Case Law Update 2012

Christopher S. Kulander
Assistant Professor of Law, Texas Tech School of Law
Of Counsel, Haynes and Boone LLP
Lubbock, Texas
chris.kulander@ttu.edu

haynesboone
Setting precedent.

TEXAS TECH UNIVERSITY
School of Law

Wendell Reeder v. Wood County Energy, LLC et al.

Opinion No. 10-0887, __S.W.3d__ (Tex. 2012), 55 Tex. Sup. Ct. J. 1366, 2012 Tex. LEXIS 735.

- Questions Considered:
  - Are there differences between the operator exculpatory clauses in the '89 vs. the '82 & '77 form JOAs?
  - How does exculpatory language in the form JOAs cover breach of contractual terms?
- Facts:
  - Operator accused of failure to maintain production on leases which then expired, causing RRC to breakup unit
  - Trial court: operator breached duty under '89 JOA.
  - COA: clause does not apply to breach of contract claims

Wendell Reeder v. Wood County Energy, LLC et al.

Opinion No. 10-0887, __S.W.3d__ (Tex. 2012), 55 Tex. Sup. Ct. J. 1366, 2012 Tex. LEXIS 735.

- Texas Supreme Court:
  - Case law: exculpatory clause of '77 & '82 forms only applies to actual work, not to K breaches
  - Parse language of the JOAs:
    - '89: "Operator shall conduct its activities under this agreement as a reasonable prudent operator, in a good and workmanlike manner, with due diligence…in accordance with good oilfield practice…but in no event shall it have any liability as Operator to the other parties for losses…except such as may result from gross negligence or willful misconduct."
    - '77 and '82: "all such operations" in a good and workmanlike…

Wendell Reeder v. Wood County Energy, LLC et al.

Opinion No. 10-0887, __S.W.3d__ (Tex. 2012), 55 Tex. Sup. Ct. J. 1366, 2012 Tex. LEXIS 735.

Citing articles by Bledsoe and Wilson, TSC finds ‘89 language broadens ranges of activities excused under exculpatory clause—contract breaches

So…with no evidence of gross negligence or willful misconduct, the ‘89 clause shields operator in this case

- Implication:
  - ‘89 form JOA exculpatory clause may protect operator from contractual claim breach
    - Unless gross negligence/willful misconduct plays a role
    - Blurry line between operation and contract breach

Edwards Aquifer Auth. v. Day

Opinion No. 08-0964, 369 S.W.3d 814 (Tex. 2012), 55 Tex. Sup. Ct. J. 343; Motion for rehearing on petition for review denied by: *Edwards Aquifer Auth. v. Day*, 2012 Tex. LEXIS 488 (Tex. 2012).

- Questions Considered:
  - Is water owned "in place" and can neighbors produce it without liability through the rule of capture?
  - Is water subject to "takings" compensation law?
- Background:
  - Well drilled in '56; artesian flow into a small lake since
  - Some irrigation and recreational use thereafter
  - Day applied for water well permit for irrigation
    - Based on historical use
  - Edwards Aquifer Authority (EAA) denied the permit

Edwards Aquifer Auth. v. Day

Opinion No. 08-0964, 369 S.W.3d 814 (Tex. 2012), 55 Tex. Sup. Ct. J. 343; Motion for rehearing on petition for review denied by: *Edwards Aquifer Auth. v. Day*, 2012 Tex. LEXIS 488 (Tex. 2012).

- State Office of Administrative Hearings: no evidence of beneficial use—deny permit
  - Affirms EAA's order to limit pull to 14 acre-feet
- District Court: SJ for EAA, denying takings claim
- CoA: EAA could limit the amount of water pulled—but landowner may claim takings
  - Water in lake ruled "state water"—under TCEQ

Edwards Aquifer Auth. v. Day

Opinion No. 08-0964, 369 S.W.3d 814 (Tex. 2012), 55 Tex. Sup. Ct. J. 343; Motion for rehearing on petition for review denied by: *Edwards Aquifer Auth. v. Day*, 2012 Tex. LEXIS 488 (Tex. 2012).

- Texas Supreme Court:
  - EAA could have found, that the water had "changed character" and thus was state water (under TCEQ)
    - Recreation use is not "beneficial"—irrigation is
    - Produced water does not always change character
  - "Ownership in place" addressed—water owned in place but subject to rule of capture, common law limits on waste, and state regulation
  - Withholding permit may amount to a takings requiring compensation under *Lucas* or *Penn Central*.

Edwards Aquifer Auth. v. Day

Opinion No. 08-0964, 369 S.W.3d 814 (Tex. 2012), 55 Tex. Sup. Ct. J. 343; Motion for rehearing on petition for review denied by: *Edwards Aquifer Auth. v. Day*, 2012 Tex. LEXIS 488 (Tex. 2012).

- Review of *Lucas* and *Penn Central*
  - *Lucas*: Does the restriction eliminate all possible use of the land? If so - takings unless use is a governable nuisance.
  - *Penn Central*: If it doesn't eliminate all use, 3 factors
    - Gov. interest; effect on claimant; investment expectations
- Implications:
  - Not merely a right to use, but a right to water in place
  - GCDs are likely to be more reluctant to withhold a permit to avoid future litigation re: takings questions
  - Water for fracing ops, currently under GCD permit jurisdiction, may not be for long in order to prevent suits

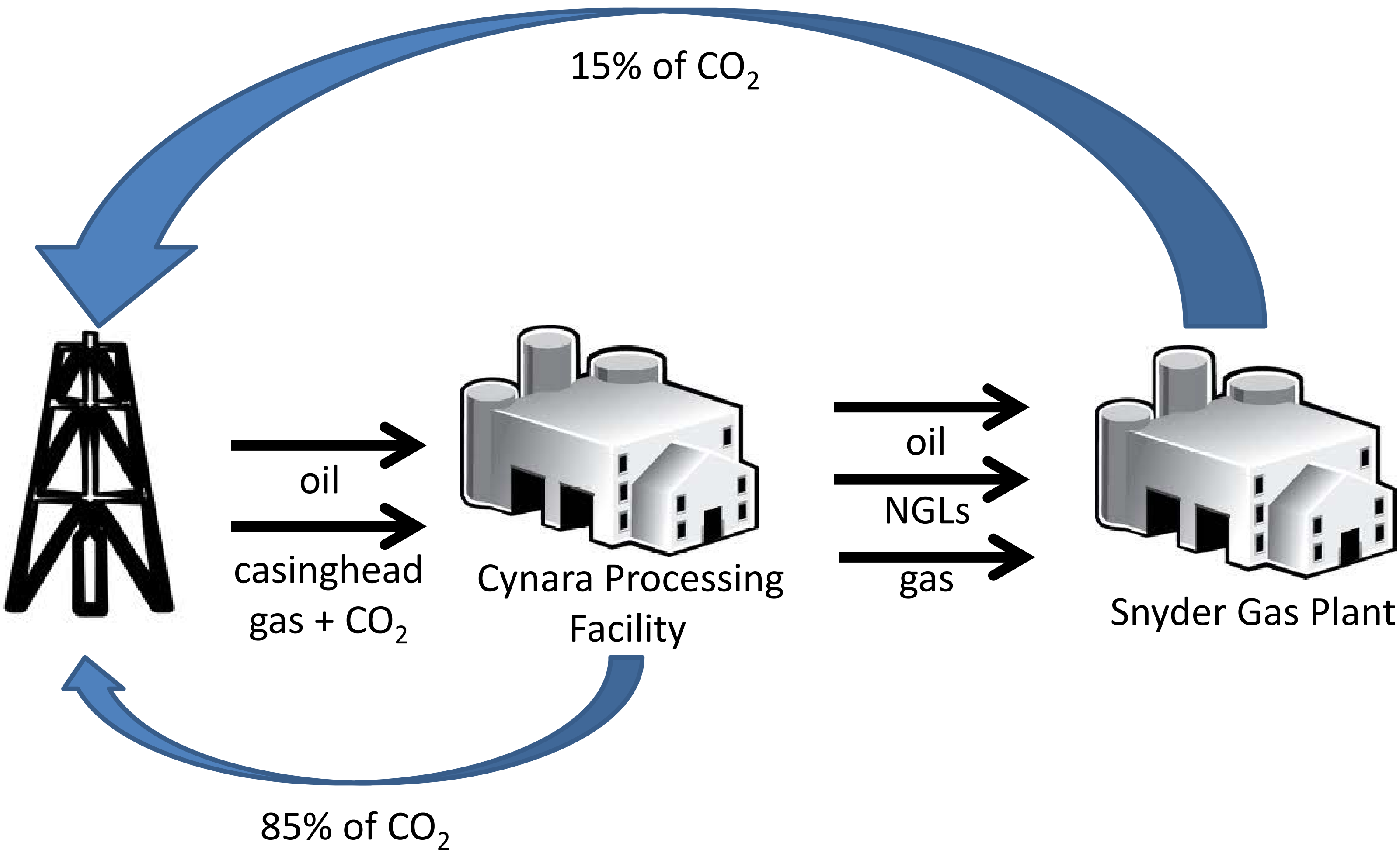
Occidental Permian Ltd. v. Marcia Fuller French et al.

Opinion No. 11-10-00282-CV, __S.W.3d__ (Tex.App.—Eastland, 2012), 2012 Tex. App. LEXIS 8996.

- Question considered:
  - Are fees charged by PoPs, which are calculated on the amount received by enhanced recovery projects, a shorting of the volume upon which royalty is calculated?
- Background:
  - Parties: French (lessor) Occidental (lessee) K-M (PoP)
  - Agreement between Occidental and K-M
    - Monetary charge: not deducted from royalty
    - In-Kind fee comprised of: 30% of value of NGLs
100% of value of casinghead gas

Occidental Permian Ltd. v. Marcia Fuller French et al.

Opinion No. 11-10-00282-CV, __S.W.3d__ (Tex.App.—Eastland, 2012), 2012 Tex. App. LEXIS 8996.



Occidental Permian Ltd. v. Marcia Fuller French et al.

Opinion No. 11-10-00282-CV, __S.W.3d__ (Tex.App.—Eastland, 2012), 2012 Tex. App. LEXIS 8996.

- French brought suit to recovery royalty claiming:
  - CO_2 ops were a "production activity" and not a "post-production activity"
  - Unlawful shorting of value upon which royalty was based violated marketing covenant
- Two leases: "market value" & "net proceeds"
- Trial Court: for lessor; Court of Appeals reverses:
  - CO_2 processing was not "production activity"
  - Used traditional TX analysis for "market value" (comparable sales, then net back) & "net proceeds" (must act as "reasonable operator")

Harding Co. v. Sendero Res., Inc.

Opinion No. 11-1000282-CV, 365 S.W.3d 732 (Tex. App.—Texarkana 2012, pet. filed), 2012 Tex. App. LEXIS 571.

- Questions considered:
  - Are intertwined entities included in non-compete agreements?
  - What are limits of K interpretation seeking meaning for all parts?
- Background:
  - Ted Walters wore three corporate hats—Sendero Resources, TWW Tyler, Inc. and Walters and Associates, L.P.
  - 2007 agreement: Harding, Sendero, a geologist, & landman with non-compete provision over “Walters”
  - TWW Tyler, Inc. get leases for competitor
  - Harding claims breach and sues. District Court finds for Harding

Harding Co. v. Sendero Res., Inc.

Opinion No. 11-1000282-CV, 365 S.W.3d 732 (Tex. App.—Texarkana 2012, pet. filed), 2012 Tex. App. LEXIS 571.

- Harding: to allow TWW Tyler, Inc. to compete would render non-compete clause meaningless
- Court of Appeals:
  - Ted Walter's signature as president of Sendero only bound him as to that entity
  - "if possible" should be read into any attempt to find every K term to have meaning
  - However, fact question existed whether Harding was owed a fiduciary duty by the Walter entities—did they act as an agent?

Seitel Data, Ltd. v. Simmons

Opinion No. 06-11-00041-CV, 362 S.W.3d 783 (Tex.App.—Texarkana, 2012), 2012 WL 129766, 2012 Tex. App. LEXIS 1446.

- Questions considered:
  - Is there a "bright line" rule that expert testimony is necessary to establish the connection between seismic blasting and damage to surface assets?
  - In an exculpatory clause, what's the potential difference between "due to" and "arising out of" language?
  - Is "mere suspicion" caused by an event followed by an effect enough to allow a finding that seismic charges ruined a well?

Seitel Data, Ltd. v. Simmons

Opinion No. 06-11-00041-CV, 362 S.W.3d 783 (Tex.App.—Texarkana, 2012), 2012 WL 129766, 2012 Tex. App. LEXIS 1446.

- Background:
  - Seismic operations conducted under "due to" K
  - Seismic charges used. Well soon sands out
  - Trial court finds for surface owner in tort and K:
    - landowning plaintiffs and water well driller testified—no expert witnesses/evidence of causation
    - Simmons relies on contract theory
- Court of Appeals
  - Requirement of expert witness testimony is matter of law
  - While some Texas case law suggests expert witness testimony is necessary in seismic cases, it is not always.

Seitel Data, Ltd. v. Simmons

Opinion No. 06-11-00041-CV, 362 S.W.3d 783 (Tex.App.—Texarkana, 2012), 2012 WL 129766, 2012 Tex. App. LEXIS 1446.

- WRT seismic damages, lay testimony is adequate to prove causation where "general experience and common sense would a enable a layman to determine, with reasonable probability, the causal relationship between the event and the condition"
- Implications:
  - More of these cases
  - Temporal proximation may work in these cases
  - "due to" language not as protective as thought

Friddle v. Fisher

Opinion No. 06-12-00018-CV, 378 S.W.3d 475 (Tex.App.—Texarkana, 2012), 2012 WL 3536796, 2012 Tex. App. LEXIS 6895.

- Questions considered:
  - What duty is owed an NPRI owner?
  - Who pays the money to non-executives?
- Background
  - Non-tract well brought it on pooled acreage
  - Lessee pays all to executive, none to NPRI owner
  - NPRI owner sues, claiming that he should have been notified of lease, pooling, and production
    - And that Statute of Limitations had been tolled

Friddle v. Fisher

Opinion No. 06-12-00018-CV, 378 S.W.3d 475 (Tex.App.—Texarkana, 2012), 2012 WL 3536796, 2012 Tex. App. LEXIS 6895.

- Fisher: cites *Montgomery v. Rittersbacher*[1]—a similar case except that lessee paid into a court trust
- Court of Appeals:
  - Differentiates *Montgomery v. Rittersbacher*
  - Citing the recent case of *Lesley v. Veterans Land Bd.,*[2] NPRI owners are held to be owed the same "utmost fair dealing" standard as non-executive mineral owners
  - Where executive accepts all the money, he is chargeable in equity as constructive trustee
  - Lease in OPR doesn't prevent the discovery rule from tolling SoL

[1] 424 S.W.2d 210 (Tex. 1968)

[2] 352 S.W.3d 479, 480-81 (Tex. 2011)

City of Houston v. Trail Enterprises, Inc.

Opinion Nos. 14-1000944-CV, 14-11-00417-CV, 377 S.W.3d 873 (Tex.App.—Houston, 2012), 2012 WL 3223662, 2012 Tex. App. LEXIS 6597.

- Question asked: How does traditional "takings" analysis currently apply in the mineral realm?
- Background:
  - 2003 suit claimed that 1967 drilling restrictions constituted a taking requiring compensation
  - Jury (after bench trial) awards $19 million
  - City appeals, claiming Trail, et al., had not satisfied administrative remedies by not applying for permits
  - TSC found the case ripe; trial court finds taking of $17m
  - Both parties appeal

City of Houston v. Trail Enterprises, Inc.

Opinion Nos. 14-1000944-CV, 14-11-00417-CV, 377 S.W.3d 873 (Tex.App.—Houston, 2012), 2012 WL 3223662, 2012 Tex. App. LEXIS 6597.

- Court of Appeals:
  - Applied *Sheffield Development Company v. City of Glenn Heights*,[1] the Texas version of *Penn Central*.
  - Applied three factors:
    - i. Was government action rationally related to a legitimate governmental end?
    - ii. What is economic impact to property owners?
    - iii. What is the interference with investment-backed expectation?
  - Court finds (i) and (iii) in favor of city, (ii) in favor of property owners

[1] 140 S.W.3d 660 (Tex. 2004)

Royalco Oil & Gas Corp. v. Stockhome Trading Corp.

Opinion No. 02-10-00455-CV, 361 S.W.3d 725 (Tex.App. – Fort Worth, 2012), 2012 WL 254037, 2012 Tex. App. LEXIS 723.

- Question considered:
  – Does the common law of leases or “traditional” Texas oil and gas law apply to the partial transfer of a lessee’s interest in a disposal well agreement?
- Background:
  – Agreement made for use of a disposal well.
    - Restriction on any assignments of the Agreement
    - Stated that agreement “in no way” affected ogm ownership
    - Provided that agreement only allow “business activities”
  – 50% of the agreement is assigned
  – Lessee fails to make payments. Lessor sues to terminate agreement and to have agreement declared a sublease

Royalco Oil & Gas Corp. v. Stockhome Trading Corp.

Opinion No. 02-10-00455-CV, 361 S.W.3d 725 (Tex.App. – Fort Worth, 2012), 2012 WL 254037, 2012 Tex. App. LEXIS 723.

- Court of Appeals—Assignment is a sublease
  - Terms like “assign” and “assignment” used in the Agreement and Assignment are not controlling
  - RRC permit for disposal well does not make the Agreement an ogm lease
  - Agreement is not for the production of minerals
  - Agreement did not pass all the interest, so the transfer is a sublease—no privity to lessor
  - Payment by assignee will not save Agreement

CNH CAPITAL AMERICA LLC v. PROGRESO MATERIALS LTD, et al

(USDC – Southern District of Texas). ***October 25, 2012***

Reminder of the importance of having the exact legal name of the Debtor on UCC-1 Financing Statements!

In this case, the secured creditor omitted the letter "s" from the word "Materials" in the debtor name listed on the UCC Financing Statement.

- Correct Name of Debtor: Progreso <u>Materials</u>, Ltd.
- Debtor Name on UCC-1: Progreso <u>Material</u>, Ltd.

Consequently, the secured creditor was not perfected and was unable to foreclose on the collateral, which had been sold to a third party without knowledge of the security interest.

Thank you!

Christopher S. Kulander
Assistant Professor of Law, Texas Tech School of Law
Of Counsel, Haynes and Boone LLP
Lubbock, Texas
chris.kulander@ttu.edu

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Setting precedent.

TEXAS TECH UNIVERSITY
School of Law

HOUSTON BAR ASSOCIATION – OIL, GAS, AND MINERAL LAW SECTION

CASE LAW UPDATE

January 22, 2013

Christopher Kulander, Associate Professor of Law, Texas Tech School of Law
Of Counsel, Haynes and Boone, LLP

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Wendell Reeder v. Wood County Energy, LLC et al.

Opinion No. 10-0887, __S.W.3d__ (Tex. 2012), 55 Tex. Sup. Ct. J. 1366, 2012 Tex. LEXIS 735.

In a decision handed down on August 31, 2012, the Texas Supreme Court compared the exculpatory language in the 1977 and 1982 form AAPL Model Form 610 Joint Operating Agreements ("*JOAs*") to the corresponding exculpatory language in the 1989 form JOA. In *Wendell Reeder v. Wood Country Energy, LLC, et al.*, Opinion No. 10-0887 ("*Reeder*"), the Court found that the operator was not liable for its activities under the JOA unless those activities involved gross negligence or willful misconduct, including a failure to conduct activities contractually prescribed.

In *Reeder*, the Court considered the case of an operator who faced claims by non-operators that it had failed to maintain production in paying quantities, causing oil and gas leases potentially worth millions of dollars to expire and the Texas Railroad Commission to break apart a unit and suspend operations therein. The operations were conducted pursuant to the 1989 form JOA and at trial, a jury found the operator had breached its duty to the non-operators by failing to maintain production in paying quantities. The court of appeals affirmed, and held that the exculpatory clause in the JOA at issue should not have applied to shield the operator from the claims of the non-operators because the clause did not apply to breach of contract claims like the ones before the court. Therefore, it was not necessary that the operator first be found to have behaved with either gross negligence or willful misconduct.

The Supreme Court of Texas first noted that, unlike the earlier versions of the form JOA that state "[Operator] shall conduct *all such operations* in a good and workmanlike manner, but it shall have no liability as Operator to the other parties for losses sustained or liabilities incurred, except such as may result from gross negligence or willful misconduct," the 1989 form JOA provides that "[Operator] shall conduct *its activities under this agreement* as a reasonable prudent operator, in a good and workmanlike manner, with due diligence and in accordance with good oilfield practice, but in no event shall it have any liability as Operator to the other parties for losses sustained or liabilities incurred except such as may result from gross negligence or willful misconduct." (emphasis added)

On prior occasions, in examining the scope of the exculpatory clause in the 1977 and 1982 form JOAs, Texas courts of appeal concluded that the scope of the exculpatory clause is limited to claims that the operator failed to act as a reasonably prudent operator, and does extend to other breaches under the JOA. One court reasoned that, as the exculpatory clause is linked directly to the "imposition of the duty to act as a reasonably prudent operator, which strictly concerns the manner in which the operator conducts drilling operations on the lease, the exculpatory clause should not be expanded to include claims against the operator for breach of contract." *Abraxas Petroleum Corp. v. Hornburg*, 20 S.W.3d 741, 759 (Tex. App.—El Paso 2000, pet. denied). This interpretation is buttressed by other courts who view the exculpatory clause's location within the "operations" section of the JOA, and not within the broader "liability of the parties" section, as indicative of the intent of the parties with respect to what liability, exactly, is intended to be limited.

However, drawing upon the difference between the exculpatory language of "its activities under this agreement" in the prior form JOAs versus "all such operations" in the 1989 form JOA, and noting that some commentators[1] have concluded the 1989 form JOA provided for a more expansive exoneration of the operator, the Supreme Court held the 1989 form JOA exculpatory language broadened the range of operator activities covered by the exculpatory clause outside of those strictly relating to operations under the JOA.

Specifically, this interpretation of the 1989 Form JOA exculpatory clause yields that the clause covers not only basic oilfield operations but also all activities covered under the form JOA. The Court opined, "The [1989 form JOA exculpatory clause] implicates a broader scope of conduct following the language of the contract. The agreed standard exempts the operator from liability for its activities unless its liability-causing conduct is due to gross negligence or willful misconduct." After subsequently finding that the operator had not acted with gross negligence or willful misconduct, the Supreme Court reversed and ruled in favor of the operator.

The implication of *Reeder* is that application of the exculpatory clause to a failure by the operator to satisfy basic contractual obligations under the 1989 Form JOA may render such

1 *See* Robert Bledsoe, *The Operating Agreement: Matters Not Covered or Inadequately Covered*, 47 ROCKY MTN. MIN. L. INST. § 15.03[1](2001); *see also* Wilson Woods, *The Effect of Exculpatory Clauses in Joint Operating Agreements*, 38 TEX. TECH. L. REV. 211, 214-15 (2005).

breach not actionable unless the breach rises to the level of "gross negligence or willful misconduct," as determined by the fact-finder. The operator in *Reeder*, and, after *Reeder*, perhaps all operators under a 1989 form JOA, would be exempted from liability to non-operators if the operator acts with mere ordinary negligence.

Edwards Aquifer Auth. v. Day

Opinion No. 08-0964, 369 S.W.3d 814 (Tex. 2012), 55 Tex. Sup. Ct. J. 343; Motion for rehearing on petition for review denied by: *Edwards Aquifer Auth. v. Day*, 2012 Tex. LEXIS 488 (Tex. 2012).

On February 24, 2012, after a wait of almost two years from oral argument, the Texas Supreme Court released its opinion in *Edwards Aquifer Authority v. Day*. The opinion contained two significant statements regarding ownership and use of groundwater pumped to the surface and stored in an impoundment.

Day, a party comprised of two individuals that were the successors to a water right holder that produced groundwater from a artesian well and then stored it in an impoundment, applied for a water well permit to the Edwards Aquifer Authority. The original water right holder had used the water in the impoundment only for recreation purposes. The Edwards Aquifer Authority found that the water in the impoundment, due to being produced and stored but not used for purposes seen as "beneficial," was now state water and beyond the control of the Edwards Aquifer Authority and the surface owner.

Surface water in Texas is primarily regulated by the Texas Commission on Environmental Quality (the "*TCEQ*") while groundwater is primarily regulated across the state by either municipalities or local groundwater conservation districts. First, a question arose over the Edwards Aquifer Authority's finding that the water in the impoundment was now state-controlled surface water (and therefore subject to the jurisdiction of the TCEQ) and was therefore beyond the Edwards Aquifer Authority's sway with regards to Day's water well drilling application. After litigation and appeal, the Texas Supreme Court first held that the necessary evidence was present so that the Edwards Aquifer Authority could find that such impoundment water had changed its character and become "state water" if not put to a beneficial use.

In this instance, no evidence of prior use of the water by Day or Day's predecessor existed except for some water-based recreation. The Court recited that it was not holding that such produced water *always* became state water or that an impoundment or lake could never be used to store groundwater for use by its original owner, but that the water would then have to be used for some beneficial purpose such as irrigation, not mere recreation.

Next, the Court addressed the larger issue of whether land ownership in fee included a real property interest in the groundwater thereunder and whether that interest, if present, is subject to the Texas Constitutional requirement of adequate compensation in the event of a "taking" for a public purpose. In likening water to oil and gas, the Court held that water can be owned in place by one owner while neighboring parties are allowed to drain it without liability through the rule of capture. After distinguishing earlier cases involving the rule of capture, the Court then examined various relevant factors used to analyze whether the Edwards Aquifer Authority's denial of Day's application had resulted in a "taking" that required compensation, namely whether the tests enumerated in the U.S. Supreme Court cases of *Lucas v. South Carolina Coastal Council*[2] and *Penn Central Transp. Co. v. NYC*[3] would be applied.

Ultimately, the Texas Supreme Court agreed with the Court of Appeals and remanded the case back to the district court for a determination of whether a "taking" requiring compensation had occurred and, if so, what compensation might be required. Most importantly, land ownership now includes an interest in the actual groundwater in place—like oil and gas in Texas—and not merely an exclusive license to develop it, as in Oklahoma.

This decision will impact future oil and gas operations that require permitting to drill water wells for drilling and recovery projects. One commentator has noted that since the analysis required for the *Penn Central* test is a fact intensive balancing of factors specific to each case, such litigation will often require extensive expert witness analysis and testimony, discovery, and extensive trial preparation.[4] Therefore, when groundwater conservation districts are determining whether or not to withhold a permit, they will have to be mindful of whether a "taking" has occurred and, if so, what compensation may be required. This may make them reluctant to deny permits in similar situations in the future to avoid litigation and possible subsequent "takings" liability.

Occidental Permian Ltd. v. Marcia Fuller French et al.

Opinion No. 11-10-00282-CV, __S.W.3d__ (Tex.App.—Eastland, 2012), 2012 Tex. App. LEXIS 8996.

On October 31, 2012, the Eastland Court of Appeals issued an opinion in which they considered a case involving a suit brought by Marcia Fuller French and other royalty owners (collectively, "*French*") who sued the successor lessee and operator of the Cogdell Canyon Reef Unit ("*Unit*"), Occidental Permian Ltd. ("*Occidental*"), to recover certain royalty payments under two oil and gas leases located in Scurry and Kent Counties, Texas.

As unit operator, Occidental had instigated a tertiary recovery operation using CO_2 purchased from Kinder Morgan CO_2 Company ("*Kinder Morgan*"). This operation resulted in casinghead gas being produced along with oil where the casinghead gas stream was comprised of up to 85.0% CO_2. After severance at the wellhead, Kinder Morgan transported the production stream to its Cynara production facility fifteen miles away where the CO_2 was removed from the production stream along with two-thirds of the natural gas liquids ("*NGLs*"). This extracted CO_2 was transported back to the Unit to be reused. The remaining gas stream, NGLs, and oil were then sent from Cynara to the Snyder Gas Plant, wherein the remaining CO_2 was extracted (and sent back to the Unit), the NGLs were stabilized, and the resultant stream was processed for sale.

[2] 505 U.S. 1003 (1992).
[3] 438 U.S. 104 (1978).
[4] *See* Jeff Civins, Ground(water)-Breaking Decision, Law360, *available at* http://www.law360.com/articles/315752/print?section=appellate (subscription required) (last visited Oct. 31, 2012).

This tertiary operation was conducted pursuant to the terms of a certain Treating and Processing Agreement ("*Agreement*") between Occidental and Kinder Morgan that required Occidental to pay Kinder Morgan two bundled fees per month. The first fee was a monetary charge from which no deduction from French's royalty was made. The second "in-kind" fee was comprised of 30.0% of the value of the NGLs and 100% of the value of the casinghead gas stream produced from the Unit. Since no royalty was paid on the in-kind fee, the in-kind fee was essentially a deduction from royalty.

French brought suit to recover royalty it deemed it was owed from the production attributable to the in-kind fee (30.0% of the value of the NGLs and 100% of the value of the casinghead gas stream). French argued at trial that the CO_2 project was a "production activity" and that the in-kind fee constituted an unlawful shorting of the amount of production upon which royalty was due. French claimed this shorting differentiated this case from nearly all other such reported cases in that the actual royalty payments were not being challenged, but rather the volume upon which the royalty payment was deficient.

After a bench trial, the district court agreed with French and held that Occidental had not paid royalty on all of the gas produced from the Unit, and therefore royalty was due on the 30.0% of the value of the NGLs and the total value of the casinghead gas stream, being the same amount of the in-kind gas fee.

On appeal, after noting that one lease contained a gas royalty clause stipulating that royalty was due on the "market value" of the gas, while the other provided that royalty was due on the "net proceeds" of the gas, the court of appeals focused on the issue of whether or not the evidence actually supported the finding that Occidental had underpaid royalties by not including casinghead gas and NGLs values attributable to the in-kind fee.

As for the "market value" lease, the court of appeals noted it is up to the plaintiff to prove market value at the well by using either comparable arm-length sales price, or when such are not available, the "net-back" method. After examining the record, the court of appeals found the trial court had not used sufficient evidence to determine the comparable arm-length sales price. Turning to the "net-back" method used by French and accepted by the trial court, the court of appeals reversed, holding that processing costs at the Cynara plant were post-production costs that were deductible from royalty. Therefore, since no deduction was calculated for processing at Cynara, French's calculation of market value using the "net-back" was incomplete and thus conducted erroneously. Because neither test used for determining market value was properly supported by evidence, the evidence was not sufficient to prove that Occidental had underpaid royalty on the "market value" lease.

Turning to the "net proceeds" lease, the court of appeals cites *Bowden v. Phillips Petroleum Co.*[5] for the Texas rule that "proceeds" or "amount realized" clauses require measurement of the royalty based on the amount the lessee in fact receives under the gas or oil sales contract. Since the trial court's royalty calculation did not include the deduction of the cost to remove of H_2S and other processing activities at Cynara, the court of appeals held again that the evidence relied upon by the trial court was insufficient to prove that Occidental had

[5] 247 S.W.3d 690, 699 (Tex. 2008).

underpaid royalties on the "net-back" lease.

The court of appeals then addressed the finding of the trial court that Occidental had violated the implied covenant to market in the leases. As to the "market value" lease, the court of appeals, citing *Bowden*,[6] noted that the Texas Supreme Court had repeatedly made clear that no such implied covenant existed in "market value" lease. As for the "amount received" lease, while the court of appeals acknowledged that the implied covenant to market could exist, it found the evidence relied upon by the trial court insufficient to show that Occidental had not acted as a reasonably prudent operator. In the end, the trial court was reversed on Occidental's points of error and French was ordered to take nothing.

Harding Co. v. Sendero Res., Inc.

Opinion No. 11-1000282-CV, 365 S.W.3d 732 (Tex. App.—Texarkana 2012, pet. filed), 2012 Tex. App. LEXIS 571.

In January 2012, the Texarkana Court of Civil Appeals decided a claim arising out of a noncompete clause within an agreement ("*Agreement*") for prospect development and oil and gas lease acquisition in East Texas. The president of Sendero Resources ("*Sendero*"), Ted Walters, was also the president and sole shareholder of TWW Tyler, Inc., and limited partner to Ted Walters and Associates, L.P., along with Sendero, which was the general partner. In 2007, Harding Company ("*Harding*") contracted with (1) Sendero, (2) a geologist named Surles, and (3) a landman named Boney, who was employed by Associates, L.P., to develop a prospect known as the "Star Prospect," an activity that included acquiring oil and gas leases in six counties along the Louisiana border. Ted Walters signed the Agreement for Sendero Resources in his capacity of president of that entity. Section 5 of the Agreement was a noncompete clause prohibiting Sendero, Surles, Boney, and "Walters" (with no further explanation to whom "Walters" covered) from competing against Harding for the acquisition oil and gas leases in an area defined in the Agreement.

In July 2008, Boney informed Harding that TWW Tyler, Inc. had been assisting competitors of Harding in acquiring oil and gas leases in the area covered by the Agreement. As a result, Harding refused to pay Sendero for services rendered under the Agreement. In response, Sendero, Surles, and Boney brought suit alleging Harding breached the terms of the Agreement. Harding counterclaimed against Sendero, TWW Tyler, Inc., Associates, L.P., and Ted Walters, alleging breach of the noncompete clause of the Agreement as well as numerous torts such as fraud.

The district court granted Sendero's motion for summary judgment. On appeal, the Texarkana Court of Appeals affirmed that the president of Sendero signed in his corporate authority and thus did not bind any other entities that he controlled. The court disagreed with Harding's argument that to disallow the Agreement to be binding on TWW Tyler, Inc. would render a portion of Section 5 of the Agreement meaningless, a result disfavored by Texas courts when interpreting a contract. The court opined instead that this canon of interpretation is qualified with the phrase "if possible" and that a general rule of contract interpretation cannot be

[6] *Id*. at 701.

used to bind a party to a contract it did not sign.

However, the Court of Appeals reversed the district's courts holding that, as a matter of law, Harding was not owed a fiduciary duty by TWW Tyler, Inc. and Associates, L.P., holding instead that there was a genuine issue of material fact as to whether one of the president's other entities acted as an agent and thus owed Harding a fiduciary duty.

Seitel Data, Ltd. v. Simmons

Opinion No. 06-11-00041-CV, 362 S.W.3d 783 (Tex.App.—Texarkana, 2012), 2012 WL 129766, 2012 Tex. App. LEXIS 1446.

On January 18, 2012, the Court of Appeals in Texarkana released the opinion of an appeal from the 273rd District Court in Shelby County that considered a breach of contract action against seismic company Seitel Data, Ltd. ("*Seitel*") to recover damages alleged to have been caused to a water well on property operated by Ralph and Laura Simmons (collectively, "*Simmons*"). The seismic operation was conducted by Seitel pursuant to the terms of a contract that stipulated that Seitel would be "responsible for damages, if any should occur, *due to* seismic operations" to Simmons. (emphasis added)

After seismic operations occurred, one of Simmons' two water wells began to experience problems with produced sand and mud where only freshwater was alleged to have be produced before seismic operations. Simmons brought suit in both tort and contract to recover for this alleged damage. At trial, Simmons presented no expert testimony on whether or not the seismic testing caused the alleged damage to the well, relying instead upon "lay testimony" by Ralph and Laura Simmons themselves and the driller of the water well. Regardless, at trial the jury awarded Simmons damages under both fraud and contract theories. Although the jury found for Simmons on both tort/fraud and contract theories, Simmons ultimately relied solely on its contract claim for recovery. Seitel appealed.

Upon appeal, Seitel argued the expert testimony was necessary and that its absence here invalidated the claim of Simmons. The court of appeals first noted that whether expert necessary in general is a question of law. The court then opined that for Seitel to prevail, it would have to show that, with regards to seismic activity, the liability analysis under contract theory is the same as under tort theory, which would require expert witness testimony to establish a standard of care. Limited Texas case law presented by Seitel was then described that attempted to illustrate that expert witness testimony was clearly necessary to prevail in tort against a seismic company,[7] but the court of appeals distinguished the cited case both on its facts and on procedural history.

The appellate court affirmed the district court, holding that expert testimony was unnecessary in this case and that the lay testimony presented was adequate to prove causation because jurors could apply general experience and "commonsense" understanding to establish, with reasonable probability, the relationship between vibrations caused by seismic-related blasting and damage to the water well. The appellate court therefore refused to establish a "bright line" rule that expert testimony was necessary to establish the connection between blasting

[7] *See* Stanolind Oil and Gas Co. v. Lambert, 222 S.W.2d 125 (Tex.Civ.App.—San Antonio 1949, *no writ*).

associated with seismic surveying and damages to surface assets such as the water well.[8]

Seitel also argued that under the language of the contractual provision, Simmons is required to show evidence robust enough to meet the proximate cause standard in order to prevail. In response, Simmons argued that this standard is applicable only in tort, not actions rooted in contract. The court of appeals, addressing the holding in *Utica National Insurance Co. of Texas v. American Indemnity Co.*[9] (wherein a clause in a contract that excluded claims for injury "due to" the rendering of professional services required a more unequivocal causation than the term "arising out of"), ruled that while the "due to" language in the contract at issue here indeed required a closer causation than "arises out of" language, the phrase did not equal proximate causation. In addition, while a mere suspicion—like that raised by having an event (the seismic survey) followed by an effect (the sand in the well)—is not legally sufficient to support a finding of causation in a tort case, here the court of appeals finds enough basis in the evidence to show that the sequence of events, combined with the general knowledge of the jury about the result of seismic charges going off, provides more than a suspicion (or a scintilla) to adequately connect the actions of Seitel with the damage to Simmons.

Friddle v. Fisher

Opinion No. 06-12-00018-CV, 378 S.W.3d 475 (Tex.App.—Texarkana, 2012), 2012 WL 3536796, 2012 Tex. App. LEXIS 6895.

On August 17, 2012, the Court of Appeals in Texarkana decided an appeal from the 62nd Judicial District Court in Hopkins County, Texas, that dealt with an executive mineral interest owner, Fisher ("*Lessor*"), that executed an oil and gas lease, but did not inform a nonparticipating royalty interest ("*NPRI*") owner, Friddle (the "*NPRI Owner*"), of the existence of the lease covering a tract encumbered by its NPRI. In addition, the lessee—Valence Operating Company, Inc. ("*Lessee*")—also failed to inform the NPRI Owner of the lease. When a non-tract well on pooled acreage was brought in as a producer, Lessee paid the entire royalty due from the well attributable to the pooled leased acreage, including the portion of that royalty attributable to the NPRI, calculated at over $90,000, to Lessor.

The NPRI Owner sued Lessor and Lessee to recover its alleged share of the total royalty. The portion of the case against Lessee was separated. The district court granted summary judgment to Lessor. On appeal, the NPRI Owner argued that the trial court erred in granting Lessor summary judgment, claiming that its claims for conversion, unjust enrichment, need for a constructive trust, and fraud were not addressed in Lessor's motion for summary judgment that the district court signed and that there existed disputed issues of material fact.

In addition, the NPRI Owner claimed that Lessor owed it a fiduciary duty and therefore a duty to notify the NPRI Owner of the execution of the lease, activation of the pooling provision, and the beginning of production. Finally, the NPRI Owner claimed that the district court misapplied Texas law concerning the discovery rule and that the NPRI Owner in that case had neither actual nor constructive notice of its claim against Lessor at the time that its claim would

[8] This refusal to find such a "bright line" rule was not expressly limited to contract claims.
[9] 141 S.W.3d 198, 202 (Tex. 2004).

have been barred by limitations. Lessor countered that it owed no duty to notify the NPRI Owner, asserting that the NPRI Owner had either actual or constructive notice of the lease and pooled unit. Lessor also asserted that the statute of limitations barred recovery for any of the NPRI Owner's causes of action.

The appellate court reversed and remanded, first distinguishing this case from *Montgomery v. Rittersbacher,*[10] wherein the Texas Supreme Court—facing a similar question, but one where the lessee had paid all the money attributable to the leasehold into a court registry instead of to the lessor—held that by bringing suit to claim the royalty, the NPRI owner had ratified the lease and was therefore only entitled to receive royalties accruing from and after the date the suit was filed.[11] Here, the appellate court distinguished *Montgomery* by holding that since Lessor—who owed the NPRI Owner a fiduciary duty, unlike the producer in *Montgomery*—had already collected the funds, the rule established in *Montgomery* did not apply.

Regarding the measure of duty that Lessor owed to the NPRI Owner, the appellate court cited the recent *Lesley v. Veterans Land Bd. of State*[12] for the proposition that the executive rights holder owed the NPRI Owner a fiduciary duty of "utmost fair dealing." The appellate court held that this duty not only required the executive to get for the non-executive every benefit that the executive gets for itself, but that "[i]f the holder of the executive right receives royalties pursuant to the rights held by an NPRI holder, he is chargeable in equity as constructive trustee with the duty to hold the royalty attributable to the holder of the NPRI,"[13] and thus the Lessor, when it elected to receive the entire royalty attributable to the lease, had a duty to hold that portion of the funds payable to the NPRI Owner as a constructive trustee. In addition, a fact question existed as to whether Lessor had a duty to inform the NPRI Owner of the lease or other agreement that affected the rights of the NPRI Owner.

Finally, regarding the statute of limitations, the appellate court held that the discovery rule tolled the statute because even if the official public records contained notification of the lease, the NPRI Owner could not be chargeable with constructive notice of the lease because it was executed and recorded after the NPRI Owner had acquired the NPRI. In addition, a fact question existed as to whether NPRI Owner had actual notice of production because the well on the unit that included the leasehold at issue was both demarked by a sign and was in obvious view. Therefore, a factual dispute existed that must be resolved by the district court. Finally, the granted summary judgment did not address all of the NPRI Owner's claims, further necessitating remanding the case.

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10 424 S.W.2d 210 (Tex. 1968).

11 *Id*. at 215.

12 352 S.W.3d 479, 480-81 (Tex. 2011).

13 *Friddle* at 8, citing Andretta v. West, 415 S.W.2d 638, 641-42 (Texas Supreme Court ruled that if the holder of the executive rights knows the name and whereabouts of the NPRI owner, it had a duty to notify the NPRI owner of lease developments and amendments and account to the NPRI owner for its portion of the lease royalty.)

City of Houston v. Trail Enterprises, Inc.

Opinion Nos. 14-1000944-CV, 14-11-00417-CV, 377 S.W.3d 873(Tex.App.—Houston, 2012), 2012 WL 3223662, 2012 Tex. App. LEXIS 6597.

The Texas 14th Court of Appeals handed down an opinion on August 9, 2012, potentially deciding a long standing dispute between mineral interest owners including Trail Enterprises Inc. (collectively, "*Trail*") and the City of Houston ("*Houston*") regarding the city's alleged inverse condemnation of Trail's fee mineral interests in and around the Lake Houston watershed. Specifically, the 2003 suit against Houston claimed that restrictions on oil and gas drilling dating from 1995 amendments to an ordinance dating originally from 1967 constituted a compensable taking of their property rights under the Texas State Constitution.

In 2005, the trial court, in a bench trial, found in favor of Trail, with a subsequently convened jury calculating damages at $19,046,700, being the diminution of value of the mineral property before and after application of the drilling restrictions. Houston appealed, challenging the verdict on ripeness grounds in that Trail had not exhausted its administrative remedies because it had not filed a formal application for new drilling permits during a period in 1997 when the drilling ban was temporarily abated. After the Texas Supreme Court found that the claim was ripe, the trial court again found that a compensable taking had occurred. The trial court entered a judgment for Trail of $17,000,000 and awarded Houston the oil and gas not recoverable from the wells that already existed on the field. Both parties appealed: Houston challenged the takings verdict and Trail appealed the transfer of the mineral interests to Houston.

Considering only Houston's argument that Trail had not established that a taking had occurred as dispositive and therefore only considering that claim in its opinion, the court of appeals reversed. Relying on the Texas takings case of *Sheffield Development Company v. City of Glenn Heights*,[14] which, in turn, largely incorporated the analysis of the U.S. Supreme Court in *Penn Central Transportation Co. v. City of New York*,[15] the court of appeals considered the three factors described in those cases for balancing of the public's interest vis-à-vis the real property owner's private interest. These factors are as follows: (1) the nature of the government's action and whether it was rationally related to a legitimate government end; (2) the investment-backed expectations of the property owners; and (3) the economic impact on the regulation or law upon the property owner.

The court first found that, since the stated purpose of the drilling ban was to protect the drinking water of Houston—an important goal that could be compromised by drilling near the source of Lake Houston—the first factor leaned heavily in favor of Houston. The court next found that, since the landowners had largely failed to prove any investment-back expectation of profit from their estate because they could point to no investments that they made or put at risk to develop the property, the second factor also leaned heavily in favor of Houston. Finally, the court considered the economic impact of the regulation on Trail, considering especially the diminution of value of the mineral estate. While the court found significant loss of value to the mineral estate, this loss was partially ameliorated by the facts that some wells were producing from the restricted estate already and that the restriction did not deny all economically beneficial use of the property as the regulations did not prevent drilling

[14] 140 S.W.3d 660 (Tex. 2004).
[15] 438 U.S. 104 (1978).

of new wells on 70-75% of the total mineral property of Trail.

Considering the three *Penn Central/Sheffield* factors *in toto*, the court ultimately found that while the anti-drilling regulations did significantly affect the value of the mineral estate of Trail, the combination of the other two factors outweighed the first, and ruled that Trail should take nothing.

Royalco Oil & Gas Corp. v. Stockhome Trading Corp.

Opinion No. 02-10-00455-CV, 361 S.W.3d 725 (Tex.App. – Fort Worth, 2012), 2012 WL 254037, 2012 Tex. App. LEXIS 723.

On January 26, 2012, the Court of Appeals in Fort Worth handed down an opinion regarding whether (1) the common law of leases generally or (2) "traditional" Texas oil and gas law applies to the partial transfer of a lessee's interest in a disposal well lease agreement. In February 2008, Stockhome Trading Corp. ("*Lessor*") entered into a salt water disposal agreement (the "*Lease*") with Triad Rovan Services, L.P. ("*Lessee*"). The Lease stated that it "shall in no way affect ownership of the oil, gas, or minerals in, on, or under the [leased premises]." The Lease was stated to be for the sole purpose of allowing the Lessee to conduct its Business Activities on the captioned land, which such activities defined as "activities relating to the disposal and treatment of water produced from oil and gas wells." The term of the Lease was for ninety-nine years or until Lessee had discontinued its "Business Activities." Finally, the Lease provided that Lessee "shall not have the right to sell more than 50% [of its interest or] to assign or sublet its interest" in the Lease without the written consent of Lessor.

Two months later, Lessor entered into a service agreement ("*Agreement*") with Royalco Oil & Gas Corp. ("*Well Operator*"). The Agreement provided that "[i]n connection with [Well Operator] providing the [s]ervices hereunder, [Lessee] assigns to [Well Operator] 50% of [Lessee's] interest." Later in the year, the Lessee failed to furnish rental payments in accordance with the Lease, and Lessor declared the Lease terminated. Lessor then sued Lessee for violation of the terms of the Lease and sued Well Operator for a declaratory judgment, inter alia, that Well Operator was a sublessee and had no standing to furnish rental payments on behalf of Lessee to cure the default that led to the termination of the Lease. The dispute focused on whether the Agreement was an assignment or a sublease. If ruled a sublease under the common law of Texas, Well Operator would have no contractual right to enforce the Lease against Lessor. The trial court granted summary judgment in favor of Lessor, and Well Operator appealed.

The appellate court affirmed, rejecting Well Operator's argument that under Texas oil and gas law Lessee had partially assigned 50% percent of the Lease because the Agreement did not constitute an oil and gas mineral lease, and that the common law of leases applied instead. Therefore, appellate court held that as a matter of law no assignment had taken place because the Agreement did not cover either the entire term of the underlying lease or the entire current interest of Lessee of the underlying lease.