WHITLEY PENN ENERGY CONFERENCE

Order in the Courts?
2022 Energy Case Law Update

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Current Energy Issues in Litigation

- Title Disputes
- Fixed v. Floating Royalties
- Continuous Development/Retained Acreage
- Personal Injury
- Joint Operating Agreement – consent to operations and accounting issues
- Fair Labor Standards Act (FLSA) Claims
- Legality of Production Sharing/Allocation Wells
- Downhole Litigation

Lease Termination

- Key Question: What is required for an oil and gas lease to continue in full force and effect?
- Fee Simple v. Fee Simple Determinable:
  - Fee Simple: full and irrevocable ownership of land
  - Fee Simple Determinable: an interest in land that will end automatically *if a certain specified event happens/does not happen*.
- Habendum Clause: dictates how long lease remains in force.
  - Producer's 88: this lease shall remain in force for a term of three (3) years from this date and as long thereafter as oil or gas of whatsoever nature or kind is produced from said leased premises or on acreage pooled therewith, or drilling operations are continued as hereinafter provided

Thistle Creek Ranch, LLC v. Ironroc Energy Partners, LLC

- **Question:** Was production in paying quantities required to keep lease alive?
- **Lease Provisions:**
  - Granting Clause: "exclusive right of exploring, drilling, mining and operating for, producing and owning oil, gas, sulphur and all other minerals."
  - Due Diligence Clause: "to use reasonable diligence to produce, utilize, or market the minerals capable of being produced" from the property
  - Habendum Clause: "as long thereafter *as operations, as hereinafter defined, are conducted* upon said land with no cessation for more than ninety (90) consecutive days."
  - Operations definition: "operations for and any of the following: drilling, testing, completing, reworking, recompleting, . . . excavating a mine, *production of oil, gas, sulphur or other mineral, whether or not in paying quantities*."

Thistle Creek Ranch, LLC v. Ironroc Energy Partners, LLC

- Undisputed that production had not been profitable for years.

- Thistle Creek claimed lease had terminated:
  1. lack of production in paying quantities; word "produced" has been settled by case law as meaning "in paying quantities."
  2. Granting Clause requires production in paying quantities
  3. Due Diligence Clause requires production in paying quantities

Thistle Creek Ranch, LLC v. Ironroc Energy Partners, LLC

- Court:
  - Lease has NOT terminated
  - habendum clause does not use the word "produced"
  - clause instead says "for as long thereafter as operations, as hereinafter defined, are conducted"
  - "operations" include "production of oil, gas, sulphur or other mineral, *whether or not in paying quantities*"
  - Lease has not terminated because the well has produced gas "whether or not in paying quantities."
  - Harmonize other provisions

Texas Oilfield Anti-Indemnity Act

- **Master Services Agreements (MSAs):** contracts that (1) outline warranty obligations connected to oilfield services and (2) allocate liabilities
- **Knock-for-knock indemnities:** makes each party responsible for any claims or costs related to deaths or injuries to their own workers as well as property damage to their own property. Each party is solely responsible for its own personnel and property, often without regard to negligence, fault or cause
- **TOAIA:** controls the extent to which parties to certain oilfield contracts can agree to indemnify each other; voids indemnity agreements that to pertain to oil wells, unless the indemnity agreement is supported by liability insurance, among other factors
- **Question:** How does amount of insurance carried by a party to an MSA affect indemnity obligations?

Cimarex Energy Co. v. CP Well Testing, L.L.C.

- MSA between Cimarex and CP Well Testing
  - CP Well obligated to obtain a "minimum" of $1 million in commercial general liability insurance and $2 million in umbrella (or excess) liability insurance.
  - CP Well obtained more than those minimums: $1 million in general liability coverage and excess coverage of $10 million.
  - $8 million above the minimum standard set in the MSA
- Personal Injury at Cimarex location
  - flash fire occurred and an oilfield worker was injured.
  - Worker sued Cimarex, CP Well, and another company for personal injury
  - Cimarex and its insurers settled the lawsuit for **$4.5 million**
  - Cimarex sought indemnity coverage from CP Well (worker was a subcontractor of CP Well)
  - CP Well tendered **$3 million** but refused to tender the additional **$1.5 million**,
  - CP Well claimed it was not required to provide any indemnity above the "minimum" amount stated in the MSA

Cimarex Energy Co. v. CP Well Testing, L.L.C.

- Cimarex sues CP Well seeking additional $1.5 million in indemnity coverage
  - Cimarex: CP Well had a contractual duty to defend and indemnify Cimarex up to $11 million ($1 million + $10 million)
  - CP Well: only agreed to maintain $1 million in general liability insurance and $2 million under the MSA; remaining coverage was not for the benefit of Cimarex.
- Court:
  - Under TOAIA, Thus, when the parties agree to provide differing [or unspecified] amounts of coverage, the mutual indemnity obligations are limited to the lower amount of insurance actually carried
  - Cimarex argued that the $11 coverage amount was the lesser amount because Cimarex had obtained coverage up to $26 million
  - CP Well's Insurance Policy: the amount of coverage available for indemnifying third-parties is limited to the lesser of the amount of coverage provided in the policy [being $10 million] or the minimum amount required by the MSA [being $3 million]
  - Because the MSA set a minimum indemnity coverage amount of $3 million, Cimarex only gets benefit of $3 million
  - Lesson: Look at policy language!!!!

Most Favored Nations Clauses

- a contract provision in which a lessee agrees to give the lessor the best terms it makes available to any other lessor
- Henderson-Bazaar
  - Bonus MFN
  - Royalty MFN
  - Overriding Royalty MFN

EP Energy, EP Company L.P. v. Storey Minerals, LTD., Maltsberger Storey Ranch, L.L.C., and Rene Barrientos, Ltd

- MFN Clause of 2009 Leases:

If . . . the lessee . . . acquires an Oil and Gas Lease [on certain lands] on such terms that the . . . bonus . . . [is] greater than th[at] provided to be paid to lessor hereunder, *lessee . . .* agrees that it will execute an amendment to this lease, ***effective as of the date of the third party lease on the leased premises, to provide that the lessor hereunder shall receive thereafter the same percentage (per net mineral acre) . . . bonus . . . as any subsequent lessor*** of the leased premises to the extent that such . . . bonus . . . [is] greater than those provided to be paid herein.

- 8,730 acres
- Bonus: $500/acre

EP Energy, EP Company L.P. v. Storey Minerals, LTD.

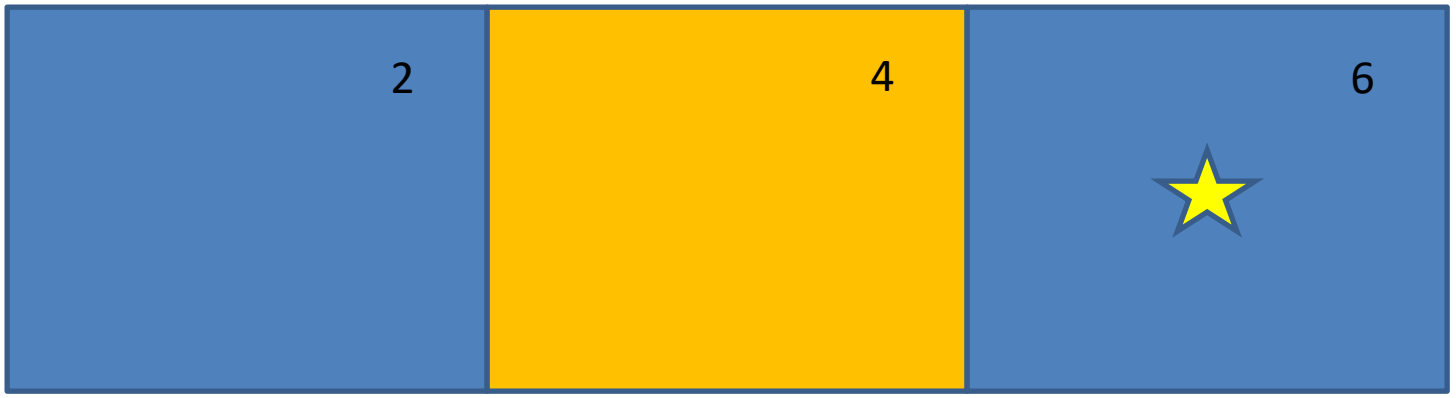
- EP acquired two additional leases ("New Leases") that triggered MFN at lease bonus of $5,200/acre
- Lessor: per MFN, EP must pay $4,700/acre lease bonus (total of $41,000,000!!!!)
- EP: the MFN only requires a lease amendment that takes effect on day of New Leases, but only requires additional bonus on leases taken *after* the New Leases (focus on "effective" and "thereafter")
  - "effective" and "thereafter" demanded a prospective construction of the MFN clause.
  - "Thereafter" meant that if the parties intended the obligation to be retroactive (and capture bonus paid under New Leases) they would have used the term "theretofore."
- Court:
  - "effective" simply meant "the executed amendment is operate 'as of the date of the third party lease,'" not that it only applied to bonuses after such date.
  - "EP's" "thereafter" argument results in the opposite of what was drafted; "thereafter" addressed when the payment would be made – after the parties executed the amendment.
  - EP must pay **$41 million** in additional lease bonus

Tier 1 Res. Partners v. Delaware Basin Res. LLC

- Question: What does the word "and" mean in the description of the leased premises in an oil and gas lease?
- February 2014: Delaware Basin Resources LLC ("Delaware Basin") entered into 12 nearly identical leases with 12 mineral owners.
- The mineral owners agreed to lease to Delaware Basin "the land covered hereby . . . described as follows: Section 6 . . . ***and*** Section 2." (Emphasis added)
- Each non-contiguous section consists of 640 acres, but the leases described the sections as follows: "said land shall be deemed to contain 1280 acres."
- 3-year primary term.
- Lease Addendum: "each of the ***separately designated tracts*** described shall be treated for all purposes ***as a separate and distinct Lease***. All of the provisions . . . shall be . . . construed as ***if a separate Lease agreement*** had been made and executed covering each such tract." (Emphasis added)

Tier 1 Res. Partners v. Delaware Basin Res. LLC

- At the end of the primary term, Delaware Basin had commenced drilling on Section 6, but not Section 2



- Lessors: leases with Delaware Basin had terminated with respect to Section 2 because no operations or production.
- Lessors signed leases with Tier 1 Resources Partners covering Section 2
- Delaware Basin sued Tier 1 and the lessors to enforce its right to develop Section 2.

Tier 1 Res. Partners v. Delaware Basin Res. LLC

- Lessors:
  - the reference to "separately designated tracts" in the Addendum must be construed as the two sections, requiring DBR to begin drilling on each section to perpetuate the lease
  - Because of DBR's failure to commence drilling on Section 2 before the primary term's expiration, the leases terminated with respect to Section 2
  - free to lease Section 2 to Tier 1.
- Delaware Basin:
  - the reference to "the land shall be deemed to contain 1280 acres" means that Section 2 and Section 6 shall be treated as a single tract, and operations on Section 6 hold Section 2
  - "separately designated tracts" language gave DBR the *option* to treat as separate leases
- Court:
  - the lease created separate leases over Section 6 and Section 2
  - the lease set forth a clear, precise, and unequivocal special limitation in each lease
  - DBR's lease of Section 2 terminated at the end of the primary term when no operations had been conducted on that specific tract.

Tier 1 Res. Partners v. Delaware Basin Res. LLC

- The "notwithstanding" clause of the addendum indicated that what followed in the addendum must control over the preceding paragraphs
- The "object" clause ("each of the separately designated tracts described shall be treated for all purposes as a separate and distinct Lease") references multiple "tracts", which necessarily means the two separate, non-contiguous tracts of land found earlier in the lease (Section 2 and Section 6)
- The "action" clause ("shall be treated for all purposes as a separate and distinct Lease") was unambiguous and clear that the separate tracts are to be treated as being held by separate leases and that each provision of the lease is to be applied to each tract individually

Questions?

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