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# Energy Newsletter

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## Shell Oil Co. v. Ross: Texas Supreme Court Opinion on the Statute of Limitations Favors Operators over Royalty Owners

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In December 2011, the Texas Supreme Court issued its latest decision on the statute of limitations and fraudulent concealment exception. In the case, Shell entered into a mineral lease with the Ross family in 1961. Under the lease, Shell agreed to pay the Rosses the standard one-eighth royalty realized from the sale of any gas produced from the land.

Shell did not consistently calculate the 1/8 interest based on the third-party gas sale price. First, from 1988 to 1994, it used a weighted average to calculate the sales price, by averaging third-party sales of the plaintiffs' gas along with other parties from the same unit. Shell contended this was a permissible calculation, but plaintiffs disagreed. Second, and more critically, from 1994 to 1997, Shell did not pay the royalty based on any sales price. Instead, Shell acknowledged that it used an "arbitrary" price by mistake.

The Ross family sued over these discrepancies in 2002, which was outside the Texas four-year statute of limitations for a contract claim. But plaintiffs argued that the claims were not barred because of the fraudulent concealment doctrine, which tolls limitations when a person attempts to conceal his wrongdoing until limitations has run. Plaintiffs contended that Shell had concealed the fact that it was underpaying the royalties because Shell's royalty statements did not reflect the amount that Shell was actually receiving from the third-party gas sales, as required by Texas law. Nothing on the face of the royalty statement, plaintiffs' argument continued, suggested that Shell was actually selling the gas for more.

At trial, Shell stipulated that unless it prevailed on its statute of limitations defense, the Rosses were entitled to recover damages for the use of the arbitrary price between 1994 and 1997. And the trial court ruled, as a matter of law, that Shell breached the lease by paying based on a weighted average between 1988 and 1994. The jury agreed with the plaintiffs and awarded damages to the Ross family.

The Texas Supreme Court reversed. The Court acknowledged that the royalty statements did not reveal that the Ross family was being underpaid. But the Court found that the Ross family had a duty to get behind the royalty statement, and "make themselves aware of relevant information available in the public record." The Court found that there were a number of such records that would have revealed to the Ross family that they were being underpaid. These other avenues of information included: asking Shell about the prices, asking the companies that bought the gas how much they paid, consulting publically available records at the Land Office, and reviewing publically available index prices for gas sales. Also important to the Court's decision was the fact that the Rosses were being paid royalties on multiple units, some of which were correctly calculated. The

Court found the discrepancy in royalty amounts between the various units should have caused the Rosses to investigate. Ultimately, the Court concluded, "[b]ecause the Rosses could have discovered Shell's alleged fraud through the use of reasonable diligence, we hold that, as a matter of law, the doctrine of fraudulent concealment cannot apply to toll the statute of limitations."

The decision should be a positive development for operators, as it will make it more difficult for royalty owners to reach back in time and claim underpayment. Instead, operators can have greater confidence that after the four-year limitations period has passed, the book on royalty payments will be closed. But the opinion serves as a cautionary note as well. Oil & gas companies themselves frequently rely on business partners to correctly account for production and other issues. This reliance occurs, for example, where an operator partners with a non-operator to produce a well, or in other joint venture arrangements Under the *Ross* decision, businesses should not expect courts to allow them easily to go beyond the limitations period and sue for older accounting errors, even where those errors might not be readily apparent. Thus, when entering into business agreements, companies should insist on reserving the right to audit for an adequate length of time, and then exercise that right within the limitations period. To see the *Ross* decision, go to: www.supreme.courts.state.tx.us/historical/2011/dec/100429.pdf.

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