

TEXAS OIL & GAS LITIGATION UPDATE

DBA OIL & GAS SYMPOSIUM

**MICHAEL K.
HURST**

**JONATHAN R.
CHILDERS**

LYNN PINKER COX HURST

**August 18,
2016**

HOT TRENDS & MAJOR DEVELOPMENTS

1. Bankruptcy litigation and workouts
2. Partnership and fiduciary disputes
3. Deals gone badly/never consummated
4. Royalty and lease litigation
5. Employment disputes
6. Expense monitoring
7. Nuisance litigation
8. Environmental/climate change
9. Recent noteworthy decisions



COOLING TRENDS

1. Fracking ban litigation
2. Damages from alleged seismic activity



ANTICIPATED TRENDS

1. Trade secret litigation
2. More shareholder and fiduciary disputes
3. Private equity litigation

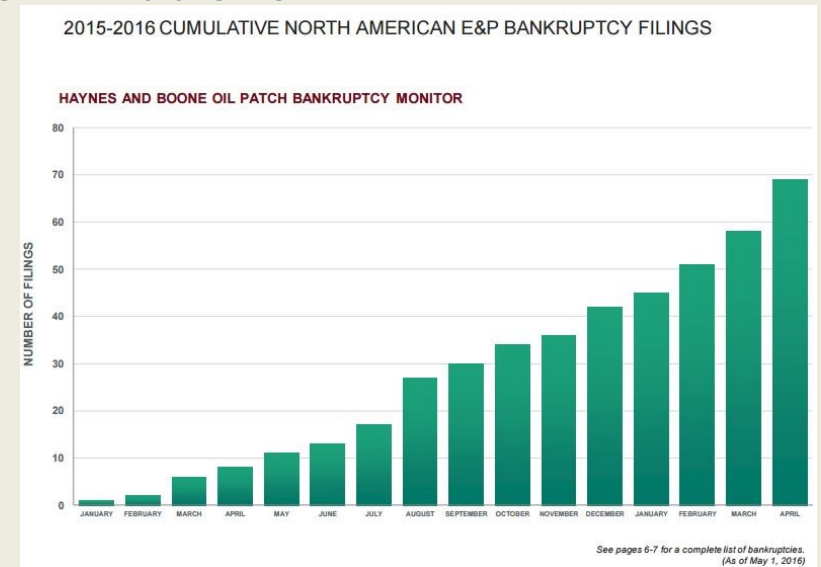


BANKRUPTCY LITIGATION & WORKOUTS

At least 85 E&Ps filed for bankruptcy.

Major Factors:

- Mounting debts
- Loss of long-term contracts
- Unfavorable borrowing base redeterminations
- Tapped-out financing facilities
- Wary and inquisitive shareholders



BANKRUPTCY LITIGATION & WORKOUTS



In re Sabine:

Sabine permitted to reject midstream agreements as executory contracts **even though** contain language stating they **are** covenants running with the land.

In re Sabine Oil & Gas Corp., 547 B.R. 66, (S.D.N.Y. Bankr. Mar. 8, 2016).

Non-binding analysis

Court concluded **“without deciding in a binding way”** that gathering agreements at issue did not run with the land under Texas law. *Id.* at 73.

Material concern

How to negotiate given uncertainty created by *Sabine*?

LYNN PINKER COX HURST

PARTNERSHIP & FIDUCIARY DISPUTES

Attorney doing business in a partnership:

Attorney remains fiduciary even when wearing a deal hat.

LW Hunt Resources, LLC et al. v. Thunderbird Oil & Gas, LLC et al., Cause No. DC 2013-00016, 32nd Dist. Ct. of Fisher County, TX (Mar. 30, 2016) (appeal pending).

Duty of executive right holder to NPRI holders:

Duty to prohibit self-dealing, but not required to place interests of NPRI holders above own.

KCM Financial LLC v. Bradshaw, 457 S.W.3d 70, 82 (Tex. 2014).

DEALS GONE BADLY/NEVER CONSUMMATED

The Williams Companies, Inc. v. Energy Transfer Equity, L.P.

ETE **not** compelled to complete its proposed acquisition of the assets of the Williams Companies.

See The Williams Companies, Inc. v. Energy Transfer Equity, L.P., C.A. No. 12168-VCG (Del. Ch. June 24, 2016).

Because **condition precedent** to merger of delivering a Section 721 Letter **did not occur**, ETE's **soft exit justified**.

“[M]otive to avoid a deal does not demonstrate lack of a contractual right to do so....[E]ven a desperate man can be an honest winner of the lottery.” *Id.* at 4.



ROYALTY & LEASE LITIGATION

Chesapeake Litigation

- \$51 million to 13,000 people
- \$15 million to City of Fort Worth



Hyder = Notable win for royalty interest holders

“[T]he effect of a lease is governed by a fair reading of its text.”

Chesapeake Expl., L.L.C. v. Hyder, 483 S.W.3d 870, 875 (Tex. 2016).

Text of lease provision: “perpetual, cost-free . . . overriding royalty”; did not state royalty to be paid on market value “at the well.” *Id.* at 872.

What’s next?

From Barnett to Eagle Ford.



LEASE DISPUTES: SHUT-IN ROYALTY PAYMENTS

Can lease be maintained by shut-in royalty payments?

Because parties negotiated for a shut-in royalty provision that **did not include** “capable of producing in paying quantities,” court would not engraft.

See PNP Petro. I, LP v. Taylor, 438 S.W.3d 723, 737 (Tex. App.—San Antonio 2014, pet. denied).

Make **clear** that payment under savings clause functions as a shut-in royalty instead of a delay rental.

See ConocoPhillips Co. v. Koopmann, No. 13-14-00402-CV, 2015 WL 2967689 (Tex. App.—Corpus Christi May 19, 2016, no pet. h).

LEASE DISPUTES: RETAINED ACREAGE

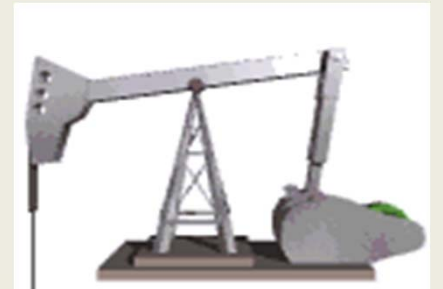
Language of lease determines effect of retained acreage clause.

“[W]e are **not bound** by what XOG may **perceive to be the industry practice** but are instead bound by the **actual intent of the parties** as expressed by the precise terms of their agreement.”

XOG Operating, LLC v. Chesapeake Expl. LP, 480 S.W.3d 22, 29
(Tex. App.—Amarillo 2015, pet. filed).

“Although ConnocoPhillips **may not have fully anticipated** the consequences of tying the retained acreage clause to a field rule . . . , this court is **not allowed to rewrite** the parties’ lease.”

ConocoPhillips Co. v. Vaquillas,
No. 04-15-00066-CV, 2015 WL 4638272, at *4
(Tex. App.—San Antonio Aug. 5, 2015, pet. abated).



LEASE DISPUTES: PRODUCTION PAYMENTS

Production payments end as to the terminated portion of a leasehold estate, **even when** production payments **continue** as to leases within the leasehold estate **that are not terminated**.



See *Apache Deepwater LLC v. McDaniel Partners Ltd.*, 485 S.W.3d 900, 908 (Tex. 2016).

UNUSED FIRM TRANSPORT DISPUTES

Terms of lease determine whether firm transportation charges are deductible from royalties.

“Firm transportation charges that are incurred for pipeline space **that is not ultimately used** are **not ‘actually incurred’** in connection with the sale of gas produced from [the] Leases” and thus are not deductible.

Commissioner v. SandRidge Energy, Inc., 454 S.W.3d 603, 622 (Tex. 2014).

EMPLOYMENT DISPUTES

1. FLSA wage and hour class actions

- Overtime v. day rate
- Misclassification of oilfield well-site managers

2. Reductions in force

- Executive compensation



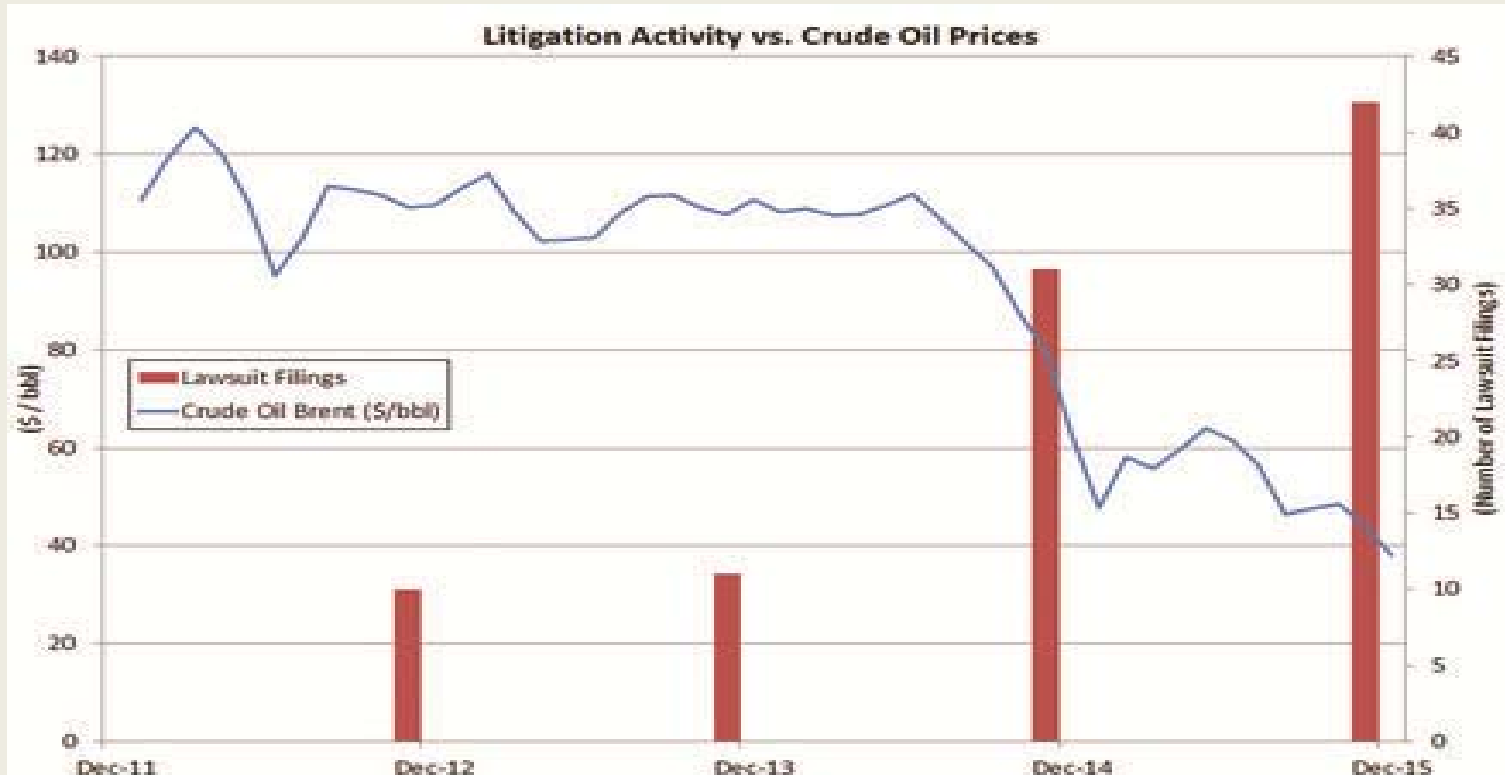
3. Employment discrimination class actions

- Downsizing/job assignments allegedly based on race

PATENT LITIGATION



patent litigation to protect licensing revenues.



LYNN PINKER COX HURST

INDEMNITY DISPUTE LITIGATION

↑ fights between operators and their contractors over responsibility for onsite injury to property and persons.

“Pass-through” indemnity

IADC daywork drilling contract at issue did not require Nabors (driller) to indemnify Encana (operator) for Encana’s separate contractual responsibility to indemnify its subcontractors.



See Nabors Drilling USA, L.P. v. Encana Oil & Gas (USA) Inc., No. 02-12-00166-CV, 2013 WL 3488152 (Tex. App.—Fort Worth 2013, pet. denied).

NUISANCE LITIGATION

New “Clarification” of Nuisance Standard:

“A ‘nuisance’ is a condition that **substantially** interferes with the use and enjoyment of land by causing **unreasonable** discomfort or annoyance to persons of **ordinary** sensibilities attempting to use and enjoy it.”

CrossTex North Texas Pipeline, L.P. v. Gardiner, No. 15-0049, ___ S.W.3d ___, 2016 WL 3483165 at *6 (Tex. June 24, 2016).

Takeaways:

1. Nuisance is a type of **legal injury**, not a cause of action.
2. Don’t need to establish **conduct** unreasonable; only that **effects** of conduct unreasonable.
3. Can be **intentional** nuisance and **negligent** nuisance.

NUISANCE LITIGATION

Intentional nuisance:

- Must show defendant “*intentionally* caused the interference.” *Id.* at 16.
- “[*A*]ctually desired or intended” to create the interference OR must have “*actually known or believed*” the interference would result. *Id.*

Negligent nuisance:

- Governed by ordinary negligence principles. *Id.* at 18.

Remedies: (1) damages; (2) injunctive relief; (3) self-help abatement

Damages:

Temporary nuisance: loss of use and enjoyment

Permanent nuisance: lost market value, including lost future rents



NUISANCE LITIGATION

Quasi-Estoppel Affirmative Defense

Quasi-estoppel precluded nuisance suit where landowners ***accepted benefits under lease*** (including royalty payments) ***yet still claimed*** drilling activities were substantially interfering with the use and enjoyment of their property.

See Titan Res., LLC v. Marsden, No. 02-14-00303-CV, 2015 WL 5727573 (Tex. App.—Fort Worth Aug. 27, 2015, pet. denied).



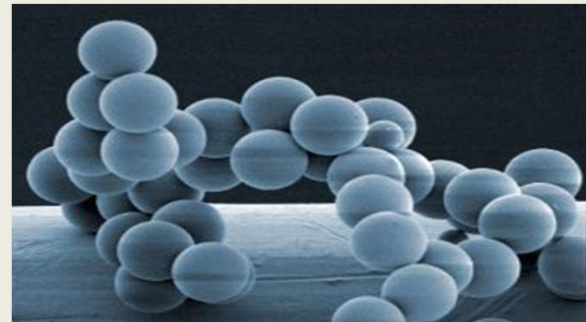
NUISANCE LITIGATION – AIRBORNE TRESPASS?

Sciscoe v. Enbridge Gathering (North Texas), L.P., No. 07-13-391-CV, 2015 Tex. App. LEXIS 5530 (Tex. App.—Amarillo June 1, 2015, no pet. h).

Homeowners in DISH sued for nuisance and trespass, alleging noise and migration of chemical particles from nearby compressor stations diminished their property values.

Amarillo Court of Appeals: airborne migration of intangible particles can conceivably constitute an actionable trespass.

Damages: diminution in property value; no mental anguish.



ENVIRONMENTAL/CLIMATE CHANGE

Pressure on Exxon and other majors from AGs and shareholders alleging nondisclosure of risks of climate change.

Exxon and Climate Change: Litigation Risks

ExxonMobil and other energy companies may face litigation from multiple directions claiming that the industry understood the threat their products posed to the climate decades ago, yet kept that knowledge from the public and shareholders.

inside
climate
news



RICO (*Racketeer Influenced and Corrupt Organizations Act*)

This law, originally designed to fight organized crime, was used successfully against tobacco companies.



Martin Act

A New York specific law that the state attorney general has used in the past to force disclosures over fossil fuel emissions.



Securities Law

These laws require companies to make disclosures to shareholders of risks that could have a material impact on the company's business.



Torts

Individuals or groups seeking compensation for harm they claim was caused by a company's actions, such as the effects of climate change caused by using fossil fuels.



International

Exxon may be vulnerable to litigation under the laws of other countries where it operates, as well as under international law.

GROUNDWATER RIGHTS

Accommodation doctrine applies to groundwater disputes

Severed groundwater = dominant estate.

“[T]he accommodation doctrine applies to resolve conflicts between a severed groundwater estate and the surface estate that are not governed by the express terms of the parties’ agreement.”

Coyote Lake Ranch, LLC v. City of Lubbock, No. 14-0572,
___S.W.3d___, 2016 WL 3176683 at *9 (Tex. May 27, 2016).



LYNN PINKER COX HURST

EMINENT DOMAIN & PIPELINES

Denbury case returns to Texas Supreme Court

At the time Denbury Green planned to construct the Green Line, did it intend for it to be a transport line for hire, or a private line?

“[R]easonable minds **could differ** regarding whether, **at the time** Denbury Green intended to build the Green Line, a reasonable probability existed that the Green Line **would serve the public.**”

Texas Rice Land Partners, Ltd. v. Denbury Green Pipeline—Texas, LLC, 457 S.W.3d 115, 121 (Tex. App.—Beaumont 2015, pet. granted).



NO MANUFACTURING EXEMPTION

Oil and gas above-ground and downhole production equipment **does not qualify** for the manufacturing exemption from the State of Texas sales and use tax.

“[T]here is **no evidence** that the equipment was applied to **cause changes in their characteristics** as hydrocarbons moved from the reservoir to the surface.”

Southwest Royalties, Inc. v. Hegar, No. 14-0743,
___ S.W.3d ___, 2016 WL 3382151, at *6
(Tex. Mar. 8, 2016).



COOLING TREND: FRACKING BAN LITIGATION

House Bill 40, TEX. NAT. RES. CODE § 81.0523

Expressly preempts authority of “a municipality or other political subdivision” to regulate an “oil and gas operation”; state has ***exclusive jurisdiction*** to regulate an “oil and gas operation.”

- Municipality ***cannot “enact or enforce an ordinance*** or other measure, or an amendment or revision of an existing ordinance or other measure, ***that bans, limits, or otherwise regulates*** an oil and gas operation within its *boundarie[s]* .”
 - **“Oil and gas operation”**: “An activity associated with the exploration, development, production, processing, and transportation of oil and gas, including ... ***hydraulic fracture stimulat[i]o[n]***.”
 - **Limits municipal powers**: Municipality can “enact, amend, or enforce an ordinance or other measure that [1] regulates only surface activity that is ***related to*** an oil and gas operation, [2] is ***commercially reasonable***, [3] ***does not effectively prohibit*** an oil and gas operation, and [4] ***is not otherwise preempted*** by state or federal law.”

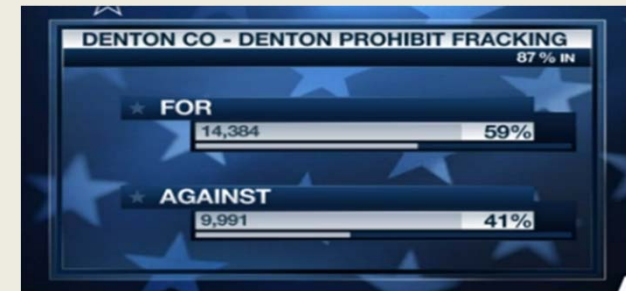
COOLING TREND: FRACKING BAN LITIGATION

House Bill 40, TEX. NAT. RES. CODE § 81.0523

What it does: Prohibits cities from doing anything that “*bans, limits, or otherwise regulates*” an oil and gas operation within its boundaries.”

What it does not do:

- Cities can still regulate noise, lighting, landscaping, traffic, and setbacks (the distance from drilling sites to homes, business, and churches).
- *Presumably* doesn't overturn Denton fracking ban.
 - Darby's office: HB40 is not retroactive.
 - **But**: prohibits “amendment or revision of an existing ordinance.”



COOLING TREND: FRACKING BAN LITIGATION

Material Issue for Fracking Bans:

Whether State of Texas's O&G regulations preempt the subject matters in the city's ordinance *with unmistakable clarity*?

Texas Supreme Court Has Spoken:

If City's regulation makes unlawful what State's regulation permits, preempted.

"[B]ecause the Houston ordinance's enforcement provisions are **inconsistent with** the statutory enforcement requirements, and the ordinance's registration requirement **makes unlawful** what the [Texas Clean Air] Act approves, we reverse[.]"

BCCA Appeal Group, Inc. v. City of Houston, No. 13-0768, ___S.W.3d___, 2016 WL 1719182 at *1 (Tex. Sep. 2, 2015).

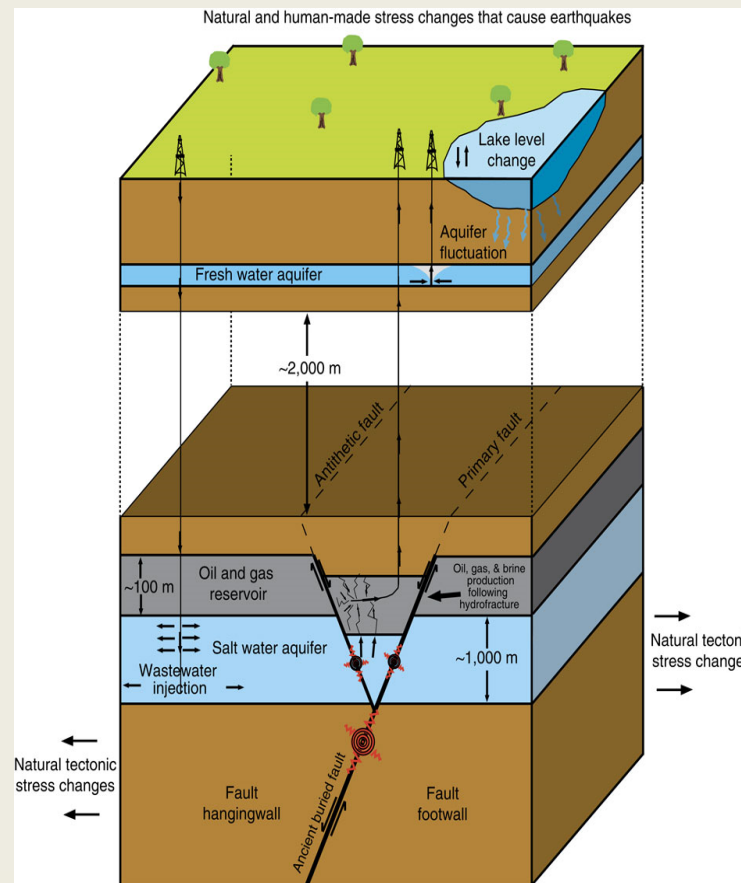
LYNN PINKER COX HURST



COOLING TRENDS

Earthquakes ?!?! Causation & Regulation

2. Injecting wastewater into ground on other side of fault (causing overall in pressure) ↑↑

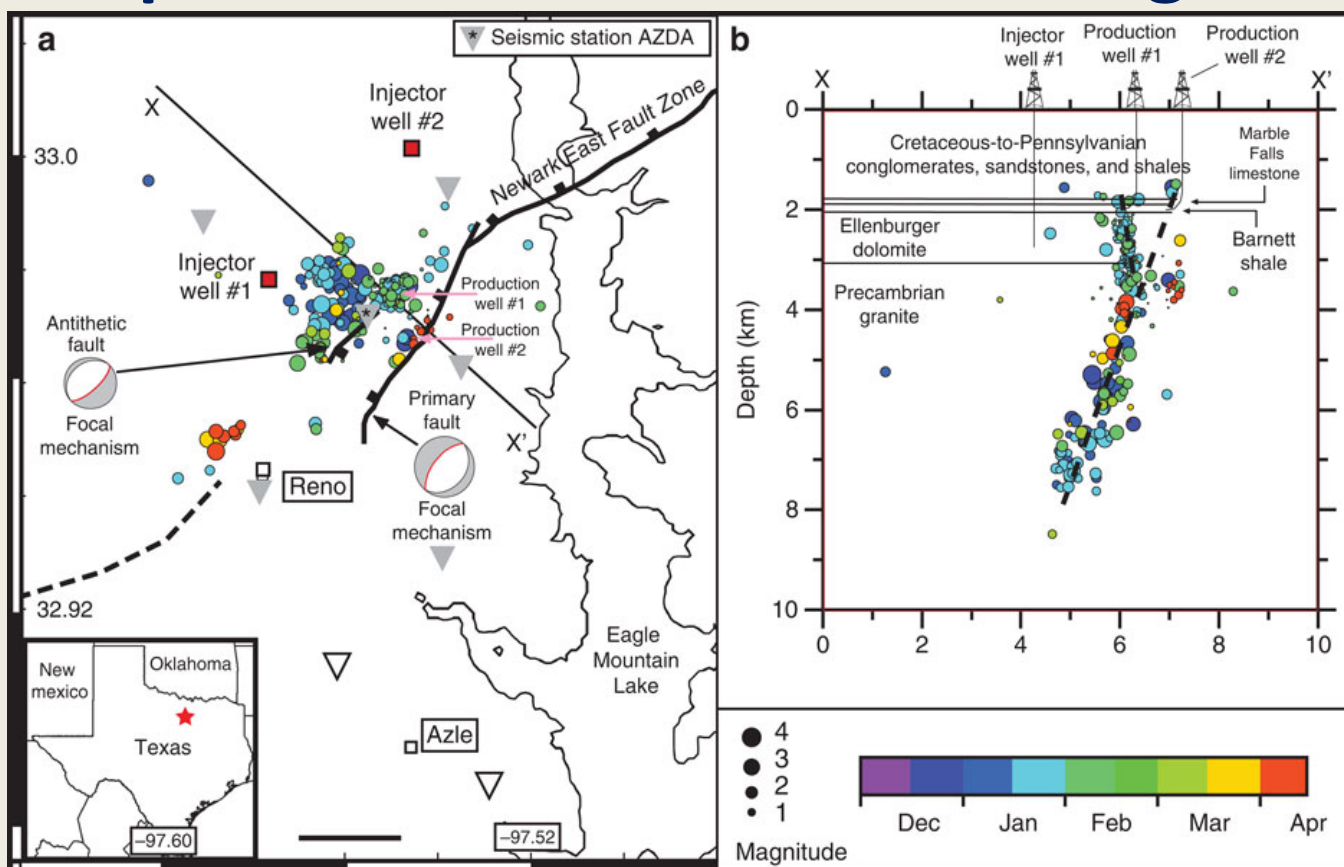


1. Extracting gas and groundwater from production well on one side of fault (causing ↓↓ in pressure).

3. Do pressure changes cause fault slip, triggering earthquakes?

COOLING TRENDS

Earthquakes ?!?! Causation & Regulation



LYNN PINKER COX HURST

COOLING TRENDS

Earthquakes ?!?! Causation & Regulation

Changes to Texas Administrative Code Regarding Disposal Wells

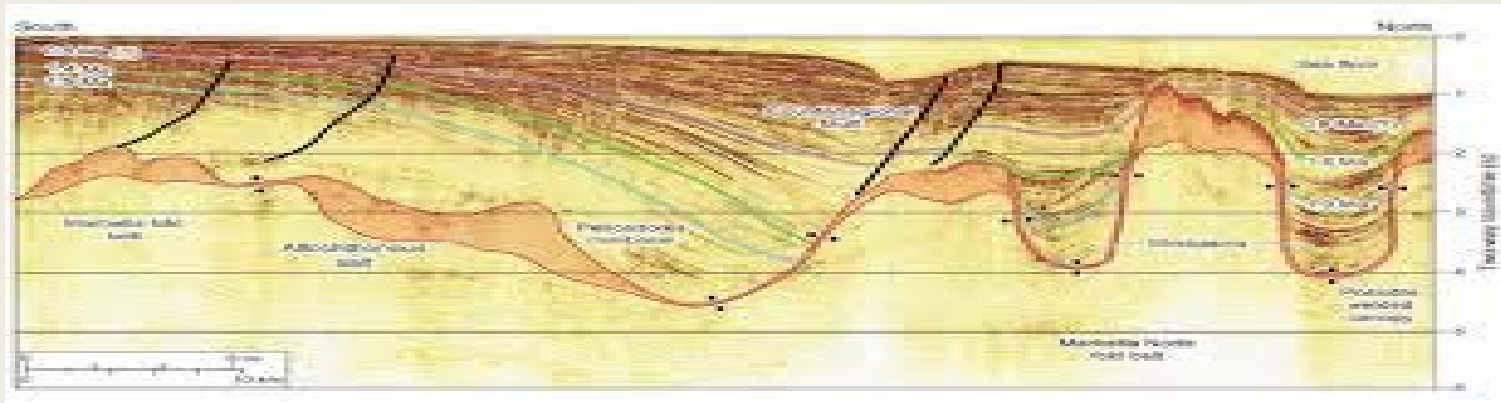
- ▶ Texas RRC adopts rules for injection permitting aimed at reducing possible earthquakes.
- ▶ Effective Nov. 17, 2014.
- ▶ Must provide information from United States Geological Survey regarding *locations of any historic seismic events* within circular area of 100 square miles centered around the proposed disposal well location. 16 TEX. ADMIN. CODE §§ 3.9(3)(B), 3.46(b)(1)(C).
- ▶ Tex. RRC can *modify, suspend, or terminate a permit* if disposal well is “*likely to be or determined to be contributing to*” seismic activity. 16 TEX. ADMIN. CODE §§ 3.9(6)(A)(vi), 3.46(d)(1)(F).

ANTICIPATED TRENDS



Trend 1: Trade Secret Litigation

- Highly competitive.
- Demand for knowledge about formation and optimal well locations
- Technology-driven
 - Advanced drilling and recovery techniques.
 - Proprietary formulas and data.



LYNN PINKER COX HURST

ANTICIPATED TRENDS

Trend 1: Trade secret litigation

To obtain trade secret damages, should present a compensation structure correctly monetizing use of the trade secret.

Southwestern Energy Prod. Co. v. Helfand, No. 13-0986,
___S.W.3d___, 2016 WL 3212999 at *14 (Tex. June 10, 2016).

Courts eager to interpret:

1. Texas Uniform Trade Secrets Act (“TUTSA”)
2. Federal Defend Trade Secrets Act of 2016

ANTICIPATED TRENDS

Trend 2: More shareholder and fiduciary disputes

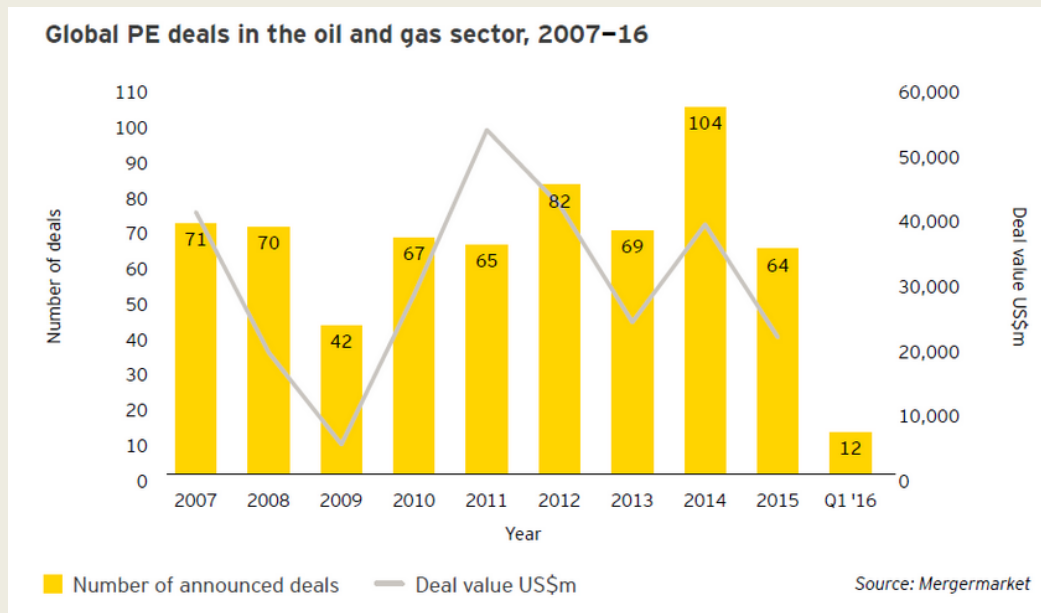
- a. Protecting profits/policing perceived insider benefits and self-dealing
- b. Tax litigation (especially MLPs)
- c. Executive compensation tied to drilling in lower-priced environment



ANTICIPATED TRENDS

Trend 3: Lawsuits regarding private equity investments

- a. Litigation over proceeds fights
- b. Disputes involving portfolio companies



Written and Presented by:

**MICHAEL K.
HURST**

mhurst@lynnllp.com

**JONATHAN R.
CHILDERS**

jchilders@lynnllp.com

LYNN PINKER COX HURST

2100 Ross Avenue, Suite 2700

Dallas, Texas 75201

214.981.3800