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# Oil and Gas Law: 2Q18 Update

Energy Law, Mineral Leases, Mineral Trespass, Royalty Disputes, Torts / May 29, 2018 / Thomas G. Ciarlone Jr.

The second quarter of the year has seen abundant activity at the intersection of the energy industry and the law. These are some of the highlights.

**Offset Wells and Liquidated Damages as Unenforceable Penalties.** Oil-and-gas leases—at least those drafted by savvy mineral owners—will often include an offset drilling clause. Such clauses stipulate that, if a well is drilled on a neighboring tract in proximity to the leasehold, the lessee generally has three options: drill an offset well to prevent drainage; release acreage, so the lessor can drill an offset well; or pay the mineral owner the same royalties it would have received if the off-lease well had been spudded on the lease. These provisions, however, can sometimes be in tension with Texas authorities holding that liquidated damages—even when negotiated at arms' length between contracting parties with equal bargaining power—are unavailable when the actual harm is reasonably ascertainable and the contractual quantum of liquidated damages does not approximate actual damages. In a consolidated proceeding in South Texas aggregating a number of related lawsuits, Chesapeake has taken the position that the offset drilling clauses in its leases constitute unenforceable penalties since the liquidated damages—*i.e.*, the royalties that would have been paid had the off-lease well been situated on the lease—always, as an operational reality, vastly outstrip the royalties on the oil that would *not* have been drained had Chesapeake drilled an offset well. For obvious reasons, operators and mineral owners alike would be wise to closely monitor the status of this litigation. The case is *In re Chesapeake Eagle Ford Royalty Litigation*, Cause No. 2016-CI-22098, pending in the 224th District Court in San Antonio.

**Anti-SLAPP Arrives in the Oil Patch.** Codified at Chapter 27 of the Texas Civil Practice and Remedies Code, the Texas Anti-SLAPP regime—"SLAPP" being an acronym for Strategic Lawsuits Against Public Participation—is torn straight from the pages of David and Goliath. It targets powerful actors who file frivolous lawsuits aimed at intimidating their critics into keeping quiet. At the risk of oversimplifying the statute, it can be used as both a sword and a shield against those who enlist litigation as a means of curbing free speech: a successful motion under the Anti-SLAPP statute will see the coercive claim dismissed, with an award of attorneys' fees to the defendant who invoked the protections of the statute. The application of the law in the oilfield is rare, especially between mineral owners and operators. Recently, however, a Texas lessor, Lona Hills Ranch, sued its lessee for trespass when the operator drilled wells on the Ranch's land after the lease had allegedly already expired. The lessee countersued the Ranch after it issued a number of public statements critical of the operator's activities, and in response the Ranch brought the Anti-SLAPP statute to bear on the operator. In resisting application of the statute, the operator argued that it was only seeking relief against the Ranch for violating the terms of the parties' mineral lease, which required the Ranch to furnish the operator with notice of any breach, and an opportunity to cure, before commencing any litigation. The trial court agreed, but the Austin Court of Appeals reversed in substantial part. Although it acknowledged that the Ranch had a contractual duty to give the operator notice and an opportunity to cure before suing, the appellate court ruled that the plain language of the operator's pleadings showed that it was seeking relief not just for the Ranch's initiation of litigation without notice, but furthermore for the Ranch's public statements about the operator's conduct. The lesson here, perhaps, is that operators should more carefully craft their pleadings; keep them narrowly focused on the discrete acts of the lessor that represent breaches of the lease; and thereby avoid the kind of overreaching that might open the door to a troublesome Anti-SLAPP claim. The case is *Lona Hills Ranch, LLC v. Creative Oil & Gas Operating, LLC*, No. 03-17-00743-CV, pending in the Third Court of Appeals in Austin.

**The Vexing Problem of Royalties Among Co-Tenants.** When multiple lessees hold the mineral rights to the same tract of land, typically they will come to an agreement to jointly operate the asset. But sometimes a lessor will go it alone and drill wells without the involvement of the other lessors. In these instances, the drilling co-tenant must pay to its mineral co-tenants in the same tract their proportionate share of production. This is precisely what Apache recently did in Glasscock County, and there was no dispute that Apache dutifully accounted to its co-tenant, Devon, for its full share of production. Apache did, however, refuse to pay royalties to Devon's lessors, who proceeded to sue both Apache and Devon under Section 91.402 of the Texas Natural Resources Code. The trial court held that, because there is no contractual relationship between Apache and Devon's lessors, the former had no obligation to pay the latter anything—at least not pursuant to the Natural Resources Code. The ruling has the potential to leave mineral owners in a lurch, albeit only temporarily as the non-operating lessee awaits production payments from its operating co-tenant, which can then be used to fund royalty payments to the lessors of the non-operating lessee. Naturally, there are contractual methods for forward-thinking mineral owners to draft around these delays, which would effectively require the non-operating lessee to front the money for royalty payments before it receives any funds from its operating co-tenant. This, of course, vests the risk of non-payment squarely in the non-operating lessee, which also sacrifices the time value of the money that it would more or less have to "advance" to its lessors. The case is *Devon Energy Production Company, L.P. v. Apache Corporation*, No. 11-16-00105-CV, pending in the Eleventh Court of Appeals in Eastland.

**Texas Supreme Court to Mineral Purchasers: Buyer Beware.** The facts here are straightforward: Orca leased nearly 1,000 mineral acres from the Red Crest Trust, via its trustee JPMorgan; the lease explicitly provided that Red Crest was offering no warranty of title; and, indeed, in the event title failed, the lease stated that Red Crest would nevertheless be entitled to keep the bonus money Orca had paid to the Trust. A letter of intent between Orca and Red Crest included a specific provision prohibiting Red Crest from leasing the acreage to anyone else. On the day Orca signed the lease with Red Crest, Orca's leasing representative asked Red Crest to confirm that the acreage remained "open" and unleased. Red Crest promptly confirmed, after ostensibly consulting a computerized database, stating that "we're good to go." As it turns out, however, Red Crest had, in fact, leased the same 1,000 acres to another party six months earlier, but did not record the lease until three days after the Trust signed the mineral lease with Orca. After discovering the earlier lease, Orca demanded that the Trust return its multimillion-dollar bonus payment, and, when Red Crest refused, Orca sued for fraud, negligent misrepresentation, and breach of contract. The intermediate court of appeals sided with Orca, but the Texas Supreme Court reversed, explaining that, even though Red Crest's representations were false, Orca could not have reasonably relied on them due to the existence of so many "red flags," not the least of which was the prominent and unusual warranty disclaimer, Orca’s level of sophistication, and the sheer size and scope of the transaction. The case is *JPMorgan Chase Bank, N.A. v. Orca Assets G.P.*, LLC, No. 15-0712, pending in the Supreme Court of Texas.

*Tom is a litigation partner in the Houston office of Kane Russell Coleman Logan PC, where he leads the firm’s energy practice group. Tom is also the host of a weekly podcast on legal news and developments in the oil-and-gas industry, available at www.energylawroundup.com, and a video series on effective legal writing, available at www.theartofthebrief.com.*

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Thomas G. Ciarlone Jr.

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