SURFACE OWNERSHIP AND RIGHTS UPDATE: REATA REVISITED – WHEN DREAMS COLLIDE

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Pat, a trial attorney who is Board Certified in Civil Trial Law by the Texas Board of Legal Specialization since 1995, represents individuals, family entities and companies who are surface owners and mineral interest owners. She also represents service companies in both transactions and litigation involving the oil and gas industry. Pat assists her clients in negotiations and manages, prosecutes, and defends claims involving surface rights, royalty owner litigation, environmental claims, operations disputes, lease and contract disputes and breaches, and condemnation actions. She also coordinates serious incident/OSHA response investigations for her clients and, if needed, civil trial defense. While she enjoys being first chair, Pat also has managed legal teams taking complex cases through trial and appeal. In addition to serving her clients, Pat has, since 1997, also served as a court-appointed or party-selected mediator.

She is chair emeritus of the Litigation Section Council of the State Bar of Texas. She is also on her second term as a member of the Texas Oil and Gas Pattern Jury Charge Committee. She is a former office and director of the Texas Association of Defense Counsel, a member of the International Association of Defense Counsel, and a member of the New Mexico Defense Lawyers Association.

Pat is a Scout through and through. She serves as legal counsel and Vice President of the Board of Directors of Boy Scouts of America–Buffalo Trial Council. For the Girl Scouts of the Desert Southwest she has served for sixteen years as a volunteer on the CAMP CEO leadership project for high school girls. Pat is a devoted sponsor of Masterpiece Theater on PBS and serves on the board of Basin PBS. She also serves on the Board of Trustees of the Howard Payne University Academy of Freedom.

Education

- Baylor University School of Law (J.D., Cum Laude, 1985), Baylor Law Review, Baylor Order of Barristers
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Recognition

- Texas Super Lawyer, 2014 through 2019 Thomson Reuters
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- Named 2018 Summit Award Winner by the Girl Scouts of the Desert Southwest
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Admissions

- States: Texas and New Mexico
- Federal: Fifth Circuit, Northern District of Texas, Western District of Texas and United States Supreme Court

Selected Publications and Presentations

- "Working Alone or as a Team: When and How Legal Superheroes Should Work Together" Ethics Presentation, State Bar of Texas, Advanced Evidence and Discovery, Houston and San Antonio 2019
- "JOA Over and Under: A League of Its Own" State Bar of Texas, Handling Your First (or Next) Oil and Gas Case, Austin, December 2018
- "Maintaining Oil and Gas Leases" AAPL Held by Production Seminar, Midland, Fort Worth, Denver, 2018, speaker and member of AAPL Held by Production Task Force
- "Witness Examination – and Planning Your Trial" Texas Association of Defense Council West Texas Joint Meeting with New Mexico Defense Lawyers Association, Ruidoso, New Mexico, 2017
- "You Only Get One Shot! Lessons from Hamilton. Witness Examination at Trial" Texas Bar CLE, Austin, December 2016
- "What to do if You Find Yourself on the Wrong Floor of the Courthouse: Litigation Update", 2016 Santa Fe Land Institute, A.A.P.L.
- "Damages and Attorney's Fees Update" Litigation Update, State Bar of Texas, Austin 2016
- "May the Force Be with You – Update on Oil and Gas Trends in the Permian Basin" North Texas Chapter of Women's Energy Network, Fort Worth November 2015
- "Expert Witness Update", Texas Association of Defense Council West Texas Joint Meeting with New Mexico Defense Lawyers Association, Ruidoso, New Mexico, August 2015
- "Legislative Update: Litigation Live Webinar" State Bar of Texas, Austin July 2015
- "Legislative Issues Roundtable": Texas Association of Defense Counsel Meeting, Galveston, Texas April 2015
- "The Pipeline Clog," Midland's Natural Gas Society of the Permian Basin, Midland, TX, October 2014
- "Energy Law in Texas," Texas Association of Defense Counsel Annual Meeting, San Antonio, TX, September 2014

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SURFACE OWNERSHIP AND RIGHTS UPDATE: REATA REVISITED - WHEN DREAMS COLLIDE

Taking a page from the mythical half million-acre ranch that is the heart of the book *Giant*, written by Edna Ferber in 1952 and the 1956 Hollywood epic of the same name, the struggle between the surface owners and the oil and gas operator is nothing new.

From "Jett Rink", based on the real rags to riches wildcatter, Glenn McCarthy, who built and lost an oil empire and the Houston Shamrock hotel, to "Bick Benedict", rumored to be based on Robert "Bob" Kleberg Jr. who saved the King Ranch from foreclosure for inheritance taxes by negotiating an oil and gas lease with the then Humble Oil, later a part of Exxon[1], the stakes have been high, and the passions about the land and the competing oil development higher.

The fictional ranch in Giant was named "Reata", which is Spanish for rope or lasso, a convenient metaphor for a place where the tug of war over rights continues because, of course, everyone thinks that their objectives are reasonable.

The objectives of this presentation are to examine the current state of the law of reasonable use and reasonable accommodation, trends in surface litigation, examine issues with surface use agreements and provide practice tips for directing or avoiding attending your own production of "Reata Revisited – When Dreams Collide".

I. BUT IT'S STILL MY RANCH: REASONABLE USE AND REASONABLE ACCOMMODATION

A. Public Policy on Dominant Estate – The Struggle Begins.

Texas law has long recognized that a landowner has the right to sever the mineral and surface estates and enter into separate conveyances of the respective estates. *Coyote Lake Ranch, LLC v. City of Lubbock*, 498 S.W. 3d 53, 60 (Tex. 2016).

The public policy of the dominant nature of the severed mineral estate is based on the concept that when the severed estate is created it has the benefit of an implied right to use as much of the servient surface estate as reasonably necessary to produce and remove minerals, while exercising "due regard" for the rights of the surface owner. *Merriman v. XTO Energy, Inc.*, 407 S.W.3d 244 (Tex. 2013). Also see *Moser v. U.S. Steel Corp*. 676 S.W. 2d 99 (Tex. 1984). Unlike "Giant" it is hoped that the protagonists are not intent on destroying the other.

The starting point of the analysis is this – the mineral owner has the right to enter the surface estate and use as much of the surface *as is reasonably necessary* in order to develop the minerals. What does reasonably necessary mean? And what does it mean under the current technology and its ever-increasing surface demands?

As a result of the "tug of war" of rights, a great deal of litigation by surface owners against operators arise out of an oil and gas operation constituting and excessive or negligent use of the surface. For an excellent primer on the issues see: Patrick H. Martin & Kramer, 1 Williams & Meyers, Oil and Gas Law Section 218.10 (2014).

B. The Accommodation Doctrine – The Rules of Engagement

The Supreme Court of Texas first articulated the accommodation doctrine in *Getty Oil Co. v. Jones*, 470 S.W.2d 618 (Tex. 1971). The Accommodation Doctrine was reinforced a year later by the Texas Supreme Court in *Sun Oil Co. v. Whitaker*, 483 S.W.2d 808, 812 (Tex. 1972). There the Court noted the public policy underpinnings of the doctrine, noting that Texas "led the way in working out accommodations which preserve unto the severed mineral owner or lessee a reasonable dominant easement for the production of his minerals while at the same time preserving a viable servient estate." *Id*. at 812.

In 2013, Texas Supreme Court in *Merriman* further explained the "rules of engagement:"

(1) A party possessing the dominant mineral estate has the right to go onto the surface of the land to extract the minerals, as well as those incidental rights reasonably necessary for the extraction.
(2) The incidental rights include the right to use as much of the surface as is reasonably necessary to extract and produce the minerals.
(3) If the mineral owner or lessee has only one method for developing and producing the minerals, that method may be used regardless of whether it precludes or substantially impairs an existing use of the surface.
(4) But, if the mineral owner has reasonable alternatives for use of the surface, one of which permits the surface owner to continue to use the surface in the manner intended, and one of which would preclude that use by the surface owner, the mineral owner *must* use the

[1] For more on McCarthy and the King Ranch see *The Big Rich: The Rise and fall of the Greatest Oil Fortunes*, by Bryan Burrough, 2009, Penguin Press, and for an essay on the King Ranch see *When We Were Kings*, Skip Hollandsworth, Texas Monthly, August 1998.

alternative that allows the continued use of the surface by the surface owner. *Id.*, at 248-49.

The Supreme Court recently declined to re-visit the accommodation doctrine when it denied the Petition for Review in *Virtex OperatingCo., Inc. v. Bauerle,* No. 04-16-00549-CV, 2017 WL 5162546 (Tex. App.--San Antonio 2017, pet. denied). However, it should be noted that the Motion for Rehearing, filed May 15, 2019, is still pending.[2]

Virtex is the helicopter game management versus oil field power-lines case. Much to the operator's surprise, at trial and on appeal, the surface owner and the hunters prevailed, but rather than as some have suggested, the result being either an aberration or misapplication, the case as compared and contrasted with *Getty* and *Merriman,* can provide guidance to the practitioner on (1) how to present such a case, (2) an argument that hopefully can lead to an amicable resolution well before litigation, or best case – (3) present yet another justification for the parties to enter into comprehensive Surface Use Agreements.

C. The Arena - To Frame Negotiations (or Trial) You Need to Know the Questions.

The Oil and Gas Pattern Jury Charge Committee has two proposed jury issues with comments that should be a starting point in your review. The first covers negligence actions; the second addresses reasonable accommodation.

Practice Point: Note that a claim of negligence is a separate claim against the dominant mineral estate by the surface estate owner. It is separate and distinct from failure to reasonably accommodate. Surface owner counsel will have to analyze the subject situation carefully to see if both actions are implicated, and from the operator side, review if the claimant is bringing the correct claim, and whetherit is supported by the evidence.

Reasonable Use, the negligence questionis found in PJC 302.2 and reads as follows:

> PJC 302.2 Question and Instruction on Reasonable Use of Surface Estate[3]
>
> Question _____
>
> Did Larry Lessee use more of the surface estate than was reasonably necessary?
>
> Larry Lessee had the right to use the surface of the land in a manner reasonably necessary for exploration, extraction, or production.
>
> Answer "Yes" or "No"
>
> Answer: _____
>
> Comm. On Pattern Jury Charges, State Bar of Texas, *Texas Pattern Jury Charges: Oil Gas* PJC 302.2 (2016).

The Reasonable Accommodation issue is found in PJC 302.3. It reads as follows:

> PJC 302.3 Question and Instruction on Accommodation Doctrine
>
> Question _____
>
> Did Larry Lessee fail to accommodate Suzie Surface Owner's existing use of the surface of the land in question?
>
> Larry Lessee failed to accommodate an existing use of the surface if –
>
> 1. Larry Lessee's use of the surface completely precluded or substantially impaired Suzie Surface Owner's existing use; and
> 2. there was no reasonable alternative method available to Suzie Surface Owner by which the existing use could be continued; and
> 3. there were alternative reasonable, customary, and industry-accepted methods available to Larry Lessee that would have allowed recovery of the minerals and also allowed Suzie Surface Owner to continue the existing use.
>
> Answer "Yes" or "No"
>
> Answer: _____
>
> Comm. On Pattern Jury Charges, State Bar of Texas, *Texas Pattern Jury Charges: Oil Gas* PJC 302.2 (2016).

[2] The Petition for Review was denied March 29, 2019. The Motion for Rehearing is still pending as of the date this article was finalized. Amicus Curiae briefs have been filed by six different parties: TIPRO, TXOGA, AAPL, PBPA, Texas American Resources, and BlackBrush Oil & Gas. Last filing in case by VirTex was August 9, 2019.

[3] Note the Pattern Jury Charge Committee notes that 3.02.2 may be utilized in conjunction with a separate jury issue on trespass. See Comm. On Pattern Jury Charges, State Bar of Texas, *Texas Pattern Jury Charges: Oil Gas* PJC 302.4 (2016).

D. Specific Lessons from *Getty, Merriman* and *Virtex.*

One of the objectives of the paper is to walk through the mechanics of *Getty, Merriman* and *Virtex* to review possible best practices and suggestion for surface use agreements considering the respective court rulings.

1. "*Getty*": Oil and Farming - *Getty Oil Co. v. Jones.* 470 S.W.2d 618 (Tex. 1971).

Getty was a suit for injunction by a farmer, Jones, who operated an existing pivot irrigation system. Jones sought injunctive relief when Getty advised it was going to install pumping units on two new wells it had just drilled that would block the irrigation system. Center pivot irrigation systems are designed to swing around a center hub. The acreage to be irrigated is severely limited if the arm cannot traverse the entire circle or half circle, compromising a very expensive system and Jones' undisputed present use of the surface.

Jones did not claim negligence nor contest right to minerals in Getty case. The case was solely tried on the issue of reasonable accommodation.

Prior to the time Getty developed its two new wells, Adobe, a different operator on the Jones farm, had drilled four wells on the eastern half of the Jones tract and had installed beam-type pumping units on each of the wells. The wells that could have interfered with the system were placed in concrete cellars to provide clearance so that the support towers of the irrigation system would clear them. On a different part of the farm, Amerada Hess had two wells that could have interfered with the irrigation system, but they chose to use hydraulic pumping units, which were short enough to avoid conflict with the irrigation system. *Getty Oil Co. v. Jones*, 470 S.W.2d at 620.

Thus, the evidence was actually more in depth than just the interference with the pivot system and complaints about increased costs and loss of investment.

Jones prevailed in the jury trial; however, the case was remanded. The Court found that the jury issues were improper[4]. Unfortunately, the submitted issues included a phrase to the effect that the pumping unites were "at such excess in height" and the Court correctly recognized that was an impermissible comment on the weight of the evidence. The Court also noted that the subject issues further did not correctly reflect the surface owner's burden. The *Getty* Court clarified and made clear the proper inquiry. "There must be a determination that under all the circumstances the use of the surface by Getty in the manner under attack is not reasonably necessary. The burden of this proof is upon Jones, the surface owner." *Id.*

The Court noted that Jones had tried to meet the burden, and in sending the case back down, further explained that the burden of the surface owner is to show "that the use which (Lessee) Getty is making of the surface is not reasonably necessary because of non-interfering and reasonable ways and means of producing the minerals that are available to (Lessee) Getty, the use of which will obviate the abandonment by (surface owner) Jones of his existing use of the surface, and that the alternatives available to (surface owner) Jones would be impractical and unreasonable under all the conditions. These are the elements to be considered by the trier of facts and the jury should be so instructed in resolving the issue of the reasonable necessity of the surface use by (Lessee) Getty, the mineral lessee." *Id.* The case was remanded, and Jones had a second chance to keep his irrigation system.

Practice Pointer: Jones had developed sufficient facts to warrant submission to the jury, in analyzing a dispute, as to the surface owner – are you considering all options- and how do you demonstrate the requisite facts to prevail? Also need to consider the cost of prosecuting such an action. As to the oil and gas operator, where is there room for compromise? Are you meeting industry standards? Could you avoid the cost, or what are your prospects for summary judgment? Cue at stage left, *Merriman*.

2. Half a Million Acres or 40 – You Still Got to Work the Cattle - *Merriman v. XTO Energy, Inc.*, 407 S.W.3d 244 (Tex. 2013).

Homer Merriman was a pharmacist, who liked his cattle[5]. This caused conflict when XTO wanted to drill on his 40–acre tract, which he used for his working pens in his cattle operation. He sought an injunction; however, the trial court granted XTO's traditional and no-evidence summary judgment alleging that he could not produce evidence sufficient to raise a fact issue that

[4] The specific jury issue in Getty: 'Do you find from a preponderance of the evidence that Getty Oil Company's erection of the pumping units in question at its Numbers One and Two Wells at such excess in height so that Plaintiff's sprinkler system will not pass over the same constituted a use of the surface of the land in question in a manner which is not reasonably necessary? 'In answering the foregoing Special Issue, you are instructed that a determination of whether the erection of such pumping units by Getty Oil Company constitutes a use of the surface of the land in question in a manner which is not reasonably necessary involves weighing the degree of harm or inconvenience, if any, such pumping units cause to John H. Jones against the utility, if any, of such pumping units to Getty Oil Company and the suitability of other measures, if any, which would substantially serve the purpose of such pumping units to Getty Oil Company at less or no inconvenience or harm, if any, to John H. Jones. *Getty Oil Co. v. Jones*, 470 S.W.2d at 623. Again, note the issue did not comport with the burden borne by Jones.

[5] Full disclosure, the author loves her cattle, on the family ranch, as well.

he had "no reasonable methods" of maintaining his cattle operations on the 40 acre tract. As set forth in *Getty*, mere inconvenience is not enough likewise, simply being impacted will not carry the surface owner's burden.

So, in a fact-based inquiry based on "reasonableness" how did Merriman fail? In examining the facts, the Supreme Court explained "(h)e did not produce evidence showing he had no reasonable method to conduct the sorting, working, and loading activities somewhere else on the subject tract." *Merriman v. XTO*, 407 S.W. 3d at 251. The Court stressed that "[e]vidence that the mineral lessee's operations result in inconvenience and some unquantified amount of additional expense to the surface owner does not rise to the level of evidence that the surface owner had *no reasonable alternative method to maintain the existing use*." *Id*. at 252 (Emphasis Added).

The Court did note that the Court of Appeals had applied an improperly stringent standard. Whether Merriman could conduct operations on *other tracts* he owned was irrelevant, and should not have been considered. The question was limited to the impact of the subject 40-acre tract. Further, the Court rejected the idea that the Court could consider possible alternative uses of the property other than the existing cattle operation.

Merriman's evidence, however, was insufficient at the end of the day. Merriman did not explain why corrals and pens could not be constructed and used somewhere else on the tract, in a case where he admitted he was using, in part, temporary pens and a portable chute. His proof did not meet the burden, yet if he had explained in greater detail the impact, it is possible there could have been a different result. For example, evidence from a third party or source on proper design, sizing, or safe handling issues could have been presented.[6] The evidence, however, was of mere inconvenience and extra cost, which was simply not enough to be deemed "unreasonable".

Merriman also faced the difficulty in trying to overcome an adverse summary judgment ruling when the parties had filed cross motions. The Court felt he "did not produce evidence sufficient to raise a material fact issue as to part of the initial element on which he had the burden of proof: that he had no reasonable alternative means of maintaining his cattle operations on the 40-acre tract." *Id*. So the cows lost.

Practice Pointer: Consider early mediation, or pre-litigation mediation as a possible solution to the impasse. Are there areas in which a surface use agreement could limit or assist with the dispute? If there is no compromise, while your clients are experts on their respective operations, consider how the evidence will be received from TRO to trial. Reach out early to experts, independent parties, and any local or governmental agencies who may be of assistance. The client needs to survive expert witness challenges, attacks that their opinions are conclusory, and bias.

Cue stage right, bring on the choppers, time for *Virtex.*

D. The Deer Barons versus Oil Barons - *Virtex OperatingCo., Inc. v. Bauerle*, No. 04-16-00549-CV, 2017 WL 5162546 (Tex. App.—San Antonio Nov. 8, 2017, pet. Denied).

Wild game management, including managed white tail herds, is big business in Texas. More than 1.2 million licenses were sold in the state in each of the last five years according to the Texas Parks and Wildlife Department. Hunting related expenditures in Texas for 2017 topped $1.8 billion, and the deer breeding industry has a direct economic impact of $349.4 million annually. Including indirect impacts--feed, vet supplies, fuel and other purchases—the total annual impact to the state economy is $786.9 million[7].

A key component for the ranches that house managed breeding stock is proper care, veterinarian treatment, artificial insemination programs, and reducing stress to the animals. Deer are not cattle that can simply be worked and just driven into pens. They require very specific protocols. They are also worth a great deal of money and can injure themselves or others if not handled correctly.[8]

Cue the helicopters in *Virtex.*

E. The Todos Santos Ranch – A Lot Like Reata

At the time of suit, Leon and Cyndi Bauerles operated Todos Santos Ranch in Dilley, Texas, comprising 8,500 acres in Frio and Zavala Counties. Virtex operated nine wells on approximately 2,000 acres of the leased acreage using generators—there was only one powerline to the ranch headquarters. Virtex's stated plan, when the dispute arose, was to drill 45 more oil and gas wells across the 2,000 acres and install a powerline system across the lease connecting all 54 wells. The dispute arose when Virtex asked for an

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[6] Size and configuration of livestock pens are widely discussed in livestock literature for example. The author's favorite source is Temple Grandin. See *Livestock Handling Systems, Cattle Corrals, Stockyards And Races*, Temple Grandin, www.grandin.com.

[7] Big Buck Bring Big Bucks to the Texas Deer Hunting Economy, Will Leschper, Texas Outdoor Digest, April 5, 2018, citing Texas Parks and Wildlife Department surveys, as well as U.S. Fish & Wildlife Service Impact Surveys for 2017, and the 2017 Study of the Agricultural and Food Policy Center at Texas A&M.

[8] Full disclosure, the author's family has a whitetail deer operation on the family ranch.

easement to start powerline construction. The ranch contended the project would create a "spider web" of lines across the ranch. The ranch filed suit. The deer and Virtex lost both at the jury trial[9] and on appeal.

Is *Virtex* an aberration and deviation from either *Getty* or *Merriman*? Or did the Bauerles simply meet *Merriman's* first challenge by presenting "evidence that the surface owner had *no reasonable alternative method to maintain the existing use*" and then providing reasonable alternatives for the powering of the wells. *Merriman v. XTO* at 252. The oil company on appeal challenged the legal and factual sufficiency of the evidence that the overhead power lines would preclude or substantially impair the current surface use. They also (improperly) argued that the evidence did not establish the power lines would make helicopter use impossible—neither *Getty* nor *Merriman* require "impossibility" as a threshold burden.

F. The Evidence in *Virtex* – Well Scripted

Todos Santos was a family run commercial hunting business and a cattle operation. The main source of income for the ranch stemmed from the hunting leases. The family owned 100% of the surface and had a 2% royalty interest in the acreage subject of the suit.

As explained in the case, the hunters used helicopters for game operations, game surveys, deer captures as well as predator and brush control. For example: "Once pilots locate a deer, they are able to push the deer into an open area, where the deer can be captured with a net gun. The operation requires pilots to fly alongside the deer—approximately 4 to 5 feet above ground—weaving in and out of brush, while at the same time, dodging trees and other obstacles. The process has been described as one of "the most extreme [forms of] flying that you can possibly do. According to several hunters, this method of deer capture is less stressful for the deer and more cost efficient for hunters. Additionally, this method has, to date, eliminated injuries to the deer. Ultimately, the captured deer are relocated to a fenced enclosure for breeding or to another nearby ranch in the event the Bauerles' ranch has a surplus of deer." Id.

The ranch presented evidence that the proposed power lines would make helicopter flying "a very dangerous situation" and the ranch pilots testified they would not fly with the planned powerlines. The jury agreed and on appeal the Court of Appeals concluded the evidence was legally and factually sufficient to establish substantial impairment.

The Court of Appeals noted evidence establishing that a lessee's proposed use *would* completely preclude *or* substantially impair the surface owner's existing use is sufficient evidence to satisfy the first prong of the accommodation doctrine. Further, the court stated Virtex had no legal authority that the substantial impairment prong can only be established by evidence showing the surface owner "has already been impaired" by the lessee's proposed use of the surface. The surface owner need only prove that his existing use would be substantially impaired or completely precluded by the mineral owner's proposed use of the surface.

The oil company next contended the ranch failed to establish that "no reasonable alternative methods existed" by which they could continue leasing property to hunters interested in using helicopters. Again, *Merriman v. XTO Energy, Inc.* held the surface owner failed to meet his burden of proof with respect to the second element of reasonable accommodation because he failed to explain why the proposed alternative methods—in that case, the use of corrals and pens in other parts of the 40-acre tract—were unreasonable. The burden then was to prove that the inconvenience or financial burden of continuing the existing use by the alternative method was so great as to make the *alternative method unreasonable. Id.*

Virtex argued that the hunting could continue on acreage outside the oil and gas lease, or on other acreage owned by the ranch. As previously noted in *Getty*, the question is not the option for the surface owner to move operations, but rather the impact on the subject tract. In any event, the Bauerles hunters explained that the deer really don't appreciate lease lines, the ranch was too large and too rough for 4-wheelers, and they would no longer lease the ranch if they could not fly.

So, the key was the testimony showed that the proposed alternative methods of managing the property made the land less likely to be leased by hunters where the primary use of the ranch was to lease it for hunting.

The final prong was also met by the ranch, they convinced the jury and survived appellate review on the issue of presenting an alternative reasonable, customary, and industry-accepted method was available that could be used to power the oil and gas wells. The ranch suggested fueling pump jacks by diesel or natural gas, a method Virtex used elsewhere, as opposed to electricity, or continuing to use rented generators to operate the pump jacks. The ranch further pointed out natural gas lines were already installed across their ranch, and Virtex could utilize these lines to power the pump jacks.

With respect to these methods, the jury heard evidence that powering the wells with natural gas was the "next best alternative," and it was not required to be the least costly method, under the accommodation doctrine, the ranch was only required to show it was a reasonable and industry-accepted alternative.[10]

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[9] Virtex was successful in obtaining a Judgment NOV on contract claims from the trial court.

[10] Last but not least, in Virtex, the ranch was awarded attorney's fees under the Declaratory Judgment Act. The argument being at time of submission the ranch was not

Practice Pointer: Note again that as far as demonstrating alternatives for the development of the minerals, it did not have to be the least costly method. Many times operators lose sight of this prong of Reasonable Accommodation.

Further, note the case dealt with a surface use agreement that was not quite as expansive as possibly it should have been. Consider what elements your surface agreement should include. But make sure it does not completely thwart development.

II. "REASONABLE ACCOMMODATION DOCTRINE" DOES NOT CREATE CONTRACT RIGHTS

***Harrison v. Rosetta Res. Operating, LP,* 564 S.W.3d 68, 70 (Tex. App. 2018)**

The *Harrison v. Rosetta Res. Operating, LP*, 564 S.W.3d 68, 70 (Tex. App. 2018) case involves a water-use dispute between an oil and gas lessee and the surface owner, the Harrison trust whose trustee, Roddy Harrison, is a local attorney in Reeves County.

Harrison had previously sold water to the prior operator, but after assignment to Rosetta, they chose to use temporary water lines and bring in water from the neighbor's tract. The new operator refused to buy water from Harrison. Water sales can be a significant component of surface income, so Harrison sued for breach of contract, claiming an oral agreement for water sales and further made a claim that Rosetta had violated an alleged local custom known as the "West Texas Rule". Harrison claimed it was customary that an oil and gas lessee would only purchase water from the surface owner of the tract it was operating and not pump in neighboring water unless necessary. The claims failed.

Harrison also urged that Rosetta, by bringing in the hoses and extra equipment, had violated reasonable accommodation because same would have been unnecessary had Rosetta purchased Harrison's water. The surface owner was, and understandably upset not only with the loss of sales, but when Rosetta refused to buy the water, it rendered the existing frac pond, infrastructure and water well "useless". Harrison also asserted claims for trespass, negligence, and gross negligence, and requested damages and attorneys' fees and an injunction of the off-lease water use.

Since there was existing water infrastructure and the former lessee utilized, Harrison argued the previous use "unified the use of the land with the oil and gas operations", and so declining to use the infrastructure and buy the water, substantially interfered with his existing use of the land as a source of water for drilling operations. The El Paso Court rejected the claim. Using the *Getty* analysis, they found the plaintiff had to show the lessee's actions have substantially interfered with or precluded the existing surface use, but it did not create contract rights. The court noted it was very uncomfortable that if the surface owner was correct, they would be holding that all mineral lessees must use and purchase water from the surface owner under the accommodation doctrine if his water is available for use.

III. HUNTING ROUND TWO – SURFACE OWNER CANNOT PREVENT OIL AND GAS DEVELOPMENT AS EXECUTIVE RIGHTS HOLDER

***Texas Outfitters Ltd., LLC v. Nicholson,* 572 S.W.3d 647, 649 (Tex. 2019).**

The Texas Supreme Court recently addressed the duties of the executive rights holder in *Texas Outfitters Ltd., LLC v. Nicholson*, 572 S.W.3d 647, 649 (Tex. 2019). In that the case addresses at length the conflict between the ranch owner's desire to control/eliminate oil field activity, the case should be noted in both negotiations and in addressing comprehensive surface use agreements, where the surface owner also has executive rights.

Texas Outfitters purchased the subject ranch with the intent to use the property as its principal's residence as well as to operate a hunting business. While there was nothing wrong per se with the principal's admitted position that he would not have purchased the property without the executive rights and the corresponding control over future mineral development, his conduct after the purchase caused concerns to be raised by the non-executive mineral interest owners. Texas Outfitters declined to enter two different leases, and then negotiations between it and the non-executive rights owners stalled. So, the non-executives sued, claiming that the leasing opportunities dried up during the period of delay, and claimed the ranch owner engaged in self-dealing to preserve the hunting and residential qualities of the ranch. *Id*.

The question was whether Texas Outfitters engaged in acts of self-dealing that unfairly diminished the value of the non-executive interest, and in a fact specific inquiry, the Texas Supreme Court held that the non-executives met the burden.

Key Issues from *Texas Outfitters* That Should Be Considered by Surface Owner Counsel:

1. In the case, the ranch and non-executives tried to reach an agreement, selling the executive rights to the non-executive, but the restrictive conditions in the proposed surface use agreement were seen as a clear impediment to oil and gas development. This was in addition to agreeing on value for the rights.

seeking an injunction, but a declaration of rights. Still an odd result as far as attorney's fees are concerned.

2. Counsel should consider in negotiating surface use agreements for clients with executive rights, are the conditions reasonable and do they create some issue that the value of the non-executive rights are being diminished due to impact on drilling opportunities, or is the agreement balanced.
3. The finders of fact did not believe the refusal to the lease was in order to see how the play developed and potentially gain more money, the stated defense of the ranch.
4. The ranch had only a small royalty interest.
5. The ranch position was further compromised in that one of the non-executives testified that the executive told her that executive planned not to lease because of his business of a hunting lease for bringing in hunters.

As noted by the Court "(b)y refusing to lease," Texas Outfitters gained "unfettered use of the surface for its hunting operation, which was always the plan for the property," as well as "the ability to sell its land at a large profit free of any oil and gas lease. Which happened, when they sold the ranch for a gain of $2,500,000.00" and the argument was made that the value had increased as a "pretty ranch" because it was not burdened by an oil and gas lease. *Id.*

IV. USING REATA TO DRILL THE NEIGHBOR - OFF LEASE LOCATIONS

***Lightning Oil Co. v. Anadarko E&P Onshore, LLC*, 520 S.W.3d 39, 47–53 (Tex. 2017).**

As many surface owners can attest, off lease locations can be both large in size, some forty acres in size, and they can be most lucrative. While the case focuses on whether there was interference with the mineral interest, *Lightning Oil Co. v. Anadarko E&P Onshore, LLC*, 520 S.W.3d 39, 47–53 (Tex. 2017) provides an excellent discussion of surface rights in general. The case's explanation of the surface's "Bundle of Sticks" are instructive for any surface disputes and are not limited to the subject of the case, which was off lease surface locations.

The Texas Supreme Court addressed a dispute where the lessee underlying the tract objected to its competition drilling through its leased minerals. The court made clear that a surface owner can grant licensees for drilling through subsurface areas containing minerals and even if it extracts a limited amount of those minerals during drilling operations or places well bores through the leased property.

While the mineral estate is dominant, reciting *Getty* et al, the Court explained that the rights of a surface owner are in certain way as extensive or perhaps arguably even more extensive than those of the mineral lessee. And "an owner of realty has the right to exclude all others from the use of the property, one of the 'most essential sticks in the bundle of rights that are commonly characterized as property.'" Id.

The Court continued: "(t)he rights conveyed by a mineral lease generally encompass the rights to explore, obtain, produce, and possess the minerals subject to the lease; they do not include the right to possess the specific place or space where the minerals are located. Thus, 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. Balanced against the small loss of minerals a lessee such as Lightning will suffer, if drilling through the minerals is determined to be a non-actionable interference with its property rights, is the longstanding policy of this state to encourage maximum recovery of minerals and to minimize waste." *Id.* So yet another example of the balancing of rights between surface and the mineral interest owner. And no, the conduct of Lightning was not a trespass.

Practice Pointer: The question on a going forward basis may be when does the traffic jam of drilling impact and create waste on the subject tract where the off-lease location is found. Further, consider using Lightning in explaining the surface rights that remain post leasing.

V. WATER CONTRACTS - BE CAREFUL IN DRAFTING (MUCH LESS TERMINATING) AN AGREEMENT

***Tollett v. MPI Surface, LLC*, No. 05-17-00435-CV, 2018 WL 2926356, at *1 (Tex. App. -Dallas 2018 no pet.).**

And Lockouts Are Ill-Advised Round One

Water has become big business, to the point cotton production in many counties in the Basin has gone down because it is much more lucrative to sell the fresh water.

An example of the typical type of water proposal that is being used by some entities is found in the *Tollett* case. In 2012, Tollett and MPI entered into an exclusive groundwater sales contract that allowed for MPI to extract and sell groundwater from Tollett's land to third parties for use in the oil and gas industry. *Tollett v. MPI Surface, LLC*, 2018 WL 2926356 at *1 (Tex. App. - Dallas 2018 no pet.). The Agreement provided a 25% royalty "of the gross sale proceeds collected by MPI from the sale of Water produced from the Lands."

As is usual with many of these type arrangements, MPI drilled water wells and built infrastructure and the surface owner contributed surface locations as well as committed his water. Between 2012 and 2016, MPI sold between three and four million dollars' worth of water under the Agreement. An issue arose as to late royalties which culminated in the Tollett's terminating the Agreement and locking out MPI. (Ill-advised self-help).

One of the challenges in all the various water arrangements is the legal structure and accounting.

Some contemplate a royalty arrangement and work similarly to a Salt-Water Disposal agreement. Some contemplate a joint venture type arrangement where the surface owner is an interest owner. In the joint venture scenario, because the water developer is paying for infrastructure, the surface owner ends up with a minority interest. Under all the incarnations the surface owner is ceding control and ownership of the water, and the potential for disputes about the accounting are becoming a serious issue.

The case spends a great deal of time pointing out that the Agreement of the parties was unclear as to the payment provisions and timing. Also, the danger of relying on course of dealing being used to defeat specific metering provisions. If you are going to insist on specific performance, you must timely and specifically make demands.

The client, rather than locking them out, should have probably taken a different route. MPI prevailed on its counterclaim for wrongful termination. It was an expensive lock out.

So, it should be considered whether cleaner drafting of the contract, perhaps seeking declaratory relief, or both would have better served the surface owner.

VI. HB 3557 THE CRITICAL INFRASTRUCTURE PROTECTION ACT. LOCKOUTS ARE ILL-ADVISED ROUND TWO

The Critical Infrastructure Protection Act was touted as part of a nationwide push to provide additional tools to prosecute pipeline protesters. It covers all aspects of oil and gas infrastructure, as well as that of other industries. Clients on both side of the surface issue need to take note.

While the act and its remedies arguably overlap penal statutes that would have covered vandalism and criminal mischief, the Critical Infrastructure Act makes damage to or destruction of a covered installation or project a third-degree felony; it also adds remedies for "impairing or interrupting operation," with both criminal and civil penalties. The civil penalties include damages, court costs, and exemplary damages. The Act applies to pipelines pre- and post-construction and if "enclosed," tank batteries, well sites, and a long list of other oil and gas facilities. Surface owners, non-operators, or any party resisting the installation of a facility or planned project, needs to take note. The day of the "self-help lock out," which was always questionable and ill-advised at best, may be over, if the act applies.

To give the Critical Infrastructure Act even more impact, it expressly removes certain possible defenses and damage limitations. The Act specifically provide that Chapter 27, the Texas Citizen Participation Act, commonly referred to at the Anti-Slapp Statute[11] does not apply. Equally significant, the punitive damage caps under Chapter 41 of the Tex. Civ. Prac. & Remedies Code do not apply to an action under the Critical Infrastructure Protection Act. So, you cannot summarily dismiss as an exercise of free speech, and no punitive damage caps. The Act also calls into question how punitive damages will be assessed, in that Chapter 41 provides specific standards, clear and convincing and state of mind, etc. Further, Chapter 41 requires a unanimous verdict, would the new Act be a ten to two vote instead? As is obvious, the Critical Infrastructure Protection Act raises a number of questions and concerns.

VII. SWD AGREEMENTS / OTHER SURFACE OIL AND GAS IMPROVEMENTS: DON'T FORGET THE *TAX MAN*

***Bosque Disposal Sys., LLC v. Parker Cty. Appraisal Dist.*, 555 S.W.3d 92, 93 (Tex. 2018.**

The Texas Supreme Court has ruled that saltwater disposal wells can have a separately assigned appraised value versus the appraised value of the land itself. *Bosque Disposal Sys., LLC v. Parker Cty. Appraisal Dist.*, 555 S.W.3d 92, 93 (Tex. 2018), *reh'g denied* (Sept. 28, 2018). The potential logical extension is to any surface installation. Local appraisal districts are increasingly assessing any kind of surface structures, SWD's, tank batteries, and locations for example. Practice Pointer: Address the property taxes in any agreement covering the use. Examples of course are fresh-water stations, water recycling installations, much less tank batteries and off lease surface locations, but make clear who bears tax liability.

VIII. *WATER--THE COMING STORM*

Just as any good rancher keeps an eye on the weather, the coming storm iswater, particularly produced and recycled water. First a few statistics and observations.

IHS Markit, a research and consulting firm, advises that the overall market for water in the Permian totaled $12.2 billion in 2018. That includes sourcing water for fracking, transporting, storing, treatment, and disposal of produced water.[12] Gabriel Collins, an energy fellow at Rice University's Baker Institute, anticipates that the market for produced water alone is

[11] Tex. Civ. Prac. Rem. Code Ann. Section 27.001 et seq.

[12] *Permian Oil Boom Uncorks Multibillion-Dollar Water Play*, February 15, 2019, Water & Energy, Water News, WEF /by Brett Walton.

several billion dollars a year and could climb to $10 billion or more in the near future as the volumes rise.[13]

Traditionally, produced water was transported by a water hauler to a SWD well where it was treated with biocide prior to its injection into a disposal formation. Conservative estimates discussed by Collins are that production can generate five barrels of water for every barrel of oil.

A recent Wood Mackenzie study estimated that water disposal costs, which may already make up as much as 25% of lease operating expenses, may add $6/bbl to operators' breakeven costs by 2025, doubling current expenditures to $22 billion in the same timeframe[14].

Maintaining a cost-effective treatment regime for produced water is made more difficult because the produced water quality varies over the lifetime of a well. Some operators manage this problem by using a blend of produced and fresh waters. Others, such as Apache, have been able to fracture entire wells using only produced water (Driver, Wade 2013). Recycling produced water can save between $1.00-2.50/bbl in LOE and $250 million in fracture treatment costs by reducing water costs. [15]

IX. RECYCLED WATER CHAPTER 122 NATURAL RESOURCES CODE

Texas House Bill 3246 is a companion of New Mexico House Bill 546. Both take effect this year.

The Texas statute acknowledges the increasing policy of recycling of fluid oil and gas waste, and the legislature has sought in the past to clarify ambiguities regarding the ownership of such waste. H.B. 3246 sought to address this oversight by addressing a situation in which fluid oil and gas waste is produced and used by a person who takes possession of that waste for the purpose of treating the waste for a subsequent beneficial use.

The new Texas law amends Chapter 122 of the Natural Resources Code as follows:

> Unless otherwise expressly provided by an oil or gas lease, a surface use agreement, a contract, a bill of sale, or another [~~other~~] legally binding document: When fluid oil and gas waste is produced and used by or transferred to a person who takes possession of that waste for the purpose of treating the waste for a subsequent beneficial use, the waste [~~transferred material~~] is considered to be the property of the person who takes possession of it for the purpose of treating the waste for subsequent beneficial use until the person transfers the waste or treated waste to another person for disposal or use.

H.B. 3246 was filed without the governor's signature on May 24 and will go into effect on Sept. 1, 2019. NMOGA lobbied for New Mexico HB 546 2019 " Upon transfer of the produced water, transferees shall be liable for the use, disposition, transfer, sale, conveyance, transport, recycling, reuse or treatment of the produced water;" The objective is to shift all liability , HB 546 states that if a fracking operator sells produced water from their operations, whoever buys it is fully liable for any consequences.

As explained on their web site: "(t)he New Mexico Oil & Gas Association (NMOGA) is a coalition of oil and natural gas companies, individuals, and stakeholders dedicated to promoting the safe and environmentally responsible development of oil and natural gas resources in New Mexico. Representing over 900 members, NMOGA works with elected officials, community leaders, industry experts, and the general public, to advocate for responsible oil and natural gas policies and increase public understanding of industry operations and contributions to the state". See www.nmoga.org.

X. THE PROBLEM WITH THE LEGISLATIVE FIX ON RECYCLING, WHO OWNS THE WATER?

An excellent place to start the discussion is to revisit *Coyote*, where again, the Texas Supreme Court addressed reasonable accommodation in the context of a severed water estate.

The *Coyote* case discusses in part the rights of the surface owner pre-severance, referring the reader to *Edwards Aquifer Auth. v. Day*, 369 S.W.3d 814, 831–32 (Tex. 2012) In *Day*, where the landowners, who owned both the surface and groundwater estates, owned an included an interest in groundwater in place that cannot be taken for public use without adequate compensation as guaranteed by article I, section 17(a) of the Texas Constitution." *See id.*. at 817. The *Day* case also discussed that ownership of groundwater in place is similar to the ownership of oil and gas in place, with

[13] *Oilfield Produced Water Ownership In Texas: Balancing Surface Owners' Rights And Mineral Owners' Commercial Objectives*, Gabriel Collins, J.D, Baker Botts Fellow in Energy & Environmental Regulatory Affairs February 2017, James A. Baker III Institute for Public Policy of Rice University.

[14]. *Disposal nightmare: In Permian Basin, every barrel of oil means four barrels of toxic water*. D. Wether, K. Crowley, and A. Nussbaum. August 29, 2018, The Dallas Morning News. *Dallas News's.*

[15] *Analyst: Water issues could extinguish Permian's surging output*, Melba McEwan, *Midland Reporter-Telegram, 2018.*

certain similar considerations and certain similar rights associated with ownership of both. *Coyote* then notes that ground water, like oil and gas, is owned by the landowner in place below the surface. *Coyote Lake Ranch, LLC v. City of Lubbock*, 498 S.W.3d at, 63.

So who owns the produced water, which is soon becoming a commodity?

An interesting view is set out in the study by Gabriel Collins, previously cited. In that paper is found the following "Executive Summary" :

> " The surface estate owns produced water as a matter of law in Texas. However, if a producer transfers produced water to another party for the purpose of treating that wastewater for "subsequent beneficial use," the water becomes the property of the person who takes possession of it. (Chapter 122 of the Texas Natural Resources Code).
>
> A key flaw in the statute is that Chapter 122 does not address how, if at all, the producer would need to split revenues with the surface owner for a sale or a for- value transfer of produced water.
>
> Barring contractual arrangements to the contrary, a producer would likely only need to split those revenues from the sale of produced water remaining after subtracting treatment and handling costs necessary to make the water marketable….."[16]

The final question for the group, if the ownership of produced water is not enough. Many of the water transactions, either royalty based or joint venture, recognize the question of ownership. But an additional question is raised by Chapter 122, what liability is potentially created for the surface owner, particularly if part of the joint venture?

Interesting food for thought and potential future cases to discuss.

[16] Also see *Quench My Thirst - Water Rights in the Context of Water Treatment Technologies,* Peter Hosey and Jesse Lotay, Texas Land Title Institute, 2013.