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May 16, 2006

Re: No. 05-1076; *Exxon Corporation and Exxon Texas, Inc. v. Emerald Oil & Gas Company, L.P., and Laurie T. Miesch, et al.*; In the Supreme Court of Texas

Supreme Court of Texas
201 W. 14th Street, Room 104
Austin, Texas 78701

By Federal Express

To the Honorable Supreme Court of Texas:

The Texas Oil & Gas Association ("TxOGA"), as *amicus curiae*, urges the Court to grant the Petition for Review in this case.^{1/} In the event the Court requests briefing, TxOGA anticipates submitting an *amicus* brief addressing in greater detail one or more of the issues raised or reserved in the Petition. However, because denial of the Petition would leave in place a court of appeals opinion (the "Opinion")^{2/} that could (a) improperly expand the implied covenants in an oil and gas lease, (b) call into question the burden of proof in lessor-lessee disputes, and (c) undercut this Court's rule of "predictability and consistency" in categorical applications of the discovery rule, all with the likely consequence of yet another round of royalty-owner litigation, TxOGA wishes at this time to express to the Court some of its more significant concerns with the Opinion.

This and a related case involve claims against the Petitioner Exxon by its former royalty owners and a *subsequent* (not successor) lessee.^{3/} At the time the subsequent lessee filed suit (and when the former royalty owners later

^{1/} TxOGA has agreed to pay the undersigned a fee for preparation and submission of this letter. None of the parties in this case will contribute to paying that fee.

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

^{3/} The subsequent-lessee claims against Exxon are the subject of the related case, *Exxon Corp. and Exxon Texas, Inc. v. Emerald Oil & Gas Co., L.P.*, No. 05-0729, in which this Court has already requested briefing.

intervened), Exxon's oil and gas leases with the former royalty owners had *terminated*. Nevertheless, the former royalty owners claimed that Exxon had improperly plugged and abandoned its wells, making it uneconomic for them or any future lessee to reenter the abandoned wells. On that premise, the former royalty owners asserted claims (among others) for common law and statutory waste, negligence and failure to develop the leases. But for application of the discovery rule to the waste claims, and the doctrine of fraudulent concealment to the breach of development claim, the claims in this case were long barred by limitations.

1. The Opinion Could Expand the Implied Lease Covenants.

According to the court of appeals, by plugging its wells in a fashion that "made reentry more difficult or impossible,"^{4/} Exxon committed actionable waste, providing the former royalty owners a private cause of action under section 85.321 of the Texas Natural Resources Code. If left unchanged, the Opinion will significantly strengthen the arsenal available to lessor-plaintiffs in royalty-owner litigation.

First, TxOGA agrees with the Petitioner 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.^{5/} Second, the Opinion's broad construction 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 disgruntled 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 instead 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

^{4/} 180 S.W.3d at 324.

^{5/} That the Natural Resources Code does not create such a private cause of action is the subject of briefing in the *Emerald* case and is an issue that has been reserved by the Petitioner in the *Miesch* case for briefing on the merits.

prudent operator.^{6/} TxOGA does not believe either of these results was intended, and neither represents sound public policy.

TxOGA is also concerned that left unchanged the Opinion will be understood to read into every oil and gas lease an implied covenant to preserve for the lessor (and all subsequent lessees) any oil or gas well that was (or might become) economically viable for reentry. 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. "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."^{7/} It would be neither prudent nor necessary to imply such a covenant in Texas oil and gas leases.

2. *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.^{8/} In addition, they were also awarded \$3.6 million in damages for breach of the development

^{6/} 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)).

^{7/} *HECI v. Neel*, 982 S.W.2d at 888 (quoting *Danciger Oil & Ref. Co. v. Powell*, 137 Tex. 484, 154 S.W.2d 632, 635 (Tex.1941)).

^{8/} 180 S.W.3d at 335.

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.^{9/} In TxOGA's view, this amounted to a double recovery on two levels.

First, if waste did in fact occur (which Petitioner disputes), it would be error to award former royalty owners the cost to drill new wells *and* to award them the value of the minerals that may be recovered by those same wells. Second, to award damages for the waste claims, and to award any additional amount as damages for the failure-to-develop claim is clearly a double recovery for the same "lost" reserves.

3. *The Opinion Unsettles the Discovery Rule.*

This Court has made it clear that (a) the discovery rule is "a very limited exception to statutes of limitations," *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); (b) it is to be applied on a categorical basis, *HECI v. Neel*, 982 S.W.2d 881, 886 (citing *Altai*, 918 S.W.2d at 457 and *Wagner & Brown*, 58 S.W.3d at 735); and (c) in determining categories of cases to which the rule applies, the focus is on the nature of the injury, *Wagner & Brown*, 58 S.W.3d at 735. Based on these principles, this Court has determined that the discovery rule does not apply to "claims arising from damage to an oil and gas reservoir." 58 S.W.3d at 736.

The Opinion is not entirely clear. On the one hand, in applying 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."^{10/} On the other, in

^{9/} *Id.*

^{10/} 180 S.W.3d at 315. TxOGA questions how damage to subsurface wellbores could constitute an injury to the former royalty owner, 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

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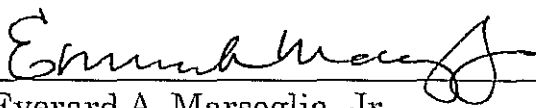
holding that Exxon breached both contract and tort duties, the court noted that “[t]he injury is not merely the economic loss to the subject matter of the contract itself, but damaged or destroyed wellbores and *ultimately, the loss of oil and gas reserves.*”^{11/} To the extent that the Opinion stands 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, and it should be overruled.

* * * *

For all the reasons outlined above, TxOGA respectfully urges that the public interest would be served by the Court granting the Petition in this case and having the opportunity to deliberate these and other issues after full briefing.

Respectfully submitted,

TEXAS OIL & GAS ASSOCIATION

By: 
Everard A. Marseglia, Jr.

cc: Counsel of record

^{10/} (...continued)
to remove well casings.

^{11/} *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” *Emerald Oil and Gas, L.C. v. Exxon Corp.*, 2005 WL 167051, at *4, ___ S.W.3d ___ (Tex.App.—Corpus Christi Jan. 27, 2005, pet. filed).

Supreme Court of Texas
May 16, 2006
Page 6

bcc: Mr. Cusimano
Mr. Ewart

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