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A Closer Look at "Clovelly" – A Common Sense Approach

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MAY 30, 2014

In *Clovelly Oil Co., LLC v. Midstates Petroleum Co., LLC*, 112 So.3d 187 (La. 2013), the Louisiana Supreme Court ruled that an AAPL model form Joint Operating Agreement (JOA) did not cover new leases acquired after the JOA was executed, where the JOA did not also include a separate area of mutual interest (AMI) provision.

This case had the oil and gas industry on tenterhooks because the form of agreement at issue was not a one-of-a-kind form unique to the two litigants in dispute but instead is probably the most widely accepted and most often used form in the industry. When an operating agreement is used in Louisiana, the particular form used is almost always one of the four editions of the "*A.A.P.L. Form 610—Model Form Operating Agreement*" developed by the American Association of Professional Landmen (AAPL): either the original, 1956 edition at issue in *Clovelly* or one of the three later editions (adopted in 1977, 1982 and 1989).

As with any model form of agreement in any industry, the use of AAPL model forms in the oil and gas industry is designed to avoid the need for drawn-out, individualized negotiations and contract forms and to have a familiar form of agreement with a well-established understanding among industry participants over its meaning, purpose and effect. By using AAPL model JOA forms, industry participants are better able to make conscious decisions of when they need or want to deviate from these well-established contract provisions. Thus, the Court's ruling in *Clovelly* affects not just the two litigants, but instead oil and gas producers and mineral lessees throughout the country.

Clovelly involved a JOA executed in 1972 using the 1956 edition of the AAPL Form 610–Model Form Operating Agreement. Although the JOA contained two added, typewritten provisions, it did not include an area of mutual interest (AMI) provision. The parties attached an Exhibit A, which does not enumerate specific leases, but instead merely contains a list of certain township sections with a corresponding plat outlining an area of several square miles in the Pine Prairie Field in Evangeline Parish, Louisiana. The original operator under the JOA held a 56.25%

working interest in the original leases, and the non-operator held the remaining 43.75% working interest. Through a series of assignments, Clovelly Oil Co. LLC succeeded to the rights of the original operator, and Midstates Petroleum Company LLC succeeded to the rights of the original non-operator.

In 2008 (36 years after the JOA was executed), Midstates obtained a new oil and gas lease covering lands within the geographic area described on Exhibit A to the JOA. In 2009, Midstates then successfully obtained production from this new lease. Clovelly promptly notified Midstates that these activities and operations were covered by the 1972 JOA and that Clovelly was entitled to both a 56.25% working interest and the right to operate the associated wells. When Midstates refused to acquiesce in Clovelly's demands, Clovelly sued Midstates. Cross motions for partial summary judgment were filed on the issue of whether the JOA applied to the new lease.

On the one hand, Clovelly relied on the typewritten Exhibit A, along with the AAPL's definition of the term "Unit Area." Section 1(5) of the AAPL form provides:

> (5) The term "Unit Area" shall refer to and include all of the lands, oil and gas leasehold interests and oil and gas interests intended to be developed and operated for oil and gas purposes under this agreement. Such lands, oil and gas leasehold interests and oil and gas interests are described in Exhibit "A."

Section I of Exhibit A is titled "Lands subject to this agreement" and reads "The following described property situated in Evangeline Parish, Louisiana," and lists specified portions of 12 enumerated township sections, with a corresponding plat outlining these same sections.

On the other hand, Midstates pointed to several other preprinted provisions in the AAPL form itself. Midstates noted the present tense in the Preamble to the JOA form:

> WHEREAS, the parties to this agreement ***are*** owners of oil and gas leases covering and, if so indicated, unleased mineral interests in the tracts of land described in Exhibit "A", and all parties have reached an agreement to explore and develop ***these leases*** and interests for oil and gas to the extent and as hereinafter provided:

Midstates also noted the present tense in the definition of "oil and gas interests" in Section 1(4) of the JOA form:

> (4) The term "oil and gas interests" shall mean unleased fee and mineral interests in tracts of land lying within the Unit Area which ***are*** owned by the parties to this agreement.

Midstates also relied on Section 23 of the JOA form, which addresses renewal or extension of leases and provides in relevant part that "[a]ny renewal lease in which less than all the parties elect to participate shall not be subject to this agreement."

Midstates argued that the Model Form JOA at issue does not cover "new leases" (that is, leases granted after the JOA was executed). In support, Midstates cited the present tense language used throughout; it also noted that Section 23 would be meaningless surplusage if all new leases were already subject to the JOA. It also noted that Exhibit A does not itself contain any AMI language and thus does not conflict with these preprinted provisions in the Model Form JOA itself.

In response, Clovelly argued that, because Exhibit A to the JOA does not list any leases but instead merely describes a geographical area, the JOA applies to all mineral interests in the lands described on the Exhibit regardless of when the mineral interests were acquired. Basically, Clovelly argued that, by including a property description and plat on Exhibit A to the JOA, the parties implicitly created an Area of Mutual Interest (AMI) provision so that each party was entitled —or, more specifically per Clovelly's argument, both entitled and required—to obtain its proportionate interest in any mineral lease or other mineral interest acquired by either party within that area.

The trial court granted summary judgment in favor of Midstates finding that the JOA "does not apply to any new oil, gas and mineral leases acquired after July 16, 1972 which are not extension or renewal leases as defined by Section 23 of the aforesaid Joint Operating Agreement."

But on appeal, the Third Circuit reversed finding a conflict between the language in the body of the 1972 JOA and the language included on the Exhibit. The Court of Appeal concluded that the Exhibit attached to the JOA reflected the area the parties intended to be developed under the JOA and because there was no language in the Exhibit that referenced specific leases or limited the coverage of the JOA to presently owned leases, the Exhibit was in conflict with the present tense language contained in the body of the JOA. And because the typewritten language in the Exhibit was prepared by the parties, the court determined it should be given greater deference than the language in the pre-printed form and thus reflects the true intent of the parties. Thus, the court concluded that the JOA should apply to the new lease because "any unleased fee and mineral interests in tracts of land lying within the unit area" delineated on the Exhibit attached to the JOA were "intended to be developed and operated" by the original parties to the JOA. The Third Circuit relied heavily on a Kansas Supreme Court decision *Amoco Production Co. v. Charles B. Wilson, Jr., Inc.*, 266 Kan. 1084, 976 P.2d 941 (1999).

With the support of various industry groups (including the AAPL, which developed the JOA form at issue; the Independent Petroleum Association of America (IPAA), which incidentally my firm represented; the Louisiana Oil and Gas Association (LOGA) and the Louisiana Mid-Continent Oil and Gas Association), Midstates filed a writ with the Louisiana Supreme Court, which then unanimously reversed the Third Circuit. Concluding that the 1972 JOA does not apply to new leases, the Supreme Court reinstated the trial court's judgment. In its discussion of bedrock contract interpretation principles, the Court noted that when printed contract provisions conflict with typewritten provisions, the typewritten provisions prevail. However, before finding such a conflict, a court should first attempt to interpret the contract as a whole and, if possible, "harmonize" the various provisions. "Most importantly, a contract must be interpreted in a common-sense fashion, according to the words of the contract their common and usual significance."

The Court found no express conflict between the language in the pre-printed form and the parties' typewritten Exhibit. The Court stated that the two provisions can be reconciled if the JOA is read to include only "presently-owned leases" (referring to language in the pre-printed form) within the geographical area identified in the Exhibit (referring to the language added by the parties). The court remarked that "this construction of the JOA is reasonable and gives effect to all of its terms." In particular, the Court focused on the language in Section 23 of the JOA, stating:

> If all future leases in the geographic area set forth in the Exhibit "A" are automatically subject to the JOA, the language of Section 23, allowing the parties to choose whether to participate in renewal or extension leases, is essentially rendered meaningless. At the very least, the Court of Appeal's interpretation is incongruous and leads the absurd result that the parties to the JOA would have the option to decide whether to participate in renewal or extension leases, which are more familiar to the parties, but new future leases, with less familiarity, would automatically be subject to the JOA.

The Court recognized that the parties could have expressly provided for the JOA's application to new leases by including an AMI provision. Citing various commentators, the Court discussed the common understanding that, with the limited exception of the extension and renewal clause, the AAPL model forms do not contain an AMI provision and thus that new leases taken within the contract area are not generally covered by the operating agreements. Incidentally, the AAPL, promulgator of the Model Form, also expressed that although the Model Form JOA is designed to accommodate specific negotiated terms and conditions, such as an AMI provision, AMI provisions are not, and have never been, included as a standard provision in any of the four editions of the Model Form JOA. Because the parties elected not to include an AMI provision in their JOA, the

Court ruled that any new leases taken within the geographic area covered were thus not subject to the JOA unless they are "renewal or replacement leases" as defined in the JOA. Because the lease at issue was a new lease and not a "renewal or replacement lease," the Court concluded that the 1972 JOA did not apply to Midstates' new lease.

By reinstating the trial court's decision, the Louisiana Supreme Court solidified the traditional interpretation of the Model Form JOA. The Court's interpretation thus fosters its oft-articulated "public policy and social purpose" in promoting the stability and certainty over the meaning and effect of contracts and deeds affecting lands; moreover, the Court's interpretation follows the long-standing civil law principle *in favorem libertatis* that contractual burdens on immovable property "are never sustained by implication—[that] the title creating them must be express, as to their nature and extent, as well as to the estate to which they are due" and thus that any doubt must be construed against the party seeking to impose the burden. In its common sense approach to contract interpretation, the *Clovelly* Court demonstrated what oil and gas operators and non-operators should expect: namely, uniform interpretation of the rights and obligations the Model Form JOA is designed to provide.