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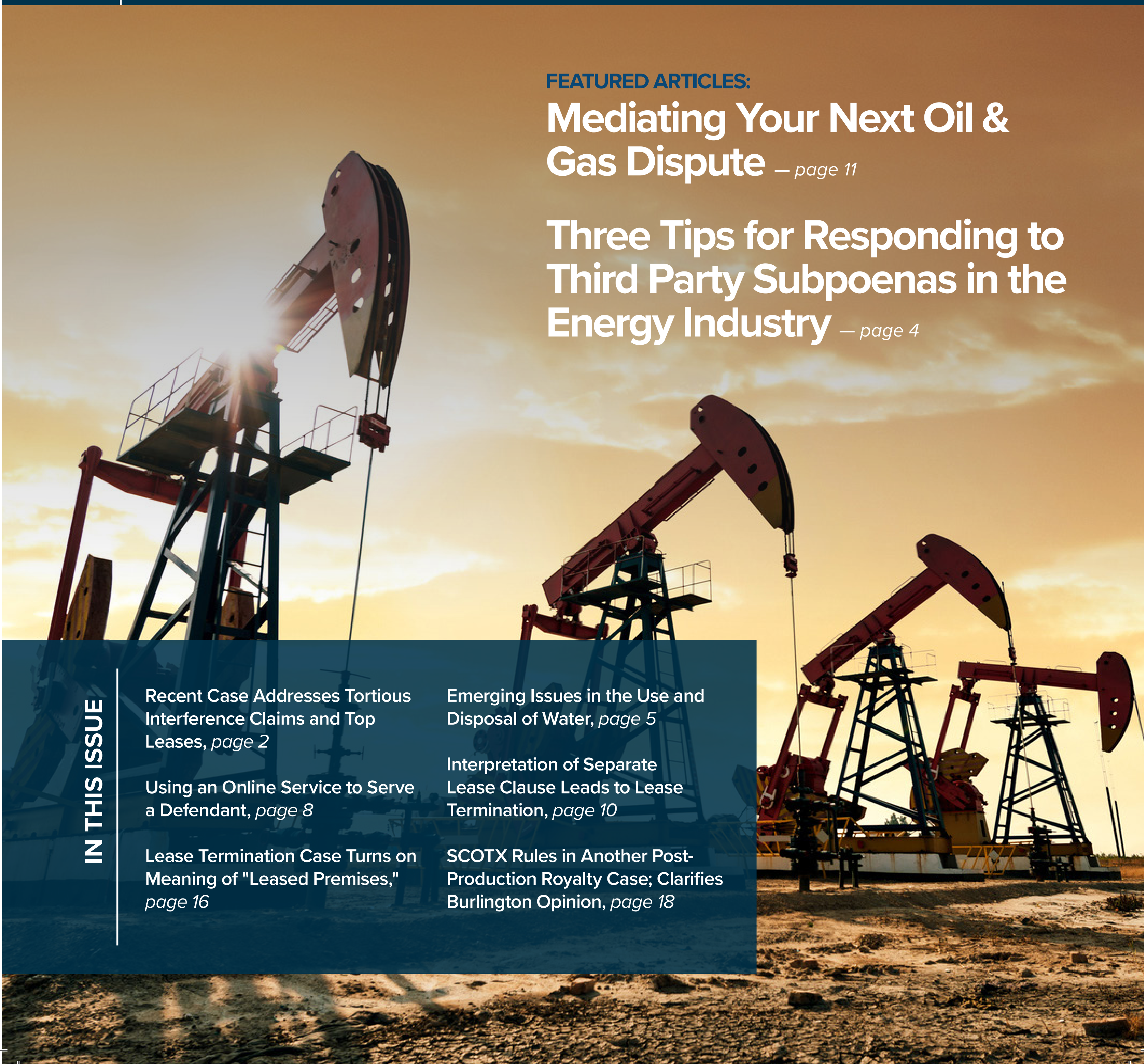
McGINNIS LOCHRIDGE

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.

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If you have any comments or wish to discuss any of these articles, please contact authors directly, or send an email to *oilandgas@mcginnislaw.com*.

MCGINNIS LOCHRIDGE

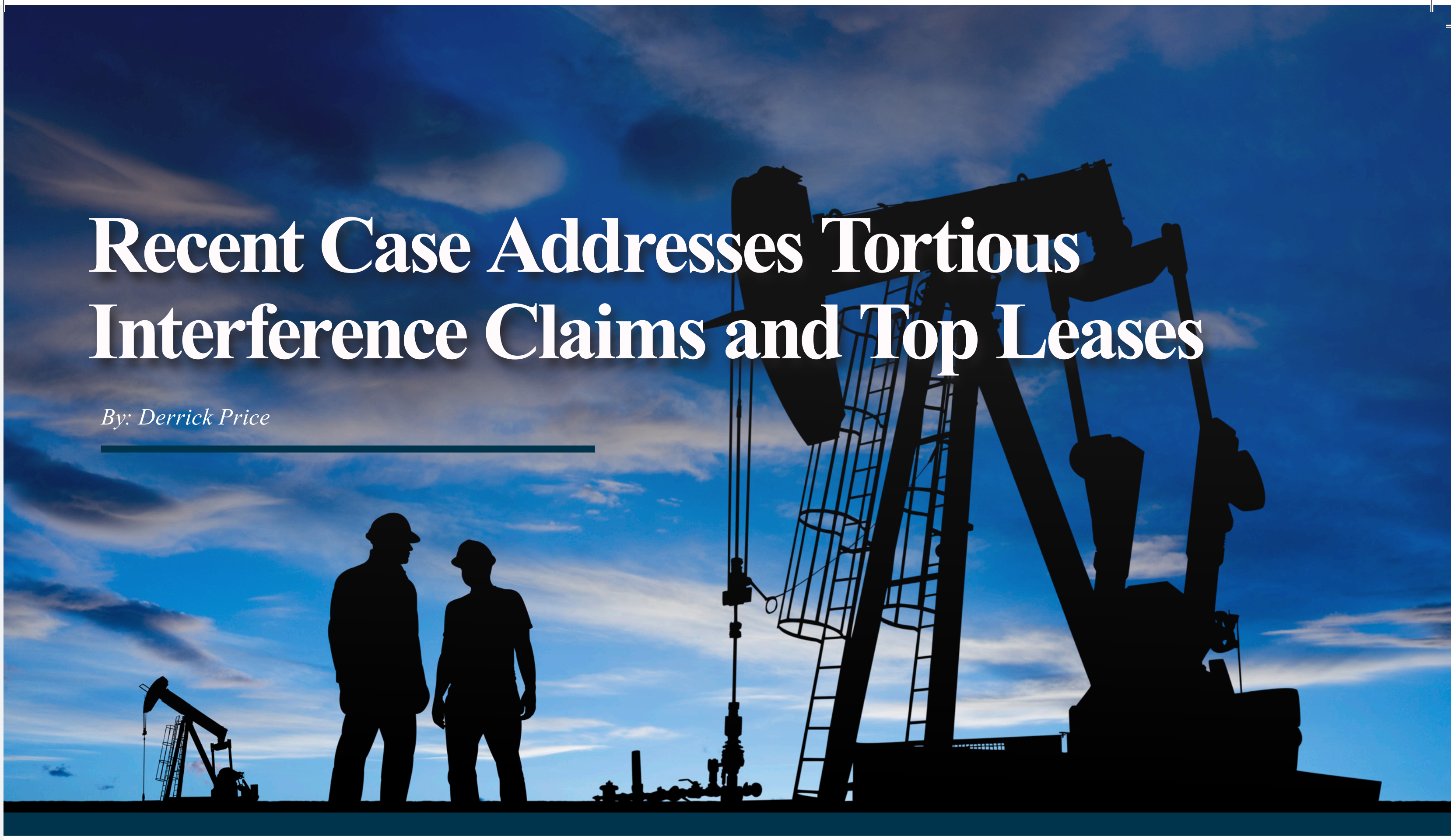
EVENTS, PRESENTATIONS & PAPERS:

UPCOMING EVENTS

- UT Law CLE's Fundamentals of Oil, Gas and Mineral Law, *Emerging and Re-Emerging Issues in the Use of Surface for Oil and Gas Operations*, presented by Austin Brister – **April 21, 2022**
- 48th Annual Ernest E. Smith Oil, Gas and Mineral Law Institute, *Construing Retained Acreage and Related Clauses after Endeavor v. Discovery Operating and XOG v. Chesapeake*, presented by Derrick Price & Lecelle Clarke – **April 22, 2022**
- 68th Annual Natural Resources and Energy Law Institute, hosted by The Foundation for Natural Resources and Energy Law (formerly RMMLF), Bruce Kramer (Program Chair) and Austin Brister (Co-Chair of Oil & Gas Section) – **July 21-23, 2022**

RECENT EVENTS, PUBLICATIONS, & RECOGNITIONS

- Jonathan Baughman named Chair of the Louisiana Mineral Law Advisory Council
- Austin Brister, speaker, *Annual Case Law Update*, First Annual U.S. Oil & Gas and Renewable Energy Law Seminar, co-sponsored by NAPE and The Foundation for Natural Resources & Energy Law — **February 8 and 10, 2022**
- Bruce Kramer, speaker, *Monty Python and the Search for the Holy Grail of Texas Oil & Gas Jurisprudence*, Houston Bar Association, Oil, Gas & Mineral Law Section — **January 27, 2022**
- McGinnis Lochridge ranked Band 1 in Texas in Energy: State Regulatory & Litigation (Oil & Gas) in Chambers USA 2021 Rankings
- Two McGinnis Lochridge Attorneys Selected to Benchmark Litigation's 2021 40 & Under Hot List: Austin Brister, Chris Halgren
- McGinnis Lochridge Ranked a 2022 "Tier 1 Texas Law Firm" in Fourteen Categories, U.S. News – Best Lawyers®
- Sixteen McGinnis Lochridge Attorneys Recognized as 2022 "Best Lawyers" by Best Lawyers in America©: Kevin Beiter, Mitchell Chaney, Ray Chester, Paul Clote, William Daniel, Cliff Ernst, Felicity Fowler, Tim George, Clarke Heidrick, Donald Jackson, Russell Johnson, Don Magee, Edward McHorse, Douglas Paul, Robert Reetz, Derek Seal
- Two McGinnis Lochridge Attorneys Recognized as 2022 "Ones to Watch" by Best Lawyers in America©: Travis Vickery, Marcus Eason
- Ten McGinnis Lochridge Attorneys Recognized as 2021 Super Lawyers: Paul Clote, Jonathan Baughman, Kevin Beiter, Mitchell Chaney, Felicity Fowler, Tim George, Clarke Heidrick, Don Jackson, April Lucas, Derrick Price
- Six McGinnis Lochridge Attorneys Recognized as 2022 Texas Super Lawyers Rising Stars: Austin Brister, Marcus Eason, Emily Franco, Chris Halgren, Jordan Mullins, Lindsey Roskopf



Recent Case Addresses Tortious Interference Claims and Top Leases

By: Derrick Price

Title disputes related to the partial termination of oil and gas leases under the terms of retained acreage clauses continue to grace the pages of this Texas' oil and gas jurisprudence. In many cases, the disputes arise when an oil and gas operator receives notice from a top lessee (who is often a competing operator) demanding release of some portion of the "bottom" lease that the top lessee claims has terminated. As Texas courts have explained "[a] top lease is a lease granted by a mineral owner during the existence of another lease that will become effective if and when the existing lease expires or terminates." *Headington Royalty, Inc. v. Finley Res., Inc.*, 623 S.W.3d 480, 485 n.3 (Tex. App.—Dallas 2021, pet. filed).

A question often asked by operators in such cases is whether they have a claim for tortious interference against the top lessee. Tortious interference claims against top lessees are somewhat difficult to maintain, principally because the top lease is contingent in nature. Practitioners have long argued that a top lease cannot interfere with a bottom oil and gas lease. That argument is based on the following premise: if the bottom lease is valid and effective, the contingent, top lease is not, and is therefore not interfering with any contract or property right; on the other hand, if the top lease is in effect, that means the bottom lease has terminated as to the acreage in dispute, and no contract or property right exists with which to interfere.

The El Paso Court of Appeals recently addressed the issue of tortious interference claims against a purported top lessee in *MRC Permian Co. v. Point Energy Partners Permian, LLC*, 624 S.W.3d 643 (Tex. App.—El Paso 2021, pet. pending). That title dispute involved ownership of four leases covering property in Loving County, Texas. The operator, MRC Permian ("MRC"), had drilled and completed five wells during the primary term of the leases, but failed to timely commence drilling on its next well by the deadline provided in the leases' continuous drilling clause. In early June of 2017, Point Energy Partners Permian, LLC ("Point Energy") acquired new leases covering the same property from the mineral owners. The new leases were traditional oil and gas leases when executed, but each was later converted to a top lease. Point Energy also acquired the mineral owners' right to seek termination of MRC's leases. MRC, apparently unaware of the new leases, subsequently informed the mineral owners that its drilling delay was caused by a force majeure event, and that a rig would soon be on location to drill the next well. Point Energy responded by letter to MRC, stating that MRC's leases had expired and that MRC was obligated to release all interest in the leases outside production units for existing wells Point Energy's letter also challenged the applicability of the force majeure clause, and warned MRC that any entry onto the leases may constitute bad faith trespass. MRC filed suit against Point Energy and the mineral owners to protect its interest, seeking a declaration that the force majeure clause applied and extended the drilling deadline. MRC also asserted claims for slander of title and tortious interference with existing contract. The parties filed a number of summary judgment motions, including competing motions on the lease termination issue. The trial court granted Point Energy's motion, determining as a matter of law that MRC's leases had automatically terminated as to the disputed acreage. The trial court also granted Point Energy and the mineral owners' motion for summary judgement against MRC's tortious interference claim. Taking a permissive appeal, the El Paso Court of Appeals determined fact issues existed as to whether the force majeure clause prevented the leases from terminating, and reversed and remanded the summary judgment. It also reversed and remanded the trial court's dismissal of MRC's tortious interference claim.

On appeal, MRC argued that the trial court's ruling on tortious interference should be reversed because it established a prima facia case of tortious interference, that Point Energy's leases were not top leases when executed, and that the interference was not justified. Point Energy and the other defendants argued that MRC could not make a prima facia case of tortious interference, that the Point Energy leases were top leases that cannot tortiously interfere, and, alternatively, that any interference was legally justified. In analyzing the tortious interference claim, the court began its analysis by restating the elements of tortious interference, which requires (1) the existence of a valid contract subject to interference; (2) a willful and intentional interference by a third party; (3) proximate causation; and (4) that the plaintiff suffered actual damage or loss. The appellate court applied its prior determination that fact issues existed as to the validity of MRC's leases. The appellate court also found that a fact issue existed as to the first element of tortious interference, whether MRC had a valid contract subject to interference. It applied the same analysis to determine that fact issues existed as to Point Energy's legal justification defense. With respect to the second element of tortious interference, willful and intentional interference, Point Energy and the other defendants argued they could not have known MRC would claim force majeure at the time they executed the new leases, and therefore there was no evidence that any interference was intentional or willful. The appellate court disagreed, citing as evidence the fact the new leases contained the same force majeure provision as MRC's leases. The court also noted that once MRC had invoked the force majeure clause, Point Energy responded by asserting the validity of its own leases and suggesting MRC would commit a bad faith trespass if it entered any portion of the leases not included in an existing proration unit. As to the third and fourth elements, causation and damages, MRC argued that Point Energy's assertion of superior title (along with the lessors' repudiation of MRC's leases), MRC was forced to alter drilling plans and lease operations in a manner that allowed MRC to develop and operate only on the production units provided for by the MRC leases' retained acreage clauses. MRC claimed this resulted in rerouting and lost-efficiency costs, and provided both testimony and documentary evidence in support of these claims. As a result, genuine issues of material fact existed as to each element, and MRC established a prima facia case of tortious interference.

In addressing Point Energy's argument that top leases could not interfere with MRC's bottom leases, the court of appeals again found fact issues related to whether or not Point Energy's leases were in fact top leases. This was because the leases, when executed, were in the form of traditional leases, but were subsequently converted to top leases. Additionally, the court of appeals focused on Point Energy's initial communication with MRC, which: (1) did not indicate Point Energy's leases were top leases; (2) asserted that Point Energy was the rightful lessee and that MRC's leases had expired as to the disputed acreage; and (3) warned that MRC could be liable for bad-faith trespass upon any entry into the disputed acreage. Based on the foregoing, the El Paso court determined a fact issue existed regarding whether the leases were top leases or traditional leases.

The El Paso Court of Appeals did not directly address the legal issue of whether a top lease can support a claim for tortious interference. The issue has, however, been raised by Point Energy in its petition for review and brief on the merits, and the case is now pending before the Texas Supreme Court. Whether the Texas Supreme Court squarely addresses the issue or not, the case raises interesting questions regarding the potential of tortious interference claims in title disputes involving top leases.

About the Author

Derrick Price *is a partner in our Austin office and a member of the Oil & Gas Practice Group. Derrick handles a wide variety of civil, regulatory and transactional matters in the oil and gas industry, representing both oil and gas operators and landowners. He has extensive experience litigating a broad spectrum of oil and gas issues, including retained acreage issues and related title claims, and he regularly advises clients on these topics. He often speaks at Texas oil and gas CLE seminars, and will be presenting on the topic of retained acreage at the 48th Annual Ernest E. Smith Oil, Gas and Mineral Law Institute on April 22, 2022 in Houston.*

For more information about the issues discussed in this article, contact Derrick at 512-495-6082 or dprice@mcginnislaw.com.

FEATURED ARTICLE

Three Tips for Responding to Third Party Subpoenas in the Energy Industry

By: William K. Grubb

In my practice, I have assisted clients ranging from publicly traded energy companies to individual executives in responding to third party subpoenas. Each subpoena is unique and fact dependent. However, below are three things to keep in mind when you or your company receive a third party subpoena.

1) HAVE COUNSEL ANALYZE THE SUBPOENA QUICKLY

Subpoenas can seek all sorts of information. For instance, a litigant may need something benign, like invoices to prove damages. Conversely, a subpoena can be a precursor to being made a party to ongoing litigation. Either way, it's important to have counsel analyze the subpoena shortly after receiving it. If the information requested is confidential or has the potential to lead to further claims, counsel will need time to develop a strategy to provide all discoverable information while protecting the client's interests. Additionally, various jurisdictions have different rules governing subpoena responses. Of note, the Federal Rules of Civil Procedure provide additional protections that can be raised only before or at the time a response is due under a subpoena. Accordingly, it's important to make sure counsel and the client's decision makers understand the client's options before deadlines pass.

2) IDENTIFY THE PERSONS WITH KNOWLEDGE OF RELEVANT FACTS AND DOCUMENTS

In responding to a subpoena, there is a balance between providing discoverable documents and the burden imposed on a non-party to the litigation. The scope of document collection can vary on the nature of the underlying litigation. Complex commercial litigation may require an extensive email search within an organization. Conversely, a subpoena seeking routine invoices between a client and a vendor may require a less extensive search. Either way, the party in receipt of a subpoena will often save time and money by identifying which person(s) in an organization have a strong knowledge base of the topics that are the subject of the subpoena. Often times, company executives or in-house counsel will have very limited knowledge of the information subpoenaed. An early conversation with others in the organization who understand the particular department or business practice implicated by the subpoena can prevent duplicative or unnecessary searches for documents. In my experience, the earlier contact is made with a person who understands the topic, the more efficient the client and counsel can be in responding to the subpoena.

3) DETERMINE WHETHER THE UNDERLYING LITIGATION HAS A PROTECTIVE ORDER IN PLACE

Subpoenas can often seek a company's internal communications. These can range from day-to-day operational information to strategy discussions between members of the C-suite. If there is a protective order in place in the underlying litigation, such orders may have provisions allowing third parties to claim the additional protections by designating information as confidential or attorney's eyes only. Most outside counsel, including McGinnis Lochridge, have resources to quickly find documents filed in the underlying litigation, including protective orders. It's important to use these resources to make sure you or your company are not producing documents that could have additional protections under a protective order.

About the Author

William K. Grubb *assists clients with complex commercial litigation, with an emphasis on oil & gas. 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. For more information, contact Will at 713-615-8515 or wgrubb@mcginnislaw.com.*

Emerging Issues in the Use and Disposal of Water

By: Austin W. Brister and Kevin Beiter

Oil and gas exploration involves a lot of water. A recent study commissioned by the Texas Water Development Board predicts that the oil and gas industry's demand for water in exploration, development, and extraction operations will continue rising through at least the year 2030.

Water has always been of significant concern in oil and gas operations, and traditionally presented fertile ground for conflict. But as demand for water supply and water disposal have relentlessly increased, competing interests around water have bred new grounds for disputes.

Conventional plays required some water for drilling and completing wells. But even greater volumes were consumed in secondary recovery and enhanced oil recovery operations that utilize water to extract oil that would otherwise be unrecoverable. Water disposal and its related costs often determined the productive lives of wells and fields.

Of course, the advent of horizontal drilling and hydraulic fracturing in unconventional shale plays have increasingly elevated two issues – how to supply the massive volumes of water needed to complete wells, and how to adequately manage the generated flowback wastewater.

In response, the oil and gas industry has continued to rapidly evolve, and each evolution presents new and previously unimagined analytical challenges. Will Rogers famously said: "Even if you're on the right track, you'll get run over if you just sit there."

In this brief article, we highlight a few major areas of emerging issues surrounding water in oil and gas operations, from the acquisition of the water, to its use, re-use and disposal.

Groundwater

In Texas, groundwater is generally considered a part of the surface estate. As with other aspects of the surface estate, a mineral lessee generally enjoys an implied right to use the groundwater, including for secondary recovery purposes.

The implied right of use, however, is not without its limitations. For instance, it is limited to operations that are both reasonable and necessary to develop and produce the minerals. Thus, landowners may claim that the lessee's use was unreasonable, or exceeded a reasonably necessary use, potentially resulting in claims such as negligence, trespass, or breach of contract. As illustrated one recent case, sometimes even the owner of a severed surface interest may have a viable cause of action for breach of lease provisions pertaining to the surface estate. *Henry v. Smith*, 2021 Tex. App. LEXIS 9508 (Ft. Worth, 2021, pet. filed).

Another critical limitation on the implied use rights is that they do not include the right to use the groundwater to benefit lands other than the leased premises. *See, e.g., Robinson v. Robbins Petro. Corp.*, 501 S.W.2d 865 (Tex. 1973). In other words, even if a lessee has assembled a significant acreage position in an area, that lessee, absent landowner consent, may not be able to use water from a water well on one tract to benefit other tracts.

An example of these limitations in play is *Sun Oil Co. v. Whitaker*, in which a surface owner contested a mineral lessee's use of underground fresh water from wells it intended to drill on the landowner's surface tract for waterflood operations. The surface owner complained that the underlying groundwater formation was closed and would not replenish itself, and that the lessee's use for waterflood operations would unreasonably deplete the water supply. The surface owner argued that the mineral lessee should be required to source water from off the leased premises. 438 S.W.2d 808 (Tex. 1972).

The Texas Supreme Court, in a 5-4 opinion, entered final judgment granting the mineral lessee's request for injunctive relief. The Court rejected the idea that the mineral lessee should be required to accommodate the surface owner by acquiring water from other tracts of land. In doing so, the Court expressly limited the accommodation doctrine to "situations in which there are reasonable alternative methods that may be employed by the lessee *on the leased premises* to accomplish the purposes of [the] lease." *Id.* at 812.

On the other hand, in at least one case a landowner claimed that the accommodation doctrine *required* the lessee to produce and purchase water from the lessor's property. In the 2018 case *Harrison v. Rosetta Res. Operating, LP*, 564 S.W.3d 68, 70 (Tex. App.—El Paso 2018, no pet.), a lessor who also owned the surface settled a prior dispute with a mineral lessee by entering into a settlement agreement that, among other things, required the lessee to buy 120,000 barrels of water from the lessor.

That prior lessee later sold the lease to Rosetta, and Rosetta began purchasing water from an adjacent property owner. The surface owner sued Rosetta, arguing that Rosetta violated an alleged local custom called the "West Texas Rule." The surface owner described that alleged custom as a creature of the accommodation doctrine, requiring lessees to buy water from the surface owner. The surface owner claimed that, by not purchasing his water, Rosetta damaged his surface estate by making his existing water well and frac pit useless.

The court rejected these claims, stating that "categorizing a refusal to buy goods produced from the land as 'interference' with the land for purposes of the accommodation doctrine would stretch the doctrine beyond recognition." *Id*. at 74.

Groundwater Mining

Given the restrictions on the implied use rights outlined above, lessees needing large volumes of water across multiple leases will often enter into a groundwater lease with the surface owner, or purchase water from a third party.

For this reason, a service industry has formed in some regions, where companies focus on groundwater mining, producing large quantities of water for sale to operators in the area for use in secondary recovery or fracturing operations. Such arrangements often include a groundwater lease with the surface owner.

Ownership of Produced Water

Oil and gas exploration and production often results in high volumes of waste water. Two types of waste water associated with an oil and gas well include: (1) flowback water and (2) produced water. Flowback water is basically all of the water and fracing fluids, mixed with drill cuttings and drilling muds, that were used in drilling and completing the well. After completion operations, a large percentage of those volumes of water will return to the surface, and must be disposed of.

Produced water, on the other hand, is water found naturally in oil and gas reservoirs. Produced water is produced from the well along with oil and gas. Depending on geological factors, produced water rates often increase over the life of a well as the reservoir is depleted.

In 2012, the Texas Supreme Court held that the surface owner has a vested property right in the groundwater below their property. *Edwards Aquifer Auth. v. Day*, 369 S.W.3d 814, 831 (Tex. 2012). However, effective September 1, 2019, House Bill 3246 amended Tex. Nat. Res. Code § 122.002 to include a paragraph reading:

> when fluid oil and gas waste is produced and used by or transferred to a person who takes possession of that waste for the purpose of treating the waste for a subsequent beneficial use, the waste is considered to be the property of the person who takes possession of it for the

> purpose of treating the waste for subsequent beneficial use until the person transfers the waste or treated waste to another person for disposal or use.

The legislation effectively transferred ownership of subsurface water produced in oilfield operations from the surface owner to the producer. That bill has been the subject of some criticism on constitutional grounds. However, as of the date of this article no reported decisions have discussed this bill.

Subsurface Salt Water

The implied right to use the surface generally extends to subsurface salt water as well. Overall, the mineral estate's use of subsurface salt water in operations presents fewer issues than use of fresh water. If the water is too saline or impure, it is not particularly valuable to either estate and, in fact, the incidental production and improper, negligent handling of salt water can result in claims.

Moreover, since the chemistry of frac water is important to effective formation stimulation, excessively saline water with the wrong chemical components is not usable, though efforts at water filtration and recycling are being developed to address these (as well as regional supply and cost) issues.

Water Disposal

Saltwater disposal has become a profitable segment of the oil and gas industry. The ability to handle and dispose of salt water and other oil and gas wastewater is now critical to the business of oil and gas.

However, it is also sometimes seen as problematic from the public policy standpoint. In addition to routine concerns about inadvertent or negligent injection of oil and gas wastewater into unintended formations—formations that are productive of oil and gas or, of more concern, productive of domestic water supplies—there has been some public association of high injection volumes with induced seismic activity.

Moreover, disposal operations (and oil and gas waste management generally), if improperly undertaken by a mineral owner, can result in claims by the surface owner based upon the obligations to use the surface estate reasonably and non-negligently. Induced seismicity has implications both in the realm of excessive or negligent use claims and public nuisance.

Wastewater disposal by a mineral owner is subject to essentially the same analysis as groundwater and the doctrine of reasonable use generally. Surface disposal of salt water may be seen as unreasonable in any given case and, in any event, is seldom a viable, permanent solution. Moreover, surface storage and disposal is generally subject to a host of regulations of state and federal agencies, including the U.S. Fish and Wildlife Service. Disposal by injection is the more common and accepted route.

At least one Texas court expressly held that disposal of salt water in nonproductive formations on the property is not an unreasonable use of the surface estate. *See TDC Eng'g, Inc. v. Dunlap*, 686 S.W.2d 346 (Tex. Civ. App.—Eastland 1985, writ ref'd n.r.e.).

Again, while the surface estate owns the subsurface formation mass, the mineral lessee owns a right to make reasonable use of the surface estate, and (absent limitation in the grant or lease) this should include use of open pore space in the subsurface for injection and disposal of produced water. Again, the right to dispose of produced water from lease production would not extend to the allow the injection and disposal of waste water derived from other lands. The surface owner's consent is required to conduct saltwater injection for disposal of water not generated by operations on the land.

Accommodation Doctrine

Groundwater serves a critical role in oil and gas production. Oil and gas lessees and their water supply chain contractors should determine whether, and to what extent, groundwater operations must accommodate existing surface uses.

In the 2012 case of *Edwards Aquifer Authority v. Day*, the Texas Supreme Court discussed similarities between minerals and groundwater and held that the ownership of groundwater is similar to the ownership of minerals, in that they are both owned in place. 369 S.W.3d 814, 832 (Tex. 2012). Left unanswered in *Day*, however, was the extent to which other oil and gas doctrines, such as the accommodation doctrine, are applicable to groundwater operations.

In the 2016 case, *Coyote Lake Ranch, LLC v. City of Lubbock*, the Texas Supreme Court addressed whether the accommodation doctrine also applies between a landowner and the owner of an interest in the severed groundwater estate. 498 S.W.3d 53 (Tex. 2016).

While the facts of that case are interesting, they are beyond the scope of this brief article. In sum, however, the Texas Supreme Court concluded that the accommodation doctrine has been soundly applied in a wide variety of contexts in the oil and gas industry. The Court also noted that there are numerous similarities in the nature of the mineral and groundwater estates, as well as in their conflicts with surface estates. As a result, the Court extended the accommodation doctrine to groundwater interests.

Conclusion

We routinely represent clients in the oil and gas industry in matters relating to the production, purchase, use, and disposal of water. These matters can become very complex, but we strive to cut through the noise to find the heart of the analysis. We are careful to align our strategy and approach with our clients' overall business goals and budget. In disputes, that often means pushing to find practical resolutions that retain value and avoid litigation. But, when necessary, we are prepared to carry out aggressive strategies in the courthouse, and we routinely appear in courtrooms across the State of Texas. This experience helps guide our transactional representations as well, as it gives us insight to assess potential pitfalls or problem areas, and close deals smoothly.

About the Authors

Austin Brister *is a partner in our Oil and Gas group. Before lawsuits are filed, Austin helps oil and gas companies analyze complicated issues, and strives to develop creative and practical business solutions. But, when necessary, Austin works hard to implement aggressive, goal-focused strategies in the courthouse. Austin frequently assists clients in resolving problems involving title disputes, injunctive relief, joint operating agreements, accounting issues, royalty disputes, lease termination disputes, surface use and trespass issues, purchase and sale issues, lease saving operations, and a host of other oil and gas issues..*

Kevin Beiter *represents clients as both a trial lawyer and transactional lawyer. With a background in petroleum geology, he has operated and participated in oil and gas exploration and development projects across North America. As a transactional lawyer, he has represented owners and operators with documentation, due diligence, and business counseling for acquisitions and divestitures and for exploration and operation. As a trial lawyer, he has represented plaintiffs and defendants, both majors and independents, in energy and environmental disputes.*

For more information, contact Austin at 713-615-8523 or abrister@mcginnislaw.com or Kevin at 512- 495-6084 or kbeiter@mcginnislaw.com.

Difficulty Serving a Defendant? Have You Tried Online Service?

By: Marcus Eason

While real-world service of process (usually) is not as interesting as Hollywood would have us believe, difficult service issues can and do arise in oil and gas suits. For instance, some people actively avoid service of process and others are just plain difficult to find.

Whatever the cause, sometimes it is challenging to pin down an address for service. When this happens, one option may be to resort to traditional, costly methods of achieving personal service (such as repeated attempts, stake-outs, or private investigators). Another option would be your run-of-the-mill substituted service, but if you do not know where a defendant can be found, that option may not be available.

But what do you do when you are unable to find a defendant online? In today's world, a growing number of litigants are turning to a new method of service – electronic service. On December 31, 2020, Rule 106 of the Texas Rules of Civil Procedure was amended to include, for the first time, the option of achieving substituted service through technological means. *See* TEX. R. CIV. P. 106. Specifically, the text of the new rule allows for substituted service to be completed "electronically" by way of "social media, email, or other technology," so long as the movant can show that such method will be "reasonably effective to give the defendant notice of the suit." This new option opens up the possibilities one may have in serving the elusive defendant.

Those wanting to take advantage of this modern version of Rule-106 should note potential difficulties in proving that a social media profile or email will be "reasonably effective to give the defendant notice of the suit." For example, regular users of social media will note the uncertainty at times in determining whether a social media profile actually belongs to a named individual. Given the language of Rule 106, recent activity on social media pages such as photo uploads, location tags, or other posts may provide evidence that such profile belongs to the defendant. Similar difficulties may arise in determining whether a defendant owns and has recently used an email account.

Regardless, the new Rule 106 in certain cases may provide an alternative avenue for substituted service that once did not exist. A crafty litigator will keep this in mind as another tool in the toolkit.

About the Author

Marcus Eason *is a partner in McGinnis Lochridge's Houston office. Marcus practices in State and Federal Courts across Texas, and represents both entities and individuals in a wide array of business litigation matters.*

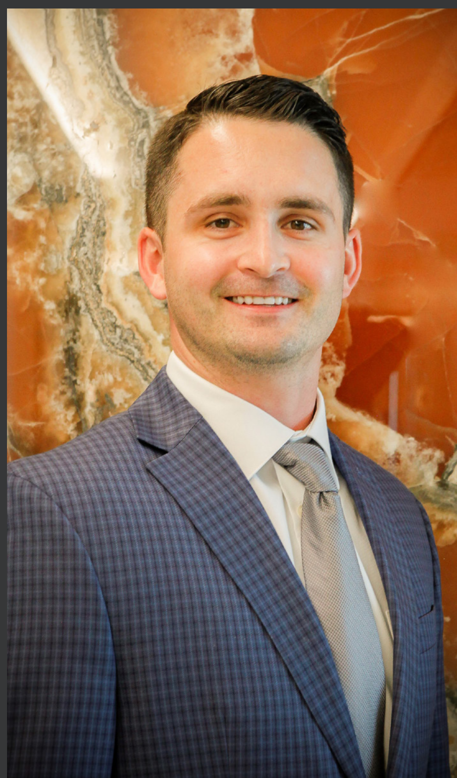
For more information, contact Marcus at 713-615-8500 or ***meason@mcginnislaw.com****.*

NEW ATTORNEY ANNOUNCEMENT

McGinnis Lochridge Welcomes

Two Oil & Gas Attorneys

Seth Isgur



Logan B. Jones

We are pleased to welcome two new lawyers in our Houston office, Seth Isgur and Logan B. Jones.

Seth spent 15 years at his previous firm focusing his practice on energy litigation and was a partner in the Energy Litigation Group at Norton Rose Fulbright. He was also the head of the firm's Eminent Domain Group, representing entities that condemned property and chairing over 50 special commissioner meetings across Texas.

"Seth brings an extraordinary amount of depth and knowledge to our oil and gas practice group as well as our Houston office. We are looking forward to Seth joining our team," said Houston partner-in-charge Jonathan Baughman.

Logan is joining the oil and gas practice group as an associate in the Houston office. His practice focuses on litigation with an emphasis on oil and gas issues. While in law school, Logan worked as a Legal Intern for a pipeline compression company and served as a Clerk for the Railroad Commission of Texas. Prior to joining the firm, Logan worked for another Houston firm that focused primarily on litigation of maritime issues.

"We are pleased to welcome these talented new colleagues to the firm," said Doug Dodds, Managing Partner. "Their arrival adds significantly to what we can offer our clients."

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Interpretation of Separate Lease Clause Leads to Lease Termination

Tier 1 Resources Partners v. Delaware Basin Resources, LLC, 633 S.W.3d 730 (Tex.App.—El Paso 2021, pet. filed).

By: Chris Halgren

In *Tier 1 Resources Partners v. Delaware Basin Resources, LLC*, the El Paso Court of Appeals held that a lease covering two 640-acre sections of land terminated as to one 640-section at the end of the lease's primary term. The court held that a "separate lease clause" required the lessee to treat the two sections as if covered by two separate leases. The lease required the lessee to release all acreage at the end of the primary term, unless the acreage was dedicated to a production unit or the lessee suspended automatic termination by conducting continuous development operations. The lessee conducted operations on only one section during the primary term, because of its holding that the sections were considered to be covered by separate leases, the court held that the lease terminated as to the other section where no operations were occurring.

In or around 2014, Delaware Basin Resources, LLC ("DBR") entered into oil and gas leases with several lessors that the *Tier 1* court referred to as the "Bush Lessors." The leases were on identical forms and covered different parcels of land. The lease subject to dispute covered two, non-contiguous 640-acre (more or less) sections of land, referred to as "Section 6" and "Section 2." The habendum clause in paragraph 2 provided that "[u]pon lease expiration, DBR's interest automatically terminated 'as to all the lands and depths then covered thereby except lands and depths then designated by Lessee . . . to be within a 'production unit' . . . assigned to each well then producing in paying quantities on the leased premises or lands properly pooled therewith.'" The court noted that DBR could suspend termination of the lease, if it timely conducted continuous development operations. However, Paragraph 11 expressly provided "each of the separately designated tracts described shall be treated for all purposes as a separate and distinct Lease." *Id.* Nothing in the lease was expressly designated a "tract."

Prior to the end of the primary term, DBR conducted operations on Section 6, but conducted no operations on Section 2. In 2017, a time after the primary term had expired and Section 2 had not been developed, the Bush Lessors executed a new oil and gas lease, with Tier 1 Resources as lessee, covering Section 2. DBR filed suit against Bush Lessors and Tier 1 Resources, contending that its lease had not expired and the Tier 1 Resources' lease was a cloud on DBR's title.

Although there were several issues in dispute, the court and the parties agreed that the central issue was whether DBR's lease had terminated as to Section 2 at the end of the primary term. The court held that Section 2 was "a clear, precise, and unequivocal special limitation that automatically terminates the lease if no operations are conducted on the covered land during the primary term." *Id.* at 739. DBR did not dispute this conclusion, but did dispute whether the lease should be interpreted as one lease covering two sections, so that operations on Section 6 would not perpetuate the lease as to Section 2.

After construing Paragraph 2, the court commented that the "dispute centers around the first sentence of Paragraph 11," which provides "Notwithstanding any other provisions in this Lease or any wording contained herein . . . each of the separately designated tracts described shall be treated for all purposes as a separate and distinct Lease." *Id.* at 740. The court explained that it was required to construe this sentence as directed by the Texas Supreme Court, such as harmonizing it with the rest of the lease in a manner which gives it effect and applying the language's plain meaning.

Ultimately, the court concluded that Paragraph 11 required the lease provisions to be applied separately to Section 2 and Section 6. Although the term "tract" was not defined in the lease, the court applied the plain meaning of that term and concluded that it must refer to the two separate sections. When the lease terms were separately applied to Section 2, where DBR conducted no operations during the primary term, the court held that the lease terminates as to that Section.

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Tips for Mediating Your Next Oil & Gas Dispute

By: Paul D. Clote and Austin W. Brister

Mediation has become an indispensable tool in Texas, allowing many lawsuits to be processed faster, more accurately and more economically. Over the last 25-years, the costs of litigation and the time to reach trial have increased exponentially. Meanwhile, in-house counsel increasingly are faced with smaller budgets, fewer in-house resources, and an expanding role in running the business and achieving corporate objectives.

In most cases, mediation can be used to rein in costs and speed up resolution of disputes—whether title issues; deal disputes; operator/non-operator disputes; royalty disputes; surface disputes; tubing failures or any number of downhole operation failures.

As oil/gas practitioners are aware, mediation is merely a third-party assisted settlement conference, in which an independent neutral helps the parties communicate, explore settlement options (including business solutions), and craft a binding settlement agreement that brings finality to the dispute.

The idea for this article arose after the authors were comparing notes about what worked and didn't work at recent oil/gas mediations. Paul Clote built his reputation as a trial lawyer over four decades. In recent years, he has transitioned his practice to serving exclusively as a mediator and arbitrator, often in oil/gas disputes.

Austin Brister is a highly experienced oil and gas litigator, focusing on operator/non-operator disputes, lease disputes, and "deals gone wrong." After exchanging observations, we thought it might be helpful to highlight recommendations to when mediating oil/gas cases. We hope you find this article insightful, and welcome any feedback or comments by email or phone call.

Tip 1: Is Your Case Ripe for Mediation?

It is important to know whether your case is ripe for mediation. Yes, one of the hallmark benefits of mediation is avoiding potentially unnecessary litigation expenses. However, some disputes are not ripe for mediation until critical threshold discovery has been completed; otherwise, mediation may be an exercise in futility and simply embolden the opposing party.

Prior to mediation, all parties should have exchanged sufficient information to capably analyze the claims and defenses, alleged damages and the risks inherent to trial. If both parties cannot accurately assess liability, causation and damages prior to mediation, do not expect meaningful settlement offers and counter-offers to be made.

Many oil and gas cases are quite complex, factually and legally. Parties often have divergent, polarized views of the material facts and legal analysis. If one party does not understand or appreciate the counter-party's position, the potential for impasse at mediation is much greater.

This is not to say that a case is only ripe for mediation once both sides have exhausted all discovery that otherwise would be completed prior to trial. Instead, evaluate whether sufficient discovery has been undertaken to allow both sides to meaningfully evaluate the risks, anticipated costs, and value of a business solution.

Whether a case is ripe for mediation may depend, to varying degrees, on whether the parties have consulted with expert witnesses, or undertaken expert discovery. Oil/gas disputes often involve expert witnesses, such as a metallurgist to evaluate casing failures; an engineer to evaluate prudent operator or negligence claims; well interference claims; drainage, operational issues or delays; accountants to evaluate damage models; experts regarding custom and usage; or surveyors regarding boundary lines. In complex cases, the parties may need to prepare for mediation by consulting with their own expert witnesses. In some cases, the parties may consider bringing their experts to the mediation, or having the experts on standby for consultation during the mediation.

Whether the case is ready for mediation also may depend on whether insurance coverage exists for the alleged loss; whether the carrier has been placed on notice and performed its requisite investigation; whether any coverage issues exist; and whether the insurance carrier has developed sufficient information to set necessary reserves.

For example, in litigation over reservoir damages, pipe failure, or a blowout, the parties should ensure that the insurance carrier has all necessary information prior to mediation. The insurance carrier must have sufficient information to assess liability risks, potential damages, and a realistic case value. If the insurance company has not set appropriate reserves sufficiently in advance of the mediation, the potential for success at mediation is greatly diminished. Adjusters never want to make decisions on the fly or enter into settlements that are not consistent with their reserves.

If you are representing an insured operator, a driller or other service company, and if the carrier is disputing coverage for some or all of the alleged losses, you may want to engage specialized coverage counsel for your insured.

Tip 2: Consider Early Mediation (But Only for the Right Case)

As a counter-point to the first tip, consider whether an early mediation might prove beneficial.

Early mediations do entail greater risk because, generally, there is less information available to assess the claims and defenses. Of course, prioritizing the necessary discovery is a challenge for even the most experienced litigation counsel. Cases are always full of surprises.

In the right case, however, there can be significant value to an early mediation (aside from obtaining quick, inexpensive discovery). Early mediations can be successful, but only if the oil/gas practitioner carefully analyzes the legal claims and undertakes the requisite investigation and documentation.

Many disputes can be ready for mediation before a lawsuit is ever filed. For instance, for the right case, a pre-lawsuit mediation may be appropriate after the mere exchange of demand letters, basic documentation and perhaps a draft complaint. A key factor is whether sufficient information has been exchanged to allow the parties to engage in a productive mediation.

In recent years, more and more contracts have included mandatory mediation provisions. The inclusion of a mediation provision can prove useful in preventing a race to the courthouse, and encouraging parties to first attempt to find good faith business solutions.

Early Dispute Resolution, sometimes referred to as EDR (or in the vernacular of the ABA, "Planned Early Dispute Resolution"), may offer benefits as well. EDR is a new approach to mediation, with parties and counsel jointly committing to an accelerated exchange of the most important documents and witness information; followed by an exchange of decision tree analytics that guide settlement offers. In the coming years, EDR may offer some litigants even greater savings in fees, costs and expenses, while promoting accurate case evaluations.

Tip 3: Adequately Prepare in Advance of the Mediation

Preparing the case and your client for mediation are often overlooked. In advance of the mediation, it is helpful to generate a written legal analysis of liability, causation and damages; and to meet with your client to discuss the issues.

Key to success at mediation are accurately evaluating the claims and defenses; analyzing the strengths and weaknesses of the issues, assessing the probabilities of specific liability and damage findings; understanding clearly the client's goals and objectives; anticipating how the opposing party is likely to negotiate at mediation; developing a reasonable settlement range for the specific case; formulating a plan on how to negotiate toward that targeted settlement range; and analyzing the best alternative to a negotiated agreement. Also important are anticipating the additional steps to complete discovery prior to trial, and the budget for trial of the case.

These suggestions may seem obvious, but often, some of these vital preparations may be overlooked. Successful lawyers arrive at mediation having previously spent meaningful time with their clients discussing the strengths and weaknesses of the case, and assessing the projected cost and expense of proceeding to trial.

Mediators can, and should, assist the parties by prompting these conversations and asking the right questions so clients can appreciate case value. But there is only so much a mediator can do, particularly given the short amount of time available. If a client arrives at mediation with significantly inflated expectations, or significantly underappreciating the risk, it can be difficult to re-set those expectations in the short time available. Good lawyers precondition their clients to understand the economic realities of the case, and the risks and expenses going forward.

After submitting written materials to the mediator, but prior to mediation, educate the mediator by using Zoom or telephone calls to discuss details of the litigation, brainstorm ideas for settlement and identify potential obstacles to settlement.

Tip 4: Use a Mediator Well-Suited for the Particular Case

Mediators are not "one size fits all." Mediators widely vary in terms of temperament, personality, experience, style or approach to the settlement process. Key to a successful mediation is selecting the right mediator—one that is well-suited to guide the parties to settlement.

It is very helpful if the mediator has experience in the type of case, industry area, or area of law involved. That expertise can be critical to understanding the case, evaluating the claims, and assisting the parties in getting to closure.

The personalities and emotional characteristics of the parties also may affect the mediator selection. If one or more parties are hard-headed, intransigent and refuse to acknowledge reality, consider using a mediator that has a blunt, extremely direct, evaluative approach. Such a "pile driver" mediator may help one or more parties appreciate the weaknesses in claims or defenses. That type of mediator, however, must be careful not to alienate the parties.

Another mediator style might be described as "listener/communicator." While all mediators are trained to listen actively, this style of mediator focuses on understanding how emotional or inter-personal conflicts may — sometimes unconsciously — drive a case.

Austin recalled a recent mediation where he represented an oilfield service company. The president felt his contributions were significantly under-appreciated and he was offended by the operator's audit and subsequent refusal to pay invoices. The chosen mediator was an extremely careful listener with a disarming demeanor. The mediator's approach helped the client know that his positions and arguments were understood and valued. That, in turn, helped guide the mediation toward a business resolution.

Tip 5: Develop a Strategic Approach, But Don't Be Afraid to Modify Your Strategy

Every case is different and every mediation is different. Parties should consider how they wish to negotiate at mediation, and develop a strategic approach to getting to settlement.

Since most mediations last long, full days, be mindful not to play all the cards at one time. Pace your presentation of evidence, legal arguments and issues to maximize the benefit of the arguments.

At some point in the day, the parties'

negotiations will likely be reduced to trading economic proposals. Until that happens, use the case details to help move the economic trades.

Tip 6: Keep an Open Mind, Remain Flexible, and Just Keep Moving

Parties achieve reasonable and appropriate settlements when they and their attorneys remain open-minded and flexible to considering a variety of settlement options.

Often, there may be a business solution that makes the most sense. Gas contract disputes, non-compete cases, trade secret disputes, patent infringement claims all have the potential for business solutions.

At mediation, good lawyers will persistently focus on their client's objectives. The recovery of cash compensation may not be the only or best way to achieve a settlement. Creative lawyers really do aid their clients by considering multiple settlement options.

Your initial impression of the appropriate settlement structure may not ultimately be the most conducive to reaching a resolution. Stay open-minded, and think outside the box, because a different structure may ultimately secure your client a favorable outcome.

Regardless of how stressful, how anxious or temperamental a party or counsel may be, remember that settlements often come at unexpected turns.

The mediation itself is a process. No matter where parties start their bargaining, and regardless of the negotiation tactics employed, persistence at mediation pays off. If settlement discussions appear to be falling apart, encourage the mediator to present multiple options to both parties. Consider using brackets, high-low proposals, "if/then" and "what would it take" questions, mediator proposals and similar procedures.

Tip 7: Remember Parties are There for a Prudent Business Decision, Not to Win a War

Most lawyers have been in a mediation where one or more parties become angry, frustrated or act out. Just deal with it. Sometimes venting is necessary for a party. Look to the mediator to retain control of the process and keep the settlement train on the tracks.

Hopefully, parties or lawyers will not become fixated on being "right" or the other side being "wrong." Instead, their focus should be on what would constitute an informed, reasonable business decision. As Mick Jagger says, "You can't always get what you want." In most cases, if the settlement terms are barely palatable to both parties, the settlement probably is appropriate.

Engaging in principled negotiations; taking the high ground; emphasizing your client's reasonable and realistic positions all pay dividends. Pie-in-the-sky demands or unrealistic cellar offers invite similarly unreasonable offers. If the parties are realistic about the facts of the case, the applicable law, and the case value, and if they accurately assess their litigation risks and expenses, the case will usually settle.

Patience pays enormous benefits. It is not uncommon for mediation to succeed because it provided a forum for one party to "be heard." Airing grievances takes time. Always look for ways to advance, constructively, the settlement discussions. Confrontational brinksmanship does not work. Patient advocacy does.

All parties should attend mediation with the focus on settlement terms based on the merits of the case or defense, and make informed business decisions. Bullying, threats, intimidation, and extreme hyperbole serve no useful purpose in mediation.

While the laser focus of all parties should be on realistic case value, parties should remain mindful of the collateral consequences to litigation. Tangible and intangible litigation costs and consequences do exist. For instance, reputational damage from litigation is possible. Rather than just being a legal gladiator, lawyers serve their clients best when they counsel them with wisdom, experience and insight.

Tip 8: Get the Settlement in Writing, With All Material Terms

Once an agreement in principle is reached at mediation, take all necessary steps to ensure that the settlement terms are reduced to a binding and enforceable agreement. If parties leave a mediation without a written, enforceable agreement, one or both parties may later develop "buyer's remorse." Without a binding agreement, one party or another may conclude overnight or upon several days' reflection, that they "could have/should have/would have" done something different at mediation.

That underscores the importance of: (a) getting all the right preparation for the mediation accomplished on the front end; and (b) getting the settlement agreement in writing, signed by the parties before they leave the mediation.

Oil and gas cases often involve complex issues. Lawyers should anticipate detailed settlement terms in advance and consider preparing a draft mediation settlement agreement before attending the mediation. Clients know their business the best of anyone, so obtaining all necessary comments and feedback from the client regarding potential settlement options is vital. Even if a more formal, detailed settlement agreement is necessary to implement the settlement terms, before leaving mediation, the parties should get all material terms of the agreement in writing and signed.

The mediation settlement agreement must be clear and have no ambiguities or material uncertainties. Otherwise, more litigation is likely.

Attorneys also should pay necessary attention to important non-monetary settlement terms. For example, in an oil/gas case, a material, non-monetary term may include repair or remediation; processing of electronic data; amendments to operating agreements or AMIs; agreements regarding future operations or accounting treatment; title curative instruments; tax provisions; releases or the discharge of outstanding liens. As with any case, a settlement may include non-disclosure and/or non-disparagement terms, or non-compete and/or non-solicitation terms. Parties are well-advised to pay special attention to any settlement terms that might offer the opportunity for future disputes between the parties.

Occasionally, the injection of non-monetary terms may disrupt the settlement negotiations at mediation. Timing is everything. Depending on the case, it may make sense to ask for non-monetary terms only after the parties are very close on the financial terms.

On the other hand, asking for certain non-monetary terms might significantly alter the monetary value of the amounts that parties could pay or accept. In those cases, it is advisable to raise those terms prior to reaching agreement on financial terms.

Conclusion

Every dispute is different, and every mediation is different. Not every case can or should settle at mediation. However, at the end of the day, most oil/gas clients value business objectives over a "win-at-any-cost" approach. By adopting a business-focused approach to mediation, and diligently preparing for the mediation, parties maximize the potential for a settlement agreement that avoids unnecessary cost, time, and the vagaries of a trial.

About the Authors

Paul D. Clote *serves as a full-time mediator, arbitrator and special master in complex commercial cases. For more than four decades, he was a litigation attorney handling trials and appeals.*

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Lease Termination Case Turns on Meaning of "Leased Premises"

King Operating Corp. v. Double Eagle Andrews, LLC, 634 S.W.3d 483 (Tex.App.—Eastland 2021, no pet. h.)

By: Chris Halgren

In *King Operating Corp. v. Double Eagle Andrews, LLC*, the Eastland Court of Appeals was required to determine the superior ownership between two lessees with competing leases over the same minerals. The earliest lease, referred to by the court as the "Robison lease" covered four tracts of land in Scurry County, Texas. The court referred to the four tracts as "Tract One," "Tract Two," "Tract Three," and "Tract Four."

Through a series of conveyances, certain King entities (collectively, "King Operating") came to own the Robinson lease. The Robisons signed a new lease with Double Eagle Andrews, LLC ("Double Eagle") covering Tracts Two and Three (the "DEA Lease"). After obtaining the lease, Double Eagle challenged a well permit application filed by King Operating to drill a well on Tract Two. Double Eagle also filed suit, contending that the Robison lease had terminated and that Double Eagle's lease was superior.

King Operating contended that the Robison lease had been perpetuated by operations on Tract One because the lease provided that operations anywhere on the leased premises would maintain the other lands. However, although the Robison Lease purported to cover all four tracts, it was undisputed that the lessors of the Robison lease did not own Tract One. Therefore, the court was required to determine whether operations on a tract of land described in a lease, but not owned by the lessor, are sufficient to maintain the lease. Ultimately, the court held that the operations did not constitute operations on the leased premises and that the Robison lease terminated because no operations were conducted on lands owned by the lessor.

The court described the issue as whether the term "leased premises," as used in the Robison lease, referred to the lands described in the lease or the estate being conveyed by the lease. Based on the use of the phrase "leased premises" throughout the Robison lease, the court held that the parties use the phrase to refer to the interest being conveyed by the lease, rather than the physical lands. For instance, the lease purports to grant the lessee the right to explore for mineral on the "leased premises," but the lessor could not grant this right to lands the lessor does not own. Therefore, the court concluded the phrase "leased premises" must refer only to lands that the lessor owned.

Based on its conclusion that the term "leased premises" did not include Tract One, the court concluded that operations on Tract One could not perpetuate the lease as to the other three tracts. Accordingly, the court held that the Robison lease expired and that Double Eagle's DEA lease was superior.

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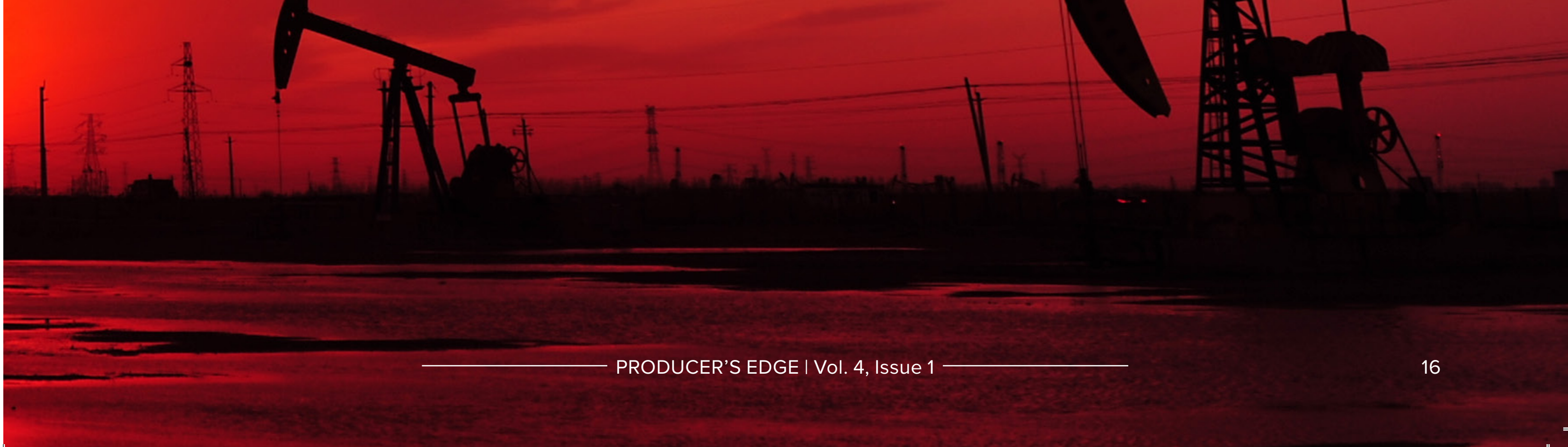

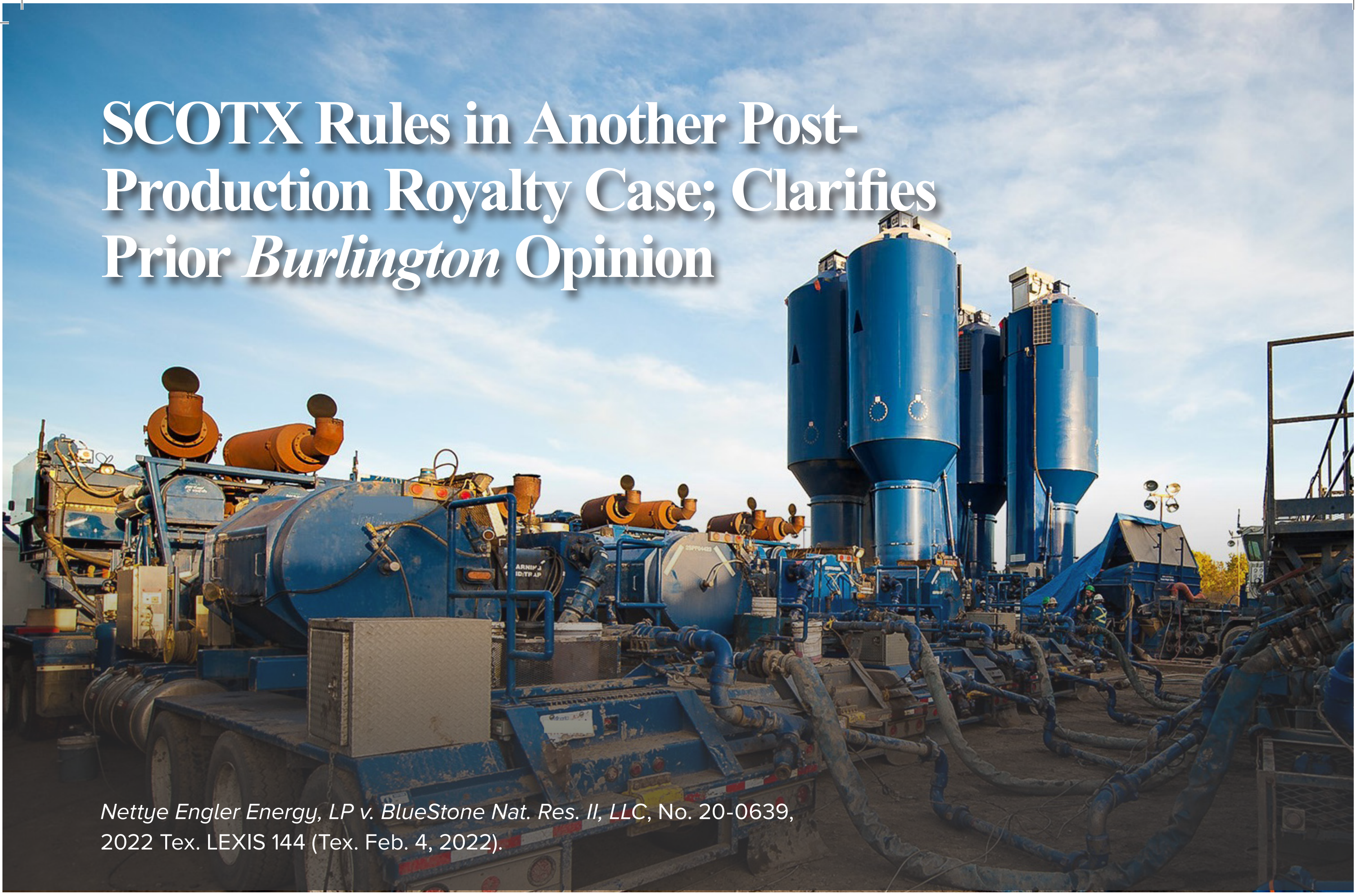

SCOTX Rules in Another Post-Production Royalty Case; Clarifies Prior *Burlington* Opinion

Nettye Engler Energy, LP v. BlueStone Nat. Res. II, LLC, No. 20-0639, 2022 Tex. LEXIS 144 (Tex. Feb. 4, 2022).

By: Austin Brister

On February 4, 2022, the Texas Supreme Court issued an opinion holding that, based on the terms of the instrument at issue, including use of the phrase "delivered to Grantor's credit, free of cost in the pipe line," BlueStone was permitted to reduce the royalty base to account for postproduction costs between the wellhead and the point of sale, and that a gathering system qualified as a "pipe line" as referenced in the instrument.

Significance and Takeaway

Perhaps one of the most significant aspects of the *BlueStone* opinion, however, is the Court's clarification of its 2019 opinion, *Burlington Res. Oil & Gas Co. v. Tex. Crude En., LLC*, 573 S.W.3d 198 (Tex. 2019). In the *BlueStone* opinion, the Supreme Court indicated that the appellate court had "misconstrued our opinion in *Burlington*" as establishing a rule that the phrase "into the pipeline" in a lease is "*always* equivalent to an 'at the well' delivery or valuation point." *Id.* at *3.

Instead, the Court emphasized that royalty obligations are a matter of construing the language of the lease, as a whole, to ascertain the parties' intent. "Although mineral transactions are subject to certain presumptions that state the 'usual' rules, we have repeatedly affirmed that parties are free to make their own bargains, and courts are obligated to enforce agreements as the parties intended." *Id*. at *28. Thus, although the *Burlington* case held that the language involved in that case equated "into the pipeline" with an "at the mouth of the well" valuation, "*we did not fashion a rule to that effect*." *Id.*

According to the Court, "the decisive factor in each... case is the language chosen by the parties to express their agreement." "Just as in *Burlington Resources*, our analysis here turns not on an immutable construct but on the parties' chosen language." *Id.*

Several recent Texas oil and gas cases have repeatedly held that parties are free to make their own bargains, and Texas courts are to construe agreements to ascertain the intent of the parties as expressed in their agreement, viewed in context of the entire agreement and not in isolation, so as to harmonize all provisions and render none meaningless.

These principles are the driving force underlying most oil and gas disputes. And these principles extend beyond just royalty disputes. Words matter, and often control the outcome in most categories of oil and gas litigation. Through a careful understanding of this approach, and a thoughtful and creative analysis of the instruments at issue, lawyers can develop an effective and persuasive strategy for the courthouse.

Factual Background

The case involved a 1986 special warranty deed, which reserved:

> 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...

Id. at *4. In 2004, the executive mineral owner executed a lease, and the lessee subsequently drilled thirty-four producing wells. For several years, the lessee calculated royalties unburdened by any postproduction costs.

In 2016, however, BlueStone acquired the leasehold interest, and began deducting a proportional share of postproduction costs. This lawsuit followed.

Analysis and Holding

The Court noted that, as a general rule, a nonparticipating royalty interest is free of costs of production, but when it is delivered in kind it generally bears its proportional share of postproduction costs.

However, as the court noted, parties may deviate from that general rule. The Court conducted a thorough review of the actual language used by the parties in order to ascertain their intent.

Engler argued that the phrase "in the pipe line" was intended to reference a downstream major transportation pipeline, and not a mere gathering system. The Court rejected that argument.

The Court noted that the deed does not refer to any particular pipeline, to any particular type of pipeline, nor any particular downstream delivery point. Moreover, because the deed did not provide a special definition for pipeline, and did not use it in a technical or special way, the Court looked to ordinary and industry definitions. In that regard, the Court pointed to definitions of "pipeline" within Williams & Meyers, as well as Webster's dictionary, and the Tex. Util. Code, all of which expressly included a gathering line.

The Court also noted that instruments requiring delivery "into the pipeline" often include additional language saying "to which the lessee connects his wells." *Id.* at *22. Indeed, such language was included in the lease at issue in Burlington. The Court reasoned that, by not including that limiting language in the 1986 deed, the parties actually made the reference to "pipeline" even broader. Moreover, that common usage reflects that it is not uncommon for the word "pipeline" to refer to a line connected to the well or on the wellsite premises.

The Court also rejected Engler's argument that the second half of the phrase, reading "otherwise free of cost at the mouth of the well," reflects a dichotomy between offsite and onsite deliveries. In Engler's view, if the lessee delivers at the well then that is onsite, and if the lessee delivers into the pipeline then that must refer to an offsite pipeline.

The Court rejected this argument. Instead, the Court examined the language of the entire provision and attempted to harmonize its terms to determine the parties' intent. The Court held that the proper interpretation is that, if a pipeline exists then the pipeline is the "preferred delivery point," and that a wellhead delivery is the "default" if no pipeline exists or the produced mineral is not capable of delivery into a pipeline. The Court reasoned that this construction best harmonized the language and created "internal consistency and parity." *Id.* at *27.

The Court also refused to consider Engler's proffered expert testimony on evidence of industry custom and usage. Engler had offered the affidavit of an attorney, who opined that the phrase "pipe line" refers to the place where title passes to a gas purchaser, and that in 1986 it was not uncommon for gathering systems to be owned by operators.

The Court did not consider Engler's expert testimony, reasoning that, although certain evidence of surrounding circumstances can be considered in construing an unambiguous contract, Engler's proffered expert testimony impermissibly would vary or contradict the plan language of the 1986 deed. Further, testimony as to how "most" gas was "usually" processed and sold under "traditional" agreements at the time "does not elucidate the meaning of the 1986 deed's words." *Id.* at *17.

About the Author

__Austin Brister__ is a partner in our Houston office. Austin represents small and mid-size oil and gas companies in a range of business disputes. Austin strives to help clients find creative and practical business solutions. But, when necessary, Austin works hard to implement aggressive, goal-focused strategies in the courthouse.

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About McGinnis Lochridge

McGinnis Lochridge is a highly experienced, multi-practice Texas law firm with more than 75 lawyers. Founded in 1927, McGinnis Lochridge has for more than 90 years maintained strong ties to its judicial and legislative traditions. The Firm has been fortunate to count among its lawyers distinguished leaders in judicial and governmental positions, including state and federal trial judges, a Texas Supreme Court justice, a Fifth Circuit justice, state and federal legislators, a past president of the Texas Bar, and even a governor of Texas. The Firm has continued to grow and adapt to meet clients' needs in a changing and increasingly complex business environment.

Today, from offices in Austin, Houston, Dallas, and Decatur, the Firm's attorneys represent energy clients throughout the country in complex litigation and arbitration. We have proven skills handling sophisticated disputes involving geology, geophysics, and petroleum engineering. Several of our lawyers have professional backgrounds and credentials in those areas. Because of the Firm's long history in handling energy disputes, the Firm's Oil & Gas Practice Group includes lawyers with a deep understanding of hydrology, seismic interpretation, log analysis, drilling, completions, hydraulic fracturing, reservoir engineering, production, transportation, hydrocarbon processing, and other related technical areas.

Throughout its history, the Firm has been a leader in the development of oil and gas law serving as trial and appellate counsel in several landmark cases setting important oil and gas law precedents. The Firm successfully represents oil and gas producers, marketers, and transporters in a wide range of matters including disputes over leasehold rights, joint interest billing, royalties, prudent operations, and constitutional limits on regulations that would unreasonably impair the oil and gas business.

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