

OIL, GAS & ENERGY RESOURCE LAW SECTION

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**OIL AND GAS
PATTERN JURY
QUESTIONS AND INSTRUCTIONS
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**Sponsored and administered by the Oil, Gas & Energy Resource Law Section
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1. INTRODUCTION TO OIL AND GAS PATTERN JURY CHARGES

1.a. Purpose of Publication

The Council of the Oil, Gas and Energy Resource Law Section envisions this project to assist the bench and bar in preparing the court's charge in oil and gas cases that are commonly dealt with, such as the following:

- Adverse possession of the mineral estate;
- Breach of express and implied covenants in oil and gas leases;
- Oil and gas lease termination;
- Breach of a farmout agreement;
- Breach of an operating agreement;
- Breach of a preferential right to purchase agreement; and
- Breach of an area of mutual interest agreement.

This volume contains questions, instructions, definitions, and comments pertaining to claims, damages and defenses. There are obviously many other areas of and issues in oil and gas litigation that are not covered, but the Council selected these topics because they are the most frequently encountered.

1.b. Scope of Pattern Charges

The infinite combinations of possible facts in oil and gas cases, and the importance of the specific language of the instruments involved, obviously make it impossible for the Council to offer questions suitable for every dispute. The Council has tried to prepare charges to serve as guides for the usual litigation encountered in these types of cases. However, a charge should conform to the pleadings and evidence of a case, and occasions will often arise for the use of questions and instructions not specifically addressed here. Particular attention must be given to the language of leases, joint operating agreements, farmouts, and other agreements upon which the claims and defenses of the parties are based, and existing precedents must be compared to see if substantially similar language makes those precedents applicable.

1.c. Use of Accepted Precedents

Like other pattern jury charge committees, the Council has avoided recommending changes in the law, and instead has based this material on what it perceives the present law to be. In some areas it has attempted to foresee theories and objections that might be made in a variety of circumstances, but not to express favor or disfavor for particular positions. In unsettled areas, the Council generally has not taken a position on the exact form of charge. However, guidelines and discussion have been provided in some areas in which there is no definitive authority to assist trial judges and lawyers in crafting more suitable questions and instructions in those areas.

Of course, they will recognize that these recommendations may be affected by future appellate decisions and statutory changes.

1.d. Principles of Style

a. *Preference for broad-form questions.* TEX. R. CIV. P. 227 provides that “the court shall, whenever feasible, submit the cause upon broad-form questions.” In this regard, see *Bargsley v. Pryor Petroleum Corp.*, 196 S.W.3d 823 (Tex. App.-Eastland, 2006, no writ). Accordingly, the basic questions are designed to be accompanied with one or more instructions. See *Texas Dep't of Human Services v. E.B.*, 802 S.W.2d 647 (Tex. 1990). The Council cautions that a broad-form issue is often inappropriate, for example when multiple claims are involved in the case, e.g., royalty claims under a number of leases that contain different royalty clauses. For guidance in the proper form of question, the practitioner should refer to *Crown Life Ins. Co. v. Casteel*, 22 S.W.3d 378 (Tex. 2000) and *Harris County v. Smith*, 96 S.W.3d 230 (Tex. 2002).

b. *Simplicity.* The Council has sought to be as brief as possible and to use language that is simple and easy to understand.

c. *Definitions and instructions.* The supreme court has disapproved the practice of embellishing standard definitions and instructions, *Lemos v. Montez*, 680 S.W.2d 798 (Tex. 1984), or of adding unnecessary instructions, *First Int'l Bank v. Roper Corp.*, 686 S.W.2d 602 (Tex. 1985). The Council has endeavored to adhere to standard definitions and instructions stated in general terms rather than terms of the particular parties and facts of the case. If an instruction in general terms would be unduly complicated and confusing, however, reference to specific parties and facts is suggested.

d. *Placement of definitions and instructions in the charges.* Definitions and instructions that apply to a number of questions should be given immediately after the general instructions required by TEX. R. CIV. P. 266a. See *Woods v. Crane Carrier Co.*, 693 S.W.2d 377 (Tex. 1985). However, if a definition or instruction applies to only one question or cluster of questions (e.g., damages questions), it should be placed with that question or cluster. Specific guidance for placement of definitions and instructions can be found in the individual PJCs and comments.

e. *Burden of proof* As is authorized by TEX. R. CIV. P. 277, it is recommended that the burden of proof be placed by instruction rather than by inclusion in each question. In this regard, see *Bargsley v. Pryor Petroleum Corp.*, 196 S.W.3d 823 (Tex. App.-Eastland 2006, no writ). When the burden is placed by instruction, it is not necessary that each question begin: “Do you find from a preponderance of the evidence that.” The admonitory instructions contain the following instruction, applicable to all questions:

Answer “Yes” or “No” to all questions unless otherwise instructed. A “Yes” answer must be based on a preponderance of the evidence unless otherwise instructed. If you do not find that a preponderance of the evidence supports a “Yes” answer, then answer “No.” The term “preponderance of the evidence” means the greater weight and degree of credible testimony or evidence introduced before you and admitted in this case. Whenever a question requires an answer

other than “Yes” or “No,” your answer must be based on a preponderance of the evidence unless otherwise instructed.

1.e. Comments and Citations of Authority

The comments provide a ready reference to the law that serves as a foundation for the charge. The primary authority cited is Texas case law. In some instances, secondary authority for example, Restatement (Second) of Contracts - is also cited. The Council wishes to emphasize that secondary authority is cited solely as additional guidance to the reader and not as legal authority for the proposition stated. Some comments also include variations of the recommended forms and additional questions or instructions for special circumstances.

1.f. Using the Pattern Charges

Matters on which the evidence is undisputed should not be submitted as no dispute as to any fact exists, by either instruction or question. Conversely, questions, instructions, and definitions not included in this volume may sometimes become necessary. Finally, preparation of a proper charge obviously requires careful legal analysis and sound judgment.

1.g. Future Revisions

The contents of questions, instructions, and definitions in the jury questions depend on the underlying substantive law relevant to the case. Accordingly, these proposed jury questions may need to be amended from time to time to reflect changes, refinements or pronouncements of relevant law. In any event, the practitioner should be familiar with the law pertaining to his/her issues and how that law relates to the specific facts of the case, and should draft appropriate jury questions and instructions to recognize those realities. Comments, criticisms, and suggestions are solicited, and will be used by a standing Committee of the Council. These should be directed to the website www.oilgas.org.

1.h. Other Sources

For commentary on substantive oil and gas law, the practitioner is invited to explore the Oil, Gas and Energy Resources Law Section website at www.oilgas.org, which includes an index by author and topic of articles presented at various continuing legal education seminars focusing on oil, gas and energy law.

2. ADVERSE POSSESSION

2.a. Comment on Adverse Possession

The purpose of adverse possession statutes is to settle land titles. *Republic Nat'l Bank v. Stetson*, 390 S.W.2d 257, 262 (Tex. 1965). Adverse possession statutes apply to the recovery of fee simple title to real property, including the minerals underlying the land, unless there has been a severance of the surface and mineral estates before the adverse possession commences. *Barfield v. Holland*, 844 S.W.2d 759, 767 (Tex. App.-Tyler 1992, writ denied); *Carminati v. Fenoglio*, 267 S.W.2d 449, 453 (Tex. App.-Fort Worth 1954, writ ref'd n.r.e.). Adverse possession claims are most commonly made with respect to the entire fee interest based on

possession and use of the surface. Therefore, the practitioner and court may encounter some conceptual difficulties in applying these statutes to mineral interests. However, it is clear that once severed, the mineral estate may be acquired separately by adverse possession of the mineral estate, but not by adverse possession of the surface estate. *Natural Gas Pipeline Co. of America v. Pool*, 124 S.W.3d 188,192-93 (Tex. 2003); *Theford v. Union Oil Co. of Cal.*, 3 S.W.3d 609 (Tex. App.-Dallas 1999, pet. denied); *Barfield v. Holland, supra*; *Watkins v. Certain-Teed Products Corp.*, 231 S.W.2d 981, 985 (Tex. Civ. App.-Amarillo 1950, no writ).

While most statutes of limitation are merely defensive in nature, statutes of limitation applicable to actions for recovery of real property function to vest title in the party establishing the required elements. Accordingly, there may be times when it is the plaintiff, not the defendant, raising adverse possession to establish title.

Generally, the party seeking to establish title by adverse possession must enter the land adversely, i.e., without permission or consent of the owner of record title, must occupy the land under a claim of right that is inconsistent with and hostile to the claim of another, and must maintain an actual and visible appropriation of the property continuously for the specified period of time. The time periods under the adverse possession statutes vary, depending on the nature of the claim and the indicia of title in the adverse possessor. For example, only three years of adverse possession is required for a party claiming under title or color of title, whereas periods of 10 to 25 years are required for a trespasser. Adverse possession claims may be brought as a statutory trespass to try title action, which provides a legal remedy, or as an action to quiet title or to remove a cloud on title, which is an equitable action.

Where there has been a severance of the surface and mineral estates, the minerals can be adversely possessed only by drilling and production operations for the statutory period of time. *Natural Gas Pipeline Co. of America v. Pool*, 124 S.W.3d at 193; *Sun Operating Ltd. Partnership v. Oatman*, 911 S.W.2d 749, 757 (Tex. App.-Amarillo 1995, writ denied); *Webb v. British American Oil Producing Co.*, 281 S.W.2d 726,734 (Tex. Civ. App.-Eastland 1955, writ refd n.r.e.); *Barfield v. Holland, supra*. After a severance of the surface and mineral estates, the surface owner's possession of the surface is not adverse to the owner of the mineral estate. *Grissom v. Anderson*, 79 S.W.2d 619,621 (Tex. 1935).

The task of counsel and the court in the submission of jury questions on adverse possession is aided by the fact that the required elements are specified in the various adverse possession statutes, and the relevant terms are defined.

The three-year statute, TEX. CIV. PRAC. & REM. CODE § 16.024, requires a person to bring an action to recover real property held by another in peaceful and adverse possession under title or color of title not later than three years from the date the cause of action accrues.

The five-year statute, TEX. CIV. PRAC. & REM. CODE § 16.025, requires a person to bring an action within five years to recover real property held in peaceful and adverse possession by another who (1) cultivates, uses, or enjoys the property, (2) pays applicable taxes on the property, and (3) claims the property under a duly recorded deed.

The ten-year statute, TEX. CIV. PRAC. & REM. CODE § 16.026, requires a person to bring an action within ten years to recover real property held in peaceful and adverse possession by another who cultivates, uses, or enjoys the property.

The basic twenty-five year statute, TEX. CIV. PRAC. & REM. CODE § 16.027, provides that a person, regardless of whether the person is or has been under a legal disability, must bring an action within twenty-five years to recover real property held in peaceful and adverse possession by another who cultivates, uses, or enjoys the property.

The other twenty-five year statute, TEX. CIV. PRAC. & REM. CODE § 16.028, provides that a person, whether or not that person is or has been under a legal disability, may not maintain an action to recover real property held for twenty-five years in peaceful and adverse possession by one who holds the property in good faith under a deed or other recorded instrument purporting to convey the property, even if the instrument is *void*.

One issue that often arises in adverse possession cases is the necessity of notice of repudiation of a prior permissive occupancy to commence adverse possession. Notice of repudiation has been required as a prerequisite to adverse possession in cases in which the prior relationship has been considered in law a permissive entry or tenancy. See, e.g., *Kidd v. Young*, 190 S.W.2d 65, 66 (Tex. 1945) (grantor who remains in possession of land after conveying it), and *Sweeten v. Park*, 276 S.W.2d 794, 797 (Tex. 1955) (party who holds over after a consent judgment divesting the possessor of his interest).

Possession of the mineral estate under an oil, gas and mineral lease has also been held to constitute a permissive entry consistent with the lessor's title, thus requiring notice of repudiation of the prior permissive relationship for the lessee's possession to become adverse after the termination of the lease. *Natural Gas Pipeline Co. of America v. Pool*, 124 S.W.3d at 194; *Killough v. Hinds*, 338 S.W.2d 707 (Tex. 1960); *Hunt Oil Co. v. Moore*, 656 S.W.2d 634 (Tex. App.- Tyler 1983, writ ref'd n.r.e.); but see *St. Louis Royalty v. Continental Oil Co.*, 193 F.2d 778 (5th Cir. 1952) (notice of repudiation to the landowner by a former lessee under a terminated oil and gas lease not required).

In some circumstances, notice of repudiation may be inferred *Natural Gas Pipeline Co. of America v. Pool*, 124 S.W.3d at 194. See also *Glover v. Union Pacific Railroad Co.*, 187 S.W.3d 201 (Tex. App.-Texarkana 2006). In *Tex-Wis Co. v. Johnson*, 534 S.W.2d 895 (Tex. 1976), the Texas Supreme Court held that "the jury may infer that notice of repudiation has been brought home to the titleholder where there has been (1) long-continued possession under claim of ownership and (2) nonassertion of claim by the titleholder." 534 S.W.2d at 901. The court held the period of adverse possession that should be considered in determining whether the possession is long enough to constitute notice of an adverse claim (which the court referred to as "the crucial time") is the period of possession prior to the commencement of the applicable limitations period. *Id.* at 901-902. The court also held that the required length of the "crucial time" for determining "long-continued possession" depended on the circumstances of the case. *Id.* at 902. The court held that the acts of living, farming, and raising livestock on the land constituted sufficient evidence from which the jury could have inferred that the titleholder had notice of repudiation of the tenancy, even though the nature of those acts was no different before and after the permissive occupancy of the land ended. *Id.* at 902. In *Natural Gas Pipeline Co. of*

America v. Pool, supra at 198, the supreme court held that continued occupation of the leased premises and production of minerals after the alleged termination of the oil and gas lease was hostile as a matter of law.

If the jury finds favorably to the proponent of an adverse possession claim, then the remedy should include a judgment vesting title to the interest that has been possessed adversely. If the dispute is between two competing landowners, the judgment will vest title to the entire fee simple estate in the land in question. If, however, the dispute involves an oil and gas lease that has allegedly terminated, and the lessee claims the mineral estate by adverse possession, the judgment vests title to the prevailing party as follows: if the lessee prevails, title to the oil and gas leasehold estate that it claimed under, which would still be subject to the royalty interest, would vest in the lessee. *Id.* at 199. If the landowner prevails, title to the minerals reverts to and vests in that landowner.

2.b. Adverse Possession Question - Three-Year Limitation Period

Did Defendant hold the land in question in peaceable and adverse possession under title or color of title for a period of three years?

You are instructed that “adverse possession” means an actual and visible appropriation of property, commenced and continued under a claim of right that is inconsistent with and hostile to the claim of another person.

You are instructed that “peaceable possession” means possession of real property that is continuous and is not interrupted by an adverse suit to recover the property.

You are instructed that “title” means a regular chain of transfers of real property from or under the sovereignty of the soil.

You are instructed that “color of title” means a consecutive chain of transfers to the person in possession that:

(A) is not regular because of a muniment that is not properly recorded or is only in writing or because of a similar defect that does not want of intrinsic fairness or honesty; or

(B) is based on a certificate of headright, land wan-ant, or land scrip.

Answer “Yes” or “No.”

Answer: _____

Source: TEX. CIV. PRAC. & REM. CODE §16.024. Submission of elements of defense in one question is proper. *Pinchback v. Hockless*, 158 S.W.2d 997, 1003 (Tex. 1942); *Davis v. Dowlen*, 136 S.W.2d 900, 905 (Tex. Civ. App.-Beaumont 1939, writ dismissed judgment corrected). The entire time period over which adverse possession is claimed should be submitted in a single question. *Pinchback*, 158 S.W.2d at 1002.

Comment: Where the dispute is between a lessor and lessee, as opposed to competing landowners, the “lease in question” may be preferable to the “land in question.”

2.c. Adverse Possession Question - Five-Year Limitation Period

Did Defendant hold the land in question in peaceable and adverse possession for a period of five years?

You are instructed that “adverse possession” means an actual and visible appropriation of property, commenced and continued under a claim of right that is inconsistent with and hostile to the claim of another person.

You are instructed that “peaceable possession” means possession of real property that is continuous and is not interrupted by an adverse suit to recover the property.

You are instructed that to establish adverse possession, the possession must have been by a person who:

- (1) cultivates, uses, or enjoys the property;
- (2) pays applicable taxes on the property; and
- (3) claims the property under a duly registered deed.

Answer “Yes” or “No.”

Answer: _____.

Source: TEX. CIV. PRAC. & REM. CODE §16.025. Submission of elements of defense in one question is proper. *Pinchback v. Hockless*, 158 S.W.2d 997, 1003 (Tex. 1942); *Davis v. Dowlen*, 136 S.W.2d 900, 905 (Tex. Civ. App.-Beaumont 1939, writ dismissed, judgment corrected). The entire time period over which adverse possession is claimed should be submitted in a single question. *Pinchback*, 158 S.W.2d at 1002.

Comment: If the dispute concerns property on which a producing oil and gas well is located, the manner in which the “applicable taxes,” *i.e.*, ad valorem taxes, have been paid bears close scrutiny.

2.d. Adverse Possession Question Ten-Year Limitation Period

Did Defendant hold the land in question in peaceable and adverse possession for a period of ten years?

You are instructed that “adverse possession” means an actual and visible appropriation of property, commenced and continued under a claim of right that is inconsistent with and hostile to the claim of another person.

You are instructed that “peaceable possession” means possession of real property that is continuous and is not interrupted by an adverse suit to recover the property.

You are instructed that to establish adverse possession, the possession must have been by a person who cultivates, uses, or enjoys the property.

Answer “Yes” or “No.”

Answer:

Source: TEX. CIV. PRAC. & REM. CODE §16.026. Submission of elements of defense in one question is proper. *Pinchback v. Hockless*, 158 S.W.2d 997, 1003 (Tex. 1942); *Davis v. Dowlen*, 136 S.W.2d 900, 905 (Tex. Civ. App.-Beaumont 1939, writ dismiss. judgment corrected). The entire time period over which adverse possession is claimed should be submitted in a single question. *Pinchback*, 158 S.W.2d at 1002.

Comment: Under TEX. CIV. PRAC. & REM. CODE §16.026 (b), peaceable and adverse possession under this section without a title instrument is limited to 160 acres, including improvements, unless the number of acres actually enclosed exceeds 160, in which case the peaceable and adverse possession extends to the real property actually enclosed. If there is conflicting evidence as to the amount of acreage enclosed, an additional question requiring the jury to find the amount of acreage actually enclosed may be required. In a case involving fenced acreage, one or more of the additional instructions may be required under TEX. CIV. PRAC. & REM. CODE §16.031 or §16.032.

You are instructed that a tract of land that is owned by one person and that is entirely surrounded by land owned, claimed, or fenced by another is not considered enclosed by a fence that encloses any part of the surrounding land.

You are instructed that possession of the interior tract by the owner or claimant of the surrounding land is not peaceable and adverse possession unless:

- (1) the interior tract is separated from the surrounding land by a fence; or
- (2) at least one-tenth of the interior land is cultivated and used for agricultural purposes or is used for manufacturing purposes.

You are instructed that possession of land that belongs to another by a person owning or claiming 5,000 or more fenced acres that adjoin the land is not peaceable and adverse unless:

- (1) the land is separated from the adjacent enclosed tract by a substantial fence;
- (2) at least one-tenth of the land is cultivated and used for agricultural purposes or used for manufacturing purposes; or
- (3) there is actual possession of the land.

Answer “Yes” or “No.”

Answer: _____

2.e. Adverse Possession Question – Twenty-Five Year Limitation Period

Did Defendant hold the land in question in peaceable and adverse possession for a period of twenty-five years?

You are instructed that "adverse possession" means an actual and visible appropriation of property, commenced and continued under a claim of right that is inconsistent with and hostile to the claim of another person.

You are instructed that "peaceable possession" means possession of real property that is continuous and is not interrupted by an adverse suit to recover the property.

You are instructed that to establish adverse possession, the possession must have been by a person who cultivates, uses, or enjoys the property.

Answer "Yes" or "No."

Answer:

Source: TEX. CIV. PRAC. & REM. CODE §16.027. Submission of elements of defense in one question is proper. *Pinchback v. Hockless*, 158 S.W.2d 997, 1003 (Tex. 1942); *Davis v. Dowlen*, 136 S.W.2d 900, 905 (Tex. Civ. App.-Beaumont 1939, writ dismissed, judgment corrected). The entire time period over which adverse possession is claimed should be submitted in a single question. *Pinchback*, 158 S.W.2d at 1002.

Comment: Use this question when party is claiming adverse possession by cultivation use or enjoyment of the property.

2.f. Adverse Possession Question – Twenty-Five Year Limitation Period

Did Defendant hold the land in question in peaceable and adverse possession for a period of twenty-five years?

You are instructed that "adverse possession" means an actual and visible appropriation of property, commenced and continued under a claim of right that is inconsistent with and hostile to the claim of another person.

You are instructed that "peaceable possession" means possession of real property that is continuous and is not interrupted by an adverse suit to recover the property.

You are instructed that to establish adverse possession, the possession must have been by a person who holds the property in good faith and under a deed or other instrument purporting to convey the property that is recorded in the deed records of the county where any part of the property is located.

Answer "Yes" or "No."

Answer: _____

Source: TEX. CIV. PRAC. & REM. CODE §16.028. Submission of elements of defense in one question is proper. *Pinchback v. Hockless*, 158 S.W.2d 997, 1003 (Tex. 1942); *Davis v. Dowlen*, 136 S.W.2d 900, 905 (Tex. Civ. App.-Beaumont 1939, writ dism. judgm. cor.). The entire time period over which adverse possession is claimed should be submitted in a single question. *Pinchback*, 158 S.W.2d at 1002.

Comment: Use this question when the party claiming adverse possession holds the property in good faith under a deed or other recorded instrument purporting to convey the property, even if the instrument is void.

3. TRESPASS AND INJURIES TO REAL PROPERTY

3.a. Comment on Damages to Real Property

Recovery for both permanent and temporary injuries to land is not permitted by Texas law. Temporary and permanent injuries are mutually exclusive, and damages for both may not be recovered in the same action. *Schneider Nat'l Carriers, Inc. v. Bates*, 147 S.W.3d 264, 276 (Tex. 2004); *Kraft v. Langford*, 565 S.W.2d 223, 227 (Tex. 1978); *Atlas Chem. Indust., Inc. v. Anderson*, 524 S.W.2d 681, 684 (Tex. 1975). Whether damage to land is permanent or temporary depends on the frequency of the injury:

[A] nuisance should be deemed temporary only if it is so irregular or intermittent over the period leading up to the suit that future injury cannot be estimated with reasonable centrality [sic].¹ Conversely, a nuisance should be deemed permanent if it is sufficiently constant or regular (no matter how long between occurrences) that future impact can be reasonably evaluated. Jurors should be asked to settle the question only to the extent there is a dispute regarding what interference has occurred or whether it is likely to continue.

Schneider Nat'l Carriers, Inc. v. Bates, 147 S.W.3d at 281. Therefore, when the permanent or temporary character of the injury is not established as a matter of law, a question concerning the factors identified by the supreme court in *Schneider Nat'l Carriers, Inc. v. Bates* may need to be submitted, followed by an appropriate permanent or temporary damage question, conditioned on the answer to the question regarding the character of the damage as permanent or temporary.

In *Schneider Nat'l Carriers, Inc. v. Bates*, the supreme court also resolved a troublesome question of nuisance law by holding:

[A] permanent nuisance may be established by showing that either the plaintiff's injuries or the defendant's operations are permanent. The presumption of a connection between the two can be rebutted by evidence that defendant's noxious operations cause injury only under circumstances so rare that, even when they occur, it remains uncertain whether or to what degree they may ever occur again.

Id. at 283.

¹ The word "certainty" in the report in the Texas Supreme Court Journal.

In actions for permanent damage to real property, a party may recover damages for the diminution in the market value of the property. *Bay Petroleum Corp. v. Crumpler*, 372 S.W.2d 318, 320 (Tex. 1963). *See also Mieth v. Ranchquest, Inc.*, 177 S.W.3d 296 (Tex. App.-Houston [1st Dist.] 2005). Damages for permanent injury, measured by the diminution in value, “comprehends and includes loss of use and enjoyment.” *Vestal v. Gulf Oil Corp.*, 235 S.W.2d 440, 442 (Tex. 1951). When the injury is temporary, the measure of damages may include recovery for loss of use and enjoyment, and cost of repair. *Id.*; *Hall v. Robbins*, 790 S.W.2d 417 (Tex. App.-Houston [14th Dist.] 1990, no writ). Damages may also be recovered for personal injuries and damage to personal property. *City of Uvalde v. Crow*, 713 S.W.2d 154, 158-59 (Tex. App.-Texarkana 1986, writ ref’d n.r.e.).

In a nuisance action, a party may also recover damages for discomfort, inconvenience, and annoyance, regardless of whether the injury is permanent or temporary. *Vann v. Bowie Sewerage Co.*, 90 S.W.2d 561, 563 (Tex. 1936); *Community Properties, Inc. v. Neely*, 611 S.W.2d 947, 952 (Tex. Civ. App.-Tyler 1981), *rev'd on other grounds*, 639 S.W.2d 452 (Tex. 1982); *Lacy Feed Co. v. Parrish*, 517 S.W.2d 845, 851 (Tex. Civ. App.-Waco 1974, writ ref’d n.r.e.).

Under an ordinary oil and gas lease without special provisions for surface damages, the lessee is not liable for damage to the surface that is reasonable and necessary for the exploration and production of minerals. However, it may be a question of fact as to what and how much is reasonable and necessary, and any use in excess of that or that is negligent is considered a trespass. *Brown v. Lundell*, 344 S.W.2d 863 (Tex. 1961).

Finally, in surface damage cases, if actionable damage is proven that is temporary, damage then the plaintiff is entitled to recover the reasonable costs of restoring the land, but this amount is capped by the diminution of the land’s fair market value before and after the damage. If the damage is permanent, then the standard is the difference in fair market before and after. *See Mieth v. Ranchquest, Inc.*, 177 S.W.3d 296 (Tex. App.-Houston [1st Dist.] 2005, in no pet.); *see also Primrose Operating Co. v. Senn*, 161 S.W.3d 258 (Tex. App.-Eastland 2005 pet. denied).

3.b. Trespass Question – Real Property

Did Defendant commit a trespass against Plaintiff?

You are instructed that a trespass can be either by an unauthorized entry of a person upon another’s land, or by causing or permitting a thing to cross the boundary of the property.

Answer “Yes” or “No.”

Answer:

Source: *Gregg v. Delhi-Taylor Oil Corp.*, 344 S.W.2d 411 (Tex. 1961); *City of Arlington v. City of Fort Worth*, 873 S.W.2d 765 (Tex. App.-Fort Worth 1994, writ dismiss’d w.o.j.).

You are instructed that there is no trespass where the owner gives actual or apparent consent to the entry. Consent to enter property may be manifested by the owner's conduct or by

the condition of the land. Consent to enter may be implied only where the owner: (1) has actual knowledge that others have been entering the land; and (2) fails to take reasonable steps to prevent or discourage those persons from entering the land.

Source: *General Mills Restaurants, Inc. v. Texas Wings, Inc.*, 12 S.W.3d 827 (Tex. App.-Dallas 2000, no pet.).

Comment: This question is appropriate in cases involving a physical entry on property, whether by persons or by substances, and in cases involving an unauthorized entry or use, such as continued production of oil or gas after termination of a prior oil, gas and mineral lease. Actions based on other types of trespass that may arise in oil and gas cases, such as seismic trespass and fracture trespass, to the extent they are actionable, may require a modified question or instruction appropriate to the facts of the case. Regarding the viability of causes of action for geophysical and fracture trespass, see *Villarreal v. Grant Geophysical, Inc.*, 136 S.W.3d 265 (Tex. App.-San Antonio 2004, pet. denied) and *GeoViking, Inc. v. Tex-Lee Operating Co.*, 817 S.W.2d 357 (Tex. App.-Texarkana 1991, writ denied), 839 S.W.2d 797 (Tex. 1992) (per curiam). See *Mission Resources, Inc. v. Garza Energy Trust*, 166 S.W.3d 301 (Tex App.-Corpus Christi 2005, pet. filed), concluding that *GeoViking* is not correct.

Coastal Oil & Gas Corporation, et al. v. Garza Energy Trust, 268 S.W.3d 1 (Tex. 2008) held that as to frac trespass, as a matter of law, that if a frac from a well in a legal location crosses lease lines, then it is not actionable. However, the main opinion in that case does not answer whether or not such a frac from a legal location is a trespass, and also leaves open the question that would arise if a frac of a well not in a legal location crossed a lease line.

3.c. Good Faith Trespass Question

Did Defendant act in good faith in producing oil and gas from the property of Plaintiff?

You are instructed that a person acts in good faith when that person does so with an honest and reasonable belief in the superiority of that person's title.

Answer "Yes" or "No."

Answer:

Source: *Gulf Prod. Co. v. Spear*, 84 S.W.2d 452 (Tex. Comm'n App., 1935, opinion adopted); *Mayfield v. Benavides*, 693 S.W.2d 500 (Tex. App.-San Antonio 1985, writ ref'd n.r.e.).

Comment: This question is appropriate as an affirmative defense in cases involving the drilling of a well or production of minerals that are not subject to a valid oil and gas lease, e.g., because of a surveying dispute or where the lease is invalid or has terminated. Under Texas law, a good-faith trespasser who produces oil or gas is liable to the owner only for the value of the minerals removed less the drilling and operating costs. *Right of Way Oil Co. v. Gladys City Oil, Gas & Mfg. Co.*, 157 S.W. 737,740 (Tex. 1913); *Bender v. Brooks*, 127 S.W. 168 (Tex. 1910); *Hunt v. HNG Oil Co.*, 791 S.W.2d 191, 193 (Tex. App.-Corpus Christi 1990, writ denied). The good-faith trespasser who produces oil or gas is entitled to deduct its drilling and completion costs, operating expenses, transportation charges, and taxes against the value of the converted minerals.

Hunt v. HNG Oil Co., 791 S.W.2d at 194. However, if the trespasser is found not to have acted in good faith, the damages are measured by the value of the minerals produced without any such deduction.

3.d. Nuisance Question

Did Defendant maintain a nuisance that proximately caused damage to Plaintiff?

You are instructed that a nuisance is a condition that substantially interferes with the use and enjoyment of land by causing unreasonable discomfort or annoyance to persons of ordinary sensibilities attempting to use and enjoy it. A nuisance may result from:

- (1) a negligent invasion of another's interests;
- (2) an intentional invasion of another's interests; or
- (3) other conduct which is culpable because it is abnormal and out of place with its surroundings that invades another's interests.

You are instructed that a nuisance may occur in one of three different ways: (1) physical harm to the property, such as encroachment of a damaging substance or by the property's destruction; (2) physical harm to a person on his or her property, such as by an assault to his or her senses or by other personal injury; or (3) emotional harm to a person from the deprivation of the enjoyment of his or her property, such as by fear, apprehension, offense, or loss of peace of mind.

Answer "Yes" or "No."

Answer: _____

Source: *Holubec v. Brandenberger*, 111 S.W.3d 32, 37 (Tex. 2003); *City of Tyler v. Likes*, 962 S.W.2d 489 (Tex.1997); *Cain v. Rust Indust. Cleaning Serv., Inc.*, 969 S.W.2d 464 (Tex. App.-Texarkana 1998, pet. denied); *Meat Producers, Inc. v. McFarland*, 476 S.W.2d 406 (Tex. Civ. App.-Dallas 1972, writ denied).

Comment: This question is proper for use in nuisance actions by third parties. Whether a lessee's operations may give rise to cause of action by the surface owner of land subject to an oil and gas lease for nuisance and whether the question and instructions regarding excessive or unreasonable surface use by a lessee should be used are not settled questions. The Texas Supreme Court has held that negligent operations by a lessee authorize the recovery of damages by the lessor or surface owner. *Brown v. Lundell*, 344 S.W.2d 863 (Tex. 1961).

3.e. Permanent/Temporary Damage Question

Was the injury, if any, to Plaintiff's real property permanent or temporary?

You are instructed that injury to real property is permanent if the specific injury or an injury of a substantially similar nature has occurred several times in the years leading up to trial

and it is reasonably certain that injuries of a substantially similar nature are likely to continue on an ongoing basis, even if the exact dates, frequency, or full extent of the likely future injury is unknown. Injury to real property is temporary if the specific injury or an injury of a substantially similar nature has occurred on a single occasion or on irregular or intermittent occasions and the likelihood of injuries of a substantially similar nature recurring in the future remains speculative so that such future injuries cannot be estimated now with reasonable certainty.

Answer "Permanent" or "Temporary"

Answer: _____

Source: *Schneider Nat'l Carriers, Inc. v. Bates*, 147 S.W.3d 264 (Tex. 2004).

3.f. Permanent Damage Question

What is the difference, if any, in the reasonable market value of Plaintiff's real property immediately before and immediately after the injury in question?

Answer in dollars and cents, if any.

Answer:

Source: *Porras v. Craig*, 675 S.W.2d 503 (Tex. 1984).

3.g. Temporary Damage Question

What sum of money, if any, if paid now in cash, would fairly and reasonably compensate Plaintiff for damage to his real property resulting from the injury in question?

Consider the following elements of damages and no other. Consider each element separately and do not include amounts for one element in the other element. Do not include interest on any damages you find.

(a) Cost of repair. Consider the reasonable and necessary cost in Forum County, Texas to restore the real property to the condition that it was in immediately before the injury.

(b) Loss of use and enjoyment. Consider the reasonable value of the use of similar real property in Forum County, Texas for the period of time required to repair the property.

Answer in dollars and cents, if any.

Answer:

Source: *Planet Plows, Inc. v. Evans*, 600 S.W.2d 874 (Tex. Civ. App.-Amarillo 1980, no writ); *Weaver Const. Co. v. Rapier*, 448 S.W.2d 702 (Tex. Civ. App.-Dallas 1969, no writ). This measure of damages is not proper, however, when the cost of repair is not economically feasible because the cost of restoration exceeds the diminution of value of the property. *See Atlas Chern.*

Indus., Inc. v. Anderson, 514 S.W.2d 309 (Tex. Civ. App.-Texarkana 1974), *aff'd*, 524 S.W.2d 681 (Tex. 1975).

Multiple causes. In the proper case, an instruction limiting the jury to damages, if any, caused by defendant and not by any other source may be necessary. *See Planet Plows, Inc. v. Evans*, 600 S.W.2d 874 (Tex. Civ. App.-Amarillo 1980, no writ). However, such an instruction may not be proper when the damages result from an indivisible injury caused by two or more wrongdoers. *See Landers v. East Texas Salt Water Disposal Co.*, 248 S.W.2d 731 (Tex. 1953).

Time limitation. In the proper case, an instruction should be given to limit the jury's consideration to damages occurring since two years before suit was filed. *See Schneider Nat'l Carriers, Inc. v. Bates*, 147 S.W.3d 264 (Tex. 2004); *see also Bayouth v Lion Oil Co.*, 671 S.W.2d 867, 868 (Tex. 1984); *North Ridge Corp. v. Walraven*, 957 S.W.2d 116 (Tex. App.-Eastland 1997, pet. denied.).

3.h. Surface Use/Accommodation Doctrine Question

Did Defendant make a use of the leased premises that was not reasonably necessary?

You are instructed that the lessee under an oil, gas and mineral lease has the right to make such use of the land covered by the leases as is reasonably necessary to carry out the purposes of the lease, having due regard for the rights of the owner of the surface estate. You shall consider only the lessee's use of [complete as appropriate under facts of case.]

Answer "Yes" or "No."

Answer:

Source of instruction. *Sun Oil Co. v. Whitaker*, 483 S.W.2d 808, 810-11 (Tex. 1972); *Getty Oil Co. v. Jones*, 470 S.W.2d 618,621-22 (Tex. 1971).

Comment: This question and instruction are appropriate in cases of alleged excessive or unreasonable use of the lateral surface, the subsurface, and the super-adjacent airspace. When the Accommodation Doctrine is invoked by a landowner because there is an existing use of the surface estate that would be precluded or impaired by the lessee's operations or the lessee has an acceptable alternative operation or use that would not impair the use of the surface, the lessee may be required to adopt the alternative operation or use. *Getty Oil Co. v. Jones*, 470 S.W.2d at 621-22. In that instance, the instruction would need to be modified to be clear that the surface owner must have an "existing use" that would be "precluded or impaired." This question may be modified for use in cases where the lessee seeks damages because the lessor or surface owner has interfered with the lessee's use of the leased premises. *See Brown v. Lundell*, 344 S.W.2d 863 (Tex. 1961), *Ball v. Dillard*, 602 S.W.2d 521 (Tex. 1980). *See also Texas Genco, L.P. v. Valence Operating Co.*, 187 S.W.3d 118 (Tex. App.-Waco 2006).

4. ISSUES ARISING BETWEEN LESSOR AND LESSEE UNDER AN OIL AND GAS LEASE

4.a. Comment on Claims for Breach of Lease Provisions

An oil and gas lease, in addition to being a conveyance, contains covenants that must be interpreted under the same rules applicable to any other contractual provision. *Hitzelberger v. Samedan Oil Corp.*, 948 S.W.2d 497, 503 (Tex. App.-Waco 1997, writ denied). If the oil and gas lease is unambiguous, then the intention of the parties as expressed in the lease must be enforced. *Heritage Resources, Inc. v. NationsBank*, 939 S.W.2d 118,121 (Tex. 1996).

Because an oil and gas lease is a contract as well as a conveyance, an action for breach of either an express or an implied covenant of the lease sounds in contract, rather than in tort. Thus, punitive damages are not recoverable. *Amoco Prod. Co. v. Alexander*, 622 S.W.2d 563, 571 (Tex. 1981). Actions for breaches of covenants generally seek damages, as opposed to actions for failure of conditions, which seek lease termination. *See Shell Oil Co. v. Stansbury*, 401 S.W.2d 623 (Tex. Civ. App.-Beaumont 1966, writ ref'd n.r.e.), 410 S.W.2d 187 (Tex. 1966); *see also Texas Oil & Gas Corp. v. Vela*, 429 S.W.2d 866, 875 (Tex. 1968).

Two common claims for breach of express lease provisions are bad-faith pooling and failure to pay royalty properly. Each is considered a breach of the express covenants of the lease because the right to pool and the method for calculating royalty are terms are provided in the lease.

The right to pool must be expressly granted in the lease, and pooling requires that these lease terms must be followed precisely. *Jones v. Killingsworth*, 403 S.W.2d 325 (Tex. 1965). However, the exercise of the express right to pool is subject to an implied duty to pool in "good faith." This duty has been interpreted as an obligation for the lessee to act as a reasonably prudent operator under the same or similar circumstances. *Alexander*, 622 S.W.2d at 570-571; *Circle Dot Ranch, Inc. v. Sidwell Oil and Gas, Inc.*, 891 S.W.2d 342, 346 (Tex. App.-Amarillo 1995, writ denied).

All leases contain express provisions on how royalty is to be paid. Disputes arising under the express provisions of the lease generally involve disagreements regarding the volume or measurement of production, the value of production for royalty payment purposes, and whether any improper deductions have been taken prior to the calculation of royalty.

Most oil and gas leases contain express provisions on how royalty is to be valued.

Royalty on natural gas is usually valued on the basis of either the amount realized from a sale at the well or on the market value at the well. Often, both are found in the same lease, depending on where the gas is sold. In all instances, however, the express language of the lease determines the manner in which lessee is obligated to pay royalties. (*See, e.g., Sowell v. Natural Gas Pipeline Co. of America*, 789 F.2d 1151, 1155 (5th Cir. 1986) (royalty calculated in a manner other than market value or amounts realized.) Thus, if the express terms of the lease at issue differ from the "standard" modern form lease, the jury questions must be modified accordingly.

The definitions of market value, “proceeds received” and “amounts realized” have been established by Texas case law. Therefore, when submitting a question regarding breach of express provisions to pay royalty, an instruction as to any established legal definition of the applicable term should be included.

There may be an issue as to whether improper deductions have been taken from the royalty amount prior to calculation of the royalty. Generally a royalty interest bears no costs of drilling and production or bringing the product to the surface but will bear its proportionate share of production and severance taxes, transportation, marketing, compression, processing, and gathering costs, unless the lease provides otherwise. Thus, if the amount realized from the sale “at the well” is the standard for royalty payments, reasonable post-production costs may be deducted from the proceeds of a sale that occurs “down-stream” or beyond the well. If market value “at the well” is the standard, the market value is to be calculated at the well. *See Judice v. Mewbourne Oil Co.*, 939 S.W.2d 133, 135 (Tex. 1996); *Heritage Resources, Inc. v. NationsBank*, 939 S.W.2d 118, 122-23 (Tex. 1996); *Parker v. TXO Prod. Corp.*, 716 S.W.2d 644,648 (Tex. App.-Corpus Christi 1986, no writ); *Le Cuno Oil Co. v. Smith*, 306 S.W.2d 190, 193 (Tex. Civ. App.-Texarkana 1957, writ ref’d n.r.e.); *see also Holbein v. Austral Oil Co., Inc.*, 609 F.2d. 206, 209 (5th Cir. 1980); *Martin v. Glass*, 571 F.Supp. 1406, 1410 (N.D. Tex. 1983), *aff’d*, 736 F.2d. 1524 (5th Cir. 1984). *See also Cartwright v. Cologne Production Co.*, 182 S.W.3d 438 (Tex. App.-Corpus Christi, 2006).

Finally, the Council has included questions 4.c.3. and 4.c.4. under this section concerning express lease provisions for convenience, although these questions concern a breach of the implied duty to market, not an express lease royalty clause.

4.b.1. Question and Instruction on Bad Faith Pooling

Did Defendant breach its duty to pool the lease in good faith?

You are instructed that Defendant owes a duty under the lease to exercise its right to pool in good faith. You are instructed that, to pool in good faith, Defendant must act as a reasonably prudent operator under the same or similar circumstances, and must consider and give due regard to Plaintiff’s interest as well as its own interest.

Answer "Yes" or "No."

Answer:

Source: *Manges v. Guerra*, 673 S.W.2d 180 (Tex. 1984); *Schlittler v. Smith*, 128 Tex. 628, 101 S.W.2d 543 (1937); *Lueke v. Wallace*, 951 S.W.2d 267 (Tex. App.-Austin 1997, no writ); *Dearing, Inc. v. Spiller*, 824 S.W.2d 728 (Tex. App.-Fort Worth 1992, writ denied); *Hawkins v. Twin Montana, Inc.*, 810 S.W.2d 441 (Tex. App.-Fort Worth 1991, no writ); *Mims v. Beall*, 810 S.W.2d 876 (Tex. App.-Texarkana 1991, no writ); *Pickens v. Hope*, 764 S.W.2d 256 (Tex. App.-San Antonio 1988, writ denied); *Comanche Land and Cattle Co., Inc. v. Adams*, 688 S.W.2d 914 (Tex. App.-Eastland 1985, no writ); *Kimsey v. Fore*, 593 S.W.2d 107 (Tex. Civ. App.-Beaumont 1979, writ refd n.r.e.); *Portwood v. Buckalew*, 521 S.W.2d 904 (Tex. Civ. App.-Tyler 1975, writ refd n.r.e.); *Mission Resources, Inc. v. Garza Energy Trust*, 166 S.W.3d 301, 316 (Tex App.-Corpus Christi 2005, pet. filed).

Comment: As discussed in the Comment to this section, pooling must be done in strict compliance with the express terms of the lease, and also in good faith, which is an implied obligation. *Circle Dot Ranch, Inc. v Sidwell Oil and Gas, Inc.*, 891 S.W.2d 342, 346 (Tex. App.-Amarillo 1995, writ denied); *Amoco Prod. Co. v. Underwood*, 558 S.W.2d 509, 512 (Tex. Civ. App.-Eastland 1977, writ ref'd n.r.e). The standard of care in assessing the good-faith performance of an operator is that of a reasonable and prudent operator under the same or similar facts and circumstances. Good faith means honesty in fact in the conduct concerned. The requirement of good faith in accomplishing the purposes of the pooling clause must not be viewed as transforming the operator's relationship into that of an agent or fiduciary. *Vela v. Pennzoil Producing Co.*, 723 S.W. 2d 199,206 (Tex. App.-San Antonio 1986, writ ref'd n.r.e.).

The Council expresses no opinion on whether it is permissible to include in the instruction examples of proper or improper exercises of the pooling power. For example, pooling just before expiration of the lease may not by itself constitute bad faith, but may be probative of that fact. Kuntz, *The Law of Oil and Gas*, p. 713 (1972). Factors that may be considered include: drawing boundaries of a pooled unit to perpetuate as many leases as possible rather than to accomplish a permissible pooling goal, (*Elliott v. Davis*, 553 S.W.2d 223, 227 (Tex. Civ. App.-Amarillo 1977, writ ref'd n.r.e.); gerrymandering of unit boundaries (*Circle Dot Ranch, Inc. v. Sidwell Oil and Gas, Inc.*, 891 S.W.2d 342, 347 (Tex. App.-Amarillo 1994, writ denied); express statements that unit boundaries have been drawn to maintain leases, (*Amoco v. Underwood*, 558 S.W.2d 509, 512-13 (Tex. Civ. App.-Eastland 1977, writ ref'd n.r.e.); pooling an undrilled tract shortly before the end of the primary term, (*Elliott v. Davis*, 553 S.W.2d at 227; *Circle Dot Ranch*, 891 S.W.2d at 347); failure to consider geological factors in forming the unit, (*Elliott*, 553 S.W.2d at 227); the absence of plans for additional development, pooling portions of leases with smaller royalties with a well-site lease that has ample acreage to support the well, (*Amoco v. Underwood*, 558 S.W.2d at 511-12); exclusion of productive acreage located near the well, and inclusion of unproductive acreage or of acreage which is probably not within the well's drainage pattern; (*Circle Dot Ranch*, 891 S.W.2d at 347). Rejection of the pooled unit by the Railroad Commission is relevant but is not a determinative factor. *Elliott*, 553 S.W.2d at 226.

Careful consideration must be given to changes in pooling brought about by modern technology. Many wells today are drilled as "horizontal wells." Horizontal wells are initially drilled vertically, and then at a pre-determined point, the drillstem deviates and proceeds "horizontally" into the targeted formation. To be considered a "horizontal well" the deviation from vertical must exceed one hundred feet. A "horizontal" wellbore can traverse several acres and several leased tracts, increasing the likelihood of recovery of minerals. Thus, each tract crossed by the horizontal wellbore may be considered a drillsite tract, and each production point on the wellbore must be considered a drillsite. Leases may have been signed by the parties before the advent of horizontal wells. See generally *Browning Oil Co. Inc. v. Luecke*, 38 S.W.3d 625, 643 (Tex. App.-Austin 2000, pet. denied).

Although use of the term "bad faith" in oil and gas pooling cases suggest a tort claim, a bad-faith pooling claim is a breach of contract claim and does not give rise to punitive damages. Further, the lessee's authority to pool a lease is derived solely from the terms of the lease, and the lessee has no power to pool absent express authority. *Southeastern Pipeline Co. v. Tichacek*, 997 S.W.2d 166, 170 (Tex. 1999); *Jones v. Killingsworth*, 403 S.W.2d 325 (Tex. 1965).

Remedies. If the jury finds the lessee has breached its duty to pool in good faith, the remedy is cancellation of the pooled unit as to the plaintiff's lease. *Browning Oil Co. Inc. v. Luecke*, 38 S.W.3d 625, 643 (Tex. App.-Austin 2000, pet. denied); *Amoco Prod. Co. v. Underwood*, 558 S.W.2d 509,511 (Tex. Civ. App.-Eastland 1977, writ ref'd n.r.e.). The plaintiff also may be entitled to damages measured by the plaintiff's undiluted royalty on the well's production from date of initial production through date of trial, assuming that the well is located on and producing from the plaintiff's lease.

4.b.2. Jury Issues on Damages in Bad Faith Pooling Cases

What amount of money do you find would reasonably compensate Plaintiff for Defendant's failure to pool Plaintiff's lease in good faith?

[Vertical well] You are instructed that Plaintiff's damages, if any, are measured by the difference in royalty Plaintiff has received from the pooled unit and what Plaintiff would have received from the well[s] on Plaintiff's lease had the unit not been formed.

[Horizontal well] You are instructed that Plaintiff's damages, if any, are measured by the royalty value of production that would have been obtained from Plaintiff's land if the unit had not been formed.

Do not add any amount for interest on damages, if any.

Answer in dollars and cents, if any.

Answer: \$ _____

Comment: Oil and gas wells may be drilled "vertically," generally meaning the surface location of the well is at or near the bottomhole location of the well; or "horizontally," where the wellbore traverses a long distance horizontally with multiple drainholes along its horizontal axis. A bad faith pooling case may involve a unit formed for either a vertical or horizontal well and the measure of damages is different depending upon which type of well is at issue. *Browning Oil Co. Inc. v. Luecke*, 38 S.W.3d 625, 643 (Tex. App.-Austin 2000, pet. denied). Usually, in a bad faith pooling case involving a vertical well, the plaintiff owns royalty under the drillsite lease where the well is located. Thus, if that plaintiff prevails, the unit is void ab initio, and this entitles the plaintiff to the amount of additional royalty that would have been paid had there been no unit, less that already received for unit production. Of course, in that event because the unit is void, royalties thereafter also are paid on a lease basis, and this takes care of the plaintiff as to future damages. However, if the plaintiff were not a drillsite owner, presumably that plaintiff would be required to prove past and future damages based on production that should have been paid if the unit had been properly formed.

If a horizontal well is involved, the damage instruction should be based upon the legal principles set out in *Browning*, 38 S.W.3d 625 (Tex. App.-Austin 2000, pet. denied), which held that a pooled unit formed in bad faith was invalid with respect to the lease, but that damages were limited to the royalty value of production from the land covered by the lease. The traditional rule

of capture does not apply because in the horizontal drainhole situation, each tract through which the drainhole traverses is in essence a “drillsite” tract.

Updated September 19, 2005; Reason: Scrivener's mistake from original draft.

4.b.3. Ratification Defense

Did Plaintiff ratify the pooled unit?

Ratification occurs when a party recognizes the validity of a transaction by acting under it, performing under it, or affirmatively acknowledging it. Ratification can also occur when a party retains the benefits of a transaction after acquiring full knowledge of it. Ratification can be either express, or implied, based on a party’s conduct.

Answer "Yes" or "No":

Answer:

Source: *Simms v. Lakewood Village Property Owners Ass’n Inc.*, 895 S.W.2d 779, 785 (Tex. App.-Corpus Christi 1995, no writ); *Solvex Sales Corp. v. Triton Mfg. Co.*, 888 S.W. 2d 845, 849 (Tex. App.-Tyler 1994, writ denied); *Fowler v. Resolution Trust Corp.*, 855 S.W.2d 31, 35 (Tex. App.-El Paso 1993, no writ); *Zieben v. Platt*, 786 S.W.2d 797, 802 (Tex. App.-Houston [14th Dist.] 1989, no writ); *Wetzel v. Sullivan, King & Sabom*, 745 S.W.2d 78, 81 (Tex. App.-Houston [1st Dist.] 1988, no writ); *Spellman v. American Universal Ins. Co.*, 687 S.W.2d 27, 30 (Tex. App.-Corpus Christi 1984, writ ref’d n.r.e.); *Yelderman v. McCarthy*, 474 S.W.2d 781, 784 (Tex. Civ. App.-Houston [1st Dist.] 1971, writ ref’d); *Leopard v. Stanolind Oil & Gas Co.*, 220 S.W.2d 259, 264 (Tex. Civ. App.-Dallas 1949, writ ref’d n.r.e.).

4.b.4. Estoppel Defense

Is Plaintiff estopped to assert a claim that Defendant breached its duty to pool in good faith?

You are instructed that estoppel arises where (1) by the conduct of one party, another has been induced to change his position for the worse, or (2) one retains benefits under a transaction, that party cannot later avoid its obligations and is estoppel to take an inconsistent position.

Answer "Yes" or "No":

Answer:

Source: *Vessels v. Anschutz Corp.*, 823 S.W.2d 762, 765 (Tex. App.-Texarkana 1992, writ denied); *Atkinson Gas Co v Albrecht*, 878 S. W.2d 236, 240 (Tex. App.-Corpus Christi 1994, writ denied). *See also Champlin Oil & Refining Co. v. Chastain*, 403 S.W.2d 376 (Tex. 1965).

4.c.1. Breach of Express Royalty Provision Question

Did Defendant fail to pay royalty properly in accordance with the terms of the lease?

Answer “Yes” or “No”

Answer: _____

Comment: This question is appropriate in situations in which the failure to pay royalties properly is based on other than a failure to pay royalties based on market value or a breach of the duty to reasonably market, e.g., failure to pay on measured volume of production or failure to base the royalties on the amount realized. This question should be submitted with the appropriate instructions and conditional questions on damages for the specific issues in dispute.

4.c.2. Breach of Express Royalty Provision Damage Question

What sum of money, if any, if paid now in cash, would fairly and reasonably compensate Plaintiff for the damages, if any, that resulted from Defendant's failure to pay royalties according to the provisions of the lease?

You shall consider only the difference, if any, between the royalty Plaintiff received and the royalty Plaintiff would have received had Defendant pay royalties according to the provisions of the lease.

Do not add any amount for interest on damages, if any.

Answer in dollars and cents, if any.

Answer: \$ _____

Comment: It may be necessary to require an answer for each well, each plaintiff, each defendant and each month at issue in the royalty dispute, particularly if plaintiff is seeking to recover prejudgment interest, if there are multiple plaintiffs, defendants, wells or sales, or if the statute of limitations is an issue.

4.c.3. Duty to Reasonably Market Production Question

Did Defendant fail to reasonably market the gas [or other product] produced from Plaintiffs' lease?

You are instructed that in marketing the gas produced from the well, Defendant has a duty to act as a reasonably prudent operator would act under the same or similar circumstances.

Answer "Yes" or "No"

Answer:

Source: *Union Pacific Resources Corp. v. Hankins*, 111 S.W.3d 69 (Tex. 2003); *Yzaguirre v. KCS Resources, Inc.*, 53 S.W.3d 368 (Tex. 2001); *Amoco Prod. Co. v. Alexander*, 622 S.W.2d 563, 568 (Tex. 1981); and *Amoco Prod. Co. v. First Baptist Church of Pyote*, 611 S.W.2d 610 (Tex. 1980).

Comment: This question is appropriate when the lease provides for royalty to be calculated on the basis of proceeds or amounts realized by the lessee and the issue is whether lessee acted prudently in marketing the gas or other hydrocarbon production. For an example of a case where a lessor failed to meet that burden of proof, i.e. failed to prove that the lessee had not acted as a reasonable and prudent operator in marketing gas, see *Migl v. Dominion Oklahoma Texas Exploration & Production Co.*, 2007 WL 475318 (Tex. App.-Corpus Christi 2007).

4.c.4. Duty to Reasonably Market Production Damage Question

What sum of money, if any, if paid now in cash, would fairly and reasonably compensate Plaintiff for the damages, if any, that resulted from Defendant's failure to reasonably market the gas?

You shall consider only the difference, if any, between the royalty Plaintiff received and the royalty he should have received had Defendant acted as a reasonably prudent operator in marketing the gas produced from the lease.

Do not add any amount for interest on damages, if any.

Answer in dollars and cents, if any.

Answer: \$ _____

Comment: Depending on the circumstances, it may be necessary to require an answer for each well, each plaintiff, each defendant and each month at issue in the royalty dispute, particularly if plaintiff is seeking to recover prejudgment interest, if there are multiple plaintiffs, defendants, wells or sales, or if the statute of limitations is an issue.

4.c.5. Breach of the Duty to Pay Royalty on Market Value Question

Did Defendant fail to pay Plaintiff royalty based on the market value at the well for gas produced from Plaintiffs lease?

You are instructed that market value is the price a willing seller not obligated to sell can obtain from a willing buyer not obligated to buy. Market value can be determined by comparable sales. A comparable sale is one that is comparable in time, quality, quantity and availability of marketing outlets. When comparable sales are not readily available, then you may subtract reasonable post-production, marketing costs from the market value at the point of sale. Post-production marketing costs include transporting the gas to the market and processing the gas to make it marketable.

Answer "Yes" or "No"

Answer: _____

Source: *Heritage Resources Inc. v. NationsBank*, 939 S.W.2d 118, 122 (Tex. 1996); *Exxon Corp. v. Middleton*, 613 S.W.2d 240, 246 (Tex. 1981); *Texas Oil & Gas Corp. v. Hagen*, 683 S.W.2d 24, 28 (Tex. App.-Texarkana 1984), *dismissed as moot*, 760 S.W.2d 960 (Tex. 1988).

Comment: Probably no area of oil and gas law has led to more confusion and litigation than the determination of market value of gas for royalty purposes. Included within the implied covenant of management and administration of the leasehold estate is the duty to market oil and gas reasonably. However, there is no implied covenant when the oil and gas lease expressly covers the subject matter of the implied covenant. *Yzaguirre v. KCS Resources, Inc.*, 53 S.W.3d 368, 373 (Tex. 2001). Therefore, when a lease requires royalty to be calculated on the market value of the gas at the well, the court will not imply a duty to market the gas so as to obtain any particular price. *Id.* at 374. Market value is also defined by statute in Texas, and the Council expresses no opinion on the propriety of instructing the jury about the statutory definition of market value found in TEX. NAT. RES. CODE § 91.402 (i) and 34 TEX. ADMIN. CODE § 3.15(a) (Vernon 1999). See *Yzaguirre*, 53 S.W.3d at 368. The last sentence in the instruction is from *Heritage*, 939 S.W.2d at 122, and the statement there that net back begins with “market value at the point of sale” is somewhat unclear. It may mean that such a starting point is the “actual price” at the point of sale, because if “market value” itself is used as a starting point, one is still left with the problem of what price to use for “market value” at the beginning of the calculation.

4.c.6. Breach of the Duty to Pay Royalty on Market Value Damage Question

What sum of money, if any, if paid now in cash, would fairly and reasonably compensate the Plaintiff for his damages, if any, that resulted from Defendant's failure to pay royalty based on the market value of the gas [or other product] at the well?

You are instructed that you shall consider only the difference, if any, between the market value of the Plaintiffs royalty share of gas produced from the subject well(s) and the amount of royalty that Plaintiff was actually paid on gas produced from such well(s).

Do not add any amount for interest on damages, if any.

Answer in dollars and cents, if any.

Answer: \$ _____

Comment: It may be necessary to require an answer for each well, each plaintiff, each defendant and each month at issue in the royalty dispute, particularly if plaintiff is seeking to recover pre-judgment interest or if there are multiple plaintiffs, defendants, wells or sales.

4.c.7. Question on Location of Sale

Was the gas at issue sold on the acreage covered by Plaintiff's lease?

Answer “Yes” or “No.”

Answer: _____

Comment: The place at which gas is sold is sometimes critical in determining whether royalty has been paid properly. In *Exxon Corp. v. Middleton*, 613 S.W.2d 240, 243 (Tex. 1981), the Texas Supreme Court concluded that the phrase, “at the wells” means gas sold on the lease in question, and the phrase, “off of the premises” refers to gas which is sold off of the leased

premises. Accordingly under a common type of royalty clause as was used in Middleton, the “market value” instruction should be used for gas sold anywhere off the lease, and the “amounts realized” or “proceeds received” instruction should be used for gas sold on the subject lease. If the location of the sale of the gas is at issue, then the jury should be asked whether the gas was sold on the subject lease. If there are different points of sale from time to time, it may be necessary to ask the location of each sale.

4.c.8. Improper Deduction Question

Did Defendant make improper deductions from royalty payable under Plaintiffs lease?

You are instructed that Defendant is entitled to deduct reasonable post-production costs, such as [taxes, treatment costs, gathering costs, marketing costs, compression costs, and transportation costs, as applicable] in calculating the royalty due under the lease.

Answer “Yes” or “No”

Answer: _____

Source: *Heritage Resources, Inc. v. Nationsbank*, 939 S.W.2d 118, 122 (Tex. 1996); *Martin v. Glass*, 571 F.Supp. 1406, 1410 (N.D. Tex. 1983), aff’d 736 F.2d 1524 (5th Cir. 1984). *See also Cartwright v. Cologne Production Co.*, 182 S.W.3d 438 (Tex. App.-Corpus Christi 2006).

Comment: Royalty is commonly defined as the landowner’s share of production, free of the expenses of production. The lessee is entitled to deduct reasonable post-production costs, such as taxes, treatment costs to render it marketable, compression, transportation, gathering, and marketing costs, in calculating the royalty due under the lease. The instruction should be modified to reflect any lease provisions that specify the costs that may or may not be deducted. This jury question is not applicable when the lease provides for royalty to be based on market value at the well, because deductions are an integral part in reaching that valuation, and presumably would have already been taken in account in estimating a market value at any particular point, such as the well-head. *Heritage*, 939 S.W.2d at 122. Compression costs may or may not be deductible, depending on whether the compression is necessary for production purposes, or for transportation purposes. *Martin v. Glass*, *supra*.

4.c.9. Improper Deductions Damage Question

What sum of money, if any, if paid now in cash, would fairly and reasonably compensate the Plaintiff for his damages, if any, that resulted from Defendant’s improper deduction from royalty payments?

You shall consider the difference, if any, between what royalty Plaintiff received and what he should have received had no improper deductions been taken.

Do not add any amount for interest on damages, if any.

Answer in dollars and cents, if any.

Answer: \$ _____

4.c.10. Untimely Payment of Royalty Question

Did Defendant fail to pay Plaintiff royalty due on production from Plaintiff's lease within ___ days of production?

Answer "Yes" or "No"

Answer: _____

Comment: A question on whether royalty payments have been timely made usually will arise under only two circumstances: either the lease at issue contains an express provision stating the time for payment, or an action has been brought under the TEX. NAT. RES. CODE §§ 91.401-91.406, which sets out a statutory time for payment. Because most standard-form royalty clauses do not provide a time period for making royalty payments, the instruction for claims brought under leases that do not provide a period for payment of royalty should conform to §§ 91.401-406.

Under TEX. NAT. RES. CODE §§ 91.401-91.406, payor must pay to the payee the proceeds received from the sale of oil or gas production on or before 120 days after the end of the month of first sale of production from the well and no later than 90 days after the end of the calendar month in which gas production is sold in subsequent months. If payments are not made within these time periods, the payments are not timely, and the payee must pay interest on the payment at the rate provided in the statute. The time period set out in this question or instruction should conform either to the express lease terms or the statutory requirements, whichever is appropriate. In regard to liability under §§ 91.401-406 between a payor and a lessee/operator, *see Anadarko E&P Co., L.P. v. Clear Lake Pines, Inc.*, 2005 WL 1583506 (Tex. App.-Austin 2005).

The statute also requires the payee give payor written notice by mail of the failure to pay timely as a prerequisite to suing the payor for non-payment and allows lessee to suspend royalty payments while title to the property is in dispute.

4.d.1. Comment on Implied Covenants

Implied covenants are a part of all Texas leases and have been recognized as enforceable contractual obligations since the early years of the last century. *Grubb v. McAfee*, 212 S.W. 464, 465 (Tex. 1919); *see also Freeport Sulfur Co. v. American Sulfur Royalty Co.*, 6 S.W.2d 1039, 141-42 (Tex. 1928) (an implied covenant for diligent and reasonable development and operation exists in a lease which makes the lessor's compensation depend upon development and operations); *WT Waggoner Estate v. Sigler Oil Co.*, 19 S.W.2d 27, 29-31 (Tex. 1929) (when lease fails to define lessee's duties as regards to development after discovery of paying production, the law implies the obligation to continue to develop and produce oil or gas with reasonable diligence).

Implied covenants arise out of the written agreement of the parties. Implied covenants must be complementary but not contrary to the express provisions of the lease. *Danciger Oil and Refining Co. of Texas v. Powell*, 154 S.W. 632, 635 (Tex. 1941). "A covenant will not be implied

unless it appears from the express terms of the contract that ‘it was so clearly within the contemplation of the parties that they deemed it unnecessary to express it’ and therefore they omitted to do so, or ‘it must appear that it is necessary to infer such a covenant to effectuate the full purpose of the contract as a whole as gathered from the written instruments.’” *HECI Exploration Co. v. Neel*, 982 S.W.2d 881, 888 (Tex. 1998) (quoting *Danciger*, 154 S.W.2d at 635). Accordingly, “there is no implied covenant when the oil and gas lease expressly covers the subject matter of an implied covenant.” *Yzaguirre v. KCS Resource, Inc.*, 53 S.W.3d 368, 373 (Tex. 2001).

The landmark Supreme Court case describing implied covenants is *Amoco Prod. Co. v. Alexander*, 622 S.W.2d 563 (Tex. 1981). In that case, the Texas Supreme Court described the implied covenants as grouped into three broad categories according to the factual basis of the dispute between the lessor and lessee, as follows: (1) covenant to develop the premises; (2) covenant to protect the leasehold and (3) covenant to manage and administer the lease. *Id.* at 567.

Amoco also identifies the standard by which a lessee's conduct under these implied covenants will be measured. The general duty of the lessee is to conduct operations as a reasonably prudent operator would to carry out the purposes of the oil and gas lease. *Id.* at 567–68. This standard is often described as the “reasonably prudent operator standard” and defined as “what a reasonably prudent operator would do under the same or similar circumstances.” It is not a fiduciary standard. Absent evidence of some special relationship between the lessor and the lessee, or some duty explicit in the language of the lease, the lessee does not owe a fiduciary duty to the lessor. *Texas Oil & Gas Corp. v. Hagan*, 31 Tex. Supp. Ct. J. 140, 142 1987 WL 47847 (December 16, 1987), opinion withdrawn, case settled, 760 S.W.2d 960 (Tex. 1988).

Please note as to issues concerning implied duties to market, for convenience, these questions are included under the questions concerning the express royalty clause, at 4.c.3. and 4.c.4., *infra*.

4.d.2. Breach of the Implied Covenant to Protect the Lease from Drainage –
Existence of Substantial Drainage Question

Has substantial drainage of oil or gas occurred from Plaintiff’s lease?

You are instructed that substantial drainage means drainage of oil or gas from Plaintiff’s lease that is more than minor drainage.

Answer "Yes" or "No":

Answer: _____

Comment: See *Amoco Prod. Co. v. Alexander*, 622 S.W.2d 563 (Tex. 1981); see also *Good v. TXO Prod. Corp.*, 763 S.W.2d 59 (Tex. App.-Amarillo 1988, writ ref’d n.r.e.). It may be necessary in some cases to specify the reservoir from which drainage is alleged or the applicable time period. For a decision of possible differences in situation where the lessee is the same on both leases, see *Amoco Prod. Co. v. Alexander*, 622 S.W.2d at 569, and *Shell Oil Co. v. Stansbury*, 410 S.W.2d 187 (Tex. 1967).

This question would likely be incorporated in a single question with the failure to protect against drainage question below. Also, there is no accepted definition or standard as to what constitutes “substantial drainage,” and the instruction used above certainly reflects this. However, it is clear that however defined, “substantial drainage” must occur and be proved before a lessee has a duty to prevent drainage, at least absent special lease provisions.

4.d.3. Failure to Protect Against Drainage Question

Did Defendant fail to act as a reasonably prudent operator by failing to prevent substantial drainage from the Plaintiffs lease?

You are instructed that a reasonably prudent operator has the duty to prevent substantial drainage of oil or gas from a lease under its control by: [*Include means of preventing drainage that are raised by the evidence*, e.g. (1) drilling additional wells; (2) re-working existing wells; (3) drilling replacement wells; (4) seeking exceptions or other relief, as may be necessary, from the Railroad Commission or other administrative agencies; (5) seeking voluntary unitization; (6) seeking compulsory pooling; or (7) taking other action. However, a reasonably prudent operator is only required to take such action(s) if, there is a reasonable expectation of making a profit after deducting all operating expenses and capital costs associated with such actions.

You are instructed that a “reasonably prudent operator” means an operator of ordinary prudence, that is, one having neither the highest nor the lowest prudence, but an operator of average prudence and intelligence, acting with ordinary diligence under the same or similar circumstances. A reasonably prudent operator must consider and give due regard to the Lessor’s interest as well as its own interest.

Answer “Yes” or “No”

Answer: _____

Source: *Amoco Prod. Co. v. Alexander*, 622 S.W.2d 563, 567, n. 1 (Tex. 1981); *Circle Dot Ranch, Inc. v. Sidwell Oil and Gas, Inc.*, 891 S.W.2d 342, 346 (Tex. App.-Amarillo 1995, writ denied); *Good v. TXO Prod. Corp.*, 763 S.W.2d 59, 61 (Tex. App.-Amarillo 1988, writ ref’d n.r.e.); *Vela v. Pennzoil Producing Co.*, 723 S. W.2d 199, 206 (Tex. App.-San Antonio 1986, writ refd n.r.e.); *Elliott v. Davis*, 553 S.W.2d 223,226-27 (Tex. Civ. App.-Amarillo 1977, writ refd n.r.e.) (citing Kuntz, *The Law of Oil and Gas*, § 48.3, p. 218 (1972)); Smith & Weaver, 1 *Texas Law of Oil and Gas*, § 5.3 A.1).

Comment: The implied covenant to protect a lease from drainage extends not only to a localized occurrence across the lease line, but also to field wide drainage. *Amoco Prod. Co. v. Alexander*, 622 S.W.2d 563 (Tex. 1981).

The reasonably prudent operator is the standard for measuring the lessee’s performance of the duty. The key issues are the actions the lessor claims the lessee should have taken to protect the lease from substantial drainage, and whether those actions could be undertaken by the lessee with a reasonable expectation of profit. *See id.* at 568 (citing *Clifton v. Koontz*, 325 S.W.2d 684, 695-96 (1959)). The supreme court noted in *Amoco Prod. Co. v. Alexander* that the duty to protect against drainage encompasses any act a reasonably prudent operator would

perform to protect the lease from drainage, including: (1) drilling replacement wells; (2) re-working existing wells; (3) drilling additional wells; (4) seeking fieldwide regulatory action; (5) seeking Rule 37 exceptions from the Railroad Commission; (6) seeking voluntary unitization; or (7) seeking other available administrative relief. However, there is no duty to do any of this unless “such an amount of oil can be recovered to equal the cost of administrative expenses, drilling or re-working and equipping a protection well, producing and marketing the oil, and yield to the lessee a reasonable expectation of profit.” The opinion does not say how much profit the lessee could require to justify its decision. Although a reasonable profit on the necessary investment should be required to find that an operator has breached its duty, under existing case law, no specific amount or percentage of profit is established as reasonable; thus, the issue must be left to a determination of what a reasonably prudent operator would do under the circumstances. Accordingly, profit should not be quantified or characterized in the instruction.

4.d.4. Drainage Damage Question

What sum of money, if any, if paid now in cash, would fairly and reasonably compensate Plaintiff for the damages, if any, that resulted from Defendant’s failure to act as a reasonably prudent operator?

Consider the following elements of damages, if any, and no other:

the difference between the royalties paid to Plaintiff in the past, and royalties which would have been paid to Plaintiff in the past if Defendant had acted reasonably to protect the tract against drainage, and

the difference between royalties which, in reasonable probability will be paid to Plaintiff in the future, and royalties which, in reasonable probability, would have been paid to Plaintiff in the future if Defendant had acted reasonably to protect the tract against drainage.

Do not add any amount for interest on damages, if any.

Answer:

Damages sustained in the past _____

Damages that will be sustained in the future _____

Source: *Texas Pacific Coal & Oil Co. v. Barker*, 6 S.W.2d 1031,1036-7 (Tex. 1928); see 4.d.6. for an acceptable variation of this same question.

Comment: The measure of damages for breach of the drainage covenant is the royalty lost on past and future production by the Defendant’s failure to prevent drainage. *Mandell v. Hamman Oil and Refining Co.*, 822 S.W.2d 153, 164 (Tex. App.- Houston [1st Dist] 1991, writ denied); *Wes-Tex Land Co v. Simmons*, 566 S.W.2d 719, 721 (Tex. Civ. App.-Eastland 1978, writ ref’d n.r.e.). In most cases, the alleged failure to protect against drainage will be a failure of the lessee to drill or timely drill an offset well to prevent the drainage. Accordingly, the damages are calculated on what the lessor/royalty owner would have received as royalty from such a well if it

had been drilled or timely drilled. This involves both a component of past and future damages, and the future production component of such a well (whether hypothetical or actual) obviously must be discounted back to a present value, and often is the subject of hotly contested expert testimony. It should be made clear that the amount of oil or gas actually drained is not the basis for damages, though of course it may affect the amount of production to be obtained from the protection well, again the correct standard against which damages would be measured.

In this respect, see *Coastal Oil & Gas Corp. v. Garza Energy Trust*, 268 S.W.3d 1 (Tex. 2008), where the royalty owner sought drainage damages occurring by an alleged frac trespass. As noted in 3.b herein, this was held to be not actionable. In addition, the Court found there was no competent evidence to support the drainage claim. The Supreme Court in *Garza* comments on drainage damages in two paragraphs at 18, in what may be dicta. The Council expresses no opinion on what is meant by these comments, or whether the Supreme Court intended to change the standard for damages in drainage cases accepted since *Barker, supra*.

4.d.5. Failure to Develop Question

Did Defendant fail to drill additional wells on the lease that a reasonably prudent operator would have drilled?

You are instructed that Defendant has a duty to drill all wells that a reasonable and prudent operator would drill under the same or similar circumstances, with a reasonable expectation of profit. This duty to drill extends to both already producing formations or strata, and also to formations or strata other than the formations or strata from which production is being obtained, but which in reasonable probability exist and are known to be capable of production.

Answer “Yes” or “No.”

Answer:

Source: *Sun Exploration & Prod. Co. v. Jackson*, 783 S.W.2d 202, 204 (Tex. 1989); *Clifton v. Koontz*, 325 S.W.2d 684, 695 (Tex. 1959).

Comment: Under the implied covenant of reasonable development, a lessee is generally obligated to drill whatever wells on the lease that a reasonable and prudent operator would drill. However, a reasonable and prudent operator will not drill a well unless there is a reasonable expectation of profit in the drilling. *Clifton v. Koontz*, 325 S.W.2d 684 (Tex. 1959). Whether there is a reasonable expectation of profit is usually a matter for expert testimony.

Also, while the lessee can fulfill the duty to reasonably develop the lease by other actions besides drilling, drilling a well is most often the action that the Plaintiff claims should have occurred. In this respect, the development well that the Plaintiff alleges should be drilled is virtually indistinguishable from the “protection well” under the Drainage Covenant discussed in 4.d.3 and 4.d.4 - both are wells that a reasonable and prudent operator would have drilled with a reasonable expectation of profit. Note that this “profit” is not just “production paying quantities,” but is a return of the money expended plus a reasonable rate of return on that expenditure. In the suggested question, the jury is asked about “additional wells” as opposed to a general question

about “development.” While either could be used depending on the facts of the particular case, this “additional wells” language, a direct quote from *Clifton v. Koontz*, is used here because in certain situations a jury may be confused by a question that asks only whether the lease has been “properly developed.” An alleged failure to drill either a development well or an exploratory well (or both) should be submitted in a “development” question. *Sun Exploration & Prod. Co. v. Jackson, supra*.

4.d.6. Failure to Develop Damage Question

What amount of money, if paid now in cash, would reasonably compensate Plaintiff for Defendant's failure to drill?

You are instructed that Plaintiff's damages, if any, are measured by what amount of royalty the Plaintiff would have received from the wells.

Do not add any amount for interest on damages, if any.

Answer in dollars and cents, if any.

Answer:

Source: *Texas Pacific Coal & Oil Co. v. Barker*, 6 S.W.2d 1031,1036-7 (Tex. 1928).

Comment: If the lessor is seeking monetary damages, then this issue should be used, conditionally submitted after the breach issue. Generally, in a case alleging the breach of the implied covenant to develop in an oil and gas lease, the lessor is required to seek monetary damages, unless it conclusively appears that such damages cannot be ascertained with the degree of certainty required in such situations. *Christie, Mitchell & Mitchell Co. v. Howell*, 359 S.W.2d 658, 660 (Tex. Civ. App.-Fort Worth 1962, writ ref d n.r.e.). If the lessor seeks cancellation of the lease as a remedy, it is the lessor's affirmative burden to show that monetary damages cannot be determined with reasonable certainty, and only if the lessor makes this showing, is that lessor then entitled to seek a cancellation of the lease.

If the wells that the Plaintiff alleges should have been drilled have a projected period of production that extends into the future past the date of trial, then the answer to the issue above will include both the past and the future income stream for the well or wells, with the future income stream being discounted back to a present value at the time of trial. If a lessor seeking monetary damages wants to obtain prejudgment interest on the portion of the verdict reflecting royalty that the Plaintiff would have received up until time of trial, *i.e.*, the past income stream, then it may be necessary to insert blanks in the answer showing the amount of lost royalty on a month-to-month basis, back to the point in time where the Plaintiff alleges that the failure to develop first occurred. In that manner, if the Plaintiff gets a favorable verdict, the trial judge would be able to calculate the prejudgment interest. If the Plaintiff does not want to do this, it would probably be possible to calculate the value of the royalty at a certain point in time, *i.e.* to calculate what the Plaintiff royalty owner could have sold the royalty for at a certain date had the lease been properly developed, and then calculate prejudgment interest from that one value at that time, and thus avoid a “by the month” type answer.

However, if cancellation of the lease is sought as a remedy, again bear in mind the Plaintiffs burden to prove that monetary damages are incapable of ascertainment, *Christie, supra*.

Finally, Texas generally follows the view that conditional cancellation is the preferred remedy when cancellation is sought. However, the cases suggest that under some circumstances, absolute cancellation might be appropriate, if it appears that conditional cancellation would be futile. *See generally WT Waggoner Estate v. Sigler Oil Co.*, 19 S.W.2d 27 (Tex. 1929); *see also* the Court of Appeals opinion in *Sun Exploration & Prod. Co. v. Jackson*, 715 S.W.2d 199, 205-6 (Tex. App.-Houston [1st Dist.] 1986, writ granted).

4.e.1. Comment on Lease Termination

Lease termination cases are generally of two types: those involving a complete cessation of production, usually for a short time, that is followed by resumption of production, and cases involving production that is alleged not to constitute paying quantities. *Cf. Watson v. Rochmill*, 155 S.W.2d 783,784 (Tex. 1941) and *Clifton v. Koontz*, 325 S.W.2d 684, 695-96 (1959).

Also, lease termination cases may involve whether a lessee has “commenced operations” before the expiration of the “primary term,” and the lessee must “commence operations” before it expires, or else the lease terminates. Absent more specific language in the lease, what actions might constitute such “operations” are discussed generally in Smith & Weaver, 1 *Texas Law of Oil and Gas*, 2 ed. § 4.5 (Mitchie 1997), and should be used in the instruction for such a question (see 4.e.; *see also Veritas Energy, L.L.C v. Brayton Operating Corp.*, 2008 WL 384169 (Corpus Christi 2008)).

Under Texas law, an oil, gas and mineral lease is a grant to the lessee of a fee simple determinable interest in the mineral estate with a possibility of reverter in the lessor. *Natural Gas Pipeline Co. of America v. Pool*, 124 S.W.3d 188 (Tex. 2003). As to the difference between a covenant and a condition, *see Stephens v. Mid-Kansas Oil & Gas Co.*, 254 S.W. 290, 295 (1923). After the expiration of the primary term, a producing lease terminates upon the cessation of production of minerals from the lease, unless it is perpetuated by a savings clause. *Watson v. Rochmill*, 155 S.W.2d 783, 784 (Tex. 1941).

The requirement that the lease produce minerals in paying quantities exists to fulfill the purpose of the lease, which is profit for both the lessor and the lessee. The lessee is not permitted to hold an unprofitable lease for purposes of speculation. *Clifton v. Koontz*, 325 S.W.2d 684 (Tex. 1959). The questions of whether the lease has terminated because of a cessation of production and whether it has terminated because of a failure to produce in paying quantities are different, although both issues are sometimes presented in the same case.

The effect of the cessation may be governed by specific lease language. Many leases contain savings clauses such as provisions for payment of shut-in royalty, or operations clauses to maintain the lease even if there is a complete cessation of production for a short period of time. Typically, an operations clause provides that if, during the primary term, production has been obtained but ceases for any reason and the lease is not otherwise held, then the lease can be maintained if lessee timely resumes the payment of delay rentals or operations. If the cessation occurs after the primary term, and the lease is not otherwise maintained, then the lessee generally

has a stated period of time in which to commence operations or the lease will terminate. *See Samano v. Sun Oil Co.*, 621 S.W.2d 580, 584 (Tex. 1981); *Sun Operating Ltd Partnership v. Holt*, 984 S.W.2d 277,282 (Tex. App.-Amarillo 1999, writ denied). The operations required to hold a lease are often defined in the lease.

If the lease does not contain an express cessation of operations clause, the lessee may be able to rely upon the temporary cessation of production doctrine to hold the lease. This doctrine was established in pragmatic recognition of the fact that wells simply do not literally produce “continuously” because they occasionally require repairs. *See generally* Smith & Weaver, 1 *Texas Law of Oil and Gas*, 2d ed. § 4.4(B) (Butterworth 1998). The courts presume that because temporary cessations are unavoidable, the parties did not intend that the lease would terminate. The lessee has the burden of pleading and proving that the cessation of production was temporary *Bradley v. Avery*, 746 S.W.2d 341 (Tex. App.-Austin 1988, no pet.).

The temporary cessation of production doctrine “applies in a wide variety of circumstances.” *Ridge Oil Co. v. Guinn*, 148 S.W.3d 143, 151 (Tex. 2004). Earlier cases suggested that the temporary cessation of production doctrine was limited to situations in which the cessation was the result of mechanical breakdown, sudden stoppage, or the like, and was unforeseen and unavoidable. *See, e.g., Amoco Prod. Co v. Braslau*, 561 S.W.2d 805 (Tex. 1978); *Midwest Oil Corp. v. Winsauer*, 323 S.W.2d 944 (Tex. 1959); *Scarborough v. New Domain Oil & Gas Co.*, 276 S.W. 331 (Tex. Civ. App.-El Paso 1925, writ dism’d). However, the Texas Supreme Court’s opinion in *Ridge Oil Co. v. Guinn* makes it clear that the doctrine is not so limited.

Additionally, while lease termination may hinge on an allegation of temporary cessation or failure to produce in paying quantities, these claims should not be confused with the situation where there is an allegation of complete cessation of production, which terminates the lease. *See Ridenour v. Herrington*, 47 S.W.3d 117 (Tex. App.-Waco 2001); *Cannon v. Sun-Key Oil Co., Inc.*, 117 S. W.3d 416 (Tex. App.-Eastland 2003); *see also Brown v. Reeter*, 170 S.W.3d 151 (Tex. App.-Eastland 2005).

Finally, it should be borne in mind that the terms “producing,” “capable of production,” and “capable of producing in paying quantities” are often found in leases, but mean different things. For example, a well is not “capable of producing” unless it would immediately produce without further equipment or repairs when “turned on.” *See Chesapeake Exploration Ltd. Partnership v. Corine Inc.*, 2007 WL 272576 (Waco 2002), and as to “paying quantities,” that should be a different inquiry than a “cessation,” although theoretically, the “cessation” if it does not terminate the lease – might be taken into account in the “paying quantities” inquiry.

4.e.2. Lease Termination Question

Did the well in question cease to produce oil and gas for a period of more than ___ consecutive days?

Answer “Yes” or “No.”

Answer:

Comment: This form of question is appropriate where the oil, gas and mineral lease in issue specifies a period of time of non-production after which the lease terminates, and there is a dispute as to the period of time of the non-production.

4.e.3. Failure to “Commence Operations” Before End of Primary Term

Did the (lessee/operator) fail to commence operations on or before [date primary term expires] for the drilling of a well on the lease?

You are instructed that “commence operations” means a good faith attempt to drill a well, and may include such actions as:

Answer “Yes” or “No.”

Answer:

Source:

4.e.4. Lease Termination Question – Operations Clause

Did Defendant fail to commence drilling or reworking operations on the well in question within ___ days after the well ceased to produce oil and gas?

You are instructed that “reworking operations” means any and all actual acts, work, or operations in which an ordinarily competent operator, under the same or similar circumstances, would engage in a good faith effort to cause a well or wells to produce oil or gas in paying quantities.

Answer “Yes” or “No.”

Answer:

Source: *Rogers v. Osborn*, 261 S.W.2d 311, 314 (Tex. 1953); *Cox v. Stowers*, 786 S.W.2d 102, 105 (Tex. App.-Amarillo 1990, no writ); *Phillips Petroleum v. Rudd*, 226 S.W.2d 464, 466 (Tex. Civ. App.- Texarkana 1949, no writ).

Comment: This question is appropriate where the lease specifies a period of time of non-production after which the lease terminates. This question must be conformed to the language of the lease in issue regarding the applicable time period, the event from which the time period is measured, any limitation on the applicability of the clause, *e.g.*, whether the operation must be prior to the discovery of gas, or whether production ceased after the discovery of oil or gas, and any specific definitions of the operations required. *See, e.g., Rogers v. Osborn*, 261 S.W.2d 311 (Tex. 1953) and *Stanolind Oil & Gas Co. v. Newman Bros. Drilling Co.*, 305 S.W.2d 169 (Tex. 1957).

Lack of Market. The following instruction is appropriate where raised by the facts.

You are instructed that a search for a market or purchaser for oil or gas does not constitute “operations” within the meaning of the lease.

Source: *Gulf Oil Corp. v. Reid*, 337 S.W.2d 267 (Tex. 1960).

4.e.5. Lease Termination Question – Dry Hole Clause

Did Defendant fail to commence drilling operations on the No. 2 well within __ days after the No. 1 well was completed as a dry hole?

Answer “Yes” or “No.”

Answer:

Source: *Rogers v. Osborn*, 261 S.W.2d 311 (Tex. 1953); *Cox v. Stowers*, 786 S.W.2d 102 (Tex. App.-Amarillo 1990, no writ); *Phillips Petroleum v. Rudd*, 226 S.W.2d 464 (Tex. Civ. App.-Texarkana 1949, no writ).

Comment: This question is appropriate when application of the operations clause is based upon the drilling of a dry hole. This question must be conformed to the language of the lease in issue regarding the applicable time period and the event from which the time period is measured, and any limitation on the applicability of the clause, *e.g.*, whether the operation must be prior to the discovery of gas, or whether production ceased after the discovery of oil or gas. *See, e.g., Rogers v. Osborn*, 261 S.W.2d 311 (Tex. 1953) and *Stanolind Oil & Gas Co. v. Newman Brothers Drilling Co.*, 305 S.W.2d 169 (Tex. 1957).

4.e.6. Lease Termination Question – Drilling or Reworking Operations at End of Primary Term

At the end of the primary term of the lease in question, did Defendant fail to engage in drilling or reworking operations that were continued with no cessation of more than _ days and that resulted in the production of oil, gas, or other mineral in paying quantities?

You are instructed that “reworking operations” means any and all actual acts, work, or operations in which an ordinarily competent operator, under the same or similar circumstances, would engage in a good-faith effort to cause a well or wells to produce oil or gas in paying quantities.

Answer “Yes” or “No.”

Answer:

Source: *Rogers v. Osborn*, 261 S.W.2d 311 (Tex. 1953); *Cox v. Stowers*, 786 S.W.2d 102 (Tex. App.-Amarillo 1990, no writ); *Phillips Petroleum v. Rudd*, 226 S.W.2d 464 (Tex. Civ. App.-Texarkana 1949, no writ). For a more specific list of what might constitute “reworking operations,” *see Bargsley v. Pryor Petroleum Corp.*, 196 S.W.3d 823 (Tex. App.-Eastland 2006, no writ). Depending on the issue, these actions might be used in the instruction accompanying this question.

Comment: This question is appropriate when operations are conducted across the expiration of the primary term and where the oil, gas and mineral lease in issue specifies a period of time of nonproduction after which the lease terminates. This question must be conformed to the language of the lease or deed in issue regarding the applicable time period and the event from which the time period is measured, any limitation on the applicability of the clause (*e.g.*, whether the operation must be prior to the discovery of gas, or whether production ceased after the discovery of oil or gas), and any definition of the operations required. *See, e.g., Rogers v. Osborn*, 261 S.W.2d 311 (Tex. 1953) and *Stanolind Oil & Gas Co. v. Newman Bros. Drilling Co.*, 305 S.W.2d 169 (Tex. 1957).

Lack of Market: The following instruction is appropriate where raised by the facts.

You are instructed that a search for a market or purchaser for oil or gas does not constitute "operations" within the meaning of the lease.

Source: *Gulf Oil Corp. v. Reid*, 337 S.W.2d 267 (Tex. 1960).

4.e.7. Shut-In Royalty Question

Did Defendant fail to payor tender a shut-in royalty payment to Plaintiff within the time specified by Plaintiffs lease?

Answer "Yes" or "No."

Answer:

Source: *Hydrocarbon Management, Inc. v. Tracker Exploration, Inc.*, 861 S.W.2d 427 (Tex. App.- Amarillo 1993, no writ).

Comment: An oil, gas and mineral lease that is not capable of producing in paying quantities may not be perpetuated by the payment of shut-in royalties. *Hydrocarbon Management, Inc.*, 861 S.W.2d at 432; *Kidd v. Hoggett*, 331 S.W.2d 515,519 (Tex. Civ. App.-San Antonio 1959, writ refd n.r.e.). "Capable of producing" means that the well does not need additional equipment to operate. *Fike v. Riddle*, 677 S.W.2d 722, 725 (Tex. App.-Tyler 1984, no writ); *Hydrocarbon Management, Inc.*, 861 S.W.2d at 434.

4.e.8. Cessation of Production in Paying Quantities Question

Did the well in question cease to produce oil and gas in paying quantities?

You are instructed that to find that a well has ceased to produce oil and gas in paying quantities, you must find both: (1) that production from the well over a reasonable period of time does not yield a profit after deducting operating and marketing costs; and (2) that a prudent operator would not continue, for profit and not for speculation, to operate the well as it has been operated.

You are further instructed that where production is sufficient to yield a return in excess of operating and marketing costs, the well is producing in paying quantities even though drilling

and equipment costs may never be repaid and the undertaking considered as a whole may ultimately result in a loss.

You are further instructed that operating expenses include expenses such as taxes, overhead charges, labor, repair, depreciation of salvable equipment, and periodic expenditures incurred in the operation of the well. You shall not consider any costs or expenses incurred in connection with the original drilling or the reworking of the well.

Answer “Yes” or “No.”

Answer:

Source: *Clifton v. Koontz*, 325 S.W.2d 684, 691 (Tex. 1959); *Evans v. Gulf Oil Corp.*, 840 S.W.2d 500 (Tex. App.-Corpus Christi 1992, writ den.); *Pshigoda v. Texaco, Inc.*, 703 S.W.2d 416 (Tex. App.-Amarillo 1986, writ ref'd n.r.e.). Note that the burden of proof in a paying quantities case is on the lessor who alleges a failure to produce in paying quantities, and that burden should not be placed on the lessee-defendant. See *Bargsley v. Pryor Production Corp.*, 196 S.W.3d 823 (Tex. App.-Eastland 2006, no writ).

4.e.9. Cessation of Production Question

Did production of oil and gas from the well in question cease?

Answer: “Yes” or “No.”

Answer:

Comment: This question should be used when there is a dispute as to whether there has been a complete cessation of production of oil and gas.

If there are multiple wells on the land covered by the oil, gas and mineral lease in issue, the question should be submitted:

Did production of oil and gas from all wells located on the land covered by the lease in question cease?

If the oil, gas and mineral lease in issue contains a cessation-of-production or reworking clause that specifies a time by which operations must be resumed or production restored, the following question should be submitted:

Did production of oil and gas cease from the well in question cease for a period of consecutive days?

4.e.10. Temporary Cessation of Production Question

Was the cessation of production of oil and gas from the well in question excused?

You are instructed that a cessation of production of oil and gas is excused when it is temporary and is caused by a sudden stoppage of production from the well, mechanical breakdown of equipment used in connection with the well, or the like.

Answer: “Yes” or “No.”

Answer:

Source: *Watson v. Rochmill*, 155 S.W.2d 783 (Tex. 1941).

Comment: This question should be used where there has been only a temporary cessation of production, i. e., production has resumed.

Updated September 19,2005; Reason: Scrivener's mistake from original draft.

4.e.11. Repudiation of Title to Lease Question

Did Plaintiff repudiate Defendant's title to the lease?

You are instructed that a lessor repudiates the lessee's title under an oil, gas and mineral lease when the lessor gives unqualified notice that the lease has been forfeited or has terminated. A suit by the lessor to have the lease terminated is a repudiation.

Answer “Yes” or “No.”

Answer:

Source: *Kothmann v. Boley*, 308 S.W.2d 1 (Tex. 1957); *Miller v. Hodges*, 260 S.W. 168 (Tex. Com. App. 1924).

Comment: This issue often arises where a lessor contends that a lease has terminated or where the lessor interferes with the lessee's occupancy of the lease, such as by locking the gate. When the lessor is found to have repudiated the lease, the lessee's duties are suspended or excused.

5. ISSUES ARISING BETWEEN OPERATORS AND NON-OPERATORS UNDER OPERATING AGREEMENTS

5.a. Comment on Breach of Operating Agreement

PJC 101.2 generally addresses the question of contract compliance in the case of an alleged breach of contract. This section addresses the question of contract compliance in the case of an alleged breach of a joint operating agreement by the nonoperator(s) against the operator. An “Operating Agreement” or “Joint Operating Agreement” (often referred to as a “JOA”) is an agreement between or among interested parties for the exploration and development of a tract of land. Typically one of the parties is designated as the operator and the agreement contains detailed provisions concerning the drilling of an initial well, the drilling of any additional wells which may be required, the sharing of expenses, and accounting methods. The authority of the operator and restrictions thereon are spelled out in detail in the typical agreement. *See H.*

Williams and C. Meyers, *Manual of Oil and Gas Terms* (11th Ed. 2000, at 738). Several trade associations and ad hoc groups have prepared model forms of operating agreements. For example, the American Association of Professional Landmen (“AAPL”) has published several versions of its standard form, beginning in 1956, with revisions in 1977, 1982, and 1989. These AAPL forms are commonly utilized for Texas onshore oil and gas joint operations, and are often used with various modifications. Also, *Seagull Energy E&P, Inc. v. Eland Energy, Inc.*, 207 S.W.3d 342 (Tex. 2006) addresses the liability of one party to an Operating Agreement (usually a non-operator) to another party (usually the operator), when an interest under the JOA has been assigned to a third party without any express assumption of liability between the assignor and assignee. Eland holds that the assignor continues to be liable under the JOA, even after having assigned its interest. Many practitioners feel that regardless of whether that result is correct or not, that the Supreme Court’s reasoning found in Eland is somewhat confusing, incomplete and inconsistent.

5.b. Breach of Joint Operating Agreement Question

Did Defendant fail to comply with the Joint Operating Agreement by [*e.g.*, failing to submit an AFE for the reworking of the No. 1 Well]?

You are instructed that the Joint Operating Agreement requires the Defendant to perform certain obligations as set out more fully in that Agreement. As to certain provisions, the Court instructs you that the Defendant was obligated as follows:

[Insert applicable provisions], *e.g.*, “Operator shall not undertake any single project reasonably estimated to require an expenditure in excess of \$25,000.00 except in connection with a well, the drilling, reworking . . . of which has been previously authorized by or pursuant to this agreement.”]

Answer “Yes” or “No.”

Answer: _____

Comment: PJC 101.2 generally addresses the question of contract compliance in the case of an alleged breach of contract. This section addresses the question of contract compliance in the case of an alleged breach of an express or specific contractual provision by the Operator of a joint operating agreement. This type of question should be used when the allegation is that the Operator breached a specific provision of the joint operating agreement (or its exhibits such as the Accounting Procedure) rather than an allegation that the Operator failed to act in a good and workmanlike manner, (or in compliance with any of the other specifically articulated standards of conduct set out in the operating agreement).

This question may also be modified for use when a nonoperator is alleged to have breached the joint operating agreement.

5.c. Breach of Express Covenant by Operator to Conduct Operations in a Good and Workmanlike Manner Question

Did Defendant fail to comply with its obligation to conduct operations in a good and workmanlike manner by either committing gross negligence or committing willful misconduct?

You are instructed that the joint operating agreement requires the Operator to conduct operations in a good and workmanlike manner. A good and workmanlike manner requires the operator to act as “a reasonably prudent operator.”

You are further instructed that the Operator is not liable under this standard unless Operator's conduct amounts to gross negligence or willful misconduct.

You are further instructed that “gross negligence” means that entire want of care which would raise the belief that the act or omission complained of was a result of a conscious indifference to the right or welfare of the person or persons to be affected by it.

Answer “Yes” or “No.”

Answer: _____

Source: *Burk Royalty v. Walls*, 616 S.W.2d 911 (Tex. 1981); *Johnston v. American Cometra, Inc.*, 847 S.W.2d 711 (Tex. App.-Austin 1992, writ denied). *Burk Royalty* was decided in 1981. Depending on the vintage of the operating agreement at issue, this may or may not be the appropriate definition for gross negligence. See discussion under Comment to damage question, *supra*. See also *Dick Watt, et al., A Litigation Perspective: Selected Thoughts on the Express Negligence Doctrine, Exculpatory Clauses, and Indemnity in Joint Operating Agreements*, 26 State Bar of Texas Oil Gas & Energy Resources Law Section Report 1, Sept. 2001.

5.d. Breach of Joint Operating Agreement Damage Question

What sum of money, if any, if paid now in cash, would fairly and reasonably compensate the Plaintiff for its damages, if any, that resulted from Operator's failure to comply with the joint operating agreement?

Consider the following elements of damages, if any, and none other:

amounts the Operator charged Plaintiff above [\$25,000.00]

Do not add any amount for interest on past damages, if any.

Answer in dollars and cents, if any.

Answer: _____

5.e. Damage Question for Breach of Express Covenant to
Conduct Operations in a Good and Workmanlike Manner

What sum of money, if any, if paid now in cash, would fairly and reasonably compensate Plaintiff for its damages, if any, that resulted from Defendant's failure to comply?

Do not add any amount for interest on damages, if any.

Answer in dollars and cents, if any, as to the following.

Damages sustained in the past:

Answer:

Damages that will in reasonable probability be sustained in the future:

Answer: —

Source: PJC 110.2

This question should be predicated on at least one “Yes” answer to the liability questions on gross negligence or willful misconduct. The damage question may not be submitted without an instruction on the appropriate measure of damages. *Jackson v. Fontaine’s Clinics, Inc.*, 499 S.W.2d 87, 90 (Tex. 1973). See P13 1103-.4 for sample instructions.

Comment. This type of liability question and damage question should be used when the issue is whether the Operator failed to act as a reasonably prudent operator. Exculpatory language is found in most model joint operating agreements. Pre-1989 Model Forms generally provide: “[Operator] shall conduct all such operations in a good and workmanlike manner, but it shall have no liability as Operator to the other parties for losses sustained or liabilities incurred except such as may result from gross negligence or willful misconduct.”

There appears no need to give an instruction defining “willful misconduct.” *Greentree Acceptance v. Combs*, 745 S.W.2d 87, 90 (Tex. App.-San Antonio, 1988, writ denied) (holding “willful misconduct” is a word of ordinary meaning and readily understood by the average person; see also *Rey v. State*, 512 S.W.2d 40,44 (Tex. App.-El Paso 1974, writ ref’d n.r.e.).

Defining gross negligence in the instruction is more complex. Normally it is understood that parties to a contract have evidenced their intention to incorporate the laws that existed at the time and place of the making of the agreement. *Amarillo Oil Co. v. Energy-Agri Products, Inc.*, 794 S.W.2d 20 (Tex. 1990); *Hardware Dealers Mut. Ins. Co. v. Gerlund*, 393 S.W.2d 309, 315 (Tex. 1965). (“contracting parties generally selected judicially construed clause with the intention of adopting the meaning which the courts have given to it.”); see also *Luling Oil & Gas v. Humble Oil & Refining Co.*, 191 S.W.2d 716,724 (Tex. 1945) (“When an agreement is silent or obscure as to a particular subject, the law and usage become a portion of it and constitute a supplement to it and interpret it.”). Thus, the appropriate definition for gross negligence may depend on when the joint operating agreement was entered into. However, in recent years the Texas Legislature has codified and transformed the term gross negligence into the term “malice”

which has been substituted for its “ancestor,” gross negligence, in the TEX. CIV. PRAC. & REM. CODE § 41.001 (7) for all causes of action accruing on or after September 1, 1995 in cases in which punitive damages are sought. See PJC - Gross Negligence (2000 ed.) - 4.2B. Although punitive damages may not be appropriate in a suit for breach of a contractually agreed upon standard of conduct in an operating agreement, the pivotal issue regarding the definition to be used appears to be whether the current statutory definition of malice has supplanted the common law definition and is therefore appropriate when defining gross negligence in the context of an operating agreement dispute, or whether the prior common law definitions set out in *Burk Royalty v. Walls*, 616 S.W.2d 911 (Tex. 1981) and *Transportation Ins. Co. v. Moriel*, 879 S.W.2d 10 (Tex. 1994) are the appropriate definitions depending on the vintage of the operating agreement. In *Moriel*, the Texas Supreme Court observed that the statute codified the common-law definition without any elemental change. *Moriel*, 879 S.W.2d at 20. The appropriate definition of gross negligence will ultimately depend on the specific facts and circumstances of the case submitted to the jury.

As a caveat, the question as to whether the exculpatory language in the JOA pertains to express contractual obligations (as well as obligations to act as a reasonable prudent Operator) was discussed in *Abraxas Petroleum Corp. v. Hornburg*, 20 S.W.3d 741 (Tex. App.-El Paso 2000, no pet.). In that case the court was faced with the argument that the pre-1989 Form exculpatory clause applied only to causes of action arising from lease operations and did not apply to Operators’ breach of other express provisions of the contract. The court decided that the provisions in the Pre-1989 Form quoted above were unambiguous and stated:

We first find that the exculpatory clause is unambiguous and therefore we will construe it as a matter of law. As some evidence that the parties did not intend that the exculpatory clause applied to any and all claims, we note that the exculpatory clause is found in an article which concerns the Operator’s authority to conduct operations in the Contract Area. More significantly, the Operator’s limitation of liability is linked directly to imposition of the duty to act as a reasonably prudent Operator which strictly concerns the manner in which the Operator conducts drilling operations on the lease. Accordingly, we conclude that the exculpatory clause is limited to claims based on an allegation that Abraxas failed to act as a reasonably prudent Operator and does not apply to a claim that it breached the JOA. Since the exculpatory clause does not apply and Appellees are not entitled to exemplary damages for breach of contract, Appellees were not obligated to prove gross negligence or willful misconduct.

Id. at 759.

The *Abraxas* case is some authority that the exculpatory clause does not pertain to contractual obligations as distinguished from its application to breaches involving operations conducted by the Operator. See also *Castle Prod. L. P. v. Long Trusts*, 2003 WL 21771718, * 13 (Tex. App.-Tyler July 31, 2003, pet. denied); *IP Petroleum Co., Inc. v. Wevanco Energy, L.L.C.*, 116 S.W.3d 888, 894-96 (Tex. App.-Houston [1st Dist.] 2003, pet. denied) (exculpatory clause applies to claims resulting from operations).

The Abraxas court held that, if the duty violated by the operator is derived from its responsibilities as operator under the JOA, then the contractual relationship is controlled by the agreement and non-operators would not be permitted to maintain common law causes of action citing *DeWitt County Electric Cooperative*, 1 S.W.3d 96, 105 (Tex. 1999). In *DeWitt*, the landowners sued the power company for cutting down trees in the utility right-of-way. The court held that the landowners could not maintain a negligence claim independent of breach of contract claim because the easement itself permitted the power company to cut trees in the easement. This was true even though landowners could have maintained a negligence suit if no agreement had ever existed between the parties. The contract spelled out the parties' respective rights about whether the trees could be cut and therefore, the contract, not common law negligence, governed the disputes.

Arguably, if the conduct of the Operator falls within the duties set out in the operating agreement - including the prudent operator standard as limited by the exculpatory clause - that a breach of those duties will be a breach of contract and nothing more. If the duties fall outside the scope of the authority given the Operator, then the Operator's conduct may rise to the level of an independent tort to which common law causes of action apply.

5.f. Breach of Specifically Enumerated Duties in the Operating Agreement by the Operator

Did the Operator breach its duties under the JOA?

Answer "Yes" or "No."

Answer:

Comment: The Operator's standard of care expressly provided for in the Joint Operating Agreement may vary from operating agreement to operating agreement, including variances in the "model forms." This will give rise to different instructions regarding the Operator's duty. The instructions ought to be contract specific.

For example, in the 1977 Model Form, the Operator was held to perform in "a good and workmanlike manner" which the court construed as requiring the Operator to be "a reasonable prudent Operator." *Johnston v. American Cometra Inc.*, 837 S.W.2d 711 (Tex. App.-Austin, 1992, writ denied).

If the activity the Operator is engaged in creates a principal-agent relationship such as selling gas for the nonoperators, unless limited contractually, then the Operator owes those "duties owed by an agent to its principal." See *Johnston v. American Cometra Inc.*, 837 S.W.2d 711 (Tex. App.-Austin 1992, writ denied); *Atlantic Richfield Co. v. Long Trusts*, 860 S.W.2d 439 (Tex. App.-Texarkana 1993, writ denied). Another court stated that where the nonoperators' gas had not been dedicated to a contract, the Operator's duty in marketing the gas for the Non-operators was "a limited duty to account for the monies received for selling his gas, to avoid conflicts of interest, and not to act as an adverse party in its capacity as the seller of his gas." *Holloway v. Atlantic Richfield Co.*, 970 S.W.2d 641, 643 (Tex. App. Dist. Tyler 1998, no writ).

The 1989 Model Form in Article VII negates a partnership, joint venture, agency or fiduciary relationship and states specifically:

In their relations with each other under this Agreement, the parties shall not be considered fiduciaries or to have established a confidential relationship but rather shall be free to act on an arm's length basis in accordance with their own respective self interests, subject however, to the obligation of the parties *to act in good faith in their dealings with each other* with respect to its activities hereunder.” (Emphasis added)

Therefore, an instruction under a 1989 Model Form Agreement may require that the Operator act in “good faith.” Significantly, the forms prior to 1989 did not negate agency, did not negate fiduciary relationship, but did not expressly obligate the parties to act in good faith.

The differing descriptions of the Operator's duties under the various forms need to be taken into account when drafting instructions. Note the differences between the pre-1989 Model Forms and the 1989 Model Forms:

Article V(A) in the 1956 Form, 1977 Form and the 1982 Form states:

[ABC Oil Company] shall be the Operator of the Contract Area and shall conduct and direct and have full control of all operations on the Contract Area as permitted and required by, and within the limits of this agreement. It shall conduct all such operations in a good and workmanlike manner but it shall have no liability as Operator to the other parties for losses sustained or liabilities incurred except such as may result from gross negligence or willful misconduct. (emphasis supplied)

By contrast, observe the language of Article V(A) in the 1989 Model Form which states:

[ABC Oil Company] shall be the Operator of the Contract Area and shall direct and have full control of all operations on the Contract Area as permitted and required by, and within the limits of this agreement. In its performance of services hereunder for the Non-operators, Operator shall be an independent contractor not subject to the control or direction of the Non-operators except as to the type of operation to be undertaken in accordance with the election procedures contained in this agreement. Operator shall not be deemed or hold itself out as the agent of the Non-operators with the authority to bind them to any obligation or liability assumed or incurred by Operator as to any third party. Operator shall conduct its activities under this agreement as a reasonable prudent Operator, in a good and workmanlike manner, with due diligence and dispatch, in accordance with good oilfield practice, and in compliance with applicable law and regulation, but in no event shall it have any liability as Operator to the other parties for losses sustained or liabilities incurred except such as may result from gross negligence or willful misconduct. (emphasis supplied)

5.g. Instructions on Payment Not Constituting Waiver

You are instructed that according to the operating agreement, payments of the operating expenses from [date] to the present do not constitute waiver. Waiver is an intentional surrender of a known right or intentional conduct inconsistent with claiming the right.

Source: Paragraph 1.(4), Adjustments of COPAS Accounting Procedure.

Comment: If the issue is operator’s failure to charge correctly under the accounting procedure, an instruction may be necessary to clarify that payment of joint interest billings does not constitute a waiver of a claim that Operator’s charges were excessive or disallowed altogether.

6. OTHER WORKING INTEREST OWNER DISPUTES

6.a.1. Breach of a Farmout Agreement Question

Did Defendant fail to comply with the Farmout Agreement?

You are instructed that the Farmout Agreement requires Defendant to perform certain obligations as set out more fully in that agreement. As to certain provisions, the Court instructs you that Defendant was obligated as follows:

[Insert applicable provisions] For example, “On or before January 15, __ , Defendant shall commence the actual drilling of an initial test well at a location [specified] and thereafter diligently drill same to a Contract Depth of 9,000 feet or a depth sufficient to test the XYZ formation.”

Answer “Yes” or “No”

Answer: _____

When to use: PJC 101.2 generally addresses the question of contract compliance in the case of an alleged breach of contract. This section addresses the question of contract compliance in the case of an alleged breach of contract involving a Farmout Agreement.

Comment: A “Farmout Agreement” is a very common type of agreement between operators, whereby a lease owner not desirous of drilling at the time agrees to assign the lease or some portion of it (in common or in severalty) to another operator who is desirous of drilling the tract. The assignor in such a deal may or may not retain an overriding royalty, back-in working interest, or production payment. The primary characteristic of the farmout is the obligation of the assignee to drill one or more wells on the assigned acreage as a prerequisite to the completion of the transfer. *See Eland Energy, Inc. v. Rowden Oil & Gas, Inc.*, 914 S.W.2d 179, 182 (Tex. App.-San Antonio 1995, writ denied).

6.b.1. Comment on Preferential Right to Purchase

A “Preferential Right to Purchase” has been defined as a right reserved by a party to a farmout or other agreement to buy the interest of the other party, provided it is willing to pay for the interest at a price that is offered in good faith. *See, e.g., Luling Oil & Gas Co. v. Humble Oil & Ref Co.*, 191 S.W.2d 716 (Tex. 1945); and H. Williams and C. Myers, *Manual of Oil and Gas Terms* (11th Ed. 2000, at 825). It has been referred to by a number of different names, including “preferential right,” “preference right,” “preference right to purchase,” “first privilege to purchase,” “preemption,” “preemptive right,” “first right of refusal,” “first refusal clause,” and “right of first refusal.”

A preferential right to purchase provision may exist as an independent agreement between the parties or as a part of another agreement. In an oil and gas context it is usually included as a pmi of an operating agreement or farmout agreement. The preferential right to purchase provision contained in the American Association of Professional Landmen (“AAPL”) Form 610 Model Form Operating Agreement for onshore operations is among the most widely known. Article VIII.F. of the 1989 version of that form provides as follows:

Should any party desire to sell all or any part of its interests under this agreement, or its rights and interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed disposition, which shall include the name and address of the prospective transferee (who must be ready, willing and able to purchase), the purchase price, a legal description sufficient to identify the property, and all other terms of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after the notice is delivered, to purchase for the stated consideration on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to transfer title to its interests to its mortgagee in lieu of or pursuant to foreclosure of a mortgage of its interests, or to dispose of its interests by merger, reorganization, consolidation, or by sale of all or substantially all of its Oil and Gas assets to any party, or by transfer of its interests to a subsidiary or parent company or to a subsidiary of a parent company, or to any company in which such party owns a majority of the stock.

A preferential right to purchase provision has been said to serve two purposes. First, it assures its holder an opportunity to acquire further interests in the contract area should a co-owner of an interest decide to sell its interest to a third party. It thus allows owners, who may have been at risk in exploratory efforts that contributed to the development of a property, to have an opportunity to acquire an additional interest in the property in preference to a third party who did not participate in such risks. Second, it ensures that the owners retaining their interest in the contract area have some degree of control in excluding undesirable participants who may not have the necessary financial ability to bear their share of expenditures or who might frustrate development with management and engineering philosophies that current owners oppose. *See generally Questa Energy Corp. v. Vantage Point Energy, Inc.*, 887 S.W.2d 217, 222 (Tex. App.-Amarillo 1994, writ denied).

Several cases have considered compliance with a prescribed manner of acceptance in the exercise of a preferential right to purchase or similar right. For example, the Texas Supreme Court applied the rule that acceptance must be in strict compliance with the offer in the case of a lease renewal option in *Zeidman v. Davis*, 342 S.W.2d 555 (Tex. 1961) (finding that the option holder had not exercised the option within the time prescribed and there were no findings of fact that made it inequitable for the option holder to require strict compliance with the option notice provision). *See also Ellis v. Waldrop*, 656 S.W.2d 902, 904 (Tex. 1983) (involving the failure by the right holder to exercise a preferential right to purchase within the prescribed 30-day period).

The rule of strict compliance was applied in another "option" case in *Tidwell v. Lange*, where the court of appeals affirmed the trial court's decision, stating the following:

In the absence of equities an optionee is held to a strict compliance with the terms of the option agreement. The lease here granted the option to [Tidwell]. [Tidwell] did not exercise it within the time prescribed, and could not have as rentals [due and owing by Tidwell] ... were unpaid on the property There are no findings of fact which make it inequitable as to [Tidwell] to require a strict compliance with the notice provision.

531 S.W.2d 384,386 (Tex. Civ. App.-Waco 1975, no writ).

The court in *Hutcherson v. Cronin*, reached the same result in the case of a lease purchase option. In considering Hutcherson's purported exercise of the purchase option, the court stated the rule as follows:

The acceptance of an option, to be effectual, must be unqualified, absolute, unconditional, unequivocal, un-ambiguous, positive, without reservation, and according to the terms or conditions of the option. Substantial compliance with the terms of the option is held not sufficient to constitute an acceptance; to be effectual, the acceptance must be identical with the offer, or, at least, there must be no substantial variation between them. An acceptance of an option must be such a compliance with the conditions as to bind both parties, and if it fails to do so, it binds neither.

426 S.W.2d 638, 641 (Tex. Civ. App.-Tyler 1968, no writ).

West Texas Transmission, L.P. v. Enron Corp., 907 F.2d 1554, (5th Cir. 1990), *cert. denied*, 499 U.S. 906 (1991) involved an effort by a preferential right to purchase holder, Valero, to avoid an "FTC approval" condition in the contract for a transaction to which the preferential right to purchase applied (Valero was unable to obtain such approval). The Fifth Circuit Court of Appeals stated that Valero misunderstood the nature of a preemptive right, which must be exercised on the terms and conditions specified in the contract granting that right. The court found that the FTC-approval condition became a term of the subject contract as long as the approval requirement was commercially reasonable, imposed in good faith, and not specifically designed to defeat Valero's preemptive rights. The court found that the FTC-approval condition was commercially reasonable, as the condition was included only after arms-length negotiations and was not unlike financing conditions routinely included in contracts among business venturers. The court also rejected Valero's contention that Valero was only required to match the price term or material terms of the subject contract. The court noted that the preferential right to purchase did not define the phrase "terms and conditions" to mean only the price term. The court further noted that, like any other offer, the exercise of an option must be "unqualified, absolute, unconditional, unequivocal, unambiguous, positive, without reservation and according to the terms or conditions of the option."

The terms and conditions of exercise were also in issue in *Texas State Optical, Inc. v. Wiggins*, 882 S.W.2d 8 (Tex. App.-Houston [1st Dist.] 1994, no writ), where the court of appeals

acknowledged that the relevant PRP had matured into an option and that the exercise of an option, like acceptance of any other offer, must be positive, unequivocal, and not change or qualify the terms of the offer. However, the court cited West Texas Transmission in noting that there is an exception where a seller imposes a term in bad faith to defeat an option, in which case the option holder may validly exercise the option while at the same time rejecting the bad faith term.

Abraham Inv. Co. v. Payne Ranch, Inc., 968 S.W.2d 518 (Tex. App.-Amarillo 1998, writ denied) is a case in which the Amarillo Court of Appeals chose to not follow West Texas Transmission and its three exceptions to the unequivocal acceptance rule of option agreements, finding that those exceptions were based in large part on the law of other jurisdictions. The court instead followed *Jones v. Gibbs*, 130 S.W.2d 265 (Tex. 1939), which held that equitable relief will be granted where the offeree failed to accept the offer within an option agreement if such failure resulted from fraud, surprise, accident, or mistake.

Particular difficulties are presented when a lease or property subject to a preferential right to purchase is conveyed together with other leases or properties for a lump sum price. The question then becomes how much of that total price was or could have been properly allocated to the preference right lease? As a starting point for the factors and complexity of such questions, see *Navasota Resources, L.P. v. First Source Texas, Inc.*, 249 S.W.3d 526 (Tex. App.-Waco 2008, pet. denied)

6.b.2. Breach of a Preferential Right to Purchase Agreement Question

Did Defendant fail to comply with the Preferential Right to Purchase agreement?

You are instructed that the Preferential Right to Purchase agreement requires Defendant to perform certain obligations as set out more fully in that agreement. As to certain provisions, the Court instructs you that Defendant was obligated as follows:

[Insert applicable provisions] For example, "In the event that Defendant desires to sell his interest in the oil and gas rights subject to this Agreement, he shall first notify the other parties to this Agreement who shall have a preferential right to purchase such interest on the same terms and conditions as those being considered by Defendant."

Answer "Yes" or "No"

Answer:

Source: PJC 101.2 generally addresses the question of contract compliance in the case of an alleged breach of contract. This section addresses the question of contract compliance in the case of an alleged breach of contract where that contract involves a Preferential Right to Purchase.

6.b.3. Preferential Right to Purchase Question

Was Defendant's failure to comply with the preferential right to purchase excused?

Answer "Yes" or "No."

Answer:

6.b.4. Affirmative Defense to Breach of Preferential Right to Purchase

6.b.5. Preferential Right to Purchase Damage Question

What sum of money, if any, if paid now in cash would fairly and reasonably compensate Plaintiff for his damages, if any, that resulted from such failure to comply with the preferential right to purchase?

[Insert appropriate instructions. *See, e.g.*, PJC 110.3 and 110.4]

Answer: \$ _____

Source: This question conforms PJC 110.2 to the question of contract damages in the case of a contract involving a preferential right to purchase.

Comment: The Texas courts have applied specific performance as a remedy for the breach of a preferential right to purchase. The court in *Abraham Inv. Co. v. Payne Ranch, Inc.*, generally described the rules as follows:

A purchaser of real estate is entitled to specific performance of a contract for sale of land when the contract is valid and enforceable, and when the terms of the contract are sufficiently clear so that the parties know of their obligations under the contract. If the seller breaches a contract for the sale of land and subsequently sells the land to another purchaser who has knowledge of the previous contract, then the subsequent purchaser stands in the shoes of the original seller when specific performance is sought and may be compelled to convey title to the first purchaser. Finally, when the seller has conspicuously breached the contract, it is only necessary that the purchaser be ready and willing, and offers to perform within his pleadings.

968 S.W.2d 518,527 (Tex. App.-Amarillo 1998, no writ) (citations omitted).

The court in *Martin v. Loft* addressed the remedy of specific performance of a preferential right to purchase as follows:

In a suit for specific performance of an agreement not to sell or transfer without first making an offer to the plaintiff, such a transfer is considered equivalent to the offer which the owner has failed to make and gives the plaintiff an election to accept or reject, that is, to purchase or decline to purchase.

482 S.W.2d 482, 922 (Tex. Civ. App.-Dallas 1972, no writ); *see also Riley v. Campeau Homes (Texas), Inc.*, 808 S.W.2d 184, 188 (Tex. App.-Houston [14th Dist.] 1991, writ dismissed). Specific performance is a remedy to be awarded by the Court, and is not a fact question for the jury.

6.c.1. Breach of Area of Mutual Interest Agreement Question

Did Defendant fail to comply with the Area of Mutual Interest agreement?

You are instructed that the Area of Mutual Interest agreement requires Defendant to perform certain obligations as set out more fully in that agreement. As to certain provisions, the Court instructs you that Defendant was obligated as follows:

[Insert applicable provisions] For example, “In the event that Defendant acquires an oil and gas lease or other similar interest in the Contract Area during the term of this Agreement, he shall notify Plaintiff in writing and offer Plaintiff the right to participate in such acquisition in a proportionate share based upon Plaintiff’s interest in the Contract Area.”

Answer “Yes” or “No”

Answer:

Source: PJC 101.2 generally addresses the question of contract compliance in the case of an alleged breach of contract. This section addresses the question of contract compliance in the case of an alleged breach of contract involving an Area of Mutual Interest.

Comment. An “Area of Mutual Interest” agreement or “AMI” is an agreement between or among parties to a farmout agreement or a joint operating agreement, or other agreement, by which the parties attempt to describe a geographical area within which they agree to share certain additional leases or other interests acquired by any of them in the future. *See Westland Oil Development Corp. v. Gulf Oil Corp.*, 637 S.W.2d 903, 73 O.&G.R. 359 (Tex. 1982). While not contained in the body of any of the American Association of Professional Landmen (“AAPL”) Joint Operating Agreement (“JOA”) forms, an AMI is often added by the parties to the JOA. *See H. Williams and C. Meyers, Manual of Oil and Gas Terms* (11th Ed. 2000, at 58).

6.c.2. Damages for Breach of Area of Mutual Interest Agreement Question

What sum of money, if any, if paid now in cash would fairly and reasonably compensate Plaintiff for his damages, if any, that resulted from such failure to comply with the AMI?

Answer in dollars and cents, if any.

Answer: \$ _____

Source: PJC 11 0.2 generally addresses the question of contract damages. This section addresses the question of contract damages in the case of a contract involving an AMI.

Comment: The court in *Abraham Inv. Co. v. Payne Ranch, Inc.*, generally described the rules regarding specific performance as follows:

A purchaser of real estate is entitled to specific performance of a contract for sale of land when the contract is valid and enforceable, and when the terms of the contract are sufficiently clear so that the parties know of their obligations under

the contract. If the seller breaches a contract for the sale of land and subsequently sells the land to another purchaser who has knowledge of the previous contract, then the subsequent purchaser stands in the shoes of the original seller when specific performance is sought and may be compelled to convey title to the first purchaser. Finally, when the seller has conspicuously breached the contract, it is only necessary that the purchaser be ready and willing, and offers to perform within his pleadings.

968 S.W.2d 518, 527 (Tex. App.-Amarillo 1998, no writ) (citations omitted). Specific performance is a remedy awardable by the Court, and is not a fact question for the jury.

7. MISCELLANEOUS ISSUES

7.a. Conversion Question

Did Defendant convert oil and gas that belonged to Plaintiff?

You are instructed that “conversion” means the unauthorized and wrongful exercise of dominion and control over the personal property of another in denial of or inconsistent with the rights of the owner of the property. It is not necessary that there be a manual taking of the property. Oil or gas is personal property once it is removed from the geological formation in which it was contained by nature.

Answer “Yes” or “No.”

Answer:

Source: *Waisath v. Lack’s Stores, Inc.*, 474 S.W.2d 444 (Tex. 1971); *Rogers v. Ricane Enterprises, Inc.*, 930 S.W.2d 157 (Tex. App.-Amarillo 1996, no writ).

7.b. Laches Question

Is Plaintiff’s claim barred by laches?

You are instructed that Plaintiff’s action is barred by laches if you find that:

- a. Plaintiff delayed in filing suit;
- b. Plaintiff’s delay is not excused; and
- c. the delay resulted in undue prejudice to Defendant’s ability to present an adequate defense;

or you find:

- a. an unreasonably delay by Plaintiff in asserting his rights; and
- b. a good-faith change of position to his detriment by Defendant because of the delay.

Answer "Yes" or "No."

Answer:

Source: *City of Fort Worth v. Johnson*, 388 S.W.2d 400, 403 (Tex. 1964); *De Benavides v. Warren*, 674 S.W.2d 353, 362 (Tex. App.-San Antonio 1984, writ ref'd n.r.e.); *Pearson v. American Fidelity & Cas. Co.*, 321 S.W.2d 620, 622 (Tex. Civ. App.-Amarillo 1959, writ ref'd n.r.e.).

7.c. Revivor Question

Did Plaintiff revive the deed to Defendant?

You are instructed that a person revives a conveyance of an estate in land by the execution [or acceptance] of a formal document in writing, even to a third party, in which the person recognizes in clear language the validity of the conveyance.

Answer "Yes" or "No."

Answer:

Source: *Westbrook v. Atlantic Richfield Co.*, 502 S.W.2d 551 (Tex. 1974); *Hastings v. Pinchinson*, 370 S.W.2d 1,4 (Tex. Civ. App.-San Antonio 1963, no writ).

7.d. Ratification Question

Did Plaintiff ratify the deed to Defendant?

You are instructed that a person ratifies a conveyance of an estate in land by the execution [or acceptance] of a formal document in writing, even to a third party, in which the person recognizes in clear language the validity of the conveyance.

Answer "Yes" or "No."

Answer: _

Source: *Westbrook v. Atlantic Richfield Co.*, 502 S.W.2d 551 (Tex. 1974); *Hastings v. Pinchinson*, 370 S.W.2d 1,4 (Tex. Civ. App.-San Antonio 1963, no writ).

7.e. Executive Rights Question

Executive Right - Fiduciary Duty

Did Defendant comply with its fiduciary duty to Plaintiff in exercising its executive right?

You are instructed that the term "executive right" means the right to develop or to lease lands for exploration, development and production of oil and gas. Defendant, as the holder of the

executive right, has a fiduciary duty to Plaintiff, the non-executive, which requires Defendant to prove that he acted with the utmost good faith toward Plaintiff and obtained for Plaintiff every benefit that Defendant obtained for himself.

Answer "Yes" or "No":

Answer:

Source: *In re Bass*, 113 S.W.3d 735 (Tex. 2003); *Manges v. Guerra*, 673 S.W.2d 180 (Tex. 1984); *Schlittler v. Smith*, 128 Tex. 628, 101 S.W.2d 543 (1937).

Comment: The executive right “is an interest in property, an incident and part of the mineral estate like the other attributes such as bonus, royalty and delay rentals.” *Day & Co. v. Texland Petroleum*, 786 S.W.2d 667, 669 (Tex. 1990). As an attribute of mineral ownership, it gives its holder the right to develop the minerals or to execute oil and gas leases which convey those minerals to others for development. *Altman v. Blake*, 712 S.W.2d 117, 118 (Tex. 1986); *French v. Chevron U.S.A., Inc.*, 896 S.W.2d 795, 797, n.1 (Tex. 1995). An interest in minerals that is subject to an executive right is referred to as a “non executive” interest, a term Texas courts use to describe both non-participating royalties (e.g. *Schlittler v. Smith* - interests that are non-possessory, where royalty may not depend on the amount of royalty in the lease, and whose owners receive no bonus money when a lease is signed), as well as non-executive mineral interests (e.g. *Day & Co. v. Texland* - interests that, depending on the language creating them, may entitle their owners to receive bonus money on the signing of a lease, and where the royalty due on the minerals leased is always governed by that royalty stipulated in the lease). See also *Marrs & Smith Partnership v. D.K. Boyd Oil and Gas Co.*, 223 S.W.3d 1 (Tex. App.-El Paso 2005).

The supreme court has not been consistent in describing the duty owed by the owner of the executive right to a non-executive owner. In *Schlittler v. Smith*, the supreme court described the executive’s duty as one of “utmost fair dealing.” 101 S.W.2d 545. In *Manges*, the supreme court described the executive’s duty both as one of “utmost good faith” and as a “fiduciary duty.” 673 S.W.2d at 183. In *In re Bass*, the supreme court flatly stated that there is a fiduciary duty between executive and non-executive interest owners. However, the supreme court in *Bass* also held that the executive had not breached the duty because he had not executed a lease, and thus had acquired no benefits for himself at the expense of the non-executives, who were non-participating royalty owners.

Because of *Bass*, the Council chose the above question as appropriate in the situation where the executive has taken action that may constitute a breach of the fiduciary duty, and like a true fiduciary duty, this question shifts the burden of proof to the executive owner. However, because *Manges* indicates perhaps that the supreme court has not considered whether or not the duty owed by the executive is a traditional fiduciary duty, such as that owed by a trustee or an attorney, rather than using PJC 104.2, the question for a breach of a traditional fiduciary duty, the Council chose to use the question set out above, which incorporates only the obligations expressly set out in the *Manges* opinion, and does not use other elements of fiduciary duty that are set out in PJC 104.2.

Whether this is correct the Council will leave to future courts, but the Council further notes that the supreme court's holding in Bass - that there could be no breach of the executive's fiduciary duty without the execution of a lease - casts doubt on the viability of a non-executive's claim against an executive owner for failure of the executive to execute an oil and gas lease. However, if a future court views different facts than found in Bass, for example a non-executive mineral owner not receiving bonus money because of the failure to lease, such a court might view that situation differently than the supreme court viewed the non-participating royalty owners in Bass. *See, e.g., Hlavinka v. Hancock*, 116 S.W.3d 412 (Tex. App.-Corpus Christi 2003, pet. denied). In that event, if *Pickens v. Hope* and similar cases remain authoritative after Bass, and the facts in a future case are believed to present a basis for a claim of breach by the executive by not signing a lease or committing some other act triggering the fiduciary duty, then the following question should be used. Note that the burden of proof remains on the non-executive in this question.

Executive Right - No Fiduciary Duty

Did Defendant fail to comply with the duty of utmost good faith and fair dealing to Plaintiff in the exercise of the executive right?

You are instructed that the term “executive right” means the right to lease lands for exploration, development and production of oil and gas. In the exercise of the executive rights, the holder thereof has a duty to use utmost good faith and fair dealing as to the interest of the non-executive “Utmost good faith and fair dealing” means the use of the same degree of diligence and discretion in exercising the rights and powers held by an executive owner as would be utilized by the average landowner seeking to obtain all the benefits that could be reasonably obtained for himself and for his non-participating royalty owner from a disinterested third party in an arms-length transaction.

Answer “Yes” or “No”:

Answer:

Source: *Hlavinka v. Hancock*, 116 S.W.3d 412 (Tex. App.-Corpus Christi 2003, pet. denied); *Pickens v. Hope*, 764 S.W.2d 256 (Tex. App.-San Antonio 1988, writ denied).

7.f. Executive Rights Damage Question

What sum of money, if any, if paid now in cash, would fairly and reasonably compensate Plaintiff for its damages, if any, that were proximately caused by such failure?

Answer in dollars and cents, if any.

Answer: _____

Breach causing termination of interest: In a case in which the conduct of the executive rights holder causes a well not to be drilled on lands covered by the non-executive’s term royalty and

results in the term royalty expiring before drilling on those lands, the following damage question is proper:

What sum of money, if any, if paid now in cash, would fairly and reasonably compensate the plaintiffs for the loss of the non-participating term royalty interest that Defendant caused to be terminated?

Source: *Kimsey v. Fore*, 593 S.W.2d 107 (Tex. Civ. App.-Beaumont 1979, writ ref'd n.r.e.).

Exemplary damages. The nonexecutive may recover exemplary damages from the executive rights holder when the breach is intentional, malicious, fraudulent, or grossly negligent, *Manges v. Guerra*, 673 S.W.2d 180, 184-85 (Tex. 1984); *Lueke v. Wallace*, 951 S.W.2d 267, 276 (Tex. App.-Austin 1997, no writ); *Dearing, Inc. v. Spiller*, 824 S.W.2d 728, 734 (Tex. App.-Fort Worth 1992, writ denied); *Mims v. Beall*, 810 S.W.2d 876,881 (Tex. App.-Texarkana 1991, no writ). Chapter 41 of the Texas Civil Practice and Remedies Code has supplanted the common law and now controls the evidentiary standard for an award of exemplary damages. PJC 110.33 and 110.34 should be submitted where exemplary damages are recoverable.