Oil and Gas Update

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January 24, 2018

- Thanks to Professor Monika Ehrman at OU for her assistance

- Over 40 cases

- With a few exceptions, I will discuss only Texas Supreme Court cases
- As time allows, I will end with a few remarks about upcoming Texas cases and some recent events beyond Texas

Carl M. Archer Trust No. Three v. Tregellas

2018 Tex. LEXIS 1153 (Tex., Nov. 16, 2018)

- Reversing the court of appeals, the Texas Supreme Court held that the four-year statute of limitations, Tex. Civ. Prac. & Rem. Code Ann. § 16.004(a)(1), did not bar a ROFER claim because the discovery rule applied
- Buyers purchased mineral interest with notice of ROFER, thus standing in seller's shoes regarding claimants' request for specific performance
- Breach of ROFER occurred when owners conveyed their mineral interest without notifying trustees (claimants) and limitations would run from that date; however:
  - **Breach was "inherently undiscoverable"**
  - Thus, accrual of ROFER claim was deferred (4 years) until claimants were advised of the conveyance by a prospective OGL lessee

Murphy Expl. & Prod. Company-USA v. Adams,
560 S.W.3d 105 (Tex. 2018)

- The court construes the term “offset well” in an offset well lease provision in the context of horizontal drilling and fracking
  - A well was drilled 350 feet of the lease line
- Lease provided that if a well was drilled within 467 feet of the leased premises, lessee must pay compensatory royalties, release acreage equivalent in size to the spacing unit for the draining well, or commence drilling of an “offset well”
- Lessee commenced a well that was 1,800 feet from the relevant leases line
- Lessors contended the well was not an “offset well”
- Held: Lessee complied with the “offset well” provision in the context of horizontal drilling into shale formations

Jack Balagia, Jr.: Comments in the *Advocate*
Winter 2018

- For the practitioner, the majority opinion raises a number of cautionary issues.
  - First, an offset well provision in an oil and gas lease can mean two different things depending on whether the triggering well is drilled horizontally, vertically, hydraulically fractured and/or completed in a shale or sandstone formation. This is especially problematic in areas of the state where both conventional and unconventional drilling occurs.
  - Further, if, as the court says, an offset well clause is not a drainage protection clause, at least with respect to unconventional wells in shale formations, then presumably the clause does not foreclose a claim for breach of the implied covenant to protect against drainage, since implied covenants will apply if not covered by an express lease provision. This outcome feels strained, since there is little reason to include an offset well clause in a lease other than to prevent drainage.

ConocoPhillips Company v. Koopman
547 S.W.3d 858, 865 (Tex. 2018)

- In 1996, Strieber conveyed acreage to Koopman, reserving 1/2 of oil and gas royalties for 15 years, and so long as there is production or "other payments"
- Technically, Koopman's interest violates RAP because she has a springing executory interest that might not become possessory with RAP.
- Ct of Appeals: The conveyance contains 2 grants: a fee simple grant from the grantor (Strieber) and the regrant of a determinable interest to the grantee (Koopman), leaving Koopman with a Possibility of Reverter, which is not subject to RAP

Lucas v. Hamm,

56 Cal.2d 583 (Cal. 1961)

"… few, if any, areas of the law have been fraught with more confusion or concealed more traps for the unwary draftsman; that members of the bar, probate courts, and title insurance companies make errors in these matters; that the code provisions adopted in 1872 [the Texas court decisions] created a situation worse than if the matter had been left to the common law…

…

it would not be proper to hold that defendant failed to use such skill, prudence, and diligence as lawyers of ordinary skill and capacity commonly exercise. … [A]n attorney of ordinary skill acting under the same circumstances might well have 'fallen into the net which the Rule spreads for the unwary' and failed to recognize the danger."

Lucas v. Hamm, 56 Cal. 2d 583, 593, 364 P.2d 685, 690 (1961)

Tro-X, L.P. v. Anadarko Petroleum Corp.,

548 S.W.3d 458 (Tex. 2018)

- Assignor filed suit for assignee's failure to recognize the Assignor's back-in interests, but the assigned leases were released after Assignee failed to drill a required offset well
- Assignee secured a new lease on the same property before the assigned lease was released. Assignor claimed that the new leases were top leases and thus subject to the back-in interest by reason of an anti-washout clause in the assignment agreement.
- Held: The assignor's back-in rights terminated
- **When a new lease is executed on an existing lease by the same parties, the existing lease is terminated, unless intent is expressly shown otherwise**. No such intent was found..

JPMorgan Chase Bank, N.A. v. Orca Assets G.P., L.L.C.,

546 S.W.3d 648 (Tex. 2018)

- **Simplified**: Bank, as trustee, leased to Orca. The lease contained the following clause:

  Negation of Warranty. **This lease is made without warranties of any kind, either express or implied, and without recourse against Lessor in the event of a failure of title, *not even for the return of the bonus consideration*** paid for the granting of the lease or for any rental, royalty, shut-in payment, or any other payment now or hereafter made by Lessee to Lessor under the terms of this lease.

- At Orca's request, the Bank agreed to allow Orca 30 more days to check title. Ultimately, Orca took the lease, but **as it turned out, the leased acreage was already under lease. Notwithstanding the clause, the Bank did return the bonus money, which Orca rejected**.

- Orca sued for lost profits, alleging breach of contract, fraud, and negligent misrepresentation.

- Held: The Texas Supreme Court reinstated the trial court's ruling, dismissing Orca's claim.

OIL AND GAS LEASE—RETAINED ACREAGE CLAUSES

Endeavor Energy Resources, L.P. v. Discovery Operating, Inc.,

554 S.W.3d 586 (Tex. 2018)

Held: Express language of retained acreage clause retaining the "governmental proration unit assigned to a well" means the acreage "**assigned**" to the well by the operator, not by the field rules

XIG Operating. LLC v. Chesapeake Exploration Limited Partnership,

554 S.W.3d 607 (Tex. 2018)

Held: Express language of retained acreage clause retains acreage "included within the **proration unit** for each well ... prescribed by field rules," and **not the acreage assigned by the operator**.

Distinguishing Reservations and Exceptions
Perryman v. Spartan Texas Six Capital Partners, Ltd.,
546 S.W.3d 110 (Tex. 2018)

- First Deed: : "***LESS, SAVE AND EXCEPT*** *an undivided one-half (½) of all royalties…from the above described premises* ***which are now owned by the grantor***."
- Subsequent Deed: *"**LESS, SAVE AND EXCEPT** an undivided one-half (1/2) of all royalties…from the above described premises **which are now owned by Grantor**. It being understood that all of the rest of my ownership in and to the mineral estate in and under the above described lands is being conveyed hereby."*
- Held:
  - The clause in the first deed is a "**reservation**"
  - The clause in the second deed was an "**exception**" qualifying the warranty
- The phrase "which are now owned by Grantor" **was not set off by a comma**; thus, it modifies the word "premises," not the phrase "1/2 of the royalties"
- Accordingly, "the most reasonable grammatical construction of this deed is that the clause excepts 1/2 of all royalties from the minerals produced from the 'premises which are now owned by grantor'" and did not reserve an additional royalty interest.

U.S. Shale Energy II, LLC v. Laborde Props., L.P.,

551 S.W.3d 148 (Tex. 2018)

- Deed reserved "**an undivided one-half (1/2) interest in and to the Oil Royalty**, Gas Royalty and Royalty in other Minerals in and under . . . the above described premises**, the same being equal to the 1/16th of production**."
- Held:
  - To the comma, the sentence unambiguously states that the parties intended a floating royalty
  - From the comma, the phrase merely informs what a 1/2 interest in royalty would have been when the deed was executed in 1951—at a time when a 1/8 royalty was **ubiquitous**
  - To construe the second phrase as limiting the first phrase would render the first meaningless
- **Comma**: In support, the Court referred to the comma placement in the second clause, which indicated a nonrestrictive dependent clause—a clause that "'gives additional description or information that is incidental to the central meaning of the sentence,'" citing Garner's *Redbook*.

URI, Inc. v. Kleberg County,

543 S.W.3d 755 (Tex. 2018)

- Not an oil and gas case, but is included for Justice Guzman's writing on the appropriate use of "context" when construing an instrument. The following is what Justice Guzman said about "context" in the opinion's introduction:

A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used.

—Oliver Wendell Holmes

We have long articulated a principle of contract construction that permits courts to consult the facts and circumstances surrounding a negotiated contract's execution to aid the interpretation of its language. [This principle]…remains susceptible to confusion and inconsistency when applied to unambiguous contract terms. The principle's limitations are, however, clear: surrounding facts and circumstances cannot be employed to "make the language say what it unambiguously does not say" or "to show that the parties probably meant, or could have meant, something other than what their agreement stated." In other words**, extrinsic evidence may only be used to aid the understanding of an unambiguous contract's language, not change it or "create ambiguity**."

When interpreting a written contract, the prime directive is to ascertain the parties' intent as expressed in the instrument. "[O]bjective, not subjective, intent controls," so the focus is on the words the parties chose to memorialize their agreement. But language is nuanced, and meaning is often context driven. Contract language is thus construed in its lexical environment, which may include objectively determinable facts and circumstances that contextualize the parties' transaction. **Surrounding facts and circumstances can inform the meaning of language but cannot be used to augment, alter, or contradict the terms of an unambiguous contract**.

Bosque Disposal Sys., LLC v. Parker Cty. Appraisal Dist.,

555 S.W.3d 92 (Tex. 2018)

- Held separate appraisal of taxpayers' saltwater disposal wells and the land where they were located did not constitute double taxation

In re Occidental Chem. Corp.,

561 S.W.3d 146 (Tex. 2018)

- After various preliminary issues, on the merits the court held:
- The right of a littoral owner to build piers and similar facilities in the water "arises out of the ownership of the abutting shoreline, not the water."
- Thus, a pier connected to the land of one county (San Patricio) are taxable only by that county and not also by the county into which the pier extends

INDEMNITIES IN SERVICES CONTRACTS etc.

In re Larry Doiron, Inc.,

879 F.3d 568 (5th Cir. 2018) (en banc)

- For determining whether a contract and work is "maritime" or not, the court replaces the unwieldy six-factor "Salty Flavor" test from *Davis & Sons, Inc. v. Gulf Oil Corp.*, 919 F.2d 313, 314 (5th Cir. 1990): (1) What does the contract provide? (2) What did the crew actually do? (3) Was the crew assigned to a vessel in navigable waters? (4) To what extent was the crew's work related to the mission of the vessel? (5) What was the principal work of the injured worker? (6) What was the injured worker doing when injured?
- **The new test**, derived from *Norfolk Southern Railway Co. v. Kirby*, 543 U.S. 14 (2004), provides a two-prong test:
  - "**First, is the contract one to provide services to facilitate the drilling or production of oil and gas on navigable waters?** The answer to this inquiry will avoid the unnecessary question from *Davis & Sons* as to whether the particular service is inherently maritime.
  - **Second, if the answer to the above question is "yes," does the contract provide or do the parties expect that a vessel will play a substantial role in the completion of the contract?** If so, the contract is maritime in nature.

N. Am. Tubular Servs., LLC v. BOPCO, L.P.,

2018 Tex. App. LEXIS 7152 (Tex. App.—Fort Worth Aug. 30, 2018, no pet.), reh'g denied (Oct. 25, 2018)

- Held: Regarding performance in **NM**, a **Master Services contract** was properly governed by Texas law, including the Texas oilfield anti-indemnity act even though New Mexico's oilfield anti-indemnity act expressly provided that it governed contracts, whether foreign or domestic
- The court applied the Restatement (Second) of Conflict of Law §§ 187(2) and 188(1)
- The court acknowledged that the first section required the application of NM law that is contrary to the "fundamental policy of a state.," but the section continues that this determination must consider the second section, which poses three inquiries that must be answered in the negative for NM law to apply:
  1. whether application of Texas law would be contrary to a fundamental policy of New Mexico (in other words, whether New Mexico's policy would be contravened by applying Texas law)
  2. whether New Mexico has a materially greater interest than Texas in determining the "particular issue" of indemnity, and
  3. whether Texas has the "most significant relationship to the transaction and the parties."
- Held: **Texas law governs**
- "[T]he place of performance factor bears little weight 'when (1) at the time of contracting it is either uncertain or unknown, or when (2) performance by a party is to be divided more or less equally among two or more states with different local law rules on the particular issue.'" Id. § 188 cmt. e.

Seismic Wells, L.L.C. v. Sinclair Oil & Gas Co.,

2018 WL 4377234 (5th Cir. Sept. 13, 2018) (per curiam)

- Clause in Joint Operating Agreement provided: "In the event any party is required to bring legal proceedings **to enforce any financial obligation** of a party hereunder, the prevailing party in such action shall be entitled to recover … a reasonable attorney's fee"
- Held: Attorney's fees are not recoverable
  - Because the claimant alleged **fraud**, the JOA became void, nullifying the provision.
  - Moreover, the **fraud** allegation was not s claim "to enforce any financial obligation…hereunder"
  - The **primary relief sought was not enforcement but injunctive**

LAND SERVICES CONTRACT
Moore v. Bearkat Energy Partners, LLC,
2018 WL 683754 (Tex. App.—Waco Jan. 31, 2018, no pet. h.)

- Court held that a written agreement to compensate a landman "for his assistance with **securing oil, gas and other mineral leases in Leon County, Texas**" violated the statute of frauds.
- Held: The **compensation agreement does not sufficiently describe any property to satisfy the statute of frauds** and is therefore not enforceable. Moreover, none of the traditional exceptions to the statute of frauds apply.
- "…the compensation agreement merely refers to 'oil, gas and other mineral leases in Leon County, Texas.' The compensation agreement does not provide any information regarding the size, shape, or boundaries of the land subject to the leases for which Moore was to be compensated…. We do not believe that this language sufficiently describes the property in question…"

Murray v. BEJ Minerals, LLC

908 F.3d 437 (9th Cir. 2018)

- Deed reserved: “all right title and interest in and to all of the oil, gas, hydrocarbons, and **minerals** in, on and under, and that may be produced from the [Montana] lands . . . together with the right, if any, to ingress and egress at all times for the purpose of mining, drilling, exploring, operating, and developing said lands for oil, gas, hydrocarbons, and **minerals**, and storing, handling, transporting, and marketing the same therefrom together with the rights to remove from said lands….” (my emphasis)

- Held” Applying its perception of Montana law and focusing on **only** the word “minerals,” the court held “minerals” included **dinosaur bones**!

Future Tex. S. Ct. Opinions to watch for

Carrizo Oil & Gas, Inc. v. Barrow-Shaver Res. Co.,

516 S.W.3d 89 (Tex. App.—Tyler 2017, pet. granted)

- The parties fought a battle of the forms over an assignment provision in a farmout agreement. Farmor proposed a farmout with no consent-to-assignment provision. Farmee countered with that consent of an assignment "shall not be unreasonably withheld."
- After numerous exchanges and negotiations, the parties agreed to the following provision: "The rights provided to BSR under this Letter Agreement may not be assigned, subleased or otherwise transferred in whole or in part, without the express written consent of Carrizo."
- When Carrizo refused to consent to an assignment, litigation ensued.
- Held: Notwithstanding expert testimony regarding alleged industry custom and practice that would imply a reasonableness standard in a consent-to-assignment provision, "**under Texas law, a consent-to-assignment provision that fails to set a standard by which to measure consent, such as reasonableness or good cause, allows a lessor to withhold consent arbitrarily**."

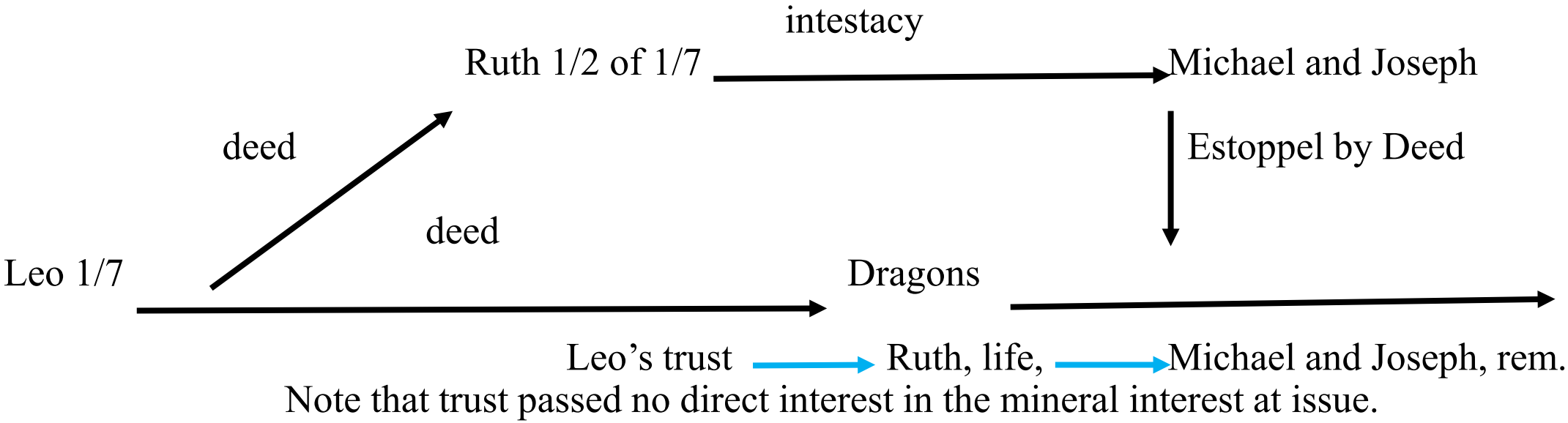
CONVEYANCING—ESTOPPEL BY DEED
Dragon v. Trial
2017 (Tex. App.—San Antonio 2017, **pet. granted**)

Chronologically:
- 1932, Leo Trial owned a 1/7 mineral interest
- 1983, Leo conveyed 1/2 to his wife, Ruth—recorded
- 1992, Leo financed the sale but deeded his 1/7 interest to the Dragons, subject to a 15-year term mineral reservation—Dragons had constructive but no actual knowledge of the prior deed to Ruth
- 1996, Leo died, devising his estate to Ruth for life and then to his two sons, Michael and Joseph
- 1997, Dragons paid for their 1/7 interest and secured a Release of Lien
- 2007, Leo's term reservation expired
- 2010, Ruth died

State of the title after Ruth's death:
- Dragons would have 1/2 of Leo's 1/7 of interest, purchased from Leo
- Michael and Joseph received Ruth's 1/2 of 1/7 interest by intestacy (her will was not probated)
- But **HELD Michael and Joseph's 1/2 of 1/7 interest, received from their mother, Ruth, passed to the Dragons by estoppel by deed because they were "privies in blood, privies in estate, and privies in law" with Leo, their father**

CONVEYANCING—ESTOPPEL BY DEED

Dragon continued



"The Trials are remainder beneficiaries of Leo's estate and trust, and, therefore, they are his privies in blood, privies in estate, and privies in law. As such, they also are bound by the recitals in the 1992 Deed. The Trials are therefore estopped from asserting title to any interests in contradiction to Leo's duty to defend the Dragons against all claims to "'all that certain parcel or tract of land.'"

Wenske v. Ealy "Hiccups"
521 S.W.3d 791 (Tex. 2017)

- Facts: A, the owner of Blackacre in fee, conveys a non-participating royalty interest of 1/2 of the royalty to B.
- Thereafter, A conveys a 1/4 mineral interest in Blackacre to C **without menton of the royalty interest conveyance, but containing a generic "subject to" lease clause**.
- A and C individually lease their interests in Blackacre P, producer, retaining a 1/4 royalty.
- After production is secured, Attorney Joe Bob issues a division order title opinion crediting C with only **1/2 of** 1/4 of 1/4 of production as his royalty, and crediting A with **1/2 of** 3/4 of 1/4 as her royalty.

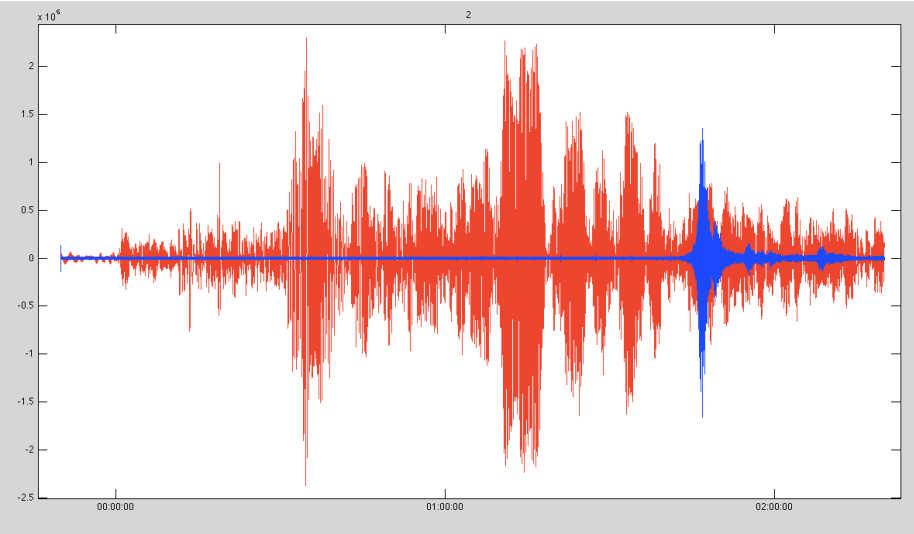
Courtesy of Bill Burford. Kelly Hart

Colorado Oil & Gas Cons. Comm'n v. Martinez,
2019 WL 179037 (Col. S. Ct. Jan. 14, 2019)

- Finding the Act ambiguous, the court stated, "… we view this history as reflecting a legislative intent to promote multiple policy objectives, including the continued development of oil and gas resources and the protection of public health and the environment, without conditioning one policy objective on the satisfaction of any other."
- "…in light of this legislative history and in the context of the Act as a whole leads us to conclude that these provisions do not allow the Commission to condition all new oil and gas development on a finding of no cumulative adverse impacts to public health and the environment…. Nor do we perceive the statutory language as creating a balancing test by which the public's interest in oil and gas development is weighed against its interest in public health and the environment…. Rather, in our view, …the Commission is required (1) to foster the development of oil and gas resources, protecting and enforcing the rights of owners and producers, and (2) in doing so, to prevent and mitigate significant adverse environmental impacts to the extent necessary to protect public health, safety, and welfare, but only after taking into consideration cost-effectiveness and technical feasibility."
- "**Respondents' proposed rule would have precluded new oil and gas development unless it could occur "in a manner that does not cumulatively, with other actions, impair Colorado's atmosphere, water, wildlife, and land resources, does not adversely impact human health, and does not contribute to climate change**."
- "Here, the Commission's finding that the issues implicated by Respondents' petition are being addressed elsewhere is amply supported by the record, and this is precisely the kind of agency action to which courts owe deference."

Colorado Voters Defeats Well Set-Back Measure Environmental Groups Undaunted

- In the November 2018 election, Colorado voters defeated an initiated measure that would have increased set-back rules for wells, which would have led to a de facto ban on drilling in large portions of Colorado, especially in Weld County
- **But** environmental groups are now asking newly elected Colorado Governor Jared Polis to declare a **9-month drilling moratorium**
- And they have promised **more initiative efforts**



Earthquakes

- **On January 15 at 7:28 a.m., the USGS reported a 4.4 magnitude earthquake** 21 miles southeast of Enid, OK and minutes later, an aftershock measuring 3.9 magnitude occurred about 10 miles to the SW of the epicenter
- **4 more quakes occurred this past weekend**
- **Dozens of quakes have occurred in this area in the last few years, resulting in the OCC curtailing some wastewater disposal well operations**
- On November 8, 2011, a 5.6 magnitude earthquake damaged St. Gregory's University, which is now closed

Mexico

- The IEA projects that shale output from the U.S. will level off in the mid-2020s, but that significant “shale gas and tight oil production outside the United States picks up in the latter part of the projection period, led by Argentina, Canada, China, and **Mexico**” to 2040.
- But Mexico’s newly elected President Obredor (**AMLO**) has halted 2 scheduled bid rounds, one for unconventional resources and he has stated that **he is opposed to hydraulic fracturing**
- **He favors a closed oil and gas system operated by PEMEX**
- **Drug cartels are diversifying** into oil and gas theft and kidnapping

May’s Brexit Woes

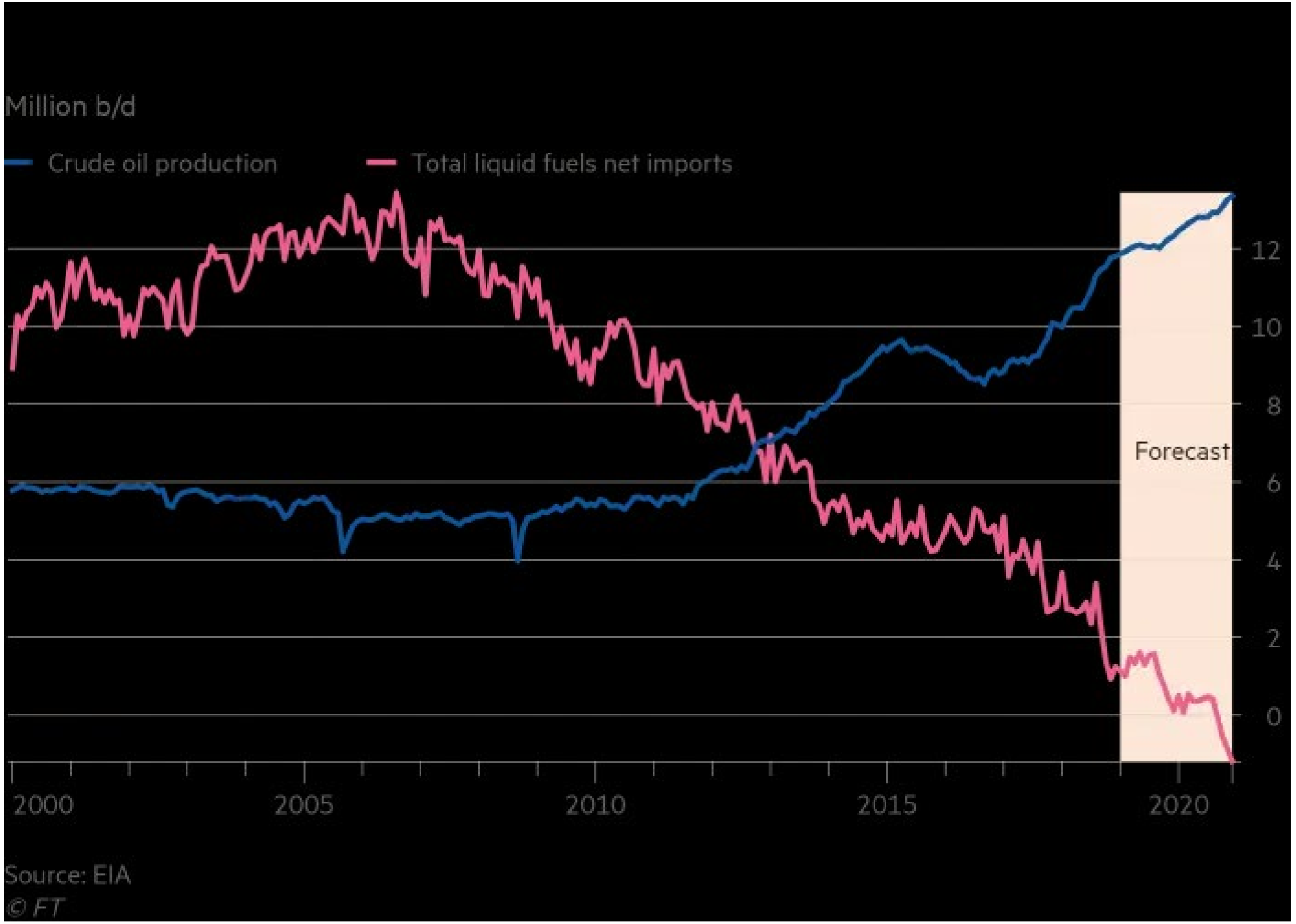
- Among the list of problems with the UK’s Brexit debacle, this one may not be high on the list, BUT:
- If, as a result of the Brexit debacle, **if Labor assumes power in the UK under Jeremy Corbyn, a fracking ban is likely, postponing, if not ending, UK shale development**

New University College, London Study (published January 8 in *Nature*)

- To have at least a 50% chance of keeping warming below 2 °C throughout the 21st Century, the cumulative carbon emissions between 2011 and 2050 need to be limited to around 1,100 gigatonnes of CO_2.
- However, the greenhouse gas emissions contained in present estimates of global fossil fuel reserves are about 3X higher
- **"[G]lobally, a third of oil reserves, half of gas reserves and over 80 per cent of current coal reserves should remain unused from 2010 to 2050 in order to meet the target of 2 °C.**
- "[D]evelopment of resources in the Arctic and any increase in unconventional oil production are incommensurate with efforts to limit average global warming to 2 °C."

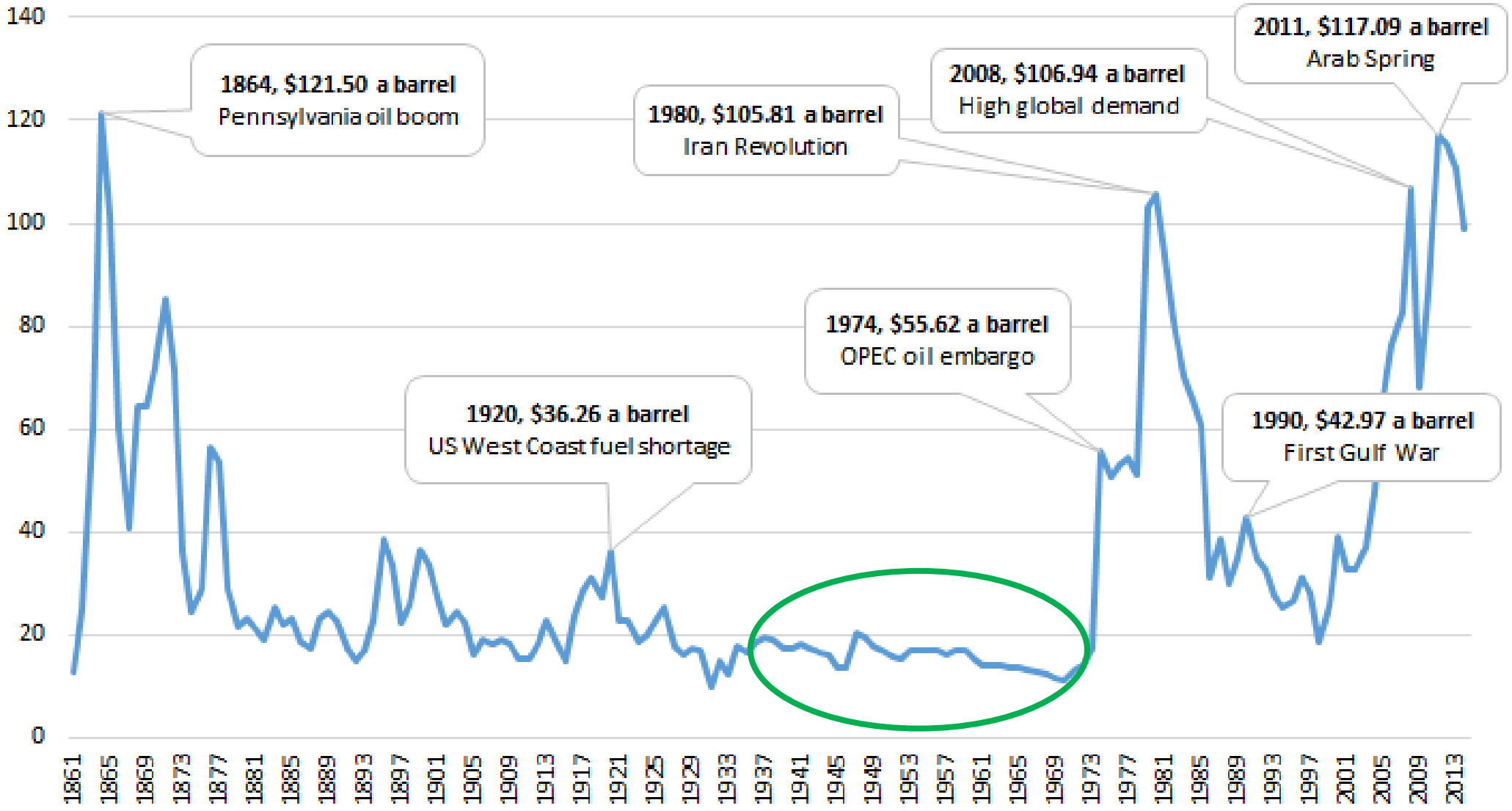
New Carbon Tax Proposal

- January 2018:
- **Yellen, Bernanke, Greenspan and Volcker, 27 Nobel laureates, and 15 former chairs of the council of economic advisors, and other leading economists, called for a US carbon tax**
- Proposal includes fees for imported goods from countries that do not have a carbon tax
- Proposal says the tax should then be rebated in cash to Americans, resulting in a net gain for the poorest 70% of households
- **Shell, BP, ConocoPhillips, and Unilever agree**

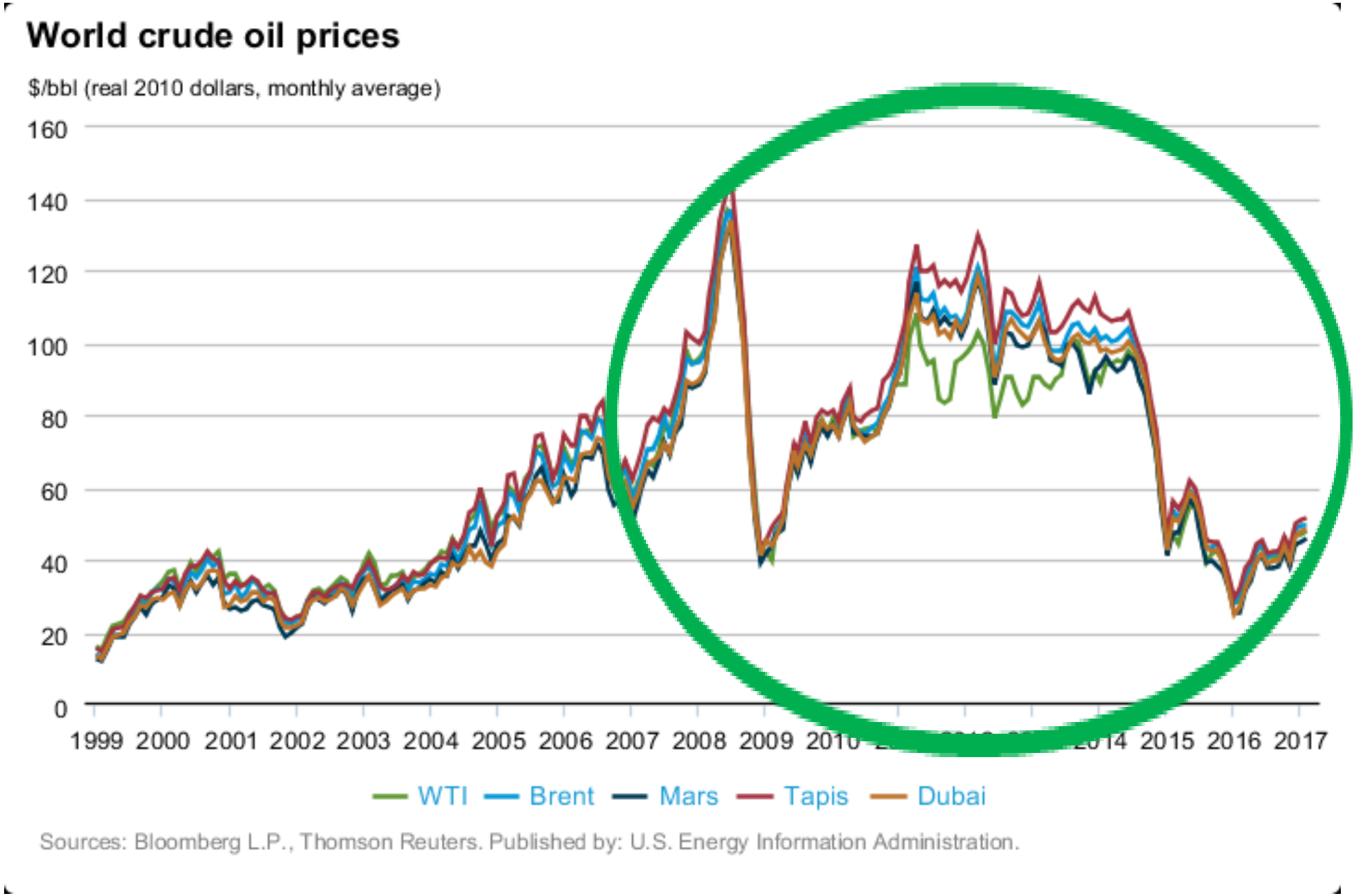

Million b/d
Crude oil production
Total liquid fuels net imports
12
10
8
6
4
2
0
Forecast
2000
2005
2010
2015
2020
Source: EIA
© FT

Historical prices of crude oil (1861 - 2014)

Real 2014 US dollars per barrel



Source: BP Statistical Review of World Energy 2015


World crude oil prices
$/bbl (real 2010 dollars, monthly average)
160
140
120
100
80
60
40
20
0
1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010
2014 2015 2016 2017
WTI
Brent
Mars
Tapis
Dubai
Sources: Bloomberg L.P., Thomson Reuters. Published by: U.S. Energy Information Administration.

Thank You!