



## Range Resources Case

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On March 6, 2015, the Texas Supreme Court decided a case involving the duties owed to the non-executive holder of a nonparticipating royalty interest by both the executive rights holder and the lessee that negotiated the lease against the executive. The Court also determined whether the non-executive can impose a constructive trust on the executive's portion of the royalty interest that had been conveyed to third parties. The opinion in *KCM Financial et al. v Bradshaw*, No. 13-0199 (Tex. 2015), held that (i) the duty of good faith that an executive owes to the non-executive can be breached when negotiating the royalty interest under some circumstances other than by leasing to a related or affiliated lessee; (ii) lessees have no duty to negotiate against their best interests even if that results in a breach of the executive's duty of good faith; and (iii) a constructive trust should not be imposed on the executive's royalty conveyed to third parties.

Bradshaw owned a non-participating royalty equal to "an undivided one-half (1/2) Royalty" and not less than an undivided 1/16 in leases that had to provide for royalty of not less than 1/8th covering some 1,773 acres out of a 2,000 acre tract in Hood County.

Steadfast owned the executive rights and executed a lease to Range providing for a 1/8th royalty and a bonus of \$7,505 per acre. There was evidence that many leases in the area had been executed with 1/4 royalties and significantly smaller bonuses. Bradshaw claimed (1) Steadfast violated its fiduciary duty to Bradshaw when it entered into the lease with Range, and (2) Range conspired with Steadfast and aided and abetted the breach.

The Court conducted a fascinating tour of the history of the relationship between an executive and a non-executive, comparing the long standing test of "utmost fair dealing" with the more recent holdings that there exists a kind of fiduciary duty which has been articulated as "the executive's duty is to 'acquire for the non-executive every benefit that he exacts for himself.'" Finding that "while an executive may be understood to have considerable latitude, the executive lacks unbridled discretion," so "the executive may discharge its duty to the non-executive without yielding entirely to the non-executive's best interest," which would be required under a straight fiduciary standard. Based on this analysis, the Court concluded that "the failure to obtain a market-rate royalty does not, in and of itself, constitute a breach of that duty" because "such a requirement would have the effect of depriving the executive of its exclusive right to make and amend leases..." but "to hold that prevailing royalty rates are immaterial as a matter of law would deprive the non-executive of adequate protection." Based on evidence in the record that a



reasonable fact finder could conclude that Steadfast breached a duty to Bradshaw, the breach-of-duty claim against Steadfast was remanded to the trial court for further proceedings.

The case is significant because, while the Court held that negotiating a below market royalty was not, standing alone, sufficient evidence to raise breach of the executive's duty, the Court did not explain what additional circumstances are sufficient to raise a fact issue of whether an executive breached its duty of good faith to the non-executive. That lack of clarity may breed litigation by dissatisfied NPRIs claiming executives should have forgone terms that benefit the executive's separately owned mineral or surface rights in order to obtain a larger royalty. Executives' fear of being sued may, in turn, result in non-executives indirectly or directly influencing future lease negotiations.

As to the claims against Range, the lessee under the Steadfast lease, Bradshaw claimed that Steadfast's alleged breach of duty can be imputed to Range under civil-conspiracy and aiding-and-abetting theories. The Court found these derivative-liability claims to be untenable as a matter of law. There was no evidence that Range was complicit in the alleged tort; instead Range was adverse to both Steadfast and Bradshaw in that "Range sought to extract the best deal it could on the most favorable terms." The fact that Range knew about Bradshaw's non-participating royalty interest was "insufficient to impute Steadfast's liability, if any, to Range." Allowing otherwise, would render arm's-length negotiation "essentially nonexistent" and "nonsensical." The court stated that "nor should a lessee be expected to give weight to a non-participating royalty interest holder's economic interests; as we have held, that is the executive's responsibility..." and "in negotiating with the executive, a lessee should not fear liability for doing nothing more than getting a good deal closed." Accordingly, the Court reversed the court of appeals' and rendered judgment that Bradshaw take nothing on the claims against Range.

Another interesting facet of the case is that Bradshaw sought a constructive trust on Range's royalty payments to the royalty owners (the executive's royalty had been assigned). In denying imposition of a trust, the Court found that the claim was against that portion of the royalty given to the executive rights holder when the executive non-executive split was made in 1960 and the "later execution of the mineral lease with Range, even if wrongful, did not convert the unreserved one-half interest into Bradshaw's property."

#### Endnotes

- 1 *Disclosure: Locke Lord LLP represented Range before the Texas Supreme Court.*
- 2 *A previous decision in the case concluded that Bradshaw had a right to a minimum 1/16th interest rather than a fixed 1/2 of 1/8th royalty. Range Res. Corp. v. Bradshaw, 266 S.W.3d 490 (Tex.App. – Fort Worth 2008, pet. denied)*

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