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I. INTRODUCTION[1]

A. Preface

The mineral lease is the basic development contract utilized in the oil and gas industry in Louisiana. It is, as noted by one court, "the most common vehicle used to obtain development of lands for oil, gas, and other minerals . . . ."[2]

Under the Louisiana Mineral Code, a "mineral lease is a contract by which the lessee is granted the right to explore for and produce minerals."[3] It is a "real right"[4] and "an incorporeal immovable" that "is alienable and heritable."[5]

The mineral lease grants the lessee the legal right and authority, for a term of time, to enter a tract of land and conduct operations on such land for the exploration and production of oil, gas, or other minerals, and to produce such minerals as might be discovered.

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1. Portions of this article are an adaptation of material contained in PATRICK S. OTTINGER, LOUISIANA MINERAL LEASES: A TREATISE (2016) [hereinafter OTTINGER, MINERAL LEASE TREATISE].
2. Mire v. Sunray DX Oil Co., 285 F. Supp. 885, 888 (W.D. La. 1968).
3. LA. REV. STAT. ANN. § 31:114 (1975).
4. *Id.* at § 31:16.
5. *Id.* at § 31:18.

No one undertakes the cost, risk, and expense of drilling a well without the fervent hope and anticipation that production will be obtained in commercial quantities. To be sure, the Louisiana Supreme Court has articulated "the main consideration of a mineral lease is the development of the leased premises for minerals."[6]

Concomitantly, it is understood that "[r]ent is, from the standpoint of the lessor, the primary motive for the contract . . . ."[7]

When the lessee's exploration and production (E&P) efforts are successful,[8] and oil or gas is produced from or attributable to the leased premises, the production of such minerals gives rise to the obligation on the part of the lessee to pay royalties to its lessor and the other parties entitled thereto.[9] The "Royalty Clause" of the mineral lease regulates this critical matter.[10]

In the broadest sense of the word, a "royalty" is the right to participate in the profits of an entrepreneurial undertaking. A well-known concept in the commercial arena, it is usually free of costs to the holder of the royalty interest.[11]

The Louisiana Mineral Code defines "royalty, as used in connection with mineral leases, [as] any interest in production, or its value, from or attributable to land subject to a mineral lease, that is deliverable or payable to the lessor or others entitled to share therein."[12]

Both lessors and lessees alike would benefit from an examination of the issues involved in calculating the lessor's royalty payment. The physical laws pertaining to temperature, gravity, and volume and the practice and operation of pipelines are universal and not state-specific. Therefore, while the laws and customs of Louisiana are the central focus of this article, consideration is also given to decisions in other states when the issue has not been taken up by a court applying the law of the Bayou State.[13]

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6. Carter v. Arkansas-Louisiana Gas Co., 36 So. 2d 26, 28 (La. 1948).
7. Melancon v. Texas Co., 89 So. 2d 135, 142 (La. 1956).
8. "E&P" means "exploration and production."
9. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 4-25(d)(2).
10. *See id.* at § 4-25.
11. Portions of this section were taken from PATRICK S. OTTINGER, *Mineral Royalties*, in LOUISIANA MINERAL LAW TREATISE, ch. 5 (Patrick H. Martin, ed., 2012) [hereinafter OTTINGER, *Mineral Royalties*].
12. LA. REV. STAT. ANN. § 31:213(5) (1983).
13. "Although the decisions of other jurisdictions are not controlling on the Courts of Louisiana, if they determine an issue practically identical with the one under consideration, they possess at least a persuasive effect and merit attention." C H F Fin. Co. v. Jochum, 127 So. 2d 534, 539 (La. 1961). *See also* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 3-03.

B. Basic Formula for the Calculation of the Lessor's Royalty Payment

Illustrative of the fact that, at its base, a royalty payment is calculated by applying the principles of mathematics, each topic or issue examined herein contributes a component part of the basic mathematical formula.

In the simplest of terms, the basic formula for calculation of a royalty payment to a lessor under a mineral lease is as follows:

> [Quantity of Product in Measured Units of Product,
> <u>times</u> Price per Unit of Product,
> <u>times</u> Lessor's Fractional Interest in Minerals, or 1.0, if Entire,
> <u>times</u> Lessor's Royalty Interest],[14]
> <u>minus</u> [Permitted Deductions or Other Withholdings, if any],[15]
> <u>times</u> [Lessor's Unit Participation Interest, or 1.0, if a "Lease Basis" Well].[16]

Each of these component parts is essential to understand the methodology by which a lessor's royalty payment is calculated, and each is examined in greater detail herein. As seen in this basic formula, there are components that contribute to the determination of a gross royalty payment (those involving multiplication); factors that serve to reduce that gross number to a net royalty payment (those involving subtraction); and a final component to reduce the net royalty payment to be attributable to the lessor's unitized tract, if such exists.

However, as in all matters, the "devil is in the details." Various issues, factors, or considerations might bear upon these discrete components, thus making the ultimate mathematical calculation anything but simple. Hence, this seemingly basic formulation can entail an array of components, while certain elements might not be presented.[17] The calculation of a lessor's royalty payment involves "much more than mere math."[18]

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14. *See infra* Part II.
15. *See infra* Part III.
16. *See infra* Part IV.
17. For example, the pertinent mineral lease might contain a "No Deductions Clause" that disallows the assessment of "post-production costs" by the lessee. *See infra* Part III.B.
18. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 4-25(d)(5).

C. The Lessee's Duty to Pay Royalty, and the Time for Payment

The courts of Louisiana have long embraced the notion that, under a mineral lease, royalties on production constitute "rent."[19] This notion is contained in article 123 of the Louisiana Mineral Code, which provides that "royalties paid to the lessor on production are rent."[20]

Article 123 of the Mineral Code further stipulates that a "mineral lessee is obligated to make timely payment of rent according to the terms of the contract or the custom of the mining industry in question if the contract is silent."[21]

The commercially printed forms of mineral leases in prevalent use in Louisiana contain no provision relative to the due date for the payment of royalties under a mineral lease. A "sophisticated lessor" (explained in Part I.D.2 hereof) might include in its mineral lease a special clause addressing the timing of payments to be made by the lessee and might also specify any duty to pay interest in the event that payments are not made when due.[22]

While it is the personal responsibility of the lessee to make royalty payments to its lessor, it does occur that the purchaser of production might, by agreement, undertake that duty on behalf of the lessee-seller of production. As noted in the following case, such an undertaking does not relieve the lessee of its paramount responsibility; it is also true, however, that a lessor must accept performance from anyone.[23]

In *Bailey v. Franks Petroleum Inc.*,[24] the defendant-lessee sold condensate production to Scurlock Oil Company. Under its division order with the purchaser, Franks and Scurlock agreed that "Scurlock would purchase the condensate production and assume Franks' obligation to pay petitioners their royalty interest under the [mineral] lease."[25] Gas and

19. *See* Milling v. Collector of Revenue, 57 So. 2d 679, 682 (La. 1952) ("Under this application of the law, it was inevitable that when the question arose as to the nature of royalty, it was held to be *rent* in the form of a portion of the produce of the land . . . .").

20. LA. REV. STAT. ANN. § 31:123 (1975).

21. *Id.*

22. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at §§ 4-16(d)(4)(vi)(B), 5-16, 13-08(i).

23. LA. CIV. CODE ANN. art. 1855 (2017) ("Performance may be rendered by a third person, even against the will of the obligee, unless the obligor or the obligee has an interest in performance only by the obligor.").

24. 479 So. 2d 563 (La. Ct. App. 1985). In the interest of full disclosure, your author represented the defendant-lessee in this suit.

25. *Id.* at 565.

condensate were produced for some eight or nine years, but Scurlock did not pay royalties to the landowners, presumably because the landowners failed or refused to sign a division order. Scurlock did, however, pay to the operator its proportionate share of the net revenue on condensate that Scurlock purchased.

After a routine audit, the landowners discovered that condensate was being reported by the operator to the Office of Conservation, but there was no evidence of actual payment to the lessor of royalties on such condensate. After written demand upon Franks, which in turn made immediate demand upon Scurlock, the latter promptly paid the accrued royalties to the landowners within thirty days of receipt of the written notice. The landowners then sued Franks, their lessee, for royalties due, penalties, interest, and attorney's fees, subject to a credit for royalties paid by Scurlock. Franks, in turn, brought Scurlock into the suit as a third-party defendant.

The trial court held for the lessors against their lessee, Franks, and also held for Franks against its purchaser of production, Scurlock. In so holding, the trial court "found that Franks was not relieved of liability to plaintiffs by the sale of condensate production to Scurlock because plaintiffs did not sign the division order sent by Scurlock."[26]

The appellate court affirmed the holding but reversed the trial court's finding that "the nonpayment of royalties for such a prolonged period of time constituted gross negligence which was tantamount to willful failure to pay royalties."[27] The appellate court found that the "nonpayment of royalties was due to negligence," not "willful nonpayment."[28] The appellate court further noted: "the record supports that Scurlock assumed Franks' obligations, negligently failed to pay royalties, and thereby rendered Franks liable on the lease."[29]

D. Obtaining Information in Support of the Royalty Payment

The discerning royalty owner will not tend to take the amount of the royalty payment, as represented by the lessee's check, "at face value." It will wish to "look under the hood" of the payment so as to understand its calculative methodology.

Particularly where the royalty owner anticipated (justifiably or not) a significantly greater check, commodity prices varied greatly, or production was declining, the royalty owner will seek to inform itself as to the manner

26. *Id.* at 566.
27. *Id.*
28. *Id.* at 567.
29. *Id.*

in which the royalty payment was calculated. There are conceivably several sources for this information, including the check stub, the sophisticated lease, online requests, and direct requests to the lessee.

1. The Check Stub

The first place to which a lessor might turn in order to ascertain the manner in which its royalty payment has been calculated is the "check stub" that accompanies the royalty check.[30]

Article 212.31 of the Louisiana Mineral Code was added in 1983 and provides for a "check stub," stating as follows:

Art. 212.31. Payment information to interest owners

A. As used in this Article:
(1) "Check stub" means the financial record attached to a check.
(2) "Division order" means a contract of sale to the purchaser of oil or gas directing the purchaser to make payment for the value of the products taken in the proportions set out in the division order, which division order is prepared by the purchaser on the basis of the ownership shown in the title opinion prepared after examination of the abstracts and which is executed by the operator, the royalty owners, and the other persons having an interest in the production.[31]
(3) "Interest owner" means a person owning a royalty interest or a working interest in an oil or gas well or unit.

B. Whenever payment is made for oil or gas production to an interest owner, whether pursuant to a division order, lease, servitude, or other agreement, all of the following information shall be included on the check stub or on an attachment to the form of payment, unless the information is otherwise provided on a regular basis:
(1) Lease identification number, if any, or reference to appropriate agreement with identification of the well or unit from which production is attributed.

30. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 1-26(k).

31. Inexplicably, this definition of a "division order" differs from the definition contained in Mineral Code article 138.1A ("[A] 'division order' is an instrument setting forth the proportional ownership in oil or gas, or the value thereof, which division order is prepared after examination of title and which is executed by the owners of the production or other persons having authority to act on behalf of the owners thereof."). *See also* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 3-30.

(2) Month and year of sales or purchases included in the payment.
(3) Total barrels of crude oil or MCF of gas purchased.
(4) Owner's final realizable price per barrel or MCF.
(5) Total amount of severance and other production taxes, with the exception of windfall profit tax.[32]
(6) Net value of total sales from the property after taxes are deducted.
(7) Interest owner's interest, expressed as a decimal fraction, in production from (1) above.
(8) Interest owner's share of the total value of sales prior to any tax deductions.
(9) Interest owner's share of the sales value less his share of the production and severance taxes, as applicable.[33]

Article 212.31B, in explicit, straightforward terms, mandates that a check stub be included with a lessor's royalty check by providing that, "[w]henever payment is made for oil or gas production to an interest owner, . . . pursuant to a . . . lease," a check stub should accompany the payment. As noted, the article specifies the required content of a check stub, "unless the information is otherwise provided on a regular basis."

While it is mandatory that the lessee-payor include a check stub, nothing in the article addresses the consequences of non-compliance.[34] The failure of the lessee to include a check stub should not give rise to an action for the breach of the mineral lease, since the duty to provide the data is statutorily, rather than contractually, grounded. As a general proposition, however, the Louisiana Supreme Court has held that the

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32. The Windfall Profits Tax was enacted in 1980, and imposed a higher tax rate on profits received by the oil industry as a result of the decontrol of oil prices. Having been repealed in 1988, this reference is meaningless as such tax does not currently exist.

33. LA. REV. STAT. ANN. § 31:212.31 (1984).

34. By way of contrast, the Texas counterpart to Louisiana's check stub statute added a private cause of action in 2002, permitting a lessor to make a complaint as to the lessee's non-compliance with the strictures of the statute. *See* TEX. NAT. RES. CODE ANN. § 91.507 (West 2002). "Without an enforcement mechanism, Payors did not face any direct liability to the royalty owner for failure to provide the required information. With the addition of Section 91.507, royalty owners may now bring a civil action against a Payor to enforce the provisions of Section 91.504 concerning information about payment deductions and adjustments, heating value and lease identification." Allen D. Cummings, *Today's Marketing, Yesterday's Leases, Check Stub Statutes: The Perfect Storm?*, Univ. of Tex. School of Law 30th Ann. Ernest E. Smith Oil, Gas and Mineral Law Inst. (2004).

violation of a statute imposing mandatory duties may be pursued as a private cause of action.[35]

Although there are no reported decisions in Louisiana concerning alleged violations of the check stub statute, there has been significant litigation in other states.[36] Plaintiffs in these suits typically contend that the lessee has not complied with the relevant statute in that the information provided on the check stub is either erroneous or fraudulent.

One significant case is a class action brought against an array of producers and pipeline companies in Oklahoma. A jury verdict in the amount of seventy-four million dollars was awarded based upon the jury's determination that the producer did not disclose the deductions of certain transportation charges on the check stub. In an unpublished opinion, the appellate court held that an award of almost nineteen million dollars in punitive damages for fraud was appropriate because the check stub misrepresented that no fees had been deducted.[37]

In another noteworthy case arising out of Oklahoma, the plaintiff's averment that the lessee was liable for constructive fraud, because it did not properly report to the lessor the amount of deductions assessed against the royalty, was denied.[38]

2. Sophisticated Lease[39]

A "sophisticated lessor" is a hypothetical lessor who owns significant land or mineral holdings to the end that it has the commercial standing to demand or insist upon terms, provisions, and considerations that are generally more favorable than a lessor who owns the executive interest in smaller tracts of land (or interests therein), such that the latter does not enjoy the "bargaining power" of the "sophisticated lessor." In Louisiana, there are land-holding companies that own many, many thousands of acres and have

35. For example, in Anderson v. Ochsner Health System, 172 So. 3d 579, 586 (La. 2014), the Louisiana Supreme Court examined the Health Care and Consumer Billing and Disclosure Protection Act, and found that "an implied private right of action exists under La. R.S. 22:1871, *et seq*. based on (1) the legislature's failure to expressly prohibit an individual remedy; (2) the legislative intent to protect consumers; and (3) the constitutional right of access to the courts in order to seek personal relief."

36. *See* Mark D. Christiansen, *The Confused State of Oil and Gas Royalty Check Stub Law*, 17 TEX. OIL & GAS L.J. 13 (2003).

37. Bridenstine v. Kaiser-Francis Oil Co., No. CJ-2000-1 (Tex. County Dist. Ct., Okla., Nov. 9, 2001), *aff'd* No. 97,117 (Okla. Civ. App., Aug. 22, 2003).

38. Roberts Ranch Co. v. Exxon Corp., 43 F. Supp. 2d 1252 (W.D. Okla. 1997).

39. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 1-13.

the ability to employ or engage a technical staff of geologists, land managers, engineers, and the like. Quite frequently, such a "sophisticated lessor" has the ability to assume a "take it or leave it" position with regard to lease terms.

For these and other reasons, the "sophisticated lessor" generally has its own specially prepared lease form and would not typically agree to use one of the prevalent commercially printed lease forms, at least not without significant modifications, additions, or alterations by way of an addendum or exhibit added to such form.

It is not uncommon to find a specially-crafted clause in a mineral lease from a "sophisticated lessor" that either requires the lessee to furnish specified information relative to production and other activities, or to permit the lessor, upon notice, to review the books and records of the lessee relative to such matters.[40]

3. Online Data

Another source of information for the lessor is the Strategic Online Natural Resources Information System (SONRIS), maintained by the Louisiana Department of Natural Resources, Office of Conservation.[41] It contains a significant amount of relevant data as reported by an operator. An array of rules or regulations, including Statewide Orders, require that the operator report a variety of information, including information pertaining to the conduct of operations, unitization, and volumes of production, all on a well or unit basis.[42] Obviously, the data on SONRIS is only as current as relevant information that is reported by an operator from time to time. This information, as reported on SONRIS, should be reliable as it is a criminal offense to "[m]ake or cause to be made any false entry or statement of fact in any report required to be made by this Chapter or by any rule, regulation, or order made hereunder."[43]

The relevant regulations do not, however, require that values or prices for oil or gas be filed with the Department of Natural Resources. Hence,

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40. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 5-23.

41. SONRIS is easily accessible through the website of the Office of Conservation.

42. The information filed with the Office of Conservation is a "public record." *See* Taylor v. Smith, 619 So. 2d 881, 884 (La. Ct. App. 1993) ("Insofar as the Office of Conservation is the 'public record' as to who is the operator of record, third parties are entitled to rely upon this 'public record' in actions against an operator, without examining the entire well file in an attempt to determine the responsible party.").

43. LA. REV. STAT. ANN. § 30:17(1) (2017).

the interested lessor can only ascertain volumes as reported, not monetary pricing.

As noted above, article 212.31 of the Louisiana Mineral Code requires that the check stub reflect, among other information, the "[t]otal barrels of crude oil or MCF of gas purchased."[44]

4. Direct Requests to the Lessee

Unless a special clause contained in the mineral lease obligates the lessee to provide information desired by the lessor, the lessee is not required to share information beyond that which the lessee is mandated to disclose on the check stub. Nevertheless, the lessee would be well-advised to try to accommodate reasonable requests by the lessor, even if there is no enforceable mechanism to require it to do so. Good will between the lessor and lessee might pay significant dividends when and if a real controversy arises.

Arguable bases for the provision of this information might be found in the requirement of article 122 of the Mineral Code that the lessee must "perform the contract in good faith and . . . develop and operate the property leased as a reasonably prudent operator for the mutual benefit of himself and his lessor."[45] However, there are no cases in which a court has found that a duty to provide information is encompassed in this article.[46]

E. Determining the Products to Which Royalty is Applied Pursuant to the "Royalty Clause"

Typically, the "Royalty Clause" of a mineral lease certainly covers oil and gas, as well as "other minerals."[47] The principle of "freedom of contract" permits contracting parties to specify the minerals to which the mineral lease pertains. This might be accomplished by including a

44. *Id.* at § 31:212.31. The measurement of natural gas is examined in Part II.B hereof.

45. *Id.* at § 31:122.

46. Cf. McCarthy v. Evolution Petroleum Corp., 180 So. 3d 252, 260 (La. 2015) ("From the language just quoted from Article 122, it appears that parties to mineral leases may contractually impose a duty for a lessee to disclose information, . . . The petition here, however, is devoid of an allegation that the parties had contractually imposed such disclosure by the lessees."). In the interest of full disclosure, your author filed a brief on behalf of certain *amici curiae* in support of a writ application by the defendant, and on the merits in this case.

47. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 1-10.

"Covered Minerals Clause," although one does not usually encounter such a provision except in a "sophisticated lease."[48]

The Commissioner of Conservation classifies a well as either an oil or gas well. This classification is determined by the "gas/oil ratio."[49] "Oil" is defined, for purposes of the Conservation Act, as "crude petroleum oil, and other hydrocarbons, regardless of gravity, which are produced at the well head in liquid form by ordinary production methods."[50] The same statute defines "gas" as "all natural gas, including casinghead gas, and all other hydrocarbons not defined as oil in Paragraph (7) of this Section."[51]

Although these definitions are contained in Section 3 of the Conservation Act,[52] the definitions also comport with the traditional and usual understanding of the terms in other contexts. Certainly, they are not defined in the Louisiana Mineral Code.

It can be a bit more complicated than that. A well might encounter different types of gas. In that event, questions exist as to whether that product is to be treated as oil or gas for purposes of the "Royalty Clause" of the mineral lease.

In the nascent stages of the industry, a new product referred to as "casinghead gas" (produced usually from oil wells) gave rise to considerable litigation and may continue to present uncertainty where the "Royalty Clause" of the mineral lease is not carefully drafted. Casinghead gas is nothing but wet gas.

For example, in *Wemple v. Producers' Oil Co.*,[53] the lessor sought an accounting for royalty on casinghead gas produced by the lessee. Judgment was rendered for the plaintiff, and pursuant to a writ application filed by the defendant, the Louisiana Supreme Court affirmed.

In the "Royalty Clause" of the pertinent mineral lease, it was specified that the royalty was to be based on one-eighth (1/8) of all oil produced and saved, and $200.00 per year for each gas well.

48. *See id.* at § 5-27.

49. LA. ADMIN. CODE tit. 43, pt. XIX, § 3501, *et seq* (2017).

50. LA. REV. STAT. ANN. § 30:3(7) (2013).

51. *Id.* at § 30:3(3).

52. The listing of definitions in Section 3 of the Conservation Act is prefaced with the admonition that, "[u]nless the context otherwise requires, the words defined in this Section have the following meaning when found in this Chapter." Hence, by force of law, these definitions are not necessarily controlling in other statutes, including the Mineral Code.

53. 83 So. 232 (La. 1919).

The lessee contended that it had the right, under the mineral lease, to produce the casinghead gas; nonetheless, since casinghead gas is neither oil nor gas, no royalties were due to lessor thereon.

The Louisiana Supreme Court held that casinghead gas, being a product saved from the production of the oil, is a part of the oil. The casinghead gas is a lighter constituent of the liquid product that would be produced as one product by another production method. Therefore, the Court held, it is subject to the same royalty provisions as oil. The mere fact that the lessee operated under a vacuum-pumping method, and thereby produced casinghead gas, is not sufficient to allow him the right and benefit of that casinghead gas free of his obligation to pay royalty on oil, which would be produced if the lessee had utilized another pumping method. The Court obviously viewed the lessee's contention as "form over substance."

Thus, the Court held that the lessor was entitled to one-eighth (1/8) of the gasoline extracted from the casinghead gas from an oil well because it was clear that the gasoline was part of the heavier oil that was being produced.

In another case,[54] a lessor sued its lessee contending that the latter had failed to properly pay royalties on a produced constituent. The respective position of the parties was set forth as follows:

> The plaintiff contends that a certain colorless fluid produced by the gas wells through separators is a high grade crude oil resulting from the normal operation of the gas wells and, therefore, comes within the oil royalty clause of the lease and not the gas royalty provision thereof.
>
> The lessee contends that the colorless fluid produced by the gas wells through the means of separators is gasoline within the meaning of the provisions of the lease covering the payment of royalty on the gas produced from the wells and that as all of this royalty has been paid, the plaintiff's additional claims for royalty are without merit.[55]

The Louisiana Supreme Court affirmed the decision of the trial court in favor of the lessee, holding that "the distillate produced by these gas wells was to be paid for by the lessee under the gas royalty clause of the lease and not under the oil royalty clause thereof."[56]

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54. Roy v. Arkansas-Louisiana Gas Co., 7 So. 2d 895 (La. 1942).
55. *Id.* at 895.
56. *Id.* at 903.

Once the character of the actual product being obtained from the well is determined, it is necessary to ascertain whether the lessor is entitled to all, or only part, of the royalty pertaining thereto.

F. Determining and Expressing the Royalty Interest

Whether the mathematics involved in determining the lessor's gross royalty payment is simple or complicated is partially dependent on the quality of the lessor's title; that is, whether it is a whole or fractional interest, and if the lessor's interest is subject to any burdens on production. "Burden" means that the mineral interest of a lessor might be subject to a real charge in the form of a mineral royalty interest.[57] In such a case, distinct calculations need to be made, lessor-by-lessor, or interest-by-interest, and this might be a more complicated or detailed calculation.

When there are multiple co-owners in a tract of land, all of whom have executed a mineral lease or leases providing for the same reserved royalty, all of the discrete royalty interests should add up precisely to the reserved royalty interest. However, the arithmetic can get more complicated if burdens exist that must be taken into consideration, particularly if the burdens do not uniformly or proportionally apply across the burdened mineral interest of the lessors.

While not mandated by any tenet of law, the industry customarily expresses revenue numbers in seven decimal places, with appropriate rounding to ensure that the formula achieves the correct arithmetical sum of all interests.

G. Determining from Whence Production is Obtained

1. Preface

The lessee cannot take the necessary steps to quantify or value the production on which the lessor's royalty is to be calculated unless it knows precisely from whence that production was obtained. This important

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57. "His share of the minerals when they are produced is royalty. At the moment of the execution of the royalty sale, under our holding in Vincent et al. v. Bullock et al., [187 So. 35 (La. 1939)], a species of real right is created, imposing a *burden* upon the land, which is subject to the prescription of 10 years liberandi causa." Continental Oil Co. v. Landry, 41 So. 2d 73, 75 (La. 1949) (emphasis added).

threshold inquiry necessarily presents both a "vertical" and "horizontal" consideration or feature.[58]

For these purposes, the "vertical" consideration has reference to the "land," or "tract of land," on which the well giving rise to the production is located. This aspect is characterized as "vertical" in the illustrative sense of a cookie cutter piercing the surface of the earth, creating a perimeter of the "tract of land" involved.[59] This "vertical" consideration is examined in Part I.G.2 hereof.

Before turning to the "horizontal" feature, it must first be noted that a well is completed for production by creating or shooting "perforations" in the casing that constitutes the borehole.[60] A "perforation" is essentially a hole punched into the casing created by a perforating gun that penetrates the production casing, its associated cement sheath, and the rock formation some distance into the reservoir, to allow the associated reservoir to be drained through the pressure differential thus created between the interior of the casing and the pressurized reservoir.

Hence, the "horizontal" component addresses the issue of the precise or actual subsurface depth of the perforations that allow oil or gas to enter

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58. It is your author's experience that there is not a universally accepted understanding of the difference between a "vertical" limitation and a "horizontal" limitation–whether it be in the context of a royalty burden, "Pugh Clause," or "depth limitation clause." On more than one occasion, your author has encountered a discussion wherein one party alludes to a "vertical" limitation or restriction, or has stated that a mineral lease has expired "vertically," only to be asked, "Don't you mean 'horizontally?'" The confusion or misunderstanding resides in the fact that "vertical" means, and in a visual sense runs, "north to south," while horizontal means, and visually runs, "east to west." Nevertheless, in the jargon of the industry, while "horizontal" might allude to a specific stratum under the earth, is not such stratum reached "vertically" from the surface of the earth to the subsurface point of production? And conversely, the term "vertical"–such as in a "vertical" "Pugh Clause" [the obvious opposite of a "horizontal" "Pugh Clause" of the type involved in Sandefer Oil & Gas, Inc. v. Duhon, 961 F.2d 1207 (5th Cir. 1992)]–conjures the notion that the exterior perimeters of a unit are, in a sense, extended into the earth, vertically, "from the surface to China." Yet to some, that seems to deal with the "horizontal" because it is running "north to south," into the earth's subsurface. The foregoing is an adaptation of footnote 175 of Chapter Ten of OTTINGER, MINERAL LEASE TREATISE, *supra* note 1.

59. If the well is a "true vertical well," it is easy. However, if there is more than a five (5°) degree deviation from true vertical, it is the bottom hole location that controls. *See infra* note 77.

60. The "borehole" is the "hole made by drilling or boring a hole." PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS: MANUAL OF OIL AND GAS TERMS 8 (16th ed. 2015).

the borehole of the well, and then to travel to the surface from the reservoir to which the perforations correlate, at which point the "[m]inerals are reduced to possession [in that] they are under physical control that permits delivery to another."[61] This "horizontal" consideration is taken up in Part I.G.3 hereof.

2. The "Vertical" Consideration: Determining the Land from Which Production is Obtained

It requires no great elaboration to understand that it is necessary to discern the geographical location of the source of production to be subjected to the formula for the calculation of the royalty payment. This necessitates an understanding of the relevant tract of land and whether the tract of land is subject to burdens or community leases.

a. Understanding "Tracts of Land"

It is essential to understand the meaning and importance of the terms "land" and "tract of land" as they pertain to the disbursement of proceeds from a well situated "on" the land. In other words, for purposes of determining the entitlement of a lessor to a royalty payment on production from a well, what is the relevance of the fact that a producing well is situated "on" a certain tract of land? What role does that geographical fact (the precise location of the well "on" the "tract of land") play in the ascertainment of the parties entitled to share in production?

Louisiana Civil Code article 462 provides that "[t]racts of land . . . are immovables."[62] Comment (c) to article 462 announces that "[l]ands may be defined as portions of the surface of the earth."[63]

Louisiana law establishes, "[u]nless otherwise provided by law, the ownership of a tract of land carries with it the ownership of everything that is directly above or under it."[64] Hence, the "owner may make works on, above, or below the land as he pleases, and draw all the advantages that accrue from them, unless he is restrained by law or by rights of others."[65]

The Louisiana Mineral Code employs the term "land" in each of the articles that define the three basic mineral rights.[66] Importantly, the

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61. LA. REV. STAT. ANN. § 31:7 (1975).
62. LA. CIV. CODE ANN. art. 462 (2017).
63. *Id.* cmt. (c).
64. LA. CIV. CODE ANN. art. 490 (2017).
65. *Id.*
66. LA. REV. STAT. ANN. §§ 31:21, 31:80, 31:114 (1975).

definition of "'royalty,' as used in connection with mineral leases," alludes to an "interest in production, or its value, from or attributable to *land* subject to a mineral lease."[67]

In *Louisiana Land & Exploration Co. v. Parish of Jefferson, Louisiana,*[68] the court stated:

> The term 'land' has a definite meaning in the law as well as in the popular mind—a meaning as settled and firm as the thing that it represents. 'Land,' to lawyer and layman alike, means the soil, the solum, terra firma, a section of Mother Earth. No argument, however ingenious, can budge this stubborn fact.[69]

More contemporary judicial recognition of the meaning of "land" is provided in *Alyce Gaines Johnson Special Trust v. El Paso E & P Co., Ltd.*,[70] where, in reference to the coverage of a mineral lease, the court stated, as follows:

> Land in Louisiana has a specific and defined meaning. According to La. Civ. C. art. 462 cmt. (c), "[l]and may be defined as portions of the surface of the earth." "Unless otherwise provided by law, the ownership of a tract of land carries with it the ownership of everything that is directly above or under it." La. Civ. C. art 490. As the Louisiana Civil Code makes clear Louisiana property law embraces the colorful Latin maxim of *cujus est solum ejus est usque ad coelum et ad inferos* ("for whoever owns the soil, it is theirs up to Heaven and down to Hell").[71]

One tract of land is separated from another different tract of land by a "boundary," a term defined in article 784 of the Louisiana Civil Code: "A boundary is the line of separation between contiguous lands. A boundary marker is a natural or artificial object that marks on the ground the line of separation of contiguous lands."[72]

A tract of land is said to be "contiguous" to another tract of land when it is so situated that one might pass from one part to the other without the

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67. *Id.* at § 31:213(5) (emphasis added).
68. 59 F. Supp. 260 (E.D. La. 1945).
69. *Id.* at 265.
70. 773 F. Supp. 2d 640 (W.D. La.), *aff'd* 438 F. App'x 340 (5th Cir. 2011).
71. *Id.* at 645.
72. LA. CIV. CODE ANN. art. 784 (2017).

necessity of crossing the property of another party.[73] Thus, the Louisiana Supreme Court has held that, where two tracts met only at a common survey point (*i.e.*, two corners touch), the tracts were not contiguous because no one could pass through a mere point.[74]

A "boundary" also might, in non-statutory vernacular, be called a "property line." In the view of the Louisiana Office of Conservation, for a variety of conservation purposes,[75] it is important to understand the "property line" between two tracts of land. In relevant rules, the term "property line" means "the boundary dividing tracts on which mineral rights, royalty, or leases are separately owned, except that where conventional units shall have been created for the drilling of the well, the boundaries of the unit shall be considered the property line."[76]

The rules of the Office of Conservation relative to the preparation of a unit survey plat provide, among other requirements of content,

> [t]he affected tracts [of land] shall be identified on the survey plat by the names of the fee and lease owners, based on the best available information. Further, each unit plat shall have an inset or attachment showing the number, name, acreage (or other basis of participation) and the unit percentage participation of each tract [of land].[77]

Thus, the necessity to fix and reflect a "property line" or "boundary" between two tracts of land (even with common, identical ownership of the surface of the land) arises when there is a change in the ownership of leasehold, minerals or royalties, not merely or exclusively if there is a change in the ownership of the land (surface) itself.

From these foundational observations, one concludes that the location of a well is to be considered "on" the "tract of land" which it is actually

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73. Baham v. Vernon, 42 So. 2d 141, 145 (La. 1949) ("'[C]ontiguous tracts of land' must be tracts or bodies of land which have one side, or at least part of one side, in common."). *See also* Turner v. Glass, 195 So. 645, 646 (La. 1940) ("Two tracts of land which touch only at a common corner are not contiguous.").

74. "And to constitute a single tract of land the lands must be so situated that one may pass from one part to the other without passing over the lands of another. But, as it is impossible to pass through a mere point, it follows that one cannot pass from said section 31 to section 1 without passing over other lands." Lee v. Giauque, 97 So. 669, 670 (La. 1923).

75. Not the least of which is the notion of "well spacing." *See* LA. ADMIN. CODE tit. 43, pt. XIX, § 1901, *et seq* (2017).

76. *Id.* at § 1903A.

77. *Id.* at § 4103A2.

situated, to the full geographic extent or areal reach of that drill site tract, as far as it goes, until a "property line" is reached, delineating another, adjacent tract under which the mineral, royalty or leasehold "mix" differs from the parent drill site tract. In this regard, the "boundary" of a "tract of land" may be indicative of a change in the ownership of the soil, of minerals, of leasehold, or of royalties under the next adjacent tract of land.

As next demonstrated, the need to delineate a "boundary" and thereby define the surface extent of a "tract of land," is absolutely critical in order for the lessee to make a proper allocation of a well's production to a distinct "tract."

In the absence of unitization, production from a "lease basis" well[78] is payable to the mineral or royalty owners of the distinct tract of land under which the bottom hole of the well is situated,[79] notwithstanding that the pertinent mineral lease covers other lands, conceivably with a different mix of royalty burdens. This observation presents itself in two distinct situations.

b. Mineral Royalty Burdening Distinct Portions of the Leased Premises

Consideration is given, in Part II.D.2 hereof, to the need to identify any burden that constitutes a real charge on the lessor's interest in minerals in a tract of land, thus resulting in a diminution of the royalty payment to which that lessor is entitled.[80]

78. Tellingly, the rules of the Office of Conservation relative to well nomenclature allude to a non-unitized well as a "lease basis" well. LA. ADMIN. CODE tit. 43, pt. XIX, § 103E2 (2017) ("All wells drilled on a lease basis shall bear the lessor's surname and initials or given name."). Indeed, it has been held that, "[i]n the absence of forced or voluntary pooling or unitization, the leased property is considered as the producing unit." Sun Exploration and Prod. Co. v. Rogers, 451 So. 2d 587, 591 (La. Ct. App. 1984).

79. The well might be a "true vertical well," in which both the well's surface location and bottom hole location (BHL) are on or under the same tract of land (without a deviation of more than 5° from the vertical (*see* LA. ADMIN. CODE tit. 43, pt. XIX, § 135A (2017))), or it might be a well that is directionally drilled from a surface location on one tract, but the bottom hole location is under a different tract of land. *See* Helmer Directional Drilling, Inc. v. Dexco, Inc., 653 So. 3d 1245, 1247, n.4 (La. Ct. App. 1995) ("There are three components to a drilling objective: (1) depth; (2) displacement; and (3) direction."). Regardless, it is the BHL that determines the tract of land entitled to share in production on a "lease basis."

80. Where it exists, a mineral royalty merely represents a reallocation of some portion of the royalty payment otherwise due in its entirety to a lessor. In totality,

Historically, the word "royalty" arose from the European feudal systems in which the sovereign owned all minerals. The right to exploit mines and quarries was granted by the Crown, in which case, a "royalty" share, free of expenses, was reserved.

One commentator explained the origin of the term "royalty" as follows:

> The term "royalty" comes down to us through the channels of the old common law of England and its derivation is interesting. Under the theory of land tenure under the feudal system in force and effect in England during the early middle ages, the title to the manor and "royal mines" of gold and silver was vested in the crown by royal prerogative and, being subject to alienation at his pleasure, was held in fief by the tenants who worked the mines and cultivated the lands under the feudal lords. The tenant held only a "working interest" so to speak, and produced the crops at his own labor and expense, while the landlords or royal fee owners, holding title direct from the crown, reserved their share of the product of the soil, which share was termed a "royalty" or that portion belonging to the landlords under royal grant or favor.[81]

In its most general sense, a royalty (whatever its kind) is a passive right in that the holder must rely on the actions (and capital) of others to generate any corpus of money to which the royalty will relate.

If a mineral royalty exists, it only encumbers the distinct tract of land that it burdens. If that seems like an obvious truism, consider the contentions made in *Shell Petroleum Corp. v. Carter.*[82]

A mineral lease was granted on the west half of a governmental section of land.[83] After the lease was granted, the lessors sold mineral royalty interests to certain parties as to the southwest quarter of the section and conveyed other or different royalty interests to other parties as to the northwest quarter of the section. The case was a concursus proceeding brought to determine entitlement to production from a well drilled in the southwest quarter of the section, burdened by one, but not both, of the mineral royalty interests.

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the revenue owed to the lessor and all mineral royalty owners should equal the royalty due under the mineral lease.

81. SAMUEL H. GLASSMIRE, LAW OF OIL AND GAS LEASES AND ROYALTIES § 17 (2d. ed. 1938).

82. 175 So. 1 (La. 1937).

83. Louisiana employs a grid system whereby governmental sections are delineated on surveys established or maintained by the Register of the State Land Office. LA. REV. STAT. ANN. § 50:121 (2017).

The owners of the royalty interest in the northwest quarter (where no well was drilled) contended that they were entitled to participate in production from the well drilled in the southwest quarter of the section, in reliance upon the "Entirety Clause" of the mineral lease.[84]

The Court rejected this contention, saying, as follows:

> The sale of the undivided interests in the royalty in this case amounts to nothing more or less than the limitation of the royalty to the N. 1/2 or to the S. 1/2 of the tract, to be participated in by the individuals purchasing the royalty to be produced from that particular tract.[85]

While the conclusion of the Court is certainly logical, it is also consistent with the "rule of capture" that prevails in Louisiana.[86]

c. "Community Leases"[87]

A "community lease" is a mineral lease that is executed by multiple lessors who own separate and distinct tracts of land that are described in, and, thus, covered and affected by, such lease as an aggregated tract of land.

In the consistent view of the courts, operations on or production from any tract of land described in a "community lease" will maintain leasehold rights in force and effect as to the entirety of the leased premises described therein. Most disputes involving "community leases" are concerned with the issue of entitlement to royalties produced from a well situated on one of the tracts included in a "community lease."

In *United Gas Public Service Co. v. Eaton*,[88] three distinct owners granted a mineral lease describing their separate tracts of land as one aggregated tract. The lessee drilled a well on one portion of the tract, and

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84. Paragraph 11 of the mineral lease was held inapplicable because the "[a]ppellants are not the vendees of the owners of separate tracts pooled in a joint lease. It is not possible, therefore, to divide the royalty in this case in proportion to the ownership of the acreage." 175 So. at 4. *See also* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 4-31 (concerning the "Entirety Clause").

85. 175 So. at 3.

86. LA. REV. STAT. ANN. §§ 31:6, 31:8, 31:14 (1975). *See also* Pierce v. GoldKing Prop., Inc., 396 So. 2d 528, 533-34 (La. Ct. App.), *writ denied* 400 So. 2d 904 (La. 1981) ("Under Louisiana's so-called 'rule of capture' a landowner is not the owner of minerals beneath the surface of his lands, but rather has only the right to search for and draw minerals through the soil and thereby become the owner thereof.").

87. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 6-03.

88. 153 So. 702 (La. Ct. App. 1934).

filed a concursus to determine ownership of royalties from that well. The court held that royalties were not to be pooled, but were solely payable to the owner of the tract on which the well was situated.

The court explained its rationale, as follows:

> The question raised by the alternative contention of Emmons and his assignees is of first impression in this state. They contend that the lease is joint as to the lessors and not severable on the basis of their ownership of the minerals when the lease was executed. The question has been before many of the courts of other oil producing states of the Union. There are two distinct lines of jurisprudence on the subject. The majority rule does not support the contention that from the fact of owners of different tracts, or owners of different interests in parcels of the same tract, joining in the same lease, a presumption arises that they intend thereby to pool their various properties or interests and tacitly agree to have the land operated as an entirety and to share in production from one or all of the tracts covered by the lease, on the basis of proportionate ownership. To the contrary, if any presumption arises at all it certainly would be in favor of the negative of such a proposition. *Intention to pool interests in this matter may only be determined from the express contract of the parties or from facts and circumstances which certainly establish such intention on their part. It should never be inferred simply from the fact that different owners joined in the same lease contract.*[89]

In *French v. Querbes*,[90] plaintiffs, husband and wife, sued to recover royalties allegedly due to them under a mineral lease. The lease covered two tracts of land—one being a 52-acre tract owned solely by the wife as her separate property, and the second being a 40-acre tract owned in community. The wife later sold one-half (1/2) of the minerals under the 40-acre tract to Williams, which deed was later ratified by the husband insofar as it affected community property.[91]

The lessee obtained production on or attributable to the 40-acre tract, and royalties were paid equally to the plaintiffs and defendants.

Plaintiffs asserted that they were entitled to 72/92 of the lease royalties,[92] rather than one-half (1/2) (or 46/92) of the royalties thereunder.

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89. *Id.* at 708 (emphasis added).
90. 8 So. 2d 631 (La. 1942).
91. *Id.* at 633.
92. Plaintiffs urged that the royalty from the well situated on the 40-acre tract in which they owned one-half (1/2) of the minerals should be disbursed pursuant

The plaintiffs contended that the mineral lease was a "community lease" and therefore royalties should be apportioned on the basis of each mineral owner's interest, on a weighted average basis, and under all tracts of land described in the lease.

The defendants resisted the demand, positing that the lease was not a "community lease" because it disclosed no intention of the parties to pool or communitize their interests under each and every distinct tract of land.

The Court did not embrace the plaintiffs' contention, stating, as follows:

> The jurisprudence of this State is well-settled, when two or more tracts of land separately owned are included in one lease, that that fact alone does not create the presumption that the lessors intended to pool their royalties or make a joint or community lease. Martel v. A. Veeder Co., 199 La. 423, 6 So.2d 335.[93]

Citing *Louisiana Canal Co., Inc. v. Heyd*, the Court stated:

> In all cases where parties owning separate tracts of land execute together one oil and gas lease covering their separate tracts and where the lease contract contains no community or pooling clause, whether they are entitled to share proportionately in the royalties, regardless of which tract is developed, depends on the intention of the parties. From the fact that the parties join in the same lease contract and from that fact alone, there does not necessarily arise a presumption that they intended to pool.[94]

The Court in *French* further explained the relevant principles, as follows:

> The majority rule is that such a lease is severable as between the lessors and each lessor only shares in production from his own land. The majority rule does not support the contention that from the fact of owners of different tracts, or owners of different interests in parcels of the same tract, joining in the same lease, a presumption arises that they intended thereby to pool their various properties or interests and tacitly agree to have the land operated

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to this formula: 20/40 + 52/52 = 72/92. The court rejected plaintiffs' contention, and held that production should be split on the basis of ownership under the drill site tract "50-50."

93. 8 So. 2d at 633.

94. *Id.* (citing 181 So. 439 (La. 1938)).

> as an entirety and to share in production from one or all of the tracts covered by the lease, on the basis of proportionate ownership. To the contrary, if any presumption arises at all it certainly would be in favor of the negative of such a proposition. Intention to pool interests in this matter may only be determined from the express contract of the parties or from facts and circumstances which certainly establish such intention on their part. It should never be inferred simply from the fact that different owners joined in the same lease contract. . . . For us to say that they did intend to pool their interests would be writing into the contract a very material provision which the parties themselves did not think well enough of to incorporate therein . . . .[95]

The plaintiffs also advanced an argument based on the usual "Proportionate Reduction Clause" contained in printed mineral lease forms. That clause provides that, "if said lessor owns a less interest" than "the entire and undivided fee simple estate therein," royalties and rentals may be reduced in proportion to the interest of the party to whom paid. The plaintiffs contended that such clause evinced an intention "to make a community or joint lease covering both tracts of land."[96]

The Court rejected this proposition, noting that such a "clause is inserted in the lease to protect the lessee against the hazard of having to pay more than the total royalty stipulated in the lease, in the event it should develop that the lessors were not the sole owners of the mineral estate."[97]

The Court explained its rejection of this contention, as follows:

> If the Court were to hold that this provision is sufficient to show the intention on the part of the lessors to pool or unitize their royalties, then practically every oil and gas lease in existence in this State confected on the identical ordinary printed forms would be joint or pooling leases, where they covered two or more tracts of land owned by different parties. Certainly, no one contemplated such a result. When lessors intend to pool or unitize their royalties they insert in the lease a statement to the effect that the royalties shall be paid according to the proportion in which the lessors own

95. *Id.* at 633-34 (internal citations omitted).

96. *Id.* at 634.

97. *Id. See also* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 4-30 (concerning the "Proportionate Reduction Clause").

> the minerals in the entire leased premises and without regard to the location of the well or wells subsequently drilled . . . .[98]

Thus, while a "Proportionate Reduction Clause" is important in a mineral lease, its inclusion does not itself operate to make the lease a "community lease."

3. The "Horizontal" Consideration: Determining the Subsurface Depth from Which Production is Obtained

The "horizontal" feature of production is an important factor if there are different interests in rights to minerals at different subsurface levels underlying the surface of the earth.

In this regard, the "horizontal" aspect has reference to a volumetric body of production, not a flat, one-dimensional line. For example, in *Sandefer Oil & Gas, Inc. v. Duhon*,[99] the court rejected a party's contention "that the word 'horizon' means a flat, parallel boundary line which would be drawn" at a certain subsurface depth and held that the district court properly determined "that the parties intended it to mean 'a body of material or a stratum found below the earth's surface, generally considered to be a bed of sand or other material which contains oil, gas, and other minerals . . . .'"[100]

While it is true that "the ownership of a tract of land carries with it the ownership of everything that is directly above or under it,"[101] it is also possible that the lessor (or its predecessor) created interests or burdens that vary by subsurface zones or depths. This circumstance can be presented in a variety of ways.

For example, a "single mineral servitude is established on a continuous tract of land notwithstanding that certain horizons or levels are excluded or the right to share in production varies as to different portions of the tract or different levels or horizons."[102]

In like manner, a mineral royalty may be established with respect to distinct subsurface zones or depths, leaving any unburdened strata free of the mineral royalty.[103]

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98. 8 So. 2d at 634.
99. 961 F.2d 1207.
100. *Id.* at 1211.
101. LA. CIV. CODE ANN. art. 490 (2017).
102. LA. REV. STAT. ANN. § 31:68 (1975).
103. *Id.*, as made applicable to mineral royalties by LA. REV. STAT. ANN. § 31:101 (1975).

Certainly, an executive owner may grant a mineral lease as to distinct subsurface depths, leaving other depths unleased. Those "other depths" may later be leased with a different royalty reserved by the lessor.

An illustration will demonstrate why it is imperative for the lessee to discern the precise subsurface point from which production is being obtained. Consider a mineral lease granted as to a "tract of land," but limited to subsurface depths from the surface of the earth to 8,000 feet. Subsurface depths deeper than 8,000 feet below the surface of the earth are not leased, so this "shallow lease" provides for a twenty percent lessor's royalty.[104]

Thereafter, a mineral lease is granted as to subsurface depths below and deeper than 10,000 feet below the surface of the earth. This "deep lease" sets forth a twenty-five percent lessor's royalty as reserved by the lessor. Hence, in this example, subsurface depths below or deeper than 8,000 feet below the surface of the earth, but shallower than 10,000 feet below the surface of the earth, are not leased.

When the Commissioner of Conservation issues an order creating and establishing a compulsory unit,[105] the Commissioner's order invariably has a "sand definition," articulating a "defined interval."[106] The order is depth-specific in that the "sand definition" will set forth a geological description or identification of the pool being unitized.[107] Accordingly, a well drilled within the exterior perimeter of a compulsory unit, although thereby satisfying the "vertical" feature, would not be deemed to constitute a unit well unless it is also completed (by way of perforations) for production from the defined sand interval (thus satisfying the "horizontal" consideration).

A well completed and producing from the first lease (the "shallow lease") would involve a twenty percent royalty, while a well completed and producing from the second lease (the "deep lease") would impose a twenty-five percent royalty. A well completed on another tract in a unit for the intervening depths, say, at 9,000 feet, would not involve the

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104. For an explanation of "shallow rights" and "deep rights," *see* footnote 143 of Chapter Five of OTTINGER, MINERAL LEASE TREATISE, *supra* note 1.

105. LA. REV. STAT. ANN. § 31:213(6) (1983).

106. The Commissioner's rules require that the pre-application notice and application for a public hearing contain a "definition of the sand proposed for unitization with such sand defined in each reservoir thereof by reference to well log measurements." *See* Rules of Procedure for Conducting Hearings Before the Commissioner of Conservation of the State of Louisiana effective October 11, 1983. *See also* LA. ADMIN. CODE tit. 43, pt. XIX, § 3901, *et seq* (2017).

107. "'Pool' means an underground reservoir containing a common accumulation of crude petroleum or gas or both. Each zone of a general structure that is completely separated from any other zone in the structure is covered by the term 'pool.'" LA. REV. STAT. ANN. § 31:213(3) (2017). *See also id.* at § 30:3(10).

calculation of royalties with respect to such land since that interval is unleased. This unique circumstance would involve significant issues discussed elsewhere.[108]

II. THE FACTORS AND CONSIDERATIONS INVOLVED IN THE CALCULATION OF THE GROSS ROYALTY PAYMENT

A. Preface

In Part I, consideration was given to assembling the array of elements or component parts that are essential to the implementation of a basic formula for the calculation of a lessor's royalty payment.

While there is probably only one way to correctly calculate the precise gross royalty owed to the lessor, there are a variety of ways to get it wrong. Purely by way of example, errors in the calculation of a gross royalty interest could arise from improper pricing for the produced oil or gas; incorrect volumes or quantities of product; uncertainty as to the status or existence of apparent burdens; or erroneous title determinations, to name only a few.

B. Quantity of Product in Measured Units

The volume of production to which our formula is to be applied is the aggregated block of production represented by the full revenue stream of the well, if it is produced on a "lease basis." However, if the well is unitized, the stream is to be both diminished and allocated on a tract basis, as discussed below.[109]

Self-evidently, the lessee's production of oil or gas generates the relevant commodity in volumetric terms. Certainly, no proper calculation of a lessor's royalty payment can proceed without first recognizing and measuring the captured product.

In a severance tax dispute, the Louisiana Supreme Court observed that the measuring or metering of oil or gas is integral to the industry, stating "[t]he plaintiff has the right under its leases not only to explore for and produce gas but also to market the gas so produced, since otherwise the right to explore for and produce would be valueless, and that in marketing the gas the producer must necessarily measure it . . . ."[110]

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108. *See* Patrick S. Ottinger, *After the Lessee Walks Away–The Rights and Obligations of the Unleased Mineral Owner in a Producing Unit*, 55 ANN. INST. ON MIN. L. 59 (2008).

109. *See infra* Parts IV.B, IV.C.

110. Bel Oil Corp. v. Fontenot, 117 So. 2d 571, 573 (La. 1959).

Oil and gas are marketed on a volumetric basis, calibrated in units. Oil is measured in barrels; a barrel of oil contains forty-two gallons.[111] In contrast, gas is measured in thousand cubic feet (Mcf), but, as will be noted, is typically marketed based upon its energy value, expressed in Million British Thermal Units (MMBtus).[112]

Check stubs have been found to report the gross price for gas expressed in MMBtus, rather than (as explicitly required by article 138.1) thousand cubic feet (Mcf), and at other times, check stubs have reflected some stated factor permitting conversion from MMBtu to Mcf. To be sure, caution should be taken in examining the quantity of gas production reported on SONRIS with that reflected in the check stub that accompanies the royalty check. An "apples to oranges" situation will arise when the information reported on SONRIS reflects volumes of gas in terms of Mcf, while the check stub might reflect market value pricing (usually tethered to a future price at New York Mercantile Exchange (NYMEX),[113] or some other benchmark), based upon a MMBtu.[114]

Gas units are converted from Mcf to MMBtu based upon an analysis of the gas as to its heating value, which is unique for each different source of gas. A very generalized "rule of thumb" formula to convert "an average" price of gas per Mcf to "an average" price per MMBtu can be achieved by dividing the former by 1.032. Conversely, to convert the price per MMBtu of gas to the price per Mcf, multiply the former by 1.032.[115] *Caveat emptor*!

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111. For an interesting history of the evolution of the 42-gallon barrel of oil (including, believe it or not, its connection to the Heisman Trophy), *see History of the 42-Gallon Oil Barrel,* AMERICAN OIL & GAS HISTORICAL SOCIETY, https://perma.cc/JSW7-94UB (last visited Aug. 17, 2017).

112. "The unit of trading shall be 10,000 MMBtu. A delivery tolerance of two percent (2%) above or below the unit of trading is permitted." N.Y. MERCANTILE EXCH., CME GROUP, NYMEX RULEBOOK ch. 220, ¶ 220102.B. (2009).

113. New York Mercantile Exchange is a commodity exchange that trades in crude oil futures (among many other products), using West Texas Intermediate ("WTI") as the traded product, and Cushing, Oklahoma as the delivery point for purposes of pricing.

114. A *British thermal unit*, or "Btu," is a measure of the heat content of fuels. It is the quantity of heat required to raise the temperature of 1 pound of liquid water by 1 degree Fahrenheit at the temperature that water has its greatest density (approximately 39 degrees Fahrenheit). *British Thermal Units (Btu)*, U.S. ENERGY INFO. ADMIN., https://perma.cc/3NKF-SLJ9 (last updated June 13, 2017).

115. The conversion factor of 1.032, as used in the internet illustration, is suggestive of a relatively low MMBtu factor. In all likelihood, gas of that

1. Measurement of Oil and Gas

The inherent physical difference between liquid and natural gas necessitates disparate approaches to the important topic of measuring the relevant commodity for purposes of accounting and royalty calculations.

a. Rules on the Metering of Oil

The Commissioner of Conservation has issued rules concerning the installation and use of meters to measure oil production. These rules include the following as set forth in Chapter 1 of Statewide Order No. 29-B as promulgated by the Louisiana Office of Conservation, to-wit:

> E.l. Each lease shall be provided with sufficient tankage or meters to permit proper gauging of the oil produced. The tanks or meters must be identified by a sign showing the ownership of the tanks or meters and name of the lease from which the oil is being produced. In no case shall meters be the sole means of measuring oil runs from any field. There must be used at least one gauge tank to check the reading of meters. Applications for the use of oil meters in lieu of gauge tanks, shall be the subject of open hearings until rules are formulated.
>
> * * *
>
> 3. All oil meters and bypass settings shall be provided with the necessary connections to permit the installation of seals and such seals shall be affixed by the operator. A record shall be kept on file and available for inspection by any agent of the department[116] or any party at interest for a period of not less than three years, which reflects the oil meter seal number, the date and time the oil meter is sealed, the date and time the seal is broken and the reason for breaking the seal. To obviate the necessity of affixing oil meter seals, oil meters with nonresettable counters may be used.[117]

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character has probably been processed through a gas plant, with most natural gas liquids removed.

116. Formerly called the Department of Conservation, the Office of Conservation was established as a governmental office within the Department of Natural Resources in connection with the reorganization of state government in 1976. *See* LA. REV. STAT. ANN. §§ 36:351-358.

117. LA. ADMIN. CODE tit. 43, pt. XIX, § 119.E.1, E.3 (2017).

b. Rules on the Metering of Gas

Louisiana law provides that gas produced in the state, and then sold, must be measured. Thus, Louisiana Revised Statutes section 30:44 requires that all "gas produced from the deposits of this state when sold shall be measured by meter" and further empowers the Commissioner to "make such regulations for delivery, metering and equitable purchase and taking as conditions may necessitate."[118]

The rules of the Office of Conservation (and the Form OGP associated therewith) require that the operator report natural gas in terms of thousand cubic feet (Mcf).[119]

A "cubic foot of gas" is defined in Louisiana Revised Statutes section 30:47, as follows:

> **LA. REV. STAT. ANN. § 30:47. Cubic foot of gas defined**
>
> A. The term "cubic foot of gas" or "standard cubic foot of gas" means the volume of gas contained in one cubic foot of space at a standard pressure base and at a standard temperature base. The standard pressure base shall be 15.025 pounds per square inch absolute and the standard temperature base shall be sixty degrees Fahrenheit.
>
> B. Whenever the conditions of pressure and temperature differ from the above standard, conversion of the volume from these conditions to the standard conditions shall be made in accordance with the Ideal Gas Laws with correction for deviation from Boyle's Law, which correction must be made unless the pressure at the point of measurement is two hundred pounds per square inch gauge, or less; all in accordance with methods and tables generally recognized by and commonly used in the natural gas industry.
>
> C. For all purposes of computing standard cubic feet of gas under this Part the barometric pressure shall be assumed to be 14.7 pounds per square inch absolute at the place of measurement.[120]

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118. LA. REV. STAT. ANN. § 30:44 (2017).

119. Official Instruction K to Form OGP provides, "Report all Natural Gas and Casinghead Gas volumes in MCF at 15.025 pounds absolute pressure and 60 degrees Fahrenheit." *See also* LA. REV. STAT. ANN. § 30:49 (1992), quoted hereafter.

120. *Id.* at § 30:47.

Noting the reference in section B of this statute to the "Ideal Gas Laws with correction for deviation from Boyle's Law,"[121] it is certainly an understatement to observe that these matters of physics are well beyond the scope of this paper, and certainly beyond the ability of this writer to expound upon them.[122]

Further context to these matters is set forth in Louisiana Revised Statutes sections 30:48-:50. Section 48 tasks the Commissioner with the responsibility to determine the "average specific gravity" and the "average flowing temperature" of flowing gas and to promulgate field rules to address these issues.

Section 49 requires the operator to "report such volumes [of gas production] in number of thousands of standard cubic feet calculated and determined" in accordance with applicable law and the rules of the Commissioner promulgated relative thereto.

It is also provided, in section 50, that "gas shall be measured, calculated, purchased, delivered, and accounted for on the basis of a standard cubic foot of gas," as defined in section 47, noted above. Penalties are provided for non-compliance with this regulatory requirement.

The protocols to ensure the integrity of measuring techniques are addressed in two relevant statutes. Thus, it is required that, with respect to "all orifice-type meters[123] used to measure the production of gaseous mineral hydrocarbons, the differential pressure recording device of said

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121. Boyle's Law, also called Mariotte's Law, expresses a relation concerning the compression and expansion of a gas at constant temperature. This empirical relation, formulated by the physicist Robert Boyle in 1662, states that the pressure (p) of a given quantity of gas varies inversely with its volume (v) at constant temperature; *i.e.*, in equation form, $pv = k$, a constant. The correlation between temperature and volume of natural gas was discovered and developed by the French physicist Edme Mariotte (1676). *Boyle's Law*, ENCYCLOPAEDIA BRITANNICA, https://perma.cc/X476-FL9E (last visited Aug. 23, 2017).

122. While these matters are of vital interest to petroleum engineers and others, the relevant aspects of these principles are incorporated into the statutes in terms that permit an operator to understand and comply with these standards. For present purposes, it is appropriate to note that the statutory definition of a "cubic foot of gas" clearly involves the interrelationship between volume, pressure, and temperature.

123. Also called an "orifice plate," this meter measures volumetric flow, although it can also calculate mass flow depending on the calculation associated with the device. The flow is determined through the difference in pressure between the upstream and the downstream side of a partly impeded pipe.

meters shall be zeroed [as of] each chart changing date, [with] the record thereof to be disclosed on the chart of each meter."[124]

Additionally, all "equipment used for the measuring of the production from the lease of gaseous mineral hydrocarbons sold or otherwise utilized off the lease shall be tested, and repaired and corrected, if necessary, not less than one time within each 6-month period."[125]

Taken together, these statutes constitute the protocols and standards by which production is to be measured in Louisiana to ensure that each owner is fairly and equitably allocated its share of production.

The measurement of produced gas was at issue in *Wegman v. Central Transmission, Inc.*, a case in which the lessee was, at a minimum, haphazard in its metering protocols.[126] There, the jury awarded the lessors the sum of $226,000 (later reduced to $135,000) and dissolved the mineral leases. On appeal, the court observed, as follows:

> According to the various contracts and leases, CTI, or its agent, was required to properly measure the gas produced. LSA-R.S. 30:44. Furthermore, CTI was responsible for insuring [sic] that each meter was properly zeroed.[127] LSA-R.S. 30:251. This was not done. Moreover, CTI comingled the gas produced by various lessees without obtaining proper permits from the Department of Conservation as required by the Department of Conservation Order No. 29–D (March 11, 1955). Because CTI failed to determine the correct amount of gas produced from the B.J. Hodge lease, the jury must determine the correct amount.
>
> While the supplemental contracts are not applicable to these wells, there is an adequate evidentiary foundation for the jury's determination. The jury was presented expert testimony on the issue of measurement. The experts testified that line loss should not exceed five percent.[128] Several experts testified that the usual amount of line loss would be two percent or less. Thus, the expert opinion presented and the provisions of the supplemental agreement form an adequate basis for the jury's determination that

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124. LA. REV. STAT. ANN. § 30:251 (1958).
125. *Id.* at § 30:252.
126. 499 So. 2d 436 (La. Ct. App. 1986), *writ denied* 503 So. 2d 478 (La. 1987).
127. To "zero" a meter is to return its starting base of measurement to zero so that each day or other period of production is properly measured, independent of any other day's production.
128. "Line loss" is the "amount of gas lost in a distribution system or pipeline." MARTIN & KRAMER, *supra* note 60.

quantity should be measured by the reading of the well charts minus three percent.[129]

2. Other Conservation Issues

One of the principal goals or objectives of the Conservation Act is that the Commissioner must endeavor to protect the correlative rights of parties having interests in a common pool or reservoir.[130] At its core, this means that the Commissioner should seek to ensure that a party has the opportunity to "obtain the tract's just and equitable share of the production of the pool."[131] In certain circumstances, this necessitates the metering of production.

a. Commingling of Oil and Gas

A particular circumstance that involves the use of metering systems is the commingling of production with permission of the Commissioner of Conservation. Pursuant to his statutory authority to "require interested persons to place uniform meters of a type approved by the commissioner wherever the [C]ommissioner designates,"[132] the Commissioner has issued Statewide Order No. 29-D-1 that regulates the "commingling of oil and gas production onshore."[133] "Commingling" is defined in that Order as "the combination of gas and/or liquid hydrocarbon production before sales from two or more leases and/or units," subject to certain exceptions.[134]

This Order further provides: that "permission to commingle gas and/or liquid hydrocarbons and to use metering, well test or other methods for allocation of production may be obtained as hereinafter provided and upon strict compliance with the procedures set forth herein."[135]

Among other requirements to be met by the applicant for a commingling order is the submission of "a diagrammatic sketch of the mechanical installation to be used along with a detailed explanation of the flow of the gas and/or liquid hydrocarbons, the procedures and frequency for

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129. 499 So. 2d at 449-50.

130. "Landowners and others with rights in a common reservoir or deposit of minerals have correlative rights and duties with respect to one another in the development and production of the common source of minerals." LA. REV. STAT. ANN. § 31:9 (1975).

131. *Id.* at § 30:9D.

132. *Id.* at § 30:3(14).

133. LA. ADMIN. CODE tit. 43, pt. XIX, § 1501, *et seq* (2017).

134. *Id.* at § 1503A.

135. *Id.* at § 1505A.

calibration/proving of metering devices and allocation formula to be utilized."[136]

Finally, the Commissioner's Order also states that "[a]ll allocation measurements must be in accordance with the American Petroleum Institute (API) *Manual of Petroleum Measurement Standards*, Chapter 20, Allocation Measurement."[137]

b. "Cross Unit Wells"

"The commissioner has jurisdiction and authority over all persons and property necessary to enforce effectively the provisions of [the Conservation Act] and all other laws relating to the conservation of oil or gas."[138] While the commissioner is invested with a wide array of powers and responsibilities,[139] "[t]he Commissioner of Conservation has only those powers expressly granted to him by the legislature. Absent a grant of authority by the legislature, the Commissioner is without authority to act."[140]

The Louisiana Legislature enacted Louisiana Revised Statutes section 30:9.2 in 2015 to authorize the Commissioner of Conservation to "permit the drilling of cross-unit wells."[141] For these purposes, a "'[c]ross-unit well' means a well drilled horizontally and completed under multiple drilling units that is designated by the commissioner after notice and public hearing to serve as a unit well, substitute unit well, or alternate unit well for said units."[142]

The Commissioner of Conservation has issued orders in the Haynesville Shale in Northwestern Louisiana, authorizing "cross-unit wells" pursuant to Louisiana Revised Statutes section 30:9.2 and in accordance with a Policy Memorandum of the Commissioner of Conservation.[143] This Memorandum sets forth the policy of the office and the procedures for applications for such

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136. *Id.* at § 1505A.1.a.ii.

137. *Id.* at § 1505A.1.g.

138. LA. REV. STAT. ANN. § 30:4A (2015).

139. *Id*. at § 30:4B, C.

140. Eads Operating Co., Inc. v. Thompson, Comm'r of Conservation of the State of La., 646 So. 2d 948, 951 (La. Ct. App. 1994), *writ denied* 652 So. 2d 1345 (La. 1995). In the interest of full disclosure, your author represented the operator in this suit.

141. LA. REV. STAT. ANN. § 30:9.2B (2015).

142. *Id.* at § 30:9.2A(2).

143. *See* Memorandum from Commissioner James H. Welsh (Nov. 2, 2012) (on file with author) (concerning "Horizontal cross unit lateral wells in shales, tight gas sands and unconventional reservoirs").

units. Among other things, the Memorandum states, as follows: "Production from each cross unit lateral well shall be separated and metered individually and this information shall be reported to the Office of Conservation in a manner to be prescribed by this office."[144]

Understandably, a principal feature or consideration in the drilling of a cross unit well is the issue of metering. The current formulation employed by the Commissioner in orders authorizing such wells is the following language in the "Definitions" section of the Order, to-wit:

> For purposes outlined in the Order promulgated herewith, "perforated length of lateral" shall mean and is hereby defined as the length of horizontal lateral wellbore wherein perforations have been made, regardless of the number of perforated stages or individual perforations, which is measured from the lesser measured depth perforation or "top of perforations" to the greater measured depth perforation or "base of perforations."[145]

The Order then typically provides, in its "Findings" section (but later adopted or incorporated by reference in its "Ordering" section), as follows:

> Unit production from said cross unit horizontal alternate unit wells should be allocated to each unit in the same proportion as the perforated length of the lateral, as defined in the DEFINITIONS section herein, in that each unit bears to the total length of the perforated lateral, as determined by an 'as drilled' survey performed after the cross unit wells are drilled and completed; and that unit production should continue to be shared on a surface acreage basis.

c. Conditional Allowables

Because the perforated borehole of a "cross-unit well"—called a lateral—"crosses" or traverses a unit boundary, such that different ownerships are affected, this formulation constitutes a method to allocate production between the affected units.

It is the practice of the Office of Conservation to issue a "conditional allowable," so as to permit an operator to produce a well that is subject to a pending unitization proceeding prior to the issuance of the order establishing the compulsory unit for the well. The allowable is subject to

144. *Id.* at ¶ 3.

145. In the vernacular of the practice, the "top of perforations" is called the "heel," while the "base of perforations" is referred to as the "toe" of the horizontal lateral wellbore.

the condition that the proceeds from the sale or other disposition of production from such well be disbursed on a unit basis.

Typically, the operator will seek and obtain an escrow agreement from all persons who would own an interest in production from the well if it were produced on a "lease basis," whereby such owners agree to the escrow arrangement, thus essentially foregoing the right to receive "lease basis" royalties on production prior to the effective date of the unit order. In the absence of some agreement whereby owners of the minerals in or under the drill site tract manifest such an arrangement, the royalty obligations of the lessee under the mineral lease (and other contracts) pertaining to the drill site owner remain unmodified in any respect.

The genesis of this rule pertaining to a "conditional allowable" is a Memorandum dated April 14, 1983, issued by the Chief Engineer of the Office of Conservation, Joseph W. Hecker, under direction of (then) Commissioner Patrick H. Martin, to the effect that "no allowable should be issued on a lease basis after pre-application or hearing has been filed."

The rationale behind this policy pertaining to "conditional allowables" is that, after the filing of a Pre-Application Notice, other parties are precluded from securing a permit to drill in the area to be affected by the unitization. Since a party's right to enforce the "rule of capture" is thereby abridged, it is only appropriate that they be protected by requiring disbursement of pre-production on a unit basis.[146]

Accordingly, whether or not the lessor of a drill site tract that is the subject of a pending unitization application is entitled, prior to the effective date of the unit, to be paid on a "lease basis" or a unit basis, depends on whether the lessor (and other parties owning an interest in production in and to the drill site tract) has signed an escrow agreement in association with the issuance of a conditional allowable.[147]

146. *See* Exxon Corp. v. Thompson, 564 So. 2d 387 (La. Ct. App.), *writ denied* 568 So. 2d 1054 (La. 1990).

147. Gladney v. Anglo-Dutch Energy, L.L.C., 210 So. 3d 903, 910 (La. Ct. App. 2016), *writ denied* 218 So. 3d 120 (La. 2017) ("[W]e find the relationship between Anglo–Dutch and Plaintiffs prior to October 30, 2012, is governed by the bargained for lease between the two parties. Anglo–Dutch's obligation to pay Plaintiffs a one-fifth royalty on all production from the well is modified only upon the Commissioner's unitization order's effective date, October 30, 2012.").

3. Adverse Legal Consequences of Inappropriate or Inaccurate Measurement of Oil and Gas

Fortunately, no court from the Bayou State has considered the adverse legal consequences resulting from poor metering procedures.[148] However, the need for accurate measurements of production from a distinct well is illustrated in a recent decision out of Ohio.

In *Lang v. Weiss Drilling Co.*,[149] the lessees, Daniel Weiss and Antero Resources Corp., ran production from multiple leases through a common metering system. This obviously disallowed any opportunity to make a precise determination of the amount of production attributable to any one of the contributing leases for purposes of ascertaining whether the lease was producing "in paying quantities." The court explained that the lessee's metering protocols involved running production through a "common meter," which necessitated the defendants to pay royalties on an estimated basis. Defendants, Antero and Weiss, argued as follows:

> Antero and Weiss presented evidence that common metering can be an accepted practice by some oil and gas companies for purposes of their internal records and paying royalties. But just because this practice is accepted by some oil and gas companies does not mean that the trial court had to accept it in this case as a valid means to measure production for purposes of whether a well is producing paying quantities of gas. It is reasonable for the court to require a more accurate method of measuring gas production. The court must be able to quantify production from the particular well at issue. It should not be required to guesstimate the amount of gas attributable to the well in question when the party responsible for the metering has chosen to use a common meter for multiple wells as opposed to individual meters for each well.[150]

Thus, "guesstimates" from a common metering system were held to be insufficient evidence to maintain the mineral lease in force and effect.

Lest one think that the role of pressure and temperature in the measurement of natural gas is merely a technical, perhaps non-legal, consideration, one should consider certain judicial actions putting these matters at issue in royalty litigation.[151]

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148. *But see Wegman*, 499 So. 2d 436.

149. 70 N.E.3d 625 (Ohio Ct. App. 2016).

150. *Id.* at 633.

151. As stated by one respected commentator, "[a]n essential element of accurate royalty calculation is accurate measurement of the oil and gas being

In a matter styled *In Re: Natural Gas Royalties Qui Tam Litigation*,[152] Mr. Grynberg, as "relator," filed a *qui tam* action questioning and challenging the manner in which the defendants measured natural gas on Federal or Indian lands for purposes of paying royalty to the Federal government.[153] With apologies for length,[154] the court explained the essential factual allegations as put forth by the Relator, as follows:

> The current series of complaints filed by Mr. Grynberg are not entirely uniform, but do share a number of common elements. The present lawsuits challenge Defendants' measurement of the volume and analysis of the heating content of natural gas, allegedly causing substantial underpayments of royalties to the United States. Relator contends that in properly calculating those royalties, it is crucial that the heating content and volume of the gas be analyzed and measured accurately pursuant to federal law as well as federal regulations and the industry standards those regulations incorporate. Relator alleges Defendants have knowingly (within the meaning of 31 U.S.C. § 3729(b)) underreported the heating content and volume of that gas by undermeasuring and misanalyzing it in the ways described in paragraphs 32-54 of his complaints (referred to by Relator as "Mismeasurement Techniques").
>
> Natural gas is measured on the basis of two factors: its heating content and its volume. Heating content is analyzed and expressed in "British Thermal Units" ("BTU's") per cubic foot; volume is measured in units of one thousand cubic feet ("MCF's"). To

extracted under the lease to determine the volume on which a royalty is due. *See generally* Michael J. Heydt, *Overview of Natural Gas Measurement Litigation*, 47 ROCKY MTN. MIN. L. INST. 16-1 (2001)." David E. Pierce, *Royalty Jurisprudence: A Tale of Two States*, 49 WASHBURN L. J. 347, 352, n.15 (2010).

152. MDL Docket No. 1293 (D. Wyo.). Internal, irrelevant text, including cross-references, omitted.

153. A *qui tam* suit is one brought by a "whistleblower" under the False Claims Act, 31 U.S.C.A. §§ 3729-3733, in which allegations are made that a federal contractor has committed fraud against the government. The successful plaintiff, called a "relator," receives a portion of the recovery.

154. Although admittedly a long quoted passage, it does provide an overview of the implications of the legal issues arising from the manner in which gas is measured in reference to its heat content and volume, as well as the context in which such issues arise. While this case was brought (albeit unsuccessfully) under the False Claims Act, it is not inconceivable that similar issues could be litigated or asserted in a private setting.

calculate the value of a given amount of natural gas one would multiply the heating content in BTU's per cubic foot by the volume in cubic feet, thus creating a product measured in millions of BTU's, or "MMBTU's." Natural gas has historically been valued and sold throughout the natural gas industry on the basis of a price per MMBTU. Pricing on a MMBTU basis has been prescribed by federal law since implementation of Order 699 by the Federal Power Commission in 1974.

Relator represents that royalties owing to the United States for natural gas produced from federal lands have been calculated as a percentage of the value of the gas so produced, which is directly affected by the gas's measured MMBTU's. Thus, Relator alleges, accurate techniques for measuring the MMBTU of gas produced from these properties are required by federal law, as well as by federal regulations and industry standards, in order to correctly calculate those royalty payments. Specifically, the Federal Oil and Gas Royalty Management Act ("FOGRMA") directs the Secretary of the Interior to "establish a comprehensive . . . system to provide the capability to accurately determine oil and gas royalties." 30 U.S.C. § 1711(a). The Act also imposes penalties on "[a]ny person who . . . knowingly or willfully prepares, maintains, or submits false, inaccurate, or misleading reports, notices, affidavits, records, data, or other written information[.]" 30 U.S.C. § 1719(d).

* * *

Under contracts commonly used in the natural gas industry, natural gas transmission companies and other purchasers, gatherers, and/or transporters of natural gas (collectively referred to as "Gas Measurers") have routinely been responsible for measuring the volume and analyzing the heating content of gas which they gather, purchase, and/or transport. Thus, the MMBTU value of natural gas produced from federal lands has been measured and determined by Gas Measurers such as Defendants; and those MMBTU measurements have been used to determine the value of natural gas, and hence the amount of royalties owing to the United States. Accordingly, royalty payments to the United States have been made either by lessees of those lands in reliance on information furnished by the Gas Measurers, or by the Gas Measurers themselves, on the basis of their own MMBTU determinations obtained from their gas volume measurements and gas heating content analyses. Relator alleges that the Mismeasurement Techniques used by Defendants

> to arrive at those determinations are all inconsistent with federal law and regulations, as well as industry standards.
>
> Relator also alleges that Defendants measure and analyze natural gas differently at the point of intake and at the point of later delivery. Defendants have allegedly been in control of the MMBTU measurement and analysis process at the point of purchase or input into a gas gathering line and/or gas pipeline (where royalty measurements are taken), as well as (directly or through subsidiaries or affiliates) the process at any later point where the gas is resold or otherwise conveyed. Relator states that the true heating content of natural gas should remain the same at any point along its path. However, by using different techniques, procedures, or assumptions in the measurement and analysis process, one can significantly (and inaccurately) alter the results of the gas's measured MMBTU value. Such selective measurement and analysis techniques, yielding a lower MMBTU value at the point of purchase or input and a higher MMBTU value at the point of resale or conveyance, result in the unjust enrichment of the Defendants and/or their affiliates.[155]

The ultimate resolution of this *qui tam* action is not relevant for present purposes, except to note that Mr. Grynberg did not prevail and was cast for significant attorney's fees under the "fee-shifting" provisions of the False Claims Act.[156]

The Relator in this suit filed numerous actions to the same effect, making the same fundamental argument. For example, in one case, this litigant "sued the defendant companies on behalf of the Government, seeking to recover a portion of natural gas royalties owed the Government, based on the defendants' having allegedly mismeasured and falsely reported the volume and heating content of gas they produced on Indian lands."[157] That suit was dismissed by the district court on the basis that the

155. In Re: Natural Gas Royalties Qui Tam Litigation, MDL Docket No. 1293, 3-6 (D. Wyo. May 2001) (Order on Motions to Dismiss).

156. In Re: Natural Gas Royalties Qui Tam Litigation, Lead Case No. 15-8054 (10th Cir. Jan. 4, 2017). The Tenth Circuit affirmed the award of attorney's fees to certain defendants of "around \$5.5 million," but reversed the award of attorney's fees to other defendants "totaling nearly \$17 million."

157. United States of America ex. rel. Jack J. Grynberg v. GPM Gas Corp., 277 F.3d 1373 (5th Cir. 2001), *cert. denied* 535 U. S. 1017 (2002).

Relator "lacked standing under Article III of the [United States] Constitution to bring a lawsuit on behalf of the Government."[158] However, that ruling was reversed on appeal.[159]

Concerning these cases, the merits and ultimate resolution thereof are not particularly important, but the allegations made by the Relator are instructive as to the ingenuity that certain plaintiffs might bring forth to address the issue of mismeasurement of natural gas.

4. Produced Gas on Which No Royalty is Due

Certain categories of oil or gas are deducted from the gross volume of production on which royalty is to be calculated, and hence, that are to be exempted from the calculation of a royalty payment.[160]

a. Production Used as Fuel in Well Operations

It is not uncommon that the "Royalty Clause" of a mineral lease permits the lessee to use a portion of the gas in connection with conducting operations on the property or in treating oil to make it marketable. Typically, the gas might be used for "lifting purposes" in order to "lift" oil or gas to the surface.[161]

For example, each of the commercially printed forms of the mineral lease used in South Louisiana[162] has, substantially, if not precisely identical, the following provision, to-wit:

> Subject to the provisions of Paragraphs 2 and 10 hereof, the royalties to be paid by Lessee are: (a) . . . one-eighth (1/8) of that produced and saved from the land *and not used for fuel in conducting operations on the property (or on acreage pooled therewith or with any part thereof), or in treating such liquids to make them marketable*; . . . (e) Lessee shall have free use of all oil, gas or any component thereof used in lease or unit operations as

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158. *Id.*
159. *Id.*
160. Principally involving natural gas rather than oil, these categories are associated with a variety of acronymic monikers, such as "FLU," which stands for "Fuel, Lost, or Unaccounted for," or "LAUF," meaning "Lost and Unaccounted for."
161. ". . . necessary to lift the oil from the ground." Stewart v. Amerada Hess Corp., 604 P.2d 854, 857, n.8 (Okla. 1980).
162. These are usually called "Bath forms," a reference to the printer of the forms—the M.L. Bath Printing Co., Shreveport, Louisiana.

> well as gas, including the components thereof, injected into subsurface strata as hereinafter defined; . . . Lessee shall have the right to inject gas, water, brine or other fluids into subsurface strata, and *no royalties shall be due or computed on any gas or component thereof produced by Lessee and injected into subsurface stratum or strata through a well or wells located either on the land or a pooled unit containing all or a part of the land*.[163]

In this regard, the North Louisiana form provides as follows: "Lessee shall have free use of oil, gas, casinghead gas, condensate, and water from said land, except water from Lessor's wells, for all operations hereunder, including repressuring, pressure maintenance and recycling, and *the royalty shall be computed after deducting any so used*."[164]

As a corollary to the foregoing explicit exclusion of fuel gas from the operation of the "Royalty Clause," royalty is typically only imposed on gas that is "produced and saved," or that is "sold," or words to that effect. Quite evidently, gas that is used as fuel is not gas that is "saved" or "sold."

To be sure, by the express terms of the commercial form of mineral lease utilized in North Louisiana,

> such gas, casinghead gas, residue gas, or gas of any other nature or description whatsoever, *as may be disposed of for no consideration to Lessee, either through unavoidable waste or leakage, or in order to recover oil or other liquid hydrocarbons, or returned to the ground,* shall not be deemed to have been sold or used either on or off the premises within the meaning of this paragraph 4 hereof. [165]

In other words, no royalty is due in respect of such gas.

Although the issue was presented in the context of Federal regulations pertinent to Federal offshore leases (and not in a private context), a Federal District Court in Louisiana found "that the decision by the Department to require payment of royalty on Lost and Used Hydrocarbons is arbitrary and capricious, and is therefore contrary to the law . . . ."[166]

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163. Paragraph 7, Bath 4B and 6 Forms (emphasis added).

164. Paragraph 9, North Form (emphasis added).

165. Paragraph 4, North Form (emphasis added).

166. Amoco Production Co. v. Andrus, 527 F. Supp. 790, 797 (E.D. La. 1981) (concerning a provision of the Outer Continental Shelf Lands Act requiring the payment of royalty of not less than 12-1/2% "in the amount or value of the production saved, removed, or sold from the lease;" *see* 43 U.S.C.A. § 1337 (2012)).

b. Lost and Unaccounted for Production

Some portion of the gas produced from a well will often be lost or unaccounted for through the normal processes of production or transportation. As stated in a recent Texas case,[167] "[g]as lost and unaccounted for is the gas lost between the wellhead and the point of sale."[168]

Unaccounted for gas loss represents the mathematical difference between the amount of gas entering a pipeline system and the amount representing the output. For example, if 100 units of gas are input into a system, and ninety-five units are output, there is an "unaccounted for" loss of five units of production.

The issue of whether royalty is due on gas that is lost or used has not arisen in Louisiana. However, in *Hall v. CNX Gas Co., LLC*,[169] a Pennsylvania court held that no royalties are due on gas that is lost or used in operations on the leased premises, explaining its ruling as follows:

> Hence, with regard to the lost and used gas specifically, we find no ambiguity or missing allocation term in the Hall lease. The language providing for royalties to be calculated on the net amount realized at the point of sale obviates the need for a term allocating lost and used gas.[170]

C. Price per Unit of Product

The next factor in the calculation of a lessor's royalty payment is to apply the pertinent price per measured unit of production to the quantity of oil or gas being produced.

While the terms of the "Royalty Clause" control,[171] two principal considerations are presented in this regard. First, to what have the parties agreed with respect to the benchmark for pricing to be applied to the royalty obligations of the lessee? Second, how are those prices to be determined, and where may they be found?

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167. Chesapeake Exploration, L.L.C. v. Hyder, 427 S.W.3d 472 (Tex. Ct. App. – San Antonio 2014), *aff'd* 483 S.W.3d 870 (Tex. 2015).

168. *Id.* at 481.

169. 137 A.3d 597 (Pa. 2016).

170. *Id.* at 604. *See also Chesapeake Exploration*, 427 S.W.3d at 482 ("Gas lost or unaccounted for is neither sold nor used.").

171. "Contracts have the effect of law for the parties." LA. CIV. CODE ANN. art. 1983 (2017). *See also* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at ch. 2.

1. Basis of Royalty Determination

What is the basis of determination of the pricing pertinent to the royalty payment due to the lessor? This integral question puts forth another area where much could be written.[172] For present purposes, a brief overview of this important topic is set forth.

With regard to the price per measured unit of production, a "Royalty Clause" in a mineral lease in Louisiana typically will take one of two basic formulations, *viz*., the monetary price of the royalty is determined either on the basis of (a) "market value at the well" or (b) "proceeds realized" by the lessee.

a. Market Value

In the "Royalty Clause" of a commercially printed form of mineral lease in prevalent use in Louisiana, royalty on gas is stated to be the stipulated fraction "of the *market value* of the gas sold or used by Lessee in operations not connected with the land leased or any pooled unit containing a portion of said land."[173]

In the "Royalty Clause" of another lease form, the following is provided with respect to royalty on certain gas types:

> [G]as produced from or attributable to said land and sold, including the gas remaining after the extraction of hydrocarbon products therefrom, [shall be the royalty fraction] of the market value at the mouth of the well of the gas so sold, including casinghead gas or other gaseous substances. *The price to be used in computing the market value at the mouth of the well shall be the price received by Lessee under an arms' length gas sales contract prudently negotiated in the light of the facts and circumstances existing at the time of consummation of such contract*; . . . ."[174]

In the form in prevalent use in North Louisiana,

> [The basis for royalty] on gas, including casinghead gas, or other gaseous substance produced from said land and sold or used off the premises or for the extraction of gasoline or other products therefrom, [is] the market value at the well [of the royalty fraction] of the gas so sold or used, provided that on gas sold at the wells

172. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 4-25(d)(5).
173. Paragraph 7(b), Bath 4B Form (emphasis added).
174. Paragraph 7(b), Bath 6 Form (emphasis added).

> the royalty shall be [the royalty fraction] of the amount realized from such sale . . . .[175]

In *Arkansas Natural Gas Co. v. Sartor*,[176] the following discussion ensued as to the meaning of the term "market value:"

> As applied to this case, the term "market price" is interchangeable with the term "market value." In the nature of things there could be no open market for natural gas. It is admitted there are no exchange quotations or other evidence to be obtained of open and notorious market prices at which any one desiring gas could purchase it, as would be available in the sale of other commodities. In this situation the modern rule is that value may be shown by evidence of other sales, provided the conditions are substantially similar, but not otherwise.[177]

Another definition of the term "market value" was put forth in *Henry v. The Ballard & Cordell Corp.*,[178] as being "the price which it might be expected to bring if offered for sale in the market."[179]

b. Price Realized

Also called a "proceeds" lease, an example is set forth in the significant case of *Frey v. Amoco Production Co.*[180] In the Frey lease, the "Royalty Clause" obligated the lessee to pay to the lessor "royalty on gas sold by the Lessee of one-fifth (1/5) of the amount realized at the well from such sales."[181]

Under a "Royalty Clause" in which the lessor is to be compensated on the basis of the price realized or received by the lessee, the lessee, in discharging its duty to prudently market the production, will essentially fix the price on the basis of which the lessor will be compensated by way of royalty. While the amount actually received by the lessee as a result of a good faith sales transaction will govern the calculation, it will still be

175. Paragraph 4(b), North Form.
176. 78 F.2d 924 (5th Cir. 1935).
177. *Id.* at 927.
178. 418 So. 2d 1334 (La. 1982).
179. *Id.* at 1337.
180. 603 So. 2d 166 (La. 1992).
181. *Id.* at 170.

subject to a lessor's inquiry under the auspices of article 122 of the Louisiana Mineral Code.[182]

2. Source for Determination of the Relevant Benchmark Price

Having identified the relevant benchmark, where (that is, from what source) does the lessee ascertain the value of the product for purposes of the "Royalty Clause?"

a. Posted Price

Historically, the price at which the lessee sells oil is based upon the "posted price" in the field. More often than not, the posted price is more artificial than it is based in reality. The price is "posted" in the sense that it is announced or published by the purchaser–often the lessee itself, or an affiliate of the lessee–by some publication, including electronic bulletin boards.

The term "posted price," as defined by the leading commentators on oil and gas law, means "[a] written statement of crude petroleum prices circulated publicly among sellers and buyers of crude petroleum in a particular field in accordance with historic practices, and generally known by sellers and buyers within the field."[183]

Over the last few decades, the practice of "posting" a specific prevailing price "in the field" for crude oil has now evolved to pricings being embodied in "assessments" based upon broad types or grades of oil in general marking areas. The regulations of the Department of Revenue continue to provide the following definition of "posted price," albeit for purposes of the assessment of severance taxes:

LA. ADMIN. CODE § 61:I.2903A

> *Posted Field Price*—a statement of crude oil prices circulated among buyers and sellers of crude petroleum and is generally known by buyers and sellers within the field as being the posted price. The posted field price is the actual price of crude petroleum advertised for a field. The area price is a statement of crude oil prices circulated among buyers and sellers of crude petroleum listing prices for different areas of the state, usually listed as north Louisiana and south Louisiana, and generally known among

182. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 3-13(e)(4).
183. MARTIN & KRAMER, *supra* note 60.

> buyers and sellers within the area as the posted price. This area price is the beginning price for crude petroleum of an area before adjustments for kind and quality (including, but not limited to, gravity adjustments) of the crude petroleum. When no actual posted field price is advertised or issued by a purchaser, the area price less adjustments for kind or quality (including, but not limited to, gravity adjustments) becomes the *posted field price*.[184]

In recognition of the fact that the contracting parties, at the inception of the lease relationship, might not know if a price has been (or will in the future be) posted or published for the field in which the leased premises is located, alternative formulations might be put forth in the mineral lease. Thus, in *Bailey v. Franks Petroleum Inc.*,[185] the "Royalty Clause" of the mineral lease read:

> Subject to the provisions of Paragraphs 2 and 11 hereof, royalties to be paid by Lessee are:
>
> (a) One-fifth (1/5) of all oil, distillate, condensate and other liquid hydrocarbons howsoever produced and saved from the leased premises to be delivered to Lessor in storage tanks furnished by Lessee at its cost, or any pipe line in the field free of all cost or charge, or, at Lessor's option, purchased by Lessee *at the price prevailing for the field on the day it is run to the pipe line or storage tank, or if there be no posted price for the field, the average price for Gulf Coast Fields of Louisiana* for oil, distillate, condensate or other liquid hydrocarbons of same grade and gravity, without any deduction for treatment or transportation costs. All oil and condensate shall be measured in tanks, and liquid meters shall not be used without Lessor's consent.[186]

While the determination of a lessor's royalty payment based on the posted price was an accepted practice for many years, litigation has ensued in recent years in which lessors have challenged the posted price as being an inappropriate benchmark, not representative of market value for the oil produced.

The most significant case in Louisiana on posted price, as a benchmark to account to a lessor, arose out of a royalty demand issued by the

184. LA. ADMIN. CODE tit. 61, pt. XXIX, § 2903A (2017).

185. 479 So. 2d 563. In the interest of full disclosure, your author represented the defendant-lessee in this suit.

186. *Id.* at 566 (emphasis added).

Department of Natural Resources of the State of Louisiana against its lessee, Chevron. In the suit that followed,[187] tried before a jury, the State contended that Chevron "cheated" it out of royalties for over a decade.[188] This conduct was based on the payment by Chevron of royalties tethered to the posted price at Chevron's Port Fourchon facility near Golden Meadow, Louisiana, rather than on market value as established by the sale of the oil to other purchasers (principally British Petroleum and Exxon).

The dispute commenced when the State made demand on Chevron in June of 2001 for almost thirty million dollars in royalties from the Bay Marchand Field operated by Chevron.[189] In response, Chevron paid additional royalties to the State in the amount of fifteen million dollars and concurrently filed a declaratory judgment[190] seeking return of the monies paid.[191]

According to newspaper accounts,[192] Chevron sought to justify the price on which royalties were calculated, based on its lawyer's argument that, after the point of production, "Chevron mingled the oil from its Bay Marchand field off the coast of Lafourche Parish with a better grade of oil which it then sold for more than the price it had posted before blending."[193]

This same newspaper report captured the lessee's argument, clearly pitched to a Lafourche Parish jury, that "selling oil that was mingled with

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187. Chevron U.S.A. Inc. v. State of Louisiana, No. 93,658, (La. Dist. Ct. 2004).

188. Although a claim for royalties is subject to a liberative prescription of three years, *see* LA. CIV. CODE ANN. art. 3494(5) (2017), that period does not apply to a state royalty claim as per the explicit text of this article. Additionally, our constitution stipulates that "[p]rescription shall not run against the state in any civil matter, unless otherwise provided in this constitution or expressly by law." LA. CONST. art. XII, § 13 (1974).

189. LA. REV. STAT. ANN. § 31:137 (1975). *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 13-28.

190. Chevron U.S.A. Inc. v. State of Louisiana, No. 93,658, (La. Dist. Ct. 2004).

191. It is unclear if Chevron paid the disputed royalties "under protest." "Louisiana law does not permit a party to recover voluntary payments merely because payment was made under protest." Bickham v. Wash. Bank & Trust Co., 515 So. 2d 457 (La. Ct. App. 1987). *See also* DLJ of La. No. 1 v. Green Thumb, Inc., 376 So. 2d 121, 123 (La. 1979) (Dennis, J., concurring) (citing the seminal case on this proposition, New Orleans & N.E.R. Co. v. La. Const. Imp. Co., 33 So. 51 (La. 1902), where it was stated that "[i]t is elementary that a voluntary payment of money under a claim of right cannot, in general, be recovered back.").

192. John McMillan, *State Wants Chevron to Pay $100 million, End Oilfield Lease*, THE ADVOCATE, Mar. 2, 2004; John McMillan, *Jury Finds Chevron Defrauded State of Oil Royalties*, THE ADVOCATE, Mar. 19, 2004.

193. *Id.*

a higher grade was similar to buying live crawfish, purging the crawfish, then cooking, peeling and packaging the mudbugs before selling them at higher prices."[194]

That interesting allegory was unavailing in Thibodaux, Louisiana. The jury answered, in the affirmative, the interrogatories as to whether "Chevron's original failure to pay the full amount of royalties due to the State of Louisiana was fraudulent," and "willful and without reasonable grounds,"[195] awarding the State in excess of eighty-two million dollars (royalties due, plus double royalties as damages, and interest),[196] plus attorney's fees in excess of twenty million dollars. Chevron settled the case after verdict.

Another case considered similar allegations,[197] but the reported decision addressed only the issue of the propriety of giving written notice of non-payment on a class-wide basis.[198]

b. Marketing through Affiliates[199]

As in the case of posted prices, issues arise when the lessee sells its production to an affiliated entity. For these purposes, an "affiliate" is a legal entity owned or controlled by, or under the control of, the lessee. The opportunity for coziness comes to mind, as does the proverbial "brother-in-law deal."

In *Tyson v. Surf Oil Co.*,[200] the lessor sued his lessee complaining about the lessee's failure to pay royalties properly. The lessee produced

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194. *Id.*

195. Chevron U.S.A. Inc. v. State of Louisiana, No. 93,658, (La. Dist. Ct. 2004) (Judgment dated April 13, 2004).

196. As to the propriety of trebling (rather than merely doubling) the royalties, *see* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 13-30(c).

197. Duhe' v. Texaco, Inc., 779 So. 2d 1070, 1073 (La. Ct. App.), *writ denied* 791 So. 2d 637 (La. 2001). The decision indicates that the "petitions claim that beginning March 23, 1988, Texaco and its producing affiliate, TEPI, underpaid oil royalties by valuing the amounts due the royalty owners on self-dealing, low-priced transfers of their oil from TEPI to Texaco Trading and Transportation, Inc. (TTTI), another wholly owned Texaco subsidiary. They claim that the calculation and payment of royalties was based on an internal transfer price, TTTI's posted price, instead of a better price, which they describe generally as market value, and that the TTTI posted price was less than market value."

198. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 13-28(f).

199. *See id.* at § 4-25(d)(6)(x).

200. 196 So. 336 (La. 1940).

gas and sold it to its affiliated companies. The Louisiana Supreme Court observed that a named individual "was the moving spirit of all three of defendant affiliated companies, and that he fixed the price of gas at which [the purchaser] would pay for it."[201] The Court held that the sale of gas "at one cent per thousand cubic feet was without the consent of the plaintiffs, [and] the price is not binding on plaintiffs and they are entitled to recover a fair market value for the gas at the well where produced."[202]

D. Lessor's Fractional Interest in Minerals[203]

1. Preface

As a foundational article in the Mineral Code, it is established that "[o]wnership of land does not include ownership of oil, gas, and other minerals occurring naturally in liquid or gaseous form . . . . The landowner has the exclusive right to explore and develop his property for the production of such minerals and to reduce them to possession and ownership."[204]

It is also recognized that a "landowner may . . . lease his right to explore and develop his land for production of minerals and to reduce them to possession."[205]

"A mineral lease may be granted by a person having an executive interest in the mineral rights on the property leased."[206]

"A mineral servitude is the right of enjoyment of land belonging to another for the purpose of exploring for and producing minerals and reducing them to possession and ownership."[207]

Taken together, these statutes give rise to the necessity to ascertain the interest of the lessor in the minerals in and to the lands made subject to the mineral lease. If the lessor owns the entirety of the rights to minerals in the land, this inquiry ends here, such that this component (for formulaic purposes) is "1.0."

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201. *Id.* at 339.
202. *Id.*
203. *See* OTTINGER, MINERAL LEASE TREATISE, supra note 1, at § 4-30.
204. LA. REV. STAT. ANN. § 31:6 (1975).
205. *Id.* at § 31:15.
206. *Id*. at § 31:116.
207. *Id.* at § 31:21. *See* PATRICK S. OTTINGER, *Mineral Servitudes*, in LOUISIANA MINERAL LAW TREATISE, ch. 4 (Patrick H. Martin, ed., 2012) [hereinafter OTTINGER, *Mineral Servitudes*].

However, if the lessor does not own the rights to minerals in the land in their entirety, it is because either the lessor's land is subject to a mineral servitude to some fractional extent, or the lessor only owns an undivided interest in the land, with the balance being owned by other co-owners.[208]

While the "Proportionate Reduction Clause" of a mineral lease is the contractual authority for the right of the lessee to reduce payments under the mineral lease to the lessor, where the lessor does not own all rights to the minerals in and under the leased property, it does not generally appertain to royalty payments. Rather, royalty payments are calculated with respect to the title of the lessor, without regard to the existence of a "Proportionate Reduction Clause."

Said differently, a royalty payment is based on the determination of the lessor's entitlement to revenue, an issue that principally takes into consideration the lessor's title to the tract of land in question and the existence of any real burdens thereon. Whatever its significance in other contexts,[209] the "Proportionate Reduction Clause" of a mineral lease generally has no pertinence in this regard.

2. Outstanding Burdens on Interest of the Lessor

It is also necessary to ascertain if the lessor's interest in minerals is subject to the rights of others, as this would necessarily reduce or diminish the net revenue interest to which the lessor is entitled. Typically, such a diminution results from the creation of a mineral royalty by the lessor or its ancestor-in-title.[210]

A mineral royalty is recognized by the Louisiana Mineral Code as one of the three "basic" mineral rights that might be created by a landowner.[211] As such, a mineral royalty is a real right[212] and an incorporeal immovable.[213] Being an incorporeal immovable, all of the laws pertinent to immovables apply to the mineral royalty, including requisites for creation, transfer and registry.[214]

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208. *See* Patrick S. Ottinger, *Oil in the Family--Obtaining the Requisite Consent to Conduct Operations on Co-Owned Land or Mineral Servitudes*, 73 LA. L. REV. 745 (2013).

209. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 4-30.

210. *See* OTTINGER, *Mineral Royalties, supra* note 11.

211. LA. REV. STAT. ANN. § 31:16 (1975).

212. *Id.*

213. *Id.* at § 31:18.

214. "Mineral rights, including mineral leases, are classified under the Mineral Code as incorporeal immovables and are subject to the Civil Code articles respecting immovable property." Guy Scroggins, Inc. v. Emerald Exploration,

Commenting on the early confusion relative to the nature of royalty, Professor Daggett remarked as follows:

> The confusion regarding royalty seems to have its roots in the notion, correct as far as it goes, that royalty is the equivalent of rent. So it is; but this rent in mineral leases is but a percentage of production from the land . . . . It usually becomes ultimately attached to a lease, as few landowners are producers. But it does not have to have a *present* lease nor *need* it have an ultimate lease upon which to ground its being, because its interest is in the *production*, by whatever method that may be achieved.[215]

A mineral royalty is now defined in article 80 of the Louisiana Mineral Code, as follows:

> **Art. 80. Nature of mineral royalty**
>
> A mineral royalty is the right to participate in production of minerals from land owned by another or land subject to a mineral servitude owned by another. Unless expressly qualified by the parties, a royalty is a right to share in gross production free of mining or drilling and production costs.[216]

The seminal case involving the mineral royalty is the case of *Vincent v. Bullock*.[217] There, the plaintiffs transferred land on February 22, 1927. In this deed, the plaintiffs reserved "in perpetuity, a one-sixteenth (1/16th) royalty of all the oil, gas and other minerals produced and saved" from the land.[218]

At issue was the legal nature of the interest reserved by the plaintiffs, *i.e.*, whether it was or was not subject to any sort of prescriptive regime.

Plaintiffs contended that the reservation in the February 22, 1927, deed

> [did] not fall in the legal category of a servitude, subject to the prescription of ten years for non-use, but characterize[d] it (1) as being in the nature of a rent charge to become operative should oil or other minerals be produced, (2) or being in the nature of a

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401 So. 2d 680, 684 (La. Ct. App.), *writ denied* 404 So. 2d 1257 (La. 1981). In the interest of full disclosure, your author represented the defendant in this suit.

215. HARRIET SPILLER DAGGETT, MINERAL RIGHTS IN LOUISIANA § 61 (Rev. Ed. 1949).

216. LA. REV. STAT. ANN. § 31:80 (1975).

217. 187 So. 35 (La. 1939).

218. *Id.* at 37.

> servitude contingent upon a future happening, i. e. the production of oil, gas or other minerals, and (3) or as * * * being in the nature of a purchase of real rights to come and not in esse, or real right based on an uncertain happening * * *.[219]

After reviewing certain general legal principles pertaining to the law of obligations and ownership, the Louisiana Supreme Court stated, "We therefore conclude that plaintiffs, by the reservation made in the transfer of their property by deed of February 22, 1927, imposed on the property a real obligation which passed with the property into the hands of the present owner."[220]

The Court turned "to the consideration of the question as to whether the prescription of ten years, liberandi causa, is applicable to the case at hand and if so, whether or not the same has been interrupted."[221] The Court explained that the "reservation in controversy here . . . is a real obligation in favor of the plaintiffs, their heirs or assigns, and in our opinion is a species of real right subject to the prescription of ten years, liberandi causa, within the meaning and contemplation of the Revised Civil Code. . . ." The Court further stated as follows:

> It is argued by some that as a royalty owner, unlike the owner of a mineral servitude, cannot go upon the land for the purpose of exploring for the minerals but must await such time as the landowner has developed it or caused the same to be done, and then if there be production to claim his royalty interest, the prescription is suspended and does not begin to run until some minerals are developed and produced, because until such time the reserver has no claim to enforce. Some are of the opinion that because the royalty owner does not have the right to explore the land for minerals, this court, in order to apply the prescription, would have to ignore the doctrine of "obstacle" of the Revised Civil Code. Others argue that when the landowner grants a real interest to a third party, because of the nature of such obligation, there is an implied obligation growing out of the contractual relation of the parties that the grantor or his heirs or assigns will use the land with reference to the royalty as a prudent administrator and that as such it is incumbent upon the owner to lease the lands for mineral development when an opportunity to do so presents itself and can absolve himself from the application

219. *Id.*
220. *Id.* at 40.
221. *Id.*

> of the prescription liberandi causa only by showing that he had no opportunity to lease the premises for mineral development.[222]

Chief Justice Fournet, the author of this seminal Louisiana Supreme Court decision, has admitted that the ruling was the result of a pre-opinion judicial conference in which the Justices decided the result to be reached in the case, but left to the Chief Justice the construction of a theory to follow in order to reach the pre-ordained result. At a conference on mineral law, Chief Justice Fournet stated:

> In accordance with our system of assigning cases by rotation, it fell to me. The court, without determining how the conclusion was to be reached, instructed me, in terms amounting to an ultimatum, to find a way to cut off this new right by the same prescription applicable to the mineral servitude, of which it was an appendage as it were.[223]

The Court provided further elucidation on the nature of the mineral royalty in *Humble Oil & Refining Co. v. Guillory*.[224] In that significant case, Guillory sold to Garland, on January 19, 1923, an

> undivided one-fourth interest in and to all royalties stipulated for or hereafter to be stipulated for, in any oil, gas or mineral lease that may be or has been executed by vendor in favor of third persons and more particularly in that certain lease executed in favor of the Louisiana Oil and Refining Corporation . . . .[225]

The instrument further recited as follows:

> It being well understood and agreed that the interest herein conveyed is and will remain an interest in all contracts by the vendor with third persons for the exploration and development of the said lands for oil, gas or other minerals, the proceeds of the rental of the said land for said purposes, but only to share in the royalties in the proportions above set forth. This grant to be continuous and to run with the land into whomsoever's hands it may fall; by assignment, bequest, devise or otherwise.[226]

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222. *Id.* at 41-42.
223. John B. Fournet, *Institute Dinner Address*, 2 ANN. INST. ON MIN. L. 89, 93 (1954).
224. 33 So. 2d 182 (La. 1947).
225. *Id.* at 183.
226. *Id.*

The Court, on original hearing, held that a provision purporting to impose the royalty on any future mineral lease, beyond the lease that was in effect on the date of the deed, was ineffective. The Court explained, "We have therefore concluded that the deed is null because it attempts to transfer a perpetual royalty in future leases and for the further ground that it contains a potestative condition[227] that is reprobated by law."[228]

On rehearing, the Court reversed itself and held that the rules pertaining to potestative conditions did not render null such a clause. The clause was upheld, with the Court stating:

> In the usual mineral royalty deed the purchaser does not receive from the landowner an obligation to drill or to grant a lease for exploration purposes. All that he acquires is a right attached to the land and the assurance that he will receive his share of the oil produced therefrom if and when successful production results.[229]
>
> Most royalty deeds contain a clause such as the following, to-wit:
>
> This sale and transfer is made and accepted subject to an oil, gas and mineral lease now affecting said Property, but the royalties hereinabove described shall be delivered and/or paid to the purchaser out of and deducted from the royalties reserved to the lessor in said lease. This sale and transfer, however, is not limited to royalties accruing under the lease presently affecting said Property, but the rights herein granted are and shall remain a charge and burden on the Property herein described and binding on any future owners or lessees of said Property and, in the event of the termination of the present lease, the said royalties shall be delivered and/or paid out of the whole of any oil, gas or other minerals produced from said Property by the owner, lessee or anyone else operating thereon.

To illustrate, if the lessor owns all rights to the minerals in the leased land, either as a landowner[230] or the owner of a mineral servitude,[231] and grants a mineral royalty for 1/32 of the oil, gas, and other minerals in the

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227. Prior to the 1984 amendments to the Civil Code articles on obligations, former codal articles characterized as "potestative" a condition that was subject to the whim of the obligor. That characterization was eliminated with the enactment of article 1770 of the Civil Code.

228. 33 So. 2d at 184.

229. *Id.* at 192.

230. LA. REV. STAT. ANN. § 31:6 (1975).

231. *Id.* at § 31:21. *See also* OTTINGER, *Mineral Servitudes, supra* note 207.

land, and thereafter executes a mineral lease providing for a one-fourth (1/4) lessor's royalty, then, upon the attainment of production, the interest of the lessor in production would be calculated, as follows: 1/4 minus 1/32, equals 7/32.

In Part II.D.2 hereof, significant consideration is given to the situation in which a lessor's gross royalty payment is reduced in respect of an outstanding burden on the lessor's interest, such as a mineral royalty interest.

3. Freeing of the Lessor's Land from a Burden

In the context of calculating the gross royalty payment, it is necessary to also examine the "flip side of that coin," that being the consequence of the extinguishment of a mineral royalty prior to the commencement of production from a well on or attributable to the burdened tract of land and the consequential removal from the lessor's mineral interest of such real charge or burden.

"Prescription of nonuse of a mineral royalty commences from the date on which it is created."[232] "A mineral royalty is extinguished by: prescription resulting from nonuse for ten years."[233]

"Prescription of nonuse running against a mineral royalty is interrupted by the production of any mineral covered by the act creating the royalty. Prescription is interrupted on the date on which actual production begins and commences anew from the date of cessation of actual production."[234]

The jurisprudence rendered prior to the enactment of the Louisiana Mineral Code reflects the application of these intrinsic tenets pertinent to the mineral royalty.

In *Union Sulphur Co., Inc. v. Lognion*,[235] the defendant conveyed a royalty interest to Mr. Pitre by deed dated September 12, 1934. Through a series of conveyances, a portion of this mineral royalty interest was acquired by various parties, with Mr. Pitre retaining one-half (1/2) of the acquired royalty. Mr. Pitre died on August 24, 1939, survived by his widow and six children, only one of whom was a minor.

Operations for drilling on the land commenced August 8, 1944 (notably, *within* ten years of the date of creation of the royalty), and the well was completed as a producer on October 5, 1944 (notably, *beyond* ten years from the date of creation of the royalty).

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232. *Id.* at § 31:86.
233. *Id.* at § 31:85(1).
234. *Id.* at § 31:87.
235. 33 So. 2d 178 (La. 1947).

The Court reaffirmed that the interest was a royalty interest and not a servitude interest. Thus, prescription accrued on September 12, 1944, since, prior to that date, no production had been secured. In view of the passive nature of the royalty, "the date of the original royalty deed and that of production were the determining factors respecting the issue of the prescriptibility [sic] of his interest."[236]

Expressly rejecting a contention that operations conducted prior to the prescriptive date served to interrupt prescription accruing against the mineral royalty, the Court said as follows:

> If the interest acquired by Clarphy Pitre from the landowner had been mineral rights (a servitude under our jurisprudence), the matter of the commencement of drilling operations would be of importance . . . . But since Clarphy Pitre's interest was only a mineral royalty (not a servitude), the doctrine relating to the exercising or use of the rights is inapplicable, and the incident referred to herein of commencing drilling operations is of no moment.[237]

Since the mineral royalty is in the nature of a real charge or burden on the land, the land or mineral servitude of which the royalty is an appendage is simply relieved of the real charge or burden at extinction. As the Louisiana Supreme Court said, the mineral royalty simply "passed out of the picture," and the "parties are in the same position as though no royalty right had ever existed."[238]

Another case, *Union Oil Co. of California v. Touchet*,[239] was a concursus proceeding that was instituted wherein the landowner and a mineral royalty owner contested the ownership of the proceeds of a 1/32 mineral royalty.

The facts disclose that Mr. Touchet, the landowner, granted a 1/32 mineral royalty on March 6, 1940. Mr. Touchet's mineral lease with Union, as amended, contained a "Pooling Clause." A well was completed for production on the Thibodeaux tract "in the immediate vicinity of the Touchet property."[240]

On February 13, 1950, near the end of the ten-year prescriptive period on the mineral royalty, Union filed a declaration creating a pooled unit with adjacent land. On the now-unitized land, a unit well was completed

236. *Id.* at 180.
237. *Id.*
238. Ark. Fuel Oil Co. v. Sanders, 69 So. 2d 745, 746 (La. 1954).
239. 86 So. 2d 50 (La. 1956).
240. *Id.* at 52.

and shut-in.[241] Included in that unit were the lands of a Mr. Sonnier whose lease (also owned by Union) did not have a "Pooling Clause," as did Mr. Touchet's lease.

The question arose as to the interruption of prescription on the mineral royalty interest. As stated by the Court, the issue was as follows:

> Since the Louise Thibodeaux Well No. 1 was not located on the lands subject to the royalty right, there was no production from this tract and the royalty right here in dispute has prescribed for want of production, unless the operating unit formed by means of the declaration filed by the Union Oil Company on February 13, 1950, within 10 years of the date of the royalty sale, was valid; for, if so, then the area comprising the unit is treated as one tract and one lease, and production from any portion of the area making up the operating unit has the same effect on property situated within the unit as if the well was drilled and completed on each of the various tracts of land embraced in the area and under each of the leases. Accordingly, if the operating unit formed by the first declaration filed by the oil company was valid and effective, the royalty right has not prescribed.[242]

The Court held that the unit was not valid. The Court stated, "Obviously the only meaning that this provision of the lease could have was that the lessor granted to the lessee authority to combine his lease with any other land or lease in the vicinity which the oil company also had authority to unitize."[243]

The lessee did not have the authority to pool the adjacent land and the declared unit was not valid. To hold otherwise would mean that a lessee could pool the leased premises with any other adjacent property, without the power and authority of that adjacent landowner to do so, and thereby extend the life of the mineral lease on the pooled leased premises. Since the unit was invalid, prescription accruing against the mineral royalty burdening the non-unitized tract was not interrupted.

In these circumstances, the net royalty payment to which a lessor is entitled when a mineral royalty remains extant as a real charge or burden on the lessor's interest, is restored to a gross royalty payment when the

241. A "shut-in" well is one that is capable of producing gas, but that is not in fact producing its gas, usually because of the lack of a market or marketing facilities. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 4-13(a).

242. 86 So. 2d at 53.

243. *Id.* at 54.

royalty interest "passes out of the picture," at least insofar as the entitlement to the fractional royalty interest is concerned.

4. "Estimated Acreage Clause"

The "Estimated Acreage Clause" in the mineral lease has no relevance to this calculation.[244] Such clause is provided for the protection and benefit of the lessee in order that it might have confidence in the calculation of delay rentals (and other payments based on delay rentals, such as "shut-in payments" and "Pugh Clause" rentals). Because of the dire consequences resulting from the failure to timely or properly pay such payments (essentially, *ipso facto* lease termination),[245] the lessee is given comfort in making such payments that are calculated on the basis of acreage.

However, as royalties on unit production are based on a survey prepared by a Registered Land Surveyor, the acreage stipulated by the parties in this clause does not control for purposes of calculating royalties. Thus, in *Greene v. Carter Oil Co.*,[246] the court stated the following with respect to the "Estimated Acreage Clause," to-wit:

> Where . . . the acreage of the leased premises is estimated, the purpose is to foreclose uncertainty as to bonus, or rentals . . . . A stipulation for estimated acreage is not forbidden by law and, therefore, parties to a contract may bind themselves with respect thereto, and this is true whether or not the estimated acreage exceeds that actually owned.[247]

The court in the *Greene* case indicates that the clause does not apply to the payment of royalties, which are to be based on actual acreage, by survey, in case of unitized production. Thus, the court explained as such:

> The primary question under consideration, however, is whether royalties based upon estimated acreage as used in [the "Estimated Acreage Clause"] are inclusive of royalties from production. Our answer must be in the negative. "Acreage based royalty" or "royalty based on acreage" as used in the lease has a distinct and special status and application, and refers to per acre payments as

244. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 4-20.
245. *See id.* at § 4-08(d)(4).
246. 152 So. 2d 611 (La. Ct. App.), *writ denied* 153 So. 2d 414 (La. 1963).
247. *Id.* at 617-18.

provided. The royalties payable from production may not be computed in such a manner.[248]

5. *"Notice of Change of Ownership Clause"*

If the lessor, after granting a mineral lease, sells the land with no reservation of minerals, or if it sells an interest in the minerals in the leased land by creating a mineral servitude, or grants a mineral royalty to a third person, each of these transactions results in a change of ownership of the rights to minerals when and if produced under the recorded mineral lease.[249] The lessee must be informed of these changes in order to modify its "pay deck" so as to pay the proper party entitled to royalties under the mineral lease.[250] How does the lessee obtain the information necessary to make these changes? Is it principally the burden or responsibility of the lessee to ascertain these changes?

In order to relieve the lessee of the onerous burden of having to check the "public records" continuously for the purpose of determining the party entitled to receive royalties or other monies under the mineral lease, the lease contract contains a "Notice of Change of Ownership Clause." An example of this important clause is the following, taken (in pertinent part) from a commercial form of mineral lease in prevalent use in Louisiana:

> All provisions hereof shall inure to the benefit of and bind the successors and assigns (in whole or in part) of Lessor and Lessee, (whether by sale, inheritance, assignment, sub-lease or otherwise), but regardless of any actual or constructive notice thereof, no change in the ownership of the land or any interest therein or change in the capacity or status of Lessor or any other owner of rights hereunder, whether resulting from sale or other transfer, inheritance, interdiction, emancipation, attainment of majority or otherwise, shall impose any additional burden on Lessee, or be binding on Lessee for making any payments hereunder unless, at least forty-five (45) days before any such payment is due, the record owner of this lease shall have been furnished with certified copy of recorded instrument or judgment evidencing such sale, transfer or inheritance, or with evidence of such change in status

248. *Id.* at 618.

249. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 4-27.

250. "The document seems to be a pay deck listing the royalty owners and their addresses. . . . Pay decks are set up by [title] analysts to keep track of ownership of oil and gas properties." Weber v. Mobil Oil Corp., 243 P.3d 1, 4, n.7 (Okla. 2010).

> or capacity of Lessor or other party owning rights hereunder. The furnishing of such evidence shall not affect the validity of payments theretofore made in advance. [251]

Thus, it has been said that:

> The very purpose of the provision of the lease relating to certified copies of recorded instruments evidencing sales or assignments affecting the leased property is to relieve a lessor of the unreasonable burden of making constant examination of Conveyance Records to see what changes of ownership have taken place since the date of the lease.[252]

In *Gulf Refining Co. v. Shatford*,[253] the court considered whether the mineral lease had been maintained when the lessee paid delay rentals to a prior owner (as reflected on the lessee's records), where that owner's assignee failed to timely provide notice of the change in ownership to the lessee in accordance with the "Notice of Change of Ownership Clause" in the mineral lease. The court refused to penalize the lessee who paid rentals based upon its own internal records, finding that the transferee was not diligent in providing notice of the change in ownership. The court further explained as follows:

> To now permit Shatford to cancel the lease so far as it affects his one-eight interest would be to reward him for his negligence and punish Gulf for living up to its contract. The rental money had been sent to the lessors' agent bank prior to the time Gulf received copies of Shatford's deeds. Shatford should not now look to Gulf for his portion of that rental money; he should look to those persons who received it-the persons from whom he secured his interest.[254]

In *Atlantic Refining Co. v. Shell Oil Co.*,[255] plaintiff-assignee of mineral lease brought an action to declare null a mineral lease executed subsequent to plaintiff's lease by plaintiff's lessor and to declare the validity of the mineral lease under which plaintiff operated. Judgment was rendered for the plaintiff, and the defendant appealed. The Louisiana Supreme Court reversed.

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251. Paragraph 9, Bath 6 Form.
252. Pearce v. S. Nat. Gas Co., 58 So. 2d 396, 398 (La. 1952).
253. 159 F.2d 231 (5th Cir. 1947).
254. *Id.* at 233.
255. 46 So. 2d 907 (La. 1950).

After executing the mineral lease, the lessor sold one-half (1/2) of the minerals to a third party. In that sale, the parties agreed that the transferee was not to participate in the delay rentals that might be paid under the mineral lease. In order to evidence that intention, certain words and provisions of the printed form to the contrary were stricken out, so that the printed form appeared, "Conveys unto Grantee One Half (1/2) of all of the royalties, ~~rentals~~ and other benefits, ~~including money rentals payable for drilling operations,~~ accruing under any valid oil, gas or mineral lease or servitude on said property which has heretofore been filed for record."[256]

That mineral sale was recorded, but a certified copy of the deed was not provided to the lessee. The mineral lease contained a "Notice of Change of Ownership Clause" providing that a change in ownership was not to be binding on lessee or impair the effectiveness of any payments made until the lessee "shall have been furnished, forty-five days before payment is due, a certified copy of recorded instrument evidencing any transfer."[257]

The plaintiff obtained a title opinion that correctly reflected the sale. Based upon that sale as disclosed by the title opinion, the plaintiff tendered one-half (1/2) of the delay rentals to the original lessor and one-half (1/2) to the lessor's transferee.[258]

When the lessor refused to accept the delay rentals, the plaintiff contended that it was entitled to rely upon the public records which reflected the sale of one-half (1/2) of the minerals to a third party.[259] The Court rejected this contention, saying:

> The fallacy of this conclusion lies, we think, in the fact that the plaintiff had no occasion to rely on the public records or to construe the contract, as no certified copy of the recorded deed evidencing the transfer of mineral interest from Furlow to Shell was delivered to plaintiff and it was not required to interpret the intention of the parties or to act in reference thereto . . . .[260]

The Court held that the delay rentals were not paid timely or properly, and thus, the mineral lease lapsed by its own terms. Consequently, the defendant's mineral lease was the valid lease.

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256. *Id.* at 908.
257. *Id.*
258. *Id.* at 909.
259. *Id.*
260. *Id.*

In yet another case,[261] after a mineral lease was granted, the plaintiff acquired an undivided one-eighth (1/8) mineral interest in the subject tract of land, later disposing of an undivided one-sixteenth (1/16) interest. The lessee did not receive a certified copy of this mineral deed.

The mineral lease provided that no "change in ownership shall be binding on lessee nor impair the effectiveness of any payments made hereunder until lessee shall have been furnished, forty-five (45) days before payment is due, a certified copy of recorded instrument evidencing any transfer, inheritance, sale, or other change in ownership * * *."[262]

The lessee, not having been provided a "certified copy of recorded instrument evidencing any transfer, inheritance, sale, or other change in ownership," paid delay rentals to the original lessors, rather than to the plaintiff. Plaintiff contended that the lessee had knowledge of the sale to plaintiff by virtue of an abstract of title that contained the instrument.

The court rejected plaintiff's contention, relying on *Pearce v. Southern Natural Gas Co.*[263] and *Atlantic Refining Co. v. Shell Oil Co.*[264] The court observed as follows:

> The opinion of the court in the Pearce case, relying upon the Atlantic Refining Company case, specifically declared (1) that a lessee is not required to take notice of public records which might show a transfer or assignment by lessor, and (2) that the very purpose of a lease provision relating to furnishing certified copies is intended to relieve the unreasonable burden of making "* * * constant examination of Conveyance Records to see what changes of ownership have taken place since the date of the lease."[265]

In *Hibbert v. Mudd*,[266] a case involving the payment of royalties (rather than delay rentals), the Louisiana Supreme Court held that lease provisions of this type "are solely for the lessee's benefit to relieve him of the unreasonable burden of constantly checking the public records for changes in ownership which may have occurred."[267] The Court further stated:

> Our interpretation of this lease provision is that the lessee is protected under the provision not only as to the effectiveness of

261. Garelick v. Sw. Gas Producing Co., 129 So. 2d 520 (La. Ct. App. 1961).
262. *Id.* at 521.
263. 58 So. 2d 396.
264. 46 So. 2d 907.
265. *Garelick*, 129 So. 2d at 522.
266. 294 So. 2d 518 (La. 1974).
267. *Id.* at 523.

> payments made without the benefit of certified evidence of an ownership change, he is also protected against the imposition of any additional burdens resulting from such an ownership change until he receives certified evidence.[268]

In *Lapeze v. Amoco Production Co.*,[269] the court stated the proposition as follows:

> The inescapable fact is that defendant was compelled to make the payment in conformity with the specific provision of the 1976 lease. They were forbidden by the lease from taking a successors' [sic] word as to his successorship for purposes of payment (Par. 9: "regardless of any actual or constructive notice"). It has been generally accepted that the lessee's better course in such 'catch 22' situations is to comply with the literal terms of the lease, regardless of the lessee's actual or constructive knowledge, and to direct payment to the original lessor until the stipulated evidence of change of ownership is furnished. "The lessee is protected when he relies on failure to furnish proof of change of ownership, but is not protected when he relies on anything else."[270]

Moreover, "[t]he provisions of the change of ownership clause are usually strictly construed with the result that there must be a literal rather than a mere substantial compliance with the provisions for giving notice of change of ownership."[271]

The lessee's strict compliance with the "Notice of Change of Ownership Clause" is important because, as explained by the Commentator:

> If the lease contains a change in ownership clause but no notice is given under such clause, a change in ownership of the lessor's interest is no excuse for the lessee's failure to pay delay rentals to the former owner of the lessor's interest, and if the lessee relies on the public records and makes payments to persons the lessee believes to be the new owners, such payments are made at the lessee's own peril.[272]

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268. *Id.*
269. 842 F.2d 132 (5th Cir. 1988).
270. *Id.* at 135 (citations omitted).
271. 3 EUGENE KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 37.9 (2011).
272. *Id.*

Similarly, another treatise states the following, to-wit:

> Absent receipt of notice in the manner required by the notice provisions of the assignment clause, the lessee or his assignee acts at his peril in paying rentals other than as provided for by the delay rental clause. Failure of the assignee to give the lessee notice of a transfer may, or may not excuse the lessee's failure to make a timely tender of delay rental payments. Likewise, failure of the assignee to give the lessee notice of a transfer will not excuse the lessee from liability for breach of express or implied lease covenants.[273]

The clause is for the protection of the lessee inasmuch as a lessee who relies on its provisions is immunized from responsibility if it pays the party shown by its records to be due and entitled to the payments under the mineral lease. The clause places the burden on the lessor or its successor to notify the lessee in a timely and proper manner so that the records can be adjusted to account for the change in ownership resulting from the transfer of the lessor's interest. If the lessee ignores the "safe-harbor" protection of the clause, it does so at its own risk.[274]

Admittedly, most of the cases that consider the "Notice of Change of Ownership Clause" of a mineral lease and non-compliance with the notice requirements of this important provision have been concerned with the payment of delay rentals under the lease, rather than of royalties. Many clauses have application to "payments made to Lessor herein named," or "payments hereunder," without distinction as to type or character of

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273. MARTIN & KRAMER, *supra* note 60, at 4.

274. *See, e.g.,* 46 So. 2d at 910 ("Thus it may be seen that the plaintiff was not acting on the record . . . but acted at its own peril in choosing an insecure method without further inquiry, when it was protected by its own contract; and furthermore, made no effort to straighten out its difficulties with Furlow, the real party in interest."); *Hibbert,* 294 So. 2d at 523 ("Our interpretation of this lease provision is that the lessee is protected under the provision not only as to the effectiveness of payments made without benefit of certified evidence of an ownership change, he is also protected against the imposition of any additional burdens resulting from such an ownership change until he receives certified evidence."); Hanks v. Wilson, 633 So. 2d 1345, 1350 (La. Ct. App. 1994) ("Obviously, the purpose of a clause such as Paragraph 9 is to protect the lessee against the possibility of losing a lease by reason of failure to pay rentals, royalties or other payments to the person entitled thereto after a change in the ownership of the land or interest therein of any person previously entitled to receive such payment.").

payment, while some clauses explicitly make reference to royalty payments as well as delay rentals.

Certainly, the circumstance of an improper payment of delay rentals is significantly more consequential than an improper payment of royalties since, in the former case, the mineral lease would otherwise automatically terminate with no opportunity to cure or rectify any incorrect payment,[275] while in the latter, the provisions of the Mineral Code require written notice of non-payment with an opportunity for the lessee to investigate and rectify any error in payment.[276]

E. Royalty Interest Stated in Mineral Lease

1. The "Royalty Clause" of the Mineral Lease

If any proof is needed that the calculation of a lessor's royalty payment involves "much more than mere math," one might note that it has taken sixty-seven pages to get to the "heart of the matter"—the lease's "Royalty Clause."

The logical starting point to calculate the royalty payment to which a lessor is entitled is the mineral lease itself. In the "Royalty Clause" of the mineral lease, the parties set forth the lessor's royalty share of production, often stated as a fraction, but the royalty might also be expressed as a decimal or percentage. The royalty is stated in the mineral lease on a "gross basis," but it might be subject to reduction.[277]

Regardless, it is essential that the mineral lease properly express the intentions of the parties with respect to the royalty share to which they have agreed. If this seems self-evident, consider the facts and circumstances presented in the following case.

In *Adams v. JPD Energy, Inc.*,[278] the court found a mineral lease null and void where there was no "meeting of the minds" as to essential terms, *viz.*, the royalty to which the parties agreed.

The plaintiffs signed a mineral lease providing for a one-eighth (1/8) royalty; the printed royalty fraction in the commercial lease form was not modified to reflect any different royalty.

Later, the plaintiffs sued for dissolution of the lease, alleging that the parties had agreed to a twenty-five percent royalty during the negotiations.

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275. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 4-08(d)(4).
276. *See id.* at § 13-29.
277. *See supra* Part II.D.2. *See also id.* at § 4-30.
278. 46 So. 3d 751 (La. Ct. App.), *writ denied* 49 So. 3d 892 (La. 2010).

The lessee responded that the parties had agreed to a twenty percent royalty, and the mineral lease should be reformed to reflect such royalty.[279]

The parties filed cross-motions for summary judgment, the plaintiff seeking cancellation based upon the absence of a "meeting of the minds" and the defendant-lessee seeking reformation to reflect a royalty based upon twenty percent. According to the appellate court, the trial court resolved the cross-motions as follows:

> Following a hearing, the district court denied JPD's motion for summary judgment, granted plaintiffs' cross-motion for summary judgment and entered a judgment declaring the mineral lease "null, void and cancelled." The court noted that the lease agreement stated that the amount of royalties would be one-eighth of production; Adams testified that he was under the impression that the royalties would be one-fourth of production; and JPD stated that the royalty provision should have stated one-fifth of production. Therefore, the court concluded that the lease was null because there was no "meeting of the minds as far as what the royalties were going to be."[280]
>
> In ruling for the plaintiff, the district court stated:
>
> I do find that there is definitely a question of fact as to what the royalty should be. The plaintiff indicates, as I have repeated time and time again, that he was under the impression that the royalties were going to be 25 percent. The Defendants were under the impression that the royalty would be 20 percent. The lease agreement itself says one-eighth. Therefore, we do not have a meeting of the minds as far as what the royalties were going to be.
>
> * * *
>
> Regardless of whether he signed it without reading or whether he read it, there is still no meeting of the minds as to royalties.[281]

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279. "Reformation of a contract is an equitable remedy available to a contracting party if the instrument recites terms to which neither party agreed. Even if the language utilized is clear and unambiguous, parol evidence is admissible to establish that the language does not embody the essence of the agreement to which there was mutual assent." Valhi, Inc. v. Zapata Corp., 365 So. 2d 867, 870 (La. Ct. App. 1978).

280. 46 So. 3d at 754.

281. *Id.* at 755.

On appeal, the appellate court affirmed, and summarized its ruling as follows:

> JPD concedes that the amount of royalties stated in the written lease was incorrect. Thus, whether Adams read the lease before signing it is of no moment. As stated above, the written lease provided that the amount of royalties would be one-eighth of production. JPD contends that the lease should have stated that the amount of royalties would be one-fifth (20%) of production, while Adams testified that he and Pierce agreed that the royalty percentage would be one-fourth (25%) of production. Therefore, based upon this record, we find that there was no "meeting of the minds" or mutual consent between the parties with regard to the amount of royalties. Accordingly, we find no error in the district court's finding that the mineral lease was null.[282]

2. Role of Division Orders[283]

While the mineral lease itself is the genesis of the pertinent royalty interest to which the lessor is entitled, it is not uncommon for the lessee or other payor of production proceeds to seek a "division order" from the lessee.

A division order is "an instrument setting forth the proportional ownership in oil or gas, or the value thereof, which division order is prepared after examination of title and which is executed by the owners of the production or other persons having authority to act on behalf of the owners thereof."[284]

While of benefit to the lessee, its role is limited by the Mineral Code. Thus, a "division order may not alter or amend the terms of the oil and gas lease. A division order that varies the terms of the oil and gas lease is invalid to the extent of the variance, and the terms of the oil and gas lease take precedence."[285]

Similarly, the Mineral Code stipulates that the "execution of a division order is not a condition precedent to receiving payment from a lessee. The

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282. *Id.* at 756.
283. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at §§ 3-30, 1-26(k).
284. LA. REV. STAT. ANN. § 31:138.1A (1992). *See also* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 1-26(k).
285. LA. REV. STAT. ANN. § 31:138.1B (1992).

lessee shall not withhold royalty payments because his lessor has not executed a division order."[286]

A lessee will typically seek to obtain a division order in the event of unitization, or if there are fractional interests or co-owned interests involved. These circumstances often give rise to uncertainty, even confusion, and the lessee seeking to secure a division order is desirous of obtaining comfort that its calculations are approved by the lessor or other person entitled to royalty.

The myriad of factors and considerations involved in reaching the amount of a gross royalty payment are necessary to be considered. The next step is to discern if that gross number is to be diminished so as to determine the net amount due to the lessor.

III. THE FACTORS AND CONSIDERATIONS INVOLVED IN THE CALCULATION OF THE NET ROYALTY PAYMENT

A. Preface

The discussion above was directed to the calculation of the gross royalty payment to which a lessor might be entitled. From this gross number, determined as it is by "mere math," there are certain factors or considerations that might constitute or give rise to deductions from that amount, thereby reducing the gross royalty to the net royalty payment ultimately reflected in the lessor's royalty check.

B. "Post-Production Costs"[287]

A tome could be written on this important topic. Particularly in the "shale plays,"[288] it has engendered a spate of litigation, including class actions, in which lessors challenge the methodology of lessees in passing along to its lessors a portion of costs incurred in the treatment, processing, or handling of production (principally natural gas) after it departs the well head and moves "downstream." Louisiana subscribes to the rule that,

286. *Id.* at § 31:138.1C. The article codifies the jurisprudential rule to the same effect. *See* Fontenot v. Sunray Mid-Continent Oil Co., 197 So. 2d 715 (La. Ct. App.), *cert. denied* 199 So. 2d 915 (La. 1967).

287. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at §§ 4-25(d)(6), 5-14.

288. The term "shale plays" has reference to the areas in which operators engage in "unconventional drilling" by employing techniques of hydraulic fracturing, or "fracking." In Louisiana, the Haynesville Shale in northwestern Louisiana is a principal example.

unless the mineral lease provides to the contrary, the lessee may assess a proportionate part of "post-production costs" against the interest of the lessor.[289]

Notably, there is no statement in Louisiana Mineral Code article 213(5) about the fact that the lessor's royalty is to be free of costs. However, courts have made reference, by way of analogy, to Louisiana Mineral Code article 80, which addresses the mineral royalty. That article provides that "[u]nless expressly qualified by the parties, a royalty is a right to share in gross production free of mining or drilling and production costs."[290]

As discussed in Part I.D.1 hereof, the lessee is required to accompany the royalty check with a check stub. A review of article 212.31 of the Louisiana Mineral Code indicates that there is no requirement that the check stub identify any deductions for "post-production costs."[291]

Rather, the only references in that article to the deductions that must be disclosed by the lessee in the check stub are to "tax deductions." Hence, there is no automatic mechanism by which the lessor might be informed of the fact that the lessee has imposed deductions for "post-production costs," or the extent or quantification thereof. This absence of any positive requirement of disclosure certainly leads to the possibility that a variance might exist in the amount shown on the check stub and the accompanying royalty check, unless the lessee supplements the statutorily required information with data pertinent to such deductions. The lessee would be prudent to explain any such differential.

C. Severance Taxes[292]

The Louisiana Constitution authorizes severance taxes to be assessed "at the time and place of severance,"[293] and such taxes are imposed by statute. They are assessed against oil and gas and other natural resources.[294]

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289. Merritt v. Southwestern Electric Power Co., 499 So. 2d 210 (La. Ct. App. 1986).

290. *See, e.g.*, Culpepper v. EOG Resources, Inc., 92 So. 3d 1141, 1143 (La. Ct. App.), *writ denied* 98 So. 3d 870 (La. 2012).

291. In contrast, the Texas check stub statute requires, among other information, the disclosure of "any other deductions or adjustments." TEX. NAT. RES. CODE ANN. § 91.502(7) (West 2002).

292. For a thorough examination of the law pertaining to severance taxes, s*ee* Robert S. Angelico, *State and Local Taxes: Current Issues in the Louisiana Severance Tax on Crude Oil and Condensate*, 64 ANN. INST. ON MIN. L. _ (2017).

293. LA. CONST. art. VII, § 4(B).

294. LA. REV. STAT. ANN. § 47:631 (1997).

These taxes are paid by the owner at the time of severance and are payable monthly.[295] Unless in an exceptional category, severance taxes on oil are based upon 12 1/2% of the "value at the time and place of severance,"[296] less charges for trucking, barging, and pipeline fees. Severance taxes on natural gas are based upon a base tax of ten cents per thousand cubic feet.[297] The rate on natural gas, however, is adjusted annually according to a defined "gas base rate adjustment" procedure, "but shall never be less than seven cents per thousand cubic feet."[298]

Reduced rates apply to an "incapable" well[299] and to a "stripper" well,[300] but application for the reduction must be timely made in advance, not after the commencement of production.[301]

An "incapable" well is a well that is incapable of producing an average of more than twenty-five barrels of oil per producing day during the entire taxable month, and which also produces at least fifty percent salt water per day.[302] The eligibility of such a well is a matter to be determined by relevant state regulatory authorities.

A "stripper" well is an oil well that is "certified by the Department of Revenue that such well is incapable of producing an average of more than ten barrels of oil per producing day during the entire taxable month."[303]

Certain categories of gas are exempt from severance taxes. Illustrative of these exemptions are the following seven categories of gas:

> (a) Gas injected "for the purpose of storing by the producer." Because this gas will eventually be "severed from the earth" (at which time the tax will be paid), this is really more of a deferred payment than an exemption.[304]
>
> (b) Gas produced in another state, transported into Louisiana, and injected for the purpose of storing by the producer.[305]

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295. *Id.* at § 47:632A.
296. *Id.* at § 47:633(7)(a).
297. *Id.* at § 47:633(9)(a).
298. *Id.* at § 47:633(9)(d)(i).
299. *Id.* at § 47:633(7)(b).
300. *Id.* at § 47:633(7)(c)(i)(aa).
301. *See* McNamara v. Bayou State Oil Corp., 589 So. 2d 1099 (La. Ct. App. 1991), *writ denied* 592 So. 2d 1335 (La. 1992).
302. LA. REV. STAT. ANN. § 47:633(7)(b) (2015).
303. *Id.* at § 47:633(7)(c)(i)(aa).
304. *Id.* at § 47:633(9)(e)(i).
305. *Id.* at § 47:633(9)(e)(ii).

(c) Gas produced from "oil wells and vented or flared directly into the atmosphere, provided such gas is not otherwise sold."[306]

(d) Gas used or consumed in maintaining the operation of a field, including heating, separating, producing, dehydrating, compressing, and pumping of oil and gas in the field where produced, provided such gas is not otherwise sold.[307]

(e) Gas consumed in the production of natural resources in this State.[308]

(f) Gas produced from "gas wells and vented or flared directly into the atmosphere, provided such gas is not otherwise sold."[309]

(g) Gas used in the manufacture of carbon black.[310]

Additionally, Louisiana has implemented a program that suspends severance taxes for certain periods of time with respect to horizontally drilled wells,[311] inactive wells,[312] deep wells,[313] and "on distillate, condensate, or similar natural resources severed from the soil or water either with oil or gas."[314] The Louisiana Office of Conservation determines the eligibility of these wells.

Louisiana Revised Statutes section 47:633(7)(a) allows a deduction for "charges for trucking, barging and pipeline fees," but the administration of this deduction has been subject to contradictory interpretations by the Secretary of the Department of Revenue.

The severance taxes are borne proportionally between the lessor and the lessee,[315] unless the mineral lease provides otherwise. While rare, there is authority for the parties to contractually shift the lessor's *in rem* responsibility for severance taxes to the lessee.

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306. *Id.* at § 47:633(9)(e)(iii).
307. *Id.* at § 47:633(9)(e)(iv).
308. *Id.* at § 47:633(9)(e)(v).
309. *Id.* at § 47:633(9)(e)(vi).
310. *Id.* at § 47:633(9)(e)(vii).
311. *Id.* at § 47:633(7)(c)(ii).
312. *Id.* at § 47:633(7)(c)(iv). However, the suspension ended on June 30, 2010.
313. *Id.* at § 47:633(9)(d)(v). These are wells drilled to a true vertical depth of more than 15,000 feet subsurface.
314. *Id.* at § 47:633(8).
315. *Id.* at § 47:632A.

Thus, in *Everett v. Phillips Petroleum Co.*,[316] the mineral lease in question obligated the lessee to pay to the lessor a bonus equal to:

> one-eighth (1/8) of the lessee's seven-eighths (7/8) working interest oil first produced and saved from the well or wells . . . *until there shall have been produced and saved to the credit of said fractional part of the oil the market value of Fifteen Thousand Dollars ($15,000.00) at the current market price at the time of production* . . . .[317]

The lessee paid to the lessor, pursuant to this clause, the stipulated bonus, but deducted $1,382.34 as the severance tax pertaining to such production. The lessor filed suit for the deducted amount. The Louisiana Supreme Court stated:

> Thus, this language denotes that plaintiffs are to be paid in oil having a market value of $15,000-not less the severance tax-because the oil, burdened with the severance tax, would not have a market value of $15,000. Since the severance tax had to be paid at the time the oil was taken from the land, oil having a market value of $15,000 means oil that can be sold on the market for that price, obviously not oil upon which a severance tax is due.[318]

Severance taxes are an essential source of revenue to the State of Louisiana, and correspondingly, a factor that diminishes the royalty to which the lessor is entitled. Exemptions and other suspensions of the tax also need to be considered in calculating the lessor's royalty payment.

IV. THE EFFECT OF UNITIZATION

As stated previously,[319] if a well is drilled on a "lease basis" without unitization, there is no need to reduce or diminish the royalty stream further. In such a case, the lessee owns the entirety (100%) of production, subject to the workings of the "Royalty Clause." If the leased land is unitized, however, another factor or consideration is introduced to the formula by which the royalty is to be calculated.

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316. 51 So. 2d 87 (La. 1951).
317. *Id.* at 95.
318. *Id.*
319. *See supra* Part III.B.

A. Types of Units

It is often said that there are three types of units: "compulsory,"[320] "voluntary," and "declared." It is more accurate to say that there are two types of units: "compulsory" and "conventional."

A compulsory unit is "a unit formed by order of a governmental agency."[321] There are five kinds of compulsory units.[322]

A conventional unit is formed by contract without intervention by the Commissioner of Conservation and might be of two kinds–either a declared unit or a voluntary (contractual) unit.[323] Typically, the instrument establishing either type of conventional unit contains a plat of survey that sets forth the tract's participation on a surface acreage basis.

B. Basis of Allocation of Unitized Production to Royalty Owners

The preliminary inquiry is to identify the basis on which unit production is to be allocated to a royalty owner in a unitized tract. Two principal methodologies are recognized nationally, *viz.*, the "weighted average approach" and the "tract allocation approach."

As determined by the Oklahoma Supreme Court in a case based upon an interpretation of the Oklahoma pooling statute,[324] one commentator explained that, under the "weighted average method," "[e]ach royalty owner was to share in 1/8th of production from the well in proportion that their acreage bore to the entire acreage of the unit."[325]

Prevailing in Louisiana is the "tract allocation method." Under this approach, each royalty owner in the unit is "entitled to be paid from the proceeds realized from the share of the production of this well allocated to

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320. Compulsory units may also be called "forced," "governmental," or "Commissioner's" units.

321. LA. REV. STAT. ANN. § 31:213(6) (1983).

322. These are a "drilling and production" unit (LA. REV. STAT. ANN. § 30:9 (2015)); a "fieldwide" or "reservoirwide" unit (sometimes called a "441 unit," being a reference to Act No. 441 of 1960) (LA. REV. STAT. ANN. § 30:5C (1992)); a "deep pool" unit (LA. REV. STAT. ANN. § 30:5.1A (2012)); an "ultra deep structure" unit (LA. REV. STAT. ANN. § 30:5.1B (2012)); and a "coal seam natural gas producing" unit (LA. REV. STAT. ANN. § 30:5.2 (2004)).

323. *See* Patrick S. Ottinger, *Conventional Unitization in Louisiana*, 49 ANN. INST. ON MIN. L. 21, 24, 26-27 (2002) [hereinafter Ottinger, *Conventional Unitization*].

324. Shell Oil Co. v. Corp. Comm'n, 389 P.2d 951 (Okla. 1963).

325. Bruce M. Kramer, *Royalty Interest in the United States: Not Cut From the Same Cloth*, 29 TULSA L.J. 449, 478 (1994).

the tracts in which they have an interest, as specifically provided in their individual contracts."[326] In subscribing to this position, the Louisiana Supreme Court announced the "proposition that private contractual rights in these leases are only superseded when they are in conflict with the valid orders of the Commissioner of Conservation, i.e., when the order is a conservation measure, pure and simple."[327]

If all mineral leases within a unit provide for the identical royalty to each lessor, and if there are either no burdens, or all burdens are consistently spread across the unit, then the royalty mix is homogenous or identical, and allocation under either method results in the same net result to each lessor, subject to any proportionate reduction.

C. Basis of Participation in Unitized Production

Having established that Louisiana subscribes to the "tract allocation approach," the next relevant inquiry is the basis of participation in a compulsory unit. Most units established by the Office of Conservation require a surface acreage basis of participation, meaning that a given unitized tract will be allocated that proportion of the entirety of unit production as its participating acreage bears to all acreage in the unit.

Another basis, albeit infrequently used, is the "acre-foot" basis of participation.[328] In these instances, the operator makes a calculation as to the volumetric configuration of the unitized reservoir so that the volumetric content underlying a particular tract is determined. That tract is then allocated the volume of the stratum underlying its surface area, determined by multiplying the surface area in acres by the thickness of the underlying stratum in feet.[329]

One case described the "acre-foot" method as a method "whereby the net sand content under each tract of land was determined, and an estimate made of all hydrocarbons in place to determine the value of the ultimate production to be obtained from each tract of land."[330]

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326. Arkansas Louisiana Gas Co. v. Southwest Natural Production Co., 60 So. 2d 9, 11 (La. 1952).

327. *Id.* at 10.

328. This basis of sharing of unit production is most often involved in "reservoirwide units," as authorized by LA. REV. STAT. ANN. § 30:5C (1992). *See Eads*, 646 So. 2d 948. In the interest of full disclosure, your author represented the operator in this suit.

329. *See* Mobil Oil Corp. v. Gill, 194 So. 2d 351, 353 (La. Ct. App. 1966), *writ refused* 194 So. 2d 738 (La. 1967).

330. Texaco, Inc. v. Vermilion Parish School Bd., 145 So. 2d 383, 385 (La. Ct. App. 1962), *rev'd in part, undisturbed in part* 152 So. 2d 541 (La. 1963).

D. Calculation of Proportionate Share of Unitized Production

If the lessor's land is unitized, the interest of the lessor will be diminished proportionately to the land's participation in the unit, regardless of the basis of participation. An exception to this statement is the situation in which the lessor's land composes the entirety of the lands included within the unit. In that event, there being no extraneous, "third-party" land contained in the unit, the entirety of production is allocable to the lessor. This is to the same effect as though the well was a "lease basis" well.[331]

By way of example, however, if the lessor owns twenty acres under lease, and the entirety of those leased lands are situated within a 120-acre unit, the lessor's royalty will constitute its royalty share of 20/120 of the entirety (8/8) of unit production, or 1/6, or .1666667 of the total unit production.

If, rather than all of the leased land being included within the unit, only 13.124 acres of the twenty-acre tract are contained in that unit, then the lessor of that tract will receive its royalty share of 13.124/120 acres.[332] The balance of 6.876 acres under lease are outside of the unit, or non-unitized, and do not share in unit production since a unit is defined as "the maximum area which may be efficiently and economically drained by the well or wells designated to serve the drilling unit as the unit well, substitute unit well, or alternate unit well."[333]

These illustrations serve to remind one that the unitization of lands creates another level of considerations in the calculation of the lessor's royalty payment.

E. Freezing Effect[334]

Some courts have considered whether a conventional unit is terminated by reason of the subsequent formation of a compulsory unit for the same well. The conclusions differ according to the kind of conventional unit involved.

331. *See* Will-Drill Resources, Inc. v. Huggs Inc., 738 So. 2d 1196, 1200 (La. Ct. App.), *writ denied* 751 So. 2d 885 (La. 1999) ("If, . . ., the unit is comprised entirely of the leased premises, . . ., the consequences to the landowner-lessor are the same as if the well were a lease well.").

332. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 11-08.

333. LA. REV. STAT. ANN. § 30:9B (2015).

334. Portions of this section are an adaptation of material contained in Ottinger, *Conventional Unitization*, *supra* note 323.

1. Declared Unit

A declared unit is an appendage or creature of the leases to which it relates.[335] Consequently, when the unitized leases expire, so does the unit.[336]

A declared unit is terminated by the subsequent creation of a compulsory unit, at least in the absence of a contrary intention in the "Pooling Clause."[337] In *Humble Oil & Refining Co. v. Jones*,[338] the lessee contended that, despite the formation of the compulsory unit for the same well for which the declared unit was previously created, the declared unit effected a freezing of participation, so that a party who was in the original declared unit, but who was excluded from the compulsory unit, would nonetheless continue to participate through the freezing relationship. In a prior opinion, the court did not agree, stating, "In the case at bar, the Commissioner has found the true participations. When this is done, the parties should not be presumed to have agreed to share their interest on the old declared unit *unless they show a specific and positive intention to freeze the old unit*."[339]

The case turned on the fact that the mineral lease containing the "pooling power"[340] did not evidence any intention to freeze the participations in the event a compulsory unit was subsequently created.[341] Because the validity and continued efficacy of a declared unit is to be determined by the language

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335. *See* LA. REV. STAT. ANN. § 31:126 (1975) ("An interest created out of the mineral lessee's interest is dependent on the continued existence of the lease . . . .").

336. Texaco, Inc. v. Letterman, 343 S.W.2d 726, 731 (Tex. Civ. App. Amarillo 1961) ("With two of the three leases making up the . . . unit terminating by their own terms, we fail to see how the unit could survive. A unitized unit is wholly dependent upon existing mineral leases.").

337. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 4-21.

338. 157 So. 2d 110 (La. Ct. App. 1963), *aff'g original decision* in 125 So. 2d 640 (La. Ct. App. 1960), *writ refused* 159 So. 2d 284 (La. 1963).

339. 125 So. 2d at 646 (emphasis added).

340. A lessee enjoys "pooling power" if the lease contains a "Pooling Clause," which is a lease provision that explicitly empowers the lessee, without the further consent or joinder of the lessor, to create a "pooled unit" merely by executing and filing a "declaration of unit" which describes the unit. Because it is a "creature of contract," the "declared unit" must strictly abide the requirements and limitations of such clause. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 4-21(a).

341. 157 So. 2d 110. Actually, there was disagreement as among the appellate judges as to whether the unit under consideration was a "declared" unit or a "voluntary" unit. The majority characterized it as a "declared" unit and the case was determined accordingly. Judge Tate dissented, viewing it as a "voluntary" unit.

of the "Pooling Clause," the requisite intention to continue the declared unit must reside in that provision, rather than in the lessee's declaration of unit.[342] This notion is consistent with the principle that an assignee acquires no greater rights than its assignor has granted it.[343]

2. Voluntary Unit

As discussed above, courts have held, in reference to declared units, that "the parties [originally affected by a *declared* unit] should not be presumed to have agreed to share their interest on the old declared unit unless they show a specific and positive intention to freeze the old unit."[344] A converse presumption applies to voluntary units.

In *Texaco, Inc. v. Vermilion Parish School Board*,[345] the court recognized:

> Voluntary units, formed through a complete agreement signed by all lessors and lessees, should *Not* be subject to change by the Conservation Commissioner's order *Unless* the parties have expressly stipulated for this change in the agreement. Here it is presumed that the parties intended to freeze their rights because all of the parties participated in the confection of the voluntary unit agreement, and where they agreed on certain fixed interests and did not contract to have them changed, their contract should be the law of the contract.[346]

Under these circumstances, the unitized portion of the voluntary unit becomes, in effect, a "unit within a unit" such that all parties to the voluntary unit share production allocable to the portion unitized in the compulsory unit on the same basis as was shared in the original voluntary unit.

In order to negate any intention to "freeze" their interests, it is common for a voluntary unit agreement to contain an "Express Dissolution Clause"[347]—often called a "Self-destruct Clause"—such as the following:

> If a unit for the Unit Well is created and established by the

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342. "It does not appear to this Court that the lessor could be said to have frozen his royalty interests in the voluntary unit unless he so declared *in the lease agreement*." 125 So. 2d at 647 (emphasis added).

343. *See* Herlitz Constr. Co., Inc. v. Matherne, 476 So. 2d 1037 (La. Ct. App. 1985). *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 2-09.

344. 125 So. 2d at 646.

345. 145 So. 2d 383.

346. *Id.* at 394 (Savoy, J., concurring) (emphasis added).

347. LA. CIV. CODE ANN. art. 2017 (2017).

> Commissioner of Conservation by formal order after public hearing, such unit shall supersede and entirely replace the unit hereby created and established as to the sand so unitized by the Commissioner of Conservation as of the effective date of such order. Except as is provided in the preceding sentence, this Unit Agreement and the Pooled Unit created and established hereby shall *ipso facto* terminate at such time as all of Said Leases terminate insofar as they cover and affect land and property within the Pooled Unit.

As has been demonstrated, the process of unitization can play a significant role in the determination of the royalties to which the unitized royalty owner is entitled. As next shown, other factors or considerations might result in further adjustment of the net royalty owed to the lessor or other royalty owner.

V. OTHER FACTORS OR CONSIDERATIONS AFFECTING THE AMOUNT OF THE ROYALTY PAYMENT

A. Preface

It sometimes happens that the lessee will have occasion to withhold amounts of money from the net royalty payment to which the lessor is otherwise entitled. As noted herein, the reason for the withholding might be contractually authorized (enforcing an express contractual right in the mineral lease); legally permitted (reimbursement to the lessee of an overpayment); or legally required (withholding Federal income taxes pursuant to Federal law).

Because these causes for royalty-reduction are not to be effectuated on a proportionate basis, tethered to quantities or values of production (rather, in most instances, it involves the enforcement of a credit in a hard, distinct dollar amount), these causes are considered herein, and not in Part III hereof relative to the factors or considerations that are involved in the calculation of the lessor's net royalty payment. Factors or considerations of the latter character are based upon quantities or values of production. The causes here under examination are not "deductions," properly speaking, but are withholdings that are legally authorized, if not required.

B. Subrogation of Taxes and Privileges Discharged by Lessee

The "Warranty Clause" in the Bath 6 Form reads, in part:[348]

348. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 4-29.

> Lessor hereby warrants and agrees to defend the title to said land and agrees that Lessee may, at its option, discharge any tax, mortgage or other lien upon the land and be subrogated thereto and have the right to apply to the repayment of Lessee any rentals and/or royalties accruing hereunder.

Although the lessee will rarely invoke this provision, it does provide authority to the lessee to reduce future royalties in order to reimburse itself for any payment made by it on behalf of its lessor to "discharge any tax, mortgage or other lien."[349] This clause gives rise to a sort of conventional subrogation.[350]

Typically, the lessee would only have occasion to invoke this provision if the lessor has granted a mortgage on the leased lands, which has not been subordinated to the mineral lease burdening the mortgaged land. Only in that circumstance is the lessee exposed to the possibility that the lessor's mortgage will be enforced, with the result that the lessee's mineral lease might be displaced by a judicial sale.[351]

The court in *Board of Commissioners of Port of New Orleans vs. Hibernia National Bank in New Orleans*,[352] stated it this way:

> The fact that a proprietor has placed a mortgage upon his property does not prohibit him from making a lease of the property, which lease, however, would be subject to the mortgage. But the sale of

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349. Properly speaking, Louisiana law does not recognize the institution of "lien;" rather, in the civil law, it is denominated as "privilege." As the Fifth Circuit has stated, "[t]he common law term 'lien' and civil law term 'privilege' will be used interchangeably throughout this opinion because the parties spoke of the terms as equivalent and as the differences between the terms are not relevant to our analysis." Shaw Constructors v. ICF Kaiser Engineers, Inc., 395 F.3d 533, 536, n.3 (5th Cir. 2004).

350. LA. CIV. CODE ANN. arts. 1826, *et seq* (2017).

351. In the event of a judicial sale resulting from the enforcement of a mortgage, "[t]he property is sold subject to any real charge or lease with which it is burdened, superior to any mortgage, lien, or privilege of the seizing creditor." LA. CODE CIV. PROC. art. 2372 (2017), made applicable to executory proceedings by art. 2724(A). *See also* P.J.'s Army Surplus & Co., Inc. v. G.D. & G., 635 So. 2d 1217, 1218 (La. Ct. App. 1994) ("In this case, the question is whether a lease, recorded after the mortgage upon which the property was foreclosed, survived the judicial sale without subsequent recordation of a new lease or ratification of the earlier lease, such that a third party purchaser would be bound by that lease. We find that it does not."). *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 12-11(c)(1).

352. 52 So. 2d 771 (La. Ct. App. 1951).

> mortgaged property under judicial process dissolves a lease on the property made and recorded subsequent to the execution and registry of the mortgage.[353]

Conversely, if the mineral lease is superior to the lessor's mortgage (by reason of recordation prior to the filing of the mortgage or the mortgage having been subordinated to the mineral lease), the lessee would have no reason or interest in invoking this provision.

When the lessee invokes this contractual right, the debt sought to be enforced is tethered to neither volume nor price; it simply represents monies expended by the lessee for the benefit of its lessor in order to "discharge any tax, mortgage or other lien," and is an absolute number.

While, by its terms, the lessee is permitted "to apply to the repayment of lessee any rentals and/or royalties accruing hereunder," the lessee would be well advised to forego the right to be reimbursed out of delay rentals that might be paid under the mineral lease, limiting the source of repayment to future royalties accruing under the lease. While both delay rentals and royalties are certainly "rent,"[354] there are significant differences between the two types of lease maintenance payments.

First, delay rentals are fixed and immutable in amount, while a royalty varies based upon many factors and considerations. Second, there is an obligation to pay royalties, but no duty to pay delay rentals (they are optional to the lessee). Most importantly, the consequence of the non-payment (or improper payment) of delay rentals is automatic lease termination,[355] while a failure to pay royalties does not result in the *ipso facto* termination of the mineral lease.[356]

Thus, notwithstanding the clarity of this contractual language, a reduction in the amount of delay rentals (by reason of the lessee availing this contractual right) is fraught with risk and has the potential to result in

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353. *Id.* at 773.

354. "Payments to the lessor for the maintenance of a mineral lease without drilling or mining operations or production or for the maintenance of a lease during the presence on the lease or any land unitized therewith of a well capable of production in paying quantities, and royalties paid to the lessor on production are rent." LA. REV. STAT. ANN. § 31:123 (1975).

355. *Id.* at § 31:133. *See also Milling*, 57 So. 2d at 682; *Melancon*, 89 So. 2d at 142 ("In the system of interpretation of oil and gas contracts which this Court has followed for many years, the lessor's royalty under the usual oil and gas lease is placed in the rent category.").

356. *See* Acquisitions, Inc. v. Frontier Explorations, Inc., 432 So. 2d 1095 (La. Ct. App. 1983).

the expiration of the mineral lease if the lessor were to successfully contend that its debt paid by the lessee was not a valid debt or incorrect in amount.

C. Recoupment of Prior Overpayments

A lessee might overpay a royalty owner for a variety of reasons. Examples include title defects that are discovered after a payment is made, payments made in error, revision of a unit that results in a reduction of the lessor's entitled participation in unit production, and other reasons.

When this occurs, the lessee will often seek to adjust future payments so as to recoup such overpayments, considering it has the right to make such adjustments. The right of the lessee to recoup overpayments by withholding from monies owed in the future must be analyzed under the law of compensation (in other states, often called "offset" or "set-off").

The Louisiana law of compensation is set forth in article 1893 of the Louisiana Civil Code, as follows:

> **Art. 1893. Compensation extinguishes obligations**
>
> Compensation takes place by operation of law when two persons owe to each other sums of money or quantities of fungible things identical in kind, and these sums or quantities are liquidated and presently due.
>
> In such a case, compensation extinguishes both obligations to the extent of the lesser amount.
>
> Delays of grace do not prevent compensation.[357]

As the Louisiana Supreme Court stated, "[a] debt is said to be liquidated 'when it is certain what is due and how much is due.'"[358] Or, as stated by another Louisiana court, a "claim is liquidated when its correctness is admitted by the debtor."[359]

However, "it is not necessary that the amount of a debt be fixed in order for the debt to be considered liquidated. A debt which can be ascertained by mere calculation or computation in accordance with accepted legal standards is considered liquidated."[360]

357. LA. CIV. CODE ANN. art. 1893 (2017).
358. Zibilich v. Rouseo, 103 So. 269, 274 (La. 1925).
359. Sims v. Hays, 521 So. 2d 730, 733 (La. Ct. App. 1988).
360. Arkla, Inc. v. Maddox & May Bros. Casing Serv., 671 So. 2d 1220, 1223 (La. Ct. App. 1996).

Further commenting on the necessity that the debt be fixed in amount, the Louisiana Supreme Court said,

> The two debts must be equally liquid . . . [A] liquid debt [is] one whose existence is certain and its quantity determined. A disputed debt is not liquid and cannot be admitted as susceptible of compensation unless the one who asserts compensation has in hand the proof of the existence of the disputed debt and is thus in a position to prove it promptly.[361]

The prudent lessee, quite apart from its legal right to be immediately reimbursed for a legitimate overpayment, would be well-served to recover the overpayment over a period of time, rather than "all at once," particularly if it is justified in knowing that production will support the full recoupment over time. This allows the lessor to continue to enjoy some portion of the revenue stream while the lessee is being reimbursed.

However, if the lessee makes the prudent decision to be reimbursed out of production over time (forgoing the right to be reimbursed at once, assuming the revenue stream would support it), it should be concerned that the lessor might sell the leased land to a third party without reserving minerals thereunder. In such an event, the lessee's ability to recoup any yet unrecovered overpayment from the vendee of the lessor is problematic to say the least. This is so because the lessee's right to be "made whole" out of future production is a matter pertaining to movable, not immovable, property.[362]

It would be in the interest of the lessee to enter into a written agreement with the debtor-lessor to acknowledge and affirm the overpayment (in precise amount); the contractual right of the lessee to be reimbursed out of future "rent" under the mineral lease; a commitment on the part of the lessor to tolerate (for lack of a better word) the lessee's right to be reimbursed; and an agreement that the lessor will not alienate the land subject to the lease without either reserving all minerals or requiring the

361. Am. Bank v. Saxena, 553 So. 2d 836, 844 (La. 1989) (internal quotation marks omitted).

362. "[C]ash is considered a corporeal movable . . . ." Succession of Tebo, 358 So. 2d 337, 339 (La. Ct. App. 1978). Merely because the money is derived from mineral rights does not change its character. "Money [generated in respect of a mineral right] is not an immovable. It is movable . . . ." Steinau v. Pyburn, 229 So. 2d 153, 154 (La. Ct. App. 1969).

vendee of the lessor to expressly acknowledge or assume the lessee's continuing right to be reimbursed out of future production.[363]

D. Withholding of Federal Income Taxes

Applicable rules and regulations of the Internal Revenue Service (IRS) require the lessor or other payee of royalties to provide to the lessee or other payor of proceeds of production a Form W-9 (Request for Taxpayer Identification Number and Certification), so as to enable the payor to properly report the amount of royalties paid to a lessor in a given tax year. The lessee or other payor reports these payments on IRS Form 1099-MISC.

If the lessor fails or refuses to provide the relevant form to the lessee, the latter is bound to withhold a portion of production (called "backup withholding") and remit the same to the IRS. The amount of the backup withholding is significant–currently twenty-eight percent of the royalty due to the lessor.[364]

Because the lessor gets credit for the amount withheld as backup withholding, this is not a deduction, but essentially a deferral or redirection of the income to the IRS for the account of the lessor-taxpayer. The prudent lessor should be motivated to provide the relevant form to the lessee so as to avoid backup withholding.

All requisite factors or considerations having been identified and applied to our basic formula, the lessee is now able to calculate the lessor's net royalty payment. However, that exercise is meaningless if the lessee fails to pay the royalty to which its royalty owner is entitled. In that exceptional situation, consideration must be given to remedies available to the lessor.

VI. LESSOR'S REMEDIES CONCERNING THE ROYALTY PAYMENT

If the scope and coverage of this article were limited strictly to the subject matter envisioned by its title, these words would not be written. The end of the preceding chapter would suffice to close the story on the methodologies involved in the calculation of the lessor's royalty payment. Nevertheless, perhaps as a bit of lagniappe, your author deems it appropriate to provide a few words to identify the array of remedies available to a lessor whose royalty payment has not been properly calculated, or has not been paid at all. Although the coverage of this topic is more superficial than

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363. The issue of whether such an agreement should be or would be effective as to third persons if filed for registry is another matter.

364. 26 U.S.C.A. § 3406 (2008).

exhaustive, further authorities are identified for the interest of the lessor concerned with an improper payment of royalties.

If the lessor disagrees with the manner in which its royalty payment has been calculated, there exists an array of remedies available—some substantive, some procedural.

A. Notice of Non-payment[365]

As an overview, before a lessor may file suit against its lessee seeking dissolution or damages for non-payment of royalties, the lessor must give the lessee written notice of non-payment and allow the lessee a period of time to evaluate the demand and respond properly. An array of remedies is available depending on the manner in which the lessee responds (or fails to respond), and the facts pertaining to the matter.

B. Prescription

A claim for underpayment or overpayment of royalties (except with respect to State lands) prescribes in three years.[366]

If a discrepancy exists between the amount reflected on the royalty check and the check stub accompanying it, the royalty owner will likely be charged with the knowledge that it discloses. This knowledge, conceivably, would be a factor in evaluating whether the lessor, at a date subsequent to the pertinent prescriptive period, could assert the doctrine of *contra non valentem*[367] to suspend the three-year liberative prescriptive period applicable to an action by the royalty owner against its lessee who has failed to pay the lessor its share of proceeds for mineral production.

365. The topic of non-payment of royalties is another one that could consume many pages. This subject matter is more fully addressed in Chapter Thirteen of this author's Treatise. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1.

366. LA. CIV. CODE ANN. art. 3494(5) (2017). *See also* Hankamer v. Texaco, Inc., 387 So. 2d 1251, 1254 (La. Ct. App. 1980), *writ granted* 392 So. 2d 669 (La. 1980), *case dismissed* 403 So. 2d 651 (La. 1981) (The court sustained an objection of prescription, saying "the claims for unpaid royalties accruing more than three years prior to the filing of the suit are prescribed.").

367. The doctrine of *contra non valentem agere nulla currit praescriptio* (typically called "*contra non valentem*"), suspends the running of prescription during the period in which the cause of action was not known by *or reasonably knowable* to the plaintiff. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 13-41.

In *Wells v. Zadeck*,[368] the issue was whether an unleased mineral owner was able to avoid the application of a ten-year prescriptive period based upon its lack of knowledge and sophistication. The Louisiana Supreme Court stated that availability of the doctrine of *contra non valentem* depends upon "the reasonableness of the plaintiff's action or inaction in light of the education, intelligence, and the nature of the defendant's conduct."[369]

The Louisiana Supreme Court further held that the lower courts "clearly failed to follow the blueprint set forth in *Marin* [*v. Exxon Mobil Corp.,* 48 So. 3d 234 (La. 2010)],"[370] by failing to examine the reasonableness of plaintiff's actions in light of the circumstances.

Rejecting the lower courts' judgments, the Court stated:

> Taking into consideration Mrs. Wells' education, intelligence, and the defendant's conduct, the conclusion of the lower courts that Mrs. Wells' inaction was unreasonable and her ignorance of a potential claim was attributable to her own neglect is not supported by the record. Moreover, we agree with the conclusion in *Amoco*[371] that there is nothing in the jurisprudence requiring the owner of a mineral servitude to continuously check the property records to determine if new unitized wells are producing from the servitude owner's property.[372]

Thus, the Louisiana Supreme Court held that "the equitable nature of the circumstances in each individual case determine the applicability of the doctrine."[373] Further, under *Marin*, the record supported a finding that *contra non valentem* should apply in such a case.

C. Right to an Accounting[374]

A lessor who is successful in obtaining a judgment of dissolution of a mineral lease will often demand an accounting from the lessee. The

368. 89 So. 3d 1145 (La. 2012).
369. *Id.* at 1151.
370. *Id.*
371. Amoco Prod. Co. v. Texaco, Inc., 838 So. 2d 821 (La. Ct. App.), *writ denied*, 845 So. 2d 1096 (La. 2003) ("The doctrine of *contra non valentem* halts the running of prescription when the plaintiff was indeed prevented from filing its claim under one of the four categories listed [in *Marin*].").
372. 89 So. 3d at 1154.
373. *Id.*
374. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 13-08(g).

purpose of an accounting is to establish that the lessee has properly and completely paid to the lessor the monies to which it is entitled.

Even where the lessor is unsuccessful in dissolving a mineral lease, but the lessee is found to have owed the money to its lessor, the court might order an accounting.[375]

The United States Court of Appeals, Fifth Circuit, noted that "at least in oil and gas lease cancellation cases[,] an accounting is ancillary to the action and exists for the equitable purpose of adjusting in one proceeding all the differences between the parties arising from the main cause of action."[376]

The duty to account is a "two-way street." That is to say, if the lessor has received funds to which it is not entitled, the lessee has an action to recover such funds as were unjustifiably paid. Although rarely cited as codal authority for an accounting, the remedy is embodied in article 2299 of the Louisiana Civil Code, which reads:

> **Art. 2299. Obligation to restore**
>
> A person who has received a payment or a thing not owed to him is bound to restore it to the person from whom he received it.[377]

Recovery from the lessor of the "thing not owed" is not precluded by negligence or error on the part of the lessee-payor. As the courts say it, "negligence per se is not a bar to recovery for the payment of a thing not due."[378]

Thus, in *Matthews v. Sun Exploration & Production Co.*,[379] the court observed the following:

> Recent jurisprudence has properly interpreted the Code Articles to provide that negligence per se by a payor is not a bar to recovery for the payment of a thing not due. (Citations omitted).

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375. Harris v. J. C. Trahan Drilling Contractor, Inc., 168 So. 2d 881, 884 (La. Ct. App. 1964) ("The plaintiffs are, however, entitled to an accounting of royalties which have accrued or may accrue to them under the terms of the lease.").

376. Williams v. Humble Oil & Refining Co., 432 F.2d 165, 170, *reh'g denied* 435 F.2d 772 (5th Cir. 1970), *cert. denied sub nom.* Humble Oil & Refining Co. v. Price, 402 U.S. 934 (1971).

377. LA. CIV. CODE ANN. art. 2299 (2017).

378. Dynamic Exploration, Inc. v. Sugar Bowl Gas Corp., 367 So. 2d 18, 24 (La. Ct. App. 1978), *writ refused* 368 So. 2d 142 (La. 1979).

379. 521 So. 2d 1192 (La. Ct. App. 1988).

> We believe the defendant's error in overpaying Mrs. Chamberlin amounted to an ordinary or "honest" mistake as contemplated by the Civil Code Articles. Consequently, Sun's error in making the overpayment does not bar its recovery of these funds.[380]

Accordingly, it is the fact that money was paid in error, rather than the reason for the erroneous payment, that establishes the right of restitution.

In the important case of *Bourgeois v. Exxon Corp.*,[381] the lessor's suit for dissolution of a mineral lease was denied on the basis of liberative prescription. The court also dismissed plaintiffs' demand for an accounting, stating that "[p]laintiffs' demand for an accounting of the proceeds of all oil and gas production is deemed to be ancillary to the main demand and fails on the same rationale."[382]

D. Security for Payment of Royalty

Recalling that the lessor's royalty constitutes "rent,"[383] a powerful remedy is provided by the Louisiana Mineral Code to the lessor "for the payment of his rent, and other obligations of the lease." A right of pledge on the lessee's "equipment, machinery, and other property" is provided in articles 146 through 148 of the Mineral Code. These articles read:

> **Art. 146. Lessor's privilege**
>
> The lessor of a mineral lease has, for the payment of his rent, and other obligations of the lease, a right of pledge on all equipment, machinery, and other property of the lessee on or attached to the property leased. The right also extends to property of others on or attached to the property leased by their express or implied consent in connection with or contemplation of operations on the lease or land unitized therewith.[384]
>
> **Art. 147. Right to seize property on premises or within fifteen days of removal**
>
> The mineral lessor may seize the property subject to his privilege before the lessee removes it from the leased premises, or within

380. *Id.* at 1198.
381. 300 So. 2d 632 (La. Ct. App.), *writ denied* 303 So. 2d 181 (La. 1974).
382. *Id.* at 635.
383. LA. REV. STAT. ANN. § 31:123 (1975).
384. *Id.* at § 31:146.

> fifteen days after it has been removed by the lessee without the consent of the lessor, if it continues to be the property of the lessee, and can be identified.[385]

Finally, article 148 adds that, "The mineral lessor may enforce his right of pledge in the same manner as the right of pledge accorded other lessors."[386]

E. Production in "Paying Quantities"

Although, properly speaking, it is not a "remedy" for an improper payment of royalty, brief mention should be made as to the important topic of production in "paying quantities." The issue arises when, even assuming the royalty payment has been properly calculated by the lessee, the amount of the payment is so minimal as to raise concerns as to whether the amount of production being obtained (particularly in reference to the "lifting costs" incurred by the lessee in bringing the production to the surface) is sufficient to meet the tenets of the "Habendum Clause."[387]

A matter regulated by articles 124 and 125 of the Mineral Code,[388] the topic is examined in detail in other writings of this author.[389]

VII. CONCLUSION

The proper payment of royalties to the lessor is one of the most important responsibilities of the lessee. The failure to pay royalties, or the payment of royalties in an improper amount, invites potential significant remedies to the lessor, including the possibilities of double damages and lease dissolution.[390]

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385. *Id.* at § 31:147.

386. *Id.* at § 31:148. While not frequently invoked, this security device is more fully examined in the aforementioned Treatise. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 12-15.

387. The "Habendum Clause" announces the duration of the mineral lease and is sometimes called the "Thereafter Clause." All of the distinct clauses in the mineral lease that address the important issue of lease maintenance come under the ambit of the "Habendum Clause." *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 4-06(a).

388. LA. REV. STAT. ANN. §§ 31:124-125.

389. *See* Patrick S. Ottinger, *Production in "Paying Quantities"–A Fresh Look*, 51 ANN. INST. ON MIN. L. 24 (2004). Also published at 65 LA. L. REV. 635 (2005). *See also* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at §§ 3-15, 3-16.

390. *See* OTTINGER, MINERAL LEASE TREATISE, *supra* note 1, at § 13-27, *et seq*.

At the core of generating a proper and correct royalty check is the mathematics inherent in that process of royalty accounting. Addition and subtraction, as well as multiplication and division, are the essence of the "mere math" with which this article is concerned. To be sure, more important than those functions—as important as they might be—are the factors and considerations involved in identifying the proper elements to be melded together.

This important function represents an intersection of the science of mathematics as well as the issues of volume, temperature, gravity and pressure, and the realities of the production activity itself, in terms of possible deduction for "post-production costs." Then the tax collector visits the scene, resulting in further diminution of the proceeds to which the lessor is entitled.

Most lessees are prudent and reasonable in the discharge of this important function. In the exceptional case where the lessee is less than prudent, appropriate remedies exist in favor of the lessor to rectify the errors or oversights of the lessee.

It is hoped that this modest work will assist the lessee in discharging its duties and responsibilities, to avoid even the conversation of these remedies.