

Fractionalization *What in the world does that mean?!*

“Fractionalization” and “dilution of interest” are terms used to describe the transfer and/or division of mineral interest into increasingly smaller pieces, sometimes to the point where the owners end up with a miniscule or almost zero interest. What starts as a large interest can become of little or no value to its owner as it is divided from one generation to the next.

Mineral interest owners are an important part of the oil and gas industry. However, many interest owners have not considered the fractionalization problem and just assume that the interests will pass on to their children and continue to hold their value. The more an interest is divided, the less valuable it becomes and the less power the owner has in a mineral lease negotiation.

Here is a common example of how these mineral interests shrink from one generation to the next:

1860 – John Smith acquires a 200-acre family farm and holds 100% of the mineral interest. (200 net mineral acres)

1870 – John Smith dies and the farm passes to his wife, Mary Smith.

1875 – Mary Smith needs some money, so she sells half of the farm and the accompanying mineral interest to an unrelated person. She retains 100 acres with the minerals until she dies in 1880. (100 net mineral acres)

1880 – Mary Smith dies and leaves the farm, undivided to her 4 children, Bob, Ann, Sally, and Rob. (They each have 25 net mineral acres)

1900 – Bob, Ann, and Sally decide to sell their interests in the farm. Rob can't afford to buy their interests. So they divide the 100 acres so that Rob has 25 acres and the rest is sold.



1930 – Rob is struggling to recover from the Great Depression. He sells 20 acres (with minerals) to make ends meet and only keeps 5 acres with minerals.

1938 – Rob executes a lease for his 5 acres, which is included in a 160-acre unit. He negotiates a 1/8 royalty. ($5/160 \times 1/8 = 0.00390625$)

1940 – Rob dies (after his wife) and leaves his interest to his 5 children. ($5/0.00390625 = 0.0078125$).

1970 – One of Rob's children, Martha, dies and leaves her interest 1/2 to her husband and half to her 3 children. (Each child gets $1/3 \times 1/2 \times 0.0078125 = 0.0013020832$).

2000 – One of Martha's children, Zachary, dies and leaves his interest to his 5 children. ($1/5 \times 0.0013020832 = 0.00026041664$).

As these mineral interests become fractionalized, it is easy to see how the oil and gas payments get smaller and smaller. If the production has continued under the 1938 lease, the payments would likely be miniscule compared to the paperwork required to properly pay the fractionalized mineral interest owners. If all of the other owners of the 160-acre unit became this fractionalized, the company would likely just shut down production on an otherwise marginal old well due to the ridiculous amount of paperwork required to properly pay the fractionalized owners. If the well produced 50 barrels/day, that would be 1500 barrels/month. If the sale price was \$60/barrel, that would mean the well made \$90,000 per month. Each one of Zachary's children would be due a check for ($0.00026041664 \times \$90,000 =$) \$2.34.

If this was the only family that fractionalized, those checks may keep coming for a while; if most were this fractionalized, it is unlikely they would continue producing this well. So, what can be done?

There are a lot of ways to prevent and/or repair the “fractionalization” of a family's minerals.

1. A family can create a Family Limited Partnership to hold the mineral interest during their lifetime. This keeps the interest intact and can offer some estate tax and liability benefits as well.
2. Mineral interests may remain intact by creating a trust in one's will which provides that the interest remains intact for the benefit of the heirs.
3. Whole interests may be transferred at the time of death or during a person's lifetime to a single person.
4. If a group of siblings wants to reconsolidate their interests, they can do so by creating a family limited partnership to hold the interest.
5. If the interest is just too small to justify doing any of the above, a family can consider:
 - a. donating small interests to charities; or
 - b. accepting royalty buy-back offers; or
 - c. selling the interests outright.

It's great to be a mineral interest owner, but it is a blessing that comes with some work. To keep mineral interests valuable for yourself and the following generations, it is important to be a good steward and retain your negotiating strength by using the strategies listed above. It is important to speak with a knowledgeable oil and gas attorney to determine which strategy makes the most sense for your family. In one county, it may not make sense to pursue a family limited partnership for 50 net mineral acres owned; in another, it may be imperative that you do so. Every mineral interest is as different as every family. Do your research.

Mineral Lease Process

► STEP 1

Initial Meeting with attorney and potential client (the Lessor). (1-2 hours)

- a. Get acquainted and discuss goals.
- b. Discuss options that client has regarding negotiation of mineral lease.
- c. Discuss terms of lease offer—royalty, bonus, term of lease.
Which factors are most important to the client? Does client own the surface as well as the mineral estate? For instance, if client owns the surface and lives there, he/she may want to determine the drilling location with the company before signing the lease, including the agreed-to location as part of the lease terms.

How many gross and net mineral acres? How strong is our bargaining position? What is the preferred timeline? Is there more than one offer on the table? Is it a proven area?

- d. Discuss how I can assist client—negotiation and/or information gathering.

► STEP 2

If client hires me, we sign an engagement letter and continue the process.

► STEP 3

Research the “Going Rate”

I do research, checking with various sources to determine the range of the “going rate” for the (a) bonus, (b) royalty, and (c) term of lease in the Texas County of the lease offer. Every county’s rate is different and changes from month to month.



► STEP 4

Draft lease terms pursuant to client’s wishes.

► STEP 5

Meeting with client (in person or via phone and e-mail).

- a. Go over my suggested response to the lease offer.
- b. Determine which terms are most important to client and which are non-negotiable.

► STEP 6

Continue negotiations with Lessee (the company making the lease offer).

► STEP 7

Work with my client and Lessee until we have agreed to the lease form.

► STEP 8

Sign and notarize lease and coordinate payment.



Collaborative Divorce Process

► STEP 1

Initial Meeting with Attorney and Potential Client (1.5-2 Hours)

- a. Get acquainted and discuss goals and “interests”.
- b. Discuss the collaborative process, other options, and challenging circumstances.
- c. Evaluate the consequences of the different options.
- d. Discuss the best way to initiate the chosen option.
- e. If client wants to hire me as his/her collaborative attorney, discuss and sign fee agreement/engagement letter.

► STEP 2

Attorneys Work to Arrange First Face-to-Face Joint Meeting with Both Clients, Attorneys, and any Other Professionals Necessary for Process. Create Agenda for First Meeting.

► STEP 3

First Joint Meeting - Clients, Attorneys, Financial Neutral, & Communications Facilitator. (1.5-2 Hours)

- a. Understand and agree to the process—sign Collaborative Law Participation Agreement.
- b. If petition for divorce has not yet been filed, a joint petition for divorce is normally signed at this meeting.
- c. Discuss interest and goals.
- d. Deal with interim issues.
- e. Discuss what information needs to be gathered and start process of gathering, deciding who will provide what information.
- f. Determine who will draft minutes, set next meeting date, and review homework items for those involved.
- g. Each attorney meets briefly after the joint meeting with his/her client to debrief.



► STEP 4

Time Between First and Second Joint Meeting.

- a. One attorney drafts and distributes minutes via e-mail to full team for review and comment.
- b. Team reviews minutes, comments via e-mail, and works on homework items.
- c. In most cases, each client meets one-on-one with financial neutral to begin compiling financial spreadsheet.
- d. In most cases, each client meets one-on-one with communications facilitator to begin process of resolving issues of how to share time with children (if there are children).
- e. Each client meets with his/her attorney to prepare for next
► joint meeting.

► STEP 5

Second Joint Meeting.

- a. Review and sign minutes from first joint meeting.
- b. Review homework items to check status of tasks.
- c. Review financial spreadsheet to determine what information is still needed.
- d. Review status of child issues.
- e. May begin generating options for settlement at this meeting, or it may be necessary to wait until the next joint meeting.

► STEP 6

- a. The process continues as in #3 and #4 above, as information is gathered and the process continues.



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Collaborative Divorce: A Different Path

In January 2007, Roy Disney (nephew of Walt Disney) and his wife filed for divorce and chose to use the collaborative process to work towards a final decree to maintain their privacy. Most people only heard a sound-byte on the evening news or saw a brief note on the internet. That is because the collaborative process keeps the family's business private. Dirty laundry is not aired for the world to see.

Leslie Henges Dolliver, a collaborative divorce attorney based in Lakeway (on the west side of Austin), Texas, cites this case as a prime example of the power of collaborative divorce.

In 2001, Texas was the first state to adopt a law providing for the collaborative practice in family law cases. The process itself was actually conceived in 1989 by Stu Webb, a seasoned Minnesota divorce attorney who decided he would find a better way to help couples or he was going to quit being a divorce attorney.

While no one can negate the fact that emotions run high when people face divorce, the collaborative process is geared toward making the transition much less painful. It's a unique process used to resolve disputes in which both parties retain separate lawyers who are hired to help the parties reach resolution. Everyone enters the situation in a spirit of good faith, honesty and respect.

Collaborative Family Law is built around three principles

No Court Clients and their lawyers agree that no one will take any contested issue to court. This allows the couple and their advisors to focus all their energies on settling their case without the fear of being called to a hearing if they disagree.

Transparent Process All information is shared, so parties can make informed decisions. There is no need for depositions or other formal forms of information gathering, because the clients and attorneys agree contractually to provide all relevant information to the other side, whether it is requested or not.

Interest-based Negotiation The interests of the husband, wife, and children drive the settlement talks. Instead of getting stuck on "I want the house", the team asks "why" and finds the true interest which may be keeping the children in the same school district. When people discuss their true interests, the team can find more common ground and more creative ways to satisfy those interests.

Key to the process is a clearly defined contractual agreement called the "participation agreement," signed at the outset of the case by all members of the settlement team, clients and their attorneys, at the

first "joint meeting." Other neutral professionals complete the collaborative team. A neutral financial professional helps the couple come up with the value of the estates and budgets for separating the households. A communications coach is also used to help manage emotions and keep the focus on solutions, not grievances.

Says Dolliver, "My job as a collaborative attorney is to facilitate cooperation and make sure we stay true to the agreement. It's not always easy. However, my specific training in collaborative practice has given me a lot of useful tools and methods to keep things on track and foster problem-solving that does not rely on adversarial tactics."

With the agreement signed and the team in place, the process moves through several phases, including information-gathering, option generation, negotiation and the finalizing of the divorce. All the meetings are geared toward accommodating the schedules of both parties, while consistently moving forward to a mutually acceptable conclusion. Each meeting has an agenda so that the parties know what topics will be discussed, and minutes are kept so that parties can see the progress they are making as they make agreements and resolve issues along the way.

"Saving time is a big reason to pursue collaborative divorce rather than a traditional, litigated divorce. But there are so many others. The collaborative process allows me to help people salvage what is left, preserve relationships with friends and relatives, learn to communicate about their children's needs, and maintain their privacy, all at a cost that is generally less expensive than a traditional, litigated divorce," Dolliver says.

To help people determine if collaborative divorce is right for them, they should read Stu Webb's book *The Collaborative Way to Divorce* or visit the Collaborative Law Institute of Texas' website at www.collablawtexas.org. More information about Leslie Henges Dolliver can be found at her website at www.lesliedolliver.com.

In a society where we see the ugliness that can occur in the case of divorce, it feels really good to help people see there's a better path, she concludes. It's like Robert Frost said in his poem *The Road Not Taken*:

*Two roads diverged in a wood, and I
I took the one less traveled by,
And that has made all the difference.*



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