Top Ten Texas Oil and Gas Cases of 2018 – Part 1 of 3

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For the next three months, we will discuss, in chronological order, significant oil and gas decisions from state courts in Texas during 2018. It is not intended to be a strict legal analysis, but rather a useful guide for landmen in their daily work. Therefore, a complete discussion of all legal analyses contained in the decisions are not always included.

1. *ConocoPhillips Co. v. Koopmann*, 547 S.W.3d 858 (Tex. 2018) (March 23, 2018)

In this case, the Texas Supreme Court rejected ConocoPhillips' claim that standard term NPRI reservations violate the Rule Against Perpetuities. In 1996, Lois Strieber sold 120 acres to Lorene Koopman, reserving a 15-year one-half NPRI which could be extended "as long thereafter as there is production in paying or commercial quantities." The 15-year term ended on December 27, 2011. Lorene Koopmann later gifted two-thirds of her undivided interest to her two children. She then executed an oil and gas lease in 2007 which had a three-year primary term and an option to extend the primary term two additional years for $24,000. Burlington subsequently tendered this payment to the Koopmans, thus extending the primary term to October 22, 2012. Despite pooling activity and Strieber's conveyance of a 60% interest in her NPRI to Burlington, a well site within the pooled unit was not yet producing any oil or gas. Production began in February 2012, which was two months after the expiration of Strieber's 15-year term NPRI. Prior to the expiration of the 15 year term, Burlington sent a letter to Koopmann indicating that it had a identified a well location, and along with the letter, paid "shut-in royalty payments" to the Koopmans in an effort to perpetuate the NPRI beyond its 15 year primary term. A dispute later arose as to whether the well was *capable* of producing in paying or commercial quantities as of December 27, 2011 (the NPRI's date of termination). Royalty payments were suspended, and a lawsuit ensued.

Burlington asserted the Koopmans' future interest in Strieber's NPRI violated the Rule Against Perpetuities and was therefore void. The basis for this argument was that the phrase "as long thereafter" within the reservation created a springing executory interest in favor of the Koopmanns that was not certain to vest within the period required by the Rule (21 years after the death of some life or lives in being at the time of conveyance). The Texas Supreme Court disagreed and held that Strieber actually conveyed a future interest to the Koopmanns that "vested" immediately, and therefore did not violate the Rule for two reasons:

(1) The Court strictly adheres to the rules of construction that courts should construe instruments equally open to two interpretations as valid rather than void, and that the Legislature requires courts to reform an interest that violates this Rule to effect the ascertainable general intent of the creator of the interest; and

(2) Modern scholarship supports construing the Rule based on its purpose and intent and avoiding its application when, like in the present case, doing so would not serve the Rule's purpose.

This modern approach is particularly appropriate because restraints on alienability and promoting the productivity of land is not an issue in the context of oil and gas. Because the court reasoned that Strieber reserved the NPRI for a limitation certain to occur at some point (i.e. for 15 years and as long thereafter as there is production in paying or commercial quantities), the Koopmanns' interest was more akin to a vested remainder (and not a springing executory interest) when it was created. Therefore, the court held that—in the context of a NPRI reservation—where 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.

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Having found that Koopmann's interest did not violate the Rule, the Court still had to address whether the savings clause perpetuated the NPRI beyond its term. Since no well was actually producing on December 27, 2011, Strieber's interest in the NPRI could continue beyond that date only if the savings clause's three requirements were satisfied: (1) there was a lease on the premises; (2) the lease was maintained in force and effect by payment of "shut-in royalties or any other similar payments made . . . in lieu of actual production"; and (3) there was a well "capable of producing oil, gas, or other minerals in paying or commercial quantities," but which is shut in "for lack of market or any other reason." The Court affirmed the appellate court's holding that "or any other similar payments made" was ambiguous as a matter of law. Therefore, there were unresolved fact issues as to whether Burlington's payment of "shut-in" royalties (later couched as delay rental payments on appeal) extended the term NPRI which necessitated remand to the trial court.

Burlington also unsuccessfully argued that Section 91.402 of the Texas Natural Resources Code barred Koopmanns' breach-of-contract claim and served as their exclusive remedy. That statute requires lessees to make royalty payments within 120 days after the end of the month of first sale of production, but it also allows a lessee to withhold royalty payments without interest when there is "a dispute concerning title that would affect distribution payments." Section 91.404(c) gives royalty owners a statutory cause of action for nonpayment of royalties and interest. Burlington argued the Texas Legislature intended royalty owners' cause of action for failure to pay royalties under Section 91.402 to be exclusive. Again, the Court disagreed with Burlington and held that the statute did not contain the requisite express "clear repugnance" to statutorily abrogate the Koopmanns' common-law cause of action based on the terms of their lease. Therefore, the Koopmanns were free to pursue that breach-of-contract claim.

2. *Endeavor Energy Resources, L.P. v. Discovery Operating, Inc.*, No. 15-0155, 2018 WL 1770290 (Tex. Apr. 13, 2018).

Endeavor Energy Resources, L.P. v. Discovery Operating, Inc. is yet another retained-acreage case decided by the Texas Supreme Court this year. The facts were as follows: Endeavor acquired oil and gas leases covering a 640-acre tract and the north half of an adjoining 640 acre tract to the south. The leases contained retained acreage clauses and Endeavor drilled four wells on the leases. The two wells drilled on the 640 acre tract were both located in the southeast quarter of the section. The two wells drilled in the north half of the adjoining tract were both drilled in the eastern portion of that half section. After completing the wells, Endeavor filed certified proration plats with the Texas Railroad Commission ("RRC"). The plats designated approximately 81 acres for each well encompassing a total of 320 acres (two quarter sections where the wells were actually located).

After Endeavor's leases' primary terms expired, Patriot Royalty and Land, LLC reviewed the leases and proration plats Endeavor filed with the RRC and concluded that Endeavor's leases terminated as to the northwest quarter of Section 9 and the southwest quarter of Section 4. Patriot then obtained leases on that acreage and later assigned them to Discovery. Discovery then drilled producing wells on that acreage, which led to the lawsuit.

When Endeavor learned that Discovery had drilled wells on the tracts, it objected to Discovery's assertion of any leasehold interest. Relying on the retained acreage clauses, Discovery asserted that Endeavor's leases had expired as to the lands outside the 81-acre proration units Endeavor formed at the RRC. In response, Endeavor argued that it retained *160* acres around each well because the leases'

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references to "maximum producing allowable" meant that each proration unit automatically consists of the greatest amount of acreage permitted per RRC rules.

At the time, the RRC's rules for the Spraberry (Trend) Area allotted 80 acres to a proration unit with an additional 80 acres of "tolerance acreage" at the operator's election. The Spraberry field rules required operators to file certified plats describing their proration units. The leases' retained acreage clauses stated, "[this] 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." The Texas Supreme Court concluded that the leases' use of "assigned" referred to the lessee's assignment of acreage through its regulatory filings.

Focusing on the specific lease language, the court agreed with Discovery that the retained acreage clauses required the operator to file a plat assigning only the amount of acreage necessary to obtain the maximum producing allowable as determined by the applicable field rules, which in this case was 80 acres. To retain 160 acres, Endeavor needed to actually assign 160 acres to each well, which it did not do. Having met the threshold requirement for compliance with the field rules, Endeavor retained "exactly what it bargained for: approximately 81 acres per well."

Notably, the court further indicated that "[a]lthough such an assignment would hypothetically raise each well's maximum producing allowable, when productive acreage is a component of the maximum producing allowable—as it is here—the operator must verify that additional acreage is actually necessary or required to achieve the maximum allowable" or it may "open itself up to claims that it is not acting in good faith in purporting to retain a substantially greater amount of acreage."

3. *XOG Operating, LLC v. Chesapeake Expl., Ltd. P'Ship*, No. 15-0935, 2018 WL 1770506 (Tex. Apr. 13, 2018).

This case is a companion to the Endeavor Case discussed above. Like in *Endeavor*, the Court wrestled with how much acreage was retained by a retained acreage clause. Here, the retained acreage clause in a term assignment from XOG Operating to Chesapeake stated Chesapeake would keep the leased acreage within the proration or pooled unit of each drilled well. However, the assignment contractually defined "proration unit" to include the boundaries of a proration unit "then established or prescribed by field rules." The Commission's field rules for the Allison–Britt Field applied. A "prescribed" proration unit under the Allison-Britt Rules was 320 acres per well.

Chesapeake filed its Form P-15 for each well and assigned proration units totaling 800 acres. XOG Operating sued Chesapeake after Chesapeake refused to release or reassign any acreage to XOG. Each side moved for summary judgment. XOG argued that the disputed acreage was not retained by Chesapeake pursuant to the term assignment's retained acreage provision because Chesapeake failed to "assign" that acreage to a proration unit in its P-15 filings. Chesapeake argued that it retained 320 acre units as "prescribed by field rules."

The same principles applied in *Endeavor* were applied in this case, but this time with a different result based on the alternative language in the retained acreage clause. The Court acknowledged that although retained acreage provisions are based on regulatory filings and rules, they are fundamentally contractual in nature and parties to these clauses are presumed to know the law and to have stated their agreement in light of it.

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The Court held that acreage "included within the proration unit for each well … prescribed by filed rules" referred to acreage set by the field rules, not acreage "assigned" by the operator (like in *Endeavor*). At the time, the field rules defined a "prescribed" proration unit as 320 acres for the Allison–Britt Field. Therefore, under the retained acreage provision's language, Chesapeake retained 1,920 acres for its 5 wells drilled—not just 800 acres. The court distinguished *Endeavor* from this case in that the field rules in *Endeavor* referred to assignments by operators claiming acreage. The field rules in this case referred to "assigned" acreage as well, but unlike the rules in *Endeavor*, the rules here also "prescribed" proration units.

STAY TUNED….

Next month, we will discuss three more cases that may have an impact on your daily work. We hope this series 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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