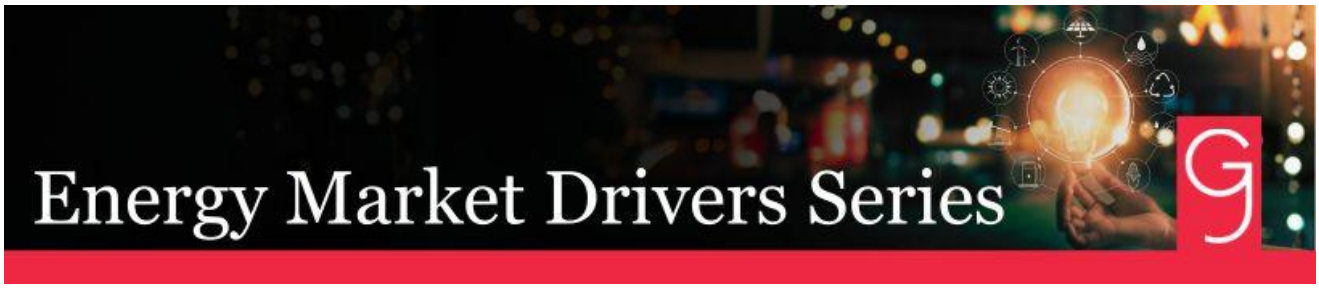

Texas Courts Reshape the Energy Landscape: Key Case Law Trends to Watch

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Recent Texas court decisions are redefining core principles in oil and gas law - from joint operating agreements and insurance coverage to subsurface ownership and royalty rights. For energy companies and investors, these rulings carry significant implications for operations, deal structuring, and litigation risk. This Alert highlights the most impactful developments and what they mean in practice, recently presented at GableGotwals' Annual Energy Market Drivers and Current Legal Issues Seminar.

Key Takeaways

1. Contract Language Still Reigns Supreme in Joint Operations

In *Tex. Crude Energy, LLC v. Burlington Resources Oil & Gas Co., LP*, the non-operated working interest owners (Non-Ops) proposed a number of wells to which the Operator consented. Under the applicable Joint Operating Agreement (JOA), the Operator was required to begin drilling these wells within 90 days, but shortly before that time expired, the Operator then announced its determination that the drilling of the well would not be prudent, and that if the Non-Ops still wanted the well to be drilled, they should resubmit it.

The trial court ruled that the operator did not breach the JOA by doing so. The court of appeals reversed because the JOA required that if the Operator consented to a well proposed by the Non-Ops, drilling of the well "shall" begin within 90 days, and resubmitting the well was not an adequate remedy. The Supreme Court of Texas may weigh in on this matter, but "shall means shall," and Operators cannot rely on broad discretion clauses to avoid explicit contractual duties.

Takeaway: Strict compliance, but not malicious compliance, with JOA provisions is critical to avoid operational disputes, particularly where the Non-Ops and the Operator may have different incentives with regard to the drilling of wells or development plans.

2. Insurance Coverage Disputes Are Expanding in Scope

In *BPX Production Co. v. Certain Underwriters at Lloyd's*, the insured poorly performed a cement job at a well, causing it to have to be shut in. The insured tendered the dispute to its insurer, which

denied coverage, effectively cutting the insured loose. After the insured declared bankruptcy, the Operator was able to take an assignment of claims that the insured had against its insurer for the failure to provide coverage. The Fifth Circuit reversed the district court's dismissal under Rule 12, holding that the Operator could bring such claims against the insurer and determine both the coverage issues as well as the insured's underlying liability for the event, in a single proceeding under the Hamel line of cases.

Takeaway: All may not be lost when the party causing harm declares bankruptcy, and its insurer has denied coverage. If the denial of coverage was wrongful, the injured party may be able to step into the insured's shoes and assert claims against the insurer directly.

3. Conditions Precedent Can Halt Development Entirely

In *Endeavor Energy Resources v. Comanche Maverick Ranch Investments*, the lease and surface agreement at issue referenced that seismic testing would be done under mutually-agreeable terms in a subsequent agreement, but the landowner later refused to negotiate. Because the existence of a seismic testing agreement was found to be a condition precedent, no obligation existed to negotiate or act in good faith. Projects can stall indefinitely if triggering conditions are not satisfied.

Takeaway: Be wary of clauses leaving key terms on related issues to be determined in a separately-negotiated agreement. There might not be any obligation for the other party to negotiate such an agreement at all.

4. The Surface Owner Usually Owns Any Subsurface Cavern or Pore Space

In *Myers-Woodward, LLC v. Underground Services Markham, LLC*, the Texas Supreme Court confirmed that surface owners, not mineral owners, generally own subsurface pore space and caverns. It overruled prior conflicting precedent; however, it recognized that mineral owners and operators under oil and gas leases may still use subsurface space as reasonably necessary for production.

Takeaway: A producer that wants to use any subsurface space for commercial purposes (e.g., storage) may want to secure an agreement with the surface owner.

5. Royalty Rights Continue to Evolve

The *Myers-Woodward* case also confirmed that a royalty of "1/8 of all oil, gas, and minerals" is an in-kind royalty interest. When producers sell the in-kind royalty owner's fractional share of the production, the producer generally should pay the royalty owner its fractional share of the net proceeds.

In *Fasken Oil & Ranch, Ltd. v. Puig*, the Texas Supreme Court ruled that the term "free of cost" in an in-kind royalty clause refers to pre-production costs, not post-production costs. A "free of cost" term in an in-kind royalty clause does not change the fact that an in-kind royalty owner is generally entitled to receive only its fractional share of the net proceeds; the royalty owner is not entitled to demand a fractional share of the gross proceeds.

Takeaway: Royalty clause language continues to be under heightened scrutiny, but as always, the Texas Supreme Court tries to enforce royalty clauses as they are written.

6. Produced Water Ownership Is Now Clear—But Questions Remain

In *Cactus Water Services, LLC v. COG Operating, LLC*, produced water is part of the mineral estate unless expressly reserved. However, unresolved issues include:

- Whether royalties apply to produced water
- How profits from reuse or disposal are allocated
- Potential implied duties regarding water management

Takeaway: This area is primed for the next wave of litigation.

The Bottom Line

Texas courts are actively redefining foundational oil and gas principles, often in ways that elevate the importance of contract clarity, strategic drafting, and proactive risk management.

From JOAs and insurance coverage to subsurface rights and emerging asset classes like produced water, the message is clear: small drafting decisions can have outsized legal and financial consequences. Companies that stay ahead of these developments will be better positioned to protect value and avoid costly disputes.

This series covers topics featured during GableGotwals' Annual Energy Market Drivers and Current Legal Issues Seminar. To receive Alerts and information on future Firm events, subscribe to our mailing list.

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