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Oil, Gas, and Minerals

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by

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This Article surveys the significant developments of the past year in the Texas law of oil, gas, and minerals. The scope of this Article is limited to decisions by Texas and federal courts and to the rules and regulations promulgated by Texas administrative agencies. The Texas Legislature enacted no measures dealing with oil, gas, or minerals during the survey period.

I. Case Law

A. Surface Deposits of Minerals

The Texas Supreme Court issued a new opinion in Moser v. United States Steel Corp. that differs in two respects from the previous Moser opinion, which the court withdrew. First, the court held that the substances of iron, lignite, and other forms of coal will not be subject to the Moser test; these substances will continue to be subject to the analysis developed in the Reed v. Wylie line of cases. Second, the Moser test for ownership of substances not specifically conveyed or reserved by name should be applied only prospectively from the date of the supreme court's original Moser opinion, June 8, 1983. Questions of title stemming from transactions prior to that date

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1. The law of oil, gas, and minerals historically has focused on the exploration for and production of minerals and hydrocarbons. By tradition, the law of oil, gas, and minerals has not included the legal aspects of the transportation, refining, and marketing of minerals and hydrocarbons. Neither have the organization and financing of the enterprises conducting these various activities been considered to be within the ambit of oil, gas, and mineral law. This Article preserves the traditional focus on the activities of exploration and production.

2. 676 S.W.2d 99 (Tex. 1984). For the facts of this case and a discussion of the supreme court's first opinion, most of which was repeated in the supreme court's new opinion, see Laity, Oil, Gas, and Minerals, Annual Survey of Texas Law, 38 Sw. L.J. 195, 198-200 (1984).


4. 676 S.W.2d at 102. Under the Moser test a severance of minerals clause includes the severance of any substances within the legal definition of the word "minerals," regardless of the depth below the surface at which the substances are found. Id.

5. 597 S.W.2d 743 (Tex. 1980). Under the Reed analysis determination of title is based on whether any reasonable method of removal of a substance near the surface would consume, deplete, or destroy the surface. Id. at 747. For a discussion of the Reed decision, see Diem & Laity, Mineral Resources, Annual Survey of Texas Law, 35 Sw. L.J. 177, 177-79 (1981).

6. 676 S.W.2d at 102. This result follows from the supreme court's addition of Reed v. Wylie to a list of cited cases dealing with substances that are not part of the mineral estate.

7. Id. at 103.
will be decided under the Reed line of cases.\(^8\)

**B. Executive Right to Lease**

The Texas Supreme Court also issued a new opinion in *Manges v. Guerra*.\(^9\) The court recharacterized Manges's breach of the standard of care incumbent on the holder of the executive right as the breach of a duty arising from the relationship of the parties.\(^10\) The supreme court previously had characterized the executive's standard of care as one arising from contract.\(^11\) The court's characterization of the standard of care as one arising from the relationship of the parties enabled the court to award exemplary damages for the breach of the executive's duty of utmost fair dealing\(^12\) and to cancel the oil and gas lease that the executive had negotiated in violation of his duty to the nonexecutive mineral interest owners.\(^13\) The court again refused to cancel the defendant's executive right, but this time the court's refusal was due to the plaintiffs' election in their motion for judgment to affirm their conveyance of the executive right to the defendant in order to seek damages.\(^14\) The court previously denied cancellation of the executive right on the ground that the breach of the executive duty was a breach of an implied covenant, which usually does not support the remedy of cancellation.\(^15\)

**C. Construction of Mineral Deeds**

In *Alford v. Krum*\(^16\) the Texas Supreme Court held that the granting clause of a deed prevails over all other conflicting clauses.\(^17\) The court found an irreconcilable conflict between the granting clause of a mineral deed, which conveyed one-half of a one-eighth interest,\(^18\) and the deed's future lease clause, which provided that in the event of a cancellation of the existing lease all future rentals would be owned jointly by the grantor and grantee,
with each owning a one-half interest. The court held that the grantor had conveyed only a one-sixteenth interest in the mineral estate in question and that the interest was not enlarged upon the termination of the lease encumbering the estate at the time of the conveyance.

The three dissenting judges took the plausible position that the interest conveyed was one-sixteenth of the mineral estate only during the term of the lease existing at the time of conveyance. Once that lease expired, the dissenting justices concluded, the interest conveyed increased to one-half of the mineral estate. The dissenting justices found no irreconcilable conflict between the granting clause and the future lease clause of the mineral deed. Grantors who wish to convey mineral interests dependent in magnitude on the reversion of the mineral estate will now have to draft the clauses more clearly than before, since the holding in Alford v. Krum weights deed interpretation in favor of finding superfluous future leasing clauses.

D. Continuous Operations Clauses and Shut-In Royalties

In Mayers v. Sanchez-O'Brien Minerals Corp. the San Antonio court of appeals determined that production from a previously shut-in gas well that occurs prior to the end of the continuous operations period specified in the controlling lease will hold the lease in force despite a failure by the lessee to pay shut-in royalties on time. The Mayers' leases included a sixty-day continuous operations clause. The lessees drilled a single well capable of producing gas in commercial quantities. With no market for the well's production, the lessees shut in the well after its completion and paid shut-in royalties for a time to the lessors. The landowners believed that the lessees had missed the anniversary date for the payment of shut-in royalties and sought a declaration that the leases had terminated. After the anniversary date alleged by the landowners but before sixty days had run, the lessees connected the shut-in well to a pipeline and began production. Although the lessees successfully argued that the landowners incorrectly calculated the anniversary date for the payment of shut-in royalties, they also contended that the continuous operations clause extended the leases to the time that actual production was achieved. The continuous operations clause by its

19. Id. at 872.
20. Id. at 874. The supreme court noted that the outcome of the case might have been different if reformation of the deed had been sought. Id. at 873.
21. Id. at 873.
22. Id. at 874 (Pope, C.J., dissenting).
23. Id.
24. Id. at 875.
26. Id. at 709.
27. The date the first shut-in royalty was paid to the landowners did not correspond with the beginning of the period indicated on the shut-in royalty receipt as the period for which the shut-in royalty was being paid. The court of appeals held that the beginning date specified on the receipt, rather than the lessee's date of payment, was the anniversary date for the payment of successive shut-in royalties, even though the lease provided that the anniversary date would be the date on which the shut-in royalty was paid. The shut-in royalty payment refused by the lessors was, therefore, timely tendered. See id. at 708.
terms came into effect if production ceased after having begun. The lessees claimed that the payment of shut-in royalties amounted to constructive production from the leases. Failure to pay shut-in royalties on the relevant anniversary date, the lessees argued, constituted a cessation of production, which in turn brought into play the sixty-day period under the continuous operations clause. The court of appeals agreed with the lessees.

Although the court of appeals was willing to view the payment of shut-in royalties as constructive production for purposes of invoking the continuous operations clause, the court indicated that it would not view the renewed payment of shut-in royalties as constructive production for purposes of complying with the sixty-day deadline for the restoration of production. Actual production, rather than constructive production, is necessary for the lease to be held beyond the continuous operations period. The court of appeals stated that "once a lease is held by the payment of shut-in royalties, the cessation of production clause does not provide a grace period for the late payment of subsequent shut-in payments."

E. Constructive Trusts

In Ginther v. Taub the Texas Supreme Court affirmed the imposition of a constructive trust on an oil and gas lease held of record by the knowing beneficiary of another's fraud. The grantee's attorney fraudulently induced the plaintiffs to convey their undivided fifty-percent interest in an oil and gas lease. At the time of the conveyance the plaintiffs believed that the grantee would reassign their interest in the lease when the plaintiffs reimbursed the grantee for delay rentals already paid by the grantee. The attorney who fraudulently induced the plaintiffs to convey their interest in the lease had represented the plaintiffs in prior business transactions and was found to have breached his fiduciary relationship with the plaintiffs.

Although the jury determined that the grantee knowingly participated in the fraud, the supreme court's opinion indicated that a constructive trust could have been imposed even upon a totally innocent beneficiary. The imposition of a constructive trust on a knowing or unknowing beneficiary of fraud, even though the beneficiary is not the actual wrongdoer, is a valid exception to the general rule that title to real property interests cannot rest in parol.
F. Implied Covenants

In Atlantic Richfield Co. v. Exxon Corp., the Texas Supreme Court rejected an attempt by the court of appeals to infer an implied covenant from a casinghead gasoline plant contract. Atlantic Richfield and others had entered into a contract more than thirty years ago with Exxon and another company, by which Atlantic Richfield and the others gained their undivided interests in the plant. The owners of the plant intended to use it to process casinghead gas produced from a nearby oil field. A separate agreement provided that the products of the processed casinghead gas would be shared among the owners of the plant in proportion to their respective interests in the field, rather than in proportion to the plant owners' interests in the unprocessed casinghead gas actually delivered to the plant from that field. In addition, the agreement provided that a two-thirds majority vote would be necessary to terminate the plant agreement. Suitable provisions were included in the agreement to guard against situations in which a single party to the agreement would have the requisite two-thirds interest to terminate the agreement or the requisite one-third interest to veto any proposed termination of the agreement. Atlantic Richfield began producing casinghead gas from the nearby field at a greater proportionate rate than the other plant owners, with the result that the other owners gained more in finished products from the plant than the unprocessed casinghead gas that they were delivering to the plant. When Atlantic Richfield's production slowed to a rate less than its proportionate ownership of the field compared to the production of the other plant owners, all parties to the plant agreement other than Atlantic Richfield voted to terminate the agreement. The other plant owners substituted a virtually identical agreement that provided that the ownership of processed products would be divided in proportion to the unprocessed casinghead gas actually delivered to the plant. Atlantic Richfield was thus unable to recoup the benefit that it had conferred upon the other plant owners by its early heavy field production. Atlantic Richfield sued to have the termination of the first plant agreement set aside and the successor agreement declared void.

One of the arguments sustained by the court of appeals but ultimately rejected by the supreme court examined a clause in the agreement that barred changes in ownership interests in the nearby field from affecting the ownership of the plant and the processed products. Atlantic Richfield argued that this clause showed the parties' intent that each party eventually would receive as processed products its original share of the field's reserves. As a result, Atlantic Richfield argued, the clause imposed upon the agreement's termination provision an implied covenant not to exercise the termi-

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38. The reader is advised to read the opinion of the supreme court in conjunction with the opinion of the court of appeals for a statement of the facts of this case. The court of appeals' opinion appears at 663 S.W.2d 858 (Tex. App.-Houston [14th Dist.]), rev'd in part and aff'd in part, 28 Tex. Sup. Ct. J. 68 (Nov. 3, 1984). The facts of the case have been simplified for this discussion.
nation provision in such a way as to thwart the intent of that clause. The court of appeals agreed with Atlantic Richfield's contention that an implied covenant limited the termination provision and concluded that the consent of all the parties would be required to modify the ownership interests in the processed products. The court of appeals also sustained Atlantic Richfield's argument that a party was under a legal duty not to exercise a cancellation provision unjustly to the injury of another party to the contract. The Texas Supreme Court refused to recognize either argument and affirmed the trial court's judgment denying all relief to Atlantic Richfield.

The court summarily rejected both arguments. The supreme court stated that no implied covenant regarding termination arises when a specific provision about termination has been included in the parties' contract. The supreme court determined that the parties' termination provision could not be varied by a perceived duty not to exercise the provision unjustly to the injury of another party; the court considered such a perceived duty as a variation of the implied covenant of good faith and fair dealing that the court had declined to recognize in an earlier session. The court's decision emphasized the necessity for a party to an agreement to think through, prior to signing the agreement, the possible courses that its relationship with the other parties might take in the future.

G. Lease Repudiation

In NRG Exploration, Inc. v. Rauch the Austin court of appeals held that operations on pooled acreage under a lease would not prevent the lessee from taking advantage of the doctrine of repudiation with regard to the unpooled acreage. The doctrine of repudiation tolls the time period provided under the habendum clause of an oil and gas lease for the fulfillment of the lessee's obligations for as long as the lessor contests the validity of the lease. The doctrine is not available, however, to lessees who continue to perform their obligations during the period of repudiation. The Rauch lease provided for a primary term of five years. At the end of the primary term the lease would remain in effect for an additional two years as to unpooled acreage if various conditions had been met. Although these various conditions were met by the Rauches' lessee, the Rauches filed suit shortly after the two-year supplemental period began, seeking cancellation of the entire lease. Two years after the suit was filed, the Rauches gave a second lease covering most of the acreage to another lessee and took a volun-

39. 663 S.W.2d at 870.
40. Id. (citing C.S. Martin & Son v. John Bonara & Co., 214 S.W.2d 841 (Tex. Civ App.—Texarkana 1919, writ dism'd)).
41. 28 Tex. Sup. Ct. J. at 70.
42. Id.
43. Id. The supreme court had declined to recognize an implied covenant of good faith and fair dealing in English v. Fisher, 660 S.W.2d 521 (Tex. 1983).
44. 671 S.W.2d 649 (Tex. App.—Austin 1984, writ ref'd n.r.e).
45. Id. at 652.
47. 671 S.W.2d at 652.
tary nonsuit in their cause against their first lessee. Shortly after the Rauches ended their litigation, NRG Exploration brought suit seeking a declaration that the first lease was still effective. In support of its position, NRG Exploration contended that the Rauches' litigation in effect repudiated the first lease, and, therefore, the running of the two-year supplemental period was suspended during the time of the Rauch litigation. The Rauches countered that the lessee must cease operations on the leased acreage if the running of the two-year supplemental period was to be tolled. Since the lessee had drilled a well during the two-year supplemental period on a unit that included part of the Rauch acreage, the lessors argued that the doctrine of repudiation did not apply. The court of appeals disagreed with the Rauches and held that operations by a lessee on a unit formed prior to the repudiating lawsuit would not prevent the lessee from relying on the doctrine of repudiation with regard to the remainder of the leased acreage.\(^4\) Production from the pooled acreage, the court of appeals noted, would not extend the term of the lease as to unpooled acreage.\(^9\)

### H. Forced Pooling Statute

The Texas Supreme Court examined the Texas forced pooling statute in *Carson v. Railroad Commission of Texas*.\(^5\) The Carsons owned a royalty interest in a tract of land within a proration unit and their lessee, BTA Oil Producers, drilled a producing well on the Carson tract.\(^5\) The Carson lease gave the lessee no authority to pool the Carson acreage. After the well had been completed as a producer, BTA Oil Producers approached the Carsons, seeking their consent to a voluntary pooling agreement. Under the terms of the proposed agreement the Carsons would have shared their royalty income with the owners of royalty interests in adjacent lands from which no production had been obtained, reducing the Carsons' royalty income by two-thirds. The Carsons refused to agree to the voluntary pooling agreement proposed by their lessee. BTA Oil Producers then applied to the Texas Railroad Commission for a forced pooling order, which was granted.

On appeal to the supreme court the proceedings centered on whether the voluntary pooling arrangement proposed by BTA Oil Producers to the Carsons had been fair and reasonable, as the forced pooling statute requires.\(^5\) The court made two significant points about the fair and reasonable test used by the statute. First, the court noted that the test affected the jurisdiction of the railroad commission to consider an application for forced pooling.\(^5\) If no fair and reasonable offer for voluntary pooling has been made, then the

\(^4\) *Id.*

\(^9\) *Id.*

\(^5\) 669 S.W.2d 315 (Tex. 1984). The Texas forced pooling statute is cited as the Mineral Interest Pooling Act and appears at TEX. NAT. RES. CODE ANN. §§ 102.001-.018 (Vernon 1978).

\(^51\) The facts of this case have been simplified for this discussion.

\(^5\) 669 S.W.2d at 316.

\(^52\) TEX. NAT. RES. CODE ANN. § 102.013(b) (Vernon 1978).
railroad commission must dismiss the application. Any judicial review of the railroad commission's determination of a fair and reasonable offer is not limited to a review of the administrative proceedings for substantial evidence in support of the agency's determination, but instead is a jurisdictional review giving the reviewing court greater latitude in scrutinizing the agency's determination. Second, the court pointed out that the criterion of deemed fairness and reasonableness given by section 102.013(c) did not apply in this type of case, in which a person is resisting being forced into a pool. The court stated that the deemed fairness criterion may be used only by a person seeking to join an existing pool on his own motion.

The supreme court decided as a matter of law that the voluntary pooling proposal made by BTA Oil Producers had not been fair and reasonable and instructed the railroad commission to dismiss BTA Oil Producers' application for want of jurisdiction. The court apparently was persuaded by three factors in arriving at its decision. First, the court objected to the timing of the offer made to the Carsons; had the offer been made before the Carson well had been drilled, the Carsons would have had reason to accept the offer not knowing whether their acreage would be productive. Second, BTA Oil Producers had refused to negotiate with the Carsons after the Carsons had rejected its offer. Third, the court apparently objected to the high-handed manner in which BTA Oil Producers had made the original offer for voluntary pooling; BTA Oil Producers' original correspondence with the Carsons suggested that the Carsons were required to accept the offer for voluntary pooling.

II. Administrative Developments

The Texas Railroad Commission adopted four sets of rules during the survey period that affect the oil, gas, and minerals area. First, the Commission promulgated rules governing the contents of an application for a qualified subdivision. During the previous survey period, the Texas Legislature amended the Natural Resources Code to provide a means by which surface owners might restrict the mineral use of suburban subdivisions. Surface owners may now apply to the Railroad Commission for approval of a plat that designates operations sites and appropriate easements. Owners of pos-

54. Id.
55. Id.
56. TEX. NAT. RES. CODE ANN. § 102.013(c) (Vernon 1978).
57. 669 S.W.2d at 316.
58. Id. at 317. The supreme court determined that the Texas Legislature intended § 102.013(c) to be a means by which a small acreage owner could force his way into a larger established proration unit by offering only to share in the royalties on an acreage basis. Id.
59. Id. at 318.
60. Id.
61. Id.
62. Id.
63. See id.
65. See Laity, supra note 2, at 205, 206.
sensory mineral interests within such a qualified subdivision will be required to use only the surface in designated operations sites and easements for their surface operations within the subdivision.67

Second, the Commission adopted amendments to rules that protect water quality.68 These amendments specify standards and set forth procedures for gaining permits for pits used to store oil field drilling fluids or to dispose of oil and gas wastes.69 Third, the Commission simplified its determination procedures under the Natural Gas Policy Act.70 This simplification was made after the Federal Energy Regulatory Commission adopted a number of orders that eliminated the need for a separate alternate filing program for Texas operators.71 Fourth, the Commission amended the definition of a marginal well to conform the definition to a statutory change made in 1983.72

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67. Id.