TEXAS OIL & GAS

CASE LAW UPDATE

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I. SCOPE OF THE ARTICLE

This article surveys oil and gas cases decided by the Supreme Court of Texas and Texas Courts of Appeals from October 1, 2010 through April 15, 2011.

II. SUMMARIES

1. The Texas Railroad Commission need not consider traffic safety when deciding to permit the conversion of an oil well into an injection well. The Texas Supreme Court held that the Railroad Commission's interpretation of the phrase "public interest" that did not include consideration of traffic-safety concerns was a reasonable interpretation of the Texas Water Code and entitled to deference. *Railroad Comm'n of Texas v. Texas Citizens for a Safe Future and Clean Water*, No. 08-0497, 2011 WL 836827 (Tex. 2011) (Mar. 11, 2011) (not released for publication).

2. A party may be liable for fraud based on misrepresentations in a well-plugging report filed with the Texas Railroad Commission. The Texas Supreme Court held that misrepresentations in a plugging report filed with the Railroad Commission could sustain an action for fraud if the filing party knew of an especial likelihood that a specific party would rely on the report at the time the report was filed. *Exxon Corp. v. Emerald Oil & Gas Co., L.C.*, No. 05-1076, 2011 WL 1226100 (Tex. 2011) (Apr. 1, 2011).

3. An oil and gas reserve determination date in an oil and gas lease does not limit the information that may be considered in the determination to only the information which was available on or before the determination date. The court of appeals held that all available information may be used to aid in the calculation of the amount of oil and gas reserves that existed on the determination date (including information discovered after the determination date) in order to ascertain if an automatic termination clause activated. *Martin v. Saga Petroleum Corp.*, 332 S.W.3d 646, (Tex. App.—Eastland [11th Dist.] Nov. 4, 2010).

4. An offer of settlement is not a demand that will activate a forfeiture clause in an oil and gas lease. The court of appeals held that a settlement demand letter was not a demand notice that was required to cause forfeiture of lease interests. *Vinson Minerals, LTD. v. XTO Energy, Inc.*, No. 02-08-00453, 2011 WL 5118649 (Tex. App.—Fort Worth, Dec. 16, 2010).

5. A producer is not liable to an oil and gas royalty owner for "benefit of the bargain" damages based on shortages in well accounts if there is no causal link between the shortages and a decrease in the royalty owner's profit or an increase in the royalty owner's expenses. The court of appeals held that there was not sufficient evidence to prove that royalty owners suffered "benefit of the bargain" damages or that the well operator breached its contract with the royalty owners or committed statutory theft. There was, however, sufficient evidence for a fraud claim against the operator. *R & R Resources Corp. v. Echelon Oil and Gas, LLC*, No. 03-07-00636-CV, 2011 WL 5575919 (Tex. App.—Austin, Jan. 14, 2011) (mem. op.).

6. A well operator may not be required before trial to deposit disputed well operating funds into the court registry before there is a finding that the operator is justly indebted to the royalty owner and that there is a danger that the funds will be lost or depleted. The court of appeals reversed a trial court's pre-trial order of attachment that required the well

operator to pay disputed royalty payments into the court registry. *In re Reveille Resources, Inc.*, No. 04-10-00742-CV, 2011 WL 149872 (Tex. App.—San Antonio, 2011, Jan. 19, 2011) (unpublished opinion).

7. A well operator and the royalty owner can both be prevailing parties in a suit brought under the same contract where the operator sues for money damages and the royalty owner sues for declaratory relief. The court of appeals held that both the well operator and royalty owner were prevailing parties because there were essentially two suits brought under the contract (one for declaratory relief and the other for damages) and each party succeeded on a least one of their claims against the other. *Mohican Oil & Gas, LLC v. Scorpion Exploration & Production, Inc.*, No. 13-09-00516-CV, 2011 WL 242424 (Tex. App.—Corpus Christi, Jan. 27, 2011).

8. Casinghead gas sold "at the well" does not include downstream sales of natural gas liquids. Also, CO2 that is injected into an underground formation to aid in oil and gas production and is later recovered is not subject to royalty payments. The court of appeals declined to interpret an oil and gas lease that provided for royalty payments on unprocessed casinghead gas sold "at the well" to include the proceeds of downstream sales of processed natural gas liquids. The court also held that CO2 used to aid in the recovery of other oil and gas hydrocarbons does not lose its character as personal property when injected back into the ground and is thus not subject to the rule of capture when it is recovered. *Occidental Permian LTD., v. The Helen Jones Foundation*, 333 S.W.3d 392 (Tex. App.—Amarillo [7th Dist.] Jan. 31, 2011).

9. The granting clause controls over a conflicting future lease clause to determine the royalty interest conveyed by a deed. The court of appeals held that the granting clause of a deed conveying a royalty interest controlled over a conflicting future lease clause because a reversion in interest would potentially occur each time a subsequent future lease was executed if the future lease clause was given effect. *Hausser v. Cuellar*, No. 04-09-00560-CV, 2011 WL 313757 (Tex. App.—San Antonio, Feb. 2, 2011) (not released for publication).

10. A mineral interest automatically reverted when the leases under a joint operating agreement terminated, even though none of the parties to the joint operating agreement asserted that the agreement or the leases subject to it had terminated. The court of appeals affirmed the trial court's determination that a 25% mineral interest reverted when 60 consecutive days passed without any production under the subject oil and gas leases, yet none of the parties complained at the time about the lapse in production. *Prize Energy Resources, L.P. v. Hoskins*, No. 04-09-00603, 2011 WL 648996 (Tex. App.—San Antonio, Feb. 23, 2011) (not released for publication).

11. A farmout agreement that does not specify drilling locations but requires the parties to later agree on mutually acceptable locations is unenforceable. The court of appeals held that a farmout agreement that requires later agreement on drilling locations leaves material matters open for future agreement and is not enforceable. *Aurora Petroleum, Inc. v. Cholla Petroleum, Inc.*, No. 07-10-0035-CV, 2011 WL 652843 (Tex. App.—Amarillo, Feb. 23, 2011) (mem. op.).

12. A pipeline operator was reasonably prudent even though an oil spill occurred from one of its pipelines and it had violated Railroad Commission regulations. The court of appeals affirmed a jury's determination that a pipeline operator was not negligent when an oil spill occurred from a leak in a pipeline coupling buried three feet underground, and where there was evidence that the operator was not negligent in maintaining the pipeline. *Smith v. BASA Resources, Inc.*, No. 11-09-00339, 2011 WL 1435273 (Tex. App.—Eastland, Apr. 14, 2011).

13. A forfeiture provision is not an unenforceable penalty for liquidated damages and may be enforced by a well operator that does not own an interest in the well production. The court of appeals upheld the forfeiture of a working interest owner's interest under a joint operating agreement because the owner did not consent to the drilling of a new well to reestablish oil and gas production to continue the leases. *Long v. RIM Operating Inc.*, No. 11-09-00328-CV, 2011 WL 1431476 (Tex. App.—Eastland, Apr. 14, 2011) (not released for publication).

14. A forged sale agreement is void and cannot be ratified by a party to the agreement. The court of appeals held that an agreement to sell oil and gas properties that was executed because of a forged signature is void from its inception and cannot be ratified by a party's acceptance of payment under the agreement. *Raven Resources, LLC v. Legacy Reserves Operating LP*, No. 11-09-00348-CV, 2011 WL 1744079 (Tex. App.—Eastland, Apr. 15, 2011) (not released for publication).

III. CASES

1. *Railroad Comm'n of Texas v. Texas Citizens for a Safe Future and Clean Water*, No. 08-0497, 2011 WL 836827 (Tex. 2011) (Mar. 11, 2011) (not released for publication).

In *Texas Citizens*, the Texas Supreme Court held that the Railroad Commission's interpretation of the phrase "public interest" that did not include consideration of traffic-safety concerns was reasonable and entitled to deference.

A company seeking to convert an oil well into an injection well for oil and gas waste must apply to the Railroad Commission for a permit before doing so. Before a permit is granted, the Commission is required to find, among other things, "that the use or installation of the injection well is in the public interest."

Pioneer Exploration, Ltd. applied to the Commission for a permit to convert an existing well into an injection well for the disposal of oil and gas waste. But several local residents living near the well – Texas Citizens for a Safe Future and Clean Water – opposed granting a permit for the proposed injection well and contested the conversion in a hearing before the Commission. Texas Citizens voiced several concerns and presented evidence that large trucks used to haul waste water to the well would create traffic safety issues and thus would not serve the "public interest."

The Commission ultimately issued a permit. Its findings focused on the proposed well's effect on the conservation of natural resources. Specifically the Commission found that the injection well would provide needed disposal capacity for expanding operations and increase the ultimate

recovery from wells in the area. The Commission also noted that it does not have jurisdiction to regulate truck traffic on the state's roads and highways.

Texas Citizens appealed to the trial court, which affirmed the Commission's order. The court of appeals, however, reversed, holding that the Commission abused its discretion in interpreting "public interest" too narrowly by focusing on the well's effect on the conservation of natural resources and not other factors. The Commission appealed to the Supreme Court, which reversed.

The Supreme Court framed the issue as one of deciding whether the Commission's interpretation of "public interest" was reasonable and in accordance with the plain language of the statute. The Court ruled that it was reasonable for four reasons. First, the Legislature included a traffic related inquiry in one part of the statute, but excluded a traffic inquiry from the portion laying out the evidence to be considered by the Commission. Second, the surrounding statutory scheme exclusively concerns matters related to the production of oil and gas, and is completely unrelated to traffic safety. Third, the Commission's purpose under the statute is to "maintain the quality of fresh water in the state to the extent consistent with public health and welfare" – a narrow policy statement that does not mention promoting traffic safety. Finally, in the portions of the statute where the Legislature intends for the Commission to evaluate a specific factor in considering the public interest, it specifically says so. Therefore, the court held that the Commission's interpretation of "public interest" was reasonable under the plain language of the statute and entitled to deference.

Chief Justice Jefferson wrote an opinion concurring in the judgment that was joined by Justice Willett and Justice Lehrmann. Chief Justice Jefferson argued that the statute at issue unambiguously precludes the Railroad Commission from considering traffic safety factors as part of its public interest inquiry.

2. *Exxon Corp. v. Emerald Oil & Gas Co., L.C.*, No. 05-1076, 2011 WL 1226100 (Tex. 2011) (Apr. 1, 2011).

In *Emerald Oil*, the Texas Supreme Court held that misrepresentations in a plugging report filed with the Railroad Commission could sustain an action for fraud if the filing party knew of an especial likelihood that a specific party would rely on the report at the time the report was filed.

Exxon Texas, Inc. was the lessee in mineral leases with Mary Ellen and Thomas James O'Connor ("royalty owners") on a field across several thousand acres in Refugio County. Exxon's lease with the royalty owners provided for a 50% royalty. Exxon operated the field for over forty years, paying over $43 million in royalties. In the early 1970's, Exxon attempted to renegotiate a lower royalty because profitability of the operation was declining. The royalty owners declined to renegotiate the royalty.

After deciding that it was no longer profitable to continue operating the field, Exxon began systematically plugging and abandoning the wells. The royalty owners in a series of letters demanded that Exxon cease plugging operations and informed Exxon that they had located a group of oil and gas companies willing to accept assignment of the leases. The royalty owners also indicated their interest in future oil and gas production in the leases.

Nevertheless, Exxon completed plugging operations and filed plugging reports with the Railroad Commission. The Railroad Commission mandates that, "[n]on-drillable material that would hamper or prevent re-entry of a well shall not be placed in any wellbore during plugging operations….Pipe and unretrievable junk shall not be cemented in the hole during plugging operations without prior approval by the district director or the director's delegate."

Emerald Oil & Gas Company, L.C. became the subsequent lessee under the leases after Exxon and attempted to re-enter the wells. Emerald encountered difficulties while attempting to re-enter and allegedly found metals, refuse, environmental contaminants, non-drillable materials, and cut casing inside the wells.

The royalty owners and Emerald sued asserting several causes of action. The issues that were ultimately appealed to the Supreme Court were the royalty owners' claims for statutory waste, common law waste, and breach of lease; as well as Emerald's claims for negligent misrepresentation, tortious interference, and fraud. The court held that the royalty owners' claims for statutory and common law waste as well as Emerald's negligent misrepresentation and tortious interference claims were barred by limitations. The court also held that the record proved as a matter of law that Exxon did not breach its lease with the royalty owners.

As for Emerald's fraud claims, however, the court held that, under this record, a fact issue existed as to whether Exxon committed fraud when it filed the plugging report with the Railroad Commission. The court focused on the intent element of fraud. It quoted the Restatement (Second) of Torts § 531 which states in pertinent part, "[o]ne who makes a fraudulent misrepresentation is subject to liability to the persons…whom he intends or has reason to expect to act…in reliance upon the misrepresentation." The court defined "reason to expect" as knowing of an especial likelihood that a specific person would rely on the misrepresentation.

The court found evidence that Exxon knew of an especial likelihood that Emerald specifically would rely on the plugging reports because an assignment to Emerald was being considered at the time Exxon filed the plugging reports. The court therefore held that a fact issue existed as to whether Exxon committed fraud when it filed the plugging reports.

The court also remanded several claims by the royalty owners that were not addressed by the court of appeals.

3. *Martin v. Saga Petroleum Corp.*, 332 S.W.3d 646, (Tex. App.—Eastland [11th Dist.] Nov. 4, 2010).

In *Saga Petroleum*, the court of appeals held that all available information may be used to calculate the amount of oil and gas reserves that existed on a certain date in order to determine if an automatic termination clause activated.

Several individuals ("Sellers") executed an assignment of oil and gas leases to Continental Investors Incorporated. Under the assignment, Sellers reserved certain production payments from the leases until the reserves in the land reached 10% of the commercially recoverable oil and gas. Once the reserves reached 10%, the production payment would terminate and that interest would pass to Continental. The

assignment called for a determination of the reserves on July 1, 1974. That date passed and neither party made such a determination.

Fina Oil purchased oil from the land subject to the leases assigned to Continental and was obligated to pay royalties to either the Sellers or Continental. In 1999, because it was unclear who was to receive the royalty payments, Fina filed an interpleader action and deposited the royalty proceeds with the court to determine who should receive them.

At trial, Continental argued that the determination of the reserves should be made based only on information that was available on or before July 1, 1974. Sellers contended that all available information, including information that came about after July 1, 1974 should be considered in determining the reserves. The trial court agreed with Continental that only information available on or before July 1, 1974 should be considered and granted Continental's motion for summary judgment. Sellers appealed.

The court of appeals reversed citing the El Paso Court of Appeals' opinion in *Concord* which previously interpreted the assignment in this case. There the court allowed engineers to use all available information to determine the reserves that existed on July 1, 1974. The court indicated that an accurate determination of the reserves was important and was the intent in *Concord*. Likewise, an accurate determination was important here, and all available information should have been considered. Therefore, the court reversed the summary judgment of the trial court.

4. *Vinson Minerals, LTD. v. XTO Energy, Inc.*, No. 02-08-00453, 2011 WL 5118649 (Tex. App.—Fort Worth, Dec. 16, 2010).

In *Vinson Minerals*, the court of appeals held that a certain demand notice required to cause forfeiture of lease interests was not sent when a settlement demand letter was sent.

Antero operated leases for and paid royalties to the Vinsons. The Vinsons began disputing Antero's calculations of royalty payments over two years and commenced an audit of Antero's accounting records. The Vinsons found several irregularities and estimated their damages at around $600,000. The Vinsons also raised other issues and eventually filed suit for numerous claims against Antero.

Two months before the Vinsons filed suit, XTO acquired Antero and the leases. XTO began negotiating with the Vinsons in order to settle their claims against Antero. The parties eventually obtained an Agreed Protective Order to aid the settlement process. Pursuant to that order, XTO requested that the Vinsons present a settlement demand to resolve all of the issues of the case. The Vinsons responded in a letter dated May 12, 2006 demanding $9,500,000 to settle its claims. XTO paid the Vinsons $103,047.68 representing royalty underpayments. Sixty days after sending the May 12 letter, the Vinsons amended their petition to allege that XTO had breached the lease agreements by failing to make undisputed royalty payments, which forfeited the leases. The forfeiture provisions of the leases required that written demand be made before the leases were forfeited.

At the trial level, the Vinsons argued that the May 12 letter constituted a proper

demand under the forfeiture provision which terminated the leases. XTO moved to exclude the letter under Texas Rule of Evidence 408 as an inadmissible offer of settlement. The trial court granted XTO's motion to exclude as well as its no-evidence summary judgment motion and dismissed the Vinsons' case with prejudice. The Vinsons appealed.

The court of appeals affirmed. The court held that the May 12 letter was not a demand letter because it began with a discussion of settlement and explicitly offered to settle all claims for $9,500,000. Therefore it was an offer of settlement that may not be used to prove liability under Texas Rule of Evidence 408. The court also held that the Vinsons did not present adequate evidence to raise an issue of fact on their remaining claims.

Chief Justice Livingston wrote a concurring opinion in which he elaborated that the May 12 letter was a demand letter also because it was written in response to XTO's request for a settlement demand.

5. *R & R Resources Corp. v. Echelon Oil and Gas, LLC*, No. 03-07-00636-CV, 2011 WL 5575919 (Tex. App.—Austin, Jan. 14, 2011) (mem. op.).

In R & R Resources, the court of appeals held that there was not sufficient evidence to prove that a well operator breached its contract with royalty owners or committed statutory theft. There was, however, sufficient evidence for a fraud claim against the operator.

Echelon, Tex-El, BairTex, and R & R Resources owned working interests in three wells which were operated by R & R Resources. The three operated under a joint operating agreement ("JOA") wherein each was responsible for paying its proportionate share of the costs incurred for drilling projects and routine operations. R & R was obligated under the JOA to keep an accurate record of the joint accounts.

The president of Tex-El began to suspect problems with R & R's accounting of the operations and requested an audit covering all three wells. Based on the audit, Echelon, Tex-El, and BairTex concluded that R & R failed to render a final accounting for one of the wells, refund over-payments on another well, perform or schedule required work, timely remit production proceeds, timely pay third-party invoices, maintain adequate working capital, and maintain adequate accounting records. As a result of these findings, Echelon, Tex-El, and BairTex voted to remove R & R as operator for good cause. However, R & R refused to relinquish its position as operator. Echelon, Tex-El, and BairTex ("Plaintiffs") filed suit seeking 1) a declaratory judgment that R & R was rightfully removed as operator; 2) temporary and permanent injunctions; and 3) damages. R & R also filed several counterclaims. The case was tried to jury and the jury found that R & R resources breached the JOA, unlawfully appropriated property, breached its fiduciary duty, committed fraud, and should not operate the wells. The jury did not find in favor of R & R's counterclaims. Over $515,000 in damages were assessed against R & R.

R & R appealed presenting twenty-eight points of error. Essentially, R & R's assertions were regarding the factual sufficiency of the evidence. R & R argued that the evidence did not support the damage awards for breach of contract, for statutory theft, and for fraud.

The court of appeals reversed the breach of contract and statutory theft findings, but upheld the finding of fraud. As to the breach of contract claim, Plaintiffs argued that shortages in their well accounts on particular dates amounted to "benefit of the bargain" damages. But the court reasoned that there was no causal connection between the shortages and the alleged damages: in other words, the shortages in well accounts did not cause reduced profits or an increase in expenses to Plaintiffs. Therefore, the court reversed the damage award for breach of contract.

As to the statutory theft claim, Plaintiffs asserted that R & R improperly appropriated funds in a certain transaction. In the transaction, a vendor was paid by R & R out of funds contributed by Plaintiffs for their share of the expenses, as required by their JOA. However, R & R did not itself contribute cash to help cover the expenses, but assigned part of its interest in a well to the vendor. Plaintiffs contended and the jury found that this amounted to statutory theft. However, the court of appeals reversed on this issue because showing that R & R paid part of an invoice with a personal asset did not prove that Plaintiffs were deprived of any of their property.

As to the fraud claim, the court of appeals found sufficient evidence to support the jury's finding of fraud because the record reflected that R & R failed to disclose facts about its capital contributions, and as custodian of the financial records, was able to conceal this from Plaintiffs for its benefit.

The court overruled R & R's remaining issues, except for attorney's fees. The court struck the attorney's fees related to the breach of contract and statutory theft claims that were reversed, but affirmed the attorney's fees awarded under the fraud claim.

6. *In re Reveille Resources, Inc.*, No. 04-10-00742-CV, 2011 WL 149872 (Tex. App.—San Antonio, 2011, Jan. 19, 2011) (unpublished opinion).

In *Reveille*, the court of appeals reversed a trial court's order that required the well operator to pay disputed well operating funds into the court registry before trial without a finding that the operator was justly indebted to plaintiff.

The defendant, Reveille Resources, Inc., owns and operates several leaseholds in which Greehey & Company, Ltd. has working interests that entitle Greehey to receive revenues generated from the production of the wells on the leases. Reveille and Greehey operated under a joint operating agreement which provided for sharing the expenses associated with drilling wells. Reveille elected to drill a well on one of the leases and submitted an Authority for Expenditure to Greehey. Greehey's share of the costs was $632,750, of which it initially paid $231,750. Greehey later asserted that it withdrew its consent to the authorization for the well and refused to pay the balance it owed. Reveille withheld royalty revenue otherwise due to Greehey from the wells to offset the amount Greehey owed.

Greehey sued alleging that Reveille wrongfully withheld $455,377.91 and Reveille counterclaimed for Greehey's unpaid share of the well drilling expenses. Greehey then filed a prejudgment attachment asking the court to order that Reveille pay $455,377.91 into the court registry. At the attachment hearing, Reveille's attorney stated that if Reveille was ordered to pay the monies into the

court's registry, Reveille would be forced to file bankruptcy.

The court granted the attachment and ordered that Reveille pay $455,377.91 into the court's registry. Reveille unsuccessfully moved to dissolve the motion and Greehey moved to enforce the attachment, which the court granted. Reveille again failed to deposit the funds and Greehey moved for and was granted sanctions and awarded attorney's fees. Reveille then petitioned for a writ of mandamus.

The court of appeals granted the writ and instructed the trial court to withdraw each of its orders. The court stated that the trial court was in error for two reasons. First, the trial court never made a finding that Reveille was "justly indebted" to Greehey, which is a necessary element before a writ of attachment may issue. Second, there was no evidence presented that the funds were in danger of being "lost or depleted," which is another necessary finding before funds may be ordered paid into the registry. Although Reveille's counsel stated that ordering Reveille to pay $455,000 into the registry would force Reveille into bankruptcy, the court stated that this did not constitute factual evidence. Instead, the court noted that the record lacked evidence regarding 1) Reveille's balance of available cash, 2) the amount or source of Reveille's revenue and operating income, 3) the cost of any ongoing drilling, 4) the extent, if any, to which available cash may be dwindling because of Reveille's operation of the wells, 5) the sale of assets, or 6) the disposition of proceeds from any sale of assets.

7. *Mohican Oil & Gas, LLC v. Scorpion Exploration & Production, Inc.*, No. 13-09-00516-CV, 2011 WL 242424 (Tex. App.—Corpus Christi, Jan. 27, 2011).

In *Mohican*, the court of appeals held that both the plaintiff and defendant were prevailing parties in their lawsuit because there were essentially two suits brought under the contract and each party succeeded on a least one of their claims against the other.

Mohican, Scorpion, and Chapco entered into a turnkey contract for the drilling and operation of a directional oil and gas well in Webb County, Texas. Under the contract, Mohican agreed to pay Scorpion, as drilling contractor, a lump sum of $1.158 million to drill the well. Chapco, which had the same owner as Scorpion, was to operate the well. Mohican paid half of the contract price up front with the other half to be paid when the well reached its total depth. Drilling commenced and Scorpion experienced several complications, but ultimately reached the total depth. Mohican paid Scorpion the rest of the contract price, but Scorpion demanded an additional $836,000 asserting that the contract converted from a turnkey contract to a daywork contract due to the drilling complications. Mohican refused to pay the additional sum, and Chapco refused to turn over operatorship of the well.

Mohican sued for a declaratory judgment and also alleged breach of contract, fraud, fraud in the inducement, and sought a verified accounting. Scorpion and Chapco filed counterclaims of breach of contract, fraud, and quantum meruit for Mohican's refusal to pay the additional $836,000, and requested judicial foreclosure on its mechanics lien on the well.

The case was tried to a jury. At the close of evidence, the trial court granted Scorpion's motion for directed verdict on all of Mohican's claims, except its claim for

declaratory relief. As to the remaining issues, the jury found that Mohican breached the drilling agreement, but the breach was not material and Mohican did not commit fraud against Scorpion. The jury awarded $139,120 in damages to Scorpion and $60,000 in damages to Chapco. In its final judgment, the trial court ruled that Mohican was entitled to declaratory relief, that Scorpion and Chapco were entitled to the damages awarded by the jury, and that Mohican was the prevailing party and should be awarded attorney's fees of $72,146.89. After offsets, the court concluded that Mohican should recover $8,481.87 from Scorpion. Mohican and Scorpion appealed.

On appeal, Mohican asserted that there was not sufficient evidence to support Chapco's damage award and Scorpion asserted that Mohican was not a prevailing party in the litigation.

The court of appeals affirmed and reversed in part. The court held that there was sufficient evidence to support Chapco's damage award. More importantly, the court of appeals held that both Mohican and Scorpion were prevailing parties in the litigation. The court agreed with the trial court that Mohican was a prevailing party because it succeeded in obtaining declaratory relief against Scorpion. The court noted that although Scorpion was awarded damages on its counterclaim, that did not demote Mohican's declaratory relief to a mere nominal, technical, or deminimis victory and to conclude otherwise would exalt monetary damages over equitable awards.

The court of appeals also held that Scorpion was a prevailing party. Although the case was tried before the same jury in the same proceeding, the court reasoned that there were essentially two suits brought under the drilling contract: one based on whether the contract was a turnkey versus drilling contract, and the other based on a breach of that contract. Because Scorpion proved a breach of contract, it was also a prevailing party. Therefore, the court reversed in part and remanded the case for determination of Mohican and Scorpion's attorney's fees.

8. *Occidental Permian LTD., v. The Helen Jones Foundation*, 333 S.W.3d 392 (Tex. App.—Amarillo [7th Dist.] Jan. 31, 2011).

In *Occidental*, the court of appeals declined to interpret an oil and gas lease that provided for royalty payments on unprocessed casinghead gas sold "at the well" to include the proceeds of downstream sales of processed natural gas liquids ("NGLs"). The court also held that CO2 used to aid in the recovery of other oil and gas hydrocarbons does not lose its character as personal property when injected back into the ground and is thus not subject to royalty payments when it is recovered.

This case involved six oil and gas leases. Four of the leases called for royalty payments on casinghead gas sold "at the well" at one eighth of the amount realized from the sale. The remaining two leases called for royalty payments on casinghead gas of three-eighths of its "market value in the field." Under each of the leases, the casinghead gas is delivered to the buyer at or near the wellhead.

The Defendants, through various acquisitions and sales, contractually became both the seller and the buyer of the casinghead gas and were required to make royalty payments to Plaintiffs. After buying the casinghead gas, Defendants would process the gas into NGLs and CO2, then

sell the NGLs and use the CO2 to capture more casinghead gas by injecting the CO2 back into the ground. Inevitably, some CO2 would be extracted with the casinghead gas which would be processed and separated from the gas and reinjected back into the ground. The CO2 would follow this cycle of injection, recovery, processing and re-injection.

Plaintiffs sued Defendants alleging that 1) Defendants failed to pay royalties calculated on the actual amount realized on the sale of casinghead gas; 2) Defendants breached an implied covenant in the amount-realized leases by failing to market the casinghead gas; 3) under the two market-value leases, Defendants did not calculate casinghead gas royalties based on its market value in the field; and 4) Defendants failed to pay a royalty on the CO2 that was extracted after being injected to aid in the recovery of more casinghead gas.

The trial court granted partial summary judgment for Defendants declaring that their lease obligations did not include having to pay royalties on the CO2. The remaining issues were tried to jury and the jury found for the Plaintiffs on all liability theories and awarded them attorney's fees. The trial court granted a judgment notwithstanding the verdict on one of the defendants' limitations defenses and for another defendant on the award of attorney's fees. The court's final order provided that the Plaintiffs recover $7,064,674.00. Both Plaintiffs and Defendants appealed.

The court of appeals reversed the Plaintiffs' award and ordered that they take nothing and affirmed the remainder of the trial court's order. The court held that the evidence was not sufficient to support the jury's findings in favor of the Plaintiff royalty owners. The Court focused on the testimony and methodology of the two expert witnesses who testified on behalf of Plaintiffs. The first expert testified to his opinion that because the Defendants became both the seller and buyer of the casinghead gas "at the well," the amounts realized by Defendants on the sale of casinghead gas was not the proceeds received under the wellhead contracts, but 100% of the proceeds of the downstream sales of processed NGLs less certain costs. The court noted that there was no dispute that the leases referred to sales of casinghead gas sold at the well then concluded that because the expert based his opinion on the proceeds of the sale of processed NGLs instead of casinghead gas sold at the wellhead, his opinion did not constitute evidence that Defendants failed to pay royalties as required by the leases.

The court then overruled the Plaintiffs' contention that Defendants failed to adequately market the casinghead gas under the market-value leases. The Plaintiffs argued that there is a market value for percentages of proceeds and that the percentages received by Plaintiffs were lower than the percentages received by others under other similar contracts. The court rejected this argument reasoning that a market-value necessarily includes a monetary amount and not just percentages.

Finally, the court rejected Plaintiff's argument that Defendants were also required to pay royalties on re-captured CO2 that was injected to help recover casinghead gas. The court compared the case to *Humble Oil* which held that natural gas injected into an underground storage formation did not lose its character as personal property and become subject to the rule of capture. Likewise, the Court reasoned, the CO2 did not lose its character as personal property when injected into the ground to help

recover casinghead gas, and therefore, Defendants were not required to pay royalties on re-extracted CO_2.

After finding that Defendants were not liable for any of Plaintiffs' claims, the court also overruled Plaintiffs' request for attorney's fees.

9. *Hausser v. Cuellar*, No. 04-09-00560-CV, 2011 WL 313757 (Tex. App.—San Antonio, Feb. 2, 2011) (not released for publication).

In *Hausser*, the court of appeals held that the granting clause of a deed conveying a royalty interest controlled over a conflicting future lease clause because a reversion in interest would potentially occur each time a subsequent future lease was executed if the future lease clause were given effect.

Reyes and Margarita Garza de Escamilla reserved to themselves a one-eighth (1/8) royalty interest in the minerals of a 256.6 acre tract of land Zapata County. Later in 1936, the Escamillas conveyed 1/2 of their royalty interest to Nathan Rosenberg, Bob Rose, Mary Ley, and J.W. Edwards ("Grantees"). Under this lease, the Grantees were paid a one-sixteenth (1/16) royalty interest (derived by multiplying the one-half (1/2) interest specified by the Escamilla deed by the one eighth (1/8) royalty previously reserved to the Escamillas).

The deed conveying 1/2 of the Escamillas' interest ("Escamila deed") contained both a granting clause and a future lease clause. The granting clause stated that an undivided 1/2 interest in oil and gas was being conveyed. The future lease clause stated that in the event a future lease was executed, then the Grantees were to receive one-sixteenth (1/16) of all oil and gas taken from the property. At some point after the Escamilla deed was executed, the pre-existing lease that reserved a one-eighth (1/8) royalty interest to the Escamillas terminated.

Later, Cuellar and Rathmell (successors of the Escamillas) executed a new oil and gas lease ("Paloma lease") covering the 256.6 acre tract with Paloma Partners I, LLC wherein Cuellar and Rathmell reserved to themselves a royalty interest of twenty-five percent (1/4). Paloma Partners began production and started accounting to the Haussers (the successors of the Grantees of the Escamilla deed) for their royalty interest. Paloma Partners initially accounted to the Haussers for one-half of the twenty five percent (1/2 multiplied by 1/4), or one eighth (1/8), royalty interest pursuant to the granting clause of the Escamilla deed. Subsequently, Paloma Partners reduced the royalty payments to one sixteenth (1/16) based on the future lease clause of the Escamilla deed. The Haussers sued for a declaratory judgment that their ownership interest under the Escamilla deed was an undivided one-half (1/2) of the royalty reserved under the Paloma lease. Both parties filed motions for summary judgment and the trial court ruled in favor of Cuellar and Rathmell and against the Haussers declaring that the Escamilla deed conveyed a one-sixteenth royalty and not an undivided one-half (1/2) interest. The trial court also awarded attorney's fees to Cuellar and Rathmell. The Haussers appealed.

The court of appeals held that the granting clause and not the future lease clause of the Escamilla deed determined the Haussers' royalty interest. The court reasoned that if the future lease clause was controlling, then a reversion in interest

would potentially occur each time a subsequent future lease was executed and would be inconsistent with the four corners of the document which involved a single conveyance with fixed rights. In its ruling, the court rejected its prior ruling in *Neel v. Killam Oil Co., Ltd.*, which held that a granting clause that conflicted with a future lease clause actually conveyed two things: a present interest and a future interest.

Therefore, the court ruled that the Haussers were entitled to an undivided one-half of the one-fourth royalty, or in other words, one-eighth royalty.

The court also reversed the award of attorney's fees. Justice Marion wrote a dissenting opinion joined by Justice Hilbig arguing that the analysis in *Neel* would have given effect to all parts of the deed.

10. *Prize Energy Resources, L.P. v. Hoskins*, No. 04-09-00603, 2011 WL 648996 (Tex. App.—San Antonio, Feb. 23, 2011) (not released for publication).

In *Prize*, the court of appeals affirmed the trial court's determination that a 25% mineral interest reverted when 60 consecutive days passed without any production under the subject oil and gas leases.

Burlington Resources, the Baker Trusts, and Michael and Patrick Rutherford each owned separate 25% mineral interests in the same piece of property. Atlantic Richfield Company ("ARCO") also owned a 25% mineral interest in the property, but was not subject to a written lease. Burlington, the Baker Trusts, the Rutherfords, and ARCO entered into a joint operating agreement ("JOA") whereby the property would be developed as a whole. Under the JOA, ARCO retained a possibility of reverter of its mineral interest if the JOA ever terminated.

Burlington's leases and the Baker Trusts' leases, which were subject to the JOA, contained "continuous production of operations" clauses providing that the leases would terminate if there was a period of sixty (60) or more consecutive days with no production. The JOA provided that it would remain in full force and effect as long as any of the oil and gas leases remained or continued in force.

In 2001, there was a 71-day period when no well on the property was operating or producing in paying quantities. However, none of the lessors were aware of the cessation of operations, and no one raised any concern at that time.

In 2004, Cliff Hoskins, who had no previous connection to the property or the JOA, conducted research on leases in the area, and became aware of the possible termination of the JOA in 2001. Hoskins contacted BP (which had purchased ARCO's rights under the JOA) and offered to buy its 25% mineral interest which Hoskins asserted had reverted to BP in 2001 when the JOA allegedly terminated because of the lapse in production. In 2007, BP deeded its claimed reverted 25% mineral interest to Hoskins, making the transfer retroactive to August 16, 2004 and reserving a 6.25% royalty interest to itself.

Hoskins and BP filed suit to quiet title in 2005. One month later, the Rutherfords, the Baker Trust, and Burlington (the remaining JOA parties) signed ratifications purporting to extend or renew the leases that made up 75% of the interest subject to the JOA. In their suit against the remaining JOA parties, Hoskins and BP sought a declaratory judgment to

quiet title plus damages for bad faith trespass, theft/conversion, recovery of unpaid proceeds under the Texas Natural Resources Code, breach of contract, and attorney's fees.

Competing summary judgment motions were filed by Hoskins and BP as well as the remaining JOA parties. The trial court granted and denied several of the motions ultimately ruling that Hoskins and BP take nothing on their trespass claims; that the lapse in production did cause ARCO's 25% interest to revert to BP; that BP's 25% interest passed to Hoskins, subject to BP's retained royalty interest of 6.25%; and that Defendants (the remaining JOA parties) were not trespassers when the JOA terminated because they were also mineral owners. The trial court also granted summary judgment against all remaining claims, counterclaims, and affirmative defenses.

As to damages, the trial court ordered the parties work together to stipulate the revenues less costs related to the production on the property during the relevant time period. The parties were unable to so stipulate and a bench trial was conducted wherein the trial court awarded $1,267,482 plus pre-judgment and post-judgment interest to Hoskins and $3,252,827 plus pre-judgment and post-judgment interest to BP. All parties appealed the judgment.

The court of appeals affirmed in part, modified and affirmed in part, reversed and rendered in part, and reversed and remanded in part. On the primary issues of the title to the ARCO mineral interest, Hoskins' and BP's trespass claim, and the trial court's calculation of damages, the court affirmed.

As to the issue regarding the title to ARCO's mineral interest, the court held that the cessation of operations in 2001 for more than sixty consecutive days automatically terminated the Baker Trusts' leases and Burlington's leases without any need for legal action. When those leases terminated, the court reasoned, the JOA also terminated causing the ARCO mineral interest to revert to ARCO's successor, BP. Although the remaining JOA parties executed ratifications of the JOA, the ratifications could not bind a non-party's interest or strip away the mineral interest that automatically reverted years before the ratifications.

As to Hoskins' and BP's trespass claims, the court held that the remaining JOA parties could not be trespassers because they became co-tenants or invitees of co-tenants after the leases and JOA terminated in 2001. The court noted that Hoskins and BP established all the elements of trespass and shifted the burden of proving a justification to the defendants. Nevertheless, the record also established that the defendants became co-tenants with the right to explore, drill, and produce minerals from the common estate without consent from any other cotenant.

As to the trial court's calculation of damages, the court of appeals affirmed the calculation of "net revenues" by adding all revenue and subtracting all costs for the relevant time period. Hoskins argued that the "well by well" method should have been used which would have excluded the costs of unprofitable wells. The court disagreed noting that as a general rule, oil and gas wells are characterized as improvements to real property, and equity requires that a person who in good faith makes improvements upon property owned by another is entitled to compensation. The court also stated that, as a general rule, co-

tenants may extract minerals from common property without first obtaining consent of the cotenants, but must account for the value of the minerals taken, less the necessary and reasonable costs of production and marketing.

The court also made several other rulings. It held that the heirs of Rutherford (a party to the JOA) were not jointly and severally liable to Hoskins and BP for damages; it affirmed the trial court's imposition of sanctions against Hoskins; and it reversed the trial court's dismissal of a cross-claim between some of the JOA parties.

11. *Aurora Petroleum, Inc. v. Cholla Petroleum, Inc.*, No. 07-10-0035-CV, 2011 WL 652843 (Tex. App.—Amarillo, Feb. 23, 2011) (mem. op.).

In *Aurora Petroleum*, the court of appeals held that a farmout agreement that requires later agreement on locations that are "mutually acceptable" to both parties leaves material matters open for future agreement and is not enforceable.

Aurora Petroleum, Inc. and Cholla Petroleum, Inc. entered into an "exploration agreement" whereby Aurora agreed to assign to Cholla its interest in four oil and gas leases and share with Cholla certain geological and geophysical data. Cholla paid $50,000 to Aurora under the agreement and agreed to commence drilling of a test well on or before January 23, 2008 at a location "mutually acceptable" to both parties. If Cholla failed to comply with its obligation to timely drill a test well, the agreement required Cholla to reassign the leases to Aurora.

Cholla proffered several drilling locations to Aurora, but Aurora rejected each one. Once the drill deadline passed, Aurora demanded the return of the four leases conveyed to Cholla plus an additional lease Cholla acquired from a third party. Cholla reassigned the original four leases and refused to assign any others. Aurora sued Cholla for specific performance and Cholla counterclaimed for the $50,000 it had paid to Aurora under the exploration agreement. The trial court granted summary judgment in favor of Cholla and ordered Aurora to return the $50,000 ruling that the agreement was invalid because it lacked essential terms and that Aurora had been unjustly enriched. Aurora appealed.

The court of appeals affirmed the trial court. Aurora argued that the agreement was valid because it was entered into by two sophisticated parties. But the court emphasized the fact that an agreement to drill a well that required the parties to agree on a site in the future was essentially an "agreement to agree" and thus not valid. The court also noted that the contract lacked provisions defining or regulating how the parties were to select a drill site, so there was nothing by which to gauge the bona fides of Aurora's conduct.

After finding that the exploration agreement was invalid, the court found that it would be inequitable for Aurora to keep the $50,000 it received from Cholla and ordered Aurora to return it.

12. *Smith v. BASA Resources, Inc.*, No. 11-09-00339, 2011 WL 1435273 (Tex. App.—Eastland, Apr. 14, 2011).

In *BASA Resources*, the court of appeals affirmed a jury's determination that a pipeline operator was not negligent when an oil spill occurred from a leak in a pipeline coupling buried three feet underground, and where there was evidence that the operator

was not negligent in maintaining the pipeline.

Plaintiffs Dean and Debby Smith sued BASA Resources for an oil and saltwater spill that resulted from a rupture of one of BASA's pipelines. The jury rendered a verdict for BASA and the Smiths appealed.

The Smiths own the surface rights of a 515.5 acre ranch subject to a mineral lease of which BASA is the successor in interest. Approximately three miles of flowline operated by BASA are located on the ranch. In 2003, a BASA employee discovered a leak of oil and saltwater from a buried flowline. The leak was caused by a rusted bolt on a coupling that was buried three feet in the ground. The employee notified his foreman of the leak and they both immediately began working to prevent the oil and saltwater from entering a nearby creek. The same day the leak was discovered, BASA hired someone to bulldoze an emergency access road so that vacuum trucks could reach the area to clean up the oil and saltwater. BASA instructed the dozer operator not to destroy any large oak trees and to do as little damage as possible to the property.

BASA was cited by the Railroad Commission for polluting the area near the creek, but subsequent inspections by the Commission revealed that there was no remaining pollution. BASA performed other remedial measures such as reseeding the area, placing gravel on the emergency road, and removing the brush and trees that had been bulldozed.

The Smiths sued BASA seeking $204,500 to replace trees, $100,863 for other remedial measures, and $125,000 in attorney's fees. The trial court entered a take-nothing judgment against the Smiths based on the jury's answers to the issues. The Smiths appealed, essentially asserting that the evidence proved their claims as a matter of law and that the jury's findings were against the great weight and preponderance of the evidence. The Smiths also complained that BASA's counsel made an inappropriate comment during closing argument when he cautioned the jury about the effect the verdict would have on their community.

The court of appeals affirmed the trial court's judgment holding that, based on these facts, there was enough evidence for the jury to conclude that BASA was not negligent in maintaining the flowline, that BASA did not commit trespass on the Smith's property, and that BASA acted as a reasonably prudent operator even though it violated a Railroad Commission rule and was fined. Finally, the court overruled the Smith's final point that the comment made by BASA's counsel during closing argument was prejudicial. The court held that any harm could have been remedied with an instruction from the court, but the Smith's did not request one.

13. *Long v. RIM Operating Inc.*, No. 11-09-00328-CV, 2011 WL 1431476 (Tex. App.—Eastland, Apr. 14, 2011) (not released for publication).

In *Long*, the court of appeals upheld the forfeiture of a working interest owner's interest in an oil and gas joint operating agreement because the owner did not consent to the drilling of a new well to reestablish oil and gas production to continue the leases.

In 2000, Long became a working interest owner in a 160-acre tract of land in Dawson County. The land was subject to

several leases (the Lindsey Leases) which were pooled under a joint operating agreement (JOA). Long's interest was also subject to the JOA.

The JOA provided that if a working interest owner does not consent to a proposed operation (like drilling a well), then the owner relinquishes the right to any production from that well until its share of costs, plus an additional 200% or 500% depending on the type of cost incurred, has been recouped by the consenting parties. The JOA further provided that if well drilling or another operation was required to perpetuate an expiring lease or leases and a party elected not to participate, then the non-participating party's interest would be assigned to the consenting parties with respect to the leases that were perpetuated by the drilling.

The 160-acre tract that was covered by the JOA had only one producing well (the Lindsey Well). In 2004, RIM became the operator of the Lindsey Well. In 2006, the Lindsey Well ceased to produce because of parting rods. RIM submitted an Authorization of Expenditure to all the working interest owners proposing a repair operation to which Long did not respond. RIM attempted the repair, determined that there was a casing collapse, and instead drilled a replacement well and reestablished production.

In 2008, RIM sent Long an assignment that transferred Long's interest in the 160-acre tract to the consenting parties. Again, Long did not respond. RIM then filed suit for declaratory judgment that Long's interest had been properly assigned because Long refused to consent to drilling the new well. The trial court granted summary judgment in favor of RIM and awarded it attorney's fees.

The court of appeals affirmed the grant of summary judgment, but reversed the award of attorney's fees. Long asserted four main arguments in its appeal: 1) That RIM lacked standing to bring the declaratory judgment action because it was not a working interest owner; 2) That the trial court did not have jurisdiction to decide the declaratory action because the other working interest owners were not parties; 3) That the forfeiture provision of the JOA violated the statute of frauds because it did not contain a proper description of the assignor or assignee; and 4) That the forfeiture of Long's interest was an unenforceable penalty. The court overruled each of Long's arguments.

As to Long's argument that RIM lacked standing, the court stated that it was unnecessary for RIM to own an interest in the well to have standing because as the operator, it is responsible to the working interest owners and, therefore, has an interest in determining who they are. Also, because the working interest owners' rights and liabilities depend, in part, on their percentage of ownership, RIM also has an interest in determining those percentages.

As to Long's argument that the trial court lacked jurisdiction, the court acknowledged that none of the other working interest owners were parties to the lawsuit and that the declaratory relief obtained by RIM could not prejudice their interests. But they were permissive parties because their presence was unnecessary for the trial court to decide whether the forfeiture provision required Long to assign his interest to them. Therefore, their absence did not deprive the trial court of jurisdiction.

As to Long's argument that the JOA violated the statute of frauds because it does not properly describe the assignor or assignees of the forfeited interest, the court stated because the JOA itself is limited to the parties to the agreement, the assignors will be those from that group who do not participate in a required well or operation; the assignees will be those who do.

As to Long's argument that the forfeiture provision was an unenforceable penalty or liquidated damages provision, the court stated that non-consent penalties are not liquidated damages, but incentives to risk takers by allowing reasonable compensation for agreeing to participate in new wells. Further, the court noted that Long is in no different position than if the well had not been drilled. Had the well not been drilled, then the Lindsey Leases would have terminated which also would have ended Long's interest. Therefore, the forfeiture provision was not an unenforceable penalty.

14. *Raven Resources, LLC v. Legacy Reserves Operating LP*, No. 11-09-00348-CV, 2011 WL 1744079 (Tex. App.—Eastland, Apr. 15, 2011) (not released for publication).

In *Raven Resources*, the court of appeals held that an agreement that was void at its inception cannot be ratified by a party's acceptance of payments under the agreement.

Raven, a company that buys and sells various oil and gas leases, entered into negotiations with Legacy to sell certain oil and gas properties. Legacy forwarded a draft of an agreement to Raven that provided for a purchase price of $26,626,000. Raven's sole managing member, Stewart, signed the draft then returned it to Legacy. Legacy continued to negotiate the sale with a Raven employee, Lee. After performing its due diligence, Legacy reduced the purchase price to $20,300,000 and forwarded these changes in a new draft agreement to Lee. Lee forged Stewart's name to the agreement because only Stewart had authority sign documents on Raven's behalf and to bind Raven to an agreement. Lee returned the agreement with the forged signature to Legacy. Legacy then paid 5% earnest money as required by the agreement, and the parties closed the deal by mail through thirty-five assignments transferring the various interests and properties. Legacy transferred the remaining balance of $18,925,000.03 into Raven's account, which Raven used to pay debts and make distributions to partners. Three weeks after the closing and after Raven had used the money to pay debts and partners, Raven discovered that Legacy had not paid $26,626,000 as required by the original draft that was signed by Stewart.

Raven sued Legacy and sought, among other things, a declaration that the agreement that had Stewart's forged signature was void and Raven sought rescission of the assignments transferring the properties. Legacy sought a declaration that even if the agreement was forged, it was nevertheless valid because Raven had ratified it. The trial court granted summary judgment in favor of Legacy and entered a take-nothing judgment against Raven.

The court of appeals reversed and remanded. The court analyzed several cases establishing the rule that a forged agreement is void and a nullity from its inception and has no legal effect. As such, a party cannot ratify what does not exist as Legacy asserted Raven did. The court noted that the only way a forged agreement may be made operative is if there is an express adoption

by the party subject to the forgery. The court also stated that although the agreement was void, the assignments that were later executed via mail were not. However, because the assignments were specifically made subject to the terms of the forged agreement, they were not complete in and of themselves.

The court reversed the trial court's judgment and remanded the issues regarding the repayment of the funds paid by Legacy as well as any issues of consideration received by Legacy from or related to the properties involved.