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This special edition of the IEL's online newsletter highlights the leadership changes in the IEL in 2014. Every two years, the institute's executive committee changes composition, with the retirement of some time-limited members including the institute's chair, and the addition of many new members to the committee. We feature photographs and biographies of the new chair, senior vice chair and executive committee members in the first article in this edition. Are you interested in getting more involved with the IEL's activities? Please speak to the chair of the practice committee of most interest to you to see how you could get more involved, or talk to Alan Dunlop or David Winn, the IEL's directors.

The Energy Law Advisor is published online six times a year, and advisory board members are sent a copy by email.

Brit Brown, Editor

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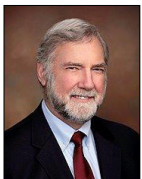


IEL News**New IEL Leadership**

Every two years, the make-up of the IEL's executive committee changes, with many appointments including the chair, senior vice chair and all the practice committee chairs being time-limited. The change of leadership officially happens at the close of the annual conference.



Wendy Daboval, currently senior vice chair, will succeed Dave Asmus as chair. Wendy is General Counsel and Vice President of Chevron North America Exploration and Production Company (CNAEP), based in Houston. Wendy originally joined Texaco in New Orleans in 1985, and stayed with the company following the merger with Chevron. She is responsible for all legal and land services for Chevron's North America upstream operations, and also serves on the CNAEP Leadership Team, Personnel Development Committee, and Compliance Committee. She also serves on Chevron's Global Upstream and Gas Law Leadership Team. Wendy is the recipient of many awards, having been most recently recognized by Houston Woman Magazine as one of the "50 Women of Influence of 2013", and in 2013 received the Premier Women in the Law Award from the Houston Association of Women Attorneys. In 2011, she received the Houston Business Journal's "Outstanding General Counsel of a Large Organization" corporate counsel award. Wendy's bachelor's degree and J.D. are both from Loyola University in New Orleans.



Our new senior vice chair will be **Larry Simon**, the current chair of the Litigation and Dispute Resolution Practice Committee. Larry joined Liskow & Lewis soon after graduating from Tulane Law School, and his practice there has focused on litigation of oil, gas and property issues, and a wide variety of commercial disputes in federal and state courts throughout Louisiana. He also has broad experience litigating issues involving regulatory rulings and orders of the Department of Conservation. Based in the firm's Lafayette office, Larry's practice emphasizes oil and gas royalty and other mineral lease issues, energy marketing contract disputes and cases involving the processing of natural gas and the contracts affecting these operations. He has additional experience in utility regulation, including in telecommunications regulation. Larry is a past president of the American Inn of Court of Acadiana, and has served on the board of governors of the Louisiana State Bar Association.

Twelve new members will be joining the executive committee for the 2014-16 period.



David Brinley, Shell's General Counsel Upstream Americas and Head of Legal USA, is a Brigham Young graduate who joined Shell in 1991. He has worked in Bakersfield, London, Tokyo, The Hague, Singapore, and Calgary, before arriving in Houston in 2010. David joins as a vice chair.



Alex Cestero takes over as chair of the Oilfield Services Practice Committee. Alex is Vice President and Co-General Counsel of Weatherford International Ltd, based in Houston. Before that he was Vice President, General Counsel, Secretary and Chief Compliance Officer of Lufkin Industries, Inc. A Stanford law graduate with BA and MBA degrees from Rice, Alex has served in leadership positions in the Texas State Bar, Texas General Counsel Forum and many other organizations, and is well known to IEL members as one of the co-chairs of the Oilfield Services Conference in 2013.



Bill Colbert, BP America's Assistant General Counsel, Global Wells Organization & Upstream Americas, also joins the executive committee as a vice chair. Bill oversees legal support for BP's upstream operations in the Americas, including the Gulf of Mexico, North America Gas, Trinidad & Tobago and the Southern Cone area in Latin America. In addition, he is responsible for managing working interest owner issues related to the *Deepwater Horizon* accident. Bill is a graduate of Haverford college and the University of Denver School of Law.



Patrick Dunn becomes chair of the Young Energy Professionals Practice Committee. Patrick is Associate General Counsel for EDF Trading North America, LLC, based in Austin. Prior to joining EDF he was Vice President and General Counsel for ZaZa Energy Corporation, Senior Legal Counsel for Hess Corporation, and Director of Land and Legal for Acock/Anaqua Operating Co., LP in Corpus Christi. His J.D. is from St. Mary's University School of Law and his bachelor's degree is from Texas A&M. Patrick also serves as vice chair of the IEL's academic outreach committee, and as one of the co-chairs of the Hartrick Symposium 2014.



Robert Goldberg joins the committee as chair of the Power and Alternative Energy Practice Committee. Rob is head of Mayer Brown's renewable energy group where his practice focuses on the energy and infrastructure sectors, including conventional and renewable power, oil and gas and toll roads. Rob was recently honored as a "Project Finance Rising Star" by Law360 for his work on several complex project financing transactions.



Bill Knull becomes the chair of the Litigation and dispute Resolution Practice Committee. He is the senior litigation partner in the Houston office of Mayer Brown LLP. A graduate of Yale University and the University of Virginia School of Law, Bill's practice is concentrated in complex commercial litigation and arbitration, with a particular focus on arbitration and litigation of international commercial and investment disputes in the oil and gas industry.



Taking over the chairmanship of the Oil and Gas Practice Committee is **J.J. McAnelly**, a partner in Bracewell & Giuliani's Houston office. J.J. has his B.B.A and J.D. from the University of Texas, and represents oil, gas and energy industry clients in a broad range of oil and gas transactions, including the purchase, sale and/or financing of exploration and producing properties, processing plants, production and storage facilities and pipeline systems, as well as day-to-day operational representation.



The new chair of the International Practice Committee will be **Alex MacWilliam**, from the Calgary office of Dentons where he advises Canadian and international clients on all legal issues relating to the environment. These include regulatory approvals, compliance, contaminated land, climate change, dealing with regulatory agencies, responses to government policies and the development of internal environmental practices and systems. Alex is widely regarded as one of the leading environmental law practitioners in Alberta.



Susan Brownlee Miller, Senior Counsel at Marathon Oil Company, joins the executive committee as a vice chair. Susan supports Marathon's Marketing and Midstream group. During her twelve years at Marathon, Susan has managed the royalty docket and supported Marathon's Bakken, Gulf of Mexico and Powder River Basin operations. Susan is a graduate of Columbia University School of Law and Wellesley College. She has an active pro bono practice, most recently including immigration, custody and guardianship matters.



The new chair of the Website, Technology and Communications Strategic Committee is **Barclay Nicolson** of Norton Rose Fulbright. Barclay's practice is focused on energy and business disputes and he has significant experience in handling energy related litigation. He has represented some of the world's major oil and gas producing and refining companies as well as some of the nation's biggest drilling and E&P companies. He holds a B.A. from the University of Texas and a J.D. from the University of Houston.



Anadarko Petroleum Corporation's Vice President and Deputy General Counsel, **David Owens**, also joins the executive committee as a vice chair. Dave is currently responsible for the management of the contracts, IP/IT, LNG, EH&S, and the international and domestic E&P sections of the Anadarko legal department. He also handles complex litigation for Anadarko. Dave received a B.A. and M.S. from West Virginia University, and his J.D. from Duquesne University School of Law.

Justin Stuhldreher of BHP Billiton also joins the executive committee as a vice chair.

Industry News

Security Interests in Renewable Energy Credits (Part III)

By Howard M. Steinberg and Reade Ryan*

Abstract Part III

In Parts I and II of this article the authors reviewed the emergence of the renewable energy attributable market and then discussed how buyers in this market can take security interests to try to protect themselves against a seller breaching its obligation to deliver these credits in the future. In this final Part III, the authors examine the means of enforcement of security interests in RECs and the issues that can arise when competing creditors are involved, and then they explore methods to "preempt" complications that can arise during the enforcement process.

Foreclosure

The creation of the security interest will give the secured party (the buyer of the REC), after default by the seller, the right to foreclose against the collateral – the credits and the Right to Generate Credits – in either (a) a public or private sale (see N.Y.U.C.C. § 9-610 - disposition of collateral after default) or (b) a so-called "strict foreclosure" – that is, acceptance by the buyer of the collateral in satisfaction of the secured obligations (see N.Y.U.C.C. § 9-620). In a sale, the buyer, the secured party, would, after default by the seller, send a written notification of the sale to (i) the seller, (ii) any guarantor or other secondary obligor of the secured obligations, (iii) any other person from whom the

* The authors are respectively partner of, and of counsel to, Shearman & Sterling LLP.

secured party has received, before the notification date, a written or electronic notification of a claim of interest in the collateral, and (iv) any other secured party or lienholder that, ten days before the notification date, held a security interest in or other lien on the collateral perfected by the filing of a financing statement. (See N.Y.U.C.C. § 9-611(c)). Such notification must be sent within a “reasonable time” before the sale, and the N.Y.U.C.C. specifies that a notification of such sale be sent after default and 10 days or more before the sale is deemed “sent within a reasonable time.” (See N.Y.U.C.C. § 9-612). Such notification would describe the debtor, the secured party and the collateral, and state the method of disposition (public or private sale) and the time and place of a public sale or the time after which any private sale is to be made. (See N.Y.U.C.C. § 9-613 (a)). The notification must also state that the debtor is entitled to an accounting of the unpaid secured obligations and the charge, if any, for an accounting. (See N.Y.U.C.C. § 9-613 (a)(4)). The basic requirement for any sale under N.Y.U.C.C. Article 9 is that every aspect of the sale, including the method, name, time, place and other terms, must be “commercially reasonable.” (See N.Y.U.C.C. § 9-610(b)). If the foreclosure is a public sale, the buyer will be entitled to bid for the purchase of the collateral by using the value of its claim against the seller. (See N.Y.U.C.C. § 9-610(c)(1)). Such bid is called a “credit bid.”

If the foreclosure is a “strict foreclosure,” the buyer will be able to retain the collateral - that is, the credits and the Right to Generate Credits – without a sale and in satisfaction of the secured obligations if, but only if, (a) the seller consents, after default, to the acceptance by the buyer of the collateral in satisfaction of the secured obligations, and (b) the buyer does not receive, within 20 days after notification of the buyer’s proposal for strict foreclosure was sent to all appropriate parties, a notification of objection to such proposal by those persons referred to in clauses (ii), (iii) or (iv) of the paragraph above or by any other person holding a subordinate interest in the collateral. (See N.Y.U.C.C. § 9-620 and § 9-621). If the buyer sends the notification of its “strict foreclosure” proposal to the seller after default and does not receive any notification of objection by the seller within 20 days after such notification is sent, the seller is deemed to have consented to the buyer accepting the collateral in satisfaction of the secured obligations. (See N.Y.U.C.C. § 9-620 (c)(2)). If the buyer sends a notification of its “strict foreclosure” proposal to the seller after default, but does receive a notification of objection either from the seller or from any of the other persons referred to above, then the buyer must foreclose on the collateral by a sale, public or private.

Priorities

It is possible for different parties to have security interests in the same collateral. Absent a written agreement among the different parties about the priority of their respective security interests in the same collateral (such agreement being usually called an “intercreditor agreement”), the priority of the various security interests will be determined by the order in which the parties have filed or otherwise have perfected their security interests – that is, the secured party who is the first to file will have first priority and will be the senior secured party. Thus, it is prudent for the buyer, before getting a security interest in collateral, to perform a search under the name of the debtor in the U.C.C. office of the jurisdiction where the debtor is “located” as set forth in U.C.C. § 9-307, in order to see what other effective financing statements, if any, are filed against the debtor and to see whether or not any such financing statements cover the collateral. While a senior secured party is not at risk of a junior secured party expunging the senior secured party’s security interest, a senior secured party does generally have to act in a commercially reasonable manner in dealing with the collateral so that the junior party is not unduly disadvantaged. (See N.Y.U.C.C. § 9-625).

Subordination

In the case of an operating generating facility, it is likely that the seller has financed its investment in the facility with loans from banks or other institutional lenders. In what is called a “project financing,” these lenders will normally have obtained a security interest in all of the seller’s assets and typically will have perfected such security interest. In this case, the buyer should check the financing statement filed by these lenders and the granting clause of the lenders’ security agreement to see if the lenders actually have a perfected security interest in the seller’s credits or Right to Generate Credits by seeing if the filed financing statement, and the description of the collateral in the security agreement’s granting clause, covers such credits or Rights to Generate Credits. If the lenders do have a perfected security interest in such credits or Right to Generate Credits then the buyer’s security interest in such credits or Rights to Generate Credits will be subordinate to the lenders’ security interest unless the lenders subordinate their security interest to the buyer’s security interest by executing an intercreditor agreement with the buyer to subordinate their senior security interest to that of the junior buyer. (See N.Y.U.C.C. § 9-339.)ⁱ In the event the lenders will not execute such an intercreditor agreement, the buyer can, and should, still perfect its junior priority security interest. And in all cases, the buyer should (i) check to make sure that the credit agreement of the lenders does not forbid the seller

ⁱ We suggest the following lien subordination clause:

Irrespective of (a) the time, order, manner or method of creation, attachment or perfection of the respective security interests and/or liens granted to the Senior Secured Creditor and the Junior Secured Creditor in or on any or all of the Collateral, (b) the time or manner of the filing of their respective financing statements or other public filing documents, (c) the dating, execution, authentication or delivery of any agreement, document or instrument granting the Senior Secured Creditor or the Junior Secured Creditor security interest and/or liens in or on any or all of the Collateral, and (d) any provision of the Uniform Commercial Code (the “U.C.C.”) or any other applicable law to the contrary, any and all security interests, liens, rights and interests of Junior Secured Creditor, whether now or hereafter arising or existing, in or on any or all of the Collateral shall be and is hereby subject and subordinate to any and all security interests, liens, rights and interests of the Senior Secured Creditor in and to the Collateral.

from granting a security interest in any of its assets (as is usually the case), and (ii) ask the seller for a representation in the security agreement in favor of the buyer that the seller's grant of the security interest to the buyer does not conflict with any other agreement by which the seller is bound.

Bankruptcy

In the context of a bankruptcy case under the Bankruptcy Code, a debtor (or its bankruptcy trustee) is given the power to request permission from the Bankruptcy Court not to perform future obligations under its "executory" contracts but rather "reject" its performance of these contracts and owe its counterparty monetary damages. (See Bankruptcy Code § 365). Given that contracts for "future" renewable energy credits and emissions reduction credits appear to be executory in nature, it is imperative that a buyer have a perfected security interest (which would not be executory) in the seller's renewable energy credits or emissions reduction credits and the seller's Right to Generate Credits if the buyer wishes to have some chance of actually obtaining the right to the generation of these renewable energy credits or emissions reduction credits. For instance, if the senior secured party would like to conduct an auction for the renewable energy credits or emissions reduction credits but the buyer has a junior security interest and can make a credit bid, the senior secured party might be inclined to avoid the complications of an auction and simply agree to transfer them to the buyer in connection with a settlement with the buyer.

Projects in Construction

In the case of a generating facility that has not been constructed yet, it may be much easier for the buyer to negotiate its security interest in the renewable energy credits or emissions reduction credits if the seller has not yet executed its financing agreements for the facility. In fact,

the buyer might even have the seller agree not to create any other security interests on its renewable energy credits and emissions reduction credits, so that the buyer will not have to be concerned about acting in its own self interest to the detriment of junior secured parties, since there will be none.ⁱⁱ

Risks Remain

The security interest approach outlined above remains untested in the New York courts (or any other state courts, so far as the authors are aware). While the authors' analysis of the character of renewable energy credits and emissions reduction credits, and Right to Generate Credits, is based on various learned sources and legislative histories, it cannot serve as a legal opinion or offer the certainty that could come with legislative action designed to protect and organize secured rights in the burgeoning market related to renewable energy credits and emissions reduction credits. The authors eagerly await such governmental initiatives. In fact, it would seem that a securitization market could even develop for sellers of future credits whereby they could "pool" their rights to receive payment for future produced credits and "monetize" this pool by selling the future receivables associated with this pool for a lump sum payment. In the meantime, all concerned parties should be aware that there are steps that they can take to attempt to assure that these valued efforts relating to the environment offer the commercial certainty that is necessary to make them successful.

ⁱⁱ We suggest the following "no lien" clause:

The Seller will not, at any time, create, incur, assume or suffer to exist any lien on or with respect to any REC whether now owned or hereafter acquired, or sign or file or suffer to exist, under the Uniform Commercial Code of any jurisdiction, a financing statement that names the seller as debtor, or sign or suffer to exist any security agreement authorizing any secured party thereunder to file such financing statement, or assign any accounts or other right to receive proceeds of any REC.

Believe It or Not: Mexico Finally Opens Up Its Oil Industry

By Carlos Moran¹

Since the 1980s and especially after the entry into force of NAFTA, Mexico has experienced a string of privatizations in both commercial and industrial sectors. Yet, the opening of the oil sector is by far the most ground-breaking one.

For the first time since 1958, Mexican law will allow profit-sharing from oil production. Yet, the much awaited and needed constitutional reform went farther than anticipated.² While hydrocarbons underground will continue to be solely owned by the Mexican State, private companies will soon be able to own and possess them right at the wellhead.

Effective December 21, 2013 and after an extremely expeditious process (without resorting to the fast-track procedure), the Mexican Constitution has been expressly

amended to allow for service, profit-sharing, production-sharing and petroleum license contracts.³

1. Why was the reform necessary?

Over the last decade Pemex's oil production has dropped from 3.3 million bpd to 2.5 million bpd. Its main fields in shallow waters in the Gulf of Mexico have entered or are about to enter a period of natural decline (Cantarell and Ku-Maloob-Zaap, respectively). Mexico needs to avail itself of the technology and financial resources required to develop its mature and deep-water fields.

The Mexican Congress has finally acknowledged that Pemex, and perhaps no other oil company in the world,

¹ Carlos Moran is a partner in the Energy and Natural Resources Practice Group of the full-service law firm Goodrich, Riquelme y Asociados, based in Mexico City. He has more than 10 years of experience in the representation of multinational companies and consortia conducting business with Pemex. (<http://goodrichriquelme.com/lawyer/carlos-a-moran/>). Peer review for the article was provided by John Cogan of Cogan & Partners LLP, Houston.

could alone be responsible for running the entire Mexican oil and gas industry and increasing its production to the levels required by the Mexican economy.

This new, ambitious and far-reaching reform aims to, among other things: avert the continued decline in Mexican oil production; maximizing oil revenues for the State; increase the supply / reduce the cost of natural gas fuel supplies and feedstocks for manufacturing industries; phase-out burdensome subsidies on gasoline; improve the competitiveness of Pemex and the country as a whole; boost the Mexican GDP; and create jobs.

2. Wasn't there an energy reform in Mexico in 2008?

Soon after the 2008 Energy Reform was passed, the Mexican President publicly acknowledged that a new and more in-depth reform was needed. The 2008 reform did not involve a constitutional amendment, yet that was the level where some of the most serious reforms were needed. For example, the apparent constitutional prohibition of production-sharing contracts and similar petroleum agreements needed to be corrected. Without a constitutional amendment, it was foreseeable that the 2008 reform would not be sufficient to stop the decline in Mexican oil production.

After the 2008 reform, Pemex continued as the exclusive provider of most activities related to oil and refined petroleum products as provided by the Regulatory Law on Article 27 of the Constitution in Relation to Oil (still in force), namely:

- (i) Exploration, exploitation, refining, transportation, storage, distribution and first-hand sales of oil and refined oil products;
- (ii) Exploration, exploitation, production and first-hand sales of gas (private companies may engage in the transportation and storage of gas).
- (iii) Production, transportation, storage, distribution, first-hand sales of oil and gas by-products susceptible of being used as industrial basic raw materials (known in Mexico as basic petrochemicals).

Pemex's monopoly never entailed a total prohibition for private or foreign companies to participate in the Mexican oil industry. Pemex was always allowed to award service contracts to private companies as long as Pemex did not share profits or production with the contractor.

Nevertheless, as a result of the 2008 reform, Pemex was allowed to award the exploration, production and operation of large blocks of oilfields to private companies for a long term under E&P risk service contracts.⁴ Several blocks (mostly on-shore mature fields) were awarded to private companies under such a contract model.

The 2008 reform gave Pemex and its subsidiary entities more contractual flexibility. However, Pemex did not make full use of that flexibility. To a certain extent this was due to the stringent civil servant liability regime to which Pemex's employees are still subject, and also because it proved impossible to change Pemex's business culture overnight (especially after having done business in a very different way for decades).

Risk service contracts did not provide a sufficient enough incentive to attract international oil companies to explore and produce oil in deep-water projects. Also, the existing legal framework was not flexible enough to permit the development of shale oil and gas production.

3. The 2013 constitutional reform

The reform only referred to articles 25, 27 and 28 of the Mexican Constitution; however, the decree enacting the reform also contained 21 transitory articles providing guidelines on how the opening of the oil sector will be carried out.

The Mexican State will continue to have inalienable rights over oil and solid, liquid and gaseous hydrocarbons in the subsoil. This is the legal regime followed by most countries, with the United States being a notable exception.

Concessions for oil and gas exploration and production are still forbidden. The reason of the prohibition is that the State wants to be free to choose the terms and contract modalities under which licenses are given and be able to discretionally refuse to award a license. The State did not like the idea of having to grant a concession to whoever applied for it and complied with all the relevant requirements (as it is the case with mining concessions).

The Mexican Constitution now allows the granting of licenses (*asignaciones*) to State-owned companies and the execution of service contracts (consideration payable in cash), profit-sharing contracts (consideration payable partially from the profits of the project), production-sharing contracts (consideration partially in kind) and license contracts (royalties to be paid upon extraction of the hydrocarbons from the subsoil) with either State-owned or private companies. The aforementioned State-owned company is not necessarily Pemex, new ones could be formed (at least theoretically). Either the State (ie. the Ministry of Energy) or the State-owned companies (ie. Pemex) will be able to enter into such contracts with private entities.

The private contractors as well as the State-owned companies are expressly allowed to book reserves, provided they report the expected economic benefits from their rights to produce hydrocarbons as opposed to ownership over them.

² See the article "The proposal to amend PEMEX's tax regime – Is it a good indication of how IOCs will be taxed when Mexico opens up to private investment in the oil sector?", contributed by Carlos Moran to the *Energy Law Advisor*, Vol. 7, No. 4, December 2013 (<http://www.cailaw.org/media/files/IEL/Publications/2013/ela-proposal-pemex-vol7-no4.pdf>).

³ The constitutional reform also opened up the electricity market completely to the private sector for the first time, but this article will focus on the oil and gas segment of the reform.

Neither Pemex nor the Federal Electricity Commission (CFE) will be privatized, but they will be allowed to operate and be managed more like private entities and less like governmental agencies. Pemex will have more budget autonomy and will continue to be awarded licenses (asignaciones).

The reform also allows private investment in the mid-stream and the down-stream.

It is still uncertain how oil and gas licenses will co-exist with the mining rights that currently cover around 30% of the Mexican soil. Both activities are deemed as public interest activities and have preference over any of other use of the land (surface and subsoil). The State may expropriate land in the event landowners oppose such uses, and, in respect of mining, the State may grant temporary occupation rights or easements in favor of private concession-holders.

The constitutional amendment decree does state that mining concessions will not grant the right to produce hydrocarbons (except for coal bed methane under certain conditions), and that mining concession-holders will have to allow the performance of oil and gas exploration and production activities in the areas within their concessions.

4. New legislation and regulations – critical to implement the opening

In order to fully put into effect the opening of the oil industry, the Mexican Congress will need to pass additional legislation and the Mexican government will subsequently need to pass detailed regulations. As Mexico has had a very restrictive energy legal framework for decades, the implementing legislation and regulations will have to be created almost from scratch.

The energy reform was very encouraging at the constitutional level, but the implementing legislation and regulations will be critical for the success of the overhaul. Legislation is required on, among many others, how contracts will be awarded, how transparency and probity in the awarding and performance of such contracts will be guaranteed, how private producers will be taxed, how the environment will be protected, and what the national content requirements will be (without contravening international treaties).

The Mexican executive and legislative branches are determined to go full-speed on the implementation of the energy reform. The main decree requires the Congress to pass implementing legislation within 6 months after of the passage of the constitutional reform. It is hence expected that contracts may be awarded to private contractors as soon as 2015.

5. The Round Zero

The decree containing the constitutional amendments also requires Pemex to choose within 3 months (due on

March 21st, 2014) the licenses (asignaciones) it wants to keep for exploration and production purposes. Pemex has the right to keep the fields (areas and depths) where it already conducts production activities, so long as it provides detailed development plans for them and proves sufficient technical, financial and operational capabilities to operate its holdings in a competitive and efficient manner. By September 17, 2014, the Ministry of Energy will decide which ones will be kept by Pemex. The rest of the areas and depths will be awarded to private contractors.

It is expected that Pemex will try to retain most of its current licenses (asignaciones), in particular those in shallow waters. Pemex will be allowed to enter into partnerships with private companies to develop them, and even to amend and restate its current contracts with private entities in order to bring them in line with the new contractual regime.

Pemex will be allowed to continue exploration works for 3 years (2 additional years may apply) in those areas in which Pemex made discoveries prior to the constitutional reform. If, during that period, Pemex is successful in its exploration work, then Pemex will be allowed to proceed to production in those areas. Otherwise, the State will reclaim those areas (even if it needs to compensate Pemex for its non-recoverable expenses).

6. Relevant agencies and regulators

The Ministry of Energy (SENER) will lead, establish and coordinate the national energy policy.

The Ministry of Energy, with the assistance of the National Hydrocarbons Commission (CNH), will have the duty of awarding licenses (asignaciones) to Pemex and the selection of areas that will be awarded under service, profit-sharing, production-sharing and license contracts. To that effect, the ministry will have to create bidding guidelines and contract models.

The Ministry of Energy will also grant permits for oil refining and gas processing.

The National Hydrocarbon Commission will conduct the bidding procedures for the awarding of service, profit-sharing, production-sharing and license contracts to be entered by, on the one hand, private contractors, and, on the other, Pemex or the Ministry of Energy. The National Hydrocarbon Commission will even be in charge of conducting the bidding procedures related to the transferring of existing Pemex contracts into the contractual regime.

The National Hydrocarbons Commission will be in charge of the technical management of licenses (asignaciones) and contracts, and the supervision of compliance with production requirements and regulation.

The National Hydrocarbons Commission will also collect

⁴ See the article "The New Pemex E&P Risk Service Contracts" contributed by Carlos Moran and Eduardo Nuñez to The Energy Law Advisor Vol 5. No. 1, January 2011 (<http://www.cailaw.org/media/files/IEL/Publications/2011/energy-law-advisor-jan-2011.pdf>).

geological, seismic and operative data, and authorize surface exploration services.

The Energy Regulatory Commission (CRE) will have among its tasks the regulation of: permits for the storage and pipeline transportation of oil, gas and petrochemicals, and granting permits for those purposes; third party access to storage and pipelines; first hand sales of oil, gas and petrochemicals.

The new National Center for Natural Gas Control (CENAGAS) will supervise operation of the national natural gas storage and pipeline network.

The Ministry of Finance (SHCP) will lay down the fiscal and economic terms and conditions to be included in the aforementioned awarding procedures and contracts.

Mexico will also have its own sovereign fund. As of 2015, the Mexican Petroleum Fund for Stabilization and Development will administer, invest and distribute oil revenues. The fund will in turn be administered by the Mexican Central Bank.

7. Business opportunities and market reactions

Mexican and international businessmen in the oil and gas sector are very enthusiastic and optimistic about the reform. They say that there are plenty of opportunities, especially, for oil majors, drilling services companies and independent shale oil and gas producers.

Despite its declining production, Mexico is still the world's 10th largest oil producer and the world's 12th top exporter. It has the world's 18th largest oil and gas reserves and the 6th largest recoverable reserves of shale gas. At the end of 2012, Mexico's 1P reserves reached 13.8 billion BCOE, its 2P reserves (proved + probable) 26 billion BCOE, and its 3P reserves 18 billion BCOE, for a total of 45 billion BCOE.

Potential for growth is great assuming that Mexico and the US share the same geology. When it comes to offshore production, the number of oil rigs in the Mexican side of the Gulf of Mexico is miniscule in comparison to the amount the other side of the border. Opportunities are believed to be abundant for shale oil and gas producers too. For example,

the Eagle Ford Shale in Southern Texas extends into Mexican territory, but it remains unexplored on the Mexican side of the border.

Some of the factors that make Mexico appear to be an attractive country for oil and gas investment are: it is regarded as a stable and friendly economy; it has an attractive geology; it is in a strategic location; and, it has skilled personnel readily available.

The Mexican Minister of Energy predicts that annual foreign direct investment in the Mexican energy sector will be in the region of US\$10 billion. According to Bank of America Corp. the opening will bring more than US\$20 billion in foreign direct investment into Mexico as soon as 2015, and a report by BBVA Compass, estimates that the opening may bring around US\$1.2 trillion to the Texas-Northern Mexico region within 10 years.

According to Pemex's CEO, numerous players have expressed interest in the opportunities posed by the Mexican oil and gas opening and are looking for business opportunities in upstream and downstream projects.

During the weeks after the entry into force of the constitutional reform, several companies and governments have made announcements signaling confidence in the implementation of the Mexican oil reform, for instance:

- The President of Guatemala announced that Pemex and Guatemala will build a 370-mile US\$1.2 billion gas pipeline between the two countries to transport gas from the port of Salina Cruz, Mexico to Guatemala.
- Russia's No. 2 oil producer, Lukoil, announced the signing of a cooperation memorandum with Pemex for the purpose of sharing information on deep-water and shale deposits.
- The largest Italian oil company, Eni S.A., announced the opening of a representative office in Mexico City and that it has entered into discussions with Pemex.
- CFE announced that it will invest (along with private companies) US\$50 billion within 4 years in the construction of natural gas pipelines to serve its combined-cycle plants.

Pipeline Regulatory Issues Arising From Oil and Natural Gas Production Growth in North America

By Steven Levine, Paul Carpenter, and Matthew O'Loughlin, The Brattle Group¹

Most of the recent headlines about pipeline transportation are narrowly focused on the environmental effects of TransCanada's Keystone XL pipeline, which is designed to transport crude oil produced from the Canadian oil sands to U.S. markets. However, the increased production of both oil and natural gas in North America has given rise to two broad pipeline regulatory issues with significant implications for the industry. On the oil side, the existing crude oil pipeline takeaway capacity has become constrained and

highly valuable as an outlet for oil seeking higher value markets. In this environment, the rules governing shipper access to constrained oil pipeline capacity have become an important issue, and a few recent cases regarding pipeline access have been brought before regulators in both Canada and the United States. On the natural gas side, shale gas production growth has resulted in the underutilization (and potential stranding) of gas pipelines that transport gas from now more expensive supply basins (due to the development

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of cheap shale supplies). This article describes some recent cases in which economic principles have been applied to help resolve these two regulatory issues.

Access to Constrained Oil Pipelines

Oil production growth in western Canada combined with the delayed development of takeaway pipeline capacity has caused apportionment (pro-rationing) on pipelines and the decline of crude oil prices in Alberta. For example, Trans Mountain Pipeline (TMPL) has been experiencing high levels of apportionment on its system. TMPL is a pipeline that transports oil from Edmonton, Alberta to refineries in Washington state, to refineries and marketing terminals in British Columbia ("BC"), and to the Westridge Dock near Vancouver (where crude oil can be exported to markets in the U.S. and Asia). In response to that apportionment, Chevron Canada Limited, the owner of the Burnaby refinery near Vancouver, BC recently applied for a "Priority Destination Designation" (PDD) from Canada's National Energy Board (NEB). TMPL has a tariff provision that allows for a PDD in the event that a destination is "not capable of being supplied economically from alternative sources." Thus, PDD status, if granted by the NEB, would provide for improved access to the pipeline for some destinations (in this case, Chevron's Burnaby refinery) relative to others.

The NEB rejected Chevron's application in the summer of 2013, finding that a PDD should only be granted in extraordinary circumstances, and that Chevron's situation did not warrant a PDD.² In making its decision, the NEB noted that the Burnaby refinery had consistently been able to meet its minimum run rate using various alternatives to its own crude oil nominations on TMPL, including secondary market options (i.e., buying from other shippers on TMPL), bidding for capacity at the Westridge dock (and redirecting it to the refinery), and the construction of facilities that allowed rail-to-truck-to-refinery movements of crude oil. While these alternatives may not be as cheap as shipping on TMPL, the NEB found them to be reasonable alternatives to the pipeline for the purpose of meeting the refinery minimum run rate. Thus, the NEB found that Chevron's Burnaby refinery had the ability to mitigate the apportionment that was occurring on the pipeline and did not need (nor deserve) preferential access to TMPL.

In the U.S., Enbridge Energy recently filed before the Federal Energy Regulatory Commission (FERC) for a change to its Mainline Nomination Verification Procedure. The Enbridge Mainline has a capacity of roughly 2.5 million barrels per day of crude oil and extends from Edmonton to destinations in Canada, the Midwest U.S., Ontario, and New York. Following a rupture on its Mainline system near Marshall, Michigan in July 2010 that reduced its capacity, Enbridge temporarily instituted a nomination verification procedure on the Mainline that was based on historic volumes. Specifically, it limited verified volumes to "the highest volume delivered to that [destination] facility during

the 24-month period leading up to July 2010."

In October 2012, Enbridge filed with the FERC to remove the historical cap that was implemented in the aftermath of the July 2010 Mainline rupture. Following a February 2013 FERC technical conference, Enbridge submitted a revised proposal for verifying nominations to destination facilities that was based on the capability of the destination facility to receive volumes from the pipeline. Specifically, the Destination Verification Procedure requires each destination facility (refinery, storage facility, or common carrier) to execute an affidavit establishing the facility's maximum capacity for receiving volumes from Enbridge. The revised proposal also required each destination facility to provide a monthly affidavit verifying that it intends and agrees to receive the applicable shipper nominations.³

Enbridge's proposed changes to its verification procedure were based on economic principles of equal access to new and existing markets, equitable treatment of all shippers, and appropriate incentives for infrastructure investment and market development. The historical cap based on a frozen historical period was no longer appropriate, or economically sensible, in light of changing market conditions. For example, some of the refineries on Enbridge's system were in the process of making substantial investments to increase their capability to run additional volumes of heavy crude oil from Canada. In addition, new downstream pipeline interconnects were being added. Without a change to the historical cap implemented after the Marshall incident, refiners that made substantial investments to run additional volumes of Canadian crude would be limited in their ability to obtain additional volumes. Retention of the historical cap would limit the ability of shippers to access new or expanded facilities off the Enbridge Mainline, discourage refinery and infrastructure investment, and interfere with the overall development of the market. Enbridge's proposal provided all of its shippers equal access to both new and existing markets. The FERC approved the changes to Enbridge's nomination verification procedure finding that the proposal was not discriminatory in that all facilities were treated the same under the procedures proposed for calculating the capability of destination facilities.⁴

Gas Pipeline Asset Stranding

The boom in natural gas production has resulted in shifting flow patterns on the North American natural gas pipeline grid. The most extreme example of this can be seen in the Northeastern U.S., where Marcellus shale gas development has increased by roughly 10 billion cubic feet per day ("Bcf/d") in the past several years. Pipeline companies in the Marcellus have been building (and the FERC has approved) many new projects to accommodate the increased production and allow Marcellus supplies to be delivered into the Northeast U.S. pipeline grid. These new supplies have had dramatic effects on the utilization of pipeline capacity into and out of the region.

² See National Energy Board, Reasons for Decision MH-002-2012, July 2013.

³ See "Order Following Technical Conference," Docket No. IS13-17, July 18, 2013 (144 FERC ¶ 61,035).

⁴ Id.

One of the pipelines most adversely affected by these new Marcellus supplies has been the TransCanada Mainline, a long-haul pipeline with a capacity of approximately 7 Bcf/d extending from Alberta through Saskatchewan, Manitoba, Ontario, and into Quebec. The Mainline was constructed, and repeatedly expanded, to deliver western Canadian supplies to eastern Canada, and for export to the U.S. Midwest and Northeast. As a result of increased shale gas production, U.S. demand for more expensive Canadian imports has fallen precipitously. In this environment, average annual Mainline flows have declined substantially over the last several years, to less than 3 Bcf/d in 2012, and expiring long-haul contracts on the pipeline have not been renewed, potentially stranding significant unrecovered investment in the Mainline. What economic and regulatory policies should apply to the potential stranding of pipeline assets? A recent decision by the Canadian NEB involving the Mainline signals how at least one regulator is grappling with the issue.

In 2011, TransCanada applied to the NEB for approval of a proposed restructuring of the tolls and services on the TransCanada Mainline. After lengthy proceedings that included 72 days of oral hearings, the NEB issued its decision in March of 2013.⁵ Instead of approving the Mainline's proposal, the NEB crafted a model for how the Mainline's tolls and services would be established over the next five years, accepting TransCanada's proposals for some elements, rejecting some of TransCanada's proposals, and instituting its own recommendations for other elements. To provide toll certainty, the NEB decided to fix Mainline firm transportation tolls at a level that it deemed to be "competitive," and that it recognized would be below full cost recovery. To give the Mainline an opportunity to recover those costs in the future, the NEB established a deferral account to keep track of those costs, the disposition of which (as between shareholders or customers) would be determined in a future proceeding. In recognizing that the Mainline was operating in a new and very competitive environment, the NEB also gave the Mainline unfettered discretion to charge what the market would bear for short-term and interruptible services, the revenues from which would be used to offset the costs accumulating in the deferral account. The NEB also recognized that the business risk of the Mainline had increased, in part as a result of its regulatory model, and awarded the Mainline an allowed rate of return which is favorable relative to returns awarded to other Canadian natural gas pipelines. While the NEB's regulatory model for the Mainline did not disallow the recovery of any costs, it sounded a stern warning in the decision that the Mainline must be accountable for its decisions, and do everything within its means to be competitive or risk the disallowance of even prudently-incurred costs in the future.

Already, the NEB's decision is having some effect on the pipeline and its customers. It has spurred TransCanada

to look for ways to redeploy a portion of the Mainline's underutilized assets to oil service (the Energy East Project). The implementation of the low-priced fixed tolls coupled with the Mainline's pricing discretion for short-term and interruptible services is causing some shippers to recontract for longer-term firm service from western Canada. In short, the higher risk environment faced by this pipeline, and perhaps many others, is causing a fundamental rethinking of the structure of rates, risks and returns to be applied to gas pipelines.

TransCanada's Energy East Project could be useful both for easing the oil pipeline constraints now impacting western Canada's oil markets and mitigating the stranded asset problem facing the TransCanada Mainline. The Energy East Project proposes to transport crude oil from Alberta to Eastern Canada for use in eastern Canadian refineries and for export from eastern Canada to overseas markets. TransCanada plans to convert some of its existing and unutilized Mainline gas pipeline capacity as part of the Energy East project. TransCanada plans to file for NEB approval of its Energy East project (and associated conversion of Mainline capacity) in 2014.

U.S. gas pipelines have also been affected by the changing flow patterns that have accompanied shale gas development. One example is the Rockies Express pipeline, a relatively new pipeline extending from Colorado to eastern Ohio. The pipeline was developed prior to the substantial development of Marcellus shale supplies and was placed into service in 2008-2009. Rockies Express was intended to transport growing Rocky Mountain supplies from west to east to serve Midwestern and Northeastern gas markets. However, with the development of Marcellus shale supplies, there is now the possibility that the eastern portion of the Rockies Express pipeline might start transporting gas in the reverse direction, from east to west to serve markets in the Midwest. In fact, Rockies Express recently filed a petition for a declaratory order with the FERC requesting a determination that new services offered in an east-to-west direction will not trigger the Most Favored Nations (MFN) provisions of existing transportation agreements it has with its original shippers that signed negotiated contracts for west-to-east service. Rockies Express told FERC in its filing that it will not offer east-to-west transportation service if such services trigger the MFN provisions of its existing contracts since the revenue stream provided by the existing contracts support Rockies Express' debt payments.⁶ Over the objections of some shippers who claimed that the issue should be addressed by the courts and that contractual and tariff language made it clear that the MFN provisions would be triggered by the offering of east-to-west service, the FERC granted Rockies Express' petition.⁷

Rockies Express is not the only U.S. gas pipeline affected by the development of Marcellus shale supplies. Other pipelines that historically delivered natural gas from the U.S.

⁵ See National Energy Board, Reasons for Decision RH-003-2011, March 2013.

⁶ See Petition for Declaratory Order and Request for Expedited Consideration of Rockies Express Pipeline in Docket No. RP13- 969, June 6, 2013.

⁷ See Order on Petition for Declaratory Order, November 26, 2013 (145 FERC ¶ 61,179)

Gulf Coast to the Midwest and Northeast U.S. have also been affected and have experienced declining demand for transportation services from the Gulf. In this environment, U.S. gas pipelines have also been considering conversion projects to mitigate their exposure to stranded costs. For example, the FERC has recently approved Trunkline's application to abandon 770 miles of gas pipeline capacity, which will be transferred to an affiliate and converted to oil transportation.⁸ In approving the abandonment, FERC rejected the protests by some shippers concerned about Trunkline's ability to meet existing gas transportation obligations and future service demands in the Midwest. Likewise, Kinder Morgan and Markwest are considering a project to convert 1,000 miles of the existing Tennessee Gas Pipeline (TGP) to allow it to transport natural gas liquids or NGLs from the U.S. Northeast to the Gulf Coast. TGP has also seen a decline in demand for its long-haul gas transportation services from the Gulf Coast. NGL production is increasing in the Northeast as a result of increased natural

gas production from the Marcellus shale, and TGP's existing assets have the potential to transport NGLs to markets (and fractionation facilities) in the Gulf Coast.

Conclusion

The increased production of oil in North America has constrained some oil pipelines and required regulators to revisit the rules governing shipper access to pipelines. Regulators have had to consider the impacts of pipeline apportionment and consider procedures to ensure equal access for shippers to new and existing markets. Increased production of natural gas has adversely impacted some incumbent gas pipelines, and resulted in regulatory and market responses to mitigate potential stranded cost impacts of shifting flow patterns. These responses have included cost deferral mechanisms, enhanced pricing discretion for short-term transportation services, and the potential conversion of some gas pipelines to oil and liquids pipelines.

⁸ See Order Approving Abandonment in Docket No. CP12-491, November 7, 2013 (145 FERC ¶ 61,108).

***H. B. Krug v. Helmerich & Payne, Inc.* 2013 OK 104, ___ P.3d ___ (Okla. Sup. Ct. Dec. 10, 2013), Petition for Rehearing pending as of February 7, 2014**

By Mark D. Christiansen¹

On December 10, 2013, the Oklahoma Supreme Court issued its decision in the long-pending trial and appellate court proceedings in *Krug v. Helmerich & Payne, Inc.*, a lawsuit that has been of great concern to many in the oil and gas industry. The underlying facts in that lawsuit involved two 640-acre drilling and spacing units in Western Oklahoma. Helmerich & Payne (H&P) and others were the prior working interest owners in those sections, and H&P was the operator of certain wells located in the two sections. H&P divested its interest in the leases and wells in 1998.

The case was certified as a class action lawsuit on behalf of the royalty owners in the two units. The complex factual backdrop of the case (which included a take-or-pay gas contract lawsuit against ANR Pipeline Company) is summarized in the court's recent opinion. The plaintiffs alleged, among other things, (a) that H&P failed to act as a reasonably prudent operator and allowed uncompensated drainage of natural gas to occur from the two sections beginning January 1, 1982, and ending December 31, 1989; (b) that H&P received payment for uncompensated drainage through its October 31, 1989, take-or-pay lawsuit settlement with ANR; (c) that H&P concealed the settlement from the royalty interest owners, (d) that the plaintiff class was entitled to a share of the sum allegedly received by H&P for drainage claims under that settlement; (e) that the class should recover all profits H&P obtained over the subsequent years from the monies that should have been paid to the royalty owners; and (f) that the defendant's conduct involved

fraud, the defendant had been unjustly enriched, and the class should recover both actual and punitive damages.

The case proceeded to a jury trial. The jury returned a verdict in favor of the plaintiff class on the alternative claims and awarded (a) \$3,650,000 for breach of the implied duty to prevent uncompensated drainage, (b) \$4,055,000 for breach of fiduciary duty for failure to prevent uncompensated drainage, and (c) \$6,845,000 for constructive fraud related to the ANR settlement. Based on its finding that H&P had been unjustly enriched,² the trial court conducted a second-stage hearing for the jury to determine, relative to the "disgorgement of profits" request, the amount of gross profit H&P made on the \$6,845,000 that H&P had failed to pay since October 31, 1989. After receiving evidence, the jury awarded the class \$61,662,000 for disgorgement of profits on that sum.

However, the trial court found that the award for disgorgement of profits should be increased to \$112,677,750. To that amount, the court added the \$6,845,000 in damages and set the total amount awarded against H&P as \$119,522,750. The court also awarded interest on the \$6,845,000 amount from the date of rendition (November 21, 2008), and interest on the remaining \$112,677,750 amount from the date of rendition (January 8, 2009) until paid in full. The court further awarded the class its costs and attorney fees.

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² The jury verdict form stated that the jury did not "find by clear and convincing evidence that the Defendant acted in reckless disregard for the rights of others," and the jury did not "find by clear and convincing evidence that the Defendant acted intentionally and with malice toward others." ¶ 18.

In reversing in part and affirming in part the judgment of the trial court, certain of the key rulings of the Oklahoma Supreme Court are as follows:

1. With regard to H&P's contention that the lower courts had allowed a breach of contract claim to be recast as an equitable unjust enrichment claim, involving the disgorgement of profits, the court recognized long-standing principles of law to the effect that a plaintiff may not pursue an equitable remedy when the plaintiff has an adequate remedy at law. With regard to contract lawsuits in particular, the court stated in part:

"Parties initiate contracts to provide a degree of certainty in their business transactions. . . The essential principle of contract law is the consensual formation of relationships with bargained-for duties. The obvious corollary is bargained-for liabilities for failure to perform those duties. 'Important to the vitality of contract is the capacity voluntarily to define the consequences of the breach of a duty before assuming the duty.' *Isler v. Texas Oil & Gas Corp.*, 749 F.2d 22, 23 (10th Cir. 1984)." ¶135.

The court found that the plaintiffs in this case relied upon, enforced and were awarded damages in the amount of \$3,650,000 based on a breach of valid oil and gas lease contracts with H&P. That award afforded the plaintiff class an adequate remedy at law, with the result that the equitable claims could not be recognized. The court reversed the \$4,055,000 award for alleged breach of fiduciary duty for failure to prevent uncompensated drainage, and further reversed the \$119,522,750 award for disgorgement of profits and constructive fraud.

2. The court rejected H&P's contention that the trial court erred in instructing the jury regarding the allegations of

uncompensated drainage. Specifically, H&P asserted that the jury should have been instructed to determine the "net flow" of gas—i.e., whether the outflow of gas from the sections was compensated for by counter-drainage and an in-flow of gas from adjoining sections. The court found that, under the facts presented in this case, H&P's gas contract litigation settlement with ANR "was based on a time period where there would not have been an outflow of gas because ANR was not taking gas at that time." ¶131. The damages award of \$3,650,000 for breach of contract (i.e., breach of the implied duty to prevent uncompensated drainage) was left intact by the court.

3. With regard to the contentions of the plaintiff class that H&P violated a fiduciary duty to the class to prevent uncompensated drainage, the court found that "the law is long-standing and settled that a producer's liability is purely a contractual one and in no sense fiduciary." ¶18. The court further found that the trial court erred in presenting the jury with an instruction that permitted the jury to find that H&P owed a fiduciary duty to the plaintiffs to prevent uncompensated drainage. Rather, because H&P's duty was contractual (i.e., based on the oil and gas lease), the court held that the remedy should be based on breach of contract.

The Oklahoma Supreme Court's rejection of the disgorgement of profits claim was particularly reassuring to those whose business and other activities involve contractual and transactional dealings. The specter of litigants attempting to seek, for example, a twenty-five percent or greater rate of return on their claims where the defendant in a suit for money happened to be engaged in profitable business activities was a troubling notion far beyond just the energy industry.

San Antonio Court of Appeals Finds that Royalties from Horizontal Well Should Be Allocated Based on Productive Portion of Well, Not its Entire Length

By Meghan Dawson McElvy

On December 20, 2013, the San Antonio Court of Appeals issued a decision concerning the proper construction of a contract used to allocate royalties from a horizontal well that traverses two separate properties. The decision, *Springer Ranch, Ltd. v. O.F. Jones III, et al.*, is important for two reasons. It is the first and only other Texas decision to address the proper method for allocating royalties for horizontal wells since the Austin Court of Appeals' opinion in *Browning Oil Co., Inc. v. Luecke* on November 9, 2000. Further, it holds that where a contract requires royalties from a horizontal well to be allocated, they should be allocated based on the productive portion of the well, not its entire length.

The horizontal well at issue in the case (the "SR2 well") began on the tract of the appellant, Springer Ranch, Ltd. ("Springer Ranch"), but ended under the property of Rosalie Matthews Sullivan, one of the appellees (collectively, "the Matthews"). As a result of a prior dispute over royalties, the

parties had executed a contract in 1993, which provided in part that: "all royalties payable under the above described Oil and Gas Lease from any well or wells on said 8,545.02 acre tract, shall be paid 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 . . ." The agreement affected six vertical wells at the time it was made.

Springer Ranch argued in a summary judgment motion that because (i) the SR2 well began on its property, and (ii) the 1993 contract prohibited allocation based on the well's production unit, it was entitled to 100% of the royalties from the well. The Matthews, however, argued in their own summary judgment motion that the SR2 well was "situated on" both Springer Ranch's and Sullivan's property and, thus, royalties should be allocated to each party based on the productive portion of the well on their properties.

In support of their motion, the Matthews submitted the affidavit of a petroleum engineer, which calculated the allocation of royalties by measuring the total distance between the SR2 well's first and last takepoints within the correlative interval, the distance between its first take point and the property line between Sullivan and Springer Ranch's properties, and the distance between the property line and the well's last takepoint. The expert then multiplied the one-eighth royalty provided under the lease by the ratio of the total distance between the first and last takepoints to allocate the royalties. Providing this summary judgment evidence was probably prudent given the decision in Luecke, in which the Austin Court of Appeals remanded an invalid pooling case for a new trial on damages where the plaintiff failed to present any evidence allowing for a determination of how much production from a horizontal well crossing multiple tracts was attributable to their own property. Importantly, Springer Ranch did not dispute the Matthews' expert's measurements or calculations, nor did it offer evidence of any other basis for determining how much production was obtained from the parties' respective tracts. The trial court ruled in favor of the Matthews, and Springer Ranch appealed.

The court of appeals affirmed the trial court's judgment. In doing so, it first analyzed the key terms of the contract—most importantly the term “well”—and concluded that Springer Ranch's construction of the term conflated the ordinary and technical meaning of the word “well” with “wellhead.” It therefore agreed with the trial court that the SR2 well was “situated on” both the Springer Ranch and Sullivan properties for purposes of the 1993 contract, and that royalties must be allocated to each. The court of appeals next addressed the method of allocation. It found that a royalty is a fraction of production, and that production—whether from a vertical or horizontal well—is not obtained from the entire length of the well, but from the part of the well that pierces and drains the reservoir in which the hydrocarbons reside. Thus, the court of appeals held that the trial court correctly allocated royalties based on the producing portion of the SR2 well, not its whole length.

Although the specific contractual language at issue in Springer Ranch limits the case's broader application somewhat, the court of appeals' approval of an allocation method for royalties based on the producing portion of a well, rather than its entire length, at least in the absence of any contractual language to the contrary, provides important clarity to operators of horizontal wells in Texas.

Colorado's Post-Referendum Strategy: Beat the Environmentalists at Their Own Digital Game

Richard S. Levick, Esq.ⁱ

President Obama's 2014 State of the Union address may very well mark a watershed moment in U.S. energy policy. The Keystone Pipeline now seems on the verge of State Department approval. Hydraulic fracturing will likely not be hindered by federal red tape. If the President's words are any indication, the energy industry likely won't be a significant target of the regulatory blitz that may come to define his final two years in office.

But while the government certainly seems to be in the energy industry's corner, the governed are another matter—and recent events demonstrate that oil and gas companies have some work to do before the people match their president's zeal.

Will Rogers once said that “politics has become so expensive that it takes a lot of money even to be defeated.” Last November in Colorado, that maxim rang true as voters in Boulder, Broomfield, Fort Collins, and Lafayette adopted moratoriums on hydraulic fracturing. Energy interests spent upwards of \$900,000 to defeat those referendums. Expensive losses indeed.

At the same time, however, environmentalists on the other side turned Will Rogers' wisdom on its ear. They

shelled out a paltry \$26,000 and scored a clean sweep. Why? Because they understand that Mr. Rogers' theory only holds true when success is pinned to strategies and tactics that are as antiquated as black and white movies. From a communications and public affairs standpoint, the energy industry dropped \$900,000 on a six-shooter. The environmental lobby spent a fraction of that sum and put an ICBM in their arsenal.

While industry devoted its resources to lobbying and TV advertising, environmentalists turned to digital and social media strategies that effectively neutralized the advantage that big budgets provide. They developed content-rich microsites that outlined fracking's supposed dangers. They used Facebook to carefully target their messages, tap into supporters' networks, and boost GOTV (Get Out The Vote) efforts. Twitter was a venue to push every positive development and promote screenings of the popular anti-fracking movies *Gasland* and *Gasland II*. YouTube channels were created to illustrate fracking's alleged impacts and infuse activist messaging with a healthy dose of fear.

In the end, Colorado was a microcosm of trends we're seeing play out nationwide. Combined, the top ten fracking opposition groups enjoy 2.1 million Facebook likes and 1.2

ⁱ Follow Richard Levick on Twitter and circle him on Google+, where he comments on the energy communications issues impacting corporate brands.

Richard Levick, Esq., Chairman and CEO of LEVICK, represents countries and companies in the highest-stakes global communications matters — from the Wall Street crisis and the Gulf oil spill to Guantanamo Bay and the Catholic Church. Mr. Levick was honored for the past four years on NACD Directorship's list of “The 100 Most Influential People in the Boardroom,” and has been named to multiple professional Halls of Fame for lifetime achievement. He is the co-author of three books, including *The Communicators: Leadership in the Age of Crisis*, and is a regular commentator on television, in print, and on the most widely read business blogs.

million Twitter followers. When compared to the 28,000 Facebook likes and 70,000 Twitter followers that supporters have attracted to date, environmentalist victories in the Centennial State come into sharper focus. They assumed control of the digital high ground in Colorado, just as they have in other regions across the country. That put the grassroots in their corner and industry interests on their heels.

Jon Haubert is a veteran of Colorado's fracking wars and is among the first to admit that industry wasn't doing enough to combat environmentalists' online advantage. As the communications director at Coloradans for Responsible Energy Development (CRED), he witnessed the impact of online advocacy first hand. Now, he is implementing strategies aimed at leveling the digital playing field.

"Their social and digital media activity created two significant challenges for those of us in support of hydraulic fracturing," says Mr. Haubert. "First, it meant the public was only getting one side of the story whenever it turned to the Web for information. Many Coloradans were looking into the issue for just the first time in the lead up to November. They didn't know what fracking was. They weren't familiar with the processes involved. They didn't understand all the steps industry takes to ensure that it is done safely. Their introduction to the issue was skewed by combative perspectives. That put us in the position of having to fight an uphill battle.

"And second, their dominance of social and digital media enabled misinformation to run rampant and take on the weight of fact. One month before the vote, environmentalists seized upon the 500-year floods in Colorado as an opportunity to connect fracking to water contamination. The reality is that the oil and gas industry does a phenomenal job when it comes to protecting our water. But that didn't matter. The word was out and the damage was done – to the point that even the Denver Post ran a front-page image implying a leak that never happened.

"Ultimately, we realized that our successful "grasstops" outreach on regulatory and legislative issues was leaving the public out of the equation. We need the average Coloradan to be as well informed as their regulators and elected officials. That's our philosophy moving forward, and it's taking us in a decidedly digital direction."

In the months following the Colorado referendums, CRED is making good on that commitment and, in fact, creating a template for success wherever environmentalists threaten fracking's prospects. The first step was a revamped website that transformed a static Web property into a dynamic

user experience. Images, video, and infographics play a more prominent role to draw users in, promote "shareable" content, and infuse industry messages with positive emotional cues. A blog keeps supporters informed on the latest developments. Prominent social media tabs now make it easy for users to stay connected on an ongoing basis.

Second was the creation of StudyFracking.com, a stand-alone microsite that seeks to educate the public on the basics of fracking and combat the misinformation that environmentalists have so adeptly disseminated. "We are finally providing people with the ability to do their own homework," says Mr. Haubert. "They don't want us to tell them what to think; they want us to demonstrate that fracking has been studied and found to be safe. They are hungry for information that lets them breathe a sigh of relief – and that is precisely what StudyFracking.com is designed to provide."

Like CRED's revamped website, StudyFracking.com is highly optimized and is often ranked on the first page of results for a variety of Google searches related to fracking in Colorado. That's important to note not only because it exponentially increases the chances that CRED messages are found amid the clutter of the online space; but because it affirms that CRED's efforts are working, as Google places added emphasis on websites that draw a strong following.

CRED's social media presence is expanding as well – due in large part to these new Web properties and new outreach initiatives aimed at supporters of American energy independence, moderate environmentalists who understand the benefits of natural gas, and the 110,000 people either employed or supported by Colorado's oil and gas industry. Its Facebook page now boasts more than 14,000 fans, 10,000 more than Conservation Colorado and the Sierra Club's Rocky Mountain Chapter combined. Its Twitter presence is still in a nascent stage, but still maintains more than 600 followers, with more signing on every day.

To some throughout the energy industry, Colorado's referendums were only minor skirmishes in the larger war over fracking's future role in U.S. energy policy; but the lessons learned are equally applicable in New York, Pennsylvania, Ohio, and anywhere else environmentalists are fighting the shale boom with every tool at their disposal. To its credit, CRED took heed and is altering its approach to advocacy in the age of the digital citizen. As a result, it's not only better positioned for Round Two; it is proving yet another of Will Rogers' maxims true. Good judgment really is borne of bad experience.

Submissions

| Email Industry News to [Brit Brown](#) and [Lilly Hogarth](#). Email Member Announcements to [Lilly Hogarth](#).

| Please submit photo with announcement if possible.



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