

PRESENTED AT

2017 Fundamentals of Oil, Gas and Mineral Law

April 13, 2017
Houston, Texas

The Operator: Liability to Non-Operators, Resignation, Removal and Selection of a Successor

John S. Lowe

Author Contact Information:
Ernest E. Smith
Rex G. Baker Centennial Chair in
Natural Resources Law
University of Texas School of Law
Austin, Texas

**THE OPERATOR: LIABILITY TO NON-OPERATORS,
RESIGNATION, REMOVAL AND SELECTION OF A SUCCESSOR**

Ernest E. Smith

Rex G. Baker Centennial Chair in Natural Resources Law
University of Texas School of Law
Austin, Texas

TABLE OF CONTENTS

I.	WHAT STANDARD IS THE OPERATOR HELD TO?	2
II.	OPERATOR LIABILITY TO NON-OPERATORS	2
A.	THE LEVEL OF THE OPERATOR’S DUTY	3
1.	Agency and Joint Venture	3
2.	Variable Standards of Conduct	5
B.	SCOPE OF THE EXCULPATORY CLAUSE	5
III.	RESIGNATION AND REMOVAL OF OPERATOR AND SELECTION OF A SUCCESSOR OPERATOR	10
A.	“DEEMED RESIGNATION”	10
B.	OPERATOR REMOVAL	11
C.	ASSIGNMENT OF THE RIGHT TO OPERATE	12
D.	VOTING ISSUES	13
1.	Voting Eligibility	13
2.	Voting of Non-uniform Interests	14
E.	INJUNCTION TO REMOVE AN OPERATOR	15
IV.	CONCLUSION	16

THE OPERATOR: LIABILITY TO NON-OPERATORS, RESIGNATION, REMOVAL AND SELECTION OF A SUCCESSOR

Ernest E. Smith

Rex G. Baker Centennial Chair in Natural Resources Law
University of Texas School of Law

To a significant extent, the rapidly developing law dealing with the operator under a joint operating agreement mirrors the process that occurred with respect to oil and gas lessees.

Like the much earlier jurisprudence dealing with the oil and gas lease, the jurisprudence dealing with joint operating agreements is directed both at interpreting specific clauses of the agreement and at defining the relationship between the party charged with managing the operation and the parties whose participation in decision-making is limited.¹

Unlike early oil and gas leases, which for several decades varied enormously in their stated duration and basic terms, joint operating agreements (JOA's) have been remarkable for their relative uniformity in content and structure. Although there are numerous specially drafted agreements, virtually all JOAs currently in use are either unaltered or modified versions of the model forms promulgated by the American Association of Professional Landmen (AAPL). There have been four such forms, and they will be referred to by the dates in which they were issued: the 1956 Model Form, the 1977 Model Form, the 1982 Model Form and the 1989 Model Form. In addition, there are analogous model forms that are widely used for unit operations. The two Unit Operating Agreements (UOA) that will be discussed in this paper are the API 1970 Operating Agreement (the API UOA) and the Rocky Mountain Unit Operating Agreement Form (RMMLF UOA) that was promulgated by the Rocky Mountain Mineral Law Foundation in 1994.

Because of the relative standardization of operating agreements, concepts and holdings arrived at under one operating agreement can often be construed as applicable to all other operating agreements and, in many instances, to other jurisdictions. Such generalizations are, of course, not possible when a court is dealing with one of the clauses that differs from form to form. Unfortunately, with occasional welcome exceptions,² courts often fail to mention which form they are dealing with, although the date of the parties' agreement (if given), the date of the case or the quoted language usually allows and educated guess as to which form is being construed.

Two of the issues that have received a significant amount of attention are the standard of conduct required of the operator and – at what may be viewed as the other end of the spectrum – operator resignation or removal and the selection of a successor. Each of these topics will be discussed in turn.

¹ Ernest E. Smith, "Joint Operating Agreement Jurisprudence," 33 Washburn L. J. 834, 835 (1994).

² *E.g.*, *In re Great Western Drilling, Ltd.*, 211 S.W.3d 828 (Tex. App. -- Eastland 2006); *R & R Resources Corp. v. Echelon Oil and Gas, L.L.C.*, 2006 WL 66458 (Tex.App.-Austin, 2006).

I. WHAT STANDARD IS THE OPERATOR HELD TO?

One of the most important and, as yet unsettled issues under the JOA is the standard of conduct to which the operator is held. The literature on this issue is extensive. Even a very partial listing of papers appearing in the proceedings of the Rocky Mountain Mineral Law Foundation's annual proceedings results in a very long footnote.³

Art. V.A. of the 1989 Model Form provides the following statement:

Operator shall conduct its activities under this agreement as a reasonable 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 regulations, 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.

This is not, however, the only language bearing on the operator's standard of conduct. Art. V.II further provides that the parties do not intend to create a mining partnership, joint venture or agency relationship among themselves, and that in their relationship with each other "the parties shall not be considered fiduciaries or to have established a confidential relationship." Hence, they are "free to act on an arm's-length basis in accordance with their own respective self-interest." Nonetheless, they are subject "to the obligation . . . to act in good faith in their dealings with each other with respect to the activities" undertaken under the JOA.

One might have wished a clearer statement -- ideally, perhaps, a standard of good-faith business judgment.⁴ Since the language is far from clear, it has, unsurprisingly, given rise to extensive litigation as well as academic comment. Most of the cases discussing the standard to which the operator is held arise in litigation with non-operators, and the standard will be discussed in that context.

II. OPERATOR LIABILITY TO NON-OPERATORS

The cases involving the operator's liability to non-operators for alleged misconduct or breaches of the JOA can be divided into two general categories: In the first category are cases concerned primarily with determining the standard of conduct or level of duty that the operator

³ John R. Reeves, "Compendium of Cases Construing the Model Form Operating Agreements," 52 Rocky Mt. Min. L. Inst. 11-1 (2006); Jonathan A. Hunter & Cheryl M. Kornick, "Operator Liability in the 21st Century: Is Being in Charge Still Worth It?" 51 Rocky Mt. Min. L. Inst. 15-1 (2005); Arthur J. Wright, "Joint Operating Agreements – Common Amendments and Mistakes," 50 Rocky Mtn. Min. L.Inst. 7-1 (2004); Scott Lansdowne, "The Contractual, Fiduciary and Ethical Obligations of a Party to a Joint Operating Agreement that Owns or Operates a Facility that Serves the Joint Operations," 41 Rocky Mt. Min. L. Inst. 13-1 (1995); Ernest E. Smith, "Duties and Obligations Owed by an Operator to Non-Operators, Investors, and Other Interest Owners" 32 Rocky Mtn. Min. L.Inst. 12-1 (1986); Christopher Lane & Catherine J. Boggs, "Duties of Operator or Manager to its Joint Venturers," 29 Rocky Mtn. Min. L.Inst. 199 (1984); Frank Erisman & Elizabeth J. Dalton, "Multi-Party Ownership of Minerals – Real Property Consequences of Joint Mineral Development," 25 Rocky Mtn. Min. L.Inst. 7-1 (1979);

⁴ See generally Gary Conine, "The Prudent Operator Standard: Applications Beyond the Oil and Gas Lease," 41 Natural Res. J. 23 (2001).

Find the full text of this and thousands of other resources from leading experts in dozens of legal practice areas in the [UT Law CLE eLibrary \(utcle.org/elibrary\)](http://utcle.org/elibrary)

Title search: The Operator: Liability to Non-Operators, Resignation, Removal and Selection of a Successor

Also available as part of the eCourse

[2017 Fundamentals of Oil, Gas, and Mineral Law eConference](#)

First appeared as part of the conference materials for the
2017 Fundamentals of Oil, Gas and Mineral Law session
"The Joint Operating Agreement (JOA)"