Endeavor Energy Resources, L.P. v. Energen Resources Corp. et al.

Issued by Texas Supreme Court on December 18, 2020

On Petition for Review from the Court of Appeal for the 11th Dist. Of Texas

Petitioner (Lessee)	Endeavor Energy Resources, L.P.
Respondent (Competing Lessee)	Energen Resources Corporation, et al.

This decision focused on the interpretation of a continuous development provisionin an oil and gas lease covering an 11,300 acre tract of land in -- County. Endeavor could retain an ongoing interest in the entire parcel *only* if it drilled a new well every 150 days. Failure to drill in accordance with the provision would result in the immediate termination of the lease as to any acreage without a producing well on it. The clause also provided:

> **[Endeavor] shall have the right to accumulate unused days in any 150-day term during the continuous development program in order to extend the next allowed 150-day term between the completion of one well and the drilling of a subsequent well.**[1]

This accumulation provision was in bold in the lease itself, and the lease contained no other definitions for any of the terms therein. The entire case turned on this clause.

The dispute focused on how to calculate the number of "unused days". Endeavor took the position that it could carry forward unused days across multiple 150-day terms. Alternatively, it argued that the provision was ambiguous on this point, meaning the language could not function as a special limitation.

Energen, however, took the position that the provision was unambiguous and allowed unused days in any given 150-day term to be carried forward only once, to the next term.

The trial court agreed with Energen, and granted summary judgment, which the court of appeals affirmed. The Supreme Court of Texas, however, held that the provision was ambiguous. It reversed the lower courts, rendered judgment for Endeavor on title, and remanded to the trial court for further consideration.

Why? Because the Court found that both parties' reading of the provision was reasonable, rendering it ambiguous. As this provision was ambiguous, it could not automatically terminate Endeavor's leasehold over the entire parcel, even though much of the land had been re-leased to Energen.

[1] The provision read, in full: "This lease shall terminate as to all non-dedicated acreage any time a subsequent well is not commenced within one hundred fifty (150) days from the completion of a preceding well. Each well herein provided to be drilled, once spudded, shall thereafter be drilled with reasonable an continuous diligence to a depth below three thousand five hundred one feet (3,501') below the surface and shall be deemed to be completed ten (10) days after the drilling rig moves off the hole or upon removal of the completion rig, whichever is sooner. **Lessee shall have the right to accumulate unused days in any 150-day term during the continuous development program in order to extend the next allowed 150-day term between the completion of one well and the drilling of a subsequent well.**

Analysis by the Court

The lease carried a primary term of three years which expired on July 21, 2009, followed by a secondary term that would continue as long as Endeavor complied with the continuous development clause. Following the primary term, Endeavor drilled the next well within the first 150-day term, extending the lease. In total, Endeavor drilled its first 12 wells without problems.

Endeavor completed its 12th well on December 17, 2014, . On November 2, 2015, some 310 days had passed without Endeavor drilling a well, and the land owner granted a top lease to Energen on parcels that had not been drilled. On November 12, 2015, Endeavor began drilling a 13th well—some 320 days after its preceding well. Litigation followed.

Energen argued that the CDC only allowed unused days from a 150-day term to be carried over to the "next" term. Under this reading, Endeavor was required to begin drilling by July 1, 2015 – 186 days after the completion of its 12th well (150 days + 36 unused days from the prior term).

Endeavor argued that the continuous development clause permitted it to "accumulate" days, which meant it could do so across multiple 150-day terms. Under this reading, Endeavor had accumulated 377 days in which to drill its 13th well, because many of its earlier wells had been drilled ahead of schedule. Alternatively, Endeavor argued that if it was wrong about the accumulation of days, the Clause was too ambiguous to automatically terminate the lease.

In attempting to discern the meaning of the accumulation provision, the Supreme Court noted several guiding principles:

- Question of lease construction are reviewed *de novo*. *Anadarko Petroleum Corp. v. Thompson*, 94 S.W. 3d 550, 554 (Tex. 2002).

- An oil & gas lease is a contract, and its construction is governed by the general principles that govern construction of contracts. *Endeavor Energy Res., L.P. v. Discovery Operating, Inc.*, 554 S.W.3d 586, 595 (Tex. 2018). Because oil & gas leases transfer and affect title to real-property interests, however, they are subject to special construction rules, including that language will not automatically terminate a leasehold unless it "can be given no other reasonable construction than one that works such result." *Knight v. Chicago Corp.*, 188 S.W.2d 564, 566 (Tex. 1945).[2]

- The most important consideration in interpreting a lease is the agreements plain, grammatical language. *Anadarko*, 94 S.W.3d at 554. The court's task it to objectively determine what an ordinary person using those terms under those circumstances would understand them to mean. *URI, Inc. v. Kleberg County*, 543 S.W.3d 755, 764 (Tex. 2018). The court also examines the entire lease to harmonize its parts, even if different parts appear contradictory or inconsistent. *Anadarko*, 94 S.W.3d at 554.

[2] Such language, when properly worded, is a "special limitation" in the lease. "A special limitation in an oil and gas lease" refers to a term that "provides that the lease will automatically terminate upon the happening of a stipulated event. *Discovery Operating*, 554 S.W.3d at 606.

- The objective meaning of words, however, often depends on the facts and circumstances that would influence a reader. *URI*, 543 S.W.3d at 757-58. Therefore, a court reads contracts keeping in mind the "particular business activity sought to be served" and avoiding unreasonable business results. *Plains Expl. & Prod. Co. v. Torch Energy Advisors Inc.*, 473 S.W.3d 296, 305 (Tex. 2015).[3]

- If, after applying all these principles, a contract's language can be read with two or more reasonable interpretations, then it is ambiguous as a matter of law. *Plains Expl.*, 473 S.W.3d at 305.

The parties here agreed that the accumulation provision was properly considered as a special limitation, and the Court analyzed it accordingly. And while the Court has been clear that it "will not find a special limitation 'unless the language is so clear, precise, and unequivocal that we can reasonably give it no other meaning.'" *Discovery Operating*, 554 S.W.3d at 606 (quoting *Anadarko*, 94 S.W.3d at 554), its opinion in this matter states it has also been "increasingly hesitant" to fall back on such default rules of contract interpretation. Notwithstanding its hesitancy, however, when all means of interpreting a lease leave it equally susceptible to multiple reasonable readings, it will be resolved against the imposition of a special limitation. *See Knight*, 188 S.W.2d at 566.

Turning to the language of the accumulation provision, a hypothetical best explains the parties' competing readings of it.

[Endeavor] shall have the right to accumulate unused days in any 150-day term during the continuous development program in order to extend the next allowed 150-day term between the completion of one well and the drilling of a subsequent well.

Suppose Endeavor used only 60 days of a 150-day term to complete Well A. The parties agreed that the "unused" 90 days of that 150-day term would carry over to the "next" term. Endeavor would have 240 days to drill Well B. Now supposed Endeavor drilled Well B after 210 days.

- According to Endeavor, because it used only 210 out of the 240 days available for Well B, it gets to carry forward 30 "unused days" to the "next" term, meaning it has 180 days to drill Well C. Endeavor focuses on the use of "accumulate" to indicate it should be able to combine its unused days across multiple terms.

- According to Energen, any days accumulated due to Well A's term *cannot* carry over to the term for Well C. This is because the term for Well C is not the "next" term relative to Well A. Energen focuses on the singular use of "any term" and "next … term" being singular (rather than terms), meaning Endeavor cannot combine days from multiple terms. Under this reading, Endeavor would have 150 days to drill Well C, as no unused days carried over.

[3] While the court should consider the facts and circumstances of the contract, including the industry it touches on, the goal is always to determine the parties' intent as expressed in the words of the contract and outside facts and circumstances cannot justify interpreting a contract to say something it unambiguously does not. *See Kachina Pipeline Co. v. Lillis*, 471 S.W.3d 445, 450 (Tex. 2015) (court should consider commercial setting of contract); *First Bank v. Brumitt*, 519 S.W.3d 95, 110 (Tex. 2017) (circumstances cannot justify interpreting contract to reach beyond its words).

The parties both focused on the accumulation provision's use of the phrase "150-day term" to support their positions. Endeavor said that the phrase was a generic term, because, after all, under both parties' reading unused days could be carried forward *at least* once, creating a "next allowed 150-day term" that was not actually 150 days. Further, the 150-day term from which days could accumulate to the next, even under Energen's reading, might actually be longer than 150-days if it had been extended by the previous term. Endeavor points out that the "150-day term" is, actually, rarely 150-days because the Clause expressly states it may be "extend[ed]".

Energen's position, which was successful at trial and on appeal, was that the phrase "150-day term" was used to convey that *every* term (whether "extended" or not) is 150 days long for purposes of calculating whether there were unused days. Energen said that the lessee may not "accumulate unused days" from a term after its 150th day, nor may a lessee use "unused days" to extend anything *other* than a 150-day term. In short, 150-days was the "default" duration from which days may be accumulated to which days may be added.

The Court pointed out that neither party advanced a third possible reading, under which 150-day term actually meant terms of exactly 150 days. This reading would have interpreted the lease to mean that *only* unextended, 150-day terms could generate unused days. Endeavor argued that such a reading, however, would have created a bizarre alternating pattern of extendable and non-extendable terms, with no purpose for such a result. The Court noted that as neither party wanted to use the most literal reading, they both struggled to demonstrate the "textual superiority" of their positions.

The Court then turned to the argument the lower courts found persuasive: the fact that the accumulation provision distinctly refers to "any … term" in the singular rather than plural with regard to the term in which days can be accumulated. This, per Energen, mean that unused days can *only* come from the one term immediately preceding the "next" term to be extended.

Endeavor countered this by arguing that Energen's focus on the "next" term forgets to answer the question of whether unused days carried over from one term become a substantive part of the latter term. If they do, there will *always* be a next term for them to carry over into. Endeavor pointed out that the Clause referenced "extending" the next term, which suggests that it becomes a term of greater than 150 days, not a 150-day term followed by a "bonus" period of use-them-or-lose-them days.

The parties also addressed the use the word "accumulate," with Endeavor arguing that it indicated a right to stack up, gather, or compile days over multiple periods. If they were not allowed to do so, then no "accumulating" would take place as a "one time accrual" is no accrual at all. Energen, however, argued that Endeavor placed too much emphasis on the word (in much the same way Endeavor argued Energen placed too much emphasis on the "next" term). Energen noted, and the Court agreed, that accumulate can also be used to describe general increases, regardless of their temporal nature, and such outsized importance cannot be placed on a generally-used term.

With a textual analysis producing a draw, the Court turned to the business objectives of the parties.[4] Endeavor argued economics - asserting its construction was a more sensible bargain[5] between the parties. Endeavor claimed that the primary benefit of the continuous development clause to the lessor was that it would produce a new well, *on average*, every 150 days. So even if Endeavor accumulates and "banks" unused days over a multiple terms, it would only allow for long hiatuses from drilling if it had produced several wells quickly, preserving this average.

Notably, Endeavor advanced another theory that the Court did not consider – but the reason for the Court's refusal to consider it merits mention. Endeavor argued course of performance, stating that if Energen's reading of the Clause was correct, the lease should have terminated in 2011 due to delays in drilling the 2nd and 3rd well or the 3rd and 4th wells. The lessor, however, did not seek to terminate the lease at the time. The Court explained that while it was appropriate to examine surrounding facts and circumstances, it was only appropriate to consider circumstantial evidence that is objective in nature, and not the subjective intent of the parties. See URI, 543 S.W.3d at 767-8. The parol evidence rule bars such considerations and evidence, including a party's "acquiescence" to another party's actions, Kachina Pipeline, 471 S.W.3d at 453, and other course-of-performance evidence. See Burlington Res. Oil & Gas Co. LP v. Tex. Crude Energy, LLC, 573 S.W.3d 198, 206 (Tex. 2019).

Energen countered that the continuous development clause's purpose was not focused on averages, but instead on having the drilling be "continuous," meaning no long breaks between wells. Energen noted that such clauses have become ubiquitous in oil and gas leases are intended to promote, literally, continuous drilling. Energen also noted that several secondary sources include examples of model continuous development clauses, and the model clauses allowed for "banking" unused days. Unlike any of the model versions, the Clause referred to a singular future "term" and used the word "next" to describe it. According to Energen, this divergence indicated a desired different meaning.

The Court noted that, at times, it has held that parties' decision to use certain provisions from a form contract while altering or removing others should be given "special weight" when construing it. *Houston Expl. Co. v. Wellington Underwriting Agencies, Ltd.*, 352 S.W.3d 462, 472 (Tex. 2011). The Court had never, though, indicated that the mere existence of model forms or templates the parties *could* have used should have any bearing on a contracts interpretation.

Having exhausted the principles of textual construction and the parties arguments regarding economic-intent, the Court held that both parties' arguments were reasonable, rendering the clause

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[4] Before declaring a contract ambiguous, a court must seek to understand its objective meaning based on its plain language, but if text alone is inconclusive, the court may consider any extrinsic circumstances that shed light on the objective meaning conveyed by the text. *See Balandran v. Safeco Ins. Co. of Am.*, 972 S.W.2d 738, 741 (Tex 1998).

[5] When the text is inconclusive, the court should "construe contracts from a utilitarian standpoint bearing in mind the particular activity being served," *Reilly v. Rangers Mgmt., Inc.*, 727 S.W.2d 527, 530 (Tex. 1987), but should not forget that parties "[a]re free to contract for … odd results. *Burlington Res. Oil & Gas Co. LP v. Tex. Crude Energy, LLC*, 573 S.W.3d 198, 211 (Tex. 2019).

ambiguous as a matter of law. As the Clause was also a special exception, its operation could not stand given its ambiguity.

The Court ended its opinion by noting: "Because '[a]mbiguities [in continuous-development clauses] are frequent in concerning the times at which wells must be commenced," "[g]reat care should be exercised in drafting to avoid question of whether the lessee has complied. Had greater care been taken in the drafting of this continuous-development clause, this litigation could have been avoided."