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## SUFFICIENCY IN LAND DESCRIPTION IN OIL AND GAS LEASES By Ralph A. Cantafio, Esq.<sup>1</sup>, Patrick Fitzgerald, Esq.<sup>2</sup>, and Christine E. Breen, Esq.<sup>3</sup>

In late 2012, the United States Court of Appeals for the 5<sup>th</sup> Circuit affirmed a Trial Court Judgment in the amount \$19,951,004.00 against Chesapeake Exploration, LLC (“Chesapeake”). This case involved an Agreement to purchase rights in oil and gas leases located in the Haynesville shale formation. See Coe v. Chesapeake, 695 F.3d 311 (5<sup>th</sup> Cir., 2012). This case provides an excellent example of the perils that result where proper care is not taken to specifically describe real property subject to an Oil and Gas Lease.

In July 2008, Chesapeake agreed to pay \$15,000 per mineral acre to purchase 5,404.75 acres of minerals from Peak Energy. Chesapeake sought to purchase all of Peak Energy’s “right, title, and interest in certain oil and gas leases located in Harrison County, Texas”. Instead of using a formal property description for each and every mineral acre subject to the Oil and Gas Lease, a map was attached as an “Exhibit A”. The legal description excepted and reserved to Seller certain rights, title and interest while carving out specific formations, intervals, strata and depths of the Cotton Valley Formation as well as reserving certain overriding royalty interests.

When the price of natural gas plummeted, Chesapeake on several occasions delayed closing. By October 2009, the fair market value of these mineral interests had decreased to \$3,000.00 per acre. The financial appeal of this transaction on the part of Chesapeake had by then diminished greatly. Chesapeake ultimately refused to honor its commitment to purchase Peak’s acreage.

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Peak Energy in September, 2009 filed a Complaint with the District Court of Harrison County to enforce its Agreement with Chesapeake. Chesapeake responded by arguing the Agreement was no more than “an Agreement to Negotiate or a Letter of Intent”. Chesapeake claimed the Agreement with Peak Energy was not binding as the Contract did not satisfy the requirements of the Texas Statute of Frauds and was too indefinite to be enforced. Peak Energy took the position that the mineral interests subject to the lease could be determined thus making the Agreement enforceable. Evidence provided at trial showed one could determine the property both conveyed and reserved because, among other things, any lease recorded upon the public record contained a depth limitation. Peak noted that one could either read the underlying leases or, to the extent the lease contained a depth severance provision, merely resort to information made available by the Texas Railroad Commission. Either way, it was argued a third party could determine the mineral interests subject to Contract. Based upon this evidence, Judgment was entered in favor of Peak Energy. Chesapeake appealed.

Chesapeake in its appeal relied upon several arguments. Initially, Chesapeake took the position that the Agreement was unenforceable under the Texas Statute of Frauds as the document did not adequately identify the property to be conveyed. To satisfy the Statute of Frauds, a contract must provide either on its face or as a consequence of reference to other existing writings or sets of data an ability to identify the property referenced in a Contract with reasonable certainty. Where an underlying document is ambiguous, extrinsic evidence (evidence above and beyond the Contract in question) may be utilized to identify the property subject to a Contract.

The District Court noted that there existed a map generated by Chesapeake utilizing GIS enhanced mapping software and by examining different layers of this map one could ascertain county lines, city lines, water boundary lines, and the location of specific gas units such that there existed an adequate legal description based upon data to satisfy the Statute of Frauds. This was an issue of first impressions not previously addressed by the Texas Courts attempting to establish “reasonable certainty” threshold for adequacy of a legal description. The Court of Appeals sought a sufficient “nucleus of description” and relied upon “recital of ownership” to satisfy the “reasonable certainty” requirement in the Statute of Frauds. The Court of Appeals found that when a Grantor owns the property being conveyed and such conveyance is of a single tract of land, despite the possibility of future development of multiple gas leases, any chance of inaccuracy or misrepresentation is minimized. Additionally, that Court noted that Texas law typically does not allow unlimited review of public records to cure an otherwise deficient property description. The Court in this case, however, determined there was an adequate nucleus of description in the Agreement so limited reliance of the public records was acceptable to satisfy the Statute of Frauds.

Chesapeake next argued that the Agreement was too indefinite to be enforced as a matter of law. The Court of Appeals engaged in analysis of previous opinions on a case-by-case basis of this legal question as to whether or not the Agreement was intended to be a contract between these parties. Chesapeake unsuccessfully argued that the Agreement did not include all of the essential terms of a contract. Chesapeake noted that the Agreement itself did not specify any lease schedule identifying every lease to be conveyed under the Agreement. Because of the unambiguous and specific language indicating the parties’ intent, the Court disagreed and ruled that the document was sufficiently definite to be enforced.

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The Court noted that the document on its face included language that specified the agreement as “valid and binding”. The Court also noted that the document was unambiguously identified as an “offer to purchase”.

The final argument of Chesapeake was that the Agreement was unenforceable because Peak Energy could not perform its terms. At trial, Peak Energy conceded that it could deliver only 1,645.91 acres, not the 5,404.75 stated in the Agreement. The Texas Court enforced the Contract by focusing upon the Adjustment Clause included in the Agreement. This Adjustment Clause stated: “To the purchase price based on the seller’s delivery of more or less than 5,404.75 net acres shall be made in accordance with the allocated value of \$15,000.00 per net acre.” (Emphasis added.) The Court found that Chesapeake was attempting to acquire any and all property that Peak could deliver under circumstances where both parties knew the total amount of acres Peak could deliver was uncertain. The Court ultimately concluded that the “more or less” language in the Adjustment Clause took into account that the thrust of the transaction was that Chesapeake was going to buy all of Peak’s acreage, no matter how small or large.

Ultimately, the Court of Appeals agreed that the proper measure of damage would be qualified by multiplying the acres actually subject to the Agreement, by \$12,000.00, which was the difference between the contract price and the market price at that time of the breach of contract by Chesapeake.

A lesson from this case is that, as painful as it may be, at the time of drafting a lease or other real property contracts, the better course of action is to provide certainty and never rely upon materials outside of the contract itself in describing the real property interests subject to that Agreement. While it is certainly understood that in drafting a Contract with some 5,404.75 acres, including the descriptions of reservations for formations, intervals, strata, and depths, the scope of the drafting process can be extensive and time consuming. It is noted that cost would have been far less than the cost of this litigation measured in attorney fees alone.

It is impossible to know precisely what Circuit Judges Dennis, Higginbotham and Jolly thought in ruling upon this case. A casual observation of the facts and the opinion of this case would suggest Peak Energy was very fortunate that these Justices felt at some level that Chesapeake did not act in good faith pertaining to the consummation of this contract. The language of the Opinion itself notes that at earlier points in time Chesapeake did not articulate that it believed the Agreement was not a contract. Chesapeake actually made representations that it intended move forward with the transaction. But for this deceptive behavior by Chesapeake, one wonders how this Court may have ruled.

Further, both parties were guilty of poor drafting. Even under circumstances where either party could perhaps not sufficiently identify the precise property being conveyed, at a bare minimum proper attention should have been paid to identifying the extrinsic evidence that would be relied upon so as to determine precisely the property being conveyed should a dispute arise. Again, Peak Energy was very fortunate that the Circuit Court found the description was sufficiently specific, despite contracting ostensibly for 5,404.75 acres. Only because Peak Energy had agreed to convey “all” of its interest was the 1,645.917 acres determined to be adequate to satisfy this term of the contract. One wonders

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whether this same conclusion would have been reached had this not been a Texas court, but instead one of Oklahoma.

Ultimately, this is an interesting case. It points out the perils of failing to specifically describe property in a lease. Yes, the situation did work out well for Peak Energy; however, Peak Energy was very fortunate to have received the ruling that it did. For oil and gas professionals the byword is to take the time to specifically describe properties. Leave as little ambiguity as possible. Make sure in the context of good contracting practices that the parties draft contracts with adequate property description that do not rely on additional documentation. Such will allow each party to benefit from the bargain they negotiated.