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> **Oil and Gas Leases – Royalty Clause Interpretation:** *A lease providing for royalties based on the "gross* value received*" does not allow the deduction of post-production costs*, *whereas royalties based on* "value received" *permits such deductions.*

In *BlueStone Natural Resources II, LLC v. Walker Murray Randle*, under Justice Guzman's unanimous opinion the court resolved whether a conflict existed between the body of the lease and an addendum concerning the deductibility of post-production costs from royalty payments. The body of the lease provided royalties would be based on market value "computed at the mouth of the well." The addendum specified that royalties should be paid for "gross value received" "without deduction." The addendum expressly "supersede[d]" any conflicting provisions in the body of the lease.

> *The opinion distinguishes Burlington Resources based on the difference between "value received" and "gross value received.*

Burlington Resources Oil & Gas Co., LP v. Texas Crude Energy LLC, 573 S.W.3d 198 (Tex. 2019), decided two years earlier, held a lease providing for royalties calculated "at the well" permits the deduction of post-production costs incurred in getting the petroleum product from the well to the market to approximate value at the well. When a lease provides for a royalty based on the "value received," the costs of getting the production to market has already been taken into account so that no further deduction is permitted.

Based on *Burlington Resources*, lessee BlueStone insisted both value "at the well" and "value received" permitted deduction of the costs of getting the production to the market. The opinion, however, rejected the lessee's argument because the lease addendum based royalties on the "*gross* value received," not simply "value received." (Emphasis added). Citing the plurality opinion in *Judice v. Mewbourne Oil Co*., 939 S.W.2d 133, 136 (Tex. 1996), the court ruled adding "gross" to "value received" had the effect of *disallowing* deduction of post-production costs, making *Burlington Resources* inapplicable. As a result, the provisions of the addendum were held to differ from the lease's main body which allowed such a deduction. In light of this conflict, the addendum prevailed. The lessee was not permitted to deduct post-production costs.

Explaining its underlying reasoning, Justice Guzman's opinion details the legal effect of the commonly used formulations of when and where royalties are calculated with respect to whether post-production costs are deducted from the amount of the royalty due the lessor.

> *Without other specification, the "free use" clause only applies to production that is used at the leased site and does not allow the royalty-free use of that production that occurs off site.*

The court also agreed with the court of appeals' interpretation of a "free use" clause. However, it remanded the case instead of affirming the rendition of a summary judgment. It perceived a fact issue concerning calculation of the amounts that could be free of royalty under the "free use" clause.

The "free use" clause excused the lessee from royalty payments for production the lessee used "in all operations" the lessee conducted "hereunder." This provision contained no explicit geographic limitation. Whether this clause excused royalty payments for off-lease uses was a question of first impression in Texas. After reviewing other jurisdiction's interpretations, the opinion concluded that "operations … hereunder" only excused royalty payments for production used on the lease site.

> *Was the court re-writing the agreement for the parties or merely supplying terms that the parties implicitly understood when forming their agreement?*

In this writer's opinion, the court transgressed its oft-repeated maxim that it should not add words to or rewrite an agreement for the parties. Without identifying any particular language explicitly imposing an on-site limitation, the opinion apparently resorts to clairvoyance to conclude it was "unlikely the[parties] intended a construction of the free-use clause that would inject uncertainty and lead to a fact-finding mission to determine whether progressively more attenuated uses 'benefit' or 'further' the lease operations."

Perhaps the opinion considered it understood that it did no more than imply a reasonable essential term the parties omitted. If so, the court should have explained when words should not be added to an agreement and when it is permissible to assume both parties implicitly understood and accepted an essential term without explicitly mentioning it. Such an explanation was necessary if, for no other reason, than to demonstrate the court was not merely substituting its judgment to complete an agreement the parties left unresolved.

> BlueStone *illustrates the risks inherent when a drafter familiar with the practices surrounding the agreement's subject overlooks that the other party, a trier of fact, or a reviewing court may not share the drafter's intimate knowledge about that subject.*

BlueStone is a cautionary tale for drafters about assuming that "everyone knows" the things drafters may consider "understood" due to familiarity with the subject. To avoid litigating the meaning of an agreement, drafters should spell out what is meant by the terms used – even if those terms are thought to be generally understood in the business. The supposedly shared understanding may well be different from that the drafter or the drafter's client may have in mind.

> **Setting Aside Default Judgments – Accident or Mistake***: Defendant's misunderstanding based on a mistake of law about the potential effect of a divorce decree was adequate to show a deliberate failure to answer was caused by accident or mistake instead of intentional disregard or the conscious indifference.*

To overturn a default judgment, the defendant must reasonably explain the failure to answer by showing it was the result of accident or mistake, not intentional or the result of conscious disregard. *In re Sandoval* addressed whether this requirement was satisfied when the defendant chose not to answer because he was mistaken about the possible consequences.

In *Sandoval*, the husband was agreeable to his divorce and awarding the community estate to the wife and did not answer her suit. He did so, however, believing the divorce decree could not affect his ownership of a house he claimed as separate property. But it did. The trial court awarded the house to the wife. The husband timely filed an equitable new trial motion supported by an affidavit explaining why he failed to answer and showing the house was purchased only with separate property assets.

The trial court denied the motion. It refused to consider the affidavit on the grounds that it was based on hearsay. The court of appeals did not consider the affidavit to run afoul of the rules against hearsay, but it upheld the trial court's refusal to consider it by identifying a defect not raised by any party in the trial court: the Spanish language affidavit contained no English translation of the jurat required by Texas Rule of Evidence 1009(a).

In its *per curiam* opinion, the Texas Supreme Court first ruled the affidavit detailing the circumstances surrounding the purchase of the house was based on personal knowledge. It had to be accepted as true because the wife did not controvert it. The omission of the English translation of the jurat was a formal defect the wife waived by not raising it the trial court.

Concerning the reasonable explanation requirement, the opinion decided this requirement was satisfied by the husband's mistaken understanding the divorce would not affect the house he claimed was separate property. The opinion explained the husband's decision was neither intentional nor the result of conscious indifference, even though it was "deliberate," because it was based on the legally mistaken belief the decree would not affect his ownership of the house. A mistake of law counts as an excusable mistake if it reasonably explains the failure to answer, even if that failure would otherwise support an inference of conscious indifference.

The court also ruled the husband's affidavit stated detailed facts which, if true, showed the house was acquired with the husband's separate property. The affidavit also asserted that the property was not developed with community funds. When that affidavit was uncontroverted, the house should not have been awarded to the wife. Thus, the affidavit "set up" the meritorious defense necessary to obtain a new trial.

In addition to setting up a meritorious defense, an equitable new trial motion must at least allege the delay involved in granting a new trial will not unfairly injure the plaintiff or cause undue delay. The husband's affidavit on this point was countered with no evidence to the contrary from the wife. Accordingly, the court reversed the lower courts and remanded the case for a new trial.

Motions to Compel Arbitration - Discovery: *A trial court abuses its discretion when it allows discovery concerning whether the parties executed arbitration agreement if there is no probative evidence of facts, not mere conclusions, supporting the claim that there was no enforceable agreement to arbitrate.*

The Texas Arbitration Act allows limited discovery if a motion to compel arbitration "lacks sufficient information regarding the scope of an arbitration provision or other issues of arbitrability." *In re Houston Pipe Line Co*., 311 S.W.3d 449, 451 (Tex. 2009) (orig. proceeding). *In re Copart* was an original proceeding challenging a limited discovery order in a motion to compel arbitration of an employment dispute. A person in the employer's human resources department supported the motion with a declaration and authenticated documents showing the employee signed an agreement to arbitrate.

The plaintiff employee countered with an affidavit that denied in conclusory fashion the existence of a valid arbitration agreement. However, the affidavit was bereft of facts which, if true, would have rendered the arbitration agreement unenforceable. The employee's affidavit acknowledged the employer claimed there was a binding arbitration agreement, but stated only, "I deny this claim." The employee provided no factual underpinnings for that denial. She further denied knowing or ever meeting the human resources employee. The employee claimed the human resources employee had no personal knowledge whether plaintiff signed the arbitration agreement or sent or received related documents. However, plaintiff's affidavit did not deny receiving or signing the arbitration agreement, did not dispute sending or receiving the various emails attached to human resource employee's declaration, and did not contest that she continued working after receiving the agreement.

In a *per curiam* opinion, the Texas Supreme Court held the trial court abused its discretion in ordering discovery on compelling arbitration based only the plaintiff's denial sans factual support of the existence of an enforceable arbitration agreement. The opinion dismissed the employee's contention the agreement was unenforceable for want of consideration because her employment was at will. Regardless of the employment's *duration*, the agreement showed consideration on its face because both parties agreed to arbitrate.

For these reasons, the court held the trial court abused its discretion to order discovery concerning the existence of or enforceability of the arbitration agreement because the plaintiff seeking that discovery demonstrated "no … reason to believe [it] would be material."