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Oil, Gas and Mineral Law

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OIL, GAS AND MINERAL LAW

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THIS Article[1] focuses on the interpretations of, and the changes to, oil, gas, and mineral law in Texas.[2] The Article examines judicial developments,[3] including decisions by both the Texas courts and the Fifth Circuit court of appeals. The Article also highlights applicable Texas legislative enactments[4] relating to oil, gas, and mineral law.[5]

I. JUDICIAL DEVELOPMENTS

A. CONVEYANCING ISSUES

1. Reservation of Minerals

In *Temple-Inland Forest Products Corp. v. United States*[6] Temple-Inland deeded approximately 77,000 acres to the United States, reserving minerals as to 59,938 acres. By its terms, the mineral estate reservation terminated in 1985, except for a one-half-mile radius surrounding twenty-two commercially producing sites. Those twenty-two sites received a five-year extension of reservation and were entitled to further five-year extensions so long as commercial operations were being carried on at the end of any extension period. At the end of the first five-year extension, six of the twenty-two tracts were still producing in commercial quantities. Beginning January 1, 1990, the United States elicited public bids for leases on all of the acreage except the six sites then producing in commercial quantities.

The Fifth Circuit was called upon to construe the language of the deed to determine the duration of the mineral reservation.[7] The United States contended that the deed expressed an intent to terminate the mineral reservation as to each individual tract that had no commercial operations at the end of a

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2. The article is devoted exclusively to Texas law.

3. *See infra* pp. 1439-73.

4. *See infra* pp. 1473-82.

5. Following former SMU annual surveys of Texas oil, gas, and mineral law, this Article utilizes headings and subheadings that provide easy access to the individual issues examined. *See, e.g.*, Stuart C. Hollimon & Robert E. Vinson, Jr., *Oil, Gas and Mineral Law, Annual Survey of Texas Law*, 46 SMU L. REV. 1591 (1993).

6. 988 F.2d 1418 (5th Cir. 1993).

7. The Fifth Circuit reviewed the question de novo.

five year period. Temple-Inland contended that the deed expressed an intent to reserve the mineral rights as to all tracts created in 1985 until no operations were conducted on any tract. The court first noted that "interpreting an unambiguous contract presents a question of law, including determining whether the contract is ambiguous."[8] Citing *Prairie Producing Co. v. Schlachter*,[9] the court held that "[a]n instrument is ambiguous only when the application of pertinent rules of construction leaves it genuinely uncertain which one of two reasonable meanings is the proper one."[10] Following standard canons of construction,[11] the deed was held to be unambiguous.[12]

The Fifth Circuit construed the deed in favor of the United States, holding that the use of the plural "reservations" in paragraphs 3 and 4 of the deed, instead of the singular, manifested an intent to create a discrete reservation as to each tract created in 1985, rather than a single collective reservation.[13] The court also noted that there was no clear language reserving the mineral rights to tracts created in 1985 which were without production in commercial quantities five years later, holding that the rule that a reservation of mineral interest must be clearly stated "applies not only to whether a reser-

8. *Temple-Inland*, 988 F.2d at 1421 (quoting REO Indus., Inc. v. Natural Gas Pipeline Co., 932 F.2d 447, 453 (5th Cir. 1991) (footnote omitted)).

9. 786 S.W.2d 409 (Tex. App.—Texarkana 1990, writ denied).

10. *Temple-Inland*, 988 F.2d at 1421 (quoting *Prairie*, 786 S.W.2d at 413).

11. Those canons include: (1) ascertaining the intent of the parties (Humble Oil & Refining Co. v. Kirkindall, 119 S.W.2d 731, 733 (Tex. Civ. App.—Beaumont 1938), *aff'd*, 145 S.W.2d 1074 (Tex. 1941)); (2) applying the "four corners" rule (Luckel v. White, 819 S.W.2d 459, 461 (Tex. 1991)); (3) construing the language of the instrument against the grantor (State v. Dunn, 574 S.W.2d 821, 824 (Tex. Civ. App.—Amarillo 1978, writ ref'd, n.r.e.)); and (4) requiring a reservation to be "stated in clear language" (*Temple-Inland*, 988 F.2d at 1422 (citing Sharp v. Fowler, 151 Tex. 490, 252 S.W.2d 153, 154 (1952)).

12. *Temple-Inland*, 988 F.2d at 1422.

13. The pertinent deed provisions are:

> [1] There is hereby excepted and reserved from the foregoing sale and conveyance all the oil, gas and other valuable minerals deposited on, in or under said lands, in accordance with the following causes, rules and regulations, to-wit:
>
> [2] Reserving to the vendor, its successors and assigns, for the period ending January 1, 1985, the right to prospect for, mine, and remove any and all gas, oil and mineral deposits on, in, or under said lands. The vendor, its lessees, successors, and assigns, shall have at any and all times full right to enter upon said lands for the purposes of prospecting for, mining, and removing gas, oil, and minerals.
>
> [3] It is further provided that if on January, 1, 1985, gas, oil and/or minerals are being produced on said land in commercial quantities, then and in that event the gas, oil and mineral reservations shall be extended on all areas within a one-half mile radius of each then existing gas or oil well or mineral operation. Such extension of gas, oil and mineral reservation shall run for a five year period from date of January 1, 1985.
>
> [4] Provided further that said gas oil, and mineral reservations shall be extended by five year periods so long as commercial operations are being carried on at the end of the then current extension period.
>
> [5] It is provided that at the end of the termination of the period ending January 1, 1985, if not as above provided extended, or at the termination of any extended period, if no commercial gas, oil or mineral operations are being carried on, then and in that event the right of the vendor, its lessees, successors and assigns to prospect for, mine and remove gas oil, and minerals shall terminate.

Temple-Inland, 988 F.2d at 1420-21.

vation was created, but to its endurance and termination."[14]

The Fifth Circuit distinguished dicta in *Williamson v. Federal Land Bank*,[15] holding that production from any one of four non-contiguous tracts of land would permanently vest a non-participating royalty interest in all four tracts, where the deed reserving the royalty interest provided for the interest to permanently vest if mineral production occurred within twenty years.[16] The court reasoned that the *Williamson* deed contained a single reservation governing all tracts, unlike the deed executed by Temple-Inland, which was held to provide that separate tracts of land were subject to separate reservations.[17] Finally, the Fifth Circuit refused to apply rules interpreting habendum clauses in oil and gas leases to a reservation provision in a deed.[18] Although the court agreed that a deed conveying a determinable interest and a mineral lease creates estates subject to the same principles of Texas law,[19] it noted that Temple-Inland's deed did not *convey* a determinable interest, but instead *reserved* one.[20]

2. *Assignments of Oil, Gas and Mineral Leases*

In *OTC Petroleum Corp. v. Brock Exploration Corp.*[21] the Amarillo Court of Appeals considered whether an assignment of interests in certain oil and gas leaseholds also conveyed an accrued, but uncollected, take-or-pay payment.

By assignment dated June 14, 1989, Brock Oil and Gas Corporation[22] assigned to OTC Petroleum Corporation "All of [Brock's] right, title and interest in and to the oil, gas and mineral leases . . . and the Jones 25-406-1 Well, and the Jones 25-406-2 Well . . . INSOFAR AS SAID LEASES COVER RIGHTS BETWEEN THE SURFACE OF THE EARTH AND THE BASE OF THE CHESTER FORMATION . . . ." The assignment also included

> [a]ll of [Brock's] rights in, to, under or derived from all agreements and contractual rights . . . relating to the SUBJECT INTERESTS, including production sales contracts . . . purchase, exchange or processing agreements, casinghead gas contracts . . . and all other contracts, agreements and instruments relating to the exploration for production, storage, treatment, transportation, processing, or sale or disposal of oil, gas

14. *Id.* at 1423-24 (citing Guaranty Nat'l Bank & Trust v. May, 513 S.W.2d 613 (Tex. Civ. App.—Corpus Christi 1974, no writ)).

15. 326 S.W.2d 560 (Tex. Civ. App.—Texarkana 1959, writ ref'd n.r.e).

16. *Temple-Inland*, 988 F.2d at 1424.

17. *Id.*

18. *Id.* Temple-Inland argued that under an habendum clause in a lease, production on one tract will hold the lease as to all tracts conveyed, citing Hillequst v. Amerada Petroleum Corp., 282 S.W.2d 892 (Tex. Civ. App.—Beaumont 1955, writ ref'd n.r.e.).

19. *Id.* at 1425 (citing Midwest Oil Corp. v. Winsauer, 159 Tex. 560, 323 S.W.2d 944, 948 (1959)).

20. *Id.* (emphasis added).

21. 835 S.W.2d 792 (Tex. App.—Amarillo 1992, writ denied).

22. Brock Oil and Gas Corporation was the managing general partner for Brock Exploration Corporation 1979-1, Ltd.

and other hydrocarbons . . . .[23]

Prior to the assignment to OTC, Brock and Northern Natural Gas Company entered into a gas purchase contract with a take-or-pay clause relating to the Jones Wells. Before the effective date of the assignment, Northern became obligated to pay, but had not yet paid, a take-or-pay amount of $38,000.00.

The parties agreed the 1989 assignment from Brock to OTC included the gas purchase contract with Northern and that the assignment was unambiguous. The parties did not agree, however, as to the ownership of the accrued $38,000.00 take-or-pay amount. Reversing the trial court and rendering, the Amarillo Court of Appeals held that although the accrued take-or-pay amount was personalty, which would not pass in the assignment of an oil and gas lease absent an express provision,[24] the assignment included contractual rights derived from contracts relating to the sale of gas.[25] Therefore, the take-or-pay claim was conveyed expressly and without qualification.[26]

The court noted the reliance of both parties on *East Texas Refining Co. v. Helvir Oil Co.*[27] and *Phillips Petroleum Co. v. Adams*,[28] stating that the cases were instructive but not controlling.[29] The court distinguished those cases on the grounds that the assignments therein, unlike the assignment from OTC to Brock, did not expressly convey any personalty unrelated to the extraction process.[30]

B. OIL, GAS, AND MINERAL LEASES

1. Surface/Mineral Relationship

In *Farm Credit Bank v. Colley*[31] the Texarkana Court of Appeals was called upon to determine whether Farm Credit Bank, a non-participating royalty owner, was entitled to royalties from the mining of surface lignite.[32] Farm Credit Bank's title was derived from a reservation of 1/16th royalty interest in "all of the oil, gas, and all other minerals in, to, on and under and that may be produced from the land."[33] The Colley's deed stated that the conveyance was subject to "all outstanding minerals and/or royalties of rec-

23. *OTC Petroleum Corp.*, 835 S.W.2d at 793.

24. *Id.* (citing Phillips Petroleum Co. v. Adams, 513 F.2d 355, 363 (5th Cir.), *cert. denied*, 423 U.S. 930 (1975)).

25. *Id.* at 795.

26. *Id.*

27. *Id.* 82 S.W.2d 392, 395 (Tex. Civ. App.—Dallas 1935, writ dism'd w.o.j.) (holding that the mere assignment of an oil and gas lease and all property incident to such lease does not transfer oil runs sold and delivered from the lease before the date of the assignment).

28. 513 F.2d 355, 363 (5th Cir.), *cert. denied*, 423 U.S. 930 (1975) (holding that a right to suspense money or other personalty unrelated to the production of oil and gas was not conveyed by an assignment of oil and gas leases, together with all personal property and equipment used or obtained in connection therewith and located thereon).

29. *OTC Petroleum Corp.*, 835 S.W.2d at 795.

30. *Id.*

31. 849 S.W.2d 825 (Tex. Civ. App.—Texarkana 1993, writ denied).

32. The trial court entered summary judgment that a royalty interest does not include surface lignite. *Id.* at 826.

33. *Id.*

ord."[34] Both parties claimed the right to royalties from the strip-mining of lignite.

Holding that Farm Credit Bank was not entitled to royalties on lignite, the court cited a series of Texas Supreme Court cases in support of two rules: (1) the phrase "and other minerals" in a severance of the mineral estate from the surface estate does not include substances which, if mined, would threaten the existence of the surface estate; and (2) lignite within 200 feet of the surface is, as a matter of law, part of the surface estate.[35] The court held that a "reservation or conveyance between private parties that covers any interest in the oil, gas, and other minerals does not include near surface lignite unless the instrument creating such interest expressly provides otherwise."[36] The rules are based upon the presumed general intent that a surface owner would not consent to a reservation or conveyance of a mineral which requires the destruction of the surface to mine.[37]

The court noted a disagreement among the courts of appeals as to whether the nonparticipating royalty interests are part of the mineral estate and subject to the same rules as other mineral interests, given that nonparticipating royalty owners have no right to disturb the surface by mining operations.[38] In holding that nonparticipating royalty interests are interests in land and part of the total mineral estate, subject to the same rules as any other mineral interest, the court followed its own previous case,[39] and the holdings of the San Antonio and Austin Courts of Appeals.[40] The court expressly rejected the ruling of the Corpus Christi Court of Appeals in *Martin v. Schneider*[41] that a royalty interest does not share the ownership traits of a mineral fee interest and should not be treated as such.[42] The court expressed concern that if it were to apply rules "to some mineral interests and not to others on the basis of the presumed intent of specific owners, we [would] create untold confusion in land titles . . . and produce bizarre results, e.g., a nonparticipating royalty owner having a greater estate than that of his grantor who owned the full mineral estate."[43]

The Tyler Court of Appeals, in *Barfield v. Holland*,[44] considered whether the purchasers of three 33-1/3 acre tracts of land, partitioned from a 100-acre

34. *Id.*

35. *Id.* at 826-27 (citing Schwarz v. State, 703 S.W.2d 187 (Tex. 1986); Friedman v. Texaco, 691 S.W.2d 586 (Tex. 1985); Moser v. U.S. Steel Corp., 676 S.W.2d 99 (Tex. 1984); Reed v. Wylie, 597 S.W.2d 743 (Tex. 1980); Reed v. Wylie, 554 S.W.2d 169 (Tex. 1977); Acker v. Gwinn, 464 S.W.2d 348 (Tex. 1971)).

36. *Id.* at 827 (citing Schwarz v. State, 703 S.W.2d 187 (Tex. 1986)).

37. *Farm Credit*, 849 S.W.2d at 827.

38. *Id.*

39. Hobbs v. Hutson, 733 S.W.2d 269 (Tex. App.—Texarkana 1987, writ denied).

40. *Farm Credit*, 849 S.W.2d at 827 (citing Storm Associates v. Texaco, 645 S.W.2d 579 (Tex. App.—San Antonio 1982, writ ref'd n.r.e.); DuBois v. Jacobs, 551 S.W.2d 147 (Tex. Civ. App.—Austin 1977, no writ)).

41. 622 S.W.2d 620 (Tex. App.—Corpus Christi 1981, writ ref'd n.r.e.).

42. *Farm Credit*, 849 S.W.2d at 827.

43. *Id.*

44. 844 S.W.2d 759 (Tex. App.—Tyler 1992, writ denied).

tract, obtained title to 100% of the minerals underlying those tracts.[45] The court examined a complex series of conveyances and cross-conveyances between three undivided cotenants in the surface and minerals of a 100-acre tract of land.[46] In each conveyance between the cotenants, the grantor reserved an undivided interest in the mineral estate, conveying surface rights only to the grantees.

The Tyler Court of Appeals found that the result of the conveyances and cross-conveyances was a severance of the mineral estate from the surface estate and a partition of the surface into three separate 33-1/3 acre tracts.[47] The mineral estate, however, remained intact and undivided with respect to the entire 100-acre tract. Subsequently, each of the three cotenants conveyed his or her 33-1/3 acre tract to the plaintiffs by general warranty deed without any mineral estate reservations. The plaintiffs claimed title to 100% of the surface and 100% of mineral estate for each tract. The court disagreed, holding that because there had been no partition of the mineral estate, each grantor had owned, and could therefore convey to plaintiffs, all of the surface of each separate tract but only a one-third undivided interest in the minerals underlying each separate tract.[48]

The Tyler court of appeals refused to apply the equitable partition doctrine to vest plaintiffs with 100% of the minerals.[49] The court first noted that the parties had not found a Texas case that precisely defined the doctrine,[50] and then held that the doctrine "applies uniformly to the conveyance of the surface estate as well as to the mineral estate:"[51]

> The doctrine of equitable partition applies only to an adjustment of equities between the cotenants themselves. When there has been a severance of the mineral estate from the surface estate by the cotenants, as is the case here, a purchaser who purchases the larger tract, by accepting separate deeds conveying separate tracts of land out of the larger tract, each described by metes and bounds, from the cotenants who had, in legal effect, partitioned the surface of the larger tract, and reserved the mineral under the partitioned tracts, cannot be awarded the entire mineral estate on, in and under the larger tract . . . . To put it differently, . . . [the purchasers] cannot compel the adjustment of other equities owned by the former cotenants in order for them to acquire *what they thought they had purchased*.[52]

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45. *Id.*

46. *Id.* at 760-63. The 294th Judicial District Court of Wood County, Texas entered judgment that the purchasers held both the surface estate and the mineral estate. *Id.* at 760-61.

47. *Id.* at 764.

48. *Id.* at 761.

49. *Id.* at 763 (hereinafter doctrine).

50. *Id.* The plaintiffs cited the following as " 'essential elements of the . . . doctrine . . . : 1) a conveyance of a specific tract of the common property; 2) the nonjoinder of all cotenants in the conveyance; and 3) the treatment of the common property including specific tracts as having equal value.' " *Id.*

51. *Id.* (citing Thomas v. Southwestern Settlement & Dev. Co., 132 Tex. 413, 123 S.W.2d 290, 300 (1939)).

52. *Id.* at 765 (emphasis added) (noting further that "[t]he courts of this State have refused to apply the doctrine of equitable partition between different tracts of land owned by the

Since the purchasers sued their grantors to establish title, and *not* to establish equities between cotenants, the doctrine of equitable partition was not applicable.[53]

Similarly, the Tyler Court of Appeals rejected the plaintiffs' argument that their grantors had ratified and acquiesced in their title to 100% of the minerals.[54] The court reasoned that the doctrines of ratification and acquiescence applied only where a "non-joining cotenant electing to recognize or ratify the act of his cotenant who has attempted to convey a specific part of the common property to another."[55] The court also rejected the argument that the grantors could be estopped to deny plaintiffs' ownership of 100% of the minerals by virtue of misrepresentations to plaintiffs concerning the title conveyed to them, stating, without citation, that "[l]and titles are governed by notice imparted by the deeds in the chain of title, duly recorded in the public records of the county where the land is situated, and not by personal representations, warranties, reliance, and estoppel. . . ."[56]

Finally, the Tyler Court of Appeals refused to apply the doctrine of adverse possession to the purchasers' favor, holding that "occupation of land under a chain of title which contains a mineral reservation is not adverse to the reserved minerals."[57] The purchasers failed to prove their adverse possession claim because neither they, nor their predecessors-in-interest, had "possessed" the minerals by actually taking them and producing them from the ground for the statutory period.[58]

Affirming and extending its decision in *Getty Oil Co. v. Jones*,[59] the Texas Supreme Court applied the "accommodation doctrine" in *Tarrant County Water Control & Improvement District Number One v. Haupt, Inc.*[60] to determine whether a governmental agency had taken a mineral estate by an inverse condemnation when it restricted the use of the surface by the mineral owner and lessee.[61] The court described the accommodation doctrine[62] as a means to balance the rights of the surface owner and the mineral owner in the use of the surface.[63] Where mining the minerals would preclude or impair the existing use of the surface, the mineral owner may be forced to adopt alternative means of mining if there are established alternative prac-

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same vendor; instead they have limited the doctrine to the land actually covered by the deed between the cotenant vendor and his vendee.").

53. *Id.* The court also rejected the purchasers' claims to the mineral estate by the doctrines of (1) ratification and acquiescence; (2) estoppel; and (3) adverse possession. *Id.* at 765-68.

54. *Id.*

55. *Id.* at 765-66.

56. *Id.* at 767.

57. *Id.*

58. *Id.* at 766-67.

59. 470 S.W.2d 618 (Tex. 1971).

60. 854 S.W.2d 909 (Tex. 1993).

61. *Id.* This action arose after a portion surface of a tract subject to an oil, gas and mineral lease was flooded to form a new lake. *Id.* at 910.

62. Also known as the alternative means doctrine. *Id.* at 911.

63. *Id.*

tices available.[64] If there is only one means of surface use to produce the minerals, the mineral owner has the right to pursue that use.[65]

Relying upon *Chambers-Liberty Counties Navigation District v. Banta*,[66] the owners of the mineral estate argued that where a governmental entity condemns the surface but not the mineral estate, interference with the mineral owner's use of the surface constitutes a taking by inverse condemnation to which the accommodation doctrine does not apply. The Texas Supreme Court disagreed, finding that the mineral owners have only a right to reasonable use of the surface, and that no taking of the of the mineral estate has occurred unless all reasonable means of access to the surface have been restricted.[67]

2. *Royalty Interests*

In *GHR Energy Corp. v. TransAmerican Natural Gas Corp.*,[68] TransAmerican Natural Gas Corporation (TransAmerican) held the working interest in certain leases, known as the "La Perla Ranch" in Zapata County, Texas,[69] by virtue of a 1975 farmout agreement with El Paso Natural Gas Corporation (El Paso). Prior to execution of the farmout agreement, TransAmerican had agreed to assign to Medallion Oil Company a one-sixteenth overriding royalty interest in oil and gas production from any mineral rights that Medallion assisted TransAmerican in obtaining.[70]

TransAmerican filed for Chapter 11 bankruptcy in 1983. In 1987 TransAmerican and Medallion entered into a settlement agreement which recognized Medallion's one-sixteenth overriding royalty interest in net revenues from the La Perla Ranch. The settlement agreement also granted to Medallion a one and one-half percent overriding royalty interest on production from "certain interests owned by TransAmerican [as of April 23, 1987], including the La Perla leasehold estate."[71] In 1990, TransAmerican and El Paso settled disputes between them by terminating the 1975 farmout agreement and all leases thereunder, and El Paso assigned all of its interest in the mineral estate in La Perla Ranch to TransAmerican.

At issue was whether Medallion's overriding royalty interest in the La Perla Ranch production survived the termination of the El Paso farmout agreement and the related leasehold interests. Both Medallion and TransAmerican filed motions for summary judgment. The bankruptcy court granted summary judgment in favor of TransAmerican.[72]

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64. *Id.*

65. *Id.* (citing Getty Oil Co. v. Jones, 470 S.W.2d 618 (Tex. 1971)).

66. 453 S.W.2d 134 (Tex. 1970).

67. *Tarrant County*, 854 S.W.2d at 912.

68. 972 F.2d 96 (5th Cir. 1992), *reh'g denied per curiam*, 979 F.2d 40, *cert. denied sub nom.*, 113 S. Ct. 1879 (1993).

69. Pursuant to the farmout agreement, TransAmerican had the right to explore and develop the La Perla Ranch field and to secure gas leases therein. *Id.*

70. The agreement was dated in 1974 and was between Medallion and Good Hope Refineries, Inc., TransAmerican's predecessor-in-interest. *Id.*

71. *Id.* at 98.

72. The district court affirmed the holding and Medallion appealed. *Id.*

The Fifth Circuit examined the documents by which Medallion's overriding royalty interests were created.[73] Stating that an overriding royalty interest "is an interest which is carved out of, and constitutes a part of, the working interest created by an oil and gas lease,"[74] and following the bankruptcy court's reliance upon *Sunac Petroleum Corp. v. Parkes*,[75] the Fifth Circuit held that when TransAmerican and El Paso terminated the leases and interests out of which Medallion's overriding royalty was carved, the royalty interest was necessarily extinguished.[76]

The court was unpersuaded by Medallion's argument that the 1990 settlement resulted in a merger of the leasehold and the mineral fee estates that would not operate to destroy the overriding royalties, stating: "TransAmerican terminated the leasehold estate and farmout agreement and acquired the mineral fee estate, free and clear of the leases. No leasehold remained in existence, thus, there could be no merger."[77] Additionally, the court held that the plain language of the settlement agreement with Medallion indicated that Medallion's interest would not survive a termination of the farmout agreement.[78]

The court also rejected Medallion's argument that TransAmerican could not surrender the leasehold interest while production continued unabated on the La Perla Ranch.[79] Relying on *Fain & McGaha v. Biesel*,[80] the court held that TransAmerican was free to terminate the leases and extinguish the overriding royalty, even though production on the La Perla Ranch properties had not ceased,[81] because the lease instrument expressly authorized TransAmerican to surrender the lease, in whole or in part, at any time.[82]

Finally, the court refused, under the terms of Medallion and TransAmerican's settlement agreement, to award Medallion an overriding royalty inter-

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73. *Id.* at 98-99 (providing fairly detailed segments of the documents at issue).

74. *Id.* at 99 (quoting Gruss v. Cummins, 329 S.W.2d 496, 501 (Tex. Civ. App.—El Paso 1959, writ ref'd n.r.e.)).

75. 416 S.W.2d 798, 804 (Tex. 1967) (providing that unless an instrument creating the overriding royalty interest expresses to the contrary, the interest terminates when the leasehold estate from which it is carved terminates).

76. *GHR Energy*, 972 F.2d at 99-100.

77. *Id.*

78. *Id.*

79. *Id.* at 100.

80. 331 S.W.2d 346, 347-48 (Tex. Civ. App.—Fort Worth 1960, writ ref'd n.r.e.) (holding that where the lease instrument authorizes release of any part of the leasehold, the leaseholder can surrender a portion of the estate and terminate an outstanding overriding royalty interest).

81. *GHR Energy*, 972 F.2d at 100. On motion for rehearing, Medallion argued that the case was controlled by Cain v. Neumann, 316 S.W.2d 915 (Tex. Civ. App.—San Antonio 1958, no writ). The Fifth Circuit rejected this argument holding that "[t]he facts in *Cain* suggested that the [lessor and lessee] . . . intentionally harmed the overriding royalty interest owner for their own unjustifiable benefit," when they terminated the original lease and entered a new lease even though production had never stopped. 979 F.2d 40, 41 (5th Cir. 1993). Instead, the Fifth Circuit found that Sunac Petroleum Corp. v. Parkes, 416 S.W.2d 798 (Tex. 1967) was applicable because there was no " 'bad faith on the part of the lessee,' " as was true with TransAmerican. *Id.* at 41. Noting that the agreement between TransAmerican and El Paso to terminate the leases was the settlement of a genuine dispute, the Fifth Circuit suggests that in any case involving a "hint of impropriety," the outcome may differ. *Id.*

82. *GHR Energy*, 972 F.2d at 100.

est on the mineral fee interest acquired from El Paso.[83] The court held that the settlement agreement granted Medallion overriding royalty interests only in those properties owned by TransAmerican as of April 23, 1987.[84] The court further held that the extension and renewal clause in the settlement agreement applied only to leases and not to fee interests.[85] The court therefore declined to alter the bargain made by the parties.[86]

In *Exploration Co. v. Vega Oil & Gas Co.*[87] the plaintiff sought a declaratory judgment. The plaintiff argued that he was entitled to an overriding royalty interest in several oil and gas leases owned by the defendant, though not mentioned therein, on the grounds that the defendant's leases recited that they were in renewal and in extension of previous leases in which the plaintiff did have such an interest. The plaintiff claimed that in the assignment creating plaintiff's interest, it was specifically provided that plaintiff's overriding royalty would continue in any renewals or extensions of the original leases. The trial court granted summary judgment for the defendant.

The court of appeals affirmed, holding that defendant had proved that the original leases had terminated for lack of production in paying quantities, that more than a year had passed after their termination, and that, in spite of language in the new leases to the effect that they were renewals of the previous leases, plaintiff had come forward with no evidence which would support its claim.[88] Citing *Sunac Petroleum Corp. v. Parkes*[89] and *McCormick v. Krueger*,[90] the court held that there could be no renewal and extension of an expired lease if the new lease was entered into after the prior lease's termination, if new consideration existed to support the new lease, if the new lease was executed under different circumstances, and if the new lease contained new terms.[91] The plaintiff's case met none of the criteria.

The plaintiff also argued that a fiduciary relationship had been created between plaintiff and defendant by the renewal and extension clause, giving rise to a constructive trust upon the new leases in plaintiff's favor. The court, however, held that the assignment which initially reserved the override did not in itself create a fiduciary relationship.[92] The court further held that the plaintiff had shown no fraud or special relationship which would otherwise create a constructive trust.[93]

In *Carter v. Exxon Corp.*[94] the issues were whether royalties on gas should be calculated on the market value of the gas in its natural state as produced

83. *Id.*
84. *Id.*
85. *Id.*
86. *Id.*
87. 843 S.W.2d 123 (Tex. App.—Houston [14th Dist.] 1992, writ denied).
88. *Id.* at 126.
89. 416 S.W.2d 798, 804 (Tex. 1967).
90. 593 S.W.2d 729 (Tex. Civ. App.—Houston [1st Dist.] 1979, writ ref'd n.r.e.).
91. *Exploration Co.*, 843 S.W.2d at 125-26.
92. *Id.* at 126-27.
93. *Id.* (citing Consolidated Gas & Equip. Co. v. Thompson, 405 S.W.2d 333 (Tex. 1966)).
94. 842 S.W.2d 393 (Tex. App.—Eastland 1992, writ denied).

or on the market value of the processed gas as it left Exxon's gas processing plant, and whether market value was determined by interstate or intrastate prices. The jury and trial court found for Exxon. The court of appeals affirmed.[95]

The lease contained a common provision for payment of royalties: "The royalties to be paid by Lessee are . . . on gas . . . produced from said land and sold or used off the premises or for the extraction of gasoline or other product therefrom, the market value *at the well* of one-eighth of the gas so sold or used . . . ."[96] In the field, casinghead gas from the wellhead was first sent to a separator to remove oil and condensate. The raw gas was processed by Exxon's Neches Gas Plant where all liquefiable hydrocarbons were removed and sent to another Exxon facility. The residue gas was used in several ways by Exxon, the primary use being re-injection into the field's reservoir to assist in lifting oil. Another use was to fuel the Neches Gas Plant, and finally, a small portion was sold in interstate commerce under contract to United Gas Pipe Line Company dated 1966.

The royalty owners argued that royalty payments should be based on the higher of either the value of the separated liquid products less the cost incurred in the processing or the intrastate market value of the gas used to make the liquid products. The court's opinion is silent as to the reasoning supporting the claim. The court, citing *Sowell v. Natural Gas Pipeline Co. of America*,[97] held that the inclusion of the words "at the well" in the royalty provision indicated that "royalties are owed for gas that is produced in its natural state, not on the components of the gas that are later extracted."[98] The court continued " '[a]t the well' designates the point in the gas production process where market value is to be calculated on the gas used for the extraction of liquid products."[99] And, "[m]arket value is to be calculated the instant the gas is produced from the reservoir."[100]

The court similarly refused the royalty owners' claim that intrastate prices should be used to determine market value.[101] The court noted that neither party disputed the fact that the gas sold to United was gas sold in interstate commerce.[102] The issue, however, was the price to be calculated on gas "used," not sold. Finding no difference, the court held that "[s]ince the gas used to make liquid products was natural gas which, if sold, would be required to be sold in interstate commerce, this gas was subject to the maximum lawful price scheme . . . ."[103]

95. *Id.* at 400.
96. *Id.* at 395 (emphasis added).
97. 789 F.2d 1151, (5th Cir.), *reh'g denied*, 793 F.2d 1287 (5th Cir. 1986) (en banc).
98. *Carter*, 842 S.W.2d at 397.
99. *Id.*
100. *Id.*
101. *Id.* at 397-98.
102. *Id.*
103. *Id.* at 399.

3. Lease Covenants

In *Evans v. Gulf Oil Corp.*[104] the mineral interest owners sued Gulf Oil and others owning working interests and overriding royalties. The owners sought a declaratory judgment that their oil and gas leases had terminated due to failure of production in paying quantities. The trial court granted summary judgment for the defendants and the court of appeals affirmed, holding that the defendants had established as a matter of law that an essential element of the plaintiffs' case did not exist.[105]

Each lease continued in effect "for so long . . . as oil, gas or other mineral is produced from said land . . . or drilling or reworking operations are conducted thereon." The court noted that the term "produced" meant "produced in paying quantities,"[106] and that in order to prove a failure of same, the plaintiffs were required to show that (1) the production failed to yield a profit after deducting operating and marketing costs, and (2) a prudent operator, operating for profit and not speculation, would not have continued to operate the well as it had been operated, even if marginally profitable.[107]

As to the first element, the plaintiffs claimed that any computation of profit had to reflect that the defendants had owed them a higher price for their royalty gas than was paid. Further, the plaintiffs claimed that depreciation of a compressor used on the wells should have been considered in determining profitability. If both were considered part of the operating and marketing costs, the wells were unprofitable.

Although the court stated that the issue of "paying quantities" was usually one of fact, it held that what might have been paid for royalty gas was irrelevant, in that it was not an actual expenditure at the relevant times and in any event, would also have increased the amounts of revenue to the working interest proportionately.[108] The court further held that while actual depreciation could be added to "lifting expenses" as an operating cost, the plaintiffs in this case had done nothing more than compute depreciation as an accounting expense without regard to actual cost.[109] The court then concluded that while there may have been actual depreciation of this equipment which could have been a legitimate operating expense, it could be mathematically shown that its actual cost for the periods in question would not render the wells unprofitable.[110]

The defendants' proof being undisputed that revenues would exceed operating and marketing expenses for the periods in question, absent the charges

104. 840 S.W.2d 500 (Tex. App.—Corpus Christi 1992, writ denied).

105. *Id.* at 502.

106. *Id.* (citing Garcia v. King, 139 Tex. 578, 164 S.W.2d 509, 511 (1942); Bales v. Delhi-Taylor Oil Corp., 362 S.W.2d 388, 390-91 (Tex. Civ. App.—San Antonio 1962, writ ref'd n.r.e.); Fick v. Wilson, 349 S.W.2d 622, 625 (Tex. Civ. App.—Texarkana 1961, writ ref'd n.r.e.)).

107. *Id.* at 503 (citing the case of Clifton v. Koontz, 160 Tex. 82, 325 S.W.2d 684, 691 (1959)).

108. *Id.* at 504.

109. *Id.*

110. *Id.* at 505.

for increased royalty and depreciation, the court held that the plaintiffs had failed to raise a fact question as to whether the wells were unprofitable.[111] The court therefore affirmed the trial court judgment.[112] The question of whether a reasonably prudent operator would have continued operations was not reached.[113]

In *Exploracion de la Estrella Soloataria Incorporacion v. Birdwell*[114] the Eastland Court of Appeals held that the execution of a division order provided by a crude oil purchaser would not save leases that had terminated for lack of production in paying quantities under the doctrine of notification or revival.[115] The court stated that "[t]he doctrine of revival or notification holds that the subsequent execution of a formal document which expressly recognizes in clear language the validity of a lifeless lease revives the lease."[116] The division orders, which were executed to recover monies held in suspense by the purchaser for production occurring prior to the termination of the leases, did not contain any language granting an estate in land or that would effect a revival of the lease.[117] In addition, the court recognized that at least one case[118] has suggested that in the absence of an express grant, the mere execution of a division order will revive an oil and gas lease only if there has been detrimental reliance on the part of the lessee.[119] Without deciding whether detrimental reliance is an element of the doctrine, the court noted that detrimental reliance had not been shown in this case.[120]

Finally, the court held that the doctrine of repudiation, by which a lessee is relieved from any obligation to conduct any operation on the land to maintain the lease in force while a judicial resolution of the controversy between the lessee and lessor over the validity of the lease is pending,[121] would not excuse the lack of operations by the lessees.[122] The court noted that the leases had terminated by their own terms prior to the time that the lessors could have repudiated the leases.[123] The court therefore held that for the doctrine of repudiation to apply, the lease must be subsisting.[124]

In *Ice Brothers, Inc. v. Bannowsky*[125] the plaintiff took an oil and gas lease

111. *Id.*
112. *Id.*
113. *See* Peacock v. Schroeder, 846 S.W.2d 905 (Tex. App.—San Antonio 1993, no writ) (addressing lease termination and production in paying quantities issues closely aligned with those issues in *Evans*).
114. 858 S.W.2d 549 (Tex. App.—Eastland 1993, no writ).
115. *Id.* at 554.
116. *Id.* (citing Westbrook v. Atlantic Richfield Co., 502 S.W.2d 551 (Tex. 1973); Loeffler v. King, 149 Tex. 626, 236 S.W.2d 772 (1951); McVey v. Hill, 691 S.W.2d 67 (Tex. App.—Austin 1985, writ ref'd n.r.e.)).
117. *Id.*
118. Bradley v. Avery, 746 S.W.2d 341 (Tex. App.—Austin 1988, no writ).
119. *Exploracion de la Estrella*, 858 S.W.2d at 554.
120. *Id.*
121. *Id.* (citing Kothmann v. Boley, 158 Tex. 56, 308 S.W.2d 1 (1957); Cheyenne Resources, Inc. v. Criswell, 714 S.W.2d 103 (Tex. App.—Eastland 1986, no writ)).
122. *Id.* at 554-55.
123. *Id.* at 555.
124. *Id.*
125. 840 S.W.2d 57 (Tex. App.—El Paso 1992, no writ).

subject to a prior, unreleased lease owned by the defendant covering land in Runnels County. The plaintiff then filed suit for a declaratory judgment that the prior lease had terminated for lack of production. As stated by the court, the lease terms in question were, in part, as follows:

> The . . . Lease was for a primary term of three years commencing from its date and was to continue "as long thereafter as operations, as hereinafter defined, are conducted upon said land with no cessation for more than ninety (90) consecutive days." [O]perations was defined . . . as production of . . . gas . . . whether or not in paying quantities.[126]

The primary issue for the jury was whether production of gas had ceased for a period of more than ninety continuous days. The trial court properly instructed the jury that the term "production" means "actually taking gas from a well in a captive state and either placing the same in storage or marketing it."[127] The defendant presented several witnesses who each testified that on numerous occasions never more than sixty days apart, he had either heard or felt gas rushing through the lines at the wellhead, but that he had not followed the flow lines to see where the gas was going. The plaintiffs' witnesses all testified that there had been no sales for the period, no meters on the wellhead, no production, and no reports of production filed with the Texas Railroad Commission. The pipeline purchaser testified that it had permanently removed its meters more than a year prior to the date of filing suit.

The jury and trial court refused to find that production had ceased for a period of more than ninety continuous days. The court of appeals reversed and rendered for the plaintiff, holding that plaintiff had been entitled to a judgment notwithstanding the verdict.[128] The basis for the court's ruling was that evidence that gas may have been flowing was no evidence that it was being taken in a "captive state" (except illegally, perhaps) or that it was being stored or marketed.[129] The court reasoned that to infer that gas was being taken in a captive state and that it was being sold or stored would be to impermissibly base an inference upon an inference.[130]

In *Gray v. Helmerich & Payne, Inc.*[131] the Grays, mineral owners and lessors, sued the record leasehold owners for trespass and breach of contract, alleging that the lease under which the defendants claimed had terminated for lack of production at the end of its primary term.[132] The defendants alleged, and the trial court by final summary judgment agreed, that the lease had been perpetuated by the commencement of actual operations before the end of the primary term, and that no trespass could have occurred.

It was undisputed that actual operations had commenced before the expi-

126. *Id.*
127. *Id.* at 59.
128. *Id.*
129. *Id.* at 61.
130. *Id.* (citing Rounsaville v. Bullard, 154 Tex. 260, 276 S.W.2d 791, 794 (1955)).
131. 834 S.W.2d 579 (Tex. App.—Amarillo 1992, writ denied).
132. The breach of contract claim is not discussed in this Article. The facts surrounding the claim are not clear from the court's opinion, and the court's ruling upon the claim does not change the result of the opinion holding or the described.

ration of the primary term which were otherwise sufficient to perpetuate the lease under its "commencement of operations" clause.[133] It was also undisputed that Texas Railroad Commission rule 3.5(a)(1)[134] provided that "[o]perations of DRILLING . . . shall not be commenced until . . . (a) PERMIT has been granted by the commission and the waiting period, if any, has terminated . . . "[135] The issue before the court was whether the Commission rule would be implied as a part of the lease so that prior receipt of a permit from the Commission was necessary to make actual operations effective to perpetuate the lease.

Noting that it was an issue of first impression in Texas and rejecting contrary precedent in Michigan,[136] the court held that "[t]he Commission's function is to administer the conservation laws and, when in doing so by granting a permit to drill a well, it does not undertake to adjudicate property rights."[137] The court concluded that "[O]btaining the drilling permit was not a prerequisite to the preliminary drilling operations which, the parties agreed, otherwise perpetuated the Grays' lease beyond its primary term."[138]

Rogers v. Ricane Enterprises, Inc.[139] is the third opinion which has been written in this dispute.[140] The facts in the case are relatively simple, but the proper legal result to flow therefrom may nevertheless be difficult. The case involves an oil and gas lease dated May 31, 1937, from Dean to Wiggins covering 7,893 acres (base lease), which provided for a primary term of ten years and "as long thereafter as oil and gas . . . is produced. . . ." The lease also provided that after expiration of the primary term, and upon cessation of production, the lessee would have sixty days within which to commence operations. The lease was assignable by the lessee in whole or in part.

Production was soon achieved on the lease, which has continued and kept the entire lease alive through all times material to this case. Subsequently, Superior Oil Company acquired the base lease and on June 1, 1949, assigned a leasehold interest in 329.3 acres upon which there was no production to Western and others (Western). The assignment in paragraph 1, among other things, required Western to drill a well within thirty days at a location which would satisfy any then existing offset obligation, and failing to so drill would cause the assignment to "cease and terminate and . . . revert to and revest in

133. Paragraph 9 of the lease provided in pertinent part:
> Notwithstanding any contrary provision, if lessee commences mining, drilling or reworking operations on said land or on a consolidated leasehold estate at any time while this lease is in force, this lease shall remain in force as provided by any provision hereof and for any longer time during which said operations, or any additional operations, are prosecuted with no cessation of more than sixty consecutive days.

Id. at 580.

134. Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE § 3.5(a)(1) (Vernon Sept. 1, 1988).

135. *Id.* at 580.

136. Goble v. Goff, 42 N.W.2d 845 (Mich. 1950).

137. *Gray*, 834 S.W.2d at 582.

138. *Id.*

139. 852 S.W.2d 751 (Tex. App.—Amarillo 1993, writ granted).

140. *See* 772 S.W.2d 76 (Tex. 1989), and 775 S.W.2d 391 (Tex. App.—Amarillo 1989) for the previous opinions.

Superior . . . ."[141] In addition, the assignment provided as follows:

> 2.
>
> Western shall and hereby does assume and agree to perform and discharge all of the [base] lease obligations. . . . To this end, it is recognized by the parties hereto . . . that there now are a number of . . . off-set wells which Western shall protect against by the drilling of properly located wells on the . . . land.[142]
>
> . . .
>
> 5.
>
> In the event that the production of oil, gas . . . is developed . . . and Western desires to abandon or cease operating the same, Western shall notify Superior . . . and Superior may, at its election, require Western to transfer and assign to Superior . . . all of Western's right . . . to said lease . . . .
>
> . . .
>
> 7.
>
> Upon the termination of the rights of Western hereunder and/or with respect to the above described lease, as herein and in said lease expressly provided, or otherwise, Western shall deliver to Superior upon demand, a good and sufficient quit-claim deed and release. Any delay . . . of Western to deliver any such quit-claim and release shall in no way prevent such rights from terminating, and reverting to and revesting in Superior as herein expressly provided and contemplated.[143]

Western immediately drilled and completed a well which was marginally productive and ceased production in July 1961. Approximately one year before the well ceased production, on August 23, 1960, the then-president of Western, acting in his *individual capacity only*, assigned the lease to the 329.3 acres to the Dakota Company, a company in which Campbell was an officer and stockholder, in return for a promissory note and deed of trust. The assignment referred to a previous assignment from Western to Campbell, but neither the instrument nor evidence sufficient as a substitute was introduced. Through a series of conveyances thereafter, Ricane Enterprises, et al. (Ricane) ended up with an assignment of the lease, and in October 1979, drilled a successful well.

The plaintiffs, stockholders and other successors to the assets of Western whose charter was forfeited in 1965, filed suit in 1984 against Ricane in trespass to try title for possession of the land. According to the court, "[a]ll parties have agreed that Western is the common source of title to the subject property."[144] It was undisputed that Western conducted no operations of any kind after 1961. Apparently and remarkably, neither Superior nor its successor was a party to the litigation and at no time has it sought to enforce its rights under the base lease.

The trial was to a jury which answered eighteen different issues. Among

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141. *Rogers*, 852 S.W.2d at 754.

142. The Supreme Court of Texas had previously held that this clause imposed a covenant, not a condition which would by its terms, terminate the assignment. *Rogers*, 772 S.W.2d at 79.

143. *Rogers*, 852 S.W.2d at 754-55.

144. *Id.* at 755.

them were findings that Western "abandoned or ceased operating" the premises;[145] that Western "abandoned the purposes" of the assignment;[146] that Western had been the owner of all or part of the property since 1960; and that it had owned a one-third working interest. The court did not mention any other finding in its opinion. The court of appeals affirmed the trial court's judgment holding for the defendants.[147]

The basis for the court's judgment was that in a trespass to try title suit, the plaintiff was required to recover on the strength of its own title, not on the weakness of its opponent's title.[148] The court held that the plaintiff could not do so in light of its nonperformance of the terms of the assignment as found by the jury.[149] Having found that the plaintiffs could not prove their title, the court applied the "well established rule" that the effect of a take-nothing judgment in a trespass case vests title in the defendant and awarded title to the defendants.[150]

There are various weaknesses in the opinion, but perhaps the most glaring is a lack of standing in the defendants to assert the breach of a contract, i.e., the assignment, to which they are not a party. The effect is to allow a mere trespasser, albeit in good faith, perhaps, to retain possession of realty as against the true record owner thereof due to the latter's failure to prove performance of all covenants in his chain of title.

C. Issues Involving Governmental Regulation

1. Railroad Commission's Authority to Regulate

R.D. Oil Co. v. Railroad Commission of Texas[151] was an appeal by an oil operator from a district court decision upholding an order of the Commission ordering that eight oil wells operated by R.D. Oil be plugged for failure to properly cement the wells to prevent pollution as required by the Commission's "Statewide Rule 13."[152] The questions before the court were whether the Commission's order was supported by "substantial evidence," whether actual pollution, not potential, was required to be shown before an order to plug could issue, and whether the Commission's decision was a taking without due process. The court of appeals affirmed the district court's judgment upholding the Commission's order.[153]

The primary burden of the operator was to demonstrate that there was not substantial evidence in the record that the cementing job was a potential pollution hazard.[154] Expert witnesses for R.D. Oil and the landowner, who

145. *Id.* at 759.
146. *Id.*
147. *Id.* at 764.
148. *Id.* at 762-64.
149. *Id.*
150. *Id.*
151. 849 S.W.2d 871 (Tex. App.—Austin 1993, no writ).
152. *See* Tex. R.R. Comm'n, 16 Tex. Admin. Code § 3.13 (Vernon 1988) ("Statewide Rule 13").
153. *R.D. Oil Co.*, 849 S.W.2d at 871.
154. *Id.* at 872. *See* Administrative Procedure and Texas Register Act, Tex. Rev. Civ. Stat. Ann. art. 6252-13a, § 19 (Vernon Supp. 1993).

was the original complainant in the Commission, were heard on the subject. The landowner's experts testified that they had taken samples of cement from near the surface that was defective and that they could indicate defects in the lower zones, because if the cement had been properly pumped into the well, the cement would have been homogenous and uniform throughout.

R.D. Oil's experts testified that the surface samples of cement were not representative of cement quality in the "critical zone" of the wells and that cement quality improves with depth and age. They also tested cement samples taken from the "critical zone," but testified that due to the small size of the samples, it was impossible to conduct all of the testing necessary to show compliance with Rule 13. Based upon that testimony and the fact that the Commission had made an uncontested fact finding that R.D. Oil had used the proper method of pumping cement into the well, R.D. Oil argued that the evidence presented by the landowner did not constitute sufficient evidence to uphold the Commission's order. The court held, however, that "reasonable minds could have reached the decision the Commission made," and "[a]ccordingly, we conclude that there is substantial evidence in the record to support the Commission's conclusion that the wells were not properly cemented to prevent pollution."[155]

On the question of whether proof of actual pollution was required before the plugging order could issue, R.D. Oil argued that Sections 89.001 and 89.041 of the Natural Resources Code[156] controlled and required a finding of actual pollution. The court, however, held that the Commission had relied instead on Section 91.101 of the Code which specifically provided for orders to plug wells to prevent pollution, and that that could apply to potential pollution as well as actual pollution.[157] The court further found that there had been no taking without due process since there was substantial evidence of potential pollution, the prevention of which was a valid exercise of the police power.[158]

In *Railroad Commission of Texas v. Lone Star Gas Co.*[159] Lone Star Gas Company (Lone Star) and Enserch Gas Company (Enserch)[160] sued the Railroad Commission and the Attorney General of Texas seeking to declare Commission Rules 30(a)(1) and (5) and 34(h)(2-4) invalid on five separate grounds, three of which related to the Commission's statutory authority, i.e., the Texas Natural Resources Code, one of which complained that the rules disregarded the separate corporate existence of Lone Star and Enserch without notice, hearing or evidence, and the last that the Rules were preempted by federal law. The trial court dismissed Lone Star's case on other grounds, but the court of appeals reversed and rendered judgment on the ground that the Rules were preempted by federal law.[161] The Texas Supreme Court re-

155. *Id.*
156. TEX. NAT. RES. CODE ANN. §§ 89.001-.041 (Vernon 1978).
157. *Rogers*, 852 S.W.2d at 874.
158. *Id.*
159. 844 S.W.2d 679 (Tex. 1992).
160. Lone Star was a division of Enserch, a subsidiary of Enserch Corporation. *Id.* at 682.
161. *Id.*

versed and rendered.[162]

The targeted rules were adopted by the Commission in 1987 in response to the pipeline companies' creation of "special marketing programs," generally known as SMPs. The SMPs evolved as the pipeline industry's answer to its over-purchase of natural gas. The SMPs, in this case, Enserch Gas Company, were separate corporate entities created by the pipeline companies for the purpose of selling cheaper spot market gas to the pipeline company's customers who would not purchase from the pipeline company at the higher price. Rather than selling gas for which it had a long-term, higher-priced obligation at a lower price, and suffer a loss, the pipeline company would have the SMP buy gas on the spot market, or from the pipeline company's long term, higher-priced supplies, at a lower price. Concerned in part with the latter transaction, and with the leverage which the pipelines could bring to bear on their producers, particularly captive producers where no other line was available, and additionally with bringing the SMPs within the priority system concerning nominations, the Commission adopted the rules involved in this litigation. Among other things, the rules allowed a properly created and operating SMP to be treated as a separate first purchaser, even though it used the identical pipeline system. In so doing the rules recognized the existence of a separate and distinct gas market, i.e., the short term or spot market which is highly price-sensitive.

The rules then attempted to prevent the misuse of the SMPs. The SMPs were required to offer to purchase gas without discrimination within a field and without unjust or unreasonable discrimination between fields to all producers for all wells on the pipeline system of the affiliated pipeline. The SMPs were also prohibited from making their offers to purchase contingent upon a release by the producer of the pipeline company's take-or-pay or other obligation, except that the SMP could require that its future takes of gas be released from the pipeline contract and that its pipeline be given a volume credit against the pipeline's quantity obligation during the period of SMP purchases. The rules in general were also intended to prevent waste, promote conservation, protect correlative rights, and protect the priority system concerning nominations, purchases, and production of gas.

The court of appeals opinion[163] contains a more extensive description of some of Lone Star's and Enserch's arguments. The opinion makes clear that Lone Star's primary purpose in the case was to eliminate any State controls on gas purchasers which might have an effect on the cost and resale price of gas, including those imposing ratability requirements and the priority system of purchases. Lone Star was successful in obtaining a ruling that even though those rules were within the Commission's statutory authority and tended to prevent waste, promote conservation, and protect correlative rights, they were nevertheless contrary to the federal policy of promoting

162. *Id.* at 696.

163. Lone Star Gas Co. v. R.R. Comm'n of Tx., 798 S.W.2d 888 (Tex. App.—Austin 1990), *rev'd*, 844 S.W.2d 679 (Tex. 1992).

lower natural gas prices.[164]

The Texas Supreme Court agreed that the statutory authority contained sufficient guidelines, that the rules were within the Commission's statutory authority and consistent with that authority, overruling Lone Star's argument that questions concerning waste and discrimination were required to be determined on a case-by-case basis in a contested hearing after notice.[165] Citing *State Board of Insurance v. Deffebach*[166] for the proposition that " 'the process of rulemaking should be utilized except in those cases . . . [when] there is a danger that its use would frustrate the effective accomplishment of the agency's functions . . . . ' "[167] the court held that "the Commission is not required to determine questions concerning waste and discrimination by a contested case proceeding."[168]

The court also held that the rules did not disregard the separate corporate existence of Enserch and Lone Star.[169] Recognizing that it was dealing with one pipeline system only, the court noted that the rules applied only to the situation where both companies used the same pipeline and refused to qualify as separate "first purchasers."[170]

Finally, the court reversed the lower court on the question of federal preemption, concluding that "Congress has not comprehensively legislated through the NGA or the NGPA to occupy the entire field of intrastate natural gas regulation."[171] Having concluded that Congress did not intend to preempt all state regulation of the natural gas industry, the court then stated the issue to be whether there was a conflict between the Commission rules and the federal law regulating a pipeline purchaser's price structures and purchasing patterns.[172] Citing *Northwest Central Pipeline Corp. v. State Corporation Commission*[173] the court noted that there were two forms of conflict preemption, one being impossibility of compliance with both state and federal law, and the other being where the state rules "[stood] as an obstacle to congressional objectives regarding its natural gas policies."[174] Lone Star did not complain that it would be impossible to comply with both state and federal regulations, only that the state rules were an obstacle to congressional objectives.

The court first concluded that "the mere fact that state regulation impacts gas prices is insufficient to conclude that the Rules are preempted."[175] And further, "[a]lthough the Rules may have an incremental effect on natural gas prices, an incremental effect on price alone is an insufficient basis to preempt

164. *Id.* at 893.
165. *Lone Star Gas*, 844 S.W.2d at 688.
166. 631 S.W.2d 794 (Tex. App.—Austin 1982, writ ref'd n.r.e.).
167. *Lone Star Gas*, 844 S.W.2d at 689.
168. *Id.*
169. *Id.* at 689-90.
170. *Id.* at 690.
171. *Id.* at 694.
172. *Id.*
173. 489 U.S. 493 (1989).
174. *Lone Star Gas*, 844 S.W.2d at 694.
175. *Id.* at 695 (citing *Northwest Central Pipeline*, 489 U.S. at 514).

the Rules . . . . Furthermore, the supreme court does not require the lowest price. Only fair prices are required."[176]

Having thus found that the rules might permissibly have an "incremental" effect on gas prices without running afoul of federal policies, the court examined whether the rules could "plausibly be related to matters of legitimate state concern . . . . "[177] The court stated the issue as follows:

> More specifically, whether the Rules primarily regulate (1) rates of gas production or gas producers which fall within the State's traditional authority to regulate rates of production, conserve resources and protect correlative rights or (2) purchasing patterns of interstate pipelines of purchasers of gas for resale after transportation in interstate commerce which fall within the federal regulatory authority over transportation and rates.[178]

The court analyzed the purposes for the rules, which included (1) minimizing monopolistic abuses which occurred when SMPs purchased gas from producers on their affiliate's pipeline system;[179] (2) preventing discrimination and monopolistic abuses by common purchasers;[180] and (3) preventing waste.[181] The court found that those purposes were legitimate and traditional state concerns, that the rules were "plausibly related" to those concerns, and held that "(c)onsequently . . . we conclude that the Rules are not preempted by federal law."[182]

2. *Appealing Railroad Commission Orders*

The case of *EnRE Corp. v. Railroad Commission of Texas*[183] was an appeal from a district court judgment dismissing a suit for judicial review of a Railroad Commission order to an operator to plug four oil wells. The issue on appeal was whether a provision of the Texas Natural Resources Code[184] which required either the payment of a civil penalty or a bond in lieu thereof as a prerequisite to judicial review was unconstitutional as violative of the open courts provision of the Texas Constitution.[185] Holding the provision unconstitutional, the court reversed and remanded the cause for judicial review.[186]

The Commission's final order to plug the four wells also required the payment of an administrative penalty of $8000. The operator timely complied with all the prerequisites for judicial review except the requirement that the penalty be paid or a bond be posted to secure its payment. Citing a recent

176. *Id.* (citing Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board, 474 U.S. 409 (1986)).
177. *Id.* at 694 (citing *Northwest Central Pipeline*, 489 U.S. at 528).
178. *Id.* at 696.
179. *Id.* at 694.
180. *Id.*
181. *Id.* at 696.
182. *Id.*
183. 852 S.W.2d 661 (Tex. App.—Austin 1993, no writ).
184. TEX. NAT. RES. CODE ANN. § 81.0533(b) (Vernon 1978).
185. TEX. CONST. art. I, § 13.
186. *EnRe Corp.*, 852 S.W.2d at 665.

Texas Supreme Court case,[187] the court held as follows:

> Although the state may legitimately require a party to prepay the penalty or post bond if the party wishes to stay execution of the order during appeal, conditioning judicial review on such requirements does not comport with the open records provision . . . Accordingly, we declare section 81.0533(b) of the Code unconstitutional insofar as it requires a supersedeas bond or cash deposit as a prerequisite to judicial review. We further declare section 81.0533(d) of the Code, the forfeiture provision, unconstitutional.[188]

The case of *Jolly v. State*[189] also involved an order by the Railroad Commission to an operator to plug several inactive oil wells. The Commission's final order, entered December 18, 1989, was ignored by the operator for approximately two years, until this case was filed to enforce the Commission's orders.

The operator did not appear at the Commission hearing in which the final order was entered, did not file a motion for rehearing, and failed to bring suit for judicial review in district court. The Commission's order, therefore, became final.[190]

The trial court, after two separate hearings in which the operator was enjoined to plug the wells or suffer large civil penalties, finally entered a final judgment that ordered the operator to plug the wells within forty-five days, assessed a penalty of $75,000, and awarded attorney's fees.[191] The operator appealed, complaining that he was not the operator, that the Commission failed to allow him to bring witnesses to the hearing, that the Commission failed to consider "evidence" he submitted by mail, failed to review its own records, misled him about the nature of the hearing, and failed to join as parties the culpable operators of the wells.[192]

Finding that each of these complaints was, in fact, a collateral attack on the Commission's order, the court held that "the Commission's order was now final and unappealable."[193] The court continued that "[a] final order of the Commission that is valid on its face is not subject to collateral attack in a subsequent enforcement proceeding."[194]

3. *General Land Office Audits*

In *State v. Flag-Redfern Oil Co.*[195] the Supreme Court of Texas consoli-

187. Texas Ass'n of Bus. v. Texas Air Control Bd., 852 S.W.2d 440 (Tex. 1993).
188. *EnRE Corp.*, 852 S.W.2d at 664.
189. 856 S.W.2d 859 (Tex. App.—Austin 1993, writ denied).
190. *Id.* at 860.
191. In the final hearing before the Commission, a $6000 penalty had been imposed by the Commission. That penalty was increased to $36,000 in the first hearing before the district court.
192. The operator also argued that he failed to receive notice of the Commission, but failed to raise the objection until his motion for rehearing in the district court. The court held that the point had not been preserved for review.
193. *Id.* at 861.
194. *Id.* (citing Corzelius v. Harrell, 143 Tex. 509, 186 S.W.2d 961, 967 (Tex. 1945), and other authorities.)
195. 852 S.W.2d 480 (Tex. 1993).

dated two cases involving the authority of the General Land Office[196] (GLO) to determine contract rights under state mineral leases and the constitutionality of the requirement that lessees under state mineral leases prepay disputed assessments of deficient royalties to the state before filing an action to contest the assessment.

The four respondents, Flag-Redfern Oil Co., Rutherford Oil Corporation, Conoco Inc., and Ladd Petroleum Corporation,[197] Lessees under state mineral leases, were the subjects of audits by the GLO which resulted in assessments of deficiencies in royalty payments owing to the State of Texas. The assessments were based, in large part, on the GLO's determination that the subject leases were not "market value" leases and that royalties could not be based on gross proceeds. Initially, the Lessees requested hearings to contest the deficiencies, but before the hearings were concluded, filed lawsuits challenging the authority of the GLO to make legal determinations in the course of audits. In one action, the GLO was enjoined from proceeding with a hearing,[198] and both trial courts granted summary judgments for the Lessees, holding that the GLO cannot determine controverted property rights and that an "audit," as defined by statute,[199] was limited to an examination for accounting-type errors resulting in royalty deficiencies.[200]

The Texas Supreme Court held that neither the express wording of Section 52.135 of the Texas Natural Resources Code, nor the legislative history and purpose of the statute, supported the lower courts' holdings that GLO audits are confined to searches for accounting-type errors in royalty payments.[201] The court rejected Lessees' constitutional argument that the broader interpretation of audit would improperly empower the GLO to determine controverted property rights.[202] The court reasoned that because the State of Texas, as a lessor, is a party to the disputed leases, a hearing under Section 52.135 is "no different, in principle, from routine decision-making by any ordinary lessor," and is an not attempt by the state to adjudicate the relative rights of private parties.[203] The holding was limited, how-

196. The General Land Office (GLO) is an executive agency charged with maintaining state-owned properties, including audits of the books and records of oil and gas leases covering state lands.

197. Hereinafter referred to as "Lessees."

198. *Id.* at 482. *See* Rutherford Oil Corp. v. General Land Office, 776 S.W.2d 232 (Tex. App.—Austin 1989, no writ).

199. TEX. NAT. RES. CODE ANN. § 52.135 (Vernon Supp. 1993).

200. General Land Office v. Rutherford Oil Corp., 802 S.W.2d 65, 68-9 (Tex. App.—Austin 1990), *aff'd*, State v. Flag-Redfern Oil Co., 852 S.W.2d 480 (Tex. 1993); General Land Office v. Flag-Redfern Oil Co., 852 S.W.2d 539 (Tex. App.—Austin 1990), *aff'd*, State v. Flag-Redfern Oil Co., 852 S.W.2d 480 (Tex. 1993).

201. *Flag-Redfern Oil Co.*, 852 S.W.2d at 483.

202. *Id.* at 484. The Lessees' argument was based upon the Texas Constitution, article II, section 1, which provides, in part, that none of the three departments of state government shall exercise any power properly attached to another department, citing Board of Water Engineers v. McKnight, 111 Tex. 82, 229 S.W. 301 (1921), for the rule that only the judicial department may determine controverted property rights by binding judgments.

203. *Id.* at 484 (distinguishing Board of Water Eng'rs v. McKnight, 111 Tex. 82, 229 S.W. 301 (1921); R.R. Comm'n of Texas v. City of Austin, 524 S.W.2d 262 (Tex. 1975); and Magnolia Petroleum Co. v. R.R. Comm'n of Texas, 141 Tex. 96, 170 S.W.2d 189 (1943)).

ever, as follows: "To the extent that section 52.135 merely allows the State to reassess its position with regard to state mineral leases, rather than to subject participants to binding judgments, we hold that the statute does not offend . . . the Texas Constitution."[204]

The Texas Supreme Court then found that hearings under Section 52.135 of the Texas Natural Resources Code do in fact result in binding judgments, and are therefore unconstitutional, because judicial review is unavailable unless a lessee pre-pays the disputed assessment amount in full.[205] The court also concluded that the prepayment provision violates Article I, Section 13 of the Texas Constitution, as an unreasonable interference with access to the courts.[206]

Consequently, although the GLO cannot make a binding determination of controverted property rights, it may conduct full scale audits which include factual and legal determinations and hold hearings for the redetermination of deficiency assessments.[207] Section 52.137 of the Texas Natural Resources Code still governs the manner in which a lessee may challenge the GLO's determinations,[208] but a lessee may bring suit as provided in the statute, without prepayment of the assessment.[209]

D. JOINT OPERATIONS

1. Construction of Joint Operating Agreements

Stine v. Marathon Oil Co.[210] involves, primarily, the meaning of an exculpatory clause in a joint operating agreement (JOA)[211] between Stine and Marathon, covering wells operated by Marathon. Both Stine and Marathon acquired their leasehold interests through a farmout agreement from InterNorth, Inc. After suit was filed by Marathon against Stine for unpaid drilling and operating expenses, Stine counterclaimed alleging that Marathon tortiously interfered with his contract for the sale of his portion of gas produced to Cibolo Gas, Inc. and breached duties owed to him under the JOA in connection with testing and completion of wells. Stine also alleged that Marathon failed to drill exploratory wells, resulting in abandonment of lease acreage, and that under the JOA he was entitled to an assignment of that acreage. Marathon ultimately collected its operating and drilling expenses and the trial court realigned the parties. The district court subse-

204. *Id.* at 484.

205. *Id.*; *see* TEX. NAT. RES. CODE ANN. § 52.137(a) (Vernon Supp. 1993).

206. *Id.* at 485 (citing LeCroy v. Hanlon, 713 S.W.2d 335 (1986); Texas Assoc. of Bus. v. Texas Air Control Bd., 852 S.W.2d 440 (Tex. 1993)) (again referencing the open courts provision).

207. *Id.*

208. *Id.*

209. *Id.* Note, however, a concurring opinion by Justice Gonzales, agreeing that the Texas Natural Resources Code section 52.137 violates the open courts provision of the Texas Constitution, but arguing that a GLO audit should be limited to the plain meaning of the term, which does not include a legal inquiry, and that the audit described by the majority does allow the GLO to adjudicate controverted property rights. *Id.* at 487-88.

210. 976 F.2d 254 (5th Cir. 1992) (applying Texas law).

211. Hereinafter, the "JOA."

quently entered summary judgment for Marathon on Stine's claim that he was entitled to an assignment of acreage abandoned by Marathon. The remaining claims were tried to a jury which, in large part, found in favor of Stine.[212] Stine appealed the lower court's ruling on summary judgment and Marathon appealed the judgment entered on the jury findings.

Marathon contended that the exculpatory clause in the JOA[213] protected it from all of Stine's claims made under the JOA, unless its actions were grossly negligent or willful. The Fifth Circuit first found the exculpatory clause to be clear and unambiguous, and held that it protected Marathon for good faith performance of duties under the JOA, but did not protect it from liability for acts outside the scope of its powers under the agreement.[214] Because the lower court had not properly instructed the jury with respect to the exculpatory clause, the judgment in favor of Stine for breach of the JOA in connection with operation of the wells was reversed and remanded for new trial.[215]

The court also reversed and rendered[216] the judgment against Marathon for tortious interference with contract, acknowledging that "the assertion of rights under, or breach of, one contract may also at the same time be a tortious interference with 'a third party's contract if it is done with a purpose and effect of preventing the third party from performing its contract with another'."[217] While noting that the jury's finding of malice in connection

212. The jury found that Marathon breached its contract with Stine by not delivering operation of two wells to Stine before plugging and abandoning them; by not furnishing information as required; by failure to complete wells in potential oil sands; and by allowing water intrusion in certain wells through gross negligence or willful misconduct. Additionally, the jury found tortious interference with Stine's contract with Cibolo and that the interference was committed with actual malice.

213. The exculpatory clause states:

> A. Designation and Responsibilities of Operator: [Marathon] shall be the Operator of the Contract Area, and shall conduct and direct and have full control of all operations on the Contract Area as permitted and required by, and within the limits of, this agreement. It shall conduct all such operations in a good and workmanlike manner, but it shall have no liability as Operator to the other parties for losses sustained or liabilities incurred, except as may result from gross negligence of willful misconduct.

Stine, 976 F.2d at 259.

214. *Id.* at 260-61 (citing Caddo Oil Co. v. O'Brien, 908 F.2d 13, 17 (5th Cir. 1990); Grace-Cajun Oil Co. No. Two v. Damson Oil Corp., 897 F.2d 1364, 1366 (5th Cir. 1990); Spiritas v. Robinowitz, 544 S.W.2d 710 (Tex. Civ. App.—Dallas 1976, writ ref'd n.r.e.). The court stated:

> It is clear to us that the protection of the exculpatory clause extends not only to "acts unique to the operator," as the district court expressed it, but also to any acts done under the authority of the JOA "as Operator." This protection clearly extends to breaches of the JOA. It also reaches other acts including acts performed "as Operator" under the authority of the JOA that amount to tortious interference with contracts with third parties. We, therefore, hold that the exculpatory clause protects Marathon from liability for any act taken in its capacity "as Operator" under the JOA (except for gross negligence or willful misconduct).

Id.

215. *Id.* at 267.

216. *Id.* at 264.

217. *Id.* at 262 (quoting American Nat'l Petroleum Corp. v. Transcontinental Gas Pipe Line Corp., 798 S.W.2d 274, 279 (Tex. 1990)).

with Stine's tortious interference with contract claim would negate the protection of the exculpatory clause, the court held that Stine had not adduced any evidence of damage as a result of any tortious act of Marathon.[218]

Finally, the Fifth Circuit affirmed the district court's summary judgment that Marathon had not violated the JOA by failing to assign acreage to Stine in lieu of surrendering that acreage, as required by the JOA.[219] The court held that, to survive the summary judgment motion, Stine had to present some evidence that Marathon intended to surrender any lease or portion of a lease without offering to assign the acreage to Stine.[220] Finding that Stine failed to adduce such evidence, the court affirmed that both parties had an obligation under the JOA to preserve the leases by drilling wells or paying delay rentals,[221] and that a statement by Marathon that it did not intend to drill new wells, made as it attempted to negotiate a sale of its leasehold interests to a third party, is not evidence of an intent to surrender a leasehold interest.[222]

Calpetco 1981 v. Marshall Exploration, Inc.[223] involved the claims of non-operating working interest owners in a number of drilling ventures against the operator of the wells. Each well invested in by a non-operator was subject to a June 1981 joint operating agreement[224] and a letter agreement specific to the investment, governing the drilling, completion, production and operation of each well. The JOA attached an Exhibit "C," setting forth accounting procedures standard to the oil and gas industry, which provided that the investors may pay charges to the operator without prejudice to their right to later contest their validity. The JOA also provided that "all bills and statements issued in the course of a calendar year are 'conclusively . . . presumed to be true and correct' twenty-four months after the end of the calendar year in which they were rendered unless, within those twenty-four months, the non-operator . . . 'takes written exception thereto and makes claim on Operator . . . for adjustment'."[225] In addition, the JOA allowed the

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218. *Id.* at 263-64. The only damage claimed by Stine was his decision to terminate his gas contract with Cibilo. The court found that the one tortious act committed by Marathon occurred after Stine had terminated the contract and so could not, as a matter of law, have caused the damage alleged. *Id.* at 264.

219. *Id.* at 266. Article VIII.A of the JOA provided:

> The leases covered by this agreement, insofar as they embrace acreage in the Contract Area, shall not be surrendered in whole or in part unless all parties consent thereto.
>
> However, should any party desire to surrender its interest in any lease or in any portion thereof, and other parties do not agree or consent thereto, the party desiring to surrender shall assign, without express or implied warranty of title, all of its interest is [sic] such lease or portion thereof . . . to the parties not desiring to surrender it.

Id. at 265.

220. *Id.* at 265.

221. *Id.* at 266 (citing Ernest E. Smith, *Duties and Obligations Owed By An Operator to Nonoperators, Investors, and Other Interest Owners*, 32 ROCKY MTN. MIN. L. INST. 12-30, 12-49 (1986)).

222. *Id.* at 266.

223. 989 F.2d 1408 (5th Cir. 1993).

224. Hereinafter the "JOA."

225. *Id.* at 1410.

investors to audit the accounts and records of the operator, within the twenty-four month adjustment period, but an audit would not extend the time for filing written exceptions and demands for adjustment.

By early 1985, one or more investors began to question representations made by the operator between 1981 and 1984, and began to question some of the charges. Documentation was requested and extensive communications with the operator continued for almost two years, with the investors contending there were overcharges by the operator and the operator contending that the investors had not paid all amounts due.

After settlement attempts were unsuccessful, the operator filed suit seeking a declaration that the charges questioned by the investors were conclusively presumed correct under the two-year limitations period found in the JOA. The operator filed several motions for summary judgment, asserting various grounds, including that the investors claims were barred by either the contractual limitations period or the four year statute of limitations for breach of contract. The investors responded, in part, that the JOA accounting procedures did not apply to costs incurred before a well reached contract depth; that both limitation periods were tolled by the fraudulent concealment of overcharges by the operator; and that the operator had waived, or was estopped from asserting, the twenty-four-month limitation.

The Fifth Circuit held that the JOA and the letter agreements, having been "executed at the same time, with the same purpose and in the course of the same transaction" were to be construed together and were not ambiguous.[226] The court agreed with the ruling of the trial court that the accounting procedures, including the twenty-four limitation period, applied to the entire project, including drilling, rejecting the argument that because most of the drilling costs were turnkeyed[227] or were covered by the letter agreements, there was no need for a JOA accounting procedure in the drilling stage.[228] The court was unpersuaded by the statement in the JOA that it " 'shall govern operations on the subject leases after the test well has been drilled to contract depth,' " stating that the investors' interpretation would render meaningless other JOA provisions, i.e., that it shall be retroactive to the date of first operations, including drilling, and the accounting procedures for the billing of overhead during drilling.[229] Consequently, the court held that the contractual limitations period in the JOA did apply to costs incurred and charges made before a well is drilled and completed to the contract depth.[230]

The court then cited *Dotson v. Alamo Funeral Home*[231] for the rule that to

226. *Id.* at 1412 (citing Jim Walter Homes, Inc. v. Schuenemann, 668 S.W.2d 324, 327 (Tex. 1984)).

227. *Id.* at 1412 n.13. Under a turnkey arrangement, the investors paid the operator a fixed price to drill a test well to a particular depth, rather than a proportionate share of all costs incurred. *Id.*

228. *Id.* at 1412.

229. *Id.* at 1412-13.

230. *Id.*

231. 577 S.W.2d 308 (Tex. Civ. App.—San Antonio 1979, no writ).

establish fraudulent concealment, the investors must show that the operator had actual knowledge of the facts alleged to be concealed and the fixed purpose to conceal them.[232] Finding no summary judgment proof of an intent or purpose to actively mislead the investors, the court upheld the lower court's summary judgment that no limitations period had been tolled by fraudulent concealment.[233] Finally, the court also found a lack of summary judgment evidence to support claims that the operator had waived the limitation periods or was equitably estopped to assert them.[234]

Smith v. L. D. Burns Drilling Co.[235] involved a number of claims and counterclaims between the operator of an oil and gas well and his investors, as plaintiffs, and an oil and gas drilling contractor, as defendant.[236] On appeal were several summary judgments entered by the trial court.

The first issue addressed by the Waco Court of Appeals was whether Smith and his investors were joint venturers. The court cited *Ayco Development Corp. v. G.E.T. Service Co.*[237] for the elements of a joint venture,[238] and examined contracts between Smith and his investors for evidence of those elements.[239] The Joint Operating Agreement granted Smith direct control of all operations and expressly stated that it was not the intent of the parties to create, nor should the agreement be construed to create, a joint venture. In addition, the Subscription Agreement provided for payment by the investors of a fixed amount for a three percent ownership in the well, and the Private Placement Memorandum provided that Smith would bear the costs of drilling and completing the well over that fixed amount per investor. Because Burns did not assert in any summary judgment pleading that the investors actually exercised any joint participation, control or operation of the well, the court, upholding the trial court's summary judgment, held that the investors were not joint venturers as a matter of law.[240]

Having found that the investors and Smith were not joint venturers, and citing a lack of privity between the investors and Burns, the court also upheld a summary judgment in favor of Burns on the investors' claims for damage to the well.[241] The court states: "Burns owed no duty, whether contractual or in tort, to the investors . . . . [T]he investors cannot individually pursue claims arising out of Smith's relationship with Burns."[242]

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232. *Calpetco 1981*, 989 F.2d at 1413-14.
233. *Id.* at 1414.
234. *Id.*
235. 852 S.W.2d 40 (Tex. App.—Waco 1993, writ denied).
236. Smith and the investors alleged causes of action for breach of contract, negligence, gross negligence, and breach of express and implied warranties. Burns brought an action against Smith and the investors for breach of a daywork drilling contract by failure to pay for services rendered thereunder.
237. 616 S.W.2d 184, 186 (Tex. 1981).
238. *Smith*, 852 S.W.2d at 41. The elements are: a community of interest in the venture; an agreement to share profits; an agreement to share losses; and a mutual right of control or management of the enterprise. *Id.*
239. *Id.*
240. *Id.*
241. *Id.* at 42.
242. *Id.*

Finally, the court considered Burns claim that the damages sought by Smith were released or barred by the terms of the daywork drilling contract.[243] Without determining whether Smith's claims were consequential and thereby expressly waived under the terms of the contract,[244] the court held that Smith's claims were barred, as a matter of law, by the clause in the drilling contract providing that "[i]n the event the hole should be lost or damaged, Operator shall be solely responsible for such damages to or loss of the hole . . . " [245]

E. MISCELLANEOUS ISSUES

1. Gas Purchase Contracts

In *HECI Exploration Co. v. Clajon Gas Co.*[246] the Austin Court of Appeals construed a 1982 gas purchase contract containing a "take-or-pay" provision requiring the purchaser, Clajon, to purchase, or pay for if available for delivery and not taken, eighty percent of a daily contract quantity of gas.[247] If Clajon paid for gas not taken in an accounting period, Clajon could, in subsequent accounting periods, withhold payment for gas received in excess of a daily minimum amount. In addition, if Clajon had paid for gas not taken when the contract expired on December 31, 1984, it could, under certain conditions over the course of the following year, take an amount of gas equal to the unrecovered balance of the prepayments. If it was impossible for Clajon to recover enough gas to make up the prepayment, HECI could be required to refund the difference. Finally, Clajon agreed to design and operate a low-pressure pipeline system that would permit HECI to deliver gas at a specified maximum wellhead pressure. In 1987 HECI filed suit against Clajon alleging breach of the take-or-pay provisions and failure to design and operate the low-pressure pipeline. Clajon filed a counterclaim for declaratory judgment and pleaded affirmative defenses and failure of a condition precedent.

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243. *Id.*

244. The contract provided: "14.12 Consequential Damages: Neither party shall be liable to the other for special, indirect or consequential damages resulting from or arising out of this Contract, including without limitation, loss of profit or business interruptions, however same may be caused." *Id.* at 42.

245. *Id.* at 42.

246. 843 S.W.2d 622 (Tex. App.—Austin 1992, writ denied). Humble Exploration Company is HECI's predecessor-in-interest. *Id.* at 625.

247. The take-or-pay provision provided:

> Buyer agrees to receive and purchase, or pay for if available for delivery and not taken, and Seller agrees to deliver and sell to Buyer from Seller's Gas Reserves, all subject to the limitations and conditions herein elsewhere provided, during each Accounting Period, a quantity of Gas Well Gas equal to the aggregate of the Daily Contract Quantities for each well connected to Buyer's pipeline system and for all Gas which Buyer is obligated to accept.

Id. at 630.

"Daily Contract Quantity" is defined as " 'eighty percent (80%) of Seller's Delivery Capacity for [each] well.' " "Seller's Delivery Capacity" was defined in pertinent part as "the maximum quantity of Gas Well GAS which can be delivered to Buyer . . . under and subject to all valid conservation rules and regulations of regulatory authorities."

Id.

Both parties filed motions for summary judgment. In a series of rulings, the trial court denied HECI's motions, granted Clajon's motions and entered judgment that HECI take nothing on its claims against Clajon.[248]

In overturning the summary judgment entered by the lower court, the Austin Court of Appeals held that the contract provisions, read together, required Clajon to take, or pay for without taking, eighty percent of all gas HECI could deliver subject to valid conservation rules and regulations of regulatory authorities.[249] The court rejected, however, Clajon's contention that its take-or-pay obligation could never exceed eighty percent of the daily allowable fixed by the Railroad Commission of Texas for each well.[250] The court found that the contract did not expressly limit the take-or-pay obligation in that manner and held that it could not imply that limitation because daily allowables are not an absolute limit on production; as a well could be overproduced or underproduced for a period of time to adjust the correlative rights and opportunities of each owner.[251]

The Austin Court of Appeals also overturned the trial court's holding that the contract did not require Clajon to take, or pay without taking, any quantities of gas in excess of those quantities which could have been lawfully taken under the Texas Common Purchaser Act and the Railroad Commission ratable take requirements.[252] Clajon had failed to adduce summary judgment proof that the Texas Common Purchaser Act[253] and the ratable take requirements limited the amount that HECI could produce for the applicable years, and failed to prove that it took and paid for the maximum allowable under the act and regulations.[254] The court therefore found it unnecessary to reach HECI's argument that the Common Purchaser Act and the Railroad Commission's ratable take requirements were preempted by federal law.[255]

The appellate court also held that the lower court had erred in finding that HECI must, as conditions precedent to Clajon's take-or-pay liability, deter-

248. The court also entered a summary judgment awarding attorneys' fees to Clajon.

249. *Id.*

250. *Id.* at 630. The court stated, without supporting authority, that to uphold the summary judgment, the contract must either explicitly state that the Daily Contract Quantity was limited to Railroad Commission allowables or that meaning must be drawn by necessary implication.

251. *Id.* (citing TEX. NAT. RES. CODE ANN. § 86.090 (Vernon Supp. 1992); Valero Transmission Co. v. Mitchell Energy Corp., 743 S.W.2d 658, 663 (Tex. App.—Houston [1st Dist.] 1987, no writ)). In addition, the court held that even if accepted Clajon's interpretation of the contract, Clajon had failed to carry its burden of proof that: (1) it had taken eighty percent of the daily allowable for each well; and (2) that HECI's production had never exceeded the daily allowables or that HECI balanced its overproduction on one day or in one balancing period with underproduction in a subsequent day or balancing period. *Id.*

252. *Id.* at 631. Article V, Paragraph 12 provided:

> 12. Nothing in this Contract shall be construed to require Seller to deliver or Buyer to purchase and receive from Seller or pay Seller for any quantities of Gas in excess of that which may be produced under the applicable rules, regulations and orders of regulatory bodies having jurisdiction.

Id. at 631 n.11.

253. TEX. NAT. RES. CODE ANN. §§ 111.081-.097 (Vernon 1993).

254. *HECI Exploration Co.*, 843 S.W.2d at 631.

255. *Id.*

mine at the end of each accounting period that Clajon's takes were deficient, request payment and offer supporting data.[256] The contract did not expressly require an invoice at the end of each accounting and the court refused to construe the contract to impose a condition precedent resulting in a forfeiture.[257] The court also rejected Clajon's contention that time was of the essence of the contract, holding that time is not assumed to be of the essence of every oil and gas transaction,[258] and that the circumstances and language of the contract did not indicate an intent to make time of the essence for the assertion of a take-or-pay claim.[259] The court also noted that even if the lower court had been right about the conditions precedent, Clajon would still not be entitled to prevail as a matter of law, stating that the law imposes a reasonable time to fulfill a condition precedent in the absence of a specified time,[260] and that what constitutes a reasonable time is a question of fact.[261]

Finally, the Austin Court of Appeals found that Clajon had failed to prove as a matter of law that it was not obligated to design and operate a low-pressure pipeline under the terms of the contract.[262] HECI did not contest Clajon's contention that its obligation to construct the pipeline was dependent upon the availability of low-pressure gas.[263] The court held, however, that Clajon's summary judgment evidence, consisting of technical gas pressure data without expert or lay testimony to explain and interpret the data, did not as a matter of law prove the unavailability of low-pressure

256. *Id.* at 632. The contract provided in pertinent part:

> 4. At the end of each Accounting period:
>
> a. If Buyer shall have failed to take a quantity of Gas Well Gas equal to the aggregate of the Daily Contract Quantities required of it hereunder during such Accounting Period, then Buyer shall pay Seller, in accordance with subparagraph b. immediately below, for that quantity of Gas Well Gas equal to the difference between the aggregate Daily Contract Quantities applicable to such Accounting period and the sum of (i) any quantities of Gas Well Gas actually purchased and taken by Buyer From Seller hereunder during such Accounting Period, and (ii) any quantities of Gas Well Gas which Buyer was not required to take during such Accounting Period by reason of force majeure (such quantity resulting from such difference being herein called "deficient taking").
>
> b. If there is deficient taking as determined in subparagraph a. immediately above, then Buyer shall pay for the deficiency as if taken, such payment to be made within thirty (30) days after receipt of Seller's request therefor and data supporting the amount requested. . . .

Id.

257. *Id.* at 633 (citing Criswell v. European Crossroads Shopping Ctr., Ltd., 792 S.W.2d 945, 948 (Tex. 1990)).

258. *Id.* at 634. The court distinguished Investors Util. Corp. v. Challacombe, 39 S.W.2d 175 (Tex. Civ. App.—Waco 1931, no writ), holding that only time is of the essence in oil and gas leasing and drilling transactions, unless a contrary intention is stated.

259. *Id.* at 633-34.

260. *Id.* (citing Pearcy v. Environmental Conservancy, 814 S.W.2d 243, 246 (Tex. App.—Austin 1991, writ denied)).

261. *Id.* (relying upon Price v. Horace Mann Life Ins. Co., 590 S.W.2d 644 (Tex. Civ. App.—Amarillo 1979, no writ)).

262. *Id.* at 636.

263. *Id.*

gas.[264]

2. *Rule of Capture*

In *Russell v. City of Bryan*[265] the Houston Court of Appeals (Fourteenth District) held that neither the rule of capture nor the statute of limitations barred an attempt by Russell (and others claiming through her) to establish title to minerals underlying a ten acre tract of land deeded by her great-grandfather to the City of Bryan.[266]

A deed dated 1925 from Tyler Haswell, Russell's great-grandfather, to the City of Bryan, failed to expressly state whether Haswell intended to convey a fee simple or merely the surface rights to the tract.[267] In 1981, the City leased the mineral interests to North Central Oil Corporation, who pooled the tract with other acreage and produced oil and gas from a well located off of the disputed tract. Seven years later, Russell sued both the City of Bryan and North Central, contending that the City of Bryan owned the surface estate only and claiming ownership of the oil and gas attributable to the acreage.

The court first addressed the question of limitations, reversing a summary judgment granted against Russell on that issue.[268] The court held that although Russell had constructive notice in 1981 that the City intended to lease minerals underlying the disputed tract, by virtue to a legal notice published in a local newspaper, the notice was sufficient only to bar the claims of subsequent purchasers.[269]

The court then addressed the trial court's second ground for summary judgment, i.e., that the rule of capture is an absolute defense to liability. The court cited *Halbouty v. Railroad Commission of Texas*[270] for the rule that "[d]ue to the 'fugitive' nature of hydrocarbons, when captured they 'belong to the owner of the well to which they flowed, irrespective of where they may have been in place originally, without liability to his neighbor for damage.' "[271] This longstanding rule would seem to dispose of the case. The producing well for the pooled acreage is located off the tract deeded to the City of Bryan by Haswell, and any minerals underlying that tract that may have been drained by the producing well would legitimately belong to the

264. *Id.* The court also held that Clajon failed to establish as a matter of law the absence of fact issues relating to one or more of the elements of HECI's claim. *Id.*

265. 846 S.W.2d 389 (Tex. App.—Houston [14th Dist.] 1992, writ denied).

266. *Id.* at 390. The lower court had entered summary judgment in favor of the City of Bryan on affirmative defenses.

267. The deed consistently used the term "dedicate" to describe the grant.

268. *Id.* at 391. The trial court had previously entered a summary judgment that the Haswell deed did not retain an interest in the mineral estate. That summary judgment was also overturned on appeal. *See* Russell v. City of Bryan, 797 S.W.2d 112 (Tex. App.—Houston [14th Dist.] 1990, writ denied).

269. *Russell*, 846 S.W.2d at 391 (citing TEX. REV. CIV. STAT. ANN. art. 6631 (Vernon 1969)). In addition, the court ruled that Russell's summary judgment affidavit had raised the "rule of discovery" to prevent summary judgment on the question of limitations. *Id.*

270. 163 Tex. 417, 357 S.W.2d 364, 375, *cert. denied*, 371 U.S. 888 (1962).

271. *Russell*, 846 S.W.2d at 391.

owners of that well. The court held, however, that the rule of capture does not apply to production from land within a pooled unit. The court stated:

> [The City of Bryan] agreed to pool disputed tract with other land; accordingly, [it] received the disputed tract's share of distributions from the pool's production, and no hydrocarbons were "captured." . . . If it is determined at trial that grantor "dedicated" surface rights only to City, appellants have been prevented from exercising their rights as owners of the mineral estate, and appellees have wrongfully received the proceeds of appellants' share of production income under the pooling agreement.[272]

In *In re Hawn*[273] debtor John Hawn obtained a loan from a bank secured by his oil and gas properties in Texas. The parties executed a security agreement[274] and the Bank perfected its lien, as a real property mortgage and a Uniform Commercial Code Article 9 security interest.[275] A second bank succeeded to the first bank's interest,[276] and loaned Hawn an additional $100,000, secured by additional oil and gas properties in Texas.[277]

Several years after the banking transactions, the Internal Revenue Service[278] filed a Notice of Tax Lien in Nueces County assessing a 100% penalty for earlier personal income taxes. The IRS eventually attempted to levy Hawn's taxes and penalties from his bank, who received all oil and gas revenue attributable to Hawn's interest. The IRS conceded that the bank held a prior lien against oil and gas in the ground, but challenged the priority of the bank's lien against the oil and gas as produced.

The Bankruptcy Court held that the security instruments gave the bank a valid first priority security interest in the oil and gas in the ground and a valid first priority interest in any oil and gas produced.[279] Therefore, the bank had a "single continuous security interest that attached as a real estate lien while the minerals are in the ground and is converted into a Uniform Commercial Code security interest at the moment minerals are ex-

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272. *Id.* at 391-92. The court cites no supporting authority for its conclusion that the rule of capture is inapplicable to the case, stating that "none of the cases cited by appellees involve a situation in which a court has applied the Rule of Capture to property in a pooled unit." *Id.* Nor does the court cite support for its holding that if Russell and those claiming through her are found to own the minerals underlying the disputed tract, they would be entitled to a share of production income under the pooling agreement. *Id.* The authors suggest that there are a number of Texas cases which have applied the rule of capture in situations of voluntarily pooled or unitized tracts, holding that a non-drillsite owner whose interest has not been voluntarily pooled may not recover any share of production from the unit. *See, e. g.*, Sun Exploration and Prod. Co. v. Pitzer, 822 S.W.2d 294 (Tex. App.—Eastland 1992, writ denied); Donnan v. Atlantic Richfield Co., 732 S.W.2d 715 (Tex. App.—Corpus Christi 1987, writ denied); and Superior Oil Co. v. Roberts, 398 S.W.2d 276 (Tex. 1966).

273. 149 B.R. 450 (Bankr. S.D. Tex. 1993)

274. The agreement was entitled "Mortgage, Deed of Trust, Security Agreement, Assignment and Financing Statement." [hereinafter "Security Agreement"].

275. The assignment was publicly recorded in Refugio County, Texas.

276. American National recorded the transaction in Refugio County, Texas.

277. In 1986 Hawn and American National executed a "Transfer Order" whereby Hawn's proceeds from the wells were paid directly to the Bank by Hewit & Dougherty, the operator.

278. Hereinafter "IRS."

279. *Id.* at 455 (citing U.C.C. § 9-401(a)(2) and stating that "[o]il and gas in the ground thus is precisely the same property as oil and gas after extraction.").

tracted."[280] The court rejected the argument that rule of capture negated Hawn's ownership of oil and gas in place.[281] Citing *Stephens Co. v. Mid-Kansas Oil & Gas Co.*,[282] the court held that the fact that Hawn could conceivably lose title to some oil and gas by drainage and the rule of capture does not alter his full vested ownership interest of the oil and gas in place.[283]

3. Partnerships

In *McAlpin v. Sanchez*[284] a geologist and landman formed an oral partnership to acquire and develop oil and gas leasehold properties. Pursuant to the terms of their oral partnership agreement, after obtaining an oil and gas lease, they sold 75 percent of the leasehold interest to non-partner investors under letter agreements. The letter agreements stated they were not intended to create a partnership or joint venture, and provided that if a well became a commercial producer, a joint operating agreement would control. Additional leases were obtained, 75 percent of those leases were sold to non-partner investors, and the new leases were added to the "contract area" covered by the joint operating agreement.

After a complex series of transactions and disputes between the partners, the partnership was dissolved. Prior to the dissolution, McAlpin (the landman partner) and his wife obtained several oil and gas leaseholds in their own names which were not assigned to the partnership. MacGregor (the geologist partner) and the non-partnership investors filed suit, asking the trial court to declare the interests of the parties under the partnership, letter agreements and joint operating agreement and to impose a constructive trust upon two leases, covering 50 and 65.5 acre tracts, acquired by the McAlpins but not assigned to the partnership.[285] The jury generally found in favor of the plaintiffs,[286] and the trial court imposed a constructive trust upon both the 50 and 65.5 acre tracts leased by the defendants. On appeal, the McAlpins argued that the imposition of the constructive trust in favor of the investors, as opposed to McGregor, was improper.

Construing the undisputed terms of the partnership agreement, the Corpus Christi Court of Appeals upheld the judgment of the trial court imposing a constructive trust in favor of the investors, as well as McGregor.[287] The court cited *Ginther v. Taub*[288] for the proposition that a constructive trust is a legal fiction, arising in equity, to prevent a wrongdoer from profit-

280. *Id.* at 455 (citing *In re* Hess, 61 B.R. 977 (Bankr. N.D. Tex. 1986)).
281. *Id.*
282. 113 Tex. 160, 254 S.W. 290 (1923).
283. *Hawn*, 149 B.R. at 455.
284. 858 S.W.2d 501 (Tex. App.—Corpus Christi 1993, writ denied).
285. The McAlpins also counterclaimed for a declaratory judgment with regard to the interests of the parties in two additional leases, fraud by the investors, clouding of their title to leases and for drainage.
286. The jury found that the McAlpins made fraudulent and negligent misrepresentations and breached duties owed to McGregor, but found that the investors were estopped to complain of the McAlpins' actions, although this finding was disregarded by the trial court. The jury found against the McAlpins on their counterclaims.
287. *McAlpin*, 858 S.W.2d at 506.
288. 675 S.W.2d 724 (Tex. 1984).

ing from his wrongful acts.[289] While the court did not hold that McAlpin owed a fiduciary duty to anyone other than his partner McGregor, it determined that a constructive trust was an appropriate method to enforce McAlpin's duty, under the express (albeit oral) terms of the partnership agreement, to sell 75 percent all partnership leases to the investors.[290] However, the court took exception to the judgment of the trial court insofar as it required the parties' interests under the trust to reflect the pro rata interest of each party under the joint operating agreement,[291] holding that "rights and duties incident to a joint operating agreement only arise during transactions relative to lands and leases expressly covered by the agreement."[292] The leases which were the subject of the constructive trust had been proposed but never acquired by the partnership, had never been made a part of the "contract area" of the joint operating agreement, and so were not subject to the terms of that agreement.[293] Since McAlpin owed no duty to the investors under the joint operating agreement, the judgment was modified to reflect the parties' interests under the oral partnership agreement.[294]

II. LEGISLATIVE ENACTMENTS

The 73d Texas Legislature considered and passed numerous laws that directly and indirectly affect the production, transportation and storage of oil, gas and minerals in Texas. This portion of the Article addresses only those laws that have a direct impact on Texas oil, gas and mineral law, and does not review collateral issues such as new tax laws on oil and gas interests and properties, or environmental laws affecting oil and gas interests.[295] Taxation, environment, and miscellaneous laws collaterally affecting oil, gas and minerals, are covered by other articles in the SMU Annual Survey issue.

This section combines a discussion and analysis of bills passed by both the Texas Senate and the House of Representatives that have become laws.[296] The last segment of this portion of the article lists those laws that indirectly relate to oil, gas and minerals, but do not directly impact those issues addressed in the "Judicial Developments" portion of the Article.[297]

289. *McAlpin*, 858 S.W.2d at 507.
290. *Id.*
291. *Id.*
292. *Id.*
293. *Id.* at 508 (citing Rankin v. Naftalis, 557 S.W.2d 940 (Tex. 1977); Fugua v. Taylor, 683 S.W.2d 735 (Tex. App.—Dallas 1984, writ ref'd n.r.e.)).
294. *Id.* Under the partnership agreement, McAlpin and McGregor would each own 12.5 percent of the leases and the remaining 75 percent would be sold to investors in percentages to be determined at the time of sale.
295. *See infra* pp. 1479-81.
296. *See infra* pp. 1474-79.
297. *See infra* pp. 1479-81 wherein the laws are listed that only indirectly affect the oil and gas issues upon which this article concentrates.

A. LAWS: OIL, GAS & MINERALS

1. Leasing State-Owned Lands

The Texas Legislature[298] amended Section 32.002 and subsequent sections of the Natural Resources Code affecting the sale, lease and development of state-owned lands[299] for the exploration, development and production of oil, gas and other minerals.[300] The act permits for the solicitation of bids to lease state-owned lands and establishes the terms for such leasing.[301] At a minimum, the lease must provide for a 1/8th royalty on gross production and a bonus of at least $10 per acre.[302] The bidder must submit a separate bid for each separate tract to be leased.[303] Each lease granted shall be for a primary term not to exceed ten years.[304] The Bill also covers reworking and shut-in procedures, the effect of litigation involving a lease, leasing riverbeds and channels, lease ratifications, and lease forfeiture.[305]

2. Railroad Commission Hearings

The legislature only passed one law with a direct impact upon Texas Railroad Commission hearings. Senate Bill No. 141 amends Section 86.085 of the Natural Resources Code concerning statewide hearings to determine market demand and the potential volume of gas to be produced in a given period.[306] The new law is significant and, therefore, is set out in full below:

> On or before the 25th day of each month, the commission, after notice and hearing, shall determine: (1) the lawful market demand for gas to be produced from each reservoir during the following month; and (2) the volume of gas that can be produced without waste from the reservoir and each well in the reservoir during the following month.[307]

Because of the significance of this legislation, it became effective May 24, 1993, unlike other oil and gas related legislation that did not take effect until September 1, 1993.[308]

3. Pipelines

Two acts were passed by the legislature concerning pipelines.[309] First, the legislature passed a bill authorizing limited partnerships to act as common

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298. Hereinafter the "legislature."
299. The existing legislation in this section of the Natural Resources Code specifically sets forth the lands to which this section does not apply.
300. *See* Tex. S.B. 962, 73d Leg., R.S. (1993).
301. *Id.*
302. *Id.* (TEX. NAT. RES. CODE ANN. §§ 32.1072(1) & (2) (Vernon 1993)). *See also* § 52.022 requiring a royalty rate on production of not less than "one-eight of the gross production or the market value of the oil and gas produced." TEX. NAT. RES. CODE ANN. § 52.022 (Vernon 1993).
303. TEX. NAT. RES. CODE ANN. § 52.015 (a).
304. *Id.* § 52.021.
305. *Id.* §§ 52.023-53.162.
306. *See* Tex. S.B. 141, 73d Leg., R.S. (1993).
307. *Id.*
308. *Id.*
309. *See* Tex. S.B. 467, 73d Leg., R.S. (1993) and Tex. S.B. 1680, 73d Leg., R.S. (1993).

carrier pipelines.[310] The limited partnerships may transport oil, oil products, gas, carbon dioxide, salt brine, fuller's earth, sand, clay, liquefied minerals and other minerals set forth in Sections 111.019 through 111.022 of the Natural Resources Code.[311]

In Senate Bill No. 467, the legislature increased the penalty for pipeline safety violations from $10,000 per violation to $25,000 per violation, with a maximum civil penalty of $500,000.[312] The State Attorney General is authorized to enforce this provision to ensure that transporters of gas or pipeline facility operators maintain safe operations.[313]

4. *Creation of the Petroleum Storage Tank Advisory Committee*

Vernon's annotated civil statutes have been amended to create the Petroleum Storage Tank Advisory Committee, with nine committee members to "provide technical expertise to the [Railroad] commission regarding petroleum storage tanks and shall advise the commission in the adoption of rules pertaining to the commission's petroleum storage tank program . . . and for the licensing and regulation of installers and corrective action specialists."[314]

The law specifies the persons who shall serve as the nine committee members, all of whom are appointed by the governor. Those persons include: three (3) persons with experience in operating underground storage tanks; one (1) professional engineer; three (3) with experience in the installation of underground petroleum storage tanks; one (1) from the financial industry with experience in underground storage tank corrective action; and one member with experience in environmental protection, fire protection, or the operation and maintenance of underground storage tanks, who is not otherwise eligible for a license to operate an underground storage tank.[315] No more than three (3) of the committee members are to come from a single metropolitan area.[316]

5. *Underground Storage Facilities*

Establishing that the Texas Railroad Commission has authority over natural gas underground storage[317] facilities, and authority over surface and subsurface equipment used for the underground storage of gas, the legislature passed House Bill No. 2622.[318] The act does not apply to a storage facility that is regulated by the United States Department of Transportation utiliz-

310. Tex. S.B. 680, 73d Leg., R.S. (1993) (amending § 1.09 of the Texas Revised Limited Partnership Act. TEX. REV. CIV. STAT. ANN. art. 6132a-1 (Vernon 1993)).
311. Tex. S.B. 680, 73d Leg., R.S. (1993).
312. Tex. S.B. 467, 73d Leg., R.S. (1993).
313. *Id.*
314. *See* Tex. H.B. 1938, 73d Leg., R.S. (1993).
315. *Id. See* TEX. REV. CIV. STAT. ANN. art. 8900 (Vernon 1993).
316. *Id.*
317. *See* Tex. H.B. 2622, 73d Leg., R.S. (1993) (now TEX. REV. CIV. STAT. ANN. art. 6053-3). The act defines natural gas underground storage: as "the storage of natural gas beneath the surface in a formation, strata, or reservoir." *Id.*
318. *See id.*

ing its authority under the Natural Gas Pipeline Safety Act.[319]

The purpose of this legislation is to establish safety standards and practices, provide for inspection and examination of storage facilities, require routine reports, imposing civil and administrative penalties, and to limit the powers of municipalities and counties in regulating these kinds of facilities.[320] As part of the safety standards, the Commission is authorized to require all owners and/or operators of underground storage facilities to install safety devices, establish fire prevention procedures, educate employees in the safety and emergency procedures, and initiate procedures to prevent the release of hazardous substances that would be harmful to the public.[321] Failure to comply with this act will result in civil and possibly administrative penalties.[322]

6. *Salt Dome Storage Facilities*

In response to continued problems with leaks and explosions of salt dome storage facilities, House Bill No. 2016 created a new section of the Natural Resources Code.[323] The act covers the storage of hazardous liquids in salt dome storage facilities.[324] As with the natural gas storage act enacted by the 73d Legislature, the Act does not cover storage facilities governed by the Hazardous Liquid Pipeline Safety Act,[325] and prohibits local governments from enacting ordinances that conflict with the Act.[326]

The Act enables the Commission to inspect and examine salt dome storage facilities, and to require reports concerning the construction, operation and maintenance of the facility.[327] Failure to comply with the Commission's orders may result in civil and administrative penalties.[328] Persons or entities desiring to contest the assessment of penalties may challenge them by complying with the procedures set forth in the Act.[329]

7. *Aggregate Quarries and Pits*

In order to minimize the potential hazards that quarries and pits may cause if they are located near a roadway, the legislature amended Sections 133.003(13), (24), (25) and (26) of the Natural Resources Code.[330] The Act

319. *Id.* The Natural Gas Pipeline Safety Act regulates interstate pipeline facilities. 49 U.S.C. §§ 1671-1680.

320. *See* Tex. H.B. 2622, 73d Leg., R.S. (1993).

321. *Id.*

322. *Id.*

323. *See* Tex. H.B. 2016, 73d Leg., R.S. (now TEX. NAT. RES. CODE ANN. § 211.001 (Vernon 1993)).

324. *Id.* The act defines a "hazardous liquid" natural gas product to include petroleum or any petroleum or liquid natural gas product and any hydrocarbon in a liquid state. *Id.* The "salt dome storage of hazardous liquids" means "the storage of a hazardous liquid in any salt formation or bedded salt formation storage facility . . . ." *Id.*

325. 49 U.S.C. §§ 2001-2111.

326. TEX. NAT. RES. CODE ANN. §§ 211.002(a)-(c) (Vernon 1993).

327. *Id.* §§ 211.013 & 211.014 (Vernon 1993).

328. *Id.* §§ 211.031 & 211.033.

329. *Id.* § 211.033.

330. *See* Tex. H.B. 1968, 73d Leg., R.S. (1993).

specifies where the quarry or pit must be located, requires that the owner/operator obtain a safety certificate, and assigns responsibilities for abandoned or inactive pits.[331] A "roadway" is defined in the Act as "the part of the public road intended for vehicular traffic that consists of an improved driving surface constructed of concrete, asphalt, compacted soil, rock, or other material."[332]

Abandoned or inactive pits must have a barrier between the public road and the pit if the pit is located in an unsafe location.[333] The Commission may grant waivers from the barrier requirement if the owner/operator submits an application showing that a governmental entity obtained a right-of-way and constructed the roadway before August 25, 1991, and the pit has remained abandoned or inactive since the roadway was constructed.[334] Finally, the Act requires a safety certificate for all active, inactive and abandoned quarries and pits.[335]

8. *Salvage of Equipment for Wells Plugged by the State*

House Bill number 2705 amends the Natural Resources Code to provide additional regulations relating to the State's authority to plug wells that pose environmental hazards.[336] This Act entitles the State to plug wells that are inactive and are leaking substances that "cause a serious threat of pollution or injury to the public health . . . ."[337] The Commission is required to first give notice to the operator of the well that the Commission intends to plug the well and salvage all equipment associated with the well.[338]

If the Commission plugs the well, it has a first lien on the equipment associated with the well and may maintain a cause of action for all reasonable expenses incurred in plugging the well.[339] "The commission shall dispose of well-site equipment or hydrocarbons under this section at a price or value that reflects the generally recognized market value of the equipment or hydrocarbons, with allowances for physical condition."[340] Any monies recovered by the Commission from the sale of such equipment is to be deposited into the "oil-field cleanup fund."[341] Owner/operators may file a claim for funds against the "oil-field cleanup fund," by following the procedures set forth in the Act.[342]

9. *Liability for Plugging Abandoned or Non-Producing Wells*

An owner/operator who sells a well that was in compliance with the

331. *Id.*
332. TEX. NAT. RES. CODE ANN. § 133.003(24) (Vernon 1993).
333. *Id.* § 133.041(b).
334. *Id.*
335. *Id.* § 133.045.
336. *See* Tex. H.B. 2705, 73d Leg., R.S. (1993).
337. TEX. NAT. RES. CODE ANN. § 89.043(b) (Vernon 1993).
338. *Id.* §§ 89.043(c), (d) & (e).
339. *Id.* §§ 89.083(a)-(j).
340. *Id.* § 89.085.
341. *Id.* § 89.085(d).
342. *Id.* §§ 89.086 & 89.087.

Commission's rules regarding the plugging of a well that has been abandoned or ceased operation, passes the duty to correctly plug the well to the person or entity that acquires the right to operate and/or control the well.[343] If, however, at the time the well is sold, the owner/operator is not in compliance with the Commission's regulations, that owner/operator may still be liable for violations relating to the plugging of the well.[344]

10. Miscellaneous

a. Pipeline Easements

Senate Bill No. 172 added Section 111.0194 to the Natural Resources Code concerning the width of pipeline easements.[345] Specifically, any pipeline easement "created through grant or through the power of eminent domain . . . is *presumed* to create an easement in favor of the common carrier pipeline . . . that extends only a width of 50 feet as to each pipeline laid under the grant or judgment in eminent domain prior to January 1, 1994."[346] The Act does not apply to pipeline easements that rare granted under the terms of oil and leases authorizing the construction of gathering lines.[347] A party may rebut the fifty-foot easement requirement by showing that a greater width is reasonably needed.[348]

b. Regulation of Compressed Natural Gas & Liquefied Natural Gas

To "protect the health, safety, and welfare of the general public," the legislature authorized the Commission to adopt standards relating to "the work of compression and liquefaction, storage, sale or dispensing, transfer or transportation, use or consumption, and disposal of compressed natural gas or liquefied natural gas."[349] Prior to engaging in any activity regarding compressed natural gas or liquefied natural gas, all persons or entities must obtain a license from the Commission.[350] If a license is granted, appropriate workers' compensation insurance coverage is required, plus any other type of insurance coverage required by the Commission.[351] The Commission

343. Tex. H.B. 2484, 73d Leg., R.S. (1993) (section 89.002 of the Natural Resources Code).
344. *Id.*
345. *See* Tex. H.B. 172, 73d Leg., R.S. (1993) (TEX. NAT. RES. CODE ANN. § 111.0194 (Vernon 1993)).
346. *Id.* § 111.0194(a) (emphasis added).
347. *Id.* § 111.0194(b).
348. *Id.* § 111.0194(c). Specifically, reasons listed in the statute for an extension of the 50-foot easement include those "for purposes of operation, construction of additional lines under the grant . . . maintenance, repair, replacement, safety, surveillance or as a buffer zone for protection of the safe operation of the common carrier pipeline. . . ." *Id.*
349. *See* Tex. S.B. 576, 73d Leg., R.S. (now TEX. NAT. RES. CODE ANN. § 116.001 (Vernon 1993)). The Act defines "compressed natural gas" as "natural gas primarily consisting of methane in a gaseous state that is compressed and used, stored, sold, transported, or distributed for use by or through a CNG system." *Id.* § 116.001 (2). "Liquefied natural gas" is defined as "natural gas primarily consisting of methane in liquid or semisolid state." *Id.* § 116.001 (3).
350. *Id.* § 116.031.
351. *Id.* § 116.036.

may suspend or revoke a license if it finds violations or noncompliance.[352] "Any party to a proceeding before the commission is entitled to judicial review under the substantial evidence rule."[353]

B. TAXATION LAWS

1. House Bills[354]

a. Tex. H.B. 925, 73d Leg., R.S. (1993) (Ch. 998).

Amending chapter 23 of the Tax Code to provide that for ad valorem tax appraisal purposes, the future value of oil and gas interests must be based on the average price for product produced during the preceding calendar year.

b. Tex. H.B. 1735, 73d Leg., R.S. (1993) (Ch. 403).

Amending Subchapter B Chapter 23 of the Tax Code to provide that for ad valorem tax appraisal purposes, the appraiser must consider the cost of remediation of existing or potential environmental damage.

c. Tex. H.B. 1920, 73d Leg., R.S. (1993) (Ch. 285).

Amending Subchapter B, Chapter 11 of the Tax Code to exempt pollution control property from taxation.

d. Tex. H.B. 1974, 73d Leg., R.S. (1993) (Ch. 1014).

Amending the Tax Code by adding Chapter 204 providing for a $10,000 severance tax credit for new field discovery wells, if at least 521 such wells are drilled in 1994, and $25,000 per well if at least 721 such wells are drilled in 1994. A credit of $25,000 for each additional well in such new fields will apply if at least 842 discovery wells are spudded in 1994.

e. Tex. H.B. 1975, 73d Leg., R.S. (1993) (Ch. 1015).

Amending Section 202.052 of the Tax Code to provide a severance tax exemption for production from wells which have been inactive for three years.

f. Tex. H.B. 2007, 73d Leg., R.S. (1993) (Ch. 1016).

Relating to the regulation of liquified petroleum gas and of the inspection and testing of liquified petroleum gas meters; providing penalties.

g. Tex. H.B. 2723, 73d Leg., R.S. (1993) (Ch. 958).

Severance tax credit for "co-production" projects. [Compare to S.B. 100].

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352. *Id.* § 116.037.
353. *Id.* § 116.037 (g).
354. Hereinafter "H.B."

2. Senate Bills[355]

a. Tex. S.B. 466, 73d Leg., R.S. (1993) (Ch. 335).

Enhanced Oil Recovery severance tax relief. [Compare to H.B. 1084].

b. Tex. S.B. 548, 73d Leg., R.S. (1993) (Ch. 667).

Venue for protest of appraised value for multicounty pipelines. [Compare to H.B. 1645].

c. Tex. S.B. 894, 73d Leg., R.S. (1993) (Ch. 588).

Relating to the administration and enforcement of motor fuel taxes; providing penalties.

C. ENVIRONMENTAL LAWS

1. House Bills

a. Tex. H.B. 923, 73d Leg., R.S. (1993) (Ch. 793).

Creates an Energy Environmental Economic Policy Committee which is charged with an obligation to develop a comprehensive long term state energy policy.

b. Tex. H.B. 1431, 73d Leg., R.S. (1993) (Ch. 528).

Amending Chapter 502 of the Health and Safety Code to expand requirements for compliance with OSHA Hazard Communication standards regarding duty to provide employees with accessibility to information regarding hazardous chemicals. A workplace chemical list and MSDS information is required for hazardous chemicals used or stored in excess of 55 gallons or 500 pounds.

c. Tex. H.B. 2049, 73d Leg., R.S. (1993) (Ch. 485).

Relating to the representation of the general public on the Natural Resource Conservation Commission, the confidentiality of information submitted to The Texas Air Control Board, and the effective administration of air quality permitting programs, including compliance with Federal Clean Air Act requirements.

d. Tex. H.B. 2623, 73d Leg., R.S. (1993) (Ch. 810).

Amending Section 401.003 of the Health and Safety Code to define and include NORM, and giving the Water Commission jurisdiction over disposal of same generated during oil and gas production.

e. Tex. H.B. 2822, 73d Leg., R.S. (1993) (Ch. 883).

To add Chapter 113.2435 to the Natural Resources Code to provide that

355. Hereinafter "S.B."

the Commission may establish consumer rebate programs for purchases of appliances and equipment fueled by LPG or other environmentally beneficial alternative fuels.

2. Senate Bills

a. Tex. S.B. 271, 73d Leg., R.S. (1993) (Ch. 394).

Amending Sections 113.241 and 113.243 of the Natural Resources Code to permit the Railroad Commission to "implement conservation and distribution plans to minimize the frequency and severity of disruptions in the supply of alternative fuels."

b. Tex. S.B. 468, 73d Leg., R.S. (1993) (Ch. 28).

Carbon Dioxide pipeline safety regulation. [Compare to H.B. 843].

c. Tex. S.B. 737, 73d Leg., R.S. (1993) (Ch. 603).

Amending Section 113.241 of the Natural Resources Code to list natural gas as an "environmentally beneficial alternative fuel" eligible for research and promotion funding.

d. Tex. S.B. 1043, 73d Leg., R.S. (1993) (Ch. 992).

Amending Chapter 401 of the Health and Safety Code to give the Texas Natural Resource Commission jurisdiction over regulation of radioactive source material recovery, processing and disposal.

e. Tex. S.B. 1049, 73d Leg., R.S. (1993) (Ch. 776).

Prevention and cleanup of oil spills. [Same as H.B. 2188].

f. Tex. S.B. 1334, 73d Leg., R.S. (1993) (Ch. 914).

Amending Chapter 28.011 give the authority to the Water Commission to regulate the distribution of underground water.

D. Miscellaneous Laws

1. House bills

a. Tex. H.B. 520, 73d Leg., R.S. (1993) (Ch. 966).

Relating to the exclusion from coverage under the Texas Unemployment Compensation Act of services performed by certain landmen.

2. Senate Bills

a. Tex. S.B. 83, 73d Leg., R.S. (1993) (Ch. 660).

Relating to the payment date of certain public utility assessments and utility service and related service provided by or to the state agency or institution, or a local government.

b. Tex. S.B. 420, 73d Leg., R.S. (1993) (Ch. 664).

Relating to requiring a gas utility to refund illegal or unlawful compensation collected by the utility.

c. Tex. S.B. 498, 73d Leg., R.S. (1993) (Ch. 859).

Public Utility Commission Sunset Reauthorization Bill - This lengthy bill makes a number of substantive changes in agency procedure and jurisdiction. The partial deregulation of independent electric co-ops is of interest to oil and gas producers, who often pay rural electric co-ops a price for electricity which substantially exceeds the cost-of-service, and thereby subsidizes residential ratepayers in the service area. The proposed change would provide less PUC oversight in ratemaking review. There is special protection for any affected customer or group of customers which consume(s) at least ten percent of a utility's annual energy sales to any customer class - such customer or customer group is entitled to request PUC review of rates charged for service.

d. Tex. S.B. 640, 73d Leg., R.S. (1993) (Ch. 412).

Amending Section 66.73(a) of the Education Code to increase fees charged for filing copies of assignments of oil and gas leases issued by the Board for Lease of University Lands.

e. Tex. S.B. 779, 73d Leg., R.S. (1993) (Ch. 80).

Relating to liability of a licensed installer or servicer of certain liquified petroleum gas systems.

f. Tex. S.B. 966, 73d Leg., R.S. (1993) (Ch. 630).

Amending Section 111.019 of the Natural Resources Code to require that Common Carriers exercising the right of eminent domain shall have a duty to disclose to the landowner copies of the same tariffs and MSDS sheets concerning commodities to be transported as are required by agencies and statutes, and to require common carriers to send copies of spill reports to affected landowners by certified mail.