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**Non-Participating Royalty Interest Litigation**

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## **Non-Participating Royalty Interest Litigation**

### **I. Introduction**

In the oil and gas context, royalty interests are non-possessory interests in real property.<sup>1</sup> A non-participating royalty interest, or “NPRI,” is an expense-free real property interest carved from the mineral estate that does not participate in the right to receive bonus or delay rentals, in the executive leasing right, or in the right to develop the estate.<sup>2</sup> The size of an NPRI may be expressed in two different ways: The deed may either specify a stipulated fraction of gross production (a “fixed royalty”), or it may specify a stipulated fraction of the royalty reserved in an oil and gas lease (a “floating royalty”).<sup>3</sup> Though the owner of an NPRI may receive royalties from the gross production of oil, gas, and other minerals, the owner does not “participate” in the execution of any oil and gas lease, the bonus payable under such lease, the delay rentals to accrue under such lease, or self-development.

Over the past century, Texas courts have struggled both to construe language granting or reserving fractional NPRIs and to define the rights associated with these unique non-possessory property interests. This Paper will examine substantive and procedural nuances commonly implicated in NPRI disputes and then examine some practical considerations for operators faced with NPRI litigation.

### **II. Substantive Law**

Frequent disputes involving NPRIs include (1) whether the interest granted or reserved is an NPRI or a non-executive mineral interest, (2) the size of the NPRI granted or reserved, (3) the effect of a third party’s attempt to alter the nature of an NPRI owner’s interest through pooling, (4) the duration of the NPRI granted or reserved, and (5) the non-executive’s obligations to the NPRI owner. Each of these issues is discussed in turn below.

#### **A. Mineral or Royalty Interest**

Owing to vagaries in instruments creating NPRIs and the different rights associated with NPRIs and non-executive mineral interests, disputes may arise as to whether an interest is an NPRI or a non-executive mineral interest. Non-executive mineral interest owners are normally entitled to share in all economic benefits allocable to the mineral estate whereas NPRI owners are typically limited to just the right to share in a portion of production or lease royalty.<sup>4</sup> Additionally, with respect to self-development, the law is more favorable as to the rights afforded a mineral non-executive than it is regarding an NPRI owner.<sup>5</sup> In such cases, the NPRI owner’s royalty is potentially tied to a conceivably non-existent lease while the mineral non-executive is entitled to its proportionate share of production less reasonable costs of production and marketing.<sup>6</sup>

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<sup>1</sup> *Sheffield v. Hogg*, 77 S.W.2d 1021 (Tex. 1934).

<sup>2</sup> *See Plainsman Trading Co. v. Crews*, 898 S.W.2d 786, 789–90 (Tex. 1995).

<sup>3</sup> *See, e.g., Watkins v. Slaughter*, 189 S.W.2d 699 (Tex. 1945) (fixed); *Schlitter v. Smith*, 101 S.W.2d 543 (Tex. 1937) (floating).

<sup>4</sup> *See* SMITH & WEAVER, TEXAS LAW OF OIL & GAS § 2.6[A][1] [hereinafter *SMITH & WEAVER*].

<sup>5</sup> *See Bullard v. Broadwell*, 588 S.W.2d 398 (Tex. Civ. App.—Eastland 1979, writ ref’d n.r.e.).

<sup>6</sup> *See id.*

Though the most litigated issue involving NPRI is determining the quantum of the NPRI, this issue often involves first determining whether the interest is a royalty interest or a mineral interest.<sup>7</sup> Intuitively, and as a general rule, an instrument that grants or reserves a “royalty,” without more, creates a royalty interest.<sup>8</sup> Conversely, a grant or reservation of oil, gas, or other minerals “in and under” the described land, without further language relating to the minerals, creates a mineral interest.<sup>9</sup> The phrase “in and under and that may be produced from” generally has a similar effect.<sup>10</sup>

Often times, an instrument will convey a specified fraction of the oil, gas and other minerals “in and under” or “in and under that may be produced and saved from” the described land and then strip the subject interest of some or all of the usual mineral estate attributes.<sup>11</sup> In such a case, it is unclear whether the parties intended to convey a mineral interest divested of some or all of the rights making up the mineral estate except the right to receive royalty—so that the owner will only receive a specified fraction of royalty—or whether the parties intended to convey an NPRI, entitling the owner to a fraction of total production.

In *Watkins v. Slaughter*, for example, the grantor retained “title to a 1/16 interest in and to all of the oil, gas and other minerals in and under and that may be produced from said land,” without any right to participate in leasing or to share in delay rentals and bonus.<sup>12</sup> Yet, the deed also stipulated that grantor “shall receive the royalty retained herein only from actual production.”<sup>13</sup> In holding that the grantor retained a 1/16 royalty, rather than a 1/16 mineral interest stripped of all incidents except royalty, the *Watkins* Court purported to assess the deed as a whole, though it relied heavily on the word “royalty” and the language indicating that the grantor would receive the royalty from “actual production.”<sup>14</sup>

In *Altman v. Blake*, a case decided thirty-one years after *Watkins*, the deed granted “an undivided one-sixteenth interest (1/16) in and to all of the oil, gas, and other minerals in and under that may be produced.”<sup>15</sup> A subsequent clause provided that the grantee “does not participate in any rentals or leases . . . .”<sup>16</sup> Because the deeds in *Watkins* and *Altman* contained identical language in their respective granting clauses and each stripped the subject interest of the right to lease and to collect delay rentals, the grantee’s heirs relied on *Watkins* to support their position that the deed conveyed a royalty interest rather than a mineral interest.<sup>17</sup> Distinguishing the two cases, the Court reasoned that the “deed in *Watkins* unequivocally stated that the grantor should ‘receive the royalty retained herein only from actual production’” and that “the [*Watkins*] court placed great emphasis on the parties’ designation of

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<sup>7</sup> See *Hausser v. Cuellar*, 345 S.W. 462, 470 (Tex. App.—San Antonio 2011, pet. denied); *Garza v. Prolithic Energy Co., L.P.*, 195 S.W.3d 137, 142–43 (Tex. App.—San Antonio 2006, pet. denied).

<sup>8</sup> See, e.g., *Halbert v. Green*, 293 S.W.2d 848, 850 (Tex. 1956) (instrument conveying “an undivided . . . interest in and to all of the royalty oil, royalty gas, and royalty on other minerals . . .” transferred a royalty interest).

<sup>9</sup> See, e.g., *Reed v. Maltsberger/Storey Ranch, LLC*, 534 S.W.3d 51, 56 (Tex. App.—San Antonio 2017, pet. denied) (holding that the phrase in and under is indicative of an intent to convey a mineral estate).

<sup>10</sup> See, e.g., *Badger v. King*, 331 S.W.2d 955, 958 (Tex. Civ. App.—El Paso 1959, writ ref’d n.r.e.).

<sup>11</sup> See, e.g., *Watkins v. Slaughter*, 189 S.W.2d 699, 699 (Tex. 1945).

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* at 700–701.

<sup>15</sup> 712 S.W.2d 117, 117 (Tex. 1986).

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* at 119–20.

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