereafter as oil or gas and associated hydrocarbons are produced in paying quantities."
    c. Royalty: how much of production, as a fraction or percentage, is to be delivered to the lessor or to the lessor's credit.
    d. Pooling: permits the lessee to combine the acreage subject to the lease with acreage subject to other leases to form a drilling unit. The pooling provision may limit the total amount of acreage that may be combined.
    e. Assignment by Lessor: specifies what notice must be given to the lessee regarding a change in the lessor's ownership before the lessee is obligated to recognize a change in ownership of the oil and gas interest. This provision protects the lessee from making improper payments under the lease.
    f. Assignment by Lessee: may restrict the lessee's ability to convey its interest without the prior written consent of the lessor.
    g. Warranty: the lessor guarantees that he or she holds title to the oil and gas interests being leased, and that it is without defect. If the warranty is breached, the lessee may recover money paid to the lessor.
    h. Pugh Clause: provides that acreage that is not part of a pooled unit will be released from the lease at the end of the primary term. Oil and gas leases may contain a horizontal Pugh Clause (relating to the surface), vertical Pugh Clause (relating to a specific depth), or both.
3. Unless otherwise specified in the conveyance, the lessor's interest in an oil and gas lease (including the right to receive royalty payments) is transferred upon a conveyance of the lessor's interest in the property, including the oil and gas interests.

C. Description of interests in oil and gas/leasehold.

1. Working Interest: owned by the operator/lessee, and bears the expense of oil and gas production.

2. Royalty Interest: lessor's interest in production.
3. Nonparticipating Royalty Interest: expense-free interest in production that comes out of the owner's/lessor's interest; no executive rights (i.e., rights to lease).
4. Overriding Royalty Interest: expense-free interest in production that comes out of the working interest owner's/lessee's interest.
5. All of these interests add up to 100 percent of the production proceeds.

VI. Dormant Mineral Act (Ohio Rev. Code § 5301.56)

A. Effective March 22, 1989 (the "**1989 DMA**"); subsequently amended on June 30, 2006 (the "**2006 DMA**"); and further amended effective January 30, 2014.

B. Operates to vest a severed mineral interest in the owner of the surface under certain circumstances.

C. Under the 1989 DMA, a mineral interest held by any person other than the owner of the surface "shall be deemed abandoned and vested in the owner of the surface" unless (a) the mineral interest is in coal, (b) the mineral interest is held by the United States, the State of Ohio or any political subdivision thereof or (c) within the preceding twenty years one or more of the following has occurred (each, a "**Savings Event**"):

1. The mineral interest has been the subject of a recorded title transaction;
2. A claim to preserve the interest has been recorded;
3. There has been actual production;
4. The mineral interest has been used in the underground storage of natural gas;
5. A drilling permit has been issued to the holder of the mineral interest and an affidavit in accordance with Ohio Rev. Code § 5301.252 has been filed in the office of the county recorder; or
6. A separate tax parcel number has been created by the county taxing authorities.

D. Unresolved issues concerning the 1989 DMA:

1. Whether the 1989 DMA is self-executing – whether, if no Savings Event occurred within the applicable twenty-year examination period, the mineral interest was automatically abandoned and vested in the owner of the surface, or whether the 1989 DMA required an affirmative act by the owner of the surface to effectuate the abandonment.
    a. The Seventh District Court of Appeals, which has jurisdiction over Belmont, Carroll, Columbiana, Harrison, Jefferson, Mahoning, Monroe and Noble Counties, recently held that the 1989 DMA is self-executing. *Swartz v. Householder*, 7th Dist. Jefferson No. 13 JE 24, 2014-Ohio-2359 (June 2, 2014).
    b. The Fifth District Court of Appeals, which has jurisdiction over Ashland, Coshocton, Delaware, Fairfield, Guernsey, Holmes, Knox, Licking, Morgan, Morrow, Muskingum, Perry, Richland, Stark and Tuscarawas Counties, also recently held that the 1989 DMA is self-executing. *Wendt v. Dickerson*, 5th Dist. Tuscarawas No. 2014 AP 01 0003 (Oct. 16, 2014).
    c. This issue is currently pending before the Supreme Court of Ohio.

2. Whether the application of the 1989 DMA is subject to a fixed or rolling 20-year examination period – assuming that the 1989 DMA is self-executing, the specific time period(s) encompassed by the phrase "*within the preceding 20 years*" found in the 1989 DMA is subject to different interpretations.

    a. One interpretation is that this language creates a fixed examination period of the 20 years preceding March 22, 1992 (which is the effective date of the 1989 DMA, plus a statutory 3-year grace period).

    b. Another interpretation is that this language creates a rolling examination period from the 20 years preceding March 22, 1989 until the effective date of the 2006 DMA on June 30, 2006. For a discussion of the fixed examination period and rolling examination period, *see Eisenbarth v. Reusser*, 7th Dist. Monroe No. 13 MO 10, 2014-Ohio-3792 (Aug. 28, 2014) (holding that the 1989 DMA creates a fixed examination period).

E. The 2006 DMA keeps most of the provisions of the 1989 DMA intact, but the 2006 DMA redefines the applicable examination period during which a Savings Event must occur in order to preserve a mineral interest. Under the 2006 DMA, a Savings Event must occur "within the twenty years immediately preceding the date on which notice [of the surface owner's intent to declare the severed mineral interest abandoned] is served or published." Additionally, the 2006 DMA significantly alters the procedure for declaring a severed mineral interest abandoned and vested with the owner of the surface.

F. To trigger the abandonment of a severed mineral interest, the owner of the surface must follow the procedure set forth in the 2006 DMA.

    1. Notice of Abandonment (to each holder of a severed mineral interest or each holder's successors or assignees; if not possible, then may serve notice by publication in at least one newspaper of general circulation in each county where the land is located).

    2. Affidavit of Abandonment (filed in the county recorder's office at least 30, but not later than 60, days after the date on which the notice of abandonment was served or published by the surface owner).

    3. Notice of Failure to File (required after January 1, 2014).

G. Under the 2006 DMA, the holder of a severed mineral interest has the right to contest any Notice of Abandonment by recording a claim to preserve the mineral interest, which claim may also be filed by the holder and as a Savings Event, or an affidavit that identifies a Savings Event having occurred.