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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 October 1, 1998 through September 30, 1999. The cases examined include decisions of courts of the State of Texas and the Fifth Circuit Court of Appeals.1

II. CONVEYANCING ISSUES

Wright v. E. P. Operating Ltd. Partnership2 is a sad tale of unintended consequences. Wright farmed on five tracts in Nolan County that were mortgaged to Mercantile Bank. Wright sold the farm to Oliver as to the surface only under an assumption agreement, and Mercantile Bank agreed to release Wright from all liability and to not foreclose upon

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1. This article is devoted exclusively to Texas law. Cases involving questions of oil, gas, and mineral law, decided by courts sitting in Texas but applying laws of other states are not included.
Wright's minerals. The deed from Wright to Oliver excepted the minerals, but Wright never got a partial release of lien from Mercantile Bank. Oliver defaulted, and Mercantile Bank's successor, Mbank Dallas, foreclosed. The trustee's deed in foreclosure did not exclude the minerals, did not refer to the prior reservation of the minerals by Wright, and did not mention the unrecorded assumption agreement. Mbank conveyed the property to its subsidiary, Oregon, Inc., again with no references to the reservation of the mineral estate. Oregon, Inc. then made five separate conveyances of the five tracts to the E.P. parties in this case. The banker told each purchaser that they were getting no minerals, and subsequent conveyances by the purchasers recognized that no mineral interest was conveyed. The Oregon, Inc. deeds recited that the interest conveyed was subject to:

[a]ny and all valid and subsisting leases, reservations, severances of any and all oil, gas and minerals in, on, and under the Property which are presently of record and which affect or relate to the Property: including, without limitation, that certain reservation of all oil, gas and minerals in, on and under the property reserved by Jimmy Max Wright, et al. in Warranty Deed to Floyd Oliver, et al., dated May 21, 1982, recorded in Volume 255, Page 615, Deed Records, Nolan County, Texas.

Nevertheless, the court held that Wright had no minerals. Wright admitted that the foreclosure was effective to convey the minerals. [Wright] did not plead or seek reformation of any instrument and did not plead fraud, estoppel, mutual mistake, ambiguity, or any cause of action that would allow the offer of extraneous evidence to explain the language in the Oregon deeds. Consequently, the trial court was called upon to interpret the Oregon deeds and determine as a matter of law the effect of their language and the estate they passed.

The recital in the Oregon deeds referring to the prior mineral reservation by Wright was held to state why the exception was made, not to make an exception or reservation of a mineral interest. The language that the conveyance was made subject to any and all reservations presently of record, including without limitation the Wright reservation, did not reserve any mineral interest in Oregon's predecessor in title, it merely recognized reservations have been made in the chain of title and excepts them from the warranty. It was not itself a reservation.

Similarly, reference to a mineral interest that has previously been foreclosed does not itself reserve that interest from conveyance. The court found that the words "valid and subsisting" had a plain meaning that, if

3. See id. at 685-86.
4. See id. at 688.
5. Id. at 686.
6. See id. at 685-88.
7. Id. at 687.
8. See Wright, 978 S.W.2d at 688.
9. See id.
10. See id.
there was an oil and gas lease in effect at the time of the conveyance, then
the property was subject to that burden. Whether the language referred
to oil and gas leases or to Wright's reservation did not matter.\textsuperscript{11} The
language "including without limitation" was merely a limitation to war-
ranty and did not create or convey any mineral interest.\textsuperscript{12} Therefore, the
deeds from Oregon did not reserve the mineral estate by reference to a
mineral interest that was no longer in existence.\textsuperscript{13}

Although not a good result for Wright, the case is important in ascrib-
ing some plain meanings to modifiers that are frequently found in con-
veyances, including recitals, "valid and subsisting," and "including
without limitation."

\textit{John G. \& Stella Kenedy Memorial Foundation v. Dewhurst}\textsuperscript{14} considers
the method for locating shoreline boundaries. The dispute concerned ti-
tle to about 35,000 acres of coastal mud flats that are intermittently inun-
dated by the waters of the Laguna Madre. The mud flats lie along the
Texas coast south of Corpus Christi where Padre Island shields more than
one hundred miles of the Texas mainland from the open waters of the
Gulf of Mexico. The eastern boundary of the Foundation's title was de-
defined in the Spanish and Mexican land grants as the Laguna Madre.\textsuperscript{15}

The court reviewed the leading Texas case defining how boundaries
defined by seashores are to be located. In the leading case of \textit{Luttes v. State},\textsuperscript{16} the supreme court created a general rule for determining shore-
lines using tide gauges, but acknowledged that some circumstances might
require using other methods. The \textit{Luttes} opinion defined the shoreline
for land grants made by Spain or Mexico as the mean higher high tide
line (MHHT), as defined by tide gauges.\textsuperscript{17}

The \textit{Dewhurst} court concluded that the measurement of high tide was
an impractical formula for the Laguna Madre and affirmed the trial
court's judgment to adopt a different methodology and a different line.
The line adopted was a meandering shoreline based on a line of vegetated
bluffs that the court believed continued to reflect the shoreline as it ex-
isted at the time of the grants.\textsuperscript{18} The significance of the case is that it
reflects an exception to the \textit{Luttes} formula for determining the location of
the shoreline, and because of the size of the Laguna Madre, it may di-
rectly affect title issues relevant to many miles of coastline.

\textit{Union Pacific Resources Co. v. Hutchison}\textsuperscript{19} wins this year's prize for
the most poorly-reasoned oil and gas case. In a typical leasing transac-
tion, Morgan leased to Hutchison on a form that included a pooling
clause. The next day, Hutchison assigned the lease on a form conveying “all right, title and interest in and to the” Morgan Lease, “together with the rights incident thereto,” reserving to Hutchison a three percent overriding royalty.\(^{20}\) Subsequent poolings were accomplished without Hutchison’s consent, and Hutchison sued Union Pacific, as the successor to Hutchison’s original assignee, to recover Hutchison’s undiluted share of production.\(^{21}\)

It is well established that an overriding royalty is an interest in land and that a royalty owner’s consent to pooling is required because pooling effects a cross-conveyance. A cross-conveyance requires a conveyance from the owner of the land. The court was well aware of this general principle and the leading cases establishing that line of authority.\(^{22}\)

The court nevertheless ignored these settled principles of property law and reached an entirely different result based on the divined intent of the parties as expressed in the document(s). There was no contention that the lease assignment was ambiguous, but the court considered not only the lease assignment but also the lease, the dates of each instrument, and the timing of those instruments, including the assignment one day after the lease, in reaching its decision. The court concluded that Hutchison’s assignee received by Hutchison’s assignment the right to pool Hutchison’s overriding royalty.\(^{23}\)

The court blithely concluded, “[I]t is doubtful that the parties intended that [Hutchison’s assignee] should have the right to pool the Morgan interests but not the right to pool Hutchison’s interest.”\(^{24}\) Lessors rarely know anything about pooling and lessees rarely want lessors to have any control over pooling, which is precisely why there is a pooling clause in most leases. On the other hand, the original lessee is almost always knowledgeable about oil and gas, oil and gas property rights, and the issues involved in the formation of pooled units. It is at least equally probable that the original lessee, Hutchison, did not want his overriding royalty pooled without his consent, and that he relied upon established property law in concluding that the simple reservation of an overriding royalty accomplished that purpose. That is, one of the fundamental attributes of an ownership interest in an overriding royalty is that it cannot be pooled (and therefore diluted) without the owner’s consent. It is equally unpersuasive that the lease assignment is dated one day after the lease. The parties would have used the same form of assignment whether the assignment was made one day, one hundred days, or one thousand days after the date of the lease.

\(^{20}\) See id. at 369.
\(^{21}\) See id. at 369-70.
\(^{22}\) See id. (citing Montgomery v. Rittersbacher, 424 S.W.2d 210, 213 (Tex. 1968); Minchen v. Fields, 162 Tex. 73, 345 S.W.2d 282, 285 (1961); Brown v. Smith, 141 Tex. 425, 174 S.W.2d 43, 46 (1943); Veal v. Thomason, 138 Tex. 341, 159 S.W.2d 472, 476 (1942)).
\(^{23}\) See id. at 371.
\(^{24}\) Id. at 371.
There are literally thousands of leasing transactions of record in Texas that follow this fact pattern. There may well be good reason to regret the original decisions made over fifty years ago that established the fundamental principle that there can be no pooling without express consent, but there have now been fifty years of conveyances based on that principle. The Hutchison opinion has introduced a great deal of uncertainty into determining the scope of the power to pool, and it is very regrettable that the petition was denied in this case.

III. OIL, GAS, AND MINERAL LEASES

A. Habendum Clause

_Sun Operating Ltd. Partnership v. Holt_ 25 reviews the lease habendum clause and various savings clauses in the context of a cessation of production caused by pipeline repairs. The lease contained the following habendum clause and continuous operations clause (which the court identified as a cessation of production clause):

Subject to other provisions herein contained, this lease shall remain in force for a term of ten years from this date, called primary term, and as long thereafter as oil, gas or other mineral is produced from said land, or as long thereafter as Lessee shall conduct drilling or reworking operations thereon with no cessation of more than sixty consecutive days until production results, and if production results, so long as any such mineral is produced.26

The lease also contained the following force majeure clause:

When drilling or other operations are delayed or interrupted by lack of water, labor or materials, or by fire, storm, flood, war, rebellion, insurrection, riot, strike, differences with workmen, or failure of carriers to transport or furnish facilities for transportation, or as a result of some order, requisition or necessity of the government, or as the result of any cause whatsoever beyond the control of the Lessee, the time of such delay or interruption shall not be counted against Lessee, anything in this lease to the contrary notwithstanding.27

There were at least ten wells on the lease, and those wells produced from 1947 to 1983. In 1983, the only pipeline to the lease was shut down for major repairs for about five months.28 Many years later, the Holts filed suit and contended that the lease terminated in 1983. The trial court submitted a single issue:

Do you find that the failure to produce oil, gas and other minerals from the Lease Number 1 premises and the Lease Number 2 premises during the period of May 26, 1983, to August 1, 1983, was solely caused by “force majeure” as defined by paragraph 10 of Lease Number 1 and Lease Number 2?

26. Id. at 280.
27. Id.
28. See id. at 280-81.
Answer: “Yes” or “No”29

There were also some jury instructions. The jury answered “No,” and the trial court entered judgment terminating the lease.

The Amarillo court quickly concluded that the temporary cessation doctrine was inapplicable because of the express sixty-day continuous operations clause in the lease.30 The court strongly emphasized that force majeure was determined almost solely by the terms of the contract. The Amarillo court refused to read into the clause an obligation on the lessee to exercise diligence to overcome the effects of the force majeure once it occurs.31 The trial court’s instructions included a recitation that the lessee must have “exercised due diligence and taken all reasonable steps to avoid, remove and overcome the effect of ‘force majeure.’”32 The court rejected these instructions as beyond the language of the force majeure clause. The charge as submitted was therefore harmful error.33

Sun also contended that it was entitled to a directed verdict because the evidence conclusively established that the sole cause of the shut-in was the pipeline problem, and therefore the force majeure clause applied. The court first considered whether “other operations” as used in the force majeure clause included production and concluded that this was the plain meaning.34 The force majeure clause may have the effect of extending the habendum clause,35 but this particular force majeure clause also required that the force majeure events be beyond the lessee’s control.36 However, the Sun parties did not prove as a matter of law that production ceased solely because of a force majeure event. There was some evidence that the lessee had thirty days notice of the impending repairs and that there were alternative solutions available.37

The court also considered the shut-in royalty clause and concluded that the presence of such a clause did not subordinate or overrule the force majeure clause or the habendum clause. It is just one clause or means by which the lease may be perpetuated.38 That is, the presence of the shut-in clause did not mean that the force majeure clause was ineffective to preserve the lease. One of the lessees on a divided part of the lease had actually paid shut-in royalties for the single well on its portion of the lease during the time the pipeline was under repair. However, the amount paid was only $50 for the one well on that lessee’s portion of the lease. Because there were multiple wells on the entire lease, the court concluded that the shut-in royalty payment was not “fifty dollars ($50.00) per well,” that the shut-in royalty clause was indivisible, and therefore the payment

29. See id. at 281.
30. See id. at 281-82.
31. See Sun Operating, 984 S.W.2d at 284.
32. Id. at 281.
33. See id. at 284.
34. See id. at 285.
35. See id. at 286.
36. See id. at 288.
37. See Sun Operating, 984 S.W.2d at 290.
38. See id. at 288-89.
of less than the full shut-in royalty would not preserve the lease.\textsuperscript{39}

\textit{Holman v. Meridian Oil, Inc.}\textsuperscript{40} considers the application of a liquidated damages clause in an oil and gas lease which is triggered by lessee’s failure to provide a release of the lease. The lease expired after the expiration of the five year primary term with no activity having ever taken place on the lease.\textsuperscript{41} The liquidated damages clause provided:

After the end of the primary term, Lessee, its successors and assigns, shall deliver a release to the Lessor within ninety (90) days of plugging and abandoning any well located on the leased premises. Such release shall cover such portions of the leased premises as were included within the proration unit established or drilling unit established as the case may be for such well. If the Lessee withholds any release, Lessor shall be entitled to reasonable attorney's fees and costs sustained by the Lessor in an attempt to obtain any release, plus an additional amount of liquidated damages of one dollar ($1.00) per acre per month for each acre of land that is not timely released.\textsuperscript{42}

No release was filed until six months after the expiration of the primary term, and lessors sued to recover $40,798.20 in liquidated damages, plus attorney's fees and costs.\textsuperscript{43} Meridian won on summary judgment, which was later affirmed.\textsuperscript{44}

Lessors did not sue on the common law duty to provide a release, but upon the contract.\textsuperscript{45} The issue was joined on whether “any release” referred to the release of all leases held of record which expired at the end of the primary term, or whether it was limited to releases addressed by the express release clause which immediately preceded the liquidated damages clause. The court ruled for Meridian for three reasons. First, there was no express duty in the lease to provide a release for leases on which no activity had taken place.\textsuperscript{46}

Second, the unreleased lease in this case was not a cloud on title. The court distinguished \textit{Witherspoon v. Green}\textsuperscript{47} because \textit{Witherspoon} involved a “drill or pay” form lease, whereas the Holman lease was an “unless” form. Meridian’s interest in the land automatically reverted back to the lessors under the latter form of lease.\textsuperscript{48}

Finally, the court indicated a reluctance to impose liquidated damages when the lessor presented no evidence of the loss of a specific sale. This reasoning seems to arbitrarily import slander of title into a contract.

\begin{footnotes}
\item[39] See id. at 289-92.
\item[40] 988 S.W.2d 802 (Tex. App.—San Antonio 1999, pet. denied).
\item[41] See id. at 804.
\item[42] Id. at 806.
\item[43] See id. at 805.
\item[44] See id. at 804.
\item[45] See id. at 805.
\item[46] See Holman, 988 S.W.2d at 806-07.
\item[47] 274 S.W. 170 (Tex. Civ. App.—Dallas 1925, no writ).
\item[48] See id. at 807.
\end{footnotes}
Duncan Land & Exploration, Inc. v. Littlepage\textsuperscript{50} holds that commercial production, in violation of a Railroad Commission shut-in order, does not constitute failure to produce gas in commercial quantities under the illegal act rule or public policy.\textsuperscript{51} Littlepage farmed out an interest in an oil and gas lease under a farmout agreement that contained the following provision:

In the event that any 20 or 40 acre tract assigned to Tierra hereunder shall fail to produce oil or gas in commercial quantities from a well situated thereon for a period of ninety (90) days, the interest of Tierra in said tract shall terminate and all interest of Tierra in and to said tract shall revert to Owner. Each assignment executed and delivered to Tierra hereunder shall contain provisions concerning such termination and reversion, and providing that such termination and reversion shall be effective upon the filing of an affidavit by Owner in the Deed Records of Young County, Texas that no commercial production of oil or gas has been obtained from such tract for a period in excess of ninety (90) days.\textsuperscript{52}

Duncan succeeded to the interest of the farmee. The court’s opinion seems to confuse “lease” and “farmout,” but apparently the farmout had no savings clauses, so that Duncan could lose its interest if there was no production in commercial quantities for more than ninety days, and Littlepage filed an affidavit to that effect.\textsuperscript{53}

The Railroad Commission shut-in the well for testing based on a neighbor’s report of smelling hydrogen sulfide. The Railroad Commission kept the well shut-in for six months, tested it three times, and the well passed all three tests. Despite the Railroad Commission’s shut-in order, Duncan periodically operated the well in order to produce commercial quantities. Littlepage contended that the rights of Duncan had terminated and reverted to Littlepage.\textsuperscript{54} Littlepage contended that public policy dictates that a party cannot recover where it must prove, as a part of its claim, its own illegal act or transaction.\textsuperscript{55}

In a classic case of bad facts making bad law, the court apparently was overwhelmed with the inequity of Duncan losing a well under circumstances where the Railroad Commission shut-in the well without good cause, for reasons which did not prove reasonable, and for an unconscionably long period of time.\textsuperscript{56} The court concluded that “the extraordinary circumstances of this case dictate that public policy should not preclude Duncan from recovery as a matter of law.”\textsuperscript{57}

\textsuperscript{49} See id. at 808.
\textsuperscript{50} 984 S.W.2d 318 (Tex. App.—Fort Worth 1998, pet. denied).
\textsuperscript{51} See id. at 330-31.
\textsuperscript{52} Id. at 322.
\textsuperscript{53} See id.
\textsuperscript{54} See id. at 322-23.
\textsuperscript{55} See id. at 328.
\textsuperscript{56} See Duncan Land, 984 S.W.2d at 329.
\textsuperscript{57} Id. at 329.
The dissent noted that “no action will lie to recover a claim for damages, if to establish it the plaintiff requires aid from an illegal transaction, or is under the necessity of showing or in any manner depending upon an illegal act to which he is a party.”58 The dissent expressed the opinion that the majority had clearly ignored binding precedent, condoned an illegal act for the purpose of protecting private contract rights, and mistakenly considered the conduct of Littlepage, which had no relevance in determining whether Duncan, a law violator seeking legal remedies, was entitled to equity.59

**B. Royalty Clause**

*W. T. Carter & Bro. v. Oryx Energy Co.*60 turns on the meaning of “with.” The dispute was over the applicable royalty provision and whether Oryx was processing gas “with a third party.” Oryx had an agreement with Teco Gas Gathering Company (“Teco Gathering”) under which Teco Gathering gathered and transported Oryx’s gas to a gas processing facility owned by Teco Gas Processing Company (“Teco Processing”). Oryx had an agreement with Teco Processing under which Teco Processing extracted natural gas liquids (“NGLs”) from Oryx’s gas at Teco’s plant. Title to the NGLs passed to Teco Processing when extracted, but title to the residue gas remained in Oryx. Teco Processing sold the NGLs and paid Oryx 70% of the net proceeds. Oryx sold the residue of the gas at the tailgate of the plant to HPL Resources Company. Oryx paid royalties to the royalty owner on 70% of the NGLs and on the sale residue gas.61

The royalty clause in paragraph 3 of the lease provided:

b. On gas, including casinghead gas or other gaseous substance produced from the Leased Premises and sold or used off the premises or for the extraction of gasoline or other product therefrom (except gas to which the provisions of subparagraphs c and d immediately below are applicable), the market value free of cost at the well of Such Fraction of the gas so sold or used, provided that on gas sold at the wells the royalty shall be Such Fraction of the amount realized from such sale . . . .

d. Lessee (itself or with a third party or parties) or any affiliate, parent, or subsidiary of Lessee shall have the right but shall not be obligated to process gas produced from the Leased Premises in an absorption or extraction plant, or other type plant or plants, whether similar or dissimilar, for the recovery of the liquid and/or liquefiable hydrocarbons, sulphur or other products therefrom, and if such gas is so processed, Lessor shall have and be entitled to a royalty of Such Fraction of all plant products, and all other hydrocarbons, sulphur

58. Id. at 335 (citing Gulf, C. & S.F. Ry. Co. v. Johnson, 9 S.W. 602, 603 (Tex. 1888)).
59. See id. at 335-37.
60. 5 S.W.3d 704 (Tex. App.—San Antonio 1999, no pet. h.).
61. See id. at 706-07.
and products so extracted, separated, produced and saved from such
gas . . . ."62

Oryx contended that 3(b) was applicable, and Carter contended 3(d)
was applicable. In other words, Oryx contended that it owed royalties on
70% of the liquids stream, but Carter contended that Oryx owed royalties
on 100% of the liquids stream, including the 30% that Teco Producing
took for itself.63 The court held that "with a third party" must be given
its plain, ordinary meaning because it was not used in any technical or
different sense. The dictionary definition included "one that shares in an
action, transaction or arrangement."64 The court rejected Oryx's position
that 3(d) was intended to apply only when Oryx owned all or part of the
processing plant,65 and noted that Oryx could have contracted with Teco
Processing to pay the royalties but did not do so.66

_Bright & Co. v. Holbein Family Mineral Trust_67 reviews the relationship
between the doctrine of acknowledgment and the statute of limitations
on a stale claim for underpayment of royalties. Bright overpaid Holbein
for seven years, from 1980 to 1987, and then Bright paid Holbein nothing
for eight years, from 1987 to 1995.68 In response to Holbein's inquiry in
1995, Bright's landman, Manaugh, investigated. After investigating the
records, Manaugh wrote Holbein a letter in which he said Bright had
"every intention of resolving the matter," and the enclosures included a
chart which showed "net due Holbein."69

Holbein finally sued Bright in 1996, and Bright relied upon the four
year statute of limitations found in section 16.004 of the Texas Civil Prac-
tice & Remedies Code.70 It was uncontroverted that the four-year bar
would ordinarily apply, except that Holbein involved the doctrine of ac-
knowledgment codified in section 16.065 of that code, which states that:

An acknowledgment of the justness of a claim that appears to be
barred by limitations is not admissible in evidence to defeat the law
of limitations if made after the time that the claim is due unless the
acknowledgment is in writing and is signed by the party to be
charged.71

The trial court and the appellate court both found that Manaugh's let-
ter and its enclosures were sufficient acknowledgment of the debt to re-
move it from the operation of the statute of limitations.72

Bright also alleged the overpayments to Holbein for the years 1980

62. _Id._ at 706.
63. _See id._ at 707.
64. _Id._ at 707-08.
65. _See id._ at 707.
66. _See W.T. Carter, 5 S.W.3d at 707 n.4._
67. 995 S.W.2d 742 (Tex. App.—San Antonio 1999, pet. denied).
68. _See id._ at 744 n.1.
69. _See id._ at 744, 746.
70. _See id._ at 744-45, 745 n.4.
71. _Id._ at 745.
72. _See id._ at 746.
through 1987 as an affirmative defense and as a counterclaim. The court rejected the overpayments as an affirmative defense, because an affirmative defense establishes an independent reason why the plaintiff should not recover. Overpayment from 1980 to 1987 did not negate Holbein's claim for nonpayment from 1987 to 1995.

The court also rejected Bright's attempt to use the overpayment as the basis of a counterclaim. As a counterclaim, the overpayment was time barred and could not be saved by the operation of section 16.069 of the Texas Civil Practice and Remedies Code. This section provides that a counterclaim, arising out of the same transaction or occurrence that is the basis of an action, may be filed on the date the answer is required, or within thirty days thereafter, even though as a separate action the claim would be barred by the statute of limitations. However, Bright did not file the counterclaim within that window of opportunity.

It is quite possible that the appellate court failed to properly address recoupment, or perhaps recoupment was not adequately presented to the court. The right to claim recoupment is applicable when an offset is based on the same contract as the claim asserted in the petition. Recoupment is a defense negating the claim or reducing the claim, pro tanto. Recoupment as a defense cannot result in an affirmative recovery for the defendant. Furthermore,

[i]t is the law of this state that where the subject-matter of a defense interposed by the defendant constitutes an independent cause of action which does not go to the foundation of the plaintiff's demand, it cannot effect a reduction of the amount of the plaintiff's recovery except by way of set-off, and the statutes of limitation are available to the plaintiff in respect to such defense. On the other hand, if the subject matter of the defense be of an intrinsically defensive nature, which, if given effect, will operate merely as a negation of the plaintiff's asserted right to recover, or in abatement, either wholly or partially, of the amount claimed, the statute of limitation does not apply.

Notwithstanding the holding in the Bright case, this would suggest there is at least a remaining argument that the overpayment of royalty can reduce pro tanto any liability for nonpayment of royalty.

C. Pooling Clause

Southeastern Pipe Line Co. v. Tichacek examines a lessee's obligations in regard to pooled properties. Lessee (Southeastern Pipe Line Company) held leases from mineral interest owners Leveridge and Tichacek. Southeastern drilled three successful wells on the Leveridge

73. See Bright & Co., 995 S.W.2d at 746.
74. See id. at 747.
75. See id. at 746-47.
76. Moriss-Buick Co. v. Davis, 127 Tex. 41, 91 S.W.2d 313, 314 (1936) (citation omitted).
77. 997 S.W.2d 166 (Tex. 1999).
tract. The Tichacek tract was located immediately to the north of the Leveridge tract. Tichacek waited three years for Southeastern to do something on the Tichacek tract, and then four days before the Tichacek lease was to expire for nonproduction, Southeastern extended it by pooling the lease with acreage from the Leveridge tract (including one of the producing wells) to form a producing unit. Half of the acreage came from the Leveridge tract, and the other half came from the Tichacek tract.78

Lessor Tichacek, believing that Southeastern had pooled in bad faith, notified Southeastern that the Tichacek lease had expired. Southeastern filed suit to declare the Tichacek lease valid. Tichacek counterclaimed for bad faith pooling and for breach of the implied covenant to protect against drainage. The jury found that Southeastern had pooled in good faith, but it also found Southeastern liable for drainage damages.79 As submitted, the jury issues on drainage did not distinguish between lease drainage, unit drainage, and the periods of time before and after the formation of the unit.80 The court held that "the lessors were required to segregate their claims between pre-pooling drainage from the leases and post-pooling drainage from the unit."81

The court recognized the principle that a lessee is obligated under the implied covenant to protect against drainage and that good faith pooling is one way to accomplish that goal.82 There were restrictions in the leases pertaining to pooling (some of the leases required that pooled acreage must equal at least half of any pooled unit),83 and the lessors urged that Southeastern was under a duty to seek lease amendments which would make lessors' theoretical "best units" possible. The court did not directly address that argument, but cited Circle Dot Ranch, Inc. v. Sidwell Oil & Gas, Inc.84 for the proposition that a "lessee's pooling decision will be upheld unless the lessee pools in bad faith."85 The court noted that a common protective measure for the lessee is to exercise its contractual pooling authority.86 The court held that, "[b]eyond the express terms of the lease, a lessor has no power to direct a lessee in its good faith pooling decisions or to revoke its authority to join in pooled units."87

If a lessee pools oil and gas leases in good faith, the lessor may no longer sue for breach of the implied covenant to protect against lease drainage by a unit well located off the individual lease. Instead, a lessor may only sue if the drainage of the unit occurs by wells located outside

78. See id. at 167-68.
79. See id. at 168-69.
80. See id. at 171.
81. Id. at 170-71.
82. See id. at 170.
83. See Southeastern Pipe Line, 997 S.W.2d at 171.
84. 891 S.W.2d 342, 346 (Tex. App.—Amarillo 1995, writ denied).
85. Southeastern Pipe Line, 997 S.W.2d at 170.
86. See id. at 170.
87. Id. at 171.
the unit. The opinion did not address the possible scenario of a non-unit well draining unpooled lease acreage, but not draining the pooled unit acreage. The court ruled that if a lessee exercises its pooling authority in good faith, as occurred in this case, a lessor cannot ignore the validly pooled unit for the lessor’s own pooling preferences.

D. IMPLIED CONVENANTS

HECI Exploration Co. v. Neel is probably the most significant oil and gas case resolved during the reporting period for this issue. It is a very important case on both implied covenants and the discovery rule, as applied in oil and gas cases. This case involves a suit by royalty owners, “Neel,” against their lessee, “HECI.” Neel sued HECI in 1993 because HECI did not notify Neel that HECI had earlier sued and obtained a judgment against the operator of an adjoining lease, AOP Operating Corporation (“AOP”).

The earlier suit involved a common reservoir under the HECI and AOP leases. AOP’s operations had damaged the reservoir when production at excessive rates caused oil to migrate into the gas cap, which diminished the recoverable reserves. Thus, the injury was not the result of drainage, but of reservoir damage. HECI sued AOP in 1988 and obtained a judgment for actual damages of $1,719,956 and punitive damages of $2,000,000. In 1989, the case was settled and a release of judgment was filed in September of that year.

Neel did not learn of the suit until May 1993 and did not sue HECI until December 1993, more than four years after the damage to the reservoir occurred. The causes of action alleged included breach of contract, negligent misrepresentation, breach of the implied covenant to protect against drainage, and unjust enrichment for retaining compensation from AOP that was attributable to Neel’s interest. HECI relied on the statute of limitations, and Neel contended that the discovery rule should apply.

The court held that any cause of action to notify Neel of a potential claim would arise at the same time as the cause of action against AOP. Because AOP’s illegal overproduction had ceased by December 1988, that was the latest possible date a cause of action could arise against HECI for failure to notify. Therefore, all of the causes of action alleged were barred by limitations, unless the discovery rule applied. The court specifically did not address whether the classification of the injury as temporary or permanent would have any effect on limitations.

The court reiterated the unifying principles behind its discovery rule cases: for the rule to apply, the injury must be inherently undiscoverable.

88. See id. at 170.
89. 982 S.W.2d 881 (Tex. 1998).
90. See id. at 884.
91. See id.
92. See id.
93. See id. at 885.
and the injury itself must be objectively verifiable. The applicability of
the rule is categorical, not case specific. That is, the rule may not be
available in a particular type of case, regardless of whether on the specific
facts of that case the injury was inherently undiscoverable and objectively
verifiable. The court concluded that "damage to the reservoir from ille-
gal production is not the type of injury that is inherently undiscover-
able." Thus, the discovery rule was not applicable to the Neel case. A
determination that the discovery rule does not apply to this type of case
does not mean that the running of limitations cannot be tolled, in a
proper case, by fraudulent concealment.

The court noted that there were several potential sources of informa-
tion available to Neel, including neighbors, other operators, Neel's lessee,
and the Railroad Commission. The court would not adopt HECI's posi-
tion that the Railroad Commission records were constructive notice, but
concluded that the Commission's records are a ready source of informa-
tion that contributes to the fact that injury to a common reservoir by an
adjoining operator is not inherently undiscoverable. There is an even
broader statement in the opinion that "[a]ny failure of a lessee to monitor
activities of operators in a common reservoir or to notify royalty owners
of a cause of action against those operators is not an inherently undiscover-
able breach." The court also stated that the same reasoning would
apply to drainage claims and cited with apparent approval all the courts
of appeals decisions limiting the discovery rule in analogous contexts.

The court of appeals had found that there was an implied covenant in
the lease to notify the lessor of the need for suit. But the state supreme
court found that, if such an implied covenant existed, the cause of action
for breach was barred by limitations and refused to consider whether
there was such an implied covenant.

The court of appeals also found that there was an implied covenant in
the lease to notify the lessor of lessee's intent to sue. No such implied
covenant exists, however. To reach this conclusion, the supreme court
gave a lengthy explanation of the types of covenants implied in oil and

94. See id. at 886.
95. HECI Exploration, 982 S.W.2d at 886.
96. See id.
97. See id. at 886-87.
98. Id. at 887.
99. See id. at 888 (citing Shivers v. Texaco Exploration & Prod., Inc. 965 S.W.2d 727, 735 (Tex. App.—Texarkana 1998, pet. denied) (holding failure of lessee to apprise
royalty owner of tax laws regarding royalties from tight formation wells was not inherently
 undiscoverable); Rogers v. Ricane Enters., Inc., 930 S.W.2d 157, 169 (Tex. App.—Amarillo
1996, writ denied) (holding that discovery rule did not apply to claims for conversion of oil
and gas); Koch Oil Co. v. Wilber, 895 S.W.2d 854, 863 (Tex. App.—Beaumont 1995, writ
denied) (holding that discovery rule did not apply to cause of action for failure to pay
royalty because available information should have put plaintiff on inquiry); Harrison v.
(holding that discovery rule did not apply to nonpayment of royalty)).
100. See HECI Exploration, 982 S.W.2d at 887.
101. See id. at 891.
gas leases and the reasons why these covenants are implied. The court firmly rejected the notion that covenants may be implied in law and asserted that covenants are implied in fact. An implied covenant must arise from the presumed intention of the parties as gathered from the instrument, and implied covenants are justified only on the ground of necessity.\(^\text{102}\)

Broadly categorized, we have recognized implied covenants to (1) develop, which means to drill an initial well and to reasonably develop the lease, (2) protect the leasehold, which includes protection from local and field-wide drainage, and (3) manage and administer the lease.

\[\ldots\]

The extent of each lessee’s implied duties is governed by the concept of what a reasonably prudent operator would do “to carry out the purposes of the oil and gas lease.”\(^\text{103}\)

Having considered the fundamental nature of implied covenants in general, the court held that Neel and HECI were owners of concurrent interests in land, each had its own interest, each had its own cause of action, and each must protect its own rights.\(^\text{104}\)

The court of appeals struggled with Neel’s unjust enrichment claim because the record was unclear as to whether HECI had recovered a judgment for all the reserves or just HECI’s interest in the reserves. The supreme court concluded that it did not matter. A cause of action for unjust enrichment by Neel against HECI must be based upon an unjust enrichment at Neel’s expense. The fact that HECI may have recovered more than it was entitled to recover did not give rise to a cause of action for unjust enrichment in favor of Neel.\(^\text{105}\)

*Hay v. Shell Oil Co.*\(^\text{106}\) is another decision denying the application of the discovery rule in the context of an oil and gas case.\(^\text{107}\) This was the first application of the *HECI* opinion by a court of appeals, and it suggests that the application of the discovery rule will indeed be limited in avoiding the application of the statute of limitations.

In this case, a pooled unit of 704 acres was formed by Shell in 1977. Shell’s 1977 Form P-15, filed with the Railroad Commission, declared all the acreage in the unit reasonably productive. Shell sold all of its interest in the unit in 1984, and in 1989, after a series of hearings before the Railroad Commission, the subsequent operator was successful in getting the

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102. *See id.* at 888-89.
103. *Id.* at 889 (citing *Amoco Prod. Co. v. Alexander*, 622 S.W.2d 563, 567 n.1, 568 (Tex. 1981)).
104. *See id.* at 890.
105. *See id.* at 891.
106. 986 S.W.2d 772 (Tex. App.—Corpus Christi 1999, pet. denied).
Railroad Commission unit reduced to 160 acres. In 1992, after reviewing the Railroad Commission records for the first time, various members of the Hay family (collectively, the “Hays”) discovered that the unit “reasonably productive” of oil and gas was described as only 160 acres.\textsuperscript{108} The Hays then sued Shell for an accounting for the full royalty share they would have received from the beginning of production had the unit been properly pooled. Shell defended on the basis of limitations, and the Hays raised both the discovery rule and fraudulent concealment. The issue was joined on motion for summary judgment.\textsuperscript{109}

The four-year statute of limitations ordinarily applies to actions for the recovery of royalty payments, and that cause of action accrues when the wrongful act causes some legal injury, even if the fact of injury is not discovered until later and all resulting damages have not yet occurred. The legal injury occurred in 1977 when the 704-acre unit was formed. Limitations would bar that claim unless, for some reason, limitations was tolled.\textsuperscript{110} In some instances the discovery rule tolls the limitations period until the plaintiff knows, or in the exercise of reasonable diligence should have known, of the wrongful act and resulting injury.\textsuperscript{111}

The court applied the \textit{HECI} test of whether the injury complained of was inherently undiscoverable and was objectively verifiable. Shell’s 1977 P-15 form may have been some evidence that the injury was inherently undiscoverable, so the court focused on whether the injury was objectively verifiable. The court cited \textit{Robinson v. Weaver},\textsuperscript{112} and \textit{S.V. v. R.V.},\textsuperscript{113} for the general proposition that swearing matches between experts will not suffice to establish that an injury is inherently verifiable.\textsuperscript{114}

The Hays’ response to the motion for summary judgment did not attack Shell’s motion as to whether it established that the injury was not objectively verifiable, but that burden was nevertheless on Shell.\textsuperscript{115} Shell carried that burden with an unobjected-to affidavit of its petroleum consultant who opined as to the uncertainties of designating the reservoir rocks as either productive or unproductive of oil and gas. The Hays supplied competing affidavit testimony as to the nature of the formation, but did not object to Shell’s affidavit.\textsuperscript{116} This suggests that the Hays may have avoided summary judgment by attacking the affidavit, but offers little comfort that the Hays could have prevailed against Shell’s limitations defense.\textsuperscript{117}

Fraudulent concealment is an equitable doctrine that provides an affirmative defense to a plea of limitations and is generally dependent upon

\begin{footnotesize}
\textsuperscript{108} See \textit{Hay}, 986 S.W.2d at 775.
\textsuperscript{109} See id. at 775-76.
\textsuperscript{110} See id. at 776.
\textsuperscript{111} See id. at 776 (citing \textit{S.V. v. R.V.}, 933 S.W.2d 1, 4 (Tex. 1996)).
\textsuperscript{112} 550 S.W.2d 18, 21-22 (Tex. 1977).
\textsuperscript{113} 933 S.W.2d 1, 15 (Tex. 1996).
\textsuperscript{114} See \textit{Hay}, 986 S.W.2d at 777.
\textsuperscript{115} See id.
\textsuperscript{116} See \textit{id.}.
\textsuperscript{117} See \textit{id.} at 778.
\end{footnotesize}
the defendant's active suppression of the truth or its failure to disclose the truth when it is under a duty to speak.\textsuperscript{118} The Hays relied primarily upon Shell's 1977 Form P-15, but the court found that one cannot fraudulently conceal facts of which one has no actual knowledge. The evidence in the case merely established the speculative nature of petroleum exploration.\textsuperscript{119}

IV. EXPLORATION AGREEMENTS

\textit{TXO Production Co. v. M. D. Mark, Inc.}\textsuperscript{120} construes the effect of a merger on a seismic licensing agreement between TXO and Mark that included a confidentiality provision. The applicable provision provided that the data "shall not be sold, traded, disposed of, or otherwise made available to third parties."\textsuperscript{121} TXO, a wholly-owned subsidiary of Marathon, merged into Marathon. Marathon then refused to pay a contractually specified $200 per mile transfer fee, and Mark eventually sued for breach of contract, conversion and misappropriation of trade secrets. On motion for summary judgment, the trial court found that the merger was a transfer of data resulting in a breach of contract and therefore entered judgment for Mark.\textsuperscript{122}

The Houston court noted that no case in Texas or any other jurisdiction had addressed this specific issue. The court reviewed many decisions from other jurisdictions that determined in other contexts that a merger is not a transfer.\textsuperscript{123} The court also relied heavily on state merger statutes (presumably found in all states), such as article 506 of the Texas Business Corporations Act, which provides that "the rights, title, and interest in property of the merging corporations vest in the surviving corporation upon merger without further act or deed and without any transfer having occurred."\textsuperscript{124} The court reasoned that there was no loss to Mark. Before the merger, there was only one entity entitled to use the data, and after the merger there was still only one entity entitled to use the data—the "same" entity.\textsuperscript{125}

Finally, the court considered the contracts themselves as to the effect of merger on the non-disclosure provisions. The possibility of a merger was certainly foreseeable, and the court refused to imply a violation of the

\begin{itemize}
\item \textsuperscript{118} See id.
\item \textsuperscript{119} See id.
\item \textsuperscript{120} 999 S.W.2d 137 (Tex. App.—Houston [14th Dist.] 1999, no pet. h.).
\item \textsuperscript{121} Id. at 138.
\item \textsuperscript{122} See id. at 138-39.
\item \textsuperscript{123} See id. at 139-41.
\item \textsuperscript{124} Id. at 142-43 n.7. To hold that a merger is a transfer would conflict with the merger statutes patterned after the Model Business Code. See 3 MODEL BUS. CORP. ACT ANN. §11.06 cmt. (1997 Supp.). To hold that a merger is not a transfer is consistent with cases construing the effect of the preferential right to purchase clause in the various AAPL joint operating agreement forms. See, e.g., Tenneco Inc. v. Enterprise Prods. Co., 925 S.W.2d 640 (Tex. 1996); Questa Energy Corp. v. Vantage Point Energy, Inc., 887 S.W.2d 217 (Tex. App.—Amarillo 1994, writ denied).
\item \textsuperscript{125} See TXO Prod., 999 S.W.2d at 143.
\end{itemize}
non-disclosure agreement when the parties themselves failed to address the issue.\(^{126}\) The court briefly considered whether the contract's prohibitions on making the seismic data "available" could encompass statutory merger (which by operation of law makes all property of the merging corporation the property of the survivor, thereby making that property "available" to the survivor), but was apparently unpersuaded.\(^{127}\) The ultimate holding was that, as a matter of law, the merger did not constitute a prohibited transfer or disclosure, and TXO was entitled to summary judgment.\(^{128}\)

*M. D. Mark, Inc. v. Nuevo Energy Co.*\(^ {129}\) deals with the interpretation of restrictions on the use of seismic data. The restrictions in the licensing agreement provided: "SECRET. [Licensee] agrees that data hereunder shall be for his own use in his exploration and development efforts, and shall not be sold, traded, disposed of, or otherwise made available to third parties, except it may be shown to partners as support evidence for joint ventures."\(^ {130}\)

The owner/licensor filed suit alleging that a series of mergers and stock sales involving its licensee violated the licensing agreement.\(^ {131}\)

On appeal, Nuevo argued that no sale or disposal of assets had occurred and that the license agreement did not contain any prohibition of a change of control by stock sale, merger, or otherwise.\(^ {132}\) The court agreed, citing *Tenneco Inc. v. Enterprise Products Co.*\(^ {133}\) (a preferential rights case) for the proposition that a sale of all the stock of a company is not a sale of any of its assets.\(^ {134}\) Similarly, the merger of a wholly-owned subsidiary into its parent company is not a sale.\(^ {135}\)

The court noted that the parties could have provided for their protection with a "change-of-control" provision in the agreement, but they did not. The court would not rewrite the agreement to insert a provision that the parties themselves did not include.\(^ {136}\) The opinion does not discuss the effect of the dragnet clause: "or otherwise made available."

*Lazy M Ranch, Ltd. v. TXI Operations, L.P.*\(^ {137}\) considers the consequences of unauthorized mineral exploration outside a permitted area. TXI and Lazy M executed a written contract granting TXI the right to explore for sand, gravel, and other construction materials by conducting subsurface tests on a specific 1,669 acres of the Lazy M Ranch. In the contract, Lazy M also granted TXI an irrevocable option to lease 300 of

\(^ {126}\) See id.

\(^ {127}\) See id.

\(^ {128}\) See id.

\(^ {129}\) 988 S.W.2d 463 (Tex. App.—Houston [1st Dist.] 1999, no pet. h.).

\(^ {130}\) See id. at 465.

\(^ {131}\) See id. at 464.

\(^ {132}\) See id. at 465.

\(^ {133}\) 925 S.W.2d 640 (Tex. 1996).

\(^ {134}\) See *M. D. Mark*, 988 S.W.2d at 465.

\(^ {135}\) See id. at 465.

\(^ {136}\) See id. at 465.

\(^ {137}\) 978 S.W.2d 678 (Tex. App.—Austin 1998, pet. denied).
the 1,669 acres to mine for sand and gravel. The contract provided a specific time period in which TXI had to exercise the option to lease the land. When TXI attempted to exercise the option, Lazy M refused to lease any of the land to TXI because TXI had allegedly breached the contract by entering upon and testing on ranch land outside the 1,669 acres specified in the contract. TXI then sued Lazy M, and the trial court granted specific performance on a motion for summary judgment.\textsuperscript{138}

A party to a contract may terminate a contract and be excused from performance of any future obligation if the other party repudiates the contract or commits a "material" breach of a "dependent" covenant. TXI's repeated and intentional violations were enough for the court to find the breach to be material.\textsuperscript{139} Rather than engage in an analysis of the dependency of the covenants, the court employed a "fairness" test and considered the following factors from section 241(a) of the Second Restatement of Contracts in reaching its decision that the contract was unenforceable against Lazy M:

1. the extent to which the injured party [Lazy M] can be adequately compensated for the part of the benefit of which he will be deprived;
2. . . .
3. the likelihood that the party failing to perform [TXI] will cure his failure, taking into account all of the circumstances including any reasonable assurances; and
4. the extent to which the behavior of the party failing to perform [TXI] comports with standards of good faith and fair dealing.\textsuperscript{140}

The court of appeals acknowledged that refusing to enforce the contract against Lazy M would effectively forfeit TXI's right to an option, and that forfeitures are to be avoided unless enforcement of the contract would be unreasonable, inequitable, or oppressive.\textsuperscript{141} However, Lazy M's summary judgment evidence established that TXI had repeatedly explored outside the contractually permitted area, and that TXI's trespasses were intentional and repeated over several protests by Lazy M.\textsuperscript{142}

Lazy M also alleged that TXI had "unclean hands" and was not entitled to the equitable remedy of specific performance. Under the doctrine of "unclean hands," a court can refuse to grant equitable relief (specific performance) to a plaintiff who has been guilty of unlawful or inequitable conduct regarding the issue in dispute.\textsuperscript{143} The court of appeals ruled that the doctrine of "unclean hands" applied since TXI's misconduct was directly related to the contract for which TXI sought specific performance.\textsuperscript{144} The summary judgment was reversed, and the case was remanded to the trial court.\textsuperscript{145}

\textsuperscript{138} See id. at 680.
\textsuperscript{139} See id. at 681.
\textsuperscript{140} See id. at 681-2.
\textsuperscript{141} See id. at 681.
\textsuperscript{142} See id. at 682.
\textsuperscript{143} See id. at 683.
\textsuperscript{144} Lazy M Ranch, 978 S.W.2d at 683.
\textsuperscript{145} See id.
The significance of this case is that if a mineral interest owner and an exploration company execute a seismic permit and lease option agreement, and the exploration company shoots seismic or conducts other exploration operations outside the area permitted by the agreement, the exploration company could lose its right to lease the mineral interest owner's lands.

V. EASEMENTS

Anderson v. Teco Pipeline Co.\(^\text{146}\) explores the scope of the power of eminent domain and the proof necessary to exercise that power for a pipeline easement. Anderson challenged the trial court's granting of a pipeline easement by arguing that Teco did not have the power of eminent domain, that Teco's pipeline would not serve a public purpose, and that Teco had failed to prove a necessity for the easement.\(^\text{147}\)

The power of eminent domain must be conferred by the legislature, either expressly or by necessary implication, and statutes granting the power of eminent domain are strictly construed in favor of the landowner and against the condemnor.\(^\text{148}\) Teco asserted that its power was derived from a statute now codified at sections 181.007-008 of the Texas Utility Code (effective September 1, 1997), which gave "gas corporations" the power to transport gas and to use such easements as may be necessary for the purpose of such corporations.\(^\text{149}\)

Although the statutes offer no definition of the term "gas corporations," the Anderson court followed other appellate courts in holding that a corporation operating a gas pipeline has the power of eminent domain if it devotes its private property and resources to public service and allows itself to be publicly regulated.\(^\text{150}\) The court found Teco's evidence on this point to be sufficient. This evidence included: regulation by the Texas Railroad Commission, the obligation to file forms with the Texas Railroad Commission, taxation as a gas utility, regulatory burdens as to rates that Teco could charge, seven to ten producers moving gas through the line, and that the pipeline was open to anyone who wanted to move gas.\(^\text{151}\)

The power of eminent domain can only be used to take property for a public purpose, and the question of whether a taking is for a public or private purpose is ordinarily one of law for the court. If the statute does not require proof of necessity, the condemnor need only show that its board of directors determined the taking was necessary.\(^\text{152}\) This determination is conclusive, absent fraud, bad faith, abuse of discretion, or arbitrary or capricious action, which could create a fact issue that may be

\(^{146}\) 985 S.W. 2d 559 (Tex. App.—San Antonio 1998, pet. denied).
\(^{147}\) See id. at 561.
\(^{148}\) See id. at 564.
\(^{149}\) See id.
\(^{150}\) See id.
\(^{151}\) See id. at 565.
\(^{152}\) See Anderson, 985 S.W.2d at 565.
submitted to the jury. Teco introduced both shareholder and director's consents stating that the pipeline was needed to serve a public purpose. However, these resolutions were in a general form relating to the general course of the pipeline over an extended distance and did not specifically address the Andersons' tract. The court held that Teco was not required to produce a resolution finding that the Andersons' particular tract was necessary for the project.

VI. RAILROAD COMMISSION

WBD Oil & Gas Co. v. Railroad Commission of Texas155 is a suit challenging the validity of the Commission's Panhandle Field Rules by way of a declaratory judgment action under the Administrative Procedure Act ("APA").156 WBD was sued in 1994 for allegedly violating certain rules, including portions of the 1989 Panhandle Field Rules.157 WBD countered by attacking the rules. The issue on appeal was the trial court's jurisdiction to consider WBD's case.158 WBD relied on the APA which provides:

the validity or applicability of a rule, including an emergency rule adopted under section 2001.043, may be determined in an action for a declaratory judgment if it is alleged that the rule or its threatened application interferes with or impairs, or threatens to impair, a legal right or privilege of the plaintiff.159

WBD claimed that the Panhandle Field Rules could be reviewed under this provision because they were "rules," and the Commission contended that they were promulgated pursuant to the contested-case procedures of sections 2001.051-.147 of the APA rather than the notice and comment rule making procedures of sections 2001.023-.034.160 After a detailed review of the nature of the Panhandle Field Rules and the process of adopting those rules, the court concluded the rules were in fact "rules" and that the district court had jurisdiction161

There is a general rule that an agency's final order is immune from collateral attack. However, this action was brought under section 2001.038 and constitutes a direct attack on the Commission's Field Rules. An aggrieved party does not have to exhaust all possible agency remedies before bringing an action under section 2001.038.162

Exxon Corp. v. Railroad Commission of Texas163 focuses on the distinctions between a "legal subdivision" and a "voluntary subdivision"

153. See id. at 565-66.
154. See id. at 566.
157. See WBD Oil & Gas, 1999 WL 46637 at *3.
158. See id. at *4.
159. See id.
160. See id.
161. See id. at *4-6.
162. See id. at *10.
163. 993 S.W.2d 704 (Tex. App.—Austin 1999, no pet. h.).
under the Texas Railroad Commission’s rules and procedures. The number of wells permitted and the location of those wells can have a significant impact on the amount of hydrocarbons an owner may recover. Because the Railroad Commission starts with the premise that every owner is entitled to at least one well, but recognizes that having many small tracts with multiple wells does not necessarily promote conservation, there is a continuing tension in the complex regulatory world administered by the Railroad Commission. The establishment of minimum spacing and density requirements for a field is a watershed date for determining the rights of small tract owners.

In this case, Oryx operated a pooled 160-acre unit comprised of a 40-acre tract and a 120-acre tract. The 40-acre tract was subdivided from a larger tract in 1947, before discovery of oil and gas in the area and before there were any field rules. In 1958, the Railroad Commission established field rules with a well-density ratio of one well per 320 acres. The 120-acre tract was created after the Commission adopted its field rules and was pooled with the 40-acre tract. The 40-acre tract is therefore a “legal subdivision,” because it resulted from the subdivision of a larger tract before the field rules were adopted, and the 120-acre tract is therefore a “voluntary subdivision,” because it resulted from the subdivision of a larger tract after the field rules were adopted.

These distinctions have important consequences under the Commission’s statewide density rule—Rule 38. For example, no exception to density requirements is necessary “for the first well on the . . . drillsite tract of a pooled unit,” for a legal subdivision having substandard acreage (less than 320 acres in this instance). An exception to the density requirements must be obtained and may be granted only to prevent waste on a voluntary subdivision having substandard acreage. In other words, one well could be located on the 40-acre tract, but no well could be located on the 120-acre tract, except after a hearing and proof that it was necessary to prevent waste. One well was drilled on the 40-acre tract, the 120-acre tract was pooled with the 40-acre tract, and there was no controversy until that single well (Well No. 5) began to fail in 1995.

Oryx sought to permit Well No. 6 on the pooled unit, but off the 40-acre tract, or alternatively to permit Well No. 6 on the 40-acre tract as a replacement well for Well No. 5. After a contested hearing with Exxon, the Commission denied Oryx’s application to drill off the 40-acre tract, but permitted the replacement well on the 40-acre tract.

Rule 38(d)(1) states expressly that:
[a]n exception to the minimum density provision is not required for the first well on a . . . pooled unit . . . composed of substandard acre-

164. See id. at 705.
165. See 16 TEX. ADMIN. CODE § 3.38 (1999) ("Rule 38").
166. See Exxon, 993 S.W.2d at 705-06.
167. See id. at 706.
168. See id.
169. See id.
age, when the . . . drillsite tract of a pooled unit . . .: (A) took its present size and shape prior to the date of attachment of the voluntary subdivision rule (§ 3.37(g) of this title (relating to Statewide Spacing Rule)) [emphasis added].170

Well No. 5 was literally "the first well," and the issue was whether the rule could be read in the constructive sense applied by the Commission. Well No. 6 would be the functional equivalent of Well No. 5 because the latter would cease production.171

The court rejected Exxon's contention that the rule must be interpreted literally and concluded that the agency's interpretation was not plainly erroneous. That interpretation protected an owner's right to a reasonable opportunity to recover a fair share, which is itself a constitutionally and statutorily protected right. Adopting a constructive meaning preserved that right, and therefore the Commission acted within its discretion.172

Exxon also contended that the 40-acre tract vanished as a "legal subdivision" when it was pooled with the 120-acre tract. Pooling in Texas results in cross-conveyances of mineral interests among the owners of the pooled acreage, so that all of them acquired an undivided interest in the resulting unit in the same proportion that their contribution of acreage bears to the acreage of the entire unit.173 Exxon reasoned that the original "legal subdivision" vanished in this cross-conveyance (subdivision). The court rejected this contention because there was no attempt to subordinate the 160-acre unit, and the language of rule 38(d)(1) clearly contemplated the continued existence of a "drillsite tract of a pooled unit," such as the 40-acre tract, when the rule states that "[a]n exception . . . is not required for a first well . . . on the drillsite tract of a pooled unit . . . ."174

VII. GAS CONTRACTS

Russell v. Panhandle Producing Co.175 is a summary judgment and venue case that turns on issues of limitations and privity of contract between the purchaser of gas and the assignees of the seller of gas. In 1981, Edwards, who was the owner of a lease in Hutchinson County with 22 producing oil wells, contracted to sell the casinghead gas from the wells to Panhandle. Shortly thereafter, Edwards made a partial assignment of his working interest to the group of plaintiffs ("Sellers") who filed this case.176 Panhandle had enforced a series of price reductions during the gas bubble years of the 1980s,177 and by their suit, Sellers sought to set

170. See id. at 706 n.1.
171. See id. at 707-08.
172. See id. at 708-09.
173. See Exxon, 993 S.W.2d at 710 (citing Montgomery v. Rittersbacher, 424 S.W.2d 210, 313 (Tex. 1968)).
174. See id. at 710-11.
175. 975 S.W.2d 702 (Tex. App.—Amarillo 1998, no pet.).
176. See id. at 705.
177. See id. at 706.
aside or to avoid the price reductions on a variety of grounds.\textsuperscript{178}

The trial court granted Panhandle's motion for summary judgment without identifying specific grounds and entered a take nothing judgment.\textsuperscript{179} In reversing the summary judgment, the appellate court found that Sellers' claims for gas delivered within the four years prior to filing suit were not barred by limitations. A contract for the sale of oil or gas is a contract for the sale of goods, and is therefore covered by the four-year statute of limitations in chapter two of the Texas Business and Commerce Code.\textsuperscript{180}

The gas purchase contract contained a contractual two-year limitation on accounting claims.\textsuperscript{181} Venue in the case could only be sustained in the county of suit if the gas purchase contract had been entered into in that county. Because only Edwards signed the gas purchase contract, the court found that the two-year contractual limitation on claims did not apply,\textsuperscript{182} and that venue was improper.\textsuperscript{183} The fact that Edwards and Panhandle made the agreement in the county of suit does not inure to the benefit of sellers for venue purposes.\textsuperscript{184} There was no evidence of an assignment of the gas purchase contract as distinguished from the assignment of the oil and gas lease.\textsuperscript{185}

\textit{Northern Natural Gas Co. v. Conoco, Inc.}\textsuperscript{186} construes a natural gas transportation and processing agreement as to the intent behind the dedication of reserves and whether a gas purchaser can unilaterally terminate gas purchase contracts and escape the obligation to deliver gas. Northern purchased gas from producers for delivery into Conoco's gas processing and gathering facilities. Northern agreed to deliver and Conoco agreed to accept "all of the gas [that] Northern purchases and receives, in accordance with Northern's gas purchase contracts with producers, . . . in keeping with all the quantity and other provisions of [Northern's] various gas purchase contracts in effect from time to time."\textsuperscript{187} The agreement was to continue "for so long as the various Gas Purchase Contracts dedicated hereunder remain in effect, but not less than twenty (20) years," unless terminated pursuant to the terms herein.\textsuperscript{188} There was also a supplemental amendment to the agreement which added new wells and recited that the agreement would apply to both the original and the new wells "for

\begin{itemize}
\item \textsuperscript{178} See id. at 709.
\item \textsuperscript{179} See id. at 704, 709.
\item \textsuperscript{180} See id. at 708-09; TEX. BUS. & COM. CODE ANN. ch. 2 (Vernon 1994 & Supp. 1998).
\item \textsuperscript{181} See Russell, 975 S.W.2d at 705.
\item \textsuperscript{182} See id. at 709.
\item \textsuperscript{183} See id. at 711.
\item \textsuperscript{184} See id.
\item \textsuperscript{185} See id. at 712.
\item \textsuperscript{186} 986 S.W.2d 603 (Tex. 1998). This case was argued December 4, 1997, originally rendered on April 14, 1998, decided October 22, 1998, held open for motions on rehearing, and then revised and issued on April 1, 1999.
\item \textsuperscript{187} Id. at 604-05.
\item \textsuperscript{188} Id. at 605.
\end{itemize}
the productive life of the wells.\textsuperscript{189}

As the Federal Energy Regulatory Commission proceeded with the deregulation of gas marketing, Northern began canceling and buying out its contractual obligations to purchase gas from producers. By 1994, Northern was no longer purchasing gas from producers and was acting only as a gas transporter.\textsuperscript{190} Conoco contended that Northern was obligated to continue purchasing all of the gas produced from the wells listed in Conoco’s agreement with Northern and to deliver that gas to Conoco for the productive life of the wells. Conoco got a favorable instruction, a finding of breach by the jury, and a judgment for $20 million in damages for lost gas processing profits.\textsuperscript{191} The court of appeals reversed, holding that the agreement did not require Northern to actually purchase any gas, but the court remanded the issue of whether Northern breached a duty of good faith by canceling all of its gas purchase contracts.\textsuperscript{192}

The supreme court agreed with the court of appeals that the agreement was unambiguous and that it did not require Northern to deliver all natural gas reserves from dedicated wells for the productive life of the wells. Northern was required to make deliveries only for so long as the gas purchase contracts remained in effect.\textsuperscript{193}

Conoco contended that Northern’s contract cancellations were contrary to the good faith standards of sections 1.203 and 2.306 of the Texas Business and Commerce Code. Section 1.203 states the general rule that “[e]very contract or duty within this title imposes an obligation of good faith in its performance or enforcement.”\textsuperscript{194} The court concluded that this provision:

\begin{quote}
does not support an independent cause of action for failure to perform or enforce in good faith.\ldots [I]t means that a failure to perform or enforce, in good faith, a specific duty or obligation under the contract, constitutes a breach of that contract. Northern, however, had no duty imposed upon it to maintain the gas purchase contracts \ldots\textsuperscript{195}
\end{quote}

Section 1.203, therefore, did not support Conoco’s claim for damages.

Although the agreement stated that it “shall be interpreted in accordance with the rules of construction and interpretation set forth in the Texas Uniform Commercial Code,”\textsuperscript{196} the court refused to apply section 2.306 regarding sales. The court noted that this was a service contract, not a sales contract, and that article two was no more applicable than article three or article nine.\textsuperscript{197}

\textsuperscript{189} Id.
\textsuperscript{190} See id. at 605.
\textsuperscript{191} See id.
\textsuperscript{192} See Northern Natural Gas, 986 S.W.2d at 605.
\textsuperscript{193} See id. at 606, 606 n.1.
\textsuperscript{194} TEX. BUS. & COM. CODE ANN. § 1.203 (Vernon 1994).
\textsuperscript{195} See Northern Natural Gas, 986 S.W.2d at 606-07.
\textsuperscript{196} Id. at 605.
\textsuperscript{197} See id. at 607.
The court found that in an output/requirements contract there is a common law duty of good faith, and that "a party who seeks to avoid performance of an output contract by having no output—or of a requirements contract by having no requirements—may not do so in bad faith." Therefore, on remand, it will be Conoco's burden to prove "Northern canceled its gas purchase contracts without a valid business reason and in bad faith."

VIII. LEGISLATION

A. EXPLORATION AND PRODUCTION


   ISSUE: Relating to a temporary exemption from the severance tax for oil and gas produced from wells under certain market conditions.

   SUMMARY: This act suspends severance tax payments which keep oil and gas producers from having to abandon "stripper wells" which produce minimal amounts of oil and gas. The exemption is available when the Comptroller of Public Accounts certifies that the average price of oil has fallen below $15.00 per barrel for three consecutive months or the average price of gas has fallen below $1.80 per MMBtu for three consecutive months, both as recorded on the New York Mercantile Exchange.

   The act requires the Comptroller to perform the first certification determination for the three-month period beginning November 1, 1998. The period of eligibility for the exemption is February 1, 1999, to August 1, 1999, and the act provides credits for severance taxes paid during a period of certified exemption. To receive the credit, the person must apply to the Comptroller for the credit not later than the expiration of the applicable period for filing a tax refund under section 111.104 of the Texas Tax Code.

   Qualifying leases under this exemption are: (i) Commission-designated oil leases producing no more than fifteen barrels per day per oil well as reported on Form P-1, and (ii) gas wells producing no more than ninety Mcf per day per gas well as reported on Form P-2, based on average daily well production. Production for qualification purposes excludes gas flared pursuant to Commission rules. The exemption expires on the earlier of September 1, 1999 or the last day of the month in which the total taxes exempted equal $45 million dollars.

   EFFECTIVE: March 11, 1999.


198. Id. at 608.
199. Id. at 608-9.
201. Codified as an amendment to TEX. TAX CODE ANN. §§ 201.057(c), 202.056(c), (d) (Vernon Supp. 2000).
ISSUE: Relating to the application of the oil and gas severance taxes to high-cost gas production and inactive oil and gas leases.

SUMMARY: This act extends for eight years the high-cost gas severance tax reduction incentive to include production from qualifying wells spudded before September 1, 2010. The act extends for ten years the two-year inactive well severance tax exemption incentive to include wells for which application is made to the Railroad Commission for certification prior to September 1, 2009, and which are designated by the Railroad Commission prior to March 1, 2010. High-cost gas is defined in section 201.057(a)(2)(A) of the Texas Tax Code.

EFFECTIVE: August 30, 1999, ninety days after date of adjournment.


ISSUE: Relating to a tax exemption for hydrocarbon production from certain inactive oil and gas leases returned to production.

SUMMARY: This act extends the two-year inactive well incentive. The deadline for making applications for certification with the Railroad Commission is extended from August 31, 1999 to August 31, 2009, and the date for the Railroad Commission to approve applications is extended from February 29, 2000 to February 28, 2010. The act provides a ten-year severance tax exemption for hydrocarbons produced from a well which has not produced oil or gas for more than one month during the two years preceding the date of application for the exemption.

EFFECTIVE: June 18, 1999.


ISSUE: Relating to a disclosure required in certain offers by mail to purchase mineral or royalty interests.

SUMMARY: This act requires an offer to purchase the mineral or royalty interest in a property to conspicuously state that the person who conveys the interest is selling the interest. The offer must state in fourteen-point type style or larger:

**BY EXECUTING AND DELIVERING THIS INSTRUMENT YOU ARE SELLING ALL OR A PORTION OF YOUR MINERAL OR ROYALTY INTEREST IN (include legal description of property).**

The act also authorizes the person who conveys the interest to bring suit against a purchaser if the purchaser fails to provide notice. Such a suit must be filed no later than the second anniversary of the date the person executed the conveyance.

EFFECTIVE: September 1, 1999.


5. Act: Act of June 18, 1999, 76th Leg., R.S., ch. 1089, § 1, 1999 Tex. Sess. Law Serv. 3951.\textsuperscript{204}

Issue: Relating to the deposit to the credit of the oil-field cleanup fund of certain fees and penalties collected by the Railroad Commission of Texas.

Summary: This act requires that a penalty collected under section 81.0531 of the Texas Natural Resources Code, regarding well plugging violations, proceeds from bonds, financial assurances, and expenses, be deposited to the credit of the oilfield cleanup fund.

Effective: September 1, 1999.


Issue: Relating to the recovery by the Railroad Commission of Texas of well plugging and oil field cleanup costs incurred by the commission.

Summary: Prior to the passage of this act, the Railroad Commission could seek reimbursement of expenses incurred in the state-funded plugging or cleanup of an oil well only through the Attorney General. This act authorizes the commission to seek reimbursement by administrative order in addition to an action brought by the Attorney General. At the Commission's request, the Attorney General may also file suit to enforce an administrative order.


Issue: Relating to a lien of the Railroad Commission of Texas on well-site equipment to secure the cost of plugging an oil or gas well.

Summary: This act prevents the removal of well-site equipment by third parties after the Commission has authorized a state-funded plugging. Under prior law, the Railroad Commission had to give at least thirty days notice by certified mail to a well operator prior to entering into a contract to plug a delinquent inactive well. With the passage of this act, the notice must also state that the Commission has a lien on all well-site equipment under section 89.083 of the Texas Natural Resources Code.

Effective: August 30, 1999, ninety days after the date of adjournment.


\textsuperscript{204} Codified as an amendment to TEX. NAT. RES. CODE ANN. § 81.0531(d) (Vernon Supp. 2000).

\textsuperscript{205} Codified as an amendment to TEX. NAT. RES. CODE ANN. §§ 89.043(c), (f) (Vernon Supp. 2000).

\textsuperscript{206} Codified as an amendment to TEX. NAT. RES. CODE ANN. §§ 89.043(c), 89.083(e) (Vernon Supp. 2000).

\textsuperscript{207} Codified as an amendment toTEX. NAT. RES. CODE ANN. §§ 91.104(b), 91.1091, 91.114(d) (Vernon Supp. 2000).
ISSUE: Relating to the reimbursement of the Railroad Commission of Texas for costs incurred by the Commission for violations regarding safety or the prevention or control of pollution.

SUMMARY: This act requires the Railroad Commission to approve a P-5 "Organization Report" renewal only if an oil and gas operator has paid all reimbursements of any plugging or cleanup costs and expenses incurred by the Commission for violation of any commission rules, orders, leases, permits, or certificates. Under prior law, there was no bar to renewal unless the plugging and cleanup costs were assessed by the commission or adjudged by a court.

EFFECTIVE: August 30, 1999, ninety days after the date of adjournment.


ISSUE: Relating to the creation of an administrative penalty for certain violations relating to the production of oil and gas.

SUMMARY: This act authorizes the Railroad Commission to impose an administrative penalty on a person who breaks or tampers with a seal on a well or who produces or transports oil or gas from a sealed well. The amount of the penalty may not exceed $10,000.00 for each violation. This act only applies to a violation that occurs on or after the effective date of this act.

EFFECTIVE: September 1, 1999.


ISSUE: Relating to the imposition of an administrative penalty by the Railroad Commission of Texas for taking certain actions regarding false applications, reports, and documents and for tampering with gauges.

SUMMARY: This act authorizes the Railroad Commission to impose administrative penalties of up to $1,000.00 per violation against persons who falsify applications, reports, or documents, or who tamper with gauges. Penalties may also be assessed against persons assisting or advising in the preparation or presentation of applications that are false or incorrect. The prior law had only provided for criminal penalties, which were poorly enforced. This act now provides both administrative and criminal penalties; however, it only applies to a violation that is committed on or after the effective date of the act.

EFFECTIVE: August 30, 1999, ninety days after date of adjournment.


210. Codified as an amendment to TEX. CIV. PRAC. & REM. CODE ANN. § 127.005(b) (Vernon Supp. 2000).
ISSUE: Relating to the provision of insurance for mutual indemnity obligations in certain mineral agreements.

SUMMARY: This act provides that oilfield mutual indemnity agreements are valid so long as the parties have insurance to cover their indemnity obligations for the benefit of the other parties.

EFFECTIVE: August 30, 1999, ninety days after date of adjournment.


ISSUE: Relating to receivers, payors, and lessees under certain mineral leases.

SUMMARY: This act provides that a district court may appoint a receiver for a royalty interest owned by a defendant who is: (a) non-resident, or (b) a person whose identity or residence is unknown. The person must not have paid taxes on the interest or rendered it for taxes during the five-year period immediately preceding the filing of the action. The plaintiff in the action, who may be another royalty owner in the same property, must allege by verified petition and prove that the plaintiff has made a diligent but unsuccessful effort to locate the defendant and will suffer substantial damage or injury unless a receiver is appointed. The plaintiff must also name the last known owner or the last record owner of the interest as defendant in the petition. When ordered by the court, the receiver is to ratify mineral leases, pooling agreements, or unitization agreements.

Section two of the act also requires the written approval of the General Land Commissioner prior to transferring liability to properly plug and abandon any wells on a state lease during a lease transfer. The Commissioner may not withhold consent unreasonably. However, upon determining that the assignee is financially incapable of properly plugging and abandoning wells, removing platforms and pipelines, or remediating contamination, the Commissioner may require the assignee to post a bond or other security to secure these obligations.

EFFECTIVE: August 30, 1999, ninety days after date of adjournment, except as provided in section 6(a) of the act.


ISSUE: Relating to a requirement that a payor of the proceeds from the sale of gas produced from certain gas wells furnish certain information to the payee.

SUMMARY: This act requires companies that pay the proceeds from the sale of gas produced from a tight formation to annually furnish the payee with the information necessary for the payee to compute his federal income tax credit provided by section 29(c)(2)(B) of the Internal Revenue

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The information provided to the payee should include: (1) information described in section 91.502(1) of the Texas Natural Resources Code, and (2) the volume of the gas measured: (a) in thousands of cubic feet and heating value; or (b) in millions of British thermal units for each thousand cubic feet. This information must be furnished to each payee no later than March 15.

**Effective:** September 1, 1999.


**Issue:** Relating to the period during which the School Land Board may reduce the royalty rate under certain oil and gas leases.

**Summary:** This act deletes the two-year limit imposed on the school land board with respect to authorizing reduced royalty rates on state leases. The act permits the board to prescribe the duration that the royalty rate reduction may be allowed.

**Effective:** September 1, 1999.

B. **Environmental**

1. **Act:** Act of June 18, 1999, 76th Leg., R.S., ch. 668, §§ 1-2, 1999 Tex. Sess. Law Serv. 3239.214

**Issue:** Relating to notice and hearing for an application for a permit for a commercial surface disposal facility.

**Summary:** This act requires publication of notice when a person files an application for a permit for a commercial surface disposal facility. A commercial surface disposal facility for purposes of this section means a facility whose primary business purpose is to provide, for compensation, surface disposal of oil field fluids or oil and gas wastes, including land application for treatment and disposal. The notice must be published at least once a week for two weeks in a newspaper of general circulation in the county in which the proposed facility will be located. There may also be a public meeting to receive comment on an application for a commercial surface disposal facility if it is in the public interest.

**Effective:** September 1, 1999.


**Issue:** Relating to the issuance of certain permits for the emission of air contaminants.

**Summary:** This act authorizes the Texas Natural Resource Conservation Commission (TNRCC) to permit "grandfathered" facilities, i.e., existing, unpermitted facilities not subject to the requirement to obtain a 


215. Codified as an amendment to Tex. Health & Safety Code Ann. §§ 382.003(9), 382.051(a), (b), 382.0511(a), (c), 382.057(a), 382.058, 382.062(b), 382.0621(d), and by adding §§ 382.05101, 382.0519, 382.05191-05196 (Vernon Supp. 2000).
pre-construction permit because they were in existence as of August 30, 1971, or had a construction contract executed by August 30, 1971, and a beginning construction date not later than February 29, 1972. The owner or operator of a grandfathered facility may apply for one of the following four types of permits by September 1, 2001:

(a) Voluntary Emissions Reduction Permit [VERP];
(b) Multiple Plant Permit;
(c) Standard Permit; or
(d) Permits by Rule.

The TNRCC must grant a VERP if the facility will use an air pollution control technology at least as beneficial as ten-year-old best-available control technology, considering technical practicability and economic reasonableness, and considering the age and remaining useful life of the facility. The TNRCC will give priority to the processing of applications for those facilities that are located less than two miles from the outer perimeter of a school, child daycare facility, hospital or nursing home.

**Effective:** August 30, 1999, ninety days after date of adjournment.


**Issue:** Relating to public participation in certain environmental permitting procedures of the TNRCC.

**Summary:** This act modifies the current permitting process for certain environmental permit programs administered by the TNRCC for which public notice and opportunity for hearing are currently required for EPA authorization of a state permit. The act requires early public notice, encourages early public involvement, and requires agency response to any substantive public comment. The act establishes criteria that would limit the scope of hearings by requiring referral of discrete issues that are in dispute and material to the decision of the TNRCC to an administrative law judge. Other issues may be considered other than those referred by the TNRCC if the judge determines that: (1) the issue is material; (2) the issue is supported by evidence; and (3) there are good reasons for the failure to supply available information regarding the issue during the public comment period. In addition, the act requires the commission to establish hearing deadlines to prevent unnecessary delays in the permitting process. The act applies to applications for issuance, amendment, and renewal of water quality permits, underground injection permits, solid waste permits, and air permits.

**Effective:** September 1, 1999.

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ISSUE: Relating to public notification of certain accidental discharges or spills into water.
SUMMARY: This act requires that notice to the TNRCC regarding spills that may cause pollution must include the location, volume, and content of the spill or discharge. The act also requires notice to local government and media of certain spills from waste water treatment or collection facilities operated by local governments if the spill or discharge may adversely affect a public or private source of drinking water.
EFFECTIVE: September 1, 1999.

C. PIPELINES

ISSUE: Relating to services of a gas utility provided to a school district.
SUMMARY: This act prohibits gas utilities and municipally owned utility systems from refusing to transport natural gas produced on state lands to school districts unless the utility is prohibited by other law or insufficient pipeline capacity exists.
EFFECTIVE: September 1, 1999.

ISSUE: Relating to the powers of a limited liability company.
SUMMARY: This act provides that limited liability companies engaged as common carriers in the pipeline business for transporting oil, oil products, gas, carbon dioxide, salt brine, fuller's earth, sand, clay, liquefied minerals, or other mineral solutions have the power of eminent domain and other rights.
EFFECTIVE: September 1, 1999.

ISSUE: Relating to the regulation of gas utilities organized as limited liability companies.
SUMMARY: This act redefines “person” and “corporation” under the Gas Utility Regulatory Act to include a limited liability company. This act clarifies that a limited liability company may act as a gas utility.

217. Codified as an amendment to TEX. WATER CODE ANN. § 26.039(b), and adding § 26.039(e), (f) (Vernon Supp. 2000).
219. Codified as TEX. REV. CIV. STAT. ANN. arts. 1528n, 2.02(D) (Vernon Supp. 2000).
220. Codified as an amendment to TEX. UTIL. CODE ANN. §§ 101.003(10), 121.001(b), 181.001(1) (Vernon Supp. 2000).
4. **Act:** Act of June 18, 1999, 76th Leg., R.S., ch. 1272, § 1, 1999 Tex. Sess. Law Serv. 4386.\(^{221}\)

**Issue:** Relating to registering pipeline operators with the Railroad Commission of Texas.

**Summary:** This act requires all pipeline operators file with the Railroad Commission the same information that oil and gas operators must provide in their Form P-5.

**Effective:** June 18, 1999.

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### D. Taxes

1. **Act:** Act of June 19, 1999, 76th Leg., R.S., ch. 1467, § 2.19, 1999 Tex. Sess. Law Serv. 4996.\(^{222}\)

**Issue:** Relating to state fiscal matters, including taxes and fees administered by the comptroller; making appropriations.

**Summary:** This act, besides amending other tax laws, amends the machinery and equipment sales tax exemption of section 151.318 of the Texas Tax Code. The act enhances the eligibility of certain process piping and other tangible personal property that assist in the chemical or physical change in the final product or that reduce either water use or wastewater flow volumes.

**Effective:** June 19, 1999, except as provided in sections 4.10 and 4.12 of the act.

2. **Act:** Act of June 18, 1999, 76th Leg., R.S., ch. 810, 1999 Tex. Sess. Law Serv. 3443.\(^{223}\)

**Issue:** Relating to taxpayer protests concerning the appraisal of certain pooled or unitized mineral interests.

**Summary:** This act provides that if a property owner files protests relating to a pooled or unitized mineral interest that is being produced at one or more production sites located in a single county with the appraisal review boards of more than one appraisal district, the appraisal review board for the appraisal district established for the county in which the production site or sites are located must determine the protest filed with that board and make its decision before another appraisal review board may hold a hearing to determine the protest filed with that other board.

If a property owner files protests relating to a pooled or unitized mineral interest that is being produced at two or more production sites located in more than one county with the appraisal review boards of more than one appraisal district and at least two-thirds of the surface area of the mineral interest is located in the county for which one of the appraisal districts is established, the appraisal review board for that appraisal district must determine the protest filed with that board and make its deci-

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222. Codified as an amendment to **Tex. Tax Code Ann.** §§ 151.318(a), (e), (o), (q), (s), and by adding (f), (t) (Vernon Supp. 2000).

A protest determined by an appraisal review board in violation of this section is void.

**Effective:** January 1, 2000.


**Issue:** Relating to tax exemptions and credits.

**Summary:** This act establishes a credit for research and development ("R&D") in Texas which applies to expenses incurred after January 1, 2000. Calculation of the credit is equal to five percent of the sum of:

(a) The excess of qualified research expenses incurred in Texas during the period upon which the tax is based in excess over the base amount for Texas; and

(b) The basic research payments determined under 26 U.S.C. § 41(e)(1)(A) during the period upon which the tax is based for Texas.

The act provides an alternative calculation method if certain elections are made.

The terms "qualified research expense," "basic research payment," and "base amount" have the same meanings in the federal R&D provisions of the Internal Revenue Code (26 U.S.C. § 41) except that all such payments and expenses must be for research conducted in Texas.

This act expires December 31, 2009.

**Effective:** October 1, 1999, except as provided in section 20 of the act.

### E. General Business and Miscellaneous

1. **Act:** Act of June 18, 1999, 76th Leg., R.S., ch. 405, § 11, 1999 Tex. Sess. Law Serv. 2543.225

**Issue:** Relating to electric utility restructuring and to the powers and duties of the Public Utility Commission of Texas, Office of the Public Utility Counsel, and the TNRCC, as well as providing penalties.

**Summary:** This act provides that the electric utility industry will be restructured to foster competition between ERCOT utility-affiliated generators and Non-ERCOT utility-affiliated generators. "ERCOT" refers to the Electric Reliability Council of Texas, which means the area of Texas served by electric utilities, municipally owned utilities, and electric cooperatives that are not synchronously interconnected with electric utilities outside of the state. ERCOT utility-affiliated generators are not connected with electric utilities outside the state, while Non-ERCOT utility-affiliated generators are interconnected with electric utilities outside the state.

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Competition will begin on January 1, 2002 between ERCOT and Non-ERCOT utility affiliated generators. Non-ERCOT utility affiliated generators’ prices will remain frozen until the region satisfies the preconditions for competition. Residential and small commercial rates will be reduced six percent on January 1, 2002 and must remain available through January 1, 2007. The reduced six percent rate will be called the “Price To Beat” (“PTB”). A utility cannot offer a price that differs from the PTB to residential or small commercial customers until the earlier of January 1, 2005 or until forty percent of the residential customers are served by another supplier. This act is significant to the oil and gas industry because of the prospect of reduced costs of electrical energy.

Effective: September 1, 1999.


Issue: Relating to certain transactions by a gas utility.

Summary: This act increases the minimum reporting requirement amount regarding the purchase, sell, or lease of a gas utility plant from $100,000.00 to $1,000,000.00. This act also repeals section 102.054 of the Texas Utilities Code, which had prohibited a gas utility from transferring gas rights without prior approval of the Railroad Commission.

Effective: September 1, 1999.


Issue: Relating to recovery of certain relocation costs by a gas utility.

Summary: This act authorizes a gas utility to recover its relocation costs through a surcharge on gas volumes sold and transported to customers in the service area where the relocation occurred. The act applies to unreimbursed gas utilities that are forced to relocate because of construction or improvement of a highway, road, street, public way, or other public work by or on behalf of the United States, Texas, or other entity having the power of eminent domain.

Effective: September 1, 1999.

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