

# **JOINT OPERATING AGREEMENT**

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**REVIEW OF OIL AND GAS LAW XX  
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## I. INTRODUCTION

In recent years, several excellent papers have been presented at this program and at other CLE institutes addressing issues arising under the AAPL Model Form Operating Agreement. Some of these are listed below.<sup>1</sup> This paper supplements these other resources with a discussion of operating agreement cases decided in Texas within the past five years. Cases dealing with the same section of the operating agreement are grouped together, and a few cases that address several issues may be discussed in more than one section of the paper.

## II. SUBSEQUENT OPERATIONS

- *Valence Operating Company v. Dorsett*, 164 S.W.3d 656 (Tex. 2005).

**Holdings:** (i) The thirty-day notice period for proposed subsequent operations under Article VI.B. of the AAPL Form 610-1977 Model Form Operating Agreement sets a deadline for the non-operator to decide whether to participate in the proposed operation, but does not forbid the operator from commencing work before the end of the notice period; and (ii) the non-consent penalty is enforceable and is not a liquidated damages provision.

Elmagene Dorsett and Valence Operating Company were parties to an operating agreement under which Valence was the operator. The original operator, TXO, drilled the initial test well in 1981. Valence acquired ownership and became the operator in 1994, and drilled eight more gas wells on the contract area from 1996 to 2001. These eight wells were drilled under the “Subsequent Operations” provisions of Article VI.B.

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<sup>1</sup> Robert Cole Grable, “Operator Liability, Marketing Obligations, Tension Points, and Royalty Calculations Under Joint Operating Agreements,” ANNUAL REVIEW OF OIL AND GAS LAW XVIII, Dallas Bar Association Energy Law Section, August 21-22, 2003; John R. Cooney, “Recent Developments Concerning Joint Operating Agreements — Preferential Rights and Exculpatory Clauses,” 55 INST. ON OIL & GAS L. & TAX’N, Ch. 11 (2004); James C. T. Hardwick, “Something Old, Something New — Current Issues Under the Joint Operating Agreement,” 51 INST. ON OIL & GAS L. & TAX’N, Ch. 6 (2000); John R. Reeves, “Significant Cases Governing the Onshore Operating Agreement,” 49 INST. ON OIL & GAS L. & TAX’N, Ch. 2 (1998).

The notice provision for Subsequent Operations provides in relevant part as follows:

Should any party hereto desire to drill any well on the Contract Area other than the well provided for in Article VI.A., or to rework, deepen or plug back a dry hole drilled at the joint expense of all parties or a well jointly owned by all the parties and not then producing in paying quantities, the party desiring to drill, rework, deepen or plug back such well shall give the other parties written notice of the proposed operation, specifying the work to be performed, the location, proposed depth, objective formation and the estimated cost of the operation. The parties receiving such a notice shall have thirty (30) days after receipt of the notice within which to notify the parties wishing to do the work whether they elect to participate in the cost of the proposed operation. . . . Failure of a party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the proposed operation. . . .

AAPL Form 610-1977, Art. VI.B. 1. The provisions governing operations by less than all parties in Article VI.B.2. allowed the consenting parties to recoup up to 100 percent of the non-consenting party's share of the costs of any new surface equipment, up to 100 percent of the non-consenting party's share of the cost of operation of the well, and up to 300 percent of the non-consenting party's share of the costs and expenses of drilling and of newly acquired equipment in the well.

Valence gave Dorsett written notice of its intent to drill each of the eight wells drilled from 1996 to 2001, but in each case Valence began preparatory work – and in some cases actual drilling operations – before thirty days had elapsed after Dorsett's receipt of the notice. Dorsett received the notices but did not consent and did not contribute to the cost of the wells. Valence therefore imposed the non-consent penalty described in Article VI.B.2.

In 2000, Dorsett sued Valence disputing the imposition of the non-consent penalty. Dorsett contended that Valence was required to allow the thirty-day notice period to elapse before commencing work on proposed operations. She contended that Valence's failure to do so was a breach of contract that prevented enforcement of the non-consent penalty. She also

contended that the non-consent penalty was an unenforceable liquidated damages provision. In addition to the causes of action related to the non-consent penalty, Dorsett also asserted causes of action alleging that Valence had damaged the surface of her land through negligence and failure to accommodate an existing surface use.

The parties filed cross-motions for partial summary judgment on the claims related to the non-consent penalty. The trial court granted Valence's motion, finding that Dorsett failed to elect to participate in the eight proposed wells, and that the non-consent penalty was enforceable against her. The summary judgment became final when the trial court severed the contract claims from the surface damage claims.

The court of appeals reversed the trial court judgment and rendered judgment for Dorsett. Citing *Hamilton v. Tex. Oil & Gas Corp.*, 648 S.W.2d 316 (Tex.App. – El Paso 1982, writ ref'd n.r.e.), the court of appeals noted that even though withholding consent to subsequent operations is within the rights of a non-operating party under the operating agreement and, therefore, is not a breach of the agreement, the non-consent penalty is nevertheless analyzed under the two-pronged test that is applied to liquidated damages provisions. 111 S.W.3d at 229 n. 2. Before a court will enforce a liquidated damages provision under that test, the court must find that the harm caused by the breach is of a nature that makes estimation of damages very difficult, and that the amount of liquidated damages that the provision calls for is a reasonable forecast of just compensation. Following *Hamilton*, the court concluded that the nonconsent penalty is a mechanism through which consenting parties are compensated for assuming the financial risks associated with exploration and development, and that the uncertainty and substantial risks in such activities are such that the provision should be enforced. 111 S.W.3d at 229.

Despite its finding that the non-consent penalty was enforceable under the two-pronged test for liquidated damages provisions, the court held that the penalty could not be recovered by Valence from Dorsett under the circumstances presented by this case because Valence failed to give proper notice of the proposed operations, and as a result, the non-consent penalty was not triggered. The court of appeals held that the operator must allow the 30-day notice period to expire before commencing the proposed operations, and because Valence commenced operations before the notice period expired, it failed to comply with the notice period and thus was not entitled to recover the nonconsent penalty from Dorsett.

In support of that holding, the court of appeals reasoned that the ordinary meaning of “proposed” is “planned for the future,” and that the term “proposed operations” in the notice provision therefore does not mean previous or current operations. 111 S.W.3d at 234. Under that interpretation of the notice provision, the court of appeals concluded that Valence failed to give proper notice, and thus could not recover the nonconsent penalty from Dorsett, because its notices for the eight wells were notices of current operations rather than proposed operations.

The supreme court reversed the judgment of the court of appeals and rendered judgment for Valence. On the issue of whether the nonconsent penalty is an unenforceable liquidated damages provision, the supreme court agreed with the lower court’s conclusion that the provision is enforceable, but disagreed with the court’s reasoning. The supreme court held that the nonconsent penalty is not a liquidated damages provision, and it expressly disapproved its treatment as such in *Hamilton* and in the court of appeals. The supreme court explained its reasoning as follows:

Dorsett contends that the non-consent penalty is an unenforceable liquidated damages provision. We disagree. This clause is different from a liquidated damages clause. Liquidated damages clauses fix in advance the compensation to a party accruing from

the failure to perform specified contractual obligations, whereas non-consent penalties reward consenting parties for undertaking a defined risk. *See Nearburg*, 943 P.2d at 567 (“[T]he non-consent penalty is the agreed-upon reward to [a consenting party] for taking the risk. . . . As a contractual arrangement, the carried interest is subject to negotiation and modification, and the parties’ rights and obligations depend upon their contract.”); RESTATEMENT (SECOND) OF CONTRACTS § 356 (1981) (“Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss.”). The non-consent penalty provision in this oil and gas operating agreement is the mechanism utilized to allow the consenting parties the opportunity to recover their investments and receive defined returns from future operations. For such operations, they undertake a financial risk that the non-consenting parties do not. Here, the non-consenting party is not being punished for breaching a contract; she simply agreed not to participate in a return on an investment she did not make. Indeed, after the provision’s requirements are met, she receives additional revenues from new wells for which she paid nothing. One Texas court of appeals, in its consideration of whether a non-consent penalty was enforceable, characterized the penalty as a liquidated damages clause and decided that it was enforceable against the non-consenting working interest owner. *Hamilton v. Tex. Oil Gas Corp.*, 648 S.W.2d 316, 321 (Tex.App. – El Paso 1982, writ ref’d n.r.e.). While *Hamilton* reached the correct result, we disapprove of its treatment of the non-consent penalty as a liquidated damages provision.

164 S.W.3d at 664.

On a practical note, the court reasoned that interpreting the nonconsent provision as an unenforceable liquidated damages provision would eliminate any incentive for parties to consent and incur the costs and liabilities for new projects. The court pointed out that under that interpretation the incentives would strongly favor not consenting because a non-consenting party would be entitled to the rewards of new operations without incurring any expense. 164 S.W.3d at 665.

In a separate concurring opinion, Justice Brister reasoned that liquidated damages are a measure of damages to be imposed on a party in the event of a breach, and that the non-consent

penalty is thus not a liquidated damages provision because a party who elects to opt out of a proposed operation is not in breach of the agreement, but instead is exercising a contractual right. Justice Brister suggested that the amount that the consenting parties are allowed to recoup is more properly viewed as a bonus to those parties rather than a penalty to be imposed on the non-consenting parties. 164 S.W.3d at 665-66.

Regarding the timing of the notice relative to the commencement of operations, the supreme court held that the notice provision in the operating agreement does not place any restrictions on when the operator can commence operations. The court explained its reasoning as follows:

We agree with Valence that this provision places no temporal limitation on Valence's ability to commence work on the proposed projects. The Agreement clearly states that "[t]he parties receiving such a notice shall have thirty (30) days after receipt of the notice within which to notify the parties wishing to do the work whether they elect to participate in the cost of the proposed operation." *Id.* Art. VI.1. This plain language in the Agreement describes Dorsett's right to receive notice of proposed operations and to elect to participate in those operations. It places no restrictions on when Valence may commence drilling or preparations for drilling. . . .

In short, the thirty-day notice period sets a deadline for Dorsett to decide whether to participate in proposed operations. Nothing in the language of the Agreement forbids the operator from commencing work before the end of the notice period. However, there is a temporal limit in the Agreement on Valence that sets a deadline, not a required start date, on Valence's commencement of work. The Agreement requires the operator to commence work no later than sixty days after the expiration of the thirty-day notice period. A.A.P.L. Form 610-1977, art. VI.B.2 (1977). This distinction between the two notice periods in the Agreement retains the working interest owner's right to thirty days notice before being required to make a decision, while also requiring the operator to commence work no later than ninety days after formally proposing the operation to the interest owners.

664 S.W.3d at 662-63.

The supreme court noted in this connection that “early” commencement of operations may actually benefit the non-operators by avoiding detrimental occurrences such as drainage by a neighboring operator. 664 S.W.3d at 663. Early commencement of the operation also gives the non-operators an opportunity to observe at least the early stages of the operation before making their elections.

- *El Paso Production Co. v. Valence Operating Co.*, 112 S.W.3d 616 (Tex.App. – Houston [1<sup>st</sup> Dist.] 2003, pet. denied).

**Holding: Non-consent penalties cannot be recovered out of the interest of a party that was not given proper notice of the proposed operation.**

Texas Oil & Gas Co., as operator under a joint operating agreement, drilled a producing well on a 680-acre contract area in Freestone County. The operating agreement provided that if any party to the agreement desired to rework, deepen, or plug a well drilled at the parties’ joint expense,

[That party] shall give the other parties written notice of the proposed operation, specifying the work to be performed, the location, proposed depth, objective formation and the estimated cost of the operation. The parties receiving such a notice shall have thirty (30) days after receipt of the notice within which to notify the parties wishing to do the work whether they elect to participate in the cost of the proposed operation.

As a non-consent penalty, the operating agreement allowed the consenting parties to take the share of production attributable to the interests of the non-consenting parties until such share was equal to “400% of that portion of the costs and expenses of drilling, reworking, deepening, or plugging back . . . which would have been chargeable to such non-consenting party if it had participated therein.”

Valence acquired the interest of Texas Oil & Gas and succeeded Texas Oil & Gas as operator. Sonat Exploration Co., predecessor in interest to El Paso, acquired a non-operating



working interest in the well. Houston Lighting & Power, needing to enlarge its ash disposal area, negotiated with Valence to acquire access rights to a tract of land in the contract area. When those negotiations fell through, HL&P offered Sonat \$204,000 for the release of Sonat's surface rights to a 91-acre tract at the well site. Sonat accepted the offer and entered into an agreement releasing HL&P from surface damages to the tract and quitclaiming to HL&P its right to use the surface for exploration, production and development. The agreement further provided that, to the extent possible under the operating agreement, Sonat assigned to HL&P its right to cause the well to be plugged and abandoned. The agreement expressly provided, however, that Sonat did not transfer any interest in the oil and gas in the tract, and it expressly excepted Sonat's right to develop and produce the minerals.

As a result of this agreement between Sonat and HL&P, Valence took the position that Sonat no longer had an interest in the well. Valence informed Sonat of this position by letter. The letter, as a "courtesy," also informed Sonat that Valence planned to workover the well, but it did not offer Sonat the opportunity to participate in the workover. Valence treated Sonat as a non-consenting party to that operation.

The ensuing lawsuit included numerous JOA-related claims and counterclaims. One of the principal issues concerned the effect of the Sonat-HL&P agreement on Sonat's status as a party to the operating agreement and on Valence's right to impose the non-consent penalty. The court rejected Valence's arguments that by quitclaiming its interest to HL&P, Sonat had repudiated or waived its rights under the operating agreement. The court concluded that because Sonat had retained its interest in the well, it was entitled to receive its proportionate share of the production. With specific reference to the non-consent issue, the court held that Sonat could not

be a non-consenting party because it had never received proper notice of the proposed operation.

The court explained its reasoning on that issue as follows:

By the terms of the JOA, a party who wanted to rework the well at the joint expense of all parties was required to give written notice of the proposed operation to the other parties. This notice was required to specify the work to be performed, the location, the proposed depth, the objective formation, and the estimated cost. A party who received such notice had 30 days in which to give notice of its election to participate. A party who did not give such notice of participation became a non-consenting party and was subject to a 400% penalty if the reworked well produced in paying quantities. There was no provision in the JOA for the imposition of the penalty if the initial required notice was not given.

112 S.W.3d at 623. Based on evidence conclusively establishing that Valence did not give Sonat proper notice, the court held that “Sonat’s failure to consent to the rework operation cannot result in the imposition of any of the contractual penalties because the obligation to give timely notice of consent is triggered *only* by the required notice of proposed operations.” *Id.* (Emphasis by the court).

- *ExxonMobil Corp. v. Valence Operating Co.*, \_\_\_\_ S.W.3d \_\_\_\_, 2005 WL 1415320 (Tex.App. – Houston [1<sup>st</sup> Dist.], June 16, 2005) (Opinion on Rehearing).

**Holding: Non-consent penalties cannot be recovered out of the interest of a party that was not given proper notice of the proposed operation.**

ExxonMobil and Valence are parties to a joint operating agreement governing operations on the Gladewater Gas Unit 16 in Gregg and Upshur Counties. Three wells on the unit produced gas from the Cotton Valley Lime formation, and it was determined that there were proven behind the pipe reserves in the shallower Cotton Valley Sand.

In 1996, ExxonMobil, which had succeeded to the interest of the original operator, entered into a farmout agreement with Wagner & Brown, Ltd. (“WB”) and C.W. Resources (“CW”), giving them the right to earn the conveyance of ExxonMobil’s interest in the Cotton

Valley Sand portion of Unit 16 upon the successful completion of a test well. WB and CW proposed two new wells to Valence, but Valence never responded to the proposals because it was not aware of the farmout agreement and thus did not know that WB and CW had any relationship with Unit 16. Because Valence did not respond to the proposals, it was deemed non-consenting on those wells, both of which were completed as producers.

Valence sued ExxonMobil for breach of the maintenance of uniform interest provision of the operating agreement. That issue is discussed in a later section of this paper. Valence contended that by farming out its interest in the Cotton Valley Sand, ExxonMobil had breached the operating agreement and caused Valence to incur non-consent penalties and the additional expense associated with the drilling of new wells that it would not have incurred but for the breach.

In affirming a trial court judgment awarding Valence recovery of the non-consent penalties, the court of appeals cited *El Paso Production Co. v. Valence Operating Co.*, *supra*, for the proposition that “Valence’s failure to consent to the drilling operation ‘cannot result in the imposition of any of the contractual penalties because the obligation to give timely notice of consent is triggered *only* by the required notice of proposed operations.’” 2005 WL 1415320 at \*11 (quoting from *El Paso v. Valence*). The court explained this further as follows:

It is not enough that WB and CW — non-parties to the JOA — notified Valence of *their* proposal to drill new wells in the Cotton Valley Sand formation to capture the same reserves that could have been accessed from the existing wellbores. Such “notice” from strangers to the JOA, coming after the farmout agreement had already been executed, entirely failed to satisfy the purpose of the notice requirement, namely, that Valence be given the opportunity to consent, or not, to a proposal made by a party to the JOA who had agreed to all its terms and conditions — not by strangers to the JOA with different interests. We hold, therefore, that the trial court correctly concluded that ExxonMobil’s breach of the notice

provision of the JOA relieved Valence of the burden of paying non-consent penalties.

2005 WL 1415320 at \*11.

- *Mobil Producing Texas & New Mexico, Inc. v. Cantor*, 93 S.W.3d 916 (Tex.App. – Corpus Christi 2003, no pet.).

**Holding: The operating agreement does not place an affirmative obligation on non-consenting parties to suspend their receipt of payments.**

Procedurally, this is an unusual case because Mobil was appealing from an order granting its own motion for summary judgment.

Mobil was the operator under an operating agreement that covered a contract area in Gonzales County. Mobil proposed a reworking operation on Well No. 1. Certain non-operators elected not to participate, but proceeds of production were nevertheless paid to them by mistake, without withholding for costs and penalties on the non-consent operation. When Mobil discovered the mistake, it sued to recover the overpayments under theories of breach of contract and unjust enrichment. Mobil moved for summary judgment on both theories of recovery. The trial court granted the summary judgment on the ground of unjust enrichment. Applying the two year statute of limitations that is applicable to actions for unjust enrichment, the court limited Mobil's recovery to the \$6,348.85 in revenues received by the defendants during the two years preceding the suit. The judgment did not award prejudgment interest or attorneys' fees to Mobil. Mobil appealed the judgment, contending that summary judgment should have been granted on the ground of breach of contract, that it should have been awarded an amount totaling \$197,062.03 for the four-year period prior to suit, and that the judgment should have included prejudgment interest and attorneys' fees.

The court of appeals affirmed the trial court judgment. The court held that the operating agreement did not place an obligation on the non-consenting parties to suspend their receipt of

payments, so there could be no recovery for breach of contract. Any recovery must therefore be under a quasi-contract theory such as unjust enrichment, subject to the two-year statute of limitations. A separate concurring opinion explained this result more fully as follows:

The agreement spelled out how the parties' interests in production would be affected should some not consent to the reworking of the well. There is no dispute that the Cantor Appellees elected not to participate in the reworking, so their revenue interest diminished in accordance with the agreement until Mobil and the consenting parties recovered the reworking costs from production. However, the operating agreement did not place an obligation on the non-consenting parties, the Cantors, to take any action in order to suspend their payments. That being so, it is difficult to see how they could breach the contract. Rather, they received moneys they were not entitled to under the agreement, a classic case for application of the doctrine of unjust enrichment.

Mobil's rights to an increased share of revenue of the well, and appellants' decreased share, are determined by the contract, but no duty was imposed on appellants to take any action to implement those terms of the operating agreement. The mere receipt of money they were not entitled to does not constitute a breach. There is no evidence that appellants' breached the contract. The summary judgment could not be properly granted on a breach of contract theory with its accompanying four year statute of limitations.

93 S.W.3d at 922.

Because Mobil could not recover for breach of contract, it was not entitled to recover prejudgment interest or attorneys' fees.

- *Stable Energy, L.P. v. Kachina Oil & Gas, Inc.*, 52 S.W.3d 327 (Tex.App. – Austin 2001, no pet.).

**Holdings:** (i) forfeiture of interest by a non-consenting party is effective when the proposed operation is commenced, and not when the participating party tenders the costs attributable to the non-consent interest that the participating party has agreed to acquire; and (ii) there will be no forfeiture of interest by the non-consenting party unless the operation that is commenced is the same as the operation that was proposed, and such operation is conducted by a duly elected operator.

This case involves a dispute over the ownership and operation of a well in Fayette County. The original owners of the well entered into a joint operating agreement under which CRB Oil & Gas was designated as the operator. The designated operator changed from time to time over the ensuing years until Kachina became operator in 1991. The original operator, CRB, owned a working interest in the well, but the succeeding operators, including Kachina, had no working interest.

In 1989 Pampell Interests purchased a minority interest in the well and became a party to the operating agreement. Pampell Interests was subsequently merged into Stable Energy. Stable and Anchor Operating Co. are affiliates.

In September 1992, the operator, Kachina, sent the working interest owners notification of a proposed workover operation on the well, which had ceased production. Stable consented to the project and tendered its share of the costs. Later, Stable agreed to assume the costs attributable to the parties who had elected not to participate, and it tendered the costs attributable to those interests. Stable already owned a 33% interest in the well, and the non-consenting parties owned a 28% interest, so the combination of those interests would give Stable a controlling interest in the well.

Although Stable had consented to the proposed workover operation and had sent checks to cover its own share of the costs plus the costs attributable to the interests of the non-consenting parties, Stable and Kachina were in dispute regarding the proposed project and other issues. During the course of that dispute, Stable contended that it was entitled to take over as operator of the well. That contention was based on a JOA requirement that the operator must have an ownership interest. Under the JOA, an operator such as Kachina, which owned no interest in the well, could be replaced upon the election of a successor operator by parties owning

a majority interest. Stable contended that its original interest plus the interests of the non-consenting parties gave it the majority interest needed to replace Kachina as operator.

Stable's affiliate, Anchor, took possession of the well and conducted an acid workover on the well. With Anchor in possession of the well, Kachina withdrew its own proposal for a workover of the well. The cost and method of the workover conducted by Anchor differed materially from the workover proposed by Kachina.

Stable filed suit seeking an accounting and a declaration that Anchor was the operator of the well. The district court found in favor of Kachina because Stable failed to establish that it had acquired the non-consent interests needed for the removal of Kachina and for the election of Anchor as successor operator. The court of appeals affirmed the judgment for Kachina.

The result in this case turned on the court's interpretation of the provisions that determine when a consenting party's acquisition of the interests of non-consenting parties becomes effective. Stable contended that the non-consenting parties' relinquishment of their interests to Stable became effective when Stable consented to the proposed operation and tendered the costs attributable to such interests to Kachina. The court rejected that position and held that relinquishment of the non-consent interests could only be triggered by commencement of the proposed operation. The court explained this as follows:

Relinquishment of non-consenting interests is governed by article VI.B.2 of the JOA: "*Upon commencement of operations* for the . . . reworking . . . of any such well by Consenting Parties . . . each Non-Consenting Party shall be deemed to have relinquished to Consenting Parties . . . all of such Non-Consenting Party's interest in the well and share of production therefrom."

Thus, the JOA does indeed provide that the parties who choose not to participate in the project forfeit their interests in the well. However, this provision specifies that relinquishment occurs upon commencement of operations. Contrary to Stable's contention that tender triggered relinquishment, the JOA mandates that ownership of non-consent interests could not have transferred to Stable until –

at the earliest – the date when the workover began. *See Abraxas Petroleum Corp. v. Hornburg*, 20 S.W.3d 741, 754-55 (Tex.App. – El Paso 2000, no pet.).

For this reason, only actual commencement of Kachina’s proposed project could have triggered relinquishment of the non-consent interests. . . .

52 S.W.3d at 332.

Stable argued that the project proposed by Kachina commenced when Anchor seized the well and performed an acid workover, and that this triggered the relinquishment of the non-consent interests. The court concluded, however, that Anchor’s activities would constitute legitimate commencement of the proposed operation only if (i) the operations performed by Anchor were the same as those proposed by Kachina, and (2) the operations were performed by a duly elected operator.

For the proposition that the operations performed must be the same as those that were proposed, the court cited the Article VI.B requirement that the proposal must inform the owners of the location, proposed depth, objective formation and the estimates cost so that they can decide whether to participate. The court concluded that “if non-consenting parties are going to forfeit their interests, it is essential that the operation triggering that forfeiture is the same one the parties rejected.” 52 S.W.3d at 333. The court concluded that this condition was not satisfied, and relinquishment of the non-consent interests was not triggered, because the evidence showed that Anchor’s project differed substantially from Kachina’s proposal.

For the proposition that legitimate commencement of the proposed operation must be executed by the duly elected operator, the court cited Article V.A., which provides that the operator shall have full control of all operations, and Article VI.B., which provides that the “operator shall perform all work for the account of the Consenting Parties.” 52 S.W.3d at 333. The court acknowledged that Kachina was vulnerable to removal as operator because it did not



own an interest in the well, but it concluded that such vulnerability was immaterial because Stable and Anchor did not have the majority interest required to elect a successor operator.

- *Abraxas Petroleum Corp. v. Hornburg*, 20 S.W.3d 741 (Tex.App. – El Paso 2000, no pet.).

**Holding: Issuing an AFE for an operation for which an AFE is not required can be a breach of the joint operating agreement.**

*Abraxas Petroleum Corp. v. Hornburg* addressed several issues under the joint operating agreement, so it is discussed in this section as well as in other sections of this paper. Insofar as subsequent operations are concerned, the principal holding is that issuance of an AFE for activities that do not require one can be a breach of the operating agreement.

Pearson-Sibert Oil Co. was the operator of the Cleo Smith lease in Stonewall County. The lease had been in continuous production from four wells since 1952. Abraxas purchased Pearson-Sibert's interest in 1992, and took over operations on the lease. Within months, operating expenses escalated and production dwindled. In November 1993, Abraxas wrote to the non-operators and informed them that all four wells had ceased to produce because the number one well had parted rods, the numbers three and four wells had holes in the tubing, and the number two well had holes in the casing. The letter described proposed workover procedures to restore the wells to production, together with a cost estimate for each well.

Article VII.D.3. of the operating agreement prohibited the operator from undertaking any single project reasonably estimated to require an expenditure in excess of \$30,000 except in connection with the drilling, reworking, deepening, completing, recompleting, or plugging back of a well which had been previously authorized. Although none of the jobs proposed for the individual wells exceeded \$30,000, the estimated total cost for the restoration of production from all four wells was \$44,250. The letter informed the non-operators that they had 30 days in which to elect whether to participate in the proposed activities, and that if they declined to consent, then

their income from the lease would be paid over to Abraxas until Abraxas had recovered 300% of their proportionate shares of the expenses.

When none of the working interest owners consented to the proposed operations within the 30-day window, Abraxas deemed their status to be “non-consent,” and it began appropriating their future runs. Of the proposed workover operations, Abraxas performed only one small project at a cost of approximately \$7,500, but it never informed the working interest owners that it had decided not to proceed with the other operations.

Several of the working interest owners filed suit against Abraxas alleging negligence, gross negligence, willful misconduct, breach of contract, and waste. The breach of contract claim alleged, among other things, that Abraxas breached the operating agreement by sending the AFE letter because no single project proposed in the letter had an estimated cost in excess of \$30,000, and because the proposed activities were not reworking operations but instead were routine operating activities which are not subject to the consent/non-consent election under the operating agreement. The jury found that Abraxas did breach the operating agreement by sending the AFE letter.

On appeal, Abraxas contended that merely sending an AFE letter could never be a violation of the operating agreement. The court rejected that argument. The court said:

We first reject Abraxas’ contention that the sending of the AFE could never violate the JOA.. Abraxas is correct that an AFE is an estimate or budget of proposed expenses, but that is not its sole or even its primary function. The sending of an AFE triggers the consent/non-consent provisions of the JOA and puts the receiving parties to an election of participating in the proposal or suffering a substantial penalty in the event the proposed work results in a producing well. Therefore, if an AFE is unjustified under the facts, then it may constitute a breach of the JOA to send the AFE and put the parties to that election.

20 S.W.3d at 755. The court also rejected Abraxas' contention that merely sending the AFE letter did not result in any damages. On that issue the court said:

Abraxas argues that the mere sending of the AFE letter did not result in any damages to Appellees. However, the sending of the AFE letter triggered Appellees' contractual obligation to elect whether to participate in the cost of the proposed operations or suffer the 300 percent penalty specified in the JOA. When Appellees did not respond to the AFE, Abraxas immediately seized Appellees' interests in the Cleo Smith lease and began appropriating their earnings. Abraxas continued to withhold the earnings even though it did not complete the operations specified in the AFE. Still further, Abraxas retained their interests until the lease had no value. Consequently, the evidence is both legally and factually sufficient to establish that sending the AFE resulted in damages to Appellees.

20 S.W.3d at 758.

### **III. EXCULPATORY CLAUSE**

With slight variations in wording, the 1977, 1982 and 1989 versions of the AAPL Model Form Operating Agreement all provide generally that the operator shall conduct operations in a good and workmanlike manner, but that it shall have no liability as operator to the other parties for losses sustained or liabilities incurred, except such as may result from gross negligence or willful misconduct. The language of the 1956 form is materially different from the later forms. The corresponding language in that form says that the operator is only liable to the other parties for losses that result from "gross negligence or from breach of the provisions of this agreement."

Several cases have considered whether the exculpatory language in the 1977 and later forms is applicable to breaches of the operating agreement that do not involve physical operations on the contract area. The Fifth Circuit, applying Texas law, considered this issue in *Stine v. Marathon Oil Company*, 976 F.2d 254 (5<sup>th</sup> Cir. 1992). The Fifth Circuit held that the exculpatory clause applies not only to the conduct of operations, but to any acts done by the operator under the authority of the operating agreement, including administrative functions.

Thus, in the Fifth Circuit's view, the exculpatory clause shields the operator from liability for any act taken in its capacity as operator unless its conduct involves gross negligence or willful misconduct.

In the following recent cases, Texas state courts have taken a narrower view of the scope of the exculpatory clause, and have held that it only extends to physical operations and not to breaches of administrative provisions. None of these cases cites *Stine*.

- ***Abraxas Petroleum Corp. v. Hornburg***, 20 S.W.3d 741 (Tex.App. – El Paso 2000, no pet.).

**Holding: The exculpatory clause is limited to claims based upon an allegation that the operator failed to act as a reasonably prudent operator and does not apply to a claim that it breached the operating agreement.**

As is explained more fully in the earlier discussion of this case, the non-operators in this case sued the operator, Abraxas, alleging that Abraxas had breached the operating agreement by sending an AFE letter for operations that were not subject to the consent/non-consent election procedures. Citing the exculpatory language in Article V., Abraxas contended that the jury's failure to make a finding of gross negligence or willful misconduct in connection with its sending of the AFE letter precluded a finding of liability for breach of contract. The court rejected that argument and held that the exculpatory clause does not apply to claims for breach of contract. The court explained its holding as follows:

We first find that the exculpatory clause is unambiguous, and therefore, we will construe it as a matter of law. As some evidence that the parties did not intend that the exculpatory clause apply to any and all claims, we note that the exculpatory clause is found in an article which concerns the operator's authority to conduct operations in the contract area. More significantly, the operator's limitation of liability is linked directly to imposition of the duty to act as a reasonably prudent operator, which strictly concerns the manner in which the operator conducts drilling operations on the lease. Accordingly, we conclude that the exculpatory clause is limited to claims based upon an allegation that Abraxas failed to

act as a reasonably prudent operator and does not apply to a claim that it breached the JOA. Since the exculpatory clause does not apply and Appellees are not entitled to exemplary damages for breach of contract, Appellees were not obligated to prove gross negligence or willful misconduct.

20 S.W.3d at 759.

- *Cone v. Fagadau Energy Corp.*, 68 S.W.3d 147 (Tex.App. – Eastland 2001, pet. denied).

**Holding: The exculpatory clause applies only to claims that the operator failed to conduct operations in a good and workmanlike manner, and does not apply to a claim that it breached the operating agreement.**

Fagadau was the operator and Cone was a non-operator under an operating agreement prepared on the 1982 AAPL Model Form. Cone filed suit against Fagadau alleging, among other things, that Fagadau had improperly charged certain expenses to his account. The trial court granted Fagadau's special exception and held that the breach of contract claim did not state a cause of action because it was not based on allegations of gross negligence or willful misconduct. Citing *Abraxas*, the court of appeals held that the trial court erred in striking the claim for breach of contract. The court explained its holding as follows:

Cone asserts that he should have been able to assert liability against FEC for alleged breaches of the terms of the operating agreement under a simple breach of contract standard. In this regard, Cone contends that various charges were improperly assessed to his account in violation of the operating agreement . . .

In the operating agreement, the language which requires a showing of gross negligence and willful misconduct immediately follows the provision requiring the operator to conduct operations in a good and workmanlike manner. Cone's complaints did not allege the failure of FEC to operate in a good and workmanlike manner. Rather, Cone's complaints alleged breaches of specific terms of the agreement and are in the nature of an accounting. . . . The gross negligence/willful misconduct requirement applies to any and all claims that the operator failed to conduct operations in a good and workmanlike manner. The court in *Abraxas Petroleum Corporation v. Hornburg*, 20 S.W.3d 741 (Tex.App. – El Paso 2000, no pet'n), reached a similar result in interpreting this same

clause. The trial court erred in striking Cone's allegations for breach of contract.

68 S.W.3d at 155.

- *IP Petroleum Company, Inc. v. Wevanco Energy, L.L.C.*, 116 S.W.3d 888 (Tex.App. – Houston [1<sup>st</sup> Dist.] 2003, pet. denied).

**Holding: The plaintiffs were required to prove the operator's gross negligence or willful misconduct because their cause of action alleged misconduct arising from the manner in which the operator conducted drilling operations.**

IP Petroleum was the operator under an unspecified version of the AAPL Model Form Operating Agreement. The operating agreement required the operator to drill an initial well “to a depth of 9125’ below the surface of the ground or a depth sufficient to test the Lower Ellenburger Formation, whichever is lesser . . . unless all parties agree to complete or abandon the well at a lesser depth.” The operating agreement also contained the standard exculpatory clause under which the operator had no liability as operator except such a may result from gross negligence or willful misconduct.

The well encountered mechanical difficulties, was more expensive than projected, and tested to produce only 3% oil and 97% water. When IP gave notice of its intention to plug and abandon the well, the non-operators filed suit alleging that IP had an obligation to further deepen the well and that its failure to do so was a breach of the operating agreement. In connection with these claims the plaintiffs expressly alleged that IP had breached its duty to conduct its activities as a reasonably prudent operator, in a good and workmanlike manner, and with due diligence, and that it had acted with gross negligence or willful misconduct. The jury found that IP failed to drill to a depth sufficient to test the Lower Ellenburger Formation and that the failure was the result of gross negligence or willful misconduct.

The court of appeals held that the evidence did not support the finding of gross negligence and willful misconduct. Even though the plaintiffs had alleged gross negligence and willful misconduct, they contended that their claim was for breach of contract, so this finding was not needed because the exculpatory clause does not apply to such claims. The court disagreed and held that the plaintiffs were required to prove the operator's gross negligence or willful misconduct because their cause of action alleged misconduct arising from the manner in which the operator conducted drilling operations, and also expressly alleged failure to conduct operations in a good and workmanlike manner and failure to act as a reasonably prudent operator. The court distinguished *Cone* and *Fagadau* on the ground that neither involved a claim that the operator failed to operate in a good and workmanlike manner and failed to act as a reasonably prudent operator.

- ***Castle Texas Production Ltd. Partnership v. Long Trusts***, 134 S.W.3d 267 (Tex.App. – Tyler 2003, pet. denied).

**Holding: The exculpatory clause is limited to claims that the operator failed to act as a reasonably prudent operator in its operations in the contract area and does not apply to a claim that it otherwise breached the operating agreement.**

This lawsuit concerned the gas balancing agreements attached as exhibits to several operating agreements under which Castle was the operator. The Long Trusts alleged that Castle had breached the terms of the gas balancing agreements in various respects related to the accounting for its share of gas and condensate. The jury found for the Long Trusts on the breach of contract claims. On appeal, the court of appeals rejected Castle's contention that the exculpatory clause was applicable to these claims. The court said:

Castle attempts to entirely escape liability for breach of contract arguing that it cannot be held to have breached the JOAs absent proof that it was guilty of "gross negligence or willful misconduct," the standard of care prescribed by Article V.A. of the JOAs. This clause, however, is limited to claims that Castle failed

to act as a reasonably prudent operator in its operations in the contract area and does not apply to a claim that it otherwise breached the JOAs. See *Abraxas Petroleum v. Hornburg*, 20 S.W.3d 741, 752 (Tex.App. – El Paso 2000, no pet.).

134 S.W.3d at 283-84.

#### IV. ABANDONMENT OF WELLS THAT HAVE PRODUCED

- *Cone v. Fagadau Energy Corp.*, 68 S.W.3d 147 (Tex.App. – Eastland 2001, pet. denied).

**Holding: Conversion of a producing well to an injection well is not an abandonment of the well for purposes of the provision governing abandonment of wells that have produced.**

One of the claims that Cone asserted against the operator, Fagadau, in this case was that Fagadau's conversion of producing wells into injection wells for purposes of a water flood constituted abandonment under the terms of the operating agreement such that Cone should have been offered the right to assume control of the wells. The applicable contract provision was Article VI.E.2. of the 1982 AAPL Model Form Operating Agreement, which provides in relevant part as follows:

Except for any well in which a Non-Consent operation has been conducted hereunder for which the Consenting Parties have not been fully reimbursed as herein provided, any well which has been completed as a producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties thereto. If, within thirty (30) days after receipt of notice of the proposed abandonment of any well, all parties do not agree to the abandonment of such well, those wishing to continue its operation from the interval(s) of the formation(s) then open to production shall tender to each of the other parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandonment. . . .



The trial court rendered partial summary judgment against Cone on this claim. The court of appeals affirmed, holding that conversion of a producing well into an injection well is not an abandonment of the well under this article. The court explained this holding as follows:

We do not construe this provision of the operating agreement as being ambiguous. The operative language of the provision is the phrase “any well which has been completed as a producer shall not be plugged and abandoned without the consent of all parties.” Cone does not dispute the fact that the wells have not been plugged. Irrespective of this fact, he contends that the wells in question have been abandoned because the efforts to remove hydrocarbons directly from them have ceased.

We disagree with Cone’s construction of this provision. “Abandonment” involves a relinquishment of possession. *See Pearson v. Black*, 120 S.W.2d 1075, 1079 (Tex.Civ.App. – Eastland 1938, no writ). The wells had not been abandoned within the ordinary and customary meaning of the term because the wells continued to be utilized on a daily basis for the purpose of water injection. Furthermore, even though hydrocarbons were not produced directly from these wells, the wells were used for the purpose of obtaining production from other wells which produce from the same “interval(s) of the formation(s) then open to production” for which Cone is compensated. As noted by a leading treatise on the subject, “the primary purpose of injecting gas or water into a reservoir is to cause the injected substance to move from the input wells toward the producing wells, driving the oil or wet gas before them.” 1 W. L. SUMMERS, THE LAW OF OIL AND GAS § 76 (1954). We note that our holding is consistent with *Osborn v. Anadarko*, 996 P.2d 9 (Wy. 2000), a Wyoming Supreme Court case which determined that the conversion of a producing well into an injection well did not constitute abandonment under a farmout agreement. Cone’s Point of Error No. 1 is overruled.

68 S.W.3d at 154.

- ***Yates Energy Corp. v. Enerquest Oil and Gas, L.L.C.***, 20 WL 1530510, at \*2.05 WL 1530510 (Tex.App. – Corpus Christi, June 30, 2005).

There is no broadly applicable holding in this case, but the case does illustrate a problem that can arise in connection with the abandonment of producing wells under all versions of the AAPL Model Form Operating Agreement.

The dispute in this case involved the Baker Gas Unit in Gonzales County. Operations were governed by an operating agreement under which Yates was the operator and Enerquest was a non-operator. When the only well on the contract area began experiencing production problems, it was agreed that Yates would abandon its interest in the well in favor of Enerquest. The transfer of interest from Yates to Enerquest was to be accomplished pursuant to the operating agreement, which provided that in instances where some but not all of the parties wanted to abandon a well, “those wishing to continue its operation shall tender to each of the other parties its proportionate share of the value of the [well].” The operating agreement further provided that each abandoning party “shall then assign to the non-abandoning parties . . . all of its interest in the well and its equipment, together with its interest in the leasehold estate. . . . The assignments so limited shall encompass the ‘drilling unit’ upon which the well is located.”

The term “drilling unit” is defined in the definitions section of the operating agreement to mean “the area fixed for the drilling of one well by order or rule of any state or federal body having authority.” During Yates’s abandonment of the well on the Baker Gas Unit, a dispute arose as to what constituted the well’s applicable “drilling unit.” This became an issue because the applicable Railroad Commission rule provided for two different sized drilling units — standard 640-acre units and optional 320-acre units. The relevant language in the rule provided as follows: “The standard drilling and proration units are established hereby to be six hundred forty (640) acres. . . . An operator, at his option, shall be permitted to form optional drilling units of three hundred twenty (320) acres.”

Yates argued that as operator, it could set the drilling unit at 320 acres. Enerquest contended that because there had always only been one well on the property, the drilling unit included the entire contract area, which contained approximately 631 acres. The trial court

rendered summary judgment for Enerquest, requiring Yates to abandon its interest in the entire contract area.

The court of appeals concluded that because the operating agreement incorporated the Railroad Commission rule in the definition of “drilling unit,” the agreement could properly be interpreted as allowing for drilling units to potentially be either 640 acres or 320 acres. 2005 WL 1530510, at \*2. Finding a fact issue on which of these unit sizes should be applied to the well on the Baker Gas Unit, the court reversed the summary judgment and remanded the case for a trial on the merits. The court explained this result as follows:

The railroad commission order fails to specify how an operator is to exercise his option in forming the optional 320-acre drilling unit, and both parties dispute how or whether this was done. This raises an as-yet unresolved issue of material fact that would be properly determined by a jury or fact-finder. *See Nixon*, 690 S.W.2d at 548. Accordingly, we conclude that the trial court erred in granting summary judgment in favor of Enerquest. . . .

WL 1530510, at \*3.

Parties to a joint operating agreement could avoid this dilemma by resolving the “drilling unit” ambiguity by agreement in the JOA, before a dispute arises.

## **V. CHANGE OF OPERATOR**

- *Abraxas Petroleum Corp. v. Hornburg*, 20 S.W.3d 741 (Tex.App. – El Paso 2000, no pet.).

**Holding: Non-operating interest owners can waive the requirements pertaining to selection of a successor operator by permitting another party to act as operator, despite a failure to qualify as such, and by accepting the benefits of that party’s performance.**

As is explained more fully in the earlier discussion of this case, Abraxas, acting as operator, sent AFEs for proposed operations to the non-operators, and then put the non-operators into non-consent status when they failed to respond to the AFEs. Abraxas had acquired the

interest of the original operator, and one of the issues in the case was whether Abraxas had ever been properly selected as successor operator in accordance with the provisions of the operating agreement.

The operating agreement provided, in part, as follows: “If Operator terminates its legal existence, no longer owns an interest in this Contract Area, or is no longer capable of serving as Operator, it shall cease to be Operator without any action by Non-Operator, except the selection of a successor.” The trial court determined that Abraxas had never been formally elected as operator. The court of appeals agreed that the original operator’s sale of its interest to Abraxas resulted in its resignation as operator, thereby invoking the requirement for election of a successor operator. Even though that was never done, the court held that the non-operating interest owners had waived the requirements for selection of a successor operator. The court cited its own earlier opinion in *Purvis Oil Corp. v. Hillin*, 890 S.W.2d 931 (Tex.App. – El Paso 1994, no writ), which held that the requirement that the operator own an interest in the contract area could be waived. The court explained its holding as follows:

Appellees seek to distinguish *Purvis Oil* because *Hillin* had been formally selected as operator. We recognize that *Purvis Oil* involved a different aspect of Article V.B.2 and that the facts are somewhat different. Nevertheless, the case stands for the proposition that non-operating interest owners can waive requirements of the JOA pertaining to selection of a successor operator by permitting another party to act as operator, despite a failure to qualify as such, and by accepting the benefits of that party’s performance. In this case, Hornburg, Hauter, and Guiberson effectively assented to Abraxas as operator and accepted the benefits of Abraxas’ performance while knowing that Abraxas, in reliance on its assignment by Pearson-Sibert, had expended time, effort, and expense to operate the Cleo Smith lease. See *Purvis Oil*, 890 S.W.2d at 937. Therefore, we find that the Appellees waived the JOA’s requirement that Abraxas be formally selected as operator. *Id.*

20 S.W.3d at 751-52.

- *Stable Energy, L.P. v. Newberry*, 999 S.W.2d 538 (Tex.App. – Austin 1999, pet. denied).

**Holding:** A successor operator that has not signed the operating agreement may nevertheless be bound by the operating agreement by ratification or estoppel.

The facts of this case are complicated and need not be outlined for present purposes. As it relates to the subject of this paper, the aspect of the case that must be noted is the court's conclusion that a successor operator was bound by the provisions of a joint operating agreement, even though the operator never signed the agreement. The successor operator had acted under the operating agreement by following its provisions for the election of a new operator, by approving a division order identifying the new operator, and by seeking to recover costs from the non-operators. The court concluded that such conduct was sufficient to bind the successor operator to the operating agreement under the doctrines of ratification and estoppel.

## VI. MAINTENANCE OF UNIFORM INTEREST

- *ExxonMobil Corp. v. Valence Operating Co.*, \_\_\_\_ S.W.3d \_\_\_\_, 2005 WL 1415320 (Tex.App. – Houston [1<sup>st</sup> Dist.], June 16, 2005) (Opinion on Rehearing; Second Motion for Rehearing filed July 1, 2005).

**Holding:** A party's disposition of its interest in the contract area only as to a certain formation is a violation of the maintenance of uniform interest provision.

ExxonMobil and Valence are parties to a joint operating agreement governing operations on the Gladewater Gas Unit 16 in Gregg and Upshur Counties. Three wells on the unit produced gas from the Cotton Valley Lime formation, and it was determined that there were proven behind the pipe reserves in the shallower Cotton Valley Sand.

In 1996, ExxonMobil, which had succeeded to the interest of the original operator, entered into a farmout agreement with Wagner & Brown, Ltd. ("WB") and C.W. Resources ("CW"), giving them the right to earn the conveyance of ExxonMobil's interest in the Cotton Valley Sand portion of Unit 16 upon the successful completion of a test well. Valence sued

ExxonMobil, contending that the farmout violated the maintenance of uniform interest provision in the JOA. The maintenance of uniform interest provision in Article VIII.B of the JOA, including strikeouts appearing in the original, provides:

E. Maintenance of ~~Uniform~~ Interest:

~~For the purpose of maintaining uniformity of ownership in the oil and gas leasehold interests covered by this agreement, and~~  
Notwithstanding any other provisions to the contrary, no party shall sell, encumber, transfer or make other disposition of its interest in the leases embraced within the Contract Area and in wells, equipment and production unless such disposition covers either:

- 1.the entire interest of the party in all leases and equipment and production; or
2. an equal undivided interest in all leases and equipment and production in the Contract Area.

Every such sale encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement, and shall be made without prejudice to the rights of the other parties.

2005 WL 1415320 at \*5 - \*6. Valence argued that the farmout violated this provision because it only covered ExxonMobil's interest in the Cotton Valley Sand rather than its entire interest, or an undivided interest in its entire interest, in all of Unit 16. The trial court ruled in favor of Valence, finding that the farmout violated the maintenance of uniform interest provision, and the court of appeals affirmed.

ExxonMobil contended that by striking the language stating that the purpose of the provision was to maintain "uniform" ownership in the leasehold interests covered by the JOA, the original parties indicated their intention *not* to require the maintenance of uniform interests. It further contended that the provision applied only to the sale or other disposition of a party's interest in the leases *and* in the wells, equipment and production. ExxonMobil contended that

the farmout did not violate the maintenance of uniform interest provision because the farmout did not cover ExxonMobil's interest in the wells, equipment and production.

Valence contended that by striking the reference to the maintenance of "uniform" interests, the originally parties were merely recognizing that they did not have uniform interests to maintain because ExxonMobil's predecessor owned an 81.8% interest in Unit 16, and Valence's predecessor owned an 18.2% interest. Valence contended that the maintenance of uniform interest provision evidenced the intent of the parties to maintain whatever interests they had under the JOA when it was executed.

In affirming the trial court on this issue, the court of appeals agreed with Valence's position and held as follows:

Because the plain language of the MOI provision in the JOA required that ExxonMobil not partition its interest in Unit 16, but that it convey either its entire interest or an equal undivided interest in all leases, wells, equipment, and production in the contract area, ExxonMobil breached the MOI provision of the JOA by conveying its interest in a portion of Unit 16 to WB and CW, namely, by conveying to them its interest in the Cotton Valley Sand formation while retaining its interest in those formations beneath the Cotton Valley Sand. We hold that the trial court did not err in finding that ExxonMobil breached the MOI provision in the JOA by conveying a portion of its interest in Unit 16 to WB and CW.

2005 WL 1415320 at \*9.

The court also affirmed the trial court's finding that this breach of the maintenance of uniform interest provision caused damage to Valence because it resulted in the drilling of additional wells to recover reserves that could have otherwise been recovered more economically by recompletion of the existing wells in the Cotton Valley Sand. On this issue, the court held as follows:

Had ExxonMobil not breached the JOA by farming out, and subsequently selling, its interest in the Cotton Valley Sand level of

Unit 16, it would have continued to have the same interest that Valence had in capturing as much oil and gas as possible from the entire unit by the most economical means that would maximize returns from the whole. By assigning its interest in the Cotton Valley Sand portion of Unit 16, ExxonMobil severed its interest from Valence's, rather than maintaining it, thereby breaching the JOA and causing Valence to incur the extra costs associated with drilling the new wells side by side with existing wells that could have been completed to access the same reserves.

2005 WL 1415320 at \*9.

## VII. PARTITION

- *Dimock v. Kadane*, 100 S.W.3d 602 (Tex.App. – Eastland 2003, pet. denied).

**Holding: The standard provisions of the AAPL Model Form Operating Agreement evidence an implied agreement not to partition the contract area.**

In this case and in three related cases<sup>2</sup> with the same names, and involving substantially the same parties and facts, the Eastland Court of Appeals held that the standard provisions of the 1956 version of the AAPL Model Form Operating Agreement evidence an implied agreement not to partition the contract area. The result should be the same under subsequent versions of the AAPL Model Form Operating Agreement because they all contain provisions that are substantially the same as the provisions that the Eastland court relied upon in these cases.

The parties owned working interests in oil and gas leases that were subject to an operating agreement entered into by their predecessors in interest. Dimock sought to partition the leases. Kadane filed a counterclaim seeking a declaration that by entering into the operating agreement and certain letter agreements, the prior owners had impliedly waived the right to

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<sup>2</sup> *Dimock v. Kadane*, 100 S.W.3d 608 (Tex.App. – Eastland 2003, pet. denied); *Dimock v. Kadane*, 100 S.W.3d 615 (Tex.App. – Eastland 2003, pet. denied); *Dimock v. Kadane*, 100 S.W.3d 622 (Tex.App. – Eastland 2003, pet. denied).



partition. The trial court and the court of appeals agreed with Kadane that the right to partition had been waived.

The court of appeals held that co-owners of a mineral estate have a statutory right to compel partition, but that they can agree not exercise that right. 100 S.W.3d at 604. The court determined that there was no express agreement not to partition, but that an implied agreement could be found in various provisions of the operating agreement, including the provision that the operating agreement would remain in force as long as the underlying leases remained in force, and the subsequent operations clause governing non-consent operations. The court explained the effect of those two provisions as follows:

The Non-Consenting Party provisions in Paragraph No. 12 of the Operating Agreement and the term provision in Paragraph 10 of the Operating Agreement, when considered together, imply an agreement not to partition. Under Paragraph No. 12, ownership of a Non-Consenting Party's interest transfers to the Consenting Parties. Thus, the Non-Consenting Party provisions directly affect title to the undivided interests in the leases. Paragraph No. 12 presupposes that a Non-Consenting Party owns an interest that is subject to transfer upon commencement of the operation. If a party to the Operating Agreement were allowed to partition and thereby destroy the joint ownership of the leases, Paragraph No. 12 would be rendered meaningless. Paragraph No. 10 provides that:

This agreement shall remain in full force and effect for as long as any of the oil and gas leases subjected to this agreement remain or are continued in force as to any part of the Unit Area, whether by production, extension, renewal or otherwise.

Paragraphs Nos. 10 and 12 indicate a "desire of the parties to retain the cotenancy status and operational status during the life of the leases." *See Sibley v. Hill, supra* at 229. We find that Kadane & Sons and TUFCO impliedly agreed not to partition the interests in the leases for as long as the leases remain in effect.

100 S.W.3d at 606. In further support of the implied agreement not to partition, the court cited the maintenance of uniform interest provision, the provision governing extensions and renewals of leases, and the provision for surrender of leases.

## VIII. CONCLUSION

Historically, the joint operating agreement has not generated as many reported decisions as one might expect of an instrument that has been so widely used over such an extended period of time. The period covered by this paper was notable both for the unusually large number of reported cases, and for the *Valence Operating Company v. Dorsett* decision by the supreme court, which has seldom spoken on issues under the joint operating agreement.