HOLLIDAY ENERGY LAW GROUP

2020 Case Law Update, Part 3

Surface Estate vs. Mineral Estate

Alyssa Isenberg

Holliday Energy Law Group PC

Holliday Energy Law Group, PC is a San Antonio-based transactional energy law firm focused on rendering title opinions and providing operational/regulatory advising to oil and gas operators active across the continental United States. We represent clients throughout all stages of a drilling program – from acquisition through divestiture – in Texas, Oklahoma, North Dakota, Ohio, New Mexico, Montana, and Illinois.

Presentation Overview

- The Accommodation Doctrine
  - *Lyle v. Midway Solar*
- Timing of Surface Damages
  - *Evans Resources v. Diamondback*

Lyle v. Midway Solar, LLC,
No. 08-19-00216-CV, 2020 WL 7769632
(Tex. App.—El Paso Dec. 30, 2020, no pet.)

- Opinion delivered: December 30, 2020

- Issue: Does the accommodation doctrine apply to a tract of land where the surface estate is being used as a solar facility and the mineral estate is undeveloped?

Lyle v. Midway Solar, LLC: Facts

- 315 acres in Pecos County ("Section 14")
- 1948 – Owners convey away surface & reserve mineral rights
- Now:
  - The Lyles – own 27.5% mineral interest
  - Drgac – owns 100% surface interest
- No mineral development
  - No leases
  - No geological studies commissioned
  - No drilling contracts
  - No plan to drill wells

Lyle v. Midway Solar, LLC: Facts

- October 2015 – Drgac & brother execute solar leases with Midway Solar
  - Covers S/2 Section 14 & portions of adjoining Sections 71, 77, & 79
  - Gives Midway right "to free and unobstructed use and development of solar energy resources" for up to 55 years (with options to extend)
  - Also gives right to place transmission lines, electrical lines, & cable lines anywhere on property, subject to Drgac's consent
  - Recognizes they don't own mineral rights
    - Mineral rights = title encumbrance
    - Drgac had no "right to control" mineral owners' activities
    - Drgac agreed to cooperate with Midway "in obtaining surface waivers … from each owner of a mineral interest"

Lyle v. Midway Solar, LLC: Facts

- Soon after – Leases amended
  - Identified "Designated Drill Site Tracts"
    - 80-acre tract at north end of Section 14 & 17-acre strip at south end
  - Lyles had no input on location of drill sites
  - No evidence as to how sites decided
- Solar Facility Construction
  - Covered 215 acres on S/2 of Section 14 with solar panels & transmission lines
    - = ~70% of surface above Lyles' mineral estate
  - Left open designated drill sites

Lyle v. Midway Solar, LLC: Facts

- 2016 – Surface Waivers
  - Midway obtained surface waiver agreements from 20 mineral interest owners on Sections 71 & 77 purporting to relinquish all right to use the surface for mineral exploration
- 2018 – Surface Waiver Issues
  - Lyles complained to Midway that surface waivers invalid as to Sec. 14
  - Midway corrected 13 waivers. 7 left unaltered.
    - Corrected waivers re-recorded without signatures from mineral owners.
  - After suit filed, Midway filed “Disclaimer of Interest”
    - Attached 20 surface waiver agreements
    - Stated that waiver agreements do not “grant, convey or transfer to Midway any right, title or interst to the mineral estate of Section 14”
    - “Any suggestion or implication that the [waivers] convey the right to develop the mineral estate of Section 14 is hereby emphatically disclaimed by Midway”
    - It was never “the intent of midway to claim” any such right.

Lyle v. Midway Solar, LLC: Facts

- Lyles filed suit against Midway & 20 individuals who signed surface waivers ("Adjoining Mineral Owners") claiming:
  - Entitled to declaration quieting title to mineral estate because surface waiver agreements created cloud on title
  - Drgac & Midway breached terms of 1948 Deed by denying reasonable access to minerals by covering 70% of surface with solar panels & transmission lines
  - Because of the above, Drgac & Midway, with participation of 20 adjoining mineral owners, were trespassing on Lyles' mineral estates
- Sought monetary damages alleging solar facility had "destroyed and/or greatly diminished the value" of their mineral estate
- Requested "mandatory permanent injunction" to remove solar facility that were "allegedly encroaching on and covering their mineral interest and easement right"

Lyle v. Midway Solar, LLC: Facts

- Trial Court – Sided with Midway & Drgac on all points
  - Midway's Disclaimer of Interest removed any purported cloud on title
    - Needed to record in Pecos County Records
  - The Accommodation Doctrine applies when interpreting the 1948 Deed
  - Under the Accommodation Doctrine, Midway owed no duty to the Lyles to accommodate right to use surface without any current use or plan to develop the mineral estate
- The Lyles appealed

Lyle v. Midway Solar, LLC: Holding

- 8th Court of Appeals Holding:
  - The Accommodation Doctrine applied because the 1948 Deed did not define the rights of the competing estates, and, applying the doctrine, Midway & Drgac owed no duty to accommodate the Lyles until the Lyles exercised their rights to develop the mineral interests.

Lyle v. Midway Solar, LLC: Analysis

The Accommodation Doctrine

Overview

- In Texas, Mineral Estate = Dominate Estate; Surface Estate = Servient Estate
  - Mineral owners have implied right to use as much of the surface as "reasonably necessary" to develop minerals
  - "A grant or reservation of minerals would be wholly worthless if the grantee or reserver could not enter upon the land in order to explore for and extract the minerals granted or reserved."
- BUT: Dominate estate rights not absolute. Limited by accommodation doctrine.
  - Requires the mineral & surface estates must exercise their respective rights with due regard for the other's
  - Balances rights of mineral & surface owners to use surface estate

Lyle v. Midway Solar, LLC: Analysis

- Surface owner must prove
  - Mineral owner's surface use completely or substantially impairs the surface owner's existing use of the surface
  - No reliable alternative method exists for surface owner to continue his existing use of the surface
  - There are "alternative reasonable, customary, and industry-accepted methods available to the [mineral owner] which will allow recovery of the minerals and also allow the surface owner to continue the existing use"
- If proven, mineral owner will be required to adopt alternative methods. If not, mineral owner has right to continue use of surface, regardless of surface damages.

Lyle v. Midway Solar, LLC: Analysis

- Texas public policy favors freedom of contract
  - Thus, if express contractual terms determine the rights between mineral & surface owners, the accommodation doctrine will not apply
  - Accommodation Doctrine will still apply if agreement is silent or unclear as to each party's rights or if parties disagree as to the intent of the parties when drafting the terms used in the agreement

Did the 1948 Deed prevent the application of the Accommodation Doctrine?

- "Grantors further reserve unto themselves, their heirs and assigns, the right to such use of the surface estate in the lands above described as may be usual, necessary or convenient in the use and enjoyment of the oil, gas, and general mineral estate hereinabove reserved."

Lyle v. Midway Solar, LLC: Analysis

- The Lyles argued the 1948 Deed expressly sets out the rights of the competing estates
- Courts have held the terms “necessary” or “convenient” are imprecise & leave “substantial room for disagreement” as to their meaning
- However, Lyles argued “usual” was clear
  - = right to drill vertical wells, which was the “usual” method in 1948
  - Applying the Accommodation Doctrine would limit their ability to drill vertically
- Court disagreed

Lyle v. Midway Solar, LLC: Analysis

- Court disagreed
  - "Usual" was used generally
  - The deed did not specify it intended "usual" to apply to the drilling method of the time
  - There was a possibility of substantial disagreement as to the parties' intent as to what the term should mean
  - Court couldn't determine with any certainty what "usual" was intended to mean when parties clearly could have stated they intended to reserve right to drill in a particular manner
  - "Usual" no more precise than "necessary" or "convenient"

Lyle v. Midway Solar, LLC: Analysis

- "Elimination of Liability Provision"
  - Grantors … shall [n]ever be liable to Grantees … for any damage or injury to the surface estate by reason of such use or for any damage or injury resulting from or claimed to have resulted from the exercise of the rights and privileges hereinabove reserved in connection with the reservation of the oil, gas, and general mineral estate."
- Lyles argued provision defined how parties would resolve such conflict. It allowed them to destroy surface without liability, negating any reason to apply the Accommodation Doctrine.
- Court disagreed: Provision only addressed what liability grantors would have for surface damages while exercising rights & privelages reserved, not what those rights & privileges may have been.

Lyle v. Midway Solar, LLC: Analysis

Applying the Accommodation Doctrine

- Midway & Drgac: Lyles had to be using the surface estate to develop the minerals to apply the doctrine
- Lyles: Claims were "ripe" for review because already suffered damages by constructing solar facility limiting any realistic mineral development
- Court looked at prior case law but found neither case directly answered whether Midway had to accommodate the Lyles' potential use. Instead found logic must apply as much as the law.

Lyle v. Midway Solar, LLC: Analysis

- The Lyles right to use the surface is only as adjunct to their mineral estate.
- If the Lyles exercised right to develop minerals, Midway & Drgac had to yield to the extent mandated under the Accommodation Doctrine.
- If Lyles did not develop mineral estate, nothing to accommodate
- Thus, Midway & Drgac owed no duty to accommodate Lyles' surface usage until the Lyles sought to develop th emineral estate

Lyle v. Midway Solar, LLC: Analysis

- Court found that holding otherwise would allow a mineral owner to recover damages for *any* surface use that could *potentially* hinder mineral development in the future.
- Also, near impossible to calculate damages. Cannot accurately predict diminished value of mineral estate when all variables used to calculate damages will inevitably have changed in future when minerals were to be developed.
- Court found it illogical to allow damages today for a mineral estate that may never be developed
- The Lyles may be successful eventually if they unsuccessfully sought to lease or otherwise develop the mineral estate
  - Not the case yet. The Lyles explicitly stated they had no development plans.

Lyle v. Midway Solar, LLC: Analysis

Trespass & Breach of Contract Claims

- The Court found even if they misapplied the Accommodation Doctrine, the outcome would be the same.
- By not developing, the Lyles also undermined claims for trespass & breach of contract

Lyle v. Midway Solar, LLC: Analysis

Trespass Claim

- The Lyles must prove
  - Plaintiff owned or had a lawful right to possess the real property
  - The defendant entered the plaintiff's real property, & such entry was intentional, physical, & voluntary
  - The plaintiffs were injured by defendant's trespass
- Because both parties hold surface rights, Midway & Drgac do not actually encroach on the Lyles' rights until the Lyles seek to exercise their rights

Lyle v. Midway Solar, LLC: Analysis

Breach of Contract Claim

- The Lyles must prove
  - A valid contract exists
  - There was performance or tendered performance by the plaintiff
  - There was a breach of contract by the defendant
  - There were resulting damages from that breach
- Under the contract, the 1948 Deed, the Lyles had a right to access the surface to develop the minerals, but by not actually developing, they had yet to actually ask to enter the property for that purpose.

Lyle v. Midway Solar, LLC: Analysis

The Quiet Title Claim

- The Lyles: Surface waivers created cloud on title because they purported to relinquish right to utilize surface estate of Section 14 for mineral development, expressly stating or implying Adjoining Mineral Owners had interests in Section 14
- Midway: Waivers didn't create a cloud on title, but even if they did, any such cloud was removed with the filing of the corrections & Disclaimer of Interest & when trial court order stated Disclaimer removed any cloud.
- Court sided with the Lyles.

Lyle v. Midway Solar, LLC: Analysis

- Plaintiff entitled to declaration quieting title by proving:
  - It has an interest in a specific property
  - A defendant's claim to the property affected plaintiff's title
  - A defendant's claim is invalid or unenforceable, even though facially valid
- Court found that the Lyles owned part of mineral estate in Section 14 but Adjoining Mineral Owners did not
- The Court separated analysis into 3 categories of waivers, the Disclaimer of Interest, & the trial court order

Lyle v. Midway Solar, LLC: Analysis

Category 1 Waivers: Waivers that Claimed Mineral Rights in the Land Covered by the Leases

- 7 waivers stated signees owned minerals under the "Surface Lands" as described in the Leases and agreed to "waive[], release[] and relinquish[] all of [their] rights to use the surface of the 'Surface Lands'" to develop minerals
- Waivers attached the Solar Leases or referenced the recording info of the Solar Leases
  - Leases covered Section 14. None of these Adjoining Mineral Owners had any rights in Section 14.
- Court found these to be a cloud on title.

Lyle v. Midway Solar, LLC: Analysis

- Court found Category 1 waivers were a cloud on title
  - On their face, Adjoining Mineral Owners claimed an interest in Section 14 they didn't have
  - The invalidity of these waivers could only be determined by referencing additional instruments to determine actual ownership
  - None of these agreements corrected or altered by Midway.

Lyle v. Midway Solar, LLC: Analysis

Category 2 Waivers: Waivers that Defined the Rights Owned by Adjoining Mineral Owners

- 3 waivers stated they had interests "under some portion or all" of the "Surface Lands," as described in the Leases, & referenced recording info for Leases
  - Leases covered Section 14. None of these Adjoining Mineral Owners had any rights in Section 14.
- Also stated the legal description for the land in which the Adjoining Mineral Owners owned an interest described in Exhibit A
  - Exhibit A expressly stated they only owned interests in Sections 71 & 77
- Stated they reserved their right to use the surface of the Drillsite Areas as described in Exhibit B
  - Exhibit B described drillsites in Section 14, as well as Sections 71 & 77
  - Expressly stated Adjoining Mineral Owners "may use the Drillsite Area only to the extent Mineral Owner holds ownership within the tract of land in which each Drillsite Area is situated"

Lyle v. Midway Solar, LLC: Analysis

- Court found Category 2 waivers were not a cloud on title
  - Included express limitations & exhibit descriptions
  - Adjacent Mineral Owners were not claiming an interest in Section 14
  - Didn't matter whether Midway's corrections were valid or not

Lyle v. Midway Solar, LLC: Analysis

Category 3 Waivers: Waivers that Claimed Rights in Drillsites

- 10 waivers stated signees owned minerals under "some portion or all" of the "Surface Land," as described in the Leases, & referenced recording info for Leases.
  - Leases covered Section 14. None of these Adjoining Mineral Owners had any rights in Section 14.
- Waivers did not clarify mineral interests actually owned
- Stated that "Mineral Owner" reserve[d] for itself, its successors and assigns the non-exclusive right to use the Surface Lands within the Drillsite Areas for [developing minerals]"
  - Drillsite Areas defined in attached exhibits as areas in Section 14, as well as Sections 71 & 77

Lyle v. Midway Solar, LLC: Analysis

- Court found Category 3 waivers were a cloud on title
  - Waivers didn't clarify that Adjoining Mineral Owners didn't own an interest in Section 14
  - Midway attempted to correct these waivers by crossing out the reference to Section 14 in the exhibit describing Drillsite Areas
    - BUT: Agreements not properly corrected or rerecorded under Texas Property Code

Lyle v. Midway Solar, LLC: Analysis

- Tex. Prop. Code allows parties to file "correction instruments" to correct previously recorded instruments, but process differs for material errors vs. nonmaterial errors
  - § 5.028 = nonmaterial changes. § 5.029 = material changes.
- Tex. Prop. Code § 5.029
  - (a)(2) states a correction instrument to "remove land from a conveyance that correctly conveys other land" = material correction
    - The Lyles said this applied
  - (b)(1) states for material changes, ALL parties must execute correction
    - None were executed by Adjoining Mineral Owners
  - Thus, Court found § 5.029 applied but was not followed

Lyle v. Midway Solar, LLC: Analysis

- Tex. Prop. Code § 5.028 – Nonmaterial Changes
  - Court found even if nonmaterial, correction instrument wouldn't comply with § 5.028 rules.
  - (c) requires that a "person who executes a correction instrument under this section shall disclose in the instrument the basis for the person's personal knowledge of the facts relevant to the correction of the recorded original instrument of conveyance."
    - Correction documents simply stated they were being rerecorded to correct Exhibit B; they did not indicate "who made the correction, or the basis for that person's knowledge of the facts relevant to the correction."
- Because correction statute not followed, Category 3 waivers were cloud on title

Lyle v. Midway Solar, LLC: Analysis

The Disclaimer of Interest

- Filed in public record.
- Referred to the 20 waivers & stated they did not "grant, convey or transfer to Midway any right, title or interest in or to the mineral estate of Section 14."
- Midway: Argued this removed any purported cloud on title
- Lyles: Waiver agreements did not purport to give Midway a right to mineral estate; rather, Adjoining Mineral Owners in Waiver Categories 1 & 2 claimed an interest.
- Court found the Disclaimer of Interest could not correct the Categories 1 & 3 Adjacent Mineral Owners' invalid claim.

Lyle v. Midway Solar, LLC: Analysis

Trial Court Order

- Court found trial court order did not clear any cloud on title
- It stated Disclaimer of Interest removed any purported cloud on title, but Disclaimer did not remove the cloud
- Additionally, the order referenced the Plaintiff's Amended Petition which wasn't part of the public records
  - "if a title researcher were looking at title fifty years hence, they would have to locate the amended petition to discern the allegations being asserted.
- Thus, Court found Categories 1 & 3 still constituted cloud on title & remanded case back to trial court to enter judgment appropriately quieting title to the Lyles' mineral estate.

Lyle v. Midway Solar, LLC: What's Next

- No formal petition for review filed with Texas Supreme Court
  - Due April 19, 2021
- Watch for Texas Supreme Court action this year
  - Already filed 2 extensions to file for review, so highly likely formal petition for review will follow

Evans Res., L.P. v. Diamondback E&P, LLC,
No. 11-18-00128-CV, 2020 WL 2838529
(Tex. App. – Eastland May 29, 2020, pet. denied)

- Opinion delivered: May 29, 2020
- Petition denied: March 5, 2021

- Issue: Was the operator obligated to pay "Location Damages" to the surface owners under the terms of a Surface Agreement for surveying the land and staking out the location of the well pads?

Evans Res. V. Diamondback: Facts

- Evans Resources, L.P. owned the mineral estate
- Evans I, Ltd., *et al*. owned the surface estate
- 2010
  - Evans Resources executed O&G lease with Bluestem Energy, LP
  - Surface owners executed Surface Agreement
    - Limited Bluestem's operations to specific section of land
    - Required Bluestem to comply with certain operation requirements
    - Required Bluestem to obtain surface owners' approval of Bluestem's operations

Evans Res. V. Diamondback: Facts

- Surface Agreement
  - Required Bluestem to pay “Location Damages” prior to commencing operations upon any well locations
  - Required Bluestem to obtain consent of surface owners as to locations of any wells, provided that the locations of the first 7 vertical wells agreed to within the Surface Agreement
  - In the event Bluestem began operations that would entitle surface owners to receive payment, Bluestem was required to remit payment within 30 days after it “first utilize[d] any of said Land for purpose of requiring such a payment.”
  - If not properly remitted, surface owners granted lien on Bluestem’s interest in the land

Evans Res. V. Diamondback: Facts

- 2014
  - Evans Resources signed Lease Amendment for drilling horizontal wells
  - The same day, Bluestem & surface owners executed a Third Amendment of the Surface Agreement
- Third Amendment of the Surface Agreement
  - Allowed Bluestem to drill and produce "Offset Section Wells" from 4 "Approved Horizontal Well Pads or AHWPs" on the land
  - For each AHWP constructed, Bluestem required to pay surface owners Location Damages of $500,000 "in advance"
  - Such payment would constitute "full and complete satisfaction for any and all Location Damages related to any well drilled (or any other operation conducted) from such AHWP"

Evans Res. V. Diamondback: Facts

- Then, subject to approval by surface owners, Bluestem assigned interests to Diamondback
- Surface owners initially conditioned consent on receiving payment of Location Damages for 2 AHWPs by Jan. 1, 2015
  - After Bluestem & Diamondback assured surface owners they'd immediately start the process of drilling wells from the AHWPs, surface owners consented without the condition
- May 2015 – Diamondback surveyed the land for the 4 AHWPs
  - Parties executed Configuration Agreement agreeing to location of 4 AHWPs
- Diamondback then never constructed any AHWPs & refused to pay Location Damages

Evans Res. V. Diamondback: Facts

- Surface Owners sued
  - Requested declaration that Location Damages were due & owing for each AHWP & requested the judicial foreclosure of the contractual lien on Diamondback's interest in the land
- The Trial Court awarded partial summary judgment in favor of Diamondback

Evans Res. V. Diamondback: Holding

- 11th Court of Appeals Holding: Based on the definitions of the terms actually used in the Surface Agreement and Third Amendment of the Surface Agreement, the payment of the Location Damages was not yet triggered by the operator by surveying and staking the AHWPs because actual drilling had not yet been commenced.

Evans Res. V. Diamondback: Analysis

Construing a Contract

- Court must determine the intent of parties by what was actually said, not what a party alleges they intended to say
- The court must harmonize all provisions so that none are rendered meaningless

Evans Res. V. Diamondback: Analysis

Timing of Location Damages Under the Surface Agreement – Vertical Wells

- Agreed to pay Location Damages "prior to commencing drilling operations" on first 7 vertical wells and "in advance" on each subsequent well
- Court determined "commencement" not defined in Surface Agreement, but Lease provided that "commence a well," "commencement of a well," "commence actual drilling operations," and "commencement of actual drilling operations" were deemed to have occurred "at such time as there has been erected on the leased premises at the location for the well, a derrick, a rig and machinery capable of drilling to a depth of 10,000 feet below the surface, the well has been 'spudded-in' and the machinery for drilling is rotating under power."

Evans Res. V. Diamondback: Analysis

- Harmonizing all provisions in the Surface Agreement, court found it was clear the parties agreed Diamondback was required to pay Location Damages for a vertical well upon commencement of drilling operations or in advance
  - And drilling operations “commenced” through the erection of equipment capable of drilling the well

Evans Res. V. Diamondback: Analysis

Timing of Location Damages Under the Third Amendment – Horizontal Wells

- Agreed to pay “in advance” “for each AHWP constructed on the land”
- Constructed not defined anywhere, so turned to dictionary term
  - “to make or form by combining or arranging parts or elements”
  - Thus, Location Damages AHWPs didn’t have to be paid until it moved necessary “parts or elements” of the AHWP onto the land
  - Court also found this definition to be consistent with expressed intent that Location Damages for AHWPs compensated surface owners for any damage “related to any well drilled (or any other operation conducted from)” the AHWP, because an AHWP would have to be constructed before there could be any damages from to the land from a well drilled on or operations conducted from an AHWP.

Evans Res. V. Diamondback: Analysis

- Parties agreed that Location Damages were due within 30 days of when Diamondback "first utilize[d]" the land for construction of an AHWP
- Surface owners argued genuine issue of fact as to whether Diamondback "utilize[d] the Land" when it surveyed & marked locations for AHWPs
- Utilize not defined anywhere, so turned to dictionary term
  - "to make use of: turn to practical use or account"
  - Thus, Location Damages had to be paid in advance of when Diamondback "ma[de] use of" or "turn[ed] to practical use" the land for construction of an AHWP
  - Court found neither survey nor staking were "parts or elements" of the AHWPs; thus, Diamondback's actions didn't constitute utilizing the land for construction of an AHWP
    - No genuine issue of fact

Evans Res. V. Diamondback: Analysis

Extrinsic Evidence

- Surface owners argued evidence of parties' negotiations of the Third Amendment created genuine issue of fact as to whether parties intended Location Damages would not be payable until AHWP was constructed
- Court found parties unambiguously agreed int Third Amendment that Diamondback would pay Location Damages for an AHWP in advance of the construction of an AHWP.
  - Because Third Amendment was ambiguous, the court cannot look to extrinsic evidence to rewrite the contract

Evans Res. V. Diamondback: Analysis

- Conclusion:
  - Diamondback hadn't begun to utilize the land for construction of the AHWPs by completing a survey or setting up stakes to mark configuration of AHWPs
  - Neither survey nor stakes are "parts" that fall under definition of construction
  - Thus, Location Damages not yet due

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QUESTIONS?

alyssa@theenergylawgroup.com