# WHEN DO THE WORDS "½ OF 1/8 " NOT EQUAL 1/16? WHEN THEY ARE FOUND IN OLD DEEDS - SOMETIMES

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## Introduction

Many people in Texas receive royalties from oil and gas production on land that they own an interest in. In the 1960's and before, mineral leases typically provided for a royalty to the property owner that was equal to 1/8 of production. Such a 1/8 royalty was standard, and almost universally found in leases. In *Garrett v. Dils Co*[1]., a 1957 Texas Supreme Court case, it was described as "the usual" royalty. Nowadays, it is not uncommon to see mineral leases with much larger royalties, equal to 1/5 or even1/4 of production.

Ever since Spindletop, many owners of real property in Texas have reserved for themselves some or all of their property's mineral rights when they otherwise transferred that property. One device that has frequently been used is a reservation known as "Non-Participating Royalty Interest," or NPRI. An NPRI is an interest in property that remains with the person who reserved it, and his or her successors in title. An NPRI owner is entitled to receive a royalty equal to a portion of future oil and gas production. Such NPRI is payable on all production from the property, even production under leases that did not exist at the time the deed reserving the NPRI was executed. An NPRI is in addition to and separate from the royalty due to a lessor under a mineral lease (which may be 1/8, 1/5, 1/4, or whatever). Frequently, the lessor and the NPRI owners are different persons. An NPRI owner has no obligation to share in the cost of production[2]. Many older deeds which contain an NPRI reservation, phrase the reservation in terms of an NPRI that is "equal to" some fraction with reference to lease royalties, such as 1/9 of 1/8[3], be provided under future mineral leases. Sometimes, they are "floating royalties"; such as 1/2 of any royalty to be paid under future leases[4]. This article addresses the phrasing of an NPRI reservation that is found in many old deeds: "1/2 of the usual 1/8 royalty."

Now that many leases do not provide for the "usual 1/8 royalty, disagreements frequently arise when an NPRI owner is entitled to "1/2 of the usual 1/8 royalty", but the lease provides for royalty of 1/5 or 1/4. Such disputes can generally be summarized as:

The NPRI owner takes the position that when the deed which reserved the NPRI interest was executed, a 1/8 royalty was so ubiquitous, that an NPRI reservation of "1/2 of the usual 1/8 royalty" just meant "1/2 of the royalty." Therefore, if a subsequent

[1] 299 S.W.2d 904 (1957).

[2] The general characteristics of NRPI's are outlined in *Pickens v. Hope,* 764 S.W.2d 256, 264 (Tex.App.—San Antonio 1988, writ denied).

[3] See, e.g., *Tiller v. Tiller,* 685 S.W.2d 456 (Tex. Civ. App. – Austin 1985, no writ).

[4] See, e.g., *Range Resources v. Bradshaw*, 266 S.W.3d 490, 493 (Tex.App. – Fort Worth 2008, pet. denied)

lease provides for a royalty of 1/4, then the NPRI owner is entitled to be paid one half of that royalty or 1/8 of production. This kind of NPRI reservation is known as a "fraction of" NPRI, it "floats with" and is a fraction of whatever royalty is provided for in future oil and gas leases.

The owners of the other interests take the position that "1/2 of the usual 1/8 royalty" always means 1/16, and 1/16 of production is all that the NPRI owner is ever entitled to receive, regardless of the royalty provided for in any particular oil and gas lease. This is known as a "fractional" NPRI, because it is always the same, fixed, fractional amount of 1/16.

To date, Texas courts have reached decisions that can be difficult to reconcile. CPAs should be aware of this controversy, so that clients are able to decide if royalties due on production from land in which they have an interest are being properly calculated, and/or their clients can seek legal advice regarding their rights and options.

**The basic legal issue**

There are certain principles that all courts will pay lip service to. A deed is a contract to be construed in light of the circumstances that existed at the time of its execution. The key inquiry is to ascertain the intent of the parties to the conveyance. If the language is not ambiguous, that intent is determined solely by the language of the Deed. If it is ambiguous, a Court may consider extrinsic evidence, but a party's subjective intent, which was not clearly articulated in the document itself, is not relevant. Each word and provision must be given its plain, grammatical meaning. A deed must be construed so as to harmonize all of its provisions. No provision should be rendered meaningless. Deeds must be construed to convey the greatest estate possible to the grantee and reserve the smallest estate possible for the grantor. A reservation must be by clear language and a reservation by implication in favor of a grantor is not favored. Any doubt as to the proper construction of the reservation must be resolved so as to reserve unto the grantor the smallest estate that the language will permit. See, e.g., three Texas Supreme Court cases -- *J.M. Davidson, Inc. v. Webster*[5], *Luckel v. White*[6], and *Coker v. Coker*[7].

The controversy over reservations of a fraction of "the usual 1/8 royalty" is the result of what has come to be called the "Estate Misconception Theory." This theory was discussed in a recent case from the San Antonio Court of Appeals, *Graham v. Prochaska*[8]. Essentially, it stands for the proposition that "in the olden days" (before 1970) there was a common misconception -- that the lessor's royalty under a lease would always be one-eighth of production. The theory then posits that given the alleged universality of that misconception, NPRI owners should not be punished for an inability to see future changes which have now resulted in larger lessor royalties.

Consequently when the world changed and lease royalties were no longer "always" 1/8, then NPRI reservations referring to a fraction (usually 1/2) of "the usual 1/8 royalty" should mean that fraction of whatever the royalty the lease particular lease provided for.

A full-fledged analysis of the legal issues discussed in these cases is beyond the scope of this article. This article is simply intended to alert CPAs to a significant issue that may be lurking in the language of deeds

[5] 128 S.W.3d 223 (Tex. 2003)
[6] 819 S.W.2d 459 (Tex. 1991)
[7] 650 S.W.2d 391 (Tex. 1983)
[8] 429 S.W.3d 630 (Tex. App.—San Antonio 2013, petition for review filed)

that nobody has looked at in years, so that they can determine whether it is in their clients' best interest to seek additional advice about their options.

**What to look for**

The most important thing to look for is the clause in the deed which reserves the NPRI. But it is not the only thing to look for. Courts have found language that this author believes was clear to be ambiguous based on other provisions, the overall structure of the deed, or extrinsic circumstances. Courts have resolved issues of intent by looking at extrinsic evidence, such as division orders executed after the deed in the *Coghill* case discussed below, to determine the intent of the drafter of the NPRI reservation. The discussed below are not an exhaustive examination of this issue; but they should provide you with enough familiarity with this issue to decide when it is best to seek assistance.

In *Harris v. Ritter*[9], a 1955 case, the Texas Supreme Court decided that a deed with an NPRI reservation of "one-half of one-eighth of the oil, gas and other mineral royalty" could only mean one thing – a reservation of a 1/16 NPRI. So the dispute in all these recent cases invariably involves a deed where this is some other language, typically insertion of the words "the usual" was before "1/8". Various courts have reached different conclusions. Frequently, the decision turns on minute details of the language of the deed. For example, the dictionary definition of "the" was discussed in the *Prochaska* case. The grammatical significance of the placement of a comma was important in *Brown v. Havard*[10].

In *Brown v. Havard*, the NPRI reservation provided: "Grantors reserve unto themselves, their heirs and assigns in perpetuity an undivided one-half non-participating royalty (Being equal to, not less than an undivided 1/16th) of all the oil, gas and other minerals. . ."

The Supreme Court concluded that the reservation was subject to more than one interpretation: (i) the parties intended to reserve 1/2 of the conventional 1/8 royalty, "being equal to" a 1/16, or (ii) the parties intended to reserve 1/2 of the royalties contained in future leases, providing further that such share must not be less than 1/16. The court concluded that the latter construction required one to ignore the presence of the "comma" between the phrase "Being equal to" and the phrase "not less than an undivided 1/16th." The Court then decided that the trial court was correct to consider the deed ambiguous, based in large part by the placement of the comma in the parenthetical, and look at extrinsic evidence such as the terms of subsequent leases and division orders and not limit its consideration to the language of the document.

In 1988, the San Antonio Court of Appeals decided Pickens *v. Hope*[11]. The deed in that case provided for an NPRI reservation of "1/4 of the usual 1/8 royalty in all of the oil, gas or other minerals produced…" The Court decided it reserved an NPRI that was always equal to a fixed fraction of 1/32 of production.

In 2013 the Corpus Christi – Edinburg Court of Appeals decided *Wynne / Jackson Development, LP v. PAC Capital Holdings, Ltd.*[12] The deed in that case contained an NPRI reservation that stated: "There is excepted herefrom and reserved unto Grantor a non-participating royalty of one-

[8] 429 S.W.3d 630 (Tex. App.—San Antonio 2013, petition for review filed)
[9] 279 S.W.2d 845 (Tex.1955)
[10] 593 S.W.2d 939 (Tex. 1980)
[11] 764 S.W.2d 256, 267-68 (Tex.App.—San Antonio 1988, writ denied)
[12] 2013 WL 2470898 (Tex.App. - Corpus Christi-Edinburg, 2013)(pet. denied). The author was counsel for Wynne / Jackson in this case.

half (1/2) of the usual one-eighth (1/8) royalty in and to all oil, gas, and other materials produced, saved and sold from the above-described property, . . ." Significantly, later in the same sentence, the deed provided that ". . . Grantor shall, nevertheless, have the right to receive one-half (1/2) of any bonus, overriding royalty interest, or other payments, similar or dissimilar, payable under the terms of any oil, gas and mineral lease covering the above-described property." The Court of Appeals held that the first part of the deed created a fixed NPRI that was always equal to 1/16 of production.

Several other recent cases have reached contrary results. In *Sundance Minerals, LP v. Moore*[13], the Fort Worth Court of Appeals was faced with a deed that contained a reservation of "one half of the usual one eighth royalty." The Court decided, based on the overall structure of the deed, that it was a "floating" NPRI equal to one half of any royalty.

In 2012, the Tyler Court of Appeals held in *Coghill v. Griffith*[14], that a reservation of "one-eighth (1/8) of the usual one-eighth (1/8) royalties provided for in any future oil, gas and/or mineral lease" created a "fraction of" NPRI which floated if the royalty was greater than 1/8. The court relied heavily on the fact that, a series of division orders were signed that always provided for an NPRI equal to one half of varying royalties.

The Texas Supreme has yet to squarely address this issue. It has declined to hear Petitions for Review in several cases, such as the *Wynne / Jackson, Sundance Minerals* and *Coghill* cases. The Petition for Review is pending in *Graham v. Prochaska*. Perhaps it will provide an answer.

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[13] 354 S.W.3d 507 (Tex. App.—Fort Worth 2011, pet. denied).

[14] 358 S.W.3d 834 (Tex.App. – Tyler 2012, pet. denied**).**