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OIL, GAS AND MINERAL LAW

*Stuart C. Hollimon**
*Robert E. Vinson, Jr.***

I. ISSUES INVOLVING CONVEYANCING

A. FRACTIONAL ROYALTY INTEREST

THE court of appeals in *White v. White*[1] construed an unambiguous 1955 royalty deed and determined that the deed conveyed a royalty interest equal to 3/8ths of 1/7th of all the oil, gas, and minerals produced from a certain tract rather than 3/8ths of 1/7th of the royalty provided for under an applicable oil, gas, and mineral lease covering the tract. The royalty deed at issue was made by Modesto White, Sr. to Alice Carrington for a term of years, with the remainder to Modesto White, Jr.[2] In this action, Modesto White, Jr. sought a declaration that the royalty deed

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1. 830 S.W.2d 767 (Tex. App.—Houston [1st Dist.] 1992, writ denied).
2. The portions of the deed relevant to the court's analysis provided:

> I, Modesto White [Sr.] . . . have granted . . . unto Alice Carrington . . . for the period ending January 1, 1962, and thereafter to Modesto [White, Jr.] . . . in fee simple forever, the following described property located in Chambers County, Texas to wit:
>
> *A non-participating mineral royalty equal to three-eighths (3/8ths) of all the oil and gas and other minerals that may be on or under and produced and saved* from the lands and interests in lands in Chambers County, Texas, owned by the said Daisy M. Gill, Deceased, at the time of her death, *said three-eighths (3/8ths) royalty interest hereby conveyed being all of the remaining interest now owned by the undersigned grantor.* The mineral royalty interest in the Estate of Daisy M. Gill shall, after the date of this conveyance, be owned three-eighths (3/8ths) by Clifford White, one-eighth (1/8) by W.P. Hamblen, one-eighth (1/8) by Jas. F. Bobbitt, *and three-eighths (3/8ths) by the grantees herein [Alice Carrington and Modesto White, Jr.],* as herein provided.
>
> No part of the lands or the royalty interests or the other mineral interests owned by the undersigned, MODESTO WHITE, in his own right, are conveyed hereby, *it being the intention of the undersigned to convey hereby only said royalty interest in the Estate of Daisy M. Gill, Deceased.*
>
> This conveyance does not cover any part of, or interest in, the surface of the lands or any other property acquired from the said Estate of Daisy M. Gill, Deceased, and this conveyance covering *only a non-participating royalty interest,* the said grantees herein *shall not be entitled to any bonuses or delay rentals to be paid on future and existing oil, gas and mineral leases,* which are reserved by the grantor herein, and the grantees herein shall not be required to sign any future lease or leases.

Id. at 768-69 (emphasis added by court) (footnotes omitted) (first alteration in original). At the time of her death, Daisy M. Gill owned an undivided one-seventh mineral interest in the property. That interest was subsequently leased under an instrument which provided for a

conveyed 3/8ths of 1/7th royalty interest; the successors of Clifford White's interest, on the other hand, asserted that the deed conveyed 3/8ths of 1/7th of the royalty provided for under the current lease (or any future valid lease) executed by the holders of the relevant executive rights. Following a bench trial on stipulated facts, the trial court determined that the deed conveyed a fractional royalty interest rather than a fraction of the royalty provided for under the lease, finding that the deed conveyed a 3/8ths of 1/7th royalty interest, such being "3/56 of all oil, gas and other minerals produced and sold" from the premises.[3] The court of appeals affirmed.[4]

Applying basic rules of deed construction, the court ascertained the intent of the parties to the deed by considering the express provisions within the four corners of the instrument and harmonizing all parts of the deed to the extent possible.[5] In doing this, the court emphasized that the intention of the grantor was expressed in the deed where it stated that the grantor "desires to convey a non-participating mineral royalty equal to three-eighths (3/8ths) of all the oil, gas and other minerals that may be on or under and produced and saved from the lands and interests in lands owned by the Estate of Daisy Gill, Deceased, in Chambers County, Texas . . . ."[6] According to the court, this language made it clear that the grantor intended to convey a definite fraction (3/8ths of 1/7th) of all the production from the tract and not merely a fraction of whatever royalty might be provided for under an unidentified oil and gas lease.[7]

B. DESCRIPTION OF PROPERTY CONVEYED

In *Robbins v. Amoco Production Co.*[8] the Court of Appeals for the Fifth Circuit, following its decision in *Clark v. Amoco Production Co.*,[9] rejected another attempt by purported heirs of James Meaders to share in the production from the famed Spindletop Field.[10] This case arose out of a 1911 deed from Ephraim Garonzik to James Meaders, which conveyed an undivided one-eighth mineral interest in four specifically described tracts: Abstract Numbers 166, 181, 182, and 183 in Jefferson County. The deed provided that the four tracts constituted all the property that certain individuals inherited from William McFadden and that the grant was intended to apply to all properties in Jefferson County that the named individuals were entitled to inherit from William McFadden.[11] Apparently, William McFad-

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fractional royalty to be paid on all production obtained from the lease premises. *See id.* at 768 n.2.

3. *Id.* at 769.
4. *Id.* at 771.
5. *Id.* at 769-70.
6. *Id.* at 770.
7. *Id.*
8. 952 F.2d 901 (5th Cir. 1992).
9. 908 F.2d 29 (5th Cir. 1990).
10. "The Spindletop Oil Field has been a leading source of oil production since 1901. The discovery of the 'Lucas Gusher' at Spindletop began the East Texas oil boom. Uncounted billions of dollars worth of oil have since been produced in the Spindletop field." Clark v. Amoco Prod. Co., 794 F.2d 967, 969 n.2 (5th Cir. 1986).
11. The deed stated:

den's estate owned thirty-seven tracts of land in Jefferson County in addition to the four tracts specifically described in the 1911 deed. Jewell Robbins claimed to be an heir of James Meaders and to represent approximately 200 other heirs. She asserted that the 1911 deed conveyed to James Meaders an undivided one-eighth mineral interest in all forty-one tracts. Robbins brought suit against Amoco Production Company, Mobil Oil Corporation, Phillips Petroleum Company, Sun Company, Sun Exploration and Production Company ("Sun E&P"), Chevron Company, U.S.A., Shell Oil Company, and Texaco, Inc., claiming that these oil companies failed to compensate the Meaders heirs $20 billion for oil and gas produced from these tracts.

The district court severed Robbins' claims against Chevron and entered summary judgment in favor of the other defendants.[12] The court held that the 1911 deed conveyed an interest in only the four specifically described tracts and that Robbins failed to prove complete chain of title to three of the four tracts.[13] Robbins appealed.

The Fifth Circuit reviewed the district court's interpretation of the 1911 deed and determined that its prior decision in the *Clark* case was dispositive of Robbins' interest.[14] In *Clark* other alleged heirs of James Meaders asserted the same construction of the same deed. The Fifth Circuit in that case held that the 1911 deed was not ambiguous and that it conveyed an interest in the four referenced tracts only.[15] The court in the present case noted that it had no reason to conclude that such decision was erroneous[16] and held that the *Clark* decision was determinative of Robbins' deed construction argument.[17]

The court then reviewed that part of the summary judgment holding that Robbins failed to establish sufficient chain of title to tracts 181, 182, and

> [T]he above described property herein conveyed is all the property that . . . J.H. McFadden, R.D. McFadden, and A.J. McFadden inherited through their ancester [sic], Wm. McFadden, and this deed is intended to convey to the said James Meaders one-eights [sic] interest in and to all properties . . . that the said J.H. McFadden, A.J. McFadden, and R.D. McFadden are entitled to by inheritance through their ancestor, the said Wm. McFadden, of every description whatsoever, situated in the said County of Jefferson.

952 F.2d at 903 (alterations in original).

12. *Id.*
13. *Id.*
14. *Id.* at 904-05.
15. *Clark*, 908 F.2d at 32. The Fifth Circuit explained:

> We agree with the oil companies that the 1911 deed unambiguously evinces an intent to convey only the four specifically described tracts. The deed initially states that "the property herein conveyed . . . is four (4) tracts." It then provides a legal description of those four properties and further explains, more generally, that "the above described property herein conveyed is all the property" that the McFaddens inherited from William McFadden. Finally, and somewhat redundantly, the deed adds that it is intended to convey a one-eighth interest in all the lands inherited by the McFaddens from William McFadden—a term already defined within the instrument as equal to the four described tracts.

Id.

16. *Robbins*, 952 F.2d at 904.
17. *Id.* at 904-05.

183.[18] The court noted that Robbins was required to prove superior title by one of three ways: (1) proof of adverse possession; (2) proof of a regular chain of conveyances out of the sovereign; or (3) proof of superior title from a common source.[19] Robbins attempted to prove title by the second method. In this connection, she introduced into evidence a deed from the State of Texas to William McFadden, a deed from Anthony Lucas to Ephraim Garonzik, and a deed from Garonzik to James Meaders. After the defendants filed their motions for summary judgment pointing out the absence of the link between McFadden and Lucas, Robbins produced an 1898 agreement by the executor of William McFadden's estate to convey certain properties to Anthony Lucas. This 1898 agreement did not identify any specific tracts being conveyed, rather it purported to convey an interest in the "tracts and parcels of land of every description thereof in reference to Wm. McFaddin [sic] estate."[20] Robbins also relied on the inventory of McFadden's estate which listed interests in about twenty-five different tracts, including Abstract No. 166 in Jefferson County. The inventory did not list Abstract Nos. 181, 182, or 183. On this basis, the Fifth Circuit held that Robbins failed to establish an unbroken chain of title to these three tracts and was not entitled to share in any production from those tracts.[21]

Finally, the court held that, even if Robbins could establish title to all four tracts, there was no evidence of damages.[22] Each oil company (except Chevron, which was severed from the action[23]) produced summary judgment evidence indicating that it had never produced minerals, or participated in any production of any minerals, from any of the four tracts. Indeed, the only lease in which any defendant had an interest in any of the four tracts was a 1944 lease to Sun E&P covering Abstract 182. As to this lease, the summary judgment evidence showed that neither Sun E&P nor its assignees ever drilled a well on the tract and that Sun E&P released its rights to the property in 1963. This release occurred more than twenty-two years before Robbins filed suit, and thus Robbins' claims against Sun E&P were held to be barred by limitations.[24]

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18. *Id.* at 905.
19. *Id.*
20. *Id.* (emphasis omitted).
21. *Id.* at 906.
22. *Id.*
23. Following severance, the district court granted summary judgment for Chevron, and the Fifth Circuit affirmed in an unpublished opinion. *Id.* at 903 n.2; *see* Robbins v. Chevron USA, 940 F.2d 1529 (5th Cir. 1991) (unpublished).
24. *Robbins*, 952 F.2d at 906. According to the Fifth Circuit:

> A party who seeks to recover damages for the extraction of minerals from his land may either ratify an existing lease and sue for royalties or regard the lease as invalid and sue for conversion. The statute of limitations is four years in the former instance and two years in the latter. Irrespective of which theory Robbins pursues, it is obvious that her claims against Sun E&P are barred by limitations.

Id. (citations omitted).

II. ISSUES INVOLVING OIL, GAS AND MINERAL LEASES

A. Surface Easement

1. Temporary Injunctions

Petty v. Winn Exploration Co.[25] concerned the interlocutory appeal of a temporary injunction preventing a surface owner from interfering with the lessee's access to the lands at issue. In 1970, Leta Glasscock granted an oil, gas, and mineral lease ("the 1970 Glasscock Lease") to Winn Exploration Company covering some of the property owned by Glasscock. The lease expressly granted Winn the right to construct roads on the leased premises.[26] At that time, Glasscock owned adjacent tracts of land that were later referred to as the "1971 Glasscock Lease," the "Howett Lease," and the "Bourge Lease." In 1977, Glasscock granted Winn a right-of-way easement across the 1971 Glasscock Lease to permit access to the 1970 Glasscock Lease from the Loma Vista County Road. Later in 1977 and 1978, Scott Petty, Jr. acquired from Glasscock the surface estate of a large portion of Glasscock's property, including all of the 1970 Glasscock Lease and most of the 1971 Glasscock Lease.

In November 1989, Petty and Winn entered into an agreement whereby Winn relinquished the 1977 easement from Glasscock across the 1971 Glasscock Lease, and Petty granted Winn a new easement permitting access to the 1970 Glasscock Lease through a different part of Petty's property which bordered Farm to Market Road 1867. This November 1989 agreement between Petty and Winn contained a provision making the easement subject to any existing and superior easements, rights, and servitudes.[27] This new arrangement resulted in Winn expending $150,000 to build an all-weather road along the new easement. Apparently, Winn desired this arrangement because the Loma Vista County Road was poorly maintained.

In the meantime, Winn acquired a farmout covering parts of the 1971 Glasscock Lease, the Howett Lease, and the Bourge Lease. In December 1989, following completion of Winn's new road, Petty advised Winn that he would be locking the gate on the old access road that connected the 1970 Glasscock Lease to the Loma Vista County Road. At that time, Petty authorized Winn to access the farmout lands through the northwest corner of Winn's 1970 Glasscock Lease. In August 1990, Winn sent Petty a letter

25. 816 S.W.2d 432 (Tex. App.—San Antonio 1991, writ denied).

26. The lease provided in part:

> Lessor, . . . does hereby grant, lease and let unto lessee the land covered hereby for the purposes and with the exclusive right of exploring, drilling, mining and operating for, producing and owning oil, gas, sulphur and all other minerals . . . , together with the right to . . . construct roads and bridges, . . . necessary or useful in lessee's operations in exploring, drilling for, producing, treating, storing and transporting minerals produced from the land covered hereby or any other land adjacent thereto.

Id. at 434.

27. The November 1989 "subject to" provision stated: "This roadway Permit is specifically made subject to any easements existing on said land and to any other rights or servitude to which said land may be subject which are senior to the rights and privileges hereby granted." *Id.* at 435.

reflecting the terms of the December 1989 agreement as follows: (1) Winn was to continue using the new road to access the 1970 Glasscock Lease from FM 1867; (2) Winn was authorized to gain access to the farmout lands through the northwest corner of the 1970 Glasscock Lease; and (3) Winn agreed not to utilize the old access road off of the Loma Vista County Road. Winn then cut the fence and installed a cattle guard near the northwest corner of the 1970 Glasscock Lease and commenced drilling operations on the farmout acreage located on the 1971 Glasscock Lease.

Several weeks later, Petty notified Winn that he was rescinding Winn's authority to cross the lease lines, and that Winn could thereafter gain access to the farmout lands only by way of the old access road off of the Loma Vista County Road. Additionally, Petty threatened termination of the 1989 right-of-way agreement. The next day, Petty had a gate welded across the cattle guard between the 1970 Glasscock Lease and the 1971 Glasscock Lease. Winn sought and obtained a temporary restraining order and later a temporary injunction, prohibiting Petty from interfering with Winn's access to the farmout lands through the northwest corner of the 1970 Glasscock Lease.[28] Petty appealed.

The majority of the appellate panel noted that the dispositive issue on the appeal of an interlocutory temporary injunction was whether the trial judge abused his discretion in granting the injunctive relief.[29] Following prior Texas case law,[30] the majority stated that the propriety of a temporary injunction against interference with an easement does not depend on the ultimate merits of the controversy regarding the existence of the easement, rather, in such situations, the controlling issue was whether there was evidence of a bona fide dispute as to the easement's existence.[31] Under the circumstances, the appellate court concluded that Petty failed to show an abuse of discretion by the trial judge.[32] Accordingly, the trial court's judgment was affirmed.[33]

2. *Locked Gates*

In *Wimberly v. Lone Star Gas Co.*[34] the court of appeals considered

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28. *Id.* at 436.
29. *Id.* at 433.
30. *See* Egan v. Woodell, 720 S.W.2d 169, 171 (Tex. App.—San Antonio 1986, writ ref'd n.r.e.); Richter v. Hickman, 243 S.W.2d 466, 468 (Tex. Civ. App.—Galveston 1951, no writ).
31. *Petty*, 816 S.W.2d at 433.
32. Specifically, the court held:

> Considering the maze of oil leases, right of way leases, farm-out agreements, and written agreements implicated by the evidence presented; the burdens placed upon the appellant by the standard of review; the limitation upon this court in reviewing such interlocutory orders; the legal recognition of the dominance of mineral rights over surface rights; the legal construction favoring implied and expressed easements in mineral lease cases; and the legal implications of "subject to" clauses, we conclude that the appellant has failed to show that the trial judge abused his discretion in granting the temporary injunction under these circumstances.

Id. at 436.

33. *Id.*
34. 818 S.W.2d 868 (Tex. App.—Fort Worth 1991, writ denied).

whether the surface owners' actions constituted unreasonable interference with the lessee's right to use the surface easement. In 1964, E. J. and Frances Wimberly acquired a tract of land, apparently subject to an existing oil, gas, and mineral lease in favor of Lone Star Gas Company. Lone Star had two producing gas wells and related pipelines on the property. In 1988, the relationship between the Wimberlys and Lone Star deteriorated, and the Wimberlys changed the locks on the entrance gate to the property but did not provide a key to Lone Star.

Lone Star filed suit against the Wimberlys, seeking, among other things, a permanent injunction prohibiting the Wimberlys from denying Lone Star access to its gas wells and pipelines on the property. The trial court granted Lone Star summary judgment, permanently enjoining the Wimberlys.[35] The Wimberlys appealed, claiming that Lone Star's summary judgment proof did not establish entitlement to summary judgment as a matter of law and that there were genuine issues of material fact regarding whether they committed a wrongful act.

Lone Star's summary judgment affidavit stated that the Wimberlys denied it access to its gas wells. E. J. Wimberly, in his affidavit, stated that he ran cattle on the land and that he had problems with the theft of his cattle. E. J. testified by way of affidavit that he periodically changed the locks at the entrance to his property in order to monitor the people entering his property. E. J. further stated that each time he received a phone call from Lone Star requesting entry onto the property, he immediately went to the property to allow Lone Star to enter. According to E. J.'s affidavit, he never denied Lone Star access to the gas wells to the property. Similarly, Frances Wimberly stated in her affidavit that she had never locked out Lone Star or taken any other action that would have denied or prevented Lone Star from gaining entry onto the property. The Wimberlys claimed that this evidence at least raised a fact issue as to whether the actions constituted unreasonable interference with Lone Star's right to enter their property.

The court of appeals rejected this argument and distinguished *Stout v. Christian*,[36] upon which the Wimberlys heavily relied.[37] That case also involved a locked gate blocking an easement where the servient owner had cattle on the property. In *Stout*, the court held that the issue of whether the locking of the gate blocking the easement was an unreasonable interference with the right to use the easement was a question of fact, where the use of the easement interfered with the running of cattle on the servient estate.[38] The court of appeals in the instant case noted that the easement deed in *Stout* required closed gates and that the servient estate owner provided keys to the dominant estate owner.[39] Accordingly, the court held that although the Wimberlys may be entitled to use locked gates on their property to pro-

35. *Id.* at 869.
36. 593 S.W.2d 146 (Tex. Civ. App.—Austin 1980, no writ).
37. 818 S.W.2d at 872.
38. *Stout*, 593 S.W.2d at 150-51.
39. 818 S.W.2d at 872.

tect their cattle, they must furnish Lone Star with a key to the gates.[40] Since the Wimberlys did not do so, their conduct was held to constitute a wrongful act as a matter of law, and therefore summary judgment was affirmed.[41]

B. ROYALTY ISSUES

1. *No Duty of Good Faith and Fair Dealing*

In *Hurd Enterprises, Ltd. v. Bruni*[42] the court of appeals held that, under the circumstances presented, an oil and gas lessee's negotiation of a take-or-pay settlement did not result in a breach of duty of utmost good faith and further held that such a duty does not ordinarily exist between a lessee and lessor.[43] In 1974, the trustees of the Bruni Mineral Trust granted an oil, gas, and mineral lease to Killam & Hurd, Ltd. Killam & Hurd drilled and completed nine producing gas wells on the property and entered into a long-term gas sales contract with United Texas Transmission Company (UTTCO). The contract included a take-or-pay provision which required UTTCO to take a certain percentage of the annual deliverability of the wells covered by the contract each year or to pay for any such gas it did not take. Killam & Hurd eventually split into Hurd Enterprises, Ltd. and Killam Oil Company, with each company obtaining one-half interest in the lease and the UTTCO contract. UTTCO thereafter failed to take or pay for the required minimum volume of gas. UTTCO eventually settled with Killam Oil and Hurd Enterprises, separately, for the take-or-pay deficiencies. In connection with these settlements, Killam Oil and Hurd Enterprises received cash payments, and UTTCO was released from all claims for take-or-pay deficiencies. Additionally, the gas contract was cancelled.

Bruni learned of these settlements and sued Killam Oil and Hurd Enterprises on a variety of legal theories for failing to share the benefit of those settlements. In this regard, Bruni asserted: (1) breach of the lease's royalty provision;[44] (2) breach of the implied marketing covenant; and (3) breach of the duty of good faith and fair dealing. The parties filed cross motions for summary judgment with regard to royalty liability. The trial court determined that the gas royalty clause was applicable to the settlement payments as a matter of law.[45] After rendering partial summary judgment for Bruni, the trial court severed the royalty liability claim, and Killam Oil and Hurd

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40. *Id.*
41. *Id.*
42. 828 S.W.2d 101 (Tex. App.—San Antonio 1992, writ denied).
43. *Id.* at 110.
44. The royalty provision in the lease provided:

> The royalties to be paid by lessee are . . . (b) on gas, including casinghead gas and all gaseous substances, *produced* from said land *and sold* or used off the premises or in the manufacture of gasoline or other product therefrom, the market value at the mouth of the well of one-eight of the gas so sold or used provided that on gas sold at the wells the royalty shall be one-eighth of the amount realized from such sale . . . .

Id. at 106 (emphasis added by court).

45. *Id.* at 104.

Enterprises appealed.[46]

During the pendency of the royalty liability appeal, Killam Oil settled with Bruni with regard to all claims except the royalty claim involved in the appeal. The remaining claims against Hurd Enterprises proceeded to trial. At trial, the jury found that: (1) Bruni's royalty share of Hurd's settlement proceeds was $98,048; (2) Hurd did not breach the marketing covenant; (3) a confidential relationship existed between Hurd and Bruni; and (4) Hurd breached its duty of good faith and fair dealing by settling the contract claims with UTTCO in the manner it did.[47] The trial court entered judgment for Bruni in accordance with these findings.[48] Thereafter, appeal of the royalty issue was decided in *Killam Oil Co. v. Bruni*[49] when the court of appeals reversed the summary judgment and rendered judgment in favor of Killam Oil and Hurd Enterprises with regard to the royalty claim, holding as a matter of law that Bruni was not entitled to royalty on settlement proceeds arising from the take-or-pay provision of the UTTCO contract.[50]

On appeal from the judgment following the trial, Hurd first contended that the trial court erred in awarding $98,048 in royalty to Bruni, because, as a matter of law, royalty owners are not entitled to share in take-or-pay settlement proceeds. The court of appeals reversed the trial court's judgment in this regard,[51] applying the "law of the case" doctrine.[52] Relying on its opinion in the first appeal and the Texas Supreme Court's denial of writ of error with regard to that case, the appellate court held that the trial court erred in awarding royalty damages to Bruni.[53]

As to the trial court's judgment regarding breach of duty of good faith and fair dealing, Hurd contended that there is no such duty in a lessor/lessee relationship. Bruni responded that it is not the relationship itself that gives rise to the duty, but rather, the duty results from the nature of the confidential relationship between the parties which exists because of the lessee's power to market the produced gas and the unequal bargaining power between the parties. The court rejected this analysis, noting that, in the absence of some other special relationship between the parties, the relationship between lessor and lessee is purely contractual.[54] In reaching this result, the court disagreed with Bruni's claim that the lessee's power to market gas gives rise to such a special relationship.[55] Recognizing that a lessee is obligated by an implied covenant in an oil, gas, and mineral lease to reasonably

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46. *Id.*
47. *Id.* at 104-05.
48. *Id.* at 105.
49. 806 S.W.2d 264 (Tex. App.—San Antonio 1991, writ denied).
50. *Id.* at 268.
51. *Hurd Enterprises, Ltd.*, 828 S.W.2d at 106, 112.
52. *Id.* at 106. The "law of the case" doctrine is "that principle under which questions of law decided on appeal to a court of last resort will govern the case throughout its subsequent stages." *Id.* at 106 n.7 (quoting Hudson v. Wakefield, 711 S.W.2d 628, 630 (Tex. 1986)).
53. *Id.* at 106.
54. *Id.* at 107 (citing Cambridge Oil Co. v. Huggins, 765 S.W.2d 540, 544 (Tex. App.—Corpus Christi 1989, writ denied)).
55. *Id.*

market production from the lease,[56] and that such duty requires the lessee to market the production with due diligence and obtain the best price reasonably possible,[57] the court nevertheless concluded that the scope of such duty is measured by the reasonably prudent operator standard and not by a highest good faith standard.[58]

Turning to Bruni's claim that there was a special relationship between the parties due to unequal bargaining power, the court noted that Bruni's argument was based on cases finding a special relationship between an insurer and insured, because the insurer had exclusive control over evaluating, processing, and denial of claims.[59] The court concluded, however, that the relationship between a lessor and lessee was distinguishable from that of an insurer and insured because the lessee does not have the exclusive control over the lessor as was present in the insurance cases,[60] particularly because the parties to the lease could negotiate and contractually define for themselves the lessee's royalty obligation.[61] Thus, finding no imbalance of bargaining power in the lessor/lessee relationship requiring the imposition of the duty of good faith and fair dealing,[62] the court concluded as a matter law of there was no confidential relationship between Hurd and Bruni,[63] and therefore no duty of good faith and fair dealing.[64]

2. *No Third-Party Beneficiary Status Under Gas Contracts*

In *Mandell v. Hamman Oil & Refining Co.*[65] the court of appeals affirmed the trial court's summary judgment denying royalty owners the right to share in the proceeds from the settlement of a take-or-pay lawsuit.[66] In 1978, Mandell and others, as lessors, leased 260 acres of land to Hamman, as lessee. In 1979, Hamman drilled and completed successful gas wells on the property and thereafter entered into a gas purchase contract with Tennessee Gas Pipeline Company. The gas contract contained a take-or-pay provision

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56. *Id.*
57. *Id.* at 107-08.
58. *Id.* at 108.
59. *Id.* at 109. Bruni relied on *Aranda v. Insurance Co. of N. Am.*, 748 S.W.2d 210 (Tex. 1988) and *Arnold v. National Mut. Fire Ins. Co.*, 725 S.W.2d 165 (Tex. 1987).
60. 828 S.W.2d at 109.
61. *Id.* at 110. The court explained:

> The parties to the lease are free to decide and to define what returns from the lease are to be regarded as "royalty." The lease transaction offers an opportunity for the lessor to receive royalty with only limited risks (mainly, the risk the lessee will not develop the lease and that drainage will remove the oil and/or gas from under the lease before the royalty owner can receive royalty from production by its lessee). On the one hand the lessee pays a bonus, takes the risks, assumes the production costs, provides lease use gas to the lessor, and in certain circumstances can lose the lease; while on the other hand the lessor can require the lessee to share information concerning exploration, production, and marketing.

Id. (citations omitted).
62. *Id.*
63. *Id.* at 112.
64. *Id.*
65. 822 S.W.2d 153 (Tex. App.—Houston [1st Dist.] 1991, writ denied).
66. *Id.* at 158, 166.

obligating Tennessee to either take a certain percentage of the wells' deliverability or pay Hamman for any such gas not taken.

In 1983, Tennessee advised Hamman that it would not honor its obligations under the take-or-pay provision of the contract. Hamman sued Tennessee for breach of the contract's take-or-pay provision, and also for Tennessee's unauthorized unilateral reduction in the contract price, and for drainage caused by Tennessee's violation of the contract's ratable take provision. Ultimately, Hamman settled its lawsuit against Tennessee for $8 million and allocated a share of the settlement proceeds to the royalty owners. The portion of the settlement proceeds distributed to the royalty owners did not include any amount allocable to the take-or-pay claim. The royalty owners refused to accept Hamman's allocation of the settlement proceeds and sued Hamman and Tennessee, asserting that they were entitled to share in the take-or-pay portion of the settlement. The trial court granted a summary judgment, denying the claims of the royalty owners, who then appealed.[67]

The royalty owners' principal contention on appeal was that the trial court erred in finding that they were not sellers or third-party beneficiaries under the Hamman-Tennessee contract. The court found that the lease provided the royalty owners with the option of either accepting their proportionate share of the proceeds from the sale of lease production sold under the contract or electing to take their share of gas produced from the lease in kind and negotiate their own gas contract with Tennessee or some other purchaser.[68] The evidence demonstrated to the court that the royalty owners never elected to take their share of gas in kind.[69] Moreover, the court em-

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67. *Id.* at 157.

68. *Id.* at 160. The leases provided for royalties: "[o]n gas, including casinghead gas or other gaseous substance, 1/4 of 8/8ths (one-fourth of eight-eighths) of all produced, excepting that used for routine lease operations or unavoidably lost in conducting such operations." *Id.* at 156. The leases further provided that the lessor had:

> the right to take his royalty share of any production either in kind or value, at Lessor's election. Said royalty, whether in kind or value, shall be delivered free of cost to Lessor or Lessor's credit at the same delivery point at which Lessee disposes of its share of the same product.

Id. With regard to the marketing of production the leases obligated the lessee to "promptly furnish Lessor with copies of all proposals made to or received by Lessee from third parties for the purchase of any such production." *Id.* Once the lessee negotiated a contract for the sale of gas and provided a copy to the lessor, then the lessor was required by the leases' provisions to notify lessee in writing, within 30 days after receipt of the contract "as to whether Lessor elects to either (i) approve such contract or (ii) take in kind and separately dispose of Lessor's royalty share of such production." *Id.* The leases provided that the lessor's failure to give written notice of election "shall be conclusively deemed an election to approve the contract proposed by Lessee." *Id.*

69. *Id.* at 160. According to the court:

> Appellants were required to affirmatively elect under the leases to take their royalty share in kind. Paragraph 3(d) of the lease gave appellants the opportunity to negotiate a gas purchase contract with Tennessee, if appellants had notified Hamman, in writing, that they would take their share in kind. The evidence indicates that appellants failed to give notice within the 30 day period after Mr. Hamman tendered the Hamman-Tennessee contract to them and, thus, elected to approve the contract and receive royalties based on *production*.

Id.

phasized that the royalty owners were not signatories to the Hamman-Tennessee contract and no reference to the royalty owners appeared anywhere in the contract.[70] In addition, the court noted that the royalty owners had never communicated with Tennessee about the provisions of the contract during the seven years which preceded the filing of the lawsuit and never made any demand upon Tennessee for take-or-pay payments under the contract.[71]

Under these circumstances, the court concluded that the royalty owners did not have title to, or the right to sell, gas produced from the lease under the Hamman-Tennessee contract and did not have the legal capacity to sell gas to Tennessee under the contract.[72] The royalty owners never undertook any action indicating that they claimed any such right.[73] On this basis, the court concluded that there was sufficient evidence to support the jury's finding that the royalty owners were not parties to the Hamman-Tennessee contract.[74]

The court also held that the royalty owners were not third-party beneficiaries to the Hamman-Tennessee contract.[75] In Texas, a contract will not be interpreted as having been made for the benefit of a third party unless it clearly appears that such was the intention of the contracting parties.[76] In this instance, the gas purchase contract was executed by Tennessee and Hamman. The evidence indicated to the court that the royalty owners did not have any agreement with Tennessee concerning satisfaction of royalty obligations and had not been involved in any communications, conversations, or dealings with Tennessee during or following the negotiation of the Hamman-Tennessee contract.[77] Instead, the court noted, all of the royalty owners' communications had been with Hamman.[78] Of further significance to the court, the Hamman-Tennessee contract made no provision for the payment of royalty obligations.[79] Based on these facts and evidence that none of the royalty owners had ever advised Tennessee that they considered themselves parties to the gas purchase contract, the court concluded that the royalty owners were not third-party beneficiaries to the Hamman-Tennessee contract.[80]

The court also rejected the royalty owners' contention that Hamman had breached its implied obligation to reasonably market production by refusing to share the proceeds from the settlement of its take-or-pay claim.[81] The

70. *Id.*
71. *Id.*
72. *Id.* at 161.
73. *Id.*
74. *Id.* at 159.
75. *Id.* at 161.
76. *Id.* (citing Merrimack Mut. Fire Ins. Co. v. Allied Fairbanks Bank, 678 S.W.2d 574, 577 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd n.r.e.); Texas Bank & Tr. Co. v. Lone Star Life Ins. Co., 565 S.W.2d 353, 357 (Tex. Civ. App.—Tyler 1978, no writ)).
77. *Id.*
78. *Id.*
79. *Id.*
80. *Id.*
81. *Id.* at 165.

royalty owners testified that the contract negotiated by Hamman was superior in all respects. In particular, the contract contained a pricing provision which yielded the highest possible price for the gas, contained a favored nations provision, an annual price redetermination clause, and factored prices based upon the MMBTU content of the gas. Noting that under the implied marketing covenant, the lessee must make certain that the gas produced under the lease is sold for the best price or under the best terms available,[82] the court concluded that Hamman's conduct satisfied this test.[83] The fact that the royalty owners were not entitled to share in the take-or-pay payments under the contract did not change the court's opinion because the court reasoned that take-or-pay payments are not payments for production, but instead are payments for non-production.[84] The receipt of such payments does not give rise to a royalty obligation or trigger exposure under the implied marketing covenant of the lease.[85]

3. *Sulphur Royalties*

Schwartz v. Prairie Producing Co.[86] concerned the issue of whether the gas royalty clause or the sulphur royalty clause in an oil, gas, and mineral lease[87] applies to sulphur recovered from natural gas containing hydrogen sulfide. In this opinion, the court determined that the lease royalty provisions at issue were ambiguous and remanded the case for jury trial.[88] The Schwartzes were the lessors under certain oil, gas, and mineral leases that were ultimately acquired by Prairie. Three gas wells were completed on the leases, which produced sour gas.[89] Prairie contracted with Cities Service Company to transport the gas from the wellhead to a processing facility, where it recovered sulphur from the gas. Cities Service kept a portion of the recovered sulphur in accordance with the processing arrangement and returned the remainder to Prairie, which sold the sulphur to third parties.

Prairie contended that the sulphur royalty clause was applicable, and it tendered to the Schwartzes royalty in the amount of $1.00 per long ton of recovered sulphur. The Schwartzes refused the payments, contending that

82. *Id.* at 164.
83. *Id.* at 165.
84. *Id.* at 164-65.
85. *Id.* (relying on Killam Oil Co. v. Bruni, 806 S.W.2d 264, 268 (Tex. App.—San Antonio 1991, writ denied)).
86. 833 S.W.2d 629 (Tex. App.—Houston [1st Dist.] 1992, writ dism'd).
87. The royalty provision in the leases at issue stated:

> As royalty, lessee covenants and agrees . . . (b) To pay lessor on gas and casinghead gas produced from said land (1) when sold by lessee, 1/4 of the amount realized by lessee, computed at the mouth of the well, or (2) when used by lessee off said land or in the manufacture of gasoline or other products, the market value, at the mouth of the well, of 1/4 of such gas and casinghead gas; (c) To pay lessor on all other minerals mined and marketed or utilized by lessee from said land, one-tenth either in kind or value at the well or mine at lessee's election, except that on sulphur mined and marketed the royalty shall be one dollar per long ton.

Id. at 631.
88. *Id.* at 632.
89. "Sour gas" is natural gas that contains hydrogen sulfide. *Id.* at 630.

they were entitled to royalties under the gas royalty clause reasoning that the sulphur was simply part of the gas stream at the time of processing and not a separate mineral. On this basis, the Schwartzes claimed royalties were due in the amount of one-fourth of Prairie's net proceeds from the sale of the sulphur. Suit followed.

Originally, the trial court granted summary judgment for Prairie.[90] That judgment was appealed,[91] and on appeal each member of the appellate panel in that case wrote a separate opinion: one justice reversed and remanded, holding that royalty should be determined under the gas royalty clause;[92] another found the royalty provisions ambiguous;[93] and the third found that the sulphur royalty clause controlled.[94] The case was remanded for a jury trial on the merits.[95] However, the case was not decided by the jury because at trial Prairie was granted an instructed verdict, and judgment was entered that the Schwartzes take nothing.[96] The Schwartzes appealed again.

On this appeal, the Schwartzes contended that the leases unambiguously provided for royalty on hydrogen sulfide gas under the gas royalty clause but, alternatively, claimed that the lease royalty clause was ambiguous and the evidence at trial raised fact issues regarding which portion of the royalty clause was applicable. Reviewing the evidence, the court noted that Prairie's expert witnesses had testified that: (1) hydrogen sulfide is a gas; (2) sulphur does not exist at the wellhead except in trace amounts; (3) all sulphur recovered is obtained from gas at the processing plant; (4) a sour gas well is not a sulphur mine; and (5) sulphur produced from hydrogen sulfide gas is considered "recovered sulphur" and not "mined sulphur."[97] Based on this and other evidence, the court determined that the royalty provisions were ambiguous and that there was evidence of probative force to raise a fact issue regarding which lease clause applied.[98] Accordingly, the instructed verdict was reversed, and the case was remanded for new trial on the merits.[99]

C. Other Issues

1. *Self Dealing By Executive*

In *Dearing, Inc. v. Spiller*[100] the holder of the executive rights to lease minerals was found to have breached the duty of utmost good faith owed to non-executive mineral interest owners by leasing the property to an entity controlled by the executive upon less than fair market terms.[101] In 1943, the

90. *Id.*
91. Schwartz v. Prairie Producing Co., 727 S.W.2d 289 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.).
92. *Id.* at 292-93 (Cohen, J.).
93. *Id.* at 293 (Dunn, J., concurring only in the judgment).
94. *Id.* at 293-94 (Bass, J., dissenting).
95. *Id.* at 293.
96. 833 S.W.2d at 630.
97. *Id.* at 631-32.
98. *Id.* at 632.
99. *Id.*
100. 824 S.W.2d 728 (Tex. App.—Fort Worth 1992, writ denied).
101. *Id.* at 732.

Haag family conveyed the fee interest in a certain 600-acre tract to Dearing, Inc.'s predecessor in interest, reserving an undivided one-half mineral interest. The deed granted Dearing's predecessor the executive right[102] with regard to the reserved mineral interest and required that any oil and gas leases provide for at least one-eighth royalty. The appellees succeeded to the interest of the Haag family.

In 1944, Dearing granted an oil and gas lease on the tract to Shell for one-eighth royalty. By 1980, the lease was held by production from a single well. The area then became "hot" due to the discovery of a new producing formation. Dearing purchased the well and stopped production, causing the Shell lease to terminate. Dearing then granted an oil, gas, and mineral lease to Royal Petroleum Corp.

The circumstances surrounding the lease to Royal were highly unusual. First, although the lease to Royal provided for one-eighth royalty, it did not provide for the payment of bonus and did not contain a Pugh clause, both provisions being routinely present in oil and gas leasing transactions.[103] Second, prior to Dearing's granting of the lease to Royal, Dearing received written lease proposals from others offering better terms, yet these offers were declined by Dearing.[104] Third, like Dearing, Royal was owned and operated by the Dearing family,[105] and Herman Dearing, president of Dearing and Royal, made no effort to lease the property to a third party because he wanted to "keep it in the family."

The appellees brought suit against Dearing and Royal, seeking actual and exemplary damages for Dearing's breach of the duty of utmost good faith, for an accounting of the net profits under the new lease, for cancellation of the lease, and for termination of the executive right as to their undivided mineral interest. The trial court, based on a jury verdict favorable to the appellees, awarded judgment for the appellees, granting the relief sought.[106] Dearing appealed, claiming, among other things, that: (1) Dearing did not owe the appellees a duty of utmost good faith because no such duty was explicitly imposed in the 1943 deed and (2) Dearing did not breach any such duty because the lease to Royal complied with the 1943 deed's sole requirement that future leases provide for at least one-eighths royalty.

With regard to the existence of the duty of utmost good faith, the court noted that as early as 1937 (six years prior to the 1943 deed) Texas courts had accepted the utmost good faith standard for executives[107] and that the

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102. The executive right is the exclusive right to execute oil and gas leases. HOWARD R. WILLIAMS & CHARLES J. MEYERS, MANUAL OF OIL AND GAS TERMS 415 (8th ed. 1992).

103. A Pugh clause generally provides that drilling operations on, or production from, pooled units shall maintain the lease only as to the lands that are included in such producing unit(s). *Dearing, Inc.*, 824 S.W.2d at 730 n.l.

104. In 1981, a prospective lessee offered three-sixteenths royalty with $35 per acre bonus. Later, another prospective lessee offered one-quarter royalty, $100 per acre bonus, and a continuous drilling obligation. *Id.* at 730-31.

105. Dearing and Royal had an identity of officers, directors and shareholders, and both had the same business address and phone number. *Id.* at 731 n.3.

106. *Id.* at 731.

107. *Id.* at 732 (citing Schlittler v. Smith, 128 Tex. 628, 631, 101 S.W.2d 543, 545 (1937)).

Texas Supreme Court had recently applied the same standard in an analogous situation, equating the standard to a fiduciary obligation.[108] On this basis, the court concluded that the duty of utmost good faith is implied by law in the relationship between an executive and non-executive, and its existence is not dependent upon specific language in the instrument creating the executive right.[109] Accordingly, the court held that, in this case, Dearing owed the appellees the duty of utmost good faith with regard to the exercise of the executive right.[110]

After reviewing the evidence, the court found that Dearing had breached this duty.[111] The court construed the requirement in the 1943 deed, that royalties be no less than one-eighth, to merely establish a minimum royalty and held that this language did not supplant the legal standard which requires the holder of the executive right to exercise that right to obtain "the highest royalty possible."[112] Noting that the duty of utmost good faith is not necessarily satisfied by obtaining the minimum required royalty, the court concluded that because the lease to Royal did not provide for the "fair market royalty prevalent in the surrounding area at that time," Dearing had breached the duty owed to the appellees by virtue of his status as holder of the executive right.[113]

2. No Obligation to Unleased Interest Owner in Absence of Ratification

In *Sun Exploration & Production Co. v. Pitzer*[114] the court of appeals denied a claim for royalties asserted against the operator of a unit by an unleased mineral owner whose interest had not been included in the unit.[115] This suit had its origin in the formation of a 5,677.35-acre unit for secondary recovery purposes by the predecessor of Sun. At the time, the plaintiffs owned an undivided one-half mineral interest in a 255.5-acre tract situated within the boundary of the unit. However, Sun's predecessor apparently mistakenly attributed the plaintiffs' ownership interest to others who had granted it oil, gas, and mineral leases, and failed to include the plaintiffs' interest in the unit. Although there had been production from the unit, there had been no production from the 255.5-acre tract.

The plaintiffs sued Sun, seeking damages for unpaid royalties attributable to their interest. The jury found that Sun was negligent in "not obtaining a

108. *Id.* (citing Manges v. Guerra, 673 S.W.2d 180 (Tex. 1984)).
109. *Id.*
110. *Id.*
111. *Id.* at 733.
112. *Id.*
113. *Id.* The court also indicated that an executive is prohibited from self dealing, through spouses, children, agents, employees, and all others whose interests are closely identified with the executives and seemed to suggest that Dearing breached the duty of utmost good faith when it dealt with its "agent", a closely held corporation. *Id.* Although stating that it did not intend to imply that an executive is barred, as a matter of law, from developing the premises himself, the court nevertheless stated that clear evidence of breach of the executive duty exists if the market value of the lease is much greater than the terms the executive grants to himself. *Id.* at 734.
114. 822 S.W.2d 294 (Tex. App.—Eastland 1991, writ denied).
115. *Id.* at 295.

lease from Plaintiffs and not joining Plaintiffs' mineral interest in the unit," and that such negligence proximately caused the plaintiffs damages in the amount of $32,863.00.[116] The trial court entered judgment for the plaintiffs for that amount plus pre-judgment interest.[117] Sun appealed.

In a very short opinion, the appellate court held that Sun had no obligation to pay royalties to the plaintiffs because: (1) there was no production from the 255.5-acre tract upon which royalties could be due;[118] and (2) the plaintiffs never ratified the unitization agreement so as to have a claim to a share of unit production.[119] The court reasoned that because there was no obligation to pay royalties to the plaintiffs prior to ratification, the plaintiffs had no cause of action for negligent failure to pay.[120] Consequently, the court of appeals reversed the trial court's judgment against Sun and rendered judgment that the plaintiffs take nothing against Sun.[121]

3. *Payment of Lease Consideration by Personal Check*

At issue in *TSB Exco, Inc. v. E.N. Smith, III Energy Corp.*[122] was whether payment for an extension of an oil and gas lease was properly tendered by the delivery of a personal check. On July 6, 1983, the owners of two tracts of land granted oil and gas leases to TSB's predecessor in interest. The leases had an original primary term of five years, and they provided the lessee with an option to extend the primary term for an additional five years.[123] The working interest in the leases was eventually assigned to TSB.

In June 1988, several weeks prior to the expiration of the original primary term, Smith Energy contacted the landowners and obtained an option to lease the same lands covered by the TSB leases, upon expiration of such leases. On July 1, 1988, a representative of TSB delivered to the lessors personal checks in the correct amounts for the purpose of extending the leases for another five years. Smith Energy's agent learned of this and advised the lessors to hold the checks without negotiating them until after July 6 because such checks might not constitute proper tender of payment. The

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116. *Id.*
117. *Id.* at 294.
118. *Id.* at 295.
119. *Id.*
120. *Id.*
121. *Id.*
122. 818 S.W.2d 417 (Tex. App.—Texarkana 1991, no writ).
123. The option provided:

> Lessee is hereby given the option, to be exercised prior to the date on which this lease or any portion thereof would expire . . . , of extending this lease for a period of five (5) years as to all or any portion of acreage then held hereunder . . . , the only action required by Lessee to exercise this option being the payment to Lessor (or for Lessor's credit to depository bank named herein) of the additional consideration of the sum of $75.00 per acre for each acre or so extended, which payment shall cover (the first year of) the extended term. No rental payments shall be due on the acreage so extended during the period following such payment and ending on the following anniversary date of this lease, but [annual] rentals shall be due on or before such following anniversary date and succeeding anniversary dates thereafter.

Id. at 419 (emphasis of court omitted).

lessors held the checks until July 7 when they returned them to TSB. Thereafter, the landowners executed new leases covering the property to Smith Energy. TSB sued Smith Energy and the landowners for breach of contract, tortious interference, and for a declaratory judgment that the leases had been extended by its tender of the checks. Following a bench trial, the court rendered a take nothing judgment, holding, among other things, that: the checks did not constitute proper tender; the landowners did not waive any right to require cash payment and were not estopped to demand cash; and, Smith Energy did not tortiously interfere with TSB's leases.[124]

TSB appealed, arguing that its delivery of the checks in the proper amounts prior to the expiration of the option constituted proper payment within the meaning of the lease provision. The appellate court agreed for two reasons.[125] First, the court adopted the rule set forth in section 249 of the Restatement (Second) of Contracts,[126] which authorizes payments to be made in any manner acceptable in the ordinary course of business in the absence of a demand for payment in legal tender.[127] Noting that an oil and gas lease is a contract and must be construed as a contract, the appellate court applied section 249 to the lease provision at issue.[128] The trial court had previously found that checks are used for payment of obligations in oil and gas leases, including option payments, in the ordinary course of business, and that the landowners made no demand for cash payment when the checks were presented or at any time before the expiration of the option.[129] Therefore, according to section 249, TSB's timely delivery of the checks to the lessors constituted proper payment.[130]

Second, the court interpreted the leases themselves to authorize payment by check.[131] After examining the other provisions in the leases, the appellate court noted that in all other situations, the leases explicitly provided that payments to the lessors may be made by check.[132] One such provision authorizing payment by check was the delay rental provision.[133] The court held that the provision for optional extension of the primary term was re-

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124. *Id.* at 420.

125. *Id.* at 420-21.

126. Section 249 provides:

> Where the payment or offer of money is made a condition of an obligor's duty, payment or offer of payment in any manner current in the ordinary course of business satisfies the requirement unless the obligee demands payment in legal tender and gives any extension of time reasonably necessary to procure it.

RESTATEMENT (SECOND) OF CONTRACTS § 249 (1981).

127. *TSB Exco, Inc.*, 818 S.W.2d at 421.

128. *Id.*

129. *Id.* at 420-21.

130. *Id.* at 421.

131. *Id.*

132. *Id.*

133. The delay rental clauses in the leases provided that payment or tender of rentals:

> may be made by check or draft of Lessee delivered or mailed to the authorized depository bank or to Lessor (at the address last known to Lessee) on or before such date for payment, and the payment or tender will be deemed made when the check or draft is so delivered or mailed.

Id. at 419.

lated to the delay rental provisions and that the two provisions should be interpreted together.[134] Since the delay rental provisions expressly authorized payment by checks, the court held that the payments for lease extensions could likewise be tendered in the same fashion.[135] The appellate court therefore reversed the trial court's judgment and rendered judgment that TSB's leases were in full force and effect and that Smith's leases were invalid.[136] The case was remanded to the trial court for a determination as to the amount of extension payment and delay rentals to which the lessors were entitled.[137]

4. *Express Production-and-Allotment Requirements*

In *Parten v. Cannon*[138] the court of appeals held that the failure of an oil and gas lessee to file a proper written description of land held by production at the end of the lease's primary term as required by the express terms of the lease[139] merely constituted a breach of covenant, not a breach of condition,[140] which did not cause the lease to terminate at the expiration of its

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134. *Id.* at 421.
135. *Id.*
136. *Id.* at 423 (on rehearing).
137. *Id.*
138. 829 S.W.2d 327 (Tex. App.—Waco 1992, writ denied).
139. Paragraph 18 of the lease provided in relevant part:

> *Lessee must within ninety (90) days after the end of the primary term of this lease as to the leased premises which is not pooled under the provisions of Paragraph 4 hereof, designate in writing and place same of record with the County Clerk in Madison County, Texas, a description of that part of the leased premises which shall be allotted to such well for production purposes,* no more than 320 acres plus 10% tolerance to be allotted in and around each well classified as a gas well by the Railroad Commission of Texas, if completed at a depth of 8,500 feet or less below the surface nor more than 640 acres plus 10% tolerance to such gas well if completed at a depth of more than 8,500 feet below the surface, and no more than 10 acres plus 10% tolerance to be allotted in and around each well classified as an oil well by the Railroad Commission of Texas if completed at a depth of 2,500 feet or less below the surface. In the case of an oil well completed at a depth of more than 2,500 feet below the surface, there shall be allotted to that well for production purposes no more land than is allowed by the permanent field rules of the Railroad Commission for oil units for that horizon, nor more than 80 acres in the absence of permanent rules. *Production or operations on said allotted area by the Lessee shall maintain this lease in effect only with regard to the land within the described area. This lease shall terminate as to such part or parts of the leased land lying outside the allotted area* unless this lease is perpetuated as to such land outside the allotted area by operations conducted thereon or by production of oil or gas or by such operations and such production in accordance with the provisions hereof.

Id. at 329 (emphasis added by court). The court referred to the first sentence of Paragraph 18 as the "designation-and-filing provision" and to the last two sentences of the paragraph as the "production-and-allotment provision." *See id.* at 330.

140. The court explained the differences between covenants and conditions as follows:

> In construing paragraph 18, we note that an important distinction exists between a condition and a covenant. *See Rogers v. Ricane Enterprises, Inc.*, 772 S.W.2d 76, 79 (Tex. 1989). As the Supreme Court pointed out in *Rogers*, the distinction between conditions and covenants lies in the appropriate remedy for their breach. *Id.* Breach of a condition results in automatic termination of the leasehold estate upon the happening of the stipulated events. *Id.* Breach of a covenant does not automatically terminate the estate, but instead subjects the

primary term.[141] The undisputed facts at trial established that the primary term of the lease ended on January 7, 1981, at which time five wells were producing in paying quantities and that the lessee never recorded a written designation allocating any portion of the lease to the producing wells. After the end of the primary term, the lessee completed six additional producing wells. In October 1986, the lessor opposed any further drilling activities on the lease, claiming that the lease had terminated due to the lessee's failure to comply with the requirements of Paragraph 18.

In reviewing the terms of the lease, the court of appeals first addressed the production-and-allotment provision. Relying upon the decision in *Mayfield v. de Benavides*,[142] which involved a similar lease provision, the court determined that the production-and-allotment provision, like the one involved in *Mayfield*, constituted an express condition specifying the maximum acreage that could be allotted to each producing well situated on the lease.[143] According to the court, this provision created a "special limitation" which, if breached, would support a decree of lease termination.[144]

The court then analyzed the designation-and-filing provision, and determined that it created a covenant, not a condition.[145] In making this determination, the court emphasized the intent of the parties expressed in the last sentence of Paragraph 18.[146] According to the court, this sentence demonstrated that the parties intended that perpetuation of the lease beyond the primary term would be conditioned upon operations or production of oil or gas on the allotted portions of the lease rather than upon the filing of a written designation of productive acreage.[147] In reaching this conclusion, the court also emphasized that the circumstances surrounding the making of the lease, as evidenced by contemporaneous correspondence between the parties, showed that the concern of the parties was to have undeveloped portions of the lease released to the lessors at the end of the primary term, but the parties never intended a forfeiture to occur on portions of the lease otherwise held by operations or production.[148] Thus, finding the designation-and-

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> breaching party to liability for monetary damages or, in extraordinary circumstances, the remedy of a conditional decree of cancellation. *Id.* Doubts should be resolved in favor of a covenant instead of a condition. *Id.* According to the court in *Rogers*, the language used by the parties to an oil and gas lease will not be held to impose a special limitation on the grant unless it is clear and precise and so unequivocal that it can reasonably be given no other meaning. *Id.*

829 S.W.2d at 329-30.

141. *Id.* at 331.

142. 693 S.W.2d 500, 502 (Tex. App.—San Antonio 1985, writ ref'd n.r.e.).

143. *Parten*, 829 S.W.2d at 330.

144. *Id.*

145. *Id.* at 331.

146. *Id.* at 330.

147. *Id.*

148. *Id.* at 330-31. According to the court:

> If, in light of surrounding circumstances, the language of a contract appears to be capable of only a single meaning, the court can confine itself to the writing. *Sun Oil Co. (Delaware) v. Madeley*, 626 S.W.2d 726, 731 (Tex. 1981). The surrounding circumstances, as reflected in John Parten's letter of 11 December 1975 to Ernest Cannon, involved the Cannons' concern that one well could "tie up a whole block of acreage for a long time," and the Partens' intent "to drill

filing provision to be a covenant and not a condition, the court held that the lessee's alleged breach of its provisions would give rise to a claim for damages, but would not support automatic termination of the lease.[149] The court concluded, however, that it was not required to determine whether the designation-and-filing provision had been breached because the lessors had previously abandoned their claim for damages.[150]

Having determined that the production-and-allotment provision did create a condition which, if breached, would support a decree of lease cancellation, the court then undertook the task of determining what portion of the lease had been maintained by operations or production attributable to lease wells as of the end of the primary term.[151] In this regard, the court considered the parties' stipulation to the effect that: (1) Well 4 held 148.33-acres (referred to as Tract A) at the end of the primary term, and the well produced until August 1987; (2) Well 6 held 161-acres (referred to as Tract B) at the end of the primary term and produced until May 1981; (3) Well 7 held 650-acres at the end of the primary term as a gas well but was reclassified in May 1982 as an oil well holding 161-acres (referred to as Tract C) which continued to produce at the time of trial; and (4) Well 8 held 161-acres (referred to as Tract D) at the end of the primary term, and the well produced until July 1985.[152] Based on these stipulations, the court determined that at the end of the primary term the lease had been perpetuated as to Tracts A, B, C, and D.[153]

Noting that Wells 4, 6, and 8 had ceased to produce at various points following expiration of the lease's primary term and that Well 7 had subsequently been reclassified as an oil well instead of a gas well, the court then addressed the issue of what portions of the lease remained currently in effect.[154] With respect to this matter, the lessee contended that because Well 7 had been classified as a producing gas well at the end of the primary term with a 640 acre proration unit being assigned to it at that time, the well was sufficient by itself to perpetuate the entire 658 acre lease for so long as the well continued to produce. The court rejected this argument, however, construing the provisions of Paragraph 18 to mean that reclassification of Well 7 as an oil well resulted in the lease being undeveloped to the extent of the acreage which existed outside the 161 acre proration unit assigned to the reclassified Well 7.[155] With regard to Tract A, production from Well 4 was

> and return to [the Cannons] the acreage that is not producing at the end of five years." The plain language of the lease indicates that, although undeveloped portions of the lease would be returned to the Cannons, the parties never intended a forfeiture to occur on portions of the lease maintained by operations or production beyond the primary term.

Id. (alteration in original).

149. *Id.* at 331.

150. *Id.*

151. *Id.*

152. *Id.*

153. *Id.*

154. *Id.* at 331-32.

155. *Id.* at 331; *see also* Nafco Oil & Gas, Inc. v. Tartan Resources Corp., 522 S.W.2d 703, 708 (Tex. Civ. App.—Corpus Christi 1975, writ ref'd n.r.e.) (the habendum clause of a lease

stipulated to have ceased in August 1987. Prior to that time, however, the lessors had opposed further drilling by the lessee. Relying upon the well-established principle that a lessor who wrongfully repudiates a lease cannot complain if the lessee suspends operations pending determination of the controversy,[156] the court concluded that the lessee was under no obligation to conduct further operations on Tract A pending resolution of the case,[157] and accordingly, held that the lease remained valid as to Tract A.[158] With regard to Wells 6 and 8 on Tracts B and D, respectively, the court concluded that factual issues remained regarding: (1) whether other wells on those tracts had produced without cessation for more than ninety consecutive days; (2) whether operations on additional wells located on those tracts had commenced within ninety days following cessation of production from other wells; and (3) whether the lessors had repudiated the lease prior to the time any of such wells had ceased production.[159] Because of the presence of these unresolved fact issues, the court reversed and remanded the case to the trial court for determination of the issues regarding Tracts B and D, but decreed that the lease remained in effect as to Tracts A and C.[160]

5. *Validity of Lease Options Under Veterans Land Program*

In a case of first impression, the district court in *Wade v. Texaco Trading & Transportation, Inc.*[161] held that the oil and gas lease at issue was not void by reason of the provisions of the Texas Natural Resources Code[162] relating to the Veterans Land Program.[163] In 1976, the Wades purchased the surface and one-half mineral interest in a particular seventy-five-acre tract, pursuant to an assignment of purchase rights under the Veteran Land Board Program. In February 1978, the Wades granted an oil, gas, and mineral lease to County Management, Inc. The lease had a primary term of five years, and it contained a provision granting County Management an option to extend the primary term for an additional five years. In February 1988, County Management exercised the option and thereafter drilled and completed a producing oil and gas well. Production from the well was sold to various purchasers, and the Wades received proper royalty payments for this production.

In 1990, the Wades filed suit against County Management and the purchasers of production for a judicial declaration that the lease was void under

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operated independently on each tract and gas production on one tract would not maintain the lease on another tract); Hunt Oil Co. v. Dishman, 352 S.W.2d 760, 764 (Tex. Civ. App.—Beaumont 1961, writ ref'd n.r.e.) (except for acreage allotted to oil production, the determinable fee on a mineral tract allotted to gas production was forfeited when a gas well was reclassified as an oil well and no reworking operations looking to further gas production were attempted).

156. *See* Kothmann v. Boley, 158 Tex. 56, 60, 308 S.W.2d 1, 4 (1957).

157. *Parten*, 829 S.W.2d at 332.

158. *Id.*

159. *Id.*

160. *Id.* at 332-33.

161. 779 F. Supp. 67 (S.D. Tex. 1991).

162. TEX. NAT. RES. CODE ANN. §§ 1.001-201.041 (Vernon 1978 & Supp. 1993).

163. *Wade*, 779 F. Supp. at 70.

section 161.227 of the Texas Natural Resources Code.[164] The Wades claimed that section 161.227(b) prohibited options in *all* leases on veteran's land. The defendants argued that section 161.227(b) did not apply to oil, gas, and mineral leases because such leases were expressly excluded from operation of the statute in section 161.227(a) and that such exclusion was applicable to section 161.227(b).

In analyzing this issue, the court began by noting that the Natural Resources Code states that its codification of existing statute law was intended to be without substantive change.[165] The court then considered the text of the statute that was codified as section 161.227.[166] The court construed the predecessor statute as excluding oil and gas leases from both the ten-year limitation and the prohibition against options.[167] According to the court, the codified version omitted several crucial phrases from the former statute that made it clear that oil and gas leases were excluded from the prohibition against options.[168] Reasoning that section 161.227 cannot be read to change the substance of the former statute,[169] the court held that the code section did not prohibit options in oil and gas leases like the one at hand.[170] In addition, the court found that the statutory predecessor of section 161.227 pertained to surface leases[171] and not to oil and gas leases, which were governed by the precursor of section 161.228.[172] The latter contained no prohi-

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164. In 1978, the code provided:

> (a) No land purchased under this chapter may be leased by the purchaser for a term of more than 10 years except for oil, gas and other minerals and as long after 10 years as minerals are produced from the land in commercial quantities.
> (b) No lease may contain a provision for option or renewal of the lease or release of the property for any term, and the taking of an option, renewal, or release agreement in a separate instrument to take effect in the future is prohibited. A lease or instrument that contains an option, renewal, or re-lease agreement in violation of this section is expressly declared to be void.

TEX. NAT. RES. CODE ANN. § 161.227 (Vernon 1978) (amended 1981).

165. *Wade*, 779 F. Supp at 69 (citing TEX. CIV. PRAC. & REM. CODE ANN. § 1.001 (Vernon 1986 & Supp. 1993), but probably referring to TEX. NAT. RES. CODE ANN. § 1.001 (Vernon 1978 & Supp. 1993)).

166. As originally adopted, the predecessor of section 161.227 provided:

> Any land purchased under the provisions of this Act may not be leased by the purchaser for any term exceeding ten (10) years except for oil, gas or other minerals and so long thereafter as any minerals may be produced therefrom in commercial quantities, and no such lease shall contain any provision for option or renewal of such lease or re-lease of such property for any term. The taking of any option, renewal or re-lease agreement in a separate instrument to take effect in the future is prohibited; and any such lease or instrument containing such an option, renewal or re-lease agreement executed after the effective date of this Act in violation hereof is expressly declared to be void.

TEX. REV. CIV. STAT. ANN. art. 5421m § 17 (Vernon 1962 & Supp. 1976) (repealed 1977).

167. *Wade*, 779 F. Supp. at 70.

168. *Id.* "The 1978 version split the 1955 version into two separate subsections. In doing so, the 1978 version omits 'and no such' 'and any such', phrases that made the exclusion of oil and gas leases from the ten year limitation also apply to the prohibition against options." *Id.* at 70 n.2.

169. *Id.* at 70.

170. *Id.*

171. *Id.*

172. *Id.* (referring to TEX. REV. CIV. STAT. ANN. art. 5421m § 18 (Vernon 1962 & Supp. 1976) (repealed 1977)). Section 161.228(b), as it existed in 1978, read as follows: "No oil, gas

bition against options in oil and gas leases, and the court found that omission to be significant, reasoning that if the legislature had intended to prohibit options in oil and gas leases, it would have done so in section 161.228(b), which governs the intended limitations on oil and gas leases, rather than in section 161.227.[173] On the basis of these arguments, the court granted summary judgment for the defendants, finding that the Wades' claims failed as a matter of law because the lease was not void under section 161.227.[174]

III. ISSUES INVOLVING STATE REGULATION

A. Rule 37 Spacing Exception

In *Schlachter v. Railroad Commission of Texas*[175] the court of appeals upheld the Railroad Commission's denial of an application for an exception to Rule 37,[176] the statewide well-spacing rule.[177] Rule 37 generally prohibits the drilling of any well nearer than 467 feet to any property line, lease line, or subdivision line unless the Railroad Commission grants an exception in order to prevent waste or the confiscation of property.[178] In this case, Schlachter's well was located 173 feet from an adjacent lease boundary. The well had been producing from the Chapel Hill (Rodessa) Field. Schlachter intended to recomplete the well in the Chapel Hill (Pettit) Field. The adjacent leaseholder protested Schlachter's application. Following a hearing, the Commission denied Schlachter's request, and a Travis County district court upheld the Commission's decision.[179]

Schlachter appealed, claiming that he was entitled to a Rule 37 exception for the prevention of waste on the basis of the Texas Supreme Court's decision in *Exxon Corp. v. Railroad Commission*.[180] According to Schlachter, the *Exxon* decision created a new category of waste, other than physical waste, that justified the granting of a Rule 37 exception. Schlachter argued that he was entitled to a spacing exception, as a matter of law, due to "economic waste," because he could recomplete the well in the Pettit formation

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or mineral lease may be for a primary term of more than 10 years and the lease may provide that it shall remain in force as long as production is obtained in paying quantities." TEX. NAT. RES. CODE ANN. § 161.228(b) (Vernon 1978) (amended 1981).

173. *Wade*, 779 F. Supp. at 70.

174. *Id.*

175. 825 S.W.2d 737 (Tex. App.—Austin 1992, writ denied).

176. 16 TEX. ADMIN. CODE § 3.37 (West Supp. 1992-93) (Tex. R.R. Comm'n, Statewide Spacing Rule).

177. *Schlachter*, 825 S.W.2d at 741.

178. Rule 37 provides:

> No well for oil, gas, or geothermal resource shall hereafter be drilled nearer than 1,200 feet to any well completed in or drilling to the same horizon on the same tract or farm, and no well shall be drilled nearer than 467 feet to any property line, lease line, or subdivision line; provided the commission, in order to prevent waste or to prevent the confiscation of property, may grant exceptions to permit drilling within shorter distances than prescribed in this paragraph when the commission shall determine that such exceptions are necessary either to prevent waste or to prevent the confiscation of property.

16 TEX. ADMIN. CODE § 3.37(a)(1) (West Supp. 1992-93).

179. *Schlachter*, 825 S.W.2d at 738-39.

180. 571 S.W.2d 497 (Tex. 1978).

for less expense than he could drill and complete a new well to such formation with proper spacing.

The court of appeals disagreed with Schlachter's interpretation of the *Exxon* case.[181] Recognizing that the term "waste" as used in Rule 37 has long been defined as "the ultimate loss of oil,"[182] the court noted that the determinative issue for a Rule 37 exception based on waste prevention is whether denial of the exception will result in the ultimate loss of minerals.[183] According to the court, the *Exxon* case merely held that economic circumstances could be considered in determining whether to grant an exception.[184] Thus, under the *Exxon* case, the Commission may grant a Rule 37 exception with regard to the recompletion of an existing well if: (1) the existing well bore will recover oil reserves that cannot be produced by any other existing well; and (2) it is not economically feasible to drill at a regular location (even though such new well would recover all of the reserves recoverable by the existing well).[185]

Schlachter's situation was found to not satisfy either condition.[186] In this connection, there was substantial evidence before the court that: (1) existing wells were capable of recovering the remaining reserves in the Pettit formation; and (2) it would be economically feasible for Schlachter to drill a new well at a regular location, since the value of recoverable reserves attributable to a new well would exceed the associated costs by more than $1 million.[187] The court therefore found that the Commission did not misinterpret or misapply the controlling legal principles and that the Commission's actions were reasonably supported by substantial evidence.[188]

B. New Gas Prorationing Rules

In April 1992, the Texas Railroad Commission substantially revamped the gas prorationing rules in Texas.[189] The stated goals of the amendments to Rules 30,[190] 31,[191] 34,[192] and 49[193] were "simplification of the present system by removal of complex mechanisms involving alphabet allowables, increased protection of correlative rights in a changing marketplace, more accurate determination of lawful market demand and a more accurate deter-

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181. *Schlachter*, 825 S.W.2d at 740.
182. *Id.* (citing Gulf Land Co. v. Atlantic Ref. Co., 134 Tex. 59, 70, 131 S.W.2d 73, 80 (1939)).
183. *Id.*
184. *Id.* at 740-41.
185. *Id.* at 741.
186. *Id.*
187. *Id.*
188. *Id.*
189. *See* 17 Tex. Reg. 3236 (1992) (to be codified at 16 TEX. ADMIN. CODE §§ 3.30, .31, .34, .49) (Tex. R.R. Comm'n).
190. 16 TEX. ADMIN. CODE § 3.30 (West 1988) (Tex. R.R. Comm'n, Gas Nominations Required. Rule 30).
191. *Id.* § 3.31 (Gas Well Allowables. Rule 31).
192. *Id.* § 3.34 (Gas to be Produced and Purchased Ratably).
193. *Id.* § 3.49 (Gas-Oil Ratio).

mination of well capability."[194]

With regard to determination of market demand, the new rules no longer rely on purchaser nominations.[195] The market demand forecast is now based on actual prior production, subject to certain adjustments. The starting point for the Commission's market demand forecast is actual production of each well for the same month of the preceding year.[196] If circumstances have changed since that time, the producer may file an "optional operator forecast."[197] However, the Commission may reject or modify an operator's optional forecast if it is consistently inaccurate or it is being used to manipulate gas allocation.[198] The forecasts are then subject to: (1) a capability adjustment, to insure that the forecasts do not exceed the total capability of the operator's wells; (2) a reservoir forecast correction adjustment, to keep the total reservoir market demand forecast in balance with production; (3) a supplemental change adjustment, which is ministerial in nature to cover such contingencies as a change of well or well test status during a prior month, or a new final order requiring modification of field or well production status; and (4) a Commission adjustment, which gives the Commission discretion to adjust the forecasts if it believes the mathematical totals incorrectly reflect market demand.[199]

Under the new rules, allowables are replaced by well capability, which is determined as the lesser of the G-10 deliverability or the highest monthly production during the last six months.[200] However, an operator may submit a "substitute capability determination" based on a registered professional engineer's analysis or on an independent tester's well test.[201] This enhanced capability determination routine replaces the "U," "L," "O" and "Regular" allowables.[202] Recognizing that this capability determination is more stringent than that under the former rules, the Commission now authorizes wells limited by capability to accumulate underage.[203] The new rules also affect allowables for wells in one-well fields, wells in non-prorated fields, special allowable wells, and section 3.49(b) gas wells.[204] Changes in this regard, together with additional changes under the new rules, are intended to make the "Immediate" allowables unnecessary.[205]

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194. 17 Tex. Reg. 3236, 3237 (1992) (Tex. R.R. Comm'n).

195. The prior rules used purchaser nominations as the starting point for the Commission's assessment of market demand. However, as the Commission noted, "Commission records show that purchaser nominations frequently substantially exceed production. Many purchasers do not even participate in the nominations process." *Id.*

196. *Id.*

197. *Id.*

198. *Id.* at 3238.

199. *Id.*

200. *Id.*

201. *Id.*

202. *Id.*

203. *Id.*

204. *Id.*

205. *Id.*

IV. ISSUES INVOLVING JOINT OPERATIONS

A. DTPA CLAIMS

In *Taylor v. GWR Operating Co.*[206] the court of appeals held that the Deceptive Trade Practices Act (DTPA)[207] has no application to disputes between an operator and non-operator,[208] and further held that an issue of fact existed concerning whether a fiduciary relationship existed between them.[209] Taylor, as non-operator, and L & B Oil Company, as operator, entered into three separate joint operating agreements in 1984 and 1985. GWR succeeded L & B as operator. GWR brought suit against Taylor after he refused to pay his share of operating expenses. Taylor counterclaimed, asserting, among other things, violation of the DTPA and breach of contract. GWR filed a motion for partial summary judgment with regard to Taylor's counterclaim based on claims that: (1) Taylor had no cause of action under the DTPA because he was not a consumer; and (2) GWR did not owe a fiduciary duty to Taylor. The trial court granted the motion and severed the counterclaim from the original suit.[210] Taylor appealed the partial summary judgment.

On appeal, the court first examined whether a non-operating interest owner under a joint operating agreement is a "consumer" under the DTPA.[211] In this regard, the court found that the decisions in *C & C Partners v. Sun Exploration & Production Co.*[212] and *Hamilton v. Texas Oil & Gas Corp.*[213] to be dispositive.[214] On the basis of such cases, the court held that, when the operator merely incurs debts for the non-operators, as a matter of law, the non-operator is not a consumer of services within the definition of the DTPA.[215]

The court then addressed Taylor's contention that the trial court erred in granting summary judgment as to its cause of action for breach of fiduciary duty.[216] Taylor emphasized the fact that GWR in its petition had a claim against Taylor for breach of fiduciary duty and that GWR asserted in its petition that the joint operating agreements between the parties contem-

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206. 820 S.W.2d 908 (Tex. App.—Houston [1st Dist.] 1991, writ denied).
207. TEX. BUS. & COM. CODE ANN. §§ 17.41-.854 (Vernon 1987 & Supp. 1993).
208. *Taylor*, 820 S.W.2d at 910.
209. *Id.* at 912.
210. *Id.* at 909.
211. The DTPA defines "consumer" as follows:

> "Consumer" means an individual, partnership, corporation, this state, or a subdivision or agency of this state who seeks or acquires by purchase or lease, any goods or services, except that the term does not include a business consumer that has assets of $25 million or more, or that is owned or controlled by a corporation or entity with assets of $25 million or more.

TEX. BUS. & COM. CODE ANN. § 17.45(4). The DTPA defines "services" so as to include "work, labor, or service . . . furnished in connection with the sale or repair of goods." *Id.* § 17.45(2).

212. 783 S.W.2d 707 (Tex. App.—Dallas 1989, writ denied).
213. 648 S.W.2d 316 (Tex. App.—El Paso 1982, writ ref'd n.r.e.).
214. *Taylor*, 820 S.W.2d at 910.
215. *Id.*
216. *Id.* at 911.

plated a fiduciary relationship. Taylor claimed that GWR's allegations in this regard either constituted judicial admissions that GWR could not disprove in its motion for summary judgment or at least created a fact issue. GWR, on the other hand, contended that the decision in *Hamilton* established, as a matter of law, that there was no fiduciary relationship between an operator and non-operator. The appellate court, however, concluded that although the existence of a fiduciary duty ultimately is a question of law for the court, circumstances giving rise to a fiduciary duty are questions of fact.[217] Noting that GWR pleaded the existence of a fiduciary relationship with Taylor in its petition and that GWR did not present summary judgment evidence to the contrary, the court held that there was a fact question which precluded summary judgment, reversed the decision of the trial court, and remanded the case for trial.[218]

B. Oral AMI Agreement

In *Crowder v. Tri-C Resources, Inc.*[219] the court of appeals affirmed a summary judgment order declaring an alleged oral area of mutual interest (AMI) agreement[220] unenforceable.[221] In November 1985, plaintiff Crowder entered into an oil and gas exploration and development agreement (the Cordele Agreement) and a joint operating agreement with Tri-C, in which Crowder agreed to participate in Tri-C's exploration and development of the Cordele Field. Neither agreement contained an AMI provision. Crowder, however, claimed the existence of an oral AMI agreement with Tri-C, under which Tri-C promised him the opportunity to participate in any interest acquired by Tri-C within a certain area surrounding the Cordele Field. Crowder claimed that the oral AMI agreement was evidenced by: a plat of the Cordele Field prepared by Tri-C's land manager after execution of the Cordele Agreement which showed an area outlined in red identified as the "area of mutual interest boundary;" deposition testimony by Tri-C's land manager confirming the existence of the AMI; and a letter dated September 16, 1986, in which Tri-C advised Crowder that it had "acquired by farmout an additional 320 acres within our area of mutual interest of the [Cordele Field]."[222]

In May 1988, Tri-C and Crowder conveyed all of their respective interests in the Cordele Field to a third party. Several months later, Tri-C acquired an interest in the same general area as the land covered by the Cordele

217. *Id.*

218. *Id.* at 912.

219. 821 S.W.2d 393 (Tex. App.—Houston [1st Dist.] 1991, no writ).

220. An area of mutual interest agreement is:

> An agreement between or among parties to a farm-out agreement . . . or other agreement by which the parties attempt to describe a geographical area within which they agree to share certain additional leases acquired by any of them in the future.

HOWARD R. WILLIAMS & CHARLES J. MEYERS, MANUAL OF OIL AND GAS TERMS 63 (8th ed. 1992) (emphasis omitted).

221. *Crowder*, 821 S.W.2d at 397, 400.

222. *Id.* at 395.

Agreement, but did not offer Crowder a chance to participate in this acquisition. Crowder brought suit claiming that under the oral AMI agreement, he had the right to acquire an interest in Tri-C's new acquisition. Tri-C asserted the affirmative defense of the statute of frauds[223] and moved for summary judgment on that basis. Tri-C's motion also contended that any AMI agreement between the parties terminated prior to the later acquisition when Tri-C and Crowder conveyed their interest in the Cordele Field to a third party. The trial court granted Tri-C's motion.[224]

On appeal, Crowder conceded that an oral AMI agreement is subject to the statute of frauds but asserted that his AMI agreement was enforceable because there was a sufficient writing to satisfy the statute, relying on the plat and the September 16, 1986 letter. The court of appeals, however, disagreed, holding that the AMI agreement asserted by Crowder did not comply with the statute's requirements.[225] The court noted that the statute requires that an AMI agreement (or memorandum of it), containing a description of the property affected, be in writing and signed by the party to be charged[226] and further requires that if the memorandum of agreement consists of two documents, the second document must refer to the first.[227] In this case, the court held that the plat did not satisfy the statute because it was not signed by a representative of Tri-C,[228] and the letter did not satisfy the statute because it did not contain a sufficient description of the property.[229] The court further held that the two documents together did not satisfy the statute either because neither the plat nor the letter referenced the other document.[230]

Crowder contended that Tri-C was equitably and judicially estopped from denying the existence of the AMI agreement. With regard to the matter of equitable estoppel, the court held that Crowder could not use the doctrine offensively to establish a cause of action for breach of the AMI agreement.[231] As to judicial estoppel, the court held that such doctrine applied only when a party in a prior proceeding stated under oath in its pleadings the contrary of the assertion sought to be made.[232] Crowder's judicial estoppel argument was based on Tri-C's land manager's deposition testimony admitting the existence of the AMI agreement. Because the land manager's deposition testimony had been given in the *same* proceeding and not in a *prior* proceeding, the doctrine of judicial estoppel was held to be not applicable.[233]

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223. TEX. BUS. & COM. CODE ANN. § 26.01 (Vernon 1987).
224. *Crowder*, 821 S.W.2d at 395.
225. *Id.* at 397.
226. *Id.* at 396.
227. *Id.*
228. *Id.*
229. *Id.*
230. *Id.*
231. *Id.* at 397.
232. *Id.*
233. *Id.*

C. Modification of Operating Agreement

Hondo Oil & Gas Co. v. Texas Crude Operator, Inc.[234] presented a dispute between an operator and non-operator regarding overhead charges made pursuant to a joint operating agreement. In 1962 and 1965, Texas Crude Operator, Inc., as operator, and Atlantic Richfield Company (ARCO), as non-operator, entered into three separate operating agreements with regard to mineral properties. Amoco Production Company also participated in the operating agreements as non-operator. Originally, the operating agreements contained a PASO-T-1955-2 Accounting Procedure standard form, which provided for a certain method for an operator to allocate overhead expenses to non-operators.[235] Texas Crude initially charged ARCO and Amoco overhead expenses based on the PASO method. In April 1978, however, Texas Crude began calculating overhead charges based on an accounting method recognized by the Council of Petroleum Accounting Societies ("COPAS").[236] The effect of this change caused the monthly overhead charges to the non-operators to rise from approximately $175 per well to over $530 per well. Although Texas Crude did not expressly notify the non-operators of this change from PASO to COPAS methods, the evidence at trial indicated that ARCO was aware of the change.[237] ARCO paid the higher overhead charges without incident for the next six years. Amoco also noticed the change, but it refused to pay the higher rate. In order to avoid dispute, Texas Crude agreed to charge overhead to Amoco at a lower rate.

In 1984, ARCO learned of Amoco's favorable arrangement with Texas Crude regarding overhead, and it attempted to negotiate with Texas Crude for a similar lower rate, without success. ARCO then unilaterally began withholding amounts from its overhead payments to Texas Crude, in order to recover what it considered overcharges. The amount of alleged overcharges was $170,755.03, which was the difference between the amounts of overhead charged ARCO and Amoco. Texas Crude responded by withholding payments to ARCO with regard to other properties in which ARCO was operator and Texas Crude was non-operator.

In the meantime, ARCO sold its interest in the properties involved in the

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234. 970 F.2d 1433 (5th Cir. 1992).

235. The PASO method "provides for a fixed rate per well plus a portion of a camp and district expenses allocated on a per well basis among the wells in the district." *Id.* at 1436.

236. The COPAS method "establishes for overhead a fixed sum per well, known as the combined fixed rate ('CFR'), and adjusts the CFR annually on April 1 of each year based upon a referenced cost index." *Id.*

237. The appellate court explained:

> An expert at trial . . . testified that ARCO knew about the switch. Texas Crude began using COPAS on April 1, 1978. April 1 is also the date on which COPAS CFRs are annually escalated. Operators and non-operators, therefore, observe April statements with some care. An ARCO accountant further testified that ARCO codes its bills when it receives them, and it uses a different code for COPAS and PASO. ARCO routinely computerizes these codes and tracks them in reports to management. Moreover, in October 1978, a member of ARCO's management complained to Texas Crude about the new rate on other properties.

Id.

lawsuit to Hondo Oil & Gas Company, effective January 1, 1987. ARCO did not advise Hondo of the dispute, and Hondo did not otherwise learn of the dispute prior to the sale. Following the sale, Texas Crude sought to recover for ARCO's underpayment of overhead charges by retaining Hondo's share of the proceeds pursuant to a claimed operator's lien. By August 1987, Texas Crude had suspended sufficient sums to offset the money retained by ARCO.

Thereafter, Hondo sued Texas Crude for breach of the operating agreement, and Texas Crude filed a third-party complaint against ARCO. The trial court determined that ARCO had breached the operating agreement, as modified, by withholding payments to Texas Crude but limited the damages awarded Texas Crude to $117,539.97 due to the statute of limitations.[238] The trial court also concluded that Texas Crude breached the operating agreement by withholding revenues due to Hondo and awarded Hondo damages of $170,755.03 plus attorneys' fees.[239] All parties appealed.

On appeal, ARCO contended that the operating agreement had not been modified so as to provide for COPAS accounting procedures because Texas Crude acted unilaterally without ARCO's consent. The Fifth Circuit disagreed, noting that under Texas law[240] parties may modify a contract by their acts and conduct.[241] In this instance, although Texas Crude did change accounting procedures unilaterally, the court determined that ARCO was aware of the change and by its conduct consented to it.[242] For example, the court noted that following Texas Crude's change to COPAS charges, ARCO's own computerized accounting codes were changed to reflect COPAS accounting methods.[243] In addition, the court emphasized that after becoming aware that Texas Crude was charging overhead under the COPAS schedule, ARCO's management complained to Texas Crude about the change with regard to a different property not involved in the lawsuit but made no complaint about similar charges made against its interest in these properties.[244] The lack of a complaint coupled with ARCO's knowledge of the charges implied consent according to the court.[245] Most importantly for the court, however, was the fact that ARCO paid the overhead charges without complaint for six years.[246] On this basis, the Fifth Circuit affirmed the trial court's conclusion regarding contract modification.[247]

ARCO next claimed that any modification, based on conduct, of the oper-

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238. *Id.* at 1437.
239. *Id.*
240. *See* Bank of El Paso v. T. O. Stanley Boot Co., 809 S.W.2d 279, 284 (Tex. App.—El Paso 1991), *modified on other grounds*, No. D-1272, 1992 WL 353291 (Tex. Dec. 2, 1992); Mid Plains Reeves, Inc. v. Farmland Indus., Inc., 768 S.W.2d 318, 321 (Tex. App.—El Paso 1989, writ denied); Emmer v. Phillips Petroleum Co., 668 S.W.2d 487, 490 (Tex. App.—Amarillo 1984, no writ).
241. *Hondo Oil & Gas Co.*, 970 F.2d at 1437.
242. *Id.* at 1438.
243. *Id.*
244. *Id.*
245. *Id.*
246. *Id.*
247. *Id.* at 1438, 1441.

ating agreement violated the Texas statute of frauds.[248] The appellate court again disagreed with ARCO's position, reasoning that a contract modification does not violate the statute of frauds if the portion of the contract being modified was not required by the statute to be in writing.[249] Because the operating agreement could conceivably have been performed within one year, the court concluded that the agreement need not be in writing, and likewise, the modification did not violate the statute of frauds.[250]

ARCO next complained that an operator has no right to charge different rates to non-operators in the same well who signed the same operating agreement, citing the provision in the operating agreement that states that the parties will be charged their proportionate share of costs and expenses. The court found no wrongdoing on the part of Texas Crude in this regard,[251] noting that the evidence at trial established that it was not uncommon for an operator to charge different rates to different non-operators in the same well because such rates are the product of negotiation.[252] There being no evidence that Texas Crude had charged ARCO a rate higher than ARCO's proportionate share, the court concluded that the mere fact that Texas Crude had decided to charge Amoco less than Amoco's proportionate share, did not require Texas Crude to take a similar loss with regard to ARCO.[253]

As the basis for claiming entitlement to interest on the sums awarded it by the trial court, Hondo argued on appeal that Texas Crude's withholding of payments violated the Texas Natural Resource Code.[254] The trial court held that Texas Crude did not violate the Code without explaining the basis for its holding.[255] Presumably the trial court concluded that Texas Crude had a reasonable doubt as to whether Hondo was entitled to the proceeds. The Fifth Circuit affirmed this result, refusing to find any violation of the Code that would have allowed Hondo to recover prejudgment interest.[256]

Texas Crude contended on appeal that the trial court erred in determining that Texas Crude breached the operating agreement by withholding proceeds owed to Hondo. The trial court's determination of breach by Texas Crude was based on findings that ARCO was primarily liable for the liabilities at issue.[257] The evidence which supported this conclusion was that after ARCO's assignment of the properties to Hondo, Texas Crude continued to demand payment of the disputed operating charges from ARCO alone; subsequent billings from Texas Crude for the post-assignment period did not

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248. TEX. BUS. & COM. CODE ANN. § 26.01 (Vernon 1987).

249. 970 F.2d at 1438.

250. *Id.*

251. *Id.* at 1439.

252. *Id.*

253. *Id.*

254. Section 91.403 of the Code (as it existed prior to the 1991 amendment) required that interest be paid for late revenue payments, unless there is "a reasonable doubt that the payee does not have clear title to the interest in the proceeds of production." TEX. NAT. RES. CODE ANN. § 91.403(b)(2) (Vernon Supp. 1990) (amended 1991).

255. 970 F.2d at 1439.

256. *Id.*

257. *Id.* at 1440.

indicate that Hondo was being held accountable for ARCO's failure to pay; and Texas Crude specifically informed Hondo that it would pay Hondo its revenues from the sale of production from the properties at issue so long as Hondo continued to pay its share of the operating expenses.[258] Based on this evidence, the Fifth Circuit applied the doctrine of quasi-estoppel, which "precludes a party from asserting, to another's disadvantage, a right inconsistent with a position previously taken by him."[259] Applying this rule to the facts presented, the court held that Texas Crude acted improperly in withholding Hondo's share of revenues attributable to the sale of production from the properties at issue.[260] The appellate court therefore affirmed the trial court's judgment, but modified the amount of damages awarded to Texas Crude against ARCO to $170,755.03.[261] It also affirmed the trial court's award of $69,072.25 in attorneys' fees to Hondo and refused to compel ARCO to indemnify Texas Crude for such fees.[262]

V. MISCELLANEOUS ISSUES

A. Statutory Mineral Lien

In *Bandera Drilling Co., v. Lavino*[263] the court of appeals held that a drilling contractor occupied the status of a "mineral contractor"[264] under the statutory mineral lien[265] as to nonoperating working interest owners.[266] In October 1985, Computech Energy & Exploration was the operator and sole working interest owner of a particular oil, gas, and mineral lease. It contracted with Bandera Drilling Company, a drilling contractor, for the drilling of two wells on the lease. In October and November 1985, the two wells were drilled and completed. Thereafter, in January 1986, Computech made various assignments of working interest to the appellees. Computech failed to pay Bandera for the drilling costs, and in March 1986 Bandera filed a lien affidavit in the county records as to Computech's interest in the lease. The other working interest owners who received assignments in January were not named in the affidavit and were not sent notice of the lien filing. Subsequently, Bandera brought suit against Computech and the other working interest owners to foreclose its lien.

Section 56.002 of the Texas Property Code provides a lien in favor of mineral contractors and subcontractors[267] who furnish supplies or labor under

258. *Id.*
259. *Id.*
260. *Id.*
261. *Id.* at 1440-41.
262. *Id.* at 1441.
263. 824 S.W.2d 782 (Tex. App.—Eastland 1992, n.w.h.).
264. " 'Mineral contractor' means a person who performs labor or furnishes or hauls material, machinery, or supplies used in mineral activities under an express or implied contract with a mineral property owner or with a trustee, agent, or receiver of a mineral property owner." Tex. Prop. Code Ann. § 56.001(2) (Vernon 1984).
265. *See* Tex. Prop. Code Ann. § 56.002 (Vernon 1984).
266. 824 S.W.2d at 784.
267. " 'Mineral subcontractor' means a person who:

an express or implied contract with a mineral property owner.[268] The statute requires that a mineral subcontractor provide notice of the lien to the property owners as a condition to perfection of the lien.[269] No such notice, however, is required of mineral contractors.[270] In this instance, the nonoperators claimed that as to them Bandera was a mineral subcontractor who had performed services for a contractor, Computech, and that Bandera's failure to provide notice to them of the lien rendered the lien unenforceable. The trial court rendered summary judgment in favor of the nonoperating working interest owners.[271] The court of appeals reversed and remanded.[272]

In reversing the trial court, the court of appeals focused upon the definition of a mineral contractor under section 56.001(2) as one who performs labor or hauls material, machinery, or supplies under an express or implied contract with a mineral property owner or with an agent of a mineral property owner.[273] The appellate court found that Bandera performed labor used in mineral activities[274] under an express contract with Computech and that Computech was a mineral property owner.[275] The court further found that Computech was an agent for the appellees, who also were mineral property owners.[276] Therefore, by definition, Bandera was a mineral contractor and not subject to the notice requirements at issue.[277] In rejecting the appellees' argument that Bandera was a mineral subcontractor, the court stated that the mere existence of an additional party, like Computech, between the laborer and some of the mineral property owners did not make Bandera a mineral subcontractor with respect to the appellees.[278] Having concluded that Bandera was a mineral contractor and therefore not required by the lien statute to give any notice to the appellees,[279] the court remanded the case for further proceedings.[280]

(A) furnishes or hauls material, machinery, or supplies used in mineral activities under contract with a mineral contractor or with a subcontractor;

(B) performs labor used in mineral activities under contract with a mineral contractor; or

(C) performs labor used in mineral activities as an artisan or day laborer employed by a subcontractor."

TEX. PROP. CODE ANN. § 56.001(4) (Vernon 1984 & Supp. 1993).

268. "'Mineral property owner' means an owner of land, an oil, gas, or other mineral leasehold, an oil or gas pipeline, or an oil or gas pipeline right-of-way." *Id.* § 56.001(3).

269. *Id.* § 56.021(b).

270. *Id.* § 56.021(a).

271. 824 S.W.2d at 783.

272. *Id.* at 782, 785.

273. *Id.* at 783.

274. "'Mineral activities' means digging, drilling, torpedoing, operating, completing, maintaining, or repairing an oil, gas, or water well, an oil or gas pipeline, or a mine or quarry." TEX. PROP. CODE ANN. § 56.001(1) (Vernon 1984).

275. 824 S.W.2d at 783-84.

276. *Id.* at 784.

277. *Id.*

278. *Id.*

279. *Id.*

280. *Id.* at 785.

B. Assignment of Contractual Obligation

In *Lone Star Gas Co. v. Mexia Oil & Gas, Inc.*[281] the court of appeals held that a purchaser of a producing property who acquired its interest "subject to" a certain gas purchase contract did not assume an express obligation contained in the contract which required the seller of the gas to indemnify the buyer for severance tax payments made by the buyer for the seller's account.[282] In October 1981, Lone Star, as purchaser, and Reita Production, Inc., as seller, entered into a gas purchase contract with regard to production from a certain well. According to the gas purchase contract: (1) Reita would pay all state severance taxes with regard to the gas delivered under the contract; (2) Lone Star would then reimburse Reita for all severance taxes; and (3) Reita would indemnify and hold Lone Star harmless with regard to payment of such taxes. In early 1982, Reita requested that Lone Star pay the severance taxes directly to the state rather than going through the two-step payment and reimbursement scheme under the contract. Lone Star agreed to the new arrangement, and new division orders were signed providing that Lone Star would make payments under the gas purchase contract for 100% of production less gross production taxes. The new division order was effective April 1, 1982. Lone Star's letter which transmitted the new division order to Reita pointed out that Reita was still responsible for severance taxes on prior production.

Later Mexia acquired Reita's interest in the property covered by the gas purchase contract with Lone Star, such acquisition being effective September 1, 1982. The assignment to Mexia provided that it was made "subject to" the gas purchase contract. Further, Mexia signed a division order, effective October 1, 1982, which provided that the gas purchase contract "insofar as applicable" controlled the purchase and sale of gas between Mexia and Lone Star.

Several years later, the State of Texas notified Lone Star that Reita had failed to pay severance taxes due on production for January, February, and March 1982. Lone Star paid the State $20,431.86 representing the taxes owed plus applicable accrued interest and then attempted to recoup that sum from Mexia. Mexia billed all owners of interest in the lease for their pro rata share of the taxes and interest, collecting $10,215.93, and paid that amount to Lone Star. Lone Star then sued Reita and Mexia seeking reimbursement of the remainder under the terms of the gas contract. Reita was never served with process. As to Lone Star's claims against Mexia, the trial court granted a take nothing judgment.[283]

Lone Star appealed, first claiming that by the terms of the written assignment from Reita, Mexia had expressly assumed Reita's contractual obligation to indemnify Lone Star for severance tax payments. The court, however, disagreed.[284] According to the court, in order for an assignee to be

281. 833 S.W.2d 199 (Tex. App.—Dallas 1992, n.w.h.).
282. *Id.* at 200.
283. *Id.* at 201.
284. *Id.* at 202.

liable for such a debt, the assignment must contain express promissory words or words of "assumption,"[285] and Mexia's acceptance of the assignment, which simply stated that it was made "subject to" the gas contract, did not expressly obligate Mexia to pay the prior debt of Reita.[286] In the absence of express language of assumption, the court found that the assignment to Mexia did not impose an obligation on Mexia to indemnify Lone Star for the severance taxes at issue.[287] The court also found that the Mexia division order further demonstrated that Mexia had not assume an obligation to reimburse Lone Star for the severance tax payments.[288] In this connection, the court noted that the division order provided that the gas contract as amended would apply "in so far as applicable" with regard to gas sales from Mexia to Lone Star.[289] The court reasoned that the Reita division order had amended the gas contract so as to provide for payment of severance taxes by Lone Star.[290] By this amendment, the court determined that the contract had been changed so that it no longer required the seller to pay severance taxes and the buyer to reimburse the seller for those payments.[291] Instead, the buyer (Lone Star) would thereafter make the tax payments and simply deduct the amount of those payments from distributions to the seller. The court found no evidence that this amendment was ever altered by the parties.[292] Thus, the court concluded that when Mexia ratified the contract by signing the division order, the indemnity obligation was no longer applicable to the sale of gas between Mexia and Lone Star.[293]

Lone Star next contended that Mexia assumed the indemnification obligation by implication, arguing that the obligation was a covenant running with the land. Again, the court disagreed.[294] In this regard, the court reasoned that privity of estate is essential to an assignee's liability on a covenant that runs with the land and that as a result an assignee is not liable for breaches of such covenants that occur before the assignment to him.[295] Here, the failure to pay taxes occurred prior to the assignment to Mexia, a time when there was no privity of estate between Mexia and Lone Star. Accordingly, the court held that Mexia was not liable to indemnify Lone Star for Reita's breach of the indemnity obligation under this theory.[296]

Finally, Lone Star contended that Mexia assumed the indemnification obligation under the contract pursuant to the doctrine of *cum onere*, which states that one must accept the burdens along with the benefits imposed under a contract. In this case, Lone Star claimed that because Mexia ac-

285. *Id.* at 201.
286. *Id.*
287. *Id.*
288. *Id.* at 201-02.
289. *Id.* at 201.
290. *Id.* at 202.
291. *Id.*
292. *Id.*
293. *Id.*
294. *Id.*
295. *Id.*
296. *Id.*

cepted benefits under the contract, such as favorable pricing provisions and the right to enforce take-or-pay provisions, it was therefore obligated to assume the burdens under the contract including the burden of indemnifying Lone Star for severance tax payments. The court recognized that an implied assumption of the burdens of a contract may be found when the benefit accepted by the assignee is "so entwined with the burden that the assignee [is] estopped from denying assumption," or when "the assignee would otherwise be unjustly enriched."[297] However, the court reasoned that in this case Mexia had not been unjustly enriched because it had received no benefit from Lone Star arising from the severance tax payment.[298] In addition, the court held that the benefits received by Mexia under the contract were not entwined with the severance tax indemnity burden, but rather were merely tangential to that burden.[299] Analogizing Lone Star's claim to one for equitable restitution by a payor demanding that an assignee return money already paid to the assignee's assignor on the grounds that the assignor failed to perform the contract, the court reasoned that the equities in this case favored Mexia because there was no evidence that Mexia had any knowledge of Reita's failure to pay the severance tax at issue whereas Lone Star, on the other hand, knew or should have known of Reita's failure in this regard.[300] Based on all the circumstances, the court concluded that Mexia had not assumed the alleged indemnification obligation either expressly or by implication.[301]

C. UNSUCCESSFUL FRAC DAMAGES

Geo Viking, Inc. v. Tex-Lee Operating Co.[302] arose out of an unsuccessful sand frac job[303] when the fracing equipment failed. Tex-Lee had drilled and completed an 8,000 foot well in the Austin Chalk Formation, which is an extremely tight formation containing intermittent fractures. The well, known as the White 1, was designed to encounter a subsurface fault and

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297. *Id.* at 203.
298. *Id.*
299. *Id.*
300. *Id.*
301. *Id.* at 200.
302. 817 S.W.2d 357 (Tex. App.—Texarkana 1991), *writ denied per curiam*, 839 S.W.2d 797 (Tex. 1992).
303. The court provided the following description of a sand frac job:

> This operation is designed to loosen or break up tight formations which contain oil or gas, thus causing the formations to have more permeability and greater production.
>
> Fracing involves the injection of a mixture of liquid and sand into the producing formation under extremely high pressure by means of pressure pumps. Initially, a gel containing very fine sand in suspension is pumped into the casing and is pressurized through perforations in the casing into the producing formation. The pressure forces the cracks open, and the fine sand fills and seals the smaller cracks closed, so that the later injections will be concentrated on the largest fractures. After this is done, increasingly heavier concentrations of a much larger grade of sand is similarly injected into the rock strata. This sand props the rock formations open so that oil and gas may return through the cracks thus created to the well site.

Id. at 359.

fracture system; however, the well missed the intended target. Nevertheless, the well produced a small amount of oil for two weeks following completion. Tex-Lee then decided to sand frac the well in an effort to create artificial fractures to connect the well bore to the natural fault and fracture system, as a means of enhancing production.

Tex-Lee hired Geo Viking to perform the fracture services, specifying that the propped frac length should be 1,000 feet,[304] and that two blenders (one being a backup) would be required.[305] Geo Viking brought two blenders out to the job site. Shortly after Geo Viking began the frac job the primary blender broke down. Rather than using the backup blender, Geo Viking had another blender delivered to the well site, and Geo Viking resumed operations, using the new blender. During a critical part of the process, this blender also broke down. Geo Viking was unable to continue the job with the backup blender because it was inoperative. Geo Viking's representatives at the well admitted that the backup blender had failed the previous day and that they knew it was not in working condition.

At the time of the equipment failure, the length of the fractures were approximately 2,500 feet, but the propped length was only about 600 feet. The well never produced oil in paying quantities after the botched frac job and was eventually plugged. Any attempt to refrac the well was considered to be futile. Tex-Lee then drilled the White Number 1-A well, which was located approximately 250 feet from the first well. This replacement well was also a nonproducer, which was unsuccessfully fraced and eventually plugged as a dry hole. Tex-Lee brought suit against Geo Viking claiming violation of the Texas Deceptive Trade Practices Act.[306] Following a jury trial, the trial court entered judgment for Tex-Lee consistent with the jury's findings.[307] Geo Viking appealed on a variety of grounds.

Geo Viking first contended that there was no evidence or insufficient evidence to support the jury's findings that Geo Viking's conduct caused damages to Tex-Lee. Geo Viking claimed that Tex-Lee failed to prove that the White 1 could have commercially produced oil or gas. The appellate court noted that a plaintiff must prove with reasonable certainty the damages caused by the defendant's conduct,[308] and the court recognized the inherent difficulty in proving damages resulting from an improperly completed well.[309] Although recovery cannot be based on "damages that are remote,

304. "Various engineering concepts may be applied to the different variables involved to calculate the distance that the fracing gel and sand has proceeded away from the well." *Id.*

305. The court explained:

> The blender mixes the sand with a gel-like semi-liquid which holds the sand in suspension during the injection and forces the combination into the well under extremely high pressure. The gel was chemically designed to break down into liquid after about two hours, depositing the sand in the formation and "propping" the fracture system open.

Id.

306. TEX. BUS. & COM. CODE ANN. §§ 17.41-.854 (Vernon 1987 & Supp. 1993).

307. 817 S.W.2d at 360.

308. *Id.* at 361.

309. *Id.*

contingent, speculative, or conjectural," the court noted that proof of damages may be provided by opinions and inferences.[310] For example, the court stated that an expert witness who is properly qualified can provide opinion testimony as to the probability of obtaining production and the extent of such production from the land at issue.[311] According to the court, this type of evidence satisfies the requirement that the damages be proven with reasonable certainty.[312] In this case, an expert geologist testified that the initial production characteristics of the well prior to fracing, the general reservoir characteristics, and the history of the fourteen wells within a one-mile radius of the White 1 well, indicating that the well would have been a good producer upon successful completion of the frac job. The expert also used this information to calculate recoverable reserves attributable to that well, which the appellate court found to be sufficient evidence.[313]

Geo Viking argued that the dry hole drilled within 250 feet of the White 1 well indicated that the well was a dry hole and that Tex-Lee therefore suffered no damages as a result of the unfinished frac job. The court dismissed this argument, noting that there was evidence that the uncompleted frac job damaged the fracture system in the vicinity of the White 1-A, thereby dooming any chance of success for the replacement well.[314]

Geo Viking next contended that the trial court erred in submitting jury questions regarding whether Geo-Viking breached the implied warranty of merchantability by providing an inoperative backup blender. The court of appeals studied the evidence in the record and determined that: (1) the agreement between the parties required that two blenders would be on location for the frac job; (2) at no time were there two working blenders on site; (3) Geo Viking knew at the time that the backup blender was broken, and Tex-Lee was unaware of this; and (4) industry custom required two blenders because of the possibility of one blender breaking down and causing the same type of problem involved in this lawsuit.[315] Accordingly, the court held that the jury question regarding whether the backup blender was not fit for the ordinary purpose for which it was intended was properly submitted[316] and that there was sufficient evidence to support the jury's findings.[317]

Geo Viking likewise challenged the trial court's submission of the jury question regarding whether Geo Viking failed to frac the well in a good and workmanlike manner. Again turning to the evidence, the court of appeals found testimony by Tex-Lee's expert witness and by a witness called by Geo Viking to the effect that intentionally providing a nonworking backup blender was irresponsible and could not be considered as "good and work-

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310. *Id.* at 360.
311. *Id.* at 361.
312. *Id.*
313. *Id.*
314. *Id.*
315. *Id.* at 362.
316. *Id.*
317. *Id.*

manlike."[318] The court therefore held that the jury issues on that topic were properly submitted and that there was sufficient evidence to support the jury's findings.[319]

Geo Viking next asserted that the trial court erred in refusing a requested instruction with regard to the damage issue. The White 1 well was situated on an eighty-acre unit, but the frac job was designed to extend the fractures beyond the unit boundaries. Geo Viking requested the trial court to instruct the jury that, in calculating damages, the jury could consider only the reserves that could have been recovered from lands within the unit boundaries. Geo Viking argued that Tex-Lee could not recover damages for lost production when it had no legal right to produce the oil in the first place. The court of appeals rejected this argument with little discussion, holding that it was contrary to the well-established rule of capture.[320] With slight modification regarding the calculation of postjudgment interest, the appellate court affirmed the trial court's judgment.[321]

On motion for rehearing, the justice who authored the original opinion changed his position regarding Geo Viking's requested damage instruction and filed a dissenting opinion.[322] This dissent noted that the rule of capture does not authorize a trespass, and that fracing under the land of another would constitute a trespass.[323] The dissent therefore reasoned that Tex-Lee could not recover damages for the loss of oil and gas to which it was not legally entitled.[324] As a result, the dissent would hold that the trial court's failure to submit Geo Viking's requested instruction constituted reversible error.[325] The Texas Supreme Court's per curiam opinion denying Geo Viking's application for writ of error stated that the denial should not be interpreted as approval or disapproval of the court of appeals' opinions regarding "the rule of capture or trespass as they apply to hydraulic fracturing."[326]

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318. *Id.* at 363.
319. *Id.*
320. *Id.* at 364. The court explained:

> [The] rule [of capture] permits the owner of a tract to drill as many wells on his land as the Railroad Commission will allow and provides that he is not liable to adjacent land owners whose lands are drained as a result of his operations. The remedy of an injured land owner under such circumstances is generally said to be self-help.

Id.

321. *Id.*
322. *Id.*
323. *Id.* at 365.
324. *Id.*
325. *Id.* at 366.
326. 839 S.W.2d at 797.