DAMAGES FOR NEGLIGENT INJURY TO AN OIL OR GAS WELL

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I. INTRODUCTION

This outline will review some of the leading Texas cases addressing damage measures for negligent harm to, or destruction of, an oil or gas well. These measures are: (1) the reasonable cash value of the well, less salvage value; (2) the reasonable and necessary cost of repair of the well; (3) lost gas or delay of gas production damages – held to be an improper measure in a negligence case concerning an oil or gas well in *Apex Pipe & Supply, Inc. v. Sesco Prod. Co.*, 736 S.W.2d 914, 918 (Tex.App.—Tyler 1987, writ denied); and (4) enterprise destruction damages where destruction of the business enterprise of the operator or owner is claimed to be the result of lost cash flow from a damaged or destroyed oil or gas well.

It is not surprising that Texas cases have involved seven-figure verdicts in litigation involving claims of oil or gas well destruction. In *Basic Energy Serv., Inc. v. D-S-B Prop., Inc.,* No. 12-10-00005-CV, 2011 WL 6187113 at *15 (Tex.App.—Tyler 2011, November 23, 2011, no pet. h.) the court of appeals modified the trial court's judgment to award $1,911,957.00 representing the replacement cost of a well. In *Bay Rock Operating Co. v. St. Paul Surplus Lines Ins. Co.,* 298 S.W.3d 216, 237 (Tex.App.—San Antonio 2009, pet. denied) the court of appeals entered judgment on the $4,527,536.00 jury verdict to the subrogee of the insured manager of an oil and gas contract and to the working interest owners after a blowout of a gas well. The jury's award of $5,696,274.00 was reversed and a take nothing judgment was rendered in a case of an alleged breach of a joint operating contract in *IP Petroleum Co. v. Wevanco Energy, L.L.C.*, 116 S.W.3d 888, 900 (Tex.App.—Houston [1st Dist.] 2003, pet. denied).

II. MEASURES OF DAMAGES FOR NEGLIGENT HARM TO AN OIL OR GAS WELL

A. THE JURY MUST DETERMINE IF THE WELL CAN BE REPRODUCED

The San Antonio Court of Appeals has stated that a determination of the damages arising from negligent well operations, which result in the destruction of the well, requires that the jury determine whether the well could be reproduced by drilling another one. *See Dowell, Inc. v. Cichowski*, 540 S.W.2d 342, 350 (Tex.Civ.App.—San Antonio 1976, no writ); *see also Dresser Ind., Inc. v. Page Petroleum, Inc.,* 853 S.W.2d 505, 511-12 (Tex.1993) (citing with approval but distinguishing *Apex Pipe & Supply, Inc. v. Sesco Prod. Co.*, 736 S.W.2d 914, 918 (Tex.App.—Tyler 1987, writ denied) in allowing the recovery of the cost of reasonable attempts to save the well as part of repair costs)).

B. DAMAGE MEASURE IF THE WELL CANNOT BE REPRODUCED, OR IF THE COST OF REPRODUCTION OF THE WELL EXCEEDS THE VALUE OF THE DAMAGED WELL

If the jury finds that the cost of the reproduction of the well exceeds the value of the damaged well as found by them, or if the jury determines upon competent testimony that the well could not have been reproduced, the damage measure should be the reasonable cash market value of the well as equipped immediately preceding its destruction, less the value of any salvage realized by the claimant. *See Dowell, Inc. v. Cichowski*, *supra*, 540 S.W.2d at 350. A plaintiff may attempt to rely on an existing oil or gas reserves report originally produced in an attempt to market an oil or gas well to prove the reasonable cash market value of the well. If so, it is imperative that a qualified petroleum engineer specializing in forecasting the reasonable cash values of oil or gas reserves be engaged to properly evaluate the claim.

C. DAMAGE MEASURE IF THE WELL CAN BE REPRODUCED

The measure of damages for negligent injury to an oil or gas well that can be reproduced is the lesser of two values: (1) the cash market value of the old well; or (2) the cost of reproducing the well with a new well equipped like the old one, less any salvage value of the old well. *See Basic Energy Serv., Inc. v. D-S-B Prop., Inc.,* No. 12-10-00005-CV, 2011 WL 6187113 at *5 (Tex.App.—Tyler, November 23, 2011, no pet. h.); *see also Dresser Ind., Inc. v. Page Petroleum, Inc.,* 853 S.W.2d 505, 511-12 (Tex.1993) (Texas high court affirmed an award of 40% of the "cash market value of the original well prior to the occurrence in question" because that was less than the cost of "remedial work on the original well."). In *Dresser Ind., supra,* the Texas high court also allowed recovery of the costs incurred in the "reasonable attempt to save the well" as part of the reasonable and necessary cost of drilling the replacement well. *Id*. at 512.

D. COST OF REPAIRS MUST BE REASONABLE AND NECESSARY

Parties seeking damages for the repair of an oil or gas well must present sufficient evidence to justify findings that: (1) the costs of repair were reasonable; and, (2) the repairs were necessary. *See Baker Hughes Oilfield Operations, Inc. v. Hennig Prod. Co*., *Inc.*, 164 S.W.3d 438, 446 (Tex.App.—Houston [14th Dist.] 2005, no pet.).

Costs of repair must be supported by evidence that the repair costs sought are reasonable or that they were usual and customary charges. *See Frost Nat'l Bank of San Antonio v. Kayton*, 526 S.W.2d 654, 667 (Tex.Civ.App.—San Antonio 1975, writ ref'd n.r.e.) (judgment based on mere testimony by non-real property expert that real property repair estimates were given, and that he had no reason to doubt the estimates, reversed on appeal); *see also Hyatt v. Tate*, 505 S.W.2d 373, 374 (Tex.Civ.App.—Houston [1st Dist.] 1974, no writ) (testimony of car mechanic

that repairs were necessary but not reasonable was insufficient to support a verdict and enabled the jury to only speculate as to whether the repair damages were reasonable).

E. EVIDENCE OF COST OF REPAIR

While an owner may testify to the market value of his property, he is not recognized as an expert qualified to testify as to the costs of restoration, absent the proper predicate. *See Uvalde County v. Barrier*, 710 S.W.2d 744 (Tex.App.—San Antonio 1986, no writ). The Fifth Circuit U.S. Court of Appeals has explained that this predicate may be shown by evidence from a person experienced in the repair of the subject of the claim that (1) the repairs were necessary [to restore the property to its prior condition], (2) the charge for labor was reasonable, and (3) the charge for parts was reasonable. *Franks v. Assoc. Air Center*, 663 F.2d 583, 590 (5th Cir.1981); *see also Moren v. Pruske,* 570 S.W.2d 442, 444 (Tex.Civ.App.—San Antonio 1978, writ ref'd n.r.e.) (evidence of repairs was sufficient where an expert in the construction business testified that a bid was submitted strictly for repair and he was familiar with price of materials and of labor in the geographic area of repair).

F. DAMAGES FOR "LOST GAS" HELD NOT RECOVERABLE

Lost gas damages have been held not available as a measure of damages for a claim of negligent damage to a gas well. *See Apex Pipe & Supply, Inc. v. Sesco Prod. Co.*, 736 S.W.2d 914, 918 (Tex.App.—Tyler 1987, writ denied). The *Apex* plaintiff argued that since it lost gas production, the appropriate measure was the value of its lost gas production -- this measure had been awarded by the trial court. *Id.* at 918. In reversing the lost gas production award as an improper damage measure for negligent damage to an oil or gas well, the *Apex* court cited numerous Texas cases for the proposition that the correct measure provides for the cost of drilling and equipping another well if the well can be reproduced by drilling another one;

provided that this cost does not exceed the reasonable cash market value of the well before the damage. *Id; but see Bay Rock Operating Co. v. St. Paul Surplus Lines Ins. Co.,* 298 S.W.3d 216, 237 (Tex.App.—San Antonio 2009, pet. denied) (lost gas damages awarded to working interest owners).

G. DOWELL, INC. V. CICHOWSKI – JURY ASKED WHETHER WELL WAS CAPABLE OF PRODUCING GAS IN PAYING QUANTITIES

Dowell, Inc. v. Cichowski, 540 S.W.2d. 342, 347 (Tex.Civ.App.—San Antonio 1976, no writ) is a leading case on well site damages. The Plaintiff in *Dowell* sought damages for repair and for loss of the well as a result of a negligent squeeze job. *Id.* at 344. In *Dowell* the trial court asked the jury: (1) whether the well had the capacity to produce oil and/or gas in paying quantities prior to the negligent act; and (2) whether the well had its capacity to produce oil and/or gas in paying quantities completely destroyed as a direct and proximate result of the negligent act. *Dowell, Inc. v. Cichowski*, 540 S.W.2d. 342, 347 (Tex.Civ.App.—San Antonio 1976, no writ). In *Dowell* plaintiff's experts testified that the well would produce in paying quantities based on physical tests, other tests and based on familiarity with the surrounding area. *Id.* at 347-49. The court of appeals in *Dowell* impliedly approved of these jury questions, and held that sufficient evidence sustained positive jury findings to them. *Id.* at 349. This case indicates that to recover well site damages the plaintiff must demonstrate that the well was capable of producing in paying quantities.

H. TEXAS SUPREME COURT DEFINITION OF CAPABLE OF PRODUCING OIL OR GAS IN PAYING QUANTITIES

In *Anadarko Petroleum Corp. v. Thompson*, 94 S.W.3d 550, 553 (Tex.2002) the Texas high court construed a lease that provided that it would remain in force for a term of one year and as long thereafter as gas is or can be produced. The *Anadarko* court considered whether the well was capable of production during periods of non-production caused by pipeline construction. *Id*. at 557. The Texas Supreme Court summarized its holding in its conclusion that: "To be 'capable of producing gas,' we conclude that a well must be capable of producing gas in paying quantities without additional equipment or repairs." *Anadarko Petroleum Corp.* at 558. In making this determination the Texas Supreme Court stated that "We approve of the *Hydrocarbon* definition." *Id*. at 558, which it reproduced.

I. HYDROCARBON MGT., INC. V. TRACKER EXPLORATION, INC.

The Amarillo court of appeals, in *Hydrocarbon Mgt., Inc. v. Tracker Exploration, Inc*., 861 S.W.2d 427, 433-34 (Tex.App.—Amarillo 1993, no writ) stated:

> We believe that the phrase "capable of production in paying quantities" means a well that will produce in paying quantities if the well is turned "on," and it begins flowing, without additional equipment or repair. Conversely, a well would not be capable of producing in paying quantities if the well switch were turned "on," and the well did not flow, because of mechanical problems or because the well needs rods, tubing, or pumping equipment.

The *Hydrocarbon Mgt.* court also explained in footnote 4 that:

> Whether production is in paying quantities is determined by ascertaining whether or not under all relevant circumstances, a reasonably prudent operator would continue to operate a well in the manner in which it is being operated for the purpose of making a profit and not merely for speculation.

Id. at n. 4 (citing *Clifton v. Koontz*, 325 S.W.2d 684 (Tex.1959)).

III. ENTERPRISE DESTRUCTION DAMAGES

In an effort to obtain a recovery, in addition to the cost of repair or the lost value of the well, oil or gas operators or owners may seek damages for the destruction of their entire business allegedly caused by lost income from the well. The measure of damages for the destruction of a business under Texas law is the difference between the value of the business before and after the business' destruction. *See Sawyer v. Fitts*, 630 S.W.2d 872, 874-75 (Tex.App.—Fort Worth 1982, no writ); *see also Wellogix, Inc. v. Accentre, LLP,* No. 3:08-cv-119, 2011 W.L. 4915862 at *8 (S.D.Tex. October 14, 2011). In the recent *Wellogix, Inc. v. Accentre* case, the court noted that the claimant's expert testified to the value of claimant Wellogix, Inc. by reference to an investment made in Wellogix in exchange for shares. *Wellogix, Inc. v. Accentre, at* *7-8. It is the value of the business and not merely the value of the oil or gas assets owned by the business that is crucial in any attempt to prove this measure. This becomes significant in circumstances where the Plaintiff is an insolvent oil or gas operator who is attempting to use an oil or gas reserves report as a means to establish lost value to escape otherwise zero lost enterprise damages. An owner of an insolvent business enterprise cannot recover for its lost value because his business has no value to lose.

IV. DTPA CLAIMS

In Texas Deceptive Trade Practices Act, TEX. BUS. & COM. CODE § 17.41-63 ("DTPA") cases, if the plaintiff proves one legitimate measure of damages, it is the defendant's burden to prove an alternative lower damages amount: *Miller v. Dickenson,* 677 S.W.2d 253, 258 (Tex.App.—Fort Worth 1984, writ ref'd n.r.e.); *Heritage Housing Corporation v. Ferguson*, 674 S.W.2d 363, 366 (Tex.App.—Dallas 1984, writ ref'd n.r.e.) and; *Jim Walter Homes, Inc. v. Castillo*, 616 S.W.2d 630, 635 (Tex.Civ.App.—Corpus Christi 1981, no writ). Thus, in DTPA cases, the plaintiff may be able to prove well damages by showing reasonable and necessary repair costs, with the burden then shifting to the defendant to show that the lower value of the

well is the appropriate measure. These DTPA cases and this rule are typically inapplicable to damage to an oil or gas well since to have standing under the DTPA a natural or legal person must be a consumer; the DTPA defines consumer as "an individual, partnership, corporation" … except the term does not include a business consumer that has assets of $25 million or more, or that is controlled by a corporation or entity with assets of $25 million or more. TEX. BUS. & COM. CODE § 17.45(4). This definition will exclude many oil and gas operators who have assets of $25 million or more.

V. CONCLUSION

Business in the oil and gas industry is expanding. It is likely that claims for damage to, or destruction of, oil and gas wells will also rise. Plaintiffs may attempt to use reserves reports on hand from marketing oil or gas assets to establish lost well value. The engagement of a petroleum engineer specializing in forecasting reasonable oil or gas reserves will help evaluate, and in a proper case, defend these claims.