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Supreme Court of Texas.
Wendell Reeder
v.
Wood County Energy, LLC, et al.
No. 10-0887.

February 27, 2012.

Appearances:

Charles Watson of LockeLord LLP, for Petitioner.

Greg Smith of Ramey & Flock, P.C., for Respondents.

Before:

Chief Justice Wallace B. Jefferson; Nathan L. Hecht, Dale Wainwright, David M. Medina, Paul W. Green, Phil Johnson, Don R. Willett, Eva M. Guzman, and Debra H. Lehrmann, Justices.

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CHIEF JUSTICE WALLACE B. JEFFERSON: The Court is ready to hear argument in the first matter 10-0887, Wendell Reeder v. Wood County Energy.

MARSHAL: May it please the Court, Mr. Watson will present argument for the Petitioner. Petitioner has reserved five minutes for rebuttal.

ORAL ARGUMENT OF CHARLES WATSON ON BEHALF OF THE PETITIONER

ATTORNEY CHARLES WATSON: May it please the Court and good morning. The court of appeals has held that an oil and gas operator, who is required to use a swabbing unit after pulling off conventional pumping to try to keep a dying field alive is liable once that field ceases to produce some paying quantities. Moreover, it is held that that liability is based in contract rather than on the standard of care, the contractual standard of care that was in the joint operating agreement. That raises four issues of critical importance and I'm going to try to get to all of them because they're all important. When does the JOA standard of care of the exculpatory clause of gross negligence or willful misconduct apply if it doesn't apply to these facts of failing to maintain operations to produce in paying quantities? If it doesn't apply here, when is it going to apply? Second, can a court of appeals read this Court's opinion of St. Joseph Hospital v. Wolff to say that if the wrong standard of care was submitted to the jury that it can look to the evidence and say it could have been legally sufficient to support an unsubmitted standard of care, breach of contract in this case? Third, can damages be proven to a reasonable certainty with competent evidence by an expert who admits that his numbers cannot be replicated, that they're based on imprecise or unknowable factors and when the jury awarded one-tenth of the damages the expert testified to? And last

and quite possibly most important because it won't do any good to get the standard of care right if we mess up the duty. What is the duty of an oil and gas operator when the jury finds that a reasonably prudent operator would no longer continue to operate with reasonable expectation of profit, which means as a matter of law the lease has expired, the subject matter of the JOA has gone away and second, when the working-interest owners who must pay for those operations flatly repudiate. Let's start now with the first issue of what is the standard of care. A great deal of precedent over the years has been put into by the court of appeals into the AAPL, standard exculpatory clause and joint operating agreements that's been around since 1956. Now in 1956, that clause said that, there would be no liability to the other interest owners or to the people by the operator unless there was gross negligence or if it was from the operator's breach of the provisions of this agreement. So the point of liability in this case that you breached other provisions of the agreement not involving oil field operations used to be a liability under the '56 form, but it changed in '77. And in '77, except for breach of the provisions of this agreement was removed and the clause simply applied to operations and no liability shall be incurred except as may result from gross negligence or willful misconduct. This clause, the '89 clause, changed yet again because courts didn't get it that gross negligence, willful misconduct, was to be the exclusive standard of care.

JUSTICE DEBRA H. LEHRMANN: And in 1989 when that form was changed to activities under the agreement, which is broader language I think you're arguing, the court of appeals said that, distinction is meaningless, right?

ATTORNEY CHARLES WATSON: That is absolutely correct, Your Honor.

JUSTICE DEBRA H. LEHRMANN: So what is your response to that?

ATTORNEY CHARLES WATSON: And the reason, and I can see why it happens. I mean courts follow precedent and it's difficult to look at the plain language and this couldn't be any plainer. My goodness when they say conduct its activities instead of its operations and in no event shall there be any liability. I mean it's harder to get clearer than that, but courts look at precedent and the Tyler Court looked at its own precedent, which was under the '77 clause. And all of the cases of Abraxas, Farbout, all of them, Cone, that have been cited in this case, if you look at the language in that case, look at the '77 clause that I've provided you in the appendix to the reply brief, you will see that they have the operations language, but my question to this Court is so what? I mean if you're going to say that the '89 form didn't change and doesn't apply to all activities and you look at the cases that are talking about operations are the only thing that have to be proven by gross negligence or willful misconduct, pray tell what is an operation if it's not producing oil and gas in paying quantities or conducting other operations.

JUSTICE DALE WAINWRIGHT: All the Texas court of appeals though go the other way. The Fifth Circuit disagrees, but all the court of appeals opinions go the other way. We haven't addressed it.

ATTORNEY CHARLES WATSON: And finally we are, Your Honor, that's right and I'm just saying give it the plain meaning and see how the AAPL has progressed that all activities means all activities.

JUSTICE DEBRA H. LEHRMANN: But when you look at the language that says shall it's proceeded by the language shall act as a reasonably prudent operator, what does that mean if it doesn't mean that if it's not identifying that category of conduct for which the operator is being excused? I mean what else does that mean?

ATTORNEY CHARLES WATSON: Well, reasonably prudent operator is the standard of care that all operators must operate under. I mean that's the point of our argument under questions 2 and 5. Once the jury finds, I mean this Court has held from Garcia v. King, Gulf Oil v. Reid forever, that the standard of care even to maintain the lease, to keep it from snapping back and going back to the lessor and ceasing to exist is that of a reasonably prudent operator with a reasonable expectation of making a profit. Reasonably prudent operator is the standard of care that underlies everything except when you're talking about liability to working interest owners and the simple truth is in the oil fields so many things can go wrong and it's frankly so easy for things to go south in a

hurry. No one would be foolish enough to operate a lease to take on that responsibility without the exculpatory clause to say the people I'm doing this for, I'm not talking about others, but I'm talking about the parties to this agreement asking me to operate. Unless they give me the exculpatory clause, I'm not doing it.

CHIEF JUSTICE WALLACE B. JEFFERSON: When would there ever be liability under the gross negligence standard. I mean you know would it be gross negligence because there is an intentional evil breach or you know because this isn't a situation where somebody has harmed due to economic injury that results, or at least allegedly so can you give an example of when there would be gross negligence?

ATTORNEY CHARLES WATSON: Sure, Your Honor. I mean, to me, you'd go back to your opinions in Moriel and Diamond Shamrock v. Hall, that type of an opinion and understand it's both gross negligence and willful misconduct. Gross negligence that results in a blowout, let's say, and you find that they knew the thing objectively. Anybody would have known it was about to blow out and subjectively you have the--

CHIEF JUSTICE WALLACE B. JEFFERSON: So would there ever be gross negligence that results in, other than damage to property or to persons and purely economic injury? Would there be an example of that somewhere?

ATTORNEY CHARLES WATSON: I guess there could be because there's gross negligence for, excuse me, there's property damage in every oil field accident, of course, but let me just shift over to--
CHIEF JUSTICE WALLACE B. JEFFERSON: It wouldn't be an accident. Could there be gross negligence in failing to produce in, failing to operate with productive quantities, I forget the phrase exactly; would that be an example of gross negligence?

ATTORNEY CHARLES WATSON: If there was an event that shut off the flow of oil, such as twisting off a drill stem or pulling casing and breaking it and they were able to prove gross negligence rather than negligence, presumably, Your Honor, yes, but also you have to slide over. Most of the suits that occur between interest owners and operators or for what for a better term would be called, pencil whipping, the operator charging too much for overhead or for charges or things like that. That's why so many of the cases under the '77 form are writing letters for AFEs when they're not authorized. That would come under willful misconduct.

CHIEF JUSTICE WALLACE B. JEFFERSON: I guess what I'm trying to get to is the disposition you seek here would be a remand to the court of appeals because they did not consider that standard of care, the gross negligence, they thought it was breach of contract, but I presume your argument would be that in no event under circumstances in this case could you ever be liable for gross negligence under these facts, matter of law.

ATTORNEY CHARLES WATSON: The disposition we seek is rendition because that was the point below. There was no evidence, none of gross negligence or willful misconduct. That's the point. I mean the court wouldn't have had to jump through the hoop to say, okay, we're going to measure the evidence against a breach of contract standard of care if there had been one shred of evidence. That's painfully obvious from reading the transcript of the oral argument transcript when they kept hammering where was the evidence. And the point is that these leases expired in January 2003. Nobody expected that jury finding, but if you look, if you look--

JUSTICE NATHAN L. HECHT: Let me ask you about that. You say that helps you, but it looks like the answer to question 8 says that, the answers to questions 2 and 5 were your fault.

ATTORNEY CHARLES WATSON: That's what it's saying and we're saying where is the evidence.

JUSTICE NATHAN L. HECHT: The jury was thinking well, yes, it ceased production in paying quantities, but the reason they did was because Reeder was not doing what he should be doing.

ATTORNEY CHARLES WATSON: Precisely, but look at the joint operating agreement. Even the joint operat-

ing agreement says, we are going to try to keep this thing alive by removing conventional pumping equipment. Now that should tell you something. And then trucking in, the back of a pickup, a V-frame, a swabbing unit at $35 an hour to try to lower, as opposing counsel said, it's a cup, but the equivalent of a bucket to pull this out a bucket at a time. If you're doing exactly what the JOA says, to do, put the bucket down, pull it up. At $35 an hour, that's what? Eight-hour day, $280 a day. At some point, the dying field dies and the reasonably prudent operator doesn't keep it going.

JUSTICE DALE WAINWRIGHT: But the Respondent says, you make $10,000 to $20,000 a month doing that.

ATTORNEY CHARLES WATSON: Well, that's interesting because look at Exhibit 44, Exhibit 44 and you will see what the jury saw at this time. In the year before they said, this thing stopped, they averaged nine barrels a day, nine, excuse me a day, nine barrels a month. Nine barrels a month, let's give them $25 oil at West Texas Intermediate. This stuff isn't worth near that. But you're looking at spending $280 a day for a swabbing unit and getting out $260 a month. What about the three months immediately before the jury said, this thing was over? You look at the last two months of 2002, zero barrels produced. December 2002, five barrels produced. January 2003 when they said, a reasonably prudent operator would have kicked it in the head and walked way, five barrels produced. That means in those three months, you have made in three months $280, but it cost you for one day $280 to do the swabbing unit.

JUSTICE DALE WAINWRIGHT: The Respondent also argues that even if you're not going to make a lot of money, at least there's activities going on that allow you to make money from other things you can do in that field, but they lost all of it because there was no activity to keep the field in operation by paying quantities.

ATTORNEY CHARLES WATSON: It's a great question and we need to go straight to it. Paragraph six, of all of these leases that are under Exhibit 10 make it crystal clear that other activities aren't just activities just like production isn't just production. Production isn't paying quantities.

JUSTICE DALE WAINWRIGHT: Paragraph six of the JOA?

ATTORNEY CHARLES WATSON: Other activities--

JUSTICE DALE WAINWRIGHT: Which paragraph in what document?

ATTORNEY CHARLES WATSON: I'm talking about paragraph six of the leases. Once the leases go away, there is no JOA; the subject matter has died. And in the leases it says, drilling or reworking activities. I would cite you to Ernest Smith's volume, I think it's section 4.5B where they go through and cite the cases both from this Court and elsewhere that say other activities have to be something other than continuing what you're doing. It has to be re-drilling or it has to be reworking and there was not one shred of evidence of re-drilling or reworking for a year and three months. When Wood County came in, spent $300,000 to raise production dramatically, but only made $200,000 in the process.

JUSTICE DALE WAINWRIGHT: Let me,as your time is up just to be sure I'm clear, under your interpretation of the joint operating agreement, Reeder can only be found liable for breach of that contract if the breach was through gross negligence or willful misconduct?

ATTORNEY CHARLES WATSON: Precisely, Your Honor.

CHIEF JUSTICE WALLACE B. JEFFERSON: Are there any further questions? Thank you, Mr. Watson. The Court is ready to hear argument from the Respondents.

MARSHAL: May it please the Court, Mr. Smith will present argument for the Respondents.

ORAL ARGUMENT OF GREG SMITH ON BEHALF OF THE RESPONDENT

ATTORNEY GREG SMITH: May it please the Court and good morning, Your Honor. It's good to be here in Austin. Things are not as Petitioner would have you believe. In fact, three of Petitioners' questions, I suggest, are not questions that would stand up under the actual facts and circumstances of this record. First of all, this is not a field in decline. What we have here is a field that was relatively low in activity because of economic circumstances. Years before the parties in this case were involved, a prior operator, because of economic circumstances, had come in and had removed pumping equipment, this field, the Harris Sand Unit had about 100 wells in it. On most of those wells, the prior operator had come in and salvaged scrapped pumping equipment, taken up tubing, done just about everything you could to take value from the equipment off of the property. Then when the Fry interest got hold of the property, they had to go back and had to slowly and surely start reestablishing this production equipment. Now the reason again is economics. It is not that there's not oil in the ground. Everyone agrees that there's oil in the ground that's commercially producible and the testimony is that once it gets up to the surface, there was like 100 or 200 million dollars of oil in the ground.

JUSTICE DAVID M. MEDINA: Isn't that generally, excuse me, isn't that generally why production stops because the costs outweigh the benefits?

ATTORNEY GREG SMITH: It certainly is, Your Honor, but in this case, the point I want to derive is that this production stopped here because of Mr. Reeder's intentional conduct. If you'll go back and look at Exhibit 50, which is a production report for Mr. Reeder's time, it starts a little before Mr. Reeder's time and you will see that the immediately preceding operator through the swabbing operations that Mr. Reeder denigrates was producing 500 to 700 barrels per month. Immediately when Mr. Reeder took over operations, I mean immediately, the production dropped from the 500 to 700 barrel level down to a 30 to 70 barrel level and then it is true that during Mr. Reeder's operations time, he dropped production all the way down to that 5 to 10 barrel a day, but he did that intentionally. The evidence is that the wells would have produced if he had swabbed the wells. Now it is not true that Reeder was swabbing when production dropped. He was swabbing one well when production was at the 30 to 70 barrel a day level, producing in fading quantities level. Then Reeder chose not to do anything and just allow production through natural flow to make it to the surface, that's when he dropped to the 5 to 10 barrel a day, his intentional conduct, Your Honors. It's not a dying field.

JUSTICE PAUL W. GREEN: And his motivation for that would be what?

ATTORNEY GREG SMITH: His motivation for that simply would be purely saving money, first of all, but secondly spite, I believe. Your Honors, in this case Mr. Reeder bought the field. He bought only the Harris Sand Unit, which concerned only the Harris Sand Formation and only about half the well bores in this tract. Mr. Reeder contended though that the Harris Sand Unit entailed everything from the surface to the center of the Earth and entailed every well bore that penetrated the Harris Sand formation. So immediately upon Mr. Reeder coming on the scene, you had for the first time ever a direct conflict between Reeder and my clients the Fry's over who owned the [inaudible] formation and who owned about 40 or 50 well bores out there. Mr. Reeder was trying to bleed the Fry's dry, that's simply what the evidence would suggest, what the jury would be entitled to find. Now, in this case, this also is not a model form relationship. It's true there's roughly the model form exculpatory clause, but everything else that's material about the operating agreement and about the associated mutual agreement is not a model system. The mutual agreement, which was executed 11 days before the operating agreement, specifically was tailored to this relationship. It had that covenant that said, the operators shall maintain production by production, excuse me, shall maintain the leases by production or operations because the Fry's had a valuable resource. They were attempting to take wells out of the Harris Sand Unit, put them in a Sub-Clarksville Unit to which they owned the formation and produce, but they needed time to do that and they needed economics to do that.

JUSTICE EVA M. GUZMAN: What did the operating agreement and the mutual agreement work together or function as a set of documents that govern the transaction? Did the operating agreement incorporate the mutual

agreement or did it supersede the mutual agreement or how did that work?

ATTORNEY GREG SMITH: Your Honor, the operating agreement gave the mutual agreement dominance, gave it superiority. Paragraph number 1 of the joint operating agreement--

JUSTICE EVA M. GUZMAN: And if it did that then how do we read all of the documents together to give effect to the meaningful terms?

ATTORNEY GREG SMITH: I think, Your Honor, this Court has to conclude that the exculpatory clause, if it reads as Reeder says, it reads, which we don't believe it does, but if it reads as Reeder says, it reads, it cannot apply in the circumstances of this case. If you'll go to paragraph number 1 of the joint operating agreement, it says, it first incorporates the mutual agreement. Then it says that, in any circumstance of a conflict between the two documents, that the mutual agreement shall be "paramount and controlling."

JUSTICE DALE WAINWRIGHT: But the mutual agreement does not have an exculpatory clause.

ATTORNEY GREG SMITH: That's correct, Your Honor; it has no exculpatory clause.

JUSTICE DALE WAINWRIGHT: But you're really only interpreting the exculpatory clause in the JOA, right?

ATTORNEY GREG SMITH: That's correct.

JUSTICE DALE WAINWRIGHT: There's no conflict. You don't allege there's a conflict.

ATTORNEY GREG SMITH: The mutual agreement is incorporated in the JOA. The point is that, well there's a second provision, Your Honor, as well that the JOA says, if there's a conflict that the JOA provision that's conflicting is deemed as though it had not been included in the JOA. Reeder's position is that there is a conflict. Now we don't think there is, but Reeder says that, you can't uphold the covenant to maintain production. Why? He says, because the exculpatory clause precludes that. He's applying the exculpatory clause as a defensive position to enforcement of the covenant to maintain production. That is a conflict, Your Honor. The covenant to maintain production, if there weren't the JOA, if there weren't the exclusionary clause, that covenant to maintain in the mutual agreement would be a gut synch breach of contract claim for the Fry's. If, as Reeder says, the exculpatory clause somehow trumps that, then there's a conflict and the JOA says, in that circumstance Reeder has it opposite of what it is. It's that the initial agreement trumps the JOA and trumps the exculpatory clause. So here, I would suggest this Court frankly should decide the case in such a way that it doesn't actually interpret this exculpatory clause. Now--

JUSTICE DALE WAINWRIGHT: I'm sorry, repeat that.

ATTORNEY GREG SMITH: This Court should decide the case based on the dominance of the mutual agreement and based on the fact that looking at the mutual agreement without the exculpatory clause, the covenant to maintain production was breached. That's where this Court should decide the case. The Court should not reach the question of what it is, what does activities mean as versus operations. Now if the Court does reach that question--

JUSTICE NATHAN L. HECHT: You think it was breached because operations could have continued and obtained production in paying quantities?

ATTORNEY GREG SMITH: Yes, Your Honor.

JUSTICE NATHAN L. HECHT: To follow up on Justice Green's question, it's to everyone's benefit if you can do that, if you do that economically.

ATTORNEY GREG SMITH: Normally, Your Honor, yes.

JUSTICE NATHAN L. HECHT: So not to make it too simple, but doesn't this just come down to should more have been done to develop the field and what standard do you apply in answering that question?

ATTORNEY GREG SMITH: It comes down to should something have been done. Reeder did nothing. Reeder let the field be inactive and he let nature take its course. Now I'll tell you not only did the prior operator produce 500 to 700 barrels, but we have a circumstance where Reeder lets production drop and then what happened in 2004? Reeder splits operations from the working interest. He sells half the working interest for $500,000, which means that an interest that he bought for $100,000, he increased the value to roughly equivalently a million dollars. At that point, he allowed the purchasers to act as de facto operators. I'll tell you who the purchasers were. They were a real estate agent and a 75-year-old gentleman, neither of whom had any prior interest at all in oil field operations. Now what did they do? They invested $300,000 and immediately, Your Honor, if you look at Exhibit 50, immediately the production goes up from that minimal level that Mr. Reeder was maintaining to a level of 400, 500, 600, 700 barrels a month. It stays at that level for the entire year until May 2005 when Reeder today in his briefs admits Reeder kicked the others off and retained production.

JUSTICE EVA M. GUZMAN: So it took I guess an investment of $300,000 to get production back to what it had been before Mr. Reeder took over the 5 to 700 barrels a day, which you contend was low because of economic circumstances. So is that right? So he had to spend $300,000 just to get to where it was to begin with?

ATTORNEY GREG SMITH: Not Mr. Reeder. Mr. Wade he did because this field was a hidden oil field and the really key to producing this field was to get it to where you could pump it as opposed to swabbing, where you could do something more active. Reeder wasn't doing that. This required specialized equipment mainly to heat the oil. When it came to the surface it gets cool and the heavy oil would kind of congeal and become more like asphalt and couldn't pump. So Mr. Wade voluntarily of his own, his own personal money, he wasn't a working interest owner. He was a limited partner in a working interest owner. He invested $300,000 to increase the production. Now this shows that it was Reeder's intentional conduct that kept the production low and I'd like to address, if I might, the issue of well did the jury in question one, by finding that production ceased in paying quantities, was that all she wrote? Did that mean termination of the leases? Absolutely not as the court in question has already surmised there's more to it than that. This Court based on, excuse me, the jury, based on the production history, was entitled to determine not that a reasonably prudent operator would have stopped producing. What the jury determined, I submit, is that a reasonably prudent operator would have done as the prior operator did and as Mr. Wade did and produced, by swabbing, at a level of multiple hundreds of barrels per month. Mr. Reeder intentionally stopped doing that.

JUSTICE EVA M. GUZMAN: So was he required to invest that additional capital? Obviously, there was some issue between the first operator you speak of, Mr. Reeder coming in and then somebody else coming in, Mr. Wade, with $300,000. Was Mr. Reeder required to pump another $300,000 into this field just to get it to produce what he thought he bought when he bought the field at 5 to 700?

ATTORNEY GREG SMITH: No, Your Honor, absolutely not. We believe Reeder's funding is an absolute red herring as we say in the briefs. The fact of the matter is is that Reeder could have maintained production, not breached the duty simply by swabbing one well at the $35 an hour price. That has nothing to do with the 300. The $300,000 was to go way beyond that.

JUSTICE EVA M. GUZMAN: But it only produced 5 to 700 is what you're telling me after they spent $300,000 and that's what was being produced when it was--

ATTORNEY GREG SMITH: Well, recognize there's no explanation in the record for why that is. I would suggest--

JUSTICE EVA M. GUZMAN: I'm trying to get to the gross [inaudible].

ATTORNEY GREG SMITH: I'd suggest they're novices they've never produced an oil well before. It takes some time to gear up production; that's what I would suggest, but that would have been the jury's to infer not in the record.

JUSTICE DALE WAINWRIGHT: As you read the jury's findings, did the jury find that Reeder acted with gross negligence or willful misconduct?

ATTORNEY GREG SMITH: Yes, Your Honor, the jury did. We submit now the jury shouldn't have been required to do that, but it absolutely did that because question 8 in the predicate instructions said that, in order to answer yes, the jury had to find gross negligence or willful misconduct.

CHIEF JUSTICE WALLACE B. JEFFERSON: You objected to that?

ATTORNEY GREG SMITH: Yes, Your Honor, our counsel objected to that. Recognize this is not a case where, unlike Wolff, where the wrong standard was submitted, an absolutely wrong standard was submitted, then we come in on appeal and say, Your Honor, there was an un-submitted standard that should have been submitted and now measure the evidence against that standard, against that balance. That's not it at all. What happened was that in the question, there is a breach of contract submission. Did Reeder fail to comply, but instead of comply, it said, specifically what was required of the duty. Did Reeder fail to maintain production, maintain the leases?

CHIEF JUSTICE WALLACE B. JEFFERSON: Mr. Watson says, if we agree with his argument about gross negligence being the only standard that he wins as a matter of law and does it go back down to court of appeals for a factual insufficiency analysis? The result ought to be that we rendered judgment in its favor and how do you answer that?

ATTORNEY GREG SMITH: Absolutely not true, Your Honor. It would be true if there were no evidence of gross negligence, but here there is evidence of gross negligence. As I said, the record plainly shows that production was maintainable at a profitable level by swabbing both before Reeder took office and during Reeder's tenure and at the end of Reeder's tenure. Reeder intentionally dropped production. He prevented the Frys from any self-help. He kicked Wade off of the premises. He diverted the money that was coming in from the oil production to his own bank account. He promised in a letter, said, I know something needs to be done. I'm going to do it and I'm going to bill you, working interest owners, unless you object. No one objected. Working interest owners testified instead. They relied on that. Then what did he do? He chose to do nothing. This is conscious indifference if there can be conscious indifference, as the Chief Justice stated, if there ever can be conscious indifference on something other than a matter of physical activity on the premises.

JUSTICE NATHAN L. HECHT: But it seems to me that just pushes the question because of course, the decision not to do more was intentional, but the question is, behind that was the evaluation of whether more should be done intentional and of course, people are making decisions based on the evidence they have. So it's hard to see how that, I mean the decision was intentional, but it's hard to see that that's what the JOA is getting at.

ATTORNEY GREG SMITH: Your Honor, the decision was intentional, but the jury was entitled to see beyond that and see that, again, it was for Reeder's own self-serving motives.

JUSTICE NATHAN L. HECHT: And that's again, coming back to Justice Green's question, what were those?

ATTORNEY GREG SMITH: Well, those, he was in mitigation with the Frys. By 2004, he had filed suit claiming that he owned everything lock, stock and barrel, including the Sub-Clarksville, which they had expressly re-

tained when they sold the Harris Sand Unit and including the 40 or so wells that the Frys had retained. That's what was at stake. Reeder was putting it all on red and letting it ride, so to speak.

JUSTICE NATHAN L. HECHT: But none of it was producing. None of it was producing.

ATTORNEY GREG SMITH: Well, it was when Reeder started. It certainly was producing at a decent clip and again that was with worse economics.

JUSTICE NATHAN L. HECHT: But in 2005.

ATTORNEY GREG SMITH: In 2005, it was producing. It produced from the time Wade got on the scene, and they purchased roughly around the start of 2004. It was producing in significant amounts all the way through 2005. So Reeder's contention--

JUSTICE NATHAN L. HECHT: Jury found that production in paying quantities ceased in both formations in January of '03.

ATTORNEY GREG SMITH: Yes, Your Honor. Now recognize in this case the statement, the contention that the lease is terminated in 2003, that contention has never been stated in this case until the briefing in this Court, never stated in the trial court, never stated in the court of appeals. At the trial court, in fact, Reeder testified the leases are still effective. Reeder's counsel stipulated that the leases were still effective and Reeder his JNOV motion, the motion that Reeder now wishes to rely on as preservation of his lease termination argument, that JNOV motion rather than saying there's no evidence because the leases have terminated in 2003, it said, there's no evidence that a reasonably prudent operator wouldn't have done what Reeder did and continued to produce. And it's the point of that was that the leases, according to Reeder, were still in operation. They were still effective.

JUSTICE EVA M. GUZMAN: They terminate, though, I mean could they terminate by their own terms in 2003? Do you really waive it if as a matter of law they terminated?

ATTORNEY GREG SMITH: That would have to be that the savings clause didn't kick in and the jury found that the savings clause kicked in. Reeder didn't contest--

JUSTICE NATHAN L. HECHT: As to the Harris, but not the Sub-Clarksville.

ATTORNEY GREG SMITH: Well, the savings clause, that may be true, Your Honor, but part of the Sub-Clarksville was saved. By the way, this is kind of a confusing circumstance. The Harris Sand Unit has one footprint, if you will, Sub-Clarksville above it and there are three areas above the Harris Sand. One is the Sub-Clarksville first unit that partially overlaps. Another is a prior Sub-Clarksville unit that was still active and another is ununitized portions. Some portion, the Sub-Clarksville first unit wasn't held. The Sub-Clarksville unit, the original unit was held by Noble and Canterol, who continued to produce that unit and then various individual tracks were held, but the Court is correct in that.

JUSTICE DALE WAINWRIGHT: Why are there two dates that the jury found as to both formations, one as to cease production in paying quantities to both formations in January 2003? Then there's a second question for both formations to production of oil and gas from the unit cease, yes, and then that answer, for the date there is September 2006. Why the dichotomy as to both formations in these dates?

ATTORNEY GREG SMITH: The dichotomy is that production continued. The jury found it wasn't in paying quantities for a period of time, but production continued. Then in 2006, when we say lease termination occurred was because of the severance and shut-in of the wells by the Railroad Commission. Now in the intervening time, the jury answered, the jury found the savings clause and found the savings clause maintained the unit

through 2006. Again, there was no dispute about that, none whatsoever until this Court. Any position about a 2003 lapse is wrong because there was intervening operations and intervening production and it was waived by Reeder. Moreover, Reeder has stopped to contend otherwise because Reeder himself was out there producing and out there taking proceeds, taking money from the field. He was telling the Railroad Commission that he was operator. He was telling Wade you have to leave. I'm the operator. I'm the only one allowed out here.

JUSTICE DALE WAINWRIGHT: Counsel, your time's about up. Let me ask you as to the gross negligence and willful misconduct standard in the exculpatory clause. That was a change in the model form in 1989. Prior to that, the language was more specific. The prior language fit pretty nicely with your argument in this case. The argument in this case is that changing to all activities broadened the scope of the exculpatory clause. We're just looking at the language of the change. Can we get there on your argument even though the courts of appeals are with you?

ATTORNEY GREG SMITH: Oh yes, Your Honor, you can.

JUSTICE DALE WAINWRIGHT: All activities is different from the narrower language in the prior model forms.

ATTORNEY GREG SMITH: Your Honor, it may well be different, but the difference is one that is immaterial in this case because here the difference, the distinction to be made here is one of action versus inaction. Activity, Your Honor, certainly still means doing something with the lease. The point is that even though there may have been a broadening, it still had to do with culpability was based on finding that the operator did something grossly negligent in the manner in which he conducted an operation or an activity. Here that's not what's involved and I would suggest that all the Texas cases, courts of appeals cases, agree with that, even the IP Wevanco case. In that case, the court explained that we have a situation where the issue is the manner in which the operator drilled this well and that's why we as a court of appeals are going to find the gross and exculpatory clause trickery. Here, there's no allegation of manner. The allegation is rather one of result or status and that is that you didn't maintain the leases. That's a result of status.

JUSTICE DALE WAINWRIGHT: Just to also clarify, in your brief you say the Wood County entities are no longer prosecuting their claims in this case. They're out of the case.

ATTORNEY GREG SMITH: That's correct.

CHIEF JUSTICE WALLACE B. JEFFERSON: Are there any further questions? Thank you, Counsel.

ATTORNEY GREG SMITH: Thank you, Your Honor.

REBUTTAL ARGUMENT OF CHARLES WATSON ON BEHALF OF PETITIONER

ATTORNEY CHARLES WATSON: May it please the Court, let me go first to the questions about evidence of gross negligence or willful misconduct. Looking at a standard of was he consciously indifferent or as you said, in Diamond Shamrock v. Hall, did he know I was going to blow up and didn't care? Here, did he know the leases were being lost and didn't care? Well, what's the evidence of it? They point to a 2006 letter where he's saying we need to get out there and do something. I'm the operator. You guys are the money guys. We need to get out there and keep these leases going. He kept going out and swabbing. He kept doing this after the jury, for three years after the jury found a reasonably prudent operator would no longer expect a profit and yet we're told that these continuing activities trying to make a profit, hoping against hope like a gambler in Vegas betting his return flight airline ticket that maybe this one will hit is somehow evidence of conscious indifference. That is the reason that the court of appeals had to flip to another standard of care and say, okay, we're not going to measure this by gross negligence. We are going to measure it by straight breach of contract.

JUSTICE NATHAN L. HECHT: On your second point, I don't understand your argument why if the court of appeals thought the standards should be lower than the ones submitted to the jury, it couldn't say that the evidence that the jury found to meet the higher standard would also meet the lower standard.

ATTORNEY CHARLES WATSON: Well, because they're entirely different standards.

JUSTICE NATHAN L. HECHT: Well, yeah, but if you find gross negligence, don't you find negligence?

ATTORNEY CHARLES WATSON: Let's read it very clearly, Your Honor. The court was not talking about negligence. It's talking about a strictly liability breach of contract. When measured against the elements of breach of contract, not the elements of negligence, the elements of breach of contract, which were not submitted, the evidence is legally and factually sufficient to support the jury findings that Reeder breached the duty as operator by failing to main production and paying quantities or by other operations.

JUSTICE NATHAN L. HECHT: But that's just if he should have. I mean if he shouldn't have done it. it wasn't a breach. You don't breach the contract by failing to develop something that can't be developed.

ATTORNEY CHARLES WATSON: That's the point.

JUSTICE NATHAN L. HECHT: It seemed to me that it just sort of melds into negligence that if the court of appeals said, the jury found the greater, why couldn't they find the lesser.

ATTORNEY CHARLES WATSON: They didn't submit the elements of negligence, Your Honor. I mean none of it was submitted. This is best being pulled out of somebody's hat of the evidence would have submitted this theory if it had been submitted and I don't think that's what you meant in Wolff.

JUSTICE PHIL JOHNSON: Was there an objection to either question 8 or question 18 about submitting elements, any other elements other than what were submitted? And, did you object to it? They objected to it on the gross negligence; did you object to it?

ATTORNEY CHARLES WATSON: It was objected to based on no evidence, Your Honor, that's it.

JUSTICE PHIL JOHNSON: Okay. Not for failure to submit elements or define breach or anything else?

ATTORNEY CHARLES WATSON: Right. Now--

JUSTICE DALE WAINWRIGHT: Counsel, does it matter whether there was any negligence at issue here? If there was a breach, there was a breach. Was it by grossly negligent conduct or willful conduct? If the field was shut down because of the failure to keep it operating and producing and paying quantities, it doesn't matter whether it was by negligence or gross negligence. A breach is a breach.

ATTORNEY CHARLES WATSON: It matters tremendously to every operator in this state, Your Honor. The operators in this state are not to be subjected to these types of damages just because they breach a contract, just because they're damaged, just because there's negligence involved. They have specifically contracted that there will be no liability for any damages, for any activity unless there is gross negligence or willful misconduct. That's got to mean something or that is a meaningless scrap of paper.

JUSTICE DALE WAINWRIGHT: But that assumes your position on the interpretation of the exculpatory clause. I'm circling back to Justice Hecht's question. Assume you don't have to prove gross negligence, then why does negligence even matter? If there's a breach, this question would have allowed the jury, question 8, to find a breach, right?

ATTORNEY CHARLES WATSON: No, Your Honor, it would not have. It didn't submit any articulable element of any recognized cause of action. It simply allowed the jury from [inaudible] to decide for itself whether there should be liability.

JUSTICE DALE WAINWRIGHT: Well, that question does submit a breach of contract standard. I mean it doesn't include negligence. It talks about gross negligence, but it does ask about a breach, breach of duty.

ATTORNEY CHARLES WATSON: It says, breach of duty and it doesn't say what that duty is; that's the point.

CHIEF JUSTICE WALLACE B. JEFFERSON: Are there any further questions. Thank you, Counsel, both Counsel. The cause is submitted and the Court will take a brief recess.

MARSHAL: All rise.

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