Fasken Oil: Another Look at In-Kind Royalty Clauses

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On March 3, 2026, the Texas Supreme Court released its opinion in *Fasken Oil & Ranch, Ltd. v. Puig*. In recent years, the Texas Supreme Court has seemingly issued at least one royalty opinion every term. *Fasken Oil* is the latest in that line of royalty opinions.

The dispute in Fasken Oil arose from a mineral deed in which the Puig grantors reserved a nonparticipating royalty interest of "an undivided one-sixteenth of the oil, gas and other minerals … in, to, and under or that may be produced from [the property] … *free of cost forever."*

The owner of the mineral estate, *Fasken Oil*, operated several oil and gas wells on the property. After producing minerals from the wells, Fasken Oil transported, treated, and processed the minerals, and then it sold *all* of the minerals — including the Puigs' 1/16th share of the minerals — to a third-party purchaser at a downstream location.

Fasken Oil paid the Puigs on a net proceeds basis. More specifically, Fasken Oil calculated its royalty payments to the Puigs as follows: it paid the Puig grantors 1/16th of the downstream sales price for Fasken Oil's production *minus* the Puig grantors' 1/16th share of "the costs incurred between the wellhead and the point of sale."

The Puigs protested that the term "free of cost" in their mineral deed meant that they were entitled to receive their royalty payments on a gross proceeds basis. They argued that they were entitled to receive 1/16th of the gross proceeds that Fasken Oil received on the sales of its mineral production from the property, *not* 1/16th of the net proceeds.

The Puigs' argument required the Texas Supreme Court to navigate the contours of several of its recent royalty opinions.

The royalty clause in the Puigs' mineral deed was an in-kind royalty clause: it expressly reserved to the Puigs 1/16th of the mineral production *in-kind*. Thus, for every unit of minerals that Fasken Oil produced from the mineral estate, 1/16th of that production belonged to the Puigs.

As the owners of 1/16th of Fasken Oil's production, the Puigs had the right to take physical possession of their royalty share of the production. And if they had taken physical possession of any of the production, the Puigs could then have sold their share of the production — on their own terms — to a third-party purchaser.

Most royalty owners, especially nonparticipating royalty interest owners, have no practical ability either to take physical possession of any oil and gas production or to market their royalty share of the production. In that event, a producer may sell the royalty owner's share of the production on the royalty owner's behalf. Fasken Oil did so. It sold the Puigs' 1/16th share of the production along with the remainder of its production.

Two of the supreme court's recent royalty cases, *Nettye* and *Myers-Woodward*, suggest that if a producer sells the royalty owner's share of the production under an in-kind royalty clause, the producer must pay the royalty owner on a net proceeds basis — *i.e.,* it must pay the royalty owner for the royalty owner's share of the *net* sales proceeds. As, indeed, Fasken Oil did.

Yet, the Texas Supreme Court in another of its royalty cases, *Hyder*, has previously commented that the term "cost-free" in a royalty clause "clearly frees the … royalty" of the burden of any "postproduction costs" and therefore contemplates that the royalty owner will receive payment on a *gross* proceeds basis.

Not surprisingly, the Puigs relied heavily on *Hyder* to argue that they were entitled to 1/16th of the gross proceeds from Fasken Oil's downstream sales. The supreme court in *Fasken Oil,* however, concluded that Fasken Oil properly paid the Puigs on a net proceeds basis rather than a gross proceeds basis. Distinguishing *Hyder,* the supreme court ruled that under the terms of the Puigs' mineral deed, the term "free of costs" meant only that the Puigs' royalty interest was free of production costs:

> We hold that the "free of cost forever" language refers to raw minerals produced at the wellhead, not to processed minerals sold downstream. Thus, it does not preclude deduction of postproduction costs from a downstream sales price to arrive at the market value of raw minerals produced at the wellhead.

Fasken Oil may have the effect — intended or unintended — of limiting the "cost-free" discussion in *Hyder* to its specific facts.

Even so, the result in *Fasken Oil* is reasonable and fair. If an in-kind royalty owner takes physical possession of its royalty share of the production, it must itself bear the post-production costs necessary to prepare the production for sale in a downstream market. The same should be no less true when the producer markets and sells the royalty owner's share of the production: the royalty owner should bear its proportional share of the post-production costs necessary to prepare the production for sale.

At the same time, *Fasken Oil* reinforces what the Texas Supreme Court has frequently recognized in its royalty opinions: the specific terms of the parties' agreements will control the outcome in any royalty litigation, and the parties are free to agree on terms that may deviate from the general rule or practice.

Especially after *Fasken Oil*, prudent producers may want to enter into separate purchase agreements with any in-kind royalty owners. Under such agreements, producers could purchase an in-kind royalty owner's share of the production *at the wellhead*, specifying that the price they will pay for the royalty owner's share of the production will be the *net proceeds* that they receive for that share of the production on selling it — *i.e.*, the price that the purchasers receive for the royalty owner's share of the production minus the royalty owner's share of the purchasers' post-production costs.

The advantage of such separate purchase agreements is that they could more plainly spell out the parties' respective rights. One of the key lessons in *Fasken Oil*, as in all of the Texas Supreme Court's royalty opinions, is that producers and royalty owners should strive to ensure that their royalty agreements plainly say exactly what they intend for them to mean.

This Alert was prepared by Byron Keeling, a member of GableGotwals' Energy, Oil & Gas Team in the Firm's Houston office. For questions about this decision or related oil and gas matters, please contact Byron or another member of the team.

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