

HOLLIDAY ENERGY LAW GROUP

FIXED vs FLOATING NPRI's

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NPI Definition

Texas Definition

- Kilfoyle v. Wright, 188 F.Supp. 899, 903, 904 (S.D. Ala. 1960)
- [A] non-participating royalty is defined as an interest in the gross production of minerals which is carved out of the mineral fee estate as a free royalty which does not carry with it the right to participate in the execution of, the bonus payable for, or the delay rentals to accrue under, oil, gas, and mineral leases executed by the owner of the mineral fee estate.

Fixed Or Floating?

The size of an NPRI can be expressed in one of two ways: The NPRI can be reserved or conveyed as a fixed fraction of gross production, commonly 1/16, or it can be dependent upon the lessor's royalty of the existing lease and every lease covering the captioned land thereafter.

In the second instance, the NPRI fraction is typically multiplied by whatever lessor's royalty is found in the existing oil and gas lease covering the captioned land.

“Fix Bayonets”

The following are examples of “fixed NPRIs” under which a fraction or percentage of gross production has been granted or reserved:

- "a one-fourth royalty in all oil, gas and other minerals in and under and hereafter produced"
- "a fee royalty of 1/32 of the oil and gas"
- "an undivided one-sixteenth royalty interest of any oil, gas or minerals that may hereafter be produced"
- "one-half of the one-eight[h] royalty interest"
- "an undivided 1/24 of all the oil, gas and other minerals produced, saved, and made available for market"
- "[one percent] royalty of all the oil and gas produced and saved[.]

“Go With The Flow”

Examples of “floating NPRIs“ under which the amount of production received by the royalty owner fluctuates according to the amount of lessor's royalty provided for in the lease:

- "1/16 of all [the] oil royalty";
- "the undivided 2/3 of all royalties";
- “one-half interest in all royalties received from any oil and gas leases“;
- “an undivided one-half interest in and to all of the royalty“;
- "one-half of one-eighth of the oil, gas and other mineral royalty
- that may be produced“;
- "one-half of the usual one-eighth royalty."

“The Doglandman’s Electric Kool-Aid NPRI Test”

The Basic Rule*

- “a” or “an” in granting or reservation clause = Fixed
- “of” or “in and to” in granting or reservation clause = Floating
- *As with all Rules, there are exceptions!

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Terminology

Estate Misconception Theory: Theory that refers to the once-common misunderstanding, perpetuated by outdated judicial authority, that a lessor retained only a percentage of the minerals (usually 1/8) in place after executing an OGL.

- TX OGL = Fee Simple Determinable with Possibility of Reverter in the Entirety.
- Courts will acknowledge but not be bound by this general rule.
- The Estate Misconception Theory will be applied based on the intent of the parties, as determined by the Court.
- E.g. Lessor leases for 1/8 royalty, then desires to sell 1/2 of his minerals. Assuming he owns the 1/8 in place by virtue of the existing lease, he sells '1/2 of my minerals, the same being a 1/16' or 'the same being a 1/2 of 1/8'

Construing The Deed – Is The Deed Ambiguous?

- Ambiguity and Deed Interpretation
- Ambiguity means that a deed is subject to more than 1 reasonable interpretation.
- UNAMBIGUOUS = COURT DECIDES AS A MATTER OF LAW
- Courts will construe an un-ambiguous deed ‘as a matter of law,’ seeking to find the parties’ intent from the four corners of the document.
- AMBIGUOUS = QUESTION OF FACT FOR JURY TO DECIDE
- Courts will not construe an ambiguous deed – that’s a ‘matter’ or ‘question of fact’ for a jury

Construing The Unambiguous Deed – Court’s Ultimate Inquiry Is To Find The Intent Of The Parties

No. 1 priority is to determine the intent of the parties.

- CAUTION: THIS WILL OVERCOME ALL PRINCIPALS OF DEED CONSTRUCTION

Four Corners Rule = Ascertain intent of the parties from the four corners of the instrument

- Based on the words USED, not the subjective intent of the parties
- i.e. What they did, not what they might have done

Intent is determined by harmonizing the instrument as a whole, particularly where there are conflicts/inconsistencies in the language used.

- Courts will presume that all language in a deed was used intentionally, even where it conflicts. They will consider all of the language and use it to find intent.

Texas Supreme Court has rejected mechanical, bright-line rules of interpretation that are contrary to an intent-based inquiry; no “no magic-words”

HYSAW V. DAWKINS – Indicator Of The Future In Deed Interpretation

Ethel's 1947 Will devises 4 tracts of land in Karnes County in fee simple to her 3 children:

- Inez = 600 acres
- Dorothy = 465 acres
- Howard = 200 acres + 150 acres

Mineral Estate Distribution – A different method

- Each of my children shall have and hold and undivided $\frac{1}{3}$ of $\frac{1}{8}$ of all OGM as non-participating royalty
- Each child shall receive $\frac{1}{3}$ of $\frac{1}{8}$ royalty, provided there is no royalty sold during Ethel's lifetime
- If royalty is sold during Ethel's lifetime, each child shall receive $\frac{1}{3}$ of the remainder of the unsold royalty

Before and after will, Ethel made a number of equal grants of royalty in the 200 & 150 acre tracts to each child

HYSAW v. DAWKINS – Indicator of the Future in Deed Interpretation

- 2005 Inez's successor leased 600 acres for 1/5 royalty
- Inez's successors claim...
 1. Howard's 200 + 150 acres were burdened by a floating (i.e. fraction of) royalty based on Ethel's inter vivos (during life) conveyance of royalty on those tracts
 2. Ethel's will created 1/3 of 1/8 = 1/24 fixed (i.e. fractional) royalty on 600 & 465 acres
 3. Excess royalties on 600 and 465-acre tracts belong to fee owner
- Howard & Dorothy successors: Multiplying the fractions and fixing the devised royalty...
 1. Evidences an intent the Ethel wanted royalty shared equally
 2. Adding 1/24th, a fixed fraction not found in the deed, is adding language
 3. Creates disharmony among provisions by mixing fixed and floating royalty language
- Trial Court = Summary Judgment for Howard and Dorothy, 1/3 floating to each child
- 4th Court of Appeals = Ruling for Inez
 1. Fixed 1/24th NPRI to non-fee owning siblings on 600 and 465 acres (Inez and Dorothy tracts); greater royalty interests intended for fee-owners
 2. Due to gifts during Ethel's life, a floating royalty on Howard's 200-acre and 150-acre tracts was intended
 3. Each provision considered in isolation

HYSAW v. DAWKINS – Indicator of the Future in Deed Interpretation

ISSUE: The proper interpretation of the double-fraction language in Ethel's will, in light of other testamentary language indicating Ethel intended to treat her children similarly with respect to their royalty interests.

HOLDING: Ethel's will devised equal $1/3$ 'of royalty' interest to each child.

Keys to Ruling

1. Intent is Paramount
2. Intent is determined by looking at 4 Corners
3. Document must be examined in entirety
4. No mechanical rules/magic words, though general rules are given consideration

HYSAW v. DAWKINS – Indicator of the Future in Deed Interpretation

The Double Fraction Dilemma

- Double fraction deeds almost always use 1/8
 - Courts for decades determined that 1/8 was the customary and standard royalty
- Possibility that parties were operating under the assumption that royalties will always be 1/8 will not alter clear and unambiguous language that can be harmonized
- Why would parties use a double fraction to convey a fixed percentage of royalty?
 1. Estate Misconception – they believed they only owned 1/8 after signing a lease
 2. Parties mistakenly believed that royalty would always equal 1/8, and wanted to grant a fraction of the royalty
- Fixed Royalty Cases – Common Themes
 - Generally straightforward mathematical approach to multiplying the fractions
 - Double fraction generally restated as a single fraction
 - Phrases such as ‘usual 1/8’ or ‘the 1/8 royalty’ are not accorded special significance
 - Lack of inconsistent language is generally noted

HYSAW v. DAWKINS – Indicator of the Future in Deed Interpretation

- Floating (fraction of) Royalty Cases – Common Themes
 - Analytical approach that emphasizes 4 Corners and Harmonization
 - Instruments tend to be more complex
 - Tend to have contradictory or inconsistent terms that court must harmonize if possible to give effect to all words

Hysaw – Affirms Texas Supreme Court’s commitment to ‘holistic approach’ to determine intent from all words and all parts of the instrument

- Words and phrases...
 - Must be construed together, not in isolation (this is where 4th Court made mistake)
 - Must be given ordinary meaning unless the context supports a technical or different meaning
- Inconsistencies/contradictions must be harmonized by construing the document as a whole
- Bright-line/mechanical rules are not a substitute for intent-based inquiry based on document’s words
- Estate Misconception Theory and historical use of 1/8 as standard royalty may inform the meaning of double fractions, but those considerations are not alone dispositive

HYSAW v. DAWKINS – Indicator of the Future in Deed Interpretation

- Double Fraction may/may not evidence intent to have fixed/floating interest
- All language in document must be considered in context before ascribing any particular meaning to use of the double fraction

So there are rules, but really there are no rules because intent of the parties as evidenced by the language used within the deed at issue is what matters



HYSAW v. DAWKINS – Indicator of the Future in Deed Interpretation

In this case...

1. Ethel gave all lands in fee simple to her three children, making an effort to point out that daughters were not favored as son's smaller tract was more valuable
2. Will describes the royalties as follows, using identical language for each child and each tract:
 1. Each of my children shall have and hold and undivided $\frac{1}{3}$ of $\frac{1}{8}$ of all OGM as non-participating royalty
 2. Each child shall receive $\frac{1}{3}$ of $\frac{1}{8}$ royalty, provided there is no royalty sold during Ethel's lifetime
 3. If royalty is sold during Ethel's lifetime, each child shall receive $\frac{1}{3}$ of the remainder of the unsold royalty
3. W/out context of remainder of the will, Court admits that it is plausible to read the double fractions as a fixed royalty with all excess royalty going to the landowner
4. Other language in will and overall structure of the royalty devise confirms Ethel's intent to create a floating royalty and equally distribute it amongst the kids
5. Third clause makes clear intent to create a floating interest – if some royalty is sold, the kids split the remainder in equal $\frac{1}{3}$ s
6. Ethel used $\frac{1}{8}$ royalty to mean entire royalty interest lessor could retain under an OGL

HYSAW v. DAWKINS – Indicator of the Future in Deed Interpretation

In this case, Court determined that Ethel...

1. Used 1/8 royalty to mean entire royalty interest lessor could retain under an OGL
2. Anticipated siblings would share royalty equally
3. Intended proportional equalization of any royalty remaining if she sold some during her life

HOLDING: Ethel granted equal 1/3 floating royalty interests

LABORDE v. U.S. SHALE – Holding After Hysaw

HOLDING: Reserved NPRI is a fixed 1/16 of gross production.

FACTS

1951 Deed from Bryan to Crews reserves NPRI:

“There is reserved ... an undivided one-half (1/2) interest in and to the ... Royalty ... in and under and that may be produced ... the same being equal to one-sixteenth (1/16) of the production. This reservation is ... a nonparticipating royalty reservation...”

US Shale = Successor to Grantor Bryan

Laborde = Successor to Grantee Crews

LABORDE v. U.S. SHALE – Holding After Hysaw

Timeline

- 2008 – Lands leased at 20%
- EOG acquires, drills and places lands in two EF units then producing
- 2010 – Laborde acquires the lands
- Sometime b/w 2010-2015, Laborde receives a division order from EOG and rejects
 - Claims EOG is improperly reducing his royalty payments under the lease b/c of erroneous categorization of NPRI as floating 1/2 of royalty and not a fixed 1/16
 - Claims should have 20% less 1/16 = 13.75%.
 - EOG is currently crediting with 20% less (1/2 of 20%) = 10%.
- 2015 – Laborde notifies EOG of dispute, EOG suspends interest
 - Note – This is the proper response. Under Section 92 of Texas Natural Resource Code, operator has the right to suspend payment in response to a title dispute

LABORDE v. U.S. SHALE – Holding After Hysaw

2015 Lawsuit

- US Shale files suit seeking declaratory judgment that 1951 NPRI is floating and that they are owed 10% of production (1/2 of 20%)
- US Shale Argument for Floating Royalty
 - That's how EOG interpreted it – not a great argument
 - “The same being equal to one-sixteenth (1/16) of production” is similar to language used where 1/8 is determined to mean royalty
 - *Graham v. Prochaska* – very similar language found to be Floating Royalty
- Laborde Argument for Fixed Royalty
 - Floating ignores phrase “same being equal to one-sixteenth (1/16) of production”
 - Deed contains no intent for floating royalty
 - First phrase “an undivided one-half (1/2) interest in and to the ... Royalty” indicates fixed
 - Last phrase “same being equal to one-sixteenth (1/16) of production” indicates fixed
 - *Graham v. Prochaska* says that this language is indicative of fixed royalty b/c no intent to have royalty float

LABORDE v. U.S. SHALE – 4th Court Looks at Typical Language from Its Prior Decisions

Fixed Royalty

1. A 1/4 royalty in all OGM in and under and hereafter produced
2. A fee royalty of 1/32 of the oil and gas
3. An undivided 1/16 royalty interest in any OGM hereafter produced
4. 1/2 of the 1/8 royalty interest
5. An undivided 1/24 of all OGM saved and made available
6. 1% royalty of all OGM produced and save

Floating Royalty

1. 1/16 of all oil royalty
2. The undivided 2/3 of all royalties
3. 1/2 interest in all royalties received from any OGLs
4. An undivided 1/2 interest in and to all of the royalty
5. 1/2 of the usual 1/8 royalty
6. 1/2 of 1/8 of the OGM royalty

LABORDE v. U.S. SHALE – Holding After Hysaw

There Are NO BRIGHT-LINE RULES; INTENT IS KEY

It is not enough to compare deed language at issue with other language in other deeds that are divorced from the present context

Intent must be determined from all words and all parts of the instrument

Court may not determine meaning of phrases used in a deed by comparing it to other phrases out of context

LABORDE v. U.S. SHALE – Graham v. Prochaska

Court determined the following language created a floating 1/2 of royalty interest:

- “One-half (1/2) of the one-eighth (1/8) royalty to be provided for in any and all leases for oil, gas and other minerals now upon or hereafter given on said land ... the same being equal to one-sixteenth (1/16) of all oil, gas and other minerals ... free and clear of all costs of production...”

Note 1951 NPRI Language:

- “There is reserved ... an undivided one-half (1/2) interest in and to the ... Royalty ... in and under and that may be produced ... the same being equal to one-sixteenth (1/16) of the production. This reservation is ... a nonparticipating royalty reservation...”

LABORDE v. U.S. SHALE – Graham v. Prochaska

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WHY?

- “One-half (1/2) of the one-eighth (1/8) royalty to be provided for in any and all leases” in isolation is fixed, BUT
- The reservation, when considered as a whole, described ‘the one-eighth (1/8) royalty’ as the royalty interest to be provided in all future OGLs
 - ‘the one-eighth (1/8) royalty’ = the royalty
- This shows an intent to reserve 1/2 of the royalty to be provided in current and future leases
- Court’s Interpretation = “One-half (1/2) of the royalty to be provided for in any and all leases for oil, gas and other minerals now upon or hereafter given on said land...”

LABORDE v. U.S. SHALE – Graham v. Prochaska

How did the court arrive at this conclusion?

- Inclusion of the word “the” and language referencing current and future leases with regard to “the one-eighth (1/8) interest” allowed court to objectively determine the parties assumed that royalty would always be 1/8
 - This was a mistaken assumption, but clear language that evidences intent
- Deed evidenced intent to convey 1/2 of any royalty provided in current and future leases, assuming it would always be 1/8, thus FLOATING

Now had to harmonize this floating royalty with fixed language “...same being equal to one-sixteenth (1/16) of all OGM...”

- Parties had intended ‘the one-eighth (1/8) royalty’ to mean ‘royalty’ and mistakenly assumed that 1/8 would always be lease royalty
- Thus logical to assume that this would always equal 1/16

Other language in the deed confirmed parties’ intent to convey 1/2 of royalty

LABORDE v. U.S. SHALE – Graham v. Prochaska

Does Graham Apply?

Court in Laborde says NO.

Unlike in Graham case, no additional language in present case...

1. Evidencing intent to create a floating interest.
2. Evidencing a belief that royalty would always be 1/8, and thus that 1/2 of that would always be 1/8

Thus, language needed to be harmonized without additional deed provisions.

These phrases are indicative of fixed royalty language.

When construed together and giving effect to all parts, the parties intended a fixed 1/16 NPRI

If parties intended a floating royalty, they would not have defined it as 1/16 'of production'

QUESTIONS?

