2005

Oil, Gas and Mineral Law

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I. INTRODUCTION

This article focuses on the interpretations of, and changes relating to, oil, gas, and mineral law in Texas from November 2, 2003 through November 1, 2004. The cases examined include decisions of state and federal courts in the State of Texas and the Fifth Circuit Court of Appeals.¹

II. CONVEYANCING

A. PROPERTY DESCRIPTION

Sunwest Operating Co. v. Classic Oil & Gas, Inc.² construes a typical multi-property conveyance afflicted with the common problem of inconsistencies and uncertainties between the text of the conveyance and the

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.
property descriptions on Exhibit A. It is a common practice in the industry to draft a conveyance of "Leases," "Lands" and "Contracts," with the Leases and Lands described on an attached Exhibit A. Limitations on the grant are sometimes found in the text of the conveyance and sometimes in Exhibit A, and sometimes the two are hard to reconcile.

In this case, two oil and gas leases were pooled into the Velma Daniels Gas Unit. A portion of each of the two leases was expressly excluded from the gas unit ("Excluded Acreage"). Sunwest, claiming under the disputed assignment, sought a declaratory judgment that it owned the Excluded Acreage. According to Sunwest, the assignment conveyed all of the working interest in the land covered by the leases, including the Excluded Acreage.3

The form of assignment in question provided in the Recitals:

1. Assignor owns an interest in the oil and gas leases described on Exhibit "A" attached hereto and made a part hereof (the "Leases") which pertain to the Lands described in Exhibit A (the "Lands"). . . . The Leases, Lands, Equipment, Contracts, Production and Data are all collectively referred to as the "Properties."
   * * *

6. Assignor agrees to assign all right, title and interest of Assignor in and to the Properties to assignee in order to vest Assignee with title in and to the Properties.4

The granting clause conveyed "all of Assignor's right, title and interest, including any and all overriding royalty interest, in and to the Properties."5 The attached Exhibit A described the unit in question as follows:

BECKVILLE
Panola County, T caption [sic]

VELMA DANIELS GAS UNIT NO. 1, 2, 3, 4, 5, 6, Seller's interest in and to acreage allocated to the Velma Daniels Gas Unit No. 1, more particularly described as 641.76 acres, more or less, . . . more particularly described in Gas Unit Designation for the Velma Daniels No. 1, a counterpart of which is recorded in . . . .6

Thirteen oil and gas leases are then scheduled by the usual reference to recording data and acreage covered by each. The two leases in question are recited as covering a specific number of acres, which was equal to the original leased acreage; that is, all the acreage including the Excluded Acreage.7 There is another provision in Exhibit A which provides as follows:

The above-described interests are subject to all valid, existing instruments of record affecting same and to all applicable unrecorded let-

3. *Id.* at 829-30.
4. *Id.* at 832.
5. *Id.*
6. *Id.*
7. *Id.*
The court analyzed the assignment utilizing the “four corners” rule of construction. Sunwest argued that the “Properties,” as defined in the recitals, included all of the acreage contained in the leases, including the Excluded Acreage. The property description on Exhibit A conveyed the assignor’s “interest in and to acreage allocated to the Velma Daniels Gas Unit,” but also listed the tracts of land covered by the leases in their entirety. The court held that the assignment conveyed only the portions of the leases that were included in the Velma Daniels Gas Unit.

The court pointed to the fact that none of the gas units described in the assignment referenced any portion of the two leases. The interest conveyed was acreage in the unit. The court also noted that Sunwest’s interpretation of the term “Properties” was overly broad because the language of the assignment itself limited the “conveyance to the interest in the oil and gas leases which pertain to the lands described in Exhibit A.”

Exhibit A also provides that the interests conveyed “are subject to” all valid instruments of record. The record showed the designation of unit for the Velma Daniels Gas Unit and the acreage included in it, but the record did not indicate that the Excluded Acreage was part of any oil or gas units described in the assignment. Therefore, Sunwest did not own an interest in the Excluded Acreage.

B. Preferential Rights

The case of *McMillan v. Dooley* deals with the continuing problem associated with the exercise of a preferential right to purchase a portion of the properties in a package sale. This case follows a typical fact pattern of an exchange of letters or communications between seller/potential buyer and the holder of the preferential right involving notice of the sale, presentation of the terms, exercise of the right, and then a controversy over whether the right was validly and timely exercised. In this particular case, the seller failed to give the required notice of sale to the holder of the preferential right, Dooley, and seller closed with the buyer, McMillen. Dooley found out about the sale almost immediately and telephoned the buyer McMillan. McMillan made an oral offer during this conversation to sell the entire package to Dooley, but Dooley declined the package because he wanted only the Dooley lease. There was an exchange of letters over the next several months. After approximately two years, Dooley sued and asked the court to fix the price for the Dooley lease and

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8. *Id.* at 833 (emphasis deleted).
9. *Id.* at 831-32.
10. *Id.* at 833 (emphasis in original).
11. *Id.* at 834 (emphasis in original).
12. *Id.* at 834-35.
for damages for bad faith trespass.\textsuperscript{14}

The court did not expend any analysis on the original failure to give notice. Instead, the court simply cited existing authority for the general principles that when there is a failure to give notice, the buyer takes subject to the rightholder's option; when the rightholder learns of the conveyance, the rightholder has the opportunity to accept or reject within the specified time frame just as if the notice was then properly given, and the continuing option is not perpetual. The rightholder must choose between exercising the right or acquiescing in the transfer.\textsuperscript{15}

Notice that a sale has occurred does not necessarily mean that the notice required by the preferential right has been given, nor does it necessarily define the terms of sale. The court must construe the language creating the preferential right to purchase.\textsuperscript{16} Most of the opinion is devoted to an analysis of whether or not the rightholder (Dooley in this case) was obligated to purchase the entire package to claim the limited interest subject to the right, the adequacy of a presentment in the context of a package sale and under the specific facts of this sale, and the obligation to exercise the right or lose it. The court cited \textit{Hinds v. Madison} for the proposition that the holder of a right on a part of a ranch could not expand that right to include all of the ranch then being sold.\textsuperscript{17} The court stated, "[i]f a rightholder is not permitted to expand his preferential purchase right to include property not covered by the provision, it would be improper for him to be required to accept other property not covered by his preferential purchase right in order to exercise his right."\textsuperscript{18}

Preferential rights agreements are broadly split into two categories: (1) "price" agreements, in which the exercise price is fixed; and (2) "terms and conditions agreements," under which the rightholder must meet the terms and conditions negotiated by seller and buyer. The latter are far more common and more troublesome. In this case, the preferential right provision reserved the right to purchase the lease, required notice of the highest bona fide price offered, and gave the holder ten days to accept or lose the right.\textsuperscript{19} The court followed the frequently cited opinion of \textit{West Texas Transmission, L.P. v. Enron Corp.}\textsuperscript{20} for the general proposition that the seller is free to strike its best deal and to require the rightholder to match that bargain, subject only to any restrictions found in the reservation of the right. The court rejected Dooley's claim that his reservation restricted McMillan's right to make his best deal.\textsuperscript{21}

\begin{itemize}
  \item \textsuperscript{14} Id. at 164-69.
  \item \textsuperscript{15} Id. at 172.
  \item \textsuperscript{16} Id. at 175.
  \item \textsuperscript{17} Id. at 179 (citing Hinds v. Madison, 424 S.W.2d 61 (Tex. Civ. App.—San Antonio 1967, writ ref'd n.r.e.)).
  \item \textsuperscript{18} Id.
  \item \textsuperscript{19} Id. at 164.
  \item \textsuperscript{20} Id. at 175 (citing W. Tex. Transmission, L.P. v. Enron Corp., 907 F.2d 1554, 1562-63 (5th Cir. 1990)).
  \item \textsuperscript{21} Id. at 175-76.
\end{itemize}
As to the adequacy of the presentment, *West Texas Transmission* has been cited for the premise that the seller is free to impose conditions on the sale,

as long as those conditions are commercially reasonable, imposed in good faith, and not specifically designed to defeat the [preferential purchase] rights. Where the owner meets these three standards, the holder of the [preferential purchase] right . . . lacks grounds to remove specific conditions from the contract, or to extract other concessions as part of the agreement.\(^\text{22}\)

In this case, Dooley obtained favorable findings that effectively tracked these criteria, but the court distinguished *West Texas Transmission* and noted that other courts have been critical of the decision.\(^\text{23}\) The court held that these factors more appropriately relate to the right to object to sale conditions not expressly prohibited by the preferential purchase provision and to the manner in which the rightholder may respond in order to exercise the right. As to the presentment itself, the court followed the more mechanical approach of *Koch Industries, Inc. v. Sun Co.*\(^\text{24}\) Under Texas law, absent some other express contractual provision, the seller has an initial duty to make a reasonable disclosure of the offer’s terms, the rightholder has a subsequent duty to undertake a reasonable investigation of any terms unclear to him, and the rightholder does not have a duty to act in order to exercise his preferential right unless and until he receives a reasonable disclosure of the terms of the contemplated conveyance.\(^\text{25}\) A sufficient presentment may be made, from a mechanical perspective, if there is a reasonable disclosure of the terms; the court found that one of McMillan’s letters conclusively established that a reasonable disclosure of the terms of the conveyance was made to Dooley.\(^\text{26}\)

Although the purchaser of property subject to a preferential purchase right takes the property subject to that right and the holder of that right can enforce its option to acquire the property, the holder must do so within the specified time frame, in accordance with the terms of the right.\(^\text{27}\) The rightholder’s duty to act is an affirmative duty and the failure to act is tantamount to a rejection of the opportunity to exercise the right. The court found that Dooley was not required to accept the package with the other leases, but he was required to timely act. In fact, he timely rejected the package deal and then did nothing until the time to act had expired. The court suggested that the proper response should have been an exercise of the right, subject to objections to disputed terms.\(^\text{28}\)

\(^{\text{22. W. Tex. Transmission, 907 F.2d at 1563.}}\)
\(^{\text{24. 918 F.2d 1203 (5th Cir. 1990).}}\)
\(^{\text{25. McMillan, 144 S.W.3d at 174 (citing Koch Indus., Inc., 918 F.2d at 1211-12).}}\)
\(^{\text{26. Id. at 176-77; see Comeaux v. Suderman, 93 S.W.3d 215, 219 (Tex. App.—Houston [14th Dist.] 2002, no pet.).}}\)
\(^{\text{27. McMillan, 144 S.W.3d at 172.}}\)
\(^{\text{28. Id. at 181; see Tex. State Optical, 882 S.W.2d at 11.}}\)
Although Dooley was not required to purchase all of the leases to exercise his option, he still had to take steps to preserve his right. Because Dooley responded in the specified time period that he wished to decline the offer, he had no right thereafter to exercise that option.

There was another lease in the same package sale subject to a preferential right in favor of Johnson. The parties to the package sale assigned no value to the Johnson lease, and the court affirmed the trial court’s judgment that Johnson was entitled to specific performance whereby he obtained ownership of the Johnson lease free of cost.

III. LEASES AND LEASING

A. Parties

Steger v. Muenster Drilling Co., holds that a life tenant could grant oil and gas leases that extended beyond the life tenant’s lifetime. The will granted a life estate to testator’s wife and provided the following:

It is my desire and I direct, that, Carrie T. Maddox, my wife, shall have fully power and authority and the same is hereby granted to her to, manage, control and lease for all purposes the real and personal estate herein after bequeathed during her life time and to extract therefrom all oil, gas and or other minerals during said period of her life estate as limited herein, and the further power and authority to manage and control jointly with her estate, all other property, collect and have the rents and revenues arising from the entire estate during the period of her life and she remaining unmarried after my death.

Although a life tenant ordinarily cannot convey an estate that is greater than one tied to her life, the instrument conveying the life estate can confer greater powers upon the life tenant. Thus, a testator or grantor can give the life tenant power to execute oil and gas leases that extend beyond the life tenant’s own lifetime. The question is one of intent.

In Steger, the plain meaning of the words in the will showed testator’s intention to give the life tenants the power to execute oil and gas leases that extended beyond the life tenants’ lifetimes. The time limits placed on the authority to lease (lifetime) did not limit the type of lease which could be executed. The court also noted that the power to extract oil, gas, and other minerals, which testator expressly gave to the life tenants, is a power to dispose of the corpus. Under this will, the life tenants could dispose of all the oil and gas during their lifetime, which necessarily includes the power to execute oil and gas leases that extended beyond their

29. McMillan, 144 S.W.3d at 180.
30. Id. at 180-81.
31. Id. at 188.
33. Id. at 364.
34. Id. at 373.
35. Id. at 374.
B. Royalty Clause

Santa Fe Snyder Corp. v. Norton holds that the Deep Water Royalty Relief Act of 1995 ("RRA") unambiguously granted royalty suspension for new leases. The Department of Interior ("Department") promulgated regulations for the administration of the RRA that granted royalty suspension only if the new lease was determined to be in a field that had not produced prior to the enactment of the RRA. Section 302 of the RRA governs royalty relief for existing leases while sections 303 and 304 provide royalty relief for new leases.

Shell Offshore successfully bid for a lease that qualified as a "new lease" under the RRA. Shell then executed the lease which mirrored the terms of the notice of sale and the Interior Department regulations. Specifically, the lease stated, among other things, that a royalty suspension would only be available if the lease was "in a field where no currently active lease produced oil or gas" before the enactment of the RRA, and that the royalty suspension, if any, would apply to the field where the lease was located, not to the particular lease. Once drilled, the well was assigned by the Department to a field that contained leases that had produced prior to the enactment of the RRA, thus excluding the well from the benefit of royalty suspension. Shell then filed suit challenging the Department's interpretation of the RRA as set forth in the regulations promulgated by the Interior Department.

The Fifth Circuit affirmed the district court's holding that section 304 mandates that, without exception, based solely on various objective factors (water depth, location of lease, and date of sale), all leases that meet the objective criteria are entitled to the benefit of royalty suspension.

C. Pooling Clause

In Pioneer Natural Resources USA, Inc. v. W.L. Ranch, Inc., the court considered the relationship between a partial release ("Pugh") clause and a pooling clause in a lease and found the pooling clause to be controlling. The W.L. Ranch lease had a primary term of one year and so long thereafter as "operations" were conducted upon "said land." The lease also authorized pooling and, if pooled, "operations" on the pooled unit would extend the primary term. Prior to the expiration of the primary term, the leased acreage was pooled to form a 378-acre unit, and Pioneer commenced drilling a horizontal well. However, the wellbore did not pene-

36. Id. at 375.
37. 385 F.3d 884 (5th Cir. 2004).
38. Id. at 888-89 (quoting 43 U.S.C. § 1337(a)(3)(C), (a)(1)(H) (2004)).
39. Id. at 890.
40. Id.
41. Id. at 893-94.
42. 127 S.W.3d 900 (Tex. App.—Corpus Christi 2004, pet. denied).
trate the W.L. Ranch lease until after the primary term expired. The well was eventually plugged and abandoned.43

W.L. Ranch brought an action against Pioneer for trespass, negligence and fraud, alleging that Pioneer drilled the well across its property after expiration of the lease. Although the lease had clearly been pooled and operations had clearly commenced before the expiration of the primary term, the lease had a partial release clause in the Addendum which read as follows:

If at the expiration of the Primary term or any time thereafter, oil or gas is not being produced in paying quantities from the lease premises, or Lessee is not then engaged in the actual drilling operations on the lease premises, this lease shall terminate as to all lands and horizons covered hereby. Lessee shall maintain the lease with respect to producing acreage at the end of the primary term from the surface to a depth of 100 feet below the stratigraphic equivalent of the deepest productive formation in any well pooled with or drilled on the 103.75 acres during the primary term.44

This lease also provided that in the event of a conflict between the Addendum and the lease, the Addendum would control.45 W.L. Ranch argued that the Addendum refers only to "lease premises," not to unitized or pooled lands, and because there were no timely operations on the "lease premises," the lease terminated.46 The trial court entered a partial summary judgment and held that the lease had terminated.47

The court of appeals reversed, noting that the Addendum included a reference to production from "any well pooled with or drilled" on the leased acreage.48 Therefore, the court found from the Addendum itself that the parties did not intend to eliminate pooling from the lease.49

More importantly, the court relied upon a presumption as to production from the Southland Royalty case:

One of the legal consequences of a unitized lease as between the lessor and lessee, in the absence of express agreement to the contrary, [sic] the life of the lease is extended as to all included tracts beyond the primary term and for as long as oil, gas or other minerals are produced from any one of the tracts included in the lease, with each lessor relinquishing his right to have his own tract separately developed.50

In the W.L. Ranch lease, the parties agreed to a unitized lease without an express agreement that the lease could not be extended by commence-

43. Id. at 904-05.
44. Id. at 905 n.6.
45. Id. at 905 n.7.
46. Id. at 905.
47. Id. at 904.
48. Id. at 906 (emphasis deleted).
49. Id.
50. Id. (emphasis in original) (quoting Southland Royalty Co. v. Humble Oil & Ref. Co., 249 S.W.2d 914, 916 (Tex. 1952)).
ment of operations or production on land other than from the ranch. The court extended the presumption arising out of a pooling clause (as expressed in *Southland Royalty* as to production) to hold that unit operations, *in the absence of an express agreement to the contrary*, will hold the lease.\textsuperscript{51} The court then held that the partial release clause was not an express agreement that the lease could not be extended by operations. The court also held that even if there was a conflict between the two provisions, it was not an irreconcilable conflict, and it is reasonable to conclude that the parties intended to agree to the pooling which was effected by Pioneer. Therefore, the lease did not terminate upon the expiration of the primary term, and drilling operations commenced on the unit effectively extended the primary term of the lease by virtue of the pooling of the lease with the other leases in the unit.\textsuperscript{52}

*Union Gas Corp. v. Gisler*\textsuperscript{53} is the first of seven related cases considering the relationship between the lease pooling clause, the filing of the designation of unit and the effect on the royalty obligation when lessee files after the date of first production. The Gisler lease pooling clause read as follows:

Lessee shall file for record in the appropriate records of the county in which the leased premises are situated an instrument describing and designating the pooled acreage as a pooled unit; *and upon such recordation the unit shall be effective as to all parties hereto*, their heirs, successors, and assigns, irrespective of whether or not the unit is likewise effective as to all other owners of surface, mineral, royalty or other rights in land included in such unit.\textsuperscript{54}

The Gisler lease was the well-site tract. Production was obtained on March 27, 2000, and the designation of unit was filed on August 7, 2000. In the unit designation, Union stated that the designation would be effective from the date of first production. On August 30, 2000, Gisler sued Union for all royalties from the date of first production until the August 7 recordation of the unit designation (Gisler also sued for bad faith pooling, drainage, breach of implied covenants, fraud, negligence, conversion, *inter alia* against Union). Union brought all of the other lessors of the pooled leases into the suit, and the other lessors contended they were entitled to share proportionately in all royalties from date of first production.\textsuperscript{55} When the competing lessors began filing motions for partial summary judgment, after the suit had been on file for nine months (fourteen months after the date of first production) and while Union paid no royalties to anyone, Union belatedly interpled royalties of $1,313,327.38, attributable to the time prior to August 7.\textsuperscript{56}

\textsuperscript{51} *Id.*
\textsuperscript{52} *Id.*
\textsuperscript{53} 129 S.W.3d 145 (Tex. App.—Corpus Christi 2003, pet. denied).
\textsuperscript{54} *Id.* at 150 (emphasis added).
\textsuperscript{55} *Id.* at 148.
\textsuperscript{56} *Id.* at 148, 152.
The various lessors won their contract claims under their separate leases on summary judgment, the contract claims were severed, and multiple appeals resulted. In this part of the controversy, the Gisler's claims for past due royalties were severed from their other claims, resulting in a final judgment against Union for an amount equal to the interpled funds, plus interest, and attorneys’ fees in the amount of $250,000.00. The principal issue on this appeal was whether Gisler was entitled to one hundred percent of royalties to the date of recordation of the unit designation. The court found no reason to depart from the settled principles expressed in *Browning Oil Co. Inc. v. Luecke*.

The lessee's authority to pool is derived solely from the terms of the lease and the parties must strictly comply with the terms of the lease. The lease provided that pooling was effective upon "recordation," and therefore there was no pooling until recordation.

Union's real problem was that six other lessors under pooled leases with functionally identical pooling clauses were also seeking payment of royalty from date of first production by summary judgment. Each of the other lessors also prevailed on their claim, thus "doubling" the royalty Union was obligated to pay. Union contended that the Gisler summary judgment and the summary judgments on the six other motions were facially contradictory. The court in this appeal held that absent express authority, a lessee has no power to pool the lessor's interests with the interests of others. Union did not pool Gisler in accordance with the terms of the Gisler lease, so nothing Union did in the subsequent, unilateral, unit designation could change Union's obligation to Gisler. The judgments as to the other royalty owners were not part of this appeal.

Union argued that it should escape further liability because of its filing in interpleader. The court refused to release Union because of Union's unreasonable delay in filing, because Union itself created the predicament, and because Union did not do equity by paying Gisler the amount payable for production prior to August 7.

Finally, the court rejected Union's argument that the trial court should not have severed Gisler's other claims for bad faith pooling which could result in either the invalidation of the unit or a reformation of the unit, which would obviously affect the royalty rights of others before and after August 7. The court found that Gisler's contract claim for royalty was distinguishable from Gisler's tort claims, and the other royalty owners had no tort claims, only their own contract claims. In finding the multiple claims were separable and distinct, the court relied heavily upon

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57. *Id.* at 148-49.
58. *Id.* at 150-51 (discussing *Browning Oil Co. v. Luecke*, 38 S.W.3d 625 (Tex. App.—Austin 2000, pet. denied)).
59. *Id.*
60. *Id.* at 151-52.
61. *Id.* at 153-54.
62. *Id.* at 155-56.
63. *Id.* at 155.
Gisler’s lease, which expressly provided that the contractual obligations were independent and “irrespective of whether or not the unit is likewise effective as to all other owners . . . included in such unit.”64 In finding that the severance was proper, the court was probably influenced by the fact that the court already knew what it was going to do with the pre-August 7 severed claims of the other lessors.

Union Gas Corp. v. Tittizer65 was the second of the seven cases. The trial court had granted Tittizer’s motion to share pro rata in royalty prior to August 7, thus effectively “doubling” Union’s royalty obligation, because Gisler was entitled to all royalty prior to August 7. The court reversed this judgment and held that because the unit was not effectively pooled under Gisler’s lease until the recordation of the designation, there was no unit production until that time. “[A]lthough there was production from March 27 on the Gisler’s lease, there was no producing well on the pooled unit until August 7.”66 Thus, the court held that the well-site lease was determinative in resolving the date by which a leasehold well becomes a unit well.

The court clearly rejected the trial court’s approach of reading each lease in a vacuum, stating, “[W]e are also constrained to construe all of the leases, Union’s late recorded unit designation, and the interplay of these instruments. . . .”67 The court continued, “We also agree with Union that the legal construction of the various leases and unit designation should be consistent.”68

Union Gas Corp. v. Dornburg,69 the third case, reaches the same result. The lease contained a recordation requirement and only slightly different language than the clauses found in Gisler and Tittizer. Union Gas Corp. v. Arnold, Union Gas Corp. v. Mission Valley Cemetery Society, Union Gas Corp. v. Mission Valley Volunteer Fire Department, and Union Gas Corp. v. Zion Lutheran Church of Mission Valley70 are indistinguishable.

D. DRAINAGE

Kerr-McGee Corp. v. Helton71 holds that expert witness testimony in a drainage case was incompetent to prove damages. The lessor Helton

64. Id. at 150.
66. Id. at *4.
67. Id. at *3.
68. Id. at *4.
sued Kerr-McGee (its lessee, who was also the offset operator) for breach of the implied covenant to protect against drainage. Helton's expert witness, Riley, presented testimony to establish the amount of gas a hypothetical offset well would have produced, that a reasonably prudent operator would have drilled the well, and the amount of royalties Helton would have received. The trial court entered judgment for damages, interest and attorneys' fees in an amount of $1,432,618.72

Riley testified that he looked at numerous accepted sources in forming his opinion, including well logs, base maps, production information, railroad commission records, and scout cards. Riley opined that the hypothetical offset would have produced at certain rates by reference to other existing wells, and that as additional wells came on, the rate would have declined at a certain rate. The court did not attempt to determine whether Riley's opinion regarding the hypothetical well's productivity was correct, but rather whether the analysis Riley used to reach his conclusions was reliable. Based on the record, the court concluded that his opinion was not reliable because there was "too great an analytical gap between the data and the opinion." The court apparently accepted the premise that data from existing wells may be considered in predicting a hypothetical well's production, but rejected Riley's testimony because the record did not show how Riley used that and other data to reach his conclusions in this case, and the record did not show why known differences in the wells would not result in different production rates. The court reversed and rendered.

E. Termination

Ridge Oil Co. v. Guinn Investments, Inc. is an important case on the temporary cessation of production ("TCOP") doctrine, lease surrender and assignment clauses, lease termination by cessation of production and relationships between owners of divided interests in the leasehold. It is probably the most important case decided during the Survey period.

The 1937 lease at issue covered two tracts of land. The leasehold in one tract was owned by Guinn, while the other was owned by Ridge. Although there had been no production on the Guinn tract since 1950, the lease stayed in effect during its secondary term by continuous production from the Ridge tract until 1997. In 1997, Ridge offered to purchase the Guinn tract in order to complete secondary recovery efforts by a waterflood. Guinn rejected this offer, leading Ridge to seek the property by other means. Intending to re-lease both tracts from the lessor, Ridge intentionally and voluntarily ceased production on the Ridge tract for

72. Id. at 249-50.
73. Id. at 254-55.
74. Id. at 257.
75. Id. at 258.
76. Id. at 260.
77. 148 S.W.3d 143 (Tex. 2004).
ninety days in order to terminate the 1937 lease. During the ninety-day cessation of production, Ridge wrote a letter to the lessor explaining its plan to re-lease the Guinn tract. In addition, Ridge voluntarily continued to pay royalties to the lessor during the stoppage. Ridge then obtained a new lease.\textsuperscript{78}

The issue was whether the 1937 lease remained in effect as to the Guinn tract. It was uncontested that production from any one tract will ordinarily continue the entire lease in effect as to all tracts under a single lease. Ridge, however, contended that production ceased and the 1937 lease terminated either when production from the Ridge tract ceased, or when Ridge executed new leases with the owners with the possibility of reverter of the mineral interest in the Ridge tract. Guinn countered by contending that the lease was continued in effect by the TCOP doctrine.\textsuperscript{79}

The court held as follows:

We agree with the court of appeals in the case before us today that, absent any language in a lease to the contrary, the temporary cessation of production doctrine applies when a lease covering more than one tract or interest is held by production from a well operated by a partial assignee of the lessee’s rights.\textsuperscript{80}

The court then turned to the central issue remaining in the case, which was to determine whether there was in fact a temporary cessation of production.\textsuperscript{81}

Perhaps the most interesting part of the case in the court of appeals was the court’s discussion of the application of the TCOP doctrine to cessations caused by third parties.\textsuperscript{82} There has been considerable uncertainty as to the type or cause of cessation that would trigger the TCOP doctrine. Reviewing the case law generally, the court concluded that the inquiry ought to be focused on the operator’s intent with respect to restoring production, rather than the cause of the stoppage.\textsuperscript{83} The court concluded that the doctrine is not limited to involuntary cessations or to physical or mechanical causes.\textsuperscript{84} The only fair and just rule is to hold that the lease continues in force unless the period of cessation is for an unreasonable length of time.\textsuperscript{85}

The Texas Supreme Court reviewed many of the TCOP cases and then adopted the reasoning of the court of appeals and went out of its way to clarify that the cause of the cessation was not the critical question. The court held the following:

\begin{enumerate}
\item Id. at 147-48; see Guinn Invs., Inc. v. Ridge Oil Co., 73 S.W.3d 523, 527 (Tex. App.—Fort Worth 2002), rev’d, 148 S.W.3d 143 (Tex. 2004).
\item Ridge Oil Co., 148 S.W.3d at 149-50.
\item Id. at 151 (citing Guinn Invs., Inc., 73 S.W.3d at 531).
\item Id.
\item Guinn Invs., Inc., 73 S.W.3d at 533-34 n.4.
\item Id. at 533.
\item Id.
\item Id. n.4 (citing Frost v. Gulf Oil Corp., 119 So. 2d 759, 762 (Miss. 1960)).
\end{enumerate}
Accordingly, although decisions at times have said that the temporary cessation of production doctrine applies when there is "sudden stoppage of the well or some mechanical breakdown of the equipment used in connection therewith, or the like," or that the doctrine applies when the cause of a cessation of production is "necessarily unforeseen and unavoidable," the circumstances in which this and other courts have applied the doctrine have not been so limited. The court of appeals in the present case correctly concluded that foreseeability and avoidability are not essential elements of the [temporary cessation of production] doctrine.\textsuperscript{86}

The court then ignored Ridge's first theory (that the 1937 lease terminated when Ridge stopped producing) and found Ridge's second theory to be dispositive: on the date the new lease became effective for the Ridge tract, there was a permanent cessation of production with respect to the 1937 lease.\textsuperscript{87}

The court noted that it was well established that a lease could terminate by surrender, mutual agreement or by signing a new one. When the owners of the possibility of reverter in the Ridge tract signed a new lease with Ridge, they effectively terminated the 1937 lease as to the Ridge tract.\textsuperscript{88} The mineral owners under the two tracts were apparently not the same,\textsuperscript{89} so the execution of the 1998 Ridge tract lease could not affect the 1937 lease as to the Guinn tract as between Guinn and his lessors. However, because all production after 1998 was on the 1998 Ridge lease, there was then a permanent cessation of production from the 1937 lease, which terminated.\textsuperscript{90}

Guinn contended that Ridge could not "washout" Guinn's interest in this manner. The court reviewed the series of cases which have sustained washout transactions in the context of overriding royalties and applied the same reasoning to washout Guinn's interest. The court found that Ridge owed no duty to the owners of the possibility of reverter in the Guinn tract or to Guinn.\textsuperscript{91} The opinion is largely based on the surrender clause, release clause and the assignment clause, but it is also based in part on the particular habendum clause in the 1937 lease. The lease provided that production would preserve the lease for so long as there was production "from said land by the lessee, or as long as operations are being carried on."\textsuperscript{92} Ridge ceased to be a lessee under the 1937 lease, and therefore, there was no production by the "lessee," who was then Guinn.\textsuperscript{93}

\textsuperscript{86} Ridge Oil Co., 148 S.W.3d at 152 (internal citations omitted). Because the court ultimately found that the cessation in this case was permanent, not temporary, the discussion and the clarification, while long-awaited, was dicta in this case.
\textsuperscript{87} Id.
\textsuperscript{88} Id. at 152-53.
\textsuperscript{89} Id. at 147.
\textsuperscript{90} Id. at 153.
\textsuperscript{91} Id. at 153-55.
\textsuperscript{92} Id. at 156.
\textsuperscript{93} Id. at 156-57.
Guinn also contended that his lease was preserved under that part of the habendum clause reciting that the lease would be preserved "as long as operations are being carried on." The court held that production ceased on March 3, 1998, when Ridge signed the 1998 lease, and none of Guinn's lessors repudiated Guinn's lease until the first of them signed a new lease with Ridge on March 28, 1998. The 1937 lease had no thirty, sixty or ninety-day clause, and the court focused its attention on the twenty-five day period after production ceased and before the first repudiation. The evidence was that Guinn acquired a drilling permit, negotiated surface damages and perhaps drove a wooden stake into the ground to mark the well site. The court concluded that Guinn did not have to undertake some activity on the lease every day, but this was virtually no activity, and it was not enough to raise a fact question as to whether operations were being carried on under the terms of the lease.94

Finally, the court rejected Guinn's claims for constructive trust, fraud and tortious interference. The court stated, "There is no confidential relationship between partial assignees of leasehold interests under a base lease."95 There was no evidence of fraud or misrepresentation, and Ridge and the lessors of the Ridge tract had the right to terminate the 1937 lease as to their interests.96

The significance of the case is that it clarifies the application of the TCOP doctrine and focuses the inquiry on the operator's intent with respect to restoring production and the reasonableness of the length of the cessation. The case is also very important in establishing that there are virtually no duties owed by one lessee to another holding divided interests under the same base lease.

Circle X Land & Cattle Co. v. Cago Inc.97 construes the right of lessees to remove equipment from land covered by a terminated lease. The lease in question provided for lease termination under the minimum royalty provision "upon notice from the Lessor." The issue in the case was whether the trial court erred in allowing 120 days from the date of its order (declaring the lease had actually terminated), rather than 120 days from the date the lease terminated, for lessee to remove equipment. The court held that the operator of the terminated lease no longer had the right to remove equipment.98 It is well established under the doctrine of repudiation that a lessee's obligations to perform under the lease are suspended when the lessor claims lease termination.99 The court distinguished these precedents as being dependent upon the continuation of the lease. In Circle X, the lease terminated "upon lessor's notice," the notice did not itself perpetuate the lease, and the court could not extend

94. Id. at 157-60.
95. Id. at 160.
96. Id.
98. Id. at *2.
99. Id. at *1.
the time for removing equipment.\footnote{Id. at *1-2.}

If the opinion is broadly construed, it is difficult to imagine any circumstances under which the lessee can safely defer removing equipment in lease termination cases. It will be a rare case that is judicially resolved before the time to remove equipment under the lease has expired. Perhaps there is some basis for narrowly construing the case as turning upon the unusual "lessor notice" provision as clearly triggering the lease termination clock, rather than the judicial declaration itself, but any suit for declaratory relief that a lease has terminated is by definition driven by a dispute as to the legal effect of the underlying facts.

In the case of \textit{Grinnell v. Munson},\footnote{137 S.W.3d 706 (Tex. App.—San Antonio 2004, no pet. h.).} the court considered the evidence required to show lease termination when the habendum clause provided that the term is for so long as there is a well "capable of producing oil and/or gas in paying quantities."\footnote{Id. at 715.} Most habendum clauses in oil and gas leases in Texas provide that the lease continues as long as oil or gas is produced in paying quantities. However, the less common clause in the lease at issue in this case provided that the lease shall continue as long as a well on the covered land is capable of producing oil and/or gas in paying quantities.\footnote{Id.}

This language is similar to the language recently considered in \textit{Anadarko Petroleum Corp. v. Thompson},\footnote{94 S.W.3d 550 (Tex. 2002).} which recited that the lease would continue as long as gas "is or can be produced."\footnote{Id. at 555.} The court stated that "the phrase 'capable of production in paying quantities' means a well that will produce in paying quantities if the well is turned 'on,' and it begins flowing, without additional equipment or repair."\footnote{Id. at 558 (citing Hydrocarbon Mgmt., Inc v. Tracker Exploration, Inc., 861 S.W.2d 427, 433-34 (Tex. App.—Amarillo 1993, no writ).} In other words, "a well is capable of production if it is capable of producing in paying quantities without additional equipment or repairs."\footnote{Id.} The court relied heavily on this precedent and evaluated the proof that was presented to show lease termination. The evidence presented showed a complete cessation of production for over eighteen months. However, there was no evidence to support a finding that the wells on the lease during the time production ceased were not capable of producing in paying quantities without additional equipment or repairs if the wells were turned on.\footnote{Grinnell, 137 S.W.3d at 716.} This finding highlights the different form of proof required to show lease termination under a "capable of producing" habendum clause.
F. Surface Rights

Cook v. Exxon Corp.\textsuperscript{109} is another in a recent series of cases which clearly hold that a landowner lacks standing to sue for injury to real property when the injury occurred before the landowner acquired the property.\textsuperscript{110} The facts in Cook are typical. Exxon developed the property, operated it and sold it between 1930 and 1990. Cook bought the property in 1994 and then sued Exxon in 2000 for removal of typical oil field junk—concrete derrick corners, pipes, etc. The court again held that a successor landowner cannot recover under these circumstances, but this opinion focused on the narrow question of the distinction between permanent and temporary injuries.\textsuperscript{111}

A temporary injury is different from a permanent injury in that a subsequent purchaser may be personally harmed by the new injury, which occurs every day the conduct is repeated, as distinguished from a permanent injury which occurred prior to the time the subsequent purchaser acquired his interest. In evaluating the injury’s continuum, the fact-finder must consider two characteristics of a temporary injury: (1) whether it is caused by irregular forces; and (2) whether the injury-causing activity can be easily enjoined. The injury in this case was clearly “permanent” because it was attributable to a single, past event, and ordering Exxon to “stop” would accomplish nothing. Moreover, for a temporary injury, the cause of action accrues when each separate injury occurs and is subject to the two year statute of limitations. Even if the injury were temporary, Cook failed to produce any evidence of a new injury that occurred after he acquired the land, and therefore Cook lacked standing to sue.\textsuperscript{112}

Davis v. Devon Energy Production Co.\textsuperscript{113} reviews the tension between the dominance of the mineral estate and the accommodation doctrine in a controversy over a lessee’s right to build permanent all-weather caliche roads through a cotton field. “[T]he lessee of a mineral lease has the right to use as much of the premises in such a manner as is reasonably necessary to effectuate the purpose of the lease.”\textsuperscript{114} But under the accommodation doctrine, “when there is an existing use of the land’s surface which would be precluded or impaired, and when under established practices in the industry there are alternatives available to the lessee whereby the minerals can be recovered, the circumstances may require the adoption of an alternative by the lessee.”\textsuperscript{115} In searching for a standard by which to gauge the degree of permissible interference, the court

\textsuperscript{109} 145 S.W.3d 776 (Tex. App.—Texarkana 2004, no pet. h.).


\textsuperscript{111} Cook, 145 S.W.3d at 779-84.

\textsuperscript{112} Id. at 782-83.

\textsuperscript{113} 136 S.W.3d 419 (Tex. App.—Amarillo 2004, no pet. h.).

\textsuperscript{114} Id. at 423.

\textsuperscript{115} Id.
noted that the Supreme Court had stated in *Acker v. Guinn* that by the execution of a lease “[i]t is not ordinarily contemplated . . . that the utility of the surface for agricultural or grazing purposes will be destroyed or substantially impaired.”\(^{116}\) The *Davis* court seized on the word “substantially” and held that the accommodation doctrine only applies when “the impairment experienced by the surface owner is, at the very least, substantial.”\(^{117}\) Whether the elements necessary to invoke the accommodation doctrine are established is a question of fact, which, in this case, were proven. For example, the evidence showed “that in a three month period, 248 proposed well treatments were cancelled because roads did not allow passage to the wells,” while the surface owner’s evidence amounted to little more than a showing that the caliche roads would be an inconvenience.\(^{118}\)

**IV. OPERATING AGREEMENTS AND OPERATIONS**

**A. Operating Agreements**

*Cass v. Stephens*\(^{119}\) is an oil and gas accounting case involving misconduct by an operator by breach of contract, conversion, and fraud. The properties were operated by Frank W. Cass, his son Michael L. Cass and Cass Oil Company, Inc. There were issues about the identity of the operator, but the jury ultimately found Frank and Michael generally responsible for operations. Stephens was a working interest owner who, during the time period in question, became disabled and eventually died, so that almost no one was looking after his interests. In summary, the evidence showed that goods and services provided to wells solely owned by Cass were charged to the joint account, delivery tickets and invoices were modified by Cass to conceal the operator’s conduct, jointly-owned equipment was moved to solely-owned wells without giving credit to the joint account, working interest owners were billed multiple times for the same property, and Cass destroyed documents which showed equipment transfers and sold jointly-owned property to third parties, all of which benefited Cass personally.\(^{120}\)

The case was filed in 1986 and tried in 1997. There was significant and systematic discovery abuse by Cass. Stephens proved much of their case with documents retrieved from Cass’s trash by Stephens’s private investigator. Over 150,000 documents were retrieved from the trash, including entire original files, and Cass even tore up and discarded the only signed copy of the original operating agreement. The court ultimately imposed sanctions for discovery abuse in an amount of almost $1,000,000.\(^{121}\)

\(^{116}\) *Id.* at 424 (citing *Acker v. Guinn*, 464 S.W.2d 348, 352 (Tex. 1971)).

\(^{117}\) *Id.*

\(^{118}\) *Id.* at 419.


\(^{120}\) *Id.* at *1-3, *13, *16.

\(^{121}\) *Id.* at *3-4, *6.
Not surprisingly, the jury found against Cass and awarded Stephens approximately $800,000 in actual damages, $1.4 million in attorney’s fees, $20 million in exemplary damages against Frank Cass individually, and $20 million more against Frank and Michael Cass, jointly and severally. Stephens voluntarily remitted all of the exemplary damages except $2.5 million against Frank and $2.5 million against Frank and Michael, jointly and severally.\footnote{122\textsuperscript{2}}

Frank Cass defended on the basis that the operator was Cass Oil Company, Inc., not Frank Cass. Frank sent a letter in 1982 on Cass Oil Company letterhead, which notified the joint interest owners that the operator, Frank Cass, was changing his name to Cass Oil Company, Inc. “[T]he Texas Railroad Commission recognized Cass Oil Company, Inc. as the operator of the wells.”\footnote{123\textsuperscript{2}} There was no election, no solicitation of votes, no amendment of the operating agreement, even though Cass knew and understood the procedure under the operating agreement for changing operators. The jury rejected Cass’ theory that Stephens had waived an election to select a successor operator. The “change-of-name” letter provided some evidence, but was not conclusive on the issue of waiver, and Railroad Commission action is not conclusive as to matters between the parties to the operating agreement. Therefore, Frank Cass remained the operator as between the parties to the operating agreement.\footnote{124\textsuperscript{2}}

The court also affirmed the jury’s finding that Frank Cass was liable as operator under the alter ego theory.\footnote{125\textsuperscript{2}} When there is such unity between a corporation and an individual that the corporation ceases to be separate and when holding only the corporation liable would promote injustice, the individual may also be held liable.

In order to hold a shareholder liable for a corporation’s actions, Article 2.21 of the Texas Business Corporations Act\footnote{126\textsuperscript{2}} requires a plaintiff to prove that the shareholder caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the plaintiff primarily for the direct benefit of the shareholder.\footnote{127\textsuperscript{2}}

The court rejected Cass’ defense that there was no finding of actual fraud, relying upon a jury instruction to support a finding by implication. More importantly, the court found that the jury’s separate finding of common-law fraud by misrepresentation was enough to support disregard of the corporate entity.\footnote{128\textsuperscript{2}}

The jury found both Frank and Michael Cass liable for conversion based on their transfers of jointly-owned equipment from the jointly-operated wells to the solely-owned wells. Cass defended principally on the
basis that the claim was for breach of contract, not conversion. The distinction was significant because breach of contract would not support exemplary damages or personal liability. The court held that notwithstanding that the COPAS accounting procedures authorized the operator to move jointly-owned equipment between wells, the evidence was more than sufficient to justify the jury's conclusion that the failure to account was not an accounting error, but intentionally done to benefit Cass. Moreover, the pattern of deception was so pervasive that it supported a claim for conversion, not merely a breach of contract.\(^{129}\)

Michael Cass defended on the additional ground that he should not be personally liable because he was not the operator. "A corporate officer or agent is always primarily liable for his own torts," and an employee may be held individually liable for an employer's tortious acts if he knowingly participates in the conduct or has knowledge of the tortious conduct, either actual or constructive.\(^{130}\) "Instigating, aiding or abetting the wrongdoing constitutes participation," and "the employee or agent may be held liable regardless of whether he receives any personal benefit from the tortious act."\(^{131}\) The record contained evidence of Michael Cass' initials approving equipment transfers, which was sufficient to hold him personally liable for conversion.\(^{132}\)

For purposes of exemplary damages and personal liability, it was important to distinguish between the claims and damages for breach of contract and the claims and damages for torts. Stephens categorized the overcharges and charges not authorized as breach of contract, charges related to the solely-owned wells and for property already owned by the joint account as fraud, and removal of jointly-owned property as conversion. The court confirmed these distinctions as appropriate.\(^{133}\)

However, only the tort claims would support exemplary damages, and the damages on the tort claims were only a part of the judgment. The court reviewed the constitutional standards applicable for exemplary damages and found that the circumstances would justify exemplary damages in an amount of three times actuals for the tort claims. Therefore, the exemplary damages for fraud awarded against Frank were reduced to $300,000, and the exemplary damages for conversion awarded against Frank and Michael, jointly and severally, were reduced to $300,000.\(^{134}\)

_Eland Energy, Inc. v. Seagull Energy E&P, Inc._\(^{135}\) construes the obligation of an assignor to pay the operator a share of the operator-incurred costs and expenses _after_ the assignor assigns all its working interest to another. Seagull was the operator of an offshore well. Eland acquired a working interest in the lease under an assignment in which Eland une-

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129. _Id._ at *15-16.
130. _Id._ at *16.
131. _Id._
132. _Id._ at *17.
133. _Id._ at *22-24.
134. _Id._ at *28-33.
quivocably assumed its proportionate part of liability under the operating agreement. Eland later sold its interest to Nor-Tex at auction for $500. After Nor-Tex filed for bankruptcy, Seagull sought to recover against Nor-Tex's assignor, Eland, for an unpaid plugging liability of $268,418.136

Eland did not contest its original assumption of liability under the operating agreement, but contended that as an assignor, Eland had no continuing liability. The appellate court agreed with Eland. The operating agreement imposed liability for costs based on each owner's participating interest, which was in turn based on ownership in the lease. After Eland assigned all its interest in the lease to Nor-Tex, it had no ownership in the lease and therefore no participating interest. The unambiguous language of the operating agreement did not require Eland to reimburse Seagull for costs or expenses incurred after Eland made its assignment.137 Operators who wish to impose restrictions on a party's ability to assign interests only to financially responsible parties must be careful to expressly include such restrictions in the operating agreement.

*Long Trusts v. Griffin*138 holds that investors/plaintiffs in gas leases pursuant to letter agreements with lease owners/defendants owned a right to assign their interests in gas wells, rather than having the owner simply crediting their interest in the wells. Some of the letter agreements entered into provided that once investors complied with the provisions of the letter agreement, the lease owners would "assign or credit" the interest to the investors. Defendants contended that they had no obligation to assign the interest, but could opt to "simply credit the plaintiff with such interest."139 The letter agreements entered into by investors and leaseholders provided that participants "shall" own their undivided interests in the working interest of the wells. Assignment was necessary to have investors' ownership rights reflected in the deed records. Thus, the court held the investors had the option of taking an assignment or allowing defendants to credit them with their interests.140

Defendants also contended that plaintiffs were required to bring an action for trespass to try title, and that their failure to do so was fatal to their case. In Texas, interests in oil and gas are real property. The letter agreements were, in effect, "contracts for the sale of interests in real property."141 As such, the letter agreements could be enforced by specific performance and it was not necessary for plaintiffs to bring a trespass to try title action for recovery.142

Defendants also challenged the trial court's order requiring them to continue marketing plaintiffs' share of the production. The letter agreements gave defendants the right to market plaintiffs' share of production,

136. *Id.* at 124.
137. *Id.* at 129.
139. *Id.* at 106.
140. *Id.*
141. *Id.* at 104.
142. *Id.*
but also gave defendants the right to discontinue marketing plaintiffs' production at any time on thirty days notice. The trial court held that because defendants had engaged in a course of action for more than twenty years, they were now estopped from discontinuing the marketing of plaintiffs' share of production. On appeal, the court concluded that defendants had a contractual right to terminate the marketing of plaintiffs' share of production and that defendants were not estopped from availing themselves of this contractual right.¹⁴³

_Mulvey v. Mobil Producing Texas & New Mexico, Inc._¹⁴⁴ holds that non-operators have no direct or vicarious liability for the conduct of the operator, "operator's drilling operations, conversion, trespass, selling and marketing gas, drainage, development and pooling, accounting, unpaid royalties and unjust enrichment claims."¹⁴⁵ Mulvey owned various mineral interests and complained of the conduct of the operators Pecos and Bay Rock, primarily relating to his right to be paid certain royalties. Mulvey added a variety of other defendants due to their alleged vicarious and direct liability for the violations of his right to be paid from two wells. All the defendants, except Pecos and Bay Rock, filed a motion for summary judgment as to the claims of direct and vicarious liability for the acts of the operator, which was granted.¹⁴⁶

There was no allegation that the defendants, "as non-operators and overriding royalty interest owners, ever personally or directly, drilled the wells, operated the wells, produced the wells, sold production, entered into contracts, or carried out any other act that Mulvey claimed was done in violation of his rights."¹⁴⁷ The only question remaining was the alleged liability of the non-operators for the actions of operators Pecos and Bay Rock.¹⁴⁸ Mulvey contended that the non-operators were vicariously liable for the acts and omissions of the operators by their "authorization" and "ratification" of the purportedly illegal acts of the operators. However, these are concepts that are only relevant to determining whether an agency relationship exists, and Mulvey failed to allege agency. The court held that the non-operator who has an overriding royalty interest has an interest which is not a tangible or real property interest, and the non-operator "cannot dictate the actions of the operator."¹⁴⁹ It is a non-possessory interest. In fact, "[i]t is the operator who has the exclusive right to drill, produce and exploit the minerals, and who also bears the burden of paying all operating and drilling costs and royalties."¹⁵⁰

The court went on to state that "the relationship between the operator and non-operator is purely contractual and therefore dictated by the con-

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¹⁴³. _Id._ at 110.
¹⁴⁵. _Id._ at 605.
¹⁴⁶. _Id._ at 599, 605-06.
¹⁴⁷. _Id._ at 605.
¹⁴⁸. _Id._
¹⁴⁹. _Id._ at 606.
¹⁵⁰. _Id._
tract terms, absent some other special relationship created by the parties.”

"The contract in this case states [the following]: Operator shall have charge of the management, development, and operation of the lands including [sic] in the Unit Area for the production of oil, gas, and other minerals therefrom." Thus, according to the contract, “the non-operators retained no ability to direct or control the actions of the operators related to gas production.”

The court held that because Pecos and Bay Rock were not acting as agents of the non-operators, and because the non-operators had no contractual control over the production of gas or payment of royalties, the trial court was correct in granting the non-operators’ motions for summary judgment.

B. Operations

*Cleere Drilling Co. v. Dominion Exploration & Production, Inc.* allocated the risk of loss in a $2,000,000 well blowout case under the standard form International Association of Drilling Contractors (“IADC”) footage drilling contract, July 1998 revision. Dominion was the operator and Cleere was the drilling contractor. Cleere lost control of the well on the way down, before reaching the "contract footage depth." "The well eventually blew out through several surface fissures approximately 600 to 900 linear feet from the hole, spewing salt water, gas, sand and chemically treated drilling mud on and around the drill site." Dominion hired Boots & Coots to control the well, and Dominion eventually hired another contractor to drill a replacement well. Cleere sued Dominion for the contract value of the footage drilled, day work after the blowout, and for certain lost equipment. Dominion sued Cleere for the well-control costs, cleanup of the surface, restoration of the surface, settlement costs of landowner damage claims, and the difference (increase) between the replacement well cost and the contract well cost.

Cleere did not contest its own negligence, but focused on the allocation of risk and indemnity provisions of the contract. Cleere’s own claims were dependent upon the contract converting to “day work” status, which never occurred, so the denial of Cleere’s claims was affirmed.

As to Dominion’s claims,

Subparagraph 18.15 of the Contract addresses all indemnity and release provisions of the Contract and specifically notes that causation, including negligence, will not justify disregard of those provisions: Indemnity obligation: Except as otherwise expressly limited herein,

151. Id.
152. Id.
153. Id.
154. Id.
155. 351 F.3d 642 (5th Cir. 2003).
156. Id. at 644.
157. Id. at 643-44.
158. Id. at 645-46.
it is the intent of parties hereto that all releases, indemnity obligations and/or liabilities assumed by such parties . . . including without limitation Subparagraphs 18.1 through 18.14 hereof, be without limit and without regard to the cause or causes thereof (including preexisting conditions), . . . breach of contract or the negligence of any party or parties . . . .\textsuperscript{159}

Cleere maintained that the contract allocated to Dominion much of the damage, irrespective of whether Cleere was negligent or otherwise at fault.

The district court held that Cleere was liable for its own negligence and that the "overarching indemnity and release provisions of Subparagraph 18.15" (which might otherwise transfer that liability to Dominion) failed because the contract did not satisfy the Texas public policy requirement that there be fair notice for release and indemnity provisions to be binding.\textsuperscript{160} This holding was reversed.\textsuperscript{161} The doctrine of "fair notice" requires that a party seeking indemnity from the consequences of its own negligence must "clearly express" that intent and the release and indemnity provisions must be "conspicuous." Dominion conceded that the intent was express, but argued that the IADC form failed the conspicuousness test. The court did not seem very sympathetic to Dominion's position, but avoided the whole issue by holding that Dominion had actual knowledge of the subject provisions of the contract, and therefore the fair notice requirements were not applicable.\textsuperscript{162} Therefore, the general transfer of liability for Cleere's negligence from Cleere to Dominion was effective.

Under Subparagraph 18.12 of the Contract, responsibility for any damages arising from "pollution or contamination" that originated below the "surface of the land" was allocated to Dominion alone. Because Subparagraph 18.15 provides that Dominion's responsibility for such damages to the surface is not negated by Cleere's having caused the blowout that resulted in the deposit of the materials on the surface, Cleere could be held responsible only if the materials did not amount to either pollution or contamination.\textsuperscript{163}

The district court's holding that the materials were not pollution or contamination was reversed.\textsuperscript{164} The court had never before considered the meaning of pollution or contamination in the context of oil and gas drilling contracts. It cited with approval definitions found in \textit{Black's Law Dictionary} and concluded that pollution is "[c]ontamination of the environment by a variety of sources including, but not limited to hazardous

\textsuperscript{159} Id. at 647.
\textsuperscript{160} Id. at 646.
\textsuperscript{161} Id. at 647.
\textsuperscript{162} Id.
\textsuperscript{163} Id. at 650.
\textsuperscript{164} Id. at 657.
substances, organic wastes and toxic chemicals," while contamination is a "[c]ondition of impurity resulting from mixture or contact with foreign substance." Thus, "all pollution is contamination, but not all contamination is pollution."

Dominion argued that the substances in question were "relatively benign and not environmental threats." The court conceded arguendo that the materials might not be pollution, but the Contract was in the disjunctive (pollution or contamination), and the substances were clearly contamination. Dominion built dikes, worked twenty-four hours a day, removed 3,900 barrels of waste fluids, and paid for surface damages. Dominion could not now argue that there was no contamination. Thus, because the risk of loss was contractually on Dominion, and the damage to the surface was contamination, Dominion lost approximately $1,000,000 of its judgment on appeal (all sums related to the clean up, restoration of the surface, and surface damage claims). Dominion was given an opportunity on remand to prove up any of such damages which were not caused by the contamination.

The court affirmed that Cleere was liable for the approximately $850,000 Dominion expended in well control costs and the cost differential for the replacement well over the contract cost. However, because Dominion failed to present any evidence on the reasonableness and necessity of the amounts actually expended by Dominion, the court also remanded for further fact findings on the issues of reasonableness and necessity.

V. SEISMIC

In Villareal v. Grant Geophysical, Inc., the San Antonio Court of Appeals determined Texas law requires actual physical entry or injury to the surface estate lying above the mineral estate in order to sustain a claim of geophysical trespass. Villareal owned a mineral estate. Grant conducted seismic surveys using three-dimensional technology across three counties, including acreage near Villareal. While conducting the surveys, "Grant obtained permission to conduct survey operations from over 2,100 surface and mineral estate owners." Grant was unable to obtain permission from everyone within the survey and did not obtain permission from Villareal. "In order to avoid trespassing on approximately 125 tracts where permits were not originally obtained, including

165. Id. at 651 (quoting BLACK'S LAW DICTIONARY 1159 (6th ed. 1990) (emphasis added)).
166. Id. (quoting BLACK'S LAW DICTIONARY 318 (6th ed. 1990)).
167. Id.
168. Id. at 650.
169. Id. at 651.
170. Id. at 653-55.
171. Id. at 655-56.
173. Id. at 267.
the Villareal property, Grant reconfigured the survey."  

Grant placed shot and receiver points only on permitted tracts. Thus, Grant never trespassed on the surface of the estate above the Villareal mineral estate, and Grant contended it never intentionally obtained unpermitted data from the subsurface of the Villareal property.

Villareal filed suit against Grant contending that data was obtained from the mineral estate without first obtaining Villareal's permission to conduct seismic testing on the Villareal mineral estate. Villareal filed claims for geophysical trespass, assumpsit in lieu of geophysical trespass (reasonable value of the use and occupation of the land in lieu of actual damages), and unjust enrichment. The trial court granted summary judgment in favor of Grant on all of the claims. The San Antonio Court of Appeals affirmed the judgment of the trial court.

The court of appeals noted that trespass includes subsurface trespass in the oil and gas context. However, based upon interpretation of precedent, the court held that lack of physical invasion or injury precluded both trespass and assumpsit claims. Because a trespass did not occur under current Texas law, Grant also did not wrongfully secure a benefit nor did Grant "passively receive one which would have been unconscionable to retain." Therefore, Grant was not unjustly enriched. Although the court was not happy with existing precedents, it confirmed that the law in Texas continues to be that a geophysical trespass will not be actionable unless there is a surface injury or trespass.

VI. MARKETING

Aurora Natural Gas, L.L.C. v. Duke Energy Trading & Marketing, L.L.C. reviewed the priority of liens and rights to proceeds from gas production under the unique Texas approach to Article 9 of the Uniform Commercial Code ("Article 9"). Because the first payment for gas production generally does not occur until late in the month following the month of production, it is inevitable that when an operator files for bankruptcy, one to three months of production will have gone down the pipe with no payment to the producer. Because the debt to the producer is "unsecured," the producer would ordinarily fall into the class of unsecured creditors with little hope of recovery. To protect the producer against this result, Texas has adopted provisions in its version of Article 9 that are designed to place the producer in the class of secured creditors as

174. Id.
175. Id.
176. Id.
177. Id. at 268-70.
178. Id. at 270.
179. Id. (stating that "[a]lthough it appears that Texas law regarding geophysical trespass has not kept pace with technology, as an intermediate court, we must follow established precedent").
to the unpaid production proceeds.\textsuperscript{182}

Texas begins by defining "first purchaser" in section 9.343(r)(3)\textsuperscript{183} in terms that are broadly effective to capture: (1) the purchaser paying the producer, or (2) the operator who is collecting all the proceeds of production from the purchaser under a "one hundred percent indemnifying" division order and then paying the producer.\textsuperscript{184} Under the facts of this case, Edge Petroleum Operating Company ("Edge") produced natural gas and sold it to various companies and affiliates ("Aurora"), who eventually filed for protection in bankruptcy. As Edge produced the gas, Aurora immediately commingled Edge's gas with other gas and sold it to Duke Energy Trading and Marketing, L.L.C. ("Duke"). Duke immediately sold the gas it purchased from Aurora to other purchasers; the gas was used and no longer existed at the time Aurora filed for bankruptcy. Edge did not file a claim against the debtor, Aurora, but instead pursued a claim directly against Duke.\textsuperscript{185}

Edge sued Duke to enforce its security interest under section 9.343\textsuperscript{186} and for conversion. Texas's version of Article 9, section 9.343 generally grants a security interest in favor of the producer to secure payment of the purchase price by the first purchaser, even though the producer does not have a formal security agreement on file and the producer does not have possession of the collateral (gas).\textsuperscript{187} The security interest extends to proceeds. Article 9 provides that "[t]he act of the first purchaser in signing an agreement to purchase oil or gas production, in issuing a division order, or in making any other voluntary communication to the interest owner... recognizing the interest owner's right operates as an authentication of a security agreement..."\textsuperscript{188} Duke and Aurora contended that Aurora "did not sign an agreement to purchase gas, issue a division order or make any other voluntary communication" to Edge recognizing Edge's right.\textsuperscript{189}

Edge sold its gas to Aurora's marketing affiliate, who, in turn, entered into a standard Gas Industry Standards Board ("GISB") base contract. Aurora ordered gas deliveries from its marketing affiliate on GISB transaction confirmation forms. "Neither the base contract nor the confirmation forms mention[ed] Edge."\textsuperscript{190} The court held that the statute

\textsuperscript{182} Id. § 9.343(a) (Vernon 2002).
\textsuperscript{183} Id. § 9.343(r)(3) (Vernon 2002) provides, in part, that a first purchaser is the first person that purchases oil or gas production from an operator or interest owner after the production is severed, or an operator that receives production proceeds from a third-party purchaser who acts in good faith under a division order or other agreement authenticated by the operator under which the operator collects proceeds of production on behalf of other interest owners.
\textsuperscript{184} Id. § 9.343(r)(3).
\textsuperscript{185} Aurora Natural Gas, 312 B.R. at 320-22.
\textsuperscript{187} Id.
\textsuperscript{188} Id. § 9.343(a).
\textsuperscript{189} Aurora Natural Gas, 312 B.R. at 323.
\textsuperscript{190} Id. at 323-24.
provides three alternative methods to trigger the security agreement authentication: (1) an agreement to purchase gas production; (2) division orders; or (3) a communication recognizing the interest owner’s right.\textsuperscript{191} Issuing a division order did not apply in this case, and a New York federal district court had recently held that the GISB base contract and confirmation forms do not constitute a voluntary communication to the interest owner under the statute.\textsuperscript{192}

The court carefully avoided the third alternative and focused on “a signed agreement to purchase gas production.”\textsuperscript{193} The court held that the base contract and the confirmation forms implicitly communicate an acknowledgment of the purchase of gas with an interest owner. Therefore, Edge did perfect a security interest in the gas sold.\textsuperscript{194}

Section 9.343(m)\textsuperscript{195} also provides certain protections for secondary purchasers (in this case, Duke). The secondary purchaser is protected if the secondary purchaser: (1) buys in the ordinary course of business; (2) obtains the interest owner’s consent to transfer free from lien; (3) makes sure the interest owner (or operator) is paid; or (4) any disputed amount is withheld.\textsuperscript{196} Defenses two, three, and four were not applicable in this case. There was also a dispute between Aurora and Duke as to whether Duke actually paid for the gas, and that dispute was subject to a pending adversary proceeding. Therefore, Duke could not automatically prevail in the \textit{Aurora Natural Gas} case based upon purchase in the “ordinary course of business,” because “payment” was yet to be determined. The court did hold that Edge’s perfected security interest would attach to either the judgment Aurora ultimately obtained against Duke for unpaid gas, or to the proceeds owned or received by Aurora from Duke as payment for the gas.\textsuperscript{197} Because Edge had not obtained relief from the automatic stay in bankruptcy under section 362 of the Bankruptcy Code,\textsuperscript{198} Edge could not pursue the collection effort directly against Duke.\textsuperscript{199} Assuming Edge did get relief from the automatic stay and proceeded against Duke, the court held that the reach of the statutory lien would be governed by whether the sale was in the “ordinary course of business.” That fact issue required a trial.\textsuperscript{200}

Edge also claimed that it could pursue an independent claim for conversion against Duke. The court noted that:

\textit{Under Texas law, conversion is established by proving . . . (1) the plaintiff owned, had legal possession of, or was entitled to possession of the property; (2) defendant assumed and exercised dominion and}

\textsuperscript{191} \textit{Id.} at 324.
\textsuperscript{192} \textit{Id.} (citing \textit{In re Enron}, 302 B.R. 455, 461-62 (Bankr. S.D.N.Y. 2003)).
\textsuperscript{193} \textit{Id.}
\textsuperscript{194} \textit{Id.}
\textsuperscript{195} \textsc{Tex. Bus. \\ \\ & Comm. Code Ann.} \textsection{9.343(m)} (Vernon 2002).
\textsuperscript{196} \textit{Id.}
\textsuperscript{197} \textit{Aurora Natural Gas}, 312 B.R. at 326.
\textsuperscript{198} 11 U.S.C. \textsection{362} (2000).
\textsuperscript{199} \textit{Aurora Natural Gas}, 312 B.R. at 326.
\textsuperscript{200} \textit{Id.} at 327.
control over the property in an unlawful and unauthorized manner; and (3) defendant refused plaintiff's demand for the return of the property.\textsuperscript{201}

Because Edge impliedly consented to the transfer to Duke and because Duke purchased and sold the gas in accordance with the usual industry practice, the court held that this was a collection action and not an appropriate case for conversion. Edge did not have a right to possession of the gas when Duke purchased and sold it; Duke lawfully assumed control over the gas and sold it in a lawful manner, and Edge never demanded possession (return) of the gas. Rather, Edge just wanted to collect.\textsuperscript{202}

VII. RAILROAD COMMISSION

\textit{SWEPI, L.P. v. Camden Resources, Inc.}\textsuperscript{203} holds that a Railroad Commission finding that SWEPI ("Shell") “failed to show probable cause to suspect” that a well drilled by Camden was not drilled in compliance with Railroad Commission Rules did not preclude a suit by Shell against Camden for trespass and conversion.\textsuperscript{204} Shell sought to prove in this litigation for sub-surface trespass and conversion that Camden’s well was bottomed on Shell’s tract. Shell was awarded no administrative relief in the parallel Railroad Commission proceeding, but the court refused to find that Shell was barred from seeking a judicial remedy by either collateral estoppel or the Rule of Capture.\textsuperscript{205}

Collateral estoppel did not bar Shell from proceeding because the Railroad Commission “does not have jurisdiction over inherently judicial actions, such as those for trespass and conversion.”\textsuperscript{206} Camden also contended that because its well complied with Railroad Commission rules and regulations, Camden was entitled to all of the production from the well under the Rule of Capture. “The ‘rule of capture’ is a well established doctrine in Texas which holds that a landowner is entitled to produce the oil and gas in place beneath his land, as well as oil and gas that settles beneath his land as the result of physical conditions and natural laws relating to the migratory nature of oil and gas.”\textsuperscript{207} Nevertheless, the Rule of Capture is limited to the production of oil and gas that is legally recovered.\textsuperscript{208}

\textit{Pantera Energy Co. v. Railroad Commission of Texas}\textsuperscript{209} considered the effect on pending applications of amendments to Railroad Commission

\begin{itemize}
  \item \textsuperscript{201} \textit{Id.} at 328.
  \item \textsuperscript{202} \textit{Id.}
  \item \textsuperscript{203} 139 S.W.3d 332 (Tex. App.—San Antonio 2004, pet. denied).
  \item \textsuperscript{204} \textit{Id.} at 339-40.
  \item \textsuperscript{205} \textit{Id.} at 335-36, 340-42 (internal quotations omitted).
  \item \textsuperscript{206} \textit{Id.} at 339.
  \item \textsuperscript{207} \textit{Id.} at 341.
  \item \textsuperscript{208} \textit{Id.}
  \item \textsuperscript{209} 150 S.W.3d 466 (Tex. App.—Austin 2004, no pet. h.).
\end{itemize}
Rule 38(d)(3)\textsuperscript{210} governing dissolution of pooled units. Special Field Rules adopted for the Panhandle, West Field by the Commission in 1948 provided for a density pattern of 640 acres in the field. Pantera controlled more than 150 separate tracts that had been pooled for almost sixty years to form forty-eight units on which forty-eight wells had been drilled. In December 2000 and September 2001, Pantera filed forty-eight applications to dissolve the formerly pooled units into their 150 component parts pursuant to Former Rule 38(d)(3). Pantera contended that the last sentence in Former Rule 38(d)(3) \textit{required} the Commission to grant its applications without deliberation, "[i]f written waivers are filed or if a protest is not filed within the time set forth in the notice of application, the application will be granted administratively."\textsuperscript{211}

If the application was granted, "each substandard-sized tract would become a ‘legal subdivision’ on which one well could be drilled."\textsuperscript{212} In other words, by filing the application with a waiver, Pantera could effectively grant itself exceptions to the density rule for the Panhandle, West Field.\textsuperscript{213} Because the Commission determined that the applications were, in effect, attempts to obtain exceptions to the density provisions without complying with Commission rules, the Commission refused to proceed unless Pantera gave notice to offset operators and mineral owners. When the Commission refused to proceed on Pantera’s applications unless and until Pantera gave notice to offset operators and owners, Pantera launched three separate legal proceedings which were all addressed in this consolidated appeal.\textsuperscript{214}

While the applications and legal proceedings were pending, the Commission amended Rule 38(d)(3) to expressly require notice to the “affected persons” (offset operators, etc.) and further provided that the Commission would grant administrative approval of an application only if it “determines that granting the application will not result in the circumvention of the density restrictions of this section or other Commission rules . . .”\textsuperscript{215}

Pantera sought without success to avoid the effect of the rule change as to its pending applications. As to whether the rule itself was procedural or substantive, the court found that the only requirement complained of was the requirement of notice, and notice provisions have long been considered procedural. Neither Pantera nor any other litigant has a vested right in a procedural remedy.\textsuperscript{216} Pantera argued that the rule was substantive because the language of the rule (“will be granted”) required the


\textsuperscript{211} Pantera Energy Co., 150 S.W.3d at 468-70.

\textsuperscript{212} \textit{Id.} at 470 n.5.

\textsuperscript{213} \textit{Id.}

\textsuperscript{214} \textit{Id.} at 470-71.

\textsuperscript{215} \textit{Id.} at 471; see New Rule 38(d)(3).

\textsuperscript{216} \textit{Id.} at 472-73.
Commission to grant the application as filed by Pantera. The court held that in this instance, the use of the phrase "will be" was, nevertheless, discretionary with the Commission.\textsuperscript{217} That is, the words were not mandatory, but merely directive. Therefore, all the issues in all of Pantera's proceedings were moot because the rule was always discretionary and is now explicitly discretionary.\textsuperscript{218} Pantera argued that the change in the rules, at least as to Pantera, was arbitrary and capricious because Pantera's applications were already pending. The court held that there really was no change as to Pantera because the Commission had, from the beginning of the dispute, insisted on notice.\textsuperscript{219} Finally, Pantera argued that the rule change would deprive Pantera of vested property rights. Given that "forced pooling does not unconstitutionally interfere with vested property rights, neither can procedural limits on the unpooling of a unit."

\textsuperscript{217} Id. at 473.  
\textsuperscript{218} Id.  
\textsuperscript{219} Id. at 475.  
\textsuperscript{220} Id. at 476.