TEXAS OIL & GAS: THE LATEST LOWDOWN ON THE LAW

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I. SCOPE OF THE ARTICLE

This article surveys selected oil and gas cases decided by Texas state and federal courts from October 1, 2013 through April 30, 2014. Below are one-paragraph abstracts of the selected cases. Full case summaries follow the abstracts.

II. ABSTRACTS

1. Landowner had no right to sue previous tenant for drilling damages to property when tenant’s lease expired before landowner purchased the property. Landowner sued his predecessor’s former tenant for damages to the land that the former tenant caused via its drilling operations. The Fifth Circuit upheld summary judgment dismissing the landowner’s claims. Under Louisiana law, the landowner had no right to sue for damages to land that the landowner purchased after the damage occurred and after the lease had expired. Further, the right to sue the tenant was a personal right and therefore had to be expressly assigned. Broussard v. Dow Chem. Co., No. 13-30544, 2013 WL 6842717 (5th Cir. Dec. 30, 2013).

2. Mineral owner had no causes of action against well operator under (1) Louisiana statute governing drilling unit reporting requirements because statutory penalty was not triggered; or (2) Louisiana statute governing production payments because the statute did not apply to owner of unleased mineral interest. The Fifth Circuit upheld a district court’s grant of summary judgment dismissing a mineral owner’s statutory causes of action against a well operator. Because the well operator provided a well expense report to the mineral owner within the statutory time period, the statutory penalty was never triggered. Further, the Louisiana statute governing production payments applied only to royalty owners and purchasers of a mineral production payment and therefore did not cover the mineral owner, who owned an unleased mineral interest. Adams v. Chesapeake Operating, Inc., No. 13-30342, 2014 WL 1303394 (5th Cir. Apr. 2, 2014).

3. Both the United States and its contractor were liable for damages caused when contractor’s barge collided with an underwater natural gas pipeline during dredging operation. The United States Army Corps of Engineers responsible for maintaining a water channel failed to include an underwater natural gas pipeline in a contract to dredge the channel. While dredging the channel, the contractor collided with the pipeline. Notice of the pipeline was, however, publicly available when the collision happened. After a bench trial, the United States District Court for the Southern District of Texas found that (1) the United States breached its duty to warn the contractor about the pipeline; and (2) the contractor breached its duty to exercise reasonable care in its dredging operations by relying solely on the dredging contract’s information about the underwater pipelines. But the contractor was not entitled to indemnity from the United States due to the contractor’s own negligence. The contractor also could not avoid liability under the government contractor defense because (1) the United States lacked immunity; and (2) the contractor failed to show that it acted without negligence. Contango Operators, Inc. v. United States, No. H-11-6532, 2014 WL 1278628 (S.D. Tex. Mar. 26, 2014).
4. Trial court’s decision to *sua sponte* strike amended answer was abuse of discretion and proper subject of mandamus relief. After plaintiff oil company filed a second amended petition claiming to represent “affected leasehold interests,” defendant well casing supplier sought and obtained leave to file a fifth amended answer asserting responsive defenses. The trial court later *sua sponte* struck the fifth amended answer and denied the supplier’s Rule 12 motion. The supplier filed a writ of mandamus. The Amarillo Court of Appeals held that, because the supplier can appeal the trial court’s denial of the Rule 12 motion, mandamus relief was not available for that ruling. But the trial court abused its discretion when *sua sponte* striking the amended answer. There was no adequate remedy by appeal because the trial court’s *sua sponte* striking the amended answer prevented the supplier from presenting the asserted defenses on appeal. *In re Trident Steel Corp.*, No. 07-13-00415-CV, 2014 WL 230933 (Tex. App.—Amarillo Jan. 21, 2014, no pet.).

5. Income distributions from family mineral rights trust created before marriage are separate property. The wife of a trust beneficiary claimed that she had a right to half of all trust distributions as community property. The San Antonio Court of Appeals affirmed the trial court’s order granting summary judgment dismissing the wife’s claims, holding that the trust distributions were the husband’s separate property. Distributions from irrevocable trusts to married beneficiaries who have no present possessory right to the trust corpus are separate property. The trial court expressly declared that the trust was irrevocable and mandated that royalty payments from the trust were income and not corpus. Further, the fact that the husband had a limited right to transfer his interest did not equate to owning the trust corpus. Nor did the husband have any right to the corpus upon the trust’s termination because the trust would not terminate until after his death. *Benavides v. Mathis*, No. 04-13-00186-CV, 2014 WL 547904 (Tex. App.—San Antonio Feb. 12, 2014, no pet.).

6. Joint operating agreement’s area-of-mutual-interest provision (“AMI”) was unenforceable when it conflicted with purchase agreement’s AMI, and joint operating agreement specified that purchase agreement controlled in event of conflict. Overriding royalty interest owner sought declaratory judgment that AMI in joint operating agreement did not apply to overriding royalty interests. The Tyler Court of Appeals upheld summary judgment for the overriding royalty interest owner. The joint operating agreement expressly mandated that, in the event of a conflict between its provisions and provisions in simultaneously executed purchase agreement, the purchase agreement controlled. The Court held that the two documents’ AMIs conflicted because the joint operating agreement’s AMI applied to a number of interests, while the purchase agreement’s AMI applied only to subsequently acquired leases. Therefore, the purchase agreement’s AMI governed and was inapplicable to the overriding royalty interests. *XH, LLC v. Cabot Oil & Gas Corp.*, No. 12-12-00338, 2014 WL 806339 (Tex. App.—Tyler Feb. 28, 2014, no pet.) (mem. op.).

7. Royalty clause in oil and gas lease mandating that royalty shall be “free and clear” of all production and post-production costs did not permit deduction of post-production costs incurred between the wellhead and the downstream point of sale. The overriding royalty clause requiring “cost-free” overriding royalty
also prohibited post-production cost deductions. No royalty was owed on lost gas because such gas was not sold or used. Oil and gas royalty interest owners sued lessees for royalty underpayments due to post-production costs deductions from royalties. The San Antonio Court of Appeals held that the lease’s royalty clause requiring royalty to be “free and clear” of all costs barred post-production cost deductions to calculate royalty valued at the wellhead. The Court similarly interpreted the lease’s overriding royalty clause, which required that overriding royalty be “cost-free,” to prohibit post-production cost deductions. But the Court found that the lessee owed no royalty on lost gas when royalties were only owed for gas that was used or sold, and lost gas was neither used nor sold. *Chesapeake Exploration, L.L.C. v. Hyder*, No. 04-12-00769-CV, 2014 WL 852102 (Tex. App.—San Antonio Mar. 5, 2014, no pet.).

8. For a lease of both a mineral estate and surface land use, mandatory venue for declaratory judgment action regarding compliance with lease renewal provisions was in county in which leased property was located. The Texarkana Court of Appeals granted mandamus directing transfer of an action on a lease of both minerals and surface use to Freestone County—the county in which the leased land was located. The lessee filed a declaratory judgment action against the lessor, seeking a judgment that the lessee complied with the lease renewal provisions, and the lessor counterclaimed to remove an encumbrance on title. So both claims concerned the lease’s validity. The lease contained features of both a mineral lease and a lease of real property and therefore implicated two mandatory venue provisions—Texas Civil Practice and Remedies Code §§ 15.011 and 15.0115. The Court of Appeals reasoned that, regardless of which mandatory provision applied, the result would be same—transfer to the county where the leased property is located. *In re Freestone Underground Storage, Inc.*, No. 06-14-00012-CV, 2014 WL 983131 (Tex. App.—Texarkana Mar. 14, 2014, no pet. h.).

III. CASE SUMMARIES


In *Broussard*, the Fifth Circuit held that a landowner did not acquire the right to sue a prior tenant for damages to the land when the damages occurred and the lease expired before the landowner’s predecessor conveyed the land to the landowner.

*Broussard* (and another party that later disclaimed any interest in the land) sued Dow Chemical Company (“Dow”) (and other entities not part of the appeal) for damages caused by drilling activities that Dow conducted on the land years before Broussard purchased it. Dow drilled a well under a lease that expired in 1977. In 2000, the landowner under that lease passed away, and his daughter, Sorrell, inherited the land. Sorrell sold the land to the Fuseliers, who then sold the land to Broussard in 2009.

The Fifth Circuit affirmed the district court’s grant of summary judgment for Dow, essentially adopting the district court’s reasoning. The Court held that the right to sue never passed to Broussard. Under Louisiana law, previous landowners cannot transfer the right to sue to an assignee when the lease had expired. So Broussard’s predecessors could not have assigned to Broussard the right to sue Dow.
Further, Dow’s lease stated that Dow would be liable only for the damages of the lessor. Although the lease also bound “successors and assigns,” none of Broussard’s predecessors—or Broussard—was a successor or an assignee of the lease.

Nor did any of the deed language that purported to transfer all rights related to the property convey the right to sue Dow. The Court recognized that the right to sue is a personal right, meaning that it must be expressly assigned and cannot be “implicitly conveyed.” So without an express assignment of the right to sue Dow, Broussard could not obtain that right via his deed.

Finally, the Court addressed Broussard’s challenge to the district court’s refusal to consider parol evidence of the intent behind the deeds conveying the land. The Court held that parol evidence cannot create an express assignment of the right to sue when such an express assignment is not present in the deed. Allowing parol evidence to do so would “essentially completely nullify the longstanding ‘express assignment’ requirement.”

The Fifth Circuit affirmed the district court’s judgment dismissing Broussard’s claims.


In this case, the Fifth Circuit upheld summary judgment dismissing a mineral owner’s statutory claims related to expense reports and production payments for the well.

Adams owned an unleased mineral interest in property located within a drilling and production unit. Chesapeake Operating, Inc. (“Chesapeake”) drilled a well on property within the unit. Although Adams was entitled to a share of the proceeds from the well, Chesapeake could recover the well expenses from Adams.

Adams sent a certified mail letter to Chesapeake demanding a well expense report under La. Rev. Stat. Ann. § 30:103.1. Chesapeake received the letter on February 12, 2011, but it did not respond by sending a well expense report to Adams until April 29, 2011. On April 14, 2011, Adams’ attorney sent Chesapeake a second letter notifying Chesapeake that, under § 30:103.2, it had forfeited its right to recover the well expenses from Adams because it had failed to send Adams a well expense report.

Adams later sued Chesapeake in Louisiana state court, claiming that Chesapeake (1) violated § 30:103.1 when it failed to provide a well expense report within the time period in § 30:103.1; and (2) failed to comply with La. Rev. Stat. Ann. §§ 31:212.21-.23 by failing to make production payments. Chesapeake removed the suit to federal court and won summary judgment dismissing Adams’ claims. The district court reasoned that (1) the penalty of § 30:103.2 was never triggered; and (2) §§ 31:212.21-.23 did not apply to owners of unleased minerals interests such as Adams.

Agreeing with the district court, the Fifth Circuit held that the penalty of § 30.103.2 was not triggered. An operator’s duty to provide an expense report is not triggered under § 30:103.1 until a written request is sent by certified mail. So Adams’ February 10, 2011 letter merely triggered Chesapeake’s duty to send Adams the well expense report. Before § 30.103.2’s penalty of forfeiting recovery of well expenses is
triggered, however, Chesapeake had to fail to respond within thirty days of receiving a second certified mail letter notifying it of its failure to provide the well expense report. Chesapeake provided the expense report within thirty days of Adams' second letter. Therefore, Adams could not recover under § 30.103.2.

Second, the Court held that §§ 31:212.21-.23 did not apply to owners of unleased mineral interests such as Adams. Section 31:212:21 specifies that it covers "the owner of a mineral production payment or a royalty owner other than a mineral lessor...." Noting that Adams admitted that he is not a royalty owner, the Court relied on the title of §§ 31:212.21-.23 to determine whether Adams qualified as an "owner of a mineral production payment." The title provided "the remedies and procedures for obtaining payment by a royalty owner other than a mineral lessor and by the purchaser of a mineral production payment...." Adams therefore did not fall within the scope of §§ 31:212.21-.23 because he was not a mineral production payment purchaser. He owned an unleased mineral interest.

The Fifth Circuit affirmed summary judgment in Chesapeake's favor.


   In **Contango**, the United States District Court for the Southern District of Texas found the United States and its contractor liable for damages caused when the contractor's barge collided with an undersea natural gas pipeline.

   The plaintiffs, Contango Operators, Inc. and certain non-operating working interest owners (collectively, "Contango") own a natural gas pipeline that runs along the Gulf of Mexico's floor. In accordance with federal laws, Contango filed with the Regulatory Division of the United States Army Corps of Engineers (the "Corps") an application for a permit to construct the pipeline in the Gulf of Mexico. The application stated that the pipeline would cross a channel that the Corps maintained. Although the Corps granted Contango a permit to construct the pipeline, the Corps never notified its Waterway Division—the Corps division responsible for giving submarine pipeline locations to engineers who prepare dredging contracts—of the pipeline's location.

   Almost two years after Contango constructed the pipeline, the Corps awarded a contract to Weeks Marine, Inc. ("Weeks") to dredge the channel that Contango's pipeline intersected. Although the dredging contract included specifications identifying five undersea pipelines located in the channel, the specifications did not identify Contango's pipeline.

   After Weeks began its dredging operation, the National Oceanic and Atmospheric Administration ("NOAA") published on its website updated charts depicting Contango's pipeline. The United States Coast Guard ("USCG") also published a Local Notice to Mariners announcing the addition of the pipeline.

   During the dredging operation, Weeks' barge struck the Contango pipeline, causing the pipeline to rupture and be shut-in for thirty-five days for repairs. Contango sued the United States and Weeks for negligence and violating various maritime laws. After conducting a bench trial, the Court announced its findings of fact and conclusions of law.
First, the Court found that the United States was liable for negligence. The United States owed Contango a duty of reasonable care. Weeks’ collision with the pipeline and resulting damage were foreseeable consequences of the Corps’ failure to include the Contango pipeline in the dredging contract specifications. The United States breached its duty of reasonable care by failing to include the pipeline in the dredging contract specifications and by failing to warn Weeks of the pipeline before Weeks’ barge collided with it. That breach was a cause of the collision and resulting damages. The Court further found that the United States failed to discharge its duty via the NOAA and USCG updated information because (1) the Corps does not require dredging contractors to independently investigate existing pipelines; and (2) the Corps knew that it was custom and practice in the dredging industry for contractors to rely on specifications that the Corps provided.

Second, the Court found that Weeks was also liable for negligence. Weeks possessed a duty to act reasonably to avoid striking the Contango pipeline. Although Weeks followed the dredging industry custom of relying on the Corps’ dredging specifications to locate pipelines, the Court found that it was unreasonable for Weeks to rely solely on that information when Weeks could so easily access the NOAA charts and USCG notice. Weeks’ breach of its duty to exercise reasonable care was a cause of its barge’s collision with the Contango pipeline and resulting damages. Weeks was further liable under THE LOUISIANA rule—a rule of law that creates a presumption of fault of a non-self-propelled vessel’s operator when such a vessel collides with a stationary object. Because Weeks should have discovered the Contango pipeline by consulting the available NOAA and USCG information, it is also liable under THE LOUISIANA rule.

Weeks did not, however, possess additional duties under maritime law. The Court found that neither various maritime regulations nor general maritime law imposed any duty on Weeks to carry up-to-date information or have a crew of licensed mariners. The maritime regulations did not apply to the type of vessel that Weeks operated. General maritime law did not impose such duties because the tugs that towed the barge during the dredging project had updated information and were manned by mariners.

Weeks claimed indemnity from the United States, arguing that it was obligated under the dredging contract to accept the Corps’ provided information as true. But the Court found that it lacked jurisdiction to consider such a contract issue as indemnity. Further, because information contrary to the Corps’ provided information was readily available to Weeks, Weeks had a duty to investigate that information’s accuracy. Weeks also could not avoid liability under the government contractor defense because (1) the United States breached its duty to Contango and lacked immunity for that breach; and (2) Weeks failed to show that it acted without negligence.

Although the Court found the United States and Weeks jointly and severally liable for Contango’s damages, it apportioned 60% of the damages to the United States. The Court recognized that the Corps was aware of the dredging industry’s common practice of relying on pipeline information from the Corps. Contango was not contributorily negligent because its pipeline complied with depth requirements.
The Court assessed a total amount of damages of $2,920,528.80, including damages for repair costs, lost hydrocarbons, deferred production, prejudgment interest, and postjudgment interest.


In **Trident,** the Amarillo Court of Appeals (1) rejected mandamus relief for a trial court’s denial of a Rule 12 motion; but (2) granted mandamus relief for the trial court’s *sua sponte* striking of an amended answer.

An oil company, Mewbourne Oil Company (“Mewbourne”), sued a well casing supplier, Trident Steel Corporation (“Trident”), for damages resulting from defective well casing inserted into a well that Mewbourne operated. Initially, Mewbourne was the only plaintiff. Approximately four years into the lawsuit, however, Mewbourne filed a second amended petition claiming that it was the plaintiff “individually and as representative of the affected leasehold interests.”

In response to Mewbourne’s second amended petition, Trident sought and obtained leave of the trial court to file a fifth amended answer. In that answer, Trident asserted, for the first time, that limitations had expired on any claims of the “leasehold interests” that Mewbourne claimed to represent and that Mewbourne lacked standing and the capacity to represent or recover on those interests’ behalf. Trident also filed a motion under Texas Rule of Civil Procedure 12 to have Mewbourne show its authority to represent the “leasehold interests.”

Trident moved for summary judgment on its limitations defense asserted in its fifth amended answer. The trial court, however, denied the motion and also *sua sponte* struck the amended answer without explanation. It also denied Trident’s Rule 12 motion. Trident filed a petition for writ of mandamus, arguing that the trial court abused its discretion in striking Trident’s fifth amended answer *sua sponte* and denying Trident’s Rule 12 motion.

The Amarillo Court of Appeals refused mandamus for the denial of the Rule 12 motion. Mandamus will issue only when (1) a clear abuse of discretion or violation of a duty imposed by law has occurred; and (2) the petitioner lacks an adequate remedy at law. Because appeal could adequately remedy the trial court’s order denying the Rule 12 motion, mandamus was not available for such an order.

But the Court of Appeals granted mandamus relief vacating the trial court’s order striking Trident’s fifth amended answer. The Court held that the trial court abused its discretion in *sua sponte* striking the fifth amended answer. The Court approved the policy allowing liberal amendments to pleadings. It emphasized the fact that Trident sought and obtained the trial court’s approval to file the amended answer. It also noted that the trial court simply struck the answer without explanation and without allowing any argument. And by doing so, the trial court forced Trident to waive its defenses asserted for the first time in that amended answer.

The Court of Appeals further found that appeal was not an adequate remedy. An appeal is inadequate when parties risk losing substantial rights, such as the ability to present a defense or make the error part of the appellate record. Trident could not
perfect for appellate review its defenses asserted for the first time in its amended answer because the trial court struck it. Defenses must appear in a live pleading or they are waived.

The Court of Appeals awarded Trident mandamus relief and directed the trial court to vacate its order striking Trident’s fifth amended answer.


In *Benavides*, the San Antonio Court of Appeals held that a husband’s royalty distributions from a trust containing oil, gas, and other mineral interests were the husband’s separate property.

The *Benavides* Family Mineral Trust (the “Trust”) was created years before the marriage between the plaintiff, Leticia Benavides (the “Wife”), and Carlos Y. Benavides, Jr. (the “Husband”). The Husband is one of the Trust’s beneficiaries and receives monthly royalty payments from the Trust.

After a court appointed the defendant as the Husband’s temporary guardian (the “Guardian”), the Guardian notified the Trust’s co-trustees of her appointment and demanded that all Trust distributions be made to her. The Wife’s counsel demanded that the co-trustees and later the Guardian deliver to the Wife one-half of all distributions owed to the Husband, claiming that Trust distributions were community property. After the co-trustees and the Guardian refused, the Wife sued the Guardian. The Guardian moved for summary judgment, arguing that the Trust distributions are the Husband’s separate property and that the Wife has no ownership interest in the distributions. The trial court granted the Guardian motion, and the Wife appealed.

The San Antonio Court of Appeals addressed the single controlling issue—whether the Trust distributions to the Husband are separate or community property. Separate property is property owned or claimed by the spouse before marriage, acquired by the spouse during marriage by gift, devise, or descent, or recovered for personal injuries suffered by the spouse during marriage. Community property is property, other than separate property, acquired by either spouse during marriage.

Distributions from testamentary or inter vivos trusts to married recipients who have no right to the trust corpus are the recipient’s separate property because those distributions are received by gift or devise. So income distributions from an irrevocable trust made during marriage are community property only if the recipient has a present possessory right to part of the corpus.

The Court of Appeals held that the Trust was irrevocable because the Trust document expressly stated exactly that. The mere ability to amend the Trust did not make it revocable.

The Wife argued that the Husband had a present, possessory right to the Trust corpus because he receives a portion of the corpus, has the right to transfer his interest, and will receive his share of the corpus upon the Trust’s termination. But the Court rejected each of these arguments. First, the Trust document expressly defined the royalty payments that the Husband received as income of the Trust and not corpus. Second, the Court noted that the Husband had only a limited ability to transfer his
interest to certain persons, and the transfer would be subject to all Trust restrictions. Such a limited transfer right does not indicate any present, possessory right to the Trust corpus. Third, the Husband had no right to receive all the corpus upon the Trust’s termination because the Trust document specified that the Trust would not terminate until long after the Husband’s death.

The Court of Appeals concluded that the Trust distributions to the Husband were his separate property. The Wife therefore had no interest in them. The Court affirmed summary judgment for the Guardian.


In this case, the Tyler Court of Appeals held that an area-of-mutual-interest provision ("AMI") in a joint operating agreement did not govern overriding royalty interests because the joint operating agreement’s AMI conflicted with a controlling and nonapplicable AMI in a simultaneously executed purchase agreement.

An owner of working interests in certain oil and gas leases, XH, LLC ("XH"), sought to enforce a joint operating agreement’s AMI against an owner of overriding royalty interests in those leases, Cabot Oil & Gas Corp. ("Cabot"). The joint operating agreement’s AMI required that, when any party acquired "any oil and/or gas interest[,]" the nonacquiring party “shall have the right to acquire [its] proportionate interest therein....” XH’s and Cabot’s predecessors also executed, simultaneously with the joint operating agreement, a purchase agreement for the working interests and the reserved overriding royalty interests. The purchase agreement contained an AMI providing that “[a]ll leases subsequently acquired by either party” will be subject to the joint operating agreement’s AMI. But the joint operating agreement stipulated that, in the event of any conflict between its provisions and the purchase agreement’s provisions, the purchase agreement would prevail and control.

After Cabot purchased the overriding royalty interests, it conveyed a portion of the interests to third parties. XH sought to enforce the joint operating agreement’s AMI against Cabot and the third parties. Cabot then sued XH, seeking, in part, a declaratory judgment that it is not required to offer to XH the opportunity to purchase its proportionate share of the overriding royalty interests. XH counterclaimed to enforce the joint operating agreement’s AMI. After both parties moved for summary judgment, the trial court granted Cabot’s motion for summary judgment as to the AMIs and denied XH’s motion for summary judgment. XH appealed.

The Tyler Court of Appeals found that the joint operating agreement’s AMI conflicted with the purchase agreement’s AMI, and therefore the purchase agreement controlled. The Court recognized that the purchase agreement’s AMI “plainly limits its scope to subsequently acquired leases.” But the joint operating agreement’s AMI encompasses many more interests, such as “any oil and/or gas interest, oil and gas leases, or other control rights that allow the participation for oil and/or gas.” Finding that nothing in the purchase agreement or the joint operating agreement indicated that either’s AMI was intended to supplement the other’s AMI, the Court held that a conflict existed with the two AMIs. Because the joint operating agreement made
the purchase agreement controlling if a conflict existed between the two, the purchase agreement's AMI governed. Therefore, the purchase agreement's narrow AMI—applicable only to subsequently acquired leases—did not affect Cabot's overriding royalty interests.

The Court further found that, even if the two AMIs did not conflict, the result would be the same. The joint operating agreement provides that its AMI does not apply to any acquisition of an interest that, prior to and at the time of its acquisition, was subject to the joint operating agreement. The Court looked principally to one of the joint operating agreement's provisions that defined overriding royalty interests as subsequently created interests, specified the parties' obligations when any party acquired such interests, and made another provision enforceable against such interests. Via those provisions in the joint operating agreement, Cabot's overriding royalty interests were "subject to" the joint operating agreement and therefore excluded from the joint operating agreement's AMI.

The Court affirmed the trial court's judgment.


In *Hyder*, the San Antonio Court of Appeals affirmed the trial court's judgment against lessees, Chesapeake Exploration, L.L.C. and Chesapeake Operating, Inc. (together, "Lessees"), for impermissibly deducting post-production costs from royalties.

For wells on the leased premises, the lease at issue required Lessees to pay royalties based on the "market value at the well" of oil and other liquid hydrocarbons. The lease further stated that the royalty "shall be free and clear of all production and post-production costs and expenses ...incurred between the wellhead and [the Lessees'] point of delivery or sale of such share to a third party.” And the holding in *Heritage Resources, Inc. v. Nationsbank* 1 "shall have no application to the terms and provisions of this Lease.” In *Heritage*, the Texas Supreme Court held that a lease’s prohibition on post-production cost deductions from royalty was “mere surplusage” because the lessor’s royalty was the market value of the gas at the well and therefore required post-production cost deductions from the downstream point of sale to calculate the gas’s market value at the well. The Court of Appeals held that the lease’s “free and clear” provision, combined with its provision rejecting *Heritage’s* application, excluded all post-production costs incurred between the point of delivery of the oil and the downstream point of sale.

The lease’s overriding royalty clause applied to royalties for wells located off the leased premises. That clause required a "cost-free...overriding royalty..." for production from the off-lease wells. The Court rejected the Lessees’ argument that "cost-free” merely reiterated Texas law that overriding royalty is free of production costs and therefore allowed post-production cost deductions. Recognizing that overriding royalty is free of production costs unless the parties agree otherwise, the Court reasoned that interpreting "cost-free" as prohibiting only production costs would render that term meaningless. Therefore, the overriding royalty clause barred post-production cost deductions from overriding royalty.

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1 *939 S.W.2d 118 (Tex. 1996).*
The royalty owners cross-appealed two issues, both of which the Court overruled. First, the royalty owners challenged the trial court’s ruling that the Lessees do not owe royalty on gas lost and unaccounted for. Gas lost and unaccounted for is gas lost between the wellhead and the point of sale. But the lease’s royalty clause bases royalty on a percentage of the price actually received. So the payment-measuring point is the amount of gas that is actually sold. Further, no royalty is owed on gas produced but not sold or used. Because gas is “used” only when it is delivered or consumed, gas that is merely produced and then lost is not used or sold.

Second, the royalty owners also claimed that the trial court should have applied the lease’s one-percent-per-month interest rate instead of the statutory five percent annual rate to their overriding royalty damages. But under the lease, the one-percent-per-month interest rate applies only to late royalties for wells located on the leased premises. The overriding royalty clause applies to off-lease wells and contains no interest rate for late overriding royalties. Therefore, the trial court correctly applied a statutory five percent rate to the overriding royalty damages.

The Court of Appeals affirmed the trial court’s judgment awarding the royalty owners damages for breach of the royalty and overriding royalty clauses, attorney’s fees, and interest.


In *Freestone*, the Texarkana Court of Appeals held that, for an action involving both a mineral lease and a real property lease, mandatory venue lies in the county in which the leased property is located.

Under the lease at issue, Freestone Underground Storage, Inc. (“Freestone”) leased a tract of land in Freestone County, Texas to Cavern Disposal, Inc. (“Cavern”). The lease granted Cavern, among other things, the right to use a saltwater disposal well on the premises and underground salt caverns, use parts of the surface of the leased premises, and maintain its office in the mobile home located on the premises. The lease was effective for a primary term and contained renewal provisions.

After Freestone claimed that Cavern had not followed the required steps to renew the lease, Cavern filed a declaratory judgment action in Panola County, Texas seeking a determination that it had complied with the lease provisions. The trial court denied Freestone’s motion to transfer venue to Freestone County. Freestone then filed a writ of mandamus, arguing that mandatory venue lies in Freestone County—the leased property’s location—under Texas Civil Practice and Remedies Code § 15.011 or § 15.0115.

Mandamus relief is the proper remedy to enforce a mandatory venue provision under Texas Civil Practice and Remedies Code § 15.0642. Under that statute, inadequacy of an appellate remedy is not necessary to warrant mandamus relief. The Court also dismissed Cavern’s contention that Freestone had waived its claim of mandatory venue under § 15.0115. Freestone’s numerous references to § 15.0115 and cited authority and arguments related to that statute preserved any error related to its application.
The Court of Appeals first analyzed the essence of the declaratory judgment action so that it could then determine what venue statute applied. Cavern sought a declaratory judgment that it had complied with the lease provisions and renewed the lease. Freestone filed a counterclaim seeking to remove an encumbrance on title. Both claims therefore depended on whether the lease had terminated.

The lease contained features of both a mineral lease—which granted the lessee a fee simple determinable interest in the minerals subject to the possibility of reverter in the lessor—and a traditional lease of real property. Specifically, the lease granted Cavern mineral rights in the salt caverns and surface use. So either § 15.011—the mandatory venue statute for actions concerning an interest in real property—or § 15.0115—the mandatory venue statute for actions involving disputes between landlords and tenants—would apply.

The Court found it unnecessary, however, to decide which mandatory venue statute applied because both would bear the same result—transfer of venue to Freestone County. If the lease was a mineral lease, then the lease’s termination would result in the transfer of a fee in realty. So a termination of the mineral lease would concern the quieting of title or the recovery of real property and therefore would implicate § 15.011, requiring transfer to the county where the minerals are located. If the lease was not a mineral lease, then the dispute would center on a conflict between a landlord and tenant over the lease terms. Although “landlord” and “tenant” are not defined in Chapter 15 of the Texas Civil Practice and Remedies Code, the Court of Appeals gave those terms their common definitions and determined that Freestone and Cavern were landlord and tenant.

Section 15.0115 would require transfer to the same county as § 15.011—the county of the leased property’s location.

The Court of Appeals conditionally granted the writ of mandamus and directed the trial court to transfer venue to Freestone County, Texas.