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MCGINNIS LOCHRIDGE

Producer's Edge

TEXAS OIL AND GAS LAW BULLETIN

FEATURED ARTICLES:

COPAS Overview — *page 11*

Offshore Wind in the Gulf of Mexico — *page 2*

IN THIS ISSUE

Royalty Recoupment: Operator's Primer for Recovering Overpayments, *page 3*

Harmonizing Assignments and Exhibits, *page 5*

Challenge to Bankruptcy Asset Sale Held "Moot" Without Stay or Uncertainty, *page 6*

Post-Van Dyke Litigation Roundup, *page 8*

New Attorney Announcement, *page 10*

The Grubb Report, *page 13*

A New Type of Lease Washouts, *page 14*

Calling Dibs! Oil and Gas Security Interests and Texas' Unique First Purchaser Statute, *page 15*

About the *Producer's Edge*

The McGinnis Lochridge Oil and Gas Practice Group publishes the *Producer's Edge* with the purpose of keeping our valued clients and contacts in the oil and gas industry updated and informed regarding interesting Texas case law and regulatory developments, as well as providing insightful articles relevant to the oil and gas community. In this print and digital publication, we also routinely welcome various other practice groups to share guest articles surveying other areas of the law important to the oil and gas industry.

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EVENTS, PUBLICATIONS & AWARDS:

SPEAKING ENGAGEMENTS AND PUBLICATIONS

- Austin Brister presented his Annual Case Law Update for the Houston Bar Association's Energy Law Section
- Austin Brister presented his 2023 Oil & Gas Case Review at the Institute for Energy Law's 75th Annual Energy Law Conference
- Bruce Kramer presented at The Foundation for Natural Resources & Energy Law's 40th Annual Oil & Gas Law Short Course on the topic of "Voluntary Pooling & Utilization / Local Regulation of Oil & Gas Operations"
- Austin Brister and Logan Jones published their 2024 annual edition of "Texas Oil and Gas Case Law Review," for Southern Methodist University's "Annual Texas Survey"
- Elias Yazbeck's article, "Come Hell or High Water: Force Majeure in Texas" was published in South Texas College of Law Houston's South Texas Law Review
- Alejandra Salas's article "Legislative Law Update on Oil, Gas and Energy Law" was published in The Texas Bar Journal
- Austin Brister presented his article "COPAS Accounting Procedures – From a Litigation Perspective" at the 50th Annual Ernest E. Smith Oil, Gas and Mineral Law Institute, April 2024
- Chris Halgren presented his article entitled "Shut-In Clauses, Force Majeure, and Temporary Cessation of Production" at the Advanced Oil, Gas & Energy Resources conference in September 2023

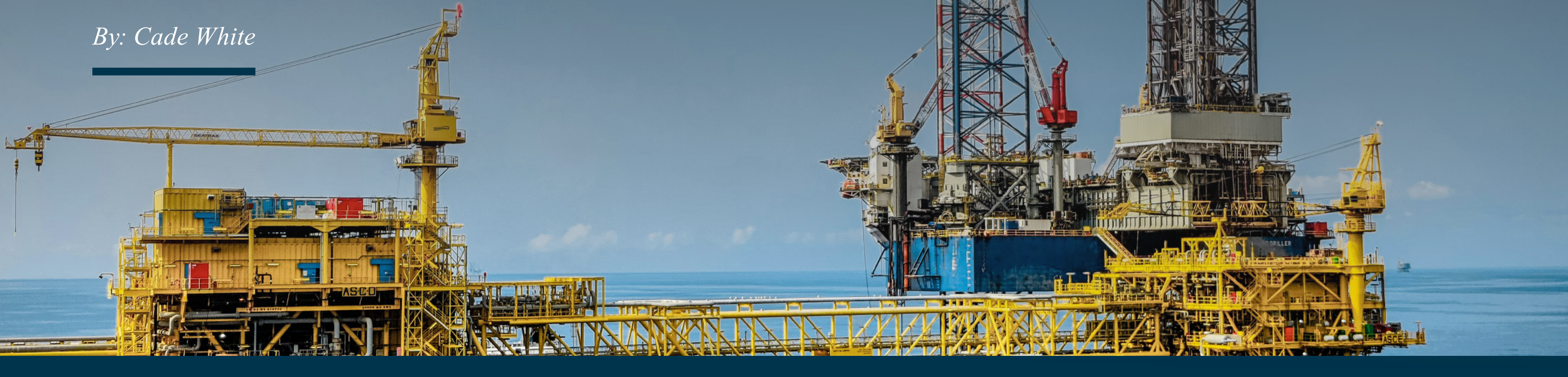
AWARDS

- Nineteen McGinnis Lochridge attorneys received 2024 Martindale-Hubbell AV Preeminent® Ratings
- Austin Brister was selected for the 2024 Lawdragon 500 Leading Energy Lawyers List
- Will Grubb was selected for the 2024 Lawdragon 500 X Next Generation List
- Fourteen McGinnis Lochridge attorneys were recognized as 2024 Texas Super Lawyers
- Eight McGinnis Lochridge Attorneys were recognized as 2024 "Rising Stars" by Texas Super Lawyers
- McGinnis Lochridge was ranked a 2024 "Tier 2 National Law Firm" in Oil & Gas Law by U.S. News - Best Lawyers®
- McGinnis Lochridge was ranked a 2024 "Tier 1 Texas Law Firm" in Oil & Gas in the Houston and Austin Metropolitan Areas by U.S. News - Best Lawyers®
- McGinnis Lochridge was ranked as "Tier 1" and "Tier 2" in sixteen other categories by U.S. News - Best Lawyers® across the Houston and Austin Metropolitan Areas
- Twenty-six McGinnis Lochridge attorneys were recognized in the 2024 Edition of "The Best Lawyers in America®"
- Seven McGinnis Lochridge attorneys were recognized as 2024 Best Lawyers: Ones to Watch® in America

Continued on page 18.

Offshore Wind in the Gulf of Mexico

By: Cade White



The United States Department of the Interior recently proposed a second offshore wind energy auction in the Gulf of Mexico after the first auction generated a high (and single) bid of $5.6 million. While offshore wind has faced its share of criticism and multiple projects on the East Coast face delays due to increasing financing costs as a result of inflation, supply chain challenges and uncertainty over offtake agreements, there are still ample opportunities for offshore construction companies.

But, like any offshore construction project, an offshore windfarm project comes with its own unique issues. Will it be a fixed-bottom project or a floating project? How sophisticated is the client in offshore construction? And, with projects being heavily financed and financing for an owner typically associated with reaching milestones on a project, how willing will the client be to work with offshore contractors when typical offshore delays arise, such as unexpected metocean conditions?

In our experience, the key to any offshore project, including offshore wind projects, and avoiding future disputes is proper planning and a clear allocation of responsibilities. If, for example, a client requires that a certain vessel be used or that a separate contractor performing the engineering associated with construction, does the installation contractor have a responsibility to double-check the suitability of the vessel or the quality of the engineer's work? Is an installation contractor responsible for examining historical weather conditions to determine the probable success of the project when WOW (waiting on weather) is the responsibility of the client? And, if array cables, of which there is a looming shortage and are increasingly expensive to insure, that transmit power from wind towers to an offshore substation are damaged during installation or by fishing trawlers or storms, will a manufacturer accept responsibility? Will the installer be blamed? These are just examples of a number of issues that have been litigated in the offshore windfarm industry.

While it seems straightforward, it is worth reminding entities to clearly delineate any roles or responsibilities on an offshore construction project through contracts and scope of work documents. If an entity understands it is not responsible to, for example, examine the suitability of a vessel, writing such qualifications in a clear and express manner into a contract or scope of work document will aid in avoiding future disputes, as express language in a contract typically controls over general language found in warranties, etc. Limiting warranties as well as the insertion of arbitration clauses is also advisable as many potential jurors do not understand the nuances or traditionally accepted standards of offshore construction, resulting in uncertainties in disputes.

There are many things a contractor can do to protect itself in an offshore construction dispute, but the first line of defense always occurs at the beginning of a project: clear allocation of responsibilities. Boilerplate language is not recommended and attention to detail, with input from your technical personnel, is certainly a better practice.

About the Author

Cade White *handles litigation across a variety of industries, with a particular focus on onshore and offshore oil and gas, insurance coverage and construction. He is a trusted legal advisor to national and multinational clients. White has advised international clients on the complexities of compliance issues in the United States, including economic and trade sanctions based on U.S. foreign policy and national security goals. He has also represented U.S. and London-based insurers in coverage and extra-contractual disputes.*

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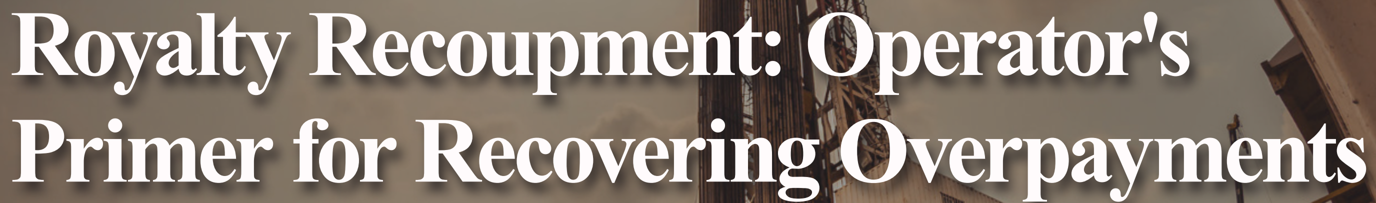

Royalty Recoupment: Operator's Primer for Recovering Overpayments

By: Austin Brister

For oil and gas operators, few things are more frustrating than discovering you may have been overpaying royalties to a person or entity in your paydeck. Whether due to clerical errors, incorrect decimal interests, or miscalculated volumes, overpaid royalties are often not returned voluntarily by their recipients. So what's an operator to do?

Fortunately, Texas law provides several options that operators may be able to utilize when seeking to recoup those misspent funds. This post explores an operator's potential rights and remedies when it comes to royalty overpayments in the Lone Star State.

Contractual Recoupment Rights

First, the at the oil and gas lease or division order. Some (but not all) expressly allow operators to recoup overpayments. For example, the Texas statutory form division order form requires payees to refund overpayments. Tex. Nat. Res. Code Ann. § 91.402(d) ("Payee agrees to refund to payor any amounts attributable to an interest or part of an interest that payee does not own.").

In practice, however, few operators actually pursue this route. Of course, by the time the overpayment is realized, many mineral and royalty owners may have already spent the overpaid funds, creating significant practical hurdles to recovery. Moreover, litigating a recoupment claim can be expensive and time-consuming, not to mention potentially subject to defenses like the voluntary payment rule (discussed below). Also, if the overpayments were made for quite some time, there may be limitations issues. *See, e.g.*, Tex. Civ. Prac. & Rem. Code § 16.004 (4-year limitations period for debt claims).

Given these realities, many operators choose to forego a breach of contract lawsuit in favor of self-help recoupment or asserting an offset claim if the royalty owner files suit (both discussed in more detail later in this article). While a contractual claim remains a theoretical option, the practical and legal challenges often make it an unappealing one for many operators.

No Contract? Consider Suing for "Money Had and Received"

Even without a contractual remedy, operators may still pursue recoupment via an equitable claim for "money had and received." The elements are of this claim are: (1) the defendant holds money; and (2) the money belongs in equity and good conscience to the plaintiff.

However, be aware that money had and received claims may be subject to a two-year limitations period in Texas. *Merry Homes, Inc. v. Luc Dao*, 359 S.W.3d 881, 884 (Tex. App.—Houston [14th Dist.] 2012, no pet.). However, also note that a few courts have indicated such claims would be subject to a 4-year limitations period. *See, e.g., Amoco Prod. Co. v. Smith*, 946 S.W.2d 162, 166 (Tex. App.—El Paso 1997, no writ)).

The Voluntary Payment Rule Defense

When asserting recoupment claims, be prepared for royalty owners to argue that your overpayments were "voluntary" and thus not recoverable under something called the "voluntary payment rule" (we'll call it the "VPR"). This equitable defense generally applies to payments made with full knowledge of all relevant facts and without fraud, deception, duress or coercion. *BMG Direct Mktg., Inc. v. Peake*, 178 S.W.3d 763, 768 (Tex. 2005). The policy is to provide finality to payments.

A significant issue in VPR disputes is whether the payment was made on the basis of a "mistake of law" or a "mistake of fact." If on the basis of a mistake of fact, then recovery will not be barred by VPR. But if payment was based on a mistake of law, then recoupment may be barred by VPR. A mistake of law generally refers to a mistake regarding the legal consequences of some facts at hand. On the other hand, a mistake of fact

generally means overpayments that are due to an unconscious ignorance or forgetfulness of a fact, such as one due to mathematical or clerical errors, ignorance of the true amount of production, or other negligent errors.

Some case examples of "mistakes of fact" allowing recoupment notwithstanding the VPR are as follows:

- Overpayments due to clerical errors and incorrect royalty calculations *(Atlantic Refining Co. v. Tidwell*, 318 S.W.2d 905 (Tex. Civ. App.—Houston 1958, writ ref'd n.r.e.))
- Payments made by an unconscious mistake as to the correct payee *(Amoco Prod. Co. v. Smith*, 946 S.W.2d 162, 166 (Tex. App.—El Paso 1997, no writ))
- Overpayments spanning multiple years based on a mistake regarding the true volume of production *(Hull v. Freedman*, 383 S.W.2d 236, 237 (Tex. Civ. App.—Fort Worth 1964, writ ref'd n.r.e.))

This analysis is highly fact-intensive, and Texas courts have analyzed an array of other factors that may weigh on whether an overpayment is based on a "mistake of fact" and whether the VPR applies.

It may be worth noting that, in *BMG Direct Mktg., Inc. v. Peake*, the Texas Supreme Court indicated that the VPR may have limited scope, stating "this Court has only applied the [VPR] only once in the last forty years, and that holding has itself been modified since." 175 S.W.3d 763, 771 (Tex. 2005). However, multiple Texas courts have subsequently confirmed that the VPR remains good law in Texas. *See,e.g.,XTO Energy, Inc. v. Goodwin*, 584 S.W.3d 481, 498 (Tex. App.—Tyler 2017, pet. denied) (noting the VPR has never been abrogated and still has application under Texas law); *Samson Expl., LLC v. T.S. Reed Props.*, 521 S.W.3d 26, 50 (Tex. App.—Beaumont 2015) (denying producer's counterclaim to recover royalty payments that evidence "conclusively established...were voluntary"), *aff'd*, 521 S.W.3d 766, 779-80 (Tex. 2017) ("concur[ring] in the court of appeals' assessment of the record"). Arguably, the VPR still applies so long as there is not a statutory or common law rule that conflicts. While some may argue the VPR has become limited in scope, the VPR has never been abrogated, Texas courts continue to refer to the VPR, and overpaid royalty owners continue to assert this defense. As such, Operators facing an overpayment situation should consider the VPR this and plan accordingly.

Self-Help Recoupment

Many operators will exercise "self-help" recoupment. This involves simply withholding or deducting overpayments from future royalty disbursements until you are repaid in full.

While no Texas case directly authorizes self-help recoupment, several respected oil and gas treatises suggest it should be available. See, e.g., Williams & Meyers, Oil and Gas Law § 657; and 3 Eugene Kuntz, A Treatise on the Law of Oil and Gas § 42.8. Several papers have also been published suggesting the validity of self-help recoupment under the theory that Texas courts exercise broad equitable principles to prevent unjust enrichment. While this theoretically presents risk of claims that self-help recoupment is improper, many operators move forward given that it usually provides a quicker and more cost-effective solution than litigation.

Recoupment Through Counterclaims

When an operator engages in self-help recoupment, there is a risk the royalty owner may sue to recover the withheld funds. If that happens, the operator should consider asserting its recoupment rights defensively through counterclaims.

In fact, even if some or all of the operator's overpayments would be time-barred by the statute of limitations if the operator were to bring that recoupment claim as an original action, the analysis may be altogether different if the operator asserts its recoupment claim in a timely-filed counterclaim. That is, under Tex. Civ. Prac. & Rem. Code § 16.069, a counterclaim arising out of the same transaction as the plaintiff's claim is revived if filed within 30 days after the defendant's answer is due, even if otherwise time-barred. Thus, if the royalty owner files suit first, an operator can arguably file a recoupment counterclaim notwithstanding limitations issues.

Therefore, depending on the duration the overpayments were made, an operator may need to act quickly to assert recoupment as a counterclaim or the operator may risk limitations issues.

Conclusion

No operator wants to be in the position of trying to claw back overpaid royalties. But if you find yourself there, Texas law offers several potential paths to recoupment. Analyze your contractual agreements, evaluate your facts, and consider your options carefully. With the right approach, operators may have legal and/or practical remedies to recover the overpayment.

About the Author

Austin Brister *is a partner in our Houston office. Austin represents small and mid-size oil and gas companies in a range of business disputes. Austin strives to help clients find creative and practical business solutions. But, when necessary, Austin works hard to implement aggressive, goal-focused strategies in the courthouse.*

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Harmonizing Assignments and Exhibits

By: Andrew T. Green

What happens when language in the body of an assignment of oil and gas interests conflicts with descriptions in the exhibits? Can limitations in the exhibit, such as depth references, supersede the operative granting language in the body of an agreement? These issues are front and center in the Texas Supreme Court's recent opinion in *Occidental Permian, Ltd., et al. v. Citation 2002 Inv. LLC*, No. 23-0037, 2024 Tex. LEXIS 369 (May 17, 2024) and the previous appellate history.

The dispute concerned two competing asset transfer agreements: (1) a 1987 sale of large acreage oil and gas properties (the "1987 Assignment"), and (2) a 1997 assignment by the same assignor of certain of the same interests, but for deeper interests (the "1997 Assignment"). Attached to the 1987 Assignment was an exhibit containing over 50 pages of spreadsheet entries describing the properties being conveyed, including references to specific depths (i.e., a tract "down to 8,393 feet"). A title dispute arose based on competing claims of ownership, raising the issue of whether the 1987 Assignment was depth-limited regarding the properties at issue, or an unlimited grant of all the assignor's interest in those properties.

The trial court granted summary judgment declaring that the 1987 Assignment was limited to certain depths as stated in the exhibit. The El Paso Court of Appeals reversed, holding that the 1987 Assignment conveyed all of the assignor's interests without any depth limitations. *Citation 2002 Inv. LLC, & Endeavor Energy Res., L.P. v. Occidental Permian*, 662 S.W.3d 550 (Tex. App.—El Paso 2022, pet. granted). The court of appeals' analysis centered on the interpretation of two seemingly contradictory precedents found in *Piranha Partners v. Neuhoff*, 596 S.W.3d 740 (Tex.2020) and *Posse Energy, Ltd. v. Parsley Energy*, LP, 632 S.W.3d 677 (Tex. App.—El Paso 2021, pet. denied).

In *Piranha Partners*, the Texas Supreme Court found that the exhibit at issue did not control the granting language in the body of the document, since the exhibit did not contain any specific limiting language, and thus served merely to more clearly identify the lease at issue. In *Posse Energy* the El Paso Court of Appeals determined that the limiting language in the exhibit at issue did control, since the language in the granting instrument was "extremely broad" and the exhibit included the critical limiting language of "insofar and only insofar as." The different results arose by applying the same standard, articulated in *Piranha Partners*: when an instrument of conveyance refers to an exhibit to provide property descriptions the court must harmonize that exhibit with the body of the agreement to determine the parties' intent. Applying that standard the court of appeals found that, unlike in *Posse Energy*, the exhibit to the 1987 Assignment did not contain any specific limiting language, and held that the 1987 Assignment conveyed all interests in the properties at issue without depth limitation of any kind.

The Texas Supreme Court agreed and affirmed the court of appeals' ruling. The Court noted the broad granting language in the body of the 1987 Assignment, stating that it transferred "all rights and interests now owned by [Assignor] . . . in the leases and other rights described herein, regardless of whether same may be incorrectly described or omitted from Exhibit A." This language, in tandem with other similarly broad clauses, emphasized the leases as the significant interests described in Exhibit A, which consequently indicated the assignor intended to convey all rights it had in the leases. Therefore, by applying the *Piranha Partners* rubric, the Supreme Court held that the 1987 Assignment unambiguously transferred all leasehold interests listed in the exhibit without reservation or depth limitations.

The immediate practical takeaway is to draft carefully. As is usually the case with contract interpretation, clarity and specificity are paramount. When attaching an exhibit to any instrument that transfers title, take care to harmonize any text or property descriptions in the exhibit with the operative language in the body of the document, or at a minimum include a clause clearly spelling out whether the document or the exhibit controls. Often times practitioners focus so intently on the terms of an agreement that the content of exhibits can be an afterthought. In the wake of *Citation 2002*, keeping all parts of the agreement in mind is essential to avoid any unintended ambiguity that might ultimately undermine the parties' intentions.

About the Author

Andrew Green *is a partner in our Houston office and handles a wide variety of business and corporate disputes. He has particular experience in the oil and gas, finance, and real estate industry. Andrew was born and raised in Conroe, Texas, and comes from a family of lawyers, including his father, who instilled in him that good lawyering means helping people by creating trusting relationships.*

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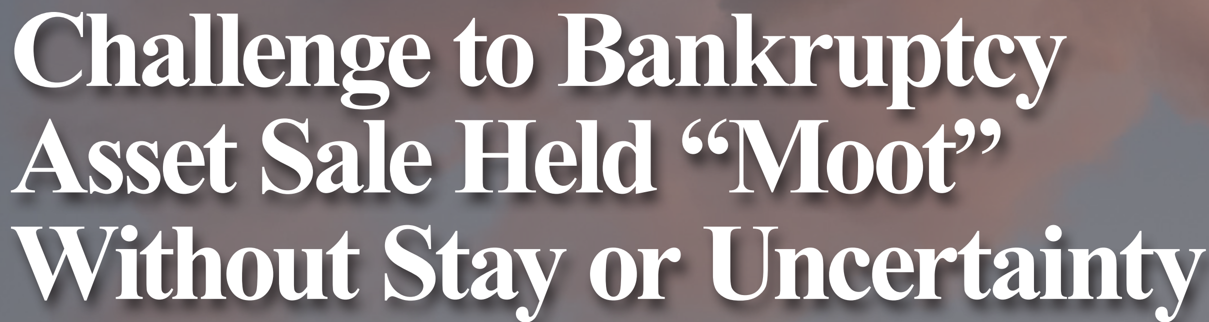

Challenge to Bankruptcy Asset Sale Held "Moot" Without Stay or Uncertainty

By: Chris Halgren

The United States Fifth Circuit recently delivered a victory for parties both Debtors in bankruptcy and purchaser of property from the Debtors' estate by affirming that an appeal of a "363 sale" is moot unless either (i) the appealing party obtains a stay of the Sale Order or (ii) can establish that the rights of the parties was "uncertain" at the time the Sale Order was entered by the bankruptcy court. *Swiss Re Corp. Sols. Am. Ins. Co. v. Fieldwood Energy III, L.L.C. (In re Fieldwood Energy LLC)*, 93 F.4th 817 (5th Cir. 2024). Absent such a showing from the appealing party, the appeal will likely be dismissed as moot.

Fieldwood Energy LLC filed for bankruptcy in 2020, seeking a reorganization of its debts and other obligations. Prior to filing, "Fieldwood Energy LLC and its affiliates (the "Debtors") were previously among the largest oil and gas exploration and production companies operating in the Gulf of Mexico." A critical issue of the Debtors' reorganization process was determining how to address significant decommissioning obligations imposed upon operators in the Outer Continental Shelf. Under 30 C.F.R §§250.1703), "A company is required, once relevant facilities are no longer used, to take such measures as plugging wells, decommissioning pipelines, removing platforms, and clearing the seafloor of obstructions created by the company's operations."

The Debtors proposed a complex reorganization plan involving a sale and series of transactions that, among other things, would cause certain "Sureties" (that had insured surety bonds supporting future decommissioning obligations) to lose their subrogation rights. The bankruptcy judge, the Honorable Marvin Isgur, approved the proposed transactions to occur "free and clear" of the Sureties subrogation and other rights, determining that the sale was "unlikely to close" if the Sureties retained their rights. Moreover, Judge Isgur noted that the Government had withheld objections to the sale, that would have effective been a "veto" of the sale, "in large part because of the plan's increased allocation of responsibility for the oil and gas assets."

The sale of the Debtors' assets was governed by 11 U.S.C. 363(f), providing for sales of a Debtors' assets "free and clear" of all liens, claims, and encumbrances. An appeal of a sale under §363(f) is

governed by 11 U.S.C. 363(m), which provides:

> The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

Judge Isgur entered a Confirmation Order approving the Plan and the §363 Sale that provided, among other things, the Sureties would not be entitled to claim a right of subrogation from the Debtors. "The Sureties sought, but failed to obtain, a stay of the Confirmation Order from the bankruptcy court" and the reorganization plan went into effect. On appeal, the District Court affirmed the Confirmation Order without reaching the merits of the appeal but, instead, holding that the appeal was statutorily moot under §363(m) and equity moot under the Fifth Circuit caselaw.

The Fifth Circuit affirmed the lower courts ruling by finding the appeal statutorily moot under §363(m). The Fifth Circuit emphasized that "[t]he limits on reversal or modification imposed by Section 363(m) serve the interests of finality and certainty, and by extension, encourage bidding for estate property. If deference were not paid to the policy of speedy and final bankruptcy sales, potential buyers would not even consider purchasing any bankrupt's property." (internal quote and cites omitted)

The Sureties argued that §363(m) was narrowed by the recent Supreme Court decision in *MOAC Mall Holdings v. Transform Holdco*, wherein the Supreme Court held that §363(m) was not jurisdiction and could therefore be waived. 598 U.S. 288, 143 S.Ct. 927, 215 L. Ed. 2d 262 (2023). In MOAC, a purchaser affirmatively indicated that it would not invoke §363(m) if third-party creditor elected to appeal a bankruptcy court's order. After the purchaser lost on appeal to the district court, the purchaser then elected to raise §363(m) as a defense despite its earlier representations. Although the district court was "appalled," it held the court was bound to follow and enforce §363(m). However, the Supreme Court vacated the judgment and remanded the case, holding that the protections of §363(m) were not jurisdiction and could be waived. "Nonetheless, the Court recognized that compliance with a precondition may be 'important and mandatory,' even when the rule is not jurisdictional. The Fifth Circuit concluded this was not a "narrowing" of §363(m), but merely a clarification that it was not jurisdiction and could be waived. The Fifth Circuit determined this clarification immaterial in this case because there was no evidence waiver.

The Fifth Circuit rejected the final two arguments based on its determination that the stay must be "obtained," not merely "sought," and the challenged provisions were not immaterial to the sale. First, the Fifth Circuit concluded that it was immaterial that the Sureties has sought a stay because §363(m) requires that the stay be obtained, not merely sought. This conclusion was based on the plain language of the statute. Second, the Fifth Circuit noted that the court had previously found appeals could proceed, despite the language of §363(m) (the court referenced *two prior cases: In re Energytec, Inc.*, 739 F.3d 215, 220-22 (5th Cir. 2013); *In re Walker Cty. Hosp. Corp.*, 3 F.4th 230, 235 n.5 (5th Cir. 2021). However, in those prior cases, the issues subject to appeal had not been fully resolved by the bankruptcy court at the time the order approving the sale was entered. The Fifth Circuit concluded that when a sales order leaves issues for later determination, the issues are not "integral to the sale" and that failure to obtain a stay may not moot an appeal. However, the Sureties subrogation rights were not left uncertain by the bankruptcy court's Confirmation Order but, instead, were expressly eliminated. As a result, the Fifth Circuit held that the Sureties appeal was moot as a result of their failure to obtain a stay of the Confirmation Order.

For oil and gas companies seeking to purchase assets out of bankruptcy, this recent ruling highlights the importance of ensuring clarity and certainty in the underlying sale order, in order to safeguard the investment and facilitate a smooth transaction and closing.

About the Author

Chris Halgren *represents operators, non-operators, and landowners in a variety of disputes ranging from seismic misappropriation, leasing issues, royalty disputes, title litigation, lease termination, midstream accounting and other related contractual disputes.*

Chris strives to identify an aggressive, yet practical approach to accomplish his clients' needs, taking into account the particular legal and business issues presented. Where litigation has been necessary, Chris has represented his clients' interests in courtrooms across Texas. Chris has obtained favorable results for his clients in Texas state and federal courts as well as in domestic and international arbitration.

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Post-Van Dyke Litigation Roundup

By: M. Alejandra Salas

By now, most oil and gas lawyers are familiar with the *Van Dyke v. Navigator Group* decision where the Supreme Court of Texas ruled that a mineral reservation of "one-half of one-eighth of all minerals" in a 1927 deed reserved "1/2 of the mineral estate," not a 1/16 interest. 668 S.W.3d 353 (Tex. 2023). In so holding, the Court relied on the legacy of the 1/8th royalty (the legacy doctrine) and the estate misconception doctrine. The legacy doctrine recognizes that during the "era" in which the deed in question was executed, "'1/8' was widely used as a term of art to refer to the total mineral estate." Consequently, for many years, lessors used "1/8" to refer to what they believed reflected their entire interest in the mineral estate. The estate misconception doctrine refers to the misunderstanding amongst landowners that they only retained a 1/8 interest in their minerals after executing a mineral lease instead of a fee simple determinable with the possibility of reverter in the entirety. The Court clarified that courts interpreting "antiquated instruments" that use 1/8 within a double fraction must begin with the presumption that 1/8 refers to the entire mineral estate. This presumption may be rebutted if, for example, there are provisions in the instrument that cannot be harmonized with the presumption or if there is a repeated use of other fractions demonstrating an intent that an "arithmetical expression" should be applied to all fractions. The Court alternatively ruled that the grantors reserved 1/2 of the mineral estate under the presumed-grant doctrine.

So far, only the El Paso Court of Appeals (the COA) has grappled with the impact of the guidelines concerning double fractions announced in *Van Dyke*. First, in *Royalty Asset Holdings II, LP v. Bayswater Fund III-A LLC*, No. 08-22-00108-CV, 2023 Tex. App. LEXIS 1677, at *1 (Tex. App.—El Paso Mar. 15, 2023, pet. denied), the COA was asked to interpret a 1945 deed reservation. This reservation concerned an "undivided 1/4th of the land owner's usual 1/8th royalty interest (being a full 1/32nd royalty interest) payable or accruing under the terms of any existing or future … lease." The COA was asked to determine whether the interest reserved was fixed or floating. Applying *Van Dyke*, the COA found that the use of a double fraction with 1/8 implicated the presumption that 1/8 referred to the entire mineral estate and thus the deed reserved an undivided floating 1/4 interest. The COA reasoned that the reference to the "usual 1/8th royalty interest" related to the legacy and estate misconception doctrines and supported the presumption that the deed reserved a floating 1/4 interest. Likewise, the reference to "existing or future…leases" indicated an intent for the royalty to take place in the future; thus, the intent must have been to reserve a floating interest. Applying "basic grammatical rules," the COA also concluded that the parenthetical referring to the interest reserved as a "full 1/32nd royalty interest" was a "nonessential

explanation of the multiple-fraction clause." Thus, it did not rebut the presumption.

Just a few months after *Royalty Asset*, the COA was asked to determine whether a 1937 deed reserved a 1/16th fixed royalty interest or a 1/2 floating royalty interest. *See Permico Royalties, LLC v. Barron Props.*, No. 08-22-00168-CV, 2023 Tex. App. LEXIS 4926, at *1 (Tex. App.—El Paso July 10, 2023, pet. filed). The deed expressly reserved "a one-sixteenth (1/16) free royalty interest, (being 1/2 of the usual 1/8th free royalty) in and to all of the oil and gas in and under, and that may be produced" and provided that the grantee "shall be entitled to receive 1/16th of the oil and/or gas produced . . . from said land, being 1/2 of the usual 1/8th royalty therein." After finding that the double fraction implicated the presumption that 1/8 refers to the entire mineral estate, the COA rejected arguments that the legacy doctrine did not apply to deeds drafted in the 1930s even though oil and gas leases existed during that period that provided for a royalty other than 1/8. The COA also concluded that the double fractions in this case must be considered regardless of their placement in nonrestrictive dependent clauses, differentiating *Permico from Royalty Asset* and a previous case also dealing with double fractions where the COA emphasized that a nonrestrictive clause is merely incidental and should not alter the sentence's essential meaning. The COA explained that the phrase "usual 1/8" in the deed reflects the royalty standard of "the era" it was drafted, indicating an intent to convey a 1/2 floating royalty interest.

On the same day, the COA applied the legacy and estate misconception doctrines to determine the size of a conveyance in a 1951 deed that did not contain a double fraction. *See Johnson v. Clifton*, No. 08-22-00132-CV, 2023 Tex. App. LEXIS 4925, at *1 (Tex. App.—El Paso July 10, 2023, pet. filed). The deed at issue conveyed an "undivided one-one hundred and twenty-eight (1/128) interest in and to all of the oil, gas and other minerals in and under the … land" and "a 1/128 (1/16 of the usual 1/8 royalty) part of all of the oil, gas, and other minerals" taken under subsequent leases. The COA reasoned that a grantor, intending to sell half of the minerals already leased, would likely believe they owned 1/8 of the minerals due to the existing lease. Thus, they would convey half of what they perceived they owned using the fraction 1/16 or a double fraction, 1/2 of 1/8. As a result, the COA held, the estate misconception doctrine also applies when the fraction in the deed is a multiple of 1/8. Because the 1/128 fraction is a multiple of 1/8, the presumption was triggered, resulting in a 1/16 mineral interest conveyance with a corresponding floating 1/16 royalty interest. The COA once again emphasized that language referring to the "usual 1/8 royalty" supported the application of the legacy doctrine.

Finally, the COA interpreted a 1947 deed conveying "an undivided three sixteenth (3/16ths) interest in and to all the oil, gas and other minerals in and under that may be produced from the … described land" and, "[i]n the event the … land" was leased, "3/16ths of one-eighth of all the oil and/or gas or other minerals produced therefrom under such lease." *Powder River Mineral Partners, LLC v. Cimarex Energy Co.*, No. 08-23-00058-CV, 2023 Tex. App. LEXIS 9410, at *1 (Tex. App.—El Paso Dec. 15, 2023, pet. filed). The question was whether the deed conveyed a fixed 3/128th royalty interest or a floating 3/16th royalty interest. Seeing as the 1947 deed contained a double fraction with 1/8, the COA applied the presumption and found that the deed conveyed a floating 3/16 royalty interest. The COA dismissed the argument that a 1942 article that was written five years before the 1947 deed was executed supported the intentional use of double fractions in conveying specific meanings about royalty interests. Instead, the COA found that the article advocated for the use of single fractions to establish fixed royalty interests and suggested that double fractions indicated an intent for the royalty owner to share in future royalties exceeding the usual 1/8. The COA also rejected an attempt to distinguish this case from *Van Dyke* based on the nature of the conveyance (royalty interest versus mineral rights with a royalty reservation). The difference, the COA found, is irrelevant as both methods create the same interest and are governed by the same legal principles. The COA also disagreed with the claim that the royalty conveyance applied only "in the event" of a lease, clarifying that the deed conveyed an immediate interest in all future royalties, effective upon execution, regardless of when production began.

About the Authors

Alejandra Salas *is a litigation associate in the Austin office of McGinnis Lochridge, LLP. She represents oil and gas exploration and production companies, royalty owners, and mineral owners in a variety of litigation matters. Prior to joining the Firm, Alejandra served as a judicial law clerk to the Honorable David Counts of the United States District Court for the Western District of Texas, Midland/Odessa and Pecos Divisions.*

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NEW ATTORNEY ANNOUNCEMENT

McGinnis Lochridge Welcomes

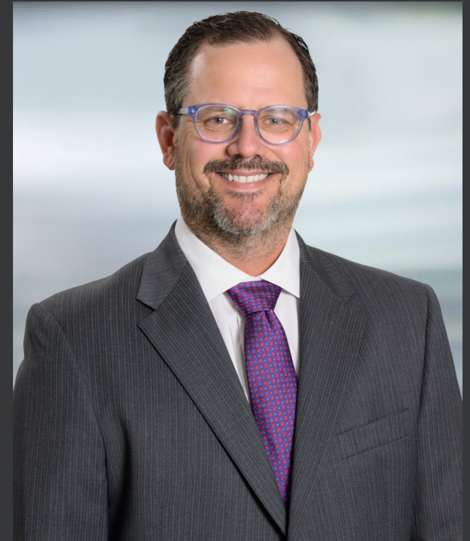
Three New Oil & Gas Attorneys

We are pleased to welcome three new lawyers to our Houston office: Cade White, Ashley Vega, and Andrew Green. "We are pleased to welcome these three talented new attorneys to the firm," says Jonathan Baughman, Partner-in-Charge of the Houston office. "Their addition to our firm adds significantly to the depth and scope of advice and representation we can offer our oil & gas clients."

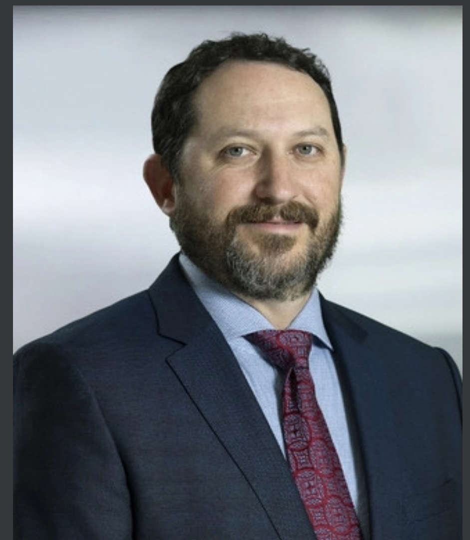
Cade White, joining as a partner in the Houston office, handles litigation across a variety of industries, with a particular focus on onshore and offshore oil and gas, insurance coverage and construction. He is a trusted legal advisor to national and multinational clients. He has advised international clients on the complexities of compliance issues in the United States, including economic and trade sanctions based on U.S. foreign policy and national security goals. He has also represented U.S. and London-based insurers in coverage and extra-contractual disputes.

Andrew Green, also joining as a partner in the Houston office, brings more than 15 years of litigation and transaction experience, with a focus on the oil and gas industry. He also handles a variety of matters for clients across a range of industries, including business and corporate disputes, and has represented leading energy, real estate, and financial companies. Green has also served as a certified mediator.

Ashley Vega joins the Houston office as an associate. Her practice focuses on commercial litigation with an emphasis on onshore/offshore energy disputes and construction defect matters. She represents both plaintiffs and defendants in federal and state court. Ashley combines her passion for detail with real-world practical thinking to help efficiently resolve complex disputes in the construction and energy sectors.



Cade White



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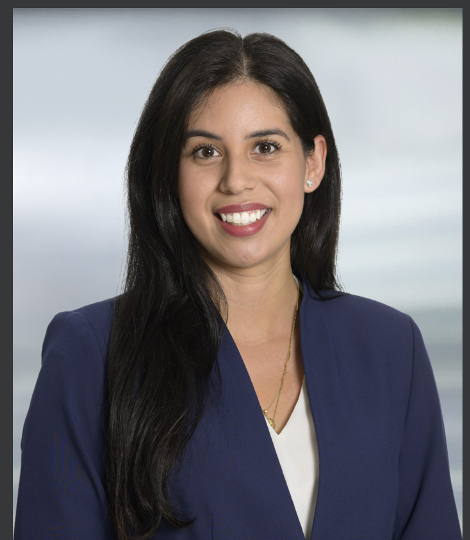

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COPAS Accounting Procedures: Key Litigation Perspectives

By: Jonathan D. Baughman

Picture this: you are in a JOA dispute, which appears likely to proceed to litigation. You know the model form JOA like the back of your hand. You have anticipated the opposing party's arguments, and you feel comfortable with your analysis of the JOA issues. You are also comfortable with the posture of your case given your history of dealings and correspondence. You also feel comfortable that your claims are within the statute of limitations. But, then it strikes you: could the COPAS accounting procedure arguably apply to this dispute? If so, could its 24-month contractual limitations provision apply?

To oil and gas lawyers, transactional and litigators alike, the COPAS accounting procedure is sometimes an afterthought. But, in the context of JOA disputes, whether or not directly involving accounting issues, the COPAS procedure can have a critical impacts on your case.

The COPAS model form Accounting Procedures are, by far, the most common form of accounting procedure attached to JOAs. When a COPAS form is attached to a JOA, it will generally govern the accounting methodology for joint operations, including procedures for billing and payment, classification of costs and expenses, and handling of audit rights and exceptions.

Despite the widespread use of COPAS forms, there is a notable lack of case law in Texas directly interpreting COPAS provisions. This is likely due to several factors, including the collaborative process in creating the COPAS forms that seemingly results in generally well-understood forms among accountants, the effectiveness of COPAS audit procedures in resolving disputes without litigation, and perhaps the fact auditors are often able to resolve many accounting issues by reference to COPAS's additional publications such as Accounting Guidelines (or "AGs") and Model Form Interpretations (or "MFIs").

However, litigation regarding COPAS accounting procedures can, and does arise. Also, even when the COPAS form is not directly litigated, it is not uncommon for provisions of the COPAS form to bear indirectly, or in a secondary manner, in a variety of disputes between non-operators, or between operators and non-operators. One of the most heavily litigated COPAS provisions is its 24-month adjustment clause, also known as

the "conclusive presumption" or "lookback" provision. This provision, found in both the 1984 and 2005 COPAS forms, generally states that all bills and statements will be conclusively presumed true and correct after the twenty-four month period, unless a timely and sufficient written exception is made.

Case law has grappled with the scope and application of this conclusive presumption. For example, in *Exxon Corp. v. Crosby-Mississippi Res., Ltd.*, 40 F.3d 1474 (5th Cir. 1995), the court held that the presumption only attaches to joint interest billings (JIBs) that provide all the details required under the COPAS form. Conversely, in *Grynberg v. Dome Petroleum Corp.*, 599 N.W.2d 261 (N.D. 1999) and *Willard Pease Oil & Gas Co. v. Pioneer Oil & Gas Co.*, 899 P.2d 766 (Utah 1995), courts applied the presumption even when the non-operator claimed not to have received the billing statements. The 2005 COPAS form was modified in several respects, including modifications bearing on the 24-month provision. For example, the 2005 COPAS form clarified that the presumption applies only to expenditures, but also clarified that it extends to payout accounting as well.

Another common issue regarding the 24-month adjustment clause is determining whether a party has avoided its preclusive effects by submitting a timely and sufficient written exception. Case law suggests that the exception should include enough detail to put the operator on notice of the dispute. *CabelTel Int'l Corp. v. Chesapeake Expl., L.L.C.*, 2012 Tex. App. LEXIS 5576 (Tex. App.--Fort Worth July 12, 2012, pet. denied)). Even if a party provides a timely written exception, if it is not sufficiently detailed, then the "conclusive presumption" may bar their claims. For example, in *Calpetco 1981 v. Marshall Expl., Inc.*, 989 F.2d 1408 (5th Cir. 1993), the Fifth Circuit held that a non-operator's counterclaim failed to constitute a sufficient written exception, as it lacked sufficient specificity regarding the disputed charges or wells at issue. The 2005 Form was modified to expressly require a "specified detailed" written exception.

In performing a multi-jurisdictional study of COPAS-related litigation, though the existing case law has not developed a wide-reaching set of well-established black-letter rules, the cases do present several potential conclusions that may be drawn. For instance, here are a few:

1. Handwritten markings on JIBs may constitute a sufficient written exception in some circumstances. See, e.g., Paint Rock Operating, LLC v. Chisholm Exploration, Inc., 989 F.2d 1408 (5th Cir. 1993).
2. In some cases, the 24-month period may be tolled by fraudulent concealment, waiver or estoppel. See, e.g., Calpetco 1981 v. Marshall Expl., Inc., 989 F.2d 1408 (5th Cir. 1993).
3. The 24-month adjustment provision may only apply to disputes between operators and non-operators, at least under forms prior to 2005. See, e.g., XCO Production Co. v. Jamison, 194 S.W.3d 622 (Tex. App—Houston [14th Dist.] 2006, pet. denied).
4. In some cases, filing a lawsuit may not be sufficient to constitute a sufficient written exception. See, e.g., Calpetco 1981 v. Marshall Expl., Inc., 989 F.2d 1408 (5th Cir. 1993).

At any rate, one thing that practitioners should keep in mind is that conducting an audit and diligently participating in the audit procedures under the COPAS form will not toll the 24-month conclusive presumption provision.

While the 24-month provision is a key aspect of COPAS litigation, disputes can arise in various other areas of joint operations accounting covered by the COPAS form. For example, litigation involving the COPAS form may touch on issues such as the calculation of operator overhead, classification of direct and indirect charges, and the treatment of affiliate goods and services.

When faced with a JOA dispute involving COPAS issues, it is crucial for oil and gas litigators to carefully consider the impact of the COPAS accounting procedure on the dispute and legal strategy. By understanding the key provisions, relevant case law, and unique facts of each case, attorneys can more effectively navigate the complexities of COPAS-related disputes and advocate for their clients' interests in joint operations accounting matters.

About the Author

Jonathan Baughman *serves as Partner-in-Charge of the firm's Houston office and chairs the Oil & Gas Practice Group. He is also the chair for the Oil, Gas and Energy Resources Law Section of the State Bar of Texas, and is one of 25 distinguished Advisory Board Members for the Louisiana Mineral Law Institute. Jonathan has been an elected member of the Firm's Management Committee since 2009.*

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THE GRUBB REPORT

Quickly Assessing Your Needs in an Offshore Dispute

By: William K. Grubb

Offshore exploration and production assets and operations can lead to a variety of novel legal issues. For example, McGinnis Lochridge has represented clients in relation to offshore overriding royalty disputes, decommissioning disputes, construction disputes, injury matters, and regulatory issues.

Given the overlapping rubric of federal regulations, federal substantive law, and even state selected or adopted law, assessing basic issues in an offshore dispute can often be more complicated than you might expect. Below are a few preliminary considerations when initially assessing an offshore dispute.

Determining the Governing Law Might Not Be as Simple as You Expect

Many in-house lawyers or executives understand that choice of law can be important. In most cases, sophisticated parties select a certain forum's law in their contracts. However, when dealing with an offshore dispute, the parties' choice of law may not be the end of the inquiry.

For example, in disputes governed by the Outer Continental Shelf Lands Act ("OCSLA"), many courts hold that OCSLA's statutory choice of law supersedes normal choice of law rules that apply. Under this framework, the law of the closest adjacent state, as a surrogate to federal law, may apply. Additionally, federal law could apply. Thus, when initially assessing an offshore dispute, a thorough analysis is needed to determine which substantive law will govern the dispute.

Decomissioning Obligations Seem Obvious, But Can Vary by State

When an operator or record title holder is required to decommission offshore assets, many assume that other and prior record title holders will pay their "fair share" of decommissioning costs. Often, other owners and record title holders pay a share, but the law is not as clear on the issue as one might think.

Whether other or prior record title holders are liable for decommissioning costs is often complicated and varies from state to state. Additionally, depending on the circumstances, deed or instrument language in the chain of title or federal regulations may a part in determining liability.

This complexity can be increased with the passage of time, as companies often have more pressing matters and assume that the costs incurred decommissioning offshore assets will eventually be accounted for.

To make sure your position is adequately protected, those involved in a decommissioning dispute should seek counsel sooner rather than later. Understanding the chain of title, the applicable law and regulations, and acting quickly will give you the best chance at the desired outcome.

Given the Complexity of Offshore Work, Clear Allocation of Responsibilities at the Beginning of a Project Can Pay Dividends

As explained by my colleague, Cade White, in his article on Offshore Wind in the Gulf of Mexico, there are a variety of variables in offshore construction. For instance, weather may play an outsized role in project schedules. As Cade suggests, parties may want to allocate the risk of a project delay due to weather, or even designate a contractor to be responsible for reviewing historical weather patterns. Given the large number of variables that can lead to disputes, taking the time on the front end to allocate risks within the applicable contracts can help stave off future disputes.

Cade's full article is available on page 2.

About the Author

William K. Grubb *is a partner in McGinnis Lochridge's Houston office. Will is a commercial litigator with experience representing clients in energy, oil and gas, and other industries. Will has represented some of the world's largest energy companies, both publicly traded and private, on complex litigation matters. He strives to provide his clients with thorough but practical advice. Will prides himself on being able to analyze complex issues and explain them to his clients, courts, and opposing lawyers in a manner that provides a clear path to a positive outcome.*

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A New Type of Lease Washouts

By: Logan Jones

El Paso Court of Appeals tells lessee that he cannot establish constructive production sufficient to hold a lease without bearing the risk and liabilities of exploration and production.

Oil and gas leases include fee simple determinable language to the effect that the lease lasts for a set number of years and then for so long as oil and gas is produced, whether that be actual or constructive production. In *Cimarex Energy Co. v. Anadarko Petroleum Corp.*, the El Paso Court of appeals clarified that when a lessee is relying on actual production to extend the life of the lease during the secondary term of the lease, actual production must be brough about through the lessee's own efforts, actively or constructively such as through the activity of an operator under an operating agreement that the lessee had joined. 574 S.W.3d 73 (Tex. App. — El Paso 2019, pet denied).

In *Cromwell v. Anadarko E&P Onshore, LLC*, the El Paso Court of Appeals was confronted with the issue of whether a cotenant lessee who had not entered into an operating agreement could nonetheless establish a level of participation necessary to extend the lessee's leases. In *Cromwell*, a lessee, David Cromwell, acquired two oil and gas leases covering six sections of land. Thereafter, on several occasions, Cromwell asked Anadarko for an operating agreement that would enable him to participate in the wells covered by his leases and an existing operating agreement covering the same property. Anadarko never responded. Eventually, the wells reached payout under the operating agreement and Cromwell began paying joint interest billings. Cromwell also elected to participate in an AFE for the installation of a compressor. After the expiration of the primary term of his lease, Cromwell continued participating in the costs of the wells covered by the leases and JOA until Anadarko realized that the primary term of Cromwell's leases had expired. Anadarko then took leases from Cromwell's lessors.

Anadarko maintained that Cromwell's leases had expired, and it was free to take leases from Cromwell's former lessors. Cromwell sued Anadarko, arguing that he had constructively participated in production under the JOA, which perpetrated his leases during their secondary terms. The trial court and El Paso Court of Appeals ruled for Anadarko. The court of appeals noted that Cromwell had merely paid his share of the wells operating expenses, which are ordinarily owned by nonparticipating cotenants. Cromwell did not shoulder risk or liabilities of exploration or development. Further, the court noted that Cromwell's payments were not indicative of the parties' intent that Cromwell participate in operations. Mere payment for a well's repair costs and equipment replacement did not rise to the level of constructive production sufficient to establish constructive production to maintain the leases. Further, even though Anadarko referred to Cromwell as an "owner" the partis conduct did not suggest an "operating relationship." Ultimately the court determined that Cromwell, as a lessee, did not cause production of oil and gas on the lands at issue so his leases terminated and Anadarko was free to take leases from his former lessors.

The outcome of *Cromwell* creates a roadmap for oil and gas operators who want to expand their rights and interest in certain property. Oil and gas operators can essentially wash out other cotenant oil and gas lessee's with an interest in the same land by refusing to include them in an operating agreement. In most cases, an operator under an operating agreement is under no obligation to extend the terms of an operating agreement to lessee with a lease covering the same land as an operating agreement. Operators might find it advantageous to refuse to enter into an operating agreement with the lessee in order to eventually gain control of the mineral rights at issue.

On the other hand, a lessee in Cromwell's situation needs to be very careful to ensure that it: (1) gets a joint operating agreement; (2) establishes constructive production (i.e. shut in royalties if permitted by the lease); or (3) goes out on the property and establishes its own production. Cimarex requires a lessee to cause production (actual or contrastive) of oil and/or gas through the lessee's own efforts.

About the Author

Logan Jones *is an associate in our Oil and Gas group. While in law school, Logan worked as a Legal Intern for a pipeline compression company and served as a Clerk for the Railroad Commission of Texas.*

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Calling Dibs! Oil and Gas Security Interests and Texas' Unique First Purchaser Statute

By: Elias M. Yazbeck

I. Security Interests in Minerals Generall

A security interest, under Texas' version of the Uniform Commercial Code (the "Texas UCC"), is an interest in personal property or fixtures which secures payment or performance of an obligation. Real property is not subject to the Texas UCC.

Oil, gas, and other minerals that have not been extracted from the ground are treated as real property, to which the Texas UCC does not apply. Instead, the property laws of Texas govern perfection. However, as the minerals come out of the ground, they cease to be part of the mineral estate and instead become both a "good" and "as-extracted collateral," to which the Texas UCC does apply.

"Perfection" is the process of publicly establishing a security interest in personal property collateral for the purpose of gaining priority. Perfecting collateral is often a law intensive process. With the assistance of outside counsel, proper perfection can enable a party who is owed money to in essence call "dibs" against underlying collateral to secure "first-in-line" rights for what is owed to them. In other words, a perfected security interest is subordinate or "second in line" to the security interest rights of anyone whose interest becomes perfected before your security interest is perfected. This is known appropriately as the "first in time, first in right" rule.

The method by which a secured party perfects its secured interest varies and is largely determined by the type of personal property serving as collateral. The Texas UCC provides a number of ways in which a creditor may perfect a security interest, and the majority of those ways are uniform from state to state. Foremost among these perfection methods is the filing of a "UCC-1" financing statement with the secretary of state. A secured party may also perfect a security interest in certain categories of collateral, including goods and money, by taking possession of the collateral. Outside counsel can assist greatly in selecting the proper method of perfection for a particular situation.

II. The First Purchaser Statute

Section 9.343 of the Texas UCC, commonly known as the First Purchaser Statute, is unique to Texas

and automatically creates a security interest in favor of working interest owners to secure the obligations of the first purchaser of oil and gas production. This "springing" security interest "exists in" or attaches to the oil and gas production itself, and also to the identifiable proceeds of that production "owned by, received by, or due to" the first purchaser. Therefore, under Texas law, working interest owners such as producers and royalty owners automatically possess a security interest in the oil and gas extracted from their properties against said first purchaser, thereby providing protection, clarity, and efficiency in the legal framework governing these transactions.

But what about perfection? The security interest provided by the First Purchaser Statute is also perfected automatically, without the filing of a financing statement, and in effect grants the interest owner superior priority over all other claimants. This is particularly important in the event of the first purchaser's bankruptcy.

Who is considered the "first purchaser" for purposes of applying the First Purchaser Statue is generally dependent on how the relevant transaction for the sale of production was structured. This is often the subject of litigation, and one of the reasons outside counsel should be retained when structuring the sale of oil and gas assets. A party can be considered a first purchaser under the First Purchaser Statute by signing an agreement to purchase oil or gas production, issuing a division order, or in making any other voluntary communication to the interest owner or any governmental agency recognizing the interest owner's right.

III. Unique to Texas

While the First Purchaser Statute does not require the filing of a financing statement in order to perfect a security interest, it is unique to Texas and is not necessarily recognized under the laws of other states. Under the Texas UCC, as well as the commercial codes of most other states, in order to determine whether a security interest in collateral is properly perfected, the court must apply the law of the state where the debtor was organized, not the claimant. By way of illustration, the law of the state where a first purchaser was organized is determinative as to interest owners pursuing claims against said purchaser. It follows that when a first purchaser is organized under the laws of a different state, the potential exists for that state's law to apply instead. To safeguard a perfected security interest from a scenario where their priority under the First Purchaser Statue, a working interest owner can work with outside counsel to enact a "belt and suspenders" approach to perfection, using alternative methods to perfect their security interest that cover a wide range of scenarios.

About the Author

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Are PSA/Allocation Wells "Pooling By Another Name"?

By: J. Derrick Price and M. Alejandra Salas

The current answer to this question is no. In *R.R. Comm'n of Tex. v. Opiela*, the Austin Court of Appeals concluded that PSA/allocation wells are not the same as pooling under Texas law. The Opiela's filed their Petition for Review with the Supreme Court of Texas in November 2023. The first issue presented by the Opielas is:

> Did the Court of appeals err in concluding that the [RRC] has the authority to issue a permit for a PSA well because production through a PSA well is not the same as pooling?

Respondents Magnolia Oil & Gas Operating, LLC ("Magnolia") and the RRC, filed their respective Responses to Petition for Review on April 29, 2024.

The debate over whether pooling authority is required to drill a multi-tract horizontal well in Texas has ranged for well over a decade. There are those that argue pooling authority is required to drill a multi-tract horizontal well under Texas law. Two major arguments are advanced on this side of the debate. First, the typical oil and gas lease allows a lessee to drill wells only on the land either covered by the oil and gas lease, or on land with which that lease is pooled. Second, the drilling of PSA/allocation wells are by definition pooling because they involve the combination of separate tracts to obtain a drilling permit. On the other side is the arguments that the typical oil and gas lease does not prohibit drilling across lease lines and that PSA/allocation wells do not involve pooling under Texas law because, among other things, no cross-conveyance of mineral and royalty interests between tracts occurs.

The *Opiela* case is based on an administrative appeal of a PSA permit issued by the RRC to Magnolia in 2018. The Opielas, lessors of 25% of the undivided interests under one of the tracts crossed by Magnolia's PSA well, filed a complaint with the RRC contesting the permit, arguing that because their lease prohibited pooling without their written consent, Magnolia had no good faith claim to operate the well. After a hearing, a proposal for decision ("PFD") was issued determining that Magnolia had a good faith claim to operate the well and that Magnolia had PSAs covering 65% of the mineral and working interests in the tracts traversed by the well. The PFD also denied the Opiela's request to revoke Magnolia's permit. The RRC adopted the PFD as its Final Order.

The Opielas appealed to the Travis County District Court on multiple grounds, including whether the RRC's informal adoption of rules for permitting PSA/allocation wells violated provisions of the Administrative Procedures Act ("APA") and whether the RRC committed error in determining that Magnolia had a good faith claim to operate the well when the lease prohibited pooling (and therefore also prohibited the drilling of an allocation well). The court concluded that the RRC had committed error in issuing the permit, and remanded to the RRC.

Magnolia and the RRC appealed to the Austin Court of Appeals, which reversed the portion of the district court's order concluding that the RRC erred by failing to consider the pooling prohibition in the Opiela's lease and affirmed the district court's ruling that Magnolia had not demonstrated a good faith claim to operate the well as a PSA well because only approximately 15.625% of the mineral and working interest owners in the Opiela's tract had signed a PSA. Thus, the court remanded the case to the RRC for further proceedings. The appellate court declined to address the issue of whether the RRC rules allowing PSA/allocation well permits violate the APA.

With respect to the issue of whether pooling authority is required to drill a PSA/allocation well, the *Opiela* opinion highlights that "pooling" "is not expressly required by Texas statutes or regulations for horizontal drilling of a wellbore that crosses property lines," leaving room for private contractual agreements establishing how production will be shared. The appellate court also drew distinctions between "pooling" and PSA wells and concluded "that production through a PSA well is not the same as pooling under Texas Law." Thus, the "lack of pooling authority alone does not prohibit drilling under a PSA."

In their Petition for Review, the Opielas argue that this conclusion is error because "[t]here is no functional distinction between pooling and PSA/Allocation wells." They note that "pooling" is commonly defined as "the integration of areas and interests in order to form a drilling unit." They further argue that allocation and PSA wells, like pooled units, "combine multiple tracts to create a single drilling unit," "drain minerals from a common reservoir or geologic formation," and "allocate production from a single well among multiple properties."

Magnolia and the RRC's respective Responses argue that pooling is not required for multi-tract horizontal

drilling because: (1) the Austin Court of Appeals so held; (2) the typical oil and gas lease allows the drilling of a horizontal well that traverses the lease from tract boundary to tract boundary, it follows that the typical lease would allow the lessee to connect a series of such horizontal wells without implicating the need to pool; (3) Professor Ernest E. Smith's support of the argument that pooling is not required provided a "recognized legal theory to a continuing possessory right in the mineral estate" (i.e., a good-faith basis) for issuing Magnolia the permit; (4) the well was not on a pooled unit, no cross-conveyance of interest has occurred, and the well was not permitted as a pooled unit well; and (5) no statute or case law compels the RRC to require pooling in order to permit multi-tract horizontal wells.

The Opiela's filed their Reply Brief on May 28, 2024. As of the date this article was submitted, the Texas Supreme Court has taken no action on the Petition. Whether the Supreme Court of Texas accepts or denies the Opiela's Petition for Review, the question of whether pooling is required for the drilling of multi-tract horizontal wells under a typical oil and gas lease will finally have an answer.

About the Author

__Derrick Price__ is a partner in our Austin office and a member of the Oil & Gas Practice Group. Derrick handles a wide variety of civil, regulatory and transactional matters in the oil and gas industry, representing both oil and gas operators and landowners. He has extensive experience litigating a broad spectrum of oil and gas issues, including retained acreage issues and related title claims, and he regularly advises clients on these topics. He often speaks at Texas oil and gas CLE seminars, and will be presenting on the topic of retained acreage at the 48th Annual Ernest E. Smith Oil, Gas and Mineral Law Institute on April 22, 2022 in Houston.

__Alejandra Salas__ is a litigation associate in the Austin office of McGinnis Lochridge, LLP. She represents oil and gas exploration and production companies, royalty owners, and mineral owners in a variety of litigation matters. Prior to joining the Firm, Alejandra served as a judicial law clerk to the Honorable David Counts of the United States District Court for the Western District of Texas, Midland/Odessa and Pecos Divisions.

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EVENTS, PUBLICATIONS & AWARDS: *CONTINUED*

AWARDS

- Tim George was recognized as "Lawyer of the Year" for Oil and Gas Law in the 2024 Best Lawyers® Publication
- McGinnis Lochridge was recognized as leading lawyers for its Oil & Gas Regulatory and Litigation practices in the Chambers USA 2023 publication
- Seven McGinnis Lochridge attorneys were recognized as leading lawyers in Chambers USA 2023
- McGinnis Lochridge was ranked a "Recommended Firm" by Benchmark Litigation 2024
- Jonathan Baughman and Travis Barton, were selected as "Litigation Stars" by Benchmark Litigation 2024
- Austin Brister was recognized on the "2024: 40 & Under List" by Benchmark Litigation
- William Grubb, Jordan Mullins, and Michael Kabat were recognized on the "2024: Future Stars List" by Benchmark Litigation

RECOGNITIONS

- Jonathan Baughman was appointed as a Member of the State Bar of Texas' Pattern Jury Charge - Oil & Gas Committee
- Jonathan Baughman was elected as the Chair for the Oil, Gas & Energy Resources Law Section of the State Bar of Texas
- Jonathan Baughman was appointed the Course Director for the Texas State Bar's 41st Annual Advanced Oil, Gas, and Energy Resources Law Course in Houston
- Jonathan Baughman served as the Chair of the Louisiana Mineral Law Institute Advisory Council
- Jonathan Baughman was appointed Co-Chair for the 2023 Foundation for Natural Resources and Energy Law, Special Institute on the Law of Permian Basin, Santa Fe, New Mexico
- Austin Brister was elected as "Treasurer" of the Houston Bar Association's Energy Law Section (2024-2025)
- Austin Brister was appointed within the Advisory Council for the Institute for Energy Law
- Austin Brister was appointed within the Programs Committee for the Foundation for Natural Resources and Energy Law

About McGinnis Lochridge

McGinnis Lochridge is a highly experienced, multi-practice Texas law firm with more than 75 lawyers. Founded in 1927, McGinnis Lochridge has for more than 90 years maintained strong ties to its judicial and legislative traditions. The Firm has been fortunate to count among its lawyers distinguished leaders in judicial and governmental positions, including state and federal trial judges, a Texas Supreme Court justice, a Fifth Circuit justice, state and federal legislators, a past president of the Texas Bar, and even a governor of Texas. The Firm has continued to grow and adapt to meet clients' needs in a changing and increasingly complex business environment.

Today, from offices in Austin, Houston, Dallas, and Decatur, the Firm's attorneys represent energy clients throughout the country in complex litigation and arbitration. We have proven skills handling sophisticated disputes involving geology, geophysics, and petroleum engineering. Several of our lawyers have professional backgrounds and credentials in those areas. Because of the Firm's long history in handling energy disputes, the Firm's Oil & Gas Practice Group includes lawyers with a deep understanding of hydrology, seismic interpretation, log analysis, drilling, completions, hydraulic fracturing, reservoir engineering, production, transportation, hydrocarbon processing, and other related technical areas.

Throughout its history, the Firm has been a leader in the development of oil and gas law serving as trial and appellate counsel in several landmark cases setting important oil and gas law precedents. The Firm successfully represents oil and gas producers, marketers, and transporters in a wide range of matters including disputes over leasehold rights, joint interest billing, royalties, prudent operations, and constitutional limits on regulations that would unreasonably impair the oil and gas business.

At McGinnis Lochridge, each client and every legal matter receives partner-level attention. This client focus ensures maximum value, efficiency, and results. At the same time, the breadth of our practice areas enables clients to rely on McGinnis Lochridge as a comprehensive resource — a single-source, trusted advisor able to address the most challenging business and legal needs.

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