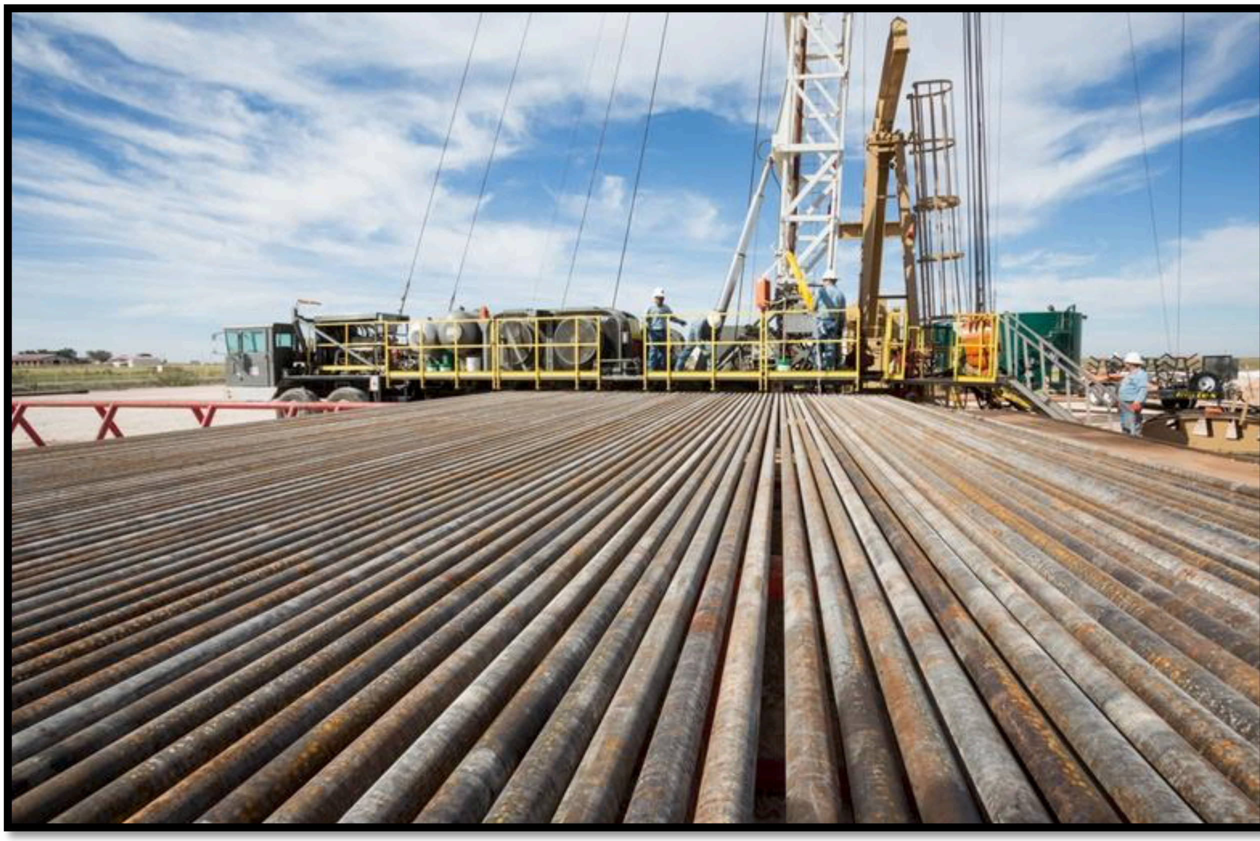
DT Oil & Gas Blog

Texas Supreme Court to Review Whether Royalty Owners Should Pay Post-Production Costs



In what could impact oil and gas royalty owners as well as energy companies across Texas, the Texas Supreme Court agreed to consider whether royalty owners are liable for post-production costs.

The case is *Burlington Resources Oil & Gas Co. LP v. Texas Crude Energy LLC et al.,* case number 17-0266, in the Supreme Court of Texas. The case is comes from the Thirteenth Court of Appeals.[1]

The case centers around how an "amount realized" clause in a royalty agreement should be interpreted. Traditionally, the "amount realized" clause means that royalties are paid based on the proceeds actually received from the sale of the gas or oil—not the market value of the oil and gas. This traditional interpretation reflects Burlington's argument that it is entitled to reduce royalties paid in the form of post-production costs like transportation and treating expenses. On the other

[1] 516 S.W.3d 638 (2017).

hand, Texas Crude argues that it should not have to pay these expenses as their contract with Burlington is unambiguous on this point.

The Texas Supreme Court most likely agreed to review the case in order to further clarify its holding in the 2015 *Chesapeake Energy v. Hyder* case.[2] In *Hyder*, the Court stated that Chesapeake could not require a group of Barnett Shale royalty owners to pay post-production costs on gas produced from wells on their land under a "cost-free" provision in the lease. The Court relied on its previous rationale by Justice Owen's plurality opinion in 1997 *Heritage Resources, Inc. v. NationsBank* case.[3] Interpreting *Heritage Resources*, the Court opined that the particular language of the lease agreement controls, "[T]he effect of a lease is governed by a fair reading of its text….Here, the lease text clearly frees the gas royalty of postproduction costs, and reasonably interpreted, we conclude, does the same for the overriding royalty."[4]

Because the Court's interpretation could send shock waves throughout the industry, trade groups are lining up and taking sides with competing amicus briefs. In support of deducting production costs are groups like the Texas Oil & Gas Association ("TXOGA"). In their brief, TXOGA concludes that the Court of Appeals' ruling "would drastically change oil-and-gas law and severely impact the oil and gas industry in Texas" and that "*Hyder* does not render all royalties based on 'amount realized' calculation automatically free from post-production costs regardless of the lease or assignment's chosen point of valuation."[5]

On the other side are groups like the Texas Land & Mineral Owners Association ("TLMA") and the National Association of Royalty Owners-Texas ("NARO"). Their brief states, "The Court of Appeals' opinion follows the well-established four corners doctrine and gives meaning to every provision within the Assignments…[and] stands for the proposition that parties may freely contract with each other to shift the allocation of post-production costs depending on the circumstances of the disposition of production."[6]

Clearly, many will be watching the Court on this one.

A date for oral argument has not been set.

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[2] *Chesapeake Exploration, L.L.C. v. Hyder*, 483 S.W.3d 870 (2016).
[3] *Heritage Resources, Inc. v. NationsBank*, 939 S.W.2d 118 (1996).
[4] *Hyder* at 876.
[5] Brief for TXOGA as Amicus Curiae, p. 41-2, *Burlington Resources Oil & Gas Co. LP, v. Texas Crude Energy LLC et al.*, 516 S.W.3d 638 (2017).
[6] Brief for TLMA and NARO as Amicus Curiae, p. 16, *Burlington Resources Oil & Gas Co. LP, v. Texas Crude Energy LLC et al.*, 516 S.W.3d 638 (2017).