TEXAS OIL & GAS LAW: RECENT COURT DECISIONS

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I. SCOPE OF THE ARTICLE

This article surveys selected oil and gas cases decided by Texas state and federal courts from May 1, 2014 through October 1, 2014. Below are one-paragraph abstracts of the selected cases. Full case summaries follow the abstracts.

II. ABSTRACTS

1. Subsequent contracting by mineral owner with well operator did not preclude subcontractors' mineral lien. Drillers filed subcontractors' lien against mineral owner after they were not paid for work performed on a well. In response, mineral owner argued that drillers did not qualify as subcontractors under the Texas mineral lien statute because the well operator with whom they contracted had later acquired an interest in the property, thereby becoming an owner instead of a contractor. The Fifth Circuit disagreed, reversing the district court's grant of summary judgment in favor of mineral owner. Under Texas law, an owner may also be a contractor, and a laborer may secure liens against both the contracting and the non-contracting owners. Further, a laborer's status as a contractor or subcontractor cannot later be changed by agreements to which he is not privy. Accordingly, drillers' subcontractors' lien was valid and their status as subcontractors did not change when the well operator acquired an ownership interest in the property. *In re Heritage Consol., L.L.C.*, No. 13-10969, 2014 WL 4238605 (5th Cir. Aug. 27, 2014).

2. Royalty based on "the amount realized by lessee, computed at the mouth of the well" authorized lessee to deduct post-production costs incurred in delivering marketable gas from the mouth of the well to the point of sale. Lessors sued oil and gas company for deducting post-production costs from the sale proceeds of natural gas. The leases at issue provided that royalty would be based on the "amount realized by Lessee, computed at the mouth of the well." The Fifth Circuit affirmed the district court's dismissal for failure to state a claim. The language used in the leases required royalty to be based on net proceeds, including deductions for reasonable costs incurred in delivering marketable gas from the mouth of the well to the actual point of sale. *Warren v. Chesapeake Exploration, L.L.C.*, 759 F.3d 413 (5th Cir. 2014).

3. No-damages-for-delay provision did not shield owner from liability for deliberately interfering with contractor's work. Contractor entered into an agreement with the Port of Houston Authority to construct a wharf. The parties' agreement included a no-damages-for-delay provision which provided that contractor would "receive no financial compensation for delay or hindrance of the Work...even if such delay or hindrance results from...the negligence, breach of contract or other fault of the Port Authority." The Port prevented contractor from proceeding with its preferred construction plan, causing contractor to miss the original contract deadline. As a result, the Port withheld liquidated damages from contractor's payments, and contractor sued, arguing that the Port intentionally caused the delays and was not protected by its no-damages-for-delay provision. The trial court entered judgment for contractor and the appellate court reversed. The Texas Supreme Court granted petition for review. In Texas, pre-injury waivers of future tort and contract liability for intentional and reckless misconduct are void as against public policy. Finding that the Port's conduct in this case was arbitrary and capricious, the Court reversed the appellate court's decision and held that the no-damages-for-delay provision was unenforceable. *Zachry Constr. Corp. v. Port of Hous. Auth. of Harris Cnty.*, No. 12-0772, 2014 WL 4472616 (Tex. Aug. 29, 2014).

4. Expert testimony utilizing the "percentage-reduction" approach was legally insufficient to support an award of stigma damages. Plaintiff sued defendant for contamination caused to the land by defendant's metal processing operations, seeking to recover the loss of the fair market value of the land. The jury awarded damages and the appellate court affirmed. However, the Texas Supreme Court reversed and rendered a take-nothing judgment in favor of defendant. Refusing to address the issue of whether stigma damages are recoverable under Texas law, the Court focused on the legal insufficiency of plaintiff's evidence. Specifically, the Court found that the "percentage-reduction" approach utilized by plaintiff's expert was replete with assumptions and analytical gaps. Accordingly, the evidence proffered by plaintiff was legally insufficient to support an award of stigma damages in this case. *Hous. Unlimited, Inc. Metal Processing v. Mel Acres Ranch*, No. 13-0084, 2014 WL 4116810 (Tex. Aug. 22, 2014).

5. Cost of removing CO_2 from casinghead gas was a post-production cost properly shared by royalty owners. Royalty interest owners sued working interest owner for underpaying royalties by deducting the cost of removing CO_2 from casinghead gas. Under the mineral leases at issue, royalty owners were to share only in post-production expenses. The trial court rendered judgment for royalty interest owners but the appellate court reversed. The Texas Supreme Court affirmed, explaining that separating CO_2 from casinghead gas is not essential for continued production. Moreover, the parties' unitization agreement allowed the working interest owner to either process the casinghead gas or to reinject it into the field. Because the royalty interest owners benefited from the working interest owner's decision to process the casinghead gas, the Court held that the royalty interest owners must share in the cost of CO_2 removal as a post-production expense. *French v. Occidental Permian Ltd.*, No. 12-1002, 2014 WL 2895999 (Tex. June 27, 2014).

6. Mineral lessee had implied right to use surface area of pooled unit as reasonably necessary to produce minerals from any part of the pooled unit. Landowners sued mineral lessee for using a road across their land to access a well located on an adjacent tract. Despite the fact that the acreage at issue had been pooled in accordance with the mineral lease, landowners contended that lessee had no right to use their surface to produce oil from another tract. The trial court rendered judgment for the landowners and the appellate court affirmed. The Texas Supreme Court reversed. Because the landowners' acreage and the adjacent tract were part of a pooled unit, lessee was permitted to use as much of the surface area of the pooled unit, including the road, as reasonably necessary to produce minerals from any part of the pooled unit. *Key Operating & Equip., Inc. v. Hegar*, 435 S.W.3d 794 (Tex. 2014).

7. Mineral lessee perpetuated lease despite temporary cessation of operations following lessor's alleged repudiation. Lessee sued lessors after one of the lessors placed a lock on the gate to the well site and called the police when the lessee's workers removed it. Lessee continued operations for some time but eventually ceased operations for over 90 days. The lease at issue contained a 90-day cessations-of-operations clause. Accordingly, lessors and the lessee of a top lease claimed that the original lease had expired. The trial court agreed, granting summary judgment against lessee. The Tenth Court of Appeals reversed, holding: (1) lessee's operations for drilling had perpetuated the lease; and (2) lessee had raised a genuine of issue of material fact regarding lessors' repudiation as an excuse for lessee's temporary cessation of operations. In Texas, the fact that a lessee continues operations following a repudiation does not waive the repudiation defense or as a matter of law negate the lessee's reliance on the repudiation. *Rippy Interests, LLC v. Nash*, No. 10-12-00233-CV, 2014 WL 4114328 (Tex. App.—Waco Aug. 21, 2014, no. pet. h.).

8. Common-law claims for environmental damage to property caused by oil and gas operations were not within the exclusive or primary jurisdiction of the Texas Railroad Commission. Landowners sued oil and gas company to recover for environmental contamination and surface damage. Defendant company moved to compel arbitration based on an agreement from a prior lawsuit. Arbitration panel assessed actual and exemplary damages against defendant company, and the trial court affirmed the arbitration award. Defendant company sought to vacate the award, arguing on appeal that the arbitration award interfered with the exclusive, or alternatively, primary jurisdiction of the Railroad Commission to develop and enforce environmental regulations related to oil and gas operations. The First Court of Appeals affirmed the arbitration award, holding that the Railroad Commission's regulatory scheme was not intended to supplant or abrogate a landowner's right to obtain common-law relief for environmental damage to his land. Moreover, the present dispute did not invoke the doctrine of primary jurisdiction because landowners were pursuing common-law claims that did not require the Railroad Commission's expertise or a uniform interpretation of the Commission's rules and regulations. *Forest Oil Corp. v. El Rucio Land & Cattle Co., Inc.*, No. 01-13-00040-CV, 2014 WL 3709477 (Tex. App.—Houston [1st Dist.] July 24, 2014, no. pet. h.).

9. Testator's will granted fee simple estates to each designated beneficiary, subject to a fractional royalty to each of the other beneficiaries. Testator devised to each of her three children specific parcels of land in fee simple, subject to "an undivided one-third (1/3) of an undivided one-eighth (1/8) of all oil, gas or other minerals in or under or that may be produced from any [of the tracts]." Descendants or devisees of the three beneficiaries eventually turned to the court to ascertain whether the will created a 1/24 fractional royalty or a one-third fraction of royalty. The trial court held that the will entitled each of the beneficiaries to one-third of whatever royalty the surface owner negotiated. The Fourth Court of Appeals reversed, holding that the language used in the will was consistent with language typically used in creating a fractional royalty interest. *Dawkins v. Hysaw*, No. 04-13-00539-CV, 2014 WL 3734205 (Tex. App.—San Antonio July 30, 2014, no. pet. h.).

10. Accommodation doctrine did not apply in groundwater context. City owned the groundwater rights associated with the land at issue. Landowner sought to enjoin the city from taking action in furtherance of the city's proposed well field plan. Landowner based its claims on the application of the accommodation doctrine in the context of groundwater. The trial court granted a temporary injunction which was later dissolved on appeal. Because the severed groundwater estate is not considered dominant over the surface estate, the Seventh Court of Appeals saw no reason for and found no authority supporting such an extension of the accommodation doctrine. Instead, the court deferred to the Texas Supreme Court or the Texas Legislature to pronounce such a change. *City of Lubbock v. Coyote Lake Ranch, LLC*, No. 07-14-00006-CV, 2014 WL 2810419 (Tex. App.—Amarillo July 10, 2014, pet. filed).

11. Based on prior negotiations between the parties, mineral lessee's payment of a shut-in royalty perpetuated lease even though no wells on the land were capable of production. Oil and gas company sought declaration that its payment of a shut-in royalty extended its mineral lease. The lease provided that the company could pay a shut-in royalty to extend the lease "if, at the expiration of the primary term there is located on the leased premises a well or wells not producing oil/gas in paying quantities." Lessors rejected the company's shut-in royalty payment, arguing that it could only extend the lease if there was a well capable of producing in paying quantities. At that time, none of the wells on the leased acreage were capable of production. The trial court granted summary judgment in favor of lessors. The Fourth Court of Appeals reversed. In the oil and gas industry, a shut-in royalty will generally perpetuate a lease only if there is a well capable of production. However, prior drafts of the parties' lease revealed that the parties had removed an express reference to "capable of producing in paying quantities" from the lease. Given these prior negotiations, the court held that the parties did not intend to apply the industry meaning of "shut-in royalty." Accordingly, company's payment of the shut-in royalty was sufficient to perpetuate the lease. *PNP Petroleum I, LP v. Taylor*, No. 04-13-00445-CV, 2014 WL 2106572 (Tex. App.—San Antonio May 21, 2014, pet. filed).

12. Mineral lessee's exclusive executive right to establish proration unit was subject to implied duty to wellbore lessee to designate a proration unit that would permit production under applicable regulations. Lease to oil and gas company (mineral lessee) included a reservation of a wellbore to be produced by the lessor or his lessees and assigns. Lessors later leased the wellbore to another company (wellbore lessee). The issue before the court was which lessee had the right to designate a proration unit encompassing the area immediately surrounding the wellbore. The trial court held that the wellbore lessee had an appurtenant contract right permitting it to designate an 80-acre proration unit for its wellbore. The Seventh Court of Appeals reversed. A lessee of a mineral interest is presumed to receive the executive right, unless expressly reserved. The mineral lease at issue included no such reservation. Accordingly, the court held that the mineral lessee retained the exclusive executive right to establish a proration unit encompassing any part of its leased acreage, including the area surrounding the wellbore. However, that right was subject to an implied duty to designate a sufficient amount and configuration of acreage to satisfy the minimum proration unit necessary for the wellbore lessee to produce oil and gas in accordance with applicable regulatory requirements. *Unit Petroleum Co. v. David Pond Well Serv., Inc.*, No. 07-12-00359-CV, 2014 WL 2118091 (Tex. App.—Amarillo May 19, 2014, pet. filed).

III. CASE SUMMARIES

1. *In re Heritage Consol., L.L.C.*, No. 13-10969, 2014 WL 4238605 (5th Cir. Aug. 27, 2014).

In *In re Heritage*, the Fifth Circuit held that subsequent contracting by the owner of a mineral interest with its well operator, whereby the well operator acquired an ownership interest in the property, did not preclude a subcontractors' mineral lien under Texas law.

Heritage Standard Corporation ("HSC") owned mineral property leases for a nonfunctioning oil well, which through a series of contractual agreements came to be operated by Lake Hills Productions, Inc. ("Lakehills"). Lakehills eventually contracted with appellants Endeavor Energy Resources, L.P., and Acme Energy Services, Inc. (collectively, "Drillers"), who performed work on the well.

However, the owners and well operators failed to pay Drillers for their work, prompting Drillers to file mineral liens against HSC (which later assigned its interest in the well to Heritage Consolidated, collectively, "Heritage"). Several other parties to these agreements also defaulted in their contractual obligations, leading the parties to enter into a settlement agreement that did not include Drillers. Drillers later filed proofs of claim in Heritage's subsequent Chapter 11 bankruptcy, asserting secured lien claims and alternatively, unsecured nonpriority claims. The bankruptcy court disposed of Drillers' mineral contractors' and subcontractors' lien claims on summary judgment, and granted Heritage's motion to dismiss Drillers' other claims. The district court affirmed.

With respect to Drillers' mineral lien claims, the Fifth Circuit's decision focused on the differences between contractors and subcontractors under the Texas mineral lien statute (Tex. Prop. Code Ann. § 56.001 *et. seq.*). The court explained that the key inquiry in determining one's status as a contractor or a subcontractor is whether there was a contractual relationship between the owner and the laborer performing the work. A laborer qualifies as a contractor when there is a direct contractual relationship between the laborer and the owner. However, a subcontractor needs to have a contractual relationship only with the contractor, and not with the actual owner. This distinction is important because the Texas mineral lien statute requires that subcontractors give notice to the mineral owner when filing a mineral lien, whereas contractors are under no such obligation.

In the present case, Drillers filed their subcontractors' lien within the six-month period required by statute and provided Heritage with proper notice. Nevertheless, Heritage insisted that Drillers' lien could not attach to its interest in the lease. Heritage's main argument was that Drillers could not be subcontractors because Lakehills had, through the prior settlement agreement, acquired a 1% ownership interest in the lease and thus was a co-owner rather than a contractor. Heritage reasoned that although a contractors' lien could attach to Lakehills's interest in the lease, Drillers' subcontractors' lien was void as to Heritage because Drillers had neither a direct contractual relationship with Heritage as the owner, nor a contractual relationship with a contractor.

The Fifth Circuit disagreed. In Texas, it is possible for an owner to also be a contractor, and for a laborer to secure liens against both the contracting and the non-contracting owners. Accordingly, a laborer may be both a contractor and a subcontractor for work performed on the same well. Moreover, the court explained that a laborer's status is determined according to the various contractual relationships at the time the work was performed. Therefore, Drillers' status as subcontractors with respect to Heritage could not later be converted by the settlement agreement, a subsequent contract to which Drillers were not privy.

Accordingly, the Fifth Circuit reversed the district court's grant of summary judgment on Drillers' subcontractors' lien claims, finding that Drillers had raised a genuine issue of material fact as to their subcontractor status.

2. *Warren v. Chesapeake Exploration, L.L.C.*, 759 F.3d 413 (5th Cir. 2014).

In *Warren*, the Fifth Circuit held that a royalty based on "the amount realized by Lessee, computed at the mouth of the well" authorized the lessee to deduct post-production costs incurred in delivering marketable gas from the mouth of the well to the actual point of sale.

In this case, Charles and Robert Warren, as lessors, brought suit against Chesapeake Exploration, L.L.C. and Chesapeake Operating, Inc. (collectively, "Chesapeake") for allegedly breaching royalty provisions in several oil and gas leases by deducting post-production costs from the sale proceeds of natural gas. Abdul and Joan Javeed later joined the suit, asserting similar claims. The district court dismissed the case for failure to state a claim.

The leases between Chesapeake and the Warrens provided that royalty would be based on the "amount realized by Lessee, computed at the mouth of the well." According to the court, this phrase means that the royalty should be based on net proceeds, with the mouth of the well as the physical point to be used as the basis for calculating net proceeds. The term "net proceeds" contemplates deductions, specifically, the reasonable costs incurred in delivering marketable gas from the mouth of the well to the actual point of sale. The court further noted that had the leases simply provided that the Warrens would receive a royalty based on the amount realized by the lessee, they would have been entitled to a set percentage of the sales contract price received by the lessee. However, because of the specific language used in the leases, Chesapeake was permitted to deduct certain post-production expenses.

Although the Javeeds' royalty provisions were substantially different from those in the Warrens' leases, the district court treated all of the leases as "functionally equivalent." The first time that the Javeeds asserted that their lease was meaningfully different was in the Javeeds' reply brief on appeal. Having waived this argument, the Fifth Circuit affirmed the district court's dismissal of the parties' claims.

3. *Zachry Constr. Corp. v. Port of Hous. Auth. of Harris Cnty.*, No. 12-0772, 2014 WL 4472616 (Tex. Aug. 29, 2014).

In *Zachry*, the Texas Supreme Court held that no-damages-for-delay provisions could not shield a party from liability for intentional or reckless misconduct.

Petitioner, Zachry Construction Corporation ("Zachry"), contracted to construct a wharf on the Bayport Ship Channel for respondent, the Port of Houston

Authority of Harris County, Texas ("the Port"). Time was of the essence to the Port; work was to be fully completed by June 2006 and two sections of the wharf had to be completed by February 2006 in order to accommodate a ship from China that was scheduled to deliver cranes to be used on the wharf. Zachry agreed to pay $20,000 per day as liquidated damages for missing deadlines.

Nine months into construction, the Port realized that it would need to expand the project to accommodate the ships that it ultimately expected to service. Zachry proposed a plan that would enable it to do the additional work and still meet its deadlines. The Port did not raise its concerns with Zachry's plan until two weeks after the final change order ("Change Order 4") utilizing Zachry's plan had been finalized. At that point, Port ordered Zachry to revise and resubmit its plans, effectively preventing Zachry from proceeding with construction. Seeing no other option, Zachry finished part of the wharf in time for the ship from China to dock, and proceeded with the project in a manner approved by the Port (which caused delays and increased cost).

In negotiating Change Order 4, the Port orally promised not to impose liquidated damages for delays as long as Zachry met its February 2006 deadline. Nevertheless, after the ship from China successfully docked, the Port began withholding liquidated damages from Zachry's payments. Zachry completed the project in January 2009, more than two-and-one-half years after the contract deadline.

Zachry brought suit, claiming some $30 million in damages from delays caused by the Port. In response, the Port pointed to a section of the parties' contract which provided that "[Zachry] shall receive no financial compensation for delay or hindrance of the Work…even if such delay or hindrance results from, arises out of or is due, in whole or in part, to the negligence, breach of contract or other fault of the Port Authority." Zachry argued, and the trial court ultimately agreed, that such a no-damages-for-delay provision could not be enforced where the Port's intentional misconduct caused the delay. After a three-month trial, the trial court entered judgment on the jury's verdict in favor of Zachry. The appellate court reversed and the Texas Supreme Court granted Zachry's petition for review.

Generally, a contractor may agree to assume the risk of construction delays and not seek damages. However, there are five generally recognized exceptions to the enforcement of such agreements, two of which the Court found applicable in this case: (1) when the delay resulted from fraud, misrepresentation, or other bad faith on the part of one seeking the benefit of the provision, and (2) when the delay is based upon active interference with the contractor or other wrongful conduct, including arbitrary and capricious acts and willful and unreasoning actions taken without due consideration and in disregard of the rights of other parties.

Here, the jury found that Zachry's delay damages resulted from the Port's "arbitrary and capricious conduct, active interference, bad faith, and/or fraud." The Port argued, and the appellate court agreed, that by including the words "other fault" in its no-damages-for-delay provision, the Port was protected from liability for the type of misconduct found by the jury. The Texas Supreme Court disagreed. According to the Court, "pre-injury waivers of future liability for gross negligence are void as against public policy." This rule applies equally to tort and contract liability as well as to both sophisticated and unsophisticated parties. Therefore, the Court reversed, holding that the no-damages-for-delay provision could not protect the Port from liability for its intentional and reckless conduct because the provision was unenforceable as against public policy.

4. *Hous. Unlimited, Inc. Metal Processing v. Mel Acres Ranch*, No. 13-0084, 2014 WL 4116810 (Tex. Aug. 22, 2014).

In *Houston Unlimited*, the Texas Supreme Court held that expert testimony utilizing the "percentage-reduction" approach was legally insufficient to support an award of stigma damages.

Defendant Houston Unlimited, Inc. operated a metal processing facility across the highway from a large tract of undeveloped ranchland owned by the plaintiff, Mel Acres Ranch. Houston Unlimited's operations contributed to the eventual contamination of the ranch. After its environmental consultant found contaminants in the area, Mel Acres filed a complaint with the Texas Commission on Environmental Quality ("TCEQ"). TCEQ ran its own tests, confirming that the ranchland was indeed contaminated. TCEQ also discovered that Houston Unlimited was in violation of several regulations governing its discharge of hazardous waste. Despite Houston Unlimited's subsequent efforts to bring its facility into compliance, Mel Acres' environmental consultant continued to find pH, aluminum, iron, and other constituents on the ranch. Mel Acres ultimately sued Houston Unlimited for nuisance, trespass, and negligence, seeking to recover the loss of the fair market value of its entire 155-acre ranch. The jury found that Houston Unlimited was negligent and that its negligence caused the ranch to lose $349,312.50 of its market value. The trial court entered judgment on the verdict and the appellate court affirmed.

One of the issues before the Texas Supreme Court was Mel Acres' right to recover stigma damages, which represent the market's perception of the decrease in property value caused by injury to the property. Mel Acres argued that stigma damages continue to exist even after the property has been fully repaired or remediated. On the other hand, Houston Unlimited argued that Texas courts should not permit the recovery of stigma damages. If such recovery were to be permitted, Houston Unlimited urged the Court to at least require that the property at issue sustain a permanent and physical injury. However, the Court refused to rule on the recoverability of stigma damages and instead focused on the legal insufficiency of Mel Acres' evidence.

At trial, Mel Acres attempted to establish its stigma damages through the testimony of a licensed real estate appraiser with 20 years of experience in the county where Mel Acres' ranch is located. While Mel Acres' expert testified that she employed the well-accepted "sales-comparison" approach to appraise the ranch's value, she actually used a different process replete with assumptions and analytical gaps.

Under the "sales-comparison" approach, an appraiser first finds data for sales of similar property that are voluntary, near in time, in the vicinity, and involve land with similar characteristics. The appraiser then uses the prices from comparison sales (which establish the market value of the similar properties) to determine the market value of the property at issue, by adjusting the price upward or downward to account for the differences between the properties.

Mel Acres' expert used the "percentage-reduction" approach. Specifically, she attempted to identify losses in market value of two sites in the general area, calculated as percentages of the unimpaired value, and then opined that Mel Acres' ranch had suffered a similar loss in its proportionate value. Yet she made no determination, and Mel Acres offered no additional evidence establishing that the diminution in the market value of the two comparison sites was in fact attributable to market stigma. The expert also failed to account for the differences between Mel Acres' ranch and the two comparison sites, the differences between the nature and degree of contamination of the three properties, and any contamination not attributable to Houston Unlimited. Accordingly, the Court held that Mel Acres' expert's reliance on insufficient data, unsupported assumptions, and the analytical gaps in her analysis rendered her opinion conclusory and legally insufficient. Because Mel Acres offered no other evidence of the ranch's lost market value, the Court reversed and rendered a take-nothing judgment in favor of Houston Unlimited. According to the Court, even if it were to allow for the recovery of stigma damages, the evidence offered in this case was legally insufficient to support such an award.

5. *French v. Occidental Permian Ltd.*, No. 12-1002, 2014 WL 2895999 (Tex. June 27, 2014).

In *French*, the Texas Supreme Court held that under the parties' unitization agreement and mineral leases, the cost of removing CO_2 from casinghead gas was a post-production cost to be shared by the royalty owners.

Petitioners (collectively, "French") owned royalty interests under two oil and gas leases, which were later pooled under a unitization agreement to form the Cogdell Canyon Reef Unit. Thereafter, a method of enhanced oil recovery was developed, whereby carbon dioxide (CO_2) is injected into a reservoir to sweep the oil to the production wells. The CO_2 then returns to the surface entrained in casinghead gas produced with the oil.

Under the parties' unitization agreement, the owners of the working interest (here, respondent Occidental Permian Ltd., or "Oxy") were given discretion to reinject casinghead gas into the field as part of operations. However, the casinghead gas produced was only about 85% CO_2, with a hydrocarbon content rich in natural gas liquids ("NGLs"), which could be extracted and sold. To increase the concentration of CO_2 in the reinjected stream and to realize the value of the NGLs entrained in the casinghead gas, Oxy elected to process the gas to remove the CO_2 and extract the NGLs. Under both leases, royalty owners were to share in post-production expenses. The costs of production were to be borne exclusively by Oxy as the working interest owner.

The present dispute arose when French sued Oxy for underpaying royalties on casinghead gas, contending that French should not be required to share in the expense of removing CO_2. In response, Oxy argued that removal of the CO_2 is necessary to make the casinghead gas marketable and is therefore a post-production cost that must be shared by the royalty owners. After a four-day bench trial, the trial court rendered judgment for French. The appellate court reversed, and the Texas Supreme Court granted French's petition for review.

The main issue in this case was whether the cost of separating CO_2 from the casinghead gas constituted a production or post-production expense. French analogized the process of separating CO_2 from the casinghead gas to the process of separating water injected into the field from the oil, which Oxy always treated as part of production. However, the Court noted that separating oil and water is a relatively simple process compared to separating CO_2 from gas, which requires special technology. Moreover, oil production would not be viable without waterflooding and the separation of oil and water, whereas separating the CO_2 from the casinghead gas is not necessary for continued production. In fact, the parties' unitization agreement gave Oxy the option of reinjecting the entire production of casinghead gas into the field. Had it exercised that option, French would not be entitled to any royalty on the casinghead gas. Therefore, the Court affirmed and held that having benefited from Oxy's decision to process the casinghead gas, French must share in the cost of CO_2 removal.

6. *Key Operating & Equip., Inc. v. Hegar*, 435 S.W.3d 794 (Tex. 2014).

In *Hegar*, the Texas Supreme Court held that a mineral lessee has the implied right to use the surface area of a pooled unit as reasonably necessary to produce minerals from any part of the pooled unit.

Key Operating and Equipment, Inc. ("Key") operated wells on two separately leased tracts: the Richardson Tract and the Curbo/Rosenbaum Tract. To access a well on the Richardson Tract, Key built a road across the Curbo/Rosenbaum Tract. Eventually, Key pooled its leased minerals under the two tracts.

Shortly thereafter, Will and Loree Hegar bought 85 acres of the Curbo/Rosebaum Tract (creating the Hegar Tract), which included the road Key was using to access its wells on the Richardson Tract. Having taken subject to Key's mineral lease, the Hegars did not object to Key's use of the road until Key drilled a new well on the Richardson Tract, causing traffic to increase. At that point, the Hegars filed suit against Key, claiming that Key was trespassing by using the road across their property. The Hegars also sought declaratory judgment that Key had no legal right to access or use the surface of the Hegar Tract in order to produce minerals from the Richardson Tract.

At trial, the Hegars presented evidence that the new well on the Richardson Tract was the only well on the pooled acreage with significant production and that the well's drainage area did not reach the Hegar's property. The trial court ruled in favor of the Hegars. The appellate court affirmed, holding that Key had no right to use the Hegars' surface to produce minerals exclusively from beneath the Richardson Tract.

Key petitioned for review, insisting that it had the right to use the Hegars' surface estate to produce minerals from any part of the pooled unit. The Texas Supreme Court agreed. If authorized by the lease, a mineral lessee may pool some or all of its leased tracts by combining them into a single unit. The legal consequence of pooling is that production and operation anywhere on the pooled unit is treated as having taken place on each tract within the unit. Here, both the Richardson lease and the Curbo/Rosenbaum lease permitted pooling.

Once Key exercised its right to pool, the two tracts lost their separate identifies insofar as production from the pooled part of the Richardson Tract also legally constituted production from the pooled part of the Hegar Tract (formerly the Curbo/Rosenbaum Tract). Therefore, the fact that the well on the Richardson Tract may not have been draining the oil beneath the Hegars' property had no legal consequence.

Ultimately, the Court reversed and held that as the mineral lessee, Key had the implied right to use as much of the surface area of the pooled unit, including the Hegar Tract, as reasonably necessary to produce minerals from any part of the acreage within the pooled unit.

7. *Rippy Interests, LLC v. Nash*, No. 10-12-00233-CV, 2014 WL 4114328 (Tex. App.—Waco Aug. 21, 2014, no. pet. h.).

In *Nash*, the Tenth Court of Appeals held that an assignee of an oil and gas lease perpetuated the lease by its operations for drilling and that its continuing operations did not as a matter of law negate its reliance on the landowner's alleged repudiation of the lease.

William L. Nash, John Donald Nash, and Charles Nash granted Range Production I, L.P. ("Range") an oil, gas, and mineral lease (the "Range Lease"), which Range later assigned to Rippy Interests, LCC ("Rippy"). The lease provided that it would remain in effect during a primary term of three years and "as long thereafter as operations, as hereinafter defined, are continued upon said land with no cessation for more than ninety (90) consecutive days." The lease broadly listed a number of activities which would qualify as operations, including "drilling." The Nashes subsequently granted a top lease to U.S. KingKing, LLC ("KingKing"), which would only become effective upon the expiration of the Range Lease.

After some confusion regarding which lease was valid, Charles Nash placed a lock on the gate to the well site. When Rippy's workers cut the lock and entered the property, Charles called the police. As a result, Rippy sued the Nashes for injunctive relief, alleging that Charles Nash had made attempts to prevent Rippy from conducting its operations. Rippy later added KingKing as a defendant and sought declaration that the Range Lease was still in effect. It was undisputed that Rippy had ceased operations for more than 90 days following Charles Nash's attempt to lock the well site. As such, KingKing argued that the Range Lease had expired. KingKing also asserted a number of claims and sought declaration that its lease was controlling. In response, Rippy asserted that the placement of the lock was a wrongful repudiation of the Range Lease, excusing its temporary cessation of operations. The trial court granted summary judgment in favor of KingKing, finding that the Range Lease had expired and was no longer effective. On appeal, Rippy argued that it had perpetuated the Range Lease by conducting operations for drilling and that the Nashes' repudiation of the Range Lease excused Rippy's performance under the 90-day cessation-of-operations clause.

The Tenth Court of Appeals held that the operations for drilling conducted by Rippy before the lease expired were adequate under Texas law to perpetuate the Range Lease. Specifically, Rippy took the following actions during the primary term: (1) obtained a drilling permit and a surface-damage release; (2) hired a drilling contractor and solicited a bid for a drilling rig; (3) hired contractors to prepare the well site; (4) through those contractors, began construction of a 2.88-acre well site and a 2.92-acre road to the well site using heavy earth-moving equipment, and installed a conductor pipe in the ground; and (5) drilled a pilot hole. The court held that these actions were, as a matter of law, sufficient to perpetuate the Range Lease.

The court also found that summary judgment was inappropriate as to Rippy's repudiation defense. In Texas, a lessor's repudiation of a lease relieves the lessee from any obligation to conduct operations. A party relying on repudiation must show: (1) a subsisting lease; (2) the lessor's unqualified notice that the lease has been forfeited or terminated; and (3) reliance on the lessor's alleged repudiation. KingKing insisted that the Nashes' alleged repudiation did not excuse Rippy's performance because (1) there was no clear, unequivocal challenge to Rippy's title and (2) Rippy did not rely on the repudiation as it had continued working on the lease premises.

The court disagreed with KingKing, finding that (1) the Range Lease was still in effect, and (2) reasonable and fair-minded jurors could conclude that putting a lock on the gate to the well site was unqualified notice to Rippy of Nashes' repudiation. The court further held that the mere fact that Rippy continued operations following the Nashes' repudiation did not automatically negate Rippy's reliance on the repudiation. Therefore, the court reversed the trial court's grant of summary judgment in favor of KingKing and rendered judgment that the Range Lease was still in effect, subject to further proceedings.

8. *Forest Oil Corp. v. El Rucio Land & Cattle Co., Inc.*, No. 01-13-00040-CV, 2014 WL 3709477 (Tex. App.—Houston [1st Dist.] July 24, 2014, no. pet. h.).

In *Forest Oil*, the First Court of Appeals held that claims based on environmental contamination and surface damage caused by oil and gas operations were not within the exclusive or primary jurisdiction of the Texas Railroad Commission, and therefore could properly be subject to arbitration.

Forest Oil Corporation ("Forest Oil") operated a plant, drilled for, and produced natural gas on a ranch in Hidalgo County, Texas. In 2005, several owners of the ranch (collectively, "the McAllens") brought suit against Forest Oil, seeking to recover for environmental damage caused to the property by Forest Oil's operations. Relying on an arbitration clause contained in a Settlement Agreement signed by the parties in a separate lawsuit, Forest Oil moved to compel arbitration. Under the Settlement Agreement, the parties reserved the right to arbitrate claims "for environmental liability, surface damages, personal injury, or wrongful death occurring at any time and relating to the McAllen Ranch Leases." The Settlement Agreement also included a separate Surface Agreement, which provided for the ongoing care and remediation of the surface estate by Forest Oil. Ultimately, two of the three arbitrators found in favor of the McAllens; the arbitration award included a finding of actual and exemplary damages, as well as a declaration of the McAllens' rights and Forest Oil's obligations under the Surface Agreement. The trial court subsequently denied Forest Oil's motion to vacate the arbitration award.

On appeal, Forest Oil argued that the trial court erred in denying its motion to vacate for the following reasons: (1) the Railroad Commission had exclusive, or alternatively, primary jurisdiction over the dispute; (2) one of the arbitrators exhibited partiality; (3) the arbitrators exceeded the scope of their authority; (4) the actual damages awarded by the arbitrators resulted from gross mistake or a manifest disregard for the law; and (5) the exemplary damages award violated the contractual limits on the arbitrators' authority.

On the jurisdictional issue, Forest Oil argued that the arbitration award interfered with the exclusive, or alternatively, the primary jurisdiction of the Railroad Commission to develop and enforce remediation requirements associated with Forest Oil's operations on the ranch. In support, Forest Oil relied on Tex. Water Code Ann. § 26.131(a)(1) ("The Railroad Commission of Texas is solely responsible for the control and disposition of waste and the abatement and prevention of pollution of surface and subsurface water resulting from activities associated with the exploration, development, and production of oil or gas or geothermal resources"); the extensive regulatory scheme promulgated by the Railroad Commission to address environmental contamination; and other statutory provisions endowing the Railroad Commission with broad authority to regulate and oversee remediation efforts of waste associated with oil and gas operations.

While the court agreed that the Texas Legislature designated the Railroad Commission as the state agency responsible for making and enforcing environmental regulations related to oil and gas operations, the court concluded that the Legislature did not intend for the Railroad Commission's regulatory scheme to abrogate a landowner's right to obtain common-law relief for injuries caused to his property by environmental contamination. As a general rule, courts are reluctant to construe a statute creating an administrative remedy in a way that would deprive a person of an established common-law remedy unless the legislature's intent to do so is clear. Here, the court found that the statutes cited by Forest Oil neither reflected the Legislature's intent to supplant or abrogate the McAllens' common law remedies, nor provided the Railroad Commission with authority to grant a remedy for wrongs that arise under common law. The court further reasoned that even if Forest Oil complied with the Railroad Commission's regulations, the McAllens could still seek redress for environmental damage caused to their property. Similarly, the parties could enter into an agreement, such as the Surface Agreement, to perform remedial work in excess of what would otherwise be required by agency regulations. Consequently, the court held that the Railroad Commission did not have exclusive jurisdiction over the dispute.

Alternatively, Forest Oil claimed that the Railroad Commission had primary jurisdiction because the Railroad Commission had been investigating the environmental contamination at the ranch since 2007 and Forest Oil was awaiting the agency's final approval of its remediation plan. Generally, courts employ the prudential doctrine of primary jurisdiction to allow an agency to initially decide an issue in two situations: (1) the agency is staffed with experts trained in handling the complex problems involved in the dispute; or (2) great benefit would be derived from an agency uniformly interpreting its laws, rules, and regulations. In this case, however, the court found that the McAllens' causes of action did not derive from Forest Oil's noncompliance with the Railroad Commission's rules and regulations. Instead, the McAllens pursued common-law claims and declaratory relief that did not require the Railroad Commission's expertise or a uniform interpretation of its rules and regulations. Accordingly, there was no need for the trial court to employ the doctrine of primary jurisdiction in favor of the Railroad Commission.

Ultimately, the court overruled Forest Oil's remaining issues and affirmed the trial court's confirmation of the arbitration award.

9. *Dawkins v. Hysaw*, No. 04-13-00539-CV, 2014 WL 3734205 (Tex. App.—San Antonio July 30, 2014, no. pet. h.).

In *Dawkins*, the Fourth Court of Appeals held that language in a testator's will granted surface and mineral rights to each sibling-beneficiary, subject to a fractional royalty of 1/24 to each of the other beneficiaries.

This case involved the construction of a will executed by Ethel Nichols Hysaw in which she devised to each of her three children specific parcels of land in fee simple, subject to "an undivided one-third (1/3) of an undivided one-eighth (1/8) of all oil, gas or other minerals in or under or that may be produced from any [of the tracts]." Specifically, Ethel devised fee simple title as follows: to Inez, 600 acres out of a 1,065-acre tract; to Dorothy, 465 acres out of the same 1,065-acre tract; and to Howard, 200- and 150-acre tracts. The parties in the present case were all direct descendants of, or devisees of, Inez, Dorothy, or Howard.

Eventually, Inez's descendants executed a lease that provided for a royalty of one-fifth of the oil and gas produced. The lease resulted in production. Dorothy's descendants also executed a lease, providing for a royalty in excess of one-eighth. The dispute arose when the parties failed to agree on how royalties should be distributed. Inez's descendants argued that the will devised to Dorothy's and Howard's descendants a fractional royalty, or a fixed fraction of production, from leases on Inez's land, and that Inez's descendants would be entitled to the rest. Dorothy's and Howard's descendants disagreed, arguing that each party was entitled to a one-third fraction of royalty, or one-third of whatever royalty the surface estate owner negotiated. In other words, Dorothy's and Howard's descendants proposed that royalties be shared equally between the three parties. The trial court agreed and granted summary judgment in favor of Dorothy's and Howard's descendants, finding that each party was entitled to one-third of royalty. Inez's descendants appealed.

To determine whether Ethel's will conveyed a fractional royalty or a fraction of royalty, the court examined various examples of both and compared those to the plain language of the will. Specifically, the court focused on three clauses in Ethel's will:

(1) "[E]ach of my children shall have and hold an undivided one-third (1/3) of an undivided one-eighth (1/8) of all oil, gas or other minerals in or under or that may be produced from any of said lands ...."

(2) "[her child] shall receive one-third of one-eighth royalty."

(3) "should there be any royalty sold during my lifetime then [each of my children] shall each receive one-third of the remainder of the unsold royalty."

With respect to the first two clauses, the court held that the provisions conformed to language typically used in describing a fractional royalty interest. Whatever subjective intent for equal distribution of royalties that Dorothy's and Howard's descendants could glean from Ethel's will could not overcome the clear and unambiguous language used. However, the court found that the third provision was conditional in nature and purported to equally divide any royalty remainder that may exist among Ethel's three children. Unlike the first two clauses, the third clause conformed to language typically used in conveying a fraction of royalty interest.

The court was careful to explain that its construction of the three royalty provisions did not create any contradictions or inconsistencies. Specifically, the court treated the second provision as an individualized restatement of the first and noted that the third provision was expressly conditional and nothing in its language applied it to any other provision. Accordingly, the court reversed the trial court's judgment and held that according to the will, the descendants of each devisee are entitled to all of the royalty earned from the acreage devised to them except for the two fractional royalty interests—fixed fractions of 1/24 of production—reserved for the devisee's siblings.

10. *City of Lubbock v. Coyote Lake Ranch, LLC*, No. 07-14-00006-CV, 2014 WL 2810419 (Tex. App.—Amarillo July 10, 2014, pet. filed).

In *Coyote Lake Ranch*, the Seventh Court of Appeals held that the accommodation doctrine does not apply to the relationship between the owner of a severed groundwater estate and the owner of the surface estate.

In the 1950s, the Purtell family conveyed to the City of Lubbock the groundwater rights associated with the land at issue. But when the City began testing and development in furtherance of a proposed well field plan, the current landowner, Coyote Lake Ranch, LLC ("CLR"), sued the city for inverse condemnation, breach of contract, negligence, and declaratory judgment, seeking to enjoin the city from taking further action. The trial court granted CLR's application for temporary injunction, and the City perfected its accelerated interlocutory appeal.

The sole principle underlying all of CLR's claims was the application of the accommodation doctrine in the context of groundwater. In the context of the mineral estate, the accommodation doctrine provides that where there is a preexisting use that would be precluded or impaired by mineral/oil operations, and under established practices there are alternatives available to the lessee whereby minerals can be recovered, the lessee must utilize one of those alternatives. A surface estate owner relying on the accommodation doctrine must demonstrate that there are available non-interfering and reasonable means of producing minerals which would permit the surface estate owner to continue his existing surface use.

According to the City, the accommodation doctrine cannot apply to groundwater because, unlike the relationship between the mineral estate and the surface estate, neither the remaining surface estate nor the severed groundwater estate is legally considered to be the dominant estate. As such, there is no reason to apply the accommodation doctrine, which was specifically designed to balance the rights of the dominant mineral estate owner and the servient surface estate owner with respect to surface use. Instead, the City contended that the express terms of the deed which conveyed the groundwater rights to the City in the first place should govern the City's relationship with CLR.

Conversely, CLR proposed extending the accommodation doctrine to the context of groundwater, drawing an analogy between the groundwater estate and the mineral estate. However, neither CLR nor the court was able to find any authority to support this argument. CLR primarily relied on *Edwards Aquifer Auth. v. Day*, 369 S.W.3d 814 (Tex. 2012). In that case, the Texas Supreme Court compared ownership of groundwater in place to ownership of oil and gas in place before ultimately deciding that landowners have a constitutionally compensable interest in groundwater. However, the Court in *Day* made no mention of the interaction between a severed groundwater estate owner and the surface estate owner when it comes to surface use. Finding no authority supporting an extension of the accommodation to the groundwater context, the court deferred to the Texas Supreme Court or the Texas Legislature to pronounce such an extension in the future. In the meantime, the court held that CLR failed to allege a viable cause of action against the City. Accordingly, the court dissolved the temporary injunction.

11. *PNP Petroleum I, LP v. Taylor*, No. 04-13-00445-CV, 2014 WL 2106572 (Tex. App.—San Antonio May 21, 2014, pet. filed).

In *Taylor*, the Fourth Court of Appeals held that the parties' prior negotiations demonstrated that the parties intended for payment of a shut-in royalty to perpetuate an oil and gas lease, even where none of the wells on the land covered by the lease were capable of producing in paying quantities.

In this case, PNP Petroleum I, LP ("PNP") sought declaration that the term of its oil and gas lease was extended by the company's payment of a shut-in royalty. The lease at issue had a one-year primary term and provided that PNP could pay a shut-in royalty to extend the term "if, at the expiration of the primary term there is located on the leased premises a well or wells not producing oil/gas in paying quantities." At the time the lease was signed, there were thirteen wells on the land that were not producing.

After a year, PNP sent the lessors, Edna Earnest Taylor and Elizabeth Earnest Herbst, a letter stating its intent to extend the term of the lease and enclosed the proper payment. However, the lessors returned the payment, arguing under Texas law, the shut-in royalty payment could not extend the term of the lease because no well on the land was actually capable of producing in paying quantities. Relying on the parties' negotiations as reflected in prior drafts of the lease, the court disagreed with the lessors' interpretation.

Generally, if a term has a generally accepted meaning in the oil and gas industry, courts will apply that meaning in construing an oil and gas lease. In the industry, payment of a shut-in royalty will generally perpetuate a lease only if there is a well that is capable of producing in paying quantities. This is true even where the shut-in royalty clause makes no mention of capacity for paying production.

However, even though this general principle applied to PNP's lease, the court found that the parties' negotiations, as reflected in prior drafts of the lease, required a different interpretation. In prior drafts, the parties had removed an express reference to "capable of producing in paying quantities." Accordingly, the court held that the parties did not intend to apply the industry meaning of "shut-in royalty." Therefore, the wells on the land covered by the lease were not required to be capable of producing in order for payment of a shut-in royalty to perpetuate the lease.

Ultimately, the court reversed the trial court's grant of summary judgment in favor of the lessors and rendered judgment that PNP's shut-in royalty payment extended the term of its lease.

12. *Unit Petroleum Co. v. David Pond Well Serv., Inc.*, No. 07-12-00359-CV, 2014 WL 2118091 (Tex. App.—Amarillo May 19, 2014, pet. filed).

In *Unit Petroleum*, the Seventh Court of Appeals held that an oil and gas lessee had an exclusive executive right to establish a proration unit encompassing any part of its leasehold estate, but that its rights were burdened by an implied duty to the lessee of a wellbore to designate a proration unit that would allow production from the wellbore under applicable governmental regulations.

This case centered around the construction of two mineral leases. The first was an Oil, Gas, and Mineral Lease between Unit Petroleum Company ("Unit"), as lessee, and Everett and Lora Tarbox, as lessors (the "Unit Lease"). This lease included a "reservation of wellbore of Tarbox Unit #1," a non-producing well that was drilled by a prior lessee. The reservation stated that the wellbore was "to be produced by LESSOR or his assigns and lessees," but was limited "to the wellbore as it currently exists and production only from the Cleveland formation in which the wellbore is currently completed." Six days after executing the Unit Lease, the Tarboxes executed a Wellbore Oil and Gas Lease in favor of David Pond Well Service, Inc. ("Pond") (the "Wellbore Lease"). At the time both leases were executed, no oil and gas was actually being produced from Tarbox #1.

The dispute arose after Unit drilled three wells on the leased property, causing a drop in the wellhead pressure at the Tarbox #1 wellbore. Pond complained to the Railroad Commission, asserting that Unit's new wells were drilled in violation of a proration plot from a previous lease that showed an 80-acre proration unit assigned to the Tarbox #1 wellbore. In response, Unit filed an "Application for the Establishment of Proration Units," assigning only a 45-acre proration unit to Pond's wellbore. Pond then filed a complaint with the Railroad Commission, and Unit filed its "Supplemental Verified Petition for Temporary Injunction and Permanent Injunction, Trespass To Try Title and Declaratory Judgment." Following a bench trial and post-trial briefing, the trial court held that: (1) the Wellbore Lease granted Pond an appurtenant contract right permitting Pond to exclusively assign, designate, and/or claim an 80-acre proration unit for Pond's wellbore; and (2) Unit was estopped from asserting ownership of an exclusive executive right to designate a proration unit for Pond's wellbore. Unit appealed.

At trial and on appeal, Pond argued that the Wellbore Lease granted it an appurtenant contract right to designate a proration unit of sufficient acreage necessary to allow the well's production under applicable government regulations. Pond derived this construction of the Wellbore Lease from the fact that the lease permitted Pond to "operate" and "produce oil and/or gas" from the Tarbox #1 wellbore. Conversely, Unit insisted that the Wellbore Lease did not grant Pond a right to designate or establish a proration unit extending beyond the physical limits of Pond's leasehold estate, which only included the wellbore. Instead, Unit argued that it retained the exclusive executive right to establish a proration unit encompassing any part of its leased acreage, including the area surrounding Pond's wellbore.

In Texas, when a lessee receives an undivided mineral interest, it is presumed that the executive right incident to that interest is also conveyed, unless expressly reserved. In construing the Unit Lease, the court noted that the reservation contained no language reserving to the Tarboxes (or their assigns or lessees) any right to use acreage outside the actual wellbore. Nor did the lease reserve the executive right to assign property outside the wellbore to a proration unit. Therefore, the court concluded that the Unit Lease gave Unit not only the right to use the surface area of its leased acreage to the extent reasonably necessary to develop and produce minerals, but also the executive right to make decisions affecting the exploration and development of its mineral estate. This necessarily included the right to establish a proration unit encompassing any part of the Unit leasehold estate.

However, the court further noted that the Tarboxes reserved the right "to produce" from the Tarbox #1, which necessarily requires sufficient acreage to be issued an allowable by the Railroad Commission. Accordingly, the court held that Unit's executive right was subject to an implied duty to designate sufficient acreage to satisfy the minimum proration unit necessary to obtain a Railroad Commission allowable for Tarbox #1.

Ultimately, the court reversed and rendered judgment declaring that under the Unit lease, Unit has the right to use the surface area of its leasehold estate to the extent necessary to develop and produce minerals, including the exclusive executive right to establish a proration unit encompassing any of its leasehold estate, subject to an obligation to designate a sufficient amount and configuration of acreage to permit Pond to produce oil, gas, and other minerals from the Tarbox #1 wellbore in accordance with applicable regulatory requirements.