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## Oil, Gas, and Mineral Law

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# OIL, GAS, AND MINERAL LAW

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## I. INTRODUCTION

**T**HIS Article focuses on the interpretations of and changes relating to oil, gas, and mineral law in Texas from November 2, 2004 through November 1, 2005. The cases examined include decisions of state and federal courts in the State of Texas and the Fifth Circuit

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Court of Appeals.<sup>1</sup>

## II. CONVEYANCING

### A. GRANT

*Gore Oil Co. v. Roosth*<sup>2</sup> is a deed-construction case holding that the deed in question was ambiguous and that the Duhig Rule did not apply. The deed provided in relevant part as follows:

HAVE GRANTED, SOLD AND CONVEYED, and by these presents do GRANT, SELL AND CONVEY unto the said Grantee all that certain tract or parcel of land situated in Knox County, Texas, described as follows ("Property"), to-wit:

\* \* \*

Grantor unto himself, his heirs and assigns, reserves free of all liens a full one-eighth (1/8) non-participating royalty interest in the Property subject to any previously conveyed or reserved mineral interest as may appear of record in Knox County, Texas.

This conveyance is made and accepted subject to all restrictions, reservations, covenants, conditions, rights-of-way and easements now outstanding and of record, if any, in Knox County, Texas, affecting the above described property.<sup>3</sup>

At the time the grantor delivered the deed, there was an outstanding 1/16 non-participating royalty. Grantor sued the leasehold owners when they deducted the 1/16 interest from his reserved 1/8. The working interest owners contended that the granting clause conveyed all of the "Property," that the Duhig Rule applied to reduce the 1/8 reserved in the first "subject to" clause to 1/16, and that the second "subject to" clause made the reduced grant subject to all other reservations of record.<sup>4</sup>

*Duhig v. Peavy-Moore Lumber Co.*<sup>5</sup> precludes a grantor and his successors from claiming title in a reserved fractional mineral interest if it would, in effect, breach the grantor's warranty as to the title and interest purportedly conveyed to the grantee. Disagreeing with the working-interest owners', the *Gore* court held that the Duhig Rule did not apply and that the deed was simply ambiguous.

The court could not reconcile the two "subject to" clauses and found the conflicting canons of construction not helpful. But for the second "subject to" clause, the court might have applied *Duhig*.<sup>6</sup> Because the deed was ambiguous, extrinsic evidence was admissible. The court considered three things as controlling on the question of intent: the deed, a

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1. This Article is devoted exclusively to Texas law. Cases involving questions of oil, gas, and mineral law decided by courts sitting in Texas but applying laws of other states are not included.

2. 158 S.W.3d 596 (Tex. App.—Eastland 2005, no pet. h.).

3. *Id.* at 598.

4. *Id.* at 599-600, 600 n.4.

5. 135 Tex. 503, 144 S.W.2d 878 (1940).

6. *Gore*, 158 S.W.3d at 601-02.

contemporary affidavit of record favoring the grantor, and various subsequent assignments listing the affidavit. The court upheld the judgment against the working interest owners of over \$270,000, plus \$80,000 in attorneys' fees, but reversed almost \$30,000 in prejudgment interest.<sup>7</sup> Under the Texas division-order statute,<sup>8</sup> prejudgment interest is not recoverable if there is reasonable doubt regarding a title dispute.<sup>9</sup>

## B. PROPERTY DESCRIPTION

*Freeman v. Stephens Production Co.*<sup>10</sup> holds that a reservation in a mineral deed is ambiguous and reverses and remands a summary judgment for trial. The deed in question conveyed:

. . . all that certain lot, tract or piece or parcel of land lying and being situated in Hidalgo county, Texas, to-wit:

All of Lot 1, Block 15; Lot 2, Block 15; The West 17.51 acres of Lot 3, Block 15; All of Lot 10, Block 15; All of Lot 9, Block 15; All of Lot 11, Block 15; All of Lot 12, Block 15; out of the Closner Subdivision of Porciones 71 and 72, also known as the San Juan Tract, Hidalgo County, Texas; EXCEPT such minerals as Grantor does not own; AND ALL of Lot No. 288 of the Kelly-Pharr Subdivision of Porciones 69 and 70, Hidalgo County, Texas; EXCEPT that there is reserved in Grantor an undivided one-half participating interest in and to all of the oil, gas or other minerals in or under said tract of land . . . .<sup>11</sup>

The issue was whether the reserved interest was in all the land conveyed, or only in Lot No. 288. The court held that the deed was ambiguous because the reservation in "said tract" was singular and could refer to just Lot No. 288, but the grant also referred to a single "tract" and then conveyed multiple tracts.<sup>12</sup> The court also addressed estoppel by deed, holding that estoppel by deed may be applied against grantors and grantees alike, and although the party against whom estoppel is sought must be a party or a privy, there is no corresponding requirement for the party invoking estoppel.<sup>13</sup>

## C. EXECUTIVE RIGHT

*Sauceda v. Kerlin*<sup>14</sup> considers the executive-right-holder's duty owed to a non-participating royalty owner. The case involved a complicated fact pattern bearing on the ownership of Padre Island. Simplified, immediately after the Mexican land grant to Padre Nicolas Balli in 1829, there

7. *Id.*

8. TEX. NAT. RES. CODE ANN. § 91.402(b) (Vernon 2001).

9. *Gore*, 158 S.W.3d at 602.

10. 171 S.W.3d 651 (Tex. App.—Corpus Christi 2005, pet. denied).

11. *Id.* at 653.

12. *Id.* at 654.

13. *Id.* at 655.

14. 164 S.W.3d 892 (Tex. App.—Corpus Christi 2005, pet. granted), *judgm't vacated w.r.m.*, No. 05-0653, 2006 Tex. LEXIS 201 (Tex. Mar. 10, 2006)).

was a deed and rescission involving Padre Balli's nephew, Juan Jose Balli, and Santiago Morales. Title to Padre Island, or parts of it, was repeatedly disputed by lawsuits, principally in 1902, 1923, and 1940. A 1938 motion for new trial re-opened the 1923 lawsuit. The resolution of the 1940 case and settlement of the matters raised in the 1938 motion for new trial resulted in the filing of this suit in 1993.

Lawyer Kerlin was a 1936 Harvard graduate working for his uncle at Sherman & Sterling in New York City. In 1937, his uncle sent him to Texas to purchase the Juan Jose Balli title to Padre Island from Balli's heirs and devisees. Kerlin hired Brownsville lawyer F.W. Seabury to help him acquire the deeds and litigate. Kerlin represented to the Balli heirs that if he received something through the deeds, each Balli heir would receive a 1/64 royalty. Kerlin acquired eleven deeds from various Balli heirs. Seabury drafted the deeds. Each deed reserved a 1/64 non-participating royalty.<sup>15</sup>

Seabury handled complicated and protracted litigation for the next six years. He represented multiple parties with conflicting claims to title, and he eventually engineered a global settlement that gave 21,000 acres to Kerlin. During the settlement negotiations and other related litigation, Kerlin and Seabury relied on the Balli heirs' underlying claim and the deeds from the Balli heirs to Kerlin for part of Kerlin's claim. The Balli heirs' claim was subsumed within a group of claims, but a tract of approximately 7,500 acres was repeatedly identified as tied to the claim of the Balli heirs.<sup>16</sup>

In November 1942, Kerlin, who was then in the Army, came to Texas on a three-day pass to settle the case. On November 9, at a scheduled hearing on a motion for new trial, a stipulation was filed that all matters had been settled (and later all claims were dismissed). On that same day, Kerlin met with his uncle and with his lawyer, Seabury. Seabury recommended they abandon the Balli claim. Kerlin then executed reconveyance deeds to the Balli heirs, which falsely recited that he had advised the Balli heirs of the reconveyance. Not only did he not tell the Balli heirs of the reconveyance deeds, but he also never delivered nor recorded the deeds. On that same day, Kerlin visited one of the Balli heirs, and in describing the purpose of his visit, he did not mention the settlement of the case. A month after the settlement, Seabury promised the defendants' counsel that no deed would be given to the Balli heirs to cloud the defendants' title and that the Balli interest would "die in Kerlin."<sup>17</sup>

In 1946, Seabury died. In 1953 and 1954, Kerlin told the Balli heirs that he acquired no title under the Balli deeds and that he was unable to establish the Juan Jose Balli title. In 1961, Kerlin sold the surface of the land he acquired for \$3,412,500. Over time, various payments were made to Kerlin for delay rentals and bonuses, but it is not clear from the opin-

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15. *Id.* at 903-05.

16. *Id.* at 905-07.

17. *Id.* at 907-08.

ion whether there was ever any production.<sup>18</sup>

The jury found that Kerlin acquired 7,500 acres for the benefit of the Balli heirs; that he breached his fiduciary duty to the Balli heirs with respect to the royalty interest reserved in the eleven deeds; that Kerlin and Seabury conspired and committed fraud; that Seabury breached his fiduciary duty in the settlement; and that Kerlin was estopped to deny the Balli deeds' validity.<sup>19</sup>

On appeal, the court first considered the statute of limitations issue. The Balli heirs argued that they avoided limitations by pleading fraudulent concealment and statutory tolling. Kerlin, on the other hand, argued that this was inapplicable because the settlement was a matter of public record. Thus, the Balli heirs had constructive notice. Kerlin also argued that the elements of "inherently undiscoverable" and "objectively verifiable," which are necessary to invoke the discovery rule, should apply.<sup>20</sup> The court unequivocally rejected this attempt to limit the role of fraudulent concealment in tolling limitations, and found that the Balli heirs had preserved their claim.<sup>21</sup>

The court also found that there was also a tolling under the statute which provides, "The absence from this state of a person against whom a cause of action may be maintained suspends the running of the applicable statute of limitations for the period of the person's absence."<sup>22</sup> Although this statute generally does not apply to nonresidents, it applies to a non-resident who was present in the state when the obligation arose.<sup>23</sup> The evidence showed that Kerlin was in Texas on his three-day pass when he settled the case, so the obligation arose.

Although the case is complicated by the other breaches of fiduciary duty, one section of the opinion clearly focuses on the breach of fiduciary duty imposed on the holder of the executive right. The court recognized that "Texas courts generally have applied a standard of 'utmost good faith' to one who exercises executive rights to lease or develop minerals."<sup>24</sup> But it concluded that under *Manges v. Guerra*,<sup>25</sup> the Texas Supreme Court created a fiduciary duty between executive and non-executive interest owners in mineral deeds, if the executive executes an oil and gas lease.<sup>26</sup> "[T]hat duty requires the holder of the executive right to acquire for the non-executive every benefit that he exacts for himself."<sup>27</sup> Because Kerlin attempted to eliminate or circumvent the Balli

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18. *Id.* at 908-09, 927.

19. *Id.* at 909.

20. *Id.* at 917-18 (citing *HECI Exploration Co. v. Neel*, 982 S.W.2d 881, 886 (Tex. 1998) for the principles behind the discovery rule).

21. *Sauceda*, 164 S.W.3d at 918.

22. TEX. CIV. PRAC. & REM. CODE ANN. § 16.063 (Vernon 1997).

23. *Sauceda*, 164 S.W.3d at 914, 918.

24. *Id.* at 916.

25. *Manges v. Guerra*, 673 S.W.2d 180 (Tex. 1984).

26. *Sauceda*, 164 S.W.3d at 916.

27. *Id.* (quoting *Manges*, 673 S.W.2d at 183-84).

heirs' royalty interests, he breached his fiduciary duty.<sup>28</sup> This supported an accounting, profit disgorgement, and a constructive trust as remedies.<sup>29</sup>

#### D. WARRANTY

*Geodyne Energy Income Production Partnership I-E v. Newton Corp.*<sup>30</sup> analyzes the effect of a quitclaim deed in the context of alleged violations of the Texas Security Act ("TSA").<sup>31</sup> The TSA gives buyers an affirmative defense against misrepresentations known to the seller which could not reasonably have been discovered by the buyer, and renders void any contractual provision requiring a buyer to waive compliance with the TSA. In *Geodyne*, a buyer purchased a fractional interest in an offshore lease at auction through the Oil and Gas Asset Clearinghouse—the largest U.S. mineral-interest auction.<sup>32</sup> Shortly after the purchase, the buyer was billed by the operator for the buyer's proportionate part of the plugging cost of the last well on the lease, which had already terminated. The lower courts rescinded the auction sale based on the TSA and assessed the abandonment costs against the seller.<sup>33</sup> Because the TSA was largely untested in the courts, and because of the large number of transactions regularly concluded through the auction process, the case attracted a lot of interest.

The Texas Supreme Court refused to directly consider the various issues under the TSA because it held that the quitclaim deed was dispositive of the issues in the case.<sup>34</sup> The only misrepresentation alleged was that the seller represented in the auction catalog that it was selling a ten-percent interest in a valid lease. There was no other evidence of misrepresentation.<sup>35</sup>

The Assignment and Bill of Sale used by the parties identified the lease, without stating the nature or percentage interest that was being conveyed. Seller conveyed to buyer:

. . . "all of [Geodyne's] right, title, and interest" in the described lease "AS IS, AND WHERE IS, WITHOUT WARRANTY OF MERCHANTABILITY," (2) provided that "this Assignment hereby conveys to Assignee . . . all of Assignor's right, title, and interest on the effective date hereof in and to the Property," and (3) concluded in the habendum clause that the assignment was "WITHOUT WARRANTY OF TITLE, EITHER EXPRESS OR IMPLIED."<sup>36</sup>

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28. *Sauceda*, 164 S.W.3d at 916.

29. *Id.* at 926-27.

30. 161 S.W.3d 482 (Tex. 2005).

31. TEX. REV. CIV. STAT. ANN. art. 581-33 § (A)(2) (Vernon 2001).

32. *Geodyne*, 161 S.W.3d at 490.

33. *Id.* at 484.

34. *Id.*

35. *Id.* at 486.

36. *Id.* at 487.

The court held that this was a quitclaim deed as a matter of law. A warranty deed conveys property, while a quitclaim deed conveys the grantor's rights in that property, if any. "In deciding whether an instrument is a quitclaim deed, courts look to whether the language of the instrument, taken as a whole, conveyed property itself or merely the grantor's rights."<sup>37</sup>

A quitclaim deed is commonly used to convey "interests of an unknown extent or claims having a dubious basis," and thus "a quitclaim deed *without warranty of title* cannot be a warranty (or 'misrepresentation') of title."<sup>38</sup> The court found that quitclaim deeds served many useful purposes, and that the TSA should not be construed to outlaw quitclaim deeds by indirectly requiring a warranty.<sup>39</sup> Although the case did not clarify the TSA, it is significant because the court so strongly and carefully adhered to the established and fundamental concepts behind the use of a quitclaim deed. There was no evidence of actual fraud, and in using a quitclaim deed under these circumstances, the seller clearly intended to transfer all of his rights in the property and whatever risk might exist as to the scope and extent of those rights. The evidence also established that the buyer knew that a plugging liability was implicit in every lease transfer, and the transfer of the plugging liability was made explicit in the assignment,<sup>40</sup> so the transfer of this liability was no surprise. Another case involving unusual or concealed facts or liabilities might produce a different result. But in *Geodyne*, the buyer got exactly what he paid for—it just turned out to be a bad bargain.

#### E. EASEMENTS

*Trenolone v. Cook Exploration Co.*<sup>41</sup> examined the rights of the surface owner and the mineral lessee in an abandoned pipeline. In 1961, Cities Service acquired a pipeline right-of-way easement under what eventually became Trenolone's residential neighborhood. The easement provided:

This right-of-way agreement may be assigned by GRANTEE, its successors and assigns, in whole or in part, vesting in any other person, firm or corporation any or all rights granted hereby, including the ownership of any facilities in place, together with full rights of ingress and egress for the maintenance, repair, operation, replacement and removal thereof.<sup>42</sup>

Trident N.G.L. Inc., successor-in-interest to Cities Service, removed portions of the pipeline, capped the rest, and released the right-of-way in 1993.<sup>43</sup> Cook, as the lessee under oil and gas leases covering the same land, claimed the right to transport gas through the pipeline. Trenolone,

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37. *Id.* at 486.

38. *Id.* at 487 (emphasis in original).

39. *Id.* at 489.

40. *Id.* at 486, 490.

41. 166 S.W.3d 495 (Tex. App.—Texarkana 2005, no pet.).

42. *Id.* at 499.

43. *Id.* at 500.



the surface owner, disputed Cook's right to use the pipeline, ownership of the easement, and ownership of the pipeline.<sup>44</sup>

Cook asserted that, as the mineral lessee and thus, the owner of the dominant estate, it had the right to use so much of the land, both surface and subsurface, as was reasonably necessary to enjoy the terms of the lease, unless there was an express limitation. The court agreed, but noted that the question of whether the lease's grant of the dominant estate carries the right to use a particular easement is a fact question. The court explained that the surface owner has the burden of proof, but the surface owner may show that the lessee's use of the surface is not reasonably necessary. However, the court did not determine whether or not this particular use was reasonably necessary; rather, the court held that fact questions existed, reversed the trial court's summary judgment for Cook, and remanded the case to the trial court.<sup>45</sup>

Presumably, the court was focused more on whether Cook could use this *particular* right-of-way and pipeline, rather than on the broad question of whether the lessee could use a pipeline to transport gas. To do this, the court first had to determine whether the pipeline was real or personal property. Whether personal property (a pipeline in this case) has become part of the realty is dependent on the intent of the parties that placed the property in the soil, which is a fact question. However, the issue in this case was determined as a matter of law because of the undisputed evidence represented by the terms of the easement itself. Cities Service had the right to *remove* the pipeline; therefore, it could not become a permanent accession to the freehold. Moreover, Trident actually did remove part of it. Therefore, the pipeline was conclusively personalty.<sup>46</sup>

The court next had to determine who had title to the personal property. Title to abandoned personal property vests in the first person who lawfully reduces it to possession. In this case, Cook started using the pipeline to transport gas in 1991; Trident formally released the right-of-way in 1993; and Cook continued using it after 1993. There was evidence that Trident informally abandoned the pipeline *before* Cook started using it in 1991. However, the court held that the finders-keepers rule on abandoned property is that a person must reduce the property to lawful possession *after* it has been abandoned, which was a fact question in this case.<sup>47</sup>

Trenolone claimed that Trident's release of the right-of-way "to the property owners" in 1993 evidenced Trident's intent that ownership of the pipeline and the easement be in the surface owners. The court held that the issue was not Trident's intent, but rather the intent of the parties to the original pipeline assignment. Based on the assignment, the court

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44. *Id.* at 497.

45. *Id.* at 498-99.

46. *Id.* at 499-500.

47. *Id.* at 501.

held that when released, the easement reverted to the surface owner, but the land was still subject to the mineral owner's reasonable use. However, ownership of the easement did not resolve ownership of the pipeline, because the pipeline is personalty and does not necessarily follow ownership of the easement.<sup>48</sup> Therefore, the court remanded for a determination of the timing of the abandonment, the beginning of Cook's use, and the reasonableness of that usage.<sup>49</sup>

### III. LEASE AND LEASING

#### A. POOLING CLAUSE

*Union Gas Corp. v. Gisler*<sup>50</sup> was the first of seven related cases considering the relationship between the lease pooling clause, the filing of the designation of unit, and the effect on the royalty obligation when the lessee files after the date of first production. A review of the opinions issued by the court of appeals is important in analyzing the resolution of the issues which finally reached the Texas Supreme Court.

The Gisler lease pooling clause read as follows:

Lessee shall file for record in the appropriate records of the county in which the leased premises are situated an instrument describing and designating the pooled acreage as a pooled unit; *and upon such recordation the unit shall be effective as to all parties hereto*, their heirs, successors, and assigns irrespective of whether or not the unit is likewise effective as to all other owners of surface, mineral, royalty or other rights in land included in such unit.<sup>51</sup>

The Gisler lease was the well-site tract. Production was obtained on March 27, 2000, and the designation of unit was filed on August 7, 2000. In the designation of unit, Union stated that the designation would be effective from the date of first production. On August 30, 2000, Gisler sued Union for all royalties from the date of first production until August 7, the date the designation of unit was filed for record. (Gisler also sued for bad-faith pooling, drainage, breach of implied covenants, fraud, negligence, and conversion, *inter alia*, against Union.). Union brought all of the other lessors of the pooled leases into the suit, and the other lessors contended that they were entitled to share proportionately in all royalties from the date of first production.<sup>52</sup> Union paid no royalties to anyone, and after the suit had been on file for nine months (fourteen months after the date of first production), the competing lessors began filing motions for summary judgment. Union then belatedly interpleaded royalties of \$1,313,327.38, attributable to the time before August 7.<sup>53</sup>

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48. *Id.* at 500.

49. *Id.* at 501-02.

50. 129 S.W.3d 145 (Tex. App.—Corpus Christi 2003, no pet.).

51. *Id.* at 150 (emphasis in original).

52. *Id.* at 148.

53. *Id.* at 152-53.

The lessors won their separate royalty claims on summary judgment, the other contract and tort claims were severed, and multiple appeals resulted. In the *Gisler* appeal on the well-site tract, the Gislers' claims for past-due royalties had been severed from their other claims, resulting in a final judgment against Union for an amount equal to the interpled funds, plus interest and attorney's fees in the amount of \$250,000.<sup>54</sup> The principal issue in the court of appeals was whether *Gisler* was entitled to 100% of royalties to the date of recordation of the unit designation. The court found no reason to depart from the settled principles expressed in *Browning Oil Co. v. Luecke*.<sup>55</sup> The lessee's authority to pool is derived solely from the terms of the lease, and the parties must strictly comply with the terms of the lease. The lease provided that pooling was effective upon "recordation," and therefore, there was no pooling until recordation.<sup>56</sup>

The court next considered Union's "double" royalty obligation. Six other lessors under pooled leases with functionally identical pooling clauses also sought royalty payments from the date of first production by summary judgment. Those lessors also prevailed on their claim in the trial court, thus "doubling" Union's royalty obligation. Union contended that the *Gisler* summary judgment and the summary judgments on the six other motions were facially contradictory. The court of appeals in *Gisler* held that, absent express authority, a lessee has no power to pool the lessor's interests with the interests of others. Union did not pool *Gisler* in accordance with the terms of the *Gisler* lease, so nothing Union did in the subsequent, unilateral, designation of unit could change Union's obligation to *Gisler*. The judgments as to the other royalty owners were not part of the *Gisler* appeal.<sup>57</sup>

Union argued that it should escape further liability because of its filing in interpleader. The court of appeals refused to release Union because of Union's unreasonable delay in filing, because Union itself created the predicament, and because Union did not pay *Gisler* for production before August 7.<sup>58</sup>

Finally, the court of appeals rejected Union's argument that the trial court should not have severed *Gisler*'s other claims for bad-faith pooling that could result in either the unit's invalidation or the unit's reformation, which would obviously affect the royalty rights of others before and after August 7.<sup>59</sup> The court of appeals found that *Gisler*'s contract claim for royalty was distinguishable from the tort claims, and the other royalty owners had no tort claims, only their own contract claims.<sup>60</sup> In finding the multiple claims were separable and distinct, the court relied heavily

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54. *Id.* at 149.

55. 38 S.W.3d 625 (Tex. App.—Austin 2000, pet. denied).

56. *Union Gas Corp.*, 129 S.W.3d at 950-51.

57. *Id.* at 151-52.

58. *Id.* at 153-54.

59. *Id.* at 156.

60. *Id.* at 155.

upon Gisler's lease, which expressly provided that the contractual obligations were independent and "irrespective of whether or not the unit is likewise effective as to all other owners . . . included in such unit."<sup>61</sup> In finding that the severance was proper, the court may have been influenced by the fact that the court already knew what it was going to do with the pre-August 7 severed claims of the other lessors.

*Union Gas Corp. v. Tittizer*<sup>62</sup> was the second of the seven cases before the court of appeals. The trial court granted Tittizer's motion to share pro rata in royalty prior to August 7, thus effectively "doubling" Union's royalty obligation, because Gisler was entitled to all royalty before August 7. The court of appeals reversed this judgment and held that because the unit was not effectively pooled under Gisler's lease until the recordation of the designation, there was no unit production until that time. Although there was production on the Gisler's lease from March 27, there was no producing well on the pooled unit until August 7.<sup>63</sup> Thus, the court of appeals held that the well-site lease was determinative in resolving the date by which a leasehold well becomes a unit well.

The court of appeals clearly rejected the trial court's approach of reading each lease in a vacuum, stating, "We are also constrained to construe all of the leases, Union's late recorded unit designation, and the interplay of these instruments. . . ."<sup>64</sup> The court continued, "We also agree with Union that the legal construction of the various leases and unit designation should be consistent."<sup>65</sup>

*Union Gas Corp. v. Dornburg*,<sup>66</sup> the third case considered by the court of appeals, reached the same result. The Dornburg lease contained a recordation requirement and only slightly different language than the clauses found in the Gisler lease and the Tittizer lease. *Union Gas Corp. v. Arnold*,<sup>67</sup> *Union Gas Corp. v. Mission Valley Cemetery Society*,<sup>68</sup> *Union Gas Corp. v. Mission Valley Volunteer Fire Department*,<sup>69</sup> and *Union Gas Corp. v. Zion Lutheran Church of Mission Valley*,<sup>70</sup> were indistinguishable.

Only the *Tittizer* case was reviewed by the Texas Supreme Court. *Tit-*

61. *Id.* at 150.

62. 171 S.W.3d 209 (Tex. App.—Corpus Christi 2003), *rev'd in part and aff'd in part*, 171 S.W.3d 857 (Tex. 2005).

63. *Id.* at 214.

64. *Id.* at 213.

65. *Id.* at 214.

66. No. 13-01-736-CV, 2003 WL 22478716 (Tex. App.—Corpus Christi Oct. 30, 2003, *pet. denied*) (mem. op.).

67. No. 13-01-737-CV, 2003 WL 22478745 (Tex. App.—Corpus Christi Oct. 30, 2003, *no pet.*) (mem. op.).

68. No. 13-01-738-CV, 2003 WL 22478757 (Tex. App.—Corpus Christi Oct. 30, 2003, *no pet.*) (mem. op.).

69. No. 13-010-739-CV, 2003 WL 22478780 (Tex. App.—Corpus Christi Oct. 30, 2003, *no pet.*) (mem. op.).

70. No. 13-01-740-CV, 2003 WL 22478927 (Tex. App.—Corpus Christi Oct. 30, 2003, *no pet.*) (mem. op.).

*tizer v. Union Gas Corp.*<sup>71</sup> affirmed on the issues and reversed and remanded on attorneys' fees. It affirmed that Tittizer was *not* entitled to royalties before the unit designation was filed, but apparently on more limited grounds.<sup>72</sup> Although the court of appeals had clearly considered the moment of pooling as to the Gisler well-site lease to be determinative, in a per curiam opinion, the Texas Supreme Court focused not on the Gisler well-site lease, but on the Tittizer lease. The court quoted the pooling clause from the Tittizer lease, not the Gisler lease, and cited established authority for the proposition that a pooled unit is not formed under a pooling clause requiring recordation until there is recordation. The court said:

We hold that *this lease* does not authorize the lessee to execute a pooling designation with a retroactive effect. The lease provides that unitization can be effective only upon recordation. We affirm the court of appeals' *conclusion* that the effective date of the pooled unit was the date of recordation of the Designation, and that Tittizer is only entitled to her pro rate share of the royalties earned after that date.<sup>73</sup>

Because both the Gisler and Tittizer leases required recordation and were designated of record at the same time, the result in this case is the same. However, should those facts change in a future case, the opinion of the Texas Supreme Court will not be as helpful as the court of appeals opinion, which recognized that until the well-site lease is pooled, there is no unit well. For example, severed claims in the *Gisler* case that were left pending in the trial court could invalidate the unit as to the Gisler well-site tract.<sup>74</sup> If so, under the court of appeals reasoning, there is no unit well ever, and the non-drillsite lessors would never share in production. But it is not clear if the Texas Supreme Court would necessarily find its *Tittizer* opinion to be controlling and reach the same result.

## B. FREE GAS CLAUSE

*EOG Resources, Inc. v. Wall*<sup>75</sup> considers a "free gas to Lessor" clause that provided:

Lessor shall have the privilege at his risk and expense of using gas from any gas well on said land for domestic use in the principal dwelling thereon out of any surplus gas not needed for operations hereunder.<sup>76</sup>

The operator, EOG, sued Walls and others for conversion or alternatively, for taking gas in violation of the contractual provisions of the lease. The court relied on existing precedent holding that (1) the benefit

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71. 171 S.W.3d 857 (Tex. 2005).

72. *Id.* at 863.

73. *Id.* at 861 (emphasis added).

74. *Union Gas Corp.*, 129 S.W.3d at 154.

75. 160 S.W.3d 130 (Tex. App.—Tyler 2005, no pet. h.).

76. *Id.* at 132.

created by a free gas clause is a covenant running with the surface estate, (2) the surface estate receives the benefits, (3) the mineral estate has the burden, and (4) if the free gas clause is limited to the “principal dwelling,” then the burden to the mineral estate cannot extend to additional dwellings without the consent of lessee.<sup>77</sup>

The case was tried by summary judgment and was reversed and remanded because there were fact issues regarding whether the Walls actually lived on the lease, whether their home was the “principal” dwelling, and whether the gas was “surplus gas.” Specifically, the court held that there can be only one “principal” dwelling.<sup>78</sup> Additionally, although the right to free gas under an oil and gas lease is an interest in real property that can be acquired or lost by adverse possession under the statute of limitations, the court rejected Walls’ affirmative defense of title by adverse possession. The statute requires a claimant relying on the twenty-five-year statute of limitations for adverse possession to come forward with a deed that purports to convey title to the property in question. In this case, the only “deed” in evidence was the oil and gas lease, and the conveyance of the gas by that lease was in controversy.<sup>79</sup>

### C. SURFACE DAMAGES

*Mieth v. Ranchquest, Inc.*<sup>80</sup> considers the proper measure of surface damages resulting from re-entry operations on an abandoned oil and gas well. The discharge of saltwater and various drilling fluids and chemicals damaged the surface,<sup>81</sup> and the Railroad Commission found numerous violations of Statewide Rule 8.<sup>82</sup> The jury found that the reasonable and necessary cost to remediate the surface was \$200,000, but the diminution in the fair market value was \$0. The trial court concluded that the injury to the property was permanent and, therefore, the correct measure of damages was the jury’s verdict of \$0.

The issues on appeal were whether the property damages were permanent or temporary and the proper measure of damages. Permanent damage results from activity that is of such a character and exists under such circumstances that it will be presumed to continue indefinitely; it is constant and continuous, not intermittent or recurrent. “The proper measure of damages for permanent injury to the land is the diminution in the value of the land.”<sup>83</sup>

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77. *Id.* at 137 (citing *Thomas v. Thomas*, 767 S.W.2d 507, 509-10 (Tex. App.—Amarillo 1989, writ denied)).

78. *Id.*

79. *Id.* at 138 (construing TEX. CIV. PRAC. & REM. CODE ANN. § 16.028 (Vernon 2002)).

80. 177 S.W.3d 296 (Tex. App.—Houston [1st Dist.] 2005, no pet. h.).

81. *Id.* at 301.

82. *Id.* at 300-01; 16 TEX. ADMIN. CODE § 3.8 (2004) (Tex. R.R. Comm’n, Water Protection).

83. *Mieth*, 177 S.W.3d at 303.

The distinction between permanent and temporary damage and the measure of damages was described as follows:

Temporary injuries are intermittent, sporadic, or recurrent injuries to land that are contingent upon some irregular force, such as rain . . . . When an injury to land is temporary and can be remediated at reasonable expense, the proper measure of damages is the cost of restoration to its condition immediately preceding the injury . . . . However, the diminution in fair market value is the measure of damages when the cost of restoration exceeds the diminution in fair market value.<sup>84</sup>

Because the evidence showed that the land's productivity had been impaired since 1996, the court held that the damage was permanent and that the landowners should take nothing.<sup>85</sup>

#### D. SUBSURFACE TRESPASS

*Mission Resources, Inc. v. Garza Energy Trust*<sup>86</sup> imposed \$10 million in punitive damages for subsurface trespass, bad-faith pooling, and breach of the implied covenants to develop and to protect against drainage. The case arose in south Texas where Mission Resources ("Coastal") operated two tracts—Share 12, in which it owned 100%, and Share 13, in which it owned 84%. Coastal conducted a large frac job on Share 12, but Coastal was slow in pursuing additional development on Share 13. The jury decided almost all questions against Coastal, and the court affirmed on all issues, except a minor point on attorneys' fees.<sup>87</sup>

This is the first Texas case to hold an operator liable for subsurface trespass by hydraulic fracture stimulation treatment of a well. Some evidence contradicted whether the trespass actually occurred and the extent of the drainage, but there was sufficient evidence for the court to affirm the jury's verdict. On the legal issue of subsurface trespass, the court acknowledged that *Geo Viking, Inc. v. Tex-Lee Operating Co.*,<sup>88</sup> which appeared to hold that fracing could not be a trespass, could not be reconciled with the *Mission* court's reading of the Texas Supreme Court's opinion in *Gregg v. Delhi-Taylor Oil Co.*<sup>89</sup> Thus, the court of appeals followed *Gregg*.<sup>90</sup> It also ruled that the royalty owners could sue for trespass, even though their ownership was only a non-possessory interest.<sup>91</sup>

The jury awarded \$1 million for subsurface trespass, which the trial court reduced to \$543,776.<sup>92</sup> This tort claim was the basis for \$10 million

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84. *Id.* at 303-04.

85. *Id.*

86. 166 S.W.3d 301 (Tex. App.—Corpus Christi 2005, pet. filed).

87. *Id.* at 309-10, 313.

88. 817 S.W.2d 357 (Tex. App.—Texarkana 1991), writ denied, 839 S.W.2d 797 (Tex. 1992) (per curiam).

89. 162 Tex. 26, 344 S.W.2d 411 (1961).

90. *Mission*, 166 S.W.3d at 310-11.

91. *Id.* at 311-12.

92. *Id.* at 310.

in punitive damages. To support a verdict of malice, the landowners had to prove by clear and convincing evidence either that Coastal specifically intended to cause substantial injury or harm, or that Coastal's acts or omissions involved an extreme degree of risk, considering the probability and magnitude of the potential harm to others.<sup>93</sup> The evidence of specific intent to cause substantial injury was, in this case, essentially circumstantial. The most significant facts appeared to be that Coastal owned a larger interest in Share 12, Coastal's engineers did not really consider the extent of the fractures relative to the lease lines, and it was a really large frac.<sup>94</sup> The court found that this was sufficient evidence of specific intent. Because the court found specific intent, it did not rule on gross negligence.

The statutory cap on punitive damages of twice economic damages would have limited punitive damages to \$1,087,532.<sup>95</sup> However, the landowners secured a favorable finding on felony theft, which made the cap inapplicable. The finding of felony theft required landowners to prove that Coastal intended to and did unlawfully deprive them of their property in an amount in excess of \$20,000.<sup>96</sup> There was sufficient evidence to show that the amount in this case exceeded \$20,000. The court was satisfied with very limited evidence to prove "beyond a reasonable doubt" Coastal's specific intent to deprive landowners of their property.<sup>97</sup>

Coastal attacked the punitive damages by arguing that the contract claim (for breach of the covenant to protect against drainage) and the tort claim (for trespass) complained of essentially the same conduct—a contract complaint, which would not support punitives. The court disagreed, but did not articulate its reasoning in concluding that the cause of action was a tort, other than to say that it could have been either, and that there was a jury finding on trespass.<sup>98</sup>

Coastal also challenged the measure of damages in the failure-to-develop charge. Coastal contended that the proper "measure of damages for the failure to develop [was] the difference between the royalty that was actually paid and the royalty that should have been paid had the lessee exercised ordinary care to develop the lease (the 'royalty rule')." <sup>99</sup>This court held that the proper measure of damages was the value of the interest income on the royalty that the landowners lost, if any, through the lessee's failure to reasonably develop the lease.<sup>100</sup>

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93. *Id.* at 313 (citing TEX. CIV. PRAC. & REM. CODE ANN. § 41.001(7) (Vernon Supp. 2004-05)).

94. *Id.* at 313-15.

95. *See* TEX. CIV. PRAC. & REM. CODE ANN. § 41.008(b), (c)(13) (Vernon Supp. 2005).

96. *Mission*, 166 S.W.3d at 315 (citing TEX. PENAL CODE ANN. § 31.03(e)(4)-(7) (Vernon Supp. 2004-05)).

97. *Id.* at 315-16.

98. *Id.* at 317.

99. *Id.* at 320 (citing *Tex. Pac. Coal & Oil Co. v. Barker*, 117 Tex. 418, 6 S.W.2d 1031, 1038 (1928)).

100. *Id.* at 320-21.



## IV. OPERATING AGREEMENTS AND OPERATIONS

## A. UNIFORM MAINTENANCE OF INTEREST CLAUSE

*ExxonMobil Corp. v. Valence Operating Co.*<sup>101</sup> held the operator liable for substantial damages for breach of the uniform maintenance of interest (“MOI”) provision of the parties’ joint operating agreement (“JOA”). The MOI provision was the typical form JOA provision found in Article VIII.B. of the JOA, except that it deleted the references to “uniform.” It provided:

E. Maintenance of ~~Uniform~~ Interest:

~~For the purpose of maintaining uniformity of ownership in the oil and gas leasehold interests covered by this agreement, and~~ Notwithstanding any other provisions to the contrary, no party shall sell, encumber, transfer or make other disposition of its interest in the leases embraced within the Contract Area and in wells, equipment and production unless such disposition covers either:

1. the entire interest of the party in all leases and equipment and production; or
2. an equal undivided interest in all leases and equipment and production in the Contract Area. Every such sale encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement, and shall be made without prejudice to the rights of the other parties.<sup>102</sup>

Three producing wells were drilled through the higher Cotton Valley Sand formation in Unit 16 and into the lower Cotton Valley Lime, but it was known that there were behind-the-pipe reserves in the higher Cotton Valley Sand. The majority owner and operator, ExxonMobil, then farmed out the higher Cotton Valley Sand formation to farmees, who proposed and drilled five wells. Not knowing that the farmees had any relationship with Unit 16, Valence made no response to the first two well proposals from the farmees. Failure to respond under the JOA is deemed to be an election to go non-consent. Valence participated in the last three wells proposed by the farmees “under protest.” Valence sued ExxonMobil to recover the non-consent penalties, the additional costs incurred to drill and complete new wells in the Cotton Valley Sand (rather than produce the zone through the existing wells), and for attorneys’ fees.<sup>103</sup> Valence recovered \$523,432 for the non-consent penalties, \$310,867 for the extra costs, and \$166,250 in attorneys’ fees, together with prejudgment interest, in a judgment that was affirmed.<sup>104</sup>

On appeal, the court rejected ExxonMobil’s argument that the deletion of the reference to “uniform” indicated an intention *not* to require the maintenance of uniform interests. The court reasoned that the deletion merely recognized the reality that ExxonMobil owned 81.8% and Va-

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101. 174 S.W.3d 303 (Tex. App.—Houston [1st Dist.] 2005, pet. denied).

102. *Id.* at 311 (strikeouts in original).

103. *Id.* at 307-08.

104. *Id.* at 307, 315, 319-20.

lence owned 18.2%, which was not “uniform.” The whole MOI provision would be meaningless if the provision was *not* intended to maintain the parties’ respective interests in the lease.<sup>105</sup> The court also rejected ExxonMobil’s argument that the MOI provision did not apply because it was only applicable to transfers of its “interest in the leases embraced within the Contract Area *and* in wells . . . .”<sup>106</sup> That is, ExxonMobil argued that it did not transfer any interest in wells; therefore, the MOI provision was inapplicable. The court responded that “When ExxonMobil transferred its entire interest in land in the Cotton Valley Sand portion of the Unit 16 oil and gas lease, it executed a conveyance of realty that transferred its interest in wells, equipment, and production appertaining to the Cotton Valley Sand formation.”<sup>107</sup> This conclusion was based on the language in the farmout, which provided that ExxonMobil agreed to convey “*all* of [its] present right, title and interest (herein referred to as ‘interests in land’) in a segregated portion of Unit 16 . . . .”<sup>108</sup>

To prove damages for the extra expense incurred in drilling the new wells, Valence showed the cost difference between the new well costs and the existing wells’ theoretical dual completion costs. The judgment awarded Valence \$310,867, which was the difference (for the three existing Cotton Valley Lime wells) multiplied by Valence’s 18.2% interest. The court affirmed this judgment as consequential damages for breach of contract. By farming out and retaining an overriding royalty, ExxonMobil relieved itself of the costs of exploiting the gas in the Cotton Valley Sand formation while creating farmees who had no interest in minimizing the number of wells or in using existing wellbores. By severing its interest from Valence’s, rather than maintaining it, ExxonMobil breached the JOA and caused Valence to incur the extra costs.<sup>109</sup>

The issue on non-consent penalties was limited to the first two wells and Valence’s failure to elect to participate.

Valence acknowledges that its non-consent damages were limited to the two wells in which it did not participate (16-4 and 16-5), multiplied by its 18.2% interest times the actual cost of drilling a well, multiplied by 200% (the 300% penalty minus 100% of the actual cost of drilling).<sup>110</sup>

The court affirmed the judgment of \$523,432 against ExxonMobil because the failure to consent cannot result in any contractual penalties unless it is triggered by the required notice of operations. ExxonMobil gave no notice, and it was not enough that the farmees gave notice of *their* proposal to drill new wells into the Cotton Valley Sand formation.

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105. *Id.* at 311-12.

106. *Id.* at 312 (emphasis added).

107. *Id.* at 314.

108. *Id.*

109. *Id.* at 316.

110. *Id.* at 318.

Such "notice" from strangers to the JOA, coming after the farmout agreement had already been executed, entirely failed to satisfy the purpose of the notice requirement, namely, that Valence be given the opportunity to consent, or not, to a proposal made by a party to the JOA who had agreed to all its terms and conditions—not by strangers to the JOA with different interests.<sup>111</sup>

#### B. SUBSEQUENT OPERATIONS CLAUSE

*Valence Operating Co. v. Dorsett*<sup>112</sup> construes the notice and nonconsent provisions applicable to subsequent operations under the A.A.P.L. Form 610–1977 Model Form Operating Agreement ("JOA"), as primarily determined by the notice provision found in Article VI.B.(1) of the JOA. The JOA provides that the operator "shall, within sixty (60) days after the expiration of the notice period of thirty (30) days. . . actually commence work on the proposed operation and complete it with due diligence."<sup>113</sup> The notice is given to other owners so that they may elect to consent to subsequent operations or elect to go non-consent.<sup>114</sup> In this case, the court held that the JOA permits the operator to commence work before the expiration of the thirty-day notice period required for subsequent operations.

Valence, as operator, proposed drilling a series of wells over time under various notices, none of which gave thirty-days notice *prior* to the commencement of operations. Dorsett argued that the non-consent provisions were inapplicable because Valence failed to give notice thirty days *prior* to the commencement of operations as required by the JOA; therefore, Dorsett should recover the leasehold interests lost over ten years. Valence argued that the operator could commence operations at any time, and that Article VI.B.(1) requires only that the operator allow the non-operator thirty days to elect to participate, regardless of the timing of the commencement of operations.<sup>115</sup>

The court agreed with Valence that "the provision's purpose is not to prohibit the early commencement of work, but to ensure that work is not unreasonably delayed after the consent deadline."<sup>116</sup> The court based its opinion on the JOA's plain language and the conclusion that early commencement could be beneficial (for instance, by offsetting a draining well) and that the entire risk of early commencement falls on the operator, with no apparent consequences to the other working-interest owners.<sup>117</sup>

Dorsett also claimed that the non-consent provisions were an unenforceable liquidated damages provision. The court, however, construed

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111. *Id.*

112. 164 S.W.3d 656 (Tex. 2005).

113. *Id.* at 661 (citing A.A.P.L. Form 610–1977 art. VI.B.2. (1977)).

114. *Id.* at 662–63.

115. *Id.* at 658–61.

116. *Id.*

117. *Id.* at 662–63.

the non-consent provisions as a reward to the consenting parties for undertaking a defined risk, rather than a liquidated damages clause.<sup>118</sup> The court expressly disapproved prior authority treating the non-consent penalty as a liquidated damages provision.<sup>119</sup> The court reasoned that to construe the provision otherwise would mean that no one would consent, because there would be no incentive to do so.<sup>120</sup> The concurring opinion also noted that the “non-consent penalty is industry vernacular” and does not appear in the JOA, but “those in the oil industry widely use and rely on clauses like the one here, and certainly consider them enforceable.”<sup>121</sup>

### C. REMOVAL-OF-OPERATOR AND PREFERENTIAL RIGHT-TO-PURCHASE CLAUSES

*Fasken Land & Minerals, Ltd. v. Occidental Permian Ltd.*<sup>122</sup> addresses disputes involving a preferential right to purchase provision and a removal of operator provision. Occidental or its affiliates (“OXY”) were the operator and seller of a 75% interest in the Midland Farms Unit (“MFU”) in which Fasken and others owned the minority interest. The packaged sale of assets was valued at approximately \$3.55 billion, and the parties allocated \$63 million as the purchase price of OXY’s interest in the MFU. Fasken disputed the adequacy of OXY’s notice in connection with the preferential right and contended that OXY had been removed as operator by a vote of the minority owners.<sup>123</sup> The court held the notice was adequate, and although OXY was voted out as operator, OXY continued as operator because no successor was elected.<sup>124</sup>

With regard to notice, the preferential right clause required the seller to give a written notice “with *full information* concerning its proposed sale, assignment, transfer of ownership or transfer of control of ownership; or other disposition, which notice shall include . . . .”<sup>125</sup> The clause enumerated four specific information categories. One category required disclosure of “the purchase price or in the event of the transfer of a . . . group of properties, an allocation of that portion of the purchase price attributable to its interest in the oil and gas estate under this Agreement or in the Unit Area . . . .”<sup>126</sup> Although there was a protracted dispute over the purchase-price allocation and how that may have affected the notice’s validity, the court held that the contractual preferential right did not require that the *basis* of the allocation be in the written notice.<sup>127</sup>

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118. *Id.* at 664 (citing *Nearburg v. Yates Petroleum Corp.*, 123 N.M. 526, 943 P.2d 560, 565 (N.M. Ct. App. 1997)).

119. *Id.* (disapproving *Hamilton v. Tex. Oil & Gas Corp.*, 648 S.W.2d 316, 321 (Tex. App.—El Paso 1982, writ ref’d n.r.e.)).

120. *Id.* at 665.

121. *Id.* at 665-66.

122. No. 08-03-00407-CV, 2005 WL 1539260 (Tex. App.—El Paso 2005, pet. denied).

123. *Id.* at \*1-6.

124. *Id.* at \*1.

125. *Id.* at \*8 (emphasis added).

126. *Id.*

127. *Id.* at \*9.

Fasken raised other objections as to the notice's adequacy, but the court held that the "notice given was sufficient to reasonably disclose the proposed transaction and to provide Fasken entities an opportunity to exercise its preferential right to purchase . . . even if there were technical deficiencies that rendered that notice less than perfect."<sup>128</sup>

With regard to whether OXY was the operator, the operating agreement for the MFU provided that the operator (OXY) could be removed by a vote of 85% of the voting interest remaining after excluding the operator's voting interest. Although Fasken and the other minority owners voted OXY out as operator, the operating agreement required that the owners elect a successor operator by "the affirmative vote of three (3) or more Working Interest Owners having at least eighty-five percent (85%) of the combined voting interest of all Working Interest Owners, provided no Unit Operator who is removed may vote to succeed itself."<sup>129</sup> OXY simply voted "no" to the proposed successor and continued to operate. The agreement also provided that "[a] Unit Operator who . . . is removed shall not be released from its obligations hereunder for a period of three (3) months after its . . . discharge unless a successor Unit Operator shall have taken over the operations hereunder prior to the expiration of said period."<sup>130</sup> The court could have read this provision to mean that the removed operator is released in three months or sooner if a successor is selected. Instead, this court held that the operating agreement did not prohibit OXY from voting "no" in elections to select a successor operator, and because no successor had been selected, OXY could continue as operator.<sup>131</sup> Fasken had also sued for damages based on OXY's continuing to operate, but the jury found that Fasken was not injured by OXY continuing operations.<sup>132</sup>

#### D. ACCOUNTING PROCEDURES

*XCO Production Co. v. Jamison*<sup>133</sup> holds that a joint operating agreement's two-year contractual limitations period does not apply to disputes between non-operators. XCO and Jamison entered into a Memorandum of Agreement, which incorporated the operating agreements for the oil and gas properties. This Agreement created a tax partnership between XCO and Jamison; XCO owned non-operated working interests in oil and gas properties in Louisiana, which it contributed to the partnership, and Jamison contributed cash. The partners' dispute involved the deduction of certain costs and the payout calculation.<sup>134</sup>

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128. *Id.* at \*10.

129. *Id.* at \*11.

130. *Id.*

131. *Id.* at \*12-13.

132. *Id.* at \*16 n.20.

133. No. 14-03-01198-CV, 2005 WL 1242289 (Tex. App.—Houston [14 Dist.] 2005, no pet.).

134. *Id.* at \*1-2.

Among other issues in the case, XCO contended that the two-year contractual limitation on accounting disputes in the operating agreement applied to the dispute between XCO and Jamison.<sup>135</sup> The court disagreed and held that the “provision clearly applies to accounting procedures between the operator and the non-operators.”<sup>136</sup> This dispute was not between the operator and a non-operator, but rather between two partners who own a non-operator’s interest.<sup>137</sup>

## V. OPERATIONS

### A. TEXAS NATIONAL RESOURCES CODE VIOLATIONS

*Emerald Oil & Gas, L.C. v. Exxon Corp.*<sup>138</sup> holds that a private cause of action exists for damages to the mineral estate if caused by conduct that violates the Texas Natural Resources Code, and the injured party may assert a claim for damages, even if it owned no interest in the land when the statutory violations occurred. Emerald alleged that Exxon intentionally sabotaged wells by improperly plugging and abandoning them, and that Exxon misrepresented the status of the wells in its Texas Railroad Commission filings.<sup>139</sup> Emerald relied upon Exxon’s filings when it acquired the properties. The trial court held that Emerald had no private cause of action for violation of the statutes. The court of appeals reversed.<sup>140</sup>

Section 85.321 of the Texas Natural Resources Code states that:

A party who owns an interest in property or production that may be damaged by another party violating the provisions of this chapter that were formerly a part of Chapter 26, Acts of the 42nd Legislature, 1st Called Session, 1931, as amended, or another law of this state prohibiting waste or a valid rule or order of the commission may sue for and recover damages and have any other relief to which he may be entitled at law or in equity. Provided, however, that in any action brought under this section or otherwise, alleging waste to have been caused by an act or omission of a lease owner or operator, it shall be a defense that the lease owner or operator was acting as a reasonably prudent operator would act under the same or similar facts and circumstances.<sup>141</sup>

The court held that this language was clear and unambiguous in establishing a cause of action and that there were equally clear precedents confirming the existence of the private cause of action.<sup>142</sup>

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135. *Id.* at \*11.

136. *Id.*

137. *Id.*

138. No. 13-99-757-CV, 2005 WL 167051 (Tex. App.—Corpus Christi 2005, pet. filed).

139. The case was a summary judgment proceeding that dismissed the claim for failure to state a cause of action. Therefore, for the purposes of this appeal, Emerald’s pleadings were accepted as true.

140. *Emerald*, 2005 WL 167051, at \*1.

141. TEX. NAT. RES. CODE ANN. § 85.321 (Vernon 2001).

142. *Emerald*, 2005 WL 167051 at \*4 (citing HECI Exploration Co. v. Neel, 982 S.W.2d 881, 890 (Tex. 1998)).

The court further held that the statute did not require that Emerald own the property at the time of the alleged tortious acts. Therefore, Emerald could assert these claims, even though Exxon's conduct occurred before Emerald acquired its interest.<sup>143</sup>

## B. PREMISES LIABILITY

*Chi Energy, Inc. v. Urias*<sup>144</sup> construed the application of statutory limitations on premises liability in a case involving an explosion on an oil well that resulted in two deaths. Chi Energy, Inc., an exploration and production company, owned the leasehold interest in the well, and Chi Operating, Inc., its affiliated operating company, drilled the well. Chi Operating and West Texas Roustabout ("WTR") agreed orally on a "turnkey" contract for used tank-battery vessels. At a time when the operator had closed the site and no one else was on the site, two employees of WTR used a cutting torch on a used oil tank to remove old fittings. The two WTR employees were killed in the resulting explosion. The jury awarded \$7,880,272 in actual damages against the operator.<sup>145</sup>

Various provisions of Chapter 95 of the Texas Civil Practices and Remedie Code, a statute originating in the 1996 tort reform package,<sup>146</sup> define "property owner" and the nature of a claim governed by the statute, and also provide certain limitations on liability. Generally, the statute applies to negligence claims brought against entities that own real property for business purposes.<sup>147</sup>

When Chapter 95 applies, a property owner will not be liable for negligence claims arising from the failure to provide a safe workplace unless: (1) the property owner exercises or retains some control over the manner in which the work is performed, other than the right to order the work to start or stop or to inspect progress and receive reports; and (2) the property owner had actual knowledge of the danger or condition resulting in the personal injury, death or property damage and failed to adequately warn.<sup>148</sup>

Both statutory requirements—control and knowledge of the danger—must be met before a landowner is held liable for injuries of an independent contractor's employee. Control means more than a general right to order workers to stop or start, a right to inspect, or right to receive re-

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143. *Id.* at \*5. *Cf.* *Cook v. Exxon Corp.*, 145 S.W.3d 776, 782 (Tex. App.—Texarkana 2004, no pet.); *Denman v. Citgo Pipeline Co.*, 123 S.W.3d 728, 732 (Tex. App.—Texarkana 2003, no pet.); *Exxon v. Pluff*, 94 S.W.3d 22, 27-28 (Tex. App.—Tyler 2002, pet. denied); *Senn v. Texaco, Inc.*, 55 S.W.3d 223, 225 (Tex. App.—Eastland 2001, pet. denied) (holding that subsequent owners have no tort claims for damages to land that occurred before they acquired their interest).

144. 156 S.W.3d 873 (Tex. App.—El Paso 2005, pet. denied).

145. *Id.* at 874-77.

146. TEX. CIV. PRAC. & REM. CODE ANN. § 95 (Vernon 1997).

147. *Chi Energy*, 156 S.W.3d at 879.

148. *Id.* at 878-79 (citing TEX. CIV. PRAC. & REM. CODE ANN. § 95.003(1)-(2) (Vernon 1997)).

ports.<sup>149</sup> Knowledge means “actual knowledge of the danger or condition resulting in the personal injury . . . and fail[ure] to adequately warn.”<sup>150</sup> The court in this case reversed and rendered the jury decision based on no evidence of control or knowledge.

In this case, there was no contractual right of control, usually a question of law, and no actual control. The necessary degree of control must extend to “operative detail” of the contractor’s work, which did not occur because these two roustabouts decided on their own to apply heat to a tank on a closed site, and the tank itself was not an inherently dangerous item.<sup>151</sup> “Moreover, there must be a nexus between the control actually exercised and the resulting injury.”<sup>152</sup>

### C. INSURANCE AND DRILLING CONTRACTS

*Helmerich & Payne International Drilling Co. v. Swift Energy Co.*<sup>153</sup> held the operator liable for spill clean-up costs, but it held that the drilling contractor’s insurer was not liable to the operator as an additional insured because the costs did not exceed the deductible. Helmerich & Payne’s (“H&P”) insurance named the operator Swift as an additional insured, but the insurance company refused to pay based on the deductible. The spill clean-up costs were \$155,000, and the deductible was \$750,000.<sup>154</sup>

The court refused to impose liability on H&P for any alleged breach of the insurance policy. Paragraph 13 of the drilling contract, which governed insurance, required H&P to acquire comprehensive general liability insurance with pollution coverage, but it did not contain any requirements regarding the deductible. Because the policy was silent as to the allocation of deductible as between or among named insureds and additional insureds, there was no contractual obligation on H&P to pay Swift the deductible.<sup>155</sup>

Swift contended that H&P breached the drilling contract by failing to pay the deductible because paragraph 13 provided that “[a]ll policies required . . . shall provide . . . that all deductibles . . . shall be the sole obligation of [H&P].”<sup>156</sup> Although this states that all deductibles shall be the sole obligation of H&P, the court said that it does not provide that H&P must reimburse the operator, Swift. It is at best an implied obligation. However, because the court found that paragraph 14 of the drilling contract transferred risk to Swift, it did not decide this question.<sup>157</sup>

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149. TEX. CIV. PRAC. & REM. CODE ANN. § 95.003(1).

150. § 95.003.

151. *Chi Energy*, 156 S.W.3d at 880.

152. *Id.*

153. 180 S.W.3d 635 (Tex. App.—Houston [14th Dist.] 2005, pet. filed).

154. *Id.* at 640.

155. *Id.*

156. *Id.*

157. *Id.* at 642.



Under paragraph 14 of the drilling contract, the parties agreed as follows:

14.11 Pollution and Contamination: Notwithstanding anything to the contrary contained herein . . . .

\* \* \*

(b) [Swift] shall assume all responsibility for, including control and removal of, and shall protect, defend and indemnify [H&P] from and against all claims, demands, and causes of action of every kind and character arising directly or indirectly from all other pollution or contamination which may occur during the conduct of operations hereunder.<sup>158</sup>

It was uncontested that the spill fell within paragraph 14.11(b). The court held that under the plain meaning of this paragraph, Swift assumed all liability for the spill and indemnified H&P. Even if paragraph 13 could be construed to impose a duty on H&P to reimburse Swift for the costs, such a construction would be contrary to paragraph 14. “When parties use the clause ‘notwithstanding anything to the contrary contained herein’ in a paragraph of their contract, they intend the paragraph to supersede all other contract provisions.”<sup>159</sup>

*Zurich American Insurance Co. v. Hunt Petroleum (AEC), Inc.*<sup>160</sup> held that the International Association of Drilling Contractors’ daywork drilling form contract is ambiguous as to the meaning of “highly corrosive or otherwise destructive elements.”<sup>161</sup> Hunt was “Operator” and Zurich’s insured (Nabors) was the “Contractor.” A tropical storm hit and submerged the rig in seawater, causing significant damage. The contractor’s insurance company sued the operator to recover the cost of repairs.<sup>162</sup>

The applicable provisions of the form contract provided:

14. Responsibility for loss or damage, indemnity, release of liability and allocation of risk:

14.1 Contractor’s Surface Equipment: Contractor shall assume liability at all times for damage to or destruction of Contractor’s surface equipment, regardless of when or how such destruction occurs, and Contractor shall release Operator of any liability for any such loss, except loss or damage under the provisions of Paragraph 10 or 14.3.

\* \* \*

14.3. Contractor’s Equipment—Environmental Loss or Damage: Notwithstanding the provisions of Paragraph 14.1 above, Operator shall assume liability at all times for damage to or destruction of Contractor’s equipment caused by exposure to highly corrosive or otherwise destructive elements, including those introduced into the drilling fluid.

\* \* \*

158. *Id.* at 638-39.

159. *Id.* at 643.

160. 157 S.W. 3d 462 (Tex. App.—Houston [14th Dist.] 2004, no pet.).

161. *Id.* at 467.

162. *Id.* at 463.

## 17. Force Majeure:

Neither Operator nor Contractor shall be liable to the other for . . . damage . . . caused by . . . action of the elements, water conditions, . . ., or other causes beyond the control of the party affected thereby . . . .<sup>163</sup>

Hunt claimed that paragraph 17 controls and that paragraph 14.3 does not because “the commonly understood meaning of paragraph 14.3 excludes damage caused by salty floodwater, and paragraph 14.3 does not expressly state that it overrides paragraph 17.”<sup>164</sup> Zurich contended that paragraph 14.3 states that Hunt is liable “at all times.”<sup>165</sup> The court concluded that the contract was ambiguous and remanded for trial.<sup>166</sup>

## VI. GAS CONTRACTS AND MARKETING.

*Calpine Producer Services, L.P. v. Wiser Oil Co.*<sup>167</sup> held that a reseller of gas was not obligated to pay the producer when the reseller’s customer failed to pay and filed for bankruptcy protection. Enron, the debtor, was obligated to pay Calpine, the reseller, \$732,906, of which \$727,161 was payable to the producer, Wiser. Enron paid Calpine only a portion of the claim in the Enron bankruptcy proceeding. Wiser sued Calpine seeking recovery of the full purchase price based on Calpine’s alleged breach of their Gas Sales and Purchase Agreement.<sup>168</sup>

The relevant contract provisions stated that the price payable was equal to the “Net Proceeds (as hereinafter defined) *received* by Buyer for gas owned or controlled by Seller and resold by Buyer under the Resale Contract(s);” “‘Net Proceeds’ shall mean . . . the difference between ‘Gross Proceeds’ . . . and ‘Authorized Costs’ . . . where ‘Gross Proceeds’ equal the sum of (a) the gross proceeds *received* by Buyer for gas owned or controlled by Seller and resold by Buyer;” and “Buyer shall make payment . . . the date it *receives* payment from its customers under the Resale Contract(s) for gas purchased hereunder.”<sup>169</sup>

The legal issue was whether Enron’s payment was a condition precedent to Calpine’s obligation to pay Wiser. The court held that payment by Enron was a condition by the plain meaning of the contract, and it refused to read into the contract a “specific requirement that where the third-party purchaser does not pay Calpine, Calpine must pay Wiser for the gas within a reasonable time of when the third-party *should have* paid Calpine.”<sup>170</sup>

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163. *Id.* at 464.

164. *Id.*

165. *Id.* at 467.

166. *Id.*

167. 169 S.W.3d 783 (Tex. App.—Dallas 2005, no pet.).

168. *Id.* at 784-86.

169. *Id.* at 786 (emphasis added).

170. *Id.* at 790 (emphasis in original).

## VII. LEGISLATION

1. ACT: Act of May 20, 2005, 79th Leg., R.S., ch. 489, §§ 1-8, 2005 Tex. Sess. Law Serv. 1351 (Vernon).<sup>171</sup> (HB 380)

ISSUE: Relating to oil- and gas-well-plugging insurance policies.

SUMMARY: This act authorizes the Railroad Commission to accept a well-specific plugging insurance policy that is approved by the Texas Department of Insurance; names the State of Texas as the owner and contingent beneficiary of the policy; names a primary beneficiary who agrees to plug the specified well bore; is fully prepaid and cannot be cancelled or surrendered; provides that the policy continues in effect until the specified well bore is plugged; provides that benefits will be paid when, but not before, the specified well bore is plugged according to Railroad Commission rules in effect at the time of plugging; and provides benefits that equal the greatest of: (1) \$2.00 per each foot of well depth; (2) if the specified well is a bay well that is producing oil or gas, the amount required under Railroad Commission rules for a bay well that is not producing oil or gas; (3) if the specified well is an offshore well that is producing oil or gas, the amount required under Railroad Commission rules for an offshore well that is not producing oil or gas; or (4) the payment otherwise due under the policy for plugging the well bore. This method of financial assurance can be used in lieu of a bond, letter of credit, or cash deposit.

To calculate the bond amount that an operator must file, if a well bore is included in a well-specific plugging insurance policy, then it is excluded.

EFFECTIVE: June 17, 2005.

2. ACT: Act of May 25, 2005, 79th Leg., R.S., ch. 1001, §§ 1-7, 2005 Tex. Sess. Law Serv. 3370 (Vernon).<sup>172</sup> (HB 484)

ISSUE: Relating to the filing of electric logs with the Railroad Commission.

SUMMARY: This act clarifies the requirement to file an electric log for any well drilling for any purpose related to exploration, production, or storage of oil or gas, including injection wells, disposal wells, or brine mining.

The act requires that an operator file a basic electric log not later than the ninetieth day after the date a drilling operation is completed. An operator who fails to timely file a written request that the electric log remain confidential must file the log with the Railroad Commission immediately after the period for filing such a request ends.

EFFECTIVE: September 1, 2005.

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171. Codified as amendments to TEX. NAT. RES. CODE ANN. §§ 91.104, 91.1041, 91.1042, 91.105, 91.107, 91.108, 91.109, 91.111(c) (Vernon Supp. 2005).

172. Codified as amendments to TEX. NAT. RES. CODE ANN. §§ 91.551(a), 91.551(b), 91.552(a), 91.553, 91.554, 91.556 (Vernon Supp. 2005).

3. ACT: Act of May 25, 2005, 79th Leg., R.S., ch. 1037, §§ 1-2, 2005 Tex. Sess. Law Serv. 3500 (Vernon).<sup>173</sup> (HB 1161)

ISSUE: Relating to the Railroad Commission providing certain information to owners of oil- or gas-royalty interests.

SUMMARY: This act allows a royalty interest owner to obtain production information that has been reported to the Railroad Commission either by (1) contacting the Commission's oil and gas division or by (2) providing the lease county and identification number on the Commission's website.

EFFECTIVE: September 1, 2005.

4. ACT: Act of May 25, 2005, 79th Leg., R.S., ch. 1119, §§ 1-3, 2005 Tex. Sess. Law Serv. 3705 (Vernon).<sup>174</sup> (HB 2440)

ISSUE: Relating to the Railroad Commission's regulation of activities associated with multiple accumulations of hydrocarbons, from which production by hydrocarbons commingling is authorized.

SUMMARY: This act provides that the Railroad Commission may regulate all activities that are under its jurisdiction and associated with commingled, separate multiple, or lenticular accumulations of oil or gas as if such accumulations were a single common reservoir.

EFFECTIVE: June 18, 2005.

5. ACT: Act of May 28, 2005, 79th Leg., R.S., ch. 874, §§ 1-3, 2005 Tex. Sess. Law Serv. 2598 (Vernon).<sup>175</sup> (SB 1103)

ISSUE: Relating to the powers and duties of the General Land Office and the disposition of certain unsurveyed public school land.

SUMMARY: This act applies to the General Land Office Commissioner's determination of whether a vacancy exists and whether to sell or lease vacant land. It clarifies the procedure for resolving claims to vacant land and favors adjoining owners or claimants who have used the land under an assumption of ownership under color of title for at least ten years.

This act defines a "good-faith claimant" as a person who, on the application commencement date, (1) occupies, uses, or has previously occupied or used, or whose predecessors-in-interest have occupied or used the land or any interest in the land for any purposes, including occupying or using (a) the surface or mineral estate for any purposes, (b) an easement or right-of-way, (c) a mineral royalty or leasehold interest; (2) has had, or whose predecessors-in-interest have had, the land enclosed or within definite, recognizable boundaries and in possession under a chain of title for at least ten years with a good-faith belief that the land was within the boundaries of a survey that was previously titled, awarded, or sold under

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173. Codified as an amendment to TEX. NAT. RES. CODE ANN. § 91.504(e) (Vernon Supp. 2005).

174. Codified as an amendment to TEX. NAT. RES. CODE ANN. § 86.081(b) (Vernon Supp. 2005).

175. Codified as amendments to TEX. NAT. RES. CODE ANN. §§ 51.171-.195 (Vernon Supp. 2005).

circumstances that would have vested title in the land if it were actually located within those boundaries; (3) is the owner of the land that (a) adjoins the land claimed to be vacant and (b) for which no vacancy application has been filed or (c) holds title under a person described in (1), (2), or (3) above or is entitled to a distributive share of a title acquired under an application filed by a person described in (1), (2), or (3) above.

To the definition of "vacancy," this act adds unsurveyed public-school land that was not, on the application date, subject to a vacancy application denied with prejudice or subject to a previous vacancy application that has been finally adjudicated by the Commissioner or a Texas court or a United States court.

This act provides a detailed procedure for receiving applications, giving notice to interested parties, and resolving claims administratively. The administrative procedure should result in a finding that the land is or is not vacant in six months or fewer.

This act also provides that a party cannot appeal a final order with a finding of "Not Vacant Land" because it is conclusive regarding the land described in the vacancy application or investigated by the Commissioner as a result of the application. A necessary party may appeal a final order to the district court where a majority of the vacant land is located not later than the thirtieth day after the final order's issuance. All necessary parties must receive notice of such an appeal by the party filing it.

Under this act, a good-faith claimant has the first preferential right to purchase or lease the claimant's interest in the vacant land. The applicant has the second preferential right to purchase or lease any interest not claimed or taken by a good-faith claimant.

If a good-faith claimant exercises his preferential right in the vacant land, the applicant has a preferential right to either an award of a perpetual 1/32 nonparticipating royalty of the vacancy's full mineral interest or a preferential right to purchase or lease any remaining interest in the vacant land. If a mineral lease exists on the vacant land, the applicant's 1/32 nonparticipating royalty interest shall be taken from the state's royalty interest for the lease's duration, provided that the applicant's share for the lease's duration may never equal more than the interest the state retains.

EFFECTIVE: June 17, 2005.

6. ACT: Act of May 27, 2005, 79th Leg., R.S., ch. 881, §§ 1-8, 2005 Tex. Sess. Law Serv. 2981 (Vernon).<sup>176</sup> (SB 1170)

ISSUE: Relating to the Railroad Commission's regulation of gas production.

SUMMARY: This act allows, but does not require the Railroad Commission to determine the status of gas production from any reservoir upon written complaint by an affected party or on its own initiative.

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176. Codified as amendments to TEX. NAT. RES. CODE ANN. §§ 86.081, 86.084, 86.085, 86.086, 86.087, 86.089(a), 86.094 (Vernon Supp. 2005).

This act requires the Railroad Commission to prorate and regulate the daily gas-well production from a common reservoir if it finds it necessary to prevent waste or adjust the correlative rights and opportunities of each gas owner in a common reservoir to produce and use or sell the gas.

This act also provides that, after determining demand for and volume of production from a prorated reservoir, the Commission shall fix the monthly reservoir allowable to be produced at the lawful market demand or at the volume that can be produced without waste, whichever is the smaller quantity. The monthly reservoir allowable shall be allocated among all wells entitled to produce gas from a prorated reservoir, but each well is restricted to the amount of gas that can be produced from it without waste.

EFFECTIVE: June 17, 2005.

7. ACT: Act of May 27, 2005, 79th Leg., R.S., ch. 346, §§ 1-6, 2005 Tex. Sess. Law Serv. 992 (Vernon).<sup>177</sup> (SB 1175)

ISSUE: Relating to the Railroad Commission's regulation of oil and gas production.

SUMMARY: This act provides that if a rule or order of the Commission limits or fixes oil production in a pool or portion of a pool, or gas production from gas wells producing gas only, and the Commission receives a written complaint from an affected party or on its own initiative, then the Commission will give notice and a hearing opportunity. After that, the Commission will distribute, prorate, or otherwise apportion the allowable production among the various producers on a reasonable basis if it thinks it is necessary to prevent waste or adjust the correlative rights and opportunities of each owner in a common reservoir to produce and use or sell the oil or gas.

This act also allows, but does not require, the Railroad Commission to allocate the allowable production of oil among the various pools in the state. The Commission can do this on written complaint and proof of such discrimination or if, on its own initiative, the Commission deems such action necessary. It must also be fair and reasonable in order to prevent unreasonable discrimination in favor of one pool over another.

The Commission can also investigate gas-producing wells after an affected party files a complaint or on its own initiative. If, after notice and an opportunity for a hearing, the Commission finds that full production from wells producing only gas from a common source is in excess of the reasonable market demand, the Commission can inquire into the gas's production and reasonable market demand. The Commission can then determine the allowable production from the common supply source. Finally, the Commission can apportion the allowable production from a prorated common supply source among the various producers on a reasonable basis, and it can limit each producer to the amount allocated.

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177. Codified as amendments to TEX. NAT. RES. CODE ANN. §§ 85.043, 85.053(a), 85.054(a) & (c), 85.055(a)-(c), 85.058 (Vernon Supp. 2005).

EFFECTIVE: June 17, 2005.

8. ACT: Act of May 25, 2005, 79th Leg., R.S., ch. 1000, §§ 1-3, 2005 Tex. Sess. Law Serv. 3370 (Vernon).<sup>178</sup> (HB 474)

ISSUE: Relating to a gas utility's duty to report certain transactions to the Railroad Commission.

SUMMARY: This act mandates that gas utilities report a sale, acquisition, or lease of a plant as an operating unit or system. This applies to transactions for more than \$1 million or a merger or consolidation with another gas utility operating in Texas, and the report must come within sixty days after the date the transaction took effect, as opposed to within a "reasonable time," as the previous law stated.

EFFECTIVE: September 1, 2005.

9. ACT: Act of May 13, 2005, 79th Leg., R.S., ch. 530, §§ 1-11, 2005 Tex. Sess. Law Serv. 1432 (Vernon).<sup>179</sup> (HB 951)

ISSUE: Relating to certain activities in easements and rights-of-way of pipeline facilities.

SUMMARY: A person may not build, repair, replace, or maintain a construction on, across, over, or under the easement or right-of-way for a pipeline facility without notifying the pipeline facility's operator. The construction can take place if the operator determines that it will not present a risk to the public or increase the risk of a break, leak, rupture, or other damage to the facility. If the operator determines there is a risk to the public or to the pipeline facility, the constructor must pay the reasonable, necessary, and documented cost of additional fortifications, barriers, conduits, or other changes necessary to prevent that risk. The construction can also take place if it is done under an existing written agreement or by a regulated utility because of a natural disaster. If these rules are violated, a constructor is liable for damages that the violation proximately caused and may be subject to injunctive relief.

EFFECTIVE: September 1, 2005.

10. ACT: Act of May 29, 2005, 79th Leg., R.S., ch. 267, §§ 1-19, 2005 Tex. Sess. Law Serv. 612 (Vernon).<sup>180</sup> (HB 2161)

ISSUE: Relating to: the Railroad Commission's power to adopt and enforce safety standards and practices applicable to transporting certain substances by pipeline and to certain facilities; the provision of severance tax credits, exemptions, and other incentives and procedures for produc-

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178. Codified as an amendment to TEX. UTIL. CODE ANN. § 102.051(a) (Vernon Supp. 2005).

179. Codified as an amendment to TEX. HEALTH & SAFETY CODE ANN. § 756.103, adding §§ 756.104 & 756.105, amending § 756.123, adding §§ 756.124 & 756.125, amending TEX. NAT. RES. CODE ANN. § 117.101(a), adding § 117.102, amending TEX. UTIL. CODE ANN. § 121.202(b), and adding § 121.2025 (Vernon Supp. 2005).

180. Codified as amendments to TEX. NAT. RES. CODE ANN. §§ 81.116(d), 81.117(d), 89.044, adding §§ 89.047 & 89.048, amending §§ 91.112(a) & 117.012, amending TEX. TAX CODE ANN. §§ 201.053 & 201.058(a), adding § 201.059, amending §§ 201.059, 201.102, 202.052(c), adding §§ 202.058, 202.060, 202.061, and amending TEX. UTIL. CODE ANN. §§ 121.201, 121.206(a) & (d) (Vernon Supp. 2005).

ing oil or gas from certain wells or plugging wells; and the procedure for computing severance taxes in connection with certain gas sales and imposing an administrative penalty.

**SUMMARY:** A person who is considering assumption of operatorship and regulatory responsibility for an orphaned well can perform a surface inspection of the well before assuming that role if the Railroad Commission allows it. The person must be an operator in good standing and must deliver written notice to the surface owner of record and to any occupant at least three days before the inspection.

If, after being designated by the Railroad Commission as the well operator, the person brings the well back into continuous, active operation or plugs the well in accordance with Commission rules within three years, then he may qualify for exemption and payments. These include a non-transferable exemption from severance taxes for all future production, a nontransferable exemption from section 81.116 and 81.117 fees for all future production, and a payment from the Commission equal to the well's depth in feet multiplied by fifty cents.

This act also provides that the owner of land containing an orphaned well may contract with a Commission-approved well plugger to plug the well. After the landowner gives notice to the operator, the well may be plugged. The Railroad Commission will reimburse the surface estate owner no more than half the cost from money in the Oil Field Cleanup Program Fund.

This act authorizes the Railroad Commission to implement rules after September 1, 2007, related to preventing pipeline-facility damage that results from a person moving earth near the facility.

This act also reduces the severance tax otherwise due on gas produced and saved from a qualifying low-producing well, which is defined as a gas well that produces no more than ninety McF per day during a 3-month period. The credit varies depending upon the average taxable gas price that the comptroller certifies as follows: 100%, less than \$2.50 per McF; 50%, from \$2.50 to \$3.00; and 25%, from \$3.00 to \$3.50.

Likewise, the act reduces the severance tax otherwise due on a qualifying low-producing oil lease, which is an oil well that is part of a lease that produces fewer than fifteen barrels of oil per day or five percent recoverable oil per barrel of produced water. The credit varies according to the average taxable oil price that the comptroller certifies as follows: 100%, less than \$22.00 per barrel; 50%, from \$22.00 to \$25.00; and 25%, from \$25.00 to \$30.00.

This act clarifies that a gas purchaser's reimbursement payments to a producer for severance taxes due are not part of the gross cash receipts upon which tax is computed.

Also, the taxpayer who is responsible for paying severance taxes on the production from a marginal well can receive a credit if enhanced-efficiency equipment is installed and used. A taxpayer may receive a credit of ten percent of the equipment's cost as long as certain criteria are met:



(1) The cumulative authorized severance tax credits may not exceed \$1,000 for any marginal well; (2) the well's enhanced-efficiency equipment must have been purchased and installed after September 1, 2005, but before September 1, 2009; (3) the taxpayer must file the credit application with the comptroller and must demonstrate that the equipment was purchased and installed within the set period; (4) each state fiscal year, the comptroller may approve only as many application as equals one percent of the producing marginal wells as of September 1, as determined by the comptroller; and (5) the equipment's manufacturer must obtain an evaluation of the product. This act defines enhanced-efficiency equipment as equipment that a Texas institution of higher education with an accredited petroleum-engineering program has approved by determining that the equipment reduces energy usage. In producing one barrel, the equipment must reduce the energy used by ten percent or more when compared to commonly available alternatives. This term does not include a motor or downhole pump.

**EFFECTIVE:** Effective September 1, 2005, except §§ 1-8, 11, 12 of this act, which are effective January 1, 2006.

**11. ACT:** Act of May 25, 2005, 79th Leg., R.S., ch. 339, §§ 1-3, 2005 Tex. Sess. Law Serv. 982 (Vernon).<sup>181</sup> (SB 1130)

**ISSUE:** Relating to a requirement that a common carrier or pipeline owner or operator report contamination.

**SUMMARY:** This act requires a common carrier or pipeline owner or operator to report any contamination to the Railroad Commission and to the owner of the land on which the pipeline is located. This includes observing or detecting any petroleum-based soil or water contamination in proximity to the pipeline: (a) hydrocarbons present on the water surface; (b) at least five linear yards of soil affected by hydrocarbons; or (c) soil affected by hydrocarbons that extends beyond the face of the excavation where the contamination is detected. The contamination report: (a) must be made within twenty-four hours of observation or detection; (b) must include the global-positioning-satellite coordinates of the contaminated site; and (c) may be made by telephone, facsimile, or e-mail.

This act also requires the Railroad Commission to collect a soil sample from the contaminated land. The Commission may not use money in the Oil Field Cleanup Program to implement this section.

**EFFECTIVE:** September 1, 2005.

**12. ACT:** Act of May 16, 2005, 79th Leg., R.S., ch. 514, §§ 1-4, 2005 Tex. Sess. Law Serv. 1402 (Vernon).<sup>182</sup> (HB 773)

**ISSUE:** Relating to the Railroad Commission's purchasing functions.

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181. Codified as an amendment to subch. C, ch. 81, TEX. NAT. RES. CODE ANN., adding § 81.056 (Vernon Supp. 2005).

182. Codified as amendments to TEX. GOV'T CODE ANN., adding § 2115.49, amending TEX. NAT. RES. CODE ANN. § 81.057, and repealing TEX. NAT. RES. CODE ANN. § 81.021 (Vernon Supp. 2005).

**SUMMARY:** This act delegates to the Railroad Commission all purchasing functions under Chapter 89, sections 91.111 and 91.112 of the Natural Resources Code relating to abandoned wells and Oil Field Cleanup Program management. The Railroad Commission can acquire goods and services relating to these activities by any method that provides the best value to the Commission according to the standards listed in section 2155.074 of the Government Code. At its request, the Railroad Commission may use the Commission's services to procure goods and services.

**EFFECTIVE:** September 1, 2005.

13. **ACT:** Act of May 29, 2005, 79th Leg., R.S., ch. 366, §§ 1-4, 2005 Tex. Sess. Law Serv. 1039 (Vernon).<sup>183</sup> (SB 1297)

**ISSUE:** Relating to the elements of the criminal offense of discharging used oil into water.

**SUMMARY:** This act provides an exception from the offense of discharging any waste or pollutant into any water—if the discharge of used oil results in less than fifteen parts per million and the person discharging waste is authorized to discharge storm water under a general permit.

**EFFECTIVE:** September 1, 2005.

14. **ACT:** Act of Apr. 28, 2005, 79th Leg., R.S., ch. 38, §§ 1-3, 2005 Tex. Sess. Law Serv. 55 (Vernon).<sup>184</sup> (SB 1299)

**ISSUE:** Relating to an exception to the prohibition against commingling used oil with solid waste if the commingling is incidental to the dismantling of scrap, used, or obsolete metals.

**SUMMARY:** This act provides an exception to knowingly mixing used oil with solid waste and disposing of it in landfills either directly or indirectly—when the commingling is incidental to and the unavoidable result of the dismantling or mechanical shredding of motor vehicles, appliances, or other items of scrap, used, or obsolete metals.

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183. Codified as amendments to TEX. WATER CODE ANN. §§ 7.147(a) & 7.176(a) (Vernon Supp. 2005).

184. Codified as amendments to TEX. WATER CODE ANN. § 7.176(a) & (c) (Vernon Supp. 2005).

