



# Oil and gas royalty disputes: complex lease terms and varying state laws create new challenges



Many exploration and production companies active in unconventional resource plays are facing a new round of royalty disputes and litigation.

Disputes between royalty owners and oil and gas operators have been the subject of litigation for decades. The structural changes in the oil and gas industry in the 1980s and 1990s, with deregulation, unbundling and the proliferation of marketing affiliates, accelerated the number and complexity of royalty disputes. With the increased activity in unconventional resource plays, exploration and production companies are dealing with a greater number of leases and lessors, as well as more complex lease terms. As a result, many operators are facing a new round of royalty disputes and litigation.

The variation in lease terms and laws in different states creates unique challenges, while concurrently, many of the issues that have been disputed in the past are resurfacing. Some of those issues are:

- Does the royalty clause call for market value or proceeds?
- Is the point of royalty measurement at the well, at the tank or somewhere else?
- What are deductible post-production costs (i.e., gathering, treating, processing, compression, transportation)?
- How are deductible post-production costs calculated?
- Are the royalty owners identified as private mineral interest owners, state government, the federal government or Indian tribes?
- How do the implied covenants apply (i.e., protect from drainage, reasonably develop, produce and market, and use due care with respect to drilling and surface operations)?

In addition to these traditional sources of dispute, the diversity of lessors and their related lease forms in the resource plays are leading to increased litigation. For example, some of the lessors in the Eagle Ford play in South Texas are large land owners with proprietary lease forms, whereas many of the lessors in the Barnett play own small tracts with highly standardized lease forms. These two extremes may result in disputes, but for different reasons. Also, while oil and gas law in states such as Texas and Oklahoma is highly evolved, it is much less so in states like Pennsylvania and Ohio, again creating the potential for disputes in the evolving legal environment. The resource plays also have some unique characteristics with litigation potential, some royalty related and some not. For example, the use of hydraulic fracturing potentially gives rise to class action lawsuits alleging ground water contamination in resource plays near suburban areas. Ground water contamination cases are also possible in rural areas, but the plaintiffs will typically be large land owners

rather than a class of similarly situated individuals. In jurisdictions with less evolved oil and gas law, local authorities have attempted to implement drilling moratoriums to study the ground water issue.

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A&M has a multidisciplinary team capable of assisting clients with analyzing financial records, establishing fact patterns, damages analysis, scenario development and expert witness testimony. We have sufficient breadth to be immediately responsive to clients' needs and the depth to bring long-term value to the dispute resolution process.

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- Coordinating engineering and other non-financial disciplines resulting in an objective and cohesive analysis
- Providing written reports and oral testimony

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