CONCERNING SELF-INTEREST:
THE EXECUTIVE DUTY AFTER *TEXAS OUTFITTERS V. NICHOLSON*

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Concerning Self-interest: The Executive Duty After *Texas Outfitters v. Nicholson*

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Of all fifty states, Texas has the most developed and expansive jurisprudence on executive duties.[2] In fact, courts from other states often cite Texas precedent in disputes concerning executive rights and duties.[3] Still, questions remain for mineral owners, prospective mineral owners, and potential lessees regarding the duties owed by executive rights holders.[4] In this decade alone, the Texas Supreme Court has issued three executive duty opinions, opinions which have attracted significant attention from scholars,[5] the oil and gas industry,[6] and even the Texas Attorney General's office.[7] These cases are *Lesley v. Veterans Land Board*;[8] *KCM Financial, LLC v. Bradshaw*;[9] and *Texas Outfitters Ltd.,*

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[2] *See*, *e.g.*, OWEN L. ANDERSON ET AL., HEMINGWAY OIL AND GAS LAW AND TAXATION 47, § 2.2(D) (Thompson West eds., 4th ed. 2004) ("Texas has the most case law dealing with the standard owed by the executive…"). The state's dominance in executive rights jurisprudence is not recent. *See* Ernest E. Smith, *Implications of a Fiduciary Standard of Conduct for the Holder of the Executive Right*, 64 TEX. L. REV. 371, 375 (1985) ("Most of the elaboration of the executive's duties has taken place in Texas courts." (citations omitted)).

[3] *See*, *e.g.*, *Murdock v. Pure-Lively Energy 1981–A, Ltd.*, 1989-NMSC-048, 775 P.2d 1292, 1296 (N.M. 1989); *Mull Drilling Co., Inc. v. Medallion Petroleum, Inc.*, 809 P.2d 1124, 1126 (Colo. App. 1991); *Welles v. Berry*, 434 S.2d 982 (Fla. App. 1983)(citing to federal case applying Texas law); *Schroeder v. Schroeder*, 479 N.E.2d 391 (Ill. App. Ct. 1985)(same).

[4] *See, e.g.*, Christopher S. Kulander, *The Executive Right to Lease After KCM Financial LLC v. Bradshaw and a Louisiana Solution to a Texas Problem*, 48 ST. MARY'S L.J. 637, 665–67 (2017); Ezra A. Johnson & Robert M. Park, *Lesley and Bradshaw: A Tale of Two Duties*, STATE BAR OF TEXAS 35TH ANN. ADVANCED OIL, GAS & ENERGY RESOURCES LAW CH. 23 (2017).

[5] Professor Bruce M. Kramer submitted an amicus brief on behalf of the petitioners in *Lesley v. Veterans Land Bd.,* 352 S.W.3d 479 (Tex. 2011). Brief for Betty Yvon Lesley et al. as Amicus Curiae in Support of Petitioners, Lesley v. Veterans Land Bd., 352 S.W.3d 479 (Tex. 2011) (No. 09-0306). In the same case, Professor Laura H. Burney argued on behalf of the respondents. *See* Transcript of Oral Argument, Lesley v. Veterans Land Bd., 352 S.W.3d 479 (Tex. 2011) (No. 09-0306).

[6] In *KCM Fin., LLC v. Bradshaw*, the Texas Oil and Gas Association, a trade association, filed an amicus brief arguing against a holding that might render lessees responsible for monitoring the executive's fulfillment of the executive duty. 457 S.W.3d 70, 86 (Tex. 2015).

[7] The Office of the Attorney General filed a brief and participated in oral argument before the Texas Supreme Court in *Texas Outfitters Ltd., LLC v. Nicholson,* 572 S.W.3d 647 (Tex. 2019). Brief for the State of Texas as Amicus Curiae in Support of Review, Texas Outfitters Ltd., LLC v. Nicholson, 572 S.W.3d 647 (Tex. 2019) (No. 17-0509).

[8] 352 S.W.3d 479 (Tex. 2011).

[9] 457 S.W.3d 70 (Tex. 2015).

LLC v. Nicholson.[10] From these cases, one "controlling inquiry" has arisen for executive duty holders,[11] along with new unanswered questions.

This paper will review Texas case law regarding duties owed by executive right holders prior to the Texas Supreme Court's recent decision in *Texas Outfitters, Ltd., LLC v. Nicholson*; examine executive duty cases involving lessees facing potential liability arising from the executive's breach of its duties; then analyze the Texas Supreme Court decision in *Texas Outfitters Ltd., LLC, v. Nicholson* and its implications. This article will conclude by comparing Texas law to executive rights jurisprudence in other states, with an emphasis on Louisiana law.

I. Introduction

In the mineral interest family, the executive right stands out for its lack of clear definition or delineation.[12] Scholars and practitioners have debated over its primary purpose,[13] its scope and concomitant duties,[14] and even its utility as a standalone right.[15] The executive right is one of the five sticks in the mineral interest "bundle" enumerated in *Altman v. Blake*[16]: (1) The right to ingress and egress (the right to develop and produce minerals);

[10] 572 S.W.3d 647 (Tex. 2019).

[11] *Id.* at 654.

[12] A leading casebook on oil and gas law comments that "Of all the rights contained within the mineral estate, the executive right to lease is possibly the right whose exact extent, purpose and limitations are the least clearly defined by case law." John S. Lowe et al., CASES AND MATERIALS ON OIL AND GAS LAW 530 (West 7th ed. 2018).

[13] Commentators conjecturing on the origins of the executive right have settled on two main reasons for its development: (1) facilitating leasing when mineral interest ownership is fractionalized and (2) surface protection. The first reason is the more favored. John S. Lowe et al., CASES AND MATERIALS ON OIL AND GAS LAW 531 (West 7th ed. 2018). *See also* Patrick A. Martin, *Unbundling the Executive Right: A Guide to Interpretation of the Power to Lease and Develop*, 37 NAT. RESOURCES J. 311, 321–325 (1997); Christopher S. Kulander, *The Executive Right to Lease After KCM Financial LLC v. Bradshaw and a Louisiana Solution to a Texas Problem*, 48 ST. MARY'S L.J. 637, 643 (2017).

[14] *See*, *e.g.*, Joshua M. Morse III & Jaimie A. Ross, *New Remedies for Executive Duty Breaches: The Courts Should Throw J.R. Ewing Out of the Oil Patch*, 40 ALA. L. REV. 187, 215–227 (1988) (noting range of standards applied to the executive right holder and advocating for treating the executive right holder as a fiduciary unless the instrument creating the relationship between executive and non-executive specifies otherwise); *cf.* Ernest E. Smith, *Implications of a Fiduciary Standard of Conduct for the Holder of the Executive Right*, 64 TEX. L. REV. 371, 405–06 (1985) (cautioning against holding the executive to a true fiduciary standard and thus preventing executive from protecting and advancing his own legitimate interests).

[15] Christopher S. Kulander, *The Executive Right to Lease After KCM Financial LLC v. Bradshaw and a Louisiana Solution to a Texas Problem*, 48 ST. MARY'S L.J. 637, 643 (2017).

[16] *Altman v. Blake*, 712 S.W.2d 117 (Tex. 1986).

(2) the right to lease (the executive right); (3) the right to receive bonus payments (the right to share in benefits obtained from the lessee); (4) the right to receive delay rentals; and (5) the right to royalty payments.[17] In Texas, it has been settled since 1990 that the executive right is a property right,[18] and is assignable, inheritable, and divisible (which can result in groups of mineral owners owning the executive right[19]). It often is equated with "the right to lease,"[20] which definition focuses on the most common application of the executive right.[21] A more encompassing formulation describes the executive right as the right to develop and make decisions regarding exploration and development, including the "stick" of ingress and egress as a correlative right.[22] Although not without critics,[23] this view of the executive right has been endorsed by the Texas Supreme Court.[24] Executive right holders commonly also own other attributes of the mineral estate or royalty,[25] but holders can own a "naked" executive right,[26] *i.e.*, the right stripped of other attributes of mineral ownership.[27]

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[17] *Id.* at 118; *Luckel v. White*, 819 S.W.2d 459, 463 (Tex. 1991)(citations omitted).

[18] *Day & Co., Inc. v. Texland Petroleum, Inc.*, 786 S.W.2d 667, 669 (Tex. 1990)(expressly holding that the executive right is "an interest in property, an incident and part of the mineral estate like the other attributes such as bonus, royalty and delay rentals," and overruling previous case law defining the executive right as a power governed by contract principles. *See id.* at 668–669).

[19] *See*, *e.g.*, *Day & Co., Inc. v. Texland Petroleum, Inc.*, 786 S.W.2d 667 (Tex. 1990) (executive right split between two owners).

[20] Patrick A. Martin, *Unbundling the Executive Right: A Guide to Interpretation of the Power to Lease and Develop*, 37 NAT. RESOURCES J. 311, 315–318 (1997).

[21] Christopher S. Kulander, *The Executive Right to Lease After KCM Financial LLC v. Bradshaw and a Louisiana Solution to a Texas Problem*, 48 ST. MARY'S L.J. 637, 643–44 (2017).

[22] *French v. Chevron*, 896 S.W.2d 795, 797 n.1 (Tex. 1995).

[23] *See*, *e.g.*, Kulander, *supra* note 21.

[24] *See Day & Co., Inc. v. Texland Petroleum, Inc.*, 786 S.W.2d 667, 669 n.1 (Tex. 1990); *French v. Chevron*, 896 S.W.2d 795, 797 n.1 (Tex. 1995). This difference in formulation is especially important when the non-executive holds a mineral interest, not a royalty interest.

[25] Monika U. Ehrman, *One Oil and Gas Right to Rule Them All*, 55 HOUS. L. REV. 1063, 1066 (2018) (citations omitted).

[26] 2 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 338 (2018) (when one owner holds a "naked" executive right, "someone else owns the non-executive mineral interest…"); Monika U. Ehrman, *One Oil and Gas Right to Rule Them All*, 55 HOUS. L. REV. 1063, 1066 (2018) (citing Christopher S. Kulander, *Big Money vs. Grand Design: Revisiting the Executive Right to Lease Oil & Gas Interests*, 42 TEX. TECH L. REV. 33, 39 (2009)).

[27] The Texas Supreme Court in *Day & Co.* indicated that the executive could be a standalone right, "severed" from the other mineral attributes. *Day & Co., Inc. v. Texland Petroleum, Inc.*, 786 S.W.2d 667, 669 (Tex. 1990).

Parties who do not own the executive right are called "non-executives" or "non-participating" owners.[28] These owners might only own an incorporeal nonparticipating royalty, whether fixed or floating, or own other attributes of mineral ownership, such as the right to bonus or delay rentals.[29] The latter are mineral interest owners in a co-tenancy relationship with the executive right holder, but lack the executive right to their interest and thus cannot lease or self-develop. Accordingly, these mineral interest owners lacking the executive right are often called non-participating mineral owners, or non-executive mineral interest holders[30] (referred to herein as "NEMIs").

The value of a non-executive's interest depends on the executive's decisions, most commonly through leasing decisions that determine bonus and royalty.[31] Because of the power the executive exercises, the executive right comes with a duty to prevent the executive from abusing its decision-making power. The 1937 case *Schlittler v. Smith*[32] first articulated, albeit in dicta, that the executive should act with "utmost fair dealing" toward the non-executive.[33] While the duty has been given various descriptions throughout the years, as discussed in the next section, Texas law settled around treating the executive's duty of utmost fair dealing as a middle ground between a true fiduciary duty, and the simple duty of good faith and fair dealing.[34] Until recently, it seemed clear that while an executive cannot unfairly diminish the value of the non-executive's interest, he does not have to place a non-executive's interests above his own.[35] In other words, it seemed sufficient for the executive to "exact every benefit for the non-executive that he would exact for himself,"[36] or, in other words, to make the same decisions he would have if the separate non-executive interest did not exist.[37] The law also seemed settled that the

[28] 1 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 301 (2018).

[29] *See* Christopher S. Kulander, *The Executive Right to Lease Mineral Real Property in Texas Before and After Lesley v. Veterans Land Board*, 44 ST. MARY'S L.J. 529, 553-55 (2013).

[30] 1 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 301 (2018); *see also* Lee Jones, Jr., *Exercise of Executive Rights in Connection with Non Participating Royalty and Non-Executive Mineral Interests*, 15 INST. ON OIL & GAS L. & TAX'N 35, 40 (1964).

[31] Christopher S. Kulander, *The Executive Right to Lease After KCM Financial LLC v. Bradshaw and a Louisiana Solution to a Texas Problem*, 48 ST. MARY'S L.J. 637, 643 (2017); Monika U. Ehrman, *One Oil and Gas Right to Rule Them All*, 55 HOUS. L. REV. 1063, 1065-66 (2018).

[32] 101 S.W.2d 543 (Tex. Comm'n App. 1937, opinion adopted).

[33] *Id*. at 545.

[34] Christopher S. Kulander, *The Executive Right to Lease After KCM Financial LLC v. Bradshaw and a Louisiana Solution to a Texas Problem*, 48 ST. MARY'S L.J. 637, 645 (2017).

[35] *KCM Fin., LLC v. Bradshaw*, 457 S.W.3d 70, 81 (Tex. 2015).

[36] *Manges v. Guerra*, 673 S.W.2d 180, 183–84 (Tex. 1984).

[37] *Pickens v. Hope*, 764 S.W.2d 256, 265 (Tex. App.—San Antonio 1988, writ denied).

executive did not owe the non-executive a duty until he exercised the executive right by leasing (that is, by gaining benefits for himself through a lease).[38] As sections II(B) and IV will discuss, the 2011 case *Lesley v. Veterans Land Board*[39] threw that standard into flux, and *Texas Outfitters v. Nicholson*[40] has complicated matters further.

II. Major Cases Defining the Executive Duty[41]

A. The Executive Duty Before *Lesley v. Veterans Land Board*

When the *Schlittler* court first articulated the "utmost fair dealing" standard, it assumed the executive's self-interest would align with that of the royalty holder and protect the royalty holder from abuse.[42] Subsequent cases, however, showed how the executive's self-interest could diverge a great deal from the royalty owner's. In *Manges v. Guerra*[43], the executive behaved with such egregious disregard for the non-executives that the *Manges* court purported to apply a fiduciary duty upon executives.[44] Between 1968 and 1971, Clinton Manges bought tens of thousands of mineral acres from entities and individuals collectively referred to as the Guerras. After the transactions were settled, Manges owned between half and 53.4 percent of the minerals, depending on the acreage, all of the surface, and the executive rights to the Guerras' reserved minerals. The conveyances provided that if Manges leased, he must procure at least a one-eighth royalty for the Guerras' non-executive mineral interest.

Manges then committed several acts that were found to breach his duty to the Guerras. To begin with, Manges encumbered the mineral estate in exchange for a loan he acquired to self-develop lands that may not have included the Guerras' interest. While the property

[38] See *In re Bass*, 113 S.W.3d 735, 745 (Tex. 2003).

[39] 352 S.W.3d 479 (Tex. 2011).

[40] 457 S.W.3d 70 (Tex. 2015).

[41] This paper provides a limited overview of how the executive duty developed. For comprehensive coverage of the executive right and duties, see Patrick A. Martin, *Unbundling the Executive Right: A Guide to Interpretation of the Power to Lease and Develop*, 37 NAT. RESOURCES J. 311, 315–318 (1997); Christopher S. Kulander, *Big Money vs. Grand Design: Revisiting the Executive Right to Lease Oil & Gas Interests*, 42 TEX. TECH L. REV. 33 (2009); Christopher S. Kulander, *The Executive Right to Lease Mineral Real Property in Texas Before and After Lesley v. Veterans Land Board*, 44 ST. MARY'S L.J. 529 (2013); Christopher S. Kulander, *The Executive Right to Lease After KCM Financial LLC v. Bradshaw and a Louisiana Solution to a Texas Problem*, 48 ST. MARY'S L.J. 637 (2017); or Monika U. Ehrman, *One Oil and Gas Right to Rule Them All*, 55 HOUS. L. REV. 1063 (2018).

[42] *Schlittler v. Smith*, 101 S.W.2d 543, 544–45 (Tex. Comm'n App. 1937, opinion adopted).

[43] 673 S.W.2d 180 (Tex. 1984).

[44] *Id.* at 183–84.

was subject to *lis pendens* notices, another operator drilling on adjoining tracts caused drainage of the Manges-Guerra minerals. Manges claimed the *lis pendens* notices made the land unmarketable to potential lessees. In the name of preventing drainage, Manges leased the minerals to himself for ten years at a one-eighth royalty, a two-dollar-per-acre delay rental, and a five dollar bonus for all of the 25,911.62 acres leased. He developed these himself, keeping seven-eighths of production. Manges then entered a farmout agreement covering the leased land, according to which he would receive a fifty percent working interest free of drilling costs, as well as a top lease. After a jury trial, the non-executives received actual and exemplary damages, cancellation of the Manges-to-Manges lease, and the cancellation, as to the Guerras' interests, of contracts that Manges had entered in violation of his executive duty.[45] The trial judgment also removed Manges as the executive, but the Texas Supreme Court reversed this judgment.[46]

The Texas Supreme Court's final opinion[47] described the executive's duty as fiduciary in its review of Manges' conduct.[48] The Court's opinion did not, however, lend much support to the idea that it was in substance applying a true fiduciary standard: the Court also quoted *Schlittler v. Smith* and called the executive's duty "[t]he duty of utmost good faith."[49] Manges, the Court elaborated, did not breach his executive duty because he failed to place the non-executives' interests above his own; he breached his executive duty through self-dealing that brought him "benefits the non-executive did not receive."[50] Applying this standard, the Texas Supreme Court affirmed most of the trial court's findings.[51]

Subsequently, *Manges* was not generally understood to require the executive right holder to actually meet a fiduciary's standard of conduct.[52] Soon after the case was released,

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[45] *Id.* at 181.

[46] The nonexecutives could have rescinded Manges' executive right, but elected to receive damages instead. The Texas Supreme Court found they could not both receive damages and rescind Manges' executive right, and thus reversed the rescission. *Id.* at 183.

[47] The Court withdrew a previously issued opinion. *Id.* at 181.

[48] *Id.* at 183–84.

[49] *Id.* at 183.

[50] *Id.* at 184.

[51] The one finding the Texas Supreme Court did not affirm was removal of Manges as the executive. *See supra* note 46.

[52] Christopher S. Kulander, *The Executive Right to Lease Mineral Real Property in Texas Before and After Lesley v. Veterans Land Board*, 44 ST. MARY'S L.J. 529, 548 (2013). *See also* Patrick A. Martin, *Unbundling the Executive Right: A Guide to Interpretation of the Power to Lease and Develop*, 37 NAT. RESOURCES J. 311, 394–397 (1997).

Professor Ernest E. Smith noted that the *Manges* court "did not unequivocally adopt a fiduciary standard. Commentators can and have disagreed on [*Manges'*] interpretation."[53] Scholars writing with the benefit of hindsight also have noted how the fiduciary duty articulated in *Manges* is similar to a lower, "quasi-fiduciary"[54] or "fiduciary duty lite"[55] standard. Overall, it is reasonable to view *Manges* as an extraordinary set of facts where the flagrant self-dealing of the executive prompted the court to use the fiduciary standard label, but without truly intending to put the executive into a trustee-like position. Applying the term "fiduciary standard" had the important effect of making available exemplary damages as a remedy for breach of a fiduciary standard.[56]

Cases applying *Manges* also did not read and apply *Manges* uniformly. For instance, *Pickens v. Hope*[57] distinguished *Manges* based on the cotenancy relationship and the complete dependency of the non-executives' interest on the executive's decisions.[58] The *Pickens* court held that the executive mineral owner did not owe a fixed, twenty-year term NPRI owner a fiduciary duty requiring the executive to develop or lease the mineral deposit (tar).[59] The court reversed a trial court judgment in finding that the executive had not breached any duty to the NPRI owner because there was not a reasonable expectation of profit from developing during the NPRI term.[60] The court commented that there was no relationship between the executive and NPRI owner giving rise to a "relationship of trust and confidence,"[61] and that *Manges* did not impose on the executive a fiduciary duty owed to the non-executive "in every case."[62] In *Dearing, Inc. v. Spiller*,[63] another case involving a self-dealing executive, the court noted while analyzing whether *Manges* applied that the property ownership between the executive and non-executives mirrored the ownership in *Manges*.[64] The court then applied the *Manges* "utmost good faith"

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[53] Ernest E. Smith, *Implications of a Fiduciary Standard of Conduct for the Holder of the Executive Right*, 64 TEX. L. REV. 371, 379 (1985).

[54] Monika U. Ehrman, *One Oil and Gas Right to Rule Them All*, 55 HOUS. L. REV. 1063, 1079 (2018).

[55] Christopher S. Kulander, *The Executive Right to Lease Mineral Real Property in Texas Before and After Lesley v. Veterans Land Board*, 44 ST. MARY'S L.J. 529, 550 (2013).

[56] *Manges*, 673 S.W.2d 180, 184 (Tex. 1984).

[57] *Pickens v. Hope*, 764 S.W.2d 256 (Tex. App.—San Antonio 1988, writ denied).

[58] *Id*. at 267.

[59] *Id*. at 271.

[60] *Id*. at 269, 271.

[61] *Id*. at 267.

[62] *Id*.

[63] 824 S.W.2d 728 (Tex. App.—Fort Worth 1992, writ denied).

[64] *Id*. at 732.

standard to an executive who had leased to himself on below-market terms and held the executive had breached that duty of utmost good faith.[65] Damages for the breach included exemplary damages and lease cancellation.[66]

The court in *Comanche Land & Cattle Co. v. Adams*[67] focused on the "utmost good faith"[68] language from *Manges* in affirming that an executive violated his duty of "utmost good faith" owed to term royalty owners by joining a joint venture oil and gas mining agreement specifically providing for no royalty instead of leasing the minerals.[69] A different court of appeals in *Mims v. Beall*[70] found facts involving family self-leasing and self-dealing analogous to *Comanche Land*,[71] but also equated the "utmost good faith" standard with an "ordinary prudent landowner" standard.[72] According to the *Mims* court, *Manges* "equated"[73] the utmost good faith standard with a fiduciary-level duty when the executive and non-executive were co-tenants. The court went on to clearly state that the *Manges* standard was not a "customary"[74] fiduciary standard, as it did not require the executive to prioritize the non-executive's interest over his own.[75] Breach of the utmost good faith standard nonetheless allowed for damages such as exemplary damages and a constructive trust, both of which were upheld in *Mims*.[76] In *Hawkins v. Twin Montana, Inc.*,[77] the Fort Worth Court of Appeals in fact noted the critical disputes about what *Manges* meant; the court then decided the case on a good faith standard without

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[65] *Id.* at 732–33.

[66] *Id.* at 733–35.

[67] 688 S.W.2d 914 (Tex. App.—Eastland 1985, no writ).

[68] *Id.* at 916.

[69] As the court assumed a trial court finding that the executive right holder arranged "an agreement that was calculated to defeat the rights of the royalty owners," whose royalty interest would pass to the executive right owner after twenty years, it is not unreasonable to assume that the executive would be have been liable under a pre-*Manges* standard as well. *Id.*

[70] 810 S.W.2d 876 (Tex. App.—Texarkana 1991, no writ).

[71] *Id.* at 879.

[72] *Id.* at 878.

[73] *Id.* at 879.

[74] *Id.*

[75] *Id.*

[76] *Id.* at 881–82.

[77] 810 S.W.2d 441 (Tex. App.—Fort Worth 1991, no writ).

analyzing *Manges*.[78] One commentator has summarized the cases by identifying a trend where courts cite the *Manges* quasi-fiduciary as the general rule, but find reasons to create exceptions, perhaps where the same level of self-dealing is not involved.[79] Indeed, *Lesley*, discussed below, stated that *Manges* and the preceding case law "did not suggest" that the standard principal-agent fiduciary duty was part of the executive's duty.[80] Another commentator whose scholarship on executive rights has been cited multiple times by the Texas Supreme Court has called the *Manges* standard a "fiduciary-lite" standard that adapts the traditional fiduciary duty to the special circumstances of oil and gas law.[81]

The Texas Supreme Court distinguished the *Manges* standard in its opinion for *In re Bass*[82] addressing an executive's failure to lease. *Bass* centered on a dispute over access to seismic data, which the non-executives were seeking in order to show the executive breached "an implied duty to develop its land."[83] The executive, Bass, had purchased the surface and mineral estate from the non-executives and their predecessors-in-interest. The non-executives, owners of a reserved NPRI, argued that Bass owed them a duty to develop the minerals based on an implied covenant to develop, or a duty arising out of the relationship between executive and non-executive. The court first rejected the proposition that an implied covenant to develop should be read into Bass's general warranty deed,[84] then turned to the executive's duty. The Court held that Bass owed the non-executives a fiduciary duty, as defined in *Manges*, but that he could not have breached it without leasing.[85]

To parse out the executive duty, the *Bass* court looked back to *Schlittler v. Smith* and discerned a "very narrow duty in which a grantee, after executing a mineral lease, owes a duty of the utmost fair dealing to protect the amount of the grantor's royalty."[86] *Manges*, the court explained, expanded on *Schlittler* by providing for a fiduciary duty between

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[78] *Id.* at 445–46 (affirming trial court ruling that the surface-owning executives breached their duty to the nonexecutives by rejecting a lease with a 1/4 royalty with some surface damage payments for a lease with a 1/8 royalty but significantly more generous surface damage payments).

[79] Monika U. Ehrman, *One Oil and Gas Right to Rule Them All*, 55 HOUS. L. REV. 1063, 1093 (2018).

[80] *Lesley v. Veterans Land Bd.*, 352 S.W.3d 479, 490 (Tex. 2011).

[81] Christopher S. Kulander, *The Executive Right to Lease After KCM Financial LLC v. Bradshaw and a Louisiana Solution to a Texas Problem*, 48 ST. MARY'S L.J. 637, 644–45 (2017).

[82] 113 S.W.3d 735 (Tex. 2003).

[83] *Id.* at 737.

[84] *Id.* at 743–44.

[85] *Id.* at 745.

[86] *Id.* at 744.

executive and non-executive interests that required the executive "to acquire every benefit for [the non-executives] that Bass would acquire for himself."[87] Notably, the *Bass* court read *Manges* as establishing a general executive duty, and not as establishing distinctions between duties owed to an executive's nonparticipating cotenants (NEMIs) and duties owed to NPRI holders.[88] [89] The court then distinguished *Manges* factually, as a case where the executive was self-dealing through leasing transactions.[90] While Bass owed the non-executives a duty, he had not breached that duty without exercising it by executing a lease and thus obtaining benefits for himself.[91] In announcing this bright-line rule, the Court seemed to imply that benefits acquired from the mineral estate were the only ones that mattered in executive duty breach cases. Without a lease, and thus no lease terms to show how the executive had agreed to distribute mineral estate benefits, the executive apparently could not breach his duty even if he could garner some benefit from not leasing. The *Bass* bright-line rule was not revisited until 2011, when the Texas Supreme Court decided *Lesley*.

Before *Lesley*, multiple appellate cases followed the *Bass* rule that the executive would not breach his duty without entering a lease, and that the executive did not have a duty to enter a lease.[92] A 2009 case from the Amarillo Court of Appeals even resulted in the executive right holders recovering attorney's fees in a breach of duty suit brought by the potential lessee and non-executives.[93] In *Aurora Petroleum Inc. v. Newton*, the executive right holders also owned the surface and an undivided one-fourth mineral interest.[94] The

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[87] *Id.* at 745. Again, this is not the typical definition of a fiduciary standard.

[88] "*Manges* extends the *Smith* duty by creating a fiduciary duty between executive and non-executive interest holders in mineral deeds... By definition, all non-participating royalty interests are non-executive interests. Thus, like *Manges,* the relationship between Bass and the McGills [the non-executives] is one of executive and non-executive. Because *Manges* held that the executive owes the non-executive a fiduciary duty, the McGills correctly state that Bass owes them a duty to acquire every benefit for the McGills that Bass would acquire for himself." *Id.* at 745 (citations omitted).

[89] The Texarkana Court of Appeals echoed this view in *Friddle v. Fisher*, a case about how executives should have treated NPRI owners to avoid breaching the executive duty when the executives signed a lease authorizing pooling without informing the NPRI owners, and then received lease payments attributable to the NPRI owners. 378 S.W.3d 475, 480–81 (Tex. App.—Texarkana 2012, pet. denied).

[90] *Bass*, 113 S.W.3d at 745.

[91] *Id.*

[92] *See*, *e.g.*, *Sauceda v. Kerlin*, 164 S.W.3d 892, 916 (Tex. App.—Corpus Christi 2005), *rev'd on other grounds*, 263 S.W.3d 920 (Tex. 2008); *Hlavinka v. Hancock*, 116 S.W.3d 412, 420 (Tex. App.—Corpus Christi 2003, pet. denied). The Eastland Court of Appeals, in a decision the Texas Supreme Court overturned, also applied the *Bass* standard in *Veterans Land Board v. Lesley* to find that the executive had not breached his duty in the absence of a lease. 281 S.W.3d 602, 618 (Tex. App.—Eastland 2009), *aff'd in part and rev'd in part*, 352 S.W.3d 479 (Tex. 2011).

[93] *Aurora Petroleum Inc. v. Newton*, 287 S.W.3d 373 (Tex. App.—Amarillo 2009, no pet.).

[94] *Id.* at 375.

non-executives owned the other three-quarters of the minerals. Their terminable interest would revert to the executives in the absence of production. Unsurprisingly, the non-executives sought to lease the minerals, but the executives refused to lease even after every other mineral owner in the area had entered a lease. In its opinion affirming a take-nothing judgment and attorney's fees for the executive, the Court of Appeals expressly rejected the proposition that the executive's duty to the non-executives "includes the duty to enter an oil and gas lease for the property on reasonable terms, should the opportunity arise."[95] The court cited to *Bass* and held that the executives could not have breached their duty without acquiring a benefit for themselves by leasing.[96] Today (and perhaps then) the factual discussion seems thin and the decision peremptory, as it did not look into the executive's reasons for not leasing, and did not consider the executive's benefits from surface use. The rules the *Aurora* court applied have anyway been overruled by *Lesley*.[97]

Another case where the executive did not lease is worth examining today, as it would come out differently under current precedent. The executives were not in breach of their duty to the non-executive in *Hlavinka v. Hancock*.[98] The Hlavinkas purchased the executive right to an 802.25 acre tract that had been part of a larger, family-owned tract. They also purchased a one-ninth mineral interest and the surface estate for farming operations. Several months after, nearby owners of smaller tracts began receiving lease offers, and tract owners neighboring the Hlavinkas eventually accepted leases. The Hlavinkas rejected three lease offers from 1996 to 1997. The first and third offers had terms inferior to their neighbors' lease terms, and the second was identical to their neighbors' leases, including a $250.00 bonus. The Hlavinkas also rejected a lease for another tract they owned nearby, and testified that they turned down the offers because they believed the terms were below market for their tract.[99] In 1998, another exploration company approached the Hlavinkas about a permit for seismic operations on their land. The Hlavinkas attempted and failed to lease for a $650.00 per acre bonus, and ended up agreeing to allow seismic operations at the urging of the non-executives. The agreement included surface damage payments of forty dollars per acre. The non-executives then sued the Hlavinkas for breach of executive duty and were awarded $187,195.65 in damages in a jury trial.[100]

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[95] *Id.* at 376.

[96] *Id.* at 377.

[97] 352 S.W.3d 479, 491 n.78 (Tex. 2011).

[98] *Hlavinka v. Hancock*, 116 S.W.3d 412 (Tex. App.—Corpus Christi 2003, pet. denied).

[99] *Id.* at 415.

[100] *Id.* at 416.

The Court of Appeals concluded that the Hlavinkas had not breached their duty and reversed the judgment.[101] The non-executives' main argument was that the Hlavinkas' behavior in failing to negotiate and enter a lease, and receiving surface damages for seismic operations, amounted to a breach of the executive duty regardless of whether the standard was fiduciary or of utmost good faith. The Court of Appeals described the standard[102] as one where the executives must "acquire every benefit for the non-executive"[103] that they would obtain for themselves. Reviewing the record, the court found the evidence showed the Hlavinkas were ready to lease and were attempting to obtain higher terms.[104] Had the Hlavinkas not done so, the court noted, they might have been sued for leasing on terms below the area market rate.[105]

The court distinguished between what the executives had done–receive surface damages as compensation–and the kind of behavior that would have constituted a breach of duty. If the executives had negotiated for surface damage payments "as a substitute for a larger bonus, royalty, or other benefit that would have to be shared with the co-mineral owners", they would have acted improperly.[106] The court then followed the apparent bright-line rule from *Bass*, and held that the executives could not have breached the executive fiduciary duty because they had not "used their power to lease."[107] This last rule was overruled in 2011 by *Lesley*.[108]

B. New Decade, New Executive Duty?: *Lesley v. Veterans Land Board*

The executive in *Lesley*, Bluegreen Southwest One, L.P. ("Bluegreen"), came to own as a successor-in-interest the executive right to a 4,100 acre tract in the Barnett Shale. Bluegreen also owned the surface and most of an undivided one-half of the minerals. The non-executives were Betty Yvon Lesley (who had sold the executive right, surface, and minerals to Bluegreen's predecessor), owner of an undivided portion of the minerals, and the Hedricks, owners of the other nonparticipating undivided one-half of the minerals. Bluegreen developed the tract into a residential subdivision and imposed restrictive covenants forbidding drilling or other development operations. The covenants could be

[101] *Id.* at 421

[102] The court did in fact describe the standard as the *Manges* fiduciary standard, but again did not apply a true fiduciary standard requiring the fiduciary to prioritize the interests of the other party. *Id.* at 418.

[103] *Id.* at 418.

[104] *Id.*

[105] *Id.* at 419.

[106] *Id.* at 421.

[107] *Id.*

[108] 352 S.W.3d 479, 491 n.78 (Tex. 2011).

altered by a vote of two-thirds of the owners entitled to vote. Bluegreen then conveyed the lots to approximately 1,700 owners, and included the minerals – excepting the non-executives' interests – in the conveyance deeds. The deeds contained no mention of the executive right.

As Bluegreen had been developing its subdivision, surrounding owners were leasing to develop minerals in the wake of a production boom in the Barnett Shale.[109] In 2005, the non-executives sued Bluegreen and the subdivision lot owners, including the Texas Veterans Land Board. The main issue in the lawsuit was whether the executive breached the executive duty to the non-executives through the restrictive covenants and a failure to lease. The Court held that the lot owners, not Bluegreen, owned the executive right, subject to the restrictive covenants.[110] Turning to the major issue, the Court explained that the executive duty is imprecise, due to the diverse types of non-executive interests that can exist.[111] The Court then reviewed Texas jurisprudence on the executive right, and reiterated that the executive duty is fiduciary in nature and requires that the executive "acquire for the non-executive every benefit that he exacts for himself."[112] Crucially, the Court read *In re Bass* as a case where the executive and non-executive disagreed over whether leasing should occur, and where the executive was not liable because the non-executives could not bring forth sufficient evidence of self-dealing. *Bass*, the Court specified, did not stand for the proposition that an executive refusing to lease was not exercising the executive right and thus could not breach his duty;[113] the executive could breach his duty "if the refusal is arbitrary or motivated by self-interest to the non-executive's detriment".[114] In other words, self-dealing and breaching the executive duty without leasing became possible. Refusals to lease warranted more scrutiny, more careful examination,[115] than the line of appellate cases applying *Bass* had suggested. Yet, the Court did not explicitly state that it was overturning or disapproving any portion of *Bass*.

[109] The Texas Supreme Court noted in its opinion that the mineral formation underlying the subdivision contained approximately $610 million in minerals, most of which could be accessed only through the subdivision. *Id.* at 482.

[110] *Id.* at 487.

[111] *Id.* at 487–88.

[112] *Id.* at 490 (citation omitted).

[113] The Court disapproved *Aurora Petroleum Inc. v. Newton*, 287 S.W.3d 373 (Tex. App.—Amarillo 2009, no pet.) and *Hlavinka v. Hancock*, 116 S.W.3d 412 (Tex. App.—Corpus Christi 2003, pet. denied), to the extent that they held otherwise. *Id.* at n. 78.

[114] *Id.* at 491.

[115] *Id.*

Nor did the Court announce a rule; it specifically declined to announce "as a general rule" whether "an executive is liable to a non-executive for refusing to lease minerals."[116] Bluegreen's actions in imposing development restrictions were not only a refusal to lease, but an impediment to future leasing. This counted as an exercise of the executive right;[117] it did not matter that by not leasing, Bluegreen was treating its own minerals in the same way as the non-executives' minerals. The court went on to hold that Bluegreen had breached its executive duty, and ruled that the restrictive covenants should be cancelled.[118] The Court remanded the issue of whether the lot owners had breached a duty by failing to lease the minerals.[119]

Although a definitive rule did not emerge from *Lesley*, some guidelines and principles did. First, it became evident that a purchaser seeking to protect the surface could not use the executive right to preclude leasing and mineral development altogether. An owner seeking to protect the surface would have to rely on the accommodation doctrine.[120] Second, an executive owes a fiduciary duty to the non-executive even in the absence of a lease; the duty does not spring into existence only after a lease is signed. An executive who makes leasing decisions without considering the interests of the non-executive runs the risk of breaching the executive duty. Lastly, one of the issues in *Lesley* was whether the non-executives could self-develop when the executive would not develop the minerals. The *Lesley* court found that the non-executives did not have a right to development, also known as the right to ingress and egress, because the right to development is correlative and accompanies the executive right.[121]

The *Lesley* court acknowledged the flexibility needed in executive duty issues by declining to set definite rules. The new guidelines it set, however, raised many questions that had been obviated by the previously prevailing understanding of *Bass*. To what extent could an executive provide for its own interests in the wake of *Lesley*? What would count as self-dealing in situations where the executive owned the surface and the non-executive did not? In situations where the executive did not own a mineral interest, and thus would not share in any mineral benefits, how should the executive negotiate for a lease? Would such an executive seeking a lease with surface protections be in breach if he could obtain more benefits for the mineral estate at the expense of allowing unwanted surface activities and surface damage? Could a non-executive push an executive to lease when the executive was unwilling to do so as a business judgment? *Lesley* had been a relatively easy case where

[116] *Id.*

[117] *Id.*

[118] *Id.*

[119] *Id.* at 492.

[120] *Id.*

[121] *Id.*

the executive was blocking development more or less permanently; it provided little guidance for an executive who wished to limit development temporarily. *Lesley*'s fact pattern also raised an interesting question: How would a court analyze a breach of duty case if the two non-executives had conflicting goals? Such a situation could easily arise if, for example, one non-executive also owned part of the surface, and the other did not, or if one non-executive owned only a floating NPRI, and the other did not own royalty but had a stake in the bonus payment.

The next executive rights case decided by the Texas Supreme Court also declined to establish a general rule. *KCM Financial LLC v. Bradshaw*,[122] discussed further in section III below, involved an NPRI owner who sued the lessor and lessee for executing a lease that had a below-market royalty and extremely high bonus of thirteen million dollars. In reversing summary judgment for the lessor, the Court again emphasized that the executive duty is not amenable to a "definitive articulation" or a "bright-line rule."[123] In finding that the executive had not established it was entitled to summary judgment on a breach-of-duty claim, the Court pointed out that no one feature, such as a failure to lease for a market-rate royalty, would be decisive; considering the transaction as a whole was crucial.[124] The Court also reiterated the "utmost good faith and fair dealing" standard in *Bradshaw*, and noted that the executive cannot self-deal, but is "not required to subordinate its interests in favor of the non-executive if their interests conflict."[125] The Court set forth a "controlling inquiry" for breach of executive duty cases: "whether the executive engaged in acts of self-dealing that unfairly diminished the value of the non-executive interest."[126] *Bradshaw* also required the Court to consider how a lessee might be liable for an executive's breach of duty.

III. A Standard of Conduct for Lessees and Operators?

Lessees and operators also sometimes become involved in issues surrounding the executive's exercise of power. Consider the following hypothetical:

> E1 has inherited the naked executive right to Shaleacre, and E2 has a nonparticipating mineral interest in Shaleacre, burdened by floating NPRIs. Operator owns other leasehold interests in the area and needs to acquire rights to Shaleacre. E1 and E2 refuse Operator's market-rate leasing offers, but suggest entering an operating agreement to develop Shaleacre without informing the NPRI

[122] 457 S.W.3d 70 (Tex. 2015).

[123] *Id.* at 74.

[124] *Id.*

[125] *Id.*

[126] *Id.* at 82.

owners. E1 and E2 make it clear they believe developing without a lease will be more profitable than leasing and having to pay the NPRIs.

What should Operator decide? Does Operator owe any duty to the NPRI owners? Does it make a difference whether the NPRIs are term NPRIs or perpetual?

Since Professor Ernest Smith addressed potential lessee liability in his classic 1981 article on the executive right and standards of conduct,[127] the Texas Supreme Court and intermediate appellate courts have not had many opportunities to clarify what level of consideration a potential lessee must pay to non-participating interest owners when negotiating for a lease or other development agreement. However, one consistent rule has emerged and become a fixture in evaluating lessee liability: While the lessee does not owe an independent duty to the non-participating interests,[128] it can be liable for executive breaches of duty if it colludes with executives to injure non-participating interests.[129] In other words, "a lessee who induces or participates in the executive's breach can also be held liable to the non-participating interest owner."[130]

Due to limited case law on the topic, there are not many examples of what behaviors will be considered evidence of a lessee's collusion or participation in the executive's breach. The first major case on lessee liability is *Kimsey v. Fore*,[131] decided in 1979. In *Kimsey*, the lessees and operator were ultimately liable to the term royalty owners due to their participating in a breach of the executives' duty. The *Kimsey* intermediate appellate court approved a jury verdict against the lessees and operator, among various other defendants, based on evidence showing the lessees and operators purposefully delayed drilling, production, and well completion until after expiration of the term royalty owners' interests. In delaying, the operator breached the implied covenant of reasonable development with respect to the term royalty owners. The operator had, not coincidentally, received instructions from one of the lessees to refrain from drilling until after the term royalty interests expired.[132] Evidence in *Kimsey* also showed that the

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[127] *See* Ernest E. Smith, *The Standard of Conduct Owed by Executive Right Holders and Operators to the Owners of Nonparticipating and Nonoperating Interests*, 32 INST. ON OIL & GAS L. & TAX'N 241 (1981).

[128] In a 1998 case, in a different context, the Texas Supreme Court commented that "Texas law has never recognized a fiduciary relationship between a lessee and royalty owners." *HECI Expl. Co. v. Neel*, 982 S.W.2d 881, 888 (Tex. 1998)(citing *Harrison v. Bass Enters. Prod. Co.,* 888 S.W.2d 532, 537 (Tex. App.—Corpus Christi 1994)). The Court seems to have carried over this rule to non-participating interest owner cases, although dicta to the contrary exists. *See Mims v. Beall*, 810 S.W.2d 876, 880–81 (Tex. App.—Texarkana 1991, no writ)("Some authorities take the position that liability will also arise if the lessee should reasonably have been aware that the executive was acting in breach of his duty." (*referring to* G.G. Bogert & G.T. Bogert, THE LAW OF TRUSTS AND TRUSTEES §§ 901–912 (2d ed. 1982)).

[129] *See KCM Fin. LLC v. Bradshaw*, 457 S.W.3d 70, 85–86 (Tex. 2015).

[130] *Mims v. Beall*, 810 S.W.2d 876, 880 (Tex. App.—Texarkana 1991, no writ).

[131] 593 S.W.2d 107 (Tex. Civ. App.—Beaumont 1979, writ ref'd n.r.e.).

[132] *Id.* at 109.

executive holders informed the lessees that they did not wish to lease until the royalty interests were terminated.[133] Although the *Kimsey* court did not, for procedural reasons, address the issue of conspiracy between the various executive rights holders,[134] the lessees, and the operator, the evidence in the record indicated that the lessees, operator, and executives were working together to avoid paying the term royalty owners. This evidence showing the lessees and operator participated in the breach of fiduciary duty was the basis for a jury verdict against them.[135]

Some of the most flagrant examples of lessee collusion involved collusion between family members. For instance, *Dearing, Inc. v. Spiller*[136] involved a lessee that was a family corporation controlled by the self-dealing executive. Similarly, the lessee in *Mims v. Beall*[137], decided a year earlier, was the executive's son. The court found that the father and son had conspired to breach the executive's fiduciary duty through a self-dealing transaction that allowed the father and son to avoid paying a market-rate royalty to the NPRI owners. The son had leased from his parents at a low royalty, and then assigned the leasehold in exchange for an overriding royalty interest. In upholding a trial court award against the executives, the Texarkana Court of Appeals stated:

> Angus Mims did not owe a fiduciary duty to the Bealls, but a lessee who induces or participates in the executive's breach can also be held liable to the non-participating interest owner. *See Kimsey v. Fore, 593 S.W.2d 107* (Tex. Civ. App.-Beaumont 1979, writ ref'd n.r.e). This participation or inducement to breach contractual obligations is similar in nature to an action for tortious interference with contractual relations. So long as the lessee maintains an arm's length position in the transaction, he does not owe a fiduciary duty or a duty of utmost good faith to the owner of a non-executive interest. If, however, the lessee agrees with the executive to an arrangement made for the purpose of excluding or minimizing the benefits of an outstanding or non-participating interest owner, the lessee can be held liable to the injured third party. Some authorities take the position that liability will also arise if the lessee should reasonably have been aware that the executive was acting in breach of his duty.[citations omitted].[138]

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[133] *Id.*

[134] *Id.* at 111.

[135] *Id.* at 108-09, 114.

[136] 824 S.W.2d 728 (Tex. App.—Fort Worth 1992, writ denied).

[137] 810 S.W.2d 876 (Tex. App.—Texarkana 1991, no writ).

[138] *Id.* at 880–81. The last sentence, which drew inspiration from trust law, was dicta and possibly overruled by *KCM Financial v. Bradshaw*, 457 S.W.3d 70 (Tex. 2015). *See supra*, note 128.

More recently, the Texas Supreme Court came closer to clarifying the standards for judging a lessee's conduct and determining lessee responsibilities toward a non-operating interest holder than it perhaps ever has before in *KCM Financial LLC v. Bradshaw*.[139] The executive duty dispute in *Bradshaw* involved multiple defendants and stages of litigation.[140] The non-executive Bradshaw inherited a floating NPRI[141] governed by a deed that indicated the NPRI should not be lower than one-eighth. Bradshaw sued the lessee and its related entity, Range Production I L.P.,[142] along with the lessor and executive right owner Steadfast Financial, L.L.C. for civil conspiracy and aiding and abetting Steadfast's breach of its executive duties. Bradshaw alleged that Range was derivatively liable for Steadfast's breach of its executive duties because it colluded with Steadfast for a higher bonus in exchange for a lower royalty rate. One of the Range entities had purchased the surface from Steadfast, but Range and Steadfast were not otherwise affiliated "except as adverse parties in an arm's-length transaction."[143] Ultimately, the Texas Supreme Court dismissed the conspiracy and derivative-liability claims against Range because, even if Steadfast had breached its duty to Bradshaw, there was no evidence that Range "was complicit in the alleged underlying tort."[144] The Court evaluated the evidence of alleged conspiracy and held that the lessee's knowledge of Bradshaw's floating NPRI, awareness of the "tensions between" Steadfast and Bradshaw, and agreement to a large bonus and one-eighth royalty were "simply insufficient to impute Steadfast's [the executive's]

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139 457 S.W.3d 70 (Tex. 2015).

140 The case involved three main appellate opinions. The earliest proceeding, *Bradshaw I*, concerned whether the NPRI owner Bradshaw held a fixed or floating NPRI. *Range Res. Corp. v. Bradshaw*, 266 S.W.3d 490 (Tex. App.—Fort Worth 2008, pet. denied). *Bradshaw I* settled that the NPRI was a "floating" NPRI of one-half of the lease royalty. *Id.* at 496. In the second appellate opinion, referred to as *Bradshaw II*, the Fort Worth Court of Appeals denied summary judgment to all of the parties Bradshaw had sued in relation to her breach of executive duty claim, except for two of the royalty owners. *Bradshaw v. Steadfast Fin., LLC*, 395 S.W.3d 348, 376 (Tex. App.—Fort Worth 2013, pet. granted), *aff'd in part, rev'd in part*, 457 S.W.3d 70 (Tex. 2015). The Texas Supreme Court's 2015 opinion is commonly called *Bradshaw III*. This paper will follow the Bradshaw I, II, III designations. The royalty owner defendants will not be discussed, as they are not central to this paper's topic.

141 The nature of the NPRI was determined during the litigation in Bradshaw I; see preceding footnote.

142 It is worth noting that at the intermediate appellate level, the lessee was denied summary judgment because its liability was dependent on whether the executive had breached its duty. *Bradshaw v. Steadfast Fin., L.L.C.*, 395 S.W.3d 348, 372-73 (Tex. App.—Fort Worth 2013). The lessee was involved in the litigation until the 2015 Texas Supreme Court decision, which overruled parts of the intermediate appellate court's opinion concerning a lessee's duty to non-executive holders. The reasoning and rules in the Supreme Court decision indicate that a lessee involved in litigation today would likely prevail on summary judgment sooner–subject to the adverse parties' appeals, of course.

143 *KCM Fin.*, 457 S.W.3d at 85.

144 *Id.*

liability, if any, to Range."[145] Furthermore, there was no "imbalance in the mineral-lease terms that substantially favored Range."[146]

While evaluating the NPRI owner's claims, the Texas Supreme Court also indicated it was wary of expanding liability for lessees, commenting that "'in negotiating with the executive, a lessee should not fear liability for doing nothing more than getting a good deal closed."[147] In rejecting Bradshaw's conspiracy claim, the Court further declared that if it were to find Range liable in *Bradshaw III*, "it would be difficult to conceive of a context in which a lessee would not owe a derivative fiduciary duty to the other side of the bargaining table. An arm's-length negotiation would be essentially nonexistent, because both sides of the table would be required to balance their interests against the non-executive's interests."[148] Thus, the Bradshaw III court indicated that lessees will not be derivatively liable for executive breaches of duty to NPRI holders unless there is a special relationship between the lessee and executive, or definite evidence of collusion beyond the lessee pursuing its commercial interests in an arms-length transaction.

In contrast to the above cases, the lessee was not even part of the court proceedings in *Luecke v. Wallace*.[149] Lessee Union Pacific Resources Company offered to lease from an executive right holder, Luecke, who owned the minerals subject to non-executive Wallace's interests. Wallace owned an undivided one-half floating NPRI and "an undivided one-half interest in any bonus money exceeding $50.00 per acre."[150] In the negotiations between Luecke and Union Pacific, Luecke first proposed leasing the tract for a 1/5th royalty and a $150 per acre bonus. Union Pacific subsequently discovered Wallace's bonus and NPRI interest while performing a title search. Before concluding a lease agreement, Union Pacific sent Luecke a letter asking for "evidence of payment of 1/2 of excess bonus money above $50.00 per acre and a Ratification and Rental Division Order setting forth the interest division."[151]

After receiving Union Pacific's letter, Luecke changed the lease transaction structure in such a way that benefited Luecke at Wallace's expense: Luecke leased to a company of which he was sole owner and president for a 1/8th royalty and bonus below

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[145] *Id.* at 86.

[146] *Id.* On an interesting note, the Court commented in dicta that "even if there were [terms substantially favoring the lessee], that is not evidence that it acted improperly." *Id.*

[147] *Id.*

[148] *Id.*

[149] 951 S.W.2d 267 (Tex. App.–Austin 1997, no writ).

[150] *Id.* at 271.

[151] *Id.*

$50.00 per acre.[152] The company then sold its lease to Union Pacific for an overriding 1/5th royalty and $150.00 per acre bonus—the same terms as had been discussed earlier. It was important that Union Pacific's obligations remained the same as in the original proposal, as it showed that Union Pacific did not benefit from the executive's self-dealing transaction. Additionally, Luecke informed Union Pacific during the final negotiations that Wallace was "on board" with the lease.[153] In truth, however, Wallace was unaware of the lease negotiations. Union Pacific was nevertheless ultimately not accused of liability on any grounds.

These cases illustrate that in Texas, a prospective lessee does not have a particular duty to the non-executive interest holders. As *Bradshaw III* emphasized, the lessee certainly does not have a duty to place the interests of the non-executives on level with or above its own. Returning to the hypothetical, however, some difficult questions remain: Can a lessee follow its commercial interest and enter a development or other agreement with the executive without leasing? After all, any non-lease agreement can be said to destroy the value of the NPRI owners' interests. In his article on lessee standards of conduct, Professor Smith explained that a prospective lessee is not able to negotiate with the executive right holder for a lease containing terms which have the express purpose of destroying or injuring the term royalty interest.[154] Such a standard of conduct seems to indicate a lessee should not negotiate an agreement with the executives that does not involve a lease and that does not involve some concession for the NPRI owners – especially if the executives provide clues that their overall goal in avoiding a lease is the greater profit they can obtain by avoiding royalty payments.[155] Furthermore, even if a lessee or operator is ultimately vindicated, *Bradshaw I*, *II* and *III* show that even the appearance of being involved in an executive's breach can bring about burdensome litigation. A potential lessee in the scenario stated above may wish to err on the side of caution and take steps beyond what a lessee is legally required to do, in order to respect non-executive interests. For instance, if the lessee chooses to develop, it could suspend any payments that would have gone to the non-executives at a market-rate lease until the statute of limitations on breach of duty claims runs out. A potential lessee may also judge the situation and choose to inform the non-executive of lease offers so as to avoid complicity in a possible breach. Such an action could create an uncomfortable situation

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[152] *Id.* at 271.

[153] *Id.*

[154] Ernest E. Smith, *The Standard of Conduct Owed by Executive Right Holders and Operators to the Owners of Nonparticipating and Nonoperating Interests*, 32 INST. ON OIL & GAS L. & TAX'N 241, 253–255 (1981).

[155] Although such admissions seem unlikely in actual negotiations, they can become part of the record. *See Texas Outfitters Ltd., LLC v. Nicholson*, 572 S.W.3d 647, 649 (Tex. 2019).

and bring about undesirable business consequences, but no legal liability would attach to the lessee for attempting to prevent an executive's breach of duty.

IV. Texas Outfitters Limited v. Nicholson

The latest addition to Texas executive rights jurisprudence is the Texas Supreme Court's 2019 opinion in *Texas Outfitters Limited, LLC v. Nicholson*. While this case did not involve a lessee defendant, its implications are important for executives and for lessees who would like to know when an executive may be breaching his or her duty. The Court's opinion was much-anticipated, as *Texas Outfitters* presented a chance for the Court to apply the guidelines in *Bradshaw* to a different kind of scenario: whether the executive breached a duty by *refusing* to lease. The San Antonio appellate court's opinion in *Texas Outfitters* had differentiated between the Lesley and Bradshaw standards, describing *Bradshaw* as a case that applied only "in context of the execution of a lease."[156] The San Antonio court's opinion also raised concerns among some oil and gas lawyers that executive right holders could now be liable for refusing to enter a lease that would have required the executive to lease his own interest, against his preferences.[157] In the petition for review, two primary questions were presented to the Texas Supreme Court:

- Does *Bradshaw* apply in all cases of alleged executive duty breach, including failure-to-lease cases? Or does it only apply when the executive has entered a lease?[158]
- Can a non-executive right holder compel the executive "to lease the executive's own mineral interest?"[159]

<u>Factual Background</u>

In 2002, the Carter family and their relatives the Hindes family each owned 50% of the mineral interest in the Derby Ranch, a 1,082-acre property in Frio County. The Carters owned the surface. A prospective buyer, Frank Fackovec, approached the Carters about purchasing the Derby Ranch. Fackovec's solely owned company, Texas Outfitters Limited (TOL)[160] ended up purchasing the surface of the ranch; a 4.16% mineral interest; and the

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[156] *Texas Outfitters Ltd., LLC v. Nicholson*, 534 S.W.3d 65, 73 (Tex. App.—San Antonio 2017, pet. granted).

[157] *See, e.g.*, Ezra A. Johnson & Robert M. Park, *Lesley and Bradshaw: A Tale of Two Duties*, STATE BAR OF TEXAS 35TH ANN. ADVANCED OIL, GAS & ENERGY RESOURCES LAW CH. 23 (2017).

[158] Petition for Review at xii, Texas Outfitters Limited, LLC v. Nicholson et al., 572 S.W.3d 647 (Tex. 2019) (No. 17-0509).

[159] *Id*. at xiii.

[160] The executive right holder will be referred to as "TOL", following the convention in the litigation. Fackovec, the sole owner of TOL, was ultimately not personally liable and his personal liability was not in dispute on appeal. *Texas Outfitters*, 572 S.W.3d at 651 n.4.

executive right. Owning the executive right was important to TOL because he intended to use the Derby as a commercial hunting ranch and, thus, wanted control over drilling activity thereon. Fackovec maintained he would not have purchased the property without it.[161] The Carters kept the non-executive rights to the other 45.84% of the minerals, and they partially seller-financed the one million dollar sale to TOL. At the time, the area had been through several boom-and-bust cycles, and the Carters seemed to believe that the minerals could not be economically developed.

Several years after TOL purchased the Derby Ranch, hydraulic fracturing improved the mineral development prospects in the area, and the Eagle Ford boom was in swing. Nevertheless, in March of 2010, TOL rejected a lease on the property offering a $450 an acre bonus and a 22% royalty for the 50% interest it and the Carters owned. Fackovec maintained this offer was too low. The Carters made no complaint, and that rejection did not become an issue.[162] In June 2010, however, El Paso Oil Exploration & Production Co. offered to lease the entire 50% interest for a 25% royalty and $1,750-per-acre bonus.[163] Though the Hindses entered into an identical lease with El Paso for the other 50% of the Ranch, TOL rejected El Paso's offer.

The Carters disagreed with TOL's refusal of the El Paso lease. Therefore, the Carters attempted to repurchase the executive rights to their own 45.84% from TOL in return for forgiving part of the loan amount TOL owed them (and alternatively, to some arrangement allowing them to lease). The first deal fell through because they could not agree on the extent of surface protections. TOL made alternate offers, including one where the Carter would end up with the executive right to their mineral interest, and TOL would receive a 25% mineral interest. After negotiations stretching over months, however, the Carters and TOL were unable to make a deal.[164] TOL received two more lease offers, but neither offer was brought to fruition: the first prospective lessee withdrew once it learned of the El Paso-Hindes lease, and the second lessee withdrew without offering a reason after TOL claimed to have accepted its offer in late 2011.[165] In June of 2011, the Carters sued TOL for breaching the executive's duty of utmost good faith and fair dealing. In 2012, TOL sold the Ranch for more than three times what it paid for it, after the area proved to be unproductive for mineral development.

161 *Texas Outfitters*, 572 S.W.3d at 649.

162 *Id.*

163 *Id.*

164 *Id.* at 650 n.2.

165 *Id.* at 650.

Bench Trial and San Antonio Court of Appeals Opinion

The case was tried to the bench. The trial court found TOL had, in fact, breached its executive duties to the Carters by refusing to enter the El Paso lease.[166] The court entered a judgment for the Carters in the amount they would have received in bonuses had TOL leased to El Paso: $867,654.32, plus interest and costs, totaling over one million dollars. The trial court's findings[167] did not clearly identify the evidence upon which it based its breach finding. For example, the trial court found credible the Carters' testimony that Fackovec said he never intended to lease.[168] The trial court also found that TOL impermissibly "gamble[d]" with the non-executive interest by waiting for a lease offer better than El Paso's – particularly given that the other 50% of the mineral estate was already leased.[169] The intermediate appellate court affirmed the trial court ruling's and held that TOL had taken actions that "essentially preclude[d] a mineral lease" out of a self-interested desire to protect the surface.[170] In its opinion, the San Antonio Court of Appeals posited that the *Bradshaw* test should apply only to cases where the executive entered a lease.[171] The relevant test for refusals to lease, according to the Court of Appeals, was from *Lesley*: Was the executive's refusal arbitrary or motivated by self-interest to the non-executive's detriment?[172] The Court of Appeals also noted as an alternative holding, however, that TOL had breached its duty under the *Bradshaw* standard if it applied.[173] As noted above, the question of what standard applied and what *Lesley* and *Bradshaw* stood for was a pressing issue at the Texas Supreme Court level.

Supreme Court of Texas Decision

At the Texas Supreme Court, TOL argued the Carters' evidence was legally insufficient to find breach and that the San Antonio Court of Appeals had misapplied the standard. All TOL had done, it claimed, was "gamble" on receiving a lease offer better than El Paso's, as a trial court finding stated. According to TOL, taking this gamble was not a breach of

[166] *Id.* at 650–51.

[167] The trial court described some of its factual findings as conclusions of law, but the error did not ultimately affect how the findings were treated. *Id.* at 653 n.7.

[168] *Id.* at 651.

[169] *Id.*

[170] *Texas Outfitters Ltd., LLC v. Nicholson*, 534 S.W.3d 65, 78 (Tex. App.—San Antonio 2017, pet. granted).

[171] *Id.* at 73.

[172] *Id.* at 71–72.

[173] *Id.* at 78 n.4.

its executive duties.[174] The Texas Supreme Court agreed that a good faith lease refusal "in honest anticipation of obtaining better terms for all"[175] would not generally be a breach of duty. Unfortunately for TOL, the Court disagreed with TOL's overall characterization of the facts and affirmed the result, albeit not the rule application, of the lower court. First, the Court clarified that one inquiry guided breach of executive duty cases, regardless of whether the executive had leased or failed to lease. The Court cited *Bradshaw* for the "controlling inquiry": "'whether the executive engaged in acts of self-dealing that unfairly diminished the value of the non-executive interest.'"[176] The Court then noted several acts of self-dealing by TOL.[177] These acts included:

- refusing the El Paso lease, which was higher in bonus and royalty than the previous lease offer it had received, knowing that the Carters owned a much greater mineral interest and wanted the lease;

- TOL knew that there would be fewer options for leasing the Carter/TOL interest to another operator once El Paso leased the other half of the minerals underlying the tract, but refused El Paso anyway;

- Negotiating for surface protection from El Paso at the Carters' expense;

- A subsequent prospective lessee's behavior (withdrawing its lease offer because El Paso had a lease on the other 50%) confirmed that TOL's refusal led to less competition for the Carters' minerals, reducing their value;

- The Carters' testimony that Fackovec stated he refused the El Paso lease due to TOL's hunting operations, not because it was waiting for a better offer;

- TOL benefited from an unleased mineral estate by running hunting operations on the surface and then selling the ranch at a higher price than it could have had a lease existed.

All this, the Court concluded, supported the trial court's finding that Texas Outfitters engaged in self-dealing at the Carters' expense.[178]

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174 Transcript of Oral Argument, Texas Outfitters Limited, LLC v. Nicholson et al., 572 S.W.3d 647 (Tex. 2019) (No. 17-0509), http://search.txcourts.gov/SearchMedia.aspx?MediaVersionID=e605ffce-c401-4bc1-9ad0-03aec98e1ba1&coa=cossup&DT=ORAL%20ARGUMENT&MediaID=094887a7-9bab-4949-8958-0ad38a909dfd.

175 *Texas Outfitters*, 572 S.W.3d at 654–55.

176 *Id.* at 652 (citing *KCM Financial v. Bradshaw*, 457 S.W.3d 70, 82 (Tex. 2015)).

177 *Id.* at 654–55.

178 *Id.* at 657–58.

Lessons and Questions following *Texas Outfitters*

The facts at issue in Texas Outfitters did not allow the Court to address certain questions lingering after Bradshaw. On one topic, however, the rule seems clear: Due to the multifarious scenarios in which an executive breach may arise, the Texas Supreme Court will not promulgate a single rule governing alleged breaches of executive duties. The Court made clear, however, the general inquiry for determining whether the executive has breached his or her duty is whether the executive has acquired benefits for only himself, or otherwise "engaged in acts of self-dealing that unfairly diminish"[179] the value of the non-executive's interest. The Court repeatedly emphasized that executive breach inquiries are a "heavily dependent on the facts and circumstances"[180] – no single fact in *Texas Outfitters* was dispositive. If circumstances warrant, an executive might be required to lease his own interest contrary to his preferences, or to otherwise "subjugate"[181] his interest to the non-executives by declining benefits that would bring about harm to the value of the non-executive's interest.[182] If a scenario such as that in *Hlavinka v. Hancock*[183] were to play out in court today, a jury or judge could reach the contrary result and hold the executives in breach of their duty for looking to neutralize surface burdens the non-executives did not share.

Texas Outfitters' unusual fact situation is also a warning to executive right holders: If you sought and paid for the executive right, but discussed your intentions with other parties, then you probably will not get what you paid for. It evidently does not matter whether the executive makes statements during negotiations, where a party might reasonably be expected to make exaggerated claims. Indeed, the case throws into doubt when the executive right can be used for surface protection. *Lesley*[184] (which had not yet been decided when TOL purchased the executive right) had made clear that protecting the surface by doing one's best to preclude development is a breach of the executive duty. *Texas Outfitters* signals that excessive fastidiousness about lease terms and surface protections can also bring about liability.

On the other hand, *Texas Outfitters* was procedurally about the sufficiency of the evidence. One way of reading Texas Outfitters is as a case about credibility and storytelling. The trial court found the non-executives' testimony more credible than the

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179 *Id.* at 655, 657.

180 *Id.* at 653.

181 *Id.* at 653 n.6.

182 *Id.*

183 *Hlavinka v. Hancock*, 116 S.W.3d 412 (Tex. App.—Corpus Christi 2003, pet. denied). The case is discussed in section II(A).

184 352 S.W.3d 479 (Tex. 2011).

executive's, and the Texas Supreme Court opened its opinion by framing the case as so: "[W]e are asked to apply the duty in the context of an executive's refusal to lease in contravention of the non-executive's known wishes."[185] The record contained as much support for framing the issue as one where the executive wished to use the right he bargained for, and where the parties could not reach a compromise.[186] Further, as noted above, the appellate courts were bound by a litany of determinations of the trial court. Perhaps *Texas Outfitters* will become, somewhat like *Manges*, a case where the court's comments on rules are particular to the facts. After all, if the trial court had not found persuasive the non-executive's testimony about TOL revealing it never intended to lease, the case might have turned out differently. Perhaps *Texas Outfitters* will lead to litigation where the non-executives' behavior will push a court to clarify to what extent an executive can protect his own interests when making leasing decisions. Whatever the future holds, for now, *Texas Outfitters* has crystallized the one guiding inquiry for executive duty cases (whether the executive "engaged in acts of self-dealing that unfairly diminish"[187] the value of the non-executive's interest), while emphasizing that one standard will be inadequate for the innumerable combinations of conflicting interests breach of executive duty cases can present.

<u>Practical Advice</u>

Going forward, what can a purchaser seeking surface protection do, barring purchase of the entire mineral estate? Is control over leasing and development still worth seeking? When, if ever, can the executive protect the surface without fear of a lawsuit when the non-executive cannot share in benefits to the surface? One option purchasers like TOL may try is ensuring the conveyance of the executive right specifies the parties' expectations upfront. Could the purchaser of the executive right negotiate for sole and absolute discretion and a waiver of any fiduciary duties the executive owes the non-executive? If the non-executive is unwilling to contract away the executive's duty entirely, or if the potential executive fears such an agreement will not be upheld, the parties could preemptively specify the contours of the duty. The deed could answer the question of what lease refusals would be acceptable. An executive could establish what level of surface protections he would be comfortable with, and the non-executive could outline what kind of lease would be acceptable in the conveyance or accompanying sale contract. An executive may also simply have to purchase a larger share of the minerals in order for his

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[185] *Texas Outfitters*, 572 S.W.3d, at 649.

[186] Indeed, the case has facts to support a different kind of story, one where TOL bargained for the executive right, and the sellers were willing to part with it when they believed mineral development was unlikely. When their predictions proved incorrect, they pushed the executive to lease against its interest, and ultimately were able to depriving him of what he had bargained for. This story is similar to a hypothetical described by Professor Ernest Smith in his 1985 paper. Ernest E. Smith, *Implications of a Fiduciary Standard of Conduct for the Holder of the Executive Right*, 64 TEX. L. REV. 371, 373-74 (1985).

[187] *Id.* at 655, 657.

decisions to appear legitimate; one of the facts against TOL's favor was that he only owned a 4.16% interest. One reason his claim to waiting for a higher bonus and royalty was viewed suspiciously was that little of the increase in benefits would accrue to him. A prospective executive's best bet, however, might just be to avoid becoming the sole owner of the surface in areas where other parties own oil and gas interests.

V. Executive rights jurisprudence in other states

Texas is a standout in the amount of executive duty litigation it experiences, but it is not unusual in the formulation of the executive right holder's duty.[188] The standard of "utmost good faith," sometimes also described as an equivalent to the "ordinary prudent landowner"[189] standard, is the majority standard across states.[190] For instance, New Mexico, an ownership-in-place state,[191] also applies the standard of utmost good faith to the executive's actions.[192] In *Murdock v. Pure-Lively Energy 1981–A, Ltd.*,[193] a perpetual royalty owner argued the executive right holder owed the royalty owner a fiduciary duty analogous to a trustee's duty.[194] The New Mexico Supreme Court rejected the idea that the executive must "subordinate his interest to those of royalty owners."[195] Instead, the court cited *Manges* and imposed the "utmost good faith standard" falling between a true fiduciary standard and ordinary good faith.[196]

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[188] Treatises and articles with a national scope overwhelmingly cite to Texas case law on the topic of executive rights. *See, e.g.*, 2 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 339 (2018); 1 E. Kuntz, Law of Oil and Gas, § 15.7 (Matthew Bender & Co., Inc., ed. 2018) ; OWEN L. ANDERSON ET AL., HEMINGWAY OIL AND GAS LAW AND TAXATION 46–53, § 2.2(D) (Thompson West eds., 4th ed. 2004); Patrick A. Martin, *Unbundling the Executive Right: A Guide to Interpretation of the Power to Lease and Develop*, 37 NAT. RESOURCES J. 311, 354–404 (1997).

[189] *Mims v. Beall*, 810 S.W.2d 876, 878 (Tex. App.—Texarkana 1991, no writ).

[190] *See* 2 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 339.2 (2018).

[191] Thomas J. Turner Jr., *A Primer on New Mexico Oil and Gas Law: State, Federal, and Fee Lands*, 6 L.S.U. J. ENERGY L. & RES. 435, 444 (2018).

[192] 1989-NMSC-048, 775 P.2d 1292 (N.M. 1989).

[193] *Id. Murdock* is one of the few cases on the duty of utmost good faith, but New Mexico's overall body of oil and gas case law is limited. Gregory J. Nibert, *Overview of New Mexico Oil and Gas Law*, 2, available at http://hadoa.memberlodge.org/resources/Documents/01_CDOA/Chapter%2013_Manual%20Plano%20Review.pdf.

[194] *Murdock*, 775 P.3d at 1295.

[195] *Id.* at 1296.

[196] *Id.*

In Illinois's leading case on the subject,[197] the Appellate Court of Illinois adopted the utmost good faith standard to govern the executive's duty to the non-executive.[198] The executive and non-executive in *Schroeder v. Schroeder* had formerly been married. The non-executive had quitclaimed to her then-husband her interest in a 54-acre tract; she reserved the minerals. The ex-husband received the exclusive right to lease her minerals until the property was sold or until he died. In a case of first impression in Illinois, the ex-wife sued the ex-husband for violating a "fiduciary obligation of utmost fair dealing in leasing her interest."[199] The ex-husband executive had leased the minerals for a one-eighth royalty, split equally between himself and the non-executive, and an overriding royalty of one-sixteenth of seven-eighths of gross production, payable only to himself. The trial court found that the override was provided in exchange for the executive's lease execution.[200] The executive also memorialized his override in a separate agreement with the lessee's landman, rather than include the override grant in the lease.[201] The court found the executive breached the duty of utmost fair dealing to the non-executive by receiving the override as lease compensation and keeping it for himself.[202] As damages, the non-executive had the executive's right voided prospectively; was awarded an assignment of one-half of executive's overriding royalty interest; and received one-half of the net proceeds of the royalty and other profits the executive had withheld, plus interest on the amount of overriding royalty the executive had wrongfully withheld.[203] The lessee and pipeline purchaser, whom the non-executive had sued to obtain impoundment and accounting of payments to the executive, both were ordered to adjust their records and accounts in line with the court's award to the non-executive.[204]

The Colorado appellate courts have not addressed the issue of what duty the executive owes the non-executive.[205] However, Colorado might follow Texas law if it does. The Colorado Court of Appeals cited Texas law when it recognized that the executive right to lease is a conveyable property interest that can be passed to an executive right holder's

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[197] *Schroeder v. Schroeder*, 479 N.E.2d 391 (Ill. App. Ct. 1985).

[198] *Id*. at 398–99.

[199] *Id*. at 393.

[200] *Id*. at 399.

[201] *Id*. at 395–96.

[202] *Id*. at 399.

[203] *Id*. at 396.

[204] *Id*.

[205] Rollin Wood, *On the Nature of the Executive Right to Lease Oil and Gas* (Feb. 15, 2018), https://www.kmd.law/articles/2018/february/on-the-nature-of-the-executive-right-to-lease-fo/. A Westlaw search confirms this dearth of Colorado case law on the executive duty.

successors in interest.[206] In *Mull Drilling*, the nature of the executive right determined what rights passed to the successors in interest of grantees of a warranty deed. At stake was whether the plaintiffs, who believed they had inherited the executive right, had validly executed leases to the land conveyed by the warranty deed. The defendants argued that the executive right was a personal right that could not be inherited or assigned unless the conveying instrument expressly provided so.[207] The court disagreed, citing the Texas approach in *Day & Co.*[208] Colorado has had no significant executive rights litigation since *Mull* was decided. One Colorado treatise comments that "it remains questionable whether the power to give an oil and gas lease" can be a standalone property ownership right after *Mull*.[209]

Louisiana, a non-ownership-in-place state,[210] codified rules from its case law on executive rights in 1975.[211] The executive right is "the exclusive right to grant mineral leases of specified land or mineral rights."[212] As in Texas, the executive right in Louisiana is a mineral right that can exist separately from the other mineral attributes, or combined with them.[213] Generally, the rules that apply to the mineral servitude apply to a mineral servitude from which the executive right has been separated.[214] The executive right is "alienable and heritable," as mineral rights in general are, unless the party creating the right provides otherwise.[215] Non-executive interests, such as mineral servitudes stripped of the executive right, are owed a duty of good faith by the executive right owner.[216]

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[206] *Mull Drilling Co., Inc. v. Medallion Petroleum, Inc.*, 809 P.2d 1124, 1126 (Colo. App. 1991)(citing *Day & Co. v. Texland Petroleum, Inc.*, 786 S.W.2d 667 (Tex. 1990)).

[207] *Id.* at 1125.

[208] *Id.* at 1125.

[209] 1B COLO. PRAC. METHODS OF PRACTICE § 10:2 (West 2019).

[210] Unlike in ownership-in-place states, a landowner does not own the minerals underneath his land, only the right to produce the minerals. Minerals can be owned once they are produced. Patrick H. Martin & J. Lanier Yeates, *Louisiana and Texas Oil and Gas Law*: *An Overview of the Differences*, 52 LA. L. REV. 769, 803 (1992). Instead of bringing about a severed mineral estate, a landowner who conveys the right to produce minerals has conveyed a mineral servitude upon the land. *Id.* at 804; LA. STAT. § 31:21 (1975).

[211] Chapter 6 of the Louisiana Mineral Code is dedicated to executive rights. LA. STAT. §§ 31:105 to 113 (1975).

[212] LA. STAT. § 31:105 (1975).

[213] LA. STAT. § 31:106 (1975).

[214] LA. STAT. § 31:111 (1975).

[215] LA. STAT. § 31:18 (1975); Patrick S. Ottinger, *Current Issues Under the Louisiana Law of Oil and Gas*, at 50, 30TH ANN. ENERGY INST. FOR ATT'YS & LANDMEN (2017).

[216] LA. STAT. § 31:109 (1975).

Louisiana calls this a reasonably prudent landowner standard.[217] Commentary and application make clear that the standard means executive should acquire for the non-executive whatever benefits he secure for himself under a lease. For example, the executive who shares the rest of the mineral rights with the non-executive should not negotiate for a lower royalty in exchange for an overriding royalty due to the executive alone.[218]

In Article 109, Louisiana has clarified by statute one of the uncertainties in Texas law: An executive right owner has no duty to enter a lease.[219] The Code expressly rejects previous case law that held the executive does not owe a duty to the non-executive.[220] This striking difference exists because Louisiana has a liberative prescription system that applies to executive rights and other mineral interests; an executive who allows ten years to pass and does not enter a lease in that time will have his interest terminate through merger.[221] Liberative prescription reduces the problems resulting from fractionalized mineral ownership,[222] a problem the executive right is commonly thought to target.[223] "Good faith operations for the discovery of minerals,"[224] which require actual drilling operations,[225] will interrupt the running of the prescriptive period.

If the executive does exercise the leasing power, however, then the executive duty applies. If an executive does breach the duty of fair dealing in leasing, the non-executive has one year from the lease being filed to bring suit against the executive for damages.[226] A lease

[217] *Id*. Texas also has some case law using the "ordinary, prudent landowner" language to mean that a duty between ordinary good faith and a fiduciary standard governs the executive's conduct. This standard is based on commentary by Williams and Meyers. *See*, *e.g*., *Mims v. Beall*, 810 S.W.2d 876, 878 (Tex. App.—Texarkana 1991, no writ).

[218] LA. STAT. § 31:109, cmt. (1975).

[219] LA. STAT. § 31:109 (1975).

[220] LA. STAT. § 31:109, cmt. (1975).

[221] LA. STAT. § 31:105, cmt. (1975).

[222] Patrick H. Martin & J. Lanier Yeates, *Louisiana and Texas Oil and Gas Law*: *An Overview of the Differences*, 52 LA. L. REV. 769, 806 (1992).

[223] Christopher S. Kulander, *The Executive Right to Lease After KCM Financial LLC v. Bradshaw and a Louisiana Solution to a Texas Problem*, 48 ST. MARY'S L.J. 637, 643 (2017).

[224] LA. STAT. § 31:29 (1989).

[225] Louisiana's Mineral Code sets out what activities will interrupt the prescriptive period. LA. STAT. §§ 31:29 to 39 (1989).

[226] LA. STAT. § 31:110 (1975).

containing terms violating the executive duty of fair dealing is "not invalid for that reason."[227]

Louisiana has clarified another matter that might not be fully settled in Texas: the non-executive's right to develop. The non-executive cannot develop without the consent of the executive right holder. This follows from Article 112, which provides that "When the executive right is separated from a mineral servitude or ownership of the land, the land or servitude owner has the right, with the consent of the owner of the executive right, to conduct drilling or mining operations on the land."[228]

Comparing executive rights and duties jurisprudence across states highlights how much more case law Texas has developed on the subject. That Texas outstrips other states in executive breach of duty litigation is unsurprising, given other features of oil and gas law in Texas. For instance, Texas does not have a surface damages act. Parties might seek the executive right to be able to negotiate surface protections and safeguards against disruption of surface use (in some cases, as we have seen, by refusing to lease altogether) rather than rely on the accommodation doctrine, where the surface user must meet a burden of proof and which can only be used to accommodate a preexisting use.[229] Texas also has no dormant mineral act or other legislation that clears title by reverting mineral interests when a mineral estate is fractionalized among owners who do not make use of their mineral interests.[230] Texas also has a compulsory pooling statute generally regarded as weak when compared to the compulsory pooling regimes of other states;[231] when making leasing decisions, executives may safely disregard the possibility of being force-pooled.

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[227] *Id.*

[228] LA. STAT. § 31:112 (1975).

[229] "To obtain relief on a claim that the mineral lessee has failed to accommodate an existing use of the surface, the surface owner has the burden to prove that (1) the lessee's use completely precludes or substantially impairs the existing use, and (2) there is no reasonable alternative method available to the surface owner by which the existing use can be continued...If the surface owner carries that burden, he must further prove that given the particular circumstances, there are alternative reasonable, customary, and industry-accepted methods available to the lessee which will allow recovery of the minerals and also allow the surface owner to continue the existing use." *Merriman v. XTO Energy*, 407 S.W.3d 244, 249 (Tex. 2013).

[230] Terrell Fenner, Comment: *A Problem Lurking Just Below the Surface: The Need in Texas for Dormant Mineral Legislation*, 2 TEX. A&M L. REV. 501, 502 (2015).

[231] Mineral Interest Pooling Act of 1965 (MIPA), TEX. NAT. RES. CODE §§ 102.003 (West). MIPA applies to reservoirs discovered and produced after March 8, 1961.

For one last contrast, North Dakota and New Mexico are both among the country's top energy-producing states,[232] [233] but both have little executive duties litigation even when taking into account the low amount of case law in each state. The executive right in North Dakota is, as in Texas, one of the rights in the mineral bundle.[234] A lessee in North Dakota who cannot obtain a lease can have the holdout interests force-pooled, regardless of the mineral owners' consent.[235] The North Dakota Industrial Commission, which maintains an active docket of force-pooling hearings, can provide in force-pooling orders for the royalty amount due to nonconsenting mineral owners.[236] This likely obviates disputes over what lease terms would have been. North Dakota also has a dormant mineral act,[237] a tool for addressing the issue of fractionalized ownership, and a robust surface owners protection act.[238] Similarly, New Mexico has a strong compulsory pooling regime[239] and, since 2007, a statutory scheme for Surface Owners Protection[240] requiring operators to offer compensation and reclaim surface estates damaged by oil and gas operations.

VI. Conclusion

Over twenty years ago, Patrick H. Martin wisely and presciently commented that "[f]rom the initial discussion of the variety of circumstances in which the executive right arises

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[232] *State Energy Profile: North Dakota*, U.S. ENERGY INFO. ADMIN. (Mar. 17, 2019), https://www.eia.gov/state/?sid=ND#tabs-3. In 2017, the most recent year for which the EIA has published data, North Dakota ranked sixth in total energy production in the nation. *U.S. States, Rankings: Total Energy Production, 2017*, U.S. ENERGY INFO. ADMIN., https://www.eia.gov/state/rankings/#/series/101.

[233] *State Energy Profile: New Mexico*, U.S. ENERGY INFO. ADMIN. (Mar. 17, 2019), https://www.eia.gov/state/?sid=NM. New Mexico ranked ninth overall in total energy production in 2017, the most recent year for which the EIA has published data. *U.S. States, Rankings: Total Energy Production, 2017*, U.S. ENERGY INFO. ADMIN., https://www.eia.gov/state/rankings/#/series/101.

[234] N.D. MINERAL TITLE STANDARDS § 5-01 (N.D. State Bar Ass'n 2012). North Dakota law has not, however, clarified whether an executive right is a real property right that can be inherited without express language indicating as much. *See* Timothy C. Dowd, *Oil and Gas Title Law – A Review of Fifty Common Problems – North Dakota*, 90 N.D. L. REV. 289, 310 (2014).

[235] The North Dakota Supreme Court has stated that an objecting owner's consent "is irrelevant if an interested person applies to the Commission for a pooling order." *Egeland v. Cont'l Res., Inc.*, 616 N.W. 2d 861, 865 (N.D. 2000). The category "interested" persons encompasses any owner (whether mineral or working interest) with an interest in production from the well proposed for the drilling unit in the pooling order. N.D. CENT CODE § 38-08-08(1) (2009).

[236] N.D. CENT CODE § 38-08-08(1) (2009).

[237] N.D. Cent. Code § 38-18.1 *et seq.* (2009).

[238] N.D. CENT. CODE §§ 38-11.1 *et seq.* (1979).

[239] N.M. STAT. §§ 70-2-17(C) (1977).

[240] N.M. STAT. §§ 70-12-1 *et seq.* (2007).

and the differing purposes that the executive right may serve it should be seen that no single standard is likely to be found applicable, nor should there be such a single standard. The standard should depend upon the nature of the interests involved, the circumstances in which they arose, and the relationship that the parties have themselves established...."[241] The Texas Supreme Court's recent decisions seem to have fixed this flexibility into law by setting forth a "controlling inquiry," but not a single standard to govern the duty the executive owes non-executives. While this flexibility is to be lauded, the questions this case law has raised and the fact-intensive inquiries that executive duty cases precipitate means uncertainty in litigation regarding executive duty breaches is sure to continue.

[241] Patrick A. Martin, *Unbundling the Executive Right: A Guide to Interpretation of the Power to Lease and Develop*, 37 NAT. RESOURCES J. 311, 375–76 (1997).