WHAT'S IN A NET ROYALTY ACRE?

We all understand the definition of "net mineral acre." It is derived by multiplying a fractional interest in minerals by the acreage over which the interest is owned. "Net royalty acre," however, has two definitions. It should, therefore, be defined in any legal document in which it appears.

Here is the first definition: "A royalty acre is the full lease royalty on one acre of land." Patrick H. Martin & Bruce M. Kramer, *Williams & Meyers Oil and Gas Law* (2013) §320.3. The royalty thus defined is computed as follows: net royalty acreage is divided by total acreage in the tract. The quotient is multiplied by lease royalty to derive the portion of production to which the royalty owner is entitled. (Ten royalty acres in a 100-acre tract covered by a lease carrying a 1/4 royalty would entitle the royalty owner to 2.5 percent of production.)

Here is the second definition: A net royalty acre is "that part of the interest in the 1/8 of the oil produced from one acre." *Payne v. Campbell*, 250 Miss. 227, 164 So.2d 780 (Miss. 1964). By this definition, a net royalty acre entitles its owner to a fixed portion of production. That portion is computed as follows: net royalty acreage is divided by the total acreage in the tract. The quotient is multiplied by 1/8 to derive the portion of production to which the royalty owner is entitled. (Ten royalty acres in a 100-acre tract would entitle the royalty owner to 1/80 of production, regardless of lease royalty.)

The Texas Supreme Court adopted the first definition in the following dicta in *Temple-Inland Forest Products v. Henderson Family Partnership*, 958 S.W.2d 183, 185 (Tex. 1997): "The owner of 50 royalty acres out of a 32,808.5 acre tract is entitled to receive 50/32,808.5 of royalty, not a 50/32,808.5 fixed royalty." The Court cited *Williams & Meyers*, *supra*, for its proposition.

An earlier case also indicated that a Texas court would use the first definition. *Abell v. Grove*, 152 S.W.2d 885 (Tex. App. – El Paso [8th Dist.] 1941) involved royalty due under a relinquishment act lease. In that case, Grove, as owner of the soil, leased a 240-acre tract. He then conveyed to Abell an undivided 1/6 of the 1/16 royalty due to Grove under the lease, "the same equal to 40 undivided royalty acres…." (One-sixth of 240 is 40.) Rejecting Abell's contention that 40 royalty acres entitled him to 1/6 of the 1/8 lease royalty, the court said: "This is in the face of the expressed provision in the conveyance that 'one-sixth of the one-sixteenth interest is equal to 40 acres.' *There is an entire absence of repugnancy in the clauses of the deed* [emphasis added]." *Id.* at 886. So, in this 1941 case, a Texas court held that a 40 net royalty acre interest in a 240-acre tract entitled its owner to a portion of a 1/16 royalty rather than a 1/8 royalty.

On the other hand, the Texas case of *Tyler v. Bauguss*, 148 S.W.2d 912 (Tex. App. – Dallas [5th Dist.] 1941) held that a conveyance of 20 royalty acres out of a 200-acre tract conveyed 1/80 of production. (Twenty acres divided by 200 acres times 1/8 equals 1/80.) Because the court held that the deed conveyed 1/80 of production rather than 1/10 of lease royalty, it seemed to use the

second definition of net royalty acre. At the time, the lands were subject to a lease which reserved a 1/8 royalty.

The second definition, that a net royalty acre is 1/8 of production from one acre of land, is also used widely.

In *Dudley v. Fridge*, 443 So.2d 1207 (Ala. 1983), Dudley, one of the plaintiffs, contracted to sell a 5 net royalty acre interest in 50 net mineral acres to the defendants. But, when the Royalty Deed was executed, it conveyed a 1/10 royalty interest[1]. At the time of the sale, the tract was covered by a lease carrying a 1/8 royalty [first lease]. The plaintiffs later executed an oil and gas lease which carried a 1/4 royalty [1/4 royalty lease].

The plaintiffs contended that the deed should be reformed to convey a 5 net royalty acre interest rather than a 1/10 interest in royalty. Holding that the defendants were entitled to 1/10 of the royalty due under the 1/4 royalty lease, the court recognized that: "Because a royalty acre is defined as a 1/8 royalty on one mineral acre, plaintiffs owned 50 royalty acres under the [first lease]. When plaintiffs conveyed a 1/10 royalty interest to [defendants] while the [first lease] was in effect, 1/10 of these 50 royalty acres equaled 5 royalty acres. The [1/4 royalty lease] may be viewed as creating 100 royalty acres. Thus, contend the defendants, their 1/10 royalty interest amounts to 10 royalty acres under the [1/4 royalty lease]." *Id.* at 1213 n.1. The court, therefore, recognized that a net royalty acre entitles its owner to 1/8 of production from one acre of land. Rather than adjusting the interest in production to change with the lease royalty, the court adjusted the tract acreage to a fictional number so that the interest in production remained constant at 1/8.

Thibodeaux v. American Land & Exploration, Inc., 450 So.2d 990 (La. App. 3rd Cir. 1984) is of similar import. Thibodeaux sold one-half his one-half royalty interest in a 29.5-acre tract to American Land. The deed contained the following language: "in no event shall the royalties conveyed herein equal less than 11.8 royalties acres." The lands were subject to a lease carrying a 1/5 royalty. The court explained in a footnote that American Land "calculated that the 29.5 acres owned by Thibodeaux and his children contained 47.2 royalty acres. In his deed to American Land, Thibodeaux transferred one-half of his one-half, or one-fourth of the total (or 11.8) royalty acres." (A 20% royalty is 1.6 times a 1/8 royalty. 1.6 times 29.5 geographic acres equals 47.2 royalty acres. One-fourth of 47.2 royalty acres is 11.8 royalty acres.) The court found in favor of American Land, holding that when American Land purchased a 1/4 interest in royalty in a 27.5-acre tract covered by a lease carrying a 1/5 royalty, it purchased 11.8 net royalty acres. As in *Dudley v. Fridge*, the court increased the tract acreage to a fictional number to keep the net royalty acreage constant to reflect a 1/8 royalty.

Other cases stating that a net royalty acre is 1/8 of production from one acre of land include *Melancon v. Cheramie*, 138 So.2d 138, 145 (La. App. 1 Cir. 1962) ("As stated by counsel for

[1] The parties appear to have made no contention that the Royalty Deed conveyed a royalty of 1/10 of gross production.

plaintiff-appellant in his brief, 'A ROYALTY ACRE is that royalty interest in production attributable to one acre under a 1/8th mineral lease."); and *Payne v. Campbell*, *supra*. See also *Castle v. Harkins & Company*, 464 So.2d 513 (Miss. 1985).

The term "net royalty acre" should not be used as if all parties agree on its meaning. Each instrument or agreement that uses the term should define the term so that all parties understand its meaning.

BIO

Chris Killion is a title attorney at Modrall Sperling in Albuquerque, New Mexico and is licensed in Texas and New Mexico. He can be reached at ckillion@modrall.com, at (505) 848-1824, or from the website: www.modrall.com