Suspension Issues

The What, The Who, The When, The Why

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Biographical Sketch

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Suspension Issues --The What, The Who, The When and the Why

This paper addresses the rights and remedies of parties to various oil and gas relationships whose funds are placed in suspense in the context of title examination. Additionally, this paper will review the statutory, contractual and common law relating to the suspense of proceeds from production, how each arises in the title examination process and title opinion, and the potential pitfalls for the company holding the proceeds in making the decision to place funds in suspense. In addition, the paper includes the some of the policies that purchasers or the parties distributing proceeds may utilize in making the determination to place the interest of a party in suspense.

This paper will not address the issues related to the calculation of royalty, in particular the complex common law cases dealing with the deduction of post-production costs, or the manner of calculation under the specific royalty provisions of an oil and gas lease (valuation issues) or by conveyance or reservation, such as market value royalty.

I. The Division Order Statute

Any discussion of the suspension of proceeds must include the statutory framework as set out in the Texas Natural Resource Code Annotated §§91.401-91.406, as amended, and commonly referred to as the "Division Order Statute." Your attention is directed to Appendix A attached to this paper for a complete copy of the statutes. References to the various sections of the statute in this paper shall refer to the Texas Natural Resources Code Annotated unless otherwise set forth. While the division order is the subject of the statute, this paper will not address all aspects of the statutes. The statutes are reviewed from the standpoint of statutory direction as to when proceeds from the sale of oil or gas must be paid, and from the title examiner's perspective, when the interest owner to receive payment may be placed in suspense without liability to the payor. Based on legislative history, the statutes were to (1) protect the lessors' rights in an oil and gas lease, and (2) to enact the existing case law. As noted below the statute contains vague provisions and contradictory terms, which do not add the utmost clarity to the issues to be determined by the title practitioner.

A. The What

1. **Proceeds**. **What is to be paid or placed in suspense?** Section 91.401 defines "Payee," "Payor," "Division Order," and "Transfer Order," and it is from these definitions that "Proceeds" as used in this paper is considered. The various definitions refer to "the proceeds derived from the sale of oil or gas from an oil or gas well located in this state," "the production of oil or gas generating such proceeds," "proceeds derived from the sale of oil or gas," "proceeds from the sale of oil, gas, or other related hydrocarbons," "payment for the products taken in

accordance with the division order," "a share of the oil or gas produced," and "merchantable title to the production sold."

2. **Interest**. Section 91.403 provides for the payment of interest on late payments which have not been made for any reason within the time limits specified in Section 91.402 other than where payments are withheld or suspended by a payor beyond the time limits specified in Section 91.402. The conditions excusing the payment of interest under Section 91.402 will be discussed below. If interest is due, the payor *must* pay interest to a payee beginning at the expiration of the time limits at two percentage points above the percentage rate charged on loans to depository institutions by the New York Federal Reserve Bank, unless a different rate of interest is specified in a written agreement between payor and payee. (emphasis added). The obligation to pay interest and receive interest terminates on delivery of the proceeds and accumulated interest to the comptroller as provided by Title 6, Property Code, which are the unclaimed property statutes or escheat statutes.

B. **The Who**

1. Who is to be paid or not? The Division Order Statute defines "Payee" as any person or persons *legally entitled* to payment from the proceeds derived from the sale of oil or gas from an oil or gas well located in this state. (emphasis added).

The Division Order Statute does not apply to any royalties that are payable to:

(1) The board of regents of The University of Texas System under a lease of land dedicated to the permanent university fund; or

(2) The General Land Office as provided by Subchapter D, Chapter 52, of the Natural Resources Code.

2. Who pays or does not pay? The Division Order Statute defines "Payor" as the party who undertakes to distribute oil and gas proceeds to the payee, whether as the purchaser of the production of oil or gas generating such proceeds or as operator of the well from which such production was obtained or as lessee under the lease on which royalty is due. The payor is the first purchaser of such production of oil or gas from an oil or gas well, unless the owner of the right to produce under an oil or gas lease or pooling order and the first purchaser have entered into arrangements providing that the proceeds derived from the sale of oil or gas are to be paid by the first purchaser to the owner of the right to produce who is thereby deemed to be the payor having the responsibility of paying proceeds received from the first purchaser to the payee.

C. **The When**

Section 91.402 provides for the time of payment of proceeds. The proceeds *must* be paid to each payee by payor on or before 120 days after the end of the month of first sale of production from the well. After that time, payments must be made to each payee on a timely basis according to the frequency of payment specified in a lease or other written agreement between payee and payor. If the lease or other agreement does not specify the time for payment, subsequent proceeds must be paid no later than:

(1) 60 days after the end of the calendar month in which subsequent oil production is *sold*; or
(2) 90 days after the end of the calendar month in which subsequent gas production is *sold*. (emphasis added).

In addition to the specific time of payment of proceeds set forth above, Section 91.402 (c)(1) sets forth the required provisions of a division order that a payee must sign in order to receive payment of proceeds, including subparagraph (F), which provides that the division order must contain provisions for the valuation and timing of settlements of oil and gas production to the payee. The statute does not further illuminate what the "timing" of settlement may provide other than as stated in the statute.

Section 91.402(e) provides payment may be remitted to a payee annually for the aggregate of up to 12 months' accumulation of proceeds if the payor owes the payee a total amount of $100 or less for production from all oil or gas for which payor must pay the payee. However, the payor may hold accumulated proceeds of less than $10 until production ceases or the payor's responsibility for making payment for production ceases, whichever occurs first. On the written request of the payee, the payor shall remit payment of accumulated proceeds to the payee annually if the payor owes the payee less than $10. On the written request of the payee, the payor shall remit payment of proceeds to the payee monthly if the payor owes the payee more than $25 but less than $100.

D. **<u>The Why</u>**

<u>Why can an interest placed in suspense without interest under the statute?</u>

Section 91.402(b), the "safe harbor" provision, provides payments may be withheld without interest beyond the time limits specified in Section 91.402(a) when there is:

(1) A dispute concerning title that would affect the distribution of payments;

(2) A reasonable doubt that the payee:

   (A) Has sold or authorized the sale of its share of the oil or gas to the purchaser of such production; or

   (B) Has clear title to the interest in the proceeds of production;

(3) A requirement in a title opinion that places in issue the title, identity, or whereabouts of the payee and that has not been satisfied by the payee after a reasonable request for curative information has been made by the payor.

The fourth issue that allows payments to be withheld without interest beyond the time specified in Section 91.402(a) is the refusal of the payee to sign a division order which includes only the provisions specified in Subsection (c) of Section 91.402.

The only provisions that may be contained in the division order which entitles a payor to receive a signed division order from a payee before the obligation to make payment to a payee are:

(1) The effective date of the division order, transfer order, or *other instrument*;
(2) A description of the property from which the oil or gas is being produced and the type of production;
(3) The fractional and/or decimal interest in production *claimed* by payee, the type of interest, the certification of title to the share of production claimed, and, unless otherwise agreed to by the parties, an agreement to notify payor at least one month in advance of the effective date of any change in the interest in production owned by payee and an agreement to indemnify the payor and reimburse the payor for payments made if the payee does not have *merchantable title* to the production sold;
(4) The authorization to suspend payment to payee for production until the *resolution* of any *title dispute or adverse claim* asserted regarding the interest in production claimed by payee;
(5) The name, address, and taxpayer identification number of payee;
(6) Provisions for the valuation and timing of settlements of oil and gas production to the payee; and
(7) A notification to the payee that other statutory rights may be available to a payee with regard to payments.

In addition to the seven enumerated conditions, Section 91.402(c)(2) provides that such division order shall contain a provision that the division order does not amend any lease or operating agreement between the interest owner and the lessee or operator or any other contracts for the purchase of oil or gas.

As an alternative to a payor form of division order containing the above conditions, Section 91.402(d) contains a model form division order for *oil payments*, but not gas payments. The model form division order is informative as to the same language which may be used in a payor form of division order to comply with the statute.

E. **Uncertainty in the Statute**

Section 91.402(b) contains numerous terms that are susceptible to multiple meanings and interpretations based on the facts and the perspective of the payor in interpreting the facts that the payor is relying on to claim one of the conditions in the statute. As illustrated by the cases discussed below, "a dispute concerning title that would affect the distribution of payments" may be a dispute relating to the interpretation of a deed as to the amount of the interest or the exact nature of the interest conveyed, or a dispute between working interest owners as to the ownership between such parties in a lease, unit or well.

Section 91.402(b)(2) includes the phrase "a reasonable doubt" that the payee has authorized the sale of its share of oil or gas, or has "clear" title to the interest in the proceeds.

Reasonable doubt has been defined elsewhere as doubt based on reason and common sense after a careful and impartial consideration of the facts, but the phrase is not defined in the statute. "Clear" title is not defined in the statute; therefore, one's opinion as to whether clear title is merchantable title, marketable title or some status of title less than either, may be deemed applicable by the interpreter of the facts.

Section 91.402(c)(1)(D) setting forth the substantial content of a division order that a payee must sign in order to receive payment provides for the authorization from the payee for the payor to suspend payment to the payee until the "resolution" of any "title dispute or adverse claim" asserted against the interest in production claimed by the payee. "Resolution" is not defined, nor does the statute designate the party who decides that "resolution" has occurred or the nature or the manner of the resolution to satisfy the statute.

II. **Contractual Provisions**

The drilling boom of the last several years has generated a voluminous number of express royalty provisions in special form oil and gas leases, which benefit the lessors, and contain complex valuations and calculations of the royalty interest. Many such provisions provide for remedies as a result of the untimely payment of royalties; such provisions include, without any limitation on creativity, the following:

1. Mandates on specific payment times;
2. No requirement on the part of the lessor to sign a division order,
3. Joint waiver of the provisions of Section 91.402 of the Tex. Nat. Res. Code Ann. or parts thereof;
4. Interest due on late payments at higher rates than set forth in the Division Order Statute;
5. Notice and absolute cure of late payment provisions;
6. Automatic lease termination if royalties not paid as provided;
7. Lease termination after notice and cure period;
8. Dispute resolution procedures;
9. Escrow of disputed royalties with an escrow agent or the court plus interest
10. Split stream sales provisions requiring payment from on party;
11. No relief from payment of royalties for non-taking working interest owners (and not subject to 3rd party gas balancing);
12. Retained security interest in proceeds of royalties and the rights and remedies of a security interest holder under the Texas Uniform Commercial Code, including the right to take possession of the collateral;
13. Furnish copies of all title opinions, and access to all records and books of the payor related to production, sales, transportation, and marketing;
14. Furnish copies of all gas sales agreements, gas processing agreements, gas plant settlement statements, and similar agreements for oil production and sales;
15. Copies of drilling and completion reports;
16. Written notice of 1st sales of oil and gas; and
17. Copies of all Texas Railroad Commission filings.

Just to name a few onerous lease provisions. The list is by no means complete.

Many of the lease provisions requiring specific times of payment are difficult questions for the oil and gas attorney and the payor of production. Many such provisions are in conflict with the Division Order Statute, and present issues as to whether an interest may be suspended under the statute or not. Very little case law exists to give the oil and gas attorney direction as to whether a particular lease provision, which is at odds with the Division Order Statute, would prevail over the statute in a judicial review, absent an express provision as to the resolution of the conflict.

Special lease royalty provisions create problems in and to themselves which must be reviewed and resolved on a case by case basis. Any analysis of such provisions is beyond the scope of this paper.

III. **Case Law interpreting the Division Order Statute relative to Suspension Issues**

The majority of the reported cases interpreting the Division Order Statute concern royalty valuation issues where the division order attempts to amend the underlying oil and gas lease, the "binding until revoked" rules enumerated in the *Gavenda*[1] case prior to the Division Order Statute and the "market value" cases of *Middleton*[2] and *Heritage*[3], and the interpretation of a "title dispute" as used in the statute. There are a number of well written papers addressing the valuation issue and the "binding until revoked" issue, and your attention is directed to those papers for an in-depth discussion of the legal issues involve.[4]

This paper will address and review the cases in which the courts rule that a particular set of facts in issue constitute or do not constitute a title dispute for the purposes of the Division Order Statute, and whether the payor has the authority to suspend the payee interest subject to the title defect without having to pay interest on the funds in suspense.

Ordinarily, a discussion of cases and the holdings of the court do not require an in depth review of the facts of each case. However, for the purposes of this paper and the benefit of the reader who may be asked to make a decision or give advice when the circumstances are appropriate to place a royalty or working interest owners fractional interest in production in suspense, this paper will set forth the facts relevant to the decision of one party or the other of placing a royalty or working interest owners interest in suspense. In addition, the discussion of the courts' reliance on particular facts and its reasoning for deciding the matter for one party or the other have been include for guidance to the practitioner.

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1 *Gavenda v. Strata Energy Inc.,* 705 S.W.2d 690 (Tex. 1986).

2 *Exxon v. Middleton,* 613 S.W.2d 240 (Tex. 1981).

3 *Heritage Resources, Inc. v. NationsBank,* 939 S.W.2d 118 (Tex. 1996).

4 Peter E. Hosey, *"Follow the Money!" Oil and Gas Leases and Division Orders,* 23rd Annual Advanced Oil, Gas and Energy Resources Law Course (2005); Michael D. Jones, *Division Orders, The uses and abuses of the Division Order,* 40th Annual Ernest E. Smith Oil, Gas & Mineral Law Institute and Fundamentals (2014); and Professor Laura Burney, *The Interaction of the Division Order and the Lease Royalty Clause,* 28 St. Mary's Law Journal 353 (1996).

1. ***Edwin M. Jones Oil Co. v. Pend Oreille Oil & Gas Co.****,* 794 S.W.2d 442 (Tex.App.-Corpus Christi 1990, writ denied).

In this case, Appellant Edwin M. Jones Oil Company sued Appellee Pend Oreille Oil & Gas Company seeking a declaratory judgment that Jones owned a working interest share in the Geffert Gas Unit, which included the Geffert No. 1 Well and the Geffert No. 2 Well. Jones also sought an accounting and recovery for its share of the natural gas production from these two wells. Pend Oreille counterclaimed, alleging that it erroneously paid Jones royalties on unit production from the Geffert Gas Unit. The jury found that Jones owned a one-third working interest in the Geffert No. 1 Well, awarded Jones $98,862.64 for its share of the well's production, and prejudgment interest on the unpaid proceeds from production of $41,518.78. The jury further found that Jones did not own a working interest in the Geffert No. 2 Well. On appeal, the court affirmed the trial court's judgment.

The case concerned an 80 acre tract of land in Live Oak County, Texas, (the Jones Tract) that Jones farmed out to Pend Oreille. Pursuant to the Farmout Agreement, Pend Oreille completed a commercial well, known as the Peet Well, and earned the lease dated June 1, 1980, on the Jones Tract. Jones had the option to convert its 1/8 of 8/8 overriding royalty interest to a 1/3 working interest in the well and the acreage allocated to the well. On December 12, 1980, Pend Oreille formed the 320 acre Peet Gas Unit, which included the entire Jones Tract. Payout of the Peet Well occurred on December 13, 1982, and on January 4, 1983, Jones converted its 1/8 of 8/8 overriding royalty to a 1/3 working interest in the well and farmout acreage allocated to the well. Following the conversion, the Peet Well ceased production, and Pend Oreille drilled a replacement well, the Geffert No. 1, on the Peet Gas Unit, but not on the Jones Tract.

On May 16, 1983, Pend Oreille formed the 352 acre Geffert Gas Unit, including the Jones Tract. Jones did not execute the pooling designation. Pend Oreille dissolved the Peet Gas Unit effective June 9, 1983.

After the Geffert No. 1 Well ceased production, Pend Oreille drilled the Geffert No. 2 Well. The evidence showed that the Geffert No. 2 Well was drilled in the Geffert Gas Unit, but was not drilled on acreage lying within the Peet Gas Unit. Jones did not execute the pooling designation for the Geffert Gas Unit, nor did Pend Oreille have the authority to pool the working interest of Jones.

On appeal, Pend Oreille contended that the evidence did not support the jury findings that Jones owned a 1/3 working interest in the Geffert No. 1 Well and that Jones was entitled to $98,862.64 in production from the well. The court held the evidence sufficient to support the jury finding that Jones owned a 1/3 working interest in the Geffert No. 1 Well and Jones was entitled to the value of its working interest equal to its 80 acre lease contributed to the Geffert Gas Unit. While not entirely clear from the opinion, apparently, the court's ruling was based in part on the Certificate of Pooling Authority filed with the Texas Railroad Commission indicating that there were no unpooled interests in the Geffert Gas Unit, when, in fact, Jones' undivided working interest in the Jones Tract was not pooled in the Geffert Gas Unit.

The trial court awarded Jones $41,518.78 in prejudgment interest pursuant to Section 91.402 (a) requiring timely payment according to the statute, and Section 91.403 (a) providing for interest if one of the exemptions in Section 91.403 (b) was not applicable. While the appellate court originally upheld the trial court finding of prejudgment interest to Jones, in its Opinion on Motion for Rehearing, the court reformed its judgment by deleting the prejudgment interest because the evidence shows that Pend Oreille disputed Jones's title to the royalty payments from the Geffert No. 1 Well, and based on the exemption in Section 91.403(b)(1) providing that interest is not applicable on payments withheld or suspended because of "a dispute concerning title that would affect distribution of payments".

2. ***Northern Natural Gas Co., a Div. of Enron Corp. v. Vanderburg,*** 785 S.W.2d 415 (Tex.App.-Amarillo 1990, no writ).

In this matter Northern Natural Gas Company, a division of Enron Corp., (Northern) appealed from the trial court's summary judgment rendered in favor of Fred S. Vanderburg, Jr. (Vanderburg) on his action for wrongfully withholding payments for production plus interest. Vanderburg is the owner of the surface and all of the oil, gas, and other minerals under a tract of land, and the owner of the lessor's 1/8 royalty interest under an oil and gas lease dated February 4, 1938, in favor of D.D. Harrington (the 1938 lease). Vanderburg's ownership of the royalty interest is undisputed.

Through a series of mesne assignments of the 1938 lease, Damson Oil Company (Damson) claimed title to the "gas rights" under the lease. Vanderburg Exploration, Inc. (VEI) claimed title to the "oil and casinghead gas rights" under the 1938 lease. At the time of the action, there were two "purported" oil wells located on the 1938 lease operated by VEI. Damson owned and operated a dry gas well on the lease and paid royalty to Vanderburg for the dry gas produced.

In 1980, Northern entered into a casinghead gas purchase contract (the contract) with a predecessor in title to VEI. The contract covered casinghead gas produced from the two wells operated by VEI. Pursuant to the contract, Northern purchases from VEI 100% of the casinghead gas produced and remits all payments to VEI. The contract provides that VEI will be responsible for making payments to royalty owners entitled to the same.

As a result two lawsuits were instituted by Damson involving a dispute as to the ownership and title of the gas produced by VEI from the 1938 lease and delivered to Northern. pursuant to the contract. Northern advised VEI of the lawsuits and stated that it would be suspending payments pending resolution of the title dispute to the gas. Vanderburg requested that Northern make payments of his royalty directly to him pending resolution of the title dispute between other parties claiming an interest other than his royalty interest.

In September 1986, Vanderburg instituted the action against Northern and VEI alleging that Northern was wrongfully withholding royalty payments due Vanderburg, that there is no title dispute as to his royalty interest, and as a third party beneficiary of the contract, he was entitled to damages. Vanderburg further pled that Northern converted his gas and that he is entitled to payment of his share of the proceeds from the sale of gas under Sections 91.401-406 and other provisions. Vanderburg also requested prejudgment interest on each unpaid payment.

In its counter-motion for summary judgment to Vanderburg's motion for summary judgment, Northern claimed that it was entitled to a judgment that Vanderburg take nothing because of the existence of the title dispute which authorized Northern, pursuant to the contract, to withhold payments from VEI for gas produced and delivered to Northern.

The trial court granted Vanderburg's motion for summary judgment and held as a matter of law that Vanderburg was entitled to damages in the amount of $44,719.42, equitable prejudgment interest on that sum, attorney's fees, and costs.

The appellate court held that Vanderburg was not a third-party beneficiary of the contract between Northern and VEI. Despite Northern's claims that it was not a payor and Vanderburg was not a payee as defined in Section 91.401, the appellate court disagreed. The court emphasized that a payee is any person "legally entitled to payment from the proceeds derived from the sale of oil or gas from an oil or gas well located in this state." Vanderburg's ownership as the legal owner of the lessor's 1/8 royalty under the 1938 lease was undisputed. The court held that Northern was the first purchaser of production of the gas from the wells. Northern claimed the benefit of the exception provided in Section 91.401(2). For the exception to apply there must be: (1) a contract between the owner of the right to produce (i.e., VEI) and the first purchaser (i.e., Northern); (2) payment of proceeds derived from the sale of oil or gas by the first purchaser to the owner of the right to produce; and (3) the assumption of the responsibility to pay proceeds to the payee by the owner of the right to produce. Although Northern had met the first and third conditions, it had not met second condition. Northern, as a first purchaser, had not paid the proceeds of the sale of gas to VEI, the owner of the right to produce. The court further held that Vanderburg was entitled to prejudgment interest under Section 91.403.

3. ***Koch Oil Co. v. Wilber,*** 895 S.W.2d 854 (Tex.App-Beaumont 1995, writ denied).

This decision contains a lengthy discussion of the facts relating to the disputes and claims of the parties prior to the cause of action being filed on October 8, 1986, by the original lessors under an oil and gas lease dated August 9, 1967, covering a 320 acre tract in Jefferson County. Approximately four years after the filing of the suit, the trial court certified a class of Plaintiffs consisting of the original plaintiffs and the remaining royalty owners in the lease totaling 82 owners.

At all relevant times for the purposes of this discussion, International Petroleum Corporation (International) and United Texas Petroleum Corporation (United) renamed Clamont Energy Corporation (Clamont) were operators of the 1967 lease.

International contracted with Tesoro Crude Oil Company (Tesoro) to be the oil gatherer. Tesoro initially set up accounts to pay all interest owners directly. Six months after Tesoro requested a division order title opinion from International and one was not provided, Tesoro began making the total payment to the operator. International agreed to pay all interest owners through an indemnifying division order with Tesoro.

In December 1984, four of the lessors, through their attorney, demanded Tesoro suspend payments for oil from the lease due to the fact that International had not been paying the lessors. At that time Tesoro suspended payments to the four lessors, and all remaining funds were paid to International. For the next three months, Tesoro attempted to get the lessors to sign division orders, but the lessors refused.

Thereafter, while International was the operator, Koch Oil Company (Koch) contracted with United to buy oil from various leases, including the 1967 lease, under a purchase agreement, which designated Koch as the "second purchaser at the lease." A division order contained United's acknowledgement that United was the "First Purchaser" of oil from the lease. United did not become the operator of the lease until four months later. Koch purchased the oil for 15 months and Koch paid United 100% of the purchase price for the oil.

The case, now some six years old, was adjudicated by the Court and the Court entered its judgment against appellants, Tesoro and Koch, on June 5, 1992. Tesoro and Koch allege error on the part of the trial court in designating each as "payors" as defined by Section 91.401. The appellate court's ruling as to Tesoro and Koch will be discussed separately.

As in the *Vanderburg* case discussed above, Tesoro sought the exemption from payment based on Section 91.401(2), but as in *Vanderburg*, Tesoro failed to meet the second condition by failing to pay the proceeds to the owner of the right to produce (International). Therefore, Tesoro was a payor for the purposes of the statute. However, in this case, Tesoro acted in response to the request of appellee-lessors to suspend payments to International for their benefit, and was therefore, absolved of responsibility for payments to the payees through payment to the owners of the right to produce. In addition, the appellate court held that appellees were not entitled to pre-judgment interest from Tesoro under Section 91.403(a). The court determined that Tesoro was authorized under Section 91.402 for suspending payments to payees because "a reasonable doubt" existed as to the appellees-lessors interest.

However, the court ruled that all material times, Tesoro was not a first purchaser as that term is defined by the statute, but became a stakeholder in suspending certain monies, and as such, is liable to all payees for whom such funds are held plus for all pre-judgment interest on the amounts owed.

With respect to Koch, the court reasoned that United and Koch may enter into an agreement designating Koch as a "second purchaser," as between United and Koch, but Koch cannot avoid the language of Section 91.401(2) defining Koch as a "payor" as to the appellees-lessors. Further, the court found that the appellees were generally "payees" for the purpose of Section 91.401(1).

The trial court's judgment was reversed and remanded. In summary comments the court stated that the case is mainly governed by Texas Natural Resources Code Annotated, Sections 91.401-91.406 (Vernon 1987), and all provisions thereunder for all damages, penalties, pre-judgment interest, and attorney's fees be determined and awarded to appellees. The definition of "payor" was amended in 1991 after this suit was instituted with respect to the conditions between the first purchaser of production and the owner of the right to produce under an oil and gas lease or pooling order.

4. ***Concord Oil Co. v. Pennzoil Exploration and Production Co.,*** 966 S.W.2d 451 (Tex. 1998).

This is the first case in which the Texas Supreme Court applied the provisions of Section 91.402 of the Texas Natural Resources Code.

This case presented an issue with which the Supreme Court, other courts, and title practitioners have struggled for many years. "What interest has been conveyed in an oil and gas property when two differing fractions appear within the conveying instrument?"

The granting clause of the mineral deed in controversy describes the interest conveyed as a 1/96 interest in minerals, but a subsequent clause states that the conveyance covers and includes 1/12 of all rentals and royalty of every kind and character. The Court emphasizes that the proper construction of such instruments has been a recurring issue. See, e.g., *Garrett v. Dils Co.,* 157 Tex. 92, 299 S.W.2d 904 (1957); *Tipps v. Bodine,* 101 S.W.2d 1076 (Tex.Civ.App.-Texarkana 1937, writ ref'd). Most recently, the Court considered oil and gas conveyances with differing fractions in *Luckel v. White,* 819 S.W.2d 459 (Tex. 1991), and *Jupiter Oil Co. v. Snow,* 819 S.W.2d 466 (1991). The Court discusses at length its analysis in construing mineral and other grants to determine the intent of the parties from all the language in the instrument. Such a discussion is beyond the scope of this paper, but your attention to directed to this case for an in depth analysis of the construction of such instruments.

After the Court's detailed review of the parts of the applicable conveyances and its construction of the conveyances, the Court held that the "Concord deed" conveyed a 1/96 interest in the minerals, a grant of a 1/12 interest in any rights or benefits under the lease in existence at the time of the grant, and the possibility of reverter of a 1/12 interest in the mineral estate.

The mineral deed in issue in the case was executed in 1937 in favor of Southland Lease and Royalty Corporation. Crenshaw Royalty Corporation acquired Southland's interest and subsequently executed two oil and gas leases under which Concord Oil Company is the lessee. The parties stipulated that at the time each of the deeds was executed, an oil and gas lease that provided for a 1/8 royalty was outstanding. That lease expired before any of the parties in this case entered into leases covering Survey Sixty-four in Zapata County.

Through various transactions, Pennzoil Exploration and Production Company succeeded to interests under the lease, and Sanchez O'Brien Oil & Gas Corporation acquired a 25% interest in the lease. In the opinion, respondents are referred to as Pennzoil. Pennzoil completed producing wells on the property, and the dispute discussed in the opinion ensued.

For the purpose of this paper, the issue in the case was the question of prejudgment interest. It was Pennzoil's contention that Sections 91.402(b)(1) and 91.403(b) govern and the Court agreed. Section 91.403(a) of the statute provides for interest on payments from the proceeds of the sale of oil or gas if the payments are made after time limits set out in Section 91.402. However, the statute permits a payor to withhold or suspend payment without interest when there is a dispute concerning title.

"There is no doubt that a dispute concerning title exists in this case." Concord and Pennzoil are both working interest owners in the lease. The Court notes that there was an indication in the legislative history of the statute that it was designed to protect the interests of royalty owners. "Nevertheless, the language of the statute is not limited to royalty interests. It is broad enough to encompass working interest owners and operators." The Court comments that Sections 91.402 and 91.403 have been applied to preclude the recovery of prejudgment interest in a suit between working interest owners with no discussion of whether the statute was intended to reach beyond royalty disputes. See *Edwin M. Jones Oil Co. v. Pend Oreille Oil & Gas Co.*, 794 S.W.2d 442, 450 (Tex.App.-Corpus Christi 1990, writ denied); *Hondo Oil & Gas Co. v. Texas Crude Operator*, *Inc.*, 970 F.2d 1433, 1439 (5th Cir. 1992). The Court held that Concord and Pennzoil fall within the definitions of "payee" and "payor," respectively, under Section 91.401.

Concord presented the argument that the exceptions under Section 91.402(b) should only apply to an "innocent stakeholder" and not to a payor who claims an interest in the proceeds, and that at a minimum, Pennzoil was required to interplead the disputed amounts in to the registry of the court or to deposit them in an interest-bearing account. The Court disagreed. The Court stated, "There is no requirement that when a title dispute arises, the payor must pay interest if it unsuccessfully asserts that it is entitled to some of all of the proceeds or that the payor must interplead or deposit the funds," again citing *Edwin M. Jones* and *Hondo.*

Alternatively, Concord sought "equitable" prejudgment interest and that equitable prejudgment interest should be awarded under the common law. The Court held that in this case an award of equitable prejudgment interest would be directly at odds with Section 91.402(b)(1), and the Court has previously held that prejudgment interest is not recoverable in such circumstances. "The Legislature has indicated very clearly in the Natural Resources Code that prejudgment interest is not due when disputes exist between a "payor" and a "payee" over oil and gas titles;" citing Section 91.403(b)(1) and *Hondo.*

5. ***Stable Energy v. Newberry,*** 999 S.W.2d 538 (Tex.App.-Austin 1999, pet. denied).

This case involved a breach of contract regarding appellant Anchor Operating Company's operation of the Knape Well #1 (Knape Well) located in the Knape Unit, and appellant Stable Energy, L.P.'s conduct as lessee of the Knape Unit. The Knape Unit is a 160 acre tract derived from three oil, gas and mineral leases in Fayette County. The appellees-plaintiffs brought the action claiming an entitlement to proceeds from the sale of oil and gas from the Knape Well. The appellants in the trial court defended their position on the theory that a dispute existed regarding appellees entitlement to proceeds from the Knape Well.

This action began as an interpleader action by Total Petroleum, Inc., (Total) and Aquila Southwest Pipeline Corporation (Aquila), the two entities purchasing the oil and gas from the Knape Well at the time the dispute arose. Total and Aquila filed the action to interplead the proceeds from the Knape Well production after being contacted by working interest owners claiming that appellants were retaining all the proceeds from the sale of the oil and gas and failing to forward to the working interest owners their shares. The interpleader actions were severed following summary judgment for Total and Aquila.

The facts in this case are composed of a lengthy discussion of: (1) assignments (recorded and unrecorded) of working interests and overriding royalty interests in the three oil and gas leases in the Knape Unit; (2) the various operators and operating agreements affecting the Knape Well and the identification of parties to the operating agreements and their decimal interest thereunder; (3) unrecorded letter agreements affecting the after-payout working interest; (4) the timing of filing of deeds of trust against the interest of certain operators and the subsequent foreclosure of same; and (5) the proper exercise of the election procedure for selecting a successor operator under the applicable operating agreements.

Appellants were all controlled by Alfred E. Pampell (Pampell) although he was not individually a party. Stable Energy, L.P. (Stable) is a Texas limited partnership formed by the merger of Pampell Interests, Inc., County Management, Inc. (CMI), and Zeal Energy Corporation. Appellant Robust Oil Company (Robust) is Stable's sole general partner, and Pampell is Stable's sole limited partner. Pampell is the president, sole shareholder, and sole director of Robust and Anchor Operating Company (Anchor). Anchor became the operator of the Knape Well in October 1992, and was operator at the time the action was filed.

The appellees are (1) the successors in interest to the original lessees of the three oil and gas leases in the Knape Unit; (2) subsequent assignees of overriding royalty interests which devolved from the original lessees of the leases (Walton appellees); (3) assignees of Charles R. Barnhill, and their assigns, of an after-payout working interest in the Knape Well (Newberry appellees), and (4) subsequent assignee working interest owners in the Knape Well, Cameron Sewell and Rodel Oil and Gas Company (Rodel).

Barnhill's company, CRB Oil and Gas, Inc., became the operator and drilled the Knape Well #1 in 1981. It is unclear from the court's opinion when the Knape Well #1 initial began production of oil and gas. In 1983, Mellon Operating Company replaced CRB Oil and Gas, Inc., as operator, after acquiring a 50% working interest in the Knape Unit and circulating an operating agreement (Mellon Operating Agreement) to all of the working interest owners. The Knape Well was operated pursuant to the Mellon Operating Agreement from 1983 through 1992, with Mellon as operator from 1983 through 1988, and Rodel as operator from 1988 through 1992. During these periods, proceeds from the sale of production of oil and gas from the Knape Well were paid.

In 1989, Pampell Interests acquired Barnhill's interest in the Knape Well at a public sale through the foreclosure of a deed of trust, and in like manner, Pampell Interests acquired Mellon's interest in the Knape Well in 1990 at a public sale through foreclosure of a deed of trust.

In 1992, Rodel resigned as operator and Stable secured the election of Anchor as the new operator. In January 1993, Anchor contracted with a new oil purchaser, Total, and directed Total to pay 100% of the oil proceeds from the Knape Well directly to Anchor. In the contract, Anchor expressly agreed to "account to and pay each interest owner for his respective proportion of said oil produced." Pampell endorsed the proceeds checks from Total to Anchor in favor of Stable and deposited the funds in Stable's bank account, and Anchor made no payments to anyone other than Stable.

In February 1994, Aquila and Stable entered into a gas purchasing contract, effective January 1, 1993. Anchor signed an indemnifying gas division order in connection with the gas purchasing contract, certifying that Anchor was entitled to receive payment for all the gas produced from the Knape Well.

Appellees became aware that the Knape Well was producing oil and gas, that it was being sold, but that they were not being paid their share of the proceeds. In February 1994, the

Newberry appellees notified Total and Aquila that they were not receiving payments on their share of production. Total and Aquila suspended payments on the Knape Well, and in July 1994, they filed interpleader actions to settle each party's rights to the funds. After the severance of the interpleader actions, the trial court rendered judgment declaring that each appellee had a valid interest in the Knape Well, affirming the interest of each appellee, and ordering appellants, jointly and severally, to pay damages, attorney's fees, and costs.

After a lengthy discussion in disposing of the appellants' issues on appeal in favor of the Newberry appellees, Sewell and Rodel, the court addressed appellants' issues relating to the Walton appellees, who are the owners of overriding royalty interests in the oil and gas leases in the Knape Unit. Appellants argued that they were authorized to cease making payments to the Walton appellees because the Walton appellees did not provide proper notice of the change of ownership or the change in the amount of ownership. The court pointed out that the only notice provision regarding change of ownership was in one of the oil and gas leases between the original lessors and lessees; therefore, the Walton appellees were not subject to such provisions. In addition, the various assignments between the original lessors and the Walton appellees contained no change of ownership provisions.

Of particular interest to the subject of suspension of interests is the appellants claim that they relied on the notice provisions in the division orders signed by Walton appellees which authorized them to stop payments because the Walton appellees were required to provide notice of any changes in ownership. The court disagreed. The notice provisions in the division order do not authorize the well operator to simply stop making payments. The court commented that the notice provisions in the division orders stated…"that the operator is not bound by changes in the division of ownership until notified in writing. This simply means that the operator may not be held liable for continuing to make payments to a former owner if it is not informed of the change in ownership. In other words, the operator is required to pay the person listed in its records until it is told otherwise."

On the issue raised by the appellants' claim of error for the trial court awarding the Walton appellees pre-judgment interest on their damages because this case involved a title dispute that would affect distribution of payments, the court clearly disagreed with the appellants' point of error. In support of its holding, the court noted that Section 91.403(a) requires a payor, such as Anchor, to pay interest to a payee if payments for oil and gas produced are not made within the specific time limits in the statute.

In addressing Appellants contention that since the Walton appellees requested the trial court to declare that they owned overriding royalty interests in the Knape Well, then the dispute between the parties was a title dispute. The court reiterated its holding that the dispute arose because the appellants inexcusably failed to pay the Walton appellees for the oil and gas sold from the Knape Well. No party to the case asserted a claim to the Walton appellees' interests or contended that their interests were invalid. In furtherance of its position, the court referred to Section 91.402(b) as only apply to those cases involving "a legitimate title dispute," and by reference to *Concord Oil Co.*, 966 S.W.2d at 461 regarding the interpretation of conflicting language in a mineral conveyance as one that give rise to a dispute concerning title.

6. ***Coastal Oil & Gas Corporation v. Roberts***, 28 S.W.3d 759 (Tex.App-Corpus Christi 2000, reh. overruled).

The case was an appeal from a summary judgment terminating a gas lease for failure to pay royalties, and the court affirmed the trial court's granting a summary judgment. On appeal, Coastal Oil & Gas Corporation and Coastal Oil & Gas USA, L.P. (Coastal) contended the trial court erred in granting the summary judgment because there were fact issues as to whether it wrongfully or unreasonably withheld royalties after sufficient notice.

Coates Energy Trusts and Coates Energy Interests, Ltd. (Coates), as lessor, executed an oil and gas lease in favor of Coastal, as lessee, covering lands in Hidalgo County, referred to as Lease "F." The lease contained a provision which required lessee to pay lessor royalties within 120 days from the date of first production, and thereafter such payments were due on or before the end of the second calendar month following the month in which the production for which the royalties or payments are to be made are sold and delivered. If lessee wrongfully or unreasonably withholds any such payments due to lessor for a period of thirty (30) days after written demand for payment is made by lessor to lessee, at the election of lessor the lease can be terminated.

Coastal drilled the F-6 well, which began producing gas on November 19, 1997. On February 25, 1998, Coastal sent a letter and a division order to all interest owners with a statement that they would pay royalties upon receipt of the completed division order. Coates did not return the division order to Coastal.

Under the terms of the lease, royalties were due by March 19, 1998, which was 120 days from the date of first production. Coastal did not pay royalties on the F-6 well by March 19, 1998. Coates sent Coastal a written demand for payment on March 24, 1998, demanding all royalties due and owing pursuant to the lease, and notifying Coastal that it had thirty (30) days, after receipt of the letter, to pay the requested amounts.

Coastal responded with a written letter on April 21, 1998, stating that they would continue to pay royalties on the "F" lease, and that Coates's written demand was "insufficient, deliberately vague and written in such a way as to keep [Coastal]…from being able to adequately respond." Coastal complained that the Coates demand letter did not explain the amounts owed, how it had improperly calculated royalties, or how Coates wished such royalties to be calculated.

On May 4, 1998, Coates notified Coastal that they were terminating the "F" lease pursuant to the terms of the lease for failure to pay royalties after written demand. Coates filed an amended petition in a suit originally filed in 1993, alleging the termination of the "F" lease based on a failure to pay royalties on the F-6 well. The trial court granted Coates's motion for summary judgment and terminated the "F" lease. By agreement, the summary judgment terminating the "F" lease was severed and made final.

The court stated that the evidence is undisputed that Coastal did not pay royalties on the F-6 well, the lease only required "written demand of payment," and did not require the lessor to explain the particulars of the breach. "Coates literally complied with the demand provision." The court determined that the lease was not ambiguous and would not consider the past dealings of the parties.

The evidence in the case shows that Coastal suspended royalty payments because Coates failed to sign the division order for the F-6 well. Coastal noted that a lessee is entitled to withhold royalty payments pending receipt of a signed division order pursuant to Section 91.402(c)(1); however, Coates responded that it did not sign the division order because it contained an provision relating to indemnification not authorized by statute, and Coastal was not justified in withholding payments.

In determining whether Coastal "wrongfully" withheld payments from Coates, the court reviewed definitions of "wrongful." In addition, the "F" lease provided that royalty payments would not be considered being wrongfully or unreasonably withheld if same were withheld by virtue of "any law, order, directive or regulation of any governmental or regulatory body having jurisdiction." If Coastal withheld payment in accordance with the natural resources code, it was not acting wrongfully under the terms of the lease.

The court discusses the relevant provisions of the Texas Natural Resources Code that entitle a payor to withhold payments of proceeds pending a receipt of a signed division order, Section 91.402(c)(1), and the exception to that provision "if an owner in a producing property will not sign a division order because it contains provisions in addition to those provisions provided for in this section, payor shall not withhold payment solely because of such refusal," Section 91.402(e). Section 91.402(c)(1) limiting the provisions that a division order may contain provides, "unless otherwise agreed, …an agreement to indemnify the payor and reimburse the payor for payments made if the payee does not have merchantable title to the production sold." (emphasis added).

The division order for the F-6 well contained a provision stating that the owner would "indemnify and hold payor harmless from all liability resulting from payments made to the owner in accordance with such division of interest, including but not limited to attorney fees or judgments in connection with any suit that [affects] the owner's interest to which payor is made a party." In this case, the "F" lease, however, was expressly executed without warranty of title. The court held that, "The parties had, therefore, otherwise agreed not to indemnify Coastal with respect to title. Consequently, the division order indemnity provision did not comply with section 91.402(c)(1)(C) and Coastal was not entitled to withhold payment on that basis."

Coastal argued that it complied with Section 91.402(d) of the code, which provides an alternative form of division orders. Coastal further urged the court that this section did not only apply to "oil payments," but was likewise applicable to gas well payments. Coastal asserted various provisions of the statute that refer to the purchase of oil and gas, and the general provisions of found in Section 91.402(d) apply to both oil and gas production. In addition, Coastal asserted provisions of the natural resources code containing definitions of "oil" and "gas." The court noted the distinctions in the natural resources code and in the proper interpretation of statutes.

In the cumulative analysis, the court held that Coastal could not withhold royalty payments based on Coates's failure to sign and return the division order, and that Coastal withholding royalty was not authorized by the natural resources code and was therefore unlawful and wrongful. The court ruled that Coastal was not entitled to rely on the lease provision allowing the withholding of payments if done under "law, order, directive or regulation of any governmental or regulatory body having jurisdiction." In the final analysis, the court held that it was wrongful for Coastal to withhold payments in light of its failure to comply with the division order statute. The court upheld the trial court's granting the summary judgment terminating the "F" lease due to Coastal's nonpayment of royalty on the F-6 well.

7. ***Browning Oil Co., Inc. v. Luecke***, 38 S.W.3d 625 (Tex.App.-Austin 2000, pet. denied).

This is another case that the title practitioner is very familiar with in their practice. Just as in the case of the *Luckel* case discussed in this paper, the familiarity with both cases is for different reasons than as discussed herein. The dispute in issue in this case concerned pooled units for horizontal drilling of oil and gas. Primarily at issue were: (1) whether lessees improperly formed pooled units for two successful horizontal wells in violation of anti-dilution restrictions in the pooling provisions of the leases, and if so, (2) what remedy lessors are entitled to. The trial court determined that lessees violated the pooling provisions in the leases, rendering the pooled units invalid. The damages issue was submitted to a jury, and based the jury's verdict, the trial court awarded lessors a monetary award, plus pre- and post-judgment interest and attorneys' fees.

The appellate court affirmed the trial court's determination that lessees breached the pooling provisions of the leases, and because of the breach the pooled units were invalid. The appellate court held that lessors are not to receive royalties on oil and gas recovered from another's land, and due to the physical distinctions between vertical wells and horizontal wells, the remedy for invalid pooling appropriate to vertical wells is inappropriate to horizontal wells. The case was remanded to the trial court for a determination of the lessors' remedies under the leases and the proper amount of damages.

On the issue of prejudgment interest of lessors' royalty share in production, appellant argued that Section 91.402 prohibits prejudgment interest in the type of dispute at issue in this matter. Appellant argued that Section 91.402(b) provides that payment of proceeds may be withheld without interest where there is: "a reasonable doubt that the payee:…(B) has clear title to the interest in the proceeds of production." Appellant contended that because this dispute concerns the appellees' royalty share in production that this exception should apply in this case.

The court on appeal disagreed stating that the purpose of the statute is to protect royalty owners from intentional payment delays while permitting delays that result from legitimate title disputes. See *Concord Oil Co. v. Pennzoil Exploration & Prod. Co.*, 966 S.W.2d 451, 461 (Tex. 1998) (citing bill analysis). In clarifying the issue, the court held that the crux of the case was whether the appellees are entitled to a pro rata share of royalties under the pooling provisions or royalties for all production from their land. Their entitlement to royalties was never in dispute. All parties acknowledged that the appellees royalty interests are valid. "Thus, the Natural Resources Code does not excuse appellant from paying prejudgment interest where there is no legitimate title dispute, but rather a dispute as to how to calculate the Lueckes' royalties."

Because the court remanded the case to the trial court for a new trial on the damages consistent with its opinion, the court withheld any comment on the appropriate manner of calculating prejudgment interest except to agree with appellant that prejudgment interest should not be assessed on funds that were deposited into the registry of the court. Accordingly, the court reversed the awards of prejudgment interest based on the damage award in the trial court and remanded same for further proceedings consistent with this opinion.

8. ***Neel v. Killam Oil Co.,*** 88 S.W.3d 334 (Tex.Civ.-San Antonio 2002, reh. overruled).

This was a case to construe a mineral deed with respect to the amount of the nonparticipating royalty interest conveyed to grantees. In September 1945, Anita Ugarte de Ortiz conveyed to Joe A. Ortiz a nonparticipating royalty interest. In December 1945, Joe A. Ortiz conveyed his entire interest in the nonparticipating royalty to George E. Neel by a deed. Appellants, George E. Neel, Jr., and Suzy Neel Mayo, are the successors-in-interest to George E. Neel.

The deed from Joe A. Ortiz to George E. Neel purports to convey an undivided 1/2 interest in and to all of the oil royalty, gas royalty, royalty in casinghead gas and gasoline, and royalty in all other minerals from the described land. The Deed contained an “existing lease” provision, which provided that grantee would receive 1/2 of royalty paid under the lease, but if the existing lease were to expire, grantee shall own as a free royalty an undivided 1/16 of: (1) the oil produced, (2) the value or proceeds of the sales of natural gas, (3) the net amount of gasoline or other products manufactured from gas or casinghead gas produced, and (4) all other minerals produced from said premises. Under a “future lease” provision, grantee “shall receive the mineral interests described in the preceding paragraph out of royalty provided for in such leases.”

At the time of the deed was executed, the land was subject to an oil and gas lease (1940 lease), which reserved a 1/8 royalty interest in production. The lease expired, and a new lease was executed on July 1, 1980, which granted a 1/4 royalty in the production of oil and gas, which lease was still in effect as of the time of the appellate decision.

While the 1940 lease was in effect, appellants received a 1/16 royalty, derived by multiplying the 1/2 interest granted in the deed by the 1/8 royalty reserved in the 1940 lease. After the 1980 lease was executed, appellants continued to receive royalties based on the 1/2 interest granted in the deed. At the time, appellees, Killam and Hurd, construed the deed’s granting clause as controlling all other clauses relying on *Alford v. Krum*, 671 S.W.2d 870 (Tex. 1984) in which the Texas Supreme Court held that when there is an irreconcilable conflict between the clauses of a deed, the granting clause prevails over all other provisions.

However, in 1991, the Texas Supreme Court issued *Luckel v. White*, 819 S.W.2d 459 (Tex. 1991), which rejected the *Alford* approach and required a return to the “four corners” approach to construe a deed with provisions that contain conflicting fractional interests. Appellees, believing that *Luckel* altered the interpretation of the deed, modified appellants interest to a fixed 1/16 royalty interest in production. To be expected, appellants disputed this interpretation claiming they were entitled to 1/2 of the 1/4 royalty reserved in the 1980 lease, and claiming that the intent of the deed was to convey a 1/2 royalty interest in any lease, regardless of when it was executed. Due to the dispute, Killam and Hurd ceased paying all royalties. At the same time, Amoco Production Company, and later, Enron Oil & Gas Company, began paying only a 1/16 royalty to Neel and Mayo.

The trial court held that Neel and Mayo owned a fixed 1/16 royalty interest; Neel and Mayo were not entitled to prejudgment interest on unpaid royalties; and Neel and Mayo's claims were not barred, in part, by the statute of limitations. The appellate court initially affirmed the trial court's judgment and reversed and remanded in part, and then withdrew its original opinion and issue the final opinion on July 13, 2002 in its place.

The court discusses its holding in *Luckel*, and that the Supreme Court in *Concord Oil*, construed a deed under which provisions other than the granting clause gave rights to the grantee that, considered in the aggregate, amounted to a larger fraction of the mineral or royalty interest specified in the granting clause. The case in point was the reverse, but it does not change the application of the rules set forth in *Luckel*. The court concluded it was the intent of the parties to the deed to convey a fixed 1/16 interest in production.

Killam and Hurd paid Neel and Mayo royalties from 1987 to 1991 based on division orders reflecting an interest of a 1/8 royalty. After *Luckel*, appellees cancelled the division orders, and appellants refused to sign new division orders showing they owned only a 1/16 royalty. Neel and Mayo asserted that Killam and Hurd wrongfully withheld the undisputed 1/16 royalty, and that they were entitled to prejudgment interest on that amount.

The court agreed with appellants and cite the provisions of Section 91.402 stating that payments may be withheld without interest beyond the time limits set out in the statute when there is "a dispute concerning title that would affect the distribution of payments," and a payor is entitled to receive a signed division order containing certain provisions, including "the fractional and/or decimal interest in production *claimed* by [the] payee…" (emphasis added).

In explaining the basis for its holding, the court stated, "The statutory provisions do not define precisely what qualifies as a title dispute for the purpose of suspending royalty payments without incurring a penalty. However, none of the company defendents disputed that Neel and Mayo were entitled to at least a one-sixteenth royalty interest; thus, there was no title dispute that 'would affect distribution of [these] payments.' Further, Killiam and Hurd's reliance on Neel and Mayo's refusal to sign a new division order reflecting a one-sixteenth royalty was misplaced. The new division order Killam and Hurd drafted did not reflect the fractional and/or decimal interest in production *claimed* by Neel and Mayo. See *id*. § 91.402(c)(1)(C). Instead, it reflected the fractional and/or decimal in production that Killam and Hurd contended was owned by Neel and Mayo. If Neel and Mayo had signed the new division orders, they would have waived their rights to the larger amount they claimed was owed to them." (emphasis added). The court cites as authority for its holding relating to the waiver of one's rights by the execution of division order, *Mattalino v. Trinity Petroleum Exploration*, 927 F.Supp. 986, 989 (S.D.Tex. 1996) and *Sun Operating Ltd. P'ship v. Oatman*, 911 S.W.2d 749, 756 (Tex.App.-San Antonio 1995, writ. denied).

The court found that it would be inequitable to allow Killam and Hurd to withhold payment on those portions of the royalties that they agreed were due. As a result, the court held that Killam and Hurd owe prejudgment interest on those royalties that were not in dispute. In a footnote, the court distinguishes its holding in this case with the Supreme Court's opinion in *Concord Oil*, in which the Court determined Section 91.403 prejudgment interest was not due because "there was no doubt that a dispute concerning title exists in this case." 966 S.W.2d at 461. The court distinguishes this case from *Concord Oil* because in that case, unlike the present case, the payor did not acknowledge that the payee was entitled to at least a portion of the withheld compensation.

9. ***Gore Oil Co. v. Roosth,*** 158 S.W.3d 596 (Tex.App.-Eastland 2005, no pet.).

The principal issue in this case concerned whether the grantor's or the grantee's successors-in-interest should bear the burden of outstanding mineral and nonparticipating royalty interests based on multiple "subject to" provisions in a general warranty deed conveying lands in Knox County. Appellee, the successors-in-interest to the grantor in the deed, brought suit against appellants, the leasehold interest owners, and others after the appellants failed to pay appellees the full amount to which they claimed to be entitled. The dispute was whether the appellee's interest was in addition to the previous outstanding mineral and royalty interests, or whether, as appellants contended, that the reservation of a 1/8 nonparticipating royalty interest made by appellee's predecessor-in-title was reduced by the outstanding mineral and royalty interests. The trial court found in favor of the appellees and entered judgment against the leasehold owners for past royalties and prejudgment interest. This court modified the judgment and affirmed.

The reservation in the deed was made "subject to" any previously conveyed or reserved mineral interest as may appear of record, and then a provision that made the conveyance "subject to" all …reservations, …now outstanding and of record, if any, in Knox County, Texas, affecting the …property. The court conducted an analysis of the "subject to" clauses to determine if the deed was ambiguous, and after applying the case law and canons of construction, determined that the deed was susceptible to more than one meaning. However, based on other evidence presented at trial, the court upheld the trial court's findings with respect to the parties intent, and ruled that appellees are entitled to a full 1/8 royalty interest.

The trial court awarded appellees prejudgment interest. The court relying on Section 91.402(b), held that prejudgment interest is not recoverable when reasonable doubt exists regarding a title dispute, and the holding in *Concord Oil* that "prejudgment interest is not due when disputes exist between a 'payor' and a 'payee' over oil and gas titles." The court reversed the trial court stating, "A title dispute clearly existed in this case, and prejudgment interest was not authorized."

10. ***Headington Oil Co., L.P. v. White,*** 287 S.W.3d 204, (Tex.App.-Houston [14 Dist.] 2009, no pet.).

This case involved ten years of litigation aimed at recovering the possession of oil and gas royalties allegedly withheld by successive well operators. Appellee Modesto White, Jr., owns a fractional nonparticipating royalty interest in oil and gas produced from a property in the Luke Bryan Survey, A-41, in Chambers County, and the other appellees are successors-in-interest to White.

In 1994 Headington acquired producing oil and gas leases on the Bryan Survey. Later that year, Headington requested division orders from each of the known interest owners, both royalty and working interests, to authorize payment of royalties on two wells. The division orders set forth the names of and fractional interests held by each of the sixty-five interest owners, including an aggregate 0.003777 interest owned by the appellees.

Evans, one of the appellees, returned the division orders to Headington unsigned, maintaining that the division order incorrectly stated the proper ownership interests of Evans, Fortenberry and White, the appellees. Evans claimed that the correct, total interests owned by the appellees was 0.053571, a 0.049794 difference from the interest set forth in the division order. Based on information provided by Evans, Headington placed the royalties accruing to appellees in suspense while it "determine[d] the correct interest for each interest."

In January 1995, Evans demanded payment from Headington of accrued royalties based on the higher royalty amount. In December 1995, Evans again demanded payment. In January 1996, Headington responded that it was still trying to clarify the ownership interests by way of a supplemental title opinion, and without the opinion, it would be impossible to determine the correct ownership amounts. In November 1996, appellees made another demand for payment, and Headington advised of its efforts to obtain a title opinion.

On March 17, 1997, White filed suit in Chambers County against Headington and Graham Royalty, Ltd., the prior operator, alleging among other things, conversion of royalties and a determination of title. In White's petition, he alleged that he owned a 0.0491 fractional interests in the wells.

On October 27, 1997, Headington provided Evans with a limited title report in which the preparer stated the inability to separately state the interests owned by [White], and his assignees [Evans] and [Fortenberry] but was able to state the combined interest owned by appellees and two other related owners. In May 1998, Headington assigned the lease to Pearl River Corporation. Bruce Gary took over operations of the wells for Pearl River Corporation. Headington transferred the suspense account for appellees to Gary, who also did not pay royalties to appellees. Gary operated the wells until October 1, 2000, when he transferred operations, along with the suspense funds, to American Coastal Energy.

In July 2005, appellees filed a seventh amended petition against appellants for an accounting, unpaid royalties based on production, prejudgment interest and other remedies. For the first time, appellees based their claim for unpaid royalties on a combined 0.01577116 fractional royalty interest, which was based on a title opinion prepared for Headington. In response, Headington filed a stipulation and interpleader with the trial court, in which it stipulated that appellees held title to a 0.01577116 fractional royalty interest in the property, and deposited into the registry of the court $38,310.20, the royalty amount based on the stipulated interest.

The trial court found in favor of appellees, awarding them the royalties held in the court registry, additional royalties owed by Gary, prejudgment interest, and other fees and costs.

On appeal, the issue of prejudgment interest was disputed by the parties, appellants arguing that there was a dispute concerning title that would affect distribution of payments, and as such, they were entitled to the exemption, the "safe harbor" provision, of Section 91.402(b). Appellees contended that there was never any dispute regarding their entitlement to royalties, merely the amount, and that such a disagreement on the amount of appellee's fractional royalty interest does not qualify as a "title dispute" under Section 91.402(b).

The court acknowledged the trial court's findings of fact established that the parties stipulated to a 0.01577116 fractional interest in the property, but considered the fact that the stipulation occurred only several months before the trial, which was eight years after the appellees filed their original petition. The court held that there was a clear disagreement regarding the appellees' fractional royalty interest from the date that the appellees refused Headington's division order until Headington filed its stipulation and interpleader in December 2005.

The court commented that the circumstances in this case are parallel to those in *Concord Oil*, the Texas Supreme Court's only decision to date applying Section 91.402. In *Concord Oil,* the court reviewed a mineral-rights deed that appeared to convey two different royalty interests. The court held that the deed was ambiguous, and stated, "There is no doubt that a dispute concerning title exists in this case." *Id*. at 461. Further, "The Legislature has indicated very clearly in the Natural Resources Code that prejudgment interest is not due when disputes exist…over oil and gas titles." *Id.* at 463.

Likewise, the Eastland Court of Appeals applied *Concord Oil's* reasoning in *Gore Oil Co.*, which concerned the construction of a deed in favor of the successors-in-interest to the original grantor. Because the central issue of the case was determining the "amount of the royalty interest held" by the grantor's successor, the court held that a title dispute "clearly existed" and consequently, "prejudgment interest was not authorized" under the statute. *Id.* at 602 (relying on *Concord Oil*). In this case, the court held that *Concord Oil* and *Gore Oil Co.* establish that prejudgment interest under Section 91.403 is not appropriate when a legitimate dispute exists regarding the amount of royalty the claimant owns.

The appellees asserted that, when there is no disagreement as to the existence of some ownership rights, a mere disagreement as to the *amount* of a royalty is not a title dispute sufficient under Section 91.402(b) to deny prejudgment interest. The appellees relied on *Stable Energy* and *Browning Oil Co.* for their argument. The court distinguished *Stable Energy* from the instant case in that the issue was not a dispute concerning the amount of royalty owed, but it was a dispute concerning whether the operator had any obligation under an assigned lease to pay claimants when the operator had received no notice of a change of interest ownership. *Stable Energy* was based on a breach of contract, rather than a legitimate title dispute. The court distinguished *Browning Oil Co.* in the respect that the award for prejudgment interest under Section 91.4703 resulted from the violation of the various leases' pooling provisions, not from disputes about the amount of the interest or who owned it.

The court held that "the record in the present case establishes that a disagreement existed among the appellants and the appellees regarding the correct amount of the appellees' fractional royalty interest from the date that appellees refused the division order until Headington filed its stipulation and interpleader". Further, "Because the disagreement affected Headington's and Gary's abilities to distribute royalty payments in accordance with Section 91.402(a), it was a title dispute. Under Section 91.402(b), this title dispute extinguished any liability for prejudgment interest."

11. ***Valence Operating Co. v. Anadarko Petroleum Corp.,*** 303 S.W.3d 435 (Tex.App-Texarkana 2010, no pet.).

This case involved the interpretation of a nonconsent provision in a joint operating agreement to develop oil and gas leases, in particular, whether Valence Operating Company (Valence) actually commenced work on its proposed operation to drill four wells within the time frame specified by the joint operating agreement. The trial court rendered judgment for Anadarko based on the jury verdict that Valence failed to comply with the provisions of the joint operating agreement by not timely and actually commencing work on the proposed operation and completing the operation with diligence, and the jury verdict for actual damages, attorneys' fees, and prejudgment interest for failure to timely pay Anadarko oil and gas revenues attributable to its interest in production.

Valence argued that Anadarko is not entitled to prejudgment interest because this suit involves a title dispute. The court in applying Sections 91.402 (a) and (b) (1)(2) and 91.403(b) disagreed, "This action is for breach of contract." Neither party disputed the other party's title to the oil and gas payments that will be paid according to the compliance or noncompliance with the terms of the Joint Operating Agreement. Therefore, this action does not involve a legitimate title dispute as contemplated by the Texas Natural Resources Code…".

IV. <u>**Title Issues and the Requirement in the Title Opinion**</u>

By its generality as to the conditions that allow a payor to withhold payments to a payee without interest, Section 91.402 (b) allows the application of a myriad of title issues to be identified as conforming to the statute. As can be observed from the cases discussed above, the courts apply the conditions of Section 91.402 based on the facts presented in the case, and without the benefit of all the facts reviewed by the court, the courts' holdings seem inconsistent in some regards.

The title issues to be addressed in a title opinion that impact the rights of the payor and the payee under the statute range from the voluntary liens and security interests created by a working interest owner in a deed of trust, mortgage or other security instrument to mechanic's and materialman's liens, or abstracts of judgment liens. In addition the model form operating agreement provides reciprocal liens between the operator and the nonoperator, which vary depending the form of operating agreement and any additional typewritten provisions that may be included therein. The relevant question in each of these issues is whether the instruments involved create a present conveyance of the rights of the grantor, mortgagor, or vendor, to another party to the instrument and right to receive the proceeds of production of the executing party. With respect to the types of liens referenced above, does the mere filing of the lien constitute a present transfer of the rights of the party against whom the lien is claimed in proceeds of production or does some other action, legal proceeding or legal foreclosure have to occur in order to transfer the rights of the party against whom the lien is claimed, and transfer the rights in the proceeds of production. The paper noted in below has an in depth discussion of liens.[5]

As to title defects in the chain of title that occur during the process of examination, the Texas Title Standards provide guidance as to whether a particular issue raised in a title examination rises to the level of a title dispute under Section 91.402(b) as to justify the suspense of an interest owners proceeds from production without the payor paying interest on the withheld amounts. There are recent articles written that identify fact situations and the necessity for a specific title requirement in response to the fact situation, which requirement would need to be satisfied to remove the title dispute or other conditions set forth in Section 91.402(b) that excuse the payment of interest on proceeds. One very beneficial presentation for the title practitioner is referenced below.[6]

V. **Company Policy and the Division Order Statute**

By its generality as to the conditions that allow a payor to withhold payments to a payee without interest, Section 91.402 (b) allows the application of a myriad of title issues to be identified as conforming to the statute. As can be observed from the cases discussed above, the courts apply the conditions of Section 91.402 based on the facts presented in the case, and without the benefit of all the facts reviewed by the court, the courts' holdings seem inconsistent in some regards.

The title issues to be addressed in a title opinion that impact the rights of the payor and the payee under the statute range from the voluntary liens and security interests created by a working interest owner in a deed of trust, mortgage or other security instrument to mechanic's and materialman's liens, or abstracts of judgment liens. In addition the model form operating agreement provides reciprocal liens between the operator and the nonoperator, which vary depending the form of operating agreement and any additional typewritten provisions that may be included therein. The relevant question in each of these issues is whether the instruments involved create a present conveyance of the rights of the grantor, mortgagor, or vendor, to another party to the instrument and right to receive the proceeds of production of the executing party. With respect to the types of liens referenced above, does the mere filing of the lien constitute a present transfer of the rights of the party against whom the lien is claimed in proceeds of production or does some other action, legal proceeding or legal foreclosure have to occur in order to transfer the rights of the party against whom the lien is claimed, and transfer the rights in the proceeds of production. The paper noted in below has an in depth discussion of liens.

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[5] Kevin M. Beiter and Raymond G. Gallaway, Jr., *The Suspense is Killing Me,* University of Texas Oil, Gas and Mineral Law Institute, 1993.

[6] Allen D. Cummings, *Texas Title Examination Standards: Introduction and Practical Exercises,* 41st Ernest E. Smith Oil, Gas and Mineral Law Institute (2015).

amounts. There are recent articles written that identify fact situations and the necessity for a specific title requirement in response to the fact situation, which requirement would need to be satisfied to remove the title dispute or other conditions set forth in Section 91.402(b) that excuse the payment of interest on proceeds. One very beneficial presentation for the title practitioner is referenced below.

V. Company Policy and the Division Order Statute There is very little or no case law giving the title practitioner guidance as to how the Division Order Statute would be interpreted by the courts in light of the factual circumstances set forth below. The opinions below are those of the author as to which provisions may be applicable to each fact circumstance, the applicability of the statutes, and whether the interests of the payee may be suspended without interest.

1. **Address Unknown**:

The payor is conducting reasonable due diligence to locate the payee. This situation is normally the result of the previous mailed division order or payments/checks having been returned by the postal service as undeliverable to the addressee or the whereabouts of the payee are unknown.

a. No division order signed due to unknown address. Payor should make reasonable efforts to locate a current address for the payee in the event the payee is located. While the unknown whereabouts of payee is not a specific defense for not making payments within the time limits specified in the statute, Section 91.402(c)(1) provides that as a condition for payment of proceeds from the sale of oil and gas production to payee, a payor shall be entitled to receive a signed division order from payee containing only the provisions of the section. Whether the efforts of the payor were "reasonable" is a fact question for the court, should a dispute arise with respect to nonpayment within the statutory period.

b. Division order [conforming to Section 91.402(c)(1)] has been executed, but subsequently payments/checks are returned by the postal service as undeliverable. In this circumstance, Section 91.402 does not contain a specific provision for withholding payments without interest on the suspended funds. The division order may contain a provision allowing the suspense of payments in the event of a change of address without notice, but such a division order would not specifically comply with Section 91.402(c))1) and could be a basis for a claim for interest on the suspended payments.

c. Reasonable due diligence efforts have been completed, but a current address or whereabouts of the payee has been unsuccessful. Since payee has not signed a division order in conformance with Section 91.402, no interest should be due on the proceeds held in suspense. Section 75.101 of the Texas Property Code provides that where mineral proceeds that remain unclaimed by the owner for longer than three years after they become payable or distributable, then the owner's underlying right to receive those mineral proceeds are presumed abandoned.

d. Section 91.402(b)(3) provides for the suspending of an interest of a payee if a requirement in a title opinion places in issue the whereabouts of the payee. The whereabouts of a payee is not normally discussed or made the subject of a requirement in a title opinion, and absent such a requirement, the payor may be subject to the payment of interest on suspended proceeds not paid within the statutory time periods.

2. **<u>Bankruptcy</u>**:

Some companies, as payor, may suspend payments when it has received a notice that the payee has filed for bankruptcy, and the payor has not received an order to release the proceeds in the manner set forth in the order. Absent a notice from the bankruptcy court that the payor should suspend the payment of proceeds to the payee, concerning a claimed dispute of title or that payee does not have clear title, Section 91.402 may not provide protection that such payments may be withheld without the payment of interest. This situation is particularly complicated by the Bankruptcy Code, the nature of the interest of the party filing for bankruptcy, whether a royalty or working interest owner and operator or nonoperator, and the type of bankruptcy filed, whether as reorganization or dissolution, and the underlying agreements and the effects of the Bankruptcy Code on such agreements.

However, where the party filing bankruptcy is the operator, the payor should suspend payments to the non-operator claimants and lien claimants, since a dispute "which would affect distribution of payments" under Section 91.402(b)(1) has occurred.

3. **<u>Deceased Interest Owner</u>**:

The action taken by payor will depend on the circumstances through which payor was advised that payee is deceased.

a. Notification by a requirement in a title opinion would provide an express exception as set forth in Section 91.402(b)(3) to withhold payments until testate or intestate succession are established as a matter of law.

b. Notification by a next of kin or other person would entitle payee to rely on the division order executed by the decedent until legal title in the successors-in-interest have been determined and a division order is executed by the personal representative, devisees, or heirs as established by law. The payor can rely on Section 91.402(b)(1) and (2)(B) as a basis for suspending the interest of the decedent.

4. **<u>Requirement in Title Opinion</u>**:

Section 91.402(b)(3) provides for the suspending of an interest of a payee if the requirement places in issue the title, identity or whereabouts of the payee. As to the question of title, the statute refers to legal title and merchantable title of the payee in other sections of the Division Order Statute, but the reference here is to no more than title of payee. The second condition of the section is that the requirement in the title opinion *has not been satisfied by the payee* after a reasonable request for curative information has been made by the payor. The author would suggest that even if the payor takes the responsibility on itself to cure the title requirement, it would be a sound policy to request curative from the payee as a basis for suspending payments without interest.

Company policies vary as to which department, whether the land department or the division order department, is responsible for obtaining the necessary curative to satisfy a title issue or requirement. In either instance, reasonable diligence should be exercised in the efforts to obtain curative to satisfy a requirement in a title opinion.

5. **Transfer of Suspense Funds**:

This situation is common as a part of the acquisition of producing property by company. If the selling company, as payor, transfers its suspense account to the buying company, as the new payor, but the records of the selling company do not identify the specifics of why the interest of the payee are held in suspense, or even if the records do, the acquiring company would in all likelihood be held liable for interest on the funds held in suspense from the date of acquisition if such payments are held in suspense for a reason that does not qualify as one of the conditions for suspense without interest under Section 91.403. Assuming the acquiring company's policy is to have new divisions orders executed by all interest owners on the acquisition of a producing property, the provisions of Section 91.402(c)(1) should excuse payment of interest during the period of its ownership, subject to compliance with the other provisions of the statute.

6. **Joint Interest Billings Delinquent**:

Some companies, payors, have the policy to suspend payments to working interest owners, a non-operating party, when the non-operating party is delinquent in the payment of its joint interest billings (JIBs). Assuming an executed joint operating agreement, the remedies for nonpayment of joint interest billings is a matter of contract between the parties. The joint operating agreement should be reviewed to determine the right of the operator to suspend payments to the non-operating party or to recoup past due JIBs out of the proceeds of production of the non-operating party. Absent express provisions in the joint operating agreement to suspend payment of proceeds from production of the non-operating party by the operator, the court's holding in *Valence* would control, and the operator would be liable for interest for all proceeds withheld.

7. **Gas Imbalances**:

As with joint interest billings, the suspension of proceeds payable to a working interest owner due to gas imbalances is a matter of contract under the terms of the gas balancing agreement between the parties. The gas balancing agreement should be reviewed to determine the manner in which an over-balanced party is to make up the over-balance gas to the under-balanced party. Absent express provisions in the gas balancing agreement to suspend payment of proceeds from production or to recover the over-balance of volumes of gas of the over-balanced party, the court's holding in *Valence* would be applicable as to the payment of interest for a breach of contract.

8. **Transfer of Interest**:

Where payor has received notice of a transfer of the interest of a payee, but payor has not received the necessary legal documentation to verify the change of ownership of the interest, the provisions of Section 91.402 (b)(2) would allow the suspension of the interest without the payment of interest. Following receipt of the legal documentation, payor should provide a transfer order complying with Section 91.402(c)(1) reflecting the change of ownership, and until executed, payor may continue to suspend payments without interest being due.

9. **Waiting on Division Order**:

As a condition for the payment of proceeds from the sale of oil and gas production to payee, a payor shall be entitled to receive a signed division order in a form that complies with Section 91.402(c)(1). Section 91.403(b) provides that interest is not due for payments made after the time limits specified in Section 91.402 where payments are withheld or suspended because of the conditions enumerated in Section 91.402. However, Section 91.403(b) will not provide an exemption for late payments where the division order does not comply with Section 91.402(c)(1).

10. **Waiting on Title Opinion**:

Section 91.402(b)(2)(b) provides that payments may be withheld without interest beyond the time limits in Section 91.402(a) when there is a reasonable doubt that the payee has clear title to the interest in the proceeds of production. Waiting on a title opinion would not qualify as a reasonable doubt about payee's title. Therefore, to lessen the penalty of interest under Section 91.402, payor may consider an estimated payment to reduce the amount of interest that will be due if the title opinion is not available within the time periods specified in the statute.

VI. **Conclusion**

The Division Order Statute is relatively new in terms of Texas and the case law is only starting to evolve with respect to Texas courts interpreting and applying the statute to matters of title disputes. As the court in *Neel* stated, "The statutory provisions do not define precisely what qualifies as a title dispute for the purpose of suspending royalty payments without incurring a penalty."

The Texas Supreme Court has defined a title dispute to the extent it involves a mineral deed that contains differing fractions within the conveying instrument, and the payor and the payee disagree as to the interpretation of the deed. In the case of *Gore Oil Co.*, a deed that is determined to be ambiguous as to the amount of royalty conveyed or reserved would constitute a title dispute for the purpose of the statute.

The courts have held that a dispute between to working interest owners and parties to a farmout agreement after the drilling of subsequent wells on different units who disagree as to whether the farmor is entitled to an interest in the subsequent well was "a dispute concerning title that would affect distribution of payments."

The court in *Vanderburg* held that the owner of an undisputed royalty interest under an oil and gas lease must be paid by the purchaser as "payor" unless the purchaser has complied with the exception Section 91.401(2). However, if the payor has acted in response to a request by the party whose interest is placed in suspense, the payor will be relieved of the penalty of paying interest on suspended proceeds.

The courts have been clear that a breach of contract dispute, such as simply failing to pay nonoperators under a joint operating agreement, or disputing the manner of calculating royalties as provided in the lease, is not a title dispute for the purposes the statute.

In *Coates*, refusal to sign a division order that contained provisions other than those specified in the statute will not relieve the payor of the obligation to pay proceeds to payee, and if payments are withheld, the payor will have to pay interest on the withheld proceeds.

Beyond the holdings of the cases discussed herein and the application of those holdings, the statute contains vague terms and terms which are not defined. The oil and gas practitioners charged with applying the statute should err on the side of caution as to the future application of the facts to the statute, and whether under the facts presented, there is a clear indication that one of the exceptions in Section 91.402 can be met and relieve the payor of the penalty of paying interest on proceeds that are withheld from the payee.

Appendix A

SUBCHAPTER J. PAYMENT FOR PROCEEDS OF SALE

Sec. 91.401. DEFINITIONS. In this subchapter:

(1) "Payee" means any person or persons legally entitled to payment from the proceeds derived from the sale of oil or gas from an oil or gas well located in this state.

(2) "Payor" means the party who undertakes to distribute oil and gas proceeds to the payee, whether as the purchaser of the production of oil or gas generating such proceeds or as operator of the well from which such production was obtained or as lessee under the lease on which royalty is due. The payor is the first purchaser of such production of oil or gas from an oil or gas well, unless the owner of the right to produce under an oil or gas lease or pooling order and the first purchaser have entered into arrangements providing that the proceeds derived from the sale of oil or gas are to be paid by the first purchaser to the owner of the right to produce who is thereby deemed to be the payor having the responsibility of paying those proceeds received from the first purchaser to the payee.

(3) "Division order" means an agreement signed by the payee directing the distribution of proceeds from the sale of oil, gas, casinghead gas, or other related hydrocarbons. The order

directs and authorizes the payor to make payment for the products taken in accordance with the division order. When used herein "division order" shall also include "transfer order".

(4) "Transfer order" means an agreement signed by a payee and his transferee (new payee) directing the payor under the division order to pay another person a share in the oil or gas produced.

Added by Acts 1983, 68th Leg., p. 966, ch. 228, Sec. 1, eff. Sept. 1, 1983. Amended by Acts 1991, 72nd Leg., ch. 650, Sec. 1, eff. Aug. 26, 1991.

Sec. 91.402. TIME FOR PAYMENT OF PROCEEDS.

(a) The proceeds derived from the sale of oil or gas production from an oil or gas well located in this state must be paid to each payee by payor on or before 120 days after the end of the month of first sale of production from the well. After that time, payments must be made to each payee on a timely basis according to the frequency of payment specified in a lease or other written agreement between payee and payor. If the lease or other agreement does not specify the time for payment, subsequent proceeds must be paid no later than:

(1) 60 days after the end of the calendar month in which subsequent oil production is sold; or

(2) 90 days after the end of the calendar month in which subsequent gas production is sold.

(b) Payments may be withheld without interest beyond the time limits set out in Subsection (a) of this section when there is:

(1) a dispute concerning title that would affect distribution of payments;

(2) a reasonable doubt that the payee:

(A) has sold or authorized the sale of its share of the oil or gas to the purchaser of such production; or

(B) has clear title to the interest in the proceeds of production;

(3) a requirement in a title opinion that places in issue the title, identity, or whereabouts of the payee and that has not been satisfied by the payee after a reasonable request for curative information has been made by the payor.

(c)(1) As a condition for the payment of proceeds from the sale of oil and gas production to payee, a payor shall be entitled to receive a signed division order from payee containing only the following provisions:

(A) the effective date of the division order, transfer order, or other instrument;

(B) a description of the property from which the oil or gas is being produced and the type of production;

(C) the fractional and/or decimal interest in production claimed by payee, the type of interest, the certification of title to the share of production claimed, and, unless otherwise agreed to by the parties, an agreement to notify payor at least one month in advance of the effective date of any change in the interest in production owned by payee and an agreement to indemnify the payor and reimburse the payor for payments made if the payee does not have merchantable title to the production sold;

(D) the authorization to suspend payment to payee for production until the resolution of any title dispute or adverse claim asserted regarding the interest in production claimed by payee;

(E) the name, address, and taxpayer identification number of payee;

(F) provisions for the valuation and timing of settlements of oil and gas production to the payee; and

(G) a notification to the payee that other statutory rights may be available to a payee with regard to payments.

(2) Such a division order does not amend any lease or operating agreement between the interest owner and the lessee or operator or any other contracts for the purchase of oil or gas.

(d) In the alternative, the provisions of Subsection (c) of this section may be satisfied by a division order for oil payments in substantially the following form and content:

DIVISION ORDER

TO: (Payor)Property No.

Effective

(Date)

The undersigned severally and not jointly certifies it is the legal owner of the interest set out below of all the oil and related liquid hydrocarbons produced from the property described below:

OPERATOR:

Property name:

County: State:

Legal Description:

OWNER NO. TAX I.D./SOC. SEC. NO. PAYEE

DIVISION OF INTEREST

THIS AGREEMENT DOES NOT AMEND ANY LEASE OR OPERATING AGREEMENT BETWEEN THE INTEREST OWNERS AND THE LESSEE OR OPERATOR OR ANY OTHER CONTRACTS FOR THE PURCHASE OF OIL OR GAS.

The following provisions apply to each interest owner ("owner") who executes this agreement:

TERMS OF SALE: The undersigned will be paid in accordance with the division of interests set out above. The payor shall pay all parties at the price agreed to by the operator for oil to be sold pursuant to this division order. Purchaser shall compute quantity and make corrections for gravity and temperature and make deductions for impurities.

PAYMENT: From the effective date, payment is to be made monthly by payor's check, based on this division of interest, for oil run during the preceding calendar month from the property listed above, less taxes required by law to be deducted and remitted by payor as purchaser. Payments of less than $100 may be accrued before disbursement until the total amount equals $100 or more, or until 12 months' proceeds accumulate, whichever occurs first. However, the payor may hold accumulated proceeds of less than $10 until production ceases or the payor's responsibility for making payment for production ceases, whichever occurs first. Payee agrees to refund to payor any amounts attributable to an interest or part of an interest that payee does not own.

INDEMNITY: The owner agrees to indemnify and hold payor harmless from all liability resulting from payments made to the owner in accordance with such division of interest, including but not limited to attorney fees or judgments in connection with any suit that affects the owner's interest to which payor is made a party.

DISPUTE; WITHHOLDING OF FUNDS: If a suit is filed that affects the interest of the owner, written notice shall be given to payor by the owner together with a copy of the complaint or petition filed.

In the event of a claim or dispute that affects title to the division of interest credited herein, payor is authorized to withhold payments accruing to such interest, without interest unless otherwise required by applicable statute, until the claim or dispute is settled.

TERMINATION: Termination of this agreement is effective on the first day of the month that begins after the 30th day after the date written notice of termination is received by either party.

NOTICES: The owner agrees to notify payor in writing of any change in the division of interest, including changes of interest contingent on payment of money or expiration of time.

No change of interest is binding on payor until the recorded copy of the instrument of change or documents satisfactorily evidencing such change are furnished to payor at the time the change occurs.

Any change of interest shall be made effective on the first day of the month following receipt of such notice by payor.

Any correspondence regarding this agreement shall be furnished to the addresses listed unless otherwise advised by either party.

In addition to the legal rights provided by the terms and provisions of this division order, an owner may have certain statutory rights under the laws of this state.

Signature of   Social Security/

Witness   Interest OwnerTax I.D. No.   Address

____________   _________________   _________________   ____________

____________   _________________   _________________   ____________

____________   _________________   _________________   ____________

Failure to furnish your Social Security/Tax I.D. number will result in withholding tax in accordance with federal law, and any tax withheld will not be refundable by payor.

(e) If an owner in a producing property will not sign a division order because it contains provisions in addition to those provisions provided for in this section, payor shall not withhold payment solely because of such refusal. If an owner in a producing property refuses to sign a division order which includes only the provisions specified in Subsection (c) of this section, payor may withhold payment without interest until such division order is signed.

(f) Payment may be remitted to a payee annually for the aggregate of up to 12 months' accumulation of proceeds if the payor owes the payee a total amount of $100 or less for production from all oil or gas wells for which the payor must pay the payee. However, the payor may hold accumulated proceeds of less than $10 until production ceases or the payor's responsibility for making payment for production ceases, whichever occurs first. On the written request of the payee, the payor shall remit payment of accumulated proceeds to the payee annually if the payor owes the payee less than $10. On the written request of the payee, the payor shall remit payment of proceeds to the payee monthly if the payor owes the payee more than $25 but less than $100.

(g) Division orders are binding for the time and to the extent that they have been acted on and made the basis of settlements and payments, and, from the time that notice is given that settlements will not be made on the basis provided in them, they cease to be binding. Division orders are terminable by either party on 30 days written notice.

(h) The execution of a division order between a royalty owner and lessee or between a royalty owner and a party other than lessee shall not change or relieve the lessee's specific, expressed or implied obligations under an oil and gas lease, including any obligation to market production as a reasonably prudent lessee. Any provision of a division order between payee and its lessee which is in contradiction with any provision of an oil and gas lease is invalid to the extent of the contradiction.

(i) A division order may be used to clarify royalty settlement terms in the oil and gas lease. With respect to oil and/or gas sold in the field where produced or at a gathering point in the immediate vicinity, the terms "market value," "market price," "prevailing price in the field," or other such language, when used as a basis of valuation in the oil and gas lease, shall be defined as the amount realized at the mouth of the well by the seller of such production in an arm's-length transaction.

Added by Acts 1983, 68th Leg., p. 966, ch. 228, Sec. 1, eff. Sept. 1, 1983. Amended by Acts 1991, 72nd Leg., ch. 650, Sec. 2, eff. Aug. 26, 1991; Acts 1995, 74th Leg., ch. 681, Sec. 1, eff. June 15, 1995.

Sec. 91.403. PAYMENT OF INTEREST ON LATE PAYMENTS.

(a) If payment has not been made for any reason in the time limits specified in Section 91.402 of this code, the payor must pay interest to a payee beginning at the expiration of those time limits at two percentage points above the percentage rate charged on loans to depository institutions by the New York Federal Reserve Bank, unless a different rate of interest is specified in a written agreement between payor and payee.

(b) Subsection (a) of this section does not apply where payments are withheld or suspended by a payor beyond the time limits specified in Section 91.402 of this code because of the conditions enumerated in Section 91.402 of this code.

(c) The payor's obligation to pay interest and the payee's right to receive interest under Subsection (a) of this section terminate on delivery of the proceeds and accumulated interest to the comptroller as provided by Title 6, Property Code.

Added by Acts 1983, 68th Leg., p. 966, ch. 228, Sec. 1, eff. Sept. 1, 1983. Amended by Acts 1985, 69th Leg., ch. 230, Sec. 18, eff. Sept. 1, 1985; Acts 1991, 72nd Leg., ch. 650, Sec. 3, eff. Aug. 26, 1991; Acts 1991, 72nd Leg., ch. 676, Sec. 1, eff. Sept. 1, 1991; Acts 1997, 75th Leg., ch. 1037, Sec. 39, eff. Sept. 1, 1997; Acts 1997, 75th Leg., ch. 1423, Sec. 14.15, eff. Sept. 1, 1997.

Sec. 91.404. NONPAYMENT OF OIL AND GAS PROCEEDS OR INTEREST.

(a) If a payee seeks relief for the failure of a payor to make timely payment of proceeds from the sale of oil or gas or an interest in oil or gas as required under Section 91.402 or 91.403 of this code, the payee must give the payor written notice by mail of that failure as a prerequisite to beginning judicial action against the payor for nonpayment.

(b) The payor has 30 days after receipt of the required notice from the payee in which to pay the proceeds due, or to respond by stating in writing a reasonable cause for nonpayment.

(c) A payee has a cause of action for nonpayment of oil or gas proceeds or interest on those proceeds as required in Section 91.402 or 91.403 of this code in any court of competent jurisdiction in the county in which the oil or gas well is located.

Added by Acts 1983, 68th Leg., p. 966, ch. 228, Sec. 1, eff. Sept. 1, 1983.

Sec. 91.405. EXEMPTIONS. This subchapter does not apply to any royalties that are payable to:

(1) the board of regents of The University of Texas System under a lease of land dedicated to the permanent university fund; or

(2) the General Land Office as provided by Subchapter D, Chapter 52, of this code.

Added by Acts 1983, 68th Leg., p. 966, ch. 228, Sec. 1, eff. Sept. 1, 1983.

Sec. 91.406. ATTORNEY'S FEES AND MINIMUM AWARD. If a suit is filed to collect proceeds and interest under this subchapter, the court shall include in any final judgment in favor of the plaintiff an award of:

(1) reasonable attorney's fees; and

(2) if the actual damages to the plaintiff are less than $200, an additional amount so that the total amount of damages equals $200.

Added by Acts 1987, 70th Leg., ch. 1011, Sec. 1, eff. Aug. 31, 1987.