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MINERAL MAYHEM

DEEDS WITH OMISSIONS

By Judon Fambrough

The recent lucrative discoveries of gas in the Barnett, Eagle Ford and Haynesville Shales sparked several appellate cases from disgruntled sellers. In these cases, the sales contracts called for the sellers to retain the minerals, but the reservation was omitted in the deeds. According to Texas law, the deed conveys all rights owned by the seller not reserved. Although these cases involved rural property, the issue is becoming more prevalent in urban areas as well.

Generally, the parties to these transactions correct the mistakes cordially by executing and filing correction deeds. What happens, though, if a cordial resolution is impossible? Can the courts order reformation of the deed? What is the statute of limitations? Is the scrivener (the professional who drafted the deeds) liable?

Governing Laws

Three rules of law answer these questions. First, the Statute of Frauds (Sections 26.01 of the Texas Business and Commerce Code and 5.021 of the Property Code) requires that agreements for the sale of real estate be placed in writing and signed to make the agreement enforceable. In this instance, the document is the earnest money contract.

Second, Texas' merger doctrine holds that at closing, all prior agreements, including those depicted in the earnest money contract, merge into the deed. The deed, not the sales contract, represents the final expression of all prior agreements.

Consider this example. The buyer and seller enter an earnest money contract for the sale of East Texas land. The seller reserves all minerals in the contract. At closing, the seller delivers the deed prepared by an attorney chosen by the title company. However, the deed omits the mineral reservation, and the mistake goes unnoticed by the seller. The deed in essence conveys the minerals to the buyer in violation of the earnest money contract.

Later, the Haynesville Shale is discovered in the area. An oil company approaches the purchaser, not the seller, to lease the minerals. The error becomes obvious and the seller demands correction.

The title company pressures the parties to resolve the issue by executing a correction deed. The buyer refuses, anticipating a windfall from the mineral ownership.

This is where the third rule of law comes into play, the statute of limitations. Has too much time elapsed for the seller to sue for deed reformation?

According to Section 16.051 of the Texas Civil Practices and Remedies Code, a suit must be filed within four years of the date the deed was delivered. If more than four years have transpired, a suit to reform the deed is barred, and the seller cannot recover the minerals.

There is an exception known as the discovery rule. The four years is measured not from the delivery of the deed, but from the time the seller should have discovered the mistake in the exercise of reasonable diligence. This means the injury must be inherently undiscoverable and objectively verifiable when the transaction occurred. The test is a question of fact for the jury. In this case, the seller would argue the discovery rule applies. The statute starts to run when the oil company approached the buyer for a mineral lease, not at closing.

Assuming the statute of limitations has not expired, how does the merger doctrine affect the situation? Remember, according to this rule, the deed is the final expression of the agreement between the parties. When a contradiction exists between the earnest money contract and the deed, the deed controls.

But, again, an exception exists. The merger doctrine applies only in the absence of fraud, accident or mistake.

Defining 'Mistakes'

An allegation of fraud, accident or mistake by either party opens the entire transaction to scrutiny. Otherwise, the merger doctrine prevents either party from introducing evidence of prior agreements contradicting the terms of the deed.

But not all mistakes are grounds for reformation. Broadly speaking, reformation may be ordered for *mutual mistakes*, not for *unilateral mistakes* unless induced by fraud, misrepresentation or undue influence.

A *mutual mistake* means both parties labor under the same misconception concerning a material fact to the transaction. For instance, a mutual mistake occurs when a draftsman *employed by both parties* chooses the wrong words to express the agreement (*Hale v. Corbin*, 83 S.W. 2d 726) or fails to express the real agreement of the parties (*Hill v. Brockman*, 351 S.W. 2d 934).

Texas Jurisprudence III, a legal treatise on Texas case law, contains a section entitled "Scrivener's Error" that is relevant to mutual mistakes. It states, "If a mistake has been made by a scrivener or typist, an instrument (the deed) may be reformed and modified by a court to reflect the true agreement of the parties when the mistake is mutual."

Two recent appellate cases exemplify this rule. In September 2010, the Tyler Court of Appeals released its opinion in the case of *Simpson v. Curtis (No. 12-09-00292-CV)*.

In October 2006, Curtis contracted to sell Simpson eight acres in Sabine County, Texas. The seller reserved all the minerals in the contract. A month later, the transaction closed at the Sabine Abstract and Title Company, the same title company that prepared the deed. But the deed did not include the mineral reservation.

Two years later, the error surfaces. Simpson refused to execute a correction deed, so Curtis sued for deed reformation based on a mutual mistake. The title company employee who prepared the deed testified she did not see the mineral reservation in the earnest money contract. The mistake was her fault.

The trial court ordered the deed reformed. Simpson appealed on two grounds. First, the evidence was legally insufficient to support a mutual mistake. To this end, the appellate court responded that two elements are needed for reformation:

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(1) There was an agreement and (2) a mutual mistake occurred when it was reduced to writing. Here, both parties were under the mutual mistaken impression that the deed followed the terms of the earnest money contract.

Secondly, Simpson contended that the merger doctrine precludes the introduction of prior agreements contradicting the terms of the deed. The court responded that the merger doctrine does not apply in the face of a mutual mistake.

A similar case was decided by the Eastland Court of Civil Appeals in April 2011 *(Gail v. Berry [11-09-00299-CV])*. The sale involved 176 acres in Scurry County, Texas. Again, the earnest money contract stated the minerals were to be reserved and the deed failed to reflect the reservation. The attorney who drafted the deed admitted making the error.

The buyer refused to sign a correction deed. The seller sued for deed reformation and won. The buyer appealed, raising the same arguments as in the previous case with a couple of exceptions. First, the buyer argued it was a *unilateral* mistake, not a *mutual* mistake.

The buyer testified she noticed the deed did not contain a mineral reservation at closing, but said, "I was satisfied that

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they had agreed to let me have the mineral interest . . .” From her perspective, there was no mutual mistake. It was a unilateral mistake.

The court ruled to the contrary. If the buyer knew of the mistake at the time the deed was signed, the judge said, a unilateral mistake by the seller equates to a mutual mistake.

Finally, the buyer argued the mistake was the fault of the attorney who drafted the deed, so the seller should sue the attorney for damages. This follows the *canons of construction,* which hold that deeds should be construed to convey the greatest estate possible to the buyer and reserve the least possible estate to the seller.

But the court responded that the canons of construction apply only when the deed is ambiguous. The buyer raised no allegation of ambiguity at trial.

However, the buyer’s argument for suing the attorney is not without merit. The case of *Bryan v. Dallas National Bank (135 S.W. 2d 249)* supports her contention even though it did not involve a mineral reservation. In that case, the scrivener of a deed of trust (a mortgage instrument) incorrectly stated the sale was subject to a $781 promissory note. The buyers wanted the deed of trust corrected (reformed) based on a mutual mistake (a scrivener’s error).

The scrivener testified that he prepared two deeds: one referenced the $781 promissory note and other did not. He picked up the wrong document when he went to closing “. . . through mistake. I did not notice that this (the reference to the $781) was in there (in the deed of trust).”

The appellate court ruled *no mutual mistake* occurred. The court stated that according to his own admissions, Bryan (the preparer) alone committed the error. It was a unilateral mistake. The evidence failed to raise an issue of an alleged *mutual mistake*.

Finally, when does the corrected or reformed deed become effective? Is it the date the correction occurs or does it relate back to the date of the original transaction? Case law holds that the mistake, once corrected, refers back to when the deed was delivered to and accepted by the buyer. (For more about this topic, see *Deed Reformation: Relation Back Doctrine* at http://recenter.tamu.edu/pdf/1191.pdf.)

This rule works well as long as the buyer has not conveyed the property to a third party. What would happen if the error was discovered *after*, not *before*, the buyer signs the oil and gas lease and the oil company records it? Can the courts effectively void the mineral lease in this instance? Remember, an oil and gas lease in Texas is a deed, not a rental or lease agreement, despite the label.

Probably not. If the oil company pays good and valuable consideration for the lease and takes it without any actual or constructive knowledge of the prior mistake, the oil company becomes what is known as a bona fide purchaser (sometimes called an innocent purchaser). Case law holds that reformation (of the prior deed) will not be granted when it disturbs the rights of a bona fide (innocent) purchaser.

Actual notice means that no one told the oil company, prior to taking the lease, that there was a mistake in the prior deed. *Constructive notice* means that the oil company could not have discovered the mistake by examining the deed records or physically visiting the property. (For more about bona fide purchasers see *Deeds and the Texas Recording Statutes,* http://recenter.tamu.edu/pdf/1267.pdf).

Seller Responsible

The doctrine regarding a bona fide purchaser stems from the principle that equity will not grant relief when the person asking for the resolution was responsible for creating the problem. That is, when one of two innocent parties must suffer (the seller or the oil company), the one responsible for creating the problem is liable. Here, the seller is responsible for not examining the deed before signing it.

Does this mean the seller is without legal recourse? If the deed cannot be reformed, the seller may sue the parties responsible for damages. In this case, the seller would probably sue both the title company and the attorney who prepared the deed. The controversy would focus on whether the title company gave the attorney correct instructions for preparing the deed and whether the attorney failed to follow those instructions. Of course, the defendants would argue the seller was at fault for failing to examine the deed before signing it.

Fambrough (judon@tamu.edu) is a member of the State Bar of Texas and a lawyer with the Real Estate Center at Texas A&M University.

THE TAKEAWAY

Things get complicated when mineral reservations spelled out in earnest money contracts are mistakenly omitted from deeds. If such errors cannot be resolved cordially, sellers and buyers are at the mercy of the statute of frauds, the merger doctrine and the statute of limitations.

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Texas A&M University
2115 TAMU
College Station, TX 77843-2115

http://recenter.tamu.edu
979-845-2031

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