Trending Oil and Gas Litigation

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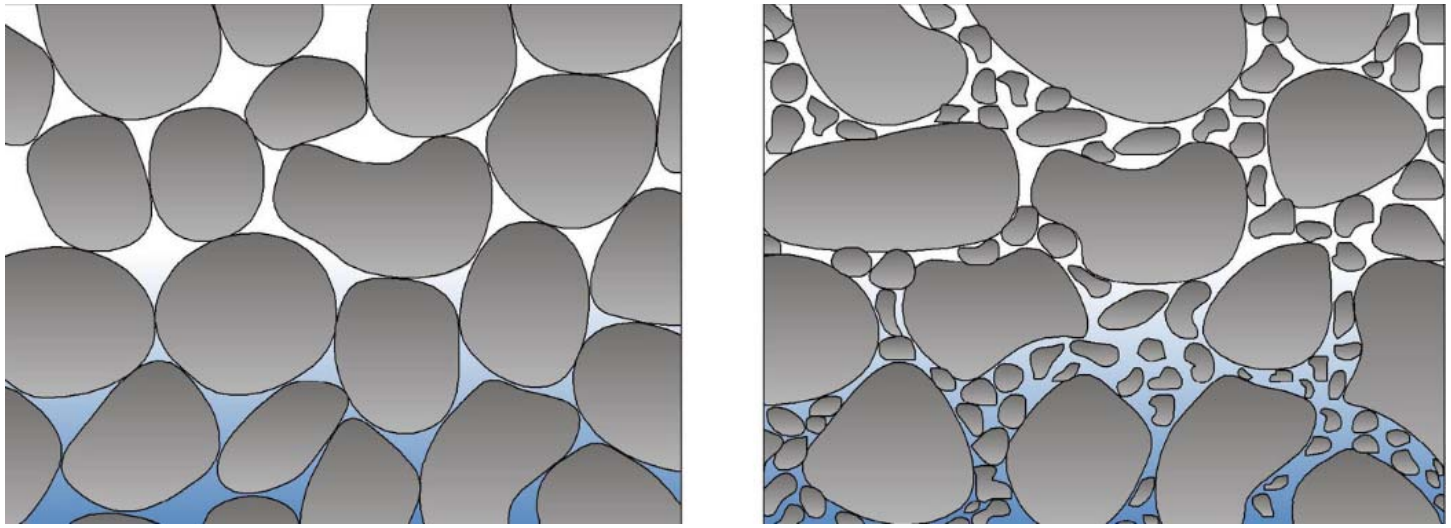
Setting precedent.

Overview

- The Basic Quest
- Unconventional Revolution Trends
- Key Cases
- The Predicted Trend

The Basic Quest

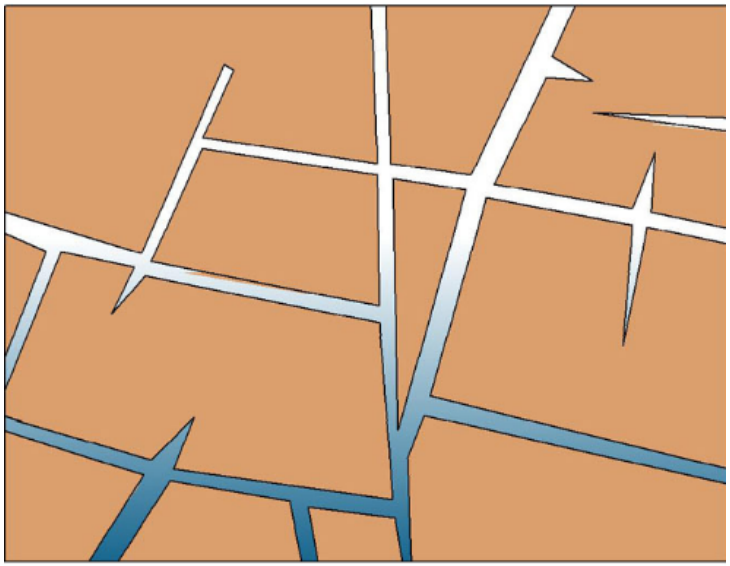
- (Oil and gas) + (porosity and permeability)



Source: http://coloradogeologicalsurvey.org/apps/wateratlas/images/fig2_1hi.jpg

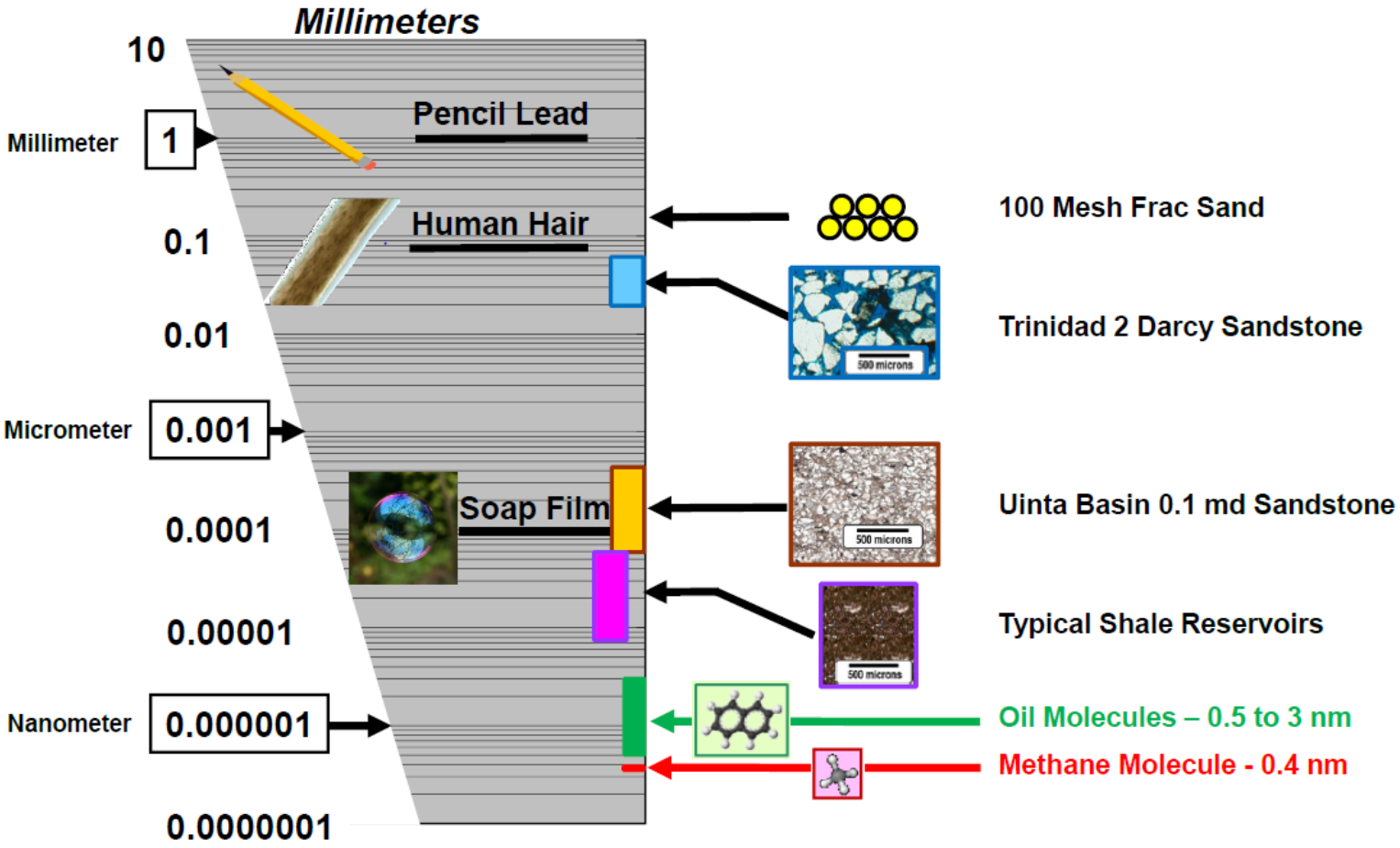
The Basic Quest

- *Effective* porosity and permeability:



Source: http://coloradogeologicalsurvey.org/apps/wateratlas/images/fig2_1hi.jpg

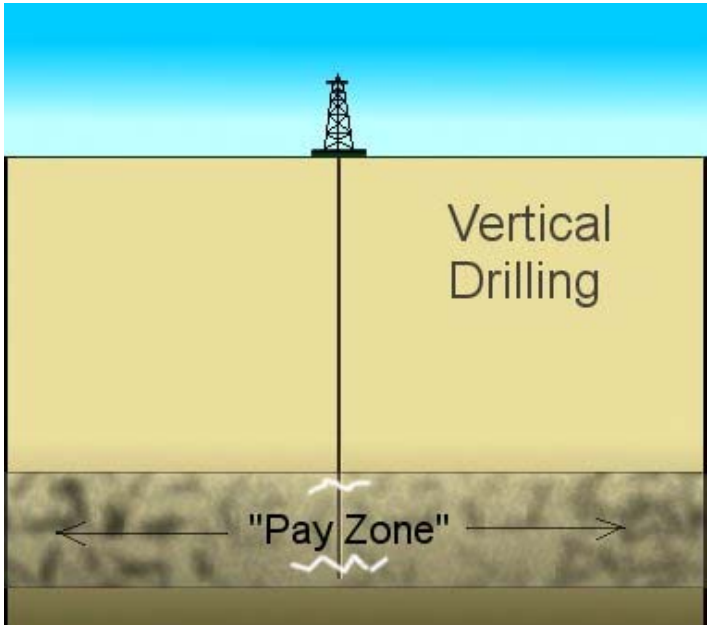
EOG Resources
Pore Throat Sizes



Source: EOG Resources presentation available at http://www.rationalinvesting.com/present/eog.pdf

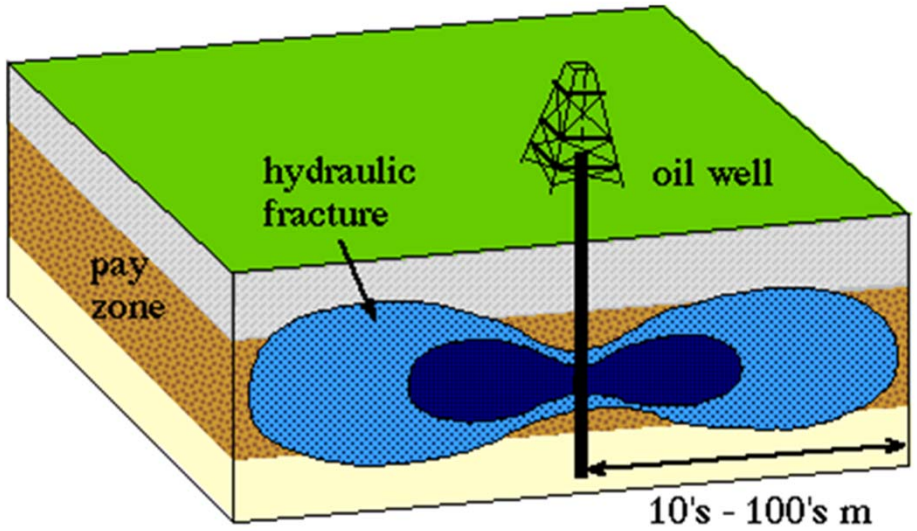
The Old Technology

- For decades, primarily “vertical” wells
- 5” - 7” diameter well draining acres of rock



The Old Technology

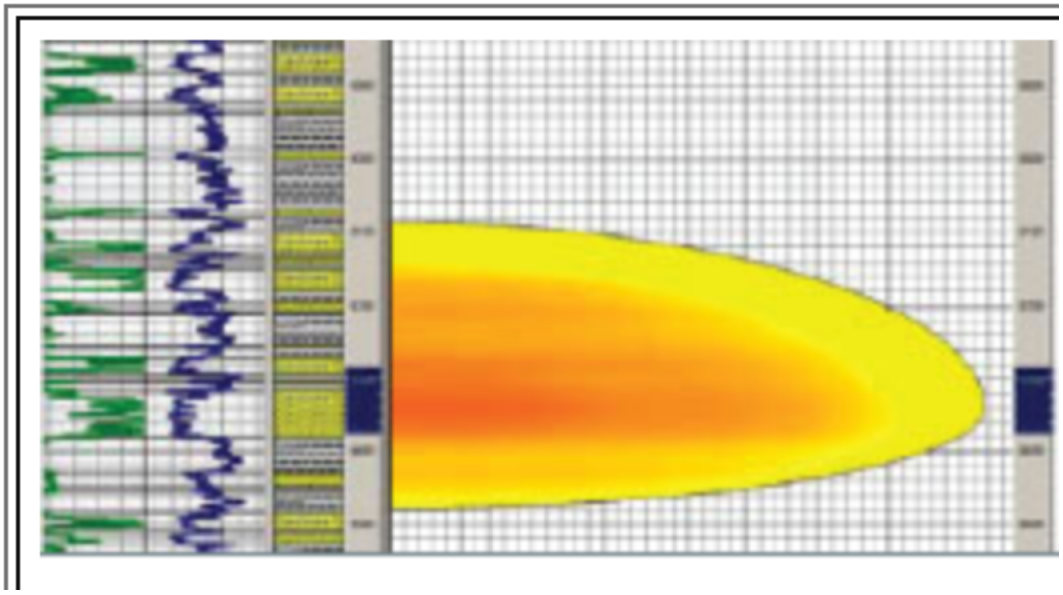
- For decades, hydraulically-fractured vertical wells to overcome low permeability



Source: http://www.cfg.cornell.edu/projects/HydroFrac/HydroFracProj.htmlf

The Old Technology

- Limited by size/reach of the fracture:



Source: http://www.halliburton.com/en-US/ps/solutions/unconventional-resources/tight-gas-complex-gas/challenges-solutions/calibrated-fracture-models.page?node-id=hgjyd46u

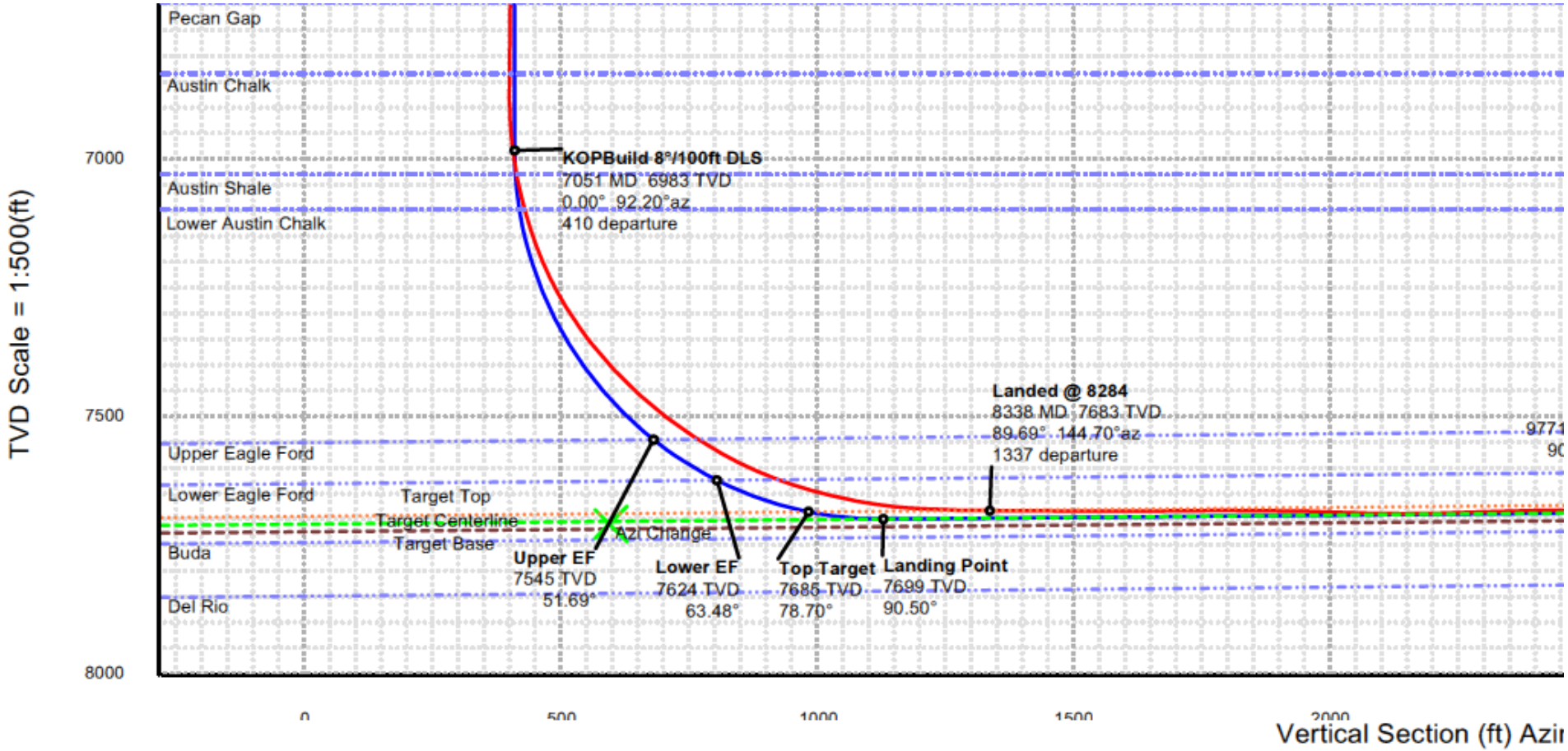
The Old Technology

- Frac “wings” extend along the path of least resistance, little control over placement.
- Oil and gas must still flow substantial distances through rock to reach the frac wings.

The Two-Pronged Shale "Revolution"

- New technology:
  - Horizontal drilling with accurate steering and measuring "on the fly"
  - Multi-stage hydraulic fracturing of horizontally drilled wells, producing more fractures

Example Horizontal Drilling



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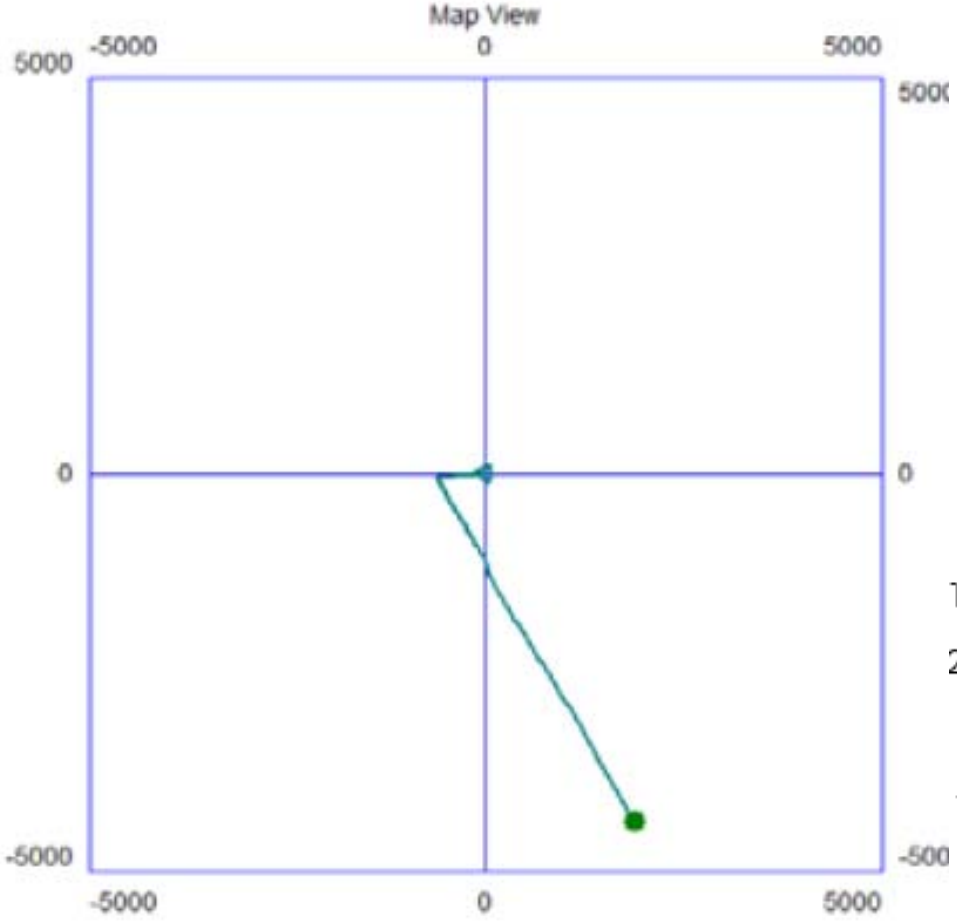
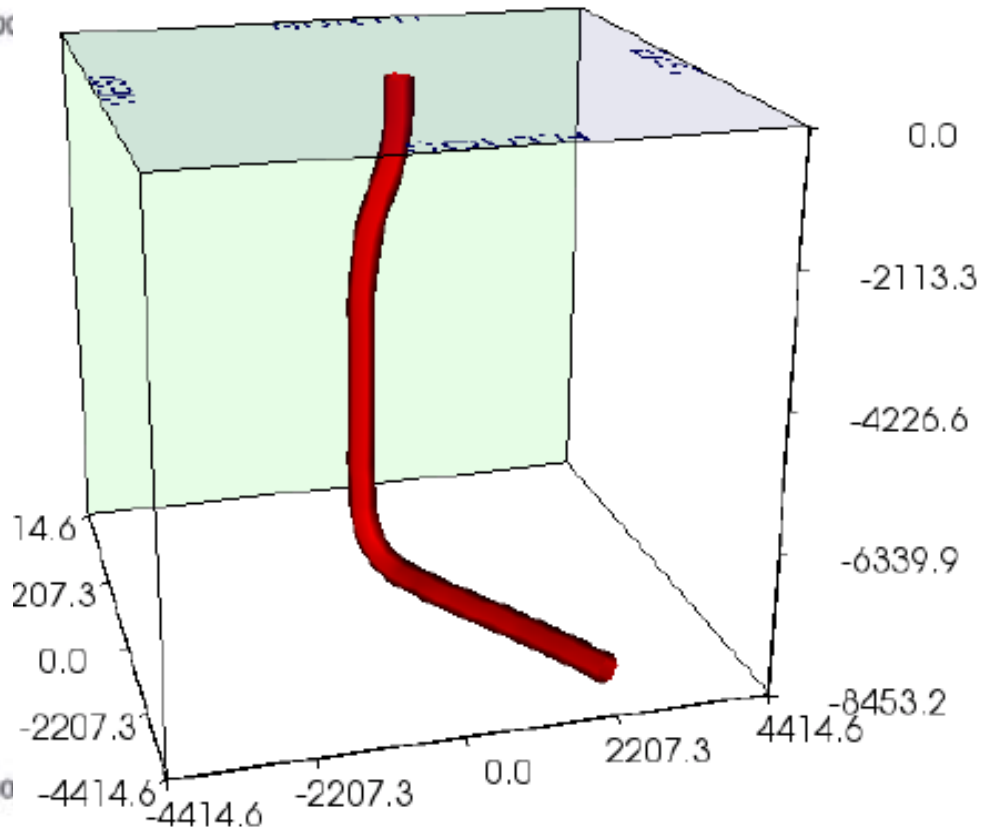
Top Down and 3D View of Horizontal Well





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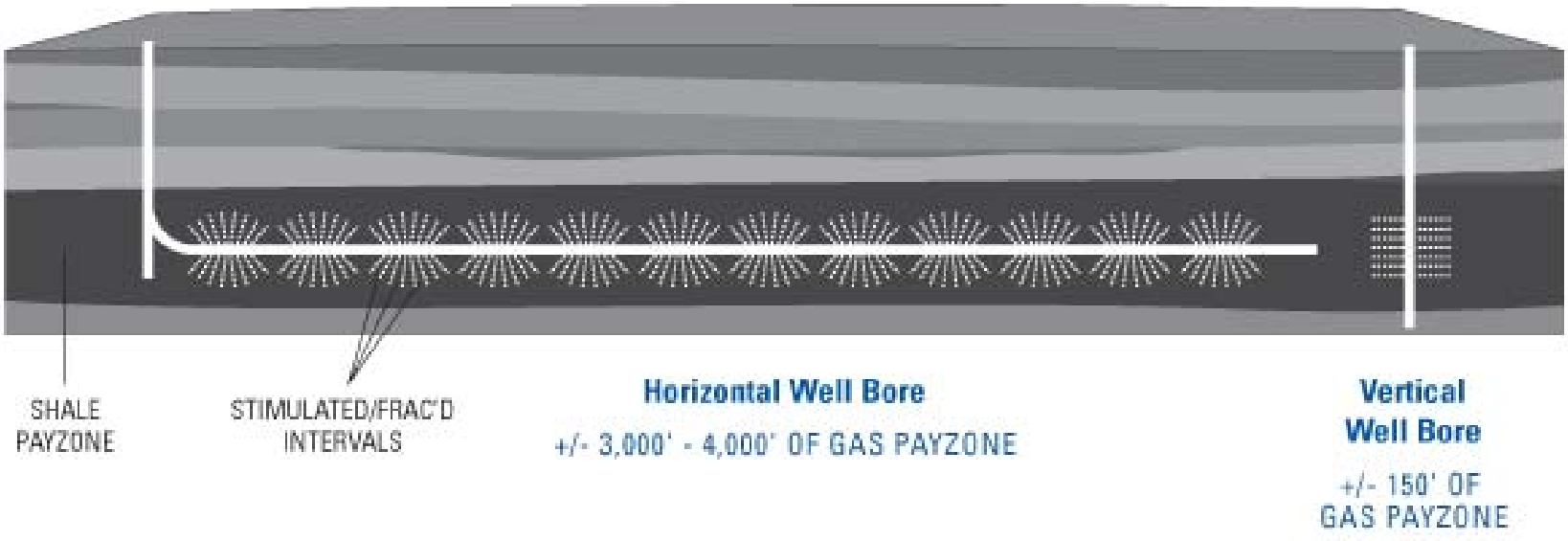
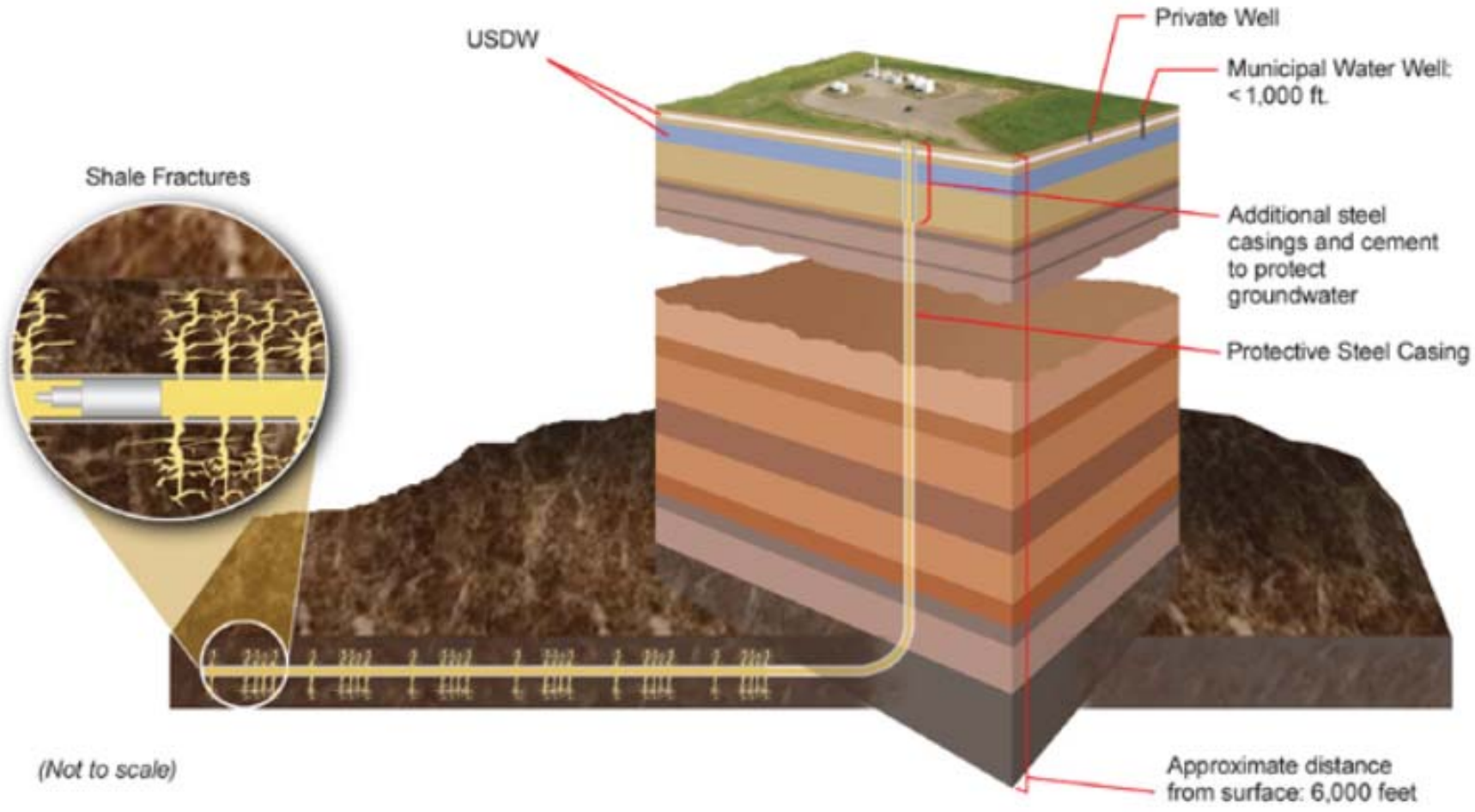
Horizontal vs. Vertical



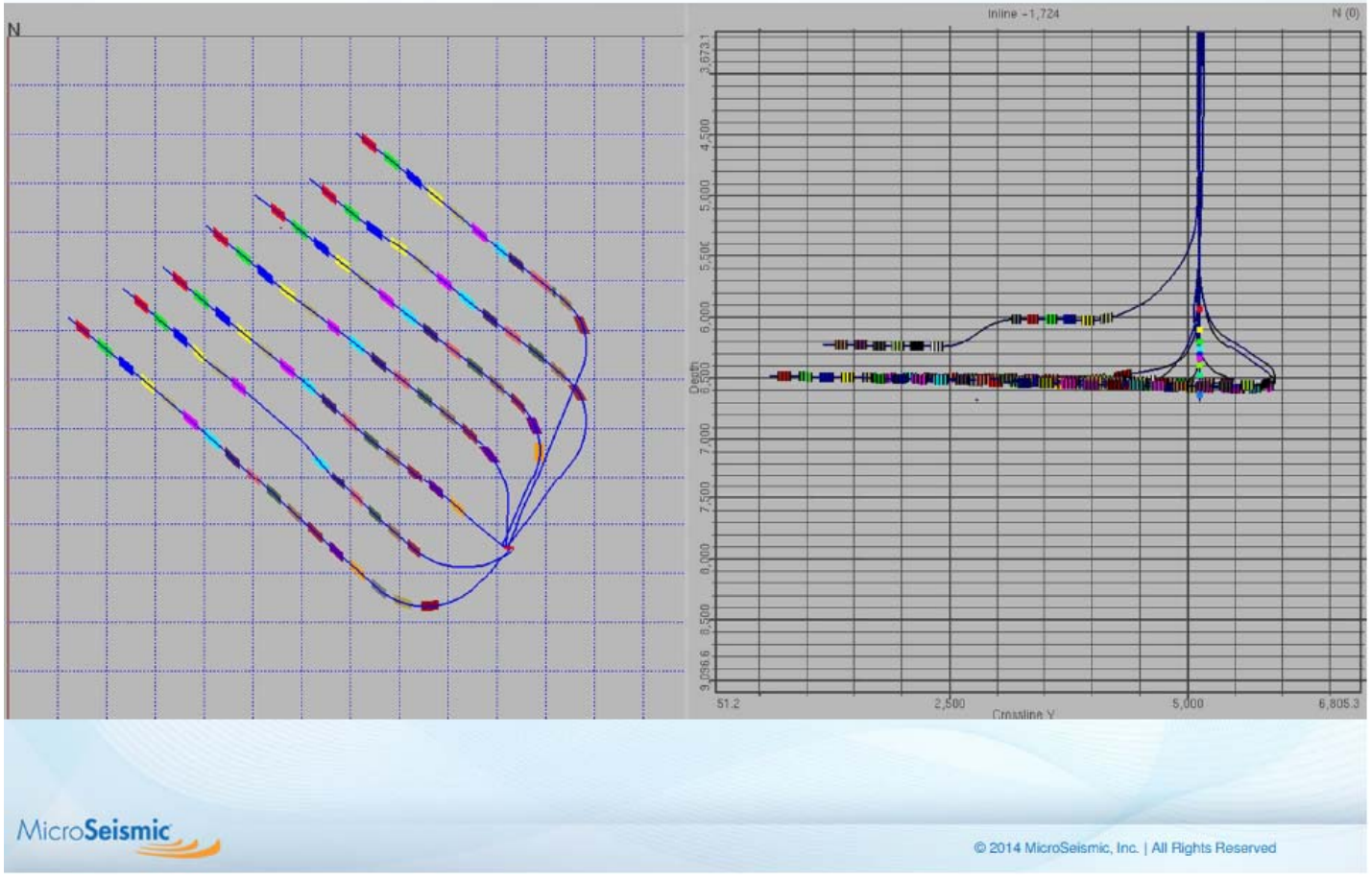
Source: West Virginia Surface Owners' Rights Organization: : http://www.wvsoro.org/resources/marcellus/horiz_drilling.html



Source: US Energy Dept., http://energy.gov/fe/hydraulic-fracturing-technology

Microseismic Technology

Watching Fractures Grow



Source: Peter Duncan at MicroSeismic, Inc., with permission

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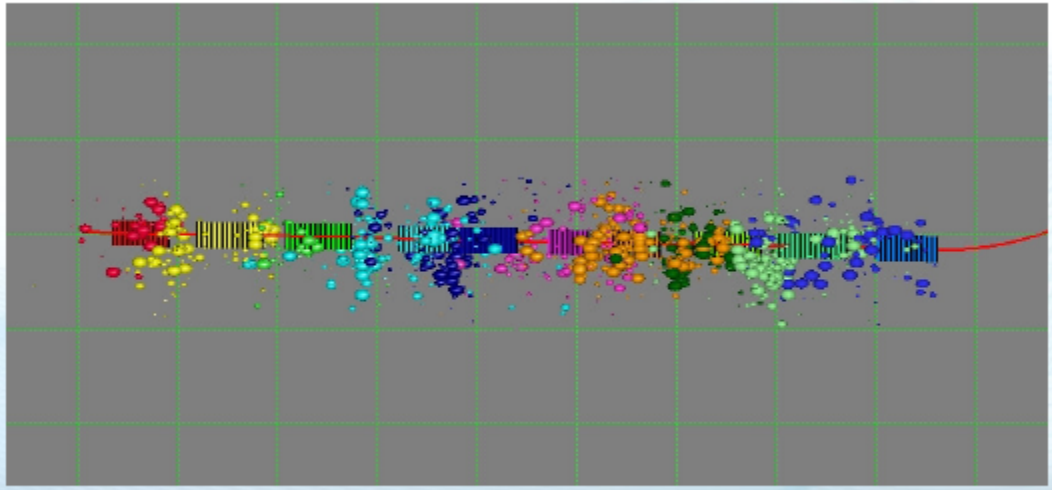
Visualizing the Fractures



MicroSeismic

Source: Peter Duncan at MicroSeismic, Inc., with permission

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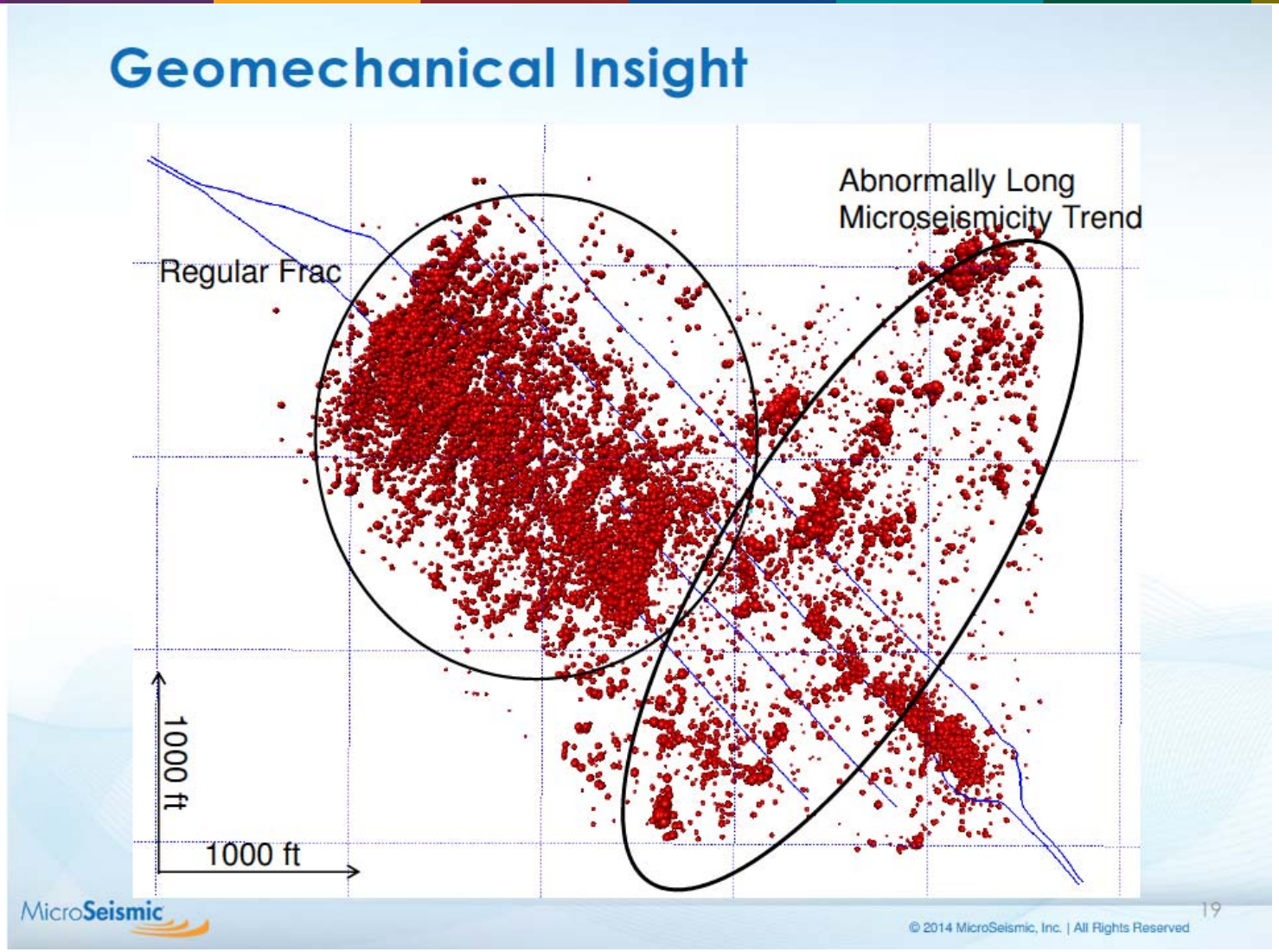

Source: Peter Duncan at MicroSeismic, Inc.. with permission

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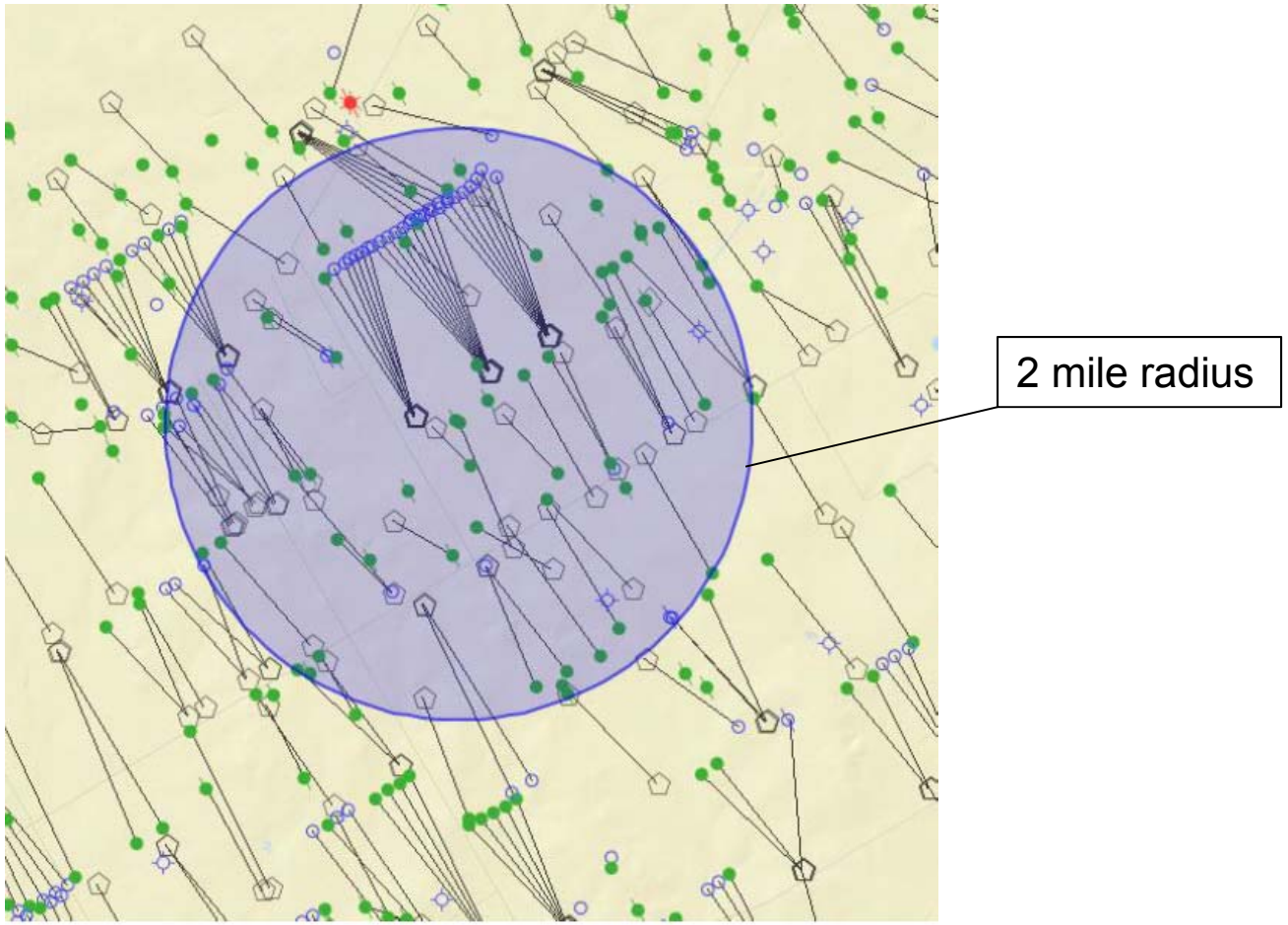
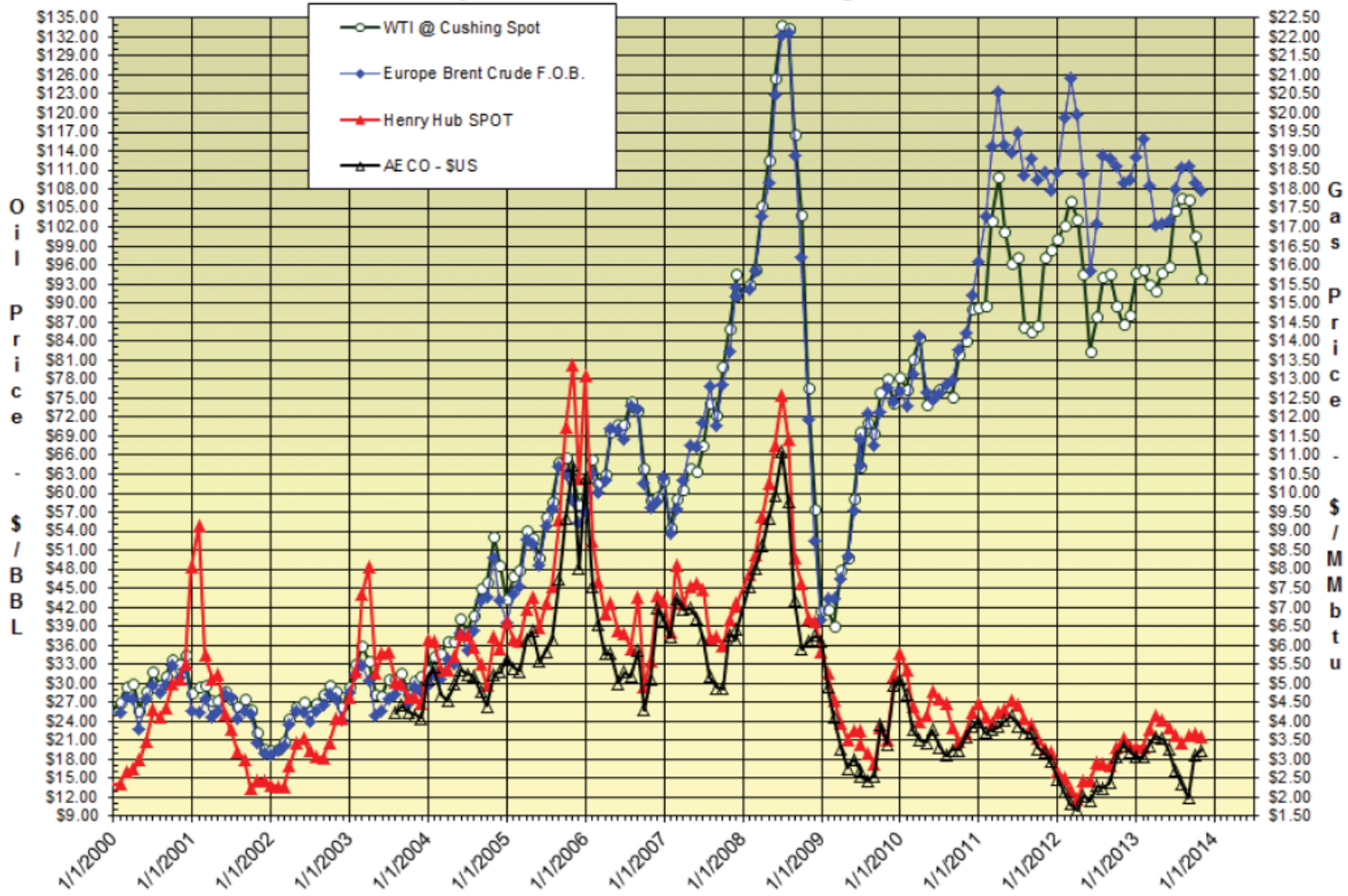
Example Horizontal Well Spacing



Oil and Gas Price Trends

- Relatively low gas prices as the unconventional technology takes hold
- Spurs focus on oil/condensate

Price history of benchmark oil and gas in U.S. dollars

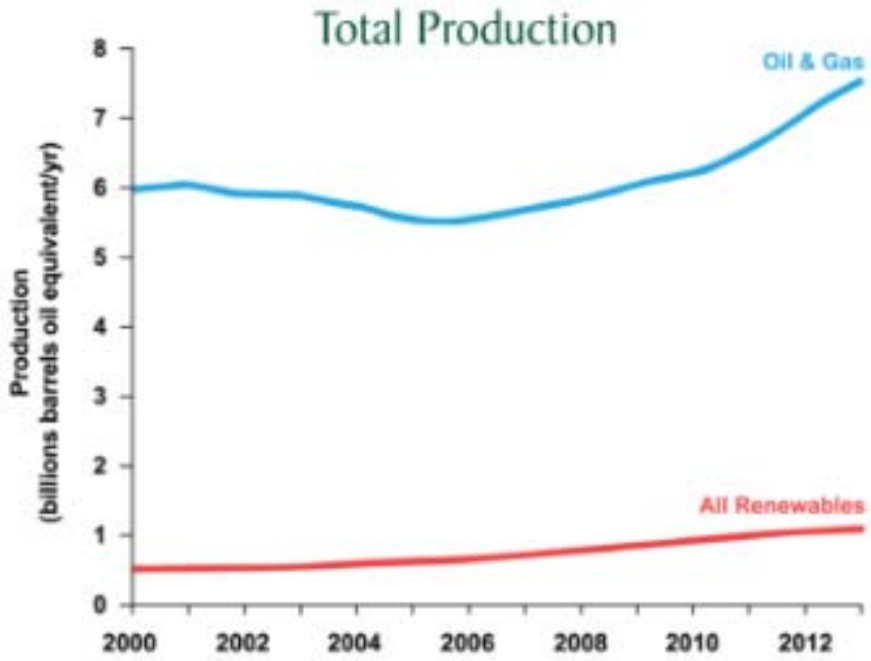


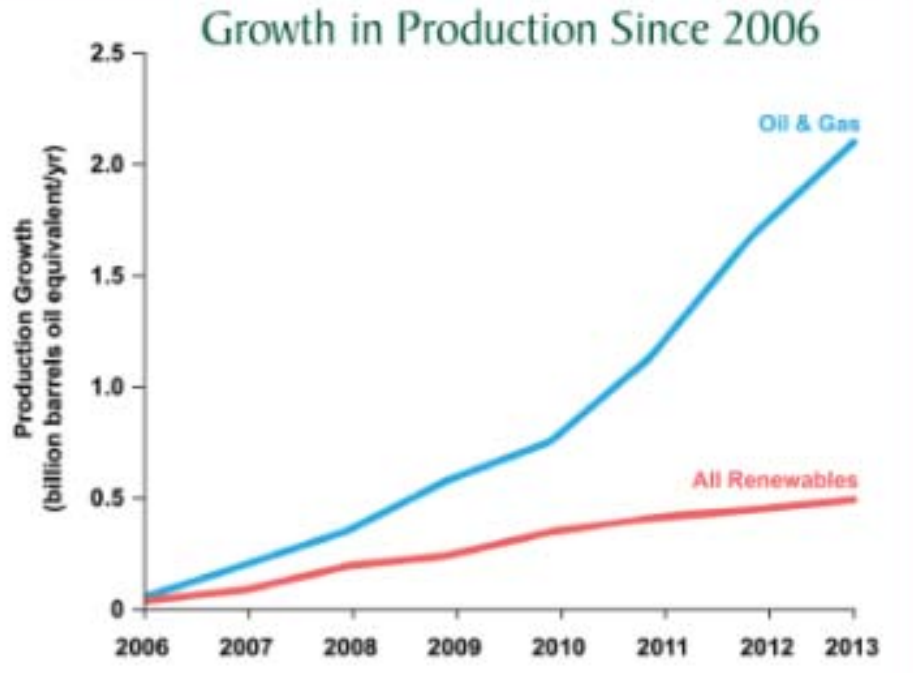
Source: Ryder Scott: http://www.ryderscott.com/Newsletters/index.php

The Economic Trend

- US oil and gas industry reverses multi-decade trend of decline
- Dramatic increase in oil/condensate production
- Dramatic expansion of oil and gas commerce in US

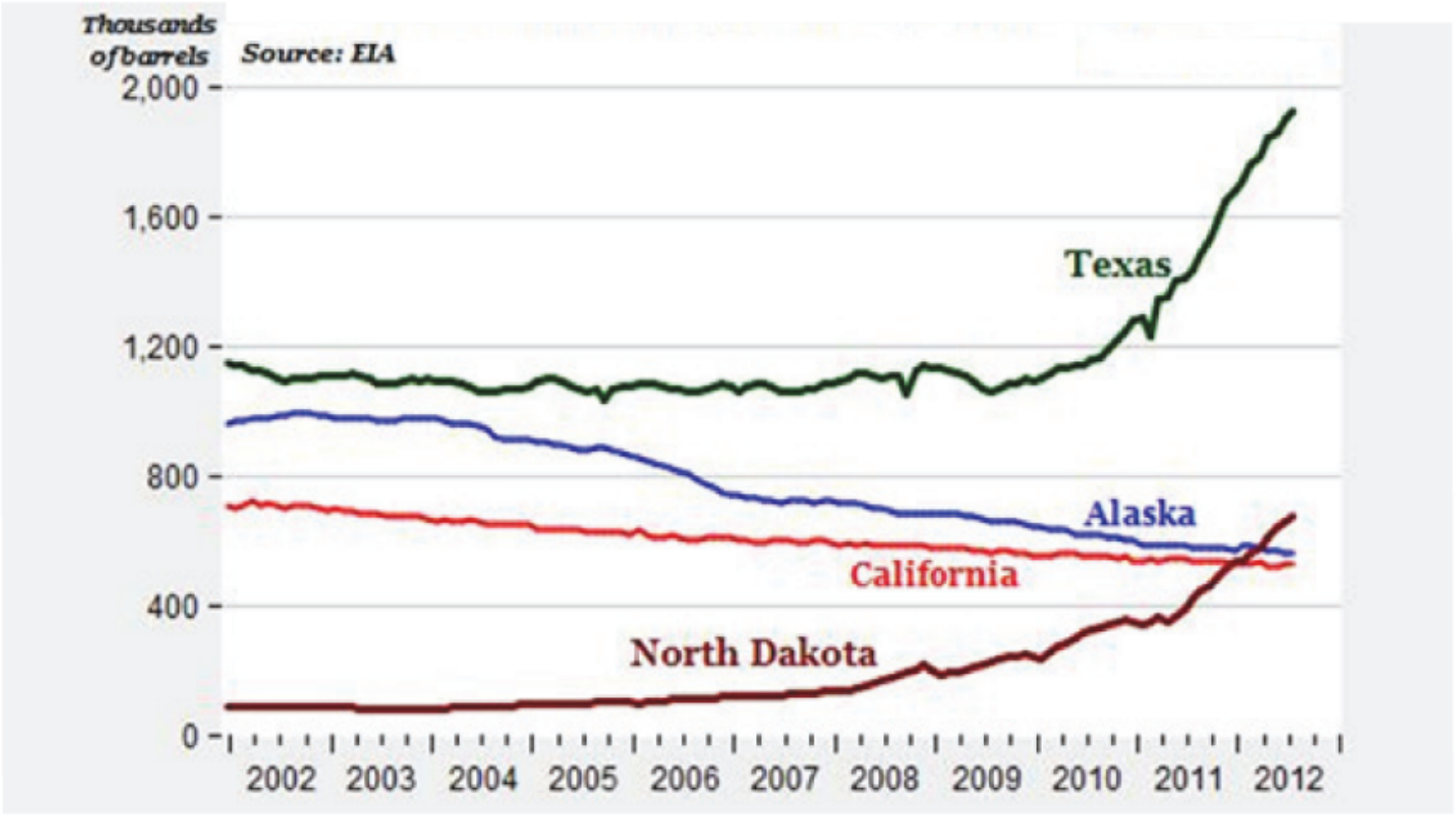
AMERICA'S SOARING OIL & GAS OUTPUT



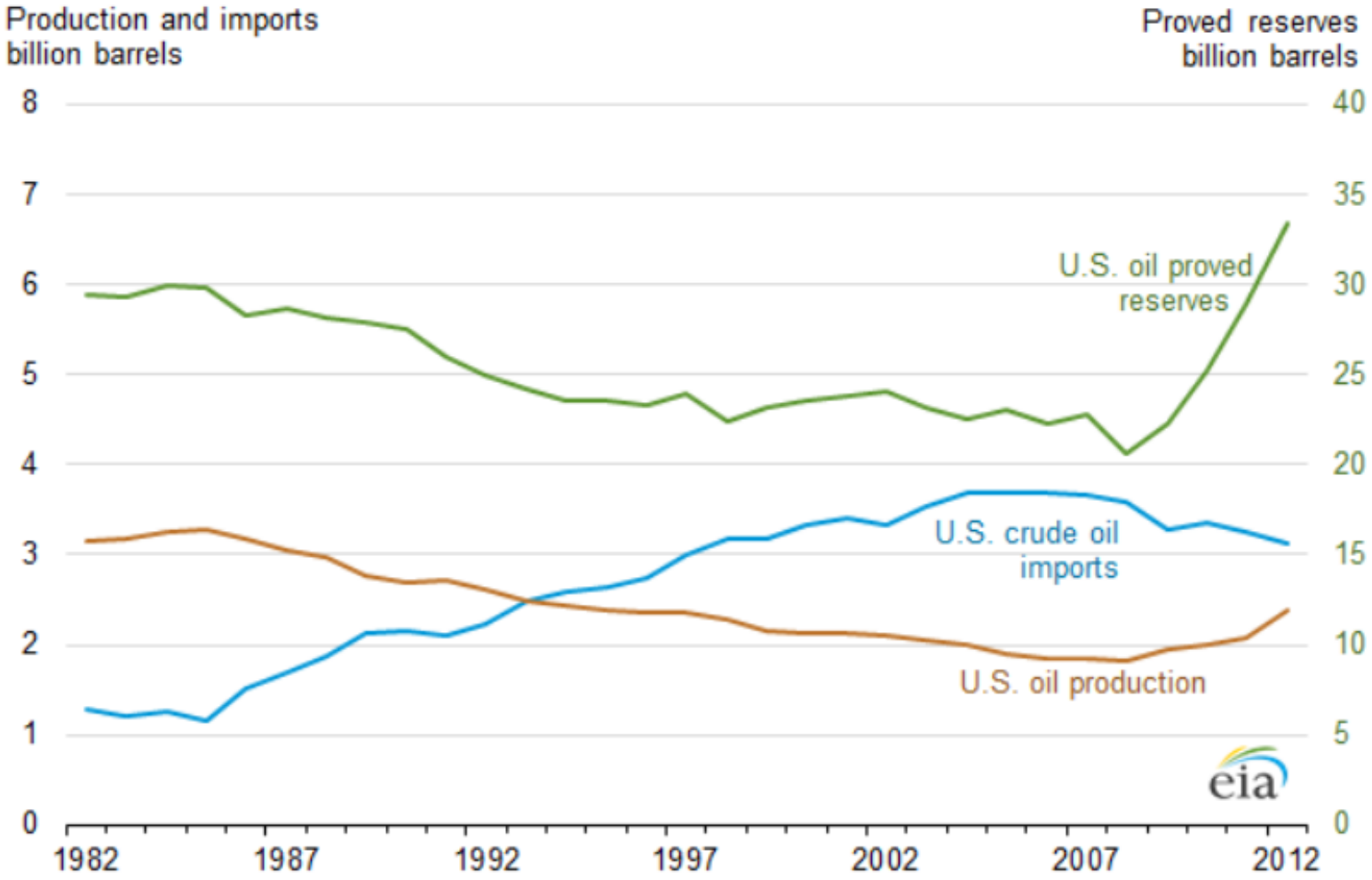


Source: US Chamber of Commerce, https://www.uschamber.com/blog/4-charts-show-how-impressive-shale-energy-boom

Daily Oil Production in the Top 4 U.S. Oil-Producing States 2002-2012

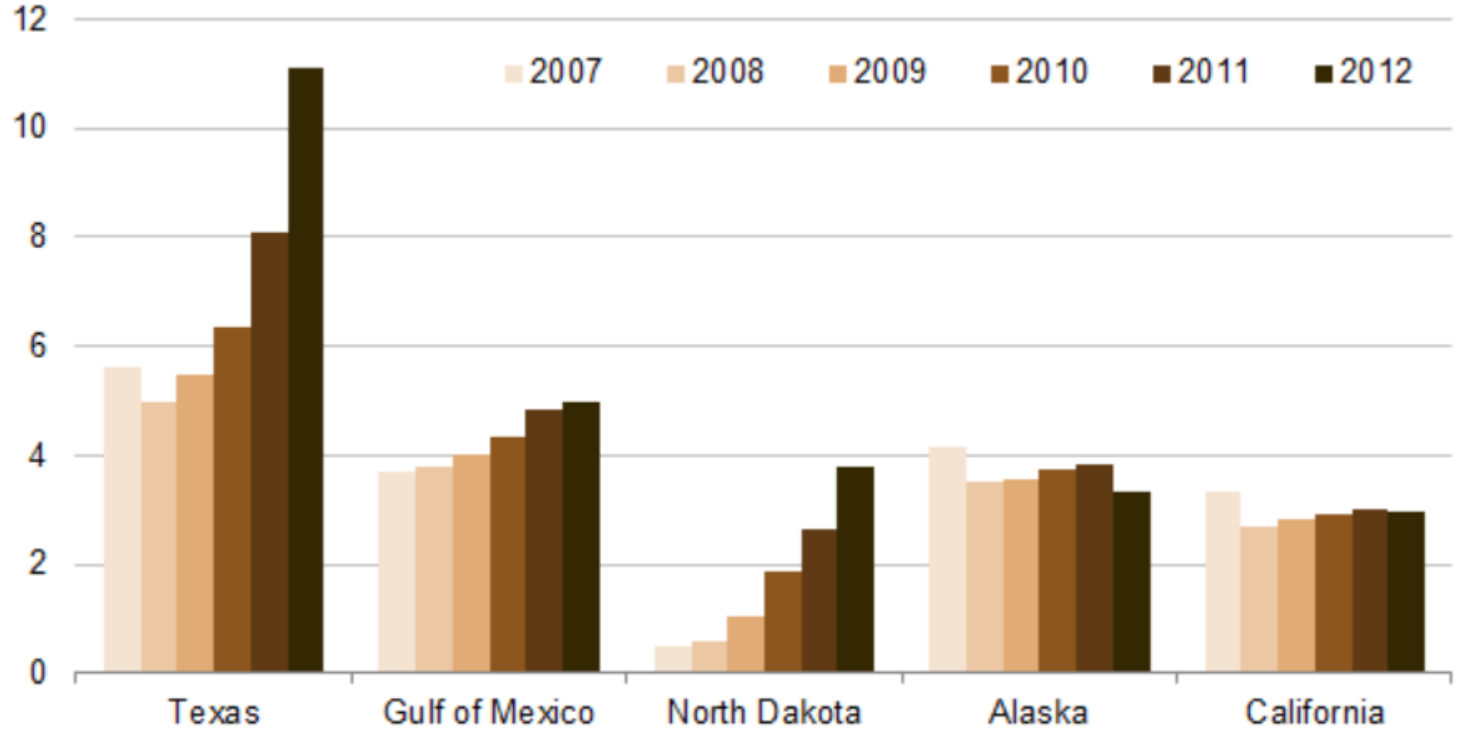


Source: Data from U.S. Energy Information Administration/Graphic by the American Enterprise Institute (October 28, 2012)



Source: http://www.eia.gov/naturalgas/crudeoilreserves/

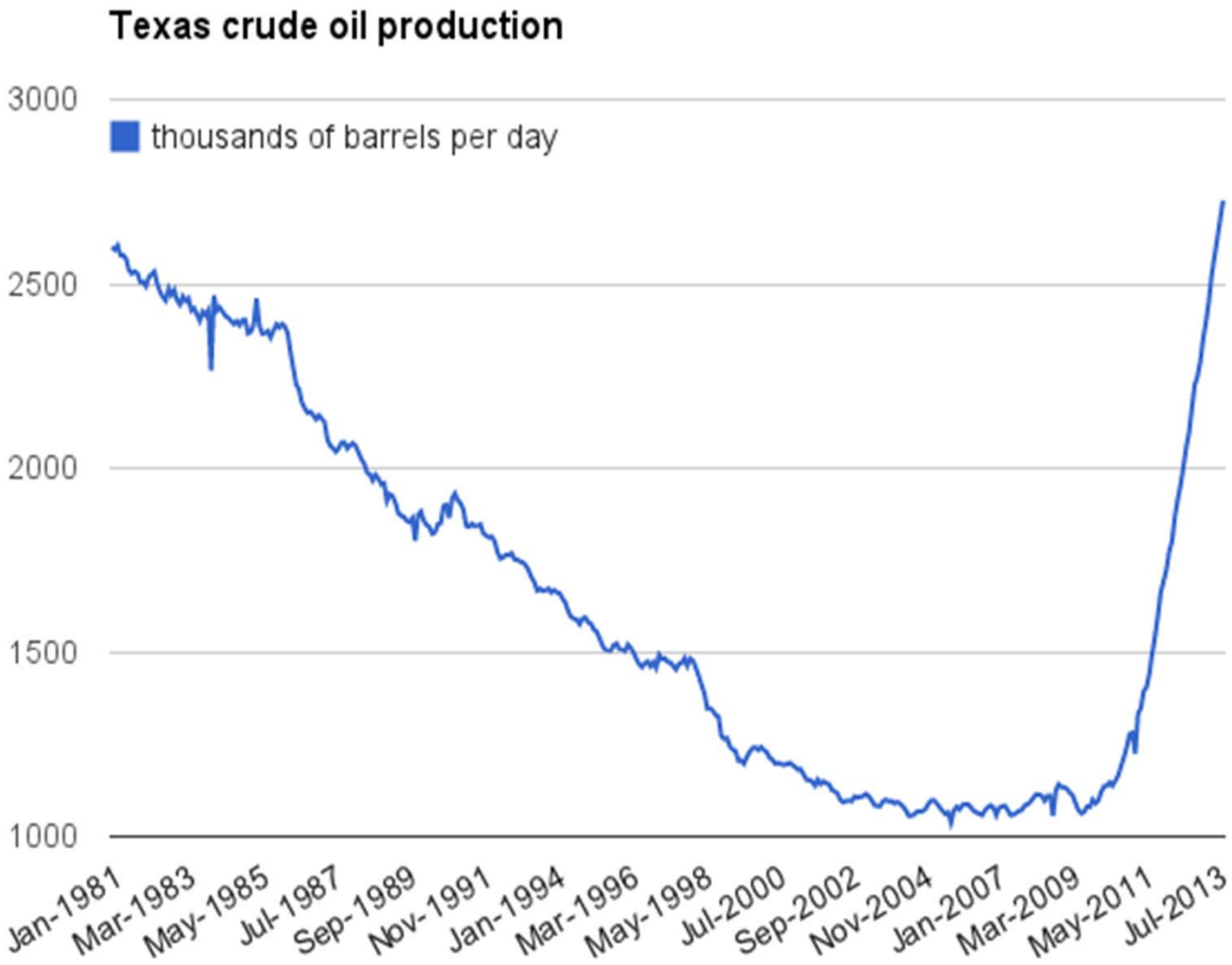
Proved reserves of the top five U.S. oil reserve states, 2007-12



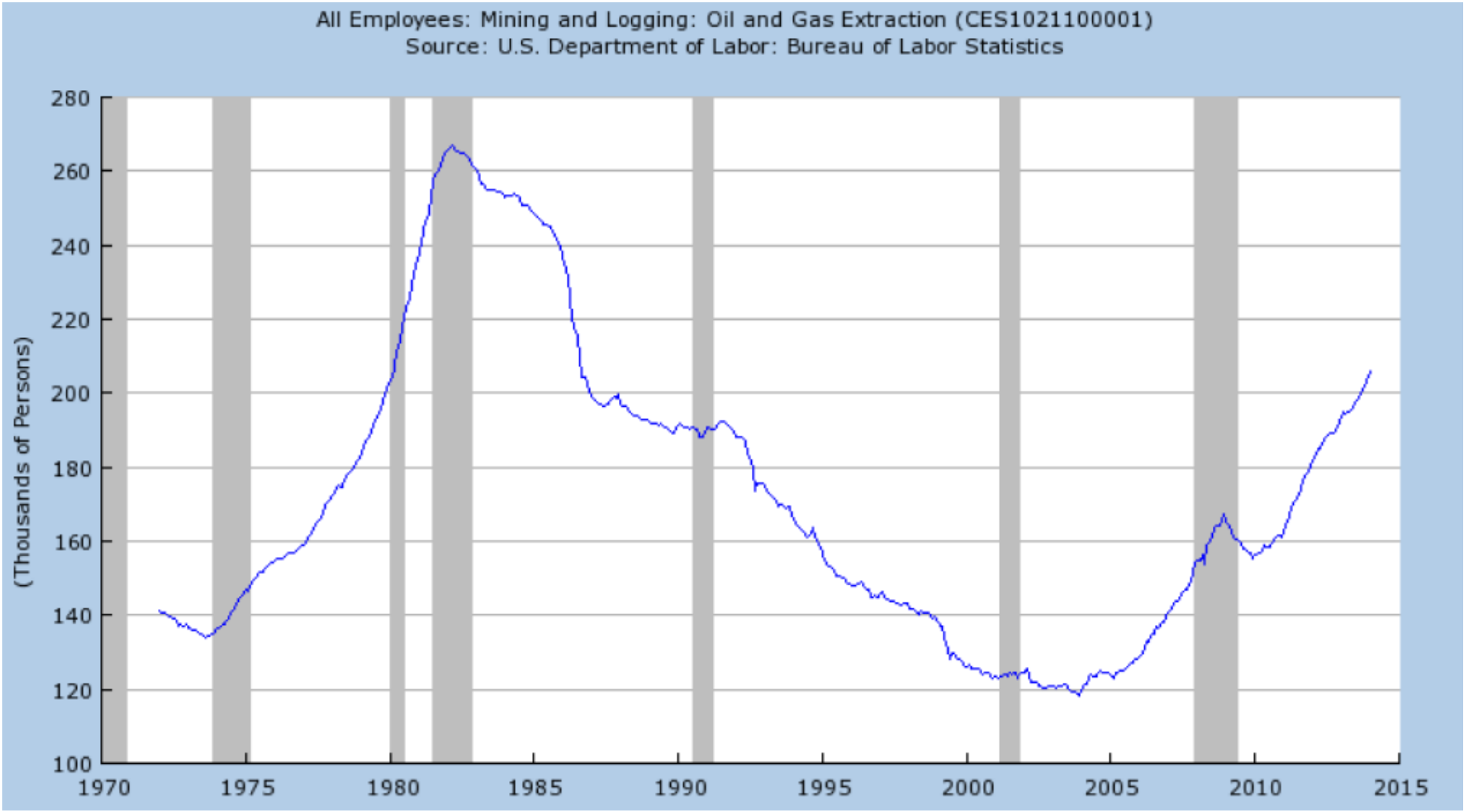
Notes: Includes crude oil and lease condensate. "Gulf of Mexico" (not a state) refers instead to the Federal offshore waters of the Gulf of Mexico. The state offshore portions of Texas, Alaska, and California are included in the state subtotal.
Source: U.S. Energy Information Administration, Form EIA-23L, "Annual Survey of Domestic Oil and Gas Reserves," 2007-12.

eia

Source: http://www.eia.gov/naturalgas/crudeoilreserves/



Source: http://fuelfix.com/blog/2013/12/03/new-data-shows-meteoric-rise-of-texas-oil/



St. Louis Federal Reserve Bank: http://research.stlouisfed.org/fred2/graph/?s[1][id]=CES1021100001

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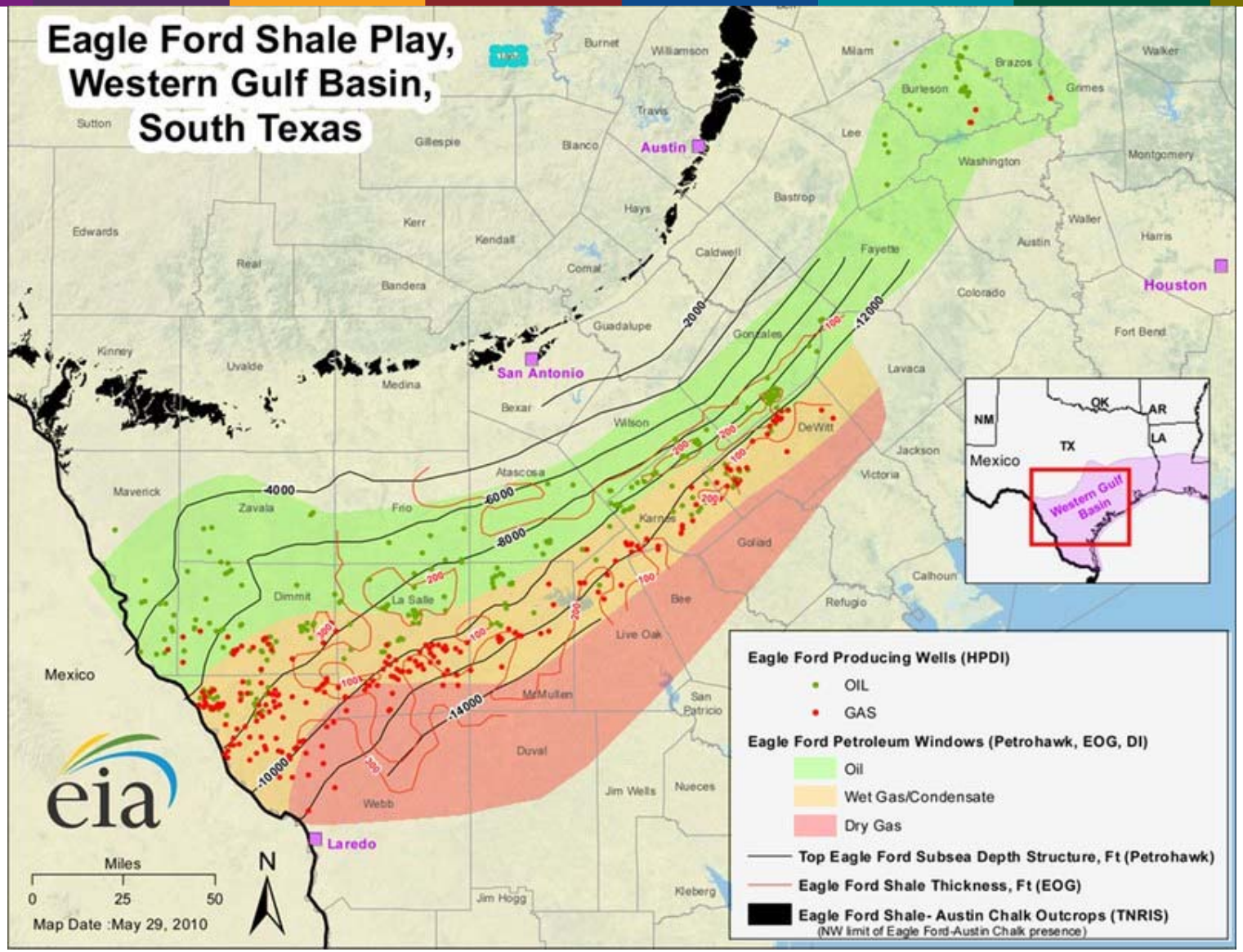
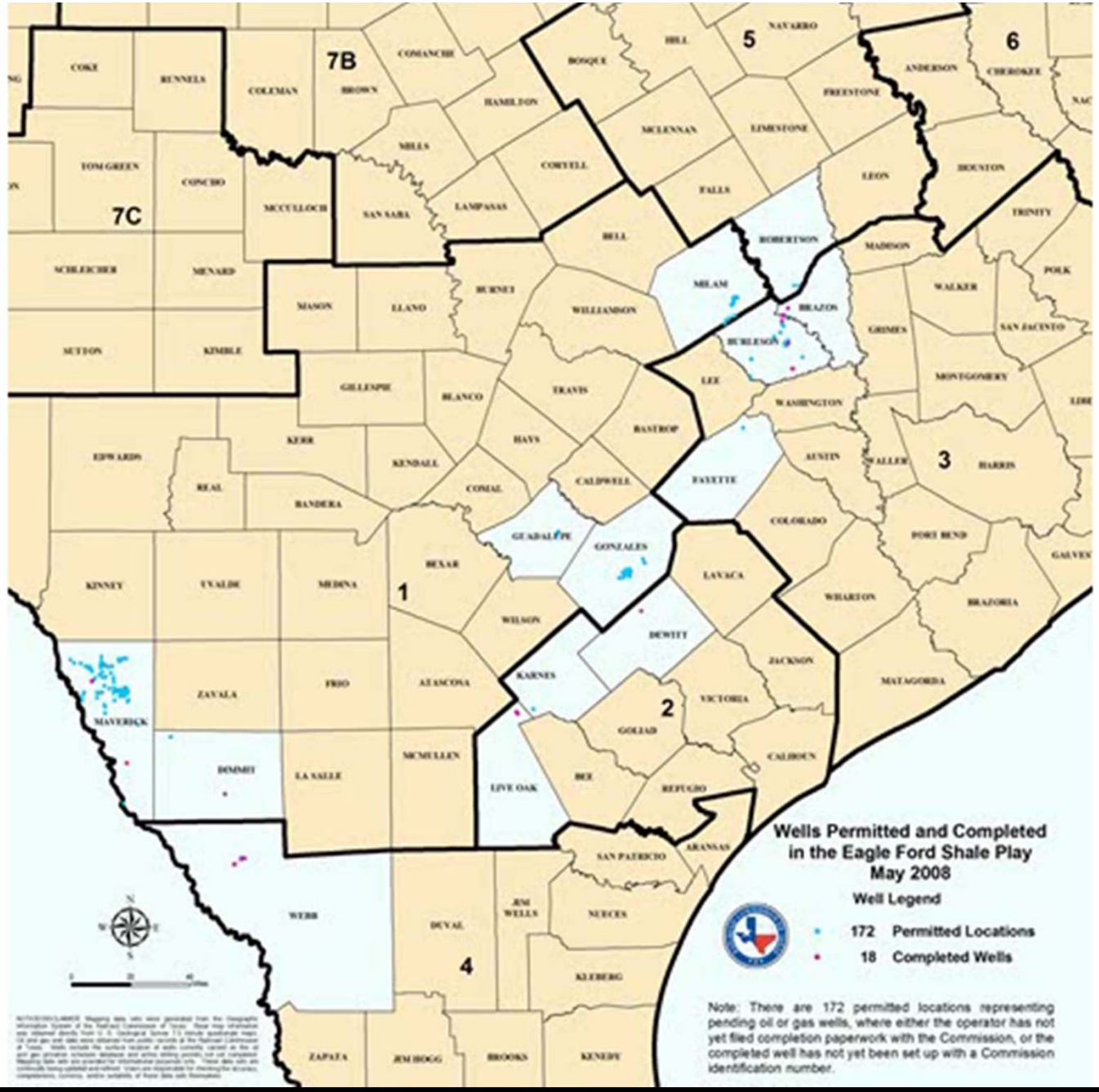
“Hot” Texas Development Areas

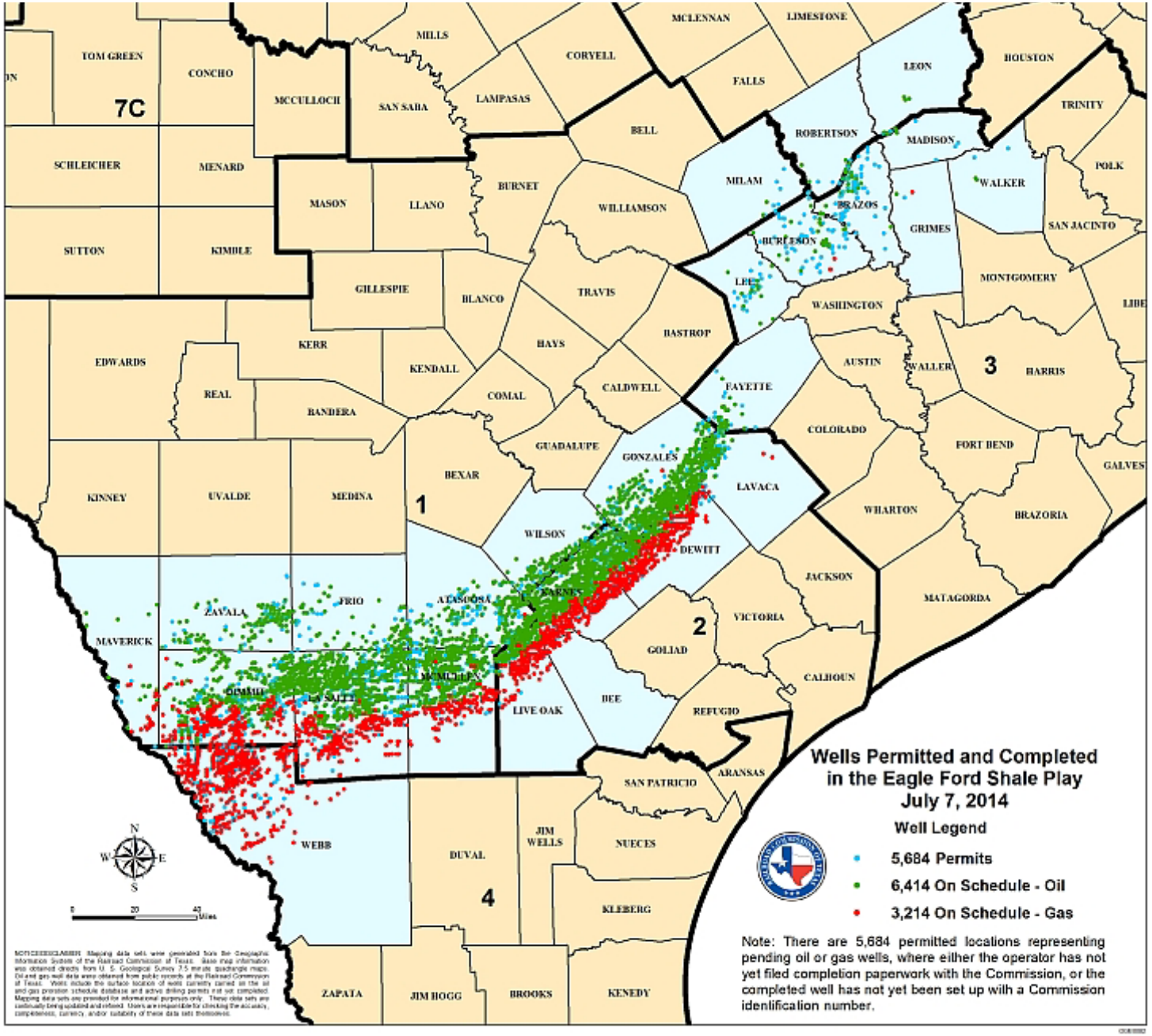
- Eagle Ford shale region
  - expected to reach 1 MPD in 2014
  - 1.6MPD peak in 2020
- Permian Basin
  - at ~1 MPD in 2013
  - currently largest concentration of drilling rigs in the nation

Eagle Ford Shale

- 2008: Petrohawk drilled first Eagle Ford wells (La Salle County)
- Discovery well flowed at a rate of 7.6 MCFD from a 3,200-foot lateral
- Located in 26 counties







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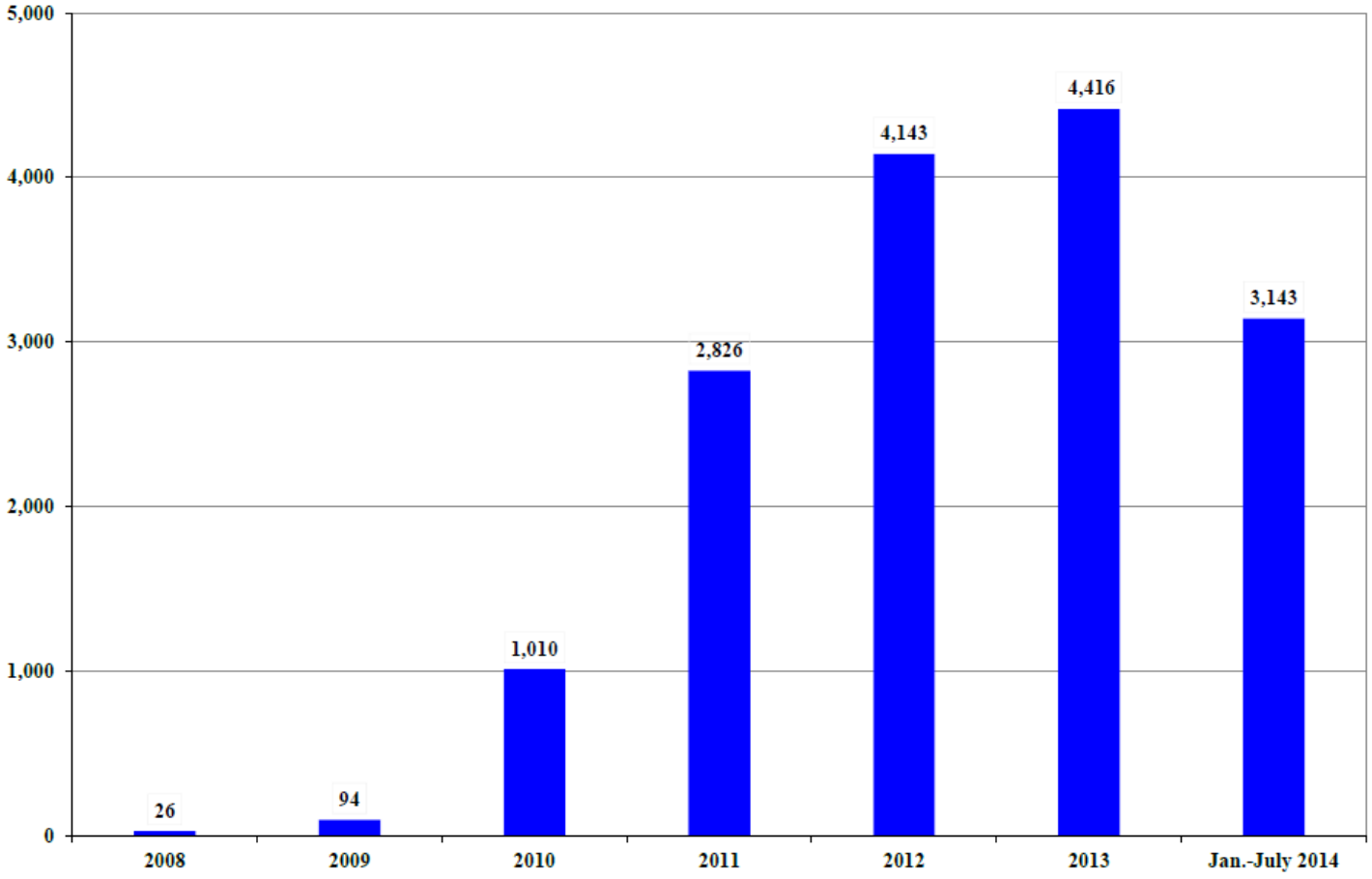
Eagle Ford Shale at Night

Source:http://geology.com/articles/oil-fields-from-space/

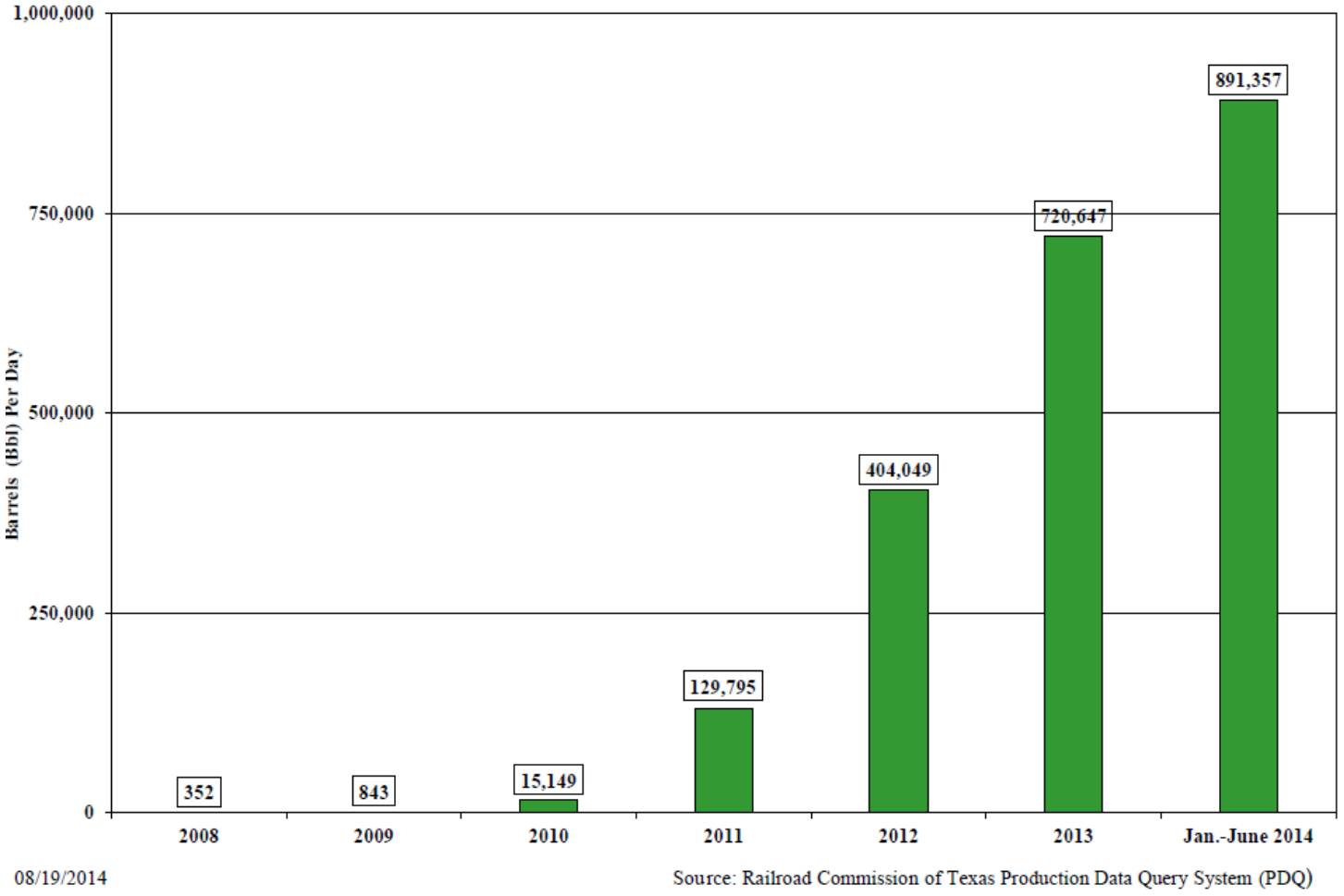
Texas Eagle Ford Shale
Drilling Permits Issued
2008 through July 2014



08/04/2014

Source: Texas Railroad Commission DrillingPermitQuery(Includes New Drill & ReEnter Permits)

Texas Eagle Ford Shale
Oil Production
2008 through June 2014



08/19/2014

Source: Railroad Commission of Texas Production Data Query System (PDQ)

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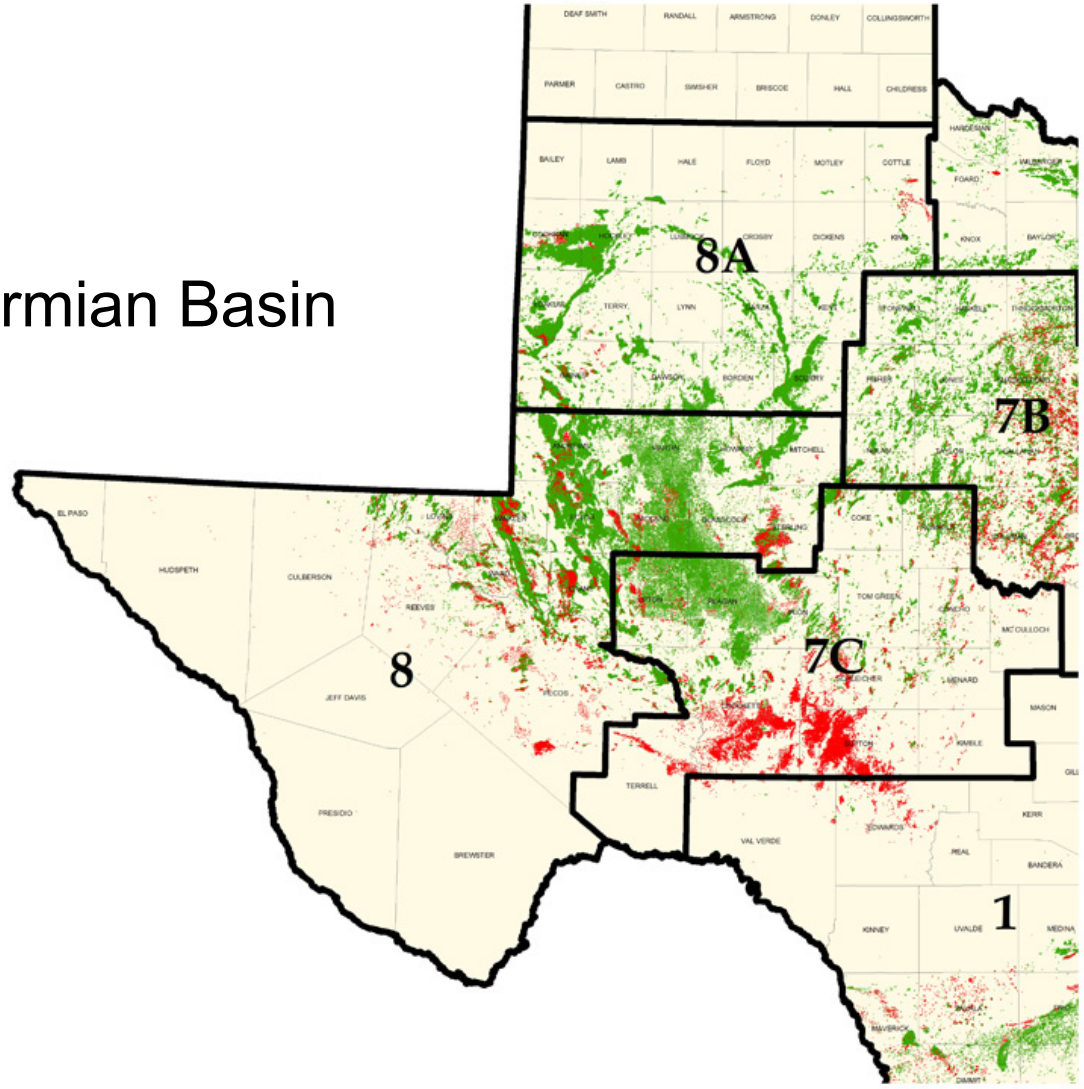
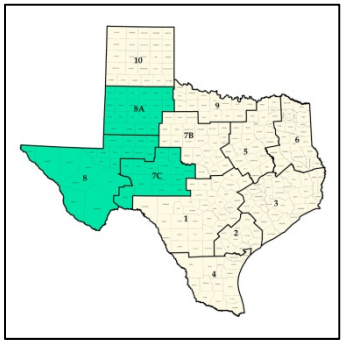
Permian Basin





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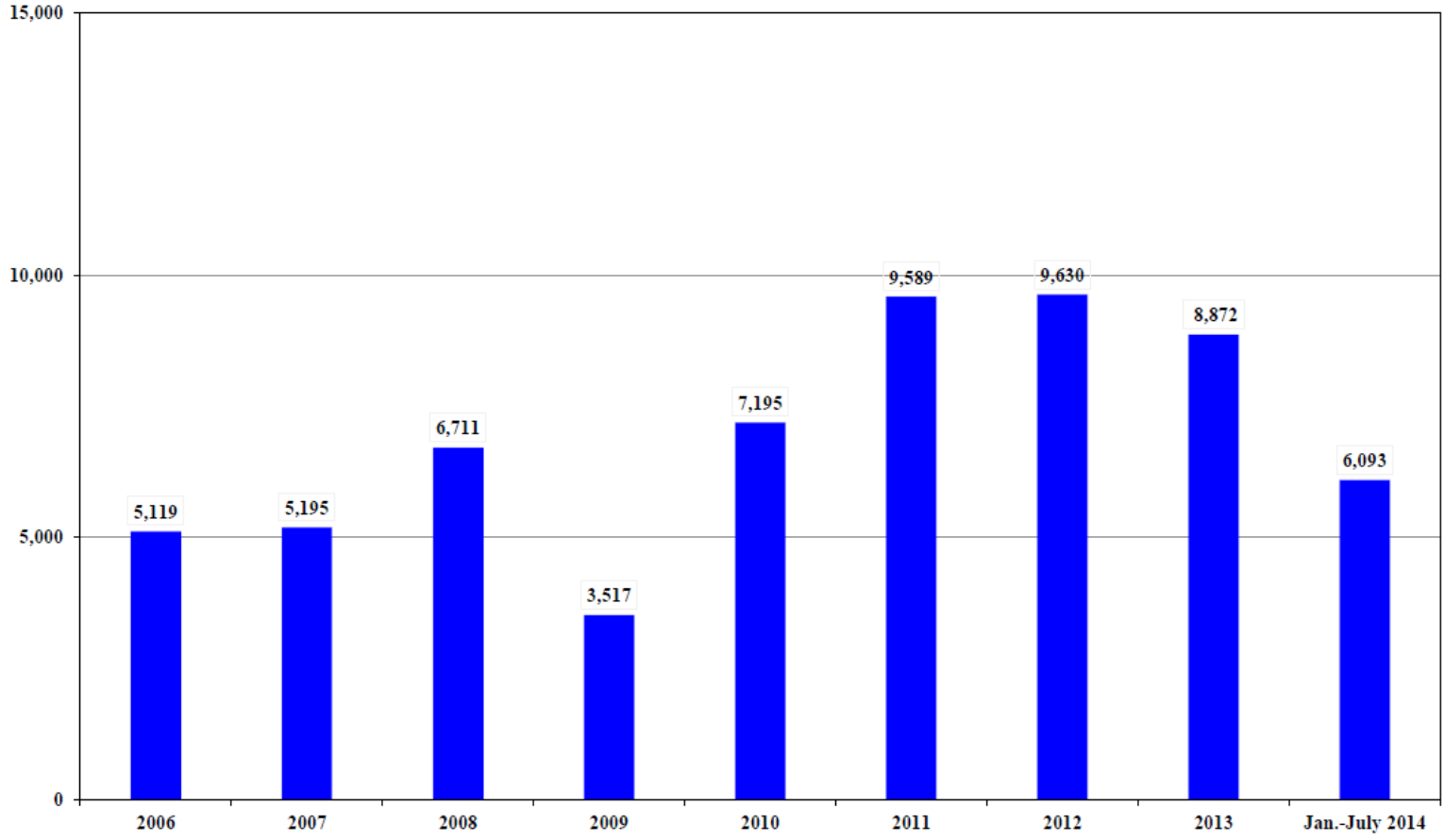
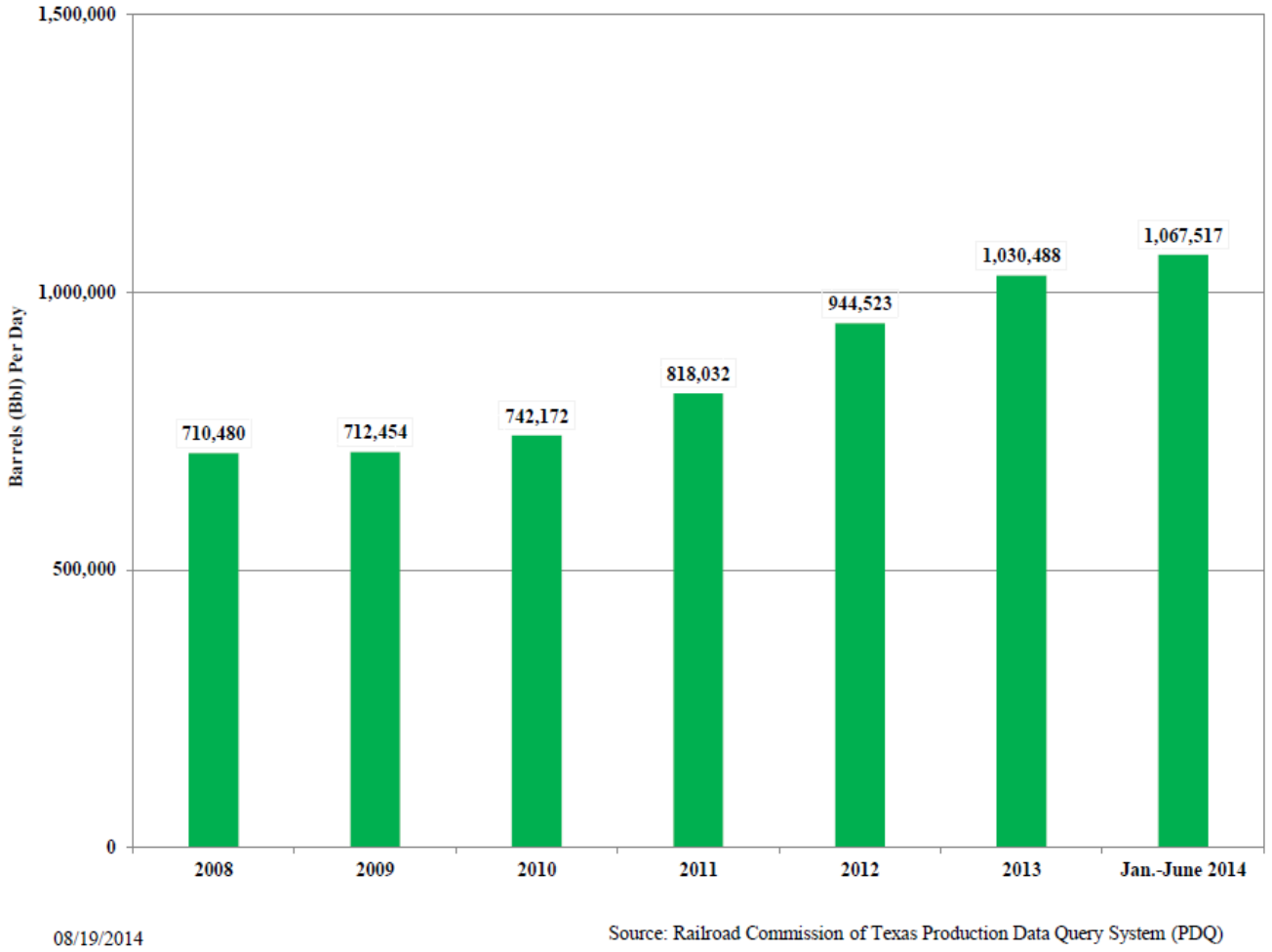
Texas Permian Basin
(District 7C, 08, & 8A)
Drilling Permits Issued
2006 Through July 2014



08/06/2014

Source: Railroad Commission of Texas Drilling Permit Online Query System (Includes New Drill & ReEnter Permits)

Texas Permian Basin
Oil Production
2008 through June 2014



08/19/2014

Source: Railroad Commission of Texas Production Data Query System (PDQ)

Bakken Shale

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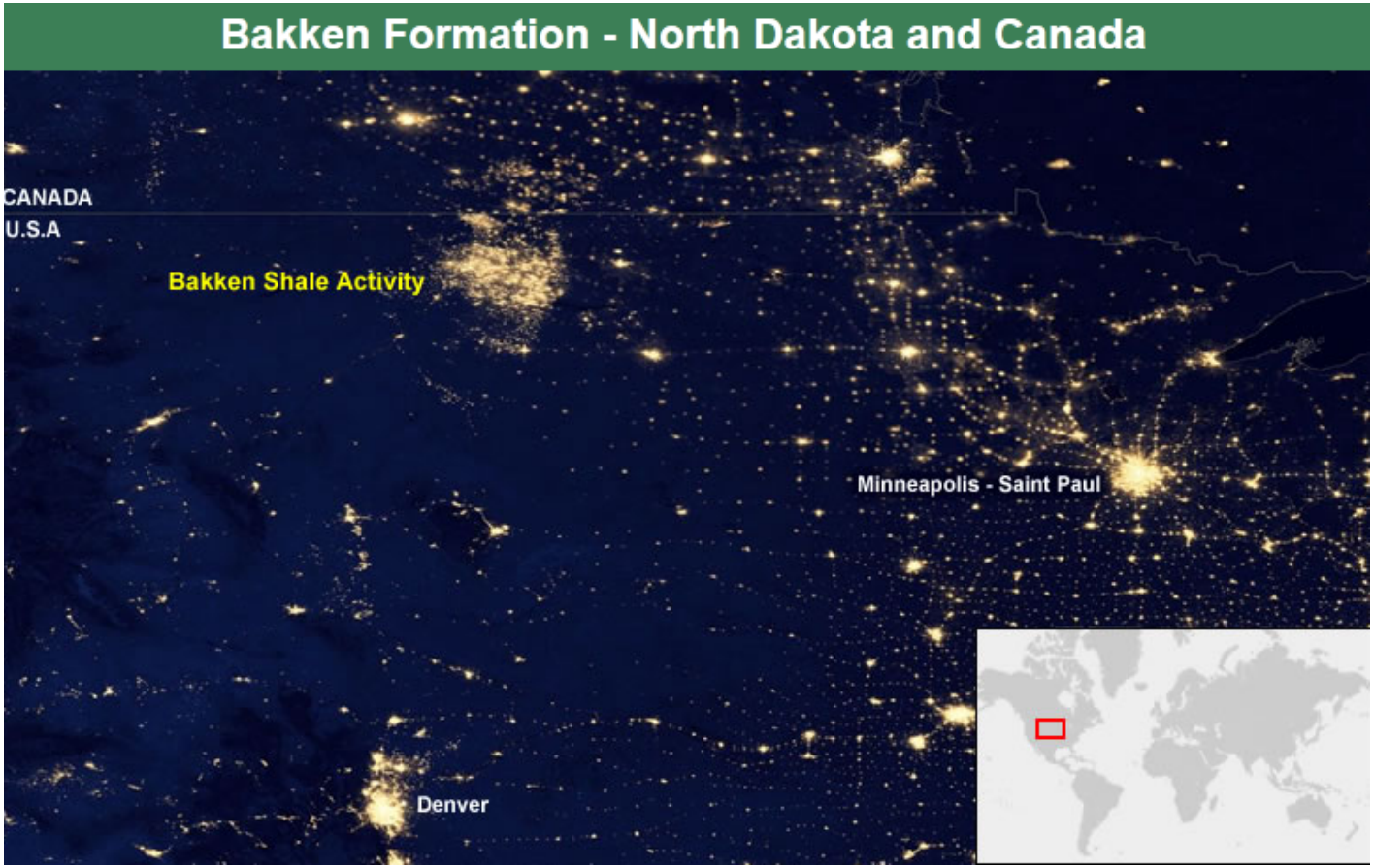
Bakken Shale at Night



Source:http://geology.com/articles/oil-fields-from-space/

Recent Trends

- Sub-surface trespass
- Production allocation & Pooling
- Surface uses and Pipeline ROW
- Royalties and NPRI
- Limitations
- Everything else

Envtl. Processing Sys. v. FPL Farming,
No. 12-0905 (Tex. Sup. Ct. argued Jan. 7, 2014)

Background:

- Surface owner (FPL) sued neighboring operator (EPS) for subsurface trespass based on migration of wastewater injected in Class I hazardous waste injection wells.
- Injection at ~ 7000 feet into salt water aquifer.
- FPL did not own mineral rights, but asserted groundwater rights.

Issue:

- Can migration of injected wastewater support a subsurface trespass claim by adjacent landowner on these facts?

Envtl. Processing Sys. v. FPL Farming, (Cont.)

Proceedings:

- Jury found no trespass, but FPL raised burden of proof issue on lack of consent and appealed on multiple grounds.
- CoA (2009) found no trespass because TNRCC/TCEQ issued injection permit. CoA relied on *RRC v. Manziel* (1962 waterflooding) and *Coastal v. Garza* (2008 hydraulic fracturing), where Tex. S.C. found no liability based on the rule of capture.

Envtl. Processing Sys. v. FPL Farming,
(Cont.)

Proceedings (cont'd):

- Tex. Sup. Ct. (2011) holds that a permit does not shield the operator from tort liability, *Manziel* and *Garza* distinguishable, sent back to CoA.
- On remand, CoA (2012) found FPL has property interest in brine, ordered new trial.
- Second appeal to Texas Sup. Ct.

Envtl. Processing Sys. v. FPL Farming, (Cont.)

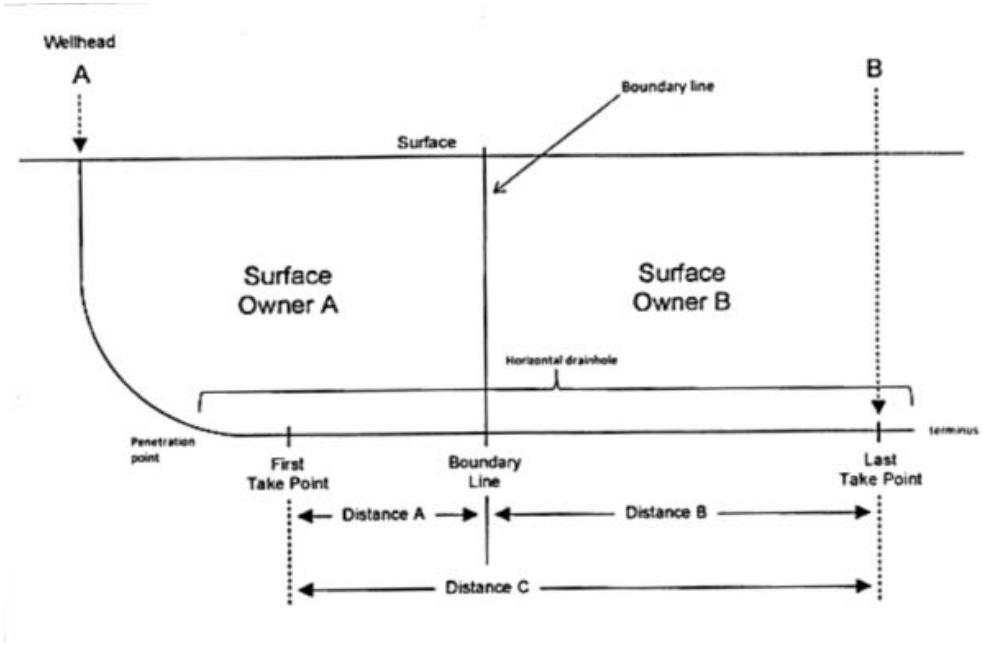
Considerations in *FPL II*:

- Present injury requirement and difficulty of proof?
- Extent of owner's subsurface property rights to water?
- Will holding be limited to Class I injection wells (not associated with oil and gas production) and water rights?
- Where will boundary be with *Manziel* and *Garza*, where no liability was found based on the rule of capture and injection was tied to extraction activities?

Springer Ranch, Ltd. v. Jones
(San Antonio COA 12/2013, no pet.)

Background:

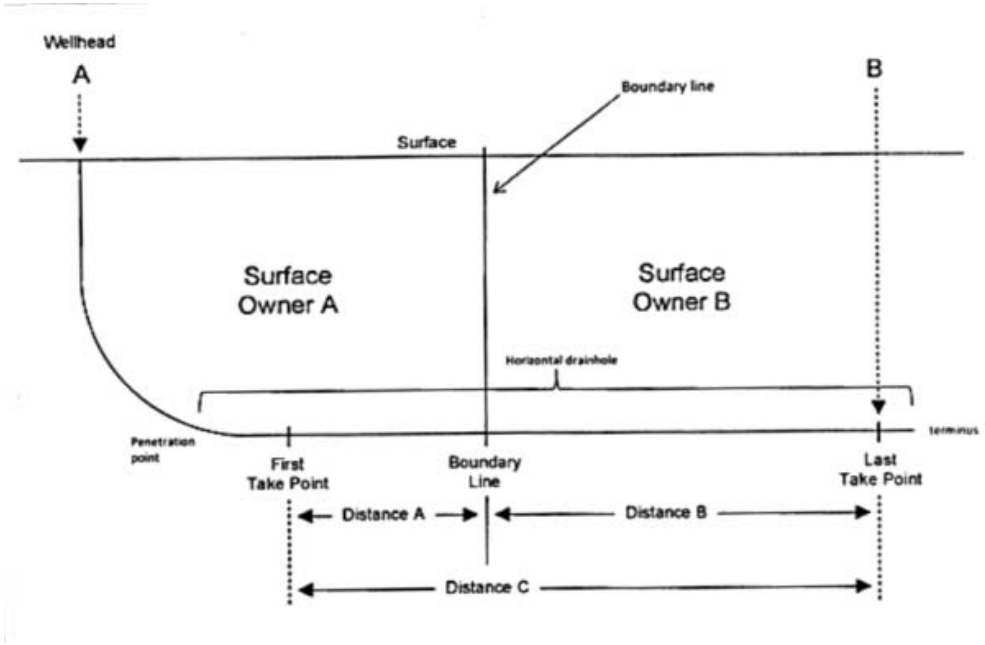
- Parties executed a 1993 contract providing that royalties from wells be paid to surface estate owner on which such wells are "situated." Initially only vertical wells, then horizontal well drilled.
- No royalty to surface estate with no wellhead.



Springer Ranch, Ltd. v. Jones
(Cont'd)

Issues:

- Based on parties' agreement, are all tracts through which a horizontal well is drilled due a portion of the royalty?
- If all tracts due royalty, how is the royalty allocated among the tracts?



Springer Ranch, Ltd. v. Jones
(Cont'd)

Contract:

- Allocated royalties "to the owner of the surface estate on which such well or wells are situated, without reference to any production unit on which such well or wells are located."

Holding:

- "situated" meant where the "well" was located
- "well" meant the entire length of well, not just the wellhead
- "surface estate" meant estate over each well segment

Rationale:

- A well only produces over the interval of the reservoir, so the discrete interval of production is more accurate for apportioning royalties and is based on the "productive portions" of the well.

Springer Ranch, Ltd. v. Jones
(Cont'd)

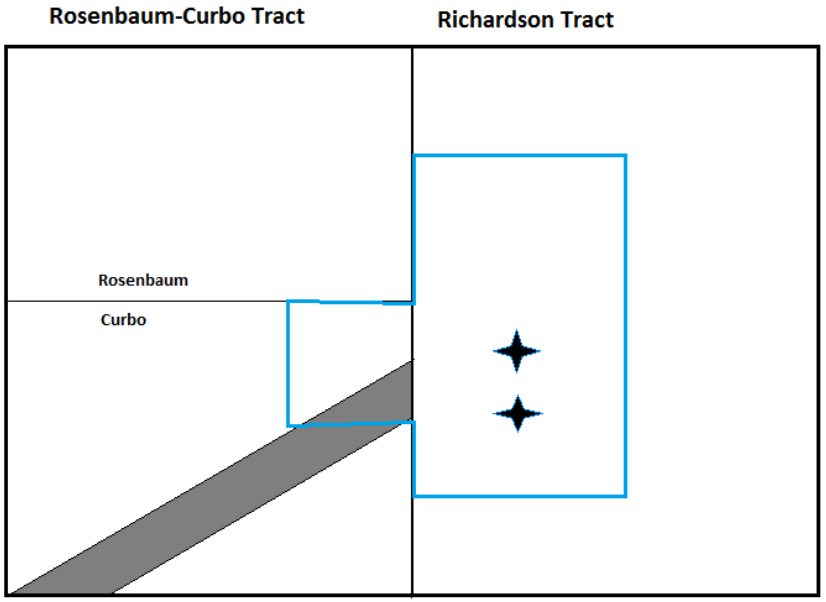
For another day:

- Court's holding assumes each foot of the productive interval, or the perhaps the perforated interval, is equally productive.
- What if the reservoir is heterogeneous and multiple productive intervals are interspersed with non-productive or poorly productive intervals?

Key Operating Equipment v. Hegar, (Tex. June 20, 2014)

Background:

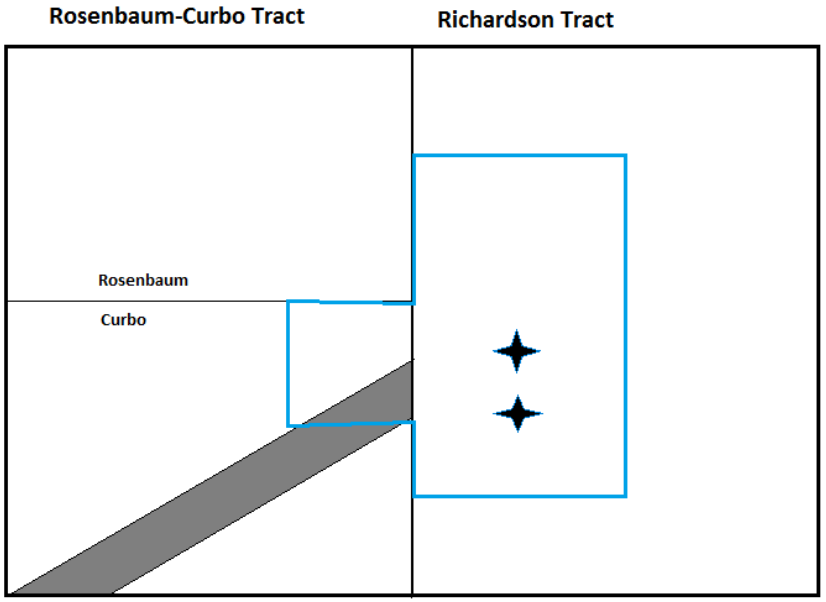
- 1987 – Key obtains lease on Richardson tract
- 1994 – Key obtains lease on Rosenbaum-Curbo tract. Builds roads across Curbo tract to operate wells on <u>both</u> Curbo and Richardson tracts.



Key Operating Equipment v. Hegar, (cont'd)

Background:

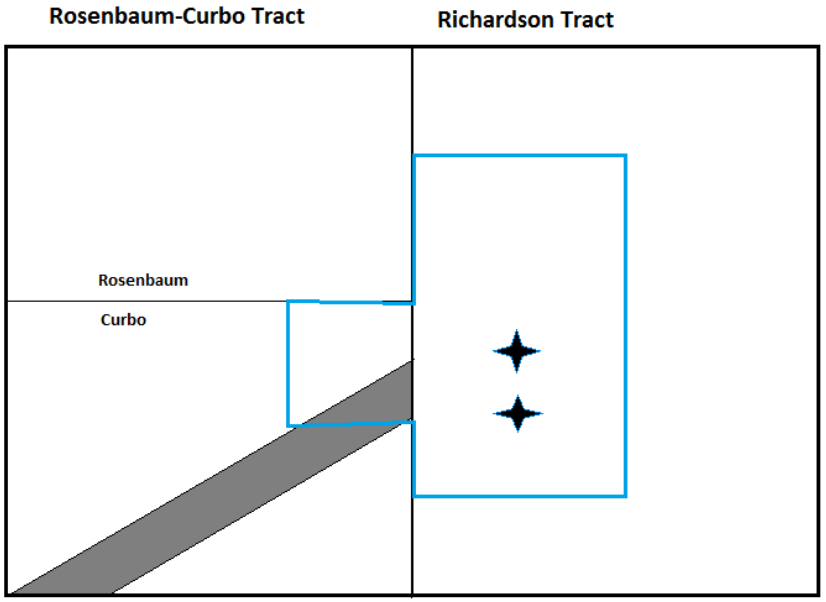
- 2000 – Rosenbaum-Curbo tract ceased production and Key loses the lease. Key's owners then bought a 1/16 interest in the Curbo mineral estate, leased the interest to Key, and the lease authorized pooling. Key creates a 40 acre unit with 30 acres from the Richardson tract and 10 acres from Curbo tract.



Key Operating Equipment v. Hegar, (cont'd)

Background:

- 2002 – Hegars purchase the surface estate and a mineral interest in Curbo tract, knowing it was subject to leases and knowing that Key used the road to service its wells.
- Hegars tolerated road until Key drilled a second well on the Richardson tract that led to increased road use.



Key Operating Equipment v. Hegar, (cont'd)

Proceedings:

- No bad faith pooling claim, Hegars sued in trespass.
- Expert testimony that no oil came from under Hegar's land.
- Trial court granted declaratory and injunctive relief and CoA affirmed

Key Operating Equipment v. Hegar, (cont'd)

Tex. Sup. Ct. Holding:

- Primary legal consequence of pooling is that production and operations anywhere on the pooled unit are treated as if they have taken place on each tract within the unit.
- Production from the Richardson tract was therefore also considered production from the Curbo tract underlying Hegar's surface acreage.
- Because the pooled tracts lost their separate identities as to the source of production, the mineral estate owner was allowed to make reasonable use of the Hegar tract to reach the Richardson tract.

Key Operating Equipment v. Hegar, (cont'd)

Tex. Sup. Ct. Holding (cont'd):

- Distinguished *Robinson v. Robbins Petroleum* (Tex. 1973), where lessee took salt water from one property to waterflood adjacent units.
- *Key* court noted that the minerals under Robinson's surface were not pooled with tracts where the water was used and that nothing authorized the increased on burden of the surface estate to benefit additional lands.
- Deftly avoids difficult proof problems of where production originates and when.

Merriman v. XTO Energy, 407 SW3d 244 (Tex. 2013)

Background:

- Merriman used a tract on his surface estate to raise cattle.
- XTO drilled near Merriman's barn.
- Merriman sought a permanent injunction claiming XTO failed to accommodate his existing use of the tract for an annual cattle roundup.

Merriman v. XTO Energy,
(cont'd)

Proceedings:

- Trial court granted XTO summary judgment, holding Merriman failed to prove he did not have available alternatives to manage cattle.
- CoA affirmed holding that if evidence showed Merriman had alternative uses for tract, he could not claim completely or substantially impaired use of the surface.
- Tex. Sup. Ct. affirmed, but for different reasons, lessening burden of proof for the surface owner.

Merriman v. XTO Energy,
(cont'd)

Holding:

Surface owner must prove for accommodation doctrine:

1. Lessee's use completely precludes or substantially impairs the existing use.
2. No reasonable alternative method available by which the ***existing*** use (cattle) can be continued, no other use need be considered (e.g., general agriculture).
3. There are alternative reasonable, industry-accepted methods available to lessee that will allow mineral recovery and also allow the surface owner to continue existing use.

Merriman v. XTO Energy,
(cont'd)

Holding (cont'd):

- MSJ affirmed because no evidence of second of three prongs; inconvenience and additional expense insufficient.
- Second prong requires proof of inconvenience or financial burden of continuing the existing use by alternative methods is so great as to make the alternative method unreasonable.
- Merriman failed to show no reasonable alternative method to conduct cattle sorting, etc. somewhere else on the tract.
- Testimony only that well precludes or substantially impairs the use of his existing corrals and pens, creates an inconvenience to him, and will result in some unquantified amount of additional expense.

Texas Rice Land Partners, Ltd v. Denbury Green Pipeline-Texas, LLC

363 S.W.3d 192 (Tex. 2012)

- **Holding:** Landowner may challenge in court the eminent-domain power of a CO2 pipeline owner that has been granted common carrier permit from RRC.
- **Common carrier status test:** "Does a reasonable probability exist that the pipeline will at some point after construction serve the public by transporting gas for one or more customers who will either retain ownership of their gas or sell it to parties other than the carrier?"

Post-Denbury decisions

- ***Crawford v. TransCanada*, 409 SW3d 908 (Texarkana 2013, pet. denied)**
- ***In re Texas Rice Land Partners,* 402 SW3d 334 (Beaumont 2013, orig. proceeding)**
  - TransCanada satisfied common carrier test for Keystone pipeline, affidavit from third party shippers, binding agreements.
- ***Crosstex NGL Pipeline v. Reins Road Farms-1*, 404 SW3d 754 (Beaumont 2013, no pet.)**
  - Affirmed denial of pipeline owner's request for a temporary injunction barring landowner from interfering with its effort to survey the property. NGL ≠ "crude petroleum" in Nat. Res. Code

Gilbert Wheeler, Inc. v. Enbridge Pipelines

No. 13-0234, (Tex. 2014)

Background:

- Family corp. owned a 153 acre, heavily-wooded "retreat." Agreed to ROW that required boring to save trees.
- Landowner sought property damages for violation of a pipeline right-of-way easement contract after cutting and bulldozing of 50-100 years old trees.

Gilbert Wheeler, Inc. v. Enbridge Pipelines
(cont'd)

Proceedings:

- Jury found for landowner. Evidence showed diminution of market value = $3000; cost to restore = $600K-$900K
- COA: When contract relates to real property, damages are measured not by benefit of bargain but by diminution of value (permanent) or cost of restoration (temporary). Trial court failed to ask jury necessary predicate question. Judgment for Enbridge, take nothing.
- Tex. Sup. Ct.: whether injury to property is temporary or permanent is a question of law for the court, although the jury must decide contested facts on which the question of law is decided.

Gilbert Wheeler, Inc. v. Enbridge Pipelines
(cont'd)

Holding:

- Relevant facts undisputed, making the issue a matter of law, not a jury issue.
- Restoration was possible, making the injury temporary. But when restoration exceeds diminution in market value to such a high degree, repairs are no longer economically feasible and injury is deemed permanent.
- If diminution in land's FMV is nominal, landowner may recover for loss of "intrinsic value" of trees.
- Reduction in FMV was nominal, only $3,000 out of $383,000, thus intrinsic value was awardable. Remanded.

French v. Occidental Permian, No. 12-1002 (Tex. 2014)

Background:

- Oxy injects CO_2 to enhance oil production, transports gas to processing facilities to remove CO_2 and other impurities, separated CO_2 is returned to wells for reinjection.
- Oxy pays Kinder Morgan in-kind fee of 30% of NGLs and 100% of residue gas to handle processing, and no royalty is paid on this fee.
- Royalty owners with market value lease sued Oxy, claiming CO_2 removal not deductible, underpayment.
- $10MM judgment for royalty owners and declaration of how future royalties must be paid.

French v. Occidental Permian, No. 12-1002
(Cont'd)

Principal issue:

- Whether removing, compressing and transporting CO_2 should be classified as production costs (not deductible) or post-production expenses (chargeable to royalty).

Holding:

- Removing CO_2 is not analogous to removing water from the oil, which is treated as a cost of production and not deductible. CO_2 removal is not necessary, unlike removing water, which is easier.
- Oxy had right to reinject casinghead gas, but chose to process it, benefitting French. Having given Oxy discretion on whether to process the gas, French must share in the cost to remove CO_2.
- Cost to remove CO_2 must be considered in market value at well.

Lesley v. Veterans Land Board
352 SW3d 479 (Tex. 2011)

Nature of duty owed by executive to non-executives:

- "Utmost fair dealing" / "fiduciary in nature" but not required to put interests of nonexecutives before his own
- No bright-line test for violation
- Refusal to lease actionable if refusal is arbitrary or motivated by self-interest to the non-executive's detriment.

Violation of duty through self-dealing.

Tolling of Statute of Limitations

"Reasonable diligence" for purpose of triggering limitations, includes a search of public records, even if complex and technical.

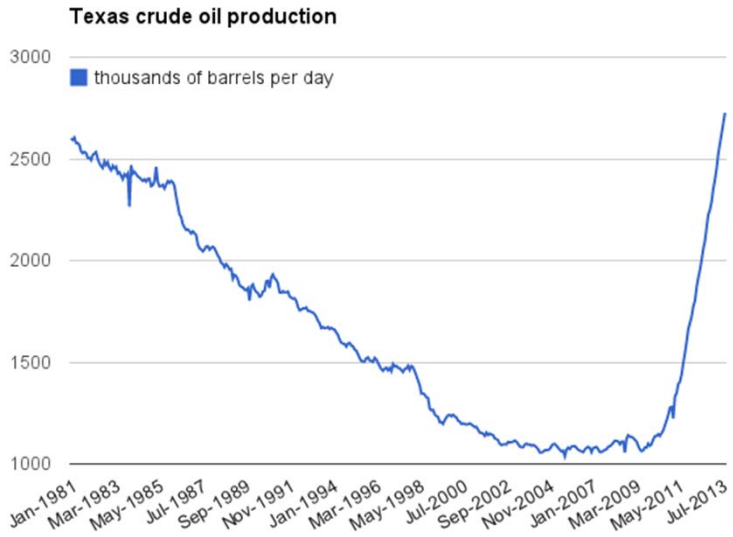
- *Shell Oil Co. v. Ross*, 356 S.W.3d 924 (Tex. 2011)
- *BP Am. Prod. Co. v. Marshall*, 342 S.W.3d 69 (Tex. 2011)
- *Kerlin v. Sauceda*, 982 S.W.2d 881 (Tex. 2008)
- *HECI Exploration v. Neel*, 982 S.W.2d. 881 (Tex. 1998)

The latest challenge:

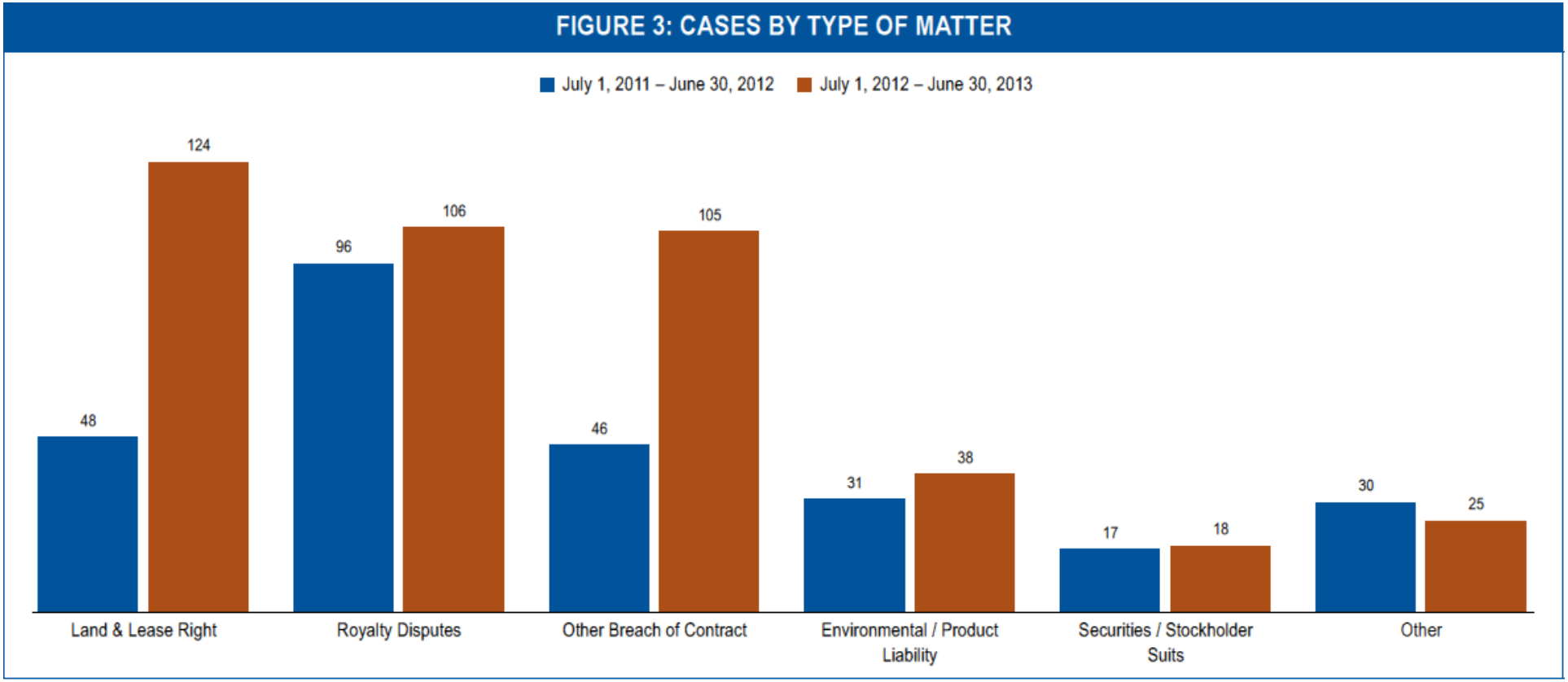
- *Samson Lone Star LP v. Hooks*, 389 S.W.3d 409 (Tex. App.-Houston [1st COA] 2012), *pet. filed*, No. 12-0920.

Prognostications

- BTI Consulting Litigation Outlook 2014
  - 60.7% of clients expect to see jump in litigation matters
- More commerce, more lawsuits:



Navigant's 2013 Unconventional Litigation Trends Report



Source: Navigant Consulting, http://www.navigant.com/~/media/WWW/Site/Insights/Energy/NavigantUnconventionalOilGasStudy_Oct13.ashx

haynesboone
Setting precedent.

All sorts of cases

- **Title, Land and Conveyance Disputes**
  - Disputes about terms of conveyance documents
  - Boundary disputes
  - Traditional title disputes about superior title
  - Slander of Title

All sorts of cases

- **Lease disputes**
  - Disputes over royalties
  - Disputes about duration of lease (habendum, delay rentals, etc.)
  - Implied covenants
  - Pooling disputes
  - Abandonment liability

All sorts of cases

- **Tort Claims against Operators**
  - Subsurface Trespass
  - Fraud and fraudulent inducement claims
  - Disputes with Surface Owners
  - Costs
  - Failed operations

All sorts of cases

- **Disagreements over the meaning, performance and obligations owing under other contracts (non-lease)**
  - Joint Operating Agreement
  - Asset Purchase and Sale Agreements
  - Farmouts and Exploration Agreements
  - Area of Mutual Interest Agreements
  - Contracts for the Purchase and Sale of Oil or Natural Gas
  - Industry Service Agreements

All sorts of cases

- **Disputes arising out of midstream operations**
  - Pipeline vs. Landowner disputes on easements and rights-of-way
- **Environmental Litigation**
  - Ground & Water Contamination
  - Air Pollution
- **And many more…**

Questions