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## Operator Removal Under the 1989 Form "Joint Operating Agreement" in Texas

In the current difficult economic climate, the number of operators having problems making timely payment to contractors for oilfield services is increasing. Litigation over whether certain exploration and production activities of an operator constitute a violation of the "good and workmanlike" standard has often ended favorably for operators. However, questions related to the *financial obligations* of an operator are different in recent case law.

### The 1989 JOA Form and Recent Litigation in Texas

Operator removal under the first three Joint Operating Agreement ("**JOA**") forms is still an uphill battle for most non-operators because the focus is on arguments related to defining what a "good and workmanlike" standard is for operator conduct. However, the 1989 JOA further refines the operator's standard of conduct and allows a non-operator to seek removal "for good cause by the affirmative vote of non-operators owning a majority interest based on ownership...after excluding the voting interest of operator." Good cause is defined to be "not only gross negligence or willful misconduct but also the material breach of or inability to meet the standards of operator contained in Article V.A. or material failure or inability to perform its obligations under this Agreement." (1989 Model Form Article V.B.1.)

The 1989 form also contains a further removal right in Article VII.D.1, whereby any party to the JOA can have its rights suspended for failure to meet *financial obligations* under the JOA—such failure is not expressly subject to any exculpatory clause. The right to suspend a party's rights under Article VII.D.1 can be exercised thirty (30) days after written notice of default. If, however, the defaulting party is the operator, the non-operators have the right by vote to appoint a new operator "effective immediately," without reference to a cure period for the operator's default.

Using two Texas cases, we have recently developed and utilized a litigation strategy to facilitate the removal of operators who fail to meet their financial obligations under the JOA. The first case, *Tri-Star Petroleum Company v. Tipperary Corporation*,<sup>1</sup> was an appeal from a temporary injunction issued by the district court in Midland, Texas, requiring Tri-Star to relinquish its status as operator and prohibiting interference with the successor operator's assumption of control while the non-operators sought a final judicial determination regarding operator removal.

Temporary injunctions require the prevailing party to show a probable right to recovery and probable injury if relief is denied. The time that the injunction is effective is important because the positions of the parties will be frozen at that time for the duration of the injunction. Injunctions are used to maintain the status quo at the last peaceable, non-contested moment in time. The court in *Tri-Star* found the last peaceable non-contested status was after the vote to replace the operator, meaning the status quo enforced by the injunction was that point after the vote where the operator had been removed by the terms of the JOA. The injunction therefore did not remove the old operator—it just made the removed operator recognize the new operator.

In rejecting the operator's defense that the gross negligence standard should apply, at least in the case of a temporary injunction for financial failures, the court removed what had been a significant hurdle in past operator removal cases—proving the operator had acted in a grossly negligent manner.

<sup>1</sup> 101 S.W.3d 583 (Tex. App. - El Paso 2003, pet. denied).

In *R & R Resources v. Echelon Oil*,<sup>2</sup> the operator appealed the grant of a temporary injunction, preventing it from opposing the designation of a new operator after being voted out for failing to meet financial obligations under Articles V.A and VII.D.1 of the 1989 JOA. The court upheld the grant of a temporary injunction, citing both *Tipperary* and the 1989 JOA for the rule that “[f]ailure to make prompt adjustments to an operating account and improperly assessed charges...have been bases for finding that an operator ‘failed or refused to carry out its duties.’”

### Operator Removal under the 1989 Joint Operating Agreement in Texas

In Texas, removal of the operator requires the new operator to provide written notification to the Texas Railroad Commission (“**RRC**”) using a P-4 form acknowledging the new operator’s responsibilities, which is also to be acknowledged by the former operator. If the former operator refuses to sign the P-4 form and the new operator wishes to officially assume operatorship in the eyes of the RRC, the new operator can file the P-4, unsigned by the former operator, along with an explanatory letter and documents showing the right to operate the property. Prior to approval of such an application, the RRC will notify the last known operator of record of its right to be heard and most likely not decide the issue, but allow the matter to be decided by judicial determination.

Based on which form of JOA is at issue and current court decisions, litigation will most likely be required to remove a current operator and resolve the dispute. A temporary restraining order or temporary injunction can be the first step. The injunctive relief sought can include both prohibiting the former operator from interfering with the successor operator’s duties and from continuing to conduct operations under the JOA, among other prohibited actions. Under certain circumstances, the temporary relief can include incidental mandatory actions on the part of the former operator, such as allowing access to records of joint operations.

After any temporary relief, the new operator can seek permanent remedies against the former operator such as:

1. A judgment declaring that the successor operator should be recognized as the operator by all parties, including the RRC, and for the removed operator to sign the P-4;
2. A permanent injunction prohibiting the former operator from interfering with the new operator’s assumption of control over operations under the JOA and prohibiting the former operator from continuing to conduct operations under the JOA;
3. A permanent injunction prohibiting the former operator from refusing to grant the new operator access to all pertinent data, records, accounts and proceeds, and well files related to the JOA or mandating delivery of those items to the new operator; and
4. An accounting for all monies received and paid by the former operator in connection with operations under the JOA.

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<sup>2</sup> No. 03-05-00479-CV, 2006 WL 66458 (Tex. App. - Austin 2006, no pet.)(unpublished opinion).