

Dean of Oil and Gas Practice Lecture Series

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Thank you everyone. I really don't know how to proceed after that. That was a very, very generous introduction. Thank you, Becky McGee. And I want to thank the Institute and the sponsors for inviting me to give this lecture.

This truly is an honor; an amazing honor for me. When I was asked to do this and I looked back to see the honorees that came before me, I was amazed. If I could be considered part of that group, part of a group that has included Judge Joe Morris or Dean Ernest Smith and so many others like them – I can't tell you how I got here. But I'm here and I'm glad to be here so we'll just move on. Just assume that I'm supposed to be here!

When I was contacted about this honor, they told me I needed to give a speech. Usually when I give a speech it's because I have a particular topic I'm asked to talk about. Well this one was up to me; the topic was up to me. So I tried to decide what it was that would be interesting and enjoyable for a luncheon but also indicate what I've been doing, why I love what I do and why I love the oil and gas business. You will find that I'm an unabashed supporter of the oil and gas business.

So I thought I might talk to you about is how I ended up in Texas practicing oil and gas law; where I came from and how I got down this path that has been, as Becky said, entirely devoted to oil, gas and energy advocacy work. First in regulatory proceedings as an advocate there, and then subsequently in litigation and in appeals. And then maybe

finish with talking about a few cases I think were significant or have created domino effects down the road over the past thirty years. I can't talk about all of them and I may pick up some you might think are strange, but they're ones I've seen how played out over time and I thought they were interesting.

I need to say that my perspective may be a little different than many who have spoken here before because my background is in domestic litigation. My work has been before the Railroad Commission and some other state regulatory agencies. Very little has been before federal agencies because obviously we don't have a great deal of federal lands in Texas. But then it's also been in litigation on the domestic side so my view point is as a practitioner, really on the ground, and what I've seen there.

So how did I get in this business? I grew up on the east coast. I grew up in New Jersey, North Carolina and Massachusetts. I was the daughter of a General Electric executive. We moved about every six years – nothing to do with the oil business. I didn't live any place where there was production. I didn't live any place where I'd see a rig out in a field anywhere. It wasn't happening there, it didn't exist. About the only oil and gas or energy discussion I would hear on a regular basis when I was growing up was about the oil embargo. I lived in Massachusetts at that time. When the oil embargo came, the price of fuel shot up. And guess what? We heated our house, a big ole house, with fuel oil. So what my mother did was go around the house turning off radiators in rooms she didn't think needed to be heated because she didn't want to pay for the fuel. Unfortunately, one of the rooms she didn't think needed to be heated was the bathroom. That made a big impression on me, but that was about it. That was my only contact with the oil business and the oil industry. There certainly wasn't anything in that which would help me down this path later on or that would guide me into the field I eventually chose.

Yet by the time I started at UT Law School in 1979 (and I think I have a classmate somewhere out here, I thought I saw him earlier), I knew I wanted to learn about oil and gas law. So I tried to ask myself why would I have been interested in this field? I was a stranger to it. Certainly didn't see it in my youth. I have decided it was a couple of things.

First, it was my grandfather. My grandfather had been a roustabout. He had been a driller, a tool pusher, and various things on rigs in the 20s, 30s, and 40s in Oklahoma. His mother was widowed when he was thirteen years old so he left school to support the family. He went to work where he could find work, which was in the oil patch. He started working on oil wells and from then on until World War II, when he stopped to build airplanes, he moved field to field to field to field drilling wells in Oklahoma and the Texas Panhandle. We would go visit my grandparents every summer and I would sit in the backyard listening to my granddad tell stories about this strange world - the oil patch - and the wildcatters and companies he had worked for.

There are two stories that my grandfather told me that remain with me today. They made a huge impression on me. One he told was that when he was drilling wells in the Panhandle of Texas. The wind would blow so hard he said it would take two men to close a wire gate. Well I would look at him and think "This is preposterous. I can't imagine such a thing". That visible image always stayed with me. It wasn't until I moved to Amarillo, shortly before I went to law school, that I realized he was right! He knew what he was talking about. That wind was blowing out there! But even more interesting, .once I started practicing law I got involved in the Railroad Commission hearings on the Panhandle Field Dispute and the White Oil Disputes. I litigated those for a number of years and it was then I realized I was litigating over some of the wells my grandfather had drilled. Life had just come around in a circle.

The second story he told that always stuck with me was when he talked about wells blowing out while he was working on them. He said there was a sound you would hear on the rig before the well starts to blow. When you hear it, you know it and you know the pipe is “fixing” to come back up the hole. So you run like hell to get as far away from it as you can. It wasn't until, once again, fairly recently I learned that my grandfather had been on the rig floor, the platform floor, when the Mary Sudik well was being drilled in the Oklahoma City Field in Oklahoma City in 1930 and blew out. It blew for 11 days. My grandfather jumped off the rig floor, ran over to a team of mules and got the hell out of there. Once again, life came back full circle. I've seen pictures of that well blowing and now know grandfather was there. So his stories might have had something, to do with telling me (at least in my heart) to study oil and gas law. It certainly put the oil and gas business in my imagination.

Secondly, I'll be very honest with you, when I was in law school, I found Scott Douglass & McConnico, the firm Scott Douglass – it may have been Scott, Douglass and Keeton at the time – or more precisely perhaps, they found me. At that time they did almost exclusively a regulatory advocacy practice and a litigation oil and gas advocacy practice. I didn't know anything about that type of a technical practice but I fell in love with it, just as quickly as I had my grandfather's stories. There's something about this business that just kept drawing me in.

One of the very first tasks I had to accomplish when I was a new lawyer at Scott Douglass, was to write a written closing statement for a big productive acreage fight just finished at the Railroad Commission. It involved the Jeffress East Vicksburg T formation or field down in South Texas. Frank Douglass, my partner, was the advocate on behalf of our client at that hearing and Bob McGinnis, with McGinnis Lochridge, was the advocate

for the other side. Those of you who knew these men or know about Railroad Commission practice know they were giants. Giants were doing this.

I did not attend the hearing, but I had the transcript. I have to tell you, as a brand new lawyer, reading a transcript made by those two advocates was like reading a novel. It was so easy to follow their arguments. What was difficult for me, however, in thinking about drafting this closing statement, was trying to figure out what was the importance of the science being presented because this was a very technical fight. We had logs and maps and engineering calculations. I really couldn't figure out what I was supposed to pull out to highlight and what its significance would be.

So the first thing I did, as the young lawyer, was to go see the consulting or the testifying expert that our side had used in this case. I asked him to explain to me what this science was all about. What are you talking about? Why is this all important? What was I going to do to make sense of it when I didn't understand the significance of what they were arguing about? I learned about geopressured reservoirs. I learned about the Hammerlindal effect. I learned about the mechanics of drilling and production, because remember I'd never even seen a rig at that point. I started learning about logs and to understanding structure maps and isopach maps. It was just a beginning, but this is where I started and I learned a very valuable lesson: use your experts. Have them inform you, teach you. They can tell you an awful lot. From then on I always made it a habit of finding the best experts I could and then have them educate me. I used to tell them, if you can explain it so that I can understand it, I can explain it to a jury. There's no question that in my practice, in a sort of technical practice, my experts have been lifeline for me.

Well I did that sort of technical regulatory practice starting 1982 until 1986. It won't

surprise some of you who have done regulatory practice at least in Texas: back then we did trial by ambush, not trial by discovery. You talk about a great training route for a new advocate! You learn to think on your feet. You might not see your witness until he came in the night before the hearing, that's when you met them. And let me tell you, they would come in off the field, walk in and see me (a new female attorney) for the first time and think "Oh my god I can't believe this". But fortunately for me (and I've been very fortunate, I didn't get here by myself), they trusted Frank Douglass and Frank Douglass trusted me. He said "you guys use her, you won't be sorry". So we got over those little bumps; it only took one or two times and then we were on our way.

But we wouldn't really get together until the night before the hearing on most of these hearings. We would have prepared some exhibits ahead of time, we would have talked on the phone, but this is when we sat down to prep on these technical hearings. Then we'd go over the hearing. We had no discovery. We hadn't taken depositions. We hadn't seen the other side's case. If we were the opponents, let's say Tim was the applicant, my job was to time this hearing as best I could. I wanted Tim to put on all of his case and get it all on before noon or, if it was a longer case, all on before dinner time, before we broke. Because then I could take it back, if it was at noon, I could take all those exhibits back, work with the expert and prepare the cross over lunch and come back ready to cross.

That's the way we did the practice. And it was fun, wasn't it? It was a great way to practice law. And it was a great way to learn. At some point I moved from the regulatory practice to courthouse. That really occurred at the end of the big Panhandle Field Rules hearings that I was involved in, once again with Tim. He and I headed up the geologic team for the gas operators in this fight with oil operators about what the field rules should

be in the Panhandle.

For those of you who are not familiar with that, in the Panhandle Field in the past, ownership of gas rights had separated from oil rights. So you had people owning the gas rights who could drill gas wells and people owning oil rights who could drill oil wells. Gas could be drilled one well per six hundred forty acres. Oil fields could be drilled on forty or eighty acres, I don't remember exactly, but a lot shorter spacing. Sometime in the late 1970s, the oil production suddenly picked up (70's, 80's) suddenly picked up in the Panhandle Field. Everybody started getting into the business of drilling oil wells. I'm talking about everybody. We had dentists and doctors and car salesmen and whatever. And they weren't investors, they were in fact the drillers. How did they do that? They hired a drilling company, probably the same one, and that drilling contractor would say "well you need to take a lease and you need to drill right here and you need to drill down to so many feet. You need to perforate this location". There were no engineers involved, there were no geologists involved, there were no maps involved. And they never drilled a dry hole.

I took a deposition of one of those drillers once and asked "did your mother ever tell you that if it's too good to be true, it's not true?" In reality, many of these "oil wells" were drilled into the gas zone of a producing gas well. The oil wells were ringed around the existing gas wells. They were producing the gas at the pipe, running it through an LTX, or low temperature extraction unit, at the surface, chilling it to drop out liquids that looked very much like that glass of water right there, and they were reporting it as oil. Well that started the fight in the Panhandle Fields. It went on for a long time, from Railroad Commission proceedings over what is "oil" and what is "gas" and ultimately through the Panhandle Field Rules hearings Tim and I participated in. The fight then went to White

Oil litigation at the courthouse and that is what moved me over to courtroom litigation. I never really went back to the Railroad Commission. I don't think they'd let me go back to Railroad Commission practice now. It has changed too much.

I've been doing some form of litigation or appellate work, since then. What I really love about this practice is I don't know where it's going to take me. I've touched, dabbled in litigation in just about anything having to do with the oil and gas business, with perhaps the exception of personal injury. I am not competent to do personal injury work. I just never know what path it's going to take me down. If you are a young lawyers and you don't know what path you're going to end up on, stick with this because it can take you anywhere. One of the places it took me – well one of the examples is, right now today, the difference between conventional production and unconventional production. We are going in new and different directions. Not just because of the science of it, but how it affects permitting, legal rights, ownership, rule of capture, all sorts of things. So you never know where you're going to head in this business.

Another unusual path I got onto was representing, with Frank Douglass, the State of Utah in a land exchange with the federal government involving 225,000 acres of state "in-holding" lands lying within federal parks, federal forests, or Indian reservations in Utah. We were asked to help Utah get a valuation of the lands to be exchanged. The potential exchange was authorized under a special act of Congress, which provided a means to litigate, between equal sovereigns, the value of the property being exchanged.

Based on exploration and production at that time the mineral value in those lands probably was not going to be the big horse. Instead, a good deal of the value was going to be what was called "natural land values". There was a big controversy brewing at the

time over whether an appraiser could assign any value to that. In reality the lands involved had natural arches and other unique geologic or historic attributes. In fact if any of you have been to Arches National Park or seen the federal government's brochure, the arch that used to advertise the park was in fact located on state in-holding lands. It obviously had value. So while I was up there to work on minerals and mineral valuation, something that I knew something about, I ended up spending most of my time working with anthropologists, archeologists, and paleontologists, to identify and catalogue, Anasazi age Indian artifacts, dinosaur bones, petroglyphs, those sorts of thing; and working with appraisers to determine how these could be valued. You talk about a dream job. I never thought I would be doing that; it was great fun. It worked out well because Utah did eventually exchange its in-holdings for a value both sides agreed on, and that exchange helped fund a permanent school fund for Utah, similar to what Texas has. That's something I wouldn't have dreamed of when I started on the project. You never know where the path is going to take you.

So, what changes have I seen? Well obviously one that's right here in the room: how many women we have here. When I started doing this there were not very many women doing a technical, first chair, oil and gas advocacy practice. I think in Texas we could probably have named on 10 fingers or less how many people were doing it. But that's grown.

In 1998 when I became chair of the Oil, Gas, and Mineral Law Section I was the first female chair. That date is important to me. We had more women, many more women, in the field by then, but still not enough. And in 1998, it's important not because I became the chair, but it was the first female or woman chair of the section. And why is that significant? The Oil, Gas, and Mineral Law Section predates the State Bar of Texas. But

it wasn't until 1998 we had enough women in the chain to start moving up the chain. To be elected to the section counsel and to move up the ladder to eventually become chair. Since then there have been other women besides me to take the chair. I was just was the start. There are more women in the section now than ever before. And now, today, I'm going to tell you what every one of you sitting in this room already knows. We have women in every single phase of the oil and gas business and the law work that goes with it. That's great. If I can go back one more time and talk about my partner Frank Douglass, he always said he wanted to plug into the "old girl" network. He said the "girls" – he called us girls and it didn't offend me – "you're going to raise the level of the game". I thank him for letting me do that and helping me do it. And I think all of you women in the field today are going to keep raising the level of the game.

So, besides the make-up of the oil and gas bar, what else has made the law practice interesting in the past or that takes us to where we are right now? There are too many cases or issues to talk about in any detail, but a few are particularly interesting to me. I'm going to take you back to when I first started practicing. One of the legal events I think is very interesting and certainly had a domino effect – just like you push one domino down and they all start to fall – is the effectiveness of take or pay contracts to increase the drilling and production of reserves in the 1980s. If you remember, we had an oil embargo, then we had more demand for production in the '70s than we had production and we were living in a world where the pipelines were basically the only game in town. They would buy at the well, they would sell to the end users and they would transport it. Pipelines found themselves in the situation where they didn't have enough in the pipeline to satisfy their end customer needs. So they entered into take or pay contracts with operators, dedicating acreage to it as incentive for those operators to spend the money to drill and

add reserves because they would have a market for this production. This was a good thing.

It was such a good thing it almost took the pipelines down. In fact, wells started being drilled and production started increasing. Add to that in the 1980s we had the unbundling of pipeline services, so now they suddenly found themselves in competition with others who could buy at the well, transport it someplace else, or just pay for transportation through the pipeline and sell to the end user. Now pipelines found themselves in a real fix. Most of you know more about this than I do. Most of you were probably far more involved in settling take or pay litigation or claims than I was, certainly in Washington. They wrapped up a lot of it. They got a lot of it settled early.

But Tennessee Gas Pipeline had a little, old take or pay contract, down in South Texas, they had entered into in 1979 dedicating acreage to it with the requirement that Tennessee take or pay for a certain percentage of production every month. The contract had a two factor escalation price clause that escalated every single month. It was a 20 year contract. For the first 15 years, there was very little production from the field. There wasn't much drilling going on. Tennessee didn't worry about that contract, did not wrap it up when they settled their other take or pay contracts.

Then in the last four or five years of the contract, the deep, Vicksburg sands were discovered in the Bob West Field on dedicated acreage. And by golly, they started drilling, and drilling picked up on a very quick basis. So now, Tennessee ended up with a take or pay contract, with a contract price that was multiple times market price, and a lot of production now dedicated to it. Tennessee Gas didn't want to take the gas. I don't blame them, I wouldn't have wanted to take it either. So what happens? We'd had some

litigation about take or pay cases in Texas. We had one pipeline – I think it was in the *Kodiak* case – that had tried to get out of a take or pay obligation by claiming commercial or economic impracticability. The court rejected that defense. You entered into a contract, you're stuck with the contract.

Tennessee tried a different tact. Tennessee's argued the take or pay contract was an output contract under the UCC. UCC places good faith obligations on output contracts to prevent seller from arbitrarily or excessively increasing the amount of output in bad faith. That was one of their defenses. That one went to the Supreme Court. Now some of you may be scratching your heads because the whole purpose of the take or pay contract when it was entered into was to drill, to create incentives for the producer to increase production. The Supreme Court eventually agreed: that, in fact, the UCC may have include faith obligations but they are "gap fillers"; they do not override the terms of the contract. The purpose of the contract was to increase production. The UCC good faith requirement did not prevent operators from drilling additional wells to increase production under the contract even if it was at the end of the contract.

But here's where the domino effect kicks in. What happened next? Well, when you produce, you pay royalty on what you produce. What royalty do you pay under a high price gas contract that is multiples over market value at the time? Contract price is at \$10.00; \$1.00 is about where the market price is. Some of those leases on which royalty was due, were market value leases. What's market value? Well, if we fall back to what we knew was the law at the time – *TXO vs. Vela*; *Exxon vs. Middleton* – market value is what a willing buyer not obligated to buy, and a willing seller not obligated to sell agree on. And comparable sales are comparable in time, quality, quantity and availability of marketing outlet. Market value is measured at the time it comes out of the ground and was tendered

for sale, not when the contract was entered into.

In *Vela*, the royalty owners prevailed on a long term gas contract claim that they were entitled to be paid royalty on market value, which was higher than the contract price under a long term dedicated contract. The Tennessee case became the “reverse *Vela*” case. When the contract price is higher than the market price but royalty is to be paid on market value, royalty must be based on market value not the higher, non-market price operating is receiving. So we had a whole series of cases and litigation over royalty, market value and duties owed. It was one of those dominoes that just kept falling. When one case establishes a legal precedent, how will it apply further down the road under different facts?

So, that’s one of the “domino” effects I think has been interesting in the practice. Another one is what to do with *NationsBank vs. Heritage*, where the court is saying that if you pay market value at the well, but the gas is sold elsewhere and there are no comparable sales at the well, then to value at the well you net back from a market price at the point of sale to get a wellhead value. But what if the lease has a “no deductions” clause that prohibits the deduction of costs from the royalty interest? How do you net back to the well? Well certainly the royalty owner says “I put that ‘no deduction’ clause in there because I meant it”. And you have the operator saying “well, you may have meant that, but you told me I was supposed to pay royalty based upon market value at the well. I’ve got to get the value at the well. I’ve got to net back my costs from the point of sale”. So we have the court telling us “you net back costs. Royalty clause controls, you net back costs. Ignore that other language in the lease as surplusage”. How many of you, you don’t have to raise your hand, but how many of you look at your operator clients with a straight face and say “you know guys, just ignore that language, don’t worry about it. You may

have six years of litigation to get back up to the Supreme Court with it, but don't worry about it. You're going to win." Yet that's the law; that's where we are now.

Okay, moving along because I'm going to take up too much time. I want to talk about where we're headed. What are we going to do with where we are now? Conventional vs. nonconventional production. I heard a great presentation this morning about that. This is going to change what we're doing. We are a situation where science has outstripped law. And law is going to have to catch up with science. Where do we see this happening? We see it right now on the ground. We see right now with the ownership issues that come with horizontal wells: the shale play, the fracking. What about trespass by subsurface fracture? We have the *Manziel* case that tells us waterflooding under a Railroad Commission permit and secondary recovery unit cannot be enjoined as a trespass. But it doesn't tell us whether or not there's a cause of action for damages.

We have the *Coastal vs. Garza* case where the Court has held there is no a cause of action for trespass when the damage that is being claimed is drainage by subsurface fracturing of a legal well. When the drainage is to a legal well, the rule of capture covers it. Now that's a more complicated case than I've just said, but that's basically the big picture. But it's because the lessors who sued for drainage had to prove actual damage and the only damages that they sought were damages for drainage to a legal well.

We have another case pending right now which is a waste water injection claim where there is a claim for trespass damages to the owner of the offset caused by the wastewater. This is not a rule of capture issue. The Supreme Court is going to have to look again at subsurface trespass issues here.

We also have other rule of capture issues on horizontal wells. *Browning vs.*

Luecke, a Court of Appeals decision. The Supreme Court didn't take the petition. In *Browning* the lessor, in what we would normally call the drillsite surface location (where the well comes to the surface for a long horizontal well that's been drilled on a pooled unit), complained her acreage was not properly pooled because her lease did not include pooling authority. While some of the "take points" (points where the horizontal pipe is perforated in the formation) were on the drillsite tract, most were located further along the horizontal well. The drillsite owner claimed "I am not pooled so I'm entitled, under the rule of capture, to everything that comes out of that well at the surface" – traditional rule of capture analysis. The Court of Appeals, however, tells us no, the traditional rule of capture does not apply to horizontal wells because it hasn't kept up with the science of drilling today. Instead damages are based on what amount of production from the horizontal well can be determined with reasonable certainty to have come from plaintiff's tract. How do we make those determinations? Well, that's where we are right now.

We are going to have to deal with other ownership issues, rule of capture, technical issues, and permitting issues as our science moves on beyond our common law. So let me just sort of wrap this up in summary. I don't want to take too long. These changes that I've talked about have resulted in litigation both to distinguish facts, and to litigate changes made in contracts as a result of law, because royalty owners haven't sat silent. They're rewriting their leases to solve some of these problems. The advent of horizontal drilling and big fracing has opened up these large plays and the conflicts we're going to deal with in the future are going to continue to be new conflicts. I think that this unconventional development will pull all energy lawyers into the fray. I don't care whether you are in an office practice, an environmental practice, a regulatory practice, a litigator, or whether you represent lessors or lessees. It is going to pull you all into trying to see

where we go now with our law and our regulatory rules. You can see that happening on the East coast right now.

This is an exciting time to be an energy lawyer in this country. You can see it on the face of the people who are doing it now, and the young people who are going to be doing it now. I teach at UT Law School and I have a class of people who are so interested in oil and gas law it blows me away. They want to do this type of practice and they want to do all phases of it. Some want to get into financing. They come with business backgrounds and they want to get into the financing side, they want to bring oil and gas expertise to deal making and financing and banking. Some want to be landmen, some want to be in-house, but they want to be part of this. They love it. You will see them coming out interested in this field, far more than any of us were when I was in law school. We just went to class. They are excited about it.

In closing, the oil, gas and energy business is a fascinating business. It has always been a fascinating business to me and it always will be. It is populated with people who are not afraid to take risks, the risks required to succeed. Unfortunately with the blow out in the Gulf and the blow out in the 24/7 news coverage we had on it, society has gotten the idea that taking risks is inherently bad. It's a bad connotation. And it's not. It is a necessary part of the business we're in. Whether you're financing the deal, you're drilling the deal, whatever you're doing. I'm not talking about careless risks, or negligent risk; I'm just talking about the risk of the business.

As I tell my law students: I don't care how much science we have today, you still are not going to know what you're going to get until you pay the money, sink the well, and see what you've got. You are taking that risk whether you're the driller, the financier,

whatever. Those are necessary risks. It takes nerve, it takes stamina, it takes a willingness to roll the dice. How can you not love practicing law in this business? It is a delight. Thank you very much.