WORKING INTEREST DISPUTES[1]
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I. SCOPE OF ARTICLE

Despite further refinements to the form operating agreements available to the oil & gas industry, many different types of disputes continue to arise among oil & gas working interest owners. Working interests in a tract of land can be co-owned by multiple parties. Two or more parties can own undivided interests in oil & gas leases, or different parties may hold leases from owners of undivided mineral interests in the same tract. Any of these scenarios will result in joint operations. During these operations, disputes may arise between the working interest owners.

Numerous issues can lead to disputes among working interest owners. Some cases involve parties that do not even have an operating agreement. In that situation, the parties' relationship is governed by common law co-tenancy principles. However, most cases arise in situations where the parties entered into a joint operating agreement. The disputes can involve the interpretation, applicability, and application of the operating agreement. Frequent areas of disagreement include the operator's standard of conduct, the election and removal of the operator, and a non-operator's failure to pay its share of the expenses incurred during the joint operations.

Operating agreements have evolved over time. They were originally drafted from scratch by the parties for each project. Form operating agreements began to appear in the 1950's. There are forms for both onshore and offshore oil & gas exploration. These forms have been revised based on changes in the industry, experiences (both good and bad) using the forms, and court rulings interpreting the agreements. Even with these revisions, disputes can and do arise between working interest owners.

This article will address several areas of working interest disputes. Attention will be given to the consequences of conducting operations without an operating agreement, the standard of care imposed upon the operator, the election and removal of the operator, the operator's remedies for a non-operator's monetary defaults, and provisions that frequently result in disputes. While exploring these topics, this article will note recent changes to the form operating agreements. The use of alternative dispute resolution procedures and ways to avoid disputes will also be discussed. The goal of this article will be to acquaint both transaction and litigation attorneys with the different types of working interest disputes they and their clients may encounter.

II. OPERATIONS WITHOUT AN OPERATING AGREEMENT

In the absence of an operating agreement, co-owners of working interests are simply mineral co-tenants.[2] Mineral co-tenancy can occur when two or more parties own undivided interests in oil & gas leases. When undivided mineral owners grant leases to different parties, the lessees become mineral co-tenants. The common law of co-tenancy then governs the operations.

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[1] This article originally appeared in the Spring 2017 Section Report of the State Bar Oil & Gas Section.

[2] 2-5 Williams & Meyers, Oil and Gas Law § 504; 1 Smith & Weaver, Texas Law of Oil and Gas §2.3[A]; Christopher S. Kulander, *Old Faves and New Raves: How Case Law Has Affected Form Joint Operating Agreements—Problems and Solutions (Part One)*, 1 OIL & GAS, NAT. RESOURCES & ENERGY J. (2015).

The producing co-tenant must account to the other co-tenants when the parties do not have an operating agreement. The non-operating co-tenant is entitled to a proportionate share of the net profits from production.[3] As the non-operating owner has no personal liability for the cost of production, the operating co-tenant cannot seek reimbursement of those costs.[4] Instead, the operator deducts the costs from the proceeds of production.[5] Therefore, the non-operating co-tenant has a "carried" interest in the production operations.[6]

The operating co-tenant must pay the non-operating owner its proportionate share of the production proceeds less its proportionate share of the drilling and operating expenses.[7] The expenses must be necessary and reasonable.[8]

In a co-tenancy situation that is not governed by an operating agreement, numerous disputes can arise. These problems include:

> What expenses, such as overhead, are deductible?[9]
>
> Are the expenses necessary and reasonable?[10]
>
> Should accounting be conducted on a well-by-well basis or on the basis of all operations conducted on the co-owned tract?[11]

These disputes and the uncertainty resulting from a pure co-tenancy situation, along with the inability to seek contribution from the non-operating co-tenants when an operation is unsuccessful, should discourage co-tenants from conducting operations without an operating agreement.

III. FORM OPERATING AGREEMENTS

Rather than deal with the problems associated with accounting to co-tenants governed only by the law of co-tenancy, most co-owned operations should be, and are in fact, conducted subject to an operating agreement.[12] One court described an operating agreement as:

> A contract typical to the oil and gas industry whose function is to designate an "operator, describe the scope of the operator's authority, provide for the allocation

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[3] 1 Smith & Weaver §2.3[A][3].
[4] *Id.*
[5] *Id*.
[6] *Id.*
[7] *Byrom v. Pendley*, 717 S.W.2d 602, 605 (Tex. 1986).
[8] *Id.*
[9] *BoMar Oil & Gas v. Loyd*, 2009 Tex. App. LEXIS 5505 (Tex. App.—Waco 2009, pet. denied), modified on rehearing, 298 S.W.3d 832; 1 Smith & Weaver §2.3[A][3].
[10] *BoMar Oil & Gas* at * 22-31.
[11] 1 Smith & Weaver §2.3[A][3].
[12] 2-19A Kuntz, Law of Oil and Gas § 19A.6.

> of costs and production among the parties to the agreement, and provide for recourse among the parties if one or more default in their obligations."[13]

Operating agreements have been around for decades.[14] Prior to the 1950's, operating agreements were relatively simple and based on each company's own form of agreement.[15] Eventually, organizations began publishing form operating agreements.

Numerous form operating agreements can be used by working interest owners engaged in joint operations. The American Petroleum Institute, the Rocky Mountain Mineral Law Foundation, and the American Association of Professional Landmen ("AAPL") have all promulgated operating agreement forms. The AAPL issued its first onshore form in 1956. The most recent onshore for was released in 2016, but it is called the 2015 form. Parties engaged in offshore operations or owning interests in a secondary recovery unit have several forms available for their use.

This article will discuss the most commonly used onshore and offshore forms, including the 2015 revisions to these agreements. Onshore, the most common AAPL forms are:

A.A.P.L. Form 610-1982 Model Form Operating Agreement (the "1982 Form 610")

A.A.P.L. Form 610-1989 Model Form Operating Agreement (the "1989 Form 610")

A.A.P.L. Form 610-2015 Model Form Operating Agreement (the "2015 Form 610")

For offshore operations, there are two AAPL forms. One form is for operations on the Outer Continental Shelf; the other is for Deepwater Operations and was recently revised. These offshore AAPL forms are:

A.A.P.L. Form 710-2002 Model Form of Offshore Operating Agreement Outer Continental Shelf (the "2002 Form 710")

A.A.P.L. Form 810-2007 Model Form of Offshore Deepwater Operating Agreement (the "2007 Form 810")

A.A.P.L. Form 810-2015 Model Form of Offshore Deepwater Operating Agreement (the "2015 Form 810")

This paper will discuss and compare these six forms and several types of disputes that may arise between working interest owners during joint operations.

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[13] *Tawes v. Barnes*, 340 S.W.3d 419, 426 (Tex. 2011) (quoting *Seagull Energy E & P, Inc. v. Eland Energy, Inc.*, 207 S.W.3d 342, 344 n. 1 (Tex. 2006).
[14] 2-19A Kuntz § 19A.6.
[15] *Id.*

IV. OPERATOR'S LIABILITY TO NON-OPERATORS

A. Operator's Standard of Conduct

An area of frequent dispute between working interest owners and operators is the standard applied to the operator's conduct of operations, including the effect of the exculpatory clause. In these types of lawsuits, the operator will assert that language in the operating agreement does not allow the working interest owners to recover damages. This argument is usually based on the exculpatory clause in the operating agreement. Whether the exculpatory language precludes a lawsuit against the operator depends on the exculpatory clause used and the nature of the claims asserted by the working interest owners.

Generally, operating agreements require either gross negligence or willful misconduct for the operator to be liable for damages to the non-operators. Based on the language of the form utilized by the parties, this liability standard applies either only to operations in the field or to all of the operator's activities under the agreement. The different language and the facts of each dispute dictate whether the exculpatory clause applies.

The onshore form revisions have used different standards in the last three versions. The 1982 Form 610 simply provided:

> It shall conduct all such <u>operations</u> in a good and workmanlike manner, but it shall have no liability as Operator to the other parties for losses sustained or liabilities incurred, except such as may result from gross negligence or willful misconduct.[16]

The 1989 Form 610 used different language, which courts have interpreted as being a substantive change:

> Operator shall conduct its <u>activities</u> under this agreement as a reasonably prudent operator, in a good and workmanlike manner, with due diligence and dispatch, in accordance with good oilfield practice, and in compliance with applicable law and regulation, but in no event shall it have any liability as Operator to the other parties for losses sustained or liabilities incurred except such as may result from gross negligence or willful misconduct.[17]

Courts interpreting the different exculpatory clauses have reached different conclusions, depending upon the particular form used by the parties.

Prior to *Reeder v. Wood County Energy, LLC*, two leading cases on this issue were *Abraxas Petroleum Corp. v. Hornburg* and *Cone v. Fagdau Energy Corp.*, both of which dealt with the 1982 Form 610.[18] In *Abraxas*, Hornburg and other working interest owners sued Abraxas. The

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[16] 1982 Form 610, Section V.A. (emphasis added).

[17] 1989 Form 610, Section V.A. (emphasis added).

[18] *Abraxas Petroleum Corp. v. Hornburg*, 20 S.W.3d 741 (Tex. App.—El Paso 2000, no pet.); *Cone v. Fagadau Energy Corp.*, 68 S.W.3d 147 (Tex. App.—Eastland 2001, pet. denied).

working interest owners alleged a variety of claims, including breach of contract based on improper AFE.[19] The trial court entered a judgment for the non-operators after a jury trial. The judgment included damages for breach of contract. On appeal, Abraxas argued that it could not be liable for breach of contract damages in the absence of a finding of gross negligence or willful misconduct on its part. The court of appeals rejected this argument and held:

> The exculpatory clause is limited to claims based upon an allegation that Abraxas failed to act as a reasonably prudent operator and does not apply to a claim that it breached the JOA. Since the exculpatory clause does not apply . . ., Appellees were not obligated to prove gross negligence or willful misconduct.[20]

Based on this holding, the court affirmed the breach of contract damages.[21] Similarly, Cone asserted a breach of contract claim and alleged that Fagadau had improperly charged items to the joint account.[22] The trial court ruled that the exculpatory clause applied and Cone could only recover if he proved gross negligence or willful misconduct.[23] The court of appeals, citing *Abraxas*, held that the exculpatory clause did not apply to Cone's breach of contract claims.[24] Both *Cone* and *Abraxas* involved allegations concerning the operator's breach of contract. The claims were in the nature of accounting, improper charges to the joint account, and improperly sending AFEs. The plaintiffs did not contend that the operator had failed to properly perform its operations in the field. On this basis, the courts found the exculpatory clause did not apply.

The court in *IP Petroleum Co. v. Wevanco Energy, L.L.C.*[25], reached the opposite result in a case involving the 1982 Form 610.[26] The working interest owners sued the operator, IP, alleging that IP had breached the operating agreement.[27] Specifically, the working interest owners claimed that IP had not acted as a reasonably prudent operator when it did not further deepen an existing well.[28] Following a jury trial, the trial court rendered judgment for the working interest owners. On appeal by IP, the court of appeals held that the exculpatory clause applied to the non-operators' claims.[29] The non-operators had alleged that IP had failed to act as a reasonably prudent operator and conduct operations in a good and workmanlike manner. These allegations concerned the manner in which IP conducted drilling operations as opposed to a claim that IP had failed to comply with some the terms of the operating agreement.[30] The court distinguished *Abraxas* and *Cone* on this point.[31] The court ruled that the working interest owners were required to prove gross negligence or willful misconduct by IP.[32] After finding that there was

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19 *Abraxas*, 20 S.W. 3d at 749.
20 *Abraxas*, 20 S.W.3d at 759.
21 *Id* at 760-761.
22 *Cone,* 68 S.W.3d at 151-152.
23 *Id* at 155
24 *Id.*
25 116 S.W.3d 888 (Tex. App.—Houston [1st Dist.] 2003, pet. denied).
26 *Id* at 892.
27 *Id* at 894.
28 *Id.*
29 *Id.*
30 *Id.*
31 *Id* at 895-896.
32 *Id.*

insufficient evidence of gross negligence or willful misconduct, the court of appeals reversed and rendered that the plaintiffs take nothing.[33]

The clear line between disputes based on accounting, administrative, and purely contractual issues and claims arising from the conduct of operations in the field was erased as to the 1989 Form 610 in *Reeder v. Wood County Energy, LLC*.[34] The Texas Supreme Court interpreted the changes between the 1982 Form 610 and the 1989 Form 610 as being substantive and departed from the precedent set in *Abraxas* and *Cone*.[35] Reeder, the operator, filed suit against Fry seeking various forms of relief, which included a declaration that Reeder was the operator and had the exclusive right of possession of the wellbores for the production of oil.[36] Fry and others filed counterclaims for conversion, violations of the Theft Liability Act, and breach of the joint operating agreement.[37] The jury found that Reeder breached his duty as operator under the JOA.[38] The trial court instructed the jury that in order to find a breach of the JOA, the operator's conduct must meet the standard of gross negligence or willful misconduct.[39] The court of appeals disagreed and held that the standard of care in the exculpatory clause does not apply to a breach of contract.[40] The court of appeals further held that the evidence was legally and factually sufficient to support the jury's findings that Reeder breached his duty as operator pursuant to a breach of contract claim.[41] Reeder filed a petition for review with the Texas Supreme Court challenging the judgment of the court of appeals.[42]

The Texas Supreme Court found that the exculpatory clause <u>did apply</u> to the conduct and that Reeder's conduct <u>did not</u> amount to gross negligence or willful misconduct.[43] The issue was whether the exculpatory clause in the JOA governed the breach of contract claims against Reeder.[44] The Texas Supreme Court noted that prior decisions on the issue dealt with exculpatory clauses modeled after the 1982 Form 610 and the AAPL's 1977 Model Form JOA.[45] Those forms provided that that the operator "shall conduct all such operations in a good and work-manlike manner."[46] The exculpatory clause in the 1989 Form 610 uses the phrase "its activities under this agreement," which is much broader.[47] Previously, only breaches of duty in operations had been protected by the exculpatory clause. However, the JOA in *Reeder* included an exculpatory clause modeled after the 1989 Model Form, which exempts the operator from liability for activities under the agreement unless the liability arose from gross negligence and willful misconduct.[48] Although it appeared that Reeder made some bad decisions as operator,

33 *Id.* at 898
34 395 S.W.3d 789 (Tex. 2012).
35 *Id.* at 793-794.
36 *Id.* at 791-792.
37 *Id.* at 792.
38 *Id.*
39 *Id.* at 795-796.
40 *Id.* at 792.
41 *Id.*
42 *Id.*
43 *Id.* at 794-797.
44 *Id.* at 792-793.
45 *Id.* at 794.
46 *Id.*
47 *Id.*
48 *Id.*

such conduct did not amount to gross negligence or willful misconduct.[49] The Texas Supreme Court reversed the decision of the court of appeals and rendered a take-nothing judgment.[50]

These cases appear to draw a line dividing claims that trigger the exculpatory clause and those that do not. When an exculpatory clause modeled after the one found in the 1982 Form 610 is used, the operator's performance of matters that can be described as administrative, such as accounting, billing, paying revenues, and administering the joint account are not subject to the exculpatory clause. On the other hand, the manner in which the operator conducts operations in the field is subject to the exculpatory clause. However, when the language found in the 1989 Form 610 is used, the protection afforded to the operator is much broader as a result of the Texas Supreme Court's decision in *Reeder*.

In response to court decisions interpreting the 1989 Form 610, primarily *Reeder v. Wood County Energy, LLC*[51], the AAPL modified the exculpatory clause in Form 610.[52] The new language clarifies that the exculpatory clause applies only to operations and not all activities:

> Operator shall conduct its activities under this agreement as a reasonably prudent operator, in a good and workmanlike manner, with due diligence and dispatch, in accordance with good oilfield practice, and in compliance with applicable law and regulation. <u>However</u>, in no event shall it have any liability as Operator to the other parties for losses sustained or liabilities incurred <u>in connection with authorized or approved operations under this agreement</u> except such as may result from gross negligence or willful misconduct.[53]

The revised language is intended to provide guidance to courts and avoid *Reeder* being applied to cases involving the new form.[54]

The most recent offshore form revision and the two prior iterations reflect the same pattern as the onshore forms. The 2007 Form 810 provides:

> The Operator shall timely commence and conduct all activities or operations in a good and workmanlike manner, as would a prudent operator under the same or similar circumstances. THE OPERATOR SHALL NOT BE LIABLE TO THE NON-OPERATING PARTIES FOR LOSSES SUSTAINED OR LIABILITIES INCURRED, EXCEPT AS MAY RESULT FROM OPERATOR'S GROSS NEGLIGENCE OR WILLFUL MISCONDUCT.[55]

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[49] *Id.* at 797.
[50] *Id.*
[51] 395 S.W.3d 789 (Tex. 2012).
[52] Jeff Weems, *Significant Changes in the AAPL 2015 610 Model Form Operating Agreement*, 29th Annual Energy Law Institute for Attorneys and Landmen (2016).
[53] 2015 Form 610, Section V.A. (emphasis on new language added).
[54] Weems, *supra*.
[55] 2007 Form 810, Article 5.2 (emphasis in original).

The 2002 Form 710 contains the identical language, except that the article "the" does not appear before the terms "Operator" and "Non-Operating".[56]

The 2007 Form 810 contains the following limitation on liability:

> Unless specifically provided otherwise in this Agreement, liability for losses, damages, Costs, expenses, or Claims involving activities or operations under this Agreement or affecting the Leases or the Contract Area which are not covered by or in excess of the insurance carried for the Joint Account shall be borne by each Party in proportion to its Participating Interest Share in the activity or operation out of which that liability arises, except that when liability results from the gross negligence or willful misconduct of a Party, that Party shall be solely responsible for liability resulting from its gross negligence or willful misconduct.[57]

The 2002 form operating agreement for operations on the shelf contains very similar language.[58]

The 2015 revision to Form 810 reflects a move away from the exculpatory clause applying to activities. The second, all capitalized sentence in Article 5.2 was deleted from the 2015 Form 810.[59] In Article 22.5, the reference to losses not covered or in excess of the Joint Account's insurance has been deleted, and liability is based on Participating Interest Shares in all cases "REGARDLESS OF FAULT."[60] This Article now provides:

> Unless specifically provided otherwise in this Agreement, liability for losses, damages, Costs, expenses, or Claims involving activities or operations under this Agreement or affecting the Leases or the Contract Area shall be borne by each Party, subject to the provisions of this Article 22.5, in proportion to its Participating Interest Share in the activity or operation out of which that liability arises REGARDLESS OF FAULT. However, subject to Articles 22.7 *(Damages to Reservoir and Loss of Reserves)* and 22.9 *(Liability for Consequential and Indirect Damages)*, when any liability results from the Gross Negligence or Willful Misconduct of a Party, that Party shall be solely responsible for such liability (including all losses, damages, Costs, expenses or Claims).[61]

The language of this Article, combined with the deletion of the exculpatory language in Article 5.2, appears to be a move away from the broad exculpatory provisions in the prior forms.

If working interest owners elect to use the 1989 Form 610, the 2002 Form 710, or the 2007 Form 810, the non-operator should insist on a revision to the exculpatory clause. The language from the 2015 Form 610 or similar language should be substituted into Article V.A. of the 1989 Form

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[56] 2002 Form 710, Article 5.2.
[57] 2007 Form 810, Article 22.5.
[58] 2002 Form 710, Article 19.5
[59] 2015 Form 810, Article 5.2.
[60] 2015 Form 810, Article 22.5.
[61] 2015 Form 810, Article 22.5.

610, and the changes to the 2015 Form 810 should be transferred into an offshore operating agreement.

B. Fiduciary Duty

Generally, the operator does not have a fiduciary duty to the non-operators. However, under certain circumstances, the operator may have a fiduciary duty. The existence of the fiduciary duty can have many negative consequences for the operator.

In most situations, the operating agreement does not create a fiduciary duty owed by the operator to the non-operator.[62] In *MDU Barnett Ltd. v. Chesapeake Exploration Ltd*.[63], the plaintiff sued Chesapeake and asserted both tort and contract claims relating to an exploration and development agreement and an operating agreement. The parties used the 1982 Form 610 for their operating agreement, under which Chesapeake was the operator.[64] Chesapeake moved to dismiss for failure to state a claim. In evaluating the plaintiff's breach of fiduciary duty claim, the court, citing *Wilson v. TXO Prod. Corp (In re Wilson)*[65] and *Luling Oil & Gas Co. v. Humble Oil & Ref. Co*.[66], held that an operating agreement does not create a trustee-type fiduciary duty.[67] The court rejected the plaintiff's claim that the operating agreement created a joint venture.[68] Finally, the court found that no informal fiduciary relationship existed.[69] For these reasons, the court granted Chesapeake's motion to dismiss the breach of fiduciary duty claim.[70]

However, this general rule can be overcome if the non-operator can establish that the parties formed a joint venture. In *Dernick Res. Inc. v. Wilstein*,[71] the non-operators sued the operator for breach of a joint venture agreement and an operating agreement.[72] In addition to contract claims, the non-operators asserted claims for breach of fiduciary duty.[73] After conducting a bench trial, the court found that many of the non-operators' claims were barred by limitations and rejected the non-operators' assertion of fraudulent concealment.[74] The trial court then submitted the remainder of the claims to a jury, which entered a verdict for the non-operators.[75] The non-operators appealed the rulings from the bench trial. Specifically, the working interest owners asserted that the operator's fiduciary duty allowed them to invoke the doctrine of fraudulent concealment to toll the statute of limitations.[76] The court of appeals found that the operator did

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[62] *MP31 Invs., LLC v. Harvest Operating, LLC*, 186 So. 3d 750 (La. App. 1 Cir. 2016); *MDU Barnett Ltd. v. Chesapeake Exploration Ltd. P'Ship*, 2014 U.S. Dist. LEXIS 18769 (S.D. Tex. 2014); 2-19A Kuntz § 19A.6(c); 3 Smith & Weaver § 17.4[A].
[63] 2014 U.S. Dist. LEXIS 18769 (S.D. Tex. 2014).
[64] *Id.* at *3.
[65] 69 B.R. 960 (Bankr. N.D. Tex 1987).
[66] 191 S.W.2d 716 (Tex. 1945).
[67] *MDU Barnet* at *16-18.
[68] *Id.* at *18-19.
[69] *Id.* at *19-20.
[70] *Id.*
[71] 312 S.W.3d 864 (Tex. App.—Houston [1st Dist.] 2009, no pet.).
[72] *Id.* at 868-873.
[73] *Id.* at 876-877.
[74] *Id.* at 875-876.
[75] *Id.* at 876-877.
[76] *Id.* at 877.

owe the non-operators a fiduciary duty.[77] The court specifically cited the existence of a joint venture agreement as creating a fiduciary duty.[78] As the operator owed a fiduciary duty to the working interest owners, the plaintiffs were allowed to assert fraudulent concealment in response to the operator's statute of limitations defense. The court remanded the case to the trial court for further proceedings.[79]

On remand, the trial court found that the operator's breach of fiduciary duty had been established as a matter of law.[80] At trial, the court took up the plaintiffs' claim that the operator should forfeit the overhead fees it had been paid by the non-operators.[81] The trial court granted fee forfeiture and awarded the working interest owners all of the overhead fees they had paid to the operator.[82] The operator appealed, and the court of appeals affirmed the fee forfeiture. Although the breach of fiduciary duty that supported the fee forfeiture claim arose from the parties' separate joint venture agreement, the trial court found that forfeiture of fees paid under the operating agreement was an appropriate remedy for the breach of fiduciary duty.[83]

The lesson to be learned from *Dernick* is that the existence of a joint venture will impose a fiduciary duty where one would otherwise not be created. *Dernick* represents an exception to the general rule that the operator does not owe the non-operators a general fiduciary duty.

C. Custody of Funds and Property

One area where an operator can be subject to tort liability is when dealing with jointly owned funds and property. The operator's duty to account to the working interest owners for revenues and advanced funds is one area where a fiduciary duty may be recognized. The operator may also be held to tort duties, independent of the operating agreement, if the operator converts jointly owned property or engages in fraudulent billing practices.

The 1989 Form 610 provides:

> Custody of Funds: Operator shall hold for the account of the Non-Operators any funds of the Non-Operators advanced or paid to the Operator, either for the conduct of operations hereunder or as a result of the sale of production from the Contract Area, and **<u>such funds shall remain the funds of the Non-Operators</u>** on whose account they are advanced or paid until used for their intended purpose or otherwise delivered to the Non-Operators or applied toward the payment of debts as provided in Article VII.B. **<u>Nothing in this paragraph shall be construed to establish a fiduciary relationship between Operator and Non-Operators for any purpose other than to account for Non-Operator funds as herein</u>**

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77 *Id.* at 877-878.
78 *Id.*
79 *Id.*
80 *Dernick Res. Inc. v. Wilstein*, 471 S.W.3d 468 (Tex. App.—Houston 2015, pet. denied). The Texas Supreme Court requested the parties submit briefing on the merits. The petition for review was denied after those briefs were submitted.
81 *Id.* at 476.
82 *Id.*
83 *Id.* at 484-485.

> **<u>specifically provided.</u>** Nothing in this paragraph shall require the maintenance by Operator of separate accounts for the funds of Non-Operators unless the parties otherwise specifically agree.[84]

This paragraph remains unchanged in the 2015 Form 610.[85] This language would appear to create a limited fiduciary duty to the non-operators. An operator that mishandles the working interest owners' funds may face liability beyond a breach of contract. The 1982 Form 610 and the offshore operating agreement forms do not include the fiduciary duty language found in the 1989 Form 610 and the 2015 Form 610.

Both the offshore and onshore forms allow the operator to commingle the non-operator's funds with its own. The 1989 Form 610 and 2015 Form 610 contain the language quoted above that relieves the operator from the obligation to maintain separate accounts.[86] The offshore forms provide, "Funds received by the Operator under this Agreement may be commingled with the Operator's own funds."[87]

The language of both offshore and onshore forms would appear to indicate that the non-operators' funds received by the operator continue to be the property of the non-operators. The 1989 and 2015 versions of Form 610 expressly state that this is the case.[88] The offshore forms' provision that non-operator funds can be commingled with the operator's "own funds" would seem to imply that the non-operators' money does not change ownership. Any different reading would mean that the funds are not truly commingled but instead become the operator's "own funds". However, this point has been litigated in at least one case.

In *Tow v. Exxon Mobil Corp. (In re ATP Oil & Gas Corp.)*[89], Exxon, as a nonoperator, advanced its share of the costs for plugging and abandonment operations to the operator, ATP.[90] The parties' operating agreement allowed ATP to commingle funds advanced by the non-operators with its own funds, which ATP did.[91] However, the agreement did not contain language similar to the 1989 Form 610 and 2015 Form 610 providing that the funds would remain the property of the nonoperators.[92] The actual cost of the decommissioning work was significantly less than the amount of the AFE.[93] Exxon requested and eventually received a check for its share of the excess funds remaining after payment of the actual decommissioning costs.[94] ATP filed for

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[84] 1989 Form 610, Section V.D.4. (emphasis added)

[85] 2015 Form 610, Section V.D.4.

[86] 1989 Form 610, Section V.D.4; 2015 Form 610, Section V.D.4.

[87] 2007 Form 810, Article 6.1; 2015 Form 810, Article 6.1; 2002 Form 710, Article 8.5 (identical language except "its" appears in the place of "the Operator's" at the end of the sentence).

[88] 1989 Form 610, Section V.D.4.; 2015 Form 610, Section V.D.4.

[89] 553 B.R. 577 (S.D. Tex. Bankr. 2016).

[90] *Id*. at 579.

[91] *Id*. at 579 n. 1. The language in the opinion indicates that the court believed the operating agreement's requirement that the operator maintain a "Joint Account" meant that the "Joint Account" would be a separate bank account maintained by the operator.

[92] The author mediated this case after the denial of the motion for summary judgment. The case settled after the mediation. The operating agreement and the parties' settlement agreement were filed in the public records of the bankruptcy court, so no confidential information is being disclosed.

[93] *Id*.

[94] *Id*. at 580.

bankruptcy less than 90 days later, and its bankruptcy trustee commenced a preferential transfer action against Exxon under 11 U.S.C. § 547.[95] Exxon filed a motion for summary judgment arguing that its funds were held in constructive trust by ATP and therefore not "property of the debtor" that could be recovered in a preference action.[96] The bankruptcy court, applying Louisiana law, held there could be no constructive trust under Louisiana law and denied Exxon's motion for summary judgment.[97] As a result, the trustee's preference action to recover the money refunded to Exxon was allowed to go forward.

If operations will be conducted under an operating agreement other than the 1989 or 2015 versions of Form 610, the non-operators will want to insist on express language providing that their funds remain their property, even when commingled with the operator's funds, until paid out by the operator as authorized by the agreement. From the operator's perspective, using the 1989 Form 610 or the 2015 Form 610 without any language directly disclaiming any fiduciary duty as to joint account funds may create a limited fiduciary duty to the non-operators.

Even without a fiduciary duty, the operator can expose itself to tort liability if it converts jointly owned equipment and sends fraudulent billings.[98] In *Cass v. Stephens*, a father and son who operated wells were sued by the non-operating working interest owner. The father, individually, was the operator under the applicable operating agreements.[99] Although he announced his resignation, he continued to operate the wells and later announced he was changing the operator to a company he owned.[100] His son assisted him and had responsibility for drilling and field operations. The non-operator's filed suit and asserted both contractual and tort claims.[101] The non-operator asserted claims for fraud and conversion based on billings for services never provided, charges for equipment that was already owned by the joint account, and the removal of jointly owned equipment.[102] After a jury trial, the trial court entered a judgment against the father and son. The judgment included damages, both actual and exemplary, for fraud and conversion.[103] The court of appeals upheld the judgment against the father and son for fraud and conversion. In response to the operator's claim that the causes of action sounded in contract and not in tort, the court observed that the non-operator designated claims for overcharges and charges not authorized by the operating agreements as being breaches of contract.[104] When the billings were for services not provided to the jointly owned wells – and actually provided to the operator's solely owned wells – and for equipment already owned by the joint account, the non-operator classified those billings as constituting fraud.[105] The court of appeals agreed and found that the operating agreements did not authorize the defendants to bill for services not provided and double bill for equipment that had already been purchased and paid for once.[106] The court

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95 *Id*.
96 *Id*.
97 *Id*. at 583.
98 *Cass v. Stephens*, 156 S.W.3d 38 (Tex. App.—El Paso 2004, pet. denied).
99 *Id.* at 48.
100 *Id.*
101 *Id.* at 49.
102 *Id.* at 58-64.
103 *Id.* at 52.
104 *Id.* at 68-69.
105 *Id.* at 68.
106 *Id.* at 69.

also upheld the judgment on the conversion claim and stated that unauthorized appropriation of jointly owned property amounts to conversion.[107] Although the exemplary damage awards were reduced due to unconstitutional excessiveness, the judgment was affirmed against the operator on the fraud and conversion claims.

To the extent that an operator's mishandling of jointly account funds or jointly owned equipment results in tort liability, the working interest owner may seek punitive damages that are not limited by statute. Punitive damages, called exemplary damages in Texas, are available when the plaintiff proves by clear and convincing evidence that the defendant committed fraud, was grossly negligent, or acted with malice.[108] Normally, exemplary damages are limited to the greater of 1) two times the amount of economic damages plus an amount equal to the noneconomic damages, or 2) $200,000.[109] However, felony theft or misapplication of fiduciary property will remove this cap.[110] As a result, an operator, who is normally only liable in contract, can open itself up to unlimited punitive damages by engaging in certain tortious conduct.

V. REMOVAL AND REPLACEMENT OF THE OPERATOR

A. Procedure

One frequent area of dispute is the question of who will operate the leases covered by the parties' operating agreement. These disputes usually arise in two different situations. One is when the working interest owners become dissatisfied with the operator and try to remove it. The other is when the operator sells its interest and the new owner seeks to become the operator. Regardless of the reasons why the parties are struggling over who will operate, these disputes are a common cause of lawsuits between working interest owners and operators.

The AAPL form operating agreements provide for circumstances in which an operator is deemed to have resigned, a mechanism for the non-operators to remove the operator, and procedures for electing a new operator. Some of these provisions require the parties to agree on the number of parties entitled to vote and/or percentages of interests at the time the agreement is executed. A reference below to a number or percentage to be agreed by the parties indicates that the form contains a blank to be filled in prior to execution. The resignation, removal, and election provisions can be summarized as follows:

> 1982 Form 610, Article V.B.
>
> Deemed resignation: Operator terminates legal existence, no longer owns an interest under the operating agreement, or is no longer capable of serving as operator.
>
> Grounds for removal: Operator fails or refuses to carry out duties as operator, becomes insolvent, files for bankruptcy, or is placed in receivership.
>
> Vote required to remove: Two or more non-operators owning a majority of the interest after excluding operator's interest.

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[107] *Id.*
[108] Tex. Civ. Prac. & Rem. Code § 41.003(a).
[109] Tex. Civ. Prac. & Rem. Code § 41.008(b).
[110] Tex. Civ. Prac. & Rem. Code § 41.008(c).

Opportunity for operator to cure: None.

Vote required to elect new operator: Two or more parties owning a majority of the interest, with the outgoing operator's interest excluded if it does not vote or votes for itself.

1989 Form 610, Article V.B.

Deemed resignation: Operator terminates legal existence, no longer owns an interest under the operating agreement, or is no longer capable of serving as operator.

Grounds for removal: Good cause, which means gross negligence or willful misconduct, material breach or inability to perform standard of operation (in a good and workmanlike manner, as a reasonably prudent operator, etc.--Article V.A.), or failure or inability to perform obligations under operating agreement.

Vote required to remove: One or more non-operators owning a majority of the interest after excluding operator's interest.

Opportunity for operator to cure: Written notice of operator's default and default not cured within 30 days.

Vote required to elect new operator: Two or more parties owning a majority of the interest, or one or more parties owning a majority in interest after excluding the outgoing operator's interest if it does not vote or votes for itself.

2015 Form 610, Article V.B.

Deemed resignation: Operator terminates legal existence, sells, transfers, or has a loss of title to more than a certain percent (to be agreed to by the parties) of its interest under the operating agreement, or is no longer capable of serving as operator.

Grounds for removal: Good cause, which includes, but is not limited to gross negligence or willful misconduct, material breach or inability to perform standard of operation (in a good and workmanlike manner, as a reasonably prudent operator, etc.--Article V.A.), or failure or inability to perform obligations under operating agreement; non-owning operator can be removed with or without cause.

Vote required to remove: Non-owing operator, with or without cause, majority in interest; If good cause shown, then one or more non-operators owning a majority of the interest after excluding operator's interest or interest of any affiliate of non-owning operator.

Opportunity for operator to cure: Non-owning operator not affiliated with a working interest owner, none; otherwise, written notice of operator's default and default not cured within 30 days.

Vote required to elect new operator: one or more parties owning a majority of the interest, or one or more parties owning a majority in interest after excluding the outgoing operator's interest if it does not vote or votes for itself; if the vote is a tie, the candidate supported by the outgoing operator or the majority of its transferees becomes operator.

2002 Form 710, Article 4

Deemed resignation: Operator ceases to own an interest under the operating agreement, or is no longer capable of serving as operator.

Grounds for removal: Operator becomes insolvent or unable to pay its debts, makes an assignment for creditors, files for bankruptcy, is placed in receivership, transfers enough of its interest such that it owns less than a non-operator, commits a substantial breach of the operating agreement, or proposes to transfer a certain percent (to be agreed to by the parties) of its interest.

Vote required to remove: One or more non-operators owning a certain percent (to be agreed to by the parties) of the interest after excluding operator's interest. Vote must be taken within a certain period of time (to be agreed to by the parties) after a non-operator learns of the grounds for removal.

Opportunity for operator to cure: None, except written notice of operator's substantial breach of the agreement and default not cured within a time period to be agreed upon by the parties.

Vote required to elect new operator: One or more parties (including a party that acquired an interest from the resigning or removed operator) owning a certain percent (to be agreed upon by the parties) of the interest after excluding the outgoing operator's interest if it does not vote or votes for itself.

2007 Form 810, Article 4

Deemed resignation: Operator ceases to own an interest under the operating agreement

Grounds for removal: Operator transfers enough of its interest such that it owns less than a non-operator, is found liable by a final judicial or arbitral decision for gross negligence or willful misconduct, commits a substantial breach of a material provision of the agreement, becomes insolvent or unable to pay its debts, makes an assignment for creditors, files for bankruptcy, is placed in receivership, or does not begin fabrication or acquisition of the Development System.

Vote required to remove: A number (to be agreed upon by the parties) of parties owning a certain percent (to be agreed upon by the parties) of the interest after excluding operator's interest. Vote must be taken within 90 days after a non-operator learns of the grounds for removal.

Opportunity for operator to cure: None, except written notice of operator's substantial breach of the agreement and default not cured within 30 days.

Vote required to elect new operator: A number (to be agreed upon by the parties) of parties (including a party that acquired an interest from the resigning or removed operator) owning a certain percent (to be agreed upon by the parties) of the interest after excluding the outgoing operator's interest if it does not vote or votes for itself.

2015 Form 810, Article 4

Deemed resignation: Operator (and its affiliate) ceases to own an interest under the operating agreement

Grounds for removal: Operator (and its affiliate) transfers enough of its interest such that its interest is reduced below the lesser of a certain percentage (to be agreed upon by the parties) or a certain percentage (to be agreed upon by the parties) of the next highest non-operator, is found liable by a final judicial or arbitral decision for gross negligence or willful misconduct, commits a substantial breach of a material provision of the agreement, becomes insolvent or unable to pay its debts, makes an assignment for creditors, files for bankruptcy, is placed in receivership, or does not begin fabrication or acquisition of the Development System.

Vote required to remove: One or more non-operators owning a certain percent (to be agreed upon by the parties) of the interest after excluding operator's interest. Vote must be taken within 90 days after a non-operator learns of the grounds for removal.

Opportunity for operator to cure: None, except written notice of operator's substantial breach of the agreement and default not cured within 30 days.

Vote required to elect new operator: A number (to be agreed upon by the parties) of parties (including a party that acquired an interest from the resigning or removed operator) owning a certain percent (to be agreed upon by the parties) of the interest after excluding the outgoing operator's interest if it does not vote or votes for itself; if the operator is to be removed for assigning only part of its interest, the successor must own more than a certain percent (to be agreed upon by the parties) or a certain percent (to be agreed upon by the parties) more than the outgoing operator.

The 2015 Form 610 introduces new aspects to the removal procedures. The 2015 revision recognizes and expressly authorizes the practice of designating an operator that does not own a working interest in the contract area.[111] This change is accompanied by a different standard and voting procedure when there is a non-owning operator.[112]

Disputes over the right to operate involve several issues. The first is whether sufficient grounds exist to remove the operator. The second concerns the conduct of the election to remove the operator and appoint a successor. Next, the language of conflicting agreements may prohibit the removal of the operator. Other issues regarding voting may arise. The courts of appeals have addressed these issues on several occasions.

B. Grounds for Removal

A leading case on the removal and replacement of the operator is *Tri-Star Petroleum Co. v. Tipperary Corp.*[113] Tri-Star and Tipperary were parties to an operating agreement covering a natural gas project in Australia.[114] Tri-Star operated the property, and Tipperary owned a non-operating working interest.[115] Tipperary filed suit alleging that Tri-Star failed to operate in a good and workmanlike manner.[116] Tipperary then sought to remove Tri-Star as operator. After the suit was filed, a majority of the non-operators affirmatively voted to remove Tri-Star as operator and selected Tipperary as successor.[117] Following the vote, Tipperary filed an amended petition which alleged Tri-Star breached its contractual obligations by refusing to step down.[118]

When Tri-Star continued to operate the property, Tipperary asked the trial court for a temporary injunction.[119] The trial court conducted a seven-day temporary injunction hearing and then

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[111] 2015 Form 610, Article V.A.
[112] *Id.*, Article V.B.5.
[113] 101 S.W.3d 583 (Tex. App.—El Paso 2003, pet. denied).
[114] *Id*. at 586.
[115] *Id*.
[116] *Id*.
[117] *Id*.
[118] *Id*.
[119] *Id*.

enjoined Tri-Star from operating the property or interfering with Tipperary's operation of the property.[120] Tri-Star appealed the trial court's temporary injunction.

The court of appeals ruled that the trial court did not abuse its discretion in entering the temporary injunction. The trial court found that the working interest owners had voted to remove Tri-Star, had elected Tipperary as the new operator, and had determined that Tri-Star failed to carry out its duties under the operating agreement.[121] Among the facts supporting the finding that Tri-Star failed to perform its obligations pursuant to the operating agreement were:

- Improper charges against the joint account,
- Failure to supply information requested by the working interest owners,
- Commingling legal fees incurred by Tri-Star in the lawsuit with joint account funds,
- Unexplained classification and reclassification of joint account charges,
- Failing to provide timely and proper adjustments to the joint account,
- Double charging the working interest owners,
- Allowing acreage to be lost, and
- Not delivering the required volume of gas under gas sales contracts.[122]

The court of appeals held there was no abuse of discretion in the trial court's findings of fact.[123] Consequently, Tipperary had shown it would likely prevail on the merits at the time of trial.[124]

The court of appeals then addressed the question of whether Tipperary had shown it would suffer a probable injury without a temporary injunction. The court of appeals held that the trial court's determination that Tipperary was faced with a probable injury was not an abuse of discretion, because Tipperary proved that Tri-Star was not producing the minimum quantity of gas required by a contract, Tri-Star's development program was causing the loss of lease acreage, and there was a threat of irreparable injury to Tipperary's property.[125]

Tri-Star also argued that the temporary injunction was a mandatory injunction.[126] A mandatory injunction requires a party to take action, and a prohibitive injunction orders a party to refrain from some action.[127] A mandatory injunction should be granted only when the plaintiff makes a

[120] *Id*.
[121] *Id*. at 589-90.
[122] *Id*.
[123] *Id*.
[124] *Id*.
[125] *Id*. at 591-92.
[126] *Id*. at 592.
[127] *Id*.

clear and compelling presentation of extreme hardship or necessity.[128] The court of appeals found that the injunction was prohibitive in nature. Although the court ordered Tri-Star to take action to allow Tipperary to take over operations, those actions were incidental to the prohibitive injunction ordering Tri-Star to not interfere with Tipperary's operation of the properties.[129]

The court of appeal's discussion of whether the temporary injunction in favor of Tipperary preserved the status quo is of particular note.[130] The status quo is the last, peaceable, non-contested status that preceded the controversy**.**[131] Tri-Star argued that the controversy did not begin with Tri-Star's refusal to comply with the vote.[132] Rather, it claimed the last, peaceable, non-contested status was Tri-Star serving as operator prior to Tipperary filing its suit.[133] While it was undisputed that Tri-Star was the operator under the operating agreement, there were several allegations that Tri-Star breached the operating agreement and had committed other misconduct.[134] The court of appeals held that the trial court had discretion to find that the status quo consisted of the working interest owners having the right to remove the operator and elect a successor.[135] This interpretation of what constitutes the status quo is helpful to working interest owners who are seeking a temporary injunction against an operator that they just ousted.

Another case arising from the removal and replacement of the operator is *R & R Resources Corp. v. Echelon Oil and Gas, L.L.C.*[136] R & R, Echelon, and others owned three wells.[137] The parties adopted the 1989 Form 610, and R & R was the operator.[138] Echelon and the other working interest owners voted to remove R & R as operator after disputes arose regarding operations and accounting procedures.[139] R & R refused to hand over operations, would not execute Railroad Commission Form P-4s, and opposed the processing of single signature P-4s to transfer operations.[140] The non-operators sued R & R and filed an application for a temporary injunction. The trial court granted the temporary injunction, and R & R appealed.[141] The trial court found that R & R's improper accounting and operation practices constituted good cause for its removal as operator.[142] These practices included:

- Holding revenue checks for several weeks after the production proceeds were received from the product purchasers,
- Not paying operating expenses on time,

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128 *Id*.
129 *Id*. at 592-93.
130 *Id*. at 587-88.
131 *Id*. at 588.
132 *Id*.
133 *Id*.
134 *Id*.
135 *Id*.
136 2006 Tex. App. LEXIS 326 (Tex. App.—Austin 2006, no pet.)
137 *Id*. at *2.
138 *Id*. at *2-3.
139 *Id*. at *4-6.
140 *Id*. at *6.
141 *Id*. at 8-9.
142 *Id*. at *23-29.

- Not billing operating expenses on a timely basis,
- Charging excessive operating expenses,
- Failing to install chemical treating systems to avoid equipment corrosion, and
- Failing to address the need for replacement materials and equipment.[143]

The court held that the trial court did not abuse its discretion in finding that good cause for removal of the operator existed and the plaintiffs would likely prevail on the merits.

The court also addressed the requirement of probable injury. The trial court found that the plaintiffs had no adequate remedy at law, because R & R's accounting and operational practices:

> have caused and will continue to cause loss and/or delay of revenue; payment of excessive and/or unnecessary lease/well expenses; late payment of lease/well expenses; exposure to lease/well creditors for non or late payment; the loss, interruption, and/or delay in production of valuable minerals; and the injury and/or damage to the well bores and/or equipment and materials located on the leases/wells.[144]

The court of appeals determined that the trial court did not abuse its discretion in finding the plaintiffs had proven a probable injury.[145]

The 2015 Form 610 clarifies what constitutes good cause to remove the operator. Section V.B.4. now provides:

> For purposes hereof, "good cause" shall include, but not be limited to, Operator's (i) gross negligence or willful misconduct, (ii) the material breach of or material inability to meet the standards of operation contained in Article V.A. or (iii) material failure or inability to perform its obligations or duties under this agreement.[146]

This language is in line with the grounds for removal in the 1989 Form 610. Consequently, the case law dealing with the 1989 Form 610, or an agreement containing similar language, remains applicable.

C. Conflicting Agreements

Regardless of the procedures set forth in the operating agreement, other agreements between the parties may prevent the removal of the operator. This was the case in *Inex Industries, Inc. v.*

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143 *Id*.
144 Id. at *20-21.
145 Id. at *21-22.
146 2015 Form 610, Section V.B.4.

Alpar Resources, Inc.[147] Under an operating agreement, Alpar was named operator of the property, which provided for the removal of the operator by a majority vote of the working interest owners.[148] This operating agreement was attached to the purchase and sale agreement by which Alpar purchased its interest from the original working interest owner.[149] The purchase and sale agreement specifically stated that Alpar would serve as operator of the properties.[150] The purchase agreement also provided that it controlled in the event of a conflict between the purchase agreement and the operating agreement.[151] When Inex attempted to remove Alpar as the operator, Alpar filed suit and asked for a temporary injunction.[152] The trial court temporarily enjoined Inex from operating the properties.[153] On interlocutory appeal by Inex, the appellate court held that the trial court did not abuse its discretion in ruling that the purchase agreement controlled Alpar's status and Alpar could not be removed under the operating agreement.[154] Thus, the court of appeals affirmed the temporary injunction.[155]

A similar dispute arose in *U.S. Energy Dev. Corp. v. Stephens Energy Grp*.[156] In that lawsuit, Stephens claimed that its predecessor in title, Slawson, could assign the position of operator when Stephens acquired Slawson's working interest.[157] The nonoperators disagreed, elected one of their own as the new operator, and filed suit when Stephens refused to turn over operations.[158] The trial court granted the nonoperators' motion for summary judgment and held that the position of operator could not be assigned.[159] The court relied upon the operator removal and resignation language in the parties' operating agreement and industry custom in ruling that Slawson could assign its right to operate to Stephens.[160] The court of appeals reversed that decision. The appellate court rejected the industry custom and usage argument.[161] The court relied on the parties participation agreement, to which the operating agreement was attached, which provided that rights and duties under the agreement could be assigned.[162] The participation agreement provided that it controlled in the event of any conflicts between it and the operating agreement.[163] Based on that language, and Oklahoma law presuming that contractual rights are assignable, the court of appeals held that Slawson could assign the position of operator.[164]

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147 717 S.W.2d 685 (Tex. App.—Amarillo 1986, no writ).
148 Id. at 686.
149 Id.
150 Id.
151 Id.
152 Id.
153 Id.
154 Id. at 687.
155 Id.
156 662 Fed. Appx. 556 (10th Cir. 2016).
157 Id. at __
158 Id. at 559.
159 Id. at 560.
160 Id. at 562-63.
161 Id. at 563-64.
162 Id. at 562-63, 565.
163 Id. at 563.
164 Id. at 565.

The lesson to be learned from these cases is that nonoperators must insist on language confirming that the operator removal, resignation, and election procedures in the operating agreement control over any conflicting language in the parties' other agreements. Otherwise, the usual expectations that an operator can be removed and that an operator's sale of its interest will result in a successor operator election may end up being incorrect.

D. Other Voting Issues

An additional issue that may arise is the argument that the election of a new operator is not necessary when the operator sells its working interest. That was the exact argument made in *Stephens*, cited above. A party buying an operator's working interest usually wants to operator the property, so it may argue it acquired the position of operator along with the operator's working interest. The 2015 Form 610 expressly negates the idea that the position of operator is assignable.[165]

Although no cases address the issue, one problem posed by the AAPL Forms, other than one new provision in the 2015 Form 610, is that they do not contain a tie-breaker provision for the election of a successor operator. Most of the AAPL Forms assume a majority will be achieved.[166] However, several possible scenarios could result in a tie vote:

- Two parties each own 50% of the working interest.
- One individual owner or a group of working interest owners holds exactly 50% and another group also owns exactly 50%.
- One party owns more than 50% of the working interest and cannot agree with the owners of the remainder of the working interest.

The offshore forms also assume that a party will win the election.[167] The 2015 Form 610 provides for a tie-breaker when the operator selling its entire interest in the contract area, in which case a tie goes to the outgoing operator's assignee.[168] Given that oil and gas properties must have an operator, a tie could force a court to craft an equitable solution not provided for in the operating agreement. The parties may very well all be unhappy with the court's decision. Rather than leave it to a judge, the parties are better off agreeing on who will operate the property. This issue could also be addressed by adding a tie-breaker provision to the operating agreement.

[165] 2015 Form 610, Article V.B. However, as in *Stephens*, this language may be overridden by language in a different agreement between the parties.
[166] 1982 Form 610, Article V.B.1; 1989 Form 610, Article V.B
[167] 2002 Form 710, Article 4.5; 2007 Form 810, Article 4.5; 2015 Form 810, Article 4.5.
[168] 2015 Form 610, Article V.B.6.

VI. OPERATOR'S REMEDIES FOR NON-OPERATOR'S DEFAULT

A. Operator Invoices and Defaults by the Non-Operator

The operator has the duty to pay the expenses incurred in operations in the contract area, and the operator then bills the non-operators for their shares of the expenses. The 2015 Form 610, provides:

> Operator shall promptly pay and discharge expenses incurred in the development and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective proportionate shares upon the expense basis provided in Exhibit "C." Operator shall keep an accurate record of the joint account hereunder, showing expenses incurred and charges and credits made and received.[169]

The offshore forms and other onshore forms contain similar or identical language.[170] Whether or not the non-operators pay the expenses as they are billed, the operator must still pay the expenses and keep the contract area free from liens.[171] When a non-operator fails to pay its share of the expenses, the operator is exposed to what can be a very significant financial loss. The AAPL's offshore and onshore form operating agreements protect the operator by providing remedies against a defaulting non-operator.

B. Operator's Lien

The operator's most powerful remedy and the source of many of its other remedies is the lien operator's lien. For example, the 2015 Form 610 grants a lien to the operator:

> Each party grants to the other parties hereto a lien upon any interest it now owns or hereafter acquires in Oil and Gas Leases and Oil and Gas Interests in the Contract Area, and a security interest and/or purchase money security interest in any interest it now owns or hereafter acquires in the personal property and fixtures on or used or obtained for use in connection therewith, to secure performance of all of its obligations under this agreement including but not limited to payment of expense, interest, and fees, the proper disbursement of all monies paid hereunder, the assignment or relinquishment of interest in Oil and Gas Leases as required hereunder, and the proper performance of operations hereunder.[172]

Similar language appears in Form 710, Form 810, and the prior versions of Form 610.[173] It should be noted that the lien is just as much a non-operator's lien as it is an operator's lien.[174]

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169 2015 Form 610, Article V.D.2.

170 1982 Form 610, Article VII.C.; 1989 Form 610, Article V.D.2; 2002 Form 710, Article 8.1; 2007 Form 810, Article 6.1; 2015 Form 810; Article 6.1.

171 2015 Form 610, Article V.D.3; 2002 Form 710; Article 5.3; 2007 Form 810, Article 5.4; 2015 Form 810, Article 5.4

172 2015 Form 610, Article VII.B

173 1982 Form 610, Article VII.B.; 1989 Form 610, Article VII.B.

The non-operators have a lien on the operator's interest to secure the operator's performance of its duties under the operating agreement.[175] However, usually the operator is the party that invokes the lien.

For the lien to be effective against subsequent purchasers or creditors, the Recording Supplement must be executed and recorded. To perfect the lien as to real property interests, such as leasehold interests and mineral fee interests, the Recording Supplement should be filed with the clerk of county in which the Contract Area is located. In addition, the lien should be perfected as to personal property, such as equipment, severed hydrocarbons, and production proceeds, by filing the Recording Supplement as a UCC-1 with the Secretary of State.

The operator's lien provides the ultimate remedy of seizure of the defaulting non-operator's interest in the contract area. After foreclosure, the defaulting party's interest is sold to pay its debt. The operator has the advantage of being able to credit bid the amount of the default at the foreclosure sale. The operator will either end up with cash to cover the default or ownership of the defaulting party's interest. In addition, the operator's lien allows the operator to effectively invoke many other remedies under the operating agreement.

C. Collection of Proceeds from the Sale of Production

If a non-operator defaults on its monetary obligations, the operator can immediately set the unpaid expenses off against the defaulting party's share of the production proceeds. The 2015 Form 610 provides:

> Upon default by any party in the payment of its share of expenses, interests or fees, or upon the improper use of funds by the Operator, the other parties shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such defaulting party's share of Oil and Gas until the amount owed by such party, plus interest as provided in Exhibit "C", has been received, and shall have the right to offset the amount owed against the proceeds from the sale of such defaulting party's share of Oil and Gas.[176]

The other forms discussed in this paper also contain this type of setoff language.[177] This remedy is a powerful one, because it does not require the operator to give the defaulting party an opportunity to cure before seizing the production proceeds.

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[174] 1989 Form 610, Article VII.B.; 2015 Form 610, Article VIIB.; 2007 Form 810, Ex. F; 2015 Form 810, Ex. F.; 2002 Form 710, Ex. I.
[175] *Id*.
[176] 2015 Form 610, Article VII.B.
[177] 1982 Form 610, Article VII.B.; 1989 Form 610, Article VII.B; 2002 Form 710, Ex. I, Article 8.6.1; 2007 Form 810, Ex. F, Article 6.3.a.(i).; 2015 Form 810, Ex. F, Article 6.3.a.(i).

D. Suspension of Rights

Once a non-operator defaults, is given an opportunity to cure the default, and fails to take corrective action, the operator can suspend all or some of the defaulting party's rights under the operating agreement. The first step in this process is the formal Notice of Default.

Under Article VII.D.1. of the 2015 Form 610:

> Any party may deliver to the party in default a Notice of Default, which shall specify the default, specify the action to be taken to cure the default, and specify that failure to take such action will result in the exercise of one or more of the remedies provided in this Article.[178]

Upon receipt of the Notice of Default, the working interest owner has 30 days to take action or suffer the consequences:

> If the default is not cured within thirty (30) days of the delivery of such Notice of Default, all of the rights of the defaulting party granted by this agreement may upon notice be suspended until the default is cured, without prejudice to the right of the non-defaulting party or parties to continue to enforce the obligations of the defaulting party previously accrued or thereafter accruing under this agreement.[179]

The offshore forms and the 1989 onshore form also provide for a Notice of Default and opportunity to cure.[180] However, the offshore forms automatically suspend some of the defaulting party's rights.[181] After suspending the rights of the defaulting party, the operator still has remedies such as lien foreclosure and a suit for damages available to it.

E. Deemed Non-Consent

Certain defaults for exploration and development expenses, as opposed to operating expenses, can result in a party being placed in the same position as a party that elected not to participate in the subsequent operation. The right to deem a party to be non-consent appears in the 2015 Form 610:

> The non-defaulting party may deliver a written Notice of Non-Consent Election to the defaulting party at any time after the expiration of the thirty-day cure period following delivery of the Notice of Default, in which event if the billing is for the drilling a new well or the Plugging Bank, Sidetracking, Reworking or Deepening of a well which is to be or has been plugged as a dry hole, or for the Completion or Recompletion of any well, the defaulting party will be conclusively deemed to have elected not to participate in the operation and to be a Non-Consenting Party

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178 2015 Form 610, Article VII.D.1.

179 Id.

180 1989 Form 610, Article VII.D.1.; 2002 Form 710, Ex. I, Article 8.6.2; 2007 Form 810, Ex. F, Article 6.3.b; 2015 Form 810, Ex. F, Article 6.3.b.

181 2002 Form 710, Ex. I, Article 8.6.2; 2007 Form 810, Ex. F, Article 6.3.b; 2015 Form 810, Ex. F, Article 6.3.b.

> with respect thereto under Article VI.B or VI.C, as the case may be, to the extent of the costs unpaid by such party, notwithstanding any election to participate theretofore made. If election is made to proceed under this provision, then the non-defaulting parties may not elect to sue for the unpaid amount pursuant to Article VII.D.2.[182]

This provision also appears in the 1989 Form 610.[183] The operator can then proceed as in any other subsequent operation conducted by less than all parties. The operator must take care in exercising this option. Just as a non-consent party cannot be forced to pay for an unsuccessful subsequent operation, a party deemed to be non-consent cannot be sued for the costs of the operation.[184]

F. Advance Billing of Expenses

One remedy available to an operator before a default is the ability to pre-bill the non-operators for the next month's estimated operating expenses. For example, 2015 Form 610 states:

> Operator, at its election, shall have the right from time to time to demand and receive from one or more of the other parties payment in advance of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within thirty (30) days after such estimate and invoice is received.[185]

The 1982 and 1989 versions of Form 610 contain similar provisions.[186] By using this option, the operator reduces the time between paying operating expenses and receiving the non-operators' shares of the costs.

This right can be even more effective when a right to advance bill, or "cash call", the costs of a subsequent operation is included in Article XVI. Such a provision allows the operator to demand payment at the time a party elects to participate in a subsequent operation. If the non-operator defaults on the cash call, the operator can use the notice of default and deemed non-consent remedies to remove the defaulting party from the operation.

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182 2015 Form 610, Article VII.D.3.
183 1989 Form 610, Article VII.D.3.
184 Id.
185 Article VII.C.
186 1982 Form 610 Article VII.C.; 1989 Form 610, Article VII.C.

G. Collection of Defaulting Party's Share from Other Working Interest Owners

If there are more working interest owners than just the operator and one non-operator, the operator can look to the non-defaulting working interest owners to cover the shortfall created by a default. Upon demand, the other working interest owners must pay what the defaulting party owes. In the 1989 Form 610, Article VII.B. provides:

> If any party fails to pay its share of cost within one hundred twenty (120) days after rendition of a statement therefor by Operator, the non-defaulting parties, including Operator, shall upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. The amount paid by each party so paying its share of the unpaid amount shall be secured by the liens and security rights described in Article VII.B., and each paying party may independently pursue any remedy available hereunder or otherwise.[187]

This provision remains unchanged in the 2015 Form 610, and the 1982 Form 610 has similar language.[188] The offshore forms also provide this remedy.[189] By exercising this remedy, the operator is only out its own proportionate share of the defaulting party's percentage of the costs. This remedy should be used in conjunction with the remedy of a suit for damages.

H. Suit for Damages

The operator also has the option of filing a suit for damages. If a remedy such as seizure of production does not make the operator whole, the operator can sue the defaulting party. Similarly, in the event that the operator is concerned deeming the defaulting party to be non-consent will not result in a satisfactory outcome, the operator can forego the deemed non-consent option and file suit. The operator can file this suit on behalf of all non-defaulting working interest owners and at joint account expense. This remedy is authorized by Article VII.D.2. of the 1989 Form 610:

> Non-defaulting parties or Operator for the benefit of non-defaulting parties may sue (at joint account expense) to collect the amounts in default, plus interest accruing on the amounts recovered from the date of default until the date of collection at the rate specified in Exhibit "C" attached hereto. Nothing herein shall prevent any party from suing any defaulting party to collect consequential damages accruing to such party as a result of the default.[190]

This same provision appears in the 2015 Form 610[191]. If the operator calls upon the other working interest owners to pay their proportionate shares of the default, this remedy should be invoked. The operator can file suit while the 120-day period provided for by Article VII.B is

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[187] 1989 Form 610, Article VII.B.
[188] 2015 Form 610, Article VII.B.; 1982 Form 610, Article VII.B.
[189] 2002 Form 710, Ex. I, Article 8.6.3; 2007 Form 810, Ex. F, Article 6.3.d; 2015 Form 810, Ex. F, Article 6.3.d.
[190] 1989 Form 610, Article VII.D.2.
[191] 2015 Form 610, Article VII.D.2.

running. The operator can collect the shortfall from the non-defaulting parties at the end of that 120-day period, which should be just around the time the operator will be in a position to file a motion for default judgment or motion for summary judgment in the lawsuit against the defaulting non-operator. The same remedy and approach are available under the offshore forms.[192]

I. Sue Defaulting Party's Predecessor

How long a party is liable for obligations under an operating agreement can result in disputes. When a successor in title to a working interest owner defaults on a financial obligation, frequently the end of economic life plugging, abandonment, and decommissioning operations, the other parties try to hold the assignor liable for the defaulting party's share of the costs.

Courts have been willing to hold former working interest owners responsible for expenses even after the owner has assigned its working interest. In both *Seagull Energy E&P, Inc. v. Eland Energy, Inc.*[193], and *Chieftain International (U.S.), Inc. v. Southeast Offshore, Inc.*[194] the courts upheld trial court judgments against former working interest owners.

In *Seagull Energy*, Eland acquired an interest in two of Seagull's offshore leases.[195] Eland later sold its interest to a third party, assigning its rights and obligations under the operating agreement as well.[196] When the third party did not compensate Seagull for operating costs, Seagull attempted to recover these costs from Eland.[197] Eland contended that since it no longer owned the working interest, it was not obligated to pay any operating expenses.[198] The trial court ruled in Seagull's favor, but the court of appeals reversed.[199] The Texas Supreme Court reversed the decision by the court of appeals and affirmed the trial court's judgment.[200] The court held that Eland's assignment of its interest did not release it from its obligations under the operating agreement.[201]

Similarly, in *Chieftain International*, Southeast owned working interests leases operated by Hunt.[202] Southeast assigned its interests to an affiliate.[203] At the time of the assignment, Southeast owed Hunt for operating expenses. The affiliate assumed Southeast's rights and responsibilities under the operating agreement but did not pay any past or present costs.[204] Six months after the assignment, Hunt and the other owners agreed to abandon the leases. Neither Southeast nor the affiliate paid its share of the abandonment costs.[205] Hunt filed suit, and the

[192] 2002 Form 710, Ex. I, Article 8.6.3; 2007 Form 810, Ex. F, Article 6.3.d; 2015 Form 810, Ex. F, Article 6.3.d.
[193] 207 S.W.3d 342 (Tex. 2006).
[194] 553 F.3d 817 (5th Cir. 2008),
[195] 207 S.W.3d at 344.
[196] *Id.*
[197] *Id.*
[198] *Id.*
[199] *Id.*
[200] *Id* at 347.
[201] *Id.*
[202] 553 F.3d at 818.
[203] *Id.*
[204] *Id.*
[205] *Id.*

trial court granted summary judgment against Southeast. On appeal, Southeast argued that, because it had assigned the interests, it was not obligated to pay the associated expenses.[206] As the Texas Supreme Court did in *Seagull Energy*, the Fifth Circuit ruled that the assignment of the working interests did not act as a release of Southeast's obligations under the operating agreement.[207]

The rulings were similar in *LLOG Exploration Offshore, LLC v. Newfield Exploration Co*.[208] and *GOM Shelf, LLC v. Sun Operating L.P*.[209] In both cases, the party that paid all of the costs of decommissioning offshore wells and platforms sought to hold a defaulting party's predecessor in interest responsible for part of the decommissioning costs.[210] In both cases, the trial courts held the predecessors in title responsible for the defaulting parties' proportionate share of the costs.[211]

Although both *Chieftain* and *Seagull* involved offshore operations, this concept has been addressed in the context of onshore operations.[212] A working interest owner subject to one of the current form operating agreements should seek a release from the other working interest owners when assigning a working interest.

The 2015 Form 610 expressly prohibits the practice of suing the predecessor in interest. Article VIII.D. provides that an assignment is effective 30 days after the operator is provided with the assignment. Once the 30-day period ends, the assignor will not be liable for expenses occurring after the end of the 30-day period[213]. The 2015 Form 810 also changes the circumstances under which an assignor can be held liable for the transferee's default.[214]

VII. OTHER AREAS OF DISPUTE

A. Preferential Rights

The application of a preferential right to purchase clause may also lead to conflicts between working interest owners. In Form 610, the preferential rights clause appears in Section VIII.F.[215] Offshore Form 810's preferential right is in Article 24.2 and Form 710's preferential right is in 262. Disputes may arise as to when the clause is triggered, what properties are subject to the preferential rights, the propriety of the seller's notice to the other parties, what the other parties must do when they receive notice of a proposed sale, and the rights of third-parties who buy interests subject to a preferential rights clause.

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[206] *Id* at 818-819.
[207] *Id* at 819-820.
[208] Civil Action No. 15-1746, 2016 U.S. Dist. LEXIS 2240 (E.D. La. January 8, 2016).
[209] Case No. 4:06-cv-3444, 2008 U.S. Dist. LEXIS 25636 (S.D. Tex. March 31, 2008).
[210] *LLOG Exploration* at *2; *GOM Shelf* at *12.
[211] *LLOG Exploration* at *17-19; *GOM Shelf* at *30.
[212] *Indian Oil Co. v. Bishop Petroleum Inc.*, 406 S.W.3d 644 (Tex. App.—Houston [14th Dist.] 2013, pet. denied).
[213] 2015 Form 610, Article VIII.D.
[214] 2015 Form 810, Article 24.1.
[215] 1982 Form 610, 1989 Form 610, and 2015 Form 610, Article VIII.F.

The exercise of the preferential right to purchase also resulted in a dispute in *MRC Permian Co. v. Three Rivers Operating Co*.[216] Three Rivers notified MRC that it intended to sell its working interest in jointly owned properties to a third-party.[217] There were ten properties in the contract area of the operating agreement and subject to the preferential right.[218] MRC only owned interests in five of those properties.[219] In its initial notice letter, Three Rivers only listed the five properties in which MRC owned an interest.[220] MRC responded affirmatively to this letter and checked the box stating its election to purchase Three Rivers' interest in those properties.[221] Three Rivers later sent a second letter listing all ten properties.[222] MRC responded with a letter stating it was prepared to exercise the preferential right as stated in its prior acceptance and questioning the inclusion of the five additional properties.[223] Importantly, MRC did not check either box on this letter as to whether it elected to purchase the properties.[224] Three Rivers removed all ten properties from its sale to the third party and then demanded that MRC purchase all ten properties.[225] MRC filed suit, and Three Rivers countersued.[226] The parties filed competing motions for summary judgment.[227] The trial court ruled that the parties had a contract for the sale of all ten properties and granted summary judgment for Three Rivers.[228] MRC appealed.

The court of appeals reversed the trial court's decision.[229] The appellate court found that when MRC agreed to purchase the five properties listed in Three Rivers' first letter, it did not make a counteroffer by sending a letter stating it wanted to purchase all of Three Rivers' interests that MRC was entitled to buy under the operating agreement.[230] At the time of its first letter, MRC did not have knowledge that the other five properties were part of the proposed sale.[231] Therefore, MRC sending its first letter and checking the election box on the notice letter was an acceptance of Three Rivers' offer to sell the first five properties.[232] MRC's response to Three Rivers' second letter was not a clear and positive acceptance of an offer on all ten properties, so no contract had been formed for the ten properties.[233] The court of appeals rendered judgment for MRC and ruled that there was an enforceable contract for the sale of the first five properties.[234] This case highlights the importance of precision in giving notice of and acceptance of a preferential right to purchase.

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[216] 2015 Tex. App. LEXIS 8203 (Tex. App.—Dallas 2015, pet. filed).The Texas Supreme Court requested the parties submit briefing on the merits. The petition for review was denied after those briefs were submitted.
[217] *Id* at *6.
[218] *Id* at *2-5
[219] *Id* at *6-7
[220] *Id.*
[221] *Id* at *8-11.
[222] *Id* at *11-14.
[223] *Id* at *14-16.
[224] *Id* at *16.
[225] *Id.*
[226] *Id.*
[227] *Id* at *17.
[228] *Id* at *17-18.
[229] *Id* at *46.
[230] *Id* at *32.
[231] *Id* at *38-39.
[232] *Id.*
[233] Id at *40-41.
[234] *Id* at *32.

B. Applicability of the Joint Operating Agreement

In some cases, disputes arise over whether the joint operating agreement even applies to a party. The courts frequently resolve this issue by refusing to allow a party to take advantage of the operating agreement and then disavow its applicability when another party sues for breach of the operating agreement.

A dispute over the applicability of the operating agreement was an in issue in the court of appeals' opinion in *Reeder v. Wood County Energy, LLC*[235] The non-operating working interest owners in a unit prevailed on their breach of contract claims against Reeder, and he appealed[236]. Reeder alleged that the operating agreement did not apply to him[237]. The court of appeals first pointed out that the operating agreement, which had been executed by Reeder's predecessor in interest, provided that it would bind the successors in interest of the parties[238]. Citing *Stable Energy, L.P. v.* Newberry[239]the court also held that Reeder had ratified the operating agreement and was estopped from denying he was bound by it[240]. In a prior lawsuit, Reeder contended he was the operator. He sent out letters identifying himself as the operator, and he exercised the duties and authority granted to the operator by the operating agreement. Reeder's words and deeds constituted a ratification of the operating agreement and estopped him from claiming it did not apply to him. Therefore, the court affirmed the trial court's judgment on the breach of contract claims against Reeder.

C. Area of Mutual Interest

When the parties include an Area of Mutual Interest (AMI) in their operating agreement, they introduce another potential source of conflict. These disputes usually involve questions of what area and what interests are covered by the AMI.

Whether an AMI required a party to offer an overriding royalty interest to the other working interest owner was addressed in *XH, LLC v. Cabot Oil & Gas Corp.*[241] The parties had a purchase agreement that provided "all leases" subsequently acquired by the parties would be subject to an AMI.[242] The parties' operating agreement also included an AMI that covered "any oil and/or gas interest (which shall be deemed to include royalties, mineral interests, and other payments out of production) or oil and gas leases or other contract rights . . . ."[243] When Cabot acquired overriding royalties, XH asserted it was entitled to participate in the acquisition.[244] Cabot filed a suit for declaratory judgment, and XH countersued. The trial court granted summary judgment to Cabot. On appeal, the appellate court observed that the AMI provisions in

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[235] 320 S.W.3d 433 (Tex. App.—Tyler 2010), rev'd on other grounds, 395 S.W.3d 789 (Tex. 2012)
[236] *Id* at 440-441.
[237] *Id* at 442.
[238] *Id* at 442-443.
[239] 999 S.W.2d 538 (Tex. App. –Austin 1999, pet. denied).
[240] *Id*, at 443.
[241] 2014 Tex. App. LEXIS 5815 (Tex. App.—Tyler 2014, no pet.)
[242] *Id* at *4.
[243] *Id* at *14-15.
[244] *Id* at *4-5.

the purchase agreement and the operating agreement were in conflict and could not be harmonized.[245] The AMI in the purchase agreement covered just leases, and the AMI in the operating agreement covered all oil & gas interests.[246] The operating agreement provided that the purchase agreement would control in the event of a conflict between the terms of the operating agreement and the purchase agreement.[247] Based on this conflicts language, the court of appeals held that the AMI in the purchase agreement, which only covered leases, controlled.[248] Therefore, Cabot had no obligation to offer the overriding royalty interests to XH and the trial court's decision was affirmed.

In *Anderson Energy Corp. v. Dominion Okla. Tex. Exploration & Prod*.[249], Dominion argued it had no duty to offer numerous interests it had acquired within a contract area to Anderson. Dominion had acquired lease, mineral, and fee interests in the AMI and drilled over 100 wells on those interests.[250] Anderson brought suit, and Dominion defended by stating that the contract area of the operating agreement was limited to the interests owned by the parties at the time of the execution of the operating agreement.[251] The trial court sided with Dominion and entered summary judgment. On appeal, Anderson attacked the trial court's finding that the contract area was limited to properties owned at the time of the execution of the operating agreement. Reading the operating agreement as a whole, including the existence of an AMI in the agreement, the court of appeals reversed and found that the contract area included subsequently acquired interests.[252] Therefore, Dominion had the duty to offer interests it acquired in the AMI during the term of the operating agreement.[253]

VIII. ALTERNATIVE DISPUTE RESOLUTION

Given their technical aspects, specialized area of law, and business nature, disputes between operators and non-operators are good candidates for arbitration. Parties to an operating agreement may decide to include an arbitration clause in their agreement. Whether they should do so is subject to an ongoing debate. If an arbitration clause is included, there may be arguments about the applicability and operation of arbitration clauses.

If a dispute is properly the subject of arbitration, the courts will enforce the arbitration clause by compelling arbitration. The failure to compel arbitration by a trial court can be corrected through an appeal to the court of appeals. The opposite – improperly requiring arbitration – is not subject to appeal or mandamus. The lesson is that if you do not want to go to arbitration, do not include an arbitration clause in your contract.

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[245] *Id* at *16-17.
[246] *Id.*
[247] *Id.*
[248] *Id*.
[249] 469 S.W.3d 280.
[250] *Id* at 285.
[251] *Id* at 286.
[252] *Id* at 292.
[253] *Id.*

If parties included an arbitration provision in their contract and have a dispute that is subject to the arbitration clause, a party can compel arbitration.[254] An order denying an application to compel arbitration is subject to an immediate interlocutory appeal.[255] Thus, if a party is improperly denied arbitration, it has an immediate remedy in the courts of appeals.

However, the party in the opposite position, having been improperly ordered to participate in arbitration, does not have an immediate appellate remedy. The statute does not provide for an appeal of an order compelling arbitration. The Texas Supreme Court has held that an order compelling arbitration is not subject to a mandamus proceeding.

In re Gulf Exploration, LLC,[256] involved an arbitration clause added by the parties to the 1989 Form 610. Great Western and others were parties to an operating agreement. The parties included an area of mutual interest, a confidentiality clause, and an arbitration provision in the operating agreement. Great Western acquired leases on properties adjacent to, but not included in, the AMI. The working interest owners filed an arbitration demand against Great Western alleging that Great Western should have allowed them to participate in the adjacent acreage. When Great Western filed a declaratory judgment action against the working interest owners, the defendants filed a motion to compel arbitration. The trial court granted the motion, stayed Great Western's lawsuit, and ordered the parties to arbitration. Great Western sought mandamus from the court of appeals. The court of appeals conditionally granted the writ of mandamus ordering the trial court to vacate its order compelling arbitration. The working interest owners took the case to the Texas Supreme Court, which overruled the Court of Appeals' decision. The Supreme Court did not address the issue of whether the parties' dispute was within the scope of the arbitration provision. Rather, the court decided the case on the question of whether mandamus was available to review an order compelling arbitration. Mandamus is not proper if the party seeking mandamus has an adequate remedy on appeal. The Texas Supreme Court held that a party improperly ordered to arbitrate a dispute has an adequate remedy on appeal. The court agreed that an incorrect order compelling arbitration may result in wasted time and money. However, delay and expense generally do not make the party's remedy on appeal inadequate. The court noted that arbitration clauses are usually contractual and prevailing parties in a breach of contract case can recover their attorneys' fees and expenses, including the fees incurred in collateral proceedings such as arbitrations. Consequently, an appeal is an adequate remedy for a party that has been wrongly ordered to arbitrate a dispute. Thus, the party being ordered to arbitration, even if the order was improper, cannot seek mandamus.

IX. AVOIDING DISPUTES

Many disputes could be avoided through proper completion of the transaction. Problems may arise after closing if one party is not properly represented in the underlying transaction. If a party is unrepresented, represented by counsel who is not knowledgeable in oil and gas transactions, or is represented by an attorney who is acting as an intermediary, the party may not get the proper advice and assistance. Disputes may also arise when form agreements are not

[254] Tex. Civ. Prac. & Rem. Code § 171.021.
[255] Tex. Civ. Prac. & Rem. Code § 171.098(a)(1); *McReynolds v. Elston*, 222 S.W.3d 731 (Tex. App.—Houston [14th Dist.] 2007, no pet.).
[256] 289 S.W.3d 836 (Tex. 2009) (orig. proceeding) (Brister, J.).

properly completed. Blanks that are not filled in or unchecked boxes for alternate provisions could lead to ambiguities or unintended consequences. If the parties simultaneously execute more than one agreement, such as an exploration agreement and a joint operating agreement, conflicting provisions can create disputes.

Anderson Energy Corp. v. Dominion Okla. Tex. Exploration & Prod., [257] discussed above, offers a lesson in making sure all of the boxes are checked when using a form operating agreement. Dominion's second defense to Anderson's claim that interests acquired by Dominion should have been offered to Anderson was that the operating agreement was terminable at will.[258] The trial court agreed with Dominion.[259] The court of appeals reversed the trial court's determination that the agreement was terminable at will, but held that it was effective for a reasonable time.[260] The parties had used the 1977 AAPL Form.[261] In Article XIII, the original parties failed to check either of the two options for the term of the agreement, which were 1) the continuation of any lease, or 2) the continuation of production.[262] The court of appeals found that, in order to give effect to the purpose of the operating agreement, including the AMI and the preferential right to purchase, a reasonable term had to be implied.[263] The court remanded the case to the trial court for a determination of what constituted a "reasonable" term.[264] It would appear that the question of whether the operating agreement was terminable at will or only lasted for a reasonable term would have been avoided had the parties checked one of the options in Article XIII of the form operating agreement.

Many disputes can be avoided with the following safeguards:

- Proper representation of both sides by an attorney knowledgeable in oil & gas transactions and free of conflicts of interest. Texas Disciplinary Rule of Professional Conduct 1.01(a) prohibits lawyers from accepting employment on a matter that the lawyer knows or should know is beyond the lawyer's competence. Rule 1.06 and Rule 1.09 prohibits representation of a party in a transaction that is the same or a substantially related to a matter in which the client's interests are adverse to a past or present client of the lawyer or the lawyer's firm. Rule 1.07 Puts strict limits on lawyers acting as intermediaries between clients. Compare with Rule 1.06(a), which prohibits lawyers from representing opposing parties in the same litigation.

- Fill in all blanks and make all available elections.

- Check agreements for internal inconsistencies or conflicts between simultaneously executed agreements.

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[257] 469 S.W.3d 280.
[258] *Id* at 292-293.
[259] *Id.*
[260] *Id* at 294.
[261] *Id* at 288.
[262] *Id* at 292.
[263] *Id* at 293-294.
[264] *Id* at 294.

X. CONCLUSION

As long as there are operators and non-operators they will get into disputes. These disputes can result from numerous issues. Such disputes frequently lead to contentious litigation involving requests for injunctive relief, actual damages, exemplary damages, and attorneys' fees. Many disputes can be avoided at the contract drafting and execution phase. Hopefully, this paper has provided counsel with tools to use in addressing these issues.

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