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## **Oil, Gas, and Mineral Law**

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# OIL, GAS, AND MINERAL LAW

Richard F. Brown\*

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**T**HIS article focuses on the interpretations of, and changes relating to, oil, gas and mineral law in Texas from October 1, 1994 through September 30, 1995. The cases examined include decisions by Texas Courts and the Fifth Circuit Court of Appeals.<sup>1</sup>

## I. CONVEYANCING ISSUES

*French v. Chevron U.S.A. Inc.*<sup>2</sup> was a deed construction case in which the issue was the mineral/royalty distinction, or whether the instrument conveyed a fixed fraction of total production royalty, or a mineral interest (and consequently merely a fraction "of royalty"). A conveyance of a mineral estate does not necessarily convey all interests in the mineral estate; rather certain interests may be held back, or reserved in the grantor.<sup>3</sup> Under a simple assignment of the "minerals," however, "it is presumed that *all* attributes remain with the mineral interest unless a contrary intent is expressed."<sup>4</sup> An assignment of a royalty, without any further grant, does not convey the right to develop, the executive right, delay rentals nor bonus. In construing difficult deeds, the phrase "in and

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1. This article is devoted exclusively to Texas law. Cases involving questions of oil, gas, and mineral law, decided by courts sitting in Texas but applying laws of other states, are not included.

2. 896 S.W.2d 795 (Tex. 1995).

3. *Id.* at 797.

4. *Id.* (quoting *Day & Co., Inc. v. Texland Petroleum, Inc.*, 786 S.W. 2d 667, 669 n.1 (Tex. 1990)).

under" is generally critical in identifying the grantor's intent to convey a mineral interest.<sup>5</sup> However, in *Watkins v. Slaughter*,<sup>6</sup> the Texas Supreme Court held that the use of the term "royalty" was critical in identifying an intent in the grantor to convey a royalty, despite the use of the "in and under" language.

The deed in *French* was titled "Mineral Deed," and paragraph one, standing alone, was clearly a conveyance of a 1/656.17 mineral interest: "1/656.17th interest in and to all of the oil, gas and other minerals, in, under and that may be produced from the following described lands . . . ."<sup>7</sup> Paragraph two then expressly described the interest conveyed as a "royalty interest only" and reserved to the grantor (1) the right to develop; (2) the right to lease (executive right); (3) the right to receive bonus payments; and (4) the right to receive delay rentals.<sup>8</sup> The court noted that under *Altman v. Blake*<sup>9</sup> the rights reserved to grantor in the *French* deed constituted four of the five interests in the mineral estate.<sup>10</sup> The only interest not reserved to grantor was the right to receive royalty payments. The holding in *French* was that a mineral conveyance in which all attributes of the mineral estate are reserved, except the right to receive royalties, is still a conveyance of minerals.<sup>11</sup> Therefore, when a deed conveys a royalty interest by the mechanism of granting a fractional mineral estate, what is conveyed is a fraction "of royalty," not a fixed fraction of total production royalty. That is, the deed conveyed 1/656.17 of royalty.

There were deed construction issues in the case, but the lasting significance of the decision will be the determination that a "bare" mineral interest (no rights, but the right to receive royalty) is still a mineral interest. It is another step in clarifying which attributes of the mineral estate attach to a "mineral" conveyance, which attach to a "royalty" conveyance, and which are presumed to be conveyed or reserved in a conveyance which is silent or unclear. In a footnote, the court is careful to overrule the court of appeals insofar as it had concluded that the right to develop was *impliedly* transferred to the grantee.<sup>12</sup> The supreme court re-stated its position that the right to develop is a correlative right which passes with the executive rights as previously held in *Day & Co., Inc. v. Texland Petroleum, Inc.*<sup>13</sup>

The significance of *French* is that there are thousands of deeds which have carved up the attributes of the mineral estate between grantor and grantee. There can be an enormous economic difference between 1/656 of royalty and a 1/656 royalty. This case, and the relatively recent case of

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5. See, e.g., *Barker v. Levy*, 507 S.W.2d 613, 617 (Tex. Civ. App.—Houston [14th Dist.] 1974, writ ref'd n.r.e.).

6. 144 Tex. 179, 189 S.W.2d 699 (1945).

7. *French*, 896 S.W.2d at 796.

8. *Id.*

9. 712 S.W.2d 117, 118 (Tex. 1986).

10. *French*, 896 S.W.2d at 797.

11. *Id.* at 798.

12. *Id.* at 797 n.1.

13. 786 S.W.2d 667, 669 n.1 (Tex. 1990).

*Day & Co.*, are the supreme court's most significant attempts to give the industry some guidelines on how those thousands of deeds should be read and how new ones should be drafted. In distinguishing *Watkins*, the appellate court reasoned that the phrase "from actual production" was critical in determining that the conveyance was a royalty, despite the use of the phrase "in and under."<sup>14</sup> This reasoning suggests that a draftsman intending to create a royalty should use the phrase "royalty from actual production." More importantly, the royalty draftsman should scrupulously avoid any reference to the other attributes of a mineral estate.

*Plainsman Trading Co. v. Crews*<sup>15</sup> extends the "surface destruction test" to non-participating royalty interests for pre-June 8, 1983 conveyances. Historically, the mineral estate has been dominant, meaning that the mineral owner has the right to use so much of the surface as may be reasonably necessary to enjoy his minerals.<sup>16</sup> For pre-June 8, 1983 conveyances, there was a presumption that a surface owner conveying "minerals" did not intend to convey the right to destroy his interest. This presumption was expanded into a rule in *Reed I* and *Reed II*.<sup>17</sup> When a deed conveyed or reserved minerals generally, it did not convey or reserve any substance the extraction of which, by any reasonable means, would consume or deplete the surface. This "surface destruction test" proved so unworkable that the court prospectively abandoned it in *Moser v. United States Steel Corp.*<sup>18</sup> as to conveyances executed on or after June 8, 1983, in favor of giving words their "ordinary and natural meaning."<sup>19</sup>

"Thus, the 'surface destruction test' had its genesis in protecting surface owners from the uncompensated destruction of their interest by the . . . exploration and extraction rights of the 'mineral' owner. A non-participating royalty interest, however, is non-possessory in that it does not entitle its owner to produce the minerals himself."<sup>20</sup> The non-participating royalty owner, having no possessory right, could never destroy the surface.

Surface owner Crews leased uranium located less than 200 feet beneath the surface, which was a fact likely to trigger the surface destruction test. Under *Friedman v. Texaco, Inc.*,<sup>21</sup> the surface destruction test determined ownership rights between the surface owner and the mineral owners, but the surface owner was also determined to own the uranium without the non-participating royalty interest burdening his interest. The non-participating royalty interest owner ("NPRI Owner") argued that whether the surface owner or the mineral owner was entitled to the uranium, the

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14. *French v. Chevron USA, Inc.*, 871 S.W.2d 276, 278 (Tex. App.—El Paso 1994), *aff'd*, 896 S.W.2d 795 (Tex. 1995).

15. 898 S.W.2d 786 (Tex. 1995).

16. See *Acker v. Guinn*, 464 S.W.2d 348, 352 (Tex. 1971).

17. *Reed v. Wylie*, 597 S.W.2d 743 (Tex. 1980)(*Reed II*); *Reed v. Wylie*, 554 S.W.2d 169 (Tex. 1977)(*Reed I*).

18. 676 S.W.2d 99 (Tex. 1984).

19. *Id.* at 103.

20. *Plainsman Trading*, 898 S.W.2d at 789.

21. 691 S.W.2d 586 (Tex. 1985).

NPRI Owner's royalty should be applicable.<sup>22</sup> The NPRI Owner reasoned that the transfer of a non-participating royalty, "even in 'minerals' which are extracted by destroying the surface, carries with it no potential that the surface owner's enjoyment will be disturbed by the non-participating royalty owners, who have no independent right to explore for or produce the minerals."<sup>23</sup> Crews argued that because title to the uranium was in the surface owner, the uranium was not subject to any royalty interest carved out of the mineral estate.<sup>24</sup> The court agreed with Crews and held that because the non-participating royalty was carved from the mineral estate, it could not attach to a substance, mineral or not, which was not part of the mineral fee estate.<sup>25</sup>

## II. OIL, GAS, AND MINERAL LEASES

### A. POOLING CLAUSE

In *Circle Dot Ranch, Inc. v. Sidwell Oil and Gas, Inc.*,<sup>26</sup> a gas well was drilled and completed on a single lease covering all of Section 3 and containing a little more than 640 acres. Six months after production was obtained, Sidwell, the operator, formed a pooled unit that was irregular in shape, its diagonal corners being in excess of 11,000 feet apart, and containing 668.23 acres.<sup>27</sup> Included in the pooled unit were 123.23 acres out of the Circle Dot lease on Section 3 and 545 acres covered by six leases on three contiguous sections of land. Without the pooling, the primary term of five of the six leases would have expired within 18 months. Circle Dot's royalty interest in gas produced from the well was reduced from .1875 to .03457735, a reduction of approximately 81%. Because part of the pooled leases were subject to only a 1/8th royalty payment, rather than the 3/16ths royalty payable under the Circle Dot lease, the overall royalty burden on the lessee was reduced by the formation of the pooled unit. The applicable pooling clause in the lease was very broad, authorizing the formation of the "unit or units to be in such shape and of such dimensions as Lessee may elect . . . ."<sup>28</sup>

"The cause was pleaded and defended, tried and decided, and briefed and argued on appeal, on the contested issue whether Sidwell exercised its pooling authority in fairness and good faith, taking into account the interests of both the lessor and lessee."<sup>29</sup> The trial court gave Sidwell a directed verdict. The Amarillo Court of Appeals reversed and remanded after determining that the issue of good faith presented a fact question.<sup>30</sup>

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22. *Plainsman Trading*, 898 S.W.2d at 788.

23. *Id.*

24. *Id.*

25. *Id.* at 790.

26. 891 S.W.2d. 342 (Tex. App.—Amarillo 1995, writ denied).

27. *Id.* at 344.

28. *Id.*

29. *Circle Dot Ranch*, 891 S.W.2d at 345 (citing *Elliott v. Davis*, 553 S.W.2d. 223, 227 (Tex. Civ. App.—Amarillo 1977, writ ref'd n.r.e.)).

30. *Id.* at 347.

The concurring judge would have reversed and rendered for Circle Dot on the theory that "good faith . . . is like other legal propositions, in that it may be conclusively established when reasonable minds could not differ."<sup>31</sup>

The interesting issue on appeal was Sidwell's argument that the duty of good faith as applied to pooling determinations was rejected by the Texas Supreme Court in *Amoco Production Co. v. Alexander*<sup>32</sup> by the pronouncement that "[t]he standard of care in testing the performance of implied covenants by lessees is that of a reasonably prudent operator under the same or similar facts and circumstances."<sup>33</sup> The Amarillo Court of Appeals noted that the pooling clause was an express covenant, and although the Texas Supreme Court has not directly articulated the duty or standard of care of a lessee in exercising the pooling clause, there are many Texas cases characterizing the standard of care or duty applicable under that clause as good faith.<sup>34</sup> The bare language of the express pooling clause implied some kind of covenant as to the standard of care for the performance of the pooling clause by the lessee.<sup>35</sup> It followed that the implied standard mandated by *Alexander* was "that of a reasonably prudent operator under the same or similar facts and circumstances."<sup>36</sup>

This finding did not make much difference to the court which concluded that "the lessee's primary obligation is to exercise the pooling power 'in good faith, taking into account the interest of both lessee and lessor.'"<sup>37</sup> Apparently the court would now submit the controlling issue as follows: Did lessee exercise the pooling option as a reasonably prudent operator would do under the same or similar circumstances by, among other things, using good faith, taking into account the interests of both lessee and lessor?<sup>38</sup> In other words, the facts and circumstances in a given pooling will determine the obligations of a reasonably prudent operator, but the primary obligation will always be to exercise the pooling power in good faith.<sup>39</sup> The court was again split on the issue of whether the reasonably prudent operator standard was even applicable.<sup>40</sup>

*Grace Petroleum Corp. v. Williamson*<sup>41</sup> considered whether a breach of the lease covenants to prevent drainage and to reasonably develop would support an award of exemplary damages. In 1980 lessee Grace prepared a unit designation that included the Williamson lease in the plat, but failed to include the lease among the schedule of pooled leases. A Grace

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31. *Id.* at 348 (Dodson, J., concurring).

32. 622 S.W.2d 563 (Tex. 1981).

33. *Id.* at 345 (quoting *Alexander*, 622 S.W.2d at 567-68).

34. *Id.*

35. *Id.* at 346.

36. *Circle Dot Ranch, Inc.*, 891 S.W.2d at 346 (quoting *Alexander*, 622 S.W.2d at 567-68).

37. *Id.* at 346.

38. *Id.* at 347.

39. *Id.*

40. *Id.* at 347 (Dodson, J. concurring).

41. 906 S.W.2d 66 (Tex. App.—Tyler 1995, n.w.h.).

employee (Wheeler) met with the Williamsons in order to secure a lease extension and a ratification of the unit. After orally agreeing to execute the lease extension and the unit ratification, the Williamsons had an attorney review the transaction. Their lawyer arranged for a ratification and for the representations concerning the lessee's future pooling intentions to be reduced to writing. The writing stated: "[W]hen a well is drilled adjoining the above mentioned tract, it is the intention of Grace, et al., to place all of the remaining acreage from the Williamson leases into the units being formed."<sup>42</sup>

Several units were subsequently formed and then re-formed, and it is not entirely clear what happened to the Williamson lease. However, by 1984 about 83 acres of the Williamson lease were left out of all the surrounding units. Williamson obtained an express jury finding that Grace made fraudulent representations that it would place all of the lease acreage into units.<sup>43</sup> At trial, Williamson recovered \$25,000 in damages for drainage and \$500,000 in exemplary damages.<sup>44</sup> The issue on appeal was whether exemplary damages were recoverable.

In Texas, exemplary damages are generally not awarded for breach of contract, but may be awarded for tort claims, such as fraud. The courts have been struggling to find a coherent legal theory to guide them in cases involving "contorts," that is, cases in which contract issues and tort issues (e.g. fraud) are mixed. A contractual relationship may create duties under both contract and tort law. This *Grace Petroleum* court said it is the nature of the injury that most often determines which duty has been breached; thus, to recover in tort, one must prove a "distinct" tortious injury with actual damages arising from that injury.<sup>45</sup> The court found that even though Williamson proved a tort (the fraud), there was no proof of any damage separate and apart from the drainage.<sup>46</sup> This loss was an economic loss to the subject matter of an enforceable contract, meaning a contract loss under the lease contract. The award of exemplary damages was reversed.<sup>47</sup>

*Grace Petroleum's* significance is that it established a precedent for "failure to pool" cases being limited to economic damages for drainage, even when the lessee fraudulently represents that an actual pooling will occur. Perhaps the case may be limited to its facts and the limited proof offered at trial. If a lessor enters into a lease (or renewal lease) in reliance on such a representation and loses other opportunities to lease, then there may be other distinct damages (e.g. lost bonus, lost pooling opportunity into some other unit, etc.).

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42. *Id.* at 67.

43. *Id.* at 68.

44. *Id.*

45. *Id.*

46. 906 S.W.2d at 69.

47. *Id.* at 70.

## B. PUGH CLAUSE

*Judice v. Mewbourne Oil Co.*<sup>48</sup> involved the construction of a Pugh-type clause which read as follows:

Notwithstanding anything in this lease agreement to the contrary, and within six (6) years from the date of this lease, Lessee shall, by instrument in recordable form, release, relinquish and surrender unto Lessor all its right, title and interest in all zones and formations except those that are then producing in paying quantities.<sup>49</sup>

On July 1, 1984, six years after the date of the lease, the well would have been producing from the Morrow, but for a temporary cessation of production. The court rejected the lessor's argument that the lease terminated on July 1, 1984 as to all formations not then physically producing. The court held that the clause was a limitation on the grant, but not on the temporary cessation clause in the lease.<sup>50</sup> The significance of the opinion is its conclusion that the general limitation on the granting clause found in a common Pugh-type clause would not render ineffective the various "savings" clauses customarily found in oil and gas leases.

## C. NON-PARTICIPATING ROYALTY

*Harrison v. Bass Enterprises Production Co.*<sup>51</sup> considered the duty owed by a lessee to a non-participating royalty owner for wrongful payment of royalty, the application of the statute of limitations, and the "Discovery Rule." Bass pooled the wellsite lease and then drilled a well. Harrison's non-participating royalty was in the wellsite tract. Harrison was not asked to ratify the pooling agreement, and Bass never paid Harrison any royalties from the well. When Harrison made his claim, Bass paid Harrison his undiluted share of the royalty for the previous four years. Harrison sued to recover for royalties prior to that time. The parties agreed that the four year statute of limitations applied, but disputed whether the Discovery Rule applied.

The court held that Harrison's claim was barred by limitations and that the Discovery Rule did not apply.<sup>52</sup> Before reaching these issues, the court first had to dispose of the tort claims raised by Harrison. Harrison asserted breach of fiduciary duty, breach of good faith and fair dealing, negligence, negligence per se, and fraud. The court concluded that there was nothing in Bass' conduct that would give rise to liability independent of the fact that a contract existed and that the only loss or damage was to the subject matter of the contract; therefore, the action was on the contract.<sup>53</sup> The fraud claim was disregarded because there was no evidence of any affirmative fraudulent statement by Bass or breach of any duty to

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48. 890 S.W.2d 180 (Tex. App.—Amarillo 1994, n.w.h.).

49. *Id.* at 181.

50. *Id.* at 183.

51. 888 S.W.2d 532 (Tex. App.—Corpus Christi 1994, no writ).

52. *Id.* at 538.

53. *Id.* at 536 (citing *Southwestern Bell Telephone Co. v. DeLanney*, 809 S.W.2d 493, 494 (Tex. 1991)).



disclose by Bass.<sup>54</sup>

The Discovery Rule is a common law concept holding that the statute of limitations does not begin to run until the cause of action is "discovered" (known or should have been known) by the plaintiff. No case in Texas has explicitly applied the Discovery Rule to a case in which a non-participating royalty owner sought to recover unpaid royalty from the lessee, and the Texas Supreme Court has recently held that it must explicitly adopt the Discovery Rule before the rule is applicable to a specific cause of action.<sup>55</sup> Based on the supreme court's restriction on the further extension of the Discovery Rule, the Corpus Christi court denied the application of the Discovery Rule. It went on to say that the Discovery Rule should not apply in this type of case and that Harrison had actual knowledge of production from a "smoking gun" memo in Harrison's own file.<sup>56</sup>

Harrison also argued that the running of the statute of limitations should have been tolled by Bass's fraudulent concealment of the wrongful payments. The court held that there was no proof of a relationship of trust between Harrison and Bass that would have created a duty on Bass's part to disclose the existence of a cause of action.<sup>57</sup> Moreover, the same "smoking gun" memo was enough to put Harrison on notice and to end the tolling effect of any fraudulent concealment.<sup>58</sup>

#### D. OVERRIDING ROYALTY

*Sasser v. Dantex Oil & Gas, Inc.*<sup>59</sup> examined the effect on Sasser's overriding royalty under a 1974 lease when the lessor and lessee entered into a new lease in 1990 without releasing of the 1974 lease. When the continuation of the old lease became questionable because of declining production, the lessor successfully obtained a higher royalty and a drilling commitment under a new lease in 1990. The instruments creating the overriding royalty made the override applicable to the existing 1974 lease, but did *not* purport to extend the override to renewals, extensions or modifications of the 1974 lease. The 1974 lease also contained a typical unilateral release clause providing that the lessee could at any time execute and deliver to the lessor or place of record a release of the lease and be relieved of all obligations as to the released land.<sup>60</sup>

Dantex refused to pay the overriding royalty under the new 1990 lease. Sasser sought a declaratory judgment alleging (1) that Dantex wrongly attempted to eliminate or "washout" Sasser's overriding royalty interest, thereby breaching its duty of good faith and fair dealing or other fiduci-

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54. *Id.*

55. *Id.* at 538 (citing *Trinity River Authority v. URS Consultants, Inc.*, 889 S.W.2d 259, 262-63 (Tex. 1994)).

56. *Harrison*, 888 S.W.2d at 537.

57. *Id.*

58. *Id.*

59. 906 S.W.2d 599 (Tex. App.—San Antonio, 1995, writ requested).

60. *Id.* at 601.

ary-type duty; or alternatively (2) that the overriding royalty continued to burden the 1990 lease which remained in effect.<sup>61</sup> A summary judgement against Sasser was affirmed on appeal.<sup>62</sup>

In reaching its decision, the *Sasser* court relied heavily on the leading Texas case of *Sunac Petroleum Corp. v. Parkes*.<sup>63</sup> In *Sunac*, it was urged that a constructive trust should be imposed to protect the overriding royalty owner based upon either (1) the specific language in the assignment or (2) the close relationship between the parties shown by the particular facts involved.<sup>64</sup> The *Sunac* assignment of overriding royalty had the "magic" language imposing the overriding royalty on leases taken in renewal and extension, but even under those circumstances the overriding royalty owner lost. The assignment expressly provided that the lessee was under "no duty to develop the land or to continue the lease in force . . . ."<sup>65</sup>

Under *Sasser* if the assignment creating the overriding royalty does not contain language imposing the override on renewals and extensions of the lease, it is unlikely that the specific language in the assignment will ever support a "washout" claim. Similarly, the opinion followed *Sunac* again in reasserting the general rule that an assignment of an oil and gas lease reserving an overriding royalty in the assignment does not usually create any confidential or fiduciary relationship between the assignor and the assignee.<sup>66</sup> In both *Sunac* and *Sasser* the courts found no evidence to make an exception to this general rule.<sup>67</sup>

Sasser urged the court to extend the fiduciary duty imposed upon an executive in *Manges v. Guerra*<sup>68</sup> to a lessee in Dantex's position.<sup>69</sup> Sasser contended that under evolving principles of Texas law, the lessee owed the overriding royalty owner a duty of good faith not to engage in intentional acts designed to eliminate or washout the overriding royalty interest owner. Sasser attempted to distinguish *Sunac*, because in *Sunac* the old lease terminated by its own terms, whereas Dantex participated in terminating the 1974 lease. This reasoning was rejected. The court stated that "the method by which the old lease terminated—so long as it [was] contractually permitted—[was] a distinction without a difference . . . ." [w]hatever a man has a legal right to do, he may do with impunity, regardless of motive . . . ."<sup>70</sup> The *Sasser* court expressly refused to follow

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61. *Id.*

62. *Id.* at 607.

63. 416 S.W.2d 798 (Tex. 1967).

64. *Id.* at 803.

65. *Id.* at 804; see also *Exploration Co., v. Vega Oil & Gas Co.*, 843 S.W.2d 123, 126 (Tex. App.—Houston [14th Dist.] 1992, writ denied) (no fiduciary duty imposed where assignment of overriding royalty contained "magic" language, but no surrender clause.).

66. *Sasser*, 906 S.W.2d at 606-07.

67. *Id.* at 607.

68. 673 S.W.2d 180, 183-84 (Tex. 1984).

69. *Sasser*, 906 S.W.2d at 607.

70. *Id.* (citing *Montgomery v. Phillips Petroleum Co.* 49 S.W.2d 967 (Tex. Civ. App.—Amarillo 1932, writ ref'd), cited in *Sunac*, 416 S.W.2d at 804).

dicta in *Matter of GHR Energy Corp.*<sup>71</sup> which suggested that the Fifth Circuit Court of Appeals "might impose a duty of good faith and fair dealing, 'if the facts . . . suggested that [the lessee] surrendered its interest in the lease to destroy the rights of the overriding royalty interest owner.'"

Sasser also contended that his override continued because the 1974 lease was never properly released or surrendered. However, "by signing a new lease with the intent to terminate a prior lease, a lessor waives strict compliance with a surrender clause and effectively terminates or releases the prior lease."<sup>72</sup> The effective release of the lease extinguished the overriding royalty. The court did have to go through a tortured look at intent and facts and circumstances to support the summary judgment, suggesting that the prudent lessee in Dantex's position should take the simple step of releasing the old lease.

### III. DIVISION ORDERS

*Heritage Resources, Inc. v. NationsBank*<sup>73</sup> was a division order case holding that royalty owners were not bound by division orders allowing the lessee to deduct transportation costs. The royalty clauses in the leases at issue expressly provided that the royalty owners would not bear any marketing costs. Lessee deducted a pro rata portion of the transportation charges charged by the gas transporter from the lessor's royalty. The lessee asserted a defense based on its division orders, which expressly provided that the royalty payments would be subject to transportation costs. After apparently conceding that the division orders ordinarily would be a defense until revoked, the court held that division orders were not binding on royalty owners when the operator benefits from an error in the orders and is thereby unjustly enriched.<sup>74</sup>

The El Paso Court ruled there was evidence upon which the trial court could properly conclude that Heritage profited from the error in the division orders, and therefore the royalty owners were not bound by the division orders.<sup>75</sup> The lessee and the gas transporter were not under common ownership, but the sole shareholder of the lessee also happened to be the

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71. 979 F.2d 40, 41 (5th Cir. 1992), *cert. denied*, 113 S. Ct. 1879 (1993).

72. *Sasser*, 906 S.W.2d at 603.

73. 895 S.W.2d 833 (Tex. App.—El Paso 1995, writ granted).

74. *Id.* at 838 (citing *Gavenda v. Strata Energy, Inc.*, 705 S.W.2d 690, 692 (Tex. 1986)). This holding is not supported by thorough analysis of the facts in *Heritage Resources*, and it is an oversimplification of *Gavenda*. In *Gavenda*, the case was remanded for a determination of the amount of royalty owed by Strata and the other working interest owner. Strata was only liable for whatever portion of the royalties it retained and was not liable for any royalties it paid out to other owners. *Id.* at 692-93. Thus, *Gavenda* stands for the premise that, if the issuer of the division order makes a mistake in the issuer's favor (and does not pay it over to another), then the issuer must give up its unjust enrichment to the rightful owner. Presumably the same recovery based on unjust enrichment would be available against any overpaid party. The critical fact issue is to determine who received the over payment.

75. *Heritage Resources*, 895 S.W.2d at 839.

majority shareholder of the gas transporter.<sup>76</sup> Nothing else in the opinion explained how the lessee Heritage profited from the transportation of the gas. Profit to the gas transporter would appear to be unrelated to the lessee, unless the corporate distinctions are ignored. It appears the court may have been more taken with its first reason for ignoring the division orders. There was a disclaimer on the division order that nothing in the division order was intended to alter or to amend the lease.<sup>77</sup>

The court also chose to ignore the express provision of the division order which limited liability for wrongful payment to a cause of action against the over-paid party. The reason given for ignoring the provision was again that division orders should be ignored when the lessee benefits from the error.<sup>78</sup>

The court found that the lessee was statutorily liable to the royalty owner.<sup>79</sup> These statutes address the liability of a payor for proceeds from the sale of gas and give a royalty owner a cause of action for interest against a payor who withholds payments beyond the time limits prescribed in the statutes. A payor includes an operator who has assumed responsibility for paying royalty owners their share of purchase proceeds.<sup>80</sup>

*Sun Operating Limited Partnership v. Oatman*<sup>81</sup> presented interesting issues on both division orders and adverse possession of minerals. In 1931 Jennie and Clara purchased a 1/4th interest in the tract in question at a partition sale. Clara died in 1935 and left her 1/8th interest to Jennie under a will probated in Arkansas. Everyone promptly forgot about the will, including the executrix Jennie, who later signed an affidavit that Clara died intestate. Sun claimed title under a 1970 lease from Jennie ("Jennie's Lease"). In 1973, Sun farmed out the shallow rights to Oatman, retaining a 1/16th overriding royalty. Sun furnished Oatman with title opinions showing that Jennie's Lease covered only 7/8ths, and suggested that Oatman get a receiver's lease on the other 1/8th. In 1974,

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76. *Id.*

77. *Id.* at 838-39.

78. *Id.* at 839.

79. *Id.* at 837. It is unclear why this holding is in the case, or what it means. The statutes cited form the legal basis for the requirement that interest be paid on delayed royalty payments. There is nothing in these statutes determining the amount payable as royalty. Thus, the court's ruling that the lessee was statutorily liable for the transportation costs as part of the royalty does not seem well reasoned or even necessary to its decision. The statute provides a cause of action in § 91.404(c) for "non-payment of oil or gas proceeds or interest on those proceeds as required in Section 94.402 or 91.403 of this code. . . ." TEX. NAT. RES. CODE ANN. § 91.401(c) (Vernon 1993). That provision simply provides for interest on late payments. The primary purpose of § 91.402 is to define when a payment is "late," when a payor can withhold payment without liability for interest, and the effect of division orders. *Id.* § 91.402. Thus, there is simply nothing in the statute which makes any party statutorily liable for royalty. The royalty obligation is a matter of contract.

80. TEX. NAT. RES. CODE ANN. § 91.401(2).

81. No. 04-93-00634-CV, 1995 WL 92593 (Tex. App.—San Antonio March 8, 1995, writ requested).

Oatman obtained a receiver's lease purportedly covering Clara's 1/8th interest as to all depths ("Receiver's Lease").

Oatman drilled and completed a well in his shallow rights in 1975. In 1976 Clara's will finally resurfaced. Oatman helped Jennie record the will, terminate the receivership and recover accrued royalties. The Receiver's Lease was not canceled, and Oatman continued to pay Jennie royalties under the Receiver's Lease.<sup>82</sup> Sun knew about Clara's will from about the time it was discovered, and, as late as 1988, Sun signed division orders on the shallow rights showing that Sun was entitled to an overriding royalty of only 7/8ths of 1/16th of production. In 1989 Sun requested an assignment from Oatman of his 1/8th under the Receiver's Lease for a deeper test proposed by Sun. Sun then reversed its position, asserted that it already owned that 1/8th, and drilled a deep gas discovery in 1990.

The issue then was whether Sun or Oatman had Clara's 1/8th under lease. Oatman filed suit claiming title under the Receiver's Lease, or alternatively, by adverse possession. Sun counterclaimed for title under the earlier Jennie's Lease. Oatman won under both his theories.

Sun argued that it held superior title under the "first in time" rule of the common source doctrine. When competing claims of title are traced back to a common source, the earlier title emanating from that common source is the better title and must be given prevailing effect.<sup>83</sup> Clara was the common source, and it is well established that the "title of a devisee under a foreign will duly probated, like that under a domestic will, becomes effective as of the date of the testator's death, the probate in the foreign state and the record in Texas being 'legal formalities required to evidence and give full effect to that right.'"<sup>84</sup> Sun argued that under *Bruni*, Jennie's Lease was valid as to Clara's 1/8th, even though the will was not filed until later, and that Clara's interest passed to Jennie at Clara's death, so that the receiver had nothing to lease.

The court rejected Sun's argument under the established rule that the vesting of the title under a foreign will is subject to the rights of intervening purchasers without notice.<sup>85</sup> Sun claimed that Clara's will was in Oatman's chain of title under Jennie's Lease, so that Oatman was on constructive notice of that will. The court noted that not even Sun believed in 1974 that Jennie's Lease covered Clara's 1/8th.<sup>86</sup>

Turning to Sun's claim that the receiver had nothing to lease, the court opines that "even if the unknown heirs of Clara did not have anything to give Oatman, Jennie did, and by not objecting to Oatman's lease [the Receiver's Lease], she effectively ratified it."<sup>87</sup> The court relied upon

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82. *Id.* at \*2.

83. *Id.* at \*4.

84. *Id.* (quoting *Bruni v. Vidaurri*, 140 Tex. 138, 166 S.W.2d 81, 93 (1942)).

85. *Id.* (citing *Mills v. Herndon*, 60 Tex. 353, 356 (1883); *Long v. Shelton*, 155 S.W. 945 (Tex. Civ. App.—Texarkana 1913, writ ref'd)).

86. *Oatman*, 1995 WL 92593 at \*5.

87. *Id.* at \*6.

*Spellman v. American Universal Investment Co.*<sup>88</sup> for the principle that when "parties by their conduct . . . recognize contracts as subsisting and binding, they thereby affirm the contracts after acquiring knowledge of the facts which entitled them to rescind." In other words, the court agreed with Sun that the receiver had nothing to lease, but because Jennie's Lease was not binding on Clara's 1/8th under the bona fide purchase exception, Clara's 1/8th was effectively unleased. After concluding that Jennie ratified the Receiver's Lease, the court also concluded that Sun ratified the Receiver's Lease by executing division orders and accepting royalties on only a 7/8ths interest, again citing *Spellman*.<sup>89</sup>

Oatman also claimed to have adversely possessed title to Clara's 1/8th as to all depths. The real question was whether Oatman went far enough in his actions with respect to the shallow rights to put Sun on notice that he was adversely possessing Clara's 1/8th in the deep rights. Sun contended that Oatman adversely possessed only the 1/8th interest for the shallow rights because the farmout effected a severance. The court stated "that an adverse possessor claiming title under a registered deed is considered to have constructive possession of all the land within the boundaries of his deed not under another's actual possession, if the adverse possessor has actual possession of any part of those lands."<sup>90</sup> The only cases cited by the court dealt with adverse possession of the surface.<sup>91</sup>

*Oatman* is therefore significant because of this extension of the doctrine of adverse possession. Such an extension holds a great deal of potential for future litigation because assignments of mineral leases following a severance are frequently inaccurate as to the depths conveyed or reserved. Assignments of leases, particularly undeveloped leases, are very commonly made without warranty. Thus, while it is important to correctly identify the lease (which usually covers all depths and all products), it is not very important to correctly identify depth restrictions, or whether the assignment covers all products, or only gas, or only oil.

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88. 687 S.W.2d 27, 29 (Tex. App.—Corpus Christi 1984, writ ref'd n.r.e.).

89. *Oatman*, 1995 WL 92523 at \*6. Finding the division orders to be a significant factor in supporting the ratification of a lease is contrary to the current trend of limiting the effect of division orders. See TEX. NAT. RES. CODE ANN. § 91.402 (g) and (h) (Vernon 1993) (making division orders revocable, terminable at will, and ineffective to change lease terms); Exxon Corp. v. Middleton, 613 S.W.2d 240 (Tex. 1981) (division orders are revocable); Sun Oil Co. (Delaware) v. Madeley, 626 S.W.2d 726 (Tex. 1981) (forty years of payments did not ratify an amendment to the lease). Finding a ratification of the Receiver's Lease by Sun was not even necessary to the decision. Whether Oatman was a bona fide purchaser for value in 1974 does not depend on the conduct of Sun after the Receiver's Lease was taken. Similarly, if Clara's 1/8th was unleased under *Bruni*, the effectiveness of the ratification of the Receiver's Lease by Jennie in 1977 does not depend upon the conduct of Sun after Jennie's ratification. If neither the *Bruni* bona fide purchaser exception nor the ratification theory are sustainable, Clara's 1/8th was leased to Sun under Jennie's Lease. If so, then the Sun division orders are just the kind of mistake that would no longer be binding once the division orders were revoked. See *Sun Oil Co. (Delaware) v. Madeley*, 626 S.W.2d 726 (Tex. 1982).

90. *Oatman*, 1995 WL 92593 at \*8 (quoting *Chase v. Faulk*, 297 S.W.2d 341, 244 (Tex. Civ. App.—El Paso 1956, writ ref'd n.r.e.)).

91. *Id.* at \*8-9.

There are numerous existing assignments made without warranty which simply list the leases conveyed, and which now form the basis of a broad claim of adverse possession.

#### IV. JOINT OPERATIONS

*Questa Energy Corp. v. Vantage Point Energy, Inc.*<sup>92</sup> was a preferential rights case construing Article VIII(g) of the applicable operating agreement which generally give all parties to the operating agreement a preferential right to purchase should any party choose to sell its interest. This preferential right was limited by the following language:

However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to dispose of its interests by merger, reorganization, consolidation, or sale of all or substantially all of its assets to a subsidiary or parent company or to a subsidiary of a parent company, or to any company in which any one party owns a majority of the stock.<sup>93</sup>

In this case, the parties to the operating agreement who were the sellers were known as the "Oakwood Entities." The Oakwood Entities were all subsidiaries of Sceptre Resources Limited (Sceptre), a Canadian company. Sceptre decided to discontinue its United States operations. Thereafter Sceptre and the Oakwood Entities sold all the U.S. properties held by the Oakwood Entities to Vantage, including approximately 600 wells on over 400 properties. Questa Energy Corporation, after learning of the completion of the sale, contended that it held a preferential right to some of the properties and sought either specific performance of the right or damages for failure to honor that right.

Vantage had no prior connection with Sceptre or its subsidiaries. The consideration given by Vantage in the sale consisted of cash and the transfer of 81% of the stock in Vantage to Sceptre. "The remaining 19% of the Vantage stock was held by the shareholders who had previously owned 100% of the stock."<sup>94</sup>

The court held that the preferential right provision of the operating agreement was not ambiguous<sup>95</sup> and that the intent of the preferential right provision was to serve two purposes:

First, it assures its holder an opportunity to acquire further interests in the contract area . . . . It thus allows those owners, who may have been at risk in exploratory efforts which contributed to the development of the property, to have an opportunity to acquire an additional interest in the property before a third party who did not participate in such risks. Secondly, and perhaps more importantly, a preferential right to purchase ensures that the owners retaining their interest in the contract area have some degree of control in excluding undesirable participants who may not have the necessary financial

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92. 887 S.W.2d 217 (Tex. App.—Amarillo 1994, writ denied).

93. *Id.* at 220.

94. *Id.* at 221.

95. *Id.*

ability to bear their share of expenditures or who might frustrate development with management and engineering philosophies which the current owners oppose.<sup>96</sup>

The court held that as a matter of law the preferential right was not triggered by this transaction and that the "interests were those held by a party or parties to the contract."<sup>97</sup> Sceptre's subsidiaries held those interests before and after the transaction took place. Therefore, as a transaction between related entities, it did not involve any outside party and, as a result, Questa was not exposed to the risk of "undesirable outsiders." Additionally, the transaction did not cause Questa to lose any of its potential rights which would have arisen in the event of a sale to an outsider.<sup>98</sup>

*Purvis Oil Corp. v. Hillin*<sup>99</sup> construed the provisions under a typical operating agreement requiring a successor operator be selected from among the parties to the agreement owning oil and gas interests in the Contract Area and that the operator be deemed to have resigned if the operator no longer owns an interest in the Contract Area. Hillin was elected operator at a time when he owned no interest in the Contract Area, but was expecting to acquire an interest under a pending trade. That deal collapsed, but Hillin later acquired an interest from another party. Several years later, Purvis (proceeding on the belief that Hillin's election was improper because Hillin did not own an interest in the Contract Area at the time he was elected) polled the non-operators, and a majority elected Purvis operator. Hillin refused to turn over control of operations.<sup>100</sup> The applicable provisions of the operating agreement read:

B. Resignation or Removal of Operator and Selection of Successor:

1. Resignation or Removal of Operator: . . . If Operator . . . no longer owns an interest hereunder in the Contract Area, . . . Operator shall be deemed to have resigned without any action by Non-Operators, except the selection of a successor.
2. Selection of a Successor Operator: . . . The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected.<sup>101</sup>

The operating agreement did contain the common removal provision stating that "[o]perator may be removed if it fails or refuses to carry out its duties hereunder . . . by the affirmative vote of two (2) or more Non-Operators owning a majority interest . . . ."<sup>102</sup>

Purvis did not proceed under the removal provision but solely under his improper election theory. The court concluded that the election of

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96. *Id.* at 222.

97. *Questa*, 887 S.W.2d at 222.

98. *Id.*

99. 890 S.W.2d 931 (Tex. App.—El Paso 1994, no writ).

100. *Id.* at 935.

101. *Id.* at 936.

102. *Id.*



Hillin was indeed defective and that Hillin was deemed to have resigned because Hillin did not own an interest in the Contract Area.<sup>103</sup> The resignation, however, never became effective because the non-operators failed to elect a successor operator. Hillin became qualified by acquiring an interest, and he could only be removed in accordance with the terms of the operating agreement.<sup>104</sup> As an alternative basis for its holding, the court found that the non-operators had waived the requirement that Hillin resign.<sup>105</sup>

*Unocal Corp. v. Dickinson Resources, Inc.*<sup>106</sup> provided a road map for promoters and possible participants who want to protect themselves at the early stages of showing a prospect. Dickinson developed an offshore Louisiana prospect and showed it to many companies, including Unocal. The Unocal meeting occurred in January, 1990. At the beginning of the meeting, Unocal's representative presented Dickinson with Unocal's waiver form and Dickinson signed it. The waiver identified the prospect area and then read as follows:

This letter is written in connection with the review by [Unocal] of certain geologic and/or geophysical data and/or land and leasehold information provided by your company.

You agree to waive any claim demand or cause of action, either legal or equitable, which may be asserted against [Unocal] concerning use of any data or information of a proprietary or confidential nature which is provided for review by [Unocal]. Such review by [Unocal] shall not preclude any oil and gas operation or activity subsequent to the review in any area which was subject to the review, or in any other area.<sup>107</sup>

During the meeting the parties shared maps, seismic data and well logs covering the prospect area. The meeting concluded with no apparent agreement on the prospect, Unocal declined to participate, and Dickinson left with all of his data.<sup>108</sup>

A few months later, Unocal purchased some state leases for \$540,000 at public auction in the same area as Dickinson's prospect. Unocal claimed that its purchase was not improper because it had developed its own concept independent of Dickinson. At trial, Unocal presented evidence that it concluded a paleo study begun in 1988 shortly before the lease sale and that it also received new seismic data shortly before the lease sale. The jury was apparently unimpressed with Unocal's case, and in response to Dickinson's suit for fraud, negligence, gross negligence, breach of confidential relationships, misappropriation of a trade secret, and quantum

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103. *Id.*

104. *Purvis*, 890 S.W.2d at 936.

105. *Id.* at 937.

106. 889 S.W.2d 604 (Tex. App.—Houston [14th Dist.] 1994), *writ denied per curiam*, 907 S.W.2d at 453 (Tex. 1995).

107. *Id.* at 607.

108. *Id.* at 606.

merit awarded Dickinson \$1,376,000 in damages on the tort claims, \$54,000 on the quantum merit claim, and \$2,600,000 in punitive damages.

The case was reversed and rendered on appeal based on the written waiver. The court found that the waiver was voluntary, unambiguous and supported by consideration. The meeting would not have occurred but for the execution of the waiver, and both sides exchanged information.<sup>109</sup> The court also recognized a strong public policy argument in support of the enforcement of the waiver. Without such agreements, an exploration company such as Unocal would never meet with a promoter such as Dickinson because of the risk of claims similar to those asserted by Dickinson.<sup>110</sup> Thus, the court held that that waiver was effective.<sup>111</sup>

Obviously the waiver was, in this case, a powerful tool limiting Unocal's potential liability in accepting a meeting to review a promoter's prospect. The court also volunteered several methods by which promoters, such as Dickinson, could protect themselves from the risk of losing their prospect. The promoter could lease the area in advance, obtain a confidentiality agreement protecting the promoter, or condition the meeting on a written agreement for a share in any future operations or a limitation on future acquisitions (a negative "Area of Mutual Interest Agreement" or forbearance agreement).<sup>112</sup>

Apparently, this court believed the key issue was Unocal's bargained for right to develop the prospect for itself, as evidenced by the last sentence of the waiver.<sup>113</sup> Although Dickinson originally contended that his signature to the waiver was fraudulently induced, he abandoned that defense at trial, conceded his signature was voluntary, and merely attacked the waiver's scope.<sup>114</sup> It is unlikely that Unocal's form of waiver would be bullet-proof in a proper case where the issue was joined in the context of fraudulent inducement.

Even in this case, Unocal did not escape entirely unscathed. With the litigation pending, Unocal elected to allow the leases to lapse and revert to the state. The court showed little sympathy for Unocal's argument that it should recover its \$540,000 investment from Dickinson. The court found that the litigation was merely part of the business risks that Unocal assumed in first acquiring and then releasing its leases.<sup>115</sup>

## V. GAS CONTRACTS

The Texas Supreme Court considered whether a standard take-or-pay gas contract is an output contract subject to the good faith and proportionality requirements of section 2.306 of the Uniform Commercial Code

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109. *Id.* at 608.

110. *Id.* at 609.

111. *Unocal*, 889 S.W.2d at 610 (citing *Dresser Indus., Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505, 508 (Tex. 1993)).

112. *Id.* at 609-10.

113. *Id.* at 609.

114. *Id.* at 608.

115. *Id.* at 610.

in *Lenape Resources Corp. v. Tennessee Gas Pipeline Co.*<sup>116</sup> Because the gas purchaser's obligation to pay under the gas contract was triggered by the seller's production capacity, which was largely within the seller's control, the court held that the contract was an output contract in accordance with TEX. BUS. & COM. CODE section 2.306.<sup>117</sup> Section 2.306(a) states that:

A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded.<sup>118</sup>

The litigation began when the gas seller split up the contract acreage, formed new, larger units, and drilled additional gas wells with significant increases in capacity. The buyer contended that the unitization and additional drilling was a "bad faith exploitation of a favorable contract term and an unreasonably disproportionate increase in the amount of gas tendered."<sup>119</sup> The court rejected the seller's argument that a contract term fixing the quantity at 85% of deliverability was sufficiently definite and that the "gap filler" provision of section 2.306 was inapplicable.<sup>120</sup>

In analyzing how the good faith and unreasonably disproportionate standards of section 2.306 should be applied, the court concluded that these were two separate tests. In tendering goods in an output contract, section 2.306 requires that the tender "1) be not unreasonably disproportionate to any normal or otherwise comparable prior output or stated estimates, and 2) be in good faith."<sup>121</sup> Therefore, if the quantity tendered is unreasonable, the fact finder could find a violation of section 2.306 regardless of a determination of good faith.<sup>122</sup> The court also expressly rejected the seller's argument that the seller had the unilateral right to drill new wells under an express provision in the gas contract because the UCC does not permit the parties to waive or amend the obligations of good faith.<sup>123</sup>

The court did not adequately address or consider the effect of its ruling in limiting the buyer's obligation to take or pay for gas, while the gas remained dedicated to the contract.<sup>124</sup> The dissent was pointedly critical of the court's apparent willingness to accept the buyer's "concession" that excess gas not taken should be released. Such action did not amount to a concession; rather, such action by the buyer had the effect of relieving the

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116. No. 94-0278, 1995 WL 453266 (Tex. Aug. 1, 1995).

117. *Id.* at \*3.

118. TEX. BUS. & COM. CODE ANN. § 2.306(a) (Vernon 1994).

119. *Lenape*, 1995 WL 453266 at \*2.

120. *Id.* at \*5.

121. *Id.* at \*8.

122. *Id.*

123. *Id.* at \*9. See TEX. BUS. & COM. CODE ANN. § 1.102(c) (Vernon 1994).

124. *Lenape*, 1995 WL 453266 at \*9.

buyer of its obligation to purchase the gas.<sup>125</sup>

In *Enserch Corp. v. Rebich*<sup>126</sup> the applicable gas contract was executed in 1980 for a term of fifteen years and called for pricing to be tied “to the ‘maximum lawful price for Section 102 . . . gas’ as determined by the federal government under the Natural Gas Policy Act of 1978 (“NGPA”).”<sup>127</sup> The Section 102 gas price was calculated monthly by the Federal Energy Regulatory Commission using a formula that resulted in a progressively escalating price that had significantly exceeded the market price for gas. When the gas market collapsed, Enserch unilaterally began paying at a market rate in 1984. For the next 100 months Rebich and his predecessors simply accepted the lower prices. In 1985 gas prices on domestic wells were deregulated, so that there was no longer a “maximum lawful price.” Deregulation, however, did not end the publication of a Section 102 price, although the price published after deregulation pertained to the type of Section 102 gas produced offshore. In March of 1993 the NGPA was repealed, and the government ceased publishing the Section 102 price altogether.

Rebich filed suit in April of 1993 to recover the underpayment for gas for the four years preceding the date that his suit was filed. The trial court granted summary judgement for Rebich. The judgment also fixed the price from March 1993 (when the Section 10 price ceased to be published) until the expiration of the contract in 1995 at the last published Section 102 price. Enserch argued that “maximum lawful price” was the controlling phrase, which the court conceded had no meaning after 1985.<sup>128</sup> Nevertheless, the remainder of the contract terminology, “. . . for Section 102 . . . gas” remained. The court concluded that the parties selected this index for their pricing scheme and that it provided a certain and definite meaning.<sup>129</sup>

Enserch argued that there were other possible interpretations rendering the contract ambiguous, or at least not subject to summary judgment. In particular, Enserch contended that the contract was silent as to a post-deregulation price, and therefore upon deregulation a commercially reasonable price or the last regulated price should control. The court rejected this argument because the parties knew in 1980 when they entered into the contract that gas prices would be deregulated in 1985.<sup>130</sup> It was not reasonable to interpret the contract as having no pricing provision applicable to the final two-thirds of the contract period.<sup>131</sup>

Enserch’s affirmative defenses of modification, ratification, amendment, and novation were each rejected, because any revision of the con-

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125. *Id.* at \*17.

126. No. 12-93-00303-CV, 1995 WL 574240 (Tex. App.—Tyler Sept. 29, 1995, no writ).

127. *Id.* at \*1.

128. *Id.* at \*3.

129. *Id.*

130. *Id.* at \*4.

131. *Enserch*, 1995 WL 574240 at \*4.

tract was required to have been in writing and signed.<sup>132</sup> The estoppel defense was rejected because there was no showing of detrimental reliance.<sup>133</sup> Waiver was rejected as a defense on the theory that the waiver, if any, was implied, and implied waiver can only be invoked to prevent fraud or inequitable consequences.<sup>134</sup>

The significance of the case is that there may still be a number of old "maximum lawful price" contracts still in effect under which producers have taken an inert position similar to the facts in this case. The opinion suggests that for these producers there may be an avenue of recovery still open against their purchaser.

## VI. REGULATION

*TCA Building Co. v. Northwestern Resources Co.*,<sup>135</sup> is a hard rock mining case in which the Railroad Commission's jurisdiction and the plaintiff's petition for a temporary injunction were considered. Northwestern surrendered or released all of its rights in certain coal leases, except insofar as necessary to complete reclamation as required by the Railroad Commission.

The Texas Surface Coal Mining and Reclamation Act expressly grants the Railroad Commission exclusive jurisdiction over "surface coal mining and reclamation operations . . . ."<sup>136</sup> However, the legislature also expressly provided that the commission was not authorized to adjudicate property title or property rights disputes.<sup>137</sup>

Although Northwestern's permit from the Railroad Commission authorized it to place no more spoil on TCA's property "than that which would allow continuation of reclamation to the elevation of the pre-mine overburden and topsoil," it did not determine whether Northwestern had the legal right to enter TCA's property to do so.<sup>138</sup> The issues involved were: 1) Northwestern's legal right to enter TCA's property to conduct reclamation operations under certain documents; and 2) TCA's right to injunctive relief to preclude such entry until the merits of the declaratory judgment and suit for damages could be determined.<sup>139</sup>

The court determined that these questions were not only "inherently judicial in nature" but also that the Railroad Commission had no jurisdiction to grant the relief sought by TCA.<sup>140</sup> Under the facts, the trial court had jurisdiction over the merits of TCA's suit and questions relating to

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132. *Id.* at \*5 (citing TEX. BUS. & COM. CODE ANN. § 26.01(b)(6) (Vernon 1994)).

133. *Id.* (citing *Gulbenkian v. Penn.*, 151 Tex. 412, 252 S.W.2d 929 (1952)).

134. *Id.* at \*6.

135. 890 S.W.2d 175 (Tex. App.—Waco, 1994, no writ).

136. TEX. NAT. RES. CODE ANN. § 134.012(a)(1) (Vernon Supp. 1996) (note that *TCA Building* dealt with an earlier version of the Texas Surface Coal Mining and Reclamation Act).

137. *Id.* § 134.012(d).

138. *TCA Building*, 890 S.W.2d at 177.

139. *Id.* at 179.

140. *Id.* (citing *Amarillo Oil v. Energy-Agri Products*, 794 S.W.2d 20, 26 (Tex. 1990)).

injunctive relief, even though the Railroad Commission might have had exclusive jurisdiction regarding reclamation operations and the determination of the amount of spoil needed to return the land to its pre-mine state.<sup>141</sup>

In *Morris v. State*<sup>142</sup> an operator tried to avoid well plugging liabilities previously assessed by contending that he did not receive the required statutory notice.<sup>143</sup> The Railroad Commission mailed notices to the addresses shown on Form P-5. Form P-5 is the organization report which all oil and gas operators are required to submit to the Railroad Commission, including their current names and addressees. The report must be refiled annually.<sup>144</sup> Morris contended that he never got the notice. The court held that the Railroad Commission's mailing of notice to the addresses shown on the P-5 was held to be sufficient to satisfy the requirements of due process.<sup>145</sup>

## VII. LEGISLATION

The Seventy-Fourth Legislature met in Regular Session and passed the following legislation relative to the oil, gas and mineral industry which may be of general interest:

1. ACT: Act of April 6, 1995, 74th Leg., R.S., ch. 26, 1995 Tex. Sess. Law Serv. 287 (Vernon).<sup>146</sup>  
 Summary: Provides for periodic testing of gas well deliverability and wellhead pressure, instead of current mandatory testing schedule of every January and July.  
 Effective: September 1, 1995.
2. ACT: Act of May 2, 1995, 74th Leg., R.S., ch. 106, 1995 Tex. Sess. Law Serv. 898 (Vernon).<sup>147</sup>  
 Summary: Requires that administrative hearings for the Texas Natural Resources Conservation Commission be delegated to the State Office of Administrative Hearings.  
 Effective: September 1, 1995.
3. ACT: Act of May 4, 1995, 74th Leg., R.S., ch. 109, 1995 Tex. Sess. Law Serv. 909 (Vernon).<sup>148</sup>

141. *Id.*

142. 894 S.W.2d 22 (Tex. App.—Austin 1994, writ dismiss'd w.o.j.).

143. *Id.* at 23-24. See TEX. GOV'T CODE ANN. § 2001.051 (Vernon 1995) (requiring reasonable notice of not less than ten days in contested cases).

144. *Id.* at 24.

145. *Id.* at 25.

146. To be codified as an amendment to TEX. NAT. RES. CODE ANN. §§ 86.141-43.

147. To be codified at TEX. GOV'T CODE ANN. §§ 2003.047 and TEX. HEALTH & SAFETY CODE ANN. §§ 361.0832(a) and (g); amending TEX. HEALTH & SAFETY CODE ANN. §§ 361.083(a) and (b); TEX. WATER CODE ANN. §§ 26.021(a)-(c), §§ 28.029(a)-(c), and subchapter H.

148. To be codified at TEX. GOV'T CODE ANN. §§ 442.005(r) and (s); §§ 442.0021-23; §§ 442.0085-86; and § 442.0095; TEX. NAT. RES. CODE ANN. §§ 161.092(c)-(e); § 191.0525; amending TEX. GOV'T CODE ANN. §§ 442.002-05(a)-(d) and (j); §§ 442.009-10; § 442.015(a)(b) and (g); § 442.0155; § 442.016; § 443.008; TEX. NAT. RES. CODE ANN.

**Summary:** Authorizes the continuation of the Texas Historical Commission and abolishes the Antiquities Committee. It requires notice be given to the Historical Commission before breaking ground on any project on state or local public land, so that the Commission may determine if a historically significant archeological site is present and requires additional precautions be taken to protect historical sites. Among the activities exempted from these requirements are:

- (1) water injection into existing oil and gas wells;
- (2) seismic exploration activity where there is no ground penetration or disturbance;
- (3) exploration production, and pipeline projects at the crossing of public roads, rivers or streams, unless they contain a recorded archeological site or a designated state land tract in Texas' submerged lands;
- (4) maintenance, operation, replacement or minor modifications to an existing exploration, production or pipeline facility; and
- (5) any project for which a state permit application was filed prior to the promulgation of rules by the Texas Historical Commission to implement this law.

**Effective:** August 30, 1995.

4. **ACT:** Act of May 4, 1995, 74th Leg., R.S., ch. 149, 1995 Tex. Sess. Law Serv. 996 (Vernon).<sup>149</sup>

**Summary:** Prohibits the Texas Natural Resource Conservation Commission from imposing more stringent requirements on air permits upon renewal, unless necessary to comply with state or federal law or to avoid a condition of air pollution. The amendments also allow an applicant for renewal of an air permit to be granted the renewal without going through the public hearing process, provided there will be no net increases in emissions or release of a new contaminant.

**Effective:** May 19, 1995.

5. **ACT:** Act of May 4, 1995, 74th Leg., R.S., ch. 150, 1995 Tex. Sess. Law Serv. 997 (Vernon).<sup>150</sup>

**Summary:** Redefines the phrase "modification of existing facility" in relation to air permitting so that a physical or operational change is not considered a

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§ 11.24; TEX. TAX CODE ANN. § 315.006(k); TEX. LOCAL GOV'T CODE ANN. §§ 5.01(a) and 6.05(j); and TEX. REV. CIV. STAT. ANN. art. 601b.

149. To be codified as an amendment to TEX. HEALTH & SAFETY CODE ANN. §§ 382.055(e) and 382.056(d) and adding § 382.056(e).

150. To be codified at TEX. HEALTH & SAFETY CODE ANN. § 382.0518(h) and amending §§ 382.003(9) and 382.0512.

“modification” if there will be no net increase in allowable emissions and the facility was permitted within the last 10 years or has installed the best available control technology within the last 10 years. An increase in the throughput of a natural gas processing, treating or compression facility is not a “modification” if the facility remains within its design capacity.

Effective: May 19, 1995.

6. ACT: Act of May 15, 1995, 74th Leg., R.S., ch. 315, 1995 Tex. Sess. Law Serv. 2708 (Vernon).<sup>151</sup>

Summary: Creates the Petroleum Storage Tank Revitalization Program by providing a \$120 million loan from the general revenue fund to pay for claims submitted by August 31, 1995. Any claims submitted prior to August 31, 1995, are to be paid prior to claims submitted after August 31, and all claims are to be paid in the order received. The law doubles the petroleum product delivery fee. All tanks are to be registered by December 31, 1995, and all contaminated sites are to be reported by December 22, 1998. Furthermore, it requires evidence of financial responsibility or private insurance for clean sites after December 22, 1998. The standards for clean-up are health-risk based. Issuance of a closure letter for a site meeting the health-risk based standard is required. The Texas Natural Resources Conservation Commission may privatize any portion of the program. This law sunsets in the year 2001.

Effective: September 1, 1995.

7. ACT: Act of May 27, 1995, 74th Leg., R.S., ch. 617, 1995 Tex. Sess. Law Serv. 3476 (Vernon).<sup>152</sup>

Summary: Permits the Texas Railroad Commission to reject and/or revoke an application, permit, certificate of compliance or organization report, if an officer, director, general partner, owner of more than twenty-five percent (25%) ownership interest or trustee of an organization has within the preceding 5 years, held a position of ownership or control and during that period the organization violated a provision of this title, a Commission rule, order, license, permit or certificate relating to safety or pollution control, unless the violation has been corrected and all fines, penalties and costs have been

151. To be codified at TEX. WATER CODE ANN. § 26.342(13), §§ 26.346(e) and (f), §§ 26.3512(f)-(k), (m); § 26.3514(f)-(i); § 26.3572(d); § 26.35735(e)-(f); § 26.3475; § 26.35731; § 26.360-63; amending §§ 26.341(b); § 26.352 §§ 26.3512(b) and (e); §§ 26.3572(b)-(c); § 26.3573(d), (f), (h), (i), (k), (p); §§ 26.3574(b), (x), (y), TEX. GOV'T CODE ANN. § 403.092(c); and redesignating TEX. REV. CIV. STAT. ANN., art. 8900 as Subchapter K, Chapter 26, TEX. WATER CODE ANN.

152. To be codified as an amendment to TEX. NAT. RES. CODE ANN. § 91.114.



paid, or if the Commission and the organization have agreed to a schedule for correcting the conditions, and the corrections are occurring on schedule.

Effective: September 1, 1995.

8. ACT: Act of May 27, 1995, 74th Leg., R.S., ch. 679, 1995 Tex. Sess. Law Serv. 3655 (Vernon).<sup>153</sup>

Summary: Provides that the anti-indemnity statute regarding oil, gas, water, and mineral wells (Chapter 127, Civil Practice and Remedies Code), does not apply to agreements with respect to the purchase, gathering, storage or transportation of oil, brine water, fresh water, condensate, produced water, petroleum products or other liquid commodities, if the parties agree in writing that the indemnity obligation will be supported by liability insurance coverage to be furnished by the indemnitor.

Effective: August 28, 1995.

9. ACT: Act of May 29, 1995, 74th Leg., R.S., ch. 681, 1995 Tex. Sess. Law Serv. 3656 (Vernon).<sup>154</sup>

Summary: Provides that royalty payments need not be disbursed until the amount due equals \$100.00 (increased from \$25.00), or until 12 months' proceeds accumulate, whichever comes first. Accumulated proceeds of less than \$10 may be held by the payor until production ceases or the payor's responsibility for making payment for production ceases, whichever comes first. Upon written request of the payee, the payor must remit accumulated proceeds annually if the payor owes the payee less than \$10. Upon written request of the payee, the payor must remit accumulated proceeds monthly if the payor owes more than \$25 but less than \$100.

Effective: June 15, 1995.

10. ACT: Act of May 19, 1995, 74th Leg., R.S., ch. 705, 1995 Tex. Sess. Law Serv. 3719 (Vernon).<sup>155</sup>

Summary: Generally promotes trucking reform by repealing the Motor Carrier Act and several other transportation related statutes. Among other provisions, it allows oil field service companies to provide ancillary trucking services that are incidental to their primary

153. To be codified as an amendment to TEX. CIV. PRAC. & REM. CODE ANN. § 127.005(a).

154. To be codified as an amendment to TEX. NAT. RES. CODE ANN. §§ 91.402(d) and (f).

155. To be codified as an amendment to TEX. REV. CIV. STAT. ANN. art. 911m, 6675c, 6675d, and 6701d; amending TEX. REV. CIV. STAT. ANN. art. 670 1/2, 883, 911k, 6519c, 6674v, 6675a-6e, 6687-9a, 6701a, 6701b-1, 6701d-11, 6701h, and 9103; TEX. ALCO. BEV. CODE ANN. §§ 41.03, 42.03, 67.01; TEX. LAB. CODE ANN. § 201.073; TEX. TAX CODE ANN. §§ 152.089, 154.001(3), 155.001(3).

- service (e.g., pipe inspection and/or coating companies can haul the pipe).
- Effective: September 1, 1995.
11. ACT: Act of May 24, 1995, 74th Leg., R.S., ch. 850, 1995 Tex. Sess. Law Serv. 4279 (Vernon).<sup>156</sup>
- Summary: Provides that the Texas Railroad Commission has exclusive control over safety standards and practices applicable to the transportation of gas and all gas pipeline facilities within the state which are not under exclusive federal control. A municipality or county may not adopt or enforce an ordinance that establishes safety standards or practices for facilities regulated under this Article or other state or federal law.
- Effective: June 16, 1995.
12. ACT: Act of May 19, 1995, 74th Leg., R.S., ch. 870, 1995 Tex. Sess. Law Serv. 4336 (Vernon).<sup>157</sup>
- Summary: Allows the Texas Railroad Commission to administratively approve downhole commingling of oil and gas.
- Effective: September 1, 1995.
13. ACT: Act of May 19, 1995, 74th Leg., R.S., ch. 871, 1995 Tex. Sess. Law Serv. 4337 (Vernon).<sup>158</sup>
- Summary: Permits the Texas Railroad Commission to allow surface commingling of oil and gas from two or more tracts of land producing from the same reservoir or from one or more tracts of land producing from different reservoirs, regardless of whether the tracts or reservoirs have the same working or royalty interest ownership.
- Effective: September 1, 1995.
14. ACT: Act of May 22, 1995, 74th Leg., R.S., ch. 895, 1995 Tex. Sess. Law Serv. 4415 (Vernon).<sup>159</sup>
- Summary: Entitles high-cost gas wells, as defined by the federal Natural Gas Policy Act of 1978, spudded or completed between September 1, 1996, and August 31, 2002, to receive a reduction in the gas production tax for up to 120 consecutive months (10 years), beginning on the first day of production, or until the cumulative value of the tax reduction equals fifty percent (50%) of the drilling and completion costs for the well, whichever occurs first. The amount of the tax reduction is calculated by subtracting from the tax rate the product of that tax rate times the ratio of drilling and completion costs for the well to twice the median drilling and

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156. To be codified as an amendment to TEX. REV. CIV. STAT. ANN. art. 6053-1.

157. To be codified as an amendment to TEX. NAT. RES. CODE ANN. §§ 85.046(b) and 86.012 (b).

158. To be codified at TEX. NAT. RES. CODE ANN. § 85.046(c).

159. To be codified as an amendment to TEX. TAX CODE ANN. § 201.057.

completion costs for high cost wells for the previous state fiscal year. (amount of tax reduction = tax rate  $\times$  (drilling and completion costs  $\div$  (2  $\times$  median drilling & completion costs) The effective tax rate may not be reduced below zero. Thus, a well could be fully tax exempt, if the costs of drilling and completing that well exceed 200% of the state median cost. Median drilling and completion costs are to be determined by the Comptroller after March 1 of each year, based on the filing of an application for tax exemption or refund under this Section. The application, for wells spudded or completed after September 1, 1995, must contain a report of the drilling and completion costs incurred for each well, as specified by the Comptroller. The information pertaining to individual wells is to remain confidential.

Effective: September 1, 1995.

15. ACT: Act of May 27, 1995, 74th Leg., R.S., ch. 937, 1995 Tex. Sess. Law Serv. 4706 (Vernon).<sup>160</sup>

Summary: Authorizes the School Land Board to allow the surface owners of Permanent School Fund lands to waive their rights and duties as state agents and to lease those lands for the purpose of exploring for and producing oil and gas and other minerals, provided that the surface owner also waives all rights to receive any part of the bonus, rental, royalty or other consideration accruing to the lessor. A surface owner may not lease to any person related within the second degree of consanguinity or affinity (i.e., parents, siblings, children, aunts, uncles, nieces, nephews or first cousins). Upon request, the School Land Board may approve leases to persons within the second degree of consanguinity or affinity.

Effective: September 1, 1995.

16. ACT: Act of May 27, 1995, 74th Leg., R.S., ch. 986, 1995 Tex. Sess. Law Serv. 4956 (Vernon).<sup>161</sup>

Summary: Creates a voluntary cleanup program under the Texas Natural Resource Conservation Commission (TNRCC). The program is to provide incentive to remediate properties by removing liability of lenders and future landowners. The program requires applicants to pay the TNRCC's reasonable review and oversight costs, plus a \$1,000 filing fee. The terms of the voluntary cleanup agreement are to be negotiated between the owner and the TNRCC.

160. To be codified at TEX. NAT. RES. CODE ANN. §§ 52.190 & 53.081, and to be codified as an amendment to TEX. NAT. RES. CODE ANN. § 53.074(a).

161. To be codified at TEX. HEALTH & SAFETY CODE ANN. §§ 361.601-361.613; and to be codified as an amendment to TEX. HEALTH & SAFETY CODE ANN. §§ 361.133(b) & (c).

While the property is in the program, the TNRCC is prohibited from initiating an enforcement action regarding the subject of cleanups. Upon completion of the cleanup program, the TNRCC will issue a certificate of completion, acknowledging the protection from liability for future landowners and lenders. This certificate of completion will be filed in the real property records of the county in which the property is located.

Effective: September 1, 1995.

17. ACT: Act of May 23, 1995, 74th Leg., R.S., ch. 989, 1995 Tex. Sess. Law Serv. 4962 (Vernon).<sup>162</sup>

Summary: Creates Texas Experimental Research and Recovery Activity (TERRA) within the Texas Railroad Commission to inventory mechanically sound and nonpolluting well bores which would otherwise have been plugged, and to allow mineral interest owners of such well bores to transfer the inactive wells into TERRA, along with a payment of up to 75% of the estimated plugging costs. In consideration for transferring the inactive well into TERRA, the Texas Railroad Commission will forbear enforcing the well owner's compliance with otherwise applicable rules regarding maintenance and plugging of inactive wells. The Texas Railroad Commission may then license out accepted wells for collection of data, production testing, or developmental research on recovery techniques, each of which must have reasonable potential to increase the recovery of hydrocarbons from the tract on which the well bores are located. The license holder may sell hydrocarbons produced during a production test and distribute the proceeds as provided in the statute, including up to one-half of the proceeds on lands in which the mineral interest is privately held.

Effective: January 1, 1996.

18. ACT: Act of May 17, 1995, 74th Leg., R.S., ch. 1007, 1995 Tex. Sess. Law Serv. 5045 (Vernon).<sup>163</sup>

Summary: Permits the School Land Board to reduce the royalty rate for reservoirs producing 15 barrels of oil per well per day or less to not less than one-sixteenth (6.25%) for up to two years. The royalty rate for the state's share on relinquishment lands is reduced to one thirty-second (3.125%), provided that the owner's rate is also reduced in the same proportion. These royalty rate reductions shall be

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162. To be codified at TEX. NAT. RES. CODE ANN. ch. 93.

163. To be codified at TEX. NAT. RES. CODE ANN. § 32.067 and TEX. EDUC. CODE ANN. § 55.84.

for two years, unless extended by the School Land Board for additional two year periods.

Effective: June 17, 1995.