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LEASES OF OIL AND GAS ROYALTIES

Dan Fergus, Jr. and Joshua R. Stein[*]

Roughly thirteen years ago, a group began to capitalize on an opportunity to exploit landowners' unfamiliarity with contract language and eagerness to enter into oil and gas leases. They cleverly used an oil and gas lease as a façade for a term royalty deed. In some cases, this worked. This Article explores the legal ramifications of those leases. Additionally, this Article offers ways a plaintiff may attack these leases and discusses the Texas legislature's attempt to prohibit them.

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I. INTRODUCTION

In approximately 2010, some saw an opportunity in the distinction between mineral interests and non-participating royalty interests ("NPRIs").[1] As every landman knows, most people are eager to sign oil and gas leases, but resistant to selling their minerals. They often do not know whether they own minerals or NPRIs.[2] Some took advantage of the landowners' lack of understanding by designing an instrument that looks like an oil and gas lease but is secretly intended to be a term royalty deed.[3] They offered NPRI owners

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1. The mineral estate consists of five components: the right to develop, the right to lease, the right to receive a bonus, the right to receive delay rentals, and the right to receive royalties. Landowners may sever and combine these five components in any manner. The most common method separates the right to receive royalties from the other components. This creates a non-participating royalty interest. Other combinations exist but are beyond the scope of this paper.

2. *See infra* Part II.

3. *Id.*

an opportunity to "lease" their royalties in exchange for a "bonus."[4] These instruments, sometimes called "royalty leases," mirrored the language in a typical oil and gas lease, down to the quarter royalty reserved for the landowner.[5] Some even replicated the format and typeface of oil and gas leases.[6]

Once signed, they presented the royalty leases to the operator or purchaser as if they were term royalty deeds and demanded payment.[7] If an operator refused to issue payments, they threatened litigation. In at least one case, they followed through. Operators and purchasers, quite understandably, viewed the royalty leases as a dispute between landowners. They considered the matter resolved if both sides signed division orders. More often than not, those division orders were signed, payments were made accordingly, and no one was the wiser.

This Article will explore the legal ramifications of these leases, offer ways to attack them as a plaintiff, and discuss the Texas legislature's attempt to outlaw the so-called royalty lease.

II. HOW TO SPOT A ROYALTY LEASE

The royalty lease is designed with litigation in mind. It has evolved over the years in response to various lawsuits, class actions, and arbitrations. The earlier royalty leases are very short and simple. They generally take the following form (emphasis has been added):

> Oil and Gas Royalty Lease
>
> This Agreement dated [omitted] between [Lessor] and [Lessee] for and in consideration of the sum of Ten and More ($10.00) Dollars and other good and valuable considerations, in hand paid by [Lessee], the receipt of which is hereby acknowledged and confessed, hereby grants, leases and lets exclusively unto the said Lessee, all of Lessor's non-participating royalty interest in and to the Royalty in all of the oil, gas, and other minerals produced and saved from the hereinafter described lands, including all proceeds hereof any the right to demand, collect, and receive the same, located in:
>
> [Property description omitted]

4. They sometimes leased mineral owners who had already signed oil and gas leases in the same manner. In Texas, a typical oil and gas lease actually conveys the mineral estate as a determinable fee, less those portions expressly reserved, such as royalty. Luckel v. White, 819 S.W.2d 459, 464 (Tex. 1991) (citing Stephens County v. Mid-Kansas Oil & Gas Co., 113 Tex. 160, 173–74, 254 S.W. 290, 295 (1923)). Thus, a "lease" of the royalty reserved in an oil and gas lease is functionally indistinguishable from a "lease" of a non-participating royalty interest.

5. *See Luckel*, 819 S.W.2d at 461.

6. *See infra* Part II.

7. *See supra* note 4.

> This is a paid up lease and subject to the other provisions herein contained. This lease, grant and conveyance shall be for a term of three (3) years from the date of this document, and as long thereafter as oil, gas or minerals are produced from said lands or lands pooled therewith, and at the termination of said production and cessation of operations to restore it, this lease and all rights granted thereby shall terminate.
>
> As royalty, Lessor reserves an equal one-fourth (25%) part of the Royalty from the sale of all oil, gas and condensate produced and saved from the land subject to the terms of this agreement.
>
> [Arbitration clause omitted]
>
> TO HAVE AND TO HOLD unto the said Lessee, its successors, and assigns said royalty interest as above set forth; and Lessor does hereby grant, lease and let said royalty interest under any valid oil and gas lease covering said lands and extensions thereof.
>
> Addendum
>
> Notwithstanding anything contained herein to the contrary, if, at the expiration of the primary term of three years of this lease, this lease is not being maintained in effect in any manner provided for herein, including but not limited to operations upon or production from the leased premises or on land pooled therewith, Lessee shall have the exclusive right and option to renew and extend this lease as to the lands then covered thereby or any portion chosen by Lessee for an additional two (2) year primary term, on or before the expiration of the three year primary term as stated herein, by payment or tender to Lessor on or before said date, a sum of money equal to the initial bonus paid under the terms and conditions of said lease.

Newer royalty leases use the following format, which typically includes the spacing and typeface of a Producer's 88 oil and gas lease. Although the new version is more verbose, the core issues are the same:

> Oil and Gas Royalty Lease
>
> THIS LEASE AGREEMENT is made as of [Date] between [Lessor] and [Lessee]. All printed portions of this royalty lease were prepared by the party hereinabove named as Lessee, but all other provisions (including the completion of blank spaces) were prepared jointly by Lessor and Lessee.
>
> 1. In consideration of ten dollars ($10.00) and other good and valuable consideration in hand paid and the covenants herein contained, Lessor hereby grants, leases and lets exclusively to Lessee, subject to the reservation contained herein, all of Lessor's royalty interest in and to all of the oil, gas and other minerals produced and saved from the hereinafter described

> lands (the 'Subject Interest'), such Subject Interest to include all proceeds thereof in and to the rights, rentals, royalties and other benefits accrued, accruing and/or to accrue and the right to demand, collect and receive same, hereinafter called leased premises:
> [Property description omitted]
> 2. This royalty lease, shall be in force for a primary term of 5 years from the date hereof, and for as long thereafter as oil or gas or other substances covered hereby are produced in paying quantities from the leased premises or from lands pooled therewith.
> 3. As Royalty on the Subject Interest leased to Lessee herein, Lessor reserves an equal one-fourth (25%) part of the Royalty and other proceeds from the sale of all oil, gas and condensate produced and saved from said Land and the Subject Interested lease to Lessee herein.
> 4. Lessor hereby expressly represents and warrants that no representation, promise or other statement that is not herein expressed has been made to Lessor in executing this Royalty Lease Document and Lessor did not rely on any representation, promise or other statement made by Lessee and/or Lessee's agent and/or employees, relating to this Royalty Lease or the subject matter thereof, except as set forth herein, and it is the Lessor's express intent to fully disclaim and disavow reliance on any such representation, promise or statement. Lessor expressly acknowledges that this Royalty Lease does not grant Lessee the right to explore for or produce oil, gas, or minerals from the leased premises.
> [Arbitration clause omitted]

The foregoing examples are meant to be illustrative, but not exhaustive. The royalty leases' authors have spent years honing their document and seeking balanced language that might not be understood by NPRI owners but survive court or arbitrator scrutiny. The authors of the royalty leases have also formed multiple companies, some of which mimic the names of large oil companies.

Although the royalty leases vary from case to case, their operative language tends to stay the same. They refer to the parties as "Lessor" and "Lessee." This language is common in oil and gas leases. Conversely, it is nonexistent in term royalty deeds, where the parties are referred to as "Grantor" and "Grantee." The royalty leases contain granting clauses which explicitly recite that "Lessor grants, leases, and lets unto Lessee . . . Lessor's non-participating royalty." The phrase "grants, leases, and lets" is standard in oil and gas leases. They recite, "As royalty, Lessor reserves an equal one-fourth (25%) part of the Royalty." A quarter royalty in an oil and gas lease is common, although the royalty lease's reservation of "royalty . . . out

of the Royalty" is somewhat incoherent. They often recite that they are "paid up leases" and refer to a "bonus." Once again, these terms are common in oil and gas leases. Term royalty deeds, of course, are not paid for in bonuses. The last sentence of the royalty lease often obliquely attempts to give notice that the royalty lease is a nonstandard term royalty deed, not an oil and gas lease.

Many royalty leases contain lengthy arbitration clauses. These clauses have prevented courts from adjudicating the royalty leases on the merits.[8] Despite the arbitration clauses, at least one class has been certified for the limited purposes of settlement.[9]

III. HOW TO ATTACK A ROYALTY LEASE

A. Limitations, the Discovery Rule, Estoppel, Declaratory Judgment

The royalty lease is surprisingly good at avoiding the applicable statutes of limitation.[10] The individuals using the royalty lease target areas with recent drilling permits and recent leases. This ensures that a good portion of the applicable limitations periods will pass before division orders are issued. An NPRI owner who believes they have signed an oil and gas lease with a three-year primary term will be unsurprised if three years pass without incident. If an operator moves a drilling rig onto the property a few months prior to the expiration of the lease, then it may well be more than another four years between execution of the royalty lease and issuance of division orders. Even so, division orders rarely alert a landowner because few landowners know what their division order interest should be, and even fewer verify their division orders through title examination.[11]

The discovery rule is likely inapplicable in royalty lease cases. There is nothing inherently undiscoverable about the four corners of the document, and a party is charged with immediate knowledge of an unambiguous instrument's terms at execution.[12] If the royalty lease is unambiguous, then the lessors are charged with immediate knowledge that they are "leasing" their NPRI, whatever that may mean. It makes little difference that

8. *See, e.g.*, Ridge Nat. Res. LLC v. Double Eagle Royalty, L.P., 564 S.W.3d 105 (Tex. App.—El Paso 2018, no pet.).

9. *See, e.g.*, Bridges v. Ridge Nat. Res., LLC, No. MO-18-CV-00134-DC, 2020 WL 7637280 (W.D. Tex. June 5, 2020).

10. The statute of limitations for fraud is four years. TEX. CIV. PRAC. & REM. CODE ANN. § 16.004. The statute of limitations for securities fraud is three years after discovery, but no more than five years after the sale. TEX. GOV'T CODE ANN. § 4008.062.

11. Certain operators have required transfer orders before issuing payments under a royalty lease. Doing so allows the operator to provide clear notice to the NPRI owners. Of course, if the NPRI owner receives that notice and does not understand it or does nothing about it, the notice provided by the transfer order will inure to the benefit of the so-called lessee.

12. Cosgrove v. Cade, 468 S.W.3d 32, 36–37 (Tex. 2015).

landowners (and practitioners)[13] do not know what legal effect "leasing" a royalty may have because "all citizens are presumptively charged with knowledge of the law."[14] Likewise in Texas, "a party to an arms-length transaction is charged with the obligation of reading what he signs, and failing that, may not thereafter, without a showing of trickery or artifice, avoid the instrument on the ground that he did not know what he was signing."[15]

B. The Royalty Lease Is an Oil and Gas Lease

A plaintiff filing untimely should ignore the discovery rule. Instead, they should ask the court to declare that the royalty lease is what it pretends to be: an oil and gas lease covering a non-participating royalty interest. This is because "a purported lease signed by a royalty owner is void."[16]

The royalty lease recites that it is a "paid up lease" secured by a "bonus" in which "Lessor . . . grants, leases, and lets exclusively unto . . . Lessee." It repeatedly and unwaveringly claims to be a lease, reciting the terms "Lease," "Let," "Lessor," and "Lessee" dozens of times. Words such as "term royalty deed" are conspicuously absent from the four corners of the royalty lease. In the oil and gas industry, "lease" means "oil and gas lease." "Lease" does not mean "term royalty deed." Courts have long ruled that words such as "lease" must be given their plain, ordinary, and generally accepted meanings.[17] Oil and gas leases are the only instruments known to Texas law which refer to themselves as "paid up leases," are secured by a "bonus," and recite "Lessor . . . grants, leases, and lets . . . to Lessee."[18]

The royalty lease is an oil and gas lease because all the provisions present within the four corners—every single operative and efficacious

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13. Oil and gas royalties are payments for the sale of the corpus of the mineral estate. Clyde v. Hamilton, 414 S.W.2d 434, 439 (Tex. 1967). It is unclear what effect, if any, "leasing" the right to receive such payments will have. If royalty leases are "leases" in the common sense of the word, then the lessee would receive the right to possess the payments during the term of the lease, but not the right to use or dispose of the payments. Plaintiffs who pursue this theory should attempt to impose a constructive trust for the benefit of the lessor.

14. Atkins v. Parker, 472 U.S. 115, 130, 105 S. Ct. 2520, 86 L. Ed. 2d 81 (1985).

15. Thigpen v. Locke, 363 S.W.2d 247, 251 (Tex. 1962) (citing Indem. Ins. Co. of N. Am. v. W. L. Macatee & Sons, 129 Tex. 166, 101 S.W.2d 553 (Comm'n App. 1937)).

16. Hawkins v. Tex. Oil & Gas Corp., 724 S.W.2d 878, 888 (Tex. App.—Waco 1987, writ ref'd n.r.e.). Instead of covering NPRIs, some royalty leases purport to lease the royalty a mineral owner reserves in his or her oil and gas lease. In such a situation, the royalty lease may be construed as a top lease instead of a term royalty deed.

17. Valence Operating Co. v. Dorsett, 164 S.W.3d 656, 662 (Tex. 2005) ("Contract terms are given their plain, ordinary, and generally accepted meanings unless the contract itself shows them to be used in a technical or different sense.").

18. *See* EnerQuest Oil & Gas, LLC v. Plains Expl. & Prod. Co., 981 F. Supp. 2d 575, 602 (W.D. Tex. 2013); *In re* Estate of Slaughter, 305 S.W.3d 804, 811 (Tex. App.—Texarkana. 2010, no pet.) ("'Bonus' is defined as '[A] payment that is made in addition to royalties and rent as an incentive for a lessor to sign an oil-and-gas lease.'").

word—indicate the royalty lease is an oil and gas lease.[19] The royalty lease is presented to NPRI owners as an oil and gas lease, it looks like an oil and gas lease, and it reads like an oil and gas lease. Therefore, it is an oil and gas lease. No language within the royalty lease indicates that it is any other form of instrument.[20] Royalty leases must be oil and gas leases because any other interpretation would violate the four corners rule, do violence to the text of the royalty lease, and impermissibly strike clauses from the text of the instrument.[21]

The defenders of royalty leases point out that the instruments lack many common clauses within oil and gas leases. The royalty lease is silent, for example, on pooling, continuous drilling, and all matters related to the transfer of royalty and arbitration. Oil and gas leases appear in many forms, and there is no standard oil and gas lease.[22] Oil and gas leases are not required to contain any terms or clauses to be "oil and gas leases," as opposed to some other type of instrument. The very first reported oil and gas lease reads in its entirety as follows:

> Agreed this fourth day of July, A.D. 1853, with J. D. Angier of Cherrytree Township, in the County of Venango, Pas., that he will repair up and keep in order, the old oil spring on land in said Cherrytree Township, or dig and make new springs, and the expenses to be deducted out of the proceeds of the oil, and the balance, if any, to be equally divided, the one half to J. D. Angier and the other half to Brewer, Watson & Co., for the full term of five years from this date. If profitable. /s/ Brewer, Watson & Co. /s/ J. D. Angier[23]

As the J. D. Angier Lease demonstrates, an oil and gas lease without a Pugh clause or a proportionate reduction clause is still an oil and gas lease.[24] The absence of several common oil and gas lease provisions within the royalty lease is immaterial.[25]

The royalty lease's use of the phrase "this is a paid up lease" is particularly problematic for its defenders (and has been removed from more current versions of the document). "Paid up lease" means the lessee has no

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19. *See* Luckel v. White, 819 S.W.2d 459, 461–62 (Tex. 1991) (holding that every clause matters and that courts must harmonize the terms of unambiguous instruments to interpret their meaning).

20. *See id.*

21. *Luckel*, 819 S.W.2d at 462.

22. 2 EUGENE KUNTZ, THE LAW OF OIL & GAS § 18.2 (1987).

23. 2 J.T. HENRY, THE EARLY AND LATER HISTORY OF PETROLEUM, WITH AUTHENTIC FACTS IN REGARD TO ITS DEVELOPMENT IN WESTERN PENNSYLVANIA 60 (1873).

24. *See* KUNTZ, *supra* note 22, at § 18.2.

25. *See* Concord Oil Co. v. Pennzoil Expl. & Prod. Co., 966 S.W.2d 451, 457 (Tex. 1998) ("Courts determine the parties' intent from the document as a whole, not from the presence or absence of certain provisions.").

drilling obligations during the primary term.[26] Lessees avoid drilling obligations by paying delay rentals or including the value of the delay rental in the bonus.[27] A delay rental is "a periodic payment made by an oil and gas lessee to postpone exploration during the primary lease term."[28] A bonus is "[a] payment that is made in addition to royalties and rent as an incentive for a lessor to sign an oil and gas lease."[29] The terms "paid up lease," "delay rental," and "bonus" contain the term "oil and gas lease" within their very definitions.[30] These terms must be given their plain, ordinary, and generally accepted meanings.[31] Oil and gas leases are the only real property interest recognized in Texas that include exploration, a primary term, delay rentals, and a bonus payment. Therefore, the term "paid up lease" exists exclusively in oil and gas leases and cannot be used in deeds. There simply is no such thing as a "paid up deed" because deeds do not contain drilling obligations, primary terms, delay rentals, or bonus payments.

Additionally problematic is the royalty lease's use of the term "bonus" to describe the purchase price (which has also been stricken from more current versions of the document). Royalty leases must be oil and gas leases because bonuses are paid to secure oil and gas leases.[32] "Bonus" is defined as an "incentive for a lessor to sign an oil and gas lease."[33] It makes no sense to claim that an "incentive for a lessor to sign an oil and gas lease" was paid to secure a deed.

The royalty lease's use of the phrase "grants, leases, and lets" is also problematic for its defenders, although more subtly so. The phrase "grants, leases, and lets" is the standard Producer's 88 granting clause and is recorded in hundreds of thousands of such leases. The phrase "grants, leases, and lets" exists in approximately 100 reported Texas cases. All involve oil and gas leases. The fact that the royalty lease uses a Producer's 88 granting clause demonstrates that it is an oil and gas lease. The same is true of the royalty lease's references to the parties as lessor and lessee. Like the royalty lease's other terminology, these words must be given their plain, ordinary, and generally accepted meanings.[34] Some royalty leases also use the phrase "to have and to hold," which is non-standard in an oil and gas lease but is not unheard of or defective.[35]

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26. EnerQuest Oil & Gas, LLC v. Plains Expl. & Prod. Co., 981 F. Supp. 2d 575, 602 (W.D. Tex. 2013).

27. *Id.* at 606.

28. *In re* Estate of Slaughter, 305 S.W.3d 804, 811 (Tex. App.—Texarkana. 2010, no pet.).

29. *Id.*

30. *EnerQuest*, 981 F. Supp. 2d at 602.

31. Valence Operating Co. v. Dorsett, 164 S.W.3d 656, 662 (Tex. 2005).

32. *In re Estate of Slaughter*, 305 S.W.3d at 811.

33. *Id.*

34. *Valence Operating*, 164 S.W.3d at 662.

35. *See, e.g.*, Rogers v. Ricane Enterprises, Inc., 772 S.W.2d 76, 78 (Tex. 1989) (interpreting an oil and gas lease reciting "to have and to hold").

C. Void and Voidable Distinction

If the royalty lease is an oil and gas lease covering a non-participating royalty interest, then it is void.[36] Critically, under *Hawkins v. Tex. Oil & Gas Corp.*, an oil and gas lease covering a non-participating royalty interest is *void*, not *voidable*.[37] This distinction resolves the limitation problems discussed above.[38] A void act is one entirely null within itself, not binding on either party, and not susceptible to ratification or confirmation.[39] Its nullity cannot be waived.[40] By contrast, a voidable act is not absolutely void within itself, is binding until disaffirmed, and may be made valid by ratification, confirmation, and the passage of time.[41] Void instruments contain fatal defects that render compliance a legal impossibility from the moment of execution.[42] Suits to remove void instruments are not subject to statutes of limitation because the passage of time will not cure the void instrument's defects.[43]

As a legal nullity, a void document cannot pass title even to an innocent purchaser.[44] A void deed cannot be ratified at a later date.[45] A void deed cannot be ratified by estoppel.[46] A void deed cannot be ratified by

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36. *Hawkins*, 724 S.W.2d at 887.

37. *Id.*

38. A limitations problem still exists as to damages, which are subject to a rolling four-year statute of limitations. *See* Lyle v. Jane Guinn Revocable Tr., 365 S.W.3d 341, 354–55 (Tex. App.—Houston [1st Dist.] 2010, pet. denied).

39. Wood v. HSBC Bank USA, N.A., 505 S.W.3d 542, 547 (Tex. 2016).

40. *Id.*

41. *Id.*

42. *See, e.g.*, TEX. PROP. CODE ANN. § 5.026(a) (informing that deeds barring sale based on race, religion, or ethnicity are void); TEX. PROP. CODE ANN. § 112.036 (noting that deeds that violate the Rule Against Perpetuities are void); Savering v. City of Mansfield, 505 S.W.3d 33, 56 (Tex. App.—Fort Worth 2016, no pet.) (en banc op. on reh'g) (explaining that a conveyance to a non-existing corporation is void); Noble Mortg. & Invs., LLC v. D & M Vision Invs., LLC, 340 S.W.3d 65, 75 (Tex. App.—Houston [1st Dist.] 2011, no pet.) (concluding that unrecorded deeds are void against bona fide purchasers without notice); Dwairy v. Lopez, 243 S.W.3d 710, 713 (Tex. App.—San Antonio 2007, no pet.) (forged deeds are void); Sanchez v. Telles, 960 S.W.2d 762, 768 (Tex. App.—El Paso 1997, pet. denied) (noting that a deed that is not signed by the grantor is void); Proctor v. Foxmeyer Drug Co., 884 S.W.2d 853, 862 (Tex. App.—Dallas 1994, no writ) (opining that deeds with fixed price options of unlimited duration are void restraints on alienation); Gray v. Vandver, 623 S.W.2d 172, 174 (Tex. App.—Beaumont 1981, no writ) (opining that deeds with fixed price rights of first refusal are void restraints on alienation); MGJ Corp. v. City of Houston, 544 S.W.2d 171, 174 (Tex. App.—Houston [1st Dist.] 1976, writ ref'd n.r.e.) (explaining that a conveyance or reservation in favor of a stranger to the deed is void); Kunkel v. Kunkel, 515 S.W.2d 941, 948 (Tex. App.—Amarillo 1974, writ ref. n.r.e.) (informing that a conveyance of homestead property without the joinder of both spouses is void); Republic Nat'l Bank of Dallas v. Stetson, 390 S.W.2d 257, 260 (Tex. 1965) (noting that a deed without a property description is void); and Fisher v. Southland Royalty Co., 270 S.W.2d 677, 680 (Tex. App.—Eastland 1954, writ ref'd n.r.e.) (explaining that a conveyance of a present estate to the heirs of a living person is void for uncertainty).

43. Ford v. Exxon Mobil Chem. Co., 235 S.W.3d 615, 618 (Tex. 2007).

44. Sanchez v. Telles, 960 S.W.2d 762, 768 (Tex. App.—El Paso 1997, pet. denied).

45. Richmond Printing v. Port of Houston Auth., 996 S.W.2d 220, 224 (Tex. App.—Houston [14th Dist.] 1999, no pet.).

46. Republic Nat'l Bank of Dallas v. Stetson, 390 S.W.2d 257, 260–61 (Tex.1965).

transference to a bona fide purchaser.[47] As a legal nullity, a void deed simply passes no title.[48]

D. Theoretical Basis for Hawkins v. Tex. Oil & Gas Corp.

Hawkins tells us that "a purported lease signed by a royalty owner is void."[49] It does not, however, explain why such a lease is void.[50] There are at least three reasons. First, leases signed by royalty owners are void because non-participating royalty owners lack executive rights.[51] Second, leases signed by royalty owners are void because royalties are mere rights appurtenant to the mineral estate, while oil and gas leases are determinable fee interests in the mineral estate.[52] The owner of a lesser estate cannot create a greater estate by conveyance.[53] Third, leases signed by royalty owners are void because non-participating royalty interests are non-possessory, while oil and gas leases are possessory.[54] The rights inherent in an oil and gas lease are precisely those stripped from non-participating royalty interests.[55]

IV. THE TEXAS LEGISLATURE WEIGHS IN

Fortunately for landowners, the Texas legislature recently enacted Texas Property Code § 5.152, which deals explicitly with royalty leasing.[56] The statute became effective on September 1, 2019, and the number of royalty leases acquired since then has dropped.[57] However, the statute has not been cited in any reported cases due to the prevalence of arbitration clauses in royalty leases.

Section 5.152 is the legislature's second attempt to prevent frauds perpetrated on mineral and royalty owners. Their first attempt was Texas Property Code § 5.151, which became effective on September 1, 1999.

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47. Bellaire Kirkpatrick Joint Venture v. Loots, 826 S.W.2d 205, 209 (Tex. App.—Fort Worth 1992, writ denied).

48. 1st Coppell Bank v. Smith, 742 S.W.2d 454, 461 (Tex. App.—Dallas 1987, no writ).

49. Hawkins v. Tex. Oil & Gas Corp., 724 S.W.2d 878, 888 (Tex. App.—Waco 1987, writ ref'd n.r.e.).

50. *Id.*

51. *See* Plainsman Trading Co. v. Crews, 898 S.W.2d 786, 789–90 (Tex. 1995) ("The words 'non-participating royalty interest' long ago acquired a well understood meaning: a free royalty does not carry with it the right to participate.").

52. *Id.*

53. *See* Jupiter Oil Co. v. Snow, 819 S.W.2d 466, 468 (Tex. 1991); Arnold v. Ashbel Smith Land Co., 307 S.W.2d 818, 824 (Tex. Civ. App.—Houston 1957, writ ref'd n.r.e.).

54. *Id.*

55. Nat. Gas Pipeline Co. of Am. v. Pool, 124 S.W.3d 188, 192 (Tex. 2003); *Plainsman Trading*, 898 S.W.2d at 789; Sun Oil Co. v. Madeley, 626 S.W.2d 726, 733, 733 n.6 (Tex. 1981).

56. The authors of this paper were involved in drafting TEX. PROP. CODE ANN. § 5.152 and testified in favor of enacting the statute before the Energy Resources Committee of the Texas House of Representatives.

57. TEX. PROP. CODE ANN. § 5.152.

Section 5.151 applied only to unsolicited purchase offers sent through the mail with a check, draft, or other payment instrument. The statute requires people sending such offers to include the following disclosure:

> BY EXECUTING AND DELIVERING THIS INSTRUMENT YOU ARE SELLING ALL OR A PORTION OF YOUR MINERAL OR ROYALTY INTEREST IN (DESCRIPTION OF PROPERTY BEING CONVEYED).

Section 5.151 has no further requirements. It does not invalidate transactions that fail to include the disclosure. Instead, it provides attorney's fees and costs to the prevailing party and allows landowners to seek damages equal to the difference between the purchase price and the fair market value of the mineral or royalty interest at the time of sale. The statute has a two-year statute of limitations.

Section 5.151 has rarely been cited in published opinions. It was, however, discussed at some length in *Ridge Nat. Res. LLC v. Double Eagle Royalty*.[58] In that case, the plaintiffs attempted to use Section 5.151 as a basis for finding the royalty lease procedurally unconscionable. The Court of Appeals disagreed:

> First, the statute applies to offers sent by mail, whereas this case involves an offer sent by email, so the statute is not squarely applicable here. Second, even if Section 5.151 applied under these facts, the statute itself does not alter or supplant Texas common law on contracts. Rather, Section 5.151 creates a statutory remedy in addition to any contractual remedies a seller may already have. . . Indeed, by the statute's own terms, the most relief a seller can get in the event the disclosure is not made is damages, not rescission of the transaction at large. . . Nothing about the text of this statute indicates that the Legislature intended for transactions like this one to be voidable, and nothing in the text of the statute excuses a party from his general duty under Texas contractual common law to read whatever instrument it is he is signing.[59]

The foregoing quote displays the shortcomings of Section 5.151. It may or may not apply to documents sent by FedEx, UPS, or other delivery services, nor does not invalidate instruments for lack of disclosure. It merely adds a statutory remedy where rights and obligations already exist at common law. Although the Court of Appeals does not discuss it, the statute oddly applies a two-year statute of limitations to fraudulent conduct, which would normally be subject to a four-year statute of limitations.

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58. Ridge Nat. Res. LLC v. Double Eagle Royalty, L.P., 564 S.W.3d 105, 134 (Tex. App.—El Paso 2018, no pet.).

59. *Id.*

Section 5.152 addressed many of its predecessors' shortcomings. Section 5.152 is limited in scope to avoid ensnaring legitimate oil and gas leases and mineral conveyances:

> This section applies only to the conveyance of a mineral or royalty interest by an instrument that
> (1) is presented to the owner of the interest by the person acquiring the interest;
> (2) is titled an oil and gas lease or an oil and gas royalty lease or has other words in the caption or other prominently displayed label that indicate that the transaction is a lease of a mineral or royalty interest; and
> (3) has the effect of conveying, permanently or for a term, all or a portion of the owner's:
>
> > (A) mineral interest in lands covered by an existing oil, gas, or mineral lease; or
> > (B) royalty interest in production from an existing oil, gas, or mineral lease.

Instruments that fall within the scope of Section 5.152 must contain the following disclosure at the top of the first page, at the top of each subsequent page, and immediately above the signature line:

> THIS IS NOT AN OIL AND GAS LEASE. YOU ARE SELLING ALL OR A PORTION OF YOUR MINERAL OR ROYALTY INTERESTS IN (DESCRIPTION OF PROPERTY BEING CONVEYED).

Unlike its predecessor, Section 5.152 is not duplicative of common law. It explicitly provides that an instrument lacking the foregoing disclosure is void (not voidable) and that a person who signs such an instrument may sue to remove it from their title. A plaintiff may also recover "all royalties and bonuses paid to the purchaser and any successor or assign of the purchaser," costs, and attorney's fees. Unfortunately, for litigants, Section 5.152 is not retroactive.[60]

Further, Section 5.152 contains no explicit statute of limitations. Because Section 5.152 is an action for recovery of real property—and because it renders non-compliant instruments void—there is no limitations period in which a claim may be brought.[61] However, recovery of royalties paid under instruments that violate Section 5.152 is a different matter. While

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60. Act of June 10, 2019, 86th Leg., R.S., ch. 914, § 2, 2019 TEX. GEN. LAWS 914 (codified in TEX. PROP. CODE ANN. § 5.152) ("The change in law made by this Act applies only to an agreement entered into on or after the effective date of this Act. An agreement entered into before the effective date of this Act is governed by the law as it existed immediately before the effective date of this Act, and that law is continued in effect for that purpose.").

61. *See* Stelly v. DeLoach, 644 S.W.3d 657 (Tex. 2022); Ford v. Exxon Mobil Chem. Co., 235 S.W.3d 615, 618 (Tex. 2007).

the statutory language is broad, claims for damages are subject to a four-year statute of limitations.[62]

Section 5.152's disclosure contradicts the estoppel theory advanced above. This contradiction, however, does nothing to change the effect of the royalty lease's other recitals. It is unclear what effect a disclosure saying "this is not an oil and gas lease" would have on a document that otherwise appears to be an oil and gas lease. Even if the royalty lease is explicitly not an oil and gas lease, it does not follow that it is a term royalty deed or some other particular form of instrument. Accordingly, a royalty lease with this disclosure may be void for indefiniteness.[63] Alternatively, a royalty lease with the disclosure may simply be ambiguous.[64]

V. CONCLUSION

Although it has not been tested in court, Section 5.152 greatly decreased the number of royalty leases executed. Either the disclosure requirements made their acquisition too difficult, or the threat of litigation made their acquisition too costly. Regardless, the royalty leases that existed prior to Section 5.152's enactment—and those executed afterward—are still clouding the title to thousands of acres. Untold sums of money are still being paid. Aggressive litigators will find no shortage.

62. *See* Lyle v. Jane Guinn Revocable Tr., 365 S.W.3d 341, 354–55 (Tex. App.—Houston [1st Dist.] 2010, pet. denied).

63. *See, e.g.*, T.O. Stanley Boot Co. v. Bank of El Paso, 847 S.W.2d 218, 221 (Tex. 1992) ("In order to be legally binding, a contract must be sufficiently definite in its terms so that a court can understand what the promisor undertook.").

64. *See, e.g.*, J. Hiram Moore, Ltd. v. Greer, 172 S.W.3d 609, 614 (Tex. 2005) (holding a deed to be ambiguous where one clause "conveys nothing" and another clause "conveys everything").

OF NUTS AND BOLTS: AN INTRODUCTION TO THE AAPL FORM 675 OIL AND GAS LEASE

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There seems an infinite volume of case law telling tales of woe, heartache, frustration, and confusion that the oil and gas lease form has wrought. Many practitioners and industry professionals talk of "basic" or "standard" oil and gas lease forms. There is, of course, no such thing. Others will refer to a "Producers 88" lease form, though multiple iterations of that particular lease form abound.

The American Association of Professional Landmen's Form 675 Oil and Gas Lease Form is probably the closest a document can come to being accurately described as a standard, basic, "producers 88-style" oil and gas lease. This Article, based on lectures the author has given to various law school classes, seeks to introduce the student or novice practitioner to the basic concepts and provisions of the oil and gas lease. The Article cites specifically to the language of the AAPL Form 675, but legal and historical concepts explored are applicable to most oil and gas leases. Moreover, even where the AAPL Form 675 is no longer used, many of its provisions nonetheless live on having been copied or otherwise carried over into more "modern" oil and gas lease forms.

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I. INTRODUCTION

Today's subject is an introduction to the oil and gas lease. This is an exciting topic as the oil and gas lease is the central component of onshore oil and gas law. The author has been a guest lecturer at various law school programs on this topic, and no matter how much time is allotted, it never seems sufficient to analyze (even at a high level) the oil and gas lease.[1] Even a form as (relatively) short and simple as the one discussed herein, weighing in at scarcely more than two pages (depending on font and paper size), could command the attention of an entire law school course.

This Article is titled an "introduction," for despite its page count, it scarcely scratches the surface of an otherwise in-depth analysis of an oil and gas lease. There seems an infinite volume of case law telling tales of woe, heartache, frustration, and confusion that the oil and gas lease form has wrought. Tomes could be written on the subject, and indeed the author gratefully recognizes the contributions made by many practitioners before him on this topic.[2]

Nonetheless, this lecture has been reduced to writing, both for the sake of making the lecture easier for the author to remember, and in the interest of providing a manageable synopsis to the student or novice practitioner.

II. THE NATURE OF THE OIL AND GAS LEASE

As noted by Lowe, Anderson, Smith and Pierce:

> [M]ost courts treat oil and gas leases, whatever their precise language, as both conveyances and contracts. A lease is a conveyance because it is the instrument by which the mineral owner conveys a property right to an oil company to explore for and produce oil and gas, reserving a royalty interest in production. A lease is a contract because the oil company accepts the

1. This Article is based on a lecture given by the author at Texas Southern University Law School, as well as the Texas Tech University School of Law Nuts-and-Bolts Oil and Gas series.

2. *See, e.g.*, A.W. Walker, Jr., *The Nature of the Property Interests Created by an Oil and Gas Lease in Texas*, 7 TEX. L. REV. 1, 32 (1928); Ben F. McDonald, Jr., *A Consideration of the Basic Structure and Provisions of the Typical Oil and Gas Lease, General Overview of Oil and Gas*, ADVANCED OIL GAS & MINERAL L. COURSE (1986); and Michael D. Jones, *Basics of an Oil and Gas Lease*, OIL GAS & ENERGY RES. 101 (Sept. 2016).

> right to explore and produce, burdened by certain express and implied promises.[3]

An oil and gas lease—and indeed oil and gas law itself—lies at the crossroads of contract and property law.[4] The main takeaway from Lowe's passage above is that an oil and gas lease functions as both a property conveyance and a contract.[5] Texas follows the ownership-in-place doctrine, and as such, in Texas, an oil and gas lease is considered a fee simple determinable in the mineral estate.[6]

Students who have taken first year property law will hopefully be familiar with the various estates in land, especially the fee simple determinable. A fee simple determinable is an estate in land that will automatically end and revert to the grantor if some specified event occurs.[7] As an example:

> O grants Blackacre to X, so long as Blackacre is used as a church. In this example, X has a fee simple determinable in Blackacre; and O has a possibility of reverter in Blackacre.
>
> If X stops using Blackacre as a church, Blackacre automatically reverts to O. This is because Blackacre has been granted to X on the condition that it be used as a church. If that condition is violated, X loses Blackacre. X's rights in Blackacre are potentially perpetual—he may hold it forever. This is why O has only a possibility of reverter.

This concept can be explored further with some added facts:

> O grants Blackacre to X, so long as Blackacre is used as a church, and X promises to pay O $20 per month. The prior example illustrates what would happen if X stopped using Blackacre as a church, but what happens if X stops paying this $20 per month?
>
> This is s a breach of contract (not a violation of the condition). X's promise to pay $20 is a covenant.

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3. JOHN S. LOWE ET. AL., CASES AND MATERIALS ON OIL AND GAS LAW 177 (6th ed. 2013) [hereinafter LOWE].

4. *Id.*

5. *Id.*

6. *See* 1 HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL AND GAS LAW § 203.1 (2010); Mitchell Energy Corp. v. Samson Res. Co., 80 F.3d 976, 982 (5th Cir. 1996) ("In Texas, an oil and gas lease conveys an estate in real property to the lessee, namely, a fee simple determinable in the mineral estate."); and Jupiter Oil Co. v. Snow, 819 S.W.2d 466, 468 (Tex. 1991).

7. Nat. Gas Pipeline Co. of Am. v. Pool, 124 S.W.3d 188, 194 (Tex. 2003) ("In Texas it has long been recognized that an oil and gas lease is not a 'lease' in the traditional sense of a lease of the surface of real property. In a typical oil or gas lease, the lessor is a grantor and grants a fee simple determinable interest to the lessee, who is actually a grantee.").

Turning now to the language of the oil and gas lease, one can often find the grant of the fee simple determinable a combination of the granting clause and the habendum clause.[8] For instance, the granting clause often says something like,

> "Lessor, in consideration of the sum of _____ Dollars ($_____), in hand paid, receipt of which is hereby acknowledged, and the royalties herein provided, does hereby grant, lease and let unto Lessee for the purpose of exploring, prospecting, drilling and . . . ."[9]

The habendum clause, usually located in the following paragraph, often provides,

> "Subject to the other provisions herein contained this Lease shall be for a term of years from this date (called the "primary term") and as long thereafter as oil and gas or other hydrocarbons are being produced from said land or land with which said land is pooled hereunder."[10]

Instead of the example above where O grants Blackacre to X, here it is:

> The lessor grants mineral estate to lessee for _____ years and so long thereafter as oil and gas or other hydrocarbons are produced from the land.
>
> The lessee has a fee simple determinable in the mineral estate; and the lessor has a possibility of reverter.

It is important to recognize that there are a number of requirements in a lease. Some of these are on the property side (conditions) and some are on the contract side (covenants). For example, having production at the end of the primary term is a condition of the lease. The payment of ordinary royalties is a covenant of the lease.

It is crucial—probably for the purposes of an oil and gas class, likely for the purposes of the Texas Bar, and definitely if (God forbid) one decides to go into the oil and gas field—to recognize and distinguish those requirements within the oil and gas lease which are conditions and which are covenants.

If, for example, the lessee forgets to pay the ordinary royalties, the consequences usually are not fatal. It is a debt owed; it is a breach of contract; there may be some interest that the lessee owes and some attorneys' fees, but, except in the most egregious of circumstances, it is not going to result in a lost lease. If, however, the lessee violates a condition of the oil and gas lease (even a little bit), that lease is often automatically extinguished.

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8. *See infra* Exhibit A, The AAPL Form 675 Oil and Gas Lease.
9. *See infra* Exhibit A, at ¶ 1.
10. *Id.* at ¶ 2.

In reviewing any oil and gas lease, it is important to identify the rights and requirements of the lessee (and some by the property owner), and in doing so, identify whether the requirements are covenants or conditions.

The AAPL Form 675 Oil and Gas Lease will be utilized and referenced throughout this article, and passages of it are reproduced where appropriate.[11] This is a very simple, old-fashioned form, which, for the purposes of an essay (or a lecture), is convenient because it is relatively bite-sized and captures the basic concepts of most oil and gas leases. In terms of forms that one might encounter in practice, however, and as a commercial matter, one would probably want something a little more robust if one were the oil company; and one would almost certainly want a different form if they were in the shoes of the mineral owner.

It is startling, however, that this form is still widely used despite its many flaws. It may be modified, carved up, or appended with various addenda, but it remains ubiquitous.

III. THE AAPL FORM 675 OIL AND GAS LEASE

A. The Granting Clause

The granting clause typically states, "Lessor . . . does hereby grant, lease and let unto Lessee for the purpose of exploring, prospecting, drilling and mining for and producing oil and gas and all other hydrocarbons, laying pipelines, building roads, tanks, power stations, telephone lines and other structures thereon . . . ."[12]

In addition to the discussion above, it is important to recognize that these rights are considered exclusive (subject to the rights of a possible cotenant). The mineral owner—the royalty interest owner as he is sometimes called—cannot go onto his land now and explore for oil and gas himself, and he cannot instruct others to do so either. In part this is due to the nature of the interests granted in the lease. The lessee has a fee simple determinable in the mineral estate. This is a present possessory interest, and it can therefore exercise domain over that mineral estate pretty much to the exclusion of all others.

There are some unusual cases out there where someone has been granted oil and gas rights and someone else has been granted coal rights and there are conflicts. However, for the purposes of this essay, it is good to understand that the rights granted in the oil and gas lease are exclusive rights.

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11. *Id.*
12. *Id.* at ¶ 1.

B. The Legal Description

This is probably one of the most straightforward (and most easily overlooked) attributes of the oil and gas lease (or any property conveyance for that matter). As previously noted, an oil and gas lease is a conveyance of an interest in land and, therefore, subject to the statute of frauds.[13] It is often taken for granted when negotiating an oil and gas lease that the parties know which land they are talking about, and yet, case law and industry lore are replete with examples of legal descriptions failing to satisfy the statute of frauds.[14] The legal description provided in the lease must be sufficient such that "a party familiar with the locality can identify the premises with reasonable certainty,"[15] or it must reference another document that does.[16]

C. The Mother Hubbard Clause

A Mother Hubbard clause typically reads as follows: "This Lease also covers and includes any and all lands owned or claimed by the Lessor adjacent or contiguous to the land described hereinabove, whether the same be in said survey or surveys or in adjacent surveys, although not included within the boundaries of the land described above."[17]

This is a kind of catch-all clause designed to capture "small unleased pieces or strips of land," which are not described in the lease and of which one or both of the parties to the lease are unaware.[18] It is designed to protect the oil and gas company and ensure that, if the leased premises are incorrectly identified, or the metes and bounds are a bit off, the oil company still gets the land it is after in taking this lease.

As noted by the late great Ben McDonald, "I have never understood why it is called 'The Mother Hubbard Clause' because, as I recall, old Mother Hubbard's cupboard was bare. The purpose of the oil and gas Mother Hubbard clause is to surreptitiously fill the cupboard—of the lessee."[19] Not surprisingly, many mineral owners prefer to strike the Mother Hubbard clause.

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13. TEX. PROP. CODE ANN. § 5.021 (West 2004); TEX. BUS. & COM. CODE ANN. § 26.01(b)(4) (West 2002).

14. *See, e.g.*, Wilson v. Fisher, 144 Tex. 53, 188 S.W.2d 150, 152 (1945); *see also* Kmiec v. Reagan, 556 S.W.2d 567, 569 (Tex. 1977); Pick v. Bartel, 659 S.W.2d 636, 637 (Tex. 1983); and Morrow v. Shotwell, 477 S.W.2d 538, 539 (Tex. 1972).

15. Gates v. Asher, 154 Tex. 538, 280 S.W.2d 247, 248–49 (1955).

16. *Pick*, 659 S.W.2d at 636.

17. *See infra* Exhibit A, at ¶ 1.

18. Jones v. Colle, 727 S.W.2d 262, 263 (Tex. 1987).

19. McDonald, *supra* note 2.

D. The Habendum Clause

A habendum clause lays out the terms of the lease and is usually drafted as follows:

> Subject to the other provisions herein contained this Lease shall be **for a term of years from this date (called the "primary term") and as long thereafter as oil and gas or other hydrocarbons are being produced from said land** or land with which said land is pooled hereunder.[20]

As noted above, the combination of the granting and habendum clauses creates a fee simple determinable.[21] As such, and as most oil and gas professionals are aware, an operator may perpetuate the life of such a lease beyond its primary term only by production or by some sort of savings clause or, where applicable, a shut-in royalty clause.[22] Moreover, it is well settled law—at least in the state of Texas—that the term "produced," when used in an oil and gas lease, means substantially the same thing as "produced in paying quantities."[23]

Production in paying quantities is therefore a condition of the fee simple determinable.[24] In order to maintain a lease beyond its primary term with production, it must be in paying quantities.[25] Stated in its simplest form, "[i]f a well pays a profit, even small, over operating expenses, it produces in paying quantities."[26] If, however, the calculation reveals a loss, the analysis proceeds to the second step of the doctrine: whether a reasonably prudent operator would continue to operate the well to make a profit and not for speculation.[27]

E. The Royalty Clause

The AAPL Form 675 royalty clause states:

> The royalties to be paid by Lessee are as follows: On oil, one-eighth of that produced and saved from said land, the same to be delivered at the wells or to the credit of Lessor into the pipeline to which the wells may be connected. Lessee shall have the option to purchase any royalty oil in its possession, paying the market price therefore prevailing for the field where

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20. *See infra* Exhibit A, at ¶ 2 (emphasis added).
21. Jupiter Oil Co. v. Snow, 819 S.W.2d 466, 468 (Tex. 1991).
22. *E.g.*, Hydrocarbon Mgmt., Inc. v. Tracker Expl., Inc., 861 S.W.2d 427, 432 (Tex. App.—Amarillo 1993, no writ).
23. *E.g.*, Clifton v. Koontz, 325 S.W.2d 684, 691 (Tex. 1959).
24. Concord Oil Co. v. Pennzoil Expl. & Prod., 966 S.W.2d 451, 460 (Tex. 1998).
25. *E.g.*, *Koontz*, 325 S.W.2d at 691.
26. Garcia v. King, 164 S.W.2d. 509, 511 (Tex. 1942) (citing Gypsy Oil Co. v. Marsh, 248 P. 329, 334 (Okla. 1926)).
27. *Koontz*, 325 S.W.2d at 691.

> produced on the date of purchase. On gas, including casinghead gas, condensate or other gaseous substances, produced from said land and sold or used off the premises or for the extraction of gasoline or other products therefrom, the market value at the well of one-eighth of the gas so sold or used, provided at on gas sold at the wells the royalty shall be one-eighth of the amount realized from such sale.[28]

This is an old-fashioned royalty clause—and not just because of the low one-eighth (1/8) royalty rate—but, startlingly, this language (or language quite similar to it) still appears in many "modern" royalty clauses despite the fact that it has been in circulation for the better part of a century.[29] As legal scholars have noted, "the ordinary royalty clause pertaining to gas is one of the most ambiguous and incomplete provisions of an oil and gas lease ever to be brought before the courts."[30]

First, we note that the royalty clause, as to oil, defaults to a "take-in-kind" provision, meaning that the royalty owner was expected to retrieve a share of the production of oil at the well. Failing that, the lessee will deliver it "to the credit of the Lessor into the pipeline," meaning that the royalty interest owner would make his own arrangements with the pipeline company for the sale of his royalty oil.[31] For all but the largest royalty owners, such a take-in-kind arrangement is virtually unheard of (and even in the case of institutional lessors, it is rare). This lease form does, of course, provide that the lessee has the option to buy the lessor's royalty oil at "the market price."[32]

The gas royalty provision, in contrast, does not provide such take-in-kind mechanism. Here, the lessor's royalty is represented purely as a right to money: the market value at the well of 1/8 or 1/8 of the amount realized from sale.

The provision is noteworthy for what it does not say (and what many more recently drafted royalty provisions attempt to address): postproduction deductions from the royalty. Many lessors include language that attempts to

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28. *See infra* Exhibit A, at ¶ 3.

29. *See, e.g.*, John McFarland, *Burlington v. Texas Crude − another Supreme Court Case on Post-Production Costs*, OIL AND GAS LAWYER BLOG (June 5, 2019), https://www.oilandgaslawyerblog.com/burlington-v-texas-crude-another-supreme-court-case-on-post-production-costs/; John McFarland, *Nettye Engler Energy v. Bluestone Natural Resources: Texas Supreme Court affirms ruling against royalty owner*, OIL AND GAS LAWYER BLOG (Feb. 9, 2022), https://www.oilandgaslawyerblog.com/nettye-engler-energy-v-bluestone-natural-resources-texas-supreme-court-affirms-ruling-against-royalty-owner/.

30. Joseph T. Sneed, *Value of Lessor's Share Production Where Gas Only is Produced*, 25 TEX. L. REV. 641, 656–57 (1948) (quoted in Dick Watt, *Oil & Gas Royalties in 2016–2017: Selected Issues*, 34TH ANNUAL ADVANCED OIL GAS & MINERAL L. COURSE (2016)).

31. McFarland, *supra* note 29 (quoting A.W. Walker, Jr.).

32. *See infra* Exhibit A, at ¶ 3.

make their royalty "cost free" or disallows the operator from deducting the royalty interest's share of various postproduction costs from the royalty.[33]

It is important to note, however, that many drafters' attempts to insert cost-free language into their royalty provisions are frustrated by the kind of archaic language illustrated above, which, nonetheless, endures the passing down from one lease form to another. The vestigial turns of phrase utilized in the above-quoted language, such as "delivered at the wells or to the credit of Lessor into the pipeline" for the oil royalty or "market value at the well" for the gas royalty, so appropriate for a different age and time, now wreak havoc in modern contexts, often rendering any attempted cost-free language moot or merely "surplusage."[34]

To be clear, the confusion often benefits the lessee, and is, without a doubt, one of the reasons the language continues to persist. Wary royalty owners are wise to insert their own (carefully drafted) royalty provisions, for as Professor A.W. Walker, Jr. noted ninety years ago, "[t]oo much care cannot be devoted to the preparation of a royalty clause in an oil and gas lease."[35]

F. The Shut-In Royalty Clause

A shut-in royalty clause typically provides:

> While there is a gas well on this Lease, or on acreage pooled therewith, but gas is not being sold or used Lessee shall pay or tender annually at the end of each yearly period during which such gas is not sold or used, as royalty, an amount equal to the delay rental provided for in paragraph 5 hereof, and while said royalty is so paid or tendered this Lease **shall be held as a producing Lease under paragraph 2 hereof**.[36]

The first questions that often arise in a lecture or classroom setting are, "Why would anyone drill a well and not produce it? Why just a gas well? Why is there not a provision like this for an oil well?" Traditionally, the shut-in royalty provision was designed for those instances where the lessee had drilled a perfectly good well but lacked a market in which to sell the hydrocarbons. More specifically, it was designed for instances in which there was no pipeline available to take the gas to market.

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33. *See, e.g.*, BlueStone Nat. Res. II, LLC v. Nettye Engler Energy, LP, 640 S.W.3d 237, 244 (Tex. App.—Fort Worth 2020), aff'd, 639 S.W.3d 682 (Tex. 2022)); Burlington Res. Oil & Gas Co. v. Tex. Crude Energy, LLC, 573 S.W.3d 198, 210 (Tex. 2019); and Heritage Res., Inc. v. NationsBank, 939 S.W.2d 118, 121 (Tex. 1996).

34. *See infra* Exhibit A, at ¶ 3.

35. A.W. Walker, Jr., *The Nature of the Property Interests Created by an Oil and Gas Lease in Texas*, 10 TEX. L. REV. 291, 291 (1932) (quoted in Bruce Kramer, *Interpreting the Royalty Obligation by Looking at the Express Language: What a Novel Idea*, 35 TEX. TECH L. REV. 223 (2004)).

36. *See infra* Exhibit A, at ¶ 3 (emphasis added).

Oil, after all, can be stored with (relative) ease and then trucked to market. Gas is another matter entirely: onsite storage is impractical, requiring (in virtually all instances) a pipeline to take it to market. This is not to overlook the fact that there is often gas associated with an oil well, though, in the absence of a pipeline, many operators have simply flared the gas in order to produce the oil.

It is important to note, however, that this particular shut-in royalty provision does not expressly require a lack of market or the absence of a pipeline in order for the lessee to avail himself of the ability to pay the shut-in royalty and perpetuate his lease. Many oil and gas leases provide specific conditions under which a shut-in payment may be utilized (e.g., for lack of market).[37] The above-quoted provision, however, merely requires that there be "a gas well on this lease, or on acreage pooled therewith," and that the gas associated with the well "is not being sold or used."[38] This is an important distinction when the lessee seeks to shut-in production from a lease due to low gas prices, for example. As the shut-in royalty states, the payment of the royalty holds the lease as a "producing Lease."[39] This permits the lease to be perpetuated under the habendum clause, but it also means that this "production" be in paying quantities—in other words, the well must be capable of production in paying quantities at the time it is shut in.[40]

Additionally, there is no express limitation in this shut-in royalty provision for how long the lease can be perpetuated through these annual payments. Many modern lease forms often include language restricting a lessee's ability to perpetuate a lease in this manner to two years.

It is crucial to highlight that this shut-in royalty provision (like many shut-in royalty provisions) treats the payment of the shut-in royalty as a substitution for production under the habendum clause. Put another way, the payment of the shut-in royalty is a condition of the lease, in stark contrast to the payment of "regular" royalties which, in this (and most leases), is merely a covenant.

Because the shut-in royalty is a condition of the lease, the question of when such a royalty must be tendered becomes paramount. Generally, a late paid or improperly paid shut-in royalty can be fatal to the lease.[41] Most modern oil and gas leases (especially those that are lessor oriented) provide (either expressly or through a court's interpretation) that the shut-in payment must be paid within a set number of days from the shut-in of the well or before the end of the primary term.[42] The language of this shut-in royalty

37. *See In re* MSB Energy, Inc., 438 B.R. 571 (Bankr. S.D. Tex. 2010).
38. *See infra* Exhibit A, at ¶ 3.
39. *Id.*
40. *See, e.g.*, Kidd v. Hoggett, 331 S.W.2d 515 (Tex. App.—San Antonio 1959, writ ref'd n.r.e.).
41. *See* Gulf Oil Corp. v. Reid, 337 S.W.2d 267, 269 (1960).
42. *See, e.g.*, EnerQuest Oil and Gas v. Plains Expl. & Prod. Co., 981 F. Supp. 2d 575 (W.D. Tex. 2013).

provision, however, suggests that a shut-in payment could be made well after the actual shut-in or expiration of the primary term.[43] The lessee need only tender his payment "at the end of each yearly period during which such gas is not sold or used."[44]

G. The Pooling Clause

The AAPL Form 675 pooling clause, in its great length, states:

> Lessee, at its option, is hereby given the right and power to voluntarily pool or combine the acreage covered by this Lease, or any portion thereof, as to the oil and gas, or either of them, with other land, lease or leases in the immediate vicinity thereof to the extent hereinafter stipulated when in Lessee's judgment it is necessary or advisable to do so in order to properly develop and operate said leased premises in compliance with the Spacing Rules of the Railroad Commission of Texas, or other lawful authorities, or when to do so would, in the judgment of Lessee, promote the conservation of oil and gas from said premises.
>
> Units pooled for oil hereunder shall not substantially exceed 80 acres each in area, and units pooled for gas hereunder shall not substantially exceed 640 acres each in area plus a tolerance of ten per-cent thereof in the case of either an oil unit or a gas unit, provided that should governmental authority having jurisdiction prescribe or permit the creation of units larger than those specified, units thereafter created may conform substantially in size with those prescribed by governmental regulations.
>
> Lessee under the provisions hereof may pool or combine acreage covered by this Lease, or any portion thereof as above provided for as to oil in any one or more strata and as to gas in any one or more strata. The units formed by pooling as to any stratum or strata need not conform in size or area with the unit or units into which the Lease is pooled or combined as to any other stratum or strata and oil units need not conform as to area with gas units. The pooling in one or more instances shall not exhaust the rights of Lessee hereunder to pool this Lease, or portions thereof, into other units.
>
> Lessee shall file for record in the county records of the county in which the lands are located an instrument identifying and describing the pooled acreage. Lessee may at its election exercise its pooling operation after commencing operations for, or completing an oil or gas well on the leased premises, and the pooled unit may include, but is not required to include, land or leases upon which a well capable of producing oil or gas in paying quantities has theretofore been completed, or upon which operations for drilling of a well for oil or gas have theretofore been commenced.
>
> Operations for drilling on or production of oil or gas from any part of the pooled unit composed in whole or in part of the land covered by this

43. Christopher Kulander, *The Oil and Gas Lease, Part IV: Other Clauses*, 5, FUNDAMENTALS OF OIL GAS AND MINERAL LAW (2021).

44. *See infra* Exhibit A, at ¶ 3.

> Lease, regardless of whether such operations for drilling were commenced or such production was secured before or after the execution of this instrument or the instrument designating the pooled unit, shall be considered as operations for drilling on or production of oil or gas from the land covered by this Lease whether or not the well or wells are actually located on the premises covered by this Lease, and the entire acreage constituting such unit or units, as to oil and gas or either of them as herein provided, shall be treated for all purposes except the payment of royalties on production from the pooled unit as if the same were included in this Lease.
>
> For the purpose of computing the royalties to which owners of royalties and payments out of production and each of them shall be entitled upon production of oil and gas, or either of them from the pooled unit, there shall be allocated to the land covered by this Lease and included in said unit a pro rata portion of the oil and gas, or other of them, produced from the pooled unit after deducting that used for operations in the pooled unit. Such allocation shall be on an acreage basis, that is to say, there shall be allocated to the acreage covered by this Lease and included in the pooled unit that pro rata portion of the oil and gas, or either of them, produced from the pooled unit which the number of surface acres covered by this Lease and included in the pooled unit bear to the total number of surface acres included in the pooled unit.
>
> Royalties hereunder shall be computed on the portion of such production, whether it be oil or gas or either of them, so allocated to the land covered by this Lease and included in the unit just as though such production were from such land. The production from an oil well will be considered as production from the Lease or oil pooled unit from which it is producing and not as production from a gas pooled unit; and production from a gas well will be considered as production form the lease or gas pooled unit from which it is producing and not from the oil pooled unit.[45]

We can see that even in a basic lease form, the pooling clause contains an intimidating volume of prose. Indeed, in this particular form, it is by far the longest clause in the document. Stepping through the various provisions, however, we can begin to grasp the functionality as well as the genesis of the pooling clause.

The lessee has no authority to pool a lease absent this kind of express authority.[46] The clause begins by noting that the lessee has the option (though not the obligation) to pool the leased premises with other tracts in order to comply with "the Spacing Rules of the Railroad Commission" or to "promote the conservation of oil and gas from said premises."[47] We can look to the current Statewide Rule 37 to find our Texas spacing rules, and of course, the

45. *See infra* Exhibit A at ¶ 4.
46. Jones v. Killingsworth, 403 S.W.2d 325, 328 (Tex. 1965).
47. *See infra* Exhibit A, at ¶ 4.

Railroad Commission can, and does, promulgate field-specific rules.[48] These rules prescribe, among other things, the minimum between-well spacing and lease-line spacing for a well.[49] So, for example, on a state-wide basis, Rule 37 provides that a well may not be drilled closer to 1,200 feet to any other well in the same horizon or closer than 467 feet to any lease line.[50] The origins of this rule lay in a desire for conservation and a protection for correlative rights, but it nonetheless created the regulatory framework in which lessees were compelled to combine their leases (or portions of their leases) in order to create units large enough to comport with the Spacing Rules.[51]

Likewise, this initial clause notes the lessee's ability to pool to "promote the conservation of oil and gas from said premises."[52] These pooling clauses of course were developed in an era of vertical wells and conventional reservoirs where, due to high degrees of porosity and permeability, a single well could theoretically impact a large drainage area, potentially straddling multiple tracts of land.[53] A lessee who had drilled a well on adjacent acreage could pool the leased premises with said acreage in recognition of the possibility that the nearby well would drain hydrocarbons from under the premises. In a similar vein, the pooling clause might permit an operator to drill one well into a reservoir straddling multiple tracts of land instead of drilling a well on each such tract in the interests of conservation.

One of the most crucial components of the pooling provision can be found buried in this clause: "Operations . . . from any part of the pooled unit . . . shall be considered as operations . . . from . . . this Lease whether or not . . . actually located on . . . this Lease."[54] This statement, coupled with the final words from the habendum clause, makes clear that upon expiration of the primary term, the lease will continue in full force and effect even if there is no production coming from the leased premises, provided there is production (or operations in pursuit thereof) within a unit in which the lease has been properly pooled.

As a practical accounting matter, royalties paid on a lease pooled into a unit will be proportionately reduced on the basis of the amount of lease acreage pooled over the total size of the pooled unit. This can be seen in the following portion of the pooling clause:

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48. *See* 16 TEX. ADMIN. CODE § 3.37 (2020) (R.R. Comm'n of Tex., Statewide Spacing Rule).

49. *Id.*

50. *Id.* at (a)1.

51. *See, e.g.*, *Pooling clause*, WILLIAM & MEYERS, *Manual of Oil and Gas Terms* (18th ed. 2022) ("A lease clause authorizing a lessee to "pool" or join the particular leased premises with other leases *for the purpose of aggregating a tract sufficient for a well permit under applicable spacing regulations*.") (emphasis added).

52. *See infra* Exhibit A, at ¶ 4.

53. *See* Caleb Fielder, *Pigs Get Fat, Hogs Get Slaughtered: A Memoir of the TRO-X v. Anadarko Petroleum Case*, 15 TEX. J. OIL GAS & ENERGY L. 29 (2020).

54. *See infra* Exhibit A, at ¶ 4.

> Such allocation shall be on an acreage basis, that is to say, there shall be allocated to the acreage covered by this Lease and included in the pooled unit that pro rata portion of the oil and gas, or either of them, produced from the pooled unit which the number of surface acres covered by this Lease and included in the pooled unit bear to the total number of surface acres included in the pooled unit.[55]

So, for example, where forty (40) acres of a lease with a one-fifth (1/5) royalty are pooled into a 640 acre unit, the lessors of such a lease (presuming they owned one hundred percent of the underlying leased minerals) would be paid a proportionately reduced royalty, resulting in one-sixteenth (1/16) of the 1/5.

The pooling clause is susceptible to abuse, however, potentially allowing the lessee to hold several large leases with only a single well. Lessors are wary of such machinations not only out of fear that much of their acreage will be tied up with little production, but also in light of the dilutive effect on their royalty payments as outlined previously. While still a basic form, this lease does attempt to limit the lessee's pooling powers by restricting the overall size of the units in which the lease may be pooled: eighty (80) acres for an oil unit and 640 acres for a gas unit. We can see again the clause's origins within the era of conventional drilling: traditionally, gas wells were able to drain a larger area than oil wells.

Note also, however, an additional reference to the Railroad Commission, which states, "should governmental authority having jurisdiction prescribe or permit the creation of units larger than those specified, units thereafter created may conform substantially in size with those prescribed by governmental regulations."[56] A great deal of confusion, heartache, and litigation has sprung from language in pooling clauses (not to mention Pugh clauses and retained acreage clauses) purporting to link the size of a pooled unit (or a retained acreage unit) to arcane rules of the Railroad Commission.[57]

The illustrated language has caused confusion, for example, by initially referencing a governmental authority having jurisdiction to "prescribe or permit" the creation of larger units and then concluding by stating that "units thereafter created may conform substantially in size with those prescribed."[58] Differences of opinion abound, therefore, in instances where, for example, Railroad Commission field rules would require (prescribe) an oil unit of 80 acres but would allow (permit) an oil unit of up to 160 acres. When coupled

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55. *Id.*

56. *Id.*

57. *See generally*, Jones v. Killingsworth 403 S.W.2d 325 (Tex. 1965); Endeavor Energy Res. v. Discovery Operating 554 S.W.3d 5860 (Tex. 2018); *see also* XOG Operating, LLC v. Chesapeake Expl. Ltd. P'ship, 554 S.W.3d 607 (Tex. 2018).

58. *See infra* Exhibit A, at ¶ 4.

with the language of this pooling provision, the lessor and the lessee may disagree on how big a unit may be created.

For what it is worth, the Texas Supreme Court ruled that a pooling provision very similar to the AAPL Form 675 pooling provision applied to circumstances closely analogous to those outlined above, limited the lessee to the size of the unit prescribed by the Railroad Commission. To be clear however, the variety of governmental authority clauses, such as the one included in this Article, far exceed the number of cases and related authority explaining them. Both lessees and lessors should exercise extreme caution when utilizing such language in their pooling provisions.

H. The Delay Rental Clause

The AAPL Form 675 delay rental clause states:

> If operations for drilling are not commenced on said land, or on acreage pooled therewith as above provided for, on or before one year from the date hereof, the Lease shall terminate as to both parties, unless on or before such anniversary date Lessee shall pay or tender to Lessor, or to the credit of Lessor in the _____, Bank at _____, Texas, (which Bank and its successors shall be Lessor's agent and shall continue as the depository for all rentals payable hereunder regardless of changes in ownership of said land or the rentals) the sum of _____ Dollars ($_____), herein called rentals, which shall cover the privilege of deferring commencement of drilling operations for a period of twelve (12) months. In like manner and upon like payment or tenders annually the commencement of drilling operations may be further deferred for successive periods of twelve (12) months each during the primary term hereof.
>
> The payment or tender of rental under this paragraph and of royalty under paragraph 3 on any gas well from which gas is not being sold or used may be made by check or draft of Lessee mailed or delivered to Lessor, or to said Bank on or before the date of payment. If such Bank, or any successor Bank, should fail, liquidate or be succeeded by another Bank, or for any reason fail or refuse to accept rental, Lessee shall not be held in default for failure to make such payment or tender of rental until thirty (30) days after Lessor shall deliver to Lessee a proper recordable instrument, naming another Bank as Agent to receive such payments or tenders.
>
> Cash payment for this Lease is consideration for this Lease according to its terms and shall not be allocated as a mere rental for a period. Lessee may at any time or times execute and deliver to Lessor, or to the depository above named, or place of record a release covering any portion or portions of the above described premises and thereby Surrender this Lease as to such portion or portions and be relieved of all obligations as to the acreage surrendered, and thereafter the rentals payable hereunder shall be reduced

> in the proportion that the acreage covered hereby is reduced by said release or releases.[59]

To the modern eye, the delay rental clause is a bizarre aberration from what we otherwise attempt to convince ourselves is a straightforward document. Afterall, why should the lessee contract for a three-year primary term only to suddenly require himself to drill within one year (unless a delay rental is paid)?

While it may seem counterintuitive, the delay rental clause was introduced for the benefit of the lessee. This was due to the implied covenant to develop the leasehold. At the dawn of oil and gas production in Texas, for example, it had become well-settled law in other oil-producing states, that, after executing an oil and gas lease (and in the absence of express language otherwise), the lessee was obligated to begin exploratory drilling activities within a reasonable time frame. As A.W. Walker, Jr. has stated, "[t]he fact that the lease fixed a definite exploratory period beyond which the lease could not endure without production[, the primary term,] was not regarded as inconsistent with this implication that efforts to obtain production must commence within a reasonable time after the lease was executed."[60] In other words, the delay rental was introduced as a way of excusing the lessee from what would otherwise be his implied duty to reasonably develop the premises during the primary term.

Another matter which becomes apparent to a reader upon reviewing most delay-rental clauses is the striking level of detail devoted to the manner and method of payment. No such detail, for instance, is provided for the payment of ordinary royalties. Some thoughtful consideration yields the answer: the satisfaction of the delay rental clause is regarded as a condition of the lease. Take the language from the delay rental clause: "If operations for drilling are not commenced . . . on or before one year from the date hereof, the Lease shall terminate . . . unless . . . ." Hence, just as with the shut-in royalty provision, the methodology of payment is treated with exacting precision. Payments are due every year on the anniversary date of the lease.

In the context of present-day oil and gas leasing, delay rentals are rarely paid—at least not in the manner they were originally envisioned. Today, most oil and gas leases are "paid up."[61] This means (depending on who you ask) either that the lessee and the lessor have agreed that all the delay rentals have

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59. *See infra* Exhibit A, at ¶ 5.

60. A.W. Walker, Jr., *The Nature of the Property Interests Created by an Oil and gas Lease in Texas: Part V*, 11 TEX. L. REV. 399 (1933), https://oilgas.org/Private/Content/Documents/8/Chapter%2006.pdf.

61. John McFarland, *The Oil and Gas Lease – Part II: The Primary Term*, OIL AND GAS LAWYER BLOG (Dec. 2, 2015), https://www.oilandgaslawyerblog.com/the-oil-and-gas-lease-part/.

been prepaid (hence "paid up")[62] or, in the alternative, merely that no delay rentals are owed and there is no drilling obligation during the primary term.[63]

Most "paid up" lease forms will identify themselves as such—either in the title of the lease or somewhere within the content—and some will expressly note that no rentals are required to keep the lease in effect during the primary term.[64] Just as often, however, an older form such as the one included is used, the delay rental provision is simply crossed out, with "paid up" printed at the top or scrawled in the margin.

Such a hasty drafting decision can lead to its own set of headaches where the lease form will reference back to the delay rental paragraph for other provisions of the lease. The included lease form, for example, provides that the shut-in royalty amount shall be "an amount equal to the delay rental provided for in paragraph 5 hereof."[65] If the delay rental clause is simply deleted (or struck through), the shut-in royalty provision becomes difficult—if not impossible—to interpret.

I. The Savings Clause

The savings clause provides:

> If prior to discovery of oil, gas or other hydrocarbons on this land, or on acreage pooled therewith, Lessee should drill a dry hole or holes thereon, or if after the discovery of oil, gas or other hydrocarbons, the production thereof should cease from any cause, this Lease shall not terminate if Lessee commences additional drilling or re-working operations within sixty (60) days thereafter, or if it be within the primary term, commences or resumes the payment or tender of rentals or commences operations for drilling or re-working on or before the rental paying date next ensuing after the expiration of sixty (60) days from the date of completion of the dry hole, or cessation of production.
>
> If at any time subsequent to sixty (60) days prior to the beginning of the last year of the primary term, and prior to the discovery of oil, gas or other hydrocarbons on said land, or on acreage pooled therewith, Lessee should drill a dry hole thereon, no rental payment or operations are necessary in order to keep the Lease in force during the remainder of the primary term.
>
> If at the expiration of the primary term, oil, gas or other hydrocarbons are not being produced on said land, or on acreage pooled therewith, but Lessee is then engaged in drilling or re-working operations thereon, or shall have completed a dry hole thereon within sixty (60) days prior to the end of

62. JOHN S. LOWE ET. AL., CASES AND MATERIALS ON OIL AND GAS LAW 494, 499 (5th ed. 2013).

63. EnerQuest Oil and Gas v. Plains Expl. & Prod. Co., 981 F. Supp. 2d 575, 601 (W.D. Tex. 2013).

64. *See e.g.*, *GLO Sample Highway Right of Way Lease*, State of Texas General Land Office, https://www.glo.texas.gov/energy-business/oil-gas/mineral-leasing/leasing/forms/Sample_Highway_Right_of_Way_Lease.pdf.

65. *See infra* Exhibit A, at ¶ 5.

> the primary term, the Lease shall remain in force so long as operations are prosecuted with no cessation of more than sixty (60) consecutive days, and if they result in the production of oil, gas or other hydrocarbons, so long thereafter as oil, gas or other hydrocarbons are produced from said land, or acreage pooled therewith. In the event a well or wells producing oil or gas in paying quantities shall be brought in on adjacent land and draining the leased premises, or acreage pooled therewith, Lessee agrees to drill such offset wells as a reasonably prudent operator would drill under the same or similar circumstances.[66]

This clause is also referred to as the "dry hole" clause, the "cessation of production" clause, or the "continuous operations" clause. These are all names of different aspects of the same basic provision. Production or drilling operations have started on the lease premises, but, for whatever reason, they have ceased, and the lessee is granted a certain grace period (here it is sixty days) in which to "save" or otherwise maintain the lease. The savings clause reproduced above has been broken out into three sections, and for ease of comprehension, it is best to tackle each in turn.

A part of the first piece and all of the second piece address what happens when the lessee has engaged in any drilling or reworking operations during the primary term, but there is no current production. For example, the lessee has drilled a well, but it is a dry hole; or the lessee began drilling operations but stopped; or the lessee drilled a producing well, but the well has stopped producing. Because this takes place during the primary term, the primary concern for lease validity is the delay rental (assuming the lease is not "paid up").

The savings clause provides various ways by which the lessee can be excused from paying delay rentals under these circumstances. If the lessee is engaged in drilling or reworking operations when the anniversary date occurs, no delay rental is owed. Likewise, if the lessee drilled a dry hole (or drilled a producing well and the production has stopped) within sixty days of the anniversary date, no delay rental is due. Delay rentals would be due upon the following anniversary date (assuming the lease is still in its primary term) absent drilling operations, reworking operations, or production within sixty days thereof.

The third piece of the savings clause plays a crucial role at the expiration of the primary term. The habendum clause states that for the lease to be perpetuated past the primary term, there must be hydrocarbons producing from the leased premises (or lands pooled therewith), but of course, this is "[s]ubject to the other provisions herein contained this Lease," such as the Savings Clause.[67] The lessee need not have production at the expiration of the primary term if he is "then engaged in drilling or reworking operations"

66. *See infra* Exhibit A, at ¶ 6.
67. *Id.*

or if he has completed a well as a dry hole within sixty days of the expiration of the primary term.[68]

This lease, however, does not define "drilling or reworking operations," and as a result, it is not unusual for the lessee and the lessor to disagree over whether the lessee was then engaged in drilling operations when the primary term expired.[69] A 1962 Texas appellate case, *Petersen v. Robinson Oil*, considered a lease with a habendum clause, delay rental clause, and savings clause extremely similar to those reproduced here.[70] In *Petersen*, the lessee staked the well location, moved a maintainer on site, and spent two hours leveling the well location.[71] The court held that "the lessee had set into motion the process of drilling a well, and that such acts preliminary to the actual work of drilling were performed with the bona fide intention of proceeding with diligence to the completion of the well."[72] Thus, the court determined that these activities were sufficient to perpetuate the lease past its primary term.[73]

Lessors can be forgiven if this scenario was not what they envisioned when agreeing to an oil and gas lease, and incidents and case law such as this has given rise to the notion of "simply moving dirt around," as a rule of thumb for perpetuating the lease.[74] More lessor-friendly lease forms provide, sometimes in great detail, express definitions for what constitutes drilling operations.[75]

For those leases which produce and are perpetuated past their primary terms, the savings clause addresses what happens when the production stops.[76] If "after the discovery of oil, gas or other hydrocarbons, the production thereof should cease from any cause, this Lease shall not terminate if Lessee commences additional drilling or re-working operations within sixty days thereafter."[77] This is generally understood to operate consistently with the conditions of the savings clause related to the expiration of the primary term:

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68. *Id.*

69. *Id.*

70. *See* Petersen v. Robinson Oil & Gas Co., 356 S.W.2d 217 (Tex. App.—Houston 1962, no writ).

71. *Id.* at 219.

72. *Id.* at 220.

73. *Id.*

74. *See generally* Celia Flowers & Melanie Reyes, *Negotiating Leases and Surface Use Agreements of Behalf of Your Landowner Client* 11, TEX. LAND TITLE INST., https://www.tlta.com/legallibrary/papers/2013/M_Minerals.pdf; *The Termination of Clauses of the Lease: The Delay Rental Clause*, https://www.petroleumeducationworkshops.com/wp-content/uploads/2015/02/comp-study-Oil-gaslease-chapter_6.pdf (last visited Oct. 4, 2022, 10:22 PM); *see also* Valence Operating Co. v. Anadarko Petroleum Corp., 303 S.W.3d 435 (Tex. App.—Texarkana 2010, no pet.).

75. *See Texas Sample Oil and Gas Lease and Surface Use Agreement*, EARTHWORKS 34, https://earthworks.org/assets/uploads/archive/files/publications/Texas-Sample-Model-Gas-Lease_201106.pdf (last visited Oct. 10, 2022) (providing that drilling operations are deemed commenced "when a derrick, a rig and machinery capable of drilling to a depth sufficient to test a prospective oil or gas horizon have been erected, and when such well has been spudded in and the rotary bit is rotating under power").

76. *See infra* Exhibit A, at ¶ 6.

77. *Id.*

> "[T]he Lease shall remain in force so long as operations are prosecuted with no cessation of more than sixty (60) consecutive days, and if they result in the production of oil, gas or other hydrocarbons, so long thereafter as oil, gas or other hydrocarbons are produced from said land, or acreage pooled therewith."[78]

This is another provision that is arguably susceptible to abuse, and it is fertile ground for disagreements between the lessor and the lessee as to what level of activity by the lessee is necessary to perpetuate the lease under this language.

Moreover, and at the risk of stating the obvious, it is important to point out that this only matters if there is only one well holding the lease (or in the case of multiple wells, that all wells have ceased to produce). If there are multiple wells on the lease and one goes down, the remaining wells still hold the lease—and these provisions don't apply.

The savings clause concludes with this oddly placed sentence:

> In the event a well or wells producing oil or gas in paying quantities shall be brought in on adjacent land and draining the leased premises, or acreage pooled therewith, Lessee agrees to drill such offset wells as a reasonably prudent operator would drill under the same or similar circumstances.[79]

This phrase would appear to have nothing to do with "saving" the lease, a dry hole, or the temporary cessation of operations. Indeed, it is merely a restatement of the implied covenant to protect the leasehold against drainage (see below) and does not place any further obligation on the lessee than would exist in its absence.[80]

J. The Assignment Clause

An assignment clause dictates the assignment rights of the parties:

> The rights of each party hereunder may be assigned in whole or in part, and the provisions hereof shall extend to their heirs, successors and assigns, but no change or division in the ownership of the land, rentals or royalties, however accomplished, shall operate to enlarge the obligations, or diminish the rights of Lessee; and no change or division in such ownership shall be binding on Lessee until thirty (30) days after Lessee shall have been furnished with a certified copy of recorded instrument or instruments evidencing such change of ownership. In the event of

78. *Id.*

79. *Id.*

80. This is perhaps added as a drafting salve, something lessor-friendly tacked onto the end of several lessee-friendly clauses.

> assignment hereof in whole or in part, liability for breach of any obligation issued hereunder shall rest exclusively upon the owner of this Lease, or portion thereof, who commits such breach. In the event of the death of any person entitled to rentals hereunder, Lessee may pay or tender such rentals to the credit of the deceased or the estate of the deceased, until such time as Lessee has been furnished with the proper evidence of the appointment and qualification of an executor or an administrator of the estate, or if there be none, then until Lessee is furnished satisfactory evidence as to the heirs or devisees of the deceased, and that all debts of the estate have been paid. If at any time two or more persons become entitled to participate in the rental payable hereunder, Lessee may pay or tender such rental jointly to such persons, or to their joint credit in the depository named herein; or, at the Lessee's election, the portion or part of said rental to which each participant is entitled may be paid or tendered to him separately or to his separate credit in said depository; and payment or tender to any participant of his portion of the rentals hereunder shall maintain this Lease as to such participant. In the event of an assignment of this Lease as to a segregated portion of said land, the rentals payable hereunder shall be apportioned as between the several leasehold owners ratably according to the surface area of each, and default in rental payment by one shall not affect the rights of other leasehold owners hereunder. If six or more parties become entitled to royalty payments hereunder, Lessee may withhold payment thereof unless and until furnished with a recordable instrument executed by all such parties designating an agent to receive payment for all.[81]

Much, if not most, of this clause is designed to excuse the lessee from making incorrect rental or royalty payments due to an assignment by the lessor who has not sufficiently provided notice to the lessee. Improper shut-in or delay rental payments, for example, could otherwise result in the termination of the lease.

Additionally, the clause freely allows for assignment by either the lessor or the lessee.[82] Many more modern (and more lessor-friendly) lease forms will often impose limitations on the lessee's ability to assign (such as by requiring consent by the lessee) though on the whole, these appear to be of limited impact.[83]

This particular assignment clause actually vests the lessee with the option of requiring his lessors to appoint an agent for receipt of royalties in the event that ownership of the royalties has become vested in more than five parties. Not surprisingly, most lessors opt to remove this clause.

Note, the second sentence of the clause provides that in the event of an assignment, "liability for breach of any obligation issued hereunder shall rest

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81. *See infra* Exhibit A, at ¶ 8.

82. *Id.*

83. *See* Mitchell E. Ayer & David W. Cias, *Consents to Assignment in Oil and Gas Leases*, 34TH ANNUAL ADVANCED OIL GAS & ENERGY RES. L. (Sept. 2016) (noting the distinction between "soft" and "hard" consents).

exclusively upon the owner of this Lease, or portion thereof, who commits such breach."[84] Typically, a party to a contract cannot avoid his responsibilities under a contract simply by selling or assigning his rights thereunder to someone else,[85] but here the lease purports to grant express permission.[86]

K. The Notice of Breach Clause

The notice of breach clause provides:

> The breach by Lessee of any obligations arising hereunder shall not work a forfeiture or termination of this Lease nor cause a termination or reversion of the estate created hereby nor be grounds for cancellation hereof in whole or in part unless Lessor shall notify Lessee in writing of the facts relied upon in claiming a breach hereof, and Lessee, if in default shall have sixty (60) days after receipt of such notice in which to commence the compliance with the obligations imposed by virtue of this instrument, and if Lessee shall fail to do so then Lessor shall have grounds for action in a court of law or such remedy to which he may feel entitled. After the discovery of oil, gas or other hydrocarbons in paying quantities on the lands covered by this Lease, or pooled therewith, Lessee shall reasonably develop the acreage retained hereunder, but in discharging this obligation Lessee shall not be required to drill more than one well per eighty (80) acres of area retained hereunder and capable of producing oil in paying quantities, and one well per six hundred forty (640) acres of the area retained hereunder and capable of producing gas or other hydrocarbons in paying quantities plus a tolerance of ten per-cent in the case of either an oil well or a gas well.[87]

The first sentence of this clause exemplifies the need for students and practitioners to recognize the distinction between a covenant and a condition in an oil and gas lease.[88] At first glance, this provision appears as an enlargement of the savings clause discussed above. For example, the lessee may discover that production has ceased on the sole well holding his lease. He fetches a copy of the lease, notes that it is (or is extremely similar to) an AAPL Form 675, reads this notice of breach clause, and suddenly breathes a sigh of relief. He need not worry (or so he thinks) about working to restore production on this lease since this provision insists there can be "no termination or reversion" of the estate unless the lessor sends the lessee

84. *See infra* Exhibit A, at ¶ 8.
85. Seagull Energy v. Eland Energy, 207 S.W.3d 342, 341 (Tex. 2006).
86. *See infra* Exhibit A, at ¶ 8.
87. *Id.* at ¶ 9.
88. *Id.*

written notice, and even then, he will have another sixty days to fix the problem.

This is simply not the case. Texas courts have had multiple opportunities to interpret provisions similar to the one here.[89] In each instance, the courts have reiterated that an oil and gas lease is a fee simple determinable, and the estate granted to the lessee will continue so long as the conditions and limitations permit (e.g., production in paying quantities after the primary term, payment of delay rentals during the primary term, payment of shut-in royalties where appropriate, drilling or reworking operations within the scope of the savings clause).[90] When one of these limitations is triggered, such as the cessation of production after the expiration of the primary term beyond the scope of what is permitted in a savings clause, "the lease is terminated by force of such limitation, and not as the result of any default in their obligations by lessee or any breach by lessees of any contractual duties imposed upon them by the terms of the lease."[91]

Put another way, the lease has not been breached, per se; it has merely expired by its own terms.[92] This can be distinguished from the lessee's breach of a covenant such as payment of ordinary royalties. Here, the notice of breach clause would come into play requiring the lessee to submit notice though it must be noted that it is doubtful whether this provision would be interpreted as requiring termination of the lease in the event of the lessee's failure to cure the breach within the sixty-day period provided.[93]

This clause also concludes with another oddly placed sentenced, noting that the lessee "shall reasonably develop the acreage retained hereunder, but . . . shall not be required to drill more than one [oil] well per eighty (80) acres . . . and one [gas] well per six hundred forty (640) . . . ."[94] While at first glance this may appear a lessor-friendly provision, it is actually a limitation on the lessee's obligations under the implied covenant to develop the leasehold. Indeed, the first part of the sentence is nothing more than a restatement of the implied covenant, that the lessee shall reasonably develop the acreage, but the sentence goes on to place a limiting definition on what requirements that covenant can place on the lessee: no more than one oil well every 80 acres, and one gas well every 640 acres.

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89. *See* Waggoner & Zeller Oil Co. v. Deike, 508 S.W.2d 163 (Tex. Ct. App. 1974); Lynch v. Southern Coast Drilling Co., 442 S.W.2d 804 (Tex. Civ. App. 1969, no writ); and Preston v. Lambert, 489 S.W.2d 955 (Tex. Civ. App. 1973, writ ref'd n.r.e.).

90. *See Waggoner*, 508 S.W.2d at 163; *Lynch*, 442 S.W.2d at 804; and *Preston*, 489 S.W.2d at 955.

91. *Lynch*, 442 S.W.2d at 807 (citing A.W. Walker, Jr., *The Nature of the Property Interests Created by an Oil and Gas Lease in Texas*, 7 TEX. L. REV. 1, 18 (1928); and 2 SUMMERS, OIL AND GAS, §§ 337, p. 394 (1959)).

92. *Id.*

93. *See infra* Exhibit A, at ¶ 9.

94. *Id.*

L. Warranty of Title Clause

The warranty of title clause provides:

> Lessor hereby warrants and agrees to defend the title to said lands and agrees also that Lessee at its option may discharge any tax, mortgage or other liens upon said land either in whole or in part, and in the event Lessee does so, it shall be subrogated to such lien with the right to enforce same and apply rentals and royalties accruing hereunder towards satisfying same. Without impairment of Lessee's rights under the warranty in event of failure of title, it is agreed that if Lessor owns an interest in the oil, gas or other hydrocarbons in or under said land, less than the entire fee simple estate then the royalties and rentals to be paid Lessor shall be reduced proportionately. Failure of Lessee to reduce such rental paid hereunder or over-payment of such rental hereunder shall not impair the right of Lessee to reduce royalties payable hereunder.[95]

It is of course not unusual for the grantor in any real estate transaction to warrant his title as the lessor would do under this clause as drafted, but this is not a general warranty, "only a covenant of warranty, a promise to defend the lessee against future lawful claims and demands."[96] However, mineral owners increasingly look to strike this warranty if for no other reason than because oil and gas operators are often in a better position to determine the title.[97]

Lessees typically allow the omission (or outright negation) of title warranty by the lessor without much of a fight. First, there is ample authority to suggest that the lessee's damages for the lessor's violation of warranty would be limited to the consideration paid (i.e., the bonus).[98] Second, it is not entirely clear just what circumstances are necessary in order for the lessee to claim a breach of warranty. A mere cloud on title (such as previous leases of record for which there are no releases) has been held to be insufficient.[99] "There is no breach until the lessee is physically or constructively ousted from the property."[100]

The next piece of the provision—often referred to as the subrogation clause—addresses the lessee's ability to discharge (i.e., pay for) taxes, mortgages and other liens affecting the mineral estate subject to the lease and to be subrogated thereto.[101] It is important to note that the lessee will typically not be concerned with liens arising after the effective date of his lease (or

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95. *Id.* at ¶ 10.
96. LOWE, *supra* note 2, at 202.
97. *See* Jones, *supra* note 2 at 22.
98. *See id.*
99. Schell v. Black 321 S.W.2d 373 (Tex. App.—El Paso 1964, no writ).
100. LOWE, *supra* note 2, at 202.
101. *See infra* Exhibit A, at ¶ 10.

liens to which the lessee had no notice when the lease was taken) since, even in the event of a foreclosure, his lease will remain intact.[102] The subrogation essentially means the substitution of one party for another, and in this context, permits the lessee who has paid off his lessor's lien to recoup such a payment from the lessor's proceeds under the lease (i.e., to deduct it from the royalty payments).[103]

The next piece of the provision—often referred to as the proportionate-reduction clause—recognizes that even though an oil and gas lease may appear to cover the entire mineral estate, the lessor and the lessee often understand that the lessor owns less than one hundred percent.[104] The proportionate-reduction language protects the lessee from being obligated to overpay royalties; for instance, where the lessor only owns fifty percent of the underlying mineral rights, the lessee will pay a proportionately reduced rate of fifty percent of the royalty listed in the lease.[105]

M. The Force Majeure Clause

A force majeure clause typically provides:

> Should Lessee be prevented from complying with any express or implied covenant of this Lease, from conducting drilling, or reworking operations thereon or from producing oil or gas or other hydrocarbons therefrom by reason of scarcity of, or inability to obtain or to use equipment or material, or by operation of force majeure, or because of any federal or state law or any order, rule or regulation of a governmental authority, then while so prevented, Lessee's obligations to comply with such covenant shall be suspended, and Lessee shall not be liable in damages for failure to comply therewith; and this Lease shall be extended while and so long as Lessee is prevented by any such cause from conducting drilling or reworking operations on, or from producing oil or gas or other hydrocarbons from the leased premises; and the time while Lessee is so prevented shall not be counted against the Lessee, anything in this Lease to the contrary notwithstanding.[106]

While this force majeure clause appears to be broadly drafted (in favor of the lessee), Texas courts have shown a reluctance to trigger these

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102. *See generally* Terry I. Cross, *Mortgage Liens – Navigating and Disarming Them in the Title Examination, Title Curative and Due Diligence Stages*, 29TH ANNUAL ADVANCED OIL & GAS AND ENERGY RES. L. COURSE (Oct. 2011).

103. *See Subrogation*, BLACK'S LAW DICTIONARY (11th ed. 2019); *see also*, *Subrogation Clause*, BLACK'S LAW DICTIONARY (11th ed. 2019).

104. *See, e.g.*, McMahon v. Christmann, 303 S.W.2d 341, 343 (1957).

105. *Id.* at 346.

106. *See infra* Exhibit A, at ¶ 11.

clauses.[107] The courts have had numerous opportunities to review force majeure clauses similar to the one above, and, while the language makes no mention of control or foreseeability, the courts have consistently utilized common law to "fill in the gaps."[108] Hence, despite how broadly the language is drafted, the lessee will need to demonstrate that some event outside his control has occurred which prevented his responsibilities under the lease in order to avail himself of the clause.[109]

N. The Signature Block

Leave it to the oil and gas industry to mess up a simple item of the oil and gas lease such as the parties' signatures. The lessee will often seek the execution of a mineral owner's spouse, even if it is undisputed that the mineral estate is the owner's sole, separate property.[110] Where a mineral estate is unsevered,[111] if the surface is within the homestead, both spouses must execute the lease.[112] Otherwise, the conveyance of the oil and gas lease is rendered inoperative so long as the property remains the homestead (or until the non-signing spouses signs or otherwise ratifies the lease).[113]

IV. CONCLUSION

The AAPL Form 675 and its closely related predecessor, the "Producers 88" lease form have roots that stretch back for over a century. For all their variations, iterations, and many mutations, it is striking how many of these provisions can be recognized (sometimes word for word) in "modern" oil and gas leases that stretch on for dozens of pages. Each lease is its own journey, however, and has its own unique meanings and interpretations, regardless of the generalizations and rules of thumb provided herein.

The proliferation of sophistication among mineral owners (and their attorneys) has manifested lease forms that are more complicated and nuanced. On occasions of query or conflict where a lease is concerned, there is no avoiding a close examination of the specific document at play and all

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107. *See, e.g.*, Atkinson Gas Co. v. Albrecht, 878 S.W.2d 236 (Tex. App.—Corpus Chrisiti-Edinburg 1994, writ denied); Sun Operating Ltd. P'ship v. Holt, 984 S.W.2d 277 (Tex. App.—Amarillo 1998, pet. denied); and Hydrocarbon Mgmt., Inc. v. Tracker Expl., Inc., 861 S.W.2d 427 (Tex. App.—Amarillo 1993, no writ).

108. *Id.*

109. *Id.*

110. *See infra* Exhibit A.

111. *I.e.*, where the mineral owner also owns the surface.

112. *See, e.g.*, Geldard v. Watson, 214 S.W.3d 202, 207 (Tex. App.—Texarkana 2007, no pet.) (citing TEX. CONST. art. XVI, § 50(b); TEX. FAM. CODE ANN. § 5.001 (Vernon 2006)); and *see* Grissom v. Anderson, 79 S.W.2d 619, 621 (Tex. 1935).

113. *Id.*

its intricacies. Rest assured, however, that the basic concepts outlined herein continue to permeate even the most exotic drafts.

EXHIBIT A

THE AAPL FORM 675 OIL AND GAS LEASE

OIL AND GAS LEASE

TEXAS FORM-SHUT-IN CLAUSE, POOLING CLAUSE

THIS AGREEMENT made and entered into the day of , 20 , by and between , Lessor and , Lessee. WITNESSETH:

1. Lessor, in consideration of the sum of _____ Dollars ($_____) in hand paid, receipt of which is hereby acknowledged, and the royalties herein provided, does hereby grant, lease and let unto Lessee for the purpose of exploring, prospecting, drilling and mining for and producing oil and gas and all other hydrocarbons, laying pipelines, building roads, tanks, power stations, telephone lines and other structures thereon to produce, save, take care of, treat, transport and own said products, and housing its employees, and without additional consideration, does hereby authorize Lessee to enter upon the land covered hereby to accomplish said purposes, the following described land in County, Texas, to-wit:

[land description]

This Lease also covers and includes any and all lands owned or claimed by the Lessor adjacent or contiguous to the land described hereinabove, whether the same be in said survey or surveys or in adjacent surveys, although not included within the boundaries of the land described above. For the purpose of calculating rental payments hereinafter provided for the lands covered hereby are estimated to comprise acres, whether it actually comprises more or less.

2. Subject to the other provisions herein contained this Lease shall be for a term of years from this date (called "primary term") and as long thereafter as oil and gas or other hydrocarbons are being produced from said land or land with which said land is pooled hereunder.

3. The royalties to be paid by Lessee are as follows: On oil, one-eighth of that produced and saved from said land, the same to be delivered at the wells or to the credit of Lessor into the pipe line to which the wells may be connected. Lessee shall have the option to purchase any royalty oil in its possession, paying the market price therefore prevailing for the field where

produced on the date of purchase. On gas, including casinghead gas, condensate or other gaseous substances, produced from said land and sold or used off the premises or for the extraction of gasoline or other products therefrom, the market value at the well of one-eighth of the gas so sold or used, provided that on gas sold at the wells the royalty shall be one-eighth of the amount realized from such sale. While there is a gas well on this Lease, or on acreage pooled therewith, but gas is not being sold or used Lessee shall pay or tender annually at the end of each yearly period during which such gas is not sold or used, as royalty, an amount equal to the delay rental provided for in paragraph 5 hereof, and while said royalty is so paid or tendered this Lease shall be held as a producing Lease under paragraph 2 hereof. Lessee shall have free use of oil, gas and water from said land, except water from Lessor's wells, for all operations hereunder, and the royalty on oil and gas shall be computed after deducting any so used.

4. Lessee, at its option, is hereby given the right and power to voluntarily pool or combine the acreage covered by this Lease, or any portion thereof, as to the oil and gas, or either of them, with other land, lease or leases in the immediate vicinity thereof to the extent hereinafter stipulated when in Lessee's judgment it is necessary or advisable to do so in order to properly develop and operate said leased premises in compliance with the Spacing Rules of the Railroad Commission of Texas, or other lawful authorities, or when to do so would, in the judgment of Lessee, promote the conservation of oil and gas from said premises. Units pooled for oil hereunder shall not substantially exceed 80 acres each in area, and units pooled for gas hereunder shall not substantially exceed 640 acres each in area plus a tolerance of ten per-cent thereof in the case of either an oil unit or a gas unit, provided that should governmental authority having jurisdiction prescribe or permit the creation of units larger than those specified, units thereafter created may conform substantially in size with those prescribed by governmental regulations. Lessee under the provisions hereof may pool or combine acreage covered by this Lease, or any portion thereof as above provided for as to oil in any one or more strata and as to gas in any one or more strata. The units formed by pooling as to any stratum or strata need not conform in size or area with the unit or units into which the Lease is pooled or combined as to any other stratum or strata, and oil units need not conform as to area with gas units. The pooling in one or more instances shall not exhaust the rights of Lessee hereunder to pool this Lease, or portions thereof, into other units. Lessee shall file for record in the county records of the county in which the lands are located an instrument identifying and describing the pooled acreage. Lessee may at its election exercise its pooling operation after commencing operations for, or completing an oil or gas well on the leased premises, and the pooled unit may include, but is not required to include, land or leases upon which a well capable of producing oil or gas in paying

quantities has theretofore been completed, or upon which operations for drilling of a well for oil or gas have theretofore been commenced. Operations for drilling on or production of oil or gas from any part of the pooled unit composed in whole or in part of the land covered by this Lease, regardless of whether such operations for drilling were commenced or such production was secured before or after the execution of this instrument or the instrument designating the pooled unit, shall be considered as operations for drilling on or production of oil or gas from the land covered by this Lease whether or not the well or wells are actually located on the premises covered by this Lease, and the entire acreage constituting such unit or units, as to oil and gas or either of them as herein provided, shall be treated for all purposes except the payment of royalties on production from the pooled unit as if the same were included in this Lease. For the purpose of computing the royalties to which owners of royalties and payments out of production and each of them shall be entitled upon production of oil and gas, or either of them from the pooled unit, there shall be allocated to the land covered by this Lease and included in said unit a pro rata portion of the oil and gas, or either of them, produced from the pooled unit after deducting that used for operations on the pooled unit. Such allocation shall be on an acreage basis, that is to say, there shall be allocated to the acreage covered by this Lease and included in the pooled unit that pro rata portion of the oil and gas, or either of them, produced from the pooled unit which the number of surface acres covered by this Lease and included in the pooled unit bears to the total number of surface acres included in the pooled unit. Royalties hereunder shall be computed on the portion of such production, whether it be oil or gas or either of them, so allocated to the land covered by this Lease and included in the unit just as though such production were from such land. The production from an oil well will be considered as production from the Lease or oil pooled unit from which it is producing and not as production from a gas pooled unit; and production from a gas well will be considered as production from the Lease or gas pooled unit from which it is producing and not from the oil pooled unit.

5. If operations for drilling are not commenced on said land, or on acreage pooled therewith as above provided for, on or before one year from the date hereof, the Lease shall terminate as to both parties, unless on or before such anniversary date Lessee shall pay or tender to Lessor, or to the credit of Lessor in the _____, Bank at _____, Texas, (which Bank and its successors shall be Lessor's agent and shall continue as the depository for all rentals payable hereunder regardless of changes in ownership of said land or the rentals, the sum of _____ Dollars ($_____), herein called rentals, which shall cover the privilege of deferring commencement of drilling operations for a period of twelve (12) months. In like manner and upon like payment or tenders annually the commencement of drilling operations may be further deferred for successive

periods of twelve (12) months each during the primary term hereof. The payment or tender of rental under this paragraph and of royalty under paragraph 3 on any gas well from which gas is not being sold or used may be made by check or draft of Lessee mailed or delivered to Lessor, or to said Bank on or before the date of payment. If such Bank, or any successor Bank, should fail, liquidate or be succeeded by another Bank, or for any reason fail or refuse to accept rental, Lessee shall not be held in default for failure to make such payment or tender of rental until thirty (30) days after Lessor shall deliver to Lessee a proper recordable instrument, naming another Bank as Agent to receive such payments or tenders. Cash payment for this Lease is consideration for this Lease according to its terms and shall not be allocated as a mere rental for a period. Lessee may at any time or times execute and deliver to Lessor, or to the depository above named, or place of record a release covering any portion or portions of the above described premises and thereby surrender this Lease as to such portion or portions and be relieved of all obligations as to the acreage surrendered, and thereafter the rentals payable hereunder shall be reduced in the proportion that the acreage covered hereby is reduced by said release or releases.

6. If prior to discovery of oil, gas or other hydrocarbons on this land, or on acreage pooled therewith. Lessee should drill a dry hole or holes thereon, or if after the discovery of oil, gas or other hydrocarbons, the production thereof should cease from any cause, this Lease shall not terminate if Lessee commences additional drilling or re-working operations within sixty (60) days thereafter, or if it be within the primary term, commences or resumes the payment or tender of rentals or commences operations for drilling or re-working on or before the rental paying date next ensuing after the expiration of sixty (60) days from the date of completion of the dry hole, or cessation of production. If at any time subsequent to sixty (60) days prior to the beginning of the last year of the primary term, and prior to the discovery of oil, gas or other hydrocarbons on said land, or on acreage pooled therewith, Lessee should drill a dry hole thereon, no rental payment or operations are necessary in order to keep the Lease in force during the remainder of the primary term. If at the expiration of the primary term, oil, gas or other hydrocarbons are not being produced on said land, or on acreage pooled therewith, but Lessee is then engaged in drilling or re-working operations thereon, or shall have completed a dry hole thereon within sixty (60) days prior to the end of the primary term, the Lease shall remain in force so long as operations are prosecuted with no cessation of more than sixty (60) consecutive days, and if they result in the production of oil, gas or other hydrocarbons, so long thereafter as oil, gas or other hydrocarbons are produced from said land, or acreage pooled therewith. In the event a well or wells producing oil or gas in paying quantities shall be brought in on adjacent land and draining the leased premises, or acreage pooled therewith, Lessee

agrees to drill such offset wells as a reasonably prudent operator would drill under the same or similar circumstances.

7. Lessee shall have the right at any time during or after the expiration of this Lease to remove all property and fixtures placed on the premises by Lessee, including the right to draw and remove all casing. When required by the Lessor, Lessee shall bury all pipelines below ordinary plow depth, and no well shall be drilled within two hundred (200) feet of any residence or barn located on said land as of the date of this Lease without Lessor's consent.

8. The rights of each party hereunder may be assigned in whole or in part, and the provisions hereof shall extend to their heirs, successors and assigns, but no change or division in the ownership of the land, rentals or royalties, however accomplished, shall operate to enlarge the obligations, or diminish the rights of Lessee; and no change or division in such ownership shall be binding on Lessee until thirty (30) days after Lessee shall have been furnished with a certified copy of recorded instrument or instruments evidencing such change of ownership. In the event of assignment hereof in whole or in part, liability for breach of any obligation issued hereunder shall rest exclusively upon the owner of this Lease, or portion thereof, who commits such breach. In the event of the death of any person entitled to rentals hereunder, Lessee may pay or tender such rentals to the credit of the deceased or the estate of the deceased, until such time as Lessee has been furnished with the proper evidence of the appointment and qualification of an executor or an administrator of the estate, or if there be none, then until Lessee is furnished satisfactory evidence as to the heirs or devisees of the deceased, and that all debts of the estate have been paid. If at any time two or more persons become entitled to participate in the rental payable hereunder. Lessee may pay or tender such rental jointly to such persons, or to their joint credit in the depository named herein; or, at the Lessee's election, the portion or part of said rental to which each participant is entitled may be paid or tendered to him separately or to his separate credit in said depository; and payment or tender to any participant of his portion of the rentals hereunder shall maintain this Lease as to such participant. In the event of an assignment of this Lease as to a segregated portion of said land, the rentals payable hereunder shall be apportioned as between the several leasehold owners ratably according to the surface area of each, and default in rental payment by one shall not affect the rights of other leasehold owners hereunder. If six or more parties become entitled to royalty payments hereunder, Lessee may withhold payment thereof unless and until furnished with a recordable instrument executed by all such parties designating an agent to receive payment for all.

9. The breach by Lessee of any obligations arising hereunder shall not work a forfeiture or termination of this Lease nor cause a termination or

reversion of the estate created hereby nor be grounds for cancellation hereof in whole or in part unless Lessor shall notify Lessee in writing of the facts relied upon in claiming a breach hereof, and Lessee, if in default shall have sixty (60) days after receipt of such notice in which to commence the compliance with the obligations imposed by virtue of this instrument, and if Lessee shall fail to do so then Lessor shall have grounds for action in a court of law or such remedy to which he may feel entitled. After the discovery of oil, gas or other hydrocarbons in paying quantities on the lands covered by this Lease, or pooled therewith, Lessee shall reasonably develop the acreage retained hereunder, but in discharging this obligation Lessee shall not be required to drill more than one well per eighty (80) acres of area retained hereunder and capable of producing oil in paying quantities, and one well per six hundred forty (640) acres of the area retained hereunder and capable of producing gas or other hydrocarbons in paying quantities plus a tolerance of ten per-cent in the case of either an oil well or a gas well.

10. Lessor hereby warrants and agrees to defend the title to said lands and agrees also that Lessee at its option may discharge any tax, mortgage or other liens upon said land either in whole or in part, and in the event Lessee does so, it shall be subrogated to such lien with the right to enforce same and apply rentals and royalties accruing hereunder towards satisfying same. Without impairment of Lessee's rights under the warranty in event of failure of title, it is agreed that if Lessor owns an interest in the oil, gas or other hydrocarbons in or under said land, less than the entire fee simple estate then the royalties and rentals to be paid Lessor shall be reduced proportionately. Failure of Lessee to reduce such rental paid hereunder or over-payment of such rental hereunder shall not impair the right of Lessee to reduce royalties payable hereunder.

11. Should Lessee be prevented from complying with any express or implied covenant of this Lease, from conducting drilling, or reworking operations thereon or from producing oil or gas or other hydrocarbons therefrom by reason of scarcity of, or inability to obtain or to use equipment or material, or by operation of force majeure, or because of any federal or state law or any order, rule or regulation of a governmental authority, then while so prevented, Lessee's obligations to comply with such covenant shall be suspended, and Lessee shall not be liable in damages for failure to comply therewith; and this Lease shall be extended while and so long as Lessee is prevented by any such cause from conducting drilling or reworking operations on, or from producing oil or gas or other hydrocarbons from the leased premises; and the time while Lessee is so prevented shall not be counted against the Lessee, anything in this Lease to the contrary notwithstanding.

IN WITNESS WHEREOF this instrument is executed on the date first above set out.

[signature of lessors and acknowledgements]

CONFLICTS ARISING FROM EXISTING OIL AND GAS LEASES AND A NEW WIND LEASE

Carter Scharmen[*]

This Article examines the interplay between existing oil and gas projects and a new or proposed wind energy project on the same land. This Article starts by examining the spacing requirements for oil and gas leases and wind leases and then looks at how the accommodation doctrine does not protect wind energy projects that are second in time. Currently, case law does not protect wind energy projects on the same land subsequent to an existing oil and gas lease. Case law has shown that the Supreme Court of Texas is willing to alter the accommodation doctrine, and it may do so to allow wind energy projects more leeway in Texas considering Texas' growing population and the rise in popularity of renewable energy.

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I. INTRODUCTION

Since Spindletop in 1901, Texas oil producers have played a major role in the United States energy market.[1] According to the U.S. Energy Information Administration, "Texas [leads] all states in crude oil production in every year" and accounts for about two-fifths of the United States' reserves and production.[2] Additionally, about a quarter of the United States' proven, dry natural-gas reserves are in Texas, which produced one-fourth of the

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1. BRYAN BURROUGH, THE BIG RICH: THE RISE AND FALL OF THE GREATEST TEXAS OIL FORTUNES 1–4 (Penguin Books, 2010).

2. U.S. ENERGY INFO. ADMIN., *U.S. Overview*, EIA, https://www.eia.gov/state/analysis.php?sid=TX#120 (last visited Sept. 12, 2022).

nation's natural gas in 2020.[3] Now, with the introduction and popularization of so-called "renewable energy" sources, energy companies in Texas are once again playing a major role in the adoption and proliferation of these new methods of energy generation. Leading the nation in wind energy production, Texas produces one-fifth of all the United States' domestically generated energy, and almost all of Texas' electricity generated by renewable sources comes from wind.[4] In 2020, Texas produced almost 30% of the United States' total wind energy.[5]

In the western portion of the state, perfectly suited for wind production, there exists an abundance of preexisting oil and gas leases. Thus, it is likely to see frequent conflicts between both lease types as both forms of energy production operations expand across the state to meet Texas' growing population and energy consumption needs. Both lease types will compete for the use of the surface estate when occupying the same tract. Wind power production is booming in West Texas, with no plans to slow down anytime soon. The U.S. Department of Energy set a goal of reaching net-zero carbon emissions by 2050.[6] This urgency to eliminate carbon emissions fostered by changes in the actual and political climates creates valuable incentives for wind developers in Texas to expand their operations.[7]

Traditionally, when there is a conflict between the mineral and surface estates, Texas courts address the issue in compliance with the dominant-servient estate doctrine.[8] The common law approach only protects the surface estate against the mineral estate's negligent or unreasonable surface use.[9] To alleviate the harshness of the dominant-servient estate doctrine, Texas courts have held that if the surface estate has a pre-existing use with no "reasonable alternative" and can prove that the mineral lessee conversely has a reasonable alternative and that the mineral use would preclude or substantially impair the surface use, then the mineral lessee would have to accommodate the surface estate and use that reasonable alternative.[10] This is widely known as the accommodation doctrine.[11] But the accommodation doctrine *only* applies when the surface use is first in time or pre-existing.[12] If pre-existing oil and gas development causes a surface conflict with a planned wind project, then the accommodation doctrine will

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3. *Id.*
4. *Id.*
5. *Id.* (stating that Texas produced almost three-tenths of the U.S.'s total wind energy in 2020).
6. RODERICK E. WETSEL & BECKY H. DIFFEN, WIND AND SOLAR LAW, § 1.02 (Lexis Nexis Matthew Bender 2022) (stating that U.S. Department of Energy set a net-zero carbon goal by 2050).
7. *See, e.g.*, U.S. ENERGY INFORMATION ADMINISTRATION, https://www.eia.gov/todayinenergy/detail.php?id=46576 (last visited Jan. 3, 2022) (showing how the U.S. production tax credit gives wind developers tax credits in decreasing percentages based on when the wind farm started construction).
8. Humble Oil & Refin. Co. v. Williams, 420 S.W.2d 133, 134 (Tex. 1967).
9. *Id.*
10. *See* Merriman v. XTO Energy, Inc., 407 S.W.3d 244, 248–49 (Tex. 2013).
11. *Id.*
12. *Id.*

not help wind developers.[13] Furthermore, with wind lease "option clauses" ranging from two to five years, mineral lessees have plenty of time to enter the property and begin developing the mineral estate.[14] There is ample commentary and case law addressing the options wind developers have when they are first in time, and further, Texas courts have already had to decide cases regarding conflicts between mineral interests and renewable energy production when the renewables were first in time.[15] But with the United States' growing population and energy consumption needs, in conjunction with the growing popularity of renewable energy production, it may be necessary for Texas courts to now reevaluate the common law approach to best suit public policy in the future.

To date, commentators have only briefly addressed the avenues available to a practitioner when production on a severed mineral estate is first in time and neither party is willing to entertain alternative solutions. Commentators have clarified, though, that existing oil and gas operations interfering with new wind energy projects is a very low probability, for various reasons.[16] Additionally, they do acknowledge that the accommodation doctrine is not an impenetrable suit of armor for wind projects in all instances if the parties will not compromise.[17] Thus, it is important for practitioners to consider a scenario where the accommodation doctrine, as it currently stands, is not reliable protection for a wind developer's clients' interests in a planned or phased wind project—as the amount of unleased land available for energy production decreases.

First, this Article presents a basic overview of the attributes of the spacing requirements of an oil and gas lease and wind lease.[18] Next, it will examine previous cases, in which courts have ruled on conflicts between first-in-time mineral estates and other second-in-time surface uses, to predict how a Texas court is likely to approach a wind lease that conflicts with a pre-existing oil and gas lease under current law.[19] Then, this Article will examine recent accommodation doctrine cases to demonstrate how the Texas Supreme Court may expand on or retool the common law approach in a way

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13. *Id.*

14. Roderick E. Wetsel & Lisa Chavarria, *Anatomy of A Wind Energy Lease*, 21ST ANNUAL ADVANCED OIL GAS & ENERGY RESOURCES LAW COURSE CHAPTER 7, 1 (2003).

15. *See* Lyle v. Midway Solar, LLC, 618 S.W.3d 857 (Tex. App.—El Paso, 2020, pet. filed).

16. Becky H. Diffen, *Energy from Above and Below: Who Wins When A Wind Farm and Oil and Gas Operations Conflict?*, 3 TEX. J. OIL GAS & ENERGY L. 240, 241 (2008) (stating that wind energy projects are capital intensive and investors will be hesitant if they perceive risks to the viability of the wind farm).

17. *Id.* at 251, 254; *see also*, Jared Berg, *Ending the Game of Chicken: Propose Solutions To Keep Texas Wind Developers and Mineral Lessees from Ruffling Each Other's Feathers*, 3 TEX. J. OIL GAS & ENERGY L. 143, 171 (2016); K.K. Duvivier & Roderick E. Wetsel, *Jousting at Windmills: When Wind Power Development Collides with Oil, Gas and Mineral Development*, 55 ROCKY MTN. MIN. L. INST. § 9.04 (2009).

18. *See supra* Part I.

19. *See infra* Part II.

that better accounts for the surface estate's rights, in light of public policy changes.[20] Finally, this Article will briefly look at how courts may potentially treat wind compared to other fugacious resources on the land such as wild animals, groundwater, or oil and gas in a scenario where Texas law may recognize a separate wind estate in the future.[21]

II. SPACING REQUIREMENTS OF OIL AND GAS AND WIND LEASES

To understand the types of conflicts that can arise between wind energy leases and oil and gas leases, it is important to understand the main attributes and spacing requirements for each type of lease. Each respective lease contracts for certain land uses and spacing requirements for its operations. Both leases are similar in the sense that they may restrict the surface owner's use of the leased tract and outline the basic rights and responsibilities of the parties. For oil and gas leases, the Texas Railroad Commission regulates the spacing requirements for wells. Texas Administration Code § 3.37 prevents operators from drilling wells within 1,200 feet of "any well completed or drilling to the same horizon on the same tract or farm, and . . . [within] 467 feet [of] any property line, lease line, or subdivision line . . . ."[22] Moreover, oil and gas companies can undertake what is known as "pooling" to meet the Railroad Commission's spacing requirements and to prevent the economic waste associated with the over drilling of a single reservoir. Pooling occurs when an operator combines two or more tracts of land to form one drilling unit.[23]

Additionally, the oil and gas lease sets up land-use restrictions for the lessee and the lessor and outlines the relationship between the parties.[24] The granting clause in an oil and gas lease typically gives the lessee the right to access the property for purposes "reasonably necessary" for their operations.[25] Because the mineral estate is the dominant estate, Texas courts construe "reasonably necessary" broadly, and hold that not only access to the land over the objection of the surface tenant is "reasonably necessary," but also things like: the right to construct roads on the leased premises, the right to mine caliche to construct roads, pad, and tank batteries, the right to lay pipes, and the right to construct storage and disposal facilities.[26] This is not an exhaustive list, though, and the parties to an oil and gas lease may contract for many other land uses. However, the above list and the Texas Railroad

20. *See infra* Part III.

21. *See infra* Parts IV–VI.

22. 16 TEX. ADMIN. CODE § 3.37 (R.R. Comm'n of Tex., Statewide Spacing Rule).

23. 4 WILLIAMS & MEYERS, OIL & GAS L. § 901 (LEXIS 2021).

24. Ernest V. Bruchez, Jr., *Surface Access and Use: Stope, Look and Listen Your Way to the Drill Site*, § VII, OIL GAS & MIN. TITLE EXAMINATION COURSE 12, STATE BAR OF TEXAS, WL 3398006 (2018) (citing *Ball v. Dillard*, 602 S.W.2d 521 (Tex. 1980)).

25. *See id.*; *see, e.g.*, Humble Oil & Refining Co. v. Williams, 420 S.W.2d 133, 134 (Tex. 1967).

26. Bruchez, *supra* note 24, at § V. II.

Commission's spacing requirements demonstrate the expansive scope of oil and gas leases' use of the surface estate, despite the law characterizing them as fee simple determinable conveyances of the mineral estate.[27]

As opposed to oil and gas leases, wind energy leases are term-of-year leases of the surface estate only.[28] They do not create fee simple determinable estates, like oil and gas leases.[29] But because wind energy leases deal with the surface estate directly, as opposed to the mineral estate, wind leases tend to encumber larger areas of land, despite each turbine consuming a relatively small surface "footprint."[30] The lease may unintentionally conflict with a severed mineral estate if the surface owner and the mineral estate owner do not communicate.[31]

As stated earlier, wind energy leases are set up similarly to oil leases in that each type of lease consists of clauses that determine the parties' rights and responsibilities. However, the clauses in a wind energy lease have different names, and each may do similar or different things compared to certain clauses in an oil and gas lease. For example, wind energy leases have "purpose" and "option" clauses, whereas oil and gas leases have "grantor" and "habendum" clauses.[32] The purpose clause in a wind lease "allow[s] the lessee to [carry out] any activity that [it] determines is necessary, helpful, appropriate, or convenient in connection with, or incidental to, the accomplishment of the construction and maintenance of the wind [lease]."[33] This includes things like constructing roads, energy storage facilities, maintenance yards, water wells, and fences.[34] These surface uses can take up more space than oil and gas leases. For example, the roads a wind energy company must install are larger than oil and gas lease roads due to the cranes necessary to construct the wind turbines.[35] Additionally, wind energy leases can encumber large portions of the surface because of turbine spacing requirements, buffer zones, and surface and subsurface transmission lines.[36] Wind energy leases also typically require non-obstruction easements "at least one mile upwind" of the wind farm to prevent tall objects from disrupting the wind's flow across the wind farm.[37]

It is important to note that wind developers that are second in time can alter their plans for a proposed wind project to accommodate existing oil and

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27. *See* Brown v. Humble Oil & Refin. Co., 126 Tex. 296, 305, 83 S.W.2d 935, 940 (Tex. 1935).
28. Wetsel & Chavarria, *supra* note 14, at 1.
29. *Id.*
30. *Id.*
31. *E.g.*, *Lyle*, 618 S.W.3d at 863 (demonstrating how renewable energy leases can affect severed mineral rights without consulting the mineral estate owners).
32. Wetsel & Chavarria, *supra* note 14, at 1–2.
33. *Id.*
34. *Id.*
35. Duvivier & Wetsel, *supra* note 17, at § 9.03.
36. *Id.*
37. Diffen, *supra* note 16, at 241.

gas production on a particular tract of land. It is possible for a wind developer to move planned transmission lines or lease roads; however, doing so is costly because they run through very narrow public utility easements.[38] Additionally, lease roads connect the entirety of the wind farm, so rerouting a road to avoid oil and gas operations in a crowded environment may not be feasible.[39] Furthermore, wind energy farms are capital-intensive endeavors, and potential investors in a wind farm may require risk premiums if they identify risks to a wind farm's profitability from other operations on the property.[40] While wind developers can alter the computer model of the proposed wind farm, an unexpected change in existing oil operations on the property could alter the computer model's productivity projections over the entire life of the wind farm.[41] Again, commentators make it clear that both types of production can coexist on the same tracts of land. But as the amount of unused land available for energy production decreases, it is important for practitioners to consider a scenario where simply rerouting transmission lines or redesigning the layout of a proposed wind farm may not be feasible.

III. CONFLICTS BETWEEN OIL AND GAS LEASES AND WIND LEASES IN AN EXISTING OIL AND GAS FIELD

Even though Texas courts indicate that they are amenable to expanding the accommodation doctrine to offer greater surface use protections, further alleviating the harshness of the dominant-servient estate doctrine, current law still does not afford protection for wind farms with a conflicting surface use subsequent to oil and gas production on the property. The current political and societal momentum driving the expansion of renewable energy development in Texas is failing to persuade Texas courts to treat wind energy development differently from other surface uses. Unless Texas courts or the Legislature decide that public policy is best served by treating wind as a natural resource, courts will approach wind developers' surface use subsequent to oil and gas production on the same tract similarly to other competing surface uses. This is in part due to the fixed term-of-years in a wind lease.[42]

To be clear, if a party is the grantor of a wind lease and a mineral lease, the retained acreage clauses and other provisions in both leases can effectively modify the common law approach to accommodate competing

38. *Id.* at 244–45.
39. *Id.*
40. *Id.* at 241.
41. *Id.* at 244–45.
42. Ernest Smith, *Wind Energy: Siting Controversies and Rights in Wind*, 1 ENV'T & ENERGY L. & POL'Y J. 281, 314–15 (2007) (discussing how conflicts between producing mineral estates and new wind leases are akin to mineral estate and agricultural lease conflicts).

surface uses.[43] More likely, both mineral and wind lessees will pressure grantors to sign non-compete agreements to prevent or greatly diminish the grantor's ability to enter into subsequent leases that may present any conflicting surface issues.[44] However, such agreements may cause problems for a wind lessee if there are other non-executive mineral owners.[45] If a severed mineral estate interest holder is already producing on the property, Texas courts apply the dominant-servient estate doctrine, and the wind lessee will not receive the benefit of the accommodation doctrine in the event of a surface conflict.[46] Consequently, a subsequent surface lessee's only recourse would be to claim that the mineral lessee is using more of the surface than is reasonably necessary or is using the surface in a negligent manner.[47]

Should the mineral lessee complain about the surface lessee's use, the dominant-servient estate doctrine requires the mineral lessee to "prove that [they] need the surface at the time and place then being used by the other user."[48] Furthermore, the accommodation doctrine does not protect a surface lessor holding a first-in-time executed lease.[49] Rather, it protects pre-existing uses for which no reasonable alternatives exist.[50] As the next section will discuss, the accommodation doctrine only protects surface owners by requiring that mineral lessees exercise their implied rights with due regard for the surface estate.[51]

The 1980 Texas Supreme Court case, *Ball v. Dillard*, exemplifies how the law approaches issues between a surface lessor and a mineral lessor on the same tract.[52] In that case, Ball entered into a five-year surface lease with the landowner in 1973.[53] Ball's lease required him to keep the road on the property, known as the "mountain road," in good repair.[54] The lease also prohibited loads over 12,000 pounds going up the road, and it gave no authority for use of the road, other than for uses not provided by the lease.[55] The next year, the landowner entered into a mineral lease with Dillard, which covered the same property.[56] The mineral lease precluded Dillard from using

43. *See* Duvivier & Wetsel, *supra* note 35, at § 9.05; *see also* Coyote Lake Ranch, LLC. v. City of Lubbock, 498 S.W.3d 53, 59 (Tex. 2016) (quoting *In re Prudential Ins. Co. of Am.*, 148 S.W.3d 124, 129 (Tex. 2004)).

44. *Id.*

45. *Id.*

46. Ernest Smith, *supra* note 42, at 314–15.

47. Atlantic Refin. Co. v. Bright & Schiff, 321 S.W.2d 167, 169 (Tex. App.—San Antonio 1959, writ ref'd).

48. *Id.*

49. *See* Ball v. Dillard, 602 S.W.2d 251, 522–23 (Tex. 1980).

50. Getty Oil Co. v. Jones, 470 S.W.2d 618, 622 (Tex. 1971).

51. *Id.* at 621.

52. *Ball*, 602 S.W.2d at 522.

53. *Id.*

54. *Id.* at 523.

55. *Id.*

56. *Id.* at 522.

the mountain road, the only road on the property.[57] Consequently, Dillard needed to construct his own road to reach the production site.[58] Because of this, Dillard's employees had to use the gate to the mountain road in the meantime.[59] Subsequently, Ball locked the gate to the road and did not give Dillard or his employees a key because he was concerned he would be liable for any damages they might cause to the road.[60] Dillard sued seeking an injunction against Ball to keep him from interfering with his rights of ingress and egress for mineral production.[61] Ball filed a counterclaim "seeking declaratory relief defining the rights of the parties under their . . . leases."[62] The Texas Supreme Court stated that Dillard possessed the dominant estate, meaning he was entitled to the rights of ingress and egress for mineral production, but he could not "make an unreasonable use of the surface."[63] The dissent noted that "this rule applies when both the owner and mineral lessee have the right of dual possession of the surface."[64] The Court further stated that "the rights of the surface holder and the mineral estate holder are reciprocal and distinct and neither party can interfere with the rights of the other."[65] The Court held that Ball "unreasonably exceeded his rights . . . as a surface lessee."[66]

The Court's holding in *Ball* is important to wind developers because it shows that surface and mineral lessees have reciprocal rights and that mineral lessees cannot unreasonably interfere with a surface lessee's use.[67] Therefore, if a mineral lessee has a pre-existing surface use that conflicts with a wind developer's ability to carry out the terms of their lease, the wind developer may argue that the mineral lessee's surface use is unreasonably interfering with their rights.[68] Such an argument will depend heavily on the specific facts of the case and typically require expert opinions at trial.[69] Moreover, Texas courts have held that the reasonableness of a mineral lessee's surface use is only an issue when it "destroys or substantially impairs the surface owner's use of the surface. . . ."[70] Thus, a wind developer who makes the unreasonableness argument will likely only succeed if they absolutely cannot

57. *Ball*, 602 S.W.2d at 522.
58. *Id.*
59. *Id.*
60. *Id.* at 525.
61. *Ball*, 602 S.W.2d at 525.
62. *Id.*
63. *Id.* at 523.
64. *Id.* at 526.
65. *Id.*
66. *Id.*
67. *Id.* at 523–24 (demonstrating that surface lessees do not have the right to interfere with the dominant estate's right to access the land).
68. *Id.*
69. *E.g.*, *Lyle*, 618 S.W.3d at 866–67 (demonstrating that experts are involved in litigation regarding the unreasonableness of surface use).
70. Davis v. Devon Energy Prod. Co., L.P., 136 S.W.3d 419, 424 (Tex. App.—Amarillo 2004. no pet.).

work around the prior conflicting surface use or present evidence that the mineral lessee put the surface use in place to purposefully block the wind developer's use of the property in that location.[71]

Furthermore, Justice Spears noted in his dissenting opinion that the terms of both leases dictated their respective party's use of the road by express covenant.[72] In his opinion, the case was not a dual possession issue, but rather a factual one whose determination depended on whether the mountain road began at the gate or where the asphalt started.[73] If the road started at the gate, then Ball was not at fault; but if the road started at the asphalt, then Dillard had the right to use that gate.[74] The dissenting opinion is noteworthy here because it demonstrates the importance of specificity when drafting competing surface leases, for the respective leases can effectively prevent surface conflicts if parties draft them with competing surface uses in mind. Though, this may not be possible if the grantors for mineral and wind leases are different parties.

IV. EXPANSION OF "FIRST IN TIME, FIRST IN RIGHT"

As stated earlier, the mineral estate is the dominant estate because of the implied right to use as much of the estate as is reasonably necessary to extract the minerals, but the mineral lessee must exercise their implied rights with due regard for the rights of the surface estate.[75] As previously mentioned, the body of law that the courts typically rely on to resolve issues arising from pre-existing surface uses is known as the accommodation doctrine. For a court to grant a surface estate owner relief under the accommodation doctrine, the surface owner has the burden of showing that the mineral lessee's operations "completely preclude[] or substantially impair[] the existing use, and . . . there is no reasonable alternative method available to the surface owner" to carry out the existing use.[76] The surface owner must also prove that the mineral lessee has "alternative reasonable, customary, and industry-accepted methods available to the lessee which will allow . . . the surface owner to continue the existing use."[77]

Recently, Texas courts have expanded the accommodation doctrine's applicability as a result of several different cases.[78] The expansion

71. Brown v. Lundell, 162 Tex. 84, 87, 344 S.W.2d 863, 866 (1961) (stating that the rights to the lessee are those only expressly granted or implied by necessity, any negligent or unnecessary interference is trespass).

72. *Ball*, 602 S.W.2d at 526.

73. *Id.*

74. *Id.*

75. *Getty*, 470 S.W.2d at 621.

76. *Merriman*, 407 S.W.3d at 249.

77. *Id.*

78. *See, e.g.*, *Lyle*, 618 S.W.3d at 874 (demonstrating that surface lessees do not have to yield to the mineral estate when there are no plans to develop the mineral estate); *see also* Lightning Oil Co. v.

strengthens the first in time, first in right dynamic, which may indicate that Texas law will continue dealing with surface conflicts in that manner in the future. For example, in *Texas Genco, L.P. v. Valence Operating Co.*, the Tenth District Court of Appeals held that a cell in a landfill that the surface owner only used to store topsoil was a pre-existing use because it was part of a larger system.[79] The court also held that directional drilling is a "reasonable, industry-accepted alternative", provided that it is not cost-prohibitive based on the economic viability of the well.[80] In light of the above, *Genco*'s expansion of the accommodation doctrine's applicability only helps wind farms if they are first in time or if the unused tract is part of a larger phased wind energy unit and there has been some sort of wind production activity on the property.

Another case regarding the accommodation doctrine that is particularly applicable to renewable energy production is *Lyle v. Midway Solar, LLC*.[81] In that case, the Lyles owned a portion of the mineral estate on a tract of land on which Midway put a solar farm.[82] Midway contracted with the surface owner, Gary Drgac, who did not have any interest in the mineral estate.[83] At the time, the Lyles had not begun or attempted to develop the minerals on the property.[84] Midway did set aside designated drill sites for future mineral production, but the Lyles did not have any input as to where they were located.[85] The Eighth District Court of Appeals held that both Midway and the Lyles had the right to use the surface, but that the latter only had that right by virtue of their mineral estate interest.[86] The court also stated that the accommodation doctrine did not apply to Midway's surface use until the Lyles decided to develop the minerals under the tract.[87]

Again, the manner in which the courts approached the issues presented by the conflicting surface uses in *Genco* and *Lyle* may indicate how Texas courts will approach such issues in a similar manner going forward.[88] Courts may simply expand on the accommodation doctrine, and the only way wind developers can use the surface without any interference from the holders of a severed mineral interest is to be first in time.[89] In *Lightning Oil Co. v.*

Anadarko E & P Onshore, LLC., 520 S.W.3d 39, 52 (Tex. 2017) (stating that mineral lessee's do not "have the [absolute] right to prevent any surface or subsurface use that might later interfere with [their] plans").

79. Texas Genco, LP. v. Valence Operating Co., 187 S.W.3d 118, 124 (Tex. App.—Waco 2006, pet. denied).

80. *Id.* at 124–25.

81. *Lyle*, 618 S.W.3d at 862.

82. *Id.* at 862–63.

83. *Id.* at 863.

84. *Id.*

85. *Id.*

86. *Id.* at 874.

87. *Lyle*, 618 S.W.3d at 874–75.

88. *See Lyle*, 618 S.W.3d.

89. Lightning Oil Co. v. Anadarko E & P Onshore, LLCy, 520 S.W.3d 39, 52 (Tex. 2017).

Anadarko E&P Onshore, LLC, the Texas Supreme Court opined that the accommodation doctrine is flexible in nature, and mineral lessees do not "have the [absolute] right to prevent any surface or subsurface use that might later interfere with [their] plans."[90] Additionally, the Texas Supreme Court has held that the accommodation doctrine applies to conflicts between the surface estate and other severed property ownership interests, such as groundwater.[91] Obviously, wind developers would not consider a scenario where their only recourse is to be first in time to be ideal, especially in light of the fact that public attitude and policy may be shifting to favor energy production that does not emit greenhouse gases. However, the cases above leave open the possibility that courts may expand on what constitutes an existing use and a "reasonable . . . industry accepted alternative" for a mineral lessee to give wind law practitioners more room to negotiate and argue when dealing with parties holding severed mineral interests.[92] Further, as this Article will discuss in the next section, the Texas Supreme Court's willingness to apply the accommodation doctrine to severed ownership interests other than oil and gas may indicate that a severed wind estate can receive the same protections under the doctrine as a severed mineral estate, should Texas courts decide to recognize it.[93]

V. COMPARABLE FUGACIOUS RESOURCES

Currently, there is a question as to whether the law allows parties to sever their wind rights as a result of reservations and conveyances of wind rights in Texas deeds, and surface owners will undoubtedly challenge these deeds in the future.[94] Depending on how Texas law decides to approach the severance issue these deeds present, they may create another avenue, aside from the dominant-servient estate and accommodation doctrines, for wind developers to deal with severed mineral interests. As stated earlier, Texas law considers the mineral estate to be the dominant estate and the surface estate to be the servient estate.[95] Though, "dominant" does not mean superior; it just means benefitted.[96] If Texas law recognized a separate wind estate benefits from the surface estate, similar to a mineral estate, then it follows that a severed wind estate is equal in dignity to the mineral estate.[97] It would be illogical for a person to own the wind rights to a property and not have the benefit of accessing them; but because Texas law is silent on whether parties

90. *Id.*
91. Coyote Lake Ranch, LLC v. City of Lubbock, 498 S.W.3d at 63.
92. *Merriman*, 407 S.W.3d at 249.
93. *See infra* Part V.
94. Ernest E. Smith & Becky H. Diffen, *Winds of Change: The Creation of Wind Law*, 5 TEX. J. OF OIL GAS & ENERGY L. 165, 176 (2010).
95. *Coyote Lake Ranch*, 498 S.W.3d at 60.
96. *Id.*
97. Duvivier & Wetsel, *supra* note 17, at § 9.06.

can sever wind rights from the surface estate, it may be necessary for practitioners to look at the law of other states and analogous bodies of law in Texas to settle disputes especially considering cases like *Coyote Ranch, LLC*.[98] The same public policies that support and encourage mineral owners to convey and develop their estates should apply to wind energy owners.[99] Because the law allows parties to sever the mineral estate from the surface, and a surface owner may have to endure the mineral estate's use of the surface in a way that is adverse to their interests, freedom to contract dictates surface owners should also be allowed to contract with wind developers, even if there is oil production on the property.

One analogous body of law that Texas courts may rely on is oil and gas law. There are many parallels between oil and gas and wind production that indicate the law should allow the surface owner to place turbines on their property, even though there is already oil and gas production. One example is the rule of capture and the law's treatment of oil and gas as a fugacious resource. While wind is more of a fugacious resource, the body of case law surrounding the rule of capture may be applicable.[100] The rule of capture operates to encourage development of oil and gas because it states that the landowner acquires title to oil and gas produced from wells on their land, even if that oil and gas migrated underneath the property from adjoining lands.[101] Texas courts have operated under the rule of capture for oil and gas for approximately a century.[102] It follows that Texas courts should allow surface owners to operate under the same rules as oil and gas. A landowner precluded from entering into a wind lease because of a pre-existing mineral lease may lose the ability to produce wind energy on their property if wind developers decide to place wind turbines upwind of a particular tract, disrupting the wind flow across the property. Therefore, it is important for attorneys to understand how these two types of leases interact, so that parties can reach compromises to ensure their respective uses of the surface and the subsurface of the land are as efficient as possible and do not generate unnecessary waste, as the availability of untapped land suitable for energy production decreases in the future.

Commentators such as Lisa Chavarria, Terry Hogwood, and Ernest Smith have explained that the comparison of wind to oil and gas, or even groundwater in regard to the rule of capture, is not perfect because a company cannot physically reduce the wind to its possession.[103] Rather, they find that wind is reduced to possession when the wind energy turns the turbines and

98. Lisa Chavarria, *Wind Power: Prospective Issues*, 68 TEX. B.J. 832, 834–35 (2005).

99. *See Lyle*, 618 S.W.3d at 862 (stating that public policy favors adding renewable energy to the state's energy portfolio); Duvivier & Wetsel, *supra* note 17, at § 9.04.

100. Chavarria, *supra* note 98, at 837 (comparing wind ownership to mineral ownership in the event Texas allows severance of wind rights).

101. *See* Elliff v. Texon Drilling Co., 146 Tex. 575, 581–82, 210 S.W.2d 558, 561 (1948).

102. Stephens Cnty. v. Mid-Kansas Oil & Gas Co., 113 Tex. 160, 167, 254 S.W. 290, 291 (1923).

103. Chavarria, *supra* note 98, at 835.

generates electricity.[104] Commentators have suggested that wind is more akin to wild animals or percolating groundwater.[105] In that case, the wind would be the property of the state until it is reduced to possession, but such a designation requires a legislative enactment.[106]

VI. CONCLUSION

In conclusion, the only current recourse available to a wind developer dealing with a pre-existing mineral estate surface is through the common law dominant-servient estate doctrine.[107] However, fluctuations in public policy may prompt a change in the common law approach to give renewable energy developers more room to argue, if a conflict does arise in the future. The Texas Supreme Court has shown signs that it is amenable to altering the common law approach in regard to the surface estate. But, for now, oil is still king in Texas.

104. *Id.*

105. *See id.*; *see also* Smith, *supra* note 42, at 300–01 (citing *State v. Bartee*, 894 S.W.2d 34, 46 (Tex. App.—San Antonio 1994, no pet.)); Fain v. Good Springs Waters of Am., Inc., 1 S.W.3d 75 (Tex. 1999).

106. *See* Smith, *supra* note 42, at 300–01.

107. Atlantic Refin. Co. v. Bright & Schiff, 321 S.W.2d 167, 169 (Tex. App.—San Antonio 1959, writ ref'd).

PROJECT BASICS AND RENEWED CONSIDERATIONS FOR TEXAS NUCLEAR ENERGY

Ben Casey[*]

In recent years, there has been an organized push for further development and use of renewable sources of energy. Undoubtedly, many of the voices behind this push are motivated by political views or out of concerns for sustainability. Often, the primary focus has revolved around policy preferences to produce traditional energy sources and wind and solar, with other sources of energy taking a back seat. While acknowledging this reality, this Comment does not champion a partisan policy. Instead, it serves as a primer on the requirements for building new nuclear energy projects, analyzing various factors that project developers should consider, including emerging technologies. Nuclear energy production has existed for decades and is currently coming back as a reliable, low-emission option. This paper expands the current discussion surrounding nuclear energy for a practical application to project development in Texas. No doubt existing federal regulations and the recently enacted Inflation Reduction Act of 2022 play a critical role in deciding whether to develop nuclear projects. Therefore, although focused on applicability in Texas, by necessity, it is national in scope.

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I. INTRODUCTION

Current geopolitical challenges and national domestic energy policies have reinvigorated discussions of energy production outside of oil and gas or wind and solar.[1] With Russia's war in Ukraine and domestic energy policies impacting oil and gas production, renewable energy advocates are scrutinizing other sources of energy production.[2] The United States is poised to increase its domestic energy portfolio in sustainable and renewable energy sources, thanks in large part to emerging technologies that allow for cheaper production.[3] Although a decrease in oil and gas production is not foreseeable in the near future, United States wind and solar projects have been increasing in size and scope in recent years, setting the stage for a boost in alternative energy projects.[4] In light of these recent developments, nuclear energy in Texas warrants new and further attention.[5]

This Comment aims to outline and introduce practicing attorneys and developers to the basics of developing and operating nuclear projects in Texas.[6] Part II of this Comment discusses the existing oil and gas industry, the recent monumental achievements of the wind and solar industry, and how nuclear energy sources can supplement energy exploration and production.[7] Part III focuses on the requirements for new nuclear projects, such as permitting, licensing, land requirements, costs, and similar considerations.[8] Lastly, Part IV looks ahead to the capability of nuclear energy to be a decisive force in meeting our expanding energy needs in the United States.[9]

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1. *See* Lincoln Pratson, *Ukraine War's Supply Chain Impacts Bust Myth of U.S. Energy Independence*, DUKE UNIV. (June 13, 2022), https://nicholas.duke.edu/news/ukraine-wars-supply-chain-impacts-bust-myth-us-energy-independence.
2. *Id.*
3. *See* Dan Gearino, *Renewable Projected to Soon Be One-Fourth of US Electricity Generation. Really Soon*, INSIDE CLIMATE NEWS (Jan. 19, 2023), https://insideclimatenews.org/news/19012023/inside-clean-energy-us-renewables-generation/#:~:text=From%202023%20to%202024%2C%20renewables,be%20unchanged%20at%2019%20percent.
4. *See id.*
5. *Id.*
6. *See infra* Part II–IV.
7. *See infra* Part II.
8. *See infra* Part III.
9. *See infra* Part IV.

II. IT'S PRONOUNCED "NU-CULAR": THE LONGSTANDING ALTERNATIVE ENERGY SOURCE

Due to its moderate climate, general lack of business regulation, and healthy job market, Texas is a favorable destination for individuals and businesses.[10] As a result, the demand for energy generation in Texas continues to rise.[11] Nearly four million residents have made Texas home in the past decade alone.[12] Last year, the statewide population exceeded 29.5 million people, and in the past two years, more than sixty-three companies have made plans to relocate to the state.[13] Coupled with continued growth is the higher demand for energy, and if met with diverse energy generation sources, production can remain consistent and reliable in a variety of conditions.[14]

A. More Is Better: Supplementing Energy Exploration and Production

Traditional energy is *not* going away.[15] New techniques and technological resources have resulted in the discovery of more reservoirs and, in turn, the recovery of more oil and gas than ever before.[16] Estimates indicate that the Permian Basin alone will "contribute up to $260 billion in gross product and more than 1 million jobs to the nation's economy."[17]

In areas of prior exploration and production, geologists and engineers agree that a large portion of available oil is still left behind.[18] According to

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10. *Business Climate*, TEX. ECON. DEV., https://gov.texas.gov/business/page/business-climate (last visited Feb. 19, 2023).

11. Tex. Comptroller of Pub. Accts., *Texas' Energy Profile: A Review of the State's Current Traditional and Renewable Energy Capabilities*, COMPTROLLER.TEX.GOV: FISCALNOTES (Sept. 2022), https://comptroller.texas.gov/economy/fiscal-notes/2022/sep/energy.php.

12. *Id.*

13. *Id.*

14. *See id.*

15. Irina Slav, *Fossil Fuels Aren't Going Away Anytime Soon*, OILPRICE.COM (May 1, 2022), https://oilprice.com/Energy/Crude-Oil/Fossil-Fuels-Arent-Going-Away-Anytime-Soon.html.

16. *See* Ryan Sitton, *Texas Oil, Gas Production Disrupting Global Energy Landscape, Requires New Mindset*, DRILLING CONTRACTOR (Nov. 7, 2017), https://www.drillingcontractor.org/guest-editorial-texas-oil-gas-production-disrupting-global-energy-landscape-requires-new-mindset-44781 (discussing hydraulic fracturing and the shale boom); Communications & Publishing, *USGS Identifies Largest Continuous Oil and Gas Resource Potential Ever*, USGS (Nov. 28, 2018), https://www.usgs.gov/news/national-news-release/usgs-announces-largest-continuous-oil-assessment-texas-and-new-mexico (estimating vast amounts of newly-discovered recoverable oil and gas resources); Ian Palmer, *The King of Shale Oil, the Permian Basin, is Still Riding the Wave*, FORBES: ENERGY (Mar. 30, 2022, 8:25 PM), https://www.forbes.com/sites/ianpalmer/2022/03/30/the-king-of-shale-oil-the-permian-basin-is-still-riding-the-wave/?sh=39dc1b9f6ebf (detailing how horizontal drilling and fracking allows for renewed production of oil and gas).

17. *Report Claims Permian Basin Will Contribute Nearly 1 Million Jobs by 2050*, HART ENERGY (Aug. 30, 2022, 12:30 PM), https://www.hartenergy.com/exclusives/report-claims-permian-basin-will-contribute-nearly-1-million-jobs-2050-201872.

18. U.S. DEP'T OF ENERGY, FOSSIL ENERGY STUDY GUIDE: OIL 1, https://www.energy.gov/sites/prod/files/2013/04/f0/HS_Oil_Studyguide_draft2.pdf (last visited Feb. 18, 2023).

the U.S. Department of Energy, "more than 195 billion barrels of oil have been produced[,] but more than 400 billion barrels have been left in the ground."[19]

Future technological developments might make it possible to recover previously unproduced oil.[20] Techniques for enhanced oil recovery (EOR) include gas injection, chemical injection, and waterflooding.[21] In order to force oil out of rock pores, "injection wells" are used to push water into the formation in a procedure known as "waterflooding."[22] Gas injection utilizes natural gas, nitrogen, or carbon dioxide to expand in formations, pushing oil out; alternatively, some gases dissolve in the oil, lowering its viscosity and allowing it to flow to the wellbore.[23] Clearly, we are not running out of oil; but to meet the rising demand, the United States, and Texas in particular, need additional energy sources.[24]

In 2007, wind accounted for only 3% of all the energy generated in Texas.[25] Since then, Texas has become the nation's leader in wind-powered electricity generation, to the point that in 2021, Texas produced nearly 26% of all wind energy in the United States.[26] By mid-2022, Texas generated 73,641 megawatts of wind energy, an astounding 28.9% increase from a year before.[27] Given these vast increases in oil, gas, and wind energy production, how might nuclear energy projects fit into Texas' future energy mix?

Simply stated, nuclear power is potential energy locked up in the nucleus of atoms.[28] Using high-speed neutrons for fission (splitting of the atoms) causes a chain reaction that generates enormous heat that is used to create steam and drive turbines, generating electricity.[29] The result "is an emissions free source of power that is considered to be a safe, reliable and affordable way to meet the state's rapid population growth without polluting the air."[30]

Texas contributes approximately 5% to the nation's total nuclear power generation capacity, placing it among the top ten states nationally.[31]

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19. *Id.* at 3.
20. *See id*. at 3–4.
21. *Id.* at 3–4.
22. *Id.*
23. *Id.*
24. Fiscal Notes Staff, *Texas' Energy Profile*, COMPTROLLER.TEX.GOV: FISCALNOTES (Sept. 2022), https://comptroller.texas.gov/economy/fiscal-notes/2022/sep/energy.php.
25. U.S. DEP'T OF ENERGY, ANNUAL REPORT OF U.S. WIND POWER INSTALLATION, COST, AND PERFORMANCE TRENDS: 2007 7 (May 2008), https://www.nrel.gov/docs/fy08osti/43025.pdf.
26. *Texas' Energy Profile*, *supra* note 11.
27. U.S. Energy Info. Admin., *Electric Power Monthly*, EIA tbl.1.14.B, https://www.eia.gov/electricity/monthly/epm_table_grapher.php?t=table_1_14_b (last updated Jan. 2023).
28. Nuclear Energy Inst., *What is Nuclear Energy?*, NEI, https://www.nei.org/fundamentals/what-is-nuclear-energy (last visited Feb. 18, 2023).
29. *Id.*
30. *The State of Nuclear Energy in Texas*, STATEIMPACT, https://stateimpact.npr.org/texas/tag/nuclear-energy-in-texas/ (last visited Feb. 18, 2023).
31. *Id.*

According to the U.S. Energy Information Administration (EIA), nuclear energy encompasses "less than 5% of Texas's total electric capacity, but produces almost 10% of the state's electricity, third behind natural gas and coal."[32] The state's two nuclear power plants at the South Texas Project (STP) near Bay City and Comanche Peak Nuclear Power Plant near Glen Rose generate approximately 60% of Texas' total emission-free power.[33]

B. Diversifying Energy Production

Nuclear energy exhibits several benefits over traditional and renewable energy sources. For example, a single pound of uranium produces up to three *million* times more energy than a pound of coal.[34] Also, nuclear energy is cleaner than oil and gas.[35] Compared to wind and solar, nuclear has a tiny footprint, requiring much less land and fewer materials to produce equivalent energy output.[36] However, where access to low-cost fossil fuels exists, new nuclear production is currently not cost-competitive.[37] Recent federal legislation aims to lower production costs to help make these energy sources competitive in the marketplace and to incentivize future projects.[38]

A large benefit of nuclear power over traditional and renewable energy sources in Texas is that nuclear power plants (NPPs) "are always on: well-operated to avoid interruptions and built to withstand extreme weather, supporting the grid 24/7."[39] "The benefits of nuclear energy extend far beyond carbon-free electricity, too. Nuclear powers space exploration, sterilizes medical equipment, provides potable water through desalination, supplies radioisotopes for cancer treatment, and much more."[40] Further, nuclear energy is uniquely valuable because it protects national security, ensures United States leadership in technology, produces reliable electricity, creates jobs, protects air quality, boosts international development, and can even power electric vehicles.[41]

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32. *Id.*

33. *Id.*; Lisa Minton, *Texas' Electricity Resources*, COMPTROLLER.TEXAS.GOV (Aug. 2020), https://comptroller.texas.gov/economy/fiscal-notes/2020/august/ercot.php.

34. *How Nuclear Power Works*, UNION OF CONCERNED SCIENTISTS: EXPLAINER, https://www.ucsusa.org/resources/how-nuclear-power-works (last updated Jan. 29, 2014).

35. *3 Reasons Why Nuclear is Clean and Sustainable*, U.S. DEP'T OF ENERGY, OFF. OF NUCLEAR ENERGY, https://www.energy.gov/ne/articles/3-reasons-why-nuclear-clean-and-sustainable (last updated June 2022).

36. *Id.*; *see also* Jared Wolf, *Nuclear Energy is Better than Solar and Wind*, SUSTAINABLE REV. (Feb. 6, 2023), https://sustainablereview.com/nuclear-energy-is-better-than-solar-and-wind/.

37. *Economics of Nuclear Power*, WORLD NUCLEAR ASS'N, https://world-nuclear.org/information-library/economic-aspects/economics-of-nuclear-power.aspx (last updated Aug. 2022); *see infra* Section III.A (explaining available tax credits within the Inflation Reduction Act).

38. *See Hydrogen Benefits and Considerations*, U.S. DEP'T OF ENERGY: ALT. FUELS DATA CTR, https://afdc.energy.gov/fuels/hydrogen_benefits.html (last visited Feb. 20, 2023).

39. *What is Nuclear Energy?*, *supra* note 28.

40. *Id.*

41. *Id.*

The biggest drawback for nuclear projects is that startup costs are expensive.[42] Also, NPPs have come under "increasing economic pressure due to the historically low cost of natural gas and the correspondingly low operating costs of natural-gas combined-cycle power plants, combined with an increase in renewable-energy capacity (specifically solar and wind) on the power grid."[43]

Another notable disadvantage is the inherent risk associated with nuclear reactors. On March 11, 2011, an earthquake and tsunami struck Japan, leading to the second-worst nuclear power accident in history.[44] The tsunami caused flooding at the Fukushima Daiichi nuclear power plant, destroying backup generators designed to pump cooling water through the reactor.[45] Consequently, over the course of the next three days, three cores largely melted, causing several explosions and releasing radioactive material into the atmosphere.[46] Public opinion and support for nuclear energy declined, despite the fact that there were no deaths or incidents of radiation sickness as a result of the meltdown.[47]

III. PROJECT CONSIDERATIONS

Texas is the national leader in energy production and has proved to be a worthwhile destination for wind and solar developers. Increased demand from population and industry presents an opportunity for new, non-traditional energy projects. The requirements for a nuclear project are dependent on the size and scope of a particular project. For this reason, this section provides an overview of various aspects to consider when creating a new nuclear project in Texas.

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42. *See* discussion *infra* Section III.A.4 (detailing various startup costs).

43. LIGHT WATER REACTOR SUSTAINABILITY, *Flexible Plant Operation and Generation*, LWRS, https://lwrs.inl.gov/SitePages/FlexiblePlantOperationGeneration.aspx (last visited Feb. 17, 2023).

44. *See What are the effects of nuclear accidents?*, WORLD NUCLEAR ASS'N, https://world-nuclear.org/nuclear-essentials/what-are-the-effects-of-nuclear-accidents.aspx (last visited Feb. 17, 2023) ("The earthquake and the ensuing tsunami resulted in the death of 19,729 people (with 2559 still missing) and devastated communities up and down the country.").

45. *Id.*

46. *Id.*

47. *See* Edwin Latré et al., *Public Opinion Change After the Fukushima Nuclear Accident: the Role of National Context Revisited*, 104 ENERGY POL'Y 124, 124 (2017) ("Public opinion studies conducted after Fukushima show that in most countries, support for nuclear energy decreased shortly after the accident."); Sci. Comm. on the Effects of Atomic Radiation, Rep. on the Work of Its Sixtieth Session, U.N. Doc. A/68/46, at 11–12 (2013) ("No radiation-related deaths or acute diseases have been observed among the workers and general public exposed to radiation from the accident . . . . No discernible increased incidence of radiation-related health effects are expected among exposed members of the public or their descendants.").

A. Setting Up

The process to set up a nuclear project varies on the size and scale of the project. However, all projects require real estate, agreements with either private landowners or state entities, and compliance with state or federal regulations. Within these requirements, the developer must consider how much land is needed for the location of a project, as well as the timeframe and total associated costs required for the project to become operational.

Nuclear power plants are highly regulated by the Nuclear Regulatory Commission (NRC) and require approval before any operations may begin. The NRC must approve any site for a nuclear power plant, pursuant to Title 10, Part 52 of the Code of Federal Regulations.[48] This process requires an application for an Early Site Permit.[49] As part of this process, the NRC considers several factors, which can reduce the number of potential suitable locations for the construction of a NPP.[50] Additionally, the NRC requires approval of a standard facility design.[51]

These requirements are generally satisfied through a combined license (COL).[52] Approval and issuance requires a review by the NRC, stakeholders, and the general public regarding the safety of the site and the plant, any effects on the environment, the plant's operational plan, and a determination that the proposed plant meets inspections, tests, analyses, and acceptance criteria (ITAAC).[53] Combined licenses are issued for a maximum of forty years with an option of a twenty-year renewal.[54] Given this timeframe and the initial capital investment to build and operate an NPP, owners would likely wish to purchase rather than lease the land on which a plant is built. The following sections discuss some additional considerations for starting new projects.

1. Operational Timeframe

It is unclear how long it takes to construct a functioning nuclear power plant. An application for a COL must contain both general and technical information, including financial qualifications, radiological emergency response plans, estimated construction completion, proposed inspections, tests, and analyses to be performed by the licensee, a final safety analysis

48. *See* 10 C.F.R. §§ 52.12–.39 (2022) (detailing the Early Site Permit process).

49. *Id.* § 52.26(a) (noting, early site permits are valid for ten to twenty years from the date of issuance).

50. *See id.* § 52.17 (detailing specific requirements of the early site permit application).

51. *See id.* § 52.47 (outlining the contents of a design certification application).

52. *Id.* § 52.1(a) ("'Combined license' means a combined construction permit and operating license with conditions for a nuclear power facility issued under subpart C of this part.").

53. *See id.* §§ 52.71–.110 (regulating combined licenses).

54. *Id.* §§ 52.104, 54.31.

report, and similar requirements.[55] Meeting these requirements to complete an application will depend on the applicant's motivation and resources.

The NRC is required to develop generic milestone schedules for "requested activit[ies] of the Commission," such as processing applications for design certifications, licenses, and permits.[56] Although each milestone schedule is project-specific and depends on an applicant's needs and the NRC staff's resources, the generic milestone to issue a combined license ranges from thirty to forty-two months.[57] A timeframe for plant construction depends on several factors, but will typically take over five years.[58]

2. Amount of Land Required

Of all energy sources, nuclear energy is the world's most efficient in land use.[59] In the United States, NPPs require "about 1.3 square miles per [one thousand] megawatts of installed capacity."[60] According to the U.S. Department of Energy, a typical nuclear facility produces 1,000 megawatts.[61] To satisfy an operator's objectives, however, new technologies in development provide for flexibility in the size of future facilities.[62]

3. Where to Locate?

Pursuant to 10 C.F.R. § 52, the NRC must approve siting for an NPP.[63] This process includes an application for an Early Site Permit.[64] Several criteria are considered during the siting process, which may restrict the

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55. *Id.* §§ 50.33, 52.77, 52.79, 52.80.

56. *See* Nuclear Energy Innovation and Modernization Act, Pub. L. No. 115–439, §§ 3(10), 102(c), 132 Stat. 5565, 5567, 5570–71 (2019).

57. *Generic Milestone Schedules of Requested Activities of the Commission*, U.S. NUCLEAR REGUL. COMM'N, https://www.nrc.gov/about-nrc/generic-schedules.html#ftnref3 (last updated Sept. 10, 2021) (noting, this is the "[t]ime it takes generically to issue a final safety evaluation for each activity after acceptance review is completed.").

58. *Economics of Nuclear Power*, *supra* note 37.

59. Hannah Ritchie, *How Does the Land Use of Different Electricity Sources Compare?*, OUR WORLD IN DATA (June 16, 2022), https://ourworldindata.org/land-use-per-energy-source (stating, "per unit of [nuclear] electricity needs 50-times less land compared to coal; and 18 to 27-times less than on-ground solar PV").

60. Nuclear Energy Inst., *Land Needs for Wind, Solar Dwarf Nuclear Plant's Footprint*, NEI (July 9, 2015), https://www.nei.org/news/2015/land-needs-for-wind-solar-dwarf-nuclear-plants.

61. *See Economics of Nuclear Power*, *supra* note 37; *see also id.*

62. *Advanced Small Modular Reactors (SMRs)*, U.S. DEP'T OF ENERGY, https://www.energy.gov/ne/advanced-small-modular-reactors-smrs (last visited Feb. 21, 2023) (noting, the development of Advanced Small Modular Reactors (SMRs) has a number of benefits, including relatively modest physical footprints, lower capital expenditures, the flexibility to be sited in regions where larger nuclear facilities are impractical, and options for supplemental power generation); *see also* U.S. DEP'T OF ENERGY, OFF. OF NUCLEAR ENERGY, *supra* note 35, (adding, SMRs have unique benefits in terms of security, nonproliferation, and safeguards).

63. *See* 10 C.F.R. §§ 52.12–.39 (2022) (detailing the Early Site Permit process).

64. *Id.*

potential locations for a feasible NPP. Staff of the NRC, in evaluating site selection suitability, have noted the following:

> Selecting a suitable site for a nuclear power station may require a significant commitment of time and resources, including safety and environmental considerations. Site selection involves consideration of the human environment, public health and safety, engineering and design, economics, institutional requirements, environmental impacts, and other factors. The potential impacts of the construction and operation of nuclear power stations on the human environment and on social, cultural, and economic features (including environmental justice) are usually similar to the potential impacts of any major industrial facility, but nuclear power stations are unique in the degree to which potential impacts of the environment on their safety must be considered. The safety requirements are primary determinants of the suitability of a site for nuclear power stations, but environmental impacts are also important and need to be evaluated.[65]

Site safety factors for conventional NPPs include: geology, seismology, atmospheric dispersion, exclusion zones, "low-population zones, population concerns, emergency planning, security, flooding, water availability, and industrial, military, and transportation facilities."[66] Environmental protection factors for conventional NPPs include the preservation of important habitats, migratory routes of important species, entrainment and impingement of aquatic organisms, entrapment of aquatic organisms, water quality, water availability, established public resource areas, prospective designated resource areas, public planning, visual resources, local fogging and icing, cooling tower drift, cooling tower plume lengths, plume interaction, noise, socioeconomic impacts, and environmental justice.[67] It is advised that project developers abide by these NRC factors to maximize their chances of winning NRC license approval.

4. Costs

Although expensive to develop, nuclear power facilities are relatively inexpensive to operate.[68] As a source of electricity, nuclear energy competes with fossil fuels in many locations.[69] Costs associated with waste removal and decommissioning are typically factored into the initial operating expenses. The competitiveness of nuclear power is increased when the social,

65. U.S. NUCLEAR REGUL. COMM'N, OFF. OF NUCLEAR REGUL. RSCH., NRC-2011-0297, GENERAL SITE SUITABILITY CRITERIA FOR NUCLEAR POWER STATIONS (2014), https://www.nrc.gov/docs/ML1218/ML12188A053.pdf.

66. *Id.* app. A.

67. *Id.* app. B.

68. *Economics of Nuclear Power*, *supra* note 37 (adding, in other words, once a nuclear power station is built, the cost of producing electricity is cheap and predictable).

69. *Id.*

health, and environmental costs associated with using fossil fuels are also considered.[70]

The levelized cost of energy (LCOE) serves as the fundamental economic metric for each generating station.[71] The LCOE "models the cash flows of a plant over its construction period and operational lifetime and determines the average price of electricity (in cents per kilowatt-hour of electricity generated) required for the plant to break even when accounting for investment costs, operational costs, and a market return to investors."[72] Once operational, nuclear power has lower running costs than practically every other fossil fuel, and there is very little chance of operating-cost inflation.[73]

Another struggle for nuclear power is its high discount rate in discounted cash flow (DCF) analyses.[74] Discount rate is a factor in determining the total cost of energy and accounts for project capital expenditures.[75] In fact, the LCOE "estimates for nuclear are highly sensitive to the choice of discount rate."[76] Because nuclear power has higher construction costs than coal—or natural gas—fired reactors, it is more adversely affected by the discount rate.[77] "The discount rate for nuclear building projects in the United States is typically 12.5%, which is higher than that of many other countries, especially those with nuclear" subsidies.[78] "The median cost of coal and natural gas are both lower than nuclear energy at the current discount rate[,]" but "at a discount rate of 3%, nuclear energy is the

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70. *Id.*

71. *Id.*

72. David Kemp & Peter Van Doren, *Would a Carbon Tax Rejuvenate Nuclear Energy?*, REGULATION 26, 29 (Fall 2022), https://www.cato.org/sites/cato.org/files/2022-09/regulation-v45n3-8.pdf.

73. *Economics of Nuclear Power*, *supra* note 37; in 2020, nuclear fuel cost 0.61 cents/kWh compared to 2.29 cents/kWh for fossil steam. *Nuclear Explained: U.S. Nuclear Statistics*, U.S. ENERGY INFO. ADMIN., https://www.eia.gov/energyexplained/nuclear/data-and-statistics.php (last updated July 12, 2022).

74. *See* Adam Hayes, *Discount Rate*, INVESTOPEDIA, https://www.investopedia.com/terms/d/discountrate.asp (last updated Aug. 29, 2021); Jason Fernando, *Discounted Cash Flow (DCF) Explained with Formula and Examples*, INVESTOPEDIA, https://www.investopedia.com/terms/d/dcf.asp (last updated Aug. 10, 2022) (Using a discount rate—the interest rate that is used to measure the time value of money); Eliot Cassel, *What is Discounted Cash Flow?*, XTRINFO (Aug. 16, 2022), https://xtrinfo.com/financial-questions/what-is-discounted-cash-flow/ ("discounted cash flow analysis determines the present value of anticipated future cash flows. The idea of the present value of money can be used by investors to assess whether the future cash flows of a project or investment will be more valuable than the initial investment."). Therefore, whether or not an investment project is financially viable can depend on the discount rate.

75. Daria Iurshina et al., *Why nuclear power plants cost so much—and what can be done about it*, BULL. OF THE ATOMIC SCIENTISTS (June 20, 2019), https://thebulletin.org/2019/06/why-nuclear-power-plants-cost-so-much-and-what-can-be-done-about-it/.

76. David Kemp & Peter Van Doren, *Nuclear Power in the Context of Climate Change* 43 (Cato Inst., Working Paper No. 68, 2022), https://www.cato.org/sites/cato.org/files/2022-07/working-paper-68-revised-3.pdf.

77. Daria Iurshina et al., *supra* note 75.

78. *Id.*

most" cost-effective choice.[79] However, reaching this number may not be possible, without significant changes; as one study aptly summarized: "After seventy years and billions of dollars in federal subsidies, nuclear would still require a specific set of circumstances—either a high natural gas price or additional government intervention through an excessive carbon tax—to be cost competitive with natural gas."[80]

In August 2022, President Biden signed the Inflation Reduction Act (IRA) into law,[81] which increases subsidies to new nuclear facilities through two tax credit alternatives, a production tax credit (PTC) and an investment tax credit (ITC).[82] Each credit has a standard credit level and a higher credit level for plants that satisfy specific wage and apprenticeship requirements.[83]

The PTC applies to existing nuclear power plants "to help preserve the existing fleet of nuclear plants."[84] A scaling rate based on the facility's gross income is included in the credit, which starts at 0.3 cents per kWh; if this amount exceeds the reduction amount, calculated at "80% times [gross receipts — (2.5 cents X kWhs)][,]" the credit is reduced.[85] To qualify for the PTC, an NPP must have been in service prior to the IRA's enactment and must sell any produced electricity "during the taxable year" (after December 31, 2023).[86] In addition, the Act provides for increased credit amounts—by a factor of five—if certain labor and wage requirements are met.[87] This would increase the base PTC amount to 1.5 cents per kWh, but the credit declines as average electricity prices exceed 2.5 cents per kWh.[88] The PTC ends on December 31, 2032.[89]

Although not specifically named, the ITC applies to advanced nuclear reactors producing clean electricity.[90] This credit allows for 30% of

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79. *Id.*; *see* INT'L ENERGY AGENCY & OECD NUCLEAR ENERGY AGENCY, PROJECTED COSTS OF GENERATING ELECTRICITY 3 (2020), https://iea.blob.core.windows.net/assets/ae17da3d-e8a5-4163-a3ec-2e6fb0b5677d/Projected-Costs-of-Generating-Electricity-2020.pdf ("With a low discount rate of 3%, reflecting a stable market environment with high investment security, the LCOE of new nuclear plants is lower than for new coal and gas plant[s].").

80. Kemp & Van Doren, *supra* note 76, at 90.

81. Inflation Reduction Act, Pub. L. No. 117–169, 136 Stat. 1929 (2022).

82. *Id.* at 1929–31.

83. *Id.* at 1931, 1993.

84. U.S. DEP'T OF ENERGY: OFF. OF NUCLEAR ENERGY, *Inflation Reduction Act Keeps Momentum Building for Nuclear Power*, (Sept. 8, 2022), https://www.energy.gov/ne/articles/inflation-reduction-act-keeps-momentum-building-nuclear-power.

85. Inflation Reduction Act § 13105, 136 Stat. at 1930; *Summary of the Nuclear-Related Provisions in the Inflation Reduction Act of 2022*, HOGAN LOVELLS (Aug. 1, 2022), https://www.engage.hoganlovells.com/knowledgeservices/news/summary-of-the-nuclear-related-provisions-in-the-inflation-reduction-act-of-2022.

86. Inflation Reduction Act § 13105, 136 Stat. at 1929.

87. *Id.* at 1931.

88. Rob O'Neill et al., *An Overview of Clean Energy Tax Legislation in the Inflation Reduction Act*, MOSS ADAMS (Aug. 26, 2022), https://www.mossadams.com/articles/2022/08/inflation-reduction-act-clean-energy-credits#section-45u.

89. Inflation Reduction Act § 13105, 136 Stat. at 1931.

90. *Id.* § 13702, 136 Stat. at 1990.

investment costs for new zero-carbon NPPs placed in operation in 2025 or later.[91] Subject to domestic content requirements (e.g., using U.S.-produced materials), an NPP is eligible for a 10% point bonus credit, raising the ITC to 40%.[92]

A recent study by the Cato Institute considered whether the IRA's tax credits are enough to incentivize new nuclear projects.[93] The authors note that the IRA "does nothing to address the underlying cost problem with nuclear power."[94] The study determined that, on average, the construction cost is "$9,000 per kilowatt of capacity constructed."[95] Nuclear power can compete with coal if construction costs are low. However, given the current estimated average NPP cost of construction and all predicted natural gas prices, nuclear power is significantly more expensive than natural gas combined cycle (NGCC) power plants.[96] The study concluded that the tax credits "are not sufficient to change the economics of nuclear power" and that "[e]ven with the IRA subsidies and even if nuclear construction costs were [sixty-five] percent less than the current costs of the [most recently constructed NPP], NGCC plants would still be cheaper unless natural gas prices remain historically high for decades."[97] While this assessment is discouraging, new technologies are being developed that may change the profitability for new nuclear projects in the near future.[98]

B. Energy Production Levels

If the energy produced by any energy project cannot be sold for a profit, then pursuing it simply does not make sense. The predicted production output and the viability of that production are two crucial variables to consider in any project.

Typically, each United States-based NPP generates about one gigawatt of energy annually.[99] In 2021, Texas NPPs produced 40,211 gigawatthours

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91. *Id.*

92. *Id.* at 1988; O'Neill et al., *supra* note 88.

93. David Kemp & Peter Van Doren, *Subsidies to Nuclear Power in the Inflation Reduction Act*, CATO INST. (Sept. 28, 2022, 12:35 PM), https://www.cato.org/blog/subsidies-nuclear-power-inflation-reduction-act.

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.*; *see also* Ellen. R. Wald, *Profitable Nuclear Plants Don't Need Subsidies — Put The Money Toward New Technologies*, HILL: OPINION (Dec. 22, 2021, 12:30 PM), https://thehill.com/opinion/energy-environment/586260-profitable-nuclear-plants-dont-need-subsidies-put-the-money-toward/ (noting, the Act has been criticized for subsidizing profitable NPPs instead of incentivizing new technologies).

98. *See* discussion, *infra* Part IV (considering the viability of small modular reactors).

99. *How Much Power Does A Nuclear Reactor Produce?*, U.S. DEP'T OF ENERGY, OFF. OF NUCLEAR ENERGY (Mar. 31, 2021), https://www.energy.gov/ne/articles/infographic-how-much-power-does-nuclear-reactor-produce (noting, this is the equivalent of 3.125 million solar panels, or 431 utility-scale (2.32 MW) wind turbines); *see also id.*

of energy.[100] Although nuclear fuel generation costs become profitable once a plant is operational,[101] the high capital cost per one thousand watts of electric capacity, or kilowatt-electric (kWe), makes traditional plant construction impractical.[102] Unsurprisingly, and as is the case with energy production in general, constructing a new NPP is not economically feasible without considerable subsidies, but emerging technologies may significantly lower the high construction costs needed to justify new reactor production.

C. Longevity

Nuclear power plants can operate for sixty years or more.[103] Operators may apply for renewal of the initial forty-year license for additional twenty-year terms.[104] The NRC regulations do not limit the number of renewals, and each renewal is subject to a review of the NPP's ability to operate safely during the renewal period.[105] To date, eighty-eight of the ninety-two American NPPs have been approved for initial license renewal.[106]

Extending the life of a nuclear reactor beyond sixty years is uncharted territory, but the NRC has issued guidance on reviewing subsequent license renewal (SLR) applications.[107] Additionally, in 2010 the Light Water Reactor Sustainability (LWRS) Program was established by the Department of

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100. U.S. Energy Info. Admin., *Electric Power Monthly*, EIA tbl.1.9.B., https://www.eia.gov/electricity/monthly/epm_table_grapher.php?t=table_1_09_b (last updated Jan. 2023); U.S. Energy Info. Admin., *Gigawatthour (GWh)*, EIA, https://www.eia.gov/tools/glossary/index.php?id=G (last visited May 1, 2023) ("One billion watthours."); U.S. Energy Info. Admin., *Watthour (Wh)*, EIA, https://www.eia.gov/tools/glossary/index.php?id=W (last visited May 1, 2023) ("The electrical energy unit of measure equal to one watt of power supplied to, or taken from, an electric circuit steadily for one hour.").

101. *See Economics of Nuclear Power*, *supra* note 37.

102. U.S. Energy Info. Admin., *Kilowatt-electric (kWe)*, EIA, https://www.eia.gov/tools/glossary/index.php?id=k (last visited Feb. 17, 2023); *see also* U.S. ENERGY INFO. ADMIN., CAPITAL COST AND PERFORMANCE CHARACTERISTIC ESTIMATES FOR UTILITY SCALE ELECTRIC POWER GENERATING TECHNOLOGIES tbl.2 (Feb. 2020), https://www.eia.gov/analysis/studies/powerplants/capitalcost/pdf/capital_cost_AEO2020.pdf (estimating the overnight cost for new U.S. NPPs at $6,041 per kilowatt-electric); *see also Economics of Nuclear Power*, *supra* note 37 ("The overnight cost is the capital cost exclusive of financing charges accruing during the construction period. The overnight cost includes engineering, procurement and construction (EPC) costs, owners' costs (land, cooling infrastructure, associated buildings, site works, switchyards, project management, licenses, etc.) and various contingencies.").

103. *Economics of Nuclear Power*, *supra* note 37.

104. 10 C.F.R. pt. 54 (2022) (adding, these renewals mean that nuclear licenses can last longer than wind or solar leases).

105. *Subsequent License Renewal Background*, U.S. NUCLEAR REGUL. COMM'N, https://www.nrc.gov/reactors/operating/licensing/renewal/slr/background.html (last updated May 18, 2022) (noting, the review consists of both environmental and safety criteria in 10 C.F.R. pts. 51 and 54, respectively); *see also id.*

106. *Status of Initial License Renewal Applications and Industry Initiatives*, U.S. NUCLEAR REGUL. COMM'N, https://www.nrc.gov/reactors/operating/licensing/renewal/applications.html (last updated Nov. 1, 2022).

107. U.S. NUCLEAR REGUL. COMM'N, NUREG-2192, STANDARD REVIEW PLAN FOR REVIEW OF SUBSEQUENT LICENSE RENEWAL APPLICATIONS FOR NUCLEAR POWER PLANTS (2017), https://www.nrc.gov/docs/ML1718/ML17188A158.pdf.

Energy to conduct research into topics that would support the long-term operation of nuclear reactors.[108] The LWRS Program includes five research and development "pathways: plant modernization, flexible plant operation and generation (FPOG), risk-informed systems analysis, materials research, and physical security."[109] Both plant modernization and FPOG pathways address the economic viability and revenue generation of NPPs.[110]

IV. WHAT THE FUTURE OF NUCLEAR HOLDS FOR OUR ENERGY NEEDS

Technological innovation provides new potential for meeting our growing energy needs. Small modular reactors (SMRs) make nuclear more scalable and flexible because these are miniature reactors that are roughly one-third of a standard reactor size and designed to generate 300 megawatt electrical (MWe) or less.[111]

In August 2020, the NRC issued the first-ever final safety evaluation report (FSER) for an SMR.[112] The final rule was subsequently published on January 19, 2023 and became effective on February 21, 2023.[113] The certification of NuScale's SMR design means that

> the NRC has determined a nuclear power plant design meets all its applicable safety requirements, independent of an application to construct or operate a plant. Any subsequent application for a combined construction and operating [license] referencing that design will not need to address any of the issues already covered by the design certification, but will instead address remaining site-specific safety and environmental issues for the proposed plant.[114]

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108. *Status of Subsequent License Renewal Applications*, U.S. NUCLEAR REGUL. COMM'N, https://www.nrc.gov/reactors/operating/licensing/renewal/subsequent-license-renewal.html (last updated Sept. 9, 2022) (noting, so far, fifteen NPPs have applied for a SLR).

109. Light Water Reactor Sustainability, *About*, LWRS, https://lwrs.inl.gov/SitePages/About.aspx (last visited Feb. 17, 2023).

110. *See* Light Water Reactor Sustainability, *Plant Modernization*, LWRS, https://lwrs.inl.gov/SitePages/Plant%20Modernization.aspx (last visited Feb. 17, 2023) ("The Plant Modernization Pathway research and development efforts address critical gaps in technology development and deployment to reduce risk and cost."); *see also Flexible Plant Operation and Generation*, *supra* note 43 ("This work focuses on interfaces between the [NPP] and the industrial-energy user that enable an [NPP] to optimize its revenue through production of electricity and nonelectrical products.").

111. 10 C.F.R. § 171.5 (2021).

112. U.S. NUCLEAR REGUL. COMM'N, ML20231A804, FINAL SAFETY EVALUATION REPORT FOR THE NUSCALE STANDARD PLANT DESIGN (2020), https://www.nrc.gov/docs/ML2023/ML20231A804.pdf.

113. NuScale Small Modular Reactor Design Certification, 88 Fed. Reg. 3287 (Jan. 19, 2023) (to be codified at 10 C.F.R. pt. 52).

114. *US Regulator to Issue Final Certification for NuScale SMR*, WORLD NUCLEAR NEWS (Aug. 2, 2022), https://www.world-nuclear-news.org/Articles/US-regulator-to-issue-final-certification-for-NuSc.

This certification is important because of SMRs lower initial capital investment which will help drive economic growth.[115] Underscoring this point, the U.S. Department of Energy has noted that:

> The case for SMR economic competitiveness is rooted in the concept that mass manufacture of modular parts and components will reduce the cost per kilowatt of electricity on par with current generating sources. There is both a domestic and international market for SMRs, and U.S. industry is well positioned to compete for these markets. DOE hopes that the development of standardized SMR designs will also result in an increased presence of U.S. companies in the global energy market. If a sufficient number of SMR units were ordered, it would provide the necessary incentive to develop the appropriate factory capacity to further grow domestic and international sales of SMR power plants.[116]

A recent study considered the economic viability of NuScale's SMR compared to large NPPs.[117] The key findings were that NuScale's SMR had a lower total and per MWe capital cost, a smaller footprint, was modular, and required less on-site construction.[118] This, in turn, means a shorter construction and commissioning period, which lowers financing costs (accounting for 20% of capital costs, compared to 40% for large NPPs).[119] The study found that much lower indirect costs more than offset the higher direct capital costs when compared to other energy sources.[120] These results are promising for future investments in new reactors; and with future advances in methods that lower construction costs, SMRs have the potential to be a viable and profitable long-term addition to Texas' energy portfolio.

V. CONCLUSION

Amid growing concerns for the protection of the environment, geopolitical tensions, and global unrest, renewed calls for sustainable low-emission energy sources grow louder. Recent congressional incentives indicate an urgency for development of renewable energy projects in addition to wind and solar. Arguably, nuclear projects could have the capability to supplement our nation's energy portfolio and provide for ever-expanding energy needs on a global scale. In evaluating new nuclear power projects,

115. *Benefits of Small Modular Reactors (SMRs)*, U.S. DEP'T OF ENERGY, OFF. OF NUCLEAR ENERGY, https://www.energy.gov/ne/benefits-small-modular-reactors-smrs (last visited Nov. 17, 2022) ("SMRs can reduce a nuclear plant owner's capital investment due to the lower plant capital cost. Modular components and factory fabrication can reduce construction costs and duration.").

116. *Id.*

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.* (adding, these indirect costs include low fuel costs, lower risk from fuel price increases, low non-fuel operating costs, and a high-capacity factor (95.7%)).

attorneys and developers should consider the requirements for setting up a project: the timeframe for becoming operational, costs, how much energy can be produced, and how long they will last. Their analysis should consider existing, as well as recently developed (and approved), technologies. By constructing projects in our state and harnessing this somewhat controversial energy source, Texas can further establish itself as the world's energy capital.

FOSTERING THE ORPHANS IN THE OILFIELD: HOW TEXAS, NEW MEXICO, AND OKLAHOMA ARE TACKLING THEIR ORPHAN WELL PROBLEM

Mike MacEwan[*]

Orphan wells are oil and gas wells left unplugged and abandoned by their operators. These types of wells are a growing problem in the oil-producing regions of the United States, such as the Permian Basin. The states that make up and surround the Permian Basin have used a variety of approaches to remediate their respective orphan well problems. These include implementing state-run programs, seeking assistance from the federal government, and encouraging surface owners to get involved. In addition to existing efforts, these states should first make a concentrated effort to get an accurate estimate of the magnitude of their orphan well problem. Once identified, states could shift their focus to well plugging. States could raise additional plugging capital from operators by creating mandatory programs of continuing financial liability. Additionally, states could strengthen their existing state-run programs by offering greater incentives to surface owners who accept plugging responsibility. Finally, states could invest in research focusing on whether abandoned wells could be repurposed for alternative energy production.

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IV. CONCLUSION 92

I. INTRODUCTION

Orphan wells are a growing problem in the United States and currently serve as a blemish on an industry that has otherwise made significant improvements to its overall carbon footprint. This Comment will first explore why orphan wells present such a serious risk and the inherent difficulty states have when attempting to plug them. Next, this Comment examines how states in and surrounding the Permian Basin have approached the issue. Finally, this Comment presents potential solutions that would enable states to accurately estimate the number of orphan wells within their borders and then plug or repurpose them as a source of alternative energy production.

A. Background

In far West Texas, situated between the towns of Fort Stockton, Monahans, and Pecos, lies what many are referring to as Texas' newest lake.[1] At first glance, the body of water looks like an ideal summer retreat. The water glistens a deep sea-like blue that would make the average patron want to blow up an inner tube and jump in on a hot summer day. Upon closer examination, however, one would quickly realize that this "lake" is not the type you would want to swim in. The red flags include a large buildup of salt crystals on the shore and the strong, potentially dangerous odor of rotten eggs stemming from the water's high sulfur content.[2]

This water formation has become known as "Lake Boehmer."[3] The "lake" spans about sixty acres and continues to grow by the day.[4] Sitting at the center of the lake is an abandoned oil well gushing water out at about two hundred gallons per minute.[5] The well was likely drilled during the 1940s or 1950s and came up dry for oil and gas.[6] Surprisingly, however, the well produced water that farmers could use to irrigate their land.[7] In these types of situations, oil companies typically deeded these wells to landowners who could get some productive use out of them.[8] While the intent was noble, this

1. *See* Russell Gold, *The Dead Sea of West Texas*, TEX. MONTHLY (Dec. 8, 2021), https://www.texasmonthly.com/news-politics/lake-boehmer-dead-sea-west-texas/.

2. *Id.*

3. *Id.*

4. Michael Marks, *A toxic lake grows unchecked in the West Texas desert*, TEX. STANDARD (Dec. 9, 2021, 7:17 AM), https://www.texasstandard.org/stories/a-toxic-lake-grows-unchecked-in-the-west-texas-desert/.

5. *Id.*

6. Gold, *supra* note 1.

7. *Id.*

8. *Id.*

type of agreement was an early contributing factor to the rise in wells left unplugged and abandoned, otherwise known as orphan wells.

The case of Lake Boehmer illustrates the orphan well problem across the United States. There is some variation among states on the exact definition of an orphan well, but it is generally agreed that an orphan well is an unproductive well that has not been plugged and whose operator is unknown or insolvent.[9] Orphan wells emerge for a variety of reasons, the most common being an operator becoming insolvent and thus no longer being able to afford to properly decommission a well.[10] The oil and gas industry is highly volatile.[11] When oil prices are high, operators are quick to jump at the prospect of drilling in hopes of taking advantage of the high prices.[12] However, when the industry takes a downward turn, those same operators are left in a vulnerable position. If they are unable to pay the costs of operating a well, the well is likely to become abandoned and left for the landowner or the state (and consequently the state's taxpayers) to clean up.[13]

Orphan wells present myriad issues for the landowner, state government, federal government, and the world at large.[14] The primary concern with orphan wells is their contribution to the heating of the earth's atmosphere.[15] Orphan wells emit a dangerous amount of methane, which is one of the most harmful emissions to the earth's atmosphere, and by some estimates, has a warming power eighty times that of carbon dioxide (in the first twenty years once it reaches the atmosphere).[16] Although estimates vary, it is generally agreed that there are around 129,000 orphan wells in the United States.[17] The aggregate effect of these wells' impact on the environment presents a significant issue that should not go overlooked.

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9. *See* HOWARD WILLIAMS & CHARLES MEYERS, MANUAL OF OIL AND GAS TERMS 817 (18th ed. 2021).

10. Megan Milliken Biven & Virginia Palacios, *Eliminating Orphan Wells and Sites in Texas*, COMM'N SHIFT 4 (Jan. 2022), https://commissionshift.org/wp-content/uploads/2022/01/Eliminating-Orphan-Wells-and-Sites-in-Texas_CommissionShift.pdf.

11. Kenneth Rogoff, *Global oil and gas prices have been highly volatile – what will happen next?*, THE GUARDIAN (July 5, 2022), https://www.theguardian.com/business/2022/jul/05/global-oil-gas-prices-supply-demand-us-europe.

12. *See* Liz Hampton, *As oil nears $100 a barrel, U.S. drillers get busy in costly shale basins*, REUTERS (Feb. 8, 2022, 8:23 AM), https://www.reuters.com/business/energy/oil-nears-100-barrel-us-drillers-get-busy-costly-shale-basins-2022-02-08/.

13. *See* Jeff Turrentine, *Millions of Leaky and Abandoned Oil and Gas Wells Are Threatening Lives and the Climate*, NRDC (July 26, 2021), https://www.nrdc.org/stories/millions-leaky-and-abandoned-oil-and-gas-wells-are-threatening-lives-and-climate.

14. *See id.*

15. *See* Jennifer Oldham, *Orphaned Gas Wells Continue to Emit Dangerous Methane*, SIERRA (March 23, 2022), https://www.sierraclub.org/sierra/2022-1-spring/notes-here-there/orphaned-gas-wells-continue-emit-dangerous-methane.

16. *See id.*

17. *See* Press Release, U.S. Dep't of the Interior, *Through President Biden's Bipartisan Infrastructure Law, 24 States Set to Begin Plugging Over 10,000 Orphaned Wells* (Aug. 25, 2022), https://www.doi.gov/pressreleases/through-president-bidens-bipartisan-infrastructure-law-24-states-set-begin-plugging.

Another problem with orphan wells is their potential impact on groundwater.[18] When wells are abandoned and not properly maintained, their casing and other materials begin to corrode, causing the well to become a conduit for dangerous toxins to travel into nearby aquifers.[19] The impact of these toxins can be hazardous (and in some cases deadly) for surrounding communities who rely on this water for drinking and irrigation.[20]

Lastly, orphan wells are a general nuisance for the landowner.[21] When a well is abandoned and not properly plugged, the landowner's ability to use and develop their land is severely limited.[22] Additionally, the landowner may be unaware of the potential health hazards associated with orphaned wells and choose to avoid the area altogether, effectively making that area of land impossible to build upon and develop.[23]

B. Methodology

As a preface to this Comment, it is pertinent to acknowledge that a majority of oil and gas wells are properly plugged and decommissioned by their oil company operators at the conclusion of their economic life.[24] A large percentage of orphan wells existing today come from a time when there was little to no regulatory oversight.[25] Additionally, not all orphan wells present the same level of risk. Some orphan and abandoned wells do not emit methane at the same level as others.[26] As a result, these wells are not as pressing of an issue, a factor that states must take into consideration when constructing their ultimate plan for remediation.[27]

The states featured in this Comment were chosen based on their oil-producing status, the magnitude of their orphan well problem, and their proximity to the Permian Basin. The goal of this Comment is to present information as to how these states are currently confronting their orphan well problems and set forth possible solutions the states could undertake to tackle their respective problems efficiently and effectively. It is also worth noting

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18. *See* Turrentine, *supra* note 13.

19. TYLER E. GASS ET AL., IMPACT OF ABANDONED WELLS ON GROUND WATER 1 (U.S. Env't Prot. Agency 1977).

20. *See id.*

21. *See generally* Nichola Groom, *Special Report: Millions of abandoned oil wells are leaking methane, a climate menace*, REUTERS (June 16, 2020), https://www.reuters.com/article/us-usa-drilling-abandoned-specialreport/special-report-millions-of-abandoned-oil-wells-are-leaking-methane-a-climate-menace-idUSKBN23N1NL.

22. *See id.*

23. *See id.*

24. *See Idle and Orphan Oil and Gas Wells: State and Provincial Regulatory Strategies 2021*, INTERSTATE OIL & GAS COMPACT COMM'N 8 (Dec. 2021), https://iogcc.ok.gov/sites/g/files/gmc836/f/documents/2022/iogcc_idle_and_orphan_wells_2021_final_web_0.pdf [hereinafter *IOGCC 2021 Report*].

25. *Id.*

26. *See* Groom, *supra* note 21.

27. *Id.* at 3.

that a major issue in solving the orphan well problem is the difficulty in getting an accurate estimate of the number of orphan wells per state.[28] While many states go to extensive lengths to document their orphan wells, an unknown number of undocumented orphan wells exist that are potentially dangerous.[29] Undocumented wells were usually drilled and abandoned prior to the existence of regulatory agencies that could track the location and operator of these wells.[30] States have adopted different methodologies to estimate the number of undocumented orphan wells within their borders. These methodologies, however, give the state a rough estimate at best and is an area that states are working diligently to improve in the near future.[31]

II. DIFFERENT STATES' APPROACHES TO THE ISSUE

Plugging and remediating orphan wells is a responsibility left largely to the states. Different states face unique challenges in approaching the orphan well issue based on their history of oil and gas production, the magnitude of their problem, and the risk level of their known orphan wells. Accordingly, many states tailor their orphan well remediation strategy to prioritize known wells that present a significant risk to human health and the environment.[32]

A. Texas

Texas is one of the most prominent oil and gas producing states in the United States.[33] Other states often look to Texas for guidance in oil and gas policy and law.[34] Texas defines an orphan well as one: "(A) for which the commission has issued a permit; (B) for which production of oil or gas or another activity under the jurisdiction of the commission has not been reported to the commission for the preceding 12 months; and (C) whose operator's commission-approved organization report has lapsed."[35] According to a 2020 report, Texas had 6,514 orphan wells.[36] Through the years, the state has established a variety of programs and incentives to tackle the orphan well problem.

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28. *See IOGCC 2021 Report*, *supra* note 24 at 5.
29. *See id.*
30. *Id.*
31. *See id.*
32. *See* Press Release, U.S. Dep't of the Interior, *Texas to Begin Work Plugging 800 Orphaned Wells Through President Biden's Bipartisan Infrastructure Law* (Aug. 25, 2022), https://www.doi.gov/pressreleases/texas-begin-work-plugging-800-orphaned-wells-through-president-bidens-bipartisan.
33. *See* Jim Malewitz, *Abandoned Texas oil wells seen as "ticking time bombs" of contamination*, TEX. TRIB. (Dec. 21, 2016, 12:00 PM), https://www.texastribune.org/2016/12/21/texas-abandoned-oil-wells-seen-ticking-time-bombs-/.
34. Coastal Oil & Gas Corp. v. Garza Energy Tr., 268 S.W.3d 1, 42 (Tex. 2008) (Willett, J., concurring).
35. TEX. NAT. RES. CODE. ANN. § 89.047(3).
36. *See IOGCC 2021 Report*, *supra* note 24 at 28.

The Railroad Commission of Texas (the Commission) requires any organization performing operations within their jurisdiction to file a Form P-5, otherwise known as an organizational report.[37] One requirement of the organizational report is that the organization provides some means of financial assurance.[38] The most readily available option for organizations to satisfy their financial assurance requirement is to provide a Form P-5PB(2), letter of credit, or cash deposit in the required amount.[39] The amount the organization is required to pay is determined by the number of wells they are operating.[40] An organization operating one to ten wells must pay $25,000.[41] An organization operating eleven to ninety-nine wells must pay $50,000.[42] An organization operating over one hundred wells must pay $250,000.[43] If an organization fails to comply with the well-plugging requirements, the money used to meet the financial assurance requirement may be used to plug their wells.[44]

In 2005, the Texas legislature created a program allowing the Railroad Commission to reimburse surface owners who take over plugging responsibility for orphan wells located on their property.[45] The surface owner must meet the requirements of the statute in order to qualify for reimbursement.[46] First, the surface owner must contract with a well cementer who has been pre-approved and is featured on the Commission's list of approved cementers.[47] Next, there are a number of requirements the well cementer must meet. These requirements include filing a P-4 form and assuming responsibility and control of the well, filing a bond or letter of credit covering the well as the Commission rules require, and ensuring that the well is plugged in compliance with the Commission rules.[48] After the well is plugged by the well cementer, the surface owner must submit an application to the Commission that details the cost incurred to plug the well.[49] Once approved, the Commission will tender payment to the surface owner in an amount not to exceed fifty percent of the lesser of either the documented plugging costs, or the average cost incurred by the Commission when

37. 16 TEX. ADMIN. CODE § 3.1(a) (2012) (Railroad Commission of Texas, Filing Requirements).

38. 16 TEX. ADMIN. CODE § 3.78(d) (2016) (Railroad Commission of Texas, Fees and Financial Security Requirements).

39. *Id.* § 3.78(g).

40. *See id*.

41. *Id.*

42. *Id.*

43. *Id.*

44. *See* Tex. R.R. Comm'n, *2021 Oilfield Cleanup Program Annual Report*, RCC 7 (2022), https://www.rrc.texas.gov/media/k3ygkpqa/oilfield-cleanup-program-annual-report-fiscal-year-2021.pdf [hereinafter *2021 Oilfield Cleanup Report*].

45. TEX. NAT. RES. CODE ANN. § 89.048.

46. *See generally id.*

47. *Id.* § 89.048(b).

48. *Id.* § 89.048(c).

49. *Id.* § 89.048(d).

plugging similar wells in the same general area in the preceding twenty-four months.[50] The funds used to reimburse surface owners come from the state's Oil and Gas Regulation and Cleanup Fund.[51] Commentators, however, have been critical of the program because surface owners are reportedly rarely ever reimbursed.[52] Since the average cost of plugging a well is estimated to be $21,000, surface owners are likely reluctant to take on well-plugging responsibility without a guarantee that they will be fully reimbursed.[53]

In addition to the surface owner reimbursement program, the state also takes on plugging responsibility through the Oil and Gas Regulation and Cleanup Fund.[54] This program is also administered through the Railroad Commission and is primarily funded by regulatory, permit, and bond fees from the industry.[55] Some additional funding stems from enforcement penalties and proceeds from the sale of equipment and hydrocarbons recovered from well plugging and site remediation efforts.[56] Once the Railroad Commission becomes aware of a site, a Cleanup Coordinator will travel to the site and conduct a site assessment that identifies and analyzes the various environmental threats the site poses.[57] The well is then added to a list of wells to be plugged through the Cleanup Fund, which is prioritized based on public health, safety, and environmental concerns.[58]

In 1984, the Railroad Commission established the Oil Field Cleanup Program.[59] Since its inception, the program has plugged over 42,000 abandoned wells across the state.[60] In 2021, the Railroad Commission plugged 1,453 abandoned wells and spent $36.2 million on well-plugging expenditures, which was no easy feat considering the challenges presented by the COVID-19 pandemic.[61]

Furthermore, Texas is set to receive federal funding to aid in its orphan well reduction efforts through the Bipartisan Infrastructure Law, which

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50. *Id.*

51. Tex. R.R. Comm'n, *Reimbursement to Surface Owners*, RCC, https://www.rrc.texas.gov/oil-and-gas/research-and-statistics/well-information/orphan-wells-12-months/reimbursement-to-surface-owners/ (last visited Oct. 23 2022).

52. David Porter, *Taking Care of Orphans (Orphan Wells, That Is)*, SHALE MAG. (Nov. 27, 2017), https://shalemag.com/taking-care-of-orphans-orphan-wells-that-is/.

53. *See* Loren Steffy, *Unplugged and Abandoned: The growing orphan well crisis facing the Railroad Commission of Texas*, COMM'N SHIFT 19 (Feb. 2021), https://commissionshift.org/wp-content/uploads/2021/02/UnpluggedandAbandoned.pdf.

54. *See* TEX. NAT. RES. CODE ANN. § 81.067.

55. *See 2021 Oilfield Cleanup Report*, *supra* note 44, at 7.

56. *Id.*

57. *Id.*

58. Tex. R.R. Comm'n, *State Managed Cleanup Program*, RCC, https://www.rrc.texas.gov/oil-and-gas/environmental-cleanup-programs/site-remediation/state-managed-cleanup-program/ (last visited Oct. 23 2022).

59. *See 2021 Oilfield Cleanup Report*, *supra* note 44, at 3.

60. *Id.*

61. *Id.*

includes a $4.7 billion investment to plug orphan wells in the United States.[62] The law represents one of the largest federal investments into plugging orphan wells in history.[63] When the law was initially announced, commentators suggested Texas should be careful about accepting the money because of the bureaucratic oversight that is generally associated with federal funding.[64] However, it is now agreed that Texas should accept the funding because of the impact it will have on cleaning up orphan wells in the state.[65] Texas will receive an initial grant of $25 million, but could be eligible to receive up to $319 million based on current estimates.[66] Texas has indicated that it plans to use its awarded funds to procure necessary equipment and hire personnel, including twenty inspectors who will be tasked with overseeing well-plugging operations.[67] Additionally, Texas plans to use the "funding to develop a methodology to measure and track methane and other [harmful] gasses."[68] In total, 800 orphan wells will be plugged through the initial $25 million grant, which were selected because of their greater depth and hydrogen sulfide emissions.[69] These 800 wells will be in addition to those plugged through Texas' state-managed programs.[70] Texas' neighbor to the west (and co-parent of the Permian Basin) is a major oil and gas producer who also deals with the issue of orphan wells.

B. New Mexico

New Mexico consistently ranks among the top oil and gas producing states in the United States, and the industry serves as a major contributor to the state's economy.[71] In 2021 alone, oil and gas contributed $5.3 billion in state and local revenue (a $500 million increase from the previous year) and provided over 134,000 jobs to the state's citizens.[72] Inherent in states known for their oil and gas production is the potential for wells to become abandoned or orphaned.

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62. U.S. Dept. of the Interior, *supra* note 32.

63. *Id.*

64. *See* Jim Wright, *Time for Texas to address our orphan well problem*, DALL. MORNING NEWS (Aug. 17, 2022), https://www.dallasnews.com/opinion/commentary/2022/08/17/time-for-texas-to-address-our-orphan-well-problem/.

65. *See id.*

66. U.S. Dept. of the Interior, *supra* note 32.

67. *Id.*

68. *Id.*

69. *Id.*

70. *See* Wright, *supra* note 64.

71. Mark Flaherty, *The Oil and Gas Industry in New Mexico*, 48 N.M. DEP'T OF WORKFORCE SOLS. LAB. MKT. REV. 7, 8 (July 2019), https://www.dws.state.nm.us/Portals/0/DM/LMI/lmr_July_19.pdf.

72. Bethany Blankley, *New Mexico oil and natural gas industry contributes record $5.3 billion in tax revenue*, CTR. SQUARE (Dec. 2, 2021), https://www.thecentersquare.com/new_mexico/article_6f6dd21c-53c0-11ec-8c4b-c3d31937b762.html.

New Mexico has faced challenges (not dissimilar to other states) in accurately estimating orphaned or abandoned wells.[73] A contributing factor to the state's challenges is the lack of a statutory definition of what New Mexico considers to be an orphaned well.[74] With no uniform definition, wells that fall under the traditional definition of "orphaned" are instead added to a list of "inactive" wells.[75] Once added to the list of inactive wells, a string of regulatory actions is initiated that could eventually lead to the state plugging or remediating the well.[76]

Orphan well estimates in New Mexico have vastly fluctuated over the past few years as a result of President Biden's Bipartisan Infrastructure Law allocating funds to plugging orphan wells.[77] In the summer of 2020, Adrienne Sandoval, the Director of the Oil Conservation Division (OCD), testified to a United States House of Representatives energy subcommittee that New Mexico had 708 known orphan wells.[78] Though, when New Mexico applied for its share of federal funding in 2022, the state estimated it had approximately 1,700 orphaned or abandoned wells.[79] Some models estimate that the actual number could be up to three times that figure.[80]

Despite its immensity, New Mexico has taken various steps toward fixing its orphan well problem. For starters, New Mexico requires the operator of wells on state or private lands that have been inactive for two or more years to file a bond.[81] For a single well, the bond must be in the amount of $25,000 plus two dollars per foot of measured depth.[82] However, New Mexico allows operators to file blanket bonds when they operate more than one well.[83] An operator can pay $150,000 for their first five wells, $300,000 for six to ten wells, $500,000 for eleven to twenty-five wells, or $1,000,000 for more than twenty-five wells.[84] Blanket bonds, however, can cause

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73. *See* Samuel Gilbert, *To understand the orphan well problem in NM, someone's going to have to count them*, SOURCE NM (May 31, 2022, 5:00 AM), https://sourcenm.com/2022/05/31/to-understand-the-orphan-well-problem-in-nm-someones-going-to-have-to-count-them/.

74. *See IOGCC 2021 Report*, *supra* note 24 at 60.

75. *See id.*

76. *See* Naveena Sadasivam & Clayton Aldern, *How New Mexico abandoned 1,000 oil and gas wells overnight*, GRIST (Feb. 16, 2022), https://grist.org/accountability/new-mexico-abandoned-oil-wells-infrastructure-bill/.

77. *See* Naveena Sadasivam, *Abandoned oil well counts are exploding – now that there's money on the table*, GRIST (Jan. 21, 2022), https://grist.org/energy/abandoned-oil-wells-cleanup-infrastructure-law/.

78. Adrienne Sandoval, N.M. Energy, Mins. & Nat. Res. Dep't of Oil Conservation Div. Dir., Statement to subcommittee on Energy and Mineral Resources (June 1, 2020).

79. Press Release, State of N.M. Energy, Mins., & Nat. Res. Dep't, *New Mexico awarded $25 million for orphan well clean-up* (Aug. 25, 2022), https://www.emnrd.nm.gov/officeofsecretary/wp-content/uploads/sites/2/new_mexico_orphaned_well_grant_08_2022.pdf.

80. *See* Clayton Aldern et al., *The Permian Basin is ground Zero for a billion-dollar surge of zombie oil wells*, Article in *Waves of Abandonment* series, GRIST (Apr. 2021), https://grist.org/abandoned-oil-gas-wells-permian-texas-new-mexico/.

81. *See* N.M. CODE R. § 19.15.8.9.

82. *Id.*

83. *See id.*

84. *Id.*

problems for the state; in many instances, the blanket bond does not come close to covering the actual cost of properly plugging an orphan well.[85] This leaves the state and its taxpayers with the burden of covering the additional costs.[86]

In 1978, New Mexico established the Oil and Gas Reclamation Fund.[87] The purpose of the fund is to employ personnel to survey abandoned wells and well sites and take on plugging responsibility when wells have been improperly plugged or not plugged at all.[88] The fund is administered by the OCD (the equivalent of the Railroad Commission in Texas).[89] The funds used for these remediation activities come from the New Mexico Oil and Gas Conservation Tax and forfeited bonds.[90] Some commentators have suggested that the fund is notoriously underfunded, which results in the state only being able to plug about fifty orphan wells per year.[91]

New Mexico is also set to receive federal funding from the Bipartisan Infrastructure Law that will assist in their orphan well cleanup efforts.[92] Like Texas, New Mexico received an initial grant of $25 million.[93] The initial grant will immediately be put to use while New Mexico waits to find out how much additional funding it is eligible to receive.[94] The state estimates that the funding will enable it to plug "dozens" of abandoned and orphaned wells per year on top of the fifty wells it is able to plug through state-facilitated programs.[95]

Overall, New Mexico is taking great strides toward fixing its orphan well problem. The state, however, appears to be discovering orphan wells faster than they can plug them.[96] Additionally, there remains a substantial number of wells included on the "inactive" well list that are at a high risk of soon being classified as orphaned.[97] More must be done in the coming years to prevent the problem from ballooning into something beyond control. A few hours northeast of the Permian Basin is another historic oil and gas producing state that has recently had to take action in confronting its orphan well problem.

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85. *See* Susan Montoya Bryan, *New Mexico official takes aim at oil, gas bond requirements*, ASSOCIATED PRESS (May 20, 2021), https://apnews.com/article/new-mexico-environment-and-nature-business-814d2f717346981723c5188280993241.

86. *Id.*

87. N.M. STAT. ANN. § 70-2-38.

88. *Id.*

89. *Id.*

90. Adrienne Sandoval, N.M. Oil Conservation Div., Dep't of Oil Conservation Div. Dir., Presentation regarding OCD Bonding Requirements and Orphan Wells (Dec. 21, 2007).

91. *See* Gwynne Ann Unruh, *Orphaned O&G Well Count Climbing*, THE PAPER (Sept. 8, 2022, 5:38 PM), https://abq.news/stories/orphaned-og-well-count-climbing,8551.

92. *See* State of N.M. Energy, Mins., & Nat. Res. Dep't, *supra* note 79.

93. *Id.*

94. *Id.*

95. *Id.*

96. *See* Sadasivam & Aldern, *supra* note 76.

97. *Id.*

C. Oklahoma

Like Texas and New Mexico, Oklahoma is one of the nation's most prominent oil and gas producing states.[98] In 2021, Oklahoma was ranked fifth in natural gas production and sixth in crude oil production.[99] Like New Mexico, Oklahoma does not statutorily define orphan well, but the Oklahoma Corporation Commission (which has regulatory authority over the state's oil and gas industry) generally considers an orphan well to be a well whose operator has gone out of business and which the state has responsibility for plugging.[100] In 2020, Oklahoma had 2,799 documented orphan wells.[101] Additionally, Oklahoma is estimated to have about 105,907 undocumented orphan wells.[102] Oklahoma faces unique challenges to orphan well remediation that stems from the vast presence of tribal lands within the state.[103]

Oklahoma has taken various actions at the state level to confront its orphan well issues. Like many other states, Oklahoma requires a form of financial assurance to ensure that oil and gas operators have the capital available to cover plugging requirements.[104] Oklahoma offers oil and gas operators the option of filing a blanket surety bond of $25,000 to prove their ability to cover their well-plugging responsibility.[105] Additionally, operators may file a surety of a lesser amount as long as it is sufficient to cover the total estimated cost of properly plugging and abandoning each well.[106] Problems arise when operators have a large number of active wells, and the $25,000 will not cover the total cost of plugging those wells should they become abandoned.

Oklahoma's orphan well-plugging efforts are also supported by the Oklahoma Energy Resources Board (OERB).[107] The OERB was founded in 1993 and "is funded through a voluntary one-tenth of one-percent assessment on the sale of oil and natural gas in Oklahoma, paid for by oil and natural gas producers and royalty owners."[108] Since its inception, the OERB has invested

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98. *See* U.S. Energy Info. Admin., *Oklahoma State Energy Profile*, EIA, https://www.eia.gov/state/print.php?sid=OK (last visited Feb. 15, 2022).

99. *Id.*

100. *See IOGCC 2021 Report*, *supra* note 24, at 64.

101. *Id.* at 28.

102. *Id.*

103. *See generally* Russell Lawson, *Orphaned Oil Wells: Plugging and cleaning abandoned sites throughout the Osage Nation cost millions of dollars*, OKLA. MAG. (Sept. 25, 2018), https://okmag.com/blog/orphaned-oil-wells/.

104. OKLA. ADMIN. CODE § 165: 10-1-10.

105. *Id.* § 165: 10-1-12.

106. *Id.*

107. *See* Okla. Oil & Nat. Gas, *2021 Annual Report*, OERB 4 (2022), http://oerb.com/wp-content/uploads/2022/03/2021-Annual-Report-4.pdf [hereinafter *2021 Oklahoma Annual Report*].

108. Okla. Energy Res. Board, *Funding*, OERB, https://oerb.com/about/funding/ (last visited Nov. 27, 2022).

more than $138 million to clean up orphaned and abandoned wells and has worked on more than 18,000 sites in total.[109] In 2021 alone, the program cleaned up 552 sites and spent $4.7 million on remediation efforts.[110] The program is especially beneficial for landowners, who are better off when they do not have to bear the burden of cleaning up orphaned or abandoned sites because it is shifted back to the industry where it belongs.[111]

Oklahoma is also in line to receive its share of funding from the Bipartisan Infrastructure Law.[112] Oklahoma received an initial grant of $25 million to plug orphaned and abandoned oil and gas wells.[113] Oklahoma will use its initial grant to plug 1,196 documented orphan wells, which have been prioritized based on their threat to human health, and the impact on safety and the environment.[114] Additionally, Oklahoma will work with the federally-recognized Indian tribes to plug wells located on their lands.[115]

The Bipartisan Infrastructure Law also includes a grant of $33 million to plug orphaned oil and gas wells in national parks, national forests, national wildlife refuges, and on other public lands.[116] A portion of this funding will go to Oklahoma, which is home to twenty-four orphaned wells in the Deep Fork National Wildlife Refuge.[117]

Lastly, the Bipartisan Infrastructure Law makes $150 million available to Tribal communities across the nation that have orphaned oil and gas wells on their land.[118] The Tribal communities must apply for the grant, but the funding nonetheless presents an unprecedented opportunity to obtain government assistance in cleaning up the oil and gas wells on their lands.[119] With so many moving parts, states must carefully consider each factor to formulate a solution that fits their needs.

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109. Okla. Energy Res. Board, *Well Cleanup*, OERB, https://oerb.com/well-cleanup/ (last visited Nov. 27, 2022).

110. *See 2021 Oklahoma Annual Report*, *supra* note 107, at 5.

111. *See Well Cleanup*, *supra* note 109.

112. Press Release, U.S. Dep't of the Interior, *Oklahoma to Begin Work Plugging Nearly 1,200 Orphaned Wells Through President Biden's Bipartisan Infrastructure Law* (Aug. 25, 2022), https://www.doi.gov/pressreleases/oklahoma-begin-work-plugging-nearly-1200-orphaned-wells-through-president-bidens.

113. *Id.*

114. *Id.*

115. *Id.*

116. Press Release, U.S. Dep't of the Interior, *Biden-Harris Administration Announces $33 Million Infrastructure Investment to Address Legacy Pollution, Spur Good-Paying Jobs on Public Lands* (May 25, 2022), https://www.doi.gov/pressreleases/biden-harris-administration-announces-more-244-million-create-good-paying-union-jobs.

117. *Id.*

118. Press Release, U.S. Dep't of the Interior, *Biden-Harris Administration Makes $50 Million Available to Clean Up Orphaned Oil and Gas Wells on Tribal Lands* (Nov. 23, 2022), https://www.doi.gov/pressreleases/biden-harris-administration-makes-50-million-available-clean-orphaned-oil-and-gas.

119. *Id.*

III. POTENTIAL SOLUTIONS

There are several strategies states could implement to better approach their orphan well problems. As mentioned, a major issue surrounding orphan wells is getting an accurate estimate of how many there are. Once states have a better estimate of the extent of their problem, they will be able to better plan for plugging and repairs. While no single solution is likely to fix the entire problem, a combination approach can hold operators liable, strengthen existing state-run programs, and repurpose wells for alternative energy production.

A. Strategies for Identifying Orphan Wells

An essential first step to solving the orphan well problem is getting an accurate estimate of its size. First, states should act now to establish programs that encourage better reporting of abandoned oil and gas wells. One way of doing so is incentivizing landowners to actively identify and report wells on their land that they believe to be orphaned and abandoned. The state could require landowners to provide photographs and other necessary documentation to establish the reliability of reports. Once reliability is established, the state could provide a small payment to the landowner to encourage further landowner participation. After the well is identified, a qualified employee can inspect the well and establish whether it is in fact orphaned or abandoned, the threat it poses to human health, safety, and the environment, and finally, how quickly the state needs to act in getting it properly plugged.

Additionally, a study published in the Environmental Science and Technology Journal has suggested using aeromagnetic surveys to identify orphaned and abandoned wells.[120] According to the study, vertical steel well casing produces an apparent intrusion in the earth's magnetic field.[121] By conducting these aerial surveys, large tracts of land are covered in a relatively short amount of time, an attribute that is especially important in a large state such as Texas. To further identify orphaned oil and gas wells, other commentators suggest using technologies such as drones, hyperspectral imaging, ground penetrating radars, and gas detectors.[122] Once the wells are identified, states can focus on finding the money to have them efficiently plugged.

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120. *See* Patricia M.B. Saint-Vincent et al., *Identifying Abandoned Well Sites Using Database Records and Aeromagnetic Surveys*, 54 Env't Sci. & Tech. 8300, 8300 (2020), https://doi.org/10.1021/acs.est.0c00044.

121. *Id.* at 8300–301.

122. Brian Wihl, Lawrence Livermore Nat'l Lab., Presentation Regarding Undocumented Well Finding Technologies for the U.S. Department of Energy 61 (Apr. 5, 2022).

B. Programs for Continuing Financial Liability

While working towards identifying orphaned oil and gas wells, states can take other immediate protective action by increasing the financial assurance requirements within their jurisdictions. Blanket bonds require a unique balancing by the state.[123] On one hand, states seek to encourage drilling by giving oilfield operators the chance to pay a fixed-cost blanket bond while operating as many wells as they want.[124] On the other hand, states must hold operators liable when they are unable to plug their wells properly. As things currently stand, states lean further towards encouraging drilling and exploration.[125] This is shown by the state's willingness to allow oil companies to operate as many wells as they want while only providing financial assurances for a fraction of the plugging costs. However, it is difficult to strike a perfect balance because well-plugging costs vary from well to well. Many states set blanket bond amounts at $100,000. Would it make much of a difference to increase that figure to $200,000? What about $300,000? Perhaps not, but even a slight increase in the current bond requirements would lessen the burden the state, its taxpayers, and landowners currently shoulder.

States can also impose a requirement where previous operators in the chain of ownership of a well maintain some degree of financial responsibility for plugging efforts should the final operator become insolvent. Although large oilfield operators are less likely to abandon wells without properly plugging them, problems arise when large operators sell off wells nearing the end of their economic life to smaller companies that are more vulnerable to shifting market conditions.[126] By requiring operators to maintain some level of financial interest in previous projects, companies will become more invested in who they are selling their wells to and may encourage the seller to take extra steps to ensure the buyer's financial well-being. States could also create or strengthen state-run programs whose primary objective is to repair and clean up oilfield waste.

C. State-Run Programs

States such as Texas and New Mexico could look to establish programs similar to the OERB in Oklahoma. The OERB is voluntarily funded by major oil companies, large and small independents, and royalty owners through a

123. *See* Greg Rogers, *The Moral Hazard of Blanket Bonds*, CARBON TRACKER (Jan. 29, 2021), https://carbontracker.org/the-moral-hazard-of-blanket-bonds/.

124. *Id.*

125. *See id.*

126. *See* Jordan Blum, *Growing problems with orphaned, abandoned wells challenges oil industry*, S&P GLOBAL (July 9, 2021, 5:02 PM), https://www.spglobal.com/commodityinsights/en/market-insights/latest-news/natural-gas/070921-growing-problems-with-orphaned-abandoned-wells-challenges-oil-industry.

fraction of a percent assessment of oil and gas sales.[127] It may be wishful thinking, but perhaps oil companies would be more willing to contribute to well-plugging efforts when it is not forced on them through increased bond requirements or other forms of government action. Small contributions from many could make a substantial impact in the aggregate and would further promote the goal of shifting the burden from the state to the industry.

States could also look to establish programs similar to Texas' surface owner reimbursement program. For these to succeed, states must agree to reimburse the surface owner in full as long as the total amount is reasonable. As the program currently stands in Texas, surface owners are only eligible to be reimbursed for fifty percent of the lesser amount of the two options, which does little to incentivize surface owners to act.[128] For instance, a surface owner with an orphan well on their property costing $20,000 to plug is unlikely to take action when they will only recover $10,000 after expending time, effort, and energy to get the well properly plugged. A promise of complete reimbursement is more likely to get surface owners to act. However, a heavy push toward plugging may not be the only solution available.

D. Repurposing for Alternative Energy Production

While much of the focus has been on plugging orphaned or abandoned wells, there is also a chance that wells could be repurposed to produce other forms of energy. As states begin to rely more on renewables, there is some thought that orphaned oil and gas wells could be repurposed to produce geothermal energy.[129] Geothermal energy production occurs when water is pumped into the earth and heated before it rises back to the surface, where energy is then captured from the steam. A grant from the United States Department of Energy has allowed researchers to commence projects in California and Oklahoma to test and evaluate the viability of repurposing abandoned oil and gas wells for geothermal energy production.[130] The opportunity to repurpose abandoned oil and gas wells for geothermal energy production efforts presents states with a unique chance to demonstrate a commitment to the further development of renewables while simultaneously cleaning up their orphan well problem. However, commentators suggest that

127. *See Funding*, *supra* note 108.

128. TEX. NAT. RES. CODE ANN. § 89.048.

129. *See* Emily J. Smejkal et al., *The Feasibility of Repurposing Oil and Gas Wells for Geothermal Applications*, GEOCONVENTION 1 (June 20, 2022), https://geoconvention.com/wp-content/uploads/abstracts/2022/73300-the-feasibility-of-repurposing-oil-and-gas-wells-f-01.pdf.

130. Press Release, U.S. Dep't of Energy, *DOE Awards $8.4 Million for Accessing Geothermal Potential from Abandoned Oil and Gas Wells* (Jan. 12, 2022), https://www.energy.gov/eere/articles/doe-awards-84-million-accessing-geothermal-potential-abandoned-oil-and-gas-wells.

it may be difficult to find viable candidates; nevertheless, there is an opportunity, and the potential benefits make it well worth the costs.[131]

IV. CONCLUSION

Orphaned and abandoned wells have a detrimental effect on human health, the environment, and the landowners who must live with them. States have taken different approaches to plugging orphan wells; some have encouraged landowners to act, some have encouraged the industry to make voluntary contributions, and some look to regulatory agencies to clean them up. The fact remains that orphaned and abandoned wells are a stain on an industry that is already watched closely by the public eye. To effectively attack the orphan well problem, states must take immediate action to get an accurate estimate of the orphan wells within their lands. Once there is an accurate estimate, states (with the federal government's help) can begin implementing programs to plug and remediate these problematic wells. The problem will not be solved overnight, and there is likely not a single solution. States, however, can take aim at the orphan well problem by implementing many different strategies and programs, chipping away one well at a time until the orphan well problem is under control.

131. Smejkal et al., *supra* note 129 at 4.

GAME OF TEXAS ENERGY THRONES: A DIVE INTO TEXAS TAX INCENTIVES TO REMAIN KING

Halee S. Sanderson[*]

In 2001, Texas enacted the Texas Economic Development Act in the hopes of bringing more renewable energy to Texas. Nonetheless, in 2022, the Texas legislature failed to extend the Texas Economic Development Act, commonly known as Chapter 313. School districts and energy companies are stuck at a standstill until more incentives are enacted. There is another statutory solution, but as this Comment will reveal, major amendments will need to be made to steer the statute to be geared more toward incentivizing renewable energy. Currently, there is no proposed legislation to reenact the tax incentives within Chapter 313 long-term. Therefore, amendments to current statutes or proposals for new legislation should be made.

First, this Comment analyzes Chapter 313, how it affected the local and state economy, and why incentivization is necessary. Second, the discussion will show the strengths and weaknesses of the current legislation in place. Finally, this Comment will discuss other possible solutions to incentivize renewable energy.

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I. INTRODUCTION

Texas is largely considered the energy hub of the United States—outproducing every other state.[1] But, comparatively, Texas has considerably fewer incentives to entice energy companies to move their operations to the state.[2] For a state focused on an agenda of promoting energy development, this may seem like an oddity.[3]

Over the last thirty years, Texas implemented two key incentives—Chapter 312 and 313 of the Tax Code—to promote energy development.[4] Now, one has expired and the other still seems clear as mud—at best—for energy companies.[5] The Texas Constitution allows the legislature to "authorize cities, towns, and other taxing units to grant exemptions or other relief from ad valorem taxes on property located in a reinvestment zone for the purpose of encouraging development or redevelopment and improvement of the property."[6] Thus, the Texas legislature should leverage its power to act and incentivize renewable energy production.

II. HISTORY OF TEXAS INCENTIVES FOR RENEWABLE ENERGY

In 1987, the Texas legislature enacted multiple laws affecting local taxation ability.[7] Specifically, the Texas legislature created Chapter 312 of the tax code, which allowed entities to abate property taxes.[8] A decade later, in a move towards promoting green energy, the legislature passed laws to instruct the Texas Public Utility Commission to adopt new rules for the state's renewable energy mandate, which "required 10,000 megawatts of renewable capacity by 2025, including 500 megawatts from resources other

1. *See* U.S. Energy Info. Admin., *Texas State Profile and Energy Estimates Overview*, EIA, https://www.eia.gov/state/?sid=TX#tabs-3 (last visited Nov. 20, 2022).

2. *See generally* VA. ECON. DEV. P'SHIP, *Offshore Wind in Virginia*, VEDP (Jan. 2022), https://issuu.com/vedpvirginia/docs/vedp_value_prop_offshore_wind_12.31.21; Econ. Dev. P'ship of N.C., *Incentives*, EDPNC, https://edpnc.com/why-north-carolina/incentives/ (last visited Nov. 20, 2022).

3. *See* Coastal Oil v. Garza Energy Trust, 268 S.W.3d 1 (Tex. 2008); Kelly v. Ohio Oil Co., 49 N.E. 399 (Ohio 1897).

4. U.S. Energy Info. Admin., *Texas State Profile and Energy Estimates Analysis*, EIA, https://www.eia.gov/state/analysis.php?sid=TX#141 (last visited Nov. 20, 2022).

5. TEX. TAX CODE ANN. § 313.007.

6. TEX. CONST. art. VIII, § 1-g.

7. TEX. TAX CODE ANN. tit. 3 (Local Taxation).

8. *Id.* § 312.002.

than wind."[9] The legislature answered this by creating Chapter 313.[10] Initially, the legislature enacted Chapter 313 because

> the State of Texas . . . slipped in its national ranking each year between 1993 and 2000 in terms of attracting major new manufacturing facilities to this state . . . a significant portion of the Texas economy continues to be based in the manufacturing industry, and the continued growth and overall health of the manufacturing sector serves the Texas economy well . . . ."[11]

This still does not explain why a state focused on promoting exergy production only has two major state tax incentives to offer companies. However, with the help of Chapter 312 and Chapter 313, "Texas exceeded the 2025 [10,000 megawatts] goal in 2009, mostly because of the state's wind farms."[12] Since the enactment of Chapter 313, "389 projects [were] approved that could have gone to other states but instead came to Texas, creating 66,400 new jobs, $3.3 billion in personal income, and $183.7 billion of new investment."[13] The state has certainly benefitted from these incentives, but there is much more opportunity that is underutilized.

III. CHAPTER 313

A. Creation of the Texas Economic Development Act

In 2001, the Texas legislature implemented the Texas Economic Development Act, which gave school districts more power to negotiate with qualified companies—most of which involve manufacturing or renewable energy—to bring in a larger tax base.[14] The tax breaks are regularly referred to as Chapter 313 and have mostly benefitted school districts and renewable energy companies.[15] As a result, the wind and solar industry effectively funded rural school districts for decades to come.[16]

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9. *Texas State Profile and Energy Estimates Analysis*, *supra* note 4.

10. *See id.*

11. Act of Jan. 1, 2002, 77th Leg., C.S., ch. 313 TEX. TAX CODE ANN. § 313.002 (amended 2013) (current version at TEX. TAX CODE ANN. § 313.002).

12. *Texas State Profile and Energy Estimates Analysis*, *supra* note 4.

13. Powering Tex., *Chapter 313: Bringing Investment and Economic Growth to Rural Texas*, POWER UP TEX., https://www.poweruptexas.org/wp-content/uploads/2021/01/Chapter-313-Fact-Sheet-Web-Version.pdf (last visited Nov. 20, 2022).

14. TEX. TAX CODE ANN. § 313.003; Act of Sept. 1, 2013, 83d Leg., R.S., ch. 1304, § 22(2), TEX. TAX CODE ANN. § 313.103 (repealed in 2013) (stating the school district has the power to accept applications for tax credits).

15. Interview with James Sanderson, Blackwell CISD Sch. Bd. President, in Blackwell, Tex. (Sept. 25, 2022).

16. *Id.*

Chapter 313 amended the state tax, education, and administration codes, specifically affecting ad valorem taxes.[17] *Ad valorem*, a Latin phrase, directly translates to "according to the value."[18] In Texas, ad valorem taxes are simply local property taxes that are continuously calculated—in order for taxing authorities to collect the proper amount.[19] The Texas Education Code entitles school districts to take state aid equal to the Chapter 313 tax credits.[20] These credits reduce an individual's property tax responsibility on a dollar-to-dollar basis.[21] The Texas Administrative Code defines key terms and procedures to receive the most amount of money, essentially creating a failsafe program for school districts to authorize a ten-year limit on the taxable property value within school districts and receive more money upfront.[22] As a result, renewable energy companies do not have to pay as much in property taxes. Additionally, this guarantees school districts will have a larger tax base.[23]

Unfortunately, subchapters B and C of Chapter 313 expired on December 31, 2022.[24] Like a deadly wound—if left untreated—rural and small school districts will die off. For the betterment of public education and to incentivize more renewable energy production, a program like Chapter 313 will need to be renewed. Currently, the only means of possible statutory support is Chapter 312, which is relatively similar to Chapter 313, but the benefiting taxing authority is different.[25] Depending on which side you take, there seems to be a lack of trust or oversight of Chapter 313 activities, which is odd considering Chapter 312 has fewer job requirements and limitations than Chapter 313.[26] The only "freedom" Chapter 313 has—compared to Chapter 312—is a school district's granting authority.[27]

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17. *See* TEX. TAX CODE ANN. § 313; TEX. EDUC. CODE ANN. § 48.254; 19 TEX. ADMIN. CODE § 61.1019 (2009) (Tex. Educ. Agency, Additional State Aid for Ad Valorem Tax Credits under the Texas Economic Development Act); H. C. Rep. H.B. 1200 (Tex. 2001).

18. Cornell L. Sch., *Ad Valorem Tax*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/ad_valorem_tax (last visited Nov. 20, 2022).

19. *Id.*; *see* TEX. TAX CODE ANN. § 26.15(g).

20. TEX. EDUC. CODE ANN. § 48.254.

21. *See* Internal Revenue Serv., *Credits and Deductions for Individuals*, IRS, https://www.irs.gov/credits-deductions-for-individuals (last visited Nov. 20, 2022).

22. TEX. ADMIN. CODE ANN. § 61.1019; Tex. Comptroller of Pub. Accts., *Tax Code Chapter 313 — Value Limitation and Tax Credits*, COMPTROLLER.TEX.GOV, https://comptroller.texas.gov/economy/local/ch313/ (last visited Nov. 20, 2022).

23. *See id.*

24. TEX. TAX CODE ANN. § 313.007.

25. *Compare* TEX. TAX CODE ANN. § 313, *with* TEX. TAX CODE ANN. § 312; *compare* TEX. TAX CODE ANN. § 312.002, *with* TEX. TAX CODE ANN. § 313.027.

26. *See* Patrick Svitek, *Texas House speaker says he's confident Legislature will revive expiring corporate tax break program* (Aug. 5, 2022, 1:00 PM), https://www.texastribune.org/2022/08/05/texas-dade-phelan-chapter-313/; *compare* Tex. Comptroller of Pub. Accts., *Chapter 313 Application Process*, COMPTROLLER.TEX.GOV, https://comptroller.texas.gov/economy/local/ch313/process.php (last visited Nov. 20, 2022), *with* Tex. Comptroller of Pub. Accts., *Step-By-Step Abatement Process*, COMPTROLLER.TEX.GOV, https://comptroller.texas.gov/economy/local/ch312/abatement-process.php (last visited Nov. 20, 2022).

27. *See id.*

B. Mechanics of Chapter 313

The Comptroller's office outlines the application process to secure a Chapter 313 tax break with the burden seemingly on the property owner and the school district.[28] To further explain:

> [A] property owner must file a Comptroller-prescribed application form with the school district. The school district may choose not to consider the application. If the school district decides to consider the application, the school district must send a copy of the application to the Comptroller and the relevant appraisal district. The school district also must request that the Comptroller provide an economic impact analysis.
> . . . .
> The Comptroller is required to make a recommendation to the school district on whether to accept or reject the application, based on the criteria in the economic impact evaluation, or any other information available to the Comptroller.
> The school district may approve the application only if it: [1] finds that the information in the application is true and correct, [2] finds that the applicant is eligible for the limitation and [3] determines that granting the application is in the best interest of the school district and this state.[29]

In actuality, after obtaining a lease or buying property—if a company is not familiar with the school district—the company representative contacts the governor's outreach division for a point of contact to start a conversation between the school district and the company to gauge interest. The company completes most of the work, not the landowner or school district.[30] After the initial negotiations between the parties, the school district and the company submit an application to the Comptroller to "cap the value" of the property taxes the company pays directly to the school district.[31] Before the 2013 amendments, the funding was basically unlimited.[32] In fact, some of the benefits for school districts came from the agreements that gave school districts the option to increase the value of education offered in the district with new buildings, athletic stadiums, and smartboards.[33] After the amendments, there are limits to the amount of money and extra benefits a school district can capture before they are required to send the surplus to the state.[34] For example, the last amended version of Chapter 313 limited the

28. *Chapter 313 Application Process*, *supra* note 26.
29. *Id.*
30. Interview with James Sanderson, *supra* note 15. Sanderson said that companies reach out to the board to send "mock" agreements and then present their plan and findings to the board.
31. TEX. TAX CODE ANN. § 313.027.
32. *See id.*
33. *See id.*
34. *See id.*

amount of money available outside of the traditional tax break that comes with the agreements:

> A person and the school district may not enter into an agreement under which the person agrees to provide supplemental payments to a school district or any other entity on behalf of a school district in an amount that exceeds an amount equal to the greater of $100 per student per year in average daily attendance . . . or $50,000 per year . . . .[35]

This amendment substantially limits the benefits available to school districts, which in turn, makes school districts less likely to consider projects with lower tax caps.[36] Renewable energy companies generally prefer a lower capped amount, so this amendment has subsequently hindered the once-growing industry of renewable energy within the state.[37]

The application also discusses job creation requirements, required investments by the company, and the limited tax value.[38] Within ninety-one days, the Comptroller can make recommendations to the school board regarding the application, but ultimately the power to approve is in the hands of the school district.[39] But the school board can only approve the application if the school board finds "that the information in the application is true and correct . . . the applicant is eligible for the limitation and . . . granting the application is in the best interest of the school district and this state."[40]

The eligible companies included: manufacturing, research and development, clean coal and other clean energy projects, renewable electricity generation, nuclear energy, computer data centers, and Texas priority projects.[41] The company types were further limited if they were not exempt under another section of the tax code.[42] In counties with a population of less than 50,000, companies were required to invest at a minimum between $1 million and $30 million, depending on the type of project.[43] The default rule requires the creation of twenty-five new job opportunities with at least 1600 hours of work, with a salary of at least 110% of the county's average weekly wages.[44]

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35. *Id.* § 313.027(i).
36. *Id.*
37. *See* Tex. Comptroller of Pub. Accts., *Report of the Texas Economic Development Act 2021*, COMPTROLLER.TEX.GOV 3 (Jan. 2021), https://comptroller.texas.gov/economy/local/ch313/biennial-reports.php.
38. *Chapter 313 Application Process*, *supra* note 26.
39. *Id.*
40. *Id.*
41. TEX. TAX CODE ANN. § 313.024.
42. *Id.* § 313.009.
43. *Id.* §§ 313.023, 313.053.
44. *Id.* § 313.021.

C. Chapter 313 Data

Chapter 313 agreements grant ten-year tax credits that vary in value by each Texas school district; that is, the school district granting the agreement wholly receives the new tax base as the only taxing authority.[45] This differs from Chapter 312 because, in Chapter 312, taxing authorities—local and county—can overlap.[46] Here, the taxing authority—school districts—cannot overlap, so the one authority benefits more when compared to a Chapter 312 abatement.[47] In 2021, the Comptroller reported over 500 active Chapter 313 agreements.[48] This created over 56,000 "full-time equivalent" (FTE) jobs through 2019.[49]

Furthermore, the projects added $2.5 billion to personal income in Texas since the start of the program.[50] The granted tax credits decreased property taxes to $16 billion, with the original worth tallying up to $47 billion.[51] Of the over 500 agreements, 61% are renewable energy companies.[52] But, in the spirit of transparency, only 28.8% of the $217 billion active investments are attributable to renewable energy.[53] This amounts to *only* adding $62.5 billion in investments to school districts that approve renewable energy projects.[54] Even though 38% of active projects are manufacturing, they account for 70.8% of the total active investments.[55] But, when looking at the active Chapter 313 renewable energy projects, the projects, on average, add $200.3 million to school district areas as an investment in the community per project.[56] Considering the data, it is clear that the state is adding more renewable energy at a much cheaper price than manufacturing developments.[57]

In a somewhat parallel line of thinking, the Comptroller estimated a total tax benefit of $10.8 billion, $2.9 billion of which has benefited school districts that enter agreements with renewable energy companies—namely

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45. *Chapter 313 Application Process*, *supra* note 26.

46. *See id*.

47. *Compare* Tex. Comptroller of Pub. Accts., *Biennial Registries of Reinvestment Zones for Tax Abatements and for Tax Increment Financing 2020*, COMPTROLLER.TEX.GOV 14 (Dec. 2020), https://comptroller.texas.gov/economy/local/ch312/biennial-reports.php, *with Chapter 313 Application Process*, *supra* note 26.

48. *See Report of the Texas Economic Development Act 2021*, *supra* note 37, at 1, 1.

49. *Id.* at 3.

50. *Id.*

51. *Id.*

52. *Id.*

53. Tex. Comptroller of Pub. Accts., *Texas Economic Development Act Chapter 313 Summary Data 2021*, COMPTROLLER.TEX.GOV 1, 1 (Jan. 2021) https://comptroller.texas.gov/economy/local/ch313/biennial-reports.php.

54. *See id*.

55. *Id.*

56. *See id*.

57. *See id*.

school districts in rural West Texas.[58] On average, the property taxes paid by companies with a Chapter 313 agreement adds $9.3 million to the local tax basis per project.[59]

Considering the wealth of opportunity, in a normal year, the Comptroller reported around 20,000 hours of work devoted to Chapter 313 application reviews, which is less than 1% of the Texas Comptroller's Office's full-time employee's total yearly time.[60]

D. Examples of Chapter 313 Programs

When Chapter 313 agreements became popular in the early 2000s, rural and urban school districts took different approaches when considering agreements. For instance, Blackwell Consolidated Independent School District (CISD) was ahead of the game when the school board accepted its first Chapter 313 agreement in 2004—gaining an estimated $9.5 million for the school district.[61] This was the first of many agreements accepted by the school district, though the West Texas district has since accepted agreements from wind, solar, and hydraulic companies.[62] There was no need for Blackwell CISD to worry about not receiving the total agreement amount because Chapter 313 uses state money to ensure an increase in economic development.[63] A few years before the Chapter 313 agreements were implemented, the school district struggled to survive.[64] However, in less than twenty years, the Blackwell CISD School Board—as a direct result of Chapter 313 adding a significant amount to the tax base—has built a multi-million dollar school, created a foundation scholarship for all students who graduate, and increased teacher pay.[65] With roughly a $10 million budget, 70% directly results from Chapter 313 agreements.[66] Like many other rural districts, Blackwell CISD relied on the tax incentives that otherwise

58. *See Texas Economic Development Act Chapter 313 Summary Data 2021*, *supra* note 53 at 1; *Report of the Texas Economic Development Act 2021*, *supra* note 37 at 18–526.

59. *See id*.

60. *Report of the Texas Economic Development Act 2021*, *supra* note 37 at 1; *Comptroller of Public Accounts*, TEX. TRIB.: GOV'T SALARIES EXPLORER, https://salaries.texastribune.org/departments/comptroller-of-public-accounts/ (last visited Nov. 20, 2022). Simple math tells us that the 2456 full-time employees who work 40 hours per week with an average of 50 weeks per year means the total number of hours worked is 4.9 million (give or take 300 thousand hours for federal holidays or those who do not take their full two weeks paid time off). 20,000 is less than 1% of 4.9 million hours.

61. Tex. Comptroller of Pub. Accts., *Report of the Texas Economic Development 2013*, COMPTROLLER.TEX.GOV 3 (Jan. 2013) 1, 1, 31 (on file with author).

62. *Id.*; *Report of the Texas Economic Development Act 2021*, *supra* note 37, at 1, 1, 20, 55, 442.

63. Olga Garza & Annet Nalukwago, *Chapter 313: Attracting Jobs and Investment*, COMPTROLLER.TEX.GOV: FISCALNOTES (Apr. 2016), https://comptroller.texas.gov/economy/fiscal-notes/2016/april/chap313.php.

64. Interview with James Sanderson, *supra* note 15.

65. *Id.*

66. *Id.*

might not have brought an additional tax base to the district without the extra burden to taxpayers.[67]

Conversely, Round Rock Independent School District (ISD) took the opposite approach of Blackwell CISD—Round Rock ISD denied a Chapter 313 project for seemingly unknown reasons. During the 150-day approval period, Round Rock killed the chance to bring Toppan Photomasks to Texas, which wanted to limit its taxable value to $100 million.[68] Admittedly, the tax incentive would have cut Toppan's payout to less than 13% of the total land value, which is less than 2% of the Round Rock ISD annual budget spread over ten years.[69] When comparing the Round Rock and Blackwell proposed agreements monetarily, they offer roughly the same amount to each district.[70]

Even though the monetary value is relatively the same in each example, the effect in a rural school district is drastically different from what a more urban school district such as Round Rock ISD can do with 2% of its budget. The differences in value do not make the credit any less vital to the public school system. Simultaneously, this has a huge effect on the economy and growth of the energy industry that Texas desperately needs with the increase in population and, thus, increased demand for energy.

IV. EXPIRATION OF CHAPTER 313

On December 31, 2022, Chapter 313 officially expired.[71] The expiration comes after a long line of Texas legislature extensions since the 2001 implementation.[72] Why the sudden change from the status quo? Some legislators claim a lack of school district transparency and accountability to the state as potential reasons for the end of the program.[73] Others point toward insufficient opportunities for some school districts and other state programs.[74] Other than basic contract disputes, no legal issues surround

67. *Chapter 313: Bringing Investment and Economic Growth to Rural Texas*, *supra* note 13.

68. Brooke Sjoberg, *Round Rock ISD declines application for agreement on potential $900M Toppan Photomasks project*, CMTY. IMPACT (May 20, 2022, 1:12 AM), https://communityimpact.com/austin/round-rock/2022/05/19/round-rock-isd-declines-application-for-agreement-on-potential-900m-toppan-photomasks-project/; Sara Hardner Leon & Michelle Alcala, *Summary of the Texas Economic Development Act*, LEON|ALCALA, PLLC, (May 19, 2022), https://go.boarddocs.com/tx/rrisd/Board.nsf/files/CEKUKR7C5689/$file/Round%20Rock%20ISD%20-%20Toppan%20313%20Presentation%20(1).pdf.

69. *Id.*; Brooke Sjoberg, *Round Rock ISD passes $518M budget for 2022-23 school year; tax rate vote to come later*, CMTY. IMPACT (June 17, 2022, 11:42 AM), https://communityimpact.com/austin/round-rock/education/2022/06/17/round-rock-isd-passes-518m-budget-for-2022-23-school-year-tax-rate-vote-to-come-later/. 100 million divided over 10 years is 10 million each year. 10 million is 1.93% of the $518 million budget approved by Round Rock ISD for 2022–2023.

70. *Id.*; Interview with James Sanderson, *supra* note 15.

71. TEX. TAX CODE ANN. § 313.007.

72. *Chapter 313: Attracting Jobs and Investment* (2016), *supra* note 63.

73. Svitek, *supra* note 26.

74. *Id.*

Chapter 313 agreements in the courts.[75] House Speaker Dade Phelan said he will readdress the tax incentives in the 2023 Texas legislature.[76] Though, currently, the legislation filed in the 2023 session has not made significant progress to reimplement the same or even a similar program.[77]

It was decided that those agreements between companies and school districts approved by December 31, 2022 were to be grandfathered into the ten-year tax breaks.[78] In order to be grandfathered in, school districts needed to submit Chapter 313 agreement applications before October 1, 2022 to allow the Comptroller the full amount of time to review the application.[79] Realistically, schools needed to push this date back a few months to give boards an adequate amount of time to approve or deny the project after receiving the Comptroller's suggestions.[80] If the Comptroller did not approve agreements before December 31, 2022, school districts and companies were left at a standstill until new tax incentives could be implemented.[81]

V. SOLUTIONS FOR INCENTIVIZING RENEWABLE ENERGY PRODUCTION

When considering comments made by members of the legislature, it seems likely the new green energy tax incentives will have more state government oversight. Ideally, though, the core of Chapter 313 will remain in place. Since most of Subtitle C expired in 2014, it is unlikely that a new solution will be as liberal as the first version.[82] The possible solutions to continue to promote green energy in Texas and address political concerns are amendments to the tax code or amendments to proposed legislation.

A. Current Statute: Chapter 312

In 1987, the Texas legislature implemented the Property Redevelopment and Tax Abatement Act, commonly referred to as Chapter 312.[83] This section of the Code gave local taxing authorities the power to negotiate with abatements as incentives for businesses to move to the region.[84]

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75. *See generally* Cirrus Wind I, LLC v. Stephens Ranch Wind Energy, LLC, No. 07-16-00098-CV, 2017 WL 1376754 (Tex. App.—Amarillo Apr. 7, 2017, no pet.); City of Westworth Vill. v. City of White Settlement, 558 S.W.3d 232 (Tex. App.—Fort Worth 2018, pet. denied).

76. Patrick Svitek, *supra* note 26.

77. *See* H.B. 2421, 88th Leg., Reg. Sess. (Tex. 2023), https://capitol.texas.gov/BillLookup/BillStages.aspx?LegSess=88R&Bill=HB2421 (indicating H.B. 2421 has only met one of seven mandatory stages for bills to become law).

78. TEX. TAX. CODE ANN. § 313.171.

79. *Chapter 313 Application Process*, *supra* note 26.

80. *Id.*

81. *See id.*

82. TEX. TAX CODE ANN. §§ 313.051–313.054.

83. *Id.* tit. 3.

84. *Id.*; Tex. Comptroller of Pub. Accts., *Chapter 312 Frequently Asked Questions*,

Chapter 312, viable after December 31, 2022, is virtually the same as Chapter 313 in that they both allow a ten-year property tax limitation, but Chapter 312 is an abatement, whereas Chapter 313 is a tax credit.[85] You, like most people, are probably scratching your head and wondering about the difference. An abatement, such as the one in Chapter 312, allows taxpayers to pay less than what otherwise is required on their tax returns because the property value is limited.[86] A tax credit, like the one through Chapter 313, credits the company with the amount they were supposed to pay.[87] To analogize, an abatement is an automatic discount sale of 50% in the entire store, whereas a credit is like having to cut a coupon out of the paper in order to get the discount.

Why would the Texas legislature set one for expiration and extend the other? The popular legal blog, JD Supra, reasons that "[u]nlike Chapter 312, which provides for the abatement of property taxes, Chapter 313 allows school districts and property owners to enter into agreements to limit the appraised value of property for ad valorem property tax purposes."[88] Essentially, the lack of state control and oversight within a Chapter 313 agreement caused the legislature not to extend the program.[89] While Chapter 312 still provides some sort of financial benefit, the main concern with a reliance on Chapter 312 is the lack of benefit to the local economy—which could deter the legislature from renewing.

1. Chapter 312 Mechanics

The process for companies to receive a Chapter 312 tax abatement is to: "[1] Adopt Guidelines and Criteria [2] Designate a Reinvestment Zone [3] Enter into a Tax Abatement Agreement [4] Mandatory Reports to the Comptroller."[90] The burden is on the taxing authority to adopt guidelines *before* approving a reinvestment zone under Chapter 312.[91] Furthermore, the guidelines must be renewed every two years—making the Chapter 312 abatement process front-loaded.[92] Chapter 312 generally allows a city or

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COMPTROLLER.TEX.GOV, https://comptroller.texas.gov/economy/local/ch312/faq.php (last visited Nov. 20, 2022).

85. TEX. TAX CODE ANN. §§ 312.006, 312.204, 313.027.

86. 26 U.S.C. § 6404(a); *Tax Code Chapter 313 — Value Limitation and Tax Credits*, *supra* note 22.

87. *Tax Credit*, TAX FOUND., https://taxfoundation.org/tax-basics/tax-credit/ (last visited Nov. 20, 2022).

88. Thomas H. Warren & Scott Wright, *Texas Extends Chapter 312 Property Tax Abatement Program*, JDSUPRA (June 26, 2019), https://www.jdsupra.com/legalnews/texas-extends-chapter-312-property-tax-11385/.

89. *See id.*; Svitek, *supra* note 26.

90. *Step-By-Step Abatement Process*, *supra* note 26 (quoting main title headings).

91. *Id.*

92. *Id.*

county taxing authority to grant an abatement.[93] Taxing authorities that enter into Chapter 312 agreements must first create their own guidelines and criteria adopted via resolution.[94] For example, "[a]n agreement may provide for the exemption of the real property in each year covered by the agreement to the extent its value for that year exceeds its value for the year in which the agreement is executed."[95]

The taxing authority then assigns an area within its governance to be a reinvestment zone.[96] Like the adoption of guidelines to name a reinvestment zone, taxing authorities are required to notify the public and hold a hearing.[97] Specifically, they must notify the public at least seven days in advance by newspaper.[98] The purpose is not only for the public's awareness but also for other overlapping taxing authorities.[99] For instance, if the City of Austin considered accepting a Chapter 312 agreement, the city would have to notify Travis County authorities in a separate written statement, in addition to the newspaper notices in the Austin American-Statesman, the Austin Chronicle, and on the city website.[100]

The public hearing is a formality to determine if the reinvestment zone statutorily qualifies.[101] To approve and designate the new reinvestment zone, the taxing authority must find two factors to be true: first, there must be evidence presented that "improvements sought are feasible and practical and would be a benefit to the land to be included in the zone and to the municipality after the expiration of an agreement . . . ." and second, there must be a showing that "the designation would contribute to the retention or expansion of primary employment or would attract major investment in the zone that would be a benefit to the property to be included in the zone and would contribute to the economic development of the county."[102] This is very similar to the Chapter 313 requirement of finding that the project is in the district's best interest.[103]

After the public hearing, the adopted ordinance goes into effect.[104] This ordinance specifically describes the land being designated for reinvestment and what tax abatements will be allowed in the zone after thirty days.[105] At first glance, the statute seems to say only landowners benefit from the reinvestment zone, but the benefit to the taxing authority comes from the

93. TEX. TAX CODE ANN. § 312.002.
94. *Id.* § 312.002(a).
95. *Id.* § 312.204(e).
96. *Step-By-Step Abatement Process*, *supra* note 26.
97. *Id.*
98. *Id.*
99. *Id.*
100. *Id.*
101. *Id.*
102. *See Step-By-Step Abatement Process*, *supra* note 26; TEX. TAX CODE ANN. §§ 312.201, 312.401.
103. *Chapter 313 Application Process*, *supra* note 26.
104. *Id.*
105. *Id.*; TAX CODE ANN. § 312.207(d).

minimum improvement portion of the agreement.[106] Some abatement benefits include reducing the unemployment rate, strengthening business, and increasing tax revenue.[107] Again, when doing a side-by-side comparison to Chapter 313—these benefits are fairly similar.[108] A key difference between the two is the lack of restriction on the amount that can be abated in a Chapter 312 agreement.[109]

Once the tax abatements go into effect, the Comptroller requires a yearly report for the length of the agreement—and then for three years after the expiration—to assess the appraisal value of the reinvestment zone.[110]

2. Chapter 312 Data

A majority of the Chapter 312 abatement terms have a ten-year agreement under one designated taxing unit; that is, the taxing unit has limited the potential property value for those ten years simply for the benefit of bringing business into the area.[111] The value for abated property between 2018 and 2029 is more than $107 *billion*.[112] The taxing unit's new base value of the abated property is now limited to roughly $13 billion—12% of the original value.[113] Unlike the hundreds of projects active under Chapter 313, Chapter 312 only has 108 reinvestment zones—most of which are industrial or commercial properties.[114] Of the active projects, 50 are under city government, 57 are from counties, and one is from an independent school district.[115] The 108 zones account for 873 total abatements.[116] This means that multiple taxing units overlap in some of the abatement zones and share the tax base brought in by the business.[117]

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106. TEX. TAX CODE ANN. § 312.204.

107. *Chapter 312 Frequently Asked Questions*, *supra* note 84.

108. *Compare Chapter 313 Application Process*, *supra* note 26, *with Step-By-Step Abatement Process*, *supra* note 26.

109. *Biennial Registries of Reinvestment Zones for Tax Abatements and for Tax Increment Financing 2020*, *supra* note 47, at 137.

110. *Step-By-Step Abatement Process*, *supra* note 26.

111. *Biennial Registries of Reinvestment Zones for Tax Abatements and for Tax Increment Financing 2020*, *supra* note 47, at 14.

112. *Id.* at 16.

113. Tex. Comptroller of Pub. Accts., *August 2022 Tax Abatement and Reinvestment Zone Log*, COMPTROLLER.TEX.GOV, https://comptroller.texas.gov/economy/local/ch312/biennial-reports.php (last visited Nov. 20, 2022).

114. *Biennial Registries of Reinvestment Zones for Tax Abatements and for Tax Increment Financing 2020*, *supra* note 47, at 10.

115. *Id.*

116. *Id.* at 17.

117. *See id.*

One of the main benefits of an abatement is the number of jobs created for the projects, though this is not necessarily a statutory requirement.[118] The Comptroller projects $225.4 million to be spent on payroll for Chapter 312 projects for the 2023 fiscal year, while the total projection for Texan salaries from 2018 through 2029 is roughly $1.6 billion.[119] This will create over 92,000 FTE jobs.[120]

Generally, Chapter 312 projects seem more likely to benefit manufacturing businesses than energy.[121] As of August 2022, the Comptroller did not report any new renewable energy projects.[122] Overall, Chapter 312 abates less than a minuscule amount of renewable projects.[123] No energy production companies of any kind break the top three business types abated; instead, 33% comes from manufacturing, 14% from industrial, and 12% from commercial.[124] Non-renewable energy makes up 11% of abated projects.[125] In the August 2022 report, the Comptroller reported 123 non-renewable businesses.[126] Unfortunately, not all of these projects are new developments; some are merely expansions.[127] While this is still a positive statistic for the energy industry as a whole, the reality is fewer renewable energy companies are receiving opportunities and thus creating less competition and growth.[128]

The data obviously shows the benefit of obtaining a Chapter 312 abatement but does not favor, as a long-term option, energy companies—specifically renewable energy. In 2020, the Comptroller reported 71 projects that were merely expanding, while only 74 new projects were granted abatements.[129] For renewable energy companies—who have not benefited from Chapter 312 compared to other types of businesses—this statistic shows that to survive in Texas, tax incentives need to focus more on engineering new energy projects. After 2022, Chapter 312 is the last man standing for original state tax breaks in relation to renewable energy companies at the local level. To continue promoting energy discovery and development, major

118. *See id.* at 8; Jess Fields, *Purpose-Driven Economic Development*, TEX. PUB. POL'Y FOUND. 5 (May 2019) https://www.texaspolicy.com/wp-content/uploads/2019/04/Fields-ACEE-Purpose-Driven-Econ-Devt.pdf.

119. *Id.* at 15.

120. *Biennial Registries of Reinvestment Zones for Tax Abatements and for Tax Increment Financing 2020*, *supra* note 47, at 111.

121. *Id*. at 188–367.

122. *August 2022 Tax Abatement and Reinvestment Zone Log*, *supra* note 113.

123. *Biennial Registries of Reinvestment Zones for Tax Abatements and for Tax Increment Financing 2020*, *supra* note 47, at 15.

124. *Id.*

125. *Id.*

126. *August 2022 Tax Abatement and Reinvestment Zone Log*, *supra* note 113.

127. *See id.*

128. *See id.*

129. *Biennial Registries of Reinvestment Zones for Tax Abatements and for Tax Increment Financing 2020*, *supra* note 47, at 14.

amendments or new incentive programs will need to be made to the tax code in the coming years.

3. Fixing the Statute in Place

For Chapter 312 to be a viable alternative for energy incentivization, amendments must require substantial job creation and prioritize renewable energy production.

The simplest solution is to copy the language in §§ 313.021(3) and (5) and add it to the general provisions in Subchapter A. This would afford twenty-five new job opportunities with at least 1,600 hours of work and a salary of at least 110% of the county's average weekly wages; in turn, this would add multiple high-paying jobs to the local economy.[130] For example, the median household income in Nolan County is $43,692, and the FPL Energy Horse Hollow Wind GP Chapter 313 agreement salary is $58,079, which amounts to nearly 133% of the county median.[131] Furthermore, the FPL Energy Horse Hollow Wind GP Chapter 313 agreement salary is over 115% of the state average salary, which is $50,137.[132]

To prioritize renewable energy, an amendment should be offered to repeal § 312.002(f). Currently, this subsection prohibits school districts from entering Chapter 312 agreements post-2001.[133] Since Chapter 313 is no longer in effect, there is not a way for school districts to double dip into the money pot. Adding school districts to eligible taxing authorities would create more opportunities for renewable energy companies to receive abatements. As we have seen with the data from Chapter 313, school districts seem more willing to grant renewable energy companies an agreement; and repealing this provision is a simple fix to a big issue.[134]

B. Alternative Solution

The only proposed legislation to add tax incentives in the 88th Texas legislature are Texas House Bill No. 31 (88R) and Texas House Bill No. 2421 (88R).[135] Neither of these fixes the long-term issues that Speaker Phelan and other legislators listed as a reason for letting Chapter 313 sunset during the 2021 session.[136] Instead, the bills offer short-term solutions for a few years,

130. TEX. TAX CODE ANN. § 313.021.

131. *See Report of the Texas Economic Development Act 2021*, *supra* note 37, at 1, 1, 20; *Nolan County, TX*, DATA USA, https://datausa.io/profile/geo/nolan-county-tx (last visited Nov. 20, 2022).

132. *See Report of the Texas Economic Development Act 2021*, *supra* note 37, at 1, 1, 20.

133. TEX. TAX CODE ANN. § 312.002(f).

134. *Compare Report of the Texas Economic Development Act 2021*, *supra* note 37, at 3, *with August 2022 Tax Abatement and Reinvestment Zone Log*, *supra* note 113.

135. H.B. 31, 88th Leg., Reg. Sess. (Tex. 2023); H.B. 2421, 88th Leg., Reg. Sess. (Tex. 2023).

136. Svitek, *supra* note 26.

but this is by no means the best way to address the overarching issues that withhold Chapter 313 from benefiting Texas in the future.

Texas House Bill 31 is more of a major overhaul on how schools calculate their student population rather than promoting green energy production.[137] Amending the requirement of looking at daily student attendance to annual average enrollment would actually increase the amount of money a school district can request in agreements.[138] The annual average enrollment is likely a larger number than the daily attendance because student absences count against daily attendance. However, if they are still enrolled in school, the district would be allowed to count that student in the average enrollment. In order for this proposal to be an effective solution, a significant amendment would need to be offered since House Bill 31 does not have any provision to reenact Chapter 313.[139]

Finally, Texas House Bill 2421 amends Chapter 313's expiration date.[140] This change extends the life of Chapter 313 to December 31, 2033.[141] A ten-year extension is a good start, but again, this seems like a band-aid over a bullet hole. So far, Texas House Bill 2421 has not made any significant progress in the legislative process and, thus, is unlikely to have the necessary support to be enacted as is.[142] An amendment is needed to fix the oversight issues that initially gave way to the expiration.[143]

The most logical place to amend the foundation of Chapter 313 is in what was previously § 313.031. This section mainly deals with the rules and oversight the Comptroller possesses over the program.[144] Before expiring, it reads as follows:

> (a) The comptroller shall:
>
> > (1) adopt rules and forms necessary for the implementation and administration of this chapter, including rules for determining whether a property owner's property qualifies as a qualified investment under Section 313.021(1); and
> >
> > (2) provide without charge one copy of the rules and forms to any school district and to any person who states that the person

137. H.B. 31, 88th Leg., Reg. Sess. (Tex. 2023).

138. *Id.* § 313.027(i).

139. *Id.*

140. H.B. 2421, 88th Leg., Reg. Sess. (Tex. 2023).

141. *Id.* § 313.007.

142. *See* H.B. 2421, 88th Leg., Reg. Sess. (Tex. 2023), https://capitol.texas.gov/BillLookup/BillStages.aspx?LegSess=88R&Bill=HB2421 (indicating HB 2421 has only met one of seven mandatory stages for bills to become law).

143. *See* Svitek, *supra* note 26.

144. TEX. TAX CODE ANN. § 313.031.

> intends to apply for a limitation on appraised value under this subchapter.
>
> (b) The governing body of a school district by official action shall establish reasonable nonrefundable application fees to be paid by property owners who apply to the district for a limitation on the appraised value of the person's property under this subchapter. The amount of an application fee must be reasonable and may not exceed the estimated cost to the district of processing and acting on an application, including any cost to the school district associated with the economic impact evaluation required by Section 313.025.[145]

This language is ambiguous. An amendment should be offered to specify the rules and oversight necessary. Making the program more objective will make the legislation more likely to stay in place. The new version should read:

> (a) The comptroller shall:
>
> (1) oversee the implementation of this subchapter by:
>
> (i) reviewing each agreement annually; and
>
> (ii) reporting the findings on or before December 31st annually to the Lieutenant Governor, Speaker of the House, House Committee on Ways and Means, House Committee on Business and Industry, House Committee on Energy Resources, House Committee on Public Education, Senate Committee on Business and Commerce, Senate Committee on Education, Senate Committee on Natural Resources and Economic Development, and Senate Committee on Local Government; and
>
> (iii) updating the Comptroller's website to reflect information gathered from school districts.

145. *Id.*

Although the Comptroller gives biennial reports, this language would: (1) codify that requirement, (2) require school districts to give more information to the state about their agreements more often, and (3) encourage more responsible spending by school districts—all of which address the rumored issues legislators had with the previous statute. Since the Comptroller has already been gathering data for Chapter 313, the transition will not severely impact the state monetarily.

The "Eligible Property" section of the new legislation could require steeper minimums for investment. The previous school district categories have five different overall investment amounts.[146] A new minimum amount for these investment types could help the state feel less responsible for supplementing the school districts. For example, the current minimum limit for a project investing $100 million is $20 million.[147] This could be implemented by requiring the company and school district to prove the agreement would add at least 5% to the taxing authority's average basis. With this requirement, it would show the state that the agreements legitimately benefit the students within the school district, as well as increase the local economy.

VI. CONCLUSION

Texas needs a new incentive, since Chapter 313 expired, to incentivize more renewable companies to build in Texas instead of other states that are offering more incentives. Chapter 312 is not enough for Texas to continue as the king of energy. The lack of projects being granted to renewable energy companies—and non-renewable energy companies—could set the Texas energy industry back twenty years. Although the legislature is looking for more oversight and innovation in Chapter 313, without a new version of the code, energy companies will be left without incentives in Texas.

When looking at a new version of Chapter 313, it will likely follow the same concepts but with more oversight from the state. Allowing school districts the opportunity to grant these agreements adds another taxing authority to the mix, giving more options to energy companies looking to move to Texas. The option to use Chapter 312 is still available for energy companies, but as the data shows, fewer energy companies are granted Chapter 312 agreements compared to Chapter 313. The gap left behind by the expiration of Chapter 313 could be filled if amendments were made or if there was a larger push from the industry to allow more abatements for energy

146. *Id.* § 313.022.
147. *Id.* § 313.027.

companies. As the data shows, there would need to be a major overhaul of granting abatements to energy companies.[148]

Not only are the state and energy companies at a disadvantage with the expiration of Chapter 313, but victims are school districts with a smaller tax base. For twenty years, these districts have relied on the money received from the energy companies. This could affect future funding, academics, and access to education. With the Texas public education system underperforming as it is, it is almost inconceivable to think about the impact of less funding for schools.[149]

It is important to have tax breaks for energy companies to continue to promote energy more efficient ways of production—as our population grows. Texas has led in oil and gas and, to continue to be the king of energy incentives, it will need to take action to encourage renewable energy. Despite the expiration of Chapter 313, as the world officially hits eight billion in population, we as an industry and state will need to develop ways to increase our energy production. Current trends are pointing toward harvesting more renewable energy.[150] To do that, Texas cannot fall behind in the effort to incentivize these projects.

148. *Biennial Registries of Reinvestment Zones for Tax Abatements and for Tax Increment Financing 2020*, *supra* note 47, at 15.

149. Renee Monrad, *States with the Best Public School Systems*, FORBES, https://www3.forbes.com/business/states-with-the-best-public-school-systems-ifs-vue-wnb/?slide=15 (last visited Nov. 20, 2022); EdWeek Rsch. Ctr., *Quality Counts 2021: Educational Opportunities and Performance in Texas*, EDUC. WEEK (Sept. 1, 2021), https://www.edweek.org/policy-politics/quality-counts-2021-educational-opportunities-and-performance-in-texas/2021/01; Adam McCann, *States with the Best & Worst School Systems*, WALLETHUB (July 25, 2022), https://wallethub.com/edu/e/states-with-the-best-schools/5335; *Texas #31 in Overall Rankings*, U.S.NEWS, https://www.usnews.com/news/best-states/texas (last visited Nov. 20, 2022).

150. U.S. Energy Info. Admin., *Monthly Energy Review*, EIA tbl.1.3 (Apr. 2022), https://www.eia.gov/energyexplained/us-energy-facts/.

INEFFECTIVE SECURITY INTERESTS: THE TEXAS LEGISLATURE'S ATTEMPT TO PROTECT TEXAS OIL AND GAS PRODUCERS, TAKE TWO

As Texas continues to be the leading oil and gas producer in the United States, the Texas legislature has made numerous attempts to protect those producers. This Comment aims to explain the legal and statutory history regarding Texas producers' ability to recover from first purchasers in other states who enter bankruptcy.

Jaret Thurston[*]

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I. INTRODUCTION: WHEN DO I GET PAID?

Oil and gas production has been filling the pockets of landowners, businessmen, and companies across Texas for over a hundred years. Currently, over 600,000 royalty owners statewide are entitled to money from their respective lessees.[1] For the most part, operators will sell oil and gas to various purchasers and then pay the royalty owners their share from the proceeds.[2] The royalty owners' mineral interest, their agreement with the operator, and the selling price of the minerals determine the amount owed to

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1. *Royalty Owners: Vital to The Ongoing Success of Oil & Gas Development*, TEX. INDEP. PRODUCERS & ROYALTY OWNERS ASS'N, https://tipro.org/current-issues/royalty-owners (last visited April 11, 2023).

2. John McFarland, *The Oil and Gas Lease – Part IV: The Royalty Clause*, OIL & GAS LAW. BLOG (Dec. 23, 2014), https://www.oilandgaslawyerblog.com/the-oil-and-gas-lease-part-i-1/.

the royalty owners.[3] The phenomenon of severing mineral rights allows individuals to own an interest in the minerals under land they do not own, such that a person living in San Antonio can own a portion of the minerals underneath another person's house in Lubbock.[4] Because of this, operators must ensure that every interest owner receives proper payment.[5] Is it not interesting that one can own the minerals under someone else's property and collect a check every month without lifting a finger? Mailbox royalties are simultaneously boosting the economy and the happiness of those who receive them.

As previously mentioned, operators sell the produced minerals to other companies and subsequently pay out the returns to the appropriate parties.[6] Therefore, if the buyer fails to pay the operator, nobody gets paid.[7] Nevertheless, the royalty owner may be able to recover from the operator depending on the previously agreed upon royalty payment structure. However, this still leaves no protection for the operator who exhausted a considerable amount of money to produce the oil and gas.[8] What happens if the purchaser fails to pay the operator or, even worse, goes into bankruptcy where other creditors are ready and waiting to collect anything they can get? This Comment will discuss how the energy industry has dealt with getting operators the money owed to them by their oil and gas purchasers.

II. WHAT IS THE PROBLEM?

Bankruptcy cases cause many to start asking the same questions: "Will I get paid? If so, when will I get paid?" As such, the oil and gas industry is not immune to wondering this question. As most practitioners know, the oil and gas industry is a roller coaster: in writing this Comment, crude oil has gone from $78 to $126 to $74—a display of just how unpredictable the industry is at times.[9] Texas is the leading oil and gas producing state in the United States, which leads it to export oil and gas across the nation.[10] In 2021, Texas produced "1.4 billion barrels of crude oil and 10.3 trillion cubic feet of

3. *Id.*

4. Tex. R.R. Comm'n, *Exploration & Surface Ownership*, RRC, https://www.rrc.texas.gov/about-us/faqs/oil-gas-faq/oil-gas-exploration-and-surface-ownership/ (last visited Nov. 1, 2022).

5. *Id.*

6. McFarland, *supra* note 2.

7. *See id.*

8. *See id.*

9. *Closing price of Brent, OPEC basket, and WTI crude oil at the beginning of each week from March 2, 2020 to April 10, 2023*, STATISTA, https://www.statista.com/statistics/326017/weekly-crude-oil-prices/ (last visited Apr. 10, 2023).

10. U.S. Energy Info. Admin., *Texas State Profile and Energy Estimates*, EIA, https://www.eia.gov/state/?sid=TX#:~:text=Texas%20is%20the%20top%20crude%20oil-%20and%20natural,and%20the%20most%20refining%20capacity%20of%20any%20state (last updated May 19, 2022).

total gas[,]" according to the Railroad Commission of Texas.[11] Further, this production "came from 165,136 oil wells and 86,612 gas wells" scattered throughout Texas.[12]

Being a highly energy-oriented state, Texas has worked to protect royalty owners and operators, though this has not always gone according to plan.[13] Texas enacted Texas Business and Commerce Code (Texas Uniform Commercial Code [UCC])§ 9.343, which provided a statutory lien to interested parties that would secure the obligation of the first purchaser of the oil and gas production.[14] This statute, however, did not require interested parties to file a financing statement—a step that is ordinarily required to assert rights in collateral, such as oil and gas.[15] Because there was no need to file a financing statement, royalty owners and operators relied on the statutory lien to protect themselves against other creditors if the first purchaser failed to pay.[16] On its face, Texas Business & Commerce Code§9.343 seems like the solution between first purchasers and the parties they owe.[17] However, statutes are seldom helpful when their ultimate outcome does not protect what they intend to protect.

III. "THE AMAZING DISAPPEARING SECURITY INTEREST"

Parties relying on the lien found out the hard way that, in effect, it did not protect against creditors when the first purchaser was located outside of Texas.[18] In the 2021 case, *In re First River Energy, LLC*, the first purchaser, First River Energy, LLC (First River), purchased oil from various operators in Texas and Oklahoma.[19] First River, a Delaware corporation headquartered in Texas, resold the oil but did not pay the producers before going into bankruptcy.[20] The court addressed this issue in detail, but not until after it put the Texas legislature on notice about its "amazing disappearing security interest" and suggested they take note.[21]

First River filed for relief under Chapter 11 of the Bankruptcy Code only one month after purchasing crude oil and condensate from producers in Texas and Oklahoma.[22] However, they failed to pay the producers despite reselling

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11. Tex. R.R. Comm'n, *Texas Oil and Gas Production Statistics for December 2021*, RRC (Mar. 11, 2022), https://rrc.texas.gov/news/031122-december-production-statistics/.

12. *Id.*

13. *See infra* Parts III–IV.

14. Act of July 1, 1999, 76th Leg., ch. 414, § 1.01, sec. 9.343, TEX. BUS. & COM. CODE ANN. (repealed 2021).

15. *Id.*

16. *Id.*

17. *Id.*

18. *See In re* First River Energy, LLC, 986 F.3d 914 (5th Cir. 2021).

19. *Id.* at 917.

20. *Id.*

21. *Id.*

22. *Id.*

the production.[23] This sparked the dispute on various security interests between the producers, relying on their statutory liens in their respective states, and Deutsche Bank Trust Company Americas (Bank)—the secured lenders for First River.[24] As a midstream service provider, First River essentially acted as a "middleman," purchasing the product and then reselling it to refineries or other companies that prepare it for distribution.[25] The procedure was standard in the oil and gas industry and required the payment by First River to the producers "on or before the 20th day of the month following delivery."[26] First River owed $27,613,066.81 in accounts receivable after selling to the downstream purchasers.[27] After First River filed for bankruptcy, "the [p]roducers filed proofs of claim asserting that they have statutorily created first-priority, perfected purchase money security interests in the proceeds of the oil and condensate pursuant either to Texas UCC Section 9.343 or Okla. Stat. Ann. tit. 52," § 549.[28]

The Bank entered into a credit agreement with First River under Delaware law, under which First River granted it a security interest in all of its assets, including accounts and proceeds.[29] This security interest was perfected by filing a financing statement in Delaware, and the perfection was properly maintained pursuant to the UCC.[30] The Bank also required First River to enter into a Blocked Account Control Agreement with JPMorgan Chase and the Bank, which gave the Bank a security interest in all the funds deposited into First River's JPMorgan account.[31] Additionally, it was settled to allow New York law to govern the agreement.[32]

After First River filed its Chapter 11 petition in Delaware, the case was transferred to the Western District of Texas.[33] Subsequently, the Bank filed an adversary proceeding to determine its priority over the producer's alleged security interests.[34] The bankruptcy court had to make a choice of law determination because Delaware did not have a similar provision to the Texas Business & Commerce Code § 9.343, but ruled that the Bank had perfected its security interests and those interests would have priority over later filed or unperfected interests of the Texas producers.[35] Accordingly, the Oklahoma statutory liens were ruled to have priority over the Bank's security interest,

23. *Id.*
24. *Id.* at 917.
25. *Id.* at 917–18.
26. *Id.* at 918.
27. *Id.*
28. *Id.*
29. *Id.* at 919.
30. *Id.*
31. *Id.*
32. *Id.*
33. *Id.*
34. *In re* First River Energy, LLC, No. 18-50085-CAG, 2019 WL 1103294, at *1 (Bankr. W.D. Tex. Mar. 7, 2019), aff'd sub nom. *In re* First River Energy, L.L.C., 986 F.3d 914 (5th Cir. 2021).
35. *In re First River Energy*, 986 F.3d at 919.

and the Bank had a first-priority security interest in the JPMorgan Chase account for First River.[36]

On appeal, the court's discussion revolved around the effectiveness of the state laws intended to protect state producers by ensuring their payments.[37] Because Delaware, the state under which First River was organized, does not recognize non-standard UCC security interests, the producers faced a difficult challenge.[38] The producers relied on Texas Business & Commerce Code § 9.343, which did not have the standard filing requirements for security interests under Article 9 of the UCC.[39] This statute provided for a "purchase money security interest" that secured the rights of the producers to receive payment from the first purchasers of the production.[40] This security interest was immediately perfected if it was evidenced by a "deed, mineral deed, reservation in either, oil or gas lease, assignment or any other such record recorded in the real property records of a county clerk, that record is effective as a filed financing statement for the purposes of this chapter."[41] The Texas statute had non-uniform Article 9 requirements to benefit interested owners.

On the other hand, the Oklahoma Lien Act did not create a UCC-like lien but instead created a state statutory lien.[42] Plain and simple, the statute stated that "[T]o secure the obligations of a first purchaser to pay the sales price, each interest owner is hereby granted an oil and gas lien to the extent of the interest owner's interest in oil and gas rights."[43] The statute further states that "an oil and gas lien 'exists in and attaches immediately to all oil and gas on the effective date of this act; continues uninterrupted and without lapse in all oil and gas upon severance; and continues uninterrupted and without lapse in and to all proceeds' until the interest owner has received the sales price."[44] Like the Texas statute, this lien did not require filing a financing statement.[45] Yet, Delaware did not have a similar statute to that of Oklahoma and Texas and, instead, followed the uniform UCC requirements, which require filing a financing statement.[46]

The varying provisions in the Texas UCC undermined the Texas producer's choice of law argument.[47] The producers argued that section 9.343 shifts the Texas UCC choice of law rules because enforcing sections 9.301(1)

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36. *Compare In re First River Energy*, 986 F.3d at 919, *with* Act of July 1, 1999, 76th Leg., ch. 414, § 1.01, sec. 9.343, TEX. BUS. & COM. CODE ANN. (repealed 2021).
37. *In re First River Energy*, 986 F.3d at 919.
38. *Id.* at 921.
39. *Id.*
40. *See id.* at 921–22; TEX. BUS. & COM. CODE ANN. §§ 9.101–.809.
41. *In re First River Energy*, 986 F.3d at 921–22.
42. *Id.*
43. *Id.*
44. *Id.* (quoting OKLA. STAT. ANN. tit. 52, § 549.3).
45. *Id.* at 923.
46. *Id.*
47. *Id.*

and 9.307(e) forces the protection under section 9.343 to be useless against out-of-state purchasers.[48] Unfortunately, the court disagreed and ruled that no exception was provided in sections 9.302–.307 that would protect the security interests in produced oil and gas.[49] The producers also claimed that section 9.301 (a choice of law provision) applied to "as-extracted collateral," further pointing to the provision that "the local law of the jurisdiction in which the wellhead or Minehead is located governs Article 9 security interests."[50] However, the Texas UCC defines "as-extracted collateral" as collateral in which the debtor has an interest before the extraction or accounts from the sales.[51] Here, First River did not receive an interest in the production until *after* the minerals were extracted, despite the producers arguing that they had the exclusive right to purchase the minerals, giving them an equitable interest pre-extraction.[52] Because the Texas Business & Commerce Code § 9.343 did not provide a particular choice of law provision for that section, Delaware law governs the priority disputes.[53] Because Delaware does not have a similar provision to Texas Business & Commerce Code § 9.343, the Texas producer's interests were unperfected, leaving the Bank with the priority security interest in First River's bankruptcy proceeding.[54] Even the financing statements producers filed after First River went into bankruptcy were second to those previously filed by the Bank.[55] In short, the Texas producers did not have any security interests with priority over the Bank.[56]

The court went on to explain how the Oklahoma lien was effective while the Texas lien was not.[57] The court stated that the Oklahoma Lien Act

> strengthens the rights of Oklahoma interests owners in three (3) ways: (1) Oklahoma oil and gas interests are now governed by real property law, which designates the applicable law by the state in which the wellhead is located; (2) Oklahoma interest owners can now obtain a lien that will remain attached until a first purchaser has paid in full the purchase price of produced oil; and (3) the Lien Act explicitly and unbendingly grants superior priority to Oklahoma interest owners above all other lienholders and UCC Article 9 secured creditors.[58]

48. *Id.* at 926.
49. *Id.* at 925.
50. *Id.* at 926.
51. *Id.* at 927.
52. *Id.*
53. *Id.*
54. *Id.* at 927–28.
55. *Id.*
56. *Id.*
57. *Id.* at 928–29.
58. *Id.* at 929–30.

In re First River Energy, LLC is evidence that Texas Business & Commerce Code § 9.343 failed to protect Texas producers' interest in the production they sell to out-of-state companies.[59] The Fifth Circuit even noted

> The bankruptcy court adroitly untangled a thorny conflicts of law issue, the result of which unfortunately, undermines the efficacy of a non-standard UCC provision intended to protect Texas oil and gas producers. . . . As a result, producers must beware of "the amazing disappearing security interest" and continue to file financing statements. The Texas legislature should take note.[60]

Accordingly, we are forced to ask ourselves the question, why did the Oklahoma statute work and the Texas statute fail?[61] Were the goals of each statute not the same, to protect oil and gas producers?[62] First River attempts to answer this question by showing us why the Oklahoma lien worked by emphasizing the choice of law issue, attachment of the interest, and superiority of the claim against other creditors.[63] The court seemed to follow suit and pointed out these issues to the Texas legislature, letting it know that the issues needed attention.[64]

IV. NO PROTECTION AGAINST OUT-OF-STATE PURCHASERS

While *In re First River Energy, LLC* is the capstone case that led the Texas legislature to attempt to change the statute, previous cases also suggested that the statute should be amended.[65] One of the cases that First River relied on was *In re SemCrude L.P.*, in which the producers had to rely on the automatically perfected security interests provided by statute because they had failed to file a financing statement.[66] Like First River, SemCrude (SemGroup) was a "midstream" service provider that purchased oil from producers and resold it to downstream producers, leading to $13.2 billion in revenue before going into bankruptcy.[67] Additionally, it had the same payment method: it would receive the production and make payment on the 20th day of the following month.[68] SemGroup warranted the oil it sold to the downstream purchasers (Appellees) to be "free from all royalties, liens, and

59. *First River Energy*, 986 F.3d. at 929–30 (quoting *Gaskins v. Texon, L.P.*, 321 P.3d 985, 991 (Okla. Civ. App. 2013)).

60. *Id.* at 917.

61. *Id.* (citing David F. Asmus, *Top Ten Surprise Texas Oil and Gas Law Cases*, SEVENTEENTH ANN. INST. ON OIL & GAS L. 379–80 (2019)).

62. *Id.* at 921.

63. *Id.*

64. *Id.* at 928–30.

65. *Id.* at 917.

66. *See In re* SemCrude L.P., 864 F.3d 280 (3d Cir. 2017).

67. *Id.* at 285.

68. *Id.* at 285–86.

encumbrances."[69] After selling too many option trades and losing money on multiple deals, SemCrude eventually went bankrupt, leaving thousands of producers unpaid.[70] The producers attempted to recover from the Appellees after the bankruptcy court held that the Bank's security interest in SemGroup's assets had priority over any state law lien.[71] The producers from Texas and Kansas asserted that their states' non-uniform amendments to the UCC gave them automatically perfected security interests in the oil sold to SemGroup, which was then sold to the Appellees.[72]

The court ruled that the producers did not have a perfected security interest, even if their state law applied.[73] Therefore, for the producers to have a claim against the Appellees, their "lien" was required to stay with the collateral even after it went through the midstream provider if SemGroup failed to pay them for the production.[74] The Texas producers also argued that Texas Business & Commerce Code § 9.343 provides them with a perfected security interest in the production.[75] The court highlighted a problem: even if Texas law applied by citing the UCC, "the law governing perfection of security interests in both tangible and intangible collateral, whether perfected by filing or automatically, is the law of the jurisdiction of the debtor's location, as determined under Section 9-307."[76] The court in *In re SemCrude, L.P.*, also discussed the exception to the debtor-location rule regarding as-extracted collateral, meaning that the local law where the wellhead is located governs perfection.[77] Yet again, the Texas producers did not qualify for this exception because SemGroup did not have a preexisting interest in the oil before it was produced from the well.[78]

In re SemCrude provides another example of how Texas Business & Commerce Code § 9.343 failed to protect Texas producers selling oil and gas out of the state when a purchaser went bankrupt.[79] Now, one might argue that the simple solution would have been for Texas producers to file financing statements for every transaction they had with an out-of-state purchaser.[80] The court even made note that "[i]f the oil producers want to encumber the oil they sell to an out-of-state first purchaser, all they need to do is comply with the rules uniformly applicable throughout the country to all sellers of

69. *Id.* at 286.
70. *Id.*
71. *Id.* at 288.
72. *Id.*
73. *Id.* at 290.
74. *Id.*
75. *Id.* at 290.
76. *Id.* at 291.
77. *Id.* at 291–92.
78. *Id.* at 292.
79. *Id.*
80. *Id.* at 291–92.

goods—file a financing statement in the state where that first purchaser is located."[81]

Is filing a financing statement in the state where the first purchaser is located burdensome on the producer? Why would the producer not have done this in the first place? One can only assume that the reason is that the Texas producers in *In re First River Energy* and *In re SemCrude* wanted to save time or money by not filing a financing statement, relying on what they thought was automatic perfection.[82] Indeed, before these cases, there was no reason for Texas producers to question the validity of their protection under UCC § 9.343, hence why the legislature is now faced with the issue of enacting a new lien.[83]

V. TEXAS PROPERTY CODE § 67.002, SOLUTION?

How could Texas, the leading oil and gas producing state, not have an effective statute that protects its producers like that of Oklahoma? The previous bankruptcy cases made it evident that something needed to be done.[84] The Texas legislature heard the court in *In re First River Energy, LLC* and immediately went to work, creating a new statute only eight months after the opinion was filed.[85] First and foremost, the "amazing disappearing security interest," First Purchaser statute, Texas Business & Commerce Code § 9.343, or Texas UCC § 9.343—whichever name you prefer—was revoked.[86]

The new security interest is provided for in the Texas Property Code § 67.002 Oil and Gas Lien:

> (a) To secure the obligations of a first purchaser to pay the sales price, each interest owner has an oil and gas lien to the extent of the interest owner's interest in oil and gas rights. The oil and gas lien exists as part of and incident to the ownership of oil and gas rights.
>
> (b) An oil and gas lien:
>
> (1) exists in and attaches to all oil and gas before severance;
>
> (2) continues uninterrupted and without lapse in all oil and gas on and after severance; and
>
> (3) continues uninterrupted and without lapse in and to all proceeds from the sale of the oil or gas.

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81. *Id.* at 293.

82. *Id.*

83. *Id.* at 292–93.

84. *See In re* First River Energy, LLC, 986 F.3d 914 (5th Cir. 2021); *In re* SemCrude L.P., 864 F.3d 280 (3d Cir. 2017).

85. *See generally* TEX. PROP. CODE § 67.002 (creating a new security interest).

86. Act of July 1, 1999, 76th Leg., ch. 414, § 1.01, sec. 9.343, TEX. BUS. & COM. CODE ANN. (repealed 2021).

> (c) Except as provided by Subsection (d), an oil and gas lien exists until the interest owner or representative first entitled to receive the sales price has received the sales price for the oil or gas production, but the lien does not continue to attach to the production after the production is sold by the first purchaser, unless the first subsequent purchaser:
>
> (1) is an affiliate of the first purchaser; or
>
> (2) has actual knowledge, not constructive notice or inquiry notice, that the first purchaser has not paid the interest owner or representative first entitled to receive the sales price.
>
> (d) As between an interest owner and a representative of an interest owner or any person claiming adversely to the interest owner or representative, the interest owner's oil and gas lien continues uninterrupted and without lapse in proceeds in the possession or control of a representative until the interest owner on whose behalf the representative acts receives the proceeds in full.
>
> (e) Except as provided by Subsection (f), a first purchaser takes free of an oil and gas lien if the first purchaser:
>
> (1) in good faith, paid the sales price for the oil or gas to an interest owner or representative otherwise apparently entitled to receive the sales price; and
>
> (2) is without actual knowledge that the interest owner or representative is not entitled to receive the sales price paid.
>
> (f) Notwithstanding Subsection (e), the oil and gas lien continues uninterrupted in the proceeds paid to or otherwise due the interest owner or representative.[87]

In the bill analysis, the Texas legislature explained that because the previous statute was a part of the Texas UCC, Texas interest owners were left unprotected when the first purchaser was located in another state.[88] The members of the legislature were concerned that if the First Purchaser statute was not amended or fixed, Texas oil and gas interest owners' security interests would likely be found as "unsecured and subordinate to other perfected security interests" when the interest owners dealt with out-of-state purchasers.[89] The goal of this new statute is to "establish oil and gas liens based on real property for applicable interest owners."[90] Subsequently, the statute addresses this in section (a), which provides,

> To secure the obligations of a first purchaser to pay the sales price, each interest owner has an oil and gas lien to the extent of the interest

87. TEX. PROP. CODE ANN. § 67.002.
88. Fiscal Note, Tex H.B. 3794, 87th Leg., R.S. (2021).
89. *Id.*
90. *Id.*

> owner's interest in oil and gas rights. The oil and gas lien exists as part of and incident to the ownership of oil and gas rights.[91]

Reading section (a) of the new statute, one can see that it is similar to UCC § 9.343 because it emphasizes the obligations of the first purchaser.[92] Both statutes are keen on ensuring the payments of the first purchaser of the oil and gas from the producers.[93] The industry commonly utilizes purchase agreements when producers sell the oil and gas on credit, just as the parties did in the *In re SemCrude* case because the first purchasers are likely a middle man in selling the oil and gas after refining or preparing the production.[94] This presents the need for a tool or safety net for producers to rely on to get their payment.

VI. HOW IS THIS DIFFERENT FROM THE ORIGINAL STATUTE?

As the court in *First River* and *SemCrude* noted, Oklahoma developed a new statute that protected its producers from the same situation Texas producers faced.[95] The Oklahoma statute provides:

> NATURE, EXTENT AND DURATION OF OIL AND GAS LIEN
>
> A. To secure the obligations of a first purchaser to pay the sales price, and to secure the obligation of any person to pay any proceeds, as defined in Section 549.2 of this title, for the acquisition of oil and gas rights, each interest owner is hereby granted an oil and gas lien to the extent of the interest owner's interest in oil and gas rights. The oil and gas lien granted by the Oil and Gas Owners' Lien Act of 2010 is granted and shall exist as part of an incident to the ownership of oil and gas rights.
>
> B. An oil and gas lien:
>
> 1. Exists in and attaches immediately to all oil and gas on April 19, 2010;
>
> 2. Continues uninterrupted and without lapse in all oil and gas upon and after severance; and
>
> 3. Continues uninterrupted and without lapse in and to all proceeds.
>
> C. An oil and gas lien exists until the interest owner or representative first entitled to receive the sales price or any proceeds, as defined in Section 549.2 of this title, for the acquisition of oil and gas rights, has received the sales price or any proceeds, as defined in Section 549.2 of this title, for the

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91. OKLA. STAT. ANN. tit. 52, § 549.3(a).

92. *Id.*; Act of July 1, 1999, 76th Leg., ch. 414, § 1.01, sec. 9.343, TEX. BUS. & COM. CODE ANN. (repealed 2021).

93. *Id.*

94. *In re* SemCrude L.P., 864 F.3d 280, 285 (3d Cir. 2017).

95. *In re* First River Energy, LLC, 986 F.3d 914, 929 (5th Cir. 2021); *In re* SemCrude L.P., 864 F.3d 280, 300 (3d. Cir. 2017).

> acquisition of oil and gas rights. Notwithstanding the immediately preceding sentence, as between an interest owner and a representative of an interest owner or any person claiming adversely to such interest owner or representative, such interest owner's oil and gas lien continues uninterrupted and without lapse in proceeds in the possession or control of a representative until the interest owner on whose behalf such representative acts receives such proceeds in full. When a first purchaser, in good faith, pays the sales price to an interest owner or a representative otherwise apparently entitled to receive the sales price and the first purchaser is without actual knowledge that such interest owner or representative is not entitled to receive the sales price so paid, then such first purchaser takes free of the oil and gas lien otherwise applicable to the oil or gas for which such payment was made. Notwithstanding the immediately preceding sentence, the oil and gas lien will continue uninterrupted in the proceeds paid to or otherwise due the interest owner or representative.
>
> D. The validity of an oil and gas lien shall not be dependent on possession of the oil or gas by an interest owner or representative. No oil and gas lien shall become or be deemed to be void or expired by reason of a change or transfer of the actual or constructive possession of or title to the oil or gas from the interest owner or representative to a first purchaser or purchaser.
>
> E. On the conveyance or transfer of any oil and gas rights by a transferor interest owner, the oil and gas lien vested in the transferor interest owner immediately before the conveyance or transfer shall remain with the transferor interest owner to the extent of any oil and gas rights retained by the transferor interest owner.
>
> F. On the conveyance or transfer of any oil and gas rights by a transferor interest owner, the oil and gas lien vested in the transferor interest owner immediately before the conveyance or transfer shall be transferred to and attach automatically to the oil and gas rights acquired by the transferee interest owner uninterrupted and without lapse and as part of an incident to the oil and gas rights so transferred or conveyed.[96]

This Oklahoma Lien Act was not placed in the UCC and provides "to secure the obligations of a first purchaser to pay the sales price, each interest owner is hereby granted an oil and gas lien to the extent of the interest owner's interest in oil and gas rights."[97] This lien attaches the oil, gas, and proceeds of such before and after severance from the mineral estate.[98] The statute also emphasizes that the lien is not a UCC security interest but a real estate interest.[99]

With Oklahoma essentially paving the road on how to protect a state's oil and gas producers through statute, Texas only needed to follow its lead by crafting a statute that is not connected with the UCC, attaches the minerals

96. OKLA. STAT. ANN. tit. 52, § 549.3.
97. *Id.*
98. *See id.*
99. *See id.*

and proceeds before, during, and after severance, and is a real property interest.

The legislature placed the new statute in the Texas Property Code and not in the UCC to avoid any conflict of law issues that appeared in *First River*.[100] Since the UCC § 9.301 provides that the location of the debtor will determine the law that governs perfection, having the security interest outside the UCC avoids this provision entirely.[101] Additionally, Texas Property Code § 67.002 provides for the creation of an oil and gas lien that exists in and attaches to all oil and gas before severance and continues after severance to the oil and gas as well as any proceeds from the sale of such oil and gas.[102] Section 67.002, however, does not extend past the first purchaser, just as the previous statute did not.[103]

VII. IS THIS GOING TO WORK?

Texas Property Code § 67.002 has only been around for a short time and has yet to be analyzed by any Texas case law.[104] One might hope that the statute never has to be used and that the oil and gas industry will flourish, purchasers will pay the producers, and business transactions will go smoothly, but that is a lofty hope as it is rarely the case. The fluctuation in pricing that comes with oil and gas is engrained in the industry itself, and it seems as if it cannot be avoided. However, if case law precedent and interpretation of the Oklahoma Lien Act are any indication on how this statute will work, the statute is arguably effective to protect Texas oil and gas producers. Now producers, and arguably the royalty owners, are going to feel much safer knowing that the bankruptcy of a first purchaser will not result in their losing all the priority rights they thought they had.

Taking both statutes on their face, the similarities in the provisions are evident:

An oil and gas lien:

1. Exists in and attaches immediately to all oil and gas [Oklahoma adds a date];
2. Continues uninterrupted and without lapse in all oil and gas upon and after severance; and
3. Continues uninterrupted and without lapse in and to all proceeds.[105]

100. *See* TEX. PROP. CODE ANN. § 67.002.
101. TEX. BUS. & COM. CODE ANN. § 9.301(1).
102. TEX. PROP. CODE ANN. § 67.002(b).
103. *Id.* § 67.002(c).
104. *Id.* § 67.002.
105. OKLA. STAT. ANN. tit. 52, § 549.3.

These three sentences included in both statutes emphasize the producers' interest in the minerals at all times.[106] As long as they have an interest in the oil and gas, meaning that until they get paid, they will have a valid lien.[107]

Additionally, there appears to be a similarity between Texas Property Code § 67.002 and the "as-extracted" provision in the UCC that was mentioned in both the *First River* and *SemCrude* cases.[108] The "as-extracted provision" provides that, in regards to the collateral such as the production or accounts, "the local law of the jurisdiction in which the wellhead or minehead is located governs Article 9 security interests."[109] As discussed earlier, the issue with this provision is the need for the debtor, or in our case, the first purchaser, to have an interest in the collateral before it was extracted in order for the security interest to be valid.[110] Now, Texas Property Code § 67.002 shifts focus from the debtor's interest in the collateral to those who have an interest in the oil and gas itself, namely producers and royalty owners.[111] This new provision provides the creditors with an interest in the oil, gas, and proceeds from such, but at all times a first purchaser has their own interest.[112] This is a significant improvement in the oil and gas industry, especially in bankruptcy settings.[113] Requiring first purchasers to have a preexisting interest in the oil and gas before severance forces oil and gas producers to enter into deals before production begins, creating the opportunity for a lease expiration or a major price fluctuation.[114] It is much more practical to give producers and royalty owners an interest in the production and proceeds because production will not slow.[115] Further, producers and royalty owners are both protected.[116]

Lastly, as discussed in *In re First River*, section 9.343 failed because of the choice of law issue.[117] Because other states did not have a similar addition to the UCC like Texas, there was a dispute regarding the appropriate choice of law because the parties were from Delaware, Oklahoma, and Texas.[118] Because First River was organized in Delaware, Texas producers were forced to suffer the consequences of Delaware law, which causes their priority to be lower than that of the Bank.[119] "Texas UCC Section 9.301(1) governs the perfection, effect of perfection and priority of security interests by applying

106. *See id.*
107. *See* TEX. PROP. CODE ANN. § 67.002.
108. *Id.*; TEX BUS. & COM. CODE ANN. § 9.102(a)(6).
109. TEX BUS. & COM. CODE ANN. § 9.301.
110. *See supra* Part V.
111. TEX. PROP. CODE ANN. § 67.002.
112. *See supra* Part V.
113. *Id.*
114. *Id.*
115. *Id.*
116. *Id.*
117. *In re* First River Energy, LLC, 986 F.3d 914 (5th Cir. 2021).
118. *See id.*
119. *Id.* at 917.

the local law of the jurisdiction where 'a debtor is located,'" effectively solving the choice of law dilemma.[120] As mentioned earlier, the new statute creates an interest in real estate and is not within the confines of the UCC.[121] Thus, Texas producers need not worry about another state's law being able to govern their priority if a purchaser from out-of-state goes bankrupt.[122] Now, because the Texas legislature has codified that other state law does not override that of the statute when a debtor is located in another state with dissimilar laws to Texas, the Texas legislature has ensured protection for state producers.[123]

VIII. IS THIS LIMITED TO OIL AND GAS?

Texas Property Code § 67.002 is titled "Oil and Gas Lien," but will its interpretation be limited to only oil and gas?[124] While they are easily the most common minerals produced and sold, wind and solar energy production are increasing.[125] If a producer sells wind or solar energy to a first purchaser and that purchaser falls into bankruptcy, could this statute serve as protection for that producer? Currently, the outcome is up in the air. Because those niches of the energy industry are relatively new, the Texas legislature's choice to leave them out of the statute may be purposeful. However, as time goes on, it is likely that Texas will have to address a problem with those industries as well. For now, wind or solar producers should file financing statements with their first purchaser to protect their interests against other creditors until there is guidance from the courts or legislature that wind or solar producers will have automatic protection.

IX. CONCLUSION

Texas UCC § 9.343 gave Texas producers a life vest that did not float while they jumped into the water without knowing they were unprotected.[126] Unfortunately for the parties in the cases, *In re First River Energy, LLC* and *In re SemCrude*, they relied on this "faulty" life vest and suffered the

120. TEX BUS. & COM. CODE ANN. §§ 9.301, 925.

121. *See supra* Part V.

122. *Id.*

123. TEX BUS. & COM. CODE ANN. § 9.301.

124. TEX. PROP. CODE ANN. § 67.002.

125. Emma Newburger, *Texas led the country in new renewable energy projects last year*, CNBC (Feb. 26, 2009, 1:00 PM), https://www.cnbc.com/2022/02/18/texas-led-the-country-in-new-renewable-energy-projects-last-year.html.

126. Act of July 1, 1999, 76th Leg., ch. 414, § 1.01, sec. 9.343, TEX. BUS. & COM. CODE ANN. (repealed 2021).

consequences.[127] The Texas legislature's recall of, and improvement to, this ineffective life vest has since restored a level of protection that Texas producers can truly rely on.

The Texas legislature's introduction of Texas Property Code § 67.002 shows how important the oil and gas industry is in Texas.[128] Protecting producers and royalty owners ensures that a massive part of the state's economy is taken care of. In 2021, the Texas oil and natural gas industry paid $15.8 billion in state and local taxes, according to the Texas Oil & Gas Association.[129] These funds support schools, roads, and other services across Texas.[130] Leaving Texas producers out in the dust when dealing with out-of-state purchasers puts the state at risk of losing valuable funding.

Thankfully, the new statute protects producers' and royalty owners' interest in the oil and gas they sell to first purchasers in Texas, and any other state, without needing to file a financing statement.[131] As far as security interests, the automatic lien that Texas Property Code § 67.002 provides has priority over any other perfected secured creditor, such as a bank or another creditor, may have.[132] Of course, bankruptcy is problematic for creditors and debtors, but now Texas producers and royalty owners are protected going forward.

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127. Deutsche Bank Trust Co. Ams. v. U.S. Energy Dev. Corp. (*In re* First River Energy, L.L.C.), 986 F.3d 914 (5th Cir. 2021); Arrow Oil & Gas, Inc. v. J. Aron & Co. (*In re* SemCrude L.P.), 864 F.3d 280 (3d Cir. 2017).

128. TEX. PROP. CODE ANN. § 67.002.

129. Tex. Oil & Gas Ass'n, *Texas Oil and Natural Gas Industry Paid $15.8 Billion in Taxes and State Royalties in Fiscal Year 2021*, TXOGA (Jan. 11, 2022), https://www.txoga.org/texas-oil-and-natural-gas-industry-paid-15-8-billion-in-taxes-and-state-royalties-in-fiscal-year-2021/.

130. *Id.*

131. TEX. PROP. CODE ANN. § 67.002.

132. *Id.*

THE PUBLIC USE STANDARD FOR COMMON-CARRIER STATUS AND CONDEMNATION AUTHORITY

Lauren Ottmers[*]

Hlavinka v. HSC Pipeline Partnership, LLC, (Tex. 2022)[1]

In *Hlavinka v. HSC Pipeline Partnership, LLC*, a landowner challenged a pipeline company's right to condemn an easement and construct a pipeline transporting polymer-grade propylene.[2] The landowner argued that his testimony should have been allowed regarding recent arms' length sales of easements to evidence the market value of such an easement.[3] The landowner stated that their family's primary purpose in owning the property was to sell pipeline easements, which had about twenty-five easements on it at the time of suit.[4]

The pipeline company, HSC Pipeline Partnership, LLC (HSC), installed the pipeline carrying the polymer-grade propylene—a byproduct of crude petroleum refining.[5] After the landowner, the Hlavinkas, rejected HSC's offer to purchase a pipeline easement, HSC initiated condemnation proceedings on 6.41 acres for a thirty-foot-wide easement that stretched 1.8 miles.[6] The Hlavinkas challenged HSC's power to condemn the property, and HSC sought a partial summary judgment and determination as to its common-carrier status.[7] HSC provided evidence of its status as a common carrier, adducing that the pipeline is available to anyone who wants to ship on the line and meet the terms of HSC's tariff.[8]

The trial court granted HSC's motion for summary judgment, and the matter proceeded to a bench trial to determine the amount of compensation for the value of the land.[9] At the bench trial, Terrance Hlavinka, who runs the Hlavinka family business, testified regarding two recent, arms' length easement sales to evidence the property's highest and best use.[10] Terrance

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1. Hlavinka v. HSC Pipeline P'ship, LLC, 650 S.W.3d 483 (Tex. 2022).
2. *Id.* at 487.
3. *Id.* at 491.
4. *Id.* at 488.
5. *Id.*
6. *Id.* at 489.
7. *Id.*
8. *Id.*
9. *Id.* at 490.
10. *Id.* at 488, 490.

Hlavinka's calculation was $3.3 million based on these comparisons.[11] HSC moved to have Terrance Hlavinka's testimony excluded as it pertained to the sales of easements to other pipelines, and the trial court granted this motion, leaving the agricultural value of the land as the only remaining testimony.[12] The trial court awarded a total of $132,293.36 in compensation to the Hlavinkas, with only $23,326.00 allocated for the easements.[13]

The Houston Court of Appeals found that common-carrier pipelines carrying oil products or liquefied minerals have condemnation authority under Business Organizations Code § 2.105.[14] The court further held that polymer-grade propylene is an "oil product" under that section.[15] According to the appellate court, the sole "existing contract [at the time of suit] between HSC and Braskem did not conclusively demonstrate public use."[16] The court held that Terrance Hlavinka's testimony regarding sales of easements on the same property was admissible as evidence of the property's market value.[17] Both the Hlavinkas and HSC appealed the court's decision to the Texas Supreme Court.[18]

First, the Texas Supreme Court addressed the issue of whether HSC had demonstrated common-carrier status with the authority to condemn an easement.[19] The Court stated that Business Organizations Code § 2.105 and Natural Resources Code Chapter 111 are the sources of condemnation authority for pipelines.[20] Further, the Court clarified that section 2.105 expands condemnation authority to common-carrier pipeline entities beyond those listed in Natural Resources Code section 11.002, and therefore Business Organizations Code section 2.105 is "an independent grant of condemnation authority."[21] While section 2.105 lists "oil product" as a product that grants condemnation authority for common-carrier pipelines, the section does not define "oil product."[22] The Texas Supreme Court concluded that polymer-grade propylene is an "oil product" because it is derived from the refinement and distillation of crude oil, and the Natural Resources Code defines oil as "crude petroleum oil."[23] Since the polymer-grade propylene is an oil product, section 2.105 gave HSC the "condemnation authority to build and construct a common-carrier pipeline to transport it."[24]

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11. *Id.* at 490.
12. *Id.*
13. *Id.*
14. *Id.*
15. *Id.*
16. *Id.*
17. *Id.*
18. *Id.*
19. *Id.* at 487.
20. *Id.* at 491.
21. *Id.* at 492.
22. *Id.* at 493.
23. *Id.*
24. *Id.* at 494.

The Texas Supreme Court then addressed the issue of the public-use requirement that a pipeline common carrier must meet in order to have eminent-domain authority.[25] The test for public use is whether the pipeline is reasonably probable to "serve even one customer unaffiliated with the pipeline owner."[26] The Court held that since HSC had an existing contract with Braskem, even if it was the only one, it served at least one customer that was unaffiliated with the pipeline owner—satisfying the public-use test.[27] The Court also found that the HSC pipeline connects to other pipeline networks, has additional capacity, and "has publicly filed a tariff with the Railroad Commission demonstrating that it offers and markets the pipeline for public hire," all going to show public use.[28]

Finally, the Court addressed the admissibility of Terrance Hlavinka's testimony regarding other sales for easements on the same property going to show the market value of the land taken by HSC.[29] The Court held that the market value of the property is to be based on the highest and best use of the land.[30] In this case, the Court found that the landowner bought the property for pipeline development and that testimony regarding arms' length transactions with "other pipeline companies that were voluntary, contemporary, local, and involve land with similar characteristics" are evidence that the highest and best use of the land was pipeline easements.[31] Since this is what the landowner had testified to, his testimony was evidence of the highest and best use of the land and evidenced the potential that the landowners could have sold the easement to another pipeline company.[32] The exclusion of this testimony by the lower court denied the landowners the chance to show that agriculture was not the highest and best use of the land, therefore constituting error.[33] The Court noted that in order to show property is a "pipeline corridor," there must be proof of a reasonable probability that the land would likely be sold to another pipeline in the near future.[34] The trial court's exclusion of Terrance Hlavinka's testimony was error.[35]

The case was remanded to the trial court for determination of the fair market value of the land at the time HSC took the land.[36]

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25. *Id.*
26. *Id.* (quoting Denbury Green Pipeline–Tex., LLC v. Tex. Rice Land Partners, Ltd., 510 S.W.3d 909, 917 (Tex. 2017)).
27. *Id.* at 495–96.
28. *Id.* at 495.
29. *Id.* at 496.
30. *Id.*
31. *Id.* at 497.
32. *Id.* at 498.
33. *Id.*
34. *Id.* at 498–99.
35. *Id.* at 499.
36. *Id.*

VAN DYKE, ET AL. V. NAVIGATOR GROUP, ET AL., TEXAS SUPREME COURT

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Van Dyke, et al. v. Navigator Group, et al., [Tex. Feb. 2023][1]

Van Dyke v. Navigator Group concerns a dispute that has lasted a decade, as well as an issue that, for multiple decades, has plagued energy practitioners and fueled countless mineral ownership lawsuits: the "'double-fraction' dilemma."[2] This use of two fractions is typically found in mineral conveyances drafted in the first half of the twentieth century. Here, the disputed deed, signed in 1924, contained a reservation that provided "[i]t is understood and agreed that one-half of one-eighth of all minerals and mineral rights in said land are reserved in grantors . . . and are not conveyed herein."[3]

Ninety years after this deed was signed, the successors of the assignee, the "White Group," claimed for the first time that the deed reserved to the grantors, and thus to their successors, the "Mulkey Group," only one-sixteenth (1/16) of the mineral and mineral rights, rather than the one-half (1/2) that both groups appeared to understand for the previous ninety years. The White Group filed a trespass-to-try-title action in 2013 arguing "that the double fractions are merely an elementary arithmetic formula with no additional meaning, so that only a 1/16 interest was ever reserved."[4] The Mulkey Group asserted two arguments to support their contention that they owned 1/2 of the minerals and mineral rights: (1) double fractions were "a term of art common at the time the deed was drafted" and were not intended to be an arithmetic formula; and, (2) the presumed-grant doctrine.[5]

Two separate yet similar theories support the argument against reading double-fractions as an arithmetic formula: the "estate-misconception theory" and the "legacy of the 1/8 royalty." The estate-misconception theory explains that there was a general misunderstanding at the time that, upon leasing their minerals, a lessor only owned a one-eighth (1/8) interest in the mineral estate ("rather than the *entire* mineral estate in fee simple determinable with the

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1. Van Dyke, et al. v. Navigator Group, et al., 2023 WL 2053175 (Tex. 2023).
2. *Id.* at *1.
3. *Id.*
4. *Id.* at *2.
5. *Id.*

possibility of reverter of the entire estate").[6] Because of this misunderstanding, "lessors would refer to what they *thought* reflected their entire interest in the 'mineral estate' with a simple term they understood to convey the same message: '1/8.'"[7] The theory of the legacy of the 1/8 royalty contends that mineral owners assumed that their royalty would always be 1/8, and therefore the term "1/8" should be seen as "a placeholder for future royalties *generally*."[8]

"The presumed-grant doctrine, 'also referred to as title by circumstantial evidence, has been described as a common law form of adverse possession.'"[9] The behavior of the parties over time is important in establishing title under this doctrine. There must have been "(1) a long-asserted and open claim, adverse to that of the apparent owner; (2) nonclaim by the apparent owner; and (3) acquiescence by the apparent owner in the adverse claim."[10]

The trial court granted the White Group's motion for partial summary judgment declaring "that the deed's reservation of 'one-half of one-eighth of all minerals and mineral rights' unambiguously reserved only a 1/16 interest in the mineral estate."[11] The Mulkey Group appealed this decision to the Eastland Court of Appeals. In 2020, the Eastland Court affirmed the trial court's decision.

The Eastland Court acknowledged that "the Texas Supreme Court has taken judicial notice that 'the usual royalty provided in mineral leases [during that era] is one-eighth.'"[12] However, the Eastland Court determined that, because the reservation was clear and there were no contradictory fractions or terms in the deed, the estate-misconception theory could not be used. Indeed, the Eastland Court pointed to the cases the Mulkey Group relied upon to support its holding against the Mulkey Group, finding that they each contained conflicting terms or fractions that had to be construed. Importantly, the Eastland Court also noted that the estate-misconception theory was the assumption that after a mineral owner "executed an oil and gas lease, they retained only a one-eighth interest in the minerals."[13] The Eastland Court found that since there was no oil and gas lease in effect at the time of the deed, "[t]he Mulkeys could not have been operating under the estate misconception theory."[14]

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6. *Id.* at *6.
7. *Id.*
8. *Id.* at *7.
9. *Id.* at *9, quoting Fair v. Arp Club Lake, Inc., 437 S.W.3d 619, 626 (Tex. App.—Tyler 2014, no pet.).
10. *Id.*, citing Magee v. Paul, 221 S.W. 254, 257 (Tex. 1920).
11. *Id.* at *2.
12. Van Dyke v. Navigator Group, 647 S.W.3d 901, 906 (Tex. App.—Eastland, 2020) (quoting Garrett v. Dils Co., 157 Tex. 92, 299 S.W.2d 904, 907 (Tex. 1957)).
13. *Id.* at 908.
14. *Id.*

Likewise, the Eastland Court was not swayed by the Mulkey Group's argument that the presumed-grant doctrine applied. The Mulkey Group pointed to the fact that both the Mulkey Group and White Group behaved in a manner consistent with both groups owning 1/2 of the minerals. The White Group countered that the presumed-grant doctrine could not apply because the "claim is not based on a gap or missing link in the chain of title that would necessitate a presumed grant but, rather, solely on the Mulkey [Group's] mistaken interpretation of the unambiguous 1924 deed."[15] The Eastland Court agreed, finding that "[a]lthough the existence of a chain-of-title gap is not an express element, courts have typically applied the presumed grant doctrine in cases where a party's lack of complete record title to land it has claimed for a long time is due to a gap in the chain of title."[16] The Mulkey Group appealed the Eastland Court's decision to the Texas Supreme Court, which agreed with the Mulkey Group, reversing both the Eastland Court's and trial court's judgments, and remanding the case to the trial court for further proceedings.

In the hope of "substantially reducing the frequency of disputes about double fractions," the Court concluded "that an accurate construction of the 1924 text requires us to accept that the equation 'one-half of one-eighth' equals one-half of the mineral estate."[17] In addition, the Court determined that "[e]ven if this were not so, nearly a century of the parties' unbroken understandings and representations would require us to recognize that allocation of present-day ownership by applying the presumed-grant doctrine."[18]

The Court first concluded that "[a]ntiquated instruments that use 1/8 within a double fraction raise a presumption that 1/8 was used as a term of art to refer to the 'mineral estate.'"[19] The presumption is rebuttable if the instrument contains some provision that a double fraction was actually meant to be simply a double fraction (requiring the calculation of the formula). In coming to such a conclusion, the Court reasoned that, because "a text retains the same meaning today that it had when it was drafted, . . . unaffected by the passage of time, linguistic developments, or the evolution of usage," it must determine "what the ordinary usage of the textually undefined term 'one-half of one-eighth' actually was."[20] The Court took great pains to make clear that this determination did not involve the examination of extrinsic evidence, but instead, was merely discerning "what a text would have meant to a

15. *Id.* at 909.
16. *Id.*
17. Van Dyke, et al. v. Navigator Group, et al., 2023 WL 2053175, at *1 (Tex. 2023).
18. *Id.*
19. *Id.* at *3.
20. *Id.* at *3–4.

disinterested audience" within "the four corners of the document" and was "a proper part of interpretation."[21]

The Court repeated "the now-familiar observation that, at the time the parties executed this deed, '1/8' was widely used as a term of art to refer to the total mineral estate."[22] Two accepted theories as to why this was so—although the Court rightly noted that "it matters less *why* the term was used in a particular way than *that* it was so widely used"—were the estate-misconception theory and the legacy of the 1/8 royalty.[23] Both theories provide courts with an "objective indication of what parties meant by using 1/8 within a double fraction."[24] The Court reiterated its position in *Hysaw v. Dawkins*, saying "it would be odd to say 'one-half of one-eighth' rather than simply 'one-sixteenth' if all that was intended by 'one-half of one-eighth' *was* 1/16."[25] Based upon these theories, the Court held that they were required to "*begin* with a presumption that the mere use of such a double fraction was purposeful and that 1/8 reflects the *entire* mineral estate, not just 1/8 of it."[26] In doing so, the Court also found that the Eastland Court's requirement of inconsistent provisions within the document, or the existence of a mineral lease at the time of the conveyance before application of the estate-misconception theory, misapprehended the same.

With respect to the Mulkey Group's argument that the presumed-grant doctrine applied, the Court also agreed with the Mulkey Group holding that even if the Court found that the Mulkey Group only reserved a 1/16 mineral interest, "the parties' history of repeatedly acting in reliance on each having a 1/2 mineral interest conclusively satisfies the presumed-grant doctrine's requirements."[27] Finally, the Court addressed the Eastland Court's implied imposition of an additional element of the doctrine (gap in title) and found that "[s]atisfying the doctrine is properly difficult, but neither our precedent nor the doctrine's underlying purposes support mandating this additional test."[28]

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21. *Id.* at *5 ("We may consider such circumstances to the extent they 'inform, rather than vary from or contradict, the [instrument's] text.'" (quoting U.S. Shale Energy II, LLC v. Laborde Props., L.P., 551 S.W.3d 148, 152 (Tex. 2018))).

22. *Id.* at *5.

23. *Id.* at *6.

24. *Id.* at *7.

25. *Id.* (citing Hysaw v. Dawkins, 483 S.W.3d 1, 10–12 (Tex. 2016)) (discussing the need "to accord . . . significance to the use of double fractions in lieu of a single fraction").

26. *Id.*

27. *Id.* at *9.

28. *Id.*