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OIL, GAS AND MINERAL LAW

*Richard F. Brown**

TABLE OF CONTENTS

I. INTRODUCTION 417
II. TITLE AND CONVEYANCING ISSUES 418
III. LEASE AND LEASING ISSUES 420
IV. INDUSTRY CONTRACTS 427
V. REGULATIONS 439
VI. CONCLUSION 442

I. INTRODUCTION

THIS article focuses on the interpretations of and changes relating to oil, gas, and mineral law in Texas from November 1, 2009, through September 30, 2010. The cases examined include decisions of state and federal courts in the State of Texas and the Fifth Circuit Court of Appeals.[1]

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1. Cases of interest during the reporting period not examined herein include: Red River Res. Inc. v. Wickford, Inc., 443 B.R. 74 (E.D. Tex. 2010) (temporary cessation of production and lessor repudiation); PEC Minerals L.P. v. Chevron USA Inc., 737 F. Supp. 2d 643 (E.D. Tex. 2010) (production anywhere on lease holds multiple tracts/units); Parker v. MSB Energy, Inc. (*In re* MSB Energy, Inc.), 438 B.R. 571 (Bankr. S.D. Tex. 2010) (shut-in royalty payments, availability of pipeline, method, timing); Wickford, Inc. v. Energytec, Inc. (*In re* Energytec, Inc.), No. 09-41477, (Bankr. E.D. Tex. Dec. 17, 2009) (lease force majeure and TRC shut-in orders); Cole v. Anadarko Petroleum Corp., 331 S.W.3d 30 (Tex. App.—Eastland 2010, pet. denied) (surface use under mineral lease and unit agreement); Simpson v. Curtis, No. 12-09-00292-CV, 2010 WL 3431856 (Tex. App.—Tyler Sept. 1, 2010, no pet.) (reformation of deed for mutual mistake); Paradigm Oil, Inc. v. Retamco Operating, Inc., 330 S.W.3d 342 (Tex. App.—San Antonio 2010, no pet.) (fraud based on concealment of payout); Berthelot v. Brinkmann, 322 S.W.3d 365 (Tex. App.—Dallas 2010, pet. denied) (proceeds from gas plant operations are personal property); Jones v. Thompson, 338 S.W.3d 573 (Tex. App.—El Paso 2010, no pet.) (Discovery Rule and TRC records); Hausser v. Cuellar, No. 04-09-00560-CV, 2010 WL 2844046 (Tex. App.—San Antonio July 21, 2010, no pet.), *withdrawn*, 2011 WL 313757 (Feb. 2, 2011) (inconsistent fractions in deed); Hudspeth v. Berry, No. 02-09-225-CV, 2010 WL 2813408 (Tex. App.—Fort Worth July 15, 2010, no pet.) (mem. op.) (meaning of the "usual 1/8" royalty); Gulley v. Davis, 321 S.W.3d 213 (Tex. App.—Houston [1st Dist.] 2010, pet. denied) (adverse possession of joint owner by enclosure); Anderson v. Shaw, No. 03-08-00352-CV, 2010 WL 2428132 (Tex. App.—Austin June 18, 2010, no pet.) (mem. op.) (ambiguous deed); Escondido Servs., LLC v. VKM Holdings, LP, 321 S.W.3d 102 (Tex. App.—Eastland 2010, no pet.) (strip and gore mineral conveyance); Swepi LP v. R.R. Comm'n of Tex., 314 S.W.3d 253 (Tex. App.—Austin 2010, pet. denied) (TRC Approval of contiguous subdivision plats for landfill operations); Lyle v. Jane Guinn Revocable Trust, No. 01-09-00081-CV, 2010 WL 1053060 (Tex. App.—Houston [1st Dist.] Mar. 11, 2010, pet. filed) (net profits interest or production payment); Adobe Oilfield Servs., Ltd. v. Trilogy Operating, Inc., 305 S.W.3d 402 (Tex. App.—Eastland 2010, no pet.) (injunction against subcontractor liens on leasehold); Wine-

II. TITLE AND CONVEYANCING ISSUES

Wiggins v. Cade held that a mineral conveyance satisfies the statute of frauds if parol testimony can connect some data in the deed with some definite land.[2] In this case, Grantor conveyed the same non-participating royalty interest to Grantee #1 and to Grantee #2 by separate deeds. Grantee #2 alleged that the legal description in the prior deed did not satisfy the statute of frauds "because it contained neither the name of the survey or the abstract number in which the property was situated."[3] The beginning point was identified in the deed as follows: "BEGINNING at an offset corner, same being the northwest corner of a tract of 45 acres of land formerly owned by Mrs. Kate Crook . . . ."[4]

Grantee #2's expert, a registered land surveyor, testified by affidavit that "he could not locate the property on the ground with reasonable certainty based on the legal description in the deeds because it contained neither the name of the survey or the abstract number in which the property was situated."[5] Grantee #1's expert, a landman and a lawyer, testified by affidavit that he was able to identify the survey in which the property was located by the reference in the legal description to the "45 acres of land formerly owned by Mrs. Kate Crook."[6] "He stated that he was able to determine this information from a search for Kate Crook in the grantor/grantee indices of the Rusk County clerk's office," and he then determined that there was only one "forty-five acre tract that Kate Crook ever owned in Rusk County."[7]

Under Texas law, "[a] recital of ownership in a deed may be used as an element of description and may serve as a means, together with some other element, of identifying the land with reasonable certainty."[8] Interpreting this rule, Grantee #2 contended that the "deed must furnish within itself, or by reference to some other existing writing, the means or data by which the land to be conveyed may be identified with reasonable certainty."[9] This court held that "[a]n individual can use parol evidence to connect data described in the instrument, such as the name of a land

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gar v. Martin, 304 S.W.3d 661 (Tex. App.—Fort Worth 2010, no pet.) (land conveyed/land described); *In re* Estate of Slaughter, 305 S.W.3d 804 (Tex. App.—Texarkana 2010, no pet.) (mineral/royalty distinction in will construction); Cherokee Cnty. Cogeneration Partners, L.P. v. Dynegy Mktg. & Trade, 305 S.W.3d 309 (Tex. App.—Houston [14th Dist.] 2009, no pet.) (GPA consequential damages exclusion); Bright v. Johnson, 302 S.W.3d 483 (Tex. App.—Eastland 2009) (reservation or exception of minerals); City of Alvin v. Zindle, No. 14-08-00458-CV, 2009 WL 4573702 (Tex. App.—Houston [14th Dist.] Dec. 8, 2009, pet. denied) (mem. op.) (noting that lease does not sever royalty or reverter from surface).

2. Wiggens v. Cade, 313 S.W.3d 468, 472 (Tex. App.—Tyler 2010, pet. denied).
3. *Id.* at 470-71.
4. *Id.* at 472.
5. *Id.*
6. *Id.*
7. *Id.*
8. *Id.* (citing Broaddus v. Grout, 152 Tex. 398, 402, 310 (1953)).
9. *Id.* at 473.

owner, to establish the sufficiency of a legal description."[10]

The significance of this case is the holding that permits opinion testimony to supplement the written deed to complete the legal description of the property being conveyed.[11] It does seem that on these facts and as between these parties, it is possible with some effort to confirm the location of the land with reasonable certainty. However, the public policy behind the statute of frauds in promoting the certainty of land titles should require something more certain than parol testimony based on a partial title opinion of a neighbor's tract. A deed of real property must be in writing, but this case holds that an essential element of the deed can be supplied by parol testimony, and that testimony need not even be testimony as to a fact, but can be opinion testimony from an expert witness.[12] A title examiner examining title to Blackacre and faced with similar facts, must now require an examination of title to Whiteacre. It would not be surprising to find title issues as to Whiteacre. Must the Whiteacre tract be "owned" for the legal description on Blackacre to be enforceable? Is it enough that there is a deed into Mrs. Kate Crook on Whiteacre, but she owns nothing?

In *Masgas v. Anderson*, the San Antonio Court of Appeals held that when a granting clause conveys all of Grantor's interest in certain oil and leases described in an exhibit to the conveyance, all of Grantor's interest is conveyed, even if a lease named in the exhibit was labeled with a percentage working interest that was less than all of grantor's interest.[13] The conveyance provided that:

> [Grantor] . . . CONVEYS . . . all of [grantor's] right, title and interest in and to the oil and gas leases described in Exhibit "A" attached hereto and made a part hereof for all purposes. . . .
>
> [Grantor] . . . does covenant . . . that [Grantor] is the lawful owner of said leases described in Exhibit "A." . . . [Grantor] further warrants that it is the owner of the working interest as set out beside each leasehold estate named in Exhibit "A."[14]

Part of the title was disputed at the time of the conveyance. Grantor claimed that only the specified working interest on Exhibit "A" (which did not include the disputed interest) was conveyed.[15]

The court held that the plain grammatical meaning of the conveyance provided that the Grantor conveyed "its entire interests in the *leases* described in Exhibit 'A.'"[16] "The reference to [Grantor's] fractional interest was in the warranty provision. While [Grantor] assigned all of its interests, it only warranted that it owned the fractional interests described

10. *Id.* (citing Ehlers v. Delhi-Taylor Oil Corp., 350 S.W.2d 567, 568-73 (Tex. Civ. App.—San Antonio 1961, no writ)).
11. *Id.*
12. *Id.* at 472.
13. Margas v. Anderson, 310 S.W.3d 567, 573 (Tex. App.—Eastland 2010, pet. denied).
14. *Id.* at 572.
15. *Id.* at 573.
16. *Id.*

in Exhibit 'A.'"[17]

The significance of the case is that it validated a common practice in drafting purchase and sale agreements and conveyances when the terms include a warranty, but grantor either does not own all of the leases or grantor intends to limit grantor's liability on the warranty to a specified interest. The intended result could have been more certain if the warranty clause began: "Without limiting the terms of the grant herein, Grantor warrants . . . ."

III. LEASE AND LEASING ISSUES

In *Shell Oil Co. v. Ross*, the First Houston Court of Appeals held: (1) that the use of a weighted average price to calculate the payment of gas royalties directly contradicted the "proceeds" or "amount realized" royalty clause in the oil and gas lease, and (2) that pooling leased lands with other acreage did not permit the lessee to pay royalties in a manner that was inconsistent with the royalty provision.[18] The lease provided that Shell would pay the royalty owners a percentage of "the amounts realized [by Shell] . . . from the sale of gas."[19] However, Shell did not use the amounts realized to calculate the royalty payment. "Instead, Shell used a 'weighted average price,' which it calculated by [proportionately] weighting its sales price" with the sales price of other working interest owners in the pooled units.[20] A royalty owner under Shell's oil and gas lease sued "Shell for breach of contract, unjust enrichment, and fraud concerning the underpayment of oil and gas royalties . . . ."[21]

Pursuant to pooling and unitization agreements, Shell pooled its leased acreage with other lands, and it "received its share of the natural gas produced, based on the amount of land it contributed to the pooled unit."[22] Shell argued that the lease provision that permitted pooling also permitted paying royalties based on a weighted average calculation because the "provision does not say that it was only that portion produced and sold by [Shell]; in fact, the implication is that it is the defined portion of all of the production, including that sold by the other working interest owners."[23]

The pooling provision in the lease "require[d] that Shell pay [royalty] based on the production of natural gas allocated to the [lease]."[24] The amount of natural gas allocated to Shell's lease represented the percentage of the natural gas produced from the "total number of surface acres in the unit" that the lease contributes to the unit.[25] However, the pooling

17. *Id.*
18. Shell Oil Co. v. Ross, No. 01-08-00713-CV, 2010 WL 670549, at *6 (Tex. App.—Houston [1st Dist.] Feb. 25, 2010, pet. granted).
19. *Id.*
20. *Id.* at *2.
21. *Id.* at *1.
22. *Id.* at *5.
23. *Id.*
24. *Id.* at *6.
25. *Id.*

provision expressly provided that in allocating such production "the *payment or delivery of royalty*, overriding royalty, and any other payments out of production, to be the entire production of unitized minerals from the portion of said land covered hereby and included in such unit *in the same manner as though produced from said land under the terms of this lease*."[26] Accordingly, because the lease expressly required Shell to calculate royalty payments based on proceeds or on the amount realized, and the pooling provision provided that "the payment or delivery of royalty" should be "in the same manner as though produced from said land under the terms of this lease,"[27] by using a weighted average calculation, Shell breached its contractual obligations under the lease.[28]

The jury found that Shell fraudulently concealed the underpayment of royalties, and the trial court ordered that Lessor recover the royalty amounts that Shell underpaid between 1988 and 1997.[29] The court stated, "Generally, a defendant's fraudulent concealment of wrongdoing will toll the running of limitations."[30] However, fraudulent concealment does not toll the statute of limitations if a plaintiff "discovers the wrong or could have discovered it through the exercise of reasonable diligence."[31]

This case is significant because it is consistent with a long line of cases holding that the agreement to pay or deliver royalty is a contractual obligation, and the manner in which royalties are payable or deliverable is determined by the terms of the lease.[32] In construing the royalty and pooling clauses together, the court found nothing in the pooling clause varied the method provided in the royalty clause for payment of royalty, except that the production constructively allocated to the lease was determined by the surface acreage formula.[33]

In *Ramsey v. Grizzle*, the Texarkana Court of Appeals held that a lease termination claim based upon the continuous operations clause must be tried as an action in trespass to try title.[34] The lease was beyond the primary term and production from the lease well was intermittent for several years.[35] The lease was for the specified term:

> [A]nd as long thereafter as operations, as hereinafter defined, are conducted upon said land with no cessation for more than ninety (90) consecutive days. Whenever used in this lease the word "operations" shall mean operations for and any of the following: drilling, testing, completing, reworking, recompleting, deepening, plugging back or repairing of a well in search for or in an endeavor to obtain production of oil, gas, sulphur or other minerals, excavating a mine,

26. *Id.* at *5.
27. *Id.* at *6.
28. *Id.*
29. *Id.* at *4.
30. *Id.* at *7.
31. *Id.* at *8 (quoting Kerlin v. Sauceda, 263 S.W.3d 920, 925 (Tex. 2008)).
32. *See id.* at *6.
33. Ramsey v. Grizzle, 313 S.W.3d 498, 504 (Tex. App.—Texarkana 2010, no pet.).
34. *Id.*
35. *Id.* at 501.

production of oil, gas, sulphur or other mineral, whether or not in paying quantities.[36]

There were multiple parties and multiple claims, but simplified, Lessor sought a declaration that the lease had terminated, and Lessee sought a declaration that the lease continued to be in force and effect.[37] Extensive, detailed, and conflicting testimony and evidence were admitted for several different time periods during which it was alleged that there was no production and no operations sufficient to preserve the lease.[38] The case was tried as if it were a suit with competing claims for declaratory judgment. The issue as submitted to the jury placed the burden on lessor to prove that lessee had failed to commence drilling or operations on the well within ninety days after the well ceased to produce oil and gas. The jury answered "no."[39]

The court recognized that placing the burden of proof was essentially outcome-determinative in this case.[40] The court determined that the case could only be tried in trespass to try title.[41] The court reasoned that the termination of a fee simple determinable determined title to the mineral estate, and that "trespass to try title claim is [generally] the exclusive method in Texas for adjudicating disputed claims of title to real property."[42] Furthermore, the court stated that "when the suit does not involve the construction or validity of deeds or other documents of title, the suit is not one for declaratory judgment."[43]

The court treated the case as a "trespass to try title" case.[44] The court stretched to find all of the necessary elements required by the statutory proceeding, particularly the requirement that the Lessee must prove up his own title.[45]

The court considered Lessee's title to effectively be an undisputed issue.[46] Therefore, the court focused on cessation of operations causing the possible termination of that title as the real issue.[47] There was not a dispute about the nature of the operations in this case. After citing existing authority for the principle that offsite preparatory work is not sufficient, but work on site is sufficient, the court found that this case turned on the credibility of the evidence.[48] There is a useful summary of the kind of evidence that both sides used to present their case (*e.g.*, Texas Railroad

36. *Id.* at 507.
37. *Id.* at 501.
38. *Id.* at 508–10.
39. *Id.* at 507.
40. *Id.* at 501.
41. *Id.* at 502–04.
42. *Id.* at 502–03.
43. *Id.* at 503.
44. *Id.* at 504 (stating "since the case involves title to real property, we will analyze it as a trespass to try title case regardless of the term or classification of the suit by the parties").
45. *Id.* at 504–05.
46. *Id.* at 506.
47. *Id.*
48. *Id.* at 508–09.

Commission records, pumper records, electric bills, equipment and service invoices, testimony, etc.). The evidence presented by Lessee was weak but good enough to secure a favorable jury finding, and the court refused to hold that the finding was against the great weight and preponderance of the evidence.[49] Lessee won, but the court reversed the award of over $49,000 in attorney's fees awarded to Lessee because there is no provision for recovery of fees for a trespass to try title suit in the Texas Property Code.[50]

The significance of this case is the clear holding that a lease termination case based on the continuous operations clause must be tried as an action in trespass to try title.[51] Notwithstanding this case, it is unlikely that a case tried under another theory can meet the formal requirements of a proceeding in trespass to try title. The case is also useful in suggesting the sources of possible evidence on lease termination, and it offers hope to any lessee whose operations "went to hell."[52] Finally, the case continues the recent spate of decisions returning to trespass to try title as *the* method of determining title claims in Texas, with the consequence that the prevailing party is denied the recovery of attorney's fees that may otherwise have been recoverable in a suit for a declaratory judgment.[53]

McCammon v. Ischy held that to prevail in trespass to try title, a plaintiff lessee must establish superior title to a common source of title, which requires a complete chain of title by documents, or establish title by prior possession, which requires some proof of actual possession.[54] In 2000, Ischy acquired leasehold title under leases that covered both producing and non-producing tracts. In 2003, McCammon acquired a lease on a certain 169.1-acre tract of land, which he believed was open because there was no production on the tract. In 2004, McCammon obtained a drilling permit and a title opinion.[55] The title examiner called for releases or an "affidavit of non-production for the land covered by two 1989 leases," which covered the 169.1-acre tract and other lands.[56] In the summer of 2004, "viewing these title issues as mere formalities," McCammon drilled a producing well on the 169.1-acre tract.[57] In August 2004, McCammon discovered that one of the two 1989 leases, which included McCammon's 169.1-acre tract, also included a tract on which Ischy had a producing well. That is, both Ischy's lease and McCammon's lease covered the 169.1-acre tract.[58]

The case was tried in a trespass to try title action in which Ischy was

49. *Id.* at 509–10.
50. *Id.* at 511 (citing Martin v. Amerman, 133 S.W.3d 262, 264 (Tex. 2004)).
51. *Id.* at 504.
52. *Id.* at 502.
53. *Id.* at 502, 508.
54. McCammon v. Ischy, No. 03-06-00707-CV, 2010 WL 1930149, at *3, 6–7 (Tex. App.—Austin May 12, 2010, pet. filed).
55. *Id.* at *1.
56. *Id.*
57. *Id.* at *2.
58. *Id.*

aligned as plaintiff.[59] Ischy won in the trial court, and the jury found that McCammon had not acted in good faith. "The [trial] court ordered McCammon to turn over operations," all of the equipment, and "almost $1 million dollars being held in suspense to Ischy."[60]

> To prevail in a trespass to try title action, a plaintiff must do one of the following: (1) prove a regular chain of conveyances from the sovereign, (2) establish superior title out of a common source, (3) prove title by limitations, or (4) prove title by prior possession coupled with proof that possession was not abandoned.[61]

Ischy sought to preserve his win on appeal under either (2) superior title out of a common source or (4) prior possession.[62]

It was established that a certain 1951 deed was a common source of title for both Ischy and McCammon, but Ischy offered no documentary evidence to establish the subsequent chain of title. Ischy tried to rely on testimony from McCammon's title attorney.[63] A plaintiff in trespass to try title is required to establish the chain of title to the common source by documents, and gaps in the chain of title cannot be filled by testimony.[64] Witnesses may be called to explain the documents but not to fill gaps in the chain.[65] Because documentary evidence is required, Ischy failed to establish superior title to McCammon from a common source.[66]

The issue submitted on prior possession asked "Was Noel Ischy lawfully in possession of the subject property when [McCammon] entered upon same?"[67] "Subject property" was defined as the 169.1-acre tract. Thus, the issue as submitted did not ask about Ischy's producing tract but only about the 169.1-acre tract. McCammon argued that possession of oil or gas requires actual drilling and production of oil or gas, and, because there was no evidence that Ischy had ever produced any oil or gas from the 169.1-acre tract, Ischy had failed to prove possession.[68] McCammon relied upon the Texas Supreme Court Case, *Natural Gas Pipeline Co. v. Pool*,[69] which held that actual drilling and production was required to prove possession in the context of adverse possession of minerals.[70] The Austin Court of Appeals in this case did not clearly adopt this reasoning but recited it in holding that there was no evidence to support Ischy's claim of prior possession.[71] There was no evidence of anything except

59. *Id.* at *1.
60. *Id.* at *2.
61. *Id.* at *3 (citing Land v. Turner, 377 S.W.2d 181, 183 (Tex. 1964)).
62. *Id.* at *2.
63. *Id.*
64. *Id.* at *5.
65. *Id.* at *4.
66. *Id.* at *4–5.
67. *Id.* at *5.
68. *Id.* at *6.
69. Natural Gas Pipeline Co. v. Pool, 124 S.W.3d 188, 193 (Tex. 2003).
70. *Id.*
71. *McCammon*, 2010 WL 1930149, at *6.

Ischy's record title.[72] This leaves open the question of exactly what is required to show prior possession in the context of leasehold interests in trespass to try title.

The court reversed and rendered, which is a dramatic change in circumstances for the parties, essentially turning on the formalities of proof required in an action for trespass to try title.[73] The court stated, "[i]f the plaintiff fails to establish his title, the effect of a take nothing judgment against him is to vest title in the defendant."[74] Title and possession of the 169.1-acre mineral estate, including all equipment and improvements, was vested in McCammon. Presumably, Ischy could have preserved his trial court victory if the evidence had included an abstract of title. The significance of the case is the technical nature of the decision, which has always been a part of this statutory proceeding, and the case highlights the unresolved question of what constitutes possession of oil and gas when there are multiple tracts and when the issue is ownership of oil and gas.

In *Holland v. Thompson*, the El Paso Court of Appeals held that the discovery rule did not toll the running of limitations on claims for fraud when the true facts could have been discovered in the records of the Texas Railroad Commission (TRC).[75] Holland held a one forty-eighth beneficial interest in the minerals underlying lands in Crockett County, Texas, owned and administered by the Bailey Estate Trust (Bailey Estate). Thompson was the operator and owner of the "majority working interest in the oil and gas leases on the Bailey Estate."[76] In 1997, Thompson filed an application with the TRC to amend field rules related to well spacing which would allow for further development of the Bailey Estate. The TRC approved Thompson's application in September of 1997. The TRC examiner's findings of fact recited that Thompson planned to drill at least fifteen wells, although there was a factual dispute as to whether Thompson did or did not have such a plan. There was other evidence in the TRC records of the value of the lands in the Bailey Estate. Thompson did not drill any new wells.[77]

In 1998, after learning that "his cousin had sold his mineral interest in the Bailey Estate to Thompson," Holland approached Thompson about selling Holland's interest to Thompson.[78] Thompson offered Holland $9,000 for his interest, a figure he arrived at by multiplying the value of the past year's production by four. There were apparently multiple representations that the lease was played out with little hope for future development. Thompson purchased Holland's interest for $9,027.27 in

72. *Id.* at *7.

73. *Id.* at *1.

74. *Id.* at *3 (citing Hejl v. Wirth, 343 S.W.2d 226, 227 (Tex. 1961)).

75. Holland v. Thompson, 338 S.W.3d 586, 595 (Tex. App.—El Paso 2010, pet. denied).

76. *Id.* at 590.

77. *Id.* at 591.

78. *Id.* at 590.

November of 1998.[79]

In late 2003, Thompson entered into a farmout agreement, and soon thereafter, the farmee began drilling on the Bailey Estate.[80] When the farmee drilled into deeper undeveloped natural gas reserves, Thompson received more than $400,000 in royalties directly attributable to the interest he purchased from Holland.[81]

Holland sued Thompson for fraud, breach of fiduciary duty, and money had and received.[82] Thompson filed traditional and no-evidence motions for summary judgment on various grounds, including that Holland's suit was barred by the four-year statute of limitations. The trial court granted summary judgment without stating its reasons.[83]

On appeal, Holland argued the discovery rule tolled the accrual of his causes of action until the farmee began drilling in 2004.[84] The court noted that "[t]he discovery rule only applies when the nature of the plaintiff's injury is both inherently undiscoverable and objectively verifiable."[85] The court reasoned that "'owners of an interest in the mineral estate . . . ha[ve] some obligation to exercise reasonable diligence in protecting their interests,'"[86] including examining additional sources of information such as TRC and lessee records.[87]

The court held that Thompson's 1997 TRC filings and, specifically, the TRC examiner's finding of fact that "Thompson plan[ned] to drill at least 15 wells" should have given Holland reason to inquire about future production on the Bailey Estate.[88] In affirming the trial court's grant of summary judgment and holding Jones's damages were not "inherently undiscoverable," the court stated:

> Even a cursory review of the 1997 application would have revealed the possibility that significant reserves existed on the Bailey leases in the Ozona NE. (Canyon 7520) Field because the Gas Proration Schedule listed them. And regardless of whether Thompson later denied that he planned to drill fifteen wells, a prudent mineral interest owner would certainly have reason to inquire about future production based on [Thompson's petroleum engineer's] representations in the application.[89]

Thompson's evidence on the data available at the TRC was based on affidavits from two petroleum engineers who testified that engineers rely

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79. *Id.*
80. *Id.* at 591.
81. *Id.*
82. *Id.* (Holland's cousin filed a parallel suit in Jones v. Thompson, 338 S.W.3d 573, 579 (Tex. App.—El Paso 2010, pet. denied).
83. *Id.* at 592.
84. *Id.*
85. *Id.* at 594 (citing Computer Assocs. Int'l v. Altai, Inc., 918 S.W.2d 453, 456 (Tex. 1996)).
86. *Id.* (quoting HECI Exploration Co. v. Neel, 982 S.W.2d 881, 886 (Tex. 1998)).
87. *Id.* (citing Wagner & Brown, Ltd. v. Horwood, 58 S.W.3d 732, 737 (Tex. 2001)).
88. *Id.* at 591.
89. *Id.* at 595.

on TRC records and on the kinds of records available in 1998.[90]

The significance of this case is the court's holding that TRC filings put a mineral interest owner on notice of the potential for future lease development.[91]

IV. INDUSTRY CONTRACTS

Preston Exploration Co. v. Chesapeake Energy Corp. held that for a Purchase and Sale Agreement (PSA) to be enforceable, the leases described on the exhibit to the PSA must be identified by reference to the volume and page where the leases are recorded.[92] In June of 2008, Chesapeake agreed to purchase oil and gas leases from Preston in two Texas counties. Over the next several months, the parties negotiated the terms of the PSA, exchanged multiple drafts by e-mail of the schedules and exhibits describing the leases to be conveyed, and delayed the proposed closing date several times.[93] There was a proposed closing date of October 7, 2008, which was delayed at the last minute by agreement to November 7, 2008, but only after Chesapeake paid to Preston a non-refundable deposit of approximately $11,000,000. Also on October 7, there was agreement on some final changes to the PSA, and Preston sent a series of e-mails to Chesapeake that afternoon which included a set of PSA exhibits and a set of assignment exhibits. Chesapeake did not review the assignment exhibits and focused on reviewing the PSA exhibits, which were not identical to the assignment exhibits. There were some agreed changes to the PSA exhibits on October 7, and, late on October 7, Preston signed the PSA with the PSA exhibits attached. The assignment exhibits were not physically attached to the PSA signed by Preston. On October 8, there were a few more agreed changes to the PSA exhibits, and Chesapeake then executed and returned to Preston the signature pages to the PSA.[94] Chesapeake did not close on November 7, Preston promptly filed suit,[95] and Chesapeake counterclaimed for return of the non-refundable deposit.[96]

Chesapeake's defense was based on the statute of frauds.[97] The statute of frauds requires that to be enforceable a contract purporting to sell oil and gas leases "'must furnish within itself or by reference to some other existing writing, the means or data by which the land to be conveyed may be identified with reasonable certainty.'"[98] The PSA exhibits as prepared by Preston contained "the name of the lessee, the effective date of the

90. *Id.* at 590.
91. *See id.*
92. Preston Exploration Co. v. Chesapeake Energy Corp., 716 F. Supp. 2d 656, 660 (S.D. Tex. 2010).
93. *Id.* at 665–66.
94. *Id.* at 666–67.
95. *Id.* at 667.
96. *Id.* at 668–69.
97. *Id.*
98. *Id.* at 660 (quoting Morrow v. Shotwell, 477 S.W.2d 538, 539 (Tex. 1972)).

lease, the gross acres leased, the royalty of the lease, and the net revenue interest in the property," and apparently also the name of the lessor, the survey, the lease term, and the net acreage.[99] The PSA exhibits also showed Preston's unique internal lease identification number for each lease, which correlated to the numbered lease files in Preston's office that contained a hard copy of the lease itself or a data sheet with the metes and bounds description for that particular lease.[100] The assignment exhibits, unlike the PSA exhibits, included the volume and page where the various leases were recorded.[101] The case generally turned upon an analysis of the adequacy of the descriptions used on the various schedules and exhibits and upon determining which documents collectively comprised the agreement of the parties.[102]

To be effective under the statute of frauds, the description cannot require a search of the public records in order to arrive at the location of the property that corresponds to each lease.[103] "The data set forth within the PSAs [did] not inherently contain such identifying information."[104] "By contrast, had the volume and page number information for each of the leases been included in the PSA exhibits, this would have constituted an explicit reference to the public records containing the required location information. This distinction between characteristic data versus volume and page information is crucial . . . ."[105]

> Public real property records . . . can be considered only if they are attached to or referenced in the contract. Here, with the data contained in the PSA exhibits, it is the search of the public records, which are wholly extrinsic to the data provided, that allows the property corresponding to each lease to be identified. If volume and page information had been provided, by contrast, the public records would have been explicitly referenced within the writing and thereby incorporated into the agreement. In that case, therefore, extrinsic evidence would have been wholly unnecessary to discern location information.[106]

Similarly, the court stated that Preston's internal lease identification numbers were insufficient because the "number[s] require[d] extrinsic testimony or evidence before their significance [could] be ascertained."[107] Therefore, "the PSAs [did] not satisfy the statute of frauds because they failed to disclose the location and boundaries of the properties corresponding to the leases to be conveyed."[108]

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99. *Id.* at 659 n.2.
100. *Id.* at 660.
101. *Id.* at 660, 668.
102. *See id.* at 668.
103. *Id.* at 659.
104. *Id.* at 660.
105. *Id.*
106. *Id.* at 659–60.
107. *Id.* at 661.
108. *Id.* at 659.

The court then considered whether the assignment exhibits (which contained recording references) were incorporated into the agreement of the parties, although not physically attached to the PSA.[109] The court held that in the modern era of remote closings and electronic documents there has to be "a more flexible approach to the statute of frauds."[110] "[S]ending several documents over email prior to the execution . . . could function in the same way as physically attaching all these documents when the contract was signed.[111] The act of "sending the documents [via e-mail] raises the logical presumption that the documents constitute part of the 'package' . . . reviewed prior to the signing of the agreement."[112] Limiting the statute of frauds in this electronic age by saying documents must be physically attached when exchanged would be contrary to the statute's purpose.[113]

However, in this case, the court found that the assignment exhibits were not "finalized documents" because the parties had not agreed upon the terms of the assignment Exhibits at the time the PSA was signed. Pursuant to basic contract law, if the exhibits are not final upon the execution of the PSA and there is not a meeting of the minds, they cannot be considered part of the parties' agreement.[114] Therefore, the agreement of the parties included no description of the leases to be conveyed, except the inadequate description on the PSA Exhibits.

Finally, the court held that Chesapeake could not recover the non-refundable deposit.[115] Even though the PSA was ultimately held to be unenforceable, Chesapeake did receive the consideration for which it bargained—a delay in making a decision on whether to close.[116]

The significance of this case is the application of the statute of frauds to a PSA and exhibits attached to a PSA. Even if the location of the leases can be determined with absolute certainty by reference to extrinsic information, if the actual legal location of the leases is not determinable from the exhibit itself, the exhibit will not comply with the statute of frauds.[117] Listing the volume and page number of the recording information for the leases being conveyed on the exhibit will incorporate the leases by reference and will satisfy the statute of frauds requirement.[118] The case is also significant for its discussion of electronic or remote closings and the treatment of electronic exhibits under the statute of frauds.

In *Valence Operating Co. v. Anadarko Petroleum Corp.*, the Texarkana Court of Appeals held that it is a question of fact as to whether non-consent operations are timely commenced under a joint operating agree-

109. *Id.* at 662.
110. *Id.* at 662–63.
111. *Id.* at 662.
112. *Id.*
113. *Id.* at 663.
114. *Id.* at 668.
115. *Id.* at 669–70.
116. *Id.* at 669.
117. *Id.* at 659–60.
118. *Id.* at 660.

ment, if there is doubt or controversy as to the intent of the party claiming to have commenced operations for drilling by performing preparatory acts.[119] Under the terms of the joint operating agreement, Valence as non-operator proposed to drill four wells, and the operator, Anadarko, went non-consent. Valence became the operator and was required to commence work on the wells by a certain date under Article VI.B.2 of the joint operating agreement.[120] Before the deadline passed, Valence prepared an authorization for expenditures, received a topographic map of locations, staked the location, took pictures of well sites, obtained preliminary lists of instruments regarding title, and did other off-site preparatory work. All other preparatory work performed by Valence, such as building access roads, restaking well locations, securing title opinions, signing drilling contracts, and the actual commencement of drilling, all occurred after the deadline.[121] When the deadline passed, Anadarko brought suit against Valence for breach of contract.[122]

The principal issue was "whether [Valence] actually commenced work on its proposed operation . . . within the time frame specified by a joint operating agreement."[123] "Actual drilling is not necessary in order to comply with an obligation to commence operations for drilling as required by . . . joint operating agreements. Preparatory activities such as building access roads to the drill site [and preparing the drill site for drilling] are usually sufficient if they are performed with the bona fide intention to proceed with . . . the well."[124] Valence's acts could be categorized as "backroom preparations" because there was almost "no on-site activity."[125] "Both Valence and Anadarko contended at trial that the issue . . . was a question of law . . . [t]he trial court, however, concluded that the issue was not established as a matter of law and submitted the issue to the jury. . . ."[126] The appellate court agreed and held that "[i]f there is doubt or controversy as to the intent of the party claiming to have commenced operations . . . by performing preparatory acts, the question is one of mixed law and fact and should be submitted to the jury."[127] The court found that the evidence was sufficient to support the jury's verdict, and it appears that the key fact was the insignificant on-site activity.[128]

The opinion is silent as to the underlying claim and judgment, but it is likely that the real issue was whether Anadarko would suffer the non-consent penalty as provided in the joint operating agreement. Anadarko

119. Valence Operating Co. v. Anadarko Petroleum Corp., 303 S.W.3d 435, 441 (Tex. App.—Texarkana 2010, no pet.).
120. *Id.* at 439.
121. *Id.* at 440.
122. *Id.* at 439.
123. *Id.* at 438.
124. *Id.* at 441 (citing Dorsett v. Valence Operating Co., 111 S.W.3d 224, 230 (Tex. App.—Texarkana 2003, *rev'd on other grounds*, 164 S.W.3d 656 (Tex. 2005)).
125. *Id.*
126. *Id.* at 439.
127. *Id.* at 441.
128. *Id.*

was awarded a judgment on its contract claim plus interest at six percent.[129] Although the opinion is sketchy, it suggests that the proposing party who fails to timely commence operations on site is assuming all the risk and risking the loss of the benefit of the non-consent penalty in the joint operating agreement.

In *Reeder v. Wood County Energy L.L.C.*, the Tyler Court of Appeals held that by ratification and quasi-estoppel an operator of a well is bound by the terms of a joint operating agreement entered into by his predecessor "when the [new] operator recognizes its validity by acting and performing under its terms, as well as affirmatively acknowledging it," and "accept[ing] the benefits and authorities of being the unit operator."[130] The case also held that an operator may be liable in damages for the value of lost production if the operator fails to preserve the unit by operations or fails to offer a well to the non-operators prior to plugging and abandoning that well.[131] The Forest Hill Field Harris Sand Unit (Harris Sand Unit), created in 1965, and the Forest Hill Field Sub-Clarksville Unit (Sub-Clarksville Unit), created in 1975, overlapped. Oil was being produced from both in 1995, when both units were owned entirely by David Fry (Fry) or companies controlled by him. When Fry conveyed an interest to an unrelated company in 1996, the parties entered into a Joint Operating Agreement (JOA), which established a sharing scheme allocating interests in wellbores between the units.[132] It also required the operator to ensure that the units produced in paying quantities[133] and, before abandoning an unproductive or defective well, to offer the well to the other parties.[134]

Two years after the parties entered into the JOA, Wendell Reeder acquired an interest in the units and became the operator. After assuming control, "Reeder refused to allow [the other parties] to use any of the wellbores he controlled . . . from the Sub-Clarksville Unit."[135] "In 2003, [Well No. 116] began to leak," and the Texas Railroad Commission ("TRC") initially recommended and later ordered Reeder to plug the well.[136] Without offering Well No. 116 to the other parties, Reeder plugged the well in 2004.[137] By September 2006, all production had ceased from the Harris Sand Unit, "and Reeder did nothing."[138] "[T]he unit expired, and the leases not held by production from other zones were lost."[139] The trial court rendered judgment for Fry and others based on

129. *Id.* at 445.
130. Reeder v. Wood Country Energy L.L.C., 320 S.W.3d 440, 443 (Tex. App.—Tyler 2010, pet. filed).
131. *Id.* at 446–47.
132. *Id.* at 439.
133. *Id.* at 445.
134. *Id.* at 446–47.
135. *Id.* at 439.
136. *Id.*
137. *Id.* at 447.
138. *Id.* at 440.
139. *Id.*

the jury's findings that Reeder breached the JOA by failing to maintain production and by failing to offer Well No. 116 to the other parties.[140] Damages were measured by the value of the lost production.[141]

On appeal, Reeder argued that the JOA did not apply to him.[142] The court held that the JOA was indeed applicable to Reeder because (1) "operating agreement[s] [are] typically in effect for as long as any of the oil and gas leases subject to the JOA remain in effect," (2) "Reeder acknowledged receiving the JOA" upon acquiring his interest in the Sand Hill Unit, (3) Reeder acknowledged that he was the operator, (4) Reeder ratified the agreement by acting and performing under its terms, and (5) because the doctrine of quasi-estoppel applied.[143] Moreover, the unit agreements provided that the terms relating to the operator and operations were binding upon assignees and were covenants running with the land.[144]

Reeder next claimed that he was protected from liability by the exculpatory clause in the JOA.[145] Under the terms of the JOA, which included a common form of exculpatory clause, the operator would not be liable unless the operator's "actions amounted to gross negligence or willful misconduct."[146] The court held that the exculpatory clause was not applicable to breach of contract claims.[147] The exculpatory clause is only applicable "to claims that the operator failed to act as a reasonably prudent operator in its operations in the contract area" as described in the JOA, and the gross negligence standard does not apply to breach of contract claims.[148] The distinction was particularly significant in this case because the case had been tried and submitted on the gross negligence standard.[149] Reeder sought to reverse the judgment based on no evidence or insufficient evidence of gross negligence. The court of appeals held that the case should not have been decided under the gross negligence standard; therefore, the issue on appeal was whether there was no evidence or insufficient evidence to support a simple breach of contract.[150]

The court of appeals held that there was sufficient evidence to support the jury's finding that Reeder breached the JOA by failing to maintain production.[151] There was an unusual provision incorporated into the JOA in this case that provided that the operator "agrees to produce and/or conduct operations on the Harris Sand Unit sufficient to maintain the

140. *Id.* at 439.
141. *Id.* at 448-50.
142. *Id.* at 442.
143. *Id.* at 442–43.
144. *Id.* at 442.
145. *Id.* at 443–44, 448.
146. *Id.* at 443–44.
147. *Id.* at 444.
148. *Id.* at 443.
149. *Id.*
150. *Id.* at 444–45.
151. *Id.* at 446.

leases and the unit."[152] Fry owned a carried working interest, and Reeder asserted that he maintained production until it became financially burdensome to perform and that the other non-operators failed to invest money in the unit. The court of appeals held that financial burden cannot excuse performance of contractual obligations.[153] The court was careful to recite that its holding was based on the unique, explicit provisions of this particular JOA, and that it was not holding that an operator could be required to conduct an operation if the non-operators elected not to participate.[154] Reeder never proposed an operation.[155]

The court also held that there was sufficient evidence to support the jury's finding that Reeder breached the JOA by failing to offer Well No. 116 to the non-operators before he abandoned it.[156] "Reeder argue[d] that he was under no obligation to notify the other parties because he did not *elect* to plug the well, but was ordered by the Railroad Commission."[157] The court held that the evidence showed that before he was ordered to close the well, [t]he [TRC] initially *recommended* that he plug the well."[158] Reeder could have plugged or repaired the well.[159] His decision not to repair amounted to a decision to plug; thus, he was obligated to offer the well to the other parties.[160]

There is a formal procedure for changing the operator of a well under the rules and regulations of the TRC.[161] Until there is a formal transfer, the old operator continues to be responsible, so the parties to a transfer of operations generally comply with those requirements.[162] However, the transfer of authority to act as operator under a JOA sometimes just "happens," and the parties do not formally comply with the JOA or document the transition. This case articulates the circumstances and theories under which the transfer may become binding, even though there is no formal election or assumption of operations by the new operator. The case also highlights the significant liability that may attach (value of lost production) if the operator fails to comply with the operator's duties. The obligation to maintain the leases and the unit is not common, but the obligation to give notice prior to plugging and abandoning a well is very common.

In *Bonn Operating Co. v. Devon Energy Production Co.*, the Fifth Circuit Court of Appeals held that a notice of a proposed well under a Joint

152. *Id.*
153. *Id.* (citing Huffines v. Swor & Gravel Co., 750 S.W.2d 38, 40 (Tex. App.—Fort Worth 1988, no writ).
154. *Id.* at 446, n.4. *Cf.* Reeder v. Wood Cnty. Energy L.L.C., No. 12-08-00175-CV, 2010 Tex. App. LEXIS 3080, at *38 n.4 (Tex. App.—Tyler April 28, 2010), *withdrawn*, 320 S.W.3d 433, 446 n.9 (Tex. App.—Tyler 2010, pet. filed).
155. *Reeder*, 320 S.W.3d at 446.
156. *Id.*
157. *Id.* at 447.
158. *Id.*
159. *Id.*
160. *Id.*
161. 16 TEX. ADMIN. CODE § 3.1(a)(1), (4), (7) (2011).
162. *Id.* § 3.78(j)(2).

Operating Agreement (JOA) was effective, even though notice was given after the well was already drilled and completed.[163] This JOA was on a 610 Model Form Operating Agreement-1956 and contained the subsequent operations clause providing that "if a party desires to drill a well it 'may give the other party written notice of the proposed operation.'"[164] "[T]he other parties to the JOA have 30 days" to respond.[165] Non-consenting parties are not liable for the costs of the proposed operation.[166] If the operation is successful, the non-consenting parties are effectively penalized by the loss of their share of production until the participating parties recover the costs of the drilling operation and of production operations multiplied by the agreed penalty factor, such as 300%.[167] Devon, the operator, sent notice to Bonn, a non-operator, after Devon's well was already down and completed. Bonn affirmatively elected to go non-consent. Bonn then sued Devon alleging breach of contract because the notice was not timely and because Devon charged Bonn for costs incurred before the well was spudded and after it was completed.[168]

"In *Valence Operating Co. v. Dorsett*, the operator sent notice . . . [before commencing operations,] . . . but then commenced operations before the thirty-day period to elect to participate expired."[169] The Texas Supreme Court held that nothing in the language of the JOA forbade the operator from commencing work before the end of the notice period.[170] In this case, the Fifth Circuit extended that reasoning to hold that there was nothing in the language of the JOA that forbade the operator from commencing work and even completing the well before sending the notice.[171] Note, however, that it was the *operator* who commenced operations without notice. Should a non-operator attempt to commence operations without timely notice, it is likely that different issues would be raised and a different result would follow.

Bonn also sought to limit the costs included for purposes of calculating the payout of the non-consent penalty. Bonn argued (under Section III of the Accounting Procedures in Exhibit C to the JOA) that "the proper time period for the accumulation of penalty costs is from the date the well is spudded (the date the drill bit pierces the surface of the earth) until completion (commencement of production)."[172] The Fifth Circuit held that Bonn was misreading Section III.4.[173] Section III related to charging different rates for overhead based on the drilling rate or the production

163. Bonn Operating Co. v. Devon Energy Prod., 613 F.3d 532, 536 (5th Cir. 2010).
164. *Id.* at 533.
165. *Id.*
166. *Id.*
167. *Id.*
168. *Id.* at 533–34.
169. Valence Operating Co. v. Dorsett, 164 S.W.3d 656, 660 (Tex. 2005).
170. *Id.* at 662–63.
171. *Bonn*, 613 F.3d at 535–36.
172. *Id.* at 535.
173. *Id.* at 534.

rate.[174] "[Section III did] not limit [the participating parties'] ability to charge non-consenting parties for all direct costs, and associated penalties, applicable to a well pursuant to the terms of Paragraph 12 of the JOA."[175] Specifically, Devon could charge for costs incurred before drilling and after completion.[176]

The significance of the case is the holding that the operator can send the notice of the proposed operation essentially at anytime, with the only "risk" being that the non-operator gets a free look before making his election. The opinion does not address access issues or the sharing of well data prior to an election being made. The holding in this case and in *Valence* should be presumed applicable to simple JOAs on simple facts. Under more complex agreements and facts, a different result might follow. For example, many JOAs have additional provisions that may include limitations on the number and timing of well proposals, priority of operations, et cetera. Construing these provisions against a backdrop of random notice periods and election periods could be difficult.

In *Beckham Resources, Inc. v. Mantle Resources, L.L.C.*, the Corpus Christi Court of Appeals held that an area of mutual interest clause (AMI) in an exploration agreement, which required notice of "all pertinent terms" of any acquisition, did not require notice in the form of a liquidated sum as to the entire cost of the acquisition, but only the terms of the participation.[177] Mantle Resources, L.L.C (Mantle) acquired a new lease within the AMI that included a drilling commitment for a deep well as consideration for the lease.[178] Mantle's notice of the acquisition to Beckham included "specific discussions of the consideration for the lease being the agreement to drill a deep well, copies of the October 2005 lease, [authorities for expenditure] for the estimated drilling costs, and diagrams showing the proposed well location."[179] Beckham had twenty days to respond, Beckham failed to respond, and a failure to respond was, under the terms of the AMI, deemed an election not to participate. Mantle drilled the well.[180] Beckham contended that "Mantle breached the AMI provision because it did not send notice or an offer to participate to Beckham once the acquisition costs became known and ascertainable when the well reached 9,000 feet in February 2006."[181]

The court of appeals concluded that the AMI required only "that Beckham be informed of the terms for its participation—i.e., that Beckham would be responsible for its share of the up-front costs of the consideration well, which was the acquisition cost of the October 2005 lease."[182]

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174. *Id.*
175. *Id.*
176. *Id.*
177. Beckham Res., Inc. v. Mantle Res., L.L.C., No. 13-09-00083-CV, 2010 WL 672880, at *8 (Tex. App.—Corpus Christi Feb. 25, 2010, pet. denied) (mem. op.).
178. *Id.* at *4.
179. *Id.* at *8.
180. *Id.* at *6.
181. *Id.* at *8.
182. *Id.*

The holding is consistent with the trend in recently decided cases involving a right of first refusal (ROFR), although none were cited in the opinion. The trend may be summarized as holding that the party with the ROFR must unequivocally exercise it or lose it. Claims as to the sufficiency of the notice are generally given little consideration, and even valuation disputes may be postponed for resolution until sometime after the right is exercised. Similarly, in this case, the exact cost would not be known until the well was drilled, but the pertinent term was that the consideration was to drill the commitment well.

In re Moose Oil & Gas Co. considers whether a lessor of lands included within a Joint Operating Agreement (JOA) has rights to sue under the JOA, either as a third-party beneficiary of the JOA or by virtue of having privity of estate.[183] Two adjacent tracts of land were leased in 1996 by landowners Barnes and Baker. In 1998, the Barnes Lease and Baker Lease were pooled into a single unit. The working interest owners in the unit entered into a Working Interest Unit Agreement (WIUA) and an attached JOA.[184] Moose, one of the non-operators and one of the lessees under the Baker Lease, proposed drilling two additional wells in the pooled unit under the terms of the JOA.[185] The operator, who was the lessee under the Barnes Lease, elected to go non-consent.[186] Moose, Tawes, and various other non-operators who owned the lessees' interest under the Baker Lease, drilled the wells. Moose acted as operator for the consenting parties in drilling the wells. Tawes and another company later acquired Moose's working interest in the Baker Lease and the wells in a foreclosure sale. "At issue in this case is Tawes' liability, as a Consenting Party, for royalty respecting production from the Baker-Barnes 1 & 2 wells under the WIUA and JOA."[187]

The JOA provided in Article VI.B2 that

> [t]he entire cost and risk of conducting such operations shall be borne by the Consenting Parties in the proportions they have elected to bear . . . .[188] [I]n a subsequent portion of its Article VI the JOA contains the statement that: "[d]uring the period of time Consenting Parties are entitled to receive Non-Consenting Party's share of production, or the proceeds therefrom, Consenting Parties shall be responsible for the payment of all production, severance, excise, gathering and other taxes, and all royalty, overriding royalty and other burdens applicable to Non-Consenting Party's share of production . . . .[189]

The Fifth Circuit called this the "Royalty Provision" for identification.

183. *In re* Moose Oil & Gas Co., 613 F.3d 521, 531 (5th Cir. 2010) (certified questions accepted by Texas Supreme Court Aug. 6, 2010).
184. *Id.* at 524.
185. *Id.*
186. *Id.*
187. *Id.*
188. *Id.* at 525.
189. *Id.*

Barnes asserted that Tawes, as a Consenting Party, was liable for all royalty owed to her and that she had standing to sue under the Royalty Provision as a third-party beneficiary of the JOA.

> [A] contract creates a third-party creditor beneficiary only if the signatories (1) intended to confer a benefit on that third party and (2) entered the contract to confer that benefit on the third party. The language of the contract must be clear, and the intent of the contracting parties controls. [A] presumption exists that parties contracted for themselves unless it 'clearly appears' that they intended a third party to benefit from the contract. . .[190] That a contract incidentally benefits some third party is insufficient to establish an intent to create a third-party beneficiary.[191]

Tawes contested third party liability.

Alternatively, Barnes argued that even if she was not a third-party creditor beneficiary, she could recover against Tawes under a theory of privity of estate. Liability to the original lessor for the payment of rent or the performance of other lease covenants may arise from either privity of contract or privity of estate.[192] Barnes asserted '[t]hat Tawes came into privity of estate with her by undertaking the obligation to pay royalty under the Barnes Lease."[193] This argument was apparently based on the reasoning that the original lessee must pay royalty to Barnes, Moose agreed to pay the royalty owed by the original lessee, Tawes acquired Moose's interest, and therefore Tawes must pay Barnes. It is unclear whether the privity of estate argument is based on the Royalty Provision in the JOA, the acquisition of Moose's leasehold estate by Tawes, or both.[194]

The lower courts found Tawes to be liable and to be responsible for all royalties.[195] The JOA in this case was similar to most JOAs because it allocated all costs and expenses and the sharing of revenue in accordance with an allocation based on the interests owned by the working interest owners.[196] However, the Royalty Provision recited that "[c]onsenting parties shall be responsible for the payment of . . . all royalty," and that language was consistent with either joint or several liability for royalty payments as between and among the Consenting Parties.[197] Moreover, the court noted in a footnote that there could also be a question as to whether Tawes could be liable for all royalties even if that sum exceeded Tawes's share of production.[198]

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190. *Id.* at 527 (citation omitted) (quoting MCI Telecomm. Corp. v. Texas Utilities Electric Co., 995 S.W.2d 647, 651 (Tex. 1999)).

191. *Id.* (citing Stine v. Stewart, 80 S.W.3d 586, 586 (Tex. 2002)).

192. *Id.* at 528 (quoting Amco Trust Inc. v. Naylor, 317 S.W.2d 47, 50 (1958)).

193. *Id.*

194. *Id.*

195. *Id.* at 526–27, 529–30.

196. *Id.* at 530.

197. *Id.*

198. *Id.* n.7.

This case involved questions of Texas law as to which there was no controlling Texas Supreme Court precedent. Accordingly, the Fifth Circuit certified the following as two of three questions to be submitted to the Texas Supreme Court:

> *Certified Question One*: Does Barnes have any right [to] enforce the contract-the WIUA and JOA-between Dominion, Moose O&G, and the Moose Assignees, including Tawes, to recover unpaid royalties, between the date of first production and February 2002, of Baker-Barnes Nos. 1 & 2 wells under what we have called the "Royalty Provision" of the JOA, either as a third-party beneficiary of the WIUA and JOA or by virtue of having privity of estate with Tawes?
>
> . . . .
>
> *Certified Question Three*: If Tawes, as a Consenting Party, is responsible for royalties under the JOA, does the JOA Royalty Provision change the agreement within the JOA such that Tawes is responsible for all of Barnes' unpaid royalty jointly and severally, or does the JOA limit Tawes' liability for unpaid royalty to the extent of his interest in the two wells at issue between the date of first production and February 2002?[199]

Tawes also claimed that there was a contractual bar to recovery by Barnes. If the contractual bar is sustained, then the Texas Supreme Court might not reach the interesting questions described above. Provision V of the WIUA provides that:

> Moose Oil & Gas Company [a non-operator] shall be the liable party to the Operator for the entire forty-six percent (46%) working interest within the Working Interest Unit for the parties hereinabove referred to as Moose [including Tawes]. Moose Oil & Gas Company shall be the responsible party, for each of said parties, to the Operator for obtaining and delivering any and all elections, notices, invoices payments and billings.[200]

However, the parties to the WIUA also agreed that they would be governed by the JOA that was attached to the WIUA as an exhibit.[201]

Tawes argued that the WIUA insulated him from liability.[202] Even if Barnes was a third-party creditor beneficiary, she could not enforce her rights against Tawes because under the contracts, her lessee "could not have enforced the Royalty Provision [in the JOA] against Tawes."[203] Under the WIUA, Barnes's lessee could only recover from Moose, which was designated as the liable party. Accordingly, Tawes contended that the same is true for Barnes because "Barnes can have no greater rights to reach Tawes than did [Barnes's lessee]."[204] The court also certified this question to the Texas Supreme Court as follows: "*Certified Question Two*:

199. *Id.* at 531.
200. *Id.* at 524.
201. *Id.* at 525.
202. *Id.* at 529.
203. *Id.* at 528–29.
204. *Id.* at 529.

If Barnes may enforce the contract, does the WIUA prevent Barnes from recovering from Tawes?"[205]

If the door is opened for lessors to assert that they are third-party beneficiaries under this common form of JOA, then the case will be very significant. There are many terms and provisions in a typical JOA that arguably could tie back to implied or express lease covenants. While there is no doubt that no one in the industry has actually intended that result, except in the most unusual of documents, if the Texas Supreme Court reads that intent into this form JOA, then the unintended consequence of the use of the forms will be to significantly increase the risk of liability for working interest owners. Working interest owners frequently have little knowledge of the terms and conditions of leases included in a unit, other than knowledge of their own leases. Even if they did have knowledge of the actual recorded lease terms, due diligence would require inquiry into the unrecorded lease file materials of other working interest owners, which are materials generally regarded to be at least business confidential. Finally, if the liability for royalty payments is extended to all royalty, even if it exceeds the working interest owner's share of production, then very small working interest owners are assuming a very big risk, particularly in today's environment of very large royalties incurred very quickly on horizontal wells.

V. REGULATIONS

In *Discovery Operating, Inc. v. BP America Production Co.*, the Eastland Court of Appeals held that Texas Natural Resources Code Section 85.321 allows owners of production or property interests to bring negligence per se claims based on violations of the Texas Railroad Commission (TRC) rules and orders.[206] While drilling an oil well, Discovery Operating, Inc. (Discovery) ran into a "highly pressurized flow of brine water" that ultimately caused Discovery damages in the form of costs to contain the flow, costs to plug and abandon the well, and lost production profits.[207] Because Discovery had never encountered similar flows in the area of the well, it investigated subsurface injection activity conducted by other entities surrounding the well as a potential cause for the flow.[208] Discovery concluded that BP American Production Company's (BP) nearby subsurface injection well was the cause for the flow, and it brought negligence per se claims against BP based upon assertions that BP had violated Section 85.045 of the Natural Resources Code as well as various TRC rules.[209]

Based on the Texas Supreme Court's opinion in *Exxon Corp. v. Emer-*

205. *Id.* at 531.

206. Discovery Operating, Inc. v. BP America Production Co., 311 S.W.3d 140, 161 (Tex. App.—Eastland 2010, pet. denied, reh'g filed).

207. *Id.* at 146, 148.

208. *Id.* at 147.

209. *Id.* at 148 (stating that Section 85.045 (which provides that waste is illegal and prohibited, based on the definition of "waste" in Section 85.046)).

ald Oil & Gas Co.,[210] the Eastland Court of Appeals ruled that the trial court was erroneous in granting BP's summary judgment motion on the negligence per se claims.[211] The trial court did not have the benefit of the *Emerald* opinion when it rendered its summary judgment ruling, but the court of appeals held that *Emerald* expressly allowed the type of negligence per se claims asserted by Discovery.[212] *Emerald* dealt with a similar negligence per se claim that rested on violations of TRC rules brought by a subsequent owner of mineral interests.[213] The court stated that *Emerald* stood for the proposition "that [Texas Natural Resources Code] Section 85.321 creates a private cause of action" for violations of TRC rules or orders.[214] Moreover, the courts have no discretion to determine whether the statute will support a negligence per se claim.[215] However, the lessee in *Emerald* lacked standing because it was a *subsequent* lessee, which was a limitation that did not apply to Discovery's claims because Discovery was not a *subsequent* lessee. Because Discovery owned the mineral interests when the alleged injury occurred, Discovery had the right to bring its negligence per se claims regardless of "whether the claims are labeled as a private cause of action for violations of statutes and [TRC] rules and orders or as negligence per se claims for violations of the same statutes, rules, and orders."[216]

The significance of this case is the court's recognition that Texas Natural Resources Code Section 85.321 creates a private cause of action for negligence per se claims arising from violations of any TRC rule or order, which may be asserted by the owners of the mineral interests who own those interests at the time the injury occurs. This suggests there will be an expanding field of claims based on TRC rules and orders not previously seen as a basis for private causes of action.

Wickford, Inc. v. Energytec, Inc. (In re Energytec, Inc.) held that a cessation of production caused by internal Texas Railroad Commission (TRC) confusion did not operate to terminate a lease because it was beyond Lessee's control, but an unexplained delay in responding to a second TRC severance did result in lease termination because it was within Lessee's control.[217] There were two separate TRC severance orders based on unrelated facts.[218] Production first ceased in March 2008 because the TRC issued the first severance order relating to the improper plugging of a well, although the TRC had previously approved the technique. Lessee used reasonable efforts to get the severance order lifted on

210. Exxon Corp. v. Emerald Oil & Gas Co., No. 05-0729, 2009 WL 795760 (Tex. Mar. 27, 2009), *withdrawn*, 331 S.W.3d 419 (Tex. 2010).
211. *Discovery Operating*, 311 S.W.3d at 161.
212. *Id.* at 160–61.
213. *See id.* at 160.
214. *Id.* at 161.
215. *Id.* at 163.
216. *Id.* at 161.
217. Wickford, Inc. v. Energytec, Inc., No. 09-41477, 2009 WL 5101765, at *5 (Bankr. E.D. Tex. Dec. 17, 2009).
218. *Id.* at *2.

January 20, 2009. However, the TRC had issued a second severance order on January 16, 2009, regarding production imbalances. Lessee received notice of the violation on December 17, 2008, but did not file the necessary forms for more than three months. This second severance order was lifted on March 25, 2009, but Lessee did not resume production for another five months, delaying until August 2009.[219] The force majeure provision of the applicable lease provided:

> If . . . the performance by Lessee of any covenant, agreement, or requirement hereof is delayed or interfered directly or indirectly by any past or future acts, orders, regulations, or requirements . . . of any state . . . or any agency . . . or authority of any [state], . . . *or on account of any other similar or dissimilar cause beyond the control of Lessee*, the period of such delay or interruption shall not be counted against the Lessee. . . .[220]

The Bankruptcy Court for the Eastern District of Texas held that because Lessee acted in good faith and used previously approved techniques, Lessee had no control over the internal TRC confusion.[221] Therefore, Lessee's interest in the minerals did not terminate as a result of the cessation caused by the TRC's first severance order.[222]

However, the court found the cessation of production attributable to the second severance order was within Lessee's control.[223] It is unclear whether the court considered the critical fact to be the three month delay in responding to the TRC, or the five month delay in resuming production. Because the court held that the lease terminated in March 2009, this implies that the critical fact was the three month delay in responding to the TRC.[224]

There was another lease on another property in this case, which the court also held had terminated based on a cessation of production.[225] As to that lease, the court held the termination was effective as of the date the well was first shut-in.[226] Because there is almost no discussion in the opinion as to the term during which Lessee was permitted to resume production, it is not clear that this court correctly addressed the specific date of either of the lease terminations; therefore, it may be incorrect to conclude that the court's recital of the effective date of lease termination is evidence of its reasoning as to the cause of the termination.

The case is significant because of the holding that internal confusion at the TRC may excuse performance under the force majeure clause in a lease. This force majeure clause expressly included administrative action as a possible basis for a suspension of Lessee's obligations. The internal

219. *Id.* at *2–3.
220. *Id.* at *5.
221. *Id.* at *4.
222. *Id.*
223. *Id.* at *5.
224. *Id.*
225. *Id.*
226. *Id.*

confusion was beyond Lessee's control. However, a delay in responding to a TRC severance order is within Lessee's control, and it appears that, in this case, the court held that the delay in responding was enough to terminate the lease.

VI. CONCLUSION

During the reporting period, there was little of interest out of the Texas Supreme Court, but there are many cases in which a petition for review has been filed or granted. This suggests that next year may be a big year for decisions out of the Texas Supreme Court. The reported cases are following the usual boom cycle of the industry. For the past several years, the decisions have been dominated by opinions focused on title, leases, leasing, and royalty. The cases this year have shifted the focus to the later stage of development where industry agreements become important. The more interesting cases deal with operating agreements, purchase and sale agreements, gas contacts, area of mutual interest agreements, and other industry contracts. Historically, there have been surprisingly few cases on operating agreements, but they are now receiving a great deal of attention. If lessors are determined to be third-party beneficiaries of operating agreements, then the trend will certainly accelerate.