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In Landmark Decision, SCOTX Holds that Produced Water Belongs to the Mineral Estate Lessee

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On June 27, the Supreme Court of Texas answered who owns produced water under Texas oil and gas leases that don't expressly address ownership. In *Cactus Water Services, LLC v. COG Operating*, the Court unanimously held that absent express contractual language to the contrary, produced water belongs to the mineral estate lessee, not the surface estate owner:

We hold that a deed or lease using typical language to convey oil-and-gas rights, though not expressly addressing produced water, includes [produced water] as part of the conveyance whether the parties knew of its prospective value or not.

This decision provides clarity for upstream and midstream entities, landowners and environmental tech start-ups grappling with the emerging value of what was once considered merely a wasteful byproduct — produced water — but now, through technological advances in recycling and mineral extraction, has the potential to become a new source of significant revenue.

Backdrop

The Court defined “produced water” as a byproduct of oil and gas exploration that includes water and “a mixture of fracking fluid, hypersaline brine, residual hydrocarbons, and other substances of varying concentrations.” Most produced water comes from fracking, and tens of millions of barrels of produced water are produced annually in Texas alone.

Until recently, produced water was generally considered a hazardous and

unwanted byproduct that was the responsibility of the well operator. However, innovations in water treatment could allow for produced water to be used agriculturally, and there is potential to extract commercially viable quantities of rare-earth minerals such as lithium from produced water. The conflict between the historical industry treatment of produced water and the potential for innovation formed the “genesis” of the dispute between Cactus and COG.

Case Background

Between 2005 and 2014, COG acquired four hydrocarbon leases from two surface owners covering approximately 37,000 acres in Reeves County, Texas, in West Texas's Permian Basin. According to the opinion, the leases grant COG the exclusive right to explore for, produce and keep “oil and gas” or “oil, gas, and other hydrocarbons.” Importantly, the leases are silent about “oil-and-gas waste” and “produced water” and “expressly prohibit any use of water except in extremely limited circumstances.”

COG's fracking operations generated nearly 52 million barrels of produced water, costing it substantial disposal costs. COG paid nearly \$21 million in disposal fees to a third-party contractor between December 2018 and March 2021 alone. But starting in 2019, the two surface owners executed “produced water lease agreements” with Cactus, which purported to “convey ‘all right, title and interest in and to ... water from oil and gas producing formations and flowback water

produced from oil and gas operations’ on the lands covered by COG’s leases,” the opinion states.

Despite possessing no permits, no infrastructure and no ability to handle, transport or dispose of produced water (Cactus had no pipelines, disposal wells or processing facilities, nor had it committed to acquiring such infrastructure), Cactus asserted to COG that Cactus was entitled to the produced water from COG’s wells.

The Court granted review to resolve whether as a default rule produced water belonged to the mineral estate or the surface estate.

The Court’s Analysis and Holding

The Court sided with COG — and thus the mineral estate. It held “a deed or lease using typical language to convey oil-and-gas rights, though not expressly addressing produced water, includes [produced water] as part of the conveyance whether the parties knew of its prospective value or not.”

The Court started with the text of the leases themselves. Because the leases specifically discussed only “oil and gas” or “oil, gas, and other hydrocarbons” and were silent as to “produced water,” the resolution of the dispute turned on whether principles governing oil and gas waste or principles governing water should apply to “produced water.” If the former controlled, the produced water would belong to the mineral estate, but if the latter controlled, it would belong to the surface estate.

Looking to industry custom, statutory and regulatory frameworks, legal precedent and documents in connection with transactions between the surface owners and COG, the Court reasoned that it was “beyond cavil, and not in genuine dispute that produced water is, and was at the time of the conveyance, oil-and-gas waste.” Indeed, the Court concluded, “Despite its colloquial appellation, produced water is not water. While produced water contains molecules of water, both from injected fluid and subsurface for-

mations, the solution itself is waste — a horse of an entirely different color.” The Court also noted that Texas statutes and regulations treat produced water and water very differently. (Colorfully, the Court likened produced water to “several substances with substantial water components that are not commonly considered to be water: blood plasma (90% water), vodka (60%), whiskey (60%), and concrete (up to 23%).” The Court reinforced that technological innovation might alter the incentive structure over the ownership of produced water, but that doesn’t alter the principle that Texas contracts are interpreted according to the parties’ expressed intent when they entered the agreement; changed circumstances do not change contracts.

The Court concluded by returning to contract law basics. Texas contracts are subject to legal and regulatory restrictions, and contracting parties “are presumed to contract in reference to the law.” Given the above background circumstances, here — and in the future — where a governing contract only conveys “oil and gas” rights (or uses other typical language) and is silent as to produced water, the produced water will belong to the mineral estate owner or lessee. “[I]f the surface owner actually wants to retain ownership of constituent water incidentally and necessarily produced with hydrocarbons [aka, produced water], the reservation or exception from the mineral conveyance must be express and cannot be implied.”

Key Takeaways for Business Owners

For upstream and midstream players: Where mineral leases are like the ones at issue here, upstream and midstream players can continue investing in produced water disposal infrastructure and treatment technologies without fear of claims from surface estate owners or third parties. Although technology is evolving to better manage oil and gas byproducts, that does not change the original scope of their leases. Contracting parties should be mindful of proposed language in new

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agreements or amendments that seek to address produced water specifically.

For surface estate owners: While surface estate owners under existing leases without express reservations for produced water will have no claim to produced water, future lease negotiations can include discussions about produced water rights and revenue sharing. Further, the Court explicitly did not address the question of “ownership of any nonhydrocarbon minerals included in liquid-waste byproduct, as no such substances are in dispute here.” Surface estate owners interested in mineral development should expressly seek reservations for minerals that might be found in produced water, such as lithium.

For investors and technology companies: Companies investing in produced water treatment and recycling technologies can obtain clear title to produced water from mineral estate lessees.