

# Texas Oil and Gas Law Journal



LexisNexis®

BRUCE M. KRAMER, EDITOR IN CHIEF

Volume 19, Number 6

December 2005

## CONTENTS

### Joint Operating Agreements—Part 2

By Stuart C. Hollimon..... 61

## CASE NOTES

### Surface Condition

*Fenner v. Samson Resources Co.*..... 68

### Protective Orders and Confidentiality

*In Re Shell E&P, Inc.*..... 70

## Joint Operating Agreements—Part 2

by  
Stuart C. Hollimon\*

### III. EXCULPATORY CLAUSE

With slight variations in wording, the 1977, 1982 and 1989 versions of the AAPL Model Form Operating Agreement all provide generally that the operator shall conduct operations in a good and workmanlike manner, but that 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. The language of the 1956 form is materially different from the later forms. The corresponding language in that form says that the operator is only liable to the other parties for losses that result from “gross negligence or from breach of the provisions of this agreement.”

Several cases have considered whether the exculpatory language in the 1977 and later forms is applicable to breaches of the operating agreement that do not involve physical operations on the contract area. The Fifth Circuit, applying Texas law, considered this issue in *Stine v. Marathon Oil Company*, 976 F.2d 254 (5th Cir. 1992). The Fifth Circuit held that the exculpatory clause applies not only to the conduct of operations, but to any acts done by the operator under the authority of the operating agreement, including administrative functions. Thus, in the Fifth Circuit’s view, the exculpatory clause shields the operator from liability for any act taken in its capacity as operator unless its conduct involves gross negligence or willful misconduct.

In the following recent cases, Texas state courts have taken a narrower view of the scope of the exculpatory clause, and have held that it only extends to physical operations and not to breaches of administrative provisions. None of these cases cites *Stine*.

Texas Oil and Gas Law Journal (USPS 021-326, ISSN 1544-7049) is published bi-monthly by LexisNexis Matthew Bender, 1275 Broadway, Albany, NY 12204-2694. Periodical Postage paid at Albany, NY and additional mailing offices.

Postmaster: Send address changes to Texas Oil and Gas Law Journal, LexisNexis Matthew Bender, Attn: Customer Service, 1275 Broadway, Albany, NY 12204-2694.

\*Stuart C. Hollimon practices law with the firm of Andrews, Kurth in Dallas, Texas. This paper is a revised version of a paper presented to the Dallas Bar Association’s Review of Oil and Gas Law XX on August 25–26, 2005. Reprinted by permission of author.

ISSN 1544-7049

© 2005 Matthew Bender & Company, Inc., a member of LexisNexis Group. All rights reserved.

The *Texas Oil and Gas Law Journal* is published by LEXISNEXIS™, telephone 1-800-833-9844.

**EDITOR IN CHIEF**

Bruce M. Kramer

**CASE NOTES EDITOR**

Katrina Rose

**PRACTICE AREA EDITOR**

John R. Prince

rand.prince@lexisnexis.com

1-800-252-9257, ext. 2168

**EDITOR**

Patricia Valentine

patricia.a.valentine@lexisnexis.com

1-800-252-9257, ext. 2286

Bruce M. Kramer is a Maddox Professor of Law at Texas Tech University School of Law in Lubbock, Texas. He is the co-author of the multi-volume treatises entitled *The Law of Pooling & Unitization* and *Williams & Meyers, Oil & Gas Law*. Katrina Rose, B.E.D., J.D.

The editors welcome suggestions for making this *Journal* more useful to Texas lawyers.

This *Journal* may be cited as 19 TEX. OIL & GAS L.J. xx (2005). The following citation form is used for court of appeals cases not yet appearing in the *South Western Reporter*: *Smith v. Jones*, No. 40,000, Op. Serv.—Civil, T6-89-23-146 (Austin [3d Dist.] Oct. 1, 1961). This form does not include a writ history because in many instances the time for filing an application may not have expired.

LEXISNEXIS™ publications are intended to help attorneys and others maintain professional competence by providing accurate, current information on selected topics, but no express or implied warranties with regard to the use of accuracy of this publication are made by LEXISNEXIS™, the editors, or the contributors. Publications are sold with the understanding that LEXISNEXIS™ is not engaged in rendering legal, accounting, or other professional advice. When dealing with specific legal matters, attorneys should consult original sources and rely on their own expertise. Other readers should engage the appropriate professional services to provide legal or other expert advice.

**A. *Abraxas Petroleum Corp. v. Hornburg*, 20 S.W.3d 741 (Tex. App.—El Paso 2000, no pet.)**

*Holding: The exculpatory clause is limited to claims based upon an allegation that the operator failed to act as a reasonably prudent operator and does not apply to a claim that it breached the operating agreement.*

As is explained more fully in the earlier discussion of this case, the non-operators in this case sued the operator, Abraxas, alleging that Abraxas had breached the operating agreement by sending an AFE letter for operations that were not subject to the consent/non-consent election procedures. Citing the exculpatory language in Article V., Abraxas contended that the jury's failure to make a finding of gross negligence or willful misconduct in connection with its sending of the AFE letter precluded a finding of liability for breach of contract. The court rejected that argument and held that the exculpatory clause does not apply to claims for breach of contract. The court explained its holding as follows:

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 apply 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 upon 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.

20 S.W.3d at 759.

**B. *Cone v. Fagadau Energy Corp.*, 68 S.W.3d 147 (Tex. App.—Eastland 2001, pet. denied)**

*Holding: The exculpatory clause applies only to claims that the operator failed to conduct operations in a good and workmanlike manner, and does not apply to a claim that it breached the operating agreement.*

Fagadau was the operator and Cone was a non-operator under an operating agreement prepared on the 1982 AAPL Model Form. Cone filed suit against Fagadau alleging, among other things, that Fagadau had improperly charged certain expenses to his account. The trial court granted Fagadau's special exception and held that

the breach of contract claim did not state a cause of action because it was not based on allegations of gross negligence or willful misconduct. Citing *Abraxas*, the court of appeals held that the trial court erred in striking the claim for breach of contract. The court explained its holding as follows:

Cone asserts that he should have been able to assert liability against FEC for alleged breaches of the terms of the operating agreement under a simple breach of contract standard. In this regard, Cone contends that various charges were improperly assessed to his account in violation of the operating agreement . . .

In the operating agreement, the language which requires a showing of gross negligence and willful misconduct immediately follows the provision requiring the operator to conduct operations in a good and workmanlike manner. Cone's complaints did not allege the failure of FEC to operate in a good and workmanlike manner. Rather, Cone's complaints alleged breaches of specific terms of the agreement and are in the nature of an accounting. . . . The gross negligence/willful misconduct requirement applies to any and all claims that the operator failed to conduct operations in a good and workmanlike manner. The court in *Abraxas Petroleum Corporation v. Hornburg*, 20 S.W.3d 741 (Tex. App.—El Paso 2000, no pet'n), reached a similar result in interpreting this same clause. The trial court erred in striking Cone's allegations for breach of contract.

68 S.W.3d at 155.

**C. *IP Petroleum Company, Inc. v. Wevanco Energy, L.L.C.*,  
116 S.W.3d 888 (Tex. App.—Houston [1st Dist.] 2003,  
pet. denied)**

*Holding:* The plaintiffs were required to prove the operator's gross negligence or willful misconduct because their cause of action alleged misconduct arising from the manner in which the operator conducted drilling operations.

IP Petroleum was the operator under an unspecified version of the AAPL Model Form Operating Agreement. The operating agreement required the operator to drill an initial well "to a depth of 9125' below the surface of the ground or a depth sufficient to test the Lower Ellenburger Formation, whichever is lesser . . . unless all parties agree to complete or abandon the well at a lesser depth." The operating agreement also contained the standard exculpatory clause under which the operator had no liability as operator except such a may result from gross negligence or willful misconduct.

The well encountered mechanical difficulties, was more expensive than projected, and tested to produce only 3% oil and

97% water. When IP gave notice of its intention to plug and abandon the well, the non-operators filed suit alleging that IP had an obligation to further deepen the well and that its failure to do so was a breach of the operating agreement. In connection with these claims the plaintiffs expressly alleged that IP had breached its duty to conduct its activities as a reasonably prudent operator, in a good and workmanlike manner, and with due diligence, and that it had acted with gross negligence or willful misconduct. The jury found that IP failed to drill to a depth sufficient to test the Lower Ellenburger Formation and that the failure was the result of gross negligence or willful misconduct.

The court of appeals held that the evidence did not support the finding of gross negligence and willful misconduct. Even though the plaintiffs had alleged gross negligence and willful misconduct, they contended that their claim was for breach of contract, so this finding was not needed because the exculpatory clause does not apply to such claims. The court disagreed and held that the plaintiffs were required to prove the operator's gross negligence or willful misconduct because their cause of action alleged misconduct arising from the manner in which the operator conducted drilling operations, and also expressly alleged failure to conduct operations in a good and workmanlike manner and failure to act as a reasonably prudent operator. The court distinguished *Cone* and *Fagadau* on the ground that neither involved a claim that the operator failed to operate in a good and workmanlike manner and failed to act as a reasonably prudent operator.

**D. *Castle Texas Production Ltd. Partnership v. Long Trusts*,  
134 S.W.3d 267 (Tex. App.—Tyler 2003, pet. denied)**

*Holding:* The exculpatory clause is limited to claims that the operator failed to act as a reasonably prudent operator in its operations in the contract area and does not apply to a claim that it otherwise breached the operating agreement.

This lawsuit concerned the gas balancing agreements attached as exhibits to several operating agreements under which Castle was the operator. The Long Trusts alleged that Castle had breached the terms of the gas balancing agreements in various respects related to the accounting for its share of gas and condensate. The jury found for the Long Trusts on the breach of contract claims. On appeal, the court of appeals rejected Castle's contention that the exculpatory clause was applicable to these claims. The court said:

Castle attempts to entirely escape liability for breach of contract arguing that it cannot be held to have breached the JOAs absent proof that it was guilty of "gross negligence or willful misconduct," the standard of care prescribed by Article V.A. of the JOAs. This clause, however, is limited to claims that Castle

failed to act as a reasonably prudent operator in its operations in the contract area and does not apply to a claim that it otherwise breached the JOAs. *See Abraxas Petroleum v. Hornburg*, 20 S.W.3d 741, 752 (Tex. App.—El Paso 2000, no pet.).

134 S.W.3d at 283–284.

#### IV. ABANDONMENT OF WELLS THAT HAVE PRODUCED

##### A. *Cone v. Fagadau Energy Corp.*, 68 S.W.3d 147 (Tex. App.—Eastland 2001, pet. denied)

*Holding: Conversion of a producing well to an injection well is not an abandonment of the well for purposes of the provision governing abandonment of wells that have produced.*

One of the claims that Cone asserted against the operator, Fagadau, in this case was that Fagadau's conversion of producing wells into injection wells for purposes of a water flood constituted abandonment under the terms of the operating agreement such that Cone should have been offered the right to assume control of the wells. The applicable contract provision was Article VI.E.2. of the 1982 AAPL Model Form Operating Agreement, which provides in relevant part as follows:

Except for any well in which a Non-Consent operation has been conducted hereunder for which the Consenting Parties have not been fully reimbursed as herein provided, any well which has been completed as a producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties thereto. If, within thirty (30) days after receipt of notice of the proposed abandonment of any well, all parties do not agree to the abandonment of such well, those wishing to continue its operation from the interval(s) of the formation(s) then open to production shall tender to each of the other parties its proportionate share of the value of the well's salvageable material and equipment, determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandonment. . . .

The trial court rendered partial summary judgment against Cone on this claim. The court of appeals affirmed, holding that conversion of a producing well into an injection well is not an abandonment of the well under this article. The court explained this holding as follows:

We do not construe this provision of the operating agreement as being ambiguous. The operative language of the provision is the phrase "any well which has been completed as a producer shall not be plugged and abandoned without the consent of all par-

ties." Cone does not dispute the fact that the wells have not been plugged. Irrespective of this fact, he contends that the wells in question have been abandoned because the efforts to remove hydrocarbons directly from them have ceased.

We disagree with Cone's construction of this provision. "Abandonment" involves a relinquishment of possession. *See Pearson v. Black*, 120 S.W.2d 1075, 1079 (Tex. Civ. App.—Eastland 1938, no writ). The wells had not been abandoned within the ordinary and customary meaning of the term because the wells continued to be utilized on a daily basis for the purpose of water injection. Furthermore, even though hydrocarbons were not produced directly from these wells, the wells were used for the purpose of obtaining production from other wells which produce from the same "interval(s) of the formation(s) then open to production" for which Cone is compensated. As noted by a leading treatise on the subject, "the primary purpose of injecting gas or water into a reservoir is to cause the injected substance to move from the input wells toward the producing wells, driving the oil or wet gas before them." 1 W. L. SUMMERS, *THE LAW OF OIL AND GAS* § 76 (1954). We note that our holding is consistent with *Osborn v. Anadarko*, 996 P.2d 9 (Wy. 2000), a Wyoming Supreme Court case which determined that the conversion of a producing well into an injection well did not constitute abandonment under a farmout agreement. Cone's Point of Error No. 1 is overruled.

68 S.W.3d at 154.

##### B. *Yates Energy Corp. v. Enerquest Oil and Gas, L.L.C.*, 2005 Tex. App. LEXIS 5046 (Tex. App.—Corpus Christi, June 30, 2005) (unpublished opinion)

There is no broadly applicable holding in this case, but the case does illustrate a problem that can arise in connection with the abandonment of producing wells under all versions of the AAPL Model Form Operating Agreement.

The dispute in this case involved the Baker Gas Unit in Gonzales County. Operations were governed by an operating agreement under which Yates was the operator and Enerquest was a non-operator. When the only well on the contract area began experiencing production problems, it was agreed that Yates would abandon its interest in the well in favor of Enerquest. The transfer of interest from Yates to Enerquest was to be accomplished pursuant to the operating agreement, which provided that in instances where some but not all of the parties wanted to abandon a well, "those wishing to continue its operation shall tender to each of the other parties its proportionate share of the value of the [well]." The operating agreement further provided that each abandoning party "shall then assign to the non-abandoning parties . . . all of its interest in the well and its equipment, together with its interest in

the leasehold estate. . . . The assignments so limited shall encompass the ‘drilling unit’ upon which the well is located.”

The term “drilling unit” is defined in the definitions section of the operating agreement to mean “the area fixed for the drilling of one well by order or rule of any state or federal body having authority.” During Yates’s abandonment of the well on the Baker Gas Unit, a dispute arose as to what constituted the well’s applicable “drilling unit.” This became an issue because the applicable Railroad Commission rule provided for two different sized drilling units—standard 640-acre units and optional 320-acre units. The relevant language in the rule provided as follows: “The standard drilling and proration units are established hereby to be six hundred forty (640) acres. . . . An operator, at his option, shall be permitted to form optional drilling units of three hundred twenty (320) acres.”

Yates argued that as operator, it could set the drilling unit at 320 acres. Enerquest contended that because there had always only been one well on the property, the drilling unit included the entire contract area, which contained approximately 631 acres. The trial court rendered summary judgment for Enerquest, requiring Yates to abandon its interest in the entire contract area.

The court of appeals concluded that because the operating agreement incorporated the Railroad Commission rule in the definition of “drilling unit,” the agreement could properly be interpreted as allowing for drilling units to potentially be either 640 acres or 320 acres. 2005 Tex. App. LEXIS 5046, at \*3–4. Finding a fact issue on which of these unit sizes should be applied to the well on the Baker Gas Unit, the court reversed the summary judgment and remanded the case for a trial on the merits. The court explained this result as follows:

The railroad commission order fails to specify how an operator is to exercise his option in forming the optional 320-acre drilling unit, and both parties dispute how or whether this was done. This raises an as-yet unresolved issue of material fact that would be properly determined by a jury or fact-finder. *See Nixon*, 690 S.W.2d at 548. Accordingly, we conclude that the trial court erred in granting summary judgment in favor of Enerquest. . . .

2005 Tex. App. LEXIS 5046, at \*6.

Parties to a joint operating agreement could avoid this dilemma by resolving the “drilling unit” ambiguity by agreement in the JOA, before a dispute arises.

## V. CHANGE OF OPERATOR

### A. *Abraxas Petroleum Corp. v. Hornburg*, 20 S.W.3d 741 (Tex. App.—El Paso 2000, no pet.)

*Holding: Non-operating interest owners can waive the requirements pertaining to selection of a successor operator by permitting another party to act as operator, despite a failure to qualify as such, and by accepting the benefits of that party’s performance.*

As is explained more fully in the earlier discussion of this case, Abraxas, acting as operator, sent AFEs for proposed operations to the non-operators, and then put the non-operators into non-consent status when they failed to respond to the AFEs. Abraxas had acquired the interest of the original operator, and one of the issues in the case was whether Abraxas had ever been properly selected as successor operator in accordance with the provisions of the operating agreement.

The operating agreement provided, in part, as follows: “If Operator terminates its legal existence, no longer owns an interest in this Contract Area, or is no longer capable of serving as Operator, it shall cease to be Operator without any action by Non-Operator, except the selection of a successor.” The trial court determined that Abraxas had never been formally elected as operator. The court of appeals agreed that the original operator’s sale of its interest to Abraxas resulted in its resignation as operator, thereby invoking the requirement for election of a successor operator. Even though that was never done, the court held that the non-operating interest owners had waived the requirements for selection of a successor operator. The court cited its own earlier opinion in *Purvis Oil Corp. v. Hillin*, 890 S.W.2d 931 (Tex. App.—El Paso 1994, no writ), which held that the requirement that the operator own an interest in the contract area could be waived. The court explained its holding as follows:

Appellees seek to distinguish *Purvis Oil* because *Hillin* had been formally selected as operator. We recognize that *Purvis Oil* involved a different aspect of Article V.B.2 and that the facts are somewhat different. Nevertheless, the case stands for the proposition that non-operating interest owners can waive requirements of the JOA pertaining to selection of a successor operator by permitting another party to act as operator, despite a failure to qualify as such, and by accepting the benefits of that party’s performance. In this case, Hornburg, Hauter, and Guiberson effectively assented to Abraxas as operator and accepted the benefits of Abraxas’ performance while knowing that Abraxas, in reliance on its assignment by Pearson-Sibert, had expended time, effort, and expense to operate the Cleo Smith lease. *See Purvis Oil*, 890 S.W.2d at 937. Therefore, we find that the Ap-

pellees waived the JOA's requirement that Abraxas be formally selected as operator. *Id.*

20 S.W.3d at 751–752.

**B. *Stable Energy, L.P. v. Newberry*, 999 S.W.2d 538 (Tex. App.—Austin 1999, pet. denied)**

*Holding: A successor operator that has not signed the operating agreement may nevertheless be bound by the operating agreement by ratification or estoppel.*

The facts of this case are complicated and need not be outlined for present purposes. As it relates to the subject of this paper, the aspect of the case that must be noted is the court's conclusion that a successor operator was bound by the provisions of a joint operating agreement, even though the operator never signed the agreement. The successor operator had acted under the operating agreement by following its provisions for the election of a new operator, by approving a division order identifying the new operator, and by seeking to recover costs from the non-operators. The court concluded that such conduct was sufficient to bind the successor operator to the operating agreement under the doctrines of ratification and estoppel.

**VI. MAINTENANCE OF UNIFORM INTEREST**

**A. *ExxonMobil Corp. v. Valence Operating Co.*, 174 S.W.3d 303, 2005 Tex. App. LEXIS 4716 (Tex. App.—Houston [1st Dist.], June 16, 2005) (Opinion on Rehearing; Second Motion for Rehearing filed July 1, 2005)**

*Holding: A party's disposition of its interest in the contract area only as to a certain formation is a violation of the maintenance of uniform interest provision.*

ExxonMobil and Valence are parties to a joint operating agreement governing operations on the Gladewater Gas Unit 16 in Gregg and Upshur Counties. Three wells on the unit produced gas from the Cotton Valley Lime formation, and it was determined that there were proven behind the pipe reserves in the shallower Cotton Valley Sand.

In 1996, ExxonMobil, which had succeeded to the interest of the original operator, entered into a farmout agreement with Wagner & Brown, Ltd. ("WB") and C.W. Resources ("CW"), giving them the right to earn the conveyance of ExxonMobil's interest in the Cotton Valley Sand portion of Unit 16 upon the successful completion of a test well. Valence sued ExxonMobil, contending that the farmout violated the maintenance of uniform interest provision in the JOA. The maintenance of uniform interest

provision in Article VIII.B of the JOA, including strikeouts appearing in the original, provides:

E. Maintenance of ~~Uniform~~ Interest:\*

~~For the purpose of maintaining uniformity of ownership in the oil and gas leasehold interests covered by this agreement, and~~ Notwithstanding any other provisions to the contrary, no party shall sell, encumber, transfer or make other disposition of its interest in the leases embraced within the Contract Area and in wells, equipment and production unless such disposition covers either:

1. the entire interest of the party in all leases and equipment and production; or
2. an equal undivided interest in all leases and equipment and production in the Contract Area.

Every such sale encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement, and shall be made without prejudice to the rights of the other parties.

174 S.W.3d 303, 311, 2005 Tex. App. LEXIS 4716, at \*16–17. Valence argued that the farmout violated this provision because it only covered ExxonMobil's interest in the Cotton Valley Sand rather than its entire interest, or an undivided interest in its entire interest, in all of Unit 16. The trial court ruled in favor of Valence, finding that the farmout violated the maintenance of uniform interest provision, and the court of appeals affirmed.

ExxonMobil contended that by striking the language stating that the purpose of the provision was to maintain "uniform" ownership in the leasehold interests covered by the JOA, the original parties indicated their intention *not* to require the maintenance of uniform interests. It further contended that the provision applied only to the sale or other disposition of a party's interest in the leases *and* in the wells, equipment and production. ExxonMobil contended that the farmout did not violate the maintenance of uniform interest provision because the farmout did not cover ExxonMobil's interest in the wells, equipment and production.

Valence contended that by striking the reference to the maintenance of "uniform" interests, the originally parties were merely recognizing that they did not have uniform interests to maintain because ExxonMobil's predecessor owned an 81.8% interest in Unit 16, and Valence's predecessor owned an 18.2% interest. Valence contended that the maintenance of uniform interest

---

\* Editor's Note: Text is overstruck in the source.

provision evidenced the intent of the parties to maintain whatever interests they had under the JOA when it was executed.

In affirming the trial court on this issue, the court of appeals agreed with Valence's position and held as follows:

Because the plain language of the MOI provision in the JOA required that ExxonMobil not partition its interest in Unit 16, but that it convey either its entire interest or an equal undivided interest in all leases, wells, equipment, and production in the contract area, ExxonMobil breached the MOI provision of the JOA by conveying its interest in a portion of Unit 16 to WB and CW, namely, by conveying to them its interest in the Cotton Valley Sand formation while retaining its interest in those formations beneath the Cotton Valley Sand. We hold that the trial court did not err in finding that ExxonMobil breached the MOI provision in the JOA by conveying a portion of its interest in Unit 16 to WB and CW.

174 S.W.3d 303, 314, 2005 Tex. App. LEXIS 4716, at \*25–26.

The court also affirmed the trial court's finding that this breach of the maintenance of uniform interest provision caused damage to Valence because it resulted in the drilling of additional wells to recover reserves that could have otherwise been recovered more economically by recompletion of the existing wells in the Cotton Valley Sand. On this issue, the court held as follows:

Had ExxonMobil not breached the JOA by farming out, and subsequently selling, its interest in the Cotton Valley Sand level of Unit 16, it would have continued to have the same interest that Valence had in capturing as much oil and gas as possible from the entire unit by the most economical means that would maximize returns from the whole. By assigning its interest in the Cotton Valley Sand portion of Unit 16, ExxonMobil severed its interest from Valence's, rather than maintaining it, thereby breaching the JOA and causing Valence to incur the extra costs associated with drilling the new wells side by side with existing wells that could have been completed to access the same reserves.

174 S.W.3d 303, 316, 2005 Tex. App. LEXIS 4716, at \*29–30.

## VII. PARTITION

### A. *Dimock v. Kadane*, 100 S.W.3d 602 (Tex. App.—Eastland 2003, pet. denied)

*Holding: The standard provisions of the AAPL Model Form Operating Agreement evidence an implied agreement not to partition the contract area.*

In this case and in three related cases<sup>1</sup> with the same names, and involving substantially the same parties and facts, the Eastland Court of Appeals held that the standard provisions of the 1956 version of the AAPL Model Form Operating Agreement evidence an implied agreement not to partition the contract area. The result should be the same under subsequent versions of the AAPL Model Form Operating Agreement because they all contain provisions that are substantially the same as the provisions that the Eastland court relied upon in these cases.

The parties owned working interests in oil and gas leases that were subject to an operating agreement entered into by their predecessors in interest. Dimock sought to partition the leases. Kadane filed a counterclaim seeking a declaration that by entering into the operating agreement and certain letter agreements, the prior owners had impliedly waived the right to partition. The trial court and the court of appeals agreed with Kadane that the right to partition had been waived.

The court of appeals held that co-owners of a mineral estate have a statutory right to compel partition, but that they can agree not exercise that right. 100 S.W.3d at 604. The court determined that there was no express agreement not to partition, but that an implied agreement could be found in various provisions of the operating agreement, including the provision that the operating agreement would remain in force as long as the underlying leases remained in force, and the subsequent operations clause governing non-consent operations. The court explained the effect of those two provisions as follows:

The Non-Consenting Party provisions in Paragraph No. 12 of the Operating Agreement and the term provision in Paragraph 10 of the Operating Agreement, when considered together, imply an agreement not to partition. Under Paragraph No. 12, ownership of a Non-Consenting Party's interest transfers to the Consenting Parties. Thus, the Non-Consenting Party provisions directly affect title to the undivided interests in the leases. Paragraph No. 12 presupposes that a Non-Consenting Party owns an interest that is subject to transfer upon commencement of the operation. If a party to the Operating Agreement were allowed to partition and thereby destroy the joint ownership of the leases, Paragraph No. 12 would be rendered meaningless. Paragraph No. 10 provides that:

This agreement shall remain in full force and effect for as long as any of the oil and gas leases subjected to this agreement remain or are continued in force as to any part

<sup>1</sup>*Dimock v. Kadane*, 100 S.W.3d 608 (Tex. App.—Eastland 2003, pet. denied); *Dimock v. Kadane*, 100 S.W.3d 615 (Tex. App.—Eastland 2003, pet. denied); *Dimock v. Kadane*, 100 S.W.3d 622 (Tex. App.—Eastland 2003, pet. denied).

of the Unit Area, whether by production, extension, renewal or otherwise.

Paragraphs Nos. 10 and 12 indicate a “desire of the parties to retain the cotenancy status and operational status during the life of the leases.” See *Sibley v. Hill*, *supra* at 229. We find that Kadane & Sons and TUFCO impliedly agreed not to partition the interests in the leases for as long as the leases remain in effect.

100 S.W.3d at 606. In further support of the implied agreement not to partition, the court cited the maintenance of uniform interest provision, the provision governing extensions and renewals of leases, and the provision for surrender of leases.

### VIII. CONCLUSION

Historically, the joint operating agreement has not generated as many reported decisions as one might expect of an instrument that has been so widely used over such an extended period of time. The period covered by this paper was notable both for the unusually large number of reported cases, and for the *Valence Operating Company v. Dorsett* decision by the supreme court, which has seldom spoken on issues under the joint operating agreement.

## CASE NOTES

### SURFACE CONDITION

*Absent explicit language in an agreement, restoration of the surface to its original condition will not be required of parties to an agreement, and absent a definition to the contrary the “surface” will not be interpreted to include subsurface layers affected by site operations on the surface.*

*Fenner v. Samson Resources Co.*, No. 01-03-00049-CV, 2005 Tex. App. LEXIS 7286 (Tex. App.—Houston [1st Dist.] Aug. 31, 2005).

### FACTS

Dr. Charles and Camilla Fenner entered into an Oil and Gas Lease with Millican Oil Company in May 1973 to allow Millican to explore and produce oil, gas, and other hydrocarbons on 692 acres of the Fenners’ property in Austin County. The Lease further provided for the laying of pipelines and the building of tanks and other equipment in order to produce, treat, store, and transport the oil, gas, and the other hydrocarbons. In May 1974, the Fenners and Millican entered into a Plant Site Lease Agreement, which covered approximately five acres within that 692 acres and allowed Millican to construct and operate a gas processing unit to gather

gas from three surrounding wells. Subsequently, in 1974 or 1975, Millican installed a gas-processing unit on the five-acre tract.

In 1979, Millican assigned its entire interest in the Fenners’ property pursuant to the Plant Site Lease Agreement and Oil and Gas Lease to Alamo Petroleum Company, which later changed its name to Amax Petroleum Company. On November 1, 1982, Amax assigned its entire interest in the two leases to Samson (then named Tenax Oil and Gas Corporation.) On January 1, 1987, Samson assigned its entire interest in the two leases to ATAPCO. In 1991, ATAPCO and Magnum entered into a joint cost-sharing agreement, and, on February 1, 1993, ATAPCO assigned its entire interest in the two leases to Magnum.

In December 1979, the Fenners and Alamo amended the Plant Site Lease Agreement to extend it until April 30, 1994. Also in 1979, Dr. Fenner made numerous complaints to Alamo concerning the effect of the oil and gas operations on the property. On December 26, 1979, the Fenners and Alamo entered into a settlement agreement, whereby Alamo paid them \$125,000 and agreed to drill additional wells. In return, the Fenners agreed to release any and all claims against Alamo. During Alamo’s and Amax’s tenure, a large saltwater disposal pit was used at the gas processing unit on the five-acre plant site to dispose of saltwater produced from the wells. In July 1982, the Texas Railroad Commission determined that the pit violated a state environmental statute and ordered the pit to be closed, causing Amax to close the pit within a month.

The Plant Site Lease Agreement, as amended, provided that it expired by its own terms on April 30, 1994. Although the Fenners and Magnum did not execute an extension of the Plant Site Lease Agreement at any time, Magnum remained on the property and continued its operations after April 30, 1994. Concerned about the plant site’s condition, Dr. Fenner took several pictures of the plant site in May or June of 1995. Dr. Fenner also wrote a letter, dated June 8, 1995, to the president of Magnum, Avinash Ahuja, in which Dr. Fenner expressed concern about the “junk everywhere,” such as “barrels, equipment, [and] pipe” on the plant site. After receiving Dr. Fenner’s letter, Magnum removed these materials.

In early 1997, Magnum gave the Fenners its notice of intent to cease operations. In February, it began cleanup of the gas processing unit and the land. Magnum made rental payments for use of the facility through April. In July, in an effort to discover buried pipes and flow lines, Dr. Fenner dug trenches throughout the five-acre plant site. At his request, Magnum removed the pipe that Fenner’s excavations had unearthed. Meanwhile, in July, Dr. Fenner also hired Newpark, an environmental consulting firm, to conduct environmental tests on the property. A July 29, 1997 report from Newpark to Dr. Fenner indicated that there was con-

tamination on the five-acre plant site. Although Magnum offered to remediate a portion of the plant site, the Fenners and Magnum were unable to reach an agreement as to the necessary remediation. On October 30, 1998, the Fenners brought suit against ATAPCO and Magnum for nuisance, trespass, conversion, negligence, negligence per se, and breach of contract, seeking an injunction and damages. On July 28, 2000, the Fenners amended their petition to add Samson as a defendant.

At trial, the Fenners proceeded solely on their claims that the Lessees had breached the Plant Site Lease Agreement and the Oil and Gas Lease. The case was submitted to the jury in broad form questions. Question Number One asked the jury, "Did any of the following Defendants fail to comply with the terms of the Plant Site Lease?" to which the jury answered, "No," for all three Lessees. Question Number Two was, "Did any of the following Defendants fail to comply with the Oil and Gas Lease?" with the answer being, "No," for all three Lessees. Because the jury found that none of the Lessees had failed to comply with either agreement, it did not answer the damages question. On November 26, 2002, the trial court rendered judgment on the verdict, ordering that the Fenners take nothing. The Fenners filed motions for judgment notwithstanding the verdict and for a new trial, both of which the trial court denied.

## DISCUSSION

The Fenners appealed. In affirming, a unanimous panel of the First Court of Appeals noted both that their arguments that the evidence was legally and factually insufficient to support the jury's findings that the Lessees did not fail to comply with agreement and the lease are contingent upon the applicability of certain lease provisions and the definitions of certain lease terms, and that none of the parties had argued that the agreement or the lease were ambiguous, but rather, the disagreement was over the construction and interpretation of certain terms.

The Fenners contended that the Lessees breached section nine of the Plant Site Lease Agreement, which provided, "At the termination of this lease, Tenant shall have a period of three (3) months time within which to remove all of the facilities placed thereon by Tenant and to generally restore the surface of the land." The Fenners' assertion was that the term "surface" is "not limited to the topmost layer of dirt and vegetation" and that it "necessarily covers all subsurface layers that are affected by the plant site operations conducted at the surface." Justice Jennings, writing for the court, noted that neither the agreement nor the jury charge provided a definition, so the court fell back on the "plain and ordinary meaning" of the word, pointing out that a dictionary definition was "the upper boundary or top of ground or soil, exposed to the air." Likewise, as to the word "restore," The Fen-

ners asserted that the word meant "to return to a former or normal state," arguing at trial that the lease required the Lessees to return the plant site to its "original condition," but the court noted that if this had been the parties' intention, "then the parties were capable of selecting such language." Justice Jennings pointed out that some other portions of agreements between the parties had done just that. Consequently, the court's view was that "the complained-of provision of the Plant Site Lease Agreement required the Lessees to 'generally restore' the upper boundary or top of the ground or soil of the plant site."

The Fenners also pointed to a provision which stated that "in the event of *partial assignment* hereof, both the original Lessee and such assignees shall nevertheless be jointly and severally liable to Lessor, their heirs, successors and assigns for *all damages to surface and subsurface of the lands covered hereby . . .*" However, Justice Jennings observed that "this provision expressly applies only to partial assignments" and "that each of the assignment contracts admitted into evidence provided that such assignments were whole, not partial, assignments." In turn, this "partial assignment" provision was not applicable. The Fenners also pointed to a "whole assignment" provision, "repeatedly" arguing, according to Justice Jennings, "that the Lessees are responsible for damages to 'the surface and the subsurface' of the land as though they were 'partial assignments.'" However, the Fenners actually never argued the failure of each Lessee to obtain the Fenners' consent, a critical aspect of the provision, before wholly assigning the lease to another oil company.

The court also rejected a "custom and usage" argument, citing *Warren Petroleum Corp. v. Monzingo*, 157 Tex. 479, 304 S.W.2d 362 (Tex. 1957), and *Ottis v. Haas*, 569 S.W.2d 508, 514 (Tex. Civ. App.—Corpus Christi 1978, writ ref'd n.r.e.), for the proposition that "the Lessees were obligated only to do what the express provisions of the leases required them to do," despite "some testimony" suggesting "it might be customary in the industry to restore the land in some manner." Also rejecting the assertion that the Plant Site Lease Agreement and the Oil and Gas Lease were breached as a matter of law, Justice Jennings wrote "the Fenners rely on evidence that shows possible damage five feet or more beneath the surface of the land. Furthermore, the Fenners have not directed us to any evidence in the 28-volume reporter's record that shows that the upper boundary or top of the ground or soil of the Fenners' land was not generally restored by the Lessees or that the Lessees caused compensable damage to the surface of the land."

And, as to the Fenners' factual sufficiency challenge, while the court did acknowledge possible inconsistencies in testimony, it nevertheless noted that the fact finder is the sole judge of the credibility of the witnesses and the weight to be given their testimony. Viewing the evidence in the light most favorable to the

verdict, the court held there was probative evidence sufficient to support the jury's findings that the Lessees did not fail to comply with the agreement or lease, further holding that the Fenners had not conclusively established that the Lessees breached the Plant Site Lease. Ultimately the court determined that it could *not* say that the jury's findings were so contrary to the evidence as to be clearly wrong and unjust, and, thus, held the evidence was factually sufficient to support the jury's findings that the Lessees did not fail to comply with the leases.

### PROTECTIVE ORDERS AND CONFIDENTIALITY

*A non-party may have standing to challenge a discovery request for information such as well logs, depletion plans, exploration plans, documents and communications (including many emails) regarding the negotiation, acquisition and sale of interests, when the information in question was the subject of a protective order in a different cause of action.*

*In Re Shell E&P, Inc.*, No. 04-05-00345-CV, 2005 Tex. App. LEXIS 7313 (Tex. App.—San Antonio Aug. 31, 2005).

### FACTS

In October 2000, Arnoldo Casas, Carolina Casas, Ferman Casas, Jr., Juanita P. Casas, Irene Casas, Santos R. Casas, Servando Casas, Yolanda Casas, Johnny Lane, III, Lydia C. Pena, Ruben Pulido, and Clementina C. Pulido employed attorneys Michael B. Silva and Paul F. Simpson of Silva & Simpson, L.L.P., to represent them with respect to certain of their oil and gas interests in Duval County. Silva's and Simpson's compensation was based on a contingency fee agreement with the Casas and the others. Silva and Simpson subsequently filed suit against Shell on behalf of the Casas, alleging that Shell's failure to drill on the Casas' property had caused them damages. While this Shell lawsuit was pending, Silva and Simpson joined the law firm of McGinnis, Lochridge & Kilgore, but continued to represent the Casas. In May 2004, the Shell lawsuit was settled for a confidential amount; however, a dispute over the Attorneys' fees arose. The Casas subsequently filed suit against the Attorneys alleging causes of action for breach of contract, deceptive trade practices and fraud, and seeking an accounting.

In connection with their pending suit against the Attorneys, the Casas requested the release of their original case file from the Shell lawsuit. The Attorneys delivered the Casas' case file, but withheld certain documents that had been produced by Shell pursuant to the terms of an "Unopposed Protective Order Regarding Confidentiality" which was signed by Judge Gabert and entered in the Shell lawsuit. In response, the Casas filed a motion to compel the Attorneys to release the original case file, including

the retained Shell documents which were described as: "(a) well logs, data and communications related thereto; (b) depletion plans and related communications; (c) exploration plans, data and communications related thereto; (d) documents and communications (including many emails) regarding the negotiation, acquisition and sale of interests; and (e) one deposition given by a member of Shell's in-house computer department" (the "Shell documents"). The Attorneys filed a response stating they are prohibited from releasing the Shell documents to the Casas by the terms of the Protective Order, which restricts disclosure of information designated as "confidential" to only "qualified persons" for the limited purpose of the Shell lawsuit. The Attorneys argued they have only temporary custody of the Shell documents, and do not have legal possession or control of the documents.

The trial court held a hearing on the Casas' motion to compel on May 16, 2005. Shell's attorney appeared at the hearing and objected to production of the Shell documents because it would violate the Protective Order. The Casas argued that Shell had no standing to object to a discovery request made in the fee lawsuit to which it was not a party. The trial court permitted Shell's attorney to participate in the hearing, but subsequently sustained the Casas' objection and ruled that Shell had no standing to object to production of the Shell documents. On May 17, 2005, the trial court entered two orders: (1) an order sustaining the Casas' objection to the appearance of Shell's counsel and striking the Shell attorney's statements from the record of the motion to compel hearing; and (2) an order compelling the Attorneys to promptly deliver the Casas' original file including the previously retained Shell documents. Shell filed, in the San Antonio Court of Appeals, a petition for mandamus challenging the trial court's orders, along with a motion for a temporary stay. The appellate court granted the motion for temporary relief.

### DISCUSSION

In ultimately granting the writ conditionally, Justice Speedlin, writing for a unanimous panel of the San Antonio court, began by observing both that mandamus relief is available only when a trial court clearly abuses its discretion and when there is no adequate remedy on appeal. and that, with respect to factual issues, an abuse of discretion is shown when it is clear from the record that the trial court could have reasonably reached only one decision, but that there is no discretion in determining what the law is or in applying the law to the facts. Citing *In re Kuntz*, 124 S.W.3d 179 (Tex. 2003) (orig. proceeding); and *Walker v. Packer*, 827 S.W.2d 833 (Tex. 1992) (orig. proceeding), the court noted that a trial court's "failure to analyze or apply the law correctly, 'as when a discovery order conflicts with the Texas Rules of Civil Procedure,' will constitute an abuse of discretion and may result in appellate reversal by extraordinary writ."

The court next addressed the matter of whether Shell, a non-party in the underlying action, had standing to object to the disclosure of documents owned by it but that were in the temporary custody of the Attorneys under the terms of the Protective Order entered in prior litigation. The Casas argue that Shell filed no pleadings and presented no evidence in the trial court, and, consequently, as a non-party had no standing to object to the disclosure of its documents. Disagreeing with this assertion, Justice Speedlin wrote, "While Shell is not a party to the fee lawsuit between the Casas and the Attorneys, Shell is a party to the agreed Protective Order entered in the prior litigation between it and the Casas." No dispute existed as to whether the Shell documents sought by the Casas were designated "confidential information" and produced to the Attorneys under the terms of the Protective Order for use only in the Shell lawsuit. Per the Protective Order, confidential documents produced by Shell must be returned to Shell at the conclusion of the litigation, the Attorneys were permitted to retain one original or copy of the documents for 24 months after conclusion of the litigation, subject to the continuing effect of the Protective Order. As Justice Speedlin summarized, "the Shell lawsuit was resolved through settlement and has thus been concluded," the Attorneys, as permitted, "have retained custody of the Shell documents during the 24-month period following the settlement," and the Protective Order "expressly states that its provisions continue to be binding after conclusion of the Shell lawsuit."

Ultimately, the court concluded that Shell, "as the non-party owner of the documents, had the right under [Texas Rule of Civil Procedure] 192.6(a) to seek protection from disclosure of its documents in the trial court, whether through an objection, assertion of privilege, motion for a protective order, or motion for en-

forcement of an existing protective order." Referring back to *Kuntz*, Justice Speedlin observed that counsel for Shell had been served with a copy of the Casas' motion to compel listing Shell as a "potentially interested party," and had appeared at the hearing after learning of the setting a few days prior. Shell participated in the hearing over the Casas' objection, arguing that the Attorneys' disclosure of the Shell documents was prohibited by the Protective Order, and warning that Shell would sue the Attorneys if the documents were disclosed in violation of the Protective Order.

The court viewed the trial court's May 17, 2005, order holding that Shell lacked standing conflicted with Rule 192.6(a), and, in turn, held that the trial court "clearly abused its discretion." Moreover, the court held that the trial court had abused its discretion in compelling production of the Shell documents that are subject to the Protective Order between the Casas and Shell., and it held additionally that Shell would not have an adequate remedy by appeal. As to the former, Justice Speedlin noted that Shell's and the Attorneys' objection was that the Attorneys did not have legal possession of the Shell documents, but rather only temporary custody under the terms of the Protective Order, and, consequently, that disclosure of the Shell documents to the Casas would subject them to potential liability for violating the Protective Order.

The Casas' argument that because the Protective Order was not filed in the underlying fee dispute case, it was not before the trial court when it ruled on the motion to compel, was viewed by the appellate court as "disingenuous." Specifically, Justice Speedlin wrote that the trial judge "was entitled to take judicial notice" of his own prior order from a related case "between substantially the same parties."

**STATEMENT OF OWNERSHIP, MANAGEMENT AND CIRCULATION**

As Required by 39 U.S.C. Sec. 3685

The Texas Oil and Gas Law Journal is published by Matthew Bender & Co., Inc., 1275 Broadway, Albany County, Albany, NY 12204-2694.

The Editor and Managing Editor are Bruce Kramer and Michael Bruno.

The publication is owned by Matthew Bender & Co., Inc., 1275 Broadway, Albany, NY 12204, a wholly owned subsidiary of Reed Elsevier U.S. Holdings., 1105 N. Market Street, Suite 900, Wilmington, DE 19801, CBM Acquisition Parent Company, 1105 N. Market Street, Suite 900, Wilmington, DE 19801, and Reed Elsevier Inc., 275 Washington Street, Newton, MA 02158.

Publication number: 021-326; ISSN 154-4704-9;

date of filing: 9/30/2005; frequency of issue: Bi-Monthly; number of issues published annually: 6 and annual subscription price: \$179.00.

Known bondholders, mortgagees, and other security holders owning or holding 1 percent of total amount of bonds, mortgages, or other securities: none.

Extent and nature of circulation (average number of copies of each issue during the preceding 12 months/actual number of copies of single issue published nearest to the filing date): (a) total number of copies (net press run): 117/110;

(b) paid and/or requested circulation: (1) sales through dealers and carriers, street vendors, and counter sales (not mailed): 0/0; and (2) paid or requested mail subscriptions: 77/78;

(c) total paid and/or requested circulation (sum of 15b(1) and 15b(2), above): 77/78

(d) free distribution by mail (samples, complimentary, and other free copies): 14/14;

(e) free distribution outside the mail (carriers or other means): 0/0;

(f) total free distribution (sum of 15d and 15e, above): 14/14

(g) total distribution (sum of 15c and 15f, above): 91/92;

(h) copies not distributed: 26/18;

total (sum of 15g, 15(h)(1), and 15(h)(2)): 117/110;

Percent paid and/or requested circulation ( $15c / 15g \times 100$ ): 85% / 85%.

I certify that the statements made by me are correct and complete. Victoria Hine, Distribution Manager.