View metadata, citation and similar papers at core.ac.uk

brought to you by CORE

provided by Texas A&M University School of Law

Texas A&M Journal of Property Law

Volume 6
Number 3 *Survey on Oil & Gas*

Article 16

12-1-2020

Survey of Selected 2019 Texas Oil and Gas Cases and Statutes

William D. Farrar
William_Farrar@baylor.edu

Follow this and additional works at: https://scholarship.law.tamu.edu/journal-of-property-law

Part of the Oil, Gas, and Mineral Law Commons, and the Property Law and Real Estate Commons

Recommended Citation

William D Farrar, Survey of Selected 2019 Texas Oil and Gas Cases and Statutes, 6 Tex. A&M J. Prop. L. 171 (2020).

This Student Article is brought to you for free and open access by Texas A&M Law Scholarship. It has been accepted for inclusion in Texas A&M Journal of Property Law by an authorized editor of Texas A&M Law Scholarship. For more information, please contact aretteen@law.tamu.edu.

SURVEY OF SELECTED 2019 TEXAS OIL AND GAS CASES AND STATUTES

By: William D Farrar[1]

I. INTRODUCTION

Texas courts and the legislature were quite active in 2019 concerning oil and gas issues. Texas courts decided many cases involving everything from deed interpretation to lease repudiation to farmout interpretation. The Texas Supreme Court has granted several petitions for review from the courts of appeal. The legislature enacted or amended statutes concerning so called "royalty leases," the Mineral Interest Pooling Act, and others. The following are summaries of some selected cases and statutes that will be of interest to those involved with Texas oil and gas law.

DOI: https://doi.org/10.37419/JPL.V6.I3.16

1. Professor (Adj.) of Oil & Gas Law and Advanced Oil & Gas Law, Baylor University School of Law and Board Certified in Oil, Gas and Mineral Law, Texas Board of Legal Specialization.

A. *Oil and Gas Leases and Provisions*

1. Offset Well Clauses

In *Bell v. Chesapeake Energy Corp.*[2], the San Antonio Court of Appeals used strict contract construction maxims to interpret an "offset clause" in two oil and gas leases to require the lessee to pay compensatory royalties. The relevant lease provisions generally provided that if an offset well were drilled by a third party within 330 feet, or within 467 feet by the if the lessee had an economic interest in it, then the lessee was required to drill a well, release acreage or pay compensatory royalty.[3] The lease defined the compensatory royalty as "an amount equal to the Royalty Share of Gross Proceeds of production from the Adjacent Well . . . ."[4]

The lessee first argued that the offset well provisions were not triggered because the "reasonably prudent operator" standard was implied in the offset clause,[5] meaning even though a well was drilled within the prescribed distance, the well is not a "triggering well" unless it was causing substantial drainage and a reasonably prudent operator would drill a protection well.[6] The court noted that the offset clauses expressly provided that a well drilled within the trigger distance was a "draining well," thus there was no requirement for the lessor to prove substantial drainage, nor was there any language implying a reasonably prudent operator standard.[7] The court held that the lessor "is not required to demonstrate anything other than the existence of an Adjacent Well within the Trigger Distances that has begun production" and thereafter the lessee must either drill, release acreage, or pay the compensatory royalty.[8]

Secondly, the lessee argued that even if the offset clause were triggered, the compensatory royalty should be based on something less

2. *See* No. 04-18-00129-CV, 2019 WL 1139584, at *1 (Tex. App.—San Antonio 2019, pet. filed) (mem. op.) (noting that the case was an accelerated appeal as a representative case of a class action).
3. *Id.*
4. *Id.* at *2.
5. *Id.* at *5.
6. *Id.*
7. *Id.* at *6.
8. *Id.*

than the "Gross Proceeds" from the adjacent well.[9] The court framed the issue as "whether Gross Proceeds are from production from the entirety of a horizontal well, any part of which falls within the Trigger Distances, or production attributable only to those perforations (take points) that are within those Trigger Distances."[10] The court noted that lease offset clause expressly provided that the surface location of a horizontal well was the determinative location of a well rather than the "take points" or location of entry into the productive formation.[11] In seeking to reduce the amount of the "Gross Proceeds" to which the royalty would be paid, the lessee argued that the lease provision did not consider the "realities" of horizontal drilling. However, the court noted that horizontal wells were discussed in the lease and held that the lessee may not now introduce extrinsic evidence of "realities" of horizontal drilling to "alter or contradict the unambiguous [l]ease language."[12]

The lessee's argument was essentially "that calculating Compensatory Royalty according to the plain language of the Leases is a bad deal."[13] The court disagreed, noting that the lessee was a sophisticated industry player, represented by experienced counsel, and fully expected horizontal wells would be drilled. Accordingly, the express language in the leases controlled requiring that the lessee pay the compensatory royalty on the gross production from the adjacent wells.[14]

2. Royalty Payments and Post-Production Cost Deductions

In *Bluestone Nat. Res. II, LLC v. Randle*, the Fort Worth Court of Appeals construed royalty payment clauses in an oil and gas lease to uphold the trial court's determination that the lessee could not deduct post-production costs from the lessor's royalty.[15] The lease in

9. *Id.* at *5
10. *Id. at* *12.
11. *Id.* at *13 (The relevant lease language stated ". . . in the case of a Horizontal Well[,] distance will be measured from the surface location or the subsurface path of a horizontal drainbore, from its point of entry into the productive horizon to its terminus, whichever is closer").
12. *Id.* at *14.
13. *Id.* at *15.
14. *Id.*
15. No. 02-18-00271-CV, 2019 WL 1716415, at *1 (Tex. App.—Fort Worth 2019, pet. filed) (mem. op.).

question was described by lessee's counsel as a "Frankenstein's Monster" with its parts "cobbled together from the parts bin of oil and gas lease provisions."[16] The lease had a printed portion with an Exhibit A attached as an addenda. The printed portion of the lease contained a royalty clause that stated lessor's royalty would be based on:

> the market value at the well of one-eighth of the gas so sold or used, provided that on gas sold by Lessee the market value shall not exceed the amount received by Lessee for such gas computed at the mouth of the well, and on gas sold at the well the royalty shall be one-eighth of the amount realized by Lessee from such sale . . . .[17]

Exhibit A provided that "it is understood and agreed by all the parties that the language on this Exhibit 'A' supersedes any provisions to the contrary in the printed lease hereof."[18] Exhibit A also included the following provision relating to royalty payments:

> *LESSEE AGREES THAT all royalties accruing under this Lease (including those paid in kind) shall be without deduction, directly or indirectly, for the cost of producing, gathering, storing, separating, treating, dehydrating, compressing, processing, transporting, and otherwise making the oil, gas[,] and other products hereunder ready for sale or use. Lessee agrees to compute and pay royalties on the gross value received, including any reimbursements for severance taxes and production related costs.*[19]

The court noted that typically there are three issues to consider: (1) the fraction of royalty such as 1/4th or 1/8th; (2) the method of

16. *Id.* (In this author's experience, this is fairly typical—leases many times are assembled with a printed form and various addenda attached modifying, or adding to, the printed form).
17. *Id.* at *2.
18. *Id.*
19. *Id.*

valuation, such as "market value" or "proceeds"; and (3) the geographic location at which the value or proceeds is determined, such as "at the wellhead" or "at the point of sale." Specifically, this case involves the last two.[20] "Proceeds" or "amount realized" is the amount the lessee actually receives from a sale, while "market value" requires payment of market price in the vicinity of the wellsite irrespective of actual sales price.[21] Market value can be determined either through the "comparable sales method" or the "net-back method."[22] The comparable sales method uses other sales that are "comparable in time, quality, quantity, and availability of marketing outlets."[23] The "net-back" method, "which determines the prevailing market price at a given point and backs out the necessary, reasonable costs between that point and the wellhead."[24]

The court found that although the preprinted lease form called for valuation based on "market value at the well," which necessarily allowed post-production cost deductions, Exhibit A to the lease provided for valuation based on proceeds received by lessee.[25] The court pointed out that although identical proceeds language on Exhibit A had been held to be "mere surplusage" in *Heritage Resources v. Nationsbank*,[26] However, the court enforced the proceeds valuation based on the Exhibit A language stating that Exhibit A controlled over the preprinted lease form in the event of any conflict. Accordingly, the lessee could not deduct post-production costs from the lessor's royalty.

3. Lease Repudiation by Lessor

In *Lona Hills Ranch, LLC v. Creative Oil and Gas Operating, LLC*,[27] the Austin Court of Appeals determined that the Texas Citizens

20. *Id.* at *4. *See also* Byron C. Keeling, *In the New Era of Oil and Gas Royalty Accounting: Drafting a Royalty Clause That Actually Says What the Parties Intend It to Mean*, 69 Baylor L. Rev. 516, 520–528 (2017).
21. *Bluestone Nat. Res.*, 2019 WL 1716415, at *8–9.
22. *Id.* at *5.
23. *Id.* (quoting Heritage Res. v. Nations Bank, 939 S.W.2d 118, 122 (Tex. 1996)).
24. *Id.* (quoting *Heritage Res.*, 939 S.W.2d at 130).
25. *Id.* at *16.
26. *Id.*
27. 549 S.W.3d 839 (Tex. App.—Austin 2019) (pet. granted).

Participation Act ("TCPA")[28] did not preclude the lessee from pursuing a breach of contract claim against the lessor for failure to comply with a "notice before litigation" clause in the lease. The lessor first filed a complaint at the Texas Railroad Commission based on lack of production, challenging the operator's "good faith claim" of the right to continue to operate the lease.[29] The Railroad Commission dismissed the complaint, finding the operator had shown a good faith claim to continue to operate the well.[30] The lessor did not appeal this decision but instead initiated litigation in the district court against the operator for trespass to try title and trespass based on allegations of lack of production.[31]

The operator filed an answer and noted it was a contract operator only and owned no interest in the well or lease and filed counterclaims alleging the lessor had interfered with the sale of oil produced, wrongfully filed the Railroad Commission complaint, and breached the lease by failing to comply with the lease's pre-suit notice requirements, which would have given the lessee an opportunity to cure.[32] The lessee intervened in the suit and filed its own counterclaim against the lessor for breach of contract.[33] The lessor filed a motion to dismiss both counterclaims under the TCPA. The trial court never ruled on lessor's motion, thus it was denied by operation of law and addressed for the first time on appeal.[34]

The appellate court found that the lessor had met its *prima facie* standard for dismissal under the TCPA, but then analyzed the operator's response to determine if it could prove each element of its breach of contract claims.[35] The court determined that the trial court should have dismissed the operator's counterclaim because, as a non-party to the lease allegedly breached, the operator could never prove a breach of contract.[36] With respect to the lessee's counterclaim, the court found that the lessor had failed to establish grounds for dismissal because the notice before litigation clause in the lease was a

28. TEX. CIV. PRAC. & REM. CODE § 27.001 (2018).
29. *Lona Hills Ranch*, 549 S.W.3d at 842.
30. *Id.*
31. *Id.*
32. *Id.* at 843.
33. *Id.*
34. *Id.*
35. *Id.* at 847.
36. *Id.* at 848.

contractual limitation on the lessor's right to petition under the TCPA.[37]

B. *Mineral Ownership*

1. Executive Rights and Duties to Non-Executives

In *Tex. Outfitters, Ltd. v. Nicholson*,[38] the Texas Supreme Court held that an executive mineral owner breached its duty of utmost good faith in failing to execute a mineral lease. Texas Outfitters, the owner of the surface estate, and a minority mineral interest also held the executive rights to 50% of the mineral estate.[39] The other 50% of the mineral estate was owned by others.[40] A lessee leased the 50% mineral interest owned by others and offered the same lease terms to Texas Outfitters for the remaining 50%.

Texas Outfitters declined to lease, believing that lease bonus amounts might go even higher and to protect his hunting business, despite the non-executive owner's desire that the lease be executed.[41] Thereafter, the non-executives requested a meeting with Texas Outfitters and proposed a resolution whereby they would purchase the executive rights to their mineral interest, forgive part of a seller-financed note that Texas Outfitters owed them, and they would lease all their minerals.[42] However, no deal was reached because the parties were unable to agree on the specific terms of surface restrictions. The non-executives filed suit against the executive for breaching the duty of utmost good faith and fair dealing for failing to enter into a lease.[43]

At a bench trial, judgment was entered against the executive owner for $867,654.32, the amount of the bonus the non-executives would have received.[44] The court of appeals affirmed, holding that "the evidence supports a finding that Texas Outfitters refused to execute the . . . lease based on its arbitrary and self-motivated refusal to permit *any* lease for the purpose of protecting its use of the surface

37. *Id.*
38. 572 S.W.3d 647 (Tex. 2019).
39. *Id.* at 649.
40. *Id.*
41. *Id.* at 650.
42. *Id.*
43. *Id.*
44. *Id.*

and to exact a benefit from the [non-executive] [e.g., the note reduction and deed restrictions] to their detriment."[45]

The Texas Supreme Court first reiterated the law regarding the executive's duty to the non-executives:

1. [T]he duty does not require an executive to subjugate his interests to those of the non-executive; rather, the executive must 'acquire for the non-executive every benefit that he exacts for himself.[46]
2. An executive is not 'wholly shielded from liability for inaction, i.e., failure to lease, noting that if an executive's refusal to lease upon request 'is arbitrary or motivated by self-interest to the non-executive's detriment, the executive may have breached his duty.'[47]

Applying these principles, the Court stated they "cannot be applied in a vacuum and must account for the fact that executives and non-executives often 'do not share in all the same

economic benefits that might be derived from a mineral lease,'"[48] and "evaluating compliance with the executive duty is rarely straightforward and is heavily dependent on the facts and circumstances."[49] The Court then noted that the trial court had made numerous findings of fact and conclusions of law and its review on appeal was to determine if "more than a mere scintilla" of evidence exists to uphold the trial court's judgment and the court of appeals affirmation in favor of the non-executive.[50]

In affirming the judgments below, the Court noted that the executive owner knew that 50% of the minerals had already been leased to a lessee and "gambling" that a higher offer would come in from a different lessee was highly unlikely and gambled

45. *Id.* at 651–52.
46. *Id.* at 652 (quoting KCM Fin., LLC v. Bradshaw, 457 S.W.3d 70, 74 (Tex. 2015)).
47. *Id.* at 652 (quoting Lesley v. Veterans Land Bd., 352 S.W.3d 479, 491 (Tex. 2011)).
48. *Id.* at 652 (quoting *KCM Fin.*, 457 S.W.3d at 82).
49. *Id.* at 653.
50. *Id.* at 653.

disproportionality with the non-executive's interest as compared to the executive's, and solely to benefit the executive's surface estate.[51]

2. Co-tenancy of the Mineral Estate

In *Cimarex Energy Co, v. Anadarko Pet. Co.*, the El Paso Court of Appeals held that one co-tenant's production activities on land would not perpetuate another co-tenant's oil and lease on an undivided interest in the same land.[52] Cimarex owned a lease with a five-year primary term on an undivided 1/6th mineral interest in 440 acres.[53] Anadarko owned leases on the other 5/6ths mineral interest. Anadarko also had the lease on an adjacent 200 acres.[54] Anadarko drilled two wells on the 440 acres, both of which paid out and produced in paying quantities thereafter.[55] Cimarex requested to participate in the costs of the development of the two wells, and Anadarko refused.[56] Anadarko then applied for a permit to drill a well on the 200-acre lease.[57] The well's location was too close to the 440 acres for a regular permit, thus Anadarko filed for a Rule 37 exception permit and notified Cimarex of the application.[58] Cimarex failed to object to the permit application, and the permit was granted. Anadarko thereafter drilled and completed a successful well.[59] The lessors of the Cimarex lease then executed top leases covering the 1/6th interest to a third party that were then acquired by Anadarko.[60] Thus, Anadarko held leases on 5/6th mineral interest and top leases on 1/6th mineral interest.

After Anadarko failed to provide information on the wells or an accounting, Cimarex filed suit seeking an accounting for its 1/6th co-tenant share of the net profits for the wells located on the 440 acres. Additionally, Cimarex attempted to force pool some of the land covered by its lease at the Texas Railroad Commission into the well located on the adjacent 200 acres using the Mineral Interest Pooling

51. *Id.* at 657.
52. 574 S.W.3d 73 (Tex. App.—El Paso 2019).
53. *Id.* at 80–81.
54. *Id.* at 81.
55. *Id.*
56. *Id.* at 82.
57. *Id.* at 81–82.
58. *Id.* at 82.
59. *Id.*
60. *Id.*

Act.[61] Cimarex and Anadarko thereafter reached a settlement in which Anadarko agreed to pay Cimarex 1/6th of the net profits for the two wells located on the 440 acres and to provide income and expense data and payments of net profits on an ongoing basis.[62] Cimarex paid its lessors their royalty on the production as well.[63] Anadarko performed under the terms of the settlement agreement, but when the five-year primary term of the Cimarex lease ended, Anadarko stopped performing, claiming Cimarex's leasehold interested had terminated because Cimarex had not established production on its lease to perpetuate the lease into the secondary term.[64]

Cimarex then filed suit against Anadarko.[65] Both parties filed motions for summary judgment.[66] Anadarko defended its position and the superiority of its top leases on the basis that the Cimarex lease required Cimarex to establish production and that the activities of Anadarko, Cimarex's co-tenant, were not sufficient to do so.[67] Cimarex argued that the lease only required production "on the lands covered by the lease." Their reasoning was that since Anadarko had established production on the same lands the lease was perpetuated and because Cimarex had paid royalties to its lessors, both they, and Anadarko as the top lessee standing in the same shoes, were equitably estopped from repudiating the Cimarex lease.[68] The trial court disagreed, finding that the Cimarex lease had expired at the end of its five-year primary term and that the doctrine of equitable estoppel was not applicable.[69]

On appeal, the parties reasserted the same arguments as below. The court of appeals relied heavily on *Hughes v. Cantwell*,[70] where the court held that a lessee of a lease covering a fractional co-tenant interest in minerals is required to undertake drilling activities and may not rely on the activities of its co-tenant.[71] The court explained as its

61. *Id.* at 83.
62. *Id.* at 83–84.
63. *Id.* at 84.
64. *Id.*
65. *Id.*
66. *Id.*
67. *Id.*
68. *Id.* at 65.
69. *Id.*
70. 540 S.W.2d 742 (Tex. Civ. App.—El Paso 1976) (writ ref'd. n.r.e.).
71. *Id.* at 90–93; Cimarex Energy Co. v. Andarko Petroleum, 574 S.W.3d 73 (Tex. App.—El Paso 2019).

reasoning in *Hughes* that the lease stated in several places that the "lessee" was authorized or obligated to do certain things, such as pay delay rentals, pool the lease, pay royalties, thus the option to either drill a well or pay delay rentals was an option for Hughes. Therefore, the fact that a co-tenant had commenced drilling operations did not keep the Hughes lease from terminating when Hughes elected not to pay delay rentals.[72] The court further explained that in order to rely on a co-tenant's activities, one must participate, actually or constructively, in paying their share of the drilling costs.[73]

Following their opinion in *Hughes*, the court noted that the Cimarex lease likewise authorized or required the "lessee" to explore for and produce oil and gas; pay royalties; undertake reworking or new drilling operations; pool the lease; designate pooled units; assign the lease; use oil, gas and water from the land for operations; and finally, to remove its equipment after lease termination.[74] Thus, reasoned the court, it is implied "that the lessors intended for Cimarex to be the one to cause production on the property in order to extend the lease into the secondary term."[75]

Cimarex next argued that it had paid royalties to the lessors based on Anadarko's production, and "it would be inherently inconsistent to interpret the lease to require it to pay royalties on Anadarko's production during the primary term, while not allowing Cimarex to rely on Anadarko's production to keep the lease alive into the secondary term."[76] However, the court disagreed, stating that it was entirely possible that the lessors could have intended that royalties be paid on a co-tenants production during the primary term, but to require its lessee, Cimarex, to establish its own production to perpetuate the lease into the secondary term.[77] Cimarex next argued that it would be bad public policy to hold that one co-tenant's activities would not perpetuate another co-tenant's lease and would discourage the leasing of minority mineral interests given that it is typically uneconomic for a minority co-tenant to undertake the financial risk of drilling a well.[78] However, the court disagreed, observing that:

72. *Cimarex Energy Co.*, 574 S.W.3d at 91.
73. *Id.*
74. *Id.* at 92.
75. *Id.*
76. *Id.* at 94.
77. *Id*. at 94–95.
78. *Id.* at 95.

> *Cimarex was aware of the laws relating to co-tenancy when it entered into the lease agreeing to take a minority interest… [and] Cimarex knowingly took the risk that other tenants on the land might refuse to agree to a joint operating agreement, and that it might be forced to, at some point, commence production on its own, as contemplated by the terms of the lease.*[79]

Cimarex next argued that its Settlement Agreement with Anadarko was a joint operating agreement, meaning Cimarex and Anadarko were jointly developing the lands, and the Cimarex lease was perpetuated by the efforts of both Cimarex and Anadarko.[80] Anadarko countered that the Settlement Agreement did nothing more than recognize Cimarex was entitled to its non-developing cotenant share of the net profits.[81] The court agreed with Anadarko, pointing out that while no particular form of agreement is required to be a joint operating agreement, the hallmarks of an operating agreement are to share revenues, share expenses, allocate liabilities, designate an operator, and define the geographic area to which it applies.[82] These attributes were juxtaposed to the Settlement Agreement, which merely recognized Cimarex as a 1/6th co-tenant entitled to a 1/6th co-tenant's share of net income. The Settlement Agreement omitted any reference to joint development, responsibility of costs and liabilities, and indeed referenced Cimarex as a "non-participating cotenant," as opposed to a "non-operator."[83]

Finally, Cimarex argued that its lessors, and Anadarko by virtue of the top lease, were equitably estopped from claiming Cimarex's lease terminated because the lessors accepted royalties on Anadarko's production during the primary term. The court dispensed with this argument stating: "we have interpreted the habendum clause in the Cimarex lease to require Cimarex to pay royalties on *any* production on the land during the "paid-up" primary term of the lease, while requiring Cimarex to cause actual production on the subject

79. *Id.*
80. *Id.* at 96.
81. *Id.*
82. *Id.* at 97.
83. *Id.*

property to extend the lease into the secondary term."[84] Finally, the court upheld the trial court's award of attorney's fees to Anadarko as a "prevailing party" under the attorney's fee provision of the Settlement Agreement.[85] The holding in the Cimarex case is a warning that when taking an oil and gas lease on a fractional interest, the lessee should include language in the lease that would recognize a co-tenant's operations or production for purposes of perpetuating the lease. It is the author's observation that this case is contrary to the assumption that a mineral lessee stands in the shoes of its lessor with respect to co-tenancy law, while honoring the general proposition that Texas jurisprudence over the years has tended to support those who are spending money, thereby incurring risk, to bring oil and gas to the surface, as opposed to those who passively rely on other's efforts. It will be interesting to see the result if petition is granted on this case.

3. Consent to Assign Clauses

In *Barrow-Shaver Res. Co. v. Carizzo Oil & Gas, Inc.*,[86] the Texas Supreme Court found that Carrizo had an unqualified right to refuse to consent to Barrow-Shaver's transfer of rights under a farmout agreement. Carizzo held oil and gas leases on 22,000 acres that were about to expire.[87] Prior to the farmout agreement being executed, the parties negotiated various drafts of the agreement, including the wording of the consent to assign clause that provided that consent could not be withheld unreasonably. Testimony at trial stated that Carizzo refused to qualify the language in the agreement but had verbally promised it would consent in the event Barrow-Shaver ever wanted to assign its rights.[88] The parties ultimately entered into the farmout agreement that contained the following clause:

> The rights provided to [Barrow-Shaver] under this Letter Agreement may not be assigned, subleased or

84. *Id.* at 100.
85. *Id.* at 101,
86. Barrow-Shaver Res. Co. v. Carizzo Oil & Gas, Inc., No. 17-0332, 2019 WL 2668317 (Tex. June 28, 2019).
87. *Id.* at *2.
88. *Id*. at *2–3.

> otherwise transferred in whole or in part, without the express written consent of Carrizo.[89]

Barrow-Shaver spent over $22,000,000 drilling an unsuccessful well on the lands covered by the farmout agreement.[90] Thereafter, a third party offered to purchase Barrow-Shaver's interest in the farmout agreement for approximately $27,000,000.[91] Barrow-Shaver requested that Carizzo consent to the assignment of the farmout agreement to the third party.[92] Carizzo refused to consent, instead offering to sell its interest in the leases to Barrow-Shaver for $5,000,000.[93] Barrow-Shaver refused to purchase the farmout agreement, and the underlying leases expired worthless.[94]

Barrow-Shaver sued Carizzo for breach of contract, fraud, and tortious interference with a contract.[95] At trial, both parties agreed that the consent to assign clause was unambiguous, but Barrow-Shaver also argued that the contract was silent on the bases that Carizzo could refuse to consent.[96] The trial court refused to admit prior drafts of the farmout agreement in which Carizzo had deleted the phrase "which consent shall not be unreasonably withheld."[97] Both parties proffered expert testimony on industry custom and usage, with respect to the standards governing when consent to assign can be withheld. Barrow-Shaver's expert opined that a standard of good faith governed, and that the request for $5,000,000 was a breach of the farmout agreement. Carizzo's expert opined that the clause was a "hard consent," and Carizzo could refuse to consent for any reason.[98] At trial, the jury found that Carizzo had breached the farmout agreement and awarded almost $28,000,000 damages and attorney's fees to Barrow-Shaver.[99] Carizzo appealed, and the 12th Court of Appeals reversed, finding that the trial court erred in not allowing the prior drafts of the farmout agreement into evidence to show that Carizzo had bargained for "hard

89. *Id*. at *1–2.
90. *Id*. at *2.
91. *Id.*
92. *Id.*
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.* at *2–3.
97. *Id.* at *3.
98. *Id.*
99. *Id.*

consent."[100] The appellate court also held that the existence of a written contract vitiated any cause of action based on fraud, and since Carizzo had the right to withhold consent, there could be no tortious interference with contract.[101] Barrow-Shaver petitioned to the Texas Supreme Court, which was granted.

The Texas Supreme Court ultimately held that the farmout agreement was unambiguous, and neither the prior drafts of the agreement, nor industry custom and usage, were admissible. In reaching this decision, the Court found that there was no breach of contract in refusing to consent because the plain wording of the agreement gave Carizzo the right to refuse to consent for any reason. The court held:

> The consent-to-assign provision plainly states that Barrow-Shaver cannot assign its rights unless it obtains Carrizo's consent, which must be express and in writing. In other words, Carrizo has a right to consent to a proposed assignment, or not. The plain language of the provision imposes no obligation on Carrizo—it does not require Carrizo to consent when certain conditions are satisfied, require Carrizo to provide a reason for withholding consent, or subject Carrizo to any particular standard for withholding consent.[102]

The majority found that there were no material terms in the consent to assign clause. Therefore, there was no need to allow extrinsic evidence to explain "immaterial terms."[103] The Court also found that industry custom and usage were not admissible when the clause was otherwise unambiguous.[104]

In response to Barrow-Shaver's argument that a duty of good faith is imposed on Carizzo in its decision whether to consent or not, the Court held "this Court has been clear that absent a special relationship, parties to a contract have no duty to act in good faith."[105]

100. *Id.*
101. *Id.*
102. *Id.* at *6.
103. *Id.* at *7.
104. *Id.* at *26–37.
105. *Id.* at *41.

The court pointed out that in its view, a farmout agreement between sophisticated parties is not similar to the relationship between insurers and insureds with unequal bargaining power.[106] Finally, the Court found no fraud cause of action was available to Barrow-Shaver because the direct language of the farmout agreement contradicted the alleged oral promise by Carizzo to consent if requested.[107]

The dissenting opinion noted that industry custom and usage evidence are routinely admitted to explain an otherwise unambiguous contract, citing the classic example of a "baker's dozen" not being a dozen but thirteen.[108] Explaining further, the dissent noted "this Court has noted that a 'thousand' rabbits may mean 1,200; a 'day' may mean 10 hours; and '4,000' shingles may mean 4500,"[109] and the majority holding "that trade custom and usage has no applicability to terms that are 'not susceptible to more than one [meaning[] and [are] not industry or vocation specific" is manifestly wrong."[110]

It should be noted that a petition for rehearing has been filed in this case. The holding in this case has potential impact beyond a farmout agreement, which was at issue in this case. Many exploration agreements, oil and gas leases, pipeline easements, and others have consent to assign clauses. It is the author's experience that if a party wishes to withhold consent with unfettered discretion, the consent to assign clause should add a qualifier such as "may withhold consent in its sole discretion" or "may withhold consent for any reason," and absent such qualifier, there should be a commercially valid reason for refusing to consent. The take-a-way from this case is that the Texas Supreme Court has adopted a very non-industry specific reading of contracts—if the contract words appear in a dictionary, then one need not consult industry custom and trade usage.

II. Statutory Changes

A. *"Royalty Leases" and Addition of Section 5.152 of the Texas Property Code*

106. *Id.* at *41–42.
107. *Id.* at *65–66.
108. *Id.* at *84.
109. *Id.*
110. *Id.* at *84–85.

In recent years, there have been an increasing number of disputes arising over purported "royalty leases," whereby a buyer purports to "lease" the royalty interest a party owns in lands that are already leased or under production. The buyers of the purported "leases" argue that the fact that the instrument is entitled or written as a lease does not prevent its effectiveness to convey a term royalty interest or a defeasible fee. Some of the bases of the dispute can be found in the class action suit entitled *Danna Sue Bridges et al v. Ridge Natural Resources*.[111] The gist of the complaint is that mineral/royalty owners receive what appears at first glance to be a typical oil, gas, and mineral lease, and they assume it is on lands not currently leased, or is a "top lease." However, the buyer claims that the "lease" is actually a conveyance, usually of the grantor's share of existing royalty in existing production from lands already under lease, rather than a lease on unproductive land that would require exploration efforts to perpetuate the lease. Some of the "royalty leases" include arbitration clauses that require any disputes to be resolved through binding arbitration.[112]

The Texas legislature added section 5.152 of the Texas Property Code, effective September 1, 2019, to require additional notices and requirements when attempting to acquire permanently, or for a term, the mineral interest or royalty interest a lessor has in an existing oil and gas lease.[113] Among the requirements are that a notice in 14 point typeface stating: "THIS IS NOT AN OIL AND GAS LEASE. YOU ARE SELLING ALL OR A PORTION OF YOUR MINERAL OR ROYALTY INTERESTS IN (DESCRIPTION OF PROPERTY BEING CONVEYED)" must appear on each page of the lease and immediately above the signature line.[114] If the notices are not included, the instrument is void, as opposed to voidable.[115]

The new statute provides for the recovery of all oil and gas revenues paid to the purported lessee, costs, and attorney's fees.[116] Finally, the statute is cumulative with other remedies, thus a

111. Class Action Complaint, Danna Sue Bridges et al v. Ridge Natural Resources, No. 7:18-cv-00134-DC, 2018 WL 10072188 (W.D. Tex. Aug. 3, 2018).
112. Ridge Nat. Res. v. Double Eagle Royalty, 564 S.W.3d 105, 116 (Tex. App.—El Paso 2018, no pet.).
113. TEX. PROP. CODE § 5.152 (2019).
114. § 5.152(c).
115. § 5.152(d).
116. § 5.152(e).

complainant could, for example, also bring claims for common law fraud, statutory fraud, and others.[117]

B. *Mineral Interest Pooling Act Amendments*

The Texas legislature, effective September 1, 2019, amended the Mineral Interest Pooling Act to provide that a unit formed under the Act will dissolve two years after formation if no drilling occurs in the unit or surface location for the unit.[118] The prior version of the statute required dissolution at the end of one year.

C. *Ownership of Fluid Oil & Gas Waste*

The Texas legislature, effective September 1, 2019, amended Texas Natural Resources Code section 122.002 to provide that a person or entity that acquires fluid oil and gas waste for the purposes of treating it for further beneficial use, owns the fluid waste, absent "an oil or gas lease, a surface use agreement, a contract, a bill of sale, or another legally binding document to the contrary."[119] Presumably, the purpose of this amendment is to resolve a dispute between a surface owner, mineral owner, and lessee over who has the right to the fluid waste, which could be quite valuable given the scarcity of water in some areas.

117. § 5.152(f).
118. TEX. NAT. RES. CODE § 102.082 (2019).
119. TEX. NAT. RES. CODE § 122.002 (2019).