

Supreme Court Reverses El Paso Court, Concludes that Production Payments Cannot Outlive Leases

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On Friday, the Texas Supreme Court ruled that production payments, like overriding royalty payments, cannot survive the termination of their respective oil and gas leases. In doing so, the Supreme Court stamped out a potentially “backwards” line of authority that we discussed in [our post from September](#).

It's important to quickly review the lifespan of the production payments at issue. In 1953, McDaniel Partners' predecessor in interest assigned a group of leases – the Cowden, Broudy and Peterman leases to Apache's predecessor.

As part of the assignment, production payments were reserved on all three leases in favor of McDaniel Partners' predecessor. The Cowden lease terminated long ago, but the Broudy and Peterman leases continued in existence.

On appeal, McDaniel Partners argued that the production payments should have continued to be paid related to Cowden lease, even though the lease had long-since terminated. This, they argued, was because the original production payment amount was derived from a cumulative working interest in *all* of the leases then active at the time the production payment was created (including the Cowden lease).

Note: Absent the production payment formula including a cumulative working interest implicating the Cowden leases, there was *no express language* in the assignment that stated the production payments would survive the termination of that lease.

The Supreme Court disagreed with the El Paso Court of Appeals and handed down an opinion consistent with prevailing oil and gas authorities. In reversing, the Court said:

Absent express language in the assignment to the contrary, we apply the general rule that **‘when an oil and gas lease terminates, the overriding royalty [or similar production payment] created in an assignment of the lease is likewise extinguished.**

Note, the Court's insertion of “[or similar production payment]” was in the original, and so the decision leaves no wiggle room with respect to the narrow distinction between production payments and overriding royalties. In this application, the Court viewed both production payments and overriding royalties as the same – neither can outlive their respective leases without express language to the contrary.

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