

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE SOUTHERN DISTRICT OF TEXAS  
HOUSTON DIVISION

In re:

CHESAPEAKE ENERGY CORPORATION, *et al.*,<sup>1</sup>

Debtors,

PETTY BUSINESS ENTERPRISES, LP, *et al.*,

Plaintiffs,

vs.

CHESAPEAKE EXPLORATION, L.L.C., *et al.*

Defendants.

Chapter 11

Case No. 20-33233 (DRJ)

Adv. Pro. No. 20-03433 (DRJ)

**AMENDED ADVERSARY COMPLAINT<sup>2</sup>**

PGE Mineral Properties, Ltd., predecessor in interest to Plaintiff Petty Business Enterprises, L.P. (“PBE”), entered into thirteen oil and gas leases covering property in Webb County, Texas, and LaSalle County, Texas, and assigned certain rights under the leases to Plaintiff Petty Energy L.P. (“Petty Energy”). With PBE, Plaintiffs The Petty Family Limited Partnership, LLP, Petty Group, LLP, Petty O&G Management, LLC f/k/a/ Van A. Petty Marital Trust, Ferncliff Investments, L.P., Baptist Foundation d/b/a HighGround Advisors, Noel Petty Minerals, Ltd., Scott James Petty, individually and as Trustee for the Scott James Petty 2009 Trust, and as Co-

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<sup>1</sup> A complete list of each of the Debtors in these chapter 11 cases may be obtained on the website of the Debtors’ claims and noticing agent at <https://dm.epiq11.com/chesapeake>. The location of Debtor Chesapeake Energy Corporation’s principal place of business and the Debtors’ service address in these chapter 11 cases is 6100 North Western Avenue, Oklahoma City, Oklahoma 73118.

<sup>2</sup> Petty filed this lawsuit in the 285th District Court in Bexar County, Texas, and amended its petition three times prior to the lawsuit’s removal to bankruptcy court. Were the case still in state court, then, this pleading would be the Fourth Amended Petition. To prevent potential confusion over how many versions have been operative in federal court, however, Petty has styled this pleading as “Amended Adversary Complaint.”

Trustee for the Petty 2007 Grandchildren’s Trust, Susan Arnim Petty, individually and as Trustee of the Susan Petty Arnim 2009 Trust, the Joan L. Petty 2009 Trust, and Co-Trustee of the Petty 2007 Grandchildren’s Trust, F.G. Brown and Joan Hill Brown, as Co-Trustees of the F.G. Brown and Joan H. Brown Revocable Trust, Frost Bank, as Trustee of the Dabney Noel Petty Trust, Scott Petty, Jr., Eleanor Petty, Thomas Arnim, Joan L. Petty, Mary Tucker Huff, Rodney Huff, Chad Huff, Heather Huff Boyle, Nelta K. Hill, David Law, Gerry Law, Jr., Olivia Kornelis, Reagan Tucker, Richard R. Fuhrmann, Charles Fuhrmann, II, Laney C. Fuhrmann, individually and as independent executrix of the Estate of Carl Fuhrmann, and Debra G. Fuhrmann (collectively, “Royalty Owners”) (collectively with PBE and Petty Energy, “Petty”) own mineral royalty, and/or non-operating working interests and associated net revenue interests covered by such leases, including the Leases (as defined below) that are the subject of this lawsuit.

Defendants Chesapeake Exploration, L.L.C. (“Exploration”), Chesapeake Operating, L.L.C. (“Operating”), (collectively referred to herein as “Chesapeake”), CNOOC Energy U.S.A., LLC (“CNOOC”), Jamestown Resources, L.L.C., (“Jamestown”), and Larchmont Resources, L.L.C. (“Larchmont”)—(all five entities collectively referred to herein as “Defendants”)—are failing to comply with the requirements of the Leases. Petty files this suit to recover damages it has suffered and continues to suffer as a result of Chesapeake’s repeated breaches of its contractual obligations under each of the Leases.

### **NATURE OF THE PROCEEDING**

1. This is an adversary proceeding brought pursuant to 28 U.S.C. § 2201, sections 105 and 362(a) of title 11 of the United States Code (the “Bankruptcy Code”), and Federal Rules of Bankruptcy Procedure 7001(1), 7001(2), and 7001(7) for damages and equitable relief.

2. Petty originally filed this lawsuit in the 285th Judicial District Court in Bexar County, Texas in a lawsuit styled *Petty Business Enters., et al. v. Chesapeake Operating LLC et*

*al.*, Cause No. 2020-CI-07957 (the “State Court Action”).

3. On June 28, 2020 (the “Petition Date”), each of the Debtors, including Debtor Exploration and Debtor Operating, filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code (the “Bankruptcy Code”) commencing the above-captioned jointly administered cases (the “Bankruptcy Cases”). The Debtors continue to operate and control their business as debtors in possession under 11 U.S.C. §§ 1107(a) and 1108.

4. On September 23, 2020, CNOOC filed a notice of removal of the State Court Action from the 285th Judicial District Court of Bexar County, Texas, to the United States Bankruptcy Court for the Western District of Texas.

5. On September 25, 2020, the United States Bankruptcy Court for the Western District of Texas transferred venue of the removed State Court Action to the Southern District of Texas for referral to the United States Bankruptcy Court for the Southern District of Texas (the “Bankruptcy Court”).

6. As outlined in more detail below, under the terms of the Leases that Petty granted to Defendants, Defendants must pay Petty royalties on *all* oil and gas production from the lands the Leases cover—regardless of whether said oil and gas production is actually sold. From January 1, 2016 to June 28, 2020, Defendants underpaid royalties to the tune of over \$41 million. Petty now seeks to recover that underpayment along with other associated damages as well as equitable relief for Defendants’ breaches of fiduciary duties that the Leases imposed.

### **JURISDICTION AND VENUE**

7. The United States Bankruptcy Court for the Southern District of Texas (the “Court”) has jurisdiction over this adversary proceeding under 28 U.S.C. § 1334.

8. This adversary proceeding is a core proceeding under 28 U.S.C. § 157(b).

9. Venue is proper in this district under 28 U.S.C. § 1409.

10. Petty confirms its consent, under rule 7008 of the Federal Rules of Bankruptcy Procedure (the “Bankruptcy Rules”), to the entry of a final judgment by the Court in connection with this Complaint to the extent that it is later determined that the Court, absent consent of the parties, cannot enter final orders or judgments in connection herewith consistent with Article III of the United States Constitution.

### **PARTIES**

11. Plaintiff Petty Business Enterprises, L.P. is a Texas limited partnership with its principal place of business at 1027 Austin Highway, Suite 200, San Antonio, Texas 78209. PBE acts through its general partner PBE Management, LLC.

12. Plaintiff Petty Energy L.P. is a Texas limited partnership with its principal place of business at 1027 Austin Highway, Suite 200, San Antonio, Texas 78209. Petty Energy acts through its general partner Strike Resources LLC.

13. Plaintiff The Petty Family Limited Partnership, LLP is a Texas limited-liability partnership with its principal place of business at 1027 Austin Highway, Suite 200, San Antonio, Texas 78209.

14. Plaintiff Petty Group, LLP is a Texas limited-liability partnership with its principal place of business at 1027 Austin Highway, Suite 200, San Antonio, Texas 78209.

15. Plaintiff Petty O&G Management L.L.C. f/k/a Van A. Petty Marital Trust, is a Texas limited-liability company with its principal place of business at 21 Poehnert Road, Boerne, Texas, 78006.

16. Plaintiff Ferncliff Investments, L.P. is a Texas limited partnership with its principal place of business at 1027 Austin Highway, Suite 200, San Antonio, Texas 78209. Ferncliff Investments acts through its general partner Heart-Bar Management, L.L.C.

17. Plaintiff Baptist Foundation d/b/a HighGround Advisors is a Texas not-for-profit

corporation with its principal place of business at 1717 Main Street, Suite 1400, Dallas, Texas 75201.

18. Plaintiff Noel Petty Minerals Ltd. is a Texas limited partnership with its principal place of business at 46 Verde Point, Boerne, Texas 78006. Noel Petty Minerals acts through its general partner DNP Minerals-GP, L.L.C.

19. Plaintiff Scott James Petty, acting individually and as trustee of the Scott James Petty 2009 Trust, and Co-Trustee of the Petty 2007 Grandchildren's Trust is a resident of Medina County, Texas.

20. Plaintiff Susan Arnim Petty, acting individually and as trustee of the Susan Petty 2009 Arnim Trust, the Joan L. Petty 2009 Trust, and as Co-Trustee of the Petty 2007 Grandchildren's Trust, is a resident of Bexar County, Texas.

21. Plaintiff Joan Hill Brown, as co-trustee of the F.G. Brown and Joan H. Brown Revocable Trust, is a resident of Tom Green County, Texas.

22. Plaintiff F.G. Brown, as co-trustee of the F.G. Brown and Joan H. Brown Revocable Trust, is a resident of Tom Green County, Texas.

23. Plaintiff Frost Bank, acting as Trustee of the Dabney Noel Petty Trust, is headquartered in Bexar County, Texas.

24. Plaintiff Scott Petty, Jr. is a resident of Bexar County, Texas.

25. Plaintiff Eleanor Petty is a resident of Bexar County, Texas.

26. Plaintiff Thomas Arnim is a resident of Bexar County, Texas.

27. Plaintiff Joan L. Petty is a resident of Bexar County, Texas.

28. Plaintiff Mary Tucker Huff is a resident of Bexar County, Texas.

29. Plaintiff Rodney Huff is a resident of Bexar County, Texas.

30. Plaintiff Chad Huff is a resident of Bexar County, Texas.
31. Plaintiff Heather Huff Boyle is a resident of Harris County, Texas.
32. Plaintiff Nelta K. Hill is a resident of Colorado County, Texas.
33. Plaintiff David Law is a resident of Comal County, Texas.
34. Plaintiff Gerry Law, Jr. is a resident of Comal County, Texas.
35. Plaintiff Olivia Kornelis is a resident of Comal County, Texas.
36. Plaintiff Reagan Tucker is a resident of Bexar County, Texas.
37. Plaintiff Richard R. Fuhrmann is a resident of Martinez, Georgia.
38. Plaintiff Charles Fuhrmann, II is a resident of Bexar County, Texas.
39. Plaintiff Laney C. Fuhrmann, acting individually and as independent executrix of the Estate of Carl Fuhrmann is a resident of Bexar County, Texas.
40. Plaintiff Debra G. Fuhrmann Petty is a resident of Bexar County, Texas.
41. Defendant Chesapeake Exploration, L.L.C. is an Oklahoma limited-liability company that has appeared, answered, and entered into the Stipulation and Agreed Order (Adv. Pro. No. 20-03399, Dkt. 49), agreeing to litigate the State Court Action and any issues related to Petty's proofs of claim in the Bankruptcy Court.
42. Defendant Chesapeake Operating, L.L.C. is a Delaware limited-liability company that has appeared, answered, and entered into the Stipulation and Agreed Order (Adv. Pro. No. 20-03399, Dkt. 49), agreeing to litigate the State Court Action and any issues related to Petty's proofs of claim in the Bankruptcy Court.
43. Defendant Jamestown Resources, L.L.C. is an Oklahoma limited-liability company that has appeared, answered, and entered into the Stipulation and Agreed Order (Adv. Pro. No. 20-03399, Dkt. 49), agreeing to litigate the State Court Action and any issues related to Petty's proofs

of claim in the Bankruptcy Court.

44. Defendant Larchmont Resources, L.L.C. is an Oklahoma limited-liability company that has appeared, answered, and entered into the Stipulation and Agreed Order (Adv. Pro. No. 20-03399, Dkt. 49), agreeing to litigate the State Court Action and any issues related to Petty's proofs of claim in the Bankruptcy Court.

45. Defendant CNOOC Energy U.S.A, L.L.C. is a Delaware limited-liability company that has appeared, answered, and entered into the Stipulation and Agreed Order (Adv. Pro. No. 20-03399, Dkt. 49), agreeing to litigate the State Court Action and any issues related to Petty's proofs of claim in the Bankruptcy Court.

## FACTS

### **A. The Petty family entered into several oil and gas leases with Chesapeake for exploration and production of minerals from their long-held, family ranches.**

46. Certain of the Royalty Owners are members of the Petty family. The Petty family is synonymous with oil and gas and ranching in Texas. O.S. Petty, the family's patriarch, was an engineer and inventor who pioneered and ultimately revolutionized the field of oil and gas exploration. He, like his father before him, amassed significant landholdings in South Texas. His son, Plaintiff Scott Petty, Jr., has continued this important family tradition of growing the family's land interests.

47. Petty owns three ranches in South Texas: the Dos Hermanos Ranch and Browne Ranch, both located in Webb County, Texas, and the Maguey Ranch located in LaSalle County, Texas.

48. Ranching operations, like the Petty's, historically served as the economic bloodline of rural South Texas. Things changed dramatically in 2008, however, with the successful drilling and completion of the first producing horizontal oil well in the Eagle Ford Shale, an oil and gas

formation that stretches from Webb County up northeasterly across the state through Leon County.<sup>3</sup> The success of this first well sparked a “land rush” to acquire prospective mineral or leasehold interests and bidding wars in the 26 counties comprising the Eagle Ford formation.

49. Chesapeake, for its part, was one of the leaders in this race to acquire significant holdings in the Eagle Ford Shale territory, spending \$1.7 billion to acquire a total of 700,000 acres by the end of 2010.<sup>4</sup> Earlier, in 2009, Chesapeake aimed to lease the Petty’s significant mineral interests as part of its growing portfolio. On October 1, 2009, PBE’s predecessor in interest entered into two oil and gas leases with Chesapeake Exploration, covering 15,729.34 acres of the Dos Hermanos Ranch, and 9143.16 acres of the Browne Ranch.<sup>5</sup> Subsequently, PBE entered into 11 oil and gas leases with Chesapeake Exploration, each dated September 14, 2010, that originally covered 5,777.377 acres of the Maguey Ranch. Following Chesapeake’s full release of eight and partial release of the remaining three Maguey Ranch Leases, there are now three effective leases that cover 709.19 acres of the Maguey Ranch. The Dos Hermanos Ranch, Browne Ranch, and three Maguey Ranch Leases are hereinafter referred to collectively as the “Petty Leases” or “Leases.”<sup>6</sup>

50. Petty owns mineral rights covered by all of the Leases.<sup>7</sup> Under the Leases, Petty granted Chesapeake Exploration the right to conduct development and drilling activities on the

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<sup>3</sup> Railroad Commission of Texas, *Eagle Ford Shale Information*, <https://www.rrc.state.tx.us/oil-gas/major-oil-and-gas-formations/eagle-ford-shale-information> (last visited October 28, 2020).

<sup>4</sup> Christopher Helman, *The Two Sides of Aubrey McClendon, America’s Most Reckless Billionaire*, *Forbes*, Oct. 5, 2011, <https://www.forbes.com/sites/christopherhelman/2011/10/05/aubrey-mcclendon-chesapeake-billionaire-wildcatter-shale/#2baf70fb5409> (last visited Apr. 29, 2020).

<sup>5</sup> Lessor PGE Mineral Properties, Ltd. changed its name to Petty Business Enterprises, LP in December 2011.

<sup>6</sup> All of the Leases are virtually identical. Accordingly, unless otherwise noted, the cited provisions herein are the same for all of the Leases.

<sup>7</sup> Petty owns the majority, but not all, of the mineral rights covered by the three effective Maguey Ranch Leases.



acreage covered by the Leases in exchange for, among other things, a 27.5% royalty on all minerals produced under the Leases. In addition, Chesapeake agreed to grant PBE or its designated, related entity the continuing option to acquire up to a 10% working interest in each well drilled under the Dos Hermanos Ranch and Browne Ranch Leases and further agreed to calculate and pay the revenue due to this working interest on the same basis, under the same lease obligations as it does for Petty's royalty. PBE, through Petty Energy, has exercised this option each time a well has been proposed by Chesapeake on the Dos Hermanos and Browne Ranch Leases, thereby acquiring a 10% working interest, entitled to a 7.25% net revenue interest, in every well Chesapeake drilled under the Dos Hermanos Ranch and Browne Ranch Leases.<sup>8</sup> To date, Chesapeake Exploration has drilled a total of 79 wells under the Dos Hermanos Ranch and Browne Ranch Leases and another 8 wells on the Maguey Ranch Leases.

51. Chesapeake Exploration assigned 1/3 of its working interests in the Petty Leases to CNOOC's predecessor OOGC, America LLC,<sup>9</sup> a unit of CNOOC International Limited, the Chinese government's national oil company, pursuant to a Limited Amendment to the Petty Leases. The assignment was effective as of October 1, 2010. Petty consented to the assignment subject to certain provisions.

52. Chesapeake Exploration also assigned a small portion of its working interest in the Leases to Jamestown and Larchmont, two entities related to or in privity with Chesapeake Exploration or its prior management.

53. Under the Leases, CNOOC, Jamestown, and Larchmont, as Chesapeake

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<sup>8</sup> Because Petty Energy's 7.25% net revenue interest is entitled to the same treatment as royalty interests under the Leases, it is included herein in all references to royalties.

<sup>9</sup> According to public filings, OOGC, America LLC's name was changed to CNOOC Energy U.S.A., LLC on December 31, 2018.

Exploration's assignees, have the same lease obligations to Petty as Chesapeake Exploration. *See* Leases, ¶¶ 13.4, 28.8. Nevertheless, Petty retains the right to collect its share of unpaid royalties solely from Chesapeake Exploration. *See* Limited Amendment at § II.

**B. Chesapeake agreed to several atypical lease provisions that favor Petty in exchange for a lucrative working interest in land covering Petty's family-held ranches.**

54. The Petty Leases are not typical so-called "Producers 88" form leases. Because the Petty ranches covered some of the most highly coveted property for developing Eagle Ford Shale production, the parties heavily negotiated the Leases and Petty persuaded Chesapeake Exploration to agree to several unique provisions that favor the royalty owner, and which are not found in form leases.

55. Subsection 5 of the Leases contains the provisions concerning the calculation and payment of royalties. Under this subsection, Chesapeake is obligated to:

- a. Pay Petty a 27.5% royalty on "all Minerals produced," including, but not limited to, all liquid hydrocarbons, gas, and natural gas liquids ("NGLs") and other plant products, regardless of whether those minerals were sold, used on or off the Leased Premises, or lost to venting, flaring, or otherwise, *see* Leases, ¶¶ 5.1–5.5, 5.9;
- b. Value Petty's production and calculate and pay royalties on liquid hydrocarbons, plant products, and gas in accordance with various pricing prongs:
  - i. **Oil, Condensate, and other Liquids.** Chesapeake is required to pay royalties for oil, condensate, and other liquid hydrocarbons based on the greater of: (i) gross proceeds plus any premiums or contractual benefits realized by Chesapeake or an affiliate that was derived from Petty's oil production; (ii) the NYMEX price or (iii) the highest price received by Chesapeake, a co-lessee, or co-tenant during the production month for oil produced from or within 50 miles of the leased premises subject to adjustments for gravity and quality. *See* Leases, ¶ 5.1.
  - ii. **Plant Products or NGLs.** Chesapeake must pay royalties for plant products or NGLs based on the greater of: (i) gross proceeds plus any premiums or contractual benefits realized by Chesapeake or an affiliate that was derived from Petty's production; (ii) the first of the

month index price for each plant product as published in the Oil Price Information Services for NGL Spot Prices at Mont Belvieu, Texas; or (iii) the highest price received by Chesapeake, a co-lessee, or co-tenant during the production month for plant products produced from or within 50 miles of the leased premises. *See Leases, ¶ 5.2.*

iii. **Gas.** For gas, Chesapeake is required to pay royalties on the greater of two pricing prongs: (i) gross proceeds plus any premiums or contractual benefits realized by Chesapeake or an affiliate that was derived from Petty's production; or (ii) the Houston Ship Channel average index price less the reasonable cost of transporting gas from the Leased Premises to the Houston Ship Channel but not to exceed \$0.14 per MMBtu. *See Leases, ¶ 5.3.*

c. Pay Petty's 27.5% royalty free of "any deduction whatsoever, either directly or indirectly" except (i) the above reasonable cost of transportation and (ii) Chesapeake may deduct from Petty's royalty the proportionate share of the severance taxes that Chesapeake actually pays to federal and state agencies. *See Leases, ¶ 5.9.* Chesapeake may also deduct a reasonable cost for gas treatment from Petty's royalty, but Petty's gas does not require treatment to be marketable.

56. In addition, Paragraph 5.7 of the Leases requires Chesapeake to treat Petty as a third-party beneficiary to any agreement "affecting the sale, exchange, use, disposition, marketing or transportation" of Petty's Minerals. It further obligates Chesapeake to pay Petty an additional 27.5% royalty on any amounts or benefits directly or indirectly realized or derived by Chesapeake or its affiliates from a laundry list of transactions and agreements, including hedging or other derivative agreements, transportation agreements, and gathering agreements. Paragraph 5.7 specifically provides that:

Further, [Petty] shall be entitled to [27.5%] of any amount or benefits realized, recovered, derived, received, or obtained by or for the benefit of [Chesapeake] or its affiliate or subsidiary, directly or indirectly, or granted to [Chesapeake] from any person or party (i) for or emanating from the barter, contribution, disposition, settlement, exchange, sale, usage, hedging, buy-out or buy-back of Minerals, (ii) under transportation agreements, purchase agreements, contracts, sales agreements, severance, any type of derivative agreement or swap of any one or more Minerals, (iii) for the execution, amendment, modification, extension, alteration, consolidation, transfer, cancellation, compromise or settlement of any agreement mentioned above, or (iv) paid as a premium, commission, commitment,

inducement, demand fee, load management fee or fee of similar import in order to commit Minerals to such buyer or dealer, or (v) as inducement to sell Minerals or in settlement thereof or any right, obligation or claim.

57. This provision further makes clear that:

It is the intent of [Petty] and [Chesapeake] that [Chesapeake] pay royalty on each and every benefit received by [Chesapeake] while marketing production as the result of each and every arrangement between [Chesapeake] and any third party emanating from the value of hydrocarbons produced from these Leased Premises.

Chesapeake is also obligated to provide Petty with notice and full details of any transaction proposed under Paragraph 5.7, including hedging or other derivative transactions, and transportation or gathering transactions, before consummating such transaction.

58. In the alternative, under the gross-proceeds prong, Chesapeake must calculate Petty's 27.5% royalty and 7.25% net revenue interest on liquids, gas, and NGLs using the gross proceeds or gross amount realized by Chesapeake or its affiliate from the first sale to a third party purchaser *plus* any premiums or benefits realized by Chesapeake or its affiliated entities. In other words, Chesapeake must include Petty's proportionate share of any hedging or other derivative benefits that Chesapeake derived from Petty's Minerals in the calculation of gross proceeds and pay Petty's 27.5% royalty based on such inclusive gross proceeds when this amount is the highest price of the various pricing prongs. Under the Leases' clear and unambiguous terms, and consistent with the application of the other pricing prongs, Petty is due royalties based on the hedge prices received by Chesapeake or its affiliate whenever those prices are greater than the prices used by Chesapeake in calculating and paying Petty royalties.

59. The Petty Leases also set forth a standard of conduct that imposes on Chesapeake two duties. In most instances, Chesapeake must perform its obligations with the "utmost good faith and fair dealing." And when performing its obligations under Paragraph 5.7, Chesapeake carries a fiduciary duty to act as Petty's trustee—meaning it must put Petty's interests above its own. Under

Texas law, a fiduciary duty encompasses a duty of good faith and fair dealing, so Chesapeake owes both duties to Petty with respect to Chesapeake's obligations under Paragraph 5.7. The Leases specifically provide that:

The standard of conduct or duty that [Chesapeake] owes to [Petty] and each royalty owner in managing this Lease and performing the express and implied duties and obligations imposed on [Chesapeake] under the terms of this Lease shall be utmost good faith and fair dealing, except, however, as to Paragraph 5.7 [Chesapeake's] standard of conduct or duty to [Petty] and each royalty owner shall be the same duty that a trustee owes to a beneficiary.

Petty Leases, Definitions and Standard of Conduct (iii).

60. Another unique provision is found in Paragraph 19.1 of the Leases, whereby PBE:

retains a first and preferred lien and security interest in all (i) Minerals produced and saved from the Leased Premises and (ii) all proceeds from the sale, disposition, exchange or transfer of such Minerals and all accounts arising therefrom and (iii) all equipment and fixtures of Lessee located on the Leased Premises (the "Collateral") to secure Lessor in the payment to it of all sums owed to it under this Lease and to secure Lessee's full compliance with the other terms and provisions of this Lease.

61. PBE has properly perfected its liens and security interests by filing a Memorandum of Oil and Gas Lease for each Lease in the real property records in the county in which the real property is located and by filing UCC-1 statements in Texas, Oklahoma, and Delaware. Thus, Petty is a secured creditor of the Debtors.

62. To be sure, under Paragraph 19.1 of the Leases, Chesapeake may grant a lien that may have priority over the Lessor's first lien, but only in limited circumstances. Chesapeake may give a lien to a third party against Chesapeake's leasehold for indebtedness advanced to Chesapeake for the purpose of drilling on or under the Leased Premises or for construction of transportation and marketing facilities which shall benefit production under the Lease. To date, Chesapeake has granted no such liens.

63. In addition, Paragraph 19.2 of the Leases provides that:

Lessee is prohibited from granting a lien, mortgage, pledge or security interest on Lessor's royalty share or portion of produced Minerals or revenue or value derived from the production of Minerals. Any direct or indirect attempt to impress a lien, mortgage, pledge or security interest on Lessor's royalty share of production or revenue or value derived therefrom shall be void and constitute a breach of this Lease.

Chesapeake, then, could not impress a lien on Petty's royalty-type (non-cost bearing) interests; any attempt to do so would be void and a breach of the Leases.

64. Also, Petty Energy has a working interest that Chesapeake could not mortgage.

Paragraph 1.4.5 of the Leases provides that:

In connection with the marketing of and accounting for [Petty's] share of production attributable to its working interest . . . it is understood and agreed by [Chesapeake] that . . . such marketing, revenue accounting and payments will be done in the same way and subject to the same requirements and obligations imposed with respect to oil and gas attributable to [Petty's] royalty."

Because Petty Energy's working interest was to be treated like a royalty, Paragraph 19.2's prohibition of liens against the Lessor's share also applied to Petty Energy's working interest.

65. Also relevant to Petty Energy's working interest is Paragraph 1.4.3 of the Leases, which provides that:

"In the event Lessor exercises this option (to acquire a 10% working interest in a well) and such well is completed as a well capable of production in paying quantities, Lessee shall, prior to first production of such well, deliver to Lessor or its designee, an assignment of this Lease, which assignment shall be of that working interest portion or percentage which Lessor elected to acquire and shall be assigned to Lessor or its designee free and clear of all liens, encumbrances and claims. . . ."

Because each assignment to Petty Energy needed to be lien free, Chesapeake had no authority to place a lien, encumbrance, or other claim on Petty Energy's working interest in the first place. To the extent that Paragraph 19.1 granted Chesapeake a limited exception for drilling (as described above), an exception that Chesapeake has never exercised, Paragraph 1.4.3 obligated Chesapeake to remove that claim at the time of the required assignment.

66. As set forth in Paragraph 59 above, when performing its obligations under

Paragraph 5.7, Chesapeake carries a fiduciary duty to act as Petty's trustee—meaning it must put Petty's interests above its own. Moreover, under Paragraph 5.7.2 of the Leases, Petty is a “third-party beneficiary of any agreement affecting the sale, exchange, use, disposition, marketing or transportation of Minerals under the Leased Premises” including any hedging of any Minerals. These provisions further confirm that Petty's interests are fully secured and prime to any competing claims by other creditors.

67. Petty has filed proofs of claims to which Chesapeake has objected. Given Paragraph 19.1 of the Leases and Petty's proper perfection of their liens and security interests, Petty is a fully secured creditor entitled to treatment as Class 1 “Other Secured Claim” under the Fifth Amended Plan. (No. 20-33233, Dkt. 2915 at 96 ¶ 193 (“[I]n the event that this Bankruptcy Court rules in the Adversary...that any such prepetition claim of the Petty Entities or any individual Petty Entity against the Debtors is secured..., then such...Claim of such Petty Entity shall be treated as a Class 1 ‘Other Secured Claim’ entitled to payment in full.”))

68. Yet another important provision of the Leases appears in Paragraph 21.1, which tolls the limitations period for any claims arising out of the Leases:

21.1 TOLLING OF LIMITATIONS: Due to the relative positions of Lessor and Lessee and in an effort to preclude potentially unnecessary and costly disputes in courts, Lessor, Lessee, and their respective heirs, successors and assigns agree to a tolling of all applicable statutes of limitations as same relate to any express or implied obligations, covenants and conditions imposed upon Lessee by virtue of this Lease. The tolling of all statutes of limitations which might be applicable to any express or implied obligations, covenants and conditions arising out of this Lease shall commence on the date hereof, and such tolling shall continue until lifted as hereinafter provided. As to any specific matter raised by Lessor or Lessee or royalty owner or surface owner, (if different from Lessor), this tolling of limitations shall be lifted as to such specified incidence in question thirty days (30) after the party or parties to whom such inquiry is addressed has received such written inquiry. Notice of an incident or inquiry shall be in writing and either mailed certified mail or delivered by public or private courier and received by the party to whom it is addressed. This agreement shall toll all statutes of limitation, regardless of whether the circumstance would constitute a reversion of any rights or breach of

any expressed or implied covenants or conditions of this Lease or would give rise to any other cause of action arising out of the relationship between the parties to this Lease and their heirs, successors and assigns. This provision shall be applicable to and inure to the benefit of all owners of royalty under the Leased Premises.

69. Since execution, there have been certain amendments to the Petty Leases. Relevant here, on September 2, 2016, Chesapeake and Petty executed a letter amendment to the Maguey Leases. The amendment provided, among other things, that Petty was entitled to a sliding-scale royalty of between 17.5% and 27.5% for produced gas volumes. The percentage used to calculate the gas royalty depends on the prior month's gas prices as determined under the valuation provisions contained in the Petty Leases.

70. In addition, in December 2015, the parties amended the Dos Hermanos Ranch and Browne Ranch Leases to provide that Chesapeake pay Petty royalties for flash gas based on a new agreed formula to calculate unmeasured volumes and the Leases' pricing prongs for gas to calculate the price. Petty later discovered, however, that due to Chesapeake's changes to its chosen well pad configuration and operations, Chesapeake was able to manipulate the way gas flowed through its facilities such that it would appear that Chesapeake was adhering to the agreed formula for measuring flash gas volumes, but in reality Chesapeake was diverting unmeasured gas to be flared. As a result, Chesapeake failed to properly measure and pay Petty royalties on these volumes lost to flaring.

**C. Petty's revenue audit reveals that Defendants breached the Leases in multiple ways, resulting in millions of dollars in unpaid royalties that are due to Petty.**

71. The Leases grant Petty the right, but not the obligation, to audit revenue, production, and the calculation and payment of royalty. In addition to performing a monthly, in-house review of the royalties paid by Defendants, Petty has conducted a formal revenue audit approximately every two years to enforce compliance with the Leases. Petty retained W.A. Waterman & Co. and Meridian Energy Advisors, L.L.C. (collectively, the "Auditors") to perform



these formal revenue audits and the extrapolations for other periods on its behalf.

72. On December 3, 2019, the Auditors submitted to Defendants a royalty audit report that identified numerous issues with Defendants' revenue and royalty payments for the production period from January 2016 through December 2017, which resulted in Defendants owing Petty over \$17 million in unpaid royalties, interest, and fees. The Auditors updated their calculations in May 2020 to reflect a range of \$19–\$21 million in unpaid royalties. At that time, the Auditors could provide Chesapeake with only a range of unpaid amounts because Chesapeake refused to provide the Auditors with the information needed by the Auditors to provide a final number. Since that time, however, the Auditors have been provided with additional information through formal discovery and have updated the range of unpaid royalties to between \$16.4–\$17.8 million.

73. On January 13, 2020, as required under the Leases, Petty sent Defendants a notice of default, demanding that Defendants pay all royalties due for this period, and a second notice of default on February 18, 2020. By letters dated March 24, 2020, Chesapeake Exploration and CNOOC informed Petty that they believed there were bona fide disputes as to the amount of royalties due. As a result, Petty was forced to file this suit to collect all outstanding amounts owed.

74. One major issue that the audit uncovered was Defendants' failure to pay Petty its share of the benefits that Defendants Chesapeake derived from hedging and other activities as required under the Leases. During the January 2016 to December 2017 period, Chesapeake engaged in large-scale hedging activities covering much of its North American oil and gas production, effectively locking in future sale prices that often turned out to be higher than what Chesapeake would have received without these activities and netting Chesapeake hundreds of millions of dollars in additional revenue. Petty was entitled to its share of the benefits of the hedging revenue. Defendants' failure to pay these amounts is a direct breach of the Leases. In

addition, Defendants failed to provide Petty with the requisite notice and details of these hedging activities, which also breached the Leases.

75. The Auditors additionally found that Defendants' calculation and payment of royalties were improper in several other ways, including:

- a. Defendants failed to pay royalties on 100% of produced oil, condensate, and liquid hydrocarbon volumes;
- b. Defendants failed to pay any royalties for skim oil volumes recovered from disposed saltwater produced with the minerals under the Leases;
- c. Defendants failed to pay on 100% of reported gas volumes;
- d. Defendants failed to pay all royalties due on unmetered flared gas;
- e. Defendants failed to properly account for the gas volumes used for gas lift purposes and thus failed to pay all royalties due on the net gas produced;
- f. Defendants used improper and unauthorized weighted average sales prices ("WASP") to calculate and pay royalties for produced oil, gas, and NGLs;
- g. Defendants improperly deducted costs for gas processing;
- h. Defendants failed to pay royalties based on the highest price for oil, condensate, and other liquid hydrocarbons in accordance with the multi-prong test set forth in the Leases;
- i. Defendants failed to pay royalties based on the highest price for gas in accordance with the multi-prong test set forth in the Leases;
- j. Defendants failed to pay royalties based on the highest price for plant products in accordance with the multi-prong test set forth in the Leases;
- k. Defendants failed to calculate royalties due based on the highest prices paid for production on or within 50 miles of the leased premises; and
- l. Defendants deducted more severance taxes from Petty's royalty than Petty's share of the amount of severance taxes Defendants actually paid.

76. Defendants' repeated failures to properly calculate and pay royalties to Petty constitute breaches of the Leases. According to the audit, Defendants' breaches have resulted in at least \$16,474,309, and possibly more than \$17,806,663 in unpaid royalties, interest, and fees owed

to Petty. The Leases also entitle Petty to recover its costs for conducting this audit and for pursuing this litigation, which are ongoing and increasing.

77. *Severance Tax.* Under the Leases, Chesapeake must pay all severance taxes due and owing by Lessor but may deduct from Petty's royalty payments only Petty's proportionate share of the severance taxes Chesapeake actually pays on the total production from each of the Leases. Chesapeake, however, has deducted more than Petty's proportionate share of severance taxes by applying the tax rate to the gross value used for Petty's royalty on a hypothetical basis, rather than using the proper method under the Leases to allocate the taxes actually paid by Petty's royalty percentage.

78. To support its improper deductions, Chesapeake has cited—and continues to cite—an inapposite 1982 Ruling by an Administrative-Law Judge in a proceeding before the Comptroller of Public Accounts of the State of Texas, in Hearing No. 10,468 that addressed payment of severance taxes under what is now Chapter 201 of the Texas Tax Code, not the respective obligations of a lessor and lessee under a negotiated lease, which is at issue here. This ruling therefore has no bearing on how Chesapeake shall fulfill its duty “to correctly calculate and pay...all severance taxes due and owing by Lessor” under the first tax sentence in Paragraph 5.9. The Leases impose a different method of calculating Petty's severance-tax deductions than the law would impose in the absence of an agreement.

**D. Defendants have continued to breach the Leases by their persistent use of a flawed methodology to calculate and pay Petty's royalty.**

79. Defendants have not changed the way that they calculate and pay Petty's royalty. Defendants, instead, have continued to use the same methodology that they used during production months January 2016 through December 2017 to calculate and pay Petty's royalty.

80. Prior to Chesapeake's bankruptcy filing, Petty conducted a summary review audit

of Defendants' revenue and royalty payments for the period from January 2018 through the end of the first quarter of 2020. This summary review tested Chesapeake's payments to Petty against Chesapeake's public disclosures (including SEC filings) and also limited materials Chesapeake provided to Petty. The Auditors' review revealed that Defendants failed to properly pay royalties in this later audit period in the same manner identified during the January 2016 through December 2017 period, including by failing to pay Petty its share of the substantial benefits Defendants realized from hedging activities. By letter dated May 22, 2020, Petty provided Defendants with written notice of default for the January 2018 to first quarter 2020 audit period.

81. Compared to royalty underpayments for the 2016–2017 time period, Defendants owe substantially more in unpaid royalties for the January 2018 through June of 2020 production months. The reason why the amount of the underpayment increased relates to Chesapeake's continuing failure to pay Petty its share of the benefits of the hedging revenue for the production months after December 2017 to the present. For perspective, according to public filings, Chesapeake's hedging and derivative arrangements generated approximately \$907 million net gains, both realized and unrealized, in just the first half of 2020, meaning that Petty would be entitled to some share of this substantial benefit under Paragraph 5.7. Even if the amount of gains were limited only to Chesapeake's reported realized gains of \$734 million, the amount due Petty under Paragraph 5.7 for the hedging or other derivative benefits would be at least \$7.5 million for just the first half of 2020. The Leases entitle Petty to its share of this and other substantial benefits that Defendants have realized but refused to pay.

82. Finally, Exploration, Operating, and an affiliated company, Chesapeake Energy Marketing, L.L.C., entered into a gas gathering ("transportation") agreement (the "GGA") with Mockingbird Midstream Gas Services, L.L.C. ("Mockingbird"), which contains certain

dedications and commitments that purport to burden certain of Petty's interests, including the Leases and the wells drilled and gas produced under the Leases.<sup>10</sup> The GGA—which was recorded in Webb County and LaSalle County—was amended as of January 1, 2020. Chesapeake may have realized certain significant financial benefits from its amendment of the GGA. Petty is entitled to its share of any amounts or benefits realized from such amendments. Chesapeake has failed to pay Petty its required share of benefits stemming from the GGA's amendment in breach of the Leases.

83. Petty's Auditors have continued to update their analyses of all claims that arose before Chesapeake filed for bankruptcy on June 28, 2020. Those analyses indicate that Defendants continued to underpay royalties in the second quarter of 2020 in the same ways described in previous paragraphs, including, but not limited to, Paragraphs 74–81. In total, the Auditors have concluded that Defendants owe Petty between \$21,688,923.00 and \$23,950,864 for the 2018–June 2020 audit period.

## **CAUSES OF ACTION**

### **Breach of Contract, Audit Period 2016–2017**

84. Petty incorporates all previous paragraphs by reference, as if set forth fully herein. Defendants have breached the Leases in numerous ways, including in the ways identified in Petty's audit of production months January 2016 through December 2017 as set forth above.

85. Petty has suffered damages as a result of Defendants' numerous breaches of the Leases. Petty seeks to recover the damages it has suffered as a result of Defendants' breaches and all other relief to which Petty is entitled, including, but not limited to, notice of and documents related to all proposed or consummated hedging, derivative, or other agreements or transactions

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<sup>10</sup> Petty has filed suits in Webb County and LaSalle County against these entities, asserting claims to quiet title and for breach of contract to the extent these dedications and commitments burden Petty's interests.

that concern or relate to oil, gas, or NGLs produced under the Leases.

86. Because Defendants failed to pay the proper royalties, Defendants owe interest on the unpaid royalties. The Leases provide that interest accrues at the maximum amount permitted under Texas law, which is 18%. Alternatively, Petty is entitled to interest as set forth in § 91.404 of the Texas Natural Resources Code.

**Breach of Contract, Audit Period January 2018 to June 2020**

87. Petty incorporates all previous paragraphs by reference, as if set forth fully herein.

88. As set forth above, Defendants have used the same methodology to calculate and pay Petty royalty for production months January 2018 to June 2020 (ending June 28, 2020, when Chesapeake filed for bankruptcy) as they did to calculate and pay Petty's royalty on production in January 2016 through December 2017. Accordingly, Defendants have breached the Leases in at least the same ways identified in Petty's audit of production months January 2016 through December 2017 as set forth herein.

89. Chesapeake has also breached the Leases by failing to provide Petty with prior notice and full details of its transactions with Mockingbird pertaining to the GGA or of its hedging and derivative arrangements or contracts. Furthermore, Defendants failed to pay Petty royalties for any benefits or amounts realized from the amendment to the GGA or other gathering or transportation agreements.

90. Defendants' breaches of the Leases by failing to pay royalties owed in full have damaged and continue to damage Petty. In total, the Auditors have concluded that Defendants owe Petty between \$21,688,923.00 and \$23,950,864, depending on whether Chesapeake's hedging profits are calculated under the gross-proceeds pricing prong or treated solely as benefits under Paragraph 5.7 of the Leases. Petty seeks recovery of all damages suffered as a result of these breaches and all other relief to which it is entitled, including, but not limited to, notice of and

documents related to all proposed or consummated hedging, derivative, or other agreements or transactions that concern or relate to oil, gas, or NGLs produced under the Leases.

91. Because Defendants failed to pay the proper royalties, Defendants owe interest on the unpaid royalties. The Leases provide that interest accrues at the maximum amount permitted under Texas law, which is 18%. Alternatively, Petty is entitled to interest as set forth in § 91.404 of the Texas Natural Resources Code.

### **Breach of Duty of Good Faith and Fair Dealing**

92. Petty incorporates all previous paragraphs by references as if set forth fully herein.

93. Except when performing its obligations under Paragraph 5.7 of the Leases, which imposes a fiduciary duty, Chesapeake must perform its obligations with the “utmost good faith and fair dealing.” Chesapeake has breached that standard of care in at least the following ways, among others:

- a) Chesapeake has calculated Petty’s severance-tax withholdings incorrectly;
- b) Chesapeake has changed a number of its well pad facilities to circumvent the measurement or recovery of flash gas and to avoid the royalties due under the Flash Gas Limited Amendment; and
- c) Chesapeake has withheld entirely, or in bad faith delayed providing, information that the Leases entitle Petty to obtain in order to audit royalty payments such that Petty was unable to complete even a preliminary audit of the 2016–17 royalty payments until 2019, when Chesapeake’s financial condition had deteriorated to the point where it was just months away from declaring bankruptcy.

### **Breach of Fiduciary Duty**

94. Petty incorporates all previous paragraphs by reference as if set fort fully herein.

95. The Leases impose on Defendants the duty to act as Petty’s trustee with regard to calculating and paying Petty its share of the benefits Chesapeake or Chesapeake’s affiliates realized both (i) from hedging or other derivative agreements obtained related to production from

or reserves under the Petty Leases, or (ii) from its transportation agreements and contract with Mockingbird. This fiduciary duty also includes the duty of good faith and fair dealing.

96. Chesapeake engaged in extensive hedging activities during production months January 2016 to December 2017 that generated hundreds of millions of dollars for Defendants. Chesapeake continued these hedging activities during production months January 2018 to the present, and similarly realized hundreds of millions of dollars in revenue. Chesapeake also engaged in changes to its transportation arrangements and contract with Mockingbird that provided Chesapeake with certain financial benefits. Chesapeake obtained these substantial benefits while marketing the Minerals produced under the Petty Leases, and the Leases obligated Defendants to calculate and pay Petty royalties on these substantial amounts. By refusing to do so, and by withholding all of the benefits for itself, Defendants put their own interests above Petty's, thereby breaching the fiduciary duty they owed Petty.

97. Additionally, Defendants have continued to put their own interests above Petty's when responding to Petty's demand that Defendants abide by the Leases. As just one example, despite unambiguous Lease language to the contrary, Defendants continue to calculate royalties in ways that have been the subject of the previous litigation and mediated settlements between the parties and insists on forcing Petty to relitigate the same issues again and again. Furthermore, after the parties amended the Dos Hermanos Ranch and Browne Ranch Leases in December 2015, Defendants agreed to use a certain formula for addressing the manner of calculating the volume of flash gas not measured due to the manner Chesapeake designed, installed, and operated a number of its well pads at the time. Thereafter, Chesapeake changed a number of its wellpad facilities to circumvent the recovery of flash gas and violate at least the spirit, and maybe the letter of the agreed amendment and other terms and conditions of the Leases. Regardless, Chesapeake's change



to the facilities results in much less flash gas being measured and/or much more gas being flared, thereby reducing Petty's royalties on that gas. Defendants' self-serving conduct further establishes that they failed to act with the utmost good faith and fair dealing, in further breach of the fiduciary duties they owe to Petty.

98. Petty was damaged by Defendants' breaches of its fiduciary duties. In addition to the related damages for these actions as a breach of contract above, Petty seeks forfeiture and disgorgement to which it is equitably entitled, including, but not limited to:

- Petty's share of all the benefits that Chesapeake or its affiliates realized from hedging or other derivative agreements obtained while marketing production under the Petty Leases; and
- Disgorgement of the profits Chesapeake or its affiliates realized from hedging or other derivative agreements obtained while marketing production under the Petty Leases, which will compensate Petty for Chesapeake's breach of the relationship of trust and deter Chesapeake from breaching fiduciary duties in the future.

**Nonpayment of Proceeds under Texas Natural Resources Code**

99. Petty incorporates all previous paragraphs by reference as if set forth fully herein.

100. Petty brings this claim for payment of proceeds pursuant to Texas Natural Resource Code §§ 91.401 et seq.

101. As owner of mineral rights under the Leases, Petty is legally entitled to payment from the proceeds derived from the sale of oil or gas from the oil or gas wells located on the Leased Premises and is therefore a payee under § 91.401(1).

102. Defendants undertook the obligation to distribute oil and gas proceeds to Petty and are therefore payors under § 91.401(2).

103. As described above, Defendants have failed to properly and timely calculate, account for, and pay correct royalties and interest due to Petty for production under the Leases for the 2016–2017 Audit Period and for the January 1, 2018 to June 28, 2020, Audit Period.

104. Petty provided Defendants with written notice of their nonpayment for the 2016–2017 Audit Period on January 13, 2020, and again on February 18, 2020. Petty provided Defendants with written notice of their nonpayment for the January 1, 2018 to June 28, 2020 Audit Period in Petty’s Original and First Amended Petitions more than thirty (30) days ago and again by written notice on May 22, 2020 and in the Second Amended Petition and Third Amended Petition. Notwithstanding such notices, Defendants have neither paid Petty the proceeds due nor provided reasonable cause for nonpayment.

105. Petty seeks to recover all outstanding amounts due from Defendants for nonpayment of royalties and benefits plus interest and costs, totaling to some \$41.7 million or more.

**Declaratory Judgment – 28 U.S.C. § 2201.**

106. Petty incorporates all previous paragraphs by reference as if set forth fully herein.

107. Under 28 U.S.C. § 2201, this Court has the power to “declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought.”

108. An actual controversy existed between Petty and Chesapeake over Petty’s secured status. Petty contended that it has valid, perfected non-avoidable liens senior to any liens Chesapeake may have granted under Paragraph 19.1 of the Leases, while Chesapeake has contended that Petty was not fully secured. Petty and Chesapeake have since stipulated that Petty is fully secured as to any amounts of royalty found by the Court to be unpaid and owing. (Adv. No. 20-03433 Dkt. 42 at 3 ¶ 2 (“With respect to the Claims, Chesapeake Parties and Petty stipulate that Petty’s Claims are fully secured by the collateral described in paragraph 19 of the Leases...and shall be treated as such in accordance with the order confirming Chesapeake Parties’ plan of

reorganization entered on January 16, 2021 [Docket No. 2915].’’)).

109. Petty therefore seeks a declaration, consistent with the parties’ stipulation, that its claims for unpaid royalties are fully secured and senior to any other interest, whether or not secured and that its lien is superior to any other liens because Chesapeake cannot prove the existence of any liens based on loans the proceeds of which Chesapeake used to drill on or under the Leases or to build infrastructure for the benefit of the Leases.

110. Petty’s Auditors have continued to update their analyses of all claims that arose before Chesapeake filed for bankruptcy on June 28, 2020. Those analyses indicate that Chesapeake continued to underpay royalties in the second quarter of 2020 in the same ways described in previous paragraphs, including, but not limited to, Paragraphs 74–81. In light of those underpayments, Petty has filed proofs of claim to which Chesapeake has objected. Petty therefore further requests that the Court, when declaring that Petty’s claims are fully secured and senior to other interests, also overrule any objections to those Petty proofs of claim covered by the Stipulation. (Adv. No. 20-03433 Dkt. 42; No. 20-33233, Dkt. 2915 at 96 ¶ 193.)

### **TOLLING OF STATUTE OF LIMITATIONS**

111. Under Paragraph 21.1 of the Leases, all limitations periods for claims arising out of the Leases were tolled until thirty (30) days beyond when Defendants received notice of Petty’s claims. Petty sent Defendants a notice of default on January 13, 2020. Therefore, Paragraph 21.1 operated to toll the statute of limitations for each of Petty’s claims until February 12, 2020.

### **DISCOVERY RULE**

112. The nature of Petty’s injuries was inherently undiscoverable because (a) Defendants were acting as Petty’s fiduciaries and “[a] fiduciary’s misconduct is inherently

undiscoverable”<sup>11</sup> and (b) Petty could not determine whether Defendants had paid the appropriate royalties without auditing the royalty payments, something that required Defendants to provide information that they repeatedly refused to turn over in full.

113. The nature of Petty’s injuries was objectively verifiable as well because it is possible to calculate the correct royalty payments and because once those payments are calculated, a comparison of the correct total with the total Defendants actually paid allows one to determine whether Defendants put their own interests above Petty’s.

114. Consequently, the statute of limitations for Petty’s claims began to run no earlier than December 3, 2019, when Petty was finally able to complete an audit despite Defendants’ continued refusal to provide all of the information Petty requested—and was entitled to—under the Leases.

115. The Leases imposed on Defendants a duty to disclose, when requested, information necessary for Petty to conduct audits.

116. Despite Petty’s repeated requests for such information, Defendants refused to provide enough of it to allow Petty to audit the royalty payments.

117. Each time Defendants refused to disclose sufficient information to allow Petty to complete an audit, Defendants did so knowing that they had breached the Leases by intentionally miscalculating royalty payments and refusing to pay Petty its portion of Defendants’ hedging profits. Put differently, Defendants had actual knowledge that a wrong occurred.

118. Each time Defendants refused to disclose sufficient information to allow Petty to complete an audit, their actions in fact concealed their breaches of the Leases (because Petty was unable to verify the correctness of the royalty payments made by Defendants to determine whether

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<sup>11</sup> *Martinez v. Martinez*, No. 10-15-00410-CV, 2017 WL 3686850, at \*10–11 (Tex. App.—Waco Aug. 23, 2017, pet. denied).

breaches had occurred).

119. Each time Defendants refused to disclose sufficient information to allow Petty to complete an audit, it was reasonable for Petty to rely on what limited information Defendants did provide because Petty had no other way to obtain information necessary to audit Defendants' royalty payments and its compliance with the Leases.

### **CONTINUING TORT**

120. The Leases impose on Defendants a fiduciary duty. Defendants have owed Petty this duty throughout the entire period of Defendants' challenged conduct. Indeed, that duty continues to this day.

121. Each royalty payment has stemmed from the Leases and the Petty's and Defendants' longstanding business relationship with one another. Each time a royalty payment was due, Defendants' fiduciary duty required them to put Petty's interests above their own. Because the royalty payments had a set method of calculation but not a set amount, what Defendants owed Petty fluctuated. Each payment, then, brought with it a new royalty calculation, not just a continued misapplication of a single past calculation.

122. Each time Defendants underpaid Petty, Defendants breached their fiduciary duties anew. Put differently, Defendants have caused Petty a repeated injury through their repetitive breach of their fiduciary duty.

123. What is more, the breach is ongoing—as Defendants have not yet stopped breaching their fiduciary duty

124. Consequently, the statute of limitations has not yet started to run. Because Defendants' conduct constitutes a continuing tort, the limitations period will begin running only when their tortious conduct ceases.

### **ATTORNEY'S AND EXPERT'S FEES**

125. Petty incorporates all previous paragraphs by reference as if set forth fully herein.

126. Pursuant to Paragraph 26 of the Leases, Petty is entitled to recover “reasonable attorney’s fees, accountant’s fees, engineer’s fees, consultant’s fees and/or expert’s fees” incurred in prosecuting the audits and this lawsuit. In addition, Petty requests an award of attorneys’ fees under Texas Natural Resources Code § 91.406 and any other available legal, equitable, or statutory grounds.

### **CONDITIONS PRECEDENT**

127. All conditions precedent to recovery by Petty have been performed or have occurred.

### **PRAYER FOR RELIEF**

Petty requests that the Court award a judgment against Chesapeake Exploration, Chesapeake Operating, Jamestown Resources, Larchmont Resources, and CNOOC for the following:

- a. Actual damages;
- b. Disgorgement for breach of fiduciary duty;
- c. Pre- and post-judgment interest, as permitted by law and provided by the Leases;
- d. Costs;
- e. Attorney fees, accountant’s fees, engineer’s fees, consultant’s fees and/or expert’s fees;
- f. A declaratory judgment that all Petty’s claims asserted in this Complaint are perfected and fully secured and senior to any other interest;
- g. A decision overruling any objections Chesapeake files to Petty’s proofs of claim regarding prepetition unpaid royalties, and interest and expenses; and
- h. All other relief to which Petty is entitled.

Respectfully submitted

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