Chapter 11

Coastal Oil & Gas Corp. v. Garza Energy Trust: Some New Paradigms for the Rule of Capture and Implied Covenant Jurisprudence¹

Bruce M. Kramer
McGinnis, Lochridge & Kilgore
Austin and Houston, Texas
and
Maddox Professor of Law Emeritus
Texas Tech University
School of Law

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¹ Coastal Oil & Gas Corp. v. Garza Energy Trust, 268 S.W.3d 1 (Tex. 2008), rev’g, Mission Resources, Inc. v. Garza Energy Trust, 166 S.W.3d 301 (Tex. App.-Corpus Christi 2005)[hereinafter Coastal Oil].
§ 11.01. Introduction.

Oil and gas law and the rule of capture go hand in hand. The rule of capture had its origin in the Appalachian Basin. The doctrine has been modified by judicial rulings and by state oil and gas conservation statutes. As the issues surrounding the rule have moved from the reasonably simple issues involving ownership of produced hydrocarbons to the more complex issues relating to subterranean storage of natural gas and the injection of fluids and/or gasses into producing formations, the rule has been invoked to respond to those technological innovations. The vast increase in the use of hydraulic fracturing techniques to recover hydrocarbons from shale and tight sands formations has triggered judicial inconsistency in the application of the rule. In *Coastal Oil & Gas Corp. v. Garza Energy Trust*, the Texas Supreme Court attempted to resolve some of those inconsistencies and apply the rule of capture so as to insulate, in most cases, an oil and gas operator from liability in the circumstance where that operator engaged in a fracing operation whereby the injected fluids crossed property lines.

Oil and gas law and the doctrine of implied covenants also go hand in hand. The origin of the implied doctrine dates back to the 1880s and the landmark decision formally pronouncing the “arrival” of the doctrine was issued in 1905 by a federal court of appeals. Notwithstanding the century-old existence of the doctrine, however, there are still plenty of unanswered questions regarding its application to specific circumstances. One such unanswered question is what remedy is available to the lessor when the

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2 See Bruce M. Kramer & Owen L. Anderson, “The Rule of Capture – An Oil and Gas Perspective,” 35 Envtl. L. 899 (2005)[hereinafter The Rule of Capture]. I want to thank my good friend Owen Anderson for not only co-authoring the Rule of Capture article with me but also in writing an article on the Coastal Oil case that was presented at the Annual Institute of Oil and Gas Law and Taxation in February 2009. Owen L. Anderson, “Subsurface Trespass After Coastal v. Garza,” 60 Inst. on Oil & Gas L. & Tax’n __ (2009) [hereinafter Anderson, Subsurface Trespass].


5 Coastal Oil, 268 S.W.3d 1 (Tex. 2008).

lessee breaches the implied covenant of reasonable development. While the traditional panoply of implied covenantal remedies usually apply, including cancellation, conditional cancellation and damages, there has been some dispute on two sub-issues, namely should damages be the sole remedy and if so, how do you measure them?\(^7\) The \textit{Coastal} opinion addressed the second of these sub-issues and did so in a way that did not clearly set out how one should calculate those damages.

\section*{§ 11.02. Some Basic Definitions.}

\subsection*{[1] — Hydraulic Fracturing or Fracing.}

Hydraulic fracturing or fracing describes a mechanical method of increasing the permeability of the reservoir rock which should lead to increased production of the trapped hydrocarbons.\(^8\) Unlike secondary and enhanced recovery operations which through various mechanical techniques seek to increase production after the primary recovery period is over, fracing facilitates and in many cases is required to have primary production.\(^9\) Hydraulic fracturing has been used since the 1940s but it was only with its use in coalbed methane, tight sands and shale formations in the 1990s that its use has become more widespread.\(^10\) Fluids, typically water, are injected into the formation under high pressure.\(^11\) After the initial injection has hopefully fractured the reservoir rock, additional fluids containing proppants

\footnotesize
\begin{itemize}
\item \(^7\) Williams & Meyers, at § 834.
\item \(^8\) Williams & Meyers, \textit{supra} note 6, 479; Anderson, “Subsurface Trespass” at § 11.03.
\item \(^11\) In the early days of fracing, gasoline gelled with napalm was used, followed by gelled oil and then by gelled water. For a while diesel fuels were used but because of the problems relating to the pollution of underground water supplies the principal fluid used today is water. Anderson, “Surface Trespass” at n. 48. There were also a few attempts by the Atomic Energy Commission in the 1950s to detonate underground nuclear devices with the hope of freeing the trapped hydrocarbons. Those efforts were unsuccessful.
\end{itemize}
are injected into the fracture in order to hold the fractures open to allow for the trapped hydrocarbons to move more easily to the wellbore.12

The Texas Supreme Court describes fracing as follows:

[Fracing] is done by pumping fluid down a well at high pressure so that it is forced out into the formation. The pressure creates cracks in the rock that propagate along the azimuth of natural fault lines in an elongated elliptical pattern in opposite directions from the well. Behind the fluid comes a slurry containing small granules called proppants—sand, ceramic beads, or bauxite—are used—that lodge themselves in the cracks, propping them open against the enormous subsurface pressure that would force them shut as soon as the fluid was gone. The fluid is then drained, leaving the cracks open for gas or oil to flow to the wellbore.13

In designing a fracing operation engineers will select the appropriate injection pressure, the required volumes of material injected and the type of proppant that is most likely to increase porosity, permeability and modulus of the reservoir rock.14 There are three different lengths that the engineers try to calculate. The first is the hydraulic length which is the distance the fracing fluid will travel, the second is the propped length, usually shorter than the hydraulic length and a measure of how far the proppants will travel and the effective length which is a still shorter distance within which the proposed fracing operation will hopefully improve production.15


The rule of capture, in my opinion, has been defined most concisely and accurately by Robert L. Hardwicke, a Texas oil and gas attorney and scholar. He said: “The owner of a tract of land acquires title to the oil and gas which he produces from wells drilled thereon, though it may be proved that part

12 Proppants are typically grains of sand or other hard substances which are mixed with the fluids. These fluids tend to have more gelling agents than the initial fluid injections in order to make the fluids more viscous so that the proppants may travel further. See American Petroleum Institute, Hydraulic Fracturing at a Glance (API 2008); Norman J. Hyne, Dictionary of Petroleum Exploration, Drilling & Production 249 (PennWell 1991).
13 Coastal Oil, 268 S.W.3d at 6-7.
14 Id. at 7.
15 Id.
of such oil or gas migrated from adjoining lands.”\textsuperscript{16} This basic definition is a rule of non-liability for the capturer of the hydrocarbons and was further refined by the Texas Supreme Court when it stated: “He [the operator] may thus appropriate the oil and gas that have flowed from adjacent lands without the consent of the owner of those lands, and without incurring liability to him for drainage. The nonliability is based upon the theory that after the drainage the title or property interest of the former owner is gone.”\textsuperscript{17}

When applied to the issue of whether or not an owner of the mineral estate could drain hydrocarbons without liability to its neighbor, the early cases all found that the “pure” form of the rule of capture applied.\textsuperscript{18} The “pure” form of the rule of capture also prevailed in a number of early cases where adjacent owners were seeking to enjoin their neighbor from using “artificial” means to extract the hydrocarbons.\textsuperscript{19} These cases basically told the party seeking injunctive relief to fall back upon the offset drilling corollary of the rule of capture, namely go out and use the same techniques be they the use of nitroglycerin or gas pumps to prevent the hydrocarbons from migrating across their property lines.

The modification of the “pure” form of the rule of capture to take into consideration the reality that you had several owners over an interconnected common source of supply was not long in coming.\textsuperscript{20} In Manufacturers’ Gas & Oil Co. v. Indiana Natural Gas & Oil Co.,\textsuperscript{21} an adjacent mineral owner

\textsuperscript{16} Robert E. Hardwicke, “The Rule of Capture and Its Implications as Applied to Oil and Gas,” 13 Tex. L. Rev. 391, 393 (1935). This language was quoted verbatim in an important Texas Supreme Court decision, Elliff v. Texon Drilling Co., 210 S.W.2d 558, 562 (Tex. 1948).

\textsuperscript{17} Elliff, 210 S.W.2d at 562.


\textsuperscript{19} See, e.g., People’s Gas Co. v. Tyner, 31 N.E. 59 (Ind. 1892); United Carbon Co. v. Campbellsville Gas Co., 18 S.W.2d 1110 (Ky. App. 1929); Jones v. Forest Oil Co., 44 A. 1074 (Pa. 1900).

\textsuperscript{20} “Rule of Capture,” 35 Envtl. L. at 911-14 describes the early legislative efforts of Indiana to modify the common law rule of capture.

\textsuperscript{21} Manufacturers’ Gas & Oil Co. v. Indiana Natural Gas & Oil Co., 57 N.E. 912 (Ind. 1900). See also Richmond Natural Gas Co. v. Enter. Natural Gas Co., 66 N.E. 782 (Ind. App. 1903).
sought to enjoin the use of “artificial” pumping devices that would allow the defendant operator to allegedly capture more the natural gas existing in the common source of supply than it was entitled to. While mentioning an Indiana statute dealing with prevention of waste and protecting correlative rights, the Indiana Supreme Court clearly modified the “pure” form of the rule of capture when it stated:

Natural gas in the ground is so far the subject of property rights in the owners of the superincumbent lands, that while each of them has the right to bore or mine for it on his own land, and to use such portion of it as, when left to the natural laws of flowage, may rise in the wells of such owner and into his pipes, no one of the owners of such lands has the right, without the consent of all the other owners, to induce an unnatural flow into or through his own wells, or to do any act with reference to the common reservoir, and the body of gas therein, injurious to, or calculated to destroy, it . . . . But the limitation is upon the manner of taking. So in the case of natural gas, the manner of taking must be reasonable, and not injurious to, or destructive of the common source from which the gas is drawn.22

The holding in Manufacturers’ Gas, however, did not influence the development of the rule of capture. While Kentucky oil and gas jurisprudence went further than any other state in incorporating the notion of correlative rights into its definition of the rule of capture,23 no other state modified the rule of capture so as to consider the techniques used to produce the hydrocarbons as somehow limiting an owner’s ability to produce from a well so long as that well was bottomed on its own land.24


Prior to the Coastal decision there had been a number of cases dealing with the inter-relationship of the injection of fluids into formations and the rule of capture. An early case applying Texas law found that there was no trespass whereby an operator was re-injecting dry gas into a formation in

22 *Id.* at 915 (emphasis added).
order to produce the wet gas which would be stripped of its natural gas liquids and reinjected into the formation.\footnote{25} Our sanguine and prescient predecessors wrote in the early editions of Williams & Meyers Oil and Gas Law:

What may be called a ‘negative rule of capture’ appears to be developing. Just as under the rule of capture a landowner may capture such oil or gas as will migrate from adjoining premises to a well bottomed on his own land, so also may [it] inject into a formation substances which may migrate through the structure to the land of others, even if this results in the displacement under such land of more valuable with less valuable substances (\textit{e.g.}, the displacement of wet gas by dry gas). The law on this subject has not been fully developed, but it seems reasonable to suggest the qualification that such activity will be permitted, free of any claim for damages, only if pursued as part of a reasonable program of development and without injury to producing or potentially producing formations.\footnote{26}

This statement was largely based on an Oklahoma case dealing with the injection of salt water into stratum that already contained salt water and no valuable hydrocarbons.\footnote{27}

The principal case adopting the negative rule of capture is \textit{Railroad Commission v. Manziel}.

\footnote{28} In \textit{Manziel} a party sought to set aside a Railroad Commission order permitting an operator to inject water into an irregularly spaced well as part of an approved secondary recovery project. The project was designed to recover an estimated 930,000 barrels of oil still left in the ground after primary recovery production. Relying in part on the \textit{Williams and Meyers} treatise, the court found that the injection of water would not
constitute a trespass.\textsuperscript{29} But the court’s opinion goes further than merely reciting the negative rule of capture by identifying various policy factors in favor of approving of such an order.\textsuperscript{30} The court is wont to enjoin an operator seeking to produce additional hydrocarbons that is armed with an order of the Commission that is designed to prevent waste, conserve natural resources and protect correlative rights.\textsuperscript{31} The complicating factor of this not being a private tort action based on trespass but rather an attack on a Commission order approving a secondary recovery operation makes \textit{Manziel} not an ideal basis for dealing with the hydraulic fracing/trespass issue. The issue of whether a state conservation agency order can somehow insulate an operator from trespass liability in private litigation has almost always been resolved against the concept of immunity from liability.\textsuperscript{32} Yet in a number of cases involving secondary recovery projects, the courts seem to emphasize the public policy aspects of enjoining such projects.\textsuperscript{33} The acceptance or rejection of this negative rule of capture theory was never clearly made because issues relating to the relationship of state conservation agencies and the courts tended to get in the way.

\textbf{[4] — The Early Cases.}

In 1961 the Texas Supreme Court issued three opinions all relating to the basic issue of whether a frac job that entails the movement of fluids beyond the property line constitutes an actionable and enjoinable trespass. In \textit{Gregg v.}

\begin{footnotesize}
\textsuperscript{29} \textit{Manziel}, 361 S.W.2d at 568.
\textsuperscript{30} Professor Jacqueline Weaver wrote that \textit{Manziel} should not be read so as to immunize injectors from tort liability in a private cause of action. Jacqueline L. Weaver, “The Legal Significance of Commission Approval of Unitized Oil & Gas Operations,” \textit{37 Inst. on Oil & Gas L. & Tax’n}, 4-1 (1986).
\textsuperscript{31} \textit{Manziel}, 361 S.W.2d at 568.
\end{footnotesize}
Delhi-Taylor Oil Corp., the owner of a standard-sized drilling tract sought to enjoin the owner of a Rule 37 exception permit that allowed a well to be drilled on a .47 acre tract from engaging in a hydraulic fracturing operation. The principal issue is whether the court or the Railroad Commission has jurisdiction to resolve the dispute that was brought by Delhi-Taylor seeking to enjoin the fracturing operation. The court had no problem finding that the Commission does not have jurisdiction to resolve claims of trespass and issue injunctions to stop such activities. While not expressly concluding that a trespass occurred, the court’s opinion clearly suggests that where there is an underground trespass it can be enjoined and that the Commission has no authority to authorize such activities. The court said:

The invasion alleged is direct and the action taken is intentional. Gregg’s well would be, for practical purposes, extended to and partially completed in Delhi-Taylor’s land. The pleadings allege a physical entrance into Delhi-Taylor’s leasehold. While the drilling bit of Gregg’s well is not alleged to have extended into Delhi-Taylor’s land, the same result is reached if in fact the cracks or veins extend into its land and gas is produced therefrom by Gregg.

In two companion cases decided the same day, the Texas Supreme Court re-affirmed the court’s power to issue injunctions to prevent fracturing operations whereby the fluids may cross property lines. When looking at the trilogy of Gregg cases one might have reasonably concluded that fracturing operations that cross property lines constitute an actionable trespass. In fact some 30 years later the Texas Supreme Court confirmed that view only to withdraw its opinion and issue a per curiam order stating that it neither approves or disapproves of the opinion of the Court of Appeals that Gregg would find that fracturing operations may constitute a trespass. In Coastal,

35 Gregg v. Delhi-Taylor Oil Corp, 344 S.W.2d at 416.
as we shall see shortly, the Court’s superficial treatment of these cases is a clear indication that the results suggested in *Gregg* would not be followed.

In *Geo Viking, Inc. v. Tex-Lee Operating Co.*,\(^38\) Tex-Lee employed Geo Viking to frac a well drilled into the Austin Chalk formation which is known as an extremely tight formation containing intermittent fractures making production difficult. The hydraulic length of the frac job was some 2500 feet while the propped length was between 550 and 640 feet. Tex-Lee argued that due to negligence in conducting the frac operation, it was unable to produce any hydrocarbons. The trespass issue arises indirectly through the evidence relating to damages. Geo Viking urged that Tex-Lee could not claim damages for the value of hydrocarbons from outside of the 80-acre unit that it allegedly could have produced had the frac job been done properly.\(^39\) The court finds that basic rule of capture principles allow for Tex-Lee to own all of the hydrocarbons that are produced through a well bore bottomed on its leasehold estate. The Court of Appeals rejected Geo Viking’s proffered jury instruction that some of that production would occur by virtue of a trespass on the neighboring lands due to the frac operation. In a *jus tertii* type analysis the majority of the Court of Appeals justices would find that if a trespass occurred it would be a matter between Tex-Lee and its neighbors and not a matter between Geo Viking and Tex-Lee. The author of the majority opinion, however, changed his mind while a motion for rehearing was pending and authored a dissenting opinion where he agrees with Geo Viking that a limiting instruction on damages was warranted because Geo Viking would not be entitled to benefit from the alleged trespass caused by the cross-boundary frac job. Relying on *Gregg*, Justice Grant would find that the rule of capture is inapplicable because the capture is the result of a trespass.\(^40\)

Although oil and gas are subject to legitimate drainage under the law of capture, the owner ‘is accorded the usual remedies against trespassers who appropriate the minerals or destroy their market value.’ . . . Fracing under the surface of another’s land constitutes

\(^{38}\) *Geo Viking*, note 37 *supra*.

\(^{39}\) *Geo Viking*, 817 S.W.2d at 363-64.

\(^{40}\) *Id.* at 364-65.
a subsurface trespass. . . Therefore, the rule of capture would not permit Tex-Lee to recover for a loss of oil and gas that might have been produced as the result of fracing beyond the boundaries of its tract.\footnote{Geo Viking, Inc. v. Tex-Lee Operating Co., 1992 WL 80263 at *2 (Tex. 1992) \textit{overruled} by Geo Viking, Inc. v. Tex-Lee Operating Co., 839 S.W.2d 797 (Tex. 1992).}

As noted above the Texas Supreme Court in a per curiam opinion, later withdrawn, had this to say about a cross-boundary fracing operation: “In denying petitioner’s application for writ of error we should not be understood as approving or disapproving the opinions of the court of appeals analyzing the rule of capture or trespass as they apply to hydraulic fracturing.”\footnote{Geo Viking, 839 S.W.2d at 798.}

While granting motions for rehearing are within the ordinary course of business for the Texas Supreme Court, issuing \textit{per curiam} opinions and withdrawing the grant of a petition for review are not. But clearly the Texas Supreme Court had touched a nerve within its initial trial balloon \textit{per curiam} opinion that got burst and left the basic issue unresolved.

There have been a number of other decisions in other jurisdictions that have dealt with the hydraulic fracing/trespass issue. In \textit{Columbia Gas Transmission Corp. v. Smail},\footnote{Columbia Gas Transmission Corp. v. Smail. 1986 WL 20906 (N.D. Ohio).} CGT sought to enjoin the drilling of a well on a tract adjacent to, but outside of the boundary of a certificated underground gas storage facility. While most of the opinion deals with the likelihood that the new well will produce non-native stored gas rather than native gas, there is evidence at the trial regarding the potential impact of a fracing operation on the storage facility. In attempting to balance the equities, the trial court allows the well to be drilled but that before a fracing operation may be attempted on the well that notice must be sent to CGT so that it may oppose such an operation before the state conservation agency.\footnote{The court further notes that the adjacent owner does not have any rights to the non-native gas under the rule of capture. \textit{Id.} at *4-5.}

In \textit{Zinke & Trumbo, Ltd. v. State Corporation Commission},\footnote{Zinke & Trumbo, Ltd. v. State Corporation Comm’n, 749 P.2d 21 (Kan. 1988).} the trespass issue was not directly involved since the case involved an action against the Corporation Commission in the setting of allowable for a fraced well. An
operator of a lease adjacent to one operated by Zinke fraced a well that was
330 feet from the property line which resulted in a 500 percent increase
in the fraced well’s flow rate.\(^{46}\) The evidence showed that the apparent
effective length was at least 400 feet and that the well was located only 330
feet from the property line. Because the Commission set the allowable for
wells based in part on the adjusted open flow rate of the well, Zinke sought
to challenge the Commission’s allowable order that had greatly increased
its competitor’s allowable. Without commenting on the trespass issue the
court noted that the Commission had a duty to protect correlative rights so
that it had to consider evidence of the frac and the potential for production
from underneath Zinke’s lease by virtue of the frac in issuing its allowable
order. The court noted, however, the Commission’s proration order would
reward the adjacent operator’s trespass since the frac obviously crossed into
Zinke’s leasehold estate.\(^{47}\)

In *ANR Production Co. v. Kerr-McGee Corp.*,\(^{48}\) the Wyoming Supreme
Court dealt with the aftermath of a hydraulic fracing operation that caused
hydrocarbons to migrate from a unitized formation to the fraced well located
in another formation. The unit agreement only covered the First Bench
Formation and specifically authorized parties to the agreement to drill to
non-unitized formations. ANR proposed to drill a well to the Second Bench
Formation located some 40-50 feet below the First Bench Formation. ANR
then fraced the well which led to the unit operator’s claim that the fracing
operation caused communication between the First and Second Bench
Formations so as to require the Commission to shut-in the well. After an
initial round of litigation affirms the Commission’s shut-in order,\(^{49}\) this
action seeks to recover damages for trespass. The issue of trespass is not
discussed by the Wyoming Supreme Court but the trial court’s order finding
a trespass is presumed correct as the parties dispute the amount of damages,
not whether damages should be paid.\(^{50}\)

\(^{46}\) *Id.* at 27.
\(^{47}\) *Id.* at 27-28.
\(^{49}\) *ANR Prod. Co. v. Wyoming Oil and Gas Conservation Comm’n*, 800 P.2d 492 (Wyo.
1995).
\(^{50}\) *ANR Prod.* n. 893 P.2d at 700.
Thus in the cases prior to Coastal it appears as if the courts are amenable to finding that a trespass occurs where the fracing operation extends beyond the property line. There also appears to be some confusion as to the role of the state conservation agency in authorizing such operations but one could have predicted that where a fracing operation crosses a property line a trespass would be found and that neither the rule of capture nor the negative rule of capture would insulate the operator from potential liability.


“A cause of action for breach of the implied duty to drill a protection well is ordinarily made out when it is established: (1) that substantial drainage has taken place on the leasehold; and (2) that an offset well would produce oil or gas in paying quantities, i.e., in sufficient quantities to repay the costs of drilling, equipping, and operating the well and to return a profit on the investment.”

The purpose of this implied covenant is to prevent the permanent loss of hydrocarbons from underneath a premises. The party asserting the alleged breach has the burden of proof to show that there is substantial drainage taking place. Likewise in most cases, the lessor has the burden of proof to show that in drilling an offset well, the lessee would make a profit after considering all of the costs of exploration, drilling, production and marketing. While the early cases dealing with the drainage covenant almost universally spoke in terms of the duty to drill an offset well, more recent cases have clearly indicated that a reasonable and prudent operator

51  5 Williams & Meyers at 79-80 (footnotes omitted).
52  See, e.g., Coyle v. North American Oil Consol., 9 So. 2d 473 (La. 1942); Shell Oil Co. v. James, 257 So. 2d 488 (Miss. 1971); Good v. TXO Prod. Corp., 763 S.W.2d 59 (Tex. App.-Amarillo 1988, writ denied).
53  See, e.g., Finley v. Marathon Oil Co., 73 F.3d 1225 (7th Cir. 1996)(applying Illinois law); Hartman Ranch Co. v. Assoc. Oil Co., 73 P.2d 1163 (Cal. 1937); Sundheim v. Reef Oil Corp., 247 Mont. 244, 806 P.2d 503 (1991). In situations where the plaintiff’s lessor is the party allegedly draining the premises, sometimes called “fraudulent drainage” some courts have modified the traditional rules and either imposed a strict liability regime or shift the burden of proof. 5 Williams & Meyers at § 824. In this case Coastal was both the plaintiff’s lessee and the party allegedly doing the draining.
might have to do something other than drilling an offset well in order to ameliorate the drainage situation.\(^{54}\)

Courts have fashioned a wide range of remedies upon a showing that the lessee has breached its implied covenant to prevent drainage. They include “outright cancellation of the lease, conditional cancellation of the lease, cancellation of the lease combined with damages for past loss, mandatory injunction to drill a protection well, and damages in the amount of the loss, both past and prospective.”\(^{55}\) A number of jurisdictions follow the traditional rule that equitable relief is only available where damages would be an inadequate remedy.\(^{56}\) Where damages are sought there are two general rules, one that provides lost royalty on the drained hydrocarbons from the time that an offset well should have been drilled and the other that measures damages on the lost royalty on the amount of hydrocarbons that should have produced from a timely drilled offset well.\(^{57}\) Thus for example in *America Southwest Corp. v. Allen*,\(^{58}\) damages were measured by the royalty payable on one-half of the production of the draining well since the court concluded that such was the amount of hydrocarbons that came from the plaintiff’s premises. Depending on which formula is used there may be over-compensation to the lessor. Under the “amount-drained-away” formula, the lessor is receiving royalty for hydrocarbons that have been drained even though the duty to prevent drainage only arises after a reasonable and prudent operator would have drilled an offset well.\(^{59}\) The lessee is not an insurer against all drainage but this formula, if not modified, might compensate the lessor for all drainage. Under the amount that would have been produced by an offset well formula the lessee might be over-compensated because


\(^{55}\) 5 Williams & Meyers at 154-55 (footnotes omitted).


\(^{57}\) 5 Williams & Meyers at § 825.2.

\(^{58}\) America Southwest Corp. v. Allen, 336 So. 2d 1297 (Miss. 1976).

\(^{59}\) 5 Williams & Meyers at 166.
the offset well might produce hydrocarbons that would not otherwise have been drained away.\textsuperscript{60} It was this latter issue that was discussed by the Texas Supreme Court in \textit{Coastal}.

\textbf{[6] — The Implied Covenant to Develop.}

The implied covenant of reasonable development can be briefly summarized as follows:

\begin{quote}
[U]pon securing production of oil or gas from the leasehold, the lessee is bound thereafter to drill such additional wells to develop the premises as a reasonably prudent operator, bearing in mind the interests of both lessor and lessee, would drill under similar circumstances.\textsuperscript{61}
\end{quote}

As with most of the other implied covenants, additional developmental wells will only have to be drilled where the lessor can sustain its burden of proof that the lessee will produce sufficient hydrocarbons to reimburse the lessee for its drilling and operating expenses along with a reasonable return on invested capital.\textsuperscript{62} While there has been some dispute as to whether the development covenant encompasses the “exploration” covenant, the number of development covenant cases has been relatively low over the years.\textsuperscript{63}

A consensus of judicial thought on the appropriate remedy for breach of the implied covenant of reasonable development has never been reached. There are a number of cases, most of which predate 1960, where the court ordered an outright cancellation of the lease, except for an area surrounding the extant well or wells.\textsuperscript{64} In other cases a decree of conditional cancellation

\textsuperscript{60} \textit{Id.} at 166-67.
\textsuperscript{61} 5 Williams & Meyers at 220. For some representative cases see Standard Oil Co. of La. v. Giller, 38 S.W.2d 766 (Ark. 1931); McMahan v. Boggess, 302 S.W.2d 592 (Ky. 1957); Wilds v. Universal Res. Corp., 662 P.2d 303 (Okla. 1983); Grayson v. Crescendo Resources, L.P., 104 S.W.3d 736 (Tex. App.-Amarillo 2003).
\textsuperscript{62} 5 Williams & Meyers at § 832.1.
\textsuperscript{63} \textit{Id.} at §§ 841-46.
\textsuperscript{64} \textit{See}, e.g., Mayhew v. Callard, 312 F.2d 295 (7th Cir. 1963)(applying Indiana law); Standard Oil Co. of La. v. Giller, 38 S.W.2d 766 (Ark. 1931); McMahan v. Boggess, 302 S.W.2d 592 (Ky. 1957); Beer v. Griffith, 399 N.E.2d 1227 (Ohio App. 1980); Amerada Petroleum Co. v. Sledge, 3 P.2d 167 (Okla. 1931).
is issued whereby the lessee is given a schedule by which one or more wells have to be drilled or the lease will be cancelled. A number of issues arise with either of these remedies, namely the normal rule that for breach of contract actions, damages is the preferred remedy, and that equitable relief will only be available where the remedy at law, damages, is inadequate. An early Oklahoma case hinted that the implied covenant of reasonable development was a “condition subsequent” so that upon its breach the lessor could exercise its right of re-entry or power of termination. This appears to be contrary to modern Oklahoma oil and gas jurisprudence which would treat this type of decree as a forfeiture action which would be discouraged. The more appropriate basis for a decree of cancellation, be it total or conditional, is that the remedy at law is inadequate. Where cancellation is sought, the lessor may have to provide notice and an opportunity to cure under the terms of the lease or by common law rule.

There are some decisions that hold that damages are the only remedy available for breach of the implied covenant of reasonable development unless the lessor can clearly show that the remedy is inadequate. The issue of the inadequacy of damages was a real one when the quality of the data regarding the yet-to-be developed reservoir was questionable. Given modern petroleum engineering tools it would not be as difficult to ascertain the nature of the reservoir where the lessee should have drilled to determine the amount of hydrocarbons that could have been produced. The real issue regarding damages, and the one the Texas Supreme Court attempted to resolve, was

66 Fox Petroleum Co. v. Booker, 253 P. 33 (Okla. 1926).
68 See, e.g., Barby v. Cabot Petroleum Corp., 944 F.2d 798 (10th Cir. 1991); Roberson Enter., Inc. v. Miller Land & Lumber Co., 700 S.W.2d 57 (Ark. 1985); Christiansen v. Virginia Drilling Co., 226 P.2d 263 (Kan. 1951); Waggone Estate v. Sigler Oil Co., 19 S.W.2d 27 (Tex. 1929).
69 5 Williams & Meyers at § 834.
how to measure damages. An early Illinois opinion applied the “lost royalty” rule treating the breach of the implied covenant to reasonable development as no different than a breach of the implied covenant to prevent drainage even though in the development covenant situation there is no “loss” of the hydrocarbons to the lessor.\textsuperscript{71} But in an early West Virginia case the court applied the “lost interest” rule, taking the position that the injury caused by the breach of the implied covenant of reasonable development is the loss to the lessor of the use of the capital represented by the oil remaining in the ground.\textsuperscript{72} The majority of courts when faced with a choice of the “lost royalty” versus “lost interest” method of calculating damages chose the “lost royalty” approach.\textsuperscript{73}

The rationale for adopting the “lost royalty” approach and dealing with the problem of double recovery was set forth most clearly by the West Virginia Supreme Court of Appeals and Errors in \textit{Cotiga Development Co. v. United Fuel Gas Co.}.\textsuperscript{74} The court said:

The court accordingly holds that Cotiga [lessor] is entitled to recover from United Fuel [lessee] royalties on the gas which should have been marketed from the leasehold during the period in question computed on the rate received by United Fuel; but that United Fuel shall have the right to offset and take credit for such sum, dollar for dollar, rather than on a cubic foot basis, in the settlement and payment for royalties for gas next thereafter marketed from the leased premises. That is to say, damages thus computed in this case shall be deemed \textit{pro tanto} the equivalent of the payment in advance of royalties on gas not actually produced and marketed from the premises, and United Fuel shall be entitled to credit for such sum, dollar for dollar, without interest thereon, when such gas shall be actually produced.

\textsuperscript{71} \textit{See} Daughetee v. Ohio Oil Co., 105 N.E. 308, 311 (Ill. 1914).
\textsuperscript{73} \textit{See, e.g.,} ANR W. Coal Dev. Co. v. Basin Elec. Power Coop., 276 F.3d 957, 969-70 (8th Cir. 2002)(applying North Dakota law); Gold Mining & Water Co. v. Swinerton, 142 P.2d 22, 34 (Cal. 1943); Texas Pac. Coal & Oil Co. v. Barker, 6 S.W.2d 1031 (Tex. 1928).
and marketed at the rate received by United Fuel when such gas is ultimately extracted and marketed.\textsuperscript{75}

\section*{§ 11.03. \hspace{1em} The Rule of Capture/Trespass Issue.}

\[1\] — The Basic Facts.

The Salinas family owns the minerals under a 748-acre tract of land known as Share 13. At all relevant times Coastal was the lessee of the Share 13 acreage as well as the lessee in adjacent acreage known as Share 15. Coastal, at the time of the litigation, was the full fee mineral owner of the minerals underlying Share 12 which was also adjacent to Share 13. Coastal was originally the lessee of the Share 12 minerals, but in 1995 purchased the possibility of reverter and the reserved royalty interest.\textsuperscript{76} Production from all three of these tracts comes from the Vicksburg T Formation located at between 11,688 and 12,610 below the surface. This formation is a tight sandstone formation that is relatively imporous and impermeable and therefore requires hydraulic fracing in order to produce. The court provided a map to show the locations of the various shares as well as where the wells were located.

Coastal drilled three wells on Share 13 between 1978 to 1983, two of which were productive. In 1994, Coastal drilled the M Salinas No. 3 well on Share 13 which was an exceptional producer. It was located some 1700 feet from the boundary line with Share 12. At that time, Coastal had a producing well on Share 12 but it desired to drill a well closer to the Share 12/Share 13 boundary line after the M. Salinas No. 3 well was drilled.\textsuperscript{77} Under Railroad Commission Rule 37, Coastal could drill a well that was no closer than 1200 feet to another producing well and no closer than 467 feet to any property line.\textsuperscript{78} Coastal then gets a Rule 37 well drilling permit to locate its Coastal Fee No. 1 Well some 467 feet from the Share 13 boundary line. This well,


\textsuperscript{76} \hspace{1em} \textit{Coastal Oil}, 268 S.W.3d at 7.

\textsuperscript{77} \hspace{1em} \textit{Id.} at 6-7.

\textsuperscript{78} \hspace{1em} 16 Tex. Admin. Code § 3.37(a)(1).
however, was closer than 1200 feet from Coastal’s extant Share 12 well and after the Railroad Commission refused to grant Coastal an exception location permit, Coastal chose to shut in the extant well. Coastal had fraced all of the wells on Share 12 and 13, but according to the plaintiff’s expert engaged in a “massive” fracing job on its new Share 12 well. Although there was some dispute between the experts, it was generally conceded that the hydraulic and proppant lengths were between 1000 and 1500 feet. The parties could not agree at all on what the effective length of the frac job on the Coastal Fee No. 1 Well was. Given the fact that the Coastal Fee No. 1 Well was no further than 600 feet from the Share 13 boundary line, there is no doubt that both the initial injection of water and the follow-up injection of fluids with proppants undoubtedly crossed over into Share 13. Shortly thereafter the plaintiffs filed this action claiming a trespass, bad faith pooling and breach of the implied covenant to develop the Share 13 lease.

The jury awarded $1,000,000 in damages for the trespass which was reduced to $543,776. It also found that Coastal acted with malice and awarded $10,000,000 in punitive damages. As to the breach of the implied covenant to prevent drainage the jury found that the damages were the same as for the trespass based on a single jury instruction. The jury also awarded $2,292,513 in damages for breach of the implied covenant to reasonably develop. A jury award of $1,000,000 on the bad faith pooling claim was reduced to $81,619 and attorney’s fees in the amount of $1,400,000 were also awarded.


Coastal argued that the plaintiffs lacked standing to sue on their trespassory claim because at the time they filed the suit they did not have a possessory estate in the minerals. Under Texas law, after a mineral owner leases its minerals the owner retains a possibility of reverter and the right to receive the economic benefits provided for in the lease including royalty. A royalty interest, while an interest in real property while it is in the ground, is not a possessory interest. Coastal was arguing that since the trespass cause of action only protects the owners of possessory estates, plaintiffs could not

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79 Coastal Oil, 268 S.W.3d at 7.
80 Coastal Oil, 166 S.W.3d 301.
assert such a claim. In an analysis that would make an old property professor grin like a Cheshire cat, the court explored the difference between trespass *quaer clausum fregit* and trespass on the case. While the basic statement that trespass is a tort that protects possessory interests in lands remains true, early common law treated the form of action known as trespass as doing an unlawful act or a lawful act in an unlawful manner that injures another’s person or property.\(^81\) Thus the Texas Supreme Court notes that trespass on the case was an early form of action that could provide relief for an injury to a non-possessor’s interest such as a reversion.\(^82\) In fact the court has on several other occasions recognized a cause of action by the owner of a possibility of reverter for injuries to the common source of supply.\(^83\) But unlike trespassory invasions of real property interests, trespass on the case claimants are not entitled to nominal damages but must prove an actual injury before a valid claim may be made.\(^84\) This distinction in trespass damage rules might have been critical had the court not determined that the rule of capture protects the operator engaging in fracing operations that cross property lines from any liability. The availability of injunctive relief, rather than damages, might have encouraged litigation seeking to stop fracing operations before they were employed had the court merely found no proof of actual damages and dismissed the case.

The one circumstance where the trespass *quaer clausum fregit* and trespass on the case distinction may affect the outcome is where the plaintiff is an unleased mineral owner. Such an owner would have the possessory


\(^82\) *Coastal Oil*, 268 S.W.3d at 9-10. Trespass on the case was the precursor of the negligence cause of action.

\(^83\) See HECI Exploration Co. v. Neel, 982 S.W.2d 881, 890 (Tex. 1998); Elliff v. Texon Drilling Co., 210 S.W.2d 558 (Tex. 1948). In the remand opinion in *Elliff*, 216 S.W.2d 824, 830-31 (Tex. Civ. App. 1948, *error ref’d n.r.e*), the Court of Civil Appeals clearly recognized that the injury to the common source of supply being claimed by a royalty owner was for damage to real property even though the actual damages awarded is more akin to a conversion remedy for personal property.

\(^84\) *Coastal Oil*, 268 S.W.3d at 10-11.
estate that would support a trespass *quare clausum fregit* claim for nominal damage and injunctive relief. But I agree with Professor Anderson’s analysis that given the policy factors emphasized by the court relating to the societal benefits of allowing fracing operations, that it would be very unlikely that the court would not apply its rule of capture analysis to insulate the fracing operator from liability, whatever the cause of action.


[a] — Trespass.

Unless the rule of capture intercedes the trespass issue would seemingly be simple to resolve. The court admits as much in its opinion when it states:

Had Coastal caused something like proppants to be deposited on the surface of Share 13, it would be liable for trespass, and from the ancient common law maxim that land ownership extends to the sky above and the earth’s center below, one might extrapolate that the same rule should apply two miles below the surface.\(^{85}\)

But the Texas Supreme Court then tips its hand as to the outcome of the case by stating that this ancient property law maxim has no place in the modern world. Noting that there is a difference between taxiing an airplane across one’s driveway and flying above one’s home at 35,000 feet, the court concludes that a physical invasion two miles below the surface should not be treated the same as a physical invasion two miles above the surface. So much for 1,000 years of Anglo-American property law.\(^{86}\)

The real shortcoming in the opinion is the court’s very summary dismissal of its own earlier opinions that when read carefully would lead the reader to believe that a physical invasion is a trespass whether it occurs

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\(^{85}\) *Coastal Oil*, 268 S.W.3d at 11.

\(^{86}\) I am reminded of another trespass case, *State v. Shack*, 277 A.2d 369 (N.J. 1971) where the New Jersey Supreme Court held that a community organizer did not commit a criminal trespass when he entered upon the lands owned by another without the owner’s permission for the purpose of providing legal and other assistance to migrant farmworkers who were temporarily housed on the owner’s land. That opinion was bereft of legal citation and is often criticized by those who oppose “judicial legislation.” The same might be said about the Texas Supreme Court opinion in *Coastal*. 

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on the surface or two miles below the surface. While the court is clearly correct in treating Gregg v. Delhi-Taylor Oil Corp. as a case primarily dealing with the notion that whether or not an act constitutes a trespass is a matter for judicial, rather than administrative resolution, the court ignores the end result in the case. The plaintiff in Gregg was seeking an injunction to stop the proposed frac operations by Delhi-Taylor that would allegedly trespass underneath Gregg’s land. The court’s action in finding that the issue was properly before the courts essentially remanded the case back to the trial court for it to determine whether or not an enjoinable trespass was threatened after the trial court had initially dismissed the action as one that should have been properly brought before the Railroad Commission.

This reading of Gregg is confirmed by the two companion cases decided the same day that also remanded the issue of enjoining the frac operations to the respective trial courts with the indication that if proven a trespass would be shown. The court accurately notes that its opinion in Geo-Viking that found a trespass by virtue of a frac operation was withdrawn.

The court also glosses over some language in Manziel that appears to favor a finding that a fluid injection program could constitute a trespass. If the plaintiffs in Manziel had sued the operator who was engaging in the injection program rather than the Railroad Commission which had issued an order authorizing such a program, the trespass issue would have been the focal point of the opinion. Instead the Texas Supreme Court properly focused on the administrative law issues involved in seeking judicial review of a Railroad Commission order, specifically whether or not the order was supported by substantial evidence in the record. In what is appropriately described as dicta, the Manziel court discusses at length the non-relevant trespass issue in a manner that sends out mixed signals relating to whether a trespass occurs. After stating that the court is “not confronted with the tort aspects of such practices,” namely the injection of fluids that might

87 Gregg, 344 S.W.2d 411.
88 Id. at 419; Delhi-Taylor Oil Corp. v. Holmes, 344 S.W.2d 420 (Tex. 1961).
89 See text accompanying notes 37 to 42 supra.
90 R.R. Comm’n v. Manziel, 361 S.W.2d 560 (Tex. 1962). For the sake of full disclosure, the Manziels were represented by the law firm I am now associated with, although in 1962 I was still a sophomore in high school in Brooklyn, New York.
cross property lines, the court then states that “we are faced with an issue of whether a trespass is committed when secondary recovery waters from an authorized secondary recovery project cross lease lines.” In a precursor to the Coastal opinion the court in Manziel notes that a court may consider and weigh the interests of society and the oil and gas industry as a whole against the interests of the individual operator who is damaged; and if the authorized activities in an adjoining secondary recovery unit are found to be based on some substantial, justifying occasion, then this court should sustain their validity.

But then the court returns to its original theme that it is reviewing the validity of a Railroad Commission order when it further concludes: “The technical rules of trespass have no place in the consideration of the validity of the orders of the Commission.”

The court does not discuss Corzelius v. Railroad Commission, where the Court of Civil Appeals made a specific holding that a Commission order may insulate an operator from trespass liability. Corzelius involved a Commissioner order that authorized an operator to drill a directional well underneath the land of another in order to help extinguish a fire that resulted from a gas-well blowout. The party who was responsible for the blowout sought to enjoin the directional drilling operation because the well bore would be a physical invasion (trespass) of that party’s fee simple determinable estate. Again the owner did not sue the party armed with the order, but the Railroad Commission. In more explicit language than what appears in Manziel, the court concludes that the order is valid and shields the drilling party from being enjoined. Because the Railroad Commission only authorized the drilling of the wells in Coastal and did not issue an order authorizing the fracking operations, both Manziel and Corzelius do not answer the question

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91 Manziel, 361 S.W.2d at 566. The court also eschews answering the question of whether the Commission order could somehow insulate the injector from tort liability.
92 Manziel, 361 S.W.2d at 568 relying in part on Corzelius v. R.R. Comm’n, 182 S.W.2d 412 (Tex. Civ. App.-Austin 1944, no writ).
93 Id. at 568-69.
95 Id. at 416-17.
raised in Coastal, namely whether a fluid injection program where the fluid crosses property lines creates trespassory/tort liability for the injector.

Plaintiff tried to argue that because hydraulic fracing is an artificial means of capturing hydrocarbons that the “pure” rule of capture should not apply. The court summarily dismisses that claim without referencing some of the early Rule of Capture decisions in Indiana that draw such a distinction. Those cases, however, never got much traction and would wreak havoc with trying to define what was a “natural” versus what was an “artificial” means of extracting hydrocarbons. A more generalized discussion of the role that correlative rights should play in defining the Rule of Capture would have been too much to expect but which could have led to the same result without having to mangle classic trespass doctrine.

The court also has some difficulty differentiating the situation between a fracing operation that extends beyond the property line and a directional or slant hole that is bottomed under a neighbor’s land. The court states:

Salinas argues that stimulating production through hydraulic fracturing that extends beyond one’s property is no different from drilling a deviated or slant well — a well that departs from the vertical significantly — bottomed on another’s property, which is lawful. Both produce oil and gas situated beneath another’s property. But the rule of capture determines title to gas that drains from another property owned by one person onto property owned by another. The gas produced through a deviated well does not migrate to the wellbore from another’s property; it is already on another’s property. . . . One cannot protect against drainage from a deviated well by drilling his own well; the deviated well will continue to produce his gas. . . The justifications for the rule of capture do not support applying the rule to a deviated well.

The physical difference between hydrocarbons migrating to a perforated well bore and hydrocarbons migrating through fractures created sub-surface

96 These cases are discussed at Kramer & Anderson, 35 Envtl. L. at 910-11, 915-18 and include Mfrs.’ Gas & Oil Co. v. Indiana Natural Gas & Oil Co., 57 N.E. 912 (Ind. 1900) and Richmond Natural Gas Co. v. Enter. Natural Gas Co., 66 N.E.782 (Ind. App. 1903).
97 Coastal Oil, 268 S.W.3d at 13-14 (footnotes omitted).
is not that significant. While it is clear that a deviated well bottomed on
the land of another is a trespass, the court in the above-quoted section
summarily dismisses the similarities between the two situations. In the
deviated well case there is a semi-permanent structure (the well bore and
casing) that encroaches, but in the hydraulic fracturing case there is a
semi-permanent expansion of the pore space through the placement of the
proppants on the other side of the property line. Likewise while the court
says that drilling a protection well does not prevent the harm caused by a
deviated well, that is clearly not the case since a well could be drilled that
would intercept some of the hydrocarbons that were being produced by the
illegally-located well.

As Professor Anderson has noted, there are better rationales for allowing
fracing across property lines, namely practical necessity and common
sense. Deviated wells are clearly not necessary for the production of
hydrocarbons. Hydraulic fracturing, on the other hand, has become an important
part of the primary production cycle from tight sands formations which are
relatively impermeable. Deviated wells are also likely to violate state oil and
gas conservation agency spacing regulations which regulate bottom hole
locations. Common sense comes into play because of our lack of knowledge
about exactly what is happening underground after any particular fracing
operation. Just as the rule of capture was adopted in part due to the lack of
understanding of the underground migration of hydrocarbons, imposing
liability on operators who engage in fracing operations because an expert
may legitimately opine that either the hydraulic length, proppant length
or effective length may have crossed a property line would unnecessarily
restrict the use of an effective tool that will lead to the production of more
hydrocarbons. Finding that fracting may lead to trespass liability would
undoubtedly cause underground waste by leaving hydrocarbons in the ground
that could otherwise have been produced.

[b] — The Public Policy Rationale.

The court does provide four rationales for applying the rule of capture in
a way that modifies the common law definition of trespass. The court believes

\footnotesize
\begin{flushleft}
98 See cases cited in I Williams & Meyers § 226.5.
99 Anderson, 60 Inst. on Oil & Gas L. & Tax’n ___ (2009).
\end{flushleft}
that the rule of capture leads to a rule of non-liability in cross-boundary frac job situations but it would perhaps have been more honest for the court to merely state that it is re-defining what constitutes a trespass to take into consideration the importance of not finding liability.\textsuperscript{100} The first is that the law provides a party suffering an injury from a neighbor’s frac job various remedies that will compensate the party for its losses. These remedies include the oft-criticized offset well rule whereby a neighboring owner is free to drill an offset well or engage in their own frac job to prevent the hydrocarbons from being drained away. If the neighboring tract is leased, then the lessor is free to bring an action for breach of an implied covenant to prevent drainage if the lessee refuses to drill an offset well.\textsuperscript{101} Furthermore the lessee who is suffering drainage may also seek to voluntarily or force pool its interest with the leasehold interest where the frac job has occurred so that all of the interested parties may share in the benefits of the operations.\textsuperscript{102} The Railroad Commission may also regulate the amount of production from the well which has been fraced if it is causing substantial drainage under its general power to protect correlative rights and its specific power to regulate production through the allowable regulatory scheme.\textsuperscript{103}

As a second rationale the court relies on an offshoot of the primary jurisdiction doctrine, namely that the Railroad Commission is best positioned to determine whether hydraulic fracing should be regulated in order to protect correlative rights and/or prevent waste.\textsuperscript{104} The court makes the accurate

\textsuperscript{100} Coastal Oil, 268 S.W.3d at 14. The majority’s view that there may be some liability under certain circumstances for cross-boundary frac jobs tempers their ability to treat this situation as one merely involving a re-definition of a trespass. It is clear that Justice Willett in his concurring opinion essentially is taking the same position as the New Jersey Supreme Court did in Shack, note 86 supra, in that he would treat cross-boundary frac jobs as not constituting any type of trespass under any circumstance.

\textsuperscript{101} The court’s analysis that seems to limit the amount of damages that may be recovered for breach of the implied covenant to prevent drainage may lessen the effectiveness of that particular remedy.


\textsuperscript{103} R.R. Comm’n v. Pend Oreille Oil & Gas Co., 817 S.W.2d 36 (Tex. 1991). In this case the allowable regulation caused Coastal to have to shut in one of its wells on Share 13 because the fraced well was too close to an existing well under appropriate Commission regulations.

\textsuperscript{104} Coastal Oil, 268 S.W.3d at 14-15.
statement that while the mineral owner owns the oil and gas in place, it does not own any specific hydrocarbon molecule since both the rule of capture and Commission regulation limit the owner’s ability to produce such hydrocarbons. Clearly Commission spacing regulations modify the rule of capture and to a certain extent put a dent into the offset well rule because, in theory, wells are not allowed to be drilled close enough to property lines to cause substantial drainage. One of the reasons why there is so little implied covenant litigation is the existence of state spacing regulation. But fracing operations are not, to date, regulated by the Railroad Commission. The offending well was located in a legal situs, some 467 feet from the property line. The designed hydraulic and propped length of the frac job was greater than 467 feet. It is clear that the Commission has the legal authority to regulate hydraulic fracing operations but to date has yet to do so. The underlying issue, however, is a common law issue, namely whether the tort of trespass has been committed. The Commission clearly lacks jurisdiction to determine whether a trespass has occurred. Whether or not it exercises its authority to protect correlative rights in these kinds of circumstances cannot be predicted. It could restrict production from a well where production is enhanced by virtue of a cross-boundary fracing job, it could prohibit cross-boundary fracing operations or it could allow such operations to be carried out without regulation. I am not sure that the Commission is any more or less competent than a court of law to make the kind of factual findings that were made in this case by the jury relating to the nature of the fracing operations and its drainage of gas from the Salinas family tract. Juries are as competent to determine these types of contested adjudicatory questions as a hearing examiner of the Railroad Commission. Furthermore, the Commission can use either its rulemaking or adjudicatory powers to deal with hydraulic fracing issues. If it does so through rulemaking, then necessarily there will be a lot of extrinsic issues brought into play that would be irrelevant in a litigation arena where one party is asserting tortious conduct by another.

105 The court ignores a number of cases finding that the Commission lacks authority to determine whether a trespass has occurred. See, e.g., L & G Oil Co. v. R.R. Comm’n, 368 S.W.2d 187 (Tex. 1963); In re SWEPI, L.P. 103 S.W.3d 578, 588 (Tex. App.-San Antonio 2003). See generally, Bruce M. Kramer and Patrick H. Martin, The Law of Pooling and Unitization § 24.02[2](3d ed. 2008).
The third rationale supporting the majority’s holding is that “determining the value of oil and gas drained by hydraulic fracturing is the kind of issue the litigation process is least equipped to handle.”106 Falling back on one of the rationales for the original adoption of the rule of capture, namely the difficulty of determining the locational origin of hydrocarbons underneath the ground, the court finds that encouraging litigation with dueling experts is not a socially beneficial course of action. While also suggesting that trial courts and juries are not allowed to weigh competing social policies in resolving litigation, it does note that the common law has long prided itself on “judicial legislation” on unresolved issues whereby the court does in fact weigh and balance potentially competing policies relating to such issues. It is also clear that the majority opinion does not shy away from making these policy choices as the list of four rationales clearly illustrates. The fact that the experts from both sides agreed that hydraulic fracturing was a necessary technique in order to produce from the type of reservoir involved here but strongly disagreed as to the extent of the fracturing operation’s impact on production from the adjacent lands, is, according to the court, the best example of why the court should not find that these underground invasions of fluids and proppants are not an actionable trespass.

Finally, the court concludes that “the law of capture should not be changed to apply differently to hydraulic fracturing because no one in the industry appears to want or need the change. . . . These briefs from every corner of the industry — regulators, landowners, royalty owners, operators, and hydraulic fracturing service providers — all oppose liability for hydraulic fracturing.”107 In addition, the court notes that hydraulic fracturing has been used for over 60 years and yet there has been no activity by the Legislature or the Commission to deal with it. This last rationale is not one that can seriously be defended as a reason not to resolve a trespass claim brought by a royalty owner. Texas is the only major producing state that does not have a

106 Coastal Oil, 268 S.W.3d at 16.
107 Id. at 16-17. I have always been critical of the Texas Supreme Court’s policy of accepting any and all amici curiae briefs although pre-decision briefs are certainly more tolerable than post-decision briefs that typically follow the Court’s publication of a “trial balloon” opinion leaving the final opinion pending while a motion for rehearing is filed.
compulsory unitization statute even though such a statute has been thought
to be very beneficial to the prevention of waste, protection of correlative
rights and conservation of natural resources. The court seems unwilling to
have a common law decision upset the apple cart of settled expectations even
though the court has done so on many other occasions.\footnote{For example, without the court’s invalidation of a number of Commission orders dealing with small tract owners ability to drill a well and be given a “living allowable” the Mineral Interest Pooling Act, Tex. Nat. Res. Code § ___, would never have been enacted. Halbouty v. R.R. Comm’n, 357 S.W.2d 364 (Tex. 1962); Atlantic Refining Co. v. R.R. Comm’n, 346 S.W.2d 801 (Tex. 1961).}

The majority’s conclusion states:

[w]e hold that damages for drainage by hydraulic fracturing are
precluded by the rule of capture. It should go without saying that
the rule of capture cannot be used to shield misconduct that is
illegal, malicious, reckless, or intended to harm another without
commercial justification, should such a case ever arise. But that
certainly did not occur in this case, and no instance of it has been
cited to us.\footnote{\textit{Coastal Oil}, 268 S.W.3d at 17.}

The key statement in this conclusion is “without commercial justification.”
One reading this holding might argue that malicious behavior justified by
commercial practicalities would not lead to a different result. Given the fact
that in this case you had all of the classic red flags including a common lessee
and a different economic circumstance depending on where the gas was
produced, notwithstanding the court’s statement it appears unlikely that a
hydraulic fracturing operation would lead to liability. The one clear case where
liability might still attach is where the operation is negligently implemented
so as to cause injury to the common source of supply.

\[4\] — Justice Willett’s Concurring and Dissenting Opinion.

While the majority opinion would not rule out the possibility of a
trespassory cause of action for certain cross-boundary hydraulic frac
operations, Justice Willett’s opinion is a classic example of an opinion
resolving a common law dispute through the use of empirical data to support
a particular policy choice. His views are not unlike that of Governor Palin of Alaska although stated somewhat more bombastically. In the first paragraph of his opinion Justice Willett states:

At a time of insatiable appetite for energy and harder-to-reach deposits — iron truths that contribute to $145 a barrel crude and $4 a gallon gasoline — Texas common law should not give traction to an action rooted in abstraction. Our fast-growing State confronts fast-growing energy needs, and Texas can ill afford its finite resources, or its law, to remain stuck in the ground. The Court today averts an improvident decision, that in terms of its real-world impact would have been a legal dry hole, juris-imprudence that turned booms into busts and torrents into trickles. Scarcity exists, but above-ground supply obstacles also exist, and this Court shouldn’t be one of them.

From those opening salvos through a cacophony of facts about the importance of energy and energy taxes to the well-being of everyone in the State, Justice Willett clearly makes the point that any impediments to continued production of hydrocarbons would be un-Texan. Noting that Texas oil and gas production has declined since 1972, a fact undoubtedly encouraged by the common law rule of capture and the offset drilling rule, Justice Willett does not want to see that decline curve continue to get worse. The way to accomplish his objectives is not to have a wishy-washy resolution of the trespass issue but a clear finding that the underground cross-boundary frac job is never going to be a trespass. Rather than question the modern relevance of the *ad coelum* doctrine about ownership extending from the heavens above to the bowels below, he would clearly find that it has no place in the modern world.

The “legal” support for this position arises from *Manziel*. As discussed earlier, while *Manziel* cites Williams and Meyers for its articulation of the negative rule of capture, neither the treatise nor the *Manziel* decision itself
deals with the issue confronting the *Coastal* court. Because *Manziel* was not a suit against the party engaging in the waterflooding operation but a suit against the Railroad Commission order authorizing such an operation, it is not directly on point. While the majority opinion does discuss, even though quite summarily, the only cases that directly deal with the cross-boundary frac trespass situation, Justice Willett ignores the *Delhi-Taylor* cases and criticizes *Geo-Viking* as a mistake that was initially corrected when the Texas Supreme Court withdrew its opinion without deciding the cross-boundary frac trespass issue.

While the majority opinion at least holds open the possibility of a trespass cause of action, presuming the plaintiff can prove an actual injury, Justice Willett would find that there is no trespass notwithstanding the physical invasion of the fluids and the proppants. Instead Willett would recognize a possible negligence claim for injury to either oil field equipment or the common source of supply but the tort would be negligence and not trespass.114

A negligence claim requires a party to show that the defendant owed it a duty and breached that duty by acting in a way that falls below the standard of a reasonable and prudent operator. A trespass _quare clausum friget_ cause of action is basically a strict liability tort based on the physical invasion of a possessory estate. A trespass on the case cause of action, however, is not all that different from a negligence cause of action. The law has traditionally recognized injuries to the common source of supply caused by a party’s negligence, even where the court may use language that suggests that a trespassory cause of action was involved.115

While somewhat critical of the majority’s view, Justice Willett saves his big cannons for the dissenters.116 He states:

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114 *See* Irgens v. Mobil Oil Corp., 442 N.W.2d 223 (N.D. 1989) which is a case involving the negligent frac ing of a well. The operator apparently chose to frac the well rather than acidize it and the plaintiff lessors were able to show that the operator did not act as a reasonable and prudent operator which caused damage to the well that was being fraced. This was not a cross-boundary frac ing injury but injury to the well where the frac operation took place.

115 *See* Elliff, 210 S.W.2d 558. In *Elliff*, the negligence caused a well to blow out that led to the cratering of a well owned by another. The court found that a trespass occurred but awarded damages more consistent with conversion or negligence rather than trespass.

116 *Coastal Oil*, 268 S.W.3d at 30, 37-42.
The dissent’s view would invite a nightmarish flood of litigation over unknowable facts. It would slow the spigot and make it far tougher to find the next barrel of crude, that next cubic foot of natural gas, particularly in less-desirable pockets. It would reward the free rider who would rather sue for trespass than drill his own well. And it would do all this at the worst possible time — one of falling production, surging demand, and near-record-high prices for both crude oil and gasoline.\(^\text{117}\)

When one makes statements based on the current state of affairs, one has to watch one’s back, or front, to make sure that things don’t change in a way that makes you look somewhat foolish. While I have no doubt that Justice Willett would not change his mind regarding this opinion now that gasoline prices have fallen to less than $2.00/gallon and a barrel of crude oil has traded in the $40-50.00 range for several months, the “drill baby drill” mantra is better suited for a political platform than for the basis of coming up with a common law opinion.


The dissenting opinion\(^\text{118}\) argues that the real issue is whether a trespass has occurred and then determining whether the Rule of Capture might provide an affirmative defense to the trespass. The majority would not insulate from liability a cross-boundary frac operation because of the nature of the physical invasion and the artificial nature by which the gas is migrating across property lines.\(^\text{119}\) The dissenters point out that the rule of capture only applies to the legal or lawful capture of fugacious hydrocarbons. Thus the traditional slant hole production that originates on the wrong side of the

\(^{117}\) Id. at 30.

\(^{118}\) It is actually a concurring and dissenting opinion with the three justices concurring as to the wrongful admissibility of a racially-charged memo that leads to a remand for a new trial and concurring as to the analysis of the implied covenant issues but dissenting on the modification of the trespass claim by the rule of capture. Coastal Oil, 268 S.W.3d at 42-47. (Johnson, J., concurring and dissenting).

\(^{119}\) Coastal Oil, 268 S.W.3d at 43. As noted earlier the notion that the Rule of Capture is limited to only “natural” means of production was clearly rejected by the majority opinion and received little support during the early development of the Rule.
property line, or production in excess of that allowed by state conservation agency regulations would not be protected production under the rule of capture. Once one treats a cross-boundary frac job as involving an illegal activity, then the dissenting opinion makes sense. The dissenters firmly believe that their approach is necessary to protect the correlative rights of owners over a common source of supply. They state:

Today’s holding reduces incentives for operators to lease from small property owners because they can drill and hydraulically fracture to “capture” minerals from unleased and unspooled properties that would otherwise not be captured. Today’s holding effectively allows a lessee to change and expand the boundary lines of its lease by unilateral decision and action — fracturing its wells — as opposed to contracting for new lease lines, offering to pool or utilizing forced pooling, or paying compensatory royalties.

Just as was the case with the small tract owner prior to the enactment of the Mineral Interest Pooling Act (MIPA), the dissenting opinion would sacrifice the public interest in order to protect the interest of a group of mineral estate owners. The problem with this view is that after the enactment of MIPA, small tract owners even if not offered a chance to have their interest pooled can “muscle-in” to an existing spacing unit. Furthermore the dissenters would prioritize the protection of correlative rights over the equally important public policy objective of preventing waste. Without hydraulic fracturing, hydrocarbons will be left in the ground. Traditional production techniques are not equipped to handle various types of formations which hold substantial quantities of hydrocarbons. Given the fact that all states except Kansas have some type of compulsory pooling legislation, the plight of the small tract owner whether leased or unleased can be ameliorated through something less creating substantial disincentives to hydraulically frac.

The dissenters also do not see a difference between the slant hole bottomed on the wrong side of a property line and a cross-boundary fracturing

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120 Coastal Oil, 268 S.W.3d at 43 relying on Elliff 210 S.W.2d at 562-63 and Comanche Duke Oil Co. v. Tex. Pac. Coal & Oil Co., 298 S.W. 554, 559 (Tex. 1929).
121 Id. at 45.
operation. I tend to agree that in theory the injection of fluids and proppants across the boundary line that permanently changes the underground structure is not functionally different from a slant hole. The majority opinion dismisses the claim based apparently on the difference between casing and proppants. Notwithstanding the similarities, I would still favor the result reached by the majority because of the ramifications of attaching liability to cross-boundary frac operation. In this case, one could argue that the trespass was intentional in that both the hydraulic and propped length were designed to extend beyond the property line. But trespass has always been a strict liability tort. The stranger who mistakenly crosses over the property line and walks on your surface estate is just as much a trespasser as the stranger who does so inadvertently. Furthermore because of the uncertainty of the underground formation and the variables that go into designing a frac operation, it would be difficult to differentiate between the intentional and accidental cross-boundary frac job.


[1] — The Implied Covenant to Prevent Drainage.

Texas law is quite clear that an operator has an implied obligation to prevent drainage from the leased premises. The elements of the cause of action are proof of substantial drainage and that a reasonable and prudent operator would have acted to prevent the drainage. Historically the test was couched in terms that a reasonable and prudent operator would have drilled an offset well, but recently the operator has other options including pooling, either voluntary or compulsory, or seeking administrative relief. The jury found that Coastal had failed to meet this obligation but was then instructed to find as damages: “[t]he value of the royalty on the gas drained from Share 13 by the subsurface trespass.” According to Coastal, this mandatory damages finding wrongly presumes that a reasonable and prudent operator would have prevented all drainage due to the frac operation on

125 Coastal Oil, 268 S.W.3d at 18.
Share 12. Coastal also asserts that there is no evidence to show the amount of drainage that could have been prevented had Coastal acted as a reasonable and prudent operator.

Relying heavily on the Williams and Meyers treatise, the Supreme Court finds that the two traditional measures of damages for breach of the implied covenant to prevent drainage may both overcompensate the lessor.\textsuperscript{126} Texas has precedent supporting both of the damages models dealing with the drainage covenant. The most recent Texas Supreme Court decision found that the one measure of damages for breach of the implied covenant to prevent drainage is “the amount of royalties that the lessor would have received from the offset well on its lease.”\textsuperscript{127} Williams and Meyers calls this model the “amount the offset well would produce” model.\textsuperscript{128} The second model or formula is the value of the royalty on the amount of hydrocarbons that have been drained from the premises. Williams and Meyers calls this model the “amount drained away” model.\textsuperscript{129} As with other areas of Texas oil and gas jurisprudence there are Texas cases that support this second damages model as well.\textsuperscript{130} Without picking one model over the other the court announces:

[The] correct measure of damages for breach of the implied covenant or protection is the amount that will fully compensate, but not overcompensate the lessor for the breach — that is, the value of the royalty lost to the lessor because of the lessee’s failure to act as a reasonably prudent operator.\textsuperscript{131}

\begin{footnotes}
\item[126] Id. at 18 (nn. 59, 61) citing Williams & Meyers, § 825.2.
\item[127] Id. citing Kerr-McGee Corp. v. Helton, 133 S.W.3d 245, 253 (2004).
\item[128] Williams & Meyers, § 825.2.
\item[129] Id.
\item[131] Coastal Oil, 268 S.W.3d at 18-19.
\end{footnotes}
The Williams and Meyers treatise says the following as to why both damages models or formulas may overcompensate the lessor:

The ‘amount-the-offset-well-would-produce’ formula gives the lessor his royalty on production from the offset well, even thought the well would produce far more oil or gas than is being drained from the land. In short, there is no necessary correlation between the lessor’s loss due to drainage and a recovery based on the amount of production from an offset well.\(^{132}\)

The ‘amount-drained-away’ formula presupposes that the offset well would have prevented all drainage, which is not necessarily true. The location of the protection well, which may be determined by a regulatory agenda, will affect its efficacy in preventing drainage. Where it is determined that for physical reasons or by virtue of valid governmental order the offset well would not prevent all drainage, damage should be allowed only for the drainage that could have been prevented.\(^{133}\)

The court did not mention a jury instruction that had been approved by a court of appeals in another drainage case which attempts to deal with the overcompensation problem when it comes to the “amount the offset well would produce” formula. In Vela v. Wagner & Brown, Ltd.,\(^{134}\) the court approved the following jury instruction:

the dollar amount of royalties that would have been paid on gas produced from wells that a reasonably prudent operator would have drilled timely and in proper locations in compliance with its duty to protect the lease from substantial drainage, minus the dollar amount of royalties that the Royalty Owners received on the gas that was actually produced from wells that would otherwise not have been drilled during the period in question.\(^{135}\)

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132 Id. at 18 (n. 59) quoting from Williams & Meyers, § 825.2 at 167.
133 Id. (n. 61) quoting from Williams & Meyers, § 825.2 at 166.
135 Id.
The overcompensation problem relating to the offset well damage formula relates to the fact that the well might produce hydrocarbons that would otherwise not be drained away and might produce hydrocarbons that would otherwise be produced from existing wells on the lease. The above jury instruction, while not perfect, attempts to minimize the chance to overcompensate the lessor.

The overcompensation problem relating to the “amount drained away” formula is caused by the assumption that an operator owes a duty to prevent all drainage. That is clearly not the situation in most cases based on the fact that the duty to drill an offset well only arises after the operator is aware, or should have been aware, that there is substantial drainage. In addition, as was stated by the court there may be regulatory or geophysical reasons why an offset well will not prevent all drainage from occurring.

The facts of this case involve common lessee or fraudulent drainage. There is no uniform treatment of common lessee drainage cases. There are several decisions where the fact of common lessee drainage is noted, but there appears to be no impact on the court’s analysis relating to the alleged breach of the drainage covenant. A second group of cases states that common lessee drainage occurred but that the normal rules governing the implied covenant to prevent drainage apply. This is the rule in Texas. A third group of cases hold that the liability to the lessee is increased typically by lessening the burden of proof placed on the lessor. Under this third group a number of courts have adopted what amounts to a strict liability

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138 Shell Oil Co. v. Stansbury, 410 S.W.2d 187, 199 (Tex. 1966).
standard for the common lessee.\textsuperscript{140} This approach which would require the operator to drill an offset well even if it was not cost-justified has been criticized.\textsuperscript{141} Another way to make it easier for lessors to win drainage covenant cases where common lessee drainage is occurring is to find that an express covenant dealing with drainage would not preempt the implied covenant, as it might otherwise do, in cases where the lessee is doing the draining.\textsuperscript{142} The \textit{Williams and Meyers} treatise suggests that where common lessee drainage is occurring, the burden of going forward with the evidence and the burden of persuasion that the offset well would produce in paying quantities be placed on the operator.\textsuperscript{143} This would leave the plaintiff/lessor with the burden of showing substantial drainage, that the lessee was causing the drainage and damages.

The Texas Supreme Court finds that the jury instruction was erroneous because it did not deal with the overcompensation issue. It also finds that there was no evidence of what amount of drainage a reasonable and prudent operator should have prevented. Given the absence of any evidence on the issue the court finds that the plaintiff cannot recover on its claim for the breach of the implied covenant to prevent drainage.\textsuperscript{144} This appears to be somewhat of a harsh remedy because as noted above, Texas has in the past used both damage models in implied covenant to prevent drainage cases. The jury instruction used in this case was in error but for the most part reflected

\begin{footnotesize}
\begin{enumerate}
\item See, e.g., Cook v. El Paso Natural Gas Co., 560 F.2d 978 (10th Cir. 1977); Phillips Petroleum Co. v. Millette, 72 So. 2d 176 (Miss. 1954); Adkins v. Huntington Dev. & Gas Co., 168 S.E. 366 (W. Va. 1932).
\item Finley v. Marathon Oil Co., 75 F.3d 1225 (7th Cir. 1996)(applying Illinois law).
\item Coastal Oil, 268 S.W.3d at 19. A similar result was reached in \textit{Kerr-McGee v. Helton}, 133 S.W.3d 245 (Tex. 2004) where the plaintiff’s damages expert testimony was excluded on \textit{Daubert} grounds leaving no admissible damage evidence. Even though the lessee did not contest the jury findings that there was substantial drainage and that a reasonable and prudent operator would have drilled an offset well, no recovery was allowed.
\end{enumerate}
\end{footnotesize}
the amount drained away model. Evidence was presented on the basis of that model and unless the plaintiff could have predicted the court’s rejection of both damages model and its replacement with the reasonable and prudent operator, don’t overcompensate the lessor model, it should have been given a chance to present relevant evidence through the remand mechanism. While the decision is reversed because of the admission of some inflammatory documents, the court’s conclusion that the plaintiff cannot recover on its claim for breach of the protection covenant will preclude a second trial on that issue.


The gist of the cause of action for breach of the implied covenant of reasonable development is the failure to produce oil or gas from a known producing formation, or the failure to produce minerals from such known formation with the proper rapidity. 145

In this case Salinas’ implied covenant of reasonable development claim was based on Coastal’s laxity in producing from the Share 13 wells after the well on Share 12 was drilled. As opposed to the drainage covenant, there is typically no permanent loss of minerals where the lessor is asserting a breach of the implied covenant of reasonable development. 146 As with other implied covenants the general standard is that of a reasonable and prudent operator taking into consideration the interests of the lessor and lessee. A lessee typically has to drill sufficient wells as would a reasonable and prudent operator, meaning that for each “proposed” well, the lessor must show that it will produce sufficient hydrocarbons to compensate the lessee for all drilling and production expenses, as well as to provide for a reasonable return on invested capital. 147

145  5 Williams & Meyers, § 831 at 217.
146  The thorny issue of whether there is an implied covenant to explore unproven areas or depths is not raised by the facts in this case. See 5 Williams & Meyers, § 845.
The implied covenant of reasonable development is rarely invoked because it requires a court to “second-guess” an operator’s decision to drill or not drill additional wells. There is a built-in bias on behalf of operators not to drill additional wells since they are bearing 100 percent of the cost and receiving something less than that in terms of revenue. So unlike the drainage cases there is a divergence of interests between the lessor and lessee in the typical scenarios involving the implied covenant to reasonably develop the premises. Our treatise summarizes the conundrum as follows:

[T]he fundamental problem faced by courts measuring the lessee’s development operations under the prudent-operator standard is to strike a balance between the number of development wells necessary to withdraw the minerals at a fair rate to the lessor and the number of wells the lessee can afford to drill and still receive a fair return for the risk he takes on the investment he makes. A number of cases recognize the problem. Some seem to tip the scale too heavily in favor of the lessee in holding that the development obligation is discharged when the lessee drills a sufficient number of sells to recover the minerals in place, however long it may take.

Others reject this position, recognizing that the lessor may deserve to have the minerals at an earlier date. This does not mean that the lessor is entitled to the minerals as fast as they can be produced.148

Just as with the implied covenant to prevent drainage, the widespread adoption of spacing regulations by state oil and gas conservation agencies has impacted the reasonable development covenant. It would be hard for a lessor to require a lessee to drill wells on patterns smaller than that allowed by the applicable statewide or field spacing rule. There would be circumstances, however, where new data and/or no drilling or completion techniques are developed so that the operator may be required to either change the spacing rule or seek the power to drill infill wells. But in many circumstances the implied covenant of reasonable development has been co-opted by state spacing regulation.

148 5 Williams & Meyers, § 832.2 at 232-33.
The traditional remedies for breach of the implied covenant of reasonable development are outright cancellation except for an area surrounding the existing producing well or wells, a conditional decree of cancellation and damages.\(^{149}\) A cancellation decree is a harsh remedy but has been granted by a number of different courts under a wide range of factual scenarios.\(^{150}\) A conditional decree of cancellation is more often issued whereby the lessee is told to engage in various operations by dates certain, otherwise portions of the lease will be cancelled.\(^{151}\) A number of courts have taken the position that damages are the only appropriate remedy unless the legal remedy can be shown to be inadequate.\(^{152}\) This appears to be the rule in Texas.\(^{153}\) Some other states treat damages as the preferred remedy.\(^{154}\)

The proper measure of damages for breach of the implied covenant of reasonable development has been richly debated over the years. In the more likely circumstance where the hydrocarbons have not been permanently lost, giving the lessor the “lost royalties” is likely to lead to a double recovery since royalties will be paid eventually when the hydrocarbons are produced.\(^{155}\) An

\(^{149}\) Id. at § 834.

\(^{150}\) See, e.g., Mayhew v. Callard, 312 F.2d 295 (7th Cir. 1963)(applying Indiana law); McMahan v. Boggess, 302 S.W.2d 592 (Ky. 1957); Waseco Chem. & Supply Co. v. Bayou State Oil Corp., 371 So. 2d 305 (La. App. 1979), writs denied, 374 So. 2d 656 (La. 1979); Beer v. Griffith, 399 N.E.2d 1227 (Ohio 1980).

\(^{151}\) See, e.g., Amerada Petroleum Co. v. Doering, 93 F.2d 540 (5th Cir. 1937); Roberson Enter., Inc. v. Miller Land & Lumber Co., 700 S.W.2d 57 (Ark. 1985); Rush v. King Oil Co., 556 P.2d 431 (Kan. 1976); Fox Petroleum Co. v. Booker, 253 P. 33 (Okla. 1926); Waggoner Estate v. Sigler Oil Co., 19 S.W.2d 27 (Tex. 1928).

\(^{152}\) See, e.g., Daughetee v. Ohio Oil Co., 48 N.E. 502 (Ill. 1914); Harris v. Ohio Oil Co., 48 N.E. 502 (Ohio 1929).


\(^{154}\) See, e.g., Meaher v. Getty Oil Co., 450 So. 2d 443 ( Ala. 1984); Southwest Gas Producing Co., Inc. v. Seale, 191 So. 2d 316 (Miss. 1966).

\(^{155}\) 5 Williams & Meyers., § 834 at 250-51 states: “By giving the lessor royalty on such oil or gas, the court may be permitting a double recovery, since the lessor may receive a royalty again when the minerals are eventually produced.” Dean Eugene Kuntz attached five labels to the damages models used in development covenant cases. They were the “royalty rule” the “interest rule,” the “future credit rule,” the “total net production rule,” and the “royalty minus costs rule.” Eugene Kuntz, *The Law of Oil and Gas* § 58.5 at 90.
early West Virginia case adopted this view and measured the damages under
the “lost interest” rule whereby what you have deprived the lessor of is the
use of the royalty money that should have been paid. This view, however,
was discarded by a later case which adopted the “lost royalties” damages
model subject to the lessee being given a credit against future production in
order to prevent a double recovery.

The early Texas jurisprudence on the proper remedy also seemed to
reject the “lost interest” damages model. In *Texas Pacific Coal & Oil Co.
v. Barker*, the court said:

The ‘interest rule’ would be impracticable in actual application
because of difficulties in fixing the period of which interest should
be awarded, and also because adoption of the rule would invite
intolerable litigation. Moreover, the award of interest only does not
give the lessor what he would have received had the lessee performed
his obligation.

The purpose of the law to give compensation for breach of contract
is subserved by allowing the injured party to have the value to him
of the contract’s performance. . . Performance of a covenant to
produce a certain quantity of oil or gas, under a contract promising
royalty, is worth to the lessor as much as the value of his royalty
at the time the oil or gas should have been produced and delivered
or marketed. Therefore, to allow the lessor the value of royalty
wrongfully withheld from him complies with the law’s fundamental
purpose of adequate compensation.

While citing *Barker* for the proposition that the “lessee [sic][lessor?] is entitled to recover ‘the full value of royalty lost to him,’ “the court’s
analysis appears to adopt the “lost interest” methodology not the “lost royalty”
methodology. The jury had returned a verdict of $1.75 million for breach of

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156 *See Grass v. Big Creek Dev. Co., 84 S.E. 750 (W. Va. 1915).*
158 *Texas Pac. Coal & Oil Co. v. Barker, 6 S.W.2d 1031 (Tex. 1928).*
159 *Texas Pacific* at 1037.
160 *Coastal Oil, 268 S.W.3d at 19.*
the implied covenant of reasonable development. The court’s analysis of this issue lacks coherency because of its failure to recognize that unless *Barker* is overruled, the lessors should be entitled to the value of the full royalties that should have been produced, not just the interest on those royalties. Coastal argued that under the “lost interest” methodology it was not merely applying an interest rate to the amount of royalties that were not timely paid, but also must consider the price, value or proceeds upon which the royalty calculation would have been determined. Coastal urged that because the price of gas had steadily increased over the period of time that it was not produced that the royalty owners received a substantial net benefit from having royalties calculated on a much higher price.

The following hypothetical shows how Coastal’s argument operates. If on January 1, 2000, the price of gas is $2.00/MCF and the lessor has a royalty of 20 percent it would be entitled to payment of $.40/MCF. You can also presume that the price of gas remains at that level for the entire year. Presume further than 1,000,000 MCF was not produced in 2000 that should have been produced by a reasonable and prudent operator. Under the “lost royalties” model the lessor would be entitled to $400,000. Under the “lost interest” model the lessor would be entitled to the interest on the unpaid $400,000. But presume now that on January 1, 2001, the price of gas is $4.00/MCF. That 1,000,000 MCF of production would generate an annual royalty of $800,000 rather than $400,000 enriching the royalty owner by 100 percent. The court did not accept Coastal’s argument and instead believed that there was sufficient evidence in the record to support the $1.75 million in damages were it not for the admission of the inflammatory memos.

The court, however, fails to reconcile the *Barker* rejection of the “lost interest” approach to damages with its acceptance of that same approach. Having emphasized the problem of over-compensating lessors under the damages models for breach of the implied covenant to prevent drainage, the court could have, but did not, overrule *Barker* and come out in favor of the “lost interest” approach. The court’s reference to giving the royalty owner the “full value of royalties” appears to adopt the “lost royalties” model but the court’s confusing analysis presumes the application of the “lost interest” model. Because of the remand, I would not want to be in the shoes of the trial judge who would have to approve jury instructions for the alleged breach of the implied covenant of reasonable development. Do you
follow Coastal’s seeming adoption of the “lost interest” rule subject to the caveats about the notion that it is not merely a simple application of interest rate times amount of royalties not paid, or do you follow Barker’s adoption of the “lost royalties” rule?

§ 11.05. Conclusion.

The Coastal decision is an important one because of its impact on the use of hydraulic fracturing techniques. Had the dissenting opinion prevailed many operators would have had to re-determine the wisdom of engaging in fracking operations where there would be a potential for the fractures and/or the proppants to cross a boundary line. Its influence in other jurisdictions will depend in part on whether or not they accept the basic premise of the majority opinion relating to how common law trespass rules may be modified by the rule of capture. It also may depend in part on how active the state Legislature and/or oil and gas conservation agency are in regulating hydraulic fracturing operations. I am also aware that such operations are being regulated by sub-state units who are concerned with the land use externalities of such operations, including the presence of hazardous and/or toxic chemicals in the injection fluids which have to be transported to and from the drill site.

The court’s delegation to the Railroad Commission of the primary responsibility to protect the correlative rights of mineral owners is troubling. State conservation agencies have always treated the prevention of underground waste as their primary responsibility. The concept of protecting correlative rights, has in my opinion, taken a back seat to the waste prevention objectives. The fact that well spacing regulations prevent waste is undoubtedly one of the reasons why they became so ubiquitous a form of regulation. The fact that such regulations also protect correlative rights by preventing parties from drilling close to property lines is a beneficial, but secondary, consideration. The Coastal decision involves basic common law rules dealing with trespass and implied covenants. The common law through the adoption of the rule of capture created the waste problem that was ameliorated through legislative, not common law, developments. As I have aged, not so gracefully I may add, I have become a bigger fan of the common law as a protector of individual rights. Courts are not insulated from political considerations, but are certainly more insulated than either the legislative or administrative branches of
government. The majority opinion in this case through its "expansion" of the rule of capture acknowledges that a problem relating to correlative rights will be created by cross-boundary hydraulic fracturing operations but that it is best left to the Legislature and the Railroad Commission to resolve that problem. From a societal standpoint I agree with the outcome and cannot posit another resolution of the issues confronting the Coastal court that would have better balanced the competing interests. I therefore await appropriate administrative or legislative actions that will allow cross-boundary hydraulic fracturing operations to take place without unduly harming the correlative rights of neighboring mineral owners.