REVISING THE JOINT OPERATING AGREEMENT FOR HORIZONTAL DRILLING

ONE SIZE DOES NOT FIT ALL

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• AAPL Model Form Operating Agreement Form 610
  – Predominant joint operating agreement in oil and natural gas industry
  – No standard agreement recognized by industry and operators prior to 1950’s
  – American Association for Professional Landsmen (AAPL) partnered with 26 oil and gas companies to develop first Model Form in 1956
• Modifications to Model Form in 1977, 1982, and 1989
• Most significant modifications occurred in 1989
• Proposed horizontal drilling modifications - 2013
• 2014 revisions to 1989 form?
MODIFICATIONS IN 1989

- Doubles the number of specifically defined terms
- Notice provisions significantly expanded to recognize developments in communication
- Clarifies and expands provisions concerning “second election” regarding consenting party’s participation in operations
- Authorizes types of fill-in-the-premium recoupment of surface equipment costs
1989 MODIFICATIONS

- Section V clarified the rights, duties and responsibilities of operators
- Section VI modified to provide for “competing” operational proposals
- Section VI clarified procedure for modifying or terminating operations once commenced
- Section VI clarified voting procedures for conducting repair work and use of subsequent equipment
- Section VII modified remedies on default
• Model Joint Operating Agreements developed by AAPL for use in offshore operations
• Developed for coal bed methane expansion
• Most operators adapt Model Form to suit their own requirements
• Seldom adopted “whole cloth”
• First horizontal well drilled over 80 years ago
• Nominal occurrence of horizontal wells until advances in hydraulic fracturing
• First horizontal wells in Kentucky and Pennsylvania occurred in 2007
• Over 80% of all Pennsylvania wells are horizontal
Model Form 610 Issues

• Provisions of the 1989 Model Form 610 did not address issues encountered during the course of horizontal drilling
• Modifications to Model Form were debated for over three years
• Definitional and substantive changes to the Model Form are necessary to minimize problems among operators and non-operating interests
Changes to Model Form

• **Definitions** - Added, revised, and supplemented several definitions to account for horizontal well drilling. For example, the term “Deepen” has been supplemented to account for the possible drilling of a horizontal well and, as a result, rules governing the deepening of a well will cover the horizontal extension of a horizontal wellbore.
• **Spudder Rigs**

  • A new section has been added to address the reality of two drilling rigs potentially used or required by horizontal drilling - Spudder Rigs and Horizontal Rigs (Article VI.B.9.).

  • If the operator desires to extend the time-period between the Spudder Rig and the “Horizontal Rig Move-On Period”, the operator may extend that timeline for “X” number of days, or beyond those days, by affirmative vote of “X” percentage of Consenting Parties.
• If the initial Horizontal Well proposal does not provide for a Spudder Rig to be utilized, the Operator may elect to utilize a Spudder Rig upon affirmative vote of “X” of the Consent Parties.
• **Drilling and Development**

• The location for an Initial Well is the “surface and bottom hole of the Lateral(s).” The language is important in the context of horizontal wells where the distance between the surface and bottom hole of the lateral can be thousands of feet.
• If a horizontal rig has not commenced operations within the “Horizontal Rig Move-On Period”, and the Consenting Parties have not extended the deadline (as set forth in (a) above), the Operator is required to re-propose the well. If only a lesser number of Interest Owners elect to continue participation in the well, the then Operator will reimburse the previous consenting parties for unused funds and the Consenting Parties are required to reimburse the parties who consented to the previous proposal for such prior party’s costs incurred.
Changes to Model Form

- **Multi-well Pads**
- Multiple horizontal wells are frequently drilled from the same pad location. If multiple wells are drilled or proposed from a single pad or location, the costs of such single pad shall be allocated, and reallocated, among all of the Consenting Parties of each of the wells on such pad. Presumably, if a party consented to a prior well, but declined to consent to a new well proposal, that party would be reimbursed for its well pad costs to the extent such party’s proportionate ownership interest in the pad was reduced by the new well.
Changes to Model Form

- **Well Completion**
- The Consenting Parties to a horizontal well do not have the option to decline to participate in a Completion attempt and “Option No. 1” of Article VI.C.1. is now mandatory for all horizontal well proposals. If Option No. 1 is not deleted or revised in some manner, the effective result is that the Completion is agreed to at the time of the initial well proposal. This change is consistent with the fact that once the wellbore has penetrated the objective formation and begins to deviate from a vertical orientation, the drilling of the horizontal segment of the wellbore is both a drilling and completion operation.
• Well completion cont’d
• Data that might be gathered and evaluated for a casing point election in a vertical well, is customarily already available at the time the decision is made to deviate from the vertical portion of a horizontal well. Consequently, horizontal wells are generally drilled as completed wells. Where it is contemplated that a horizontal well will be perforated and some form of stimulus performed, there is generally no identifiable point for a casing point election to be made.
• Less than 100% Participation-If the Operator elects to proceed with drilling operations without 100% of the working interest owners having signed the 1989 JOA (Horz.), there are now two options the parties may select. One option, and formerly the only option, is for the Operator to indemnify the Non-Operators for all costs incurred in the well operation that would have been charged to the Non-Operators if all of the interest owners joined the JOA.
Changes to Model Form

• Less than 100% participation in 1989 JOA (Horz.) – cont’d
• The other option is for the Operator to advise all parties of the total interest of the parties who have executed the 1989 JOA (Horz.). Each party joining the 1989 JOA (Horz.) then has the right to (i) limit its participation in that well to its interest shown on Exhibit “A” (as opposed to its aggregate participation interest in the well proposal) or (ii) carry a portion of the interest of the party non-executing party. The Operator must carry the interest of any non-executing party that is not otherwise carried by a Consenting Party.
Changes to Model Form

- **Other Provisions**
- As the 1989 JOA enters its fourth decade of use, most practitioners are accustomed to seeing (often numerous) additions to Article XVI. Some of the most common additions are now included in the updated 1989 JOA (Horz.).
- The provisions of Article XVI now expressly control over any other article of the 1989 JOA (Horz.).
Changes to Model Form

• The Operator is given the right to cease drilling a horizontal well, if the horizontal well has reached its objective depth and, more importantly, to a distance or “Displacement” that a reasonably prudent operator would deem further drilling is not justified or required. The Operator may also conduct operations at a variance from the operations outlined in an approved AFE proposal, in Operator’s discretion as a reasonably prudent operator. With respect to both of these additions, it would be important for the Non-Operators to consider what level of control the Operator should maintain over the distance and length of the horizontal leg of the well.
Changes to Model Form

• Priority of Operations is now included by default in Article XVI - (1) testing, coring or logging; (2) complete drilling operations of proposed Laterals; (3) extend or Deepen a Lateral; (4) kick out and drill an additional Lateral in the same formation; (5) Plug back he well to another formation or zone; (6) Sidetrack; and (7) plug and abandon the well.

• The Operator also has the ability to not conduct a contemplated operation if a reasonably prudent operator would not do the same, for fear of placing the hole in jeopardy or losing the hole prior to completion.
• Next, it must specify the following:
  – Total Measured Depth
  – Surface and Bottom Hole Locations
  – Horizontal Distances/Displacement
  – Utilization and Scheduling of Rigs
  – Stimulation Operations, Staging and Sizing.
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