Confidentiality Agreements and AMI Overview

By
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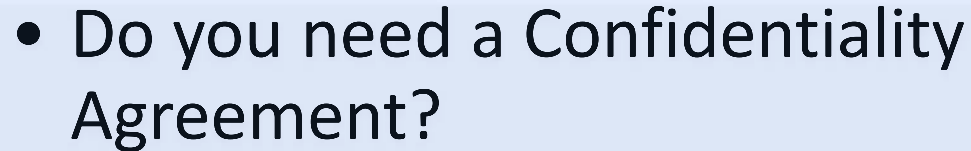
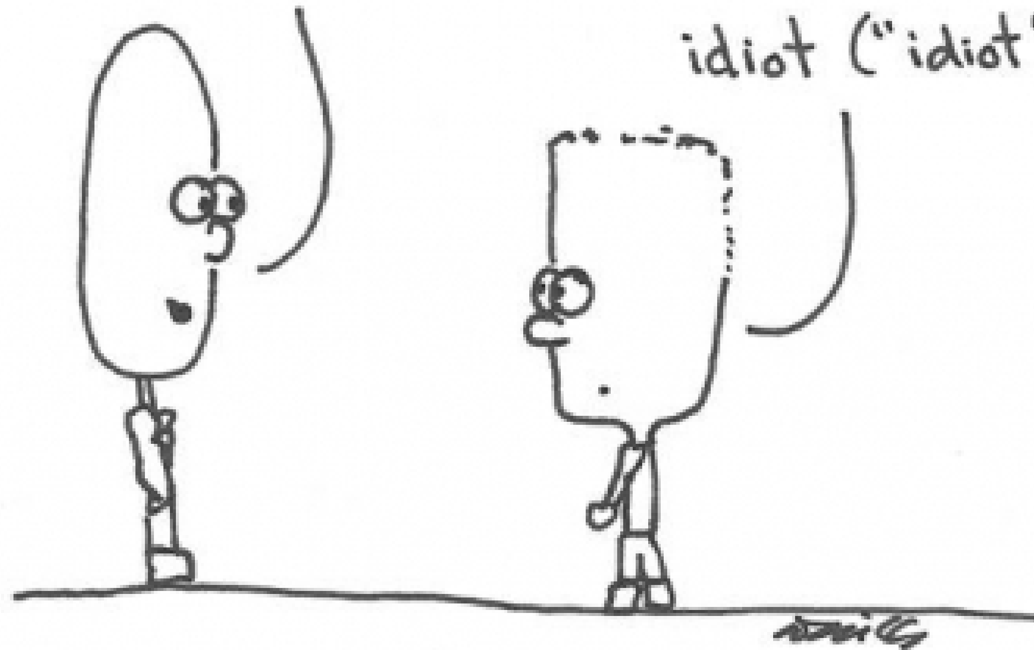
Serving the Oil & Gas Industry Along the Gulf Coast and in the Gulf of Mexico

Outline



Defined Terms

- “CA” means Confidentiality Agreement
- “CI” means Confidential Information
- “DP” means Disclosing Party
- “OCSAB CA” mean OCS Advisory Board Model Form Confidentiality Agreement
- “RP” means Receiving Party
- “TUTSA” means Texas Uniform Trade Secrets Act



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If lawyers talked like they wrote.

Do you need a Confidentiality Agreement?

- Vortt Exploration Co. v. Chevron, 787 S.W.2d 942 (Tex. 1990).
- Vortt and Chevron each acquired leases in a 160 acre tract of land located in Young County, Texas.
- Vortt contacted Chevron for a farmout; however, Chevron declined.
- Vortt then proposed to Chevron to enter into a JOA to jointly drill a test well. Vortt showed Chevron its maps and seismic covering the tract.
- The parties could not agree on a JOA, so Chevron drilled a successful test well on the tract.

Vortt v. Chevron

- Chevron then brought suit for declaratory judgment requesting that the Vortt leases be found invalid.
- Vortt counterclaimed for quantum meruit for the seismic services and maps Vortt provided to Chevron during the negotiations.
- Elements of quantum meruit are:
  - Valuable services were rendered;
  - To the person being charged;
  - Which services were accepted by the person being charged; and
  - **Which the person being charged was reasonably notified that the person providing the services expected compensation.**

Vortt v. Chevron

- Vortt contended that it shared the information in expectation of entering into a JOA with Chevron.
- Chevron contended that the information provided was part of "horse trading" involved in the negotiations. The parties negotiated for over four years.
- The trial court held that Chevron owed Vortt $178,750 in damages.
- The appellate court reversed in favor of Chevron.
  - Appellate court did not that Chevron was on notice that Vortt expected Chevron **to pay** for the information if the parties could not agree upon a JOA.

Vortt v. Chevron

- The Texas Supreme Court reversed the appellate court and agreed with the trial court.
- Court held that form of payment for quantum meriut does not have to be monetary.
  - Compensation may be an interest in land.
- Court believed that Vortt provided CI in belief that Chevron would execute a JOA covering lands.
- Held that Chevron was "reasonably notified" that Vortt expected to "be paid" for the services.

Vortt v. Chevron

- The dissent noted Chevron never asked to see the information, and Vortt never told Chevron it expected anything in return for the information.
  - The information cost Vortt roughly $18,000.
- "Was ever fainter hope more richly rewarded? For not refusing to look at Vortt's information, Chevron must pay ten times its cost. … A frustrated negotiator should never overlook this tactic in attempting to induce agreement. The recipient of such charity, however, should beware."

Do you need a Confidentiality Agreement?

- Unocal v. Dickinson Resources, 889 S.W.2d 604 (Tex. Ct. App.-Houston 1994).
- Arthur Dickinson was an independent geologist that generated the Tigre Point Prospect on Vermilion Block 7 in State of Louisiana waters.
- DRI attempted to market its prospect to third parties. Quintana drilled a 18,000' test well on the prospect that was a dryhole.
- DRI showed the prospect to about 30 companies without success.

Unocal v. Dickinson Resources

- Dickinson met with Unocal on January 9, 1990 to show the prospect. Prior to the meeting, Unocal required Dickinson to sign a waiver form.
- "You agree to waive any claim … which may be asserted against … Union concerning use of any data or information of a proprietary or confidential nature which is provided for review by … Union. Such review by … Union shall not preclude any oil and gas operation or activity subsequent to the review in any area which was subject to the review, or in any other area."
- The parties showed each other their maps, seismic data and well logs. Unocal informed DRI it was not interested in the prospect.

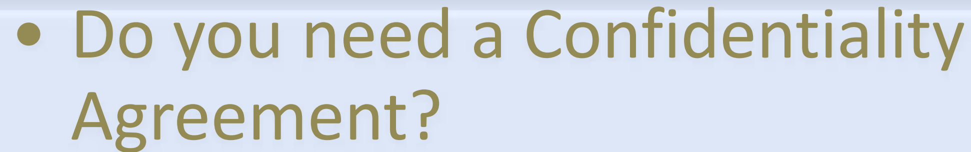
Unocal v. Dickinson Resources

- Unocal acquired three tracts covering Vermilion Block 7 for $540,000 at State of Louisiana lease sale in April 1990.
- DRI contacted Unocal requesting compensation. Unocal refused stating it developed the prospect independently.
  - DRI filed suit against Unocal seeking damages.
- The trial court found that Unocal breached its confidential relationship with DRI, and that Unocal was guilty of negligence, fraud and **misappropriation of trade secrets**.
- The jury awarded damages to DRI for tort claims equal to $1,376,000, plus $54,000 for quantum merit, plus punitive damages of $2,600,000.

Unocal v. Dickinson Resources

- On appeal, Unocal argued that DRI relinquished its right to bring the suit because it executed the waiver agreement.
- DRI claimed that the waiver was unenforceable because it was not supported by consideration. Unocal claimed the waiver "was the price of admission to the meeting."
  - The court noted that "to an independent geologist attempting to sell his prospect, this meeting had tangible value."
- The court overturned the lower court's decision and found DRI's claim was relinquished because of the waiver.
- The court noted that DRI could have protected itself by requiring a CA or an AMI agreement.

Outline



- Do you need a Confidentiality Agreement?

- **What are Trade Secrets?**

- Nuts and bolts of Confidentiality Agreements and AMI provisions.

What are Trade Secrets?

What are Trade Secrets?

- Effective September 1, 2013, Texas adopted the Texas Uniform Trade Secrets Act (TUTSA).
- Definition of Trade Secret under TUTSA:
  - Means information, including a formula, pattern, compilation, program, device, method, technique, process, financial data, or list of actual or potential customers or suppliers that: (A) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and (B) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

THE VAULT
COCA-COLA

What are Trade Secrets?

- Provides remedies for **misappropriation** of **trade secrets**.
  - Prior to TUTSA, Texas courts recognized common law claims of misappropriation of trade secrets.
  - TUTSA displaces conflicting common law and other civil remedies for misappropriation of a trade secret.

What are Trade Secrets?

- A trade secret under Texas common law has been recognized as “any formula pattern, device or compilation of information which is used in one’s business and presents an opportunity to obtain an advantage over competitors who do not know or use it.”
- The Texas Supreme Court has specifically held that “geological seismic data are trade secrets…”.
  - The court also cited with approval an opinion of the Indiana Supreme Court that held “information regarding the potential location of oil fields is entitled to trade secret protection.”

What are Trade Secrets?

- Under Texas common law, the elements of misappropriation of trade secrets are:
  - Existence of a trade secret
  - Breach of a confidential relationship or improper discovery of a trade secret
  - Use of the trade secret
  - Damages.

What are Trade Secrets?

- In addition to injunctive relief, TUTSA allows the following damages for misappropriation of a trade secret:
  - Actual losses
  - Unjust enrichment
  - A reasonable royalty
  - Exemplary damages
  - Attorney's fees may also be awarded to the prevailing party.

Misappropriation of Trade Secrets

- *In re* TXCO Resources, Inc., 47 B.R. 781 (W.D. Tex. 2012).
  - TXCO had operations in the Eagle Ford Shale in the Maverick Basin.
  - TXCO entered a farmout agreement with Encana to earn 50% working interest by paying 100% of drilling costs.
  - TXCO spent nearly $31MM in drilling wells.
  - The price of oil fell from almost $126 per barrel in July 2008 to $33 per barrel in January 2009. TXCO was faced with shortfall of cash flow.
  - TXCO engaged Goldman Sachs to find potential buyers for its assets.

In re TXCO Resources, Inc.

- TXCO and Peregrine entered into a CA dated March 5, 2009.
- The CA provided that Peregrine would not acquire any of TXCO's assets for a period of three years.
- The parties met several times to review TXCO's CI; however, an agreement was not reached.
- Because of the cash flow problems, TXCO was not able to finance continuous drilling operations on a lease covering the BLS Acreage.
- On October 6, 2009, Peregrine obtained a lease on the BLS Acreage.

In re TXCO Resources, Inc.

- TXCO fired its COO because he was partially responsible for its financial situation.
  - In this separation agreement, he pledged a continuing duty of loyalty to the company.
- Peregrine hired the ex-COO of TXCO.
- The ex-COO persuaded his former subordinate to send him CI, which he then provided to Peregrine.
  - Ex-COO sent email to Peregrine contact regarding CI that stated: “But don’t ask me where I got it.”

In re TXCO Resources, Inc.

- TXCO subsequently sold its assets to Newfield for $223MM. During the negotiations of the PSA, TXCO discovered that Peregrine had leased the BLS Acreage.
- TXCO filed suit in November 2009 against Peregrine for misappropriation of CI, and the rights to the suit were transferred to the reorganized TXCO (RTXCO).
- RTXCO alleged that Peregrine:
  - Misused the CI under the CA; and
  - Misappropriated the trade secrets.

In re TXCO Resources, Inc.

- Under Texas common law, the elements of misappropriation of trade secrets are:
  - Existence of a trade secret;
  - Breach of a confidential relationship or improper discovery of a trade secret;
  - Use of the trade secret; and
  - Damages.

Elements of Misappropriation

- Existence of a trade secret
  - Subsurface data which included core samples, seismic data, well logs, and geologic maps.
  - Production data which included initial, daily and monthly production data.
  - Operations data which included land files, drilling schedules, agreements with 3rd parties, and AFEs.

Elements of Misappropriation

- Court found that the technical, geologic, geophysical and engineering knowledge acquired by TXCO extremely valuable.
- Court noted that TXCO attempted to protect its competitive position by maintaining confidentiality of data.
  - TXCO would require the execution of CA prior to providing a presentation.

Elements of Misappropriation

- Breach of a confidential relationship
  - Peregrine breached the CA when it acquired leases formerly held by TXCO outside of any transaction with TXCO.
    - The CA provided that Peregrine would use the CI **solely for the purpose of evaluating a transaction with TXCO.**
  - In addition to receiving CI through the CA, Peregrine received trade secrets by improper means through the ex-employee of TXCO.

Elements of Misappropriation

- Use of trade secret
  - Peregrine used the CI to acquire leases within the Maverick Basin.
  - The court noted that about 30 companies signed the CA; however, only Peregrine had multiple meetings with TXCO, and subsequently acquired leases within TXCO's acreage position.

Elements of Misappropriation

- Damages
  - Actual damages based on the value of what was lost by the plaintiff. Usually measured by lost profits.
    - TXCO argued that Peregrine's use of the CI prevented TXCO from obtaining new leases on the BLS acreage.
    - However, the court found that the TXCO was unable to find a partner to help fund the continuous drilling operations on the lease, and that was the reason for the loss of the lease.

Elements of Misappropriation

- Damages
  - Courts also use "reasonable royalty" standard to address situations where misappropriated idea is used.
  - Concept based upon what the parties would have agreed to as a fair price for licensing the trade secret to the RP.
  - Court said the "amount of a reasonable royalty for TXCO's trade secrets can be based on the cost of a farmout or other joint exploration agreement, through which Peregrine could have properly acquired and used TXCO's trade secret information."

Elements of Misappropriation Damages

- TXCO entered into Farmout Agreement with Encana and agreed to pay 100% of the drilling costs to earn a 50% working interest.
- If TXCO agreed on deal with Peregrine, then Peregrine would have participated for 50% of TXCO's working interest and borne half of the $31MM in drilling costs spent by TXCO.
- The court found that $15MM was a reasonable royalty for Peregrine use of TXCO's trade secrets.

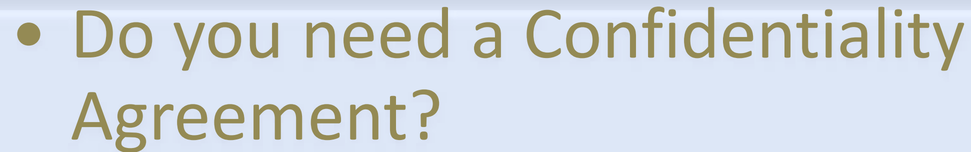
Elements of Misappropriation Damages

- TXCO also claimed breach of contract of the CA because of Peregrine's use of the data.
- The CA provided that in exchange for access to the CI, Peregrine agreed that it would use the Evaluation Material "solely for the purpose of evaluating a possible transaction" with TXCO.
- Although the CA did not prevent Peregrine from obtaining oil and gas leases in the Maverick Basin, its terms clearly prohibited Peregrine from using TXCO's CI in the course of its business.

Elements of Misappropriation Damages

- TXCO failed to prove that it suffered damages that were directly and proximately caused by Peregrine's breach of the CA for the same reasons it could not recover lost profits for the misappropriation of trade secrets.
- TXCO would have lost its leases on the BLS Acreage, and been unable to renew them regardless of Peregrine's breach of the CA.

Outline



Nuts and Bolts of Confidentiality Agreements

- Definition of Confidential Information
  - DP generally prefers this definition to be drafted broadly.
  - OCSAB CA lists CI on exhibit.
  - DP should include any notes, analyses or other documents or information prepared by the RP, but derived from or including CI provided by the DP.

Nuts and Bolts of Confidentiality Agreements

- Exclusions to CI
  - Publicly available information.
    - Includes information that is public or becomes public by reason other than the RP's breach of the CA.
    - Contrast "generally available" versus "known by the public." Former is more favorable to RP because "known" is a more limited concept.

Nuts and Bolts of Confidentiality Agreements

- Exclusions to CI
  - Information in RP’s possession.
    - Includes information that was available to the RP on a non-confidential basis prior to the disclosure by the DP.
    - DP may wish to put burden of proof on RP that it already possessed such information, because may be difficult to prove.
      - Example phrase “Evaluation Material does not include information that Recipient **can demonstrate**…”.

Nuts and Bolts of Confidentiality Agreements

- Exclusions to CI
  - Information in RP's possession.
    - May also include information subsequently provided to the RP on a non-confidential basis by a third party who is not bound by obligations of confidentiality.
  - Information independently developed by RP.
    - Covers information that is developed without the use of the CI covered by the CA or otherwise in violation of the CA.

Nuts and Bolts of Confidentiality Agreements

- Exclusions to CI
  - Information required to be disclosed by law.
    - Examples are court order or subpoena.
    - Instead of an exception, the DP should make provision for such required disclosure elsewhere in CA. Disclosed information is still treated as CI, but RP is permitted to make the required disclosure.

Nuts and Bolts of Confidentiality Agreements

- Purpose for which the CI may be used.
  - CA will typically provide that the use of the CI may be used in the evaluation of a potential transaction.
  - OCSAB CA provides in recitals that the CI is being provided "solely in connection with the possible acquisition by Reviewing Party… of a interest in the properties listed on Exhibit A from Disclosing Party."
  - OCSAB CA further provides that "The Reviewing Party … agrees to use the Confidential Information solely for the purpose of evaluating the Possible Transaction."

Nuts and Bolts of Confidentiality Agreements

- Return or Destruction of CI
  - Upon termination of discussions, a CA will usually require the RP to return all CI.
  - Any CI prepared by the RP based upon the Evaluation Materials should be destroyed by the RP, versus returned to the DP. RP may be required to certify the destruction in writing.

Nuts and Bolts of Confidentiality Agreements

- Term
  - A term is typically included regarding the obligations to maintain the Evaluation Material confidential.
  - OCSAB CA provides "Reviewing Party's obligations in Sections 1, 2 and 3 of this Agreement shall terminate ___ years after the Effective Date."

Nuts and Bolts of Confidentiality Agreements

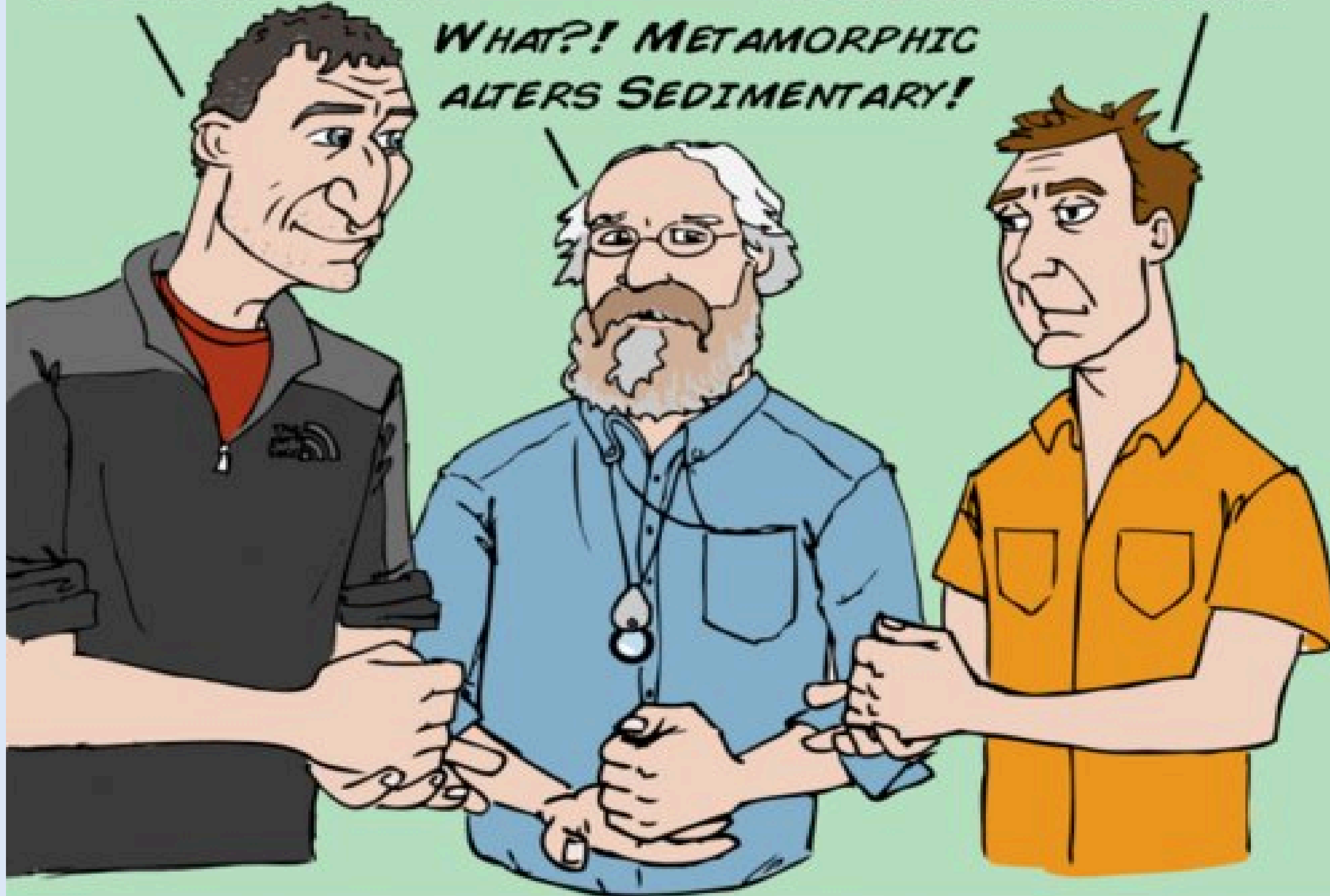
- Remedies for breach.
  - DP will want to provide for relief in the form of an injunction in order to prevent further disclosures of the CI.
  - DP may also want to include indemnity provision requiring the RP to indemnify it for all costs and expenses it may incur in enforcing the terms of the CA.
  - RP should require a waiver of all exemplary / punitive damages.
  - DP should include provision that it is entitled to all equitable remedies available at law.

Nuts and Bolts of Confidentiality Agreements

- Assignment provisions
  - CA will typically prohibit assignment by the RP, but provide that it is assignable by the DP.
  - Prospective purchasers should be aware that another purchaser of the properties (instead of the DP) may seek to enforce the terms of the CA.

Nuts and Bolts of Confidentiality Agreements

- Choice of law
  - DP may seek to establish jurisdiction on their "home court" for disputes arising under the CA.
  - In British Borneo v. Enserch Exploration, 28 F.Supp. 2nd 999 (E.D. La. 1998), the court questioned in a footnote whether the choice of law provision in CA was enforceable because of OCSLA.
    - The CA contained a "buy-back" provision which Enserch was trying to enforce against British Borneo.
    - The court found that it had subject matter jurisdiction through OCSLA because enforcement of buy-back provision in CA involved rights to obtain and develop leases on the OCS.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WHAT?! METAMORPHIC ALTERS SEDIMENTARY!
NO NO NO. IGNEOUS MELTS METAMORPHIC!
THE UNDERSTANDABLY LESS POPULAR GEOLOGY VERSION OF ROCK-PAPER-SCISSORS. ROCK-ROCK-ROCK.

Nuts and Bolts of Confidentiality Agreements

- AMI and Buyback provisions
  - To protect leasehold positions, a DP may require an Area of Mutual Interest or a Buy-back provision.
    - An AMI usually implies reciprocal obligations versus a buy-back provision which is a one-way obligation.
  - The buy-back provision restricts the use of CI within a defined area by prohibiting the acquisition of any property interest within the area for a specified period of time.

AMI and Buy-Back Provisions

- Creates an option in favor of DP which becomes a contract of sale when accepted by the DP in the manner and within the time prescribed.
  - OCSAB CA provides that DP has the right, but not the obligation, to acquire from RP [all][__%] of the acquired interest.
- The notice by the RP of the acquired interest must be given in the required form to initiate the election period.
  - OCSAB CA provides that the notice is to include the consideration paid, and all terms and conditions of the acquisition.

AMI and Buy-Back Provisions

- OCSAB CA provides that DP has 30 days after receipt of written notice from RP to acquire the interest.
  - Failure to respond is deemed an election not to acquire the interest.
- Similar issues to exercise of preferential rights to purchase.
  - Instead of divestiture of property, AMI relates to acquisition of property.

AMI and Buy-Back Provisions

- Allocation of purchase price issues when:
  - Acquired interest lies partially within AMI area.
  - Acquired interest is part of a package sale.
- Does AMI provision apply to acquisitions of the interest by merger or exchange.
  - Consideration paid by RP for acquired interest may be construed to limit AMI rights to transfers for cash consideration.

AMI and Buy-Back Provisions

- OCSAB CA provides "right to acquire an interest by any means in any lands or leases lying" in the AMI Area.
  - Further provides that "interest" includes any real property or contractual right, including without limitation, any lease, operating interest, non-operating interest, concession, production sharing contract, risk service contract or any other right, whether direct or indirect, to receive hydrocarbons or proceeds from the sale thereof.
  - Right to acquire an interest; e.g. Farmouts

AMI and Buy-Back Provisions

- J-O'B Operating Co. v. Newmont Oil Co., 560 So.2d 852 (La. App. Ct. 1990).
- One of the parties to an AMI acquired a State of Louisiana lease and offered it to the other parties.
- Part of the consideration for the lease was a seismic program to be conducted by the company.
- Court held that cost of the seismic program was part of consideration for the lease, and that the AMI partners were obligated to share in cost to acquire their proportionate share of the lease.

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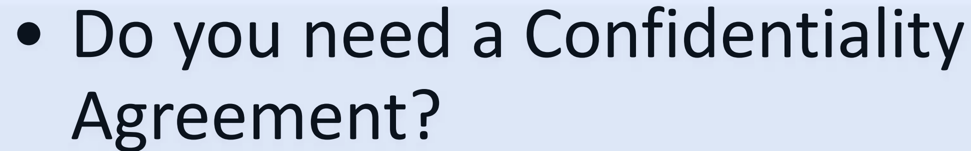

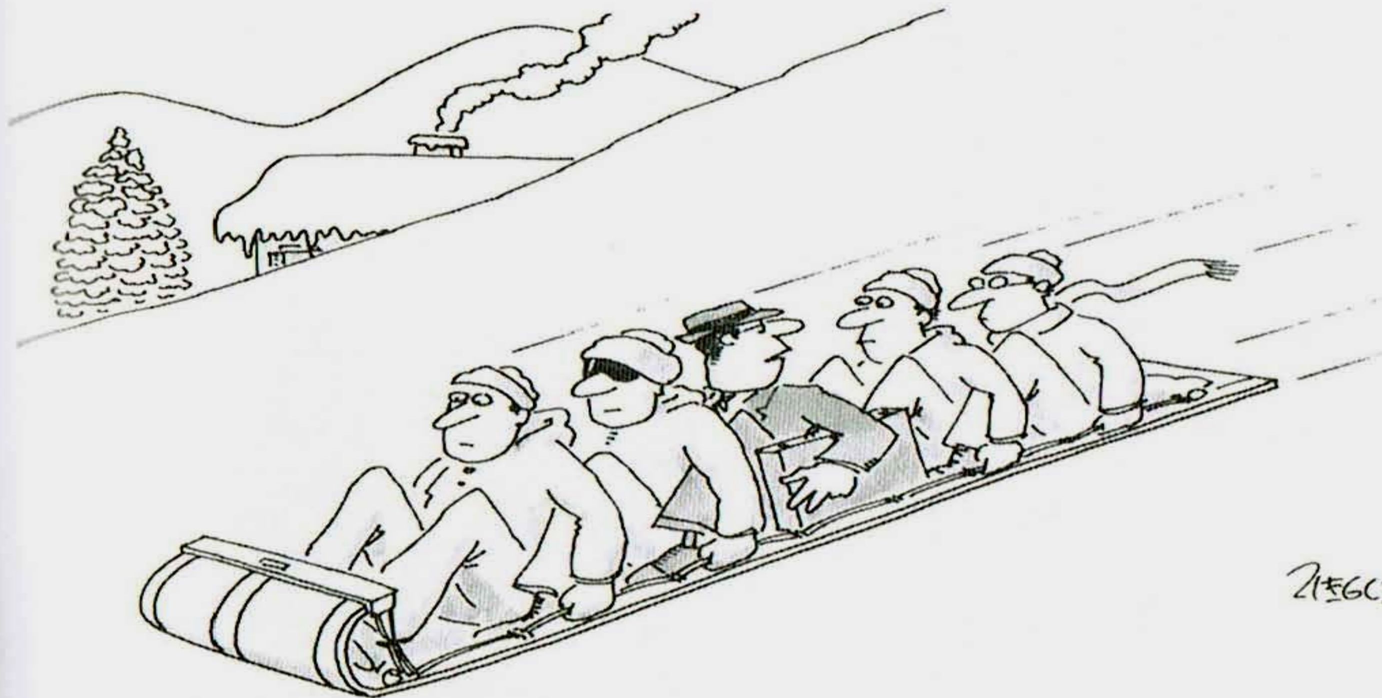

"Look, I'm not saying it's going to be today. But someday—someday—you guys will be happy that you've taken along a lawyer."

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Sources

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