Insights
March 2024

Skadden

Three Unfolding Cases Could Shape Future Energy Litigation, and Perhaps Business Practices

This article was published in the March 2024 issue of *Insights*.

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Michelle P. Scheffler
Partner / Houston
713.655.5130
michelle.scheffler@skadden.com

Rachael K. Cox
Associate / Houston
713.655.5153
rachael.cox@skadden.com

Key Points

- Oil and gas producers — particularly smaller-scale ones — should take note of Texas' challenge to the EPA's new methane emissions regulations, as they could affect the industry financially.
- The outcome of an appeal in a climate change suit brought by the state of Delaware against big energy companies could influence similar cases in other jurisdictions.
- Energy professionals should keep their eyes on the Supreme Court of Texas as it continues to shape the scope of royalty clauses in oil and gas leases.

A stream of judicial decisions in the pipeline will have important implications for the energy industry. The three cases discussed below are among those that energy litigators and industry professionals are watching in 2024.

Texas v. EPA Methane Emissions Litigation

The state of Texas has petitioned for review in the U.S. Court of Appeals for the District of Columbia Circuit, challenging the Environmental Protection Agency's (EPA's) newly published rules regarding methane emissions.

The EPA announced the rules in December 2023, imposing restrictions on both future and existing oil and gas operations that will require companies to monitor their equipment for methane emissions. The rules also raise the national ambient air quality standard for particulate matter, ban "flaring" and establish a way to detect excessive methane emissions using third-party sensing capabilities.

Three Unfolding Cases Could Shape Future Energy Litigation, and Perhaps Business Practices

Texas was the first state to challenge these new rules, filing suit the day they were published. The state, represented by Attorney General Ken Paxton, contends that these regulations are an overreach and lack a scientific basis. Attorney General Paxton expressed concern that the rules will also cause harm to Texas' economy and "result in the closure of manufacturing and industrial facilities, putting workers out of jobs and devastating the surrounding communities."

This is not the first time Texas has sued over the EPA's methane regulations. In 2016, Texas, North Dakota and several other states collectively challenged a set of then-new rules, calling them an overreach and asserting that such regulations would harm the thriving shale oil economies in their respective states. That litigation is still pending in the D.C. Circuit.

The petition for the new case was filed on March 6, 2024, and is set to be consolidated with suits filed by dozens of other states on the same grounds.

Why we're monitoring this case: With over half of the states joining in this suit, it is clear that these new regulations are causing major concerns. By way of example, the Texas Railroad Commission, which regulates oil and gas exploration and production in Texas, stated in a recent press release that Texas has already made great strides in cutting pollution without these rules, and that keeping marginal wells "in production not only reduces waste and the state's plugging liability but also provides funding for our schools, protects the stability of our electricity grid, and puts food on the table for thousands of Texans."

If the new rules go into effect, the steep costs of implementation could cause significant strain especially on small operators across other major oil and gas states and the industry at large.

Delaware Climate Change Litigation

In 2020, the state of Delaware sued 31 major fossil fuel companies in Delaware Superior Court alleging negligent failure to warn, trespass, common law nuisance and violations of the Delaware Consumer Fraud Act relating to climate change.

Alleging that the corporate defendants knew or should have known that their production and the subsequent use of their fossil fuels would harm the planet — and necessarily Delaware and its citizens — the state brought this case amid a wave of climate change suits around the country.

On January 9, 2024, the court dealt the defendants a major victory as Judge Mary M. Johnston dismissed several of the state's claims. The judge ruled that the state could not pursue damages for injuries caused by emissions produced outside of Delaware because such claims are preempted by the federal Clean Air Act.

This decision limits the state to its claims based on the greenhouse gases first emitted in Delaware. As that encompasses only a fraction of the defendants' alleged activities, Judge Johnston's decision substantially curtails the scope of the state's suit and potential damages going forward.

Delaware filed an application for an interlocutory appeal of the lower court's dismissal of many of the state's claims, but the court denied that application because "the likely benefits of interlocutory review do not outweigh the inefficiency, disruption, and probable costs."

Why we're monitoring this case: Climate change litigation is at an all-time high. While the Delaware case concerns actions allegedly taken within one state, its ultimate conclusion could provide guidance and lessons for other climate change cases.

Hilcorp Royalty Litigation

In a January 12, 2024, opinion in *Carl v. Hilcorp Energy*, the U.S. Court of Appeals for the Fifth Circuit certified two questions of state law to the Supreme Court of Texas.

Plaintiff-trustees brought the mineral royalty class action complaint in the Southern District of Texas against Hilcorp for allegedly failing to pay the plaintiffs royalties it owed on gas "used off the premises" for post-production purposes — an alleged violation of the oil and gas lease's off-lease clause.

The lease also included a free-use clause, which provided for Hilcorp's "free use of gas … when used for 'operations' on the lease premises." Following the district court's dismissal of the complaint for failure to state a claim, the plaintiffs appealed to the Fifth Circuit.

Faced with the question "whether the free-use clause here, when read in conjunction with the rest of the lease, permits deduction of gas used off-lease for post-production purposes" — as well as how to apply such a deduction under Texas law — the Fifth Circuit concluded that the Supreme Court of Texas was better equipped to resolve those questions of law.

The Fifth Circuit noted that because "the interpretation of mineral leases are an important and significant part of Texas state law," deferring to Texas on these issues was appropriate.

On January 19, 2024, the Supreme Court of Texas agreed to answer the questions certified by the Fifth Circuit. The parties argued their respective positions on March 19, 2024, and a decision is expected to follow in the coming months.

Three Unfolding Cases Could Shape Future Energy Litigation, and Perhaps Business Practices

Why we're monitoring this case: *Hilcorp* is next in a growing line of cases to come before the Supreme Court of Texas on royalty lease interpretation. Just last year, the court in *Devon Energy Prod. Co., L.P. v. Sheppard* issued royalty owners a win, enforcing a lease clause providing for royalties on more than just gross proceeds from the sale of oil and gas. The court deemed it a "proceeds plus" clause.

And in 2021, *BlueStone Natural Resources II, LLC v. Randle* addressed a similar issue, interpreting a lease clause and determining that the lessee there could not deduct post-production costs from the lessor's royalty because of superseding language in an addendum.

The Supreme Court of Texas has made clear that, where possible, oil and gas leases will be interpreted according to their plain meaning, and that parties to these agreements must clearly express their intentions in writing.

As for *Hilcorp*, litigators who encounter royalty disputes — especially those in Texas — should pay close attention because the court's decision will further impact how various clauses in oil and gas leases will be interpreted.

One Manhattan West / New York, NY 10001 / 212.735.3000
1000 Louisiana St. / Suite 6800 / Houston, TX 77002 / 713.655.5100