Texas Court Decision a Cautionary Tale for Oil and Gas Operators

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On January 30, 2015, the Texas Supreme Court issued its first major decision impacting the oil and gas industry. The Court found, among other things, that (1) the fraudulent tolling doctrine tolled the statute of limitations allowing a mineral owner to bring a breach of contract claim based on an oil and gas operator's misrepresentation in a publicly filed document; and (2) the oil and gas operator breached the most favored nations clause by paying higher royalties on a nearby lease.

Charles G. Hooks and other plaintiffs ("Hooks") sued Samson Lone Star Limited Partnership, now known as ***Samson Lone Star, LLC*** ("Samson") in 2007 for breach of contract, failure to pay royalties, fraud, fraudulent inducement, and statutory fraud for misrepresenting a well's bottom-hole location, which resulted in Hooks not being paid royalties based on an "offset obligation" clause in the lease. Samson asked Hooks to amend the subject lease in 2001 to pool into a unit associated with a new well that fell within the protected zone identified in the lease. Samson, however, provided Hooks with a plat created by its landman that incorrectly placed the well's bottom hole outside of the protected zone. This incorrect plat was also filed with the Texas Railroad Commission.

Samson argued the fraudulent concealment tolling doctrine should not apply therefore barring Hooks' claim under the statute of limitations because a person acting with reasonable diligence would have discovered the true location of the well's bottom hole in 2000 or 2001 based on older Railroad Commission records containing: (1) a directional survey with an attached plat correctly placing the bottom hole's location; and (2) plans that revealed that Samson originally intended the well to bottom within the boundary. At trial, a jury found for Hooks awarding more than $20 million in damages. The appellate court reversed finding the claim was not timely brought.

The Texas Supreme Court reversed finding that Hooks acted with reasonable diligence. Although reasonable diligence would require one to examine readily available information in the public record, the most recent Railroad Commission filing falsely conveyed that the well had been completed outside the protected zone. The Court found that Hooks did not need to double-check the more recent filings against earlier filings because "fraud vitiates whatever it touches."

The Court also found that Samson breached the most favored nations clause when it paid a higher royalty to the State of Texas. Samson argued that it paid 25% royalties to both parties, but was the result of an increase in the State's "unit royalty interest" (used to induce the State to allow pooling), which resulted in an increase in the State's allocation of production from the unit. Pursuant to the recent decision in *Key Operating & Equip., Inc. v. Hegar*, 435 S.W.3d 794, 798-99 (Tex 2014), production anywhere on a pooled unit is treated as production on every single tract. Therefore, the State's grant of a royalty to the State on production from the unit meant that Samson increased the State's 25% royalty on production from its tract.

The Court also addressed breach of the formation production clause, and various other claims: "unpooling" offset provision, attorney's fees, and post-judgment interest.

In sum, oil and gas operators should now be even more careful to ensure that their regulatory filings are correct and consistent. Even though this decision is narrow, it is possible that there will be an increase of mineral rights owners bringing suit arguing that any inaccuracy taints the public records with fraud. This is also an important reminder for oil and gas operators to carefully negotiate lease terms and to think proactively and in the long-term about the impact of including terms within a lease.

National Law Review, Volume V, Number 56