

OG ENERGY EDUCATION SERIES



OLIVA
GIBBS LLP

NAVIGATING THE CROSSROADS:

EVOLVING SURFACE USE ISSUES
AND INNOVATIVE SOLUTIONS

WEDNESDAY, SEPTEMBER 13, 2023

12:00 PM TO 1:00 PM CT



Speaker:

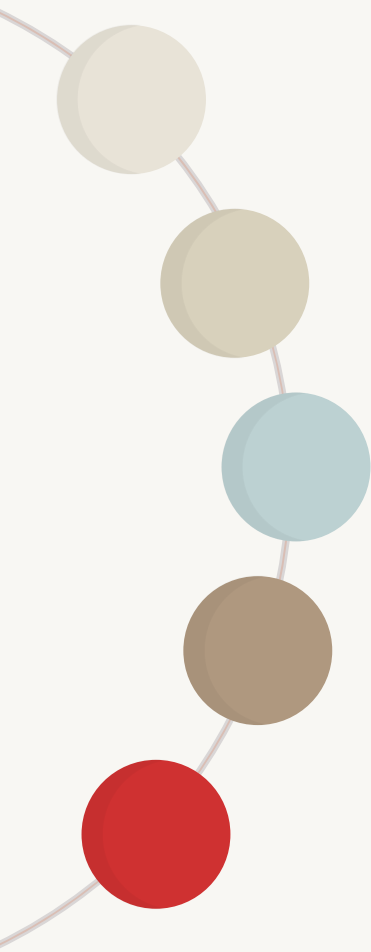
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Overview

- 
- I. Introduction
 - II. Mineral Severances
 - III. Dominant Estate Theory
 - IV. Accommodation Doctrine
 - V. Midway Solar
 - VI. Accommodation Agreements, Waivers, & Tex. Qualified Sub. Statute
 - VII. Best Practices

I. Introduction



Introduction

- ❖ The development of renewable energy sources
- ❖ The implication of the oil and gas industry
- ❖ Applicability
 - Accommodation Doctrine
 - Dominant vs. Servient Estates
 - Executive Right Holders
 - Title Insurance Policies

II. Mineral Severances



Mineral Severances

- ❖ Ownership rights in a tract of land are often split between the surface estate and the mineral estate.
- ❖ An owner of both the surface estate and the mineral estate can sell, convey, or partially convey the rights to either the surface or the mineral estate.
- ❖ Selling one but not the other creates a mineral severance.

Ownership Rights – Bundles of Fun

Surface Estate Owner	Mineral Estate Owner	Executive Right Holder
❖ The right to use and enjoy the surface, except for any surface rights that belong to the mineral owner	❖ Royalty ❖ Bonus ❖ Delay rentals ❖ Executive Right ❖ Has the right to develop minerals (developmental right), including the right of ingress and egress	❖ The right to lease ❖ Often considered “fused” with the developmental right (but not always)



III. Dominant Estate Theory



Dominant Estate Theory

- ❖ Under the dominant estate theory, when a mineral estate is severed from the surface estate, the mineral estate is considered the **dominant** estate, and the surface estate is considered the **servient** estate.
- ❖ Effectively, this means a mineral estate owner may make reasonable use of the surface to develop their mineral acreage without being liable for trespass.
- ❖ ***Midway Solar Preview***: A 1948 mineral deed gave mineral owners the right to use as much of the surface as was “usual, necessary, or convenient.” Does this implicate vertical drilling? Horizontal drilling?

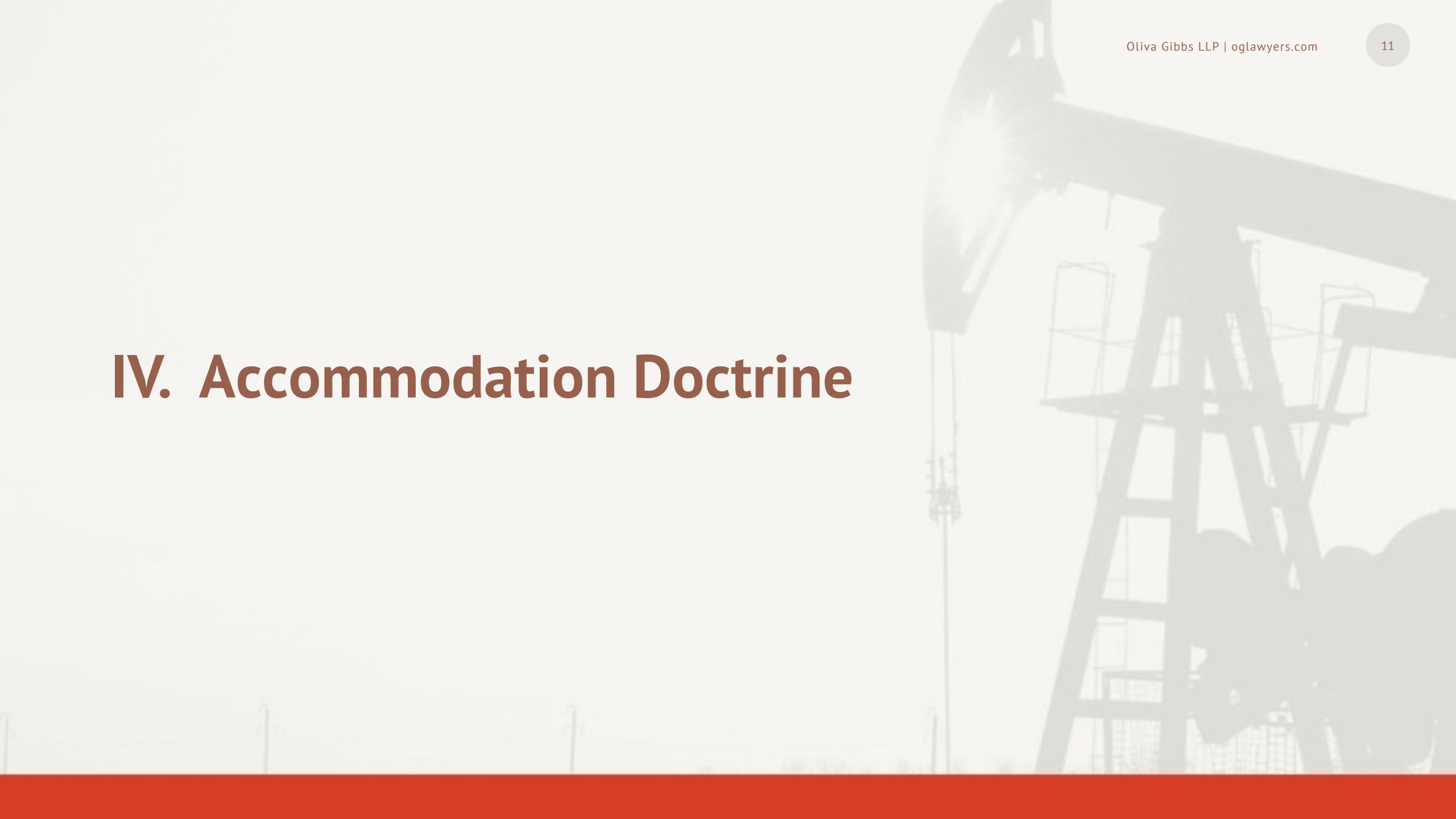
But what is considered reasonable?

What is Considered “Reasonable”?

- ❖ **Reasonable use** generally includes geophysical exploration, drilling, building roads, installing machinery, and storage tanks, etc.
 - There is a general duty to act as a “reasonable prudent operator”
- ❖ But is this really everything? Is the dominant estate all powerful?



IV. Accommodation Doctrine



Getty Oil Co. v. Jones (1971)

Facts: Getty installed a pump jack to produce oil from the lessor's land. The pump jack, which extended to a height of 17 feet, interfered with Jones' irrigation operations

Held: The court found that Getty had reasonable, low-cost alternatives to the pump jack

Getty Oil Rule: If the proposed use of the surface by the mineral owner will substantially impair *existing* surface uses AND the mineral owner has reasonable alternatives available, the mineral owner MAY have to accommodate the surface owner



Current Analysis of the Accommodation Doctrine

1. Surface owner has an existing use
2. The proposed use by the mineral owner completely precludes or substantially impairs the surface owner's existing use
3. The surface owner has no reasonable alternatives
4. The mineral owner has "alternative, reasonable, customary, and industry-accepted methods available" to develop the minerals



Note: *The Accommodation Doctrine may strengthen over time or after a surface facility or use is in existence for a while*

Question: When does a surface use become an “existing use”?

1. This question has never been resolved by the courts
2. Remember – there must also be “no reasonable alternative to the surface use”
3. As mentioned, the Accommodation Doctrine strengthens over time, but it is unclear *how much* time
4. Fact-intensive inquiry
5. It seems clear that the accommodation doctrine is more of a shield than a sword



V. Lyle v. Midway Solar, LLC



V. *Lyle v. Midway Solar, LLC* (1)



Facts:

- ❖ A renewable company constructed a solar facility which covered 70% of the 315-acre surface estate
- ❖ O&G had **never** been produced on this tract (complete dead zone)
- ❖ Plaintiffs sued based on breach of a 1948 mineral deed, trespass, the accommodation doctrine and quiet title (adjacent surface waivers)
- ❖ Monetary damages and removal

Lyle v. Midway Solar, LLC (2)

- ❖ Aerial photo of the solar farm
- ❖ Note the areas at both ends of the solar farm for O&G
- ❖ No room for drilling at the center of the solar facility



Lyle v. Midway Solar, LLC (3)

❖ Plaintiff's Argument

- Plaintiffs claimed their ability to develop their mineral estate had been impaired by the construction of the solar facility.
- Accommodation Doctrine should allow them to prevent any surface use that may one day interfere with extraction of their minerals.

❖ Defendant's Argument

- ME owners have never once tried to develop their mineral estate; why bring this now? Damages are speculative.
- In addition, we did leave land available for O&G development.

Lyle v. Midway Solar, LLC (4)

The El Paso Court of Appeals:

- ❖ Until the Lyles seek to develop their minerals, Midway owes no duty to the Lyles respecting the surface usage
- ❖ Theory of the dominant estate is not absolute
 - *Q: Is there some kind of affirmative action required to protect your dominance?*
- ❖ The ME owner cannot have the unilateral right to dictate the use of the surface
- ❖ The Accommodation Doctrine *does* apply. Punt?



Lyle v. Midway Solar, LLC – On Appeal (5)

- ❖ **At issue:** whether Petitioners' various claims are ripe (use it or lose it?)
- ❖ **At issue:** whether the accommodation doctrine is independently worthy of review
 - No consultation with mineral owners on drill site locations (unilateral)
 - No geological analysis
 - Drillsite too small, obstructed. Vertical drilling is most feasible due to geology and location of historical trendline for development
 - Catch-22: can't develop their minerals because the minerals can't be developed! Also, no "due regard" for mineral owners.



* *Petition to review denied on November 19, 2021, and rehearing again denied on April 1, 2022.*

* *Framework for analysis. Avoid by reaching agreement beforehand.*

VI. Accommodation Agreements, Waivers, & Tex. Qualified Sub. Statute

Surface Waiver / Accommodation Agreements

- ❖ **Surface Waiver** – voluntary agreement between the surface estate owner and the mineral estate owners that governs the relationship between the parties. Usually broader than an accommodation agreement.
- ❖ **Accommodation Agreement** – may include drill pad size and location, shared use of roads, notice of operation provisions, consents to assign, etc.
 - Easements for gathering pipelines, tank batteries, etc. may need to be taken into account.
- ❖ Both prevents ME owners from interfering with the operations on the surface
 - Would prevent the ME owner from asserting their rights under the accommodation doctrine.
- ❖ Will likely require a payment of some form to secure the agreement
- ❖ Operators are under **NO** obligation to sign either

Black Stone & Longroad Deal - The Rise of “Blanket Accommodation?”

- ❖ In mid-July 2023, Black Stone Minerals, L.P. announced a multi-year deal with Longroad Energy (a renewable developer) for exclusive access to several thousand acres across 12 states for potential large-scale solar development
- ❖ Preserves Blackstone’s ability to develop the minerals
- ❖ Allows the parties to “transact efficiently and repeatedly”
- ❖ Is this the future of renewable development with large institutional mineral investors?
 - Locks in solar development revenue for the mineral owner
 - Possibly anti-competitive?



Waivers and Accommodations – Who Needs to Sign?

- ❖ **Types of owners:** Mineral, NEMI, NPRI, Lessees, Mortgagees (extinguished by foreclosure)?
- ❖ **Duties of an Executive Rights Holder:** An Executive Right Holder owes a duty of utmost good faith and fair dealing (UGFAFD) to non-executive right holders.
 - Not a fiduciary duty, but no “self-dealing”
 - Applies to NPRIs and NEMIs
 - Would waiving a mineral owner’s rights and pocketing the money be a potential breach?
 - Best practice would be to have NEMIs also execute a waiver, but possibly NPRIs as well?

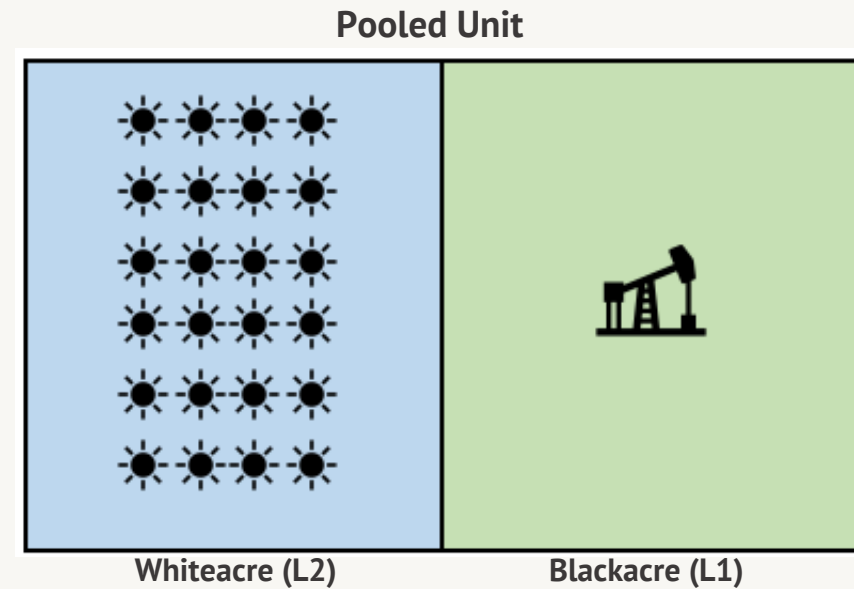
Waivers and Accommodations – Who Needs to Sign? (Continued)

❖ **Duties of a Lessee to a Lessor:** None other than to act as a Reasonable Prudent Operator (RPO)

- So, if the minerals are under lease, do you only need to get the signature of the lessee?
- May depend on the circumstances
- A lease creates a **fee simple determinable** with a **possibility of reverter**

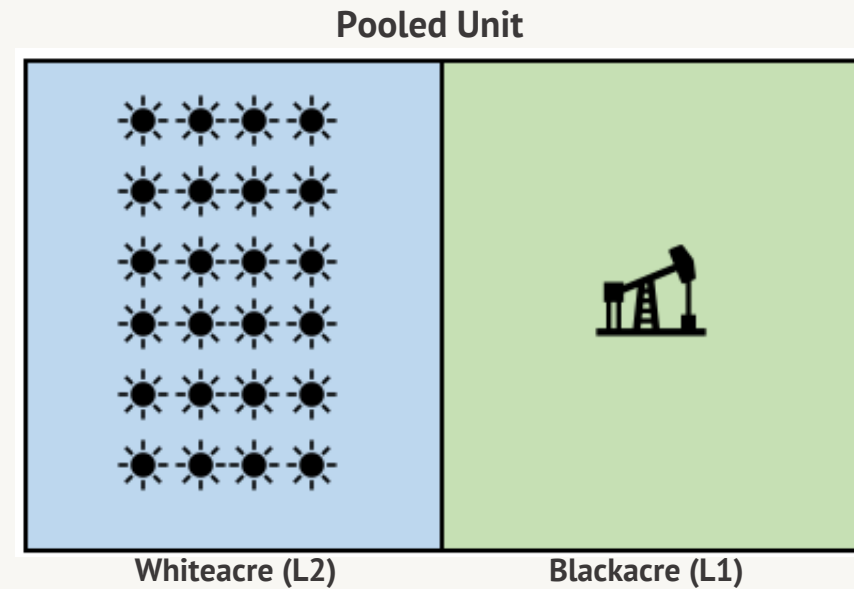
Who needs to sign? - Hypothetical

- ❖ Operator “O” has 100% of the working interest under Blackacre (L1) and Whiteacre (L2).
- ❖ The two leases/tracts are pooled, and a single marginal well has been producing for many years. It is possible that the well is going to stop producing entirely and the leases will be lost within the next year.
- ❖ O has no plans to drill additional wells to maintain its lease. This is a high-cost tight shale designated area, but there is some permitting activity for horizontal gas wells nearby.



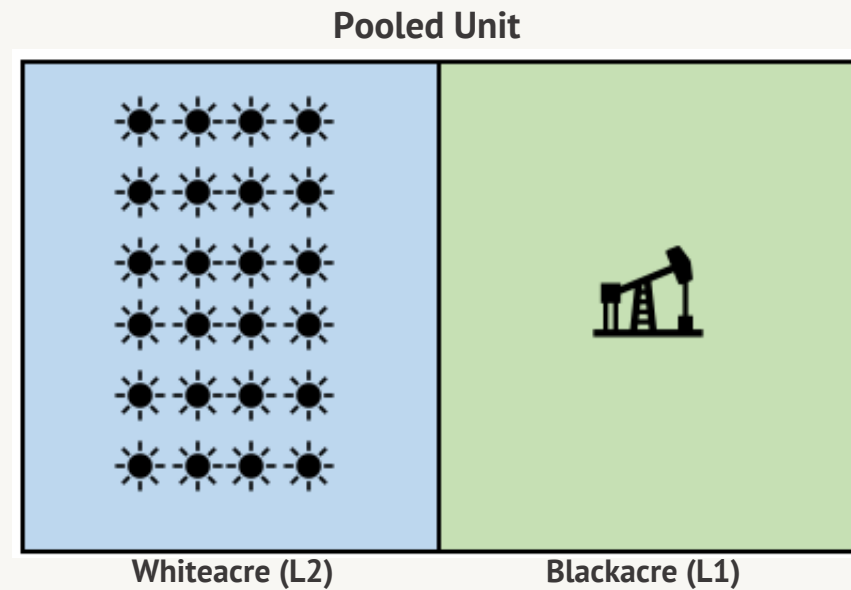
Who needs to sign? - Hypothetical

- ❖ Solar Developer “SD” obtains an option to lease Whiteacre, runs title, and discovers that O has a lease on the minerals.
- ❖ SD has an option to lease the surface of Whiteacre, and approaches O to negotiate an accommodation agreement covering the area of interest (AOI) for its proposed solar facility.
- ❖ SD does not approach the mineral owners, believing that obtaining a waiver/accommodation from the lessee only is sufficient.



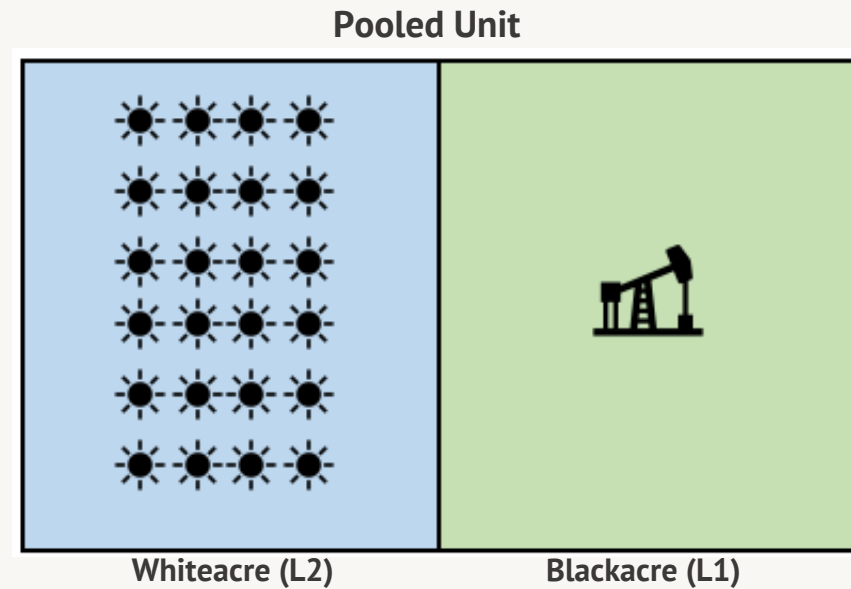
Who needs to sign?

1. Should SD developer obtain accommodation agreements from both the mineral owner and its lessee?
2. What duty runs from O to the mineral owner?
3. What duty runs from SD to the mineral owner?
4. What standing/remedies might the mineral owner have?
5. What incentive does O have to negotiate a fair agreement (taking into account the fact that these waivers or accommodations may very well outlive an oil and gas lease)?
6. Does it matter whether the lease is in the primary term, near its end, or in the middle of a robust development program (life-cycle argument)?
7. Could there be a difference if development or permitting activity in the area is horizontal or vertical?



Who needs to sign? - Hypothetical

- ❖ The most likely outcome is that the dispute would be between the Solar Developer and the Mineral Owner (*Lyle*)
- ❖ However, best practice for a Lessee and Solar Developer may be to have the mineral owner sign off along with the Lessee
 - Probably more important if it is a primary term lease that may **never be drilled** or a producing lease/unit that is **near the end of its life** with no future development plans.
 - In other words, the **mineral owner's standing may increase** depending on how remote the possibility of reverter may be. Otherwise, the lease conveys a fee simple determinable and arguably the lessee has the right to do whatever they want.



Who needs to sign? – Lessee Liability

1. Holding a Lessee liable seems to be a remote possibility, but it is possible that a mineral owner could argue that a lessee waiving surface rights for a solar facility for its own benefit **exceeds authority under the lease** and is not an act of an **RPO**.
 - Possible there could be a cause of action for failure to act as a reasonable prudent operator because O pockets the money and building a solar facility has nothing to do with developing the minerals.
2. There is also an argument that the accommodation agreement only curtails the *Lessees* rights and **will not survive the lease**. Not the Lessee's problem!
3. Note that if the facility has been *already been built* you get into an accommodation doctrine analysis.
 - If the surface owner has signed off and the facility has been there a while, the AD offers more protection (AD offers more protection as time passes).

Who needs to sign? – Lessee Liability

1. If there is a **good faith negotiation** and the accommodation agreement is truly fair and based on some assessment of development in the area, then the mineral owners may have less standing
2. There is an argument that O only signed the accommodation agreement to squeeze a little more value out of the prospect and there was no true negotiation based on the possibility of future development.
3. Unjust enrichment? Money had and received? Conversion? Breach of contract/duty? Removal of all or a portion of your facility?

TX Qualified Subdivision Statute (TNRC 92.001-.007)

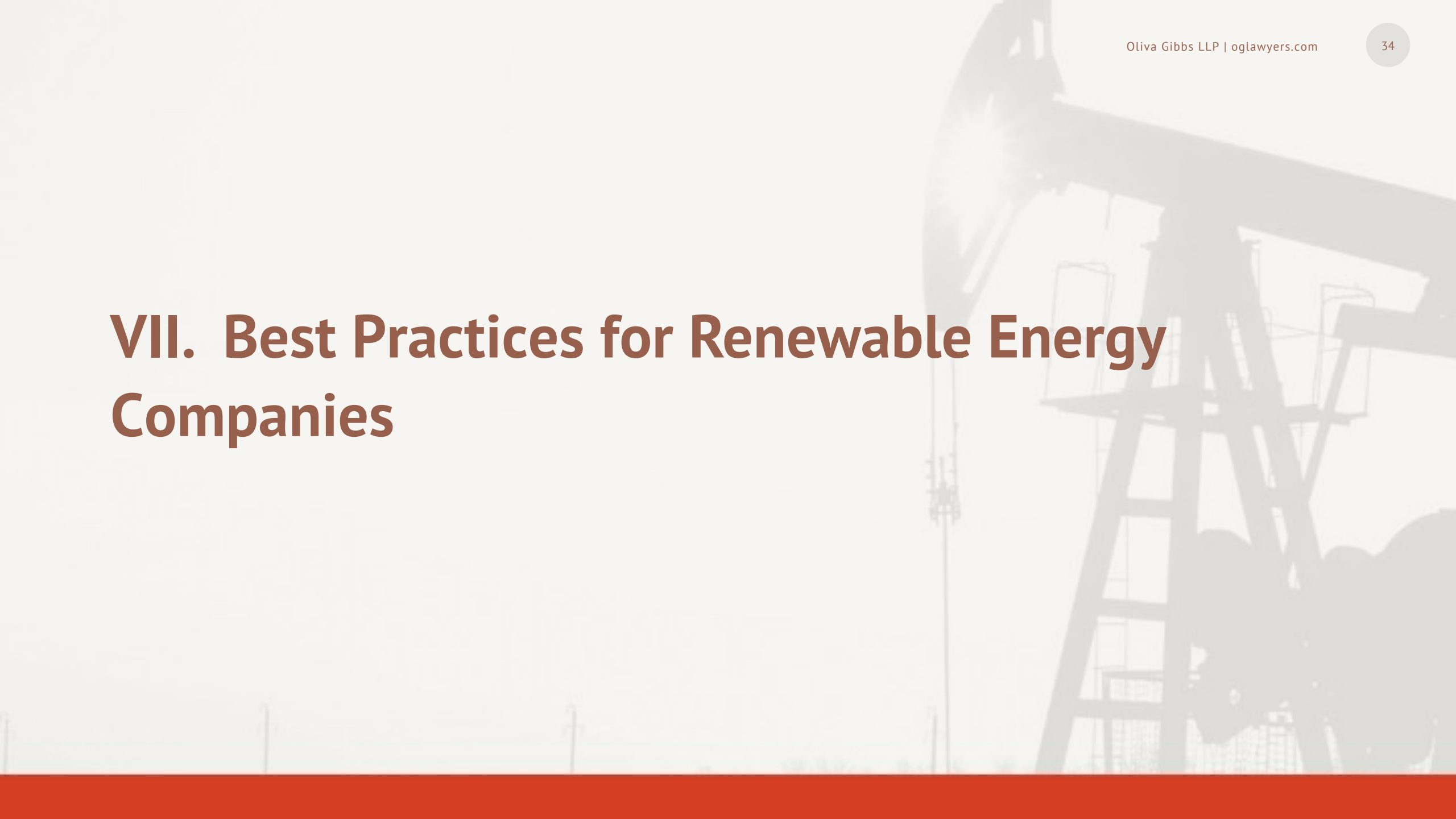
- ❖ The QSS is an exception to the common law Accommodation Doctrine.
 - It provides a procedure for owners of the surface estate to limit mineral owners' use of the surface based on the surface's future development, delegating administration to the RRC.
 - A QS is created by filing a plat for approval with the RRC and in the county.
 - The QSS states that (i) a single tract can't be greater than 640 acres, (ii) it has to be in a county of at least 400,000 residents or in an adjacent county of at least 140,000, (iii) it has to be for residential, commercial, or industrial use, and (iv) there has to be a designated 2-acre (at least) drillsite for every 80 acres and allowances for road and pipeline easements.
 - The RRC will then have a hearing to consider "the adequacy of the operations sites and road and pipeline easements."
 - Note that the 140,000-residency requirement limits you to ~35 of the 255 counties in Texas.

TX Qualified Subdivision Statute (TNRC 92.001-.007)

❖ *SWEPI LP v. R.R. Comm'n of Tex. & Hidalgo County*

- Case interpreting the QSS
- SWEPI (i) took issue with the fact that the RRC had allowed two contiguous tracts to be developed for a landfill and (ii) argued that a landfill was not an “industrial” use within the meaning of the QSS.
- SWEPI lost on both counts.
- The court notes that the statute is intended to maximize both surface use and mineral use in population dense areas.
- It is not too much of a stretch to imagine a solar facility being an industrial use within the meaning of the statute. Otherwise, Texas has very little in the way of mineral “condemnation” outside the accommodation doctrine.

VII. Best Practices for Renewable Energy Companies



Best Practices for Renewable Energy Companies

- ❖ Construct renewable projects on low value acreage where no O&G has been discovered
- ❖ Create **agreed-upon** drilling areas/islands within the projects in the event O&G is discovered
- ❖ Pursue surface waiver or accommodation agreements and limit the number of drilling islands
- ❖ Avoid tracts that have multiple severed mineral interests (difficult in Texas)
- ❖ If you have already built your facility, remember - reliance on the accommodation doctrine improves over time



Putting It All Together

❖ Avoid Triggering Accommodation Doctrine Issues By:

- Obtaining a surface waiver or accommodation agreement;
- Build solar (and to a lesser extent wind) facilities in areas that have not seen much O&G development; and
- Review past production, regulatory spacing (Rule 37, 38, 86)

Putting It All Together (Continued)

❖ Additional Considerations

- ME owners are under no obligation to sign a surface use agreement; may require financial compensation.

❖ Best Practice

- Obtain surface waiver agreements from ALL of the ME holders, their lessees and non-execs(?)

❖ Minimum Requirements

- Look at county records to check for fractional mineral estate owners
- Determine if you want to take the business risk of not obtaining waivers from all parties

What about my title insurance policy (T-19 Endorsement)?

- ❖ Title insurance policies provide title endorsements that may give a solar developer or its financiers some protection from oil and gas development
 - (Texas Forms T-19.1, et seq)
- ❖ However, instead of relying on the accommodation doctrine, title insurance companies will often want to see surface waivers or accommodation agreements for a certain percentage of the mineral owners
- ❖ Often do not specialize in identifying proper parties and may exclude mineral ownership as a mere encumbrance on the surface
- ❖ Such policies insure only the value of the underlying real estate rights and improvements up to the amount actually purchased (not operating revenues and profits, etc.)

Conclusion

- ❖ The Dominant Estate Theory is a powerful tool for oil and gas operators in Texas, but it is not absolute
- ❖ Renewable energy companies should be wary about relying upon the Accommodation Doctrine; the only way to ensure a ME owner cannot assert their rights is to obtain a surface waiver agreement
- ❖ ER holders must also be careful to avoid breaching their duty of utmost good faith and fair dealing (may want to seek waivers from nonexecs as well)
- ❖ It is advisable to consult with an experienced oil and gas broker and law firm when faced this issue
 - Reliance on a real estate commitment or pro forma is not sufficient to identify mineral owners, as those documents are not required to include mineral rights.
 - Make sure you are obtaining agreement from the right mineral owners, lessees, and nonexecs?

Questions?



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