COMMENT

THE DISCOVERY RULE: SHOULD OIL AND GAS LEASES BE DIFFERENT?[?]

TABLE OF CONTENTS

I. INTRODUCTION 1284

II. STATUTES OF LIMITATIONS AND THE DISCOVERY RULE 1286
A. *Statutes of Limitations* 1286
B. *The Discovery Rule* 1287

III. *HECI EXPLORATION CO. V. NEEL* 1290
A. *Factual and Procedural History* 1290
B. *Texas Supreme Court Decision* 1292
C. *The* HECI *Legacy* 1294

IV. THE DISCOVERY RULE SHOULD APPLY TO OIL AND GAS CASES 1299
A. *Oil and Gas Leases Warrant Application of the Discovery Rule* 1300
B. *Royalty Disputes Are Inherently Undiscoverable* 1301
C. *Texas Courts Apply the Discovery Rule in Oil and Gas Cases* 1302
D. *Texas Courts Apply the Discovery Rule Generally* 1303
E. *Application of the Discovery Rule Outside Texas* 1305
F. *The Discovery Rule Codified* 1308

V. THE DISCOVERY RULE IN OIL AND GAS CLAIMS 1309

VI. CONCLUSION 1312

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I. INTRODUCTION

"Oil has been king" in Texas for the past century.[1] Wealth from mineral production has built cities, established universities, and developed economies.[2] But life has not been easy for everyone in the kingdom.[3] Since the advent of the oil and gas lease, land and royalty owners have battled with oil and gas producers over when the clock starts to tick on disputes.[4] Statutes of limitations are intended to prevent stale claims,[5] but when does a cause of action accrue so that the statute starts to run? Typically, an action begins to accrue at the time the injury occurs.[6] This creates a problem for many land and royalty owners who rely on oil and gas producers to provide the very information that would notify them of an injury.[7]

The discovery rule is a judicial construct that suspends accrual of a claim until the plaintiff knew or should have known that he was injured.[8] Prior to 1998, Texas land and royalty owners relied on the discovery rule to toll the statute of limitations until they discovered the alleged violations.[9] In 1998, however, the Texas Supreme Court delivered what may be interpreted as a devastating blow to the application of the discovery rule in claims arising under oil and gas leases.[10]

In *HECI Exploration Co. v. Neel*,[11] the Texas Supreme Court determined that Mr. Neel, a royalty owner, should have

1. Russell Gold, *Rancher Revolt; Landowners Unite to Push for Changes in Oil, Gas Industry*, SAN ANTONIO EXPRESS, March 26, 2000, at A1.

2. *Id.* (listing Texas A&M University and the University of Texas as "the state's flagship universities" established by wealth from mineral production).

3. *Id.* (noting that despite bringing prosperity, "a century of oil and gas production also has left thousands of abandoned, potentially leaking wells and aging pipelines across the state").

4. Refer to notes 93–105, 124–40, and 168–79 *infra* and accompanying text (discussing examples of such disputes).

5. Robinson v. Weaver, 550 S.W.2d 18, 20 (Tex. 1977).

6. Computer Assocs. Int'l, Inc. v. Altai, Inc., 918 S.W.2d 453, 458 (Tex. 1996) (referring to the traditional rule in Texas that a cause of action accrues and the limitations period begins to run as soon as the plaintiff suffers injury).

7. Refer to Part III.C *infra* (contending that land and royalty owners should not have the burden to investigate potential injury unless they have reason to suspect wrongdoing).

8. Mitchell Energy Corp. v. Bartlett, 958 S.W.2d 430, 436 (Tex. App.—Fort Worth 1997, pet. denied) (noting that Texas courts have applied the discovery rule to causes of action for property damage).

9. Keely Coghlan, *Texas Eyes Changes to Royalty Dispute Clock*, THE OIL DAILY, Apr. 24, 2000, *available at* 2000 WL 10342847 (commenting that the *HECI* decision "changed all that").

10. *Id.*

11. 982 S.W.2d 881 (Tex. 1998).

discovered that a neighboring operator, who had engaged in illegal overproduction, had permanently damaged the reservoir beneath Mr. Neel's Texas property.[12] Additionally, the court concluded that Mr. Neel should have realized that his own lessee, HECI, had sued the wrongdoer and obtained a $3.7 million judgment even though HECI kept information about both the lawsuit and the judgment from Mr. Neel.[13] Mr. Neel was neither a geologist nor an engineer; he was like many royalty owners who depend on royalty payments to supplement their income.[14] If Mr. Neel was not entitled to rely on the discovery rule to toll the statute of limitations, who is?

In response to the *HECI* decision, hundreds of land and mineral owners together formed the Texas Land & Mineral Owners Association (TLMA).[15] TLMA's objective is to protect and promote land and mineral owners' interests before the judiciary, legislature, and the Texas Railroad Commission.[16]

In Texas' 2001 legislative session, TLMA proposed that the four-year statute of limitations be amended to include the following:

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12. *Id.* at 886.

13. *Id.*

14. *See* Summary, Texas Land & Mineral Owners Assoc. 1–2 (2000) (on file with the Houston Law Review). The Texas Land & Mineral Owners Association suggests that:

> The average mineral owner is not a person of great wealth but average folks whose income is earned predominantly from work. Often their mineral ownership is in small fractional interests which came with property when purchased or inherited from their family. They are not the privileged class, they have jobs they go to every day, or farms and ranches they work. Many of these folks are retired and living on fixed incomes and the small royalty checks they receive are important to their life style.

Id. at 1.

15. TEXAS LAND & MINERAL OWNERS ASSOC., ARE YOU GETTING THE ROYALTY TREATMENT? (2000). TLMA's members have joined together out of a sense of frustration that "stems from seeing their rights and property values diminished . . . by the actions of the oil industry, the Texas Railroad Commission, the Texas judicial system and . . . the State Legislature." Summary, Texas Land & Mineral Owners Assoc., *supra* note 14, at 1.

16. Summary, Texas Land & Mineral Owners Assoc., *supra* note 14, at 1. State oil and gas conservation agencies have executive authority to carry out and enforce oil and gas conservation laws enacted by the legislatures. 5 EUGENE KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS 367–68 (1991). Generally, state legislatures "confer broad powers on a Commission to promulgate regulations. . . . [I]f regulations are promulgated, a violation is presumed to violate correlative rights and to constitute waste." *Id.* at 368. In Texas, the Railroad Commission is responsible for regulating the oil and gas industry. 2 ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS 8-30 (2d ed. 2000). The Texas Natural Resources Code empowers the Railroad Commission with the authority and responsibility for conserving and preventing the waste of oil and natural gas, plugging depleted wells, safe drilling and operation of wells, requiring the reporting of oil and gas related activities, including well drilling records, and issuing drilling permits. *Id.* at 8-30 to 8-32.

> For the purposes of this Section, a cause of action arising out of or relating to an interest in an oil and gas lease does not accrue until the facts giving rise to the cause of action are discovered or, by the exercise of reasonable diligence, should have been discovered.[17]

Consequently, this amendment would make the discovery rule applicable to all causes of action arising under an oil and gas lease.[18] One can argue that TLMA's amendment does not create new law, but merely codifies the common law that courts have applied for years.[19]

This Comment discusses the discovery rule and its application in oil and gas cases in Texas. Part II briefly explains the origin and application of the discovery rule. Part III reviews the Texas Supreme Court's recent decision in *HECI Exploration Co. v. Neel*[20] and its implications for land and royalty owners seeking to apply the discovery rule in Texas. Part IV argues that the discovery rule should be applied in claims arising under oil and gas leases because of the unique relationship between operators and royalty owners. Part IV also compares the application of the discovery rule in Texas with its application in other states. Part V suggests that the discovery rule is consistent with the purpose of the statute of limitations and should not be precluded from application in oil and gas cases.

II. STATUTES OF LIMITATIONS AND THE DISCOVERY RULE

A. Statutes of Limitations

Statutes of limitations prevent plaintiffs from "sleeping on their rights" and require parties to diligently protect their interests.[21] Public policy supports the application of statutes of limitations.[22] First, plaintiffs should not be allowed to assert

17. Summary, Texas Land & Mineral Owners Assoc., *supra* note 14, at i (proposing that the amendment be added to Chapter 16, Section 16.004 of the Texas Civil Practices and Remedies Code).

18. *See id.*

19. Refer to Part IV.C *infra* (citing cases that apply the discovery rule to oil and gas claims).

20. 982 S.W.2d 881 (Tex. 1998).

21. James R. MacAyeal, *The Discovery Rule and the Continuing Violation Doctrine as Exceptions to the Statute of Limitations for Civil Environmental Penalty Claims*, 15 VA. ENVTL. L.J. 589, 591 (1996) (noting that statutes of limitations "encourage the prompt presentation of claims").

22. *Id.* at 590–92 ("[S]ome courts have noted that statutes of limitations are primarily instruments of public policy and court management and are not designed to exempt defendants from liability, although this may be their effect.").

stale claims.[23] Claims should be brought while memories are fresh, witnesses may be contacted, and evidence is available.[24] Second, defendants should not be required to defend against fraudulent claims, particularly "at a time when the true facts can no longer be proved."[25] Finally, statutes of limitations promote judicial efficiency.[26] They alleviate the burden on courts to hear older claims and preclude perpetual exposure to liability.[27]

B. The Discovery Rule

Reliance on statutes of limitations to achieve the benefits of certainty and predictability risks preclusion of meritorious claims that "happen to fall outside an arbitrarily set period."[28] Courts apply the discovery rule to protect plaintiffs against being barred from remedies merely because they were unaware an injury occurred.[29] The discovery rule delays commencement of the statute of limitations until the plaintiff knew or should have known about the wrongful act and resulting injury.[30] Application of the discovery rule prevents what the Texas Supreme Court has described as the "shocking results" of barring a plaintiff's suit before the plaintiff has even discovered the injury.[31]

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23. *Id.* at 590–91 (suggesting that the purpose of the statute of limitations is to avoid the unfairness of requiring defendants to defend such claims).

24. *Id.*; Rogers v. Ricane Enters., Inc., 930 S.W.2d 157, 166 (Tex. App.—Amarillo 1996, writ denied) (explaining that statutes of limitations are not directed to the merits of any particular case, rather, "they are a result of a legislative assessment of the merits of cases in general").

25. MacAyeal, *supra* note 21, at 591 (asserting that there is an assumption that "plaintiffs with meritorious claims will assert them promptly," and thus, "long-delayed claims are inherently suspect").

26. *Id.* at 591–92 ("[D]etermining distant historical facts is far more complicated and time-consuming than proving recent occurrences.").

27. *Id.* (pointing out that "society at large has an interest in settling contingent obligations, particularly in commercial transactions, so that resources are not tied up indefinitely in anticipation of possible claims").

28. S.V. v. R.V., 933 S.W.2d 1, 6 (Tex. 1996) (explaining that statutes of limitations seek to strike a balance between the benefits of excluding stale claims and the risks of excluding meritorious claims).

29. MacAyeal, *supra* note 21, at 595–96 ("Most courts agree that . . . what matters is a plaintiff's awareness of the existence of certain facts, not . . . a conclusion that a valid claim exists.").

30. *S.V.*, 933 S.W.2d at 4–5 (noting that the court first used the term "discovery rule" in *Gaddis v. Smith*, 417 S.W.2d 577, 578 (Tex. 1967), and has considered the rule's applicability to the statute of limitation's "legal injury rule" in an "assortment of settings").

31. Computer Assocs. Int'l, Inc. v. Altai, Inc., 918 S.W.2d 453, 457 (Tex. 1996) (explaining that without a "principled basis for distinguishing between cases in which the rule applies and those in which it does not," the primary purpose of the statute of limitations would be undermined).

Courts traditionally have viewed the discovery rule as a narrow exception to the application of statutes of limitations.[32] Texas courts have applied the discovery rule by balancing the following factors:

> (1) the nature of the plaintiff's case and the type of evidence required to establish and defend the claim;
>
> (2) the length of the limitations period in question and the wrongful act's susceptibility to discovery within that period;
>
> (3) the susceptibility of cases to fraudulent prosecution if limitations is tolled.[33]

In Texas, application of the discovery rule requires a two-tiered inquiry.[34] The "unifying principle" test requires that the injury be inherently undiscoverable and objectively verifiable.[35] Few cases fail the "unifying principle" test on the basis that the injury is not objectively verifiable.[36] Courts find an injury "objectively verifiable" if the facts upon which liability is asserted are demonstrated by direct, physical evidence.[37]

The most difficult aspect of the "unifying principle" test may be demonstrating to the court that the injury was inherently undiscoverable.[38] "Inherently undiscoverable" does not require that an injury be impossible to discover.[39] If this were the case, a lawsuit "would never be filed and the question whether to apply the discovery rule would never arise."[40] Instead, an injury is "inherently undiscoverable" if it is unlikely that a duly diligent party would ordinarily learn of the wrongful act.[41] In determining whether injuries are inherently undiscoverable,

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32. *Id.*

33. *See id.* at 455–56.

34. *Id.*

35. *Id.* at 456 (stating that the "unifying principle" test is a threshold inquiry that determines whether the discovery rule should apply to a particular type of case).

36. *But see* Hay v. Shell Oil Co., 986 S.W.2d 772, 778 (Tex. App.—Corpus Christi 1999, pet. denied) (finding the plaintiff's injury not objectively verifiable). The Hays sued Shell for improperly including non-productive acreage in a pooled unit. *Id.* at 774. The court found that, although the Hays provided evidence that their injury was inherently undiscoverable, they did not address the issue of whether the injury was objectively verifiable. *Id.* at 777. Additionally, Shell's expert testimony established the uncertainty of petroleum exploration and that the nonproductivity of the acreage included in the pooled unit was not objectively verifiable. *Id.*

37. S.V. v. R.V., 933 S.W.2d 1, 7 (Tex. 1996) (commenting that the court has not always emphasized this requirement if "the alleged injury was indisputable").

38. Refer to Part III.B *infra* (discussing the Texas Supreme Court's "inherently undiscoverable" analysis in *HECI Exploration Co. v. Neel*).

39. *S.V.*, 933 S.W.2d at 7.

40. *Id.*

41. *Id.*

courts often consider when the plaintiff "actually did discover ... or, in the exercise of reasonable diligence, *should* have discovered" the injury.[42]

The oil and gas industry has attempted to preclude the application of the discovery rule to all oil and gas cases.[43] TLMA's proposed amendment has been characterized as an effort to "put Texas well outside the national mainstream" and to "single out certain industries for different treatment under the law."[44] Opponents to the amendment have commented that "[g]ranting special privileges for royalty owners will unreasonably expose businesses and individuals to costly and unnecessary lawsuits, cause liability insurance premiums to skyrocket, and seriously impair the ability of Texas businesses to access credit and capital investment."[45] Opponents also argue that, because the oil and gas industry is both regulated and required to make numerous public filings, "nothing that a lessee does or fails to do ever can be considered 'inherently undiscoverable.'"[46]

Proponents of the discovery rule maintain that the oil and gas industry's argument does not reflect reality.[47] Average royalty owners do not monitor the Railroad Commission or courthouse records,[48] and even if they did, "much of the technical information would look like Greek, assuming that it[] [is] accurate, which often it is not."[49]

The recent Texas Supreme Court decision in *HECI Exploration Co. v. Neel*[50] appears to side with the oil and gas industry. In *HECI*, a royalty owner sued his lessee for a portion of a judgment received against a neighboring producer who had illegally overproduced and permanently damaged the reservoir

42. Tanglewood Terrace, Ltd. v. Texarkana, 996 S.W.2d 330, 340 (Tex. App.—Texarkana 1999, no pet.) (emphasis in original) (emphasizing that the task is not to decide whether the plaintiff could have discovered the injury).

43. Dick Watt, *Pro/Con; Discovery Rule in Oil and Gas Cases?*, TEXAS LAWYER, Aug. 4, 1997, at 14 (commenting that the industry's offensive against the discovery rule has been called "the 'lessees' constructive notice/public records defense").

44. TEXAS CIVIL JUSTICE LEAGUE, ASSAULT ON CIVIL JUSTICE REFORM: SPECIAL INTERESTS WANT SPECIAL RULES 1 (1999) (noting that in the 1990s, the Texas Legislature made tort reforms that "save billions of dollars in insurance premiums" and have helped Texans invest "capital dollars that create jobs").

45. *Id.* at 3.

46. Watt, *supra* note 43, at 14.

47. *Id.* (stating that the oil and gas industry's argument ignores how ordinary people live).

48. *Id.*

49. *Id.*

50. 982 S.W.2d 881 (Tex. 1998).

beneath the royalty owner's land.[51] The royalty owner did not participate in the lawsuit against the neighboring producer because his lessee failed to notify him of the damage and the lawsuit.[52] In fact, by the time the royalty owner discovered that his lessee had been awarded almost $4,000,000 in damages, the statute of limitations had already run.[53] The court determined that, even though the Railroad Commission records would not have alerted the royalty owner to the reservoir damage or the subsequent lawsuit, the discovery rule did not apply because injury to a common reservoir by an adjoining operator is not inherently undiscoverable.[54] This decision suggests that, regardless of the accuracy or sufficiency of the information provided by oil and gas operators, land and royalty owners may not rely on the discovery rule because their injuries are always discoverable.[55]

III. *HECI EXPLORATION CO. V. NEEL*

A. Factual and Procedural History

Mr. Neel and members of his family owned royalty interests in an oil and gas lease operated by HECI.[56] Between 1985 and 1988, AOP Operating Corporation, a lessee operating on adjoining acreage that shared a common reservoir with the HECI leasehold, periodically engaged in excessive overproduction.[57] AOP's overproduction violated rules promulgated by the Texas Railroad Commission, and HECI filed formal complaints.[58] By December 1988, AOP's overproduction resulted in permanent damage to the reservoir and loss of oil and gas reserves that HECI otherwise could have produced.[59]

HECI sued AOP in 1988, and in May 1989 was awarded $1,719,956 in actual damages and $2,000,000 in punitive damages.[60] The court also granted permanent injunctive relief.[61]

51. *Id.* at 883–84.
52. *Id.* at 884.
53. *Id.*
54. *Id.* at 887.
55. Refer to Part III *infra* (discussing the *HECI* case in detail).
56. *HECI*, 982 S.W.2d at 884.
57. *Id.*
58. *Id.*
59. *Id.* ("[P]roduction by AOP at excessive rates caused oil to migrate into the gas cap overlying the oil reserves, which diminished the amount of oil and gas that can be recovered.").
60. *Id.*
61. *Id.*

Subsequently, HECI and AOP settled the dispute, and HECI filed a release of the judgment.[62]

The Neels did not learn of HECI's lawsuit against AOP until 1993.[63] At that time, they sued HECI to recover a one-sixth share of HECI's judgment against AOP.[64] The Neels claimed breach of contract to pay royalty on production, negligent misrepresentation for failure to notify them about either the illegal overproduction or the lawsuit, breach of implied covenant to protect the leasehold, and unjust enrichment.[65] The trial court granted HECI's motion for summary judgment on three specific points:

> (1) the Neels did not convey to HECI their causes of action against AOP; (2) there was no fiduciary relationship between the Neels and HECI; and (3) the express terms of the lease did not impose on HECI an obligation to give the Neels information affecting their interest in the leasehold.[66]

The Austin Court of Appeals affirmed summary judgment against the Neels' claim for royalty on lost production and reversed summary judgment against the Neels' remaining claims.[67] Determining that the discovery rule applied to the other causes of action, the court found that HECI had neither negated the merits of the claims nor established that the Neels "should have known of [their injury]."[68] The court of appeals dismissed HECI's argument that the existence of its suit against AOP was inherently discoverable.[69] The court concluded that nothing in the Railroad Commission records would have notified the Neels that HECI had sued AOP, "much less the need [for the

62. *Id.*

63. *Id.*

64. *Id.* "Under the lease, the Neels conveyed their rights in the oil to HECI" in exchange for one-sixth of the oil produced. Neel v. HECI Exploration Co., 942 S.W.2d 212, 216 (Tex. App.—Austin 1997), *rev'd in part by* 982 S.W.2d 881 (Tex. 1998).

65. *HECI*, 982 S.W.2d at 884.

66. *Neel*, 942 S.W.2d at 215 (noting the trial court's reasons for granting partial summary judgment and commenting that "[t]he [trial] court later granted a multi-faceted motion for summary judgment, disposing of all the Neels' claims . . . without stating a specific basis").

67. *Id.* at 223. The court concluded that the Neels did not have a cause of action under the royalty provisions of their lease because their royalty interest accorded them one-sixth of the oil *produced*. *Id.* at 219. "Texas narrowly defines 'produced' as oil physically extracted from the ground." *Id.* (citing Rogers v. Osborn, 261 S.W.2d 311, 312 (Tex. 1953)). Because the judgment against AOP awarded damages to HECI based on "the reduction in value of 'HECI's reserves' [in place], not production," the Neels were not entitled to any portion of HECI's judgment against AOP. *Id.*

68. *Id.* at 222.

69. *Id.* at 221–22.

Neels] to represent their own interests in such a suit."[70] The court agreed with the Neels' contention that due diligence did not require them to scour newspapers in jurisdictions in which they did not live or to "comb through records of the . . . district clerk's office looking for lawsuits that might adversely affect their interests."[71] Because the Neels had no reason to suspect injury or wrongdoing, the court distinguished this case from others in which "the royalty interest owners knew facts that should have triggered knowledge of their injury."[72] On appeal, the Texas Supreme Court reversed this decision, holding that the Neels' injury was not inherently undiscoverable.[73]

B. Texas Supreme Court Decision[74]

Before examining whether the discovery rule applied to the Neels' claims, the Texas Supreme Court established that "[a]ny causes of action based on a duty to notify the Neels [of their] claim against AOP accrued contemporaneously with the Neels' causes of action against AOP for damage to the reservoir."[75] Therefore, the Neels' claims against HECI accrued at the same time as their claims against AOP.[76]

The court noted that the discovery rule has been applied to categories of cases in which the nature of the injury is "inherently undiscoverable" and the injury itself is "objectively verifiable."[77] In analyzing whether the reservoir damage was inherently undiscoverable, the court's decision turned on the fact

70. *Id.* at 221.

71. *Id.*

72. *Id.* at 221–22, 222 n.5 (distinguishing *Neel* from cases such as *Rogers v. Ricane Enteprises, Inc.*, 930 S.W.2d 157 (Tex. App.—Amarillo, 1996, writ denied), in which the working interest owner could see wells producing on the property for several years before filing a lawsuit, and *Harrison v. Bass Enterprises Production Co.*, 888 S.W.2d 532 (Tex. App.—Corpus Christi 1994, no writ), in which the royalty owners knew production had occurred and knew that they had received no royalty from that production).

73. HECI Exploration Co. v. Neel, 982 S.W.2d 881, 886 (Tex. 1998).

74. In addition to its discovery rule analysis, the Texas Supreme Court determined that lessees do not have an implied duty to notify royalty owners of intentions to sue an adjoining operator for damage, and that summary judgment was properly granted in favor of HECI on the unjust enrichment claim. *Id.* at 890–92.

75. *Id.* at 885 (disagreeing with the court of appeals' finding that the causes of action accrued on the date that HECI sued AOP).

76. *Id.* The court reasoned that, if the discovery rule applied, the cause of action accrued at the time the Neels knew or, through the exercise of reasonable diligence, should have known that AOP was excessively producing. *Id.* at 886.

77. *Id.* (citing S.V. v. R.V., 933 S.W.2d 1, 6 (Tex. 1996) and Computer Assocs. Int'l, Inc. v. Altai, Inc., 918 S.W.2d 453, 456 (Tex. 1996), and commenting that, in applying these two "unifying principles," the court "attempted to bring predictability and consistency . . . in this area").

that the reservoir extended beyond the Neels' property line.[78] The court decided that royalty owners should know whether their reservoir is shared with others because "when there are other wells drilled in a common reservoir, there is the potential for drainage or damage to the reservoir."[79] The court suggested that the Neels could have obtained information about the existence of a common reservoir and operations conducted in it from HECI or from the Railroad Commission.[80] The court held that, because the damage to the reservoir caused by AOP's illegal production was not the type of injury that is inherently undiscoverable,[81] HECI's failure to notify the Neels that a cause of action existed against AOP was also not inherently undiscoverable.[82] The court did not decide the issue of whether a covenant to notify royalty owners should be implied in a mineral lease, but instead concluded that "[i]mplied covenants do not dispense with the need for royalty owners to exercise due diligence in enforcing their contractual rights, expressed or implied, within the statutory limitations period."[83] Because the Neels did not make any inquiries about potential damage to the reservoir, the court concluded that they could not sue "for breaches of contract that could have been discovered within the limitations period if reasonable diligence had been exercised."[84] In other words, that someone was drilling on an adjacent tract of land should have caused the Neels to suspect possible damage to their reservoir.[85] Consequently, the Neels should have known to ask HECI if it

78. *Id.*

79. *Id.*

80. *Id.* The court rejected HECI's contention that "all records maintained by the Railroad Commission constitute constructive notice to royalty owners of their content." *Id.* The court further stated that, although "some records of the Railroad Commission in certain circumstances may provide constructive notice, the records regarding illegal production by AOP are not of that character in the context of the Neels' claims against HECI." *Id.* at 887.

81. *Id.* The court restricted its analysis to whether the type of injury was "inherently undiscoverable." *Id.* at 886–87. Upon concluding that it was not, the court did not proceed to discuss whether the injury itself was "objectively verifiable." *See id.* at 886, 888.

82. *Id.* at 886–87 ("[W]hen the Neels knew or should have known that they had a cause of action against AOP, they knew or should have known that HECI had not told them of that claim.").

83. *Id.* at 887 (explaining that, had AOP drained the reservoir and had HECI violated the express or implied covenant to protect the leasehold by doing nothing, "it does not follow that the cause of action the Neels would have against HECI would be inherently undiscoverable").

84. *Id.* at 887–88.

85. Refer to note 80 *supra* and accompanying text (citing the court's assertion that a royalty owner should determine whether a common reservoir underlies its lease). *See also HECI*, 982 S.W.2d at 886 ("[W]ells visible on neighboring properties may put royalty owners on inquiry.").

had sued anyone recently concerning the reservoir. Because the Neels did not so inquire, HECI was entitled to keep the entire judgment.[86]

C. The HECI *Legacy*

The *HECI* decision has been interpreted as standing for the proposition that virtually all injuries arising from oil and gas claims are discoverable, in effect precluding application of the discovery rule.[87] The Texas Supreme Court found that the Neels should have discovered their injury, despite the court's admission that a review of Railroad Commission records would have revealed only that the Neels shared a common reservoir with other landowners.[88] The court concluded that the existence of a common reservoir shifted the burden to the Neels to inquire about potential injury.[89] Would a duly diligent lay-person really know that the existence of a common reservoir should trigger suspicion about overproduction-induced reservoir damage?

The court pointed to other cases in which courts of appeals held that the discovery rule did not apply in "analogous contexts."[90] These cases are analogous to *HECI*, however, only in that they involve oil and gas issues.[91] The cases are distinguishable from *HECI* because, unlike the Neels, the plaintiffs could have learned of their injury from information contained in public records.[92]

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86. *Id*. at 888, 892 (holding that the Neels' claims for breach of contract and negligent misrepresentation were barred by limitations and rendering judgment that the Neels take nothing).

87. *See* Information Sheet, Texas Land & Mineral Owners Assoc. 1 (1999) (commenting that the case "wiped out the 'discovery rule'").

88. *HECI*, 982 S.W.2d at 886–87.

89. *See id*. at 886–88.

90. *Id*. at 888 (citing Rogers v. Ricane Enters., Inc., 930 S.W.2d 157, 169 (Tex. App.—Amarillo 1996, writ denied); Koch Oil Co. v. Wilber, 895 S.W.2d 854, 863 (Tex. App.—Beaumont 1995, writ denied); and Harrison v. Bass Enters. Prod. Co., 888 S.W.2d. 532, 538 (Tex. App.—Corpus Christi 1994, no writ)).

91. *See* Neel v. HECI Exploration Co., 942 S.W.2d 212, 221–22, 222 nn.4–5 (Tex. App.—Austin 1997) (citing *Rogers*, 930 S.W.2d at 157; *Wilber*, 895 S.W.2d at 854; and *Harrison*, 888 S.W.2d at 532), *rev'd in part by* 982 S.W.2d 881 (Tex. 1998). The cases that the Texas Supreme Court suggests are "analogous" to *HECI* are the same cases the court of appeals cited to support its decision that the Neels were not given reason to suspect injury. Refer to note 72 *supra* and accompanying text. The court of appeals carefully distinguished these cases from *HECI* because they all involved circumstances in which the royalty owner had actual knowledge of injury. Refer to note 72 *supra* and accompanying text (describing the case-specific circumstances indicated by the court of appeals).

92. Refer to notes 93–105 *infra* and accompanying text (detailing the pertinent cases).

For example, in *Rogers v. Ricane Enterprises, Inc.*,[93] the Rogers Group, shareholders of a corporate oil and gas lessee, sued to recover possession of a working mineral interest consisting of an approximately 330-acre tract located on a leasehold of nearly 8,000 acres.[94] The Rogers Group claimed that assignment of this interest was void and that the defendant operator had converted the oil and gas beneath the property.[95] The court found that the Rogers Group could not rely on the discovery rule to toll the statute of limitations because the Rogers Group could have discovered defendant's production both by visual inspection of the land and by reviewing mandatory filings with the Railroad Commission.[96]

In *Koch Oil Co. v. Wilber*,[97] royalty owners brought a class action suit against operators for failing to pay royalties.[98] The court rejected the plaintiffs' contention that the discovery rule should apply.[99] In particular, the court referred to "[p]ublic records from the railroad commission introduced in the trial court" to show that the royalty owners were aware that royalty payments had ceased.[100]

Similarly, in *Harrison v. Bass Enterprises Production Co.*,[101] a nonparticipating royalty interest owner sued an operator to recover unpaid royalties.[102] The court refused to apply the discovery rule because the royalty owner's own files indicated that the operator was producing from the leasehold, and the owner was aware that he had received no royalty payments.[103] A review of public records could have verified that the royalty owner had a cause of action against the operator for unpaid royalties.[104] As a result, the court found that the owner could have discovered his injury using due diligence.[105] Unlike *HECI*, in each of these cases a review of Railroad Commission records would have revealed the plaintiffs' injury.

93. 930 S.W.2d 157 (Tex. App.—Amarillo 1996, writ denied).
94. *Id.* at 162.
95. *Id.*
96. *Id.* at 169.
97. 895 S.W.2d 854 (Tex. App.—Beaumont 1995, writ denied).
98. *Id.* at 859–61.
99. *Id.* at 863.
100. *Id.*
101. 888 S.W.2d 532 (Tex. App.—Corpus Christi 1994, no writ).
102. *Id.* at 535.
103. *Id.* at 538.
104. *Id.*
105. *Id.*

In *HECI*, the Texas Supreme Court admitted that the Neels would not have discovered AOP's illegal overproduction or the resulting damage to their reservoir in Railroad Commission records.[106] Nevertheless, the court determined that the mere fact that the Neels shared a reservoir with other landowners shifted the burden to the Neels to inquire about potential injury.[107] Previously, however, the Texas Supreme Court had held that "[p]laintiffs [have] a right to rely on the presumption that [the] defendant [will] obey the law."[108] Consequently, plaintiffs have no duty to determine wrongdoing on the part of the defendant until facts are presented that would put an ordinarily prudent person on inquiry.[109] Courts have relied on this reasoning to determine when a plaintiff should suspect injury.[110]

For example, in *Tanglewood Terrace, Ltd. v. City of Texarkana*,[111] an apartment complex owner sued the Texarkana City Water Department for overcharges on water bills resulting from billing errors that extended over a period of sixteen years.[112] The court decided that the owner "had a right to rely on the presumption that [the city] would obey the law."[113] Because the owner was given no reason to believe that an incorrect rate had been charged, the discovery rule applied to toll the running of the statute of limitations until the time the owner actually discovered the injury.[114]

The Austin Court of Appeals applied similar reasoning in *City of Austin v. North Austin State Bank*.[115] The bank sued the city to recover excess sums paid for electricity over a period of seven years.[116] The city argued that the bank could have discovered the city's mistake by comparing the city utility ordinance, which listed the rate that the bank should have been charged, to the bank's erroneous monthly statements.[117] According to the city, the bank was therefore put on notice and

106. HECI Exploration Co. v. Neel, 982 S.W.2d 881, 887 (Tex. 1998).

107. *Id.* at 886–87.

108. El Paso Elec. Co. v. Raynolds Holding Co., 100 S.W.2d 97, 101–02 (Tex. 1937) (holding that utility customers had the right to assume that electric bills were not unlawfully discriminatory).

109. *Id.* at 102.

110. Refer to notes 111–20 *infra* and accompanying text (summarizing cases applying this reasoning and finding no duty to inquire about potential injury).

111. 996 S.W.2d 330 (Tex. App.—Texarkana 1999, no pet.).

112. *Id.* at 334.

113. *Id.* at 342.

114. *Id.*

115. 631 S.W.2d 564, 566 (Tex. App.—Austin 1982, no writ).

116. *Id.* at 565.

117. *Id.* at 566.

would have discovered the injury had it diligently pursued the matter.[118] Rejecting the city's argument, the Austin Court of Appeals decided that the bank "had a right to rely on the presumption that [the city] would obey the law and would give [the bank] the benefit of the rate that [it was] entitled to receive under the published schedule."[119] The bank was "under no duty to exercise diligence to discover the over-charges (even if [it] could have reasonably done so) until [it] came into possession of facts sufficient to cause [it] to distrust [the city], and also to put an ordinarily prudent person on inquiry."[120]

The *HECI* case is arguably more analogous to *Tanglewood Terrace* and *North Austin State Bank* than to the oil and gas cases that the Texas Supreme Court listed to support its decision. As in *Tanglewood Terrace* and *North Austin State Bank*, the plaintiffs in *HECI* should have been entitled to presume that their lessee was obeying the law.[121] The Railroad Commission determines and enforces the amount each operator may produce in order to increase efficiency and prevent damage to reservoirs.[122] Additionally, lessees are under contractual and statutory obligations to provide accurate royalty payments and information to their lessors and the Railroad Commission.[123] As a result, the burden to investigate potential injury should not have shifted to the plaintiffs until they had reason to suspect wrongdoing. Mere knowledge that the Neels shared a common reservoir with other landowners should not have been viewed as sufficient grounds to suspect AOP or HECI of wrongdoing, or to require the Neels to inquire about damage.

Recently, the Texas Supreme Court reviewed another oil and gas claim involving the application of the discovery rule. In *Wagner & Brown, Ltd. v. Horwood*,[124] royalty owners sued their lessee for incorrect royalty payments on gas production.[125] Prior

118. *Id.*

119. *Id.* at 566–67 (quoting from and relying on the Texas Supreme Court's reasoning in El Paso Elec. Co. v. Raynolds Holding Co., 100 S.W.2d 97 (Tex. 1937)).

120. *Id.* at 567.

121. Refer to notes 111–14 *supra* and accompanying text (discussing *Tanglewood*) and notes 115–20 *supra* and accompanying text (discussing *North Austin State Bank*).

122. SMITH & WEAVER, *supra* note 16, at 10-5 to 10-6, 10-40 to 10-42 (explaining that the Railroad Commission regulates production by establishing an efficient rate of production from each field and then allocating this optimum production rate among the different leaseholds and wells).

123. Watt, *supra* note 43, at 14 (arguing that the highly regulated nature of the oil and gas industry will not create a situation in which nothing can ever be deemed inherently undiscoverable).

124. No. 00-0041, 2001 WL 987344 (Tex. Aug. 30, 2001).

125. *Id.* at *1.

to 1985, the royalty owners hired an independent firm to review their lessee's statements and were informed that their lessee was charging excessive compression fees, thereby reducing the royalties payable under their leases.[126] The royalty owners contacted their lessee about the overcharges and were informed that the compression fee had been reduced.[127] In 1996, the royalty owners sued, alleging that their lessee had not reduced the compression fee, but instead had doubled the fee over a ten year period.[128]

Because the statute of limitations had run, the trial court granted summary judgment in favor of the defendants on all claims that accrued prior to 1992.[129] The court of appeals reversed summary judgment and remanded the cause for further proceedings, holding that the discovery rule applied to toll the statute of limitations.[130] In analyzing whether to apply the discovery rule, the court determined that the injury could be objectively verified through a combination of expert testimony and financial records.[131] The court found that the statements given to the plaintiffs indicated that an injury had not occurred.[132] Under these facts, the nature of the plaintiffs' injury was inherently undiscoverable despite due diligence.[133]

On review, the Texas Supreme Court determined that the court of appeals erred in applying the discovery rule.[134] Using *HECI*'s analysis to guide its decision, the court decided that the nature of the royalty owners' injury was not inherently undiscoverable because the royalty owners had the ability to determine whether the compression fees were proper and reasonable.[135] The court found that the royalty owners had "several sources of information available . . . from which they could have discovered the propriety of [the] post-production

126. *Id.* (explaining that operators are entitled to deduct post-production costs, such as compression fees, from royalty payments).

127. *Id.*

128. *Id.*

129. *Id.* at *2.

130. *Id.*

131. Horwood v. Wagner & Brown, Ltd., No. 08-98-00234-CV, 1999 WL 33321789, at *7 (Tex. Ct. App.—El Paso Sept. 21, 2001), *reversed by* 2001 WL 987344 (Tex. Aug. 30, 2001).

132. *Id.* at *4.

133. *Id.*

134. *Horwood*, 2001 WL 987344, at *6.

135. *Id.* at *4–5 (commenting that, because the injury was not inherently undiscoverable, the court did not need to consider whether the injury was objectively verifiable).

charges."[136] These "sources," however, consisted of the lessee accused of wrongdoing, the general partner of the lessee, which was responsible for compressing the gas, and the gas purchasers who deducted the compression charges from the amount they paid to purchase the gas.[137] Of the three, only the lessee was legally required to provide information to the royalty owners.[138] The court's decision suggests that, though the lessee misled the royalty owners, the injury could have been discovered if only the royalty owners had asked the lessee whether it was excessively charging fees in order to underpay its royalty obligations.[139] As in *HECI*, because the royalty owners in *Horwood* did not "turn to the lessee for information," they were unable to rely on the discovery rule to protect their claims from the statute of limitations.[140] Unfortunately, *Horwood* appears to confirm *HECI*'s legacy as providing oil and gas producers with an incentive to hide wrongful acts until the statute of limitations has run.

IV. THE DISCOVERY RULE SHOULD APPLY TO OIL AND GAS CASES

Despite the looming legacy of the *HECI* decision, Texas courts should continue to apply the discovery rule to oil and gas cases. There are several reasons to support application of the discovery rule to claims arising from oil and gas issues. First, oil and gas leases are different from other leases because they convey a fee simple determinable, and royalty owners rely on lessees for their expertise and to provide accurate information.[141] Second, many royalty disputes are inherently undiscoverable.[142] Third, Texas courts traditionally have applied the discovery rule in oil and gas cases and in cases involving other legal issues.[143] Finally, other states have refused to exclude application of the discovery rule from certain types of cases;[144] in fact, the discovery rule has been codified in some state laws.[145]

136. *Id.* at *4.
137. *Id.*
138. *Id.*
139. *Id.*
140. *Id.* at *4, *6.
141. *See* SMITH & WEAVER, *supra* note 16, at 2-3, 4-8 to 4-9.
142. Refer to Part IV.B *infra*.
143. Refer to Parts IV.C and IV.D *infra*.
144. Refer to Part IV.E *infra*.
145. Refer to Part IV.F *infra*.

A. Oil and Gas Leases Warrant Application of the Discovery Rule

Oil and gas leases are unique from other types of leases or contracts. Unlike leases for apartments or vehicles, oil and gas leases convey a fee simple determinable.[146] In other words, when a mineral owner signs an oil and gas lease, the lessee becomes the owner of the oil and gas in the ground as long as production continues.[147] The timeframe for the oil and gas lease is indefinite, and the lessor retains only a contractual right to receive royalties and other benefits specified in the contract.[148] Moreover, when a lease on an apartment or car terminates, the entire apartment or car is returned to the lessor.[149] With oil and gas leases, however, the minerals extracted and sold on the energy market are gone forever.[150] That the lessee has superior knowledge not easily discoverable by the royalty owner also makes oil and gas leases unique.[151] The lessor relies on the operator to determine whether there is oil or gas beneath the surface and, if there is, to extract and sell it, providing the lessor his fractional share.[152]

Most courts have been reluctant to define the relationship between a royalty owner and an operator as fiduciary in nature.[153] Courts have noted, however, that a special relationship exists.[154] Operators have knowledge of information not readily available to royalty owners.[155] Additionally, operators have a statutory duty to notify royalty owners of their financial benefits and the methods by which proceeds will be paid.[156]

146. SMITH & WEAVER, *supra* note 16, at 2-23.

147. *Id.*

148. Summary, Texas Land & Mineral Owners Assoc., *supra* note 14, at 3.

149. *Id.* at 4.

150. *Id.*

151. *See id.* at 3 (noting that, although "[m]ost operations are meticulously documented," this information is not available within the Railroad Commission for royalty owners to review, and that most operators consider records regarding operations "confidential and proprietary and will not release this information without a court order").

152. *Id.*

153. *See, e.g.*, Goodall v. Trigg Drilling Co., 944 P.2d 292, 296 (Okla. 1997) (Summers., V.C.J., concurring) (quoting Professor Kuntz as stating that "standards applied to fiduciaries are entirely too strict. . . . because the lessee has not undertaken to manage and develop the property for the sole benefit of the lessor").

154. *See, e.g.*, *id.* at 296–97 (suggesting that the relationship between an operator and royalty interest owner is quasi-fiduciary because a "'special relationship of trust and confidence has been developed between the parties . . . [and because] one party rel[ies] upon the superior specialized knowledge and experience of the other'" (quoting Colonial Imports v. Carlton Northwest Inc., 853 P.2d 913, 917 (Wash. 1993))).

155. *Id.* at 296.

156. *Id.*

"While an operator may maximize its own business profits, it should not be allowed to do so to the detriment of the royalty owners who have bestowed confidence and trust in the business integrity of the operator."[157]

Courts have determined that application of the discovery rule is most warranted when the defendant is in a position of "superior knowledge" and has full opportunity to know that its conduct breaches a duty to the plaintiff.[158] Requiring royalty owners to "stake out all government agencies in which their lessees might initiate proceedings that might affect the royalty owners' interest. . . . would impose great burdens not only on royalty owners, but on the courts, agencies and the non-oil interests served by those entities."[159] It is because of the unique nature of this contractual relationship between royalty owners and operators that many injuries arising under oil and gas leases are inherently undiscoverable.

B. Royalty Disputes Are Inherently Undiscoverable

Discovery rule claims in oil and gas cases "typically arise out of wrongful drainage, pooling, development, marketing and accounting issues between royalty owners and oil companies."[160] These claims involve damages that are generally measured as underpayment of royalties.[161] Typically, underpayment of royalties is inherently undiscoverable because only the operator knows the information necessary to discover the wrongdoing.[162] "[P]ricing information contained in publicly filed indexes and private publications can not be translated into equivalent prices without additional information regarding the type of product being produced, any market deductions, and the basis for pricing."[163] Furthermore, royalty payments are "so complex and

157. *Id.*

158. *See, e.g.*, Gust, Rosenfeld & Henderson v. Prudential Ins. Co. of America, 898 P.2d 964, 968 (Ariz. 1995) (finding that a breach of contract claim is subject to the discovery rule when the injured party has difficulty detecting the injury because he was not a party to the agreement).

159. Watt, *supra* note 43, at 14 (proposing that the discovery rule should be applied to claims arising under oil and gas leases).

160. Summary, Texas Land & Mineral Owners Assoc., *supra* note 14, at 2.

161. *Id.*

162. *Id.*

163. *Id.* (explaining that documents filed by the operator with the Railroad Commission do not tell the royalty owner what he needs to know, and noting that in a recent deposition taken during a royalty payment dispute against a unit of Fina, Inc., one Texas Railroad Commission hearings examiner testified that "even the Railroad Commission staff members cannot determine many basic characteristics about a well just from an operator's public filings").

obscure that mineral owners are regularly taken advantage of by producers."[164]

Questioning the Texas Supreme Court's decision in *HECI*, the San Antonio Court of Appeals commented recently that the oil and gas industry is an area in which "the smartest and most aggressive can make a great deal of money from a less-knowledgeable class of royalty interest owners."[165] The court suggested that royalty owners are not in a position to determine what records provide constructive notice.[166] Additionally, the court commented that requiring them "to hire the experts necessary to investigate whether the Railroad Commission records reveal they are being cheated is inherently unfair and unworkable in the oil and gas business environment."[167]

C. Texas Courts Apply the Discovery Rule in Oil and Gas Cases

Despite what opponents of the discovery rule may suggest, Texas courts have applied the discovery rule to cases involving oil and gas claims. For example, *Dorchester Gas Producing Co. v. Hagy*[168] involved a royalty dispute.[169] The royalty owner sued for underpayment of royalties pursuant to a contract that required royalties to increase upon a federal order increasing minimum wellhead prices.[170] Although a federal order subsequently raised the minimum wellhead price, the royalty owner's royalties did not increase.[171] The court found that the injury was inherently undiscoverable because the plaintiff could not learn of any price increases except through one of the parties to the federal order, such as the producer.[172] Consequently, the court applied the discovery rule to prevent the plaintiff's claims from being barred by the statute of limitations.[173]

164. Gold, *supra* note 1, at A1 (quoting Seldon Graham, Jr., a retired Exxon attorney and petroleum engineer, as saying that he could analyze "anybody's" royalty check and find mistakes to the benefit of the operators).

165. Advent Trust Co. v. Hyder, 12 S.W.3d 534, 540 n.1 (Tex. App.—San Antonio 1999, pet. denied) (noting that it was "bewildered" by the Texas Supreme Court's decision and suggesting that the *HECI* decision not only failed to bring predictability and consistency to this area of the law, but made the situation worse).

166. *Id.*

167. *Id.*

168. 748 S.W.2d 474 (Tex. App.—Amarillo 1988, writ dism'd by agr.).

169. *Id.* at 475.

170. *Id.* at 476.

171. *Id.* at 477.

172. *Id.* at 480.

173. *Id.*

In *Houston Endowment Inc. v. Atlantic Richfield Co.*,[174] royalty owners sued working interest owners for underpayment of royalties.[175] Atlantic Richfield Company (Arco) argued that the discovery rule should not apply to royalty dispute cases because production volumes and severance taxes are a matter of public record, thus making the amount owed discoverable and calculable.[176] The court determined that "Arco's underpayment of royalties was not information about which the royalty owners, using due diligence, would ordinarily learn."[177] In fact, the court decided the royalty owners would not have learned this information unless it was supplied by a working interest owner.[178] The court ruled that, because the injury was both inherently undiscoverable and objectively verifiable, the discovery rule tolled the statute of limitations until the royalty owners subjectively knew or should have known of the underpayment.[179]

Texas courts have also applied the discovery rule to property damage causes of action.[180] In *Bayouth v. Lion Oil Co.*,[181] for example, plaintiffs brought suit claiming damages for permanent injury to land caused by saltwater migration from oil leases.[182] The Texas Supreme Court decided that "[a]n action for permanent damages to land accrues, for limitation purposes, upon discovery of the first actionable injury."[183]

D. Texas Courts Apply the Discovery Rule Generally

Texas courts have also applied the discovery rule in a variety of other types of claims, such as cases involving negligence,[184]

174. 972 S.W.2d 156 (Tex. App.—Houston [14th Dist.] 1998, no pet.).

175. *Id.* at 157–58.

176. *Id.* at 160.

177. *Id.*

178. *Id.*

179. *Id.* at 159–60. Although the court applied the discovery rule in this case, Arco's summary judgment proof established that the royalty owners knew or should have known about the underpayments more than four years before they took action on the claim. *Id.* at 162. As a result, the court found that Arco was entitled to summary judgment based on the statute of limitations. *Id.* at 163.

180. *See, e.g.*, Mitchell Energy Corp. v. Bartlett, 958 S.W.2d 430, 435–36 (Tex. App.—Fort Worth 1997, pet. denied) (finding that "under the discovery rule, the test is not discovery of the *cause* of the injury; rather the test is discovery of the injury itself") (emphasis in original).

181. 671 S.W.2d 867 (Tex. 1984).

182. *Id.* at 868.

183. *Id.* (explaining that "[a]n action for permanent damages to land must be brought within two years from the time of discovery of the injury").

184. *See, e.g.*, Diesel Fuel Injection Serv., Inc. v. Gabourel, 893 S.W.2d 610, 613 (Tex. App.—Corpus Christi 1994, no writ) (concluding that the statute of limitations was

fraud,[185] breach of contract,[186] defamation,[187] medical malpractice,[188] and legal malpractice.[189] In cases in which one party has a fiduciary duty to another, such as attorney or medical malpractice, injuries are often found inherently undiscoverable due to one party's reliance on the expertise of the other.[190] Apart from cases involving special relationships, the Texas Supreme Court has "indicated that the discovery rule applies when it is otherwise difficult for the injured party to learn of the wrongful act."[191] The common thread in all discovery rule cases is that the wrong and injury, due to their nature and without fault of the plaintiff, were unknown to the plaintiff.[192]

In *Diesel Fuel Injection Service, Inc. v. Gabourel*,[193] Gabourel sued for negligent repair of an engine.[194] The engine failed to perform properly for over a year after Diesel Fuel Injection Service completed the overhaul.[195] Finally, the engine completely failed and Gabourel took it to another repair company, which discovered that the problems were caused by a piece of wood in

properly tolled because the plaintiff was unable to discover the problems concerning his boat's engine).

185. *See, e.g.*, Ruebeck v. Hunt, 176 S.W.2d 738, 740 (Tex. 1943) (determining that fraud tolled the statute of limitations because the faulty construction of the roof was undiscoverable by the homeowner and because the homeowner relied on the contractor to inspect the roof).

186. *See, e.g.*, Enterprise-Laredo Assocs. v. Hachar's, Inc., 839 S.W.2d 822, 837–38 (Tex. App.—San Antonio 1992, writ denied) (reasoning that plaintiff's breach of contract claim is not barred by limitations because plaintiff's ability to discover overcharges would have required more than reasonable diligence).

187. *See, e.g.*, Kelley v. Rinkle, 532 S.W.2d 947, 949 (Tex. 1976) (deciding that the discovery rule applies to cases involving the publication of defamatory reports to credit agencies).

188. *See, e.g.*, Hays v. Hall, 488 S.W.2d 412, 414 (Tex. 1972) (deciding that the discovery rule applied in a case involving a negligently performed vasectomy that was confirmed by a subsequent pregnancy); Gaddis v. Smith, 417 S.W.2d 577, 581 (Tex. 1967), *superseded by statute in* Delgado v. Burns, 650 S.W.2d 505 (Tex. App.—Houston [14th Dist.] 1983), *rev'd*, 656 S.W.2d 428 (Tex. 1983) (holding that "[c]auses of action based upon the alleged negligence of a physician in leaving a foreign object in his patient's body are proper subjects for the 'discovery rule'").

189. *See, e.g.*, Willis v. Maverick, 760 S.W.2d 642, 646 (Tex. 1988) ("[T]he statute of limitations for legal malpractice actions does not begin to run until the claimant discovers or should have discovered through the exercise of reasonable care and diligence the facts establishing the elements of his cause of action.").

190. *See* S.V. v. R.V., 933 S.W.2d 1, 5 (Tex. 1996) (citing *Willis*, 760 S.W.2d at 646, as an example of an attorney's error being inherently undiscoverable because of the client's ignorance of the law).

191. *Id.* at 6 (referring to *Gaddis*, 417 S.W.2d at 580).

192. *Id.* at 7.

193. 893 S.W.2d 610 (Tex. App.—Corpus Christi 1994, no writ).

194. *Id.*

195. *Id.* at 610–11 (noting that Gabourel returned the engine to Diesel Fuel Injection Service several times because it froze up, spit oil, did not have the required power, used excessive amounts of oil, and generally exhibited substandard performance).

the oil strainer.[196] The court decided that, because the problem with the engine could not be discovered without taking the engine apart, it was inherently difficult to discover.[197] As a result, the court applied the discovery rule and found that the statute of limitations did not bar Gabourel's claims.[198]

E. Application of the Discovery Rule Outside Texas

Application of the discovery rule varies by jurisdiction. Some courts apply "the discovery rule to broad categories of cases based on the nature of the wrong."[199] California and Oklahoma courts, for example, apply the discovery rule to tort claims.[200] Other courts refuse to limit the application of the discovery rule to narrow categories. Maryland, South Carolina, and Arizona, for example, expressly apply the discovery rule to common law cases involving both contract and tort law.[201] Moreover, the Alaska Supreme Court has found persuasive the policy argument that "[a] defendant should not be allowed to profit from a plaintiff's ignorance."[202]

196. *Id.* at 611.

197. *Id.*

198. *Id.* at 613.

199. MacAyeal, *supra* note 21, at 601.

200. *See, e.g.*, Leaf v. City of San Mateo, 163 Cal. Rptr. 711, 716 (Cal. Ct. App. 1980) (noting that the discovery rule has been "extended in the tort area" to include claims involving medical malpractice, legal malpractice, accountant malpractice, libel, products liability, violation of the right to privacy, negligent breach of contract, and negligent manufacture and marketing of drugs); N.C. Corff P'ship, Ltd. v. OXY USA, Inc., 929 P.2d 288, 293–94 (Okla. Ct. App. 1996) (finding that the discovery rule tolled the statute of limitations until the landowners became aware of groundwater pollution caused by former oil and gas well operators). *But see* April Enters., Inc. v. KTTV, 195 Cal. Rptr. 421, 437 (Cal. Ct. App. 1983) (finding that "[a]pplying the discovery rule to certain, rather unusual breach of contract actions poses no more burden for the courts than the date-of-injury accrual rule in most instances").

201. *See, e.g.*, Gust, Rosenfeld & Henderson v. Prudential Ins. Co. of America, 898 P.2d 964, 968–69 (Ariz. 1995) (en banc) (commenting that the important inquiry in applying the discovery rule is whether the plaintiff's injury or the conduct causing the injury is difficult to detect and not whether the claim is based on contract or tort law, and noting that "whether a tort victim or a contract claimant, a blamelessly uninformed plaintiff cannot be said to have slept on his rights"); Poffenberger v. Risser, 431 A.2d 677, 680 (Md. 1981) (reiterating the court's position that "'fairness to a plaintiff who has not slept on his rights justifies exceptions to (the) general rule'" and holding that, as there is "no valid reason why [the discovery] rule's sweep should not be applied to prevent an injustice in other types of cases," the discovery rule is to be "applicable generally in all actions"); Santee Portland Cement Co. v. Daniels Int'l Corp., 384 S.E.2d 693, 695 (S.C. 1989) (noting that the trend in recent years "has been toward recognition and expansion of the discovery rule" and finding no justification for refusing to extend it to contract causes of action), *overruled by* Atlas Food Sys. & Servs., Inc. v. Crane Nat'l Vendors Div. of Unidynamics Corp., 462 S.E.2d 858 (S.C. 1995).

202. Bauman v. Day, 892 P.2d 817, 828 (Alaska 1995) ("[I]n the absence of a statute directing a contrary rule, the discovery rule is applicable to common law contract causes

In *Frey v. Amoco Production Co.*,[203] the Fifth Circuit considered a royalty underpayment claim brought after the limitations period had run.[204] The court concluded that if the payment information included with the royalty check stub "contains an internal inconsistency cognizable from the face of the document, then it may be held that the stub's recipient could have reasonably known of a cause of action from the date of receipt."[205] In this case, however, the check stub understated the volume of gas produced.[206] The court found that the duty to investigate further did not arise until the royalty owner had reason to suspect an underpayment.[207] "Absent suspicion of Amoco, the plaintiffs had no reason to request further information from Amoco . . . ."[208] The court concluded that Louisiana's discovery rule[209] operated to suspend limitations until the royalty owner had reason to suspect an underpayment.[210]

In *N.C. Corff Partnership, Ltd. v. OXY USA, Inc.*,[211] surface owners sued former oil and gas well operators for pollution of groundwater.[212] Reviewing summary judgment in favor of the operators, the court of appeals noted that the statute of limitations for nuisance claims resulting in permanent damage "begins to run at such time as it becomes obvious and apparent that the land in question has been permanently damaged."[213] The court of appeals also commented that Oklahoma applies the discovery rule to toll the statute of limitations "'until such time as a reasonable person under the circumstances of the case would

of action.").

203. 943 F.2d 578 (5th Cir. 1991).

204. *Id.* at 586 (commenting that Louisiana's three-year liberal prescription period is "effectively a statute of limitations").

205. *Id.* at 587.

206. *Id.*

207. *Id.*

208. *Id.*

209. In Louisiana, the discovery rule of *contra non valentum agere nulla currit praescriptio* "suspends the running of prescription during the period in which the cause of action was not known by or reasonably knowable by the plaintiff." La Plaque Corp. v. Chevron U.S.A. Inc., 638 So. 2d 354, 356 (La. Ct. App. 1994).

210. *Frey*, 943 F.2d at 587 (noting that, absent internal inconsistencies shown on check stubs or rumors causing suspicion of Amoco, the royalty owners had no reason to request further information from Amoco and, consequently, could not have discovered royalty miscalculations).

211. 929 P.2d 288 (Okla. Ct. App. 1996).

212. *Id.* at 291 (noting the plaintiffs' allegation that OXY had improperly plugged or operated the wells on their land, resulting in elevated levels of chloride compounds in the groundwater beneath the plaintiffs' land).

213. *Id.* at 293.

have discovered the injury' and resulting claim."[214] Determining that "[t]he type of harm that can result from exploration and production operations, and the extent to which a landowner reasonably should be expected to be aware of such consequences" is an issue of fact,[215] the court of appeals reversed summary judgment and remanded the claim for further proceedings.[216]

U.S. Oil & Refining Co. v. State Department of Ecology[217] involved the issue of whether the Washington State Department of Ecology was time barred from collecting civil penalties against an oil company for illegally discharging pollutants.[218] The Washington Supreme Court held that the discovery rule applied to determine when the cause of action accrued.[219] Because the state waste regulatory scheme is based on self-reporting, without the discovery rule, industries would be able to discharge pollutants, fail to report the violation, and escape penalties.[220] The court noted that it has "a duty to construe and apply limitation statutes in a manner that furthers justice."[221] The court explained that the premise underlying all limitation statutes is "that 'when an adult person has a justiciable grievance, he usually knows it and the law affords him ample opportunity to assert it in the courts.'"[222] The court found this premise inapplicable "where the plaintiff must rely on the defendant's self-reporting."[223] The court held that, "[w]here self-reporting is involved, the probability increases that the plaintiff will be unaware of any cause of action, for the defendant has an incentive not to report it."[224] The court commented that not applying the discovery rule "would penalize the plaintiff and reward the clever defendant."[225]

214. *Id.* at 293–94 (quoting Weathers v. Fulgenzi, 884 P.2d 538, 541 (Okla. 1994)).

215. *Id.* at 294.

216. *Id.* at 295–96.

217. 633 P.2d 1329 (Wash. 1981).

218. *Id.* at 1331 (relating that on eighteen separate occasions U.S. Oil & Refining Co. had "submitted inaccurate monitoring reports and exceeded its effluent limits").

219. *Id.* at 1333–34.

220. *Id.*

221. *Id.* at 1334 (commenting that the court must balance "the possibility of stale claims" against "the unfairness of precluding justified causes of action," but that the "balancing test has dictated the application of the rule where the plaintiff lacks the means or ability to ascertain that a wrong has been committed").

222. *Id.* (quoting Ruth v. Dight, 453 P.2d 631, 634 (Wash. 1969)).

223. *Id.*

224. *Id.* (explaining that in some cases not applying the discovery rule would deny the plaintiff "a meaningful opportunity to bring a suit").

225. *Id.*

F. The Discovery Rule Codified

Some states have codified the discovery rule, as TLMA aspires to do with its amendment. The Texas Deceptive Trade Practices Act, for example, includes the discovery rule by specifically providing as follows:

> All actions brought under this subchapter must be commenced within two years after the date on which the false, misleading, or deceptive act or practice occurred or within two years after the consumer discovered or in the exercise of reasonable diligence should have discovered the occurrence of the false, misleading, or deceptive act or practice.[226]

Additionally, "thirty-nine states and the District of Columbia have adopted the Uniform Trade Secrets Act, which provides a discovery rule exception that tolls the statute of limitations in misappropriation of trade secret cases."[227] Colorado has incorporated the discovery rule into the statutes of limitations for both contract and tort claims.[228]

The Mississippi legislature codified the discovery rule for actions that involve "latent injury or disease."[229] In *Donald v. Amoco Production Co.*,[230] the Mississippi Supreme Court reviewed a case in which a purchaser of land sued oil companies for dumping oil field waste.[231] The court noted that it had applied the discovery rule "where the plaintiff w[ould] be precluded from discovering harm or injury because of the secretive or inherently undiscoverable nature of the wrongdoing in question" or "when it is unrealistic to expect a layman to perceive the injury at the time of the wrongful act."[232] Because the damage to property caused by the disposal of radioactive oil field waste was detectable only through the use of a survey meter, the court applied the discovery rule exception codified in

226. TEX. BUS. & COM. CODE ANN. § 17.565 (Vernon 2001).

227. Computer Assocs. Int'l, Inc. v. Altai, Inc., 918 S.W.2d 453, 458 (Tex. 1996) (citing UNIF. TRADE SECRETS ACT § 6, 14 U.L.A. 462 (1990)). "No state supreme court, however, has yet adopted the discovery rule exception for trade secret cases as an exercise of its common law jurisdiction." *Id*.

228. Trinity Broad. of Denver, Inc. v. City of Westminster, 848 P.2d 916, 923 (Colo. 1993) (citing COLO. REV. STAT. § 13-80-108 (1987) and noting the legislative intent to incorporate the discovery rule into the 1986 amendments to the Colorado Governmental Immunity Act).

229. MISS. CODE ANN. § 15-1-49 (2001) (establishing that the cause of action does not arise until the plaintiff "has discovered, or by reasonable diligence should have discovered, the injury").

230. 735 So. 2d 161 (Miss. 1999).

231. *Id.* at 164.

232. *Id.* at 168.

the statute of limitations.[233] The court commented that the legislature adopted the discovery rule "because it is illogical to bar an action before its existence is known."[234]

V. THE DISCOVERY RULE IN OIL AND GAS CLAIMS

Other policy reasons support application of the discovery rule. Application of the discovery rule is fair because it ensures that meritorious claims are heard and that plaintiffs are not precluded from a legal remedy merely because they were not aware of their injury.[235] The California Supreme Court called the discovery rule the "most important" exception to the general rule for defining the accrual of a cause of action because it allows diligent plaintiffs to bring their claims.[236]

Opponents of the discovery rule have argued its application in oil and gas contexts would "expose one of the state's basic industries and largest employers to a literal flood of stale claims."[237] They have suggested that "[e]xtending the discovery rule to oil and gas contract claims creates the possibility of claims for underpaid royalties thirty or forty years after payment, when records are lost, people long dead, and ownership of working and royalty interests have changed."[238] Additionally, opponents portray the application of the discovery rule as unfair, commenting that "[p]eople dealing in good faith under contracts should be able to close the books with certainty four years after payment or performance."[239]

In reality, however, the discovery rule does not undermine statutes of limitations. As one court has noted:

> The discovery rule itself contains procedural safeguards protecting against lengthy litigation on the issue of accrual.

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233. *Id.* (commenting that to time bar the plaintiff's claims "would put undue burden and cost on subsequent purchasers of real property" and "'would not only undermine the purposes for which statutes of limitations exist, but would also engender disrespect for our civil justice system'").

234. *Id.* at 166–67.

235. U.S. Oil & Refining Co. v. State Dept. of Ecology, 633 P.2d 1329, 1334 (Wash. 1981) (determining that for an injury to be "inherently undiscoverable" under the discovery rule, it must be unlikely to be discovered within the limitations period despite the use of due diligence).

236. Norgart v. Upjohn Co., 981 P.2d 79, 88 (Cal. 1999).

237. TEXAS CIVIL JUSTICE LEAGUE, ASSAULT ON CIVIL JUSTICE REFORM: SPECIAL INTERESTS WANT SPECIAL RULES 3 (1999) (commenting that the group's "top priority for the 2001 legislative session" will be to oppose and defeat TLMA's proposed discovery rule bill).

238. *Id.* at 5.

239. *Id.* at 4 ("Even the Internal Revenue Service has only three years to assert a claim for additional taxes.").

> It presumes that a plaintiff has knowledge of injury on the date of injury. In order to rebut the presumption, a plaintiff must plead facts sufficient to convince the trial judge that delayed discovery was justified. And when the case is tried on the merits the plaintiff bears the burden of proof on the discovery issue. Failure to meet this burden will result in dismissal of the suit.[240]

Because plaintiffs continue to bear the burden of proof, they are motivated to protect their interests and bring a claim as soon as they know they are injured.[241] Plaintiffs gain no benefit from delay, but "will be more likely to suffer prejudice from the lack of evidence associated with a stale claim than a defendant."[242]

Similarly, the discovery rule does not penalize those who deal in good faith under contracts. If parties are dealing in good faith, oil companies will not underpay royalties or hide information from royalty owners, and royalty owners will not bring unmeritorious or fraudulent claims against oil companies. If royalty owners have been incorrectly paid, working interest owners dealing in good faith would want to ensure that the situation is remedied, regardless of when the injury occurred or when the royalty owner learned about it.

Finally, allowing legal remedies to expire before injuries are even discovered gives defendants an incentive to conceal information until the statute of limitations runs so that they cannot be held accountable.[243] Particularly in oil and gas cases in which the plaintiff depends on the defendant's self-reporting, without the discovery rule lessees would be encouraged to conceal illegal operation until after the statute of limitations runs.[244]

The discovery rule is the only mechanism that provides incentives for oil and gas producers to comply with regulations that require accurate reporting.[245] "[D]espite Texas law requiring a response to royalty owner inquiries, most oil companies either refuse to produce information or just ignore the

240. April Enters., Inc. v. KTTV, 195 Cal. Rptr. 421, 437 (Cal. Ct. App. 1983) (citation omitted).

241. MacAyeal, *supra* note 21, at 600–01 (arguing that the discovery rule does not undermine the primary policy of statutes of limitations).

242. *Id.* at 600.

243. Gold, *supra* note 1, at A1 (citing Jack Hunt, president of King Ranch, as stating that producers have an incentive to hide information because, after the statute of limitations period has run, they will not be held accountable).

244. Refer to notes 216–24 *supra* and accompanying text.

245. Summary, Texas Land & Mineral Owners Assoc., *supra* note 14, at 2 (asserting that royalty owners with limited financial resources are "put at the mercy of the operators to tell them the truth and provide accurate information").

inquiry."[246] There are few, if any, negative consequences for oil and gas operators who do not provide accurate and complete information to land and royalty owners. The Texas Royalty Reporting Statute, for example, lists the information an operator must include with each royalty payment.[247] The statute has no teeth, however.[248] If the royalty owner does not receive this information, his only remedy is to make a written request by certified mail.[249] The operator is "required" to respond to a written request by certified mail within sixty days, but faces no penalty if it chooses not to do so.[250] TLMA hopes that codification of the discovery rule will solve this problem and that oil and gas operators will be motivated to provide royalty owners with accurate information in order to prevent courts from finding that injuries were inherently undiscoverable.[251]

TLMA suggests that private royalty owners should receive the same protection as government-owned royalties.[252] In 1996, Congress enacted a seven-year statute of limitations for claims by the federal government for underpayment of royalties.[253] Legislators provided that the statute of limitations is tolled if the lessee does not supply records in a timely manner, if the accounting required is not performed, or if the oil company conceals facts to evade payment.[254] TLMA views the fact that Congress requires cooperation from the oil companies to determine if royalties are being underpaid as an illustration of the inherent undiscoverability of many royalty claims.[255]

246. *Id.* (determining that the only available alternative for royalty owners is to file a lawsuit).

247. TEX. NAT. RES. CODE ANN. § 91.502 (Vernon 2001).

248. *Id.* § 91.505. This provision states that a royalty payor must respond to a royalty owner's written request for information by certified mail within thirty days after the request is received. *Id.* Yet, the statute does not provide a penalty if the payor fails to comply with this provision. *Id.* Compare this with provisions in Nevada that entitle a royalty owner to receive $100 per violation and $100 for each month that elapses until the operator provides the required information. NEV. REV. STAT. ANN. § 522.115 (Michie 2001). Moreover, in North Dakota an operator that fails to provide a royalty owner with "an information statement that will allow the royalty owner to clearly identify the amount of oil or gas sold and the amount and purpose of each deduction made from the gross amount due" is guilty of a class B misdemeanor. N.D. CENT. CODE § 38-08-06.3 (1999).

249. TEX. NAT. RES. CODE ANN. § 91.507.

250. *Id.* (stating that either party may request mediation or file a lawsuit).

251. *See* Summary, Texas Land & Mineral Owners Assoc., *supra* note 14, at 5 (discussing the proposal of a ten-year statute of limitations).

252. *Id.* at 4 (pointing out that the State of Texas has no limitations in pursuing claims under state lands leased to oil companies).

253. 30 U.S.C. § 1724 (2001).

254. *Id.*

255. Summary, Texas Land & Mineral Owners Assoc., *supra* note 14, at 4 (indicating that studies by the federal government show the amount of unpaid royalties in the United

Certainly, individual royalty owners, who lack Congress's resources and clout, deserve the protection afforded by the discovery rule.

VI. CONCLUSION

This year Texas land and mineral owners proposed a bill that could have ensured application of the discovery rule to claims arising under oil and gas issues. They see codification of the discovery rule as an effective way to counter the Texas Supreme Court's decision in *HECI* and to preserve their rights and interests against the oil and gas industry. Although this proposed amendment received heavy opposition, the discovery rule is not as destructive to the legal balance as some portray. First, many injuries arising out of oil and gas claims are indeed inherently undiscoverable and require the application of the discovery rule. Second, Texas courts have applied the discovery rule in oil and gas cases as well as in a variety of other types of cases. The Texas Supreme Court itself has commented that the discovery rule is an important legal tool to prevent the injustice of precluding a party from remedy merely because he was not aware that he was injured. Third, many other states apply the discovery rule, and some have even incorporated it into statutes of limitations. Finally, application of the discovery rule does not undermine statutes of limitations. Plaintiffs continue to bear the burden of proof and do not benefit from delay. Ultimately, plaintiffs who do not and cannot find out that they have been injured until after the statute of limitations has run are able to rely on the discovery rule in order to bring a variety of claims. There appears to be no justification for excluding oil and gas claims from application of the discovery rule.

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States is significant).