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How Does the JOA Affect Title?

FORT WORTH
APL

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JOA As A Title Doc

- **The most popular JOAs are those produced by the American Association of Professional Landmen**
  - Onshore, United States, lower 48 forms promulgated in 1956, 1977, 1982, and 1989. Then came the 1989H for horizontal drilling. Replaced by the 2015.
  - Form for the Continental Shelf (710), deepwater offshore (810), and others.
  - The RMMLF has its own forms.

Examples from the AAPL Form 610 - 2015

JOA Structure

- Exhibit A usually is based on the lease ownership at the time of the JOA's formation, it does not control lease ownership.
- The Owners are agreeing to contractually burden their ownership for the purpose of developing the minerals.
- JOA uses "contribute" 15 times
  - In sense of supplying a share or proportional part of money or property toward the prosecution of a common enterprise.
  - Is not a term of conveyance.

JOA Changes

- JOA now expressly controls operations off of the Contract Area but under the JOA. Art. III.B.:
  - Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and paid, and all equipment and materials acquired in operations ~~on the Contract Area~~ conducted under this agreement shall be owned, by the parties as their interests are set forth in Exhibit "A."
- Ownership applies to equipment and materials not leases.

The Contract Area

- 5 blank lines on the cover page.
- But, Art. II.A. says Ex. A will include a description of lands and leases and interests subject to this agreement.
  - No mention of the cover page.
  - Suggestion: use cover page description as a quick way to find the right JOA, not to control lands covered.
- Attaching maps is risky
  - Challenged based on S/F.
  - Suggestion: List lands covered by survey names and abstract numbers or section, township, and range.

Unleased Acreage in the CA

- CA defined as
  - “intended to be developed and operated for Oil and Gas purposes under this agreement”
- *Ritchie*
  - Unleased acreage or interest in CA acquired by a JOA owner not covered unless there is an AMI
- *Myself*
  - If a party to the JOA acquires an interest within the Contract Area it will be subject to the JOA even if acquired after the date the JOA was signed.

JOA Provision Affecting Title

- The Cross-Conveyance.
  - Some believe JOA creates a cross-conveyance of interests so each owner holds legal title to its Exhibit A interest in each lease described in Exhibit A. The relevant language:
  - WHEREAS, the parties to this agreement are owners of Oil and Gas Leases and/or Oil and Gas Interest in the land identified in Exhibit "A," and the parties hereto have reached an agreement to explore and develop these leases and/or Oil and Gas Interests for the production of Oil and Gas to the extent and as hereinafter provided.
  - Exhibit "A," shall include the following information:
    - (1) Description of lands subject to this agreement,

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    - (4) Percentages or fractional interests of parties to this agreement,

The JOA As A Cross-Conveyance

- **Article II.A. continued:**
  - (5) Oil and Gas Leases and/or Oil and Gas Interests subject to this agreement …. Article II.A.
  - "Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and paid, and all equipment and materials acquired in operations on the Contract Area shall be owned, by the parties as their interests are set forth in Exhibit "A." In the same manner, the parties shall also own all production of Oil and Gas from the Contract Area subject, however, to the payment of royalties and other burdens on production as described hereafter." Art. III.B.
  - But Art. III.B., lines 45-47: "Nothing contained in this Article III.B. shall be deemed an assignment or cross-assignment of interests covered hereby, and in the event two or more parties contribute to this agreement jointly owned Leases, the parties' undivided interests in said Leaseholds shall be deemed separate leasehold interests for the purposes of this agreement."

The JOA As A Cross-Conveyance

- **One Texas Case,** p. 3
  - *Gillring Oil Co. v. Hughes*, a 1981 Texas Civ. App. From Beaumont.
  - Contract Area of 401 acres, several leases.
  - Formed 320 acre Unit entirely within the Contract Area.
  - Gillring owned no interest in excluded tracts. Owned 75% of one 25 acre tract.
  - Gillring sued to distribute production based on ownership of Unit, not Exhibit A to JOA.
  - Court of Appeals
    - By executing the operating agreement, Gillring had relinquished 75% of its ownership in the 25 acres in exchange for 6.23% of each acre within the 401 acres.

The JOA As A Cross-Conveyance

- *Gillring* Case
  - JOA Language:
    - "(A)ll costs and liabilities incurred in operations under this contract shall be borne and paid, and all equipment and material acquired in operations on the Unit Area shall be owned, by the parties as their interests are given in Exhibit 'A.' All production of oil and gas from the Unit Area, subject to the payment of lessor's royalties, shall also be owned by the parties in the same manner."
  - The 1956 form lacks the following language from all subsequent AAPL Forms: "however, this shall not be deemed an assignment or cross-assignment of interests covered hereby."
  - Unlikely that a Texas court will conclude that the current AAPL Form JOA results in a cross-conveyance of interest in the Exhibit A leases.

The JOA As A Cross-Conveyance

- What if it were a cross-conveyance
  - Parties to the JOA are in privity of estate with lessor.
    - Each party liable for the performance of the covenants, express and implied, under each lease.
  - Conveyance by WIO must be as to each lease in Exhibit A instead of in the original lease.
  - Normal cotenancy rights substantially modified by the JOA.
  - Prohibition on assignment?
  - Changes the royalty burdens.
    - WIOs contributing low royalty leases lose the economic advantage.

The Deemed Lease

- Section III.A.:
  - “If any party owns an Oil and Gas Interest in the Contract Area, that Interest shall be treated for all purposes of this agreement and during the term hereof **as if** it were covered by the form of Oil and Gas Lease attached hereto as Exhibit “B,” and the owner thereof **shall be deemed** to own both royalty interest in such lease and the interest of the lessee thereunder.”

The Deemed Lease

- *Prize v. Hoskins* case, p. 5
  - ARCO contributes 25% MI
  - Other 75% covered by leases with 60 day continuous operations clauses.
  - 71 day period with no production or operations.
  - Leases terminated. JOA says continues “as long as the oil and gas leases subjected to this agreement remain … in force.”
  - Was the Deemed Lease a lease in force?

The Deemed Lease

- *Prize v. Hoskins*, cont'd.
  - Court:
    - The leases covering the 75% were the only oil and gas leases "subjected to this agreement."
    - ARCO had contributed a mineral interest.
    - Leases expired and ARCO got it MI back.
- Can you be a BFP of a deemed lease? Does lack of *cash* consideration matter?
- Can a deemed lease be surrendered or a well drilled on a deemed lease be abandoned?

The Deemed Lease

- Failure to attach a form of lease or to fill in the terms.
- If the form fails then the owner likely becomes a cotenant.
  - Can you change the Ex. A interests?
  - Retroactive?

Surrender of Interest

- If you desire to surrender a lease you own, it cannot be surrendered until it has been offered to the other parties to the JOA. If any so elect, the Owner must assign to the electing parties.
- Owner keeps existing liabilities but released from future obligations.
- Acquiring parties must pay difference between salvage value and estimated costs of salvaging, P&A, and restoration. Vice versa if deficit.

Surrender of Interest

- Non-Consent
  - Parties to JOA agree to participate in the Initial Well.
  - The parties elect whether or not to participate in subsequent operations.
    - This election process is outlined in Article VI of the JOA.
      - Each may participate or not participate in a subsequent operation.
  - Party not participating subject to a “penalty” for not consenting to such operations
    - In the form that penalty is relinquishment of interest in the well and its share of production therefrom until paid.

Surrender of Interest

- Non-Consent
  - Parties often customize non-consent penalty:
    - “sit out-fall out” (non-consent results in the permanent relinquishment of the Non-Consenting Party’s interest in the well or in the lease or in the prospect)
    - May farmout in lieu of non-consent.
    - Standard: relinquishment until the proceeds (after deducting taxes and other lease burdens) equals percentage of the costs incurred with respect to both (i) surface equipment and operating expenses, and (ii) the costs and expenses of drilling and the equipment in the well.
  - Non-consent penalty rewards parties who assume the Non-Consenting Party’s interests and reward the Consenting Parties for accepting additional risk.

Surrender of Interest

- Non-Consent
  - Not a cross-conveyance
    - "nothing more than a rearrangement of contractual rights and obligations of the partners as to specific operations within the enterprise as a whole."
      - still a party to the JOA and entitled to rights and subject to obligations.
      - Printed form does not affect lease ownership, just the production.

Other

- Where parties are co-owners the title implications are more uncertain but should be the same. Non-Consenting Party "relinquishes" its interest in the well and its related production and present ownership is vested in the Consenting Parties until the non-consent penalties have been satisfied."

Surrender of Interest

- Non-Consent
  - Conine: non-consent provision requires conveyance of the working interest during the period of relinquishment.
  - Not supported by current language.
- *Olin* case, p. 17
  - Are non-consenting parties liable for plugging obligations under RRC regs as non-operators?
  - Held -- a non-consenting party is responsible for plugging and abandoning a well, even if production from the non-consent operation has yet to recoup the non-consent penalties. Ownership of a future interest in the well was still a working interest resulting in liability for plugging even though non-consenting party was not currently bearing its working interest.
- Distinction
  - Case was about reach of RRC regs, not an interpretation of JOA. Courts tend to favor expansive reach of police powers.

Surrender of Interest

- Not a cross-conveyance -- implications
  - How much of the leasehold working interest is affected? Proration unit? No transfer of WI. Non-consents participate in future wells and future operations in non-consent wellbore.
  - Non-Consenting Party still access Contract Area, information about all operations, vote to surrender leases, vote on the removal/replacement of the Operator.
    - NOTE: 2015 JOA restricts access to information from a non-consent operation until payout or 2 years after commenced.
      - Exceptions for payout calculations.

Surrender of Interest

- Cross-conveyance not necessary to achieve the intent of the non-consent provision. Only interests re-distributed:
  - Obligation to bear costs
  - Right to production
  - Power to set objectives of the proposed operation
- Relinquishment viewed as temporary transfer of rights in production and accounting device to compensate parties drilling the well.
- Derman suggests the non-consenting party consider selling its reversionary interest to party who can assume future liabilities.

Surrender of Interest

- Failure to Pay.
  - Option to non-defaulting parties.
  - Notice to defaulting party
    - Notice of Default
    - Then Notice of non-consent election.
  - Special remedy if default is related to drilling new well or the Plugging Back, Sidetracking, Reworking, Deepening or Recompletion.
    - If party defaults in payment of such obligations, following cure period, party “conclusively deemed” to have elected not to participate in the operation and to be a Non-Consenting Party with respect thereto.
  - Retroactive election not to consent to an operation.

Surrender of Partition Right

- Cotenants have an absolute right to partition jointly owned property.
- Partition right can be waived.
- Art. VIII.E. (2015)
  - If permitted by the laws of the state or states in which the property covered hereby is located, each party hereto owning an undivided interest in the Contract Area waives any and all rights it may have to partition and have set aside to it in severalty its undivided interest therein.

Preferential Purchase Right

- Art. VIII.F. of the 2015 JOA
  - Excludes mortgages, foreclosure of mortgages, merger, re-org, total sale to 3rd party, trf to parent or sub.
  - Frequently deleted.
- What interests?
  - “all or any part of its interests under this agreement.”
  - So any interest created after contribution to JOA.
  - 2007 Dallas case (p. 9) applied to ORRI.

Preferential Purchase Right

- Package Sales (Texas)
  - Must offer to pref right holder even if part of a package.
  - Holder of right not req'd to accept other interest in the package.
  - Strict compliance with response requirements.
- CC court, p.10, -- continuously disregarding pref right may estop owners from asserting breach.
- Eastland court, p. 10 -- failure to observe when partial assignments made is not a waiver of pref right when entire interest later sold.

Preferential Purchase Right

- *Navasota v. First Source*, p. 9
  - 1989 JOA included pref right.
  - First Source parent signed LOI with CHK requiring CHI to purchase 20% of parent's stock, 1/3 of First Source's WI, and AMI covering 13 counties.
  - Notice by First Source did not include all terms; just 1/3 of WI at $700/ac and CHK pay 1/3 for ¼ for 44% of 6 Bossier wells.
  - Navasota accepted.
  - Two hours later, First Source withdrew.

Preferential Purchase Right

- First Source told Navasota it would have to pay for stock, enter into AMI, etc.
- Held
  - Texas follows rule that pref right is triggered when tract is included in a package of properties.
  - First Source could not require purchase of common stock or enter into large AMI in order to invoke.
  - When Navasota accepted First Source notice, became a binding contract.

Maintenance of Uniform Interest

- Art. VIII.D. of 2015
  - Cannot sell or encumber Leases or Interests in CA or in wells, equipment etc. unless
    - Sell entire interest, or
    - Sell undivided % of all.
- Case
  - Exxon farmed out part. Valence sued.
    - Breach caused Valence to be subject to additional expense of drilling wells in producing formations already accessible from existing wells.

Lien Provisions in the JOA

- Liabilities not joint.
  - Art. VII.A.
    - No party shall have any liability to third parties hereunder to satisfy the default of any other party in the payment of any expense or obligation hereunder.
- Reciprocal Liens Granted under Art. VII.B.
  - 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.

Lien Provisions in the JOA

- Interests covered:
  - leasehold interests, working interests, operating rights, and royalty and overriding royalty interests in the Contract Area now owned or hereafter acquired
  - Production
  - Equipment
  - Accounts, contract rights, inventory
  - General intangibles
  - All proceeds and products.
- Each party req'd to execute recording supplement and F/S
- Warranty of first lien.

Lien Provisions in the JOA

- *Mbank Abilene* case, p. 13
  - JOA lien prevailed over unrecorded D/T where bank had *Westland* notice.
  - Gave Operator priority over creditors who had received an assignment of production from debtor non-opr with respect to suspended funds.

Random Tax Acts

- Texas Comptroller issued PLR, p. 11
  - If you do not elect out of Subchapter K
    - Art. IX
  - JOA owners are subject to franchise tax.
    - Issued December 11, 2017.
  - In spite of disavowel of partnership treatment as set out in Art. VII.A.

Tax of the Living Dead

- *Seagull* case, p. 13
  - Seagull -- Operator.
  - Eland former WIO
  - Offshore lease
  - Eland assigned all interest in lease – shortly before plugging and abandonment costs were to be incurred. Eland's assignee declared bankruptcy. Operator sued. Texas Supreme Court held that JOA language on transfer not enough to release party from obligations incurred after assignment.
  - All WIOs who assign all interest in leases subject to JOA remain liable for future costs incurred unless get a specific release.

Tax of the Living Dead

- *Seagull* case.
  - No express release language.
  - But, language in last 7 lines of 1989 says transferor liable for post-transfer costs if transferor consented to such costs. Implies not liable for any liabilities to which it did not consent.
  - Need to add express release language as to future obligations incurred but preserve liability for prior obligations.

Transfer of Interest

- *Seagull v. Eland*
- The JOA at issue was a customized offshore JOA.
  - After examining various provisions, the court concluded that "Nowhere do they mention the subject of release or the consequences which are to follow the assignment of a working interest. These subjects are, however, mentioned elsewhere in the agreement…" and "The operating agreement simply does not explain the consequences of an assignment of a working interest to a third party."

Tax of the Living Dead

- *Indian Oil v. Bishop*, p. 14
  - 1989 Form; Bishop operator, Trotter WIO.
  - Trotter assigned to Indian Oil in 2002; informed operator.
  - Indian failed to pay workover AFE's in 2007.
  - Court found for Indian and distinguished Seagull because of the different language in 1989 JOA.
  - Trotter not liable for 2007 AFE.
  - Trotter liable for P&A because Trotter admitted P&A liability.

Tax of the Living Dead

- Art. VIII.D. of 2015 Tries to Fix *Seagull*.
  - Transfer relieves transferor of liability for cost and expense incurred after 30 day notice period but
  - Does not relieve liability for
    - Previously incurred operation
    - Includes approved operation in which agreed to participate
    - Transferee "jointly and severally liable" with transferor for operation in which transferor agreed to participate.
  - Open question about P&A liability.
    - BOEM leases P&A may be incurred from drilling.
    - Generally, onshore not incurred before proposed or billed.

Not Necessarily Title

- Prior JOAs
  - No way to change Exhibit A
    - Did it anyway
- 2015
  - Duty to amend imposed on Operator
  - Must seek consent of parties whose interest would change.
  - Does not consent – Opr can change anyway
    - Based on outside atty's opinion
  - Must provide changed Ex to all parties.

Not Necessarily Title

- Amending Ex. A.
  - Party that did not consent may sue.
    - Must join all affected
  - If wins, Opr must re-amend Ex. A

Royalty Burdens

Lease Burdens under the JOA.

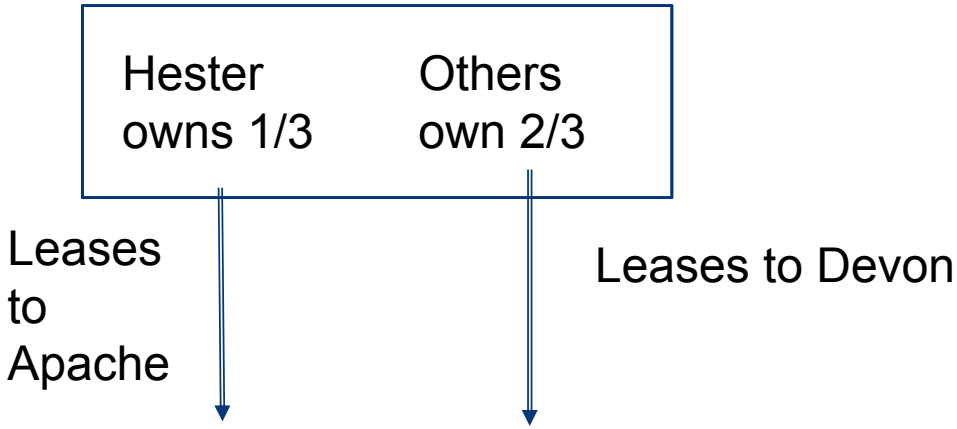
- Article III.B. Does not bind the lessor -- just allocates royalty burden under the JOA.
- 2015 JOA created two options:
  - Option 1: Requires the WIOs to deliver a share of burdens up to a [blank] percentage.
    - Burdens WIO's interest with the lowest royalty figure; distributes on a weighted average basis.
    - Party who contributed lease with excess burdens "shall assume and alone bear all such excess obligations…."
      - Allows parties to maintain benefit of higher NRI attributable to lower royalty leases.
  - Option 2: WIO must deliver all burdens on its share of production except SCI
- Exception. If drilling unit and Contract Area identical each party must pay all burdens on production from the Contract Area -- the blank is eliminated.

Royalty Burdens

- Option 1 illustrates the tract allocation approach of the *Puckett* case, p. 20.
  - Involved some lessees selling into Intrastate while other sold into Interstate.
  - Held: Plaintiff Lessors could only look to the price received by their lessee for basis of royalty payment.
- Option 2 follows a weighted average approach of the *Prickette* case, p. 20.
  - Said it was a pooled unit.
  - Distinguished *Puckett* because was a venue case and cal of royalty when 2 WIOs sold at different prices.

Devon v Apache

550 S.W.3d 259 (Tex.App. Eastland 4/30/18)



Apache drills 6 wells; pays royalty to Hester and, after recovering costs, pays 2/3 of the net to Devon.

Devon's Lessors say, "no", the Payor statute, §91.402(a) TNRC trumps cotenancy and operator of the well must pay Devon's Lessors

Court: DLs are not payees of Apache b/c A never undertook to enter into a legally binding relationship with them so DLs never legally entitled to payment from A.

Royalty Burdens

- Prior JOAs referred to the “payment of royalties” or the party’s share of “the royalty amount stipulated”.
- 2015 JOA, Art. III.B. in Option 1 refers to “burdens” and defines the burdens to include “royalty, overriding royalty, production payment or other burden on production.”
  - Some WIO must have tried to avoid a burden because it was not a royalty
  - But not aware of such a case.

Royalty Burdens

- "Subsequently Created Interests" are not counted as burdens payable by the joint account.
  - Pre-existing mortgage on contributed lease is SCI automatically.
  - SCI includes burden created after the date of the JOA and not on Ex. A.
  - SCI includes burden (ORRI, PP, NPI) if not on Ex. A and created prior to the JOA
    - But only to extent it causes the aggregate burdens to exceed what is in the blank in Art. III.B.
    - Owner can ↑↑ burdens up to amount in the blank.

Subsequently Created Interest

- Consequences of an SCI
  - Burdened party assumes all liability for SCI and indemnifies other parties.
  - SCI is subject to all of the Art. VII.B. enforcement rights (foreclosure, lien, etc.).
  - Imposition of burden on party creating SCI probably not binding on lienholder
    - Use of recording memorandum helps but only as to subsequent purchasers

Title

- Prior JOAs required title to be approved by an examiner or accepted by the parties.
  - Rare compliance.
- 2015 JOA changed the requirement so that it must be approved by the examining attorney or accepted by the Operator. Art. IV.A.
  - Copies of T/O still required to be provided to parties.
- For vertical wells, title exam of entire unit was optional.
  - For horizontals, each tract expected to be penetrated is a drillsite so, effectively, the entire unit must be examined. Art. IV.A. of the 2015 concurs.

Title

- For JOA purposes, when did title fail?
  - Either at Effective Date or during the term if appropriate. Art. IV.B.1.
- Warning:
  - Art. IV.B.1 say title fails when an interest covers a lesser interest or less lands as to aerial extent or Zones (depths) unless disclosed on Ex. A.
  - Art. IV.B.3 which says no failure for operation of an express term in a lease is a title failure starts by excluding failures under Art. IV.B.1.
  - Need to list all limits in leases in Ex. A: Pugh clauses, depth limits, etc.

Title Curative

- Party contributing leases has 90 days to cure (get new lease).
  - If successful, contributor keeps all interest.
- Contributor bears loss. Cannot charge development or operating costs to joint account
  - But no liability to other parties by reason of title failure.

Date of the JOA

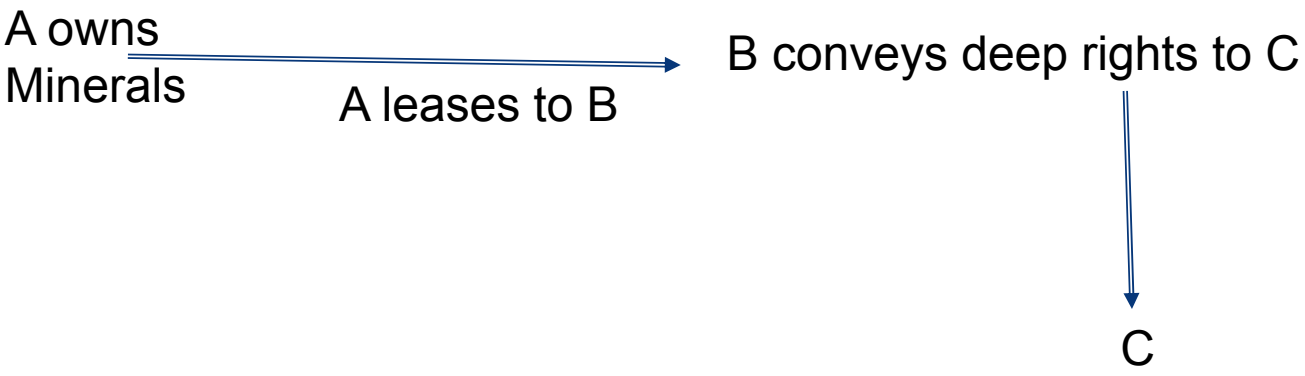
- Not a random act.
  - Failure to enter into JOA or starting operations before JOA signed can result in formation of a mining partnership.
    - Mining partnership implied by law, without written agreement, creates general partnership with joint and several liability.
  - Date on cover page and in Article XVI should be the same.
  - Signature blocks should carry a date prior to the commencement of operations.
  - Initial Well date in Article VI.A. should be after Article XVI date in order to create a binding obligation.
  - Date in Article XVI sets the date before which a lease burden will not be considered a Subsequently Created Interest in Article III.

Obviating a Pugh Clause

- *Albert v. Dunlap*, p. 31
- Lease said expire at end of primary term as to all below deepest depth drilled – a horizontal Pugh.
- Before end of primary term, Lessors and Lessees executed a pooling declaration which pooled production as to all depths covered by the leases.
- Since, at the time of execution of the declaration, all depths were covered by the lease, the Pugh clause was obviated.

Larry Long v. Miken Oil

12-13-00252-CV (Tex. App. – Tyler 2014, no writ)



B and C are NOT cotenants

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