

## NOTE

### Adverse to Reason: The Texas Supreme Court's Disconcerting Approach to Adverse Possession of Mineral Leases in the *Pool* Case and Its Progeny

#### *I. Introduction*

In *Natural Gas Pipeline Co. of America v. Pool*,<sup>1</sup> the Texas Supreme Court issued a bewildering decision applying the doctrine of adverse possession to severed oil and gas lease interests. Relying on its adverse possession jurisprudence, the Texas Supreme Court reversed the appellate court holdings in favor of the lessors, withdrew a previous opinion in favor of the lessors, and substituted a new opinion granting the lessees a fee simple determinable in the mineral leases.<sup>2</sup>

This note explores the significance of the *Pool* ruling in the context of Texas' decisions that have applied the property doctrine of adverse possession to claims for severed mineral rights. Although this note focuses on Texas' substantive and statutory law, jurisdictions where property owners commonly sever mineral estates, such as Oklahoma, Louisiana, or Wyoming, should note the overarching principles regarding the rights of lessors. This note shows how errors in interpreting and applying legal doctrines can disenfranchise property owners; specifically, the note argues that the *Pool* court erred in three respects. First, the court improperly diverged from its previous rulings to incorporate constructive repudiation into its jurisprudence regarding adverse possession of mineral estates. Second, the court failed to give adequate consideration to the mutually beneficial and permissive nature of an oil and gas lease. Third, the note posits that the Texas Supreme Court's misapplication of the doctrine of adverse possession provides unscrupulous lessees with a means of fraudulently disenfranchising lessors without fear of judicial redress.

Part II outlines the doctrine of adverse possession and traces the Texas Supreme Court's development of the law as applied to mineral leases. Part III discusses the facts, issues, and holding of *Pool*, as well as the arguments made by the dissent. Part IV analyzes the methodologies used by the Texas Supreme Court's majority in reaching its decision in *Pool* and proposes alternative applications of the law. Part V analyzes the impact of the *Pool* ruling on later Texas cases. The note concludes with Part VI.

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1. 124 S.W.3d 188 (Tex. 2003).

2. *Id.* at 189-90.

## II. Adverse Possession Before Pool

Statutes of limitations have a long history in Anglo-American law, extending back beyond the thirteenth century.<sup>3</sup> Every jurisdiction has statutes of limitations that fix the period of time in which a landowner must sue to recover land from adverse occupiers.<sup>4</sup> While these statutes differ substantially in the duration of the established periods, in provisions for extending the normally operative period, and other specific details, a large body of case law complements the statutes by elaborating on the kind of possession that will cause the statutory period to begin to run, and to continue running, against the rightful property owner.<sup>5</sup>

This note addresses judicial application of the doctrine of adverse possession to severed mineral estates. While generally disfavored, adverse possession gives hostile occupiers a means of acquiring title to property.<sup>6</sup> By adversely possessing an estate, the occupier creates an absolute title by deed from the record owner via judicial proceeding.<sup>7</sup> Courts can apply the doctrine of adverse possession to a fee simple estate, a surface estate, and a severed mineral estate.<sup>8</sup>

### A. Severance of Mineral Estates

In general, an adverse occupant cannot possess a mineral estate until the rightful owner has severed it from the greater estate.<sup>9</sup> The United States Supreme Court has held that a property owner may sever an interest in subsurface minerals from ownership of the surface estate.<sup>10</sup> The owner of the estate can then transfer legal title of the mineral estate to different parties.<sup>11</sup> Once the property owner severs the mineral estate from the surface estate, Texas law regards the mineral estate as wholly separate and distinct from the

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3. 16 RICHARD R. POWELL, *POWELL ON REAL PROPERTY* § 91.01 (Michael Allan Wolf ed., 2000).

4. *Id.*

5. *Id.*

6. *See Francis v. Rogers*, 2001 OK 111, ¶ 13, 40 P.3d 481, 486.

7. 3 AM. JUR. 2D *Adverse Possession* §§ 1, 248, 255 (2006).

8. *Id.* § 1 (explaining that adverse possession often creates fee simple title to an estate); *id.* §§ 278, 280, 289 (explaining how adverse possession of both surface and mineral estates can occur).

9. *See infra* Part II.B.

10. *Del Monte Mining & Milling Co. v. Last Chance Mining & Milling Co.*, 171 U.S. 55, 60 (1898).

11. *See id.*

surface estate.<sup>12</sup> The severance can pertain to a particular substance, mineral, subsurface depth, or geologic formation,<sup>13</sup> and an occupier can mature title to any of these estates via adverse possession.

*B. Adverse Possession*

The doctrine of adverse possession holds a unique status in common law. Generally, landowners may seek compensation for wrongful acts done to their land by others.<sup>14</sup> Nevertheless, the doctrine of adverse possession limits a landowner's rights. Adverse possession allows an occupier to claim title to another's estate when the occupier uses that estate continuously, exclusively, openly, notoriously, and hostilely for a statutory period of time.<sup>15</sup> The Texas legislature defines adverse possession as "an actual and visible appropriation of real property, commenced and continued under a claim of right that is inconsistent with and is hostile to the claim of another person."<sup>16</sup> Thus, before an occupant can manifest the statutory requirements of adverse possession, he or she must adversely possess the estate.

An occupier must satisfy a few requirements to adversely possess an estate. First, the occupier must give objective notice of an adverse claim to the rightful property owner.<sup>17</sup> Once the occupant adversely possesses an estate, the rightful owner's claim for ejectment commences.<sup>18</sup> Adverse occupation for a period longer than that prescribed by statute creates a new title to the property in the occupant and terminates the rights of the prior owner.<sup>19</sup> Essentially, occupiers use adverse possession to forcibly transfer a property interest.

A public policy argument justifies using the doctrine of adverse possession. Fundamentally, a failure to exploit mineral wealth creates economic injury to the public.<sup>20</sup> The existence of economic markets for minerals proves that the public values the production and exploitation of minerals like oil, natural gas, and coal. By leaving the minerals in situ, the supply of scarce minerals

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12. *Harris v. Currie*, 176 S.W.2d 302, 304-05 (Tex. 1943).

13. See 1 EUGENE KUNTZ, *LAW OF OIL & GAS* § 10.4 (1987).

14. 1 HOWARD R. WILLIAMS & CHARLES J. MEYERS, *OIL AND GAS LAW* § 223 (2007).

15. BLACK'S LAW DICTIONARY 59 (8th ed. 2004).

16. TEX. CIV. PRAC. & REM. CODE ANN. § 16.021(1) (Vernon 2006).

17. See, e.g., POWELL, *supra* note 3, § 91.04; see also *Reitsma v. Pascoag Reservoir & Dam, L.L.C.*, 774 A.2d 826, 832 (R.I. 2001) (stating statutory requirements that the occupant's possession be continuous, exclusive, open, notorious, and hostile are used as evidence to support the occupier's objective claim, and to show that the claim is not permissive).

18. See, e.g., POWELL, *supra* note 3, § 91.02; see also *Ontelaunee Orchards v. Rothermel*, 11 A.2d 543, 545 (Pa. Super. Ct. 1940).

19. See, e.g., POWELL, *supra* note 3, § 91.10.

20. *Id.* § 91.01.

available to consumers remains lower and the price of those minerals remains higher. Further, locating the owners and procuring consent to exploit mineral estates can be more difficult as the severance grows older. Thus, courts may justifiably grant possession of the mineral estate to an occupant that puts the estate to more publicly beneficial use when the rightful owner of the mineral estate fails to exploit the mineral wealth.

### *C. Adverse Possession of a Severed Mineral Estate*

Property owners hold severed mineral estates, like other estates, subject to adverse possession. In Texas, execution of an oil and gas lease severs the mineral estate from the surface estate.<sup>21</sup> Where the property owner has severed the mineral estate from the surface estate, adverse possession of the surface estate alone will not provide adverse title to the mineral estate.<sup>22</sup> The adverse party cannot possess the mineral estate solely by occupying the surface, because doing so fails to establish a claim adverse to or inconsistent with possession of the mineral estate.<sup>23</sup> Rather, the occupier must exploit the mineral estate to adversely possess that estate.<sup>24</sup>

The Texas Court of Civil Appeals announced the threshold for actual possession of a severed mineral estate in *Broughton v. Humble Oil & Refining Co.*: “[s]uch dominion must be exercised over the minerals as will be notice to the owner of the mineral estate that the possessor of the surface is claiming the minerals also.”<sup>25</sup> The Texas courts, however, have not defined “dominion” except to say that an occupier can only mature title to the mineral estate via actual possession of the minerals.<sup>26</sup> When an adverse occupant begins exploratory drilling, the statute of limitations begins running subject to

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21. See *Rogers v. Ricane Enters.*, 772 S.W.2d 76, 80 (Tex. 1989). In Oklahoma, once the mineral estate has been severed, adverse possession of the surface estate does not mature to the mineral estate because two estates of equal dignity cannot merge and must remain separate. See *Ferguson v. Hillborn*, 1965 OK 84, ¶ 27, 402 P.2d 914, 921.

22. WILLIAMS & MEYERS, *supra* note 14, § 224.1. Often, owners of large tracts of land sever the mineral estates and convey them to subsidiaries to protect themselves from adverse possessors. *Id.* (citing *Houston Oil Co. of Tex. v. Moss*, 284 S.W.2d 131 (Tex. 1955)).

23. See KUNTZ, *supra* note 13, § 10.4. After severance, the mineral owner only retains a protected interest in the mineral estate and easements appurtenant to that interest. Thus, surface occupation does not give rise to a cause of action against which a statute of limitations can run. The mineral owner, having no interest in the surface, takes no notice of surface conditions and justifiably ignores them. *Id.*

24. WILLIAMS & MEYERS, *supra* note 14, § 224.1.

25. 105 S.W.2d 480, 483 (Tex. App. 1937).

26. See *Hunt Oil Co. v. Moore*, 656 S.W.2d 634, 641 (Tex. App. 1983).

interruptions of the oil and gas operations.<sup>27</sup> Thus, in Texas, an occupier can adversely possess a mineral estate as soon as he begins drilling a well, and the statute runs as long as the occupier has continuous, actual possession of the oil and gas produced therefrom.<sup>28</sup> These elements of adverse possession provided the framework for the Texas Supreme Court's ruling in *Pool*.

### III. Natural Gas Pipeline Co. of America v. Pool

#### A. Statement of the Case

In 1926, J.T. Sneed Jr. and his wife, Zella, granted an oil and gas lease to Marland Oil Company to remain in force “for a term of ten years from this date, and as long thereafter as oil or gas, or either of them, is produced from said land by the lessee.”<sup>29</sup> Marland Oil subsequently assigned the lease to Texoma Natural Gas Company.<sup>30</sup> In 1936, J.T. Sneed, Jr. and Elizabeth Sneed Pool, individually as executors of the estate of Zella Sneed, executed a separate gas lease to Texoma, to remain in force “so long as natural gas is produced from any portion [of the land conveyed] under this contract . . . .”<sup>31</sup> In a separate agreement, the parties consolidated the 1926 and 1936 leases,<sup>32</sup> and the operator drilled the J.T. Sneed #1 well on the consolidated acreage.<sup>33</sup> The well produced gas throughout the primary term, but suffered production stoppages during its secondary term.<sup>34</sup>

Separately, in 1937, J.T. Sneed, Jr. and Elizabeth Sneed Pool granted a natural gas lease to Texoma, to endure “pending the commencement and continuation of drilling operations on said land . . . and as long thereafter as natural gas is produced and marketed from any well on said land.”<sup>35</sup> The operator drilled two gas wells, the J.T. Sneed SN11 and the J.T. Sneed SN15, which produced through the primary term, but these wells also did not produce

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27. WILLIAMS & MEYERS, *supra* note 14, § 224.4 (citing *Kilpatrick v. GulfProd. Co.*, 139 S.W.2d 653 (Tex. App. 1940)).

28. *Id.* (citing *Counce v. Yount-Lee Oil Co.*, 87 F.2d 572 (5th Cir. 1937) (applying Texas law)).

29. *Natural Gas Pipeline Co. of Am. v. Pool (Pool II)*, 30 S.W.3d 639, 642 (Tex. App. 2000), *rev'd*, 124 S.W.3d 188 (Tex. 2003).

30. *Id.*

31. *Id.*

32. *Natural Gas Pipeline Co. of Am. v. Pool*, 124 S.W.3d 188, 190 (Tex. 2003).

33. *Id.* The operator drilled a replacement well in 1994. *Id.*

34. *Pool II*, 30 S.W.3d at 643. The periods of nonproduction were August 1941, June through September 1963, July through August 1964, June 1979, March 1983, July 1984, and February through July 1997. *Id.*

35. *Natural Gas Pipeline Co. of Am. v. Pool (Pool I)*, 30 S.W.3d 618, 624 (Tex. App. 2000), *rev'd*, 124 S.W.3d 188.

during certain periods of the secondary term.<sup>36</sup> Notably, the record indicated that the lessees had stopped producing to benefit from expected higher winter prices.<sup>37</sup>

In May 1998, the successors-in-interest to the lessors of the respective Sneed Leases sued for decrees that the leases had terminated automatically because the lessees had failed to produce, and the plaintiffs further sought damages for conversion.<sup>38</sup> The successors-in-interest to the lessees denied the allegations and alternatively asserted affirmative defenses.<sup>39</sup> The lessees offered as their primary alternative defense that they had “obtained a fee simple determinable in each of the mineral estates by adverse possession.”<sup>40</sup> In February 1999, the trial court granted partial summary judgment in both suits, finding that the Sneed Leases had terminated as a matter of law when the lessees stopped producing.<sup>41</sup> The cases subsequently went to jury trials on the issues of remedies and affirmative defenses.<sup>42</sup>

In the trial for the 1926 and 1936 leases, the jury found that the lessees had at all times acted in good faith, despite the production stoppages.<sup>43</sup> Further, the jury found that the lessees had not acted fraudulently and excused any failure to produce natural gas.<sup>44</sup> Nevertheless, the jury contradicted itself by finding that the leases had in fact expired and that the lessees had acquired the severed mineral estates by adverse possession.<sup>45</sup> The trial judge, finding the evidence insufficient for the jury’s incongruous determinations, entered judgment for the lessors notwithstanding the jury verdict.<sup>46</sup>

In the trial for the 1937 lease, the jury found that the lessees had acted in bad faith in producing gas after production stoppages had automatically

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36. *Id.* The periods of nonproduction were August 1959, July through August 1960, June through July 1961, June through October 1963, July through August 1964, and June 1969. *Id.*

37. *Pool*, 124 S.W.3d at 203 (Jefferson, J., dissenting). Favorable market conditions from higher demand benefit the lessors as well as the lessees, as higher revenues driven by higher prices will result in larger royalty payments. *Id.*; see also *infra* Part IV.A.2.

38. *Pool II*, 30 S.W.3d at 643; *Pool I*, 30 S.W.3d at 624.

39. *Pool II*, 30 S.W.3d at 643; *Pool I*, 30 S.W.3d at 624. Specifically, the lessees contended that, “the leases did not terminate because there ha[d] been production in paying quantities at all times, notwithstanding the periods of nonproduction, or that production was restored within a reasonable period of time under the temporary cessation of production doctrine.” *Pool*, 124 S.W.3d at 191.

40. *Pool*, 124 S.W.3d at 191.

41. *Pool II*, 30 S.W.3d at 643; *Pool I*, 30 S.W.3d at 624.

42. *Pool II*, 30 S.W.3d at 643; *Pool I*, 30 S.W.3d at 624.

43. *Pool II*, 30 S.W.3d at 643.

44. *Id.*

45. *Id.*

46. *Id.*

terminated the lease.<sup>47</sup> Moreover, while the lessees had not produced natural gas fraudulently, the jury would not excuse the temporary failure to produce natural gas.<sup>48</sup> Further, although the lease had expired, the lessees had not acquired title to the severed mineral estate by adverse possession.<sup>49</sup> The trial court entered judgment in accordance with the jury verdict.<sup>50</sup> The total award after trial to the combined lessors was \$5,902,937.92 plus fees, costs, and prejudgment interest.<sup>51</sup> The appeals court upheld the rulings in favor of the plaintiffs.<sup>52</sup>

*B. Issue*

In *Pool*, the Texas Supreme Court considered whether the constructive repudiation of a mineral estate tenancy initiated the statutory adverse possession period.<sup>53</sup> The court of appeals had stated that the lessees could not establish adverse possession because they had not given actual notice of repudiation of the lessors' titles to the severed mineral estates.<sup>54</sup> Further, the tenant must objectively repudiate the tenancy to begin the adverse possession process against the landlord.<sup>55</sup> Texas, a state that treats an oil and gas lease as a fee simple determinable estate that automatically terminates when production stops, traditionally imposed upon a holdover lessee the requirement of repudiating the former tenancy by actual notice before the adverse possession

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47. *Pool I*, 30 S.W.3d at 624.

48. *Id.*

49. *Id.*

50. *Id.*

51. *Natural Gas Pipeline Co. of Am. v. Pool*, 124 S.W.3d 188, 191 (Tex. 2003). The trial court for the 1926 and 1936 leases, using stipulated damage calculations, awarded the lessors \$234,766.20 in actual damages to be paid by Natural Gas Pipeline Co. and MidCon Gas Services, and \$545,416.79 in actual damages to be paid by Chesapeake Panhandle Limited Partnership, for a total award of \$780,182.99 plus attorneys' fees and costs. *Id.* The trial court for the 1937 lease found the lessees jointly and severally liable for \$1,522,754.93 in actual damages, and found Natural Gas Pipeline Co., MidCon Gas, and Chesapeake Panhandle each individually liable for \$1,200,000 in exemplary damages, for a total award of \$5,122,754.93 plus attorneys' fees, costs, and prejudgment interest. *Id.*

52. *Id.*

53. *Id.* at 194-97.

54. *Id.* at 192. The lessees appealed the trial rulings to the Texas Court of Appeals, Seventh District, in Amarillo. The appeals court agreed with the separate trial rulings that the various leases had terminated because production stopped in violation of the respective habendum clauses. *Id.* The appeals court further found that laches was not an applicable defense, that the lessors were not entitled to attorneys' fees, that the lessors' execution of division orders did not revive the leases, that exemplary damages were not available because of the lack of evidence of fraud, that statutes of limitations barred trespass and conversion claims, and finally that damages should be reduced. *Id.*

55. WILLIAMS & MEYERS, *supra* note 14, § 224.3.

period could run.<sup>56</sup> On appeal, the Texas Supreme Court focused on the requirement of actual notice in its *Pool* ruling.

### C. Holding

Justice Priscilla R. Owen, writing for a 6-1 majority of the Texas Supreme Court, determined that the lessees had established adverse possession as a matter of law.<sup>57</sup> Further, the court determined that the hostile lessees did not acquire a fee simple in the full mineral estate.<sup>58</sup> Instead, the lessees only gained “the same interest[s] that they adversely and peaceably possessed, that is, the oil and gas leasehold estates as defined by the original leases.”<sup>59</sup> In conclusion, the Texas Supreme Court held that “the court of appeals erred in failing to hold that the lessees in these two cases acquired fee simple determinable mineral estates by adverse possession,” and accordingly reversed the judgments by the courts of appeals and rendered judgments for the lessees.<sup>60</sup>

### D. Rationale of the Majority

The majority focused on Texas’ strict rules regarding transfer of a determinable estate. An oil and gas lease grants a fee simple determinable in the severed mineral estate to the lessee.<sup>61</sup> Once the lease terminates, the lessee retains no interest in the mineral estate because it reverts in whole to the lessor,<sup>62</sup> who can renegotiate for more favorable lease terms and a new signing bonus. Where the lessor receives the reversion but the former lessee nevertheless asserts a claim to the estate, the holdover lessee can only claim a “permissive tenancy” and cannot begin to adversely possess the severed mineral claim until giving the lessor notice of repudiation.<sup>63</sup> Whether constructive repudiation of a permissive tenancy could initiate the adverse possession of a mineral estate was unclear until the *Pool* case.

In *Pool*, the Texas Supreme Court diverged from established adverse possession law. Traditionally, a permissive tenant must clearly repudiate the

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56. *Id.* § 224.4 (citing *Anadarko Petroleum Co. v. Thompson*, 60 S.W.3d 134 (Tex. App. 2000), *rev'd*, 94 S.W.3d 500 (Tex. 2002); *Pool II*, 30 S.W.3d 639, 646 (Tex. App. 2000), *rev'd*, 124 S.W.3d 188; *Pool I*, 30 S.W.3d 618 (Tex. App. 2000), *rev'd*, 124 S.W.3d 188).

57. *Pool*, 124 S.W.3d at 192.

58. *Id.* at 199.

59. *Id.*

60. *Id.* at 202.

61. *Id.* at 199.

62. *Id.* at 194.

63. *Id.* (citing *Tex-Wis Co. v. Johnson*, 534 S.W.2d 895, 899 (Tex. 1976)); *see also* 49 AM. JUR. 2D *Landlord & Tenant* § 353 (2006).

tenancy to begin the adverse possession process against the landlord.<sup>64</sup> Nevertheless, the *Pool* majority refused to require actual notice of repudiation to terminate a permissive tenancy where the permissive tenant gives constructive notice of repudiation.<sup>65</sup> Further, the majority announced that it will presume constructive notice of repudiation where the facts indicate a long-continued use of the land,<sup>66</sup> and where the facts show that the adverse occupant has made a long-continued, open, notorious, and exclusive claim of title to the mineral estate that is inconsistent with the existence of title in the lessor.<sup>67</sup> Consequently, an oil and gas lessee provides constructive notice of repudiation to the lessor where it continues to physically remove and dispose of the valuable, nonrenewable minerals for its own account.<sup>68</sup> The majority held that by producing natural gas once the leases had expired and the mineral estates had reverted to the lessors in their entirety, the lessees acted in a manner hostile to the lessors' ownership of all the minerals in place.<sup>69</sup> Thus, the majority's statement of law failed to take into account the permissive nature of an oil and gas lease and the inability of a lessor to meticulously account for a lessee's activities.

Applying the facts of *Pool*, the majority reasoned that once the lessees actually stopped producing, the leases automatically terminated and reverted to the lessors.<sup>70</sup> Thereafter, the former lessees no longer held a right to produce and market any minerals.<sup>71</sup> Further, the holdover lessees' refusal to pay the full amount of the proceeds that they owed to the lessors constituted constructive notice of repudiation of the former lessors' fee simple in the severed mineral estate.<sup>72</sup> The fact that the holdover lessees paid a one-eighth royalty for minerals produced and marketed did not negate the constructive notice of repudiation because the lessees should have paid the lessors for all of the production—essentially an eight-eighths royalty.<sup>73</sup>

Thus, rather than find that the acceptance of royalty payments by the lessors constituted either constructive or actual permission to the holdover lessees to continue to explore, produce, and market minerals, the Texas Supreme Court considered the royalty payments proof that the holdover lessees acted hostile

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64. WILLIAMS & MEYERS, *supra* note 14, § 224.3.

65. *Pool*, 124 S.W.3d at 194.

66. *Id.* (citing *Tex-Wis Co.*, 534 S.W.2d at 899).

67. *Id.* (citing *Vasquez v. Meaders*, 291 S.W.2d 926, 928 (Tex. 1956)).

68. *Id.* at 196.

69. *Id.*

70. *Id.* at 194.

71. *See id.* at 197.

72. *Id.* The accounting called for all proceeds minus the costs of extraction. *Id.*

73. *Id.*

to the lessors' exclusive rights to explore for and produce minerals.<sup>74</sup> The majority opinion fails to account for the fact that a lessor and lessee enter into an oil and gas lease for the mutual benefit of both parties, whereby the lessor permits the exploration for and production of minerals. In *Pool*, the Texas Supreme Court established an unprecedented lessee-friendly approach to adverse possession.

#### *E. Jefferson's Dissent*

Justice Wallace B. Jefferson's dissent criticized the majority for refusing to address whether, in fact, the leases terminated due to production stoppages.<sup>75</sup> Failing to do so, the dissent argued, "puts the cart before the horse."<sup>76</sup> When, as in these cases, the underlying oil and gas lease does not include a savings clause to avoid automatic termination, Justice Jefferson would prefer that the Texas Supreme Court hold that periods of nonproduction during the secondary term of the lease should not necessarily terminate the lease.<sup>77</sup> Had the majority found that the "temporary cessation-of-production doctrine" precluded lease termination, then adverse possession would not have been an issue.<sup>78</sup>

The Texas Supreme Court's refusal to apply the temporary cessation-of-production doctrine forced the majority to use adverse possession to maintain the leases. Justice Jefferson felt that the majority also failed in its application of adverse possession.<sup>79</sup> According to the dissent, the majority's definition of constructive notice of repudiation creates a harsh rule for any lessor, particularly where many parties own small fractions of a royalty interest.<sup>80</sup> Justice Jefferson's dissent alluded to, but did not cover in depth, the true problems with the majority's application of the doctrine of adverse possession.

#### *IV. Analysis*

Because Texas has not adopted the temporary cessation-of-production doctrine to preserve oil and gas leases where the operator stops producing to benefit from expected higher prices,<sup>81</sup> the *Pool* majority had to abuse the doctrine of adverse possession to reach its desired conclusion. After

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74. *Id.*

75. *Id.* at 202 (Jefferson, J., dissenting).

76. *Id.*

77. *Id.* at 203 (citing *Watson v. Rochmill*, 155 S.W.2d 783, 784 (Tex. 1941)).

78. For a discussion of the temporary cessation-of-production doctrine, see *infra* Part IV.A.

79. *Pool*, 124 S.W.3d at 202 (Jefferson, J., dissenting) ("The Court's resolution of the case introduces a new twist on adverse possession that, at least on its face, divests a prior owner of property without the sort of notorious ouster we have previously mandated.").

80. *Id.* at 203.

81. *Id.* at 205.

discussing the merit of applying temporary cessation-of-production doctrine, this note argues two points. First, the majority opinion obviated the need for the adverse possessor to actually repudiate the record owner's title to the severed mineral estate before adverse possession begins.<sup>82</sup> Second, the majority opinion discarded the requirement that the hostile occupier possess the estate adverse to or inconsistent with a claim of right.<sup>83</sup> By disavowing actual repudiation and ignoring the requirement that an occupant must make a claim that is adverse to a claim of right, the Texas Supreme Court enabled the disenfranchisement of lessors by deceitful lessees.

*A. Rationale for Adopting "Temporary Cessation-of-Production Doctrine"*

Oil and gas wells, by their nature, do not produce constantly. Inevitably, production will stop due to mechanical breakdowns, reworking problems, or, as in *Pool*, market conditions.<sup>84</sup> The temporary cessation-of-production doctrine addresses the premise that the lessor and lessee must have contemplated that production stoppages would occasionally occur.<sup>85</sup> As a result, the parties must have contemplated the inevitability of these short delays and deemed them excusable.<sup>86</sup> Thus, courts should uphold a lease where a reasonable and prudent operator would temporarily stop producing.<sup>87</sup> The legal flexibility of the temporary cessation-of-production doctrine lets courts craft solutions that reflect both the mutual benefits sought by the parties and the permissive nature of mineral exploration and production.

*1. Discrediting the Texas Rule*

In Texas and elsewhere, courts refuse to cancel leases when brief production stoppages would benefit the lessors as well as the lessees.<sup>88</sup> Texas courts, however, only allow production stoppages where the lessee can show either

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82. *Id.* at 202.

83. *Id.* at 209.

84. *Id.* at 203.

85. *Bryan v. Big Two Mile Gas Co.*, 577 S.E.2d 258, 265-66 (W. Va. 2001).

86. *Id.*

87. *Id.*

88. *See, e.g.*, *Reynolds v. McNeill*, 236 S.W.2d 723 (Ark. 1951) (stoppage allowed after the breakdown of production equipment); *Fuqua v. Chester Oil Co.*, 246 S.W.2d 1007 (Ky. 1952) (stoppage allowed for change to secondary recovery methods); *Frost v. Gulf Oil Corp.*, 119 So. 2d 759 (Miss. 1960) (stoppage allowed for reworking); *Feland v. Placid Oil Co.*, 171 N.W.2d 829 (N.D. 1969) (stoppage allowed due to the lack of saltwater disposal facilities); *Durkee v. Hazan*, 1968 OK 96, 452 P.2d 803 (stoppage allowed to drill the well deeper); *Midwest Oil Corp. v. Winsauer*, 323 S.W.2d 944 (Tex. 1959) (stoppage allowed to remove a pipe obstruction).

a sudden stoppage of the well or a mechanical breakdown.<sup>89</sup> Moreover, Texas courts have explicitly refused to apply temporary cessation-of-production doctrine where the operator briefly stopped producing due to financial difficulties.<sup>90</sup> Doing so, however, fails to acknowledge that situations arise that call for the lessee to temporarily stop producing until mineral markets improve. In *Pool*, the lessees stopped producing to benefit from expected higher winter prices.<sup>91</sup> Higher prices benefit both the lessor and the lessee. Accordingly, the Texas Supreme Court could have applied the temporary cessation-of-production doctrine to preserve the leases for a production stoppage that would benefit both parties.

The Texas Supreme Court's refusal to extend the temporary cessation-of-production doctrine to stoppages for marketing natural gas runs counter to the rights and duties implied in an oil and gas lease. Both Texas and Oklahoma courts recognize that lessees assume an implied covenant to market production.<sup>92</sup> As a practical matter, a lessee who has otherwise acted in good faith and with reasonable planning may still encounter difficulties when marketing its natural gas production. While an oil producer can easily store and sell its production, a natural gas producer must immediately prepare the gas for transportation in pipelines.<sup>93</sup> Moreover, while oil producers often pay royalties by transferring produced oil to the royalty owner, which allows lessors to make independent arrangements for sale, gas producers usually pay royalties in terms of a percentage of the sale price or market value.<sup>94</sup> Thus, the lessor of a natural gas lease must depend on the lessee's marketing efforts to maximize its royalty value.

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89. See *Cobb v. Natural Gas Pipeline Co. of Am.*, 897 F.2d 1307, 1309-10 (5th Cir. 1990) (applying Texas law); *Bradley v. Avery*, 746 S.W.2d 341, 343 (Tex. App. 1988).

90. See *Watson v. Rochmill*, 155 S.W.2d 783, 784 (Tex. 1941); *Fick v. Wilson*, 349 S.W.2d 622 (Tex. App. 1961).

91. *Natural Gas Pipeline Co. of Am. v. Pool*, 124 S.W.3d 188, 203 (Tex. 2003) (Jefferson, J., dissenting).

92. See, e.g., *Craig v. Champlin Petroleum Co.*, 300 F. Supp. 119, 125 (W.D. Okla. 1969) (applying Oklahoma law), *rev'd on other grounds*, 435 F.2d 933 (10th Cir. 1971); *Amoco Prod. Co. v. First Baptist Church of Pyote*, 579 S.W.2d 280 (Tex. App. 1979), *writ refused n.r.e.*, 611 S.W.2d 610 (Tex. 1980). The United States District Court for the Western District of Oklahoma specifically stated that "[the] lessee . . . has an implied duty and obligation in the exercise of reasonable diligence, as a prudent operator, with due regard for the interest of both lessor and lessee, to obtain a market for the gas produced . . . at the prevailing market price." *Craig*, 300 F. Supp. at 125.

93. See *Frey v. Amoco Prod. Co.*, 603 So. 2d 166, 175-76 (La. 1992).

94. See *Curry v. Tex. Co.*, 8 S.W.2d 206, 210 (Tex. App. 1928).

## 2. Endorsing the Oklahoma Rule

While the Texas Supreme Court refused to bend its rules to acknowledge the mutual benefits derived from marketing natural gas, the Oklahoma Supreme Court assisted lessors and lessees in a slightly different context in *Pack v. Santa Fe Minerals*.<sup>95</sup> In *Pack*, the court held that temporarily shutting in a natural gas well for marketing reasons did not terminate a lease.<sup>96</sup> The court rejected the notion that such a production stoppage should terminate a lease because Oklahoma statutory law indicates a strong policy against forfeiture of estates.<sup>97</sup> Rather, the court held that whether a production stoppage terminates a lease depends on the facts of each case and the “compelling equitable circumstances.”<sup>98</sup> Finally, the Oklahoma Supreme Court held that temporary production stoppages for marketing benefits could not ipso facto deprive the parties of their mutually beneficial lease.<sup>99</sup>

The Oklahoma Supreme Court’s view indicates that the lessee fulfills its primary duty to the lessor when it discovers oil, gas, or other minerals. The lessee must thereafter proceed with exploration and production subject to an implied covenant to market the extracted minerals within a reasonable time and at a *reasonable price*. The maintenance of a lease despite temporary production stoppages better suits the goals of the lessor and lessee because a prudent operator, having taken the risks of drilling successfully, will seek to maximize its profit by marketing its production.<sup>100</sup> The lessee’s actions to maximize the price received for production benefit the lessor by resulting in higher royalty payments.

In *Pool*, the lessees temporarily stopped producing in order to benefit by later selling production at predicted higher prices.<sup>101</sup> The Oklahoma courts would permit the stoppage if the facts indicated that the stoppage was reasonable. Maintaining the leases in such a situation fulfills two goals. First, by maintaining the leases the Texas Supreme Court would have facilitated and endorsed the *Pool* lessees’ execution of their implied duty to market natural gas production. Second, by maintaining the leases the court would have

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95. 1994 OK 23, 869 P.2d 323.

96. *Id.* ¶ 31, 869 P.2d at 331.

97. *Id.* ¶ 9, 869 P.2d at 326-27 (citing 23 OKLA. STAT. § 2 (1971); *Stewart v. Amerada Hess Corp.*, 1979 OK 145, ¶ 10, 604 P.2d 854, 858).

98. *Id.* (quoting *Stewart*, ¶ 10, 604 P.2d at 858).

99. *See id.*

100. *See Bristol v. Colo. Oil & Gas Corp.*, 225 F.2d 894 (10th Cir. 1955) (holding that under Oklahoma law, an eight-year production delay for marketing was reasonable due to the production of impure gas and the lack of an available pipeline).

101. *Natural Gas Pipeline Co. of Am. v. Pool*, 124 S.W.3d 188, 203 (Tex. 2003) (Jefferson, J., dissenting).

enabled the lessees to maximize the price they received for production, leading to higher revenues for the lessees and higher royalty payments for the lessors. Nevertheless, the Texas Supreme Court held that the production stoppages cancelled the *Pool* leases. The *Pool* ruling paradoxically imposes upon lessees an implied duty to market the produced natural gas, yet denies them the ability to maximize revenues by waiting for favorable natural gas prices. The Texas Supreme Court's refusal to extend the temporary cessation-of-production doctrine to marketing stoppages not only leads to an absurd contradiction with the implied duty to market, but also harms both the lessors and lessees by denying them the ability to maximize their mutual lease benefits.

*B. Repudiating Constructive Repudiation*

Rather than apply the temporary cessation-of-production doctrine, the Texas Supreme Court found that the lessees had constructively repudiated their holdover tenancies and adversely possessed the leases. The majority, however, defined constructive notice of repudiation in a manner that contradicts the intentions of the contracting parties. Normally, adverse possession of a severed mineral estate cannot begin until the lessor receives actual notice of repudiation from the lessee.<sup>102</sup> Nevertheless, the *Pool* majority held that the notice of repudiation may be inferred or constructive rather than actual.<sup>103</sup> The Texas Supreme Court's circular logic means that although a hostile occupier manifesting the statutory adverse possession factors cannot claim the severed mineral estate until it gives notice of repudiation to the lessor, the Texas Supreme Court is willing to infer notice where the hostile claimant has already manifested the statutory adverse possession factors. The majority's promotion of ex post facto analysis lowers the burden on the adverse occupant by eliminating the requirement that the occupant's claim be objectively adverse to the claim of the rightful owner.

The common interpretation of oil and gas leases precludes adoption of the constructive repudiation of title. Where a hostile party produces and markets minerals while claiming a lease from the mineral owner, that party cannot claim adverse possession.<sup>104</sup> The assertion that long-continued use supports

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102. *Id.* at 194 (majority opinion) (citing *Tex-Wis Co. v. Johnson*, 534 S.W.2d 895, 899 (Tex. 1976)).

103. *Id.* Texas substantive law permits a jury to “‘infer notice of repudiation without any change in the use of the land,’ if there has been ‘long-continued use.’” *Id.* (quoting *Johnson*, 534 S.W.2d at 899). The Texas Supreme Court held that “constructive notice will be presumed where the facts show . . . that the adverse occupancy and claim of title to the land involved in this suit has been long continued, open, notorious, exclusive and inconsistent with the existence of title in the respondent.” *Id.* (quoting *Vasquez v. Meaders*, 291 S.W.2d 926, 928 (Tex. 1956)).

104. See KUNTZ, *supra* note 13, § 10.5.

sufficient notice of repudiation creates the possibility that a lessee may assert a hostile claim, even though both the lessor and the lessee have proceeded for several decades in accordance with the original lease.<sup>105</sup> Under a traditional adverse possession analysis, the lessee in that scenario could not make a hostile claim. In the *Pool* cases, the lessees paid royalties and otherwise seemed to abide by the terms of the original leases.<sup>106</sup> Thus, the Texas Supreme Court now holds that a holdover lessee need not take any overt steps to assert an adverse claim. Rather, the Texas Supreme Court will consider any operations under an oil and gas lease sufficient to create an adverse environment. The *Pool* majority's interpretation refutes the Texas Supreme Court's previous finding that, "[t]he primary object of an oil and gas lease is to 'secure development of the property for the mutual benefit of the parties.'"<sup>107</sup>

*C. Discarding Adversity to a Claim of Right*

The Texas Supreme Court manipulated notice of repudiation in a way that failed to give adequate consideration to the fact that the lessee holds a necessarily permissive claim to the mineral estate that it obtained via consideration. In an oil and gas lease, the lessor and lessee share a common goal of "mutual benefit." The lessee wins its benefit in the form of profits obtained by producing and marketing the mineral estate. For the lessor, the benefit comes in the form of royalty profits generated by exploiting the mineral estate. Contrary to the traditional notion of "mutual benefit," the majority specifically stated:

[A]n oil and gas lease contemplates that the mineral estate itself may be permanently and irrevocably depleted by removing and exhausting the minerals. An oil and gas lessee that holds over continues to physically remove and dispose of the very valuable, non-renewable minerals for its own account. Such actions are by their nature hostile to the lessor's ownership of all the minerals in place once the lease expires and the mineral estate reverts to the lessor in its entirety.<sup>108</sup>

Rather than embrace the mutual nature of the oil and gas agreement, the majority characterized the relationship as necessarily hostile.

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105. *Pool*, 124 S.W.3d at 202 (Jefferson, J., dissenting).

106. *See id.* at 197 (majority opinion).

107. *Id.* at 203 (Jefferson, J., dissenting) (quoting *Garcia v. King*, 164 S.W.2d 509, 512 (Tex. 1942)).

108. *Id.* at 195-96 (majority opinion).

Contrary to the ruling of the Texas Supreme Court, where both parties continue to believe that they have a functioning contract, the lessee can only exploit the mineral estate with the lessor's permission. In *Pool*, the majority quickly dismissed the fact that the holdover lessees continued to pay a royalty to the lessors.<sup>109</sup> That fact, however, highlights the permissive nature of the lessees' rights. By executing an oil and gas lease, the lessor grants the lessee certain rights for the mutual, agreed-upon benefit of the two parties. The nature of those rights precludes the lessee from acting as if the contract is valid while simultaneously making a hostile claim against the rightful owner of the mineral estate.

The majority's ruling leaves open an opportunity for a lessee to fraudulently conceal the termination of an oil and gas lease, and then continue to act as though the lease is still in effect without fear of legal repercussion. Often, the lessor of a fractional mineral interest resides far from the routine operations of the party called upon to exploit the mineral estate for the parties' mutual benefit. Under the law stated in *Pool*, whenever that distant lessor errs in its oversight, the lessee can safely assume that by acting as though the lease is still in effect, the lessee will maintain the lease despite its duties to the lessor under contract. Maintenance of the lease thereafter harms the rightful property owner by precluding him from renegotiating for better lease terms and a new lease bonus. Moreover, after *Pool*, the Texas Supreme Court will grant the lessee a new lease by adverse possession.

The majority, in dismissing as immaterial the fact that the "adverse" lessees paid royalties, discarded the requirement that hostile possession be adverse to or inconsistent with a claim of right. When a lessor accepts a royalty payment it accepts the primary consideration paid by the lessee in return for the right to explore and produce the mineral estate. In other words, the lessor's acceptance of the royalty payment demonstrates an existing lease. In *Pool*, the lessees resumed production after brief stoppages, drilled a replacement well, erected signs on the property, and paid ad valorem taxes.<sup>110</sup> From a lessor's perspective, the lessees exercised rights consistent with the rights they enjoyed under the leases. Rather than indicate hostility to the lessors' claims of right, the lessees acted as though the leases were still in effect and exploited the mineral estate with permission from the lessors.<sup>111</sup> The findings that the majority used to prove constructive notice of repudiation were as follows: first, the lessees remained on the property for the statutory period of time; second, the lessors did not demand the full eight-eighths payment of royalties, only the

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109. *Id.* at 197.

110. *Id.*

111. *Id.*

portion designated by the leases; and third, the lessees continued to deplete the mineral resources of the property.<sup>112</sup> The Texas Supreme Court's findings do not indicate hostility by the lessees. Instead, the findings indicate that the lessors extended permission to the lessees to holdover the tenancies to the mineral estates. By misinterpreting these facts, the *Pool* majority set the stage for the disenfranchisement of lessors.

### V. Impact

The Texas Supreme Court insisted in *Pool* that constructive repudiation of a holdover tenancy commences the running of the statute of limitations on an adverse possession claim. As a result, courts applying Texas law have focused strictly on the economic benefits accrued to lessees without giving proper weight to the equitable desires of the lessors. Subsequent decisions by both the United States District Court for the Northern District of Texas and the Texas Court of Appeals have entrenched the rule that, in Texas, a lessee need not actually repudiate the tenancy to adversely mature title to a mineral lease.

#### A. *Pace v. Chesapeake Panhandle Ltd. Partnership*

In *Pace v. Chesapeake Panhandle Ltd. Partnership*, an operator completed the Jester T-1 well in 1931 as a commercial natural gas producer within the primary terms of each of its controlling leases.<sup>113</sup> After receiving assignment of the lease in 1992, MidCon Gas Services Corp. conveyed all its right, title, and interest in the leases to a company that would eventually be named Chesapeake Panhandle Limited Partnership.<sup>114</sup> Chesapeake and its predecessors in title had paid all the applicable taxes on the mineral estate since at least 1978, and exclusively produced natural gas from the subject property since 1941.<sup>115</sup> From 1941 and continuously thereafter, Chesapeake visibly possessed the subject property at all times, and Chesapeake and its predecessors in title provided the plaintiffs and their predecessors an accounting of all gas produced on a monthly basis as a one-eighth royalty, keeping the remaining seven-eighths proceeds for themselves.<sup>116</sup>

After the lessees claimed title by adverse possession, the lessors sued on the notion that “newly discovered evidence of an intentional effort on the part of the lessees to conceal periods of non-production from the lessors” preempted

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112. *Id.* at 203 (Jefferson, J., dissenting).

113. *Pace v. Chesapeake Panhandle Ltd. P'ship*, No. Civ. A. 2:99-CV-0327-J, 2004 WL 1194453, at \*1 (N.D. Tex. May 27, 2004).

114. *Id.*

115. *Id.*

116. *Id.*

the lessees' claim that it could adversely possess the subject well.<sup>117</sup> The Texas appellate courts have long held that statutes of limitation for adverse possession subject to fraud cannot run until the victim discovers, or should have discovered, the fraud.<sup>118</sup> Nonetheless, the court bypassed any discussion of fraud and proceeded immediately to the factors that supported a finding of adverse possession of the mineral leases.<sup>119</sup> Based on *Pool*, the court declined to determine whether production stoppages terminated the leases.<sup>120</sup> Instead, the court summarily concluded that production intermittently stopped, that the leases did terminate, and that the lessees nevertheless had acquired the leases in fee simple determinable by adverse possession.<sup>121</sup> Finally, the court dismissed the fraud claims because, pursuant to *Pool*, constructive repudiation of the leases commenced claims for adverse possession.<sup>122</sup>

The *Pool* and *Pace* rulings set a disturbing precedent. Where a holdover producer continues to exploit the mineral estate, the producer may fool the lessor into believing that it continues to honor the lease. Conceivably, a holdover lessee can knowingly conceal its termination of the lease. Thereafter, so long as the lessee reestablishes production, the lessee's knowing concealment of the lease termination does not amount to misrepresentation that would constitute a fraud.

#### B. *Glover v. Union Pacific Railroad*

The Texas Court of Appeals adopted the *Pool* majority's rationale for constructive repudiation in *Glover v. Union Pacific Railroad Co.*, wherein many parties owned small fractions of a royalty interest.<sup>123</sup> In *Glover*, a lessor's heirs claimed the decedent's mineral estate by inheritance.<sup>124</sup> The

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117. *Id.* at \*2.

118. *See, e.g.*, *Glenn v. Steele*, 61 S.W.2d 810, 810 (Tex. 1933); *Carruth Mortgage Corp. v. Ford*, 630 S.W.2d 897, 900 (Tex. App. 1982); *Cartwright v. Minton*, 318 S.W.2d 449, 454 (Tex. App. 1958). The standard for discovery of fraud is the exercise of diligence as would be done by a person of ordinary care and prudence. *See, e.g.*, *Glenn*, 61 S.W.2d at 810; *Cartwright*, 318 S.W.2d at 454.

119. *Pace*, 2004 WL 1194453, at \*2.

120. *Id.*

121. *Id.* Because it declined to analyze the plaintiffs' fraud claim, the court proceeded immediately to the fulfillment of the ten year statute of limitations provided by the Texas Civil Practice and Remedies Code. *Id.* (citing TEX. CIV. PRAC. & REM. CODE ANN. § 16.026(a) (Vernon 2006)).

122. *Id.*

123. *Glover v. Union Pac. R.R. Co.*, 187 S.W.3d 201, 215 (Tex. App. 2006).

124. *Id.* at 206-07. The decedent's title arose via a 1904 deed that conveyed land next to a railroad right-of-way, although the deed did not actually describe the strip within the right-of-way where the minerals were found. *Id.*

cotenant possessors had operated wells on the strip for approximately seventy years.<sup>125</sup> The lessor's heirs argued that they alone owned the mineral estate through the initial grant and that the lessees could not adversely possess the mineral estate because they had not sufficiently repudiated the cotenancy to allow the statute of limitations to run.<sup>126</sup> The Texas Court of Appeals held that, pursuant to *Pool*, the producers had provided constructive notice of repudiation of the cotenancy by their long-continued and open mineral production.<sup>127</sup>

The *Glover* case demonstrates the practical difficulties inherent in Texas' new constructive repudiation jurisprudence. Often, lessors split their mineral interests among many heirs, some of whom live far from the drilling operations. While a fractional lessor may know that a lessee has erected drilling equipment and engages in mineral production, the lessor likely cannot discern whether the lessee's claim is hostile or permissive. Further, so long as the producer pays the royalty denominated in the original lease, the derivative lessor has no reason to think that the holdover lessee has established an adverse claim to the lease or to the mineral estate.

As *Pace* and *Glover* illustrate, the *Pool* ruling established a precedent whereby a lessee can conceal a production stoppage that would otherwise terminate the lease. Rather than let the mineral estate revert to the original lessor, who might renegotiate for a new bonus and more favorable royalty terms, the Texas Supreme Court will grant the holdover lessee a new lease by adverse possession. If the holdover lessee merely re-engages in exploiting the mineral estate, then the occupier need not apprise the rightful owner that the lease has terminated and therefore the mineral estate has reverted. Instead, Texas courts hold that continued possession of the estate by the lessee repudiates the rightful owner's claim to the mineral estate, even though many lessors never have reason to know that the lessee let the lease terminate by failing to produce.

#### VI. Conclusion

The Texas Supreme Court's errors in interpreting and applying legal doctrine deprive property owners of their rights. Because the Texas courts consider constructive repudiation the base requirement for asserting a claim of adverse possession, producers may rob property owners of the full value of their mineral estates by purposeful misrepresentations. After years of decisions that diluted the lessors' ownership rights in favor of the oil and gas

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125. *Id.* at 207 n.2.

126. *Id.* at 207.

127. *Id.* at 213-16.

industry, the Texas courts have allowed the exception to swallow the statutory rule. The Texas Supreme Court introduced a new view of adverse possession that divests the rightful property owners of their mineral estate without as much as a notice of the expulsion.<sup>128</sup> Without actual notice of adversity or termination, the rightful property owner has no reason to know that a producer can claim the adverse possession of a new lease.<sup>129</sup>

Despite the public benefits from mineral exploitation, courts should not let a producer purposely conceal the termination of a lease to withhold a mineral estate from its rightful owner. Demanding actual repudiation as a prerequisite to adverse possession of a mineral estate does not place a substantial impediment on exploitation of a mineral estate. Rather, it merely forces a producer to either abide by the terms of its lease, or to deal openly and honestly with the lessor. As long as the Texas courts continue to support constructive repudiation of a mineral lease, they will endorse opaque dealings that harm property owners. To remedy this, either the Texas Supreme Court should overrule its support of constructive repudiation in *Pool*, or the Texas legislature should take steps to protect mineral owners from disenfranchisement.

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128. *Natural Gas Pipeline Co. of Am. v. Pool*, 124 S.W.3d 188, 202 (Tex. 2003) (Jefferson, J., dissenting).

129. *Id.* at 203.