

# DISPUTES BETWEEN OPERATORS AND NON-OPERATORS

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# SOURCES OF DISPUTES

- ▶ Operator's Standard of Conduct
- ▶ Fiduciary Duty
- ▶ Custody of Funds and Property
- ▶ Preferential Rights
- ▶ Maintenance of Uniform Interest
- ▶ Applicability of the JOA
- ▶ Area of Mutual Interest
- ▶ How Long Do Obligations Under the JOA Last

# ANOTHER ISSUE FOR ANOTHER DAY

- ▶ When a non-operator fails to pay its share of expenses, what are the operator's remedies?
- ▶ This issue would require an additional hour to address, so it is not covered in this presentation.

# WHAT ABOUT THE 2015 FORM?

- ▶ We are still waiting for the 2015 Form 610 Operating Agreement to be released.
- ▶ Where we know that the 2015 Form will differ from the 1989 Form, that will be noted in this presentation.

# OPERATOR'S STANDARD OF CONDUCT

It shall conduct all such operations 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.

AAPL 1982 Form, Section V.A.

# OPERATOR'S STANDARD OF CONDUCT

# Operator shall conduct all such operations 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, but in no event it shall it have ~~no~~ 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.

AAPL 1989 Form, Section V.A. (compared to AAPL 1982 Form, Section V.A).

# OPERATOR'S STANDARD OF CONDUCT

Leading Cases (pre *Reeder v. Wood County Energy, LLC*):

- ▶ Exculpatory clause did not apply to claims for breach of the operating agreement and improper charges to the joint account. *Abraxas Petroleum Corp. v. Hornburg*, 20 S.W.3d 741 (Tex. App.—El Paso 2000, no pet.), and *Cone v. Fagdau Energy Corp.*, 68 S.W.3d 147 (Tex. App.—Eastland 2001, pet. denied).
- ▶ Exculpatory clause did apply to claim that operator failed to properly deepen a well. *IP Petroleum Co., Inc. v. Wevanco Energy, L.L.C.*, 116 S.W.3d 888 (Tex. App.—Houston [1<sup>st</sup> Dist.] 2003, pet. denied).

# OPERATOR'S STANDARD OF CONDUCT

*Reeder v. Wood County Energy, LLC*, 395 S.W.3d 789 (Tex. 2013)

- ▶ Conversion, Violations of Theft Liability Act, Breach of Contract
- ▶ Exculpatory Clause Did Apply
- ▶ AAPL 1989 Form, Not AAPL 1982 Form

The AAPL 2015 Form 610 Operating Agreement will address this ruling.



# OPERATOR DOES NOT HAVE A FIDUCIARY DUTY . . .

*MDU Barnett Ltd. v. Chesapeake Exploration Ltd.*, 2014 U.S. Dist. LEXIS 18769 (S. D. Tex. 2014)

- ▶ AAPL 1982 Form
- ▶ Plaintiff Asserted Tort and Contract Causes of Action Relating to Exploration and Development Agreement and Operating Agreement
- ▶ Court Granted Motion to Dismiss Fiduciary Duty Claim, Because No Fiduciary Duty Under JOA

# . . . UNLESS THE PARTIES FORMED A JOINT VENTURE

*Dernick Res. Inc. v. Wilstein*, 312 S.W.3d 864 (Tex. App.—Houston [1<sup>st</sup> Dist.] 2009, no pet.), and *Dernick Res. Inc. v. Wilstein*, 471 S.W.3d 468 (Tex. App.—Houston [1<sup>st</sup> Dist.] 2015, pet. filed).

- ▶ Joint Venture Agreement and Operating Agreement
- ▶ First Opinion: Fiduciary Duty Created by Joint Venture Agreement
- ▶ Second Opinion: Upheld Forfeiture of Overhead Fees Paid by Non-Operator to Operator as Penalty for Breach of Fiduciary Duty

**WE ARE GOING  
TO FORM A JOINT  
VENTURE WITH...**

**NO!**



# CUSTODY OF FUNDS AND PROPERTY

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 such funds shall remain the funds of the Non-Operators 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. **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 specifically provided.**

AAPL 1989 Form, Section V.D.4. (emphasis added).

# CUSTODY OF FUNDS AND PROPERTY

*Cass v. Stephens*, 156 S.W.3d 38 (Tex. App.—El Paso 2004, pet. denied)

- ▶ Operator Billed Joint Account for Services Never Provided and for Equipment Already Owned by Joint Account
- ▶ Operator Moved Jointly Owned Equipment to Wells Owned Entirely by Operator
- ▶ Judgment for Fraud and Conversion, Including Exemplary Damages, Upheld on Appeal

# REMOVAL OF PUNITIVE DAMAGE CAP

- ▶ Exemplary Damages: the greater of 1) two times the amount of economic damages plus an amount equal to the noneconomic damages, or 2) \$200,000. Tex. Civ. Prac. & Rem. Code § 41.008(b).
- ▶ If the amount involved makes the crime a felony, then misapplication of fiduciary property, forgery, commercial bribery, theft, and securing execution of a document by deception remove this cap. Tex. Civ. Prac. & Rem. Code § 41.008(c).
- ▶ Make allegation of crime as a cap buster in pleadings.

# PREFERENTIAL RIGHTS

Party exercising preferential right to purchase is not required to purchase assets that are outside of the contract area or the scope of the operating agreement. *Navasota Resources, LP v. First Source Texas, Inc.*, 249 S.W.3d 526 (Tex. App. —Waco 2008, pet. denied).

Parties should take care to be precise in providing notice of a transaction covered by the preferential right and in exercising the preferential right. *MRC Permian Co. v. Three Rivers Operating Co.*, 2015 Tex. App. LEXIS 8203 (Tex. App.—Dallas 2015, pet. filed).

# MAINTENANCE OF UNIFORM INTEREST

*ExxonMobil Corp v. Valence Operating Co.*, 174 S.W.3d 303  
(Tex. App.-Houston [1<sup>st</sup> District] 2005, pet. denied)

- ▶ Exxon Executed Farmout of Interest in Only One Formation
- ▶ Court Ruled MOI Clause Applied
- ▶ Damages Awarded to Valence



# APPLICABILITY OF JOA

- ▶ JOA Can Apply to a Party that Did Not Sign It
- ▶ Cannot Act Under JOA or Take Advantage of It and then Deny It Applies
- ▶ *Stable Energy, L.P. v. Newberry*, 999 S.W.2d 538 (Tex. App. – Austin 1999, pet. denied)
- ▶ *Reeder v. Wood County Energy, LLC*, 320 S.W.3d 433 (Tex. App.—Tyler 2010)

# AREA OF MUTUAL INTEREST

Conflicting AMI provisions in purchase agreement and operating agreement can cause confusion. *XH, LLC v. Cabot Oil & Gas Corp.*, 2014 Tex. App. LEXIS 5815 (Tex. App.—Tyler 2014, no pet.)

Court considered existence of AMI in deciding that contract area was not limited to what the parties owned at execution. *Anderson Energy Corp. v. Dominion Okla Tex. Exploration & Prod.*, 469 S.W.3d 280 (Tex. App.—San Antonio 2015, no pet.)

# HOW LONG DO OBLIGATIONS UNDER THE JOA LAST?

A party can still be liable under the JOA after assigning its interest in the contract area to a third party. *Seagull Energy E&P, Inc. v. Eland Energy, Inc.*, 207 S.W.3d 342 (Tex. 2006), and *Chieftain International (U.S.), Inc. v. Southeast Offshore, Inc.*, 553 F.3d 817 (5<sup>th</sup> Cir. 2008).

The 2015 AAPL Form 610 Operating Agreement will explicitly provide that the assigning party is no longer liable after the assignment.

# HOW LONG DO OBLIGATIONS UNDER THE JOA LAST?

When the parties failed to check a box to elect the term of the JOA, it is not terminable at will. It will have a “reasonable” term. *Anderson Energy Corp. v. Dominion Okla Tex. Exploration & Prod.*, 469 S.W.3d 280 (Tex. App.—San Antonio 2015, no pet.)

The result in this case is an example of the problems caused by the failure to check an option in a form.

# REMOVAL OF OPERATOR

- ▶ Procedure
- ▶ Grounds for Removal
- ▶ Conflicting Agreements

# REMOVAL OF OPERATOR

Operator may be removed if it fails or refuses to carry out its duties hereunder, or becomes insolvent, bankrupt or is placed in receivership, by the affirmative vote of two (2) or more Non-Operators owning a majority interest based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of Operator.

AAPL 1982 Form, Section V.B.1

# REMOVAL OF OPERATOR

Operator may be removed if it fails or refuses to carry out its duties hereunder, or becomes insolvent, bankrupt or is placed in receivership, only for good cause by the affirmative vote of two (2) or more Non-Operators owning a majority interest based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of Operator; such vote shall not be deemed effective until a written notice has been delivered to the Operator by a Non-Operator detailing the alleged default and Operator has failed to cure the default within thirty (30) days from its receipt of the notice or, if the default concerns an operation then being conducted, within forty-eight (48) hours of its receipt of the notice. For purposes hereof, "good cause" shall mean not only gross negligence or willful misconduct but also the material breach of or inability to meet the standards of operation contained in Article V.A. or material failure or inability to perform its obligations under this agreement.

AAPL 1989 Form, Section V.B.1 (compared to AAPL 1982 Form V.B.1.)

# REMOVAL OF OPERATOR

Key differences between the two forms are that the AAPL 1989 Form:

- ▶ Requires written notice of default before the operator can be removed.
- ▶ Provides a clearer definition of when the operator can be removed.
- ▶ Only requires the vote of one non-operator, not two, to remove the operator.



# GROUNDNS FOR REMOVAL

*Tri-Star Petroleum Co. v. Tipperary Corp.*, 101 S.W.3d 583  
(Tex. App.—El Paso 2003, pet. denied)

- ▶ Improper Joint Account Charges
- ▶ Failure to Supply Information to the Working Interest Owners
- ▶ Commingling Legal Fees with Joint Account Funds
- ▶ Double Charges
- ▶ Allowing Acreage to Be Lost
- ▶ Not Meeting Volume Requirements in Gas Purchase Contracts

# GROUNDNS FOR REMOVAL

*R&R Resources Corp. v. Echelon Oil and Gas, LLC*, 2006 Tex. App. LEXIS 326 (Tex. App.—Austin 2006, no pet.)

- ▶ Holding Revenue Checks
- ▶ Not Paying Operating Expenses
- ▶ Not Billing Expenses in a Timely Manner
- ▶ Excess Charges
- ▶ Failure to Maintain and Replace Equipment

# CONFLICTING AGREEMENTS

*Inex Industries, Inc. v. Alpar Resources, Inc.*, 717 S.W.2d 685  
(Tex. App.—Amarillo 1986, no writ)

- ▶ JOA Allowed for Removal of Operator
- ▶ Purchase Agreement Provided Purchaser Would Operate
- ▶ Purchase Agreement Controls Over JOA
- ▶ Working Interest Owners Tried to Remove Purchaser as Operator
- ▶ Court Ruled Purchaser Could Not Be Removed

# INJUNCTIVE RELIEF

- ▶ Temporary Restraining Order
- ▶ Temporary Injunction
- ▶ Permanent Injunction

# TEMPORARY RESTRAINING ORDER

Tex. R. Civ. P. 680

- ▶ Imminent, Irreparable Injury and No Adequate Remedy at Law
- ▶ Injury Will Occur Before a Hearing on a Temporary Injunction Can Be Held

# TEMPORARY INJUNCTION

Operator's failure to produce minimum gas quantities, actions resulting in loss of acreage, and conduct that threatened injury to property justified temporary injunction. *Tri-Star Petroleum Co. v. Tipperary Corp.*, 101 S.W.3d 583 (Tex. App.—El Paso 2003, pet. denied).

Temporary injunction removing operator affirmed where operator caused lost or delayed revenues, billed unnecessary expenses, did not pay expenses on time, and caused damage to wells and equipment. *R&R Resources Corp. v. Echelon Oil and Gas, LLC*, 2006 Tex. App. LEXIS 326 (Tex. App.—Austin 2006, no pet.).

# PERMANENT INJUNCTION

Tex. R. Civ. P. 680

Prove:

- ▶ Prevail on the Merits
- ▶ Irreparable Injury
- ▶ No Adequate Remedy at Law

# ARBITRATION

- ▶ Arguments For and Against Arbitration
- ▶ Terms of Arbitration Provision
- ▶ Enforceability



# ARBITRATION

## Arguments For Arbitration:

- ▶ Having an Oil & Gas Dispute Decided by Someone Experienced in Oil & Gas Law and Familiar With the Industry
- ▶ Avoiding a Jury Trial
- ▶ Having More Control Over the Process
- ▶ Avoiding Scheduling Difficulties
- ▶ May be Faster
- ▶ May be Less Expensive

# ARBITRATION

## Arguments Against Arbitration:

- ▶ Limited or No Right to Appeal
- ▶ May be More Expensive
- ▶ May Not be Any Faster Than Litigation in Court
- ▶ Arbitrators Do Not Reach More “Correct” Results Than Judges and Juries
- ▶ Just Allows Another Layer of Litigation

# ARBITRATION

If the Parties Opt for Arbitration, the Arbitration Provision Should Include Certain Terms:

- ▶ The Decision of the Arbitrator is Final and Binding.
- ▶ All Claims or Disputes Relating to, Arising Under, or Connected With the Agreement Will Be Decided in Arbitration and the Issue of Whether or Not a Claim or Dispute Is Subject to Arbitration Will Be Decided by the Arbitrator.
- ▶ Who the Arbitrator or Arbitrators Will Be or How the Arbitrator or Arbitrators Will Be Selected.

# ARBITRATION

## Arbitration Terms Continued:

- ▶ The Rules or Statutes Applicable to the Arbitration.
- ▶ Choice of Law, Limitation of Remedies, and Allocation of Costs.
- ▶ Limits on Discovery, If Any.
- ▶ Whether the Arbitration Will Be Conducted Through an Alternative Dispute Resolution Organization, Such as AAA or JAMS, or Be an Ad Hoc Arbitration Administered by the Arbitrator or Arbitrators.
- ▶ If the Parties Opt for a Right to Appeal the Arbitrator's Decision, Where Available (such as in Texas), or Under the Appellate Rules of the Dispute Resolution Organization.

# ENFORCEABILITY

- ▶ Tex. Civ. Prac. & Rem. Code § 171.021 and Tex. Civ. Prac. & Rem. Code § 171.098(a)(1). Order denying arbitration is subject to interlocutory appeal, but order compelling arbitration is not subject to interlocutory appeal.
- ▶ If a party is improperly denied arbitration, it has an immediate remedy in the courts of appeals. *McReynolds v. Elston*, 222 S.W.3d 731 (Tex. App.—Houston [14<sup>th</sup> Dist.] 2007, no pet.).
- ▶ The opposite is not true. A party that is improperly compelled to arbitrate cannot seek mandamus. *In re Gulf Exploration, LLC*, 289 S.W.3d 836 (Tex. 2009) (orig. proceeding) (Brister, J.).

# HOW TO AVOID DISPUTES

- ▶ Conduct Due Diligence on the Other Party Before Signing the Contract.
- ▶ Properly Prepare and Complete Closing Documents. Make Sure All Changes Have Been Made. Fill in Blanks and Make Elections.
- ▶ Beware of Non-standard or Contradictory Forms or Agreements.
- ▶ Both Sides Should be Represented by Experienced Oil and Gas Counsel.

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