

The Mineral/Royalty Conundrum

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The Problem

- There are numerous form deeds from the 40's, 50's, 60's and beyond, that have plagued landmen and attorneys alike for years, which ambiguously purport to convey either a mineral interest or a royalty interest.
- The fact-specific language used in these deeds, along with mixing and matching attributes of a mineral interest, have caused confusion and misinterpretation of the resulting interest.
- Some deeds convey, no doubt, a royalty interest, but the question remains whether that interest is a fixed or floating royalty.
- This presentation will discuss the attributes of mineral and royalty interests and their application to several of these commonly used deeds.

Texas Mineral Fee

- Texas Mineral Fee Basic Attributes:

1. The right to execute oil and gas leases
2. The right to develop
3. The right to receive royalty
4. The right to receive bonus payments
5. The right to receive delay rentals.

- Either a deed contains language indicative of:

- A fractional interest in the mineral fee, stripped of certain attributes, or
- it purports to convey a royalty interest and contains additional language transferring rights normally associated with a mineral fee interest

Example 1:

Purports to convey royalty but also grants extensive rights of surface and subsurface use.

- Grantor conveys to Grantee
 - "all of my right, title and interest in and to all of the oil royalties, gas royalties, and royalty in casinghead gas, gasoline and royalty in other minerals in and under, and that may be produced and mined from Blackacre, together with the right of ingress and egress at all times for the purpose of mining, drilling and exploring said land for oil, gas and other minerals and removing same therefrom."
- Analysis
 - The Grantor is attempting to convey all of the royalty rights, as well as the developmental rights.
 - There are only a few reported cases that involve attempted transfer of strict royalty interest that specifically mention the development right in the deed.

Example 1 Analysis Continued

- Where the description of a reserved or conveyed interest has left the owner with any attributes of the mineral estate other than the right to receive royalty, courts have had little difficulty holding that the interest is a mineral interest, not royalty interest.
 - E.g. *Diamond Shamrock Corp. v. Cone*, 673 S.W.2d 310 (Tex. Civ. App.--Amarillo 1984, writ ref'd n.r.e.).
 - Conveyed the executive right without the right to receive bonus and delay rentals.
- Even where an interest is referred to as a "royalty interest," it may be construed otherwise if other attributes ascribed to said interest demonstrate such an intention to convey a mineral interest.
- Courts will look to the language of the deed and all of the provisions as a whole in an attempt to harmonize internally inconsistent expressions and to determine the true intentions of the parties.

Acklin, et al. v. Fuqua

193 S.W.2d 297 (Tex. Civ. App.--Amarillo 1946, writ ref'd n.r.e.)

- The parties filed a trespass to try title suit to determine the type of interest resulting from the following grant:

one-eighth of all the natural gas, oil, petroleum and substances being all the royalty, in on or under the following described lot..., together with the right to enter thereupon, open mines, drill wells, lay pipe lines and erect all structures necessary or convenient in searching for and removing any natural gas, oil or petroleum.
- The Court stated that there is inconsistency between
 - "one-eighth of all the natural gas, oil, petroleum and substances" and
 - "being all the royalty."
- However, the court looked at the continued language to determine the intention of the parties in the grant.
 - "together with the right to enter thereupon, open mines, drill wells, lay pipe lines...,"
- The Court found that such language granting the right of production is in harmony with an intention to convey a mineral fee.

Williams v. J. & C. Royalty Co.

254 S.W.2d 178 (Tex. Civ. App. - Eastland 1953, writ ref'd)

- A deed reserved "one-half of the royalty retained" in a pre-existing lease but the deed further stated that the Grantor was given access to said lands and development rights.
- The Grantee argued that this reservation in the deed created a royalty interest which terminated when the existing lease terminated.
- The court disagreed and emphasized that the retention of the development rights by the Grantor evidenced an intent that the interest reserved would survive the termination of the existing lease.
- The court also indicated that the reserved interest was a mineral interest even though the parties used the term "royalty interest." *Id.* at 180.

Prairie Producing Co. v. Schlachter

786 S.W.2d 409 (Tex. App.-Texarkana 1990, writ ref'd)

- The original deed purported to transfer "one-half of the oil, gas and other minerals in and under and that may be produced" to the Grantees, with a granting clause specifically conveying the development right.
 - The deed contained a "subject-to" clause because of an existing lease in favor of the Grantee which conveyed one-half of all royalties under the lease except for the right to receive delay rentals and bonus.
 - There was also a "future lease" clause which had a similar disposition of the component parts of the benefits under the lease, i.e. one-half of the royalties, but no bonus or delay rentals.
 - The deed, however, did not mention the executive rights.
- As successors in interest to the Grantor, the Schlachters sued the lessees of the Grantee, claiming that the deed only transferred a royalty interest.

Schlachter, continued

- Disagreeing with the Schlachters, the court found that the deed **transferred an interest in the mineral estate** because
 - the parties used the traditional words to describe a mineral estate, "in and under and that might be produced,"
 - and titled the instrument "Mineral Deed."
- The court applied the "**greatest interest**" canon
 - In the absence of language to the contrary, all sticks contained within the bundle of what is considered a mineral interest are conveyed.
- The Grantors in *Schlachter*
 - **expressly** conveyed the development right and the right to receive royalty,
 - and by application of the canon, therefore **impliedly** transferred the executive right.
- The reservation of the rights to receive a bonus and delay rentals is not inconsistent with the conveyance of a mineral interest and does not relegate the interest conveyed to a mere royalty interest. *Altman v. Blake*, 712 S.W.2d 117 (Tex. 1986).
- The *Schlachter* court further stated that the rights expressly granted and reserved, i.e. the right of ingress and egress for the purpose of mining and drilling, would, in fact, be inconsistent with the conveyance of a mere royalty interest.

Case Summary

- The aforementioned cases seemingly stand for the premise that a strict royalty interest cannot be coupled with the right to develop, as is the case in Example 1; therefore it is possible that a court of competent jurisdiction would conclude that a mineral interest was conveyed therein, despite the title and use of the phrase "royalty interest."
- However, it is entirely possible that a different conclusion could be reached for various reasons.
- *See also Day & Co. v. Texland Petroleum, Inc.*, 786 S.W.2d 667 (Tex. 1990); *Tenneco Oil Co. v. Alvord*, 416 S.W.2d 385 (Tex. 1967); *Schlittler v. Smith*, 128 Tex. 628, 101 S.W.2d 543 (Tex. Comm'n App. 1937, opinion adopted).

Example 2

- Grantor conveys an undivided one-sixteenth ($1/16$) interest in and to all of the oil royalty, gas royalty, and royalty in casinghead gas, gasoline and royalty in other minerals in and under, and that may be produced and mined from Whiteacre, together with the right of ingress and egress at all times for the purpose of mining, drilling and exploring said land for oil, gas and other minerals and removing the same therefore. In addition, the deed states that the Grantee does not by these presents acquire any right to participate in the making of future oil and gas mining leases....nor of participating in the bonus or bonuses which Grantor herein shall receive for any future lease, nor of participating in any rental to be paid for the privilege of deferring the commencement of a well under any lease, now or hereafter.
- The deed further states that in the event Grantor, or as in the status of the fee owners of the land and minerals, or as the fee owner of any portion of said land, shall operate and develop the minerals therein, Grantee herein shall own and be entitled to receive as a free royalty hereunder, (1) an undivided $1/128$ of all the oil produced and saved...to Grantee's credit free of cost..., (2) $1/128$ interest of the value or proceeds...of natural gas, and (3) $1/128$ of the net amount of gasoline produced from the wells.

Example 2 Analysis

- The initial granting language contained in Example 2 is very similar to that in Example 1, but further clarifies the intent of the grant to exclude the Grantee from obtaining any executive rights or the rights to receive bonuses and delay rentals.
- As discussed above, the court in *Schlachter* stated that a royalty owner has no right to explore and drill.
 - The court further provided that if a royalty interest had been intended, there would be no need to reserve rentals and bonuses, because a royalty interest does not share in bonuses and rentals unless the conveyance or reservation specifically provides otherwise. *Schlittler v. Smith*, 128 Tex. 628, 101 S.W.2d 543 (Tex. Comm'n App. 1937, opinion adopted).

Example 2 Analysis, continued

- To complicate matters, Example 2 contains additional language stating:

"that in the event Grantor, or *as in the status of the fee owners of the land and minerals*, or as the fee owner of any portion of said land, shall operate and develop the minerals therein, Grantee herein shall own and be entitled to receive as a free royalty hereunder, (1) an undivided 1/128 of all the oil produced and saved...to Grantee's credit free of cost..., (2) 1/128 interest of the value or proceeds...of natural gas, and (3) 1/128 of the net amount of gasoline produced from the wells" (emphasis added).
- In the interest of trying to harmonize the varying provisions contained in the deed, this language should be taken into account as to the ultimate intentions of the parties.

Alford v. Krum

671 S.W.2d 870 (Tex. 1984)

- The Court stated that if other paragraphs in a deed could be construed to be in conflict with the granting clause, it would not be permissible to give them controlling effect and thus overturn the clear and explicit intention of the parties as expressed by the controlling language, the granting clause.
- The question in this instance is whether the granting clause is clearly attempting to convey a mineral fee as opposed to a royalty.

Watkins v. Slaughter

144 Tex. 179, 189 S.W.2d 699 (1955)

- The deed that was subject to the litigation therein granted
 - a 15/16 mineral interest and reserved a one-sixteenth (1/16) interest, using a traditional mineral estate description.
 - The deed also conveyed the executive right, along with the right to receive bonus and delay rentals to the Grantee, similar to the intended reservation by the Grantor in Example 2.
- Under these circumstances, the court in *Watkins* held that only a royalty interest was reserved.
 - Because the Grantor was denied the authority to lease, along with the right to bonuses and delay rentals, and especially because the deed "announced unequivocally" that the Grantor would "receive the royalty retained herein only from actual production," it was obvious that the parties considered the reserved interest to be a royalty.
- The deed in *Watkins* however, did not mention the right of development.

Fixed v. Floating Nonparticipating Royalty

- One of the more common problematic situations today is deciphering the resulting interest in an instrument that purports to convey/reserve either a fixed royalty or a floating royalty.
- A fixed royalty entitles the owner with a fixed percentage of royalty ownership that is independent of the size of royalty provided in the lease.
- A floating royalty is a fraction of the royalty provided in the lease, whatever that may be. This type of royalty is multiplied by the lessor's royalty provided in the lease and can therefore, fluctuate from lease to lease. See Patrick H. Martin & Bruce M. Kramer, Williams and Meyers, Oil and Gas Law §327.1, at 81 (2014).

Leal v. Cuanto Antes Mejor, LLC

2015 Tex. App. LEXIS 6724, No. 04-14-00694-CV, ---S.W.3d--- (Tex. App. – San Antonio, July 1, 2015)

- On July 1, 2015, the Fourth District Court of Appeals interpreted a 1988 deed ("1988 Deed") to determine whether the grantors conveyed a floating or fixed nonparticipating royalty interest.
 - The Grantors therein reserved all of the oil, gas and other minerals, except "*an undivided one-fourth (1/4) non-participating royalty interest hereinafter specifically conveyed to Grantees There is specifically conveyed to Grantees herein an undivided one-fourth (1/4) interest in and to all of the royalty paid on production of oil, gas and all other minerals. The interest conveyed unto Grantees shall be a non-participating royalty interest and Grantees shall be entitled to a non-participating interest in and to any royalty paid from the production.*" (emphasis added)
 - The court provided several examples of a fixed royalty:
 - A 1/4 royalty in all minerals in and under and hereafter produced;
 - One-half of the one-eighth royalty interest;
 - An undivided 1/24 of all the minerals produced, saved, and made available for market;
 - 1% royalty of all the oil and gas produced and saved;
- See Williams & Meyers, Oil and Gas Law §327.1, at 81 (2014).

Leal, continued

- The court also provided several examples of a floating royalty:
 - 1/16 of all oil royalty;
 - One-half interest in all royalties received from any oil and gas leases;
 - An undivided one-half interest in and to all of the royalty;
 - One-half of one-eighth of the oil, gas and other mineral royalty that may be produced;
 - One-half of the usual one-eighth royalty.
- The court noted that the first paragraph merely states that the Grantor reserves a 1/4 nonparticipating royalty "hereinafter conveyed" to the Grantee. The next paragraph actually quantifies the royalty. The actual quantity of the royalty, however, is unambiguously expressed as a fraction of a royalty – "interest in and to all of the royalty" and "interest in and to any royalty."
- As a result, the court concluded that the royalty owner is entitled to a share of mineral production equal to the stated fraction times the royalty retained in the lease.

Medina Interests, Ltd. v. Trial

2015 WL 3895902, No. 04-14-00521-CV, ---S.W.3d--- (Tex. App. – San Antonio, June 24, 2015, pet. Pending)

- On June 24, 2015, the Fourth District Court of Appeals interpreted a 1949 deed ("1949 Deed") to determine whether the grantors reserved a floating or fixed nonparticipating royalty interest.
- The Grantors therein reserved an "undivided interest in and to the 1/8 royalties paid the landowner upon production of oil, gas and other minerals" from the subject land.
- Medina, the successor-in-interest of the Grantees, sued for trespass to try title and contended that the Grantors shared a fixed 1/8 royalty. The Grantors contended that they are entitled to a portion of a floating royalty. The Trial Court determined that the deed reserved a floating royalty.
- On appeal, the court first noted that when the 1949 Deed was executed, there was no existing oil and gas lease covering the subject land. As stated in *Graham v. Prochaska*, in older deeds like the 1949 Deed, the 1/8 royalty provided to lessors was so consistent and ubiquitous that landowners would often refer to the 1/8 royalty, when they actually were referring to the royalty, of whatever size, that the lease provided. 429 S.W.3d 650, 660 (Tex. App. – San Antonio 2014, pet. Denied)
- Therefore, the court reasoned that the reference to "the 1/8 royalty" arose from an assumption that the lessor's royalty for any future lease would always be 1/8.

Medina, continued

- The court then noted the language used in the 1949 Deed contemplated the possibility of future production. The court reasoned that use of such language indicated that the Grantors contemplated future leasing on the property and intended their interests to adjust according to the royalties under lease.
- The court notes that the language used in this paragraph – standing alone – bears some similarity to language that has been interpreted as stating a fixed royalty. But it does not limit its analysis of this language in “isolation.” See *Coker v. Coker*, 650 S.W.2d 391, 393 (Tex. 1983). Stating that when the reservation is read in full and in the context of the entire deed, the court indicated that it does not believe that the use of the fraction 1/8 in the paragraph limits the Grantors to a fixed 1/8 royalty.
- Observing that “the fact that the usual royalty provided in mineral leases is one-eighth,” the court states that the use of the fraction 1/8 “reflects the common misconception of that period that the landowner’s royalty would always be one-eighth of production.” See *Garrett v. Dils Co.*, 299 S.W.2d 904, 907 (Tex. 1957).
- The court ultimately held that the Grantors reserved “unto themselves an undivided interest in a floating royalty.”
- While the court’s analysis of the royalty (i.e. fixed v. floating) is sound, issue can be taken with whether the reserved interest fails as a whole for want of sufficient description in the quantum reserved.
 - The Grantors reserved “an undivided interest in the 1/8 royalties.” No matter the court’s interpretation that the 1/8 fraction is floating and is really meant to convey whatever the current royalty is under a lease, what is the quantum of “undivided interest” in said floating royalty?

Conclusion

- As one can see, there are varying results in cases attempting to decipher the mineral-royalty distinction depending on what mineral estate attributes are conveyed or reserved, or in the case of a royalty conveyance, whether it is a fixed or floating interest.
- In the interest of caution, a prudent operator should examine the entire deed and all provisions therein to determine the resulting interest, and if there is any room for doubt, a Stipulation of Interest Agreement, with present granting language, should be procured from the parties to the deed in question, or their current heirs or assigns, that contains a clear reflection of their ownership interests.