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Thomas K. Dougherty

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SELECTED ISSUES IN OIL AND GAS TITLE EXAMINATION

Thomas K. Dougherty

REFERENCES

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Arkansas Bar Association

Natural Resources Institute Seminar 2000

Selected Issues In Title Examination

February 23, 24 and 25, 2000

By

Thomas K. Dougherty

SELECTED ISSUES IN TITLE EXAMINATION

The topic which I have been asked to speak on is selected issues in title examination. Some of you may think the approach that I have taken to this topic is elemental. I prefer to think of it as fundamental.

If you will turn to Exhibit "A", you will see that I have attached an Original Title Opinion and this opinion will be the basis of my discussion. I will discuss it from the examiner's perspective which will hopefully enlighten you as you review title opinions in the future. I will also, from time to time, throw in some nuggets on Texas Law that may assist you or at least offer some guidance in the future.

DESCRIPTION

Generally, in the caption of our opinion, we try to use the description contained as the deed reference in the oil and gas lease covering the land being examined. In this regard, you will note that the penultimate paragraph of this opinion reminds the recipient that matters of survey are not covered by this opinion. If it is a drillsite tract, then obviously, it is a good idea to survey the land intended to be drilled upon prior to commencing operations. This survey should reveal encroachments or material discrepancies in the description.

ADDRESSEE

The addressee portion of the title opinion is not as immaterial as may appear at first glance. If you will look at the last paragraph of this opinion, you will see that the opinion is prepared for, and intended for the benefit of, the recipient and may not be relied upon by any other party without the examiner's written consent.

Primarily, the reason we do this is to prevent Joe Bob from securing a new lease covering the land once our client's lease expires and then purporting to rely upon the opinion in drilling his well, to which he may take several shortcuts and drag us kicking and screaming into his lawsuit. Also, this paragraph may help prevent discovery of the title opinion in the event of litigation.

On April 28, 1999, the Texas Supreme Court decided McAmish, Martin, Brown & Loffler v. F. E. Apling Interests, 991 SW2d 787 (Tex. 1999), holding that lawyers may be liable to non-clients for negligent misrepresentations. In short, liability may exist even in the absence of privity. We would advise all lawyers who provide title opinions or opinion letters and other information for the guidance of others in business transactions to analyze this holding carefully.

Most oil companies acquire title opinions prior to drilling a well on lands located in Texas. We have always wondered whether a title opinion would be discoverable by an adverse party in the event of litigation. Discovery in this context means whether you would be obligated to supply a copy of the title opinion to the adverse party for their use in the litigation process. Such was the case in Arkla, Inc. v. Harris, 846 SW2d 623 (Tex.App. - Houston [14th District], 1993). The underlying issue was brought by the Santa Fe Railroad Company which claimed that for the previous 50 years, Arkla and its predecessors had been wrongfully draining minerals from under Santa Fe's railroad tracks. Santa Fe had filed a Motion for Production of title opinions prepared for Arkla which Santa Fe alleged showed that Arkla knew that it did not own minerals under Santa Fe's rights of way. The Trial Judge ordered production of a number of title opinions and partially as a result of this order, this appeal resulted. Arkla claimed that the work product privilege prohibited discovery of the title opinions.

The Court recognized an exception for the work product of an attorney, but stated that the exception is limited to the work and preparation for litigation. In essence, these exemptions protect from disclosure documents, opinions and legal theories prepared in actual anticipation of litigation or trial; it is not an umbrella for materials assembled in the ordinary course of business. The Court went on to say, that even if the title opinions were privileged, that a person waives the privilege "if he voluntarily discloses or consents to disclosure of any significant part of the privileged matter unless such disclosure itself is privileged." If a matter for which a privilege is sought has been disclosed to a third party, thus raising the question of waiver of the privilege, the party asserting the privilege has the burden of proving that no waiver occurred. Santa Fe claimed that the title opinions were passed around "like a used deck of cards" thereby waiving any privilege. The Appellate Court remanded this case to the Trial Court and ordered the Trial Court to review all of the alleged privileged documents in private. From that review, the Trial Court would be better able to determine which of the documents were protected by the claimed privilege and which may have been waived by non-privileged disclosure to third parties.

What does this mean in English and what steps can you take to prevent disclosure of your title opinions? This will depend on the facts in existence at the time the title is examined. If you and the examining attorney anticipate litigation arising from drilling on a tract of land which is the subject of the attorney's opinion, then it may be helpful to have the attorney place on the opinion "prepared in anticipation of litigation, attorney work product asserted". This may not, in and of itself, protect the opinion from disclosure but it is certainly worth the argument. Also, if companies are asserting conflicting claims to a valuable tract of land and litigation is either pending or imminent, then you should not allow any third party access to your title opinions because this may waive the privilege regarding disclosure of the title opinion. The next time your name appears as addressee in a title opinion, you can just shake your head and say WOW!

MATERIALS EXAMINED

The next item listed in a title opinion refers to the materials examined, which comprises the SOLE basis of the examiner's opinion. Just about everyone we know in this day and time are utilizing runsheets, and not certified abstracts, in determining which instruments are pertinent to the land described in the caption.

Obviously, this means that the opinion is only as good as the landman who is preparing the runsheet. It has been our experience that a good, competent landman is fully able and qualified to provide an abstract or a runsheet which an attorney can rely on in the preparation of an opinion.

Sometimes we will see a reference in a deed which is contained in the abstract or the runsheet to a deed not contained in the runsheet. We will generally point this out to the landman and act as if it had been included in our runsheet for examination purposes. The flip side of that is, sometimes upon review of our opinion by a competent landman, he will notice something that we have missed or that we may have, God forbid, stated incorrectly. It makes for a much better situation and provides a greater service to the client, if the landman and attorney work together to correct any mistakes or omissions that may be contained in their work because the bottom line is we want our client to drill the well safely, or at least be fully aware of the business risk to be incurred in the drilling of a well.

Another problem that may arise in this context is a reference to an unrecorded instrument in a recorded instrument. In Westland Oil Development Corp. v. Gulf Oil Corp., 637 SW2d 903 (Tex. 1982), the court held that a transferee of an interest in an oil and gas lease was, as the result of a reference to an unrecorded farmout agreement contained in a recorded conveyance in the chain of title to the interest

acquired by such transferee, charged with constructive notice of a preferential purchase right established in the unrecorded farmout agreement. The decision in the Westland case has been extended in a holding that a reference to an unrecorded operating agreement contained in a recorded conveyance in the chain of title to the oil and gas interests serving as collateral makes the lien and security interest of the Deed of Trust subordinate to the lien of the operator under the operating agreement MBank Abilene, N.A. v. Westwood Energy, Inc., 723 SW2d 246 (Tex. App. - Eastland 1986). Obviously, the lesson learned from these cases is to require all unrecorded documents referenced in your chain of title.

OWNERSHIP

The next portion of the opinion is the ownership. I hate to say that this portion is self-explanatory, but, this section of the opinion is self-explanatory. Often times we will denote significant requirements by subjecting the ownership of a particular entity to a footnote which will refer you to the pertinent requirement. Other times we will set forth before and after payout interests or limit the opinion to specific depths.

ANALYSIS OF THE LEASES

Again, this is an apparently benign section of the opinion which is sometimes overlooked by company landmen. The case of Hitzelberger v. Samedan Oil Corp., 948 SW2d 497 (Tex. App. - Waco, 1997, writ denied) is a prime example of why landmen and division order analysts should review each lease, or at least critical leases, prior to commencing operations on the lands covered by said lease or on lands pooled therewith.

In Hitzelberger, the lessor claimed the lease had terminated when the lessee paid royalties late. The lessor relied upon the following provision in the lease royalty clause:

Within 120 days following the first sale of oil or gas produced from the leased premises, settlement shall be made by Lessee or by its agent for royalties due hereunder with respect to such oil or gas sold off the premises and such royalties shall be paid monthly thereafter without the necessity of Lessor executing a division order transfer order. If said initial royalty payment is not so made under the terms hereof, this lease shall terminate as of 7 a.m. the first day of the month following expiration of said 120-day period.

Although production was obtained in the primary term, after making royalty payments timely for two months the lessee failed to make the next two monthly payments within the 120 days, as stipulated in the above clause. Regardless, the trial court determined the lease had not terminated, finding the lease could not terminate during the primary term. The court of appeals, however, reversed and rendered holding that the lease unambiguously created a terminating condition, which modified the primary term created in the lease's habendum clause.

CHAIN OF TITLE

The chain of title is self-explanatory and is inserted more for convenience rather than for substantive reasons. Often times it will assist a subsequent purchaser of the property in getting a feel for the land as opposed to merely looking at ownership and requirements.

All of our clients seem to welcome the chain of title as a portion of the title opinion.

REQUIREMENTS

We have three sets of standard requirements which we usually place as Requirement Nos. 1, 2 and 3. These involve limitation affidavits, tax certificates and non-production affidavits. Each of these are important and should be satisfied, at least by a landman's statement, with respect to every opinion. The remaining requirements we insert in an opinion are applicable only to the specific tract covered by the opinion and they can take many shapes, forms and sizes. We will discuss hereinbelow selected examples of problems that may arise in the examination of lands.

Sometimes, in Texas, and probably in Arkansas, ownership of mineral interests can be ambiguous and protection leases are necessary. In Texas, protection leases have been recognized as not being a slander of title. *Santa Fe Energy Operating Partners, L.P. v. Correo*, 948 SW2d 780 (Tex. App. - San Antonio, 1997, writ denied). Without going into the facts, the Court held that Santa Fe was justified as a matter of law in taking the protection lease from record owners. The lease from the other claimants contained a proportionate reduction clause and the court relied heavily on this clause in throwing out the slander of title claim. If you are sued in Arkansas by an unhappy claimant because you have secured protection leases, this may offer a good place to start your research.

We have all examined assignments creating overriding royalty interests. Sometimes the assignment will provide that the overriding royalty interests will also extend to "renewals and extensions" of said leases. What is meant, and more importantly, what is not covered by renewals and extensions? The latest case in Texas dealing with this issue is The Exploration Company v. Vega Oil and Gas Company, 843 SW2d 123 (Tex.App. - Houston, 14th District, 1992, no writ history). This suit concerned three (3) oil and gas leases executed in favor of Retamco Properties, Inc., predecessor-in-interest to The Exploration Company. Retamco reserved an overriding royalty interest in an assignment to AAA Operating Company and the assignment contained the following language: "The overriding royalty interest herein reserved shall be binding upon and encumber all extensions and renewals of any of said leases hereafter secured by Assignee, its successors or assigns. Four (4) different units were formed and the three (3) leases were pooled therein. There was a producing well on each unit. Vega obtained new leases from the mineral owners and filed suit to declare the original leases void. Vega, in its motion for summary judgment, submitted Affidavits from the mineral owners stating that production from said units had ceased for more than 90 days. The original working interest owners under the old leases assigned their right, title and interest under the old leases to Vega in settlement of litigation and the question became whether The Exploration Company is entitled to their overriding royalty interest from the new leases. The Court then went into the question of what is a "renewal or extension", and revisited the test established in Sunac Petroleum Corp. v. Parks, 416 SW2d 798 (Tex. 1967):

A lease is not a renewal or extension if: (1) the new lease was entered into after the old lease had already expired; (2) new consideration exists to support the new lease; (3) the new lease was executed under different circumstances; and, (4) the new lease contains different terms. The Court concluded, from an application of our facts to this test, that the new leases were not in renewal or extension of the old leases. The ORRI was lost. The Court stated in this opinion that appropriate language in the assignment could have prevented the termination of the overriding royalty interest. This case reinforces that you must draft with care when creating an overriding royalty interest.

Typically, oil and gas attorneys render title opinions and require additional instruments in order to supplement the fee simple owner's chain of title. A lot of times, the curative instruments are drafted by landmen. The question has arisen recently in our firm, and I'm sure in other firms, whether an improperly drafted curative instrument executed and placed in the fee simple owner's chain of title could impose liability upon an oil and gas lessee or operator for negligence. We are not aware of any case law in Texas which does impose this liability upon an oil and gas

lessee or operator. However, we are not sure that the right set of facts have yet been presented to the appellate courts. A title company has been held liable for failure to use reasonable care in preparing and filing curative instruments when they have undertaken the duty to cure title. *Zimmerman v. First American Title Insurance*, 790 SW2d 690 (Tex. App. - Tyler, 1990, writ denied).

The same rationale would seem to apply to an operator or lessee who solicits execution of instruments relating to a lessor's fee simple title and the instrument is prepared negligently.

The courts have left the door open and, given the right fact situation, we foresee the day when a lessee is held liable to a lessor for curative data the lessee has negligently prepared which adversely affects its lessor.

We recently had a question arise in the area of negligently drafted curative. The somewhat simplified facts are as follows:

- (1) "A" owned the lands and conveyed them to "B", reserving a 1/16 royalty interest.
- (2) "B" later conveyed the lands to "C", reserving for his life a non-participating royalty interest of 1/2 of the royalty owned by him at the time of the conveyance.
- (3) "C" executed an oil and gas lease which provided for a 3/16 royalty interest. "A" and "B" ratified the lease.
- (4) An attorney doing title on this tract felt the deed from "B" to "C" was ambiguous and called for "B" and "C" to execute a stipulation of interest. A landman prepared a stipulation of interest which set forth that "A", "B" and "C" each owned a 1/16 royalty interest. The stipulation contained present words of grant and both "B" and "C" executed the instrument.

The existing lease later terminated. Some years later, "C" executed a new lease (in favor of the same company) which provided for a 1/6 royalty and not a 3/16 royalty. A dispute arose between "B's" successors and "C". The successors to "B" alleged that they were entitled to a 1/16 royalty under the lease and that their interest was a perpetual interest and not limited to the life of "B". Of course, "C" was contending "B's" successors were entitled to a $1/2 \times 1/6$ royalty less $1/2 \times 1/16$ and

that their interest was limited to "B's" life. "C" also contacted the lessee and let it be known if he lost anything due to his execution of the stipulation, he was going to hold the company responsible.

"B" and "C" eventually resolved their differences, and the lessee joined in the settlement agreement. It gave up a small interest when it considered its potential liability as well as other facts not discussed herein.

As a follow-up, and this might sound like an advertisement, the Supreme Court of Texas has held that the routine preparation of instruments having a legally binding effect, such as deeds, constitutes the unauthorized practice of law. Hester Title & Abstract Company, Inc. v. Grievance Committee, 5th Congressional District, State Bar of Texas, 179 SW2d 946 (Tex. 1944). You've got to resist the temptation to over-utilize the services of company landmen and field landmen in the preparation of curative materials. Our address is 708 First Place, Tyler, Texas.

Oil and gas companies are free to waive any requirements set forth in an opinion and the nomenclature in the industry is the acceptance of a "business risk", based on the passage of time, the impossibility of curing the requirement or a risk benefits analysis. Prior to waiving requirements in an opinion, we would advise you to speak with your attorney and more importantly, your boss.

As noted above, the last two paragraphs in a title opinion are very important with respect to what is not covered by the opinion. The provisions are self-explanatory and are often times referred to as the "CYA" provisions. We suspect that you can figure out what these initials stand for.

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A PROFESSIONAL CORPORATION

ATTORNEYS AT LAW

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BOARD CERTIFIED - OIL, GAS & MINERAL LAW
TEXAS BOARD OF LEGAL SPECIALIZATION

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EXHIBIT "A"

February 23, 2000

ORIGINAL TITLE OPINION

State:
County:
Mineral Fee:
Unit:

IN RE:

All that certain tract, lot or parcel of land in Maverick County, Texas, on the James Gunn Survey, described as follows:

Beginning at the E or S E corner of a 50-acre tract belonging to Mrs. Herman;

THENCE S 45 W at 315 varas to corner;

THENCE N 45 W at 902 varas to corner;

THENCE N 45 E at 315 varas to corner;

THENCE S 45 E at 905 varas to the place of beginning, containing 50 acres of land, more or less.

Joe Blow, Landman
Big Bucks Oil Company
1111 Park Ave.
New York, NY 10002

Gentlemen:

In accordance with your request, we have examined the following materials for the purpose of determining record title to the captioned tract of land:

1. Runsheet consisting of 11 numbered pages, prepared by Bob Sharpe, Landman, purporting to set forth all recorded instruments pertinent to the captioned tract of land from Sovereignty of the soil to December 7, 1999, at 4:00 p.m.
2. The records of the County Clerk's Office and the District Clerk's Office of Maverick County, Texas, as to the instruments shown by the above referenced runsheet as being pertinent to this title.
3. Plat indicating the location of the captioned land.

From an examination of the above, and basing our opinion solely thereon, you are advised that record title to the captioned tract of land, subject to the comments and requirements set forth hereinbelow, as of December 7, 1999 at 4:00 p.m., is vested as follows:

SURFACE AND MINERAL ESTATE (INCLUDING 1/6 ROYALTY ON OIL AND GAS)

Thomas K. Dougherty

All

OIL AND GAS LEASEHOLD ESTATE

Big Bucks Oil Company

5/6 NRI
100% WI

CHAIN OF TITLE

REQUIREMENTS

1.

REQUIREMENT

You should obtain and submit for examination two Affidavits of Limitation showing the history of the use, occupancy and possession of the captioned tract of land covering a period of at least twenty-five years.

2.

REQUIREMENT

You should obtain and submit for examination tax certificates evidencing that all taxes accruing to the captioned land have been paid through 1999.

3.

REQUIREMENT

You should obtain and submit for examination an Affidavit of Non-Production evidencing that the captioned land has never produced oil, gas or other minerals, and has never been included in a unit or units which produced oil, gas or other minerals so that we may determine that prior oil and gas leases and term royalty deeds covering said land have expired. In addition to the captioned land, said affidavit should also cover and include all of the lands described in Oil and Gas Lease dated February 1, 1952, at Volume 295, Page 531.

4.

COMMENT

This opinion covers only surface and oil and gas.

ANALYSIS OF LEASE

Dated:

Recorded:

Lessor:

Lessee:

Land Covered:

Interest Covered:

Primary Term:

Royalty:

Shut-in Royalty:

Delay Rentals:

Depository Bank:

Pooling:

Coverall Clause:

Proportionate
Reduction Clause:

Warranty:

Special Provisions:

REQUIREMENT

None; advisory only.

This opinion is based solely on our examination of the above data, and we do not certify as to parties in possession, surveys, boundaries, capacities of the parties, payment of taxes or other matters not apparent from the data examined.

This Title Opinion is rendered solely and exclusively for the benefit of Big Bucks Oil Company, and it is not a representation of the title of the property to any other party.

Very truly yours,

DOUGHERTY LAW FIRM, P. C.

By: _____
Thomas K. Dougherty

TKD/sm