

**INTEREST DUE  
UNDER  
TEXAS OIL AND GAS LEASES**

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Paul Simpson, a partner in the law firm of McGinnis, Lochridge & Kilgore, L.L.P., has testified before committees of the Texas Senate and the Texas House of Representatives on oil and gas issues and proposed legislation that would affect the oil industry and mineral and royalty owners in Texas. He has spoken at legal seminars on oil and gas issues and other matters, including regular presentations of the Texas Land and Mineral Association.

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Texas law has long been a tangled web of confusion in what should be a simple matter: how much interest is owed to one who has been damaged. The Texas courts and legislature have altered and tailored rules governing interest in recent years in an attempt to untangle the web. While some simplification has resulted, serious confusion remains. See [Appendix C](#). In particular, the goal of simplifying the calculation of interest due injured parties has, of late, gained the upper hand over the competing goal of fully compensating injured parties for their injuries. This paper addresses some of the resulting complexity and unknowns as to when and how interest is determined.

Moreover, changes in the rules governing prejudgment interest intended to streamline awards in tort cases have been shoehorned into economic-loss contract disputes for which they are not suited, leading to results inappropriate in the contractual arena. The specific statute requiring interest on unpaid amounts due under Texas oil and gas leases attempts to ensure royalty owners and others receive their share of proceeds derived from oil and gas production. However, that statute leaves key issues undefined that remain unresolved by Texas courts.

**TEXAS NATURAL RESOURCES CODE INTEREST**

In 1983, the Texas Legislature first enacted a statute requiring interest on untimely payments of “proceeds derived from the sale of oil or gas production.” TEX. NAT. RES. CODE § 91.402(a), § 91.403, Acts 1983, 68<sup>th</sup> Leg., ch. 228, § 1, *amended by* Acts 1991, 72<sup>nd</sup> Leg., ch. 650, § 3. In adopting this new requirement, the Legislature sought to create some protection for royalty owners to ensure they were paid royalty on a timely basis. As the legislative history noted, there was “no specific law to protect royalty owners in Texas from intentional practices to delay their royalty checks. While it is generally accepted that a great deal of these delays stem from legitimate title problems, it is also recognized that some of these delays are intentional and should be addressed by the Legislature.” HOUSE COMM. ON ENERGY, BILL ANALYSIS, Tex. H.B. 1775, 68<sup>th</sup> Leg., R.S. (1983), cited in *Concord Oil Co. v. Pennzoil Exploration & Prod. Co.*, 966 S.W.2d 451, 461 (Tex. 1998).

However, the Natural Resources interest provisions impose payment requirements on the obligations of “payors” to remit sums to “payees” – not just royalty owners. TEX. NAT. RES. CODE §§ 91.402-404. The statute defines a “payee” as “any person or persons legally entitled to payment from the proceeds derived from the sale of oil or gas from an oil or gas well” located in Texas, and defines a “payor” to include “the party who undertakes to distribute oil and gas proceeds to the payee, whether as the purchaser of the production of oil or gas generating such proceeds or as operator of the well . . . .” *Id.*, § 91.401. The requirements of the statute extend to all payments for “proceeds derived from the sale of oil or gas production from an oil or gas well

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located in” Texas. *Id.*, § 91.402. Given the broad definitions of these terms, the statute extends to payments by operators or lessees to working interest owners, royalty owners, and overriding royalty owners. *See Concord*, 966 S.W.2d at 461; *Stable Energy, L.P. vs. Newberry*, 999 S.W.2d 538, 554 (Tex. App.—Austin 1999, writ denied).

The statute mandates payment to payees on or before 120 days after the end of the month of first sale of production from the well. TEX. NAT. RES. CODE § 91.402(a). Thereafter, the statute requires proceeds be paid within 60 days after the end of the month oil is produced, or 90 days after the end of the month of production for gas. *Id.*, § 91.402(a)(1)-(2). The statute allows payment to be withheld beyond these time limits if there is dispute concerning title that would affect the distribution of payments; if there is a reasonable doubt that the payee has sold or authorized the sale of its share of the production to the purchaser; if there is a reasonable doubt that the payee has clear title to the claimed interest in the proceeds; or if there is a requirement in a title opinion that places a title, identity, or whereabouts of the payee in question that has not been satisfied by the payee after reasonable request. *Id.*, § 91.402(b). Except in these circumstances, the statute requires payment of interest on proceeds due if payment is not made within the specified time limits, beginning with the expiration of those time limits. *Id.*, § 91.403. To compel recovery of the Natural Resources Code interest, the royalty owner (or other payee) must give written notice by mail of the claim at least 30 days before filing suit. *Id.*, § 91.404.<sup>2</sup>

Unless there is a written agreement between the payor and the payee specifying a different rate of interest, the statute specifies the applicable rate. Beginning in 1983, the applicable rate was the “percentage rate on loans to depository institutions by the New York Federal Reserve Bank.” Acts 1983, 68<sup>th</sup> Leg., ch. 228, § 1 (amended 1991). This specified percentage rate is more commonly known as the “discount rate” or “window rate” charged by the New York Federal Reserve Bank. *See Appendix A*. In 1991, the Legislature amended the Natural Resources Code to increase the applicable percentage rate on untimely payments, increasing it to 2 percentage points above the discount rate. TEX. NAT. RES. CODE § 91.403(a) comment (Vernon 2001). The applicable interest rates from September 1983 to the writing of this paper are depicted in [Appendix B](#).

The Natural Resources Code provision specifying interest due (hereinafter the “interest statute”) is not a model of clarity. TEX. NAT. RES. CODE § 91.403. For instance, it requires interest be paid if “payment” is not made within the prescribed time limits. *Id.*, § 91.403(a). However, it does not specify the “payment” at issue, although it presumably means the payment of “proceeds derived from the sale of oil or gas production” specified elsewhere in the statute. *See id.*, § 91.402(a). More importantly, the statute does not state if the mandated interest is to be computed as simple or compounded interest. The statute also does not specify if the interest rate

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<sup>2</sup> After requiring written notice as a prerequisite for filing suit, the statute says the payee “has a cause of action for nonpayment of oil or gas proceeds or interest on those proceeds” in “any court of competent jurisdiction in the county in which the oil or gas well is located.” TEX. NAT. RES. CODE § 91.404(c). Nevertheless, it has been held that this purported “mandatory venue provision ... does not prohibit a lessee from bringing a declaratory judgment action to determine the computation of royalties” in a county **other than** the location of the well. *Yzaguirre v. KCS Resources, Inc.*, 47 S.W.3d 532, 545 (Tex. App.—Dallas 2000), *aff’d*, 53 S.W.3d 368 (Tex. 2001). The non-mandatory aspect of this “mandatory” venue provision, coupled with the required pre-lawsuit notice, may explain the dearth of case law construing the Natural Resources Code interest provision.

in effect when the payment is due is to be applied until it is paid, or if the applicable interest is to fluctuate over time with the specified window rate.

Since the statute was passed in 1983, **no reported case** has discussed how to calculate interest called for by those Natural Resources Code provisions. Only four reported cases have even held that interest under the statute was or might be proper. See *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 647-48 (Tex. App.—Austin 2000, pet. denied); *Stable Energy, LP v. Newberry*, 999 S.W.2d 538, 553-54 (Tex. App.—Austin 1999, pet. denied); *Bright & Co. v. Holbein Family Mineral Trust*, 995 S.W.2d 742, 748 (Tex. App.—San Antonio 1999, pet. denied); and *Northern Natural Gas Co. v. Vanderburg*, 785 S.W.2d 415, 420 (Tex. App.—Amarillo 1990, no writ).

The other reported cases that have addressed the interest statute held it did not apply, either for procedural reasons or because there was a bona fide dispute over title that obviated the interest requirements imposed by the statute. See *Concord Oil Co. v. Pennzoil Exploration & Prod. Co.*, 966 S.W.2d 451, 462-63 (Tex. 1998) (dispute existed over title, so prejudgment interest not awarded); *Koch Oil Co. v. Wilber*, 895 S.W.2d 854, 865 (Tex. App.—Beaumont 1995, writ denied) (no interest due when lessors refused to sign division order); *Cirrus Prod. Co. v. Clajon Gas Co., LP*, 993 F.2d 1551 (10<sup>th</sup> Cir. 1993, unpublished opinion) (no interest awarded on judgment for unpaid amounts due under gas purchase contract because plaintiff made no claim for interest); *Hondo Oil & Gas Co. v. Texas Crude Operator, Inc.*, 970 F.2d 1433, 1439 (5<sup>th</sup> Cir. 1992) (no interest due on payments withheld due to “reasonable doubt” as to payee’s title); and *Edwin M. Jones Oil Co. v. Pend Oreille Oil & Gas Co.*, 794 S.W.2d 442, 450-51 (Tex. App.—Corpus Christi 1990, writ denied) (title was disputed, so no interest was due on unpaid amounts). Moreover, it is not possible to back-calculate just how interest was calculated in the few opinions that mention the relevant amounts awarded under the Natural Resources Code interest provisions. See *Bright v. Holbein*, 995 S.W.2d at 744 n. 3 and 746 (\$5,031 on actual damages of \$11,134 accrued from 1987 to 1995); *Northern Natural Gas Co. v. Vanderburg*, 785 S.W.2d at 418, 420 (10% compounded daily awarded under then-common law standard for amounts due beginning in August 1983 was proper, because the defendant “does not claim that the interest rate stated in the judgment fails to conform to the rate prescribed” by the Natural Resources Code although, as reflected in [Appendix B](#), 10% compounded exceeded the then-applicable Natural Resources Code rate).

Finally, in the one case directly confronted with the question of how to calculate interest under the Texas Natural Resources Code, the court sidestepped the issue in remanding the dispute for a new trial on damages. The court noted, “We will withhold comment on the appropriate manner of calculating prejudgment interest . . .” because the “nature of the underlying dispute” would determine which interest rate standard would apply, and the nature of that dispute might change on remand. *Browning Oil*, 38 S.W.3d at 648.<sup>3</sup> The Supreme Court

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<sup>3</sup> *Browning* identified two alternative possible prejudgment interest standards – “general principles of equity” or “section 301.002 of the Texas Finance Code” – and cited *Johnson & Higgins of Texas, Inc. v. Kenneco Energy, Inc.*, 962 S.W.2d 507, 530 (Tex. 1998) and *Southeastern Pipe Line Co. v. Tichacek*, 977 S.W.2d 393, 399 (Tex. App.—Corpus Christi 1998), *rev’d in part on other grounds*, 997 S.W.2d 166, 170 (Tex. 1999). *Browning*, 38 S.W.3d at 648. *Kenneco* involved computation of equitable prejudgment interest under common law, and *Tichacek* disallowed pre-*Kenneco* equitable prejudgment interest on damages for a lessee’s failure to protect against drainage. However, §301.002 of the Texas Finance Code does not specify prejudgment interest. Therefore, it is not apparent what the

recently denied the petition for review in *Browning* (45 Tex. Sup. Ct. J. 367 (February , 2002)), so calculation of interest under the Natural Resources Code could be addressed after remand.

Therefore, there is presently no definitive answer (“controlling legal authority”) as to how to calculate interest under the Natural Resources Code interest provisions. It may well be that, as in the case of a prior interest statute, courts will apply simple interest in the absence of a legislative directive to compound interest. *See, e.g., Phillips Petroleum Co. v. Stahl Petroleum Co.*, 569 S.W.2d 480, 488 (Tex. 1978); Pemberton, *A Guide to Recent Changes and New Challenges in Texas Prejudgment Interest Law*, 30 TEX. TECH L. REV. 71, 79 (1999). In addition, there is no authority as to whether the Natural Resources Code requirements impose a fixed interest rate until the unpaid amount is due, or a rate that fluctuates with the discount rate. If the latter, the calculation required is considerably more complex, particularly if additional unpaid amounts accrue during the same period of time.

### CONTRACT DAMAGES

Protecting a contracting party’s bargained-for exchange is a fundamental function of contract law. A party is entitled to the results bargained for in a contract. Therefore, contract damages are measured by what the party would have received under the contractual arrangement. RESTATEMENT (SECOND) OF CONTRACTS § 347 (1979). This measure is intended to give the injured party the “benefit of the bargain” by putting him in “as good a position as he would have been in had the contract been performed. RESTATEMENT (SECOND) OF CONTRACTS § 344(a), § 347 cmt. (1979). *See also* 5 Corbin on Contracts § 992 (1964) (the aim of compensating for breach of contract is “to put the injured party in as good a position as he would have had if performance had been rendered as promised”).

Oil and gas leases normally contain a variety of express and implied covenants and obligations. *Amoco Prod. Co. v. Alexander*, 622 S.W.2d 563, 567-70 (Tex. 1981). Such obligations are contractual in nature, and their breach is a breach of contract. *Id.* at 571. Therefore, damages for breach of express and implied covenants and obligations of oil and gas leases are measured as contract damages.

The measure of damages for a breach of contract is what the injured party would have received if the other party had performed the contract. *See, e.g., Chicago Milwaukee & St. Paul Ry. Co. v. McCaull-Dinsmore Co.*, 253 U.S. 97, 100 (1920); *Turboff v. Gertner, Aron & Ledet Inv.*, 840 S.W.2d 603, 610 (Tex. App.—Corpus Christi 1992, writ dismissed); *R.G. McClung Cotton Co. v. Cotton Concentration Co.*, 479 S.W.2d 733, 738 (Tex. Civ. App.—Dallas 1972, writ refused n.r.e.); and *J.C. Engelman, Inc. v. Sanders Nursery Co.*, 140 S.W.2d 500, 508 (Tex. Civ. App.—El Paso 1940, writ refused). This measure of damages applies with equal force to breaches of oil and gas leases. The measure of damages owed the lessor for breach of an oil and gas lease is the amount of royalties the lessor would have received had the contract been performed. *See Guardian Trust Co. v. Brothers*, 59 S.W.2d 343, 345-46 (Tex. Civ. App.—Eastland 1933, writ refused) (to give the lessors the value of the contract’s performance, damages

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*Browning* court’s reference to the Texas Finance Code means, unless it assumed the Natural Resources Code rate would be incorporated by virtue of the Finance Code’s other provisions for prejudgment interest.

for failure to drill well required by lease were “measured by the value of their royalty” that was not paid: “We can see no just reason for departing from the well-established rule of law for measuring damages simply because the contract relates to the sinking of an oil well”); *Fain-McGaha Oil Corp. v. Owens*, 121 S.W.2d 982, 983 (Tex. 1938) (holding that *Guardian Trust*, which was “identical upon the facts,” properly stated the rule as to the measure of damages, and writ was refused in *Guardian Trust* “to set the question at rest”).

For example, damages for breach of the duty to protect a leasehold against drainage are measured by the royalty that would have been paid if a protection well had been drilled and produced. See *Southeastern Pipe Line Co. v. Tichacek*, 977 S.W.2d 393, 399 (Tex. App.—Corpus Christi 1998), *rev'd in part on other grounds*, 997 S.W.2d 166, 170 (Tex. 1999); *Freeport Sulphur Co. v. American Sulphur Royalty Co.*, 6 S.W.2d 1039, 1045 (Tex. 1928); *Texas Pacific Coal & Oil Co. v. Barker*, 6 S.W.2d 1031, 1037 (Tex. 1928); *Wes-Tex Land Co. v. Simmons*, 566 S.W.2d 719, 721, 722-23 (Tex. Civ. App.—Eastland 1978, writ *ref'd n.r.e.*); *Guardian Trust*, 59 S.W.2d at 345-46 (to give the lessors the value of the contract’s performance, damages for failure to drill well as required by lease were “measured by the value of their royalty” that was not paid). As in any contract, the goal of damages is to give the injured party the “benefit of the bargain” that was broken.

Logically, restoring the injured party to the position he would have been in had the contract been performed means giving that party the benefit of having received sums due, including interest beginning when the sums were due. In this manner, the party is compensated for the loss of use of the money due as damages from the time the injury occurred, until judgment. See Pemberton, *A Guide to Recent Changes and New Challenges in Texas Prejudgment Interest Law*, 30 TEX. TECH L. REV. 71, 132 and n. 427(1999). Fully compensating the injured party for loss of the value of the contractual bargain requires compensation for the lost principal (damages), as well as interest on the principal for the time the principal (damages) was withheld. However, the competing concern of furthering uniformity and simplicity in computing prejudgment interest has led Texas to a different result.

In contrast to this logical result, Texas now applies a statutory prejudgment interest standard devised for tort cases – simple interest, accruing only upon the earlier of written notice of a claim or filing of a lawsuit – to economic-loss contract disputes, regardless of when the breach occurred, despite the parties’ prior relationship, and irrespective of the actual quantifiable economic loss suffered by detention of the injured party’s money. In adopting this standard, Texas has created further inequity in its prejudgment interest law, while arguably defeating the Legislature’s goal of promoting prompt resolution of disputes. See, e.g., Pemberton, 30 TEX. TECH L. REV. at 132-35.

The Texas Natural Resources Code interest provision addresses only claims for non- or under-payment of royalty or other payments due on “proceeds derived from the sale of oil or gas production.” TEX. NAT. RES. CODE § 91.402(a). Other claims under typical oil and gas leases (e.g., for breach of implied covenants) are not within the scope of that statutory interest scheme. Hence, recovery of interest on sums owed must be based on some other grounds. The following sections summarize relevant standards in Texas for computing prejudgment interest in various types of cases.

## **I. CLAIMS ARISING UNDER A CONTRACT IN WHICH A RATE OF INTEREST IS SPECIFIED.**

The rate may be stated as a numerical percentage; however, the rate is sufficiently specified if it can be calculated from the terms stated in the agreement. TEX. FIN. CODE § 302.002; *see Community Savings & Loan Ass'n v. Fisher*, 409 S.W.2d 546, 550 (Tex. 1966) (if contract contains all essential terms and determining rate is merely matter of computation, contract sufficiently specifies rate of interest).

### **A. Rate Allowed.**

A person whose claim arises under a written contract that specifies a rate of interest is entitled to prejudgment interest at the rate specified, provided that the rate specified does not exceed the maximum lawful rate. TEX. FIN. CODE § 303.001(a); *e.g., Pegasus Energy Corp. v. Cheyenne Petroleum Co.*, 3 S.W.3d 112, 123-24 (Tex. App.—Corpus Christi 1999, pet. denied); *Texon Energy Corp. v. Dow Chemical Co.*, 733 S.W.2d 328, 331 (Tex. App. — Houston [14th Dist.] 1987, writ ref'd n.r.e.). The maximum lawful rate is two times the “auction rate,”<sup>4</sup> rounded to the nearest one-quarter of one percent, *id.* § 303.003(a), and is published in the Texas Register. *Id.* § 303/011. However, the maximum lawful rate is never less than 18% nor more than 24% per annum. *Id.* § 303.009(a), (b). The current rate ceiling is 18% per annum.

### **B. Time of Accrual.**

Prejudgment interest accrues in accordance with the terms of the contract. *Cook Composites, Inc. v. Westlake Styrene Corp.*, 15 S.W.3d 124, 141 (Tex. App.—Houston [1st Dist.] 2000, pet. dism'd).

### **C. Simple/Compound Interest.**

A prevailing claimant is entitled to simple or compound interest as specified in the contract. *Texon Energy Corp. v. Dow Chemical Co.*, 733 S.W.2d 328, 331 (Tex. App.—Houston [14th Dist.] 1987, writ ref'd n.r.e.).

## **II. CLAIMS ARISING UNDER A CONTRACT IN WHICH NO RATE OF INTEREST IS SPECIFIED.**

### **1. Rate Allowed.**

The law governing interest on claims in this category has been the subject of considerable confusion. Nevertheless, three principles emerge from the cases. First, interest, in the technical sense, may be awarded only if provided by statute. *Watkins v. Junker*, 40 S.W. 11 (1897); *Heidenheimer v. Ellis*, 3 S.W. 666 (1887). Second, where interest is not provided by statute, the equivalent of interest may be awarded, in equity, as damages. *Phillips Petroleum Co. v. Stahl Petroleum Co.*, 569 S.W.2d 480, 485-87 (Tex. 1978).

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<sup>4</sup> The “auction rate” is the “auction average rate quoted on a bank discount basis for 26 week treasury bills issued by the United States government, as published by the Federal Reserve Board, for the week preceding the week in which the weekly rate ceiling is to take effect.” TEX. FIN. CODE § 303.003(c). Monthly, quarterly and annualized ceilings are based on averages of the weekly ceilings. *Id.* §§ 303.005(b), 303.008(b).

By statutes in existence prior to 1997, prejudgment interest was allowed at the legal rate of 6% per annum only on contracts “ascertaining the sum payable.” *Stahl Petroleum*, 569 S.W.2d at 483; *Strata Energy, Inc. v. Gavenda*, 753 S.W.2d 789, 792 (Tex. App.—Houston [14th Dist.] 1988, no writ). Prior to the Texas Supreme Court’s decision in *Cavnar v. Quality Control Parking, Inc.*, 696 S.W.2d 549 (Tex. 1985), courts awarded prejudgment interest on claims under contracts that did not ascertain the sum payable at an equitable rate equal to the legal rate, *i.e.*, 6% per annum. *E.g.*, *Watkins v. Junker*, 90 Tex. 584, 588, 40 S.W. 11, 12 (1897). *Cavnar* threw into doubt the proper equitable prejudgment rate, an issue that was finally resolved in *Perry Roofing Co. v. Olcott*, 744 S.W.2d 929, 931 (Tex. 1988). After February 10, 1988 (the date of the *Perry Roofing* opinion), equitable interest on contracts not ascertaining the sum payable was allowed at a rate equal to the judgment rate, *i.e.*, a floating rate ranging between 10% and 20% per annum. TEX. FIN. CODE § 304.003(c) (formerly TEX. REV. CIV. STAT. ANN. art. 5069-1.05, § 2).

In its codification of the interest statute in the Texas Finance Code, the Legislature carried forward the allowance of 6% legal interest “on all accounts and contracts ascertaining the amount payable.” TEX. FIN. CODE § 302.002. However, in the same session, the Legislature also adopted an amendment to the prior legal interest statute (TEX. REV. CIV. STAT. ANN. art. 5069-1.03, repealed) which provides: “If a creditor has not agreed with an obligor to charge the obligor any interest, the creditors may charge and receive from the obligor legal interest at the rate of six percent a year on the principal amount of the credit extended beginning on the 30th day after the date on which the amount is due.” Act of June 20, 1997, 75 Leg., ch. 1396, § 1, eff. September 1, 1997, originally codified as TEX. REV. CIV. STAT. ANN. art. 5069-1C.002. In 1999, the Legislature amended section 302.002 to conform to the 1997 amendment in Chapter 1396. Act of May 10, 1999, 76th Leg., ch. 62, § 7.18(a), eff. September 1, 1999.

The first notable point about the current version of section 302.002 is the absence of any reference to an ascertainable amount or sum. The effect of the omission is unclear, however, because section 302.002 allows legal interest only to a “creditor” and “on the principal amount of the credit extended.” A “creditor” is “a person who loans money or otherwise extends credit.” TEX. FIN. CODE § 301.002(a)(3). It would appear, then, that section 302.002 might require an ascertainable amount, *i.e.*, the “credit extended,” after all. If this interpretation is correct, then the line of cases under the prior law may be of continued importance.

Alternatively, however, an argument can be made that an extension of credit need not be made in the form of a cash advance. That interpretation is supported by the definition of “creditor” as a person who “loans money *or otherwise extends credit.*” *Id.* (emphasis added). Under that interpretation, arguably, a creditor would be entitled to legal interest on any amount owed, regardless of whether the amount is ascertainable from the face of the contract. What is clear in any event is that some category of contract obligee is entitled to charge and receive legal interest at the rate of six percent per year.

The next question, then, is whether such a person is entitled (or limited) *prejudgment* interest at the legal rate. Under prior law, the answer was “yes.” If a creditor was entitled to legal interest under a contract in which no rate was agreed to, the creditor was also entitled (or limited) to prejudgment interest at the legal rate. Conversely, a creditor who did not qualify for the legal rate, was frequently awarded prejudgment interest at the higher equitable rate.

The answer is not clear under the current law. Section 302.002 authorizes a creditor to receive “legal interest,” which is defined as “interest charged or received in the absence of any agreement by an obligor to pay contract interest.” TEX. FIN. CODE § 301.002(a)(8). Significantly, however, legal interest “does not include judgment interest.” *Id.* There would be no difficulty if “judgment interest were defined as interest on a judgment, but it is not so limited. “Judgment interest” is defined as “interest on a money judgment, whether the interest accrues *before*, on, or after the date the judgment is rendered.” *Id.* § 301.002(a)(7) (emphasis added). That definition would seem to include prejudgment interest. If so, then legal interest does not include prejudgment interest and, arguably, a creditor entitled to legal interest at six percent per annum under section 302.002 outside of litigation (accruing from 30 days after the date of breach) would be limited to prejudgment interest at the common law equitable rate. *See, e.g., International Turbine Services, Inc. v. VASP Brazilian Airlines*, 278 F.3d 494 (5th Cir. 2002).

The Texas Supreme Court in 1998 determined that economic damages for breach of contract should (after eleven years) be subject to the 1987 “tort reform” statutory scheme for prejudgment interest, although that 1987 legislation had left undisturbed the 1985 pre-tort-reform *Cavnar* standard that, until 1998, had governed economic contract damages. *Johnson & Higgins of Texas, Inc. v. Kenneco Energy, Inc.*, 962 S.W.2d 507, 530-31 (Tex. 1998). Thus, for economic-loss-only claims under contracts not specifying interest (such as non-royalty claims of breach of typical oil and gas leases), prejudgment interest is to be computed in Texas as simple interest at the postjudgment rate (10%), accruing from the earlier of 180 days after the defendant receives written notice of the claim or the lawsuit is filed, whichever happens first. *Id.* at 531-32.

### **III. CLAIMS FOR WRONGFUL DEATH, PERSONAL INJURY AND PROPERTY DAMAGE.**

Prejudgment interest, if requested, is required pursuant to Texas statute on claims for wrongful death, personal injury, and property damage. TEX. FIN. CODE § 304.102; *Olympia Marble & Granite v. Mayes*, 17 S.W.3d 437, 441 (Tex. App.—Houston [1st Dist.] 2000, no pet.). It is clear that Section 304.102 does not apply to all torts. *E.g., Weldon v. Green*, 985 S.W.2d 170, 180 (Tex. App.—Corpus Christi 1998, pet. denied)(section does not apply to claims for fraud or breach of fiduciary duty). Property damage means damage to tangible property. *See Spangler v. Jones*, 861 S.W.2d 392, 398 (Tex App.—Dallas 1993, writ denied). Mere economic loss does not qualify as a personal injury, *Casteel v. Crown Life Ins. Co.*, 3 S.W.3d 582, 596 (Tex. App.—Austin 1997), *aff’d in part and rev’d in part on other grounds*, 22 S.W.3d 378 (Tex. 2000), or property damage. *Johnson & Higgins of Texas, Inc. v. Kenneco Energy, Inc.*, 962 S.W.2d 507, 530 (Tex. 1998).

#### **A. Rate Allowed.**

The prejudgment rate is equal to the rate on judgments. TEX. FIN. CODE § 304.103. The judgment rate is the “auction rate,” (*see supra* n.1) but never less than 10% or more than 20% per annum. TEX. FIN. CODE § 304.003(c).

#### **B. Time of Accrual.**

Prejudgment interest accrues on the amount of the judgment beginning on the earlier of the 180th day after the date the defendant receives written notice of the claim or the date the suit

is filed. TEX. FIN. CODE § 304.104; *Marathon Corp. v. Pritzner ex rel. Pritzner*, 55 S.W.3d 114, 146 (Tex. App.—Corpus Christi 2001, no pet. hist.). With certain exceptions for periods during which a settlement offer may be accepted, TEX. FIN. CODE § 304.105, and periods of delay, *id.* § 304.108, prejudgment interest accrues from the date of accrual until the day preceding the date of judgment. *Id.* § 304.104.

C. Simple/Compound Interest.

Prejudgment interest on claims for wrongful death, personal injury and property damage is calculated on a simple interest basis. TEX. FIN. CODE § 304.104.

**IV. CLAIMS FOR OTHER TORTS.**

Prejudgment interest is recoverable on tort claims other than claims for wrongful death, personal injury and property damage. Because those claims are not included in section 304.102, *see Johnson & Higgins of Texas, Inc. v. Kenneco Energy, Inc.*, 962 S.W. 507, 530 (Tex. 1998), or any other statute, prejudgment interest is recoverable only in equity. *See Cavnar v. Quality Control Parking, Inc.*, 696 S.W.2d 549, 554 (Tex. 1985); *see, e.g., Spangler v. Jones*, 861 S.W.2d 392, 398 (Tex. App.—Dallas 1993, writ denied) (breach of fiduciary duty).

A. Rate Allowed.

The prejudgment interest rate is equal to the rate on judgments. *Cavnar*, 696 S.W.2d at 554. The judgment rate is the “auction rate” (*see supra* n.1), but never less than 10% or more than 20% per annum. TEX. FIN. CODE § 304.003(c).

B. Time of Accrual.

Under *Cavnar*, prejudgment interest begins to accrue six months after the occurrence of the incident giving rise to the cause of action. 696 S.W.2d at 555. It is likely now, however, that equitable prejudgment interest begins to accrue 180 days after the date the defendant receives notice of the claim or suit is filed, whichever occurs first. *See Owens-Illinois, Inc. v. Estate of Burt*, 897 S.W.2d 765, 769 (Tex 1995); *Johnson & Higgins*, 962 S.W.2d at 531.

C. Simple/Compound Interest.

Prejudgment interest on tort claims other than wrongful death, personal injury and property damage is governed by the common law and is calculated on a simple interest basis. *Johnson & Higgins*, 962 S.W.2d at 532.

## Summary

The interest owed under a Texas oil and gas lease depends on the nature of the claim asserted, and the context in which the interest is computed.

Assuming the lease does not specify an interest rate, interest is due under the Texas Natural Resources Code on unpaid or underpaid royalties (and other payments due on the proceeds derived from the sale of production) beginning 120 days after the first month of production, and 60 days after the month oil is produced or 90 days after gas is produced. The applicable interest rate is the New York Federal Reserve “discount rate” or “window rate,” plus two percent. Such interest is probably to be calculated as simple interest, and presumably fluctuates with the specified rate (although the statute does not so specify and there is no authority interpreting the statute).

For other sums owed under a lease (if the lease does not specify a rate), interest due is computed at 6% simple per year.

After a lawsuit is filed, the interest that will be awarded on damages may differ. If the lease specifies an interest rate, that rate will be used to calculate prejudgment interest. If the lease does not specify a rate, prejudgment interest will be computed for unpaid or underpaid royalty (or other sums due from sales proceeds, under the Natural Resources Code interest provision) in accordance with the statute (just as before litigation). However, to recover the Natural Resources Code interest, the royalty owner (or other payee) must give written notice of the claim at least 30 days before filing suit.

For other sums due under the lease (e.g., damages for breach of covenants), and again assuming the lease does not specify any interest rate, the judgment will include prejudgment interest on the damages, computed as simple interest at the rate of 10% per year. However, such prejudgment interest begins to accrue only on the date the lawsuit is filed or 180 days after the defendant receives written notice of the claim, whichever is earlier.

The foregoing conclusions are summarized in tabular form in [Appendix C](#).

# APPENDIX A

## The Discount Window

(Reprinted from the New York Federal Reserve website at:  
<http://www.ny.frb.org/pihome/fedpoint/fed18.html>.)

- *At the discount window, the Federal Reserve lends funds to depository institutions.*
- *The Fed's lending programs include short-term adjustment credit, [seasonal credit](#), and extended credit for banks with longer-term credit needs.*
- *Changes in the discount rate, which the Fed charges on short-term adjustment credit, are regarded as an indicator of monetary policy.*

### **Discount Window Lending**

Through the discount window, Federal Reserve Banks lend funds to depository institutions. All depository institutions that maintain transaction accounts or nonpersonal time deposits subject to reserve requirements are entitled to borrow at the discount window. This includes commercial banks, thrift institutions, and United States branches and agencies of foreign banks. Prior to the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980, discount window borrowing generally had been restricted to commercial banks that were members of the Federal Reserve System.

Discount window loans are secured by collateral that exceeds the amount of the loans. In 1999, the Federal Reserve expanded the range of acceptable collateral to include such items as investment-grade certificates of deposit and AAA-rated commercial mortgage-backed securities. Previously, the range of acceptable collateral consisted of such items as U.S. Treasury securities, state and local government securities, collateralized mortgage obligations (AAA), consumer loans, commercial and agricultural loans, and certain mortgage notes on one-to-four-family residences.

To receive a discount window loan, a borrower must first fully use reasonably available alternative sources of funds, such as the federal funds market and loans from correspondent banks and other market sources. The latter include the credit programs that the Federal Home Loan Banks and the Central Liquidity Facility of the National Credit Union Administration provide for their members. Usually, relatively few depository institutions borrow at the discount window in any one week. Consequently, such lending provides only a small fraction of the banking system's total reserves.

The Fed does not loosen or tighten its discount window administration policies when it loosens or tightens monetary policy. In 1999, however, the Fed did liberalize its discount window policy in anticipation of possible Y2K-related liquidity strains in the economy. From October 1, 1999, through April 7, 2000, it established a special liquidity facility that borrowers could use without having to first seek credit elsewhere. Following the attacks on the Pentagon and World Trade Center in September 2001, the Fed again encouraged depository institutions needing liquidity to borrow from the discount window. Reserve Banks lent \$45.5 billion to depository institutions on September 12, 2001, the record for a single day.

The term "discount rate" usually is applied to the interest rate on adjustment credit, one of several forms of loans available from the Federal Reserve in its role as lender of last resort.

Adjustment credit consists of short-term (usually overnight or weekend) loans to depository institutions facing unexpected outflows of deposits or insufficient reserves in the money market. Two other types of credit that the Federal Reserve provides are extended credit and seasonal credit. The former consists of loans for periods longer than those permitted under adjustment credit. This form of credit is available to individual banks experiencing financial difficulty and to groups of institutions facing deposit outflows because of changes in the financial system, a natural disaster, or some other cause. A bank receiving extended credit must provide the Federal Reserve Bank with a business plan showing how it will solve the problem that necessitates its use of extended credit. The Fed monitors borrowing by undercapitalized institutions to insure compliance with the FDIC Improvement Act of 1991, which stipulates, for example, that the Fed may not lend to a critically undercapitalized institution for more than five days beyond the date on which it became critically undercapitalized without incurring a potential liability to the FDIC. The discount rate may be charged for the first 30 days of extended credit, but this time period can be adjusted at the discretion of the Reserve Banks. Thereafter, the Fed charges a rate that is linked to market interest rates and is at least a half percentage point higher than the discount rate. The Fed provides seasonal credit to small- and mid-sized depository institutions able to demonstrate a clear pattern of recurring intra-year fluctuations in funding needs. Major users of seasonal credit are banks in agricultural and seasonal resort communities. The interest rate on seasonal credit is based on the federal funds rate and the rate in the secondary market for 90-day certificates of deposit.

A Reserve Bank has the legal authority to advance credit to individuals, partnerships, and corporations that aren't depository institutions, after consultation with the Board of Governors of the Federal Reserve System. To do so, the Reserve Bank must first determine that credit isn't available from other sources and that failure to provide the credit would adversely affect the economy. This authority has not been used in more than 60 years.

### **The Discount Rate**

The discount rate is important for two reasons: (1) it affects the cost of reserves borrowed from the Federal Reserve and (2) changes in the rate can be interpreted as an indicator of monetary policy. Increases in the discount rate generally reflect the Federal Reserve's concern over inflationary pressures, while decreases often reflect a concern over economic weakness.

In recent years, however, the discount rate's importance as a tool of monetary policy has been limited, because banks have done little adjustment borrowing at the discount window. The Fed expresses its monetary policy goals mainly in terms of a target for the federal funds rate, the rate charged by banks on short-term loans of excess reserves to other banks. Fluctuations in the federal funds rate around its target level provide useful indications of the availability of bank reserves relative to the demand for them.

By law, the discount rate is set every two weeks by the directors of each Reserve Bank, subject to the approval of the Board of Governors. Discount window lending, open market operations, and reserve requirements are the three main monetary policy tools of the Federal Reserve System. Together, they influence the cost and availability of money and credit.

Usually the discount rate is lower than the federal funds rate. In October 2001, for example, the discount rate was 2.0 percent and the federal funds rate was 2.5 percent. However, the Fed does not allow banks to borrow at the discount window for profit. Thus, it monitors discount window and federal funds activity to make sure that banks are not borrowing from the Fed in order to lend at a higher rate in the private money markets.

The frequency of discount rate changes varies. For example, there was just one change in 1996, and none in 1997. However, from January to October 2001, when the Fed was concerned about signs of weakness in the economy, it lowered the discount rate ten times - from 6.0 to 2.0 percent.

Sometimes, changes in monetary policy are not accompanied by changes in the discount rate. For example, the Fed left the discount rate unchanged when it lowered short-term rates in September 1998 and when it raised them in June 1999.

		<u>Discount Rate (%)</u>	<u>Federal Funds Rates (%)</u>
January	1996	5.00	5.25
March	1997		5.50
September	1998		5.25
October	1998	4.75	5.00
November	1998	4.50	4.75
June	1999		5.00
August	1999	4.75	5.25
November	1999	5.00	5.50
February	2000	5.25	5.75
March	2000	5.50	6.00
May	2000	6.00	6.50
January 3,	2001	5.75	6.00
January 4,	2001	5.50	
January 31,	2001	5.00	5.50
March	2001	4.50	5.00
April	2001	4.00	4.50
May	2001	3.50	4.00

**(Reprinted from the New York Federal Reserve website at:  
<http://www.ny.frb.org/pihome/fedpoint/fed18.html>.)**

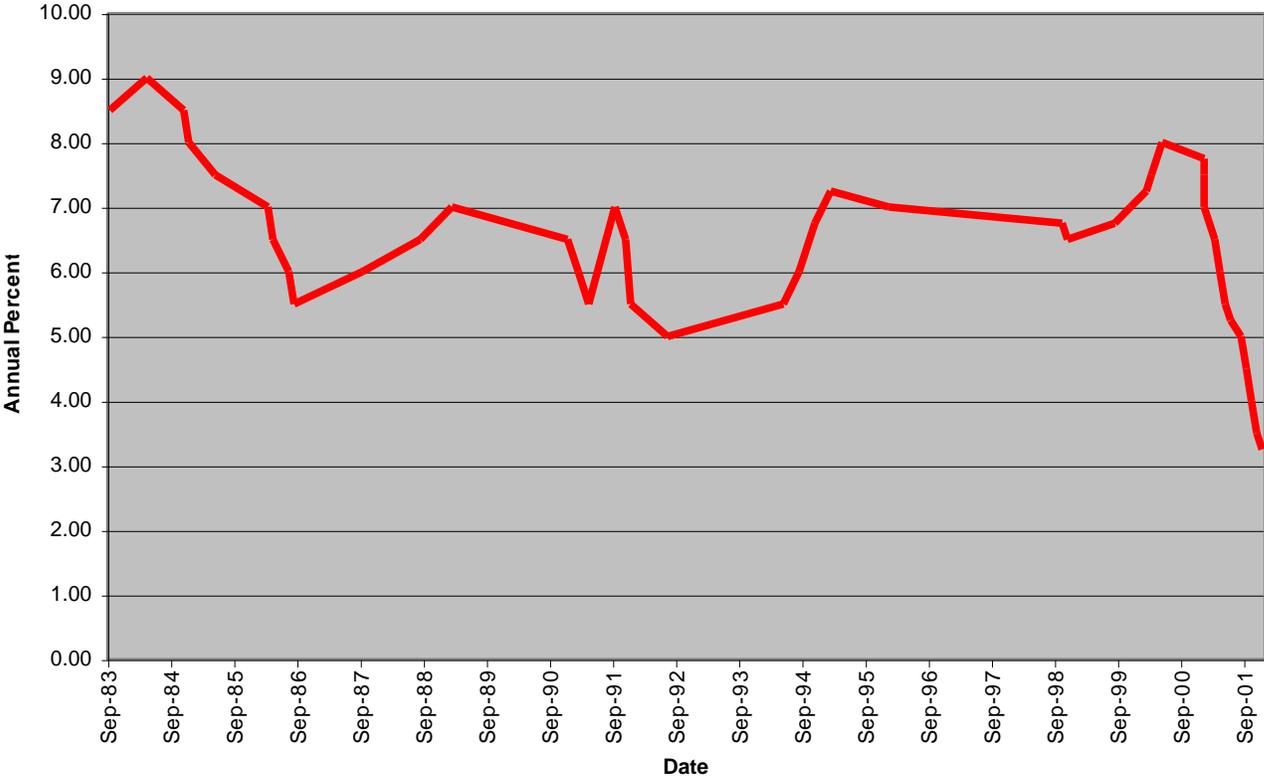
## **APPENDIX B**

### **N. Y. Federal Reserve "Discount Rate"**

<b>Date</b>	<b>NY Fed. Reserve Discount Rate</b>	<b>Discount Rate + 2%</b>	<b>Natural Resources Code Rate</b>
09/01/83	8.50		8.50
04/06/84	9.00		9.00
11/21/84	8.50		8.50
12/21/84	8.00		8.00
05/17/85	7.50		7.50
03/07/86	7.00		7.00
04/18/86	6.50		6.50
07/10/86	6.00		6.00
08/20/86	5.50		5.50
09/04/87	6.00		6.00
08/09/88	6.50		6.50
02/24/89	7.00		7.00
12/18/90	6.50		6.50
02/01/91	6.00		6.00
04/30/91	5.50		5.50
09/13/91	5.00	7.00	7.00
11/06/91	4.50	6.50	6.50
12/20/91	3.50	5.50	5.50
07/02/92	3.00	5.00	5.00
05/17/94	3.50	5.50	5.50
08/16/94	4.00	6.00	6.00
11/15/94	4.75	6.75	6.75
02/01/95	5.25	7.25	7.25
01/31/96	5.00	7.00	7.00
10/15/98	4.75	6.75	6.75
11/17/98	4.50	6.50	6.50
08/24/99	4.75	6.75	6.75
11/16/99	5.00	7.00	7.00
02/02/00	5.25	7.25	7.25
03/21/00	5.50	7.50	7.50
05/19/00	6.00	8.00	8.00
01/03/01	5.75	7.75	7.75
01/04/01	5.50	7.50	7.50
01/31/01	5.00	7.00	7.00
03/20/01	4.50	6.50	6.50
04/18/01	4.00	6.00	6.00
05/15/01	3.50	5.50	5.50
06/27/01	3.25	5.25	5.25
08/21/01	3.00	5.00	5.00
09/17/01	2.50	4.50	4.50
10/02/01	2.00	4.00	4.00
11/06/01	1.50	3.50	3.50
12/11/01	1.25	3.25	3.25

For the latest discount rates, see: <http://www.ny.frb.org/pihome/statistics/dlyrates/fedrate.html>.

Texas Natural Resources Code Rate



**APPENDIX C**  
**INTEREST DUE UNDER TEXAS OIL AND GAS LEASES**

	<b>Applicable Interest Rate</b>	<b>Accrual</b>	<b>Simple/Compound</b>	<b>Source</b>
<b>Interest Specified in Lease</b>	Specified rate, up to 18% (variable rate ceiling up to 24%)	Per lease	Per lease	FINANCE CODE §§ 303.001(a), 303.009
<b>Interest not Specified: Royalty / Proceeds from Sale of Oil or Gas</b>	N.Y. Federal Reserve discount rate plus 2%	60 days after month of oil sale or 90 days after month of gas sale	Simple (?)	NATURAL RESOURCES CODE § 91.403
<b>Interest not Specified: Other Economic Claims / Breach of Covenants</b>	Pre-litigation: 6 %	30 days after amount is due	Simple	FINANCE CODE § 302.002
	Litigation/prejudgment: 10% (postjudgment rate)	Earlier of date suit filed or 180 days after written notice of claim received	Simple	Equity / Common law ( <i>Johnson &amp; Higgins of Texas, Inc. v. Kenneco Energy, Inc.</i> )
<b>Property Damage</b>	10% (postjudgment rate) (variable rate up to 20%)	Earlier of date suit filed or 180 days after written notice of claim received	Simple	FINANCE CODE §§ 304.103, 304.003(c)
<b>Torts other than wrongful death, property damage and personal injury</b>	10% (postjudgment rate) (variable rate up to 20%)	Earlier of date suit filed or 180 days after written notice of claim received	Simple	Equity / Common law ( <i>Johnson &amp; Higgins of Texas, Inc. v. Kenneco Energy, Inc.</i> )