Recent Decisions Impacting the Oil & Gas Industry

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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 October 1, 2014 through April 29, 2015. Below are one-paragraph abstracts of the selected cases. Full case summaries follow the abstracts.

II. ABSTRACTS

1. Defendant's reasons for increasing royalty did not affect applicability of most-favored-nations clause, and formation-production clause required defendant to convert volume of condensate to its equivalent volume in gas. Plaintiff brought claims against defendant for fraud and various breaches of oil and gas leases. Defendant argued that plaintiff's fraud claims were barred by limitations. The Texas Supreme Court disagreed and held that earlier inconsistent filings with the Texas Railroad Commission did not establish that, as a matter of law, plaintiff failed to exercise reasonable diligence where more recent filings with the Commission were fraudulent. On other issues, the Court held that defendant breached the most-favored-nations clause by increasing the State's royalty; defendant's motive for doing so was irrelevant. The Court also held that defendant did not breach formation-production clauses by converting the volume of condensate at the surface to its equivalent volume as a gas. Doing so ensured that the total volume that defendant paid royalties on related to the volume that defendant reported to the Commission. Finally, the Court held that plaintiff ratified a new unit by accepting royalties from it; thus, plaintiff could not recover from the old unit. *Hooks v. Samson Lone Star, Ltd. P'ship*, No. 12-0920, 2015 WL 393380 (Tex. Jan. 30, 2015).

2. Lack of consent is an element of a trespass cause of action. Landowner brought a trespass action when wastewater migrated into the subsurface of his land. Owner of wastewater operations argued that prior settlement during operations permitting process represented consent to wastewater trespass. The Texas Supreme Court agreed and reversed the court of appeals' holding that lack of consent was an affirmative defense to trespass. Historically, Texas has defined trespass to include action taken without authorization. Additionally, court-established factors indicated that the landowner should bear the burden of proof in establishing lack of consent. Therefore, the Court held that lack of consent is a element of trespass that must be established by the landowner. *Envtl. Processing Sys., L.C. v. FPL Farming Ltd.*, No. 12-0905, 2015 WL 496336 (Tex. Feb. 6, 2015).

3. Genuine issue of material fact existed regarding breach of fiduciary duty by executive right holder. Holder of executive interest leased mineral rights for a 1/8 royalty and a large per-acre bonus despite at least one offer for a 1/4 royalty. Owner of non-participating royalty interest argued that this constituted a breach of the executive right holder's fiduciary duty of good faith and fair dealing. The Texas Supreme Court reversed summary judgment in favor of executive right holder, finding that the royalty and bonus structure of the lease provided sufficient evidence of self-dealing to raise a genuine issue of material fact as to breach of fiduciary duty. However, the Court refused to allow the royalties from the lease to be placed into a constructive trust because the present circumstances did not satisfy the underlying purpose of such a remedy. *KCM Fin. LLC v. Bradshaw*, No. 13-0199, 2015 WL 1029652 (Tex. Mar. 6, 2015).

4. Reservation of "one-half of the usual 1/8th royalty" provided for a fraction of royalty interest. Grantors reserved "one-half of the usual 1/8th royalty." The issue on appeal was whether this language created a fixed 1/16th fractional royalty or a one-half fraction of royalty. Based on the plain language of the reservation, the court held that appellants owned a one-half fraction of royalty interest, which entitled them to receive one-half of the royalty as provided for in any mineral leases covering the property. *Butler v. Horton*, 447 S.W.3d 514 (Tex. App.—Eastland 2014, no pet.).

5. Production anywhere on a pooled unit maintained leases as to all lands covered by the leases. Retained acreage clause provided that, when continuous development ends, the lease terminates as to all acreage except for each proration unit established under the rules and regulations of the Texas Railroad Commission upon which there exists a well capable of producing in commercial qualities. The court held that under this clause, all acreage included in a designated proration unit would be retained by the existence of a well capable of producing in commercial quantities, regardless of whether the well was located on the leased premises or on acreage pooled therewith. Such well existed in this case. Thus, production anywhere on the pooled unit was sufficient to maintain leases as to all lands covered by those leases. *Chesapeake Exploration, L.L.C. v. Energen Res. Corp.*, 445 S.W.3d 878 (Tex. App.—El Paso 2014, no pet.).

6. Royalty clause was structured as a "market value at the well" clause and did not include carbon dioxide as a separately payable mineral. Lessee ceased royalty payments on extracted carbon dioxide upon completion of a new extraction plant. Lessors argued that the royalty clause contained in their lease was structured to provide for separate royalties on gas and carbon dioxide. The court disagreed and held that specific language in the royalty clause indicated a market value at the well royalty, which is calculated using the value of raw gas at the point of production. The court also pointed to a progressive royalty structure in the lease based on the sequential stages of gas processing, which would be rendered a nullity under the lessor's interpretation of the lease. Finally, the court determined that transportation costs could not be deducted from royalties until actually incurred by lessee. *Comm'r of Gen. Land Office of State v. SandRidge Energy, Inc.*, 454 S.W.3d 603 (Tex. App.—El Paso 2014, pet. filed).

7. False recital in deed did not negate save-and-except clause. Plaintiffs sued defendant for making royalty payments on only half of plaintiffs' mineral interest. However, defendant's royalty calculations were correct because plaintiffs only owned half of the mineral interest at issue. Predecessor deed included a save-and-except clause that reserved one half of the mineral interest to the grantors. A false recital in the deed did not cut down the interest excepted. *Griswold v. EOG Res., Inc.*, No. 02-14-00200-CV, 2015 WL 1020716 (Tex. App.—Fort Worth Mar. 5, 2015, no. pet. h.).

8. Failure to file certified proration plats resulted in automatic termination of a lease containing a continuous development clause. Defendant drilled four wells and assigned approximately half of leased acreage thereto. Upon expiration of continuous development periods, landowner leased unassigned acreage to new lessees. Defendant attempted to amend its acreage assignments, and landowner brought

trespass to try title action. The court held that the use of the word "assigned" in the termination clause of the lease indicated that the defendant could not escape from its obligation to assign acreage to wells; therefore, the lease had terminated with respect to the unassigned acreage. *Endeavor Energy Res., L.P. v. Discovery Operating, Inc.*, 448 S.W.3d 169 (Tex. App.—Eastland 2014, no. pet. h.).

9. Pooling agreement negated the horizontal Pugh clause of a lease. Lessee held the rights to two oil and gas leases, one of which contained a horizontal Pugh clause. During the primary term, a maximum depth of 4,135 feet was reached. The lessee pooled the two leased units together and began drilling operations, producing at between 4,164 and 4,176 feet. A party holding the rights to production payments from the lessee brought an action to enforce those rights when the lessee failed to pay. The lessee claimed that due to the horizontal Pugh clause, its production was not valid for the purposes of this payment. The court disagreed and held that the pooling agreement rendered the Pugh clause void and that all production from the pooled unit was subject to the required production payments. *Albert v. Dunlap Exploration, Inc.*, No. 11-12-00064-CV, 2015 WL 730119 (Tex. App.—Eastland Feb. 12, 2015, no. pet. h.).

10. Top lease containing no conditional language did not violate Rule Against Perpetuities. Landowner executed a top lease which was to take effect upon termination of the existing lease on the same land. After execution of the top lease, the lessee under the top lease sought termination of the existing lease for failure to produce in paying quantities. Existing leaseholder claimed that the top lease violated the Rule Against Perpetuities. The court disagreed and held that because the top lease contained no conditional language, it was a transfer of a present and vested interest in the land. Additionally, the court held that the trial court abused its discretion by limiting the jury instruction on production in paying quantities to a 15-month period during which production was slow. *BP Am. Prod. Co. v. Laddex, Ltd.*, No. 07-13-00392-CV, 2015 WL 691212 (Tex. App.—Amarillo Feb. 17, 2015, no. pet. h.).

III. CASE SUMMARIES

1. *Hooks v. Samson Lone Star, Ltd. P'ship*, No. 12-0920, 2015 WL 393380 (Tex. Jan. 30, 2015).

In *Hooks*, the Texas Supreme Court explored a variety of oil and gas related issues. In 2006, the plaintiff sued the defendant for, among other things, breach of contract and failure to pay royalties under the Texas Natural Resources Code section 91.404. Plaintiff later added claims for fraud, fraudulent inducement, and statutory fraud. Plaintiff's claims derived from three oil and gas leases—the Hardin County Leases and the Jefferson County Lease.

Plaintiff's fraud claims concerned the Jefferson County Lease, which permitted pooling and contained "offset obligations." These offset obligations provided that if a gas well were completed within 1,320 feet of plaintiff's lease line but was not unitized with plaintiff's acreage, then the defendant would either have to drill an offset well, pay plaintiff compensatory royalties, or release the offset acreage. In 2000, the defendant drilled a well that bottomed within the 1,320–foot protected zone. But, instead of complying with the original offset obligations, defendant asked plaintiff to amend the Jefferson County Lease to pool into a unit associated with the new well. In

connection with this request, defendant provided plaintiff with a plat that incorrectly placed the well's bottom hole outside of the protected zone. A plat with the same false information had already been filed with the Texas Railroad Commission. However, older Railroad Commission records contained a directional survey and an attached plat that correctly placed the bottom hole within the 1,320–foot boundary.

Plaintiff asserted his fraud claims in 2007, claiming that defendant deprived plaintiff of compensatory royalties by misrepresenting the well's bottom-hole location and fraudulently inducing plaintiff to pool. Although the trial court awarded plaintiff over $20 million in damages on these claims, the court of appeals reversed, holding that plaintiff's fraud claims were barred by limitations. The issue before the Texas Supreme Court was whether reasonable diligence would have uncovered a correct public Railroad Commission filing when more recent filings contained false information.

After examining prior decisions, the Court explained that it would not, as a matter of law, hold that plaintiff should have discovered the accurate information when the more recent filings conveyed false information. According to the Court, "[t]hough reasonable diligence should lead to information in the public record, here, the fraudulent information itself taints the public record. To require, as a matter of law, that [plaintiff] double-check the more recent filings against earlier filings is a higher burden than reasonable diligence requires." The Court ultimately held that defendant's fraud extended to the Railroad Commission record; thus, earlier inconsistent filings could not establish, as a matter of law, that plaintiff failed to exercise reasonable diligence. Accordingly, the Court remanded the fraud issues for further consideration.

Next, the Court addressed plaintiff's claim that defendant breached the "most-favored-nations" clauses contained in all three leases. A most-favored-nations clause provides that a lessee who pays higher royalties on nearby leases must pay matching royalties to the lessor under the subject lease. Plaintiff claimed that defendant breached the most-favored-nations clauses by paying a higher royalty to the State of Texas.

Originally, defendant leased an oil and gas interest from the State at the same 25% royalty that defendant was paying plaintiff. But defendant later increased the State's royalty in order to induce the State to consent to a Pooling Agreement. Defendant argued that the most-favored-nations clauses were inapplicable because the clauses only applied to "reserved royalty . . . payable under" another *lease*, not a pooling agreement.

The Court disagreed, explaining that, under the most-favored-nations clauses, the royalty imposed by the Pooling Agreement was in fact "payable under" the lease. In fact, the Pooling Agreement itself stated that it was entered into by the State as "Lessor" and defendant as "Lessee." Defendant's reason for increasing the State's royalty—to induce the State to enter into the Pooling Agreement—did not affect the applicability of the most-favored-nations clause. Thus, the Court held that the court of appeals erred in holding that defendant did not breach the most-favored-nations clause.

The Court then addressed plaintiff's claims for breach of the formation-production clauses, which provided that:

> For the purposes of calculating all royalties payable under Article III. herein, it is expressly provided that all such calculations shall be based on formation production as reported on Texas Railroad Commission forms P–1 and P–2.

As used on the Texas Railroad Commission forms P–1 and P–2, formation production describes the total volume of gas removed from the underground reservoir. However, not all gas that leaves the reservoir continues to be a gas at the surface; instead, some condenses. When reporting the total volume of gas removed from the reservoir to the Railroad Commission, defendant converted the volume of condensate at the surface to its equivalent volume as a gas. Plaintiff argued that this was incorrect, and that the formation production is the volume of all production while it existed in the reservoir as gas. In other words, plaintiff took the position that the formation-production clause required defendant to pay a 25% royalty on the liquid condensate, which must then be converted to its equivalent in gas volume so that another 25% royalty may be paid on it again.

The Court disagreed. According to the Court, the formation-production clause simply required defendant to convert the volume of condensate to its equivalent volume in gas, ensuring that the total volume that defendant paid royalties on related to the volume that defendant reported to the Railroad Commission. The Court affirmed the court of appeals' ruling on this issue.

Next, the Court turned to plaintiff's "unpooling" claims. Defendant attempted to pool the Hardin County Leases into the "Blackstone Minerals A–1 Unit," but because the owner of 87.5% of the mineral interest in the tract where the well in this unit was located refused to pool, defendant decided to amend the unit designation. In doing so, defendant renamed the unit as the "Joyce Du Jay No. 1 Unit" and significantly altered its boundaries. Defendant then proceeded to pay plaintiff royalties on production from the Joyce Du Jay No. 1 Unit, but not from the original Blackstone Minerals A–1 Unit. Plaintiff later sought to retrieve these royalties, claiming that defendant was not authorized to "unpool" the Blackstone Minerals A–1 Unit. However, the court of appeals held, and the Texas Supreme Court affirmed, that by accepting royalties from the new unit, plaintiff ratified the new unit and thus could not recover from the old unit.

Finally, the Court addressed plaintiff's claims for breach of the offset provisions contained in the Hardin County Leases. The offset provisions required that if a well were completed within 1,320 feet of plaintiff's lease line but was not unitized with plaintiff's acreage, then within ninety days of production from the infringing well, defendant must either drill an offset well, pay compensatory royalties, or release the offset acreage. Choosing to pay compensatory royalties incurred a recurring monthly obligation to do so. The first compensatory royalty would be due "following the expiration of ninety (90) days after the end of said calendar month in which production [is] first marketed."

Defendant pooled the Hardin County Leases and drilled wells within 1,320 feet of the pooled units but more than 1,320 feet from plaintiff's individual tracts. Based on entire-acreage clauses[1] contained in the

[1] These clauses provided that:

leases, plaintiff argued that the 1,320-foot protected zone extended around the pooled units rather than plaintiff's individual tracts. However, because the court of appeals decided this claim on limitations without reaching the merits, the Court remanded for further consideration.

2. *Envtl. Processing Sys., L.C. v. FPL Farming Ltd.*, No. 12-0905, 2015 WL 496336 (Tex. Feb. 6, 2015).

In *Environmental Processing Systems*, the Texas Supreme Court held that lack of consent was an element of a cause of action for trespass, with the burden of proof on the party seeking relief.

J.M. Frost III ("Frost") owned land adjacent to another tract owned by Environmental Processing Systems, L.C. ("EPS"). EPS operated a wastewater injection well on its land pursuant to valid TNRCC and TCEQ permits. During the permitting process, Frost requested a hearing to contest EPS's application, and the two parties reached a settlement for $185,000 that was binding on each party's successors-in-title.

After FPL Farming Ltd. ("FPL") purchased the land from Frost, EPS sought to amend its permits to increase the volume of allowable wastewater injection. The amendments were granted in 1999. Three years later, FPL brought an action against EPS for trespass, negligence, and unjust enrichment due to wastewater migration into the subsurface land owned by FPL.

At trial, the jury found that FPL had consented to the wastewater entry by EPS, and the court entered a take-nothing judgment, which was confirmed by the court of appeals. The Texas Supreme Court reversed and held that government-issued permits did not shield the permit holder from tort liability. On remand, the court of appeals reversed the trial court's take-nothing judgment and held that consent was an affirmative defense to trespass, on which EPS held the burden of proof. EPS appealed.

The issue before the Texas Supreme Court was whether consent was an element of trespass or an affirmative defense. The definition of trespass has traditionally included some requirement of unauthorized action. This indicated to the Court that consent is an element rather than an affirmative defense. The Court also looked to *20801, Inc. v. Parker*, 249 S.W.3d 392 (Tex. 2008) for guidance. In *20801*, the Texas Supreme Court explained that in determining which party bears the burden on a particular fact, courts should consider: (1) "the comparative likelihood that a certain situation may occur in a reasonable percentage of cases," and (2) "the difficulty in proving a negative." Using these factors, the Court concluded that consent is a rarely contested issue in trespass cases, and that landowners are in the best position to prove lack of consent. Therefore, the Court held that consent is an element of trespass. This placed the burden of proof on FPL, which it failed to meet.

> Operations for drilling on or production of gas from any part of the pooled unit which includes all or a portion of the Leased Premises ... shall be considered as operations for drilling on or production of gas from the Leased Premises, ... and the entire acreage constituting such unit or units shall be treated for all purposes, except the payment of royalties on production from the pooled unit, as if the same were included in this Lease.

3. *KCM Fin. LLC v. Bradshaw*, No. 13-0199, 2015 WL 1029652 (Tex. Mar. 6, 2015).

In *KCM Financial*, the Texas Supreme Court held that a genuine issue of material fact existed as to whether the executive mineral right holder had breached its fiduciary duty owed to the holder of a non-participating royalty interest. The court further held that the holder of a non-participating royalty interest cannot impose a constructive trust on royalty payments made to assignees.

Betty Lou Bradshaw ("Bradshaw") held a non-participating royalty interest in Mitchell Ranch, which entitled her to 1/2 of any future royalties, which were not to fall below a 1/8 interest in gross production, creating a minimum reserved interest of 1/16 of future gross production. The interest did not provide any right to participate in the execution of leases or to any related bonuses or delay rentals. After a series of unrelated transactions, Steadfast Financial LLC ("Steadfast"), later renamed KCM Financial LLC, became the mineral interest holder of the leased land, which carried with it the right to execute leases and the right to related bonuses and delay rentals.

In 2006, despite at least one offer for a lease providing for a 1/4 royalty, Steadfast executed a mineral lease with Range Resources Corporation ("Range") that provided for a 1/8 royalty on production, and an extremely high per-acre bonus. Bradshaw filed suit, alleging that by leasing for a 1/8 royalty rather than the industry standard 1/4 royalty, Steadfast had breached its fiduciary duty to her. At trial, Steadfast argued that Bradshaw's non-participating royalty interest provided for a fixed 1/16 royalty and that its lease with Range had satisfied that requirement. The court disagreed and granted a partial summary judgment in favor of Bradshaw on that issue, finding instead that the non-participating royalty interest entitled Bradshaw to a *minimum* 1/16 royalty that could increase based on the negotiated royalty clause. The court of appeals affirmed in an interlocutory appeal.

Bradshaw later brought additional claims for fraudulent transfer against transferees of Steadfast's royalty interest, alleging that the transfers were made for less than reasonably equivalent value and that Steadfast was made insolvent by the transfers. Bradshaw sought a constructive trust on the proceeds from those royalty interests. The trial court granted summary judgment in favor of Steadfast and its transferees. On appeal, the court partially reversed the summary judgment because a genuine issue of material fact existed as to whether Steadfast's fiduciary duty had been breached.

The issues before the Texas Supreme Court were: (1) whether Steadfast breached a fiduciary duty owed to Bradshaw by executing a mineral lease that provided for a 1/8 royalty and a high per-acre bonus, and (2) whether a constructive trust on proceeds from Steadfast's royalty interests was appropriate.

On the fiduciary duty issue, both parties agreed that Steadfast owed Bradshaw a duty of utmost good faith and fair dealing, but disagreed as to whether that duty had been breached. The Court held that, considering Steadfast's selection of a 1/8 royalty and larger bonus in lieu of a 1/4 royalty, there was sufficient evidence of self-dealing to raise a genuine issue of material fact, rendering summary judgment improper.

On the constructive trust issue, the Court noted that constructive trusts were not designed as a way of collecting damages, but rather as a means of preventing unjust enrichment. In this case, the Court held that a constructive trust was inappropriate because Bradshaw was seeking a constructive trust as a way of making herself whole.

4. *Butler v. Horton*, 447 S.W.3d 514 (Tex. App.—Eastland 2014, no pet.).

In *Butler*, the Eastland Court of Appeals held that a reservation of "one-half of the usual 1/8th royalty" provided for a fraction of royalty interest rather than a fractional royalty.

The case turned on the interpretation of a reservation contained in a 1968 deed. The reservation provided that:

> There is excepted from this conveyance and reserved unto ... grantors, their heirs and assigns, *one-half of the usual 1/8th royalty on all oil, gas, casinghead gas, and gasoline, and one-half of the usual and customary royalty on sulphur, coal, uranium, and all other minerals in, on, or under, or that may be produced from the above described land*; it being understood and agreed that it shall not be necessary for the Grantors, their heirs or assigns, to join in the execution of any mineral lease or leases on the property, but that *the Grantors, their heirs or assigns, shall be entitled to one-half of any bonus payments or delay rentals which may be paid in connection with any lease on the property, and that in the event of production from said land, either by a lessee, by an owner, or by anyone else, the Grantors, their heirs or assigns, shall be entitled, free of cost, to one-half of the royalty on said minerals, as provided above.*"

The sole issue on appeal was whether the district court erred in holding as a matter of law that the deed reserved a fixed 1/16th fractional royalty rather than a one-half fraction of royalty.

A "fraction of royalty" provision provides for a fractional share of the royalty that is provided for in a lease; the interest is not fixed, but rather floats in accordance with the amount of the royalty provided for in a lease. In contrast, a "fractional royalty" interest remains fixed regardless of the amount of the royalty provided for in a future lease.

Neither party argued that the deed was ambiguous. Accordingly, in an effort ascertain the intent of the parties, the court applied the rules of contract construction. Based on the plain language of the reservation, the court ultimately concluded that the grantors specifically reserved the right to receive "one-half of any bonus payments or delay rentals which may be paid in connection with any lease on the property." And, in the event of production, grantors reserved the right to receive, "free of cost, . . . one-half of the royalty on said minerals, as provided above." According to the court, a reference to "one-half of the usual 1/8 royalty" has traditionally been held to effectuate a reservation of a fraction of

royalty. Therefore, the court reversed the trial court and held that appellants were the owners of a one-half fraction of royalty interest, which entitled them to receive one-half of the royalty as provided for in any oil, gas, and other mineral leases covering the property.

5. *Chesapeake Exploration, L.L.C. v. Energen Res. Corp.*, 445 S.W.3d 878 (Tex. App.—El Paso 2014, no pet.).

In *Chesapeake Exploration*, the El Paso Court of Appeals reaffirmed the general principle that production anywhere on a pooled unit maintains the lease as to all lands covered by the lease, both within and outside the unit.

The case involved the construction of two 1976 oil and gas leases and their effect on a 640-acre pooled gas unit. An 80-acre portion of Section 25 was pooled with a 560-acre portion of Section 18 to form the Cadenhead No. 1 Pooled Gas Unit. In 1978, a well was drilled and completed on the 560-acre portion of Section 18, and has continually been producing ever since (the Cadenhead No. 1 well). The next year, a well was completed on Section 25 (the Cadenhead No. 2 well). This well was included in a 640-acre pooled gas unit named the Cadenhead No. 2 Pooled Gas Unit, consisting of 560 acres from Section 25 and 40 acres from Section 18. The designated proration unit for the Cadenhead No. 2 well included all of Section 25. This well ceased producing in 1988 when it was plugged and abandoned.

The retained acreage clauses in the leases provided that, when continuous development ends, the lease terminates as to all acreage except for:

> [E]ach proration unit established under ... [the] rules and regulations [of the RRC ...] upon which there exists (either on the above described land or on lands pooled or unitized therewith) a well capable of producing oil and/or gas in commercial quantities ....

The issue in the case was whether, under the retained acreage clause, the leases remained in effect as to all of Section 25, or only as to an 80-acre portion of Section 25. The action ensued when Energen Resources Corporation ("Energen") and Chesapeake Exploration, L.L.C. ("Chesapeake"), both having obtained permits to drill wells on the 560-acre portion of Section 25, requested that the other cease operations. Neither party complied.

At trial, Chesapeake argued that the retained acreage clause expressly provided for rolling termination of proration units as they cease to produce. Under this interpretation, the proration unit for Cadenhead No. 2 well ceased to exist in 1988; thus, the 1976 leases terminated as to the 560-acre portion of Section 25 on which that well had been drilled, irrespective of continued production from the Cadenhead No. 1 Pooled Gas Unit. Energen argued that, under the retained acreage clause, all acreage included in a designated proration unit was retained if a well capable of producing in commercial quantities existed on the leased premises or on acreage pooled therewith. The trial court agreed and granted summary judgment in favor of Energen.

The El Paso Court of Appeals affirmed. According to the court, the language of 1976 leases confirmed that

production anywhere on Section 25, or land pooled with it, would maintain the leases as to the entirety of Section 25. First, the habendum clauses provided for continuation beyond the primary term "as long . . . as oil, gas, or other mineral is produced from said land or land with which said land is pooled." Under Texas law, a habendum clause referring to "said land" extends the lease as to all the leased property while there is production somewhere on the property. Additionally, the pooling clauses provided that:

> Drilling operations and production on any part of the pooled acreage shall be treated as if such drilling operations were upon or such production was from the land described in this lease whether the well or wells be located on the land covered by this lease or not.

Under these clauses, production anywhere on a pooled unit would maintain the leases in effect as to all of the lands covered by the leases.

The court further held that the plain language of retained acreage clauses demonstrated the parties' intent for the leases to continue as to each designated proration unit as long as the unit had a well capable of producing in commercial quantities when continuous development ceased. Thus, the court of appeals affirmed summary judgment in favor of Energen.

6. *Comm'r of Gen. Land Office of State v. SandRidge Energy, Inc., 454 S.W.3d 603 (Tex. App.—El Paso 2014, pet. filed).*

In *SandRidge*, the El Paso Court of Appeals held that, under the parties' oil and gas agreement, the royalty clause was effectively a "market value at the well" clause which excluded carbon dioxide as a separately payable mineral. The court further held that transportation charges must be actually incurred before they can be properly deducted from royalties.

Appellees SandRidge Energy, Inc. and SandRidge Exploration and Production, L.L.C. (collectively, "SandRidge") were lessees under twelve oil and gas leases[2] containing virtually identical royalty clauses.

Prior to 2010, SandRidge transported sour gas to one of its extraction plants, sold the extracted carbon dioxide, and paid a royalty on that sale to the lessors. But in September 2010, SandRidge completed construction of a new extraction plant where, in exchange for extracted carbon dioxide, the plant would not charge SandRidge for the cost of extraction. SandRidge informed the lessors that because carbon dioxide would no longer be sold, it would no longer be paying the carbon dioxide royalty. As a result, the lessors sought declaratory relief on SandRidge's obligation to pay royalties on the carbon

[2] Seven of these leases (the "State Leases") were held by the Texas General Land Office ("GLO"), one of the leases (the "Citation Lease") was jointly held by Wesley West Minerals Ltd. ("West") and Longfellow Ranch Partners, L.P. ("Longfellow"), three of the leases (the "Green and Purple Leases" and the "2005 Longfellow Lease") were exclusively held by Longfellow, and one of the leases (the "South Piñon Fee Lease") was held exclusively by West.

dioxide. The trial court ruled in favor of SandRidge on all issues, and the lessors appealed.

With respect to the State and Citation Leases, the lessors argued that the royalty clause created separate royalties for natural gas and carbon dioxide. The court disagreed for two reasons. First, the court explained that the use of the phrase "gross production" when describing the method of valuation made it clear that royalty was payable only on raw gas. This indicated that the royalty clause at issue was to be read as a "market value at the well" royalty clause that did not include carbon dioxide as a payable substance. Second, the court emphasized the fact that the lease included a "progressive application" of royalty payments to three sequential stages of production and refinement of natural gas: one for non-processed gas, a second for processed gas, and a third for other products resulting from gas. The court determined that the lessors' interpretation of the first royalty clause as a "gross proceeds" clause would render the second and third clauses useless by subsuming post-processing royalty payments. However, the court of appeals did not address the second and third royalty clauses due to the lessors' failure to raise the issues at trial.

With respect to the Green and Purple Leases, the parties disagreed as to whether firm transportation charges were deductible from royalties. A firm transportation charge is an upfront reservation fee a gas producer pays to a pipeline owner in order to secure future space in the pipeline for the delivery of its gas to distant markets. SandRidge conceded at trial that the firm transportation charges were incurred prior to production and were calculated based on "anticipated production" from the Green and Purple Leases as well as other nearby leases. Per the terms of the Green and Purple Leases, the firm transportation charges could only be taxed against royalties on a pro rata basis:

> The royalties reserved by [Longfellow], and which shall be paid by [SandRidge], are ... on gas ... [sold by SandRidge] ... one-eighth (l/8th) of the net proceeds derived from the sale thereof ... remaining after deducting ... all costs and expenses actually incurred by ... [SandRidge in]... transporting ... the gas so sold …

Thus, the court held that the charges had to actually be incurred from sales of gas produced from the leases before they could be properly deducted from royalties.

Finally, with respect to the South Piñon Fee Lease, the court determined that the royalty clause provided for separate royalty payments for both natural gas and carbon dioxide because it consisted of two explicitly stated paragraphs—one for a gas royalty, and one for a processed gas royalty, which included carbon dioxide.

7. *Griswold v. EOG Res., Inc.*, No. 02-14-00200-CV, 2015 WL 1020716 (Tex. App.—Fort Worth Mar. 5, 2015, no. pet. h.).

In *Griswold*, the Fort Worth Court of Appeals held that a false recital in a deed did not negate a save-and-except clause.

Danny and Rhonda Griswold (the "Griswolds") leased their mineral interest in 31.25 acres to EOG Resources, Inc. The Griswolds later sued EOG for breach of contract and conversion, claiming that EOG had made royalty payments for only half of

the Griswolds' mineral interest. EOG argued that its royalty calculations were correct because the Griswolds only owned 50% of the mineral estate in the leased acreage. The parties filed competing motions to summary judgment, and the trial ruled in EOG's favor.

The summary-judgment evidence showed that the 31.25 acres was previously part of a 74-acre tract. Through a series of conveyances, the 31.25-acre tract was eventually conveyed to James and Diana Caswell (the "Caswell Deed"). The Caswell Deed provided that:

> LESS, SAVE AND EXCEPT an undivided 1/2 of all oil, gas and other minerals found in, under[,] and that may be produced from the above described tract of land heretofore reserved by predecessors in title . . .

The deed from the Caswells to the Griswolds contained identical "less, save, and except" language as set forth above. The sole issue on appeal was the proper construction of this clause.

On appeal, the Griswolds argued that the save-and-except clause attempted to except an interest "heretofore reserved by predecessors in title" when, in fact, the only interest previously reserved by a predecessor in title was extinguished in 1938 when the entire estate—both mineral and surface—merged together. According to the Griswolds, this rendered the save-and-except clause a legal nullity. The Griswolds further argued that a save-and-except clause, unlike a reservation, cannot create a mineral interest when one does not exist.

The court acknowledged that exceptions and reservations are not strictly synonymous. Ordinarily, an exception does not pass title itself; instead, it operates to prevent the excepted interest from passing at all. However, a save-and-except clause may have the same legal effect as a reservation when the excepted interest remains with the grantor.

Here, the court held that the save-and-except clause excepted a one-half interest in the oil, gas, and other minerals. The phrase "heretofore reserved by predecessors in title" was but a recital purporting to state why the exception was made. Such a phrase, even if false, does not cut down the interest or estate excepted. Therefore, the court affirmed.

8. *Endeavor Energy Res., L.P. v. Discovery Operating, Inc.*, 448 S.W.3d 169 (Tex. App.—Eastland 2014, no. pet. h.).

In *Endeavor*, the Eastland Court of Appeals held that an oil and gas lease automatically terminated upon the lessee's failure to file certified proration plats with the Texas Railroad Commission.

Endeavor Energy Resources, L.P. and Endeavor Petroleum, LLC (collectively, "Endeavor") leased four land plots from Patriot Royalty and Land, LLC ("Patriot"). Each lease contained a termination section with a continuous development clause providing for automatic termination of the lease in the event that the lessor was not producing at the end of the primary term. The termination section also contained a clause providing for automatic termination at the end of production except as to lands located within a governmental proration unit assigned to a producing well.

Cumulatively, the four leases gave Endeavor the rights to drill on the northern half of one unit ("Section 9") and the entirety of a second unit ("Section 4"). Endeavor drilled and began producing from four wells—two on the northeastern quarter of Section 9, and two on the southeastern quarter of Section 4. During the relevant course of events, all four wells produced in paying quantities. After completing each of the four wells, Endeavor filed certified proration plats pursuant to Texas Railroad Commission Field Rule #3, assigning land in the northeastern quarter of Section 9 and in the southeastern quarter of Section 4 to the wells. This left the northwestern quarter of Section 9 and the remaining three quarters of Section 4 unassigned.

Upon the expiration of the continuous development periods of each lease, Patriot leased the unassigned land to Discovery Operating Inc. ("Discovery"). Asserting that the producing wells were sufficient to hold the unassigned land under the continuous development clause, Endeavor sought to amend its proration plats to increase the assigned acreage for each well. Discovery and Patriot brought a trespass to try title action and were granted summary judgment at trial. Endeavor appealed.

Endeavor contended that the continuous development clause allowed it to maintain the lease as to the maximum number of acres allowable for each well under Field Rule #3, which would include the unassigned land. The court disagreed, pointing to the use of the word "assigned" in the termination clause. Considering the termination section of the lease as a whole, no portion therein could be construed to relieve Endeavor of its obligation to assign acreage to wells under a certified proration plat. Thus, the court affirmed.

9. *Albert v. Dunlap Exploration, Inc.*, No. 11-12-00064-CV, 2015 WL 730119 (Tex. App.—Eastland Feb. 12, 2015, no. pet. h.).

In *Dunlap*, the Eastland Court of Appeals held that a pooling agreement negated a horizontal Pugh clause affecting one of the pooled units.

Between 1995 and 1996, Evelyn Petty Ferguson and Durwood Petty (collectively, the "Predecessors") leased two tracts of land to United Energy Partners, Inc. ("United")—a 251.5-acre tract (the "251.5 Acre Lease") and a 70.5-acre tract (the "70.5 Acre Lease"). The 251.5 Acre Lease contained a horizontal Pugh clause providing that at the end of the primary term, the lease would expire as to any land not assigned to a well or any land below the deepest point reached during the primary term. The 70.5 Acre Lease did not contain a Pugh clause.

During the primary term of the 251.5 Acre Lease, two wells were drilled and completed, reaching a maximum depth of 4,135 feet. Per agreement, the 251.5 Acre Lease and the 70.5 Acre Lease were pooled into one production unit totaling 322 acres. Subsequently, David Albert and ABX Oil and Gas, Inc. ("Albert" and "ABX" or, collectively, the "Appellants") obtained United's interest in the leases and the pooled unit. In 2003, Albert entered into an agreement with Dunlap Exploration, Inc. ("Dunlap") to develop the pooled unit. This resulted in four wells that were assigned 160 of the 322 acres. ABX conducted drilling operations on the remaining 162 acres, which resulted in one well producing at a depth of 4,172 to 4,176 feet ("BPE No. 6 Well") and another well producing at a depth of 4,164 to 4,167 feet ("BPE No. 1D Well").

As a result of an unrelated settlement in 2008 between the Dunlap and the Appellants, Dunlap became entitled to production payments resulting from minerals extracted from the pooled unit. In late 2009, Appellants did not pay Dunlap for production from BPE No. 6 and BPE No. 1D, claiming that the horizontal Pugh rendered invalid production from depths below 4,135 feet.[3] Dunlap filed suit, seeking to enforce the provisions of the 2008 settlement. The trial court awarded summary judgment in favor of Dunlap on the basis that the pooling agreement had destroyed the effect of the horizontal Pugh clause, rendering the production from BPE No. 6 and BPE No. 1D valid and subject to the settlement agreement.

On appeal, the court examined the language of the pooling agreement, focusing on two key clauses. First, the pooling agreement contained a clause stating that the pooling agreement would apply to "all depths covered by [the] leases." Second, the pooling agreement contained a clause stating that the pooling agreement would become effective from the date "of the first production from the pooled unit lands." From this language the court determined that, because the first production from the pooled unit lands occurred before the depth limitations of the horizontal Pugh clause were triggered, the phrase "all depths covered" included depths below 4,135 feet. The court of appeals held that all production from BPE No. 6 and BPE No. 1D was valid and subject to the settlement agreement; therefore, Dunlap was entitled to production payments from those wells.

[3] The Predecessors informed Dunlap that any rights to trespass under the lease that would have resulted from drilling to these depths had been assigned to Albert.

10. *BP Am. Prod. Co. v. Laddex, Ltd.*, No. 07-13-00392-CV, 2015 WL 691212 (Tex. App.—Amarillo Feb. 17, 2015, no. pet. h.).

In *BP America*, the Amarillo Court of Appeals held that a top lease did not violate the Rule Against Perpetuities. The court further held that limiting a jury instruction on production in paying quantities to a 15-month period was an abuse of discretion.

BP America Production Company ("BP") held the rights to an oil and gas lease (the "Arrington Lease"). Production under the lease slowed significantly during the secondary term in 2005, but increased in 2006. In 2007, the landowners entered into a top lease with Laddex Ltd. ("Laddex"), conveying their reversionary interest in the lease to Laddex. After the top lease was executed, Laddex sought termination of the Arrington Lease, alleging that the slowed production in 2005 terminated the lease for failure to produce in paying quantities. BP moved for summary judgment due to lack of subject matter jurisdiction on the basis that the top lease violated the Rule Against Perpetuities. The court denied BP's motion. At trial, the jury found that the slowed production in 2005 represented a failure to produce in paying quantities, declaring the Arrington Lease retroactively terminated.

On appeal, BP claimed that the trial court erred in overruling its motion for summary judgment. In response, Laddex argued that the top lease did not violate the Rule Against Perpetuities because the right conveyed by the landowner was a present and vested interest. The court of appeals agreed and held that, because the top lease did not contain any conditional language, the transfer of a present and vested

reversionary right to Laddex was not a violation of the Rule Against Perpetuities.

BP also contended that the court abused its discretion by limiting the jury instruction on production in paying quantities to a 15-month period of slowed production. The court agreed with BP and held that evidence of profitability surrounding the period of slowed production is material to a determination of the profitability of a lease. Thus, the trial court abused its discretion by imposing the 15-month limitation.