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CAUSE NO. 2013-59098

XS CAPITAL INVESTMENTS, LP and RURAL ROUTE 3 HOLDINGS, LP,	§	IN THE DISTRICT COURT
Plaintiffs,	§	
VS.	§	HARRIS COUNTY, TEXAS
ORCA ICI DEVELOPMENT JV, ORCA ASSETS G.P., LLC, and MRC ENERGY CORPORATION f/k/a MATADOR RESOURCES COMPANY,	§	234th JUDICIAL DISTRICT
Defendants.	§	

XS' Response to MRC Energy Corporation's Motion to Compel Arbitration of Specific Claims

Matador has moved to compel arbitration of two of XS' claims—tortious interference and declaratory judgment—based on an arbitration clause in Orca and Matador's Purchase, Sale and Participation Agreement (the "PSPA"). However, XS[1] is not and has never been a party to the PSPA. Instead, Matador is forced to argue for direct benefits estoppel, claiming that XS's claims are wholly dependent on the PSPA and that XS seeks benefits under the PSPA.

That is not the case. In fact, the complete opposite is true: the PSPA is entirely irrelevant to XS's claims. XS' discussion of the PSPA in reference to these claims is simply to note that the PSPA does not excuse Matador's tortious conduct (as Matador will claim). XS' claims stand completely independent of the PSPA. Moreover, the PSPA's arbitration provision limits the parties to actual damages, which is likely Matador's true motivation behind its attempt to split XS' claims between this lawsuit and a yet-to-be-filed arbitration. Allowing Matador to unilaterally contract away its liability for exemplary damages for tortious conduct towards a

[1] For the sake of clarity, "XS" refers to both plaintiffs, XS Capital Investments, LP and Rural Route 3 Holdings, LP. But to avoid any doubt or confusion, it is indisputable that neither of the plaintiffs are or have ever been signatories to the PSPA, and the arguments in this response apply equally to both.

third-party non-signatory would be both unconscionable and absurd. Simply put, XS' never agreed to arbitrate its claims against Matador and, instead, has the right to pursue its remedies in this Court.

Legal Standard

As the party seeking to compel arbitration, Matador bears the burden of establishing (1) the existence of a valid arbitration agreement that can be enforced against XS; and (2) that the claims raised fall within that agreement's scope. *In re Kellogg Brown & Root, Inc.*, 166 S.W.3d 738, 741 (Tex. 2005). "Generally, only signatories to an arbitration agreement are bound by the agreement." *In re James E. Bashaw & Co.*, 305 S.W.3d 44, 54 (Tex. App.-Houston [1st Dist.] 2009, orig. proceeding).

In only rare circumstances, a signatory to a contract containing an arbitration provision can compel arbitration against a non-signatory, as Matador attempts to do here against XS. Matador relies on direct benefits estoppel, which can prevent a non-signatory from avoiding an arbitration provision "only if [the non-signatory] seeks, through the claim, to derive a direct benefit from the contract containing the arbitration provision." *In re KBR*, 166 S.W.3d at 741. "[I]f the facts alleged in support of the claim stand alone, are completely independent of the contract, and the claim could be maintained without reference to the contract, the claim is not subject to arbitration" under direct benefits estoppel. *Pennzoil Co. v. Arnold Oil Co., Inc.*, 30 S.W.3d 494, 498 (Tex. App.—San Antonio 2000, no pet.). "The benefits [sought by the non-signatory] must be direct—which is to say, flowing directly from the agreement." *In re KBR*, 166 S.W.3d at 741 (quoting *MAG Portfolio Consult., GMBH v. Merlin Biomed Group LLC,* 268 F.3d 58, 61 (2d Cir. 2001)).

Even if the Court finds existence of an applicable arbitration agreement, the Civil Practice and Remedies Code prohibits the Court from enforcing unconscionable arbitration agreements." Tex. Civ. Prac. & Rem. Code § 171.022 ("A court may not enforce an agreement to arbitrate if the court finds the agreement was unconscionable at the time the agreement was made.").

Arguments and Authorities

A. XS' claims are independent of the PSPA

Matador has moved to compel arbitration of XS' tortious interference and declaratory judgment claims based solely on the fact that XS' complaint simply mentions the PSPA in relation to these claims. Matador's argument is unsupported by the facts or the law.

Matador is correct to note that XS' tortious interference claim refers to the PSPA:

> 60. Although Matador knew about the Working Interest Agreement, and accepted payments pursuant to the Working Interest Agreement, Matador willfully and intentionally interfered with the Working Interest Agreement, without authority or privilege to do so. To the extent that Matador claims it withheld its consent under the PSPA, such consent was unreasonably withheld.
>
> 61. As a direct and proximate cause of Matador's wrongful interference with contract, Plaintiffs have suffered damages in an amount to be determined at trial.

Fourth Amended Complaint. However, mere mention of the contract containing the arbitration provision is nowhere sufficient to establish direct benefits estoppel. *VSR Fin. Services, Inc. v. McLendon*, 409 S.W.3d 817, 832 (Tex. App.—Dallas 2013, no pet.) (citing *In re KBR*, 166 S.W.3d at 741.) ("Direct benefits estoppel may not apply if the claim merely "relates" to the contract containing the arbitration provision."). "Under both Texas and federal law, whether a claim seeks a direct benefit from a contract containing an arbitration clause turns on the substance of the claim, not artful pleading.... When determining whether claims fall within the scope of the arbitration agreement, we look to the factual allegations, not the legal claims." *Id.*

Matador fails to address the actual relevance of XS' mention of the PSPA. The PSPA is not mentioned in connection with the elements of tortious interference. *See Murray v. Crest Construction, Inc.,* 900 S.W.2d 342 (Tex.1995) (the elements of tortious interference are the existence of a contract subject to interference, an act of interference that was willful and intentional, proximately causing plaintiff's damages, with actual damage or loss to plaintiff.). The PSPA is wholly irrelevant to the elements and allegations regarding Matador's tortious interference.

So why does XS even mention the PSPA? The parties know that both Orca and Matador have tried and will continue to try to excuse some of their illegal behavior by relying on terms in the PSPA. XS merely mentions the PSPA to state that it does not provide a defense to Matador (i.e. Matador was not contractually privileged to interfere with the contract between XS and Orca). XS could have just as easily left that statement out—the allegations against Matador would not have changed. And the substance of XS' claim would not have changed.

XS' tortious interference claim against Matador is not based—in any way—on the PSPA, and Matador's liability does not arise from the PSPA. *In re Vesta Ins. Group, Inc.*, 192 S.W.3d 759, 761 (Tex. 2006) ("The obligation not to interfere with existing contracts is a general obligation imposed by law."); *In re Weekley Homes*, 180 S.W.3d 127, 132 (Tex. 2005) ("Claims must be brought on a contract and arbitrated if liability arises solely from the contract or must be determined by reference to it.").

Direct benefits estoppel asks the simple question: Could the claim still exist without the underlying contract? If so, direct benefits estoppel does not apply. Here, there is nothing special about the PSPA in relation to the tortious interference claim. Matador could just have easily tortiously interfered with the Working Interest Agreement if the PSPA did not exist. And XS

could have brought the same tortious interference claims against a wholly unrelated party, without being bound under an arbitration provision, if that third-party had committed the same tortious acts as Matador. *Fridl v. Cook*, 908 S.W.2d 507, 513 (Tex. App.—El Paso 1995, writ dism'd w.o.j.). XS seeks no benefit from the PSPA, does not seek to enforce the PSPA, and does not predicate or otherwise calculate its damages based on the PSPA. XS' claims do not approach the high burden necessary for direct benefits estoppel. *See, e.g.*, *In re KBR*, 166 S.W.3d at 741 (vacating order compelling arbitration because non-signatory KBR did not seek benefits "flowing directly from the agreement" and KBR's claims "relate[d] to" but could stand independent of the contract); *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 195 S.W.3d 807, 816 (Tex. App.—Dallas 2006, no pet.)(rejecting direct benefits estoppel when the plaintiff did "not seek to benefit from or enforce the contractual obligations" in the contract containing the arbitration provision."); *Petrobras America, Inc. v. Vicinay Cadenas, S.A.*, 921 F. Supp. 2d 685, 696 (S.D. Tex. 2013) (rejecting direct benefits estoppel because "the Purchase Order does not provide part of the factual foundation for the claims asserted—Petrobras's entire case does not hinge on any expressly asserted rights under the Purchase Order.").[2]

Similarly, the sole relevance of the declaration sought by XS—that, to the extent Matador withheld its consent, such withholding was unreasonable—is to prevent Matador from asserting the PSPA as a *defense* to the tortious interference claim (or other tort claims). XS

[2] *Cf. Stanford Dev. Corp. v. Stanford Condominium Owners Assoc.*, 285 S.W.3d 45, 49 (Tex. App.—Houston [1st Dist.] 2009) (direct benefits estoppel applied because the plaintiff brought claims for breach of express and implied contractual duties and express and implied warranties under the contract containing the arbitration provision); *Int'l Paper Co. v. Scwabedissen Maschinen & Anlagen GMBH*, 206 F.3d 411, (4th Cir. 2000) (applying direct benefits estoppel because the "contract provides part of the factual foundation for every claim asserted ... [defendant] failed to honor the warranties in the Wood-Schwabedissen contract, and it seeks damages, revocation, and rejection 'in accordance with" that contract. International Paper's entire case hinges on its asserted rights under the Wood-Schwabedissen contract"); *Carlin v. 3V, Inc.*, 928 S.W.2d 291, 295 (Tex. App.—Houston [14th Dist.] 1996) ("Appellee based its entire case on the rights it acquired from the 1981 agreement and would have no case if it did not exist... All of these claims sound in tort and arise out of the 1981 Italian agreement.").

knows that both Orca and Matador intend to rely heavily on Matador's behavior under the PSPA. Indeed, Orca and Matador have already conducted an arbitration under this exact provision in the PSPA and on very similar issues. That arbitration was settled, and the collusive settlement that resulted from that closed-door, two-party arbitration forms the basis for a number of XS' claims in this lawsuit. XS' attempts to prevent Matador from relying on its collusion with Orca do not somehow create "benefits" for XS under the PSPA or otherwise condition XS' claims on the existence of the PSPA.

B. The arbitration provision would unconscionably limit XS' remedies

In addition, applying the PSPA's arbitration provision to XS would be unconscionable and grossly inequitable. The PSPA's arbitration provision prohibits the arbitration panel from awarding anything beyond actual damages. XS is seeking exemplary damages for Matador's tortious interference, as is XS' right under Texas law. XS is currently free to seek those exemplary damages before this Court. But if XS is forced to arbitrate its tortious interference claim under the PSPA's arbitration provision, there is a chance that XS' available remedies will be restricted to actual damages. This is unconscionable under the law. *See, e.g.*, *In re Halliburton Co.*, 80 S.W.3d 566, 572 (Tex. 2002) (discussing procedural unconscionability and finding an arbitration provision enforceable because "[a]ll remedies the employee could have pursued in the court system are available in the arbitration" and citing other cases for the same proposition); *Venture Cotton Coop. v. Freeman*, 2014 WL 2619535 at *4-5 (Tex. Jun 13, 2014) (examining unconscionability with reference to statutory claims of signatories: "[I]t would be unconscionable for an arbitration agreement to mandate arbitration of a statutory claim and at the same time eliminate the rights and remedies afforded by statute ... When parties agree to arbitrate a statutory claim, a party does not forego the substantive rights afforded by the statute;

it only submits to their resolution in an arbitral, rather than a judicial, forum") (internal quotations omitted). But more importantly, it is grossly inequitable: XS never agreed to arbitrate these claims, and it absolutely never agreed to somehow limit the damages it could seek for tortious acts committed by Matador. If Matador's plan is allowed to succeed—and if Matador is able to shield itself from exemplary damages—this would lead to absurd results: parties would be able to unilaterally protect themselves from exemplary damages by writing arbitration agreements and damages limitations into a side agreement and then claiming that the side agreement was a necessary part of any tortious interference claim. This result would be diametrically opposed to both public policy and the law.

In short, Matador claims that the PSPA is the very foundation of XS' claims. But the opposite is true: XS only mentions the PSPA to argue its *irrelevance* to the elements and defenses to Matador's tortious behavior and seeks a declaration of the same. XS, as a non-signatory, cannot be compelled to arbitrate its claims under direct benefits estoppel or any other theory. For these reasons, Matador's motion to compel should be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

This is to certify that on this the 24th day of July, 2014, a true and correct copy of the above and foregoing instrument was properly forwarded to the following counsel of record in accordance with Rule 21 of the Texas Rules of Civil Procedure as indicated below:

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