OPERATOR REMEDIES ON MISPAYMENT

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COMMON CAUSES OF MIS-PAYMENT

- HUMAN ERROR
  - Clerical Mistakes
  - Typographical error
  - Miscalculation
  - Mistaken Identity
  - Misinterpretation

UNCOMMON CAUSES OF MISPAYMENT

- Fraud
- Recording error
  - Mis-indexed instrument
  - Instrument recorded in wrong county

TYPES OF MISPAYMENT

1) **Underpayment**
   - Royalty payee is due royalties on past production
   - Usually caught by payee
   - Generally may be cured
2) **Overpayment**
   - Royalty payee was paid more than its share
   - May go undetected for many years
   - More challenging (practically and legally)

FORM OF ACTION OF MISPAYMENT

1) **Underpayment**
   - Suit against Operator will be for breach of contract
     - Costs and fees can be pleaded
   - Statutory right to sue set forth in TNRC 91.404
   - Read the lease for termination provisions
2) **Overpayment**
   - Suit by Operator will be for conversion or unjust enrichment
     - Costs and fees cannot be pleaded.

ACTION ON MISPAYMENT – LEASE TERMINATION

XTO Energy, Inc. v. Pennebaker, 2011 Tex. App. LEXIS 10194

- Facts and Trial Court Findings:
  - Lessor sued for nonpayment, conversion, trespass to try title, and for a declaration to terminate the lease
  - Lessors notified XTO of intent to terminate via two letters
  - Trial court held the lease terminated according to its terms (as to all acreage even though nonpayment claim was related to one of three producing wells)

ACTION ON MISPAYMENT – LEASE TERMINATION (cont.)

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ACTION ON MISPAYMENT – LEASE TERMINATION (cont.)

XTO Energy, Inc. v. Pennebaker, 2011 Tex. App. LEXIS 10194

- On Appeal (opinion from December 29, 2011)
  - Reversed the trial court because affidavit not filed in Tarrant County property records (even though notice of intent given)
  - Cancellation not favored; strict contract compliance required

ACTION ON MISPAYMENT – LEASE TERMINATION (cont.)

XTO Energy, Inc. v. Pennebaker, 2011 Tex. App. LEXIS 10194

The lease contains a provision granting the lessor an option to terminate the agreement if royalties are not timely paid. Specifically, paragraph 3(F) provides in pertinent part:

> [I]f Lessee fails to timely pay royalty as herein required; then in addition to all other rights and remedies available to Lessor, Lessor shall, at its option, have the right to cancel and terminate this lease as to all of the lands covered hereby by filing an affidavit **[*3]** of record in Tarrant County, Texas reciting the non-payment of royalties; provided, however, Lessor shall give written notice to Lessee at the address set forth above of such intention to cancel and terminate this lease . . . .

ROLE OF THE DIVISION ORDER

Gavenda, et al. v. Strata Energy, Inc., et al., 705 S.W.2d 690 (1986)

- Facts
  - The Gavendas executed division orders on a purported 1/16 NPRI
  - The Gavendas later revoked the division orders, claiming a 1/2 NPRI
  - Strata Energy refused to pay the additional 7/16 NPRI when demand was issued for previously unpaid royalties, and the Gavendas sued

ROLE OF THE DIVISION ORDER (cont.)

Gavenda, et al. v. Strata Energy, Inc., et al., 705 S.W.2d 690 (1985)

- Actions at Trial and Appeal
  - Strata argued that the division orders were binding on the Gavendas until revoked
  - The Gavendas argued that the general rule regarding division orders should be ignored because of unjust enrichment to the operator

ROLE OF THE DIVISION ORDER (cont.)

Gavenda, et al. v. Strata Energy, Inc., et al., 705 S.W.2d 690 (1986)

- Holding
  - The Court reaffirms the idea that the division orders (and transfer orders) are binding until revoked.
  - The Court explains that there are two reasons for its holding; detrimental reliance and certainty. The Court stresses the unfairness of potentially exposing oil and gas operators to double liability

ROLE OF THE DIVISION ORDER (cont.)

Gavenda, et al. v. Strata Energy, Inc., et al., 705 S.W.2d 690 (1986)

- Holding (cont.)
  - The Court acknowledges an exception where the operator would benefit from an incorrect division error, under an unjust enrichment theory.

ROLE OF THE DIVISION ORDER (cont.)

Gavenda, et al. v. Strata Energy, Inc., et al., 705 S.W.2d 690 (1986)

- Holding (cont.)
  The Court sets forth the remedy for the Gavendas for anything not owed by Strata –
  Generally, the underpaid royalty owners, however, have a remedy: they can recover from the overpaid royalty owners. Allen v. Creighton, 131 S.W.2d 47, 50 (Tex.Civ.App.--Beaumont 1939, writ ref'd). The basis for recovery is unjust enrichment; the overpaid royalty owner is not entitled to the royalties. See 4 Williams, supra, § 707 at 613 (1984); 3 A. Summers, supra, § 590 at 139-40 (1957)

STATUTE OF LIMITATIONS

Texas Civil Practice and Remedies Code

Sec. 16.004. FOUR-YEAR LIMITATIONS PERIOD.

(a) A person must bring suit on the following actions not later than four years after the day the cause of action accrues:

(1) specific performance of a contract for the conveyance of real property;

(2) penalty or damages on the penal clause of a bond to convey real property;

(3) debt;

(4) fraud; or

(5) breach of fiduciary duty.

STATUTE OF LIMITATIONS (cont.)

Texas Business and Commerce Code

Sec. 2.725. STATUTE OF LIMITATIONS IN CONTRACTS FOR SALE.

(a) An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued. By the original agreement the parties may reduce the period of limitation to not less than one year but may not extend it.

(b) A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach.

STATUTE OF LIMITATIONS (cont.)

Shell Oil Co. v. Ross, 356 S.W.3d 924 (Tex. 2012)

- Facts
  - Ross family underpaid
  - In one month, price paid on certain wells was 93% higher than that paid on other wells
  - Shell admitted it simply made a mistake
  - Rosses alleged Shell had intentionally concealed the underpayment
  - Rosses filed suit 5-7 years after the underpayments occurred

STATUTE OF LIMITATIONS (cont.)

Shell Oil Co. v. Ross, 356 S.W.3d 924 (Tex. 2012)

- Holding
  - Statute of limitations period was not extended by either Fraudulent Concealment or Discovery Rule
  - The Rosses could have discovered the underpayment through the exercise of due diligence
  - Readily available public information was available to reveal the discrepancy.
  - Payees must exercise reasonable diligence in examining their royalty statements; certain underpayments are discoverable

STATUTE OF LIMITATIONS (cont.)

Bright & Co. v. Holbein Family Mineral Trust, 995 S.W.2d 742

(Tex. App. – San Antonio 1999)

- Facts
  - Bright paid royalty to Holbein from 1980 to 1987
  - Holbein contacted Bright regarding the non-payment in 1995
  - Bright tendered the royalty from 1991 to 1995, contending that the period from 1987 to 1991 was barred by limitations
  - Bright refused payment and commenced suit

STATUTE OF LIMITATIONS (cont.)

Bright & Co. v. Holbein Family Mineral Trust, 995 S.W.2d 742

(Tex. App. – San Antonio 1999)

- Actions at Trial and Appeal
  - Bright alleged breach of contract and statutory non-payment of royalties from 1987 - 1995
  - Holbein alleged that Bright had acknowledged the debt (resetting the limitations period)
  - Bright alleged payment as an affirmative defense and counterclaim, on the basis that they had overpaid from 1980 – 1987 and the overpayment made up for the later non-payment

STATUTE OF LIMITATIONS (cont.)

Bright & Co. v. Holbein Family Mineral Trust, 995 S.W.2d 742

(Tex. App. – San Antonio 1999)

- Holdings
  - The four-year statute of limitations barred Holbein's claim for royalties from 1987 - 1991
  - The facts pleaded were insufficient to support a finding that Bright had acknowledged the claim and reset the clock, because there was no clear acknowledgement of the debt by Bright, nor a promise to pay
  - The four-year statute of limitations barred Bright from using any overpayment from 1980 – 1987 to offset the later non-payment

STATUTE OF LIMITATIONS (cont.)

Contrast – North Dakota

N.D.C.C. 28-01-15 and

Kittelson v. Grynberg, et

876 N.W.2d 443 (2016)

28-01-15. Actions having ten-year limitations.

The following actions must be commenced within ten years after the claim for relief has accrued:

1. An action upon a judgment or decree of any court of the United States or of any state or territory within the United States;
2. An action upon a contract contained in any conveyance or mortgage of or instrument affecting the title to real property except a covenant of warranty, an action upon which must be commenced within ten years after the final decision against the title of the covenantor; and
3. Any action or proceeding for the foreclosure of a mortgage upon real estate.

STATUTE OF LIMITATIONS (cont.)

Contrast – North Dakota

N.D.C.C. 28-01-15 and

Kittelson v. Grynberg, et al

876 N.W.2d 443 (2016)

[38.] Ultimately, because this action involves interpretation of an oil and gas lease, an instrument affecting the title to real property, the district court properly determined that the statute of limitations that governs this action is N.D.C.C. § 28-01-15(2) which provides a ten year statute of limitations.

SETOFF AND RECOUPMENT

SETOFF

Setoff is an equitable right of a creditor to deduct a debt it owes to the debtor from a claim it has against the debtor arising out of a separate transaction.

SETOFF AND RECOUPMENT (cont.)

RECOUPMENT

Recoupment is an equitable right of a creditor to deduct a debt it owes to the debtor from a claim it has against the debtor arising from the same transaction or occurrence.

DEFENSES TO RIGHT TO RECOUP

VOLUNTARY PAYMENT RULE

The concept known commonly as the voluntary payment doctrine is a long-standing doctrine of law, which clearly provides that one who makes a payment voluntarily cannot recover it on the ground that he was under no legal obligation to make the payment.

The doctrine has its origins in early nineteenth century English common law and has since been adopted into American jurisprudence as early as 1838.

Although it is an affirmative defense and not a cause of action, it is so easy to assert that it has a burden-shifting effect.

VOLUNTARY PAYMENT RULE (cont.)

Typical exceptions asserted to avoid the application of the doctrine:

- Fraud
- Duress (typical defense to contract claims)
- Mistake of fact
  - Not a mistake of law
  - Not facts of which you are charged with notice

VOLUNTARY PAYMENT RULE (cont.)

BMG Direct Marketing, Inc. v. Peake, et al., 178 S.W.3d 763 (Tex. 2005)

- Facts
  - Peake and similarly situated persons in the class actions sued BMG Marketing, Inc. for refund of late payments, contending that the payments were an illegal penalty.

- Actions at Trial and Appeal
  - BMG argues voluntary payment as an affirmative defense.

VOLUNTARY PAYMENT RULE (cont.)

BMG Direct Marketing, Inc. v. Peake, et al., 178 S.W.3d 763 (Tex. 2005)

- Holding
  - The Court articulates the Texas test for voluntary payment - "`[M]oney voluntarily paid on a claim of right, with full knowledge of all the facts, in the absence of fraud, deception, duress, or compulsion, cannot be recovered back merely because the party at the time of payment was ignorant of or mistook the law as to his liability.'" *Pennell v. United Ins. Co.,* 150 Tex. 541, 243 S.W.2d 572, 576 (1951) (quoting 40 Am.Jur. § 205 (1942)).
  - The Court acknowledges that the defense would apply, but sidesteps by decertifying the class.

VOLUNTARY PAYMENT RULE (cont.)

Samson Exploration, LLC. v. T.S. Reed Properties, Inc., 521 S.W.3d 766 (Tex. 2017)

- Facts
  - Samson drilled a well, formed a unit, and then amended the unit
  - Samson drilled another well and formed an overlapping unit. The overlapping unit designation was depth-limited but overlapped the horizon in the first unit
  - Nobody is happy, everybody sues – the overlapping unit owners and certain unpooled unit owners

VOLUNTARY PAYMENT RULE (cont.)

Samson Exploration, LLC. v. T.S. Reed Properties, Inc., 521 S.W.3d 766 (Tex. 2017)

- Actions at Trial and Appeal
  - Samson claimed a right of reimbursement from amended unit owners to offset the payments to the overlapping unit owners
  - Samson claimed that unit owners were unjustly enriched by the payments
  - Samson disputed the application of the voluntary payment rule to bar recovery

VOLUNTARY PAYMENT RULE (cont.)

Samson Exploration, LLC. v. T.S. Reed Properties, Inc., 521 S.W.3d 766 (Tex. 2017)

- Holding
  - The Court follows the standard test for voluntary payment - "`[M]oney voluntarily paid on a claim of right, with full knowledge of all the facts, in the absence of fraud, deception, duress, or compulsion, cannot be recovered back merely because the party at the time of payment was ignorant of or mistook the law as to his liability.'"
  - The Court noted that Samson's payments were voluntary and that Samson made the payments with full knowledge of the fact that it had created units that shared significant areas of their pools, including the zone being produced by one of its wells.

VOLUNTARY PAYMENT RULE (cont.)

Samson Exploration, LLC. v. T.S. Reed Properties, Inc., 521 S.W.3d 766 (Tex. 2017)

- Holding (cont.)
  - The Court noted that Samson never exercised its authority to amend the designation of the declaration, even though the designation that it filed expressly provided that Samson reserved the right to do so.
  - The Court noted Samson did not allege that any of the claimants were guilty of any acts of fraud, that it paid the royalties under duress, or that it was compelled to pay royalties over its objection to doing so.

BEST PRACTICES

- Obtain division orders
- Seek assistance from counsel when you have questions
- Empower your division order analysts to do the same

THANK YOU FOR HAVING ME

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