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TRANSACTIONAL EVOLUTION OF OPERATING AGREEMENTS IN THE OIL AND GAS INDUSTRY

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I. INTRODUCTION

Mineral development requires coordination whenever more than one party possesses development rights in a targeted property. To provide the necessary coordination the transactional response has been the joint operating agreement ("JOA"). When more than one party has the right to drill on a tract of land, there must be some mechanism to avoid wasteful competition for scarce resources, such as a drilling permit.\(^2\) Even when the issuance of multiple drilling permits is permissible,\(^3\) it will often be more efficient to have all interested parties participate in the first well before deciding to proceed with a second well. The JOA contractually coordinates development of lands encompassed by the "contract area" the parties designate. When coordination is required for a larger block of properties covering an entire oil and gas reservoir, the developing parties will enter into a "unit" operating agreement ("UOA").


\(^2\)Other scarce resources could include the surface area needed to conduct operations, the availability of drilling rigs, and the money interested parties are willing to invest in a venture.

\(^3\)For example, if the target area is an 80-acre tract of land it may be possible to obtain simultaneous drilling permits to test the same formation on opposite 40-acre portions of the 80-acre tract. However, this offers no solution when each party's geology indicates the optimum drilling location is on the same 40-acre portion.
Whether the operation is governed by a JOA or UOA, the agreements are designed to accomplish the same goals: (1) define the initial operations in which all parties having development rights will participate; (2) provide a mechanism for conducting subsequent operations to develop and maintain production from the contract area; (3) provide for the day-to-day management of the properties by a designated “operator”; (4) define the rights and duties between the “operator” and the “nonoperators”; and (5) define the rights and duties between the parties to the agreement and those who are not parties to the agreement.5

This article examines the legal contexts in which joint operations take place by focusing on the property and contract dimensions of the joint development relationship. These legal contexts

4For JOA operations this is typically a mandatory obligation to participate in the “Initial Well.” For example, the A.A.P.L. Form 610-1989 Model Form Operating Agreement states, at Article VI., § A., Page 5, Line 67: “The drilling of the Initial Well and the participation therein by all parties is obligatory . . . .” If a party is not willing to participate in the initial well, they will either grant a farmout to a party that is or, if they are a cotenant or pooled interest, participate on a passive carried basis.

For UOA operations frequently there will be parties with development rights who choose not to participate in the risks associated with the unit plan of development. For example, in Trees Oil Company v. State Corporation Commission, 105 P.3d 1269 (Kan. 2005), the owner of a producing lease objected to having to give up current income from their individual well in exchange for the prospect of greater unit income from a proposed waterflood operation. If the objecting parties hold a large interest the unitization may not be feasible. In Trees the parties proposing the unit had sufficient interests to force the non-consenting parties into the proposed unit operation. Kan. Stat. Ann. § 55-1305(1) (2005) (requiring a minimum of 63% approval by working interest owners and royalty owners when the project is designed to extend production from a field that has reached its economic limit).

5Another commentator places the functional tasks assigned to the JOA into “three separate stages of prospect development,” which include:

1. The initial testing of the Contract Area (the “Exploration phase”);

2. The further development of the Contract Area, if the initial exploration is successful (the “Exploitation phase”); and

3. Operation of the producing properties through the depletion of the reserves (the “Production and Abandonment” phase).

Thomas P. Schroedter & Lewis G. Mosburg, Jr., An Introduction to the AAPL Model Form Operating Agreement, INSTITUTE ON THE OIL AND GAS JOINT OPERATING AGREEMENT at 1-1 to 1-2, (Rocky Mountain Mineral Law Foundation, May 1990).
will be considered in conjunction with the various “standard” operating agreement forms that have evolved through the years. The foundational legal context for joint operations is the “property” dimension which defines each party’s oil and gas ownership rights and obligations.

II. THE PROPERTY DIMENSION OF OIL AND GAS OWNERSHIP

Before considering the impact of contract law on a JOA, the parties’ base ownership rights must be defined in the things that are the object of the JOA. This means a property law analysis must be applied before the contract law analysis. Once the rights and obligations arising from property law are identified, it will be easier to identify how such base property rights have been, or need to be, affirmed, negated, or redefined by the JOA. The first inquiry will be whether the parties to the JOA are common law cotenants.

A. Common Law Cotenancy

Occasionally some or all of the parties to a JOA will be common law cotenants. This occurs when the parties lease from owners of undivided mineral interests in the same tract of land. In those cases the relational status of the lessors will transfer to their lessees. It also occurs when a lessee assigns an undivided interest in a lease they own and creates the relational status in the first instance.

Frequently the parties will not be common law cotenants. For example, each party may own interests in different leases, covering differing tracts of land, which comprise the contract area or pooled area. This will almost always be the case with unit operations and other situations where the “contract area” includes a large block of acreage instead of merely a drill site or offsetting drill sites.

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6 OWE L. ANDERSON ET AL., HEMINGWAY OIL AND GAS LAW AND TAXATION 167-68 (4th ed. 2004) (“Each co-tenant has the right to execute a lease upon his or her interest. Thereupon the lessee becomes a co-tenant with the other undivided interest owners in the minerals and enjoys the same right to develop and produce that existed in its lessor.”). Professors Kramer and Martin describe the lessee relationship as follows: “When land or minerals are concurrently owned, each concurrent owner may execute leases to different lessees, thereby giving rise to a concurrent ownership of the leasehold.” 2 PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS OIL AND GAS LAW 579 (2006).

7 The relational status can also be contingent, such as when a farmee has the ability to “earn” an assignment of an undivided leasehold interest in non-drill site acreage under a farmout. As to drill site acreage the contingent interest may flow from the farmor’s “back-in” rights, including the right to convert an overriding royalty to an undivided working interest. See John S. Lowe, Analyzing Oil and Gas Farmout Agreements, 41 SOUTHWESTERN L. J. 759, 838-39 (1987).
Often there will be a mix of relationships. Parties to a JOA or UOA may be common law cotenants as to some of the lands within the unit, pooled, or contract areas, but as to other lands they will not have a cotenant relationship. Does this mean the rights of the parties to the JOA or UOA will vary depending upon the parties' property-based relationships? More precisely, is there a difference between lessees who hold their leases as common law cotenants as opposed to lessees who lack a cotenant relationship? If the answer to this question is anything but an unequivocal “no,” the parties’ contractual agreements should seek to equalize the status of all parties to the JOA or UOA, regardless of their common law cotenant status.\(^8\)

There are at least three important areas where common law cotenant status can impact the rights of the parties.\(^9\) First, cotenants enjoy a loosely defined “fiduciary” relationship under some circumstances. Second, cotenants have common law accounting rights that may run counter to the business goals of the parties to a JOA or UOA. Third, cotenants have a right to end the cotenancy relationship through partition.

1. **Fiduciary Obligations?**

   Although many cases can be found which make the broad statement that cotenants owe fiduciary obligations to one another,\(^10\) a fiduciary relationship has in fact been found to exist only in very limited circumstances. These circumstances include when one cotenant purchases the entire property at foreclosure\(^11\) or one cotenant receives funds to which the other cotenants are entitled to

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\(^8\)The A.A.P.L. Form 610 – 1989 Model Form Operating Agreement seeks to do this in the “ownership clause” by stating: “[I]n the event two or more parties contribute to this agreement jointly owned Leases, the parties’ undivided interests in said Leaseholds shall be deemed separate leasehold interests for the purposes of this agreement.” 89 Form, Art. III, § B, at 2, lines 30-31 (emphasis added). Similar language is not found in the 56, 77, or 82 A.A.P.L. Form 610 Model Form Operating Agreements. David E. Pierce, *The Law of Disproportionate Gas Sales*, 26 TULSA L. J. 135, 144-46, 149 (1990).

\(^9\)Which means the answer to the foregoing question cannot be an unequivocal “no.”

\(^10\)Many cases hold that a cotenant, under certain circumstances, owes “fiduciary” obligations to the other cotenants in a property. William B. Stoebuck & Dale A. Whitman, *The Law of Property* 210 (3d ed. 2000) (“When cotenants acquire their concurrent interests at the same time . . . they are held to be subject to fiduciary duties with respect to their dealings with the common property.”).

\(^11\)Id. (“A major consequence of the existence of a fiduciary relationship among a group of cotenants is that an individual cotenant who acquires an outstanding superior title to the common property must hold it for the benefit of the other cotenants, provided they offer to contribute their pro rata shares of the cost of acquisition within a reasonable time.”).
a proportionate share.\textsuperscript{12} The major problem in this area is determining when other cotenant activities might be subject to fiduciary principles.

Professor Kuntz begins his analysis of the issue with the proposition that a mere cotenancy relationship, absent special circumstances, is not a fiduciary relationship.\textsuperscript{13} \textit{Dicta} in many cases suggest the cotenant relationship is fiduciary.\textsuperscript{14} However, closer analysis reveals that courts do not evaluate cotenancy issues applying general fiduciary principles.\textsuperscript{15} The broader \textit{dicta} nevertheless creates uncertainty regarding when fiduciary concepts might be successfully applied to a situation.

2. Special Accounting Principles?

If the parties are common law cotenants, a majority of jurisdictions allow one cotenant to develop the oil and gas even over the objection of other cotenants.\textsuperscript{16} The non-developing cotenants are carried in the development, generally on a well-by-well basis, with the developing cotenant obligated to account for any net revenue realized from their efforts to obtain production from a well.\textsuperscript{17} The right to payment arises once revenue from a well exceeds the reasonable development

\textsuperscript{12}For example, Professor Kuntz has noted: "In the matter of accounting to a cotenant for his share of production, it has been held that a fiduciary relationship does exist with the result that the statute of limitations will not run on the claim for an accounting until the relationship is repudiated." \textit{Id.} at 144-45.

\textsuperscript{13}"Unless there are special circumstances demonstrating a relationship of trust and confidence between the particular parties, the relationship between cotenants is not a fiduciary relationship, nor is the relationship one of principal and agent." \textit{Id.} at 144-45.

\textsuperscript{14}In \textit{Delk v. Markel American Ins. Co.}, 81 P.3d 629, 643 (Okla. 2003), the court states: "Tenants in common each stand in a relation of mutual trust and confidence to each other." This suggests the tenancy in common relationship alone creates a fiduciary relationship.

\textsuperscript{15}For example, in \textit{Delk} the court follows its statement of general fiduciary concepts with the following: "Where one cotenant comes into possession of funds belonging to other cotenants, she becomes a trustee of such funds and stands in a fiduciary relationship to the other cotenants." \textit{Delk}, 81 P.3d at 643. Arguably this unique factual context limits the scope of the broader statement that tenants in common have a "relation of mutual trust and confidence" in all situations.

\textsuperscript{16}\textit{Owen L. Anderson et al., Hemingway Oil and Gas Law and Taxation} 167 (4\textsuperscript{th} ed. 2004) ("A majority of jurisdictions view production by a co-tenant as enjoyment of the estate, rather than waste.").

\textsuperscript{17}\textit{Id.} at 169.
and operation costs associated with the well.\textsuperscript{18} Normally this "timing" issue for the distribution of net revenue does not create a problem.

When there are disproportionate takes from a gas well resulting in gas imbalances between the owners in the well, disputes can arise over how the parties should be brought back into balance.\textsuperscript{19} Gas balancing may be a product of agreement, statute, or the application of judicial principles when the parties have not addressed the issue.\textsuperscript{20} The cotenancy relationship offers a property-based argument that each cotenant is entitled to their share of net production revenue currently as opposed to some future balancing upon well depletion or through future disproportionate takes.\textsuperscript{21} The same argument can be made by the producing cotenant that all other cotenants must currently accept their share of the net revenue as opposed to asserting a right to some sort of delayed balancing remedy. This approach differs from the various "balancing" remedies courts have employed to address disproportionate takes.\textsuperscript{22}

3. Partition

One of the basic rights of all cotenants is the right to end the cotenancy through partition.\textsuperscript{23} Although in some states the right may be limited to prevent "fraud or oppression," the right is otherwise unrestrained.\textsuperscript{24} However, a cotenant can voluntarily limit their right to partition by

\textsuperscript{18} \textit{Id.} at 169-70 ("Each non-joining co-tenant has the right to receive his or her proportionate share of the products produced, but must bear the reasonable costs of development, production, and marketing. The producing co-tenant, however, has the right of recoupment, and may retain all of the production until he or she has recouped costs.").


\textsuperscript{20} \textit{Id.} at 136-37. The role of industry custom and usage to address gas balancing issues is critically analyzed in David E. Pierce, \textit{Defining the Role of Industry Custom and Usage in Oil & Gas Litigation}, 57 SMU L. Rev. 387, 423-35 (2004).


\textsuperscript{23} EUGENE KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS 186 (1987).

\textsuperscript{24} \textit{Id.} at 187 ("The purpose of partition is to terminate the co-ownership so that each owner can enjoy his interest without hindrance from the other . . . ").
contract. JOAs and UOAs typically contain express language restricting the right to partition.

B. Rule of Capture, Ownership, and Correlative Rights

Rights in oil and gas are defined first by identifying the surface boundaries which delineate the subsurface area in which the owner can claim an interest in the oil and gas resource. Regardless of the ownership theory applied, the "owner" in a tract of land has the right to enter the land to explore for, extract, and thereby "capture" the resource. To protect the resource while in the reservoir, each owner possesses certain "correlative rights" to prevent other owners overlying

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25E.g., Dimock v. Kadane, 100 S.W.3d 608 (Tex. Ct. App. 2003), pet. denied, (cotenants in oil and gas leases, by entering into a joint operating agreement, impliedly agreed not to partition their interests while the agreement was in effect).

26The 1989 Model Form Operating Agreement provides:

E. Waiver of Rights to Partition:

If permitted by the laws of the state or states in which the property covered hereby is located, each party hereto owning an undivided interest in the Contract Area waives any and all rights it may have to partition and have set aside to it in severalty its undivided interest therein.

89 Form, Art. VIII, § E, at 15, lines 28-31. The American Petroleum Institute's Model Form of Unit Operating Agreement, Third Edition, January 1970, incorporates the API's Model Form of Unit Agreement which provides, in Article 13:

13.2 Waiver of Rights to Partition. Each party hereto agrees that, during the existence of this agreement, it will not resort to any action to partition the Unitized Formation or the Unit Equipment, and to that extent waives the benefits of all laws authorizing such partition.

API Model Form of Unit Agreement, Art. 13, § 13.2, at 16. The API Model Form of Unit Agreement and the API Model Form of Unit Operating Agreement can be found in JOHN S. LOWE ET AL., FORMS MANUAL TO ACCOMPANY CASES AND MATERIALS ON OIL AND GAS LAW 6-32 (Unit Agreement), 6-64 (Unit Operating Agreement) (4th ed. 2004).

271 DAVID E. PIERCE, KANSAS OIL AND GAS HANDBOOK 3-2 (1986) ("Oil and gas property rights are initially determined according to surface boundaries. The owner of land owns the surface and any minerals beneath the surface.").

28Id. at 3-4 ("Regardless of the ownership theory in effect, the rule of capture prevails as the guiding principle for determining ultimate ownership in oil and gas.").
the reservoir from *improperly* interfering with each party's opportunity to capture the resource.\(^{29}\)

In many instances it will be impractical and inefficient for those having rights in a common reservoir of oil or gas to independently exercise their capture rights. This creates the incentive to combine their rights to develop a defined area potentially overlying a reservoir of oil and gas. Often some form of coordinated development is dictated by conservation regulation.

### C. Conservation Regulation

In order to "prevent waste" and "protect correlative rights" laws have been enacted to establish ground rules for the free exercise of the rule of capture. All producing states have some sort of location restrictions on oil and gas wells.\(^{30}\) Restrictions come in two forms: (1) wells must be located a minimum distance from property lines; and (2) the number of wells on a tract of land is limited by minimum distances between wells and similar density-regulating formulas. The result is a minimum block of acreage is required to obtain a drilling permit.\(^{31}\) Assembling the minimum block of acreage often requires bringing separately-owned tracts of land together for development. This can be done through voluntary agreement and in most states through various forms of compulsory pooling.\(^{32}\) When multiple tracts of land are brought together, the working interest owners typically enter into some form of JOA to coordinate development of the pooled area. When an area is unitized, all interest owners will enter into a Unit Agreement; the working interest owners will also enter into a Unit Operating Agreement.\(^{33}\)

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\(^{29}\) *Id.* "Proper" interference occurs when a neighboring landowner exercises their right of capture and causes oil and gas to migrate to their well from surrounding properties. "Improper" interference occurs when a neighboring landowner either willfully or negligently injures the reservoir so that other owners in the common reservoir are unable to recover the resource by exercising their capture rights.


\(^{31}\) As Professor Sullivan notes in his treatise: "Under a system of minimum acreage spacing or specified drilling units the small tract that cannot meet the requirements of the spacing rule is denied a well." ROBERT E. SULLIVAN, HANDBOOK OF OIL AND GAS LAW 308 (1955).

\(^{32}\) *Id.* ("In order to prevent confiscation of the recoverable oil beneath such tracts and to give each owner the opportunity to produce his fair share thereof, spacing statutes and regulations provide for pooling."). *See* Oscar E. Swan, The Comparisons, Contrasts, and Effects of Compulsory Pooling Statutes, 28 Rocky Mt. Min. L. Inst. 911 (1982).

\(^{33}\) John S. Lowe et al., Forms Manual to Accompany Cases and Materials on Oil and Gas Law 6-32 (Unit Agreement), 6-64 (Unit Operating Agreement) (4th ed. 2004).
III. THE CONTRACTUAL DIMENSION OF OIL AND GAS OWNERSHIP

A. Freedom of Contract

The exercise of free will to order one’s affairs through enforceable agreements is a basic right. This right is typically expressed as “freedom of contract.”\(^{34}\) The court in \textit{St. Louis Southwestern Ry. Co. of Texas v. Griffin}\(^{35}\) states: “The citizen has the liberty of contract as a natural right which is beyond the power of the government to take from him.”\(^{36}\) Although this statement is subject to some obvious qualifications,\(^{37}\) it accurately describes the basic premise that contracting parties are generally at liberty to define the “private law” that will govern their relationships.

Therefore, the parties to a JOA or UOA have the capacity to fully define the contours of their relationship and the specific rights and duties that will govern their relationship. This is what the parties aspire to as they prepare their agreements. Professor Kuntz observes in his treatise: “The JOA is a carefully structured instrument designed to govern a great variety of operations over a long period of time.”\(^{38}\) Any attempt to address a “great variety of operations” will be difficult; the level

\(^{34}\)As I have noted previously:

“Freedom of contract” and “freedom of conveyance” describe the basic policy of a free society which allows the parties to an instrument to impose, and in turn, consent to whatever terms they may objectively construct for themselves. The exceptions to this freedom concern situations where free will has not in fact been allowed to operate. These include instances of misrepresentation, mistake, duress, undue influence, unconscionability, and lack of capacity. The other exceptions concern the exercise of free will which conflicts with a recognized public policy.


\(^{35}\)171 S.W. 703 (Tex. 1914).

\(^{36}\)\textit{Id.} at 704.

\(^{37}\)The same governmental source of public policy fostering freedom of contract is also the source of other public policies that can override or limit freedom of contract. For example, the legislature may limit a contracting party’s ability to be indemnified against its own negligence. \textit{E.g.}, Piña v. Gruy Petroleum Mgmt. Co., 136 P.3d 1029 (N.M. Ct. App. 2006) (invalidating choice-of-law provision that would require drilling contractor to indemnify oil company). \textit{See generally} E. Allan Farnsworth, \textit{Contracts} 313 (4th ed. 2004) (Chapter 5 “Unenforceability on Grounds of Public Policy”).

of difficulty increases exponentially when the issues must be addressed “over a long period of time.” This is perhaps what prompted Professor Sullivan to observe in his treatise: “An operating agreement is a complex instrument.”39 However, lest we think the task impossible, Professor Martin reminds us:

It [the JOA] is simply a business deal, a contract to get a hole into the ground that may or may not be productive of oil or natural gas. It is a way of sharing risks or satisfying state regulatory limits on how many wells can be drilled in a given area.40

The task of creating a JOA that can “govern a great variety of operations over a long period of time” has been made much simpler by the efforts of lawyers and landmen culminating in the various “A.A.P.L. Form 610” versions of “Model Form Operating Agreement.” The transactional evolution of the JOA is itself an important part of the industry’s history.

B. The Evolution of Contracts to Govern Joint Operations

1. 1956 to the Present

a. Onshore Operations

There are currently four versions of the AAPL41 “Model Form Operating Agreement” that have served as the starting point for coordinating development of oil and gas leases. The first is dated 1956 with the earliest versions titled the “Ross-Martin” Form 610 “Model Form Operating Agreement-1956.”42 In 1967 the AAPL made minor revisions to the form, including deletion of the name “Ross-Martin,” so after that date the form was titled: “A.A.P.L. Form 610.”43 The first major revision to the 1956 form occurred in 1977 with introduction of the “A.A.P.L. Form 610–1977


41This was the abbreviation for the “American Association of Petroleum Landmen” until 1990 when the organization’s name was officially changed to the “American Association of Professional Landmen.” The change was made because many of its members are involved in providing services to the hardrock mining industry.

42The Ross-Martin Company of Tulsa, Oklahoma printed and marketed the agreement as the Ross-Martin, Kraftbilt Form 610. J.O. Young, Oil and Gas Operating Agreements: Producers 88 Operating Agreements, Selected Problems and Suggested Solutions, 20 ROCKY MTN. MIN. L. INST. 197, 200-01 (1975).

43Id. The 1967 revisions are listed at page 200.
Model Form Operating Agreement.”44 The next revision occurred in 1982 with the “A.A.P.L. Form 610–1982 Model Form Operating Agreement.”45 The last revision was released in 1989 as the “A.A.P.L. Form 610-1989 Model Form Operating Agreement.”46

Through the years there have been competing operating agreement forms but none have achieved the widespread use of the various AAPL forms. For example, the Rocky Mountain Oil and Gas Association developed the “Rocky Mountain Joint Operating Agreement Form 3” which was introduced in 1959.47

Operations in Canada have been dominated by the Canadian Association of Petroleum Landmen’s (“CAPL”) model forms of Operating Procedure which have been available in some form since 1969.48 The most recent version of the Canadian form is the 1990 CAPL Operating Procedure which is currently in the process of being revised.49

b. Offshore Operations

Various offshore forms have been developed through the years and have become similarly

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46The 1989 Form is the focus of the Rocky Mountain Mineral Law Foundation’s Special Institute on The Oil and Gas Joint Operating Agreement, which is Volume 1990, Number 2 of the Foundation’s Mineral Law Series. See generally Thomas P. Schroedter & Lewis G. Mosburg, Jr., An Introduction to the AAPL Model Form Operating Agreement, INSTITUTE ON THE OIL AND GAS JOINT OPERATING AGREEMENT at 1-1, (Rocky Mountain Mineral Law Foundation, May 1990).

47J.O. Young, Oil and Gas Operating Agreements: Producers 88 Operating Agreements, Selected Problems and Suggested Solutions, 20 ROCKY MTN. MIN. L. INST. 197, 202 (1975).


49The third draft of the proposed 2007 CAPL Operating Procedure was distributed to the industry for comment in November of 2006. http://www.capl.ca/member/
standardized with the increasing need to share risk with multiple developers. The American Petroleum Institute ("API") published the first model offshore operating agreement form in 1984 which is designated: API Model Form 5U05. This became the model for most offshore operating agreements until the API released Model Form 5U05 Second Edition, July 1996. The AAPL, in 1997, obtained the exclusive rights to the API’s Model Form 5U05 and renamed it the “Model Form of Offshore Operating Agreement, AAPL Model Form 710-1998.” In 2000 the AAPL released the “AAPL Model Form of Offshore Deepwater Operating Agreement” which addresses in greater detail the special issues associated with the use of platforms and facilities. This form is designated AAPL-810 (2000). The current version of the AAPL Model Form 710-2002, and the AAPL-810 (2000), can be obtained from the AAPL’s website.

c. International Operations

Even in the international arena the AAPL forms have influenced the international forms. However, international operating agreements will be influenced by the areas in which the parties must operate. For example, although the AAPL on-shore agreements influenced many early JOAs

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50 Risk-sharing is the dominant reason for entering into operating agreements covering offshore operations. Because the mineral resource is owned by a governmental entity, the prospect of multiple leases in a small area is reduced. Instead, the need to join together to coordinate operations will be driven by the capital needed to explore and develop the field and the ability to use expensive centralized facilities. See generally R. Thomas Jorden, Jr., Deepwater in the Gulf of Mexico: Continuing Work Toward a Model Form Operating Agreement, INSTITUTE ON OIL AND GAS DEVELOPMENT ON THE OUTER CONTINENTAL SHELF at 2-1, (Rocky Mountain Mineral Law Foundation, Oct. 1998).

For a discussion of practices prior to the development of a standardized form to guide negotiations see: Darrel L. Black, Brief Overview of General and Special Provisions in Offshore Operating Agreements, INSTITUTE ON OFFSHORE EXPLORATION, DRILLING AND DEVELOPMENT at 6-1, (Rocky Mountain Mineral Law Foundation, Nov. 1975). In 1975 Mr. Black accurately predicts: “The frontier—the future area of major development of new reserves—is truly underwater.” Id.

51 R. Thomas Jorden, Jr., The AAPL’s Work Toward a New Model Form Shelf Operating Agreement, INSTITUTE ON OIL & GAS DEVELOPMENT ON THE OUTER CONTINENTAL SHELF at 7-1, (Rocky Mountain Mineral Law Foundation, April 2002).

52 These forms can be obtained from the AAPL’s website at http://www.landmand.org/.

53 OIL AND GAS LAW FOR A NEW CENTURY: PRECEDENT AS PROLOGUE 98 (Patrick H. Martin ed., Matthew Bender 1997) (Chapter Four, The Joint Operating Agreement—An Unsettled Relationship?, by Patrick H. Martin). Professor Martin observes: “The American joint operating agreement has even migrated offshore to foreign climes where it has been adapted to local operating conditions and circumstances.” Id.
affecting the United Kingdom Continental Shelf, in 1976 the U.K. Offshore Operators Association drafted a model form JOA for the area. Subsequently the state-owned British National Oil Corporation created the “BNOC Proforma Joint Operating Agreement for _____ Round Licenses.”

The most active group seeking to provide model forms in the international arena is the Association of International Petroleum Negotiators (“AIPN”). The AIPN “Model Form International Operating Agreement” has been described as “the most commonly used form of operating agreement outside of North America and Europe.” The first version of the Model Form International Operating Agreement was made available in 1990, followed by revisions in 1995 and 2002. A survey of AIPN’s members revealed the 1995 version had “strong global acceptance . . . with some hesitance to the form’s use in French speaking Africa and Australia.” The AIPN also publishes a model form of Unitization and Unit Operating Agreement.

When considering various approaches to an international operating agreement, the underlying motivation to share development risks will be a unifying force. As Andy Derman observed in 1991:

The oil and gas industry has historically used groups or consortia as vehicles to conduct exploration, development and production activities. By forming groups, companies have been able to limit their financial exposure on the drilling of any single well or prospect. Companies have felt more secure diversifying and playing in a wide number of plays. It is common to hear companies talk in terms of drilling


55The AIPN website is at: http://www.aipn.org/.


58Jacqueline Lang Weaver & David F. Asmus, Unitizing Oil and Gas Fields Around the World: A Comparative Analysis of National Laws and Private Contracts, 28 HOUS. J. INT’L L. 3, 62 (2006). The Weaver & Asmus article is an excellent study of international unitization and the agreements used to accomplish unitization; it is a “must read” for anyone dealing with unitization in an international setting.
sufficient wells to get the statistics working in their favor. This is even more important in the international setting because of the enormous costs involved and the inherent political risk.  

2. Before 1956

Professor Robert Sullivan, in his 1955 oil and gas treatise, describes the contents of the commonly-encountered operating agreements which suggests they contained many of the same provisions ultimately incorporated into the AAPL’s Ross-Martin form. Marvin Wigley observes that when industry representatives came together in 1952 to try and develop a standard form of operating agreement, 17 different company operating agreements were considered. However, about 80% of these forms contained similar provisions. J.O. Young, writing for the Foundation’s 20th Annual Institute, describes how the industry moved from multiple individual company forms to development of the 1956 Ross-Martin form. Young describes the process as follows:

In 1952 a group of individuals, mostly oil company landmen, from Tulsa and Oklahoma City believed that there was enough similarity in the various forms used by different companies that it was practical to attempt to prepare a standard form. Invitations to a meeting in Tulsa were sent to 28 of the larger oil companies. In response, representatives were sent to the Tulsa meeting by all but one company which apparently abstained because of a belief that such a joint effort might have adverse antitrust implications. A steering committee of seven members was appointed which met once or twice a month for approximately two years. Seventeen company forms were used as a basic working model and paragraphs were assigned to different company representatives for drafting after consultation with the appropriate departments of their respective companies.

After approximately two years of drafting, a legal committee was formed consisting of members of the law departments of several companies. After nearly two more years, the agreement was considered to be sufficiently complete and polished that it could be submitted to the industry.

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62 J.O. Young, Oil and Gas Operating Agreements: Producers 88 Operating Agreements, Selected Problems and Suggested Solutions, 20 ROCKY MTN. MIN. L. INST. 197,00-01 (1975).
In 1956, John Folks . . . presented the form to the Annual Meeting of the American Association of Petroleum Landmen, held in Denver, Colorado. At about the same time, the Ross-Martin Company of Tulsa, Oklahoma sent out an operating agreement package, consisting of the 610 Form and the COPAS or PASO Accounting Procedure then in use, to some seven thousand individuals and companies who had been accounting procedure customers of the company. The agreement was endorsed by the A.A.P.L. at the 1956 meeting and it rapidly gained stature as more people became familiar with it.63

Prior to 1956 the demand for an industry-wide approach to joint operations was apparently limited because most development involved lower-risk relatively shallow oil wells. As developers drilled deeper, and as gas, with its wider spacing patterns, became a targeted resource, the need for joint operations increased.64

3. Field-Wide Development

It is interesting that model forms of unit operating agreements became available before the AAPL model forms.65 These initial forms were the work of the Rocky Mountain Oil and Gas Association’s “Public Lands Committee” and were titled “Form 1 (Undivided Interest)” and “Form 2 (Divided Interest).”66 Form 1 became available in May 1954 and Form 2 in January 1955.67 In each case the UOA was designed to complement the regulatory unit agreement prescribed by the Secretary of Interior pursuant to 1946 amendments to the Mineral Leasing Act of 1920.68 The “Divided Interest” form is designed to accommodate the creation of “participating areas” within the

63Id. at 199-200.

64Thomas P. Schroedter & Lewis G. Mosburg, Jr., An Introduction to the AAPL Model Form Operating Agreement, INSTITUTE ON THE OIL AND GAS JOINT OPERATING AGREEMENT at 1-2 to 1-3, (Rocky Mountain Mineral Law Foundation, May 1990).


66Id.

67Id. This is how the organization’s form operating agreement acquired its “Form 3” designation. All of these forms are now owned by the Rocky Mountain Mineral Law Foundation and marketed as: “Form 1–Rocky Mountain Unit Operating Agreement–Oil and Gas (Undivided Interest),” “Form 2–Rocky Mountain Unit Operating Agreement–Oil and Gas (Divided Interest),” and “Form 3–Rocky Mountain Joint Operating Agreement–Oil and Gas.” They can be purchased through the Foundation’s website: http://www.rmmlf.org/.

68Id. at 158-59.
unitized area. Owners of interests within a participating area will “participate” in the costs and production from the participating area. Areas outside the participating area, but within the unit boundaries, may become eligible for participation at some later date as more information becomes available regarding productivity of unit acreage. 69

Onshore unitization projects that do not involve federal land are most often patterned off of the American Petroleum Institute’s Unit Agreement and Unit Operating Agreement forms. 70 I use the phrase “patterned off of” because I have seen dozens of unit agreements and unit operating agreements containing language almost verbatim from the API forms, but I have never seen an API form in use. 71

4. Promotion

What I describe as the “promotion” operating agreement is more about promotion than operation. The operator will typically be the promoter and the nonoperators will typically be passive investors. Many times the primary purpose of the promotion operating agreement is to create another profit center for the promoter even if the wells are marginal producers and result in a negative cash flow to the investors. Although the promotion operating agreement may borrow terms from an AAPL Model Form Operating Agreement, rarely will an AAPL form be used. Instead the operating agreement will be integrated as part of the investment package with terms that clearly favor the promoter/operator. However, even in the non-promoted situation an AAPL Model Form Operating Agreement can be considered a “security” under the securities laws. 72

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69 Id. See Patrick H. Martin & Bruce M. Kramer, Williams & Meyers Manual of Oil and Gas Terms 287 (10th ed. 1997) (defining “Divided type of unit operating agreement”).

70 The API’s forms can be purchased through its website at: http://www.api.org/.

71 Much of the language I have seen tracks the “Third Edition, January 1970” API Model Form of Unit Agreement and the API Model Form of Unit Operating Agreement. See John S. Lowe, et al., Forms Manual to Accompany Cases and Materials on Oil and Gas Law 6-32 (Unit Agreement) & 6-64 (Unit Operating Agreement) (4th ed. 2004).

72 People v. Pahl, 2006 WL 3040920 (Colo. Ct. App., Aug. 24, 2006) (not released for publication) (criminal proceeding in which jury properly found the joint operating agreement was a “security”).

1–16
IV. INTERSECTION OF PROPERTY AND CONTRACT: RELATIONSHIPS

Through careful counseling and drafting it is possible to create optimum relationships for clients engaged in oil and gas operations. However, it is not possible to make what is in fact a “cat” into a “dog” by merely labeling it a “dog.” If the factual attributes point towards “cat,” we have a “cat,” not a “dog.” This is particularly true when the question is raised by someone not a party to the agreement. For example, in deciding whether the operator is acting as the nonoperators’ “agent,” as opposed to an “independent contractor,” the factual realities of the situation will be evaluated. Courts will examine what they “are” as opposed to what the parties say they are.74

73 The Restatement (Third) of the Law of Agency abandons use of the term “independent contractor” reasoning:

[T]he common term “independent contractor” is equivocal in meaning and confusing in usage because some termed independent contractors are agents while others are nonagent service providers. The antonym of “independent contractor” is also equivocal because one who is not an independent contract may be an employee or a nonagent service provider.

RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. c, at 20 (2006). The question under the Restatement (Third) is whether the operator is acting as an “agent” or a “nonagent service provider.”

74 Of course “saying” you are not an agent will be a fact to be considered in determining whether that is, in fact, the case. In the Restatement (Third) of the Law of Agency these concepts are discussed under § 1.02 which states:

An agency relationship arises only when the elements stated in § 1.01 are present. Whether a relationship is characterized as agency in an agreement between parties or in the context of industry or popular usage is not controlling.

RESTATEMENT (THIRD) OF AGENCY § 1.02 (2006). Comment a. explains:

Whether a relationship is one of agency is a legal conclusion made after assessment of the facts of the relationship and the application of the law of agency to those facts. Although agency is a consensual relationship, how the parties to any given relationship label it is not dispositive. Nor does party characterization or nonlegal usage control where an agent has an agency relationship with a particular person as principal. The parties’ references to functional characteristics may, however, be relevant to determining whether a relationship of agency exists.

Id. at cmt. a.
Like most contract and property litigation, operating agreement disputes often concern interpretation of the agreement. Frequently the interpretive issue will be whether the agreement creates a particular relationship. Once a court concludes a certain relationship exists, it will trigger application of specific rights and obligations to resolve the interpretive issue. Therefore, as a prelude to examining the express JOA or UOA terms, the range of possible relationships applicable to the operating agreement should be considered.

To aid analysis in this area, relationships have been placed into two categories: "deliberate" relationships and "remedial" relationships. Deliberate relationships are those the parties clearly intend to create through the express and implied terms of the JOA or UOA. Remedial relationships are those the parties probably did not consciously intend to create, but they are being used by a litigant, or the courts, to pursue a desired outcome.

A. Deliberate Relationships

The deliberate relationship that parties to a JOA or UOA seek to create is an arm's-length contractual relationship. This is particularly the case when the operator and nonoperators are all sophisticated oil and gas developers. The parties will rely upon the express and implied-in-fact terms of their contract to define their rights and obligations. In most cases the parties intend that the operator function as the nonoperators' independent contractor (nonagent service provider) as opposed to their agent. Each provision of the operating agreement should be carefully evaluated to determine whether something more than an arm's-length relationship is intended, or required.


76Professor Martin observes: "The source of this [JOA] litigation now is not so much the specific language of the forms but the standard applied by the court to the conduct of the parties (especially the operator) under the agreement, or perhaps despite the agreement." OIL AND GAS LAW FOR A NEW CENTURY: PRECEDENT AS PROLOGUE 98, 99 (Patrick H. Martin ed., Matthew Bender 1997) (Chapter Four, The Joint Operating Agreement–An Unsettled Relationship?, by Patrick H. Martin).

77Id. at 102 ("Legal reasoning proceeds by use of categories and analogies, sometimes whether apt or not.").

78See generally, David E. Pierce, Exploring the Jurisprudential Underpinnings of the Implied Covenant to Market, 48 ROCKY MTN. MIN. L. INST. 10-1, 10-4 to 10-6 (2002) (discussing the implied-in-fact analysis for providing an omitted term).
Even under an arm’s-length relationship, to the extent a party has discretion to act, or the capacity to manipulate the other parties’ expected contractual benefits, an implied obligation to act in good faith may be imposed. The Restatement (Second) of Contracts provides: “Every contract imposes upon each party the duty of good faith and fair dealing in its performance and its enforcement.”79 The comment instructs: “Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party . . . ."80 However, like the type of relationship the parties create, the parties are able to control the extent to which an implied obligation of good faith can operate by being more precise about the limits on each party’s rights and obligations. This alerts each party to the express terms that will define and govern their relationship at the formation stage of the transaction.81 If the terms are too harsh, they will either be satisfactorily negotiated or no relationship will be created.

B. Remedial Relationships

If the express and implied terms of a contract fail to provide a party with the rights they desire, they may be able to find those rights by advocating that a remedial relationship exists between the parties. The relationship is “remedial” because it probably wasn’t contemplated until the party talked with their lawyer once a dispute arose under the contract. Remedial relationships can be placed into two categories that depend upon whether the relationship is being asserted by a party to the contract, or a non-party.

79Restatement (Second) of Contracts § 205 (1981).

80Id. at cmt. a. Comment d. provides additional examples of the scope of good faith “performance”:

Subterfuges and evasions violate the obligation of good faith in performance even though the actor believes his conduct to be justified. . . . A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of power to specify terms, and interference with or failure to cooperate in the other party’s performance.

Id. at cmt. d.

81This gives rise to an interesting correlation between the implied covenant of good faith and the use of more explicit language in the agreement to avoid triggering the need for implication. If more explicit language is used to eliminate discretion on the issue, the party being asked to accept the offer may find it unacceptable now that the other party’s unexpressed discretionary outcome has been expressed. Even though the language is accepted, the more explicit statement of the obligation may be subject to a claim it is unconscionable.
1. Asserted by a Party

Remedial relationships asserted by a party to the contract are designed to elevate the underlying arm's-length contractual relationship to a fiduciary relationship. The theories to accomplish this goal are well-known, and include claims the contract created the relationship of: (1) principal and agent; (2) trustee and beneficiary; (3) partners; or (4) joint venturers.

Nonoperators will argue for a principal/agent relationship when the operator is undertaking a task such as marketing nonoperator production. For example, under the 1956, 1977, and 1982 AAPL Model Form Operating Agreements, and to a lesser extent under the 1989 Form, when a nonoperator fails to dispose of their share of the production the operator is given the “right . . . to purchase such [nonoperator] oil and gas or sell it to others . . . .”82 If the operator elects to “sell” the gas, it can be argued the operator is functioning as the nonoperator’s marketing agent.83 Professor Smith recommends that this problem be avoided by electing to purchase the nonoperator’s gas instead of undertaking to market nonoperator gas.84

To have an agency relationship:

[O]ne person (a “principal”) manifests assent to another person (an “agent”) that the agent shall act on the principal’s behalf and subject to the principal’s control, and the agent manifests assent or otherwise consents so to act.85

If we assume the statement “sell it to others” is a sufficient manifestation of assent to act on the nonoperator’s behalf, the next issue is whether the operator is “subject to the [nonoperator’s] principal’s control . . . .”86 I mention this to merely point out that if the classical elements of an agency relationship cannot be readily identified then it is likely the parties did not intend to create an agency relationship. The first five words of the first black-letter rule of agency state: “Agency


83Ernest E. Smith, Gas Marketing by Co-Owners: Problems of Disproportionate Sales, Gas Balancing and Accounting to Royalty Owners 12-1, 12-5, INSTITUTE ON NATURAL GAS MARKETING II (ROCKY MOUNTAIN MINERAL LAW FOUNDATION, April 1988).

84Id. at 12-17. Professor Smith concludes his analysis noting: “Purchase of the nonoperators’ gas [as opposed to selling it for the nonoperator] is the alternative which provides the best legal safeguards for the operator who sells the entire production of a gas well.” Id.

85RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006).

86Id. at cmt. c (“The person represented has a right to control the actions of the agent.”).
is the *fiduciary relationship* . . . 87 That, of course, is what drives the nonoperator to argue for an agency relationship. 88

The trustee/beneficiary relationship will often be argued to exist whenever the operator is holding funds belonging to the nonoperator. The partner or joint venturer relationship will be argued to exist whenever the nonoperator believes the operator’s good faith arm’s-length dealings have nevertheless resulted in an unacceptable situation. 89 The nonoperator wants more protection than they can get from their arm’s-length contractual relationship. The operator’s protection against these types of claims will be the express terms of the operating agreement.

2. **Asserted by a Non-Party**

Remedial relationships asserted by a non-party to the contract are usually designed to impose operator liability on the nonoperators. 90 Many of the theories will be the same, such as principal and agent, partnership, and joint venture. However, the most common theory used by third parties, typically creditors of the operator, is "mining partnership." 91 The remedial nature of the "mining partnership" is perhaps best illustrated by the fact that nobody ever consciously sets out to create a "mining partnership." Instead it is a remedial construct a litigant argues exists and therefore certain rights should be conferred upon the litigant once the mining partnership elements are established. 92

Another category of relationships that are often remedial in nature are those created by statute. These will most often arise when the contract area has been assembled through statutory

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87 RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006) (emphasis added).

88 If it were a third party seeking to establish an agency relationship between the operator and nonoperator, the nonoperator would deny its existence.

89 See Ernest E. Smith, *Duties and Obligations Owed by an Operator to Nonoperators, Investors, and Other Interest Owners*, 32 ROCKY MTN. MIN. L. INST. 12-1 (1986).

90 However, in some cases the third-party may want to impose nonoperator liability on the operator.


92 Ernest E. Smith, *Duties and Obligations Owed by an Operator to Nonoperators, Investors, and Other Interest Owners*, 32 ROCKY MTN. MIN. L. INST. 12-1, 12-6 (1986).
pooling\textsuperscript{93} or unitization.\textsuperscript{94}

V. CONCLUSION

Freedom of contract should operate at its zenith when dealing with JOAs and UOAs. These transactions are typically the product of active negotiation among highly sophisticated industry participants. Operatorship often goes to the party with the largest ownership in the contract area and therefore the party that has the most at stake in the enterprise.

If the parties to a JOA or UOA wish to avoid the ownership and relational issues noted in this article, they should structure and document their transaction with the goal of thwarting the predictable litigation-driven assertions of a fiduciary relationship. If you don’t like what the courts and commentators are trying to do to your relationship, ensure you make it impossible, or at least intellectually difficult, to turn your arm’s-length transaction into a fiduciary relationship. This assumes, of course, the parties are willing to forego more demanding fiduciary standards in favor of a contract-based approach to defining the rights and obligations of each party. This is probably what most parties desire, until they are on the receiving end of another party’s opportunistic behavior that lies just beyond the reach of the express and implied contract terms. Courts should, however, define the rights and obligations of the parties based upon their deliberate actions at the time of contracting instead of their remedial maneuvering at the time of a dispute.

\textsuperscript{93}David E. Pierce, The Law of Disproportionate Gas Sales, 26 TULSA L. J. 135, 149-56 (1990) (discussing pooling and other special purpose statutes).

\textsuperscript{94}E.g., Young v. West Edmond Hunton Lime Unit, 275 P.2d 304, 309 (Okla. 1954).
Transactional Evolution of Operating Agreements

David E. Pierce
Professor of Law
Washburn University

The Important Role of the Joint Operating Agreement

"I know of no other agreement in use in the petroleum industry, or any other industry for that matter, that can be compared to the Operating Agreement from the standpoint of frequency of use and the multitude of complicated situations and eventualities it is required to anticipate in its provisions."

Marvin L. Wigley, RMMLI (1978)
The Essence of the Joint Operating Agreement (JOA)

- A contract to coordinate the actions of two or more owners having development rights in a designated "contract area."

The Essence of the Unit Operating Agreement ("UOA")

- A contract to coordinate the actions of two or more owners having development rights in all or a substantial portion of an oil and gas reservoir.
The Goals of the JOA and UOA

• (1) Define the initial operations in which all parties will participate.
• (2) Provide mechanism for conducting subsequent operations.
• (3) Provide for day-to-day management.
• (4) Define rights and duties of “operator” and “nonoperators.”
• (5) Define rights with third parties.

Phases of Contract Area Development

• (1) Initial testing (**Exploration**).
• (2) Further development (**Exploitation**).
• (3) Operation through depletion (**Production & Abandonment**).
The Legal Contexts of Joint Operations

- Property Dimensions

- Contract Dimensions

The Intersection of Contract and Property

- Continuing liability under the JOA or UOA.


- When a party to a JOA assigns all their interest in the Contract Area to an assignee, the assignor, nevertheless, remains liable for performance of JOA obligations associated with the assigned interest.
The Intersection of Contract and Property

- No "advance novation" clause like clauses commonly found in oil and gas leases.
- "In the event of an assignment [of this oil and gas lease] . . . liability for breach of any obligation issued hereunder shall rest exclusively upon the owner of this Lease . . . who commits such breach."

The Intersection of Contract and Property

- Contract analysis: "a party cannot escape its obligations under a contract merely by assigning the contract to a third party." Seagull Energy
- Landlord/Tenant analysis: privity of contract or privity of estate. In this case the assignor was itself an assignee (no privity of contract, only privity of estate).
The Intersection of Contract and Property

- Covenant Running With the Land analysis: parties intended the obligations to run with the property interest [working interest] being transferred.
- Parties intend that obligations associated with the working interest transfer with the benefits.
- Suretyship analysis? Problem of new obligations created after the assignment.

The “Property” Dimension

- What is the precise legal relationship of the parties to the JOA or UOA?
- Does the JOA or UOA language modify the legal relationship of the parties?
- **Goal:** All parties under the JOA or UOA should have the same legal relationship.
The “Property” Dimension

- Are any of the parties to the JOA or UOA common law cotenants?
- Cotenants in the mineral estate lease to multiple lessees.
- Lessee assigns an undivided interest in their leasehold estate.
- Separately-owned interests are pooled.

The “Property” Dimension

- Why does it matter whether the parties to the JOA or UOA are common law cotenants?
- Fiduciary Obligations.
- Special Accounting Principles.
- Right to Partition.
The "Property" Dimension

- Is there a fiduciary relationship among cotenants?
- Sometimes.
- "Tenants in common each stand in a relation of mutual trust and confidence to each other." *Delk v. Markel American*
- How much is *dicta*, how much is holding?

The "Property" Dimension

- The broad statements have been made in the context of two specific situations.
- (1) Acquiring title at a foreclosure sale of property previously owned by cotenants.
- (2) Holding funds received on behalf of all the cotenants.
The “Property” Dimension

- Professor Kuntz:
  - “Unless there are special circumstances demonstrating a relationship of trust and confidence between the particular parties, the relationship between cotenants is not a fiduciary relationship, nor is the relationship one of principal of agent.”

The “Property” Dimension

- Special Accounting Principles
- Non-developing cotenant entitled to share in net proceeds.
- Disproportionate gas sales and gas imbalances.
- Cotenant entitled to immediate payment of their share of net proceeds?
- Timing issue.
The "Property" Dimension

- **Partition**
  - Basic right of a cotenant is the ability to end the cotenancy through partition.
  - Ability to waive right to partition.
  - Express or implied.
  - JOA & UOA typically contain express language waiving the right of partition.

The "Property" Dimension

- Combining properties often necessary to protect correlative rights and prevent waste.
- Rule of capture, spacing, pooling, unitization.
The "Contract" Dimension

• Freedom of Contract

• "'Freedom of contract' and 'freedom of conveyance' describe the basic policy of a free society which allows the parties to an instrument to impose, and in turn, consent to whatever terms they may objectively construct for themselves."

The "Contract" Dimension

• "The exceptions to this freedom concern situations where free will has not in fact been allowed to operate. These include instances of misrepresentation, mistake, duress, undue influence, unconscionability, and lack of capacity. The other exceptions concern the exercise of free will which conflicts with a recognized public policy."
The "Contract" Dimension

- "[T]he parties to a JOA or UOA have the capacity to fully define the contours of their relationship and the specific rights and duties that will govern their relationship."

The "Contract" Dimension

- **Professor Kuntz:** "The JOA is a carefully structured instrument designed to govern a great variety of operations over a long period of time."
- **Professor Martin:** "[The JOA] is simply a business deal, a contract to get a hole into the ground that may or may not be productive of oil or natural gas."
The "Contract" Dimension

• The drafting process has been greatly aided by various organizations developing model JOA and UOA forms.

Development of the Form Agreements

• 1954 RMOGA Rocky Mountain Unit Operating Agreement Form 1 (Undivided Interest)
• 1955 RMOGA Rocky Mountain Unit Operating Agreement Form 2 (Divided Interest)
• 1956 Ross-Martin Form 610 Model Form Operating Agreement—1956
• 1959 RMOGA Rocky Mountain Joint Operating Agreement Form 3
Development of the Form Agreements

- **1960** API Model Form of Unit Agreement and API Model Form Unit Operating Agreement (3d ed. 1970)
- **1967** A.A.P.L. Form 610 Model Form Operating Agreement—1956
- **1969** CAPL Model Form Operating Procedure
- **1977** A.A.P.L. Form 610 Model Form Operating Agreement—1977

Development of the Form Agreements

- **1982** A.A.P.L. Form 610 Model Form Operating Agreement—1982
- **1984** API Model Form 5UO5 Offshore Operating Agreement
Development of the Form Agreements

• 1990 AIPN Model Form International Operating Agreement

• 1998 Model Form of Offshore Operating Agreement, AAPL Model Form 710-1998 (AAPL acquires rights to API Form 5U05).

• 2000 AAPL Model Form of Offshore Deepwater Operating Agreement, AAPL Model Form 810 (2000).

Development of the Form Agreements

• Creation of the AAPL line of JOAs.

• J.O. Young's historical account.

• The same drafting process has been repeated to create the other model forms.

• The driving forces:
  – In the early days, coordination.
  – Today, share risk.
Development of the Form Agreements

- Promoted agreements and the JOA
- Part of the investment package.
- Generally unsophisticated investors.
- Operation is another profit center.
- JOA can be a "security" under the securities laws. *People v. Pahl*, 2006 WL 3040920 (Colo. Ct. App., Aug. 24, 2006) (criminal proceeding, jury found JOA was a "security").

The JOA and the "Relationship"

- "Through careful counseling and drafting it is possible to create optimum relationships for clients engaged in oil and gas operations."
- Interpretive issues.
- What sort of relationship does the JOA create?
The JOA and the "Relationship"

- Two categories of relationships:
  
  - (1) "Deliberate" Relationships
  
  - (2) "Remedial" Relationships

"Deliberate relationships are those the parties clearly intend to create through the express and implied terms of the JOA or UOA."

"Remedial relationships are those the parties probably did not consciously intend to create, but they are being used by a litigant, or the courts, to pursue a desired outcome."
The JOA and the "Relationship"

- **The Deliberate Relationship:**
  - Arm's-length contractual relationship.
  - Sophisticated members of the industry.
  - Express and implied terms of the contract.
  - Operator as a "nonagent service provider."
  - Good faith in performance and enforcement.
  - Specific standards to limit good faith.

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The JOA and the "Relationship"

- A thought about the implied obligation of good faith.
- Contract-based standard.
- Cannot disclaim, but can control with the use of express contract language.
- When it is spelled-out, other party put on notice and can object at the formation stage. Unconscionability also possible.
The JOA and the "Relationship"

• **The Remedial Relationship:**
  • "The relationship is ‘remedial’ because it probably wasn’t contemplated until the party talked with their lawyer once a dispute arose under the contract."
  • Two types: (1) asserted by a party to the contract; (2) asserted by a non-party.

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The JOA and the "Relationship"

• **Remedial Relationships Asserted by a Party:**
  • (1) Principal and Agent
  • (2) Trustee and Beneficiary
  • (3) Partners
  • (4) Joint Venturers
  • **The goal:** elevate the duty from an arm’s-length standard to a fiduciary standard.
The JOA and the “Relationship”

- Remedial Relationships Asserted by a Non-Party:
  - Similar to those of a Party, but frequently the “mining partnership” will be used.
  - Mining partnerships are found to exist, they are not intentionally created.

The JOA and the “Relationship”

- Other Remedial Relationships:
  - Those created by statute.
  - Pooling, unitization, and special purpose statutes.
Conclusion

- Most of the "bad" things that happen to a party to a JOA or UOA will be self-inflicted.
- These are contracts and the parties are free to fashion them so as to create the rights, obligations, and relationships they desire.
- The presentation during the next two days will assist you in these tasks.
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