

PROPERTY PROVISIONS OF THE JOINT OPERATING AGREEMENT: AN UPDATE FOR THE NEW 2015 FORM JOA*

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I. INTRODUCTION

Since the birth of the oil and gas industry, “joint operations have facilitated the exploration [and development] of tracts whose operating rights have been dispersed among co-owners with undivided interests.”¹ Joint operations have also

enabled the development of pooled and unitized tracts, contributing to efficiency . . . and conservation of a depleting resource. The coordination necessary for all types of joint operations has been achieved primarily through the [joint] operating agreement,^[2] which has become the most

1. Gary B. Conine & Bruce M. Kramer, *Property Provisions of the Joint Operating Agreement*, 3-1 ROCKY MTN. MIN. L. INST. (2007).

2. Several model form joint operating agreements (JOAs) have been developed within the industry to simplify negotiations, standardize terms and provisions, and obtain consistency in legal interpretations. In 1956, the American Association of Petroleum Landmen (which later changed its name to the American Association of Professional Landmen (AAPL)) published the first version of its model form JOA, designated AAPL Form 610 and designed for joint operations on private lands. AM. ASS’N OF PROF’L LANDMEN, A.A.P.L. FORM 610-1956: MODEL FORM OPERATING AGREEMENT (1956) [hereinafter FORM 610-1956]. AAPL Form 610 was modified in 1967, 1977, 1982, and 1989. See Keith Hall, *Joint Operations and the New AAPL Form 610-2015 Model Form Operating Agreement*, 3-6 ROCKY MTN. MIN. L. FOUND. (2016). These forms are referred to in this Article as the “1967 Form JOA,” the “1977 Form JOA,” the “1982 Form JOA,” and the “1989 Form JOA,” respectively. For an analysis of the differences between the 1982 Form JOA and the 1989 Form JOA, read *Comparison of the 1989 A.A.P.L. Model Form Operating Agreement to the 1982 Model Form*. See Gary B. Conine, *Comparison of the 1989 A.A.P.L. Model Form Operating Agreement to the 1982 Model Form*, proceedings at the 4th Annual Oil & Gas Institute, South Texas College of Law, Aug. 9, 1990. In 2011, the AAPL formed a task force to revise the 1989 Form JOA in order to reflect the increasing use of horizontal drilling techniques, changes in the law, and changes in industry practice. See Jeff Weems, *The Model Form Meets the 21st Century*, 42D ANNUAL ERNEST E. SMITH OIL, GAS & MIN. L. INST. 2-3 (2016), https://utcle.org/ecourses/0c6229/get-asset-file/asset_id38093. In 2013, this AAPL task force published AAPL Form 610-1989

common instrument in the industry after the oil and gas lease.

Most analytical papers dealing with the joint operating agreement (or JOA) have focused on the crucial details of conducting exploration, development and production operations within the designated contract area and the legal relationship of the parties to the agreement. These papers emphasize the functional aspects of the JOA [that] commit the parties to participate in and share expenses for, and production from, joint operations. But there are other important provisions in the JOA . . . [that] adjust the rights and duties of the parties outside the context of actual operations.³

In 1988, Professor Gary B. Conine published *Property Provisions of the Operating Agreement—Interpretation, Validity, and Enforceability*, in the *Texas Tech Law Review*, a highly-cited law review article that examines the provisions of the Joint Operating Agreement (JOA) that expand, limit, and define the property interests of the parties both inside and outside the contract area.⁴ These provisions

not only clarify the parties' rights with respect to the transfer, acquisition and loss of interests but also facilitate such matters as the deferral of commitments to participate in future operations [A]t first glance these provisions may resemble a random collection of property clauses, many of which are found in other instruments [used] in the industry and appear to be only peripherally important to joint operations, [but] they . . . are essential to the structure and effectiveness of the JOA as a long-term transaction. In

(horizontal modifications), a modified version of the 1989 Form JOA to incorporate revisions relating to horizontal development. *Id.* at 3. This form is referred to in this Article as the "1989-H Form JOA." In 2016, the AAPL published a revised version of its entire form JOA, the AAPL Form 610-2015, referred to herein as the "2015 Form JOA." See AM. ASS'N OF PROF'L LANDMEN, A.A.P.L. FORM 610-2015: MODEL FORM OPERATING AGREEMENT (2016) [hereinafter FORM 610-2015]. Although this Article focuses on the AAPL model forms for onshore operations, it should be noted that various other form JOAs have been published. See AM. ASS'N OF PROF'L LANDMEN, A.A.P.L. FORM 710-2002: MODEL FORM OF OFFSHORE OPERATING AGREEMENT (2002); see also AM. ASS'N OF PROF'L LANDMEN, A.A.P.L. FORM 810-2007: MODEL FORM OF OFFSHORE OPERATING AGREEMENT (2007). For example, these include AAPL Form 710-2002 and AAPL Form 810-2007 which govern offshore operations. See AM. ASS'N OF PROF'L LANDMEN, A.A.P.L. FORM 710-2002: MODEL FORM OF OFFSHORE OPERATING AGREEMENT (2002); AM. ASS'N OF PROF'L LANDMEN, A.A.P.L. FORM 810-2007: MODEL FORM OF OFFSHORE OPERATING AGREEMENT (2007). In addition, the Rocky Mountain Oil & Gas Association issued its Form 1 (undivided interests) and its Form 2 (divided interests) in 1954 and 1959, respectively, each of which was designed for units on unproven tracts comprised, in part, of federal leases. ROCKY MOUNTAIN OIL AND GAS ASS'N, ROCKY MOUNTAIN UNIT OPERATING AGREEMENT FORM 2 (DIVIDED INTERESTS) (1994); ROCKY MOUNTAIN OIL AND GAS ASS'N, ROCKY MOUNTAIN UNIT OPERATING AGREEMENT FORM 1 (UNDIVIDED INTERESTS) (1954). In discussions with the President of the Colorado Petroleum Association, a partial successor to the Rocky Mountain Oil & Gas Association, it appears these forms are no longer published or in significant use.

3. Conine & Kramer, *supra* note 1.

4. See generally Gary B. Conine, *Property Provisions of the Operating Agreement—Interpretation, Validity, and Enforceability*, 19 TEX. TECH L. REV. 1263 (1988). The 1988 article was prepared under a summer research grant awarded by the Oil, Gas & Mineral Law Section of the State Bar of Texas. *Id.* For further discussion and coverage of additional issues, the reader is referred to Professor Conine's 1988 article. See *id.*

a sense, these provisions are the “mortar” that holds the procedural “bricks” of the JOA together.⁵

Professor Conine prepared an updated version of his influential article for the 2008 Rocky Mountain Mineral Law Foundation Special Institute on Joint Operations.⁶ In both his article and special institute paper, Professor Conine focused on the 1982 Form JOA.⁷ This Article is an update to those prior works to greater emphasize the 1989 Form JOA, cases and developments since its publication, and the implications of the revisions to the JOA in the new 2015 Form JOA published by the American Association of Professional Landmen (AAPL).⁸ Consistent with Professor Conine’s 2008 Article, the purposes of this Article are to review and examine:

[(1)] the various provisions typically included in the JOA [that] affect the property interests of the parties, . . . [(2)] how [these provisions] are used to structure the operating agreement, [(3)] the ways in which [these provisions] are used to protect the integrity of the transaction during its protracted term and promote fair dealing among the parties through restrictions on transfers and acquisitions, and [(4)] the legal issues that often arise with respect to the validity and enforceability of these provisions.⁹

II. STRUCTURING THE JOINT OPERATING AGREEMENT

The JOA is designed to organize operations on a specific collection of properties. Consequently, the transaction will be dependent on an accurate identification of the boundaries within which its provisions apply. [Because] . . . allocation of costs and production among the parties for future operations will be determined by the property interests contributed by each, . . . the interests contributed by each party [must] be clearly described and . . . some agreement [must] exist on how each party’s share of costs and production will be affected if title to all or part of its interest turns out to be defective or fails during the term of the agreement. These functions are performed by Exhibit A to the JOA and the [JOA’s failure of title provisions.]¹⁰

The JOA “also uses the property interests of the parties to facilitate some of its most important provisions.”¹¹ Specifically, property interests define

5. Conine & Kramer, *supra* note 1.

6. *See id.*

7. *See id.*; *see also* Conine, *supra* note 4.

8. *See infra* Parts II–V.

9. *See* Conine & Kramer, *supra* note 1.

10. *See id.*

11. *Id.*

“incentives and rewards for participating in future operations” and secure the parties’ obligations “to bear a share of costs in future operations” under the “operator lien” provisions.¹²

A. Creating (and Revising) the Contract Area

Operations conducted under the JOA take place within the [c]ontract [a]rea created by the instrument. This area is comprised of the leasehold and mineral interests[] contributed by the individual parties who execute the JOA, as identified in Exhibit A to the agreement[.] Within this aggregation of property interests, the operating agreement controls what mineral activities will take place, the party that will conduct those projects, and the manner in which costs and production will be allocated among the parties.

Despite the natural tendency to . . . conceptualize the [c]ontract [a]rea as a region within certain surface boundaries, it is actually a multi-dimensional zone that may cover less than all mineral substances, less than all development rights, and less than all subsurface depths and formations within its surface perimeter.¹³ For this reason, [Article II of the JOA] prescribes several pieces of information that should be included [on Exhibit A] to obtain a full description of the [c]ontract [a]rea[.]¹⁴

The functions of Exhibit A include: (1) to describe the *lands* subject to the JOA; and (2) to describe the *leases and interests* subject to the JOA as well as any applicable depth restrictions, the specific leases or mineral properties involved, and the percentage of ownership held by each party within the contract area.¹⁵ “The significance of precision in compiling and reviewing the information in Exhibit A to the JOA [can be] illustrated” by several cases.¹⁶

In the absence of an Area of Mutual Interest (AMI) provision, leases and interests acquired after the effective date are not usually contemplated by the parties to be covered by the JOA. Consistent with this understanding, in *Clovelly Oil Co. v. Midstates Petroleum Co.*, the court held that the operating agreement’s preprinted language limited Exhibit A’s definition of the

12. *Id.*

13. *See, e.g.,* Morgan v. Mobil Oil Corp., 726 F.2d 1474 (10th Cir. 1984); Colorado Interstate Gas Co. v. HUFO Oils, 626 F. Supp. 38 (W.D. Tex. 1984), *aff’d*, 802 F.2d 133 (5th Cir. 1986); Superior Oil Co. v. Roberts, 398 S.W.2d 276 (Tex. 1966).

14. Conine & Kramer, *supra* note 1.

15. *See* AM. ASS’N OF PROF’L LANDMEN, A.A.P.L. FORM 610-1982: MODEL FORM OPERATING AGREEMENT art. IIA (1982) [hereinafter FORM 610-1982]. The 1989 Form JOA and the 2015 Form JOA add “burdens on production” to this list and provide under Article IV.B.1(g) that if a party contributes an interest in a wellbore or in production only, the party’s absence of an interest in the remainder of the contract area is a failure of title unless Exhibit A reflects that the party did not have any interest in the remainder of the contract area. *See* AM. ASS’N OF PROF’L LANDMEN, A.A.P.L. FORM 610-1989: MODEL FORM OPERATING AGREEMENT arts. IIA & IV.B.1(g) (1989) [hereinafter FORM 610-1989]; *see also* FORM 610-2015, *supra* note 2.

16. Conine & Kramer, *supra* note 1.

contract area to only those leases and interests owned by the parties at the time the agreement was executed, reasoning that the parties could have included an AMI provision if the parties intended the JOA to apply to future leases.¹⁷ Similar arguments were made in *Anderson Energy Corp. v. Dominion Oklahoma Texas Exploration & Production, Inc.*, in which the plaintiff asserted that the operator had breached the JOA by acquiring leases and interests within the contract area and drilling more than one hundred gas wells.¹⁸ In its defense, the operator argued that because the JOA recital stated that the parties are “owners” of leases and oil and gas interests, and the definitions of “oil and gas” and “oil and gas interests” are those “owned” by the parties, the parties only intended the JOA to apply to leases and interests owned as of the effective date.¹⁹ In this case, however, the JOA did include an AMI provision.²⁰ The court rejected the operator’s argument, reasoning that because the parties referenced maps naming platting land and because an AMI provision was included in the agreement, the lands and leases subject to the JOA included the subsequently acquired leases and interests.²¹

Even in cases in which an AMI provision was absent, however, courts have found that a JOA covers subsequently acquired leases and interests within the geographic area described in Exhibit A.²² Consider the following two cases. In *Amoco Production Co. v. Charles B. Wilson, Jr., Inc.*, “the lease did not cover all depths anticipated by the parties to the JOA.”²³ In *Kincaid v. West Operating Co.*, “the lease covered only an undivided one-half of the mineral estate in an important tract.”²⁴ In both cases, the information as to these properties set forth in Exhibit A “suggested that all mineral rights at all depths were included,” and “the party contributing less than all the operating rights in the leased area later acquired the outstanding interest and asserted that the JOA did not apply to the newly acquired property.”²⁵ And in both cases, the court held that the parties intended the JOA to include all interests acquired within a specific geographic area, despite the absence of an AMI clause.²⁶ These cases highlight the importance

17. See *Clovelly Oil Co. v. Midstates Petroleum Co.*, 112 So.3d 187, 196 (La. 2013).

18. See *Anderson Energy Corp. v. Dominion Okla. Tex. Expl. & Prod., Inc.*, 469 S.W.3d 280, 285 (Tex. App.—San Antonio 2015, no pet.).

19. *Id.* at 287.

20. *Id.* at 285.

21. *Id.* at 290.

22. See *Kincaid v. W. Operating Co.*, 890 P.2d 249 (Colo. Ct. App. 1994); *Amoco Prod. Co. v. Charles B. Wilson, Jr., Inc.*, 976 P.2d 941 (Kan. 1999) (holding that the absence of an AMI does not mean the parties did not intend to include all interests acquired in the future).

23. *Conine & Kramer, supra* note 1; see *Amoco Prod. Co.*, 976 P.2d at 944.

24. *Conine & Kramer, supra* note 1; see *Kincaid*, 890 P.2d at 251.

25. *Conine, supra* note 1; see *Kincaid*, 890 P.2d at 253; *Amoco Prod. Co.*, 976 P.2d at 954.

26. See *Kincaid*, 890 P.2d at 253; *Amoco Prod. Co.*, 976 P.2d at 954. In contrast, in a case in which a party’s leasehold interest was overstated in Exhibit A in anticipation of acquiring a larger interest by way of a farmout arrangement when a well was drilled under the JOA, it was held that the newly acquired interest was not to be shared among the JOA parties under the Acreage and Cash Contributions clause under the rationale that Exhibit A already included the new interest, indicating that the parties intended to

of attention to detail and clearly reflect the parties' intent when drafting Exhibit A.²⁷

Recognizing that mistakes can be made during drafting, the new 2015 Form JOA adds a mechanism that requires the operator to amend Exhibit A from time to time to correct mistakes or reflect changes of ownership retroactive to the date of the mistake or change.²⁸ This right is not unilateral, however, but requires the consent of the affected parties.²⁹ If a party fails to grant consent, the operator may nevertheless amend Exhibit A to conform to a title opinion, but the non-consenting party may pursue litigation to determine the parties' interests.³⁰

B. The Deemed Lease

If the contract area includes unleased mineral interests, the mineral owner does not enter the transaction on equal footing with parties who contribute only a leasehold working interest.³¹ To place all JOA parties in the same position, any mineral interest contributed is deemed subject to an oil and gas lease, which is attached to the JOA as an exhibit.³² Under this scheme, the unleased mineral interest is encumbered with a cost-free royalty (payable to the mineral owner regardless of its participation or non-participation in drilling activities) and is given a term that expires if there is no production after a prescribed date, just as with true leasehold interests committed to the contract area.³³

Rights under the deemed lease may be conveyed like any other interest in oil and gas, so care must be taken in drafting the instrument to be attached. The deemed lease was the subject of *Prize Energy Resources, L.P. v. Cliff Hoskins, Inc.*, in which a non-operator contributed a mineral interest to the JOA, triggering the creation of the deemed lease.³⁴ The non-operator subsequently sold all of its rights under the JOA except for its retained royalty interest and possibility of reverter under the deemed lease, such that the underlying mineral interest would revert back if the JOA terminated.³⁵ The JOA provided, like many JOAs, that it would remain in effect only so long as the oil and gas leases subject to the agreement continued in effect.³⁶ When

exclude the farmout interest from the Contributions clause when the operating agreement was executed. See *Martin Expl. Co. v. Amoco Prod. Co.*, 637 So.2d 1202 (La. Ct. App. 1994).

27. See generally *Kincaid*, 890 P.2d at 249; *Amoco Prod. Co.*, 976 P.2d at 941.

28. See FORM 610-2015, *supra* note 2, at art. III.B.

29. See *id.* at art. III.B.3.

30. See *id.* at art. III.B.6.

31. See *id.* at art. III.A.

32. See *id.*

33. See *id.*

34. *Prize Energy Res., L.P. v. Cliff Hoskins, Inc.*, 345 S.W.3d 537, 546 (Tex. App.—San Antonio 2011, no pet.).

35. *Id.*

36. See *id.*; see FORM 610-2015, *supra* note 2, at art. XIII, Option #1.

the leases that were contributed to the JOA terminated, the operator continued to produce, and the successors to the non-operator sued to quiet title to the mineral interest and for trespass and conversion.³⁷ The court rejected the operator's argument that the deemed lease somehow continued the JOA in effect because, unlike the underlying leases, it did not contain a cessation of production clause.³⁸ The JOA's duration was dependent on the continuation of the underlying leases, not the deemed lease.³⁹

C. Failure of Title

Problems with lease and property descriptions arise in part because

at the time the JOA is being prepared for execution, there is little or no time to conduct title examinations and the parties must act on the assumption that each participant knows and has revealed the true size, extent and legal quality of the interest it purports to contribute to the transaction.⁴⁰

There is no requirement that individual parties submit proof of their interest before signing the JOA.⁴¹ Rather, title examination is required on the drillsite, or if it is requested by a majority of the parties that consented to the drilling operations or the operator has elected, on the drilling unit, before commencement of drilling operations.⁴²

As a result, a party's representation of the interest it is contributing to the [c]ontract [a]rea may turn out to be incorrect. It can also be correct initially but later become partially or wholly invalid due to a failure to comply with one of the express [or] implied covenants contained in a lease.⁴³

These failures of title have been dealt with in one of two ways: either the loss from the title failure is imposed on the party that "contributed the interest to the [c]ontract [a]rea," or "the loss is treated as a joint loss" and imposed on all parties to the JOA.⁴⁴ Industry has generally understood that initial failures of title, that is, the failure of a party to own the interest it purports to contribute at the outset, should be borne by the contributing party alone, while subsequent losses of an interest for failure of production should be shared by all of the parties.⁴⁵ This understanding was called into question

37. *Prize Energy Res., L.P.*, 345 S.W.3d at 547.

38. *Id.* at 554–55.

39. *See id.* at 554.

40. Conine & Kramer, *supra* note 1.

41. *See* FORM 610-2015, *supra* note 2, at art. IV.A.

42. *See id.*; FORM 610-1989, *supra* note 15, at art. IV.A.; FORM 610-1982, *supra* note 15, at art. IV.A.

43. Conine & Kramer, *supra* note 1.

44. *See id.*

45. *See generally id.*

in *EOG Resources, Inc. v. Killam Oil Co.*⁴⁶ There, EOG succeeded to interests in certain zones earned by its predecessor under a farmout agreement with the plaintiff, Killam, with operations governed by a JOA that appears from the opinion to be the 1977 Form JOA.⁴⁷ When EOG lost record title in the zones contributed for failure of continued production, and such title reverted to Killam under the farmout agreement, EOG argued that it retained a contractual right under the JOA to share in its proportionate interest in production.⁴⁸ The court agreed with Killam that EOG lost all of its interest in production from the zones under the unambiguous language of the JOA.⁴⁹

To make clear the distinction between a failure to have title at the outset and the subsequent loss of title, the 2015 Form JOA defines a “failure of title” as occurring only when an interest contributed by a party is determined to be invalid “as of the effective date,” unless the limitations are disclosed on Exhibit A.⁵⁰ Earlier versions were not clear that a failure of title excluded interests lost for failure of production, simply stating that should a failure of title occur, the party that contributed the affected interest or lease would alone bear the entire loss.⁵¹

If a failure of title is established, the party who contributed the affected interest is allowed ninety days to acquire or reacquire the interest, free of the renewal and extension provisions of the JOA.⁵² If the party is unable to acquire the lost interest, the proportionate cost and production shares of the parties in the contract area are revised to reflect the reduction in the interest of the party that purported to contribute the failed interest.⁵³ If title is found to be invalid, however, a party is still entitled to its share of revenues, but may not recoup its share of expenses before the date its title is found to be

46. *See* *EOG Res., Inc. v. Killam Oil Co.*, 239 S.W.3d 293 (Tex. App.—San Antonio 2007, pet. denied).

47. *Id.* at 296–97.

48. *Id.* at 299–300.

49. *Id.* at 300.

50. FORM 610-2015, *supra* note 2, at art. IV.B.1.

51. *See* FORM 610-1989, *supra* note 15, at art. IV.B.1; FORM 610-1982, *supra* note 15, at art. IV.B.1; AM. ASS'N OF PROF'L LANDMEN, A.A.P.L. FORM 610-1977: MODEL FORM OPERATING AGREEMENT art. IV.B.1 (1977) [hereinafter FORM 610-1977].

52. *See* FORM 610-2015, *supra* note 2, at art. IV.B.1.

53. *See id.* Under the 1982 Form JOA, liability for conversion of production attributable to a failure of title is borne entirely by the parties whose interests failed, while under the 1989 Form JOA and the 2015 Form JOA, such liability is shared severally by all parties that received such production based on the amount of the converted production received. *See id.*; FORM 610-1989, *supra* note 15, at art. IV.B.1; FORM 610-1982, *supra* note 15, at art. IV.B.1. If an interest of another party to the JOA in a producing well increases as a result of a failure of title, then the party whose title was lost will be entitled to receive any proceeds of production until it has been reimbursed for its unrecovered costs for the well, which afford the losing party protection similar to a good faith trespasser. *See* FORM 610-2015, *supra* note 2, at art. IV.B.1(c). Similarly, if the true owner of the failed interest who is not a party to the JOA later pays for any costs previously incurred by the losing party, such payments are to be refunded to the party whose interest failed. *See id.* at art. IV.B.1(e). Such attempts to isolate JOA parties from liability to third parties may be undermined where the transaction is held to create a partnership or to result in a cross-conveyance of the properties described in Exhibit A.

flawed, because the JOA provides that there shall be no retroactive adjustment of revenues or expenses.⁵⁴ The failure of title itself does not constitute proof of fraud. Because the JOA takes into account that a title failure might occur in the future, the JOA provides a lawful cause for the formation of a contract even if a party is found not to own a valid oil and gas lease at the time the JOA is executed.⁵⁵

Similarly, where a party, “through mistake or oversight,” fails to make or erroneously makes a payment required to maintain a lease or interest, and as a result the lease or interest terminates, that party alone will bear the entire loss by a proportionate reduction of its interest.⁵⁶ But other losses, such as those resulting from a failure of the parties to propose and carry out operations for the exploration and development of a lease, are treated as joint losses.⁵⁷ No adjustment is made in the interests attributable to the JOA parties.⁵⁸ The same treatment is given to loss of a leasehold interest for non-payment of a shut-in royalty payment resulting from the operator’s failure to promptly notify the non-operators that a well has been shut-in.⁵⁹

D. Structural Transfers

The oil and gas interests contributed by the parties comprise the contract area for the JOA, but these interests are also used to structure some of the mechanisms that define and implement the joint operations that take place under the JOA.⁶⁰ Transfers of and encumbrances placed on these interests are crucial to the function of the JOA and occur by contract under the subsequent operations and operator’s lien provisions of the JOA.⁶¹ Such transfers and encumbrances can also arise by implication as a result of the cost and production sharing prescribed by the instrument.

1. Transfers as Penalties

Although the parties usually commit themselves under the JOA to participate in initial operations within the contract area, decisions to participate in subsequent operations are normally deferred until immediately

54. See FORM 610-2015, *supra* note 2, at art. IV.B.1(b).

55. See *Mayne & Mertz, Inc. v. Sweet Lake Land & Oil Co.*, 28 So.3d 1227, 1233–34 (La. Ct. App. 2010).

56. See FORM 610-2015, *supra* note 2, at art. IV.B.2. Article IV.B.2 contains similar protections to reimburse the party whose interest is lost for mistake or erroneous nonpayment or underpayment as those described previously for a party whose title failed at inception. *Id.*

57. See *id.* at art. IV.B.3.

58. See *id.*

59. See *id.* at art. VII.E.

60. See generally *id.*

61. See *id.* at art. VII.B.

preceding commencement of the new project.⁶² The delay is intended to insulate the parties from binding commitments to future projects and allows each to consider the most current geologic information obtained from prior operations, current market conditions, and its own changing financial position before making further commitments.

Typically, this is accomplished by providing an opportunity for all parties to elect to participate or not participate in major operations after the drilling of the initial well, subject to some form of “penalty” for opting not to participate in a project.⁶³ A decision not to participate in a subsequent operation is not a breach, and therefore this penalty does not involve liquidated damages or an unenforceable penalty.⁶⁴ Unless the operating agreement provides otherwise, the operator may not impose nonconsent penalties for failure to pay for the costs to drill the initial well.⁶⁵

Any party that desires to drill a subsequent well or to rework, deepen, or plug a non-producing well is required to give written notice of the proposal to each of the other parties.⁶⁶ The 1989-H Form JOA expanded the notice requirement for horizontal wells to include more detailed information, including total measured depth, surface hole location, terminus, displacement, and utilization and scheduling of rigs.⁶⁷ The 2015 Form JOA incorporates these requirements for proposed horizontal wells and adds similar requirements for vertical well proposals, including depth, surface and bottom hole locations, objective zone, utilization and scheduling of rigs, and stimulation operations.⁶⁸ In the case of both vertical and horizontal wells, the

62. See generally *id.* at art. VI.B.1 (allowing the parties to consider and compile information before committing to further development).

63. See *id.* at art. VI.B.2; FORM 610-1989, *supra* note 15, at art. VI.B.2; FORM 610-1982, *supra* note 15, at art. VI.B.2; FORM 610-1977, *supra* note 51, at art. VI.B.2. To avoid the characterization of the risk penalty that is imposed associated with converting a consenting party into a non-consenting party in connection with a default, the 2015 Form JOA adds a usury savings clause which states that, “to the extent that all or any part of the risk penalty to be recovered pursuant to Article VI.B or Article VI.C, as the case may be, in connection with the provisions of this Article VII.[D].3, is determined to constitute interest on a debt, such interest shall not exceed the maximum amount of non-usurious interest that may be contracted for, taken, reserved, charged, or received under law.” See FORM 610-2015, *supra* note 2, at art. VII.D.3.

64. See *Nearburg v. Yates Petroleum Corp.*, 943 P.2d 560, 566 (N.M. Ct. App. 1997) (citing Gary B. Conine, *Rights and Liabilities of Carried Interest and Nonconsent Parties in Oil and Gas Operations*, 37 INST. ON OIL & GAS L. & TAX’N § 3.04[3][c], at 3–32 (1986)). The penalty label has led to an attack on the validity and enforceability of the provision. See *id.* Although in *Hamilton v. Texas Oil & Gas Corp.* the court of appeals construed the provision as an enforceable liquidated damages clause based on the risk compensation achieved through the arrangement, in *Valence Operating Co. v. Dorsett*, the Texas Supreme Court relied on *Nearburg v. Yates Petroleum Corp.* to hold that the non-consent provision involved reasonable compensation for risk—not a breach—and was more accurately referred to as a “sole risk clause.” See *Valence Operating Co. v. Dorsett*, 164 S.W.3d 656, 665 (Tex. 2005) (relying on *Nearburg*, 943 P.2d 560); *Hamilton v. Tex. Oil & Gas Corp.*, 648 S.W.2d 316 (Tex. App.—El Paso 1982, writ ref’d n.r.e.).

65. See *Enterra Energy, LLC v. Wadi Petroleum, Inc.*, Nos. 06-9217 C/W 07-0409, 2008 WL 687183, at *1–2 (E.D. La. Oct. 2, 2008) (applying Louisiana law).

66. See FORM 610-2015, *supra* note 2, at art. VI.B.1.

67. See FORM 610-1989, *supra* note 15, at art. VI.B.1.

68. See FORM 610-2015, *supra* note 2, at art. VI.B.1.

2015 Form JOA (unlike the 1989 Form JOA and earlier forms) now expressly requires any such proposals for subsequent operations to be accompanied by estimated drilling and completion costs set forth in an Authorization for Expenditure (AFE).⁶⁹

Upon receipt of the notice and proposal, a party's election to participate must be exercised within thirty days, or within forty-eight hours if a drilling rig is on location, and the proposal is to rework, sidetrack, recomplete, plug back or deepen the well.⁷⁰ A nonoperator that elects not to participate may not thereafter change its election.⁷¹ The proposing party must act in good faith when it decides that forty-eight hours notice is sufficient.⁷² In *Chisnos, Ltd. v. JKM Energy, L.L.C.*, the court held that an attempt to pass off a workover rig as a drilling rig to trigger the forty-eight hour notice period was in bad faith when the operator appeared to have plenty of time to send a thirty-day notice.⁷³

The operator must then commence the proposed operation within ninety days after the expiration of the thirty-day notice period (or as promptly as possible after the forty-eight-hour notice period), although an operator may commence the subsequent operations (or even complete the operations) before sending the notice.⁷⁴ Early commencement does not harm non-operators, but instead places greater risk on the operator that the cost of the operation will fall entirely on him.⁷⁵

"The risk and cost of the operation are borne by the" parties that consent to the proposed operations "in proportion to the interest for which they have elected to be responsible."⁷⁶ For situations in which there are non-consenting parties, this necessarily means that some of the consenting parties have had to assume additional liabilities to pursue the project.⁷⁷ To compensate them for the assumption of these greater obligations, the consenting parties are granted a benefit upon commencement of the operation.⁷⁸ The mechanism to achieve this adjustment varies, depending on the nature of the anticipated

69. See *id.*; FORM 610-1989, *supra* note 15, at art. VI.B.1; FORM 610-1982, *supra* note 15, at art. VI.B.1; FORM 610-1977, *supra* note 51, at art. VI.B.1.

70. See FORM 610-2015, *supra* note 2, at art. VI.B.1 (emphasis added).

71. See *XTO Energy Inc. v. Smith Prod. Inc.*, 282 S.W.3d 672, 678–79 (Tex. App.—Houston 2009, pet. granted).

72. See RESTATEMENT (SECOND) OF CONTRACTS § 205 (AM. LAW INST. 1981) (suggesting that all contracting parties have a duty of good faith and fair dealing).

73. *Chisnos, Ltd. v. JKM Energy, L.L.C.*, 258 P.3d 1007, 1114 (N.M. Ct. App. 2011).

74. See *Bonn Operating Co. v. Devon Energy Prod. Co.*, 613 F.3d 532, 535 (5th Cir. 2010) (applying *Valence* and holding that an operator may even begin drilling and complete a well before sending notice under the 1956 Form JOA); *Valence Operating Co. v. Dorsett*, 164 S.W.3d 656, 662 (Tex. 2005) (stating that an operator may commence operations for drilling during the notice period for non-operators to elect to participate or go non-consent).

75. See *Valence Operating Co.*, 164 S.W.3d at 663.

76. *Conine*, *supra* note 4, at 1288; see *Bonn Operating Co.*, 613 F.3d at 533.

77. See *Bonn Operating Co.*, 613 F.3d at 533.

78. See *Conine*, *supra* note 4, at 1288.

operations and local custom.⁷⁹

The most common method entails relinquishment by each non-consenting party of its “interests in the well and its production until proceeds from the sale of production^[80] attributable to [its] interest[], after deducting taxes and lease burdens,” equal a specified multiple of the costs incurred in the operation.⁸¹

Once this recovery has occurred, the interest reverts to the non-consenting party.⁸² This arrangement has been held to create a *Manahan*-type carried interest in which the title to the relinquished interest actually passes between the parties.⁸³ During the “penalty” period, the non-consenting party loses its possessory rights in the property, but retains a future interest in the form of a possibility of reverter.⁸⁴

The consenting parties will be responsible for the payment of royalty and similar burdens on the leases and interests of the nonconsenting parties

79. *See id.*

Popular methods have included: (1) cash payments to consenting parties to cover additional expenses; (2) transfer of the right to production for a limited time; and (3) forfeiture by the nonconsenting party of all or part of its interest in the [contract area], with corresponding adjustments in the parties’ interests under the operating agreement.

Id.; see John M. McCollam, *A Selective Comparison of Contractual Operating Problems under Federal Offshore and Onshore Oil and Gas Leases*, 29 INST. ON OIL & GAS L. & TAX’N 229, 254 (1978).

80. Note, however, that under the 1989 Form JOA and the 2015 Form JOA, relinquishment in the case of reworking, sidetracking, deepening, or plugging back only pertains to a party’s rights in production. *See* FORM 610-2015, *supra* note 2, at art. VI.B.2(c); FORM 610-1989, *supra* note 15. The same is true for a completion under Option #2 of art. VI.C. in the 1989 Form JOA and the 2015 Form JOA. FORM 610-2015, *supra* note 2, at art. VI.C; FORM 610-1989, *supra* note 15. The 1956 Form JOA provides that the non-consenting party also relinquishes “its leasehold operating rights.” FORM 610-1956, *supra* note 2, at art. 12 ¶ 3. Other older forms call for relinquishment of the operating rights or working interest in the well or even permanent relinquishment of the leasehold interests associated with the well.

81. Conine, *supra* note 4, at 1289; *see* Railroad Comm’n v. Olin Corp., 690 S.W.2d 628, 630 (Tex. App.—Austin 1985, writ ref’d n.r.e.).

82. *See id.*

83. *See id.*; PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS OIL AND GAS LAW: ABRIDGED SECOND EDITION § 424.1 (2004).

84. *See* Olin Corp., 690 S.W.2d at 630. Nevertheless, the non-consenting party continues to have a voice in many future operations affecting the well or the leased premises where the well is located. *See generally* Tarrant v. Capstone Oil & Gas Co., 178 P.3d 866 (Okla. Civ. App. 2007); Hill v. Heritage Res., Inc., 964 S.W.2d 89 (Tex. App.—El Paso 1997, pet. denied). The non-consenting party is still permitted to elect: (1) to participate in future wells regardless of location; (2) to participate in sidetracking the initial well to a new bottom-hole location (provided it tenders its share of costs in drilling the initial well to the point in which the sidetracking begins); (3) to vote on surrender of any lease in the contract area; (4) to acquire an interest in any renewal or extension lease; and (5) to vote on removal and appointment of an operator based on its original proportionate interest in the contract area. *See* Tarrant, 178 P.3d at 870; Hill, 964 S.W.2d at 111. The retention of these rights normally associated with a working interest suggests that the interest actually transferred to the carrying parties is a production interest. If so, the relinquished interest might be better characterized as a *Herndon*-type carried interest. *See* Conine, *supra* note 4, at 1294–96 (providing a more thorough development of this argument). Note that the 2015 Form JOA adds language that requires the operator to restrict the access of the non-consenting parties to the well location, and to information, and reports until the earlier of recoupment or two years after the commencement of the operation. FORM 610-2015, *supra* note 2, at art. V.D.5(b).

during the nonconsent period.⁸⁵ The Texas Supreme Court in *Tawes v. Barnes* held that this temporary structural conveyance of the nonconsenting parties' interests is not an assignment or conveyance of a permanent interest sufficient to put the consenting parties in privity of estate with the owners of royalty in the nonconsenting parties' leases and interest or to give rise to a third-party beneficiary relationship between these royalty holders and the consenting parties.⁸⁶ The non-consenting party will, however, remain responsible to pay and discharge any subsequently created interests, such as an overriding royalty or production payment, created after the date of the agreement, attributable to such production.⁸⁷

Using complete forfeiture as the non-consent penalty is less common.⁸⁸ Although non-consent penalties with recoupments approaching 500% may amount to a virtual forfeiture, the express requirement for forfeiture is clearly the most extreme and certain incentive for participation.⁸⁹ It also carries the secondary advantage of precluding some parties from later benefiting from the risks assumed by others in the early exploration of a sizeable contract area.⁹⁰

Enforcement of a forfeiture penalty requires close attention to the proper execution of the provisions on subsequent operations. Because of the harshness of the result, forfeitures are not favored in law or equity.⁹¹ The forfeiture provision itself must be expressed clearly and unequivocally, and must be executed in strict compliance with its terms.⁹² The forfeiture

85. See FORM 610-2015, *supra* note 2, at art. VI.B.2(d).

86. See *Tawes v. Barnes*, 340 S.W.3d 419, 428-30 (Tex. 2011).

87. See FORM 610-2015, *supra* note 2, at art. III.C ¶ 1; FORM 610-1989, *supra* note 15, at art. III.C ¶ 1. For a different result, where the court found that the holder of a subsequently created overriding royalty was not entitled to any royalty during the non-consent period, see *Boldrick v. BA Oil Producers*. *Boldrick v. BA Oil Producers*, 222 S.W.3d 672, 674 (Tex. App.—Eastland 2007, no pet.). In that case, the JOA signed in 1973 contained an additional provision that stated that any subsequently created interest shall be specifically made subject to all terms and provisions of the operating agreement and that a subsequently created interest is chargeable with a pro rata portion of costs and expenses as if it were a working interest. See *id.* Interestingly, the recording supplement puts the holder of a subsequently created overriding royalty, production payment, or net profits interest on notice that its interest is “subject to suspension if a party is required to assign or relinquish to another party an interest which is subject to such burden[s]” and subject to the operator’s lien. See AM. ASS’N OF PROF’L LANDMEN, A.A.P.L. FORM 610RS-1989: MODEL FORM RECORDING SUPPLEMENT TO OPERATING AGREEMENT AND FINANCING STATEMENT § 1.F(ii), (iii) (1989) [hereinafter FORM 610RS-1989].

88. See generally *Long v. Rim Operating, Inc.*, 345 S.W.3d 79 (Tex. App.—Eastland 2011, pet. denied). The parties are always free to negotiate a hybrid approach, where for certain operations a non-consenting party may participate after the recovery of costs and the penalty and certain other operations require a non-consenting party to relinquish its interest. See, e.g., *id.* at 91 (upholding special provision in operating agreement for non-consenting party to relinquish interest for a well or operation necessary to perpetuate a lease).

89. See *id.* at 84-85.

90. See *id.*

91. See *Dickerson v. Bd. of Trs.*, 204 S.W.2d 418, 423 (Tex. Civ. App.—Fort Worth 1947, writ ref’d).

92. See *Phillips Petroleum Co. v. Rudd*, 226 S.W.2d 464, 486 (Tex. Civ. App.—Texarkana 1949, no writ).

provision is also subject to waiver, expressly or by conduct inconsistent with the exercise of the right.⁹³ The beneficiary of a right of forfeiture of a property interest resulting from a breach of a condition can waive the right or be estopped to enforce it if he fails to exercise the right to the detriment of the forfeiting party when he acquires knowledge that the requisite conditions have occurred.⁹⁴ For example, if forfeiture were imposed as a result of a party's non-consent, but the subsequent operations were unsuccessful, a later oversight permitting that party to participate in operations in the forfeited property requiring expenditure of his funds on the project would most certainly be grounds for waiver or estoppel.⁹⁵

2. Liens and Security Interests

The second express conveyance in the operating agreement is the grant of liens and security interests.⁹⁶ The operator is authorized to pay all expenses incurred during the development and operation of the contract area, keeping an accurate record of the joint account reflecting all charges and credits.⁹⁷ At its election, the operator may charge each party with its share of expenses after those costs have been paid by the operator or it may invoice each party for advance payment of estimated expenses for the next succeeding month.⁹⁸ Interest at a rate prescribed in the accounting procedures is incurred for failure to promptly pay or reimburse the operator.⁹⁹ Ultimately, if a payment is not made within 120 days after the rendition of a statement, the non-defaulting parties, upon request of the operator, must pay their proportionate share of the unpaid amount from their own funds.¹⁰⁰

Although the lien in the operating agreement historically has been referred to as the "operator's lien," under the 1989 Form JOA and the 2015 Form JOA, the lien runs to and from all parties to the JOA.¹⁰¹ To secure payment of all of a party's obligations under the JOA, each party grants to the other parties a contractual lien and security interest on its oil and gas

93. See *Am. Cas. Co. v. Conn.*, 741 S.W.2d 536, 539–40 (Tex. App.—Austin 1987, no writ).

94. See *Lawyers Tr. Co. v. City of Houston*, 359 S.W.2d 887, 891–92 (Tex. 1962). This presents a particular problem for consenting parties in jurisdictions that apply the cross-conveyance theory, in which the non-consent provisions arguably become conditions to each party's title creating a fee simple on condition subsequent subject to a right of entry for condition broken. In this context, forfeiture is not automatic, but requires assertion of the forfeiture by the benefiting party. Failure to assert forfeiture in a timely manner and to properly reflect its effects in accounting and other practices under the operating agreement may result in a waiver of the penalty. See *id.* at 890–91.

95. See *id.* at 891; see also *Benavides v. Hunt*, 15 S.W. 396, 399 (Tex. 1891); *Hedick v. Lone Star Steel Co.*, 277 S.W.2d 925, 929–30 (Tex. Civ. App.—Texarkana 1955, writ ref'd n.r.e.).

96. See FORM 610-2015, *supra* note 2, at art. VII.B.

97. See *id.* at art. V.D.2.

98. See *id.* at art. VII.C. In the 2015 Form JOA, the time to pay such an advance has been extended from fifteen to thirty days after the date the estimate and invoice has been received. See *id.*

99. See *id.*

100. See *id.* at art. VII.B ¶ 5.

101. See, e.g., FORM 610-1982, *supra* note 15, at art. VII.B ¶ 1 (granting lien to operator only).

leases and oil and gas interests in the contract area and its share of all production and equipment.¹⁰² This lien is an enforceable security interest, and the lienholder has the right to foreclose on any of the collateral specified in the security agreement.¹⁰³ As long as the JOA expressly authorizes foreclosure, or the use of any other remedy at law or equity, against any or all of the collateral without limiting or prescribing the exercise of such rights, the operator may exercise those remedies on any portion of the collateral, regardless of any fiduciary duties that might be imposed under the JOA.¹⁰⁴

The contractual lien in the operating agreement meets the basic requirements for the creation of a mortgage and a security interest in certain parts of the real and personal property of each party.¹⁰⁵ However, several writers have noted deficiencies in the security provisions of some earlier JOA forms that may result in fewer rights for the lienholder than expected.¹⁰⁶ As described below, these deficiencies largely were remedied in the 1989 Form JOA and the 2015 Form JOA if used together with the AAPL-Form 610RS-1989 Model Form Recording Supplement to Operating Agreement and Financing Statement (Recording Supplement) published by the A.A.P.L. in 1989.¹⁰⁷

a. Collateral Descriptions

First, complaints were raised as to the sufficiency of collateral descriptions in older forms such as the use of the ambiguous term “oil and gas rights”¹⁰⁸ that “may not include all of a party’s rights associated with the mineral estates within the [c]ontract [a]rea, such as non-operating interests

102. See FORM 610-2015, *supra* note 2, at art. VII.B ¶ 1; FORM 610-1989, *supra* note 15, at art. VII.B ¶ 1.

103. See *Gunn v. Stagg*, 197 So. 2d 125, 129 (La. Ct. App. 1967); *Doanbuy Lease & Co. v. Melcher*, 488 P.2d 339, 342 (N.M. 1961); *Syring v. Sartorius*, 277 N.E.2d 457, 459 (Ohio Ct. App. 1971).

104. See *Bays Expl., Inc. v. PenSa, Inc.*, No. Civ-07-754-D, 2012 WL 4128120, at *16 (W.D. Okla. 2012) (quoting *Conine*, *supra* note 4, at 1303-04); *Amarex, Inc. v. El Paso Nat. Gas Co.*, 772 P.2d 905, 908 (Okla. 1987); *Houston & W. Tex. Co. v. Storey*, 117 S.W.2d 832, 837 (Tex. Civ. App.—El Paso 1938, no writ); *Andreau v. Mich. Wis. Pipeline Co.*, 712 P.2d 372, 377 (Wyo. 1986). However, wrongful exercise of the operator’s lien can result in charges of conversion and intentional interference with contractual relations. See *Estate of T.K. Jackson v. Phillips Petroleum Co.*, 676 F. Supp. 1142, 1146, 1148 (S.D. Ala. 1987).

105. See FORM 610-2015, *supra* note 2, at art. VII.B ¶ 5; FORM 610-1989, *supra* note 15, at art. VII.B ¶ 5.

106. See Robert C. Bledsoe, *Operating Agreements from the Standpoint of the Non-Operator*, ST. B. TEX., ADVANCED OIL, GAS & MINERAL L. COURSE F-16 (1985); J. David Heaney, *The Joint Operating Agreement, the AFE and COPAS-What They Fail to Provide*, 29 ROCKY MTN. MIN. L. INST. 17-1 (1983); George J. Morgenthaler, *Planning Ahead for a Co-Participant’s Bankruptcy: A Stitch in Time*, 32 ROCKY MTN. MIN. L. INST. 13-1 (1986); J. O. Young, *Oil and Gas Operating Agreements: Producers’ 88 Operating Agreements, Selected Problems and Suggested Solutions*, 20 ROCKY MTN. MIN. L. INST. 7-1 (1975).

107. See FORM 610RS-1989, *supra* note 87.

108. See FORM 610-1982, *supra* note 15, at art. VII.B; FORM 610-1977, *supra* note 51, at art. VII.B.

and reversionary rights.”¹⁰⁹ Further, a defaulting party’s share of production is included in the listed collateral, but under older forms, property such as inventories, accounts, and proceeds are not.¹¹⁰ Although a security interest in collateral such as production will continue in any identifiable proceeds, the security interest ceases to be perfected twenty-one days after receipt by the debtor if the financing statement does not expressly apply to proceeds.¹¹¹ Moreover, in the absence of an assignment of proceeds in the security agreement, most purchasers are reluctant to pay proceeds to the operator, and a demand for payment will likely result in no more than a suspension of payments to any party.¹¹² In addition, the collateral descriptions under older forms may not include after-acquired property such that only the interests owned by a party at the time of its default may be subject to foreclosure.¹¹³

In contrast to older forms, the 1989 and 2015 AAPL Form JOAs use the more clearly defined terms “Oil and Gas Leases” and “Oil and Gas Interests.”¹¹⁴ They also expand the description of the collateral covered by the lien and security interest to include, among other things, leasehold interests, working interests, operating rights, royalty and overriding royalty interests, as-extracted oil and gas, accounts, contract rights, inventory, and general intangibles.¹¹⁵ The lien and security interest now expressly covers all after-acquired real property interests of a party in the contract area and all products and proceeds of all of the specifically described categories of collateral.¹¹⁶

Article 9 of the Uniform Commercial Code (UCC) was significantly revised, effective July 1, 2001, including provisions recommended by a task force on oil and gas finance.¹¹⁷ The 2001 revisions to UCC Article 9 clarified that minerals in the ground are treated as real property and excluded from Article 9,¹¹⁸ minerals subject to attachment at the time of extraction are a new category of “as-extracted collateral,” and treated separately,¹¹⁹ and minerals

109. Conine & Kramer, *supra* note 1.

110. See FORM 610-1982, *supra* note 15, at art. VII.B; FORM 610-1977, *supra* note 51, at art. VII.B.

111. See U.C.C. § 9-315(d) (AM. LAW INST. & UNIF. LAW COMM’N 2018).

112. See Walter K. Boyd, *Crude Oil Purchasing—Its Title Opinions and Division Orders*, 18 INST. ON OIL & GAS L. & TAX’N 233, 268 (1967); Morgenthaler, *supra* note 106, at 13-1; Young, *supra* note 106, at 7-1.

113. Whether after-acquired collateral is covered under a security agreement is a question of contract interpretation and is not covered by a statutory rule in the UCC. See U.C.C. § 9-108, cmt. 3 (AM. LAW INST. & UNIF. LAW COMM’N 2018). If the security agreement covers after-acquired collateral, then a financing statement will be effective to cover after-acquired collateral of the types of property indicated in the financing statement without mentioning after-acquired collateral. See *id.* § 9-502, cmt. 2.

114. FORM 610-2015, *supra* note 2, at art. VII.B; FORM 610-1989, *supra* note 15, at art. VII.B.

115. See FORM 610-2015, *supra* note 2, at art. VII.B; FORM 610-1989, *supra* note 15, at art. VII.B.

116. See FORM 610-2015, *supra* note 2, at art. VII.B ¶ 1; FORM 610-1989, *supra* note 15, at art. VII.B ¶ 1.

117. See Alvin v. Harrell, *Oil and Gas Finance under Revised UCC Article 9*, 33 TEX. TECH. L. REV. 31, 32 (2001).

118. See U.C.C. § 9-102(a)(44) (AM. LAW INST. & UNIF. LAW COMM’N 2018).

119. See *id.* § 9-102(a)(6).

subject to attachment after extraction are goods, usually as inventory held for sale.¹²⁰ The collateral descriptions in the 1989 and 2015 Form JOAs and the recording supplement comport with the UCC revisions, but as discussed below, implicate the filing of financing statements.¹²¹

b. Secured Obligations

Second, commentators complained that earlier forms limited secured obligations to debts owed for costs and expenses, but did not apply to other indebtedness created in the course of the transaction.¹²² These obligations might include, *inter alia*, liability of the operator for funds collected in excess of operating costs that are misappropriated by the operator for other uses.¹²³ In response, the 1989 and 2015 AAPL Forms expanded the obligations secured by the lien and security interest to cover “all . . . obligations” under the operating agreement, including obligations to assign and relinquish interests in oil and gas leases and obligations of the operator to properly perform operations¹²⁴ rather than just payment obligations.¹²⁵

c. Remedies

Third, commentators complained of deficiencies in available remedies. For example, earlier forms granted to the operator alone the right to receive direct payments from purchasers of production after a default.¹²⁶ After a default by the operator, the non-operators had no reciprocal right in their lien on its interest.¹²⁷ The drafters of the 1989 and 2015 Form JOAs responded by expanding the right to collect proceeds of production to all of the parties, and by expressly providing that purchasers may rely on a notice of default instructing the purchaser to release production.¹²⁸

120. *See id.* § 9-102(a)(44), (48).

121. *See* FORM 610-2015, *supra* note 2, at art. VII.B; FORM 610-1989, *supra* note 15, at art. VII.B; FORM 610RS-1989, *supra* note 87.

122. *See* FORM 610-1982, *supra* note 15, at art. VII.B (specifying “to secure payment of its share of expense”); FORM 610-1977, *supra* note 51, at art. VII.B. (providing “to secure payment of its share of expense”); 1956 Form JOA, *supra* note 2, at § 9 (specifying “to secure the payment of all sums due”); *see also* Conine & Kramer, *supra* note 1.

123. *See* Conine & Kramer, *supra* note 1.

124. *See* FORM 610-2015, *supra* note 2, at art. VII.B, ¶ 1; FORM 610-1989, *supra* note 15, at art. VII.B ¶ 1.

125. *See, e.g.*, FORM 610-1982, *supra* note 15, at art. VII.C.

126. *See, e.g.*, FORM 610-1982, *supra* note 15, at art. VII.B ¶ 1; FORM 610-1977, *supra* note 51, at art. VII.B ¶ 1.

127. *See, e.g.*, FORM 610-1982, *supra* note 15, at art. VII.B ¶ 1; FORM 610-1977, *supra* note 51, at art. VII.B ¶ 1.

128. *See* FORM 610-2015, *supra* note 2, at art. VII.B, ¶ 4; FORM 610-1989, *supra* note 15, at art. VII.B ¶ 4.

Older forms also relied exclusively on standard legal procedures for foreclosure, which imposed a considerable burden on lienholders.¹²⁹ No provision was made for non-judicial foreclosure or, where permitted by law, for the waiver or reduction of rights of redemption, valuation, appraisal, stay of execution, or marshalling of assets, which can greatly speed recovery and reduce attorneys' fees.¹³⁰ These rights and a number of new contractual remedies were inserted into the 1989 and 2015 Form JOAs, including the suspension of a defaulting party's rights under the agreement, the express right of the non-defaulting parties to bring a suit for damages, and the right of the non-defaulting parties to deem a defaulting party to have elected not to participate in an operation.¹³¹

d. Failure to Ensure Proper Perfection

Perhaps no defect in the lien is as significant as the absence of sufficient information to facilitate perfection of the liens created in the operating agreement. The lien is effective between the parties without being placed of record,¹³² but must be filed in the real property records and as provided in the UCC to establish priority over third parties as to the real and personal property described as collateral in the JOA.¹³³ Unperfected security interests are avoidable in bankruptcy¹³⁴ and subordinated to the interests of most other claimants.¹³⁵

Each party must be responsible to ensure the perfection of its lien and security interest against the other parties, which under the UCC requires the filing of a financing statement.¹³⁶ This has become a much simpler process since the issuance of the Recording Supplement.¹³⁷ Although simple form

129. See Conine, *supra* note 4, at 1381–84.

130. See *id.*

131. See FORM 610-2015, *supra* note 2, at art. VII.D; FORM 610-1989, *supra* note 15, at art. VII.D. For a comprehensive discussion of the perfection and priority of the liens and security interests and the remedies of the parties upon a default under the 1989 Form JOA in particular, see Jeffrey S. Munoz & Nikita S. Taldykin, *Best Management Practices—Securing Your Position*, 56 ROCKY MTN. MIN. L. INST. 3-1 (2010).

132. See *Wilson v. TXO Prod. Corp.* (*In re Wilson*), 69 B.R. 960, 964 (Bankr. N.D. Tex. 1987).

133. See TEX. PROP. CODE ANN. § 13.001(a) (West 1984). *But see* K.E. Res., Ltd. v. BMO Fin. Inc. (*In re Century Offshore Mgmt. Corp.*), 119 F.3d 409, 413 (6th Cir. 1997) (stating mortgage filed first under Louisiana's race recording statute is contractually subordinate to interests under the operating agreement in which the mortgage cites that it is "subject to" the operating agreement); *Grace-Cajun Oil Co. No. 3 v. FDIC*, 882 F.2d 1008 (5th Cir. 1989) (maintaining that under Louisiana Revised Statute 31.204, a mortgage of production proceeds is encumbered by the obligation to pay well costs pursuant to an unrecorded JOA).

134. See 11 U.S.C. § 544(a) (2011) (stating that a trustee in bankruptcy may set aside unperfected security interests).

135. See U.C.C. § 9-334 (AM. LAW INST. & UNIF. LAW COMM'N 2018).

136. See *id.* § 9-310.

137. See Paul G. Yale, *The AAPL Operating Agreement and the Deadbeat Non-Operator*, 38-2 OIL, GAS & ENERGY L. SEC. OF THE ST. B. TEX. 7 (2014), <http://m.grayreed.com/portalresource/lookup/wosid/cp-base-4-37802/media.name=/AAPLOperatingAgreementandDeadbeatNonOperator.pdf> ("The

financing statements are available for filing in all states, the Recording Supplement may be filed as a financing statement as it contains all the elements for a financing statement required by the UCC.¹³⁸ As to personal property, the signatures of the other parties are no longer required for the filing of a financing statement to perfect a security interest in personal property under the UCC.¹³⁹ Signatures and acknowledgments, however, will be required to perfect the lien in the real property records and enforce the real property lien against third parties.¹⁴⁰

Perhaps the most neglected requirement since the adoption of Revised Article 9 relates to the locations in which the financing statement must be filed.¹⁴¹ To perfect the lien on real property against third parties, state law will ordinarily require the filing of the JOA or the recording supplement in the county or parish where the contract area is located.¹⁴² Similarly, the UCC requires the filing of a financing statement that covers fixtures and as-extracted collateral in the county or parish records.¹⁴³ However, to perfect and establish priority as to other types of personal property, including equipment, severed oil and gas held for sale as inventory, and the proceeds thereof, the financing statement must be filed in the state filing office, often the secretary of state, where each other party to the JOA is “located”—defined for most entities as the state office where the party is incorporated or organized.¹⁴⁴ If there are multiple parties to a JOA and a party desires to

recording supplement was designed to comply not only with the real property laws of the states . . . but also with security interest provisions of the [UCC]”).

138. See U.C.C. § 9-102(a)(39), (70) (AM. LAW INST. & UNIF. LAW COMM’N 2018) (defining “financing statement” and “reward,” respectively); see also FORM 610-1989, *supra* note 15, at art. VII.B.15–20. Under Revised Article 9, to perfect a security interest for most collateral types, a financing statement need only provide the name of the debtor, the name of the secured party, and a description of the collateral. See *id.* at § 9-502(a). An important exception applies to as-extracted collateral and any oilfield equipment that may be considered fixtures, for which the financing statement must also state that it covers as-extracted collateral and fixtures, indicate that it is to be filed in the real property records (usually by recital), provide a description of the real property, and provide the name of the record owner if the debtor is not the record owner. U.C.C. § 9-502(a), (b). This last requirement might easily nullify a financing statement as to the property on a lease if the working interest owner that contributed the lease has not put the lease on record and the record owner is not indicated in the financing statement. See *generally id.*

139. See U.C.C. § 9-502(b) (AM. LAW INST. & UNIF. LAW COMM’N 2018).

140. See *Amarex, Inc. v. El Paso Nat. Gas Co.*, 772 P.2d 905, 908 (Okla. 1987).

141. See U.C.C. § 9-501 (AM. LAW INST. & UNIF. LAW COMM’N 2018).

142. See FORM 610-1989, *supra* note 15, at art. VII.B.15–20.

143. See U.C.C. § 9-501 (AM. LAW INST. & UNIF. LAW COMM’N 2018). Perfection and priority of a security interest in as-extracted collateral is governed by the law where the wellhead is located. See *id.* § 9-301.

144. The UCC reaches this result in a somewhat meandering route. See *id.* § 9-307(c). Under UCC § 9-307(e), a debtor that is a registered organization (defined in UCC § 9-102 to include corporations, limited partnerships, limited liability companies, etc.) is located in its state of organization. See *id.* While a debtor is “located” in the jurisdiction, the local law of that jurisdiction governs perfection and priority. See *id.* § 9-301(1). This choice-of-law rule is true in all cases, except when the collateral is located in another jurisdiction. See *id.* § 9-301(1)–(2). When the local law of a state governs perfection of a security interest, then the financing statement must be filed in the state filing office. See *id.* § 9-501(a)(2). Of note,

perfect its security interest against each other party, it must therefore file a separate financing statement in each state where each party is organized or incorporated.¹⁴⁵ In making such filings, a party must be particularly careful to use the name of the other parties indicated on their articles or certificate of incorporation (for a corporation), or in the articles or certificate of formation of organization (for an LLC), among other things.¹⁴⁶

After perfection and priority are obtained, the parties must vigilantly monitor perfection to account for the propensity of JOA parties to transfer all or a portion of their interests, often multiple times, during the life of the JOA, or to merge or combine with other parties.¹⁴⁷ Although generally a financing statement filed against a transferor of assets is effective to perfect assets secured by the JOA against the transferee that becomes bound by the JOA, this statement is subject to some qualifications.¹⁴⁸ First, if a transfer or merger causes the name of the debtor on the financing statement to be seriously misleading, then a filed financing statement is only effective as to assets acquired by the transferee before or within four months after the transfer or merger.¹⁴⁹ In other words, the financing statement remains effective as to the transferred assets, but not as to assets acquired more than four months after the transfer or merger unless a new financing statement is filed during that four-month period.¹⁵⁰ Second, if the transferee is incorporated or organized in a different jurisdiction than the transferor, the financing statement will expire one year after the transfer of the collateral unless a new financing statement is filed against the transferee.¹⁵¹

Further, much like the parties must monitor the primary term of their oil and gas leases, the parties must also monitor financing statement filing dates for expiration.¹⁵² Generally, a financing statement becomes ineffective within five years after the filing of the financing statement unless a continuation statement is filed within six months before the expiration of the

Louisiana has not adopted this state filing system. *See* LA. STAT. ANN. § 10:9-501 (2011). If Louisiana law governs, a financing statement may be filed with the clerk of court of any parish without regard to the location of the debtor or the collateral. *See id.* Louisiana has made a number of other significant non-uniform changes to Article 9; for a discussion, see generally, James A. Stuckey, *Louisiana's Non-Uniform Variations in the U.C.C. Chapter 9*, 62 LA. L. REV. 793 (2002).

145. *See* U.C.C. § 9-501 (AM. LAW INST. & UNIF. LAW COMM'N 2018).

146. *See id.* § 9-503. Failure to use the exactly correct name may render the financing statement fatally defective. *See id.* §§ 9-506, 9-508, 9-516. In 2010, the UCC was amended to provide that a registered organization's name for Article 9 purposes is the "name on the public organic record most recently filed with or issued or enacted by the registered organization's jurisdiction of organization which purports to state, amend, or restate the registered organization's name." *Id.* § 9-503(a)(1).

147. *See id.* § 9-508.

148. *See id.* § 9-508(a).

149. *See id.* § 9-508(b)(1); *see also* JULIAN B. McDONNELL & JAMES P. NEHF, 1-1A SECURED TRANSACTIONS UNDER THE UCC § 1A.05 (2014).

150. *See* U.C.C. § 9-508(b) (AM. LAW INST. & UNIF. LAW COMM'N 2018).

151. *See id.* § 9-316(a)(1).

152. *See generally id.* § 9-515 (providing information regarding the duration and effectiveness of a financing statement).

five-year period.¹⁵³ There is an exception for financing statements that constitute a “record of mortgage” filed in the county or parish records, whereby the financing statement remains effective until the record is released.¹⁵⁴

Although the recording supplement appears to satisfy the requirements for a “record of mortgage” filed as a financing statement so long as the recording supplement is duly recorded,¹⁵⁵ recall that the recording supplement is only effective as a financing statement under the UCC to cover fixtures and as-extracted collateral.¹⁵⁶ Also, the official UCC appears to contain a strange glitch, in that the continued effectiveness of a record of mortgage only remains effective as a fixture filing, but not with respect to as-extracted collateral.¹⁵⁷ Texas has corrected this glitch,¹⁵⁸ but other producing states have not.¹⁵⁹ In states that carried forward this glitch when adopting Revised Article 9, financing statements filed of record in the county or parish must be continued every five years to protect as-extracted collateral similar to financing statements filed in the state office.¹⁶⁰

Finally, consider that the operator may also utilize state mechanics’ and materialmen’s liens, or similar statutory liens, against the interests of the non-operators under the express terms of the 1989 and 2015 Form JOAs,¹⁶¹ even though the operator is also the owner of a working interest.¹⁶² These

153. *See id.* § 9-515(a), (d), (e).

154. *See id.* § 9-515(g).

155. *See id.* §§ 9-502(c), 9-102 (defining “mortgage” as an interest in real property).

156. *See id.* §§ 9-102(a)(39), (70), 9-502(b).

157. *See id.* § 9-515(g).

158. *See* TEX. BUS. & COM. CODE ANN. § 9.515(g) (West 2017).

159. *See, e.g.*, COLO. REV. STAT. § 4-9-515(g) (West 2017); KAN. STAT. ANN. § 84-9-515(g) (West 2018); N.M. STAT. ANN. § 55-9-515(g) (West 2017); N.D. CENT. CODE ANN. § 41-09-86 (West 2017); WYO. STAT. § 34.1-9-515(g) (West 2017).

160. *See* Telephone interview with Lynn P. Hendrix, Partner, Bryan Cave (Sept. 6, 2016). Mr. Hendrix stated that he has advocated to the National Conference of Commissioners on Uniform State Laws to correct this problem. *See id.*

161. *See* FORM 610-2015, *supra* note 2, at art. VII.B, ¶ 7; FORM 610-1989, *supra* note 15, at art. VII.B, ¶ 7. In the absence of a contractual lien, each party may have a partner’s lien on a defaulting party’s interest for advances made on its behalf, assuming the operating agreement is construed to create a mining partnership. Terry Noble Fiske, *Mining Partnerships*, 26 INST. ON OIL & GAS L. & TAX’N 187, 221 (1975). If the interests within the contract area are subject to concurrent ownership among all parties, the operator would have a similar right in most states as a co-tenant to offset production against expenses incurred in developing the minerals. It has been suggested that parties to the operating agreement might also be protected by an equity lien in the absence of an express security interest, provided the facts infer an intent to pledge the property for such a debt. *See* Heaney, *supra* note 106, at 17-1.

162. *See, e.g.*, *Amarex, Inc. v. El Paso Nat. Gas Co.*, 772 P.2d 905, 909–10 (Okla. 1987) (citing *Uncle Sam Oil Co. v. Richards*, 158 P. 1187 (Okla. 1916)) (dismissing the notion from *Uncle Sam Oil Co. v. Richards* that an operator who is also a co-owner is not entitled to enforce an oil and gas lien). In Kansas, it appears that a statutory lien claimed by an operator is valid if it is limited to the interest of his cotenant, but is not valid if it is claimed on the entire lease. *See* *Klima Well Serv., Inc. v. Hurley*, 133 F. Supp. 3d 1297, 1301 (D. Kan. 2015) (quoting David Pierce, *Kansas Oil and Gas Lien Law*, 56-J. KAN. B. ASS’N 8, 8–9 (Aug. 1987)) (concluding that while the statute sets the breadth of the statutory lien to reach the whole leasehold, the unjust enrichment policy underlying the statute allows a lien to be asserted against a nonoperator’s fractional interest in the lease).

liens often arise under statutes specifically aimed at labor or material furnished for oil and gas operations.¹⁶³ The statutory lien will attach only to the specific property mentioned in the lien statute, which generally will include oil and gas leases and interests, and material or machinery,¹⁶⁴ but may or may not include the proceeds of production.¹⁶⁵

If an operator asserts a statutory lien, it must strictly comply with the procedures to perfect the lien under the lien statute.¹⁶⁶ For example, under Texas law, to secure a lien the claimant must file an affidavit with the county clerk of the county where the property is located.¹⁶⁷ In *In re Wave Energy, Inc.*, an engineer who performed work filed a lien claim on a document that contained an oath and was acknowledged by a notary.¹⁶⁸ The court held that the document failed to constitute an affidavit because an affidavit requires a jurat (a statement by the notary or other authorized person showing that the oath was sworn in her presence), and an acknowledgment is not a jurat.¹⁶⁹

3. Implied Reciprocal Transfers

One further structural feature that should be noted is the possibility of the creation of co-tenancies among the JOA parties with respect to the leases contributed to the contract area, when none existed before execution of the agreement.¹⁷⁰ There are no words of grant contained in the JOA that produce the transfers needed to accomplish this redistribution of title.¹⁷¹ Instead, such transfers are implied under legal theories applied by some courts. When the phenomenon has occurred, the transfer has been based on the analogy between the sharing arrangements established by the JOA and those in pooling and unitization agreements.¹⁷²

163. See, e.g., COLO. REV. STAT. § 38-24-101; N.M. STAT. § 70-4-1; TEX. PROP. CODE ANN. § 56.003(2) (West 1984).

164. See TEX. PROP. CODE § 56.003(2); see also COLO. REV. STAT. § 38-24-101; N.M. STAT. § 70-4-1.

165. Compare N.M. STAT. § 70-4-1 (stating that the lien includes “the proceeds from the sale of oil and gas produced therefrom inuring to the working interest”), with *Chambers v. Nation*, 497 P.2d 5, 8 (Colo. 1972) (stating that the lien statute does not cover proceeds of production), and *Wilkins v. Fecht*, 356 S.W.2d 855 (Tex. Civ. App.—San Antonio 1962, writ ref’d) (stating that lien does not cover proceeds of production). But see *Abella v. Knight Oil Tools*, 945 S.W.2d 847 (Tex. App.—Houston 1997, no writ) (holding that statutory lienholders entitled to the appointment of a receiver to protect the value of oil and gas leases covered by liens until foreclosure action where defendants claim they have the right to receive proceeds of production).

166. See, e.g., TEX. PROP. CODE § 56.021(a).

167. See *id.*

168. *Wave Energy, Inc. v. Ogle (In re Wave Energy, Inc.)*, 467 F. App’x 248, 249 (5th Cir. 2012).

169. See *id.* at 251–52.

170. See *Masgas v. Anderson*, 310 S.W.3d 567, 570 (Tex. App.—Eastland 2010, pet. denied).

171. See *id.* (stating JOA and division order could not be read together to constitute a deed because neither contained words of grant indicating intent to convey disputed working interests).

172. See *Conine*, *supra* note 4, at 1278–86.

“In most instances, the pooling and unitization of tracts has been characterized as a contractual arrangement among the owners of separate properties for the sharing of expenses and production The rationale for the contract theory focuses on the absence of granting language in pooling agreements.”¹⁷³ “In contrast, the courts of Texas, California, Illinois, and Mississippi [have taken] the position that pooling [and] unitization [agreements] result[] in a cross-conveyance of interests among the parties As a result, title to each tract in the unit is” deemed to be literally assigned to each party in an amount equal to its participation.¹⁷⁴ “This cross-conveyance theory is based on the provisions of the pooling instrument” ascribing an interest in production to each party regardless of the location of the well within the unit.¹⁷⁵ In Texas, as in other states, the issue of whether a pooling agreement is a cross-conveyance arises most often in situations in which a party claims that all parties to the agreement are indispensable parties to a lawsuit,¹⁷⁶ but it also has implications for rights of partition, the Statute of Frauds, the Rule against Perpetuities, and other rights and restrictions arising under property law.¹⁷⁷

One might argue that the sharing of production under a JOA according to the parties’ respective ownership creates a cotenancy.¹⁷⁸ One Texas court extended the concept of implied cross-conveyancing to the JOA, but the precedential value of the case is severely limited by its factual setting, which did not directly raise an issue of title but involved distribution of production from a gas unit created inside a contract area.¹⁷⁹ Further, the requirement that each party take in kind or separately dispose of its share of production “militates against a common ownership theory.”¹⁸⁰

Despite the right of each owner to separately take and market its share of production, the Oklahoma Supreme Court in *Harrell v. Samson Resources Co.* concluded that, although the parties did not own undivided interests in the same property, the ownership clause created a co-tenant-like relationship as to gas sold.¹⁸¹ Under this rationale, the attempted sale by the overproduced cotenant was a “derogation” of the rights of the underproduced cotenant that constituted an outster, and thus it required an accounting to the

173. *Id.* at 1279–80.

174. *Id.* at 1280.

175. *See id.*

176. *See generally, e.g.,* *Veal v. Thomason*, 159 S.W.2d 472 (Tex. 1942).

177. *See* 2 BRUCE M. KRAMER & PATRICK H. MARTIN, *THE LAW OF POOLING AND UNITIZATION* § 19.01 (3d. ed. 2015).

178. In a recent North Dakota case, the plaintiff argued that it was entitled to well information from the operator in part because the parties to the JOA were cotenants. *See* *Come Big or Stay Home, LLC v. EOG Res., Inc.*, 816 N.W.2d 80 (N.D. 2012). The court rejected this argument, noting that North Dakota law also rejects the idea that pooling creates a cotenancy. *See id.* at 87.

179. *See* *Gillring v. Hughes*, 618 S.W.2d 874 (Tex. App.—Beaumont 1981, no writ).

180. *Doheny v. Wexpro Co.*, 974 F.2d 130, 134 (10th Cir. 1992) (applying Wyoming law).

181. *Harrell v. Samson Res. Co.*, 980 P.2d 99, 103 (Okla. 1998) (citing David Pierce, *The Law of Disproportionate Gas Sales*, 26 TULSA L. J. 1 (1990)).

underproduced cotenant in equity where there was no balancing agreement.¹⁸² Because of this co-tenancy relationship, the court held that the underproduced cotenant was entitled to predepletion cash balancing in the absence of a provision that limited available remedies to balancing in kind and because “balancing in kind was not feasible.”¹⁸³ In a more recent case applying *Harrell*, the court stated that a sale by an overproduced party is not automatically a “derogation” of rights that results in an ouster, but rather requires a balancing of the equities and depends upon whether the seller denies any future liability for the overproduction.¹⁸⁴

Most operating agreements used today, including the 2015 Form JOA, contain an express disclaimer of any cross-conveyance of interests,¹⁸⁵ and court decisions involving pooling agreements containing such disavowals have consistently respected the express intent of the parties by rejecting any implication of cross-conveyance.¹⁸⁶ Indeed, the court in *Harrell* pointed out that the 1956 Form JOA at issue did not contain the cross-conveyance disclaimer that the AAPL added to the 1977 Form JOA and 1982 Form JOA.¹⁸⁷

III. RESTRICTIONS ON TRANSFERS AND RELINQUISHMENTS

Although each party to the JOA contributes one or more leasehold or mineral interests to the contract area, it also retains its individual title to that property.¹⁸⁸ This puts each party in a position in which it can disrupt the structure of the JOA and endanger the relationships created by the transaction simply by exercising those property rights.¹⁸⁹ Several provisions have been inserted into the standard JOA forms to limit or restrict the exercise of these rights.

182. *See id.* at 102.

183. *See id.* at 104.

184. *Unit Petroleum v. Mobil Expl. & Prod. N. Am., Inc.*, 78 P.3d 1238, 1242 (Okla. Civ. App. 2003); *see also Sanderson v. Yale Oil Ass’n*, 246 P.3d 1109, 1112 (Okla. Civ. App. 2010) (stating that the sale by an underproduced party is not a derogation of rights that constitutes an ouster; the statute of limitations did not start to run).

185. For example, Article III.B of the 2015 Form JOA, 1989 Form JOA, and 1982 Form JOA declares that it shall not “be deemed an assignment or cross-assignment of interests covered hereby.” FORM 610-2015, *supra* note 2, at art. III.B; FORM 610-1989, *supra* note 15, at art. III.B; FORM 610-1982, *supra* note 15, at art. III.B.

186. *See, e.g.*, *Stumpf v. Fid. Gas Co.*, 294 F.2d 886, 894–95 (9th Cir. 1961); *Phillips Petroleum Co. v. Peterson*, 218 F.2d 926, 930 (10th Cir. 1954); *Garvin v. Pettigrew*, 350 P.2d 970, 971 (Okla. 1958). This is distinctly different from the practice before the 1950s by which parties to the operating agreement exchanged leasehold assignments within the contract area. *See, e.g.*, *U.S. Truck Lines v. Texaco, Inc.*, 337 S.W.2d 497 (Tex. Civ. App.—Eastland 1960, writ denied).

187. *Harrell*, 980 P.2d at 102–03. It thus appears unresolved whether the disclaimer of cross-conveyance language in the more recent form JOAs would defeat the co-tenancy in production in Oklahoma. Of the subsequent cases citing *Harrell*, both *Unit Petroleum* and *Sanderson* appeared to involve a 1956 Form JOA. *Sanderson*, 246 P.3d at 1110; *Unit Petroleum*, 78 P.3d at 1239.

188. *See* FORM 610-2015, *supra* note 2, at art. IV.

189. *See generally id.*

A. Waiver of Partition

In many instances, the contract area covered by the JOA is subject to joint ownership among the contracting parties. This may result from the fact that the JOA was executed among cotenants to facilitate the joint development of a single tract.¹⁹⁰ Alternatively, the cotenancy may have been formed as a result of an express or implied cross-conveyance of interests when several tracts originally owned by different parties were committed to the JOA or a related pooling agreement.¹⁹¹ In either event, each cotenant may have the right to seek a division of the joint property through judicial partition.¹⁹² This gives each owner the potential to force a dissolution of the contract area and an early termination of the JOA.¹⁹³

Although the right of judicial partition is regarded by both common law and statutory law as an absolute right of any cotenant,¹⁹⁴ it can be waived by express or implied agreement of the joint owners.¹⁹⁵ To prevent the early termination of the JOA by judicial partition, beginning with the 1977 Form JOA, the AAPL form operating agreements include an express provision by which each contracting party waives the right of partition within the contract area during the term of the JOA.¹⁹⁶ Provided the agreed waiver is limited to a reasonable period of time and reasonably related to the purpose of the restriction, it is not regarded as an unreasonable restraint on alienation and in the absence of fraud or misrepresentation is fully enforceable.¹⁹⁷

Nevertheless, there are instances in which the waiver of partition has been omitted from the JOA form or intentionally deleted by the parties.¹⁹⁸ When this is the case, a question will sometimes arise as to whether a waiver of partition is implied from the general terms of the JOA.¹⁹⁹ Not surprisingly, courts of the various producing states are divided over the issue.²⁰⁰ Two distinct approaches have emerged.²⁰¹ One gives deference to the cotenant's right of partition and refuses to imply waiver under the JOA regardless of its terms; the other recognizes an implied waiver in which the terms of the JOA

190. *See generally id.*

191. *See generally supra* Section II.D.3 (discussing implied reciprocal transfers).

192. *See, e.g.,* Daven Corp. v. Tarh E&P Holdings, L.P., 441 S.W.3d 770, 777 (Tex. App.—San Antonio 2014, pet. denied).

193. *See generally id.*

194. *See id.* at 776–77. Texas law favors partition-in-kind and mineral interests are susceptible to partition if the property can be divided in kind without materially impairing its value. *See id.*

195. *See* Warner v. Winn, 191 S.W. 2d 747, 751 (Tex. Civ. App.—San Antonio 1945, writ denied).

196. *See, e.g.,* FORM 610-2015, *supra* note 2, at art. VIII.E; FORM 610-1989, *supra* note 15, at art. VIII.E; FORM 610-1982, *supra* note 15, at art. VIII.E; FORM 610-1977, *supra* note 51, at art. VIII.F.

197. *See, e.g.,* Figge v. Ohio L & M Co., Inc., No. 625, 1993 WL 472773 (Ohio Ct. App. 1993).

198. *See* Conine, *supra* note 4, at 1311–12.

199. *See id.*

200. *See id.* at 1312–13.

201. *See id.*

pass a certain threshold in modifying the property rights of the parties.²⁰²

For example, the courts of Oklahoma and Kansas have long concluded that there is no implied bar to partition under written agreements placing exclusive management of properties in one party that is obligated to operate and fully develop the leases,²⁰³ even when complemented by provisions granting a preferential right to purchase²⁰⁴ or non-consent penalties requiring forfeiture and assignment of each non-participant's working interest.²⁰⁵

A more accommodative position on the issue has been developing in Texas. Initially, it appeared that Texas might take the same position that developed in Oklahoma and Kansas. In *Warner v. Winn*, a Texas court was asked to grant a decree of partition affecting a collection of leases subject to a 1937 operating agreement.²⁰⁶ The operating agreement obligated the operator, at his own expense, to drill four wells on the leases.²⁰⁷ Thereafter, operating and development expenses were to be borne proportionately by the parties.²⁰⁸ In the absence of an express restriction on partition, the court granted the plaintiff's request for a decree, making it clear that a delegation of control over operations would be insufficient in itself to indicate that the parties intended to waive the right of partition.²⁰⁹ At the same time, the *Warner* court recognized that there could be exceptions to the absolute right to partition, noting that an agreement precluding partition could be implied "when a granting of such relief would destroy the estate sought to be partitioned."²¹⁰

This exception was first applied to an operating agreement in *Sibley v. Hill*.²¹¹ In that case, some of the co-owners of two leases brought suit for partition and cancellation of the operating agreement that covered the properties.²¹² The operating agreement provided that it was to continue in

202. *See id.*

203. *See, e.g.,* *Sweeney v. Bay State Oil & Gas Co.*, 133 P.2d 538, 539 (Okla. 1943). For a similar position taken by a Louisiana court, see generally *Delta Drilling Co. v. Oil Finance Corp.*, 196 So.2d 914 (La. 1940).

204. *See* *Komarek v. Perrine*, 382 P.2d 748, 750 (Okla. 1963).

205. *See* *Home-Stake Prod. Co. v. Tri-State Pipe Co.*, 415 P.2d 377 (Kan. 1966).

206. *Warner v. Winn*, 191 S.W.2d 747, 748-49 (Tex. Civ. App. 1945, writ ref'd n.r.e.).

207. *See id.* at 748-49.

208. *See id.* at 749.

209. *See id.* at 751-52.

210. *See id.* at 751. Over time, Texas courts have acknowledged several contractual provisions affecting title that imply a waiver of partition. *See, e.g.,* *Hulsey v. Keel*, 700 S.W.2d 255, 258 (Tex. App.—San Antonio 1985, writ ref'd n.r.e.) (specifying grants of carried interests in any development of the property); *Long v. Hitzelberger*, 602 S.W.2d 321, 323 (Tex. Civ. App.—Eastland 1980, no writ) (stating express drilling covenants that comprise part of the consideration for the transfer of a leasehold interest); *Inner City Props., Inc. v. Gibbs*, 560 S.W.2d 503, 504 (Tex. Civ. App.—Houston [14th Dist.], writ ref'd n.r.e. 1977) (maintaining restrictions of use and occupancy granted to parties jointly approved by the co-owners); *Allison v. Smith*, 278 S.W.2d 940, 945-46 (Tex. Civ. App.—Eastland 1955, writ ref'd n.r.e.) (discussing transfers of executive rights); *Elrod v. Foster*, 37 S.W.2d 339, 342 (Tex. Civ. App.—Austin 1931, writ ref'd) (stating express drilling covenants that must be performed to maintain a lease).

211. *See* *Sibley v. Hill*, 331 S.W.2d 227, 229 (Tex. Civ. App.—El Paso 1960, no writ).

212. *Id.* at 227-28.

effect so long as there was production from the leases, and contained a preferential right to purchase clause benefiting each party to the JOA.²¹³ The court construed these elements to indicate “a clear implication that the absolute right of partition had been contracted away.”²¹⁴ “A contrary result would enable the plaintiffs to escape their contractual commitments relating directly to title matters.”²¹⁵

More recently, in *Dimock v. Kadane*, the Texas Court of Appeals sitting in Eastland, Texas affirmed a district court holding that an implied waiver of partition is created in operating agreements containing (1) a term provision stipulating that the JOA is to remain in full force and effect as long as any of the leases within the contract area are alive, and (2) a subsequent operations provision imposing a non-consent penalty.²¹⁶ The court explained that to allow a party “to partition and thereby destroy the joint ownership of the leases, [the non-consent mechanism in the JOA] would be rendered meaningless.”²¹⁷ The court noted several other provisions in the operating agreement creating property rights that are also inconsistent with the right of partition.²¹⁸ These include the maintenance of uniform interest clause, the provision on extension and renewal of leases, and the provision on the surrender of leases.²¹⁹

The Texas courts seem to be telling us that there is no reason to imply a waiver of partition where cotenants have entered into an operating agreement that does no more than appoint a single party to operate existing wells under circumstances in which there is no remaining contingent drilling obligation in any party.²²⁰ Partition can still be accomplished equitably among all co-tenants through sale and liquidation because the only value any owner can expect to receive is through its proportionate share of production.²²¹

On the other hand, where partition will “destroy”²²² (that is, where “a contracting party could frustrate or completely avoid responsibilities and rights under a contract”²²³) rights beyond those established by co-tenancy

213. *Id.* at 228–29.

214. *Id.* at 229.

215. Conine, *supra* note 4, at 1314 (citing *Sibley*, 331 S.W.2d at 229).

216. *Dimock v. Kadane*, 100 S.W.3d 602, 605–06 (Tex. App.—Eastland 2003, pet. denied). Another Texas decision, *MCEN 1996 Partnership v. Glassell*, took a more lenient position on implied waiver of partition, but in the context of co-tenancies created by cross-conveyances under several pooling agreements. *MCEN 1996 P’ship v. Glassell*, 42 S.W.3d 262, 264 (Tex. App.—Corpus Christi 2001, pet. denied). The court of appeals indicated that the various term provisions in each of these pooling agreements amounted to an express waiver of partition. *Id.* The *Dimock* court was presented with the argument that the term stated in the JOA was sufficient in itself to find an implied waiver. *Dimock*, 100 S.W.3d at 606. The court did not endorse the argument. *See id.* at 606 n.3.

217. *Id.* at 606.

218. *Id.* at 606–08.

219. *See id.* at 606–07; accord Conine, *supra* note 4, at 1314–15.

220. *See Dimock*, 100 S.W.3d at 602; *Sibley*, 331 S.W.2d at 227.

221. *See Dimock*, 100 S.W.3d at 602; *Sibley*, 331 S.W.2d at 227.

222. *Dimock*, 100 S.W.3d at 606.

223. *Id.* at 608.

itself before the end of the term of the operating agreement, the Texas courts are willing to imply a waiver of the co-tenant's right of partition.²²⁴ In the two cases in which this implied waiver has been found, a partition would have effectively ended the operating agreement and destroyed the non-consent penalty imposed for refusals to participate in future development or the preferential right to purchase, which is available if a co-tenant decides to sell its interest in the contract area.²²⁵ The same destruction of valuable property rights would occur if there was a partition of an operating agreement containing any of the other three provisions mentioned by the *Dimock* court.²²⁶ If any of these provisions are contained in the operating agreement, the contract area cannot be partitioned equitably.²²⁷

B. Preferential Right to Purchase

Over time, the preferential right to purchase (preferential right) clause²²⁸ has been the most controversial property provision in the JOA.²²⁹ It typically requires any party proposing a bona fide sale of any of an interest in the contract area to give written notice to the other parties of the terms of the prospective sale,²³⁰ and grants a right to the other parties, exercisable within a prescribed period²³¹ after receipt of the notice, to purchase the interest under the same terms proposed in the transaction with the third party.²³² It is

224. *See id.*

225. *See id.*; *Sibley*, 331 S.W.2d at 229.

226. *See Dimock*, 100 S.W.3d at 606–08.

227. *See id.* In each instance the parties are assuming risks for themselves individually and benefits for others that can be escaped by partitioning the contract area and terminating the operating agreement. *See id.*

228. Also known as a right of first refusal or preemptive right. *See Conine*, *supra* note 4, at 1316 n.207. Although it has been referred to as a form of option, it is distinguished from an option because the holder of the preferential right may only exercise the right in connection with a sale by the other parties. *See id.* at 1316. A true option allows the optionee to exercise the right during a prescribed option period at a specified price regardless whether the optionor desires to sell at that time. *See id.* at 1317. The distinction between a right of first refusal and an option is important in the context of the Rule against Perpetuities and the Rule against Restraints on Alienation. *See infra* Sections V.B, C (discussing the rules at length). That said, a preferential right is essentially a dormant option that ripens into an option when an interest is offered in connection with a sale. *See McMillan v. Dooley*, 144 S.W.3d 159, 171 (Tex. App.—Eastland 2004, pet denied).

229. *See, e.g.*, *Conine*, *supra* note 4, at 1315.

230. The terms to be communicated in the notice are often kept to a minimum and include only the name and address of the prospective transferee, the purchase price, and the terms of the offer. *See* FORM 610-1982, *supra* note 15, at art. VIII.F. The 1989 Form JOA and the 2015 Form JOA add “a legal description sufficient to identify the property” to this same article. FORM 610-2015, *supra* note 2, at art. VIII.F; FORM 610-1989, *supra* note 15, at art. VIII.F.

231. The period to exercise the right is usually short in order to avoid undue delay in closing the third-party sale if the option is not exercised. *See, e.g.*, FORM 610-2015, *supra* note 2, at art. VIII.F; FORM 610-1989, *supra* note 15, at art. VIII.F; FORM 610-1982, *supra* note 15, at art. VIII.F (providing a ten-day period).

232. *See* FORM 610-2015 *supra* note 2, at art. VIII.F; FORM 610-1989, *supra* note 15, at art. VIII.F; FORM 610-1982, *supra* note 15, at art. VIII.F; FORM 610-1956, *supra* note 2, at § 18.

common to provide that the parties exercising their rights will share proportionately in the acquisition based on the relative size of their interests in the contract area.²³³

The holder of a preferential right has no power to force a sale.²³⁴ The decision on when, and under what terms, an interest is to be sold rests exclusively in the hands of the owner of that interest.²³⁵ As a result, despite the impediment the provision can create to the transfer of property, properly drafted preferential rights have been declared valid and enforceable.²³⁶ As is true for options, however, the preferential right is strictly construed against the holder of the right.²³⁷

In the JOA, the preferential right serves two purposes. First, it assures its holder an opportunity to acquire further interests in the contract area. The holder's evaluation of the area may be greatly enhanced by initial development and may increase its interest in procuring a larger stake in future operations under the JOA.²³⁸ Further, there is some feeling that if any parties should have an opportunity to acquire an interest in the contract area, it ought to be those that were at risk during the exploratory efforts that led to the development of the property.²³⁹

The second purpose behind the preemptive right is control over the admission to the joint operations of undesirable participants who may not have the necessary financial ability to bear their share of expenditures or who may frustrate development with engineering and management philosophies opposed by the current parties to the JOA.²⁴⁰

Unfortunately, the preemptive right is not always interpreted in a manner that promotes these two functions of the clause.²⁴¹ This limited effectiveness and the various complications created by the provision, together with the discouraging effect the clause can have on potential buyers reluctant to incur the cost of evaluating a property and negotiating its purchase when it may be subjected to preemption, often leads to the deletion of the provision from the JOA form.²⁴² Retention or deletion of the preferential right is a

233. See Conine, *supra* note 4, at 1316–17.

234. See *id.* at 1317.

235. See *Fasken Land and Minerals, Ltd. v. Occidental Permian Ltd.*, 225 S.W.3d 577, 590 (Tex. App.—El Paso 2005, pet. denied); see also *Hartnett v. Jones*, 629 P.2d 1357, 1363 (Wyo. 1981); 5A CORBIN, CONTRACTS § 1197 (1964); 6 ATKINSON ET. AL., AMERICAN LAW OF PROPERTY 507 (Casner ed. 1952). The preemptive right is not triggered by preliminary negotiations between offerors and potential purchasers. *Tenneco Inc. v. Enter. Prods. Co.*, 925 S.W.2d 640, 645 (Tex. 1996) (discussing natural gas fractionation plant).

236. See Conine, *supra* note 4, at 1317.

237. See *Exeter Expl. Co. v. Fitzpatrick*, 661 P.2d 1255, 1269 (Mont. 1983).

238. See *Questa Energy Corp. v. Vantage Point Energy Inc.*, 887 S.W.2d 217, 222 (Tex. App.—Amarillo 1994, writ denied).

239. See *id.*; *Brown v. Samson Res. Co.*, Nos. 99-6344, 99-6345, 2000 WL 1234851, at *2 (10th Cir. Aug. 31, 2000).

240. See *Questa Energy Corp.*, 887 S.W.2d at 222.

241. See *id.*

242. See Arthur J. Wright, *Joint Operating Agreements—Common Amendments and Mistakes*, 50

matter which deserves careful consideration before the outset of joint operations, but must be made without a clear picture of the future transactions that may be affected by the decision.²⁴³

1. Restrictions on Applicability

Under most clauses, preferential rights are contingent on a proposed “sale” by the current owner—²⁴⁴ a triggering event that has been the subject of extensive litigation.²⁴⁵ Though not universally accepted, it appears that most courts construe the term to require an arms-length agreement between willing parties to the transfer of property based on a cash consideration.²⁴⁶ The majority of decisions have concluded that the preferential right does not apply to “involuntary” sales.²⁴⁷ Thus, transfers by descent or public sales by administrators,²⁴⁸ condemnations,²⁴⁹ judicial sales,²⁵⁰ and foreclosure sales²⁵¹ generally do not trigger the option.²⁵² The courts also tend to refuse to activate the clause when the transfer is a gift or is based on a donative intent

ROCKY MTN. MIN. L. INST. 7-1, § 7.06 (2004).

243. See *Questa Energy Corp.*, 887 S.W.2d at 218–19, 222.

244. See *Navasota Res., L.P. v. First Source Tex., Inc.*, 249 S.W.3d 526, 530 (Tex. App.—Waco 2006, pet. denied). Even where the provision is contingent on an “assignment,” there has been a tendency to equate that event with a sale. See *Exeter Expl. Co. v. Fitzpatrick*, 661 P.2d 1256, 1258–59 (Mont. 1983) (reasoning that the term “assignment” was ambiguous in this context and that the later provisions of the clause granted “an option to purchase,” intimating that the preemptive right would only apply in the event of proposed sale to a third party (emphasis in original)).

245. See, e.g., *Isaacson v. First Sec. Bank*, 511 P.2d 269 (Idaho 1973); *McLeod v. Sandy Island Corp.*, 216 S.E.2d 746 (S.C. 1975); *Navasota Res., L.P.*, 249 S.W.3d at 526.

246. See, e.g., *Rainbow Oil Co. v. Christmann*, 656 P.2d 538, 543–44 (Wyo. 1982) (addressing preemptive right in farmout agreement).

247. See P.G. Guthrie, Annotation, *Rights of Holder of First Refusal Option on Real Property in Event of Sale at Foreclosure or Other Involuntary Sale*, 17 A.L.R. 3d 962, § 2 (1968).

248. See, e.g., *McIntosh v. Alger (In re Rigby's Estate)*, 167 P.2d 964, 969 (Wyo. 1946). *But see Hartnett v. Jones*, 629 P.2d 1357 (Wyo. 1981) (dicta) (concluding that a preemptive right to purchase was void because it violated the rules against perpetuities).

249. See J.P. Ludington, Annotation, *Right to Damages or Compensation upon Condemnation of Property, of Holder of Unexercised Option to Purchase*, 85 A.L.R. 2d 588, § 2 (1962).

250. See, e.g., *Richfield Oil Corp. v. Security-First Nat'l Bank*, 323 P.2d 834, 837–38 (Cal. Dist. Ct. App. 1958) (holding that where a tenant has a first refusal clause, the tenant is entitled to specific performance when, within twenty days of a higher bid by a third party, the tenant confirms it will match the bid); *Blankman v. Great W. Food Distribs., Inc.*, 293 N.Y.S.2d 368, 370–71 (N.Y. Sup. Ct. 1968). *But see Cities Serv. Oil Co. v. Estes*, 155 S.E.2d 59, 61–64 (Va. 1967) (holding that a tenant should have right of first refusal when giving bona fide offer within thirty days of a public judicial sale after death of landlord).

251. See, e.g., *Draper v. Gochman*, 400 S.W.2d 545, 547 (Tex. 1966) (holding that an owner had “a desire to borrow money, rather than a desire to sell the property”). *But see Price v. Town of Ruston*, 132 So. 653, 654–56 (La. 1931) (upholding a preferential right in foreclosure sale on the theory of transferred intent to sell in execution of mortgage).

252. See, e.g., *Blankman*, 293 N.Y.S.2d at 368; *In re Rigby's Estate*, 167 P.2d at 964; Ludington, *supra* note 249, at § 2. In most instances, however, the preferential right will survive the transaction and continue to burden the property interest as to future sales by the new owners. See *Draper*, 400 S.W.2d at 547.

due to the absence of an arms-length sale.²⁵³ A transfer on the basis of non-cash consideration, such as performance of a drilling obligation or an exchange of properties in some cases, has been held not to constitute a “sale.”²⁵⁴ Additionally, for unexplained reasons, the preemptive right has been held inapplicable to a sale by one co-tenant to another.²⁵⁵

Also limiting the application of the preferential right are express restrictions included in the JOA itself.²⁵⁶ It is common for the provision in the JOA to explicitly preclude its application to transfers through mortgages, dispositions by merger, reorganization or consolidation, or the sale of all, or substantially all, of the assets to a related company.²⁵⁷ The provision only applies to sales of assets, so the sale of a participating company’s stock from one entity to another is not subject to the right even though a change of control of the participant might result from the transaction.²⁵⁸ A Texas court of appeals in Houston has held that a right of first refusal may be triggered where a party transfers its interest to a wholly-owned subsidiary and then sells all of the subsidiary’s stock to a third party—a so-called “Texas two-step”²⁵⁹—stating that the character of the transaction depends on the intent and purpose of the parties.²⁶⁰ But the Texas Supreme Court expressly disapproved of this reasoning, stating that to view multiple transactions as a single transaction undermines the law’s mandate that restrictions on transfer

253. See, e.g., *Isaacson v. First Sec. Bank*, 511 P.2d 269 (Idaho 1973); *Exeter Expl. Co. v. Fitzpatrick*, 661 P.2d 1256, 1258–59 (Mont. 1983); *Perritt Co. v. Mitchell*, 663 S.W.2d 696 (Tex. App.—Fort Worth 1983, writ ref’d n.r.e.).

254. See *Panuco Oil Leases, Inc. v. Conroe Drilling Co.*, 202 F. Supp. 108, 114–15 (S.D. Tex. 1961) (assigning interest pursuant to a farmout agreement). *But see Anderson v. Armour & Co.*, 473 P.2d 84, 89 (Kan. 1970) (holding that when property is allegedly traded, a lease provision that requires notice of sale to the lessee is effective, allowing the lessee to negotiate purchase and sale).

255. See *Tex. Co. v. Graf*, 221 S.W.2d 865, 866 (Tex. Civ. App.—Fort Worth 1949, writ ref’d); see also *Pellandini v. Valadao*, 7 Cal. Rptr. 3d 413, 418 (Cal. Ct. App. 2003) (holding that the right of first refusal was not triggered by co-tenant’s conveyance to another co-tenant). The concept may form the basis of a holding that the preemptive right in the JOA does not apply among joint venturers. See generally John S. Sellingsloh, *Preferential Purchase Rights*, 11 ROCKY MTN. MIN. L. INST. 2-1 (1966).

256. See *Coral Prod. Corp. v. Cent. Res., Inc.*, 730 N.W.2d 357, 383, 397–98 (Neb. 2007); *El Paso Prod. Co. v. Geomet, Inc.*, 228 S.W.3d 178, 179 (Tex. App.—Dallas 2007, pet denied).

257. See *Questa Energy Corp. v. Vantage Point Energy, Inc.*, 887 S.W.2d 217, 222 (Tex. App.—Amarillo 1994, writ denied). Thus, in *Questa Energy Corp. v. Vantage Point Energy, Inc.*, a sale of oil and gas interests by Sceptre Resources Limited and three of its wholly-owned subsidiaries to Vantage Point in exchange for cash, a promissory note, and 81% of the stock of Vantage Point did not trigger the preferential right, but constituted a transfer of the property interests from three existing Sceptre subsidiaries to a new Sceptre subsidiary created by the transaction. See generally *id.* Related companies are usually listed as subsidiaries, parents, subsidiaries of parents, and companies in which the company owns a majority of the stock. See *id.*; e.g., *Kroehnke v. Zimmerman*, 467 P.2d 265, 266–67 (Colo. 1970) (discussing a conveyance of real property to a family corporation).

258. See *Tenneco Inc. v. Enter. Prods. Co.*, 925 S.W.2d 640, 644–46 (Tex. 1996) (affecting ownership of natural gas fractionation plant); *Rainbow Oil Co. v. Christmann*, 656 P.2d 538, 543–44 (Wyo. 1982) (discussing farmout agreement).

259. See Wright, *supra* note 242, at § 7.06.

260. *Galveston Terminals, Inc. v. Tenneco Oil Co.*, 904 S.W.2d 787, 791–92 (Tex. App.—Houston [1st Dist.] 1995, writ dism’d).

be narrowly construed.²⁶¹ Note, however, that although the provision is narrowly construed and highly restricted, its applicability to assets includes not only rights and interests contributed to the JOA, but also “rights and interests in the [contract area],” which has caused courts to conclude that it applies to overriding royalty interests held by a participant.²⁶²

Parties may also modify the preferential-rights provision to restrict its applicability even further.²⁶³ In *Coral Production Corp. v. Central Resources, Inc.*, the parties modified the provision to also exclude from its coverage a sale of “substantially all of the assets and/or stock of the selling party [that] is sold to a non-affiliated third party.”²⁶⁴ After a defendant sold substantially all of its assets to multiple non-affiliated third parties, the plaintiff argued that the exception was not applicable because by its plain language it only applied to a purchase by a single non-affiliated party.²⁶⁵ The court held that, because of the rule of construction in the JOA instructing that words used in the singular include the plural, the parties intended to exclude a sale when the selling party was exiting the oil and gas business, even when there were multiple purchasers.²⁶⁶

The extensive list of exclusions, both express and by implication, severely narrows the range of transactions that trigger the preemptive right.²⁶⁷ Though there are uncertainties from state to state, unless the transaction is a voluntary cash sale of assets to a party that is not controlled by the seller, there exists a question over whether the notice initiating the purchase option must be given. Although this in some instances undermines a purpose of the provision to stymie participation by undesirable parties, the limitations may be necessary to avoid the characterization of the provision as an undue restraint on alienation.

2. Obligations and Procedures

When the preferential right has been triggered by a pending sale, the obligations of the parties are relatively clear, but the parties must strictly comply.²⁶⁸ The selling party is required to give the prescribed notice of the proposed sale and allow the holder of the preemptive right an opportunity to

261. *Tenneco Inc.*, 925 S.W.2d at 646 (citing *Conine*, *supra* note 4, at 1302 n.231, 1320).

262. *See Coral Prod. Corp. v. Cent. Res., Inc.*, 730 N.W.2d 357, 372–75 (Neb. 2007) (holding royalty interest sold in an arms-length sale is covered by the preferential right but remanding as to whether transfer was an arms-length sale); *El Paso Prod. Co. v. Geomet, Inc.*, 228 S.W.3d 178, 179, 182 (Tex. App.—Dallas, 2007, pet. denied).

263. *See Coral Prod. Corp.*, 730 N.W.2d at 370–73.

264. *Id.* at 364 (emphasis removed).

265. *See id.* at 368–69.

266. *See id.* at 371–72.

267. *See* Keith T. Smith & Shawn H.T. Denstedt, *Preemptive Rights and the Sale of Resource Properties: Practical Problems and Solutions*, 30 ALTA. L. REV. 57 (1992) (discussing the nature of, and exceptions to, preemptive rights).

268. *See id.* at 76.

exercise its option.²⁶⁹ The holder of the right must be extended the option to acquire the property on the same terms available to the third party, not at an increased price²⁷⁰ or on terms to be negotiated.²⁷¹ Once the holder receives notice of the proposed sale, the preferential right matures into an enforceable option and is treated as an outstanding offer of sale for the duration of the option period.²⁷² This is true regardless of the fact that the seller failed to send notice and the optionee nevertheless obtained actual²⁷³ or inquiry²⁷⁴ notice by some other means.²⁷⁵

To exercise the right of first refusal, the holder of the preferential right must respond with an unequivocal acceptance based on the same terms established in the transaction between the seller and the third party.²⁷⁶ As to

269. See *Hill v. Zuckermen*, 355 P.2d 521, 525 (Mont. 1960).

270. See *Fordoche, Inc. v. Texaco, Inc.*, 463 F.3d 388, 392 (5th Cir. 2006). In *Fordoche, Inc. v. Texaco, Inc.*, the court of appeals, applying Louisiana law, determined that the written notice was deficient for two reasons. *Id.* at 389. First, the notice failed to adequately describe the property being offered for sale. *See id.* at 393–94. The only descriptive information provided was a list of the JOAs involved and the wells and well numbers subject to each of the JOAs, together with supplemental designations of the production units and sands from which the oil and gas were being obtained. *See id.* No clarification was provided as to whether the properties being sold were “mineral leases,” “leasehold interests,” “working interests,” or “unitized substances.” *See id.* at 396. Because the notice did not clearly describe the particular property interests for sale, the court held that the notice failed to comply with the requirements of the preemptive clause of the JOAs. *See id.* Second, the notice was deficient because it excluded certain properties that were being offered to the third-party purchaser. *See id.* at 395. These exclusions included the seller’s interest in tangible facilities, surface leases, and rights-of-way used in the operation of each unit. *See id.* at 397. These excluded properties were to be sold to the third-party purchaser in any event, and the right holders were informed that they would have to enter into a production-handling agreement with that party if they elected to exercise their purchase rights. *Id.* at 393. This precluded the right holders from being able to take control of unit operations after the transactions were completed. *See id.* at 394. To make matters worse, no adjustment was made in the price allocation to reflect the value of these exclusions, meaning that the right holders would be charged 10% to 15% more than the third-party purchaser for the properties actually offered in the notice. *Id.* at 397. The court of appeals concluded that the seller’s offer breached the provisions of the preferential right by failing to include all attributes of the seller’s working interest (including both tangible and intangible properties needed for operation of the units) and by failing to offer the properties to the right holders at the same price offered to the third-party purchaser. *Id.* at 397–98.

271. See, e.g., *Superior Portland Cement, Inc. v. Pac. Coast Cement Co.*, 205 P.2d 597, 613–14 (Wash. 1949). In a situation in which the subject of the proposed sale is governed by a series of JOAs, each with its own preemptive right clause but executed by less than all of the current parties to the joint operations, notices are to be sent and options allowed in the order in which the separate JOAs were signed. *IMCO Oil & Gas Co. v. Mitchell Energy Corp.*, 911 S.W.2d 916, 919 (Tex. App.—Fort Worth 1995, no writ).

272. See *McMillan v. Dooley*, 144 S.W.3d 159, 172 (Tex. App.—Eastland 2004, no pet).

273. See *Exeter Expl. Co. v. Fitzpatrick*, 661 P.2d 1256, 1258 (Mont. 1983).

274. See *Humphrey v. Wood*, 256 S.W.2d 669, 672 (Tex. Civ. App.—Amarillo 1953, writ ref’d n.r.e.).

275. In many cases, the holder of the preemptive right does not discover the sale to an outsider until the new owner begins to propose new operations or requests that future production or proceeds of production be sent to it, rather than the seller. However, constructive notice through the recording of an instrument of conveyance will not impart the required knowledge in this context. See *Exeter Expl. Co.*, 661 P.2d at 1258.

276. See *Pinchin v. Kinney*, 623 S.W.2d 783, 785–86 (Tex. App.—Austin 1981, no writ); see also *Tenneco, Inc. v. Enter. Prods. Co.*, 925 S.W.2d 640, 644 (Tex. 1996).

the interests covered by the preferential right, the optionee's acceptance must be "unconditional, identical to the offer, and . . . [must] not modify, delete or introduce any new terms" ²⁷⁷ Any attempt to modify the terms of the sale in exercising the option will constitute a rejection of the offer, ²⁷⁸ as will an attempt by the optionee to accept only a portion of the interest being offered that is subject to the preemptive right, such as when a party elects to acquire the working interest in only one of two wells included in the JOA's contract area. ²⁷⁹

In *MRC Permian Co. v. Three Rivers Operating Co.*, the defendant was required to give the plaintiffs notice under a preferential rights provision of a sale that included five properties in the contract area. ²⁸⁰ The defendant delivered an offer to the plaintiffs for the five contract area properties for an allocated price of \$6.3 million and included a box to check for the plaintiffs to elect to purchase. ²⁸¹ The plaintiffs responded by letter that they were exercising their preferential rights as to the five properties, and further stated that they made "this election to purchase all of [the defendant's] interest in the [contract area] created by the subject JOA . . . even if the interest [was] not specifically listed in Exhibit A" to the letter that was sent to them by the defendant. ²⁸² Along with their letter they returned the defendant's notice with the box checked. ²⁸³ The defendant then sent a second notice letter purporting to withdraw the initial offer and stating this new letter was sent as a substitute. ²⁸⁴ In this second substitute letter, the defendant offered ten properties for an allocated price of \$14.2 million. ²⁸⁵ The plaintiffs responded by letter that they still intended to purchase the properties offered in the original notice but that they wanted to meet to resolve the differences in the properties offered. ²⁸⁶ They did not check the box indicating their willingness to purchase the ten properties. ²⁸⁷ The third-party buyer excluded all ten properties from its purchase, but the plaintiffs refused to purchase all ten properties, asserting that they had a contract to buy the five properties offered in the first notice. ²⁸⁸

277. *Samson Res. Co. v. Amerada Hess Corp.*, 41 P.3d 1055, 1059 (Okla. Civ. App. 2002).

278. *See McMillan v. Dooley*, 144 S.W.3d 159, 178–80 (Tex. App.—Eastland 2004, pet. denied); *Hutcherson v. Cronin*, 426 S.W.2d 638, 641 (Tex. Civ. App.—Tyler 1968, no writ).

279. *See Brown v. Samson Res. Co.*, Nos. 99-6344, 99-6345, 2000 WL 1234851, at *4–5 (10th Cir. Aug. 31, 2000) (applying Oklahoma law). This is particularly true when the JOA containing the preemptive right contains a uniform interest provision. *Amerada Hess Corp.*, 41 P.3d at 1059.

280. *MRC Permian Co. v. Three Rivers Operating Co.*, No. 05–14–00353–CV, 2015 WL 4639711, at *2 (Tex. App.—Dallas Aug. 5, 2015, pet. denied).

281. *See id.* at *3.

282. *Id.*

283. *See id.*

284. *See id.* at *4.

285. *See id.*

286. *See id.* at *5.

287. *See id.*

288. *See id.*

The court recited the rules that the offeror controls an option and that an acceptance must conform to the conditions of the offer to create a binding contract, but that an offer may not be withdrawn once accepted.²⁸⁹ Based on these rules, the court held that the plaintiffs complied with the conditions of acceptance in the first notice and accepted the defendant's original offer as to the five properties included in the original notice.²⁹⁰ The defendant argued that the plaintiffs' response constituted a rejection and counteroffer of the original notice because it stated that the plaintiffs elected to purchase additional properties.²⁹¹ The court, however, turned to the contract rule that "an acceptance that merely reserves rights or expresses an interest in buying more items 'is not thereby invalidated *unless the acceptance is made to depend on an assent to the changed or added terms.*'"²⁹² Because the plaintiffs did not condition their acceptance, but merely added that they would purchase all of the defendant's interests in the contract area, their acceptance was not a counteroffer or rejection.²⁹³

The defendant also argued that the plaintiffs could not accept an offer to purchase less than all of the properties in the contract area because the preferential-rights provision applied to all of the properties.²⁹⁴ The court essentially dismissed this argument because it was up to the defendant to identify the relevant properties in its offer notice.²⁹⁵ As to the second notice from the defendant, the court held that the plaintiffs had never accepted this offer because they did not strictly comply with the terms of the offer.²⁹⁶

Regardless of the manner in which the right holder acquires notice of the sale,²⁹⁷ failure to exercise the option within the prescribed period will constitute a waiver of the preemptive right and is equivalent to a rejection.²⁹⁸ Still, the election period may not begin to run until long after the consummation of a sale if the only notice to the right holder is long delayed actual or inquiry notice.²⁹⁹ In such a case, the election may even accrue to

289. *See id.* at *7.

290. *See id.* at *10–11.

291. *See id.* at *11.

292. *Id.* (quoting RESTATEMENT (SECOND) OF CONTRACTS § 61 (AM. LAW INST. 1981)).

293. *See id.* at *10.

294. *See id.*

295. *See id.* at *11.

296. *See id.* at *6.

297. *See Chesapeake Operating, Inc. v. Pintail Prod. Co., Inc.*, No. CIV–12–55–D, 2013 WL 5596899, at *8–9 (W.D. Okla. Oct. 11, 2013) (explaining that, in the context of a tag-along right, a party has constructive notice of acquisition and is charged with the duty of further inquiry when acquisition is reported in market publications and the party receives information indicating the interest has been transferred).

298. *See Ellis v. Waldrop*, 656 S.W.2d 902, 904 (Tex. 1983); *McMillan v. Dooley*, 144 S.W.3d 159, 180 (Tex. App.—Eastland 2004, writ denied). *But see Mobil Expl. & Producing N. Am., Inc. v. Graham Royalty Ltd.*, 910 F.2d 504 (8th Cir. 1990). With a ten-day election period, Mobil became aware of the March sale in mid-June and waited until October 11 to assert its preferential right to purchase, two days after post-closing settlement was concluded by seller and buyer. *See id.*

299. *See, e.g., Graham Royalty Ltd.*, 910 F.2d at 508.

the right holder's successors and be exercised by them.³⁰⁰ However, during the period in which notice is delayed, the right holder can lose its rights under the preferential right on a theory of laches if it waits an unreasonably long time to exercise its right,³⁰¹ or under a theory of quasi-estoppel if it engages in conduct that is inconsistent with an intention to exercise its right to purchase, as when it enters into a beneficial agreement with the buyer or joins with the buyer in obtaining benefits from the state conservation commission, which stems from the activities of the buyer on the property in question.³⁰² Nevertheless, the preferential right is a continuing right and failure to exercise the right of first refusal in one transaction does not extinguish the right as to subsequent sales.³⁰³

Remedies for breach of the preferential right vary depending on whether the sales transaction involves a package sale and depending on the jurisdiction of the court considering the matter.³⁰⁴ Generally, if only an interest burdened with the preemptive right is involved in the sale, the holder of that right can obtain damages³⁰⁵ or specific performance.³⁰⁶ In package sales, courts finding a breach have enjoined the owner from completing the transfer to the third party,³⁰⁷ ordered a reconveyance to the original owner with an injunction on future sales that do not honor the preemptive rights of the plaintiff,³⁰⁸ or decreed specific performance allowing the right holder to acquire the burdened property alone³⁰⁹ or all properties in the package sale under the terms of the third party's agreement with the seller.³¹⁰ The latter remedy has been a subject of controversy, with some courts refusing to order specific performance in the context of package sales on the theory that, in the absence of an allocation formula, there is no reasonable method for determining the terms of sale for the burdened property alone.³¹¹

300. *See id.*

301. *See, e.g.,* Kirk v. Cimarex Energy Co., 604 F. App'x 718, 728 (10th Cir. 2015); Marken v. Goodall, 478 F.2d 1052, 1054 (10th Cir. 1973).

302. *See, e.g.,* Mulvey v. Mobil Producing Tex. & N.M. Inc., 147 S.W.3d 594, 607–08 (Tex. App.—Corpus Christi 2004, pet. denied).

303. *See, e.g.,* Foster v. Bullard, 496 S.W.2d 724, 736 (Tex. Civ. App.—Austin 1973, writ ref'd n.r.e.).

304. *See generally* Gamble v. Cornell Oil Co., 154 F. Supp. 581 (W.D. Okla. 1957), *aff'd*, 260 F.2d 860 (10th Cir. 1958).

305. *See id.* at 588.

306. *See Foster*, 496 S.W.2d at 735.

307. *See Myers v. Lovetinsky*, 189 N.W.2d 571, 576 (Iowa 1971).

308. *See id.*

309. *See Pitman v. Sanditen*, 626 S.W.2d 496, 497 (Tex. 1982); *Navasota Res., L.P. v. First Source Tex., Inc.*, 249 S.W.3d 526, 529 (Tex. App.—Waco, 2008, pet. denied). This can include rescission of a completed sale in which the third-party purchaser cannot claim to be a bona-fide purchaser because it received actual notice of the preferential right to purchase before the assignment of the property. *See Larson Operating Co. v. Petroleum, Inc.*, 84 P.3d 626, 628 (Kan. Ct. App. 2004).

310. *See Beets v. Tyler*, 290 S.W.2d 76, 82–83 (Mo. 1956); *First Nat'l Exch. Bank v. Roanoke Oil Co.*, 192 S.E. 764, 770 (Va. 1937) (involving efforts by the initial owners to compel the optionee to accept all properties in the package).

311. *See Myers*, 189 N.W.2d at 577; *see also* Atl. Ref. Co. v. Wyo. Nat'l Bank, 51 A.2d 719, 722 (Pa.

To protect the good-faith purchaser, use of reconveyance or specific performance is limited to those situations in which the third party has actual or constructive notice of the JOA and its preemptive provisions.³¹² However, for situations in which the assignment to the outside party is made expressly subject to the JOA and the buyer has had an opportunity to examine the seller's land records containing the JOA, the buyer is bound to the terms of that instrument and its provisions, making it jointly and severally liable along with the seller for breach of the preferential right.³¹³ At this point, ultimate responsibility for any damages may hinge on the indemnity provisions of the sales contract between the buyer and the seller.³¹⁴

3. Mechanical Problems and Complications

One of the principal objections to including the preferential right in a JOA is the chilling effect it can have on the ability to market an interest in the contract area. This problem can be overcome by obtaining a waiver of the preemptive right from the other parties to the JOA before a prospective purchaser undertakes to evaluate the properties and negotiate a sales contract.³¹⁵ This approach works well if the holders of the preemptive right are cooperative and have no desire to acquire the property at any price.³¹⁶ But in cases in which the JOA parties want to see the negotiated terms before making their decisions on exercise of the option, it may be difficult to attract potential buyers.³¹⁷

The preferential right is also beset with other problems that reduce its appeal. The most widely cited is the uncertainty generated by a package sale in which the seller's interest in the contract area is only a part of the properties being sold. Some courts have held that a package deal involving multiple properties does not invoke the preferential right,³¹⁸ although Texas courts appear to follow the rule that a preferential right is invoked by package sales.³¹⁹ Most judicial decisions in the oil and gas context have held that the

1947).

312. Cf. *Gamble v. Cornell Oil Co.*, 154 F. Supp. 581, 588 (W.D. Okla. 1957), *aff'd*, 260 F.2d 860 (10th Cir. 1958).

313. See *Mobil Expl. & Producing N. Am., Inc. v. Graham Royalty Ltd.*, 910 F.2d 504, 506 (8th Cir. 1990).

314. See *id.* at 508. The court of appeals in *Graham Royalty Ltd.* held that, because the breach occurred when notice was required (at least ten days before the sale), the buyer was protected by the seller's indemnity in their sales agreement, which made the seller responsible for all liabilities arising prior to closing. See *id.*

315. See John English, *Dealing with Third Parties*, 43 ROCKY MTN. MIN. L. INST. 7-1 (1995).

316. See *id.*

317. See *id.*

318. See *Guaclides v. Kruse*, 170 A.2d 488, 495 (N.J. Super. Ct. App. Div. 1961); *Sawyer v. Firestone*, 513 A.2d 36, 39 (R.I. 1986).

319. See *Navasota Res., L.P. v. First Source Tex., Inc.*, 249 S.W.3d 526, 532-33 (Tex. App.—Waco 2008, pet. denied); *McMillan v. Dooley*, 144 S.W.3d 159, 171 (Tex. App.—Eastland 2004, pet. denied).

preemptive right is applicable to a package sale,³²⁰ but differ on whether the right must be exercised against the unit interest alone³²¹ or against the entire property package.³²²

For situations in which the right of first refusal extends only to the interest within the JOA's contract area, it will be necessary for the parties to allocate an appropriate portion of the total sales price to that interest before the right holder is provided with notice of the sales terms being presented. Although some modern sales contracts in the oil and gas industry now provide a mechanism for allocating the sales price among the various properties in a package,³²³ the resulting allocation is often the subject of some dispute between the parties to the JOA.

Fasken Land & Minerals, Ltd. v. Occidental Permian Ltd. provides an example.³²⁴ In 2000, Occidental Permian agreed to purchase all of the assets of Altura Energy, a limited partnership between AMOCO and Shell Oil Company, for a total of \$3.6 billion.³²⁵ Included in the package was an interest in the Midland Farms Unit that was subject to a unit operating agreement containing a typical preferential right.³²⁶ Although Occidental disagreed, representatives for Altura concluded that it had to provide notice to the other working-interest owners in the unit.³²⁷

In advance of the notice, Altura asked Occidental, as buyer, to allocate a portion of the purchase price to the Midland Farms Unit (Unit) on the rationale that the purchaser had a better understanding of how the property was valued within the package.³²⁸ Occidental did this by reviewing the independent reserve report on the properties and making adjustments in the global assumptions to reflect differences in the Unit.³²⁹ In doing so, Occidental cut the Unit's projected probable reserves in half and retained the original numbers for proved developed reserves and proved developed non-producing reserves.³³⁰ The resulting allocation placed the purchase price for the Midland Farms Unit at \$63 million.³³¹ This figure was within the

320. See Harlan Abrigt, *Preferential Right Provisions and Their Applicability to Oil and Gas Instruments*, 32 Sw. L.J. 803, 808 (1978).

321. See generally *Maron v. Howard*, 66 Cal. Rptr. 70 (Cal. Ct. App. 1968); *Humphrey v. Wood*, 256 S.W.2d 669 (Tex. Civ. App.—Amarillo 1953, writ ref'd n.r.e.).

322. See *First Nat'l Exch. Bank v. Roanoke Oil Co.*, 192 S.E. 764, 771-72 (Va. 1937).

323. See, e.g., *Brown v. Samson Res. Co.*, Nos. 99-6344, 99-6345, 2000 WL 1234851, at *1-2 (10th Cir. Aug. 31, 2000) (involving a sales contract allowing for exclusion of properties due to the exercise of preferential rights and a corresponding reduction of the total purchase price based on a schedule allocating values to individual leasehold interests).

324. See *Fasken Land & Minerals, Ltd. v. Occidental Permian Ltd.*, 225 S.W.3d 577 (Tex. App.—El Paso 2005, pet. denied).

325. *Id.* at 581-82.

326. *Id.* at 590.

327. *Id.* at 582.

328. *Id.*

329. *Id.* at 582-83.

330. *Id.* at 583.

331. *Id.*

value range of \$40 million to \$110 million set by Altura's personnel, based on which risk factors were used.³³² However, \$63 million was still well above the minimum value that could have been assigned to the property.³³³

In the March 22 notice sent to the plaintiffs, Altura set the purchase price at \$63 million, payable in cash at closing, and requested an election within fifteen days after receipt of the notice.³³⁴ The plaintiffs responded with a letter asserting they had not been provided with "sufficient information" with which to make a decision.³³⁵ They requested that Altura provide the exhibits to the purchase and sale agreement that were not included with the notice materials, along with information to verify the basis of the price allocation.³³⁶ The plaintiffs asserted that this information was necessary to meet the notice requirements calling for "full information concerning [the] proposed sale" and that the plaintiffs would not consider the option period to have commenced until the information was received.³³⁷

Subsequent communications and discussions failed to resolve the matter and the plaintiffs eventually brought a lawsuit concerning compliance with the preferential right as a related issue dealing with attempts to replace Occidental as operator of the Unit.³³⁸

With regard to the adequacy of the written notice under the preferential right, the appellate court held that the purpose of the requirement was to provide prompt notification of a proposed sale and that the notice was only required to include those pieces of information specifically enumerated in the clause (that is, name and address of the proposed purchaser; the purchase price allocated to the property; the legal description of the property; and the terms of the proposed sale).³³⁹ The court concluded that the notice did not have to include information on the method used to allocate the purchase price.³⁴⁰ Citing *Mecom v. Gallagher*, the court noted that the notice provided by Altura was "sufficient to reasonably disclose the proposed transaction and to provide . . . an opportunity to exercise" the preferential right, despite technical deficiencies that might render the notice less than perfect.³⁴¹

There are often a number of questions that arise in the context of a package sale that can be of concern to a right holder. However, the notice of the proposed sale that the right holder receives does not have to provide answers to every conceivable question about the transaction.³⁴² It is adequate

332. *Id.*

333. *Id.* at 583–84.

334. *Id.* at 584.

335. *Id.* at 585.

336. *See id.*

337. *See id.* at 585, 589.

338. *See id.* at 585.

339. *See id.* at 590.

340. *See id.*

341. *Id.* (citing *Mecom v. Gallagher*, 213 S.W.2d 304, 312 (Tex. Civ. App.—El Paso 1947, no writ)).

342. *See generally id.*

if it makes a reasonable disclosure of the terms of the deal. Although the right holder does not have to act until it receives a reasonable disclosure of the terms of the proposed sale, it has a duty to undertake a reasonable investigation to clarify any terms that it does not understand.³⁴³ Given the requirement that a reply of acceptance must be unequivocal and not alter the terms of the offer, it may be difficult for the right holder to secure information without responding in a way that will be construed as a rejection.

In *McMillan v. Dooley*, the original lessee to an oil and gas lease on his family property had retained a right of first refusal under a farmout agreement by which the leasehold was eventually transferred to McDonald.³⁴⁴ When McDonald later agreed to sell the lease and three others in a package deal, the right holder was notified of the proposed sale and invited to purchase the entire package of four leases.³⁴⁵ The right holder declined to purchase all four properties and delayed further discussions on the purchase of his original lease until after his election period had expired.³⁴⁶ The court ultimately decided that the notice was adequate, despite the fact that he was not required to accept other properties included in the package, and the right holder should have taken affirmative steps to preserve its option within the election period.³⁴⁷ This could have been accomplished, the court noted, by declaring its intent to exercise the preferential right subject to objections over the specific terms in the notice.³⁴⁸ The timeliness with which the right holder brings its lawsuit to enforce its rights may also be a factor, particularly if production values are rising.³⁴⁹

C. Maintenance of Uniform Interest

Further restrictions on the transfer of interests within the contract area are contained in the provisions that require the maintenance of uniform interests (MOI). Except as otherwise provided in the JOA,³⁵⁰ no party to the JOA may transfer or encumber its interest in leases, wells, equipment, or production within the contract area unless the disposition covers (1) the party's *entire* interest within the contract area or (2) an *equal undivided*

343. See *McMillan v. Dooley*, 144 S.W.3d 159, 174, 177 (Tex. App.—Eastland 2004, pet. denied) (citing *Koch Indust., Inc. v. Sun Co., Inc.*, 918 F.2d 1203, 1212 (5th Cir. 1990)).

344. *Id.* at 164–65.

345. *Id.* at 166.

346. *Id.* at 167.

347. See *id.* at 178.

348. See *id.* at 181.

349. See *id.* at 180–81.

350. See FORM 610-2015, *supra* note 2, at art. VI.B.2(d). The language “except as otherwise provided herein” was added to the JOA in recognition that the contract itself may require a party to transfer its interest in a well or property in a non-uniform way. See *id.* (detailing the relinquishment of the interest of a non-consenting party); see also *id.* at art. VI.F (discussing the relinquishment of interest in connection with abandonment).

percent of its present interest in all assets within the contract area.³⁵¹ This assures each party will maintain the same ratio of ownership throughout the contract area.³⁵² Unlike some of the other property provisions, this restriction applies to any form of transfer, whether by sale, gift, exchange, encumbrance, or otherwise, and is not conditioned on the exercise of any option or an election by other parties to the JOA.³⁵³

The MOI provision serves two purposes. The purpose most often cited is the avoidance of complications that can interfere with the efficient administration of the joint operations.³⁵⁴ Unless the fractional interests of the parties remain uniform, as initially established under the operating agreement, the operator will confront an increasingly complex pattern of ownership that varies by geographic area.³⁵⁵ Such variations will inevitably necessitate different notices, responses, and accounting for each well or project; complicate gas balancing; and require separate metering of production from different wells.³⁵⁶ The result will be an increase in administrative burdens and costs for the operator that will eventually be passed through to the non-operators.³⁵⁷

A secondary purpose of the MOI provision is to protect the integrity of certain mechanisms in the operating agreement, such as the operator's lien.³⁵⁸ If a party were allowed to sell its interest in productive wells in the contract area, the operator's ability to recover that party's unpaid costs for subsequent operations on new wells could be severely hampered depending on the treatment given the original encumbrance by the courts.³⁵⁹ Interestingly, the most significant decision that has emerged with regard to the MOI provision focused on this secondary purpose and the effect of a horizontal sub-division on elections for participation in subsequent operations.³⁶⁰

351. See *id.* at art. VII.D; FORM 610-1989, *supra* note 15, at art. VIII.D; FORM 610-1982, *supra* note 15, at art. VIII.D; FORM 610-1956, *supra* note 2, at § 20. Earlier JOA forms required the granting party to convey "an equal undivided interest." See, e.g., FORM 610-1982, *supra* note 15, at art. VIII.D; FORM 610-1956, *supra* note 2, at § 20. This language could either refer to a conveyance of the same fractional interest in each lease (for example, a "one-quarter working interest" in each lease owned in the contract area), or to an equal fractional share of the grantor's interest in each lease (for example, "one-half of the assignee's right, title and interest" in each lease). The 1989 Form JOA and the 2015 Form JOA change the language to "equal undivided percent of the party's present interest," making clear that the clause requires the assignee to convey an equal fractional share of its interest in each lease, which is the only way to assure uniform interests are maintained throughout the contract area. FORM 610-2015, *supra* note 2, at art. VII.D; FORM 610-1989, *supra* note 15, at art. VIII.D.

352. See *Pitco Prod. Co. v. Chaparral Energy, Inc.*, 63 P.3d 541, 544 (Okla. 2003).

353. See *id.*

354. See George F. Kutzschbach, *Operating Agreement Considerations in Acquisitions of Producing Properties*, 36 INST. ON OIL & GAS L. & TAX'N 7-1, 7-27 (1985).

355. See *id.*

356. See *id.*

357. See *id.*

358. See Conine, *supra* note 4, at 1328-29.

359. See *id.*

360. See *id.*

In *ExxonMobil Corp. v. Valence Operating Co.*, the two litigants were successors-in-interest to companies that had entered into an operating agreement in 1983 covering a single lease and containing an MOI provision.³⁶¹ Three wells had been drilled in the contract area that were producing from the Cotton Valley Lime formation.³⁶² During drilling operations, it was determined that the shallower Cotton Valley Sand formation also contained proven, behind-the-pipe reserves.³⁶³

In 1996, ExxonMobil entered into a farmout agreement with Wagner & Brown, Ltd. and C.W. Resources, giving these farmees a right to drill certain wells in the contract area to a depth sufficient to test the shallower Cotton Valley Sand formation and earn the conveyance of ExxonMobil's interest in the lease covered by the contract area from the surface down to the base of the Cotton Valley Sand.³⁶⁴ The farmees' proposals to drill two new wells in the contract area were ignored by Valence, which had no knowledge of the farmout agreement at that time.³⁶⁵ As a result, the farmees deemed Valence to be a non-consenting party and subject to the non-consent penalty on the two wells.³⁶⁶ Following inquiries to ExxonMobil, Valence was informed about the farmout and elected to participate "under protest" in three subsequent wells proposed by the farmees.³⁶⁷

Valence eventually sued ExxonMobil for breach of contract.³⁶⁸ In an appeal of a verdict in favor of Valence, the court held that, by farming out and horizontally sub-dividing its working interest in the lease, ExxonMobil breached the MOI provision in the JOA.³⁶⁹

361. *ExxonMobil Corp. v. Valence Operating Co.*, 174 S.W.3d 303, 307 (Tex. App.—Houston [1st Dist.] 2005, pet. denied); *see also* *Pitco Prod. Co. v. Chaparral Energy, Inc.*, 63 P.3d 541, 543 (Okla. 2003) (explaining how a prior violation of MOI resulted in different ownership in two wells and an election of separate operator for each).

362. *ExxonMobil Corp.*, 174 S.W.3d at 307.

363. *See id.*

364. *See id.*

365. *See id.*

366. *Id.*

367. *Id.*

368. *See id.*

369. *Id.* at 314. ExxonMobil argued that it did not breach the MOI based on two factors. *Id.* at 311–12. First, it noted that a nonstandard introductory clause reciting that the purpose of the MOI was to maintain uniformity of interest had been stricken from the JOA. *Id.* It argued that this indicated that the parties never intended JOA to require that the parties maintain uniform ownership within the contract area. *Id.* The court declined to accept this argument, electing instead to adopt Valence's explanation that the introductory clause was deleted because there was initially no uniformity (that is, equality) of interests because ExxonMobil started with an 81.8% interest in the leases, compared to Valence's 18.2%. *Id.* at 314. The court reasoned that the remaining language of the MOI would have no rational meaning if ExxonMobil's explanation was adopted. *Id.* Second, ExxonMobil argued that the MOI was not applicable unless its assignment covered not only its interest in the lease but also its ownership in the existing wells, equipment, and production, none of which were to be transferred under the farmout agreement. *Id.* at 311. The court responded by noting that any assignment of a leasehold working interest carried with it any interest in wells, equipment, and production pertaining to that portion of the lease. *Id.* at 314.

Valence recovered damages for two types of injury, neither of which had any relation to additional administrative costs associated with the horizontal sub-division.³⁷⁰ First, it was awarded damages for the production lost as a result of the imposition of the non-consent penalty for the first two farmout wells.³⁷¹ Because the transfer of rights to the farmees violated the MOI provision, any notice of proposed operations from the farmees was no more than an invalid notice from a stranger to the JOA.³⁷²

Second, Valence recovered the proportion of the costs it paid for drilling the last three farmout wells in excess of what it would have cost to simply plug back and complete the existing wells, on the theory that the only reason the new wells were drilled was to satisfy the terms of the farmout agreement.³⁷³ Valence successfully argued that, but for ExxonMobil's improper farmout, the parties to the JOA would have waited until the lower Cotton Valley Lime formation was depleted and then re-completed the original wells in the Cotton Valley Sand at much less expense, rather than drilling three new wells.³⁷⁴

The court noted that, "The purpose of the MOI provision was to ensure that the parties to the JOA retained the same interests in the lease that they had when they executed the contract," unless certain conditions were met in any assignment.³⁷⁵ If ExxonMobil had not breached the MOI, it would have continued to own the same interest as Valence in capturing as much production as possible from the entire unit by the most economical means.³⁷⁶ By farming out a disproportionate portion of its interest, ExxonMobil "severed its interest" from that of Valence, creating separate investment regimes and causing Valence to incur additional costs necessitated by the terms of the farmout agreement.³⁷⁷

Despite its broad language, the MOI provision has been held not to prevent a party from conveying an interest in production, such as an overriding royalty or a production payment, out of its working interest.³⁷⁸ In *McCall v. Chesapeake Energy Corp.*, the named plaintiff in a class action

370. *Id.* at 315.

371. *Id.* at 316–17.

372. *Id.*

373. *Id.* at 315.

374. *Id.*

375. *Id.*

376. *Id.*

377. *Id.* at 316. But consider *El Paso Production Co. v. Valence Operating Co.*, in which a non-operator, under threat of a condemnation action and for a cash consideration, released its surface rights in a ninety-one-acre unit and assigned its rights to authorize plugging and abandonment of the unit well to the surface owner, Houston Lighting and Power Company. See *El Paso Prod. Co. v. Valence Operating Co.*, 112 S.W.3d 616, 620 (Tex. App.—Houston [1st Dist.] 2003, pet denied). The appellate court held that the non-operator neither repudiated nor waived its rights under the JOA by its actions. *Id.* at 622. Although the court noted that the JOA contained a MOI provision, the clause did not play a role in the court's rationale. *Id.*

378. See *McCall v. Chesapeake Energy Corp.*, 817 F. Supp. 2d 307, 319 (S.D.N.Y. 2011), *aff'd*, 509 F. App'x 62 (2d Cir. 2013).

alleged that the defendants violated the MOI provision in a JOA by entering into ten volumetric production payment transactions with certain bank defendants.³⁷⁹ The court held that the MOI provision applies only to mineral interests in the ground, not to a party's share of production.³⁸⁰ In reaching its decision, it looked to the provisions relating to subsequently created interests as evidencing the right of a party to convey an interest in its proportionate share of production.³⁸¹

D. Surrender of Leases

Given the release provisions in most oil and gas leases, which expressly permit the lessee to surrender all or any part of the leasehold, each party to the JOA is likely to have the power to surrender all or part of the interest it contributed to the contract area.³⁸² The surrender of a lease will have the effect of carving that interest out of the contract area and releasing it from the terms of the JOA, a result which may or may not be acceptable to the other parties to the operating agreement.³⁸³ To provide the other parties some control over the surrender of a lease, the JOA typically includes its own surrender of lease provision that has some of the same mechanisms as the preferential right but with something similar to a "put" rather than a "call" option.³⁸⁴

The provision prohibits the surrender of all or any part of a lease included in the contract area unless all parties have consented to the release.³⁸⁵ If unanimous consent is obtained, the leasehold interest may be released without a reduction of the cost and production share allotted to the lessee in the JOA, the released interest having been judged essentially

379. *Id.* at 316.

380. *Id.* at 319.

381. *See id.* Note that the standard MOI clause includes "production" in the list of interests that are subject to the clause. *See* FORM 610-2015, *supra* note 2, at art. VIII.D; FORM 610-1989, *supra* note 15, at art. VIII.D; FORM 610-1982, *supra* note 15, at art. VIII.D. In reading the opinion, one has to wonder why the court in *McCall* never addressed the meaning of the word "production" as it is used in the MOI clause. *See McCall*, 817 F. Supp. 2d 307, 307–22. Reading the JOA as a whole, in light of the taking in kind by the parties of their share of production and the recognition in the JOA that parties may subsequently create overriding royalties and production payments, the term "production" as used in the MOI clause logically means future production of minerals in places associated with the sale of the underlying oil and gas leases or interests. *See* FORM 610-2015, *supra* note 2, at art. VIII.D; FORM 610-1989, *supra* note 15, at art. VII.D; FORM 610-1982, *supra* note 15, at art. VII.D. The drafters of future versions of the form should consider clarifying this point by excepting from and cross-referencing in the MOI clause the provision on subsequently created interests.

382. *See* FORM 610-2015, *supra* note 2, at art. VIII.A.

383. *See id.* at art. VIII.A.

384. *See* FORM 610-2015, *supra* note 2, at art. VIII.A; FORM 610-1989, *supra* note 15, at art. VIII.A; FORM 610-1982, *supra* note 15, at art. VIII.A; FORM 610-1956, *supra* note 2, at § 24. Only very minor changes were made to the surrender of leases provision in the 2015 Form JOA. *See* FORM 610-2015, *supra* note 2, at art. VIII.A.

385. *See* FORM 610-2015, *supra* note 2, at art. VIII.A.

worthless or unusable by all the parties.³⁸⁶ On the other hand, if any JOA party objects to the proposed release, protection is afforded to the leasehold owner by requiring the objecting party or parties to accept an assignment of the leasehold interest,³⁸⁷ without warranty of title, and to compensate the surrendering owner for his share of the salvage value in any wells and equipment sited on the assigned property.³⁸⁸ The assigned interest is automatically released from the contract area and the provisions of the operating agreement,³⁸⁹ and the assignor is relieved of all future obligations accruing under the JOA with respect to the assigned interest.³⁹⁰

E. Abandonment of Wells and Reassignment Duties

A provision similar to the Surrender clause is the provision on plugging and abandoning previously producing wells for which the recoupment period under the non-consent penalty has run.³⁹¹ Under the terms of the abandonment provision, such wells cannot be abandoned without the consent of all parties to the JOA.³⁹² If all parties have not agreed to a proposed abandonment within thirty days of notice, those wishing to continue to

386. *See id.*

387. *See id.* The assigned interest will cover all leasehold interests (whether operating or non-operating), rights in subsequent production, and all interests in wells, equipment, and material associated with the property proposed for surrender. *See id.* Non-operating rights owned by another party but subject to the restrictions on subsequently created interests would also be included in this transfer. *See id.* If the surrendering party owns a mineral interest deemed subject to a lease under the JOA, the assignor is not required to convey the mineral estate but to grant an oil and gas lease in the form attached as an exhibit to the JOA. *See id.*

388. *See id.* Salvage value is to be determined by deducting estimated costs of equipment salvage and plugging and abandoning any existing well from the value of all material determined in accordance with the JOA's accounting procedures. *See* McCollam, *supra* note 79, at 293. Because the cost of removing an offshore drilling or production platform can exceed salvage value, the assigning party may owe a cash payment to the assignees, a possibility that should be specially addressed in the offshore operating agreement. *See id.*

389. A new operating agreement for the assigned interest must be negotiated by the assignees. For small areas in which a complex sharing formula is not required, it has been suggested that the initial JOA provide that the released area be automatically subject to a new operating agreement in a form substantially identical to the original JOA, with appropriate adjustments in interests to reflect the proportionate ownership of the new owners, as required under the Acreage or Cash Contributions provision. *See* FORM 610-2015, *supra* note 2, at art. VIII.C.

390. *See id.* at art. VIII.D.

391. *See id.* at art. VI.F.2; FORM 610-1989, *supra* note 15, at art. VI.E.2; FORM 610-1982, *supra* note 15, at art. VI.E.2. Abandonment of dry holes is governed by art. VI.E.1 (or art. VI.F.1 in the 2015 Form JOA), which does not entail any assignment of interests, but treats a suggestion to continue operations as a proposal for subsequent operations governed by art. VI.B. *See* FORM 610-2015, *supra* note 2, at art. VI.F.1. The 2015 Form JOA changes the consent requirement for abandonment of a dry hole from all parties to all parties owning an interest at the time of the dry hole completion proposal, meaning that non-consenting owners no longer have the right to consent to such abandonment. *See id.* The 2015 Form JOA also changes the time required to respond to an abandonment proposal from forty-eight hours to thirty days where a drilling rig is not on location, recognizing that there may be some time between drilling and completion of a well and the drill rig might be moved off-site in the interim. *See id.*

392. *See* FORM 610-2015, *supra* note 2, at art. VI.F.3.

operate the well from subsurface intervals then open to production must pay each of those desiring to abandon the well his proportionate share of the salvage value of the material and equipment in the well.³⁹³ In return, those electing to continue operations receive an assignment of the abandoning parties' interests in the well and its equipment and the leasehold estate as to the intervals then open to production.³⁹⁴ Again, this assignment is made without warranty of title or fitness for use.³⁹⁵

As to producing wells for which the recoupment period has not yet expired, parties who elected to participate are first given an opportunity to determine whether they desire to conduct further operations with the well.³⁹⁶ If not, then the non-consenting parties are also afforded an opportunity to take over the well before it is permanently plugged and abandoned.³⁹⁷

Unlike the case with the surrender of a lease, the terms of the JOA continue to apply to the assigned interest following an abandonment proposal.³⁹⁸ However, the abandoning parties are released from any responsibility for the well or the transferred leasehold interest, and the interests of the parties in other portions of the contract area remain unchanged.³⁹⁹ This procedure produces an internal variation in the participation rights of the JOA parties within the contract area that is inconsistent with the goals of the MOI provision.⁴⁰⁰ The 2015, 1989, and 1982 JOA Forms ameliorate the impact of non-uniform ownership by requiring the parties electing to continue operations to reimburse the operator for any additional costs that may arise as a result of their separate ownership in the well.⁴⁰¹

In the event the well and its leasehold interests are assigned to parties who desire to continue operations and those assignees later propose to plug and abandon, the original assignors are granted a reassignment option to

393. *See id.*

394. *See id.* It should be noted that the properties covered by this assignment include not only the well but also the leasehold rights associated with it. *See id.* at art. III.A. As to depth, the leasehold rights assigned must cover any intervals open to production. *See id.* As to surface area, they must include all rights within the well's drilling unit, described in the JOA's definitions to include the area required for drilling a single well under applicable conservation regulations or, if no rule or order exists, an area consistent with the prior drilling pattern in the contract area. *See id.* at art. I. If the interest of the abandoning party includes a mineral interest, the owner must deliver an executed lease covering the abandoned interest using the lease form attached as an exhibit to the JOA, with a primary term of one year. *See id.* at art. VI.F.3.

395. *See id.* at art. VIII.A.

396. *See id.* at art. VI.F.2.

397. *See id.* at art. VI.F.3; FORM 610-1989, *supra* note 15, at art. VI.E.3; FORM 610-1982, *supra* note 15, at art. VI.E.J.

398. *See* FORM 610-2015, *supra* note 2, at art. VI.F.2.

399. *See id.*

400. *See id.* at art. VIII.D.

401. *See id.* at art. VI.F.2; FORM 610-1989, *supra* note 15, at art. VI.E.2; FORM 610-1982, *supra* note 15, at art. VI.E.2.

repurchase their earlier interests at salvage value.⁴⁰² Reassignment clauses are often employed to protect a non-operating interest against premature loss by providing its owner an opportunity to preserve the lease during its primary term despite the desire of the working interest owner to allow the lease to expire.⁴⁰³ They may also be used, as in the JOA, to avoid decisions to forego operations at any time during the term of the lease.⁴⁰⁴ In the operating agreement, it is possible that the lease is being maintained by production elsewhere in the contract area.⁴⁰⁵ Thus, the intent is to limit the effect of the initial abandonment assignment so that it does not become a forfeiture of interest.⁴⁰⁶ Instead, the original owner is allowed an option to reacquire his interest, after reassessing the potential of the property on the latest-available data, when the operating parties again determine to discontinue operations.⁴⁰⁷ This assures that the maximum benefit is obtained from the initial investment in drilling the well by keeping the well open as long as some party believes operations to be worthwhile.⁴⁰⁸

This reassignment clause is incredibly simple, leaving many terms open to interpretation.⁴⁰⁹ A well-drafted provision must address the precise interest to be reassigned and the time parameter for the option notice and election.⁴¹⁰ Neither is provided in the AAPL operating agreement.⁴¹¹ Literally, the provision only requires the reassignment of an interest in the well alone, despite the initial conveyance of the well, its equipment, and the leasehold related to the well's drilling unit.⁴¹² It is only equitable and logical to assume that all of these interests are to be reassigned, but this is far from clear.⁴¹³ Similarly, it is not clear that the reassignment is to be without warranty, although the reacquiring party is protected by provisions on subsequently created interests.⁴¹⁴

402. See FORM 610-2015, *supra* note 2, at art. VI.F.2.

403. See Paul W. Eaton, *The Reassignment Provision—Meaningful or Not?*, 20 ROCKY MTN. MIN. L. INST. 17 (1975).

404. See *Atl. Ref. Co. v. Moxley*, 211 F.2d 916 (5th Cir. 1954); *United Cent. Oil Corp. v. Helm*, 11 F.2d 760 (5th Cir. 1926).

405. See FORM 610-2015, *supra* note 2, at art. III.B.

406. See *id.* at art. VIII.D.

407. See *id.* at art. VI.F.2.

408. See generally Eaton, *supra* note 403.

409. See FORM 610-2015, *supra* note 2, at art. VI.F.2. The provision simply provides: "Upon proposed abandonment of the producing zone assigned or leased, the assignor or lessor shall then have the option to repurchase its prior interest in the well (using the same valuation formula) and participate in further operations therein subject to the provisions hereof." *Id.*

410. See James M. Colosky, *The Reassignment Provision—The Agony in the Oversight*, 30 ROCKY MTN. MIN. L. INST. 5 § 5.02 (1984).

411. See FORM 610-2015, *supra* note 2, at art. VI.F.2.

412. See *id.*

413. See *id.*

414. See *id.*

Along this same line, it should be noted that no guidelines are provided on the time within which notices and elections must be communicated.⁴¹⁵ Professor Conine has warned that, “This could become a serious problem if the leasehold is about to expire and the prior owner is precluded from a timely opportunity to keep it alive.”⁴¹⁶ Since that warning, operators have been sued for providing notice of an intent to abandon the sole well in the contract area after the well ceased producing and the leases had been allowed to expire.⁴¹⁷ In *Fuller v. Phillips Petroleum Co.*, the court held that the abandonment clause imposed no obligation on the operator to provide notice of an intent to abandon a well before the expiration of the underlying leases because the abandonment clause “mandates notice only of an . . . intent to plug and abandon a well, not notice . . . of an impending lease termination.”⁴¹⁸

Given the difficulty and uncertainties in determining the precise moment at which a lease terminates for failure to produce in “paying quantities,” it is highly unlikely that the drafters of the JOA forms ever intended to burden the operator with the duty of notifying the non-operators of such an event.⁴¹⁹ Instead, it is more logical to assume the drafters intentionally left the risk of loss of a lease or leases due to a failure to conduct operations on the individual parties to the JOA, each of whom is in a position to monitor the progress of operations and circulate their own proposals for any corrective action that they believe are prudent and necessary to maintain the leases within the contract area. This interpretation is buttressed by a change to the 2015 Form JOA which allows any party to submit an abandonment proposal.⁴²⁰

IV. DISTRIBUTION OF ACQUIRED INTERESTS

Another set of property provisions grants each party to the JOA a right to share proportionately in acquisitions by others after the operating agreement goes into effect.⁴²¹ The obligation to notify others and allow them

415. *See id.*

416. Conine, *supra* note 4, at 1336.

417. *See generally* Fuller v. Phillips Petroleum Co., 872 F.2d 655 (5th Cir. 1989).

418. *Id.* at 659. The court proceeded to hold that the Surrender of Lease provision in the JOA was also inapplicable to the case because it applied to a voluntary relinquishment of a lease, not a termination of a lease by its own terms for failure to maintain operations. *Id.* at 659–60. The court in *Norman v. Apache Corp.*, reached the same conclusion but remanded the case for a determination of whether the failure to give notice of lease termination by the operator of a gas well was a breach of his duty to conduct himself as a prudent operator under circumstances in which it may have given assurances that it intended to keep the leases in effect through continuous operations. *Norman v. Apache Corp.*, 19 F.3d 1017, 1030–31 (5th Cir. 1994).

419. *See* FORM 610-2015, *supra* note 2, at art. VI.F.1; *see also* T.W. Phillips Gas & Oil Co. v. Jedicka, 42 A.3d 261, 277 (Pa. 2012); Windsor Energy Grp., L.L.C. v. Noble Energy, Inc., 330 P.3d 285, 287 (Wyo. 2014).

420. *See* FORM 610-2015, *supra* note 2, at art. VI.F.2.

421. *See id.* at art. VIII.B–C, XVI.K.

an opportunity to elect to participate in the acquisition can be found in the Acreage or Cash Contributions clause, the Lease Renewal and Extension clause, and if added to the JOA, the AMI clause.⁴²² In each instance, these provisions are intended to ensure a fair distribution of benefits derived from the joint investment of the parties and the information and data obtained from joint operations.⁴²³

These considerations are similar to those that arise in fiduciary relationships, in which the trust and confidence placed in another places him in a position to take advantage of the situation.⁴²⁴ As a consequence, in those jurisdictions that characterize the JOA as a joint venture, the requirements contained in these sharing provisions would likely be imposed on the joint venturers in any event.⁴²⁵ Although sometimes limited to acquisitions within the area targeted by the venture,⁴²⁶ fiduciary duties have been applied to acquisitions of neighboring properties that may be developed from data obtained in joint operations or which may be needed to protect the area of operations from drainage.⁴²⁷ There is a hint that these same results might also be reached through an extension of fiduciary duties to cotenants.⁴²⁸

In any event, having attempted to remove fiduciary obligations from the JOA by denying the existence of any joint venture or partnership, the operating agreement contractually applies some of the protections surrendered in this denial by imposing sharing arrangements on certain acquisitions.⁴²⁹

A. Acreage and Cash Contributions

To encourage exploration activity, mineral owners and lessees in the vicinity of a drill site who may gain indirect benefits from the drilling of a well will often agree to support the operation through cash or acreage contributions.⁴³⁰ Where drilling is a joint effort of multiple parties, the

422. *See id.*

423. *See, e.g.,* Superior Oil Co. v. Cox, 307 So. 2d 350, 355 (La. 1975). Occasionally, however, parties have limited the application of such clauses to a term shorter than that of the JOA itself. *See* Ballard v. Devon Energy Prod. Co., 678 F.3d 360, 362 (5th Cir. 2012) (limiting the AMI to three years); McFarland Energy Inc. v. Texoil Co., CIV. A. No. 89-5298, 1990 WL 93848, at *1 (E.D. La. June 25, 1990) (limiting the AMI to one year).

424. *See, e.g.,* ERI Consulting Eng'rs, Inc. v. Swinnea, 318 S.W.3d 867, 873-74 (Tex. 2010).

425. *See* Kaye v. Smitherman, 225 F.2d 583, 594 (10th Cir. 1955), *cert. denied*, 350 U.S. 913 (1955); Tex. Oil & Gas Corp. v. Hawkins Oil & Gas, Inc., 668 S.W.2d 16, 17 (Ark. 1984). However, establishing that the protections of one of these clauses apply even though not expressly included in the JOA can be difficult. *See* Cont'l Res., Inc. v. PXP Gulf Coast, Inc., No. CIV-04-1681-F, 2006 WL 2865509 (W.D. Okla. Oct. 5, 2006) (holding, under Texas law, that an AMI provision does not create a joint venture, partnership, or agency relation between the parties).

426. *See* Fuqua v. Taylor, 683 S.W.2d 735, 738 (Tex. App.—Dallas 1984, writ ref'd n.r.e.).

427. *See* Foley v. Phillips, 508 P.2d 975, 979 (Kan. 1973).

428. *See* Rex Oil Ref., Inc. v. Shirvan, 443 P.2d 82 (Okla. 1968).

429. *See generally* FORM 610-2015, *supra* note 2.

430. *See id.* at art. VIII.C.

industry generally deems it inequitable for one party to take advantage of the other participants by contracting for such contributions for itself alone.⁴³¹ To promote a fair distribution of these contributions, the Acreage or Cash Contributions clause of the operating agreement requires that such contributions be distributed among the parties that share the cost of the operations.⁴³²

Under this provision, any party obtaining a cash contribution based on a joint operation must pay the contribution to the operator for application against the expenses of the operation;⁴³³ a contribution of acreage must be promptly assigned, without warranty of title, to the consenting parties that shared the cost of operation in proportion to the costs each has borne for the operation.⁴³⁴ This latter obligation also applies to acreage outside the contract area that is contributed to support the drilling of a well inside the contract area.⁴³⁵

Controversies involving this clause have focused primarily on acreage contributions in which one party to the JOA assigns an interest to another party to the JOA as part of a farmout agreement between them.⁴³⁶ Under those circumstances, the courts decided that the Contributions clause does not apply.⁴³⁷ The issue was first confronted by a Louisiana court in *Superior Oil Co. v. Cox*.⁴³⁸ Pursuant to a farmout agreement with Superior, Midwest, and Belco, Cox drilled and completed a producing well and the four parties entered into a JOA.⁴³⁹ Midwest and Belco thereafter entered into a second farmout agreement, whereby Cox could earn additional acreage outside the contract area by drilling a second well within the contract area.⁴⁴⁰ All four parties elected to participate in the second well, and after it was completed, Superior brought suit to compel Cox to assign Superior a part of the outside

431. See *Martin Expl. Co. v. Amoco Prod. Co.*, 637 So. 2d 1202, 1207 (La. Ct. App. 1994).

432. See FORM 610-1989, *supra* note 15, at art. VIII.C; FORM 610-1982, *supra* note 15, at art. VIII.C; FORM 610-1956, *supra* note 2, at § 25.

433. See FORM 610-1989, *supra* note 15, at art. VIII.C; FORM 610-1982, *supra* note 15, at art. VIII.C; FORM 610-1956, *supra* note 2, at § 25. Note that to avoid confusion between a cash contribution and payments received for the sale of production, the 1982 Form JOA, the 1989 Form JOA, and the 2015 Form JOA expressly exclude receipts from the sale of production from the effects of the Contributions clause. See, e.g., FORM 610-2015, *supra* note 2, at art. VIII.C. Other operating agreements extend this exclusion to advance incentive payments for production and advances obtained in loan transactions. See *McCollam*, *supra* note 79, at 285.

434. See generally FORM 610-2015, *supra* note 2, at art. VIII.C. The acreage acquired does not become part of the contract area covered by the original operating agreement. See *id.* Instead, it is treated as a new area subject to a separate but substantially similar operating agreement among the assignees. See *id.*

435. See FORM 610-2015, *supra* note 2, at art. VIII.C.

436. See *id.* Note that such an assignment would be dealt with under the preferential right to purchase provision but for the fact that the transactions did not entail a sale for a monetary consideration.

437. See *Superior Oil Co. v. Cox*, 307 So. 2d 350, 355 (La. 1975); *Martin Expl. Co. v. Amoco Prod. Co.*, 637 So. 2d 1202 (La. Ct. App. 1994).

438. *Cox*, 307 So.2d at 355.

439. *Id.* at 351.

440. *Id.* at 352.

acreage earned under the second farmout.⁴⁴¹

The court concluded that the acreage contribution clause was not intended to apply to contributions among parties to the operating agreement, reasoning that the clause functions only to protect the parties to the operating agreement “against the possibility that one of them might obtain an undue advantage from an outsider at the expense of those paying for the operations”⁴⁴² The second conveyance only rearranged interests belonging to the parties to the operating agreement. In the aggregate, the assignment did nothing to improve the position of the other parties over Superior.⁴⁴³ It was a zero-sum transaction in which no one gained anything over Superior that would not have been obtained among the other parties in the absence of the assignment to Cox.⁴⁴⁴

Martin Exploration Co. v. Amoco Production Co. represented the first reported case interpreting the clause involving an acreage contribution made by an outside party, but the court declined to apply the protections of the Contributions clause based on the peculiar facts.⁴⁴⁵ Anticipating drilling a well, Amoco approached Martin and Gulf Oil requesting that they farm out their acreage in the area to Amoco.⁴⁴⁶ Gulf agreed to farmout part of its lease to Amoco, but Martin did not.⁴⁴⁷ Later, when some of Martin’s leases were included in the unit and Amoco began drilling a second well, Martin agreed to participate in the costs of the second well and the two parties executed a JOA that was back-dated to a date before the date of the Gulf-Amoco farmout.⁴⁴⁸ Martin then demanded that it be assigned part of the acreage that was earned by Amoco under the Gulf-Amoco farmout agreement for drilling the second well.⁴⁴⁹

With an assignment from a non-party (Gulf) based on an agreement (the Gulf-Amoco farmout agreement) that post-dated the effective date of the JOA between Amoco and Martin, the elements needed to trigger the Contributions clause seemed to be present.⁴⁵⁰ The court, however, concluded

441. *Id.*

442. *Id.* at 355 (emphasis in original); *see also* Harper Oil Co. v. Yates Petroleum Corp., 733 P.2d 1313 (N.M. 1987) (relying on *Cox*, the court held that the Contributions clause applied only to acreage adjacent to the contract area owned by non-parties to the operating agreement).

443. *See Cox*, 307 So. 2d at 354–55.

444. *See id.* The court also argued that the assignment to Cox did not affect Superior’s proportionate interest in the well and that there was no actual contribution, apparently in the sense that Cox assumed that portion of the costs for which Midwest and Belco would have been responsible without increasing the costs charged to Superior. *Id.* at 355. This part of the court’s rationale is suspect, because the Contributions clause is concerned with the improper advantage gained by one party, not by the loss shifted to another. It may be a valid argument where the assigned interest is limited to the well being drilled, but not when a broader interest is being assigned.

445. *Martin Expl. Co. v. Amoco Prod. Co.*, 637 So. 2d 1202, 1207–08 (La. Ct. App. 1994).

446. *Id.* at 1203.

447. *Id.* at 1203–04.

448. *Id.* at 1204.

449. *Id.*

450. *See id.* at 1204–05; *see also* Superior Oil Co. v. Cox, 307 So. 2d 350, 355 (La. 1975) (discussing

that the purpose of the Contributions clause was not violated. Although Amoco had no interest in Gulf's lease at the time the JOA became effective, Exhibit A to the operating agreement attributed that leasehold interest to Amoco, and only the Amoco interest was burdened or affected by Gulf's back-in interest at payout.⁴⁵¹ Because the cost attributable to that acreage was borne by Amoco, it gained no undue advantage over Martin when it eventually gained actual ownership of the interest from Gulf.⁴⁵² The case therefore both illustrates the application of the Contributions clause and serves as a reminder of the importance of the information contained in Exhibit A.⁴⁵³

From these cases, it is clear that the purpose of the Contributions clause is “to protect the participants of a joint operating agreement against the possibility that one of them might obtain an undue advantage from an outsider at the expense of those paying for the operations.”⁴⁵⁴ It also appears from the facts of these disputes that it makes no difference whether the contract for the acquisition was executed before or after the JOA became effective or whether the acreage acquired is inside or outside the JOA's contract area.⁴⁵⁵ Where a party to the JOA obtains an interest in consideration of joint operations—whether the arrangement was established before or after the JOA was executed and regardless of location—the Contributions clause grants the other participants a proportionate share in the acquisition unless a court concludes that the parties intended to exempt the acquisition from the effects of the provision.⁴⁵⁶

B. Area of Mutual Interest

The standard form JOA does not prohibit a party from acquiring properties except in connection with the extension or renewal of leases or under the Contributions clause if the properties are acquired in consideration of conducting operations that are covered under the JOA.⁴⁵⁷ Subject to those limited exceptions, a party is free to acquire properties either inside or outside the contract area without obligation to the other parties to the JOA.⁴⁵⁸ Unless the parties have fiduciary duties to each other because they have formed a partnership or joint venture (or are deemed to form a partnership or joint

the purpose of the Contributions clause).

451. *Martin Expl. Co.*, 637 So. 2d at 1208.

452. *Id.*

453. *See id.* at 1207–08.

454. *Id.* at 1207 (citing *Superior Oil Co.*, 307 So. 2d at 355).

455. Note that the 2015 Form JOA changed the application of the clause from an operation “on the [c]ontract [a]rea” to an operation “under this agreement.” FORM 610-2015, *supra* note 2, at art. VIII.C.

456. *See generally Superior Oil Co.*, 307 So. 2d at 355; *Martin Expl. Co.*, 637 So. 2d at 1207–08.

457. *See Clovelly Oil Co. v. Midstates Petroleum Co.*, 112 So. 3d 187, 193–96 (La. 2013) (describing Exhibit A's definition of the contract area).

458. *See id.*

venture), they may compete with one another in their land acquisitions taking full advantage of information obtained from joint operations.⁴⁵⁹ To prevent this competition, the parties may insert an AMI provision into the JOA.⁴⁶⁰

Although not a part of most standard JOA forms,⁴⁶¹ the AMI provision merits discussion because the clause is often the subject of disputes.⁴⁶² Attorneys also debate the advisability of adding such a provision.⁴⁶³ Absent an effective release and novation, the original parties to the JOA may continue to be bound by the AMI provision as a personal covenant long after they have assigned away their leases and interests in the contract area.⁴⁶⁴ Further, an active party that has entered into multiple operating agreements may find it difficult to account for intersecting areas of interest and obligations that may conflict.⁴⁶⁵

[An] AMI clause . . . ensure[s] every party to the JOA an opportunity to acquire a proportionate interest in any acquisitions within a prescribed area encompassing the [c]ontract [a]rea, regardless of the state of development of the newly acquired acreage. In essence, the AMI clause requires that any party acquiring an oil and gas interest within the [c]ontract [a]rea or within a specified distance from its perimeter give notice of the acquisition and its

459. *See id.*

460. For further materials on the AMI clause, see Mark T. Nesbitt, *Area of Interest Provisions—Two Edged Swords*, 35 ROCKY MTN. MIN. L. INST. 21 (1989); Dante L. Zarlengo, *Area of Mutual Interest Clauses Regarding Oil and Gas Properties: Analysis, Drafting, and Procedure*, 28 ROCKY MTN. MIN. L. INST. 14 (1982).

461. One writer has recommended the following AMI interest clause for use with the 1982 Form JOA:

Except for acquisitions pursuant to Article VIII(B) or VIII(C), if at any time prior to 5 years from the date hereof any party hereto acquires any interests in oil and gas within the contract area or within 2 miles of the outer perimeter of the contract area, such party shall give notice in writing to all of the other parties hereto which notice shall contain a description of the interest acquired, consideration paid therefore, and all other pertinent information necessary to describe such acquisition. All parties receiving such notice shall have 15 days from the receipt thereof to advise the acquiring party in writing of its election to participate in such acquisition failing which the party receiving such notice shall have no right to such acquisition. All parties electing to participate in such acquisition shall furnish to the acquiring party, with notice of their election to participate, their proportionate part (the same interest which they have in the contract area) of the costs of the acquisition, failing in which the affirmative response shall not be deemed effective and shall not entitle such party to participate. If any parties elect not to participate in such acquisition, the acquiring party shall notify all other parties of such refusal and all such other parties shall have the same right to respond within fifteen (15) days thereafter as applied in the case of the first notice. The acquiring party agrees to execute such assignments and conveyances as are necessary to reflect the acquisition as a matter of record as soon as reasonably possible after determination of the interests of the parties pursuant to the foregoing provisions. There shall be no obligation of any party hereto with respect to acquisition outside the area covered by this provision.

Robert C. Bledsoe, *Problem Areas in Drafting Operating Agreements—Some Suggested Solutions*, in ST. B. TEX., ADVANCED OIL, GAS AND MIN. L. INST. COURSE, N-24-25 (Oct. 15, 1981).

462. *See Conine & Kramer, supra* note 1, at art. III.B.

463. *See id.*

464. *See id.*

465. *See* 2-19A EUGENE KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 19A.4(a) (2016).

terms to all other parties to the operating agreement, who then have an option for a specified period to elect to participate in the acquisition. As with [other] options, the notice constitutes a continuing offer that matures into a bilateral contract of sale only when [the offer is] accepted by the optionee in the manner and within the time prescribed [by the notice].⁴⁶⁶

Failure to provide notice in writing and as otherwise prescribed by the clause will not be deemed notice and will not initiate the election period.⁴⁶⁷

However, where the AMI clause is ambiguous and the parties have construed the provision by course of conduct to require oral notice, or where oral notice is sufficient to place a reasonable party [on] inquiry notice, the substantive requirements of the clause may be deemed to be completed and the election period will be triggered.

To convert its option rights into a contract right, the optionee must communicate its exercise of the election within the time frame prescribed and indicate its unequivocal acceptance of the optionor's offer based on the sales terms negotiated by the buyer and seller. If the optionee fails to respond during the election period following proper notice, the option will expire. Silence following knowledge of an acquisition from some other source, whether amounting to actual or inquiry notice, can result in waiver of the option or, if the optionor relies to its detriment on the optionee's failure to indicate an interest, the optionee may be estopped to assert its option rights.

[If] the AMI option is exercised properly, the optionee is entitled to an assignment of its prescribed share in the acquisition. Under the typical AMI, this share is equal to the optionee's fractional interest in the [c]ontract [a]rea, as specified in Exhibit A. This allows the optionee to receive that fractional interest *of* the interest acquired, thereby preserving the relative

466. Conine & Kramer, *supra* note 1, at art. III.B (footnotes omitted); see *Courseview, Inc. v. Phillips Petroleum Co.*, 312 S.W.2d 197, 207 (Tex. 1957). The event that triggers the obligation to provide notice of an acquisition is dependent on the precise language used in the AMI provision. See *San Saba Energy, L.P. v. McCord*, 167 S.W.3d 67, 69–74 (Tex. App.—Waco 2005, pet. denied). The event can be anything ranging from obtaining a contractual right to acquire the property to an actual transfer of title. *Id.* In *San Saba Energy, L.P. v. McCord*, an AMI party obtained the right to acquire a leasehold interest but backed out of the transaction before title was actually transferred. *Id.* at 70–71. But the party still made a profit when the contract rights in the sales agreement were sold to another entity. *Id.* at 71. In a suit alleging breach of the AMI clause, the trial court granted summary judgment in favor of the defendant but the appellate court remanded the case for a trial on the proper interpretation of the triggering event in the AMI provision due to ambiguities in the documents. See *id.* at 72, 74. The case stands as another warning about the care that must be taken in drafting these provisions and the necessity of clearly addressing all the circumstances in which the clause is to apply, particularly where AMI requirements are repeated in multiple layers of documents and conflicting statements in the documents create uncertainties. See *id.* at 71–74. Damages for failure to provide notice and for permitting other AMI parties to share in the acquisition have been held to include lost revenue from the disputed interest, less acquisition costs attributable to that interest. See, e.g., *Kincaid v. W. Operating Co.*, 890 P.2d 249, 251, 254 (Colo. App. 1995).

467. Conine & Kramer, *supra* note 1, at art. III.B.

risks and rewards that exist under the JOA.⁴⁶⁸

That said, the court will not imply an obligation to reoffer proportionately to the electing parties the interests that are declined or waived by the non-electing parties absent a specific provision to that effect.⁴⁶⁹

A number of recent cases illustrate the importance of meticulous care in drafting the AMI provision and of punctilious compliance with its terms.⁴⁷⁰ In *Beckham Resources, Inc. v. Mantle Resources, L.L.C.*, the optionee failed to respond to several notices from the optionor, and then argued that the notices were deficient because they failed to include “all pertinent terms” as required by the AMI provision—specifically that the notices did not set forth a liquidated purchase price for the subject lease.⁴⁷¹ The consideration for the lease, however, was to drill a deep well on the property; and the optionor included with the notices an Authorization for Expenditure (AFE) that estimated the cost of participating in the well.⁴⁷² The court rejected the optionee’s argument that the true acquisition cost could only be determined after the well was drilled, finding the notice sufficient.⁴⁷³

In *SubISSI Holdings, L.P. v. Hilcorp Energy I, L.P.*, the optionor alleged that the optionee forfeited its right to participate in the acquisition because, although it responded that it would participate, it failed to deliver payment within the time required.⁴⁷⁴ The provision stated: “If . . . the [receiving party] elects to acquire its respective . . . [i]nterest, then the Offering Party shall execute, acknowledge, and deliver to [the receiving party] an assignment thereof, . . . and [the receiving party] shall pay . . . the Offering Party . . . [the associated] Purchase Price.”⁴⁷⁵ Interpreting this language, the court concluded that the election to participate by the optionee triggered concurrent obligations of the receiving party (to pay) and the offering party (to deliver

468. *Id.* (footnotes omitted); see *Cont’l Res., Inc. v. PXP Gulf Coast, Inc.*, No. CIV-04-1681-F, 2006 WL 2865509 (W.D. Okla. 2006) (holding that the optionee was entitled to a fractional interest); *Mountain Fuel Supply Co. v. Chorney Oil Co.*, 335 F. Supp. 59, 62–65 (D. Wyo. 1971) (explaining that oral notice was sufficient for an ambiguous AMI clause).

469. See, e.g., *Cyanostar Energy, Inc. v. Chesapeake Expl., L.L.C.*, 317 P.3d 217, 220 (Okla. Civ. App. 2013).

470. See *Beckham Res., Inc. v. Mantle Res., L.L.C.*, No. 13-09-00083-CV, 2010 WL 672880, at *24–26 (Tex. App.—Corpus Christi Feb. 25, 2010, pet. denied); *Subissi Holdings, L.P. v. Holcorp Energy I, L.P.*, No. 04-07-00674-CV, 2008 WL 2515698, at *2–5, *10–12 (Tex. App.—San Antonio June 25, 2008, no pet.).

471. *Beckham Res., Inc.*, 2010 WL 672880, at *24–25.

472. *Id.* at *14–16.

473. *Id.* at *24–26. Similarly, in *J-O’B Operating Co. v. Newmont Oil Co.*, the court held that J-O’B failed to provide an unequivocal and unconditional acceptance of Newmont’s offer when J-O’B refused to pay its share of seismic costs. *J-O’B Operating Co. v. Newmont Oil Co.*, 560 So. 2d 852, 859–60 (La. Ct. App. 1990). The acquired sublease was contingent on obtaining an extension of the underlying lease, and the underlying lease was extended based on assurances that a seismic program would be conducted. *Id.* at 855–56, 858.

474. *Subissi Holdings, L.P.*, 2008 WL 2515698, at *2–4.

475. *Id.* at *10 (emphasis in original).

an assignment) under the consequent clause; delivery of the assignment was not a condition precedent to payment.⁴⁷⁶

The optionee then argued that its payment obligation was never triggered because the optionor never tendered a proper assignment pursuant to another portion of the AMI provision, which stated that a receiving party would lose its right to the offered interest “[i]f [the receiving party] . . . elects to acquire but fails to pay its Purchase Price on or before the thirtieth (30th) day following the date that the Offering Party tenders the assignment”⁴⁷⁷ The optionor had tendered an assignment and a settlement statement after receiving the optionee’s election to participate, but the assignment was unexecuted.⁴⁷⁸ The court held the unexecuted assignment was sufficient to trigger the payment obligation, stating:

[i]f a contract calls for successive acts, . . . there is no breach by one if the precedent act has not been performed by the other; but if the contract contemplates concurrent acts, it is sufficient to put one party in default that the other party is ready, willing, and offers to perform his part of the contract.⁴⁷⁹

For the optionee, time was of the essence, and they were not excused from tendering payment during the thirty-day option period because the unexecuted assignment indicated that the optionor was ready and willing to perform.⁴⁸⁰

In *Ballard v. Devon Energy Production Co., L.P.*, the Fifth Circuit had occasion to interpret an AMI provision that stated in the final single-sentence paragraph of the provision that, “[t]he above subparagraph of 31F” would terminate after three years from the effective date of the AMI.⁴⁸¹ Section 31F was the AMI provision containing five paragraphs, the first three of which related to acquisitions, the fourth of which related to surrenders of leases, and the fifth of which was the termination clause at issue.⁴⁸² The plaintiff asserted “[t]he above subparagraph” referred only to the surrender clause (that is, the immediately preceding paragraph) such that the restrictions on acquisitions remained in effect, while the defendant asserted “[t]he above subparagraph” referred to all of subsection F of section 31 (that is, the entire AMI provision).⁴⁸³ The court concluded that the only reasonable reading was that the termination sentence applied to the entire AMI provision.⁴⁸⁴

476. *See id.* at *10–12.

477. *Id.* at *2–5.

478. *Id.* at *4–5.

479. *Id.* at *4 (quoting *Perry v. Little*, 419 S.W.2d 198, 201 (Tex. 1967)).

480. *Id.* at *6.

481. *Ballard v. Devon Energy Prod. Co., L.P.*, 678 F.3d 360, 363 (5th Cir. 2012).

482. *Id.*

483. *Id.* at 364.

484. *Id.* at 370.

Before an AMI provision is inserted into the JOA, the parties need to carefully consider some of the complications that can arise in its application. The AMI provision relies on some of the same procedures and mechanisms used in the Preferential Right provision.⁴⁸⁵ As a result, it can encounter many of the ambiguities and difficulties often associated with the preemptive right.⁴⁸⁶ For example, unanswered questions can arise concerning application of the clause to acquisitions in which only a portion of the property being transferred lies within the (AMI), as in some package sales, or where the acquisition includes unsevered mineral and surface estates.⁴⁸⁷ Here, the parties confront the same price allocation issues that arose in connection with the Preferential Right.⁴⁸⁸

The AMI clause presents particular concerns for large companies and firms highly active in the vicinity of the contract area due to the possibility of inadvertently entering into separate agreements that turn out to have overlapping areas of mutual interest.⁴⁸⁹ This situation can be particularly troublesome when companies merge, only to discover that the surviving entity has conflicting obligations in some AMIs.⁴⁹⁰ At the very least, the AMI clause can complicate and delay industry transactions by adding a further layer of procedures and parties that must be dealt with.⁴⁹¹

In 2000, the Texas case of *North Central Oil Corp. v. Louisiana Land & Exploration Co.* raised questions about the scope of the AMI clause.⁴⁹² Prior to this case, it had been assumed by many in the industry that the Preferential Right and the AMI provisions governed two distinctly different types of property transfers and worked in conjunction to provide two different protections to the JOA parties.⁴⁹³ The Preferential Right covered transfers to an outsider of interests already dedicated to the contract area, while the AMI governed newly acquired interests within the contract area and its nearby vicinity.⁴⁹⁴ The *North Central* case challenged this distinction.⁴⁹⁵

Various cotenancies were created in a series of almost identical farmout agreements that incorporated by reference a JOA based on the 1956 Form

485. See Gerald F. Slattery, Jr. & Amanda Davis Landry, *Understanding Areas of Mutual Interest, Preferential Rights, and Maintenance of Uniform Interest Provisions in Joint Operating Agreements*, 56 ANN. INST. ON MIN. L. 323, 324 (2009).

486. See *id.* at 329.

487. See *id.* at 329–30.

488. See *Ballard*, 678 F.3d at 363.

489. See W.F. Pennebaker, *Recent Developments in Oil and Gas Law with Drafting Suggestions*, 34 INST. ON OIL & GAS L. & TAX'N 353, 359 (1983).

490. See *id.*

491. See *id.*

492. See *N. Cent. Oil Corp. v. La. Land & Expl. Co.*, 22 S.W.3d 572, 576–77 (Tex. App.—Houston [1st Dist.] 2000, no pet.).

493. See generally *id.*

494. See *id.*

495. See generally *id.*

JOA, but the Preferential Right clause was struck from the form.⁴⁹⁶ When one cotenant assigned an undivided one thirty-second working interest in the underlying leases to another cotenant, the plaintiff, a third cotenant, brought suit asserting it was entitled to a proportionate share of the transfer under an AMI clause contained in the farmout agreements.⁴⁹⁷ The plaintiff relied on the Texas Supreme Court's decision in *Courseview, Inc. v. Phillips Petroleum Co.*, which held that the acquisition of an overriding royalty interest that previously had been carved out of a lease committed to the contract area was still an interest covered by the AMI provision.⁴⁹⁸ The defendants responded by arguing that such an interpretation would convert the AMI provision into a Preferential Right.⁴⁹⁹

Without endorsing the plaintiff's position, the appellate court rejected the defendants' argument, noting that the two provisions relate to entirely different transactions (acquisitions versus dispositions) and are triggered by different actors (assignees versus sellers).⁵⁰⁰ This is particularly important in that the restrictions placed on the Preferential Right emanate from efforts to prevent the provision from creating unreasonable restraints on alienation and have no application to requirements associated with the acquisition of property.⁵⁰¹ Because the court felt that both sides had reasonable explanations for the meaning of the AMI clause, the case was remanded to the trial court for a factual determination of the intent of the parties, leaving us without definitive guidance.⁵⁰²

If the AMI overlaps with the Preferential Right, it also might overlap with other property provisions in the JOA, which would threaten to undermine the structural integrity of the agreement.⁵⁰³ Consider, for example, the problems that would be created if an AMI clause were applied in the context of a well abandonment.⁵⁰⁴ When a participating party proposes to abandon a well before the end of the "penalty" phase and the other participating parties disagree, the abandoning party is to transfer its interest in the well to the other participants.⁵⁰⁵ The AMI, if applied, would require an assignment to all JOA parties, making no distinction between participants

496. *See id.* at 574, 580.

497. *See id.* at 574.

498. *Courseview, Inc. v. Phillips Petroleum Co.*, 312 S.W.2d 197, 208 (Tex. 1957). For an opinion seemingly to the contrary, the Twelfth District Texas Court of Appeals held that the AMI provision did not apply to an overriding royalty that was created after the date of the JOA because the AMI did not apply to a "subsequently created interest[]." *See XH, LLC v. Cabot Oil & Gas Corp.*, No. 12-12-00338-CV, 2014 WL 2505541, at *1 (Tex. App.—Tyler May 30, 2014, no pet.).

499. *N. Cent. Oil Corp.*, 22 S.W.3d at 579.

500. *Id.* at 581.

501. *See Slattery & Landry, supra* note 485, at 343.

502. *See id.*

503. *See generally N. Cent. Oil Corp.*, 22 S.W.3d at 579.

504. *See FORM 610-2015, supra* note 2, at art. VIII.

505. *See id.*

and non-participants.⁵⁰⁶ Because the AMI clause is a typewritten addition to the JOA, the normal rules of construction give priority to the AMI even though the conflicting provisions on well abandonment provide more detail on the terms of the transfer.⁵⁰⁷

In the interest of preserving the integrity of the JOA, the AMI and the other property provisions in the JOA should be interpreted as limited to the specific purposes each clause was intended to serve in the context of joint operations.⁵⁰⁸ Applying a limited interpretation would restrict the AMI clause to acquisitions of new interests not previously dedicated to the contract area for the purpose of preventing the parties from abusing their access to information derived from joint operations and investments.⁵⁰⁹

C. Renewal or Extension of Leases

The [JOA] provision . . . pertaining to the [renewal or extension] of leases is, to a limited degree, a form of [AMI provision]. As a standard provision in [the] . . . 1982 [Form JOA, the 1989 Form JOA, and the 2015 Form JOA], the provision is the closest the instrument[s] come[] to expressly protecting the interests of all parties against cash-based acquisitions prompted by knowledge generated in joint operations. However, it applies only to leases within the contract area [that] . . . have expired.⁵¹⁰

For example, for situations in which a term mineral interest was subject to an operating agreement, the JOA provision has been found not to apply to the purchase of a future interest in a reversion that followed the term mineral interest.⁵¹¹

The extension and renewal provision is intended to prevent . . . [a “washout”] of the interests of . . . [JOA] parties in the expiring leases through the termination of the original lease and the subsequent execution of new leasehold rights not subject to the terms of the [JOA]. The typical

506. *See id.*

507. *See* Coral Prod. Corp. v. Cent. Res., Inc., 730 N.W.2d 357, 370–71 (Neb. 2007) (“In order to harmonize provisions that appear to be in conflict, . . . courts will apply printed provisions to typewritten provisions”)

508. *See* Conine, *supra* note 4, at 1267.

509. *See generally* Courseview, Inc. v. Phillips Petroleum Co., 312 S.W.2d 197 (Tex. 1957). Access to information provides a basis for distinguishing the holding in *Courseview* on overriding royalty interests from the transfer of actual working interests. *See id.*

510. Conine, *supra* note 4, at 1348–49. The similarities between the AMI provision and the Renewal or Extension clause can lead to confusion when a party is acquiring several leases within the AMI at one time, when a party is acquiring new leases, or when a party is acquiring renewal leases. *See id.* Although the provision on renewal leases does not usually specify the precise information that must be provided in the notice, one court has held that the acquiring party must notify other JOA parties that renewal leases are included in the properties. *See* McFarland Energy Inc. v. Texoil Co., No. 89-5298, 1990 WL 93848 (E.D. La. 1990).

511. *See* ENI Producing Props. Program Ltd. P’ship 1982-I v. Samson Inv. Co., 977 P.2d 1086, 1088 (Okla. 1999).

renewal and extension clause will require any party securing an extension or renewal of all or part of a lease included in the contract area . . . to notify the other parties, who then have an option for a prescribed period to share in the acquisition in proportion to their interests in the contract area by paying a like portion of the acquisition costs. To clarify and limit the timeframe of the provision, a renewal lease is often defined as any leasehold interest acquired or contracted for within six months after the expiration of the original lease.⁵¹²

If less than all parties exercise their options to participate, two results obtain. First, the electing parties' shares in the extension or renewal are increased to reflect each electing party's proportionate interest in the aggregate of interests electing to participate in the acquisition. Second, the extended or renewed lease is released from the contract area and no longer subject to the provisions of the . . . [JOA]. This is the same treatment accorded leases proposed for surrender when only a portion of the parties elect to retain the leases. [Earlier forms of the clause were criticized because they failed] to subject the leases [that were] newly acquired by less than all parties to an operating agreement of substantially similar form as the existing . . . [JOA]⁵¹³

This problem was remedied in the 1989 Form JOA and the 2015 Form JOA.⁵¹⁴

V. VALIDITY AND ENFORCEMENT

Because [the] various property provisions [of the operating agreement attempt to] place significant restrictions and encumbrances on the property rights of the parties, disagreements over their application . . . [are to be expected] In any litigation concerning . . . [these provisions], validity and enforceability play a major role [Issues will arise over whether] . . . the provisions . . . are void for failure to comply with traditional limitations and requirements [imposed on] real property transactions, including those imposed under the Statute of Frauds, the Rule against Perpetuities, and the Rule on Restraints against Alienation.⁵¹⁵

Controversies can also be expected over whether a transferee is bound by the terms of an operating agreement to which it was not an original signatory, raising questions involving assumption and covenants running with the land.⁵¹⁶

512. Conine, *supra* note 4, at 1349.

513. *Id.* at 1349–50.

514. See FORM 610-2015, *supra* note 2, at art. VIII.B.2; FORM 610-1989, *supra* note 15, at art. VIII.B.

515. Conine, *supra* note 4, at 1370.

516. See *id.*

A. Statute of Frauds

In general, both mineral interests and oil and gas leaseholds have been treated as real property interests. As such, they are subject to the rules relating to real property, including the Statute of Frauds. Although . . . [arising from legislation that is] subject to local variations in content and interpretation, the Statute of Frauds as it relates to real property customarily precludes enforcement of [a conveyance] . . . unless the [transaction] has been reduced to writing and signed by the party alleged to be bound by its terms. Agreements . . . [governed by the] Statute of Frauds must [(1)] embody the essential terms of the transaction, [(2)] provide a sufficient description of the . . . property [involved] to permit identification, and [(3)] exhibit the [authorized] signature of any party obligated under its provisions.

The Statute of Frauds has been held to require that oil and gas leases and contracts for their transfer be in written form.⁵¹⁷

Although at least one court has suggested that contracts for development such as the operating agreement must comply with the Statute of Frauds, all jurisdictions would not likely agree.⁵¹⁸

The breadth of the Statute of Frauds varies from state to state . . . , [and some statutes that] apply to conveyances or contracts for conveyances of real property . . . [make no reference to the broader category of] instruments affecting interests in land [which arguably extend far enough to include the development agreements in general.] Thus, . . . a contract for development of an oil and gas lease would not be subject to the [Texas] Statute of Frauds.

Nevertheless, . . . individual provisions of the [JOA that involve] transfers or agreements for transfers of real property interests which must clearly comply with the Statute of Frauds to be enforceable. Provisions granting the operator's lien, nonconsent penalties requiring relinquishments and forfeitures, and acreage contribution clauses . . . are in this category. Additionally, property provisions granting various options to acquire interests inside and outside the contract area may be subject to the Statute of Frauds requirements. Decisions pertaining to agreements other than . . . [the JOA] have held that one form of option, the preferential right . . . relating to mineral interests, must comply with the Statute of Frauds.⁵¹⁹

517. *Id.* at 1371 (internal citations omitted).

518. *See id.*; *see also* *Sonat Expl. Co. v. Mann*, 785 F.2d 1232, 1234 n.1 (5th Cir. 1986) (speculating in passing that Mississippi law "would require that contracts involving oil and gas development be reduced to writing").

519. *Conine*, *supra* note 4, at 1372-73; *see* *Michael v. Busby*, 162 S.W.2d 662 (Tex. 1942); *Cove Invs., Inc. v. Manges*, 588 S.W.2d 792 (Tex. Civ. App.—San Antonio 1979), *rev'd on other grounds*, 602 S.W.2d 512 (Tex. 1980); *Cherry v. Salinas*, 355 S.W.2d 833, 834-35 (Tex. Civ. App.—San Antonio 1962, writ ref'd n.r.e.); *Noxon v. Cockburn*, 147 S.W.2d 872, 874 (Tex. Civ. App.—Galveston 1941, writ ref'd). The danger lies primarily in failing to provide a full specification of terms for the future sale at the time the option agreement is signed. Even where terms in a future third party agreement are adopted as the

Texas courts have also applied the Statute of Frauds to AMI provisions.⁵²⁰

Even if all or parts of the operating agreement are governed by the Statute of Frauds, the usual JOA form is sufficient to be declared valid if care is taken.⁵²¹ Although conceivable that an operating agreement could be oral, “arrangements for most contemporary joint operations are sufficiently complex to necessitate the use of a written agreement.”⁵²²

The description of the property to be conveyed must provide at least the means or data to identify the property with reasonable certainty.⁵²³ As with other real property transactions, failure to adequately identify the property affected by the agreement can render the agreement ineffectual against that interest.⁵²⁴ Under Texas law, this task is aided by the ability to describe the property in another writing that is referenced to in the JOA.⁵²⁵ Parole evidence may also be admitted to identify the property with reasonable certainty, so long as the JOA—or a document referenced in the JOA—contains essential terms identifying the “nucleus” of the location or describing the land.⁵²⁶

In the specific case of the JOA, the parties will not usually know at the time of the instrument’s execution which specific properties might become subject to a relinquishment or transfer obligation.⁵²⁷ This issue was addressed recently in *Long v. Rim Operating, Inc.*, in which a JOA based on the 1982 Form JOA contained a non-standard “Other Provision” requiring a party to relinquish its interest in a lease if the party did not consent to an operation required to perpetuate or earn an interest in the lease.⁵²⁸ The non-consenting working-interest owner argued that the provision was unenforceable because the parties conditionally agreed to convey property without knowing which property would be conveyed, or to whom the conveyances would be made.⁵²⁹ The court held that because the provision referenced a contract area that was

option terms, the absence of a formula for determining the sales price in a package transaction may be a fatal deficiency. See Harry M. Reasoner, *Preferential Purchase Rights in Oil and Gas Instruments*, 46 TEX. L. REV. 57, 60 (1967).

520. See *Westland Oil Dev. Corp. v. Gulf Oil Corp.*, 637 S.W.2d 903, 908–09 (Tex. 1982); *Crowder v. Tri-C Res., Inc.* 821 S.W.2d 393 (Tex. App.—Houston [1st Dist.] 1991, no writ). But see *Palmer v. Fuqua*, 641 F.2d 1146, 1158–59 (5th Cir. 1981) (concluding that an AMI provision in a limited partnership agreement was not an offer of property but was a requirement to make an offer to comply with a fiduciary obligation).

521. See Conine, *supra* note 4, at 1373.

522. *Id.*

523. See *Kmiec v. Reagan*, 556 S.W.2d 567, 569 (Tex. 1977).

524. See *Westland Oil*, 637 S.W.2d at 910.

525. See *McElroy v. Danciger*, 241 S.W. 1098, 1102 (Tex. Civ. App.—Amarillo 1922, no writ).

526. See *Gates v. Asher*, 280 S.W.2d 247, 248 (Tex. 1955); see also *Carpenter v. Phelps*, 391 S.W.3d 143 (Tex. App.—Houston [1st Dist.] 2011, no pet.) (discussing how a series of emails referencing an investor “pitch package,” a Railroad Commission filing, an assignment and bill of sale, and two drawings were insufficient to identify property).

527. See, e.g., *Long v. Rim Operating, Inc.*, 345 S.W.3d 79, 89 (Tex. App.—Eastland 2011, pet. denied).

528. See *id.*

529. *Id.* at 85.

sufficiently described, the provision did not violate the Statute of Frauds.⁵³⁰ If the contract area is not sufficiently described, then a future requirement to relinquish or transfer an interest likely will be unenforceable.⁵³¹

It is more likely that Statute of Frauds problems will develop under the operating agreement for failure to ensure that the instrument is fully executed by all parties or by their authorized agents.⁵³² Because thorough title examinations are not likely to be available when the JOA is signed and may not be obtained afterwards, errors are common.⁵³³ In the case of individuals, parties or their counsel “often [fail] to check local requirements on joinder of spouses to ensure that both husbands and wives execute the instrument where required”⁵³⁴ Care must also be taken to ensure that parties representing corporate and partnership interests sign in a correct and authorized capacity.⁵³⁵

Nonetheless, failure of a single party to execute an operating agreement will have no effect on the validity of the instrument with respect to the executing parties under the 1989 and 2015 Form JOA, if the agreement provides that it “shall be binding upon each party who executes the same . . . regardless of the failure of any other party to execute the same.”⁵³⁶

Some significant changes were made to the execution provision in the 1989-H Form JOA that were carried forward to the 2015 Form JOA, but first some background is in order. The 1989 Form JOA added an execution provision that allows the operator to terminate the agreement if all non-operators have not executed the agreement before the spud date of the initial well, but not later than five days before the date the operator was required to commence the initial well.⁵³⁷ If the operator terminates the agreement under this provision, it is required to return any sums already advanced by the non-operators.⁵³⁸ The 2015 Form JOA modified this

530. *Id.* at 89 (citing *Westland Oil Dev. Corp. v. Gulf Oil Corp.*, 637 S.W.2d 903, 909 (Tex. 1982)).

531. *See id.* at 88; *Long Trs. v. Griffin*, 222 S.W.3d 412, 416 (Tex. 2006).

532. *See Conine*, *supra* note 4, at 1374.

533. *See id.*

534. *Id.* at 1374–75.

535. *See id.* at 1375.

536. *See Sw. Gas Prod. Co. v. Creslenn Oil Co.*, 181 So. 2d 63, 68 (La. Ct. App. 1965); *see also* FORM 610-2015, *supra* note 2, at art. XV.A; FORM 610-1989, *supra* note 15, at art. XV.A. Note, however, that an unexecuted sample operating agreement with incomplete provisions attached to another instrument is of no effect. *See King-Stevenson Gas & Oil Co. v. Texam Oil Corp.*, 466 P.2d 950, 956 (Okla. 1970). Further, modifications of an operating agreement are not binding on the parties other than those accepting the terms of the amendment when the agreement’s obligations are individual and several, rather than joint. *See Osborn v. Rogers*, 363 P.2d 219, 222 (Okla. 1961); *McFarlane v. Clevenger*, 665 S.W.2d 819, 824–25 (Tex. App.—Corpus Christi 1983, writ ref’d n.r.e.). On the other hand, an operating agreement termed “preliminary” by the parties can be effective until later modified if so intended by the parties. *Chevron U.S.A., Inc. v. Martin Expl. Co.*, 447 So.2d 469, 472 (La. 1984). Estoppel may also play a role in binding a non-executing party to the terms of the operating agreement. *See Great W. Oil & Gas Co. v. Mitchell*, 326 P.2d 794, 800 (Okla. 1958).

537. *See* FORM 610-1989, *supra* note 15, at art. XV.A.

538. *See id.*

requirement slightly by allowing the operator to deduct costs already incurred by the operator attributable to the operation before termination.⁵³⁹

Alternatively, the operator could proceed and indemnify the signing non-operators for the non-signing parties' share of the costs of the initial well, in which case the operator would be entitled to all of the revenue that would have been received by the non-signing parties. The 1989-H Form JOA added an optional provision carried forward in the 2015 Form JOA that would allow an executing party, in the event the operator elects to proceed without signatures from all listed parties, to elect to carry its proportionate share of the non-signing parties' share of costs.⁵⁴⁰

Despite these provisions, partial performance is an exception to the requirement that an agreement be signed by the party alleged to be subject to its terms.⁵⁴¹ Thus, a party may be bound by the operating agreement even if it has not executed the document when that party fails to object to the operator's activities in that capacity over a number of years.⁵⁴²

B. Rule against Perpetuities

The common law Rule against Perpetuities provides that, "[n]o interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest."⁵⁴³ The policy behind the rule, which is applicable to mineral estates as well as surface interests, is one of promoting the commercial use of property by preventing restraints on the alienation of property for undue periods of time.⁵⁴⁴ Because several property provisions in the JOA place conditions and limitations on the transfer of various interests, there is always a concern that the Rule against Perpetuities could be used by the courts to declare one or more of those provisions invalid.⁵⁴⁵ Specifically, these provisions include the carried interests and reversionary rights created by the non-consent penalty; the preferential right; the AMI provision; the provisions on the extension and renewal of leases; and the acreage contribution clause—all of which seek to compel the conveyance of property interests at a point in the future which may exceed the time limitations prescribed by the rule.⁵⁴⁶

539. See FORM 610-2015, *supra* note 2, at art. XV.A.

540. See *id.*; FORM 610-1989, *supra* note 15, at art. XV.A.

541. See *Pou v. Dominion Oil Co.*, 265 S.W. 886, 888 (Tex. Comm'n App. 1924).

542. See *Auster Oil & Gas, Inc. v. Stream*, 764 F.2d 381, 389 n.7 (5th Cir. 1985).

543. J. GRAY, THE RULE AGAINST PERPETUITIES § 201 (4th ed. 1942); RESTATEMENT OF PROPERTY § 374 (AM. LAW INST. 1944).

544. EUGENE KUNTZ, LAW OF OIL & GAS § 17.1 (1987); BRUCE M. KRAMER & PATRICK H. MARTIN, WILLIAMS & MEYERS, OIL & GAS LAW § 320.1 (2015).

545. For more general information on the application of the Rule against Perpetuities in the oil and gas context, see Bruce M. Kramer, *Modern Applications of the Rule against Perpetuities to Oil and Gas Transactions: What the Duke of Norfolk Didn't Tell You*, 37 NAT. RES. J. 281 (1997).

546. See *id.* at 300-04.

For example, the Rule against Perpetuities has been applied to invalidate options for the acquisition of property interests if the exercise of the option could potentially occur beyond the time limitations of the rule.⁵⁴⁷ The preferential right to purchase and other provisions in the JOA are sufficiently analogous to such options that the courts have had to consider the application of the Rule against Perpetuities.⁵⁴⁸ Fortunately, the trend has been to relax the inflexible application of the rule and to give effect to the intention of the parties.⁵⁴⁹

Many states, including Colorado, New Mexico, Kansas, North Dakota, and California, have amended the common law rule by enacting some form of the Uniform Statutory Rule against Perpetuities (USRAP).⁵⁵⁰ In addition to validating contingent future interests that satisfy the common law rule, USRAP also validates interests that actually vest within ninety years after the date of the grant and allows the court to reform interests that violate either the common law rule or the ninety-year “wait-and-see” period.⁵⁵¹ USRAP, however, specially states that the statutory rule does not apply to nondonative transactions such as commercial transactions under the rationale that the rule “is [a] wholly inappropriate instrument of social policy to use as a control over such arrangements.”⁵⁵² Even though options and preferential rights should be valid when USRAP is applicable, validity may turn on the effective date of the enactment of the statute.⁵⁵³

For example, in *Atlantic Richfield Co. v. Whiting Oil and Gas Corp.*, the Colorado Supreme Court considered whether a revocable option granted in 1983 to repurchase oil shale property violated the Rule against Perpetuities.⁵⁵⁴ Colorado had adopted USRAP, but as enacted it only applied to abolish the common law rule for nonvested interests created after May 31, 1991.⁵⁵⁵ The parties disagreed whether USRAP allowed the trial court to

547. See, e.g., *Melcher v. Camp*, 435 P.2d 107, 115 (Okla. 1967) (holding the preferential right to purchase oil and gas lease invalid).

548. See *Reasoner*, *supra* note 519, at 65–71; e.g., *Producers Oil Co. v. Gore*, 610 P.2d 772, 774 (Okla. 1980).

549. See *First Nat'l Bank & Tr. Co. v. Sidwell Corp.*, 678 P.2d 118, 126 (Kan. 1984).

550. See *Statutory Rule against Perpetuities Summary*, UNIFORM L. COMMISSION, <http://www.uniformlaws.org/Act.aspx?title=Statutory%20Rule%20Against%20Perpetuities> (last visited Feb. 24, 2018).

551. UNIF. STAT. RULE AGAINST PERPETUITIES §§ 1(a), 3 (2014).

552. *Id.* at § 4, cmt. A.

553. See *Larson Operating Co. v. Petroleum, Inc.*, 84 P.3d 626, 633 (Kan. Ct. App. 2004).

554. See *Atl. Richfield Co. v. Whiting Oil & Gas Corp.*, 320 P.3d 1179, 1180 (Colo. 2014).

555. COLO. REV. STAT. § 15.11.1102.5(1)(b)(I) (West 2018). In 2006, Colorado amended its statutory Rule against Perpetuities to provide that a “nonvested property interest is invalid unless it either vests or terminates within one thousand years after its creation.” See *id.* This 1,000 year vesting rule states that it is only applicable to “interests in trust and powers of appointment with respect to all or any part of a trust, which interest or power is created after May 31, 2001.” *Id.* § (1)(a). Commercial transactions entered into after May 31, 1991 are not subject to the rule at all in Colorado. See Lynn P. Hendrix, *Death of the Rule against Perpetuities in Commercial Transactions*, 21 COLO. LAW. 475, 476 (1992).

retrospectively reform a grant made before the effective date of adoption.⁵⁵⁶ The Colorado Supreme Court, however, never reached the reformation issue—instead, the court focused on the threshold matter of whether the option violated the common law rule.⁵⁵⁷

In past decisions, the Colorado Supreme Court had applied the rule to ordinary options and preemptive rights without much analysis.⁵⁵⁸ But in this case, the court took the opportunity to expound on the litany of reasons against applying the rule to options and preemptive rights.⁵⁵⁹ These reasons include: (1) that the vesting period based on lives in being makes little sense in commercial transactions; (2) that the rule was designed to prevent dead-hand control of family dynasties, not commercial transactions; and (3) that equity and free markets favor the enforcement of options and preferential rights in negotiated contractual arrangements.⁵⁶⁰ The court also referred to the Restatement (Third) of Property: Servitudes, which expressly states that the rule no longer applies to options and rights of first refusal with respect to the purchase of land.⁵⁶¹ As to its past holdings, the court concluded that, when it had said in the past that it was applying the rule to options and preferential rights, it really had been applying a Rule against Unreasonable Restraints on Alienation.⁵⁶²

The court ultimately concluded that the option poses no effective restraint on alienation because it was fully revocable, also quoting the rule that “an interest, which is presently destructible, is not subject to the Rule against Perpetuities.”⁵⁶³ Although the dicta is helpful, the court never reaches the question of whether an ordinary option granted in a negotiated transaction that creates an absolute right to purchase might still violate the rule.⁵⁶⁴

In jurisdictions that retain the common law rule, however, some courts have found it inapplicable to provisions of the JOA.⁵⁶⁵ In *Melcher v. Camp*, the Oklahoma Supreme Court previously determined that a preemptive right to acquire an oil and gas lease, if and when a lease was granted on certain

556. See *Atl. Ritchfield*, 320 P.3d at 1183. The court of appeals noted that some states expressly exclude interests arising from nondonative transfers from the operation of the entire act, including the reformation provisions, and not just from the vesting requirements. See *id.*

557. See *id.* at 1191.

558. See, e.g., *Atchison v. City of Englewood*, 463 P.2d 297, 310–11 (Colo. 1969) (holding that the rule’s application to “ordinary options” is “firmly established”); see also *Perry v. Brundage*, 614 P.2d 362, 366 (Colo. 1980) (holding that the rule applies to both options and preemptive rights).

559. See *Atl. Ritchfield*, 320 P.3d at 1183–85.

560. See *id.*

561. See *id.* at 1184; RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 3.3 cmt. a (AM. LAW INST. 2000).

562. See *Atl. Ritchfield*, 320 P.3d at 1188–89 (quoting RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 3.3 cmt. b (AM. LAW INST. 2000) (“[I]n permitting the social utility of the particular arrangement to avoid invalidation, courts in fact are applying the Rule against Unreasonable Restraints on Alienation rather than the rule against perpetuities.”)).

563. GRAY, *supra* note 543, at 512.

564. See *Atl. Ritchfield*, 320 P.3d at 1191.

565. See, e.g., *Producers Oil Co. v. Gore*, 610 P.2d 772 (Okla. 1980).

property, was void as a violation of the rule.⁵⁶⁶ When the validity of the preferential right to purchase an Oklahoma oil and gas leasehold interest later arose in the context of an operating agreement, the Tenth Circuit Court of Appeals certified the question to the Oklahoma Supreme Court for clarification.⁵⁶⁷ As part of its rationale for declaring the Rule against Perpetuities inapplicable in this latter instance, the Oklahoma Court expressed its “strong view that the Rule against Perpetuities should not apply to oil and gas operating agreements.”⁵⁶⁸ Opinions by courts in several other producing states have reached this same conclusion.⁵⁶⁹

It is important to note a second basis for the decision in *Producer’s Oil Co. v. Gore*. The Rule against Perpetuities has no application in a situation in which a preemptive right to purchase is contained within a lease and limited to the duration of the leasehold estate.⁵⁷⁰ The court concluded that the preferential option under the JOA was similarly limited to the term of each lease within the contract area.⁵⁷¹ The preemptive right granted by the JOA could only remain viable as long as the underlying lease itself was in effect. Thus, the Rule against Perpetuities was inapplicable.⁵⁷²

It should also be noted that many cases, such as *Weber v. Texas Co.*, have distinguished the preferential right to purchase from an unending option to acquire the property at the discretion of the optionee.⁵⁷³ Because the preferential right can only be exercised when the present owner decides to sell and on terms accepted by the proposed third-party buyer, the court in *Weber* reasoned that the provision did not offend the commercial purposes behind the rule.⁵⁷⁴

566. Melcher v. Camp, 435 P.2d 107, 114–15 (Okla. 1967).

567. See *Producers Oil*, 610 P.2d at 773.

568. See *id.* at 774 (quoting *Producers Oil Co. v. Gore*, 437 F. Supp. 737, 742 (E.D. Okla. 1977)).

569. See, e.g., *Greenshields v. Warren Petroleum Corp.*, 248 F.2d 61, 70–72 (10th Cir. 1957), *cert. denied*, 355 U.S. 907 (1957); *Cambridge Co. v. E. Slope Inv. Corp.*, 700 P.2d 537, 540 (Colo. 1985); *Denney v. Teel*, 688 P.2d 803, 807–10 (Okla. 1984); *Harnett v. Jones*, 629 P.2d 1357, 1362–63 (Wyo. 1981). In *Larson Operating Co. v. Petroleum, Inc.*, the court held that the Uniform Statutory Rule against Perpetuities adopted in Kansas, KAN. STAT. ANN § 59-3401 (West 2017), exempts non-vested property interests created by non-donative transfers, and therefore does not apply to the preemptive right granted in the JOA. *Larson Operating Co. v. Petroleum, Inc.*, 84 P.3d 626 (Kan. Ct. App. 2004). The court noted that “the rationale for this exemption is that the Rule against Perpetuities is a wholly inappropriate instrument of social policy to use as a control over commercial and governmental transactions.” *Id.* at 633.

570. See *Producers Oil*, 610 P.2d at 775–76; RESTATEMENT OF PROPERTY § 395 (AM. LAW INST. 1944).

571. *Producers Oil*, 610 P.2d at 776.

572. See *id.* at 776; see *Harnett v. Jones*, 629 P.2d 1357, 1362–63 (Wyo. 1981) (holding that the preferential right to purchase contained in joint venture agreement was not voided by the rule because partnership would terminate upon death of any partner which by definition is a life in being).

573. *Weber v. Tex. Co.*, 83 F.2d 807, 808 (5th Cir. 1936), *cert. denied*, 299 U.S. 561 (1936).

574. *Id.*; see also *Murphy Expl. & Prod. Co. v. Sun Operating Ltd. P’ship*, 747 So. 2d 260 (Miss. 1999) (concluding that the Rule against Perpetuities was inapplicable to the preferential right to purchase in the JOA).

C. Rule against Unreasonable Restraints on Alienation

Restrictions that unreasonably interfere with the free transfer of real property are also void under the common law.⁵⁷⁵ The purpose of this rule, like that of the Rule against Perpetuities, is to promote the utilization of land by precluding impediments to future development.⁵⁷⁶ However, there is a distinction between the two rules. The Rule against Restraints on Alienation is broadly concerned with all transfer restrictions.⁵⁷⁷ The Rule against Perpetuities, on the other hand, applies to restrictions that specifically defer the vesting of an interest in a third party, thereby imposing limitations on intervening transfers.⁵⁷⁸ Like the Rule against Perpetuities, the Rule against Restraints on Alienation applies to mineral and oil and gas interests.⁵⁷⁹

On policy grounds, common law restrictions on undue restraints on alienation are constrained by the same respect for commercial development as observed by the courts in oil and gas cases dealing with perpetuities.⁵⁸⁰ As long as the restraint is indirect and ancillary to a legitimate commercial purpose, the restriction should survive judicial scrutiny under the Rule against Undue Restraints.⁵⁸¹ Thus, it has been held that the preferential right to purchase in an oil and gas context does not restrain alienability in the sense prohibited by the rule.⁵⁸² As previously discussed, however, the law may distinguish between a preferential right to purchase and a pure option, the latter of which is more likely to constitute an unreasonable restraint.⁵⁸³

Under the Restatement (Third) of Property: Servitudes, direct restraints on alienation are invalid if unreasonable.⁵⁸⁴ Reasonableness is determined by weighing the utility of the restraint against the consequences.⁵⁸⁵ The Restatement (Third) would allow standard preferential rights under the JOA because it states that rights of first refusal that allow the right to purchase on the same terms and conditions as the owner may receive from a third party are valid.⁵⁸⁶ Following the Restatement and similar reasoning, Texas courts have routinely upheld preferential rights.⁵⁸⁷

575. *See, e.g.*, *Shields v. Moffitt*, 683 P.2d 530, 534 (Okla. 1984) (holding that a lease restricting assignment by lessee without the lessor's written consent is void).

576. *See* Jeffrey J. Scott, *Restrictions on Alienation Applied to Oil and Gas Transactions*, 31 ROCKY MTN. MIN. L. INST. § 15.03(2) (1985).

577. *See id.*

578. *See* *Dallapi v. Campbell*, 114 P.2d 646, 649 (Cal. Dist. Ct. App. 1941).

579. *See* *KRAMER & MARTIN*, *supra* note 544, at § 320.1.

580. *See id.*

581. *See* *Reasoner*, *supra* note 519, at 61.

582. *See* *Weber v. Tex. Co.*, 83 F.2d 807, 808 (5th Cir. 1936), *cert. denied*, 299 U.S. 561 (1936); RESTATEMENT OF PROPERTY § 413(1) cmt. c (AM. LAW INST. 1944).

583. *See supra* Sections III.B.1–3 (describing certain rights to purchase as unreasonable restraints).

584. *See* RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 3.4 (AM. LAW INST. 2000).

585. *See id.*

586. *See id.* § 3.4 cmt. f.

587. *See, e.g.*, *Navasota Res., L.P. v. First Source Tex., Inc.*, 249 S.W.3d 526, 538 (Tex. App.—Waco 2008, *pet. denied*) (following the Restatement, citing cases, and concluding that “Texas courts have

The Restatement (Third) takes a stricter approach for options, but the typical AMI should also be valid under its reasoning.⁵⁸⁸ Under the Restatement (Third), the reasonableness of an option depends on its duration and the exercise price of the option.⁵⁸⁹ If the price is fair market value as it is under a typical AMI, it is more likely to be valid than a fixed-price option because fixed-price options are considered to discourage improvements.⁵⁹⁰

The Restatement (Third) also provides that the longer the duration of the option, the more likely it will be invalid.⁵⁹¹ The AMI included with a JOA may be limited by the term of the underlying leases if it expires with the remaining provisions of the JOA.⁵⁹² Even if the underlying interest is a fee interest of unlimited term, the provisions of the operating agreement which deem such interest subject to a lease should allow the application of similar reasoning if the provisions of the hypothetical lease are construed to release the mineral interest from the JOA upon the expiration of the supposed lease term.⁵⁹³ Nevertheless, the AMI might stay outstanding for an extremely long period.⁵⁹⁴ In such case, the Restatement (Third) states that an option with a long duration may be justified by the purpose of the option or if “it is clear that the parties expressly bargained over the specified duration.”⁵⁹⁵

Although one might attempt to address the duration issue by adding an express sunset provision to the AMI (which may be wise for business reasons), consider that the option period itself is usually an extremely short period after the purchase of property by a party to the AMI.⁵⁹⁶ There is another even stronger reason, however, that an AMI provision should not be invalidated as a restraint on alienation.⁵⁹⁷ Such a provision is much more a restraint on the purchase of property than it is on the sale of property; the seller is not constrained on its ability to sell to whomever it chooses whenever it chooses.

Instead of a restraint on alienation, the AMI would be better characterized as a common law restraint on competition for property within the contract area, which is also a type of restraint subject to scrutiny.⁵⁹⁸ Such restraints are also invalid if unreasonable, but the Authors are unaware of any reported cases that applied a common law property competition restraint

without exception upheld provisions like the [Preferential Rights provision] at issue here as reasonable restraints on alienation.”)

588. See RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 3.4 (AM. LAW INST. 2000).

589. See *id.* at § 3.4 cmt. e.

590. See *id.*

591. See *id.* at § 3.4 cmt. c.

592. See generally *id.*

593. See generally *id.*

594. See generally *id.*

595. See *id.* at § 3.4 cmt. e.

596. See generally *cf. Sunset Law*, BLACK’S LAW DICTIONARY (Bryan A. Garner, ed. 9th ed. 2009).

597. See RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 3.6 (AM. LAW INST. 2000).

598. See *id.*

analysis to an AMI provision.⁵⁹⁹ A sunset provision or defining the geographic area narrowly might also reduce the likelihood that an AMI would be deemed an invalid restraint on competition.⁶⁰⁰ Although beyond the scope of this Article, the parties should also be concerned with potential anti-trust issues in the context of AMIs and JOAs generally.⁶⁰¹

D. Application to, and Priority against, Assignees and Assignors

1. Pure Contract Law Analysis

The typical operating agreement does not forbid the parties from transferring their interests in the contract area. Such transfers may be subject to preferential rights or requirements for the maintenance of a uniform interest, but these limitations clearly contemplate that conveyances will occur.⁶⁰² However, the operating agreement expressly requires that any conveyance be made “subject” to the JOA⁶⁰³ and proclaims that its terms shall be binding on the assigns of each party.⁶⁰⁴ The question is whether these provisions are adequate to assure that the transferee of a party’s interest will be bound by the terms of the JOA.

The effect of the assignment and delegation of a lease or interest subject to a JOA on the required performance of a promise by the assignor or assignee may depend on whether the promise is characterized as a contractual promise or a covenant running with the land. Under a pure contract analysis, contractual rights generally may be assigned and contractual duties may be delegated, but the delegation of a duty or even the assumption of that duty by an assignee does not release the assignor from liability unless the obligee of the duty agrees to release the assignor.⁶⁰⁵ Such an assumption and release is referred to as a novation.⁶⁰⁶ If, however, the assignee assumes the obligations of the assignor but the other parties to the contract do not release the assignor, then the assignee is obligated to perform under the contract and the assignor becomes a surety for the performance of the obligation by the assignee.⁶⁰⁷

599. *See id.*

600. *See generally cf. Sunset Law*, BLACK’S LAW DICTIONARY (Bryan A. Garner, ed. 9th ed. 2009).

601. *See generally* Timothy R. Beyer, *Tangled Relationships: Antitrust Considerations, Recent Enforcement Acts, and Proposed Solutions When Using AMIs and Other Forms of Collaboration*, 59 ROCKY MTN. MIN. L. INST. 13 (2013); Daniel L. Wellington et al., *Benchmarking, Joint Operations, and Antitrust Law: Boundaries for Cooperation among Competitors in the Oil and Gas Industry*, 54 ROCKY MTN. MIN. L. INST. 31 (2008).

602. *See generally supra* Sections III.B.1, III.C (discussing preferential rights and maintenance of a uniform interest)

603. *See* FORM 610-2015, *supra* note 2 at art. VIII.D (“Every sale, encumbrance, transfer or other disposition . . . shall be made expressly subject to this agreement . . .”).

604. *See id.* at art. XIV.B.

605. *See* RESTATEMENT (SECOND) OF CONTRACTS § 317–18 (AM. LAW INST. 2013).

606. *See generally id.*

607. *See id.* at § 328 cmt. a, Illust. 1; 9 JOHN E. MURRAY, JR. & TIMOTHY MURRAY, CORBIN ON

This contract law analysis was applied by the Supreme Court of Texas in *Seagull Energy E&P, Inc. v. Eland Energy, Inc.*⁶⁰⁸ Eland assigned its interest in the lease subject to a JOA, and after the assignee failed to pay its share of costs and declared bankruptcy, the operator pursued Eland.⁶⁰⁹ The court rejected the argument that had been successful in the court of appeals that the language of the operating agreement imposed no continuing obligation on the assignor because a party was only obligated to pay costs in proportion to its participating interest.⁶¹⁰

The holding in *Seagull* was heavily criticized by commentators under a number of rationales.⁶¹¹ One argument against *Seagull* posits, applying a landlord-tenant analysis, that the operator had no right to enforce the JOA against Eland because it had neither privity of contract (which arises between the original parties to the JOA) nor privity of estate with Eland, an intermediate assignee that subsequently assigned its interest.⁶¹² When Eland was assigned its interest, however, it expressly assumed its assignor's obligations under the JOA to the operator, who was likely an intended beneficiary of the assumption.⁶¹³ Other arguments of commentators include that the decision was contrary to the understanding of the industry⁶¹⁴ and that the decision should be interpreted as limited to general obligations such as the plugging and abandonment (P&A) costs at issue in *Seagull*, not subsequent operations that are subject to consent/nonconsent and commenced after the date of the assignment.⁶¹⁵

This latter interpretation has support in decisions issued since *Seagull*.⁶¹⁶ In *GOM Shelf, LLC v. Sun Operating Ltd. P'ship*, the court applied *Seagull* to hold an assignor liable for P&A operations on the Outer Continental

CONTRACTS § 49.6 (Matthew Bender ed., 2017).

608. *Seagull Energy E & P, Inc. v. Eland Energy, Inc.*, 207 S.W.3d 342, 346–47 (Tex. 2006).

609. *See id.* at 344.

610. *Eland Energy, Inc. v. Seagull Energy E&P, Inc.*, 135 S.W.3d 122, 129 (Tex. App.—Houston [14th Dist.] 2006), *overruled by*, 207 S.W.3d 342, 347 (Tex. 2006).

611. Despite the criticism, in *Pennaco Energy Inc. v. KD Co. LLC*, *Seagull* was extended to the liability of an assignor under surface use agreements. *Pennaco Energy, Inc. v. KD Co.*, 363 P.3d 18, 33 (Wyo. 2015).

612. *See* Christopher S. Kulander & David W. Lauritzen, *A Flock of Trouble: Liability under Oil and Gas Joint Operating Agreements after Seagull v. Eland*, 14 TEX. WESLEYAN L. REV. 217, 230 (2008); Preston R. Mundt, Comment, *The Assignor Giveth and the Operator Taketh Away: Oil and Gas Working Interest Owners Beware of Continuing Liability*, 40 TEX. TECH L. REV. 419, 423–24 (2008); *see also* David A. Thomas, *How Far Does the Covenant Run? Covenants that Run with the Land in Oil and Gas Transactions*, 53 ROCKY MT. MIN. L. INST. 19, § 19–05 (2007).

613. *See* RESTATEMENT (SECOND) OF CONTRACTS § 318 cmt. b (AM. LAW INST. 2013) (indicating that an assignee may or may not promise the assignor/obligor to render performance, and “[i]f he does so promise, the obligee may in some cases be an intended beneficiary of the promise”).

614. *See* Kulander & Lauritzen, *supra* note 612, at 232.

615. *See* David Patton, *Bad Moon Rising—The Continuing Liability of an Assignee after Assignment*, 53 ROCKY MTN. MIN. L. INST. 31 § 31.03 (2007).

616. *See, e.g.*, *GOM Shelf, LLC v. Sun Operating Ltd. P'ship*, No. 4:06-cv-3444, 2008 WL 901482 (S.D. Tex. 2008).

Shelf.⁶¹⁷ Although the assignment clause in the JOA at issue contained a release “of all obligations hereunder which accrue subsequent to the date of the delivery to the purchaser of written assignment or conveyance of such interest, . . .” under OCSLA such obligations “accrue” when a party becomes a lessee or owner of operating rights, not when expenses for P&A operations are incurred.⁶¹⁸

In *Indian Oil Co., LLC v. Bishop Petroleum Inc.*, the operator attempted to hold an assignor liable for the costs to workover and then plug and abandon an unproductive well.⁶¹⁹ The JOA provided that an assignor is not relieved of “obligations previously incurred by such party.”⁶²⁰ The court held that this language meant the assignor was liable for obligations incurred before the date of the assignment but not entirely new operations, and that workover operations cannot be considered an obligation previously incurred.⁶²¹ Because the assignor never tendered a jury instruction to apportion damages and acknowledged in oral argument that he was liable for P&A expenses, the matter was remanded for a new trial although the court never affirmatively resolved the assignor’s legal responsibility for P&A costs.⁶²²

The 2015 Form JOA addresses *Seagull* by the addition of the following language in the assignment provision:

Except as otherwise provided herein, any transfer by a party shall relieve the transferor from liability for the cost and expense of operations attributable to the transferred interest which are *conducted* after the expiration of the 30-day period above provided [receipt by operator of transfer documents] . . .⁶²³

As described in *Indian Oil Co.*, the provision then continues language (now as a proviso) forward from the 1989 Form JOA that an assignment does not relieve a party of obligations “incurred” before the assignment, including those attributable to an approved operation.⁶²⁴ The 2015 Form then adds:

617. *See id.* at *11.

618. *Id.* at *4; *see also* *Nippon Oil Expl. U.S.A. Ltd. v. Murphy Expl. & Prod. Co.—USA*, No. 10-2850, 2011 WL 2456358 (E.D. La. 2011) (holding the assignor responsible for its share of decommissioning costs as accruing before the date of the assignment, but not for the increase in such costs arising from a hurricane after the date of the assignment where, under the terms of the JOA, the operator was required to charge the costs of fires, floods, storms, etc. to the joint account).

619. *Indian Oil Co., LLC v. Bishop Petroleum Inc.*, 406 S.W.3d 644, 648 (Tex. App.—Houston [14th Dist.], 2013 pet. denied).

620. *Id.* at 657.

621. *See id.* at 658–60.

622. *Id.* at 659.

623. FORM 610-2015, *supra* note 2, at art. VIII.D (emphasis added).

624. *See id.*

The transferee shall be jointly and severally liable with [the] transferor for payment of its share of all costs and expenses attributable to an approved operation conducted hereunder in which its transferor had agreed to participate.⁶²⁵

The release language now included in the Form JOA should be respected by the courts to relieve an assignor of liability for subsequent operations for which an assignor has not been provided notice or the opportunity to participate,⁶²⁶ but lawsuits may continue to arise under the assignment provision because it does not expressly address when P&A liabilities accrue or are incurred.⁶²⁷ The 2015 Form JOA does state that “approved” operations in which the assignor has agreed to participate before the assignment is incurred, but does not indicate what other obligations, such as P&A liabilities, might be incurred before the date of an assignment.⁶²⁸

Further, in his 1988 article, Professor Conine wisely points out that the JOA should contain a provision that expressly requires an assignee to assume the obligations of its assignor to eliminate the need for an analysis in most cases as to whether covenants run with the land where an operator or other party seeks to hold an assignee liable.⁶²⁹ Curiously, such a provision was not added to the 2015 Form JOA.⁶³⁰

In light of this omission, consider the case in which an assignee of an interest does not expressly assume the assignor’s obligations and has no notice of the JOA, despite the requirement in the JOA that the assignment be made subject to the JOA.⁶³¹ Making the assignment “subject” to the JOA may provide notice of these covenants but does not impose any personal obligation on the assignee.⁶³² The JOA specifically states that it is “binding upon and shall inure to the benefit of the parties . . . and their . . . successors and assigns, . . .” which may be sufficient to hold an assignee responsible for its obligations when the assignee has notice of the JOA or accepts the benefits

625. *See id.*

626. *See generally* Seagull Energy E & P, Inc. v. Eland Energy, Inc., 207 S.W.2d 342, 344 (Tex. 2006). *See also* KUNTZ, *supra* note 465, at § 51.2 (discussing a common clause in oil and gas leases that purports to release the lessee after an assignment). Kuntz states, in the context of an assignment of a lease, there is no reason to question the validity of such a clause, although there is a theoretical question whether the clause could be invoked to protect an assignor that makes an assignment to a financially irresponsible party to escape liability. *Id.*

627. *See* FORM 610-2015, *supra* note 2, at art. VIII.

628. *See id.*

629. *See* Conine, *supra* note 4, at 1385.

630. *See generally* FORM 610-2015, *supra* note 2.

631. *See id.* at art. VIII.

632. *See generally* Chatham Pharm., Inc. v. Angier Chem. Co., 196 N.E. 2d 852, 854 (Mass. 1964) (stating that unless assignee expressly assumes assignor’s personal duties, he is not bound to perform them); Rio Gas Co. v. Midcon Gas Servs. Corp., No. 01-96-00967-CV, 1999 WL 333152 (Tex. App.—Houston [1st Dist.] 1999, pet. denied); Rosse v. N. Pump Co., 353 S.W.2d 287 (Tex. Civ. App.—Austin 1962, writ ref’d n.r.e.) (noting that the phrase “subject to” is a term of qualification and not of contract).

of the transaction.⁶³³ But absent notice to the assignee, an argument might be made that neither the assignor nor the assignee is liable under the 2015 Form JOA for operations after the date of the assignment.⁶³⁴ To remedy this possibility, the language in Article VIII.D of the JOA might be revised as follows:

Every sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement and shall be made without prejudice to the right of the other parties, and any transferee of an ownership interest in any Oil and Gas Lease or Interest shall be deemed a party to this agreement as to the interest conveyed from and after the effective date of the transfer of ownership; provided, however, that the other parties shall not be required to recognize any such sale, encumbrances, transfer or other disposition for any purpose hereunder until thirty (30) days after Operator has received a copy of the instrument of transfer or other satisfactory evidence thereunder in writing from the transferor or transferee. In the case of a transfer of an ownership interest in any Oil and Gas Lease or Interest, the transferee is deemed to assume, and the transferor shall ensure that the instrument of transfer or an instrument executed concurrently therewith provides for the express assumption by the transferee of, [all] [the] duties and liabilities of the transferor under this agreement with respect to the transferred interest [arising from and after the date and time of the assignment]. Except as otherwise provided herein, if the transferee of an interest in an Oil and Gas Lease or Interest has expressly agreed to such an assumption of the transferor's duties and liabilities attributable to the transferred interest, then the transferor ~~any transfer by a party shall be relieved of the transferor from liability under this agreement~~ for the cost and expense of operations attributable to the transferred interest which are conducted after the expiration of the thirty-day period above provided; . . .

2. Covenants that Run with the Land

If the assignee has not expressly assumed the obligations of its assignor, then issues of notice and classification of provisions under the JOA as covenants running with the land become very important.⁶³⁵ In contrast to a

633. Reeder v. Wood Cty. Energy, L.L.C., 320 S.W.3d 433, 443, 11–13 (Tex. App.—Tyler 2010), *rev'd sub nom*, Reeder v. Wood Cty. Energy, LLC, 395 S.W.3d 789 (Tex. 2012), *opinion supplemented on reh'g* (Mar. 29, 2013); *see also* Imperial Ref. Co. v. Kanotex Ref. Co., 29 F.2d 193, 199 (8th Cir. 1928) (holding that where assignor assigns all right and delegates all duties in assignment, assignee can impliedly undertake the performance of the duties by voluntarily accepting the benefits of the transaction); Fasken Land & Minerals, Ltd. v. Occidental Permian Ltd., 225 S.W.3d 577, 594 (Tex. App.—El Paso 2005, *pet. denied*) (stating that quasi-estoppel precludes a party from accepting benefits and then taking an inconsistent position to avoid obligations); Stable Energy, L.P. v. Newberry, 999 S.W.2d 538, 547 (Tex. App.—Austin 1999, *pet. denied*) (noting that ratification occurs when a party to a contract acts, performs, or acknowledges the contract).

634. *See generally* FORM 610-2015, *supra* note 2.

635. *See* Conine, *supra* note 4, at 1385–86.

pure contractual analysis, if a promise or “burden” under a JOA is characterized not simply as a contractual or “personal” obligation, but a covenant running with the land, the burden will obligate not only the immediate parties but future assigns as well, and the assignor of the land may be automatically relieved from its future performance of the promise upon assignment.⁶³⁶ In today’s climate of low oil and gas prices, classification may also have bankruptcy implications. While an executory contract such as a JOA may be rejected in bankruptcy,⁶³⁷ covenants that run with the land are property interests that cannot be rejected.⁶³⁸

In the recent unreported case of *TransTexas Gas Corp. v. Forcenergy Onshore, Inc.*, during the pendency of the initial lawsuit, the plaintiff received a drilling proposal from the defendant and shortly thereafter declared bankruptcy.⁶³⁹ The defendant claimed that by not consenting to the drilling proposal, the plaintiff should be subject to the nonconsent penalty provisions.⁶⁴⁰ The plaintiff responded that because it never assumed the obligations or signed the operating agreement when it acquired its interest, it was not bound by the JOA.⁶⁴¹ The court agreed with the defendant, finding that the entire JOA runs with the land because of the provision therein that it was binding on successors and assigns.⁶⁴² The court also held that the interests of the defendant that were relinquished by the plaintiff under the nonconsent provisions were excluded from the bankruptcy estate because the Bankruptcy Code expressly excludes a “farmout agreement” and the JOA met the definition of a farmout agreement.⁶⁴³

Generally, a covenant runs with the land *at law* (a real covenant) when (1) it touches and concerns the land,⁶⁴⁴ (2) the original covenanting parties

636. *See id.*

637. *See* 11 U.S.C. § 365(a) (West 2018) (stating that a debtor in possession, “subject to the court’s approval, may assume or reject any executory contract . . . of the debtor”).

638. *See* Goeveia v. Tazbir, 37 F.3d 295, 298 (7th Cir. 1994); Banning Lewis Ranch Co. LLC v. City of Colo. Springs (*In re* Banning Lewis Ranch Co., LLC), 532 B.R. 335, 346 (Bankr. D. Colo. 2015).

639. *TransTexas Gas Corp. v. Forcenergy Onshore, Inc.*, No. 13-10-00446-CV, 2012 WL 1255218, at *1 (Tex. App.—Corpus Christi Apr. 12, 2012, pet. denied) (mem. op. not designated for publication).

640. *Id.* at *2.

641. *Id.*

642. *Id.* at *6. The court reached its conclusion with little analysis and no mention of privity of estate. *See id.*

643. *See id.* at *7 (citing Rhett G. Campbell & David M. Bennett, *Bankruptcy in the New Millennium: Energy, Insolvency, and Enron*, 48 ROCKY MTN. MIN. L. INST. 18, 19 (2002)). Specifically, the Bankruptcy Code states that the property of the debtor’s estate does not include “any interest of the debtor in liquid or gaseous hydrocarbons to the extent that . . . the debtor has transferred . . . such interest pursuant to a farmout agreement . . .” 11 U.S.C. § 541(b)(4)(A)(1). The Code defines a farmout agreement as “a written agreement in which the owner of a . . . [working interest] . . . has agreed to transfer or assign all or a part of such right to another entity” that agrees as consideration to perform operations to develop or produce on the property. *Id.* § 101(21A).

644. *See* RICHARD R. POWELL, *POWELL ON REAL PROPERTY* § 60.04(3)(a) (Michael Allan Wolf ed., 2000). It has been said that this requirement is satisfied for a burden to run if the covenant renders the covenantor’s legal interest in land less valuable, and for a benefit to run, if the covenantee’s legal interest in land is rendered more valuable. *See id.* A covenant to pay money touches and concerns the land if the

intended that the covenant run with the land,⁶⁴⁵ and (3) there is privity of estate. In contrast, a covenant that runs in equity (an equitable servitude) requires notice to the successor rather than privity, such that a purchaser for value without actual, constructive, or inquiry notice of the covenant would not be subject to the burden.⁶⁴⁶ If there is no intent that the benefit or burden of a covenant run to successors, then the covenant is considered personal to the original parties and will not run with the land.⁶⁴⁷

Historically, courts of law awarded damages, but courts of equity granted only injunctions barring certain actions.⁶⁴⁸ As such, courts of equity enforced only negative covenants—that is, a prohibition on doing something on the land.⁶⁴⁹ A preferential right to purchase is a negative covenant in that it prohibits a party to the JOA from transferring an interest without first offering the interest to the other parties.⁶⁵⁰ Clearly, the requirement for a party to pay its proportionate share of a subsequent operation is an affirmative obligation, but so are requirements to transfer property in the future.⁶⁵¹ For example, the extension and renewal clause and the AMI clause are likely affirmative covenants in the former case because the covenant requires a party to contribute an extended or renewed lease and in the latter case because it requires a party to offer a proportionate interest in a newly acquired lease or interest to the other parties to the JOA.⁶⁵² Under historical conceptions, the benefitted party would need to show *privity of estate* to enforce these obligations as covenants at law.⁶⁵³

money is used for improvements that touch and concern the land. Thomas, *supra* note 612, at § 19.04[5][b][iv].

645. The JOA expressly provides that “the terms hereof shall be deemed to run with the Leases or Interests included within the [c]ontract [a]rea.” Form 610-2015, *supra* note 2, at art. XV.B.

646. See RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 1.4 cmt. a (AM. LAW INST. 2000).

647. See Form 610-2015, *supra* note 2, at art. X.V.B. § 60.01[5]. In Texas, the elements are that the covenant (1) touches and concerns the land, (2) relates to a thing in existence or specifically binds the parties and their assigns, (3) is intended by the original parties to run with the land, and (4) the successor to the burden has notice. *Inwood N. Homeowners’ Ass’n, Inc. v. Harris*, 736 S.W.2d 632, 635 (Tex. 1987). Horizontal privity may also be required in Texas.

648. See generally RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 8.3 cmt. a (AM. LAW INST. 2000).

649. See *id.*

650. See *Navasota Res., L.P. v. First Source Tex., Inc.*, 249 S.W.3d 526, 532 (Tex. App.—Waco 2008, pet. denied).

651. See generally *Collins v. City of Harker Heights Tex.*, 503 U.S. 115, 126–27 (1992) (recognizing that affirmative obligations involve a duty to act); *Holbein v. Austral Oil Co., Inc.*, 609 F.2d 206, 209–10 (5th Cir. 1980) (affirming the obligation to pay a proportionate share of production costs in a mineral lease).

652. See *Dimock v. Kadane*, 100 S.W.3d 602, 607–08 (Tex. App.—Eastland 2003, pet. denied) (holding that an extension and renewal clause obligates parties that want to participate to proportionately contribute); see also *Ballard v. Devon Energy Prod. Co.*, 678 F.3d 360, 369 (5th Cir. 2012) (explaining the obligations of an AMI in a JOA).

653. See generally *Excel Willowbrook, L.L.C. v. JP Morgan Chase Bank, N.A.*, 758 F.3d 592, 599–600 (5th Cir. 2014) (recognizing historical obligations arising from privity of estate).

Privity of estate comes in two basic forms: vertical privity and horizontal privity.⁶⁵⁴ Traditionally, vertical privity required that a successor seeking to enforce a covenant must succeed to the same quantum of estate (for example, fee simple to fee simple) held by the original covenantee, but this requirement has been relaxed in most jurisdictions such that to show vertical privity, the successor need only succeed to a portion of the original estate of the covenantee.⁶⁵⁵ This requirement would normally be satisfied in the context of a JOA in which the assignee succeeds to the leasehold or other interest of the assignor.⁶⁵⁶

Horizontal privity, however, is more difficult. Horizontal privity generally means that the original parties had a simultaneous existing interest (referred to as mutual privity) as landlord and tenant or an interest as grantor and grantee when the covenant was created.⁶⁵⁷ For example, a property owner might reserve a covenant for itself or for a third party out of a conveyance.⁶⁵⁸ In the case of a JOA, when the contract is executed the parties may not be tenants in common and the JOA may not be executed in connection with a conveyance.⁶⁵⁹ Rather, the parties may simply be working interest owners that are combining their interests for the orderly development of an area or to comply with state spacing and pooling requirements.⁶⁶⁰

Scholars overwhelmingly advocate for the abolition of horizontal privity.⁶⁶¹ Issued in 2000, the Restatement (Third) of Property: Servitudes

654. See *id.* at 600 n.20. Mutual privity means that at the time the covenant was created, the covenantor and the covenantee owned a simultaneous existing interest in the same land, which might be satisfied by a landlord-tenant relationship or when the parties are the dominant and servient owners of an easement. 20 AM. JUR. 2D COVENANTS § 27 (2017). Mutual privity, also referred to as “Massachusetts privity,” may be required in a very small number of jurisdictions. See, e.g., *Morse v. Aldrich*, 36 Mass. 449, 453–54 (1837); see also 14C MASS. PRAC., SUMMARY OF BASIC LAW § 14:110 (4th ed. 2010–2017). The First Restatement of Property requires vertical privity and either horizontal privity or mutual privity. RESTATEMENT (FIRST) OF PROPERTY §§ 534, 535 (AM. LAW INST. 1944). As such, many court decisions lump together the concept of mutual privity and horizontal privity under a single heading referred to as “horizontal privity.” RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 2:4 cmt. a (AM. LAW INST. 2000); see also *Excel Willowbrook, L.L.C.*, 758 F.3d at 600 n.20 (recognizing both vertical and horizontal privity).

655. See RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 5.2 cmt. b (AM. LAW INST. 2000).

656. See *id.* § 5.2.

657. See Thomas, *supra* note 612, § 19.04(5)(b)(i).

658. See, e.g., *Newco Energy v. Energytec, Inc.* (*In re Energytec, Inc.*), 739 F.3d 215, 221–22 (5th Cir. 2013) (providing that the owner of a pipeline system assigned its property rights to another, while reserving a covenant for a third party to receive a fee for product transported through the pipeline).

659. See, e.g., *Tawes v. Barnes*, 340 S.W.3d 419 (Tex. 2011) (discussing a JOA without tenancy in common or a conveyance).

660. See *id.* In this circumstance, the parties may have to rely on the cross-conveyance theory expressed in *Gillring Oil Co. v. Hughes*, which has little judicial support. See *Gillring Oil Co. v. Hughes*, 618 S.W.2d 874 (Tex. Civ. App.—Beaumont 1981, no writ).

661. See, e.g., Lawrence Berger, *A Policy Analysis of Promises Respecting the Use of Land*, 55 MINN. L. REV. 167 (1970); Olin L. Browder, *Running Covenants and Public Policy*, 77 MICH. L. REV. 12 (1978); Ralph A. Newman & Frank R. Losey, *Covenants Running with the Land, and Equitable Servitudes: Two Concepts, or One?*, 21 HASTINGS L.J. 1319 (1970); William B. Stoebuck, *Running Covenants: An Analytical Primer*, 52 WASH. L. REV. 861 (1977).

rejects the horizontal privity requirement, reasoning that the requirement “serves no necessary purpose and simply acts as a trap for the poorly represented”⁶⁶² Despite the American Law Institute’s best efforts, the requirement seems to persist.⁶⁶³ One commentator reported in 2013 that not a single reported case had rejected the horizontal privity requirement after the Restatement (Third)’s adoption in 2000.⁶⁶⁴ In one recent case, a federal bankruptcy court applying Texas law issued a nonbinding finding that gathering agreements which dedicated gas were not covenants running with the land, in part because they did not convey a property interest sufficient to satisfy the horizontal privity requirement.⁶⁶⁵ The parties in the case disagreed as to whether horizontal privity had been abandoned in Texas because some courts had analyzed whether covenants ran with the land without addressing horizontal privity.⁶⁶⁶ The court concluded that numerous Texas courts still expressly included horizontal privity in their analyses.⁶⁶⁷

The courts that cling to horizontal privity arguably do so in part because they resort to concepts of equitable servitudes when such privity is lacking.⁶⁶⁸ Further, because of the modern combination of courts of law and equity and due to extreme confusion of judges and practitioners as to the difference between covenants at law and covenants at equity, courts have over time muddied the waters and awarded whatever relief they feel is appropriate to remedy the breach of a covenant or servitude.⁶⁶⁹ Given the confusion, in the Restatement (Third) of Property: Servitudes, the American Law Institute dropped the distinction between real covenants and equitable servitudes entirely.⁶⁷⁰

Under the Restatement (Third), both real covenants and equitable servitudes are encompassed within the term “covenant that runs with land.”⁶⁷¹ A covenant runs with the land if the covenant is a “servitude,” and either the benefit or burden runs with the land.⁶⁷² The term “servitude” is broadly used to cover easements, profits, and covenants.⁶⁷³ The only requirement for the creation of a servitude is that for the owner of the property to be burdened he

662. RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 2.4 cmt. b (AM. LAW INST. 2000).

663. See Michael Lewyn, *The Puzzling Persistence of Horizontal Privity*, PROB. & PROP., May 2013, at 32.

664. See *id.*

665. Sabine Oil & Gas Corp. v. HPIP Gonzales Holdings, LLC (*In re Sabine Oil & Gas Corp.*), 550 B.R. 59, 68–69 (Bankr. S.D.N.Y. 2016).

666. *Id.* at 65.

667. *Id.*

668. See Lewyn, *supra* note 663, at 35.

669. See POWELL, *supra* note 644, at § 60.07.

670. See RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 1.4 (AM. LAW INST. 2000).

671. See *id.*

672. See *id.* § 1.3.

673. See *id.* § 1.1(2). The Restatement (Third) states that to the extent special rules and considerations applicable to profits for the removal of timber, oil, gas, and minerals apply, the special rules are not within the scope of the Restatement. *Id.*

must enter into a contract or make a conveyance intended to create a servitude that complies with the Statute of Frauds or an exception to the Statute of Frauds.⁶⁷⁴ In essence, the Restatement (Third) dispenses with both the privity requirement (for covenants formerly classified as running at law) and the notice requirement (for covenants formerly classified as running in equity), although notice is still required for practical purposes because an unrecorded servitude is subject to extinguishment under a local recording act unless the servitude would be discovered by reasonable inspection or inquiry.⁶⁷⁵

Even if a burden under a JOA is determined to touch and concern the land, it does not necessarily follow that the assignor is relieved of its obligations under the JOA by virtue of the assignment of its property interests.⁶⁷⁶ The Restatement (First) of Property and the Restatement (Third) of Property: Servitudes differ in their approaches to resolving this question.⁶⁷⁷

Under the Restatement (First) of Property, whether such a promisor is relieved of its liability depends upon “the intention manifested in the making of the promise,”⁶⁷⁸ which may be inferred from the circumstances such as the nature of the act promised.⁶⁷⁹ In particular, the Restatement asks whether such promises are “of such a character that they can be satisfactorily performed *only* by the possessor of the land affected.”⁶⁸⁰ Applying this approach to the JOA, although a promise to convey or relinquish land only can be performed by the possessor of the land, one might argue that other promises, such as an obligation to pay a proportionate share of the costs of operation after an assignment, might be of a character that the possessor of the land need not perform the obligation.⁶⁸¹

The test as to the continuing liability of the promisor under the Restatement (Third) is more crystallized, and does not depend on whether such obligations are simply *capable* of being performed by the former

674. *Id.* § 2.1(1).

675. *See id.* § 7.14.

676. *See id.* § 3.2. Technically, the Restatement (Third) also dispensed with the touch and concern requirement and replaced it with a rule that asks whether the servitude imposes an unreasonable restraint on alienation or an undue restraint on trade, and whether it is unconscionable, illegal or unconstitutional, or otherwise violates public policy. *See id.* § 3.2 cmt a; *see also* Chieftan Intern. (U.S.), Inc. v. Southeast Offshore, Inc., 553 F.3d 817, 819 (5th Cir. 2008) (holding that assignment does not necessarily relieve a party to a JOA from its obligations).

677. *See* RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 4.4(1) (AM. LAW INST. 2000); RESTATEMENT (FIRST) OF PROPERTY § 538 (AM. LAW INST. 1944).

678. RESTATEMENT (FIRST) OF PROPERTY § 538 (AM. LAW INST. 1944).

679. *See id.* § 538 cmt. c.

680. *Id.* § 538 cmt. a (emphasis added).

681. *See generally* Seagull Energy E & P, Inc. v. Eland Energy, Inc., 207 S.W.3d 342, 347 (Tex. 2006). In *Seagull*, the court cited in dicta to the examples in Restatement (First) of Property § 538, Comment c, illustrations 1 and 2 as evidence that the burden to pay the P&A costs was not intended to run with the land. *See id.*; RESTATEMENT (FIRST) OF PROPERTY § 538 cmt. c, illus. 1 (AM. LAW INST. 1936). Illustration one suggests that a promise to pay for water delivered to the land would not run with the land, while a promise to maintain a dam would run with the land. *See* RESTATEMENT (FIRST) OF PROPERTY § 538 cmt. c, illus. 1 (AM. LAW INST. 1936). The court argued that Eland *could* have fulfilled its obligations after the transfer of its interest. *Seagull Energy E & P, Inc.*, 207 S.W.3d at 347.

owner.⁶⁸² Under the Restatement (Third) test, “[A]n original party or successor to a servitude burden that runs with an interest in property incurs liability on account of the servitude burden only for obligations that accrue during the time the party or successor holds the burdened property interest.”⁶⁸³ This rule applies to a burden appurtenant, which is a burden tied to the ownership or occupancy of particular property, as distinguished from a burden in gross, which is not tied to ownership or occupancy.⁶⁸⁴ The rules governing liability to perform contracts applies to burdens in gross.⁶⁸⁵ Under this test, one might argue that all obligations under the JOA, including the obligation to pay costs and expenses accruing after the date of an assignment of property, are tied to the ownership of the underlying leases and interests within the contract area.⁶⁸⁶

3. Notice

Assuming the JOA’s provisions constitute covenants running with the land, a transferee is not bound by those provisions unless it has notice of those provisions.⁶⁸⁷ One way to assure notice is to ensure that any assignment of an interest in the contract area contains an express provision referencing the existence of the JOA, a result obtained when an assignment provides that it is made “subject to” the JOA as required by the provisions of most JOA forms.⁶⁸⁸ Another way to accomplish this is to establish constructive notice by recording the JOA in the appropriate records.⁶⁸⁹ Before the publication of the Recording Supplement, the customary practice was to avoid recording the operating agreement in either the real property or UCC records.⁶⁹⁰ If neither of these steps are taken, the only remaining way to bind the assignee to the terms of the JOA is through inquiry notice.

682. See RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 4.4(1) (AM. LAW INST. 2000).

683. *Id.*

684. See *id.* § 1.5(1), (2).

685. See *id.* § 4.4(3).

686. See generally *id.*

687. See *Inwood N. Homeowners’ Ass’n, Inc. v. Harris*, 736 S.W.2d 632, 635 (Tex. 1987) (citing *Westland Oil Dev. Corp. v. Gulf Oil Corp.*, 637 S.W.2d 903, 910–11 (Tex. 1982)) (“In Texas, a covenant runs with the land when it touches and concerns the land; relates to a thing in existence or specifically binds the parties and their assigns; is intended by the original parties to run with the land; and when the successor to the burden has notice.”). *But see supra* text accompanying notes 644–47 (noting an exception to the notice requirement for covenants running with land at law when horizontal privity is present, which is not common for the parties to a typical JOA).

688. See *Boldrick v. BTA Oil Producers*, 222 S.W.3d 672, 674–75 (Tex. App.—Eastland 2007, no pet.) (holding the provisions of a JOA bound the assignee of an overriding royalty interest that explicitly stated it was subject to the agreement, as required by the language of the agreement, even though the assignee had not read the agreement.). See generally FORM 610-2015, *supra* note 2.

689. See generally discussion *supra* Section II.D.2 (explaining the origin and purpose of the Recording Supplement).

690. See discussion *supra* Section II.D.2 (detailing procedures replaced by Recording Supplement).

In *Westland Oil Development Corp. v. Gulf Oil Corp.*, the defendant acquired interests in a producing field through two farmout agreements.⁶⁹¹ An assignment delivered pursuant to one of these farmout agreements recited that the conveyance was subject to an operating agreement.⁶⁹² Review of the JOA would have revealed references to a related letter agreement containing an AMI clause benefiting the plaintiff.⁶⁹³ The plaintiff asserted its rights under the AMI clause with respect to interests acquired by the defendant under the second farmout agreement.⁶⁹⁴ Neither the operating agreement nor the letter agreement containing the AMI were recorded.⁶⁹⁵

The court held that the AMI was a covenant running with the land and that knowledge of its existence was imputed to the defendant through inquiry notice.⁶⁹⁶ The court held that under Texas law any purchaser of real property is required to reasonably and diligently investigate any reference in their chain of title until thorough knowledge of all matters affecting their chain of title is obtained.⁶⁹⁷ This includes both the instruments that are specifically referenced in recorded documents and instruments that would be revealed by a review of those referenced materials.⁶⁹⁸ In general, transferees are imputed with knowledge if existing facts would cause a reasonable person to search for a referenced document and the search, if pursued with diligence, would lead to actual notice of the document's contents.⁶⁹⁹

Inquiry notice, however, is an uncertain method of imputing knowledge of the JOA and subject to considerable evidentiary problems.⁷⁰⁰ Consider, for example, *Chesapeake Exploration, L.L.C. v. Valence Operating Co.*,⁷⁰¹ in which Chesapeake leased several properties in 2005 that Valence argued were conveyed to it in 1991.⁷⁰² The earlier 1991 conveyance to Valence referenced a 1975 JOA that was not mentioned in the lease to Chesapeake but covered the land leased to Chesapeake.⁷⁰³ After the court ruled that Valence was not actually conveyed any interest in the property that was later leased to Chesapeake, Chesapeake sought a declaratory judgment that its lease was not subject to the 1975 JOA.⁷⁰⁴ Valence argued that Chesapeake had inquiry notice of the JOA because the 1991 assignment to Valence

691. *Westland Oil*, 637 S.W.2d at 905.

692. *Id.* at 906.

693. *See id.* at 905.

694. *Id.*

695. *See id.* at 906.

696. *Id.* at 911.

697. *Id.* at 912–14.

698. *See id.*

699. *See id.*

700. *See generally id.*

701. *See Chesapeake Expl., L.L.C. v. Valence Operating Co.*, No. H-07-2565, 2008 WL 4240486 (S.D. Tex. Sept. 10, 2008).

702. *See id.* at *1.

703. *See id.* at *1–2.

704. *Id.* at *2–3.

referenced the JOA.⁷⁰⁵ The court disagreed because the 1975 JOA was not in Chesapeake's chain of title, and it had no duty to search the entire grantor index for all entries related to its grantor.⁷⁰⁶

There is no trustworthy method of ensuring notice to third parties and bankruptcy trustees short of recording the instrument pursuant to local recording statutes. As such, parties should use the Model Form Recording Supplement to provide notice to third parties.⁷⁰⁷ Without proper notice, there is a substantial risk that assignees of interests in the contract area will not be bound by the terms of the JOA, regardless of local rules governing other elements for covenants running with the land.

VI. CONCLUSION

The JOA, like the oil and gas lease, is a complex instrument containing a myriad of interdependent provisions. It is somewhat simplistic to segregate its property terms from the rest of the document for special consideration. Their purpose and impact are relevant only in the context of the overall enterprise. Isolation of the provisions does, however, permit us to focus on their significance without being distracted by the debate over fiduciary duties and clauses dealing with operating decisions, financial commitments, and accounting procedures.

The property provisions play a significant and sometimes crucial role in providing the mechanisms by which a long-term transaction like the JOA can remain viable throughout its term. They also impose duties of fairness and equity among participants for instances in which general fiduciary duties are disclaimed by the instrument itself. All of this is achieved while maintaining significant freedom in the transfer and disposition of property interests.

Consequently, the property provisions scattered throughout the JOA deserve considerable respect and focused consideration during the negotiations leading to execution of the instrument. Care must be used in deciding whether to retain, delete, or add some of these provisions, with particular attention given to the effect the presence or absence of the provisions will have on future relations among the JOA parties and the difficulties they may present for transactions outside the JOA that individual parties may want to pursue. Properly employed, however, these provisions can add stability to the JOA as a business transaction and secure long-term benefits from operations within the contract area.

705. *Id.* at *5.

706. *Id.* at *6-7.

707. *See* FORM 610-2015, *supra* note 2.