Preferential Rights and Exculpatory Clauses
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04-03-2004

This paper was presented at the 55th Annual Program on Oil and Gas Law, presented by the Institute for Energy Law of the Center for American and International Law (formerly the Southwestern Legal Foundation) on February 19-20, 2004 in Houston, Texas.

PDF Verison: 55th Annual Program on Oil and Gas Law

RECENT DEVELOPMENTS CONCERNING JOINT OPERATING AGREEMENTS—PREFERENTIAL RIGHTS AND EXCULPATORY CLAUSES

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§ 1.01 Preferential Purchase Rights

Preferential purchase rights, sometimes called a preferential right of preemption, a "preference right," "right of first refusal," or "preemptive right," hereinafter "PRP," have been the subject of numerous scholarly articles, perhaps out of keeping with the number of reported cases on the subject. Because of that body of existing scholarship,[(2)] it is not my purpose to review in detail the many issues which may arise with respect to PRPs. Rather, I will attempt to provide a brief overview of those issues and discuss recent developments concerning PRPs.

Although commentators,[(3)] and experience tell us that drafters of joint operating agreements (JOAs) often delete PRP provisions, they are found in the 1956, 1977, 1982 and 1989 versions of the American Association of Petroleum Landmen (A.A.P.L.) Model Form Operating Agreement,[(4)] the Rocky Mountain Mineral Law Foundation (RMMLF) Mining Joint Operating Agreement, the RMMLF Exploration, Development and Mine Operating Agreement,[(5)] farmout agreements,[(6)] and processing plant agreements.[(7)] The rationale for such provisions is usually that they provide parties to such an agreement with an opportunity to increase their "stake" in the property, and the means to avoid undesirable "partners." [(8)] The 1989 A.A.P.L. PRP provision provides:

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 the 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 case where any party wishes to mortgage its interests, or to transfer its interests 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.(9)

I will briefly summarize several issues which have arisen concerning PRPs, and then discuss recent case law developments.

[1] Validity—Statute of Frauds, Rule Against Unreasonable Restraints on Alienation, Rule Against Perpetuities

In most jurisdictions, mineral agreements containing PRPs are subject to the Statute of Frauds; however, if the agreement identifies the property, and the method of exercise and the means for determination of the purchase price are specified, the Statute is satisfied.(10) PRPs have been attacked as violating the Rule against Unreasonable Restraints on Alienation. However, the Rule invalidates only unreasonable restraints on alienation, and generally PRPs have been upheld against such attacks.(11) Whether the Rule Against Perpetuities invalidates a PRP has been the subject of much commentary.(12) The decisions are not uniform; some jurisdictions have struck down PRPs on the theory that the PRP creates a future interest, the vesting of which is dependent upon the owner's desire to sell and therefore uncertain as to time.(13) However, most oil and gas jurisdictions would uphold the typical PRP in a JOA, taking the position that either the PRP does not create a future interest because the holder cannot compel the owner to sell or the PRP does not unreasonably restrain alienability.(14)

[2] Interpretation—What is a "Triggering Event?"

The A.A.P.L. 1989 JOA PRP provision states that it applies when any party "desire[s] to sell all or any part of its interests," and that written notice must be given to the holder of the PRP, typically all other parties to the JOA, specifying "the name and address of the prospective transferee . . . , the purchase price, a legal description . . . and all other terms of the offer."(15) The provision goes on to provide that the PRP is not applicable where any party wishes to mortgage his interest, to transfer in lieu of foreclosure, 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. (16)

Much of the litigation over PRPs has dealt with the issues of what constitutes a "sale," or whether a particular transaction is exempted from the operation of the PRP by provisions such as those in the A.A.P.L. form. While the language of the particular PRP of course governs, most courts have no trouble concluding that donative transfers (17) or "involuntary" transfers (those by descent, public sales by administrators, condemnations, judicial or foreclosure sales)(18) do not trigger the PRP. Whether an "exchange" will trigger the PRP is a difficult issue. Some courts have held that an exchange is not a "sale" and that the right, therefore, is not triggered;(19) other courts, depending on the particular circumstances, have held that exchanges are subject to the PRP.(20) The result may depend on whether the transaction, structured as an exchange, has the same practical effect as a sale and whether the exchange may have occurred as a means to defeat application of the PRP.(21) Two opposing lines of reasoning have developed: (1) any arm's-length transaction having the practical effect of a sale, putting the property beyond the reach of the PRP holder, ought to be subject to the PRP; and (2) if sophisticated parties had intended the PRP to apply to an exchange, they could have said so.(22)

Another difficult question, which so far seems not to have arisen in the mineral context, is where an interest in property subject to a PRP is owned by co-tenants and one desires to sell to the other. In non-mineral transactions, typically a real estate lease with a preference purchase right or right of first refusal ("option appendant"), most courts hold that a sale by one co-tenant to another will not trigger the PRP.(23). Whether that result would be appropriate in the oil and gas context, where one co-tenant proposes to transfer an operating interest to his co-tenant, is an interesting question. The rationale of allowing the PRP to increase his "stake" is applicable, but the rationale of avoiding undesirable partners is not (presumably both co-tenants were acceptable partners at the outset).

The most perplexing questions have arisen in two contexts: (1) where the tract burdened by the PRP is offered as part of a "package" of properties, and other properties in the package are not subject to the PRP; and (2) where the burdened tract is effectively transferred to a third party by a two step transaction involving transfer to a subsidiary followed by a stock sale. Most of the recent developments in this "narrow corner of the law" have dealt with these issues.

[3] Package Sales

A "package sale" may involve the prospective transfer of several properties for a consideration applicable to the entire package, without identifying the consideration applicable to the tract burdened by the PRP. Two commentators have suggested that the PRP clause in this situation violates the Statute of Frauds because the third party offer does not identify the price applicable to the burdened tract.(24) To date this argument has not been judicially adopted. A New York court, in a non-mineral context, has held that a PRP is not applicable to a package sale because the owner, by offering the package for sale, did not manifest an intention to sell "only" the burdened tract. (25) However, most courts, especially those dealing with mineral issues, have held that the PRP is applicable to a package sale but differ as to the remedies available.

Commentators appear to agree that, where the seller and purchaser have not allocated a portion of the purchase price to the burdened tract, the majority rule is that reconveyance of the burdened tract will be required and the seller will be enjoined from selling the tract without compliance with the PRP.(26) The rationale here is that specific performance of the PRP should not be granted either because there is no reasonable basis for allocating part of the purchase price to the burdened tract, or because the owner had not manifested an intent to sell the burdened tract other than as part of the package.(27) A second view is that courts may allow specific performance and allocate a portion of the purchase price to the burdened tract.(28) While there have not been many cases dealing with this issue in a mineral context, in non-mineral contexts, some courts have held that the apportionment fixed by the parties in allocating the purchase price may be disregarded.(29) Still a third view, distinctly a minority, is that the PRP may be exercised as to the entire package.(30)

Most package sale PRP cases have not involved oil and gas, but recently, there have been a few. Other recent cases have involved the "two-step" process, the interplay of the PRP provision, the "area of mutual interest" provision, partition, application of PRPs to overriding royalty interests, and the Rule Against Perpetuities. These cases are discussed below.

[4] Recent Developments

James C. T. Hardwick summarized recent developments applicable to PRPs in a paper presented to The 51st Institute on Oil and Gas Law and Taxation in 2000.(31) This summary includes some of the developments pointed out in Mr. Hardwick's excellent paper as well as other recent interpretations of the PRP.

[a] Package Sales

Two cases arising in Oklahoma dealt with interesting package sale issues – *Brown v. Samson Resources Co.*, 2000 U.S. App. LEXIS 22389 (10th Cir. 2000) and *Samson Resources Co. v. Amerada Hess Corp.*, 2002 Ok. Civ. App. 32, 41 P.3d 1055 (Okla. Ct. App. 2001).

[i] *Brown v. Samson Resources Co.*

In *Brown v. Samson Resources Co.*, 2000 U.S. App. LEXIS 22389 (10th Cir. 2000), Brown, Huber, and Samson were all parties to a joint operating agreement executed in 1959. The JOA contained a PRP provision substantially identical to the A.A.P.L. form's PRP provision. In 1997, Huber agreed to sell many oil and gas interests, including interests in the "Cummings" and "Lance" wells, to Coda Energy. As is often the case in package sale agreements executed by sophisticated parties, the purchase agreement accounted for the existence of PRP holders by allowing for exclusion of a property, and a reduction in the purchase price, in the event a party exercises a PRP. The purchase agreement attached a schedule allocating values for individual leases. Huber notified Brown and Samson of its intent to sell interests in the Cummings and Lance wells and laid out the terms of the proposed sales. The letter to Samson listed the aggregate price for both wells. Brown elected to exercise the PRP with respect to the Cummings well, and Samson elected to exercise its PRP rights with respect to both the Cummings and Lance wells. Subsequently, in a letter to Samson and Brown confirming exercise of the PRPs, Huber listed separate values for the Cummings and Lance wells. Samson then withdrew its original election and notified Huber that Samson would exercise its PRP solely as to the Cummings well.

Huber considered the refusal to purchase the interests in both wells a violation by Samson of the PRP provision, and sold its interests in the Cummings well to Brown. Brown then sued Samson, seeking a declaratory judgment confirming Brown's ownership of the Cummings well and an immediate cash balancing. Samson counterclaimed, joining Huber as a third-party defendant, asserting that Huber's conveyance to Brown was null and void.

The trial court granted Samson's motion for summary judgment, on the theory that Huber had proposed to sell two separate and distinct interests, one in the Cummings well and the other in the Lance well, thereby activating two separate PRPs, and that Samson could exercise either right exclusive of the other. The Tenth Circuit reversed.

The Tenth Circuit began its analysis with a discussion of *Ollie v. Rainbolt*, 669 P.2d 275 (Okla. 1983), a case involving the sale of stock in which the Oklahoma Supreme Court had addressed package sale issues. In *Ollie*, the sale of burdened stock as part of a package with other stock was enjoined until the seller received a bona fide offer unrelated to any other stock and gave the PRP holder appropriate notice to exercise its PRP (thus following the majority rule).(32)

The Tenth Circuit then reasoned that the language in the PRP provision referring to the sale of "any part of its interest," referred to the seller's interest – not the PRP holder's interest – thereby giving the seller "unfettered" discretion to sell "any part of its interest."(33) Using the same method of interpretation, the court clarified the next sentence in the PRP provision – the holder "shall then have an optional prior right … to purchase on the same terms and conditions the interest" which the seller proposes to sell – to "strictly limit[] Samson's preferential purchase right to the very interest '[Huber] proposes to sell.'"(34) Therefore, Samson was required to exercise its PRP, if at all, as to both the Cummings and Lance wells. The fact that the purchase agreement with Coda attached a schedule allocating values for individual leaseholds did not change the fundamental nature of the Huber-Coda transaction, which was a package sale of all the interests included; the attachment of the schedule was simply in recognition that some properties were subject to a PRP, and others were not. Thus, the Tenth Circuit reversed the summary judgment in Samson's favor and remanded, directing the trial court to consider Brown's cause of action for cash balancing.

While recognizing *Brown* as a case that "presents an opportunity to examine the public policy implications and propriety of the exercise of a preferential right in individual parts of a larger package deal," the Tenth Circuit Panel declined to examine the implications, noting that the Oklahoma Supreme Court "apparently will be asked to decide the issue sooner rather than later."(35)

The Tenth Circuit Panel was referring to *Samson Resources Co. v. Amerada Hess Corp.*, No. CJ-96-38 (Okla. D. Ellis County Aug. 31, 1999), a case filed by Samson which was before the Oklahoma Court of Civil Appeals. The Tenth Circuit's prediction that the Oklahoma Supreme Court would revisit package sales issues "sooner rather than later" was somewhat off the mark. In December of 2001, the Oklahoma Court of Civil Appeals decided Samson and the case never made it before the Oklahoma Supreme Court.

[ii] *Samson Resources Co. v. Amerada Hess Corp.*

In *Samson Resources Co. v. Amerada Hess Corp.*, 2002 Okla. Civ. App. 32, 41 P.3d 1055 (2001), Samson, along with Amerada, was a party to three JOAs containing a PRP provision substantially similar to A.A.P.L. Form 610, Article VIII. F (1989). The JOAs also contained a "maintenance of unit ownership clause" providing in pertinent part:

[N]o party shall sell, encumber, transfer or make other disposition of its interest in the leases embraced within the Unit Area and in wells, equipment and production unless such disposition covers either:

(1) The entire interest of the party in all leases and equipment and production; or

(2) An equal undivided interest in all leases and equipment and production in the Unit Area.(36)

The "maintenance of interest" provision went on to provide that "every such sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement, and shall be made without prejudice to the rights of the other parties."(37) The contract also provided that if a third-party exercised a PRP, that property would be eliminated from the assets and the purchase price reduced.

In 1996, Amerada entered into a contract to sell its interests in "hundreds of leases" to DLB Oil and Gas Inc. (DLB), allocating the purchase price among the assets in accordance with the fair market value of the assets as set forth in an attachment to the contract.(38) Amerada notified Samson it was selling its interests in two wells covered by a JOA. Samson responded, electing to purchase only the interest in one of the wells.

A week later Amerada informed Samson it was selling its interests in five other wells, covered by yet another JOA, and Samson opted to purchase both wells. Two days later Amerada notified Samson it was selling its interests in five other wells, covered by yet another JOA, and Samson elected to purchase Amerada's interest in only three of the five wells. The next day, Amerada advised Samson it was selling its interests in three other wells covered by a JOA; Samson elected to purchase only one of the three wells.

Amerada then notified Samson that it did not consider Samson's first "partial" election to be valid. Amerada argued in the court of appeals that Samson's attempt to purchase only part of the interests offered under each JOA violated both the PRP clause and the maintenance of unit ownership clause, and that Samson was required to accept or reject all the interests under each JOA.

The court explained that the maintenance of unit ownership clause "constrained the terms upon which Amerada could offer its interests," and required Amerada "to sell its entire interest in all the leases or an equal undivided interest in all the leases covered by each JOA."(39) According to the court, the maintenance of unit ownership clause made the sale contract expressly subject to that clause. Because the maintenance of unit ownership clause was a "term and condition of the sale contract," in order to accept the offer, "Samson was required to accept that condition and purchase Amerada's entire interest under each applicable JOA."(40)

The end result of both *Brown v. Samson Resources Co.* (10th Cir.) and *Samson Resources Co. v. Amerada Hess Corp.* (Okla. Ct. App.) is the same—the PRP holder cannot "cherry pick" burdened tracts covered by a single JOA, and must exercise the PRP with respect to all of the burdened tracts covered by a single JOA included in the third-party offer. The result was reached through different reasoning—by the Tenth Circuit in its analysis of the "clear and unambiguous language" of the PRP provision,(41) and by the Oklahoma Court of Civil Appeals through its analysis of the combination of the PRP provision and the "maintenance of unit ownership" clause.(42) The Oklahoma Court's approach raises an interesting issue. Suppose that a party to a JOA proposes to sell only some, but not all, of its interests covered by JOA, in violation of the maintenance of unit ownership clause. The Oklahoma Court held that by virtue of the maintenance of ownership clause, that clause "was a term and condition of the sale contract" and the PRP holder is "required to accept that condition."(43) Is the PRP holder entitled to exercise the PRP with respect to only the interests offered for sale, even though the interests were offered for sale in violation of the maintenance of ownership clause? Is the PRP holder entitled to exercise the PRP with respect to all of the seller's interests in the JOA, as if the maintenance of ownership clause had been complied with? If so, what basis is there for determining the price and terms for the properties not included in the sale offer?

[b] Two-Step Transactions

Mr. Hardwick pointed out the possible "loophole" in the A.A.P.L. PRP provision pursuant to which a seller might first transfer its interest in a property to a wholly-owned subsidiary, then transfer the stock in the subsidiary to a third party.(44) Under the A.A.P.L. 1989 provision, the PRP is not applicable to a "transfer of . . . 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."(45) In addition, the PRP is applicable only to "interests under this agreement [the JOA], or its rights and interests in the Contract Area" and not to the sale of stock.(46) The two-step transaction has met with mixed success.

[i] Galveston *Terminals Inc. v. Tenneco Oil Co.*

In *Galveston Terminals Inc. v. Tenneco Oil Co.*, 904 S.W.2d 787 (Tex. App. 1995), a right of first refusal was contained in a 1980 agreement between Galveston Oil Terminal, Inc. (Galveston) as seller, and Tenneco as buyer. In 1989, without notice to Galveston, Fina acquired the property. In 1990, Fina signed a contract to sell the property to Defendant Payne, who later assigned his rights in the contract to Defendant Tatsumi U.S.A. Corporation. Fina then informed Plaintiff that it had received and accepted from Tatsumi an offer to buy the property, which was Galveston's first notice that Fina owned the property. Plaintiff sued Tenneco, Fina Tatsumi, and Payne, alleging breach of the 1980 Galveston-Tenneco contract. Galveston sued Fina alleging the transfer from Tenneco was void, and sued Payne and Tatsumi for interfering with Galveston's contractual rights. Defendants moved for summary judgment on the grounds that no sale took place except for the sale from Fina to Tatsumi, with respect to which Fina complied with the PRP. The basis of the "no sale by Tenneco" defense was that in 1988, as part of a restructuring, Tenneco formed new subsidiaries including TOC-Gulf Coast Inc.; Tenneco owned 100% of the stock of TOC-Gulf Coast. Later in 1988, Tenneco invited proposals for the sale of certain of its subsidiaries; Fina was one of the bidders, and in October 1988, Tenneco's parent and Fina entered into a stock purchase agreement for the sale of all of the stock of TOC-Gulf Coast. In early November 1988, Tenneco conveyed to TOC-Gulf Coast (the subsidiary) thousands of acres of real estate including the property at issue. The stock purchase transaction between Tenneco's parent and Fina was closed five days later. Six months later, all of the assets of the subsidiary were distributed to the sole shareholder, Fina, and the subsidiary was later dissolved. The trial court granted summary judgment to the defendant. The appellate court reversed the judgment and remanded, directing the trial court to examine the stock purchase agreement entered into in October 1988 between Tenneco's parent and Fina to determine whether Tenneco had "elected to sell" its interest in the property. The court was concerned that "the summary judgment evidence viewed as a whole presents a picture of a transaction that, in a roundabout way, accomplished just what a direct sale would have: the transfer of title to $605 million worth of real estate from Tenneco to Fina, all within a seven-month time frame."(47) Because the PRP provided that it was triggered in the event "Tenneco . . . elects to sell . . .," the court held that defendants had failed to establish their burden on a summary judgment motion.(48)

[ii] Tenneco Inc. v. Enterprise Products Co.

The two step transaction fared much better, and *Galveston Terminals* was criticized, in *Tenneco Inc. v. Enterprise Products Co.*, 925 S.W.2d 640 (Tex. 1996). That case involved a PRP in an operating agreement covering a plant. Enterprise claimed that three transactions involving Tenneco's ownership share breached the PRP provision. The first transaction was a transfer from Tenneco to its subsidiary Tenneco Natural Gas Liquids Corporation, wholly-owned by Tenneco. In the second transaction, Tenneco sold its stock in Tenneco Natural Gas Liquids to Enron Gas Processing Company, and Tenneco Natural Gas Liquids' name was changed to Enron Natural Gas Liquids Corporation. In the third transaction, Enron sold Enron Natural Gas Liquids stock to Enron Liquids Pipeline Operating Limited Partnership. The court noted that the Enterprise Parties did not claim that the first transfer—of the plant to the wholly-owned subsidiary—triggered the PRP, because the operating agreement allowed transfer to wholly-owned subsidiaries. With respect to the second and third transactions, the evidence was that Tenneco had offered Tenneco Natural Gas Liquids *assets* for sale before it settled upon the stock sale transaction; Tenneco and Enron announced the completion of the second transfer in press releases; and for tax purposes Tenneco and Enron treated the second transfer as an asset sale rather than a stock sale. The Texas Supreme Court reinstated the trial court's summary judgment for Tenneco because, as a matter of law, the second transfer was a stock sale and not a transfer of assets. The court held that regardless of whether the parties originally proposed an asset sale, the only relevant transaction was the stock sale; the press release did not describe the plant as an asset, but simply one of the company's "operations"; and tax treatment was not relevant because state law, not the Internal Revenue Code, controlled characterization of the transaction. The Enterprise Parties relied upon *Galveston Terminals*, but the Texas Supreme Court rejected that case, stating:

We expressly disapprove of the court's reasoning in Galveston Terminals. Sound corporate jurisprudence requires that courts narrowly construe rights of first refusal and other provisions that effectively restrict the free transfer of stock. [Citations omitted.] Viewing several separate transactions as a single transaction to invoke the right of first refusal compromises the law's unfavorable estimation of such restrictive provisions.(49)

The court also observed that the parties could have included "change of control" provisions in the PRP, but did not.(50)

[iii] ***Fina Oil & Chemical Co. v. Amoco Production Co.***

A recent Louisiana case, *Fina Oil & Chemical Co. v. Amoco Production Co.*, 673 So.2d 668 (La. Ct. App. 1996), *writ denied*, 679 So.2d 1353 (La. 1996), also dealt with the two step transaction.(51) Amoco owned a 50% interest in and operated three fields, each subject to JOAs containing PRPs. In the first transaction, Amoco transferred its interest in the leases (with other property) to a subsidiary, MW Petroleum Corporation (MW), as part of a restructuring. Nine months later, Amoco sold its stock in MW to Apache Corporation (Apache). The Louisiana Court held that the first transaction was exempt from the PRP as a reorganization. It held the second transaction, the stock sale, was also exempt from the PRP. However, the opinion contains analysis of whether MW as a corporate entity should be disregarded and the sale treated as a sale of assets, discussing concepts of piercing the corporate veil and alter ego. The Court relied on evidence of Amoco's legitimate business purpose of reorganization, not circumvention of the PRP, in creating MW, and the fact that Apache submitted an offer only for the stock of MW, and not an offer for the properties. Thus, in Louisiana at least, it seems important that there be some "legitimate business purpose" to the first step of the transaction—transfer to the wholly-owned subsidiary.(52)

[iv] ***Citgo Petroleum Corp. v. Occidental Chemical Corp.***

In 2002, the Tenth Circuit decided *Citgo Petroleum Corp. v. Occidental Chemical Corp.*, 29 Fed. Appx. 525, 2002 U.S. App. LEXIS 1053 (unpublished). Citgo had a PRP to purchase a plant in Lake Charles, Louisiana (the "Lake Charles facility") in the event Cities Service Company (Cities) received an offer to purchase the plant from another party. The PRP provided that it was not triggered by a lease of five years or less or by a transfer to an entity in which the seller retained at least a 50% interest. Occidental Petroleum Corporation (OPC) succeeded to Cities' rights. In 1998, OPC proposed a "master transaction agreement" with Equistar Chemicals under which three subsidiaries of OPC would join Equistar and receive a 29.5% ownership interest in the partnership.(53) The OPC subsidiaries would also receive $420 million in cash, and the partnership would assume $205 million of OPC subsidiaries' debt. In exchange, the OPC subsidiaries were to contribute certain petrochemical facilities, including the plant, to the partnership. Both parties conceded that had this master transaction agreement gone into effect, the PRP would have been triggered. However, that agreement never went into effect; after discovering the PRP "which had initially been overlooked" and after OPC failed to obtain a waiver of its provisions, the parties entered into a new "master transaction agreement."(54) Under that new agreement, the assets, excluding the Lake Charles facility, would be contributed to a different partnership, OPP1; OPC's parent Oxy Chem would then lease the Lake Charles plant to OPP1, which would assign its interest in the lease to Equistar. The second step of the transaction was set to occur at the end of the five-year lease term. Equistar and OPP1 would form a partnership called the Lake Charles Partnership, with OPP1 having an equity interest of 50.1% and Equistar having 49.9%, at which time the Lake Charles facility would be contributed to the Lake Charles Partnership. The partnership would then enter into an operating agreement with Equistar giving Equistar the right to make all day-to-day decisions of the partnership. Thus, "in form at least," a wholly-owned affiliate of the seller would continue to own a 50.1% interest in the Lake Charles facility.(55) Citgo sued, claiming breach of the PRP provision; the trial court granted summary judgment to defendants.

Applying Louisiana law, the Tenth Circuit affirmed, rejecting Citgo's arguments that the court should look to the "economic substance and practical effect" of the completed transactions and that the second transaction was a "sham designed to mask the true effect of the transaction."(56) The court stated that the terms of the PRP provision were clear and unambiguous, and noted that the PRP was negotiated between sophisticated parties who specifically defined "disposition" to include only a sale of the property.(57) The court discussed *Fina Oil and Chemical Co. v. Amoco Production Co.*, pointing out that the Louisiana Court of Appeals had placed emphasis upon either the presence or absence of arm's length dealing, or the effect of the conveyance as placing the property beyond the reach of the holder of the right. Even though the two step transaction involved an "arm's length transaction," the Tenth Circuit held that it did not trigger the PRP because the PRP obviously contemplated the possibility of "some sort of arm's length transaction" by its allowance of contribution of the property to an entity 50% owned by the seller.(58) As to placing the property beyond the reach of the right holder, the Tenth Circuit observed that the two step transaction did not have that result, because the Lake Charles Partnership might later convey the property and the PRP would be applicable.

[v] *Williams Gas Processing—Wamsutter Co. v. Union Pacific Resources Co.*

Wyoming has also weighed in on the two step transaction debate. In *Williams Gas Processing—Wamsutter Co. v. Union Pacific Resources Co.*, 25 P.3d 1064 (Wyo. 2001), involving a gas plant and gathering system, Union Pacific Resources transferred its interest to a second-tier wholly-owned subsidiary which had been created pursuant to the terms of a merger agreement between Union Pacific and the buyer Duke Energy. In step two, Union Pacific sold all of its stock in a first-tier subsidiary, which owned the second-tier subsidiary to which the property had been transferred, to Duke. The trial court granted summary judgment holding that the PRP had not been triggered by the merger and subsequent stock sale. The Wyoming Supreme Court reversed, stating that it could not construe the PRP narrowly in the context of stock transfers because Union Pacific's position rested upon a "highly tortured and technical reading of the contract terms."(59) The court acknowledged *Tenneco Inc. v. Enterprise Products Co.* and *Fina Oil* as "instructive" but held that it could not erase the rights bargained for in the PRP provision.(60)

[c] Other PRP Cases

Questa Energy Corp. v. Vantage Point Energy, Inc., 887 S.W.2d 217 (Tex. App. 1994), held that a transfer to a corporation which simultaneously became a subsidiary of the transferor (by contributing 81% of the transferee's stock to subsidiaries of the transferor) did not trigger a PRP provision, noting that the property remained subject to the PRP in the event of sale to "an outsider."(61) *Dimock v. Kadane*, 100 S.W.3d 615 (Tex. App. 2003), held that a PRP provision was a factor militating against the right of partition. *Online Resources Inc. v. Stone Energy Co.*, 1999 U.S. Dist. LEXIS 17057 (E.D. La. 1999), held that a PRP which applied to any "desire to sell, farmout, or otherwise dispose of all or any part of its interest in the Lease"(62) was ambiguous because the term "interest" was not defined,(63) and interpreted the PRP to include overriding royalty interests.(64) *Murphy Exploration and Production Co. v. Sun Operating Ltd. Partnership*, 747 So.2d 260 (Miss. 1999), upheld a PRP (substantially similar to the 1977 A.A.P.L. Form 610 version) as valid under the Rule Against Perpetuities, because the contract involved a leasehold interest in minerals and free alienation of the interest was not restrained.

§ 1.02 Exculpatory Clauses

Article V.A. of the 1977 and 1982 A.A.P.L. Form 610 provides: "[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."(65) The 1956 Form substituted the words "or from breach of the provisions of this agreement" in place of "or willful misconduct."(66) The 1989 Form is, arguably, substantially different. Article V.A. of the 1989 Form provides in part:

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 regulation, 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. (67)

One commentator has suggested that because the 1956, 1977 and 1982 forms use the words "all such operations"—which referred to operations on the Contract Area, the 1989 Form broadened the protection for operators by its extension of the exculpatory clause to protect the operator with respect to "its activities under this agreement."(68) The issue which has been the subject of differing judicial opinions and commentary is the extent to which the exculpatory clause protects the operator from claims brought by other parties to the JOA for breach of the JOA. That subject—whether the operator owes "fiduciary" duties to non-operating working interest owners, and application of the JOA exculpatory clause, was the subject of an extensive article in the Spring 2003 issue of the Southern Methodist University Law Review.(69) That article and others address the thorny issue of whether the operator owes a fiduciary duty to non-operating working interest owners,(70) a subject beyond the scope of this paper.(71) Rather, I will discuss recent cases dealing with application of the exculpatory clause.

[1] ***Stine v. Marathon Oil Co.***

In *Stine v. Marathon Oil Co.*, 976 F.2d 254 (5th Cir. 1992), Internorth farmed out acreage to Stine. Stine assigned a portion of its interest under the farmout to Marathon; Stine and Marathon signed a letter agreement and a JOA. The farmout required Stine to drill several exploratory wells and continue a regular schedule of drilling, or the leasehold acreage not in production would revert. The letter agreement provided that Stine would drill the first three exploratory wells, but gave Marathon the right to take over as operator after the first three wells were completed. Stine drilled the first three wells; the last was productive. Marathon took over as operator and drilled additional wells. Marathon proposed to plug and abandon dry wells. Stine objected and wanted the wells tested; Marathon did not test the wells, but plugged and abandoned them. Stine argued that Marathon failed to turn the wells over to him in accordance with the JOA. Stine contended that Marathon failed to complete wells in formations that later proved productive, and refused to share information, in breach of the JOA. Stine also contended that Marathon tortiously interfered with a contract for Stine to sell gas by collecting as "nonconsent" penalties proceeds from Stine's gas sales.(72) A jury found that Marathon had breached the JOA by not delivering operation of two wells to Stine before plugging and abandoning them, by not furnishing information as required, and by not completing certain wells. The jury also found Marathon had tortiously interfered with Stine's contract to sell gas by causing the purchaser to wrongfully withhold payments to Stine.

Applying Texas law, after quoting Article V.A. of the JOA, similar to the A.A.P.L. Form 610 1977 and 1982 forms, the court held that the exculpatory clause protected Marathon from liability for "any action taken in connection with the completion, testing or turnover, or any well drilled under the provisions of the JOA" unless Stine could prove gross negligence or willful misconduct.(73) Importantly, the court then held:

This protection extends to Marathon's various administrative and accounting duties, including the recovery of costs under the authority of the JOA. It is clear to us that the protection of the exculpatory clause extends not only to 'acts unique to the operator,' as the district court expressed it, but also to any acts done under the authority of the JOA 'as Operator.' This protection clearly extends to breaches of the JOA. It also reaches other acts including acts performed 'as Operator' under the authority of the JOA that amount to tortious interference with contracts with third parties.(74)

[2] *Abraxas Petroleum Corp. v. Hornburg*

Abraxas Petroleum Corp. v. Hornburg, 20 S.W.3d 741 (Tex. App. 2000), involved the "Cleo Smith Lease," which had been in continuous production since 1952, producing 1.6 million barrels of oil by 1992. A JOA covering the lease was executed in 1984. In 1992, the four wells on the lease were still producing over 1,000 barrels of oil per month. The operator sold its interest to Abraxas. Shortly thereafter, lease operating expenses increased and production dwindled. Abraxas issued an Authorization for Expense (AFE) letter describing proposed "workover" procedures to restore the wells to production; none of the jobs exceeded $30,000.(75) None of the working interest owners elected to proceed with workover operations, and Abraxas thereafter treated them as "non-consent."(76) However, Abraxas performed only one small project of the proposed workover operations at a cost of $7,500. Thereafter, production dwindled further, and Abraxas shut down the lease and produced only one barrel from each well per day per month to hold the lease. The working interest owners sued Abraxas. The jury determined that Abraxas breached the JOA by sending the AFE letter and by failing to perform all of the work proposed.

The appellate court held that sending the AFE letter could be a breach because the proposed repairs were less than $30,000 per well and did not constitute "reworking" operations as defined in the JOA, but rather were ordinary operating expenses.(77) Abraxas argued that the breach of contract claim could not stand because the jury had not made a finding of gross negligence or willful misconduct, and that Abraxas was, therefore, protected by the exculpatory clause in Article V.A. of the JOA. The working interest owners responded that the exculpatory clause "applies only to causes of action arising from lease operations and does not apply to the operator's breach of contract."(78) The court adopted the working interest owners' argument and held the exculpatory clause did not protect Abraxas. The court found it significant that the exculpatory clause was "linked" to the Operator's conduct of operations on the Contract Area and the duty to act as a reasonably prudent operator: "Accordingly, we conclude that the exculpatory clause is limited to claims based upon an allegation that Abraxas failed to act as a reasonably prudent operator and does not apply to a claim that it breached the JOA."(79)

[3] Cone v. Fagadau Energy Corp.

In *Cone v. Fagadau Energy Corp.*, 68 S.W.3d 147 (Tex. App. 2001), decided a year after Abraxas, Fagadau was the operator, and Cone was a working interest owner, under a JOA. Fagadau proposed a water flood, including conversion of a producing well into an injection well. Cone refused to participate. The Railroad Commission approved the water flood and unitization and production increased significantly. Cone disputed charges to his account, claiming they were improperly assessed in light of his non-participation in the water flood. Fagadau sued Cone for the disputed charges; Cone counterclaimed alleging violations of the JOA, which was the 1982 A.A.P.L. Form 610 Model Form. The trial court granted Fagadau a special exception regarding the applicable level of culpability, ruling that Cone was required to show gross negligence or willful misconduct. The Court of Appeals ruled that the exculpatory clause was not applicable.(80) The court again found significant the fact that the exculpatory clause immediately followed the provision requiring the operator to conduct operations in a good and workmanlike manner. The court noted that Cone's complaints did not allege failure to operate in a good and workmanlike manner, but rather alleged breaches of specific terms of the agreement in the nature of an accounting; and, citing Abraxas, held that "the gross negligence/willful misconduct requirement applies [only] to any and all claims that the operator failed to conduct operations in a good and workmanlike manner." (81)

[4] *Castle Texas Production Ltd. Partnership v. The Long Trusts*

Abraxas was again applied to exclude operations of the exculpatory clause from a breach of contract claim in *Castle Texas Production Ltd. Partnership v. The Long Trusts*, 2003 Tex. App. LEXIS 6640 (Tex. App. 2003) (*approved for publication*). The case involved several JOAs; Castle bought Atlantic Richfield's interest in the leases and in the JOAs in December 1992. The dispute primarily concerned the balancing agreements attached as Exhibits E to the JOAs. At the time Castle bought Atlantic Richfield's interest, the Long Trusts were not taking their share of gas produced. In 1996, the Long Trusts sold their gas production at the wellhead to

Cherokee Gas Marketing; Castle advised that a contract with Castle Pipeline was necessary. Negotiation of that contract took almost a year. During this delay the Long Trusts sued Castle alleging breach of the JOAs and conversion of the Long Trusts' share of gas and condensate. The jury found for the Long Trusts against Castle on the breach of contract claims. The appellate court affirmed the judgment on that verdict, rejecting application of the exculpatory clause. The Court held that the clause "is limited to claims that Castle failed to act as a reasonably prudent operator in its operations in the contract area and does not apply to a claim that it otherwise breached the JOAs."(82)

[5] ***IP Petroleum Inc. v. Wevanco Energy, L.L.C.***

In *IP Petroleum Inc. v. Wevanco Energy, L.L.C.*, 116 S.W.3d 888 (Tex. App. 2003), the non-operating working interest owners and the operator executed a JOA described as an A.A.P.L. Form. Cleveland Oil wanted to test a geologist's theory that deepening a well in the Ellenburger Formation could tap a productive oil area in the "cave floor zone."(83) Cleveland Oil enticed several investors, including Plaintiffs. IP was chosen as operator of the well; Cleveland Oil, IP, and the investors executed an A.A.P.L. Form JOA containing the usual exculpatory clause. The well encountered mechanical difficulties, cost much more than projected, and when completed, tested to produce 3% oil and 97% water. IP thereafter gave notice of its intent to plug and abandon. Plaintiffs sued IP, alleging that IP had an obligation to further deepen the well and its failure to do so was a breach of the JOA. The jury found that IP did not drill to a sufficient depth and that failure was the result of gross negligence or willful misconduct.

The first issue addressed by the appellate court was whether the exculpatory clause applied to the breach of contract claim. Plaintiffs contended that the clause could never apply to any breach of contract claim, but the court disagreed. Discussing Cone and Fagadau, the court distinguished those cases by stating that neither involved a claim of failure to operate in a good and workmanlike manner. However, the Plaintiffs' claim in IP Petroleum was alleged misconduct arising from the manner in which IP conducted drilling operations—Plaintiffs had specifically alleged failure to conduct operations in a good and workmanlike manner and failure to act as a reasonably prudent operator. "Accordingly, the exculpatory clauses in the JOA applied, and the plaintiffs had to establish that IP was grossly negligent or acted with willful misconduct when it breached the contract."(84) The court then held the evidence was insufficient to show gross negligence or willful misconduct.

[6] ***Palace Exploration Co. v. Petroleum Development Co.***

In *Palace Exploration Co. v. Petroleum Development Co.[PDC]*, 316 F.3d 1110 (10th Cir. 2003), PDC planned to drill a well and invited Palace, a New York-based oil and gas investor, to participate in the project. The parties signed a letter agreement which anticipated execution of an exploration agreement and JOA. Between the time of the letter agreement and execution of those agreements, PDC determined the initial geological information depicted in one of the maps sent to Palace was wrong and decided to shift the well location 1,600 feet, but did not notify Palace of the relocation. Palace sent the information it had to its consultant and vice president, who advised he thought the estimated well costs were underestimated and that he thought drilling mud would be required as opposed to drilling "on air."(85) Palace brought this to the attention of PDC which, according to Palace, advised Palace that drilling mud would not be required. The well was drilled, and PDC encountered a water zone, which required use of drilling mud. Palace declined to participate in completion of the well.

Palace sued in New York for rescission of the exploration agreement and JOA which had been executed and for "rescissionary damages."(86) The case was transferred to the Northern District of Oklahoma, and the Tenth Circuit applied Oklahoma law. Just prior to trial, the court extended discovery and Palace asserted in a pre-trial order a claim for breach of contract based on PDC's alleged gross negligence. However, the trial court refused to permit the breach of contract claim to go to trial.

On appeal, the Tenth Circuit held the trial court was wrong in not permitting the breach of contract claim to proceed, and reversed and remanded for a jury trial on Palace's breach of contract claim. The Tenth Circuit—describing Palace's original complaint which sought only rescission—referred to the exculpatory clause which provided: 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."(87) The exculpatory clause was substantially similar to the A.A.P.L. 1977 and 1982 form. The Tenth Circuit stated that "Palace did not articulate any theory of recovery whereby it could recover legal damages based on breach on contract, for the above-referenced exculpatory clause limited PDC's potential liability to willful acts or acts that resulted from gross negligence."(88) There was no other discussion by the Tenth Circuit concerning the application of the exculpatory clause.

[7] *Shell Rocky Mountain Production, L.L.C. v. Ultra Resources, Inc.*

In *Shell Rocky Mountain Production, L.L.C. v. Ultra Resources, Inc.*, 226 F.Supp.2d 1331 (D. Wyo. 2003), Shell and Ultra executed several JOAs, as part of a settlement, providing that the party with the majority ownership of jointly-held working interests would be the operator. In 2002, Shell proposed the drilling of a new well to a depth of 12,500 feet; but farmout lands under the agreement were limited to 9,931 feet, and Ultra protested that it should be operator because a well to that depth would reach lands where Ultra held a majority interest. The same situation existed with respect to other wells (i.e., drilled to below "farmout depth" and into lands where Ultra owned the majority interest). Shell filed a declaratory judgment action to enforce the terms of the settlement agreement; Ultra filed a complaint in Wyoming state court seeking damages for breach of the agreement and reformation of the JOAs to comply with the terms of the settlement agreement. The state court action was removed and both actions were consolidated. Both parties moved for summary judgment with respect to the exculpatory clause. Shell argued that Ultra's counterclaim for breach of the JOAs was barred by the exculpatory clause in Article V.A. of the JOAs, which was substantially similar to the A.A.P.L. 1977 and 1982 forms. Ultra argued that the clause applied only to tort claims. The district court held that the exculpatory clause applied to Ultra's claim for breach of contract, relying on *Palace Exploration v. Petroleum Development Co.*, in which the Tenth Circuit stated the Plaintiff had not articulated any theory of recovery where it could recover legal damages based on breach of contract because the exculpatory clause limited potential liability to willful acts or gross negligence. The U.S. District Court for the District of Wyoming concluded: "The Palace decision applies directly to the issue the Court is deciding here. As the Tenth Circuit held, this exculpatory clause bars suit against an operator for breach of contract, or for anything else other than willful acts or gross negligence."(89) The court then allowed Ultra to amend its complaint to allege gross negligence or willful misconduct.

[8] The Apparent Conflict—As Yet Unresolved

There is obvious tension between the Fifth Circuit's decision in *Stine* and the decisions of the Texas Courts of Appeals in *Abraxas*, *Cone*, *Castle Texas*, and *IP Petroleum*. Interestingly, none of the Texas cases cite *Stine*. The approach followed by the Tenth Circuit in *Palace Exploration*, at least as read by the federal district court in Wyoming in Shell Rocky Mountain, appears to follow the Fifth Circuit's approach to exculpatory clauses in *Stine* (although *Stine* is not cited in either *Palace Exploration or Shell Rocky Mountain*).

The decisions in *Palace Exploration and Shell Rocky Mountain* can perhaps be harmonized with the approach taken by the Texas Court of Appeals. Arguably, in *Palace Exploration*, the breach alleged moving the location of the well was part of the "operations on the contract area" and failure to advise of the change in location was a failure to operate in a "good and workmanlike manner." However, the claim in *Palace Exploration* does not appear to have been based upon failure to conduct operations in a good and workmanlike manner; and Palace Exploration assumed applicability of the exculpatory clause, as its claim for breach of contract was expressly based on gross negligence.(90) It is perhaps more of a stretch to argue that Ultra's claim in *Shell Rocky Mountain* was based on "drilling operations," although the gravamen of the complaint was that Shell had drilled to depths below those specified as "farmout depth." It is not clear from the opinion in *Shell Rocky Mountain* whether Ultra's claim for breach of the JOAs alleged a failure to operate in a good and workmanlike manner.

An opposing argument can be made that the JOA breaches alleged in *Palace Exploration* and *Shell Rocky Mountain* are more akin to the breaches alleged in *Abraxas* (sending an AFE letter in breach of the JOA), *Cone* (alleged imposition of charges in violation of JOA for water flood operation); and *Castle Texas* (claim for conversion of produced gas and condensate in violation of JOA). *Abraxas*, *Cone*, and *Castle Texas*, especially in view of *IP Petroleum*, can be read to hold that the exculpatory clause applies only to a claim where the specific breach alleged is failure to operate in a good and workmanlike manner. Moreover, the expansive language in *Shell Rocky Mountain* can be read to hold the exculpatory clause applies to any claim for breach of contract.

As yet, this apparent conflict appears unresolved. Which is the better rule? *Stine* is a well-reasoned opinion, citing precedent(91) and commentary. Both the *Stine* approach and that followed in *Abraxas* purport to apply the unambiguous language of the exculpatory clause. Arguably, *Stine* is more consistent with the notion that parties executing JOAs are not bound to blindly follow A.A.P.L. forms, can negotiate for exceptions to the exculpatory clause, and if they intend to limit its operation and to exclude breach of contract claims, they can do so.

ENDNOTES

1. Modrall, Sperling, Roehl, Harris & Sisk, Albuquerque, New Mexico. I gratefully acknowledge the assistance of Ms. Margaret Coffey-Pilcher.

2. *See* Janice K. Borgerson & Brian T. Dolan, "*Preferential Purchase Rights," in* INSTITUTE ON MINING AGREEMENTS II*, 11-1 (Rocky Mtn. Min. L. Found. 1981) [hereinafter Borgerson & Dolan]; Mark B. Christiansen, "Preferential Right of Purchase Issues in Oil and Gas Property Sales," 35* NAT. RESOURCES & ENV'T *32, 36 (1996); J. R. Cooney and L. P. Ausherman, "Preferential Purchase Rights in Mineral Agreements," 37* ROCKY MTN. MIN. L. INST.*, 9-1 (1991) [hereinafter Cooney and Ausherman]; Timothy C. Dowd, "Preferential Rights to Purchase in Oil and Gas Transactions," 49* ROCKY MTN. MIN. L. INST. *5-1 (2003) [hereinafter Dowd]; James C. T. Hardwick, "Something Old, Something New—Current Issues Under the Joint Operating Agreement," 51* SWLF INST. ON OIL & GAS L. & TAX'N*, § 1.06, at 26 (2000) [hereinafter Hardwick]; C. David Heaney, "The Joint Operating Agreement, the AFE and COPAS – What They Fail to Provide," 29* ROCKY MTN. MIN. L. INST. *743 (1983); J. Hovey Kemp, "Hidden Rule Against Perpetuities Problems in Oil and Gas Transactions," 32* ROCKY MTN. MIN. L. INST.*, 16-1 (1986) [hereinafter Kemp]; Blair Klein & Noel Burke, "The Farmout Agreement: Its Form and Substance," 24* ROCKY MTN. MIN. L. INST. *479 (1978); Kutzschbach, "Operating Agreement Considerations in Acquisitions of Producing Properties," 36* SWLF INST. ON OIL & GAS L. & TAX'N *7-1 (1985) [hereinafter Kutzschbach]; John R. Reeves, "The Development of the Model Form Operating Agreement: An Interpretive Accounting," 54* OKLA. L. REV. *211, 278 (2001); Jeffrey J. Scott, "Restrictions on Alienation Applied to Oil and Gas Transactions," 31* ROCKY MTN. MIN. L. INST. *15-1(1985) [hereinafter Scott]; John S. Sellingsloh, "Preferential Purchase Rights," 11* ROCKY MTN. MIN. L. INST. *35 (1966) [hereinafter Sellingsloh]; see also Abright, "Preferential Right Provisions and Their Applicability to Oil and Gas Instruments," 32 SW L.J. 803 (1978) [hereinafter Abright]; Conine, "Property Provisions of the Operating Agreement—Interpretation, Validity, and Enforceability," 19* TEX. TECH. L. REV. *1263 (1988) [hereinafter Conine]; Timothy W. Dowdy, "A.A.P.L. Form 610 Model Form Operating Agreement: Selected Provisions Impacting Onshore Producing Property Transfers," 47* ROCKY MTN. MIN. L. INST. *13-1, 13-5 to 13-26 (2001) [hereinafter Dowdy]; Reasoner, "Preferential Purchase Rights in Oil and Gas Instruments," 46 TEX L. REV. 57 (1967) [hereinafter Reasoner]; 2* WILLIAMS & MEYERS, OIL AND GAS LAW *§ 428.3 (1959 & Supp. 1990).*

3. Dowd, supra note 2, at 5-3; Hardwick, supra note 2.

4. Hardwick, supra note 2, §1.06, at 26 n.76. Mr. Hardwick points out a potential significant difference between the 1956 and 1989 JOAs and the 1977 and 1982 JOAs as applicable to "two-step" transactions. See discussion infra § 1.01[4][b]. Mr. Dowd points out two other differences in the 1989 form: 1) for the PRP to apply, a box must be checked, and 2) a legal description must be included in the preferential right notice. Dowd, supra note 2, at 5-4 n.10.

5. RMMLF Mining Joint Operating Agreement (Form 4), § 12; RMMLF Exploration, Development and Mine Operating Agreement (Form 5A), Exhibit H. See Dowd, supra note 2, at 5-4 n.13.

6. See Dowd, supra note 2, at 5-3 n.8; Panuco Oil Leases, Inc. v. Conroe Drilling Co., 202 F. Supp. 108, 109-10 (S.D. Tex. 1961); Alameda Corp. v. TransAm. Nat. Gas Corp., 950 S.W.2d 93, 95 (Tex. App. 1997).

7. See Dowd, supra note 2, at 5-3 n.9; Citgo Petroleum Corp. v. Occidental Chem. Corp., 29 Fed. Appx. 525, 526 (10th Cir. 2002); Tenneco Inc. v. Enter. Prods. Co., 925 S.W.2d 640, 642 (Tex. 1996); Williams Gas Processing—Wamsutter Co. v. Union Pac. Res. Co., 25 P.3d 1064, 1067-68 (Wyo. 2001).

*8. Brown v. Samson Res. Co., 2000 U.S. App. LEXIS 22389 at *8 (2000); Conine, supra note 2, at 1317.*

9. Dowdy, supra note 2, at 13-49.

10. Cooney and Ausherman, supra note 2, at 9-10. Some commentators have suggested that a PRP as to one tract may be invalid under the Statute when the tract is included in a "package deal" because the package deal terms might not supply the price and essential terms of sale. See generally Abright, supra note 2, at 806; Borgerson & Dolan, supra note 2, at 11-18 to 11-19; Kutzschbach, supra note 2, at 7-4 to 7-7; Reasoner, supra note 2, at 59-60.

11. See Cooney and Ausherman, supra note 2, at 9-11 to 9-12; Dowd, supra note 2, at 5-7 to 5-8. However, the Rule may invalidate a PRP which is unlimited as to duration or at a fixed or reduced price. See Cooney and Ausherman, supra note 2, at 9-12.

12. See Abright, supra note 2, at 808-10; Borgerson & Dolan, supra note 2, at 11-23 to 11-27; Conine, supra note 2, at 1375-80; Cooney and Ausherman, supra note 2, at 9-15 to 9-16; Dowd, supra note 2, at 5-8 to 5-9; Kemp, supra note 2, at 16-4 to 16-5; Scott, supra note 2, at 15-11 to 15-15; Sellingsloh, supra note 2, at 42-47.

13. See Cooney and Ausherman, supra note 2, 9-14 n.35.

14. See Weber v. Texas Co., 83 F.2d 807, 808 (5th Cir. 1936); Gartley v. Ricketts, 107 N.M. 451, 760 P.2d 143, 145 (1988); Robroy Land Co. v. Prather, 24 Wash. App. 511, 622 P.2d 367, 370 (1980); see also Dowd, supra note 2, at 5-9 nn.30-33.

15. See supra note 9.

16. Id.

17. See Cooney and Ausherman, supra note 2, at 9-16 n.44.

18. Draper v. Gochman, 400 S.W.2d 545 (Tex. 1966); Abright, supra note 2, at 813; Conine, supra note 2, at 1318; Scott, supra note 2, at 15-27 to 15-28; P.G. Guthrie, Annotation, Rights of Holder of "First Refusal" Option on Real Property in Event of Sale at Foreclosure or Other Involuntary Sale, 17 A.L.R.3D 962 (1968). However, Louisiana has held that the holder of a preferential right has the right to match the highest bid at a foreclosure sale. Price v. Town of Rustan, 171 La. 985, 132 So. 653 (1931). California has held that an executor's sale triggered a preference right. Richfield Oil Corp. v. Sec.-First Nat'l Bank of Los Angeles, 159 Cal. App. 2d 184, 323 P.2d 834 (1958). See Borgerson & Dolan, supra note 2, at 11-36, for discussion of related cases.

19. Panuco Oil Leases, Inc. v. Conroe Drilling Co., 202 F.Supp. 108 (S.D. Tex. 1961) (transfer of burdened working interest in consideration of agreement to drill is "exchange," and not a "sale" triggering PRP in farmout agreement); Weber Meadow-View

Corp. v. Wilde, 575 P.2d 1053 (Utah 1978); see also Abright, supra note 2, at 812; Borgerson & Dolan, supra note 2, at 11-38; Conine, supra note 2, at 1319; Kutzschbach¸ supra note 2, at 7-19 to 7-22.

20. See, e.g., Anderson v. Armour & Co., 205 Kan. 801, 473 P.2d 84 (1970); see also Abright, supra note 2, at 812; Borgerson & Dolan, supra note 2, at 11-38; Kutzschbach, supra note 2, at 7-21.

21. See Dowd, supra note 2, at 5-10.

22. Id.

23. See, e.g., Wilson v. Grey, 560 S.W.2d 561 (Ky. 1978); Baker v. McCarthy, 122 N.H. 171, 443 A.2d 138 (1982); Borgerson & Dolan, supra note 2, at 11-32 to 11-33. Borgerson & Dolan note that even in the non-mineral cases, this result is not universal. Id.

24. Abright, supra note 2, at 807; Reasoner, supra note 2, at 60.

25. Sautkulis v. Conklin, 1 A.D.2d 962 (1956), aff'd, 2 N.Y.2d 919, 161 N.Y.S.2d 885, 141 N.E.2d 916 (1957); see Reasoner, supra note 2, at 76. However, later New York cases, while refusing to grant specific performance ordering conveyance of the burdened tract, have enjoined the seller from selling the burdened property or have required a reconveyance in the event of sale to maintain the status quo. See Tarallo v. Norstar Bank, 534 N.Y.S.2d 485 (3d Dep't 1988); see also Kutzschbach, supra note 2, at 7-5 n.12 & 7-23.

26. See Borgerson & Dolan, supra note 2, at 11-42; Kutzschbach, supra note 2, at 7-22 to 7-24; see also Dowd, supra note 2, at 5-19 to 5-20.

27. See Borgerson & Dolan, supra note 2, at 11-42.

28. See, e.g., Maron v. Howard, 258 Cal. App. 2d 473, 66 Cal. Rptr. 70 (1968); Berry-Iverson Co. of N.D., Inc. v. Johnson, 242 N.W.2d 126 (N.D. 1976); Pitman v. Sanditen, 626 S.W.2d 496 (Tex. 1982); Riley v. Campeau Homes (Texas), Inc., 808 S.W.2d 184 (Tex. App. 1991); Foster v. Bullard, 496 S.W.2d 724 (Tex. App. 1973, writ ref'd, n.r.e.), appeal after remand, 554 S.W.2d 66 (Tex. App. 1977 writ ref'd n.r.e.); First Nat'l Exch. Bank of Roanoke v. Roanoke Oil Co., 169 Va. 99, 192 S.E. 764 (1937); Cohen v.Thomas & Son Transfer Line, Inc., 586 P.2d 39 (Colo. 1978); Jean E. Maess, Annotation, Option to Purchase Real Property as Affected by Optionor's Receipt of Offer For, or Sale of, Larger Tract Which Includes the Optioned Parcel, 34 A.L.R.4TH 1217, 1221 (1984); see also Abright, supra note 2, at 817-18 (citing California, Florida, Michigan, and North Dakota cases); Borgerson & Dolan, supra note 2, at 11-43 (citing North Dakota, California, North Carolina, Florida, and Michigan cases); Conine, supra note 2, at 1325 (citing California and Texas cases); Kutzschbach, supra note 2, at 7-23 (describing cases in California, Florida, Michigan, and North Dakota, and possibly Colorado, Texas, and Virginia as minority views); Reasoner, supra note 2, at 75 (citing Michigan, California, and Florida cases); see also Dowd, supra note 2, at 5-20.

29. See Foster v. Bullard, supra note 28. Mr. Hardwick has suggested that an improper allocation of the purchase price, more heavily weighting the burdened tract, to discourage exercise of the PRP may result in tort liability and result in exemplary damages; he cites Dorchester Hugoton, Ltd. v. Dorchester Master Ltd. P'ship, 898 P.2d 1311 (Okla. App. 1993), to support this proposition. Hardwick, supra note 2, § 1.06[5], at 40-41.

30. See, e.g., Beets v. Tyler, 365 Mo. 895, 290 S.W.2d 76 (1956); First Nat'l Exch. Bank of Roanoke v. Roanoke Oil Co., 169 Va. 99, 192 S.E. 764 (1937). See also Borgerson & Dolan, supra note 2, at 11-44; Abright, supra note 2, at 818; Reasoner, supra note 2, at 75-76.

31. See Hardwick, supra note 2.

*32. 2000 U.S. App. LEXIS 22389 at *8-*9*

*33. Id. at *14.*

34. Id.

*35. Id. at *10 & n.4 .*

36. 41 P.3d at 1056-57.

37. Id. at 1057. The portion of the maintenance of interest provision quoted by the Court is substantially identical to the 1956, 1977, and 1982 versions of A.A.P.L. Form 610. See Dowdy, supra note 2, at 13-49 to 13-53.

38. 41 P.3d at 1057.

39. Id. at 1059.

40. Id. The Court did not address any issues concerning the enforceability of the maintenance of uniform interest clause. See Dowdy, supra note 2, 13-28 to 13-30; Hardwick, supra note 2, § 1.02, at 2-11.

*41. 2000 U.S. App. LEXIS 22389 at *18.*

42. 41 P.3d at 1059.

43. Id.

44. See Hardwick, supra note 2, § 106[4][d], at 39; see also Dowd, supra note 2, at 5-11. Dowdy describes the transactions as the "Texas two step." Dowdy, supra note 2, at 13-21 to 13-23.

45. See supra note 9.

46. Id.

47. 904 S.W.2d at 791.

48. Id. at 792.

49. 925 S.W.2d at 646.

50. Id.

51. Dowdy describes Fina Oil as "the Louisiana crawfish." Dowdy, supra note 2, at 13-23 to 13-24.

52. 673 So.2d at 674.

53. 29 Fed. Appx. at 527.

54. Id.

55. Id.

56. Id. at 530.

57. Id. at 531.

58. Id.

59. 25 P.3d at 1072.

60. Id.

61. 887 S.W.2d at 222.

*62. 1999 U.S. Dist. LEXIS 17057 at *5.*

*63. Id. at *15.*

*64. Id. at *18 (citing, among others, Cooney and Ausherman, supra note 2).*

65. See Robert C. Bledsoe, "The Operating Agreement: Matters Not Covered or Inadequately Covered," 47 ROCKY MTN. MIN. L. INST. 15-1, 15-7 to 15-8 (2001) (alteration in original). Mr. Bledsoe addresses problems with exculpatory clauses which might arise under "fair notice" requirements of the express negligence rule in Texas, Colorado, Montana, Oklahoma and Utah, and under anti-indemnity statutes in New Mexico and Wyoming. Id. at 15-10 to 15-18.

66. Id. at 15-8 n.17.

67. Id. at 15-7 (alteration in original).

68. Id. at 15-7 to 15-8.

69. John Burritt McArthur, "Judging Made Too Easy: The Judicial Exaggeration of Exculpatory and Liability—Limiting Clauses in the Oilfield's Operator Fiduciary Cases," 56 SMU L. Rev. 925 (2003) [hereinafter McArthur]; see also Richard F. Brown, "Oil, Gas and Mineral Law," 54 SMU L. Rev. 1521, 1533-36, 1538-39 (2001).

70. Id. at 950 n.94, 951 n.95, 952 nn.100 & 102, & 958 n.121; see also Patrick H. Martin, "The Joint Operating Agreement—An Unsettled Relationship?," SWLF SPECIAL INST. 98, 116 n.39 (1997).

71. As indicated by the title of his article, McArthur disagrees with the trend of recent decisions viewing the relationship of parties to a joint operating agreement as being governed by contract rather than "fiduciary" principles. Mr. McArthur believes this trend has "substantially increased protection for the large corporations that dominate oil field operations," McArthur, supra note 53, at 927, and that while the debate will "rage on," "[m]ajor producers, with their concentrated resources and stakes, are likely to dominate the *debate through their legions of lawyers and lobbyists." Id. at 974. Mr. McArthur acknowledges that Professor Martin, and others, take a somewhat different view. Id. at 952 n.100, 958 n.121; See Martin, supra note 69. While finding myself more in sympathy with Professor Martin's views on the fiduciary duty issue, I will confine myself to discussion of recent cases dealing with the exculpatory clause.*

72. 976 F.2d at 258.

73. Id. at 261.

74. Id.

75. 20 S.W.3d at 747.

76. Id. at 748.

77. Id. at 756-57.

78. Id. at 759.

79. Id. A similar result was reached in Energen Resources MAQ, Inc. v. Dalbosco, 23 S.W.3d 551 (Pet. denied 2001) where an exculpatory clause in a farmout agreement, applicable to failure to maintain the parties' interests in acreage, was held inapplicable to a claim that the farmoutee had breached the custom and practice of notifying the farmoutor of plugging and abandoning a well.

80. The granting of the special exception was deemed harmless because the trial court had determined the breach of the contract claims on a simple breach of contract standard.

81. 68 S.W.3d at 155.

*82. 2003 Tex. App. LEXIS 6640 at *37 (citing Abraxas, 20 S.W.3d at 759).*

83. 116 S.W.3d at 891.

84. Id. at 896. In addition to the usual Article V.A. exculpatory clause, a substantially identical exculpatory clause (no liability except for gross negligence or willful misconduct) appeared in the portion of the agreement stating that IP would drill the well with due diligence to a specified depth sufficient to test the formation unless further drilling was impractical or all parties agreed to complete or abandon the well at a lesser depth. Id. at 892.

85. 316 F.3d at 1114.

86. Id.

87. Id.

88. Id.

89. 226 F.Supp.2d at 1337.

90. 316 F.3d at 1115. The Tenth Circuit stated that before filing the claim for breach on contract based on gross negligence, Palace's trial brief "did not expound upon PDC's failure to act as a reasonably prudent operator." Id. Thus, Palace Exploration can perhaps be read as applying the exculpatory clause to claims based on failure to act as a reasonably prudent operator.

91. Caddo Oil Co. v. O'Brien, 908 F.2d 13 (5th Cir. 1990), was one of the cases cited, in which a similar result was reached—operator not liable, in absence of willful misconduct, to account to nonoperator for charges for operations.