Texas Oil and Gas Law
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November 1, 2012

A little Texas History


♦ 1836 – Republic of Texas Congress formed Texas General Land Office (GLO) to manage public lands in Texas. The GLO is still in business today.

♦ Convention of 1845 – U.S. Senate and House of Representatives accepted Texas’ Annexation offer: Texas retains all of its “vacant and unappropriated lands” as well as its estimated $12 million public debts. Federal government was offered Texas’ public lands for debt forgiveness, but no deal made.

♦ 12/29/1845 – Texas admitted to Union as 28th state, but retains all public lands and minerals, including submerged “offshore” lands in Gulf of Mexico out to 3 marine league line (10.35 miles) versus 3 miles in other states.

♦ 1854 – Texas Legislature charters several railroads and grants them public lands to encourage building of track and development of vast undeveloped lands. 16 sections of land granted for every mile of track laid. Approximately 90% of 36 million acres of public lands granted for internal improvements went to railroads. Chevron owns 2.2 million fee mineral acres in Permian Basin of West Texas as a result of one such grant.

♦ 1919 – Texas Legislature enacts “Relinquishment Act” to reserve minerals on all lands sold with mineral classification, but appoint “owner of soil” as agent for leasing.

♦ 1931 – Texas Legislature enacts Sales Act of 1931, allowing state to sell public lands and reserve a “free royalty” (nonparticipating royalty interest).

♦ State acreage:
  o 168,217,600 total acres in Texas
  o 2,977,950 federal land (1.8%)
  o 13,000,000 GLO-managed state lands (8%)

♦ This means:
  o Very little federal/BLM lands
  o Large amount of state-owned lands including millions of acres dedicated to the Permanent School Fund (PSF) for public school districts and the Permanent University Fund (PUF) to the U.T. and A&M systems.
  o Very large amount of land privately-owned by individuals and companies small and large: King Ranch in South Texas is 1.25 million acres – bigger than Rhode Island’s 677,120 acres, and some 1.0 acre mineral tracts in East Texas have as many as 200 owners
  o Very little Indian tribal lands
  o Varied title history: Spanish, Mexican, Republic of Texas, State and private lands
Texas Regulatory Authorities

1. Texas Railroad Commission ("RRC")
   - Regulates oil and gas, not railroads
   - Established in 1891 – oldest regulatory agency in Texas; formed to regulate railroads
   - 1894 first major oil discovery in Texas at Corsicana (note Colonel Drake’s Titusville, Pennsylvania discovery was 28 years earlier in 1866)
   - 1901 Spindletop salt dome field discovered near Beaumont
   - 1919 RRC granted jurisdiction to regulate oil & gas production by Texas Legislature
   - Today 241,000 active oil and gas wells in Texas producing 1.7 million BOPD and 11.5 BCFGPD
   - Handles everything from permitting to proration allocation of production to spills and leaks, but does not adjudicate mineral/real property disputes or contract disputes. Go to court.
   - Environmental issues associated with exploration and production regulated by RRC – spills and leaks, under memorandum of understanding with the Texas Commission of Environmental Quality (TCEQ) at 16 Tex. Admin. Code §3.30

2. TCEQ – Environmental regulatory authority in Texas regulates air emissions and disposal wells

3. 90-Plus groundwater conservation districts regulate use of groundwater, with limited authority over water use in oil and gas operations. Some areas of state not within a district; common law water use law applies.

Texas oil and gas law general principles

Texas oil and gas property law embraces two main doctrines of “equal dignity”:

(1) ownership of oil and gas in place, which gives the lessee a determinable fee therein; and

(2) the law of capture which gives an owner the right to produce all of the oil and gas that will flow out of a well on his/her land, subject to conservation laws of Texas. Arco v. Railroad Commission, 346 S.W.2d 801 (Tex. 1961); Coastal Oil & Gas Corp. v. Garza, 268 S.W.3d 1 (Tex. 2005)(reaffirming rule of capture to preclude hydraulic fracture/trespass claim, and citing Professors Smith and Weaver’s treatise: “The rule of capture may be the most single important doctrine of oil and gas law.”)

Fee title can be severed into separate surface and mineral ownership, which has five attributes (“bundle of sticks”) that can be separately conveyed/owned:

(1) right to explore and develop (ingress and egress)

(2) right to execute oil and gas lease (“executive right”)

(3) right to receive bonus payments

(4) right to receive delay rentals

(5) right to receive royalty payments (under a lease or a perpetual nonparticipating royalty interest (“NPRI”).

Once severed, separate mineral attributes can be owned so long as parties intend. Day & Co.

Texas does not have:

(1) dormant mineral act like in Ohio, Ohio Rev. Code Ann. §5301.56, where landowners can seek a declaration that inactive mineral interests were abandoned and gain title; or

(2) prescription like in Louisiana, La. Rev. Stat. §31.27, where severed minerals revert to surface owner if no development of minerals have occurred in 10 years.

So, severed mineral interests can be owned in perpetuity in Texas. Check title to sovereign to verify ownership.

Most mineral owners do not self-develop, but grant oil and gas lease:

(1) transfer of real property interest (not a “lease” like a surface or apartment lease)

(2) interpreted under contract law principles (determine intent of parties as expressed by the plain written words used in the four corners of the lease)

(3) conveys fee simple interest in minerals, including oil and gas in place, to lessee for stated term of lease

(4) lessor reserves “possibility of reverter” and a royalty interest (non-possessory interest)

Natural Gas Pipeline Co. of America v. Pool, 124 S.W.3d 188 (Tex. 2003); McMahon v. Christman, 303 S.W.2d 341 (Tex. 1957).

Rights granted lessee under oil and gas lease

(1) fee simple determinable interest in the minerals, including the oil and gas in place

(2) right to produce all you can subject to Texas’ conservation laws (RRC regulations) under rule of capture

(3) for term specified in lease (“habendum clause”) usually a fixed primary term in years, and “so long as” oil or gas produced, or a substitute for production occurs (drilling, shut-in payments, or other savings clause). Ridge Oil Co. v. Guinn Invs., 148 S.W.3d 143 (Tex. 2003); Natural Gas Pipeline Co. of America v. Pool, 124 S.W.3d 188 (Tex 2003); Krabbe v. Anadarko Petro. Corp., 46 S.W.3d 308 (Tex. App. – Amarillo 2001, pet. denied) (listing of typical savings clauses).

(4) “Production” in habendum clause means production in paying quantities, which is a profit, however small, over day-to-day operating and marketing expenses such as labor and electricity costs to pump and run well equipment, supplies and taxes, but not drilling or reworking expenses. Clifton v. Koontz, 325 S.W.2d 684 (Tex. 1959). If no profit over a reasonable time (6-24 months per Texas courts), second prong of test used to determine if a reasonably prudent operator would continue to operate well with expectation of making a profit and not merely speculating well’s profitability will change. Clifton v. Koontz; Dreher v. Cassidy, L.P., 99 S.W.3d 267 (Tex. App. – Eastland 2003, no writ).

(5) Right to use as much of surface as is reasonably necessary, even if use destroys surface, as the mineral estate in Texas is “dominant” over a severed surface estate.

• Ball v. Dillard, 602 S.W.2d 521 (Tex. 1980) – “A grant of minerals would be worthless to a grantee if he could not enter upon the land for exploration and extraction of the minerals granted.” A mineral lessee “holds the dominant estate.”

• No obligation to pay “damages” to surface owner – Texas has no surface damage act as does Oklahoma. Lessee required to pay damages only if: (1) it uses more of land than was reasonably necessary; or (2) it commits specific acts of negligence. Then required to pay

- No implied duty to restore surface to original condition after operations completed. *Warren Petroleum v. Monzingo*, 304 S.W.2d 362 (Tex. 1957). Most recent lease forms contractually require it.

- Subject to the “accommodation doctrine” which requires lessee to use due regard for lessor’s preexisting surface use:
  - Existing surface use with no reasonable or practical alternatives
  - Mineral owner’s use impairs surface use
  - Reasonable alternatives are available to surface owner


6. Implied right to use groundwater in operations on the lease or on land pooled therewith.

- right implied by case law if not expressly granted by oil and gas lease
- extends to not only water used in drilling, but to waterflood operations
- note: surface owner owns groundwater in Texas – water found in aquifers below surface.


7. Right to pool leased tract with other lands

- Has to be set out in lease – lessee has no power to pool without lessor’s express authorization, usually in pooling clause. *Jones v. Killingsworth*, 403 S.W.2d 325 (Tex. 1965).
- For pooling to be valid, must strictly comply with method and purposes specified in lease. *Tittizer v. Union Gas Corp.*, 171 S.W.3d 857 (Tex. 2005).
  - MIPA historically used to allow small tract owner to “muscle in” to producing voluntarily-created unit to prevent drainage.
  - Common reservoir discovered and produced after 3/8/1961
  - Application, hearing and RRC order: avoid drilling unnecessary wells, protect correlative rights, or prevent waste.
  - Rarely used since 1965: 238 applications, 100 granted, 25 denied, rest settled
  - Recent years (since 1996) – 6 granted
- Currently – reverse use of MIPA begun in Finley Resources’ Application for Formation of MIPA Unit, Newark East (Barnett Shale) Field, Tarrant County, Texas, RRC Oil & Gas Docket No. 09-0252373:
→ 96 acre voluntary unit proposed
→ 1 mile from downtown Fort Worth
→ 26 unleased residential town lots (6% of Unit)
→ Not able to drill horizontal well without trespass (drilling under) or Rule 37 exception (too close to tract per Texas spacing rules)
→ RRC granted MIPA application, effectively “force-pooling” holdout tracts
• RRC currently studying MIPA and its use to determine if regulations needed
• Because Texas usually utilizes voluntary pooling by the lessee under terms of lease (and not a governmental forced-pooling order after evidentiary hearing), lessors often bring “bad faith pooling” claims against lessees for failure to exercise pooling power in good faith (an implied lease obligation). *Southeastern Pipe Line Co. v. Tichacek*, 997 S.W.2d 166 (Tex. 1999); *Circle Dot Ranch, Inc. v. Sidwell Oil & Gas Inc.*, 891 S.W.2d 342 (Tex. App.-Amarillo 1995, writ denied). *See also* the State Bar of Texas’ Oil, Gas and Energy Resource Law Section’s Pattern Jury Charge 4.b.1 (question and instruction on bad faith pooling at page 17) found at [http://www.oilgas.org/Content/PDFs/PatternJuryCharges_20090707.pdf](http://www.oilgas.org/Content/PDFs/PatternJuryCharges_20090707.pdf).

**Limitations issues in oil patch – 2 kinds:**

1. Statute of limitations that bar litigating an old claim:
   • Torts (negligence, trespass, conversion) – 2 years per Tex. Civ. Prac. & Rem. Code §16.003
   • Breach of contract (includes breach of implied covenants) – 4 years per §16.004 (debt) and §16.051 (other contracts)
   • Fraud – 4 years per §16.004

2. Limitations of real property actions, a.k.a. adverse possession statutes
   • Variable terms all require actual and visible appropriation of real property (includes mineral interests and oil field easements) inconsistent with and hostile to claim of another person.
   • 5 years per §16.025 – uses the property under recorded deed and pays taxes
   • 10 years per §16.026 – cultivates, uses or enjoys the property
   • 25 years per §16.028 – possessor under this statute has good and marketable title against all others, even those under a disability (would otherwise toll)

**Tolling attempts**

Mineral and royalty owners try to revive old claims against lessees/operators, alleging limitations/adverse possession “tolled” (does not run) by:
• Discovery rule – nature of plaintiff’s injury inherently undiscoverable
• Fraudulent concealment – wrongdoing actively and deceitfully concealed wrongdoing
• Fraud in chain of title
Texas Courts usually refuse to toll limitations or prevent adverse possession from running:

**Limitations**

- **HECI Exploration Co. v. Neel**, 982 S.W.2d 881 (Tex. 1998) – 4 year statute of limitation barred royalty owners’ breach of implied covenant against drainage claim against lessee:
  - Royalty owners on notice of claim and injury by operations and illegal production in violation of RRC rules on adjacent tract in common reservoir
  - RRC records open and available to public may provide constructive notice of illegal production and thus injury
  - “Royalty owners cannot be oblivious to the existence of other operators in the area or the existence of a common reservoir. In some cases, wells visible on neighboring properties may put royalty owners on inquiry. In any event, a royalty owner should determine whether a common reservoir underlies its lease because it knows or should know that, when there are other wells drilled in a common reservoir, there is the potential for drainage or damage to the reservoir.” *Id.* at 886
  - Royalty owners need to investigate and police their interests

- **BP America Prod. Co. v. Marshall**, 342 S.W.3d 59 (Tex. 2011) – mineral owners fraud claim against operator/lessee barred by 4 year statute of limitations where well log on file with RRC provided notice that operator’s operations in nonproductive formation not designed to obtain production, but merely perpetuate lease beyond end of primary term, despite fraudulent statements made by Arco landman.

- **Shell Oil Co. v. Ross**, 356 S.W.3d 924 (Tex. 2011) – royalty owner could not rely on fraudulent concealment doctrine to toll untimely royalty mispayment claims where royalty owner’s injury could have been discovered from “readily accessible and publicly available information” – correct gas prices on file at Texas General Land Office and publicly-available posted index prices, and was on notice to investigate by widely varying gas prices on royalty check stubs, but didn’t even call Shell to inquire.

- **Samson Lone Star, L.P. v. Hooks**, 2012 Tex. App. Lexis 4353 (Tex. App. – Houston [1st Dist.] 5/31/12, no subsequent appellate history) - $21 million fraud judgment in favor of mineral owner/lessor against its lessee set aside on appeal. Lessor found to have constructive notice of directional survey on file with RRC showing bottom hole location of directional well and thus injury (breach of offset well provision in oil and gas lease) within 4 year limitation period, despite overt fraud by landman – fabricated plat showing directional well location did not trigger offset clause and oral misrepresentations. Justice Sharp wrote special opinion “reluctantly” concurring due to *BP v. Marshall*, and to warn that Texas courts have “placed an unnecessary and very heavy burden on lessors.”

**Adverse Possession**

- **Natural Gas Pipeline Co. of America v. Pool**, 124 S.W.3d 188 (Tex. 2003) – lessee may adversely possess “back” a mineral leasehold estate that expired years earlier.
  - 1937 oil and gas leases had multiple gaps in production of 30 days – 153 days.
  - Cessations of production appear to terminate leases
  - Lessor files suit 39 years later as to one lease, and 57 years later as to second lease
  - Lessee established adverse possession of mineral leasehold estate “as a matter of law” by 14 and 29 years of continued production and royalty payments under 3, 5 and 10 year statutes
Lessee holding out under oil and gas lease, so that is what it earned via adverse possession; not the full mineral estate

Mineral owners claimed lessee should have alerted them leases terminated, but court held mineral owners can’t claim ignorance. “A record titleholder’s ignorance of what it owns does not affect the running of limitations.” Id., at 198. Burden on lessors to investigate and timely sue.

- **Glover v. Union Pacific**, 187 S.W.3d 201 (Tex. App. – Texarkana 2005, pet. denied) – claim by alleged owners under a railroad right-of-way in the East Texas Field to minerals lost by adverse possession due to drilling production, royalty payments and tax payments

- **BP v. Marshall**, 342 S.W.3d 59 (Tex. 2011) – Court held alleged fraud in chain of title (Arco landman oral and written misrepresentations to mineral owners regarding continuous operations) did not prevent adverse possession from running and continuous royalty payments, drilling and production enough to establish as a matter of law “ouster” against a co-tenant and adverse possession