ENERGY NEWS ALERT

BEATTY & WOZNIAK, P.C.
Energy in the Law

Landmen Beware! When you cross state lines, interpretations vary!

By: Kyle Allen

While Colorado has recently become the apparent epicenter of regulatory efforts relating to the oil and gas industry, the State of Texas remains the rig count champion of the United States. As traditionally-western operators move into the producing fields of South and West Texas, it is imperative that their land departments recognize the potential for striking differences between oil and gas laws in Texas and the laws of other western states.

This article presents an important difference between the laws of Colorado and Texas that land departments should be aware of. In particular, this article addresses how each jurisdiction interprets the magic words "at the well" and "at the mouth of the well" within the royalty clause of an oil and gas lease to reach strikingly different conclusions about whether the lessee may deduct the lessor's proportionate share of the post-production transportation costs from the royalty payment.

A typical royalty clause reads:

> As a royalty, Lessee covenants and agrees: (a) to deliver to the credit of Lessor *at the wells* or to the credit of Lessor in the pipe line to which the wells may be connected, one-eighth part of all oil produced and saved by Lessee from said land; and (b) to pay Lessor for gas and casinghead gas produced from said land when sold by Lessee, one-eighth of the amount realized by Lessee, computed *at the mouth of the well.*

(emphasis added.) The experienced landman operating in Colorado is likely aware of the Colorado Supreme Court's ruling in *Rogers v. Westerman Farm*

Company, 29 P.3d 887 (Colo. 2002). In this case, the court held that the phrase “at the well” is insufficient to allocate costs between the lessor and lessee in connection with the calculation of royalty payments. Instead, this allocation of costs—and in particular post-production transportation costs—is a factual question determined under the implied covenant to market, a topic not addressed in this article.

This same experienced landman’s first venture into Texas, however, might be through an unseen minefield. Savvy local Texas counsel, passionate about protecting their neighbors’ interests, will strike “at the wells” and “at the mouth of the well” from the royalty clause. This otherwise experienced landman may not be aware that the Supreme Court of Texas views the existence of our magic words quite differently than does the Colorado Supreme Court.

In *Heritage v. NationsBank*, 939 S.W.2d 118, 121 (Tex. 1996), the Supreme Court of Texas held that the lessee properly deducted post-production transportation costs from the mouth of the well to the point of sale despite a provision in the royalty clause that “there shall be no deductions from the value of Lessor’s royalty by reason of any required [...] transportation, or any other matter to market such gas.” The court reasoned that where a lessee receives value at the well, the deduction from the lessor’s royalty of post-production costs for transportation of the gas from the well to the point of sale did not reduce the value of the gas at the well. Therefore, to eliminate the permissible deduction of post-production transportation costs, Texas counsel will strike any reference to calculating the royalty “at the well” or “at the mouth of the well.”

Landmen and oil and gas attorneys working for companies that operate in multiple states under various regulatory authorities must recognize that each jurisdiction may have its own unique legal requirements and interpretations. As the example above shows, what appears to be a minor, inconsequential change can have significant economic impacts to the oil and gas operator.

For further information, please contact Kyle Allen.