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The 40th Annual Page Keeton
Civil Litigation Conference
Current Issues in Oil & Gas Law

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Chesapeake v. Hyder
483 SW3d 870 (Tex. 2016)

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Royalty Payments under Oil & Gas Leases

- Royalties are the primary source of the lessor's compensation under an oil and gas lease.
- Royalties are also the primary source of disputes between lessors and lessees, as one might imagine.



The Natural Conflict Between Lessors and Lessees

- A **lessor seeks to maximize royalties** and expects payment that reflects his share of the sales price **without deduction of any costs**.



- A **lessee** also seeks maximum payment for the product. But as the holder of the cost-bearing interest in the oil and gas, **expects lessors to share proportionately in certain costs** incurred to acquire that ultimate sales price.

Costs Associated with Producing and Marketing Oil & Gas

- **Production costs:** The costs associated with extracting the oil and gas from the earth and bring it to the surface (e.g., exploring, drilling, installing and maintaining a well, and other upstream activities).
- **Post-production costs:** The costs required to make the minerals marketable (e.g., gathering, compressing, processing, and transporting to market).



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Who Pays for What?

- **General Rule:** Royalties are **free of production costs but share** a proportion of **post-production costs unless** the parties agree otherwise (Cf. *Heritage Resources*)
 - In other words, lessees (producers) alone are responsible for finding and extracting the oil and gas, but lessors (royalty owners) must help pay for the costs required to prepare the product for market.

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