Top Ten Texas Oil and Gas Cases of 2018 - Part 3 of 3

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This is the final installment of the three-part series discussing significant oil and gas decisions from state courts in Texas during 2018. It is not intended to be a strict legal analysis, but rather a useful guide for landmen in their daily work. Therefore, a complete discussion of all legal analyses contained in the decisions are not always included.

7. *Murphy Exploration & Production Co.-USA v. Shirley Adams, et al.*, No. 16-0505, 2018 WL 2449313 (Tex., June 1, 2018)

In this case, the Texas Supreme Court held that an offset well clause in an operator's leases with the plaintiffs did *not* require the operator to drill wells reasonably calculated to protect against drainage from the neighboring tract. Four justices issued a stinging dissent[1] arguing the majority disregarded the well-established meaning of the term "offset well" as used in the Texas oil field for decades.

In 2009, Murphy Exploration & Production Co.-USA entered into two oil and gas leases with the plaintiffs (the Herbsts).[2] The leases contained identical offset well clauses, which provided:

It is hereby specifically agreed and stipulated that in the event a well is completed as a producer of oil and/or gas on land adjacent to and contiguous to the leased premises, and within 467 feet of the premises covered by this lease, that Lessee herein is obligated to … commence drilling operations on the leased acreage and thereafter continue the drilling of ***such off-set well or wells*** with due diligence to a depth adequate to test the same formation from which the well or wells are producing from the adjacent acreage.

When a well on a neighboring tract triggered this clause, Murphy drilled a well on the Herbsts' tract … 2,100 feet from the triggering well. It was undisputed this well would *not* prevent drainage from the neighboring tract. Thus, the Herbsts argued the well did not satisfy the leases' offset well clause because it was not designed to protect against drainage.[3] In response, Murphy argued the well satisfied the offset well clause because it was drilled on the leased premises to the same depth as the triggering well, which Murphy claimed is all the leases' explicit language required. Murphy argued the notion that an offset well must actually protect against drainage or even be reasonably calculated to do so has no place in horizontal drilling in tight shale formations where drainage is minimal. The trial court sided with Murphy. The San Antonio Court of Appeals sided with the Herbsts. The Texas Supreme Court granted review.

The Texas Supreme Court began its analysis by noting the law is well-established that courts interpret oil and gas leases just like any other contract. Thus, a court must read the lease, give its terms their plain and ordinary meaning and enforce the lease as written. Courts may not modify a lease's explicit language absent extraordinary circumstances. However, a court can consider the context in which a lease was negotiated and executed to inform its interpretation of the words used in the lease. And a court can interpret words and phrases in a lease in accordance with any special definitions those terms have in a particular industry.

In a 5-4 opinion, the court held Murphy's offset well clause did *not* require Murphy to drill a well to protect against drainage from the neighboring tract and that Murphy's well, some 2,100 feet from the triggering well, satisfied the leases' offset well clause. The court's opinion was based on two important premises. First, the court held Murphy's leases provided their own definition of "offset well." That is, the leases stated that when the offset well clause was triggered, Murphy had to drill a well (1) on the Herbsts' tract, (2) with due diligence and (3) to the same depth as the triggering well, and the drilling of "**such offset well**" would satisfy the offset well clause. Because the leases used the term "such offset well" when setting forth three criteria for a satisfactory well, but did not include a proximity requirement or an express protection requirement, the court would not impose one.

Second, the court considered the "surrounding circumstances" under which the leases were executed in interpreting the offset well clause. The court noted leases were executed in 2009 and were drafted with horizontal drilling in the Eagle Ford Shale in mind. The court considered expert testimony presented by Murphy that drainage is almost nonexistent from horizontal wells in tight-shale formations like the Eagle Ford. Thus, the court concluded it would be "illogical" for an offset well clause to require a well — even an "offset well" to attempt to protect against nonexistent drainage.

Four justices dissented, arguing the commonly understood definition of "offset well" required Murphy to drill its offset well at a location where a reasonably prudent operator would drill to protect the leasehold from actual or potential drainage, regardless of whether any was actually occurring. The dissent claimed the majority opinion effectively read the term "offset" out of the leases.

While the court purported to limit its holding to the facts before it, the Murphy opinion may have far-reaching consequences for the Texas oil and gas business. The vast majority of wells drilled in Texas today are horizontal, tight-shale wells. The court's opinion indicates the common understanding of an "offset well" is antiquated in this context. How can operators protect against drainage that does not exist? The Murphy opinion indicates the Texas Supreme Court believes they cannot — and that they no longer have to even try.

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[1] Justices Johnson, Green, Guzman and Boyd.

[2] The leases covered adjacent 302-acre tracts in Atascosa County.

[3] The Herbsts did not contend Murphy's offset well had to "actually" protect against drainage and never stated how close to the triggering well the offset well had to be. Rather, the Herbsts merely argued the offset well had to be "in close proximity to the lease line adjacent to the tract where the triggering well was drilled" and that Murphy's purported offset well was not close enough.

8. *U.S. Shale Energy II LLC v. Laborde Properties L.P.*, No. 17-0111, 2018 WL 318952 (Tex., June 29, 2018)

In this case, the Texas Supreme Court considered whether the royalty interest reserved to the grantor in a 1951 deed was fixed (set at a specific percentage of production) or floating (dependent on the royalty amount in the applicable oil and gas lease). In 1951, J.E. and Minnie Bryan conveyed by deed a tract of land in Karnes County to S.E. Crews. The deed reserved an NPRI to the Bryans, as follows:

There is reserved and excepted from this conveyance unto the grantors herein, their heirs and assigns, an undivided one-half (1/2) interest in and to the Oil Royalty, Gas Royalty, and Royalty in other Minerals in and under or that may be produced or mined from the above described premises, the same being equal to one-sixteenth (1/16) of the production. This reservation is what is generally [sic] termed a non-participating Royalty Reservation.

Through a series of conveyances, U.S. Shale acquired a share of the Bryans' NPRI. In 2009, EOG acquired a lease on the subject tract providing for a lessor's royalty of 20 percent, i.e., one-fifth. In 2010, Laborde acquired some of the property burdened by the Bryan-U.S. Shale NPRI and thus became a lessor under EOG's lease. EOG sent Laborde a division order crediting the Bryan heirs and U.S. Shale with one-half of the one-fifth royalty under EOG's lease for a total royalty of one-tenth of production. Laborde disputed the division order, alleging the Bryan heirs and U.S. Shale should only be credited with one-sixteenth of production by virtue of a fixed one-sixteenth NPRI reserved in the Bryan deed. After Laborde notified EOG of its disagreement, EOG put all parties in suspense, and litigation ensued. The trial court ruled for the Bryan heirs and U.S. Shale. The Court of Appeals reversed, and the Texas Supreme Court granted review.

The Texas Supreme court explained that a royalty may be conveyed or reserved as a "fractional" royalty interest or a "fraction of" royalty interest. A "fractional" royalty interest is referred to as a "fixed" royalty because it remains constant and is untethered to the royalty amount in a particular oil and gas lease. A "fraction of" royalty interest is referred to as a "floating" royalty because it varies depending on the royalty in the oil and gas lease in effect and is calculated by multiplying the fraction in the royalty reservation by the royalty in the lease.

Turning to the Bryan deed, the court found that read independently, the first clause of the royalty reservation unambiguously reserved a floating royalty ("an undivided one-half (1/2) interest in and to the Oil Royalty, Gas Royalty and Royalty in other Minerals"). The issue was whether the second clause ("the same being equal to one-sixteenth (1/16) of the production") indicated an intent to fix the Bryans' NPRI at one-sixteenth of production. In determining that it did not, the court noted that when the Bryan deed was executed, a one-eighth lessor's royalty was "ubiquitous." Thus, even though no lease was in effect covering the Bryans' property at the time the deed was executed, the Bryans must have assumed that when a lease was taken on the property, it would provide for a one-eighth royalty. Of course, one-half of a one-eighth royalty equals one-sixteenth. Thus, the court reasoned the Bryans must have intended to reserve a one-half floating royalty, which the Bryans must have assumed would equal one-sixteenth of production. Had they not, the first clause of the reservation tying the NPRI to the applicable royalty would be rendered meaningless. Accordingly, the court reinstated the trial court's judgment finding the Bryan deed unambiguously reserved a floating one-half royalty interest.

Three justices dissented,[4] finding the Bryan deed's reference to one-half of the "Oil Royalty, Gas Royalty and Royalty in other Minerals," none of which were defined terms in the deed, did not unambiguously create a floating royalty. The dissent found the reservation's second clause, however — "the same being equal to one-sixteenth of production" — could not have more plainly stated an intent to reserve a fixed one-sixteenth royalty. Accordingly, the dissent would have held the Bryan deed's reservation created a fixed one-sixteenth royalty interest.

9. *Louis Dorfman, et al. v. JP Morgan Chase Bank N.A., et al.*; No. 02-17-00387-CV, 2018 WL 5074769, (Tex. App. — Fort Worth, Oct. 18, 2018)

This is the second appeal in a lawsuit over a title dispute in Karnes County, Texas. In 2010, Petrohawk Properties L.P. acquired a lease on approximately 200 mineral acres in the Eagle Ford. The owners of the property were Dorfman and Moravits.[5] Dorfman and Moravits traced their ownership in the tract back to a 1901 deed from William Mayfield to Mary Moravits. Around the same time that Petrohawk acquired its lease, JP Morgan Chase Bank N.A., acting as trustee for the Red Crest Trust, leased the very same acreage to Orca Assets G.P. LLC. Orca traced the trust's ownership back to a 1929 deed from Mary Moravits to H.J. McMullen. Unbeknownst to JP Morgan, however, the 1929 deed from Moravits to McMullen had been "cancelled and held for naught" by a 1944 judgment in a lawsuit by Mary Moravits and her sons. It is unclear just what Orca knew about this judgment. It was undisputed that when Orca leased the acreage from JP Morgan, however, Orca knew there was a "problem" with the title but was prepared to defend it and believed it could be resolved in the Red Crest Trust's favor. In 2011, Petrohawk filed suit against JP Morgan and Orca seeking to quiet title based on the 1944 judgment. The trial court sided with Petrohawk, Dorfman and Moravits. The 1929 deed was void and, as a result, so was Orca's lease.

The trial court allowed a permissive interlocutory appeal of its title decision, and the Court of Appeals affirmed. The case was then remanded back to the trial court for adjudication of Dorfman and Moravits' tort claims against JP Morgan and Orca.

Specifically, Dorfman and Moravits alleged JP Morgan and Orca had slandered their title to the disputed acreage and that JP Morgan had been negligent in leasing the acreage to Orca when it should have known the Red Crest Trust did not own it.[6] A slander of title claim, however, requires evidence of "legal malice"

[4] Justices Boyd, Johnson and Blacklock.
[5] As used herein, "Dorfman" and "Moravits" refers collectively to the plaintiffs, Louis Dorfman, K1 Holdings Ltd., Sam Myers, J.M.D. Resources Inc., Bill Cogdell Bowden, Barbara Standfield, Stacey Dorfman-Kivowitz, Julia Dorfman, Mark Dorfman, David Phillip Cook, Cheryl King Cook, Sam Y. Dorfman Jr., Frank Moravits, individually and as the trustee of the Moravits Children Trusts Nos. 1 and 2, Shelby Moravits and Jerry Kortz.
[6] Dorfman and Moravits also brought claims against JP Morgan and Orca for tortious interference with property rights and tortious interference with existing and

from the defendant. And malice is not present if a claim to title is made under a reasonable belief that the claimant had title. Therefore, if a party claims title "under color of title upon the advice of attorneys, or upon reasonable belief that a party has title to the property acquired," he has not acted with legal malice. Likewise, a negligence claim requires proof the defendant acted unreasonably.

Both the trial court and the Court of Appeals found that Dorfman and Moravits presented no evidence that JP Morgan or Orca acted with legal malice or even unreasonably when they claimed title to the disputed acreage. The Court of Appeals noted that JP Morgan and Orca had several legal arguments as to why, notwithstanding the 1944 judgment, they held valid title to the acreage, and "[a]lthough these arguments were unavailing at the end of the day, they evinced the reasonableness of JP Morgan and Orca Assets' belief under the applicable law that JP Morgan held title to the tract." The absence of any proof of unreasonableness was fatal to Dorfman and Moravits' slander of title, negligence and tortious interference claims. Thus, the claims were dismissed.

10. *Carl M. Archer Trust No. Three, et al v. Ronald Ralph Tregellas and Donnita Tregellas*, -- S.W.3d --, No. 17-0093, 2018 WL 6005071 (Tex. 2018).

In this case, the Texas Supreme Court held the Discovery Doctrine tolled the statute of limitations for breach of a right of first refusal ("ROFR") in mineral property even though the conveyance made in violation of the ROFR was filed in the public records. In June of 2003, members of the Cook family executed a deed conveying the surface estate of a tract of land in Hansford County, Texas (top of the Panhandle) to two trusts (the "Trustees"). The sellers retained the mineral estate, but granted the Trustees a right of first refusal ("ROFR") to purchase the mineral estate.

In March of 2007, two of the ROFR grantors (the "Farbers"), executed a mineral deed conveying their interest in the mineral estate to Ronald and Donnita Tregellas. The Farbers did not notify the Trustees of the sale, but the deed was filed of record on March 30, 2007. Nevertheless, the Trustees did not learn of the sale until May 4, 2011. The Trustees then promptly sued the Farbers and the Tregellases for breach of the ROFR and tortious interference on May 5, 2011. The Trustees sought damages and specific performance requiring the Tregellases to transfer the mineral interest the Trustees.

The defendants argued the Trustees' claims were barred by the statute of limitations. Specifically, the defendants argued the Trustees' claims accrued on March 28, 2007 at the very moment the mineral estate was transferred to the Tregellases in violation of the ROFR. Because the Trustees did not file suit until May 5, 2011, the defendants argued the Trustees missed the four-year statute of limitations by seven days. In response, the Trustees argued the Discovery Doctrine tolled the limitations period to May 4, 2011, the date they learned of the offending conveyance, among other arguments.

The trial court sided with the Trustees, but the Amarillo Court of Appeals reversed, holding that the Trustees cause of action accrued when the mineral estate was conveyed without notice on March 28, 2007. The court of appeals held that the breach of a right of first refusal is not the type of "inherently undiscoverable" injury to which the Discovery Doctrine applies because conveyance documents, like the Farber to Tregellas deed, are usually filed in the public records.

The Texas Supreme Court reversed the court of appeals and reinstated the trial court's judgment. The Court noted that a ROFR grantor has a duty to provide the grantee with notice of his or her intention to sell the property burdened by the ROFR. Thus, a ROFR holder does not have a duty to "continually monitor public records" for conveyances made in violation of the ROFR. Accordingly, the violation of a ROFR is the type of "inherently undiscoverable" injury to which the Discovery Doctrine applies. This situation is different than an underpaid royalty owner, for example, who has a duty to confirm his or her royalties have been paid correctly, and thus, is put on notice of royalty underpayments based on Railroad Commission filings. Pursuant to the Discovery Doctrine, the Trustees' claim for breach of the ROFR did not accrue until May 4, 2011, the date on which the Trustees discovered the offending conveyance, and thus, their May 5, 2011 lawsuit was timely. The Court, therefore, reinstated the trial court's judgment, and awarded the Tregellases' mineral estate to the Trustees.

CONCLUSION

We hope this series has helped you address the legal issues presented by modern oil and gas activities. As always, if you believe one of these decisions might have a bearing on an action you are about to take or a decision you might make, consult a lawyer.

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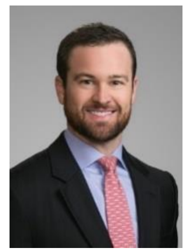

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prospective contractual relationships. However, the appellate court's analysis of the slander of title claim was dispositive of these additional tort claims as well.