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12. Current Issues on Joint Operating Agreements

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I. The JOA Concept

This paper discusses current issues regarding joint operating agreements, focusing on recent decisions from courts in Louisiana. For the purposes of this paper, the “current” timeframe is roughly ten years, although there will be some reference to older cases that touch on issues that we think are pertinent today. Because it is the most frequently used form for onshore operations, AAPL Form 610, last revised in 1989, will be used as the contract of reference.

A joint operating agreement is the means by which persons in the oil and gas industry jointly develop a prospect and share in the risks and rewards of exploration and production. It is defined as “[a]n agreement between or among interested parties for the operation of a tract or leasehold for oil, gas and other minerals.”¹ A JOA typically provides “for the development of the premises for the joint account,” and the parties “share in the expenses of the operations and in the proceeds of development, but the agreement normally is not intended to affect the ownership of the minerals or the rights to produce.”²

The concept is simple, *i.e.*, to get wells drilled while spreading costs and sharing benefits. Practicality dictates that someone has to be in charge, so an operator is appointed. The problem is that, historically, parties did not pay much of a premium to the operator. Presumably, control was its own reward. Because there was no real financial reward to the operator, there naturally was an attempt to limit the potential liability the operator might incur because of his status, in particular, his liability to the non-operators. On the other hand, because the non-operators had no real control, the non-operators have historically attempted to shield themselves from actions by third parties to the agreement. These concepts form the most basic tenets behind operating agreements in general and the AAPL form in particular.

Much of the focus of this paper will be on the legal implications of the form and content of the JOA arrangement. Beyond this basic concept, the paper will discuss not only how the agreement functions between the parties who initially entered into it, but also the problems that arise when parties to the agreement change, or when things are not done as

¹ Williams & Meyers, *MANUAL OF OIL & GAS TERMS*, 12th ed. 2003.

² *Id.*

anticipated under the agreement, and how and when the agreement expires.

II. Rights and Responsibilities of the Operator

Article V of the Form 610 operating agreement establishes the rights and duties of the operator. Initially it addresses the designation and responsibility of the operator, requires that the parties name the operator, and states that the operator shall “conduct and direct and have *full control* of all operations on the Contract Area as permitted and required by, and within the limits of this agreement.”³ It also provides that the operator shall be an independent contractor, that the operator will not be or hold itself out as “agent” of non-operators, and that the operator “shall not have the authority to bind” the non-operators “to any obligation or liability assumed or incurred by Operator as to any third party.”⁴ It further states that the operator must conduct its activities in a reasonably prudent manner in accordance with good oil field practice and in compliance with applicable law and regulation, but it goes on to provide that “*in no event shall [the operator] have any liability as operator to the other parties for losses sustained or liabilities incurred except such as may result from gross negligence or willful misconduct.*”⁵

Furthermore, Article VII sets forth a disclaimer regarding the nature of the agreement and the duties and liabilities involved:

It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other *partnership, joint venture, agency relationship* or association, or to render the parties liable as partners, co-venturers, or principals. In their relations with each other under this agreement, *the parties shall not be considered fiduciaries* or to have established a confidential relationship but rather shall be free to act on an arm’s-length basis in accordance with their own respective self-interest, subject, however, to the obligations of the parties to act in good faith in their dealings with each other with respect to activities hereunder.⁶

Thus, the agreement provides quite clearly that the operator acts only for itself when dealing with the outside world, and that the operator’s potential for liability to non-operators is extremely limited. Even though the above provisions in the JOA rather succinctly set out the relationship of the parties between themselves and with reference to others, problems

³ A.A.P.L. Form 610 (1989) Model Form Operating Agreement, Art. V (emphasis added).

⁴ *Id.*

⁵ *Id.* (emphasis added).

⁶ *Id.* Art. VII (emphasis added).

arise because courts often find a legal relationship that has different implications than those stipulated by the parties.

III. Is the RELATIONSHIP a Joint Venture or Partnership?

Certain legal rights and responsibilities flow from the characterization of a relationship. Co-owners, partners, joint venturers, principals and agents: each of these legal determinations has consequences to the rights and obligations that exist between the parties and as to outside parties. There has been quite a bit of litigation over whether the JOA confers partnership or joint venture status because of these legal implications. The JOA declares that it is “not a partnership” and that the parties are “not . . . fiduciaries,” but courts nevertheless have found that how the parties characterize the relationship is not conclusive as to its legal status. In doing so, courts have sometimes found that the agreement is a partnership or a joint venture, that the parties owe fiduciary duties to one another, and that the partners (*i.e.*, the non-operators) can be responsible to third parties, despite stipulations to the contrary.

A joint venture can be defined as “a special combination of two or more persons, where in some specific venture a profit is jointly sought without any actual partnership or corporate designation.”⁷ “The essential elements of a joint venture are generally the same as those of partnership, *i.e.*, two or more parties combining their property, labor, skill, etc., in the conduct of a venture for joint profit, with each having some right of control.”⁸ The difference is that a joint venture is usually formed for a limited duration or purpose, whereas a partnership is usually formed to transact general business of a particular kind.⁹ The criteria for a joint venture or partnership are:

1. A contract between two or more persons;
2. A juridical entity or person is established;
3. Contribution by all parties of either efforts or resources;
4. The contribution must be in determinate proportions;
5. There must be joint effort;
6. There must be a mutual risk vis-à-vis losses;
7. There must be a sharing of profits.¹⁰

⁷ *Coffee Bay Investors, L.L.C. v. W.O.G.C. Co.*, 03-0406, p. 7 (La. App. 1 Cir. 4/2/04), 878 So. 2d 655, 670 (internal quotations omitted).

⁸ *Id.*

⁹ *See id.*; *Riddle v. Simmons*, 589 So. 2d 89 (La. App. 2 Cir. 1991).

¹⁰ *Id.*

Louisiana law generally applies the rules of partnerships to joint ventures. The fiduciary duty that is owed between members of a joint venture is the same as that which exists between partners in a partnership.¹¹ This fiduciary duty is a heightened standard of conduct that may be owed between the partners or joint venturers. Louisiana Civil Code article 2809 provides that “[a] partner owes a fiduciary duty to the partnership and to his partners.” It also states that a partner “may not conduct any activity, for himself or on behalf of a third person, that is contrary to his fiduciary duty and is prejudicial to the partnership. If he does so, he must account to the partnership and to his partners for the resulting profits.”¹² Therefore, the significance of the partnership finding is that the participants are fiduciaries who owe one another the highest degree of care in the transaction of the affairs of the entity.¹³

Inasmuch as the JOA seems to fit the classical definition of a partnership or joint venture, litigation has arisen involving both third party liability and the liability of their partners *inter se*. Historically, the courts looked at the nature of the venture and identified it as what it appeared to be, and in doing so, often ignored self-serving language in the JOA trying to negate the existence of a partnership.¹⁴ What courts often overlook is Louisiana Mineral Code article 215,¹⁵ which specifically states that a JOA is not a partnership unless it expressly says that it is. Article 215 reads as follows:

A written contract for the joint exploration, development, or operation of mineral rights does not create a partnership unless the contract expressly so provides.

In effect, the article reverses the rule that the court should look to the substance of the relationship rather than to the declaration of the parties. There are very few cases applying this Code article, although it obviously addresses the joint operating agreement situation and negates the existence of a partnership (or joint venture), absent a specific declaration creating the partnership. A literal reading of article 215 would apply it only to written contracts, thus implicating only those contracts which must be in writing to have efficacy. Because of the somewhat arbitrary manner in which the writing requirement has been

¹¹ See *id.* at pp. 7-8, 878 So. 2d at 670; see also *Cajun Elec. Power Coop., Inc. v. McNamara*, 452 So. 2d 212 (La. App. 1 Cir. 1984).

¹² *Id.*

¹³ See *Grand Isle Campsites, Inc. v. Cheek*, 262 So. 2d 350 (La. 1972).

¹⁴ See, e.g., *Cajun Elec. Power Coop., Inc. v. McNamara*, 452 So.2d 212 (La. App. 1 Cir. 1984).

¹⁵ La. R.S. 31:215.

enforced by the courts, it is not certain that this reading of the article will result in the full scope of coverage seemingly intended by the legislature.

IV. Duties Owed among the Parties to the JOA

As demonstrated in the decisions discussed below, JOA participants are generally at arms' length and do not require special protection, and thus the courts should not be inclined to find those fiduciary duties generally arising from partnership or joint venture status. In *Dime Box Petroleum Corp. v. Louisiana Land and Exploration Co.*,¹⁶ the non-operator, Dime Box, claimed that the operator, LL&E, owed a fiduciary duty and was liable because it obtained some purchasing advantages that it did not share with the venture. The court found that this was an area in which a fiduciary relationship could conceivably be imposed, but because the parties were both sophisticated and of equal bargaining rank, because the operating agreement had disavowed a joint undertaking, and because the parties had specifically stated that the measure of the operator's liability would be "gross negligence or willful misconduct," the court concluded that there was no joint venture and no fiduciary relationship. *Dime Box* was a Colorado case, but the reasoning regarding equal footing would, as a general rule, apply equally in Louisiana.

In a case applying Louisiana law, *Caddo Oil Co. v. O'Brien*,¹⁷ O'Brien claimed that Caddo, as operator, owed a fiduciary duty and an accounting. The accounting obligation would effectively have shifted the burden from O'Brien to disprove the correctness of operating charges to Caddo, who would have to account for and justify all charges. The court held that the operator owed no such fiduciary duty:

O'Brien is incorrect. Caddo was under no duty to provide O'Brien with an accounting. Rather, the onus was on O'Brien to conduct an audit if he believed one necessary. Under the terms of the Operating Agreement, the Operator is liable to the Owners only in cases of the Operator's willful misconduct. The terms of the Operating Agreement control, and Caddo's actions are to be judged by a prudent operator standard, not by that of a fiduciary.¹⁸

More recent Louisiana cases shed light on the partnership/joint venture-fiduciary duty issue. One is the case of *Johnco, Inc. v. Jameson Interests*.¹⁹ Through inheritance and an agreement, Johnco and Jameson owned minerals in indivision. Then, as the court described it, they partitioned the minerals but combined their mineral rights affecting the same property. They separately leased their respective mineral rights. By

¹⁶ 717 F. Supp. 717 (D. Co. 1989); *aff'd* 938 F.2d 1144 (10th Cir. 1991).

¹⁷ 908 F.2d 13 (5th Cir. 1990).

¹⁸ *Id.* at 17.

¹⁹ 98-1925 (La. App. 3 Cir. 6/23/99), 741 So. 2d 867.

virtue of a deal with a geologist and geophysicist to promote exploration of the property, Jameson received an overriding royalty interest and the potential for additional cash. Johnco felt entitled to a share of that additional consideration and sued everyone, claiming a fiduciary duty based upon co-ownership and joint venture theories. The court held that the existence of a joint venture would be a fact determination, “ultimately predicated upon contract either express or implied,”²⁰ and upheld the lower court’s finding that no joint venture existed. The court then avoided the fiduciary duty/co-ownership issue by finding no co-ownership of the mineral rights between Johnco and Jameson. The concurring opinion correctly observed that a finding of co-ownership, in and of itself, would not have necessarily resulted in the establishment of a fiduciary obligation. The court’s reference to a potential implied joint venture suggests that parol evidence might have been allowed to establish such a relationship, with its attendant fiduciary obligation. The court’s suggestion notwithstanding, it would seem that a written agreement would be necessary to create a joint venture under these facts.

*Coffee Bay Investors, L.L.C. v. W.O.G.C. Co.*²¹ involved both a joint operating and ancillary agreements between an investment firm and an oil and gas well operator. Coffee Bay provided W.O.G.C., the operator, with funds to drill a well in exchange for an undivided 50% interest in the oil and gas leases affecting the well prospect. Coffee Bay agreed to share expenses related to the development of the prospect. The anticipated well was never drilled and the venture failed, without W.O.G.C. ever assigning the lease. The court found that even absent a formal assignment, Coffee Bay was bound to pay the agreed-upon consideration. It then held that the arrangement amounted to a joint venture, even though the agreement expressly disavowed the parties’ intent to create either a partnership or a joint venture. The court remanded the case for a determination of whether the failure of the venture was the result of a breach of W.O.G.C.’s fiduciary duty.

Another recent case in which the court has looked past the wording of the agreement to its substance is *Phoenix Associates Land Syndicate, Inc. v. E.H. Mitchell & Co., LLC*.²² This case involved a purported operating agreement between a lessee and third party operator. The lease contained a provision that prohibited subleasing. The court found that the relationship between the lessee and the operator was in fact a sublease in violation of the anti-subleasing provision. The court looked at the substance of the “operating agreement” and found that the agreement transferred ownership of the solid minerals to the third party and not just

²⁰ *Id.* at p. 13, 741 So. 2d 871.

²¹ 03-0406 (La. App. 1 Cir. 4/2/04), 878 So. 2d 665.

²² 07-0108 (La. App. 1 Cir. 9/14/07).

the ability to operate the mining venture. Therefore, despite the parties' agreement that the operating agreement was not and should not be construed as a lease or a sublease, the court found that it was exactly that.

In *Double-Eight Oil & Gas L.L.C. v. Caruthurs Producing Co.*,²³ the court held that a co-owner operator, in the absence of an operating agreement, owed a fiduciary duty to the non-operating owners. The court went on to find that the duties were not actually breached under the facts. The court repeatedly noted that there was not an operating agreement between the parties, but did not discuss whether the situation would have been different if there were an operating agreement.

*Riddle v. Simmons*²⁴ involved the purchase of a large tract of land by several parties. The intent behind the purchase of the property was primarily a real estate development, but it also involved the development of minerals. The facts are fairly complicated, and involve various transfers, rights, obligations and interests, and the use of different legal entities by various parties. The simplified facts are that, at various points, there were discussions among the co-owners about developing mineral rights and securing the right to purchase gas in the field. Ultimately, one of the co-owners, Simmons, obtained a gas transportation agreement and constructed a pipeline to transport gas for a fee. The court found a joint venture and forced Simmons to share profits with the other co-owners. The court held that this agreement did not require a writing because the joint venture did not focus on the pipeline (an immovable), but rather the ability to obtain gas for transportation in the pipeline, which was the source of the joint venture's profit.

V. Significance of the Writing Requirement

As noted, *Riddle v. Simmons* raised the issue of whether a writing would be required, depending upon whether the venture dealt with immovable property. Numerous other cases have discussed the writing requirement in varying contexts, with mixed results. The weight of the authority seems to be that, when mineral leases, the operations thereon and production therefrom are at issue, a writing is required. Nevertheless, there is a fair amount of inconsistency over the necessity of a writing for agreements governing mineral-related activities. The impact of these determinations vary depending on the issue in the lawsuit, *i.e.*, partnership or joint venture status, venue, choice of law, or validity of judgments, but the analysis should theoretically produce consistent results. Although it is not certain how it will be resolved when the facts are established, the courts seem to make the issue of a writing requirement dependent upon the manner in which the right or obligation

²³ 41,451 (La. App. 2 Cir. 11/20/06), 942 So. 2d 1279.

²⁴ 40,000 (La. App. 2 Cir. 02/16/06), 922 So. 2d 1267.

at issue is sought to be enforced, rather than upon the actual nature of the right or obligation.

The result in *Riddle v. Simmons* is consistent with an earlier Louisiana Supreme Court decision in *Hawthorne v. Conoco*,²⁵ in which the court held that a suit against a pipeline company to rescind a gas purchase contract was not an action to assert an interest in immovable property, even though the pipeline itself was considered an immovable. A similar analysis, leading to a different conclusion, is found in the Fourth Circuit in Court of Appeal case of *CLK Co. v. CXY Energy Inc.*²⁶ This case was based upon the failure to convey an overriding royalty interest, and the plaintiff attempted to cast his claim in a way that sounded like a claim for money compensation. The court concluded: “the fact that CLK’s claim is compensable in money does not preclude it from being categorized as an immovable or as a real right.”²⁷ The court found that the interest subject to that dispute was a real right. The First Circuit Court of Appeal in *Rock Energy, Inc. v. Equity Oil Co.*²⁸ held to the contrary in an action for half of the proceeds from an assignment of seismic options. The court distinguished *CLK* and found that, even assuming that the seismic options were “incorporeal immovables,”²⁹ the object of the action was money, and not an interest in the actual options.

The Third Circuit case of *Ironwood Resources, Ltd. v. Baby Oil, Inc.*³⁰ involved complaints by a non-operator that the operator improperly refused to allow an audit, improperly charged and netted expenses, refused to authorize direct payment of revenues to the non-operators, and failed to communicate with the non-operators. The court discussed *CLK* and *Rock Energy* as well as other prior cases, and found this to be an action asserting rights in incorporeal immovable property. The court reasoned: “Plaintiffs *sub judice* seek to protect their interests in immovable property by enforcing a contract under which Defendants operate and manage their interest in that immovable property.”³¹ Under this rationale, which seems correct, any claim seeking to enforce the rights or obligations flowing from the management or operation of mineral rights would be one asserting a right in immovable property. As such, disputes relating to operating agreements involve interests in immovable property, and should be written.

²⁵ 377 So. 2d 285 (La. 1979).

²⁶ 98-0802 (La. App. 4 Cir. 9/16/98), 719 So. 2d 1098.

²⁷ *Id.* at p. 17, 719 So. 2d at 1104.

²⁸ 01-1005 (La. App. 1 Cir. 5/10/02), 818 So. 2d 920.

²⁹ *Id.* at p. 7, 818 So. 2d at 922.

³⁰ 05-467 (La. App. 3 Cir. 2/1/06), 921 So. 2d 1189.

³¹ *Id.* at p. 7, 921 So. 2d at 1193.

While, in many cases, these decisions are meant to resolve questions of venue and other procedural issues, they are of great moment with respect to the issue of whether a fiduciary relationship exists. Applying article 215 of the Mineral Code and requiring a written operating agreement should negate the existence of that status and any special (fiduciary-type) obligations that might arise thereunder. The JOA's standard disclaimer about an intent to form a partnership or joint venture should be unnecessary but would serve to reinforce the conclusion that no partnership or joint venture exists.

Finally, as a general rule, title to real rights in a state should only be determined by the law of that state. Two recent out-of-state cases involving preferential rights to purchase mineral interests under joint operating agreements reached different results in determining the law of which state would apply in the extra-territorial adjudication of those preferential rights claims. *Coral Production Corp. v. Central Resources, Inc.*³² involved a Nebraska court applying Texas law to a Nebraska lease interest, and *El Paso Production Co. v. Geomet, Inc.*³³ involved a Texas court applying Alabama law to Alabama interests. Louisiana, per Civil Code article 3535, would require that any adjudication of real rights in Louisiana immovables be governed by Louisiana law.

VI. Duties Owed to Third Parties

The classification of the entity as a joint venture or partnership also has significant impact on participants *vis-à-vis* third persons. Under Louisiana law, a finding of partnership or joint venture status would impose liability on the non-operators as partners or joint venturers for obligations contracted by the operator. The Louisiana Civil Code specifies the effect of partnership status on persons who deal with the partnership. Article 2814 makes each partner an agent of the partnership:

A partner is a mandatary of the partnership for all matters in the ordinary course of its business other than the alienation, lease, or encumbrance of its immovables. A provision that a partner is not a mandatary does not affect third persons who in good faith transact business with the partner.

Article 2815 states that “[a] provision that a partner shall not participate in losses does not affect third persons.” Furthermore, article 2816 governs when a partner can bind the entire partnership, and by extension, the other partners:

An obligation contracted for the partnership by a partner in his own name binds the partnership if the partnership benefits by the transaction or the transaction involves matters in the ordinary course

³² 730 N.W. 2d 337 (Neb. 2007).

³³ 228 S.W. 3d 178 (Tex. App.-Dallas 2007).

of its business. If the partnership is so bound, it can enforce the contract in its own name.

As noted above, the form JOA expressly provides that it is not a partnership or joint venture, but nevertheless, courts have been inclined to ignore self-serving stipulations and analyze the relationship based upon how it is structured rather than what the parties choose to call it. In *Posey v. Fargo*,³⁴ *Duncan v. Gill*,³⁵ and *Young v. Reed*,³⁶ the courts held that joint oil and gas operations constituted a joint venture causing liability of all participants to third parties. Mineral Code article 215, discussed above, would seem to obviate this problem, if properly applied by courts. For the same reasons as it serves to prevent fiduciary obligation claims between the participants, article 215 should also protect against third party liabilities.

A related avenue for liability to third parties would seem to be *via* a more traditional mandate or apparent authority analysis, without regard to partnership or joint venture status. The obvious significance is that, in the event of insolvency of the operator, contractors will often attempt to hold the non-operators liable for the debts contracted by the operator. Again, the form JOA contains a disclaimer in Article VII, which states that “[i]t is not the intention of the parties to create, nor shall this agreement be construed as creating, a[n] . . . agency relationship.”³⁷ It would appear that, absent an affirmative act on the part of the non-operator which would suggest responsibility, the non-operators, not having created a formal agency relationship, and in fact, having formally denied same, should not be personally liable for those debts. The jurisprudence does not always follow this line of reasoning.

An illustrative case is *Liberty Services, Inc. v. Amoco Production Company*,³⁸ in which Amoco had various arrangements with Alliance Operating Corporation, including an operating agreement, a unit agreement, and a facilities operating agreement. The plaintiff, Liberty, provided services to Alliance, who went bankrupt. In addition to pursuing lien claims against Alliance’s property, Liberty advanced a number of claims against Amoco based upon the series of agreements, along with a filing by Amoco with the MMS allowing Alliance to act on behalf of Amoco with respect to MMS obligations. Liberty alleged that the agreements and the MMS filing ultimately established a partnership, joint venture, and/or actual or apparent agency status. While the court

³⁴ 187 La. 122, 174 So. 175 (La. 1937).

³⁵ 227 So. 2d 376 (La. App. 4th Cir. 1969).

³⁶ 192 So. 780 (La. App. 2d Cir. 1939).

³⁷ A.A.P.L. Form 610 (1989) Model Form Operating Agreement, Art. VII (emphasis added).

³⁸ Civ. A. No. 90-4490, 1991 U.S. Dist. LEXIS 18620 (E.D. La. Dec. 20, 1991).

acknowledged that, under article 215, any partnership or joint venture would have to be in writing, the court nevertheless refused to make a ruling on summary judgment about whether the writings at issue established a partnership or actual agency relationship, but chose rather to delve further into facts surrounding conduct of the parties. Thus, again a court is suggesting that a writing requirement is not determinative, and presumably non-existent. The only issue the court was able to resolve without further evidence was apparent authority. Although Liberty claimed that the MMS filing created apparent authority of Alliance to act on Amoco's behalf, the court found that, because Alliance failed to show that it had seen and relied on the filing before supplying services, it could not support the apparent authority claim.

Also pertinent is the recent Louisiana federal district court case styled *Burlington Resources, Inc. v. United National Insurance Co.*,³⁹ in which Burlington was a non-operator of a well that suffered a blowout. Burlington sought reimbursement under an insurance policy for its share of sums paid to the mineral lessor by the operator for lost reserves due to the blowout. The policy provided contractual liability coverage as opposed to general negligence coverage for tort liability. The issue was whether the settlement with the mineral lessor was necessary because of Burlington's own negligence or because Burlington was required to reimburse the operator under the JOA. The claim against the insurance company was only valid if it were premised on reimbursement under the JOA. The court found that, since the operator had full control over operations, the non-operator had no potential tort liability. Therefore, because liability was contractual under the JOA, coverage applied. An interesting reverse twist was provided by the decision of the Louisiana Fourth Circuit Court of Appeal in *Helmer Directional Drilling v. Dexco, Inc.*⁴⁰ There, a drilling contractor sought payment for additional services under a drilling contract with the operator. The court found as a matter of credibility that the operator would not have authorized the additional services claimed by the driller because such would have required the operator to exceed its authority for expenditures under the JOA. Thus, the court looked to the internal limitations of the contract to conclude that there was no third party liability. In a not dissimilar vein, *Mobil Exploration & Producing U.S. Inc. v. Certain Underwriters Subscribing to Cover Note 95-3317(A)*,⁴¹ held that, where an interest owner/non-operator was a third party beneficiary of the drilling contract and had in fact accepted benefits of the contract, it was correspondingly bound by

³⁹ 481 F. Supp. 2d 567 (E.D. La. 2007).

⁴⁰ 653 So. 2d 1245 (La. App. 4 Cir. 1995).

⁴¹ 01-2219 (La. App. 1 Cir. 11/20/02), 837 So. 2d 11.

the consequential damage limitation in the drilling contract and could not recover consequential damages from the driller.

VII. The Operator's Standard of Care & the Exculpatory Clause

Aside from the question of loyalty, which is addressed by the existence *vel non* of a fiduciary duty, there is also a question of competence, *i.e.*, to what standard is the operator held in the conduct of operations? At law, the naturally-applying standard would be normal negligence, but a gross negligence stipulation, if effective, would change that. Gross negligence is defined under Louisiana law as "the want of even slight care . . . the want of that diligence which even careless men are accustomed to exercise."⁴² By implication, Louisiana Civil Code article 2004 allows a change in the standard. That article provides: "Any clause is null that, in advance, excludes or limits the liability of one party for intentional or gross fault that causes damage to the other party." Article 2004 does not permit absolution from gross fault, but clearly permits the raising of the standard of liability to gross fault or intentional misconduct.

In *Huggs, Inc. v. LPC Energy, Inc.*,⁴³ the Fifth Circuit, applying Louisiana law, was faced with a situation in which the operator failed to pay delay rentals on two leases which then expired, and let two others expire because of failure to conduct operations or assign the leases to the other participants, who might have maintained them. The court found that the leases lost because of the failure to pay delay rentals did not warrant compensation because the applicable agreements specifically excused the operator from liability from mistake or oversight in connection with the payment of delay rentals. However, with respect to those leases lost because they were not maintained by operations and were not assigned, the court found that the operator had committed gross negligence and had violated the duty expected of a prudent operator. There is no mention of the fact that gross negligence was stipulated as a standard, but it nevertheless is what the court concluded had occurred. Effectively, the court suggested that a failure to pay delay rentals could be the result of excusable neglect, but to fail to act to maintain a lease after production ceases constitutes gross negligence.

*Grace-Cajun Oil Co. No. Two v. Damson Oil Corp.*⁴⁴ involved a situation in which Damson acted as operator in marketing its own and Grace Cajun's gas. The operating agreement contained an exculpatory

⁴² *State v. Vinzant*, 7 So. 2d 917 (La. 1942); *Roton v. Vernon E. Faulconer, Inc.*, 42,452 (La. App. 2 Cir. 10/3/07), 966 So. 2d 790, 795; *First Commonwealth Corp. v. Hibernia Nat'l Bank of New Orleans*, 891 F. Supp. 290, amended 896 F. Supp. 634 (E.D. La. 1995) *aff'd*, 5 F.3d 622 (5th Cir. 1996).

⁴³ 889 F.2d 649 (5th Cir. 1989).

⁴⁴ 897 F.2d 1364 (5th Cir. 1990).

clause stating that Damson would have “no liability as Operator to the other parties for losses sustained, or liabilities incurred, except such as may result from gross negligence or from breach of the provisions of this agreement.”⁴⁵ Damson marketed the gas to Louisiana Intrastate Gas Corporation (“LIG”) at a price above the then-regulatory price limit. The higher price received would have been allowed had Dawson filed a well status application with the Louisiana Department of Natural Resources and had it approved. Because the well status application was not filed, LIG recouped the difference between higher and lower prices. Grace-Cajun ultimately sued Damson for its share of the loss occasioned by the recoupment. The court did not find gross negligence or a breach of the operating agreement, saying: “It is not necessary to resolve whether the district court applied an improper standard to its determination of Damson’s liability under the operating agreement. The gas purchase contract clearly defines Damson’s duty.”⁴⁶ The court was not impressed with Damson’s argument that Grace-Cajun was not a party to the gas sales agreement with LIG, nor did it choose to apply the exculpatory clause in the joint operating agreement. Because the gas was sold by Damson pursuant to the JOA, it would appear that the court was incorrect in not applying the gross negligence standard to determine whether the failure to file the application was mere oversight or, in fact, inexcusable neglect.

There is a series of cases applying or failing to apply the exculpatory clause from other jurisdictions, and there appears to be a conflict between the various state and federal courts over the scope of the exculpatory clause. In *Abraxas Petroleum Corp. v. Hamburg*,⁴⁷ the court held that the exculpatory clause only applied to claims alleging failure to act as a prudent operator, which standard, in turn, only pertained to the manner in which drilling operations were conducted on a lease. The court found that, as this was a breach of contract claim in which the operator had not conducted agreed-upon services, the gross negligence standard did not apply. Several cases have followed, such as *IP Petroleum v. Wevanco Energy, L.L.C.*,⁴⁸ in which the court applied the gross negligence standard to actual drilling operations. Another is *Palace Exploration Co. v. Petroleum Development Co.*,⁴⁹ in which the Tenth Circuit Court of Appeals upheld an Oklahoma federal district court opinion finding that there was negligence, but not gross negligence, on the part of an operator who had made certain misstatements or errors of

⁴⁵ *Id.* at 1366.

⁴⁶ *Id.* at 1367.

⁴⁷ 20 S.W. 3d 741 (Tex. App.-El Paso 2000).

⁴⁸ 116 S.W. 3d 388 (Tex. App.-Houston (1st Dist.) 2003).

⁴⁹ 374 F.3d 951 (10th Cir. 2004).

judgment. Although drilling operations were involved, the court characterized it as an alleged breach of the JOA, thus supposedly reconciling its opinion with *Abraxas*. Despite stated attempts to reconcile the cases, these results seem inconsistent. Clearly, certain courts are reluctant to apply the gross negligence standard across the board, while others will apply the clause as written.

The Louisiana case of *Roton v. Vernon E. Faulconer, Inc.*⁵⁰ involved a claim based on fatal injuries suffered by a teenager while trespassing on a well site. The court concluded that the operator was not liable, not based on the exculpatory clause in the JOA, but based on La. R.S. 9:2800.4, which provides:

An owner of oil, gas, or mineral property *shall not be liable* to any person who *unlawfully enters* upon his oil, gas, or mineral property, for damages for any injury, death, or loss which occurs while on the oil, gas, or mineral property of the owner, *unless* such damage, injury, or death was caused by the *intentional act* or *gross negligence* of the owner.⁵¹

The court emphasized that the statute includes in the definition of “owner” a “person . . . in control of any oil, gas, or mineral property.”⁵² Therefore, the court reached a similar result *vis-à-vis* a trespasser under statutory law as should apply under the exculpatory clause in a joint operating agreement.

VIII. Enforcement of the JOA

A. Notices and Billing

Although not always, the courts will generally attempt to apply the parties’ agreement as written. For example, in *Texaco Exploration & Production Inc. v. Smackco, Ltd.*,⁵³ the operator failed to comply with the JOA’s requirement of 48-hours’ notice to the non-operator prior to abandoning a well. The court held that the non-operator was entitled to damages in the amount of the cost to re-mobilize the rig and drill to the point where the operator abandoned the well, which would put the non-operator in the place it would have been had the contract not been breached. This result is consistent with an older decision, *Lancaster v. Petroleum Corporation of Delaware*,⁵⁴ which involved an operator of a well that blew out during drilling. The operator, Petroleum, recommended the plugging and abandonment of the well, resigned, and threatened to plug the well that day unless another operator took over

⁵⁰ 42,452 (La. App. 2 Cir. 10/3/07), 966 So. 2d 790.

⁵¹ La. R.S. 9:2800.4(E) (emphasis added); *Roton*, 966 So. 2d 795.

⁵² La. R.S. 9:2800.4(A)(1); *Roton*, 966 So. 2d at 795.

⁵³ No. CIV. A. 98-2293, 1999 WL 447082 (E.D. La. 1999).

⁵⁴ 491 So. 2d 768 (La. App. 3d Cir. 1986).

that day. The operating agreement stated that the operator could resign upon 90-days' notice. The non-operator, Lancaster, found another operator by agreeing to give the substitute operator a substantial portion of his back-in interest. The court found that Petroleum had breached the operating agreement by failing to honor the ninety-day notice of resignation provision⁵⁵ and awarded damages based upon the rights that were given up to entice the new operator into taking over operations.

In *Palace Exploration Co. v. Louisiana Exploration & Drilling Co.*,⁵⁶ the court held that the operator of an oil well was not entitled to interest and attorney fees in an action to collect unpaid bills from a non-operator pursuant to the operating agreement. The court reasoned that the operator did not comply with the plain language of the operating agreement requiring that the non-operator receive bills for the operator's services before the interest and attorney fees provision was triggered. Therefore the operator was entitled to neither contractual nor legal interest.

B. Status and Rights of Participants

Transfers of interests under an operating agreement can often create their own unanticipated problems. In *Union Oil Co. of California v. Cheyenne Oil Properties, Inc.*,⁵⁷ a working interest owner in an offshore oil and gas lease attempted to transfer its interest to another. Upon learning of the purported sale, the operator billed the purported transferee for costs associated with the lease operations and abandonment. Ultimately, the sale did not occur, so the operator brought suit under the JOA against the original owner and the purported transferee. The trial court granted summary judgment in favor of the operator against the original owner. The appellate court reversed, finding that summary judgment was prohibited by a factual question as to whether the working interest owner ever effectively conveyed its interest. The operator was thus not able to collect against the initial working interest owner because that party had never been billed under the JOA, and there remained a viable issue as to whether the operator would be able to collect against the purported transferee due to the question of whether the transfer was effected. This latter issue was addressed by the trial court in *Terrebonne Parish School Board v. Castex Energy, Inc.*,⁵⁸ although not in the JOA context. In *Castex*, the landowner sought to enforce lease restoration obligations and the trial court found, *inter alia*, that there was no liability

⁵⁵ Arguably, the withdrawal would have been actionable even absent a specific ninety-day notice provision. See *Tabco Exploration, Inc. v. Tadlock Pipe & Equipment, Inc.*, 617 So. 2d 606 (La. App. 3 Cir. 1993).

⁵⁶ 01-1063 (La. App. 5 Cir. 2/13/02), 812 So. 2d 100.

⁵⁷ 02-1330 (La. App. 3 Cir. 3/5/03), 839 So. 2d 1170.

⁵⁸ 01-2634, p. 7 n. 5 (La. App. 1 Cir. 3/19/04), 878 So. 2d 522, 527.

on the part of Castex Energy because, although the mineral lease had been assigned to it by Samson Petroleum, and although Castex Energy was the current operator of the wells, the assignment had never been approved by the landowner, as required by the lease.

In *Duncan Oil Properties, Inc. v. Vastar Resources, Inc.*,⁵⁹ the court interpreted language stating that “other parties” were entitled to vote for a new operator when the current operator sold its working interest. The court held that the assignee of an operator’s working interest became one of the “other parties” allowed to vote for the new operator. Thus the assignee under a Form 610 joint operating agreement was entitled to vote for a new operator after purchasing the operator’s rights and interests.

Pittencrieff Resources, Inc. v. Firstland Offshore Exploration Co., 942 F. Supp. 271 (E.D. La. 1996) is a case involving an offshore exploration agreement which was not on a “standard” form, although its provisions, and the problems created, are not atypical. The operating agreement provided that no well that had once produced could be abandoned without the consent of all parties owning an interest in the platform. A non-operator had a desire to take over the platform and operate it, while the operator and other non-operators wanted it abandoned, as they were concerned about future exposure if the non-operator took over the platform and maintained the lease. The operating agreement allowed any non-operator an election to take over the platform in the event that abandonment was proposed. As it turns out, the non-operator was not current on payment of its joint interest billings, and thus the operator took the position that the non-operator was not entitled to participate in operations or vote. Inasmuch as exercising the option to take over the platform and wells required an “election,” the question became whether a party which could not vote, could nevertheless exercise an election to take over the platform. The court equated electing to voting and held that a party in default could not elect to take over the platform and wells.

C. Preferential Rights

There are perennial problems involving identifying and valuing interests that are subject to rights of first refusal or “preferential rights.” In *Online Resources, Inc. v. Stone Energy Corporation*,⁶⁰ a party to a JOA sought to enforce the preferential rights provision in the agreement against another party who conveyed an overriding royalty interest to an outside party. The seller took the position that the overriding royalty interest was not subject to the preferential rights provisions of the JOA, but the court disagreed. The court concluded that, where the JOA gives a preferential right to the other interest owners to purchase any “interest”

⁵⁹ 16 P.3d 465 (Okla. 2000).

⁶⁰ No. CIV. A. 99-2006, 1999 WL 997495 (E.D. La. 1999).

that another party should sell, the term “interest,” according to industry usage, applies to interests beyond the “working interest,” including the overriding royalty interest.

A more recent case involving the preferential rights provision is *Fordoche Inc. v. Texaco Inc.*,⁶¹ in which the operator had agreed to sell interests under four JOAs containing rights of first refusal in favor of other parties to the JOAs. The operator did offer the interests to the other working interest owners, but the issue was whether there was a good faith tender. The proposed sale involved a number of interests in sixteen separate oil and gas fields along the Gulf Coast, and the four JOAs at issue were in one of these sixteen fields. Of the \$78.7 million sales price, the “allocated” price for the interests in the four JOAs was around \$2 million. When the tender of the right of first refusal was made, the offerees requested more information. More information was given, but it was insufficient to satisfy the offerees. Ultimately, the tender was deemed refused and the interests were sold to the third party. The court agreed with the plaintiffs that there was an issue as to whether the tender was in good faith because: (1) there was not an adequate description of exactly what properties or interests were being sold; (2) the sale included unitized facilities actually already co-owned by the offerees; and (3) the allocated price could not be confirmed as the actual sales price. The case was remanded to determine whether the tender was in good faith given these problems. Whether or not this result is correct is not as significant as is the understanding of the substantial problems created by the rights of first refusal in sales involving multiple properties or facilities. Carving specific interests and facilities out of a bulk sale with allocated pricing will often involve judgments which create shades of gray in a tender and acceptance or refusal process that was envisioned as either black or white. Resolving such issues in the limited time frame available to effect such a sale presents difficulties.

IX. The Life of the JOA.

An iteration of Article XIII of the form JOA provides that the agreement remains in existence so long as any of the affected leases are alive: “This agreement shall remain in full force and effect . . . so long as any of the Oil and Gas Leases subject to this agreement remain or are continued in force as to any part of the Contract Area, whether by production, extension, renewal or otherwise.”⁶² It goes on to provide that “[t]he termination of this agreement shall not relieve any party hereto from any expense, liability or other obligation or any remedy therefor which has accrued or attached to the date of such termination.”⁶³ This

⁶¹ 463 F.3d 388 (5th Cir. 2006).

⁶² A.A.P.L. Form 510 (1989) Model Form Operating Agreement, Art. VIII.

⁶³ *Id.*

would mean that, just because the agreement expires does not mean that the obligations that “attached” while the agreement was alive are extinguished. This effectively tracks the law of mineral leases: when mineral leases expire, some obligations owed under them remain alive – the restoration obligation in particular. In this regard, the lessee loses rights but not all obligations.

The case of *Isadore v. Probe Offshore, L.L.C.*⁶⁴ involved a welder who was injured during restoration operations on a mineral lease operated by Probe. The welder sued Probe in tort. The court concluded that Probe was immune from tort liability under the Worker’s Compensation two-contract statutory employer theory. The court reasoned that Probe was obligated to conduct restoration activities as both an implied obligation of the mineral lease and under the JOA. The plaintiff contended that Probe could not avail itself of the two-contract theory since the mineral lease and the JOA had expired by the time the restoration activities were being conducted and the accident occurred. The court noted that “[a] lease’s expiration triggers certain restoration duties for the mineral lessee and the field’s operator under the mineral lease and JOAs” and that “[t]he lessor has ten years to enforce these obligations in court.”⁶⁵ The court concluded: “We find that the obligations under the lease and the JOAs still existed when Probe contracted with SWAP for site restoration work. This is true even though production had ceased under the . . . Mineral Lease at the time that Mr. Isadore was injured.”⁶⁶ Thus, there is authority for the continued existence of obligations under the JOA after it and the mineral leases covered by it expire.

This case was followed by the Louisiana Supreme Court case of *Corbello v. Iowa Production*,⁶⁷ in which the court stated that the restoration obligation arises upon the expiration of the mineral lease:

The duty to repair the leased premises does not arise until the lease expires, at which time the lessee must return the property in good order. The 1929 mineral lease is still in effect and is not the subject of this litigation. Thus, even the present leaseholder does not yet have a duty to repair under the terms of the lease.⁶⁸

⁶⁴ 01-777 (La. App. 3 Cir. 12/19/01), 815 So. 2d. 876.

⁶⁵ *Id.* at p. 15, 815 So. 2d at 888.

⁶⁶ *Id.* at p. 16, 815 So. 2d at 888.

⁶⁷ 02-0826 (La. 2/25/04), 850 So. 2d 686.

⁶⁸ *Id.* at p. 23, 850 So. 2d at 703; *see also Kling Realty Co. v. Texaco, Inc.*, Civ. A. No. 06-1492, U.S. Dist. LEXIS 94322 at *32-33 (W.D. La. Dec. 18, 2007) (“While a usual contract claim begins to run from the date that the contract was allegedly breached, the Louisiana Supreme Court held in *Corbello v. Iowa Production*, 850 So. 2d 686, 705 (La. 2003), that a breach of contract claim under an oil and gas production lease arises upon termination of the lease.”).

However, the subsequent Third Circuit case of *Doré Energy Corporation v. Carter-Langham, Inc.*⁶⁹ allowed the landowner to proceed with certain lease remediation claims prior to the expiration of the mineral lease, thus raising a question about what obligations arise when. Although its meaning is not entirely clear, the court seemed to conclude that certain claims are triggered by the cessation of operations in particular areas of the leased premises, rather than the expiration of the lease. Therefore, under *Doré*, the ten-year lease restoration period might sometimes be a one-year period (due to the one-year liberative prescription period for tort claims), and it might begin to run prior to the expiration of the lease.⁷⁰ In any event, for so long as the mineral lease obligations continue to exist, the JOA rights and obligations should still apply with respect to these obligations.

X. Conclusion

The jurisprudence involving joint oil and gas operations does not provide a model of consistency. It would seem that agreement affecting joint operations under mineral leases should be written, and should not be construed as joint ventures under specific statutory law (*i.e.*, La. R.S. 31:215), but this is not always the case. Because under Louisiana law there is nothing prohibiting contracting parties from reducing the standard of conduct to gross negligence, the courts should honor a stipulation that “in no event” should the operator be responsible for losses to non-operators, but that is not always how the law is applied. That being the case, would-be operators should seriously consider such potential liability issues before agreeing to act as operator.

⁶⁹ 04-1373 (La. App. 3 Cir. 5/4/05), 901 So. 2d 1238.

⁷⁰ The Third Circuit issued a subsequent opinion entitled *Hardee v. Atlantic Richfield*, which seemed to confuse the issue by suggesting that, under the facts presented, the prematurity of the claims should be determined later by the jury, but without ruling on the correctness of the *Doré* opinion. See 05-1207 (La. App. 3 Cir. 4/5/06), 926 So. 2d 736.