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## Texas

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# ONE J

*Oil and Gas, Natural Resources, and Energy Journal*

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### *I. Introduction*

The following is an update on Texas case law relating to oil, gas, and mineral law from August 1, 2017 to July 31, 2018.

### *II. Case Law*

#### *A. Fraction of Royalties*

##### *1. US Shale Energy II LLC et al v. Laborde Properties, LP.*<sup>1</sup>

A nonparticipating royalty is:

an interest in minerals which is nonpossessory in that it does not entitle the owner to produce the minerals himself, or permit him to join in leases of the mineral estate to which the royalty is appurtenant, and does not entitle the owner to share in the bonus or delay rentals, if any, paid for such lease. It merely entitles the owner to a certain share of the production under said lease free of expenses of exploration and production.<sup>2</sup>

Because the nonparticipating royalty interest burdens the lease royalty, it is necessary to carefully examine the drafting language associated with reserving or conveying the same. While the differences are subtle, the results can be dramatic.

In *US Shale Energy II LLC et al v. Laborde , LP*<sup>3</sup>, the Texas Supreme Court addressed the question of whether specific language in a deed reserved fixed or floating nonparticipating royalty.

In 1951, the Bryan family sold their mineral interest in a tract of land in Karnes County, excepting and reserving therefrom “an undivided one-half (1/2) interest in and to [the royalty] . . . in and under . . . the above described premises, the same being equal to one-sixteenth (1/16) of the production.”<sup>4</sup> Laborde Properties LP bought the tract in 2010.<sup>5</sup> At that time,

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1. 551 S.W.3d 148 (Tex. 2018).

2. *Arnold v. Ashbel Smith Land Co.*, 307 S.W.2d 818, 825 (Tex. Civ. App.—Houston 1957, writ ref’d n.r.e.) (citation omitted).

3. 551 S.W.3d 148 (Tex. 2018).

4. *Id.* at 150.

the Bryan successors were being paid one-half (1/2) of a one-fifth (1/5) royalty, for a total of one-tenth (1/10<sup>th</sup>) of production.<sup>6</sup> Laborde argued that this payment was incorrect, and that, based on the reservation language in the 1951 deed, the Bryan successors were only entitled to a “fixed” royalty of one-sixteenth (1/16<sup>th</sup>) production.<sup>7</sup>

The trial court sided with the Bryan successors, but in 2016, the Fourth Court of Appeals in San Antonio reversed, ruling the language “the same being equal to one-sixteenth of the production” had shown an intent to reserve a fixed royalty interest.<sup>8</sup>

The Texas Supreme Court looked to “the language and structure of the reservation at issue” as its “sole guide in ascertaining the intent of the parties,” and in a 6-3 decision, ruled that the deed in question reserved “a floating 1/2 interest in the royalty in all oil, gas, or other minerals” produced from the property.<sup>9</sup>

In its analysis, the court sought to reconcile the two clauses in the reservation: “an undivided one-half (1/2) interest in and to the Oil Royalty,” and “the same being equal to one-sixteenth (1/16) of the production.”<sup>10</sup> The majority started with the proposition that the first phrase expressed the parties’ “intent to tie the reservation to the royalty rate that was in effect at any given time,” or to reserve a floating royalty.<sup>11</sup> When the deed was negotiated in 1951, 1/8 was the typical landowner’s royalty rate in oil and gas leases; however, the oil and gas lease in this case was not negotiated until 2008. Since “the parties could not have intended to tie the reservation to something that simply did not exist,” the court ruled that the reservation must have referred “to a royalty that could come into being at some point in the future.”<sup>12</sup>

Relying on the fact that 1/8<sup>th</sup> was the “standard” landowner’s royalty in oil and gas leases, the court held that the second clause, “that the same being equal to one-sixteenth (1/16) of the production,” did not modify the plain meaning of the first clause.<sup>13</sup> The reference to 1/16<sup>th</sup> clarified “as an

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5. *See id.*

6. *Id.*

7. *Id.*

8. *Id.* at 151.

9. *Id.* at 150.

10. *Id.* at 152.

11. *Id.* at 153.

12. *Id.*

13. *Id.* at 160.

incidental factual matter, what a ½ interest in the royalty amounted to when the deed was executed.”<sup>14</sup>

This is the first fraction-of-royalty case to reach the Texas Supreme Court since *Hysaw v. Dawkins*,<sup>15</sup> decided in 2016.

### *B. Reservations and Exceptions*

#### *1. Perryman v. Spartan Texas Six Capital Partners, Ltd.*<sup>16</sup>

In this case, the court distinguished between a reservation and an exception. A reservation is used in a deed when the grantor wants to reserve something from the conveyance for himself, whether it be a right or an ownership interest. An exception notes and preserves a previous reservation made in prior deeds, and excludes from the current grant the right, or ownership interest which was previously reserved.<sup>17</sup>

In 1977, Ben Perryman conveyed a tract of land in Montague County to his son and daughter-in-law, Gary and Nancy Perryman. The deed contained the following language:

LESS, SAVE AND EXCEPT an undivided one-half (1/2) of all royalties from the production of oil, gas and/or other minerals that may be produced from the above described premises which are now owned by Grantor.<sup>18</sup>

At the time of this conveyance, Ben Perryman owned all of the minerals and royalty in the land.

In 1983, Gary and Nancy Perryman conveyed the land to GNP Inc. The deed contained the following language:

LESS, SAVE AND EXCEPT an undivided one-half (1/2) of all royalties from the production of oil, gas and/or other minerals that may be produced from the above described premises which are now owned by Grantor. It being understood that all of the rest of my ownership in and to the mineral estate in and under the above described lands is being conveyed hereby.<sup>19</sup>

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14. *Id.*

15. *See* 483 S.W.3d 1 (Tex. 2016).

16. 546 S.W.3d 110 (Tex. 2018).

17. ERNEST E. SMITH & JACQUELINE LANG WEAVER, *Texas Law of Oil and Gas* Ch. 1, § 3.9[A] (LexisNexis Matthew Bender 2018).

18. *Perryman*, 456 S.W.3d at 114.

19. *Id.* at 114.

The deed from Gary and Nancy Perryman to GNP Inc. did not mention the prior reservation in the 1977 deed.<sup>20</sup>

The Supreme Court disagreed with both the trial court and court of appeals' construction of the deed reservation and with the construction argued by both sides in the dispute. The court construed the "save and except" language of the 1977 deed as a reservation and held that the same language in the 1983 deed was not a reservation, but rather an exception to the grantor's warranty of title.<sup>21</sup>

Holding that the phrase "which are now owned by Grantor" modifies the word "premises," not the phrase "1/2 of the royalties," the court concluded "that the most reasonable grammatical construction of this deed is that the clause excepts 1/2 of all royalties from the minerals produced from the 'premises which are now owned by grantor.'"<sup>22</sup> As a result, the 1983 deed did not reserve any royalty interest. However, because Ben Perryman owned fee simple title at the time of the 1977 deed, "the 1/2 royalty interest excepted from the grant necessarily remained with Ben, rather than passing to the grantees or remaining outstanding in another."<sup>23</sup> "Although Ben's deed did not expressly "reserve" the 1/2 royalty interest for himself, "the legal effect of the language excepting it from the grant was to leave it to the grantor."<sup>24</sup>

### C. Retained Acreage Clauses

#### 1. *Endeavor Energy Res., L.P. v. Discovery Operating, Inc.<sup>25</sup> and XOG Operating, LLC v. Chesapeake Expl., Ltd. P'Ship.*<sup>26</sup>

In two separate retained acreage clause cases, the Texas Supreme Court interpreted a retained acreage clause to determine ownership of mineral rights covered by competing oil and gas leases. The court applied the same principles but reached two different outcomes.

In *Endeavor Energy Res., L.P. v. Discovery Operating, Inc.*, Endeavor acquired several oil and gas leases covering a 640-acre tract of land (Section 4), and the north half of an adjoining section (Section 9) to the

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20. *Id.*

21. *Id.* at 119-20.

22. *Id.* at 121 (emphasis in original).

23. *Id.* at 125.

24. *Id.* at 22 (citing *Pich v. Lankford*, 302 S.W.2d 645, 650 (Tex. 1957)).

25. 448 S.W.3d 169 (Tex. App. 2014), *aff'd*, No. 15-0155, 2018 WL 1770290 (Tex. Apr. 13, 2018).

26. 480 S.W.3d 22 (Tex. App. 2015), *aff'd*, No. 15-0935, 2018 WL 1770506 (Tex. Apr. 13, 2018).

south.<sup>27</sup> The leases contained retained acreage clauses.<sup>28</sup> Endeavor drilled four wells: Two in the southeast quarter of Section 4 and two in the northeast quarter of Section 9 in the Spraberry (Trend Area) Field.<sup>29</sup> Upon completion of the wells, and prior to the expiration of the primary terms, Endeavor filed certified proration plats with the Texas Railroad Commission.<sup>30</sup> Each plat designated approximately 81 acres, comprising the entire southeast quarter of Section 4 and the northeast quarter of Section 9.<sup>31</sup> Endeavor did not include any acreage in either the southwest quarter of Section 4 or the northwest quarter of Section 9, as it had not drilled any wells in those locations.<sup>32</sup> After the primary terms of Endeavor's leases expired, Patriot Royalty and Land, LLC reviewed the leases and certified proration plats Endeavor filed with the Railroad Commission, and concluded that Endeavor's leases had terminated as to the southwest quarter of Section 4 or the northwest quarter of Section 9.<sup>33</sup> As a result, Patriot obtained leases on that acreage and later assigned them to Discovery Operating, Inc.<sup>34</sup> Discovery drilled four wells on that acreage.<sup>35</sup> Upon discovery of the newly drilled wells, Endeavor asserted that, based on the retained-acreage clauses, its leases were still valid, and filed new proration plats assigning 160 acres to each well.<sup>36</sup> The new plats included the acreage described in Discover's leases.<sup>37</sup> Discovery filed a trespass action against Endeavor. Both parties filed motions for summary judgment.<sup>38</sup> The trial court ruled in favor of Discovery.<sup>39</sup>

At the time of the Endeavor leases, the Railroad Commission's rules for the Spraberry (Trend) Area allowed 80 acres to a proration unit with an additional 80 acres of "tolerance acreage" at the operator's election.<sup>40</sup> The

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27. *Id.* at 171-72.

28. *Id.*

29. *Id.* at 172-73.

30. *Id.* at 173.

31. *Id.* at 173-74.

32. *Id.*

33. *Id.* at 174.

34. *Id.*

35. *Id.*

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.* at 173.

Spraberry field rules required operators to file certified plats describing their proration units.<sup>41</sup>

The Endeavor leases' retained acreage clauses stated:

[T]his lease shall automatically terminate . . . save and except those lands and depths located within a governmental proration unit assigned to a well [containing] the number of acres required to comply with the applicable rules and regulations of the Railroad Commission of Texas for obtaining the maximum producing allowable for the particular well.<sup>42</sup> Relying on the retained acreage clauses, Discovery argued that Endeavor's leases had expired as to the lands outside of the 81-acre proration units that Endeavor originally formed and filed with the Railroad Commission.<sup>43</sup> Endeavor argued that it retained 160 acres around each well because its leases' references to "maximum producing allowable" meant that each proration unit automatically consists of the greatest amount of acreage permitted under the Railroad Commission rules.<sup>44</sup>

The court first addressed the phrase "proration unit assigned to a well" and concluded that it is not the Railroad Commission's responsibility to review and unilaterally assign acreage to proration units; rather, the lessee assigns the proration acreage through its regulatory filings with the Railroad Commission.<sup>45</sup> If the lessee's filings conform with the qualifications of the special field rules, the filing will be accepted by the Railroad Commission.<sup>46</sup>

Next, the court addressed the clause "maximum producing allowable". Endeavor argued that the phrase meant that Endeavor's retained proration units must automatically consist of 160 acres, despite the fact that their original filings with the Railroad Commission only assigned approximately 81 acres to its wells, "because that amount will result in the 'maximum producing allowable,'"<sup>47</sup> under the special field rules.<sup>48</sup> The Court disagreed and held that "Endeavor retained exactly what it bargained for: approximately 81 acres per well."<sup>49</sup>

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41. *Id.*

42. *Id.* at 172

43. *Id.* at 176-77.

44. *Id.* at 177.

45. *Id.* at 177-78.

46. *Id.*

47. Endeavor Energy Res., L.P. v. Discovery Operating, Inc., No. 15-0155, 2018 WL 1770290 at \*11 (Tex. Apr. 13, 2018).

48. *Id.* at \*12.

49. *Id.*



In conclusion, the court held that Discovery's leases were in fact valid because Endeavor's leases had terminated as to all acreage outside of the certified proration unit plats that it had filed prior to the expiration of the leases' primary terms.<sup>50</sup>

*XOG Operating, LLC v. Chesapeake Expl., Ltd. P'Ship* was another retained acreage clause case considered by the court this year. In this case, the retained acreage clause was included in an assignment of lease from XOG to Chesapeake. The assignment provided that, upon expiration of the continuous development period in the assignment:

Said lease shall revert to Assignor, save and except that portion of said lease included within the proration or pooled unit of each well drilled under this Assignment and producing or capable of producing oil and/or gas in paying quantities. The term "proration unit" as used herein, shall mean the area within the surface boundaries of the proration unit then established or prescribed by field rules or special order of the appropriate regulatory authority for the reservoir in which each well is completed. In the absence of such field rules or special order, each proration unit shall be deemed to be 320 acres of land in the form of a square as near as practicable surroundings [sic] a well completed as a gas well producing or capable of production in paying quantities.<sup>51</sup>

Chesapeake completed 6 wells on the lease, 5 of which were located in the Allison-Britt (12,350) Field in Wheeler County.<sup>52</sup> (A sixth gas well was completed in a formation with no special field rules.)<sup>53</sup> There, the field rules provided that "no proration unit shall consist of more than three hundred twenty (320) acres," and that proration units of less than 320 acres would be "fractional proration units."<sup>54</sup>

Chesapeake filed Form P-15 for each well with the Railroad Commission, assigning production acreage totaling 802 acres.<sup>55</sup> XOG argued that the Form P-15 filings limited the acreage retained by

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50. *Endeavor Energy Res., L.P. v. Discovery Operating, Inc.*, 448 S.W. 3d at 178-79.

51. *XOG Operating, LLC v. Chesapeake Expl., Ltd. P'Ship*, 480 S.W.3d 22, 24-25 (Tex. App. 2015) (emphasis in original), *aff'd*, No. 15-0935, 2018 WL 1770506 (Tex. App. 13, 2018).

52. *See id.* at 25.

53. *Id.* at 25-26.

54. *Id.* n.1 (Campbell, J., dissenting).

55. *Id.* at 25-26.

Chesapeake to those 802 acres.<sup>56</sup> Chesapeake argued that “it was the clear intent of the parties to retain the amount of acreage prescribed by the applicable field rules or, in the absence of any field rules, 320 acres per well.”<sup>57</sup>

Applying general contract construction principles, the court held that the “plain language of the agreement defines a ‘proration unit’ (and concomitantly the retained acreage) as the area prescribed by the applicable field rules, or in the absence of field rules, 320 acres – nothing more, nothing less.”<sup>58</sup> Since “the parties expressly agreed that the assignee would retain that portion of a given lease included within a ‘proration unit’ for the Allison-Britt field, the acreage retained by a given well within that field was the standard proration acreage of 320 acres – irrespective of what the operator may have designated in a Form P-15 filing.”<sup>59</sup>

#### *D. Offset Well Clause*

##### *1. Murphy Expl. & Prod. Co.—USA v. Adams*<sup>60</sup>

In this case, the court decided whether an offset well clause must be reasonably calculated to prevent drainage in the context of shale drilling.

In 2009, Murphy Exploration & Production Company entered into two essentially identical oil and gas leases which covered two contiguous 302-acre tracts in Atascosa County.<sup>61</sup> The leases contained identical offset well clauses, which provided:

[I]n the event a well is completed as a producer of oil and/or gas on land adjacent and contiguous to the leased premises, and within 467 feet of the premises covered by this lease, that Lessee herein is hereby obligated to . . . commence drilling operations on the leased acreage and thereafter continue the drilling of such off-set well or wells with due diligence to a depth adequate to test the same formation from which the well or wells are producing from [sic] the adjacent acreage.<sup>62</sup>

The offset well clause was triggered when Comstock Oil & Gas, LP drilled a producing horizontal well on the tract adjacent to and southwest of

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56. *Id.*

57. *Id.* at 26.

58. *Id.* at 29.

59. *Id.*

60. No. 16-0505, 2018 WL 2449313 (Tex. June 1, 2018).

61. *Id.* at \*1.

62. *Id.*

the tracts covered by the leases.<sup>63</sup> Although the clause permitted Murphy to pay royalties based on the neighboring well's production or release acreage, Murphy instead chose to drill a well on the Herbsts' tract 2,100 feet from the triggering well.<sup>64</sup> The well was completed in November 2012, and Murphy began paying royalties on production.<sup>65</sup> Here, "[t]he lessors and royalty owners under the leases (collectively, Herbst) sued Murphy for breach of contract, alleging that Murphy failed to comply with the offset [well] provision" because the Murphy well was too far from the lease boundary to qualify as an offset well, and was not designed to prevent drainage from the Herbsts' tract.<sup>66</sup> Murphy argued that the offset well provision in the lease did not contain any location or minimum spacing requirements for the offset well, but only required that the well be drilled "on the leased acreage" and "to a depth adequate to test the same formation from which the well or wells are producing from [sic] on the adjacent acreage."<sup>67</sup>

In a 5-4 opinion, the Court analyzed the oil and gas lease using traditional contract principles and held that the offset well clause did not require Murphy to drill a well to protect against drainage from the neighboring tract.<sup>68</sup> Thus, Murphy's well, though located 2,100 feet from the triggering well, satisfied the offset well clause.

The court noted that "the provision's only specific requirements with respect to where to drill 'such off-set well' are that it be 'on the leased acreage' and 'to a depth adequate to test the same formation' from which the triggering well is producing."<sup>69</sup> "The clause does not reference drainage."<sup>70</sup> The court looked to the express language within the four corners of the lease agreement, and refused to imply further restrictions. Murphy's leases provided their own definition of "offset well"—when the clause was triggered, Murphy was required to drill a well (1) on the Herbsts' tract (2) with due diligence, and (3) to the same depth as the triggering well. The drilling of "such offset well" would satisfy the offset

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63. *Id.*

64. *See id.*

65. *Id.* at \*2.

66. *Id.*

67. *Id.*

68. *Id.* at \*6-\*7.

69. *Id.* at \*3.

70. *Id.*

well clause.<sup>71</sup> The lease language did not include a proximity requirement or an express protection requirement after the term “such offset well”.<sup>72</sup>

In support of its reasoning, the majority noted that the leases were executed in 2009 and drafted with horizontal drilling in the Eagle Ford Shale in mind.<sup>73</sup> Murphy presented expert testimony that drainage is almost non-existent from horizontal wells in tight-shale formations like the Eagle Ford.<sup>74</sup> Thus, it was unreasonable for an offset well clause to require a well to even attempt to protect against non-existent drainage.

#### *E. Term Royalty Interest and the Rule Against Perpetuities*

##### *1. ConocoPhillips Co. v. Koopmann.*<sup>75</sup>

In 1996, Strieber sold 120 acres in Dewitt County to Koopmann, excepting and reserving

...one-half (1/2) of the royalties from the production of oil, gas . . . and all other minerals . . . which reserved royalty interest is a non-participating interest and is reserved for the limited term of 15 years from the date of this Deed and as long thereafter as there is production in paying or commercial quantities.<sup>76</sup>

The 15-year term ended on December 27, 2011.<sup>77</sup> At that time, the land was under lease to Burlington.<sup>78</sup> The land had been pooled in a unit, but as of August 2011, there had been no production.<sup>79</sup> Strieber conveyed 60% of her reserved term royalty to Burlington “presumably as an incentive to motivate Burlington to begin drilling.”<sup>80</sup> A well had been drilled in 2011, but on December 27<sup>th</sup>, that well was not producing.<sup>81</sup>

Burlington claimed that the Strieber reservation created a future interest in the Koopmanns that was void under the rule against perpetuities and that

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71. *Id.* at \*6-\*7.

72. *Id.* at \*3, \*5-\*7.

73. *Id.* at \*4.

74. *Id.* at \*2.

75. 547 S.W.3d 858 (Tex. 2018), reh'g denied (June 22, 2018).

76. *Id.* at 863.

77. *See id.* at 864.

78. *Id.*

79. *Id.* at 863.

80. *Id.*

81. *Id.* at 863-64.

Burlington's interest was independently maintained because its activities satisfied the deed's saving clause.<sup>82</sup>

After providing a lengthy analysis of the Rule and its application, the court ultimately adopted modern interpretation of it based on the purpose and intent of the rule rather than on an archaic, black letter reading of it, holding that, under the specific facts in this case, the Koopmanns' future interest in the NPRI created by the Strieber's deed was not invalidated by the rule against perpetuities.<sup>83</sup>

[W]here a defeasible term interest is created by reservation, leaving an executory interest that is certain to vest in an ascertainable grantee, the Rule does not invalidate the grantee's future interest. . . . Our holding does not run afoul of the constitution's prohibition of perpetuities because the future oil and gas interest at issue here does not restrain alienability indefinitely—to the contrary, giving effect to a future interest that is certain to vest in a known grantee actually promotes alienability.<sup>84</sup>

The court added “[w]e limit our holding to future interests in the oil and gas context in which the holder of the interest is ascertainable and the preceding estate is certain to terminate.”<sup>85</sup>

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82. *Id.* at 864.

83. *Id.* at 880.

84. *Id.* at 873 (citation omitted).

85. *Id.*