



# On the Docket

*Catching up with oil and gas case law.*

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**AS ANY PRACTITIONER WITH THE LEAST EXPOSURE TO THE OIL AND GAS INDUSTRY CAN ATTEST,** the pace of exploration and development activity during the past several years, from the surprising plays in the Barnett and Eagle Ford shales to the tried-and-true Permian Basin, has filled the civil dockets with oil field litigation. Space doesn't permit mention of more than a handful of the many recent reported cases, but those dealing with a few topical issues stand out.

## **SUBSURFACE TRESPASS**

Some are convinced that the recent surge in oil and gas activity, dependent in no small part on advances in the technology of hydraulic fracturing, would not be possible absent the rule announced in *Coastal Oil & Gas*

*Corp. v. Garza Energy Trust*, 268 S.W.3d 1 (Tex. 2008). Coastal had drilled its Coastal Fee No. 1 Well on a tract known as Share 12, 467 feet from the boundary of Share 13, in which the plaintiffs owned royalty interests. In completing the well, Coastal injected sand-laden fluids at high pressure through the wellbore and into the gas-bearing underground reservoir, intentionally inducing fracturing of the rock to promote the flow of gas to the well.

The fracturing extended well underneath the plaintiffs' Share 13, and they sued Coastal for damages resulting from the drainage of gas brought about by the fracturing. Without squarely deciding whether the fracturing under Share 13 constituted trespass, the Supreme Court of Texas held, on the basis of the rule of capture, that it was not actionable. The court was unpersuaded that the frac-



turing process is “unnatural” and analogous to an operator’s producing through a wellbore intentionally deviated underneath another’s land, and operators who are in regulatory compliance need not be concerned whether only on-lease rock is fractured in their well completions.

Does a similar rule apply to the underground disposal of wastewater resulting from oil field operations? At this point the answer seems to be that it probably does not. In *FPL Farming Ltd. v. Environmental Processing Systems, L.C.*, 351 S.W.3d 306 (Tex. 2011), the court rejected the notion that a disposal well operator’s obtaining a permit for the well from a state agency, in this case the Texas Commission on Environmental Quality, immunized it from a trespass claim brought by an adjoining landowner who could show that waste fluids injected through the well would eventually migrate to the deep subsurface underlying the plaintiff’s land. The court expressly declined to decide whether deep wastewater migration from one tract to another constitutes actionable trespass, but it took pains to distinguish the circumstances from those of *Coastal v. Garza* and to point out that the rule of capture does not apply. On remand the court of appeals held that the adjoining landowner does have a trespass cause of action. *FPL Farming Ltd. v. Environmental Processing Systems, L.C.*, 383 S.W.3d 284 (Tex. App.—Beaumont 2012, pet. filed). At this writing, the Supreme Court is considering the well operator’s petition for review.

### DUTIES OF EXECUTIVE MINERAL OWNER

It is common for the right to execute oil and gas leases to be segregated from other aspects of the mineral ownership, so that an executive owner may have the right to execute a lease binding on another’s “nonparticipating” mineral or royalty interest. Texas courts have long held that the executive owes a duty of fair dealing to nonexecutive owners in exercising the leasing right, but the bounds of the duty have not been well defined. On the basis that the executive’s duty is only to acquire for the nonexecutive every benefit that he exacts for himself, relying principally on *In re Bass*, 113 S.W.3d 735 (Tex. 2003), some decisions have suggested that an owner of executive rights has no duty whatsoever to the nonparticipating royalty or mineral owner unless and until the executive decides to lease, even if failure to lease is to the advantage of the executive but not the other.

*Lesley v. Veterans Land Board*, 352 S.W.3d 479 (Tex. 2011), clarifies that the executive’s duty is not so narrow. In that case a real estate developer who had acquired a fraction of the minerals but all of the executive right imposed restrictive covenants on the purchasers of subdivided lots, prohibiting drilling operations. In doing so the developer had breached its duty to the nonparticipating

mineral owners, the court held. *Bass* should not be misread to shield the executive from liability for any refusal to lease; if the refusal is arbitrary or motivated by self-interest to the nonexecutive’s detriment, the executive may have breached its duty. The court expressly declined to hold that as a general rule an executive is liable to a nonexecutive for refusal to lease minerals, pointing out that the developer’s action in this case was, in effect, a negative exercise of the executive right from which the executive received a benefit not shared by the nonexecutive. The extent of the duties of the owner of executive rights bears more clarification.

### POOLING MAY SURVIVE LEASE EXPIRATION

No review of Texas case law developments of the past several years would be complete without mention of *Wagner & Brown Ltd. v. Sheppard*, 282 S.W.3d 419 (Tex. 2008), a decision that, although delivered without any justice’s dissent, has perplexed many practicing in the field of oil and gas law. Given that the right of an oil and gas lessee has always been held strictly construed and dependent upon the express terms of the oil and gas lease, it has been widely assumed that any pooling of a lessor’s interest must terminate with the expiration of the lease. When the lease at issue in *Wagner & Brown* expired, although others committed to the same pooled unit did not, the court held, the lessor’s now-unleased mineral interest remained pooled on the basis that the lease authorized the lessee to pool the “premises” and the “lands,” not merely the lessor’s interest pursuant to the lease. Most leases that allow pooling contain similar wording, and it remains to be seen whether a pooled unit survives even the cessation of all production from the unit and expiration of all the committed leases unless the lessee affirmatively acts to dissolve it.

Another interesting aspect of *Wagner & Brown* is its treatment of the costs of development and production that an oil and gas operator may recover from the proceeds of the share of production attributable to a cotenant who does not join in the operations, the former lessor having become such a nonjoining cotenant when his lease expired. The rule has long been that any cotenant has the right to develop and produce jointly owned land for oil and gas production, accounting to a nonjoining cotenant for the cotenant’s share of net proceeds, but case law does not make the proper method of calculating the operating profit entirely clear. There were two wells in the pooled unit, one successful and the other not. *Wagner & Brown*, the operator, sought to recover its cost of drilling both wells out of the proceeds of production from both, on an aggregate basis. The court let stand the decision of the court of appeals, 198 S.W.3d 165 (Tex. App.—Texarkana 2006), that *Wagner & Brown* must



account to the unleased and nonjoining cotenant on a well-by-well basis. To the contrary, the court in *Prize Energy Resources, L.P. v. Cliff Hoskins Inc.* 345 S.W.3d 537 (Tex. App.—San Antonio 2011, no pet.), held that an operating cotenant may recover the cost of drilling multiple wells on a lease out of production from any of them, on an aggregate basis, at least where the unsuccessful well for which cost recovery is sought was of some benefit to the project as a whole. In recent years there has been an obvious increase in operators' willingness to undertake development without leases or other participation of substantially all the owners of interests in the land, and there are likely to be further developments.

tort claims arising from Exxon's alleged sabotage of wellbores upon their abandonment were barred because they had knowledge of facts by which they could have discovered the damage more than the limitations period of two years before suit was filed. Perhaps more significantly, the court held that although Exxon's lessors had standing to sue for Exxon's alleged breach of statutory duties to properly plug wells, the mineral owners' subsequent lessee, Emerald, did not.

*BP v. Marshall* also expanded the doctrine of *Natural Gas Pipeline Co. v. Pool*, 124 S.W.3d 188 (Tex. 2003), that a lessee's continuing to produce oil and gas after the expiration of its lease may mature a limitation title, by adverse

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#### DELAY IN BRINGING SUIT

Since *HECI Exploration Co. v. Neel*, 982 S.W.2d 881 (Tex. 1998), oil and gas plaintiffs have been frustrated by their difficulty in convincing courts to apply the discovery rule or the doctrine of fraudulent concealment to avoid the statutes of limitation. Their frustration is likely to continue. Despite the defendant lessee's deliberate concealment of its wrongfully continuing to operate under an expired lease, the lessors were held in *BP America Production Co. v. Marshall*, 342 S.W.3d 59 (Tex. 2011), to be barred by limitations from pursuing their damage claims. The plaintiffs could have discovered the lessee's wrongdoing by reviewing information publicly available at the Texas Railroad Commission as early as 1982, and the defendant's fraudulent concealment could toll the statute of limitations only until the fraud could have been discovered with reasonable diligence. The court in *Shell Oil Co. v. Ross*, 356 S.W.3d 924 (Tex. 2011), rejecting the argument that reasonable reliance on the defendant's fraudulent representations negated any duty to investigate, held that the plaintiffs were barred by limitations from seeking damages for underpayment of royalty. Reliance is not reasonable when information revealing the truth could have been discovered, and the court pointed to several circumstances that should have alerted the plaintiffs to discrepancies in their royalty payments and means by which they could have investigated them.

In the companion cases of *Exxon Corp. v. Emerald Oil & Gas Co.*, 348 S.W.3d 194 (Tex. 2011), and *Exxon Corp. v. Emerald Oil & Gas Co.*, 331 S.W.3d 419 (Tex. 2010), the court likewise held that the plaintiff lessors'

possession, to an interest in the land tantamount to the expired leasehold. The leases at issue in *BP v. Marshall* had expired in the absence of production or operations in the early 1980s, but there were other leases on undivided mineral interests in the same land that unquestionably remained in effect. Unlike the circumstances in *Pool*, where a single lease covering the entire mineral estate had expired because of a hiatus in production, the unleased mineral owners in *BP v. Marshall* had become their former lessee's cotenants.

The adverse possession statutes require possession, in order to result in establishment of a limitation title, to be inconsistent with and hostile to the claims of all others. Where a cotenancy exists, this requires the proponent of an adverse possession claim to prove ouster—unequivocal, unmistakable, and hostile acts the possessor took to dispossess the cotenant. Establishing what seems a low threshold for this burden, the court held that the lessee's continuing to pay royalty for the statutory period, coupled with the lessor's acceptance of it, was an unmistakably hostile and unequivocal assertion of title sufficient to constitute the required ouster.

#### OPERATING AGREEMENTS

Given the ubiquity of joint operation of oil and gas properties by multiple working interest owners, usually under forms of agreement with relatively standard provisions, it is interesting that historically not a great many cases have construed them. There have been several in the recent past:

- The court in *Reeder v. Wood County Energy, L.L.C.*, No. 10-0887, 55 Tex. Sup. Ct. J. 1366, 2012 WL



3800231 (Tex. Aug. 31, 2012, reh'g pending), held that the exculpatory clause of a 1989 AAPL Form 610 model form (as distinguished from earlier forms), relieved the operator of responsibility to the non-operating working interest owners, even for breaches of contract, except for liability arising from gross negligence or willful misconduct.

- A royalty owner whose lessee is a party to a joint operating agreement is not a third-party beneficiary and may not seek payment from other working interest owners under a provision of the agreement allocating royalty responsibility, held the court in *Tawes v. Barnes*, 340 S.W.3d 419 (Tex. 2011).
- *Valence Operating Co. v. Dorsett*, 164 S.W.3d 656 (Tex. 2005), followed by *Bonn Operating Co. v. Devon Energy Production Co., L.P.*, 613 F.3d 532 (5th Cir. 2010), held that an operator was not in breach of its operating agreement in failing to submit a well proposal to a non-operator until after the well was commenced, rather than before commencement as the agreement specified, and could enforce the nonconsent penalties resulting from the non-operator's failure to participate. Both courts further held that the provisions of the agreement for relinquishment of a nonconsenting owner's interest in a well in which it declines to participate were not unenforceable penalties but instead a reasonable method of risk allocation.
- Likewise, a "required well" provision under which a party must relinquish some interest forever if it declines to participate in a proposed operation is not an unenforceable penalty, held the court in *Long v. RIM Operating Inc.*, 345 S.W.3d 79 (Tex. App.—Eastland 2011, pet. denied).
- In order to invoke the nonconsent provisions of an operating agreement against a party that has elected (or is deemed to have elected) not to participate in an operation, the party proposing the operation must timely commence the well in the same manner that a lessee must typically commence operations in order to extend the term of an oil and gas lease, according to *Valence Operating Co. v. Anadarko Petroleum Corp.*, 303 S.W.3d 435 (Tex. App.—Texarkana 2010, no pet.); "back-room" preparations short of actual operations on the ground are not enough.
- Once a party receiving a well proposal makes its election not to consent, it is bound by that election even if it purports to withdraw it within the contractual response period. *XTO Energy Inc. v. Smith Production Inc.*, 282 S.W.3d 672 (Tex. App.—Houston [14th Dist.] 2009, pet. granted, dism'd by agreement).

## CONVEYANCING

The ongoing fractionation of interests in minerals, by conveyance or by operation of law, and owners' desire to segregate various aspects of the mineral estate from others create vast opportunities for uncertainty in the conveyance of those interests. The past several years have seen no shortage in the reported cases dealing with the construction of oil and gas conveyances. Most of these turn on the peculiar wording of the instruments under consideration. An observation that may be useful here is that the courts have adhered to the four-corners doctrine, that a deed or conveyance must be considered as a whole, giving effect to each of its expressions of intention and attempting to harmonize, to the extent possible, those that seem to be contradictory.

That task is not always an easy one, as illustrated by the opinion of the court, sitting en banc, as well as the dissent, in *Hausser v. Cuellar*, 345 S.W.3d 462 (Tex. App.—San Antonio 2011, pet. denied), in which the court construed a deed to have conveyed one-half of the royalty under any lease on the tract involved and not a fixed one-sixteenth of total production. Other recent examples of this analysis are *Moore v. Noble Energy, Inc.*, 374 S.W.3d 644 (Tex. App.—Amarillo 2012, no pet.), in which the court emphasized that where there are competing possible interpretations, the court must ask itself whether there is more than one *reasonable* interpretation; *Coghill v. Griffith* 358 S.W.3d 834 (Tex. App.—Tyler 2012, pet. denied); and *Sundance Minerals, L.P. v. Moore*, 354 S.W.3d 507 (Tex. App.—Fort Worth 2011, pet. denied). The intentional flexibility of the four-corners doctrine occasions some uncertainty in its application, and it can of course be misapplied. Any other fixed rule would undoubtedly lead to unintended results, and not necessarily to more clarity, and it is encouraging to observe that the courts seem to exhibit no lack of confidence in the rules of construction they are required by precedent to observe.

This article could not possibly note all of the kinds of cases that might be of interest but highlights some of the developments that may have lasting importance. Controversies will continue to arise, of course, and those who practice in the oil and gas area can look forward to the law's continued evolution. **TBJ**



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