Chapter 5

The

Royalty Clause

DIFFERENT TYPES OF ROYALTY

Landowner Royalty is a term sometimes used to refer to the fractional amount of production negotiated by the mineral owner at the time the oil and gas lease is signed. This fractional amount of production is the mineral owner's share of gross production, free from the expenses of exploration, drilling, developing, and operating the lease.

Royalty ownership is not the oil or gas minerals being produced from the well, rather it is a share of the revenues from the production of oil or gas being produced. Royalty is nothing more than a person's piece of the production pie that comes from a producing oil and gas well. Just as an author of a best selling novel would receive a royalty check *based* on the sales of his or her book, a royalty owner would receive a royalty payment based on the production of a producing well.

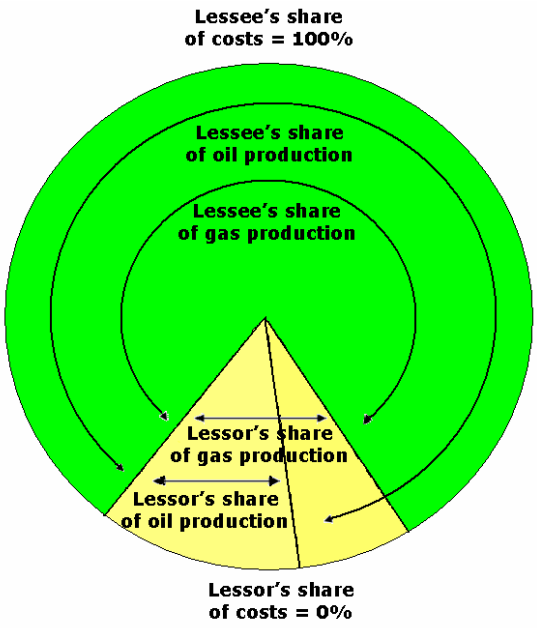
Royalty Clause

In consideration of the premises the said lessee covenants and agrees:

1st. To deliver to the credit of lessor free of cost, in the pipe line to which it may connect its wells, the one-eighth (1/8) part of all oil produced and saved from the leased premises.

2nd. On gas including casinghead gas or other gaseous substance, produced from said land and sold or used in the manufacture of products therefrom the market value at the well of three-sixteenths (3/16) of the gas so sold or used, such proceeds to be less severance and other excise taxes, said payments to be made monthly.

In most cases, the terms landowner royalty, leasehold royalty or lessor's royalty are one and the same.



Generally, royalty is defined as a *cost-free* share of production paid or delivered to the lessor. Cost-free refers to costs associated with drilling, completing, and producing the well; however, the lessor may be assessed a share of costs incurred after production.

As seen in the illustration, the lessor's royalty for gas is greater than for oil (see lease language above), Since royalty is cost free it bears no costs associated with development, exploration or production. Those costs are borne by the lessee.

Nonparticipating Royalty - Just as the mineral ownership can be severed from surface ownership so too a *royalty* ownership can be severed from the *mineral* owner. Mineral owners can convey either all or a part of their share of *royalty* interest in a tract of land to a non-mineral owner. When this happens the severed royalty owner is referred to as a nonparticipating royalty owner.

Nonparticipating royalty means that the royalty owner does not participate in or maintain certain types of rights. These owners have no rights to lease oil and gas minerals since they own no minerals. They would not share in any bonus money given when an oil and gas lease is signed and they would not receive any delay rentals due under the terms of the lease. All they own is a royalty interest and their piece of the pie will simply come in the form of a royalty check when there is production from a producing well.[1]

A deed that reads, "1/24th of all of the oil, gas and other minerals *produced*, saved and made available for market" and continued by granting leasing, bonus and rental rights to the grantor would be considered a royalty conveyance because the deed is limiting the minerals as to those that are produced. These minerals are no longer in the ground.[2]

A deed that would read, "1/24th of the oil, gas and other minerals that *may be produced"* would be considered a mineral conveyance because the deed is limiting the minerals as to those that may be produced. These minerals are still in the ground.[3]

Example 1: of nonparticipating royalty ownership:

Jason Johnson, the owner of 100% of the minerals under a certain tract of land, conveyed a 1/24th nonparticipating royalty interest to his grandson. The conveyance covered a 1/24th royalty interest in and to the entire tract of land. When Jason Johnson signed the oil and gas lease with your company, he negotiated a royalty rate of 3/16th. If your company drilled a well, royalty checks would be sent to both Jason Johnson and his grandson in the following amounts:

Total royalty paid	=	3/16 or 18.75%
Royalty paid to grandson	=	1/24 or 4.16666%
Royalty paid to Mr. Johnson	=	18.75000%
		- 4.16666%
		14.58334%

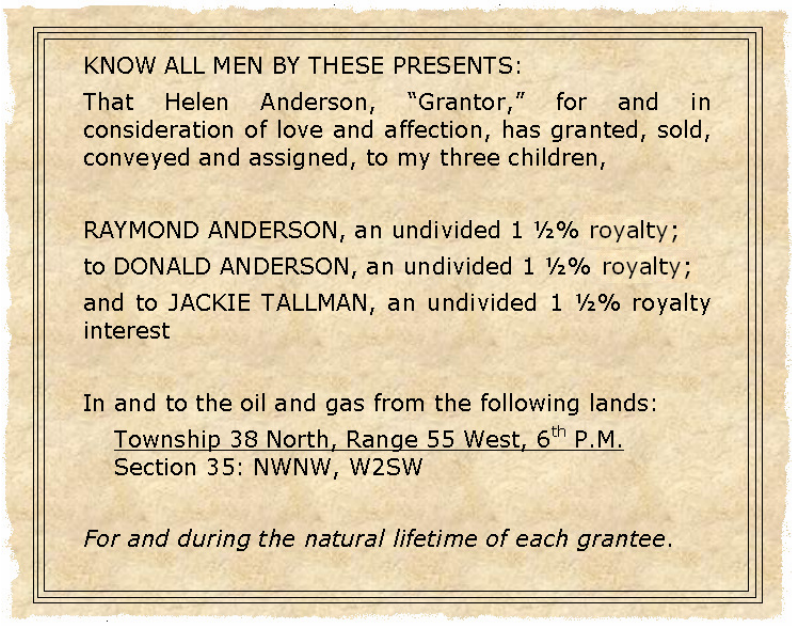
Example 2: If Jason Johnson would have conveyed a 1/24th of his 3/16th lease royalty he would be conveying a fraction of his royalty not a fractional

royalty from the land. In this case the royalty percentages would be as follows:

Total royalty paid	=	3/16 or 18.75%
Royalty paid to grandson	=	1/24 of 18.75% = 0.78125%
Royalty paid to Mr. Johnson	=	18.75000%
		- 0.78125%
		17.71875%

Perpetual nonparticipating royalty – Nonparticipating royalty can be conveyed either as a perpetual or a non-perpetual interest. A perpetual nonparticipating royalty continues to apply under any oil and gas lease and will continue forever into the future unless somehow changed.

Non-perpetual nonparticipating royalty is a royalty interest that will expire at the end of a particular term, such as when the lease expires, at the end of production from a producing well, or on a given date.



KNOW ALL MEN BY THESE PRESENTS:

That Helen Anderson, "Grantor," for and in consideration of love and affection, has granted, sold, conveyed and assigned, to my three children,

RAYMOND ANDERSON, an undivided 1 ½% royalty;
to DONALD ANDERSON, an undivided 1 ½% royalty;
and to JACKIE TALLMAN, an undivided 1 ½% royalty interest

In and to the oil and gas from the following lands:
Township 38 North, Range 55 West, 6th P.M.
Section 35: NWNW, W2SW

For and during the natural lifetime of each grantee.

This example royalty deed creates a non-perpetual nonparticipating royalty interest.

In this case Helen Anderson, grantor is conveying a non-perpetual non-participating royalty interest to her three children. The conveyance limits the term of ownership "during the natural lifetime of each grantee.

Term mineral or term royalty conveyances or reservations simply convey or reserve minerals or royalty for a specified period of time.

Conveying or reserving minerals and or royalty can be done in one of three manners:

First, both minerals and royalties can be conveyed or reserved without any specified term attached to the conveyance.

Second, both minerals and royalties can be conveyed or reserved for a specified time period. This is called a *term-mineral* or *term-royalty interest.* In this case, upon the expiration of the specified term, the minerals or royalty will revert back to the other party. Generally, the holder of a term interest can sign an oil and gas lease, but that lease or portions thereof, *will not continue* beyond the expiration date of the term mineral interest. This issue can create a challenge. Unless the conveying document provides for the continuation of the lease past the expiration date, a lease will not transfer to the reversionary mineral owner and two leases should be taken - one from the holder of the term interest and the other from the holder of the reversionary interest.

Third, both minerals and royalties can be conveyed with the following language: conveyed or reserved for a *fixed term* and "as long thereafter as oil or gas is produced."

In order for this option to take effect and move the term mineral into a "secondary term" there must be either oil or gas production in paying quantities not only during the term of the deed but at the date of expiration of the term or there must be diligent operations in place. If not, the minerals or royalty will revert back to the other party.

In early oil and gas leases, the lessor's compensation for gas was a stated sum per completed gas well.

Overriding Royalty is the fractional amount of gross production created out of the lessee's share of oil and gas production (working interest owner). This interest is also free from the expenses (cost-free) of exploration, drilling, developing, and operating the lease. A common characteristic of an overriding royalty is that the interest terminates when the lease terminates. In other words, if your company assigned their leases to another company, carving out a 3.25% override on each of the leases, the life of that override would depend on the other company's ability to keep the lease alive, by paying rentals, making shut-in payments or drilling operations.

Minimum Royalty - From time to time, a lessor will add language to the lease whereby the annual royalty payment must meet a certain threshold. If the royalty during this period falls short of this threshold, the lessor is required to pay a minimum royalty amount established in the lease language. Usually, the lease language will stipulate that if minimum royalties are not met the lease will terminate.

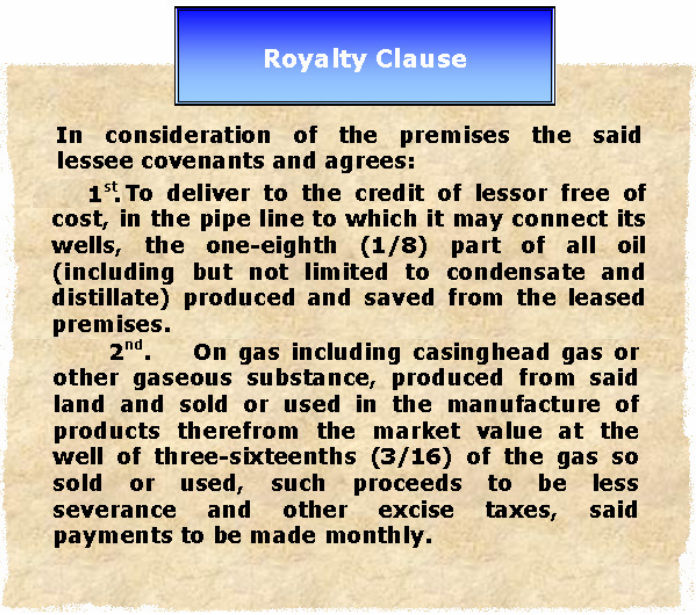
Production Payments - Production payments are similar to overriding royalty interests in that they, through an assignment, are usually carved out of a working interest owner's share of production. Owners of production payments do not pay

for any of the costs associated with the drilling or production from a well. The main area of difference between an override and a production payment is the term or length of life of the interest. An override exists for the life of the lease; the production payment ends after a certain amount of specified money has been paid to the holder of the interest. Production payments create a type of ownership similar to that of a debtor/creditor relationship; however, the assignor is only obligated to pay if there is production.

ROYALTY CLAUSE

The royalty clause is that portion of the lease which sets out the fractional amount of production due the lessor. This can also be referred to as "leasehold royalty".

In the example language, the lessor negotiated a different fractional amount of oil ($1/8^{th}$) than for gas ($3/16^{th}$). This interest is cost free to the lessor meaning that the lessor bears no costs associated with the drilling of any well. Those risks and costs are borne entirely by the lessee.



CALCULATING ROYALTY WHEN THE LESSOR OWNS LESS THAN 100%

Calculating the lessor's royalty when he or she owns less than 100% of the interest under the leased tract of land is addressed in the Proportionate Reduction Clause.

> "If said lessor owns a less interest in the above described land than the entire and undivided fee simple estate therein, then the royalties and rentals herein provided shall be paid the lessor only in the proportion which his interest bears to the whole and undivided fee."

When this occurs the lessor is only entitled to receive their royalty based on the percentage of the minerals owned.

Example: Beverly Downing leased a 160-acre tract of land to your company. According to the lease she is entitled to receive a three-sixteenths royalty;

however she only owns an undivided 25% interest in the tract of land. The royalty calculation for Ms. Downing should be:

18.75 royalty X .25% owned in the tract = 4.6875%

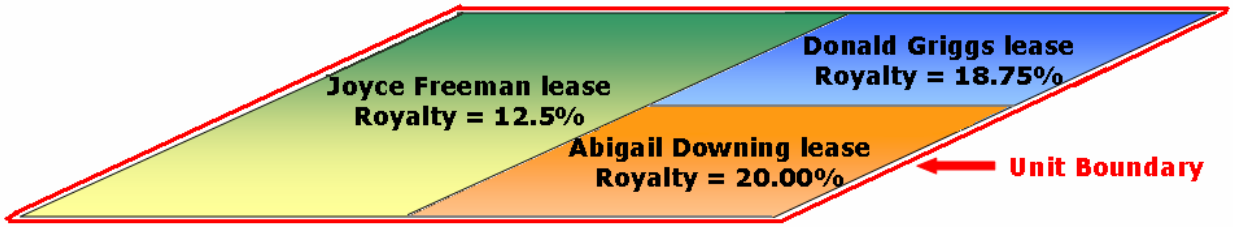
If a lease well was drilled on this tract of land, Ms. Downing would receive 4.6875% of all production in the form of her royalty payments.

CALCULATING ROYALTY IN LIGHT OF THE POOLING CLAUSE

In most cases, a single lease is smaller than a drilling unit. When this happens, all leases inside the boundary of the unit are said to be pooled together. All leases inside the unit boundary then share in the production from the unit well.

Once inside a producing unit, the calculation of the royalty attributed to any one lease must be based proportionality on the net acres covered by the lease. The royalty clause must be interpreted alongside the polling clause of the lease.

Example: As seen in the illustration, Joyce Freeman owns the W/2 of Section 32. Donald Griggs owns the NE/4 and Abigail Downing owns the SE/4 of the section. Your company has formed a 640-acre unit, pooling all three leases into the unit. Based on the mineral acreage owned by these three parties and the royalty amount found in their leases, their royalty calculations would be a follows:



Joyce Freeman = 320/640 X 12.5% = 6.25% royalty
Donald Griggs = 160/640 X 18.75% = 44.6875% royalty
Abigail Downing = 160/640 X 20% = 5% royalty

DETERMINING THE PRODUCT THAT SHOULD BE PAID

The royalty clause generally mentions several types of products that may be produced including: oil, gas, condensate, distillate, casinghead gas, or, in the case of our lease example, other gaseous substance. Defining each of these products becomes an important part of determining the appropriate royalty rate paid to the lessor.

Natural Gas Wells

Natural gas wells can contain a mixture of different substances that exist in a gaseous state while underground. The terms condensate, distillate or natural gasoline describe these substances.

Condensate is a product recovered from natural gas that is originally in a gaseous or vapor state while in the reservoir. This product becomes liquid hydrocarbons, through condensation, at the surface.

Distillate is a product recovered from a gas well and condensed into a liquid by a separator. Distillate is defined as almost pure gasoline.

Oil Wells

Oil wells can produce another type of substance called *casinghead gas* which describes a vapor that is produced from an oil well. The gas is removed by means of an oil and gas separator located near the well or it can be left to accumulate in the well between the production string and the casing. Once the gas is separated, it can be used for a number of purposes including fuel for the well operation or processed petroleum products.

Example 1: If an oil well was drilled and the well produced casinghead gas, according the language in royalty clause of the lease, all oil would be paid a royalty rate of $1/8^{th}$ and the casinghead gas would be paid a $3/16^{th}$ royalty rate.

Example 2: If a gas well was drilled that produced condensate, according to the language in the royalty clause of the lease, all gas would be paid a royalty rate of $3/16^{th}$ and all condensate would be paid a $1/8^{th}$ royalty.

ROYALTY PAID ON OIL

Most oil and gas leases actually *give* the lessor his or her share of the oil saved and produced. The oil becomes the lessor's property. Consider the wording:

> "deliver to the credit of lessor free of cost, in the pipeline the one-eighth part of all oil produced and saved."

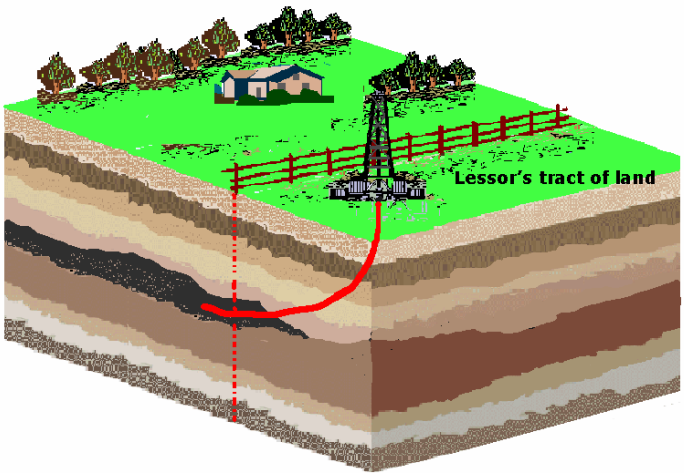
Royalty Paid on Oil

In consideration of the premises the said lessee covenants and agrees:

1st. To deliver to the credit of lessor free of cost, in the pipe line to which it may connect its wells, the one-eighth (1/8) part of all oil (including but not limited to condensate and distillate) produced and saved from the leased premises.

The royalty owner can take the oil in kind. In most cases, the oil becomes payable in kind by delivering it into the pipeline to which the well is connected. This share of the oil is credited to the lessor's account. Payment then becomes the duty of the purchaser.

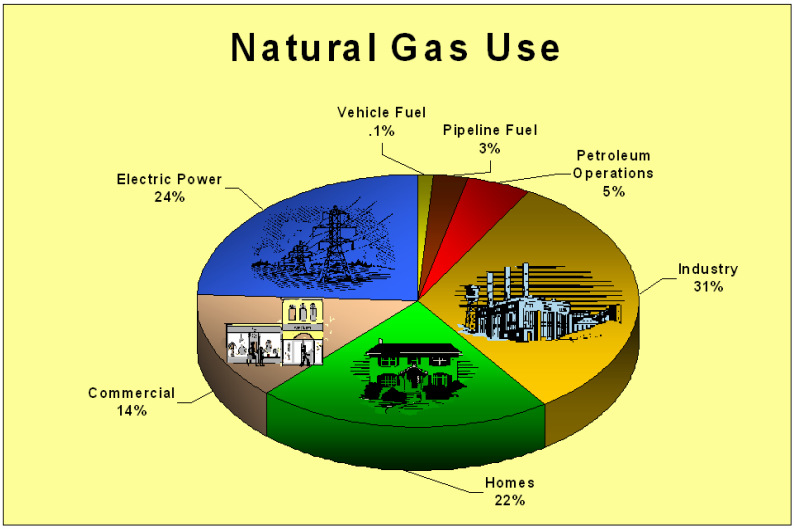
Notice, too, the oil is to be delivered *free of cost*. The royalty owed the lessor on oil is, first of all, free of cost, as stated in the lease and is calculated on the gross production rather than the net production of the product. Therefore, the lessor would receive 1/8th of all oil produced (free of cost, in the pipeline) without any deductions associated with the cost of production.



If a well is drilled on the lessor's tract of land but has bottom holed and is producing from an adjoining tract, the lessor is entitled to his or her share of royalty.

ROYALTY PAID ON GAS

As has been previously discussed, in the beginning of our country's oil and gas history, gas had little commercial value; therefore there was no provision in the lease to pay royalty for gas. Today, the value of natural gas is tremendous and is used for many everyday uses, as can be seen from the chart.



As the value of natural gas became realized, the lease language changed to include gas royalty.

Gas is different from oil. Whereas, oil is a liquid product, gas is a gaseous product and has the capacity of indefinite expansion. Therefore, gas cannot be given to the lessor or placed in some sort of storage tank on behalf of the lessor. "As a consequence, royalties thereon are always payable in money and never in kind. Upon production, title to all of the gas, including the royalty share of the lessor, is vested in the lessee, and he has the absolute right to dispose of the entire production." [4]

Royalty Paid on Gas

2nd. On gas including casinghead gas or other gaseous substance, produced from said land and sold or used in the manufacture of products therefrom the market value at the well of three-sixteenths (3/16) of the gas so sold or used, such proceeds to be less severance and other excise taxes, said payments to be made monthly.

In contrast to oil, when gas royalty is being paid the lessor is paid a stated sum of money based on (in our lease example) the (1) market value, (2) at the well.

"On gas, including casinghead gas, condensate and other gaseous substances, produced from said land and sold or used…the market value at the well of three-sixteenths of the gas so sold or used…"

THREE GROUPINGS OF GAS ROYALTY CLAUSES:

Gas royalty is typically measured by one of two factors (1) what the lessee sold the gas for (Proceeds) or (2) the value placed on the gas at the time it was sold (Market Value): therefore, leases can be grouped into one of three categories:

1. Proceeds Leases
2. Market Value Leases
3. A mixture of both

Proceeds Leases calculate the royalty payment based on the proceeds (money) received by the lessee in their sale of the gas.

Proceed leases can be grouped into one of two categories, (1) *net proceeds*, or (2) *gross proceeds* leases.

A *net proceeds* lease will calculate the royalty payment based on the proceeds received by the lessee in their sale of the gas but will allow the lessee to deduct most of the costs of production and post production.

Example language:

> "Lessee shall pay lessor, as royalty, one-eighth of the net proceeds from the sale of gas…"

Under a *gross proceeds* lease the lessee is obligated to pay the lessor his or her full royalty share of the actual proceeds (money) received from the sale of gas. The calculation would be to multiply the amount of money received from the sale of the gas by the lessor's fractional royalty found on the lease.

Example language:

> "Lessee shall pay Lessor for gas from each well where gas is found one-eighth …of the gross proceeds at the prevailing market rate…"

Market Value Lease – Under a *market value* lease the royalties are to be calculated based upon the *price* that would be paid by a willing buyer to a willing seller in a free market.

Market value can be defined as the *current prevailing price* of gas when the gas is delivered rather than the *proceeds* received under a gas contract. In other words, the market value, at the time the gas is sold, may be higher or

lower than the amount paid to the lessee under a gas contract. In order to calculate royalty, one must use the current prevailing price when the gas is delivered multiplied by the fractional royalty found on the lease.[5]

As can be seen, market value leases can pose problems for a lessee whose contract price is much less than the current market value of the gas. Whereas, Oklahoma courts have generally taken a pro-lessee position on these types of issues, Kansas courts have taken a pro-lessor position.

In the case of *Foster v. Atlantic Refining Company*, the court recognized that market value prices might exceed those prices as set out in a gas contract and become a financial liability to the lessee. They stated,

> "Whether entering into the contract was provident or not does not change the royalty provisions. The fact that the ascertainment of future market price may be troublesome or that the royalty provisions are improvident and result in a financial loss to [Lessee] 'is not a web of the Court's weaving'. [Lessee] cannot expect the court to rewrite the lease to [Lessee's] satisfaction."[6]

Example language:

> "To pay the lessor one-eighth, at the market price at the well for the gas so used…"
>
> "Lessee shall pay Lessor for gas from each well where gas is found one-eighth …of the gross proceeds at the prevailing market rate…"

A Mixture of both - these types of leases can also be referred to as Waechter Leases and the language address both proceeds and market value. This type of lease provides that the lessee pay the lessor a royalty on the gas marketed from the proceeds if sold at the well, or, if marketed off the leased premises, then a royalty based on the market value at the well.

Example language:

> "Lessee shall pay Lessor monthly as royalty on gas marketed from each well one-eighth of the proceeds if sold at the well, or if marketed off the leased premises, then one-eighth of the market value thereof at the well."[7]

CALCULATING ROYALTY

Calculating royalty is not always an easy matter. Getting the product to the refineries and processing plants can be very expensive. Processing gas so that its value reaches its maximum potential is also expensive and the

question arises, "When calculating royalty is the lessor responsible for any of these fees?" If so, the calculation of the lessor's royalty is based on their proportionate part of these fees and the lessor would receive their gross less their share of these deductions. If not, the royalty owner would receive their full gross amount.

When it comes to this issue, the royalty owners clearly stand on one side of the fence and the oil companies stand on the other side of the fence with only a courtroom in between. This issue has seen more than its share of litigation across the country. Because of the volumes of court cases and differing opinions on the matter, the following discussion will only touch the surface of how this issue has been addressed.

GETTING THE PRODUCT TO THE PROCESSING PLANT

DEHYDRATION AND COMPRESSION COSTS

Oil wells contain water to one degree or another. The more water being produced the greater the issues that might arise. In oil, the water will generally separate as the oil settles. In other cases, the problems can only be resolved through a chemical or heating treatment. The water removed must be disposed of and that means injecting the water back into the ground. Transporting this water may also pose issues for the lessee and all of those issues cost money.

Natural gas wells also produce water and face the same problem as cited. However, since gas must be transported through a pipeline system, the water issue, at times, must be dealt with prior to transporting the gas to the processing plant. Most pipeline companies will not transport gas that contains more than seven pounds of water per million cubic feet of natural gas.[8]

Often the pressure that pushed natural gas out of the ground is not great enough to push the product into an already pressurized pipeline. When this occurs gas cannot become marketable until it is first compressed. Compression also costs money.

TRANSPORTATION COSTS

The only effective way to move natural gas from the well to the market place is through pipelines. These pipelines are called the gathering system. In many cases, gas must travel great distances before it reaches the processing plant. The American Gas Association estimated that in 1999 there were over 36,100 miles of gathering system pipelines in the United States.[9] All of this comes with a price tag.

States have different opinions about how these costs should be borne. The majority of states feel that royalty should be subject to subsequent costs such as transportation, gathering and dehydration.

The state of Wyoming, on the other hand, has addressed this issue by passing the Wyoming Royalty Payment Act. Under WYO. STAT. ANN. § 30-5-304(a), (v), (vii), costs of production cannot be deducted from an overriding royalty or royalty payment. The statute goes on to address non-deductible costs as the cost of transporting gas into a market pipeline and all charges between the wellhead and the market pipeline except those specifically excluded from the definition. This not-deduction does not include transportation costs from the point of entry into the market pipeline. This Act provides that a royalty is the mineral owner's share of production "free of the costs of production."

Colorado, Kansas and Oklahoma have adopted the *marketable product theory* which says that the lessee is required to pay all costs in making the product marketable through their implied covenant to market the gas. To this extent, the mineral owner receives a cost free share of the gross proceeds from the sale of the gas.

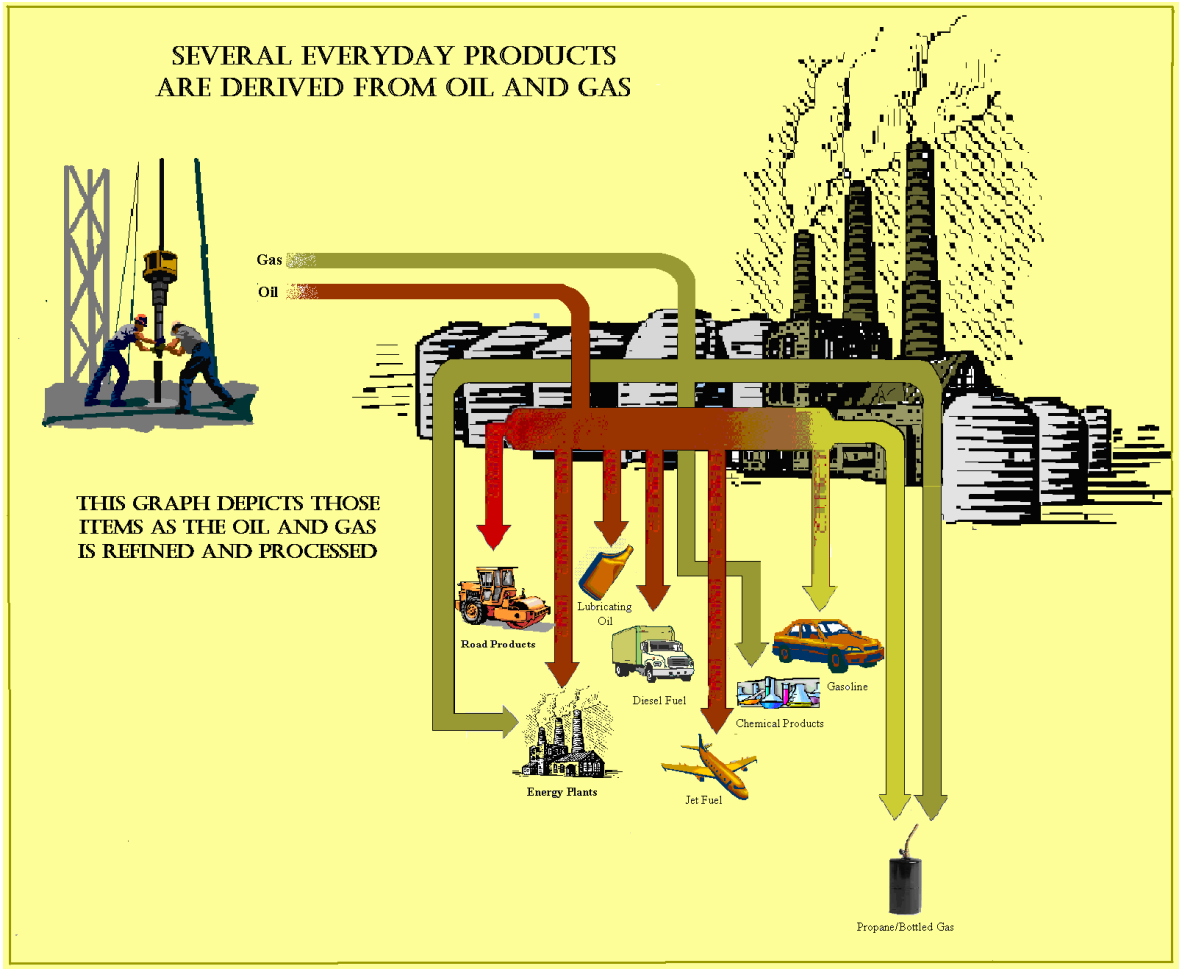
A Kansas court quoted the following from M. Merrill, Covenants Implied in Oil and Gas Leases:

> "'If it is the lessee's obligation to market the product, it seems necessary to follow that his is the task also to prepare it for market, if it is unmerchantable in its natural form. No part of the costs of marketing or of preparation for sale is chargeable to the lessor.'"[10]

PROCESSING OIL AND GAS

Oil and gas must be refined and processed. When crude oil comes out of the ground it will most likely look dark and sticky. One could not put a quart of this oil into the engine of his or her car and expect great results. Nor could one take the same product and fill the gas tank expecting any better results. Crude oil must go through a heating process whereby the substance is separated into liquids and gases. After the refining process, one barrel of crude oil produces approximately 20 gallons of gasoline, 7 gallons of diesel fuel, jet fuel, propane to heat homes, and other products such as ink, crayons, bubble gum, dishwashing liquids, deodorant, eyeglasses, records, tires, ammonia, and heart valves.[11]

Natural gas is similar to crude oil in that it too must go trough a refining process. Over one-half of the homes (approximately 62.5 million) in the United States are heated by natural gas. Natural gas is also a critical ingredient for the manufacture of products such as: paints, fertilizer, plastics, antifreeze, dyes, photographic film, medicines, explosives, and propane. Natural gas is used to produce steel, glass, paper, clothing, and brick and is used in homes to run furnaces, water heaters, and clothes dryers.[12]



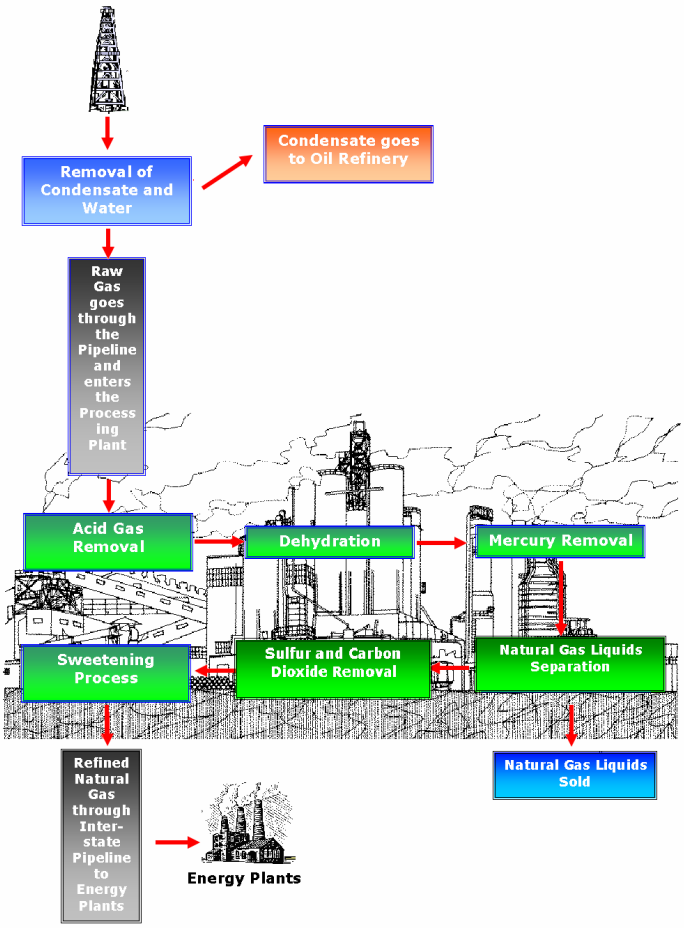
The gas leaving the well contains methane gas and the gas used in homes is made up mostly of methane gas, but as it comes out of the ground it contains a variety of other products including ethane, propane, butane, pentanes, water vapor, hydrogen sulfide, carbon dioxide, helium, nitrogen and other compounds. In order to turn this raw natural gas into its most

valuable state, processing of the gas must take place. The refining process simply separates all of the differing compounds from the raw natural gas. This process can be very involved whereby several removal processes take place. They are:

- The Removal of Oil and/or Condensate
- The Removal of Water
- The Separation of Natural Gas Liquids
- The Removal of Sulfur and Carbon Dioxide[13]

Natural gas liquids (NGL's) such as ethane, propane, butane, iso-butane and natural gasoline become valuable commodities of the raw natural gas and can be used for enhancing oil recovery, providing raw materials for oil refineries or petrochemical plants, and other sources of energy.[14]

Once these processes take place, the natural gas is referred to as dry natural gas and ready to be moved into a major transportation pipeline.



THE ROYALTY CLAUSE AND PROCESSING GAS

Generally, as gas moves farther from the wellhead it becomes more valuable in nature. This happens because of two elements. First, the operator spends money so that the product can move through the gathering system. These fees might be in the area of dehydration, compression or gathering fees. Secondly, the gas becomes more valuable as it is refined at the processing plant.[15]

The cost of achieving the end value can be very expensive. Typically, the lessee will want to pay the lessor a value as close to the point of extraction as possible and lessors will seek to value their share of production as far downstream as possible. "If a downstream value is used to calculate royalty, lessees will seek to deduct the investment value of the gas before

applying the royalty fraction. Lessors will seek to have their royalty calculated on the total downstream value without deduction of any investment value."[16]

THE LANGUAGE IN THE ROYALTY CLAUSE

When dealing with the gas royalty clause one must determine if the language in the lease exempts the lessor for paying any of the costs associated with making the product valuable. The language in the lease is primarily the deciding factor and land administrators should examine each royalty clause separately.

> A Texas Court was called upon to address the issue of dehydration in a dispute where oil was involved. The lease provided for a one-eighth royalty that was free of costs, in the pipeline. They found, "Whether the savings be in the oil as it emerges from the earth or after a separating…or by distilling…, or by any other means whatsoever, under the very terms of the lease, the oil having been produced and saved from the wells on the lease, the Lessor has title to, and is entitled to receive, a one-eighth part thereof." *Reynolds v. McMan Oil & Gas Co*.[17]

One of the important issues cited by the court was the lease language,

"free of cost."

The court also would not allow the lessee to deduct other costs associated with removing casinghead gasoline from the oil. The reason again went back to the lease language. Casinghead gasoline was addressed in the royalty clause under the oil royalty portion requiring the lessor to deliver the casinghead gas to the tanks free of cost.

Whereby, the lease language in the Reynolds case exempted the lessor's from paying dehydration costs, the lease language in another Texas case did not exempt them from paying.

In *Holbein v. Austral Oil Co., Inc*., the royalty clause provided for a one-eighth royalty from the amount realized by the Lessee from the sale of gas. The court held that the costs were incurred subsequent to production of the well, "and should be borne by non-operating interests as well as operating interests".[18]

A Kansas court dealing with compression costs and a lease containing the following language, "pay one-eighth of the proceeds from the sale of gas at the mouth of the well," found that the lease contained some ambiguities since it did not fully address marketing costs. The court determined that when ambiguities exist, the finding should be in favor of the lessor if the

lessee provided the lease form. The rationale is that if the lessee provides the lease form they are the ones who have primary opportunity to address any and all marketing concerns by placing them in the lease language. This finding seems to be universally upheld in courts across the land.

In the case of *West v. Alpar Resources, Inc*. the royalty provision read as follows:

> The lessee shall pay lessor, as royalty, one-eighth of the proceeds from the sale of the gas, as such, for gas from wells where gas only is found and where not sold shall pay Fifty ($50.00) Dollars per annum as royalty from each such well, and while such royalty is so paid, such well shall be held to be a producing well.

The well drilled produced both gas and hydrogen sulfide which was a product that had to be removed in order for the gas to be marketable. The removal process was very expensive and the lessee proceeded to deduct the removal expenses from the lessor's share of production.

The North Dakota court found, "Although the foregoing authorities provide background and helpful insight, we must ultimately decide this case upon the express language of the lease using appropriate rules for interpreting contractual agreements." Remember that the operative words were one-eighth of the proceeds from the sale of the gas, as such. The court found in favor of the lessor.

A Kentucky court in *Warfield Natural Gas Co. v. Allen* denied the deduction of marketing expenses because the language in the royalty clause based the royalty on one-eighth of proceeds received from the sale thereof.

Footnotes

[1] "Title Curative for the Field Landman a Guide to Conducting Title Curative - Primarily in the State of Texas," Curtis D. Horne, CPL, *p.8.*

[2] Miller v. Speed, 245 S.W.2d 250 (Tex. Civ. App. 1952, no writ).

[3] Hooks v. Neill, 21 S.W.2d 532 (Tex. Civ. App. 1929, writ ref'd).

[4]All About Royalties, Chapter 7, Rocky Mountain Law Instutute, Robert E. Sullivan, (1971).

[5]An Introduction to Kansas Oil & Gas Law, David E. Pierce, University School of Law, 1988, p. 78.

[6]Foster v. Atlantic Refining Co., 329 F.2d 485 (5th Cir. 1964).

[7]*Waechter v. Amoco Production Co., 217 Kan. 489, 490, 537 P.2d 228, 231 (1975).*

[8]Calculating the Landowner's Royalty, Rocky Mountain Mineral Law Foundation, Chapter 13, J. Clayton La Grone.

[9] www.naturalgas.org.

[10]Gilmore, 192 Kan. at 393, 388 P.2d at 607.

[11] www.eia.doe.gov/kids/energyfacts, Melanie Harper.

[12] Energy Information Administration, *Natural Gas Annual 2004*, December 2005, 2006.

[13] www.naturalgas.org.

[14] Ibid.

[15]Exploring the Origins of Royalty Disputes, David E. Pierce, Petroleum Accounting and Financial Management Journal, 2004.

[16]Ibid.

[17]Calculating the Landowner's Royalty, Rocky Mountain Mineral Law Foundation, Chapter 13, J. Clayton La Grone.

[18]Ibid.