2023 OIL AND GAS CASE UPDATE

PRESENTED BY LISA VAUGHN

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Lisa Vaughn is one of just five Texas lawyers that are board-certified by the State Bar of Texas Board of Legal Specialization in both Oil, Gas & Mineral Law and in Civil Trial Law.

She has served on the State Bar's Pattern Jury Charge Committee for the Oil and Gas Pattern Jury Charges for more than a decade, and now serves as that committee's Chair. Her articles have appeared in a variety of scholarly journals, and she is frequently asked to speak to local and state organizations on litigation, oil and gas, and ethics topics. She has also been chosen by the National Institute of Trial Advocacy to instruct lawyers around the country on trial advocacy techniques.

Lisa Vaughn graduated with honors from the Ohio State University College of Law in the top 10% of her class after being Managing Editor of the Ohio State Law Journal and winning awards for writing, legal knowledge, and advocacy, including being awarded "best oral advocate" at a moot court competition judged by the late Supreme Court Justice Antonin Scalia.

During her 30-year legal career, Lisa has been a partner at several of the state's largest and most prestigious firms, but now has her own firm, Vaughn Law Offices, in Fort Worth and Arlington, Texas, where she has a broad civil litigation practice with a focus on oil and gas and real estate-related litigation.

When not advocating for her clients, Lisa spends her spare time working on cars and racing her highly modified 1995 BMW M3 in wheel-to-wheel races on various dedicated road courses around the country.

THEME FOR 2023 OIL & GAS CASE UPDATE : FINDING MEANING AND NOT GETTING EATEN

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RECENT O&G SUPREME COURT CASES GROUPED INTO FOUR CATEGORIES

I. Meaning of royalty calculations: Post-production costs

II. Meaning of lease language: Obligation to protect against drainage

III. Meaning of statutes

IV. Meaning of conveyances

I. MEANING OF ROYALTY CALCULATIONS: POST-PRODUCTION COSTS

- **Bluestone Natural Res. II, LLC v. Randle, 620 S.W.3d 380 (Tex. 2021)**
  - Primary issue: deduction of post-production costs
  - Lease originally provided:
    - calculate royalties from market value at the well (*Heritage Resources* & general rule of apportioning expenses)
  - Lease addendum:
    - "royalties accruing . . . shall be without deduction . . . for postproduction costs" and Lessee agreed to compute royalties "on the gross value received."
    - Lessee's argument: no conflict between lease and addendum; provisions could be harmonized and netting-back used
  - Holding: the provisions did conflict because of "gross"; addendum prevails, post-production costs not deductible
  - Helpful discussion of the issues and drafting considerations

I. MEANING OF ROYALTY CALCULATIONS: POST-PRODUCTION COSTS – CONT'D

- **Nettye Engler Energy, L.P. v Bluestone Natural Resources II, LLC, 639 S.W.3d 682 (Tex. 2022)**
  - Primary issue: deduction of post-production costs for NPRI
  - Mineral deed conveys mineral interest but reserves non-participating royalty interest
    - NPRI is "in kind" (so, instead of money, owns the fractional share of minerals in place)
    - Deed requires delivery of the NPRI fractional share "free of cost in the pipeline, if any, otherwise free of cost at the mouth of the well or mine..."
  - Issue: does "free of cost in the pipeline" preclude deduction of post-production costs? And if so, to what type of pipeline – gathering, transportation, processing plant?
    - Producer argued *Burlington Resources* where court found that a royalty that was to be calculated when "delivered into pipelines, tanks or other receptacles to which the well may be connected" meant it was calculated at the "mouth of the well"
  - Holding: failure to specify type of pipeline, coupled with default of "at the mouth" meant deductions for costs incurred after production were proper
  - Case also notable for
    - discussions on deed and contract construction
    - Discussions on when attorney's opinion on interpretation may be admissible

I. MEANING OF ROYALTY CALCULATIONS: POST-PRODUCTION COSTS – CONT'D

- **Devon Energy Prod. Co., L.P. v. Sheppard - March 2023**
  - Primary issue: deduction *and addition* of post-production costs
    - "new wrinkle to a perennial problem: how to calculate the landowner's royalty"
  - Lease language for royalty calculation provided that "[if] any reduction or charge for [post production] expenses or costs" had been "include[d]" in "any disposition, contract or sale" of production, those amounts "shall be added to the . . . gross proceeds so that [the] royalty shall never be chargeable directly or indirectly with any costs or expenses other than its pro rata share of severance or production taxes."
  - Issue: does this language really require royalties to be paid on more than what was received?
  - Holding: Yes.
    - "based on this language, the landowners' royalty is payable not only on gross proceeds but also on an unaffiliated buyer's post-sale post production costs if the producers' sales contracts state that the sales price has been derived by deducting such costs from published index prices downstream from the point of sale. . . . This broad lease language unambiguously contemplates a royalty base that may exceed gross proceeds and plainly requires the producers to pay royalties on the gross proceeds of the sale plus sums identified in the producers' sales contracts as accounting for actual or anticipated post production costs, even if such expenses are incurred only by the buyer after or downstream from the point of sale."

LESSONS FROM POST-PRODUCTION INTERPRETATION CASES

- Age-old lease interpretation standards – such as *Heritage* – do not trump actual language, especially if it is negotiated language
  - Repeated refrain encapsulated in *Nettye*:
    - "Although mineral transactions are subject to certain presumptions that state the 'usual' rules, we have repeatedly affirmed that parties are free to make their own bargains, and courts are obligated to enforce agreements as the parties intended. We discern that intent from the language the parties used to express their accord, viewed not in isolation, but in context."
  - And again in *Devon*:
    - "In keeping with our commitment to freedom of contract, we will not rewrite the leases to 'add to or subtract from [their] language' or to 'interpolate constraints' not found in the unambiguous language."
- Result: if the language is capable of a clear interpretation, even if counter-intuitive, that interpretation will prevail.
- Remember that interpretation is a question of law, to be reviewed de novo.

II. MEANING OF LEASE LANGUAGE: OBLIGATION TO PROTECT AGAINST DRAINAGE

- **Rosetta Res. Operating, LP v. Martin, 645 S.W.3d 212 (Tex. 2022)**
  - Primary issue: meaning of express covenant to protect against drainage
    - Drainage – result of rule of capture
    - Nice discussion of implied covenant to protect against drainage: (a) proof of substantial drainage, and (b) that an RPO would act to prevent the drainage – that is, that the RPO has a reasonable expectation of profit
  - Issue raised by oddly worded language that arguably applied different standards to wells triggering the obligation to protect, and to wells that were actually draining (that is, could there be separate triggering and draining wells, such that a lessee may have an obligation to protect against drainage from a non-triggering well)
  - Actual language:
    - "Notwithstanding anything contained herein to the contrary, it is further agreed that [(1)(a)] in the event a well is drilled on or in a unit containing part of this acreage or is drilled on acreage adjoining this Lease, [(b)] the Lessor [read "Lessee"], or its agent(s) shall protect the Lessee's [read "Lessor's"] undrilled acreage from drainage and [(2)] in the opinions of reasonable and prudent operations [read "operators"], [(a)] drainage is occurring on the un-drilled acreage, even though the draining well is located over three hundred-thirty (330) feet from the undrilled acreage, [(b)] the Lessee shall spud an offset well on said un-drilled acreage or on a unit containing said acreage within twelve (12) months from the date the drainage began or release the acreage which is un-drilled or is not a part of a unit which is held by production."
  - Holding: court found 3 categories of wells could trigger; obligation extended only to "undrilled" portion of the land; remanded for whether the triggering and draining wells could be separate because both were "reasonable interpretations"
  - Lesson: Carefully define obligations and industry terms such as "drainage" and "offset well"

III. MEANING OF STATUTES – CORRECTION DEED

- **Broadway Nat'l Bank v. Yates Energy Corp., 631 S.W.3d 16 (Tex. 2021)**
  - Property Code sections on correction instruments permit correction deeds "including an ambiguity or error that relates to the description of or extent of the interest conveyed."
    - Sec. 5.029: " (b) A correction instrument under this section must be: (1) executed by each party to the recorded original instrument of conveyance the correction instrument is executed to correct or, if applicable, a party's heirs, successors, or assigns; and (2) recorded"
  - Issue: does the language "or if appliable, the party's assignees" require the current assignee to sign the correction deed?
  - Facts: Fee simple conveyed, but prior parties file correction deed that only life estate conveyed
    - original deed, 2005: trustee executes mineral deed to siblings; John is supposed to get life estate but gets fee simple
    - 2012: John executes royalty deed to Yates
    - 2013: bank files correction deed signed by John
  - Holding: "if applicable" means only if the original party is unavailable; thus subsequent assignees do not have to sign and can have their interest changed (in this case, Yates' fee simple is changed to life estate), even if that fails to protect subsequent purchasers; their protection lies in other statutes.
  - Case also notable for discussion of the cannons of statutory construction (settling on "considering statutory scheme as a whole" and "plain language") and that matters of statutory construction are legal questions that are reviewed de novo.

III. MEANING OF STATUTES – EMINENT DOMAIN

- **Hlavinka v. HSC Pipeline P'ship, LLC, 650 S.W.3d 483 (Tex. 2022)**
  - Primary Issue: statutory eminent domain authority
    - Was pipeline a common carrier?
    - Did the eminent domain statues for oil or liquified minerals apply to polymer grade propylene?
  - Holdings:
    - Following *Texas Rice Land Partners* cases, common carrier status requires only evidence that the pipeline serves one unaffiliated customer (and that determination of public use is a matter of law)
    - "Oil or liquified minerals" applies to PGP, as it is derived from components of crude petroleum
  - Case also notable for discussion of owner testimony of value (permitted) and valuation based on sales of other easements (permitted if there is evidence that easements is highest and best use)
  - Echoing *Broadway v Yates*: statutes should be interpreted "as written" and "as a whole"

IV. MEANING OF CONVEYANCES

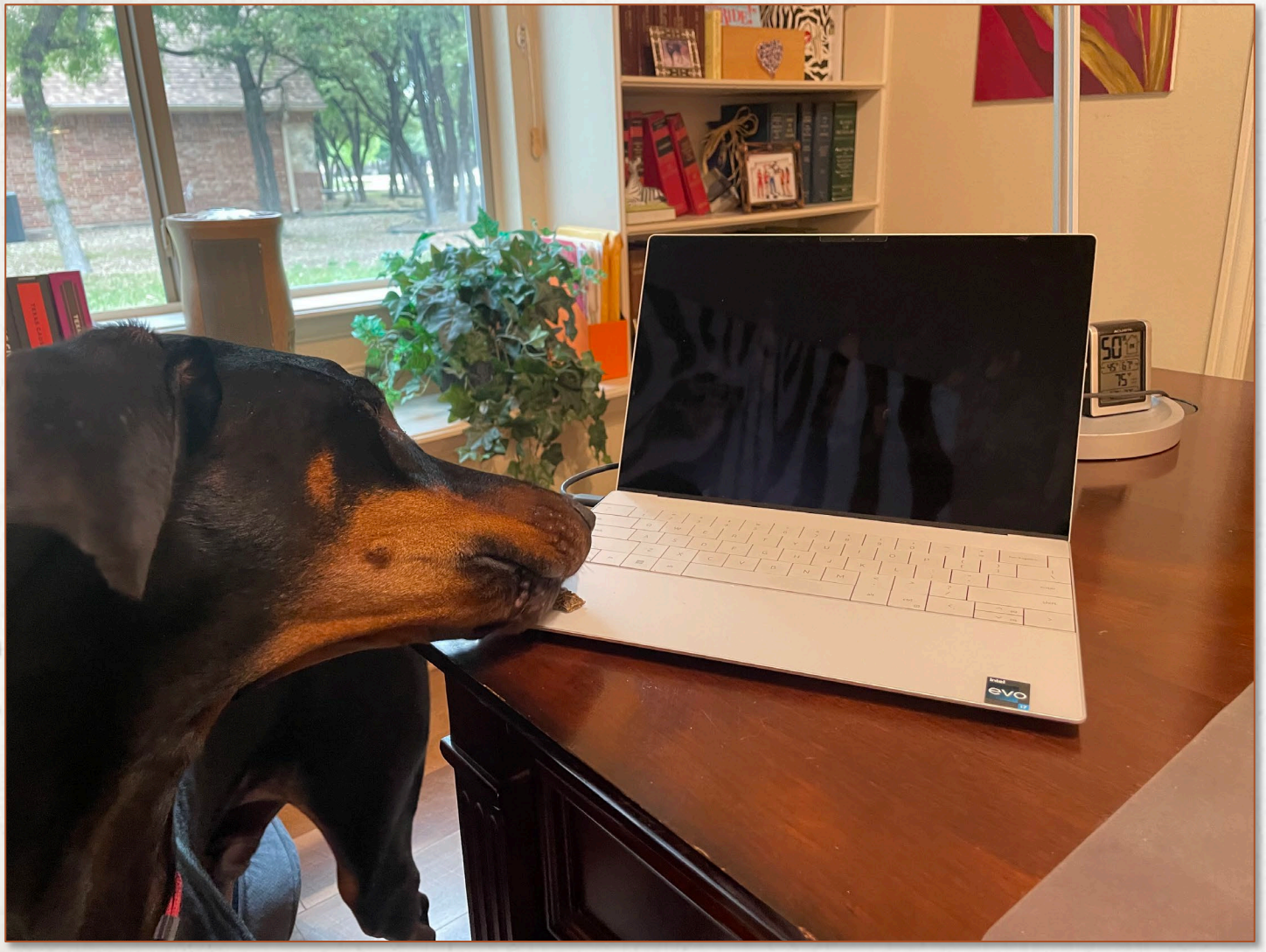
- **Jordan v. Parker (Tex. 2022)**
  - Primary Issue: Does deed conveying "all right title and interest" include possible remainders?
  - Facts:
    - H's will leaves entire estate to wife with remainder to two children and power to sell or dispose of any interest. Part of estate is an interest in Cottonwood Ranch.
    - At H's death, W owned some of Cottonwood Ranch in her own right, plus what got willed to her
    - Later, W conveys her original share of Cottonwood Ranch to kids. (Still owns life estate in what was H's share)
    - Then, Son conveys "all right title & interest" in Cottonwood Ranch to his two kids.
      - Possibly importantly: everyone continues to behave as if Son still owns remainder interest from Father.
    - Then, W dies. Then Son dies, leaving his estate to wife Kathy.
    - Issue: had Son conveyed away his potential remainder interest in ranch, or did Kathy get it?
  - Holding: no. Absent language "clearly manifesting" an intent to convey "expectancy" interests, a deed conveying "all" property includes only property actually owned at time of conveyance

IV. MEANING OF CONVEYANCES, CONT'D

- **Van Dyke v. The Navigator Grp. (Tex. 2023)**
  - Primary Issue: Does 1924 deed reserving "one-half of one eighth" of the minerals reserve half of the minerals, or 1/16th?
  - SMH quote in holding that deed reserved half the minerals:
    - "Only in a legal text could the formula "one-half of one-eighth" mean anything other than one-sixteenth. But in the law, "one-half of one-eighth" sometimes equals one-half-in the context of reservations of mineral interests. ... . Those results may seem bizarre, unsatisfying, and literally fuzzy math."
  - Reasoning: contracts, deeds, and wills must interpreted with the meaning of the words used at the time drafted.
    - Recognition that at time of deed, "1/8th" was a term of art to reference the mineral estate
    - Also, "estate misconception theory" reflects the prevalent (but, as it turns out, mistaken) belief at the time, that, in entering into an oil-and-gas lease, a lessor retained only a 1/8 interest in the minerals rather than the entire mineral estate in fee simple determinable with the possibility of reverter of the entire estate
    - Opinion reserves chance that parties could actually mean that double fractions be multiplied, but states ""We are, frankly, not aware of double fractions including 1/8 that were aimed at simple multiplication rather than referencing the mineral estate as a whole."
  - Court creates "rebuttable presumption" that in deed of that era, using "1/8th" in a double fraction means the entire mineral estate
  - Case also decided on back-up theory: presumed grant doctrine a/k/a "title by circumstantial evidence,"
  - Court describes this as a common-law form of adverse possession, with 3 elements – claim that is open and adverse to apparent owner, nonclaim by the other party, acquiescence by apparent owner. And possibly a 4th element: a gap in title

LESSONS FROM THESE INTERPRETATION CASES

- Parties' right to contract is of vital importance
- Actual language is crucial, especially if it is negotiated language
- The entirety of the document or statute affects meaning
- Historical context of the document counts in determining what the words meant
- More specifically:
  - "All" means "all in existence" not "all that could ever be"
  - "Of 1/8th" is code for "of the mineral estate"
  - It is possible, but tough, to preclude deduction for post-production costs
  - "Oil product" means any liquid product derived from crude petroleum oil or gas
  - "Public use" includes use by just one unaffiliated entity



LITIGATORS:
USE TO HELP
FIND MEANING

DRAFTERS:
USE TO HELP AVOID
GETTING EATEN

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