# APACHE v. CASTEX AND THE WILLFUL MISCONDUCT STANDARD

University of Texas School of Law
**48TH ANNUAL**
**ERNEST E SMITH OIL, GAS AND MINERAL LAW INSTITUTE**
April 22, 2022

## TABLE OF CONTENTS

# Apache v. Castex and the Willful Misconduct Standard in JOA(s)

## I. INTRODUCTION: THE JOINT OPERATING AGREEMENT

The Joint Operating Agreement ("JOA" or "Operating Agreement") is the most ubiquitous industry contract delineating the rights and obligations among parties jointly engaged in the exploration and production of oil, gas and mineral resources. Given the substantial expense, complexity and risk involved in such activities, very little development occurs without a JOA, a series of JOAs, or another variety of risk and benefit allocating agreement. Oil and gas exploration and production companies ("E&Ps") and other industry participants typically allocate and manage risk and spread costs by combining together such that no individual E&P or investor bears all risks for any given project. In this way, not only can participants avoid total risk for any one project, but they can—with sufficient resources—enter into similar risk-sharing arrangements for separate and simultaneous geographically and/or geologically distinct projects. But whereas some combinations toward a joint enterprise can help to limit liability (corporations) or have potential tax advantages (partnerships), joint development of mineral interests among a diverse group makes a highly customized instrument attractive. Historically, E&Ps each crafted individual forms for managing joint projects with other companies and investors and those various forms were both expensive to develop and doomed to collide with the other participants' own forms.

In an effort to bring some uniformity and predictability to the allocation of rights and responsibilities among joint development participants, the American Association of Professional Landmen ("AAPL") developed and published the first Model form JOA in 1956: the AAPL Form 610 Model Operating Agreement. Since the original 1956 Form, the AAPL promulgated a number of revised forms including in 1977, 1982, 1989 and most recently in 2015. The various iterations of the Model Form JOA have been developed to address changing technologies and developing industry issues and legal doctrine from decades of court interpretations of the various JOA provisions. For instance, in 2013 AAPL developed a revised version of the 1989 Model Form—the 1989 Horizontal Form JOA—to address peculiarities involved in horizontal drilling not anticipated by previous model forms when horizontal drilling was much less prevalent.

Each of the various Model Form JOAs sets out the fundamental relationship among the parties from the initial combination of resources, exploration through various phases, development and production. One party is designated Operator with the sole right and responsibility (at least initially) to execute the various duties involved in drilling and producing wells for the benefit of all parties to the JOA. All other parties to the JOA are non-operating parties or "Non-Ops." Unless the Operator is a non-owner contract operator, the Operator and Non-Ops often share the benefits and burdens of joint operations in proportion to their respective interests in the working interests of the various mineral leases dedicated to the JOA. The main objectives of the JOA are to: (a) designate the relative rights and responsibilities of the Operator and Non-Ops as concerns the operations and activities to be undertaken, (b) provide mechanisms for resolving potential disagreements between some or all of the parties as to those operations and activities, and (c) allocate the costs and benefits of the operations according to the respective parties' interests.

One of the many objectives of the JOA is to avoid joint and several liability to third parties beyond the extent of a party's respective interest in the project. As to liability *among and between* the parties to the JOA for the operations and activities undertaken thereunder, the model form JOAs have attempted to carefully delineate and limit those liabilities. Since the Operator is the one party designated to conduct expensive and potentially risky operations and activities on behalf of all JOA participants, the Operator understandably wants the freedom to discharge its responsibilities without nitpicking, second guessing and Monday morning quarterbacking by the Non-Ops. Having washed their hands of the risky work of the Operator, the Non-Ops are generally willing to cede to the Operator considerable discretion while remaining wary of being exposed to unreasonable costs or risks to the joint enterprise. Consequently, from the initial 1956 AAPL Form 610, the JOA has included some incarnation or another of what is known as the "Exculpatory Clause."

## II. THE EXCULPATORY CLAUSE

The word exculpate derives from the Latin words "ex", meaning "from" and "culpa", meaning "blame." to exculpate someone is to decree that person free from blame or responsibility. The JOA exculpatory clause is designed to shield the Operator from responsibility to the Non-Ops for damages caused in the course of the Operator's performance of its duties pursuant to the terms of the JOA. The early construction of the exculpatory clause provided that:

> "_____ shall be the Operator of the Contract Area, and shall conduct and direct and have full control of all operations on the Contract Area as permitted and required by, and within the limits of, this agreement. 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 from breach of the provisions of this agreement."[1]

This initial version of the Model Form 610 appeared to differentiate potential liability for losses or liabilities incurred as a result of the Operator's performance of operations on the Unit Area as opposed some other "breach of the provisions of this agreement." The 1977 and 1982 versions of Model Form 610, included exculpatory language as follows:

> "[The Operator] 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*."[2]

Thus the 1977 and 1982 forms introduced the "willful misconduct" language in place of "from breach of the provisions of this agreement."[3] The scope of the exculpatory clause and whether it extended to more administrative actions of the Operator unrelated to actual oilfield operations was not settled and judicial interpretations were inconsistent. In 1992, the 5th Circuit Court of Appeals in a Texas diversity case held that the exculpatory language extended beyond oilfield operations and included all activities of the Operator pursuant to the JOA.

## III. INTERPRETING THE EXCULPATORY CLAUSE(S)

### A. *Stine v. Marathon Oil Co.*

Stine and Marathon were parties to a JOA containing an exculpatory provision providing that the Operator "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 as may result from gross negligence or willful misconduct."[4] The reach of the exculpatory clause became a central issue in a dispute that developed between Stine and Marathon relating to the disposition of certain wells drilled by Marathon.

Pursuant to a letter agreement between Stine and Marathon, Stine drilled three exploratory wells after which Marathon had the right to take over as operator of the wells.[5] After Marathon became operator, it drilled two additional wells, which it claimed were dry.[6] Marathon proposed to plug and abandon the wells but Stine objected and requested that they be tested for oil in shallow formations.[7] Marathon declined to test the wells and subsequently plugged and abandoned them.[8] Marathon contended that Stine could have taken over as Operator but it neglected to do so, leaving Marathon to P&A the wells pursuant to what Marathon contended was an order from the Texas Railroad Commission.[9] Stine disputed that the RRC ordered the wells plugged and characterized the alleged order as an "inquiry" for which Marathon could have obtained an extension of time.[10] Stine claimed that Marathon failed to turn these wells over to Stine in accordance with the JOA, and Stine had to drill replacement wells to test the shallow formations.[11]

For several years thereafter, Marathon continued acting as Operator of what became known as the South Branch Field and both parties drilled various wells under their letter agreement.[12] Over time, a number of additional disputes arose between Stine and Marathon. Stine complained that Marathon failed timely to complete wells in formations that later proved to be productive, that Marathon refused to share information as required by the JOA, and that Marathon tortiously interfered with Stine's gas contract with Cibolo Gas, Inc., the pipeline serving the South Branch Field.[13]

Under the terms of the JOA, Marathon had the right to take the proceeds of Stine's sale of gas to recover for unpaid operational expenses.[14] At trial, Marathon claimed that Stine owed over $600,000 for his share of drilling and operating expenses.[15] Stine admitted owing Marathon for these expenses but claimed Marathon wrongfully overcharged him and wrongly collected his proceeds from gas sales to Cibolo.[16] Although ultimately admitting that Stine was overcharged, Marathon disputed Stine's damages claims and asserted that because the JOA gave Marathon the right to take proceeds of Stine's gas sales to Cibolo, Marathon couldn't be liable for

[1] AAPL Form 610 Model form Operating Agreement - 1956
[2] AAPL Form 610 1982 Model Form Operating Agreement (emphasis added); *see also* Andrew B. Derman, *Joint Operating Agreement: Working Manual*, 2 NATURAL RESOURCES LAW SECTION MONOGRAPH SERIES 27 (1986) (discussing various provisions of 1982 form JOA).
[3] Derman, *Joint Operating Agreement: Working Manual* at 27.
[4] 976 F.2d 254, 259 (5th Cir. 1992).
[5] *Id.* at 257.
[6] *Id.*
[7] *Id.*
[8] *Id.*
[9] *Id.*
[10] *id.*
[11] *Id.*
[12] *Id.*
[13] *Id.* at 258.
[14] *Id.*
[15] *Id.*
[16] *Id.*

# Title search: Apache v. Castex and the Willful Misconduct Standard in JOA(s)



First appeared as part of the conference materials for the
48th Annual Ernest E. Smith Oil, Gas and Mineral Law Institute session
"*Apache v. Castex* and the Willful Misconduct Standard in JOA(s)"