Energy Law Update: Top Ten Texas Oil & Gas Cases of 2019 - Part 1 of 3

By: Chance Decker and Ryan Sears, Gray Reed

For the next three months, we will discuss significant oil and gas decisions from state courts in Texas during 2019. 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.

1. *Barrow-Shaver Resources Company v. Carrizo Oil & Gas, Inc.*, No. 17-0332, -- S.W.3d --, 2019 WL 2668317 (Tex. June 28, 2019).

In this case, the Texas Supreme Court held that evidence of industry custom cannot be used to alter an unambiguous consent to assignment clause. The case involved a Carrizo Oil & Gas, Inc.'s ("**Carrizo**") interest in a 22,000-acre lease in North Texas. The lease was set to expire if a producing well was not drilled by April 23, 2011. Carrizo entered into a farmout agreement with Barrow-Shaver Resources Company ("**Barrow-Shaver**"), in which Barrow-Shaver would earn a partial assignment of Carrizo's interest in the lease in exchange for drilling a producing well. The farmout was memorialized in a letter agreement. An early draft of the letter agreement contained the following "soft" consent to assignment language:

The rights provided to [Barrow-Shaver] under this Letter Agreement may not be assigned, subleased or otherwise transferred in whole or in part, without the express written consent of Carrizo which consent shall not be unreasonably withheld.

In subsequent negotiations, Carrizo removed the "which consent shall not be unreasonably withheld" language. Thus, the consent to assignment clause read as follows:

The rights provided to [Barrow-Shaver] under this Letter Agreement may not be assigned, subleased or otherwise transferred in whole or in part, without the express written consent of Carrizo which consent shall not be unreasonably withheld.

Barrow-Shaver objected to the deletion of this language, but according to Barrow-Shaver, Carrizo's land manager assured Barrow-Shaver that Carrizo would provide its consent to assignment. Barrow-Shaver ultimately relented and accepted the "hard" consent to assignment clause Carrizo demanded.

Before Carrizo's lease expired, Barrow-Shaver drilled an unsuccessful well on the farmed-out acreage (spending $22,000,000 in the process). Raptor Petroleum II, LLC then offered Barrow-Shaver $27,000,000 for its farmout rights. Carrizo, however, would not consent to the assignment. Instead, it proposed selling its interest in the lease to Barrow-Shaver for $5,000,000. Barrow-Shaver did not respond to the offer and Raptor's offer for the farmout rights fell through.

Barrow-Shaver sued Carrizo for breach of contract and fraud, alleging that even though the consent-to-assignment clause didn't expressly say it, industry custom imposed a reasonableness requirement upon Carrizo's right to withhold consent. According to Barrow-Shaver, conditioning consent to an assignment upon the payment of $5,000,000 from the assignor was not reasonable and offended oilfield custom. The jury agreed and awarded Barrow-Shaver a $27,000,000 verdict against Carrizo.

Barrow Shaver's victory was short-lived. The Court of Appeals reversed the trial court and entered a take-nothing judgment in favor of Carrizo. The Texas Supreme Court affirmed, holding that the absence of language in the farmout agreement requiring Carrizo's withholding of consent to be reasonable meant Carrizo could withhold consent for any reason or no reason at all. When an agreement is unambiguous, as the farmout agreement was, evidence of industry custom cannot be used to impose obligations the contract's plain language does not impose itself. Additionally, because the farmout agreement unambiguously gave Carrizo a hard consent right, Barrow-Shaver could not have reasonably relied upon Carrizo's land manager's representations that consent would not be withheld. Thus, Barrow-Shaver's fraud claim was dismissed as well.

2. *Burlington Resources Oil & Gas Company, LP v. Texas Crude Energy, LLC*, 573 S.W.3d 198 (Tex. 2019).

In this case, the Texas Supreme Court held that a royalty delivered "into the pipeline, tanks or other receptacles with which the wells may be connected" is akin to a royalty delivered "at the wellhead." Thus, the payee was entitled to deduct its post-production costs from its royalty calculation, notwithstanding the fact the royalty would be calculated based on the "amount realized" from downstream sales.

Amber Harvest, LLC ("**Amber Harvest**") an affiliate of Texas Crude Energy, LLC ("**Texas Crude**") owns overriding royalty interests in oil and gas leases operated by Burlington Resources Oil & Gas Company ("**Burlington**") in Live Oak, Karnes and Bee Counties. The royalty is "delivered by [Burlington] into the pipelines, tanks or other receptacles" to which the wells are connected, free of production costs and calculated based on the "value of the oil, gas or other minerals" produced under the leases. The term "value" is defined as the "amount realized" from the sale of the oil or gas produced from the leases or any product thereof.

For nine years, Burlington deducted its post-production costs from the amount realized on downstream sales prior to calculating Texas Crude and Amber

Harvest's royalties. Disagreements arose, and citing the ORRI's definition of "value," Texas Crude alleged it was entitled to royalties based on the sales price derived from downstream sales with no deduction for Burlington's post-production costs. Relying on the Texas Supreme Court's 2016 opinion in *Chesapeake Exploration & Production, LLC v. Hyder*, the trial court granted summary judgment for Texas Crude and the court of appeal affirmed. The Texas Supreme Court granted review to clarify its holding in *Hyder.*

In general, oil and gas royalty interests are free of production expenses, but usually subject to post-production costs. Post-production costs generally refer to processing, compression, transportation and other costs to prepare raw oil or gas for sale at downstream location.

Post-production processing enhances oil and gas's value after it leaves the well. Therefore, accounting for post-production costs becomes necessary when a royalty is valued at the wellhead, but the sale used to calculate the royalty occurs downstream. In this situation, the lessee is generally entitled to deduct its post-production costs from the downstream sale price prior to calculating the royalty.

Of course, parties are free to contract for a royalty valued downstream, without deduction of post-production costs. In *Chesapeake Exploration & Production, LLC v. Hyder*, 483 S.W.3d 870 (Tex. 2016), for example, the Texas Supreme Court held that a royalty based on the "amount realized" from a downstream sale of oil or gas grants the royalty holder a right to a percentage of the sale proceeds with no adjustment for post-production costs.

Texas Crude and Amber Harvest argued the "amount realized" language in ORRI creates the kind of cost-free royalty the Supreme Court discussed in *Hyder*. The operative clause required Burlington to pay a royalty based on the "value" of the oil and gas produced, and defined "value" as the "amount realized" from Burlington's sales.

In this case, however, the Texas Supreme Court clarified that even when a royalty is *calculated* based on the amount realized on downstream sales, a payee is entitled to deduct post-production costs if the royalty is "valued" at the wellhead.

Here, Texas Crude and Amber Harvest's royalty interest was to be "delivered to [Texas Crude] into the pipelines, tanks or other receptacles with which the wells may be connected, free and clear of all development, operating, production and other costs." Though this language is not a model of clarity, the Texas Supreme Court held this clause is akin to delivering a royalty at the wellhead. When a royalty is delivered, and thus valued, at the wellhead, the payee is entitled to deduct post-production costs, even when the sales used to calculate the royalty occur downstream.

3. *Ellison v. Three Rivers Acquisition, LLC*, No. 13-17-00046-CV, 2019 WL 613262 (Tex. App.—Corpus Christi, Feb. 14, 2019, pet filed).

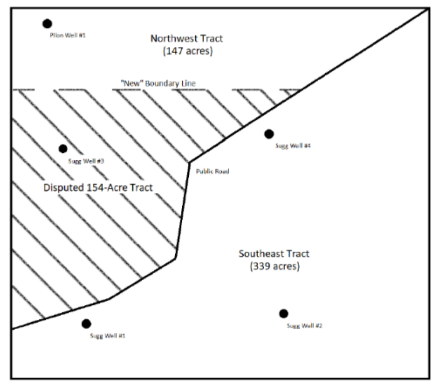
This case demonstrates two important lessons for oil and gas practitioners regarding: (1) interpreting discrepancies between metes and bounds property descriptions and general acreage statements, and (2) best practices for drafting boundary stipulations.

When J.D. Sugg died in 1925, his family inherited a section of land in Irion County. Some of Sugg's heirs agreed to swap land with the Noelkes, nearby landowners. To effectuate the swap, the Suggs executed a deed on July 26, 1927, which conveyed several tracts to the Noelkes (the "**Sugg Deed**"). The Sugg Deed described one of these tracts as

"all of ... the lands located North and West of the public road which now runs across the corner of [the applicable survey], containing 147 acres more or less."

There was just one problem: there were actually 301 acres in the section northwest of the only public road that ever ran through the survey. Thus, the question became, did the deed convey all 301 acres northwest of the public road, or just 147 acres?

The Suggs, Noelkes and their respective successors always treated the Suggs Deed as conveying 301 acres, not 147. Nevertheless, in 2008, Samson Oil and Gas ("**Samson**") asked Jamie Ellison (who had acquired a mineral lease on the Northwest Tract), to sign a boundary stipulation purporting to resolve the metes and bounds v. acreage discrepancy in the Suggs Deed. The Boundary Stipulation would have moved the property line to a new location consistent with an original conveyance of just 147 acres. Thus, the Boundary Stipulation would have made the property lines look like this:



Jamie Ellison signed a letter to Samson stating he agreed to the new boundary, but Samson never actually sent him a Boundary Stipulation and the letter didn't contain any conveyance language.

Samson subsequently drilled a producing oil well south of the new boundary line on the 154-acre tract that Samson contended was *not* conveyed in the Suggs Deed. Concho eventually acquired Samson's lease. Throughout this time period, Sunoco purchased the oil from the well on the 154-acre tract.

In 2013, Jamie Ellison's surviving spouse, Marsha, filed a trespass-to-try title suit against Concho arguing she was the rightful owner of the disputed 154-acre tract. Concho moved for summary judgment on Marsha's claims, arguing the 2008 letter signed by Jamie Ellison: (1) relinquished any claim Marsha might possess in the land beyond the 147-acre tract depicted in the 2008 Boundary Stipulation; and (2) ratified the boundary as depicted in the 2008 Boundary Stipulation and letter. Concho also brought a counterclaim against Marsha for breach of the 2008 Boundary Stipulation letter (it argued the letter was a contract). The trial court granted Concho's motion and dismissed all of Marsha's claims. The jury awarded Concho $1,030 in out of pocket damages and $392,479.39 in attorneys' fees on its breach of contract claim.

The Court of Appeals reversed, holding the 2008 Boundary Stipulation was null and void. The court held that, notwithstanding the metes and bounds v. acreage statement discrepancy in the Sugg Deed, it unambiguously conveyed 301 acres—not 147—because the metes and bounds description controls.

Likewise, because there was only one public road running through the section, there was no legitimate dispute about where the property boundary was prior to the 2008 Boundary Stipulation being executed. In the absence of a legitimate boundary dispute, a boundary stipulation is only effective if it contains words of conveyance (like a deed) and complies with the Statute of Frauds. Here, the 2008 Boundary Stipulation and letter from Samson to Jamie Ellison contained neither.

Thus, the two lessons this case teaches are: (1) in case of a discrepancy between a metes and bounds description and a statement of acreage, the metes and bounds description controls, unless the language of the conveyance or the facts clearly demonstrate otherwise. (2) Always use words of conveyance in boundary stipulations to ensure their enforceability.

STAY TUNED …

Next month, we will discuss three more cases that may have an impact on your daily work. We hope this series will help 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.

ABOUT THE AUTHORS

CHANCE DECKER, PARTNER – cdecker@grayreed.com

An aggressive and results-driven litigator, Chance Decker focuses on resolving high-stakes disputes for businesses in the oil and gas industry. His client list includes major players and growing businesses across the energy industry, including E&P companies, interstate pipeline companies, pipe and steel distributors, and oilfield services companies. Chance earned his B.S. from Texas A&M University and his J.D. from University of Houston Law Center.

RYAN SEARS, PARTNER – rsears@grayreed.com

Leader of Gray Reed's Energy Transactions Practice Group, Ryan Sears serves as outside general counsel for both domestic and international energy clients, focused primarily on structuring upstream and midstream transactions and advising on the various issues that typically arise during the exploration and production of oil and gas. He earned his undergraduate degree and his law degree from the University of Oklahoma.