

Fundamentals of Royalty Calculation: How a Few Small Words Can Make a Big Difference

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1

Royalty Clauses Confound Texas Courts

- “The parties could have saved considerable time, money, and heartache if [they had trashed] their cryptic language”

--Burlington Res. Oil & Gas Co. v. Texas Crude Energy, LLC, 573 S.W.3d 198, 210 n.10 (Tex. 2019) (Blacklock, J.)



2

Types of Royalty Clauses

Royalty clauses tend to fall in one of three categories:

1. *Fixed Price* – e.g., \$0.25 per ton of minerals.
2. *In Kind* – e.g., 1/8 of the minerals.
3. *Monetary* – e.g., 1/8 of the market value of the minerals at the wellhead.

3

Fixed Price Royalty Clauses

- Yes, these animals do exist.
- They usually apply to minerals, like salt or sulphur, that do not rapidly swing up or down in value.
- Fixed price royalties are easy to calculate. But they make no sense for oil or gas production.



4

In Kind Royalty Clauses

- The royalty owner *owns* its royalty share of the production.
- The royalty owner *may* receive its royalties “in kind” by taking physical possession of its royalty share of the production.
- Or the producer may sell the royalty owner’s share and pay the royalty owner the *net proceeds* (*i.e.*, sales price minus post-production costs) for the royalty owner’s share of the production.

5

Monetary Royalty Clauses



- The royalty owner is entitled only to a money payment for its royalty share.
- Monetary clauses commonly have three components:
 - (1) the royalty fraction or share of the production (such as 1/8 or 25%);
 - (2) the royalty yardstick (such as “proceeds” or “market value”); and
 - (3) the location for measuring the yardstick (such as “at the well” or “at the point of sale”).
- Each of these three components may significantly affect the amount of royalties that a producer owes.

6

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