# TEXAS OIL & GAS
# CASE LAW UPDATE
# TADC Spring 2012 Edition

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## I. SCOPE OF THE ARTICLE

This article surveys selected oil and gas cases decided by Texas state and federal courts from September 30, 2011 through May 8, 2012. Immediately below are one-paragraph abstracts of the selected cases. Full case summaries follow the abstracts.

## II. ABSTRACTS

**1. A lessee with knowledge of a pre-existing lease on the same property ratifies its otherwise voidable lease by performing under the agreement.** The court of appeals held that a lessee who had actual knowledge of a pre-existing lease ratified its otherwise voidable lease by paying a bonus to the lessor. Due to the ratification, the lessee was barred from seeking damages from the lessor who fraudulently procured the lease. *Thomson Oil Royalty, LLC v. Graham*, 351 S.W.3d 162 (Tex. App.—Tyler 2011, no pet.).

**2. A subsequent land purchaser cannot recover for injuries that occurred before the purchase unless the deed expressly so provides or the purchaser obtains an assignment.** The court of appeals held that a land owner had standing to sue for property damage that occurred before the owner purchased the land. The previous owners were five tenants in common. The current land owner acquired assignments of claims from three, and joined the remaining two as plaintiffs. *Vee Bar, Ltd. v. BP Amoco Corp.*, 361 S.W.3d 128 (Tex. App.—El Paso 2011, pet. filed).

**3. To obtain status as a third-party beneficiary under an oil and gas lease, one must demonstrate that the contracting parties intended a benefit.** The court of appeals held that a rancher was not an intended beneficiary under an oil and gas lease agreement. The rancher previously held a surface-use lease on the property for the purpose of grazing cattle. But the rancher did not qualify as a "lessor's tenant" under a provision granting such persons protection under the oil and gas lease. *EOG Resources, Inc. v. Hurt*, 357 S.W.3d 144 (Tex. App.—Fort Worth 2011, pet. denied).

**4. Royalty reservations should be construed in light of the deed as a whole.** The appeals court held that a deed reserved a "fraction of royalty"—rather than a "fractional royalty" interest—despite stating that the grantor reserved "one half of the usual one eighth" royalty. When reading the deed as a whole, the parties' intent to create a fraction of royalty became clear to the court. *Sundance Minerals, L.P. v. Moore*, 354 S.W.3d 507 (Tex. App.—Fort Worth 2011, pet. denied).

**5. Adverse possession of the severed mineral estate requires both drilling and production.** The court of appeals held that a well operator could not demonstrate adverse possession under the five-year statute of limitations because it had been less than five years since production started. However, the operator successfully demonstrated adverse possession under the more lenient requirements of the ten-year limitations period. *Conley v. Comstock Oil & Gas, LP*, 356 S.W. 3d 755 (Tex. App.—Beaumont 2011, no pet. h.).

**6. The key to distinguishing a "fraction of royalty" from a "frac-**

**tional royalty" interest lies in harmonizing the deed's many royalty clauses.** The court of appeals held that a deed reserved a fraction of royalty—rather than a fractional royalty interest—despite an arguably conflicting clause in the deed. The court harmonized the deed's clauses to determine the nature of the reservation. *Coghill v. Griffith*, 358 S.W.3d 834 (Tex. App.—Tyler 2012, no pet. h.).

**7. An oil and gas lease that covers a contiguous tract of land spanning multiple counties only has to be recorded in one of those counties.** The court of appeals held that a land purchaser was not a bona fide purchaser for value because it had constructive notice of an oil and gas lease. Under Chapter 11 of the Texas Property Code, the lease only needed to be recorded in one of the counties in which the property was located. *Aston Meadows, Ltd. v. Devon Energy Prod. Co.*, 359 S.W.3d 856 (Tex. App.—Fort Worth 2012, no pet. h.).

**8. A salt water disposal lease agreement does not qualify as an "oil and gas lease."** The court of appeals held that a salt water disposal lease agreement was not executed for the purpose of recovering minerals from property. Thus, the disposal agreement could not be considered an oil and gas lease for purposes of determining whether an interest qualified as an assignment or a sublease. *Royalco Oil & Gas Corp. v. Stockhome Trading Corp.*, No. 02-10-00455, 2012 WL 254037 (Tex. App.—Fort Worth Jan. 26, 2012, no pet. h.).

**9. 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 691584 (Tex. App.—Houston [1st Dist.] 2012, no pet. h.).

**10. A grantor can retain all or part of his mineral interest without expressly reserving the mineral interest.** The court of appeals held that a party conveyed one half of his mineral interest—not his entire interest—despite not including the reservation in the deed's reservation clause. According to the court, a proper interpretation of the granting clause demonstrated that the grantor intended to reserve part of his mineral interest. *Hunsaker v. Brown Distrib. Co.*, No. 04-11-00699-CV, 2012 WL 953211 (Tex. App.—San Antonio March 21, 2012, no pet. h.).

**11. An oil and gas lessee's interest can be held subject to a joint operating agreement that the lessee did not sign.** The court of appeals held that an oil and gas lessee was bound by a joint operating agreement executed before the lessee acquired his interest in the property. The lessee had constructive notice of the JOA before it acquired its interest, and the JOA created a covenant running with the land. *TransTexas Gas Corp. v. Forcenergy Onshore, Inc.*, No. 13-10-00446, 2012 WL 1255218 (Tex. App.—Corpus Christi April 12, 2012, no pet. h.).

**12. Regulations governing royalties owed to the federal government will be construed with heavy weight given to agency interpretation.** The Fifth Circuit held that an oil and gas lessee owed additional royalties to the federal government based on improper deductions for gas treatment and compression. Giving great deference to the Department of the Interior, the court ruled that compression and treatment costs were incurred to place gas in a marketable condition. *Citation Oil & Gas Corp. v. U.S. Dep't of Interior, No. 10-20729*, 2011 WL 5025486 (5th Cir. Oct. 21, 2011).

**13. Non-operating working interest owners may acquire standing as third-party beneficiaries through "Non-Ops" clauses.** The district court held that non-operating working interest owners were intended third-party beneficiaries under a letter agreement's "Non-Ops Clause," due to the express language of the Clause, as well as the conduct of the contracting parties. *Chesapeake La., L.P. v. Buffco Prod., Inc.*, No. 2:10-CV-359 (JRG), 2012 WL 1003761 (E.D. Tex. March 22, 2012).

## III. CASE SUMMARIES

### 1. *Thomson Oil Royalty, LLC v. Graham*, 351 S.W.3d 162 (Tex. App.—Tyler 2011, no pet.).

In *Thomson Oil*, the court of appeals held that a lessee who had actual knowledge of a pre-existing lease ratified its otherwise voidable lease by paying a bonus to the lessor.

In 2008, Thomson Oil Royalty LLC and EOG Resources Inc. battled to acquire a mineral lease on Camille Graham's property in the Haynesville Shale formation. Significantly, Graham put her signature on two documents at nearly the same time: 1) a memorandum of oil, gas, and mineral lease leasing a 306-acre tract to EOG; and 2) a traditional oil and gas lease that leased the same 306-acre tract to Thompson Oil, along with a separate 241-acre tract. EOG recorded its memorandum lease in the Real Property Records of San Augustine County before Thomson Oil recorded its lease. As a result, EOG held the lease to the 306-acre tract, and Thomson Oil filed suit against Graham seeking damages for fraud, breach of contract, and unjust enrichment.

At summary judgment, Graham argued that even if she procured the oil and gas lease with Thomson Oil through fraudulent conduct, Thomson Oil ratified the contract after learning of the fraud. The trial court agreed with Graham's argument, and granted summary judgment to Graham on the affirmative defense of ratification. Thomson Oil lodged an appeal.

On appeal, the court explained that a contract procured by fraud can be ratified. Ratification is the adoption or confirmation—by one with actual knowledge of all material facts—of conduct which that person has the right to repudiate. Ratification occurs when a party recognizes the validity of a contract by acknowledging it or performing under it.

Turning to the facts of the case, the court stated that because Graham had already leased the 306-acre tract to EOG, Thomson Oil could have rescinded its lease with Graham. But even after learning that EOG had already filed its memorandum lease—and, in fact, seeing

the memorandum lease at the county clerk's office—Thomson Oil declined to rescind the lease. Instead, Thomson Oil went forward with filing the lease covering the 306- and 241-acre tracts. Also, Thomson Oil paid the $137,000 bank draft to Graham it had previously delivered to Graham as a bonus. Shortly thereafter, Thomson Oil assigned its interest in the 241-acre tract to Devon Energy for $200,000.

Based on this timeline of events, the court concluded that Thomson Oil acquired actual knowledge of the EOG lease before it consummated its lease with Graham for the same property. Accordingly, the court ruled that Thomson Oil ratified its lease agreement with Graham, thereby barring Thomson Oil's causes of action.

**2. *Vee Bar, Ltd. v. BP Amoco Corp.*, 361 S.W.3d 128 (Tex. App.—El Paso 2011, pet. filed).**

In *Vee Bar*, the court of appeals held that a land owner had standing to sue for property damage that occurred before the owner purchased the land.

In 1994, Vee Bar Ltd. purchased a large ranch from five siblings—the Wheeler siblings. The siblings owned the ranch as tenants in common, with each owning an undivided 1/5 interest in the land. Years later, Vee Bar sued several oil and gas companies, including BP Amoco Corporation, seeking to recover damages for injury to a 640-acre tract. Vee Bar alleged that the defendants deposited toxic hydrocarbons and toxic substances into the land while operating wells under various oil and gas leases. Several defendants filed pleas to the jurisdiction, claiming that Vee Bar did not have standing because the alleged damage occurred before Vee Bar's purchased the property. The trial court granted the pleas and Vee Bar appealed.

On appeal, the court explained that a cause of action for injury to real property belongs to the person who owned the property at the time of the alleged injury. A subsequent purchaser cannot recover for injuries that occurred before the purchase unless 1) the deed expressly so provides or 2) the purchaser obtains an assignment. The court quickly disposed of the first exception because the deed did not contain an express provision conveying to Vee Bar the siblings' right to sue for real property damage.

With respect to the second exception, the court noted that none of the Wheeler siblings had assigned the claim at the time Vee Bar filed suit. But after the pleas to the jurisdiction were filed, Vee Bar obtained an assignment from three of the five siblings, then joined the remaining siblings as involuntary plaintiffs. The defendants argued that three assignments weren't enough—all five would be necessary—because of the rule that all tenants in common must join in a suit to recover for injury to real property.

The rationale underlying this joinder requirement, the court explained, is to prevent multiple suits, duplicative recovery, and inconveniences to the parties. But according to the court, that rationale did not apply to the circumstances at hand. After all, all the five siblings were represented in the suit in some fashion: three were represented through assignment, and the remaining two were joined as plaintiffs. As a result, the court reversed, holding that Vee Bar had standing to sue the oil and gas

companies for any injuries that occurred before Vee Bar purchased the ranch.

**3. EOG Resources, Inc. v. Hurt, 357 S.W.3d 144 (Tex. App.—Fort Worth 2011, pet. denied).**

In *Hurt*, the court of appeals held that a third party was not an intended beneficiary under an oil and gas lease agreement, thus barring the third party's breach-of-contract claim.

In 2004, EOG Resources Inc. entered into an oil and gas lease agreement with Standard Investment Company ("SIC"). As lessee under the agreement, EOG acquired the right to produce oil and gas from a large tract known as the Houston Ranch.

In 2005, a rancher named James Hurt entered into an agreement with SIC to lease grassland on the Houston Ranch for purposes of grazing cattle. A few years later, Hurt received a shipment of 327 cattle and decided to move the cattle to the northwest pasture of the Houston Ranch. Hurt had previously checked the condition of the pasture's perimeter fence, but he did not check the fence on the day he moved the cattle.

Hurt later discovered that the perimeter fence was damaged near a well site in the northwest pasture, causing him to lose ten head of cattle. That same day, after receiving word of the damaged fence, an EOG foreman met Hurt at the well site to view the damages. EOG then repaired the fence over the next two days.

Hurt demanded that EOG compensate him for the lost cattle. When EOG refused, Hurt brought suit for breach of the 2004 oil and gas lease agreement, claiming that he was a third-party beneficiary under the lease. The court denied EOG's motions for a directed verdict on Hurt's breach of contract claim. The jury then awarded Hurt damages for the lost cattle. EOG filed motions for new trial and for judgment notwithstanding the verdict, but to no avail. Consequently, EOG filed an appeal.

On appeal, EOG argued, among other things, that the court erred in holding that Hurt was a third-party beneficiary of the 2004 oil and gas lease agreement. The appeals court agreed. The court explained that a third party may recover on a contract made between other parties if the parties 1) intended to secure a benefit to that third party and 2) entered into the contract directly for the third party's benefit. A third party does not have the right to enforce a contract if it only received an "incidental" benefit. Also, to qualify as an intended third-party beneficiary, a party must demonstrate that she is either a "donee" or "creditor" beneficiary of the contract. A creditor beneficiary is a third party to whom the contract promisee owes a debt.

Considering the facts of the case, the court noted that EOG and SIC were the only parties to the lease agreement. The many obligations set out in the lease agreement ran exclusively been SIC and EOG. And neither SIC nor EOG owed Hurt any duty or obligation at the time the 2004 lease agreement was executed. Most importantly, however, the court determined that an examination of the lease agreement revealed no intent to convey a benefit on Hurt.

Hurt argued that the lease agreement *did* confer a benefit upon him because he qualified as a "Lessor's tenant"

under the lease agreement. The lease stated that EOG, as lessee, would have to pay "Lessor's tenants" for all damages to livestock. But the court rejected Hurt's argument, explaining that Hurt's lease on the Houston Ranch expired in 2006—two years before his cattle escaped through the damaged fence. Regardless, the court also declared that even if Hurt did qualify as a Lessor's tenant, the livestock were not "damage[d]"; they were lost. Finally, making one last observation with respect to Hurt's "Lessor's tenant" argument, the court declared that SIC did not even have the right to lease the surface of the Houston Ranch for grazing purposes. According to the court, SIC exclusively held the executive right to the mineral estate. The right to lease the surface is that of the surface estate owner.

The court then turned to Hurt's final argument. Hurt argued that because the lease required EOG to pay for or replace fencing it damages, the lease provided a direct benefit to Hurt. The court quickly disposed of this argument as well, concluding that such a benefit is merely incidental—not intended. Thus, the court reversed the trial court's judgment and rendered judgment that Hurt take nothing.

**4. *Sundance Minerals, L.P. v. Moore*, 354 S.W.3d 507 (Tex. App.—Fort Worth 2011, pet. denied).**

In *Sundance Minerals*, the court of appeals held that a deed reserved a "fraction of royalty" despite stating that the grantor reserved "one half of the usual one eighth" royalty. According to the court, when reading the deed as a whole, that language merely provided an example of the type of interest the grantor intended to reserve.

In 1958, the Holders conveyed a large tract of real property to the predecessor-in-interest to Sundance Minerals L.P. The Holders reserved in the deed "an undivided and non-participating one-half interest in the oil, gas, and other mineral rights." Years later, after Sundance Minerals had acquired the property, Sundance leased the land to Quicksilver Resources for a one-fifth royalty. The Holders argued that the 1958 reservation entitled them to one-half of whatever royalty is payable under the then-existing lease. Thus, under the Quicksilver lease, the Holders sought a one-tenth overall royalty.

Sundance Minerals disagreed. According to Sundance, the deed only reserved a fixed, nonparticipating one-sixteenth royalty. Sundance supported its argument by pointing to a separate portion of the deed, which stated that the Holders "shall be entitled to one half of the usual one eighth royalty." On this basis, Sundance Minerals sought a declaratory judgment. After reviewing the deed's language, the trial court concluded that the 1958 deed reserved a "fraction of royalty" equal to one-half of any royalty paid under subsequent leases. As a result, the court declared that the Holders were entitled to one-half of the one-fifth royalty under the Quicksilver lease. Sundance Minerals lodged an appeal.

On appeal, the court endeavored to harmonize the various clauses used in the deed's royalty reservation. Before doing so, however, the court explained the distinction between a "fraction of royalty" and a "fractional royalty" interest. A fraction of royalty conveys a frac-

tional share of the royalty that is contained in an oil and gas lease; it is not fixed, but rather floats in accordance with the size of the landowner's royalty contained in the present lease. On the other hand, a fractional royalty interest entitles the owner to a specified fractional amount as stated in the deed. Thus, a fractional royalty remains constant notwithstanding any changes in the amount of the royalty provided in one lease to the next.

Turning to the dispute, the court noted that the deed's language purported to reserve one-half of the entire mineral estate—not just one-half of the royalty interest. Yet, latter portions of the deed clarified that the rights to receive bonuses and lease money, and to develop the mineral estate, were exclusively those of the grantee. Thus, the court was left to determine whether the royalty reservation was a fraction of royalty or a fractional royalty interest.

Reading the document as a whole, the court concluded that the Holders intended to reserve to themselves and their successors one-half of any royalties flowing from oil, gas or mineral leases. That the deed also discussed reservation of "one half of the usual one eighth" was not consequential, according to the court. Such language merely clarified the type of interest the Holders intended to reserve. Thus, the Holders reserved a fraction of royalty.

The fraction of royalty, as applied to the then-existing lease, entitled the Holders to one-half of the one-fifth royalty interest—rather than one half of a one-eighth royalty, as argued by Sundance Minerals. Consequently, the appeals court affirmed the lower court's ruling with respect to the royalty reservation. And after considering a host of factors relevant in determining the reasonableness of attorney's fees, the court also affirmed the lower court's award of attorney's fees to the Holders.

### 5. *Conley v. Comstock Oil & Gas, LP*, 356 S.W. 3d 755 (Tex. App.—Beaumont 2011, no pet. h.).

In *Conley*, the court of appeals held that a well operator could not demonstrate adverse possession under the five-year statute of limitations because it had been less than five years since production started. However, the operator successfully demonstrated adverse possession under the more lenient requirements of the ten-year limitations period.

Margaret Conley and other plaintiffs (collectively, "Conley") sued Comstock Oil and Gas L.P., among others, for conversion of minerals. Comstock was the operator of three wells in the Hamman Unit. Conley alleged that the Hamman wells were drilled within the boundaries of the Bartolo Escobeda Survey, which Conley claimed ownership in. Significantly, the Escobeda Survey was filed in 1835 and therefore held seniority over the surveys under which Comstock and the relevant landowners claimed their interests. The trial court ruled in favor of Comstock on cross-motions for summary judgment, and entered judgment that Conley take nothing. Conley appealed.

The appeals court affirmed the trial court's ruling on two grounds—1) adverse possession, and 2) the doctrine of presumed lost deed. Comstock moved for summary judgment on the three-, five-, and ten-year statutes of limitation under Chapter 16 of the Texas Civil Practice & Remedies Code, claiming that

it adversely possessed the minerals underlying the Hamman Unit.

To establish adverse possession under the three-year statute, the moving parties must conclusively establish that they possessed the disputed property "under title or color of title" for at least three years. The court ruled that Comstock could not demonstrate color of title as a matter of law, due to an idiosyncrasy with one of the three surveys comprising the Hamman unit. Two of the three surveys comprising the Hamman Unit were patented by the General Land Office before the Constitution of 1876 was enacted. As a matter of supreme court precedent, these surveys sufficiently provided Comstock with color of title, the court explained. However, the third survey—patented two years after ratification—did not provide color of title, for the single reason that the record failed to disclose whether one tract's land certificate was issued before ratification.

Under the five-year statute, the moving party must demonstrate that for five years it used the property, paid taxes, and claimed the property under a duly registered deed. Adverse possession of the severed mineral estate requires both drilling and production. Importantly, suit was filed in the case less than five years after production started. Thus, the court ruled that Comstock failed to establish that five years had passed since production. Therefore, Comstock could not rely on the five-year statute of limitations.

Next, the court explained that under the ten-year statute of limitations, the moving party must show that the property was held in peaceable and adverse possession by another who cultivated, used, or enjoyed property. According to the court, Comstock produced minerals under leases that were of record and did not terminate. Comstock continued operations under the leases and the wells continue to produce minerals. And the property and production records demonstrated continuous exercise of dominion over the disputed mineral estate for more than ten years. Thus, the court held that Comstock successfully demonstrate adverse possession as a matter of law.

The court also ruled that Comstock established its title under the Doctrine of Presumed Lost Deed. This Doctrine, the court explained, has been described as a common law form of adverse possession. Its purpose is to settle title disputes where one does not have complete record title to property but has long made a claim of right to that property. The court noted that the Escobeda Survey was filed in 1835, while the surveys forming the source of title for Comstock and the landowners were filed between 1847 and 1884. This, the court declared, demonstrates that the controversy over the location of the Escobeda arose long ago. Also, since 1835 the only efforts to assert ownership in the chain of title for the Escobeda were directed at lands neighboring the Hamman Unit. With this, the court held that Comstock established title by presumed grant of the lost-deed doctrine.

### 6. *Coghill v. Griffith*, 358 S.W.3d 834 (Tex. App.—Tyler 2012, no pet. h.).

In *Coghill*, the court of appeals held that a deed reserved a fraction of royalty—rather than a fractional royalty interest—despite an arguably conflicting clause in the deed.

In 1961, Patricia Coghill's predecessor in interest conveyed 191 acres to Henry Griffith's predecessor in interest. The deed included a future lease clause reserving a royalty interest in the grantor. Specifically, the deed stated that the grantor retained "an undivided one-eighth (1/8) of the usual one-eighth (1/8) royalties provided for in any future oil, gas and/or mineral lease."

Years later, Coghill inherited the royalty interest reserved in the 1961 deed. An oil and gas lease existing at that time provided for a royalty of three-sixteenths. As a result, a division order was signed in 1981 indicating that Coghill would receive one-eighth of the three-sixteenths royalty for minerals produced from the subject property.

In 2004, Griffith purchased the subject property and also began receiving one-eighth of the three-sixteenths royalty. But Griffith took the position that Coghill was receiving an improper royalty. Specifically, Griffith contended that the 1981 division order was based on an incorrect construction of the 1961 deed. According to Griffith, Coghill should only receive a one-eighth of a one-eighth royalty—not one-eighth of three-sixteenths. The dispute made its way to court.

After reviewing the 1961 deed, the trial court granted summary judgment to Griffith, ruling that Coghill was only entitled to a one sixty-fourth royalty interest. Consequently, Coghill filed an appeal.

On appeal, the court endeavored to harmonize the many royalty clauses contained in the 1961 deed. Before doing so, however, the court laid out two important definitions. First, the court explained that a "fraction of royalty" conveys a fractional share of the royalty that is contained in an oil and gas lease; it is not fixed, but rather floats in accordance with the size of the landowner's royalty contained in the present lease. On the other hand, a "fractional royalty" interest entitles the owner to a specified fractional amount as stated in the deed. Thus, a fractional royalty remains constant notwithstanding any changes in the amount of the royalty provided in one lease to the next.

With this backdrop, the court took on the deed's royalty clauses. The court explained that two of those clauses clearly described the interest as a fraction of royalty. The future lease clause, however, did not expressly do so. Rather, the future lease clause described the interest as reserving one-eighth of the "usual" one-eighth royalty.

Drawing upon precedent, the court interpreted the future lease clause to be a de facto fraction of royalty. In other words, the court construed the clause to reserve one-eighth of any royalty provided in future leases, even if the royalty is higher than one-eighth. Also, the court concluded that the deed created a royalty "floor"—future leases could provide for a royalty higher than one-eighth, but not lower.

The court indicated that the following language from the 1961 deed was important to the court's conclusion: all future leases "shall provide for at least a royalty on oil of the usual one-eighth." The court also made clear, however, that it received significant guidance from the Texas Supreme Court's decision in *Luckel v. White*, 819 S.W.2d 459 (Tex. 1991). In *Luckel*, the Supreme Court

held that a deed's future lease clause provided a fraction of royalty that would not be deterred by the specific fractional interest stated in the granting clause. According to the court, the fractional interest in the granting clause simply demonstrated the parties' intent to prohibit royalties below one-eighth.

Due to the court of appeals' harmonization of the deed's royalty provisions, the court held that Coghill was entitled to a one-eighth of three-sixteenths royalty. Therefore, the court reversed the trial court and rendered judgment for Coghill.

### 7. *Aston Meadows, Ltd. v. Devon Energy Prod. Co.*, 359 S.W.3d 856 (Tex. App.—Fort Worth 2012, no pet. h.).

In *Aston Meadows*, the court held that when an oil and gas lease relates to a contiguous tract of land spanning multiple counties, the lease only has to be recorded in one of those counties to provide a purchaser with constructive notice.

In 2001, Aston Meadows Ltd. purchased a 182-acre tract in Tarrant County. Aston Meadows intended to develop the property for residential use. But unbeknownst to them, the property was subject to a 1977 oil and gas lease that encumbered several hundred acres of land in both Tarrant and Wise counties. Significantly, at the time Aston Meadows purchased its tract, the oil and gas lease was only recorded in Wise County, and there were no signs of any oil and gas production on the property.

Not long after purchasing the tract, Aston Meadows discovered that Devon Energy Production Company L.P.—the oil and gas lessee—was drilling horizontally under the property. Aston Meadows sued Devon Energy, claiming that the lease was invalid because it was not recorded in Tarrant County when Aston Meadows purchased the property. Thus, Aston Meadows argued that it was a bona fide purchaser for value.

The trial court ruled for Devon Energy on summary judgment. Specifically, the court held that the lease was properly recorded pursuant to Texas Property Code § 11.001(a). That section provides that "[t]o be effectively recorded, an instrument relating to real property . . . must be recorded in the county in which a part of the property is located." Aston Meadows appealed.

The Fort Worth Court of Appeals began its analysis by explaining that notice sufficient to defeat bona fide purchaser status may be actual or constructive. And under the Property Code, an instrument that is properly recorded in the proper county provides sufficient notice.

Aston Meadows argued that section 11.001(a) requires that an instrument relating to a multiple-county tract must be recorded in *each* of the counties. The court rejected that argument, however. According to the court, the predecessor statute to section 11.001(a) was consistently construed as requiring recording in only one of the relevant counties. And, importantly, section 11.001 was enacted as a "nonsubstantive recodification" of the property-related revised civil statutes.

Aston Meadows also argued that requiring recording in only one county would improperly burden a purchaser of property that has been subdivided from a multi-county tract into a single-county

tract. Further, Aston Meadows contended that a purchaser should only be required to search property records in the county in which the purchased property is located. The court had little sympathy for this argument, declaring that such a rule would turn the recording system on its head. In the end, the court construed section 11.001(a) in line with the construction given to its predecessor: an instrument relating to a contiguous tract of land spanning multiple counties need only be recorded in one of the counties.

Even accepting such an interpretation of section 11.001(a), Aston Meadows argued that the lease was not properly recorded. According to Aston Meadows, the lease consisted of three separate tracts, one of which was located completely within Tarrant County. Thus, Aston Meadows contended, the tract located wholly in Tarrant County should have received its own recording in that county. Once again, the court rejected Aston Meadows' argument. The court concluded that the grantor intended to convey a single interest in one contiguous tract—not multiple tracts. Therefore, the court ruled that the lease was properly recorded in Wise County, affirming the trial court's ruling in favor of Devon Energy.

**8. *Royalco Oil & Gas Corp. v. Stockhome Trading Corp.*, No. 02-10-00455, 2012 WL 254037 (Tex. App.—Fort Worth Jan. 26, 2012, no pet. h.).**

In *Royalco*, the court of appeals held that a salt water disposal lease agreement was not executed for the purpose of recovering minerals from property. Thus, the disposal agreement could not be considered an oil and gas lease for purposes of determining whether an interest qualified as an assignment or a sublease.

In 2008, Stockhome Trading Corporation entered into a Salt Water Disposal Lease Agreement with Triad Rovan Services L.P. Significantly, the lease stated that it shall "in no way affect ownership of the oil, gas or minerals in, on or under the property." Rather, the sole purpose of the lease, as expressly stated in the document, was to allow Triad to conduct "Business Activities," defined to include activities relating to the disposal and treatment of water produced from oil and gas wells. Also, the lease provided that, without Stockhome's consent, Triad "shall not have the right to sell more than 50% to assign or sublet its interest in this Lease or the Premises." The lease provided a term of ninety-nine years and called for Triad to make monthly rental payments.

Later, Triad entered into a services agreement with Royalco, under which Royalco agreed to complete and operate the saltwater disposal well. Importantly, the services agreement included a provision "assign[ing]" to Royalco 50% of Triad's interest in the Salt Water Disposal Lease Agreement.

In the following months, Triad failed to pay rent to Stockhome. Royalco offered to cure the default on behalf of Triad, but Stockhome declined to accept the offer. Stockhome then sued Triad for breach of the lease agreement. Stockhome also sought a declaratory judgment that Royalco was a sublessee of Triad and therefore had no standing under the lease, and that Royalco's sublease with Triad terminated immediately upon Stockhome's termination of the lease. The trial court granted summary

judgment for Stockhome on its declaratory judgment action.

Royalco appealed, contending that the services agreement it executed with Triad was an assignment—not a sublease. The appeals court began its analysis by summarizing the distinction between an assignment and sublease. If the lessee transfers his entire interest in part or all of the premises without retaining any reversionary interest, the transfer is an assignment. In that case, the assignee becomes the tenant in place of the original lessee and is in privity of estate with the lessor. On the other hand, the transfer is a sublease if the lessee retains any reversionary interest whatsoever. Under a sublease, the transferee is not in privity of estate or privity of contract with the lessor.

Royalco argued that under Texas law, oil and gas leases are different than ordinary leases and are subject to different rules. Further, Royalco argued that because the Salt Water Disposal Lease Agreement was an oil and gas lease, the interest transferred to Royalco by Triad was an assignment. The court rejected this argument, however. According to the court, nothing in the lease agreement indicated that the lease was for the recovery of minerals from the property. By its plain terms, the sole purpose of the lease was for the purpose of drilling and operating a salt water disposal well.

Royalco pointed out that the Railroad Commission of Texas—which issues permits for oil and gas wells—issued a permit for the disposal well. Thus, Royalco argued, the lease should be considered an oil and gas lease. The court dismissed this argument as well, explaining that that the Railroad Commission's issuance of a permit merely reflects the legislature's policy concerning the maintenance of quality fresh water and its corresponding delegation of responsibility for overseeing injection wells. Simply because the Railroad Commission issued a permit for the disposal well does not make the lease agreement an oil and gas lease.

Next, the court took on Royalco's contention that the services agreement did in fact transfer Triad's full interest in the lease, thus creating an assignment. But the court made clear that the transfer instrument must convey "both the entire time for which the lease runs *and* the entire estate or interest conveyed by the original lease." Here, the services agreement expressly transferred only 50%. Thus, as a matter of law, the transferred interest could not qualify as an assignment.

After similarly disposing of Royalco's remaining arguments, the court affirmed the trial court's judgment: Royalco was a sublessee under the services agreement, and the sublease terminated upon Stockhome's termination of the Salt Water Disposal Lease Agreement.

### 9. *Samson Lone Star, Limited Partnership v. Hooks*, No. 01-09-00328, 2012 WL 691584 (Tex. App.—Houston [1st Dist.] 2012, no pet. h.).

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. Ultimately, 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 the both the lessee and the Texas Railroad Commission.

The court then turned to discuss Hooks' claim that Samson was defective in 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.

**10. *Hunsaker v. Brown Distrib. Co.*, No. 04-11-00699-CV, 2012 WL 953211 (Tex. App.—San Antonio March 21, 2012, no pet. h.).**

In *Hunsaker*, the court of appeals held that a party conveyed one half of his mineral interest—not his entire interest—despite not including the reservation in the deed's reservation clause.

Maurice Hunsaker conveyed property to Brown Distributing Co., Ltd. ("Brown"). At the time Hunsaker executed the deed, he owned a one-quarter mineral interest in the property. A dispute arose between the parties over the extent to which Hunsaker conveyed his mineral interest to Brown. Hunsaker claimed that he only conveyed one-half of his one-quarter mineral interest; Brown argued that Hunsaker conveyed the entire mineral interest. Suit was filed and both parties moved for summary judgment. The trial court agreed with Brown's interpretation of the deed, ruling that Hunsaker conveyed his entire one-quarter mineral interest. Hunsaker appealed.

On appeal, the San Antonio Court of Appeals reversed the trial court's ruling and rendered judgment for Hunsaker. The court reached this conclusion by harmonizing the language in the deed's granting clause with that of its royalty reservations. The granting clause stated that Hunsaker "grants, sells, and conveys land that is more particularly described on Exhibit A." In turn, Exhibit A described the metes and bounds of the property and stated: "There is also included in this conveyance one-half (1/2) of all oil, gas, and other minerals . . . on and under said property now owned by Grantor."

Hunsaker argued that the above language should be construed as conveying only one-half of his one-quarter mineral interest. In response, Brown contended that the deed should be read as conveying Hunsaker's entire mineral interest, due to the fact that Hunsaker did not specifically reserve any mineral interest. Brown attempted to support its argument by pointing out that the deed did contain royalty reservations, but none of

them reserved an interest in Hunsaker. The court rejected Brown's argument, however, noting that the deed made clear that the property's royalty reservations were not limited to those reservations specifically identified in the deed.

Brown also argued that language in Exhibit A should be construed to mean that Hunsaker conveyed one-half of all minerals in the property, not one-half of his mineral interest. In support of this argument, Brown explained that courts construe deeds conveying a mineral interest "under the land described" as granting the mineral interest under the entire tract—not just the interest owned by the grantor. Once again, the court found problems in Brown's argument. First, the court noted that such an interpretation would render other provisions in the deed meaningless and would conflict with the deed's list of reservations. Second, the court noted that cases construing "under the land described" as conveying the entire mineral interest are easily distinguishable: the deeds in those cases did not contain language indicating the interest being conveyed was that "now owned by the Grantor." Exhibit A *did* contain such language.

Accordingly, the appeals court held that the deed only conveyed one-half of Hunsaker's one-quarter mineral interest.

**11. *TransTexas Gas Corp. v. Forcenergy Onshore, Inc.*, No. 13-10-00446, 2012 WL 1255218 (Tex. App.—Corpus Christi April 12, 2012, no pet. h.).**

In *TransTexas*, the court of appeals held that an oil and gas lessee was bound by a joint operating agreement executed before the lessee acquired his interest in the property.

Two parties—TransTexas Gas Corp. and Forcenergy Onshore, Inc.—held interests in an oil and gas lease called the Krueger Lease. The parties disagreed with respect to whether they obtained their respective interests subject to a September 1982 join operating agreement (the "JOA"). This disagreement proved important when TransTexas refused consent to drilling proposals made by Forcenergy. Forcenergy claimed that TransTexas was bound by the non-consent provision in the JOA, under which Forcenergy would be entitled to recover non-consent recoveries. The dispute made its way up to the Corpus Christi Court of Appeals.

On appeal, TransTexas argued that the non-consent provision was inapplicable for two reasons—1) TransTexas did not assume the obligations under the non-consent provision, and 2) the obligations did not run with the land. TransTexas contended that it did not assume obligations under the non-consent provision because it did not sign the JOA. The court quashed this argument, however, explaining that purchasers are bound by every recital fairly disclosed by any instrument that forms an essential link in the chain of title. Significantly, TransTexas admitted that it had constructive notice of the JOA because of an assignment executed before it acquired rights in the Krueger Lease.

TransTexas also argued that it did not assume obligations under the non-consent provision because the JOA was amended by subsequent actions of the parties. Specifically, TransTexas pointed to a 1984 assignment and letter agreement, neither of which referred to

the JOA. But this argument proved fruitless as well, due to the fact that TransTexas acquired rights in the Krueger Lease from a party to the JOA who did *not* join in the 1984 agreements.

The court then turned to the second argument posited by TransTexas that the JOA did not run with the land. In Texas, parties must intend to create a covenant running with the land in order to effectuate a covenant. The court reviewed the JOA, and found the following language: The JOA shall be "binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, representatives, successors, and assigns." According to the court, this language was sufficient—the covenants in the JOA ran with the land. Consequently, the court ruled that TransTexas was bound by the obligations under the non-consent provision in the 1982 JOA.

In addition to considering the applicability of the JOA's non-consent provision, the appeals court also addressed questions of res judicata and bankruptcy protection, among others. The court first held that the case was not barred due to an earlier suit between the parties.

Second, the court held that certain property rights of TransTexas were not shielded by its bankruptcy. Specifically, the court ruled that under the JOA, TransTexas transferred its rights to the wells and production to the consenting parties, including Forcenergy. Significantly, the federal bankruptcy code excludes from the bankruptcy estate any oil and gas interests subject to a "farmout" agreement—a written agreement whereby a party "agrees to transfer or assign an oil and gas interest that includes, as consideration, defined operations upon the property." Because the non-consent provision operated as a farmout agreement, the court ruled that TransTexas's relinquished interests were not included in its bankruptcy estate.

**12. *Citation Oil & Gas Corp. v. U.S. Dep't of Interior, No. 10-20729*, 2011 WL 5025486 (5th Cir. Oct. 21, 2011).**

In *Citation*, the Fifth Circuit held that an oil and gas lessee owed additional royalties to the federal government based on improper deductions for gas treatment and compression.

Citation Oil and Gas Corporation leased federal land in North Dakota from the United State Department of the Interior (the "Interior"). Under the terms of its leases, Citation was required to pay royalties on the oil and gas it extracted. The North Dakota Office of the State Auditor conducted an audit of Citation's royalty payments on the leases, and found that Citation had made insufficient royalty payments due to improper deductions for gas treatment and compression. The State Auditor sent letters to Citation describing its findings and informing Citation that Citation could provide documents or comments to refute the Auditor's determinations. Citation expressed disagreement with the State Auditor's findings, but did not provide documentation to support its findings.

Based on the audit, a subagency of the Interior—the Minerals Management Service, or MMS—issued orders requiring Citation to pay additional royalties. Citation appealed the determination of the MMS, but a director of the MMS de-

nied the appeal. Citation then appealed to the Interior Board of Land Appeals ("IBLA"), but once again to no avail. Next, Citation appealed the IBLA's decision to the United States District Court for the Southern District of Texas, which granted summary judgment in favor of the Interior. Finally, Citation appealed to the Fifth Circuit.

At the circuit court, Citation disagreed with the Interior's interpretation of agency regulations, as well as the Interior's use of certain documentation and estimates. First, Citation complained about the Interior's conclusion that compression and treatment costs should not have been deducted from Citation's proceeds. Under federal regulations, a party leasing federal land must place gas in a marketable condition and market the gas for the mutual benefit of the lessee and lessor, at not cost to the federal government. Repeating its own precedent, the court explained that "marketing costs cannot be deducted from the gross proceeds, equal to the value of production, before royalty is calculated."

Citation argued that it sold unprocessed gas to a third party, Koch Hydrocarbon Company, and that such gas was already in a marketable condition. According to Citation, the price Koch paid to Citation was the appropriate amount off of which to base its royalty payments. In response, the Interior contended that the costs of treatment and compression were incurred to put the gas in a marketable condition and, consequently, those costs should not have been deducted from Citation's gross proceeds when calculating royalties. Further, the Interior stressed that the agreements between Citation and Koch were "processing contracts" under which Citation was paid a percentage of the proceeds realized by Koch's sales of the dry gas and gas byproducts. Also, Koch did not pay Citation until a sale was made, and the amount paid was reduced by a share of the costs for treatment, compression, and electricity. For these reasons, the Interior concluded that Citation's royalty payments should have been based on the amount Citation received from Koch—plus Citation's share of the fees incurred for treatment and compression.

Significantly, the court recognized that an agency's interpretation of its own regulations receives "substantial deference," and courts must give the agency's interpretation controlling weight unless the interpretation is "plainly erroneous or inconsistent with the regulation." Under this high standard, the court affirmed the district court, ruling in favor of the Interior. According to the court, two factors were particularly important in accepting the Interior's interpretation that the compression and treatment costs were incurred to place the gas in a marketable condition: 1) Citation's gas was transferred to Koch under processing agreements, and 2) Citation was paid based on Koch's sales of Citation's dry gas and gas byproducts.

Next, the court considered Citation's argument that it should have received a transportation allowance that would have greatly reduced the amount of additional royalties it owed. But the court quickly disposed of this argument as well, concluding that Citation never filed the appropriate form requesting the allowance. Also, the court recognized that the Interior's decision in this regard was not arbitrary or capricious.

In its final argument, Citation claimed that the Interior's orders were arbitrary and capricious because it relied on flawed data and estimates. The Interior relied on receipts from the operator of the unit, Exxon, for calculations related to the leases. And it relied on estimates to calculate costs during months not covered by the audit. The court concluded that the Interior's reliance on the receipts and estimates was reasonable in light of the fact that Citation did not provide any records controverting the Interior's calculation.

### 13. *Chesapeake La., L.P. v. Buffco Prod., Inc.*, No. 2:10-CV-359 (JRG), 2012 WL 1003761 (E.D. Tex. March 22, 2012).

In *Buffco*, the district court held that non-operating working interest owners were intended third-party beneficiaries under a "Non-Ops Clause" in a letter agreement.

Chesapeake Louisiana L.P. entered into a letter agreement with Buffco Production Inc. in 2008. Under the letter agreement, Chesapeake would acquire the working interests of Buffco and its non-operating leasehold cotenants with respect to multiple oil and gas units. The letter agreement contained a Non-Ops Clause by which Chesapeake agreed to acquire all of the lease-hold estate beneath the relevant properties. When Chesapeake failed to acquire certain interests, several non-operating working interest owners sued. The plaintiffs argued that they were third-party beneficiaries under the letter agreement's Non-Ops Clause.

At summary judgment, the United States District Court for the Eastern District of Texas considered the question of third-party-beneficiary status. The court explained that a third party is entitled to sue for breach of a contract made between two other parties if—as part of their agreement—the contracting parties intended to confer a direct benefit on the third party. Whether an agreement intends to confer a direct benefit on a third party sufficient to make that party a third-party beneficiary is a question of law.

The Non-Ops Clause provided in part: "Chesapeake also agrees to make this offer to any non-operated working interest owners in the Properties . . . under the same terms and net acre price as stated in this offer." According to the court, this language made explicit that Chesapeake agreed to make the same deal under the letter agreement to any non-operating working interest owner in the subject properties. The court also noted that Chesapeake asked Buffco for information regarding the non-operating interest owners, and requested a copy of billing spreadsheets. This information indicated to the court that both Chesapeake and Buffco understood that third-party ownership interests existed and would need to be verified in order to properly execute the Non-Ops Clause.

Based on the express language of the Non-Ops clause, combined with the conduct of Buffco and Chesapeake, the court concluded that the parties understood that the non-operating working interest owners would benefit from the letter agreement. As a result, the court held that the non-operators were third-party beneficiaries with standing to bring suit.

In addition to its ruling with respect to third-party beneficiaries, the court

also addressed issues concerning unjust enrichment, breach of contract, and the right of first refusal.