Fixed vs. Floating Non-Participating Royalty Interest: Texas Courts Trending Toward Floating as Industry Players Look for Guidance

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As the oil and gas industry continues to advance in technology through the shale revolution, previously unprofitable areas have become prospects.[1] The result of this advance in technology includes unearthing both profitable formations and complex title. As one is running title, preparing a title opinion, or answering a client's question, one may come across the following reservation language: "[o]ne-half (1/2) of one-eighth (1/8) of the oil, gas and other mineral royalty that may be produced." Assuming that the lease relating to this granting language—previously at 1/8 royalty—expired and has now been re-leased at a more common 1/4 royalty, would one advise the client to pay (1/2 x 1/8 = .0625) or (1/2 x 1/4 = .125)? This article identifies the problem of fixed vs. floating non-participating royalty interests (NPRI), the methodology courts use to interpret this issue, a jurisdictional look across Texas, and a recommendation of what practitioners should analyze moving forward.

What is a fixed vs. floating non-participating royalty interest?

The mineral estate can be separated into five sticks: "(1) the right to develop (the right of ingress and egress), (2) the right to lease (the executive right), (3) the right to receive bonus payments, (4) the right to receive delay rentals, (5) the right to receive royalty payments."[2] Three categories make up the fifth stick in the bundle. First, the lessor royalty, where the lessor receives a portion of each barrel of oil produced. Second, the overriding royalty interest, where the working interest owner carves from his own leasehold interest a deferred payment to an industry player in exchange for their work in gaining production. Third, the NPRI which is carved out of the lessor's interest and does not require a lease before the interest is carved out. This article will focus on the third category of the fifth stick, the non-participating royalty interest. These NPRIs may be conveyed or reserved as a fraction of a leased royalty (fixed NPRI), or as a fraction of the entire royalty interest (floating NPRI).[3]

For decades, the oil and gas industry standard was for lessor's to execute an oil and gas lease at a 1/8 royalty. This trend eventually shifted to NPRI conveyances, where drafters refer to the standard royalty when reserving or conveying an interest as clarification. In addition to the above example, another common reservation may have read: "one-half (1/2) of the usual one-eighth (1/8) royalty[.]" Here, the question is whether the grantee is receiving 1/2 of 1/8 perpetually, a fixed NPRI, or 1/2 of "X" where X is the current lease term, a floating NPRI.[4]

How do courts interpret these deeds?

To begin, courts will determine if the language in the contract is ambiguous (viewed as a question of fact for the jury) or unambiguous (where the court decides as a matter of law). Typically, both parties will agree that the contract language is unambiguous and then proceed to offer differing interpretations of what the language means. When analyzing an unambiguous deed that has a divergence in what each party believes, the court's primary objective is to determine intent as expressed within the four corners of the document.[5] Typically, the language of a deed, outside of the granting clause, gives little guidance to determine the intent of parties.[6] This results in courts placing great weight on each word and punctuation to aid in analyzing intent.[7] In *Laborde*, the grant provided the following: "an undivided one-half (1/2) interest in and to the Oil Royalty, Gas Royalty and Royalty in other

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[1] *See* Coastal Oil & Gas Corp. v. Garza Energy Tr., 268 S.W.3d 1 (Tex. 2008).

[2] Altman v. Blake, 712 S.W.2d 117, 118 (Tex. 1986).

[3] Hyshaw v. Dawkins, 483 S.W.3d 1, 9 (Tex. 2016).

[4] *Id.* at 8.

[5] U.S. Shale Energy II, LLC v. Laborde Properties, L.P., 551 S.W.3d 148, 151 (Tex. 2018) *citing* Wenske v. Ealy, 521 S.W.3d 791, 793 (Tex. 2017).

[6] *Id.*

[7] *Id.*

Minerals in and under or that may be produced or mined from the above described premises, the same being equal to one-sixteenth (1/16) of the production."[8] When looking at the grammatical structure, the granting language of "the same being equal to one-sixteenth (1/16) of the production[,]" is a non-restrictive dependent clause being offset by a comma, giving additional information that is incidental to the central meaning.[9] The Court, relying on this grammatical interpretation, downplayed the clarifying phrase of one-sixteenth as an explanation to the first clause of 1/2 of royalties. This one-sixteenth (1/16) is incidental to the independent clause, and the Court found a floating NPRI. This holding cuts against the grain of precedent and arguably was not the intent of the grantor; the intent of a contract does not change because the circumstances surrounding the contract do not match the scenarios anticipated—here, the change in a standard royalty.[10]

How do courts across Texas rule on these issues?

In *Range Res. Corp v. Bradshaw*, from the Second Court of Appeals of Texas, the court faced a similar case to the language discussed above.[11] Here, the court placed great weight on an additional phrase of "not less than one-sixteenth (1/16)" to indicate that the intent of the parties was to clarify a floating NPRI not to fall below (1/16). Consequently, this means it could rise above (1/16). A carefully written opinion can discount previous rulings with similar language to distinguish one set of facts from another. Take, for example, the cases of *Wynne/Jackson Dev., L.P. v. PAC Capital Holdings, Ltd.*, out of the Thirteenth Court of Appeals of Texas, and *Sundance Minerals, L.P. v. Moore*, out of the Second Court of Appeals of Texas. Similar language was used in the two deeds, conveying "one-half (1/2) of the usual one-eighth (1/8) royalty in and to all oil, gas, and other minerals produced[.]" The similar language of "the usual one-eighth" was viewed by the *Wynn/Jackson* court to be a fixed NPRI and *Sundance* court to be a floating NPRI. Another example out of the Eleventh Court of Appeals in Eastland held that the language of "one-half of the usual 1/8 royalty" was a floating NPRI.[12]

Finally, the Supreme Court of Texas had to rectify the decision of the Fourth Court of Appeals in San Antonio after finding a conveyance was a fixed NPRI. Here, a deed provided the following: "one-third (1/3) of an undivided one-eighth (1/8) of all oil, gas or other minerals in or under that may be produced" and the court found a fixed NPRI. The Supreme Court of Texas reversed, finding a floating NPRI. The Court held that the court of appeals improperly placed significant weight on *Williams and Meyer's* text when interpreting the deed, looking for the closest syntax to the language of the treatise to make their determination.[13]

Conclusion

While it appears that courts are moving in the direction of interpreting questionable conveyances as floating over fixed NPRIs, the Court has consistently rejected mechanical rules or requiring the use of "magic words" to effectuate one outcome over another. With courts finding two different meanings in similar granting language, relying on treatises to connect syntax, and the grammatical construction of non-restrictive clauses, industry experts are left scrambling on which direction to look for guidance besides the jurisprudential trend. Moving forward, industry players should consult each deed looking for sentence structure to determine if the usual "one-eighth" language is a dependent or independent clause. Additionally, individuals can look towards the *Williams and Meyers* text for guidance, but as seen in *Hysaw*, this is not the end-all-be-all. Finally, when evaluating each clause, look for the preposition "of" as a common term synonymous with multiplication to indicate a potential floating NPRI. Alternatively, look for "a" or "an" to identify a potential fixed NPRI.

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[8] U.S. Shale Energy II, LLC v. Laborde Props., L.P., 551 S.W.3d 148, 150 (Tex. 2018).

[9] *Id.* at 154; *See also* Reed v. Maltsberger/Storey Ranch, *LLC*, 534 S.W.3d 51 (Tex. App.—San Antonio 2017) (evaluating a mineral deed by analyzing the location of the semicolon of the granting language).

[10] French v. Chevron U.S.A. Inc., 896 S.W.2d 795, 797 (Tex. 1995) (holding presumption that attributes remain with mineral estate unless there is express intent otherwise).

[11] Range Res. Corp. v. Bradshaw, No. 2-07-263-CV, 2008 Tex. App. LEXIS 3426 (Tex. App.—Fort Worth May 8, 2008). *See also* Christopher Kulander, *Fixed vs. Floating Non-Participating Oil & Gas Royalty in Texas: And the Battles Rage on ...*, 4 Tex. A&M L. Rev. 41 (2016).

[12] Butler v. Horton, 447 S.W.3d 514, 518 (Tex. App.—Eastland 2014).

[13] Hysaw v. Dawkins, 483 S.W.3d 1, 14 (Tex. 2016).