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Gulf Coast Land Institute

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Legal Update for Landmen: Case Law, Legislation, and Regulatory

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Legislative Update

ACT NO. 5

S.B. No. 38

DRILLING UNITS

Amends La. R.S. 30:10, the Louisiana Risk-Fee Statute

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ACT NO. 5; S.B. No. 38; DRILLING UNITS

For a detailed update on the 2022 Amendments to La. R.S. 30:10, the Louisiana Risk-Fee Statute, see:

https://www.gamb.com/an-overview-of-the-2022-amendments-to-la-r-s-3010-the-louisiana-risk-fee-statute/

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ACT NO. 5; S.B. No. 38; DRILLING UNITS

Amends R.S. 30:10 relative to drilling units and provides for:

- definitions;
- procedures, obligations, and remedies;
- written notice;
- information required to be furnished;
- indemnification;
- changes of ownership;
- title opinions;
- subsequent unit operations;
- terminology; and
- for related matters.

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La. R.S. 30:10 – Written Notice

An owner drilling or intending to drill may notify all other owners in the unit of the drilling or intent to drill and give each owner the opportunity to elect to participate in the risk and expenses of such well ("risk charge notice").

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La. R.S. 30:10 – Written Notice

New law changes one option for the drilling owner to include in the risk charge notice:

- (aa) An authorization for expenditure form (AFE), which shall include a detailed estimate or the actual amount of the cost of drilling, testing, completing, and equipping such well. The AFE shall be dated within one hundred twenty days of the date of the mailing of the risk charge notice.
- (bb) The proposed or actual location of the well.
- (cc) The proposed or actual objective depth of the well.
- (dd) An estimate of ownership as a percentage of expected unit size or approximate percentage of well participation.
- (ee) In the event that the well is being drilled or has been drilled at the time of mailing the risk charge notice, then a copy of all available logs, core analysis, production data, and well test data from the well which has not been made public.
- (NEW) (ff) At the option of the drilling owner, a statement that payment in full of the notified owner's share of costs as set forth in the AFE is required to be included with any election to participate.

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La. R.S. 30:10 – Written Notice

Under the revisions, failure to make timely election (or payment as may be required) is deemed an election not to participate, giving the drilling owner entitlement to own and recover out of production the nonparticipating owner's share of reasonable expenditures plus an additional risk-fee charge of 200 percent.

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La. R.S. 30:10 - Information to be Furnished by Nonparticipating Owner

Requires the nonparticipating owner to furnish to the drilling owner:

1. *a true and complete, or redacted, copy of a mineral lease or other agreement creating any lessor royalty or overriding royalty*
2. *a sworn statement of ownership of the nonparticipating owner as to each tract within the unit in which that owner has an interest and the amounts of lessor royalty and overriding royalty for which that owner is entitled to receive a portion of proceeds from the sale or other disposition of production*

Important because . . .

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La. R.S. 30:10 – Indemnification

New law requires the nonparticipating owner to indemnify and hold harmless the drilling owner against claims related to amounts paid based on information provided by the nonparticipating owner

"The nonparticipating owner shall also restore to the drilling owner any amounts paid by the drilling owner to the nonparticipating owner in reliance on the information furnished pursuant to Subitem (gg) of this Item, if and to the extent determined to be incorrect."

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La. R.S. 30:10 – Change in Ownership

New law provides that no change or division in the ownership of a nonparticipating owner is binding upon a drilling owner for the purpose of paying to the nonparticipating owner for the benefit of its lessor royalty owner or overriding royalty owner, until a certified copy of the instrument constituting the chain of title from the original nonparticipating owner has been furnished to the drilling owner.

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La. R.S. 30:10 – Title Opinions by Drilling Owner

New law provides that where a drilling owner obtains a title opinion from a licensed Louisiana attorney on a tract of land in the unit, the actual reasonable costs incurred for the title examination and opinion is chargeable as a unit operating cost and recoverable by the drilling owner out of the tract's share of production.

This guaranteed recoupment cost as specified in the statute constitutes a valuable tool for drilling owners to protect their investment and abate litigation in this regard.

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Pending: HB 590
Royalty Payments & Non-Participating Owners

BY REPRESENTATIVE BAGLEY (Not yet passed, referred to committee)

Specifies that where owners in a drilling unit choose not to participate in the costs of a unit well, royalty payments must be paid directly from the drilling owner to the royalty owner instead of through the nonparticipating owner.

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ACT NO. 443 / H.B. No. 165 / WIND ENERGY

Note: The legislation governs only wind leases in Louisiana waters which extend three nautical miles from its coastline. Beyond three nautical miles and extending out to 200 nautical miles are federal waters governed by the Bureau of Ocean Energy Management (BOEM) and their rules and regulations

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La. R.S. 30:209

- *Existing law authorizes the State Mineral and Energy Board (board) to enter into operating agreements whereby the state receives a share of revenues from the production of oil, gas, and other minerals.*

- *New law retains existing law and adds wind energy as a source of energy whereby the board may enter into operating agreements for the state to receive a share of revenues*

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La. R.S. 30:209

§ 209. State Mineral and Energy Board; authority

•

In order to carry out the provisions of R.S. 30:208, the State Mineral and Energy Board may:

* * *

(4)(a) Enter into operating agreements whereby the state receives a share of revenues from the production of oil, gas, and other minerals, and wind energy, after deduction of costs, in whole or in part, such as for drilling, testing, completion, equipping, or operating a well or wells, as may be agreed upon by the parties, and assumes all or a portion of the risk cost of development or production activity in those situations where the board determines it is in the best interest of the state, either in equity or in developmental productivity to do so, such as, but not limited to the following illustrations:

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La. R.S. 30:127

New law makes offshore wind farms more economically viable by increasing the maximum acreage for offshore wind leases to 25,000 acres instead of the 5,000 acre limit for oil and gas leases

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La. R.S. 30:127

§ 127. Opening bids; minimum royalties; terms of lease; deposit; security

* * *

E. If all written bids are rejected, the board may immediately offer for competitive bidding a lease upon all or any designated part of the land advertised, upon terms appearing most advantageous to the state. This offering shall be subject to the board's right to reject any and all bids. No lease shall be for more than five thousand acres, except leases for wind energy production which shall not exceed twenty-five thousand acres. Where a lease provides for delay rental, the annual rental shall not be for less than one-half the cash bonus. All lands shall be accurately described in a lease.

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La. R.S. 41:1732 & 41:1734 Decommissioning Plans

- *New law will result in wind farm operators having to draft a decommissioning plan for the end of the facility's life and to provide "financial security to ensure closure of the site pursuant to the decommissioning plan."*

- *Restoration "includes removing the wind energy production facility along with any necessary infrastructure facilities and restoring the property to as near as reasonably possible to the condition of the property prior to the commencement of the construction of the facility. BOEM has similar decommissioning requirements for wind leases on federal waters.*

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La. R.S. 41:1732

1732. Lease authority and royalties

* * *

C. Any lease granted under the provisions of this Chapter shall require a decommissioning plan for the end of the facility's expected life or upon circumstance that would require closure of the facility. The decommissioning plan shall include the estimated cost of site closure and remediation that includes removing the wind energy production facility along with any necessary infrastructure facilities and restoring the property to as near as reasonably possible to the condition of the property prior to the commencement of construction of the facility. Additionally, the leases shall be subject to the same decommissioning rules and regulations as oil and gas and sulphur facilities under provided by the provisions of Subpart Q of Part 250 of Chapter II I of Part 585 of Subchapter B of Chapter V of Title 30 of the Code of Federal Regulations (30CFR 250.1700 585.900 et seq.) to the extent they are not inconsistent with the provisions of this Section or any rules or regulations promulgated pursuant to this Chapter.

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La. R.S. 41:1734

§ 1734. Powers and duties of the secretary of the Department of Natural Resources

A. The secretary of the Department of Natural Resources shall promulgate rules and regulations pursuant to the Administrative Procedure Act to implement the provisions of this Chapter and to institute reasonable fees for services performed by the department. The rules and regulations shall include all provisions necessary to accomplish the intent of the legislature as stated in this Chapter and shall provide for the following:

(1) Criteria for setting the annual rent or royalty amounts for leases executed pursuant to this Chapter.

(2) Criteria for setting a primary term for leases and the necessary wind energy production or other actions by the lessee to continue the lease beyond the primary term. The rules and regulations shall also provide for the release of acreage at the end of the primary term on that portion of the lease where none of the necessary wind energy production or other actions occur.

(3) Requirements for financial security to ensure proper closure of the site pursuant to the decommissioning plan.

(4) Requirements for determining that if no responsible party can be located or such party has failed or is financially unable to undertake decommissioning required by the lease and that no energy has been produced from the facility from wind for two years. These requirements shall include notice to the last operator of record.

B. The secretary may expend sums payable to the department from the financial security required by the rules and regulation promulgated pursuant to this Section and enter into contracts for the purpose of restoration of wind energy sites pursuant to the terms of the lease or when the secretary has determined there is no responsible party pursuant to this Section. Restoration of a wind energy site includes removing the wind energy production facility along with any necessary infrastructure facilities and restoring the property to as near as reasonably possible to the condition of the property prior to the commencement of construction of the facility.

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La. R.S. 41:1733
Board's authority to grant lease

A prior version of Louisiana's offshore wind legislation contemplated that the Board would establish and advertise a minimum percentage of revenue to be produced by each wind turbine as a minimum requirement for granting the lease.

This language was scrapped by the Act and substituted with a broad grant of authority to the Board to accept the bid it finds most advantageous to the State.

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La. R.S. 41:1733

§ 1733. Award of state wind leases

* * *

D. A lease may be granted in whole or in part. Prior to the advertisement for bids for each lease there shall be a minimum dollar amount set and a minimum percentage of revenue to be produced by each wind turbine to be known as an "electric power production royalty", which shall be advertised by the State Mineral and Energy Board as a minimum requirement for granting the lease. No lease shall be granted in whole or part unless the amount of any electric power production royalty has been approved by the House Committee on Natural Resources and Environment and the Senate Committee on Natural Resources prior to advertisement. The State Mineral and Energy Board has authority to accept the bid it finds is most advantageous to the state and may lease upon whatever terms it considers proper. Such lease shall include a provision permitting the state, at its option, to take in kind all or any of the portion due it as royalty.

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Further Louisiana Legislative Update

Louisiana Oil & Gas Association's (LOGA) Legislative Tracker

https://www.loga.la/tracker

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Louisiana Jurisprudence Update

- Subsurface Trespass (*Hill v. TMR Expl. Inc.*)
- Acquisitive Prescription (*1026 Conti Holding, LLC v. 1025 Bienville, LLC*)
- Post-production Costs from Unleased Mineral Owners (*Johnson, et al v. Chesapeake Louisiana, LP*)

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Hill v. TMR Expl., Inc. (La. App. 1st Cir. 8/4/22), 353 So.3d 823, *writ denied*.

- The Hills own an undivided interest in an approximately 23-acre tract in WBR Parish, Section 93, T7S, R10E, adjacent to land owned by A. Wilbert's Sons, LLC.
- Wilbert's granted TMR Exploration, Inc. an oil, gas, and mineral lease on its property.
- TMR received a directional drilling permit but drilled horizontally, trespassing onto the Hill's property and produced the well from 2008-2010, when it assigned the lease to Park, who became operator.
- Park entered into leases with some of the Hills in 2012.
- Plaintiffs assert that, prior to leasing, Park (and TMR) illegally produced/sold oil from their subsurface.
- Plaintiffs sought money from Chaucer Corporate Capital who insured Park from June 1, 2010-June 1, 2011.

Hill v. TMR Expl., Inc. (La. App. 1st Cir. 8/4/22), 353 So.3d 823, *writ denied*.

- In 2021, Chaucer filed a motion for summary judgment on three grounds:
  - Park knew of the alleged property damage before the policy period began (violating the insurance policy),
  - There was no coverage for "property damage" expected or intended from the standpoint of the insured, and/or
  - Dishonesty or infidelity of the insured party (Park) results in no coverage.

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Hill v. TMR Expl., Inc. (La. App. 1st Cir. 8/4/22), 353 So.3d 823, *writ denied*.

- Chaucer's argument:
  - Chaucer claimed the Plaintiffs judicially confessed that Park knew before the policy period began because the Plaintiffs filed pleadings in another suit to cancel Park's leases alleging that it knew about the subsurface trespass before entering into the lease agreements.

  - Plaintiffs sent Park a request for admission that Park knew about the location of the bottom hole before becoming operator. Park did not respond and the leases were cancelled. Chaucer cited that Plaintiffs previously argued that Park intentionally trespassed, converted, and produced minerals from underneath their property in bad faith and that by June 2010, Park obtained information that would have alerted it to the trespass.

Hill v. TMR Expl., Inc. (La. App. 1st Cir. 8/4/22), 353 So.3d 823, *writ denied*.

- The Hills' argument:
  - The court did not expressly state that the request was deemed admitted.
  - Park later stated it only became aware of the subsurface trespass when it got new mapping in September or October 2011 (3-4 months after the policy in question ended).
  - Plaintiff argued that even if the request is deemed admitted, there's a genuine issue of fact because Park has contradicted that since.

Hill v. TMR Expl., Inc. (La. App. 1st Cir. 8/4/22), 353 So.3d 823, *writ denied*.

- Trial Court: agreed with Chaucer and relied on Park's unanswered request for admission as proof that Park knew about the trespass before signing the insurance policy with Chaucer.
- Appeal Court issues for consideration:
  - Whether the trial court erred in finding that the requests for admission were previously deemed admitted, and
  - Whether the trial court further erred by giving preference to the unanswered requests for admission over Park's interrogatory responses, and
  - Whether the court erred in its finding that Park knew about the property damage before assuming the role of operator.

Hill v. TMR Expl., Inc. (La. App. 1st Cir. 8/4/22), 353 So.3d 823, *writ denied*.

- Held: Since evidence may not be weighed and such conflicts resolved on summary judgment, the trial court erred by giving preference to Park's unanswered request for admissions. The discrepancy has created a genuine issue of material fact concerning when Park became aware that the well bottomed on the Hill property. Maps relied on by Chaucer were illegible and only lead to more questions about what Park knew and when.
- The appeal court also found that the Hills' statements that Park knew it was trespassing were not judicial confessions. They were merely factual assertions not based on personal knowledge.

1026 Conti Holding, LLC VS. 1025 Bienville, LLC, No. 2022-C-01288 (3/17/23)

- Issue 1: Can someone acquire ownership of property via acquisitive prescription (10 or 30 year) if he acquires a "right of use" of the property, and uses the property as the apparent owner for 60 years, but does not give actual notice sufficient to alert *the landowner* that his property is in jeopardy?
- Holding: No

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1026 Conti Holding, LLC VS. 1025 Bienville, LLC, No. 2022-C-01288 (3/17/23)

- Saxton acquires several lots of property in the French Quarter (lots 8, A, and B), and a parking lot (lot AA) in 1921.
- Saxton mortgaged lots 8, A, and B, but not the parking lot (AA)
- Saxton defaulted on the mortgage, and lots 8, A, and B were sold at Sheriff's sale (bot not the parking lot)
- Holzer Brothers purchased the property in the French Quarter (lots 8, A, and B)
- The Sheriff's deed included in it "the right of use of the yard and alley shown in the Waddill survey"
- The "yard" is the parking lot (AA)

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1026 Conti Holding, LLC VS. 1025 Bienville, LLC, No. 2022-C-01288 (3/17/23)

- From 1444 – 2000 (56 years), the Holzers exclusively used lot AA for access, parking, deliveries, storage, and other uses incidental to the operation of their businesses
  - They paid the property taxes
  - They did not let anyone else use the lot
  - They placed a gate on the lot so no one else could get it.
  - A Holzer representative testified that while we did not have "paper title" to the lot, "We think we own [it]. We used it. It was ours."

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1026 Conti Holding, LLC VS. 1025 Bienville, LLC, No. 2022-C-01288 (3/17/23)

La. Supreme Court disagreed

- "A person enjoying the use of a servitude is a precarious possessor. See La. Civil Civ. Code art. 3437;"
- "Acquisitive prescription does not run in favor of a precarious possessor or his universal successor. La. Civ. Code art. 3477."
- "However, by undertaking certain actions, a precarious possessor can change his type of possession and begin to prescribe."
- ***While the Holzers also prevented others from using the lot, there is no evidence they prevented Saxton or his heirs from using the lot. Absent that evidence, the act of excluding third parties could reasonably be construed as an exercise of the Holzers' right to use the property, which is not sufficient to "give the owner some notice that his property is in jeopardy."***

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1026 Conti Holding, LLC VS. 1025 Bienville, LLC, No. 2022-C-01288 (3/17/23)

Why does this matter: Person seeking to acquire ownership via acquisitive prescription must give the owner actual notice that his property is in jeopardy.

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1026 Conti Holding, LLC VS. 1025 Bienville, LLC, No. 2022-C-01288 (3/17/23)

Issue 2: The Holzers then sold the lot. If the subsequent purchasers enjoy the same type of exclusive possession for 10 years, can they acquire it by acquisitive prescription?

Holding: In this case, YES

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1026 Conti Holding, LLC VS. 1025 Bienville, LLC, No. 2022-C-01288 (3/17/23)

- The Holzers sell the lot to Bruno Properties in 2000.
- "Bruno Properties believed the Holzers had acquired the lot by acquisitive prescription." (not by just title)
  - Court said the mistake was reasonable and that Bruno Properties was not in bad faith.
- Bruno Properties would not be in bad faith if they did not know:
  - its seller only had a servitude of use,
  - the seller was a precarious possessor,
  - that precarious possession cannot prescribe, and
  - that the precarious possession was not converted to adverse possession
  - ***Imputing this degree of knowledge to Bruno Properties is inconsistent with the status of that law in the community at large.***

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1026 Conti Holding, LLC VS. 1025 Bienville, LLC, No. 2022-C-01288 (3/17/23)

- Then, Bruno Properties sold the property to Bienville, who obtained a title opinion certifying Bruno had valid title to the parking lot (AA), further solidifying good faith.

- "***If the belief by the possessor results from a title opinion of a reputable attorney, the issue should simply be whether a reasonable person would act on such an opinion. Current practice would seem to indicate that having a good title opinion would be the ultimate in reasonableness***."

- Why does this matter: Title opinion from a reputable attorney will bolster good faith in an acquisition subject to acquisitive prescription issues

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Johnson, et al v. Chesapeake Louisiana, LP, 2022 WL 989341 (W.D. La. 3/31/2022)

- March 2019 – Western District of Louisiana rules that operators cannot recover post-production costs from unleased mineral owners on theories of unjust enrichment or co-ownership, holding that 30:10 does not allow for such deductions.
  - 30:10 gives unleased mineral owners in a unit the chance to participate in a well up front. If not, costs of development and operation are chargeable to the unleased owners in the unit.
- Here, defendant Chesapeake sought rehearing with a new theory: *negotiorum gestio* ("management of business") found in Louisiana Civil Code article 2292, set seq.

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Johnson, et al v. Chesapeake Louisiana, LP, 2022 WL 989341 (W.D. La. 3/31/2022)

- What's *negotiorium gestio*?
  - Art. 2292
    - There is a management of affairs when a person, the manager, acts without authority to protect the interests of another, the owner, in the reasonable belief that the owner would approve of the action if made aware of the circumstances.
  - Art. 2297
    - The owner whose affair has been managed is bound to fulfill the obligations that the manager has undertaken as a prudent administrator and to reimburse the manager for all necessary and useful expenses.

Johnson, et al v. Chesapeake Louisiana, LP, 2022 WL 989341 (W.D. La. 3/31/2022)

- Plaintiff reiterated that the court was right the first time and that there was no need for a reconsideration.
- Plaintiff relied on the plain language of 30:10(A)(3):
  - If there is included in any unit created by the commissioner of conservation one or more unleased interests for which the party or parties entitled to market production therefrom have not made arrangements to separately dispose of the share of such production attributable to such tract, and the unit operator proceeds with the sale of unit production, then the unit operator shall pay to such party or parties such tract's pro rata share of the **proceeds of the sale of production** within one hundred eighty days of such sale.
- Proceeds = no post-production cost deductions

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Johnson, et al v. Chesapeake Louisiana, LP, 2022 WL 989341 (W.D. La. 3/31/2022)

- The Western District Court agreed with defendant Chesapeake and changed its opinion on reconsideration to allow for post-production costs under this newly introduced management theory.
- The Louisiana Supreme Court recognized a “quasi-contractual relationship is created between unit operator and unleased mineral owner with whom the operator has not entered into contract.” Wells v. Zadeck,2011-1232 (La. 3/30/12), 89 So. 3d 1145, 1149.
- Louisiana courts have held that unleased mineral owners have a cause of action under quasi-contract based on La. Civ. Code art. 2292. So, an operator should also have rights under this doctrine.
- The court found that the statutes could be read in harmony and that disallowing the deduction of post-production costs would lead to free riding unleased mineral owners.

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Johnson, et al v. Chesapeake Louisiana, LP, 2022 WL 989341 (W.D. La. 3/31/2022)

- Note: in a companion case entitled *Self v. BPX Operating, Co.*, 595 F. Supp. 3d 528 (W.D. La. 3/31/22), the court reached the same conclusion. Oral argument was heard on December 6, 2022 before the 5th Circuit. Awaiting the decision now.

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Texas Case Law Update

- Lease Issues (*Fort Apache Energy Inc. v. Short OG III Ltd.)*
- Post-production Costs (*Devon Energy Prod. Co., L.P. v. Sheppard*)
- Corrective Title & Bona Fide Purchaser Doctrine (*Yates Energy Corp. et al v. Broadway National Bank, Trustee)*

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Fort Apache Energy Inc. v. Short OG III Ltd. (In re Aztec Oil & Gas Inc.), No. H-17-1252 (S.D. Tex. July 21, 2022).

- Issue: Does Texas law allow an oil and gas lessee (lease holder) to rely on a co-tenant's production to extend the term of the lease?
- Holding: No

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Fort Apache Energy Inc. v. Short OG III Ltd. (In re Aztec Oil & Gas Inc.), No. H-17-1252 (S.D. Tex. July 21, 2022).

- Through a complicated factual history, Fort Apache Energy, Inc. and Resaca Resources became lease holders (co-tenants) of land in Tyler County, Texas.

- Resaca Resources drilled and made a well.

- Fort Apache did not.

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Fort Apache Energy Inc. v. Short OG III Ltd. (In re Aztec Oil & Gas Inc.), No. H-17-1252 (S.D. Tex. July 21, 2022).

Fort Apache's lease read:

- This lease shall remain in force for a term of three (3) years from the above date herein, hereinafter called the "primary term," and as long thereafter as operations, as hereinafter defined, are conducted upon said land with no cessation for more than ninety (90) consecutive days.
- "Operations" in the lease is defined as:

Whenever used in this lease the word "operations" shall mean all operations for and any of the following: drilling, testing, completing, reworking, recompleting, deepening, plugging back or repairing of a well in search for or in an endeavor to obtain production of oil, gas, sulphur or any other minerals, excavating a mine, production of oil, gas, sulphur or other mineral, whether or not in paying quantities.

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Fort Apache Energy Inc. v. Short OG III Ltd. (In re Aztec Oil & Gas Inc.), No. H-17-1252 (S.D. Tex. July 21, 2022).

- Fort Apache argued, instead of conducting operations itself, "that it attempted to co-develop the property (with Resaca Resources). It says that it was not economically viable to drill on already developed land."

- Court held, while it "while it may be true that it was uneconomical" that is not "reason to justify lack of production"

- "As a co-tenant, Fort Apache had equal rights and access to produce on the land. It did not. Based on testimony by Fort Apache, it never intended to develop on the land. It relied on a speculative agreement that was rejected."

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Fort Apache Energy Inc. v. Short OG III Ltd. (In re Aztec Oil & Gas Inc.), No. H-17-1252 (S.D. Tex. July 21, 2022).

Why does this matter: Lease holders cannot rely on a co-tenants operations to hold a lease, you must have your own operations (absent a co-development agreement).

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Devon Energy Prod. Co., L.P. v. Sheppard, 2023 Tex. LEXIS 223

- Texas Supreme Court's opening line: "This oil-and-gas dispute presents a new wrinkle to a perennial problem: how to calculate the landowners' royalty under the terms of a mineral lease."

- Where the parties agree:
  - landowners' royalty is free of costs between wellhead and POS
  - Producers cannot charge royalty holders with a proportionate share of those expenses

- The disagreement:
  - Whether a "bespoke lease" provision also makes the landowners' royalty free of *post-sale* postproduction costs that add value after the POS but are not part of the producers' gross proceeds.

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Devon Energy Prod. Co., L.P. v. Sheppard, 2023 Tex. LEXIS 223

- Peculiar lease language (Eagle Ford Shale "Sheppard Leases" from 2007 [before the shale was successful]) found at Paragraph 3(c):
  - "If any disposition, contract or sale of oil or gas shall include any reduction or charge for the expenses or costs of production, treatment, transportation, manufacturing, process[ing] or marketing of the oil or gas, then such deduction, expense or cost shall be added to . . . gross proceeds so that Lessor's royalty shall never be chargeable directly or indirectly with any costs or expenses other than its pro rata share of severance or production taxes."

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Devon Energy Prod. Co., L.P. v. Sheppard, 2023 Tex. LEXIS 223

- Part L to the leases' addendum further states:
  - Payments of royalty under the terms of this lease shall never bear or be charged with, either directly or indirectly, any part of the costs or expenses of production, gathering, dehydration, compression, transportation, manufacturing, processing, treating, post-production expenses, marketing or otherwise making the oil or gas ready for sale or use, nor any costs of construction, operation or depreciation of any plant or other facilities for processing or treating said oil or gas. Anything to the contrary herein notwithstanding, it is expressly provided that the terms of this paragraph shall be controlling over the provisions of Paragraph 312] of this lease to the contrary and this paragraph shall not be treated as surplusage despite the holding in the cases styled "Heritage Resources, Inc. v. NationsBank", 939 S.W.2d 118 (Tex. 1996) and "Judice v. Mewbourne Oil Co.", 939 S.W.2d [133,] 135-36 (Tex. 1996).

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Devon Energy Prod. Co., L.P. v. Sheppard, 2023 Tex. LEXIS 223

- Usually, the landowners' royalty is free of the expenses incurred to bring minerals to the surface (production costs) but not expenses incurred thereafter to make production marketable (postproduction costs).
- A landowner's royalty free of postproduction costs is more valuable to the royalty holder—and more costly to the producer—because it means the landowner will share in the enhanced value of production but not the expenses incurred to make it so.
- “We have grappled with these issues many times, but the variation presented in this appeal is one of first impression.”

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Devon Energy Prod. Co., L.P. v. Sheppard, 2023 Tex. LEXIS 223

- The royalty dispute arose when the landowners discovered that the producers sold oil under contracts setting the sales price—and thus the gross sales proceeds—by using published index prices at market centers downstream from the point of sale and then subtracting $18 per barrel for the buyer's anticipated post-sale costs for "gathering and handling, including rail car transportation." The producers did not add the $18 adjustment to the royalty base and, instead, paid royalty only on their gross sales proceeds.
- The landowners read the leases as requiring royalty to be paid on additional sums that are not gross proceeds and that do not inure to the producers' benefit: the buyer's actual or anticipated costs to enhance the value of production after the point of sale.

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- Landowner argument:
  - Paragraph 3(c)'s specially written language unburdens the royalty interest from postproduction costs irrespective of the producers' unilateral choices about where and in what condition to sell production and, in that way, affords the producers latitude in structuring their sales transactions without impacting the royalties payable to the landowners.
  - If the producers had incurred those same costs to take production to market, there would be no dispute that the landowners' royalty would be calculated on the downstream value without reduction for those expenditures. In their estimation, Paragraph 3(c) makes the royalty calculation consistent no matter where the producers choose to sell production.

Devon Energy Prod. Co., L.P. v. Sheppard, 2023 Tex. LEXIS 223

- Producer argument:
  - The landowners' construction of Paragraph 3(c) is contrary to the industry's expectation that a royalty free of postproduction costs means only those costs incurred up to the point of sale. In their view, nothing in the leases contemplates payment of a royalty on expenses to enhance the value of production after the point of sale to the first unaffiliated buyer.

Devon Energy Prod. Co., L.P. v. Sheppard, 2023 Tex. LEXIS 223

- Texas Supreme Court's discussion:
  - Freedom of Contract: Contracts are not ambiguous when they can be given a definite and certain meaning and must be enforced as written, when possible. Courts will not rewrite contracts to match industry standards when their terms are unambiguous.
  - "The question is not whether an unaffiliated buyer's postproduction costs are gross proceeds under the leases or under the law. Of course, they are not. The question is whether the leases nonetheless require the producers to pay royalty on those costs."

Devon Energy Prod. Co., L.P. v. Sheppard, 2023 Tex. LEXIS 223

- Texas Supreme Court's discussion (cont.):
  - A plain and natural reading of Paragraph 3(c) unambiguously contemplates royalty payable on an amount that may exceed the consideration accruing to the producers.
  - As the court of appeals explained, Paragraph 3(c)'s prohibition on "indirectly" charging the royalty with postproduction costs could only refer to the buyer's post-sale expenditures because all other pre-sale expenditures—whether incurred directly or indirectly by the producers—are already included in gross proceeds.
  - An obvious and reasonable purpose for a provision like Paragraph 3(c) is to provide the producer with the flexibility to sell production at any point downstream of the well while discharging the landowners from the usual burden to share the costs of rendering production marketable—whether through direct expenditures or indirectly through a lower valuation at the producer's chosen point of sale.

Devon Energy Prod. Co., L.P. v. Sheppard, 2023 Tex. LEXIS 223

- Texas Supreme Court's discussion (cont.):
  - We thus agree with the landowners that the Sheppard and Crain leases are "proceeds plus" leases that employ a two-prong calculation of the royalty base. First, the producers must properly determine their gross proceeds from selling the production, which by definition must be free of postproduction costs. HN11 Second, when the producers' contracts, sales, or dispositions state that enumerated postproduction costs or expenses have been deducted in setting the sales prices, those costs and expenses "shall be added to the . . . gross proceeds."

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Devon Energy Prod. Co., L.P. v. Sheppard, 2023 Tex. LEXIS 223

- Texas Supreme Court's warning:
  - In so holding, we once again caution that, "[i]f anything is clear from the many Texas decisions dealing with royalty provisions, it is that different royalty provisions have different meanings," and the construction of an oil-and-gas lease must ultimately be based predominantly on the particular clause at issue construed within the context of the lease as a whole. Today, we address only the specific language of the provisions before us as applied to the disputed issues on appeal.

Yates Energy Corp. et al v. Broadway National Bank, Trustee, (Tex. App. — San Antonio Aug. 3, 2022, no pet. h.) (mem. op.)

Previously, the Texas Supreme Court ruled Execution of a 2013 Amended Correction Mineral Deed by the parties to the original 2005 Mineral Deed and the 2006 Correction Mineral Deed, without joinder of the current owners of the minerals, complied with Texas Property Code §5.029 (even after a third party acquired the property).

The case was remanded to the court of appeals to determine whether the third-party owners were innocent (bona fide) purchasers, such that they retain their right to the property?

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Yates Energy Corp. et al v. Broadway National Bank, Trustee, (Tex. App. — San Antonio Aug. 3, 2022, no pet. h.) (mem. op.)

- John Evers acquired ownership of mineral rights from his mother (left in the Mary Frances Evers Trust).
- In 2005, Broadway Bank, in its capacity as trustee, conveyed interests in the subject minerals to John.
- A **2005** Mineral Deed conveyed an undivided 25% interest in the subject minerals to John **in fee simple**.
- In **2006**, Broadway Bank (only, not John) executed a Correction Mineral Deed, which purported to **change John's interest in the subject minerals from a fee simple interest to a life estate**.
    - The 2006 Trust Amendment conveyed the subject minerals to John in fee simple "[b]y oversight.

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Yates Energy Corp. et al v. Broadway National Bank, Trustee, (Tex. App. — San Antonio Aug. 3, 2022, no pet. h.) (mem. op.)

- Fee Simple: The person who holds real property in fee simple absolutely can do whatever he wants with it, such as build on it, sell it, or dispose of it by will. The law views this type of estate as perpetual. Upon the death of the owner, if no provision has been made for its distribution, the owner's heirs will automatically inherit the land.
- Life Estate: a present possessory estate that it limited in duration by a measuring life. Most commonly, a life estate is granted for the life of the grantee. The grantee receives a possessory interest in the estate until the death of the measuring life. At that time, the interest reverts back to either the original grantor or to a third party, called a remainderman (here, Broadway Bank).

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Yates Energy Corp. et al v. Broadway National Bank, Trustee, (Tex. App. — San Antonio Aug. 3, 2022, no pet. h.) (mem. op.)

1. Following the 2006 Correction Mineral Deed, Broadway Bank filed the Correction Deed into the public records, and mailed a copy to Yates Energy, who apparently has a mineral lease at the time.
2. In 2012, John Evers executed a royalty deed and an assignment of overriding royalty interest conveying his (ownership) interest in the subject minerals to Yates Energy.
3. Yates Energy then assigned some of the interests it acquired from John to EOG, Jalapeno, ACG3, Glassell Non-Operated Interests, and Curry Glassell.
4. Then, **in 2013**, a title attorney raised concerns about the validity of the 2006 Correction Mineral Deed. In response to these concerns, **Broadway Bank executed and recorded an Amended Correction Deed**.
5. **The 2013 Amended Correction Deed was signed by all the parties**. Like the 2006 Correction Deed, it conveyed only a life estate to John, and stated that the 2005 Mineral Deed's fee simple conveyance to John was an "oversight" that was inconsistent with the Trust Amendment.

Yates Energy Corp. et al v. Broadway National Bank, Trustee, (Tex. App. — San Antonio Aug. 3, 2022, no pet. h.) (mem. op.)

- John Evers dies in 2014. Yates Energy and the companies Yates assigned its interest to argue they are the owners of subject minerals.
- Texas Supreme Court rules the 2013 Amended Correction Deed was a valid instrument that granted John only a life estate in the subject minerals, such that his interest reverted back to the remainderman upon his death
- ISSUE: But were Yates et. al "Bona Fide" or good faith purchasers, such that they are entitled to own the subject minerals?

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Yates Energy Corp. et al v. Broadway National Bank, Trustee, (Tex. App. — San Antonio Aug. 3, 2022, no pet. h.) (mem. op.)

Was Yates Energy a Bona Fide Purchaser? NO – Court granted Broadway Bank's (the remainderman) MSJ

- Broadway Bank sent Yates recorded copies of the 2006 Correction Mineral Deed (that was unenforceable). That instrument, which is substantively identical to the (enforceable) 2013 Amended Correction Deed, recited that the 2005 Mineral Deed had conveyed the interests to John in fee simple "[b]y oversight."
- Yates argued 2006 Correction Mineral Deed "was ineffective and unenforceable" and notified Yates only "of an alleged mistake that had never been proved or properly corrected." Yates argued that "a void correction deed provides notice of nothing."
- Yates cites *Tanya L. McCabe Trust v. Ranger Energy LLC*, which held that a recorded correction instrument "could not be construed as notice to a subsequent buyer of the facts stated therein" because that instrument was not executed in compliance with section 5.029
- But the Court held this case was distinguishable because Yates actually received the document by mail
- "***We decline Yates's invitation to hold that an invalid correction instrument is wholly ineffective to impart notice on a subsequent purchaser where, as here, that purchaser conceded that it received a copy of the instrument before it acquired the property at issue***."
- The 2006 document apparently was sufficient to "excite the suspicions of a person of ordinary prudence."

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Yates Energy Corp. et al v. Broadway National Bank, Trustee, (Tex. App. — San Antonio Aug. 3, 2022, no pet. h.) (mem. op.)

Were Yates Energy assignees Bona Fide Purchaser? Court denied Broadway Bank's MSJ

- Broadway Broadway Bank did not mail the 2006 Correction Mineral Deed to Yates' assignees. Nor did Yates' knowledge impute to the assignees.
- Broadway Bank argued the assignees "had constructive notice of the 2006 Correction Mineral Deed because that instrument was filed of record before they acquired their interests in the subject minerals."
- "Under Texas law, a subsequent creditor or purchaser is only deemed (to have) constructive notice of recorded documents within its direct chain of title that either reveal the interests of another, or that contain recitals that would put a prudent purchaser on inquiry notice of another's interest outside the chain of title."
- Accordingly, assignees' chain of title would have included any instruments executed by John between his acquisition of the property and his conveyance of it to another, but that chain would not include any instruments executed by Broadway Bank after it conveyed the property to John.

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Yates Energy Corp. et al v. Broadway National Bank, Trustee, (Tex. App. — San Antonio Aug. 3, 2022, no pet. h.) (mem. op.)

- The result of it all is that Yates was divested of its interests in the minerals.
- It's back to the probate court for the other parties.
- More likely, it's on to the Supreme Court for another round of appeals
- The holding of the Texas Supreme Court will probably have other repercussions for property owners and their lessees who often use correction instruments for title curative and other purposes. As an example, the Texas Title Examination Standards will be updated with a cautionary note and guidance for title attorneys based on the *Broadway Nat'l Bank* case

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Mississippi Case Law Update

- Applicability of exhaustion of administrative remedies
- “Mortmain” law and bequests of land to religious organizations

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Tiger Production Company, LLC v. Pace, 353 So. 3d 429 (Supreme Court of Mississippi October 2022)

- Tiger is the operator of several oil wells and SWD wells near the Paces' property.
- The Paces claimed trespass, negligence and/or wantonness, nuisance, and damages.
- Tiger laid a SWD line across the Paces' property, without the landowner's consent.
- The Paces also allege that the SWD line leaked resulted in poisoning and death of cattle.

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Tiger Production Company, LLC v. Pace, 353 So. 3d 429 (Supreme Court of Mississippi October 2022)

- Tiger filed a motion to dismiss, arguing that the Paces had not exhausted their administrative remedies before the Mississippi Oil and Gas Board.
- Tiger claimed that because the "damages to their land [were] from regulated oil and gas exploration and production activities," they needed to pursue their case before the board.
- The Mississippi Supreme Court upheld the trial court's holding that the Paces were not required to exhaust their administrative remedies first because there was no adequate administrative remedy and these were common law claims, not statutory claims.

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Mississippi Baptist Foundation v. Mississippi Attorney General, et al. 2023 Miss. LEXIS 75

- Court: Mississippi Supreme Court
- Date: March 16, 2023
- Reverend McCool died testate in 1969. Part of his estate was a ½ mineral interest in property in Amite County.
- The will left the mineral interest to the Mississippi Baptist Foundation (MBF) as Trustee who was to “manage, care for, invest, re-invest and handle the corpus” and pay income to the Reverend’s wife until her death, and then to his sister until her death. After the two women died, the property would be for the use and benefit of foreign missions carried on by the MBF.
- The wife died in 1973 and the sister in 1986.

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Mississippi Baptist Foundation v. Mississippi Attorney General, et al. 2023 Miss. LEXIS 75

- At this time, Mississippi's "mortmain" law was still in effect.
- Mortmain = dead (mort) hand (main)
  - Some form of this law was found throughout the United States at some point. The original rule was that corporations should not own land because their perpetual existence keeps it out of commerce and limits potential tax payments to the government.

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Mississippi Baptist Foundation v. Mississippi Attorney General, et al. 2023 Miss. LEXIS 75

- Timeline of Mortmain in Mississippi:
  - 1857 – first mortmain law enacted (Mississippi became a state in 1817)
  - 1890 – testamentary devises to religious institutions were absolutely null
  - 1940 – mortmain law allowed testators to give no more than 1/3 of their estate to a religious organization and the religious organization could hold the property for up to ten years. If the organization did not sell the property within the ten years, it will revert to the heirs at law of the testator
  - 1988 – clarification of the mortmain law states that the ten year period starts after the devise to the religious organization becomes effective as a fee simple or possessory interest
  - 1996 – mortmain law was repealed in Mississippi

Mississippi Baptist Foundation v. Mississippi Attorney General, et al. 2023 Miss. LEXIS 75

- In December 2019, MBF filed a complaint to probate the Reverend's will (originally probated in Louisiana) to confirm and quiet title to the mineral interest.
- MBF's argument:
  - The wife and sister had life estates in the mineral interest and therefore the mortmain laws were not triggered until the sister died in 1986.
  - Since the mortmain law was repealed without a savings clause in 1996, MBF retained ownership of the mineral interest.
- Heirs' argument:
  - Wife and sister were mere income beneficiaries of the mineral interest and MBF had a possessory interest way back in 1969.

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Mississippi Baptist Foundation v. Mississippi Attorney General, et al. 2023 Miss. LEXIS 75

- Trial Court Issues:
  - Were the mortmain laws constitutional?
  - Does the MBF or the wife's heirs own the mineral interest?
- January 2022 – trial court ruled in favor of the wife's heirs
  - Held: the wife and sister were income beneficiaries, with no possessory interest in the property, and that MBF was consequently divested of the property in 1979, ten years after the Reverend's death.
  - Held: the mortmain law was constitutional

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Mississippi Baptist Foundation v. Mississippi Attorney General, et al. 2023 Miss. LEXIS 75

- Mississippi Supreme Court:
  - Upholds trial court's judgment in favor of the wife's heirs.
  - Found that neither the wife nor sister had a possessory interest in the mineral interest because it was left to MBF as Trustee. MBF had full rights to divest the property for the benefit of the trust.
  - "A trustee possesses property as if it were the absolute owner with the power of disposition; thus when the trustee is the proscribed institution, the ten years began running at the death of the testator."
  - The mortmain law was triggered at the Reverend's death in 1969 and reverted to the heirs by law in 1979.

Mississippi Baptist Foundation v. Mississippi Attorney General, et al. 2023 Miss. LEXIS 75

- Mississippi Supreme Court:
  - Punts on the constitutional issue
  - States that MBF had, at most, 10 years from 1979 to bring its action to remove any cloud on the title. Since MBF waited decades to bring a claim that the mortmain law is unconstitutional, its claim is untimely and the court need not address it.
  - Mississippi AG asked the court to not discuss constitutionality of the statute.

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THANK YOU!

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