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## Oil, Gas and Mineral Law

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# OIL, GAS AND MINERAL LAW

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## I. INTRODUCTION

**T**HIS Article focuses on the interpretations of and changes relating to oil, gas, and mineral law in Texas from November 2, 2008 through November 1, 2009. The cases examined include decisions of state and federal courts in the state of Texas and the United States Court of Appeals for the Fifth Circuit.<sup>1</sup>

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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. See *BP Am. Prod. Co. v. Marshall*, 288 S.W.3d 430 (Tex. App.—San Antonio 2008, pet. filed) (fraud concealing lease termination and adverse possession of leasehold by co-tenant); *Garner v. Griffin*, No. 13-06-621-CV, 2009 WL 200772 (Tex. App.—Corpus Christi, Jan. 29, 2009, no pet.) (mem. op.) (cotenants' lease does not repudiate title of other co-tenants); *Retamco Operating, Inc. v. Republic Drilling Co.*, 278 S.W.3d 333 (Tex. 2009) (acquiring a Texas lease creates personal jurisdiction over out-of-state defendant); *Sun-Key Oil Co. v. Cannon*, No. 11-07-00025-CV, 2009 WL 626071 (Tex. App.—Eastland Mar. 12, 2009, no pet.) (mem. op.) (adverse possession after lease termination for cessation of production); *Headington Oil Co. v. White*, 287 S.W.3d 204 (Tex. App.—Houston [14th Dist.] 2009, no pet.) (division order statute interest on unpaid royalties); *Berkley v. R.R. Comm'n of Tex.*, 282 S.W.3d 240 (Tex. App.—Amarillo 2009, no pet.) (TRC injection permit and trespass); *Derwen Res., LLC v. Carrizo Oil & Gas, Inc.*, No. 09-07-00597-CV, 2008 WL 6141597 (Tex. App.—Beaumont May 21, 2009, pet. denied) (mem. op.) (ambiguity in deed); *Thompson v. Clayton*, No. 08-07-00152-CV, 2009 WL 1620428 (Tex. App.—El Paso June 10, 2009, no pet.) (easement distinguished from license); *Kohout v. City of Fort Worth*, 292 S.W.3d 703 (Tex. App.—Fort Worth 2009, no pet.) (permit under city ordinance); *Cambridge Prod., Inc. v. Geodyne Nominee Corp.*, 292 S.W.3d 725 (Tex. App.—Amarillo 2009, pet. denied) (errors in Designation of Unit); *BoMar Oil & Gas, Inc. v. Loyd*, No. 10-08-00016-CV, 2009 WL 2136404 (Tex. App.—Waco Jul. 15, 2009, pet. filed), op. on mot. for reh'g, 298 S.W.3d 832 (Tex. App.—Waco Oct. 14, 2009, pet. denied) (expenses chargeable to unleased cotenant); *Rosenthal v. R.R. Comm'n of Tex.*, No. 03-09-00015-CV, 2009 WL 2567941 (Tex. App.—Austin Aug. 20, 2009, pet. denied) (mem. op.) (salt water disposal); *Tex. Rice Land Partners, Ltd. v. Denbury Green Pipeline-Tex. LLC*, 296 S.W.3d 877 (Tex. App.—Beaumont 2009, pet. filed) (TRC filings make pipeline com-

## II. TITLE AND CONVEYANCING ISSUES

*Enerlex, Inc. v. Amerada Hess, Inc.* held that a deed that conveyed all rights in the described lands with a general warranty, but failed to quantify the grantor's interest, was a quitclaim deed.<sup>2</sup> Enerlex sought to avoid the effect of five unrecorded gift deeds by claiming that Enerlex was a bona fide purchaser for value.<sup>3</sup> The deed into Enerlex conveyed "all right, title and interest in and to all of the Oil, Gas . . . from the . . . described lands."<sup>4</sup> The deed also provided that "Grantor does hereby warrant said title to Grantee."<sup>5</sup>

Enerlex argued that the deed conveyed an interest in property. It was not restricted to any interest the grantor may have owned, because the grantor conveyed "all right, title and interest" as opposed to all of "my right, title, and interest."<sup>6</sup> Enerlex also argued that the deed was not a quitclaim deed because it contained a general warranty and did not have "as is" or "without warranty" language.<sup>7</sup> The Eastland Court of Appeals rejected these arguments because the mineral deed did not quantify the grantor's interest, saying, "It is more significant that at no point in the deed did [the grantor] warrant or represent that she actually owned any mineral interest."<sup>8</sup> The court of appeals effectively construed the deed as conveying all of the grantor's interest in the sections conveyed, rather than a specific interest in certain sections."<sup>9</sup>

A conveyance of all of Blackacre with warranty would clearly be a deed with warranty, not a quitclaim deed, and the grantee would be a bona fide purchaser as long as he remained without notice of the unrecorded claim. The court of appeals apparently relied upon the recital that "[i]t is the intent of Grantor to convey all interest in the said county whether or not the sections or surveys are specifically described herein"<sup>10</sup> to hold that the conveyance of "all" of the named sections broadly conveys all of the grantor's interest, rather than a specific interest.<sup>11</sup> Because of the difficulty and uncertainty in correctly describing the lands and leases conveyed in complex oil and gas assignments, it is a common practice to include a dragnet clause like the one in this case to catch any interest that was inadvertently omitted or incorrectly described. This case suggests the practice may inadvertently convert a warranty deed into a quitclaim deed.

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pany common carrier); *Fort Worth & W. R.R. Co. v. Enbridge Gathering (NE Tex. Liquids), L.P.*, 298 S.W.3d 392 (Tex. App.—Fort Worth 2009, no pet.) (condemnation of pipeline easements under railroad).

2. 302 S.W.3d 351, 355 (Tex. App.—Eastland Oct. 8, 2009, no pet.).

3. *Id.* at 353.

4. *Id.* at 355 (internal punctuation omitted).

5. *Id.* at 354.

6. *Id.*

7. *Id.* at 355.

8. *Id.* at 354.

9. *Id.* at 355.

10. *Id.* at 354 (internal punctuation omitted).

11. *Id.* at 355.

*Houchins v. Devon Energy Production Co.* held that language in a deed stating that the grantor retains mineral rights and exempts them from conveyance is an effective reservation of mineral rights regardless of its placement within the warranty clause.<sup>12</sup> The grantor alleged that he reserved the mineral rights under a clause that stated “[t]o the extent that Grantor maintains any mineral rights to the subject property, Grantor expressly retains such mineral rights to the subject property and exempts same from the conveyance herein.”<sup>13</sup> The grantee argued that the clause was not a reservation of the mineral interests, but rather an exception to the grantor’s warranty of title.<sup>14</sup> The grantee contended that the location of the clause within the warranty clause listing other exceptions to title was indicative of the nature of the clause as an exception to the warranty rather than a reservation of the minerals.<sup>15</sup>

The Houston First Court of Appeals dismissed grantee’s argument by stating, “Rather than focusing on characterizing the deed language at issue as an ‘exception’ or a ‘reservation,’ our primary objective in construing a deed is to determine the intent of the parties from the four corners of the deed.”<sup>16</sup> The court of appeals examined the entire deed in order to give effect to all provisions, “so that none will be rendered meaningless.”<sup>17</sup> The court of appeals concluded that the clause was sufficiently clear to reserve a mineral interest, and its effectiveness was not undercut by the location of the clause within the deed.<sup>18</sup> The significance of *Houchins* is the clear holding that a mineral reservation will be given effect, regardless of its location within the deed, even if it is found within the warranty clause.

### III. LEASE AND LEASING ISSUES

*Blackmon v. XTO Energy, Inc.* examines the definition of “production in paying quantities” (PPQ) and determines the appropriate remedy for a lessee’s failure to pay shut-in royalties.<sup>19</sup> In *Blackmon*, “the third party who had been purchasing the gas produced from [the well at issue] refused to continue because the carbon dioxide content was greater than three percent.”<sup>20</sup> No gas was produced during the time required for the lessee to install an amine processing unit to make the gas marketable by removing the excess carbon dioxide.<sup>21</sup> The lessors first alleged that the oil and gas lease had terminated because the lessee could not sell the gas without first processing it. The lessors argued that the well was not capa-

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12. No. 01-08-00273-CV, 2009 WL 3321406, at \*5 (Tex. App.—Houston [1st Dist.]) Oct. 15, 2009, pet. denied) (mem. op.).

13. *Id.* at \*2.

14. *Id.*

15. *Id.*

16. *Id.* at \*3.

17. *Id.*

18. *Id.* at \*5.

19. 276 S.W.3d 600, 603-04 (Tex. App.—Waco 2008, no pet.).

20. *Id.* at 602-03.

21. *Id.* at 603.

ble of PPQ “because it needed additional equipment or repairs in order to produce ‘marketable gas.’”<sup>22</sup>

The Waco Court of Appeals, however, focused on whether the well was capable of producing gas in marketable *quantity*, not marketable *quality*. The court of appeals stated that the “[w]ell was connected to pipeline facilities and was capable of producing a high volume of raw gas at the wellhead.”<sup>23</sup> Therefore, the processing unit “was not the type of ‘additional equipment’ necessary to enable gas to flow from the wellhead in a producing quantity.”<sup>24</sup> Rather, the processing unit was installed to render the gas to be “marketable quality.”<sup>25</sup> The court of appeals concluded that the well was “capable of flowing from the wellhead . . . in a marketable *quantity* regardless of whether the . . . processing unit was installed downstream”; thus, “the well was capable of [PPQ] when it was shut in.”<sup>26</sup> The court of appeals further noted that the processing unit required to process the carbon dioxide out of the gas produced was installed downstream of the wellhead.<sup>27</sup> The court of appeals reasoned that those cases holding that this type of equipment is a post-production cost further supported its conclusion that the equipment was not necessary to actually *produce* the gas.<sup>28</sup>

The lessors next alleged that the lessee’s failure to pay shut-in royalties resulted in the automatic termination of the lease.<sup>29</sup> The court of appeals focused on whether this particular shut-in royalty provision created a special limitation, a condition subsequent, or a covenant.<sup>30</sup> The court of appeals noted that “[i]n case of doubt as to the true construction of a clause in a lease, it should be held to be a covenant, and not a condition or limitation, as the law does not favor forfeitures.”<sup>31</sup> Leases utilizing an “unless” form and providing that the payment of shut-in royalties is a form of constructive production have routinely been held to create a special limitation that will terminate the lease if the shut-in royalty is not paid.<sup>32</sup> However, the lease in this case provided that if a well were shut-in, the lease would continue, but if the well were shut-in for a continuous ninety days, the lessee “shall pay” shut-in royalties.<sup>33</sup> “For breach of [a] mere covenant the lessor has no right of reentry, unless . . . there is an express clause in the agreement to this effect, but has the right to sue for damages only.”<sup>34</sup> Because the lease in this case was a covenant and because there was no express clause divesting the estate of the lessee, the

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22. *Id.*

23. *Id.*

24. *Id.* at 604.

25. *Id.*

26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.* at 605.

30. *Id.*

31. *Id.*

32. *Id.* at 606.

33. *Id.* at 605.

34. *Id.* at 606 (quoting *Johnson v. Gurley*, 52 Tex. 222, 226-27 (1879)).

court of appeals held that the provision for payment of shut-in royalties could only be enforced by a suit for money damages.<sup>35</sup>

The significance of this case is that it sharpens and narrows the analysis required to determine whether a well is capable of PPQ. This court drew a line between the equipment necessary to produce gas and the equipment required to make the gas marketable (the equipment which is normally included in post-production costs). That is, the equipment necessary for the gas to flow when the well is turned “on” does not include all of the equipment necessary to make the gas marketable. This court cited with approval the Texas Supreme Court’s opinion holding that for a well to be capable of PPQ, “there must be facilities located near enough to the well that it would be economically feasible to establish a connection so that production could be marketed at a profit.”<sup>36</sup> Apparently, the connection to a pipeline is “near enough,” but there is nothing in this opinion to indicate whether the production could be marketed “at a profit.” Presumably, profitability was uncontested.

*Blackmon* also demonstrates that when a shut-in royalty provision is determined to be a covenant by the court, that covenant may be enforced only by a suit for money damages and not by a suit for lease termination.<sup>37</sup> Stated more generally, under a “shall pay” shut-in royalty clause coupled with a provision that the mere existence of a shut-in well capable of producing in paying quantities is constructive production, the failure to pay shut-in royalties will not result in lease termination.

*Vortt Exploration Co. v. EOG Resources, Inc.* held that two separate saving clauses (force majeure and shut-in royalty) can be stacked to save a lease, but the lessee must comply with the terms of each to perpetuate the lease.<sup>38</sup> For adverse possession to be adverse under a terminated lease, there must be a new well, a recompletion, production, or sales.<sup>39</sup> An oil and gas lease executed in 1980 with a primary term of two years was held into the secondary term by PPQ. In November 2001, the gas purchaser stopped taking gas from the well, and the well was disconnected from the pipeline. In February 2006, “a pipeline connection became available,” but “the well was not equipped to produce” because the “gas could not enter the pipeline without a compressor.”<sup>40</sup> The well was never reconnected.<sup>41</sup> On March 24, 2006, notice was sent to the lessee as required by this particular lease that the shut-in royalty payments were delinquent.<sup>42</sup> On July 21, 2006, the lessee tendered shut-in royalties.<sup>43</sup>

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35. *Id.* at 607.

36. *Id.* at 603 (citing *Anadarko Petroleum Corp. v. Thompson*, 94 S.W.3d 550, 559 (Tex. 2002)).

37. *Id.* at 607.

38. No. 11-07-00159-CV, 2009 WL 1522661 (Tex. App.—Eastland May 29, 2009, pet. granted) (mem. op.).

39. *See id.* at \*8.

40. *Id.* at \*4-6.

41. *Id.* at \*1, \*4.

42. *Id.* at \*6.

43. *Id.*

The shut-in royalty clause in the lease read as follows:

While there is a gas well on said land or on lands pooled therewith and if gas is not being sold or used off the premises for a period in excess of three full consecutive calendar months, and this lease is not then being maintained in force and effect under the other provisions hereof, Lessee shall tender or pay to Lessor . . . . If such payment of shut-in royalty is so made or tendered by Lessee to Lessor, it shall be considered that this lease is producing gas in paying quantities and this lease shall not terminate, but remain in force and effect.<sup>44</sup>

The lessee contended that the lease continued in force and effect under the force majeure clause and the shut-in royalty clause.<sup>45</sup> Lessee also asserted adverse possession under the three-year and five-year statutes.<sup>46</sup>

Under the habendum clause of the lease, once the primary term ended, the lease was to remain in effect “as long thereafter as oil, gas or other mineral is produced from said land or land with which said land is pooled hereunder.”<sup>47</sup> An oil and gas lease creates a fee simple determinable that will automatically terminate, absent some other lease provision, “upon the happening of the event by which it is limited.”<sup>48</sup> Here, “that event is a cessation of production.”<sup>49</sup> The lessee argued that although production ceased in November 2001, the lease was still in effect because the lease contained a force majeure clause that excused any failure to produce the well, and because shut-in royalties were paid, there was constructive production.<sup>50</sup>

“A force majeure clause in an oil and gas lease excuses a lessee from nonperformance of obligations contained in the lease if the nonperformance ‘is caused by circumstances beyond the reasonable control of the lessee.’”<sup>51</sup> However, here, “even if the force majeure clause applied to the original cessation of production[,] . . . a pipeline connection became available in February 2006.”<sup>52</sup> Thus, “under the very best scenario” for the lessee, when the pipeline connection again became available in February 2006, the event triggering the force majeure clause no longer existed.<sup>53</sup> The lessee then had “ninety days to either resume production or to pay shut-in royalty.”<sup>54</sup> The lessee failed to carry out either option.<sup>55</sup>

Shut-in royalty payments are paid as a substitution for production.<sup>56</sup> To perpetuate a lease by paying shut-in royalties when a well is not actu-

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44. *Id.* at \*5.

45. *Id.* at \*4, \*5.

46. *Id.* at \*8.

47. *Id.* at \*4.

48. *Id.*

49. *Id.*

50. *Id.* at \*4-5.

51. *Id.* at \*4 (citing RICHARD W. HEMINGWAY, *THE LAW OF OIL AND GAS* § 7.11 (3d ed. 1991)).

52. *Id.* (internal emphasis omitted).

53. *Id.*

54. *Id.* at \*5.

55. *Id.* at \*4.

56. *Id.* at \*5.

ally producing, the payment must be timely or the lease will terminate under the habendum clause.<sup>57</sup>

The Eastland Court of Appeals relied upon evidence that the well could not enter a pipeline without a compressor, to conclude that “the well was not capable of production in paying quantities at the time it was shut in.”<sup>58</sup> A “shut-in royalty clause will not extend the term of the lease” if the well is not “capable of producing in paying quantities at the time it is shut-in.”<sup>59</sup>

Notice was sent to the lessee (as required under this particular lease) on March 24, 2006, notifying the lessee that shut-in payments were delinquent, but it was not until July 21, 2006, that the lessee tendered shut-in royalties. The court held that because shut-in royalties were tendered more than ninety days after the pipeline connection became available in February 2006, the lease terminated for lack of production, even if the well was capable of PPQ.<sup>60</sup> It was not perpetuated by the payment of shut-in royalties, because the payment was not timely.<sup>61</sup> The opinion is silent as to whether the “shall pay” provision in the shut-in royalty clause could have made payment a covenant, rather than a condition.

Finally, the lessee argued that it re-acquired title to the leasehold under the three-year and five-year statutes of limitation.<sup>62</sup> The court of appeals rejected this argument because the holdover by the lessee was not adverse; the court stated that “[t]here was no evidence that it drilled a new well, recompleted an existing well in a new formation, produced any oil or gas, or sold any production from this lease.”<sup>63</sup>

*Vortt Exploration* illustrates that while lease savings clauses can be stacked to save a lease (e.g. force majeure plus shut-in royalty), the lessee still must comply with the terms of each clause to perpetuate the lease. It also lists the activities which may be “adverse” under the statute of limitations when a holdover lessee continues to operate.<sup>64</sup>

*Aurora Petroleum, Inc. v. Newton* held that the owner of executive rights has no duty to lease.<sup>65</sup> Newton owned all of the surface rights, an undivided one-fourth mineral interest, and all of the executive rights for the entire tract. When Newton refused to lease, Aurora Petroleum filed suit on behalf of all the non-participating mineral owners and sought to force Newton to enter into a lease. Aurora Petroleum claimed that Newton, as the holder of the executive right, had a duty to lease.<sup>66</sup>

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57. *Id.* at \*6.

58. *Id.* at \*5-6.

59. *Id.* at \*5 (citing *Hydrocarbon Mgmt., Inc. v. Tracker Exploration, Inc.*, 861 S.W.2d 427 (Tex. App.—Amarillo 1993, no pet.)).

60. *Id.*

61. *Id.*

62. *Id.* at \*8.

63. *Id.* at \*8.

64. *See generally id.*

65. 287 S.W.3d 373, 377 (Tex. App.—Amarillo 2009, no pet.).

66. *Id.* at 375.



In *Manges v. Guerra*, a Texas Supreme Court decision from 1984, the holder of the executive right (Manges) leased the property to himself at terms that were more advantageous to him than to the non-participating mineral owners.<sup>67</sup> The supreme court held that Manges breached a fiduciary duty owed to the non-participating mineral owners.<sup>68</sup> In *Aurora Petroleum*, the Amarillo Court of Appeals distinguished *Manges*, because the duty of the executive right owner could arise only after the oil and gas lease were granted. There was no lease in this case, so the *Manges* fiduciary duty was not applicable.<sup>69</sup>

The court of appeals equated the duty to lease with the duty to develop. In *In re Bass*,<sup>70</sup> the Texas Supreme Court stated that "a duty to develop a mineral estate arises not from a fiduciary relationship, but from the implied covenant doctrine of contracts law in which courts read a duty to develop into an oil and gas lease when necessary to effectuate the parties' intent."<sup>71</sup> The *Aurora Petroleum* court concluded that the duty to lease (develop) could not be based on a fiduciary duty, but only on an implied contractual covenant.<sup>72</sup> Under the facts of the case, the non-participating mineral interests apparently were subject to a reversion to the fee owner (Newton) if production were not obtained.<sup>73</sup> The opinion is silent on this point, but it clearly suggests that Newton's interests were not aligned with the non-participating owners. Also, it is arguably implied in the creation of a term interest that some effort will be made to obtain production. Nevertheless, the court of appeals held that because Newton never entered into an oil and gas lease, there could not be an implied duty to develop.<sup>74</sup> Newton's obligation to the non-participating mineral interest owners was to secure for the non-participating mineral owners the right to share in the same benefits Newton acquired for Newton. Because Newton did not lease their interest or acquire any benefit for himself, there was not a breach of fiduciary duty to the non-participating mineral interest owners.<sup>75</sup> The significance of this case is the holding that the owner of the executive rights has no duty to lease.<sup>76</sup>

#### IV. INDUSTRY CONTRACTS

*XTO Energy Inc. v. Smith Production Inc.* held that a non-consent election under a 1982 American Association of Petroleum Landmen form Joint Operating Agreement (JOA) as to subsequent drilling operations is

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67. 673 S.W.2d 180, 182-83 (Tex. 1984).

68. *Id.* at 183-84.

69. *Aurora Petroleum*, 287 S.W.3d at 376.

70. 113 S.W.3d 735, 743 (Tex. 2003).

71. *Id.*

72. *See Aurora Petroleum*, 287 S.W.3d at 377 (quoting *In re Bass*, 113 S.W.3d 735, 743 (Tex. 2003)).

73. *Id.* at 375.

74. *Id.* at 377.

75. *Id.*

76. *See id.*

final when made.<sup>77</sup> Pursuant to two JOAs “based on the American Association of Petroleum Landmen Model Form Operating Agreement 610-1982[,]” the operator gave written notice to the non-operators of its proposal to drill four new wells.<sup>78</sup> The JOA gave the non-operators thirty days to elect to participate or go “non-consent.” One of the non-operators (the Non-Consenting Party) gave notice to the operator that it was electing not to participate in drilling the wells.<sup>79</sup> Then, within the thirty-day election period provided in the JOA, the Non-Consenting Party sent the operator a letter stating that it was electing to participate, that it was revoking its prior notification to the contrary, and that the election not to participate had been sent in error. Notwithstanding the second notice, the operator continued to treat the non-operator as a Non-Consenting Party under the JOA. The Non-Consenting Party brought suit against the operator for breach of contract.<sup>80</sup>

In a matter of first impression, the Houston Fourteenth Court of Appeals concluded that “under the unambiguous language of the agreements, such a party may not change its election after it gives notice of its election to the proposing party.”<sup>81</sup>

Article VI.B of the JOA in this case generally tracks the form of the 1982 Model Form Operating Agreement and provides the procedures the parties to the JOA must follow when a new well is proposed. Article VI.B provides in part:

**B. Subsequent Operations:**

1. *Proposed Operations:* Should any party hereto desire to drill any well on the Contract Area other than the [initial well], . . . the party desiring to drill . . . such a well shall give the other parties written notice . . . . The parties receiving such a notice shall have thirty (30) days after receipt of the notice within which to notify the party wishing to do the work whether they elect to participate in the cost of the proposed operation . . . . Failure of a party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the proposed operation.<sup>82</sup>

Thus, “[i]f the Consenting Parties comply with the requirements of Article VI.B.2.” by drilling the well as proposed, “then the interest of any Non-Consenting Party is subject to the Non-Consent” penalties included in the JOA,<sup>83</sup> which in this case included a 400% penalty on drilling costs.<sup>84</sup>

The JOA is silent as to whether the Non-Consenting Party may, change its election. The Non-Consenting Party argued that the JOA was “unam-

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77. 282 S.W.3d 672, 682 (Tex. App.—Houston [14th Dist.] 2009, pet. granted).

78. *Id.* at 674.

79. *Id.*

80. *Id.* at 674-75.

81. *Id.* at 674.

82. *Id.* at 677 (quoting from the JOA).

83. *Id.*

84. *Id.* at 675.

biguous and allowed the [Non-Consenting Party] to change its election within thirty days of receiving [the] notices,” or [i]n the alternative, that the JOA [was] ambiguous.”<sup>85</sup> The court of appeals disagreed and held that “allowing such a change in election would conflict with the intent of the parties as expressed in the unambiguous language of Article VI.B.”<sup>86</sup>

In reaching its conclusion, the court of appeals used the “four corners” approach to ascertain the intentions of the parties.<sup>87</sup> In applying this approach, the court of appeals examined the two JOAs “in their entirety in an effort to harmonize and give effect to all of their provisions so that none will be rendered meaningless.”<sup>88</sup> The court of appeals found that the timing of the procedures set forth in Article VI was consistent with the intent not to allow changes to elections by the receiving parties.<sup>89</sup> Article VI of the JOA “require[s] the proposing party to notify the Consenting Parties of any Non-Consenting Party ‘immediately after’ the expiration of the Notice Period” and also requires that proposed operations must be commenced within ninety days after the expiration of the notice period.<sup>90</sup> The court of appeals stated, “Construing Article VI to not allow changes in election by the receiving parties is consistent with the provisions of the JOA.”<sup>91</sup>

The timing of required events under Article VI of the JOAs, accompanied by the time-sensitive nature of drilling operations (i.e., the proposing party must make financial arrangements, begin drilling within ninety days of the expiration of the notice period, and pursue operations with due diligence), led the court of appeals to conclude that the operator’s construction of the JOA was “the only reasonable construction of the language at issue.”<sup>92</sup> In this case, all of the non-operators made their election before the Non-Consenting Party changed its election, but that was not a factor the court of appeals deemed relevant. The court of appeals expressly held that the notice period provided in the JOA expired *as to the Non-Consenting Party* when the Non-Consenting Party gave notice of its election.<sup>93</sup>

The significance of the case is the holding that, under a very common form of JOA, an election to go “non-consent” as to subsequent drilling operations is final when made and cannot be revoked.<sup>94</sup> It cannot be revoked even if the revocation is within the thirty days originally given under the form JOA to the non-operator to make an election or even if

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85. *Id.* at 675-76.

86. *Id.* at 678-79.

87. *Id.* at 676.

88. *Id.* (citing *MCI Telecomms. Corp. v. Tex. Utils. Elec. Co.*, 995 S.W.2d 647, 652 (Tex. 1999)).

89. *Id.* at 678.

90. *Id.* at 679.

91. *Id.* at 678-79.

92. *Id.* at 679-80.

93. *Id.* at 677-78.

94. *See id.* at 682.

the general notice period is still open because some other non-operator has not yet elected.

*Virginia Power Energy Marketing, Inc. v. Apache Corp.* held that a “reasonable efforts” contract provision does not trump a force majeure clause so as to require delivery to alternate delivery points on a pipeline damaged by hurricanes.<sup>95</sup> Apache agreed to deliver gas to Virginia Power at two specific points on a pipeline subsequent hurricanes damaged Apache’s production facilities and pipeline. One delivery point was damaged and not capable of delivering the contract quantity.<sup>96</sup> There was a sufficient quantity of gas available at the second delivery point to satisfy Virginia Power and all of Apache’s other buyers. Apache delivered more than the minimum contract quantity to one third-party buyer and reduced the quantity of gas to Virginia Power and the other buyers by about fifty percent. Apache ranked the buyers and disproportionately reduced the allocation to Virginia Power to conform to Apache’s internal allocation of a specific source (i.e., specific platforms) of the gas supply delivered to that delivery point.<sup>97</sup> That specific platform dedication was not part of the Virginia Power contract.<sup>98</sup> Virginia Power covered the shortfall at a higher price in the spot market from various sellers, including Apache. Virginia Power then offset its increased costs against Apache.<sup>99</sup>

The Houston Fourteenth Court of Appeals held that Apache could rely upon the force majeure clause in the North American Energy Standards Board (NAESB) base contract, which specifically mentioned hurricanes.<sup>100</sup> The base contract did not define “reasonable efforts.” In balancing the tension between the requirement to make “reasonable efforts” to avoid invoking force majeure and the force majeure clause itself, the court of appeals relied upon the rule of construction that a contract should not be construed in a way that would render portions of it meaningless.<sup>101</sup> The court of appeals held that to require Apache to make deliveries at an alternate point because of the hurricane damage would render the contract provisions on specific delivery points and force majeure meaningless.<sup>102</sup> The court of appeals also rejected a similar statutory substitute performance argument based on UCC § 2-614,<sup>103</sup> because the statutory provision is a “gap-filler” provision that applies only if the parties do not have a specific agreement.<sup>104</sup>

It was undisputed that the first delivery point was damaged and incapable of delivering the specified quantity. However, Virginia Power con-

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95. 297 S.W.3d 397, 403 (Tex. App.—Houston [14th Dist.] 2009, pet. denied).

96. *Id.* at 401.

97. *Id.* at 408.

98. *Id.* at 406.

99. *Id.* at 401.

100. *Id.* at 404-05.

101. *Id.* at 403-04.

102. *Id.*

103. TEX. BUS. & COM. CODE ANN. § 2.614(a) (Vernon 2009).

104. *Va. Power*, 297 S.W.3d at 405.

tended that Apache could have delivered the contract quantities at the second delivery point.<sup>105</sup> Apache again invoked the force majeure clause, which only applied under the NAESB base contract if “the hurricanes caused a ‘loss or failure of [its] gas supply.’”<sup>106</sup> The term “gas supply” was not defined in the contract.<sup>107</sup> The issue was ultimately determined to present a fact question that could not be resolved in a summary judgment proceeding.<sup>108</sup> However, the court of appeals did discuss the meaning of “gas supply” under the NAESB contract and the right of a seller to allocate the available gas supply among multiple buyers.<sup>109</sup>

Apache contended that it was a common industry practice to internally allocate specific sources of supply (certain platforms) to specific delivery points. However, Apache presented no evidence that effectively supported that argument, and Virginia Power did present evidence that contested Apache’s custom and usage claim. Therefore, the court of appeals proceeded on the basis of the plain and ordinary meaning of “gas supply.”<sup>110</sup> It concluded that the meaning of “gas” was clear but the meaning of “supply” was not. Apache’s evidence did not address the effect of the hurricanes on all the possible sources of supply but only on those platforms that Apache had internally designated as allocable to the first delivery point. Therefore, Apache left open the fact question as to whether or not it could have delivered the gas at the second delivery point.<sup>111</sup>

Moreover, the court of appeals held that even if it accepted Apache’s narrow definition of “gas supply,” there was still a fact issue as to Apache’s ability to deliver gas. The record showed that enough gas was delivered to meet the contract requirements of all five buyers, but that one of those buyers took a disproportionately large amount over the minimum contract volume specified in its contract.<sup>112</sup> Apparently Virginia Power and the third-party buyer held different priorities or rankings in the event that deliveries were curtailed, but there was nothing in the record to explain the rankings. The court of appeals held that existing authority supporting allocations in the event of a shortage (without additional evidence from Apache) would not support a disproportionate allocation when there was no shortage.<sup>113</sup>

The significance of the case is that it illustrates how the simple and basic terms of the NAESB contract leave many issues open for controversy. It clarifies the relationship between events of force majeure and the reasonable efforts required to avoid them. Again, the discussion of

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105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.* at 409.

109. *Id.* at 405-07.

110. *Id.*

111. *Id.* at 407-08.

112. *Id.* at 408.

113. *Id.* at 408-409 (citing *Tejas Power Corp. v. Amerada Hess Corp.*, No. 14-98-00346-CV, 1999 WL 605550, at \*1 n.1 (Tex. App.—Houston [14th Dist.] Aug. 12, 1999, no pet.)).

gas supply and allocations among multiple buyers highlights the lack of specificity in the simple NAESB contract.

*Dynegy Midstream Services, L.P. v. Apache Corp.* held that for gas sold at the wellhead under common “percentage of proceeds” contracts, the gas processor was not obligated to compensate the producer for drips or condensate gathered before the gas reached the processing plant or for unaccounted-for gas lost between the wellhead and the tailgate of the processing plant.<sup>114</sup> Apache, the producer, entered into multiple “percentage of proceeds” contracts (covering production in Texas and New Mexico). Pursuant to these contracts, Apache transferred title to gas it produced to the processor (which also owned the gathering system) at or near its wellheads and received a percentage of the proceeds from the “sales of residue gas at the tailgate” of various processing plants.<sup>115</sup> Apache contended it should be compensated for condensate gathered before the gas reached the processing plant and for unaccounted-for gas that disappeared between production at the wellheads and the sale at the tailgate of the processing facilities. Apache sued for breach of contract, for violations of the New Mexico Unfair Practices Act (the Act), and for “a declaratory judgment on whether [it] was entitled to payment for condensate collected at compressor booster stations.”<sup>116</sup>

Typical “percentage of proceeds” contracts, like Apache’s contracts, determine payment to the producer based on the amount of gas sold at the tailgate of the processing plant.<sup>117</sup> “The parties were free to apportion the risk of pipeline losses or other losses as they wished.”<sup>118</sup> However, there were no provisions in Apache’s contracts requiring the processor to meet “efficiency targets with respect to leakage” or to compensate Apache for unaccounted-for gas.<sup>119</sup> Apache’s payment “was limited to a percentage of the proceeds from actual sales,” but Apache was seeking to recover “for sales that never occurred.”<sup>120</sup> Accordingly, “contract damages for gas lost between the wellhead and the tailgate were not recoverable.”<sup>121</sup>

The Act covers unfair and deceptive trade practices that include misrepresentations.<sup>122</sup> “Recovery of actual damages under the [Act]” requires an injury and a causal relationship between the misrepresentation and the injury.<sup>123</sup> However, the alleged misrepresentations of the gas processor related to the failure to pay Apache for unaccounted-for gas.<sup>124</sup> Because the gas processor was not obligated “to pay Apache for unac-

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114. 294 S.W.3d 164, 174 (Tex. 2009).

115. *Id.* at 169.

116. *Id.* at 167.

117. *Id.* at 169.

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.* at 170.

122. *Id.* at 171.

123. *Id.*

124. *Id.*

counted-for gas that was never sold," even if the Act was applicable and the misrepresentations were made, Apache was not injured, and there could be no recovery under the Act.<sup>125</sup>

Title to the gas was transferred at or near the wellhead.<sup>126</sup> Therefore, the liquids and condensate "from the gas stream downstream of the well-heads," removed at compressor stations, were owned by the gas processor.<sup>127</sup> The contracts provided that Apache would be paid for liquids that were saved and sold at the processing plant.<sup>128</sup> The compressor stations were not processing plants, and "gas liquids were not 'saved and sold' at the compressor stations."<sup>129</sup> "Liquid field condensate drops out of the gas stream because of changes in pressure and temperature, and must be removed from the gathering system to prevent blockage."<sup>130</sup> The liquids are not marketable until impurities are removed.<sup>131</sup> Further, "ten of the eleven contracts expressly provid[ed] that any liquids exiting the gas stream en route to the final processing plants" belonged to the processor.<sup>132</sup> None of the "percentage of proceeds" contracts specified "that condensate precipitating at compressor stations is treated differently from condensate precipitating at any other point in the gathering system."<sup>133</sup> Accordingly, the processor was not obligated to account to Apache for "condensate that fell out of the gas stream at the . . . compressor stations."<sup>134</sup>

*Dynergy Midstream Services* is a reminder that parties to a "percentage of proceeds" contract are free to apportion the risk of pipeline losses and to allocate the proceeds of production in the contract. If a producer wants to further apportion the risk of pipeline loss, the producer should ensure that the "percentage of proceeds" contract contains efficiency thresholds and that the contract requires the processor to account for losses that exceed the specified thresholds. Similarly, if a producer wants to share in the proceeds from liquids collected out of field separators, drips, or compressor stations, then the contract must specify that the producer will share in proceeds for products extracted at points other than the tailgate of the processing plant.

*ERG Resources, LLC v. Merlon Texas, Inc.* held that an assignment conveying the assignor's "right, title, and interest" in certain lands as of a specified effective date and "the personal property thereon" conveys the oil in storage on the land as of the effective date, regardless of when it

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125. *Id.*

126. *Id.*

127. *Id.*

128. *Id.*

129. *Id.* at 173.

130. *Id.* at 172.

131. *Id.*

132. *Id.* at 173.

133. *Id.*

134. *Id.* at 174.

was produced.<sup>135</sup> Paragraph one of the assignment conveyed assignor's "right, title, and interest in [the Land] . . . including . . . without limitation, the properties and/or oil and gas units located thereon, . . . together with . . . the *personal property thereon*, appurtenant thereto, or used or obtained in connection with said properties and/or oil and gas units."<sup>136</sup> Paragraph five of the assignment conveyed the assignor's "right, title, and interest in and to the oil, gas of any kind and nature, other hydrocarbons and other minerals in, on and produced from or allocated to the leasehold interest sold to [assignee] from and after the Effective Date hereof."<sup>137</sup> It was undisputed that the "[o]il . . . severed from the Land by production [was] personal property."<sup>138</sup> The assignor contended that the oil in storage on the land as of the effective date, but produced prior to the effective date, belonged to the Assignor.<sup>139</sup>

The Houston First Court of Appeals held:

[P]aragraph 5 gives [the assignor] a mineral interest—an interest in the oil and gas in place as of the Effective Date of the Assignment. Paragraph 5 does not conflict with paragraph 1. Paragraph 1 addresses the conveyance of all kinds of personal property, including the oil "thereon" the Land, while paragraph 5 addresses the conveyance of the oil and gas in place.<sup>140</sup>

Thus, the oil and gas in place passed as of the effective date by paragraph five, and the personal property on the land was conveyed as of the effective date by paragraph one.<sup>141</sup> The court of appeals found that the language used in paragraph five is the language that "is historically used to transfer a mineral estate, that is, the oil, gas, and other minerals in place, not severed from the ground."<sup>142</sup> Presumably, it was the "in, on and produced from" language that the court of appeals found persuasive.<sup>143</sup>

Purchase and sale agreements and assignments frequently use a series of descriptive paragraphs to describe the property interests to be transferred. It is common to describe the oil and gas leases to be conveyed and the personal property located thereon. Generally, the parties are thinking in terms of wellhead and surface equipment when using that language. It is also common to have an effective date provision to allocate between the parties the right to the production and the obligation to bear the costs. This generally works for gas, which is not usually in storage, but oil in the tanks creates a special issue. *ERG Resources* is significant

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135. No. 01-08-01007-CV, 2009 WL 3491049, at \*4 (Tex. App.—Houston [1st Dist.] Oct. 29, 2009, no pet.) (mem. op.).

136. *Id.* (emphasis added).

137. *Id.* at \*3.

138. *Id.* at \*4.

139. *Id.* at \*1.

140. *Id.* at \*4.

141. *Id.*

142. *Id.* (citing *Gex v. Tex. Co.*, 337 S.W.2d 820, 825 (Tex. Civ. App.—Amarillo 1960, writ ref'd n.r.e.)).

143. *See generally id.*



because it highlights the careful draftsmanship required to carry out the parties' intent as to oil in storage.

## V. REGULATIONS

In *Anadarko E & P Co. v. Railroad Commission of Texas*, the Austin Court of Appeals held that a permit issued by the Texas Railroad Commission (TRC) granting a well-spacing exception under Statewide Rule 37<sup>144</sup> (Rule 37) without proper notice was void, not voidable, and that lease geometry could be considered by the TRC in granting an exception.<sup>145</sup> An offset owner argued that the operator of the Barksdale Well No. 8 (the Well) failed to establish under Rule 37 that the Well "was necessary to prevent waste" and, because the offset owner was not given notice, that the original permit was void.<sup>146</sup>

"Rule 37 allows the [TRC] to grant an exception to the spacing requirements thereunder on two grounds: to prevent waste and to prevent the confiscation of property."<sup>147</sup> The court of appeals noted:

The supreme court has defined the term "waste", as used in Rule 37, to mean 'the ultimate loss of oil.'<sup>148</sup> Under this definition, the court explained that a Rule 37 exception to prevent waste may be justified if a *substantial* amount of oil or gas that otherwise would ultimately be lost will be saved by the drilling of a well . . . . To obtain a Rule 37 exception to prevent waste, it must be shown that . . . closer spacing of wells is necessary to recover the hydrocarbons.<sup>149</sup>

The court of appeals further stated that:

[T]o obtain a Rule 37 exception, [the operator] was required to show that unusual conditions—*i.e.*, different from conditions in adjacent parts of the field—existed under the tract for which the exception was sought; that as a result of these unusual conditions, hydrocarbons cannot be recovered by any existing well or by additional wells drilled at "regular" locations; and that the volume of otherwise unrecoverable hydrocarbons is substantial.<sup>150</sup>

The court of appeals found that the record demonstrated that the unit on which the Well was located was "an irregularly shaped unit with a

144. In relevant part, Rule 37 provides:

No well for oil, gas, or geothermal resource shall hereafter be drilled nearer than 1,200 feet to any well completed in or drilling to the same horizon on the same tract or farm, and no well shall be drilled nearer than 467 feet to any property line, lease line, or subdivision line; provided the commission, in order to prevent waste or to prevent the confiscation of property, may grant exceptions to permit drilling within shorter distances . . . .

16 TEX. ADMIN. CODE § 3.37(a)(1) (2010) (Tex. R.R. Comm'n, Statewide Spacing).

145. *Anadarko E & P Co. v. R.R. Comm'n of Tex.*, No. 03-04-00027-CV, 2009 WL 47112, at \*7, \*14 (Tex. App.—Austin Jan. 7, 2009, no pet.) (mem. op.).

146. *Id.* at \*12.

147. *Id.* at \*12 (citing 16 TEX. ADMIN. CODE § 3.37(a)(3)).

148. *Id.* (citing *Gulf Land Co. v. Atl. Ritchfield Co.*, 131 S.W.2d 73, 80 (Tex. 1939)).

149. *Id.* (citing *Wrather v. Humble Oil & Ref. Co.*, 214 S.W.2d 112, 117 (Tex. 1948)).

150. *Id.*

panhandle section” on which no regular locations existed, “although regular locations [did] exist on the unit.”<sup>151</sup> “The Well was located in the panhandle section of the unit equidistant from east and west lines.”<sup>152</sup> “The evidence showed that [there was a] rapid depositional environment” in the area of the Well.<sup>153</sup> “The evidence [further] showed that [the] rapid depositional environment would impact the heterogeneity, permeability, and porosity in the area of [the Well].”<sup>154</sup> Based on this evidence, the TRC “determined that the lease geometry of the panhandle section coupled with the impact of the rapid depositional environment constituted an unusual condition that precluded the reservoir from being adequately drained by wells at regular locations.”<sup>155</sup> Therefore, the court of appeals concluded that there was “a reasonable basis in the record . . . to support the [TRC’s] finding of unusual conditions at the location of [the Well].”<sup>156</sup>

The working interest owner argued that the TRC’s “order was not supported by substantial evidence because the [TRC’s] consideration of ‘lease geometry’ was improper.”<sup>157</sup> The court of appeals noted that “[i]n considering whether to grant a Rule 37 exception to prevent waste, the [Texas Supreme Court] has held that the [TRC] need not confine its analysis to the sole question as to whether [a] well will save oil that otherwise would be lost.”<sup>158</sup> “Rather, ‘the [TRC] should be left reasonably free to exercise its sound judgment and discretion,’ keeping in mind that the [TRC’s] duty is to conserve oil and gas above ground as well as below.”<sup>159</sup> The court of appeals held that the TRC may consider factors beyond mere geology in determining whether requirements necessary to grant a Rule 37 exception to prevent waste have been met.<sup>160</sup> Therefore, the court of appeals rejected the working interest owner’s claim that the TRC “was forbidden from considering lease geometry when determining whether a Rule 37 exception should have been granted to prevent waste.”<sup>161</sup>

The working interest owner further argued that the TRC’s “order was not supported by substantial evidence because the [TRC] failed to make a finding that no well at a regular location would drain the hydrocarbons to be recovered by [the Well].”<sup>162</sup> “Contrary to this assertion, the TRC expressly determined . . . that [the] lease geometry coupled with the impact of the depositional environment would preclude the panhandle sec-

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151. *Id.* at \*13.

152. *Id.*

153. *Id.*

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.* at \*14.

158. *Id.* (citing *Gulf Land Co. v. Alt. Ritchfield Co.*, 131 S.W.2d 73, 85 (Tex. 1939)).

159. *Id.*

160. *Id.*

161. *Id.*

162. *Id.*

tion of the [unit] from being drained 'by wells at regular locations.'"<sup>163</sup> The court of appeals, therefore, rejected the working interest owner's argument.<sup>164</sup>

There was also a procedural point of some significance. Rule 37 requires that notice of hearing be given to certain offset owners, and the issue was the effect of a Rule 37 exception which is granted under circumstances where the offset owner did not receive notice.<sup>165</sup>

The plain language of Rule 37 places the burden of correctly identifying affected persons squarely upon the applicant . . . . It is therefore incumbent upon the applicant for a Rule 37 exception to ensure that the correct parties have been identified so that the Commission may provide proper notice to those parties.<sup>166</sup>

The court of appeals stated that "[i]n the absence of proper notice, we conclude that the Commission did not err in declaring the original permit 'void'—i.e., the production was illegal from its inception—rather than 'voidable.'"<sup>167</sup>

*Anadarko E & P* is significant because it confirms that the TRC may consider factors beyond mere geology in determining whether requirements necessary to grant a Rule 37 exception to prevent waste have been satisfied. Specifically, the configuration of the lease may be considered.<sup>168</sup> The holding that a permit issued under a Rule 37 exception is void, not voidable, is also significant. Further, production under a void permit is illegal from inception.<sup>169</sup>

*Exxon Corp. v. Emerald Oil & Gas Co.* held that the Texas Natural Resources Code creates private causes of action for breach of the statutory duties to properly plug wells and not commit waste, and establishes that subsequent owners do not have standing to sue prior owners "for injury to realty [which occurred] before the subsequent owner acquired his interest."<sup>170</sup> Exxon Corporation (Exxon) held mineral leases subject to a fifty-percent royalty covering several thousand acres in Refugio County, Texas. During the 1980s, after negotiations to reduce the royalty failed, "Exxon systematically plugged and abandoned [its] wells," because the leases were no longer profitable.<sup>171</sup> After the leases terminated, Emerald Oil & Gas Company (Emerald) acquired a portion of the leases and "attempted to reenter the wells" but encountered unexpected difficulties.<sup>172</sup> Emerald alleged that Exxon caused those difficulties by intentionally sabotaging the wells during Exxon's plugging and abandon-

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163. *Id.*

164. *Id.*

165. *Id.* at \*8.

166. *Id.* (citations omitted).

167. *Id.* at \*7.

168. *Id.* at \*14.

169. *Id.* at \*7.

170. No. 05-0729, 2009 WL 795760, \*2, \*4-5 (Tex. Mar. 27, 2009), *reh'g granted* Nov. 20, 2009.

171. *Id.* at \*1.

172. *Id.*

ment of the leases. Among other claims, Emerald sued Exxon for “(1) breach of [the] statutory duty to properly plug a well[ ] [and] (2) breach of [the] statutory duty not to commit waste.”<sup>173</sup>

Section 85.321 of the Texas Natural Resources Code provides:

A party who owns an interest in property or production that may be damaged by another party violating the provisions of this chapter . . . or another law of this state prohibiting waste or a valid rule or order of the commission may sue for and recover damages and have any other relief to which he may be entitled at law or in equity.<sup>174</sup>

The Texas Supreme Court held that the plain language of the statute creates a private cause of action.<sup>175</sup> However, in this case, Emerald’s complaints about the actions of Exxon did not constitute waste.<sup>176</sup> “Taking Emerald’s allegations as true, they do not constitute waste under the Natural Resources Code because Exxon’s alleged conduct did not cause the loss of oil or escape of gas.”<sup>177</sup>

Section 85.321 also creates a private cause of action for violating Railroad Commission rules regulating plugging.<sup>178</sup> The supreme court first analyzed whether Emerald had standing to maintain suit.<sup>179</sup> The supreme court explained that the statute’s use of the language, “a party who owns an interest in property . . . may be damaged by another party *violating* the provisions of this chapter,” could support different interpretations.<sup>180</sup> The language could support an interpretation that an owner may bring suit only for an injury concurrent with ownership.<sup>181</sup> However, the language could also support the interpretation that an owner may bring suit for any past violation or violation concurrent with ownership.<sup>182</sup>

To determine the meaning of the language, the supreme court looked to the statute’s predecessor, which applied common-law standards.<sup>183</sup> Common law provides that:

[A] cause of action for injury to real property accrues when the injury is committed. The right to sue is a personal right that belongs to the person who owns the property at the time of the injury, and the right to sue does not pass to a subsequent purchaser of the property unless there is an express assignment of the cause of action.<sup>184</sup>

The significance of *Exxon Corp.* is the unequivocal holding that the Natural Resources Code creates a private cause of action for damages resulting from statutory violations. In dictum, the Texas Supreme Court

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173. *Id.*

174. TEX. NAT. RES. CODE ANN. § 85.321 (Vernon 2009).

175. *Exxon Corp.*, 2009 WL 795760, at \*2.

176. *Id.* at \*4.

177. *Id.* at \*4 (citing TEX. NAT. RES. CODE ANN. §§ 85.045-.047 (Vernon 2007)).

178. *See id.*

179. *Id.*

180. *Id.* at \*4, \*2 (emphasis added).

181. *Id.* at \*4.

182. *Id.*

183. *Id.*

184. *Id.* at \*5 (citations omitted).

also recognized that there is a statutory defense to such civil claims based on the reasonably prudent operator standard.<sup>185</sup> The holding that a subsequent owner lacks standing to sue for pre-existing damages to realty, absent an express assignment of the cause of action, is consistent with long-standing precedent.<sup>186</sup>

A related case, also styled *Exxon Corp. v. Emerald Oil & Gas Co.*,<sup>187</sup> indicates that false filings with the TRC will generally not support private causes of action for fraud.<sup>188</sup> This case is the culmination of nearly fourteen years of litigation between royalty owners and their lessee, based on disputes arising under leases granted in the 1950s. The leases covered several thousand acres and included a fifty-percent royalty clause and “stringent disclosure, development, and surrender clauses.”<sup>189</sup> During the term of the leases, the lessee and successor lessees (collectively “Exxon”) “drilled 121 wells and produced at least 15 million barrels of oil and more than 65 billion cubic feet of gas, resulting in the payment of more than \$43 million in royalties.”<sup>190</sup> As the field began to decline, Exxon sought to amend the leases and reduce the royalty. The royalty owners refused, and negotiations continued for years, increasing in intensity as Exxon’s threat to plug and abandon became more imminent. The royalty owners identified other oil companies interested in taking over the leases, including the predecessor to Emerald Oil & Gas, L.P. (Emerald). The royalty owners urged Exxon to sell or transfer its interest to Emerald or some other company.<sup>191</sup>

Because Exxon determined that the leases were no longer profitable, Exxon finally began plugging wells in 1989.<sup>192</sup> The royalty owners threatened to sue Exxon in August of 1990 if Exxon plugged any wells that were capable of producing in paying quantities as to the interest of the royalty owners. The royalty owners threatened to sue under the leases and common law and to sue for waste.<sup>193</sup> As Exxon plugged the wells, it disclosed the plugging methods for each well in a plugging report on Form W-3 filed with the TRC.<sup>194</sup> Exxon pursued the plugging project until its completion in 1991, despite objections from the royalty owners and offers from potential buyers.<sup>195</sup>

Emerald had offered to purchase Exxon’s interest in 1989 and again in 1990.<sup>196</sup> After reviewing Exxon’s plugging reports, Emerald acquired a

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185. *Id.* at \*2.

186. *See id.* at \*5.

187. No. 05-1076, 2009 WL 795668, \*10 (Tex. Mar. 27, 2009), *reh’g granted* Nov. 20, 2009.

188. *Id.* at \*8-10.

189. *Id.* at 1.

190. *Id.*

191. *Id.* at \*1-2, \*3 n.5.

192. *Id.* at \*2.

193. *Id.* at \*1.

194. *Id.* at \*2.

195. *Id.*

196. *Id.* at \*10.

new lease from the royalty owners in 1993 and attempted to reopen the plugged wells in 1994. Emerald's attempts proved futile because Emerald encountered junk in the hole. In 1995, Emerald obtained Exxon's internal well records on the plugged wells from another party on an adjoining tract and discovered that Exxon's internal records differed substantially from the records filed with the TRC. Concluding that Exxon intentionally sabotaged the field, Emerald sued Exxon in . . . 1996, and the royalty owners intervened.<sup>197</sup>

The supreme court severed the plaintiffs' negligence per se claim, along with claims based on the statutory duties to properly plug the wells and avoid committing waste, on the issue of whether the statutes created a private cause of action.<sup>198</sup> The statutory claims were resolved on the same day in a related case also styled *Exxon Corp. v. Emerald Oil & Gas Co.*,<sup>199</sup> discussed above.

All of the tort claims asserted in this case that were subject to a two-year statute of limitations were held to be barred by limitations.<sup>200</sup> The remainder of the opinion focused on the alleged fraud based on the Form W-3s filed with the TRC and the royalty owners' claim of breach of the lease based on the development clause in the leases.<sup>201</sup>

Regarding the plaintiffs' claim of fraud based on the Form W-3s filed with the TRC, "Exxon [did] not dispute that it plugged the wells using non-standard plugging procedures."<sup>202</sup> However, it did "admit[ ] to cutting the well casing and leaving it in the wellbore."<sup>203</sup> Emerald and the royalty owners claimed that Exxon injured them by making material misrepresentations on its plugging reports, upon which the plaintiffs justifiably relied.<sup>204</sup> However, to prevail on its claim of fraud, the plaintiffs also had to demonstrate that Exxon "made the representation with the intent that the other party would act on that representation or intended to induce the party's reliance on the representation."<sup>205</sup>

The TRC rules provide, "Non-drillable material that would hamper or prevent re-entry of a well shall not be placed in any wellbore during plugging operations . . . . Pipe and unretrievable junk shall not be cemented in the hole during plugging operations without prior approval by the district director . . . ." <sup>206</sup> Exxon obviously did not comply with this rule. Exxon nevertheless claimed that it could not have anticipated that the plugging reports it filed would impact future operators, because the re-

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197. *Id.* at \*2.

198. *Id.* at \*3.

199. No. 05-0729, 2009 WL 795760, \*1-2 (Tex. Mar. 27, 2009), *reh'g granted* Nov. 20, 2009.

200. *Exxon Corp.*, 2009 WL 795668, at \*3-4.

201. *Id.* at \*4-10.

202. *Id.* at \*2 n.6.

203. *Id.*

204. *Id.* at \*8.

205. *Id.*

206. 16 TEX. ADMIN. CODE § 314.6(c)(10) (2010) (Tex. R.R. Comm'n, Statewide Spacing).

porting requirements are intended to protect against pollution and are not intended to provide notice to future operators.<sup>207</sup> The supreme court rejected Exxon's argument based on the TRC's objectives for the reporting requirements: (1) protect the environment and (2) allow "reentry into the wells for commercial purposes."<sup>208</sup>

Although the supreme court accepted Emerald's argument that false information in the plugging records could reasonably induce detrimental reliance, the supreme court stated that this alone did not establish that Exxon *intended* to induce the plaintiffs' reliance.<sup>209</sup> Rather, the plaintiffs "must show an especial likelihood that the party who made the misstatement knew the claimant would rely on the information in the type of transaction the defendant contemplated."<sup>210</sup> This is a specific, focused inquiry. Relying upon public information as part of a general industry practice, which information turns out to be false, is, as a matter of law, insufficient.<sup>211</sup> The inquiry is "not satisfied by evidence that a misrepresentation may be read in the future by some unknown member of the public or of a specific industry."<sup>212</sup> The supreme court found there was some evidence that could support a finding of fraud: Emerald's earlier attempts to acquire the wells and Emerald and the royalty owners' attempts to stop Exxon's plugging. Therefore, the trial court's directed verdict for Exxon on fraud was reversed and the case remanded on that issue.<sup>213</sup>

The leases with Exxon contained a development clause requiring Exxon to fully develop the leased tracts.<sup>214</sup> To satisfy the requirement, the leases provided that Exxon had to "drill[ ] and complete[ ] [one well] in each horizon or stratum capable of producing [oil or gas] in paying quantities for a specified number of acres" per well.<sup>215</sup> As required by the lease, Exxon drilled the required number of wells.<sup>216</sup> However, the royalty owners claimed that Exxon did not "complete" two productive zones, because it failed to exploit the full potential of the tracts.<sup>217</sup>

Because the lease did not define "drill" and "complete," the supreme court interpreted the lease through a canon of contractual construction which holds "that technical words are to be interpreted as usually understood by persons in the profession or business to which they relate, unless there is evidence that the words were used in a different sense."<sup>218</sup> The

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207. *Exxon Corp.* 2009 WL 795668 at \*8.

208. *Id.* at \*9.

209. *Id.*

210. *Id.* (citing *Ernst & Young, L.L.P. v. Pacific Mut. Life Ins. Co.*, 51 S.W.3d 573, 581-82 (Tex. 2001)).

211. *Id.*

212. *Id.* at \*10.

213. *Id.*

214. *Id.* at \*4.

215. *Id.* at \*5 (alteration in original).

216. *Id.* at \*6.

217. *Id.* at \*4.

218. *Id.* at \*5 (quoting *Barrett v. Ferrell*, 550 S.W.2d 138, 142 (Tex. Civ. App.—Tyler 1977, writ ref'd n.r.e.)).

supreme court held that “for a well to be considered ‘drilled and completed,’ . . . a hole must be dug in the ground, and if oil or gas is encountered, the casing must be perforated or otherwise prepared for production.”<sup>219</sup> Because Exxon drilled the required number of wells and produced in paying quantities from the two contested zones, the supreme court held that Exxon did not breach the leases, even though Exxon did not fully exploit the zones’ potential.<sup>220</sup> Exxon was not liable for breach of the development clause of the leases.<sup>221</sup>

The significance of the case is the holding that false filings with the TRC will not support private causes of action based on fraud, except in very narrow circumstances. A plaintiff “must show an especial likelihood that the party” making the false filing specifically knew the plaintiff would rely upon the false “information in the type of transaction” contemplated by the party making the filing.<sup>222</sup> The case also provides a definition of “drill and complete,” which is construed to mean to drill and perforate the hole or otherwise prepare for production.<sup>223</sup> The contention that “complete” used in this context means to fully develop was rejected.<sup>224</sup> Finally, the plaintiffs’ loss on all of the two-year tort claims based on limitations suggests that landowners should be more aggressive about filing suit or seeking tolling agreements, regardless of the status of on-going lease negotiations.

The Texas Supreme Court cases are likely to have the most lasting significance simply because they generally consider novel issues or finally settle and become the definitive precedent on the issue presented and resolved. There are a number of cases further refining the issues surrounding (1) adverse possession of the leasehold by a lessee continuing in possession and producing after lease termination, (2) the extent to which a well must be capable of producing before the payment of shut-in royalties will be authorized and permitted to extend an oil and gas lease, and (3) the rights to participate in proceeds downstream of the wellhead and the obligation to bear costs incurred downstream of the wellhead. These broad areas of inquiry are still generating controversy and should be of continuing importance in case law for several more years.

## VI. LEGISLATION<sup>225</sup>

1. *Act*: Act of May 31, 2009, 81st Leg., R.S., ch. 442, §§ 1-6, 2009 Tex. Gen. Laws 1031 (Vernon).<sup>226</sup>

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219. *Id.*

220. *Id.* at \*7.

221. *Id.*

222. *Id.* at \*9.

223. *Id.* at \*5.

224. *Id.*

225. Portions of the legislative section of this Article were supplied to the author by Ben Sebree, Vice-President for Governmental Affairs, Texas Oil & Gas Association, Austin, Texas.

226. Codified as amendments to TEX. NAT. RES. CODE ANN. §§ 89.002(a)(7), 91.019, 91.111(c), adding §§ 89.002(9), 89.002(10), 89.002(11), 89.002(12), 89.002(13), 89.021,



*Issue:* Relating to the plugging requirements for inactive oil or gas wells.

*Summary:* This act requires an operator of an inactive well to plug the well “on or before the date the operator is required to renew” its organization report in accordance with applicable statutes and the rules of the TRC in effect at the time of plugging.<sup>227</sup> The act defines an “inactive well” as an “unplugged well with no reported production, disposal, injection, or other permitted activity” for more than twelve months.<sup>228</sup> The act allows a person who assumes responsibility for the physical operation and control of an existing well up to six months from the date of the TRC approval to transfer the ownership of the well to satisfy the plugging requirements for the well or obtain a plugging deadline extension.<sup>229</sup>

The act authorizes the TRC to grant a deadline extension for plugging an inactive well if the operator files an extension application which includes the following information: (1) written affirmation by the operator that the electric service to the well’s production site has been terminated; (2) operator must have emptied all production fluids and purged related piping, tanks, vessels, and equipment associated with wells that have been inactive for more than five years but less than ten years, and operator must have “removed all surface process equipment and related piping, tanks, [and] tank batteries” for wells that have been inactive for ten years or more; (3) a statement that the well is in compliance with TRC rules and orders; and (4) a statement that the operator possesses, and can provide upon request, “evidence of a good faith claim to a continuing right to operate the well.”<sup>230</sup> The act requires the TRC to be prepared to grant deadline extensions for plugging inactive wells by September 1, 2010.<sup>231</sup>

Effective: September 1, 2009.<sup>232</sup>

2. *Act:* Act of May 31, 2009, 81st Leg., R.S., ch. 1175, §§ 1-35, 2009 Tex. Gen. Laws 3725 (Vernon).<sup>233</sup>

*Issue:* “Relating to the powers and duties of the School Land Board and the commissioner of the General Land Office” concerning the leasing of minerals<sup>234</sup>

*Summary:* This act authorizes the prospective pooling or unitization of “[o]il and gas underlying land that is owned by [the] state, [which] was

89.022, 89.023, 89.024, 89.025, 89.026, 89.027, 89.028, 89.029, and 89.030 (Vernon Supp. 2010).

227. § 2 (TEX. NAT. RES. CODE § 89.022(a)).

228. § 1 (TEX. NAT. RES. CODE § 89.002(a)(12)).

229. § 2 (TEX. NAT. RES. CODE § 89.023(b)).

230. § 2 (TEX. NAT. RES. CODE § 89.023(a)(1)-(3)).

231. § 2 (TEX. NAT. RES. CODE § 89.029(f)).

232. § 6.

233. Codified as amendments to TEX. NAT. RES. CODE ANN. §§ 32.001(4), 32.002(a), 32.002(b), 32.061, 32.102, 32.105, 32.107(a)-(c), 32.110(a) and (c), 32.203, 32.253, 51.001(8), 51.013(b), 51.014, 51.052(e), 51.052(f), 51.052(g), 51.052(i) and 51.052(k), 51.056, 51.066, 51.070(a), 51.070(b), 51.071, 51.073, 51.086(a), 51.172(4), 51.172(7), 51.177(a), 51.180, 51.181(a), 51.181(b), 51.187(a), 51.194(a), adding §§ 32.002(a-1), 32.002(f), 32.003, 32.207, 51.001(12), 51.194(a-1), 51.194(a-2), 61.021(c) (Vernon Supp. 2010).

234. *Id.*

acquired to construct or maintain a highway, road, street or alley, . . . and [is] subject to an oil or gas lease.”<sup>235</sup>

The act requires a compensatory royalty to be “paid in the same proportion that the acreage of the state lease has to the acreage of the state lease plus the acreage of a *standard* proration unit *under statewide field rules or, if applicable, the special field rules adopted by the [TRC] for the field in which the well has been completed.*”<sup>236</sup> The act removes the condition for the state to be required to pay a compensatory royalty each month to the Commissioner of the General Land Office after “the oil or gas is sold and delivered from a well [that is] causing drainage or . . . located within 2,500 feet of the leased premises and completed in a producible reservoir under the state lease.”<sup>237</sup>

The act provides that no one, including the state and local government, is authorized “to claim damages relating to production from a legally permitted and . . . producing well” if the well is drilled before the effective date of the act.<sup>238</sup>

Effective: June 19, 2009.

3. *Act*: Act of May 25, 2009, 81st Leg., R.S., ch. 1311, §§ 1-3, 2009 Tex. Gen. Laws 4717 (Vernon).<sup>239</sup>

*Issue*: “Relating to the authority of a gas corporation to use a public right-of-way.”<sup>240</sup>

This act gives a gas corporation the authority “to lay and maintain lines over, along, under, and across a public road, a railroad, railroad right-of-way, an interurban railroad, a street railroad, a canal or stream, or a municipal street or alley” as long as the pipeline complies with all of the TRC’s safety regulations and guidelines from the Texas Department of Transportation.<sup>241</sup> The act also provides that the proposed route of a pipeline and the proposed location of pipeline-related facilities must maximize, to the extent reasonably practicable, the use of “*existing easements and public rights-of-way.*”<sup>242</sup> The act prohibits a municipality from assessing “a charge for the placement, construction, maintenance, repair, replacement, operation, use, relocation, or removal of a gas pipeline facility . . . under . . . a public road, highway, street, alley, stream, canal, or other public way.”<sup>243</sup>

Effective: September 1, 2009.<sup>244</sup>

235. § 2 (TEX. NAT. RES. CODE § 32.002 (9-1)).

236. § 1D (emphasis added) (TEX. NAT. RES. CODE § 32.203)).

237. *Id.*

238. § 34(1).

239. Codified as amendments to TEX. UTIL. CODE ANN. §§ 121.2025(a), 181.005 (Vernon Supp. 2010).

240. *Id.*

241. § 2 (TEX. UTIL. CODE § 181.005(a)(1)).

242. § 2 (TEX. UTIL. CODE § 181.005(c)).

243. § 1 (TEX. UTIL. CODE § 121.2025(a)).

244. § 2.

4. *Act*: Act of May 25, 2009, 81st Leg., R.S., ch. 1145, §§ 1-3, 2009 Tex. Gen. Laws 3580 (Vernon).<sup>245</sup>

*Issue*: Relating to the requirement of an entity with eminent domain power to provide property owners with landowner's bill of rights.<sup>246</sup>

*Summary*: The act requires "an entity with eminent domain authority [to] provide a copy of the landowner's bill of rights statement to a landowner before or at the same time as the entity first represents in any manner to the landowner that the entity possesses eminent domain authority."<sup>247</sup> This act also provides that an entity with eminent domain authority must provide the property owner with a landowner's bill of rights statement no later than seven days before the date the entity makes a final offer.<sup>248</sup>

Effective: January 15, 2010.<sup>249</sup>

5. *Act*: Act of May 18, 2009, 81st Leg., R.S., ch. 224, §§ 1-13, 2009 Tex. Gen. Laws 615 (Vernon).<sup>250</sup>

*Issue*: Relating to the injection and geologic storage of anthropogenic carbon dioxide.<sup>251</sup>

*Summary*: This act provides that the TRC has jurisdiction over the injection and geologic storage of carbon dioxide in a reservoir that initially produces "oil, gas, geothermal resources, or a saline formation directly above or below the reservoir."<sup>252</sup> However, the jurisdiction is subject to the review of the legislature based on the recommendations made in the preliminary report.<sup>253</sup>

The act prohibits the "drilling or operating [of] an anthropogenic carbon dioxide injection well for geologic storage . . . without first obtaining the necessary permits from the [TRC]."<sup>254</sup> The act authorizes the TRC to "impose fees to cover the cost of permitting, monitoring, and inspecting anthropogenic carbon dioxide injection wells for geologic storage and geologic storage facilities."<sup>255</sup> The act requires that any TRC rules adopted to implement this program should be consistent with applicable rules and regulations adopted by federal agencies "governing the injection and geologic storage of anthropogenic carbon dioxide," which includes the United States Environmental Protection Agency.<sup>256</sup>

245. Codified as amendments to TEX. PROP. CODE ANN. § 21.0112(a) (Vernon Supp. 2010).

246. *Id.*

247. § 1 (emphasis added) (TEX. PROP. CODE § 21.0112(a)).

248. *Id.*

249. § 3.

250. Codified as amendments to TEX. WATER CODE ANN. §§ 27.002(19), 27.002(20), 27.002(21), 27.002(22), 27.002(23), 27.002(24), 27.002(25), 27.051(b), 27.071, 27.072, 27.073(a), adding §§ 27.041, 27.042, 27.043, 27.044, 27.045, 27.046, 27.047, 27.048, 27.049, 27.050, 27.051(b-1) (Vernon Supp. 2010), and adding TEX. NAT. RES. CODE ANN. §§ 91.801, 91.802, 120.001, 120.002, 120.003, 120.004 (Vernon Supp. 2010).

251. *Id.*

252. § 2 (TEX. WATER CODE § 27.041(a)).

253. § 2 (TEX. WATER CODE § 27.042(a)).

254. § 10(b)(1)-(3).

255. § 2 (TEX. WATER CODE § 27.043).

256. § 2 (TEX. WATER CODE § 27.045(a)(1)).

The act authorizes the TRC to issue a permit under the program if it determines the following criteria have been satisfied: “(1) . . . the injection and geologic storage of anthropogenic carbon dioxide will not endanger . . . any oil, gas, or other mineral formation; (2) . . . with proper safeguards, both ground and freshwater can be adequately protected from carbon dioxide migration . . . ; (3) . . . the injection of anthropogenic carbon dioxide will not endanger or injure human health and safety; (4) . . . the reservoir into which the anthropogenic carbon dioxide is injected . . . is capable of being made suitable for protecting against the escape . . . of anthropogenic carbon dioxide from the reservoir; and (5) . . . the permit [applicant] meets all . . . statutory and regulatory requirements for [issuing] the permit.”<sup>257</sup>

The act provides that the TRC has jurisdiction over the extraction of “anthropogenic carbon dioxide stored in a geologic storage facility” and authorizes the TRC to adopt rules to allow the carbon dioxide “to be extracted for commercial or industrial use.”<sup>258</sup> The act requires the Commissioner of the General Land Office to “prepare and file with the legislature a preliminary report on a recommended framework for managing activities [relating] to geologic storage on state-owned land.”<sup>259</sup>

Effective: September 1, 2009.<sup>260</sup>

The legislation summarized here is only a small sample of the legislation that passed and an even smaller sample of the legislation that was proposed. The trend is toward addressing the increasing conflict between urban land owners with no stake or only a small stake in the production of oil and gas and an industry under increasing pressure to find and produce oil and gas competitively in an increasingly globalized marketplace. Voting power in the Texas legislature has shifted away from the rural areas, where most of the oil and gas is found, to the urban areas, where most of the votes are found. Therefore, the challenge is how to balance the call for increased regulation within the urban areas with the reality that most oil and gas operations in Texas are in rural areas.

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257. § 3 (TEX. WATER CODE § 27.051(b-1)).

258. § 7 (TEX. NAT. RES. CODE § 120.004(a)).

259. § 9(b).

260. § 13.

