Top Ten Texas Oil & Gas Cases of 2020 – Part 2 of 3

By: Ryan Sears and Rusty Tucker, Gray Reed

This is a continuation of the three-part series that began last month discussing significant oil and gas decisions from state courts in Texas during 2020. 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.

***4. Mayo Found. For Med. Educ. & Research v. BP Am. Prod. Co.*, 447 F. Supp. 3d 522 (N.D. Tex. — Amarillo [7th Dist.] March 20, 2020, no pet.)**

Mayo Foundation Medical Education & Research was the successor lessor under an oil and gas lease that included Section 157 in Robert County, among other lands. The lease reserved a veto power in the lessor over any assignment of the lessee's interest in the lease. The third amendment of the lease, executed by Mayo and its lessee on May 29, 1998, replaced the original consent-to-assign clause with the following clause in Paragraph 7:

The rights and obligations of the Lessee hereunder are not assignable or transferable in any respect by it, except upon the written approval of Bank One Trust Company, N.A., as Agent, or any successor Agent, which approval shall not be unreasonably withheld.

BP America Production Co. succeeded to the leasehold interest in the lease. BP and Latigo Petroleum finalized a purchase and sale agreement for lands including Section 157 in September 2019. However, pursuant to a 1996 operating agreement with Courson Oil & Gas, Inc., BP was first obligated to offer the interest in Section 157 to Courson, which Courson accepted. Mayo opposed the transfer due to its past business dealings and litigation with Courson and threatened to withhold approval. In January 2020, BP notified Mayo that Courson had elected to acquire BP's rights in Section 157 (they intended to close over the "soft consent"). Mayo filed a complaint, a motion for temporary restraining order (which was denied without prejudice), and a motion for a preliminary injunction. The appeal focused on the injunction.

The court was presented two primary questions: Given Texas' strong presumption against restraints on alienation of property and the presumption that an oil and gas lessee may freely assign its interests, the court had to decide if it should even recognize Paragraph 7 as enforceable; and if Mayo may validly withhold consent to assign, was such a refusal to consent "reasonable" in the case with Courson. In short, the consent-to-assign paragraph was valid but Mayo's refusal to consent was unreasonable.

The court relied upon the first restatement of property law to reach the conclusion that the consent to assign provision was valid and enforceable, which left the question of whether Mayo was reasonable in its refusal to consent.

The court lamented that there was essentially no case law guidance in Texas on what constitutes "reasonableness" in this context. To answer the question, the court looked to other jurisdictions, restatements, treatises and law review articles to establish the following factors to help it determine whether it was "reasonable" for a lessor to refuse to consent to the assignment of an oil and gas lease: assignee's solvency and track record on making timely royalty payments; assignee's industry reputation for honesty and reliability; assignee's prior working relationship with lessor; assignee's capacity to operate the leasehold in an efficient manner; whether assignee is a "lease flipper" that will not develop the property; and whether assignee would increase the number of non-cost-bearing interests on the property, such as overriding royalties and production payments.

Reviewing the briefing before it, the court found that Mayo presented no evidence that Courson failed to timely pay royalties and no evidence of malfeasance that tended to undermine Courson's reputation for honesty or reliability. To the contrary, the record indicated that Courson was an established and capable operator with active operations in the area.

In identifying factors to help it determine whether or not Mayo's refusal to grant consent was reasonable, it noted that at least one commentator has argued that a lessor may "reasonably" withhold consent if the prospective assignee is a competitor in the field. In this case, evidence indicated that Mayo was actually a partial owner of Latigo Petroleum. Still, the court was unwilling to be the first Texas court to apply this factor as the decisive one in a case arising under Texas law. Mayo was not able to convince the court that its refusal to grant consent was reasonable.

U.S. District Courts grant preliminary injunctions only when the plaintiff establishes *all* of the following:

- It is substantially likely to succeed on the merits of the underlying case,
- It is substantially likely to suffer irreparable harm if the injunction is not granted.
- The threatened injury outweighs any harm that the injunction may occasion for the defendant.
- The injunction will not undermine the public interest (the "*Winter test*").

So, even though the consent-to-assign provision was valid, because Mayo failed to prove it had exercised the restraint in a reasonable manner, the court found that Mayo was not substantially likely to prevail on the merits — the first factor of the *Winter* test. Consequently, the court denied Mayo's motion for a preliminary

injunction without prejudice for its ability to continue to prosecute its underlying case against BP.

***5. Tommy Yowell, et al. v. Granite Operating, et al.*, No. 18-0841, 2020 WL 2502141 (Tex. 2020)**

This case deals with the cy pres doctrine (a doctrine to reform deeds as nearly as possible to accomplish the grantor's intent). In this case, a predecessor to Granite Operating leased mineral rights in Wheeler County in 1986. The lease was later assigned with a reservation of an overriding royalty to the Yowells, which included a provision saying that if the lease terminated, and the lessee obtained an "extension, renewal or new lease or leases" covering the same mineral interest, then the reserved override would carry over. The industry term for such a provision is an "anti-washout" clause.

This case deals with a convoluted chain of title. Essentially, the lessee was top-leased but struck a deal with the top lessee whereby it released the old lease in exchange for an assignment of the two top leases. Production was established, but the successor lessees, Granite and Apache, refused to credit the Yowells' overriding royalty, claiming that the rule against perpetuities voided it because the time period in which it could attach to the new leases was indefinite.

The trial court rendered judgment for Granite, and the Yowells filed this appeal. The Amarillo Court of Appeals affirmed the trial court's decision, concluding that the overriding royalty in the new leases was not certain to vest within 21 years of a life in being as required by the rule against perpetuities. The Court of Appeals rejected the Yowells' argument that § 5.043 of the Texas Property Code should be used to reform the assignments to avoid application of the rule against perpetuities on grounds that the four-year statute of limitations in § 16.051 of the Texas Civil Practice and Remedies Code barred the Yowells' claims.

The Yowells appealed to the Texas Supreme Court. The Texas Supreme Court essentially agreed with Court of Appeals, holding that the reservation of the overriding royalty created a springing executory interest to which the rule against perpetuities applied. However, the Texas Supreme Court disagreed that the four-year statute of limitations barred the Yowells from seeking reformation under § 5.043 of the Property Code and remanded the case to the court of appeal to determine how the statutory codification of the cy pres doctrine included in § 5.043 of the Property Code could be utilized to save the reservation.

Although *Yowell* did not offer any guidance on distinguishing extensions and renewals of oil and gas leases from new leases because Granite conceded that the top leases were "new" leases, it said it agreed with a 10th Circuit decision, *Independent Gas & Oil Producers Inc. v. Union Oil of Cal.*, which held that the rule against perpetuities did not apply to extensions and renewals with regard to an anti-washout clause arising in Oklahoma. However, the rule does apply to anti-washout clauses involving new leases. By its ruling, *Yowell* established that overriding royalty owners can argue that if the anti-washout clause with no time limits applies to extensions and renewals, the rule does not apply.

***6. Terrance J. Hlavinka, et al. v. HSC Pipeline P'ship LLC*, 605 S.W.3d 819 (Tex. App. — Houston [1st Dist.] June 18, 2020, pet. filed Nov. 2, 2020)**

The Hlavinkas owned nearly 16,000 acres in Brazoria County that they acquired in 2003 for the primary purpose of generating income from pipelines. HSC owns pipeline systems in Texas for the transportation of various products, including polymer grade propylene, which was at issue here. In April 2016, HSC's sole manager, Enterprise Products OLPGP Inc., applied to the Texas Railroad Commission for a permit to operate a new 44-mile-long pipeline on behalf of HSC. HSC and the Hlavinkas could not agree on terms to the 30-foot wide and temporary workspace easement across four tracts of the land.

HSC filed a condemnation proceeding. The Hlavinkas filed a plea to the jurisdiction challenging HSC's eminent domain power — arguing that since HSC was not a common carrier, it did not have authority to condemn their property. HSC filed a traditional motion for summary judgment to establish its right to condemn as a matter of law. In support of its motion, HSC attached the following documents: a copy of a T-4 permit to operate the pipeline; an affidavit from Roger Herrscher, vice president of Enterprise; a pipeline tariff it filed with the RRC; and a redacted copy of the transportation service agreement between Braskem (HSC's customer) and HSC.

The trial court issued an order denying the Hlavinkas' plea to jurisdiction and granting HSC's motion for partial summary judgment. The Hlavinkas appealed, among other matters, the finding that HSC was a common carrier, to whom the power of eminent domain had been delegated by the state.

In Texas, under Section 111 of the Texas Natural Resources Code, common carriers have the right and power of eminent domain. Section 2.105 of the Business Organizations Code provides an independent grant of eminent domain authority for common carriers. HSC argued that it was a common carrier because propylene is an "oil product" and a "liquefied mineral." The court looked to the Natural Resources Code for the definition of "oil," the Texas Railroad Commission for the definition of "product," the industry definition of "crude oil" and the U. S. Energy Information Administration for the definition of "crude oil" to reach the conclusion that the propylene that HSC transported in the pipeline was an "oil product" for purposes of Section 2.105.

However, HSC's powers of eminent domain must be for a public use. To qualify as a common carrier under Section 111.001(6) of the Natural Resources Code, "a reasonable

probability must exist that the pipeline will at some point after construction serve the public by transporting gas for one or more customers who will either retain ownership of their gas or sell it to parties other than the carrier." The burden is on the pipeline company to establish its common carrier bona fides.

The Texas Supreme Court has said that this test balances the property rights of Texas landowners with our state's robust public policy interest in pipeline development, while also respecting the constitutional limitations placed on the oil and gas industry. The court went into much greater detail, but it ultimately said that other than issuing a press release announcing the pipeline and filing a tariff with the Railroad Commission, there was no evidence that HSC was actively marketing the pipeline's resources to other suppliers of PGP in the vicinity. The court concluded that HSC did not establish it was a common carrier with the power of eminent domain because there was evidence that the pipeline would serve only HSC's private interest in selling its PGP to its customer Braskem by transporting the sold product in the most expeditious and least expensive way, by a pipeline traversing seized property. The court remanded for further proceedings.

STAY TUNED …

Next month, we will discuss the final four 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.

ABOUT THE AUTHORS

RYAN SEARS, PARTNER – rsears@grayreed.com

Leader of Gray Reed's Energy Transactions Practice Group, Ryan Sears serves as outside general counsel for both domestic and international energy clients, focused primarily on structuring upstream and midstream transactions and advising on the various issues that typically arise during the exploration and production of oil and gas. He earned his undergraduate degree and his law degree from the University of Oklahoma.

RUSTY TUCKER, ASSOCIATE – rtucker@grayreed.com

Rusty Tucker advises energy clients on the entire range of transactions and issues that arise during oil and gas operations in Texas and many states across the country. He has prepared, reviewed and negotiated many different types of contracts and agreements, with a strong emphasis on purchase and sale agreements, production sharing agreements, oil-and-gas leases, assignments and deeds. As a former landman, Rusty also conducts title examinations and renders opinions for producers with drilling operations throughout Texas and performs the same with local counsel in other jurisdictions, including Louisiana, Oklahoma, New Mexico and Pennsylvania. He earned his undergraduate degree from West Virginia University and his law degree from Southern Methodist University Dedman School of Law.

HAPL Scholarship Applications

HAPL Student Scholarship Applications – Due March 15

HAPL scholarships are available for graduating high school students of current members and college students enrolled in an AAPL approved Petroleum Land Management or Energy Management Program. The criteria for applying and online application can be located by visiting our website at http://www.hapl.org/scholarships/.

The fully completed application, transcript (if required) and two letters of recommendation must be submitted online or received by the HAPL Office located at 800 Bering Dr., Ste. 120, Houston, TX 77057 **postmarked on or before March 15**. Late applications **will not** be considered.

Scholarship recipients will be honored at the HAPL Scholarship and Tribute to Education Luncheon in May.

For questions, please contact the Scholarship Chairman – Ashlee Hansen at ashlee.hansen@conocophillips.com or 832-486-6022 or the HAPL Office at hapl@hapl.org.