Evolution of the Executive Right: From *Bass* to *Texas Outfitters*

CLINTON M. BUTLER and ELIZABETH R. KOPECKI,
Karnes City and San Antonio
LANGLEY & BANACK, INC.

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I. BACKGROUND OF *TEXAS OUTFITTERS*.

A. Introduction.

This paper focuses on the evolution of the executive duty, particularly as it applies to "failure to lease" cases and the implications of *Texas Outfitters Ltd., LLC v. Nicholson*, 534 S.W.3d 65 (Tex. App.—San Antonio 2017, pet. granted). It is the authors' opinion that if the holding in *Texas Outfitters* were to stand, it would represent a radical expansion of the duty owed by an executive right holder to his non-executives and would change the executive right from a quasi-fiduciary duty into an outright fiduciary duty, similar to that of a trustee. The Texas Supreme Court heard oral arguments in *Texas Outfitters* on October 10, 2018, and a decision is anticipated in early to mid-2019.

Prior to the Texas Supreme Court's decision in *Lesley v. Veterans Land Bd. of State*, 352 S.W.3d 479 (Tex. 2011), Texas law did not require an executive to enter into an oil and gas lease and no liability could attach to an executive who elected not to enter into an oil and gas lease. *See In re Bass*, 113 S.W.3d 735, 744 (Tex. 2003) ("*Smith* involved a very narrow duty in which a grantee, after executing a mineral lease, owes a duty of the utmost fair dealing to protect the amount of the grantor's royalty. The *Smith* duty, therefore, arises in conjunction with the execution of a lease. . . [In *Manges*, w]e stated that '[a] fiduciary duty arises from the relationship of the parties . . . [t]hat duty requires the holder of the executive right, Manges in this case, to acquire for the non-executive every benefit that he exacts for himself.' Accordingly, we held that Manges breached his fiduciary duty to the Guerras by making a lease to himself under numerous unfair terms.").

In *Texas Outfitters*, the court of appeals upheld the trial court's finding that the executive breached its duty in failing to execute a single lease in favor of El Paso Oil & Gas ("El Paso") even though doing so would have required the executive to lease its own minerals together with the minerals owned by the non-executives on the terms dictated by the non-executives. *See Texas Outfitters Ltd., LLC*, 534 S.W.3d at 79 ("Because there is more than a scintilla of evidence supporting the trial court's finding that Texas Outfitters breached its duty by refusing to execute a lease with El Paso, we overrule Texas Outfitters' legal sufficiency challenge."). Therefore, if *Texas Outfitters* stands, executives will be forced to sell their real property rights on the terms demanded by their non-executives or risk being sued by their non-executives for failure to lease. *See, e.g.*, *Jupiter Oil Co. v. Snow*, 819 S.W.2d 466, 468 (Tex. 1991) ("The common oil and gas lease is a fee simple determinable estate in the realty."). This holding represents a radical departure from existing Texas law and could further evolve the executive ***right*** into a ***burden***.

B. Facts of *Texas Outfitters*.

In 2002, Texas Outfitters Limited, LLC ("TOL") purchased 1,082 acres of land in Frio County, Texas from Carter Ranch, Ltd. ("Carter Ranch") and Dora Jo Carter ("Carter") for approximately $1,000,000.00. The Carter Ranch and Carter will be collectively referred to herein as the "Carters". Frank L. Fackovec ("Fackovec") is the managing member of TOL and the acreage is commonly referred to as the "Derby Ranch". Fackovec, through TOL, purchased the Derby Ranch in furtherance of his ranch outfitting business, which included a large deer breeding operation and high value game hunts. At the time of the sale, the Carters owned 100% of the surface and 50% of the minerals in the Derby Ranch. The other 50% of the minerals were owned by a third party known as the Hindes family. Along with the surface, TOL purchased 4.16% of the bonus, royalty, ingress and egress, and delay rental interest and the Carters' 50% executive right in the Derby Ranch. Thus, after the sale, the Carters held 45.84% of the minerals and 0% of the executive right while TOL owned 4.16% of the mineral interest, 50% of the executive right, and 100% of the surface of the Derby Ranch.

Prior to the Derby Ranch purchase, the Hindes family leased their 50% mineral interest to El Paso. The terms of the lease were $1,750.00 per acre bonus payment, 25% royalty, and scant surface protection terms (which makes perfect sense because the Hindes family had no interest or care in the surface of the Derby Ranch). At the time the Hindes family executed its lease, El Paso did not make a formal attempt to lease the remaining 50% mineral interest from the Carters (who had not yet sold the executive right to TOL), and there was no guarantee that El Paso would be able to lease the remaining mineral estate.

As a professional ranch outfitter, the quality of the land and wildlife were essential to Fackovec, and he specifically purchased the Derby Ranch because of its location and ability to support wild game, which the Carters were fully aware of at the time of the purchase. TOL financed a portion of the purchase price for the Derby Ranch by signing a promissory note to the Carters.

After purchasing the Derby Ranch in 2002, Fackovec moved in and began making improvements, which included building a home, a lodge, guest cabins, an irrigation well, high fencing, deer pens, and a deer-handling facility.

The improvements were made so that TOL could begin deer breeding operations and running guided big game hunts for its guests, particularly deer hunts.

In or around the spring of 2009, Fackovec was approached for the first time by someone interested in leasing the Derby Ranch minerals, and was introduced to Energy & Exploration Partners, LP ("ENEXP") which offered to lease all of the minerals from the Derby Ranch. On or around March 2010, ENEXP offered lease terms including $450.00 per acre bonus payment, 22 1/2% royalty, and a three-year primary term. After receiving this offer from ENEXP, Fackovec began researching the Eagle Ford Shale and realized that it could potentially become a much more lucrative, producing play over time. In his research, Fackovec discovered that the Eagle Ford Shale was in its infancy at that time and that as shale plays mature, they typically command higher bonus payments. Fackovec also learned that mineral owners in areas 15 miles away from the Derby Ranch were leasing their minerals for $2,500.00 to $3,000.00 per acre. According to Fackovec's trial court testimony, this information, combined with Fackovec's knowledge that bonus payments in other shales reached up to $30,000.00 per acre, made Fackovec patient and leery of acting too quickly to sign a mineral lease at the expense of leaving a substantial sum of money on the table.

In or around September 2010, El Paso began talking with Fackovec regarding leasing all of the mineral interest in the Derby Ranch. El Paso offered to lease the minerals on the same terms the Hindes family agreed upon at $1,750.00 per acre bonus, 25% royalty, and the same scant surface protection terms that were agreed to by the Hindes family. **The lease proposed by El Paso included TOL's mineral interest <u>and</u> the non-executives' mineral interest.** When the Carters learned about this lease offer, they asked Fackovec to accept the lease form and bonus as presented. However, Fackovec testified that he did not want to lease TOL's mineral interest on the terms that El Paso proposed because he believed the bonus offer was too low and did not think the surface protection terms negotiated by the Hindes family were adequate to protect his commercial and recreational uses of the surface. Unfortunately, El Paso was not interested in leasing the non-executives' mineral interest without also leasing TOL's undivided mineral interest and informed Fackovec that any deal for the Carters' interest would have to include TOL's mineral interest as well. Because Fackovec did not want to lease TOL's mineral interest on these terms, the El Paso deal was not consummated. Had El Paso made an offer to lease just the non-executives' mineral interest, Fackovec's testimony is that he would have agreed to lease the Carters' interest on the terms proposed. However, no such offer was ever proposed by El Paso.

Following rejection of the ENEXP and El Paso offers, Fackovec was contacted by the Dan Hughes Company ("Dan Hughes") to lease the Derby Ranch minerals. Fackovec entered into preliminary discussions with Dan Hughes and an offer was made to lease the minerals for a $2,000.00 per acre bonus payment, 25% royalty, with surface protection terms that Fackovec believed were adequate to protect the surface estate. After the two parties exchanged information, Fackovec followed-up with Dan Hughes and accepted the lease offer because it contained acceptable surface protection provisions. Unfortunately for all involved, before the deal was finalized and shortly after Fackovec accepted the lease terms on behalf of TOL, Dan Hughes discovered the other half of the mineral estate (the Hindes family's 50% interest) had already been leased to El Paso, so Dan Hughes pulled its lease offer.

Finally, toward the end of 2011, TOL negotiated a mineral lease with BlackBrush. The terms of this lease were $1,500.00 per acre bonus payment, 25% royalty, and acceptable surface protection terms. TOL accepted the BlackBrush offer. However, after TOL informed Blackbrush that it had accepted the offer, BlackBrush never contacted TOL again and did not return TOL's attempts to contact BlackBrush.

It is important to note that out of all the leases that the various exploration and production companies proposed to TOL, not one lease sought to lease only the non-executives' mineral interest. Each and every proposed lease required TOL to lease its undivided mineral interest along with the non-executives' mineral interest.

At trial and on appeal, TOL took the position that TOL was under no obligation to lease its undivided mineral interest in the Derby Ranch, and because the non-executives cannot force TOL to lease its undivided interest, their claims against Fackovec and TOL must necessarily fail. However, these arguments were rejected by the trial court and the court of appeals. *See Texas Outfitters Ltd., LLC v. Nicholson*, 534 S.W.3d 65, 78 (Tex. App.—San Antonio 2017, pet. granted) ("We hold the evidence establishes Texas Outfitters' refusal to lease was arbitrary or motivated by self-interest to the Carters' detriment.").

II. HISTORY OF THE EXECUTIVE RIGHT.

A. *Schlittler v. Smith*.

Although the underlying issue in *Schlittler v. Smith* centered around a disagreement regarding the meaning of the word "royalty," in 1937, the Texas Commission of Appeals, whose opinion was subsequently adopted by the Texas

Supreme Court, defined the duty owed by an executive right holder to his non-executives as being a duty of utmost fair dealing. *Schlittler v. Smith*, 101 S.W.2d 543, 544–45 (Tex. 1937), *distinguished by In re Bass*, 113 S.W.3d 735, 737 (Tex. 2003) ("We think that self-interest on the part of the grantee may be trusted to protect the grantor as to the amount of royalty reserved. Of course, there should be the utmost fair dealing on the part of the grantee in this regard."). However, the duty described in *Smith* only arose when an executive was actively involved in leasing the property. *See id.* For nearly 70 years, until *Manges*, this was the standard by which the executive right holder's actions were measured, and no duty or potential breach thereof arose until a lease was consummated.

B. *Manges v. Guerra.*

Clinton Manges ("Manges") purchased one-half of 55,000 to 60,000 mineral acres in Jim Hogg and Starr Counties from the M. Guerra & Son Partnership, together with the executive right to the entire 55,000 to 60,000 mineral acres. *Manges v. Guerra*, 673 S.W.2d 180, 181 (Tex. 1984). Manges then acquired the executive right and a one-half mineral interest in 16,000 mineral acres from the Virginia C. Guerra Estate (the M. Guerra & Son Partnership and Virginia C. Guerra Estate will be referred to collectively herein as "Guerra"), with the other one-half interest being reserved by the Virginia C. Guerra Estate. *Id.* at 182. Guerra sued Manges for breach of the executive right alleging Manges leased some of the minerals to himself at below market rates and did not exercise diligence in leasing to third parties. *Id.* at 181. Specifically, Manges engaged in the following bad acts:

- On May 10, 1974, Manges executed a deed of trust securing a note in the principal amount of $7,028,346.00, covering "all of the oil, gas and other mineral interests ... including ... executive rights and powers" owned or claimed by Manges and affecting lands in Starr and Jim Hogg Counties;

- On September 11, 1974, Manges executed two instruments to Gas Producing Enterprises. One of the instruments was an option to purchase oil and gas and the other was a "Repayment Agreement, Collateral Assignment and Security Agreement." These instruments covered the mineral interest Manges purchased from Guerra. The option contract purported to give Gas Producing Enterprises the right to purchase oil and gas produced from all of the mineral estate to which Manges held the executive right and was executed in connection with a loan from Gas Producing Enterprises to Manges of $2,800,000.00 (later increased to $5,000,000.00). Manges was to use this money in drilling and developing the mineral interest. Neither contract required Manges to drill and develop the Guerra lands in particular; and

- After suit was filed by Guerra, Manges discovered that wells on an adjoining tract were draining the Guerra/Manges minerals. Manges, claiming that he was unable to lease to anyone else because of the *lis pendens* notices, leased 25,911.62 acres to himself on April 20, 1977. This lease was for a term of ten years and provided for a one-eighth royalty, a $2.00 per acre annual delay rental, and a $5.00 bonus <u>for the entire acreage</u>.

Id. at 182. At trial, the jury was instructed:

> "[T]he possessor of an 'Executive Right' as herein defined owes to the co-mineral owners the same degree of diligence and discretion in exercising the rights and powers granted under such Executive Rights as would be expected of the average land owner who because of self-interest is normally willing to take affirmative steps to seek or to cooperate with prospective lessees . . . that in the exercise of the executive rights, the holder thereof is required to use utmost good faith and fair dealing as to the interest of the non-executive mineral interest owners. You are further instructed that the holder of the executive rights has a duty to prevent drainage of oil or gas from any lands covered by the executive rights. In any lease executed by the holder of the executive rights, the holder thereof is required to obtain all benefits that could be reasonably obtained from a disinterested third party." *Id.* at 183.

In finding Manges' actions constituted a breach of his duty as holder of the executive right, the Court explained, "The duty of utmost good faith owed by an executive has been settled since *Schlittler v. Smith*." *Id.* This duty, which the Court expressly called a fiduciary duty "arises from the relationship [of the parties] and not from express or implied terms of the contract or deed." *Manges v. Guerra*, 673 S.W.2d 180, 183 (Tex. 1984). When exercising the executive right, the holder is required "to acquire for the non-executive every benefit that he exacts for himself." *Id.* Here, Manges breached his duty as the executive right holder by engaging in self-dealing and acquiring numerous benefits for himself that the non-executives did not receive. *Id.* at 184 ("In our opinion Manges' conduct amounted to a breach of his fiduciary duty as found by the jury in making the lease to himself, in agreeing upon a $5[.00] nominal bonus for 25,911.62 acres of land, and in dealing with the entire mineral interest so that he received benefits that the non-executives did not receive. His taking one hundred percent of seven-eighths of the three producing wells, his taking one-half of the working interest, free and clear of costs, by his farm-out to Schero, was also the receipt of special benefits that the non-executives did not receive.").

Courts have also found a breach of the executive duty in the following circumstances:

(1) Failure to act when possible drainage was taking place. *See Hawkins v. Twin Montana, Inc.*, 810 S.W.2d 441, 444 (Tex. App.—Fort Worth 1991, no writ);

(2) Negotiating or entering into a lease designed to defeat the rights of the non-executives. *See Comanche Land & Cattle Co., Inc. v. Adams*, 688 S.W.2d 914, 916 (Tex. App.—Eastland 1985, no writ) ("Since there are no findings of fact, we must presume that the trial court found from the evidence that rather than exercising utmost good faith, the owner of the executive right purposely entered into an agreement that was calculated to defeat the rights of the royalty owners."); and

(3) Masking extravagant bonuses and royalties as surface damage payments. *See Portwood v. Buckalew*, 521 S.W.2d 904, 919 (Tex. Civ. App.—Tyler 1975, writ ref'd n.r.e.) ("These pleadings, together with other pleadings alleging that appellants breached their duty to deal with appellee's children with utmost fairness would, in our opinion, be sufficient to authorize the entry of a judgment for a specific interest in the royalty upon a constructive trust theory.").

It is important to note that while some courts have misleadingly described the executive duty as being fiduciary in nature, the executive right, as it currently stands, is not a true fiduciary duty because the rights of the executive are not subservient to the rights of the non-executive; instead, the executive must only ensure that he does not secure a greater benefit for himself than he secures for the non-executive. *See Texas Outfitters Ltd., LLC v. Nicholson*, 534 S.W.3d 65, 71 (Tex. App.—San Antonio 2017, pet. granted) ("Although the supreme court 'ha[s] characterized an executive[ ] duty of utmost fair dealing as fiduciary in nature,' the supreme court recently clarified the executive's fiduciary duty does not incorporate the traditional fiduciary obligation to place the interest of the other party before its own. 'This limitation distinguishes the executive duty from a more paradigmatic fiduciary relationship, like principal and agent.' The executive's fiduciary duty of utmost good faith and fair dealing does not require the executive 'to wholly subordinate its interests in favor of the non-executive if their interests conflict' or 'to grant priority to the non-executive's interest,' and 'the executive may discharge its duty to the non-executive without yielding entirely to the non-executive's best interests.'"); *Mims v. Beall*, 810 S.W.2d 876, 879 (Tex. App.—Texarkana 1991, no writ) ("In *Manges,* the court held that the fiduciary duty is owed only in the area of the executive interest owner's duty to obtain appropriate benefits for the non-participating royalty holders. Furthermore, in *Manges,* the Supreme Court does not apply the customary standard that the fiduciary must subordinate its own interest to those of the non-participating interest owner, but instead charges the fiduciary with acquiring for the non-executive every benefit that he exacts for himself."). While the executive duty is not a true fiduciary duty at this time, that will certainly change if *Texas Outfitters* is not reversed or substantially modified by the Texas Supreme Court.

C. *In re Bass.*

In *Bass*, the Texas Supreme Court for the first time took up the issue of whether an executive has a duty to lease the non-executive's mineral interest and if liability could attach to the executive for failing to lease the non-executive's mineral interest. In *Bass*, the Texas Supreme Court clarified the scope of *Smith* and *Manges* and explained that the *Smith* duty "arises in conjunction with the execution of a lease" and "*Manges* extends the *Smith* duty by creating a fiduciary duty between executive and non-executive interest holders in mineral deeds." *In re Bass*, 113 S.W.3d 735, 744–45 (Tex. 2003). However, the "fiduciary duty" described in *Manges* only obligates the executive "to acquire for the non-executive every benefit that he exacts for himself." *Id.* So, as explained above, the duty owed by an executive is not in line with a traditional fiduciary duty. Importantly, the Court held that without a lease in place, the executive right has not been exercised and there can be no breach:

> "What differentiates this case from *Manges,* however, is that no evidence of self-dealing exists here. **Bass has not leased his land to himself or anyone else. Bass has yet to exercise his rights as the executive.** Because Bass has not acquired any benefits for himself, through executing a lease, no duty has been breached." *Id.* at 745 (emphasis added).

As a result, it is indisputable that until the Court's opinion in *Lesley*, the executive was not obligated to lease the minerals and could not be held liable unless and until he exercised the executive right by leasing the property. *See id.* ("Traditionally, a duty to develop land arises under an oil and gas lease either through an explicit provision in the lease or through an implied covenant to develop. **No lease exists in this case. Furthermore, without exercising his power as an executive, Bass has not breached a fiduciary duty to the McGills as non-executives.** Because the record both fails to demonstrate the existence of an oil and gas lease that would create an implied duty to develop and fails to show that Bass has breached his duty as the executive, we hold the trial court abused its discretion in compelling trade secret production.") (emphasis added).

In addition, the rule of law handed down by *Bass* that an executive could not be liable to his non-executive for failing to lease was upheld in the lower court decision of *Hlavinka v. Hancock*, 116 S.W.3d 412 (Tex. App—Corpus Christi 2003, pet. denied), *disapproved of by Lesley v. Veterans Land Bd. of State*, 352 S.W.3d 479 (Tex. 2011). In *Hlavinka*, the Hlavinkas acquired an 802.25-acre tract, a one-ninth mineral interest, and all of the executive rights. *Id.* at 415. Between the years 1996 and 1997, oil and gas activity picked up in Wharton County where the property was located and the Hlavinkas were presented with several lease offers ranging from $175.00 an acre bonus with a one-fifth royalty to $250.00 an acre bonus with a one-fourth royalty. *Id.* at 415–16. However, the Hlavinkas were aware that other landowners in the area had received bonus payments of around $600.00 per acre, so they held out for a better offer. *Id.* Thereafter, the non-executives filed suit against the Hlavinkas claiming they breached their executive duty in failing to lease. *Id.* at 416. After losing at the trial court, the Hlavinkas appealed and successfully obtained a reversal based upon the Texas Supreme Court's holding in *Bass*. *See id.* at 420 (discussing the rule set forth in *Bass* that without executing a lease there can be no breach of the duty owed by the executive to the non-executives "because they have not acquired any benefits for themselves pursuant to any lease").

D. *Lesley v. Veterans Land Bd.*

After *Bass* and *Hlavinka*, Texas law was clear that an executive could not be held liable for failure to lease and that the executive's duty only applied when the executive acquired a benefit for himself through leasing that he did not share with his non-executive. However, *Lesley* removed that certainty and opened the door to a further examination into an executive's refusal to lease.

In *Lesley*, 352 S.W.3d at 481, Bluegreen Southwest One, L.P. ("Bluegreen") acquired the surface and executive right to 4,100 acres near Fort Worth and developed the property into a subdivision. In doing so, Bluegreen imposed restrictive covenants on the lots, including a prohibition against "commercial oil drilling, oil development operations, oil refining, quarrying or mining operation[s]." *Id.* However, the restrictive covenants could be amended or deleted "by the written agreement or signed ballot of two-thirds . . . of the Owners (including the Developer) entitled to vote." *Id.* at 481–82. The trial court found that Bluegreen breached its executive duty by imposing restrictive covenants that limited oil and gas development and by failing to lease. *Id.* at 482. The court of appeals disagreed and held that Bluegreen, as the executive right holder, was under no legal obligation to lease and that no duties are owed to the non-executives until the executive right is exercised by leasing the minerals. *Id.* at 483.

In finding that the executive possessed an active duty to lease the non-executive's mineral interest, the Court in *Lesley* stated:

> "Nevertheless, we do not agree with Bluegreen and the land owners that *Bass* can be read to shield the executive from liability for all inaction. It may be that an executive cannot be liable to the non-executive for failing to lease minerals when never requested to do so, but an executive's refusal to lease must be examined more carefully. ***If the refusal is arbitrary or motivated by self-interest to the non-executive's detriment, the executive may have breached his duty.*** While there was an allegation of self-interest in *Bass*, we concluded that it was not sufficiently supported by the record to [warrant] compelling discovery of privileged information." *Lesley*, 352 S.W.3d at 491 (emphasis added).

While the Court opened the door to examining the motives behind an executive's refusal to lease, the Court declined to establish a bright-line rule, "But we need not decide here whether as a general rule an executive is liable to a non-executive for refusing to lease minerals, if indeed a general rule can be stated, given the widely differing circumstances in which the issue arises." *Id.* ("Bluegreen did not simply refuse to lease the minerals in the 4,100 acres; it exercised its executive right to limit future leasing by imposing restrictive covenants on the subdivision. This was no less an exercise of the executive right than Manges's execution of a deed of trust covering Guerra's mineral interest. Bluegreen argues that it did not breach its duty as executive because the restrictive covenants benefitted only its interest in the surface estate, and its mineral interest was treated the same as Hedrick's and Lesley's. But Manges's deed of trust secured loans for his personal benefit and encumbered his mineral interest as well as Guerra's, yet we held that he breached his duty. Following *Manges*, we hold that Bluegreen breached its duty to Hedrick and Lesley by filing the restrictive covenants. The remedy, we think, should be the same as in *Manges:* cancellation of the restrictive covenants.").

The Court acknowledged and quickly brushed aside the developer's goals to protect the subdivision by holding the executive right and using that right to protect the surface of the property that the developer negotiated and paid for, "We recognize that Bluegreen as a land developer acquired the executive right for the specific purpose of protecting the subdivision from intrusive and potentially disruptive activities related to developing the minerals. But the common law provides appropriate protection to the surface owner through the ***accommodation doctrine***." *Id.* at 492 (emphasis added). Because the restrictive covenants placed on the subdivision by the executive right holder effectively precluded future leasing, the supreme court found this to be a sufficient exercise of the executive right to hold the executive liable.

Although some uncertainty exists regarding the scope of *Lesley*, one thing is clear—*Lesley* did not hold that an executive had to lease ***his*** own mineral interest. Further, *Lesley* made it clear that an executive right holder is not required to make his interests subservient to the non-executives' interest, "A fiduciary duty often, as it would for agent and principal, 'requires a party to place the interest of the other party before his own', but we did not suggest in *Andretta, HECI*, or *Manges* that this requirement was part of the executive's duty. Rather, we stated in *Manges* that the executive's duty is to 'acquire for the non-executive every benefit that he exacts for himself.'" *Id.* at 490.

E. *KCM Financial v. Bradshaw.*

The Court re-visited the executive duty issue once again in *KCM Fin. LLC v. Bradshaw*, 457 S.W.3d 70 (Tex. 2015). *Bradshaw*, unlike *Lesley*, involved a typical executive duty breach in which the executive was alleged to have acquired, through its lease, a benefit that was not shared with its non-executive. The facts of *Bradshaw* are straight-forward. The non-executive held a non-participating royalty interest and was not entitled to share in bonus payments. *Id.* at 75. The deeds wherein the non-executive's interest was reserved contained a minimum royalty requirement for future leases and mandated that the royalty be "not less than one-eighth." *Id.* Subsequently, the executive signed a lease providing for a one-eighth royalty with a bonus of $7,505.00 per acre, for a total bonus payment of $13 million. *Id.* at 78. In its suit against the executive, the non-executive claimed that even though the lease met the requirements set out in her deeds, the standard royalty rate at the time the lease was executed was one-fourth and the executive "engaged in self-dealing by obtaining an exorbitant bonus payment at the expense of securing a higher royalty. Because [the non-executive] had no interest in the bonus payment, she contends the trade-off diminished the value of her interest." *Id.*

In *Bradshaw*, the Court once again explained an executive does not owe a true fiduciary duty to the non-executive, "Importantly, though the relationship between an executive and a non-executive has been described as fiduciary in nature, the executive is not required to grant priority to the non-executive's interest." *Id.* at 81. However, the executive will be found to have breached his duty to the non-executive if self-dealing is involved. *Id.* ("In evaluating whether an executive has breached a duty owed to a non-executive, evidence of self-dealing can be pivotal. When we have declined to find a breach of the duty, we have generally observed the absence of self-dealing. The intermediate appellate courts have proceeded similarly. Self-dealing has most commonly been observed in situations where the executive employs a legal contrivance to benefit himself, a close familial relation, or both. This was most readily apparent in *Manges,* but it has also been a feature of a multitude of other Texas cases.") (citations omitted). Further, the Court explained that an inquiry into whether an executive breached its duty should also consider whether the interest of the non-executive was de-valued,

> "[T]he value of a non-participating royalty interest is not left exclusively to the whims of the executive. To the contrary, while an executive may be understood to have considerable latitude, the executive lacks unbridled discretion. Our jurisprudence in this area of the law emerged in recognition of the potential for abuse inherent in this division of rights. **In the absence of a fiduciary-like duty of utmost good faith and fair dealing, an ill-intentioned or indifferent executive holder could significantly compromise or extinguish the value of a non-executive interest.** Thus, while an executive has a largely unfettered hand in negotiating and structuring a mineral lease, that discretion is circumscribed by the duty owed to a non-executive. If the semantics surrounding the nature of this duty have shifted subtly over the years, this much is clear: An executive owes a non-executive a duty that prohibits self-dealing but does not require the executive to subjugate its interests to those of the non-executive. **Thus, in ascertaining whether the executive breached its duty to the non-executive, the controlling inquiry is whether the executive engaged in acts of self-dealing that unfairly diminished the value of the non-executive interest.** Although the contours of the duty remain somewhat indistinct, these tenets guide our analysis of the claims before us." *Id.* at 81–82 (citations omitted) (emphasis added).

Accordingly, *Bradshaw* outlined a two-prong inquiry in executive duty cases. First, was the executive engaged in self-dealing? If so, did that self-dealing unfairly diminish the non-executive's interest? If the answer to both of those questions is "yes", the executive will be found to have breached his duty to the non-executives. However, *Bradshaw* did not clarify whether this test applied to all executive duty cases or only those in which the executive acquired a benefit through leasing that was not shared with his non-executives.

III. WHERE DOES THIS LEAVE US?

A. Outcome of *Texas Outfitters*.

At the time TOL purchased the property from the Carters, no case law existed regarding an executive's failure or refusal to lease. However, by the time TOL declined the El Paso lease, *Bass* was the controlling precedent. Fast forward to trial, *Lesley* had become rooted law, *Bradshaw* was recently decided, and an open question existed as to whether the ambiguous case-by-case standard provided for in *Lesley* would apply in *Texas Outfitters* or would the two-pronged test provided for in *Bradshaw* apply. In handing down its judgment, the trial court seemed to apply both the standard set forth in *Lesley* and the two-pronged test provided for in *Bradshaw* to the facts at hand. In doing so, the trial court found that TOL's refusal to lease benefitted TOL to the Carters' detriment and diminished the Carters' mineral value in the amount of $900,000.00, which is the amount of the bonus payment that was lost (*Bradshaw*), while at the same time pronouncing that TOL was liable for its decision not to lease because the decision was motivated by self-interest (*Lesley*).

When engaged with the facts of the case, it becomes evident that the trial court relied more upon the words of *Lesley* than the test provided for in *Bradshaw* because it is difficult to understand how the non-executive's mineral interest as a whole was devalued by TOL's refusal to accept the single lease offer made by El Paso when a higher offer was later received from Dan Hughes and withdrawn only when Dan Hughes discovered the lease executed in favor of El Paso by the Hindes Family, a third party beyond the control of TOL.

The trial court's findings of fact and conclusions of law in *Texas Outfitters* provided in relevant part:

1. Findings of Fact.

   - In May and June of 2010 the Hindes family negotiated and executed an oil gas and mineral lease with El Paso pertaining to their undivided 50% mineral interest in the Derby Ranch;
   - The terms of the lease were a primary term of three years, a bonus of $1,750.00 per acre, and a 25% non-participating royalty interest for the Lessor;
   - El Paso offered TOL the same $1,750.00 per acre three year lease with a 25% non-participating royalty interest;
   - The offer necessarily included the mineral interest of both TOL and the Carters;
   - Exercising its executive right not only to its own interest but also to the Carters' mineral interest, TOL refused to enter into a lease with El Paso;
   - TOL, as expressed through its sole owner Fackovec, had no objection to the 25% royalty interest. His stated reason for refusing to lease was because he wanted to see how the play matured and try to get more money; and
   - After this lawsuit was filed, TOL, through its sole owner Fackovec, received an offer of $2,000.00 per acre for a lease. However, the offer was withdrawn when it was learned that the Hindes family had already leased their 50% mineral interest.

2. Conclusions of Law.

   - The duty of the executive right holder to the non-executive is a relationship of trust, with a duty of utmost fair dealing. This duty is breached by self-dealing;
   - It may be that an executive may not be liable to the non-executive for failing to lease minerals when never requested to do so; (*Bass*)
   - If the refusal [to lease] is motivated by self-interest to the non-executive's detriment, the executive may have breached his duty; (*Lesley*)
   - The executive claimed his reason for refusal to lease was to get more bonus money. More bonus money would have benefitted the non-executive as well, so it could not be said to be self-dealing in and of itself;
   - However, in this case the executive chose to gamble with not only his 4.16% mineral interest but also with the non-executive owners' 45.84% mineral interest when he knew that they did not want to gamble;
   - The executive took this gamble when he knew that the other 50% mineral interest had already been leased to the same lessee that he refused to lease to. The pool of potential lessees was unfavorably affected by the owner of the 50% mineral interest having already leased its interest;
   - By refusing to lease, the executive gained for itself unfettered use of the surface for its hunting operation, which was always the plan for the property from the time of its purchase; (*Lesley*)

- By refusing to lease, the executive gained for itself the ability to sell its land at a large profit free of any oil and gas lease; (*Lesley*)
- The executive breached its duty of utmost fair dealing in refusing to enter into the oil and gas lease offered to it by El Paso; and
- The breach of that duty caused damages to the non-executive owners in the amount they would have received had the lease been signed by the executive.

A complete copy of the trial court's Amended Findings of Fact and Conclusions of Law can be found on Appendix "A". On appeal, TOL argued that the trial court's findings of fact did not support the ultimate finding that TOL breached its executive duty. But, the court of appeals disagreed and determined that the trial court's factual findings were sufficient to support the judgment,

> "In its 'Conclusions of Law,' the trial court found several elements of the Carters' breach of executive duty claim: (1) Texas Outfitters owed the Carters a duty because it held the executive right to lease the Carters' mineral interest in Derby Ranch; (2) Texas Outfitters breached its duty by refusing to execute a lease with El Paso; and (3) the breach of that duty caused damages to the Carters in the amount they would have received had Texas Outfitters executed the lease with El Paso. We may not disregard the trial court's ultimate findings as to these elements simply because the trial court designated them as 'conclusions of law.' In its 'Findings of Fact,' the trial court found that if Texas Outfitters had executed the lease with El Paso, the Carters would have received \$867,654. Taken together, the trial court's findings disclose the ground that the trial court found supported a \$867,654 damages award: a breach of the executive duty. We therefore hold the trial court's fact-findings are sufficient to support the judgment." *Texas Outfitters Ltd., LLC v. Nicholson*, 534 S.W.3d 65, 76 (Tex. App.—San Antonio 2017, pet. granted).

The court of appeals then considered whether the trial court correctly found TOL breached its duty by looking for evidence that "Texas Outfitters (1) refused to lease and (2) its refusal to lease was arbitrary or motivated by self-interest (3) to the Carters' detriment." *Id.* at 76. The first element was quickly found because Texas Outfitters received multiple offers and did not lease the property. *Id.* Next, the court evaluated whether such refusal to lease was arbitrary or motivated by self-interest. "Texas Outfitters argues it refused to lease (1) to protect its existing use of the surface, which is a legitimate interest; and (2) to obtain a higher bonus payment for both itself and the Carters, which the trial court found was not self-dealing. Although protecting an existing use of the surface estate is a legitimate interest, an executive breaches its duty if it protects the surface estate by refusing to permit any mineral lease." *Id.* at 77. This language is taken directly from the *Lesley* decision, which indicates the Fourth Court of Appeals decided that *Lesley* applied to refusal to lease cases while *Bradshaw* applied to cases of self-dealing.

TOL then argued that it was simply seeking reasonable surface protections, but the court of appeals disagreed for two reasons, "First, Texas Outfitters' three settlement offers demonstrate it not only sought to protect its existing use of the surface, but also sought to obtain a significant reduction on the amount it owed Dora Jo for Derby Ranch or a portion of the Carters' royalty interests. Alternatively, Texas Outfitters offered to sell the surface and all of its mineral interest back to the Carters for \$4.2 million. The evidence supports an inference that Texas Outfitters refused to lease not only to protect its existing surface use, but also to exact a benefit from the Carters at their expense. Second, Texas Outfitters did not merely seek surface protections with El Paso; it refused to permit any lease unless the Carters agreed either to convey a portion of their royalty interest or to accept deed restrictions (i.e. restrictive covenants) and a \$263,000 reduction on the note. Carolyn testified the proposed restrictive covenants were too restrictive and would have interfered with executing future leases. Thus, Texas Outfitters, like the executive in *Lesley*, sought to protect an existing surface use with restrictions that would essentially preclude a mineral lease. Because the evidence supports a finding that Texas Outfitters' refusal to lease was arbitrary and motivated by self-interest, Texas Outfitters breached its duty under *Lesley*." *Id.* at 77–78.

B. Unanswered Questions.

The outcome of *Texas Outfitters* and its potential of being upheld by the Texas Supreme Court has left many of us with some unanswered questions in the field of executive duty law. Questions that now exist as to the law regarding the executive duty include but are not limited to:

- Are there two different standards for executive duty cases:
  - Refusal to lease cases under a *Lesley* standard; and
  - Executed lease cases under the *Bradshaw* standard?

- Is the executive now capable of being told by the non-executives that he must lease the minerals?

- What if one non-executive wants to lease, but another non-executive does not like the terms of that lease? Who should the executive listen to?

- Is the executive mandated to lease his own mineral interest if that is the only way an oil and gas company will lease the non-executive's mineral interest?

- What about surface damages?
    - If surface damages are a benefit that the executive/surface owner acquires for himself and does not acquire for the non-executive, should the executive attempt to negotiate a higher royalty or roll the surface damages into the bonus payment in lieu of a separate surface damage payment (assuming the non-executive has a right to share in the bonus payment)?

C. Potential Solutions.

As lawyers, we naturally hate questions that we do not already know the answer to. Unfortunately, Texas case law regarding what does and does not constitute a breach of the executive duty has left us with more questions than answers for ourselves and for our clients. One way to avoid the uncertainty surrounding the executive duty is to advise clients to only purchase the executive right covering their mineral interest. The tragedy of *Texas Outfitters* is that if TOL had only purchased the executive right over its 4.16% mineral interest and left the Carters with the executive right over their interest, TOL would have been able to refuse any and all lease offers or negotiate any terms it saw fit and there would be nothing the Carters could do about it because TOL, as a mineral co-tenant, would have owed them no legal duty.

If your client is in the process of acquiring land and surface protections are a concern, you may consider including surface restriction language in the deed that requires the inclusion of certain surface protection terms in any subsequent lease executed by the mineral interest owner. Another potential avenue would be to get the grantor to convey to the grantee the right of ingress and egress. While the right of ingress and egress is an unexplored right in Texas oil and gas law, it is clear that the right of ingress and egress gives its holder the right to allow for surface activity on the property in order to explore for and produce the minerals below. *See Lightning Oil Co. v. Anadarko E&P Onshore, LLC*, 520 S.W.3d 39, 49 (Tex. 2017) (describing the rights associated with the right to develop (also known as the right of ingress and egress), including, "the right to go onto the surface of the land to extract the minerals, as well as those incidental rights reasonably necessary for the extraction."). However, one should be cautious of the Texas Supreme Court's statement in *French v. Chevron*, 896 S.W.2d 795, 797 n.1 (Tex. 1995) that "the right to develop is a correlative right and passes with the executive rights." Whether courts would allow for the holder of that right to use it as a sword and shield has yet to be determined by the courts. But, as a word of caution, if the jurisprudence in Texas regarding the executive right is any indication as to what the Texas Supreme Court and its lower progeny might hold, one would be wise to not rely on this right too heavily.

But what advice should you give your client if your client already owns the executive right over someone else's minerals? One extreme would be for you to recommend your client convey the executive right back to the non-executives as a way to rid himself of the burden of the executive duty. But, as *Texas Outfitters* evidences, beware of hardball negotiations to sell the executive right back as it may be held against your client in a future case. Another answer would be to get the non-executives to sign a written consent to any decision that the executive makes, preferably prior to the decision being made.

However, no matter what decision an executive makes regarding minerals owned by a third party, one thing is now perfectly clear—the executive's duty is more burdensome and ambiguous than it was twenty years ago and an open question now exists as to whether this right is even worth owning anymore. Therefore, when acquiring or exercising the executive right, it is important that the executive take any and all precautions possible to insulate himself from claims that may be made by the non-executives. The best way for the executive to attempt to achieve this security is by and through the help and advice of a qualified attorney who specializes in the field of oil and gas.