

THE JOINT OPERATING AGREEMENT

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THE JOINT OPERATING AGREEMENT

- A JOINT OPERATING AGREEMENT (JOA) IS USUALLY ENTERED INTO AFTER PERIOD OF NEGOTIATION AMONG THE PARTICIPANTS.
 - CAN BE:
 - CO-LESSEES OF POOLED MINERAL INTERESTS.
 - INVESTORS WHO ARE PARTICIPATING IN A PROMOTED PROSPECT FOR THE FIRST TIME.
 - EXPERIENCED COMPANIES THAT HAVE DECIDED TO UNDERTAKE A HIGH RISK OR HIGH COST PROJECT JOINTLY.
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- THE PARTICIPANTS WILL MAKE SOME INITIAL DECISIONS, SUCH AS THE GEOGRAPHIC SCOPE OF THE AGREEMENT AND THE LOCATION AND DEPTH OF THE FIRST WELL, BEFORE THEY EXECUTE A FORMAL AGREEMENT.

OPERATOR AUTHORITY

The JOA grants the operator very broad authority to carry out these initial exploration and drilling decisions and to act as manager of all operations within the specified area.

- The language of article V.A. of the 1989 AAPL Form provides that the operator "shall conduct and direct and have full control of all operations on the Contract Area"
- The operator's discretionary authority is not totally unlimited; for example, the operator has no power to pool unleased mineral interests/royalties contributed to the Contract Area by non-operators unless it has express power.
- The operator is required to maintain specified types of insurance at a certain level, and some decisions require input or approval of the nonoperators.
- The operator cannot incur costs in excess of a stated maximum unless all parties consent.
- Operator cannot deepen or plug and abandon a well without consent of the nonoperators.

JOAs used in offshore and international operations, where costs and risks are high, usually go much further in requiring nonoperator approval or consent to decisions.

OPERATOR AUTHORITY

Most operating agreements give the nonoperators the right to remove the operator, but restrict this right to removal for specified reasons, such as refusal to carry out duties or bankruptcy.

- The 1989 AAPL Form authorizes removal "for good cause," which it defines as gross negligence, willful misconduct, material breach of operating standards, or material failure or inability to perform obligations.
- A majority vote of at least two nonoperators who together own a majority interest in the Contract Area, exclusive of the operator's interest, is normally required to remove the operator and to select a successor operator.
- There are many situations in which a nonoperator may conclude that he has been damaged by operator misconduct or failure to abide by the terms of the JOA.

NONOPERATOR LIABILITY FOR COSTS

Initial Drilling

- Decisions to drill an initial well or conduct additional operations are usually based upon a document called Authority for Expenditure (AFE); prepared and circulated by the operator.
- In the case of an initial well the parties examine and agree to this document, which specifies the well's location, its depth, and the time when it must be commenced, before they execute the operating agreement.
- One important aspect of the AFE is that it contains an estimate of the cost of drilling the well.
- This relates to a risk facing the parties to the operating agreement - the possibility of substantial cost overruns.

NONOPERATOR LIABILITY FOR COSTS

Additional Development

Both offshore and on-shore JOAs limit the operator's authority to commit non-operators to the costs of drilling additional wells/other major operations, such as deepening or re-working.

- Most agreements include a "nonconsent" provision that any party can invoke with respect to all operations other than those connected with the initial well.
- The parties who agree to undertake additional operations must bear the entire cost of the operation.
- The party who refuses his consent to such operations may lose all interest in the new or deeper portion of the well.
- More commonly the nonconsenting party acquires a carried interest in the operation.
- Nonconsenting party is not entitled to any share of the production from the well until the operator and other consenting parties have recouped the nonconsenting party's share of the cost several times over from the non-consenting party's share of the production.

NONOPERATOR LIABILITY FOR COSTS

Additional Development

- This type of clause has been attacked as an unenforceable penalty clause and defended as a provision for liquidated damages.
- The Texas Supreme Court has disagreed with this and pointed out that the non-consenting party is not being punished or made liable in damages for breaching a contract; for that party had the express option not to consent to additional operations.
 - The clause is a contractual mechanism for compensating the consenting parties for the risk they incur in going forward with additional operations without the participation of the non-consenting parties. *Valence Operating Co. v. Dorsett*.
- A party that exercises its non-consent option has a carried interest that does not entitle it to any current income, but it may still be subject to regulatory control and to penalties for actions of the operator.
 - A well plugging statute was held applicable to nonoperators who had gone nonconsent as to a gas well that was being reworked.

NONOPERATOR LIABILITY FOR COSTS

Liability to JOA Creditors

- The operator has the exclusive right and duty to contract for material and services for the Contract Area and is clearly liable for payment. If the operator fails to pay or become insolvent, the creditors may attempt to hold nonoperators liable.

OWNERSHIP AND MARKETING OF PRODUCTION

As a general rule, each participant in the JOA owns a share of production in accordance with its proportionate interests in the Contract Area and "shall take in kind or separately dispose of its proportionate share."

- Most controversies over marketing have arisen where a party has failed to dispose of its share of natural gas or oil.
- JOAs typically make provision for this contingency by authorizing the operator to purchase the nonoperator's share or to sell it for the account of the nonmarketing party "at the best price obtainable in the area."
- If gas is involved, the operator may also have the right to treat all undisposed production as belonging to it, in which event the operator will need to and make adjustments ("balance") at a later date.

MISCELLANEOUS PROVISIONS AND EXHIBITS

Miscellaneous Provisions, Exhibits

The JOA contains provisions dealing with a wide variety of specific subjects.

- Many provisions deal with the property interests of the participants and govern such matters as maintenance of title, liens and encumbrances, and the acquisition or transfers of interests.
- The property provision that has generated the most litigation is the preferential right of purchase.
 - This clause gives the JOA participants a preferential right to purchase the interest of any party who has offered it for sale to a third person.

MISCELLANEOUS PROVISIONS AND EXHIBITS

In addition to the variety of clauses contained in the body of the JOA, the instrument contemplates the attachment of several exhibits.

- Exhibit A identifies the Contract Area and sets out the parties' fractional ownership interests. The contents of this exhibit must, of course, be separately drafted for each operating agreement.
- Exhibit C establishes the procedure for billings, payments and charges to the parties' joint account.
- Exhibit C is usually a form instrument. The one most commonly used was promulgated by the Council of Petroleum Accountants Societies (COPAS).
- Exhibit D lists both the types and amounts of insurance the operator is required to carry.

MISCELLANEOUS PROVISIONS AND EXHIBITS

Other documents or exhibits, such as the gas balancing agreement, a statement of nondiscrimination, or a tax partnership agreement, may be attached to the JOA, depending upon the intent of the parties.

One frequent attachment is an Area of Mutual Interest Clause.

- To avoid unequal and unfair distribution of benefits generated by joint operations, most operating agreements provide that any cash or acreage received under a bottom hole, acreage contribution, or other support agreement must be distributed proportionately for the benefit of all parties.
- Provides any party acquiring an oil and gas interest within the area governed by the operating agreement or within a specified distance from its perimeter must give all other parties an option to participate on a proportional basis.

History of AAPL Form JOA

American Association of Professional Landmen (AAPL) Form 610-AAPL Form Joint Operating Agreement

- Since 1956, the AAPL has provided the domestic oil and gas industry with a standardized form of operating agreement governing the development of oil and gas properties.
- The AAPL Form was revised in 1977, 1982, 1989 and 2013 (added Horizontal Drilling).

MAIN AAPL FORM JOA PARTS

- TITLE PAGE

- TABLE OF CONTENTS

- PREAMBLE

- ARTICLES

- I. DEFINITIONS

- II. EXHIBITS

- III. INTERESTS OF PARTIES

- IV. TITLES

- V. OPERATOR

- VI. DRILLING AND DEVELOPMENT

- VII. EXPENDITURES AND LIABILITY OF PARTIES

- VIII. ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

- IX. INTERNAL REVENUE CODE ELECTION

- X. CLAIMS AND LAWSUITS

- XI. FORCE MAJEURE

- XII. NOTICES

- XIII. TERM OF AGREEMENT

- XIV. COMPLIANCE WITH LAWS AND REGULATIONS

- XV. MISCELLANEOUS

- XVI. OTHER PROVISIONS

AAPL FORM JOA STRUCTURE

AAPL FORM JOA

There are blanks to fill-in and check boxes

Also Options to choose from

AAPL FORM JOA - COVER PAGE

Date: Insert an effective date for the AAPL Form JOA, which should be same as/earlier than the date inserted in Article VI.A.

Operator: Insert proper legal name; should be consistent with operator named in Preamble and Article V.

Contract Area: Insert legal description of the lands covered by AAPL Form JOA.

AAPL FORM JOA - PREAMBLE

Properly identify the operator of the contract area by correct legal name.

“THIS AGREEMENT, entered into by and between , _____ hereinafter designated and referred to as "Operator," and the signatory party or parties other than Operator, sometimes hereinafter referred to individually as "Non-Operator," and collectively as "Non-Operators.”

AAPL FORM JOA - ARTICLE II

AAPL Form JOA Exhibits

- Eight exhibits included; check the corresponding box if applicable.
- AAPL Form JOA Exhibit A includes the following information:
 - Description of lands subject to this agreement,
 - Restrictions, if any, as to depths, formations, or substances,
 - Parties to agreement with addresses and telephone numbers for notice purposes,
 - Percentages or fractional interests of parties to this agreement,
 - Oil and Gas Leases and/or Oil and Gas Interests subject to the agreement.
 - Burdens on production.

AAPL Form JOA Exhibit B

- Form oil and gas lease.

AAPL FORM JOA - ARTICLE II

AAPL Form JOA Exhibits (cont.)

- AAPL Form JOA Exhibit C - Council of Petroleum Accountant Societies (“COPAS”) accounting procedure.
- AAPL Form JOA Exhibit D - Insurance.
- AAPL Form JOA Exhibit E - Gas balancing agreement.

AAPL FORM JOA - ARTICLE II

- AAPL Form JOA Exhibits (cont.)
 - AAPL Form JOA Exhibit F - Certification of non-discrimination and non-segregation of facilities.
 - AAPL Form JOA Exhibit G - Tax partnerships.
 - AAPL Form JOA Exhibit H – Miscellaneous exhibits.

AAPL FORM JOA - ARTICLE III

- Interests of Parties
 - Interests of Parties in Costs and Production - maximum leasehold burden amount.
 - “Regardless of which party has contributed any Oil and Gas Lease or Oil and Gas Interest on which royalty or other burdens may be payable and except as otherwise expressly provided in this agreement, each party shall pay or deliver, or cause to be paid or delivered, all burdens on its share of the production from the Contract Area up to, but not in excess of, _____...”

AAPL FORM JOA - ARTICLE VI

Operator

- Designation and Responsibilities of Operator – Same as the legal name of the operator designated on the AAPL Form JOA Cover Page and Preamble

AAPL FORM JOA - ARTICLE VI

- Drilling and Development
 - A. Initial Well - The anticipated date for commencement of operations, legal description of the exact well location and target subsurface formation (if a Horizontal Well, surface and Terminus/Termini of the Lateral(s))
 - B.2 Subsequent Operations; Operations by Less than All Parties
 - B.2(b)(i)-(ii) - Desired non-consenting party percentages.
 - “(i) _____% of each such Non-Consenting Party's share of the cost of any newly acquired surface equipment beyond the wellhead connections (including but not limited to stock tanks, separators, treaters, pumping equipment and piping), plus 100% of each such Non-Consenting Party's share of the cost of operation of the well commencing with first production and continuing until each such Non-Consenting Party's relinquished interest shall revert to it under other provisions of this Article, it being agreed that each Non-Consenting Party's share of such costs and equipment will be that interest which would have been chargeable to such Non-Consenting Party had it participated in the well from the beginning of the operations; and
 - (ii) _____% of (a) that portion of the costs and expenses of drilling, Reworking, Sidetracking, Deepening, Plugging Back, testing, Completing, and Recompleting, after deducting any cash contributions received under Article VIII.C., and of (b) that portion of the cost of newly acquired equipment in the well (to and including the wellhead connections), which would have been chargeable to such Non-Consenting Party if it had participated therein.”
 - B.2(c) - Consenting party recovery percentage for reworking, recompleting or plugging back.

AAPL FORM JOA - ARTICLE VI

- Drilling and Development
 - B.2 Subsequent Operations; Operations by Less than All Parties
 - B.2(c) - Consenting party recovery percentage for reworking, recompleting or plugging back.
 - “Any such Reworking, Recompleting or Plugging Back operation conducted during the recoupment period shall be deemed part of the cost of operation of said well and there shall be added to the sums to be recouped by the Consenting Parties ____% of that portion of the costs of the Reworking, Recompleting or Plugging Back operation which would have been chargeable to such Non- Consenting Party had it participated therein..”

AAPL FORM JOA - ARTICLE VI

- Drilling and Development

VI.B.9. – Subsequent Operations, Spudder Rigs (*new provision*)

- (a) Within Approved Horizontal Well proposals (i.e. proposals which include an approved AFE). If an approved Horizontal Well proposal provides that a Spudder Rig shall be utilized, and Operator desires to extend the proposed Horizontal Rig Move-On Period, Operator may obtain one or more extensions, each for a period of time not to exceed ___ days only [–] of not less than ___% in interest of the Consenting Parties to the drilling of the proposed well.
- (b) Not Within Approved Horizontal Well proposals. If an approved Horizontal Well proposal does not provide that a Spudder Rig may be utilized, and Operator subsequently desires to utilize a Spudder Rig, Operator may utilize a Spudder Rig upon notice to the Drilling Parties (which notice shall include a Horizontal Rig Move-On Period) and the affirmative vote of not less than ___% in interest of the Consenting Parties. Extension(s) of the Horizontal Rig Move-on Period may be requested by Operator in the same manner as provided in Article VI.B.9.(a) immediately above.

AAPL FORM JOA - ARTICLE VI

- Drilling and Development

VI.B.9. – Subsequent Operations, Spudder Rigs (*continued*)

- (c) Failure to meet Horizontal Rig Move-On Period. If a rig capable of drilling a Horizontal Well to its Total Measured Depth has not commenced operations within the Horizontal Rig Move-On Period, or any approved extension(s) thereof, unless ___% in interest of the Consenting Parties agree to abandon the operation, Operator shall re-propose the well in the manner provided in Article VI.B of this agreement. Any party which was a Non-Consenting Party to the original drilling proposal shall be entitled to a new election. Costs of the operation, incurred both before and after such re-proposal, shall be borne as follows:
 - (1) Operator shall promptly reimburse all unused funds previously advanced for the drilling of the well to each party who advanced such unused funds;
 - (2) If the well's drilling operations are subsequently resumed, all costs, whether incurred before or after the re-proposal, shall be borne by the Consenting Parties to the re-proposed well; and, the Consenting Parties shall proportionately reimburse each party who consented to the original proposal but did not consent to the re-proposal such party's share of costs incurred prior to the re-proposal; and
 - (3) If the well's drilling operations are not subsequently resumed pursuant to a reproposal as herein provided, all costs incurred prior to the re-proposal, and all costs of abandonment, shall be borne and paid by the original Consenting Parties.

AAPL FORM JOA- ARTICLE VI

- Drilling and Development (Continued)
 - C. Completion of Wells; Reworking and Plugging Back
 - VI.C.1. – Completion of Wells: Completion (Casing Point Election)
 - Option No. 1: All necessary expenditures for the drilling, Deepening or Sidetracking, testing, Completion and equipping of the Well, including tankage and/or surface facilities.
 - Option No. 2: All necessary expenditures for the drilling, Deepening or Sidetracking and testing of Vertical Wells.
 - Notwithstanding anything to the contrary, including the selection of Option 2, or anything else in this agreement, Option 1 shall apply to all Horizontal Wells.

AAPL FORM JOA- ARTICLE VI

- Drilling and Development (Continued)

- D. Other Operations

- The limit on operator's single-project budget on a single project.
 - Minimum ownership percentage for consenting parties associated with other operations.

□“Operator shall not undertake any single project reasonably estimated to require an expenditure in excess of ____Dollars (\$____) except in connection with the drilling, Sidetracking, Reworking, Deepening, Completing, Recompleting or Plugging Back of a well that has been previously authorized by or pursuant to this agreement; provided, however, that, in case of explosion, fire, flood or other sudden emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion are required to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emergency to the other parties. If Operator prepares an AFE for its own use, Operator shall furnish any Non-Operator so requesting an information copy thereof for any single project costing in excess of ____Dollars (\$____). Any party who has not relinquished its interest in a well shall have the right to propose that Operator perform repair work or undertake the installation of artificial lift equipment or ancillary production facilities such as salt water disposal wells or to conduct additional work with respect to a well drilled hereunder or other similar project (but not including the installation of gathering lines or other transportation or marketing facilities, the installation of which shall be governed by separate agreement between the parties) reasonably estimated to require an expenditure in excess of the amount first set forth above in this Article VI.D. (except in connection with an operation required to be proposed under Articles VI.B.1. or VI.C.1. Option No. 2, which shall be governed exclusively by those Articles). Operator shall deliver such proposal to all parties entitled to participate therein. If within thirty (30) days thereof Operator secures the written consent of any party or parties owning at least ____% of the interests of the parties entitled to participate in such operation, each party having the right to participate in such project shall be bound by the terms of such proposal and shall be obligated to pay its proportionate share of the costs of the proposed project as if it had consented to such project pursuant to the terms of the proposal.”

AAPL FORM JOA- ARTICLE VI

- Drilling and Development (Continued)

- F. Terminations of Operations

- Minimum consenting parties percentage for commenced operation termination.

- “Upon the commencement of an operation for the drilling, Reworking, Sidetracking, Plugging Back, Deepening, testing, Completion or plugging of a well, including but not limited to the Initial Well, such operation shall not be terminated without consent of parties bearing ___% of the costs of such operation; provided, however, that in the event granite or other practically impenetrable substance or condition in the hole is encountered which renders further operations impractical, Operator may discontinue operations and give notice of such condition in the manner provided in Article VI.B.1, and the provisions of Article VI.B. or VI.E. shall thereafter apply to such operation, as appropriate.”

AAPL FORM JOA- ARTICLE VI

- Drilling and Development (Continued)
 - G. Taking Production In-Kind
 - Select Option 1 or Option 2
 - Option 1 attaches a gas balancing agreement.
 - Option 2 states: “Each party shall take in kind or separately dispose of its proportionate share of all Oil and Gas produced from the Contract Area, exclusive of production which may be used in development and producing operations and in preparing and treating Oil and Gas for marketing purposes and production unavoidably lost. Any extra expenditures incurred in the taking in kind or separate disposition by any party of its proportionate share of the production shall be borne by such party. Any party taking its share of production in kind shall be required to pay for only its proportionate share of such part of Operator's surface facilities which it uses. “

AAPL FORM JOA- ARTICLE VIII

- Acquisition, Maintenance or Transfer of Interest

- F. Preferential Right to Purchase

- Select if is the intent of parties.

- “Should any party desire to sell all or any part of its interests under this agreement, or its rights and interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed disposition, which shall include the name and address of the prospective transferee (who must be ready, willing and able to purchase), the purchase price, a legal description sufficient to identify the property, and all other terms of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after notice is delivered, to purchase for the stated consideration on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to transfer title to its interest to its mortgagee in lieu of or pursuant to foreclosure of a mortgage of its interests, or to dispose of its interests by merger, reorganization, consolidation, or by sale of all or substantially all of its Oil and Gas assets to any party, or by transfer of its interests to a subsidiary or parent company or to a subsidiary of a parent company, or to any company in which such party owns a majority of the stock.”

AAPL FORM JOA- ARTICLE X

Claims and Lawsuits

- Operator may settle claims without approval of non-operators, up to a dollar amount set by parties.
 - “Operator may settle any single uninsured third party damage claim or suit arising from operations hereunder if the expenditure does not exceed ____ Dollars (\$____) and if the payment is in complete settlement of such claim or suit. If the amount required for settlement exceeds the above amount, the parties hereto shall assume and take over the further handling of the claim or suit, unless such authority is delegated to Operator. All costs and expenses of handling settling, or otherwise discharging such claim or suit shall be at the joint expense of the parties participating in the operation from which the claim or suit arises. If a claim is made against any party or if any party is sued on account of any matter arising from operations hereunder over which such individual has no control because of the rights given Operator by this agreement, such party shall immediately notify all other parties, and the claim or suit shall be treated as any other claim or suit involving operations hereunder.”

AAPL FORM JOA- ARTICLE XIII

Term of Agreement

- Two options:
 - Option 1 maintains AAPL Form JOA for as long as any of the oil and gas leases committed to it remain in force.
 - Option 2 terminates effectiveness of AAPL Form JOA within a specified period.
- “?” Option No. 1: So long as any of the Oil and Gas Leases subject to this agreement remain or are continued in force as to any part of the Contract Area, whether by production, extension, renewal or otherwise
- “?” Option No. 2: In the event the well described in Article VI.A., or any subsequent well drilled under any provision of this agreement, results in the Completion of a well as a well capable of production of Oil and/or Gas in paying quantities, this agreement shall continue in force so long as any such well is capable of production, and for an additional period of days thereafter; provided, however, if, prior to the expiration of such additional period, one or more of the parties hereto are engaged in drilling, Reworking, Deepening, Sidetracking, Plugging Back, testing or attempting to Complete or Re-complete a well or wells hereunder, this agreement shall continue in force until such operations have been completed and if production results therefrom, this agreement shall continue in force as provided herein. In the event the well described in Article VI.A., or any subsequent well drilled hereunder, results in a dry hole, and no other well is capable of producing Oil and/or Gas from the Contract Area, this agreement shall terminate unless drilling, Deepening, Sidetracking, Completing, Re- completing, Plugging Back or Reworking operations are commenced within days from the date of abandonment of said well. “Abandonment” for such purposes shall mean either (i) a decision by all parties not to conduct any further operations on the well or (ii) the elapse of 180 days from the conduct of any operations on the well, whichever first occurs.”

AAPL FORM JOA- ARTICLE XIV

- Compliance With Laws and Regulations
 - B. Governing Law - Insert state of governing law where majority of contract area lies.
 - “This agreement and all matters pertaining hereto, including but not limited to matters of performance, non-performance, breach, remedies, procedures, rights, duties, and interpretation or construction, shall be governed and determined by the law of the state in which the Contract Area is located. If the Contract Area is in two or more states, the law of the state of _____ shall govern.”

AAPL FORM JOA- ARTICLE XVI

- Other Provisions (Special Provisions) There may be no need for this article if everything is already covered, but it is often included and may address special matters such as:
 - Drilling and operation of horizontal wells (next)
 - Treatment of advance well cost payment
 - Escrow agreements for payment of costs
 - Specific rights against defaulting parties
 - Additional obligation well requirements
 - Additional relinquishment for non-consenting parties, priority of operations, areas of mutual interest

AAPL FORM JOA - CONCLUSION

Pay close attention to accurate completion of each section of the AAPL Form JOA

Consider additions if horizontal drilling is contemplated

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