



Unrecorded Agreements and the Duty of Inquiry

Texas and Oklahoma Series

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The Unrecorded Agreement

Road Map

- What are the different types of notice?
- What is an unrecorded agreement?
- What is the examiner's duty to learn more about the unrecorded agreement?
- Why do the terms of an unrecorded agreement matter?



Conveying Real Property

- To effectively convey an interest in real property:
 - Complies with Statute of Frauds
 - Instrument in writing
 - Executed
 - Properly IDs land conveyed
 - Must be delivered during lifetime of grantor
- If all of the above, then grantor cannot divest the grantee of the interest in that instrument*

*This rule has been modified



Notice

- Under common law, first in time, first in right
- Texas enacted the Recording Act (1836)
 - A grantor could divest the first grantee in favor of the second grantee if the second grantee had no notice of the prior conveyance and paid valuable consideration
 - This protects bona fide purchasers without notice



Notice

- 3 types of recording statutes = Race, Race-Notice and Notice
 - Race: if junior grantee records first, she wins (even if she had notice of prior conveyance)
 - Race-Notice: junior grantee must not have notice and must also file first
- Texas' Recording Statute = Pure Notice Statute



Notice

- Pure Notice Rule
 - A conveyance is void as to a subsequent purchaser for valuable consideration without notice unless the instrument has been acknowledged, sworn to or proved and filed for record
 - An unrecorded instrument is binding on subsequent purchasers who do not pay valuable consideration or who have notice
 - This does not require an instrument to be recorded to be effective



Notice

A bona fide purchaser is a purchaser for valuable consideration without notice

So, how does a subsequent purchaser get “notice”?

- Constructive Notice
- Actual Notice
- Inquiry Notice



Recording – Constructive Notice

- Constructive notice is not knowledge
- Filing of record provides “constructive notice”
- A conveyance is void as to a subsequent purchaser for valuable consideration without notice unless it has been filed of record
- An instrument is filed when deposited with the county clerk
 - Even if it isn’t properly indexed
 - Even if the record is destroyed



Recording – Constructive Notice

- If an instrument in the chain of title is properly filed it provides notice of its own existence
- A party claiming under a properly filed instrument does not have to verify the clerk recorded it
- There is no duty to run the deed records to acquire notice of the instrument
- If it's improperly filed, the subsequent purchaser does not have constructive notice, but if she finds it, she has actual notice



Actual Notice

- Actual notice is a question of fact
- Actual notice is information learned from the appropriate source
 - Information learned from an agent or attorney authorized to provide information constitutes notice
- Actual notice is actual knowledge
 - Knowledge of some facts can give rise to a duty to inquire



Inquiry Notice

- Inquiry notice is knowledge of fact that would cause a reasonably prudent purchaser to further investigate
- You cannot ignore suspicious facts and claim to be an innocent purchaser
- This is best understood as implied actual notice
- You are charged with knowledge of facts you could have discovered through reasonable inquiry



The Unrecorded Agreement

- A buyer has notice of
 - all properly recorded instruments in the chain of title and
 - all instruments properly referenced in those recorded documents, whether recorded or not
- Effectively incorporating the unrecorded agreement:
 - The recorded instrument must:
 - [1] plainly refer to another writing
 - [2] by name



Duty to Investigate

Westland Oil Development Corporation v. Gulf Oil Corporation

Issue: Did an unrecorded letter agreement with an area of mutual interest provision, *referred to* in a joint operating agreement, which operating agreement was *referred to* in an recorded assignment, impute notice?



Duty to Investigate

Facts:

- Mobil held leases in Pecos County
- To develop the leases, Mobil entered a farmout agreement with Westland
- Under the farmout, Westland would get a $\frac{1}{2}$ interest in the leases once it completed drilling obligations



Duty to Investigate

Facts continued:

- Westland transferred its rights to “C&K” by a letter agreement
- The letter agreement included an AMI provision (which is the provision at issue in this case)
- C&K developed some of the field and Mobil assigned an ½ interest to C&K
- C&K and Mobil entered into a JOA



Duty to Investigate

Facts continued:

- The C&K JOA had a conflicts provision which said the Westland farmout and C&K letter agreement prevailed and that the interests under the JOA were subject to the Westland farmout as amended by the assignment from Mobil to C&K
- Mobil then entered into a farmout with Hanson covering lands covered by the JOA (so the Hanson farmout was subject to the C&K JOA)



Duty to Investigate

Facts continued:

- Hanson enters farmouts with C&K and others, all subject to the C&K JOA
- Hanson assigned the farmouts to Superior and Gulf, who completed the drilling obligations and were assigned $\frac{1}{2}$ interests from Mobil
- Westland sued Superior and Gulf to get their share



Duty to Investigate

Arguments:

- Westland said the AMI provision in the C&K letter agreement was binding on Superior and Gulf because:
 - Superior and Gulf were on notice of the AMI
 - The AMI was a covenant running with the land
- Superior and Gulf said they were bona fide purchasers for value and without knowledge
 - The AMI was not recorded, nor was it in their chain of title



Duty to Investigate

Arguments:

- Superior and Gulf said it was not reasonable to assume that the JOA referenced in their assignment would reference another document affecting title
- Superior and Gulf wanted this decided as a question of fact (did they know?) rather than being imputed with notice as a matter of law (should they have known?)
- Superior and Gulf also said they had no duty to inquire because a reasonable person would not have thought that a JOA would contain references to a letter agreement which contained an AMI



Duty to Investigate

- Holding: A buyer is presumed to have notice of all instruments in his chain whether recorded or not
- Implication: Duty to inquire as to the contents of documents outside of the chain of title, but referenced in documents within the chain of title, required as a matter of law
- Incorporation by reference rule
- This includes documents referenced in unrecorded documents!



Duty to Investigate

- Before *Westland*, the duty to investigate was determined based on a reasonable person standard – would a reasonable person think a document referenced in the chain of title affects title?
- After *Westland*, no question of fact as to whether a reasonably prudent examiner should have investigated
- Failing to investigate because reference to unrecorded information does not appear to be reasonably related to title is not a defense
 - Conducting a “thorough and exhaustive” investigation which reveals information is not available might be a defense



Potential Pitfalls

So why does this matter?

- *Westland* only impacts buyers without actual knowledge!
- If you had knowledge, there would be no need to inquire
- You can have no knowledge, have investigated the record, and still be imputed with knowledge



Potential Pitfalls

Examples of agreements, sometimes unrecorded, which can have an impact on title or can have an impact on revenue:

- Leases
- Deeds
- Assignments
- Joint Operating Agreements
- Assignments of Earned Interests
- Farmouts
- AMI Agreements
- Preferential Rights
- Purchase and Sale Agreements



Potential Pitfalls

Preferential Rights to Purchase

- Owner is required when and if he decides to sell, to offer the property first to the entity entitled to the right on terms identical to those the owner has received from a third party

[1] gives each party the opportunity to increase its ownership in an area of common interest

[2] gives parties some control over identity of co-owners



Potential Pitfalls

Area of Mutual Interest Agreement

- Parties agree that within an area on a map they agree to share certain additional leases acquired for a specified term
- Buyer should determine whether an acquisition will trigger an existing AMI agreement, resulting in sharing the purchase with third parties
- Buyer may be buying an AMI obligation because Seller was subject to an AMI with a third party



Potential Pitfalls

Purchase and Sale Agreements

- Claw-backs
 - Example: If Buyer does not transfer well permits within 1 year Buyer must re-assign unpermitted wells to Seller; Post-closing, Buyer assigns its interest to a 3rd party. Assignment to 3rd party references prior Assignment to Buyer which references unrecorded PSA
 - Example: Seller assigns defected property to Buyer; Seller has 180 days post-Closing to cure; If Seller fails to cure, Buyer must re-assign defect property to Seller; claw-back is spelled out in 5th Amendment



Potential Pitfalls

Joint Development Agreements

- Nested references
 - JDA is recorded as “Memorandum of Agreement” which references unrecorded JDA
 - Unrecorded JDA references
 - Marketing Agreement
 - Gas Purchase Contract
 - JOA
 - Supplement to JOA
 - Gathering Agreement
 - 3-party Contingency Agreement
 - AMI
- Re-assignments upon achievement of specified return



Potential Pitfalls

Joint Operating Agreements

- **Non-Consent Provisions:** The seller may have gone “non-consent” to operations under the JOA - it did not agree to bear the costs of drilling and operating. In this case, seller would not be entitled to a share in revenue until the consenting parties recoup their costs plus a penalty (over 100%)
- This arrangement is rarely reflected in the record
- The Seller may also be benefiting from a non-consent interest which terminates after payout occurs



Potential Pitfalls

Joint Operating Agreements

- Maintenance of Uniform Interest Provision
- Restricts transfers of “non-uniform interests” within the contract area
- Non-uniform interest: sale of deep/shallow rights, assignment or reservation of all or part of a particular unit, drill site, or well-bore within a multi-well unit, subject to a JOA with no depth limitations
- MUI applies to sales, gifts, exchanges, mortgages, and any other encumbrance or transfer
- May even extend to transfers of overriding royalty interests, production payments, net profit interests



Potential Pitfalls

Farmouts

- Back-In Interests
 - Addresses whether the farmor's retained non-operating interest will be converted to a share of the working interest at payout of the well
 - Options: No conversion, mandatory conversion, and optional conversion



Potential Pitfalls

Farmouts

- Once a farmout has been fully performed, the farmee is entitled to a recordable assignment
- Sometimes the parties forget to request the earned assignment
- This would result in a discrepancy between record title and the seller's records



Potential Pitfalls

Farmouts

Term Assignments- convey an interest from farmor to farmee for a specific term

Assigned interest reverts to assignor if assignee doesn't drill a producing well to a certain depth by the end of a term

Terms and conditions may be specified in unrecorded farmout

Seller could have assignment of record that it would be obligated to reassign because the interest was not earned



Protecting Against Pitfalls

- Westland sets out a presumption that a purchaser has notice of unrecorded information referenced in recorded documents in his chain and that purchaser has fulfilled his duty of inquiry
- Review each recorded instrument in the chain of title and identify all recitals, references or other matters affecting title, whether recorded or unrecorded
- Conduct a thorough and exhaustive investigation to determine whether any unrecorded document referenced affects title
- Including any instrument referenced in those unrecorded documents



Protecting Against Pitfalls

- Buyer's team should have knowledge of documents and provisions which can impact title, even if unrecorded
- Buyer should negotiate for a reasonable due diligence period
- Buyer should request and review copies of all unrecorded instruments referenced
- Buyer should negotiate for indemnification for any damages or loss of title resulting from unrecorded sources
- Buyer should negotiate for seller to make representations that the seller has provided the buyer with all title information and that the only outstanding interests are those that have been disclosed



Thank You!

Questions?



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