

Form Joint Operating Agreements

Filling in the Blanks

Forms, Blanks & Additional Provisions

- Currently, there exist four form Joint Operating Agreements (“JOAs”) promulgated by the American Association of Petroleum Landmen (“AAPL”)—1956, 1977, 1982 and 1989. “Additional Provisions” of the JOA (Article XVI in 1989 Form JOA) are used to “customize” the JOA.
- Purpose of this talk: describe some of the common changes made to JOAs and common additions in Article XVI.

Exhibits

- Form JOAs have a battery of exhibits. Example:
 - Property Description—
 - must be legally accurate
 - list all known burdens, otherwise they are considered subsequently created interests
 - Accounting Procedure
 - Insurance
 - Gas Balancing Agreement—needed with split stream of gas
 - Non-discrimination statement—necessary for federal leases
 - Tax Partnership
 - *Memorandum of Operating Agreement*
 - Crucial in superiority and application of security interest

Subsequently Created Interests vs. Non-consent Operations

- Article III.C provides for non-consent penalties for payments of production, which are recoupment of the cost of the operation plus a certain multiple of that amount before non-consent can share
- However, consenting parties could be subject to ORIs, NPIs or other interests sold off by the non-consenting parties after execution of the JOA.
- Consider: provision in Article XVI making the leaseholds upon which the non-consent operations are being conducted clear of the burdens created subsequent to the JOA and require the non-participating party creating such subsequent burdens to hold the participating parties harmless.

AMI Descriptions in JOA

- Grants each party to JOA opportunity to acquire a proportional interest in each other party's acquisitions of additional property within the area of the AMI.
- AMIs are being seen more and more often in JOAs in areas undergoing initial exploration where initial leasing efforts are ongoing.
- We continue to see descriptions in Exhibit A and associated AMIs that are not legally sufficient. These are *entirely void*.

Acceptable Exhibit A or AMI Legal Land Descriptions in a Nutshell

- “must furnish within itself, or by reference to some other existing writing the means or data by which the particular land may be identified with reasonable certainty.”¹
- The essential details cannot be supplied by parole evidence—this includes supplying a land description.
- Writings identified in reference to a description must be in existence.

¹ See *Wilson v. Fisher*, 188 S.W.2d 150, 152 (Tex. 1952).

Practical Considerations

- Threshold question: could a surveyor go out and easily reconstitute the AMI boundary with the information contained in the AMI? (*Not* intrinsic knowledge.)
- Easiest, cheapest method: have AMI boundary follow survey/block or twp/range boundaries.
 - Or other man-made boundaries—roads, powerlines, etc.
 - Or, at least, natural boundaries—typically a river or stream.
- Contain complete metes and bounds description.
- Make boundary line thin on survey.
- Include all survey/block or twp/range names on survey

Case Law Landmarks—what has worked, what has not:

- **Worked**—series of documents included in an exhibit that was expressly incorporated into the AMI agreement which included:
 - Provided acreage encircled by a black line on survey
 - Attached commonly-used commercial map which included abstract numbers, survey information and block identification
- **Didn't work**—survey with no scale & thick black border.
 - did not show size of the tract or number of acres
 - contained no reference to recorded deeds or other instruments

1: *M. Trust Corp. v. NAV LJH Corp.*, 837 S.W.2d 215 (Tex. App.—Ft. Worth, writ denied)

2: *Guenther v. Amer-Tex Const. Co.*, 534 S.W.2d 396 (Tex.Civ.App.—Austin 1976, no writ)

Article V.A: Responsibilities of Operator

- 1989 Form has an expanded duty of care—standard prudent operator/workmanlike manner PLUS “with due diligence and dispatch, in accordance with good oilfield practice...”
- Standard does not cover contract claims—only operations (*Abraxas*)
- Must meet conspicuousness requirement—*but may not!* (*Dresser*)

Operator Removal

- 1956 Form – Operator removal not addressed.
- 1977 Form - Article V.A:
 - that the operator must conduct itself in a “good and workmanlike manner”
 - can be removed for failure to perform necessary “duties”—not these are not defined
 - liability allowed only for “gross negligence or willful misconduct”—a high standard.
- 1982 Form - operator removal through the vote of two or more non-operators owning majority interest excluding the voting interest of the operator.
- In Texas, winning operator removal under these forms is difficult as courts are reluctant to rule on what is “good and workmanlike” operation.

Operator Removal – 89 Form

Two ways to remove

- Article V.B.1: “Good cause” is not only “gross negligence/willful misconduct” but also “material failure or inability to perform its obligations under this Agreement.”
 - Requires two votes—to remove & to replace
- Article VII.D.1: any party can have its rights under the JOA suspended for failure of financial obligations.
Remedies for default:
 - if non-operator: 30 days to cure, then suspension of rights
 - if operator, then immediate removal with vote of non-operators

Article V.D – Rights and Duties of Operator

- The Operator is not a fiduciary of the Non-Operator
- While Operator can hold funds, Non-Operators are provided access to both financial and operational information.
 - Should parties in default have such access?
- Must pay contractors to keep the Contract Area free of liens.

Article VI.A - Initial Well

- Note blanks for beginning operations on obligatory first well—date, TD, target
- Other “unseen” blanks to consider”
 - who decides that the target depth has been reached for sufficient well logging?
 - what suite of well logs will be run?
 - what order will the operations be done?

Article VI.B—Subsequent Operations

- '89 form requires that only consenting parties receive notice for drilling, reworking, plugging back, deepening, sidetracking or recompleting.
- However, Article VI.B.2(b) seems to provide that parties non-consenting to drilling and completing may not have relinquished their right to participate in subsequent deepening and sidetracking. (i.e. they aren't out of the game completely as before when going non-consent.)
 - Consider: Additional Provision providing that initial non-consent to drilling means non-consent to all operations in that well, whereas non-consent to subsequent operations are non-consent only as to that particular operation.

Subsequent Operations

- Operator is not required to wait for votes/consents to come in before starting operations.¹
 - Must still provide notice
 - Consider Addition Provisions that:
 - Allow/disallow Operator to start operations during voting/consenting period
 - Limit the number of operations and/or proposals that can be undertaken

Valance Operating Co. v. Dorsett 164 S.W.3d 656 (Tex. 20050).

Article VI.B—Operations

- Deepening and Sidetracking are separate operations in which non-consent parties can participate.
- Order of Operations
 - Majority *interest* prevails.
 - Consider Additional Provision adding operations and/or changing the order provided.
- Consent required from all parties for operations on well currently able to produce in paying quantities.

Article VI.E—Well Abandonment

- Abandonment of producing well requires notice and consent of all.
- Abandonment of dry hole is the same—but if objection from any Non-Operator is not received in 48 hours after Operation determines the hole is dry, they are deemed to have consented. Objectors take over well and indemnify Operator for further operations.
- VI.E(2)—parties taking over a well must prove up financial capability or Operator may retake

Article VI.E—Transfer of Interests: *Accrual of P&A Liabilities*

- **Problem:** Plugging and abandonment costs may accrue when the well permit is issued by the appropriate authority.* That means *Surprise!* liability for plugging orphaned wells may fall back on parties who assigned the well while it was still producing.
- **Solution:** Add language to Article XVI that expressly relieves any assignor of Contract Area interest of all costs and liabilities associated with plugging, abandonment and remediation of any wells then existing or thereafter drilled on the assigned leaseholds.

*see *GOM Shelf, LLC v. Sun Operating Limited Partnership* 2008 WL 901482 (S.D. Tex. 2008).

Article VII.A—Liability of Parties

- Important function of the JOA: prevent the parties from being joint-venturers or members of a partnership.
- Allows parties to act in self-interest and prevents them from being fiduciaries to one another.
- Non-Operators are therefore not liable to third parties.

Article VII.B—Liens & Security Interests

- Each JOA party grants the other a lien of its real property and a security interest on its portion of production.
- Cross-liens among parties cover current or after-acquired real and personal property as well as fixtures.
- These lien rights include the *power of sale*.

Payments for Operations:

Category of Costs

- Some accounting procedure agreements, typically included in Form JOAs as Exhibit C, separate costs related to exploration and development from “overhead” or “administrative” costs, with the first to be paid by the joint account of all the parties to the JOA, while the operator covers the overhead costs exclusively.
- **Problem:** Conflict can occur when it is not clear into which category a particular cost falls.
- **Solution:** Categorize particular types of costs such as expenses related to applications, filings and presentations to regulatory agencies, travel costs of operator, legal bills, title expenses and costs related to marketing to remove doubt.

Other Provisions:

Billing of Additional Interests

- **Problem:** Operators sometimes have difficulties in maintaining accurate records of which parties are currently non-operators, particularly as ownership in the leaseholds comprising the contract area of the JOA fragment.
- **Solution:** Consider prohibiting the Operator from making more than one billing for the entire interest credited to each original party to the JOA.
 - If any original party to the JOA disposes of all or a part of its interest, it is solely responsible for billing *its* assignee(s), and, in turn, for transferring such payment to the Operator along with notice of the conveyance.

Payments for Operations:

AFE Overruns

- **Problem:** The terms of the various form JOAs have not eliminated fights over cost-overruns when costs exceed what the non-operators expected.
- **Solution:** Requirement that the Operator must give notice when it determines an operation in progress will cost more than a certain % of the AFE – often 125%
 - Notice should be detailed enough for non-operators to make the decision whether to go on or go non-consent.

Payments for Operations:

Prepayments

- **Problem:** When operators and contractors are very busy, funds must always be readily available to quickly settle expenses.
- **Solution:** Provision allowing Operator to collect from non-operators prepayment for the expenses foreseen in the AFE.
 - For example, such prepaid cost could either be the estimated dry hole cost, as shown on the applicable AFE, for any well to be drilled under the JOA except the initial well, or could include the estimated cost for any other completion, reworking, side-tracking, deepening, or plugging back operation.

Bankruptcy Considerations

Consider adding the following to Article XVI:

- Bankrupt/insolvent Operator must resign
- Must select to either assume or reject within thirty days of filing or being deemed insolvent.
- If Bankruptcy Court prevents removal of Operator, consider a temporary operating committee which includes Non-Operators.

Incomplete and Unexecuted JOAs and Ancillary Documents

- Problem: we continue to come across incompletely executed JOAs, JOAs missing attachments and exhibits, and AMI and Recording Memorandum that have not been recorded. These breed litigation.
- The JOA and its ancillary documents such as the Recording Memorandum and AMI Agreement should be *signed* by all parties and *recorded* as necessary
- Avoid having to deal with questions of what ancillary documents and exhibits are part or not part of the JOA. However, if the issue arises...

JOAs are made up of several components—some unsigned

- Separate doc must be “sufficiently related” to the document for which incorporation is sought.
 - Main agreement must reference unsigned one
 - Main agreement must reference existing doc
 - Oral testimony or mere estoppel claim not enough to prove up unsigned AMI agreement
- A unrecorded, unsigned hand-drawn plat does not provide cause for equitable estoppel to enforce the AMI
 - Estoppel is not a cause of action but a defense.

Crowder v. Tri-C Resources, Inc. 821 S.W.2d 393 (Tex.App.—Houston [1st Dist.] 1991, no writ)