

Most Favored Nations Clause: Something to Consider

Recently, the San Antonio Court of Appeals rendered an opinion in *BP America Production Company v. Zaffirini*, addressing the interpretation of a “most favored nations” clause of an oil and gas lease. Landowners negotiating oil and gas leases should be aware of most favored nations clauses and may want to consider requesting them in mineral lease agreements.

What is a “most favored nations” clause?

According to Black’s Law Dictionary, a most favored nations clause is defined as “a clause in an agreement between two nations providing that each will treat the other as well as it treats any other nation that is given preferential treatment.” These types of clauses have been used in various types of contracts, including those in the oil and gas industry. Essentially, the clause ensures that a mineral lessor will receive equal treatment to other lessors entering into similar lease agreements with the same lessee. Generally, these clause provide that if the lessee enters into a lease with another party within a certain timeframe and a specified distance or tract, and the new lease contains more favorable terms than the first lease, those terms will also be granted to the first lessor.

Here is an example of one way a most favored nations clause might read:

If at any time or times prior to a well being completed on the leased premises, or prior to a well being completed in any pooled or unitized units in which the leased premises are included, Lessee or its assigns shall obtain a lease from or make a contract with a mineral owner under the leased premises other than Lessor, then Lessor shall be entitled to any benefits paid for, granted or reserved in such lease or contract which are greater or more favorable than those paid for, granted or reserved in this lease. Lessee shall pay Lessor immediately Lessor’s prorate share of such benefit, including without limitation, bonus, royalty, rental or shut-in payment or any other benefit more favorable to such mineral owner than the payment for or the benefits of this lease

The Case

In *Zaffirini*, BP entered into two separate leases to produce oil and gas from the same mineral estate of a 7,520 acre ranch in Webb County, Texas.

First, BP entered into a lease with Diana Solis (“Solis Lease”) for her 30% undivided mineral estate. The Solis Lease provided a \$1,300 bonus for Ms. Solis. It also contained a “most favored nations clause.” This required that if BP agreed to more favorable bonus or royalty terms with any other co-owner in the same mineral estate, that BP would pay Solis according to the more favorable terms.

Next, BP negotiated with several other lessors who were co-owners of the remaining 70% of the mineral rights on the ranch. Initially, BP offered the other lessors the same \$1300 per acre bonus as it had paid under the Solis lease. The other lessors countered requesting the \$1,300 per acre bonus plus a separate \$700 per acre consent-to-assignment fee. BP then proposed another counter offer of \$1,750 per acre. The parties entered into a lease ("Zaffirini Lease") which contained the following language: "...Part of the consideration herein paid by Lessee to Lessor for this lease agreement includes \$1,750 dollars per net mineral acre as paid up bonus...." The Zaffirini Lease also contained a most favored nations clause.

BP's Additional Payment to Solis

After BP entered into the Zaffirini Lease, it notified the parties to the Solis lease and paid an additional \$450 per acre bonus (equating to an additional payment of \$1,026,000) pursuant to the most favored nations clause. BP believed it was obligated to pay the extra bonus to Solis because it granted Zaffirini a more favorable bonus term than it had granted to Solis. After this payment was made, the parties to the Zaffirini Leasors demanded that BP pay them an additional \$450 per acre pursuant to their most favored nations clause. They based this argument on the claim t hat their bonus was only \$1,300 and the remaining \$450 paid to them by BP was a separate consent to assignment payment. BP refused to make the additional payment and sued the parties to the Zaffirini Lease, seeking a declaratory judgment as to BP's obligations under the Zaffirini Lease. BP argued that it did not owe any additional monies to the Zaffirini Lessors because the \$450 was a bonus, and alternatively, if the \$450 payment was not considered a bonus, that the Solis Lessors should be required to refund the additional payment made to them by BP. (Additional claims were added later both by BP and by the Plaintiffs, but that is beyond the scope of this article.)

The Trial Court Decision

In 2011, the trial court sided with the Zaffirini Lessors, finding that the \$450 per acre payment was not a bonus. Further, the court found that Solis was entitled under equity to retain the \$1,026,000 that BP voluntarily paid to her. Not surprisingly, BP appealed this decision.

The San Antonio Court of Appeals Decision

Last week, the San Antonio Court of Appeals reversed this portion of the trial court's judgment. The Court of Appeals found that the Zaffirini Lease was unambiguous and that the parties' intent as expressed in the lease was for the \$1,750 per acre payment to be a bonus. This was based on the lease language, the common understanding of the word "bonus" in the oil and gas context and the circumstances surrounding the lease agreement. The lease term specifically referred to the entire payment as a bonus, and despite the Lessors' attempt during negotiations to keep the two payments separate, BP consistently insisted on an all-inclusive bonus payment and rejected the separate payment language. Thus, BP did not breach its contract with the Zaffirini Lessors, and properly paid the Solis Lessees the additional bonus of \$450/acre.

What Can Be Learned?

The *Zaffirini* case provides useful information for landowners considering entering into a mineral lease.

First, it describes a most favored nations clause and outlines the benefit of including this type of clause in a lease. Landowners who are able to negotiate for these clauses in a lease ensure that other parties within a certain area and certain timeframe will not be able to lease their mineral rights for a higher price. If higher prices are later obtained, this results in a benefit for the original lessor. For the Solis Lessors, that benefit was over \$1 million. Lessors should at least be aware of these clauses and should seek counsel from an attorney as to whether inclusion of this type of clause would be beneficial in an oil and gas lease.

Second, the case highlights the importance of ensuring that lease language is extremely clear and specific. It was clear from the negotiations that the Zaffirini Lessors wanted to ensure that the bonus payment was limited to \$1,300 per acre—probably to ensure that the Solis Lessors did not receive additional monies. As drafted, however, the lease did not provide for separate terms and, regardless of the Zaffirini's desire for the payments to be considered separately, the court refused to interpret the unambiguous contract language otherwise. Parties to a lease must ensure that their intent is specifically spelled out in the lease language.