

No. 05-1076

IN THE SUPREME COURT OF TEXAS

EXXON CORPORATION AND EXXON TEXAS, INC.,

PETITIONERS,

V.

EMERALD OIL & GAS COMPANY, L.P.,
AND LAURIE T. MIESCH, ET AL,

RESPONDENTS.

BRIEF OF *AMICUS CURIAE*
TEXAS OIL & GAS ASSOCIATION

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No. 05-0466

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To The Honorable Supreme Court of Texas:

The undersigned attorneys submit this *Amicus Curiae* Brief pursuant to Rule 11 of the Texas Rules of Appellate Procedure and respectfully request that it be received and considered by the Court.

TxOGA's INTEREST

This Brief is submitted on behalf of the Texas Oil & Gas Association (“TxOGA”), a general, multipurpose, trade association representing the Texas oil and gas industry. TxOGA’s members, which produce and market more than ninety percent of all Texas’ crude oil and natural gas, are directly and significantly affected by all aspects of Texas oil and gas law. As an

organization, TxOGA participates actively in selected cases as *amicus curiae* to encourage the observance and maintenance of that substantial body of oil and gas law Texas courts have carefully developed over many decades, and to urge caution in departing from the general principles underlying that jurisprudence. TxOGA is particularly mindful of the need for restrained and deliberate judicial scrutiny of attempts to modify or enlarge contractual obligations beyond those agreed upon by the parties and expressly set forth in their written agreement by (a) expanding implied covenants and (b) fashioning tort liability out of strictly contractual relationships.

TxOGA has agreed to pay the undersigned a fee for the preparation and submission of this Brief.^{1/}

TxOGA's CONCERNS

This is another oil and gas royalty case. Unlike traditional lessor/lessee disputes, however, it does not involve a claim for breach of the contractual obligation of the lessee to pay royalty on produced minerals. Neither does it involve a claim of drainage (either to an offsetting lease or for the benefit of the lessee) or damage to an underground reservoir. Rather, like so much recent royalty-owner litigation, this case involves an attempt by

^{1/} Although Petitioners are members of TxOGA, neither of them participated in the preparation of this Brief, and neither will contribute to funding the payment of fees to the undersigned.

royalty owners to impose extra-contractual liability (this time on a *former* lessee) where none would exist under the express terms of the written oil and gas lease. In addition, but for the trial court’s application of the discovery rule to the waste claims, and the doctrine of fraudulent concealment to a “breach of development” claim, the claims in this case were long barred by limitations.

TxOGA is concerned that denial of the Petition in this case would leave in place a court of appeals opinion (the “Opinion”)^{2/} that (a) threatens to expand the existing universe of implied covenants in an oil and gas lease and call into question the burden of proof in lessor/lessee disputes, (b) disregards the one-satisfaction rule, (c) undercuts this Court’s rule of “predictability and consistency” in categorical applications of the discovery rule, and (d) blurs the historical distinction between contract and tort claims, all with the likely consequence of yet more royalty-owner litigation.

FACTS^{3/}

Exxon drilled and operated over 120 wells in the Mary Ellen O’Connor Field (the “Field”) under four separate oil and gas leases dating back to the

^{2/} *Exxon Corp. v. Miesch*, 180 S.W.3d 299 (Tex.App.–Corpus Christi, 2005, pet. filed).

^{3/} This section summarizes only so much of the record facts as are pertinent to the issues addressed in this Brief.

1950's. When a natural production decline combined with a 50 percent royalty burden to make operating the wells unprofitable, Exxon sought to renegotiate the uneconomic leases with its then lessors. Those negotiations were unsuccessful; Exxon decided to terminate the leases; and by August 16, 1991, Exxon had plugged and abandoned all its wells in the Field.^{4/}

After Exxon had lawfully severed its contractual relationship with the former lessors and terminated all of its operations, the former lessors then leased a portion of the Field to Emerald Oil & Gas, L.C. When Emerald became dissatisfied with its efforts to reenter certain of the wells, it sued Exxon for “wrongful conduct in plugging and abandoning,” and Emerald’s Lessors intervened. The trial court disposed of Emerald’s claims by summary judgment and directed verdict, and issues raised by those claims are the subject of a separate Petition for Review in this Court.^{5/}

The remaining plaintiffs (Emerald’s Lessors) asserted various claims against their former lessee (Exxon). Among others, those claims were for

^{4/} 180 S.W.3d at 314.

^{5/} The issues raised by Emerald were the subject of a separate court of appeals opinion, *Emerald Oil & Gas, L.C. v. Exxon Corp. & Exxon Texas, Inc.*, No. 13-99-757-CV, 2005 WL 167051 (Tex.App.—Corpus Christi 2005, pet. filed), which is in turn the subject of a separate Petition for Review in this Court, *Exxon Corp. & Exxon Texas, Inc. v. Emerald Oil & Gas Co., L.P.*, No. 05-0729 (Tex. filed Sept. 9, 2005).

common law and statutory waste, negligence *per se*, and failure to develop.^{6/} On the waste claim, the jury found that Exxon committed “waste on property or production in which [Emerald’s Lessors] own an interest,” that Exxon failed to “act as a reasonably prudent operator under the same or similar circumstances,” and that Emerald’s Lessors were entitled to the benefit of the discovery rule until January 24, 1995. On the waste claim the jury awarded Emerald’s Lessors \$5 million as (a) the cost to drill new wells, (b) the value of the minerals that cannot be recovered, and (c) loss of bonus payments. In addition, the jury found that Exxon acted with malice and awarded \$10 million in punitive damages.^{7/} The Corpus Christi court of appeals affirmed on all of Emerald’s Lessors’ claims against Exxon.

ARGUMENT

I. The Opinion Could Expand the Universe of Implied Lease Covenants.

According to the court of appeals, by plugging its wells in a fashion that “made reentry more difficult or impossible,”^{8/} Exxon committed actionable

^{6/} Specifically, Emerald’s Lessors asserted claims for (1) breach of regulatory duty to plug a well properly; (2) breach of regulatory duty to refrain from committing waste; (3) negligence *per se* based on alleged violations of various Natural Resources Code sections and Railroad Commission regulations; (4) tortious interference with economic opportunity; (5) fraud; and (6) negligent misrepresentation. 180 S.W. 3d at 312.

^{7/} The jury also found for Emerald’s Lessors on their failure to develop claim against Exxon, but neither that finding nor the award of damages is the subject of this Brief.

^{8/} 180 S.W.3d at 324.

waste, providing the former royalty owners a private cause of action under section 85.321 of the Texas Natural Resources Code.^{9/} If left unchanged, the Opinion will significantly, and improperly, strengthen the arsenal available to lessors in suits against their current and former lessees.

A. Creating A New Implied Covenant

The lessor/lessee relationship is strictly contractual^{10/} and must be determined from the provisions of the lease.^{11/} Texas courts protect the lessor's interest by enforcing express lease terms and by implying various other lease covenants where necessary and appropriate to protect a lessor against the lessee's wrongful pursuit of its own self-interest at the expense of the lessor.^{12/}

^{9/} TxOGA agrees with Petitioners that section 85.321 neither (a) creates a new private cause of action for waste nor (b) sweeps within its reach violations of all the State's conservation laws and regulations.

^{10/} *Hurd Enters. Ltd. v Bruni*, 828 S.W.2d 101, 107 (Tex.App.—San Antonio 1992, writ denied) (citing *Cambridge Oil Co. v. Huggins*, 765 S.W.2d 540, 544 (Tex.App.—Corpus Christi 1989, writ denied)).

^{11/} *Texas Oil & Gas Corp. v. Vela*, 429 S.W.2d 866, 870 (Tex. 1968); *Exxon Corp v. Middleton*, 613 S.W.2d 240, 245 (Tex. 1981).

^{12/} *Bruni*, 828 S.W.2d at 107-08.

[T]he relationship between a lessor and lessee has been held to be purely contractual. . . . A unity of interest arises as a result of the lessor/lessee relationship because the parties derive mutual economic benefits from the gas production. It is also recognized that the parties' interests will conflict in matters of maintaining production, marketing the product, treating, testing and reworking wells, and in appearing before administrative bodies. The protection for the lessor arises out of the lease agreement and is provided (continued . . .)

However, this Court “has not lightly implied covenants in mineral leases,” and will not imply one “unless ‘it was so clearly within the contemplation of the parties that they deemed it unnecessary to express it [in writing],’ and therefore they omitted to do so,” or it appears necessary “to effectuate the full purpose of the contract as a whole as gathered from the written instrument.”^{13/} Thus, this Court has made clear that the burden for creation of new implied covenants is on the party seeking to establish the new covenant.

TxOGA is concerned that the Opinion will be understood to read into every oil and gas lease a new implied covenant to preserve for the lessor (and all subsequent lessees) any oil or gas well that is not currently economical for the lessee, but which might be economically viable for reentry for some other party or under other circumstances. Such a covenant has never been recognized in Texas (or anywhere else to TxOGA’s knowledge) and should not be created by virtue of the Opinion below. Neither the Opinion, nor any of the parties in this case, has demonstrated that it would be either prudent or

through the use of express covenants, like the duty to pay royalty, and through implied covenants which arise by virtue of the lessor/lessee relationship.

Id. at 107 (citations omitted).

^{13/} *HECI Exploration Co. v. Neel*, 982 S.W.2d 881, 888 (Tex. 1999) (quoting *Danciger Oil & Ref. Co. v. Powell*, 137 Tex. 484, 154 S.W.2d 632, 635 (Tex. 1941)).

necessary to imply such a covenant in Texas oil and gas leases.

B. Shifting the Burden of Proof

As in all contract actions, the lessor has the burden of proof in an action for breach of express or implied lease terms.^{14/} The Opinion's broad application of section 85.321 not only effectively creates a new implied covenant, it also shifts the burden of proof from the lessor to the lessee.

Under the court of appeals' construction of section 85.321, a financially-motivated royalty owner need not bring an action for breach of an implied lease covenant (and bear the burden of proving that the lessee failed to act as a reasonably prudent operator under the same or similar circumstances). Instead, a royalty owner might choose to bring an action under section 85.321, alleging "waste," and put the lessee to the burden of proving that it *did* act as a reasonably prudent operator.^{15/} Applying section 85.321 this way effectively shifts the burden of proof in lessor/lessee disputes and would call

^{14/} See *Heritage Res., Inc. v. NationsBank*, 939 S.W.2d 118, 122 (Tex. 1997) (lessor has burden to prove market value at the well).

^{15/} Section 85.321 provides, in part:

Provided, however, that in any action brought under this section or otherwise, alleging waste to have been caused by an act or omission of a lease owner or operator, it shall be a defense that the lease owner or operator was acting as a reasonably prudent operator would act under the same or similar facts and circumstances.

180 S.W.3d at 318 (quoting Tex. Nat. Res. Code Ann. § 85.321 (Vernon 2001)).

into question the precedential value of decades of oil and gas decisions of this Court in a brand new round of royalty litigation. TxOGA doubts the Texas legislature intended either of these results when it included the *defensive protection* language concerning reasonably-prudent operations in section 85.321.

II. The Opinion Disregards the One-Satisfaction Rule.

The former royalty owners were awarded \$5 million in damages for waste, representing (a) the cost to drill new wells, (b) the value of the minerals that could not be recovered, and (c) the loss of bonus payments.^{16/} They were *also* awarded \$3.6 million in damages for breach of the development covenant, representing the amount they would have received for minerals produced had Exxon fully developed the oil and gas leases, less the costs of operation and production and any royalty received from their subsequent lessee.^{17/} In TxOGA's view, this amounted to a double recovery on two levels.

First, if waste did in fact occur (which Petitioners vigorously dispute), it would be error to award Emerald's Lessors the cost to drill new wells *and* to award them the value of the minerals that may be recovered by those same

^{16/} 180 S.W.3d at 335.

^{17/} *Id.*

wells. Once Emerald's Lessors have been compensated for the "lost" minerals (*i.e.*, the minerals that have been wasted and can no longer be recovered because the wellbores were damaged), there is no need to pay them to drill new wells to recover those same minerals. The court allowed a "double dip" when it also awarded the cost to drill wells

Second, to award damages for the waste claims, and to award any additional damages for the failure-to-develop claim, is clearly a double recovery for the same "lost" reserves. In order to rationalize allowing the same recovery twice, the court of appeals held that the one-satisfaction rule was not violated because the failure-to-develop damages were awarded under a contract theory, while a waste theory supported the damages for destruction of the wellbores and the consequent loss of reserves. But the court's rationale ignores the fact that the real loss claimed in this case (the loss of reserves) formed the same basis for both recoveries. The court of appeals allowed a second double dip and should be reversed.

III. The Opinion Unsettles the Discovery Rule.

The court of appeals held that, "[t]he discovery rule applies if (1) the injury is inherently undiscoverable, and (2) the evidence of the injury is objectively verifiable."^{18/} However, TxOGA does not believe, as it seems the

^{18/} 180 S.W.3d at 315 (citing *HECI Exploration Co.*, 982 S.W.2d at 886; *Velsicol Chem. Corp. v. Winograd*, 956 S.W.2d 529, 531 (Tex. 1997)).

court of appeals did, that the cases it cited, or any other of this Court's discovery rule precedents, stand for the proposition that the discovery rule *always* applies so long as the “inherently undiscoverable” and “objectively” verifiable standards are met. Neither do we believe that the discovery rule may always be applied in a lower court's discretion so long as this Court has not yet definitively prohibited its application. TxOGA believes that the law is the other way around, and no court may apply the rule to any case unless the case falls squarely within a category of cases this Court has affirmatively held is to receive the benefits of the discovery rule.

This Court has made it clear that (a) the discovery rule is “a *very* limited exception to statutes of limitations,”^{19/} (b) it is to be applied on a categorical basis, as determined by this Court,^{20/} and (c) in determining categories of cases to which the rule applies, this Court's focus is on the nature of the injury.^{21/} Based on these principles, this Court has determined that the discovery rule does not apply to “claims arising from damage to an

^{19/} *Wagner & Brown, Ltd. v. Horwood*, 58 S.W.3d 732, 734 (Tex. 2001) (emphasis added, quoting *Computer Assocs. Int'l, Inc. v. Altai, Inc.*, 918 S.W.2d 453, 455-56 (Tex. 1996)).

^{20/} *Wagner & Brown*, 58 S.W.3d at 735; *HECI Exploration Co.*, 982 S.W.2d at 886 (citing *Altai*, 918 S.W.2d at 457).

^{21/} *Wagner & Brown*, 58 S.W.3d at 735 (quoting *HECI Exploration Co.*, 982 S.W.2d at 886).

oil and gas reservoir.”^{22/} This Court’s settled jurisprudence concerning these straightforward rules of application will now become unsettled, because not only did the court of appeals not focus on the “nature of the injury” in this case, the Opinion is also not at all clear about what the court of appeals considered the injury to be.

On the one hand, in that part of the Opinion in which it discussed whether to apply the discovery rule, the court considered the injury to be “inherently undiscoverable” because “[d]amage to *subsurface wellbores* cannot be determined by visual inspection or even a review of publicly available records.”^{23/} But to the extent the injury in this case was damaged subsurface wellbores, TxOGA questions how such “damage” could constitute an injury to Emerald’s Lessors, inasmuch as the wellbore is commonly the personal property of the lessee, not the lessor. In fact, the typical Texas oil and gas lease expressly gives the lessee the right to remove all machinery and fixtures, including the right to remove well casings.

^{22/} *Id.* at 736.

^{23/} 180 S.W.3d at 315 (emphasis added). The court of appeals noted that “the record is replete with physical evidence pertaining to the intervenors’ injury, *that is, cut casing, shifted casing, refuse and other junk in the wellbores, and unexpected plugs and obstacles in the wellbores.* Experts testified that *the wellbores were damaged.*” *Id.* at 316 (emphasis added). The court also noted that Emerald’s Lessors’ damages were “for the destruction of the wellbores and the consequent loss of reserves.” *Id.* at 336.

On the other hand, in holding that Exxon breached both contract and tort duties, the court noted that “[t]he injury is not merely the economic loss to the subject matter of the contract itself, but damaged or destroyed wellbores and *ultimately, the loss of oil and gas reserves.*”^{24/} To the extent the Opinion stands for the proposition that the discovery rule applies to a claim for damage to an oil and gas reservoir, it directly conflicts with *Wagner & Brown* and creates uncertainty about the rule established in *HECI* and *Altai*, among other decisions of this Court.

In either case, the court of appeals’ holding concerning the discovery rule should be reversed.

IV. No Tort Duties Were Breached In This Case.

As noted above, because the lessor/lessee relationship is strictly contractual, the lessor’s protections are to be found in the express terms of the lease and, *where necessary and appropriate*, in a limited number of implied lease covenants. On that basis, Texas courts have consistently rejected attempts by lessors to fashion tort claims for asserted losses, even

^{24/} *Id.* at 319 (emphasis added). This portion of the Opinion is consistent with the lower court’s opinion in *Emerald*, in which it held that the Texas Natural Resources Code expressly grants a cause of action to a party “who is alleging that *its interest in production* was damaged” 2005 WL 167051, at *4 (emphasis added).

where the losses are claimed to have resulted from affirmative acts of their lessee on adjoining lands or from “self-dealing.”^{25/}

This Court applied those very principles in *Amoco Prod. Co. v. Alexander*,^{26/} where a lessor argued that drainage should be considered tortious due to the unique fact that Amoco was both its lessee and was causing the drainage.^{27/} This Court disagreed, holding that the lessor’s remedy was for breach of the contractual covenant to protect against drainage and would not support a claim for punitive damages.^{28/}

That no higher duty is owed by an oil and gas lessee to its lessor is also clearly established in Texas, because the contractual relationship created by a Texas oil and gas lease is not one of the relationships that impose a

^{25/} See, e.g., *Amoco Prod. Co. v. Alexander*, 622 S.W.2d 563, 571 (Tex. 1981); *Grace Petroleum Corp. v. Williamson*, 906 S.W.2d 66, 68-69 (Tex.App.—Tyler 1995, no writ); and *Bruni*, 828 S.W.2d at 111-12.

^{26/} 622 S.W.2d 563 (Tex. 1981).

^{27/} *Amoco Prod. Co. v. Alexander*, 594 S.W.2d 467, 479 (Tex.Civ.App.—Houston [1st Dist.] 1979), modified and aff’d, 622 S.W.2d 563 (Tex. 1981). The lessor argued that Amoco’s self interest in producing an adjoining lease, at the lessor’s expense, should be considered tortious.

^{28/} *Alexander*, 622 S.W.2d at 571. The Court made it clear that “[e]very claim of improper operation by a lessor against a lessee should be tested against the general duty of the lessee to conduct operations as a reasonably prudent operator in order to carry out the purposes of the oil and gas lease.” *Id.* at 568. The Court also made it clear that a lessee’s liability for drainage is neither increased nor judged by a higher standard, just because the drainage is caused by the lessee’s actions on adjoining lands. *Id.* at 569.

fiduciary duty as a matter of law.^{29/} Nor does it give rise to an “informal” fiduciary relationship, such as may exist “in those cases ‘in which influence has been acquired and abused, in which confidence has been reposed and betrayed.’”^{30/}

Texas courts have consistently held that under a typical oil and gas lease no fiducial duties are owed by a lessee to a lessor, because the lessee is neither a formal fiduciary (he is not agent, lawyer, partner, etc.), nor an informal fiduciary (no confidential relationship exists), and the relationship is not “special” (as that term is understood in Texas jurisprudence). As early as 1967, this Court held that there is no fiduciary or confidential relationship between a mineral lessee and its lessor, nor does a constructive trust arise between those parties.^{31/}

^{29/} See *Crim Truck & Tractor Co. v. Navistar Int’l Transp. Corp.*, 823 S.W.2d 591, 593-94 (Tex. 1992) (citing *Kinzbach Tool Co. v. Corbett-Wallace Corp.*, 138 Tex. 565, 160 S.W.2d 509, 513 (1942) (principal/agent) and *Johnson v. Peckham*, 132 Tex. 148, 120 S.W.2d 786, 787 (1938) (partners)).

^{30/} *Crim Truck & Tractor* at 594 (quoting *Texas Bank & Trust Co. v. Moore*, 595 S.W.2d 502, 507 (Tex. 1980)). Unlike the relationship of insured and insurer, in which Texas courts are most likely to find “special” relationships, the lessor/lessee relationship is one in which each party is motivated by a desire to make a profit, and there is no element of trust or unequal bargaining position. As this Court has said, “a party to a contract is free to pursue its own interests, even if it results in a breach of that contract, without incurring tort liability.” *Id.*

^{31/} *Sunac Petroleum Corp. v. Parkes*, 416 S.W.2d 798, 805 (Tex. 1967). While it has been held that an *executive* (the holder of the right to lease the minerals) may owe a duty of utmost good faith to nonexecutives, any such duty would arise from the relationship of the parties and not from the terms, expressed or implied, of a contract or deed. *Manges v. Guerra*, 673 S.W.2d 180, 183 (Tex. 1984).

Moreover, to the extent that a lessee's action may cause a potential diminution in royalties, the lessor's loss is an economic injury under the lease. Where the injury is only the economic loss to the subject of a contract, the action sounds in contract alone.^{32/} Because the jury in this case found that the Emerald's Lessors' loss was the value of the minerals "wasted," the loss, if any, was solely an economic loss under the oil and gas lease, and would not support an award of punitive damages.

CONCLUSION

It would be improper to permit the Opinion below to (a) create any new implied covenants in an oil and gas lease, (b) shift the burden of proof in lessor/lessee disputes, (c) modify the one-satisfaction rule, (d) undercut the "predictability and consistency" this Court demands in applications of the discovery rule, or (e) blur the distinction between contract and tort claims. To do so will result in unnecessary litigation, and TxOGA urges the Court to reverse the court of appeals.

^{32/} *Southwestern Bell Tel. Co. v. DeLanney*, 809 S.W.2d 493, 494-95 (Tex. 1991).

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