Oil, Gas and Mineral Law

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This Article focuses on the interpretations of, and changes relating to, oil, gas, and mineral law in Texas from November 2, 2007, through November 1, 2008. The cases examined include decisions of state and federal courts in the State of Texas and the Fifth Circuit Court of Appeals.¹


I. INTRODUCTION

His Article focuses on the interpretations of, and changes relating to, oil, gas, and mineral law in Texas from November 2, 2007, through November 1, 2008. The cases examined include decisions of state and federal courts in the State of Texas and the Fifth Circuit Court of Appeals.
II. TITLE AND CONVEYANCING ISSUES

Silver Oil & Gas, Inc. v. EOG Resources, Inc. is a boundary dispute case resolved by the assumption that the surveyor did not intend to overlap a senior survey. Silver brought suit based on its contention that EOG's wells were located too close to the boundary line between Surveys 9 and 10, Block Q5. A simplified sketch illustrates the dispute between the parties:

![Sketch of boundary dispute](image)

Section 116, Block 1 to the west and Sections 9 and 12, Block Q6 to the east were the senior surveys. In between were the filler surveys, which filled the gap between the senior surveys. Therefore, Sections 117 1/2, Block 1 and Sections 9 and 10, Block Q5 were junior surveys. All three surveyors who testified at the trial agreed that the original surveyor made an error of 222.45 varas when he re-surveyed Survey 116, Block 1. The error "affected the total east–west distance of the junior surveys, so that the called distances along the southern line of the junior surveys exceeded the distance actually available between the senior surveys." Silver contended that the correct boundary between Sections 9 and 10, Block Q5 was 222.45 varas east because the sections should start at the known corner and be laid out in order. EOG contended that the boundary was correctly located by a distance call back from Block Q6.

The trial court ruled for EOG. Silver claimed the following errors were made by the trial court:

1. adopting a construction that impermissibly shortens a senior survey; (2) failing to locate the surveys in question from the nearest

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2. 246 S.W.3d 197, 200-02 (Tex. App.—San Antonio 2007, no pet.).
3. Id. at 200.
4. Id.
5. Id.
6. Id.
7. Id.
8. Id. at 202.
established corner; (3) locating the surveys from an unmarked prairie line; and (4) granting to EOG Resources and TEMA lands that were sold to Silvers predecessors more than a century ago [i.e., Silver claimed under the senior patent].

The San Antonio Court of Appeals determined that the standard of review was "sufficiency of the evidence" because there were fact issues behind each surveyor's opinion. What constitutes boundaries is a question of law, but determining where the boundaries are upon the ground is a question of fact. When determining the location of boundary lines in a survey, the applicable cardinal rule is that the footsteps of the original surveyor should be followed, if they can be ascertained, even if they are inconsistent with the calls and references in the surveyor's field notes. "However, if the location of the actual footsteps of the surveyor cannot be established with reasonable certainty, all of the surrounding facts and circumstances should be considered in order to arrive at the purpose and intent of the surveyor who made the original survey." All of the court's analysis appears to be driven by its primary assumption that the original surveyor did not intend to overlap the Q6 senior survey.

Because the trial court's judgment did not resolve any issue pertaining to the location of the survey lines in Section 116, the court found that a junior survey was not used to shorten or change the boundary lines of the senior survey of Section 116.

Silver argued that the court should have used the nearest known corner to locate the surveys. Although the location of the southwest corner of Survey 117-1/2 was undisputed by the parties, the acreage used by the original surveyor to make the distance calls for the filler surveys was affected by the mistake in Survey 116. As a result, the certainty of the corner's location would not be useful in determining the location of the filler surveys. Therefore, the trial court's decision to work back from the senior survey to the east was justified.

Unmarked prairie lines (like the Q6 line) are not ordinarily used to locate other surveys. However, calls for adjoinder will prevail even if adjoinder is with an unmarked but ascertainable line. Exceptions exist in the event the call for adjoinder was made "upon misapprehension, mistake, or conjecture." The adjoinder call in this case was not a mistake because the surveyor intended for the surveys to adjoin line Q6 and to account for the full amount of available acreage; he was mistaken as to

9. Id. at 199.
10. Id.
11. Id. at 202-03.
12. Id. at 204 (citing TH Invs., Inc. v. Kirby Inland Marine, L.P., 218 S.W.3d 173, 204 (Tex. App.—Houston [14th Dist.] 2007, pet. denied)).
13. Id.
14. Id. at 204-05.
15. Id. at 205.
16. Id. at 204.
17. Id. at 205 (citing Frost v. Socony Mobil Oil Co., 433 S.W.2d 387, 396 (Tex. 1968)).
18. Id. (citing Turner v. Smith, 122 Tex. 338, 61 S.W.2d 792, 800 (1933)).
the amount of acreage available because of the error in Survey 116.\textsuperscript{19} Because the Q6 line was an ascertainable line, the trial court’s decision to rely upon it was not erroneous.\textsuperscript{20}

Silver argued that Section 9 was patented to its predecessors forty years before Section 10 was patented to the predecessors of EOG.\textsuperscript{21} However, the court held that "[t]he survey and location of the land determines the rights of the parties, not the issuance of patents."\textsuperscript{22}

Determining the original surveyor’s intent is the cardinal rule used in locating boundary lines.\textsuperscript{23} EOG successfully argued that the intent to adjoin with the Q6 line was paramount; therefore, fixing the boundary by the call west from the Q6 line was proper.\textsuperscript{24} The significance of the case appears to be the great weight given to the presumption that the surveyor did not intend to overlap a senior survey. Because an illegal location (e.g., too close to a lease line) generally means that there is no right to produce the well at the illegal location, boundary locations can be critical in oil and gas operations.

\textit{Longoria v. ExxonMobil Corp.} reviewed party joinder issues in the context of trespass to try title and declaratory judgment claims.\textsuperscript{25} The claims were based on adverse possession prior to the severance of the surface and mineral estates. Longoria and forty-one other plaintiffs claimed an interest in 9,200 acres based on the adverse possession of the tract by Jose M. Longoria, his brother and sister-in-law beginning in 1898. The underlying dispute involved an alleged fraudulent deed in 1919 and a 1924 partition suit that did not name the Longorias as parties. The Longoria plaintiffs originally claimed an undivided one-half interest in the surface and the minerals in the entire 9,200 acres.\textsuperscript{26} Longoria sued in trespass to try title and for a declaratory judgment against eleven oil and gas companies, which leased over 6,700 acres, and Lopez, who was unleased and owned approximately 1,016 acres in fee. Longoria did not sue the surface owner, the other unleased mineral owners, the royalty owners, the non-participating royalty owners, or the owners of the possibility of reverter under the oil and gas leases.\textsuperscript{27}

There was a protracted fight over joinder and various motions to dismiss and amendments to the pleadings.\textsuperscript{28} The trial court eventually dismissed the case without prejudice because of the Longorias’ "failure to
join absent mineral owners." After considering the application of Rule 39 of the Texas Rules of Civil Procedure and the discretion given to the trial court as to matters of joinder and in determining dismissals, the San Antonio Court of Appeals affirmed.

The trial court's discretion is governed by Rule 39:

Rule 39(a) provides that a person who is subject to service of process shall be joined as a party to an action if: (1) his presence is needed to adjudicate the dispute and accord complete relief to those already parties; (2) his ability to protect his interests may be impaired or impeded if he is absent; or (3) his absence leaves one already a party subject to a substantial risk of multiple or inconsistent obligations.

Although expressed in mandatory terms, it is left to the trial court to determine whether an absent person falls within the rule. Rule 39 is applicable to both trespass to try title and declaratory judgment claims.

In their attempt to avoid dismissal, the Longorias amended their pleadings to claim that joinder of additional parties was not required. They made no claim to the surface estate, and they claimed only those minerals owned and possessed by parties who were named as defendants. Royalty, non-participating royalty, and the possibility of reverter are each non-possessory interests. The Longorias claimed that they were unleased co-tenants and stipulated they would be burdened by the royalties otherwise payable by the named defendant oil and gas company lessees. The Longorias argued that the possibility of reverter had "no real ascertainable value" and that the unjoined mineral owners would not be prejudiced by a judgment which was not binding on them. In other words, the Longorias narrowed their claim to the leasehold interests of the named defendant oil and gas companies and the fee mineral interest of Lopez.

The San Antonio Court of Appeals held that "the fact an absent person does not have title to or possession of the minerals to which the Longorias seek title is not dispositive if the relief the Longorias seek could impair the person's ability to protect any interests he claims." The court emphasized that a person must be joined if, as a practical matter, the disposition might "impair or impede his ability to protect that interest." The court noted that a judgment in this case could "impair the absent lessors' ability to convey the royalty interests and possibilities of reverter they claim to own," and a declaration that the 1924 judg-

29. Id.
30. TEX. R. CIV. P. 39(a), (b).
31. Longoria, 255 S.W.3d at 184.
32. Id. at 179 (quoting TEX. R. CIV. P. 39(a)).
33. Id. at 180.
34. Id.
35. Id. at 181.
36. Id. at 179.
37. Id. at 181.
38. Id. at 182.
39. Id. (citing TEX. R. CIV. P. 39(a)).
40. Id.
ment was void, "even if not technically binding on the absent lessors, royalty interest owners, and owners of the unleased mineral estate, would cloud their title."\textsuperscript{41}

The Longorias relied heavily on two Texas Supreme Court cases, \textit{Brooks v. Northglen Association}\textsuperscript{42} and \textit{Clear Lake City Water Authority v. Clear Lake Utilities Co.},\textsuperscript{43} to support their claim that the trial court abused its discretion.\textsuperscript{44} The court of appeals rejected that argument and distinguished the supreme court cases cited as limited to whether it was \textit{fundamental error} for the trial court to proceed without the absent parties in those cases.\textsuperscript{45} The defendants in those supreme court cases failed to raise the issue of joinder at the trial court level, so the issue on appeal was not judicial discretion under Rule 39, but rather lack of jurisdiction based on fundamental error.\textsuperscript{46} Although the trial court was not deprived of jurisdiction in those cases, the trial court could be required to join those same parties if the issue was timely raised under Rule 39 in the trial court.\textsuperscript{47} "When, as here, the necessity of joining additional parties has been raised in the trial court, 'the fact that the decree would not be technically binding on the absent party is not the controlling factor.'"\textsuperscript{48}

"When the trial court determines a person falls within the provisions of Rule 39(a) and is subject to service of process, he must be joined."\textsuperscript{49}

Because the Longorias were given the opportunity to join the additional parties but made no attempt to do so, the court held Rule 39(b) was not applicable.\textsuperscript{50} Rule 39(b) only governs the analysis of trial court's discretion in proceeding when parties cannot be joined.\textsuperscript{51} Here, there was nothing in the record to show that the absent parties could not be joined.\textsuperscript{52}

The case is significant because it carefully analyzes the narrow grounds upon which the failure to join parties is not a reversible error in the supreme court opinions. It is authority for the premise that all owners should be joined in trespass to try title and declaratory judgment actions affecting title.\textsuperscript{53} However, the trial court's discretion is very broad, and that discretion may produce different results on similar facts.\textsuperscript{54} In applying Rule 39(a), "there is no arbitrary standard or precise formula for de-

\begin{itemize}
  \item \textsuperscript{41} Id.
  \item \textsuperscript{42} 141 S.W.3d 158 (Tex. 2004).
  \item \textsuperscript{43} 549 S.W.2d 385 (Tex. 1977).
  \item \textsuperscript{44} See Longoria, 255 S.W.3d at 182.
  \item \textsuperscript{45} Id.
  \item \textsuperscript{46} Id.
  \item \textsuperscript{47} Id.
  \item \textsuperscript{48} Id. (citing Royalty Petroleum Corp. v. Dennis, 160 Tex. 392, 332 S.W.2d 313, 317 (1960)).
  \item \textsuperscript{49} Id. at 184.
  \item \textsuperscript{50} Id.
  \item \textsuperscript{51} Id.
  \item \textsuperscript{52} Id.
  \item \textsuperscript{53} Id. at 183.
  \item \textsuperscript{54} Id. at 182.
\end{itemize}
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Determining whether a particular person falls within its provisions.\textsuperscript{55}

Range Resources Corp. v. Bradshaw examines whether the grantor of an interest in minerals reserved a “fraction of royalty” or a “fractional royalty.”\textsuperscript{56} The royalty reservation provided the following:

[1] The Grantors herein reserve unto themselves, their heirs and assigns, and except from this conveyance an undivided one-half (1/2) Royalty (\textit{Being equal to not less than} an undivided one-sixteenth\(\text{[h]}\)\(\text{[1/16]}\)) of all the oil, gas and/or other minerals in, to, and under or that may be produced from said . . . land . . . .

[2] Said interest hereby reserved is a Non-Participating Royalty . . . provided, however, that all such leases shall provide for Royalty of \textit{not less than} one-eighth (1/8). . . .

[3] In the event oil, gas or other minerals are produced from said land, then said Grantors, their heirs and assigns, shall receive \textit{not less than} one-sixteenth (1/16) portion (\textit{being equal to} one-half (1/2) of the customary one-eighth (1/8) Royalty) of the entire gross production and/or such net proceeds as hereinabove provided . . . .\textsuperscript{57}

The owner of the non-participating royalty interest contended the interest reserved was one-half “of royalty,” and the mineral owners contended the interest reserved was a fixed one-sixteenth of production. The Fort Worth Court of Appeals construed the reservation language in the deed to create a “fraction of royalty” instead of a “fractional royalty.”\textsuperscript{58} To reach its conclusion, the court examined the four corners of the deed to ascertain the intent of the parties.\textsuperscript{59} The court noted that each paragraph contained “not less than” language.\textsuperscript{60} The parenthetical language found in paragraph 1 states that the reserved share of production was to be “\textit{equal to not less than} an undivided one-sixteenth\[h]”.\textsuperscript{61} The court interpreted this to express the intent to establish a minimum one-sixteenth share of production, rather than a fixed share of production.\textsuperscript{62}

Paragraph 2 provides that all leases “shall provide for Royalty of \textit{not less than} one-eighth (1/8).”\textsuperscript{63} The court found that, when the first two paragraphs were read together, it was evident that the parties contemplated future leases would be executed on the property and that royalty rates in subsequent leases might vary.\textsuperscript{64} However, regardless of the royalty, the language found in paragraph 2 ensures the grantor that the re-

\textsuperscript{55} Id. at 180 (quoting Cooper v. Tex. Gulf Indus., Inc., 513 S.W.2d 200, 204 (Tex. 1974)).

\textsuperscript{56} 266 S.W.3d 490, 491 (Tex. App.—Fort Worth 2008, pet. filed).

\textsuperscript{57} Id. at 493-94 (emphasis added).

\textsuperscript{58} Id. at 497-98.

\textsuperscript{59} Id. at 493 (citing Luckel v. White, 819 S.W.2d 459, 461 (Tex. 1991); Bennett v. Tarrant County Water Control & Imp. Dist. No. One, 894 S.W.2d 441, 446-47 (Tex. App.—Fort Worth 1995, writ denied)).

\textsuperscript{60} Id. at 496.

\textsuperscript{61} Id. at 493.

\textsuperscript{62} Id. at 495-96.

\textsuperscript{63} Id. at 494.

\textsuperscript{64} Id. at 495-97.
tained royalty interest would be calculated on at least a one-eighth royalty.\textsuperscript{65} When the court read paragraph 2 with the parenthetical in paragraph 1, the court determined that the clauses worked together to ensure that the grantor would be entitled to at least a one-sixteenth share of production.\textsuperscript{66}

Paragraph 3 provides that the grantor is entitled to receive “not less than one-sixteenth (1/16) portion (being equal to one-half (1/2) of the customary one-eighth (1/8) Royalty) . . . of the entire gross production.”\textsuperscript{67} Like the other paragraphs, the “not less than” language requires that the grantor receive a minimum of one-sixteenth of production.\textsuperscript{68}

A “fractional royalty” is a fixed fractional amount of oil and gas, while a “fraction of royalty” is a fractional amount that is determined upon the execution of some future lease.\textsuperscript{69} The court determined that by using “not less than” language, the royalty calculation was not intended to be fixed.\textsuperscript{70} The court concluded that because the parties intended that the royalty was not to be fixed, the reserved interest could not be a “fractional royalty,” and, therefore, one-half “of royalty” was reserved by the grantor.\textsuperscript{71}

The significance of the case is that it continues the resurgency of the “four corners” rule as the rationale for interpreting cases similar to \textit{Range Resources}.

\section*{III. LEASE AND LEASING ISSUES}

\textit{Veritas Energy v. Brayton Operating Corp}. held that marking the location of a proposed lease road will not preserve a lease that requires that drilling operations be commenced before the expiration of the primary term.\textsuperscript{72} The lease required that operations be commenced on or before the expiration of the primary term and defined “operations” as:

for and any of the following: drilling, testing, completing, reworking, recompleting, deepening, plugging back or repairing of a well in search for or in an endeavor to obtain production of oil, gas, sulphur or other minerals, excavating a mine, production of oil, gas, sulphur or other mineral, whether or not in paying quantities.\textsuperscript{73}

The Corpus Christi Court of Appeals stated that the threshold issue was whether the lessee performed “drilling or for drilling” operations within the meaning of the lease before the expiration of the primary term.\textsuperscript{74} The

\begin{footnotesize}
\begin{enumerate}
\item[65.] \textit{Id}. at 496.
\item[66.] \textit{Id}.
\item[67.] \textit{Id}. at 494.
\item[68.] \textit{Id}. at 496.
\item[69.] \textit{Id}. at 493.
\item[70.] \textit{Id}. at 495-96.
\item[71.] \textit{Id}.
\item[73.] \textit{Id}. at *1.
\item[74.] \textit{Id}. at *2.
\end{enumerate}
\end{footnotesize}
case centered on whether back dragging of grass with a back hoe to mark the location of a road constituted operations within the meaning of the lease.75 Ultimately, the court held that those operations did not.76

On June 5, 2003, a dirt work company hired by the lessee used a backhoe to back drag grass from the curve in the road on the lessor’s property to the highway area. Later that day, due to rainy conditions, the dirt work company stopped the activity. On June 6, the primary term expired. Lessee resumed work on the road on June 9th or 10th, after the primary term of the lease.77 After reviewing the facts in many possible precedents, the court found that “in each case where it was found that the lease extended into its secondary term, there was considerably more activity toward conducting drilling operations than that undertaken by Veritas [in this case].”78 The court also found that the work done to evaluate the prospect before the lease was acquired and assembling data for possible investors could not be “operations” that would preserve this lease.79

The significance of the case is that it adds to the precedents that define the commencement of operations for purposes of propelling a lease past the expiration of the primary term and into the secondary term. It suggests, consistent with other precedents, that the test may be more rigorous if there is a requirement for “drilling operations” rather than just “operations.”80 However, even “drilling operations” is broader than “the mere cutting of [a] hole.”81

In AFE Oil & Gas, L.L.C. v. Armentrout, the Fort Worth Court of Appeals held that a Barnett Shale gas well that had not been fraced by the end of the primary term was not capable of producing gas at the time shut-in royalties were paid.82 Lessee began operations on the well on July 30, 2003.83 The primary term expired on August 1, 2003. The lease, as amended, could be continued in force for up to ninety consecutive days without actual production if operations were being conducted on the land or if the well was capable of producing and was shut in for no more than ninety days.84 The well was shut in on August 5, 2003.85 In August, the well was acid perforated, a technique used to stimulate production of a gas well, and apparently some gas did flow.86 Lessee attempted to pay shut-in royalties to lessor in October 2003. Lessee fraced the well in No-

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75. Id. at *1.
76. Id. at *5.
77. Id. at *4.
78. Id.
79. Id. at *4 n.3.
80. Id. at *5.
81. Id. (citing Reid v. Gulf Oil Corp., 323 S.W.2d 107, 115 (Tex. Civ. App.—Beaumont 1959), aff’d, 337 S.W.2d 267, 269 (Tex. 1960)).
83. Id. at *1.
84. Id. at *3.
85. Id.
86. Id. at *1, *3.
November 2004. Lessor refused to accept the shut-in royalty payment and brought suit for lease termination.

The Fort Worth Court of Appeals stated:

To avoid forfeiture of the lease, most gas leases allow for the lease to be extended even if the well is not producing gas if shut-in royalties are paid and the well is actually capable of producing gas. In other words, if further work on the well is required before the well will be capable of producing gas, then even paying shut-in royalties will not prevent the termination of the lease. The term “capable of production” has been held to mean capable of producing gas in paying quantities where the lease does not define the term.

The parties contested the issue and produced conflicting testimony on whether the well could produce natural gas at the time the shut-in royalties were paid. Lessee contended that “capable of production” means that gas will flow when the well’s switch is turned on. Lessee presented evidence that in August 2003, there was a quantity of gas in the well and that the operator’s daily reports showed there was gas flowing during this period of time.

Lessor offered evidence from several sources that gas wells in the Barnett Shale will not produce without fracture stimulation. At the end of the primary term, lessee had only performed an acid perforation (an entirely different procedure), and the well had not been fraced. Lessor also supplied expert testimony indicating that a month after the lessee’s November 20, 2004, frac job, the well was still not capable of production. In addition, lessor’s expert testified that the well could not be turned on or begin to flow on either August 5, 2003, the date the well was shut-in, or in October 2003, when the shut-in royalty payments were tendered to Lessor.

The issue was submitted as follows:

The trial court thus submitted this question to the jury: “Do you find that in October, 2003, the Armentrout No. 2 Well was not capable of producing gas?” The trial court instructed the jury that a well is not capable of producing gas if the well needs further work, repairs, or equipment in order to produce gas. The jury sent a note to the trial judge asking, “[M]ust the gas be able to flow in order to be considered ‘producible’?” The judge then submitted this supplemental instruction: “In response to your question, you are instructed that in order for a gas well to be ‘capable of producing gas’; the gas must be able to flow.” The jury found that the well was not capable of producing gas, and the trial court entered final judgment for [lessee].

87. Id. at *3.
88. Id.
89. Id. at *2 (footnotes omitted).
90. Id.
91. Id. at *5-6.
92. Id. at *3.
93. Id.
94. Id. at*2.
The court of appeals found the evidence was sufficient to support the jury's finding that the well was not capable of producing gas at the time the shut-in royalty payments were made.\(^9\)

The significance of this case is that the lessee relied heavily on *Anadarko Petroleum Corp. v. Thompson*\(^9\) to argue that "capable of production" required only that "gas will flow when [the well's] switch is turned on."\(^9\) However, the jury's finding was that gas would not flow, and, at least in this case, the well had to be fraced before a shut-in royalty payment could hold the well.\(^9\)

*Coastal Oil & Gas Corp. v. Garza Energy Trust* held that damages for drainage by hydraulic fracturing are precluded by the rule of capture when the only result of the operation is that the oil or gas migrates more easily to another tract.\(^9\) However, if the operation results in actual injury (damage to the reservoir or to an offsetting well), there may be liability,\(^9\) and the rule of capture will not "shield misconduct . . . without commercial justification."\(^9\) The case is also important for its holdings on the standing of mineral owners in trespass and drainage cases\(^9\) and the measure of damages in drainage cases.\(^9\)

Lessor owned the mineral interest in a 748 acre tract in Hidalgo County called "Share 13." Coastal was the Lessee in Share 12, Share 13, and Share 15, which were adjoining. Coastal eventually acquired the fee interest in Share 12, so that Coastal also owned the royalty interest in that tract.\(^9\) Of the three wells Coastal drilled between 1978 and 1983, two of them were productive: the M. Salinas No. 1 and M. Salinas No. 2V. In 1994, Coastal drilled the M. Salinas No. 3 on Share 13, which was an exceptional producer.\(^9\)

The M. Salinas No. 3 was located approximately 1,700 feet from Share 12. The Pennzoil Fee No. 1 was the closest well on Share 12 to the M. Salinas No. 3. In 1996, Coastal drilled the Coastal Fee No. 1 on Share 12 as close to Share 13 and the M. Salinas No. 3 as the Texas Railroad Commission's statewide spacing rules permitted.\(^9\) Coastal then shut in the Pennzoil Fee No. 1 but later drilled the Coastal Fee No. 2 on Share 12 close to Share 13. Lessor believed that Coastal was allowing gas to be drained from Share 13, on which Coastal owed Lessor a royalty, to the wells on Share 12 where Coastal was entitled to the gas unburdened by any royalty obligations. Lessor sued Coastal for breach of its implied

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95. Id. at *1.
96. 94 S.W.3d 550 (Tex. 2002).
98. Id. at *4-5.
99. 268 S.W.3d 1, 17 (Tex. 2008).
100. Id. at 11.
101. Id. at 17.
102. Id. at 10-11.
103. Id. at 19-20.
104. Id. at 5.
105. Id. at 6.
106. Id.
covenant to develop Share 13 and to prevent drainage. Coastal promptly drilled eight wells on Share 13 within fourteen months.\textsuperscript{107} When Coastal formed a gas unit including parts of Share 12 and Share 13, Lessor added a claim for bad-faith pooling to Lessor’s lawsuit for breach of the implied covenant to develop and protect.\textsuperscript{108}

The Vicksburg T formation was the productive formation under both Share 12 and Share 13. It is a “tight” sandstone formation from which natural gas cannot be commercially produced without hydraulic fracture stimulation (fracing). All the wells on Shares 12 and 13 were completed in the Vicksburg T formation and fraced. Lessor also added a claim for trespass to its lawsuit, which alleged that Coastal’s fracing of the Coastal Fee No. 1 on Share 12 invaded the reservoir beneath Share 13, resulting in substantial drainage of gas from Share 13. There was evidence that the frac job on the Coastal Fee No. 1, when compared to the other wells, was “massive.”\textsuperscript{109} The parties agreed that the hydraulic and propped lengths of the frac crossed the lease line, but they presented conflicting expert opinions on whether the effective length of the frac crossed the lease line.\textsuperscript{110} Lessor won a jury verdict on all of its claims.\textsuperscript{111}

The Texas Supreme Court had not previously decided whether subsurface fracing can give rise to an action for trespass, and its opinion in this case did not fully resolve the issue.\textsuperscript{112} For many years, hydraulic fracture stimulation has been a very common practice. The trial court judgment against Coastal, of approximately $15,000,000, combined with the fear in the industry that this very common industry practice would now be subject to a significant legal risk, generated intense interest and a blizzard of amicus briefs.\textsuperscript{113} For the past several years, this case has probably been the most visible oil and gas case working its way through the judicial system.

The general expectation was that the supreme court would have to decide whether subsurface fracing was or was not a trespass. However, the supreme court determined it did not have to decide this broad issue.\textsuperscript{114} Actionable trespass requires an injury, but Lessor’s only claim of injury was that Coastal’s fracing operation made it possible for gas to flow from beneath Share 13 to the Share 12 wells. Under the rule of capture, there were no damages because the gas Lessor claimed to have lost simply did not belong to Lessor.\textsuperscript{115} “That rule gives a mineral rights owner title to the oil and gas produced from a lawful well bottomed on the property, even if the oil and gas flowed to the well from beneath another owner’s

\begin{itemize}
\item \textsuperscript{107} Id.
\item \textsuperscript{108} Id. at 7-8.
\item \textsuperscript{109} Id. at 7.
\item \textsuperscript{110} Id.
\item \textsuperscript{111} Id. at 8.
\item \textsuperscript{112} Id. at 11-12.
\item \textsuperscript{113} Id. at 17 n.56.
\item \textsuperscript{114} Id. at 12.
\item \textsuperscript{115} Id. at 12-13.
\end{itemize}
Therefore, Lessor did not prove any recoverable damages (such as actual damage to Lessor's wells or to the reservoir) caused by the frac operation.\textsuperscript{117}

This case does not completely remove the risk of trespass by subsurface frac because the supreme court carefully distinguished potential liability attributable for actual damages to an offsetting well or to the reservoir.\textsuperscript{118} Furthermore, the rule of capture will not "shield misconduct that is illegal, malicious, reckless, or intended to harm another without commercial justification."\textsuperscript{119} Although not clearly foreclosed, the remaining risks of liability for subsurface trespass by frac appear to be based on conduct causing actual damages, not the nominal damages of a trespass, and those risks fall within conventional existing tort theories of liability, such as negligence.

In his concurring opinion, Justice Willett wrote that he would find that there was simply no trespass, rather than there were no damages.\textsuperscript{120} In his opinion, trespass is a court-defined doctrine, and the court should refine that definition to hold that a frac is not a trespass.\textsuperscript{121} He found the issue to be indistinguishable from the secondary recovery water flood, which the court permitted in \textit{Railroad Commission of Texas v. Manziel},\textsuperscript{122} except that the water flood was arguably more invasive and inflicted greater and more irreversible damage than fracture stimulation.\textsuperscript{123} The dissent would not consider whether the rule of capture precluded damages until it was first determined whether hydraulically fracturing across lease lines is a trespass.\textsuperscript{124} The dissent found that the gas did not migrate naturally to Coastal and that a frac was essentially indistinguishable from a slant hole trespass.\textsuperscript{125} In any event, until the trespass issue is decided, Coastal’s frac must be illegal because the jury found it was a trespass.\textsuperscript{126} Therefore, given that the production was illegal, the rule of capture did not apply because the rule only applies to gas that can be legally produced.\textsuperscript{127}

The supreme court characterized Lessor’s claim that the rule of capture did not apply as an argument that the rule should be changed.\textsuperscript{128} The supreme court found "four reasons not to change the rule of capture to allow one property owner to sue another for oil and gas drained by hydraulic fracing that extends beyond lease lines.”\textsuperscript{129} "First, the law already

\begin{thebibliography}{99}
\bibitem{116} Id. at 13.  
\bibitem{117} Id.  
\bibitem{118} Id.  
\bibitem{119} Id. at 17.  
\bibitem{120} Id. at 29-30.  
\bibitem{121} Id. at 36.  
\bibitem{122} 361 S.W.2d 560 (Tex. 1962).  
\bibitem{123} Coastal, 268 S.W.3d at 36-37.  
\bibitem{124} Id. at 42.  
\bibitem{125} Id. at 42, 44.  
\bibitem{126} Id. at 43.  
\bibitem{127} Id. at 42-43.  
\bibitem{128} Id. at 13.  
\bibitem{129} Id. at 14.
\end{thebibliography}
affords an owner who claims drainage full recourse” (self-help drilling, counter-fracture stimulation, offer to pool, force pool, and Commission regulations).130 “Second, allowing recovery for the value of gas drained by hydraulic fracturing usurps to courts and juries the lawful and preferable authority of the Railroad Commission to regulate oil and gas production.”131 The law of trespass should not take over the Commission’s role.132 “Third, determining the value of oil and gas drained by hydraulic fracturing is the kind of issue the litigation process is least equipped to handle.”133 When litigating recovery for drainage resulting from fracing, trial judges and juries cannot take into account critical factors such as social policies, industry operations, and the greater good.134 Also, material facts are hidden below miles of rock, thus making discovery of the events difficult.135 “Fourth, the law of capture should not be changed to apply differently to hydraulic fracturing because no one in the industry appears to want or need the change.”136

The supreme court did support Lessor’s claim of standing.137 Coastal sought to defeat Lessor on jurisdictional grounds because trespass is ultimately an injury to the right of possession, and a royalty owner, like Lessor, has no right of possession. The supreme court held that this definition of trespass was over-simplified.138 Assuming Lessor could show more than a mere trespass—meaning actual, permanent harm to the property to affect the value of the royalty or the reversion—then Lessor has standing.139

The supreme court also reviewed Lessor’s claims for breach of the implied covenant to protect against drainage, breach of the implied covenant to develop, and bad-faith pooling.140 “Coastal had an implied obligation to act as a reasonably prudent operator to protect Share 13 from drainage.”141 Although it noted Coastal failed to meet this obligation, the jury was instructed to calculate damages by “the value of the royalty on the gas drained from Share 13 by the subsurface trespass by the Coastal No. 1 fracing operation.”142 The court had previously held that the correct measure of damages was the “offset royalty formula,” i.e. the amount of royalties the drained lessor would have received from the offset well.143 However, the lessor would be overcompensated if pro-

130. Id.
131. Id. at 14-15.
132. Id. at 14-16.
133. Id. at 16.
134. Id.
135. Id.
136. Id.
137. Id. at 10.
138. Id. at 9-10.
139. Id. at 10.
140. Id. at 17.
141. Id.
142. Id. at 17-18.
143. Id. (citing Kerr-McGee Corp. v. Helton, 133 S.W.3d 245, 253 (Tex. 2004)).
duction from the offset well was greater than the drainage.  

There is also a line of cases holding that the correct measure of damages is a royalty on the "amount drained away." However, this measure would also overcompensate the lessor if some of the drainage could not have been prevented.

The correct measure of damages for breach of the implied covenant of protection is the amount that will fully compensate, but not overcompensate, the lessor for the breach—that is, the value of the royalty lost to the lessor because of the lessee's failure to act as a reasonably prudent operator.

The supreme court also cited with approval the statement, "[t]he measure of damages for breach of the drainage covenant is the royalty interest on the production lost by the producer's failure to prevent drainage." Absent any evidence in this case of the proper measure of damages, Lessor could not recover against Coastal on Lessor's claim for breach of the protection covenant.

Coastal also had an implied obligation to continue to develop Share 13 with reasonable diligence after the M. Salinas No. 3 was completed. Lessor claimed to have lost interest income because royalties were not paid to Lessor sooner. Coastal offered evidence showing that the delay actually benefitted Lessor because the price of gas increased over time. For breach of the development covenant, the lessor is entitled to recover "the full value of royalty lost to him." The parties agreed that the jury should have been instructed to find the difference between the value of what Lessor received and what should have been received, which Coastal believed should be zero. The supreme court found some evidence to support the jury's verdict, but the issue was generally moot because this part of the case was remanded for a new trial on other grounds.

Similarly, the supreme court found that there was some evidence to support the jury's finding of bad faith pooling, but this issue was also remanded on other grounds.

The significance of the case is that now there are only a few unusual circumstances that might support liability for subsurface trespass by hydraulic fracture stimulation. The rule of capture generally trumps tres-
pass. Operators can continue to do business as usual. If the frac operation damages the neighbor's well or the reservoir, then the operation will result in liability. A royalty owner has standing to sue for this kind of claim. The measure of damages in a drainage case has now been clarified as "the amount that will fully compensate, but not overcompensate, the lessor for the breach—that is, the value of the royalty lost to the lessor because of the lessee's failure to act as a reasonably prudent operator."154

IV. INDUSTRY CONTRACTS

Navasota Resources, L.P. v. First Source Texas, Inc. construed the preferential right to purchase provision in the 1989 Model Form Operating Agreement (M.F.O.A.) as applied to a package sale.155 The holder (Holder) of the preferential right (Right) sued the working interest owners and the purchasers of a portion of the working interest (Owners) to enforce the Right. The trial court entered summary judgment in favor of the Owners.156 The Waco Court of Appeals rendered judgment in favor of the Holder on the claims for breach of contract and specific performance, and it remanded the cause to the trial court to determine attorney's fees and any lost revenue since the exercise of the Right.157

The Right in this case was found in a standard A.A.P.L. 1989 M.F.O.A. joint operating agreement (JOA) covering a Contract Area referred to as the "Hilltop Prospect."158 The JOA contained the following form provision:

Should any party desire to sell all or any part of its interest under this agreement, or its rights and interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed disposition, which shall include the name and address of the prospective transferee (who must be ready, willing and able to purchase), the purchase price, a legal description sufficient to identify the property, and all other terms of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after the notice is delivered, to purchase for the stated consideration on the same terms and conditions the interest which the other party proposes to sell . . .159

Under the terms of the proposed transaction between Gastar Exploration, Ltd. (Gastar) and Chesapeake Energy Corporation and its affiliate, Chesapeake Exploration Limited Partnership (Chesapeake), Chesapeake would (1) purchase a percentage of Gastar's outstanding shares of common stock, (2) enter into a thirteen-county area of mutual interest with Gastar (AMI), (3) pay $5,012,933 for one-third of Gastar's net leasehold

154. Id. at 18-19.
156. Id. at 528-29.
157. Id. at 544.
158. Id. at 529.
159. Id. at 529-30.
acreage that was subject to the JOA, and (4) pay 44% of the costs through casing point on certain test wells in order to earn a 33.33% working interest. On October 18, 2005, the Owners sent the Holder a letter informing them of the Chesapeake deal and giving the Holder the opportunity to exercise its preferential right to purchase by (1) paying $5,012,933 for one-third of Gastar’s net leasehold acreage that was subject to the JOA and (2) paying 44% of the costs through casing point on certain test wells in order to earn a 33.33% working interest.

On October 21, the Holder notified the Owners of its intent to exercise its preferential right. Later the same day, the Owners sent a second letter to the Holder that stated the October 18, 2005, letter was erroneous; therefore, the Owners were rescinding the original notice letter. A second notice letter was sent to the Holder two days later, and it stated that, in order for the Holder to exercise its preferential right to purchase, it must comply with every aspect of the agreement, i.e., the stock purchase, the thirteen-county AMI, the cash price, and the promoted carry. The Holder refused to accept the “modified” offer and brought suit.

The court first considered the fundamental question of whether a preferential right to purchase can be triggered by a package sale. According to the majority rule, a third party’s offer to purchase property as part of a package sale, subject to a preferential right provision involving multiple properties or a larger tract of land, does not invoke the preferential right provision. Texas courts, on the other hand, have almost uniformly followed the line of cases that holds that a preferential right is invoked by a package sale. In this case, the court followed the minority rule and held that the first proposal invoked the Right because the proposal included the sale of the Owners’ working interest in acreage that was subject to the JOA.

Given that the Right was invoked, the court then had to determine whether the Holder was required to purchase shares of common stock or enter into the thirteen-county AMI to exercise its Right. The Right in the JOA stated that a party who desires to exercise the Right “must agree to purchase the interest being sold ‘on the same terms and conditions’ as a third party has agreed to purchase that interest.” The Owners argued that the AMI and stock purchase were additional “terms and conditions” for the purchase of the Hilltop Prospect, while the Holder argued

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160. Id. at 530.
161. Id.
162. Id. at 531.
163. Id. at 533-35.
164. Id. at 533.
165. Id. (citing Sawyer v. Firestone, 513 A.2d 36, 39-40 (R.I. 1986)).
166. Id. at 534 (citing Brenner v. Duncan, 27 N.W.2d 320, 322 (Mich. 1947)); see also McMillan v. Dooley, 144 S.W.3d 159, 178-79 (Tex. App.—Eastland 2004, pet. denied.).
167. Navasota, 249 S.W.3d at 535.
168. Id. at 535-37.
169. Id. at 535.
that these items were separate transactions included within the deal.\textsuperscript{170} The court found that "virtually every authority of which we are aware agrees that the holder of a preferential right cannot be compelled to purchase assets beyond those included within the scope of the agreement subject to the preferential right in order to exercise that right."\textsuperscript{171} The court held that the Owners could not require the Holder to purchase shares of common stock or enter into a thirteen-county AMI in order to exercise its Right.\textsuperscript{172}

The court also reviewed whether the Right placed an unreasonable restraint on alienation. Texas courts look to the Restatement of Property when any alleged restraints on alienation are at issue.\textsuperscript{173} The court found that the Restatement directly addressed the issue raised by the Right in this case, as follows:

If the right to purchase is on the same terms and conditions as the owner may receive from a third party, if the procedures for exercising the right are clear, and if the period within which it must be exercised is relatively short, the right of first refusal is valid unless the purpose is not legitimate. Since the practical effect of the restraint on alienability is minimal, duration of the first-refusal right should not affect validity.\textsuperscript{174}

Without exception, Texas courts have upheld preferential right provisions like the one at issue in this case as reasonable restraints on alienation; therefore, the court held that the Right was not an unreasonable restraint on alienation.\textsuperscript{175}

The Owners argued that awarding the Holder specific performance would result in the Holder being permitted to exercise its preferential right with regard to the Hilltop Prospect by paying less than the "true value" of the Owners' working interest. The Owners put in affidavit evidence that the "true value" was higher, and they argued there was, therefore, an issue of material fact that would preclude summary judgment.\textsuperscript{176}

The Owners contended that the value of the prospect was substantially higher than reflected in the notification letter sent to the Holder or the letter of intent between the Owners and the Holder, but the higher value was ultimately accounted for in the deal through the stock purchase and AMI.\textsuperscript{177} The court found that while some courts in other jurisdictions agree, the only Texas cases addressing this issue follow the rule that "the seller should be held to the allocated price absent affirmative evidence of

\textsuperscript{170} Id.
\textsuperscript{171} Id.; see also McMillan, 144 S.W.3d at 179.
\textsuperscript{172} Navasota, 249 S.W.3d at 537.
\textsuperscript{173} Id. (citing Sonny Arnold, Inc. v. Sentry Sav. Ass'\textsc{n}, 633 S.W.2d 811, 813-15 (Tex. 1982)).
\textsuperscript{174} Id. at 538 (quoting \textsc{Restatement (Third) of Prop.} § 3.4, cmt. f (2004)).
\textsuperscript{175} Id. at 538-39 (citing Perritt Co. v. Mitchell, 663 S.W.2d 696, 698-99 (Tex. App.--Fort Worth 1983, writ ref'd n.r.e.).)
\textsuperscript{176} Id. at 543.
\textsuperscript{177} Id. at 540-41.
bad faith or of some other improper basis for the allocated price."\textsuperscript{178} The Right in this case does not require the Holder "to pay 'true value' or fair market value."\textsuperscript{179} The provision "requires only that the holder match the third-party offer."\textsuperscript{180} Thus, the Holder was entitled to specific performance.\textsuperscript{181}

The significant aspects of the case are the holdings that a package sale does trigger a preferential right to purchase, that the Holder cannot be required to purchase some asset other than the property subject to the Right, and that the allocated price will apply in the absence of bad faith or of some other improper basis for the allocated price.

\textit{In re XTO Resources I, LP} held that reserve estimates, recoverable gas reserve estimates, projected future revenues, and the location of proved undeveloped acreage and proved developed not producing acreage are trade secrets.\textsuperscript{182} Trade secrets are privileged from disclosure "if the allowance of the privilege will not tend to conceal fraud or otherwise work injustice."\textsuperscript{183} The "party asserting the trade secret privilege has the burden of proving that the discovery information sought qualifies as a trade secret."\textsuperscript{184}

Texas courts rely on the following six-factor test to determine whether information can be classified as a trade secret:

(1) the extent to which the information is known outside of his business; (2) the extent to which it is known by employees and others involved in his business; (3) the extent of the measures taken by him to guard the secrecy of the information; (4) the value of the information to him and to his competitors; (5) the amount of effort or money expended by him in developing the information; \textsuperscript{185} and (6) the ease or difficulty with which the information could be properly acquired or duplicated by others.

The party claiming a trade secret is not required to satisfy all six factors because trade secrets do not always meet every factor, and other circumstances may be influential to the analysis.\textsuperscript{186}

The Texas Supreme Court in \textit{In re Bass} held that the 3-D geological seismic data at issue in the case could be considered a trade secret.\textsuperscript{187} XTO presented evidence on all six factors through the means of affidavits and other evidence that was similar to the situation in \textit{In re Bass}. The Fort Worth Court of Appeals ultimately held that the data sought by the Real Parties in Interest was a trade secret and was protected by Rule

\textsuperscript{178} \textit{Id.} at 542.  
\textsuperscript{179} \textit{Id.} at 543.  
\textsuperscript{180} \textit{Id.}  
\textsuperscript{181} \textit{Id.}  
\textsuperscript{182} 248 S.W.3d 898, 900 (Tex. App.—Fort Worth 2008, no pet.).  
\textsuperscript{183} \textit{Tex. R. Evid.} 507.  
\textsuperscript{184} \textit{In re Bass,} 113 S.W.3d 735, 737 (Tex. 2003).  
\textsuperscript{185} \textit{Id.} at 739 (quoting \textsc{Restatement of Torts} § 757 cmt. B (1939) and \textsc{Restatement (Third) of Unfair Competition} § 39 reporter's n. cmt. B (1995)).  
\textsuperscript{186} \textit{Id.} at 740.  
\textsuperscript{187} \textit{Id.} at 742.
In SubISSI Holdings, L.P. v. Hilcorp Energy I, L.P., the San Antonio Appeals Court held that tendering an assignment and the obligation to pay were concurrent obligations under a Joint Operating Agreement (JOA) and that it was not necessary for the assignment to be executed to trigger the obligation to pay.\(^{188}\) SubISSI and Hilcorp jointly operated mineral leases pursuant to a valid JOA.\(^{189}\) Hilcorp acquired property that was inside the Area of Mutual Interest (AMI) described in the JOA, and Hilcorp offered SubISSI the opportunity to participate in this acreage. SubISSI elected to participate, and Hilcorp delivered a letter enclosing three originals of an unexecuted assignment, a bill of sale, and wire transfer instructions.\(^{190}\) The JOA provided that if the party receiving the offer to participate does elect to participate, "then the Offering Party shall execute, acknowledge, and deliver to [the receiving party] an assignment thereof . . . , and [the receiving party] shall pay . . . the Offering Party' the associated purchase price."\(^{191}\) Payment was due within thirty days following the date the assignment was tendered.\(^{192}\) SubISSI did nothing for a period of time that exceeded thirty days, and then it attempted to pay Hilcorp. Hilcorp refused to take the money, contending SubISSI had forfeited its right to participate because it missed the thirty-day deadline to pay under the JOA.\(^{193}\) SubISSI argued "that Hilcorp was obligated to deliver a fully executed assignment before [SubISSI] was obligated to pay" and to trigger the thirty-day clock. Hilcorp argued that the obligations were mutual covenants and that its tender of an unexecuted assignment was sufficient.\(^{194}\)

The San Antonio Court of Appeals found that the JOA did not create a condition precedent that obligated Hilcorp to deliver a fully executed assignment to SubISSI in order to become entitled to receive payment from SubISSI.\(^{195}\) "A condition precedent is an act or event 'that must occur before there is a right to immediate performance and before there is a breach of contractual duty.'"\(^{196}\) Where the intent of the parties is not clear, the agreement is interpreted as creating a covenant instead of a condition.\(^{197}\) The election to participate was a condition precedent.\(^{198}\) Electing to participate was required to obligate Hilcorp to assign the in-

\(^{188}\) In re XTO Res. I, LP, 248 S.W.3d 898, 902-05 (Tex. App.—Fort Worth 2008, no pet.).

\(^{189}\) No. 04-07-00674-CV, 2008 WL 2515698, at *3 (Tex. App.—San Antonio June 25, 2008, no pet.) (mem. op.).

\(^{190}\) Id.

\(^{191}\) Id.

\(^{192}\) Id. at *1.

\(^{193}\) Id.

\(^{194}\) Id. at *2.

\(^{195}\) Id.

\(^{196}\) Id. at *3.

\(^{197}\) Id. (quoting Hohenberg Bros. Co. v. George E. Gibbons & Co., 537 S.W.2d 1, 3 (Tex. 1976)).

\(^{198}\) Id.

\(^{199}\) Id.
terest and to obligate SubISSI to pay for the assignment.\textsuperscript{200}

However, once this election was made, Hilcorp and SubISSI had concurrent obligations. Once SubISSI elected to participate, Hilcorp \textit{“shall execute, acknowledge, and deliver . . . an assignment . . . and [SubISSI] shall pay . . . the associated purchase price.”}\textsuperscript{201} The court noted that the JOA “explicitly use[d] the conjunctive word ‘and’ rather than a temporal word such as ‘then’ or ‘afterward.’”\textsuperscript{202} The court found that, based on the plain language of the JOA, this portion of the agreement created concurrent obligations.\textsuperscript{203}

The court also determined that Hilcorp’s delivery of the letter and unexecuted assignment was an acceptable tender triggering SubISSI’s thirty-day period to pay under the JOA.\textsuperscript{204} The legal definition of “tender” depends on the agreement’s circumstances.

If a contract calls for successive acts, . . . there is no breach by one if the precedent act has not been performed by the other; but if the contract contemplates concurrent acts, it is sufficient to put one party in default that the other party is ready, willing, and offers to perform his part of the contract.\textsuperscript{205}

After finding that the obligation to pay was a concurrent obligation, the court found Hilcorp was ready, willing, and had offered to perform.\textsuperscript{206} The letter from Hilcorp provided in part, “after execution return all three [original assignments] to my attention for further execution and handling. Hilcorp will return one fully executed original to your attention.”\textsuperscript{207} The court found that this was a clear indication that Hilcorp would “comply with its concurrent obligation to execute, acknowledge, and deliver” the assignment.\textsuperscript{208} Therefore, the letter and the unexecuted assignment was a sufficient “tender” to trigger the deadlines imposed under the JOA.\textsuperscript{209}

The case highlights the importance of strict compliance when exercising optional rights. “Because an option to purchase property is a unilateral benefit to the optionee, options must be exercised strictly according to the terms of the agreement.”\textsuperscript{210}

\section*{V. REGULATIONS}

\textit{Strata Resources v. State}, held that (1) the State of Texas was not precluded from recovering the costs of plugging oil wells because the Texas Railroad Commission converted the wells to water wells, even if the con-
verted water wells provided a benefit to the landowner, and (2) to challenge the value the Commission obtained when disposing of an operator’s equipment, an operator must make a claim on the oil-field cleanup fund pursuant to section 89.086 of the Texas Natural Resources Code.211

The Commission plugged two wells after the operator ignored orders requiring that the operator bring the wells into compliance or plug them.212 However, rather than simply plugging the wells, the State converted the wells to water wells for the benefit of the landowner, without giving notice to the operator. Finding that the Commission plugged the wells pursuant to statute,213 the court held that the State was allowed to seek reimbursement from the operator for plugging the wells.214

The crux of the operator’s argument was that:

while the Commission had the right to seek reimbursement for fully plugging the wells, the Commission cannot recover those costs if it plugs the well in a manner allowing it to be used as a water well—even when doing so would cost the State less than fully plugging the well, and yield the added benefit of a water well.215

Finding no support for the operator’s position, the court concluded that the Commission plugged the wells according to the requirements of 16 Texas Administrative Code section 3.14(b)(4) and (5).216 The court stated that “[t]he fact that the Commission’s method of plugging also provided a benefit to the landowner by converting the wells into water wells has no bearing on the State’s ability to seek reimbursement from the operator . . . for plugging the well.”217

The operator also argued that plugging costs could not be imposed because the State failed to prove the value of the salvaged well-site equipment, which the operator was entitled to offset against plugging costs.218 The State contended that the Texas Natural Resources Code “allows, but does not require, such an offset and that to challenge the value of the offset,” the operator was required but failed “to make a claim on the oilfield cleanup fund under section 89.086.”219

The operator testified that the recognized market value of the salvaged equipment was “‘greatly in excess’ of the salvage price set by the Commission.”220 The court then noted that “[t]o the extent that the Commission decide[d] to dispose of well equipment, section 89.085 require[d] it to do so ‘in a commercially reasonable manner.’”221 The court held that the

211. 264 S.W.3d 832, 845, 847 (Tex. App.—Austin 2008, no pet.).
212. Id. at 845.
214. Id.
215. Id.
216. Id.
217. Id.
218. Id. at 846.
219. Id. See TEX. NAT. RES. CODE ANN. § 89.086 (Vernon 2007).
221. Id. (citing TEX. NAT. RES. CODE ANN. § 89.085).
reasonableness of the salvaged equipment’s sale price was irrelevant.\textsuperscript{222} The operator was required to file a claim on the oilfield cleanup fund under section 89.086.\textsuperscript{223} Failing to make such a claim, the operator was precluded from challenging the reasonableness of the salvage price set by the Commission.\textsuperscript{224}

The significance of the case is the segregation of liability for plugging costs from the recovery of offsetting salvage costs from the oilfield cleanup fund and the freedom given to the State to determine how to plug the well.

\textit{Moore v. Jet Stream Investments, Ltd.} held that failure to comply with regulations is not within a lease force majeure clause, but an agreed temporary injunction may change the measure of damages for production by the trespasser prior to final judgment.\textsuperscript{225} The Texas Railroad Commission requires operators of oil and gas wells to post financial assurance to ensure wells are plugged when production ceases. When the Commission changed its rules in 2002 to require financial assurance from all operators, many of the very small operators had trouble finding a source for the required bond or letter of credit. Moore was one of those small operators who, though reasonably diligent, failed to find a source. When Moore did not post the required assurance, he was ordered to cease production. After about eleven months with no production, Moore finally obtained a letter of credit, which the Commission accepted, and production resumed. Lessor sued for lease termination.\textsuperscript{226}

Moore contended that the lease was preserved by the operation of the force majeure clause, which provided:

\begin{quote}
All terms and express or implied covenants of this lease shall be subject to all Federal and State Laws, Executive Orders, Rules and Regulations, and this lease shall not be terminated, in whole or in part, nor Lessee held liable for damages, for failure to comply therewith, if compliance is prevented by, or if such failure is the result of, any such Law, Order, Rule or Regulation.
\end{quote}

Moore argued the terms of the force majeure clause did not require the event be beyond the lessee’s reasonable control. Although the phrase “beyond the reasonable control of the lessee” was missing, the Texarkana Court of Appeals found that the lease contemplated such a requirement because the lease required compliance to be prevented by or the result of a regulation.\textsuperscript{227} The regulation at issue did not compel production to terminate, but merely imposed conditions on producers in order to continue production.\textsuperscript{228} Because some forms of financial assurance were available,
“the Texas Railroad Commission’s regulation requiring financial assurance did not preclude compliance with the lease . . . [and] the regulation was not a force-majeure event.”

The court next rejected a series of arguments by Moore claiming that production on a related tract perpetuated the lease. The lease originally included 1533.27 acres, and those lands included the “Perry Tract.” It was conclusively established that at the time of trial the Perry Tract was held by production, but the Perry Tract was apparently included in a partial release executed in 1952. Moore contended that production from any land described in the original lease (for example the Perry Tract) held the lease. The court disagreed because the original lease had effectively terminated as to the land partially released, which included the well site for the producing well. The court relied primarily upon Ridge Oil Co. v. Guinn Investments, Inc. Moore first sought to avoid the effect of Ridge Oil by the terms of the assignment clause in the lease. The lease included a typical lease assignment provision which provided:

The rights of either party hereunder may be assigned in whole or in part, and the provisions hereof shall extend to the heirs, successors and assigns of the parties hereto, but no change or division in ownership of the land, rental or royalties however accomplished shall operate to enlarge the obligations or diminish the rights of lessee . . .

Moore also argued that the entirety clause in the lease preserved the lease as an indivisible operating unit and made the release of some acreage irrelevant. Based on the lease’s repeated use of the word “hereunder,” the court held that both concepts only applied to tracts of land still bound by the lease.

The lease also contained a version of a fairly common “notice of default” clause. The clause provided:

In case of cancellation or termination of this lease from any cause, Lessee shall have the right to retain, under the terms hereof, around each well producing, being worked on, or drilling hereunder, the number of acres in the form allocated to each such well under spacing and proration rules issued by Texas Railroad Commission of the State of Texas, or any other State or Federal authority having control of such matters; or, in the absence of such rulings; forty (40) acres around each such well in as near a square form as practicable, and in the event lessor considers that operations are not being conducted in

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230. Id. at 422.
231. Id. at 422-25.
232. Id. at 422 & n.4.
233. Id. at 423-24.
234. 148 S.W.3d 143 (Tex. 2004). In that case, the Ridge Tract and the Guinn Tract were both covered by the original lease. The parties executed a new lease covering just the Ridge Tract. The Texas Supreme Court held that production from the Ridge Tract would not hold the original lease for the Guinn Tract after the new lease was executed on the Ridge Tract. Id. at 153.
235. Moore, 261 S.W.3d at 423.
236. Id. at 424.
compliance with this contract, lessee shall be notified in writing of
the facts relied upon as constituting a breach hereof and lessee shall
have sixty (60) days after receipt of such notice to comply with the
obligations imposed by virtue of this instrument.\textsuperscript{237}

Moore claimed he was entitled to forty acres around each of his two
wells, which were producing when he received notice from the lessor.
The court held the lease terminated, not on the date when Moore re-
ceived notice of termination from the lessor, but approximately eleven
months earlier, when the Commission shut the wells in and the time to
restore production lapsed.\textsuperscript{238} The fee simple determinable granted by the
lease automatically terminated upon the breach of the special limita-
tion—that production continue in paying quantities.\textsuperscript{239} Because there is
nothing the lessee can do to correct the breach, the notice provision does
not apply.\textsuperscript{240} Although Moore later restored production to some wells,
this was after the lease had already terminated, and, thus, he was not
entitled to any land around the wells.\textsuperscript{241}

The trial court prohibited Moore from recovering his equipment and
from removing the casing.\textsuperscript{242} The court of appeals held that an “operator
has an implied right to remove leasehold equipment within a reasonable
time of the expiration of the lease, even in the absence of a specific provi-
sion authorizing such removal.”\textsuperscript{243} Moreover, this specific lease had ex-
press language permitting lessee to remove both equipment and casing
after the expiration of the lease.\textsuperscript{244} However, the lessee “does not have
the right to remove the casing if the well is producing or the removal
would damage the well.”\textsuperscript{245} Under those circumstances, the lessee ordi-
narily recovers the value of the casing in place, less the cost of removal.\textsuperscript{246}

When a producer trespasses and extracts oil, gas, or other minerals, the
measure of damages is determined by whether the trespass was in good
faith or bad faith. The measure of damages for good faith trespass is the
value of the minerals less the cost of production. The measure of dam-
ages for bad faith trespass is the value of the minerals without deduction.
If entry is with full knowledge of the adverse claim, the trespass is conclu-
sively presumed to be in bad faith.\textsuperscript{247} The court of appeals held that les-
sor was estopped from claiming bad faith trespass in this case because
lessee had affirmatively requested that production continue and had
agreed to a temporary injunction requiring Moore to continue to

\begin{itemize}
  \item \textsuperscript{237} Id. at 425.
  \item \textsuperscript{238} Id. at 426.
  \item \textsuperscript{239} Id.
  \item \textsuperscript{240} Id.
  \item \textsuperscript{241} Id.
  \item \textsuperscript{242} Id. at 426-27.
  \item \textsuperscript{243} Id. at 427.
  \item \textsuperscript{244} Id.
  \item \textsuperscript{245} Id. at 428.
  \item \textsuperscript{246} Id.
  \item \textsuperscript{247} Id. at 428-29.
\end{itemize}
produce.\textsuperscript{248}

Force majeure clauses will be enforced as written, and this case illustrates the fine distinctions that may be made with the result that the lease is lost or saved. Here, the lease was saved, if subject to a regulation with which the lessee could not comply, but only if compliance was "beyond the reasonable control of lessee," which was implied into the clause. Once land is released from a lease, whatever happens on the released land is not likely to have any effect on the unreleased lands still under lease. The holdings on the right to remove equipment and casing and the measure of damages for trespass generally follow existing case law. Because temporary injunctions are common in this context, the possible effect on the measure of damages resulting from an agreed temporary injunction is significant.

VI. ETHICS

\textit{Kerlin v. Sauceda} held that claims of breach of contract, breach of fiduciary duty, and fraud by a non-participating royalty owner against the mineral owner based on a mineral deed were all barred by limitations.\textsuperscript{249} The case addressed fraudulent concealment in the context of a mineral deed and the duties owed by the mineral owner to a non-participating royalty owner. Further, the case involved a lengthy and complicated fact pattern bearing on the ownership of Padre Island. The Corpus Christi Court of Appeals' opinion published more complete facts in \textit{Sauceda v. Kerlin}.\textsuperscript{250} Simplified, there were ancient title issues related to the Mexican land grant to Padre Island, which was repeatedly disputed by lawsuits, principally in 1902, 1923, and 1940. There were many claimants with questionable title. In 1937, a lawyer named Kerlin purchased the Juan Jose Balli title claim to Padre Island from Balli’s heirs and devisees. Lawyer Kerlin hired a local lawyer, F. W. Seabury from Brownsville, to help him with acquiring the deeds and in the related, complex litigation. Kerlin represented to the Balli heirs that if Kerlin received something through the deeds, each Balli heir would receive a one-sixty-fourth royalty. Kerlin acquired eleven deeds from various Balli heirs. Seabury drafted the deeds. Each deed reserved a one-sixty-fourth non-participating royalty.\textsuperscript{251} Lawyer Seabury took the lead in handling complicated and protracted litigation for the next six years, and he eventually engineered a global settlement that resulted in acquiring 21,000 acres for Kerlin. The Balli heirs got nothing.\textsuperscript{252}

The jury verdict generally found that Kerlin acquired 7,500 acres for the benefit of the Balli heirs, that Kerlin failed to comply with the fiduci-
ary duty owed to each of the Balli heirs with respect to the royalty interest reserved in the eleven deeds, that Kerlin and Seabury committed fraud and breached Seabury’s fiduciary duty in the settlement, and that Kerlin was estopped to deny the validity of the deeds from the Balli heirs. The Texas Supreme Court first considered “whether Kerlin’s fraudulent concealment of the Balli [heirs’] entitlement to royalty payments and the details of the [1942] settlement prevented [the statute of] limitations from running.”

Kerlin argued the four-year statute of limitations barred the breach of contract, fraud, and breach of fiduciary duty claims, while the two-year statute prevented the related conspiracy claims. Kerlin also claimed that the Balli heirs “could have timely discovered the existence of their claims through the exercise of reasonable diligence.” The supreme court agreed with Kerlin’s position because “[f]raudulent concealment will not . . . bar limitations when a party discovers the wrong or could have discovered it through the exercise of reasonable diligence.”

In evaluating whether the claims could have been discovered, the supreme court reasoned by analogy from its opinion in HECI Exploration Co. v. Neal. In HECI, oil and gas royalty owners sued their lessee for failing to advise them of the lessee’s successful suit against an adjoining operator for damages to the common field. In that case, the Texas Supreme Court’s opinion was somewhat vague, but it found that the royalty owners could have discovered their possible claim by Railroad Commission records or visible operations on the adjoining property. In Kerlin, the Texas Supreme Court carefully noted that the application of the discovery rule was “categorical,” and while the effect of fraudulent concealment in tolling limitations was not, HECI was “instructive.”

The 1942 dismissal and “Kerlin’s receipt of more than 20,000 acres in fee simple and 1,000 mineral acres were a matter of public record more than forty years before the Balli heirs filed [their] lawsuit.” The Balli heirs knew they were not getting any royalty, and they could have exercised reasonable diligence, thus allowing them to discover the existence of any claims before their claims were barred. The court said, “royalty owners are not entitled to ‘make . . . no inquiry for years on end.’”

The significance of the case is the holding that the tolling of the statute by fraudulent concealment with respect to a mineral deed is essentially resolved by the same inquiry that is required under the discovery rule.

253. Id. at 909.
254. Kerlin, 263 S.W.3d at 925.
255. Id.
256. Id.
257. Id. (citing HECI Exploration Co. v. Neal, 982 S.W.2d 881 (Tex. 1998)).
258. HECI, 982 S.W.2d at 886-87.
260. Id. at 926.
261. Id. at 925 (citing HECI, 982 S.W.2d at 887-88).
262. Id. at 925-26.
All of the other issues in the case simply disappeared with the dispositive ruling on limitations.

Four of the justices were not content to let it go with that. In the concurring opinion, they wrote that the court of appeals opinion generated ninety-five headnotes, and every one of the legal concepts was misapplied.263 The concurring opinion then briefly addressed a number of interesting oil and gas issues with ethical implications. First, the concurring opinion noted that the transaction involving the mineral deeds was a sale,264 and Kerlin did not represent the Balli heirs,265 nor did Seabury.266 “Like any other buyer, Kerlin owed his sellers (the heirs) no fiduciary duty after buying their interests.”267 Moreover, in the court of appeals’ analysis, the fiduciary duty was derived from the duty owed by the holder of executive rights to non-participating royalty owners in executing an oil and gas lease, but Kerlin sold his interest and owed no duty to account for the sale of his own interest.268 The court of appeals was also in error by applying estoppel by deed. Estoppel by deed only applies to the grantor, only as to after-acquired title, and does not apply to quitclaim deeds.269 In the concurring opinion, the justices clearly expressed their concern at the number of lawsuits being filed to upset South Texas land titles and the court’s intent to discourage that trend.270

263. *Id.* at 928 (Brister, J., concurring).
264. *Id.* at 929.
265. *Id.* at 931.
266. *Id.* at 932.
267. *Id.* at 931.
268. *Id.* at 931-32.
269. *Id.* at 930-31.
270. *Id.* at 932.