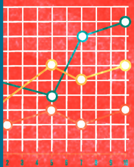
LANDMAN magazine

Top 10 Texas Oil and Gas Cases of 2022

Read about significant oil and gas decisions from Texas courts on page 30.



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Top 10 Texas Oil and Gas Cases of 2022

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This article discusses significant oil and gas decisions from state and federal courts in Texas during 2022, listed in chronological order after giving deference to the Supreme Court of Texas. It is not meant to be a strict legal analysis, but rather a useful guide for landmen in their daily work. We do not intend these summaries to be a complete discussion of the legal and practical effects of each case.

Nettye Engler Energy v. Bluestone Natural Resources II[1]

Decided Feb. 4, 2022

This is another in a series of postproduction cost disputes. The court clarified *Burlington Resources v. Texas Crude Energy.*[2] Contrary to the reasoning by the Court of Appeals, *Burlington* did not establish a rule that "delivery into the pipeline" or similar phrasing creates a valuation or delivery point at the well or nearby. Rather, *Burlington* reiterated that all contracts are construed as a whole to ascertain the parties' intent from the language they used to express their agreement.

Recall the basic Texas PPC cost-sharing rule: A royalty interest bears its proportional share of PPCs from the point of delivery to the purchaser or working interest owner unless the conveyance specifies otherwise. Likewise, a royalty interest is free of PPCs incurred before delivery. The question in cases such as this: Where is the delivery point?

Engler's predecessors conveyed 646 acres by a special warranty deed reserving an undivided 1/8th nonparticipating royalty interest in and to all the oil, gas, etc. The deed required the royalty "to be delivered to grantor's credit free of cost in the pipeline, if any, otherwise free of cost at the mouth of the well or mine."

Gas produced at the wells is collected in a gas-gathering system on the lease for compression, processing and delivery to third-party transportation pipelines off the lease and then sold to third parties.

Former operator Quicksilver valued Engler's NPRI at the point of sale to the gas purchaser's pipeline, freeing Engler's royalty from the burden of postproduction costs. Under current operator Bluestone's valuation, delivery of Engler's share occurs at the point where unprocessed gas enters the on-site gathering system, thus bearing its proportional share of PPCs from that point forward.

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1 639 S.W.3d 682 (Tex. 2022).

2 573 S.W.3d 198, (Tex. 2019).

Engler argued that the delivery point was downstream of the wellsite at the transportation pipeline, if not farther, because a gas gathering pipeline is not a pipeline and use of the term "otherwise" to introduce the alternative delivery point "at the mouth of the well or mine" negated a construction of "the pipeline, if any" as including any pipeline at or near the wellhead.

The court rejected Engler's contention that a gathering system is not a pipeline. Resorting to contemporaneous dictionaries, treatises, decisions and regulations, the court concluded that a gas gathering pipeline is a pipeline in common industry and regulatory parlance. The deed in question did not limit the delivery location to a specific pipeline nor prohibit delivery to a pipeline at or near the well if any.

The court concluded that Bluestone discharged its royalty obligation by delivering Engler's fractional share of production in the gathering pipelines on the premises. Therefore, Bluestone properly deducted PPCs between that point and the point of sale. The Court of Appeals held that delivery occurs in the gathering pipeline, but misconstrued *Burlington* in reaching the correct result.

The court rejected affidavits by attorneys purporting to clarify and explain what the original drafting parties could have meant by "in the pipeline." Courts will consider only objectively determinable extrinsic facts and circumstances surrounding the contract's execution that do not vary or contradict the contract's plain language. The instrument was unambiguous and it was within the court's province to determine its meaning. The expert testimony Engler relied on to construe the phrase would impermissibly add words of limitation to modify the deed's terms.

In re Eagleridge Operating LLC[3]

Decided March 11, 2022

Does a former working-interest owner/operator of a well bear continuing responsibility for a defective gas gathering line despite having conveyed its ownership interest? The line was constructed by the former owner as operator of record.

Aruba Petroleum owned a minority working interest in the Donnell 2-H well and was operator of record, for which it received a fee with the consent of the majority working-interest owner, USG Properties Barnett II. As operator, Aruba was responsible for drilling, operating and servicing the well and securing proper equipment. In 2013, while Aruba was a working interest owner and operator, a gas line was installed on the property. Aruba and USG paid their proportionate share of the construction expenses.

Four years later, Aruba conveyed its working interest to USG and ceased serving as operator. Eagleridge Operating subsequently entered into a written contract with USG to serve as operator and assumed control of the well in 2017. (One could assume a Railroad Commission of Texas Form P-4 was on file as well as a Model Form JOA, but the court doesn't say.) A few months later the gas line ruptured and injured Lovern, the plaintiff in the underlying negligence suit.

Eagleridge sought to designate Aruba as a responsible third party, asserting that Aruba, as a prior owner-operator, caused or contributed to Lovern's injuries because Aruba was responsible for installing the gas line, selecting the materials and determining its placement on the property.

Lovern moved to strike Aruba's designation and sought a partial summary judgment. He argued that, under the Supreme Court's opinion in *Occidental Chemical Corp. v. Jenkins*,[4] a former premises owner owes no duty — and has no responsibility — related to the condition of the premises after conveying its ownership. *Occidental* involved a sole owner-operator's improvements. On the other hand, Aruba was not just a property owner — it also received a fee as operator and made improvements in that capacity. Accordingly, said Eagleridge, Aruba had a duty as an independent contractor, and that duty did not terminate when its control over the property ceased.

The trial court granted both of Lovern's motions and the Court of Appeals denied Eagleridge's request for relief. The Supreme Court's review was confined to whether *Occidental* precluded Aruba's responsibility for defects in the pipeline and whether the trial court erroneously struck Aruba's designation as a responsible third party.

The Supreme Court agreed with the lower courts and denied relief to Eagleridge, reaffirming its position that *Occidental* precludes the "dual-role" analysis Eagleridge proposed. A property owner, when making improvements on its own property, acts solely in its capacity as an owner and not as an independent contractor. That analysis is not altered by the fact that USG paid Aruba to operate the well. The core holding in *Occidental* is based on ownership, and the court held that Aruba was a property owner exercising its possessory right to develop its property when it installed the gas line.

Aruba's responsibility for premises defects did not survive conveyance of its ownership interest to USG. Aruba and USG were tenants in common, and each could construct improvements on

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3 642 S.W.3d 518 (Tex. 2022).

4 478 S.W.3d 640, (Tex. 2016).

the property without the other's consent. Aruba's right to construct the pipeline was independent of, did not arise from and was not extinguished by its agreement to serve as operator of record. Aruba's receipt of compensation as operator neither transformed it from an owner into an independent contractor nor materially distinguished the case from *Occidental*.

Mustafa v. Americo Energy Resources LLC[5]

Decided April 12, 2022

Is it worth it for an absentee landowner to devote spending extra dollars, days and windshield time to discover what mischief an oil and gas operator might be making on the property? The landowner-plaintiffs in *Mustafa v. Americo Energy* would certainly say so.

The "discovery rule" offered them no help in their suit against their lessee for negligence when visible soil contamination occurred more than two years before suit was filed and the landowners had not visited the property in over six years. The two-year statute of limitations barred the landowners' claim.

- 2002 and 2004: Mustafa and Lahijani purchase land on which the Bash No. 1 well is located.
- 2002: Americo acquires the 1937-era oil and gas lease on the land.
- November 2008: Bash No. 1 ceases production but oil field equipment remains on the ground, readily visible.
- February 2015: Contents of production tanks are removed but tank bottoms containing sand, oil and saltwater residue remain, leaving a noticeable area of stained soil.
- March 2016: Landowners visit the property for the first time since 2010 and noticed a "white area" around the saltwater tanks near the Bash No. 1. The Railroad Commission orders Americo to treat the soil and remove leftover debris. The RRC informs Americo that the landowner had indicated numerous spills in the past.
- June 2017: Tests indicate the property is contaminated from oil and gas operations.
- October 2017: Landowners sue Americo for negligence and other claims for failure to take the "requisite steps to prevent leaks or pollution to the property once the wells became inactive."

Americo pled the two-year statute of limitations and the landowners pled the discovery rule, asserting that the statute should be tolled because they did not discover the alleged negligence until March 2016.

The trial court granted Americo's motion for summary judgment on limitations. The Court of Appeals reviewed whether Americo met its burden to: conclusively prove when the cause of action accrued and negate the discovery rule.

Generally, a cause of action accrues when a wrongful act causes some legal injury, even if the fact of injury is not discovered until later and even if all resulting damages have not yet occurred. Here, the landowners agreed that no activity on the land could have caused contamination after February 2015, so the injury occurred then, at the latest. Because suit was filed in October 2017, the two-year statute would seemingly bar recovery.

On the other hand, the discovery rule, when applicable, defers accrual of a cause of action until the plaintiff knew — or exercising reasonable diligence should have known — of the facts giving rise to the cause of action. But the rule only applies when the nature of the injury is inherently undiscoverable and the evidence of injury is objectively verifiable. If exercising reasonable diligence would lead to the discovery of the injury, then it is not inherently undiscoverable, and thus the rule does not apply.

The landowners argued that owners like themselves cannot typically learn of contamination within the limitations period. They said they had no reason to visit the property and therefore did not have any way of discovering the issue.

The court found that due diligence requires both visual observation and an inquiry into the lessees' activities. By not visiting their property in over six years, especially with the knowledge that numerous spills had occurred in the past, the landowners failed to exercise due diligence. Had they done so, they would have observed the stained soil left behind in 2015, leading them to

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5 650 S.W.3d 760 (Tex. App. — Houston [14th Dist.] 2022, pet. denied).

investigate further and discover the contamination. The injury caused by Americo's negligence was not inherently undiscoverable, and the discovery rule did not apply.

The dissent believed the majority was incorrect to hold that injuries like these accrue when they occur and visiting the land just 13 months after operations are completed is a failure of the landowner to exercise due diligence. This is an unrealistic expectation for landowners, the justice wrote.

Bachtell Enterprises, LLC v. Ankor E&P Holdings Corp.[6]

Decided May 26, 2022

Nonoperators under the 1989 Model Form JOA have been hoping to drive a stake through the dark heart of *Reeder v. Wood County Energy LLC.*[7] *Bachtell* might be a start. The question was whether the Article V.A. exculpatory clause exonerated the operator that intentionally passed expenses to nonoperators without their consent.

The clause did not allow the operator to engage in such activities. The term "activities" is not so broad as to protect an operator such that it can have no liability for breach of any contract, absent willfulness.

Ankor, the operator, negotiated with CDM to construct a gas plant and told the nonoperators that third-party ownership of the plant would, among other things, "eliminate the need for the [nonoperators] to provide capital for construction."

The nonoperators approved authorities for expenditure for expenses totaling $385,000. Additional AFEs would cover certain other expenses. The JOA required nonoperator consent for "any single project reasonably estimated to require an expenditure in excess of $50,000."

Article V.A. required Ankor to "[c]onduct its activities ... as a reasonably prudent Operator, ... It shall have no liability as Operator ... for losses sustained or liabilities incurred, except such as may result from willful misconduct."

A year after the CDM agreement, Ankor told the nonoperators that until the plant was paid off, CDM would "retain all plant revenue as credit towards the full operating costs, transfer and fractionation fees, and amortized capital. Any balance due [CDM] is born by the Ownership. The balance ... due [CDM] is approximately $1,590,000." Ankor then sent a joint interest billing totaling $1.6 million. The nonoperators refused to pay.

Ankor sued the nonoperators, claiming breach of the JOA for failure to pay the JIBs. Nonoperators responded that Ankor breached first by:

- Charging for gas plant construction without consent.
- Withholding revenue without consent or authority.
- Committing nonoperators' gas to CDM without authority.
- Agreeing not to disclose the CDM service agreement.
- Charging unauthorized attorneys' fees.

The jury found that both Ankor and the nonoperators breached the JOAs but Ankor breached first — and its breach was the result of willful misconduct. Both sides were awarded damages by the jury. The trial court awarded damages and attorneys' fees to Ankor and a take-nothing judgment against the nonoperators.

The exculpatory clause did not absolve Ankor of liability for failing to obtain consent for charges over $50,000. Other clauses were a factor in the holding, for example:

- Imposing individual liability for performance of each party's obligations.

6 651 S.W.3d 514 (Tex. App. — Houston [14th Dist.] 2022, pet. denied).

7 395 S.W.3d 789, (Tex. 2013).

- Prohibiting Ankor from withholding oil revenues to reimburse costs in the absence of a nonoperator delinquency.

In response to Ankor's argument that "activities" should be construed broadly to include even intentional breaches of contract that do not rise to the level of willful misconduct, nonoperators countered that "Ankor's interpretation of the exculpatory provision turns [it] into a provision that allows the operator to impose liability on the Non-Operators when it is intended only to be a shield to the Operator's liability."

The clause was substantially similar to the one in *Reeder* in which the SCOTX held that the term "activities" broadened the scope of the clause to include actions under the JOA beyond operations. (The 1982 form protects the operator's "operations"; the 1989 protects "activities.") In *Reeder* the operator was shielded from liability for his activities.

The appellate court refused to extend *Reeder* to excuse Ankor's willful misconduct. Ankor could not use the exculpatory clause offensively to impose liabilities on nonoperators that Ankor knowingly incurred without consent. The nonoperators were excused from their payment obligations. Judgment for Ankor was reversed.

RKI Exploration & Production LLC v. AmeriFlow Energy Services LLC & Crescent Services LLC[8]

Decided June 23, 2022

At issue in this case were two master service agreements. RKI was the operator of a well in Loving County; AmeriFlow and Crescent were contractors. A sand separator exploded at the wellsite injuring or killing three workers who worked for another subcontractor. The result was three suits in New Mexico and a mazelike series of indemnity demands, denials, settlements and judgments, including settlement of one death case for $9.1 million.

This brief summary highlights the takeaways from a 72-page behemoth of an opinion based on a 10,000-page record.

The court defined a phrase common to master service agreements: "**arising in connection herewith.**" Indemnitees AmeriFlow and Crescent argued that the phrase "encompasses all activities reasonably incident to or anticipated by the principal activity of the MSA, which was oil well operation."

No, it doesn't. The court determined that the phrase requires a causal connection between the MSA and the claims for which the indemnitee sought indemnity. The scope of work envisioned in the MSA was defined by work orders, and the indemnity could go no further than the scope of work.

The court considered the plain meaning of "herewith," referred to the dictionary definition of "arise," and concluded that although "arise" has a broad meaning, it still connotes some causal nexus. If there was no connection between an indemnitee's contract obligations and the indemnity obligation, an indemnitor would be required to indemnify even if performance was not an alleged cause of a loss. There must be a but-for causal connection between the indemnity claim provided for in the contract provision and "something else." What the "something else" turns on is the meaning of "in connection herewith."

The required connection created by the use of "arise" or "arising" was limited by the additional phrase that narrowed the scope of the connection created by the word "arise." That limiting phrase was "in connection herewith." Citing dictionaries, the court concluded that "herewith" means "accompanying this writing or document." The court interpreted "arising in connection herewith" to mean originating from the document or writing in which the obligation is contained. The term is a description of the relationship that a purported indemnity claim must bear to the underlying obligations between the parties.

RKI the indemnitor refused to participate in settlement negotiations, ignored demands for indemnity and refused to enter an appearance in the suit for the indemnitee. This raised the question about whether RKI waived its right to contest defense and indemnity claims because it wrongfully denied those claims. If denial was wrongful, RKI would be bound by the settlement of the underlying suit and unable to insist on adjudication of the indemnitees' rights to indemnity and damages.

The premise of AmeriFlow and Crescent's argument was that when an indemnitor denies its obligation, the indemnitee has the right to make a good faith and reasonable settlement with the injured party without judicial ascertainment of liability. Here, whether RKI wrongfully denied indemnity was not established. An indemnitor may not be held liable for an indemnitee's purely voluntary payment to an injured party. The indemnitees assumed the risk of being able to prove the facts that might have made them liable to the plaintiff as well as the reasonableness of the amount they paid.

SM Energy Co. v. Union Pacific Railroad Co.[9]

Decided June 23, 2022

The question before the court was: When is a suit a trespass to try title and not a declaratory judgment action?

SM Energy and Union Pacific are parties to three oil and gas leases covering lands in Howard County. Each lease contained the same

8 No. 02-20-00384-CV, 2022 WL 2252895 (Tex. App. — Fort Worth June 23, 2022, no pet.) (mem. op.).

9 652 S.W.3d 830 (Tex. App. — Eastland 2022, no pet. h.).

forum-selection clause providing for exclusive venue in "Omaha, Nebraska and no other place."

Union Pacific demanded that SM pay damages for breaching the leases. SM failed to pay in time but later tendered the damages and identified other leases in violation of a most-favored-nations clause. Union Pacific eventually accepted tender of SM's offer but maintained that SM owed more than $5 million in liquidated damages.

SM sued Union Pacific in Howard County asserting that SM is the owner of the leasehold estate and that Union Pacific had unlawfully dispossessed SM of its right to possession. Union Pacific responded with a motion to dismiss for improper venue, arguing that Omaha was the proper forum, citing the forum-selection clause and Texas' "major transactions" venue rule.

The trial court granted Union Pacific's motion. SM appealed and argued that the trial court erred in enforcing the forum selection clause and erred by finding that Nebraska was a proper forum to litigate the dispute.

The Court of Appeals affirmed. SM asserted that its trespass to try title action could only be litigated in Texas; therefore, a Texas court should have exclusive subject-matter jurisdiction. The court considered the *substance* of SM's petition and saw a claim for declaratory judgment to determine SM's obligations, not trespass-to-try-title. SM pleaded certain elements of trespass to try title but its claims of dispossession were, in substance, dependent on an initial determination that the liquidated damages provision was unenforceable.

Second, the court disagreed that SM's claim was a suit to remove a cloud on title. SM could not show that Union Pacific's claim was invalid or unenforceable, which is a prerequisite to a suit to remove a cloud on title.

Third, the court disagreed with SM's contention that enforcement of the forum selection clause would violate Texas' public policy against piecemeal litigation. For all intents and purposes, the claimant was Union Pacific because Union Pacific is the party asserting that SM breached the leases.

The trial court also erred by finding that Nebraska was a proper forum to litigate the dispute. The 640-acre lease met the requirements of a "major transaction" as described by the Civil Practice and Remedies Code § 15.020. This question turned on whether the lease evidenced consideration exceeding $1 million for purposes of the statute. The lease failed to state consideration exceeding $1 million, but related documents could be considered as evidence of a major transaction. One week after execution of the lease, Union Pacific confirmed to SM's predecessor-in-interest that the original lessee paid Union Pacific a lease bonus of $2.4 million. The court considered the confirmation as a separate instrument that was executed at the same time, for the same purpose and in the course of the same transaction such that the documents could be analyzed together.

This case shows us that:

- Courts will look to the substance, not the form, of a party's pleadings to determine whether a claim is for trespass to try title or declaratory judgment.
- When the issue of dispossession of title is secondary to the determination of the breach or enforceability of a contract, courts may find the case to be for declaratory judgment, not trespass to try title action.
- The lease and separate documents reflecting payments that relate to the lease may be construed together for purposes of establishing the value of the lease.

Fort Apache Energy Inc. v. Short OG III Ltd. (In re Aztec Oil & Gas Inc.)[10]

Decided July 21, 2022

Texas law does not allow an oil and gas lessee to rely on a co-tenant's production to extend the term of the lease. Fort Apache and Short *et al.* owned competing leases on 112 acres in Tyler County. The Southern Star lease expired because Fort Apache did not operate on the land during the primary term and could not rely on its lack of operations to extend the lease. Fort Apache testified that it was not economically viable to drill its own well on already developed land and it had no intention to develop the lease. The fact that an operation is uneconomical is not a reason to justify a lack of production. As co-tenant, Fort Apache had equal rights and access to produce.

Fort Apache argued without success that Short *et al.* lacked standing to challenge a motion for summary judgment on expiration of the Southern Star lease because they were not third-party beneficiaries or contracting parties. Their standing was derived from their defense against Fort Apache's trespass claim.

A co-tenant has the right to possess land to extract minerals and only owes an accounting of the proceeds less reasonable costs in production and marketing. Short *et al.*, as owners of a competing lease, did not trespass because they were co-tenants. Fort Apache's trespass claim failed because it did not offer evidence to show that Short *et al.* dispossessed it from the land.

A lessee who never intends to drill a well cannot rely on its lessor's repudiation of an oil and gas lease.

In this limited space we will try — suboptimally — to do justice to the maze of facts and events behind this ruling. Let's just say, generally speaking, the following happened:

10 No. H-17-1252, 2022 WL 2905373 (S.D. Tex. July 21, 2022).

Hranivitz Sr. and McBride each owned half of the land and signed competing leases. People died. Their descendants and successors signed some leases and ratified others, some with authority and some without, some timely and some not. More people died, leading to a legal tug of war over who had lawful title to the property and the right to dispose of it — the administrator of the estate or the testamentary trustee.

Fort Apache sued alleging seven assorted causes of action. Short *et al.* counterclaimed.

Aztec — the working interest owner with Short *et al.* filed for bankruptcy. The working interest owners' counterclaims and third-party claims were still pending in a bankruptcy adversary proceeding.

The bankruptcy court issued an opinion that the Southern Star lease was superior to the Miller lease and ratification of the Miller lease was void, but at the time, the prevailing lease might have expired.

Short *et al.'s* claim for expiration of the Southern Star lease prevailed. Because Fort Apache never conducted operations on the lease after trying and failing to negotiate a joint development agreement with Short *et al.*, the lease expired. Fort Apache's partial summary motion was denied.

The takeaway from this case is that operations by the lessor of a co-tenant will not extend another oil and lease covering the same land beyond the primary term.

City of Dallas v. Trinity East Energy LLC[11]

Decided Aug. 1, 2022

During the height of the Barnett Shale drilling boom, the city of Dallas identified a potential site for gas exploration and issued an RFP to lease several thousand acres owned by the city.

Trinity won the bid and determined the City owned an additional tract in the area —Radio Tower. Trinity insisted the Radio Tower tract be included in the lease.

The city agreed to include Radio Tower and another tract — the Gun Club tract — in the lease but only as proposed drillsite locations.

Trinity began preparations for drilling and obtaining the necessary permits, including special use permits, from the city. Trinity submitted applications for SUPs for Radio Tower, Gun Club and another private tract, Luna South. The applications were filed correctly and in accordance with applicable laws. After a lengthy delay, the city denied Trinity's SUP applications. The city's attorney contacted Trinity regarding other drillsites, but none of those sites was feasible — one was underwater, the landowner of another would not agree to drilling and others were too remote. Trinity lost a subsequent appeal of the SUP denial.

The city then amended the gas drilling ordinance and imposed restrictions that effectively precluded drilling on the lease. The lease subsequently expired and the interest reverted to the city.

Trinity sued the city on several causes of action, including breach of the lease, statutory fraud, negligent misrepresentation and regulatory taking. Trinity presented evidence at trial that the fair market value of Trinity's leases that could be developed from the three drillsites was $26,580,000 to $40,698,000 before denial of the SUPs. It also presented evidence that after denial of the SUPs, the property was worth nothing and the lease expired.

At trial, the jury did not find that the city breached the lease, but did find that the city committed statutory fraud and negligent misrepresentation and awarded damages. Over the city's objection, the trial court submitted the question of the fair market value of Trinity's property before and after denial of the SUPs to the jury. The jury found the fair market value of Trinity's property before the denial of the SUPs was $33,639,000 and zero after the denial. The trial court determined that the city committed a regulatory taking by failing to approve the special use permits and awarded Trinity compensation in the amount of $33,639,000. The trial court signed findings of fact and conclusions of law in connection with its regulatory taking findings. The city appealed the fair market value/expert rulings and the regulatory taking finding.

To comprehend the regulatory taking ruling, one must understand a few constitutional law precepts. The Texas Constitution states, "No person's property shall be taken, damaged, or destroyed for or applied to public use without adequate compensation being made, unless by the consent of such person." Inverse condemnation is "a cause of action against a governmental defendant to recover the value of property which has been taken in fact by the governmental defendant, even though no formal exercise of the power of eminent domain has been attempted by the taking agency." To plead a claim for inverse condemnation, the claimant must allege an intentional government act that resulted in the uncompensated taking of his property.

The city argued there was insufficient evidence to support the trial court's finding that its denial of the SUP's constituted a regulatory taking. The city argued that Trinity still had beneficial use of its property because Trinity had other drillsites from which it could access some of the leased acreage. Trinity produced evidence that the best way to maximize the value of its interest was to use the Radio Tower, Gun Club and Luna South tracts as drillsite locations — this was the reason

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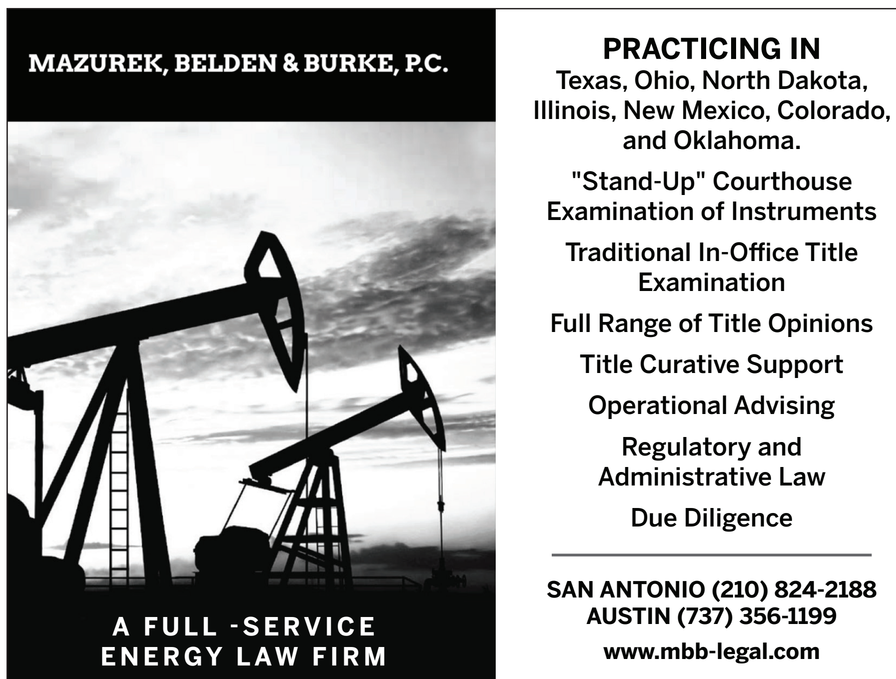
11 No. 05-20-00550-CV, 2022 WL 3030995 (Tex. App. — Dallas Aug. 1, 2022, no pet. h.) (mem. op.).



Trinity demanded the three sites be included in the final lease and the city agreed to include them.

The city also argued that Trinity could have drilled on other tracts in Irving and Farmers Branch to access the leased acreage. However, the city produced no evidence that those drillsites provided reasonable or economically viable access to Trinity's minerals. Trinity produced expert evidence that using those sites would require complex drilling and excessively long wellbores.

The city further argued that Trinity could have sought SUPs for different sites but did not identify any evidence that Trinity would have been able to obtain SUPs from the city for other sites that would have permitted Trinity to reasonably and economically develop its interests.

The Court of Appeals affirmed the trial court's finding that, other than the three sites proposed in the SUPs, Trinity did not have reasonable access to locations from which it could economically develop its mineral interests. Therefore, the city's denial of the SUPs resulted in a regulatory taking.

There were significant evidentiary rulings at trial that were upheld by the appellate court. The city argued that Trinity's expert's testimony on market value was unreliable and therefore the evidence was insufficient to support the jury's value findings.

The court found that the expert's testimony regarding value using the "proposed units" method was sufficient. The expert opined on the value of the acreage Trinity had under lease at the time of the taking and offered different valuation scenarios. Because Trinity presented evidence that lessors are motivated to consent to units if those units are necessary to develop minerals, the expert's testimony regarding proposed units was sufficiently supported.

The court also found that the expert's testimony regarding value using the "comparable sales" method was sufficient. The expert opined regarding comparable sales from other counties. This testimony was appropriate because the comparable sales included acreage with similar thickness as the city acreage. "Comparable sales need not be in the immediate vicinity of the subject land, so long as they meet the similarity test," the appellate court wrote.

Finally, the court found that the expert's "discounted cash-flow" analysis was sufficiently certain. "When comparable sales are not available or inadequate as a measure of market value, other methods may be used to estimate fair market value," the court wrote. The expert opined on estimated future production, future prices and estimated costs of production to calculate the net income for the property. Importantly, the expert used publicly available price forecasts for his calculations. "[W]hen evidence of potential profits is used to prove the market value of an income-producing asset, the law should not require greater certainty in projecting those profits than the market itself would," the court found. While there was conflicting evidence regarding whether Trinity's interests would be productive, resolving those conflicts was for the jury.

The city argued the trial court abused its discretion by submitting fair market value questions to the jury before the court determined there had been a regulatory taking. The city argued the issues should have been bifurcated. The trial court has discretion to bifurcate and properly decided against bifurcation given the potential for unnecessary and considerable repeating of evidence.

Not included in this summary is a detailed jurisdictional analysis regarding interlocutory appeals and final judgments that would be of interest to appellate nerds — as they jovially refer to themselves — but to no one else.

Yates Energy Corp. et al v. Broadway National Bank, Trustee[12]

Decided Aug. 3, 2022

Recall *Broadway National Bank, Trustee v. Yates Energy Corp.* in which the Texas Supreme Court ruled that execution of the 2013 amended correction mineral deed by the parties to the original 2005 mineral deed and the 2006 correction mineral deed, without joinder of the current owners of the minerals, complied with Texas Property Code §5.029. The question remaining was whether the current owners were a bona fide purchaser for value without notice. Skipping rulings on side issues, the result is that current owner Yates was not a BFP. Other appellants survived to fight another day.

Yates et al. acquired their interests in the minerals before execution of the 2013 deed. But in 2006, Broadway sent Yates recorded copies of the 2006 deed, which recited that the 2005 deed had conveyed interests to John Evers in fee simple by oversight, that the conveyance should have been limited to a life estate and that specific individuals owned remainder interests.

Yates' concession that it received the 2006 deed before it acquired its interest satisfied Broadway Bank's threshold summary judgment burden that Yates had received actual notice of the claims. The burden shifted to Yates to present evidence raising a genuine issue of material fact about whether it had actual notice. Yates argued:

- Actual notice is a question of fact, not of law. The court concluded there was no room for reasonable minds to differ about whether Yates received actual notice.
- Actual notice would not defeat its BFP defense because the 2006 deed was ineffective and unenforceable and notified Yates only of an alleged mistake that had never been proved or properly corrected. The court declined to hold that an invalid correction instrument is wholly ineffective to impart notice on the subsequent purchaser. The validity of the remainderman's claimed interest was irrelevant to whether Yates had notice of that claim. Yates did not raise a genuine issue of material fact about whether the deed's factual recitations were "sufficient to excite the suspicions of a person of ordinary prudence."
- Only a correction instrument that complies with § 5.029 could defeat a BFP defense. Not so; a purchaser who acquires property with constructive or actual notice of a potential third party claim cannot successfully assert a BFP defense. It didn't matter that the recording of the 2006 deed was insufficient as constructive notice because it was outside Yates' chain of title. Yates received actual notice.
- Evers as holder of a life estate could sell the property in fee simple as long as he held the proceeds for the remaindermen. But Evers did not have unlimited power to dispose of the fee estate, and there was no evidence that Evers held the proceeds for the remainderman.

Broadway conclusively showed that Yates received actual notice of the remainderman's claim, and Yates presented no evidence that raised a genuine issue of material fact. The court affirmed the probate court judgment that Yates was not entitled to protection as a BFP.

While Yates could pass no greater interest than it owned, that general rule applies only if the grantee fails to show himself to be a BFP. There was no evidence that appellants Jalapeño Corp., Glassell Non-Operated Interests Ltd., and Curry Glassell — assignees of Yates — received actual notice of the facts in the 2006 deed. A subsequent purchaser is only deemed to have constructive notice of recorded documents within its direct chain of title. Jalapeño and the Glassell party's chain would not have included any instruments executed by Broadway after it conveyed the property to Evers. Broadway did not show as a matter of law that Jalapeño or Glassell had constructive notice of the remainderman's claims.

Broadway and ACG3 Mineral Interests — an assignee of Yates — and Glassell Nonoperating all filed competing motions for summary judgment. The evidence and appellants did not conclusively establish either the BFP defenses or that those appellants had actual or constructive knowledge of the remainderman's claims. Summary judgment for Broadway against ACG3 and Glassell Nonoperating was reversed.

Broadway and EOG also filed competing motions for summary judment. The evidence did not conclusively establish that EOG had actual knowledge of the 2006 deed when it acquired its interest in the minerals. A fact issue remained on that subject.

On an interesting evidentiary point, EOG submitted an affidavit from an EOG landman asserting that EOG acquired Evers' interest without notice. The court determined that the affidavit was not conclusive proof of the fact. Nevertheless, summary judgment against EOG was reversed.

The result of it all is that Yates was divested of its interests in the minerals. It's back to the probate court for the other parties. More likely, it's on to the Supreme Court for another round of appeals.

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12 No. 04-17-00310-CV, 2022 WL 3047107 (Tex. App. — San Antonio Aug. 3, 2022, no pet. h.) (mem. op.).

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Enervest Operating LLC v. Mayfield and Ingham[13]

Decided Sept. 28, 2022

The 4th Court of Appeals harmonized a market-value-at-the-mouth-of-the-well royalty clause and a free use provision to conclude that the royalty owners must bear their share of fuel gas, which the court deemed to be a postproduction cost.

The common thread throughout the myriad oil and gas royalty cases decided recently by Texas courts could be "harmony" — the reading of different, seemingly conflicting, contract provisions so as to give meaning to all.

Gas royalties were to be paid on "gas ... produced ... and sold or used off the premises, ... the market value at the mouth of the well of one-eighth of the gas."

The free use provision allowed the lessee to have "free use of ... gas ... from said land ... for all drilling operations hereunder, and the royalty shall be computed after deducting any so used."

Enervest used some of the gas sent downstream for sale as fuel gas to power compressors and dehydrators and did not pay royalty on that gas. Lessors asserted that Enervest improperly deducted this fuel gas from their royalties. Enervest responded that the market-value-at-the-mouth-of-the-well provision requires the lessors to bear their share of PPCs, including fuel gas, as a matter of law.

The Court of Appeals concluded that "market-value-at-the-mouth-of-the-well" has a commonly accepted meaning in the industry that identifies the location for the calculation of royalties and requires royalty owners to share the burden of PPCs.

The court deemed fuel gas to be a PPC because it is used to facilitate the production of gas that is sold and contributes to the material enhancement of the value of the gas. The trial court judgment for lessors was reversed. According to the court, the trial court's judgment was based on an "isolated reading of the free use clause" that ignored the plain language of the royalty clause requiring that royalty be based on market value at the well.

The court denied lessors' argument that Enervest's predecessors paid royalty on fuel gas and therefore Enervest must do the same. When a contract is unambiguous, estoppel as a result of past conduct of the parties has no application.

The court found a difference in the free use language in *Bluestone v. Randle* "in all operations hereunder" compared with the language in the case at bar "for all drilling operations hereunder" and did not find *Bluestone* to be instructive.

The court did not accept lessors' comparison of the oil royalty clause — which states specifically that the lessor shall bear its proportion of oil treating expenses — to the gas royalty, which does not have language specifying that the gas royalty must not bear PPCs. Such a reading would ignore the gas royalty provision's express language.

HONORABLE MENTIONS

Foote and Cypert v. Texcel Exploration and Decker[14]

Decided Jan. 10, 2022

This case determined that cattle loitering uninvited around a well and tank battery and causing destruction are trespassers, not licensees.

Foote arranged with Yates to graze 650 head of cattle on Yates' pasture and paid Cypert to take care of them. Texcel operated the Hertel oil and gas lease on the property. Decker was Texcel's pumper. The lease did not require Texcel to fence off the property or its equipment. A one-wire electric fence surrounded the wellsite and tank battery to protect the premises from, you guessed it, wandering cattle. If the wire fell to the ground or hit brush or other material, it would ground out and no longer be "hot."

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13 *No. 04-21-00337-CV,* 2022 WL 4492785 (Tex. App. — San Antonio Sept. 28, 2022, no pet. h.) *(mem. op.).*

14 640 S.W.3d 574 (Tex. App. — Eastland 2022).

There was conflicting testimony about who did or did not do what to cause the bovine incursion. In short, 300 cattle — no doubt drunk on hydrocarbon fumes — pushed over the fence and broke a PVC pipe, spilling saltwater and oil on the ground. In total, 132 perished from drinking oil and others were under their expected weight at sale time.

Foote and Cypert sued Texcel and Decker for failure to construct and maintain an adequate fence around the wellsite and tank battery, which created a dangerous condition that proximately caused the death and injury of cattle. The theories were premises liability and negligent undertaking.

In order to recover against a mineral lessee/operator for injury to cattle, an owner or lessee of the surface must obtain a jury finding on one of the following:

- The lessee/operator intentionally, willfully, or wantonly injured the cattle.
- The lessee/operator used more land than was reasonably necessary for carrying out the purposes of the lease, and as a result of some negligent act or omission, they proximately caused injury to the surface owner's cattle.

The plaintiffs did not meet this burden. Their failure was in ignoring these requirements and seeking to expand the law to the same standards for protecting people from a premises defect. Plaintiffs contended that because Foote was in business with Yates and the landowner (Yates leased the property), his status extended to his cattle on the entire premises, including the area where Texcel operated. The evidence established that the cattle did not have the status of invitees on the area of Texcel's operations. The premises liability theory concerns the duty an owner or occupier of land owes to a person injured on the property.

By denying the cattle were licensees, the jury essentially determined that the cattle were trespassers. There was abundant evidence for this conclusion. Texas has never categorized livestock as people for premises liability purposes. The rule likens wandering cattle and other domestic animals to trespassers upon the legitimate area of oil and gas operations.

The plaintiffs pursued other arguments without success, including that the cattle were poisoned in an area where they were undisputedly invitees. In Texas, however, an operator has no duty to fence or otherwise protect or prevent livestock from entering the premises of a mineral lease. Tercel was not liable for the fluids deposited outside its legitimate area of operations because the cattle caused the fluids to escape.

The plaintiffs also contended that the fence was inadequately maintained. Because there was no duty in the first place, the inquiry was whether the defendants acted in a way that required imposition of a duty where one would not otherwise exist, which the plaintiffs failed to prove.

Anne Carl v. Hilcorp Energy Co[15]

Decided Nov. 30, 2021

This postproduction cost case came too late to be included in last year's report but deserves attention. Is a Texas lessee allowed to deduct gas used by the lessee off the lease premises from the lessor's gas royalty? The answer was "yes" based on the language in the oil and gas lease at issue.

THE LEASE PROVISIONS

Gas royalty owners brought a class action in the U.S. District Court for the Southern District of Texas alleging underpaid royalties on two wells. Paragraph 3 of the lease addresses gas royalty and free use of gas:

- "The royalties to be paid by lessee are … **on gas** … 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 well** of one-eighth of the gas so sold or used."
- "Lessee shall have free use of oil, gas … from said land … for all **operations hereunder**, and the royalty on oil, gas and coal shall be computed after deducting any so used."

Hilcorp did not pay royalty on gas used off the lease premises. Plaintiffs alleged that the royalty clause requires royalty to be paid on any gas used off the premises and that, even absent the royalty provision, the free use clause independently and expressly allows gas to be used only on the lease premises, so royalty must be paid for gas used off the premises.

Hilcorp responded that the market-value-at-the-well valuation means that royalties need not be paid on gas used off the premises that increases the value of the raw gas in preparation for downstream sale. The "off-lease use" and "free use" provisions do not change this structure.

The court reviewed the seminal Texas PPC cases *BlueStone v. Randle*, *Heritage*, *Burlington Resources*, *French* and the Mississippi case *Piney Woods*. When the location for measuring market value is "at the well," market value may be estimated by subtracting from proceeds of a downstream sale PPCs incurred between the well and the point of sale. Because these costs add value to the gas, backing out the necessary and reasonable costs between the sales point and the wellhead is an adequate approximation of market value at the well. Therefore, for gas that is subsequently treated, processed and transported for sale at a remote location, necessary and reasonable

15 2021 WL 5588036 (S.D. Tex. 2021).

value enhancing PPCs are properly deducted from the royalty calculation.

GAS ROYALTY

Applying that methodology, the court found that reasonable and necessary PPC's may be deducted from the royalty calculation. As the Texas Supreme Court explained in *Burlington Resources*, the term postproduction cost generally applies to processing, compression, transportation and other costs expended to prepare raw oil or gas for sale at a downstream location. The lease in this case did not define "postproduction expenses" in any unique way. The complaint as much as acknowledged the standard arrangement. The court concluded that these "off-lease" uses are PPC's that are properly excluded from the royalty calculation.

The court agreed with Hilcorp that despite that free use was only for on-lease operations, Hilcorp was not precluded from deducting gas used as fuel or in-kind payment for postproduction services in this market-value-at-the-well lease. The court determined that under Texas case law, the market-value-at-the-well provision is the critical clause. The court interpreted Paragraph 3 as a matter of law and determined that Hilcorp was entitled to deduct reasonable and necessary value enhancing PPCs.

For a case with similar language decided by a different Southern District judge, see Fitzgerald, Trustee v. Apache Corp.[16]

The result was the same but was achieved by different reasoning.

CONCLUSION

We hope this article will help you address the legal issues presented by modern oil and gas activities. As always, if you believe one of these decisions might have a bearing on an action you are about to take or a decision you might make, consult a lawyer.

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16 2021 WL 5999262, Dec. 21, 2021 (S.D. Tex. 2021).