TEXAS OIL & GAS
CASE LAW UPDATE
TADC Fall 2012 Edition

Greg W. Curry
Gregory D. Binns
Reed C. Randel

Thompson & Knight LLP

October 12, 2012

I. SCOPE OF THE ARTICLE

This article surveys selected oil and gas cases decided by Texas state and federal courts from May 9, 2012 through September 25, 2012. Immediately below are one-paragraph abstracts of the selected cases. Full case summaries follow the abstracts.

II. ABSTRACTS

1. In a condemnation proceeding, oil and gas production can be factored into land's value, but cost-saving to the lessee cannot. The Texas Supreme Court held that money that a lessee would save by not having to remove a plant from leased land cannot be considered in valuing the land in a condemnation proceeding. While oil and gas production may be considered in land valuation, considering money that would be saved as a result of the condemnation proceeding violates the value-to-the-taker rule. *Enbridge Pipelines (East Texas) L.P. v. Avinger Timber, LLC*, No. 10-0950, 2012 WL 3800234 (Tex. Aug. 31, 2012).

2. Exculpatory clauses in a JOA modeled after the 1989 Model Form Operating Agreement exempt operators from liability claims that do not arise from gross negligence or willful misconduct. The Texas Supreme Court held that an exculpatory clause in a joint operating agreement ("JOA") that was modeled after the revised exculpatory clauses in the 1989 Model Form Operating Agreement protects operators from liability for activities under the agreement not arising from gross negligence or willful misconduct. The court held that the clause's protection extends to a JOA, unlike previous Model Form Operating Agreements. *Reeder v. Wood County Energy, LLC*, No. 10-0887, 2012 WL 3800231 (Tex. Aug. 31, 2012).

3. Restrictive covenants concerning mineral rights do not reserve mineral interests in future conveyances. The court of appeals held that a restrictive covenant recorded when no surface or mineral rights were conveyed to another party did not constitute a future reservation of mineral interests. Stating that a conveyance of land is subject to prior restrictions does not constitute an express reservation of mineral interests in a warranty deed conveyance. *Farm & Ranch Investors, Ltd. v. Titan Operating, L.L.C.*, 369 S.W.3d 679 (Tex. App.—Fort Worth 2012, pet. filed).

4. When leaseholds end on released acreage, overriding royalty interests ("ORRI") on the released acreage are extinguished. The court of appeals held that absent more specific contractual language in a lease, "termination of the present lease" includes partial termination with respect to ORRI agreements. Therefore, an ORRI can be partially extinguished as to the released acreage. *SM Energy Co. v. W.H. Sutton*, No. 04-11-00752-CV, 2012 WL 1864352 (Tex. App.—San Antonio May 23, 2012, pet. filed).

5. Crucial to the interpretation of "most favored nations" clauses is the policy underlying such clauses. The court of appeals held that a lessee's pooling agreement with the State of Texas did not trigger the "most favored nations" clause under the oil and gas lease. Although the State received higher royalties on one unit, the higher royalties were not the result of increase in market price. *Samson Lone*

Star, Limited Partnership v. Hooks, No. 01-09-00328, 2012 WL 1951113 (Tex. App.—Houston [1st Dist.] May 31, 2012, no pet.).

6. Parenthesis cannot be ignored in determining the amount of royalty reserved. The court of appeals held that a royalty reservation was unambiguous, and affirmed a trial court's determination that "a one-half non-participating royalty interest (one-half of one-eighth of production)" reserved a fractional royalty as opposed to a fraction of royalty. Because there was only one reasonable interpretation of the clause, the clause was unambiguous and summary judgment on the issue was proper. *Moore v. Noble Energy, Inc.*, No. 07-10-00434-CV, 2012 WL 2912739 (Tex. App.—Amarillo July 17, 2012, no pet. h.).

7. Protection of drinking water and previous existence of producing wells on land outweigh economic impact in finding that no compensable taking occurred. The court of appeals held that no compensatory taking had occurred when the City of Houston prohibited further drilling on property owners' property despite economic impact to property owners. The governmental interest in protecting drinking water as well as the lack of investment-backed expectations in further drilling tipped the *Penn Central* analysis in the city's favor. *City of Houston v. Trail Enterprises, Inc.*, No. 14-10-00944-CV, 14-11-00417-CV, 2012 WL 3223662 (Tex. App.—Houston [14th Dist.] Aug. 9, 2012, no pet. h).

8. Holders of an executive interest owe NPRI owners a fiduciary duty when they hold disputed funds. The court of appeals held that when holders of an executive interest hold funds owed to holders of a nonparticipating royalty interest ("NPRI"), they hold the funds in constructive trust for the NPRI. *Friddle v. Fisher*, No. 06-12-00018-CV, 2012 WL 3536796 (Tex. App.—Texarkana Aug. 17, 2012, no pet. h.).

9. Accepting royalty payments in accordance with pooling agreements ratify the agreement, precluding claims for greater royalty amounts. The court of appeals held that accepting royalty payments on pooled units acts as a ratification, barring landowners from being able to raise claims for improper pooling and inadequate royalty payments. While the landowners may have had claims if they had not accepted the payments, their claims ended when they cashed the checks. *Ohrt v. Union Gas Corporation,* No. 13-05-00621-CV, 2012 WL 3757386 (Tex. App.—Corpus Christi Aug. 31, 2012, no pet. h.).

10. Shaded in portions of a map attached to an agreement provide enough certainty to make the agreement binding. The Fifth Circuit held that an agreement to convey oil and gas leases which includes areas shaded in on an attached map provide enough reasonable certainty to make the agreement binding. *Coe v. Chesapeake Exploration, L.L.C.*, No. 11-41003, 2012 WL 3966722 (5th Cir. Sep. 12, 2012).

11. Oil companies can be found guilty of the Migratory Bird Act ("MTBA") for dead birds found in oil tanks. The district court ruled that even without intent to capture birds, an oil company was guilty of violating the MTBA when ten birds protected under the act were found dead inside open-top

tanks located at its petroleum refinery. *United States v. CITGO Petroleum Corporation*, Criminal Action No. C-06-563, 2012 WL 3866857 (S.D. Tex. Sept. 5, 2012).

III. CASE SUMMARIES

1. *Enbridge Pipelines (East Texas) L.P. v. Avinger Timber, LLC*, No. 10-0950, 2012 WL 3800234 (Tex. Aug. 31, 2012).

In *Enbridge Pipelines*, the Texas Supreme Court held that money that a lessee would save by not having to remove a plant from leased land cannot be considered in valuing the land in a condemnation proceeding.

In 1973, the Simpson family, owners of Avinger, LLC, leased a 23.79 acre portion of their 418 acres of land to a gas processing company, Tonkawa Gas. The lease was for ten-years, and gave the lessee the perpetual option to renew for another ten years. One of the provisions in the lease stated that after the lease expired, the lessee, as whole owner of the gas processing facilities, had six months to remove the plant, or the landowner could negotiate with the lessee for the purchase of the plant.

Tonkawa built a large natural gas processing facility, and the Simpsons gave several easements for roads, more pipelines, and a high-voltage electric line. In 1998, Koch, a later owner of the gas processing facility, renewed the lease with Avinger, although the lease term was reduced to three years with a three-year option. Most importantly, the lease terms changed so that Koch no longer possessed a right of never-ending renewal, reserving a reversionary interest for Avinger.

Enbridge Pipelines, a public utility company offered to purchase the land from Avinger, but Avinger refused their offer. Enbridge Pipelines then merged with Enbridge Processing, the new leaseholder, giving Enbridge Pipelines the ability to secure the land through eminent domain. After Enbridge Pipelines filed a petition for condemnation, the commissioners awarded Avinger $47,580 as compensation when it failed to appear at its hearing. Avinger objected to the award, and took its case to trial in order to determine the fair market value of the land.

At trial, each side put on an expert to determine the land's fair market value. Enbridge Pipeline's expert valued the land at $47,940, and claimed that the land's best use was as vacant rural residential property. The trial court excluded this testimony based on Avinger's argument that this valuation did not appraise the land in its current condition, as a source of oil and gas production, and instead falsely assumed that the land was vacant and barren.

Avinger's expert valued the land at $20,955,000. The expert arrived at this number by taking into account the land's value in producing oil and gas, and most notably by considering the lease provision that would have required Enbridge Pipelines to remove the plant from the land within six months. By acquiring the land through eminent domain, Enbridge Pipelines would bypass this lease provision. Enbridge Pipelines objected to this testimony on the grounds that it violated the value-to-the-taker rule, as well as the project-enhancement rule. The trial court de-

nied Enbridge Pipeline's motion to exclude this testimony, and the jury awarded Avinger $20,955,000 as compensation.

Enbridge Pipelines appealed trial court's ruling to exclude its expert testimony as well as its ruling to allow Avinger's testimony. The Texarkana Court of Appeals upheld both of the trial court's decisions. Avinger then appealed to the Texas Supreme Court.

In overruling the court of appeals, the Texas Supreme Court held that Avinger's expert's testimony was impermissible because it violated the value-to-the-taker rule. According to the court, the value-to-the-taker rule prohibits an owner from receiving an award based on a land's unique value to the taker, as opposed to the value of the land to others who may or may not be able to possess the land through condemnation. The Texas Supreme Court held that while the value of the land as a gas processing site was not unique to Enbridge Pipelines, the value of not having to remove the gas processing plant was. Therefore, Enbridge Pipelines was not required to compensate Avinger for this unique value which resulted from the lease's terms.

The Texas Supreme Court held that the testimony improperly took into account the costs that Enbridge Pipelines saved by avoiding obligations under the lease. Because its ruling on the value-to-the-taker rule demanded a remand to the trial court, the Texas Supreme Court did not consider Enbridge Pipeline's claim that the testimony also violated the project enhancement rule.

The Texas Supreme Court upheld the trial court's exclusion of Enbridge Pipelines' expert because Avinger was entitled to get the value of the land based on its use for oil and gas production as opposed to as vacant rural land.

2. *Reeder v. Wood County Energy, LLC*, No. 10-0887, 2012 WL 3800231 (Tex. Aug. 31, 2012).

In *Reeder*, the Texas Supreme Court held that an exculpatory clause in a joint operating agreement ("JOA") modeled after the revised exculpatory clauses in the 1989 Model Form Operating Agreement exempts operators from liability for all activities under the agreement not arising from gross negligence or willful misconduct.

The Forest Hill Field in Wood County had two oil-bearing units, the Sub-Clarksville Unit and the Harris Sand Unit. David Fry, through his company, Dekrfour, Inc. bought a working interest in the Sub-Clarksville unit. Dekrfour then entered into a mutual agreement with Secondary Oil Corporation, and the mutual agreement became part of a JOA that the parties entered into eleven days later.

The JOA under which the parties operated included an exculpatory clause that was modeled after the 1989 Model Form Operating Agreement. The exculpatory clause included the following: "Operator shall conduct its activities under this agreement as a reasonable prudent operator... but in no event shall it have any liability as Operator to the other parties for losses sustained for liabilities incurred except such as may result from gross negligence or willful misconduct."

Wendell Reeder became the operator of the Harris Sand Unit when he and his

partner purchased an 87.5% working interest in the unit wells which had previously been transferred to Secondary. Reeder formed a limited partnership, Wood County Oil and Gas, Ltd. with two other investors.

Reeder's working relationships with his partners and David Fry eventually became strained. Reeder filed a suit against Fry and others asserting that he was the operator and had exclusive right of possession of the wellbores. Fry and his business partners filed a counterclaim, alleging that Reeder had illegally removed oil from the Sub-Clarksville formation, and fraudulently reported it as production from the Harris Sand Unit. Most notably, they alleged that Reeder had failed to obtain production in paying quantities as required by the JOA. Wood County filed a cross claim against Reeder, asserting that Reeder in his capacity as operator had squandered efforts to increase production, losing millions of dollars worth of valuable leasehold rights

At trial, a jury found that Reeder had breached his duty as operator by failing to maintain production in paying quantities or other operations in the Forest Hill Field. The trial court entered judgment that Reeder take nothing and awarded damages against Reeder. Reeder timely appealed the trial court's decision.

The court of appeals upheld the trial court's decision. It ruled that there was legally and factually sufficient evidence to support the jury's findings that Reeder had breached his duties as operator. The court of appeals further stated that the exculpatory clause only applied to the claims that Reeder had breached his duty in operations, and not to the claims that he had otherwise breached the JOA. Reeder then appealed to the Texas Supreme Court.

The Texas Supreme Court began its analysis by determining whether the exculpatory clause in the JOA set the standard to adjudicate the breach of contract claims against Reeder. The Texas Supreme Court distinguished the present case from decisions in which an exculpatory clause was found to not generally apply to a JOA.

In previous decisions, courts had dealt with JOA agreements modeled after the 1977 and 1982 Model Forms. In these model forms, the exculpatory clauses stated that the operator "shall conduct all such operations in a good and work-manlike manner," while the exculpatory clause in the 1989 form refer to "its activities under this agreement…." The court held that the shift from "all such operations" to "its activities" was no small change.

The shift in language in the exculpatory clause, according to the Texas Supreme Court, led to broader protection for operators from liability for their actions under the JOA. Previously, only breaches of duty in operations had been protected in exculpatory clauses. Because the exculpatory clause at issue in this case was modeled after the 1989 Model Form, the court held that the agreed standard exempted the operator from liability for its activities unless its liability resulted from gross negligence or willful misconduct.

Having determined the proper standard under which to judge Reeder's conduct, the court next turned to whether there was legally sufficient evidence to show that Reeder's conduct had been

the result of gross negligence or willful misconduct. Although Reeder may have made wrong decisions in his role as operator, the Texas Supreme Court found no legally sufficient evidence to shift Reeder's conduct into the category of gross negligence or willful misconduct. Having found no legally sufficient evidence, the Texas Supreme Court reversed the court of appeals and rendered a take-nothing judgment.

3. *Farm & Ranch Investors, Ltd. v. Titan Operating, L.L.C.*, 369 S.W.3d 679 (Tex. App.—Fort Worth 2012, pet. filed).

In *Farm & Ranch Investors, Ltd.*, the court of appeals held that a restrictive covenant recorded when no surface or mineral rights were conveyed to another party did not constitute a future reservation of mineral interests.

In 1994, Caldwell's Creek, Ltd., the owner of roughly sixty acres of land in Colleyville recorded a deed restriction that stated that "[n]o oil drilling, oil development operations, oil refining, quarrying or mining operations of any kind shall be permitted upon or on any lot." Most importantly, it further stated that "[a]ll mineral rights shall belong and shall continue to belong to the limited partnership of Caldwell's Creek, LTD." These restrictive covenants did not accompany any transfer of land.

After Caldwell's Creek, Ltd. recorded the covenants, it later divided its land into nine separate lots which it conveyed between 1994 and 1999. The warranty deeds stated that they were "made subject to any and all easements, restrictions, and mineral reservations affecting said property..." The warranty deeds included no specific reservations of mineral interests.

Caldwell's Creek, Ltd. later attempted to convey its oil, gas, and mineral rights in the land in October, 2005 to Farm & Ranch based on the recorded restrictions and the deeds it issued to the lot owners. Farm & Ranch attempted to negotiate a mineral lease with Titan Operating, L.L.C. which later determined that Farm & Ranch did not hold any mineral rights in the land and contracted with the nine lot owners directly.

Titan filed suit against Farm & Ranch seeking a declaratory judgment that it owned the mineral rights to the nine lots, while Farm & Ranch counterclaimed for breach of contract. After both parties filed summary judgment motions, the trial court granted Titan's motion while denying Farm & Ranch's motion.

On appeal, Farm & Ranch argued that the deed restrictions made by Caldwell's Creek, Ltd. reserved the mineral interest in the land, and that Caldwell's Creek, Ltd. had only conveyed surface estates to the nine lot owners. Because Caldwell's Creek, Ltd. owned the mineral and surface rights at the time that it recorded the restrictions, the court of appeals ruled that no such reservation was made. An owner cannot reserve for himself an interest in property that he already owns, and because the restrictions were not part of a conveyance of surface or mineral rights to another party, the restrictions did not reserve any future interest in the land.

Farm & Ranch further argued that the "shall continue to belong" language in the recorded restrictions indicated that it was a future-looking statement

that could only be interpreted as a future reservation. In disagreeing with Farm & Ranch, the court of appeals agreed with the trial court that this is not the only interpretation of this language. The court interpreted "shall continue to belong" to mean that nothing in the 1994 restrictions and reservations deprived Caldwell's Creek Ltd. of its ownership in the mineral rights in the property at that time.

Finally, Farm & Ranch argued that the "subject to" language in the conveyance read the restrictions into the conveyed warranty deeds. This language, according to the court, was not a clear enough intention on Caldwell Creek Ltd.'s part to reserve an interest in the conveyance. Therefore, even though the conveyances were made subject to the previous restrictions, these restrictions were not enough to reserve a mineral interest in the land. Although Caldwell's Creek Ltd. may have intended to reserve a mineral interest in the land, the previously recorded restrictions alone were not enough to do so.

4. *SM Energy Co. v. W.H. Sutton*, No. 04-11-00752-CV, WL 1864352 (Tex. App.—San Antonio May 23, 2012, pet. filed).

In S*M Energy*, the court of appeals held that an overriding royalty interest ("ORRI") can be partially extinguished as to the released acreage after a lease is partially terminated.

In 1966, Sutton Producing Corporation leased approximately 40,000 acres from Briscoe Ranch, Inc. for oil and gas exploration. Seven weeks after it signed the lease, Sutton assigned its leasehold to Kenoil Corporation and three individuals, reserving an ORRI of 5.46875% for itself. This conveyance contained a savings provision with respect to the ORRI, which stated that the ORRI would "apply to all amendments, extensions, renewals or new leases taken on all or part of the lease premises within one year after termination of the present lease."

The 1966 lease contained a release provision that allowed the lessee to release all or part of its leasehold estate "and thereby be relieved of all obligations as to the released acreage or interest." On or before March 31, 2000, Crimson Energy Company L.P., a successor lessee under the 1966 lease released about 22,000 of the original 40,000 acres back to Briscoe Ranch.

More than one year and one day after the March, 2000 release, Crimson Energy signed three new leases with Briscoe Ranch which covered all of the previously surrendered 22,000 acres. Several assignments later, the leases were finally assigned to SM Energy. After realizing that they had not been paid on their ORRIs on the 2001 leases, the Suttons sued SM Energy on May 13, 2010 seeking quiet title in their ORRIs and unpaid royalties as well as prejudgment interest.

SM Energy contended that the ORRIs had been extinguished, or were barred by the statute of limitations and that the Suttons were not entitled to prejudgment interest. Both sides filed motions for summary judgment. The trial court granted the Suttons' motion stating that their ORRIs burdened the 2001 leases, and awarded them royalties. SM Energy appealed, arguing that the ORRIs were extinguished, the discovery rule did not apply, that all claims before May 13, 2006 were barred by the statute

of limitations, and that the Suttons were not entitled to prejudgment interest.

The court of appeals held that because the original 1966 lease allowed the lessee to release all or part of the lease, any ORRI pertaining to released acreage was extinguished with the release. Therefore, when Crimson Energy released 22,000 acres of its leasehold, it released the Suttons' ORRIs on the released acreage, although the ORRIs on the remaining 18,000 acres remained in effect.

The Suttons argued that even if their ORRIs were extinguished that the savings clause in the 2001 lease applied to their ORRIs because the 1966 lease should be viewed as the "present lease" in the clause, and the 1966 lease was never terminated in its entirety. The court of appeals rejected this argument, holding that the parties to the 1966 lease must have presumed that the ORRIs were easy to destroy. The burden was on the ORRI holders to expressly include a provision to save their ORRI from being extinguished. Further, there is no language in the assignment's savings clause to indicate that "termination of the present lease" can only mean the lease in its entirety. Therefore, the court held that "termination of the present lease" allowed for partial termination.

The court of appeals thus held that the ORRIs were extinguished by the 2000 release, and that the savings clause did not apply to the 2001 lease because it was entered into more than a year and a day after the release. Because its decision on the first issue was dispositive, the court did not address the other issues raised by SM Energy on appeal. The court of appeals ruled that the Suttons' ORRIs were extinguished and that they therefore should take nothing.

5. ***Samson Lone Star, Limited Partnership v. Hooks*, No. 01-09-00328, 2012 WL 1951113 (Tex. App.—Houston [1st Dist.] May 31, 2012, no pet.).**

In *Hooks*, the court of appeals held that a lessee's pooling agreement with the State of Texas did not trigger the "most favored nations clause" under the oil and gas lease. Although the State received higher royalties on one unit, the higher royalties were not the result of increase in market price.

Charles Hooks, the lessor under a series of oil and gas leases, sued Samson Lone Star Limited Partnership, the lessee. Hooks claimed—among many other things—that Samson breached the oil and gas leases by failing to properly pay royalties to Hooks and family. Specifically, Hooks made a claim for unpaid royalties based on Samson's allegedly improper "unpooling" of one particular unit. Hooks also claimed that Samson failed to pay royalties in accordance with the "most favored nations" clause contained in all three of the Hook's leases.

Following a trial verdict in favor of Hooks, the trial court entered a final judgment awarding the Hooks family more than $21 million. Samson appealed on eight issues ranging from the sufficiency of the evidence to interpretation of the oil and gas leases. After granting a re-hearing of a March, 2012 opinion, the appeals court reversed significant portions of the trial court's final judgment and rendered a take-nothing judgment on most of Hooks' claims.

The court first ruled that Hooks' fraud claims were barred by the statute of limitations, due to the fact that information that would have informed them of any alleged fraud existed in records available from both the lessee and the Texas Railroad Commission.

The court then turned to discuss Hooks' claim that Samson owed higher royalty payments because of Samson's improper unpooling. Samson pooled several leases in accordance with its authority to do so under its leases with Hooks. However, under the habendum clause contained in those leases, unpooling required agreement of the lessors or the cessation of the production of any "unitized substance." In contravention of the habendum clause, Samson unpooled several leases when it redesignated the BSM unit. As a result, the court held that Samson breached the oil and gas leases by violating the habendum clause and by failing to pay Hooks royalties on production from the BSM unit. But the court's analysis did not end there.

Samson argued that Hooks ratified the redesignation of the BSM unit through its subsequent conduct. Specifically, Hooks waited more than four years from the date the BSM unit was redesignated to file suit for breach of contract. Furthermore, Hooks accepted royalty checks from the amended pooling units after receiving notification that the BSM unit had been redesignated. Thus, the court held that Hooks expressly agreed to accept the redesignation of the BSM unit and was estopped to assert its interest in previously unpaid royalties from the BSM unit.

Next, the court addressed Hooks' argument that he should have received higher royalties based on the "most favored nations" clause contained in the leases. The most favored nations clause obligated Samson to pay Hooks a royalty equal to that payable under any third-party oil and gas lease located within three miles of any boundary covered by the Hooks' leases. Hooks claimed that a pooling agreement executed by Samson and the State of Texas was a third-party lease within the meaning of the most favored nations clause.

The court began its analysis by explaining that a most favored nations clause is a vendor protection clause that enables the vendor to receive the benefit of increases in market price over the term of a lengthy contract. The court then addressed the agreement between Samson and the State. According to the court, Samson did not enter into an oil and gas lease with the State; Samson entered into a pooling agreement that raised the royalty payable to the State on production from the DuJay unit. In reality, the court explained, the pooling agreement was a "settlement agreement," designed to induce the State to accept the redesignation of the BSM unit and to compensate the State for the loss of royalties. Thus, the difference between royalties payable to the State and Hooks was not the result of market price. Therefore, the court ruled that the most favored nations clause in the Hook's leases was not triggered by the higher royalty paid under the settlement agreement between Samson and the State.

The court then quickly disposed of Hooks' interpretation of the formation production clause as doubling the amount of royalties Samson owed to Hooks on the liquid condensate produced from the well. According to the

court, the formation production clause unambiguously provided that the Hooks were entitled to a 25% royalty on all gas and liquid hydrocarbons at the time proceeds are received from their sale—and no more. As a result, the court reversed the trial court's final judgment awarding damages to Hooks.

6. ***Moore v. Noble Energy, Inc.***, No. 07-10-00434-CV, 2012 WL 2912739 (Tex. App.—Amarillo July 17, 2012, no pet. h.).

In *Moore*, the court of appeals held that a deed's provision which includes parenthesis cannot be ignored, and a fractional royalty was reserved, not a fraction of royalty.

In 1955, J.C. Moore conveyed 160 acres in Wheeler County to the Veterans' Land Board of the State of Texas. In this deed, Moore reserved a "one-half non-participating royalty interest (one-half of one-eight of production)." Noble Energy, Co, as successor of the Veterans' Land Board, held an oil and gas lease signed in 2003, providing for a payment of a 3/16 royalty. A dispute later arose regarding payment of the 3/16 royalty, and the Moores filed suit in 2010.

The Moores argued that the language in the 1955 deed was ambiguous, and that it reserved a non-participating royalty of one-half of the royalty of any future leases. Noble Energy, however, argued that the deed was unambiguous, and that it reserved the Moores a 1/16 non-participating royalty interest. The trial court granted Noble Energy's motion for summary judgment, and the Moores filed a timely appeal. On appeal, the Moores continued to argue that the reservation's language was ambiguous.

While both parties agreed that the Moores possessed a non-participating royalty interest in the natural gas, the issue was the amount of that royalty interest. Although the Moores attempted to argue that the deed attempted to reserve a one-half royalty interest in future conveyances, the court of appeals rejected this argument.

The Moores tried to persuade the court that the deed reserved a fraction of royalty, as opposed to a fractional royalty. A fraction of royalty reserves a fraction of the royalty retained by the lessor, while a fractional royalty reserves the stated fraction of gross production. The Moores urged the court of appeals to ignore the parenthesis in its analysis of the reservation, but the court of appeals ruled that doing so would contradict the common rule of construction. Because the parenthesis stated an actual fraction, and none of the deed's language was consistent with deeds that reserve a fraction of royalty, the court of appeals held that the only plausible interpretation was that the deed reserved a fractional royalty.

Ultimately, the court of appeals held that only one interpretation of the reservation's language was reasonable. Because of this, it found no ambiguity in the clause, and held that the trial court properly granted Noble Energy's motion for summary judgment.

7. ***City of Houston v. Trail Enterprises, Inc.***, No. 14-10-00944, 2012 WL 3223662 (Tex. App.—Houston [14th Dist.] Aug. 9, 2012, no pet. h).

In 1967, the City of Houston enacted an ordinance that restricted the drilling of new oil and gas wells in a "control

area" around Lake Houston, a major source of public drinking water. Originally, the restrictions applied regardless of whether the property was within the City's boundaries or in its extraterritorial jurisdiction ("EJT"). In 1977, the restrictions were changed to only apply to areas in the ETJ. In 1996, the city annexed a formerly restricted area of land, thus lifting the restrictions, but in 1997 the City changed its ordinances to once again apply the restrictions to property within the city limits.

No new drilling occurred in the eleven months during which the restrictions did not apply to the property owned by Trail and other plaintiffs. Further, neither Trail nor any of the appellees obtained their property rights during the eleven-month period for which the restrictions were lifted.

In 2003, Trail, joined by the other appellees, filed suit against the City, claiming that the 1997 City ordinance constituted an inverse condemnation for which a taking had occurred. In 2005, after a bench trial, the trial court ruled in Trail's favor, and following an appeal on the issue of ripeness by the city in which the Texas Supreme Court ruled for Trail, the trial court entered a $17 million judgment for Trail.

The City then filed an appeal on the merits, arguing that Trail had failed to establish that a taking had occurred. The court of appeals applied the *Penn Central* test in its analysis. Under the test, the court considered three factors: (1) the character of the governmental action; (2) the extent to which the regulation has interfered with reasonable and distinct investment-backed expectations; and (3) the economic impact of the regulation on the claimant. No one factor is considered paramount, and courts should weigh all three factors when determining if a taking has occurred.

In considering the first factor, governmental interest, the court of appeals found that the factor weighed in the City's favor. The express purpose of the restrictions were to protect the public water supply at Lake Houston, which is a large source of water for the city. Although the appellees posed the question—and the City had no good answer—as to why the restrictions had only applied to ETJ areas and not those areas located within the city limits, it introduced no evidence on the matter for court of appeals to consider.

The court of appeals determined that the second factor, reasonable investment-backed expectations, also weighed in the City's favor. Only one of the appellees had acquired their interest in the land at a time when drilling was allowed—before the 1967 ordinances. Because the rest of the appellees obtained the property at times when drilling was not allowed, the court did not accept the argument that their investments were made with the expectation that they would be able to drill. Further, the court pointed out that the drilling ban did not affect producing wells in existence on the properties before the 1967 ordinance. Since no drilling occurred and no land was sold during the 11-month period before the 1997 ordinance, the court sided with the City.

On the final issue, the court determined that the economic impact weighed in favor of the appellees. Although there were disputes as to how much appellees could drill on their land even if they were allowed, the court still

held that the drill ban caused at least some economic impact. This, however, was not enough to outweigh the degree to which the first two factors tipped the scale in the City's favor. Therefore, the court of appeals ruled that no taking had occurred and reversed the trial courts decision, rendering judgment in the City's favor.

8. ***Friddle v. Fisher*, No. 06-12-00018-CV, 2012 WL 3536796 (Tex. App.—Texarkana Aug. 17, 2012, no pet. h.).**

In *Friddle*, the court of appeals held that when holders of an executive interest hold funds owed to holders of a non-participating royalty interest ("NPRI"), they hold the funds in constructive trust for the NPRI.

In 1949, M.L. Friddle conveyed an 84.7-acre tract of land to Barney Martin, reserving a one-fourth NPRI in the oil, gas, and other mineral estate of the tract. In 1992, this NPRI was conveyed to Martin Friddle. Later, Barney Martin and his wife conveyed another one-fourth NPRI in the 84.7-acre tract to each of two other individuals. The following day, the Martins conveyed the 84.7-acre tract to the Fishers, and the deed specifically excepted the three individual one-fourth NPRIs. Eventually, Friddle obtained the other two one-fourth NPRIs.

In 1998, the Fishers signed an oil and gas lease on the land with Valence Operating Company. Neither the Fishers nor Valence provided any notification of the lease to any of the NPRI holders. Valence drilled an off-site well but pooled the 84.7-acre tract in the "Ames-Antrim Gas unit." Valence obtained no ratification of the lease by the NPRI holders, and the NPRI holders received no royalty payments.

Friddle became aware of the lease agreement in 2008 and filed suit. In his suit, he alleged that the Fishers held a fiduciary duty to notify him when a lease containing a pooling clause was executed, and that they failed to do so. Friddle further claimed that the Fishers received over $90,000 in payments that should have been paid to the holders of the NPRI. Therefore, Friddle claimed, the money that should have been paid to the NPRI holders should be deemed held in constructive trust by the Fishers for the benefit of the NPRI holders. After both parties filed motions for summary judgment, the trial court granted the Fishers' motion, and Friddle appealed.

In response to Friddle's appeal, the Fishers argued that the only fiduciary duty they owed Friddle, if any, was that of "utmost fair dealing" to the owners of other interest in the mineral estate, such as holders of an NPRI. Friddle, however, argued that the Fishers, as owners of executive rights, further owed him the duty of notifying him when they signed a lease that authorized pooling.

The court of appeals sided with Friddle. In overturning the trial court, the court of appeals held that when the Fishers accepted royalty payments which were payable under the lease they had signed, including payments owed to the owners of the NPRI, they had a duty to hold a portion of the funds as constructive trustees for holders of an NPRI. Because of the fiduciary relationship that the Fishers had with Friddle, they had a greater duty than just entering into a lease of the utmost fair dealing.

Although the court of appeals held that the Fishers owed Friddle additional fiduciary duties in notifying him, it stopped short of indicating exactly what those duties were. The court of appeals held that the extent to which the fiduciary must go in order to locate and notify an NPRI holder about a lease is a question of fact. The court of appeals then reversed and remanded the case for further proceedings in the trial court.

9. *Ohrt v. Union Gas Corporation*, No. 13-05-00621-CV, 2012 WL 3757386 (Tex. App.—Corpus Christi Aug. 31, 2012, no pet. h.).

In *Ohrt*, the court of appeals held that accepting royalty payments on pooled units acts as a ratification, barring landowners from being able to raise claims for improper pooling and inadequate royalty payments.

Union Gas entered into separate oil and gas leases in Victoria County with Burnette Ohrt, David Ohrt, the Mcadams, the Heinolds, the Chiolcoats, and Ronald Albrecht between 1999 and 2000. Pooling was permitted in each of these leases. Union Gas contracted Union Gas Operating Company ("UGOC"), its wholly owned subsidiary, to act as operator. UGOC drilled the Ohrt-Albrecht No. 1 Well in July 2000, on land owned by Ronald Albrecht. UGOC renegotiated and amended the lease with the Ohrts around this time regarding contingencies if Union Gas pooled acreage for gas production.

Union Gas then formed the Ohrt-Heinold Unit. On October 10, 2000, UGOC filed a Designation of Pooled Unit for 697.4935 acres, 82 acres of which belonged to the Ohrts, for the Ohrt- Albrecht Gas Unit. It filed the Designation of Pooled Unit for the Ohrt-Heinold Gas Unit on January 15, 2001. Division orders were sent to the Ohrts in January 2001, and Union Gas began sending the Ohrts royalty payments in March, 2001 for the pooled units. The Ohrts accepted and cashed these checks, until they sent a demand letter on October 30, 2001 demanding 100% royalties from the date of first production of the Ohrt-Heinold Well.

The Ohrts' lease provided for 3/16 royalty payments which could be diluted by pooling arrangements. Because the pooling agreements violated depth limitations included in their lease, the Ohrts argued that the pooling should be considered ineffective, and that they were entitled to full payment under the lease. At trial, a jury returned a verdict in Union Gas's favor. The jury concluded that the Ohrts ratified Union Gas's conduct, even if impermissible, by accepting royalty payments for several months without objection before raising an issue.

On appeal, the Ohrts argued that they were entitled to pre-pooling royalties because the Designation of Pooled Unit for the Ohrt-Heinold Gas Unit was filed four months after the unit was drilled. Therefore, they argued, this was done in violation of the lease's pooling provisions. Although the court of appeals agreed that the pooling was not effectuated until the Designation was filed, the acceptance of the royalty payments made based on the pooled units as opposed to the full amount in the lease, served as a ratification by the Ohrts.

Because the Ohrts accepted the royalty payments without objection, the court of appeals held that the Ohrts had

waived their causes of action for both pre-pooling royalties as well as improper pooling. Therefore, the court of appeals affirmed the trial court's take-nothing order.

10. *Coe v. Chesapeake Exploration, L.L.C.*, No. 11-41003, 2012 WL 3966722 (5th Cir. Sep. 12, 2012).

In *Coe*, the Fifth Circuit held that an agreement to convey oil and gas leases which includes areas shaded in on an attached map provide enough reasonable certainty to make the agreement binding.

In July 2008, Chesapeake Exploration, LLC entered into an agreement to purchase deep rights held by Peak Energy Corporation in certain leases in the Haynesville Shale formation, for $15,000 per acre. The agreement took place after oilman Greg Wood contacted Richard Coe, a member of Peak. The parties signed an agreement which stated that approximately 5,404.75 net acres would be sold, allowing for adjustments to the purchase price if more or less land was delivered. Attached to the signed agreement was a map of Harrison County and neighboring counties, in which several areas were highlighted with "PEAK" written next to them. The agreement stated that it would be binding and that the closing date for the transaction would be August 31, 2008.

In working to finalize the agreement, both parties requested and obtained extensions to the closing date. On October 9, Chesapeake requested that closing be postponed to January, 2009. Six days after making the request, Chesapeake informed Coe that it would no longer be completing the transaction. Chesapeake's supervisor of acquisitions informed Coe that the decision was made because of timing issues and called the properties "edgy," but the Fifth Circuit noted that the decision coincided with a steep decline in natural gas prices that began in August, 2008.

Peak and Coe filed suit against Chesapeake to enforce the agreement, but Chesapeake argued that the July agreement had been nothing more than an agreement to negotiate, and that it was therefore not binding. Further, Chesapeake argued that the agreement did not comport with the Texas statute of frauds and was too indefinite to be enforced. Following a bench trial, the court ruled that the July Agreement was enforceable, and awarded Peak damages.

On appeal Chesapeake argued, amongst other things, that the trial court erred in enforcing the July Agreement because the agreement did not adequately identify the property to be conveyed, and violated the statute of frauds. Chesapeake argued that the language in the agreement that "certain gas leases" which were shown on the attached map was not certain enough.

The Fifth Circuit disagreed with Chesapeake. The court held that the description in the July Agreement was similar to other agreements that have been enforced in which the selling party agreed to convey all the property he owned in a specified state, county or survey. In the July Agreement, Peak conveyed all its rights in oil and gas interests in the areas marked as Exhibit A. Peak further described the land to be conveyed by stating that the "certain" leases were only those which included "depths, intervals and formations below the ... Cotton valley formation." The court viewed this

provision as an additional limitation which narrowed the areas covered by the agreement.

The Fifth Circuit held that the terms in the July Agreement were more than enough to provide a reasonable description necessary to contain an adequate nucleus of description. Because it contained an adequate nucleus of description, the trial court did not err in concluding that the agreement was enforceable.

In its final claim, Chesapeake argued that the agreement was unenforceable because Peak was unable to perform its obligations under the agreement. At trial, Peak admitted that although the July Agreement had called for approximately 5,4404.75 acres, it only would have been able to convey 1,645.917 acres. While the Fifth Circuit acknowledged that this difference, greater than 10%, would have been enough for Texas courts to decline to enforce a contract, this disparity did not require the trial court to do so.

The Fifth Circuit relied on the adjustment provision that the parties included in the July Agreement as well as the fact that Chesapeake had previously made it known that it was interested in acquiring any and all of Peak's land that it could. Therefore, the Fifth Circuit concluded that the trial court had not erred in concluding that Peak was willing and able to tender performance on the July Agreement. The Fifth Circuit therefore concluded that a binding contract existed and affirmed the trial court's order.

11. *United States v. CITGO Petroleum Corporation*, Criminal Action No. C-06-563, 2012 WL 3866857 (S.D. Tex. Sept. 5, 2012).

In *CITGO*, the district court ruled that even without intent to capture birds, an oil company was guilty of violating the Migratory Bird Act ("MTBA") when ten birds protected under the act were found dead inside open-top tanks located at its petroleum refinery.

The MTBA criminalizes the taking or killing of a migratory bird "at any time, by any means or in any manner," without a permit or when otherwise permitted by regulation. On July 17, 2007 CITGO was convicted on three counts of taking and aiding and abetting the taking of migratory birds. The charges arose because ten birds were found dead inside two tanks at the CITGO East Refinery plant, owned by CITGO, between April and May of 2003. CITGO moved for the court to vacate the convictions, and argued that the indictment brought against it failed to state an offense.

In its motion, CITGO argued that the MTBA only criminalizes intentional actions directed towards migratory birds such as hunting and poaching, but that it does not criminalize the unintentional killing of these birds as happened at its refinery plant. It argued that since its conduct of operating refinery plants was not directed towards the killing or capturing of birds, that the government's indictment failed to state an action for which it could be convicted under the MTBA.

In making its decision, the district court relied on the condition of the tanks that the birds were flew in to. The tanks in question violated the Clean Air Act because they were supposed to be covered. Additionally, Texas law requires that tanks that are greater than eight feet in diameter have a screen or net to prevent harm to birds.

The district court considered differing views issued by various courts regarding whether conduct that did not target the killing or capturing of birds is covered by the MTBA. Eventually, the district court ruled that the additional criminal conduct by CITGO, violating the Clean Air Act by not covering the tanks, distinguished the CITGO case from decisions in which courts had held no violation of the MTBA occurred as a result of otherwise lawful actions.

The district court also considered the foreseeability of whether CITGO's actions would cause harm to birds. Based on testimony at trial that CITGO employees had witnessed dead birds in tanks at the plant in years before 2003, and the fact that the plant was located along the Corpus Christi ship channel where many migratory birds flew overhead, the district court concluded that the death of migratory birds was a foreseeable result. Because of its failure to comply with the Clean Air Act, and the foreseeability of its actions, the district court affirmed its earlier decision and denied CITGO's motion to vacate its convictions.

999999 999948 Active 5309908.1