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The Oil and Gas Lease, Part II: The Royalty Clause in an Oil and Gas Lease

***2017 Fundamentals of Oil, Gas, and
Mineral Law***

**Monika U. Ehrman
The University of Oklahoma College of Law**

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Overview

- What is the lease royalty?
- How is royalty calculated?
- Post-production costs
- Market value
- Other issues arising in royalty

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What is the lease royalty?

- Mineral interest owner v. lessor
- Working interest owner v. lessor
 - Cost bearing v. non-cost bearing interests
- Royalty interest owner
 - Lease royalty
 - Nonparticipating royalty interest
 - Overriding royalty interest
- Shut-in royalty is not a royalty



What is the lease royalty?

- Royalty interest is a non-possessory interest in real property
 - *Sheffield v. Hogg*, 77 S.W.2d 1021 (1934)
- Subject to Statute of Frauds
- After production, royalty interest becomes personal property



What is the lease royalty?

- What does mineral interest owner receive if oil and gas lease executed?
 - Bonus & royalty
 - Delay rentals & shut-in payments
- Is incentive for mineral interest owner to execute the oil and gas lease and convey mineral interest to lessee



What is the lease royalty?

- Royalty is lessor's principal form of compensation if hydrocarbons are produced
- Royalty is a cost-free share of production
 - *Heritage Res., Inc. v. NationsBank*, 939 S.W.2d 118 (Tex. 1996)
- Negotiated between the parties
- Critical component of negotiation because may be perpetual (i.e., production does not cease)

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