Old Forms, New Fights: The Joint Operating Agreement & Lessons from Recent Texas Litigation

Monika U. Ehrman
SMU Dedman School of Law
SMU Lyle School of Engineering (courtesy)

Joint Operating Agreements under pressure.

Navigating Liens, Lessors, and Lateral Wells in 2026

A.A.P.L. FORM 610 - 1989

MODEL FORM OPERATING AGREEMENT
HORIZONTAL MODIFICATIONS

OPERATING AGREEMENT

DATED

OPERATOR

CONTRACT AREA

NotebookLM

A.A.P.L. FORM 610 - 1989

MODEL FORM OPERATING AGREEMENT
HORIZONTAL MODIFICATIONS

OPERATING AGREEMENT

DATED

________________ , __________ ,
Year

OPERATOR ____

CONTRACT AREA ____

____

____

The JOA

- Joint operating agreements (JOAs) "are contract[s] typical to the oil and gas industry whose function is to designate an operator, describe the scope of the operator's authority, provide for the allocation of costs and production among the parties to the agreement, and provide for recourse among the parties if one or more default in their obligations." -- *Tawes v. Barnes*, 340 S.W.3d 419, 426 (Tex. 2011).

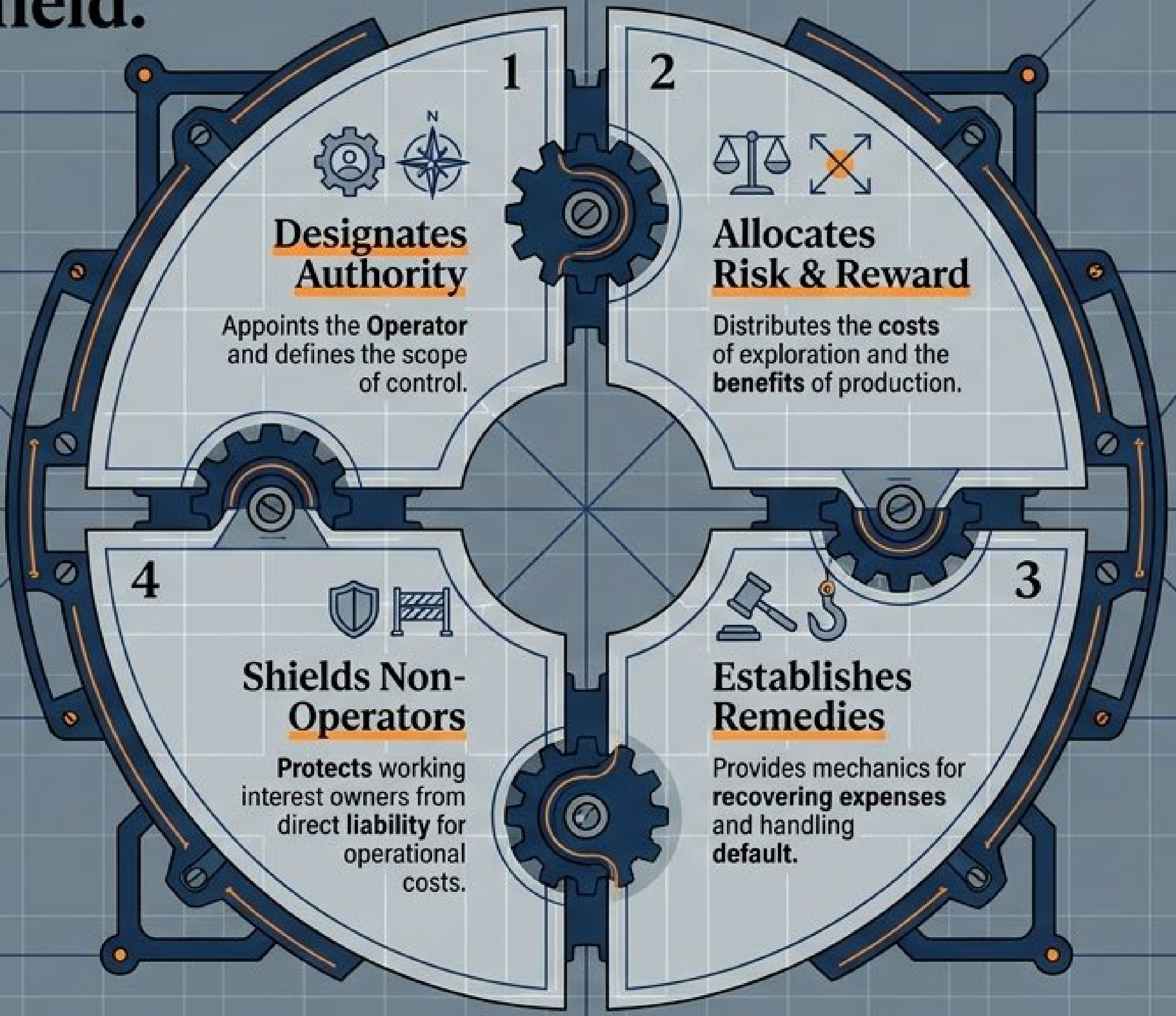
Overview of the JOA

- Contract governing operations between working interest or mineral owners
- May operate independently or be part of another contractual arrangement such as a farmout
- JOA sets out (1) obligations of parties to share expenses of exploration, drilling, and production, (2) rights of parties to share in benefits, (3) methods for recovering expenses (remedies), and (4) default

Overview of the JOA

1. Obligations of parties to share expenses of exploration, drilling, and production
2. Rights of parties to share in benefits
3. Methods for recovering expenses (remedies)
4. Default
5. Designation and removal of Operator
6. Limits on transfer and acquisition
7. Rights of production

The foundational operating system of the oilfield.



"JOAs are contract[s] typical to the oil and gas industry whose function is to designate an operator, describe the scope of the operator's authority, provide for the allocation of costs and production... and provide for recourse among the parties." — Texas Supreme Court in *Tawes v. Barnes* (2011)

Overview of the JOA

- JOA participants designate one participant as Operator
- Most often Operator has largest fractional interest or greatest operating expertise
- Operator has great control subject to contractual limitation and removal
- Operator unlike international management committee or Canadian joint venture

Contract interpretation

- Not very much litigation in Oklahoma or Texas regarding the joint operating agreement
- Apply rules of general contract interpretation
- Follow cannons of contract interpretation
- Courts seek to effectuate intent of the parties at the time of execution

Legacy contracts face three modern stress tests in 2026.

Financial Contagion

(CL III v. Steelhead)

What happens when a co-owner buys a third-party statutory lien and forecloses on the joint property?

Outside Interference

(Evans v. Petroplex)

Can an unleased mineral owner enforce a JOA against a non-operating working interest owner to demand royalties?

Technological Evolution

(McCully v. Ovintiv)

Does a 1982 JOA restricted to a specific "Contract Area" apply to modern multi-section horizontal allocation wells?

A case study in three parts

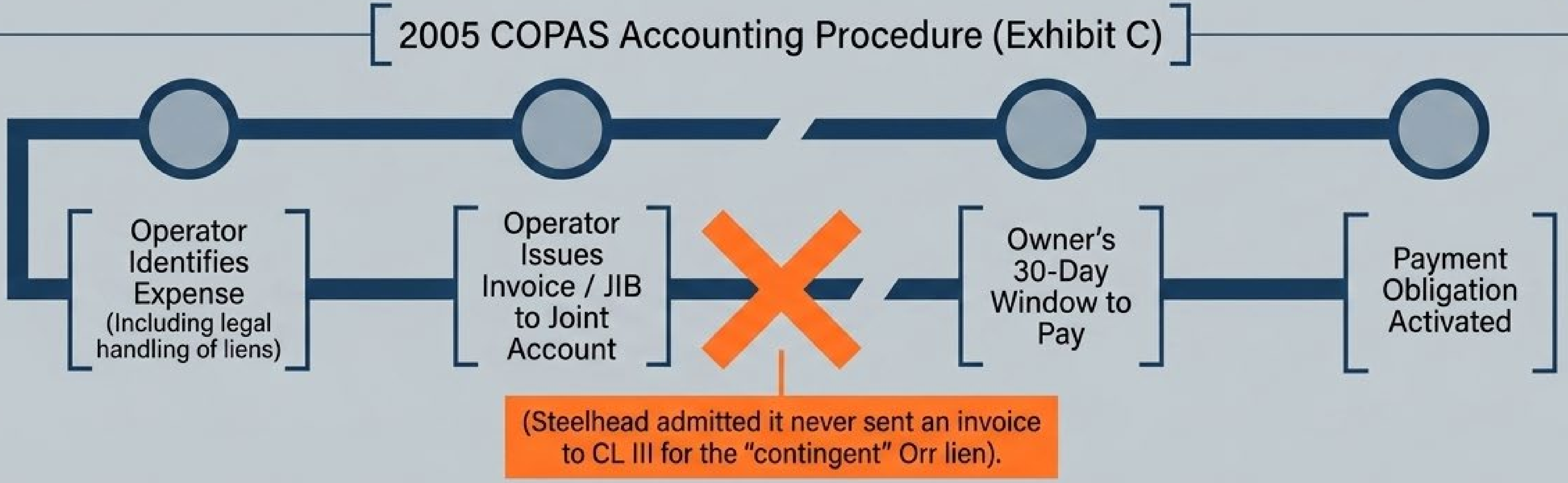
- Liens and foreclosures → ***CL III Funding Holding Co., LLC v. Steelhead Midstream Partners, LLC* (2026)**
- Cross-conveyances and third-party beneficiaries → ***Evans Res., L.P. v. Petroplex Energy, Inc*. (2026)**
- Old JOAs apply to horizontal wells that cross the Contract Area → ***McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc*. (2026)**

LIENS AND FORECLOSURE

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners, LLC, No. 02-21-00188-CV, 2026 LX 10972 (Tex. App.—Fort Worth Jan. 8, 2026, no pet. h.)

The parties have a lengthy and contentious history. [*4] And while much of that history is irrelevant to the dispositive issue—the JOA's plain language—it nonetheless shapes the arguments and judgment before us.

An unbilled contingent liability does not trigger a JOA breach.



No Proactive Duty

The JOA's plain language does not require an owner to calculate and volunteer payment for unbilled expenses. The operator's bill is the mandatory trigger.

Lien Acquisition is Lawful

The JOA's "Permitted Liens" clause imposes a duty on the Operator to keep the property free of liens. It does not prohibit Owners from acquiring, holding, or foreclosing on preexisting, third-party statutory liens.

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

MEMORANDUM OPINION ON REMAND

This "long-running dispute" returns to us on remand. *Steelhead Midstream Partners, LLC v. CL III Funding Holding Co., LLC, 709 S.W.3d 605, 605-08 (Tex. 2024)*.

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

- CL III and Strategic Energy co-own pipeline and oil and gas interests; enter into JOA with Steelhead Midstream, Property operator
- Property was subject to preexisting statutory lien; Strategic argued that CL III predecessor was responsible for debt underlying lien & that CL III had agreed to pay
- CL III disagreed

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

- JOA did not address lien and Steelhead never invoiced CL III for lien as Property expense
- CL III settled lien with debtholder, acquired the lien, and filed suit in Montague County to foreclose on the Property in satisfaction
- Strategic & Steelhead sued CL III in Tarrant County, alleging CL III breached the JOA

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

- JOA did not address lien and Steelhead never invoiced CL III for lien as Property expense
- CL III settled lien with debtholder, acquired the lien, and filed suit in Montague County to foreclose on the Property in satisfaction
- Strategic & Steelhead sued CL III in Tarrant County, alleging CL III breached the JOA

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

- CL III secured foreclosure in Montague County, but Tarrant County trial court found that CL III violated the JOA
- US District Court found the Tarrant County lawsuit a collateral attack on the foreclosure judgment

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

- Texas Supreme Court disagreed—distinguished between Property owners' shared liability to lienholder for *construction debt* & CL III's separate *contractual debt* to Strategic & Steelhead for agreeing to pay expenses under the JOA

"[p]roperly understood, [Strategic and] Steelhead's Tarrant County lawsuit seeks to establish not that the result of the foreclosure litigation was incorrect, but that the result of the foreclosure litigation triggers contractual obligations CL III owes to [Strategic and] Steelhead").

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

- Case returned to 2nd App. Court to review Strategic & Steelhead's breach of contract claim under JOA

Issue: Did CL III's "separate[] agree[ment with Strategic & Steelhead] . . . to share all expenses as between themselves" either (1) require CL III to proactively calculate and pay for its share of the lien debt without receiving a bill from Steelhead for the amount; or (2) prohibit CL III from acquiring, holding, or enforcing the preexisting third-party lien on the Property?

The answer is no; the plain language of the JOA contained no such requirement or prohibition.

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

Pre-JOA history

- CL III predecessor, WBH Energy, and Strategic's predecessor, US Energy, entered into JOA to develop Property in 2011—each owned 50% working interest
- WBH affiliated was Operator and hired Orr Construction to build pipeline. WBH did not pay its 50% share and Orr put lien on Property

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

Pre-JOA history

- Later, WBH and operator affiliate filed for bankruptcy; Strategic acquired US Energy’s interest in Property (with US Energy serving as its GP)
- During bankruptcy, US Energy settled with one of WBH’s lenders—CL III

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

Pre-JOA history

- According to US Energy, it agreed not to oppose CL III's acquiring WBH's Property interest if:
    1. CL III would not hold US Energy liable for WBH's Property-related debts; and
    2. CL III would allow a US Energy affiliate—Steelhead--to serve as operator

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

"Time would tell that CL III understood the settlement differently."

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

The JOA

- In 2015, Strategic & CL III (owners) and Steelhead (operator) entered into a JOA

Owners bear individual liability for respective share of costs and expenses

Each owner "shall be liable only for its Participating Interest of the costs of acquiring, construing, maintaining, repairing[,] and operating the [Property]" and that "[s]uch costs and expenses shall be determined by Operator in accordance with the terms of Exhibit ‘C.’”

Detailed JOA billing procedures are set forth in the COPAS.

- Ex. C is the 2005 Council of Petroleum Accountants Societies, Inc. (COPAS) Accounting Procedure for Joint Operation, which detailed how, when, and what the operator could bill to the owners
- Much of JOA—including COPAS—relates to Operator's rights & responsibilities in its payment, billing, and collection of Property expenses

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

- JOA requires that:
  1. "Operator shall pay . . . all accounts . . . for services . . . and for materials supplied . . . and shall keep the [Property] free from Liens resulting therefrom except for Permitted Liens,"; and
  2. Operator would "invoice each System Owner on a periodic basis" and "charge . . . [them] their respective share . . . of such costs and expenses."

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

"Permitted Liens" by definition included liens for obligations "that [we]re . . . not due or delinquent or, if due or delinquent, [we]re being contested in good faith by Operator in appropriate proceedings . . . so long as the proceedings d[id] not pose a risk of sale, forfeiture, or loss of any System Owner's interest."

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

"COPAS provided what, when, and how the invoicing was to be done. . . [T]he procedures stated that the operator would 'bill the System Owners on or before the last day of the month for their proportionate share of the Joint Account for the preceding month,' that '[s]uch bills [should] be accompanied by statements that identify the AFE (authority for expenditure),' and that 'all charges and credits [must be] summarized by appropriate categories of investment and expense."

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

COPAS "procedures also listed out categories of expenses that the operator 'shall charge [to] the Joint Account' and bill to the owners, with one such category being 'LEGAL EXPENSE[S],' i.e., the 'fees and costs of handling . . . [or] discharging litigation, claims, and liens incurred in or resulting from operations under the Agreement, or necessary to protect or recover the Joint Property.'

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

- Under COPAS, Owners required **upon receiving an invoice for payment** to pay within 30 days
- If Owner fails to fully pay, Operator required to "provide prompt notice to all System Owners of such event," and Operator authorized to take certain enforcement actions, such as making a "Cash Call."
- Each owner grants other JOA parties "a lien and/or security interest" on its Property interest to secure performance of all obligations under JOA

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

- JOA allowed Operator to reserve portion of net monthly revenue otherwise payable to an owner if the operator "deem[ed it] reasonably necessary or appropriate . . . based on Operator's projection of reasonably foreseeable expenses," and it provided a procedure for the operator to request an advance from the owners.

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

- JOA emphasized that the parties' reciprocal liens were "given to secure only the debts of each severally"; that "no System Owner shall have any liability to third parties hereunder to satisfy the default of any other System Owner in the payment of any expense or obligation hereunder"; and that the parties were "free to act on an arm's-length basis . . . subject, however, to the obligation of the Parties to act in goodfaith in their dealings with each other with respect to activities hereunder."

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

- In 2016, less than a year after JOA execution, CL III settled pipeline debt with Orr, acquired right to enforce and sued US Energy to foreclose
- In 2017, Strategic and Steelhead file Tarrant County breach of JOA action and request antisuit injunction; Strategic added to foreclosure lawsuit

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

- "In the midst of this legal chaos," CL III and Strategic sell their interests to Eagleridge Energy II, LLC. Under CL III contract, Eagleridge agrees "it would be 'responsible for all costs, expenses, claims, liabilities, and obligations arising from or related to the ownership, operation and maintenance of the Properties . . . Attributable to periods from and after' the date of sale."

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

- In 2019, CL III obtains a foreclosure judgment against the Property
- Eagleridge pays the judgment and intervenes in the litigation, aligning with Strategic and Steelhead

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

- At trial, evidence introduced that CLE III was never invoiced for the lien, calling it a “contingent liability”

“According to U.S. Energy's former president, Steelhead would not have invoiced either Strategic or CL III for the Orr lien expense until "resolution of that lawsuit."

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

- But because Strategic and CL III had assigned Property interests to Eagleridge before the foreclosure lawsuit's resolution, Steelhead never sent CL III a bill for the lien expense.

“When U.S. Energy's former president was asked if ‘Steelhead, Strategic, or [U.S. Energy] ever sen[t] CL III a notice of default’ for its failure to pay the lien expense, he responded, "We sent them the lawsuit.”

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

- Trial court finds for CL III, awarding $2 million—a figure that included:

(1) attorneys' fees incurred in the foreclosure suit,

(2) the amount Eagleridge had paid to satisfy the foreclosure judgment,

(3) attorneys' fees and contingent appellate attorney's fees in the Tarrant County lawsuit, and
(4) prejudgment interest from August 7, 2017

CL III Funding Holding Co., LLC v. Steelhead Midstream Partners (2026)

Holdings are simple:

1. The JOA did not require CL III to pay an unbilled expense. "The JOA (and its COPAS procedures) made the operator's bill the trigger for the owners' payment obligations."

2. The JOA did not prohibit CL III from acquiring, holding, or foreclosing on the lien. "None of the JOA provisions . . . nor anything else in the JOA—prohibited the owners from acquiring, holding, or foreclosing on a preexisting third-party lien."

Challenge and Lessons

- Follow the contract
- Title searches are still critical –> do not let liens sit
- Shortened hold of properties increasing turnover; caveat assignee! Due diligence in transactions requires curing of defects
- Effective date of assignments may not capture existing/contingent liabilities

CROSS-CONVEYANCES AND THIRD-PARTY BENEFICIARIES

Evans Res., L.P. v. Petroplex Energy, Inc., No. 11-24-00192-CV, 2026 LX 141860 (Tex. App.—Eastland Mar. 12, 2026, no pet. h.)

Outside interference challenges the shield of the non-operator

Entity Map

Evans (The Lessor)

An unleased fee mineral owner whose lease on cotenancy acreage partially terminated in 2018.

The Stressor: Evans bypasses Diamondback and directly sues the Anwars for "Money Had and Received," demanding an equitable accounting of cotenant profits and claiming the Anwars pocketed his rightful royalties from the horizontal wells.

The Anwars (The Non-Operators)

JOA participants who contributed separate leases and hold a 35% working interest in horizontal well production.

Diamondback (The Operator)

The lessee of the Evans lease and the party responsible for distributing revenue under the JOA.

Without privity, third parties cannot pierce the JOA

No Privity of Estate

The JOA expressly states in Article III.B: "Nothing contained in this Article… shall be deemed an assignment or cross-assignment of interests." The Anwars received no permanent interest in the Evans lease.

No Privity of Contract

The Anwars never contractually assumed a duty to pay royalties directly to Diamondback's lessors.

No Third-Party Beneficiary

The JOA explicitly disclaims third-party liability. The intent of a JOA is to allocate operating expenses, not to benefit unleased mineral owners.

The Ruling: A lessor cannot enforce a JOA against a non-operator. Furthermore, the Anwars proved they only received their 35% allocation from their own contributed leases, defeating the "money had and received" claim.

Evans Res., L.P. v. Petroplex Energy, Inc. (2026)

- Evans (Diamondback lessor and unleased mineral interest owner) seeks oil and gas royalties allegedly paid by Diamondback to the Anwars (JOA parties) for horizontal wellsite locations on cotenancy acreage.
- Absent privity of contract, privity of estate, or third-party beneficiary status, a lessor cannot enforce the JOA

CHALLENGES AND LESSONS

- Absent privity of contract, privity of estate, or third-party beneficiary status, a lessor cannot enforce the JOA
- Third party beneficiary status must be clearly intended in the contract

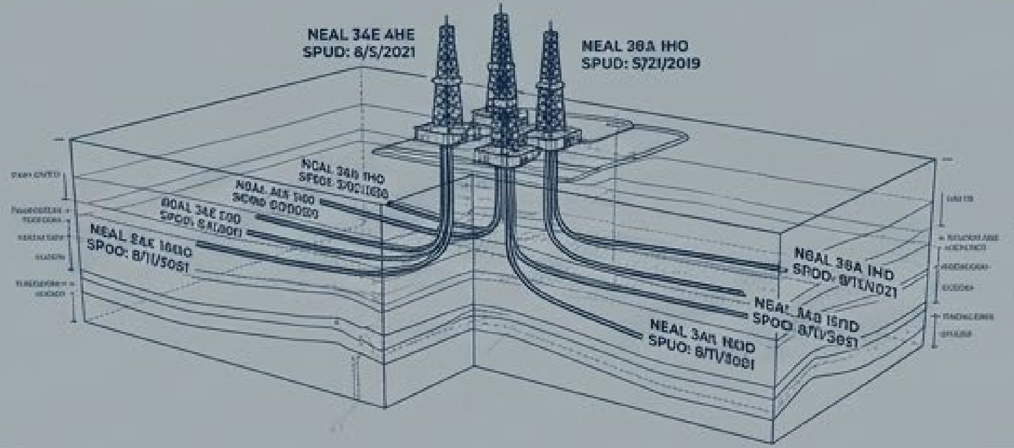
OLD JOA APPLY TO HORIZONTAL WELLS THAT CROSS THE CONTRACT AREA

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc., No. MO:24-CV-00018-DC, 2026 LX 148623 (W.D. Tex. 2026)

Technological evolution collides with legacy Contract Areas.

The Setup (1982)

The original parties execute a JOA covering a specific "Contract Area" (Section 46, from surface to the base of the Dean formation).



The Evolution (2026)

Ovintiv (Operator) proposes the "Neal Wells"—modern allocation wells spudded off-lease in Sections 34 and 39, producing through Section 46, and ending off-lease.

The Stressor:

McCully (Non-Operator) goes non-consent. Later, after an acquisition by Spearpoint, McCully argues the 1982 JOA simply does not apply because the horizontal wellbores are not fully encompassed within Section 46, meaning Ovintiv cannot charge non-consent penalties.

[“On” the Contract Area does not mean “solely within” it.]

The Court’s Finding:

- Under Texas law, a horizontal well is located “on” every tract where a productive portion of the well is located (Springer Ranch).
- The JOA expressly applies to “any well on the Contract Area” and grants the operator control over “all operations on the Contract Area.”
- Crucially, the 1982 JOA contains no explicit requirement that a wellbore remain “solely within” the boundary lines. Courts refuse to read new limiting language into the text.

Conclusion:

The 1982 JOA applies to the productive lateral segment within Section 46, regardless of where the surface hole is located.

***McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc.* (2026)**

- Ovintiv owned working interests in various sections in Upton County, including Sec. 46
- McCully owned working interests in Sec. 46, but working interests were depth limited. No other interests owned in other sections
- Ovintiv obtained title opinions and never credited McCully with any working interests in certain Neal wells (not at issue)

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

7. Ovintiv drilled the following horizontal wells through Section 46:

WELL NAME	API	SPUD DATE	PRODUCING STATUS	BALLOT
NEAL 34E 4HE	4246141759	8/5/2021	ACTIVE	June 2021
NEAL 34F 8HE	4246141764	8/8/2021	ACTIVE	June 2021
NEAL 34G 10HD	4246141766	8/9/2021	ACTIVE	June 2021
NEAL 34X 15HD	4246141921	Original: 8/11/2021	ACTIVE	June 2021
NEAL 39A 1HD	4246141275	9/21/2019	ACTIVE	September 2019
NEAL 39A 2HF	4246141276	9/20/2019	ACTIVE	September 2019
NEAL 39B 6HC	4246141280	9/15/2019	ACTIVE	September 2019
NEAL 39B 7HF	4246141281	9/16/2019	ACTIVE	September 2019
NEAL 39B 10HE	4246141284	9/16/2019	ACTIVE	September 2019
NEAL 39C 11HF	4246141285	9/24/2019	ACTIVE	September 2019
NEAL 39C 14HE	4246141288	9/21/2019	ACTIVE	September 2019
NEAL 34F 6HD	4246141762	8/7/2021	ACTIVE	No
NEAL 34X 14HE	4246141770	8/10/2021	ACTIVE	No
NEAL 39A N 5HE	4246141378	11/22/2019	ACTIVE	No
NEAL 39A 4HJ	4246141278	9/19/2019	ACTIVE	September 2019
NEAL 39B 9HJ	4246141283	9/6/2019	ACTIVE	September 2019
NEAL 39C 13HJ	4246141287	9/22/2019	ACTIVE	September 2019

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- Neal Wells (at issue) were all drilled through Sec. 46 from surface locations on neighboring lands (Sec. 34, Sec. 39)
- Neal Wells all have perforations and produce from Sections 34, 39, and 46 (and some from Sec. 2)
- McCully does not own an interest in Sections 2, 34, or 39—only 46

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- 1977 form JOA executed in 1982 and Ovintiv (Operator) and McCully (non-operator) are successors in interest to original parties
- JOA contains "non-consent penalty" provisions, which apply “when one party exercises the right not to participate in a drilling operation

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- The non-consenting party declines to contribute any upfront costs and thereby avoids the risk of a potential failed operation, but it also gives up the right to share in proceeds from the well until the participating parties recoup a pre-set multiple of certain costs. The non-consent provisions incentivize the parties to share the costs and risks of development activities, while leaving each party free to opt out of operations it perceives to be ill-advised or insufficiently lucrative. *See Valence Operating Co. v. Dorsett*, 164 S.W.3d 656, 665 (Tex. 2005)

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- "If all working interest owners shared equally in production revenues from subsequent projects, whether they consented or not . . . the incentives would strongly favor <u>not consenting</u> because, [in the absence of the 'penalties'], a non-consenting party would be able to reap the rewards of new operations without incurring any expense." *Valence Operating Co. v. Dorsett*

***McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc.* (2026)**

- "If all working interest owners shared equally in production revenues from subsequent projects, whether they consented or not . . . the incentives would strongly favor <u>not consenting</u> because, [in the absence of the 'penalties'], a non-consenting party would be able to reap the rewards of new operations without incurring any expense." *Valence Operating Co. v. Dorsett*

***McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc.* (2026)**

- JOA "Contract Area" includes Sec. 46 from the surface to the base of the Dean formation (but above the Wolfcamp). It does not include Secs. 2, 34 or 39
- Neal Wells at issue: (1) produce from Contract Area under the JOA; (2) under a claim made by McCulley; and (3) McCulley has recognized ownership interest

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- McCulley does not dispute reasonableness of actual costs incurred by Ovintiv to drill, complete, equip, and operate the Neal Wells
- "The JOA expressly applies to 'any well on the Contract Area.' Ex. D-1 art. VI.B. The Neal Wells are 'wells,' and at least part of those wells are 'on' the Contract Area. The JOA uses the term 'well' repeatedly, without modifiers."

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- JOA provides that parties own their share of oil and gas "from the Contract Area," and are liable for their share of the "costs of developing and operating the Contract Area"
- Under Article VII, "parties are proportionately responsible for expenses incurred in the development and operation of the Contract Area"

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- JOA provides that parties own their share of oil and gas "from the Contract Area," and are liable for their share of the "costs of developing and operating the Contract Area"
- Under Article VII, "parties are proportionately responsible for expenses incurred in the development and operation of the Contract Area"

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- Neal Wells are allocation wells. Ovintiv allocates all costs, production, and revenues associated with the Neal Wells to various interest owners based on owners' relative ownership in the minerals traversed by the wells
- Ovintiv calculates a "tract participation factor" for each tract, which is ratio of the productive portion of the well’s lateral located on each tract to the total length of the well’s productive lateral, measured from its first to its last take point

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- In these allocation wells, an interest owner’s share of the well's costs and revenues is calculated by multiplying the party's ownership interests in each tract by that tract’s participation factor
- McCully did not dispute allocation method or reasonableness of the costs allocated to its interests in the Neal Wells

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- In these allocation wells, an interest owner’s share of the well's costs and revenues is calculated by multiplying the party's ownership interests in each tract by that tract’s participation factor

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- Allocation method is how Ovintiv calculates both (1) the "costs of developing and operating the Contract Area" and (2) the Parties' proportionate shares of production from the Contract Area
- McCully did not dispute allocation method or reasonableness of the costs allocated to its interests in the Neal Wells

***McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc.* (2026)**

"'The phrase 'solely within the Contract Area' <u>does not appear</u> within the JOA, and the JOA <u>does not include</u> any other language limiting the type of well that the Operator can drill.

The JOA <u>does not include</u> any language restricting the Operator's use of new technologies or drilling techniques. The JOA expressly grants the Operator authority to 'conduct and direct and have full control over all operations on the Contract Area as permitted and required by, and within the limits of, this agreement.'"

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- Ovintiv proposed each of the Neal Wells to McCulley, which chose to go non-consent
- Ovintiv's well proposals contained the proper information (AFEs, location plats, etc.) and properly stated they were subject to the JOA. Proposals stated that Neal Wells would produce from Sec. 46 and other lands.
- Well proposals clearly stated that Ovintiv would apply nonconsent penalties

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- McCulley reviewed and went non-consent in 2019 and 2021 Neal Well proposals
- The 2019 and 2021 proposals provided McCully notice of all the Neal Wells that would traverse interests owned by McCully
- No evidence that McCully objected to JOA's application to Neal Wells

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- McCulley reviewed and went non-consent in 2019 and 2021 Neal Well proposals
- The 2019 and 2021 proposals provided McCully notice of all the Neal Wells that would traverse interests owned by McCully
- No evidence that McCully objected to JOA’s application to Neal Wells; McCully geologist advised to go nonconsent

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- McCully made decision to nonconsent knowing it could back into "good wells" and that Ovintiv would likely apply nonconsent penalties
- After commencement, McCully did not pay for any Neal Well expenses; Ovintiv applied non-consent penalties; McCully did not object

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- Some Neal Well surface locations changed, which changed well names
- "These slight deviations did not change the renamed wells' target objectives or economic projections and are not uncommon in the industry. Industry custom and practice is that operators need not re-ballot such wells because small changes in surface hole location are not material and would not cause a reasonable non-operator to change its election."

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- Some Neal Well surface locations changed, which changed well names
- "These slight deviations did not change the renamed wells' target objectives or economic projections and are not uncommon in the industry. Industry custom and practice is that operators need not re-ballot such wells because small changes in surface hole location are not material and would not cause a reasonable non-operator to change its election."

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- So, what changed?
- "McCully experienced a change of ownership and management in 2022, when Spearpoint Resources ("Spearpoint") acquired 100% of the equity interests in McCully from Cheryl Mellenthin."

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- McCully asked Court to declare that JOA does not apply to the Neal Wells, and as a result, the nonconsent penalties do not apply
- Declaratory judgment allows any U.S. court to "declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought." – Declaratory Judgment Act

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- Court begins with a review of contract law to construe a JOA
- "In construing a JOA, the ordinary principles of contract interpretation apply." *See ExxonMobil Corp. v. Valence Operating Co.*, 174 S.W.3d 303, 312 (Tex. App.—Houston [1st Dist.] 2005, pet. denied) ("In interpreting a joint operating agreement, we apply principles of contract law.")

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. **(2026)**

- Court begins with a review of contract law to construe a JOA
- "In construing a JOA, the ordinary principles of contract interpretation apply." *See ExxonMobil Corp. v. Valence Operating Co.*, 174 S.W.3d 303, 312 (Tex. App.—Houston [1st Dist.] 2005, pet. denied) ("In interpreting a joint operating agreement, we apply principles of contract law.")

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

1. "The primary concern of the court is to ascertain the true intentions of the parties as expressed in the instrument." *Coker* v. *Coker*, 650 S.W.2d 391, 393 (Tex. 1983)."
2. "To that end, courts must consider the entire writing in an effort to harmonize and give effect to all the provisions of the contract so that none will be rendered meaningless." *Id*.
3. "No single provision taken alone will be given controlling effect; rather, all the provisions must be considered with reference to the whole instrument." *Id*.

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

Does a JOA which covers only Section apply to allocation wells drilled through and on that Section?

Yes. The JOA applies because the Neal Wells develop and are on the Contract Area. Court refers to JOA Preamble, Art. V.A, Art. VII)

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- McCully argues the JOA governs only if the well is full encompassed within the bounds of the named Contract Area (Sec. 46). According to McCulley, if the productive lateral crosses the Section, the JOA ceases to apply
- Court holds that McCully's interpretation is not supported by JOA language

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

"Under Texas law, a horizontal well is located 'on' every tract on which a productive portion of the well is located. *Springer Ranch, Ltd. v. Jones*, 421 S.W.3d 273, 284 (Tex. App.—San Antonio 2013, no pet.)(concluding that a well may be "situated 'on' more than one 'surface estate'" and that the "only plausible construction" of an allocation agreement was that "royalties must be allocated on the basis that the productive portions of the [] well are situated on both [parties'] properties.")

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- Because of how horizontal wells are viewed under Texas law, "[i]t follows that the JOA applies to wells to the extent they develop and produce from the Contract Area. In th[is] case, the JOA applies to the portions of horizontal wells that fall within its Contract Area, which is Section 46."

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- *McCulley* is distinguishable from *Hill v. Heritage Res.* 964 S.W.2d 89 (Tex. App—El Paso 1997, pet. denied). In *Hill*, there was a negotiated depth limitation in the defined Contract Area
- *McCully* JOA has no such limitation. Whereas McCully focuses on "operations be ***on*** Contract Area," Court says that does not mean "entirely within" & focuses on parties' intent

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- A court is not "permitted to read additional limiting language into the JOA. Caselaw is clear that reading, for example, "solely within" or other words of limitation into the JOA to limit the JOA's application to only wells that are entirely within the Contract Area would "impermissibly add words of limitation to modify the [JOA's] terms," which is not permitted. *Nettye Engler Energy, LP v. BlueStone Nat. Res. II, LLC*, 639 S.W.3d 682, 691 (Tex. 2022).

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- Court also holds that **JOA applies to horizontal wells that traverse the Contract Area**
- "No direct evidence of whether the original parties to the JOA contemplated the use of horizontal wells to develop the Contract Area. But this lack of evidence does not prevent the JOA's application to the Neal Wells. *See Browning Oil Co., Inc. v. Luecke*, 38 S.W.3d 625, 638 (Tex. App.—Austin 2000, pet. denied) ('Although the parties executed the leases and amendments prior to the surge of horizontal drilling and likely did not contemplate the possibility of horizontal wells, no language specifically limits the applicability of the [] provisions to vertical wells.')"

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- Operator who entered the JOA in 1982 also entered into three oil and gas leases in 1980-82 that use the same language found in this JOA, including "well," "drilling," "operating," and "production."
- McCully agrees that these same words, when used in those leases, do apply to the Neal Wells.

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- McCully does not contend that the JOA prohibits horizontal drilling; it believes that the JOA allows and applies to horizontal drilling, including allocation wells—the entirety of those wells just needs to be located within the JOA's Contract Area

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- McCully raises questions on JOA provisions that would inoperable or "rendered meaningless" for off-Contract Area wells, such as:
    a. Article III.B as it pertains to ownership of equipment
    b. Articles V.B.1 and V.B.2, as they pertain to removal of the Operator and election of a successor
    c. Article VI.B, as it pertains to sidetracking a wel
    d. Article VI.D, as it relates to the right of Non-Operators to access the Contract Area
    e. Article VI.E, as it pertains to plugging wells.

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- Court says needs actual case in controversy on those issues (which are not before the Court) --> But note that practitioners should be cautious
- And, even if some provisions seem inoperable, "Texas courts try to harmonize the provisions of a contract to avoid rendering any of them meaningless."

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- No breach of JOA when wells renamed
- Art. VI.B does not expressly address re-balloting or specify when post-proposal changes require a new well election; Court applies reasonableness analysis

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- Distinguishes *Key Operating & Production Co., LLC v. White Capital Group, LLC*, which analyzed material and nonmaterial deviations. "There, the court did not treat the mere existence of differences between the proposed and drilled wells as dispositive. Instead, it examined whether those differences were material, relying on expert testimony that the two drilling paths diverged in consequential respects, including their surface locations, target sand intercepts, and overall risk profiles."

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- Ovintiv's well information contained more detail than JOA required; so, little basis for McCully's argument
- Evidence showed no material changes made to renamed wells

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- McCulley also made claims outside the JOA (extracontractual), which the Court held were barred
- Unlike *Evans*, where Evans was not a party to the JOA, parties to a contract must seek contractual remedies
  - Money had and received claim is based on quasi-contract and unjust enrichment → but valid contract governs

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- Unlike *Evans*, where Evans was not a party to the JOA, parties to a contract must seek contractual remedies
  - Equitable accounting → the duty of a producing co-tenant to account to a nonconsenting or nonproducing co-tenant is a default rule that applies only in the absence of an agreement

McCully-Chapman Expl., Inc. v. Ovintiv USA, Inc. (2026)

- Unlike *Evans*, where Evans was not a party to the JOA, parties to a contract must seek contractual remedies
  - "McCully's claim under Tex. Nat. Res. Code §§ 91.402 and 91.404 likewise fails. Those provisions provide a remedy for the nonpayment of proceeds that are due to a payee. But under the Court's conclusions above, the JOA governs the Neal Wells, and Ovintiv properly applied the JOA's non-consent provisions to McCully's interests in those wells."

Challenges and Lessons

- JOAs are contracts and the parties must demonstrate their intent through the JOA or by subsequent amendments
- JOAs can be long-lived, like the oil and gas lease; so, changes in technology and operations must be thought of and included within the language during the drafting or renegotiation (after assignment) period

Challenges and Lessons

- JOAs designed to modify the default, common law regime by enabling co-tenants to exercise operating rights efficiently and to allocate the drilling risks and costs. *In re Eagleridge Operating*, 642 S.W.3d at 522
- Such agreements do more than apportion costs—they allocate shared liabilities and provide contractual remedies if a party defaults. *Cimarex*, 574 S.W.3d at 97

Challenges and Lessons

- Finally, under the JOA, the Operator is granted great powers to manage and oversee the operations. The nonoperators are granted contractual remedies and rights through that same contract

Actionable Lesson 1: Operational Hygiene

Bill Everything Explicitly

CL III proves that relying on "netting out" revenues or assuming partners will pay contingent liabilities is fatal. If it is an expense, it must be invoiced formally under Exhibit C/COPAS to **trigger default mechanisms.**

Document Immaterial Deviations

McCully protects operators from re-balloting for minor surface hole changes (e.g., Spudder hole adjustments). However, clearly document that **target formations, risk profiles, and allocations** remain identical to the original proposal to avoid Key Operating materiality traps.

Over-Communicate on Proposals

Include AFEs, plats, and explicit notices that JOA non-consent penalties will apply to multi-tract allocation wells.

Actionable Lesson 2: Transactional Due Diligence.

Clear Title Pre-Acquisition

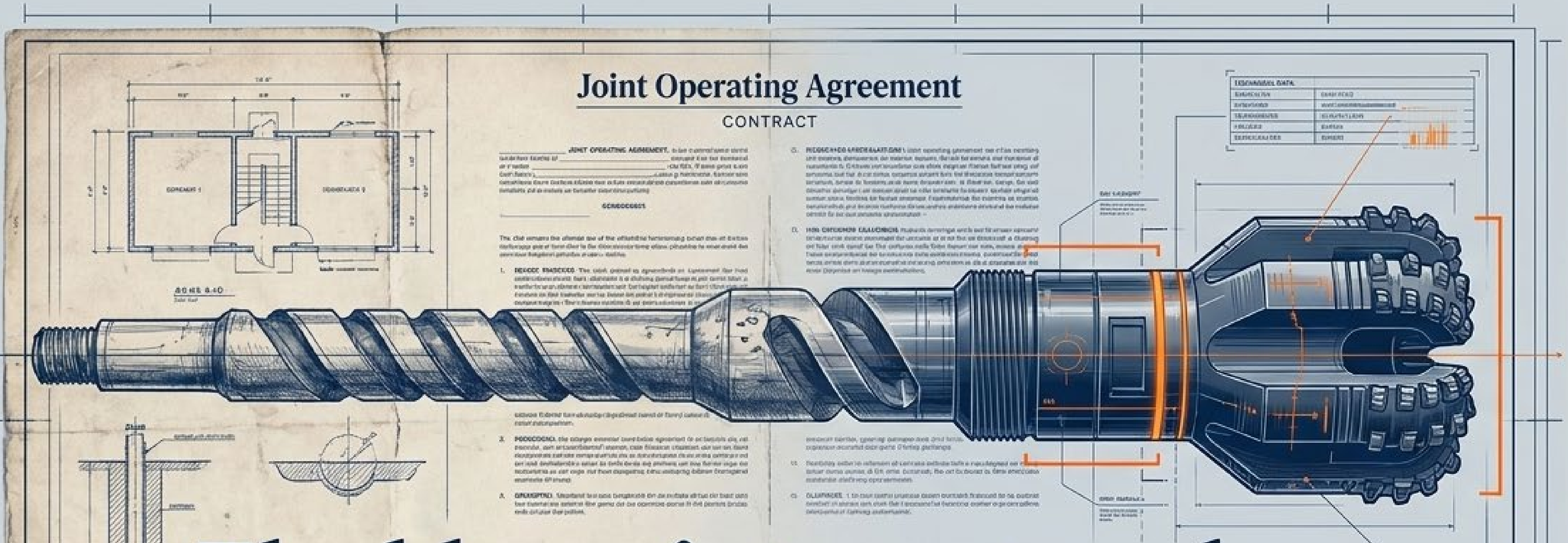
CL III is a **warning.** The JOA's **"Permitted Liens"** clause will not automatically protect you from preexisting statutory encumbrances. Shortened hold times increase turnover risks. Do not let liens sit.

Drafting for Technology

Do not rely on courts to interpret 1970s AAPL forms for 2020s technology. When amending or drafting new JOAs, **explicitly define** how **allocation wells**, tract participation factors, and cross-boundary operations will be handled.

Protect the Privity Shield

Ensure new JOA drafts maintain the **strict anti-cross-assignment language** that saved the non-operators in *Evans*.



The blueprint must evolve.

The JOA remains the ultimate law of the oilfield. As technology scales and financial structures fracture, your contracts must evolve with them—explicitly, not implicitly.

[Draft for tomorrow's technology, not yesterday's precedent.]

SMU Dedman School of Law

Monika U. Ehrman

Professor of Law

SMU Dedman School of Law

Professor of Engineering (by courtesy)

Civil & Environmental Dept., SMU Lyle School of Engineering

mehrman@smu.edu

@MonikaEhrman