UPDATING THE AAPL MODEL FORM JOA: NEW HORIZONTAL DRILLING PROVISIONS AND MORE

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Biographical Information

Dorsey is a native Oklahoman. He attended the University of Oklahoma where in 1977 he received a B.B.A., majoring in Petroleum Land Management (PLM). Upon graduating, Dorsey began his career with Exxon Corporation where he was trained and specialized as a pooling and unitization landman. Dorsey has also held various staff and management positions with Mesa, Inc., Crawley Petroleum Corporation, Union Pacific Resources Company, The Williams Cos. and Cheyenne Petroleum Company. Dorsey is currently manager/president of UnitPro Land Consultants, LLC in Oklahoma City where he offers expert witness services for litigation involving land contracts, and he assists companies in structuring, preparing and/or negotiating their land deals and related contracts. He is an author and has given hundreds of presentations and seminars to such organizations as the American Association of Professional Landmen (AAPL), the Southwestern Legal Foundation, the Texas, Oklahoma, Kansas and Arkansas Bar Associations, and many local landmen’s associations and other industry-related organizations. Dorsey served as Chairman of the AAPL 1989 Operating Agreement Revision Committee from 1986-1989, and he has been an instructor for AAPL’s CPL Review courses since 1984 where his topics include pooling and unitization, operating agreements and well trades. He currently serves on AAPL’s JOA Task Force responsible for revising the AAPL Model Form Operating Agreement.
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INTRODUCTION

The oil and gas industry has witnessed the introduction and development of many new technologies since the first well was drilled in Pennsylvania by Col. Drake. These new technologies have included advancements in the drilling and completion of oil and gas wells, and the production therefrom. Of all of these new technologies, perhaps the greatest contribution to the industry has been the introduction of the horizontal drilling of wells, especially when combined with the new hydraulic fracking technology.

As drilling and production technologies have been introduced and developed over the years, or industry customs and practices established and accepted by a vast majority, or case law that re-defines the laws governing our contracts, so have the needs for the contracts and agreements that govern these operations to be updated to address these new technologies, customs and practices and interpretive laws. The most notable of these contracts and agreements is, without question, the AAPL Model Form Operating Agreement (hereinafter referred to as "JOA").

This paper explores the parallel between advances in horizontal drilling technology and its effects on the next step in the evolution of the JOA. A review of the new horizontal drilling language recently drafted by AAPL’s JOA Task Force is given. This paper also identifies other possible modifications that may occur in the next revision of the JOA.

HISTORY OF HORIZONTAL DRILLING

While a few may say that some form of horizontal drilling has been around since the 1920's, it wasn't until the late 1970's and 1980's that horizontal drilling began to be commercially viable. Originally, horizontal wells had to be drilled using rigs and equipment normally associated with the drilling of vertical wells. However, technology was eventually developed just for horizontal drilling, including bigger and better rigs, large diameter drill pipe, hole opening equipment, and more accurate steering methods, that have helped to substantially

1 American Association of Professional Landmen's Form 610 - Model Form Operating Agreement

2 http://www.tech-faq.com/horizontal-drilling.html

increase production from wells at very little additional cost. In the past 2-3 years, over 10,000 permits to drill horizontal wells have been applied for, with the longest known horizontal lateral being nearly seven (7) miles long. Horizontal drilling has even been used as a reason to go to war when in 1990, Iraq claimed that Kuwait’s horizontal wells were stealing oil from under Iraq’s oil fields thereby justifying Iraq's invasion of Kuwait⁴.

**HISTORY OF THE AAPL MODEL FORM JOA**

The AAPL Model Form Operating Agreement was first introduced to the oil and gas industry in 1956, one year following the birth of what is now known as the American Association of Professional Landmen ("AAPL"). At the time of its release, the 1956 JOA⁵ was considered state of the art, and enjoyed almost immediate and widespread acceptance by the oil and gas industry. The success of the 1956 JOA is attributable, in large part, to the incorporation of many of the most common provisions found in a majority of company form operating agreements that contained essential provisions, and its provisions represented common industry customs and practices.

In 1967, AAPL released alternate sets of pages 1-2 to the 1956 JOA. One alternate set of pages was used if all title losses were to be individual losses. The other alternate set of pages were used if all title losses were to be joint losses.

In June 1977, AAPL released for publication a revised 1977 Model Form JOA⁶. The 1977 JOA Revision Committee was formed primarily to address the need for the JOA to be updated to keep pace with advancements in technologies and industry practices. Among the new provisions found in the 1977 JOA are a Subsequently Created Interest provision to address leasehold burdens created after the effective date of the JOA, and an optional Casing Point Election provision that, if chosen, provided that a party who participated in the drilling of a well had the right to go non-consent on a proposed completion attempt should the operator recommend setting pipe and attempting completion in the well.

AAPL released for publication the 1982 JOA⁷ in February 1982. While many of the changes found in the 1982 JOA in formatting, several new provisions did appear including a Sidetrack provision (that also applied to Deepening operations), and an Abandonment of Non-Consent Operations provision that prohibits the plugging and abandonment of a well without the consent of all parties that participated in the drilling of the well. The 1982 JOA also provides a page 8 to be used if a Gas Balancing Agreement is to be attached to the JOA, and a page 8 alternate if there is not a Gas Balancing Agreement attached to the JOA.

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⁴ A Short History of Horizontal Drilling for Oil and Natural Gas, http://www.oilgascenter.com

⁵ AAPL Form 610 - 1956 Model Form Operating Agreement

⁶ AAPL Form 610 - 1977 Model Form Operating Agreement

⁷ AAPL Form 610 - 1982 Model Form Operating Agreement
Following the oil and gas industry's exposure to a multitude of issues surrounding the near fatal collapse of the industry in the early 1980's, AAPL once again took steps to see that the JOA adequately addressed the needs of the industry. As a result of a new JOA Revision Committee, the 1989 JOA\(^8\) was released for publication in August 1989. Some would call the 1989 JOA a major overhaul of the 1982 JOA with a number of modifications and new provisions. Many changes were made to the JOA to address bankruptcy and creditor related issues as it was determined that the prior AAPL JOA's did not provide adequate protection to the JOA parties. Other new provisions included a Rights and Duties of Operator provision, a Deepening provision separate and apart from a revised Sidetracking provision, an Order of Preference of Operations provision to address situations where there are competing proposals of any type, a Termination of Operations provision allowing a stipulated majority to terminate an operation in progress, and a Defaults and Remedies provision to deal with parties who are in default of paying their expenses.

With the increase of drilling for coalbed methane in the late 1990's, and to keep up with the unusual and unique issues that often arise in such operations, AAPL formed a JOA Task Force in 2002 that drafted modifications to be incorporated into the 1982 and 1989 JOA's for dealing with the drilling of coalbed methane wells. Several alternative provisions address such things as the sharing of roads, pads and production facilities by different operators and owners of wells, and the equitable allocation of the costs attributable thereto, to help reduce costs to all owners. Rather than create a new JOA, the recommended modifications can be found on the AAPL website and copied for incorporation into a party's JOA.

**FORMATION OF THE AAPL JOA TASK FORCE**

In September 2011, AAPL announced it was forming a new JOA Task Force. The Task Force was given two (2) objectives. The first objective was to draft modifications and new provisions for incorporation into the 1982 and 1989 JOA's that address horizontal drilling, and to release this new language to the industry as soon as possible. The second objective was to revise the entire JOA after releasing the horizontal drilling modifications for publication.

The Task Force began conducting a series of conference calls and meetings in November 2011 to discuss horizontal drilling provisions for the JOA. The Task Force completed its first objective, and submitted its recommendations to the AAPL Board for approval at the March 2013 Board Meeting. The AAPL Board approved the Task Force recommendations, and the new language was submitted to Forms-On-A-Disk, makers of JOA-On-A-Disk, for publication. Although the Task Force was advised that it would take at least two (2) months to have the new language incorporated into the JOA's, the recommendations were returned to the Task Force for several minor changes. This lead to additional conference calls and several changes to the prior language. The revised new language was re-submitted to Forms-On-A-Disk in late July 2013, and the new forms should be available shortly.

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\(^8\) AAPL Form 610 - 1989 Model Form Operating Agreement
The Task Force's approach was to take a 1989 JOA as a starting point for drafting the horizontal drilling modifications. Once these modifications were drafted and approved, they were then translated into the 1982 JOA. Since the 1989 JOA already contains provisions that address several important concepts that the 1982 JOA does not, additional modifications were necessary for the 1982 JOA so that the new horizontal language would work make sense.

At this point I must mention an article written by Lamont Larsen entitled *Horizontal Drafting: Why Your Form JOA May Not Be Adequate For Your Company's Horizontal Drilling Program* and its influence on the JOA Task Force. In his article, Mr. Larsen recommended new and revised definitions, and new provisions, that only apply to horizontal wells. The JOA Task Force incorporated several of these definitions and provisions in a more comprehensive approach to horizontal drilling.

The JOA Task Force has now shifted its focus to reviewing and revising the entire JOA and drafting modifications that will bring the JOA into the 21st century (it has been 24 years since the JOA was last revised!). This review process is not yet far enough along to say what modifications and new provisions might ultimately be recommended by the JOA Task Force. However, I don't believe there is any question that a number of modifications will ultimately come from this process. Common provisions that are frequently added to JOA's, court decisions and the role emails may play in sending proposals and making elections under the JOA are certainly topics that will be examined.

**NEW HORIZONTAL DRILLING PROVISIONS**

As mentioned above, the JOA Task Force considered the recommendations of Lamont Larson as a good starting point for deliberating what modifications and new provisions should be incorporated into the JOA to address horizontal drilling. Discussion was centered around the application of defined terms under the JOA as they apply to horizontal drilling. Also, new defined terms unique to horizontal drilling and horizontal wells were introduced. There was also much discussion regarding the growing use of "spudder" rigs associated with horizontally drilled wells. These discussions resulted in new provisions that define what "spudder" rigs are, how they are used, and how their employment affects compliance with the JOA.

The new horizontal drilling language drafted by the JOA Task Force redefines several existing terms but only as they apply to the drilling of horizontal wells. Several definitions that take on new meanings include the terms "Deepen" and "Sidetrack" operations in horizontal wells. Parties that elected to non-consent the drilling of a well do not have the right to participate in these types of operations in horizontal wells like they did in vertical wells. And, a "Drillsite" is defined for horizontal wells as including all tracts a wellbore is located on, or a Lateral travels under.

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9 *Horizontal Drafting: Why Your Form JOA May Not Be Adequate for Your Company's Horizontal Drilling Program*, by Lamont C. Larsen, Davis Graham & Stubbs LLP, Rocky Mountain Mineral Law Foundation Journal, Vol. 48 No. 1
New definitions include the following:

**Displacement** - unless already defined by the governing state agency, shall mean the length of a Lateral;

**Horizontal Rig Move-On Period** - the number of days between the release of a Spudder Rig and the date a rig capable of drilling a horizontal well to its Total Measured Depth has moved on to location;

**Horizontal Well** - unless already defined by the governing state agency, shall mean a well containing one or more Laterals in which the horizontal component extends at least 100' in the objective Zone and exceeds the vertical component of the Completion interval;

**Lateral** - that portion of a wellbore that deviates from its vertical orientation to a horizontal orientation, and all wellbore beyond such deviation to the well's Total Measured Depth;

**Spudder Rig** - a drilling rig utilized for drilling all or a portion of the vertical component of a Horizontal Well (does not include a rig used only for setting conductor pipe);

**Terminus** - unless already defined by the governing state agency, means the furthest point drilled in a lateral;

**Total Measured Depth** - when used in connection with a horizontal well means the distance from the surface of the ground to the Terminus, measured along and including the vertical component of a well and Lateral (for horizontal wells, all references to "depth" or "total depth" are deemed to be referring to Total Measured Depth);

**Vertical Well** - a well drilled, Completed or Recompleted other than a Horizontal Well.

In Article VI.A (Initial Well), both the surface and bottom hole locations of the Lateral must now be provided. New requirements for proposing Subsequent Operations are found in Article VI.B. Specifically, proposals for drilling Horizontal Wells must include (1) the type of operation being proposed is a Horizontal Well operation, and (2) drilling and Completion plans specifying the proposed Total Measured Depth, surface hole location, bottom hole location, horizontal Displacement, rig utilization, and Completion staging and sizing, and (3) estimated costs as set forth on an AFE (an AFE is now required with all proposed Subsequent Operations. Whereas, previously, a proposing party need only provide the estimated costs of the proposed operation).

New provisions addressing the employment of "spudder" rigs, and multi-well pads, have also been introduced. Spudder rigs may be employed if approved in an AFE or, if not in an approved AFE, by a majority in interest of the Consenting Parties to the AFE. Further, if the operator should fail to meet the Horizontal Rig Move-On Period, the procedures the parties must follow including re-proposing the well, and allowing the previously Non-Consenting Parties to a
new election. Also addressed are matters involving the return of any advanced funds should the proposed operation not be conducted, what happens if the parties decide not to drill the well horizontally during the Horizontal Rig Move-On Period, and providing that commencement of operations with a Spudder Rig shall satisfy any commencement requirements under the JOA.

Many area find it necessary and common to drill multiple wells from a single drilling pad or location. These wells sometimes have different owners and/or different ownership percentages. A new provision has been introduced that requires the costs of the pad or location to be allocated proportionately to the wells located thereon, and the costs re-allocated each time a new well is drilled thereon.

**REVISING THE JOA; A NEW MODEL FORM**

As mentioned above, the JOA Task Force is just getting started on its revision of the entire JOA. Therefore, I cannot say with any certainty what modifications and new provisions to expect in the next revision of the JOA. However, as reported in my paper entitled *Joint Operating Agreements: Bringing the Model Form Into the 21st Century*[^10], I expect there will be serious discussions regarding the following:

**Payment of royalties and other lease burdens**, the 1989 JOA added a new provision that clarified how royalties are paid when the JOA Contract Area describes a working interest unit versus a single pro-ration or spacing unit. I believe improvements could be made to the language in this provision to insure the JOA reflects current industry customs and practices.

**Pugh Clauses**, these provisions may have an effect on the Contract Area ownership. There are good arguments, both pro and con, as to whether the lands and/or depths that terminate or expire due to a Pugh Clause are to be treated as individual losses or joint losses. I support optional provisions in the JOA whereby Option No. 1 is chosen if these losses are to be treated as an individual loss, and Option No. 2 is chosen if they are to be treated as a joint loss.

**Exculpatory Clause**, The recent Texas Supreme Court decision involving the Exculpatory Clause found in the 1989 JOA[^11] is guaranteed to be an issue addressed by the JOA Task Force. I suspect the 1989 JOA language will be re-written to more closely resemble the 1982 JOA language.

**Cash Calls**, consideration will probably be given to adopting a cash call provision that will require a party to pre-pay its share of an entire operation's estimated cost as opposed to the

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[^10]: *Joint Operating Agreements: Bringing the Model Form Into the 21st Century*, The Landman (American Association of Professional Landmen magazine) September/October 2011 Issue

current language that only requirements pre-payment for the next succeeding month's estimated costs to be incurred\textsuperscript{12}.

\textbf{Operator Affiliates.} many operators have subsidiary or affiliate companies that serve as the operating entity for the designated operator. This has on occasion led to disputes concerning operatorship under the JOA, and whether the operating entity can serve as Operator under the JOA since it owns no record title interest in any leases in the Contract Area. I support allowing such operating entities to serve as Operator provided that if the designated Operator should sell its interest, the operating entity is deemed to have resigned as Operator.

\textbf{Emails}, new language addressing the use of emails to send notices and proposals, and make elections, is a necessity for the next revision of the JOA. But it might be a little bit more complicated than what most would think. Regardless, emails will be addressed in the next revision.

\textbf{CONCLUSION}

As oil and gas drilling, completion and production technologies have evolved, so have the industry's needs for changes to the governing contracts and agreements that support such operations including JOA's. This is especially true with the development of horizontal drilling, and the unique technical, legal and regulatory challenges and issues horizontal drilling presents. And if time is any indication of what to expect, the needs of the industry will be met in large part through the modifications and new provisions prepared and submitted by the AAPL JOA Task Force.

\textsuperscript{12} AAPL Form 610-1989 Model Form Operating Agreement, Article VII.C. Advances, page 12, lines 60-69