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MINERALS: EXAMINATION AND COVERAGE ISSUES

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- Personal Information

Celia Flowers was born in Wills Point, Texas on March 1, 1956. Ms. Flowers was admitted to the Texas bar in 1990.

- Professional Experience

After graduating from law school in 1990, Ms. Flowers began private practice in civil litigation with an emphasis on oil and gas matters, business and commercial litigation, insurance defense, and real estate. She has worked with major pipeline companies throughout East Texas in acquiring easements through condemnation, defending surface damage issues, and other pipeline related issues, including litigation over pipeline explosions involving numerous defendants. Additionally, Ms. Flowers prepares oil and gas title opinion and litigates contract matters for numerous oil and gas clients. Ms. Flowers owns twelve title insurance companies licensed in Van Zandt, Rusk, Wood, Cherokee, Panola, Gregg, Upshur, Marion, Harrison, Rains, Kaufman, and Smith Counties. Ms. Flowers is Board Certified in Oil & Gas Law, Residential Real Estate Law, and Civil Trial Law by the Texas Board of Legal Specialization. She is admitted to practice before U. S. District Court, Eastern District of Texas and Northern District of Texas. Prior to attending law school, Ms. Flowers was a petroleum landman for approximately ten years.

- Educational Background

Ms. Flowers received her preparatory education at Tyler Junior College and graduated with an Associate in Arts (A.A.) in 1987, *summa cum laude*. She then attended the University of Texas at Tyler, completing that phase of her education with highest honors. Ms. Flowers then attended law school at Baylor University and graduated in 1990 with a Juris Doctor (J.D.) degree. While in law school, Ms. Flowers was a member of the Order of Barristers and a recipient of the American Jurisprudence Award for Remedies, Edwin P. Horner Award for Oil & Gas, John R. Wilson Remedies Award, Baylor Law School Honors List, Carlton J. Smith & Clifton Cummings Scholarships, Who's Who in American Colleges and Universities, the Dean's List, the National Dean's List, the President's Honor Roll and a member of the Harvey M. Richey Moot Court Society, 1988-90.

Celia C. Flowers (continued)

- Professional Development

Ms. Flowers is currently a Member of the College of the State Bar of Texas, Texas Board of Legal Specialization, Smith County Bar Association; Rusk County Bar Association, Gregg County Bar Association, Van Zandt County Bar Association, International Right of Way Association, State Bar of Texas, East Texas Association of Petroleum Landmen, and American Association of Petroleum Landmen. She has served on the Board of Directors of the Texas Land Title Association since 2004 and is presently serving as TLTA's President-Elect for 2007-2008. Flowers' article relating to "Surface Use and Access Issues" was published by the Southwestern Legal Foundation in 1999. Ms. Flowers article relating to "Right-of-Way Condemnation" was published by the International Right-of-Way Association, North Texas Chapter 36, in 2002 and her article on Legal Updates was provided to the East Texas Association of Petroleum Landmen in April of 2002. Ms. Flowers co-authored the article "Exercising the Power of Eminent Domain" for the State Bar of Texas Continuing Education Seminar on "Suing and Defending Governmental Entities" in July, 2004. Her paper entitled "Protecting and Defending Your Mineral Title" was presented at the 2006 Oil, Gas & Mineral Law Institute. She has also served as a panelist for the 25th Annual Oil, Gas & Energy Resources Law Course: A Panel Perusing the Perfectly Perplexing Problems of Pipelines.

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Minerals: Examination and Coverage Issues

PART I. EXAMINATION ISSUES: BASIC TENETS OF TEXAS OIL, GAS, AND MINERAL LAW

I. Distinguishing Ownership of the Surface Estate and the Mineral Estate

In Texas, the surface and minerals, coexisting on a particular tract of land, are not inextricably bound and may therefore be severed into separate estates.[1] When the owner of a real-property estate conveys the property without exceptions or reservations, the grantee of the conveyance acquires the same real-property title that the grantor had, which necessarily includes the rights to all minerals.[2] However, the owner of a real-property estate may at any time convey, or reserve in a conveyance, all or any part of the owner's interest in the minerals.[3] When such a severance of the surface and minerals estates occurs, the mineral estate becomes the dominant estate and the surface estate becomes the subservient estate.[4]

The separate mineral and surface estates created by grant or reservation are considered fee simple absolutes and thus each may be freely conveyed, transferred, and/or assigned.[5] The general principles of real property law apply equally to each of these estates.[6] Thus, the mineral estates possess all the incidents and attributes of an estate in land.[7]

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1 *Moser v. U.S. Steel Corp*., 676 S.W.2d 99 (Tex. 1984).

2 *Robles v. Robles*, 965 S.W.2d 605 (Tex. App.---Houston [1st Dist.] 1998 pet. denied).

3 *Altman v. Blake*, 712 S.W.2d 117 (Tex. 1986).

4 *Id.; see also Property Owners of Leisure Land, Inc. v. Woolf & Magee, Inc*., 786 S.W.2d 757 (Tex. App.---Tyler 1990, no writ).

5 *Barfield v. Holland*, 844 S.W.2d 759 (Tex. App. Tyler 1992, writ denied).

6 *Id.*

7 *Acker v. Guinn*, 464 S.W.2d 348 (Tex. 1971); *Hill v. Heritage Resources, Inc*., 964 S.W.2d 89 (Tex. App. -

A. Specific Components of the Surface Estate

A severance of "minerals" includes: "all substances within the ordinary and natural meaning of that word, whether their presence or value is known at the time of severance."[8] Certain substances, however, belong to the surface estate as a matter of law.[9] These include building stone, limestone, caliche, surface shale, water, sand, gravel, and near-surface lignite, iron, and coal.[10] With respect to lignite specifically, lignite within 200 feet of the surface is part of the surface estate, and a reservation or conveyance covering any interest in the "oil, gas, and other minerals" will therefore not include near-surface lignite unless the instrument creating such interest expressly provides otherwise.[11]

This same analysis, however, is not necessarily applicable to conveyances between the State of Texas and private parties.[12] Specifically, conveyances by the State of Texas to a private party must be construed according to the intent of the Legislature.[13] Thus, if the Legislature intended to convey the surface estate and retain minerals, the mining of which would destroy the surface, then the court must give effect to that intention.[14]

--El Paso 1997, review denied); *Mapco, Inc. v. Carter*, 808 S.W.2d 262 (Tex. App.---Beaumont 1991*) judgment rev'd in part on other grounds*, 817 S.W.2d 686 (Tex. 1991*); see also Ely v. Briley*, 959 S.W.2d 723 (Tex. App.---Austin 1998, no pet.).

8 *Moser*, 676 S.W.2d at 102.

9 *Id.; see also Reed v. Wylie*, 597 S.W.2d 743 (Tex. 1980).

10 *Moser*, 676 S.W.2d at 102, *Reed*, 597 S.W.2d at 746; *Gifford-Hill & Co., Inc. v. Wise County Appraisal Dist*., 827 S.W.2d 811 (Tex. 1991).

11 *Farm Credit Bank of Texas v. Colley*, 849 S.W.2d 825 (Tex. App. ---Texarkana 1993, writ denied); *Hobbs v. Hutson*, 733 S.W.2d 269 (Tex. App. ---Texarkana 1987, writ denied).

12 *Schwarz v. State*, 703 S.W.2d 187 (Tex. 1986).

13 *Id.*

14 *Id.*

B. Specific Components of the Mineral Estate

The mineral estate consists of five component parts: 1) the right to delay rentals; 2) the right to bonus payments; 3) the right to royalty payments; 4) the right to lease (the executive right); and 5) the right to develop.[15] The specific mineral interest(s) conveyed or reserved in a particular grant is to be determined from all the provisions of the conveyance instrument.[16]

II. Determining Ownership of Particular Mineral Interests

Each of the five component parts of the mineral estate is a separate, distinct property interest that may be conveyed or may be reserved in connection with a conveyance of a mineral interest.[17] An unqualified reservation of the mineral estate reserves the entire bundle of property rights accorded to the estate.[18] The separate conveyance, however, of the mineral estate's various component parts has led to significant problems in the real estate and oil and gas industries.[19] This is partially due to antiquated and/or poorly drafted conveyance instruments, which do not clearly reflect and define the components being transferred, and partially due to problems arising from the practical application of case law construing mineral conveyances.

A. Distinguishing Mineral Interests and Royalty Interests

A "royalty interest" is generally defined as the landowner's share of production, free of the expenses of production, but usually subject to postproduction costs, including taxes,

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15 *Altman v. Blake*, 712 S.W.2d 117, 118 (Tex.. 1986).

16 *Temple-Inland Forest Products Corp. v. Henderson Family Partnership, Ltd.*, 958 S.W.2d 183 (Tex. 1997).

17 *Id.; see also Briley*, 959 S.W.2d 723.

18 *Briley*, 959 S.W.2d 723.

19 *See* Kuntz, Law of Oil and Gas, Chapter 16 "Construction of Instruments Creating Interests in Oil and Gas, § 16.2 (2007); *see also* The Law of Pooling and Unitization, Chapter 7 "Methods of Pooling," § 7.05, (2006 3rd Edition); *See also* Williams, "Stare Decisis and the Pooling of Nonexecutive Interests in Oil and Gas," 46TEX. L. REV. 1013 (1968).

treatment costs to render it marketable, and transportation costs.[20] As opposed to the broader "mineral estate," a royalty interest is considered a "non-possessory" interest in the larger mineral estate, and thus, the owner of a royalty interest has no legal right to use and possess the property.[21] In addition, the same instrument may convey an undivided portion of the mineral estate and a separate royalty interest, and the royalty interest conveyed may be larger or smaller than the interest conveyed in the minerals in place.[22]

It is important to note that like the royalty interest, a reservation other specific mineral component parts, such as a reservation of the right to delay rentals and/or the right to bonus, is not inconsistent with the conveyance of a mineral interest and therefore does not relegate the interest conveyed to a mere royalty interest.[23] In fact, the granting of the other rights and the reservation of these rights would be inconsistent with the conveyance of a mere royalty interest.[24] Conversely, a grant of a royalty interest, without any further grant, would not convey an interest in delay or other rentals, bonus payments, or the executive right.[25] Thus a royalty interest is simply a mineral interest stripped of appurtenant rights other than the right to receive royalties.[26]

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20 *Heritage Resources, Inc. v. NationsBank*, 939 S.W.2d 118 (Tex. 1996); *Temple-Inland Forest Products Corp*., 958 S.W.2d 183; *Enron Oil & Gas Co. v. Joffrion*, 116 S.W.3d 215 (Tex. App. Tyler 2003).

21 *Concord Oil Co. v. Pennzoil Exploration and Production Co*., 966 S.W.2d 451 (Tex. 1998); *Luckel v. White*, 819 S.W.2d 459 (Tex. 1991).

22 *White*, 819 S.W.2d 459.

23 *French v. Chevron USA, Inc*., 871 S.W.2d 276 (Tex. App.---El Paso 1994), *judgment aff'd*, 896 S.W.2d 795 (Tex. 1995); *Prairie Producing Co. v. Schlachter*, 786 S.W.2d 409 (Tex. App. ---Texarkana 1990, writ denied).

24 *Schlachter*, 786 S.W.2d 409.

25 *Altman v. Blake*, 712 S.W.2d 117 (Tex. 1986); *Concord Oil Co. v. Pennzoil Exploration and Production Co*., 966 S.W.2d 451 (Tex. 1998); *French*., 896 S.W.2d 795.

26 *French*., 896 S.W.2d 795.

B. Severing the Executive from the Non-executive Components of the Mineral Estate

One of the most complex areas that has arisen with respect to the severance of the mineral estate relates to the ability of a mineral owner to create royalty interests in one party while giving the power to lease to another.[27] When the executive right to lease is severed from the rest of the mineral estate, a fiduciary duty arises between the executive owner and the non-executive owner.[28] The executive owes a duty of "utmost good faith" to the non-executive in dealing with leasing the mineral interests.

The severance of the executive and non-executive is particularly troublesome with respect to a mineral leasehold estate owner's ability to develop the minerals through pooling or Specifically, Texas law complicates a lessee's ability to make use of the pooling/unitization clause when the components of the mineral estate are divided amongst executive owners and non-executive owners. This is so because Texas law holds that when one party owns the executive right to grant a lease to an oil and gas company for the development of a particular tract of land, the executive's power does not extend to the right to pool/unitize the non-executive's interest.[29] Stated another way, the holder of executive mineral rights cannot pool, and thereby bind, the interests of a royalty owner without the royalty owner's consent.[30]

Accordingly, the balkanization of the mineral estate into executive and non-executive interests creates a situation where non-executive owners can "'hold out' for 'extortion'-type

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27 The Law of Pooling and Unitization, Chapter 7 "Methods of Pooling," § 7.05, (2006 3rd Edition).

28 *Manges v. Guerra*, 673 S.W.2d 180, 183-84 (Tex. 1984); *Mims v. Beall*, 810 S.W.2d 876, 878 (Tex. App.---Texarkana 1991, no writ).

29 *Montgomery v. Rittersbacher*, 424 S.W.2d 210, 213 (Tex. 1968).

30 *See id; see also MCZ, Inc. v. Triolo*, 708 S.W.2d 49, 53 (Tex. App.---Houston [1st Dist.] 1986, writ ref'd n.r.e.).

payments in order for them to sign a pooling agreement."[31] The transaction costs increase, in extreme cases, sufficiently prevents the development of the property, but even in ordinary cases, the transaction costs will invariably increase the development costs.[32]

Hence, the interpretation of a particular mineral conveyance could potentially render a the mineral estate unusable due to competing and conflicting interests amongst owners that will deter oil and gas companies from leasing. These consequences must be considered in light of Texas contract construction law. Specifically, Texas courts construe agreements between parties "from a utilitarian standpoint bearing in mind the particular business activity sought to be served and will avoid when possible and proper a construction which is unreasonable, inequitable, and oppressive."[33] In other words, Texas courts will not construe agreements to achieve absurd results.[34]

III. Use of the Surface Estate by the Mineral Estate Owner

As previously stated, the rights of the mineral estate to explore and develop are said to be dominant over the rights of the surface estate. In the absence of express contractual language to the contrary, the mineral estate owner and/or lessee has the right to use so much of the surface that is reasonably necessary for mineral exploration and development purposes, including geophysical operations.[35] However, those rights must be exercised with due regard for the rights

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31 The Law of Pooling and Unitization, Chapter 7 "Methods of Pooling," § 7.05, (2006 3rd Edition).

32 The Law of Pooling and Unitization, Chapter 7 "Methods of Pooling," § 7.05, (2006 3rd Edition).

33 *Frost Nat. Bank v. L & F Distributors, Ltd.*, 165 S.W.3d 310, 311-12 (Tex. 2005) (citing *Reilly v. Rangers Mgmt., Inc.*, 727 S.W.2d 527, 530 (Tex.1987).

34 *Illinois Tool Works, Inc. v. Harris*, 194 S.W.3d 529, 533 (Tex. App.---Houston [14th Dist.] 2006, no pet.).

35 *Ball v. Dillard*, 602 S.W.2d 521 (Tex. 1980); *Phillips Petroleum Co. v. Cowden*, 241 F.2d 586 (5th Cir. 1957).

of the surface owner.[36]

A. Limitations on Surface Use

Typically the granting clause of the oil and gas lease contains a broad grant of specific activities that the mineral lessee is authorized to conduct. Limitations may be placed on the mineral lessee's right to use the surface of the leased premises by specific contractual terms, often attached to the lease as a rider. In addition to any contractual limitations that may be placed on the lessee's activities, case law requires that the lessee must not use more land than is reasonably necessary to conduct its exploration and production activities, and the lessee must not be negligent in its use of the surface.[37]

Reasonable use includes the right to ingress and egress upon the land for exploration and production of oil and gas.[38] Reasonable use further includes the right for the mineral estate owner to select the timing of drilling operations.[39] As stated earlier, the mineral lessee must exercise its rights to use the surface of the land with due regard to the rights and uses of the surface owner.[40] The concept of due regard has been articulated by the Texas courts as the "accommodation doctrine."

i. Contractual Provisions

The language of the contractual provisions of the oil and gas lease must always be reviewed for any specific damage provisions or other limitations on the use of the surface of the property. The contractual provisions are controlling and dictate the mineral lessee's rights and

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36 *Gulf Production Co. v. Continental Oil Co.*, 139 Tex. 183, 132 S.W.2d 553 (Tex. 1971).

37 *Harris v. Currie*, 176 S.W.2d 302, 305 (Tex. 1943).

38 *Ball v. Dillard*, 602 S.W.2d 521, 523 (Tex. 1980).

39 *Robinson Drilling Co. v. Moses*, 256 S.W.2d 650, 652 (Tex. Civ. App.—Eastland 1953, no writ).

40 *Gen. Crude Oil Co. v. Akien*, 344 S.W.2d 668, 669 (Tex. 1961).

obligations. The granting clause of the oil and gas lease contains the required words of grant to create an interest in the lessee.[41] A typical granting clause will set forth broad rights of the lessee to conduct exploration and development. The following clause is a typical granting clause taken from the Pound Printing & Stationery Company, Producers 88 (4/76) Revised Form:

> Lessor in consideration of ____Dollars ($_____), in hand paid, of the royalties herein provided, and of the agreements of Lessee herein contained, hereby grants, leases and lets exclusively unto Lessee for the purpose of investigating, exploring, prospecting, drilling and mining for and producing oil, gas and all other minerals, conducting exploration, geologic and geophysical surveys by seismograph, core test, gravity and magnetic methods, injecting gas, water and other fluids, and air into subsurface strata, laying pipe lines, building roads, tanks, power stations, telephone lines and other structures thereon and on, over and across lands owned or claimed by Lessor adjacent and contiguous thereto, to produce, save, take care of, treat, transport and own said products, and housing its employees, the following described land in _____ County, Texas, to-wit:...

Such broad language of the granting clause has been the industry's attempt to describe all uses which may be likely made by the lessee. Case law cited herein further supports all reasonable uses necessary for the lessee to explore and produce the property.[42]

The mineral owner may include special provisions or "riders" when the oil and gas lease is executed that provide for certain surface damages or otherwise enlarge the rights of the surface owner. A surface use agreement may also be included in a conveyance or reservation of oil and gas interests. Many of these riders and surface use agreements place restrictions on how the surface is to be used for oil and gas operations. Like the lease itself, the riders and any ancillary agreements are construed according to the written provisions. For example, riders and ancillary

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41 Williams & Meyers, Manual of Oil and Gas Terms, 8th Ed. 1991.

42 *Harris*, 176 S.W.2d 302, 305 (Tex. 1943); *Ball v. Dillard*, 602 S.W.2d 521, 523 (Tex. 1980); *Robinson Drilling Co. v. Moses*, 256 S.W.2d 650, 652 (Tex. Civ. App.—Eastland 1953, no writ); *Gen. Crude Oil Co. v. Akien*, 344 S.W.2d 668, 669 (Tex. 1961).

42 Williams & Meyers, Manual of Oil and Gas Terms, 8th Ed. 1991

agreements may require that pipelines laid pursuant to the lease are to be buried below plow depth, that a well cannot be drilled within a specified distance of buildings, or even totally prohibit the use of the surface for drilling.

Other typical riders may require that operations not be conducted until certain conditions are met, such as giving notice to or obtaining permission from the current surface owner. Likewise, many riders set out certain obligations that must be met once operations are completed such as the obligation to restore the land or remove the equipment. In addition, some older oil and gas lease forms and many special riders require that the surface owner be compensated for specific surface damages caused by the lessees's operations such as damage to growing crops, fences and/or timber. Sometimes these specific damage clauses require payments for "damage to improvements." This broad reference does not appear to specifically require that the improvements be physically damaged and thus gives rise to the opportunity for the surface owner to argue that it includes any reduction in market value the improvements may suffer as a result of the lessee's operations on the property. Other clauses are so specific that they set out schedules for the payment of certain amounts for damages for certain types of activities conducted by the lessee.

ii. Case Law on Surface Use Limitations

In addition to the above contractual limitations, case law requires the mineral lessee must use only so much of the surface as is reasonably necessary for the exploration and production of the minerals. Further, the mineral owner must no be negligent in its use of the surface. Absent some express contractual provision, the surface owner has no right to recover from the mineral lessee for surface damage unless the surface owner can prove either specific acts of negligence

or that more of the land was used by the lessee than was reasonably necessary.[43]

The law appears to be in the lessee's favor. However, in practice, every attorney who represents surface owners in disputes over surface damages knows he must claim the lessee was negligent or used more land than was necessary. Excessive use and negligence are questions of fact for a jury and is not determined by the court.[44] Therefore, it is sufficient that the owners simply claim that the lessee violated these duties to enable the owner to file a lawsuit. Lawsuits such as these result in a loss of money by the lessee to defend himself, and the lessee has no summary legal proceeding in which to resort. Much to the landowner's ultimate dismay, thus far, the courts have found negligence in relatively few cases.[45] Most of the instances where negligence was found involved saltwater pollution of either the surface or of fresh water. The courts have taken a very liberal view of what actions are "reasonable" on the part of lessees.

iii. Due Regard and the Accommodation Doctrine

The mineral estate owner's right to use the surface is further limited by the rule of "due regard." Specifically, the mineral estate owner must conduct his activities with due regard for the surface estate.[46] Out of the concept of "due regard," Texas courts have developed what is presently referred to as "the accommodation" doctrine and/or "the alternative means" doctrine. The accommodation doctrine was first articulated by the Texas Supreme Court in the case of

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43 *Humble Oil & Refining Co. v. Williams*, 420 S.W.2d 133 (Tex.1967).

44 *Humble Oil & Refining Co. v. Whitten*, 427 S.W.2d 313 (Tex. 1968); *Brown v. Lundell*, 344 S.W.2d 863 (Tex. 1961).*Elliff v. Texon Drilling Co*., 210 S.W.2d 558 (Tex. 1948); *Lone Star Gas Co. v. McGuire*, 570 S.W.2d 229 (Tex. Civ. App.---Waco 1978, no writ); *Willey v. Vincik*, 458 S.W.2d 236 (Tex. Civ. App. ---Corpus Christi 1970, no writ); *Robinson Drilling Co. v. Thomas*, 385 S.W.2d 725 (Tex. Civ. App. ---Eastland 1964, no writ); *Hudson v. West Central* Drilling Co., 195 S.W.2d 387 (Tex. Civ. App. ---Eastland 1946, writ refused n.r.e.); Sinclair Prairie Oil Co. v. Perry, 191 S.W.2d 484 (Tex. Civ. App. ---Texarkana 1945, no writ);

45 *See id*; see also *Oryx Energy Co. v. Shelton*, 942 S.W.2d 637 (Tex. App. ---Tyler 1996, no pet.); *Currey v. Ingram*, 397 S.W.2d 484 (Tex. Civ. App. Eastland 1965, writ refused n.r.e.); *Texaco, Inc. v. Spires*, 435 S.W.2d 550 (Tex. Civ. App. Eastland 1968, writ refused n.r.e.).

46 *Gen. Crude Oil Co. v. Akien*, 344 S.W.2d 668, 669 (Tex. 1961).

Getty Oil Co. v. Jones.[47]

In balancing the equities, the Texas Supreme Court formulated the accommodation doctrine, which holds:

> [w]here there is an existing use by the surface owner which would otherwise be precluded or impaired, and where under the established practices in the industry there are alternatives available to the lessee whereby the minerals can be recovered, the rules of reasonable usage of the surface may require adoption of an alternative by the lessee.[48]

The accommodation doctrine recognizes a greater duty on the mineral lessee than previously imposed. The doctrine does not, however, stand for the proposition that the surface estate is now the dominant estate, nor that the mineral lessee must, at all costs, avoid interference with the surface owner's use.[49] In fact, if there is no reasonable alternative to the one complained of by the surface owner and the activity is consistent with industry standards, the mineral-estate owner is entitled to proceed.[50] Moreover, the burden of satisfying an accommodation doctrine claim is on the surface estate owner.

Since *Getty*, case law further defining the accommodation doctrine has been scarce. However, the few courts that have addressed the doctrine appear to have interpreted it narrowly, rather than broader. For instance, specific deed reservations in one's chain of title can work to waive the accommodation doctrine.[51] Furthermore, a showing of mere inconvenience in

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47 470 S.W.2d 618, 622 (Tex. 1971).

48 *Id.* at 622.

49 *Id.* at 628; *see also Sun Oil Co. v. Whitaker*, 483 S.W.2d 808 (Tex. 1972).

50 *Tarrant County Water Control and Improvement Dist. Number One v. Haupt, Inc*., 854 S.W.2d 909, 911-12 (Tex. 1993).

51 *Landreth v. Melendez, 948 S.W.2d 76,* 81 (Tex. App.--- Amarillo 1997, no pet.).

relocating surface operations is not enough to give rise to the accommodation doctrine.[52]

Most recently, the Waco Court of Appeals issued an opinion on the accommodation doctrine with respect to existing landfills on the surface estate.[53] In holding that evidence was sufficient to support the application of the accommodation doctrine in favor of the surface owner, the court stated the following:

> [Plaintiff] has an existing use of cell 20 that would be precluded or substantially impaired. Although waste is not currently being disposed of in cell 20, cell 20 is indisputably a part of the deed-recorded and state-registered landfill. Clay has been mined from cell 20, and topsoil is being stored there. If a well were drilled there, [Plaintiff] would have to redesign other cells and lose the use of others. And sufficient evidence supports the jury's finding that directional drilling is a reasonable, industry-accepted alternative . . . Moreover, the [the evidence] showed that regardless of the costs and decreased yield, the projected $15 to $25 million in gas reserves [warrant Defendant's] directional drilling, regardless of the increased costs.[54]

B. Miscellaneous Rights of Lessees Supported by Case Law

The following rights of the mineral lessee have been recognized by the courts:

Courts clearly have held that the mineral lessee may build roads where necessary for the transportation of heavy machinery and the servicing of well sites.[55] Construction of roads by the mineral lessee has always been a source of aggravation to the surface owner. Additionally, the mineral lessee may construct roads from the caliche excavated form the leased premises.[56] In East Texas, iron ore and clay would be the likely substance. Similarly, subject to any state or federal statutes, the mineral lessee has the right the use fresh water and salt water produced from

52 *Ottis v. Haas*, 569 S.W.2d 508, 514 (Tex. Civ. App.—Corpus Christi 1978, writ ref'd n.r.e.).

53 *Texas Genco, LP v. Valence Operating Co*., 187 S.W.3d 118 (Tex. App.---Waco 2006, pet denied).

54 *See id.* at 124-25.

55 *Gulf Oil Corp. v. Walton*, 317 S.W.2d 260 (Tex. Civ. App.--El Paso 1958, no writ).

56 *Davis v. Devon Energy Production Co., L.P*., 136 S.W.3d 419 (Tex. App.---Amarillo 2004, no pet.).

the land for its operations and the right to dispose of salt water produced in the course of operations.[57]

Furthermore, Courts have allowed wide latitude to mineral lessees when selecting the surface location for drill sites. A surface owner cannot compel the lessee to use abandoned well bores or abandoned surface locations rather than drilling new wells.[58] Likewise, the mineral lessee generally has been unrestricted in determining when the well is to be drilled. For example, one Texas court has held that the mineral lessee was not liable for damage to a mature crop by beginning operations before the crop could be harvested.[59] Moreover, no advance notice is due to the surface owner advising the drilling operations will begin.[60] However, as a matter of policy, most companies find a better "spirit of cooperation" if they make it their practice to notify the surface owner prior to entering the property.

The courts have also recognized the right of the mineral lessee to use the surface for geophysical exploration operations.[61] And, absent a specific contractual provision, the mineral lessee has been held not liable to the surface owner for damage to standing timber or growing crops unless it is shown that more of the land was used than was reasonably necessary.[62] Similarly, in cases involving livestock, the only duty imposed upon the mineral lessee is not to intentionally, willfully or wantonly injure the cattle as long as the operator is within his area of

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57 *TDC Engineering, Inc. v. Dunlap*, 686 S.W.2d 346 (Tex. App. ---Eastlan 1985, writ ref'd n.r.e.).

58 *Walton*, 317 S.W.2d 260.

59 *Moses,* 256 S.W.2d 650.

60 *Parker v. Texas Co*., 326 S.W.2d 579 (Tex. Civ.. App.--El Paso 1959, writ ref'd n.r.e.).

61 *Wilson v. Texas Co*., 237 S.W.2d 649 (Tex. Civ.. App.--Fort Worth 1951, writ ref'd n.r.e.); *Phillilps Petroleum Co. v.. Cowden*, 241 F.2d 586 (5th Cir. 1957); Yates v. Gulf Oil Corporation, 182 F.2d 286 (5th Cir. 1950).

62 *Williams*, 20 S.W.2d 133.

operations and not using more land than is reasonably necessary.[63] Further, absent an express provision requiring a mineral lessee to restore the surface of the land to its prior condition, the oil and gas lesseee has no duty to make such restoration.[64] And, a purchaser of a surface estate burdened by a lease is in no position to complain about customary drilling operations.[65]

As stated above, implicit in the right to explore is the right to conduct geophysical operations on the surface of the property. Also, because the right to explore is an attribute of the mineral estate rather than the surface estate, it makes sense that the consent of the surface owner is not sufficient to conduct seismic operations on the land where the purpose of the seismic survey is to evaluate the land upon which the seismic operations are being conducted.[66] Thus, unless the grant or reservation provides otherwise, the mineral owner has the implied right to enter upon and make reasonable use of the surface of the land to conduct exploration activities including geophysical operations. A mineral owner or mineral lessee has the right to use as much of the surface as is reasonably necessary for the mineral exploration and development. Absent a contractual provision to the contrary, if the use of the surface is reasonable, the surface owner has no right to recover for surface damages and or require the surface be restored.[67]

C. The Role of the Real Estate Professional

The above recitations of the law regarding the use of the surface of real property can cause confusion for an experienced oil and gas attorney. It is very difficult for even the seasoned Real Estate Professional to address all concerns that may arise on the behalf of a buyer or seller

63 *See, generally,* note 47 *supra*.

64 *Warren Petoleum Corp. v.. Monzingo,* 304 S.W.2d 362 (Tex. 1947).

65 *Ottis v. Haas,* 569 S.W.2d 508 (Tex. Civ.. App--Corpus Christi 1978, writ ref'd n.r.e.).

66 *Id.*

67 *Cowden,* 241 F.2d 586.

when the sale of the real property does not include all the mineral interests. The transaction that the Realtor is handling may involve a mineral reservation on behalf of the Seller. That reservation may spark a multitude of questions from the buyer on how the reservation will affect him.

Even more problematic is the fact that in the East Texas area there are few remaining parcels of land where there has been no prior reservation of the mineral interest in the chain of title. Unless the reservation is for a surface mineral such as iron ore or of coal/lignite, the lender does not generally care whether there is a reservation for oil and gas. However, the potential buyer may (or may not) understand that with any reservation of oil and gas comes the right to explore as discussed above. It is when the new buyer wakes up one morning to see surveying flags in his new pasture or to see workers staking out a well location, that the realtor gets the call.

To be put into the position to explain the law in this area is not a comfortable spot for the Real Estate Professional. In any transaction of rural property, it is best that the realtor mention that the title policy will only cover the surface estate. The contract itself will deal with the mineral interest. It is important that the buyer understand that someone other than the seller may own a mineral interest in the property he is about to purchase. For a full explanation of what that might mean to the buyer, he should be referred to an attorney familiar with oil and gas law.

PART II. COVERAGE ISSUES: THE EVOLVING RELATIONSHIP BETWEEN THE MINERAL ESTATE AND TITLE INSURANCE

I. "Where There's a Will, There's [Unfortunately] a Way"

When customers question title insurance coverage of mineral ownership, they often receive answers such as "title insurance does not extend to the minerals" or "our services can only expressly cover the surface of the property." In Texas, however, neither of these statements is correct. Under the Texas Forms, it is possible to insure separate mineral interests and the amount thereof. Even though insuring portions of the mineral estate is not often done (as it strikes fear in the hearts of all underwriters), the fact is that it *can* be done, and it is this possibility that gives rise to coverage conundrums.

Two distinct issues are presented: First, there is a possibility that portions of the mineral estate itself can be insured, which involves determining *who* owns certain mineral interests and *the exact nature and amount* of their ownership; second, with surface owners who own no portion of the mineral estate under their land, their title insurance policy could protect against damage to the surface and existing improvements caused by production and extraction of minerals. Dancing this "Texas two-step" is both the blessing and curse of title companies throughout the state. Confronting the first issue gave rise to our historic means of excepting all portions of the mineral estate from coverage under our policies, as described in Section II, and recent developments in this area are addressed in Section IV. The second issue above involves issuance of the T-19 and T-17 and the additional protections these endorsements provide, as discussed in Section III, along with current developments concerning the availability and affect of these endorsements, addressed in Sections III and IV.

II. Exceptions to Coverage Pertaining to Mineral Estate

Under Texas law, a title insurance policy that provides general coverage against losses will expressly *include* coverage as to every cause not specifically excepted in the policy.[68] Because, as noted above, it is possible to insure mineral interests, title insurance companies have endeavored to be as clear as possible in articulating that any losses relating to the mineral estate will *not* be covered (with the exception of certain losses protected by issuance of a T-19 or T-19.1 endorsement, as discussed herein). As with all insurance contracts, title insurance policies will be construed liberally by the courts in favor of the insured, provided that the court will attempt to construe the document to effectuate the intent of the parties.[69] The courts will accept extrinsic evidence as to the parties' intent only when a certain term is ambiguous; otherwise, the definition of an unambiguous policy provision is a question of law for the court.[70]

Essentially all underwriters operating in Texas, whether in-state or out-of-state, have made the business decision to wholly exclude the mineral estate from coverage under their title insurance policies. The general method for effectuating this is to place "Surface Estate Only" on Schedule A, and then to insert the following as an exception on Schedule B: "Rights to oil, gas, and other minerals of every kind and character in, on, and under the property described in Schedule A, together with the rights, privileges, and immunities relating thereto." The following exception is also often seen in various forms on Schedule B: "Right to use any portion of the surface estate of the property to produce and develop oil, gas, and other minerals in and under the land, including the right of ingress and egress for purpose of producing and mining said

68 *Clements v. Stewart Title Guaranty Co*., 537 S.W.2d 126 (Tex. Civ. App.- Austin 1976, writ ref. n.r.e.).

69 *Cook Consultants, Inc. v. Larson*, 677 S.W.2d 718 (Tex. App. – Dallas 1984, writ granted), judgment aff'd in part, rev'd in part on other grounds at 690 S.W.2d 567 (Tex. 1985).

70 *Stewart Title Guar. Co. v. Cheatham*, 764 S.W.2d 315 (Tex. App.- Texarkana 1988), writ den.).

minerals." Finally, all mineral severances, outstanding mineral interests, mineral or royalty deeds, and mineral leases are listed as separate exceptions on Schedule B.[71]

While the effectiveness of the above items has only recently been questioned, as addressed below, Texas courts have historically approved this method as a means of excepting mineral interests from coverage. In *Eames v. St. Paul Title Ins. Co.*, the policy at issue listed as an exception on Schedule B "All minerals reserved in" the contested deed.[72] Consequently, the Waco Court of Appeals held that the title company was not obligated to defend the insured against a third-party claim pertaining to this mineral interest.[73] Alternatively, the costs associated with omitting mineral severances in the chain of title can be considerable. In *American Title Ins. Co. v. Byrd*, the title company failed to include certain mineral reservations on Schedule B of the policy.[74] The Texas Supreme Court held that while the title company could not be held liable for actionable fraud under Article 4004, the company could be held liable under the common-law doctrine of false representation of a material fact.[75]

III. Express Insurance and Issuance of Endorsements T-19 and T-17

A. Applicable Law

Endorsements, when issued in conjunction with title insurance policies, add coverages that would otherwise be excluded under the policy.[76] Endorsement language will generally

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71 Underwriting requirements vary as to the extent of the search necessary when locating all outstanding mineral interests and severances for inclusion on Schedule B. While many underwriters consider a 25 to 30 year search sufficient, others do not deem the search "adequate" unless the chain of title is examined back to the year 1900.

72 654 S.W.2d 560, 561 (Tex. App. – Waco 1983, writ ref. n.r.e.).

73 *Id.* at 560-561.

74 384 S.W.2d 683, 684-686 (Tex. 1964).

75 *Id.* at 685-686.

76 *See Mesa Operating Co. v. California Union Ins. Co.*, 986 S.W.2d 749 (Tex. App.- Dallas 1999).

"supercede and control" over conflicting terms in the policy itself; however, courts will not read the endorsement apart from the main policy, such that the endorsement provisions should only be held to supercede policy provisions when the two are "truly in conflict."[77] We were unable to locate a reported Texas case from a state or federal court that construes or interprets endorsements T-19, T-19.1, or T-17.

B. T-19 Endorsement

The T-19 Endorsement, entitled "Restrictions, Encroachments, Minerals Endorsement" provides additional coverage for certain surface or improvement damage resulting from mineral production and extraction.[78] The pertinent coverage item in T-19, being paragraph 3(b), protects against damage to existing improvements, including lawns, shrubbery, or trees, resulting from " . . . the future exercise of any right to use the surface of the land for the extraction or development of minerals excepted from the description of the land or excepted in Schedule B." Similarly, coverage language in T-19.1, being paragraph 2(b), protects against damage to existing buildings resulting from " . . . the future exercise of any right existing at Date of policy to use the surface of the land for the extraction or development of minerals excepted from the description of the land or excepted in Schedule B."

As expected, underwriting standards vary widely concerning requirements that must be met prior to issuance of T-19 or T-19.1. In many cases, unless one of the following items applies to EVERY exception listed on Schedule B, underwriters require that paragraph 2(b) or 3(b) be deleted from the endorsement:

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77 *Mutual Life Ins. Co. v. Daddy$ Money, Inc*., 646 S.W.2d 255, 259 (Tex. App.-Dallas 1982, writ ref. n.r.e.); *Mesa Operating Co.*, 986 S.W.2d 749; *Westchester Fire Ins. v. Heddington Ins., Ltd*., 883 F. Supp. 158, 165 (S. Dist. Tex. – 1995), aff'd 84 F.3d 432 (Fifth Cir. 1996).

78 The T-19 is issued in conjunction with a Mortgagee's Policy, while the T-19.1 is its counterpart issued with an Owner's Policy. Both the T-19 and T-17, along with issuing instructions and applicable rate rules, are included in the Basic Manual.

(1) All minerals have been severed from the surface of the mortgaged land, and, prior to the mineral lease's inception, all mineral owners joined in a recorded agreement that (a) generally waived/relinquished rights to use the surface or (b) designates a drill-site that does not include any part of the mortgaged land

(2) The mineral lease stipulates that no exploration or production will occur on the surface of the land covered by the insured mortgage.

(3) The mortgaged land is located within the municipal boundaries of an incorporated city that has enacted a drilling-permit ordinance, and no permit has been issued for drilling on the mortgaged land.

(4) Subsequent to inception of the mineral lease, the lessee or its assignee has joined in a recorded agreement that (a) generally waives/relinquishes rights to use the surface of the mortgaged land or (b) designates a drill-site that does not include any part of the mortgaged land.

Clearly, with such guidelines, it is difficult to provide coverage under paragraphs 2(b) and 3(b) in most instances.

C. Mounting Difficulties of Mineral Interest Searches and T-19 Issuance

To obtain a license in Texas, a title plant must have twenty-five (25) years of records. However, because many mineral severances occurred much longer than twenty-five years ago, a thorough search of the records available to most plants will not reveal all outstanding mineral interests. Underwriters operating in Texas are aware of this, and certain underwriters have, as recently as October of this year, required mineral interests to be searched back to the year 1900; only a search from 1900 forward will be "adequate" when customers are requesting T-19 issuance. Also, the consequences here extend well beyond T-19 because, as described above,

including all outstanding mineral interests on Schedule B is a method utilized on all policies, whether or not a T-19 is being requested. Certain underwriters are requiring mineral interest searches for all policies that extend far beyond the twenty-five year mark.

The time and expense involved in these extensive mineral searches are simply not covered by the premium amounts from our policies; it is cost-prohibitive to conduct these searches at the courthouse (when we must go behind our plant dates), thus making it cost-prohibitive for us to do the necessary leg work for T-19 issuance and even for issuance of some policies in general. These situations involve taking calculated risks with each property, and we must constantly strive to assist our underwriters in finding the middle ground between catching outstanding mineral interests while still providing coverage, particularly in the form of T-19, to our customers. This issue will undoubtedly continue to develop and must be addressed by all Texas title companies.

D. T-17 Endorsement and Recent Developments

The T-17 Endorsement, entitled "Planned Unit Development" or "PUD," may be issued in conjunction with a Mortgagee's Policy to cover, among other items, certain loss arising by virtue of present violations of restrictive covenants listed in Schedule B as restricting the use of the land. Recent controversy here has arisen in conjunction with the ability of developers, under the TEXAS NATURAL RESOURCES CODE, to designate a pad site or drilling site on the recorded subdivision plat. The mere designation of a pad site on the plat should not affect the rights of mineral owners, who obtained their interest prior to recordation of the plat, to produce and develop their minerals.

However, developers around the state, particularly those in the panhandle and in West Texas, are arguing that losses suffered pursuant to the drilling of a well at locations other than

the "designated drill site" are covered by paragraph (1) of their T-17 Endorsement. In almost all of these instances, the oil company had drilled a well in compliance with Texas Railroad Commission Regulations and pursuant to leases from mineral owners whose interests had been severed from the surface prior to recordation of the plat. The developers and lenders argue that, under the language of the paragraph (1), the existence of the severed minerals and the owners' resulting right to develop their minerals constituted a "present" violation of the Subdivision Regulations at the time the policy was issued.

While this argument will likely be a losing one under the T-17, many in the Texas title insurance industry worry about the effects of this and similar arguments made in reliance on certain American Land Title Association Endorsements. Several powerful Texas players are pressing for Texas usage of the 9.96 Endorsement and its counterparts, some of which cover loss arising from certain *future* violations of restrictions, not just *present* violations, as in the T-17. Usage in Texas of a similar form would certainly be disastrous in cases where the city itself alters its ordinances to allow for drilling that may violate certain restrictions applicable to the land.

E. Express Insurance Under Procedural Rule 39

Also available in certain circumstances, if the title company considers the risk acceptable, is express insurance under P-39(b) as to surface damage resulting from mineral development or extraction. Title companies are most likely to offer this coverage if the following items apply: (1) the property is within the city limits; (2) the city's drilling ordinances severely restrict drilling within the city limits; (3) there is currently little or no mineral production in the area; (4) the insured property is geographically small. In instances where no buildings of any kind are currently located on the land, P-39 express coverage may also be available to protect against

damage to future buildings constructed on the land. This coverage may read as follows:

> Rights, if any, of any holder of an oil and gas or mineral interest (the "Minerals") in the land to exercise any right of access to the Minerals by physically damaging, partially or totally, permanent buildings subsequently constructed on the land. Company insures the Insured against loss, if any, sustained by the Insured under the terms of this Policy by reason of the enforcement of said rights as to the land. Company agrees to provide defense to the insured in accordance with the terms of this Policy if suit is brought against the Insured to enforce said rights as to the land.

IV. Current Issues Affecting Title Insurance and the Mineral Estate

A. Placing Exceptions on Schedule B No Longer Sufficient?

As noted above in Section II, historical exception of losses arising from the mineral estate has been effectuated in Texas policies by inserting "Surface Estate Only" in Schedule A, along with the inclusion in Schedule B of exceptions covering all rights in and to the minerals, including specific exceptions as to each outstanding mineral interest. However, as pointed out in Section II, certain large underwriters in Texas are concerned that *excepting* as to all mineral rights and interests is no longer enough; now, some underwriters want the mineral estate itself listed on Schedule A as being expressly *excluded* from the insured estate. For example, when insuring the fee simple estate, Item (2) on Scheduled A would read as follows:

> Fee simple estate, subject to, and the Company does not insure title to, and excepts from the description of the land, coal, lignite, oil, gas, and other minerals in, under, and that may be produced from the land, together with all rights, privileges, and immunities relating thereto.

For various reasons, some of which are discussed below, some in the industry are

concerned that the Texas Department of Insurance will soon declare our historical methods of exception (as described in Section II) insufficient, and in lieu of this impending doom, a few underwriters are now opting to insert minerals language as an *exclusion* listed on Schedule A, as opposed to a mere *exception* set forth on Schedule B.

B. "Surface Estate Only" – Violation of Procedural Rule 5?

During the last few years, much concern has been raised over title companies' historical usage of "surface estate only" on Schedule A, combined with the following exception on Schedule B: "Rights to oil, gas, and other minerals of every kind and character in, on, and under the property described in Schedule A, together with the rights, privileges, and immunities relating thereto." Many customers, including large state agencies, have increasingly argued that this "blanket exception" as to the mineral estate is not allowed in Texas; they argue that usage of this exception, along with "surface estate only," amounts to a "general exception" that is expressly prohibited by P-5.

Proponents of our historical means for excepting mineral interests argue that title companies have gone to great lengths to specifically list all the rights and incidents of mineral ownership on Schedule B that could possibly affect the surface, being (1) rights of mineral owners generally, (2) rights of mineral owners to access and damage the surface for mineral extraction, and (3) listing each outstanding mineral interest, severance, and lease individually. If this is a "general" exception prohibited by P-5, how much more specific can be we be?

The Texas Department of Insurance has not yet declared our historical methods a violation of P-5, nor has any reported Texas state or federal case dealt with this issue. Proponents of our historical method view these changes are premature; if an ounce of prevention is worth a pound of cure, what is a pound of prevention worth when the disease doesn't exist?

C. "Surface Estate Only" – Insures Certain Mineral Interests?

Perhaps the most volatile issue pertaining to mineral coverage today is whether or not the phrase "surface estate only" encompasses the minerals in certain instances. Does inclusion of this language on Schedule A result in title insurance covering mineral interests in the land? While no case discussing this principle has yet been appealed and reported, this argument is being made pursuant to litigation in West Texas due to poorly-developed subdivisions and from litigation in North Texas due to explosive development throughout the Barnett Shale Formation.

Proponents of this theory argue that, as to the insured property, if the surface estate and mineral estate have never been severed from one another (meaning no mineral reservation or mineral deed occurs in the chain of title), then the phrase "surface estate" encompasses the mineral estate because the two are legally bound together until explicitly separated. This argument is based in part on the "greatest possible grant" doctrine applicable to conveyances. This basic tenet of Texas property law provides that when land is conveyed and no mineral interest is expressly reserved or excepted, the grantor's intent was to give all his interest in the property, which means the conveyance covered the surface and the minerals. Proponents also claim that their theory is supported by other areas of property law, such as the law pertaining to adverse possession, which provide that if the minerals and surface have never been severed, then title to the both estates shall pass because the two are still bound.

Opponents of this concept argue that, while it is true that the surface and mineral estates are one until severed, they remain SEPARATE estates nonetheless, such that reference to one estate does not automatically encompass the other simply because no severance has occurred. Throughout the chain of title, the two estates are at the very least *conceptually* distinct from one another at all times. Though as of yet no state or federal court has opined on this issue, such an

appellate decision may surface in the near future.

V. Conclusion

As advertised, the relationship between Texas oil, gas, and mineral law and the title industry is an ever-evolving relationship that will continue to change in the coming years. Understanding the delicate interplay between our underwriters, our state regulators, and our court system requires constant vigilance. And while adhering to their guidelines, we should constantly challenge all players in the industry to help us provide a higher standard of insurance to our customers.