

Texas Supreme Court Decision Clarifies Surface Estate Rights

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AUSTIN, TX.—In its 2017 term, the Texas Supreme Court already has issued several opinions with the potential to impact the state’s oil and natural gas operators significantly. Of these opinions, *Lightning Oil Co. v. Anadarko E&P Onshore LLC* is likely the most significant, since the case concerns the relationship between the mineral and surface estates as it relates to the development of oil and gas drilling operations that target minerals under adjoining leases.

On May 19, 2017, the Texas Supreme Court released its highly-anticipated opinion in *Lightning Oil*, a case that centers on whose permission is necessary to allow a nonlessee operator to drill through the subsurface to reach minerals under an adjacent tract of land.

The court determined that, based on the facts presented, permission from the surface estate owner alone was sufficient to allow the nonlessee operator to drill through the subsurface to reach minerals on an adjoining tract.

Surface Estate Rights

By way of background, the *Lightning* mineral lease was conveyed by a lessor of a severed mineral estate. Anadarko holds a mineral lease under the Chaparral Wildlife Management Area, which abuts *Lightning*’s lease. Anadarko’s lease requires that “drilling locations will be established off (Chaparral) when prudent and feasible.” Accordingly, Anadarko requested *Lightning*’s permission to construct a pad site over the *Lightning* estate with wellbores that would start vertically, and then kick-off horizontally through portions of *Lightning*’s mineral-bearing

formations into the Chaparral mineral estate. After *Lightning* denied Anadarko permission to build the pad site and conduct drilling operations, Anadarko sought and received permission from the surface estate owner to construct the pad site. Anadarko expressly disclaimed any intention to perforate in or produce minerals from *Lightning*’s leasehold.

In response, *Lightning* brought trespass and tortious interference causes of action against Anadarko, seeking an injunction to prevent Anadarko from its proposed drilling activities. Specifically, *Lightning* alleged that Anadarko’s proposed drilling activities could interfere with *Lightning*’s future development operations and that by drilling through mineral-laden formations, Anadarko would encroach on *Lightning*’s exclusive right to possess, use and appropriate the oil and gas *Lightning* “owns in place.” The Texas Supreme Court rejected both arguments.

The court rejected *Lightning*’s contention that Anadarko’s proposed drilling activities could give rise to an injunction based on the mere possibility of an impact to *Lightning*’s future development operations. According to the high court, the general rule is that “an unauthorized interference with the place where the minerals are located constitutes a trespass as to the mineral estate only if the interference infringes on the mineral lessee’s ability to exercise its rights.” The court found that the record only demonstrated *Lightning*’s speculation that Anadarko’s proposed drilling activities could interfere with the surface and subsurface spaces necessary for *Lightning* to exercise its right to develop minerals in the future. However, the Supreme Court found, mere speculation is not enough, because ob-

taining injunctive relief requires a petitioner to prove that absent such relief, it will suffer imminent, irreparable harm.

The Texas Supreme Court likewise rejected *Lightning*’s contention that Anadarko’s proposed drilling activities would interfere with the minerals themselves by drilling through and extracting a quantum of minerals as part of the drilling process. The court announced a balancing test to determine whether “the small amount of minerals lost through (Anadarko’s drilling) will support a trespass action.” Specifically, in determining the interests of the mineral estate lessee and the surface estate lessee, the court stated that it must weigh “the interests of society and the interest of the oil and gas industry as a whole against the interest of the individual operator.”

The results of the Texas Supreme Court’s balancing test found that the total volume of minerals lost through Anadarko’s proposed drilling would be relatively small. Conversely, the Supreme Court found, society and the wider oil and gas industry have a significant interest in allowing operators to utilize off-lease drilling arrangements. Because it can take several thousand feet to kick off a vertical wellbore and transition the roughly 90 degrees from vertical to horizontal, when an operator drills a horizontal well from the surface under which its minerals lie, significant deposits of minerals are left in the transitional interval—which are unrecoverable unless another well is drilled.

The court determined that the interests of society and the oil and gas industry in developing off-lease well pads, and consequently minerals that otherwise would be unrecoverable, outweighs *Lightning*’s interest in the small volume of lost minerals. Therefore, the court found that

Anadarko's proposed intrusion would amount to nothing more than a nonactionable interference with property rights.

While significant, *Lightning Oil* is far from the last word on the relationship between the surface estate owner and the mineral estate owner. For example, *Lightning Oil* may be distinguishable if the mineral estate lessor is able to show that the proposed drilling activities will cause imminent, irreparable harm. Similarly, *Lightning Oil* may be distinguishable if the mineral estate lessor is able to show that a significant amount of minerals will be lost through the proposed drilling activities, or if the mineral estate lessor is able to show that the targeted minerals can be developed from an on-lease tract.

RRC Authority

In *Forest Oil v. El Rucio Land and Cattle Co. Inc., et al.*, the Texas Supreme Court addressed whether the Texas Railroad Commission has exclusive or primary jurisdiction over claims for environmental contamination, thus precluding civil suits for damages and other judicial relief. The plaintiffs in *Forest Oil* alleged that the operator was responsible for environmental contamination, improper disposal of hazardous materials and maliciously donating contaminated pipe to the lessor. After an arbitration panel found the operator responsible for a multi-million dollar award, the operator asserted that the RRC has exclusive or primary authority to resolve claims of oil and gas contamination. The Texas Supreme Court disagreed.

The high court first examined the statutes that authorize the RRC to regulate oil and gas operations and any resulting environmental contamination. According to the court, these statutes give the RRC exclusive authority, in relation to other state agencies, to regulate oil and gas related contamination, but the statutes do not preclude common law recovery through civil lawsuits. Therefore, the court found, the RRC does not have exclusive jurisdiction over environmental contamination allegedly resulting from oil and gas development operations.

According to the Texas Supreme Court, the RRC does not have primary jurisdiction where the civil claims are "inherently judicial in nature." The plaintiff's claims for negligence, negligence per se, fraud, assault, intentional battery and breach of contract, the court found, are inherently judicial.

Operators may distinguish *Forest Oil* on at least two grounds. First, the Texas Supreme Court did not address whether the collateral attack doctrine would bar civil courts from adjudicating disputes pending or decided by the RRC through a contested case proceeding. Second, the court stated, by seeking a RRC "deter-

mination of contamination allegations and complying with (RRC) cleanup orders, an operator can reduce or eliminate the landowner's damages."

Shut-In Royalty Clause

In *BP America Production Company v. Red Deer Resources LLC*, the Texas Supreme Court considered the application of a shut-in royalty clause. The lease at issue contained more than 2,000 acres held by a well that produced fewer than 10 Mcf a day. Red Deer Resources obtained a top lease for the acreage, and when BP shut in the well, Red Deer alleged that the lease had terminated for lack of production in paying quantities or for total cessation of production.

On review, the high court considered whether BP's lease terminated because of a total cessation of production. Generally, the party claiming total cessation of production must prove production has ceased totally for a period longer than that permitted in the lease's cessation of production savings clause and that no other savings provision, such as a shut-in clause, sustains the lease. The shut-in royalty clause provided BP with the right to maintain the lease upon payment of an annual shut-in royalty within a year after the last day gas was sold or used from a well capable of producing gas.

The court found that under the shut-in royalty clause, "the payment related back

to the beginning of the accrual period when the last gas was sold or used" and that a "retroactive shut-in clause . . . allows the producer to shut in a well up to 12 months after production has ceased, with constructive production relating back to the date the last gas was sold or used."

The court further found that the shut-in royalty clause placed the burden on Red Deer to prove that the well was incapable of producing in paying quantities over a reasonable period of time as of June 4, 2012, the date that gas from the well was last used or sold. However, because Red Deer had obtained a jury finding that the well was incapable of producing in paying quantities over a reasonable period as of June 13, 2012—the date the well was shut in—Red Deer did not carry its burden of proof as a matter of law.

Had Red Deer obtained a jury finding that the well was incapable of producing in paying quantities over a reasonable period as of June 13, 2012, the court may have reached a different conclusion. *Red Deer Resources* serves as another reminder to operators that the specific language of individual leases generally controls over broader rules established through case law. Given that the analysis of *Red Deer Resources* depends heavily on the language of the lease at issue, the case may be limited to its facts or to similar leases. □



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