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Four Practical Tips for Optimizing Insurance Recovery in Litigation Arising from the Oil-Price Slump

By Micah Skidmore

Earlier this month, the U.S. Energy Information Administration released its short-term energy outlook forecasting continued weakness in crude oil prices through 2016 and into 2017.[1] Already, the combination of historically high domestic production and declining demand at home and overseas has caused financial distress for domestic E&P companies.[2] In addition to lower than anticipated revenues and corporate downsizing, E&P companies can also expect increased litigation arising from the ongoing price distortions in energy markets. Disputes between landowners and lessees, employment-related claims, and corporate litigation with contracting parties, shareholders and regulators are each likely to increase as financial pressures mount. Fortunately, in the face of this surge in litigation, liability insurance may provide a much needed source of liquidity and protection for plaintiffs and defendants alike. Here are four practical tips for risk managers and in-house counsel to maximize recovery from insurance for defense costs, damages and other liability in litigation arising from the oil-price slump.

Landowner/Lessee Disputes

Over the past year, sustained weakness in energy prices has caused North American rig counts to fall sharply—from 1670 in February 2015 to 720 today—a decrease of more than 56 percent.[3] As production continues to decline, litigation between landowners and lessees over lease terminations, retained acreage and royalty calculations has correspondingly increased.[4] With this rise in litigation, both lessors and lessees should be aware and take advantage of the liability insurance coverage available to protect defendants against exposure to defense costs and damages and to provide plaintiffs with a potential source of recovery.

General liability insurance, for example, typically provides coverage for defense costs and damages an insured is obligated to pay because of bodily injury or property damage, including the "loss of use" of tangible property that is not physically injured. In *ConocoPhillips Company v. Vaquillas Unproven Minerals, Ltd.*, 2015 WL 4638272 (Tex. App.—San Antonio Aug. 5, 2015, pet. filed), the San Antonio Court of Appeals ruled that ConocoPhillips was required to release all but 40 acres surrounding producing and shut-in natural gas wells capable of producing in paying quantities after the parties' lease terminated. ConocoPhillips had argued for retention of 640 acres per well. In *XOG Operating, LLC v. Chesapeake Exploration Ltd. P'ship*, 2015 Tex. App. LEXIS 9411 (Tex. App.—Amarillo Sept. 2, 2015, pet. filed), the Amarillo Court of Appeals likewise ruled on another retained acreage dispute, finding that Chesapeake could retain 320 acres per well. In both cases, the landowners fundamentally challenged the loss of the mineral estate accompanying lessees' retention of excess lease acreage. That "loss of use" of real

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[1] U.S. ENERGY INFORMATION ADMINISTRATION, SHORT-TERM ENERGY OUTLOOK (Feb. 2016), ("Brent crude oil prices are forecast to average $38/b in 2016 and $50/b in 2017. West Texas Intermediate (WTI) crude oil prices are expected to average the same as Brent in both years. However, the current values of futures and options contracts continue to suggest high uncertainty in the price outlook.").
[2] Jennifer Reingold, *The Devastating Impact of Falling Oil Prices, in One Chart*, FORTUNE (Dec. 15, 2015).
[3] Baker Hughes, Rotary Rig Count Summary (Feb. 19, 2016).
[4] *See, e.g.*, *Chesapeake Exploration, LLC v. Hyder*, 2016 Tex. LEXIS 113 (Tex. Jan. 29, 2016) ("The Hyders and Chesapeake agree that the overriding royalty is free of production costs; they dispute whether it is also free of postproduction costs.").

property may qualify as "property damage" for purposes of triggering either a duty to defend or a duty to indemnify the lessee under a commercial general liability policy.[5]

Other disputes likely to surface with mounting dissatisfaction over low royalties may also include the elements needed to justify payment of defense costs or damages under general liability policies or other common forms of liability insurance.[6] In particular, claims by landowners (or regulators) alleging fraudulent royalty calculations may prompt coverage under a lessee's D&O or E&O policies, which generally insure against loss, including defense costs, to an insured individual or organization resulting from a claim alleging "wrongful acts." With energy firms under increasing financial pressure from stagnant, low oil prices, it is imperative to seek out and pursue recovery from all available liability insurance.

Labor and Employment Litigation

By some counts, declines in oil prices since the end of 2014 had already resulted in more than 250,000 layoffs in the global energy industry by the end of last year.[7] As supply continues to outpace demand for oil and natural gas, with new Iranian production and continued slowing in the Chinese economy anticipated in 2016, E&P companies will continue to look to payrolls to reduce expenses. Additional layoffs and salary cuts are coming.[8] The rising tide of unemployment in the oilfield will inevitably prompt workers and regulators to bring new wage and hour claims under the Fair Labor Standards Act ("**FLSA**"), along with other employment litigation, including discrimination claims.

Companies carrying Employment Practices Liability Insurance ("**EPLI**") are protected from loss arising from claims for specific employment practices "wrongful acts" such as wrongful termination, breach of employment contract, harassment, discrimination, employment-related misrepresentations and retaliation. Historically, traditional "wage and hour" claims have been excluded under many EPLI policies. But as employers are increasingly subject to these claims, many insurers have provided some limited coverage for alleged FLSA violations. For example, some policy endorsements provide sublimited coverage for defense costs incurred to oppose wage and hour claims. Terms may also be added to EPLI policies to insure the cost of defending investigations by government regulators, both with respect to FLSA violations as well as inquiries by U.S. Immigration and Customs Enforcement. Other insurers have offered stand-alone Wage & Hour Liability Insurance policies targeted to large employers.

For E&P companies that do not have specialized "wage and hour" insurance, a conventional EPLI policy may nonetheless afford some coverage for collateral allegations made in FLSA litigation. Assertions of discrimination or harassment, for example, may justify coverage for defense costs, even when those claims are made alongside allegations of excluded "wage and hour" violations.[9] Particularly in the current volatile economic environment, risk managers and in-house counsel should carefully review the allegations in labor and employment suits against the terms of the company's EPLI policy to determine what coverage may be available. Alternatively, with the increase in FLSA litigation at large, many companies may find value in procuring specific wage and hour coverage, whether in a stand-alone policy or EPLI endorsement.

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[5] *Cf.* *Mid-Continent Casualty Co. v. Camaley Energy Co., Inc.*, 364 F. Supp. 2d 600 (N.D. Tex. 2005) (holding that lessees' loss of use of an oil lease qualifies as "property damage").

[6] *See, e.g.*, *Clayton Williams Energy, Inc. v. BMT O&G TX, L.P.*, 2015 WL 4134577 (Tex. App.—El Paso July 8, 2015, pet. filed) (addressing allegations that lessee's farmout agreement had caused lessors "special damages stemming from the loss of the Petrohawk Lease; loss of hydrocarbons; loss of value to the mineral estate from June 1, 2011, until the date the trial court issued its Phase I Findings of Fact and Conclusions of Law on January 29, 2013; and damages to the wellbore, subsurface, and reservoir").

[7] Charles Kennedy, *Oil Jobs Lost: 250,000 and Counting, Texas Likely to See Massive Layoffs Soon*, OILPRICE.COM (Nov. 23, 2015).

[8] Nathan Bomey, *More job cuts expected for oil workers in 2016*, USA TODAY (Jan. 8, 2016).

[9] *See, e.g.*, *PHP Insurance Service Inc. v. Greenwich Insurance Co.*, 2015 U.S. Dist. LEXIS 106274 (N.D. Cal. Aug. 12, 2015) ("To be sure, the claims actually asserted in the underlying action involved violations of California labor law. However, Greenwich would have the Court construct a silo around those claims and conclude that no duty to defend could ever be triggered in such an action, regardless of the facts alleged in the complaint or the language of the Policy. . . . The breadth of the duty to defend is such that the possibility the Ho plaintiffs could assert claims arising out of their factual allegations concerning PHP's discrimination against and harassment of its employees triggered Greenwich's duty to defend under the Policy until such time as it could be shown that there was no longer any potential for coverage.").

Policy Buybacks

Most general liability policies are "occurrence" policies, triggered when bodily injury, property damage or personal and advertising injury "occurs." As a result, some claims may be made in the present that implicate (latent) injuries and insurance from the distant past. Asbestos and environmental litigation, for example, can allege injuries from decades ago, and the liability insurance policies in place from years past may still respond with coverage for defense costs and damages.

An insurer's potential liability under legacy insurance policies may be substantial.[10] With that potential legacy liability comes an opportunity for corporate policyholders. Insurers and insureds may negotiate a "buyback" of legacy "occurrence" policies in which the insured releases all claims and obligations under a series of policies, such that the policies are rescinded or cancelled, in exchange for payment. In some cases, the "buyback" includes the resolution of specific pending claims under the subject contracts. In other cases, the parties' transaction turns on the prospective future exposure the insurer may have under the policies to be "bought back." In either case, a well-conceived policy buyback may provide an important source of liquidity to the corporate policyholder.[11]

E&P companies contemplating a policy "buyback" should seek professional help in evaluating the appropriate consideration and the value of the potential insurance coverage to be compromised in the transaction, both in terms of the likely liability exposure, including defense costs, and the scope of the available coverage. Care should also be given to ensure that compliance with contractual and statutory requirements, including anti-nullification laws, if applicable, is not sacrificed in the exchange.[12] If compliance can be achieved, a thoughtful and deliberate policy "buyback" may provide significant value to E&P companies under pressure from current market conditions.

Investor, Regulatory and Contractual Litigation

The prolonged slump in oil prices and the accompanying pressure on earnings may prompt a variety of non-employment claims in litigation. Shareholders and joint venture partners may allege breaches of fiduciary duties, misrepresentations or fraud in connection with action or inaction relating to the current adverse market conditions. As a growing number of companies seek bankruptcy protection, creditors and trustees may bring similar claims against corporate management and directors. Consolidation through distressed M&A activity may trigger strike suits. Aggregate distress in the energy industry will draw increased scrutiny from regulators regarding individual corporate disclosures. Owners, operators and service companies unable either to meet contractual obligations or negotiate a satisfactory compromise may find themselves embroiled in litigation over contracts. In short, economic pressure created by excess supply and slackening demand may put many E&P companies in the position of plaintiff or defendant in some form of litigation before the crisis abates.

D&O insurance provides coverage to the "insured organization" and its officers, directors and employees for loss, including defense costs, arising from claims made during the policy period for "wrongful acts," including acts, errors and omissions committed or omitted in an insured capacity. Depending on whether the insured organization is a public or private company, the "claims" insured under a D&O policy may be limited to "securities claims" or may include any written demand for monetary relief, including all manner of civil or regulatory proceedings. Some D&O policies may also include coverage for regulatory investigations of insured individuals and organizations. Many D&O policies exclude coverage for claims by one insured (entity or

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[10] Jonathan Stempel, *Court Orders Travelers to Pay $500M in Johns-Manville Asbestos Claims*, INSURANCE JOURNAL (July 22, 2014).

[11] Douglas Mcleod, *Honeywell settles asbestos liabilities with Equitas*, BUSINESS INSURANCE (April 1, 2003), ("Equitas Ltd. will pay $472 million to Honeywell International Inc. in a policy buyback, settling all of Honeywell's asbestos and other claims against Lloyd's of London syndicates reinsured by Equitas, the two sides announced.").

[12] *See, e.g.*, LA. REV. STAT. ANN. § 22:1262 (2016) ("No insurance contract insuring against loss or damage through legal liability for the bodily injury or death by accident of any individual, or for damage to the property of any person, shall be retroactively annulled by any agreement between the insurer and insured after the occurrence of any such injury, death, or damage for which the insured may be liable, and any such annulment attempted shall be null and void.").

individual) against another, subject to exceptions for claims brought by a trustee or receiver in bankruptcy. Many D&O policies also exclude coverage for claims against an insured entity arising out of a breach of contract.

Notwithstanding these exclusions, D&O insurance may prove an essential financial resource for E&P companies to offset liability for defense costs, settlements and judgments in litigation arising out of the current oil-price slump. Shareholder claims (brought without the assistance of insured officers and directors), trustee claims in bankruptcy, regulatory investigations and M&A strike suits are paradigmatic, covered D&O claims. Even claims brought by one insured against another or claims alleging breach of contract may trigger some coverage under conventional D&O insurance, when coupled with claims by a non-insured entity or individual or when paired with allegations beyond the parties' contracts. With all of the economic forces weighing on E&P companies, it is incumbent on risk managers and in-house counsel to pursue and exhaust the financial benefits afforded by corporate liability insurance. Doing so will best position corporate policyholders to weather the current crisis and take advantage of the future recovery in energy markets.

If you have questions about the policy buybacks or the availability of insurance coverage in connection with landowner/lessee disputes, employment litigation, or investor, regulatory and contractual disputes, please contact one of the Haynes and Boone Insurance Recovery Practice Group partners listed below.

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