# In the
# Court of Appeals
# Second Appellate District of Texas
# at Fort Worth

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No. 02-19-00236-CV

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BLUESTONE NATURAL RESOURCES II, LLC, Appellant

V.

NETTYE ENGLER ENERGY, LP, Appellee

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On Appeal from the 153rd District Court
Tarrant County, Texas
Trial Court No. 153-308401-19

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Before Kerr, Bassel, and Womack, JJ.
Memorandum Opinion by Justice Womack

## MEMORANDUM OPINION

### I. INTRODUCTION

Appellant BlueStone Natural Resources II, LLC appeals the trial court's order granting Appellee Nettye Engler Energy, LP's traditional summary judgment motion. BlueStone also appeals the trial court's order denying its own summary judgment motion. In one issue, BlueStone argues that the trial court erred by finding that Engler's nonparticipating royalty interest prohibits the deduction of postproduction costs for gathering and compressing gas in relation to a deed granting Engler a royalty interest in the land subject to this case. Because we hold that the royalty interest by its express terms creates a standard royalty subject to postproduction costs, we reverse both orders and render judgment in favor of BlueStone.

### II. BACKGROUND

In June 1986, Engler's predecessors conveyed a 645.569-acre tract of land in Tarrant County to BlueStone's predecessors. In the special warranty deed, the grantors excepted and reserved from their conveyance a one-eighth nonparticipating royalty interest (NPRI) in the minerals conveyed, using the following language:

> Grantor hereby excepts and reserves unto itself, its heirs, successors and assigns, an undivided one-eighth nonparticipating (1/8th) royalty interest in and to all of the oil, gas and other minerals on, in and under the Subject Property. Grantee . . . shall have the exclusive right . . . to drill for and produce oil, gas and other minerals from the Subject Property and the exclusive power and right to execute oil and gas and other mineral leases covering the interest hereby excepted and reserved and to receive and keep any bonus, delay rental or any other payment other than royalty paid by any such lessee, provided that . . . Grantor . . . shall

> be entitled to receive from Grantee . . . and from any one else producing any oil, gas or other mineral, a free one-eighth (1/8) of gross production of any such oil, gas or other mineral said amount to be delivered to Grantor's credit, free of cost in the pipe line, if any, otherwise free of cost at the mouth of the well or mine . . . .

In 2004, BlueStone's predecessors leased the tract's minerals, and numerous producing wells were drilled. As a functional matter, after gas is produced from these wells, it enters a gathering system ultimately owned by Crestwood Equity Partners, LP.[1] Crestwood gathers and processes the gas and then delivers it to a larger transportation pipeline system owned by Energy Transfer LP. The gas is then sold at various delivery points along Energy Transfer's system. Both Crestwood and Energy Transfer charge BlueStone for their services.[2]

In April 2016, BlueStone became the operator of the producing gas wells located on the subject tract, having acquired them from Quicksilver Resources, Inc. Unlike its predecessor Quicksilver, BlueStone interpreted the NPRI to be a standard NPRI that was free of the costs of production but subject to postproduction costs. Accordingly, BlueStone computed and paid royalties to Engler based on the value of gas produced, calculated at the point at which the gas entered the pipeline attached to

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[1]In its brief, and in its brief in support of its summary judgment motion in the trial court, Engler states that the parties to this litigation also refer to Crestwood as "CowTown Partners."

[2]Neither Energy Transfer nor any of its subsidiaries or affiliates is affiliated with BlueStone or any of its subsidiaries or affiliates. Likewise, neither Crestwood nor any of its subsidiaries or affiliates is affiliated with BlueStone or any of BlueStone's subsidiaries or affiliates.

the wells rather than at the point of sale, and it deducted postproduction costs related to delivery of the gas to market. The postproduction costs BlueStone deducted from Engler's royalties fell into four general categories: transportation, gathering and compression, regulatory fees, and severance taxes.

After discovering that BlueStone was deducting these postproduction costs from the value of its royalty interest, Engler filed suit claiming common-law theories of conversion and money had and received. Later, after months of discovery, Engler and BlueStone stipulated to the amounts deducted, concluded that there were no material facts in dispute, and filed cross-motions for traditional summary judgment based on the language from the 1986 Deed.

In its summary judgment motion, BlueStone argued that the language in the 1986 Deed established a standard NPRI and that Engler's royalty interest is subject to the general rule that royalty interests bear postproduction costs. Engler, through its summary judgment motion, argued that its reserved royalty is explicitly "cost free" and that BlueStone's deducting of postproduction costs from its royalties is inconsistent with the terms of the 1986 Deed. In its response to BlueStone's motion, Engler appeared to raise an alternative argument that, at the very least, the language in the 1986 Deed prohibited BlueStone from deducting gathering and compression costs while gas was in the gathering system and that Engler should bear no postproduction costs until the gas is delivered into one of two major transporting pipelines—the Cross-Tex North Texas Pipeline and the Energy Transfer Paris Loop Pipeline.

The trial court denied BlueStone's motion and granted Engler's. In its order granting Engler's motion, the court found that BlueStone should not have deducted at least some of its postproduction costs but reserved the issue of the "calculation of [the] proper post-production costs [for] a separate proceeding."

A few days after the trial court ruled on the summary judgment motions, the Supreme Court of Texas issued its opinion in *Burlington Resources Oil & Gas Co. LP v. Texas Crude Energy, LLC*, 573 S.W.3d 198 (Tex. 2019). In its opinion, the court addressed language similar to language in the 1986 Deed, construing the meaning of language that a royalty interest shall be delivered "into the pipelines, tanks, or other receptacles with which the wells may be connected" as being tantamount to phrases such as "at the well" or "at the wellhead," and that such phrases establish a valuation point that generally requires a royalty interest to bear postproduction costs. *Id.* at 211.

BlueStone then moved that the trial court reconsider its summary judgment orders in light of *Burlington Resources*. On May 24, 2019, the trial court held a hearing on both BlueStone's reconsideration motion and the issue of which postproduction costs were properly charged against Engler's interest. On May 31, 2019, the trial court signed an order denying BlueStone's reconsideration motion and found that Engler's royalty interest was "free of all post-production costs besides severance taxes, regulatory fees, and transportation costs." Specifically, the trial court rendered judgment in the amount of $88,849.33 for liability that accrued on or before March 31, 2019, representing the sum of the gathering and compression costs charged

through that date. In short, the trial court found that BlueStone's only improper deduction was gathering and compression costs.[3] Later, the trial court severed the liability through March 31, 2019, from liability accruing after that date in a separate order, and then, on June 26, 2019, modified the severance order clarifying that its May 31 severance order had created a final judgment in a new, severed cause, disposing of all liability that had accrued on or before March 31, 2019. BlueStone now appeals the trial court's rulings on both summary judgment motions. Engler has not appealed the district court's finding that severance taxes, regulatory fees, and transfer costs are to be deducted from its royalty interest.

## III. Discussion

In one issue, BlueStone challenges the trial court's granting of Engler's summary judgment motion. Specifically, BlueStone argues that the trial court erred by finding that Engler's royalty interest is free of the postproduction cost of gathering and compressing the gas from the wells on the subject tract. Both parties to this appeal agree that the language in the 1986 Deed reserving Engler's royalty interest is unambiguous. But the parties take contrasting positions as to what the language from the 1986 Deed specifically reserved. BlueStone's position is that the general rule

[3]Engler's alternative argument in its response to BlueStone's motion for summary judgment seems to be the basis for the trial court's finding that Engler's royalty interest was free of gathering and compression costs but not free of severance taxes, regulatory fees, and transportation costs, all of which are traditionally considered postproduction costs. *Heritage Res., Inc. v. NationsBank*, 939 S.W.2d 118, 121 (Tex. 1996).

regarding an oil and gas royalty valuation applies and that Engler's royalty interest thus bears postproduction costs. Engler argues that the parties used language in the 1986 Deed that conveyed a royalty interest free of postproduction costs. We agree with BlueStone.

**A. Standard of Review**

We review a summary judgment de novo. *Travelers Ins. Co. v. Joachim*, 315 S.W.3d 860, 862 (Tex. 2010). When both parties move for summary judgment and the trial court grants one motion and denies the other, the reviewing court should review both parties' summary judgment evidence and determine all questions presented. *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 289 S.W.3d 844, 848 (Tex. 2009). We should then render the judgment that the trial court should have rendered. *See Myrad Props., Inc. v. LaSalle Bank Nat'l Ass'n*, 300 S.W.3d 746, 753 (Tex. 2009); *Mann Frankfort*, 289 S.W.3d at 848.

**B. Interpreting Oil and Gas Royalty Provisions**

The rules of contract construction apply to an instrument conveying or reserving a mineral interest, regardless of whether the instrument is a deed or a lease. *See ConocoPhillips Co. v. Koopmann*, 547 S.W.3d 858, 874 (Tex. 2018); *Tittizer v. Union Gas Corp.*, 171 S.W.3d 857, 860 (Tex. 2005). An oil and gas lease is a contract, and its terms are interpreted as such. *Tittizer*, 171 S.W.3d at 860. In construing an unambiguous contract, we seek to enforce the intention of the parties as it is expressed in the lease. *Koopmann*, 547 S.W.3d at 874. We give terms their plain,

ordinary, and generally accepted meanings unless the instrument shows that the parties used them in a technical or different sense. *Id.* (citing *Heritage Res.*, 939 S.W.2d at 121).

We examine the entire writing and attempt to harmonize all its parts, even if different parts appear contradictory or inconsistent. *Anadarko Petroleum Corp. v. Thompson*, 94 S.W.3d 550, 554 (Tex. 2002) (citing *Luckel v. White*, 819 S.W.2d 459, 461 (Tex. 1991)). A court examines all of the writing's provisions "because we presume that the parties to a lease intend every clause to have some effect." *Id.* (citing *Heritage Res.*, 939 S.W.2d at 121). And we cannot change the contract merely because we or one of the parties comes to dislike its provisions or thinks that something else is needed in it. *Arlington Surgicare Partners, Ltd. v. CFL Invs., LLC*, No. 02-15-00090-CV, 2015 WL 5766928, at *2 (Tex. App.—Fort Worth Oct. 1, 2015, no pet.) (mem. op.) (citing *Cross Timbers Oil Co. v. Exxon Corp.*, 22 S.W.3d 24, 26 (Tex. App.—Amarillo 2000, no pet.)).

**C. Royalty Provisions and the Allocation of Postproduction Costs**

A frequent source of conflict between lessors and lessees (or in this case between grantor and grantee) regarding royalty provisions is which party bears the costs of processing minerals once they are extracted from the ground. *BlueStone Nat. Res. II, LLC v. Randle*, No. 02-18-00271-CV, 2019 WL 1716415, at *3 (Tex. App.—Fort Worth Apr. 18, 2019, pet. granted) (mem. op.). That is, which party will bear postproduction costs? *Id.* At its most elementary level, a royalty is the landowner's

share of production from a lease. *See U.S. Shale Energy II, LLC v. Laborde Props., L.P.*, 551 S.W.3d 148, 154 (Tex. 2018). A non-participating royalty interest is a royalty interest that does not include the right to lease the mineral estate, receive delay rentals, or bonus payments. *Hysaw v. Dawkins*, 483 S.W.3d 1, 9 (Tex. 2016).

There are costs both for bringing the minerals, such as oil and gas, to the surface and for processing those minerals once they are brought out of the ground. *Randle*, 2019 WL 1716415, at *3. Under Texas law, a royalty is free of the expenses of production—the expenses of bringing minerals to the surface. *Chesapeake Expl., LLC v. Hyder*, 483 S.W.3d 870, 872 (Tex. 2016) (op. on reh'g) (citing *Heritage Res.*, 939 S.W.2d at 121–22). But once the minerals reach the surface, the "royalty is usually subject to post-production costs, including taxes, treatment costs to render it marketable, and transportation costs." *Heritage Res.*, 939 S.W.2d at 122. As with any contract, the parties may modify the general rule that the lessor bears the postproduction costs. *Hyder*, 483 S.W.3d at 872; *Heritage Res.*, 939 S.W.2d at 122.

### D. The Royalty Provision and *Burlington Resources*

Citing *Burlington Resources*, BlueStone argues, as it did in the trial court, that the 1986 Deed establishes a valuation of Engler's royalty interest burdened with postproduction costs. 573 S.W.3d at 211. At issue in *Burlington Resources* was the question of where the valuation of the lessor's royalty occurred and whether the language of the lease involved conveyed a royalty burdened with postproduction

costs. *Id.* at 202. The language contained in the lease at question in *Burlington Resources* stated:

> The overriding royalty interest share of production shall be delivered to ASSIGNEE or to its credit into the pipeline, tank or other receptacle to which any well or wells on such lands may be connected, free and clear of all royalties and all other burdens and all costs and expenses except the taxes thereon . . . .

*Id.* at 201.

In determining the valuation point of the royalty provisions involved, the *Burlington Resources* court focused on the question of what "into the pipeline" means. *Id.* at 207. After analyzing multiple oil and gas treatises, the court concluded that the phrase "into the pipeline" was the equivalent of language that created a valuation point "at the wellhead or nearby." *Id.* at 211. The court further concluded that, like a valuation point at the wellhead or nearby, a valuation point defined as "into the pipeline" meant that the royalty interest was burdened with postproduction costs. *Id.* at 212.

Here, the 1986 Deed contains the valuation provision "a free one-eighth (1/8) of gross production of any such oil, gas or other mineral said amount to be delivered to Grantor's credit, free of cost *in the pipe line*, if any, otherwise free of cost at the mouth of the well or mine." (emphasis added). A strict application of the holding in *Burlington Resources* to the valuation provision in the 1986 Deed compels us to conclude that the valuation point of the royalty interest involved in this case is the

equivalent of a valuation point "at the wellhead" and, thus, Engler's royalty interest bears postproduction costs.

Engler argues that the *Burlington Resources* court did more than analyze the phrase "into the pipeline"; rather, Engler contends that the court analyzed the provision of "into the pipelines, tanks or other receptacles with which the wells may be connected" in its entirety. Engler asserts that in that case, it was the mineral lease's use of "into the pipelines, tanks or other receptacles with which the wells may be connected" that led the court to conclude that the lease set the valuation point at the wellhead. It contends that *Burlington Resources* did not hold that "in the pipeline" language, by itself, sets valuation at the wellhead. Engler then argues that the 1986 Deed's use of the phrases "free of cost in the pipe line" and "free of cost at the mouth of the well" are separated by the disjunctive term "otherwise" demonstrating that these phrases have distinctive and mutually exclusive meanings, "referring to two different places[] and two different products [oil versus gas]." Engler asserts that "free of cost at the mouth of the well" sets the valuation point for oil, that "free of cost in the pipe line" sets the valuation point for gas, and the fact that the 1986 Deed sets out two distinct valuation points indicates that the grantors intended the phrase "in the pipe line" to mean somewhere other than at the wellhead. Engler construes the 1986 Deed to express an intention by the drafters that "pipeline" means one of the two "major" pipelines that are far from the wellhead, and it contends that "pipeline" in the 1986 Deed cannot mean the gathering system connected at or near

the wellheads that ultimately connects to either of the two "major" pipelines. Engler cites no authority to support any of these propositions.

We reject Engler's attempted distinguishing of *Burlington Resources*. First, the *Burlington Resources* court did in fact focus heavily on the singular phrase "into the pipeline." *Id.* at 208–11. Indeed, the court consistently referred to the provision as the "'into the pipeline' provision" and equated it with a valuation point "at or near the well." *See id.* at 211 ("[A]s we conclude, these parties intended their 'into the pipeline' clauses to place the royalty valuation point at or near the well.").

Second, we reject Engler's suggestion that a gathering system is not a pipeline. As BlueStone points out, the Supreme Court of Texas has defined a gathering system as a pipeline. *See Bayou Pipeline Corp. v. R.R. Comm'n*, 568 S.W.2d 122, 124–26 (Tex. 1978) (holding that a gathering system was a pipeline subject to regulation by the Railroad Commission under the Cox Act and the Public Utilities Regulatory Act); *see also In re AIU Ins. Co.*, 148 S.W.3d 109, 111 (Tex. 2004) ("A few months after the policy issued, Dreyfus merged with American Exploration Company, which had wells and a *pipeline gathering system* in Hidalgo County.") (emphasis added). And numerous statutes refer to a gathering system as a pipeline. *See* Tex. Health & Safety Code Ann. § 756.121(3) ("'Pipeline facility' means a pipeline used to transmit or distribute natural gas or to gather or transmit oil, gas, or the products of oil or gas."); Tex. Nat. Res. Code Ann. § 111.084 ("The operation of gathering systems for crude petroleum by pipeline or by truck in connection with the purchase or purchase and sale of crude

petroleum is a business in the mode of the conduct of which the public is interested, and as such is subject to regulation by law."); Tex. Tax Code Ann. § 171.1012(k-2) ("This subsection applies only to a pipeline entity: (1) that owns or leases and operates the pipeline . . . and only to that portion of the product to which the entity does not own title; and (2) that is primarily engaged in gathering, storing, transporting, or processing crude oil, . . . natural gas, condensate, and natural gas liquids. . . ."); Tex. Util. Code Ann. § 121.451(3) ("'Low-pressure gathering system' means a pipeline that operates at a working pressure of less than 50 pounds per square inch."). We conclude that there is no support for Engler's position that a gathering system is not a pipeline.

Third, this court construes (as Engler does at times in its brief)[4] that the phrase "free of cost in the pipe line, if any, otherwise free of cost at the mouth of the well or mine" to mean that if there is a pipeline, then the valuation is made "in the pipe line," and if there is not (otherwise) a pipeline, then the valuation is made "at the mouth of the well or mine." And regardless of the grantor's unexpressed, subjective intent, the 1986 Deed's use of the phrase "in the pipe line" effectively sets the valuation point at the wellhead.

[4]Engler states in its brief that "[t]he subject royalty provision couldn't be clearer in stating that the reference to 'free of cost at the mouth of the well' only applies if there is no pipe line."

## E. The Royalty Provision and *Hyder*

Engler makes multiple arguments contending that this case is resolved by the Supreme Court of Texas decision in *Hyder* and that under the holding in that case Engler's royalty interest is free of postproduction costs. 483 S.W.3d at 872. Engler argues first that what it refers to as the "granting clause" in the 1986 Deed and the granting clause in *Hyder* are "all but identical." But in making this comparison, Engler fails to address the language involved in *Hyder* that is significantly different from the language found in the 1986 Deed.

In *Hyder*, the court was tasked with interpreting an overriding royalty provision that said that the grantor held "a perpetual, cost-free (except only its portion of production taxes) overriding royalty of five percent (5.0%) of gross production obtained." *Id.* The question that the *Hyder* court faced was whether this provision created a royalty interest free of postproduction costs. In concluding that the provision did create such a royalty interest, the court focused specifically on the parenthetical "(except only its portion of production taxes)." The court reasoned that although the use of the term "'cost-free' may simply emphasize that the overriding royalty is free of production costs," in the case of the *Hyder* provision, that could not be the case because "cost-free" had the parenthetical expressing a postproduction cost. *Id.* at 873. As the *Hyder* court stated, "The [parenthetical] exception for production taxes, which we have said are postproduction expenses, cuts against Chesapeake's argument. It would make no sense to state that the royalty is free of

production costs, except for postproduction taxes (no dogs allowed, except for cats)." *Id.* at 874. The 1986 Deed's granting language, on the other hand, has no "except for cats" exception language. In other words, unlike the granting provisions involved in *Hyder*, the granting clause in the 1986 Deed does not specifically except any postproduction costs. This leads us to Engler's next *Hyder* argument: that the 1986 Deed's "free one-eighth (1/8) of gross production" language makes the reserved royalty interest free of postproduction costs. *Hyder* does not support this argument, however.

*Hyder* makes clear that "drafters frequently specify that an overriding royalty does not bear production costs [by expressing a "free" royalty] even though an overriding royalty is already *free* of production costs simply because it is a royalty interest." *Id.* (emphasis added). The *Hyder* court also stated that a number of lease provisions discussed in other cases support the view that the phrase "cost-free overriding royalty" is often a synonym for an overriding royalty burdened with postproduction costs. *See id.* at 873 n.19 (listing cases where courts have interpreted "free of costs" in overriding royalty provisions as referring to production costs only). That is, *Hyder* recognizes that language describing a "free" royalty generally creates a royalty free of production costs but burdened with postproduction costs. There is also textual support in the 1986 Deed demonstrating that "free" is referring to production costs. Indeed, the clause at question contains the word "free" three times. The third time, the clause states "otherwise free of cost at the mouth of the well or

mine." Engler does not argue, nor would it comport with the discussion in *Hyder* and other cases regarding the use of terms like "free," "cost-free," and "free of cost," that the use of the term "free of cost" in relation to a valuation at "the mouth of the well or mine" means that minerals taken from the mouth of the well are not subject to the general rule that royalties are burdened with postproduction costs. *See id.* The very text that Engler points this court to supports that "free" and "free of costs" refer to production costs. We conclude that the use of the term "free" utilized in the 1986 Deed is a reference to the free-from-production-cost nature of a standard oil and gas royalty.

**F. Engler's Remaining Contention**

In its brief, Engler seems to make one more argument as to why the 1986 Deed establishes a royalty interest free of postproduction costs—it asserts that the grantors who conveyed the land to the grantees in this case "would have no motivation to burden their royalty with post-production costs." But the same argument can easily be made about the grantees—the grantees would have no motivation to burden their interest with postproduction costs especially given that the default rule in Texas is that a grantor's royalty interest bears them. Further, as a reviewing court, we are not to look to the drafters' subjective intent to construe the express language. *See Nat'l Union Fire Ins., Co. v. CBI Indus., Inc.*, 907 S.W.2d 517, 521–22 (Tex. 1995) (excluding extrinsic evidence that would show the parties' subjective intent to contradict express contract language). As discussed above, we conclude that the express terms of the

1986 Deed create a standard royalty burdened with postproduction costs consistent with the holding in *Burlington Resources*.

We hold that the royalty provisions contained in the 1986 Deed create a traditional royalty interest that is burdened by postproduction costs. We therefore reverse the trial court's order granting Engler's summary judgment motion. Thus, we render judgment, consistent with BlueStone's summary judgment motion, that Engler's causes are dismissed and Engler is not entitled to the relief it sought in the trial court.

## IV. CONCLUSION

Having held that the trial court erred by granting Engler's summary judgment motion and by denying BlueStone's summary judgment motion, we reverse the trial court's orders granting Engler's motion and denying BlueStone's, and we render judgment in favor of BlueStone.

/s/ Dana Womack

Dana Womack
Justice

Delivered: July 9, 2020