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Oil, Gas and Mineral Law

*Richard F. Brown**

TABLE OF CONTENTS

I. INTRODUCTION

This article focuses on the interpretations of and changes relating to oil, gas, and mineral law in Texas from November 1, 2015, through October 31, 2016. The cases examined include decisions of state and federal courts in the State of Texas and the U.S. Court of Appeals for the Fifth Circuit.[1]

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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. Page limitations of this publication required the omission of some cases of interest. The facts in the cases are sometimes simplified to focus on the legal principles.

II. TITLE AND CONVEYANCING ISSUES[2]

A. *Hysaw v. Dawkins*

In *Hysaw v. Dawkins*,[3] the Texas Supreme Court considered the double-fraction issue in the context of a will-construction dispute and held that the will devised a fraction of royalty, not a fractional royalty.[4] The supreme court used this case to give some guidance on how these double-fraction conveyances are to be construed. The parties aligned as descendants of three sibling-beneficiaries—Inez, Dorothy, and Howard—under the 1947 will of their mother, Ethel.[5] Ethel's will divided her land into three unequal tracts, and she devised to each child fee simple title in one of the tracts, subject to the conveyance of a non-participating royalty to each child in all of the tracts.[6] The will provided (with mirror-image provisions for each child) as follows:

> I will and bequeath to each of the above named children fee simple title to the lands designated to go to them, subject, however, to the following . . . [1] *each of my children shall have and hold an undivided one-third (1/3) of an undivided one-eighth (1/8) of all oil, gas or other minerals in or under or that may be produced from any of said lands, the same being a non-participating royalty* interest; that is to say . . . [the named child] shall not participate [as to the land devised

2. Other cases dealing with title and conveyancing issues include the following: Wenske v. Ealy, No. 13-15-00012-CV, 2016 WL 363735, at *1 (Tex. App.—Corpus Christi Jan. 28, 2016, pet. denied) (mem. op.) (deed construction); Mueller v. Davis, 485 S.W.3d 622 (Tex. App.—Texarkana 2016), *rev'd*, No. 16–0155, 2017 WL 2299316 (Tex. Mar. 23, 2017) (deed Mother Hubbard clause); Consol. Prop. Interests, LLC v. Payne, No. 12-15-00105-CV, 2016 WL 786939, at *1 (Tex. App.—Tyler Feb. 29, 2016, no pet.) (mem. op.) (three-part mineral deed); Spartan Tex. Six Capital Partners, Ltd. v. Perryman, 494 S.W.3d 735 (Tex. App.—Houston [14th Dist.] 2016, pet. filed) (Duhig Rule); Burlington Res. Oil & Gas Co. v. Petromax Operating Co., 486 S.W.3d 703 (Tex. App.—Texarkana 2016, no pet.) (construction of assignment); Dragon v. Harrell, No. 04-14-00711-CV, 2016 WL 1238165, at *1 (Tex. App.—San Antonio Mar. 30, 2016, pet. denied) (mem. op.) (deed conveying fraction of royalty or fractional royalty); Alford v. McKeithen, No. 12-14-00262-CV, 2016 WL 1253902, at *1 (Tex. App.—Tyler Mar. 31, 2016, no pet.) (mem. op.) (deed incorporating less than all of Exhibit A into the deed); Bounds v. Prud'Homme, No. 12-15-00177-CV, 2016 WL 1254072, at *1 (Tex. App.—Tyler Mar. 31, 2016, pet. filed) (mem. op.) (deed construction of reservation); Kardell v. Acker, 492 S.W.3d 837 (Tex. App.—San Antonio 2016, no pet.) (conveyance of royalty); Bauer v. White, No. 13-16-00054-CV, 2016 WL 3136608, at *1 (Tex. App.—Corpus Christi June 2, 2016, pet. denied) (mem. op.) (community property presumption); Richardson v. Mills, No. 12-15-00170-CV, 2016 WL 7488860, at *1 (Tex. App.—Tyler Dec. 30, 2016), *superseded on rehearing*, No. 12-15-00170-CV, 2017 WL 511893 (Tex. App.—Tyler Feb. 8, 2017, pet. denied) (deed or lease construction); Combest & Mountain Laurel Minerals v. Mustang Minerals, LLC, 502 S.W.3d 173 (Tex. App.—San Antonio 2016, pet. filed) (reservation in land described or interest conveyed); Laborde Props., L.P. v. U.S. Shale Energy II, LLC, No. 04-16-00168-CV, 2016 WL 5922404, at *1 (Tex. App.—San Antonio Oct. 12, 2016, pet. filed) (mem. op.) (fixed or floating royalty clause); Jackson v. Wildflower Prod. Co., Inc., 505 S.W. 3d 80 (Tex. App.—Amarillo 2016, pet. denied) (mineral deed without warranty is a quitclaim deed); Greer v. Shook, 503 S.W.3d 571 (Tex. App.—El Paso 2016, pet. filed) (conflicting fractions, legacy of the one-eighth royalty, and estate misconception).

3. 483 S.W.3d 1 (Tex. 2016).

4. *Id.* at 16.

5. *Id.* at 5.

6. *Id.*

> to the other two children], but that [2] *the said [named child] shall receive one-third of one-eighth royalty, provided there is no royalty sold or conveyed by me covering the lands so willed to [the child]*, and [3] *should there be any royalty sold during my lifetime then [the three children] shall each receive one-third of the remainder of the unsold royalty*.[7]

The supreme court broke the clause into the three separate numbered clauses for analysis. Inez's descendants executed a lease that provided for a royalty of one-fifth.[8] Inez's descendants contended the will devised to Dorothy and Howard a fractional royalty on Inez's land (one-third of one-eighth equals one twenty-fourth to each). Dorothy's and Howard's descendants contended the will devised to Dorothy and Howard a one-third fraction of royalty on Inez's land (one-third of one-fifth equals one-fifteenth to each).[9]

The supreme court reviewed construction principles applicable to wills and observed that "[s]imilar construction principles apply to non-testamentary instruments [i.e., deeds] conveying mineral interests."[10] The supreme court used will and deed precedents without distinction,[11] concluding that the will showed Ethel's intent for each of her children to share equally in all royalties under all circumstances. It relied on the first provision's sharing of royalty by each child in the royalties from all the lands; the equal sharing required under the third provision's fraction of royalty devise; and the fact that Ethel used the term "'one-eighth royalty' as shorthand for the entire royalty interest a lessor could retain under a mineral lease."[12] The supreme court thus held that "Ethel's will devised to each child 1/3 of any and all royalty interest on all the devised land tracts."[13]

From the beginning of the oil and gas industry in Texas until the mid-1970s, a lessor's royalty under an oil and gas lease was almost always one-eighth.[14] The royalty rate of one-eighth was "so pervasive that, for decades, courts took judicial notice of it as the standard and customary royalty."[15] Thousands of mineral deeds drafted during those years may have been drafted under the assumption that the royalty would always be one-eighth (i.e., that it would never be, for example, one-fifth—referred to as "historical standardization") or that the lessor's interest in lands after the execution of a lease was only a one-eighth interest (rather than all, subject to a fee simple determinable in the lessee—referred to as "estate

7. *Id.* at 14.
8. *Id.* at 6.
9. *Id.*
10. *Id.* at 8 (citing Luckel v. White, 819 S.W.2d 459, 461–62 (Tex. 1991); Sun Oil Co. v. Madeley, 626 S.W.2d 726, 731 (Tex. 1981)).
11. *Id.*
12. *Id.* at 15–16.
13. *Id.* at 16.
14. *Id.* at 6, 9.
15. *Id.* at 9–10.

misconception").[16] "[C]onveyances containing double fractions or two or more differing fractions present recurring interpretative challenges."[17] The simplest example would be a conveyance of "one-half of the usual 1/8th royalty,"[18] followed by a subsequent oil and gas lease providing for a three-sixteenths royalty. In this example, did the grantee receive a fixed royalty of one-half of one-eighth, which equals one-sixteenth of production, or a floating royalty of one-half of three-sixteenths, which equals three thirty-seconds of production? "[C]ourt opinions construing double-fraction language have yielded mixed results, with no discernible unifying principle except to the extent the outcome derives from the conveying instrument's specific language."[19]

> Today, we reaffirm our commitment to a holistic approach aimed at ascertaining intent from all words and all parts of the conveying instrument. To discern intent, words and phrases must be construed together and in context, not in isolation.[20] . . .
>
> We further eschew reliance on mechanical or bright-line rules as a substitute for an intent-focused inquiry rooted in the instrument's words. To that end, the estate-misconception theory and the historical use of 1/8 as the standard royalty may inform the meaning of fractions stated in multiples of 1/8, but these considerations are not alone dispositive.[21]

There are no bright-line rules, but we are looking for rules to better forecast the construction to be given to a problematic conveyance. This case, and other precedents, suggest that fractional royalties (particularly large ones) will be rare, courts will lean toward finding fraction "of" royalty to be the parties' intent, "two grants" will be rare, and historical standardization along with estate misconception will be liberally applied to harmonize conflicting provisions. Thus, much to the chagrin of title examiners, the significance of this case is that, like pornography, you will know the meaning of a double-fraction conveyance when you see it.

B. *Goss v. Addax Minerals Fund, LP*

In *Goss v. Addax Minerals Fund, LP*,[22] the Amarillo Court of Appeals held that the discovery rule does not apply to defer the accrual of a cause of action to correct a plainly evident omission on the face of an unambiguous deed.[23] The parties aligned as successors-in-interest to Grantor and Grantee under a 1994 deed. The contract for sale expressly provided that

16. *Id.* at 10–11.
17. *Id.* at 9 (citing Garrett v. Dils Co., 299 S.W.2d 904, 906 (Tex. 1957); Concord Oil Co. v. Pennzoil Expl. & Prod. Co., 966 S.W.2d 451, 454 (Tex. 1998)).
18. *Id.* at 11 n.13.
19. *Id.* at 11.
20. *Id.* at 13 (citing Plainsman Trading Co. v. Crews, 898 S.W.2d 786, 789 (Tex. 1995)).
21. *Id.*
22. No. 07-14-00167-CV, 2016 WL 1612918, at *1 (Tex. App.—Amarillo Apr. 21, 2016, pet. denied) (mem. op.).
23. *Id.* at *5.

Grantee was to receive all of the minerals. The 1994 deed, prepared by the title company, reserved and excepted the minerals, and Grantee saw the deed in 1994. In 2005, Grantee talked to the title company about the minerals, and on November 30, 2005, the title company "fixed" the problem by filing an affidavit reciting that the reservation of the minerals to Grantor was a scrivener's error.[24] Grantee believed and relied upon the title company's assurance that the affidavit confirmed Grantee's title and ownership in the minerals.[25] In March 2012, Grantor leased the minerals. In April 2013, Grantee sued, alleging "the . . . 1994 deed unambiguously conveyed the minerals to [Grantee]" (alternatively the deed was ambiguous).[26] Grantee also sued for reformation and to quiet title, asserting that the cause of action accrued in March 2012 and that the discovery rule applied. The minerals were awarded to Grantor on motion for summary judgment.[27]

The format of the deed generally followed the State Bar of Texas real estate form deed.[28] The granting clause conveyed "the property, . . . except as to the reservations from and exceptions to warranty."[29] The deed then provided:

> RESERVATIONS FROM AND EXCEPTIONS TO CONVEYANCE AND WARRANTY: Reservations, restrictions and easements of record, and current year ad valorem taxes. LESS, SAVE AND EXCEPT HERE FROM ALL OIL, GAS AND OTHER MINERALS, IN, UNDER AND PRODUCED FROM THE ABOVE DESCRIBED PROPERTY.[30]

Because there were no minerals outstanding in any other party, it did not matter whether the provision as to minerals was construed to be a reservation or exception. Either way, the minerals did not pass to Grantee, and therefore Grantor either reserved the minerals or still owned the minerals.[31]

The court of appeals also rejected Grantee's alternative argument that the deed was ambiguous. Grantee contended that "the 'subject to' language in the deed's granting clause [was] intended only to limit the warranty of title."[32] The court held that this alternative reading of the deed was unreasonable.[33] "A deed is ambiguous only if application of established rules of construction leaves the instrument susceptible to more

24. *Id.* at *1.
25. *Id.* at *5.
26. *Id.* at *2.
27. *Id.*
28. *Id.* at *1 n.1.
29. *Id.* at *1.
30. *Id.*
31. *Id.* at *4.
32. *Id.*
33. *Id.*

than one meaning.[34] And the two meanings must each be reasonable."[35]

"A claim for reformation of a [voidable] deed is subject to a four-year limitations period."[36] "A plainly evident omission on an unambiguous deed's face is not a type of injury for which the discovery rule is available."[37] The court of appeals also held that, even if the discovery rule did apply, Grantee had actual knowledge of the issue more than four years before suit was filed and was required to timely file "[r]egardless of [Grantee's] subjective belief concerning the effect of the deed."[38] This is a deed construction case that appears to follow established precedent as to the application of the discovery rule to plainly evident omissions from deeds.

C. *Coyote Lake Ranch, LLC v. City of Lubbock*

In *Coyote Lake Ranch, LLC v. City of Lubbock*,[39] the Texas Supreme Court held that "the accommodation doctrine applies to resolve conflicts between a severed groundwater estate and the surface estate that are not governed by the express terms of the parties' agreement."[40] Coyote Lake Ranch (Ranch) is about ninety miles northwest of the City of Lubbock (City). In 1953, the owner of the Ranch executed a deed reserving some water rights but conveying most of its groundwater rights to the City.[41] The deed included extensive provisions pertaining to the City's use and development of the groundwater, such as the following:

> [W]ith the full and exclusive rights of ingress and egress in, over, and on said lands, so that the Grantee of said water rights may at any time and location drill water wells and test wells on said lands *for the purpose* of investigating, exploring producing, and *getting access* to percolating and underground water; together with the rights to [construct certain facilities like pipe lines, power lines, and access roads, etc.] on, over and under said lands *necessary or incidental* to any of said operations, together with . . . the rights to use all that part of said lands *necessary or incidental* to the taking of percolating and underground water and the production, treating and transmission of water therefrom. . . .[42]

In 2012, the City proposed a plan for a total of eighty test and production wells but was unable to reach an agreement with the owner of the

34. *Id.* at *3 (citing Brown v. Havard, 593 S.W.2d 939, 942 (Tex. 1980); DeWitt Cty. Elec. Coop., Inc. v. Parks, 1 S.W.3d 96, 100 (Tex. 1999)).

35. *Id.* (internal citations omitted) (citing Lopez v. Munoz, Hockema & Reed, 22 S.W.3d 857, 861 (Tex. 2000); Colom. Gas Transmission Corp. v. New Ulm Gas, Ltd., 940 S.W.2d 587, 589 (Tex. 1996)).

36. *Id.* at *5 (citing Cosgrove v. Cade, 468 S.W.3d 32, 37 (Tex. 2015)).

37. *Id.* (quoting *Cosgrove*, 468 S.W.3d at 37).

38. *Id.*

39. 498 S.W.3d 53 (Tex. 2016).

40. *Id.* at 64.

41. *Id.* at 55–56.

42. *Id.* at 56 n.6 (emphasis added).

Ranch.[43] Undeterred, the City began mowing paths to potential drill sites on the Ranch, citing the broad powers it obtained in the 1953 Deed.[44] The Ranch owner contended that the City had breached the terms of the deed and that the City was obligated to comply with the accommodation doctrine. The City responded that there was no law holding that the accommodation doctrine applied to severed groundwater estates and that the City was authorized by its deed to proceed.[45] The principal issue was whether the accommodation doctrine applies to severed groundwater estates.

The accommodation doctrine broadly provides that "[a]bsent an agreement to the contrary, an oil-and-gas lessee has an implied right to use the land as reasonably necessary to produce and remove the minerals but must exercise that right with due regard for the landowner's rights."[46] *Getty Oil Co.* specifically held:

> [W]here there is an existing use by the surface owner which would otherwise be precluded or impaired, and where under the established practices in the industry there are alternatives available to the lessee whereby the minerals can be recovered, the rules of reasonable usage of the surface may require the adoption of an alternative by the lessee.[47]

Because the accommodation doctrine is only applicable if there is no agreement between the parties, the supreme court first analyzed the rights the 1953 Deed gave to the City:

> The deed gives the City the right to drill wells "at any time and location" but only "for the purpose of" conducting operations to access the groundwater. The deed then limits the City's use of the Ranch to what is "necessary or incidental" to those operations. But the deed leaves unclear whether the City can do everything necessary or incidental to drilling anywhere, as it claims, or only what is necessary or incidental to fully access the groundwater, as the Ranch argues.[48]

Because the deed did not clearly determine the rights of the parties, the supreme court turned to the question of whether the accommodation doctrine should apply to a severed groundwater estate.

The supreme court then reviewed and commented upon most of its accommodation doctrine cases.[49] Of particular interest, it cited to and quoted from the *Merriman* case with approval as to the elements that must be proved to obtain relief:

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43. *Id.* at 57.
44. *Id.*
45. *Id.*
46. *Id.* at 55 (citing Getty Oil Co. v. Jones, 470 S.W.2d 618, 621 (Tex. 1971)).
47. *Id.* at 61 (alteration in original) (quoting *Getty Oil Co.*, 470 S.W.2d at 622).
48. *Id.* at 59 (footnote omitted).
49. *Id.* at 60–63 (citing *Getty Oil Co.*, 470 S.W.2d at 618; Sun Oil Co. v. Whitaker, 483 S.W.2d 808 (Tex. 1972); Humble Oil & Ref. Co. v. West, 508 S.W.2d 812 (Tex. 1974); Tarrant Cty. Water Control & Improvement Dist. No. One v. Haupt, Inc., 854 S.W.2d 909 (Tex. 1993); Merriman v. XTO Energy, Inc., 407 S.W.3d 244 (Tex. 2013)).

> To obtain relief on a claim that the mineral lessee has failed to accommodate an existing use of the surface, the surface owner has the burden to prove that (1) the lessee's use completely precludes or substantially impairs the existing use, and (2) there is no reasonable alternative method available to the surface owner by which the existing use can be continued. If the surface owner carries that burden, he must further prove that given the particular circumstances, there are alternative reasonable, customary, and industry-accepted methods available to the lessee which will allow recovery of the minerals and also allow the surface owner to continue the existing use.[50]

"The accommodation doctrine, based on the principle that conflicting estates should act with due regard for each other's rights, has provided a sound and workable basis for resolving conflicts between ownership interests."[51] Groundwater and mineral estates, while somewhat different, are also very similar in that they are subterranean, have the same right to use the surface, are controlled by the rule of capture, are protected from waste, and are owned by the landowner in place.[52] The supreme court was "reluctant to search for a new approach to resolving disputes over a severed estate's implied right to reasonable use of the surface when a proven rule [was] at hand."[53] Accordingly, the supreme court held that "the accommodation doctrine extends to [severed] groundwater estates."[54] The supreme court expressly declined to consider in this opinion "whether the accommodation doctrine is workable when both the minerals and the groundwater have been severed from the land."[55]

The supreme court was unanimous in extending the accommodation doctrine to severed groundwater estates, but three justices in a concurring opinion partially disagreed with the majority. Those justices would have held that the deed itself governed some of the contested surface uses in the case.[56] This case is significant in that it extended the accommodation doctrine to severed groundwater estates.

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50. *Id.* at 62 (quoting *Merriman*, 407 S.W.3d at 249 (Tex. 2013)).
51. *Id.* at 63.
52. *Id.*
53. *Id.* at 64.
54. *Id.* at 65.
55. *Id.* at 65 n.55.
56. *Id.* at 65–67 (Boyd, J., concurring).

III. LEASE AND LEASING ISSUES[57]

A. *Chesapeake Exploration, L.L.C. v. Hyder*

In *Chesapeake Exploration, L.L.C. v. Hyder*,[58] the Texas Supreme Court held that an overriding royalty was free of all post-production costs.[59] The opinion also attempts to clarify the deductibility of post-production costs generally under "market value at the well" and "proceeds lease" royalty clauses. The Hyder family leased 948 mineral acres in the Barnett Shale under a lease that included an overriding royalty as part of the royalty payable to lessor.[60] The relevant parts of the lease in dispute provided for "'a perpetual, cost-free (except only its portion of production taxes) overriding royalty of five percent (5.0%) of gross production obtained' from directional wells drilled on the lease but bottomed on nearby land";[61] an optional right to take royalty in-kind; and a disclaimer that "Lessors and Lessee agree that the holding in the case of *Heritage Resources, Inc. v. NationsBank*, 939 S.W.2d 118 (Tex. 1996) shall have no application to the terms and provisions of this Lease."[62] *Heritage Resources* construed a market value at the well royalty clause and held that the royalty payable in that case was effectively subject to its proportionate part of post-production costs because market value at the well meant at the well.[63] The parties in *Hyder* aligned as "Lessor" and "Lessee." They agreed that the overriding royalty payable to Lessor was "free of production costs; they dispute[d] whether it [was] also free of postproduction costs."[64]

Before focusing on the overriding royalty clause, the supreme court briefly addressed the gas royalty clause, which was a "proceeds" provision:

> [T]he price-received basis for payment in the lease is sufficient in itself to excuse the lessors from bearing postproduction costs. . . . But

57. Other cases dealing with lease and leasing issues include the following: Flanagan v. Chesapeake Expl., LLC, No. 3:15-CV-0222-B, 2015 WL 6736648, at *1 (N.D. Tex. Nov. 4, 2015) (mem. op.) (implied duty to reasonably market); Anadarko Petroleum Corp. v. TRO-X, L.P., 511 S.W.3d 778 (Tex. App.—El Paso 2016, pet. filed) (top leases); Allegiance Expl., LLC v. Davis, No. 02-13-00349-CV, 2016 WL 1164331, at *1 (Tex. App.—Fort Worth Mar. 24, 2016, pet. denied) (mem. op.) (production in paying quantities); Escondido Res. II, LLC v. Justapor Ranch Co., No. 04-14-00905-CV, 2016 WL 2936411, at *1 (Tex. App.—San Antonio May 18, 2016, no. pet.) (mem. op.) (lease termination for failure to pay royalties); Conocophillips Co. v. Koopmann, No. 13-14-00402-CV, 2016 WL 2967689, at *1 (Tex. App.—Corpus Christi May 19, 2016, pet. filed) (mem. op.) (perpetuation of term NPRI); Brammer Petroleum, Inc. v. Bagley Minerals, L.P., No. 06-15-00091-CV, 2016 WL 3212496, at *1 (Tex. App.—Texarkana June 8, 2016, no. pet.) (mem. op.) (lease termination for cessation of production); Mayo Found. for Med. Educ. v. Courson Oil & Gas, Inc., 505 S.W.3d 68 (Tex. App.—Amarillo 2016, pet. filed) (continuous drilling and retained acreage clause).

58. 483 S.W.3d 870 (Tex. 2016).

59. *Id.* at 871.

60. *Id.* at 871–72.

61. *Id.* at 872.

62. *Id.*

63. Heritage Res., Inc. v. Nations Bank, 939 S.W.2d 118, 130–31 (Tex. 1996).

64. *Hyder*, 483 S.W.3d at 872.

> the royalty provision expressly adds that the gas royalty is "free and clear of all production and post-production costs and expenses," and then goes further by listing them. This addition has no effect on the meaning of the provision. It might be regarded as emphasizing the cost-free nature of the gas royalty, or as surplusage.[65]

"The court of appeals reasoned otherwise, relying on the 'free and clear' language to conclude that both the oil and gas royalties are free of postproduction costs. [Lessee] has not challenged that ruling in this Court."[66] The supreme court evidently wanted to clarify that, under both market value at the well and proceeds lease royalty provisions, the royalty provisions themselves "excuse the lessors from [directly] bearing postproduction costs."[67] However, the calculation or determination of the royalty payable might have the same indirect effect as deducting post-production costs proportionately.

Turning to the overriding royalty clause, the supreme court first noted the general rule that "an overriding royalty . . . is free of production costs, but must bear its share of postproduction costs unless the parties agree otherwise."[68] Lessor argued that the express requirement in this lease "that the overriding royalty be 'cost-free' can only refer to postproduction costs, since the royalty is by nature already free of production costs without saying so."[69] Lessee argued that "'cost-free overriding royalty' is merely a synonym for overriding royalty, and a number of lease provisions [analyzed] in other cases support that view."[70] The supreme court noted that "[t]he [express] exception for production taxes, which [are] postproduction expenses, cuts against [Lessee's] argument . . . [because i]t would make no sense to state that the royalty is free of production costs, except for postproduction taxes."[71] Furthermore, "[t]he exception for taxes might be taken to indicate that 'cost-free' refers *only* to postproduction costs."[72] However, an illogical taxes "exception" to freedom from production costs is common in Texas leases.[73] Nevertheless, Lessee here must show that "cost-free" cannot refer to post-production costs in this lease.[74]

Lessee argued that "because the overriding royalty is paid on 'gross production[,'] the reference is to production at the wellhead, making the royalty tantamount to one based on the market value of production at the wellhead, which bears postproduction costs."[75] The supreme court rea-

65. *Id.* at 873 (footnote omitted).
66. *Id.* 873 n.18 (citation omitted) (citing Chesapeake Expl., L.L.C. v. Hyder, 427 S.W.3d 472, 477–78 (Tex. App.—San Antonio 2014), *aff'd*, 483 S.W.3d 870 (Tex. 2016)).
67. *Id.* at 873.
68. *Id.* at 871.
69. *Id.* at 873.
70. *Id.* at 874.
71. *Id.*
72. *Id.* (emphasis added).
73. *Id.*
74. *Id.*
75. *Id.*

soned that "gross production" established the volume on which the overriding royalty was due, but "says nothing about whether the overriding royalty must bear postproduction costs."[76] This "simple 'cost-free' requirement of the overriding royalty" clause referenced all costs, including post-production costs.[77]

The supreme court also noted that, had Lessor taken Lessor's "overriding royalty in kind, as [Lessor was] entitled to do, [Lessor] might have use[d] the gas on the property, transport[ed] it . . . to a buyer, or pa[id] a third party to transport the gas to market as [Lessor] might negotiate."[78] The supreme court reasoned that "[t]he fact that the [Lessor] might or might not be subject to postproduction costs by taking the gas in kind does not suggest that they must be subject to those costs when the royalty is paid in cash."[79]

The supreme court concluded that "cost-free" as used in this lease and as applied to the overriding royalty included post-production costs.[80] The supreme court did not rely upon the *Heritage Resources* disclaimer in the lease, and the supreme court's explanation of that holding may be the most significant part of the case:

> *Heritage Resources* does not suggest, much less hold, that a royalty cannot be made free of postproduction costs. *Heritage Resources* holds only that the effect of a lease is governed by a fair reading of its text. A disclaimer of that holding, like the one in this case, cannot free a royalty of postproduction costs when the text of the lease itself does not do so. Here, the lease text clearly frees the gas royalty of postproduction costs, and reasonably interpreted, we conclude, does the same for the overriding royalty. The disclaimer of *Heritage Resources*' holding does not influence our conclusion.[81]

B. *Apache Deepwater, LLC v. McDaniel Partners, Ltd.*

In *Apache Deepwater, LLC v. McDaniel Partners, Ltd.*,[82] the Texas Supreme Court held that a production payment from land covered by multiple leases was reduced by the expiration of two of the leases.[83] The parties aligned as successors in interest to Grantor and Grantee under a 1953 assignment of four oil and gas leases which reserved a production payment as follows:

> [Grantor] reserves . . . as a "production payment interest," the title to and ownership of one-sixteenth of thirty-five sixty-fourths of seven-eighths *(1/16th of 35/64ths of 7/8ths, being one sixteenth of the entire interest in the production from said lands to which [Grantor]*

76. *Id.*
77. *Id.* at 875.
78. *Id.*
79. *Id.*
80. *Id.*
81. *Id.* at 876.
82. 485 S.W.3d 900 (Tex. 2016).
83. *Id.* at 901.

> *claims to be entitled under the terms of said respective oil and gas leases)* of the total oil, gas, casinghead gas and other minerals in and under and which may be produced from the above described land . . . until the net proceeds of said reserved interest . . . shall have amounted in the aggregate to [$3,550,000.00 and 1,420,000 barrels of oil].[84]

The issue in the case was the meaning and effect of the emphasized language in the above provision. Two of the leases expired. The two expired leases covered thirty-two sixty-fourths of the mineral estate, and the two leases continuing in effect covered three sixty-fourths of the mineral estate. Grantor contended it was still entitled to one-sixteenth of thirty-five sixty-fourths of seven-eighths. Grantee contended that Grantor's interest was reduced because Grantor owned only one-sixteenth of three sixty-fourths of seven-eighths.[85]

The case ultimately turned on the nature and operation of a production payment and the construction of this particular assignment. There was no useful precedent on production payments, and the supreme court generally reasoned from cases involving overriding royalties. "For purposes of this case, [the supreme court] agree[d] that no meaningful difference exists between the two."[86] "Normally, when an oil and gas lease terminates, the overriding royalty created in an assignment of the lease is likewise extinguished."[87] "And, like an overriding royalty, 'anything that terminates the lease necessarily destroys the [production] payment.'"[88] The supreme court held that "the general rule [is] that 'when an oil and gas lease terminates, [a] . . . production payment[ ] created in an assignment of [that] lease is likewise extinguished.'"[89]

Having resolved the general rule for a production payment, the supreme court then turned to an analysis of the assignment to determine whether the assignment showed that the parties had a different intent. "This production payment has two parts: (1) the fractional share of production that [Grantee] must pay, and (2) the total amount of money and production that is to be received before the interest terminates."[90] Part (2) was not contested; the issue was part (1).[91]

The supreme court looked at what was actually being conveyed in the assignment, which was four leasehold estates that were fee simple determinable in nature.[92] The language in the assignment did not suggest that the production payment should come out of anything other than each of

84. *Id.* at 902 n.1 (emphasis added).
85. *Id.* at 903.
86. *Id.* at 905.
87. *Id.* (quoting Sunac Petroleum Corp. v. Parkes, 416 S.W.2d 798, 804 (Tex. 1967)).
88. *Id.* (alteration in original) (quoting A.W. Walker, Jr., *Oil Payments*, 20 TEX. L. REV. 259, 288 (1942)).
89. *Id.* at 908 (quoting *Sunac Petroleum Corp.*, 416 S.W.2d at 804).
90. *Id.* at 906.
91. *Id.*
92. *Id.* at 907.

the leases.[93] All four leases were specifically identified in the assignment, and the explanatory phrase in the production payment clause referred to "said respective oil and gas leases," indicating the leases were to be treated separately.[94] "Absent express language in the assignment to the contrary, we apply the general rule that 'when an oil and gas lease terminates, the overriding royalty [or similar production payment] created in an assignment of the lease is likewise extinguished.'"[95] Accordingly, the correct production payment amount was one-sixteenth of three sixty-fourths of seven-eighths because the production payment on the terminated leases, which covered thirty-two sixty-fourths, was extinguished.[96]

This case is significant because it holds that production payments burdening the leasehold estate ordinarily terminate when the lease terminates. The case also has implications for the assignment of production payments generally, because it is quite common for those assignments to cover large tracts with many leases, and the parties usually do not address the possible lease termination question.

C. *Adams v. Murphy Exploration & Production Co.–USA*

In *Adams v. Murphy Exploration & Production Co.–USA*,[97] the San Antonio Court of Appeals held that the commonly understood meaning of "offset well" as used in an oil and gas lease offset well clause is "a well used to protect against drainage."[98] To be entitled to summary judgment, a party claiming that a well is an "offset well" as a matter of law must conclusively prove that the well is protecting the leased tract against drainage from the well on the adjacent tract.[99] The lease contained an offset well clause that would be triggered if a well was "completed as a producer of oil and/or gas on land adjacent and contiguous to the leased premises, and within 467 feet of the premises covered by [the] lease."[100] The offset well clause required that Lessee would have the option to either drill an offset well, pay Lessor royalties equivalent to the amount of production as that of the adjacent well, or release the amount of acreage required for an offset well.[101] A triggering horizontal well was drilled and completed in the Eagle Ford Shale on a tract adjacent to the leased tract. To satisfy the offset well requirement, Lessee drilled its own horizontal

93. *Id.*
94. *Id.*
95. *Id.* at 908 (quoting and supplementing Sunac Petroleum Corp. v. Parkes, 416 S.W.2d 798, 804 (Tex. 1967)).
96. *Id.*
97. 497 S.W.3d 510 (Tex. App.—San Antonio 2016, pet. filed).
98. *Id.* at 515 (citing Coastal Oil & Gas Corp. v. Garza Energy Tr., 268 S.W.3d 1, 14 (Tex. 2008); Shell Oil Co. v. Stansbury, 410 S.W.2d 187, 188 (Tex. 1967) (per curiam); Middle States Petroleum Corp. v. Messenger, 368 S.W.2d 645, 654 (Tex. Civ. App.—Dallas 1963, writ ref'd n.r.e.)).
99. *Id.* at 517 (citing *Coastal Oil & Gas Corp.*, 268 S.W.3d at 14; Nixon v. Mr. Prop. Mgmt. Co., 690 S.W.2d 546, 548 (Tex. 1985)).
100. *Id.* at 512.
101. *Id.* at 514 (citing Hooks v. Samson Lone Star, Ltd. P'ship, 457 S.W.3d 52, 66 (Tex. 2015)).

Eagle Ford Shale well approximately 2,100 feet from, and parallel to, the adjacent triggering well (Lessee's Well).[102]

Lessor sued for breach of contract, Lessee counterclaimed for a declaratory judgment, and Lessee's summary judgment was the subject of the appeal.[103] The issue was whether Lessee's well, drilled in response to the triggering well, was an "offset well" under the lease.[104] There was no additional definition of "offset well" in the Lease.[105] Lessor argued that an offset well is "a well that actually prevents drainage" and "must be drilled 'as close as reasonably possible to the [triggering well] so that it can truly 'offset' or 'counterbalance' the [triggering] well.'"[106] Therefore, Lessee breached the lease because Lessee's well was not an offset well. Lessee argued that "the offset well clause does not require an offset well be drilled [within any] particular . . . distance"; that an offset well is commonly understood in the oil and gas industry to mean "any well drilled on an adjacent lease or property"; and that the distance is particularly irrelevant here because both wells were drilled into the Eagle Ford Shale formation, where "drainage across lease lines has limited application."[107] Accordingly, Lessee's well was an offset well as a matter of law.

The court of appeals started its analysis by stating that it "must give meaning and effect to all the lease's words"[108] and "[i]f the term offset well has a commonly understood meaning in the oil and gas industry," the commonly understood meaning should be applied.[109] In determining the commonly understood meaning, the court reviewed the definition in a treatise and examined how Texas courts have defined an offset well.[110] The court concluded that "the commonly understood meaning of offset well is a well used to protect against drainage."[111] In order to conclusively prove that a well is an offset well, Lessee must show that the well is actually "protecting [the leased] tract[ ] from drainage by the [triggering] well."[112]

The court of appeals held that the summary judgment evidence offered by Lessee did not conclusively answer whether Lessee's well was actually

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102. *Id.* at 512.
103. *Id.* at 511, 512 n.3.
104. *Id.* at 514.
105. *Id.* at 512.
106. *Id.* at 514.
107. *Id.* at 514, 516.
108. *Id.* at 514 (citing Valence Operating Co. v. Dorsett, 164 S.W.3d 656, 662 (Tex. 2005); Heritage Res., Inc. v. NationsBank, 939 S.W.2d 118, 121 (Tex. 1996)).
109. *Id.* (citing Zurich Am. Ins. Co. v. Hunt Petroleum (AEC), Inc., 157 S.W.3d 462, 465 (Tex. App.—Houston [14th Dist.] 2004, no pet.); Mescalero Energy, Inc. v. Underwriters Indem. Gen. Agency, Inc., 56 S.W.3d 313, 320 (Tex. App.—Houston [1st Dist.] 2001, pet. denied)).
110. *Id.* at 514–15.
111. *Id.* at 515 (citing Coastal Oil & Gas Corp. v. Garza Energy Tr., 268 S.W.3d 1, 14 (Tex. 2008); Shell Oil Co. v. Stansbury, 410 S.W.2d 187, 188 (Tex. 1967) (per curiam); Middle States Petroleum Corp. v. Messenger, 368 S.W.2d 645, 654 (Tex. Civ. App.—Dallas 1963, writ ref'd n.r.e.)).
112. *Id.* at 517 (citing *Coastal Oil & Gas Corp.*, 268 S.W.3d at 14; Nixon v. Mr. Prop. Mgmt. Co., 690 S.W.2d 546, 548 (Tex. 1985)).

protecting the Lease from drainage from the triggering well.[113] Expert testimony offered by Lessee about the Eagle Ford Shale and typical drainage patterns was "merely speculative or conclusory" and did not conclusively prove that the Lessee's well was an offset well.[114] Consequently, the court reversed and remanded to the trial court.[115]

The significance of this case lies in its holding that an offset well drilled and completed in the same formation and parallel to the triggering well may not be an "offset well." The burden of proof on drainage under the implied covenant to prevent drainage is generally on the lessor. In this case, under this express offset-well clause, it appears the burden of proof shifted to the lessee to prove that the obligation well was actually preventing drainage.

IV. INDUSTRY CONTRACTS[116]

A. *Catlin Specialty Insurance Co. v. L.A. Contractors, Ltd.*

In *Catlin Specialty Insurance, Co. v. L.A. Contractors, Ltd.*,[117] the U.S. District Court for the Southern District of Texas held that an indemnity agreement within a Master Service Agreement (MSA) between a trucking contractor and a surface contractor, both providing services to an oil and gas well site, was not void under the Texas Oilfield Anti-Indemnity Act (TOAIA) because there was not a "close nexus" to production activities.[118] Shell Oil Company was developing an oil and gas lease, and it contracted with Wolverine Construction, Inc. (Surface Contractor) to build well pad sites and private roads. Surface Contractor signed an MSA that included mutual indemnity provisions with L.A. Contractors, LTD (Trucking Contractor) for Trucking Contractor to supply and transport

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113. *Id.* at 517.
114. *Id.* (citing Burrow v. Arce, 997 S.W.2d 229, 235 (Tex. 1999)).
115. *Id.* at 516–17.
116. Other cases dealing with industry contracts include the following: Fort Apache Energy, Inc. v. Resaca Res., LLC, No. 09-14-00325-CV, 2016 WL 637985, at *1 (Tex. App.—Beaumont Feb. 18, 2016, no pet.) (mem. op.) (durable power of attorney, estoppel by deed, Division Order statute); SEC v. Arcturus Corp., 171 F. Supp. 3d 512 (N.D. Tex. 2016) (joint venture agreement as a security); Aery v. Hoskins, Inc., 493 S.W.3d 684 (Tex. App.—San Antonio 2016, pet. filed) (pooling by cross-conveyance as appurtenant to the land or interest in gross); Garcia v. Genesis Crude Oil, L.P., No. 13-14-00727-CV, 2016 WL 1732436, at *1 (Tex. App.—Corpus Christi Apr. 28, 2016, no. pet.) (mem. op.) (payment satisfies Division Order Statute); *In re* WBH Energy, LP, No. 15-10003-HCM, 2016 WL 3049666, at *1 (Bankr. W.D. Tex. May 20, 2016) (recovery of attorney's fees under joint operating agreement); Hardwick v. Smith Energy Co., 500 S.W.3d 474 (Tex. App.—Amarillo 2016, pet. granted, judgm't vacated w.r.m.) (Statute of Frauds and prospect agreement); Gemini Ins. Co. v. Drilling Risk Mgmt., Inc., 513 S.W.3d 15 (Tex. App.—San Antonio 2016, pet. filed) (blowout insurance); Stetson Petroleum Corp. v. Cathedral Energy Servs., Inc., No. H-14-1049, 2016 WL 4572197, at *1 (S.D. Tex. Aug. 31, 2016) (drilling contract); HighMount Expl. & Prod. LLC v. Harrison Interests, Ltd., 503 S.W.3d 557 (Tex. App.—Houston [14th Dist.] 2016, no. pet.) (deduction of fuel gas and marketing costs from royalty); Shell W. E & P, Inc. v. Pel-State Bulk Plant, LLC, 509 S.W.3d 581 (Tex. App.—San Antonio 2016, no. pet.) (construing the Texas mineral lien statute).
117. No. H-14-261, 2016 WL 4276131, at *1 (S.D. Tex. July 25, 2016), *report and recommendation adopted*, No. H-14-0261, 2016 WL 4747689 (S.D. Tex. Aug. 15, 2016).
118. *Id.* at *6.

construction materials and aggregate to Surface Contractor.[119] One of Trucking Contractor's employees involved in transporting and delivering a cattle guard was killed in an automobile accident, and the estate brought a claim against the Surface Contractor.[120] The Surface Contractor made demand upon the Trucking Contractor under the indemnity clause in the MSA, but the Trucking Contractor refused to defend and indemnify. The Surface Contractor settled the case, and the Surface Contractor's excess liability insurance carrier then brought this subrogation action to recover from the Trucking Contractor under the indemnity clause in the MSA.[121] The issue in the case was whether the indemnity provision was void because it violates the TOAIA.[122]

The TOAIA was created to prevent inequity in certain contractor indemnity agreements; it states that

> an agreement "contained in, collateral to, or affecting an agreement pertaining to a well for oil, gas, or water . . . is void if it purports to indemnify a person against loss or liability" when that damage is based in whole or in part on the indemnitee's own negligence and arises from personal injury, death, or property injury.[123]

The Trucking Contractor argued that the TOAIA applied because the "TOAIA applies to an agreement concerning the rendering of well or mine services or performing 'an act collateral' to well or mine services."[124] The Surface Contractor argued that the incident was related to the delivery of cattle guards and not the production of oil, so the TOAIA did not apply and thus the indemnity agreement was enforceable.[125]

The district court held that the TOAIA would only apply if the service provided bears a "close nexus with production activities."[126] This is narrowly construed to mean that "the services called for by the contract bear a close nexus to a well and are directed toward the goal of obtaining or maintaining production from a well."[127] Further, it is the agreement itself that governs whether the TOAIA applies, not the specific incident.[128] Although "the MSA [did] not specifically outline the work [the Trucking Company] was to perform on [the Surface Contractor's] behalf," the district court relied upon the testimony of the Trucking Company for those facts.[129]

The district court discussed *Coastal Transport Co. v. Crown Central Pe-*

119. *Id.* at *1.
120. *Id.* at *2, *7.
121. *Id.* at *2.
122. *Id.* at *5.
123. *Id.* at *6 (alteration in original) (quoting TEX. CIV. PRAC. & REM. CODE ANN. § 127.003 (West 2011)).
124. *Id.* (citing TEX. CIV. PRAC. & REM. CODE ANN. § 127.001 (West 2011)).
125. *Id.*
126. *Id.* (citing John E. Graham & Sons v. Enron Oil & Gas Co. (*In re* Complaint of John E. Graham & Sons), 210 F.3d 333, 339–40 (5th Cir. 2000)).
127. *Id.* (quoting *In re Complaint of John E. Graham & Sons*, 210 F.3d at 343).
128. *Id.* at *7 (citing TEX. CIV. PRAC. & REM. CODE ANN. § 127.003 (West 2011)).
129. *Id.*

troleum Corp.,[130] where the Fourteenth Houston Court of Appeals considered whether the TOAIA applied between a petroleum company and a transportation company.[131] In that case, the court of appeals found that, "the [TOAIA] applied to contracts for services involved in the drilling or servicing of wells, and found that [the petroleum company] was involved in refining, supplying, and transportation of petroleum, and was therefore not involved in the drilling or servicing of wells, so the TOAIA did not apply."[132] Similarly here, the Surface Contractor is a construction company that is not involved in the drilling and servicing of wells, so a "close nexus" with production activities did not exist, and therefore the TOAIA does not apply to the MSA between the Surface Contractor and the Trucking Contractor.[133]

The significance of this case lies in its holding that an indemnity agreement in an MSA is not subject to the TOAIA unless there is a "close nexus" to the actual drilling or servicing of wells.

B. *Tregellas v. Archer Trust No. Three*

In *Tregellas v. Archer Trust No. Three*,[134] the Amarillo Court of Appeals analyzed the effect of the statute of limitations, discovery rule, constructive notice, and a correction deed in the context of an alleged breach of a right of first refusal to purchase minerals. On June 16, 2003, the Cook family (Grantor), which then owned both the surface and mineral estate in a tract in Hansford County, Texas (Land), conveyed only the surface to the trustees of various trusts (Grantee). In a separate but contemporaneous document, Grantor granted to Grantee a right of first refusal (ROFR) to purchase the minerals on the Land.[135] The ROFR stated that "in the event that [Grantor], and/or their successors and/or assigns, desire to sell any or all of the [Land], [Grantee], their heirs and assigns, shall have the right to purchase the [Land on the same terms offered]," but "[t]his Right of First Refusal shall be subordinate to and [Grantor] or their successors or assigns . . . shall have the right to execute, to mortgage or otherwise encumber the [Land].[136] The parties aligned as successors-in-interest to Grantor and Grantee under the ROFR.[137]

There were two separate sales. On March 28, 2007, Sharon and Rodney Farber (two of the family members included in Grantor) sold their undivided mineral interest in the Land by a mineral deed that was subsequently recorded on March 30, 2007 (Farber Sale). It was undisputed that

130. 20 S.W.3d 119 (Tex. App.—Houston [14th Dist.] 2000, pet. denied).
131. *Catlin Specialty Ins. Co.*, 2016 WL 4276131 at *7 (citing *Coastal Transp. Co.*, 20 S.W.3d at 127).
132. *Id.* (citing *Coastal Transp. Co.*, 20 S.W.3d at 127).
133. *Id.* (citing John E. Graham & Sons v. Enron Oil & Gas Co. (*In re* Complaint of John E. Graham & Sons), 210 F.3d 333, 343 (5th Cir. 2000)).
134. 507 S.W.3d 423 (Tex. App.—Amarillo 2016, pet. filed).
135. *Id.* at 426.
136. *Id.* at 427.
137. *Id.* at 426.

Grantee was not notified about Grantor's intention to make the Farber Sale, and Grantee was not given an opportunity to purchase the mineral interest under the terms of the ROFR. On May 4, 2011, Grantee acquired actual knowledge about the Farber Sale and filed suit against Grantor the next day.[138]

Grantor argued that the trial court erred in ordering specific performance of the ROFR regarding the Farber Sale because Grantee filed the suit outside the statute of limitations.[139] The court of appeals agreed, reasoning that a suit for specific performance of an agreement for an ROFR is the same as a suit for specific performance of a contract.[140] The statute of limitations for specific performance of a contract is four years after the cause of action accrues.[141] Determining when the cause of action accrues is a question of law.[142] "Under the discovery rule, accrual of a cause of action is deferred until the injured party learned of, or in the exercise of reasonable diligence should have learned of, the injury-causing act."[143] The Texas Supreme Court has held that this rule should be applied to breach of contract suits only in rare cases because diligent parties "should generally discover any breach during the relatively long four-year limitations period provided for such claims."[144]

> As is true in this case, because of the requirements of the statute of frauds and the recording statutes, a conveyance of real property in violation of a right of first refusal is very likely to be reflected in a publicly-recorded instrument. Once properly recorded, the instrument is subject to inspection by the public. And knowledge of the conveyance is likely to be readily available from other public sources like tax rolls and from commercial sources like abstractors.[145]

That is, the injury was not "inherently undiscoverable," and therefore the discovery rule was not applicable.[146]

The deed on the Farber Sale was executed on March 28 and recorded on March 30, 2007.[147] The court of appeals recites that the limitations period commenced when the injury was sustained on March 28, unless the accrual date was tolled.[148] The same result would evidently follow if the deed was never recorded; therefore, the court held that limitations on

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138. *Id.* at 427.
139. *Id.* at 429–30.
140. *Id.* at 430.
141. *Id.* (citing Tex. Civ. Prac. & Rem. Code Ann. § 16.004(a)(1) (West 2002); Gilbreath v. Steed, No. 12-11-00251-CV, 2013 WL 2146230, at *4 (Tex. App.—Tyler May 15, 2013, no pet.) (mem. op.)).
142. *Id.* at 432 (citing Seureau v. ExxonMobil Corp., 274 S.W.3d 206, 226 (Tex. App.—Houston [14th Dist.] 2008, no pet.)).
143. *Id.* (citing Cosgrove v. Cade, 468 S.W.3d 32, 36 (Tex. 2015)).
144. *Id.* (quoting Via Net v. TIG Ins. Co., 211 S.W.3d 310, 315 (Tex. 2006) (per curiam)).
145. *Id.* at 433 (internal footnote and citations omitted) (citing Tex. Prop. Code Ann. § 13.001 (West 2014); Tex. Bus. & Com. Code Ann. § 26.01 (West 2015)).
146. *Id.*
147. *Id.* at 427.
148. *Id.* at 432.

breach of an ROFR runs from the date of the deed because there is usually a deed and it is usually recorded.[149]

Grantee, on a motion for rehearing, argued that the court "failed to give effect to Texas case law that owners of property are under no duty routinely to search the deed records for later-filed documents impugning their title."[150] The court held that Grantee owned no interest in the minerals and the ROFR was merely a contractual right.[151] Grantee also cited authority "for the proposition that Texas law provides that the holder of a right of first refusal has no duty to act until the holder receives notice of a sale in violation of the right."[152] Nevertheless, the court held that whether or not the discovery rule applied was decided on a categorical basis and that the breach was not inherently undiscoverable.[153]

Because there is usually a deed and deeds are usually recorded, the court of appeals reasoned that "the [Grantee's] injury [was] of the type that generally is discoverable by the exercise of reasonable diligence."[154] The application of the discovery rule is decided on a "categorical" basis, which means that, under this decision, the cause of action for breach of ROFRs on real property will run from an accrual date no later than the date the conveyance in breach is executed. To protect the holder's interest, the holder is effectively required to continually check the deed records, which, of course, no one intends to do when an ROFR is created. This was a bench trial in which the trial court found all the elements necessary under the discovery rule and expressly held that Grantee had no duty to consult the public record.[155] The court expressly did not base its decision on constructive notice, but rather only on the general limitation of the discovery rule that the rule may only be invoked when the injury is inherently undiscoverable.[156] It should be noted that this was a contractual ROFR, not recorded, and not an interest running with the land.

In 2008, Brenda Cook Smith (one of the members of Grantor) died, leaving her undivided mineral interest to her husband, Ed Smith, and son, Dalton Smith. The Smiths negotiated a sale of her mineral interest (Smith Sale) for $20,000, which was never completed.[157] Once again, Grantee was neither notified of the intended sale nor given an option to purchase the mineral interest involved in this second sale.[158]

After Grantee filed suit on the Farber Sale, the Smith Sale was revived and restructured as a loan using a deed of trust. There was a ninety-day promissory note in the amount of $20,000, secured by a deed of trust on

149. *Id.* at 432–33.
150. *Id.* at 433.
151. *Id.* at 433–34.
152. *Id.* at 434 (citing Koch Indus., Inc. v. Sun Co., Inc., 918 F.2d 1203, 1212 (5th Cir. 1990)).
153. *Id.*
154. *See id.* at 433.
155. *Id.* at 433–34.
156. *Id.* at 433 n.10.
157. *Id.* at 427.
158. *Id.* at 428.

the mineral interest, a default, and a non-judicial foreclosure sale in August 2012. Grantee first learned of the Smith Sale in November 2012 and amended the earlier petition against the Farber Sale to include the Smith Sale.[159]

Grantor argued that there was no breach of the ROFR regarding the Smith Sale because Grantor transferred the mineral interest through a non-judicial foreclosure sale.[160] The Texas Supreme Court has held that "the holder of a right of first refusal was not entitled to exercise the right at the time of a foreclosure sale of the land under a deed of trust,"[161] but there may be an exception if the deed of trust was "a subterfuge or device" used to sell the land.[162] The court declined to consider whether that exception existed or applied in this case.[163]

The court held that Grantor breached the ROFR because Grantor did not disclose that Grantor was willing to sell the mineral interest.[164] An ROFR carries with it "the right to receive notice of a third-party offer."[165] Therefore, because Grantor did not give notice of Grantor's willingness to sell, which was undisputed, Grantor breached the ROFR with the proposed 2008 Smith Sale before the mineral interest was actually sold in 2011 by way of a foreclosure.[166] The court affirmed the trial court's granting of specific performance as to the Smith Sale but reversed as to the Farber Sale.[167]

After closing on the ROFR in 2003, Grantee discovered that the property description in the ROFR listed the incorrect county. Grantee's attorney corrected the mistake and sent the new document to Grantor. Two family members signed the corrected document in February 2004, and it was recorded in September of that year. None of the other family members responded or signed it.[168]

Grantor argued that the ROFR violated the statute of frauds because it listed the wrong county and that the correction instrument was ineffective to cure the ROFR because it did not comply with Section 5.031 of the Texas Property Code.[169]

> Section 5.031 makes a correction instrument recorded before September 1, 2011, that substantially complies with Property Code section 5.028 or 5.029 and that purports to correct a recorded original instrument of conveyance effective to the same extent as provided in section 5.030 unless a court "renders a final judgment determining

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159. *Id.* at 427–28.
160. *Id.* at 434.
161. *Id.* (citing Draper v. Gochman, 400 S.W.2d 545, 545 (Tex. 1966)).
162. *Id.* at 435 (quoting *Draper*, 400 S.W.2d at 547).
163. *Id.*
164. *Id.* at 436–37.
165. *Id.* at 435 (citing Joseph M. Perillo, 11 Corbin on Contracts § 11.4 (Matthew Bender, 2016)).
166. *Id.* at 436–37.
167. *Id.* at 437.
168. *Id.* at 427–28.
169. *Id.* at 428 (citing Tex. Prop. Code Ann. § 5.031 (West 2014)).

that the correction instrument does not substantially comply" with section 5.028 or 5.029.[170]

In this case, the court held that there was sufficient evidence to support the trial court's finding that the 2004 correction instrument did substantially comply with Sections 5.028 and 5.029.[171] Specifically, the correction was "nonmaterial" as defined by Section 5.028.[172] It was undisputed that the error in the county name was typographical, and substantial compliance with the statute excuses these types of errors.[173] Therefore, the court held that Grantee met the essential requirements of Section 5.028 in preparing and recording the 2004 correction instrument, and the court did not reach the statute of frauds question.[174]

The significance of this case lies in the court's holding that a cause of action for breach of a contractual ROFR on real property accrues no later than the date a conveyance in breach of the ROFR is executed, and the discovery rule does not apply.

C. *North Shore Energy, L.L.C. v. Harkins*

In *North Shore Energy, L.L.C. v. Harkins*,[175] the Texas Supreme Court held that an option to lease did not preclude others from entering the optioned lands and conducting geophysical operations.[176] In 1995, Lease #1 was granted by Owners to Lessee #1, covering approximately 400 acres. In 1996 (while Lease #1 was still in effect), Lease #2 was granted by Owners to Lessee #2, covering approximately 1300 acres out of 1700 acres *save* and *except* the 400 acres covered by Lease #1. Lease #1 terminated. In 2009, Owners entered into an Option Agreement with Lessee #3 that allowed Lessee #3 to select multiple small tracts to be separately leased at Lessee #3's option out of the same lands described in Lease #2, which had terminated. A few months later, Lessee #3 gave Owners notice under the Option Agreement that it was exercising its option, and Lessee #3 paid the lease option exercise price of $200 per acre for a 169.9-acre tract. Lessee #3 did not actually execute a formal lease with Owners because a lease form was attached to the Option Agreement. Lessee #3 drilled a producing well on its optioned 169.9-acre tract. A large portion of that acreage was included in the 400 acres originally leased under Lease #1, and the well itself was located on that same 400 acres. Lease #4 was granted by Owners to Lessee #4, covering the same 400 acres originally covered by Lease #1.[177] Lessee #4, with Owners' permission, conducted a seismic survey over all of the land subject to the Option Agreement dur-

170. *Id.* (quoting Tex. Prop. Code Ann. § 5.031 (West 2014)).
171. *Id.* at 429.
172. *Id* at 428 (citing Tex. Prop. Code Ann. § 5.028(a)(1) (West 2014)).
173. *Id.*
174. *Id.* at 429.
175. 501 S.W.3d 598 (Tex. 2016) (per curiam).
176. *Id.* at 600.
177. *Id.* at 600–01.

ing the option period.[178] Lessee #3 sued Lessee #4 and Owners, who then counterclaimed on competing claims of title, trespass, conversion, tortious interference, and for damages, with an additional geophysical trespass claim by Lessee #3 against Lessee #4.[179]

On appeal, most of the opinion focused on whether the 400 acres was subject to the Option Agreement.[180] After parsing the language of the Option Agreement, the supreme court ultimately decided that the Option Agreement was subject to only one reasonable interpretation and was therefore not ambiguous; thus, the Option Agreement excluded the 400-acre Lease #1 tract from the optioned acreage as a matter of law.[181] The supreme court primarily relied upon a four-corners analysis of the Option Agreement itself, but also considered the circumstances surrounding its execution to determine whether an ambiguity existed.[182] Specifically, the supreme court considered the $50-per-acre option bonus payable upon execution of the Option Agreement and the fact that, mathematically, the total sum paid excluded the 400 acres.[183]

Because the 400-acre tract was not included in the optioned land, the trial court victory for Lessee #3 collapsed. Owners could not be liable for breach of contract or for attorney's fees, nor could Lessee #3 be liable for taking a lease on the 400-acre tract.[184] This left only Lessee #3's claim against Lessee #4 for geophysical trespass.[185]

Under the Option Agreement, Owners granted to Lessee #3 the "exclusive option to acquire oil and gas leases on all or a portion of Said Land under the terms and provisions of that certain Oil and Gas Lease form set forth on Exhibit 'B.'"[186] The lease form granted exclusive exploration rights, but Lessee #3 never executed the lease.[187] The supreme court focused only on the Option Agreement, which did not explicitly grant to Lessee #3 the exclusive right to explore for minerals or to exclude others from doing so before it exercised its option.[188] "An option agreement does not pass title or convey an interest in property."[189] Because Lessee #3 never exercised its option, it had no right of possession or title and thus no standing to assert geophysical trespass.[190]

This is a contract interpretation case. The significance of this case lies in the supreme court's use of the option bonus payment as "surrounding

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178. *Id.* at 605.
179. *Id.* at 601.
180. *Id.* at 602–04.
181. *Id.* at 604 (citing Columbia Gas Transmission Corp. v. New Ulm Gas, Ltd., 940 S.W.2d 587, 589 (Tex. 1996)).
182. *Id.* at 602 (citing Plains Expl. & Prod. Co. v. Torch Energy Advisors Inc., 473 S.W.3d 296, 305 (Tex. 2015)).
183. *Id.* at 603.
184. *Id.* at 605.
185. *Id.*
186. *Id.*
187. *Id.*
188. *Id.* at 606.
189. *Id.* at 605.
190. *Id.* at 606.

circumstances" to conclude that the Option Agreement was not ambiguous, as well as its holding that an Option Agreement, with an attached exclusive-right-to-explore lease form, is not an agreement that will bar others from exploring during the option term.

V. LITIGATION ISSUES[191]

A. *Southwestern Energy Production Co. v. Berry-Helfand*

In *Southwestern Energy Production Co. v. Berry-Helfand*,[192] the Texas Supreme Court examined the proper remedy, damages, and proof of damages when a trade secret oil and gas prospect is misappropriated. In this case, the evidence presented for trade-secret-misappropriation damages was held legally insufficient to support the entire jury award, and the case was reversed and remanded for new trial.[193]

Toby Berry–Helfand (Engineer) worked for seven years analyzing data across five counties in East Texas to identify very specific "'sweet spots' for drilling and producing from the James Lime [reservoir] with multiple stacked payout."[194] In 2004, Engineer obtained leases covering 6,300 acres in two specific sweet spots called the Pearson and Pearson Northeast prospects in Nacogdoches County to generate interest in the drill-ready prospects and the broader James Lime play. In February 2005, Engineer pitched the deal to Southwestern Energy Production Co. (SEPCO).[195]

"Before [Engineer] disclosed any information, . . . SEPCO executed a confidentiality and noncompete agreement that required SEPCO to maintain the information's confidentiality, use it solely to evaluate the Pearson prospects for purchase from or development with [Engineer]," and "not to compete with [Engineer] in a specified area of mutual interest for one year."[196] Engineer then "provided detailed information about the Pearson prospects and identified sweet-spot prospects throughout the play."[197] "At the time of the presentation, SEPCO had not acquired any mineral leases with James Lime as the primary drilling objective, had never drilled a James Lime well, had been dissuaded from pursuing James Lime ventures by an internal study conducted in 2003, had declined to participate in a James Lime play with [a third party] in 2003, and had zero

191. Other cases dealing with litigation issues include the following: Arbuckle Mountain Ranch of Tex., Inc. v. Chesapeake Energy Corp., 810 F.3d 335 (5th Cir.), cert. denied, 136 S. Ct. 2522 (2016) (class action on leases terminated by foreclosure); Longoria v. Exxon Mobil Corp., No. 04-15-00536-CV, 2016 WL 4013793, at *1 (Tex. App.—San Antonio July 27, 2016, pet. denied) (mem. op.) (necessary parties); Carlton Energy Group, LLC v. Phillips, No. 01-09-00997-CV, 2016 WL 4536284, at *1 (Tex. App.—Houston [1st Dist.] Aug. 30, 2016, no. pet.) (prospect valuation).
192. 491 S.W.3d 699 (Tex. 2016).
193. *Id.* at 704–05.
194. *Id.* at 705, 705 n.2.
195. *Id.* at 706.
196. *Id.* at 707.
197. *Id.*

horizontal wells."[198]

SEPCO never extended an offer to Engineer. Engineer then closed a deal with Petrohawk Properties, L.P. (Petrohawk) on the Pearson prospects specifically and a broader deal across three counties.[199] "By the fall of 2010, SEPCO had acquired 1,888 leases and drilled more than 140 wells—88 of them James Lime horizontal wells—in areas clustered around the sweet spots [Engineer] had identified."[200] Almost all of SEPCO's leases were in the sweet spots, all of the wells produced, and those wells "generated an undisputed $381.5 million in production revenue."[201] The jury found that SEPCO "misused proprietary information acquired under [the] confidentiality agreement."[202] Additionally, liability was not contested on this appeal.[203]

The principal evidence on damages was the contemporaneous Petrohawk agreement, Engineer's testimony, and expert testimony by Engineer's expert. Rather than call an expert witness, SEPCO instead attacked Engineer's evidence and the expert's methodology.[204] Under the Petrohawk agreement, Engineer received $1.8 million for the Pearson prospects, an overriding royalty interest, a 6.25% back-in after payout, monthly consulting fees, and a similar arrangement across three counties. "Hundreds and hundreds" of leases were acquired by Petrohawk.[205] The overriding royalty was generally about 3%, but it was a sliding-scale royalty, subject to expansion or reduction based on existing lease burdens, with more than one trigger point. The overriding royalty could have ranged from zero to about 6.75%.

Engineer testified that she received an average of 3% on her Petrohawk leases, and although she did not testify that such terms were "reasonable and customary" or provide an average for all of the leases, the supreme court accepted that testimony as "some evidence of 'the prices past purchasers or licensees of the trade secret may have paid.'"[206] There was also some evidence that some of the SEPCO wells had a net revenue interest greater than 75%, which would support at least some overriding royalty under the Petrohawk agreement's scheme of a sliding-scale royalty.[207] The expert also testified that the Petrohawk deal would be "a customary and reasonable type of compensation that someone would receive for identifying a prospect."[208] The expert opined as to a damages number considerably larger than the number the jury awarded. The critical issue in the case was the 3% "average" overriding royalty that

198. *Id.* at 706.
199. *Id.* at 707–08.
200. *Id.* at 709.
201. *Id.*
202. *Id.* at 704.
203. *Id.* at 710.
204. *Id.* at 716.
205. *Id.* at 708.
206. *Id.* at 714.
207. *Id.* at 714–15.
208. *Id.* at 715–16.

the expert assumed in his calculations based on Engineer's testimony about her experience with the Petrohawk leases.[209]

The jury similarly found SEPCO's "profits" to be $381.5 million (which corresponds to the evidence of past production revenue). A 3% overriding royalty applied to that number equals $11.445 million, which was the number the jury awarded for past damages. The jury awarded $0 for future damages and $0 for exemplary damages.[210] The trial court ordered a post-verdict accounting and awarded an additional $23.89 million in equitable disgorgement of profits and $4.6 million in attorney's fees and interest.[211]

There are multiple ways to prove damages for misappropriation of a trade secret, including the value of the plaintiff's lost profits, the defendant's actual profits, the value another would have paid, the development costs saved by the defendant, and a reasonable royalty.[212] For claims arising after September 1, 2013, there is an applicable statute.[213] The parties disputed the reliability of the Expert's damages calculation.

The supreme court noted that "the Petrohawk agreement actually employs a sliding-scale overriding royalty tied to the total royalty burden, and analogous agreements in the record similarly bear payout terms tied to the total royalty burden."[214] Consequently, "the sliding scale in the Petrohawk agreement zeroes out at a specified threshold."[215] The supreme court noted that "[f]ailure to take the sliding-scale overriding royalty into consideration in calculating a reasonable royalty for [Engineer's] trade secret[ ] [was] a critical misstep. . . . [W]hen there is objective evidence from which more certainty can be gleaned, it is incumbent on the plaintiff to produce that evidence."[216]

The supreme court further noted that "because the actual overriding royalty interest on the [SEPCO] wells could have been determined," using the average overriding royalty received under the Petrohawk agreement was not probative.[217] The supreme court remanded because there was evidence to support damages, but less than the full amount awarded.[218]

Because the supreme court remanded for a new trial, it declined to address or rule upon a number of other issues. Perhaps most importantly, the Tyler Court of Appeals had held that disgorgement of profits was not available, to which the supreme court responded: "[W]e have not expressly limited the [equitable disgorgement of profits] remedy to fiduci-

209. *Id.* at 715.
210. *Id.* at 710.
211. *Id.*
212. *Id.* at 711 (citing Bohnsack v. Varco, L.P., 668 F.3d 262, 280 (5th Cir. 2012)).
213. *Id.* at 711 n.7 (citing Texas Uniform Trade Secrets Act, Tex. Civ. Prac. & Rem. Code §§ 134A.001–.008, 134.003, .004) (West 2011 & Supp. 2016)).
214. *Id.* at 720.
215. *Id.*
216. *Id.*
217. *Id.*
218. *Id.* at 721.

ary relationships nor foreclosed equitable relief for breach of trust in other types of confidential relationships."[219]

The significance of this case lies in the supreme court's guidance given on the measure of damages, the role of expert testimony, and the burden of proof in recovering for a lost prospect. The case was tried on theories of breach of contract, breach of fiduciary duty, theft, and fraud.

B. *Saner v. BridgeTex Pipeline Co.*

In *Saner v. BridgeTex Pipeline Co.*,[220] the Eastland Court of Appeals held that, in order "to satisfy the constitutional 'public use' requirement, . . . a person intending to build a pipeline" for crude petroleum under Section 111.002(1) of the Natural Resources Code must demonstrate that a reasonable probability exists that "the pipeline will at some point after construction serve the public by transporting crude petroleum for one or more customers who will either retain ownership of their crude petroleum or sell it to parties other than the carrier."[221]

BridgeTex Pipeline Company, LLC (BridgeTex) was engaged in the construction of a pipeline for the transportation of crude petroleum from the Permian Basin to the Texas Gulf Coast.[222] In 2013, the Texas Railroad Commission (TRC) designated BridgeTex as a common carrier and granted it a T-4 permit.[223] BridgeTex, through condemnation, acquired an easement for a crude petroleum pipeline that would run across Walter B. Saner's (Saner) land.[224] Saner challenged the proposed taking by arguing that the pipeline was not built for a constitutional public use.[225]

In *Texas Rice Land Partners, Ltd. v. Denbury Green Pipeline-Tex. LLC*,[226] the Texas Supreme Court held that "[t]o qualify as a common carrier with the power of eminent domain, [a] pipeline must serve the public; it cannot be built only for the builder's exclusive use."[227] The supreme court established a test for determining what qualifies as a public use for a carbon dioxide pipeline by holding that "under Section 111.002(6), a reasonable probability must exist that the pipeline will at some point after construction serve the public by transporting gas for one or more customers who will either retain ownership of their gas or sell it to parties other than the carrier."[228] The *Denbury* court limited its decision to "'persons seeking common-carrier pipeline status under Section

219. *Id.* at 729.
220. No. 11-14-00199-CV, 2016 WL 4009973, at *1 (Tex. App.—Eastland July 21, 2016, pet. denied).
221. *Id.* at *3 (citing Tex. Rice Land Partners, Ltd. v. Denbury Green Pipeline—Tex., LLC, 363 S.W.3d 192, 202 (Tex. 2012)).
222. *Id.* at *1.
223. *Id.*
224. *Id.*
225. *Id.*
226. 363 S.W.3d 192 (Tex. 2012).
227. *Saner*, 2016 WL 4009973, at *2 (alterations in original) (emphasis omitted) (quoting *Denbury Green Pipeline—Tex., LLC*, 363 S.W.3d at 200).
228. *Id.* (quoting *Denbury Green Pipeline—Tex., LLC*, 363 S.W.3d at 202).

111.002(6)' applicable to carbon dioxide pipelines."[229]

The court of appeals agreed with other Texas courts of appeals in concluding that, "[d]espite *Denbury*'s limitation to carbon dioxide pipelines, . . . [the] 'reasonable probability' test [applied] to other provisions of the Natural Resources Code, including the provision granting common carrier status to crude petroleum pipelines."[230] Accordingly, the court of appeals held that "to satisfy the constitutional 'public use' requirement . . . a person intending to build a pipeline under Section 111.002(1)" must demonstrate that "a reasonable probability . . . exist[s] that the pipeline will . . . serve the public by transporting crude petroleum for one or more customers who will either retain ownership of their crude petroleum or sell it to parties other than the carrier."[231]

The evidence introduced included testimony that "BridgeTex ha[d] entered into a transportation services agreement with a [third-party shipper]"; "BridgeTex was in negotiations with twelve to fourteen other third-party shippers who may either become contract shippers or spot shippers"; "BridgeTex had received five unsolicited applications from prospective spot shippers"; and "the pipeline [would] be connected to seven to ten refineries, not owned by BridgeTex, along the Texas Gulf Coast."[232] The court of appeals held that the evidence introduced at trial satisfied *Denbury*'s reasonable probability test; thus, the pipeline was built for a constitutional public use.[233]

This case is significant in that the court extends the application of *Denbury*'s reasonable probability test to Section 111.002(1) of the Natural Resources Code, which grants common carrier status to crude petroleum pipelines.

VI. REGULATION ISSUES[234]

A. *SOUTHWEST ROYALTIES, INC. V. HEGAR*

In *Southwest Royalties, Inc. v. Hegar*,[235] the Texas Supreme Court held that a sales tax exemption for equipment used in processing was not ap-

229. *Id.* (quoting *Denbury Green Pipeline—Tex., LLC*, 363 S.W.3d at 202 n.28).

230. *Id.* (citing Crawford Family Farm P'ship v. TransCanada Keystone Pipeline, L.P., 409 S.W.3d 908, 922 (Tex. App.—Texarkana 2013, pet. denied); Crosstex NGL Pipeline, L.P. v. Reins Rd. Farms–1, Ltd., 404 S.W.3d 754, 761 (Tex. App.—Beaumont 2013, no pet.)).

231. *Id.* at *3 (citing *Denbury Green Pipeline—Tex., LLC*363 S.W.3d at 202).

232. *Id.*

233. *Id.* at *4.

234. Other cases dealing with regulation issues include the following: R.R. Comm'n of Tex. v. Gulf Energy Expl. Corp., 482 S.W.3d 559 (Tex. 2016) (Texas Railroad Commission (TRC) negligence in plugging well); Samson Lone Star Ltd. P'ship v. Hooks, 497 S.W.3d 1 (Tex. App.—Houston [1st Dist.] 2016, pet. filed) (TRC records as notice); Texas v. U.S. Envtl. Prot. Agency, 829 F.3d 405 (5th Cir. 2016) (Clean Air Act and coal-fired electrical generating plants); Total Gas & Power N. Am., Inc. v. Fed. Energy Regulatory Comm'n, No. 4:16-1250, 2016 WL 3855865 (S.D. Tex. July 15, 2016) (Natural Gas Act), *appeal docketed*, No. 16-20642 (5th Cir. Sept. 26, 2016).

235. 500 S.W.3d 400 (Tex. 2016).

plicable to downhole equipment such as casing, tubing, and pumps.[236] The sales tax exemption applied to

> tangible personal property directly used or consumed in or during the actual . . . processing . . . of tangible personal property for ultimate sale if the use or consumption of the property is necessary or essential to the . . . processing . . . operation and directly makes or causes a chemical or physical change to . . . the product being . . . processed . . . for ultimate sale.[237]

Southwest Roylaties, Inc. (Southwest) argued that "hydrocarbons extracted from an underground reservoir must be separated into their component parts to produce saleable products, and the equipment for which it sought refunds was used in 'processing' the hydrocarbons as they were extracted from the reservoir."[238] The trial court ruled against Southwest because Southwest's equipment did not directly cause the change in the hydrocarbons.[239] The Austin Court of Appeals also ruled against Southwest because it found the use of the word "processing" in the statute to be ambiguous, and the Comptroller's interpretation was not plainly erroneous or inconsistent.[240] The issue before the supreme court was whether Southwest's equipment was used for "processing" and, if so, whether Southwest's processing was the actual and direct cause of the chemical or physical change in the hydrocarbons.[241]

The supreme court first interpreted the tax statute. Because "processing" was not defined, the supreme court gave the word its ordinary meaning.[242] It essentially adopted the Comptroller's definition and held that the term "processing" meant "the application of materials and labor necessary to modify or change characteristics of tangible personal property."[243] "[I]t is undisputed that hydrocarbons undergo physical changes as they move from underground reservoirs to the surface; the disagreement is about the role Southwest's equipment plays in those changes."[244] Expert testimony for the State established that "phase changes" in the oil and gas were a "natural, physical process that occurs from the reservoir to the top of a well and whether casing was in the well was only incidental to the changes" because "the casing and tubing were essentially only conduits through which the hydrocarbons exit the reservoir and proceed to the surface."[245]

Thus, the supreme court narrowed its inquiry to "whether the equipment . . . was *used* in the *actual* physical application of materials and labor

236. *Id.* at 402.
237. *Id.*; TEX. TAX CODE ANN. § 151.318(a)(2) (West 2015).
238. *Southwest Royalties, Inc.*, 500 S.W.3d at 403.
239. *Id.*
240. *Id.* at 403–04.
241. *Id.* at 404.
242. *Id.* at 405 (citing State v. $1,760.00 in U.S. Currency, 406 S.W.3d 177, 180 (Tex. 2013)).
243. *Id.* at 406.
244. *Id.*
245. *Id.* at 407.

to the hydrocarbons that was necessary to cause, and caused, a physical change to them."[246] The supreme court reasoned that the changes in the substances were natural changes, and "[w]hile the equipment unquestionably was both used in and necessary to the efficient recovery of hydrocarbons from their reservoirs, there is no evidence that the equipment acted upon the hydrocarbons to modify or change their characteristics."[247] "Southwest did not prove that the equipment for which it sought a tax exemption was used in 'actual manufacturing, processing, or fabricating' of hydrocarbons within the meaning of Tax Code section 151.318[(a)](2), (5), or (10)," and was therefore not entitled to a tax exemption.[248]

Phase changes in hydrocarbons from the reservoir to the surface are the result of changes in temperature and pressure, and not the result of casing, tubing, and pumps. The significance of this case lies in the supreme court's holding that the downhole equipment is not exempt from sales tax because only equipment used in processing the hydrocarbons is exempt. "Processing" in this context means changing the characteristics of tangible personal property.[249]

VII. CONCLUSION

Title examiners in Texas are continually faced with the difficult task of resolving the meaning of older conveyances including multiple fractions in which the intent of the parties may be unclear. There are thousands of instruments with this problem. In *Hysaw v. Dawkins*,[250] the Texas Supreme Court restates its bias toward a four-corners rule of construction to determine the intent of the parties, uninhibited by a set of formal rules of construction. However, *Hysaw* is an attempt to reduce the number of deed construction cases driven by this issue. It broadly assumes that parties do not usually intend a complicated division of interest, and the surrounding circumstances at the time of execution should inform the courts when resolving these controversies. Perhaps the new rule of construction is Occam's Razor.[251]

Although *Coyote Lake Ranch, LLC v. City of Lubbock*[252] will be cited as a landmark case at the confluence of water law and oil and gas law for extending the accommodation doctrine to severed groundwater estates, it is equally important for the emphasis it gives to the rules presented in the *Merriman v. XTO Energy, Inc.*[253] case, which explain that the mineral

246. *Id.* (emphasis added).
247. *Id.* at 407–08.
248. *Id.* at 409.
249. *Id.* at 406 (citing 34 TEX. ADMIN. CODE § 3.300(a)(10) (2004) (Comptroller of Pub. Accounts, Manufacturing; Custom Manufacturing; Fabricating; Processing)).
250. 483 S.W.3d 1 (Tex. 2016).
251. *See generally* Casarez v. Val Verde County, 16 F. Supp. 2d 727, 729 (W.D. Tex. 1998) (explaining that the phrase "Entia non sunt multiplicanda praeter necessitatem," otherwise known as Occam's Razor, means "[d]on't complicate things any more than is required"—i.e., "keep it simple.").
252. 498 S.W.3d 53 (Tex. 2016).
253. 407 S.W.3d 244 (Tex. 2013).

estate is, indeed, the dominant estate.

The *Chesapeake Exploration, L.L.C. v. Hyder*[254] case deals with an overriding royalty on its face, but the reasoning and holding in that case applies to royalties generally and to post-production costs in particular. Simplified, if the intent is to make the royalty cost-free, then the draftsman should use the words "cost-free" and not just market value. Lessors for years have insisted on market-value royalty clauses to insulate themselves from the risk and vagaries of a proceeds lease, but it is clear that market value at the well, without more, will always burden the lessor's royalty with its proportionate part of post-production costs.

These cases and the other Texas Supreme Court cases reported are the ones most likely to have a lasting impact, but there are also groups of cases clustered around recurring issues that are gradually adding definition to the scope of those issues.

The discovery rule continues to be narrowly construed and limited on a categorical basis. The scope of the application of the rule is very important in the oil and gas industry because many property rights are based on real property, and many industry agreements can last for decades. Long periods of time may elapse before there is actual knowledge of an injury.

Texas has had its share of cases attacking pipelines, with a frequent issue being challenges to the "public purpose" foundation of a condemnation. Under present Texas law and case law, it appears that this issue will continue to be a relatively easy hurdle to jump, and Texas will remain "pipeline friendly."

As 2016 closes, the industry is waiting to see if pledged production cuts will materialize, what the effect on the balance between supply and demand will be, and how fast America's shale producers will ramp up their operations. It is widely reported that approximately one hundred U.S. exploration and production companies have failed during this downturn, and approximately one-half of the rigs operating in the United States are now operating in the Permian Basin.

The effect on reported Texas cases is not yet apparent, but it seems likely that the number of reported cases dealing with conveyancing and leasing issues will tail off, and there will be more cases on industry contracts and operational issues as operators focus on completions and drilling on existing leases.

254. 483 S.W.3d 870 (Tex. 2016).