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Producer's Edge

TEXAS OIL AND GAS LAW BULLETIN

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About the *Producer's Edge*

The McGinnis Lochridge Oil and Gas Practice Group publishes the *Producer's Edge* with the purpose of keeping our valued clients and contacts in the oil and gas industry updated and informed regarding interesting Texas case law and regulatory developments, as well as providing insightful articles relevant to the oil and gas community. In this print and digital publication, we also routinely welcome various other practice groups to share guest articles surveying other areas of the law important to the oil and gas industry.

We hope that you find this publication to be helpful and we welcome you to share copies with your friends and colleagues. If your friends or colleagues would like to receive the *Producer's Edge*, please invite them to sign up at *mineral.estate/subscribe*.

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EVENTS, PRESENTATIONS & PAPERS:

RECENT EVENTS, PUBLICATIONS, & AWARDS

- Austin Brister and Michael Szymanski, Oil, Gas, and Mineral Law, 7 SMU Ann. Tex. Surv. — **2021 (publication pending)**

- 68th Mineral Law Institute, *Trends and Developments in Pooling and Unitization,* presented by Bruce Kramer — **April 16, 2021**

- 47th Annual Ernest E. Smith CLE, *Force Majeure During and After the COVID Pandemic*, presented by Austin Brister & Derrick Price – **March 26, 2021**

- "Primer on the Reasonable Prudent Operator Standard," published in NALTA Magazine, ALTA Houston, and PBLA February 2021 Newsletter, authored by Austin Brister & Michael Szymanski — **February 2021**

- Young Natural Resources Professionals Coffee Break, featuring Austin Brister & Bruce Kramer — **January 2021**

- Rocky Mountain Mineral Law Foundation webinar, *Oil & Gas regulatory developments,* presented by Bruce Kramer — **January 2021**

- McGinnis Lochridge Selected to 2021 Edition of "Best Law Firms" by Best Lawyers – Energy Law, Natural Resources Law, Oil & Gas Law

- McGinnis Lochridge Lawyers Selected as Benchmark Litigation stars: Travis Barton, Jonathan Baughman, and Steven Watkins

- *The Best Lawyers in America* 2021 Recognizes 18 McGinnis Lochridge Attorneys

- McGinnis Lochridge recognized in Chambers USA 2020 Rankings – Oil & Gas Litigation

Ten Cases to Watch in 2021

By: Christopher L. Halgren

There are several cases before the Texas Supreme Court that we are watching closely. Each case examines different issues, but may have a notable impact on the industry going forward. Below is a brief summary of each case. The cases are divided based on their status as of **April 2021**.

Recent Cases Decided (Subject to Rehearing or Reconsideration as of April 15, 2021):

Bryan C. Wagner, et al. v. Apache Corporation, CAUSE NO. 19-0243

The Supreme Court affirmed the appellate court's rendition of judgment in favor of Apache Corporation ("Apache") in a $15 million indemnity dispute. Apache asked the trial court to compel the Petitioners to arbitrate, despite the fact they were non-signatories to the applicable arbitration agreement. The appellate court held that Apache could compel arbitration. Effective April 1, 2001, Wagner acquired certain oil and gas assets from Apache in a purchase and sale agreement that included an arbitration agreement. The same day, Wagner assigned the assets to the other Petitioners – each a related entity – subject to the Apache PSA. The court of appeals concluded this was sufficient for the non-signatory Petitioners to assume the obligation to arbitrate. In their Petition for Review, Petitioners challenge whether the non-signatories are bound by the arbitration agreement and whether the third-party claims for which indemnity is sought fall within the scope of the arbitration agreement. The appellate court's opinion is styled *Apache Corp. v. Bryan C. Wagner*, Nos. 02-18-00132-CV, 02-18-00135-CV, 2018 Tex. App. LEXIS 9766 (Tex. App.—Fort Worth Nov. 29, 2018).

Eagle Oil & Gas Co. v. TRO-X, LP, CAUSE NO. 18-0983

The Texas Supreme Court affirmed the appellate court's determination that TRO-X's claims related to revenue from producing properties were not barred by *res judicata* or collateral estoppel, even though the parties previously litigated whether Eagle breached the parties' agreement to convey TRO-X an interest in the properties. Eagle argued that TRO-X could have, but didn't, seek recovery of revenue from the properties in the first suit. However, TRO-X argued – and the appellate court agreed – that the claims in the second suit were not barred because commercial production was not achieved until after the judgment in the first suit became final. Before the Supreme Court, Eagle contends that this ruling "creates a claim-splitting exception for suits involving income-producing property." Eagle also contends that TRO-X waived its right to receive title to the disputed properties because they were not demanded in the first trial. The appellate court's opinion is styled *Tro-X, L.P. v. Eagle Oil & Gas Co.,* 608 S.W.3d 1 (Tex. App.—Dallas 2018).

Sundown Energy LP, et al. v. HJSA No. 3 Limited Partnership, CAUSE NO. 19-1054

The Texas Supreme Court reversed the court of appeal's judgment in part, rendered judgment in the lessee's favor, and remanded the case to the trial court for further proceedings. The parties dispute the interpretation of an oil and gas lease's continuous development obligation. The lease provided that, to maintain the full lease, the lessee had to engage in continuous development operations every 120 days, with the clock starting with the

completion or abandonment of one well and running until "drilling operations" are commenced on an "ensuing well." Sundown contends that "drilling operations" is defined by the lease to include drilling, reworking, or other operations on an existing well. Further, Sundown contends that "ensuing well" does not mean a "new well," but rather the next well on which it conducts "drilling operations," including operations on an existing well. Respondent argued, and the court of appeals agreed, that the continuous drilling obligation required the drilling of a new well. Not merely drilling operations (as that term was defined by the lease) on an existing well. In its petition for review Sundown, among other things, contends that the appellate court failed to harmonize all the language in the lease and that its holding conflicts with the Supreme Court's *Endeavor* opinion pertaining to special limitations. The appellate court's opinion is styled *HJSA No. 3, Ltd. P'ship v. Sundown Energy Ltd. P'ship,* 587 S.W.3d 864, 867 (Tex. App.—El Paso 2019).

Case argued, but no opinion released (as of April 15, 2021):

***Concho Resources, Inc. et al. v. Marsha Ellison, D/B/A Ellison Lease Operating,* CAUSE NO. 19-2033**

Respondent, Marsha Ellison, brought claims against several parties including Concho, Samson, and Sunoco. Concho acquired certain oil and gas wells from Samson, which Ellison contends are trespassing on her property. The appellate court found the wells were located on Ellison's property and that a 2008 Boundary Agreement was not effective to alter the ownership of the property because it did not identify a grantor or grantee, it did not contain words of grant, and there was no uncertainty regarding the boundary at the time of its execution. The appellate court also concluded that Concho was a bad faith trespasser as a matter of law. Concho has asked the Supreme Court to review the appellate court's conclusions related to the 2008 Boundary Agreement. The dispute with Samson and Sunoco concerned whether both entities could be considered "payors" of royalty as defined by the Natural Resources Code. The appellate court found that Ellison raised a fact issue on this point. Samson argues that there can only be one statutory "payor" and the appellate court's finding to the contrary will "wreak havoc" on the industry. It has filed its own petition for review on this point. The appellate court's opinion is styled *Ellison v. Three Rivers Acquisition LLC,* 609 S.W.3d 549 (Tex. App.—Corpus Christi 2019).

***Regency Field Services, LLC, et al. v. Swift Energy Operating, LLC,* CAUSE NO. 19-0545**

Regency operated an injection well for H_2S/CO_2 that allegedly caused a plume of gas to encroach on several mineral estates. Swift owned several leases in the area that are referred to as the PCQ lease and the non-PCQ leases. All the wells are near Regency's injection well. The appellate court held that Swift's claims pertaining to the PCQ lease was time barred because Swift filed suit too late after the plume had invaded the leased premises. However, because the plume had not yet reached the non-PCQ leases, Swift's claims as to those leases were not time barred. Both parties filed petitions for review. Swift contends that the appellate court erred by finding that its claims pertaining to the non-PCQ leases were time barred by basing its decision on the date the plume first invaded the leased minerals. Swift contends that the true "legal injury" should not be construed to occur when the plume first invades the mineral estate, but rather should include more than mere presence. Regency's petition for review asks the Supreme Court to examine the lower court's rejection of Regency's limitations argument as to the non-PCQ wells. Regency contends that if Swift has sufficient information to assert a claim for damages to leases that the plume has not yet reached, then the statute of limitations should be running. Regency contends that the appellate court's decision permits Swift to assert claims and sue for damages, while at the same time arguing that no limitations period has begun to run because the plume has not reached the non-PCQ leases. The appellate court's opinion is styled *Swift Energy Operating, LLC v. Regency Field Servs. LLC,* 608 S.W.3d 214 (Tex. App.—San Antonio 2019).

***BPX Operating Company, et al. v. Margaret Ann Strickhausen,* CAUSE NO. 19-0567**

BPX seeks review of the appellate court's opinion that rendered judgment in Respondent's favor, when the appellate court rejected BPX's "implied ratification" theory. BPX purported to pool Respondent's lease and paid Strickhausen royalties based on production from the pooled unit. Strickhausen argued that she did not ratify the lease by accepting royalties nor should she be estopped from challenging the unit because the well was partially on Strickhausen's property, and, as a result, she was entitled to royalties from the well. In its petition for review, BPX contends that a royalty owner should be deemed to ratify a unit by knowingly accepting royalty checks and that such acceptance should bar a later challenge to the unit. The appellate court's opinion is styled *Strickhausen v. Petrohawk Operating Co.,* 607 S.W.3d 350, 351 (Tex. App.—San Antonio 2019).

Briefing requested (as of April 15, 2021):

Nettye Engler Energy, LP v. Bluestone Natural Resources II

Petitioner is the owner of a non-participating royalty interest created by a Deed and described as being a "free one-eighth (1/8th) of gross production" and required "to be delivered to Grantor's credit, free of cost in the pipeline, if any, otherwise free of cost at the mount of the well or mine…" BlueStone was operating a well and paying royalties to Petitioner, but deducting post-production costs. Petitioner contends that the court of appeals erred by finding that the Deed's use of "free" referred to production costs, rather than post-production costs. The appellate court's opinion is styled *BlueStone Nat. Res. II, LLC v. Nettye Engler Energy, LP*, No. 02-19-00236-CV, 2020 Tex. App. LEXIS 5095 (Tex. App.—Fort Worth July 9, 2020).

Richard D. Crawford v. XTO Energy, Inc., CAUSE NO. 20-0092

Crawford is seeking review of an appellate court opinion holding that Crawford's predecessor in title, Mary Ruth, lost title to a "Disputed Tract" of minerals under the "strips and gores doctrine." The court reached its decision based on Mary Ruth owning only the minerals in the Disputed Tract, but had waived her right to enter the tract to develop the minerals in a 1964 conveyance. When, in 1984, Mary Ruth conveyed away adjacent property she owned, she was left with minerals that – as of 1984 – she had no ability to develop. Accordingly, the appellate court determined the Disputed Tract no longer had any value to her and should be deemed to have been included in the 1984 conveyance. Crawford seeks review of that decision challenging, among other things, whether the strip and gore doctrine should apply to severed mineral interests – particularly, whether a several mineral interest could ever cease to be a benefit to the mineral owner. The appellate court's opinion is styled *Crawford v. XTO Energy, Inc.*, No. 02-18-00217-CV, 2019 Tex. App. LEXIS 11066 (Tex. App.—Fort Worth Dec. 19, 2019).

Petition filed (as of April 15, 2021):

Rosetta Resources Operating, LP v. Kevin Martin, et al., CAUSE NO. 20-0898

The Respondent lessors contend that Rosetta breached an oil and gas lease by allegedly failing to protect the leasehold against drainage by either drilling an offset well or releasing acreage. Rosetta seeks review of the appellate court's decision to reverse the trial court's judgment in its favor and render judgment in favor of its lessors. In its petition for review, Rosetta contends that the appellate court misconstrued the offset well clause because, according to Rosetta, the appellate court's interpretation would render the clause "geographically limitless." The clause at issue provides that the Lessee must "protect the Lessee's undrilled acreage from drainage and in the opinions of reasonable and prudent operations, drainage occurred on the un-drilled acreage, even though the draining well is located over [330] feet from the undrilled acreage …." If the clause is triggered, the Lessee must either drill an offset well or release acreage. Rosetta contends that the clause is only triggered if drainage is actually occurred. The court of appeals disagreed. Rosetta seeks review of that decision. The appellate court's opinion is styled *Martin v. Rosetta Res. Operating, LP*, No. 13-19-00431-CV, 2020 Tex. App. LEXIS 7952 (Tex. App.—Corpus Christi Oct. 1, 2020).

ExxonMobil Corporation v. City of San Francisco, et al., CAUSE NO. 20-0558

ExxonMobil is seeking review of the Dallas Court of Appeals holding that the Respondents – all potential defendants in the main action – lack sufficient minimum contacts with Texas to subject them ExxonMobil's lawsuit in Texas. Although the Supreme Court will be addressing jurisdictional issues, this case is one to watch because of the importance of the suit to the State of Texas and the many oil and gas companies (and their employees) based in Texas. ExxonMobil brought suit against the Respondents in order to obtain pre-suit discovery and evaluate potential claims. ExxonMobil contends that the Respondents have conspired to use tort litigation against ExxonMobil and other Texas oil and gas companies by, as the trial court found, commencing litigation that "expressly target[s] the speech, research, and funding decisions of ExxonMobil and other Texas-based energy companies to chill and affect speech, activities, and properties in Texas." Although referring to the Respondents' conduct as "lawfare," the court of appeals held there was insufficient contacts with Texas to subject the Respondents to personal jurisdiction in Texas. In a concurring opinion, Justice Sudderth "urge[d] the Supreme Court to reconsider the minimum contacts standard" that the appellate court found controlling. The appellate court's opinion is styled *City of S.F. v. Exxon Mobil Corp.*, No. 02-18-00106-CV, 2020 Tex. App. LEXIS 5226 (Tex. App.—Fort Worth June 18, 2020).

About the Author

Chris Halgren *is a partner in our Houston office and a member of the Oil and Gas Practice Group. With horizontal drilling transforming the energy landscape across Texas, Chris developed an emphasis on oil and gas related matters. He has represented operators, non-operators, and landowners in a variety of disputes ranging from seismic misappropriation, leasing issues, royalty disputes, title litigation, lease termination, midstream accounting and other related contractual disputes.*

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FEATURED ARTICLE

Texas Environmental Enforcement Update

By: Lisa Uselton Dyar

In recent months, environmental policy and regulatory enforcement have been garnering significant attention nationally and statewide. The aim of this article is to highlight enforcement-related developments specific to Texas in a few areas, including: monitoring and control of methane emissions; changes to the Texas Commission on Environmental Quality's ("TCEQ's") Penalty Policy and other TCEQ updates; and how a properly conducted environmental audit can reduce potential enforcement penalty exposure.

Focus on Permian Basin Flaring

Regulators, nongovernmental organizations, and oil and gas industry members have all been focusing attention on identifying, assessing and managing methane emissions associated with oil and gas operations and controversial associated practices of flaring and venting unwanted gas. The recent and ongoing activities in the Midland and Delaware Basins are at the epicenter of this focus. The selected examples discussed below provide a limited snapshot overview of recent developments.

Using data from satellites, helicopters, aircraft, vehicles and towers, the Environmental Defense Fund ("EDF") conducted four aerial surveys of 1,200 sites in the Midland and Delaware basins during 2019-2020. The Permian Methane Analysis Project, known as PermianMAP, produced a report on oil and gas methane emissions in the Permian Basin.[1] PermianMAP's interactive map shows detected emissions and malfunctioning flares, and identifies local operators. The report highlights unlit and malfunctioning flares and impacts of related emissions. EDF's stated intent of the project is to share data with the public so companies and state officials can take swift action to reduce emissions across the basin.

Texas regulators are beefing up their approach to monitoring flaring activity and related emissions in response to growing pressure from environmental groups and other stakeholders. In late 2020, the Railroad Commission of Texas ("RRC") adopted changes to

[1] *See* https://permianmap.org/ and https://data.permianmap.org/pages/flaring.

Form R-32, Application for Exception to Statewide Rule 32, which now requires more detailed representations from oil and gas operators applying for flaring exceptions, and provides specific guidance related to flaring.[2]

The TCEQ, which regulates air quality, surface water management, water quality, and waste management associated with oil and gas activities, including air emissions resulting from flaring and venting operations at oil and natural gas production and processing sites implemented the Permian Basin Find It and Fix It Initiative between November 2, 2020 and January 31, 2021. The initiative provided owners and operators limited enforcement discretion for actively addressing potential compliance issues. TCEQ issued compliance alerts, and held a series of virtual workshops to discuss the initiatives, emissions events, and authorizing oil and gas operations in connection with the initiative.[3] Statewide, the agency's response to emissions events continues to be a high enforcement priority. Texas lawmakers have filed several bills related to venting or flaring natural gas in the current legislative session.[4]

Oil and gas operators and producers are also actively monitoring and working to control methane emissions.[5] For example, the Texas Methane & Flaring Coalition represents seven industry trade associations and 40 operators who voluntarily agreed to identify and promote operational and environmental recommended practices to minimize flaring and methane emissions.[6] In early February 2021, the Coalition announced its goal of ending routine flaring by 2030. Another partnership led by researchers at The University of Texas at Austin and bringing together EDF, ExxonMobil, Gas Technology Institute (GTI) and Pioneer Natural Resources, aims to demonstrate a novel approach to measuring methane emissions from oil and gas production sites, using advanced technologies such as a sensor network that will leverage advances in methane-sensing technologies, data sharing, and data analytics to provide near-continuous monitoring.[7] One potential application of the sensor network allows producers and regulators to find and fix significant methane releases at or below the cost of current monitoring technologies, many of which measure emissions only on an annual or semi-annual basis. The first phase of network development, which will test a wide range of methane sensing technologies and assess their ability to operate autonomously, will be conducted in the Permian Basin.

TCEQ Updated Administrative Enforcement Penalty Policy

TCEQ is responsible for conducting inspections and related enforcement of various air, water and waste regulatory requirements pursuant to federal delegation agreements and state authority. Enforcement actions can involve administrative, civil, criminal penalties, and injunctive relief. Most TCEQ enforcement cases are resolved through agreed orders, which assess administrative penalties and require corrective actions. In some cases, TCEQ will refer a matter to the Texas Attorney General's Office for civil enforcement. In other situations, TCEQ's Environmental Crimes Unit provides support and expertise for criminal environmental violations.

TCEQ generally assesses administrative penalties in accordance with its Penalty Policy, first developed about 20 years ago, and updated in a fifth revision on January 28, 2021.[8] The Penalty Policy describes TCEQ's policy objectives for computation and assessment of administrative penalties the TCEQ staff recommend to the Commission. Specific recent events, which TCEQ found not to be protective of public health, Texas' natural resources, and sustainable economic development, prompted proposed changes to the Penalty Policy prior to the 2021 legislative session.[9]

The TCEQ Executive Director described revisions to the Penalty Policy as necessary to drive better decision-making and safety processes within TCEQ's authority.[10] The Executive Director and his staff prepared and presented recommendations to the three TCEQ Commissioners.[11] Following input from the TCEQ Commissioners, the Executive Director solicited public comment on the recommended revisions for a 30-day period.[12] On January 28, 2021, the Commissioners adopted

[2] *See* RRC Open Meeting Notice for Wednesday, November 4, 2020, Item 195, available at https://rrc.texas.gov/media/bcsclnct/final-conference-agenda-for-november-4-2020_.pdf.

[3] *See, e.g.*, https://www.tceq.texas.gov/assets/public/assistance/sblga/oil-gas/OG-EE-Compliance-Alert.pdf. Workshop recordings and other compliance alerts are available at https://www.tceq.texas.gov/assistance/industry/oil-and-gas/oil-gas-online-workshops.

[4] *See, e.g.*, S.B. 388 by Eckhardt and H.B. 1521 by Hinojosa (relating to the reduction of methane gas flaring on land dedicated to the permanent university fund); H.B. 1377 by González (relating to the repeal of the exemption from the severance tax for flared or vented gas); H.B. 1494 by Goodwin (relating to the applicability of the gas production tax to flared or vented gas at an increased rate; imposing tax); H.B. 1452 by Rosenthal (relating to the establishment by the RRC of a policy to eliminate the routine flaring of natural gas from wells or other facilities regulated by the commission).

[5] Requiring capture of the value of flared and vented gas is also an active policy objective. *See, e.g.*, https://www.houstonchronicle.com/business/energy/article/Banning-routine-flaring-could-net-oil-companies-15897481.php.

[6] *See* https://texasmethaneflaringcoalition.org/about/.

[7] *See* https://news.utexas.edu/2020/05/19/sensor-network-could-change-how-methane-emissions-are-detected/.

[8] *See* https://www.tceq.texas.gov/assets/public/comm_exec/pubs/rg/rg253/penaltypolicy2021.pdf.

[9] See, *e.g., "TPC Port Neches Plant Fire," https://www.tceq.texas.gov/response/tpc-incident.*

[10] TCEQ Commission Work Session, September 24, 2020, https://www.tceq.texas.gov/assets/public/comm_exec/agendas/worksess/marked/2020/200924.Mrk.pdf.

[11] *See* https://www.tceq.texas.gov/downloads/news/interoffice-memorandum-penalty-policy.pdf.

[12] *See* TCEQ Press Release (September 30, 2020), https://www.tceq.texas.gov/news/releases/tceq-opens-public-comment-period-on-revised-penalty-policy-proposal-and-begins-compliance-history-rulemaking-1.

the ED's recommendations and issued the new version of the Penalty Policy, known as "Revision 5."

Revision 5 applies to violations documented in investigations commencing on or after January 28, 2021 and to violations investigated on or after September 21, 2011 and referred for enforcement on or after January 24, 2021.[13] Revision 5 updates include alignment with current TCEQ practices and statutory changes since the last update in 2014. The new version reduced availability of penalty deferrals, updated implementation language, and other adjustments to language to improve clarification.

Allowing a greater exercise of discretion in assessing a penalty is a key change of Revision 5 because it increases uncertainty to the regulated community. TCEQ sought to remove existing policy constraints to allow flexibility to assess a penalty appropriate to fit a violation's duration and circumstances. In addition, changes to determining number of violation events will allow for higher penalties for continuing violations. Increases in penalty enhancement percentages for actual releases and programmatic major violations expand the potential range of a proposed penalty. Further, respondents with two or more administrative penalty orders within the preceding two years are no longer eligible for a 20 percent deferral of penalties for expedited settlement.[14]

The TCEQ Executive Director deferred his initial proposed change to create a penalty enhancement of 20 percent for reportable emissions events that occur in counties with populations of 75,000 or greater using the "other factors that justice may require" statutory penalty factor.[15] Following receipt of public comment, the Executive Director indicated he and his staff would continue to develop additional data and conduct a "deeper dive" to study impacts a regulated entity might have on nearby populations. After the Executive Director develops such information, he signaled a possible return to the TCEQ Commissioners later in 2021 with a more data-supported recommendation to include an upward penalty enhancement adjustment for reportable emission events.

Other TCEQ Enforcement Updates

Compliance History

TCEQ initiated a rulemaking project in 2020 to revise its compliance history rules. The rulemaking project intends to add a new rule to allow the Executive Director to reclassify a site's compliance history classification if that site has caused, suffered, allowed, or permitted the creation of exigent circumstances, such as a major explosion or fire that impacts the surrounding community and environment.[16]

Sour Gas Handling

TCEQ has issued several compliance alerts specific to the oil and gas industry such as the sour gas handling alert, which focuses on hydrogen sulfide ("H_2S") emissions from oil and natural gas handling and production sites. Sour sites are subject to increased regulatory requirements. While the RRC's Statewide Rule 36 imposes certain requirements when an H_2S concentration is at or above 100 parts per million ("ppm"),[17] TCEQ designates upstream operations – which requires permitting, reporting, and possibly additional emission controls – as sour when the H_2S concentration is at approximately 24 ppm.[18]

Water Discharge Permits

At the direction of the 86th Texas Legislature in House Bill 2771, RRC and TCEQ began working together for TCEQ to gain primacy for all surface water discharge issues in the state, including authority to regulate produced water generated during oil and gas extraction. Upon receiving approval by EPA in January 2021, authority to regulate these discharges transferred from RRC to TCEQ.[19] TCEQ now issues federal wastewater discharge permits for produced water, hydrostatic test water, and gas plant effluent discharges resulting from certain oil and gas activities into water in the state. This simplifies the previous authorization process – instead of needing approval from RRC, EPA and TCEQ, operators generally now need only obtain one approval from TCEQ.

Texas Environmental Health & Safety Audits

During times of increased regulatory enforcement policies and penalties, environmental audits take on renewed relevance. Environmental audits are proven tools regulated entities can proactively use to reduce liability for administrative and civil penalties in exchange for voluntarily reviewing, disclosing and correcting violations of environmental requirements.

[13] The TCEQ's statutory authority to assess administrative penalties increased to $25,000 per day, per violation on September 21, 2011. Any violations subject to an investigation prior to September 21, 2011, if any, would be calculated under the prior penalty policy.
[14] *See supra* n. 8 at 22 (discussing deferral); Tex. Water Code §§ 7.105(b)(2), (b)(4), and (b)(6) (describing specific administrative penalty orders and type of violations that create ineligibility for deferral).
[15] Tex. Water Code § 7.053(4).
[16] *See* https://www.tceq.texas.gov/news/releases/tceq-opens-public-comment-period-on-revised-penalty-policy-proposal-and-begins-compliance-history-rulemaking-1; TCEQ Rulemaking Project 2020-049-060-CE.
[17] 16 Tex. Admin. Code § 3.36.
[18] 30 Tex. Admin. Code § 101.1(96) (defining sour as an H2S concentration more than 1.5 grains per 100 cubic feet, or more than 30 grains of total sulfur per 100 cubic feet).
[19] *See* 86 Fed. Reg. 9332 (February 12, 2021) (January 15, 2021 approval of State of Texas request for NPDES Program authorization for discharges of produced water, hydrostatic test water, and gas plan effluent within the state); Acts 2019, 86th Leg. R.S., ch. 1140 (H.B. 2771), eff. September 1, 2019.

In Texas, regulated entities can take advantage of the Texas Environmental, Health, and Safety Audit Privilege Act ("Audit Act") to systematically assess compliance with environmental or health and safety laws.[20] TCEQ and the RRC have established policies for their Audit Act programs.[21] With important exclusions and qualifiers, the scope of the Audit Act extends to evaluation of compliance with any environmental or health and safety requirement within the jurisdiction of a state agency or local program with delegation.[22] A Notice of Audit must be submitted to the regulatory agency with jurisdiction prior to initiation of review and disclosure of violations.[23] Timely disclosure of violations and implementation of appropriate corrective actions are also necessary conditions to meet to be eligible for penalty immunity.[24] The Audit Act offers immunity from administrative and civil penalties for violations voluntarily disclosed and corrected pursuant to Audit Act notification, disclosure, and correction requirements.[25]

[20] *See generally* Tex. Health & Safety Code Chapter 1101.
[21] Current policies are available at https://www.tceq.texas.gov/assets/public/comm_exec/pubs/rg/rg-173.pdf, and https://www.rrc.state.tx.us/media/wpzdrtv3/audit-privilege-act-guide-nov-2017.pdf.
[22] Tex. Health & Safety Code § 1101.003(a)(3) (defining "environmental or health and safety audit").
[23] *Id.* § 1101.154(b).
[24] *Id.* § 1101.152(a).
[25] *Id.* § 1101.151.

Environmental audits are also advantageous tools to consider employing during environmental due diligence of acquisition of facilities subject to environmental regulations. Texas' Audit Act includes provisions for conducting pre-acquisition audits before acquiring facilities, and for extending review following acquisition. Under coverage of a pre-acquisition audit, a prospective purchaser has a layer of protection under which to review potential or suspected compliance issues and assess the state of environmental liabilities prior to taking ownership and responsibility.

A Few Takeaways

Colorless and odorless methane emissions are gaining visibility through focused attention by regulators and stakeholders. In turn, emerging technologies and methods are advancing to mitigate and reduce methane emissions. Expect to see continued development on all fronts of the flaring issue.

TCEQ penalty assessments have the potential to increase from current levels, especially for events TCEQ identifies as significant.

Preparing a proactive plan to maintain compliance and manage risk of noncompliance is always prudent. With the trend of increased regulatory focus on environmental issues, utilizing the Audit Act can help to reduce potential enforcement exposure.

About the Author

Lisa Uselton Dyar *is a partner in our Austin office and a member of the Environmental Practice Group. Lisa has extensive experience in all areas of environmental law, including permitting, compliance, auditing, enforcement, and related litigation matters. Early in her career, Lisa served as a senior enforcement attorney in the Litigation Division of the Texas Commission on Environmental Quality. There, she was recognized for her outstanding leadership as lead counsel for some of the agency's most complex and high-profile air and multimedia enforcement cases, and for drafting statewide consolidated environmental enforcement legislation, now codified in Chapter 7 of the Texas Water Code.*

For more information about the issues discussed in this article, contact Lisa at 512-495-6168 or ldyar@mcginnislaw.com.

FEATURED ARTICLE

SCOTX Determines Lease Did Not Authorize Certain Post-Production Costs or Free Use of Gas

Bluestone Nat. Res. II, LLC v. Randle, No. 19-0459, 2021 Tex. LEXIS 206 (Mar. 12, 2021)

By: Chris Halgren

In this case, the Texas Supreme Court was confronted with two separate lease interpretation questions. The first question concerned whether BlueStone could deduct post-production costs from Randle's royalty payment. The second was whether BlueStone was required to pay for gas it produced from the lease, but utilized in connection with its lease operations. The Court held for Randle on both questions, concluding that post-production costs could not be deducted and that BlueStone was required to pay for the disputed gas. The case was remanded to the trial court for a determination of the volume of gas used by BlueStone so that damages could be computed.

The post-production costs issue concerned competing clauses in the lease, one in the original pre-printed form and the second in an addendum. Notably, the addendum expressly provided that it would control in the event of a conflict. The pre-printed form provided that royalties would be paid based on the "market value at the well." The Addendum provided that BlueStone must "compute and pay royalties on the gross value received" and also set out "typical 'no deductions' language …."

The dispute centered around whether the language between the Addendum and the pre-printed form conflicted. BlueStone correctly argued that this "at the well" language has historically been determinative in courts finding that post-production costs could be deducted. If there was no conflict, then this language should be given controlling effect and post-production costs should be deductible.

"The phrase 'gross value received,' was both a description of how and where to value the royalty…"

BlueStone argued that the "at the well" language was the only language in the lease that set a "valuation point," i.e. where the royalty is to be valued. BlueStone insisted that the "gross value received" language set out how but not where to value the royalty. In other words, BlueStone argued that Randle was entitled to royalty valued based on the gross value received (Addendum) at the well (Form). Further, BlueStone argued that to determine the gross value received at the well, BlueStone should be permitted to "net back" to the well by deducting all post-production costs. However, the Supreme Court disagreed and held for Randle based on the Court's determination that the phrase "gross value received," in the context of this lease, was both a description of how and where to value the royalty, the "where" being at the point of sale.

The Court pointed to its 25-year-old opinion in *Judice v. Melbourne Oil Co.* to explain that the phrase "gross value received at the well" gives rise to an "inherent conflict." In this case, the Court concluded that this "inherent conflict" is resolved by the Addendum's express provision stating that the Addendum's terms control in the event of any conflict with the pre-printed form. The Court also emphasized the lease's use of the term "gross amount realized" rather than "amount realized," explaining that the use of the term "gross" signified that no post-production costs should be deducted, whereas the phrase "amount realized" does not indicate one way or the other.

The Court also addressed the parties' dispute over BlueStone's claim that it had a contractual right to utilize leasehold gas, royalty free, in off-lease operations so long as those off-lease operations benefited the lease. The lease contained a "free use clause," providing that the "Lessee shall have free from royalty or other payment the use of … gas … produced from said land in all operations which Lessee may conduct hereunder …." The Court noted that it "has not had occasion to resolve a dispute a dispute involving a

free-use clause, and the intermediate appellate court cases the parties cite are not instructive." Therefore, the Court turned to cases examining similar lease issues under North Dakota, New Mexico, and Colorado law. Cases from North Dakota and New Mexico seemed to authorize off-lease gas use, so long as it benefitted the lease. The justification seemed to be that permitting off-lease use did not harm the royalty owner and was beneficial to the lessee because the lessee could centralize operations. The Court then turned to a Tenth Circuit opinion in *Anderson Living Trust v. Energen*, where the court examined multiple leases — some governed by New Mexico law and another group governed by Colorado law. The Supreme Court determined that the leases in *Anderson Living Trust* most closely resembled the BlueStone lease at issue. The Tenth Circuit held that the plain language in the lease limited free use to operations on the lease. However, noting that New Mexico had a more expansive view of the clause, the Tenth Circuit held that off-lease use was permissible under the New Mexico leases. The court reached the opposite result on the Colorado leases based on the court's interpretation of the plain language.

The Texas Supreme Court agreed that the plain language of the lease limited the free use clause to operations on the leasehold and was not intended to expand to off-lease uses that may benefit the lease. The case was remanded for a determination of damages.

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Location Damages Not Due After Merely Staking and Surveying a Well

Evans Res., LP v. Diamondback E&P, LLC, 2020 Tex. App. LEXIS 4173, 2020 WL 2838529 (Tex. App. – Eastland, May 29, 2020, pet. filed)

By: Ian Davis

In this contract interpretation case, the parties disputed whether the lessee was required to pay horizontal well location damages to the lessor when it had merely conducted a survey and placed stakes on the land, but did not follow through with drilling a well.

The oil and gas lease and related surface agreement at issue required the lessee to pay the lessor location damages "prior to commencing drilling operations" for 7 pre-identified vertical wells. A subsequent amendment to the lease also required the lessee to pay location damages "in advance" for each horizontal well constructed on the land.

The Eastland Court of Appeals held that, under the terms of a lease and surface agreement (i) the lessee was required to pay the lessor "location damages" within 30 days of when the lessee first began construction on certain horizontal wells; (ii) absent a contractual definition, construction commenced when the lessee moved the necessary parts of the well onto the land; and (iii) the lessee's action of conducting a survey and laying stakes on the ground did not trigger the location damages payment period.

The court interpreted the amendment in harmony with the vertical wells' location damages provision. Therefore, the lessee was not obligated to pay horizontal well location damages until it had moved hardware components of the horizontal well onto the land. Because conducting a survey and placing stakes on the ground did not implicate any components of the horizontal wells, the lessee did not yet owe location damages. The court also found that this interpretation did not constitute a condition precedent or forfeiture of rights because: (i) the location damages provision did not use conditional language (i.e. if, provided that, on condition that, etc.) and (ii) when location damages became payable did not involve forfeiture of the lessor's rights under the lease.

About the Author

Ian Davis *is an associate in our Austin office and a member of the General Litgation Practice Group. He has experience in a variety of areas, including: commercial litigation in state and federal courts; state and federal administrative and regulatory compliance (data security and privacy, public utilities, healthcare, and consumer finance); contested hearings before the State Office of Administrative Hearings; international trade compliance (EAR, FTR, and ITAR); and business and partnership disputes.*

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FEATURED ARTICLE

Royalty Disputes Continue to Thrive: Two Recent Postproduction Cost Deduction Cases

By: Austin W. Brister

Our firm has significant experience handling royalty disputes, including on both the plaintiff and defendant side. Royalty disputes continue to thrive across Texas, including disputes regarding whether a royalty interest must bear a proportionate share of post-production costs like transportation, compression, processing, and marketing. These disputes often turn on determining the proper "valuation point" for the royalties. For instance, if a royalty provision establishes a valuation point "at the well," then that factor generally suggests the royalty is subject to postproduction costs. On the other hand, if the royalty provision establishes a valuation point "at the point of sale," then that factor generally suggests the roya¬lty is free of postproduction costs.

Other cases have focused on the meaning of phrases such as "gross production," "cost-free," and enforceability of no-deducts provisions. As one recent case shows, sometimes parties utilize unique language that requires the lessee to actually add amounts to its proceeds before calculating royalties.

This article discusses two recent Texas appellate court cases regarding deduction of postproduction costs. In both cases a petition for review has been filed with the Texas Supreme Court.

BlueStone v. Engler Energy

One recent case is *BlueStone Nat. Res. II, LLC v. Nettye Engler Energy, LP*, No. 02-19-00236-CV, 2020 Tex. App. LEXIS 5095 (Tex. App.—Fort Worth July 9, 2020). This case is of interest to trial lawyers and in-house lawyers for its interpretation of two notable Texas Supreme Court cases on deduction of

post-production costs: the "*Burlington Resources*" case from 2019, and the *Hyder* case from 2016.

In *BlueStone*, the owner of a nonparticipating royalty interest (NPRI) contended that a 1986 deed creating the NPRI interest contained language that prohibited the deduction of postproduction costs. The 1986 deed contained the following language:

> This Grantor ... shall be entitled to receive ... a free one-eighth (1/8) of gross production of any such oil, gas or other mineral said amount to be delivered to Grantor's credit, free of cost in the pipe line, if any, otherwise free of cost at the mouth of the well or mine...

In 2004, BlueStone's predecessors leased the tract and drilled numerous producing wells. BlueStone's predecessors incurred a number of prost production costs, but did not pass those costs onto the NPRI owner.

In 2016, BlueStone acquired these leasehold interests and began to deduct from the NPRI a share of BlueStone's postproduction costs for transportation, gathering, and compression. The NPRI owner filed suit. The trial court granted the NPRI owner's motion for summary judgment. This appeal followed.

On appeal, BlueStone argued that the 1986 deed's use of the phrase 'in the pipe line" indicated that the royalty was to be valued at the pipeline and therefore was subject to postproduction costs. The Fort Worth Court of Appeals agreed with BlueStone, reversing the trial court and rendering judgment in favor of Bluestone.

The *BlueStone* case is of interest due to its analysis of two Texas Supreme Court decisions regarding postproduction costs: *Burlington Resources Oil & Gas Co. LP v. Texas Crude Energy, LLC,* 573 S.W.3d 198 (Tex. 2019) and *Chesapeake Expl., L.L.C. v. Hyder,* 483 S.W.3d 870, 872 (Tex. 2016).

In *Burlington Resources Oil & Gas Co. LP v. Texas Crude Energy, LLC,* 573 S.W.3d 198 (Tex. 2019), the Texas Supreme Court held that the phrase "into the pipelines...with which the wells may be connected" was tantamount to the phrase "at the well," thereby establishing a valuation point that requires a royalty interest owner to bear postproduction costs.

The NPRI owner made several arguments in an attempt to distinguish *Burlington*. The NPRI owner argued that *Burlington* was based on the full phrase in that case and did not broadly hold that "into the pipeline" sets a valuation point at the wellhead. Instead, the NPRI owner argued that the holding in *Burlington* was limited to instruments referencing pipelines "connected" to the well. The *BlueStone* court disagreed, stating *Burlington* "did in fact focus heavily on the singular phrase 'into the pipeline.'"

The NPRI owner also argued that, because the 1986 deed did not include a "connected to the well" phrase like in *Burlington*, that reflects that the parties to the 1986 deed were referring to a major pipeline downstream, and not merely a gathering system connected to the well. The *BlueStone* court rejected that argument as well, pointing to multiple resources indicating that a gathering system is a type of pipeline.

The NPRI owner also argued that, because the two phrases "free of cost in the pipeline" and "free of cost at the mouth of the well" are separated by the word "otherwise," that means they are mutually exclusive. The NPRI owner argued that the second phrase refers to gas with a valuation point at the mouth of the well, and therefore the first phrase must refer to oil and a valuation point somewhere other than the wellhead. The *BlueStone* court rejected that interpretation as well. Instead, the court construed the word "otherwise" as simply meaning that the valuation point is at the pipeline if there is a pipeline, otherwise the valuation point is at the mouth of the well.

The NPRI owner also attempted to draw several analogies between the 1986 deed and the *Hyder* case. The NPRI owner cited *Hyder* in arguing that the phrase "cost free" in the 1986 deed means free of postproduction costs. The appellate court rejected that comparison. The appellate court noted that the *Hyder* decision was not based solely on the phrase "cost free," but was instead "focused specifically" on the parenthetical that followed, which read "cost-free (except only its portion of production taxes)." Even though the phrase "cost-free" in a royalty provision typically means only that the royalty free of production costs, this parenthetical in Hyder reflected a different intention given that it made an exception for "production taxes" which is a type of postproduction cost. Therefore, based on that parenthetical, the *Hyder* Court held that the parties intended for the phrase "cost-free" to mean free of postproduction costs.

The *BlueStone* court also rejected the argument that the 1986 deed's use of the phrase "a free one-eighth (1/8) of gross production" brought the 1986 deed in line with *Hyder*. The court explained that *Hyder* recognized the phrase "free" in a royalty provision typically refers only to production costs and not production costs. The *BlueStone* court explained that the 1986 deed did not express a contrary intent, as the word "free" appeared in multiple other locations in the context of production costs. Moreover, in the phrase "free of cost at the mouth of the

well," the reference to the mouth of the well suggests the word "free" is used in its standard nature, in reference to production costs.

Devon Energy v. Sheppard

Another recent postproduction costs royalty case is *Devon Energy Prod. Co., L.P. v. Sheppard,* No. 13-19-00036-CV, 2020 Tex. App. LEXIS 8378 (Tex. App.—Corpus Christi Oct. 22, 2020). McGinnis Lochridge lawyers, Austin Brister, Kevin Beiter, and Jordan Mullins represented the appellees in this case.

This case involves "highly unique royalty provisions" in lease forms prevalent during the shale boom in the Eagle Ford area. The leases at issue included the following "add to proceeds" provision:

> If any disposition, contract or sale of oil or gas shall include any reduction or charge for the expenses or costs of production treatment, transportation, manufacturing, process or marketing of the oil or gas, then such deduction, expense or cost shall be added to the market value or gross proceeds so that Lessor's royalty shall never be chargeable directly or indirectly with any costs or expenses other than its pro rata share of severance or production taxes.

Another provision in the addendum indicated that royalties "shall never bear or be charged with, either directly or indirectly, any part of the costs or expenses of" several enumerated categories of postproduction costs.

The royalty owners argued that these lease provisions required the lessee to add any 'reduction or charge' included in any 'disposition, contract or sale of oil or gas' to the lessee's gross proceeds before calculating royalties. The lessors argued that a wide variety of the lessee's purchase agreements, purchase statements, processing arrangements, and other instruments reflected reductions or charges, and therefore they should have been added to the lessee's gross proceeds prior to calculating the lessors' royalties.

The lessees argued that the controlling language in the leases was the royalty provision indicating that royalties were to be paid on the basis of "gross proceeds at the point of sale." The lessees argued that this established a valuation point at the point of sale, whereas the lessees argued that the reductions or charges at issue in this case were incurred downstream of the point of sale.

The lessors and lessees submitted a joint stipulation to the court, identifying twenty-three different scenarios for the court's consideration. The trial court granted summary judgment in favor of the lessors, and this appeal followed.

The appellate court emphasized that Texas courts construe oil and gas leases by seeking to enforce the intention of the parties, and that they seek to give effect to all parts and do not give any single provision controlling effect.

The appellate court reviewed the "highly unique royalty provisions" in the underlying leases and concluded that it is "exceptionally broad, and there is nothing in the leases suggesting that [it] is limited to pre-point-of-sale expenses." The court further explained that the initial royalty clause indicates that "royalty is to be initially based on the [lessees'] gross proceeds (before [this unique additional provision] is applied)." The court explained that, if it were to hold that royalties were due only on gross proceeds, then the court would be rendering this additional "add to proceeds" provision meaningless.

The court also explained that this unique provision differs "significantly" from a mere "no deducts" clause, as it does not concern deductions made to the royalty; rather, it focuses on the dispositions and sales contracts, and applies if they contain a "reduction or charge" for such expenses. Moreover, the phrase indicating that the royalty shall never be "directly or indirectly" charged with such costs reflected an intent that the royalty should not be reduced where "a downstream sales price is reduced to account for costs incurred or anticipated by the purchaser."

Ultimately, the court concluded that this unique language reflected the parties' intent to base the royalty on more than mere gross proceeds. The court coined this a "proceeds plus" royalty. The court held that this language requires the lessee to add to its gross proceeds any reduction or charge that is included in a disposition, contract, or sale of oil and gas, so long as the charge is for one of categories enumerated within the lease addendum.

The *Devon* case serves as a reminder that determining whether a royalty interest bears postproduction costs is not merely a matter of determining the valuation location.

About the Author

__Austin Brister__ is a partner in our Houston office and a member of the Oil and Gas Practice Group. Austin represents oil and gas exploration and production companies and landowners in complex litigation, including mineral and leasehold title disputes, surface trespass and damages, royalty calculation and payment disputes, operator/non-operator disputes, removal of operator, lease termination/perpetuation disputes, retained acreage and proration unit issues, and an array of other issues in the upstream oil and gas sector.

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SCOTX Holds "Banking" Provision Legally "Ambiguous," Precludes Partial Termination

Endeavor Energy Res., L.P. v. Energen Res. Corp., 615 S.W.3d 144 (Tex. 2020)

By: Austin W. Brister

Over the last decade, it has become relatively common to include continuous development provisions in oil and gas leases. These provisions generally allow a lessee to hold the lease in its entirety during the secondary term by continuing to drill new wells within defined timelines. These provisions vary widely, and disputes often arise as to the meaning of when a well is "completed" or "abandoned," when the next well must be "commenced," at what stage the well is considered "commenced," and what type of drilling, drilling rig, or preparatory operations suffice.

Disputes regarding the interpretation of these provisions have served as a prolific source of litigation over the last several years. Significant consequences can flow from this interpretation, as the lease will generally call for a termination or partial termination once the lessee fails to timely "commence" the next continuous development well.

The Texas Supreme Court recently issued an opinion in *Endeavor Energy Res., L.P. v. Energen Res. Corp.,* 615 S.W.3d 144 (Tex. 2020), analyzing a continuous development provision that allowed the lessee to "bank" or "accumulate" the number of days a well was commenced ahead of schedule, and apply that to extend the "next" deadline.

The *Endeavor* case involved a lease covering 11,300 acres in Howard County, Texas. The lease contained a continuous development provision,

and an "accumulation clause" that read as follows:

> Lessee shall have the right to accumulate unused days in any 150-day term during the continuous development program in order to extend the next allowed 150-day term between the completion of one well and the drilling of a subsequent well.

The lessee, Endeavor, drilled twelve timely wells under the continuous development provisions. Endeavor then waited 321 days to spud the thirteenth well. Endeavor asserted that this thirteenth well was drilled timely because Endeavor had accumulated enough unused days in all of its previous wells to allow for that period. Endeavor argued that it had accumulated 227 unused days over the life of the lease, bringing its total permitted timeline for the thirteenth well to 377 days (i.e., 150 days plus 227 days).

Shortly before Endeavor drilled its thirteenth well, the lessor executed a new lease in favor of a new lessee, Energen. Energen filed suit alleging that Endeavor's thirteenth well was not timely, and therefore the prior lease partially terminated, and Energen's new lease was the valid and effective lease. Energen argued that unused days earned in a given term extended timeline only as to the immediate following term. Endeavor had drilled the twelfth well 36 days early, and therefore Energen argued the deadline for the thirteenth well was 186 days.

The trial court held in favor of Energen, and the appellate court affirmed, focusing on the phrases "next allowed" and "150-day term" as pointing to an individual next well rather than the entire continuous development term.

The Texas Supreme Court reversed the court of appeals, holding that the banking provision was reasonably susceptible to multiple meanings, rendering the continuous development clause legally "ambiguous," and therefore unenforceable as a special limitation (i.e., unenforceable to bring about an automatic termination).

The Court walked through the provision, and concluded that an analysis of the text itself was "inconclusive." For instance, the Court determined that neither side interpreted the phrase "150-day term" to mean precisely what it says, but concluded that neither side's position was unreasonable. The Court acknowledged the court of appeals' analysis that the phrase "next…term" indicated that only a singular term was extended. However, the Court acknowledged Endeavor's "forceful rebuttal" that unused days from one term become part of the "next" term, and because there will always be a "next" term for unused days to roll into, that means unused days may be carried forward indefinitely. The court indicated the phrase "accumulate" was inconclusive because it can reference both a gradual accumulation over time or increases in general, whether sudden, incremental, or otherwise. Ultimately, the Court called the decision between the parties' textual interpretations "too close to call," and that neither party's arguments decisively supports either interpretation.

The Court also analyzed the parties' non-textual arguments, and determined that both "advance plausible understandings of the provision's commercial purpose," but that neither pointed to a single objectively correct construction. For instance, Endeavor contended that its construction represented a more sensible bargain, allowing Endeavor to receive the benefits of exceeding the drilling timelines, while still averaging about one well every 150 days. However, the Court acknowledged Energen's argument that the purpose of a continuous development clause is not to achieve an "average" duration of gap, but rather to ensure there are no excessively long gaps. The Court acknowledged that both parties set forth "plausible understandings of the provision's commercial purpose," but concluded that neither was "sufficient to break the tie created by the Lease's ambiguous language."

Ultimately, the Court concluded that the description of the drilling schedule required to avoid termination was reasonably susceptible to more than one meaning, and therefore it was legally ambiguous and unenforceable to cause a partial termination under these circumstances. The Court indicated that "it has long been the rule that contractual language will not be held to automatically terminate the leasehold estate unless that 'language…can be given no other reasonable construction than one which works such result."

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Seeking or Defending a Temporary Restraining Order or Injunction? Five Questions Outside Counsel Will Ask.

By: William K. Grubb

Typically, litigants seeking a temporary restraining order ("TRO") or a temporary injunction ("TI") are in a hurry.[1] For example, an oil and gas operator may seek an injunction to stop interference with its operations, an employer may pursue an injunction to prevent the use of confidential and proprietary data by a former employee, or a property owner may seek an injunction to halt a continuing trespass. Conversely, litigants may be faced with defending a request for a TRO or TI in situations where an injunction could significantly disrupt their business, if not shut it down completely. Whether seeking or defending a TRO or TI, litigants and their outside counsel often have to mobilize quickly to present their best case to a court on short notice.

Importantly, the legal standards required to obtain a TRO or TI are almost often more onerous than those that apply when merely seeking damages in a non-emergency setting. Thus, understanding what information your outside counsel will need and the burdens of seeking a TRO or TI are critical to quickly and effectively obtaining or preventing injunctive relief.

In most instances, your outside counsel will likely ask the following questions in preparation for a TRO or TI hearing:

1. What's the Emergency?

In most situations, the party seeking an injunction will have to convince a court that, among other things, a probable, imminent, and irreparable injury will occur in the absence of a TRO or a TI. In short, even a steadfast belief that you will prevail on your claims is not enough. There must be an irreparable injury that will probably occur if the offending party is not immediately prevented from taking a specific action.

2. Who will sign the declaration or affidavit (and eventually testify to) proving the facts supporting a TRO or TI?

Requests for a TI must usually be supported by an affidavit or declaration. Determining which person will sign the affidavit or declaration is one of the first steps in preparing a request for a TRO or TI. Conversely, when defending against a TRO or TI, the defending party will often want to question anyone who signed supporting affidavits or declarations. Thus, selecting a person with the proper knowledge and credibility is important. Also, testimony is often required at a TI hearing. When deciding who will sign affidavits and declarations, parties should consider whether that person will be willing to testify.

3. Why wouldn't a money judgment remedy the potential harm?

As mentioned above, probable, imminent, and irreparable injury is often an essential element of injunctive relief. In analyzing whether such harm or injury exists, outside counsel will want to know why a money judgment would not remedy the harm. Additionally, successfully obtaining injunctive relief does not typically provide for the immediate payment of financial damages, an issue that is typically reserved for a trial on the merits. Thus, whether

[1] In Federal Court, there are Temporary Restraining Orders and Preliminary Injunctions.

defending or seeking injunctive relief, outside counsel will want to know what is unique about the injury.

4. Can the party seeking relief post a bond?

TROs and TIs must be supported with a bond. Courts require bonds to protect against potential damage to the party enjoined if the TRO or TI was entered when it should not have been. The determination of the amount of bond is often left to the discretion of the Court. If seeking a TRO or TI, outside counsel will likely ask about the client's ability to post a bond. If defending a TRO or TI, outside counsel will typically want to know whether the bond amount suggested by the other side is sufficient to protect against damages.

5. Is the party seeking a TI confident in their ability to defend it on appeal?

Temporary injunctions are typically subject to an immediate appeal. Appellate courts often closely scrutinize the scope of a temporary injunction. Thus, the party obtaining a temporary injunction may have to defend it on appeal. Interlocutory appeals can be expensive to pursue and defend. Outside counsel will likely want to know their client's appetite to engage in a potential appeal.

About the Author

__William K. Grubb__ is an associate in our Houston office and a member of the Oil & Gas Practice Group. Will's experience includes defending clients at temporary injunctions hearings, including as the first chair, successfully representing clients before the Texas Supreme Court on merits briefing, drafting and arguing dispositive motions for matters in state and federal court, and handling interlocutory appeals before Texas courts. Will assists clients with complex commercial litigation, with an emphasis on oil & gas.

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NEW ATTORNEY ANNOUNCEMENT

McGinnis Lochridge Welcomes

Four New Attorneys

Across Three Practice Groups

We are pleased to welcome four new attorneys in our Austin and Dallas offices: Partner Traci Clements, Of Counsel Dan Clemons, and Associates McLean Bell and Ian Davis. These additions bring a wide array of experience in issues including oil and gas royalty underpayment, executive compensation, outside general counsel representation, mergers and acquisitions, complex business arbitration, commercial litigation, and international trade compliance.

Traci Clements represents clients in a range of general employment matters, with a specific focus on employee benefits and compliance issues related to the Employee Retirement Income Security Act (ERISA). She has previously worked in HR and served as in-house counsel, including General Counsel to a publicly traded company. Managing Partner Doug Dodds remarked, "With her combination of business and legal acumen, Traci will provide our clients with the counsel and solutions they'll need in the dynamic business environment ahead."

Daniel Clemons focuses his practice on outside general counsel representation, mergers and acquisitions, debt and equity financing, and other commercial transactions. Before joining McGinnis Lochridge, Dan served in legal roles as outside counsel, in-house counsel and head of legal operations, and as a revenue analyst. "Dan's experience and background will make him a valuable resource for our clients," said Ed McHorse, head of McGinnis Lochridge's Corporate and Tax Practice Group.

McLean Bell is a member of the firm's General Litigation practice group. He practices in a wide variety of industries and has experience representing both individuals and entities. His matters span from complex business arbitration to oil and gas royalty underpayment. McLean's command of the court room landed him on numerous Mock

Trial and Moot Court teams at Baylor Law, where he earned his JD and graduated cum laude.

Ian Davis practices General Litigation. He has experience in a variety of areas, including commercial litigation in state and federal courts; state and federal administrative and regulatory compliance (data security and privacy, public utilities, healthcare, and consumer finance); contested hearings before the State Office of Administrative Hearings; international trade compliance (EAR, FTR, and ITAR); and business and partnership disputes.

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Court Examines Evidence of Damages in Nuisance Action Against Midstream Company

Enter. Crude GP LLC v. Sealy Partners, LLC, 2020 Tex. App. LEXIS 8868, 2020 WL 6741546 (Tex. App.––Houston [14th Dist.] Nov. 17, 2020, no pet.).

By: Ian Davis

In this case, the Fourteenth Court of Appeals in Houston found that a property developer had sufficiently plead the prima facie elements of a nuisance claim against a crude oil marketing company that had erected above-ground crude tanks on its adjacent property. Most importantly, with respect to the damages element, the court found that the developer had satisfied its evidentiary burden to defeat a TCPA motion to dismiss when it offered two affidavits (submitted by its real estate broker and financing broker) stating that the Defendant's nuisance had impacted the potential to develop every portion of the developer's land.

Plaintiff owned a tract of land adjacent to Defendant. Plaintiff had a plan to construct a mixed use development on its property. Defendant had previously represented to Plaintiff that it would not construct crude tanks on its property until it had investigated the extent of the blast zone that would result from the crude tanks, and communicated its findings to Plaintiff. Subsequently, Defendant constructed the crude tanks without consulting Plaintiff. Among other causes of action, Plaintiff sued Defendant for nuisance, alleging that the blast zone created by the crude tanks rendered Plaintiff unable to develop its property as planned.

Defendant filed a motion to dismiss under the Texas Citizens Participation Act (TCPA). The trial court denied Defendant's motion, and Defendants appealed.

The appellate court began its opinion by evaluating whether the TCPA applied to Defendant's motion to dismiss. It concluded Defendant had shown, by preponderant evidence, that Plaintiff's action related to Defendants' exercise of the right of association. Specifically, the court pointed to the fact that, as a prerequisite to constructing the crude tanks, Defendant had applied for and received permits from the municipality. Next, the court asked whether Plaintiff had sufficiently plead the prima facie elements of nuisance. Whether a defendant may be held liable for causing a nuisance depends on: (i) the culpability of the defendant's conduct; (ii) whether the interference is a nuisance; and (iii) whether the interference caused loss or damage.

As to the first element, the court concluded that Plaintiff had sufficiently pleaded negligent culpability, but had failed to present any evidence that Defendant had intentionally created the nuisance.

As to the second element, the court held that Plaintiff had sufficiently plead the existence of a nuisance by and through Defendant's construction of the crude tanks. It cited the following factors supporting its conclusion: (i) Plaintiff's planned development constituted a social utility that would benefit the community; (ii) Defendant's prior knowledge of Plaintiff's planned devel-

opment; (iii) the reasonable likelihood that the blast zone necessitated by the crude tanks would interfere with Plaintiff's intended development; and (iv) the magnitude of that interference.

As to the third element, damages, the court held that Plaintiff had presented "clear and specific evidence that the market value of [its] land was reduced substantially as a result of" Defendant's alleged nuisance. Specifically, the court found that Plaintiff's two affidavits (submitted by its real estate broker and financing broker) presented "clear and specific evidence that no portion of [Plaintiff's] parcel is capable of being built upon without being affected by the impact zones of the [Defendant's] tanks." Defendant argued that the two affidavits alone were insufficient to defeat its motion to dismiss, and that Plaintiff should be required to submit evidence of its applications for development financing, or relevant correspondence with potential financers. The court rejected Defendant's argument, noting that "the quantum of evidence required is no more than that which is necessary to support a rational inference that the allegation of fact is true." As a result, the court held that Plaintiff had met its burden "by providing some clear and specific evidence that it cannot develop its property as planned due to an inability to obtain any economically feasible financing, and a resulting loss in market value and future lost rents."

Having found that the Plaintiff sufficiently plead the prima facie elements of a nuisance claim, the court held that the district court did not err in denying Defendant's TCPA motion to dismiss.

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Court Examines Evidence of "Good and Workmanlike Manner" in Well Blowout Case

BEPCO v. RMTDC Operations, LLC, No. 11-18-00118-CV, 2020 Tex. App. LEXIS 5676, 2020 WL 4218776 (Tex. App.—Eastland, July, 23, 2020, no pet.)

By: Austin W. Brister

In this case, the Eastland Court of Appeals held that there was sufficient evidence to support a jury verdict that a drilling consultant and "company man" met their contractual duty to "perform all work with due diligence and in a good and workmanlike manner," even though the company man was not present during drilling operations when a pipe was allegedly improperly connected, leading to a casing collapse, and ultimately, $3,500,000 in damages.

BEPCO, LP hired Total Energy Services ("Total") to provide drilling consultation services for the drilling of a well in Eddy County, New Mexico. The parties entered into a Master Service Agreement ("MSA"), which required Total to "perform all work with due diligence and in a good and workmanlike manner satisfactory and acceptable to [BEPCO]." BEPCO chose one of Total's consultants, Mr. Valencia, to serve as the "company man." Neither the MSA nor BEPCO's written drilling prognosis provided any instructions as to which operations Mr. Valencia was required to personally supervise.

After BEPCO's drilling contractor cemented the well, the drilling contractor moved on to the washout procedure. Mr. Valencia was meeting with representatives from the Bureau of Land Management (BLM), and was not present during the washout procedure. BEPCO's drilling contractor performed a "bottoms up" washout procedure. During the washout procedure, a hydraulic collapse occurred, followed by a mechanical collapse, effectively blocking the well, causing $3.5 Million in alleged damages and causing BEPCO to abandon the well.

BEPCO filed suit, claiming that the cause of the collapse was a high-pressure hose that was not properly connected to the correct valve. BEPCO claimed that Valencia should have been present during the washout and that, because he was not, he was not able to confirm that the hose was properly connected. BEPCO argued that, by failing to supervise the washout procedure and failing to confirm that the high-pressure hose was connected to the correct valve, Mr. Valencia failed to perform his duties with due diligence and in a good and workmanlike manner.

The case proceeded to a five-day jury trial. The trial involved an array of competing witness testimony, and a battle of experts. The jury found

that Total did not breach the MSA, and the trial court rendered a take-nothing judgment against BEPCO. BEPCO appealed on grounds that the evidence was legally and factually insufficient to support the verdict regarding breach of the MSA. This appeal followed.

The appellate court noted that, to challenge the legal sufficiency, BEPCO must demonstrate that there is no evidence to support the jury's decision and that the evidence establishes, as a matter of law, all vital facts in support of the Appellant. To challenge the factual sufficiency, BEPCO must demonstrate that the finding is so contrary to the great weight and preponderance of the evidence that it is clearly wrong and unjust.

The court reviewed BEPCO's claim that the cause of the collapse was an improperly connected hose. The appellate court pointed out that BEPCO did not present any direct evidence that the high-pressure hose was improperly connected, and that BEPCO's expert admitted that his "theory" would be wrong if the hose was properly connected. Instead, BEPCO relied upon its expert witness who opined that pressure data recorded during the washout ("Pason data") reached an "unusual" level and that his calculations suggested that "collapse pressures" could have been exceeded in a particular 0.52-second interval between existing data measurements. However, the court surveyed an array of competing evidence the jury could have relied upon. For instance, Total's expert attacked this theory as being based upon "unreasonable" assumptions and "unreliable" calculations that he had never before seen. BEPCO's expert admitted that he made a number of assumptions and that he had never seen anyone perform a similar calculation to show pressures that were not actually recorded. BEPCO's expert also admitted that the recorded pressures did not actually exceed the pipe's rated "collapse pressure" and that defective piping could have caused the collapse. However, the pipe was not tested for defects.

The court then turned to the issue of whether Mr. Valencia should have personally supervised the washout. BEPCO argued that Mr. Valencia himself conclusively admitted at trial that he should have supervised the washout operation if a bottoms-up procedure was used. The court rejected BEPCO's argument, questioning whether there was any evidence that Valencia had the authority to make an admission on behalf of Total.

The court further explained that this issue was "hotly contested" at trial. The court reviewed a range of competing testimony on this issue from six different witnesses. On one hand, there was testimony that a "bottoms up" procedure was "standard" for BEPCO and that BEPCO "always had [] used the bottoms-up washout procedure." On the other hand, there was testimony that a "bottoms up" procedure was "less common," that it would have been the "wrong way" to do it, and that such procedure was "unforeseeable" and "unexpected" in these circumstances. There was further testimony that Valencia's job duties included meeting with a BLM representative, and by doing so, Valencia was "doing his job" during the washout, that Valencia was not required to supervise the washout procedure, that other washout procedures were not supervised by the company man, and that a bottoms-up washout procedure does not require any more supervision than a top-down procedure.

The court concluded that it was the jury's role to determine the credibility of witnesses and the weight to give their testimony. The court also held that it is the jury's role to resolve conflicts in the evidence. The court held that, after examining the evidence, there was sufficient evidence to support the jury's determination that Valencia did not breach the MSA. The court affirmed the trial court.

This case serves as a reminder of the complexity of cases involving the reasonable prudent operator standard or similar standards such as "good and workmanlike." As our readers will recall, it is not uncommon for operating agreements in the oil and gas industry to adopt the reasonable prudent operator standard, or to adopt a similar standard like a "good and workmanlike" standard. As the appellate court in this case noted, though this is a breach of contract case, the incorporation of a "good and workmanlike" standard can cause the action to sound like a negligence case. These cases often turn to a battle of witnesses and a battle of experts. These cases can be complex and can involve a vast array of technical evidence. Careful planning and strategy are critical to the effective presentation of these cases.

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County Without Jurisdiction to Tax Minerals in Adjacent County, Despite Cross-County Pooling

San Augustine Cty. Appraisal Dist. v. Chambers, No. 12-20-00128-CV, 2021 Tex. App. LEXIS 478 (Tex. App.—Tyler Jan. 21, 2021, pet. filed)

By: Austin W. Brister

If a lessee pools a mineral owner's interests with lands in an adjacent county, does that mean the adjacent county now has authority to assess production taxes on that mineral owner? That question was recently answered by the Tyler Court of Appeals.

Chambers and several other mineral owners own interest in Shelby County, Texas, and entered into oil and gas leases. Those leases were pooled to form gas units that included lands owned by third parties located in the adjacent San Augustine County. San Augustine County Appraisal District (SCAD) assessed taxes on Chambers' interests, and Chambers sought judicial review.

The Chambers group argued that their interests were properly taxed only in Shelby County, and not in San Augustine County. SCAD disagreed, arguing that pooling resulted in a cross-conveyance of interests. Back in 2017, the dispute made its first trip to the Tyler Court of Appeals in *Chambers v. San Augustine Cty. Appraisal Dist.,* 514 S.W.3d 420, 425 (Tex. App.—Tyler 2017, no pet.). In that first opinion, the appellate court held that SCAD did not conclusively prove cross-conveyance given that the lease prohibited cross-conveyance. The matter was remanded for further proceedings.

After remand, SCAD contended that by signing division orders and accepting royalties, the Chambers group ratified the unit designations or were estopped to deny ratification of the unit designations, that the unit designations themselves worked a cross-conveyance, and therefore the Chambers group waived any right to protest the cross-conveyance language in their leases.

The Tyler Court of Appeals disagreed, reasoning with SCAD, affirming the trial court's judgment in favor of the Chambers group.

The court reasoned that, though there is a presumed intention for pooling to cross-convey interests, pooling itself does not require a cross-conveyance. Because the leases expressly prohibited cross conveyance, there was no cross conveyance in this case despite the pooling. Therefore, the Chambers group does not own any interests in minerals in SCAD, and SCAD has no taxing authority over the Chambers group's Shelby County interests.

The court rejected SCAD's ratification, waver, and estoppel arguments. The court explained that, even though signing a division order and accepting payments can ratify unitization, that was not dispositive because unitization alone does not entitle SCAD to tax Shelby County interests. Instead, the dispositive question was whether there was a cross-conveyance, which depends on the lease language, not unitization.

The court further explained that division orders do not modify leases, convey royalties, nor transfer title. Even if signing division orders and accepting payments were to ratify unitization, that does not act as a ratification of cross-conveyancing.

Finally, the court rejected SCAD's estoppel defense, explaining that because unitization can exist without a cross-conveyance, the Chambers group's acceptance of the benefits of unitization was not inconsistent with the lease language prohibiting cross-conveyancing.

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Accommodation Doctrine Decides Surface Use Dispute Between Solar Facility and Mineral Owner

Lyle v. Midway Solar, LLC, No. 08-19-00216-CV, 2020 Tex. App. LEXIS 10385, 2020 WL 7769632 (Tex. App.—El Paso, Dec. 30, 2020, no pet. h.).

By: Michael Szymanski

In this dispute involving competing uses of the surface between a mineral owner and a large-scale solar company, the El Paso Court of Appeals found that the Accommodation Doctrine would apply to balance the parties' competing uses of the surface. However, the court held that, at least at this time, the solar company was uninhibited by the mineral owner's claims because the mineral owner was not actively seeking to develop their minerals, thus there was no competing use for the solar operator to accommodate.

Midway Solar obtained leases from the surface owners to operate a large-scale solar facility. The surface leases contained a provision which purported to designate certain tracts as "drill site tracts" for the benefit of any present or future mineral development. The Lyles own an undivided mineral interest covering a 315-acre tract of land in Pecos County. Approximately 70% of that 315-acre tract is covered by Midway's solar lease and planned solar development. The Lyles' interest is derived from a 1948 Deed which severed the minerals from the surface.

Lyle filed suit alleging that Midway Solar breached the 1948 Deed by denying the Lyles a reasonable opportunity to develop their minerals and alleging that Midway Solar was trespassing on the Lyles' mineral estate. The trial court ruled in favor of Midway on both counts.

On appeal, the Lyles argued that they could not be obligated to accommodate the solar company under the accommodation doctrine because the express terms of the 1948 Deed already defined the parties' respective rights. The Lyles pointed to a phrase in the 1948 Deed reserving to the Lyles' predecessor the right to use the surface "as may be usual, necessary or convenient." The Lyles claimed that the word "usual" indicated that the parties intended to allow only those drilling methods that were "usual" in 1948, i.e. vertical drilling. As such, the Lyles argued that the 1948 Deed gives the Lyles the right to use vertical drilling and it would be improper to apply the accommodation doctrine which may alter or limit that defined right.

The court rejected that argument and instead held that the 1948 Deed's use of the term "usual" was in a more general sense, permitting the mineral owner the right to use the surface in the "usual" manner to enjoy the mineral estate. The court explained that there is no way to know precisely what the parties meant by the word "usual," and if the parties had intended for a particular drilling method to be utilized, the parties could have simply said so.

The Lyles also pointed to another provision in the 1948 Deed which the Lyles claimed eliminated the mineral owner's liability for damages to the surface estate. The Lyles argued that provision also negated any basis for accommodating competing surface uses. However, the court explained that the clause only relieves liability for exercising "the rights and privileges hereinabove reserved," and therefore it does not actually define the limits of

those rights and privileges. As such, the court held that the 1948 Deed did not preclude application of the accommodation doctrine.

The court then turned to Midway's claim that the Lyles must be currently using or planning to use the surface for mineral development in order to maintain the claims Lyle asserted. The Lyles disagreed, arguing that Midway was essentially blocking all reasonable methods of using the surface to develop the minerals. The Lyles likened their situation to that of *Tarrant County Water Control & Improvement Dist. No. One v. Haupt, Inc.,* 854 S.W.2d 909, 911 (Tex. 1993). In *Haupt*, a water district permanently flooded all but 12 acres out of the mineral owner's 80-acre tract resulting in the mineral owner bringing an inverse condemnation claim. While the flooding was a reasonable use of the surface by the water district, there was insufficient evidence to support any reasonable alternative means of developing the minerals. As a result, the flooding constituted a taking. The Lyles argued that the *Haupt* case stands for the rule that an impediment on the surface that blocks mineral development is sufficient to justify a claim for damages.

The court rejected that argument, pointing out that the *Haupt* holding was largely based upon the fact that the mineral owner in that case was actively seeking to develop its minerals. Here, the Lyles conceded that they had no current plans to develop their minerals. Instead, the court likened the Lyles situation to *Lightning Oil Co. v. Anadarko E&P Onshore, LLC,* 520 S.W.3d 39, 45 (Tex. 2017). In *Lightning*, the Texas Supreme Court held that a mineral owner does not have the right to prevent a party from using the surface in a manner that *may later* interfere with the mineral owners' development plans, because such a right would render the mineral estate absolutely dominant and would interfere with the balance achieved by the accommodation doctrine.

Here, the court noted that the Lyles conceded that they had no active plans to develop their minerals, and there was no evidence that they had sought to market a lease, commission any geological studies, or enter into any drilling contracts. The *Lyle* Court concluded that until the Lyles seek to develop their minerals, there is nothing for Midway to accommodate. As such, Midway has not encroached on the Lyles' implied surface rights unless and until the Lyles actually seek to exercise their rights to use the surface. Having decided that there is no controversy over conflicting uses of the surface, the court held that the trial court should have dismissed the claims without prejudice.

This case serves as a reminder that disputes between oil and gas and alternative energy are on their way. As the *Lyle* court stated in the opening line of this opinion, "Texas is a leader in energy. Undeniably, Texas produces the nation's largest share of oil and gas. At the same time, its public policy favors adding renewable energy sources into the State's energy portfolio."

About the Author

Michael Szymanski *is an associate in our Houston office and a member of the Oil and Gas Practice Group. Prior to joining the Firm, Michael worked as a geophysicist for over three years for a major seismic reprocessing company. Later, while attending law school, Michael worked full-time in the Land Department of an oil and gas company as a Lease Analyst, processing and monitoring more than $15 million of annual company drilling projects in the company's South Texas and Wyoming assets.*

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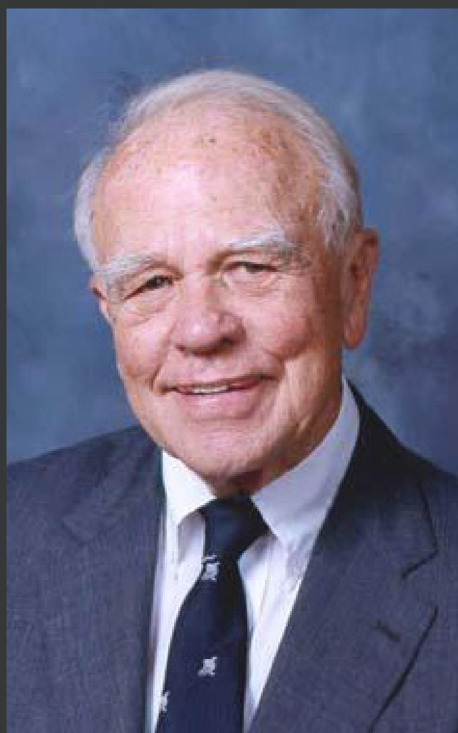
McGinnis Lochridge Mourns the Passing of Namesake Partner, Lloyd Lochridge



We are deeply saddened by the loss of our beloved friend, partner, and Firm namesake, Lloyd P. Lochridge, Jr. As any of his colleagues will attest, Mr. Lochridge was a true leader with a heart of service, and passion for his career. Mr. Lochridge leaves behind a significant legacy of leadership, dedication, professionalism, and service.

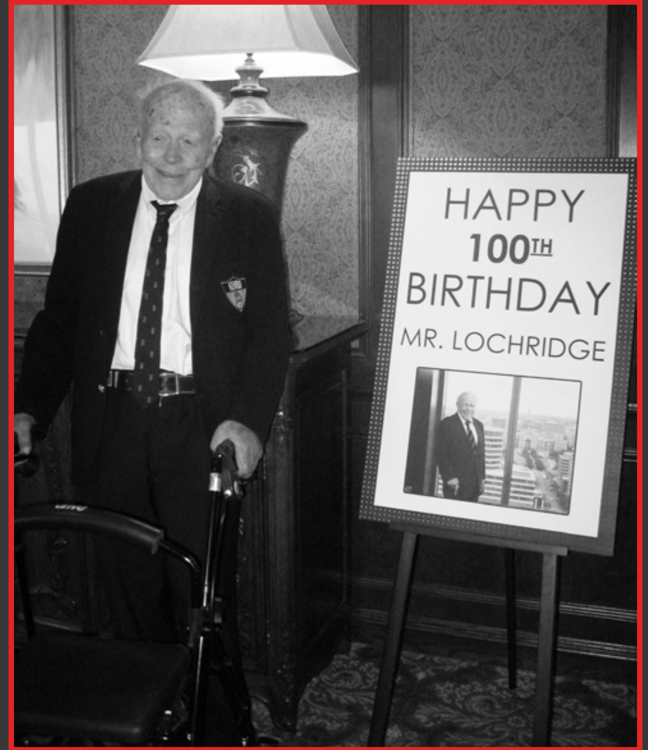
Born in 1918, Mr. Lochridge graduated with honors from Princeton and earned his J.D. in 1941 from Harvard Law School. After graduation, he served in the navy during World War II, ultimately leaving active duty as a Lieutenant Commander and beginning his career in law.

At our firm, Mr. Lochridge was a friend and mentor to many. He was an outstanding role model, and a shining example of professionalism and advocacy for clients. In May of 2017, Mr. Lochridge and his late son, Patton "Pat" Lochridge were both inducted as Texas Legal Legends by the State Bar of Texas Litigation Section. Even after his 100th birthday, when most people would have long since retired, Mr. Lochridge could be found in the office most weekdays, dressed neatly in a suit and tie, working on his tasks for the day.

Mr. Lochridge left a great impact on our firm and the legal industry as a whole. Mr. Lochridge served as President of the State Bar of Texas, served on numerous bar committees, and was a Life Fellow of the Texas Bar Foundation. Mr. Lochridge was also an active leader in the American Bar Association, and a member of the executive council of the National Conference of Bar Presidents.

Mr. Lochridge was a voracious advocate for pro bono work, both by devoting hundreds of hours per year to pro bono clients, and by encouraging service by other attorneys at McGinnis Lochridge. For years, he coordinated the firm's involvement in Volunteer Legal Services in Austin. In addition to his pro bono work, Mr. Lochridge served the community through numerous local organizations and charities, including the Austin Opera, Symphony Board, Salvation Army, Boy Scouts of America, Austin Community Foundation, English Speaking Union, American Inns of Court, and the Church of the Good Shepherd.

Mr. Lochridge and his late wife Frances, the love of his life, were blessed with six children, and many grandchildren and great grandchildren. The passing of Mr. Lochridge marks the end of an era, not only for McGinnis Lochridge, but for the Texas Bar as a whole. We mourn with Mr. Lochridge's family as we celebrate the life of their beloved father, grandfather, and great grandfather.

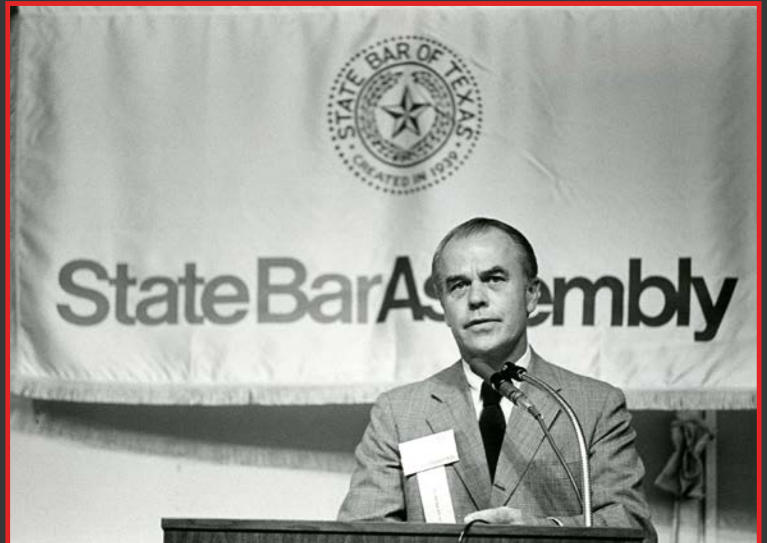


Austin American-Statesman

NEWSMAKERS

Matt Rourke AMERICAN-STATESMAN

Lloyd Lochridge, left, and J. Chrys Dougherty have been challenging each other on the squash court for decades. They played again Tuesday, Chrys' 90th birthday. Lloyd is 87.



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Joint Operating Agreements and the Reasonably Prudent Operator Standard

By: Jonathan Baughman

Background on JOA Forms

The reasonably prudent operator standard is not only applicable to the lessor/lessee relationship. It also applies, for instance, to the operator/non-operator relationship. In that context, joint operating agreement forms typically provide an express provision indicating the standard by which the operator is expected to perform. Modern operating agreements typically will expressly include within that standard some reference to the "reasonably prudent operator standard."

The most commonly used JOA form for on-shore US assets in Texas is the "Model Form 610," published by the American Association of Professional Landmen ("AAPL"). Over the last several decades there have been multiple revisions of the Form 610, including material differences in the provisions defining the Operator's standard of performance and the exculpatory provision. While the first version of the Form dates back to 1956, this article will briefly touch on the standards set forth in the 1982, 1989, and 2015 AAPL Forms.

Evolution of JOA Standards from "Good and Workmanlike Manner" to "Reasonably Prudent Operator"

The 1982 version of the AAPL JOA form stated that the Operator "shall conduct all such operations in a good and workmanlike manner." Courts have generally construed that standard to be similar to the "reasonably prudent operator" standard. The 1989 version of AAPL's JOA form was amended to actually incorporate the phrase "reasonably prudent operator" within its provision. When the AAPL most recently updated the Model Form 610 JOA in 2015, they maintained the "reasonably prudent operator" standard within the form.

Exculpatory Provisions in Joint Operating Agreements

One of the most hotly contested aspects of the operating agreement has been the scope of the exculpatory provision. Generally speaking, an exculpatory clause functions by relieving the operator of liability in the event damages are caused by the operator during its performance unless the operator was "grossly negligent" or engaged in "willful misconduct." In other words, while the JOA form provides that an operator must act as a "reasonably prudent operator," the exculpatory provision relieves the operator of liability for certain types of operations or activities. Again, however, that limitation on liability will not apply if the liability results from the operator's "gross negligence" of "willful misconduct."

A number of courts have addressed how far model form exculpatory claus-

es sometimes extend. These decisions vary and in some cases demonstrate two different scopes that have been applied to exculpatory clauses. For instance, one of the earlier cases discussing this standard was in the Fifth Circuit's decision in *Stine v. Marathon Oil Co.,* 976 F.2d 254, 257 (5th Cir. 1992). In this case, the Court extended the exculpatory clause to all of the operator's actions including breaches of contract for administrative and accounting duties.

A number of other courts in and outside of Texas have directly or indirectly rejected the Fifth Circuit's interpretation of the exculpatory clause in Stine. For instance, in *Abraxas Petroleum Corp. v. Hornberg,* 20 S.W.3d 741 (Tex. App.—El Paso 2000, no pet.), the court limited the reach of the exculpatory clause to the operator's operations on the contract area.

One explanation might be that the courts are implicitly concerned about granting an operator such wide latitude on matters where the operator and the non-operators interests are not aligned. This was the rationale given by the Tenth Circuit in *Shell Rocky Mountain Production v. Ultra Resources, Inc.,* 415 F.3d 1158 (10th Cir. 2005), when the court stated that "while a higher standard for breach might apply to drilling… and other risky operations because most operators have the same incentive as non-operators to do well in operations, it is nonsensical to apply such a standard to administrative and accounting duties where the operator can profit by cheating, or simply overcharging, its working interest owners."

AAPL's various versions of the JOA differ in the scope of the exculpatory clause. Several lawsuits have been fought over the meaning of those differences.

The 1982 JOA form contains an exculpatory provision that applies to "operations on the contract area," while the 1989 JOA form applies to all "activities under this Agreement."

Back in the late 1980's and early 1990's, some commentators suggested that this difference in language significantly broadened the scope of the protection afforded by the 1989 JOA Form exculpatory clause. That interpretation was ultimately confirmed by the Texas Supreme Court in the *Reeder v. Wood County* case, where the Court held that, among other things, the phrase "activities under this Agreement" served to relieve the operator from liability for all activities, not merely operations, and activities outside of the contract area, not merely those that were performed within the contract area. For practical purposes, several commentators have interpreted that as meaning that the exculpatory provision under the 1989 JOA Form could theoretically relieve an operator from liability for certain accounting obligations and for certain breach of contract actions. A thorough review of these cases and potential analyses could very easily span an entire paper, and would be outside the scope of this short article.

Many industry participants believed that the interpretation set forth in *Reeder v. Wood County* case was inconsistent with the industries' intentions. As such, when the AAPL formed a task force to update the Model Form 610, one of the changes implemented was a clarification of the exculpatory provision, with the intention of making clear that it applies only to operations, and not to a breach of the operating agreement itself.

As suggested above, even if an exculpatory provision applies to a given category of conduct, the Operator may still be held liable if the damages result from "gross negligence" or "willful misconduct." These are difficult standards to prove. To prove gross negligence, the plaintiff must show the defendant had "actual subjective knowledge of an extreme risk of serious harm." *IP Petroleum Co. v. Wevanco Energy, LLC, 116 S.W.3d 888, 897 (Tex. App.—Houston [1st Dist.] 2003, pet. denied)* The magnitude of the risk is judged from the viewpoint of the defendant at the time the events occurred. "The harm anticipated must be extraordinary harm, not the type of harm ordinarily associated with breaches of contract or even with bad faith denials of contract rights; harm such as 'death, grievous physical injury, or financial ruin.'" As for willful misconduct, Texas courts have applied a standard akin to gross negligence. A finding of willful misconduct requires evidence of "a specific intent by [the operator] to cause substantial injury to [the nonoperators]."

Conclusion

The "reasonably prudent operator standard" has become a critical component of Texas oil and gas law, applying in many scenarios and relationships. As discussed in the last edition of *Producer's Edge*, it forms a foundational component of the implied covenants in oil and gas leases, and is often directly or indirectly incorporated into a variety of express provisions. In addition, the standard is also incorporated in many joint operating agreement forms, including the Model Form 610 JOA, published by the AAPL.

About the Author

Jonathan Baughman *serves as Partner-in-Charge of the Firm's Houston office and chairs the Oil & Gas Practice Group. He was elected to a three-year term on the Council for the Oil, Gas and Energy Resources Law Section of the State Bar of Texas and serves as secretary, and is one of 25 distinguished Advisory Board Members for the Louisiana Mineral Law Institute. Jonathan is an elected member of the Firm's Management Committee since 2009.*

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Discovery Tools Held to Allow the Drilling of 6 Test Wells in Surface Use Dispute

In re Plains Pipeline, L.P., No. 08-19-00224-CV, 2020 Tex. App. LEXIS 8546 (Tex. App.—El Paso Oct. 30, 2020, no pet.)

By: Austin W. Brister

In several prior articles in *Producer's Edge*, we have explored surface use disputes, including disputes regarding competing uses of the surface between the owners of the surface estate, water estate, and mineral estate. In these cases, it can often be challenging to prove up the nature, extent, and value of what lies beneath the surface. It can also be difficult to prove what is or is not a reasonable accommodation under the "accommodation doctrine." A recent case reflects a novel approach of using discovery tools to actually drill test wells to gather that evidence.

The Underlying Dispute

In this case, a water company and an oil company disputed which party owned the dominant right to drill for water resources below the surface in Winkler County, Texas.

The oil company, Plains, asserted that it owned the dominant rights to the groundwater pursuant to a 1928 surface lease. Pursuant to that lease, Plains had maintained an oil tank farm, high-pressure pipelines, and other equipment on the land. Plains argued that its rights were dominant, and that any rights owned by the groundwater company were subordinate to Plains' earlier rights.

The water company, Winkler, claimed that the groundwater rights were severed from the surface, and that Winkler obtained the dominant rights to the severed groundwater by virtue of a groundwater lease.

Winkler filed suit seeking a declaratory judgment that Winkler owned the dominant rights to the groundwater estate, Winkler had the right to use the surface for that development, and that there were no reasonable alternative means for Winkler to develop the groundwater estate. Winkler also claimed that Plains' use of the surface ousted Winkler from the surface and prevented groundwater development.

The Disputed Discovery

Winkler filed a motion for pre-trial inspection of the property pursuant to Tex.R.Civ.P. 196.7. Winkler initially sought to drill 11 test holes, to complete two of the wells, and to place a grid of electrical probes across the entire 160-acre tract for two weeks.

Plains objected. At an evidentiary hearing, Plains argued that the burden outweighed any evidentiary benefit. Plains argued that the proposed discovery presented too significant a burden and risk given the proximity to active operations, presence of active and abandoned underground high pressure lines and high voltage lines, and potential security issues. The trial court initially denied Winkler's request.

Winkler then deposed Plains' expert witness and filed a motion to reconsider. Winkler claimed that, based on new information obtained in that deposition, Winkler could amend its requests to avoid interfering with Plains. Winkler reduced its request to seven wells, moved the test holes to areas where Plains had no current operations, and dropped its request to complete the wells. Winkler also dropped its request to place a grid of probes across the entire surface.

The trial court held another evidentiary hearing. Winkler presented a hydrogeologist who testified that the aquifer varies significantly from place to place as to the type of underlying sediment, which greatly impacts the amount of groundwater and means to recover. He testified that there was a lack of information in the area, and that he needed additional data from test holes in order to recommend where to place production wells.

On the other hand, Plains called a bio-geo-chemist who testified that

the aquifer is essentially a linear trough, and that the test wells could be moved 100 feet and still give a valid assessment. However, on cross-examination, he admitted that an earlier government study stated that sediment in the area was not continuous. He also admitted that more information would help determine where to place the wells.

The trial court reversed course and granted Winklers request to inspect the property. Plains filed a writ of mandamus, arguing that the discovery order was improper because (1) it is not relevant to the issue of who holds superior title to the groundwater, and (2) it did not properly balance the competing interests.

Relevance Issue

Winkler argued that the discovery was relevant because, if Winkler holds title to the groundwater, then Plains must accommodate Winkler's interests, and the test holes would allow the trial court to formulate an accommodation plan. Winkler also argued that the information would be relevant to the damages portion of Winkler's claim.

Plains argued that the case revolves around the issue of title, and that Winkler's discovery is not relevant to that issue.

The appellate court rejected Plains' argument, noting that the trial court was not required to resolve the title issue prior to resolving a discovery dispute. The court noted that neither side filed a summary judgment motion regarding the title issue, and neither side moved to proceed with a separate trial on the title issue. The court held that the discovery sought was relevant to the pleaded allegations, and "[j]ust because the title issue might be the predominant dispute between the parties, Winkler was not relieved of its burden to prepare other facets of its case for a final hearing."

Would the Discovery Grant Winkler's Ultimate Relief

Plains also argued that the discovery sought would grant Winkler the ultimate relief Winkler sought in the lawsuit. The court acknowledged that a party should not be able to gain their ultimate relief through a discovery order. However, the court said that is not the case here, because Winkler's ultimate objective is not to gain access and drill test holes, but rather to drill and develop a water well.

Balancing the Equities

The court acknowledged that an inspection order is appropriate only where (1) discovery cannot be obtained from a more convenient, less burdensome, or less expensive source, or (2) the burden of the proposed discovery outweighs its likely benefits.

The court indicated that the evidence supported the argument that the critical test holes are in the center of the property, and that there was evidence that Winkler could not present an accommodation plan without mapping the strata with on-site test holes. While some data already existed regarding how much groundwater exists under the property, "Winkler is not compelled to accept its current estimate… if additional data will reasonably provide it a more accurate estimate."

Plains argued that the test holes would disrupt its on-going business operations, and potentially the flow of that oil, while it would only provide marginally relevant evidence. However, the court explained that these are factual dispute that the trial court could have fairly weighed in favor of Winkler.

Winkler's hydrogeologist testified that the holes could be drilled and plugged in under three days. Winkler also called a driller, who testified that he could use "811 dig test" to locate existing utilities and that he could use a high pressure water stream to drill the hole in order to avoid striking an underground obstruction with a drill bit.

The court also pointed to evidence that Plains already has 140-180 contractor employees on the premises most days, and several operating heavy equipment, yet there had only been a handful of accidents over several years.

Ultimately, the court held that trial courts are granted discretion to resolve factual issues, and a relator must establish that the trial court could reasonably have reached only one decision. Here, the trial court fleshed out these factual issues in two lengthy hearings, and the appellate court found no reason to disturb the trial court's order.

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Court Holds "Property Owner Rule" was Inapplicable to Valuation of Mineral Reserves

Jatex Oil & Gas Expl. L.P. v. Nadel & Gussman Permian, L.L.C., No. 11-17-00265-CV, 2020 Tex. App. LEXIS 6689, 2020 WL 4873836 (Tex. App.—Eastland, Aug. 20, 2020, no pet.)

By: Austin Brister and Michael Szymanski

This case held that the Property Owner Rule generally does not extend to the valuation of mineral reserves because such a valuation is based on matters of a technical or specialized nature. As such, valuation of mineral reserves generally requires expert testimony under Rule 702 of the Texas Rules of Evidence.

Jatex was a non-operator, and Nadel & Gussman Permian (NGP) was an operator. The parties were subject to a joint operating agreement. Jatex alleged that NPG improperly included Jatex in a deepening project and NPG erroneously assessed charges to Jatex's account for the project. Jatex argued that this was improper because Jatex had not made a written election to participate in the project. Jatex alleged that those erroneous charges caused a bank to foreclose on Jatex's mineral leasehold interests, which the bank purchased at the foreclosure sale for $1,500,000.

Jatex filed suit against NGP, claiming that NPG breached the parties' joint operating agreement by failing to act as a reasonably prudent operator. Jatex filed a motion for summary judgment and attached a declaration signed by its owner, John A. Truitt, attesting that he believed the properties foreclosed upon were worth closer to $12,000,000. The trial court denied Jatex's motion, excluded Mr. Truitt's declaration, and granted NPG's cross-motion for summary judgment. This appeal followed.

On appeal, Jatex asserted that Mr. Truitt's opinions regarding the value of the mineral estate is admissible under the "Property Owner Rule." The court explained that, under the Property Owner Rule, a property owner is generally qualified to testify as to the value of his property even if he is not an expert and would not otherwise be qualified to testify to the value of other property. The rule is based on the presumption that an owner will be familiar with his own property and know its value. Entities can prove the value of their property through officers or employees.

However, the court held that the Property Owner Rule does not extend to matters that are of a technical or specialized nature. For instance, one prior case held that valuation of mineral reserves constitutes expert opinion evidence because it requires a "technical specialized nature of ... valuation," that "is based on special knowledge, skill, experience, training, or education in a particular subject." The court pointed to the technical nature of Mr. Truitt's opinion on valuation, including his self-proclaimed "expertise," which the court noted was an indication that Mr. Truitt was giving

expert opinion evidence. The court also noted that Mr. Truitt criticized the valuations performed by NPG's expert and by the bank's expert and cited to technical publications for a variety of technical acronyms included in his valuation, further indicating the valuation's technical nature..

Because Mr. Truitt's opinions constituted expert testimony, the court held that the opinions should have been disclosed in discovery. To the contrary, prior to the motions for summary judgment Jatex actually "undesignated" Mr. Truitt as an expert in valuation, and during his deposition Mr. Truitt testified that he had not performed a valuation of the mineral interests.

The court also held that Mr. Truitt's testimony failed to provide a sufficient description of his analysis that he used so that the court can determine if his conclusions are reliable. For instance, Truitt's opinion was devoid of supporting data for his calculations, and his entire opinion was set out in just two pages that were largely filled by just two charts. As a result, the court held that there was too great of an analytical gap in Mr. Truitt's valuation for his conclusions to be assessed for their reliability. Accordingly, the court held that his opinion testimony was conclusory and that the trial court did not abuse its discretion by striking Truitt's valuation from summary judgment evidence.

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Court Interprets ORRI Assignment to Exclude Producing Intervals

Jones Energy, Inc. v. Pima Oil & Gas, L.L.C., 601 S.W.3d 400 (Tex. App.—Amarillo 2020, no pet.)

By: McLean Bell

In *Jones Energy*, the Amarillo Court of Appeals considered whether an overriding royalty interest assignment excluded royalty payment for existing wells or existing producing intervals. Pima, the successor to the assignee, alleged that it was owed unpaid royalty on a horizontal well drilled after the parties executed the Assignment, because the well was not subject to the Assignment's exception. The relevant part of the Assignment stated:

> The assigned ORRI shall extend to and burden the interest of Assignor, its successors and assigns, in 1) the Wright 117 unit well(s) producing on the lands described above at the time of acquisition by the Assignor, *save and except in the intervals of the formation(s) open to production in, and only in, the wellbore of the aforementioned well(s)* and 2) any additional leases or interests in leases acquired by Assignor.

Pima sought royalty payment for a well producing from the Granite Walsh, which is the same formation that was being produced at the time of the Assignment. Thus, Pima argued that the exclusion only applied to then existing wellbores. Conversely, Jones argued that the Assignment's reference to wellbores was merely the means by which the excluded producing intervals were identified.

The Court ultimately turned to a Retainer Agreement to aid its interpretation of the Assignment. The Retainer Agreement was executed in conjunction with the Assignment and was subject to its terms. Moreover, the Retainer Agreement provided that Pima would be assigned an ORRI, exclusive of producing zones in the wellbores of then existing wells. Using the rules of grammar, the court held "in the wellbores" was a prepositional phrase functioning as a modifier of the phrase producing zones. Thus, the court agreed with Jones, holding that the assignment excluded producing intervals, meaning Pima was not entitled a royalty interest.

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FEATURED ARTICLE

Enforcing and Avoiding Restrictive Covenants in Oil and Gas

By: Eric Johnston

Restrictive covenants — more commonly referred to as non-compete agreements or agreements not to compete — are frequently used in the oil and gas industry to curtail unfair competition. Non-compete agreements prevent an employee from leaving his or her position with their current employer and accepting employment with a competitor of the employer and using the knowledge gained during employment to directly compete. Other types of restrictive covenants include non-solicitation agreements, which prevent an employee from leaving his or her position with their current employer and soliciting other employees, contractors, or customers to join them in their position with the new employer. Additionally, non-compete agreements often contain confidential information agreements that restrict the employee's ability to use the proprietary information of the employer against it or to improperly disseminate the proprietary information.

Many Texas employees casually sign restrictive covenants, including agreements not to compete, with a mindset that these agreements are unenforceable. Meanwhile, Texas employers assume that all agreements not to compete are enforceable. Thus, it is of no surprise with the differing views that agreements not to compete and their counterparts, are the cause of many fast-paced and expensive lawsuits every year in Texas.

A recent decision by a Texas Court of Appeals exemplified the difficulties that employees, employers, and their lawyers face with agreements not to compete. In *Titan Oil & Gas Consultants, LLC v. Willis*, the Texas Court of Appeals in Texarkana upheld a trial court's ruling that a covenant not to compete was unenforceable as it pertained to a contractor working in the oil and gas industry. In determining whether the covenant not to compete was enforceable, the *Titan* Court applied Texas Business and Commerce Code section 15.50(a) which provides:

> [A] covenant not to compete is enforceable if it is ancillary to or part of an otherwise enforceable agreement at the time the agreement is made to the extent that it contains limitations as to time, geographical area, and scope of activity to be restrained that are reasonable and do not impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee.

In recent years, Texas courts have largely focused on the second half of section 15.50(a). Namely, courts have analyzed whether an agreement not to compete is reasonable in its limitations as to time, geographical area, and scope of activity to be restrained. The *Titan* Court, however, diverged from this recent trend. Rather, in *Titan* the Court

analyzed whether the agreement not to compete was part of an "otherwise enforceable agreement" and whether the covenant is "ancillary to part of" that agreement. The Court's focus was due to the trial court granting summary judgment on the basis that the covenant not to compete was not designed to enforce Willis' return promise in the agreement not to compete.

What does it mean to be part of an "otherwise enforceable agreement" and whether the covenant is "ancillary to part of" that agreement? As the *Titan* Court explained, to satisfy the requirement that the covenant not to compete is ancillary to or part of an otherwise enforceable agreement, "the employer must establish both that (a) the consideration given by the employer in the agreement is reasonably related to an interest worthy of protection and (b) the covenant not to compete was designed to enforce the employee's consideration or return promise in the agreement." In sum, an agreement or covenant not to compete cannot stand alone without any new consideration from the employer to the employee.

Texas courts have long recognized that access to confidential or proprietary information, trade secrets, customer information, and specialized training may constitute good and valuable consideration for a covenant not to compete. This principle has created confusion amongst lawyers and employers—for example, if an employer is updating its restrictive covenants must it provide new consideration to the employees?

Following this principle, Titan argued that Willis received consideration for signing the agreement not to compete, because he received new confidential information and promised not to use the confidential information to its detriment. Titan further argued that it trained Willis in procedures and processes he needed to perform his job as a contract consultant. However, the undisputed evidence found that Willis did not receive confidential information of Titan; rather, Willis received confidential information of another oil and gas company. Furthermore, the Court found that Titan provided no new training to Willis, but rather Willis received his training from the other oil and gas company. Titan did not expend any money or resources for the training.

The Court in *Titan* held that Titan did not provide any consideration for Willis' promise not to use confidential information for his benefit, and thus the covenant not to compete was unenforceable. Importantly, the Court distinguished the *Titan* decision from other cases "where in exchange for a promise not to disclose confidential information, the employer expends money and resources to provide the employee with specialized training or the employee gains access to the employer's clients and their confidential information because of the employer's relationship with the clients."

Employers, especially those operating in the oil and gas industry, should take note of the decision in Titan. The Titan Court makes clear that a covenant or agreement not to compete must be part of an "otherwise enforceable agreement" be "ancillary to part of" that agreement. In particular, employers should assure that employees are provided consideration for the employee's promise not to compete. *Titan* notes that if an employer enters into an agreement for a promise not to disclose confidential information or compete with that information and the employer expends money and resources to provide the employee with the required training or access to the confidential information, then proper consideration is exchanged.

However, *Titan* calls into question whether proper consideration would exist to support an agreement not to compete if an employer reemploys a contract consultant who already had access to the same confidential information, or if the employer offers employees updated or new agreements not to compete. Therefore, employers should make certain to document the consideration provided to the employee in exchange for the promise not to compete—such as the expending of the employer's money and resources to provide the employee training to access the confidential information.

Further, if the consideration for the agreement not to compete is the access to confidential information, employers should confirm that new consideration exists in exchange for the employee accessing the employer's information or the information of the employer's clients because of the employer's relationship with the clients. A petition for review was filed by Titan in January 2021, asking the Supreme Court of Texas to review this decision.

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Common Carrier Succeeds in "Paramount Importance" Fight Against Electric Utility Entity

DCP Sand Hills Pipeline, LLC v. San Miguel Elec. Coop., Inc., No. 04-19-00288-CV, 2020 Tex. App. LEXIS 8917 (Tex. App.—San Antonio Nov. 18, 2020, pet. filed)

By: McLean Bell

In a common carrier condemnation case, the San Antonio Court of Appeals held that the trial court erred in holding the paramount importance doctrine prevented the common carrier from condemning land for a pipeline easement when the land condemned would interfere with only 14% of a lignite mining operation. San Miguel is an electric cooperative fueling its power plant by virtue of a lignite strip mine lease located on a 2200-acre tract in McMullen County. A dispute arise when DCP (a common carrier) negotiated a series of pipeline easements with the surface owners. San Miguel argued that the second pipeline would interfere with its future mining.

San Miguel filed suit seeking declaratory relief that the pipeline easements were void and that San Miguel's rights were superior. DCP counterclaimed seeking to condemn the land covered by its pipeline easement. DCP also argued that San Miguel's lignite lease was invalid. The trial court held that San Miguel's lignite lease was superior and that DCP's easement was void.

On appeal, DCP argued that, because the underlying issue was title to real property, the claims should have been brought as trespass to try title claims and not as declaratory relief. The appellate court disagreed, holding that, though trespass to try title is the proper statute to determine the validity or superiority of possessory rights in land, it does not apply when a claimant seeks to establish the validity of an easement.

DCP also argued that San Miguel failed to prove a superior right in its lignite lease because San Miguel had alleged failed to pay an adequate amount of delay rentals to keep the lignite lease alive. The appellate court rejected this argument, holding that it was DCP's burden to present evidence that the delay rental payments were not properly paid. DCP failed to present sufficient evidence, because DCP only cited to its own pleadings which is not proper evidence.

The court of appeals then turned to DCP's condemnation arguments. San Miguel argued against the condemnation, urging the court to apply the paramount importance doctrine. The paramount importance doctrine prevents condemnation by a common carrier when it is shown that: (1) the property is already devoted to a public use; and (2) the condemnation would practically destroy or materially interfere with the use to which it has been devoted.

As for the first prong, the court found that a fact issue existed as to whether the pipeline would materially interfere with San Miguel's existing public use. Specifically, the evidence showed that San Miguel was not actually mining the 2200-acre tract when DCP acquired its easements. And while San Miguel argued that it was preparing to mine the tract, evidenced by numerous studies of the land in 1975, San Miguel had not applied for a permit to mine the area where the easement would be located until after DCP installed the pipeline.

In regards to the second prong of the paramount importance doctrine, the court reversed the trial court's conclusion that DCP's counterclaim was barred by the paramount importance doctrine. Moreover, the court held that DCP would not materially interfere or practically destroy the land, because only 10-14% of San Miguel's lignite would be sterilized as the result of the pipeline. When considering practical destruction or material interference, the court looks to the entire affected property, and not only to the section where whatever preexisting use would be destroyed.

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Reservation of Future ORRI in New Leases Violates the Rule, But May Be Reformed

Yowell v. Granite Operating Co., No. 18-0841, 2020 Tex. LEXIS 425, 2020 WL 2502141 (Tex. May 15, 2020).

By: Michael Szymanski

In this case, the Texas Supreme Court held that the Rule Against Perpetuities (the Rule) was violated by the purported reservation of a future overriding royalty interest in "new leases" under a so-called "anti-washout" provision. Rather than invalidating the reservation, the Court held that the offending provisions were potentially subject to judicial reformation.

The ORRI at issue was created by reservation in a 1986 assignment. That assignment included an anti-washout provision that purported to cover any extension, renewal, or new lease executed by the assignee or his successors in interest. In 2007, the prior lease terminated and a top lease took effect. The top lease was obtained by a different lessee from the same mineral owner and covering the same property as the prior lease. Following a leasehold title dispute, the lessee of the prior lease acquired the leasehold in the 2007 top lease. The lessee did not give any effect to the ORRI in this new lease that was purportedly reserved under the anti-washout provision contained within the 1986 assignment.

The Court analyzed several prior cases and concluded that an ORRI is a non-possessory property interest. The Court then turned to the issue of whether the ORRI purportedly reserved as to "new leases" violated the Rule. To make that determination, the Court explained that the analysis first looked at whether the property interest vested at the time of its creation. If so, the Rule does not apply. If the interest does not vest at the time of its creation, then the analysis turns on whether the interest must vest, if at all, within the timeline prescribed by the Rule. If the answer is yes, then the interest does not violate the Rule. But if the answer is no, then the interest violates the Rule.

The Court explained that, for an interest to vest at the time of its creation, the owner must have an immediate right to the enjoyment of that interest and its vesting cannot be conditioned upon the happening of a future event. If such a condition exists, then the interest cannot vest upon its creation, making it an executory interest subject to the Rule. Analyzing the 1986 assignment, the Court found that the ORRI purportedly reserved in new leases was conditioned upon the execution of a new lease. Therefore, the Court concluded that the interest in future leases did not vest at the time of its creation.

As to the second question, the Court pointed out that at the time of the 1986 assignment, there was no guarantee that the ORRI in new leases would vest within the Rule's timeframe. The Rule requires the interest to vest within "twenty-one years after the death of some life in being at the time of the reservation." The Court explained that, for the ORRI in new leases to come into existence, the following conditions would first need to occur: (1) termination of the underlying 1986 lease, (2) grant of a new lease covering the same mineral interest, and (3) the new lease must be obtained by the same lessee as the lessee of the prior lease, or their successor or assign. The Court pointed out that those conditions could never be certain to occur, and could occur long after the Rule's prescribed timeframe. Therefore, the Court held that the ORRI purportedly reserved in "new leases" was in violation of the Rule.

Nevertheless, rather than holding that the purported reservation was void, the Court held that the reservation is a kind of property interest that may be reformed pursuant to Section 5.043 of the Texas Property Code, if possible, to reflect the creator's intent within the limits of the Rule. The Court reversed the court of appeals' judgment regarding the validity of the reservation, and remanded the case to the court of appeals to consider whether the reservation can be reformed to comply with the Rule.

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Lessee's Obligation to Spud Offset Well Triggered By Drilling of Nearby Well and By Drainage From a Different Well

Martin v. Rosetta Res. Operating, L.P., No. 13-19-00431-CV, 2020 Tex. App. LEXIS 7952, 2020 WL 5887566 (Tex. App.—Corpus Christi, Oct. 1, 2020, pet. filed).

By: Austin W. Brister and Michael Szymanski

In this express drainage/offset case, the Corpus Christi Court of Appeals held that the drilling of a nearby well within a defined proximity to the lease triggered a general duty on the lessee to protect undrilled acreage from drainage, and the existence of drainage from a different well triggered a further obligation to spud an offset well, even though that other well was not within the defined proximity to the lease premises.

This case involved two leases (the Martin Leases), each of which contained the following identical offset/drainage provisions in the addendum:

> Notwithstanding anything contained herein to the contrary, it is further agreed that in the event a well is drilled on or in a unit containing part of this acreage or is drilled on acreage adjoining this Lease, the Lessor [sic], or its agent(s) shall protect the Lessee's [sic] undrilled acreage from drainage and in the opinions of reasonable and prudent operations, drainage is occurring on the un-drilled acreage, even though the

> draining well is located over three hundred thirty (330) feet from the un-drilled acreage, the Lessee shall spud an offset well on said un-drilled acreage or on a unit containing said acreage within twelve (12) months from the date the drainage began or release the acreage which is un-drilled or is not a part of a unit which is held by production.

Rosetta and Newfield established the Martin Unit, which contained a portion of the Martin Leases and drilled the "GU-1 Well." About a year and a half later, Newfield established the unrelated nearby "Simmons Unit" and drilled the "Simmons-1 Well." Martin filed suit against both Newfield and Rosetta, arguing that each of these wells triggered the offset obligations under the Martin Leases. Subsequently, the trial court severed the claims against Newfield and the claims against Rosetta.

In 2018, the claims against Newfield made their first pass up to the Corpus Christi Court of Appeals.[1] We discussed that case within Iss. 1 of Vol. 1 of *Producer's Edge* back in 2019. In that prior case, the court held that this offset provision was not triggered by Newfield's drilling of the nearby Simmons-1 Well because the "Simmons Unit" was not "adjoining" the Martin leases, which was a condition precedent under this provision. The court adopted a plain and ordinary meaning of the term "adjoining", and held that even though the Simmons Unit was nearby, it was not "adjoining" because it was separated from the Martin Leases by a thin strip of land.

Following that prior appellate decision, the Martins amended their petition against Rosetta to claim that their obligations were triggered not by the Simmons-1 Well, but instead by the drilling of the GU-1 Well. It was undisputed that the GU-1 Well, unlike the Simmons well, was located "on or in a unit containing part of" the Martin Leases. The trial court held in favor of Rosetta and this appeal followed.

Rosetta argued that all of its obligations under this express lease provision were triggered only when two conditions both occur: (1) a well is drilled on or in a unit containing the lease or on adjoining lands and (2) that same well is causing drainage as determined by "the opinions of reasonable and prudent operations."

The court construed the provision as imposing two independent obligations: a general duty to "protect" from drainage, and an additional independent duty to "spud an offset well." The court construed the first obligation as being triggered only by the drilling of a well within the defined proximity to the Martin leases (i.e., "on or in a unit containing part of this acreage" or "on acreage adjoining this Lease"). Unlike the prior case which focused on the non-adjoining Simmons unit, the parties in this case both conceded that the Martin Unit contained part of the Martin Leases. Therefore, the court held that this general duty to "protect" was triggered when the GU-1 Well was drilled within the Martin Unit. The court held that the presence of drainage is irrelevant to this first duty.

The court then turned to the additional "independent" express duty to spud an offset well. Though that phrase was preceded by the "opinions of reasonable and prudent operations" clause, the court rejected Rosetta's interpretation that such clause defined "the nature and quality of the drainage necessary" and thereby served as a condition precedent to their duty to spud an offset well. As the court explained, this phrase does not itself contain conditional language, such as "if" or "in the event."

However, the court acknowledged that both parties' constructions interpreted this clause as imposing a condition on the obligation to drill an offset well. Regardless, the court pointed out that it was undisputed that the Simmons-1 Well was draining the undrilled portions of the Martin Leases. As the court pointed out, "the fact that the drainage to the Martin Leases was caused by the Simmons-1 Well rather than the GU-1 Well does not alter the obligations of the lessee…" Therefore, the court held that Rosetta was obligated to either spud an offset well or release the undrilled acreage.

It is difficult to narrowly define a takeaway from this case. Indeed, the court pointed out that the provision at issue "suffers from both a lack of accuracy and a lack of clarity." At any rate, the case serves as a cautionary reminder to lessees that, just because an express offset provision references the reasonable prudent operator standard, that does not necessarily serve as a significant condition precedent to the lessee's obligations. A petition for review has been filed with the Texas Supreme Court.

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[1] *Martin v. Newfield Expl. Co.,* No. 13-17-00104-CV, 2018 Tex. App. LEXIS 2435 (Tex. App.—Corpus Christi Apr. 5, 2018, pet. denied).

Industry Custom Admissible to Impute Notice of Expectation of Payment in Quantum Meruit Suit

Pearl Res., LLC v. Charger Servs., LLC, No. 08-19-00096-CV, 2020 Tex. App. LEXIS 5785, 2020 WL 4251373 (Tex. App.—El Paso July 24, 2020, pet. denied)

By: Michael Szymanski

In this quantum meruit case, the Court held that industry custom can serve as sufficient evidence to impute notice on an operator of an expectation of payment by an emergency services subcontractor.

Pearl Operating and Pearl Resources were lessees, and Pearl Operating was an operator (collectively "Pearl"). Pearl entered into a Turnkey Drilling Contract with PDS Drilling to drill a well. That contract stated that PDS was an independent contractor and disclaimed any principal-agent relationship. The contract also gave PDS complete control of the wellsite and indicated that PDS would be "responsible for maintaining control and assuming responsibility for all claims arising directly or indirectly from a wild well incident."

Shortly after drilling began, a blowout occurred, causing freshwater contaminated with hydrogen sulfide to erupt from the well and head toward a water reservoir. An employee of Bison Drilling, a drilling rig subcontractor hired by PDS, contacted the owner of Charger Services, which provides earth movement and dirt work, and asked Charger to mobilize their equipment to help contain the runoff water. Charger mobilized equipment that same night. Shortly after emergency remediation began, drilling contractor PDS walked away, and the Railroad Commission assumed control of the site. During the emergency cleanup, a Pearl representative was on site, serving as Pearl's "eyes and ears" and attending meetings regarding remediation activities.

Charger was ultimately successful in containing the runoff. Charger first sent its invoice to PDS. However, after the invoice remained unpaid for almost a year, Charger sent Pearl a demand for payment and filed suit against Pearl for breach of contract and quantum meruit. The case proceeded to a bench trial, where the trial court found that Pearl was liable to Charger based on quantum meruit.

On appeal, Pearl first argued that the existence of an implied-in-fact contract precludes a quantum meruit claim against a third party covering the same subject matter. In support, Pearl relied on a prior decision by the *El Paso Court of Appeals in Chico Auto Parts & Service, Inc. v. Crockett,* 512 S.W.3d 560 (Tex. App.—El Paso 2017, pet. denied). In Chico, a company provided remediation services on a well but was unable to obtain payment. A dispute arose as to which of several owners and affiliates had requested the services. Ultimately, the court found that one of the parties acted as the agent of the operator in requesting the remediation services, which created an implied contract between the operator and the service company. Because an implied contract existed covering those services, the court held that the service company could not maintain a quantum meruit cause of action against another party. However, the *Pearl* Court rejected Pearl's analogy, distinguishing Chico from the present facts because there were neither factual findings nor evidence in the reporter's record in the *Pearl* case that Bison had the authority to act as an agent for PDS. This conclusion was not changed by the fact that Bison was PDS' subcontractor. Moreover, there was no evidence of any of the alleged terms of an implied contract nor any partial payment made by either Pearl or PDS for Charger's services.

Pearl also attacked the sufficiency of the evidence as to Charger's quantum meruit claim. For instance, Pearl argued that Charger rendered the services for PDS, not for Pearl. The appellate court rejected that argument, pointing to evidence that Charger knew that Pearl was the operator prior to arriving at the site, and the services provided a value to Pearl as the owner. Moreover, the court explained that the fact that Charger initially sought payment from Pearl does not mean that Charger did not provide the services for Pearl's benefit.

Pearl also argued that there was not sufficient evidence of Pearl's acceptance of Charger's services. Pearl argued that merely being present and not objecting is not sufficient to establish their acceptance. The court rejected that argument, pointing out that acceptance can be proven in quantum meruit cases by showing that the defendant knew of the services and did not object. Here, the evidence showed that Pearl had representatives on site during the remediation efforts, in attendance at remediation meetings, and Pearl's representatives communicated the remediation plans directly to Pearl's owners.

Finally, Pearl argued that the evidence was insufficient to show that Pearl

had reasonable notice that Charger expected to be paid directly by Pearl. The *Pearl* Court rejected that argument, noting that the evidence established Pearl was a sophisticated mineral operator, whose owner had more than forty years of experience in the oil and gas industry. The court further pointed to testimony from two of Charger's owners that they expected payment from Pearl because it was customary in the industry for emergency subcontractors to look to the operator or lessee for payment. The appellate court analyzed a prior decision which held that notice of expectation of payment in a quantum meruit claim need not be shown by explicit notice, and evidence of custom and usage within an industry is relevant to a determination of whether an owner should have known that a party anticipated compensation for services rendered. The court also emphasized that Pearl was a sophisticated mineral operator, that Pearl took over the operations after the blowout, and that there was no evidence that Pearl would have any reason to believe Charger was doing the work for free.

This case serves as a reminder of the important role that common law theories and industry custom can sometimes play in defining the scope of an operator's liabilities and obligations. Subcontractors performing services in the oil and gas industry need not necessarily obtain a contract to seek payment directly from an operator.

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TCRP Update: The New, Improved, and Federalized Texas Rules of Civil Procedure

By: McLean Bell and Ian Davis

On January 1, 2021, several amendments to the Texas Rules of Civil Procedure went into effect. The majority of the changes are aimed at streamlining discovery in a way that more closely mirrors the Federal Rules. The most substantive change is to Rule 194, which used to be titled Requests for Disclosures. As the Rule's name would suggest, these disclosures were requested, not required. The 2021 amendment changes this.

Under amended Rule 194, parties must serve mandatory initial disclosures no later than 30 days after the defendant files its answer. The contents of initial disclosures are the same as former requests for disclosure, with the addition of two new items: (i) a computation of each category of damages; and (ii) a copy of documents in the party's control that may be used to support a claim or defense. Moreover, discovery now commences on the day that initial disclosures are due.

Amended Rule 194 also requires pretrial disclosures, which must be made at least 30 days before trial. A party must disclose: (i) the names, addresses, and telephone numbers of each witness the party expects to present; and (ii) an identification of each documents or exhibit the party expects to offer. Parties need not disclose impeachment evidence.

Finally, amended Rules 194 and 195 now impose mandatory testifying expert disclosures. A party seeking affirmative relief must make these disclosures no later than 90 days before the discovery period ends, and all other parties must disclose their experts no later than 60 days before discovery ends. The contents of these disclosures are the same as before, with the addition of three new items: (i) a statement of the expert's qualifications; (ii) a list of cases in which the expert testified or was deposed (limited to previous 4 years); and (iii) a statement of the expert's compensation.

Other amendments include changes to Rule 47 and Rule 169 – the rules governing expedited actions. Claims seeking only monetary relief of 250,000 or less are now governed by the expedited action rules under Rule 169. This amendment substantially increased the monetary limit for expedited actions, and the monetary limit excludes interest, penalties, attorney's fees, court costs, and exemplary damages. The practical impact is that more cases will fall within the fast-tract discovery rules. Under the amendment, discovery is limited to 180 days, with trial settings 90 days later. To accommodate more complex cases falling within the 250,000 limit, Rule 190.2 – Level 1 discovery rules – now provides 20 hours of deposition time, as opposed to 6 hours.

Substituted service rules were also changed. Rule 106 now permits parties to motion for substituted service through electronic mediums such as email. As an initial matter, practitioners will need to prove to the court that the email or other service method is an account actually held by the party to be served. Moreover, the party seeking substituted service must show that the service will be reasonably effective to give the party notice of the lawsuit.

Miscellaneous Case Updates

Water Well Deed

Childers v. Yarborough, No. 13-18-00125-CV, 2020 Tex. App. LEXIS 4080 (Tex. App.—Corpus Christi May 28, 2020, no pet.)

In *Childers*, a land owner asked the Corpus Christi Court of Appeals to hold that an Expenses and Liabilities Agreement terminated a cotenant's rights in a water well. Childers was as a successor to a grantee of a 5/32 interest in a Water Well. Pursuant to the water well Deed, grantees were obligated to pay for costs and maintenance of the well. Years later, the grantees executed an "Agreement Relating to the Sharing of Expenses and Liabilities Incident to a Water Well." The Agreement elaborated on how the expenses and liabilities would be shared among the Grantees.

The dispute centered on a term provision in the Agreement, which stated that "the agreement shall be for a term of years not to exceed the useful life of the referenced water well but in no event for more than twenty (20) years." Yarborough, the owner of the land where the water well existed, argued that the cotenant's interests in the wells terminated at the end of the 20-year term. The trial court agreed with Yarborough, but the court of appeals reversed. It held that there was no interpretation of the Agreement that could support an explicit or implicit termination of the cotenant's interests in the water well. Furthermore, the court held that the 20-year term referred to the sharing expenses Agreement and not to the estate in the well.

Contract Formation Dispute

McGehee v. Endeavor Acquisitions, LLC, 603 S.W.3d 515 (Tex. App.—El Paso, 2020, no pet.).

In this contract interpretation case, the El Paso Court of Appeals held that the sellers of a surface estate and certain mineral interests could not void a contract when the buyer manifested its acceptance by tendering payment to the sellers.

The buyer sent an unsolicited purchase and sales agreement (PSA) to the sellers. In it, the buyer offered to purchase the sellers' surface estate and mineral interests. The sellers modified the PSA by crossing out the initial purchase price of $185,000 and replacing it with $200,000. The sellers executed the modified PSA and delivered it along with the general warranty deeds to the buyer and did not impose any conditions on the method by which the buyer could manifest its assent.

On appeal, the sellers sought a declaration that the contract was void and unenforceable because the buyer had failed to deliver the executed PSA to them prior to a formal closing. The court rejected the sellers' argument that the terms of the unsolicited PSA imposed any conditions on the buyer's acceptance of the sellers' counteroffer. Further, the court found that the buyer had manifested its assent to the counteroffer when it tendered a check to the sellers for the modified purchase price - $200,000. As a result, the PSA was valid and enforceable against the sellers.

Interpretation of Covenant of Seisin

Chi. Title Ins. Co. v. Cochran Invs., Inc., 602 S.W.3d 895 (Tex. 2020).

In this case, the Texas Supreme Court held that a seller of real property could not be held liable for breach of the implied covenant of seisin when the buyer had purchased the real property by special warranty deed. Under the terms of the special warranty deed, the seller agreed to warrant the property against persons claiming "by, through, and under" the seller, but not against any prior owners. When the bankruptcy trustee of a prior owner sued the seller for violating the automatic bankruptcy stay, the buyer's title insurance company paid the trustee for its interest in the property. Subsequently, the buyer's title insurance company sued the seller for breach of the implied covenant of seisin.

Looking to the "intent of the parties based on the plain language of the deed as a whole," the Supreme Court held that recovery for breach of the covenant of seisin was foreclosed by the special warranty. The Court noted that the special warranty contained a qualifying expression that limited the scope of the seller's liability for breach of the covenant of seisin. This result reflected the "intent of the parties based on the plain language of the deed as a whole."

The Court rejected the buyer's argument that its holding would render all special warranty deeds as quitclaim deeds. It pointed out that,

under the special warranty, the seller had warranted to protect against title claims “by, through, and under” the seller, which was certainly more protection than provided under a quitclaim deed. In addition, the Court opined that the buyer’s preferred interpretation would effectively transform special warranty deeds into general warranty deeds.

Applicability of UDJA to Title Dispute

Boren v. Newport Operating, LLC, No. 02-19-00358-CV, 2020 Tex. App. LEXIS 8517 (Tex. App.—Fort Worth Oct. 29, 2020, no pet.)

In *Boren*, two mineral lessees sought to adjudicate competing claims to the mineral rights under a tract of land. Boren sued Newport seeking declaratory relief and attorney’s fees under Uniform Declaratory Judgment Act (UDJA) and alternatively plead trespass to try title. In a no-evidence summary judgment, Newport alleged that the UDJA was not the proper vehicle to seek relief in instances of competing claims of title. Moreover, Newport requested to receive attorney’s fees if it successfully disposed of Boren’s improper UDJA Claim. The trial court granted Newport’s summary judgment and awarded Newport attorney’s fees.

The issue on appeal centered on the distinction between a UDJA and trespass to try title claim. If the UDJA claim was merely a disguised trespass to try title claim, attorney’s fees would not be allowed, regardless of who was successful. The reason, the court held, is because attorney’s fees are not authorized under the trespass to try title statute. The court agreed with Newport that the UDJA claim was improper. Moreover, the UDJA is not the proper vehicle for adjudicating competing claims to title. In effect, the Fort Worth Court of Appeals held that Boren attempted to bring a trespass to try title claim through the UDJA, which was improper.

Despite the impropriety of the UDJA claim, Newport could not recover attorney’s fees. The logic behind the appellate court’s holding was a little circular: because the plaintiff improperly used the UDJA to seek relief for which attorney’s fees would not have been recoverable, the defendant cannot recover attorney’s fees to dispose of the claim. Effectively, a plaintiff or defendant cannot recover attorney’s fees when the UDJA claim, however improper it may be, is based on a statute that does not provide attorney’s fees.

Fixed/Floating Royalty Deed Dispute

Van Dyke v. Navigator Grp., 2020 Tex. App. Lexis 10448*; 2020 WL 7863330 (Tex. App—Eastland December 31, 2020, no pet)

In this double fraction royalty deed case, the Mulkey Assignees argued that the estate misconception theory should apply to a deed interpretation. The 1924 deed reserved “1/16 of the mineral and mineral rights to George H. and Frances E. Mulkey (1/2 of 1/8) and conveyed 15/16th of the minerals and mineral rights to G.R. White and G.W. Tom of the land conveyed." The estate misconception theory has sometimes been applied to old oil and gas deeds, and the theory is built upon the misconception apparently applied by some mineral owners in the early twentieth century that a royalty interest under an oil and gas lease would always be just one-eighth as a matter of law. Accordingly, the Mulkey Assignees argued that the reservation entitled them to one-half of all minerals and mineral rights rather than 1/16th. The Eastland Court of Appeals disagreed.

The court of appeals refused to apply the estate misconception theory to a deed that is unambiguous. Furthermore, the court held that evidence of circumstances – such as the estate misconception – can be used as an aid in contract construction, but that such evidence cannot be used to create an ambiguity.

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