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OIL, GAS, AND MINERAL LAW

Richard F. Brown*

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I. INTRODUCTION

This Article focuses on the interpretations of, and changes relating to, oil, gas, and mineral law in Texas from November 2, 2005, through November 1, 2006. The cases examined include decisions of state and federal courts in the State of Texas and the Fifth Circuit Court of Appeals.¹

II. CONVEYANCING

In Arias v. Kerlin,² the parties litigated the title to Padre Island. While the case does not directly involve any oil and gas issue, it is an important title decision for titles originating when the United States contested Mexican sovereignty. Descendants of Padre Balli claimed that in 1999 they discovered that an 1847 “Tutor’s Deed” was fraudulent and ineffective to convey title because one of the children named in the deed as grantor, Jesus Balli, was twenty-two years old and married at the time of the conveyance. Because Jesus Balli was not a minor, his father could not lawfully enter into a deed on behalf of Jesus Balli. The defendant, Kerlin, filed a motion for summary judgment on multiple grounds, which the trial court granted, but, on appeal, was reversed and remanded.³

The Tutor’s Deed was signed on March 17, 1847, in Matamoros, Mexico, and confirmed by a Mexican court decree. “However, by late 1845, Texas had joined the United States, and American soldiers began occupation of the border area, including Padre Island, while the exact boundary

³ Id. at *1.
between Texas and Mexico remained in dispute.\textsuperscript{4} The parties agreed that, under Mexican law at the time, a male remained a minor until he either reached the age of twenty-five or married, but, under American law at the same time, a male became an adult at twenty-one.\textsuperscript{5} Therefore, one of the critical questions was which law applied. The court of appeals referred to case law for the general rule that title granted by the Mexican government on or before December 19, 1836, is good, and Mexican authority to grant lands in Texas north or east of the Rio Grande ended with the signing of the Treaty of Guadalupe Hidalgo on May 30, 1848. Title to land in Texas that the Mexican government acknowledged after December 19, 1836, is not given automatic recognition.\textsuperscript{6}

Kerlin cited \textit{Martin v. Weyman}\textsuperscript{7} to argue that jurisdiction of the Mexican State of Tamaulipas over the premises in dispute did not cease until May 30, 1848. \textit{Martin} confirmed Mexican authority over a disputed border tract in which Mexico retained \textit{de facto} jurisdiction. The court of appeals construed \textit{Martin} as standing for the premise that determining which country held \textit{de facto} jurisdiction is a fact question to be resolved on a case-by-case basis, and, in this case, there was some evidence that American troops had been occupying Padre Island since 1845.\textsuperscript{8} The court of appeals found that “Texas courts have held the Mexican government was divested of its jurisdiction over the disputed area possibly as early as 1836 and at least by 1845 or 1848,” and, therefore, “the Mexican court affirming the transfer of Padre Island in 1847 was most likely without jurisdiction over the property involved.”\textsuperscript{9} Moreover, because Kerlin had not provided sufficient evidence that the Mexican government retained jurisdiction, summary judgment was improper.\textsuperscript{10}

Any holding that determines the applicable law based on the status of troop deployments from 160 years ago presents obvious problems of proof and introduces uncertainty into land titles. It works against Kerlin in this case because, to prevail, he must show that Mexico did in fact retain jurisdiction over Padre Island in 1847.

In \textit{Garcia v. Garcia},\textsuperscript{11} the San Antonio Court of Appeals held that a deed’s general grant of “all” is not limited by a more specific description included in the deed. The grantor owned eighteen surface acres and an undivided 60.2395 oil-gas-and-other-mineral acres. The deed conveyed the following:

All that certain lot, tract or parcel of land, situated in the County of Zapata, State of Texas, more particularly described as follows, to-wit:

\begin{itemize}
  \item \textsuperscript{4} \textit{Id.} at *3.
  \item \textsuperscript{5} \textit{Id.} at *2.
  \item \textsuperscript{6} \textit{Id.} at *3.
  \item \textsuperscript{7} 26 Tex. 460, 465 (Tex. 1863).
  \item \textsuperscript{8} \textit{Arias}, 2006 WL 20778, at *3.
  \item \textsuperscript{9} \textit{Id.} at *4.
  \item \textsuperscript{10} \textit{Id.}
\end{itemize}
Eighteen (18) acres of land, more or less, undivided, being all out [sic] right, title and interest in and to 891.30 acres of land, more or less, in Porclones Nos. 34 and 35, Zapata County, Texas

* * *

... in this connection it is the intention of the Grantors herein to sell and convey to the Grantee herein all interest of every kind and character, and from whatever source acquired, in and to said entire 891.3 acre tract.\(^\text{12}\)

The court of appeals held that the deed was unambiguous and conveyed all of grantor’s interest.\(^\text{13}\) The court of appeals relied on existing authority\(^\text{14}\) for the principle that a broad, general granting clause that is a conveyance of “all” of the grantor’s interest will broaden a more specific, limited description. The court of appeals found that the description’s final clause was conclusive and that the rule of construction that the specific controls over the general only applies when there is a conflict or repugnance between the descriptions used.\(^\text{15}\) In this deed, there was no conflict, and “situations in which general grants cannot be given effect have not arisen frequently,” and “it only rarely happens that general grants cannot be given literal effect.”\(^\text{16}\)

In *Garza v. Prolithic Energy Co., L.P.*\(^\text{17}\), the San Antonio Court of Appeals analyzed two deeds raising the issues of (1) the mineral-royalty distinction and (2) the conflicting fractions and the “two-grant theory.” The deed forms at issue were the three-paragraph forms commonly used in the 1930s and 1940s that included a granting clause, a “subject to” clause, and a “future lease” clause.\(^\text{18}\) One of the deeds was to Claypool and denominated as a “Royalty Contract,” and the second was to Lee and denominated a “Mineral Deed.” The text used in the two forms was very similar. As a general rule, the name given to an instrument is not given controlling effect. The court of appeals disregarded the names, reached the same result favoring the grantees as to both deeds, and found that the interests conveyed were mineral interests.\(^\text{19}\) The Royalty Contract included in pertinent part the following three clauses:

1. In the granting clause, the Royalty Contract provided: “[A]n undivided one-half (1/2) interest in and to all the oil, gas, and other minerals in and under the [Property].... Together with the rights of ingress and egress at all times for the purpose of taking said minerals.”\(^\text{20}\)

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12. Id. at *1.
13. Id. at *4.
16. Id. at *4.
18. Id. at 145.
19. Id. at 139.
20. Id.
2. In the "subject to" clause, the Royalty Contract provided: "It is distinctly understood and herein stipulated that said land is under an Oil and Gas Lease made by Grantor providing for a royalty of 1/8th of the oil and certain royalties or rentals for gas and other minerals and that Grantor herein shall receive One-half (1/2) of the royalties and rentals provided for in said lease insofar only as said lease covers the land hereinabove described; but he shall have no part of the annual rentals paid to keep said lease in force until drilling has begun."21

3. In the "future lease" clause, the Royalty Contract provided: "It is further agreed that Grantee shall have no interest in any bonus money received by the Grantor in any future lease or leases given on said land, and that it shall not be necessary for the grantee to join in any such lease or leases so made; That Grantee shall receive under such lease or leases one-sixteenth (1/16th) part of all oil, gas and other minerals taken and saved under such lease or leases, and he shall receive the same out of the royalty provided for in such lease or leases, but Grantee shall have no part in the annual rentals paid to keep such lease or leases in force until drilling is begun.22

The warranty clause in the Royalty Contract warranted "all and singular the said minerals . . . ."23 The controversy arose in the usual manner: the existing one-eighth royalty lease terminated, and a new one-fifth royalty lease replaced it.24

The first issue was to resolve whether the interest conveyed was a mineral interest or a royalty. Grantee asserted that it was a mineral interest; therefore, Grantee was entitled to one-half of one-fifth of production. Grantor asserted that the interest conveyed was a fixed royalty of one-sixteenth of production.25 Analysis of the mineral-royalty distinction always begins with Altman v. Blake,26 which defines the five essential attributes of a severed mineral estate as: (1) the right to develop (the right of ingress and egress); (2) the right to lease (the executive right); (3) the right to receive bonus payments; (4) the right to receive delay rents; and (5) the right to receive royalty payments. Subsequent authority holds that the parties may choose whether to grant or reserve each of the attributes, and a "bare" mineral right stripped of all attributes except the right to receive royalty is, nevertheless, still a mineral interest.27 The reasoning is that carving out such rights is redundant and would be unnecessary if the instrument in question was intended to be a royalty deed. The court of appeals reasoned that this "Royalty Contract" was a mineral deed because it reserved in grantors at least the second, third, and fourth attrib-

21. Id.
22. Id. at 139-40.
23. Id. at 140.
24. Id.
25. Id. at 141.
26. 712 S.W.2d 117 (Tex. 1986).
utes (and possibly the first) of a mineral interest. The court of appeals also gave weight to the use of the words “in and under” in the granting clause, which usually refers to a mineral interest. The court of appeals found for the grantees but was silent as to the reference in the warranty clause to “the said minerals,” which was one of the points urged by the Claypool-Lee grantees.

The Mineral Deed to Lee was similar, except that the interest conveyed was 15/32 rather than one-half, and the “future lease” clause required a lease with a royalty of at least “the usual one-eighth” and “Grantee shall receive under such lease or leases 15/32 of 1/8 part . . . .” The court of appeals held that both deeds conveyed a mineral interest and then turned to the second question, which was to resolve conflicting fractions.

The Claypool-Lee grantees claimed that they were entitled to one-half of one-fifth and 15/32 of one-fifth, respectively. The successors to the grantor claimed that Claypool should get the “fixed royalty” of one-sixteenth and that Lee should get 15/32 of one-eighth. The successors to the grantors conceded that the granting clause conveyed a mineral interest but contended that, upon execution of the new lease, a portion of the royalty effectively reverted back to them. The court of appeals went through a tortured analysis of difficult cases constraining three-grant forms and chose to rule on the basis of a broad “four-corners” analysis. It acknowledged the reasons behind the development of the three-grant form, the typical royalty of one-eighth when the Royalty Contract and Mineral Deed were executed, and noted that there was nothing in those two conveyances that made it evident that two differing estates were being conveyed. The conveyances could be harmonized by holding that the grantees were to consistently receive a one-half and 15/32 interest, respectively, of whatever amount of royalty was paid under the future-lease clause. The court of appeals bolstered its conclusion by referring to the Mineral Deed, which clearly contemplated that future leases might have a royalty greater than one-eighth, but Lee would share in 15/32 of one-eighth under leases containing the “usual one-eighth.” Logically, a greater royalty would result in a greater interest to Lee.

It would be hard to say which phrase is more hated by title examiners: “two-grant theory” or “surface-destruction test.” The Garza court faced a difficult task in rationalizing cases construing these three-grant forms. The Garza result is probably a good one. When these forms were being used, royalties were almost always one-eighth, and it would be a very

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28. Garza, 195 S.W.3d at 142.
29. Id. at 137.
30. Id. at 147.
31. Id. at 140.
32. Id. at 142-43.
33. Id. at 143-45.
34. Id. at 145-46.
35. Id. at 146.
36. Id.
unusual and very creative grantor who actually intended two separate grants of differing interests.

In Ramirez v. Flores, the San Antonio Court of Appeals considered the reformation of a deed. Ramirez agreed to sell the surface and one-sixteenth of the mineral estate in certain land to Flores. After the sale closed, Ramirez discovered that the title company made a mistake, and that the deed transferred the surface estate and the entire mineral estate to Flores. Flores refused to correct the error.

A party is entitled to reformation of a deed when it can prove that it reached an agreement with the other party, but the deed contains a mutual mistake and does not accurately reflect the agreement that the parties entered into. A mutual mistake is “one common to both or all parties, wherein each labors under the same misconception respecting a material fact, the terms of the agreement, or provision of a written instrument designed to embody such an agreement.” It is well established in Texas that a scrivener’s failure to embody the true agreement of the parties in a written instrument is a “mistake” that is grounds for reformation on the basis of mutual mistake.

A senior escrow agent for the title company testified about the parties’ agreement at trial. She stated that the earnest money contract reflected that Ramirez agreed to convey the surface estate and one-sixteenth of the mineral estate to Flores. She also testified that, due to an oversight, the attorney preparing the deed was not furnished a copy of the earnest money contract, thus the warranty deed was erroneously drafted. Ramirez testified that the parties had not entered into subsequent agreements to alter or change the agreed upon terms of the earnest money contract. Flores testified that the warranty deed was consistent with an oral agreement reached between the parties after the earnest money contract was executed.

The signed earnest money contract provided: “This contract contains the entire agreement of the parties and cannot be changed except by their written agreement.” Texas law generally permits a written contract that is not required to be in writing to be modified by a subsequent oral agreement, even if the contract includes a clause prohibiting oral modifications. However, the earnest money contract that Ramirez and Flores entered into could not be modified by a subsequent oral agreement be-

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38. Id. at *1.
39. Thalman v. Martin, 635 S.W.2d 411, 413 (Tex. 1982).
40. Allen v. Berrey, 645 S.W.2d 550, 553 (Tex. App.—San Antonio 1982, writ ref’d n.r.e.).
42. Id. at *2-3.
43. Id. at *4.
44. Hyatt Check Builders-Engineers Co. v. Bd. of Regents, 607 S.W.2d 258, 265 (Tex. App.—Texarkana 1980, writ dism’d).
cause the law required that it be in writing. After reviewing the evidence, the court of appeals held that Ramirez was entitled to reformation of the warranty deed as a matter of law.

In Stewman Ranch, Inc. v. Double M. Ranch, Ltd., the Eastland Court of Appeals construed a deed reservation to determine whether it reserved one-half of the royalty in “the described lands” or only one-half of the royalty that the grantors then owned. Grantors did not own 100% of the royalty interests conveyed in the deed. Instead, they owned undivided interests of varying amounts under the several tracts conveyed. The deed contained the following reservation:

There is, however, excepted and reserved to the Grantors an undivided one-half (1/2) of the royalties to be paid on the production of oil, gas, and other hydrocarbons from the described lands which are presently owned by Grantors . . .

Grantors argued that the reservation was for one-half of the total royalties from the described lands, which, as to some tracts, would zero out the grantees because grantors did not even own one-half in certain tracts when conveyed. Grantors contended that they should win under the established rules distinguishing between reservations in the lands “conveyed” (which reserve a fraction of the mineral estate conveyed) and reservations in the lands “described” (which reserve a fraction of the minerals under the land described). The court of appeals refused to apply this rule because of the reservation’s unique language specifying lands “which are presently owned by Grantors.” If the clause modifies the preceding words “the described lands,” then the reservation operates to reserve one-half of the total royalties. If the clause modifies “royalties to be paid,” then the reservation means that the grantors retained only one-half of the royalty that they owned at the time of the conveyance.

To determine the clause’s meaning, the court of appeals referred to the basic rules of grammatical construction, including the doctrine of last antecedent. The restrictive dependent clause, “which are presently owned by Grantors,” would ordinarily refer to the last antecedent, “the described lands,” which would mean that the grantors win. But, the court of appeals also refused to apply this rule. The court of appeals held that the clause would be superfluous if it modified “the described lands” because

47. 192 S.W.3d 808 (Tex. App.—Eastland 2006, pet. denied).
48. Id. at 810.
49. Id.
50. Id. at 811.
52. See King v. First Nat’l Bank of Wichita Falls, 192 S.W.2d 260, 262-63 (Tex. 1947).
54. Id.
55. Id.
the sentence would not change if the clause was removed. The court of 
appeals reasoned that it must find a reference that would make the clause 
meaningful and that it could not ascribe a “futile” or “vain” purpose to 
the agreement’s words. Applying the clause to the phrase “one-half (1/2) of 
the royalties” harmonizes and gives effect to every part of the agree-
ment. The court of appeals held that the clause refers to and defines 
“one-half (1/2) of the royalties,” and that the grantors reserved an inter-
est in one-half of the royalties that they owned when they conveyed the 
lands.

The court of appeals effectively read the phrase, “which are presently 
owned by Grantors,” so as to convert a reservation of one-half of the 
royalties from the lands described to one-half of the royalties from the 
interest conveyed in the lands described.

In EOG Resources, Inc. v. Wagner & Brown, Ltd., the Corpus Christi 
Court of Appeals construed the meaning of a farmout agreement’s depth 
limitation, expressed as “the deepest producing interval as obtained in 
the test well.” Farmor retained the deep rights under a provision in the 
farmout agreement that provided:

The Assignment provided for above shall be limited in depth to 100 
feet below the deepest producing interval as obtained in the test well, 
shall be without warranty either express or implied and shall reserve 
to Longhorn all rights below the assigned depths, together with such 
rights as are necessary to Longhorn’s full enjoyment of the reserved 
deeper rights.

It was undisputed that the test well (Well #1) produced at depths between 
9,679 and 9,729 feet, which was in the Morris Sand geologic formation. The 
dispute arose when Well #2 produced from the Morris Sand at depths 
between 10,230 and 10,266 feet. Farmor contended that it held the deep 
rights below 9,829 feet; farmee contended that its interest followed the 
formation to the deepest part, plus one-hundred feet.

Farmee effectively claimed that the “producing interval” was the Mor-
riss Sand. The court of appeals disagreed and held that the qualifying lan-
guage “deepest producing interval as obtained in the test well” made it 
clear that the depth limitation was fixed, not a variable depth. The 
court of appeals noted that if they had intended to include the entire 
Morris Sand as found under the property, the parties could have referred 
to other readily available terms such as formation, horizon, field, reser-
voir, or stratigraphic layer.

56. Id. at 812-13.
57. Id.
58. Id. at 813.
60. Id. at 341.
61. Id. (emphasis added).
62. Id.
63. Id. (emphasis in opinion).
64. Id. at 345.
The case highlights the significant property rights that may turn on a few words used to express a depth limitation. A more common clause used to reserve deep rights would reserve “all rights 100 feet below the base of the Morris Sand formation as encountered at 9,729 feet beneath the surface in the wellbore of the [well].”

In First Permian, L.L.C. v Graham, the Amarillo Court of Appeals held that a preferential right reserved by the holder of a production payment terminated when the production payment was fully paid. Under the assignment in question, the grantors conveyed certain oil and gas leases for $500,000. Payment was in the form of $100,000 in cash and a production payment of $400,000 plus interest. The reserved interest terminated upon the final production payment. The assignment also contained a preferential right to purchase the leases. Successors to assignor and assignee contested whether or not the preferential right survived the termination of the production payment. The successor to assignor argued that the preferential right was a separate and independent covenant that was not terminated by payout of the production payment.

The court of appeals disagreed and held that the preferential right was intended to exist only so long as necessary to protect the interest of assignor, and assignor’s successors, in the full payment for the lease. It was uncontroverted that the preferential right in this case was a real covenant. The preferential right terminated because (1) a real covenant endures only so long as the interest in land to which it is appended and (2) only owners of the land that the covenant was intended to benefit can enforce it.

In Glover v. Union Pacific Railroad Co., the Texarkana Court of Appeals applied the doctrine of strips-and-gores and adverse possession to determine title to the minerals in a railroad right-of-way. Campbell owned a tract that straddled a railroad right-of-way, including the minerals beneath that right-of-way. Campbell executed separate deeds in 1904 conveying to others the acreage “north” and “south” of the railroad, but the deeds were silent as to the railroad right-of-way itself. At issue in this case was ownership of the six acres lying within the railroad right-of-way south of the centerline (“Campbell Tract”). Campbell’s 1904 conveyance as to the tract south of the railroad (“Nettleton Tract”) described the lands conveyed by metes and bounds, and as “bounded on the N. by the Right of way of the Texas & Pacific R.R. Co. . . .” Some of the successor owners of undivided interests in the Nettleton Tract (“Claim-
ants”) claimed the minerals in the Campbell Tract. Those minerals had been produced since 1931 by successor owners (“Defendants”), who claimed under a separate chain of title that originated in a 1931 oil and gas lease from Campbell’s widow on the Campbell Tract. In 1932, the railroad made an adverse possession claim, and the original oil company lessee conveyed a one-half interest to the railroad. As a final additional complication, there was also a 1932 quitclaim deed from the owner of a one-eighth interest in the Nettleton Tract to Defendants. Based on the quitclaim of the one-eighth interest, Claimants positioned themselves as co-tenants with Defendants in the Nettleton Tract, which, according to Claimants, included the Campbell Tract. Therefore, the general nature of the suit as brought by Claimants was not in trespass to try title, but rather for an accounting among co-tenants.

The court of appeals characterized the case as concerning “royalty interests,” but Claimants were seeking a share of production as an unleased co-tenant, not a share of royalty.

Claimants held record title to the centerline of the railroad. Because Campbell’s deed of the Nettleton Tract did not expressly reserve rights to the minerals under the Campbell Tract (railroad right-of-way), those minerals passed to his grantee under the presumption that a deed conveys land to the center of the right-of-way even when the deed describes the abutting land as extending only to the edge of the right-of-way. In fact, in 1940, the Texas Supreme Court reaffirmed this principle in a decision on Campbell’s lands north of the railroad. The doctrine of strips and gores “requires the strip (1) to be small in comparison to the land conveyed, (2) to be adjacent to or surrounded by the land conveyed, (3) to belong to the grantor at the time of the conveyance, and (4) to be of insignificant or little practical value.”

Defendants challenged on the fourth element, but the court of appeals said that the right-of-way had little value in 1904, before oil was discovered. Thus, Claimants held record title to the Campbell Tract.

The court of appeals then held that the Claimants lost their title to Defendants by adverse possession. Because the widow Campbell, as lessor, owned no minerals in the Campbell Tract, she and the original lessee were naked trespassers. Thus, the widow Campbell, the original oil company lessee, and the railroad were all naked trespassers. The oil company and the railroad then acquired the one-eighth quitclaim deed as to the Campbell Tract from Nettleton, which made them co-tenants with Claimants. Each co-tenant has the right to develop the minerals in the tract, subject to a duty to account to the other co-tenants. Therefore, it is

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74. Id. at 207.
75. Id. at 207 n.2, 210-11.
76. Id. at 211.
77. Id. at 212 (citing Rio Bravo Oil Co. v. Weed, 50 S.W.2d 1080 (1932)).
78. Glover, 187 S.W.3d at 212 nn.8-9, 219 n.22 (citing Cox v. Campbell, 143 S.W.2d 361 (1940)).
79. Id. at 212.
80. Id. at 212-13.
81. Id. at 213-14.
usually harder to perfect title by adverse possession against co-tenants because it is difficult to show that the production was "adverse."\textsuperscript{82}

Claimants first contended that Defendants could not meet their burden of proving that they actually \textit{possessed} the entire mineral estate because none of the Defendants were claiming the entire interest in the Campbell Tract. It is not clear, but, apparently, the court of appeals concluded that the claim of the Defendants under the widow Campbell's lease was to the entire mineral estate, regardless of the quitclaim of the one-eighth from Nettleton.\textsuperscript{83}

Claimants next contended that the possession was not \textit{adverse}. Before a co-tenant can begin to adversely posses the land, the co-tenant must repudiate the tenancy.\textsuperscript{84} But, actual notice is not required.\textsuperscript{85} The court of appeals said:

Such notice may be constructive and will be presumed to have been brought home to the co-tenant or owner when the adverse occupancy and claim of title to the property is so long-continued, open, notorious, exclusive and inconsistent with the existence of title in others, except the occupant, that the law will raise the inference of notice to the co-tenant or owner out of possession, or from which a jury might rightfully presume such notice. It is held that repudiation of the claim of a co-tenant and notice thereof may be shown by circumstances and that a jury may infer such facts from long continued possession of the land under claim of ownership and non-assertion of claim by the owner.\textsuperscript{86}

The court of appeals had no trouble finding sufficient constructive notice based on the Defendants' production and operations on the property for almost seventy years. Therefore, under the ten-year statute of limitations, Defendants perfected title by adverse possession.\textsuperscript{87}

Because the 1904 Campbell deed of the Nettleton Tract did not clearly cover the land to the center of the right-of-way, and because the widow Campbell and her lessees "re-entered" by virtue of the oil and gas lease, the court of appeals also held that estoppel by deed (grantor cannot claim adversely against grantor's own deed) did not bar Defendant's from taking adversely.\textsuperscript{88} Because either the two-year or four-year statute of limitations applies to suits for an accounting by a co-tenant, limitations would bar any claim for an accounting of production before Defendants acquired title by adverse possession.\textsuperscript{89}

\textsuperscript{82} \textit{Id.}
\textsuperscript{83} See \textit{id.} at 214.
\textsuperscript{84} \textit{Id.} at 215.
\textsuperscript{85} \textit{Id.}
\textsuperscript{86} \textit{Id.}
\textsuperscript{87} \textit{Id.} at 215-16.
\textsuperscript{88} \textit{Id.} at 216-17.
\textsuperscript{89} \textit{Id.} at 219-20.
III. LEASES AND LEASING

In *Bargsley v. Pryor Petroleum Corp.*, the Eastland Court of Appeals strictly construed a sixty-day clause limited to “drilling” and held that other “operations” will not preserve the lease. The lease clause provided:

If, at the expiration of the primary term of this lease, oil or gas is not being produced on the leased premises, but lessee is then engaged in drilling for oil or gas, then this lease shall continue in force so long as drilling operations are being continuously prosecuted on the leased premises; and drilling operations shall be considered to be continuously prosecuted if not more than sixty (60) days shall elapse between the completion or abandonment of one well and the beginning of operations for the drilling of a subsequent well. If oil or gas shall be discovered and produced from any such well or wells drilled or being drilled at or after the expiration of the primary term of this lease, this lease shall continue in force so long as oil or gas shall be produced from the leased premises.

The lessee’s activities included: long-stroking the existing oil well; laying a pipeline; doing electrical work; installing, checking, and repairing flow lines; replacing a tank; keeping the electricity on; and keeping the equipment on the lease. “While these activities under certain circumstances might be considered to be ‘operations,’ that is a question we do not address, as these ‘operations’ are not ‘drilling operations’ as a matter of law.”

The lease also provided:

In case of cancellation or termination of this lease for any cause, lessee shall have the right to retain under the terms hereof twenty (20) acres of land around each oil or gas well producing, being worked on or drilling hereunder.

Lessee argued that the lease should not have been terminated as to the twenty acres around each well that fell within this lease provision. The court of appeals reversed and remanded the summary judgment on the issue as to whether the oil well on the lease was “being worked on,” which was a fact question.

In *Cartwright v. Cologne Production Co.*, the Corpus Christi Court of Appeals held that post-production costs are deductible proportionately from the royalty interest under the lease and division order in question. The lessee, Cologne, ran the gas produced from the lease through gathering lines, treatment facilities, and compressors, all located on the leased

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91. *Id.* at 826-28.
92. *Id.* at 826.
93. *Id.*
94. *Id.* at 828.
95. *Id.*
97. *Id.* at 444-46.
premises. Compression was necessary to enter the sales pipeline. Co-
cologne deducted the treating and compression costs proportionately from
the royalty share.\textsuperscript{98} The court of appeals never quoted the royalty provi-
\begin{itemize}
  \item [99] The court of appeals never quoted the royalty provision from the 1922 lease, but the applicable division order read:
\end{itemize}

In making settlements for the interests of the undersigned in said
proceeds, you are authorized to use the net proceeds received by you
at the wells when the gas is sold at the wells; but if sold or used off of
the premises, you are authorized to use the market value at the wells
of the gas so sold or used off of the premises, such market value at
the wells is in no event to exceed the net proceeds received by you
from such sale.\textsuperscript{99}

The court of appeals relied on existing authority to describe the general
rule for the deduction of post-production costs:

Production costs are the expenses incurred in exploring for min-
eral substances and in bringing them to the surface. Absent an ex-
press term to the contrary, these costs are not chargeable to the non-
operating royalty interest. Whatever costs are incurred \textit{after} produc-
tion of the gas or minerals are normally proportionately borne by
both the operator and the royalty interest owners. These post-pro-
duction costs include taxes, treatment costs to render the gas market-
able, compression costs to make it deliverable into a purchaser's
pipeline, and transportation costs. The parties may, however, modify
this general rule by agreement.\textsuperscript{100}

The court of appeals found the “royalty provision language” in this
case to be indistinguishable from the division order in \textit{Judice v. Mewbourne Oil Co.},\textsuperscript{101} which held that “at the well” means before value
is added by preparing the gas for market.”\textsuperscript{102} In \textit{Cartwright}, the lessee
contended that the law applicable when the lease was executed should
govern at that time, and \textit{Pan American Petroleum Corp. v. Southland Royalty Co.},\textsuperscript{103} held that \textit{no costs} were to be deducted from the royalty
share.\textsuperscript{104} The \textit{Cartwright} court found \textit{Pan Am} to be distinguishable be-
cause (1) the issue there was the deductibility of compression costs, (2)
compression in \textit{Pan Am} was \textit{not} necessary to enter the pipeline, and (3)
the \textit{Pan Am} opinion merely held that there were “no properly deductible
items of expense.”\textsuperscript{105}

Thus, notwithstanding some of the uncertainty that has existed as to
the deduction of post-production costs since the decision in \textit{Heritage Re-
\textsuperscript{100} Id. at 444-45 (citations omitted).
\textsuperscript{101} Id. at 443.
\textsuperscript{102} Id. at 444-45 (Tex. 1966).
\textsuperscript{103} Id. at 137.
\textsuperscript{104} Id. at 134.
\textsuperscript{105} Id. at 519 (Tex. Civ. App.—El Paso 1965, writ dism’d).
\textsuperscript{106} Id. at 524-25.
\textsuperscript{107} Id. at 445.
\textsuperscript{108} 939 S.W.2d 118 (Tex. 1996).
cally re-asserted conventional wisdom on the deduction of post-production costs.

In *Chesapeake Operating, Inc. v. Denson*, the Amarillo Court of Appeals construed a lease amendment affecting leases previously owned by Texoma Natural Gas Company. Texoma acquired division orders that expressly amended the underlying lease and provided:

It is understood that at this time you are subject to and are paying an occupation or production tax of two per cent (2%) of the market value of gas produced and saved. If hereafter there shall be any increase in the amount of said tax, or there shall be levied any new occupation, production, severance or other excise tax, one-eighth (1/8) of such increase shall be deducted from the above agreed royalty value of the gas which is then applicable.\(^{108}\)

When the division order amendment was signed, the producer was obligated, by statute, to pay the production tax. The production-tax statute was later amended to obligate both producers and royalty-interest owners to pay their pro-rata share of the tax. The issue was whether the producer had the continuing obligation to pay all of the first two percent of the tax, or whether the royalty owner’s obligation to bear a proportionate part extended to and included the first two percent.\(^{109}\)

The court of appeals held that the royalty owner was obligated to bear a proportionate part of the tax only to the extent that it exceeded the threshold of two percent.\(^{110}\) The court of appeals reasoned that the amendment clearly provided that the sharing arrangement was only applicable to an increase in the tax, and subsequent statutory changes had no effect on the pre-existing contractual arrangement.\(^{111}\)

In *Tana Oil and Gas Corp. v. Cernosek*, the Austin Court of Appeals determined a class action royalty-accounting case on processed gas brought by lessors against their lessee under leases with several varieties of “net proceeds” or “amount realized” royalty clauses. Lessee entered into a field-wide gas purchase and processing (“POP”) contract with the gas processor in which lessee agreed to sell to the gas processor, at the well, all gas produced from the class members’ combined leases as well as the right to process the gas.\(^{113}\) In exchange, the processor agreed to pay lessee eighty-four percent of the combined monthly sales prices of the natural gas liquids extracted from the raw gas and eighty-four percent of the residue gas. The gas contract also obligated lessee to provide its proportionate part of gas at no cost to the gas processor for plant fuel and compression. Thus, this was an eighty-four percent POP contract on a wellhead sale with pricing and volumes determined at the tailgate of the

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108. *Id.* at 370.
109. *Id.* at 370-71.
110. *Id.* at 373.
111. *Id.* at 372.
112. 188 S.W3d 354 (Tex. App.—Austin 2006, pet. denied).
113. *Id.* at 356.
plant after deductions for line losses, fuel, and compression. A separate contract reimbursed lessee for compression, and lessee added those receipts to the amount it received under the POP contract and accounted on the total to its lessors for their royalty. The lessor class contended that they were entitled to royalties based on 100% of the gross metered volumes of gas sold at the well (that is, they should be paid on 100% POP, rather than 84% POP), that lessee should pay royalties on gas that the processor consumed, and that lessee had improperly burdened the royalty owners with downstream post-production costs. A judgment for the class of approximately $3 million was reversed on appeal.

Depending on the specific royalty provision in the applicable lease, the lessee was generally obligated to pay a fractional share of either the “amount realized” or “net proceeds” from its sale of gas at the well. The term “amount realized” has been construed to mean the proceeds received from the sale of the oil or gas. The lessee sold the raw gas to the processor at the well and received eighty-four percent of the resale price of the residue gas and extracted liquids after treatment. The class members argued that, since lessee was obligated to pay royalties on one-hundred percent of the total volume of gas sold at the well, they were entitled to royalties on the additional sixteen percent of the proceeds from the sale of the residue gas and the extracted liquids after processing, regardless of the fact that lessee did not receive, and was not owed, this portion of the post-processing sales proceeds under the contract.

The court of appeals found that the sale of raw gas at the well was separate and distinct from the third-party sales of the residue gas and extracted liquids on the open market. Lessee did not sell the residue gas or the liquids; lessee sold raw gas at the well before any value was added by preparing the gas for market. Therefore, “[t]his pricing formula represents the negotiated value of the raw gas.” Lessee did not receive one-hundred percent of all of the proceeds from the sales of the residue gas and the liquids. Instead, lessee received only eighty-four percent of all of the proceeds from the sales of the residue gas and the liquids. By paying the class-member lessors royalties on one-hundred percent of the money lessee actually received, lessee ultimately paid royalties on one-hundred percent of the total volume of raw gas sold at the well. Because lessee paid royalties based on the proceeds received, the court of appeals held that lessee did not breach the leases owned by the class members.

The court of appeals also held that the leases permitted the deduction of reasonable post-production costs. The class members argued that it

114. Id. at 357 n.4, 361 n.6.
115. Id. at 358-59.
116. Id. at 360.
117. Id.
118. Id.
119. Id.
120. Id. at 360-61.
121. Id. at 362.
was improper for lessee to deduct the compression and treating costs from the sales of the raw gas that lessee sold at the well. The court of appeals again stated that lessee was required to pay royalties on either the amount that it realized or its net proceeds from the gas at the well. The Texas Supreme Court has stated that the term “net proceeds” expressly contemplates deductions, while the phrase “at the well” means before value is added by preparing the gas for market. Therefore, the plain language of the applicable royalty clauses acknowledged that deductions may be necessary to determine the value of gas at the well. The post-production costs added value to the raw gas sold by lessee, and, if these costs are not deducted, then the class members’ royalties would be based on the proceeds that lessee received from the sale of the raw gas, plus the costs incurred to prepare the gas for sale on the open market. Thus, lessee’s net proceeds cannot be determined unless post-production costs are deducted, and no royalty is due on post-production expenses.

Similarly, the court of appeals also found that lessee did not breach the leases by failing to pay royalties on gas that the processor consumed. “We do not know, nor is it relevant, why [lessee] agreed to these terms. Our only concern is whether [lessee] fully complied with its obligations as stated in the lease agreements.” Under the lease, lessee was to pay the class members royalties on the net proceeds that it actually received from the sale of raw gas at the well.

The case clearly and firmly stands for the principle that the price payable for royalty purposes on a wellhead sale of gas may be determined by reference to a downstream point of sale and be contingent upon the price received at that point, that is, a classic POP contract. Under a “proceeds” lease, lessee must pay royalty on the full amount received by lessee, net of reasonable and necessary post-production costs. This was a summary judgment case, so no issues were presented on the reasonableness of such fees, nor were there any issues about affiliate sales.

In ConocoPhillips Co. v. Ramirez, the San Antonio Court of Appeals distinguished between statewide rules and field rules in the context of construing the application of a Pugh-type clause. The specific lease clause in this case provided:

At the end of five years after the expiration of the primary term hereof, Lessee covenants and agrees to execute and deliver to Lessor a written release of any and all portions of this lease which have not been drilled to a density of at least forty (40) acres for each produc-

122. Id. at 361.
123. Id. at 360 (citing Judice v. Mewbourne Oil Co., 939 S.W.3d 133, 137 (Tex. 1996)).
124. Id.
125. Id. at 361-62.
126. Id. at 362.
127. Id.
128. Id.
ing oil well and three hundred and twenty (320) acres for each producing or shut-in gas well from depths above 5,000 feet from the surface of the ground and 640 acres for each producing or shut-in gas well from depths below 5,000 feet from the surface of the ground except that in case any rule adopted by the Railroad Commission of Texas or other regulating authority for any field on this lease provides for a spacing or proration establishing different units of acreage per well, then such established different units shall be held under this lease by such production, in lieu of the units above mentioned.

The lessor argued that the Texas Railroad Commission adopted two rules—statewide Rules 37 and 38. In other words, lessor argued that the well in question held only forty acres, rather than 640 acres.\textsuperscript{130} Many leases have similar clauses, so the ruling in this case is very significant.

The court of appeals held that statewide Rules 37 and 38 apply to the field in which the gas well was drilled, but those rules were not adopted for this field.\textsuperscript{131} Therefore, ConocoPhillips was entitled to hold 640 acres surrounding the gas well.\textsuperscript{132} The court of appeals principally relied upon the procedural differences in establishing statewide and field rules as a basis for its holding.\textsuperscript{133} However, a more compelling reason is that to rule otherwise would make the clause meaningless. Statewide rules existed when the lease was executed, and, if they were to apply, the statewide rules would always trump the larger units specified in the lease, rendering that part of the clause meaningless.\textsuperscript{134}

In Wagner & Brown Ltd. v. Sheppard,\textsuperscript{135} the Texarkana Court of Appeals analyzed the rights of lessor and lessee under a terminated well-site lease in a pooled unit. Lessor owned a one-eighth interest in a 62.72-acre tract included in a pooled unit of 122 acres. Lessee pooled the lease, and drilled the Landers No. 1 on the lease as a producer. The lease terminated on March 1, 1997, and lessee then drilled the Landers No. 2 on the lease as a producer. It was undisputed that the lease terminated on March 1, 1997, and that the parties were thereafter co-tenants. At issue was the allocation of production, recoupment of historic costs, and recoupment of future costs.\textsuperscript{136}

Lessee contended that the pooling agreement was still in effect and that lessee should account to lessor as a co-tenant (rather than as a royalty owner) but on a pooled-tract basis (one-eighth of 62.72/122). Lessor contended that the lease terminated; therefore, the pooling agreement as to lessor terminated, and lessee should account to lessor as a co-tenant (rather than as a royalty owner), but on a tract basis (one-eighth). The issue was whether, after termination of the lease, lessor’s mineral interest

\textsuperscript{130} Id. at *1.
\textsuperscript{131} Id. at *2.
\textsuperscript{132} Id. at *3.
\textsuperscript{133} Id. at *2.
\textsuperscript{134} Id. at *3.
\textsuperscript{135} 198 S.W.3d 369 (Tex. App.—Texarkana 2006, pet. filed).
\textsuperscript{136} Id. at 372-73.
was still subject to the pooled unit. A pooling is ordinarily a cross-conveyance of real property interests, which means that all parties share in proportion to their contribution to the pool. The court of appeals in this case concluded that it did not have to analyze the consequences of unscrambling a cross-conveyance of real property interests because the lease in this case contained specific language that the pooling by the lessee would not result in a cross-conveyance among the participants in the pool. The division of royalty payments was dictated by the lease, not by underlying real property concepts. Therefore, the lease was a transfer of an interest in reality to the lessee, but the pooling was not a transfer of an interest in reality to the other participants in the pool. The lease created a determinable fee, it terminated, lessee could pool no more than lessee owned, and lessee only had an ownership interest until the lease terminated. Moreover, the "pooling agreement" in this case transferred "only lessee's interest—a determinable fee—that ceased when the lease terminated." Therefore, the pooling was no longer effective as to the interest of lessor under the terminated lease. The opinion does not address whether the pooling is still effective as to the other participants in the pool.

The Landers No. 1 was drilled and completed as a producer before lease termination. A lessor has no liability for costs that the lessee incurs. After the lease terminated, lessor, as an unleased co-tenant, was obligated to bear lessor's share of costs and expenses before sharing in any revenues. The court of appeals held that lessee could recoup one-eighth of costs incurred after lease termination, but lessee could not recoup for any costs incurred before lease termination.

Lessees also attempted to deduct certain expenses generally described as "leasehold, land-legal, and overhead expenses," which the trial court denied. The court of appeals agreed on procedural and evidentiary grounds but commented on the limited right of recovery. Certain types of expenses are recoverable from co-tenants, but those expenses must be reasonable and necessary, and they must benefit the co-tenancy. In the oil and gas context, the Texas Supreme Court has held that the extracting tenant must account for the value of the minerals taken, less the necessary and reasonable costs of production and marketing. Lessee cannot deduct for unsuccessful reworking operations or for dry holes.

137. Id. at 374-76 (citing the leading cases Montgomery v. Rittersbacher, 424 S.W.2d 210, 213 (Tex. 1968), Brown v. Smith, 174 S.W.2d 43, 46 (1943)).
139. Id. at 376 n.5.
140. Id. at 377.
141. Id.
142. Id.
143. Id. at 378.
144. Id. at 379.
145. See Byrom v. Pendley, 717 S.W.2d 602, 605 (Tex. 1986).
146. Wagner & Brown Ltd., 198 S.W.3d at 378.
Lessee had performed a workover on the Landers No. 1, which cost $592,000 and generated $10,000 in revenue over two years. Lessee contended that it should be able to recoup or deduct reasonable and necessary expenses on a tract basis rather than well-by-well. The court of appeals found no precedent directly on point, but all prior cases generally spoke to recoupment as to wells rather than as to a tract. Therefore, the court of appeals concluded that the recoupment rules applied to work on individual wells, not to the tract in general. The court of appeals also said that lessee could not recover because the failed re-entry was of no benefit to the co-tenancy.

The case is significant because it addressed in some detail the issues remaining between lessor and lessee on a terminated-but-producing well-site lease included in a pooled unit. The opinion avoids an analysis of the basic concept of a cross-conveyance of realty and the effect on that cross-conveyance of a lease termination. The case also does not address the rights and obligations of the other participants in the pool.

IV. OPERATING AGREEMENTS AND OPERATIONS

In Seagull Energy E & P, Inc. v. Eland Energy, Inc., the Texas Supreme Court determined whether the sale of a non-operating working interest that is subject to an operating agreement releases the seller from its obligations to the operator under the operating agreement. Seagull, as operator, sued Eland as non-operator, and its assignee, Nor-Tex, when Nor-Tex failed to pay certain joint-interest billings. Eland refused to pay because it no longer owned an interest in the leases. The trial court awarded judgment to Seagull on summary judgment against Eland and Nor-Tex, jointly and severally, for more than $268,000, plus interest and attorney’s fees. Eland appealed.

The supreme court reviewed several provisions in the operating agreements and found that none of them explicitly provided what would happen when there was an assignment of a working interest to a third party. As a general rule, a party who assigns its contractual rights and duties to a third party will remain liable unless the other contracting party expressly or impliedly releases them. Because the operating agreement did not expressly provide that Eland’s obligations would terminate upon assignment of the agreement and because Seagull did not expressly release Eland from liability following the assignment of its working interest, the supreme court held in favor of Seagull.

In Duke Energy Field Services v. Meyer, the Amarillo Court of Appeals reversed a jury verdict for damages to cattle caused by a pipeline
The pipeline easement provided that the pipeline company would “pay [landowner] for any other or additional damages to growing crops, grass, fences, improvements, and livestock which may result of the exercise of the rights” granted in the easement.155

Meyer, who had forty-five cows on the land, went to his pasture where he saw his cows standing in a black-green oily product. He saw them licking and rubbing their noses in it. One cow aborted the next day, and, over a period of time, thirty cows aborted or had dead calves. The next year, seventeen of the thirty-nine remaining cows were barren or had calves that died.156

The court of appeals found that the evidence was legally sufficient to support the finding of causation, even though Duke argued that expert testimony was necessary to establish causation, because Duke failed to object to the testimony.157 But the court of appeals found the evidence to be factually insufficient to support the finding of causation because several other conditions or events could have caused the cows to abort, and there was no evidence to show that one was more probable than the other.158 The case highlights the proof required in a case involving oil spills and injury to livestock.

In Stephens v. Finley Resources, Inc.,159 the Amarillo Court of Appeals held that a saltwater-disposal agreement granting lessee authority to dispose of saltwater from off-lease wells on the leased premises did not affect or limit lessee’s implied and express rights under the lease to dispose of saltwater from lease wells on the leased premises.160 The oil and gas lease was executed in 1945. In 1984, lessor and lessee agreed to allow the lessee to use a lease well as a disposal point for salt water from off-lease wells in exchange for a rental payment to lessor.161 Lessee later cancelled the agreement, stopped paying the rental, but continued to inject lease water into the well.162

The court of appeals relied on existing authority to reject lessor’s claim that the 1984 agreement limited Finley’s rights to dispose of saltwater. A lessee has an implied right to dispose of saltwater produced from lease wells in conjunction with performing its contractual obligations and may do so by injecting it into an oil and gas well on the leased premises, assuming that the lease does not expressly provide otherwise.163 Lessee had the “right to use so much of the land as was reasonably necessary in the production of oil and since the production of oil necessarily involved

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154. Id. at 154.
155. Id. at 151.
156. Id. at 151-53.
157. Id. at 153.
158. Id. at 154.
160. Id. at *1-3.
161. Id. at *1-2.
162. Id. at *1.
163. Id.
its separation from salt water, [lessee] would have the right, ordinarily under the implied terms of the lease, to use the land for that purpose . . . ."\textsuperscript{164}

Lessor did not challenge the underlying implied or express right that the lease granted, but contended that the 1984 agreement supplemented that right, relying on specific language in the agreement.\textsuperscript{165} The court of appeals rejected that argument because the 1984 agreement did not mention the mineral lease, nor did it expressly state that the agreement was intended to negate or limit the rights given to the lessee under the mineral lease.\textsuperscript{166} The court of appeals did place special emphasis on the lease clause granting lessee water rights, which provided that “lessee has the right to use water from said land, except water from lessor’s wells, for all operations . . . including repressuring, pressure maintenance and recycling . . . .”\textsuperscript{167}

The court of appeals held that, once the 1984 agreement terminated, lessee no longer had the right to use the lease well for disposal of off-lease saltwater; however, lessee’s right to dispose of saltwater from lease wells was still in effect.\textsuperscript{168}

Lessors and lessees frequently enter into agreements ancillary to operations on the lease to address matters not covered by the lease or to clarify, expand, or limit rights and obligations related to the lease. This case illustrates the inherent risk that such an agreement may be construed to conflict with express or implied lease terms. This suggests that the draftsman should consider when and how to use concepts such as: “In addition to the other terms and conditions of the lease . . . .”; “Except as expressly limited herein, the lease is ratified and confirmed as fully in force and effect . . . .”; “Without limiting the rights granted to lessee under the lease, lessee agrees that lessee will . . . .”; or “Notwithstanding paragraph . . . of the lease . . . .”

In \textit{Texas Genco, LP v. Valence Operating Co.},\textsuperscript{169} the Waco Court of Appeals discussed the accommodation doctrine and approved a broad-form jury question on the reasonableness of directional drilling. In the case, a surface owner sued to enjoin the mineral owner from straight-hole drilling a gas well on a tract that was a part of the surface owner’s ash-disposal landfill for its nearby electrical power generation plant. The tract in question was part of a landfill approved by the Texas Commission on Environmental Quality, and there was ample evidence of the unique use and the serious consequences for the surface owner of drilling in the landfill. Surface owner offered the mineral owner compensation for the additional cost of directional drilling and a corridor to drill just outside the landfill. Negotiations failed, the mineral owner began constructing a

\textsuperscript{164} Brown v. Lundell, 162 Tex. 84, 92 (Tex. 1961).
\textsuperscript{165} Stephens, 2006 WL 768877, at *1.
\textsuperscript{166} Id. at *2.
\textsuperscript{167} Id. at *1.
\textsuperscript{168} Id. at *2.
\textsuperscript{169} 187 S.W.3d 118 (Tex. App.—Waco 2006, pet. denied).
pad, the surface owner obtained a temporary injunction, and trial proceeded on the surface owner’s suit for a permanent injunction and the mineral owner’s counterclaim for damages. The trial court submitted three questions rather than a broad-form submission and, based on the jury’s answers, denied the permanent injunction and awarded mineral owner $400,000 in damages. The court of appeals reversed.\(^\text{170}\)

In Texas, the dominant mineral estate has the right to reasonable use of the surface estate to produce minerals, but the right must be exercised with due regard for the rights of the surface estate owner. The accommodation doctrine takes the concept of “due regard” and balances the rights of the surface and mineral owners in the use of the surface.\(^\text{171}\) The court of appeals relied heavily on its previous experience in *Haupt I* and *Haupt II*, and it discussed in detail the accommodation doctrine, the elements, the burden of proof, and the form of submission:

Where there is an existing use by the surface owner which would otherwise be precluded or impaired, and where under the established practices in the industry there are alternatives available to the [mineral owner] whereby the minerals can be recovered, the rules of reasonable usage of the surface may require the adoption of an alternative by the [mineral owner].\(^\text{172}\)

The mineral estate is the dominant estate, and if there is but one way to produce the minerals, the mineral owner has the right to pursue his use. The court of appeals emphasized, though, that if there is another way to produce the minerals, the mineral owner may be required to use it.\(^\text{173}\)

The surface owner has the burden of proof on all the elements and the burden of obtaining the findings necessary to carry that burden. In order to prove that the mineral owner should use the alternative-industry practice, the surface owner must first show “that any alternative uses of the surface, other than the existing use, are impracticable and unreasonable under all the circumstances.”\(^\text{174}\) The surface owner must next show that the challenged mineral owner’s surface use is not reasonably necessary to the mineral owner under all circumstances. This may be done by proving that the mineral owner has other reasonable means of production available that will not interfere with the surface owner’s existing use.\(^\text{175}\)

The case was submitted on three questions that the court of appeals disapproved, stating that the trial court should have submitted a broad-

\(^{170}\) *Id.* at 120-21.

\(^{171}\) *Id.* at 121-22 (citing the leading cases of Getty Oil Co. v. Jones, 470 S.W.2d 613 (Tex. 1971) (“Getty”), Tarrant County Water Control & Improvement Dist. No. 1 v. Haupt, Inc., 854 S.W.2d 909 (Tex. 1993) (“*Haupt I*”), and Haupt, Inc. v. Tarrant County Water Control & Improvement Dist. No. 1, 870 S.W.2d 350 (Tex. App.—Waco 1944, no writ) (“*Haupt II*”)).

\(^{172}\) *Texas Genco*, 187 S.W.3d at 121-22 (quoting both *Haupt I* and *Getty*) (emphasis added).

\(^{173}\) *Id.* at 122.

\(^{174}\) *Id.*

\(^{175}\) *Id.*
The court of appeals ruled on the effect of the jury finding as a legal question under a *de novo* standard of review. The opinion's entire focus was on the court's analysis of that verdict and its conclusion that there was sufficient evidence and an adequate finding to satisfy the second element: the mineral owner had other reasonable means of production available that would not interfere with the surface owner's existing use. The mineral owner argued that the surface owner failed to submit or secure a finding on the first element (any alternative use is impractical), and, therefore, it should be deemed found against the surface owner. The court of appeals held that there was no fact issue, it was not contested at trial, and the evidence conclusively established that the surface owner's only reasonable use of the tract was as a part of the landfill. Therefore, although this case went against the mineral owner on difficult facts and a procedural issue, it appears that in most cases the surface owner could have a difficult time proving that "any alternative uses of the surface, other than the existing use, are impracticable and unreasonable under all the circumstances."  

Because a directional well is almost always a theoretical alternative (but with increased risk, time, and expense), there has been speculation as to whether a directional well would be a reasonable alternative (as contemplated by Jones, Haupt I, and Haupt II) and as to who would bear the increased burden. Apparently, under *Texas Genco*, the mineral owner is required to bear the entire burden and risk. The court of appeals held that directional drilling is a reasonable, industry-established, alternative method to gain access, and there was a jury finding that it was a "reasonable" alternative. The opinion says:

On the issue of the reasonableness of directional drilling as an economically viable alternative, which Valence disputed because of the increased cost and alleged decreased yield, Genco presented evidence that Valence's cost estimates were too high and that Valence could extract all of the gas. Moreover, the evidence showed that regardless of the costs and decreased yield, the projected $15 to $25 million in gas reserves in Holmes No. 8 warrant Valence's directional drilling, regardless of the increased costs. In conclusion, legally sufficient evidence supports the jury's answers to Questions 1 and 1(a).

If the mineral estate is truly the dominant estate, it would seem more logical that the surface owner must compensate the mineral owner in damages for forcing the alternative use. *Texas Genco* will encourage every surface owner to litigate because they have nothing to lose except litigation costs, and they might get lucky on a jury finding of a "reasonable" alternative. The mineral owner has always been at risk in damages.

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176. *Id.* at 123 n.2.
177. *Id.* at 124-25.
178. *Id.* at 124 n.5.
179. *Id.* at 123.
180. *Id.* at 123-25.
181. *Id.* at 125.
for excessive or unreasonable surface use, but, apparently, the surface owner who establishes an existing use gets a free pass. However, if the surface owner must first prove "that any alternative uses of the surface, other than the existing use, are impracticable and unreasonable under all the circumstances," then it should be a rare occurrence for a surface owner to force an alternative surface use by the mineral owner.

In Devon Energy Production v. Hockley County Appraisal District, the Amarillo Court of Appeals held that a county appraisal district can assess for ad valorem taxation only for that portion of a producing formation within the county. In this case, the lease was located (eighty-four percent) in Hockley County and (sixteen percent) in Terry County. The smaller producing formation, the Clearfork Formation, was located (fifty percent) in Hockley County and (fifty percent) in Terry County. Terry County assessed tax on fifty percent of the value of the Clearfork. Instead of using the geographic boundaries of the Clearfork as determinative, Hockley County began with the boundaries of Devon’s lease and assessed tax based on the surface acres of the lease located in Hockley County. Combining the assessments, the Clearfork was effectively valued for tax purposes at 134% of its fair market value. The court of appeals held that no property can be assessed for ad valorem taxes at a greater value than its fair cash market value, that the taxes must be assessed and paid in the county where the property is situated, and an appraisal district may only assess property within its district (which in this instance was limited to Hockley County). The burden of proving the property’s location is on the taxing unit.

V. GAS CONTRACTS AND MARKETING

In ConocoPhillips Co. v. Incline Energy, Inc., the Eastland Court of Appeals held that Buyer under a gas-purchase agreement was not required to account to Seller for the sale of natural gas liquids ("NGLs"). The pricing clause provided:

Subject to all terms, conditions and provisions of the Agreement, for the period beginning on the effective date hereunder and extending for the Term hereof, the price per MMBTU to be paid by Buyer to Seller each month shall be eighty percent (80%) of the price(s) which Buyer receives under its Resale Agreement(s) for all gas purchased and sold hereunder at the Point(s) of delivery, such gas produced from the subject lands and leases.

183. Id. at 882-83.
184. Id. at 880-81.
185. Id. at 882.
186. Id. at 883.
188. Id. at 382.
189. Id. at 379.
Buyer based its payment to Seller on the weighted average residue-gas price applied to the full-volume and heating value ("MMBTU") at the point of delivery into the Buyer's pipeline. Seller contended that it should also be paid on processed NGLs in addition to residue gas.\textsuperscript{190}

The court of appeals held that Buyer was correctly paying for the gas and the "resale" of gas would exclude NGLs that were removed before the first gas resale.\textsuperscript{191} In reversing the trial court's finding that the contract was ambiguous and its entry of a judgment for Seller, the court of appeals refused to find either a patent or latent ambiguity in the contract. When the gas purchase agreement and the subsequent amendment were executed, the Natural Gas Policy Act ("NGPA") of 1978 was in effect. Under the NGPA, the sale would have been a "first sale," and the Buyer's subsequent sale to a third party would be a "resale." Resales based upon residue gas were always expressed in terms of MMBTUs, and sales of NGLs were always stated in terms of gallons. Therefore, the court of appeals found that the contract could be given a definite and certain meaning, so it was not patently ambiguous.\textsuperscript{192}

The court of appeals summarily rejected the trial court's finding of a latent ambiguity. Latent ambiguities only arise when a contract fails by reason of some collateral matter that is applied to the contract's subject matter. Here, the alleged ambiguity did not arise out of some collateral matter, but rather, out of the "very heart and essence of the agreement: the pricing mechanism."\textsuperscript{193}

VI. LITIGATION

In \textit{Ruiz v. Stewart Mineral Corp.},\textsuperscript{194} the Tyler Court of Appeals discussed the applicability of a declaratory judgment action to establish title by adverse possession and deed construction. B.S. and Daisy Wettermark owned an undivided one-half mineral interest in certain land, and they executed a power of attorney in favor of Witherspoon. B.S. Wettermark died in 1935, and in 1938 Witherspoon executed a deed by which he purported to convey, as attorney-in-fact, the one-half undivided interest owned by both B.S. and Daisy to grantees.\textsuperscript{195}

Grantees continuously developed the undivided one-half mineral interest from 1949 to 2003. In their original petition, grantees sought only a declaratory judgment that they owned the undivided one-half interest formerly owned by the Wettermarks. They claimed that the 1938 deed by Witherspoon as attorney-in-fact was valid to convey the mineral interest of Daisy Wettermark, but, regardless of the deed's validity, grantees claimed that they were the rightful owners of Daisy's interest and B.S.

\textsuperscript{190} \textit{Id.} at 379-80.
\textsuperscript{191} \textit{Id.} at 382.
\textsuperscript{192} \textit{Id.} at 381.
\textsuperscript{193} \textit{Id.}
\textsuperscript{194} 202 S.W.3d 242 (Tex. App.—Tyler 2006, pet. denied).
\textsuperscript{195} \textit{Id.} at 245.
Wettermark’s interest by adverse possession under the five-year and ten-year adverse-possession statutes.\textsuperscript{196} The successors to the Wettermarks (“Defendants”) claimed that a trespass-to-try title action is the statutory form of action required and the exclusive remedy for determination of title.\textsuperscript{197} A trespass-to-try title action is a procedure by which rival claims to title or right of possession may be adjudicated.\textsuperscript{198} In a trespass-to-try title action, the plaintiff may recover by proving a regular chain of conveyances from the sovereign, a superior title out of a common source, title by limitations, or prior possession that has not been abandoned.\textsuperscript{199} Adverse possession is defined as “an actual and visible appropriation of real property, commenced and continued from a claim of right that is inconsistent with and is hostile to the claim of another person.”\textsuperscript{200} The court of appeals held that, based on the pleadings and evidence, this was an adverse possession case, and, as such, the claim could only be resolved in a statutory trespass-to-try title action.\textsuperscript{201} This is also the holding in the leading case of Martin, which the grantees attempted to distinguish because Martin was a boundary case. The court of appeals refused to make that distinction. The court of appeals also declined to follow other appellate decisions rendered before Martin, holding that title could be resolved on an adverse-possession claim in a suit to quiet title.\textsuperscript{202} Because the court of appeals held that a declaratory judgment action was not the appropriate vehicle for resolving adverse-possession claims, it reversed summary judgment on those grounds.\textsuperscript{203}

The parties agreed that Witherspoon could not act on behalf of B.S. Wettermark after his death in 1935, but grantees also sought a declaration that the 1938 deed was effective to convey Daisy’s one-fourth of the minerals. Because Defendants challenged the validity of the acknowledgment, the court of appeals reviewed the document in which Witherspoon was given the authority to act as attorney-in-fact. The court of appeals found that a notary public properly acknowledged it, and therefore an effective deed as to Daisy’s interest existed.\textsuperscript{204}

The Declaratory Judgments Act provides that:

A person interested under a deed, will, written contract, or other writings constituting a contract or whose rights, status, or other legal relations are affected by a statute, municipal ordinance, contract, or franchise may have determined any question of construction or validity arising under the instrument, statute, ordinance, contract, or

\textsuperscript{196} Id.; TEX. PRAC. & REM. CODE ANN. § 16.025 and § 16.026 (Vernon 2002).
\textsuperscript{197} Ruiz, 202 S.W.3d at 246-47.
\textsuperscript{198} Ruiz, 202 S.W.3d at 247 (citing Martin v. Amerman, 133 S.W.3d 262, 267 (Tex. 2004)).
\textsuperscript{199} Id. (citing Rogers v. Ricane Enters., Inc., 884 S.W.2d 763 (Tex. 1994)).
\textsuperscript{200} TEX. CIV. PRAC. & REM. CODE ANN. § 16.021(1) (Vernon 2002).
\textsuperscript{201} Ruiz, 202 S.W.3d at 247; Martin v. Amerman, 133 S.W.3d 262, 267 (Tex. 2004).
\textsuperscript{202} Ruiz, 202 S.W.3d at 247-48.
\textsuperscript{203} Id. at 250.
\textsuperscript{204} Id. at 248.
franchise and obtain a declaration of rights, status, or other legal relations thereunder.\textsuperscript{205}

Therefore, the trial court's summary judgment as to Daisy's one-fourth of the minerals was affirmed because the judgment properly declared that her interest passed to the grantees under the 1938 deed.\textsuperscript{206}

The trial court had awarded over $57,000 in attorney's fees, but the court of appeals held that attorney's fees in this case could not have been awarded on the adverse-possession claim.\textsuperscript{207} And, although attorney's fees could be awarded under the Declaratory Judgments Act, the fees as to each claim would have to be segregated. "An award of attorney's fees erroneously based upon evidence of unsegregated fees requires a remand."\textsuperscript{208}

In \textit{Vial v. Gas Solutions, Ltd.},\textsuperscript{209} the Texarkana Court of Appeals determined whether the heirs to an allegedly defrauded party have standing to bring suit and whether fraudulent concealment tolls the statute of limitations. Vial contended that its predecessor was fraudulently induced to sign a well-spacing agreement with Gas Solutions' predecessors in 1931. In the agreement, all parties agreed not to drill any additional wells. The agreement contained the following recital, which is the basis of this lawsuit: "WHEREAS, the above tract of land adjoins on the south the right of way of the Texas & Pacific Railroad which right of way is under lease for oil and gas purposes to Gregg Oil Company."\textsuperscript{210} Vial alleged that there was no lease on the right-of-way, the recital misled Vial's predecessor into believing that Gregg Oil Company had a valid lease on the right-of-way, and the false representation fraudulently induced Vial's predecessor to enter into the well-spacing agreement.\textsuperscript{211}

Gas Solutions first challenged Vial's standing to sue because the general rule is that a party lacks standing to sue for damage to property if an injury to the property occurs before the plaintiff purchases the property. In other words, the right to sue belongs to the predecessor in title, and, if it is not expressly conveyed, then the subsequent purchaser has no cause of action. In this case, Vial was not a subsequent purchaser of the property, but, rather, heir to the predecessor in title.\textsuperscript{212} Moreover, the suit was not for damages to property, but for fraud. A fraud claim is personal to the defrauded party, but the heirs of the defrauded party have standing to sue to recover for the fraud. Therefore, Vial had standing to bring suit as heir to the injured party.\textsuperscript{213} Similarly, the fact that the right-of-way may have been adversely possessed later had no relevance to Vial's claim.

\textsuperscript{205} \textsc{Tex. Civ. Prac. \& Rem. Code Ann.} § 37.004(a) (Vernon 1997).
\textsuperscript{206} \textit{Ruiz}, 202 S.W.3d at 250.
\textsuperscript{207} \textit{Id.} at 249-50.
\textsuperscript{208} \textit{Id.}
\textsuperscript{209} 187 S.W.3d 220 (Tex. App.—Texarkana 2006, no pet.).
\textsuperscript{210} \textit{Id.} at 226.
\textsuperscript{211} \textit{Id.} at 224-25.
\textsuperscript{212} \textit{Id.} at 225-27.
\textsuperscript{213} \textit{Id.} at 227.
for fraud in connection with the 1931 well-spacing agreement.\textsuperscript{214}

The four-year statute of limitations is applicable to claims based on fraud, and, therefore, Vial's claim was clearly barred unless the statute was tolled. Vial contended that the statute of limitations was tolled by Gas Solutions' fraudulent concealment of the fraudulent inducement. Fraudulent concealment is an equitable defense to limitations that estops the defendant from relying on the statute of limitations. Fraudulent concealment tolls the statute of limitations until the plaintiff, using reasonable diligence, discovers or should have discovered the injury.\textsuperscript{215}

The court of appeals held that, even if a fact issue existed concerning the underlying tort, i.e., whether some misleading recital or some subsequent conduct or document created a duty to disclose, Vial did not raise a fact issue concerning fraudulent concealment.\textsuperscript{216} Fraudulent concealment requires that the defendant have actual knowledge that a wrong has occurred and that there was a "fixed purpose to conceal the facts necessary for the plaintiff to know that it has a cause of action."\textsuperscript{217} Vial did not present any evidence that Gas Solutions' predecessors intended to conceal the cause of action from Vial. There was just confusion about who owned the right-of-way.\textsuperscript{218}

The court of appeals also found that Vial or Vial's predecessors should have discovered their alleged injury concerning the land years ago.\textsuperscript{219} Mineral interest owners have an obligation to exercise due diligence to protect their interests. The doctrine of fraudulent concealment only tolls the statute of limitations until the plaintiffs, using reasonable diligence, discover or should have discovered the cause of action. Gas Solutions and their predecessors had been openly extracting oil and gas from the land covered by the lease since the 1930s. The wells were clearly visible, and there was no evidence that Gas Solutions or its predecessors conducted their activities in a clandestine manner.\textsuperscript{220} Because the alleged fraud occurred more than seventy years ago, and the statute of limitations had not been tolled, the court of appeals found that the four-year statute of limitations barred Vial's claim to bring suit.\textsuperscript{221}

\textsuperscript{214} Id. at 228.
\textsuperscript{215} Id. at 228-29.
\textsuperscript{216} Id. at 230.
\textsuperscript{217} Id. at 230-31 (quoting Santanna Natural Gas Corp. v. Hamon Operating Co., 954 S.W.2d 885 (Tex. App.—Austin 1997, pet. denied)).
\textsuperscript{218} Id. at 231.
\textsuperscript{219} Id.
\textsuperscript{220} Id.
\textsuperscript{221} Id. at 232.