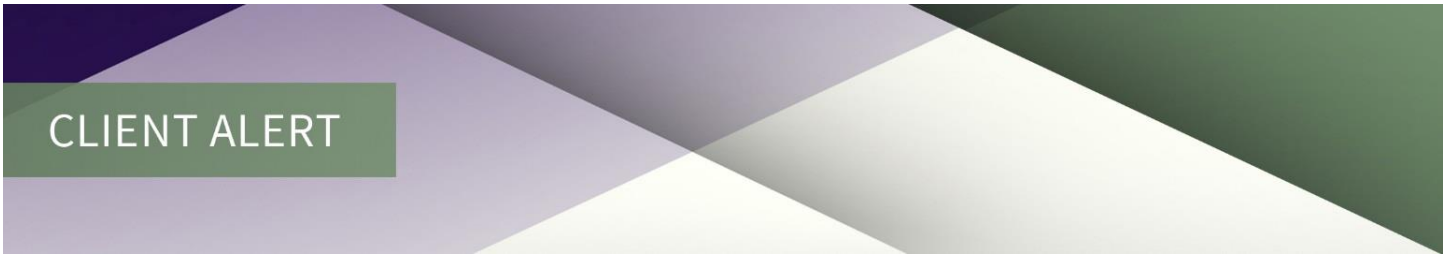

Landmark Holding from Texas Supreme Court on Consents to Assign

July 17, 2019

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In *Barrow-Shaver Resources Company v. Carrizo Oil & Gas, Inc.*,[1] the Texas Supreme Court upheld the decision of the Tyler Court of Appeals[2] to overturn a $28 million jury verdict in favor of Barrow-Shaver Resources Company ("BSR") on its tortious interference with contract, breach of contract and fraud claims against Carrizo Oil & Gas, Inc. ("Carrizo") based on Carrizo's refusal to grant its consent to an assignment of BSR's interest in the parties' farmout agreement. In holding that Carrizo's refusal could not be a breach of contract because the plain language of the contract unambiguously entitled Carrizo to withhold its consent, the court declined to read a qualifier into the consent-to-assign provision due to "industry custom" or the perceived reasonableness of the withholding party. This decision has broad applicability not only with respect to the oil and gas industry but also to many commercial contracts governed by Texas law.

The Facts

Carrizo held a leasehold interest in 22,000 acres in North Central Texas where BSR was prospecting for oil and gas. Shortly before Carrizo's leasehold interest was set to expire, the parties entered into a farmout agreement (the "Agreement") pursuant to which BSR would earn an interest in the lease in exchange for the drilling of a well thereon, which would, in turn, extend the term of the lease. The parties spent part of their negotiations focused on the consent-to-assign provision, which ultimately stated that the rights of BSR under the Agreement could not be assigned "without the express written consent of Carrizo." While the first iteration of the provision contained a proviso that Carrizo's consent

[1] *Barrow-Shaver Resources Company v. Carrizo Oil & Gas*, *Inc*., No. 17-0332 (Tex. 2019).

[2] *Carrizo Oil & Gas, Inc., v. Barrow-Shaver Resources Company*, 516 S.W.3d 89 (Tex. App.—Tyler 2017, pet. granted).

was “not to be unreasonably withheld,” Carrizo deleted the reasonableness requirement. BSR objected to the deletion, and, on more than one occasion, Carrizo provided assurances to BSR that Carrizo would provide its consent to any future transfer.

BSR commenced drilling before the expiration of the lease, but its drilling efforts were unsuccessful. When Raptor Petroleum II, LLC (“Raptor”) later approached BSR with an offer of approximately $27 million for an assignment of BSR’s rights under the Agreement, BSR requested that Carrizo consent to the proposed assignment. After BSR declined Carrizo’s offer to purchase its interest in the lease for $5 million, Carrizo refused to consent to the assignment and BSR’s deal with Raptor fell through.

BSR sued Carrizo for tortious interference with contract, breach of contract and fraud. The trial court did not allow the admission of evidence relating to prior drafts of the Agreement and the negotiations related thereto but did tell the jury that it could consider “industry custom” in its deliberations. The jury sided with BSR on all claims and awarded approximately $28 million in damages.

The Court of Appeals reversed on all three claims, reasoning that the deletion of the reasonableness requirement indicated that Carrizo bargained for and obtained a hard-consent requirement.

The Decision

The Texas Supreme Court held that (1) the plain language of the Agreement allowed Carrizo to withhold its consent such that Carrizo’s actions were not a breach of contract as a matter of law, and (2) BSR could not reasonably rely on Carrizo’s oral assurances that it would grant its consent to future assignments when the terms of the Agreement were unambiguous.

Because the terms of the consent-to-assign provision were not ambiguous, the court determined that it was improper to consider extrinsic evidence, such as the prior drafts and negotiations. Similarly, the court considered it inappropriate to consider “industry custom” due to the fact that the language of the Agreement could be clearly understood without referring to common practices in the oil and gas industry. In the opinion of the court, allowing such a result would limit parties’ ability to bargain for express contractual provisions and permit judicial review of even unequivocal phrases.

The court also refused to read a duty of good faith or fair dealing into the Agreement. While some contracts governed by Texas law, such as those between an insurer and an insured, are subject to a duty of good faith and fair dealing, the Agreement (and, by extension, any comparable oil and gas farmout or joint venture agreement) was not one of them. The court was reticent to extend such a duty to the Agreement, especially given that Carrizo and BSR were both sophisticated parties capable of negotiating a technical and industry-specific agreement. Again, because the consent-to-assign provision was unambiguous, Carrizo was entitled to withhold its consent for any reason (including a demand for payment of millions of dollars) or for no reason.

With respect to BSR's fraud claim, the court believed that BSR, as a party experienced in these types of negotiations, should have been duly aware of the risks of entering into a written contract which was directly at odds with oral statements made by the counterparty. Although Carrizo assured BSR more than once that it would grant any consent to assignment (saying things such as "It won't be a problem" and "Don't worry about it"), the court found that BSR failed to exercise ordinary care in protecting its own interests and could not justifiably rely on such statements. As a sophisticated party, BSR should have known that the oral representations, especially ones conflicting with the terms of the Agreement, were not to be trusted in the context of a negotiation.

Key Takeaways

The *Carrizo* decision underscores the importance of the plain language of a contract over industry custom or the underlying motives of the counterparty and demonstrates the respect (and deference) Texas courts will extend to a commercial contract negotiated between sophisticated parties and the benefit of the bargain struck pursuant to the contract's express terms. As a result of the ruling, under Texas law, without explicit language to the contrary, unqualified consent-to-assign provisions in contracts similar to farmout agreements will be interpreted strictly as written. For those oil and gas industry participants who often rely on the verbal assurances of their counterparties or "handshake" understandings, the *Carrizo* decision should be taken into account both with respect to existing contractual arrangements and future contractual ventures. In addition, oil and gas industry participants should take heed of the *Carrizo* decision not only in the context of farmout and similar asset-level joint venture agreements but also in connection with navigating consents to assignment in oil and gas leases and other commercial contracts that are implicated in connection with A&D activity on a daily basis.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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