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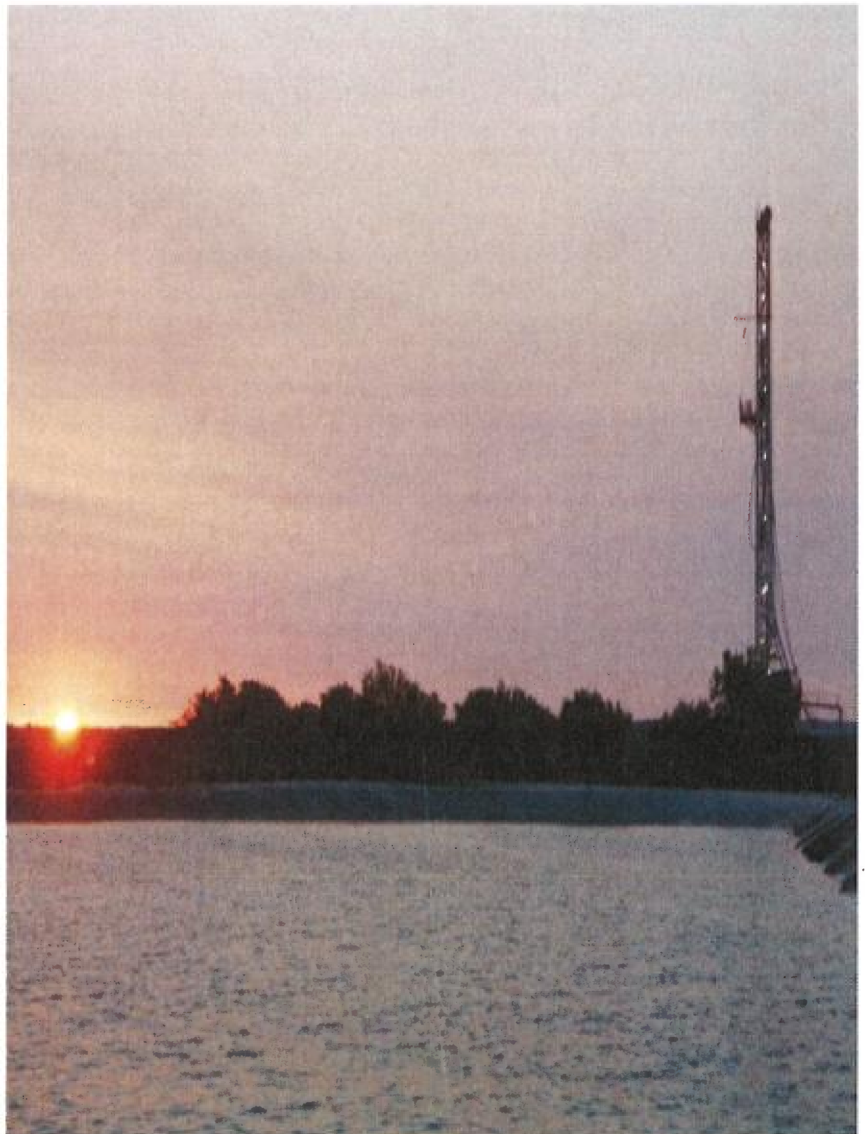

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COPAS ACCOUNTING PROCEDURES: LEGAL ISSUES IN THE PAST AND LEGAL ISSUES THAT MIGHT ARISE IN THE FUTURE[1]

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A. Contract Interpretation Applicable to COPAS Accounting Procedures

Before addressing a number of the specific issues that courts have addressed which involve the COPAS accounting procedures, one must keep in mind that the accounting procedure is an exhibit often attached to a contract—the joint operating agreement—which is interpreted by the courts as any other contract. As such, courts have routinely used general rules of contract interpretation to interpret accounting procedures. *Oklahoma Oil & Gas Exploration Drilling Program v. W.M.A. Corp*, 877 P.2d 613, 615 (Okla. Civ. App. 1994).

As a contract, the language in the COPAS accounting procedure is to be "given its plain and ordinary meaning unless some technical term is used in a manner meant to convey a specific technical concept." *Id.* "If the language is clear and unambiguous, the courts interpret the language as a matter of law." *Id.* The court in *Pitco Prod. Co. v. Chaparral Energy, Inc.*, 63 P.3d 541, 545–46 (Okla. 2003) recapitulated the rules for construing a JOA:

> The JOA is a contract to be construed like any other agreement. If language of a contract is clear and free of ambiguity the court is to interpret it as a matter of law, giving effect to the mutual intent of the parties at the time of contracting. Whether a contract is ambiguous and hence requires extrinsic evidence to clarify the doubt is a question of law for the courts....The mere fact the parties disagree or press for a different construction does not make an agreement ambiguous. A contract is ambiguous if it is reasonably susceptible to at least two different constructions. To decide whether a contract is ambiguous we look to the language of the entire agreement.

See also North Central Oil Corp. v. Louisiana Land & Exploration Co., 22 S.W.3d 572, 575–76 (Tex. App.—Houston [1st Dist.] 2000, pet. denied) (noting that a contract is not ambiguous if it can be given a definite or certain meaning as a matter of law. On the other hand, if the contract is subject to two or more reasonable interpretations, the contract is ambiguous).

It is only when the contract or COPAS accounting procedure is ambiguous that extrinsic evidence, such as the actions and conduct of the parties as well as industry custom and usage, become admissible. As one court has pointed out: "[t]he failure of a JOA to expressly address a question may create an ambiguity requiring extrinsic evidence, such as

[1] Portions of this article were previously published and presented in conjunction with the Rocky Mountain Mineral Law Foundation's Special Institute on Joint Operations (2007), COPAS Accounting Procedures, the 2005 COPAS Accounting Procedures, the Audit Process, and Legal and Practical Considerations. Portions of this paper have been updated to reflect recent developments. For additional legal analysis of COPAS accounting procedures, see Karla Bower & Mark D. Christiansen, *COPAS For Landmen And Lawyers*, 48 ROCKY MTN. MIN. L. INST. § 26 (2002); Susan Richardson, *Will Stapling Create Harmony? Or The Art Of Reconciling The JOA And The COPAS*, DALLAS BAR ASS'N, Review of Oil & Gas Law XIX, (Aug. 19-20, 2004); Ben H. Welmaker, *Oil And Gas Accounting Procedures: Claims For Adjustments And Audit Issues*, STATE BAR OF TEXAS, 24th Annual Advanced Oil, Gas and Energy Resources Law Course (Oct. 2006); Jonathan Baughman & Derrick Price, *COPAS And The 2005 COPAS Accounting Procedures—Significant Changes For Changing Times*, STATE BAR OF TEXAS, Section Report, (Mar. 2005).

industry custom and usage, to determine the intent of the parties." *Stephenson v. Oneok*, 99 P.3d 717, 721 (Okla. Civ. App. 2004) (citing *Oxley v. General Atlantic Resources, Inc.*, 936 P.2d 943, 946 (1997)). When the meaning of an ambiguous contract is in dispute, evidence of extrinsic facts is admissible, and construction of the contract becomes a mixed question of law and fact and should be submitted to the jury under proper instructions. *Stephenson v. Oneok*, 99 P.3d 717, 721 (Okla. Civ. App. 2004). For an excellent article providing a detailed analysis of the use of custom and usage in oil and gas litigation, *see* David E. Pierce, *Defining The Role Of Industry Custom And Usage In Oil & Gas Litigation*, 57 SMU L. REV. 388 (Spring 2004).

In fact, on several occasions, courts have admitted testimony concerning custom and usage in the industry which has included reference to COPAS publications. *See HI Mountain Energy Corp. v. Avra Oil Co.*, 2002 WL 660891 (Tex. App.—El Paso 2002, no pet.) (court found that parties had contemplated additional overhead adjustments as operations continued. However, there was no set overhead adjustment formula and the court found future adjustments would be governed by COPAS); *Cass v. Stephens,* 156 S.W.3d 38, 53–54 (Tex. App.—El Paso 2004, pet. denied) (court admitted expert's testimony and reliance upon COPAS Bulletins in opining that operator failed to comply with COPAS accounting procedure); *Atlantic Richfield Co. v. Holbein,* 672 S.W.2d 507, 515–16 (Tex. App.—Dallas 1984, writ ref'd n.r.e.) (court admitted testimony citing COPAS manual that industry wide practice was to deduct allocated volume for fuel gas before computing settlement owed to royalty owners). Nevertheless, as the Texas Supreme Court has pointed out, while course of performance, course of dealing, and trade usage can supplement or qualify the express terms of the contract, they cannot be used to contradict the clear and unambiguous terms of the contract. *Sun Oil Co. v. Madeley*, 626 S.W.2d 726, 732 (Tex. 1981).

Finally, it should be noted that ambiguities could occur when provisions in the COPAS accounting procedure are in conflict with the joint operating agreement. However, each of the pre-printed A.A.P.L. model form operating agreements (the 1956, 1977, 1982, and 1989) contain a provision stating that in the event of a conflict between the terms of the operating agreement and the accounting procedure, the terms of the operating agreement prevail. *See, e.g.,* A.A.P.L. Form 610 Model Form Operating Agreement-1956, ¶ 8 *and* A.A.P.L. Form 610-1989 Model Form Operating Agreement, Art. II.

B. Applicability of COPAS Model Form Interpretations and Accounting Guidelines

COPAS issues publications to assist the industry in addition to issuing the COPAS accounting procedures. COPAS Accounting Guidelines (AGs) assist in establishing industry standards, and Model Form Interpretations (MFIs) assist the industry in interpreting the various COPAS accounting procedures. These publications are updated by COPAS on a regular basis and provide recommendations and guidelines for joint account issues that tend to arise in practice.[2]

As discussed above, courts generally treat the COPAS accounting procedures as any other contract. Therefore, if the language of the accounting procedure is clear and unambiguous under the circumstances of the dispute, the court should not consider industry custom or usage to contradict the language contained in the accounting procedure. This can become important in whether a court will consider the numerous resources that

[2] For instance, COPAS issued Model Form Interpretation 51 for guidance in interpreting the 2005 COPAS Accounting Procedure.

COPAS has published such as the Model Form Interpretations and Accounting Guidelines.

C. Past Legal Issues Involving The COPAS Accounting Procedure

When one considers how long COPAS accounting procedures have been used in the industry, it is remarkable how relatively few reported cases there are dealing with the various COPAS accounting procedures. This is a tribute to how well the COPAS organization has established its model forms over time and how well in practice the members in the industry have resolved their disputes. As discussed below, most of the litigation surrounding the COPAS accounting procedures has involved the legal presumption created by the Adjustments provision.

1. The Pertinent Provisions of the COPAS Accounting Procedure: Statements and Billings (Section I of the Accounting Procedure) and the Adjustments Provision.

Undoubtedly, the most heavily litigated aspect of the COPAS accounting procedures has involved the 24-month Adjustments provision. Since the creation of COPAS, each published version of accounting procedures distributed by COPAS has contained an Adjustments provision. In fact, provisions very similar to the Adjustments provision contained in the COPAS accounting procedure were in use prior to the existence of COPAS.[3] From a practical and legal standpoint, the Adjustments provision can have the most significant legal effect on a non-operator's ability to obtain adjustments to the joint interest account. However, the Adjustments provision must be read in conjunction with the Statements and Billings provision.

The 1984 COPAS accounting procedure provides in pertinent part:

> Statements and Billings. Operator shall bill Non-Operators on or before the last day of each month for their proportionate share of the Joint Account for the preceding month. Such bills will be accompanied by statements which identify the authority for expenditure, lease or facility, and all charges and credits summarized by appropriate classifications of investment and expense except that items of Controllable Material and unusual charges and credits shall be separately identified and fully described in detail.
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> Adjustments. Payment of any such bills shall not prejudice the right of any

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[3] For instance, the Court in *Harris v. Ashland Oil & Refining Co.*, 315 S.W.2d 327, 329 (Tex. Civ. App.—El Paso 1958, no writ) discussed an operating agreement entered into in 1954 which contained the following language:

> Operator shall furnish to Non-Operator an itemized statement of all expenditures, receipts, charges and credits covering each month's bills hereunder, and such statement covering the preceding month's bill shall be mailed to Non-Operator on or before thirty (30) days thereafter, and within fifteen (15) days after receipt by Non-Operator, Non-Operator shall pay the Operator, subject to further audit and adjustment, if necessary, its proportionate share of the sum or sums so expended by the Operator for the development and operation of the premises for oil, gas and casinghead gas; *provided, that, if no objection is made by the Non-Operator within six (6) months, the statement furnished by the Operator shall be final and conclusive as to the charges.* All accounts shall draw interest at the rate of six (6) per centum per annum after sixty (60) days from the last day of the month in which charge is made. Non-Operator shall have access during regular business hours and at reasonable intervals to Operator's books and all records relating to the operation and may make audits semi-annually of said accounts. The Operator shall not be liable or held for any expense involved in such examination or audit. (emphasis added).

> Non-Operator to protest or question the correctness thereof; provided, however, all bills and statements rendered to Non-Operators by Operator during any calendar year shall conclusively be presumed to be true and correct after twenty-four (24) months following the end of any such calendar year, unless within the said twenty-four (24) month period a Non-Operator takes written exception thereto and makes claim on Operator for adjustment. No adjustment favorable to Operator shall be made unless it is made within the same prescribed period. The provisions of this paragraph shall not prevent adjustments resulting from a physical inventory of Controllable Material as provided for in Section V.

The 2005 COPAS accounting procedure provides in relevant part:

> 2. Statements And Billings. The Operator shall bill Non-Operators on or before the last day of the month for their proportionate share of the Joint Account for the preceding month. Such bills shall be accompanied by statements that identify the AFE (authority for expenditure), lease or facility, and all charges and credits summarized by appropriate categories of investment and expense. Controllable Material shall be separately identified and fully described in detail, or at the Operator's option, Controllable Material may be summarized by major Material classifications. Intangible drilling costs, audit adjustments, and unusual charges and credits shall be separately and clearly identified.
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> 4. Adjustments. A. Payment of any such bills shall not prejudice the right of any Party to protest or question the correctness thereof; however, all bills and statements, including payout statements, rendered during any calendar year shall conclusively be presumed to be true and correct, with respect only to expenditures, after twenty-four (24) months following the end of any such calendar year, unless within said period a Party takes specific detailed written exception thereto making a claim for adjustment. The Operator shall provide a response to all written exceptions, whether or not contained in an audit report, within the time periods prescribed in Section I.5 (*Expenditure Audits*)." (emphasis added)

The revisions to the Adjustments provision in the 2005 COPAS accounting procedure (as indicated by the highlighted language above), appear to clear up any gray areas that may have existed under the prior versions of the accounting procedures as well as make it clear that the written exceptions must be "specific and detailed" in order to avoid the conclusive presumption that can be created.

2. Relevant Caselaw Interpreting The Conclusive Presumption

Several federal and state courts throughout the country have interpreted the "conclusive presumption" language used in the Adjustments provision.[4] These cases are discussed below.

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[4] The Adjustments provision has been described as acting for all practical purposes to shorten the statute of limitations for breach of contract claims. *See,* John Burritt McArthur, *A Twelve-Step Program For COPAS To Strengthen Oil & Gas Accounting Protection*, 49 SMU L. REV. (1996). The statute of limitations in most states is longer than 2 years. For example, Texas is 4 years, TEX. CIV. PRAC. & REM. CODE ANN. § 16.004 (West 2011); Alaska is six years, ALASKA STAT. § 09.10.050 (West 1994); Louisiana has a ten-year prescriptive period, LA. CIVIL CODE Art. 3499 (West 2011); New Mexico is six years, N.M. STAT. ANN. § 37-1-3 (West 1990); Oklahoma is five years, 12 OKLA. STAT. ANN. TIT. 95

a. ***Calpetco 1981 v. Marshall Exploration***

In *Calpetco 1981 v. Marshall Exploration, Inc.*, 989 F.2d 1408, 1416 (5th Cir. 1993), James Michael set up numerous limited partnerships ("Calpetco") which invested in oil and gas deals with Marshall Exploration ("Marshall"). Marshall Exploration served as the operator and Calpetco acted as non-operator. The Operating Agreement had "standard accounting procedures" attached which provided:

> Calpetco may pay charges from Marshall without prejudice to its right to later contest their validity. However, all bills and statements issued in the course of a calendar year are "conclusively. . . . presumed to be true and correct" 24 months after the end of the calendar year in which they were rendered unless, within those 24 months, the non-operator (Calpetco) "takes written exception thereto and makes claim on Operator (Marshall) for adjustment."

Id. at 1410. In its written opinion, the court noted that "the procedures are virtually identical to those promulgated by the Council of Petroleum Accountants Societies, and are standard in the oil and gas industry." *Id.* at 1410 n.1. The accounting procedures also allowed Calpetco to audit Marshall's accounts and records within the 24-month adjustment period. Audits were to be conducted at Calpetco's expense, and did not extend the time for filing written exceptions and demands for adjustment. *Id.* at 1410. Eventually Calpetco, the non-operator, invested in 55 wells. Calpetco began to review certain charges and requested documentation from Marshall. Extensive communication continued for almost 2 years with Calpetco asserting overcharges by Marshall and Marshall asserting that some of the Calpetco partnerships had not paid amounts due. Marshall conducted at least a partial review of the Calpetco accounts and some adjustments were made. *Id.*

Marshall filed a lawsuit in 1987 against Calpetco seeking a declaration that charges questioned by Calpetco were conclusively presumed correct. In response, Calpetco filed 16 counterclaims against Marshall. Subsequently, Marshall moved for summary judgment on grounds that Calpetco's claims were barred by the 24-month adjustments provision or the Texas four-year statute of limitations for breach of contract. Marshall claimed that Calpetco failed to provide sufficient written exceptions under the Adjustments provision.

Calpetco responded that the contractual and statutory statute of limitations should be tolled because Marshall had fraudulently concealed its overcharges in addition to the defenses of waiver and estoppel. The district court granted Marshall's motion for summary judgment holding that Calpetco's claims were barred by the 24-month adjustments provision and that Calpetco failed to produce sufficient evidence to defeat summary judgment on its claims of fraudulent concealment, waiver, and estoppel. *Id.* at 1411.

On appeal, the Fifth Circuit Court of Appeals held that the 24-month adjustments provision governed all billing and payments between Marshall and Calpetco throughout their drilling ventures and that summary judgment was appropriately granted against the fraudulent concealment, waiver, and estoppel claims. *Id.* at 1413. To establish fraudulent concealment, the court stated that Calpetco had the burden of proving that 1) Marshall had actual knowledge of the facts it allegedly concealed (the overcharges), and 2) it was Marshall's "fixed purpose" to conceal them." *Id.* at 1313–14. The court found that Calpetco failed to meet its burden.

(West Supp. 1996); Wyoming is ten years, WYO. STAT. ANN. § 1-3-105(a)(i) (West Supp. 1995).

Calpetco claimed that its counterclaims filed in the lawsuit were sufficient "written exceptions" under the Adjustments provision. In addressing this argument, the court found that Calpetco's counterclaims could not as a matter of law constitute a written claim for adjustment since they did not point to specific charges or specific invoices and did not specify which partnerships or wells had been overcharged. *Id.* at 1416. The court also noted that the lengthy communications between Marshall and Calpetco lacked sufficient specificity to constitute the requisite exceptions and claims for adjustments. *Id.* The court also rejected Calpetco's claim that Marshall was estopped from asserting the 24-month adjustments provision because Marshall allegedly acted in a manner inconsistent with that right by entering into negotiations with Calpetco. The court reasoned that Calpetco had no reason to believe that it need not file a written exception or file suit while awaiting the outcome of an audit. *Id.* at 1414.

b. *Exxon v. Crosby-Mississippi Resources*

In *Exxon v. Crosby-Mississippi Resources, Ltd.*, 775 F.Supp. 969, 975 (S.D. Miss. 1991) *aff'd in part and rev'd in part*, 40 F.3d 1474 (5th Cir. 1995), the district court held that the bills and statements rendered by the operator during the 24-month period were entitled to a "conclusive presumption" of correctness if written exception was not made within the specified time period. In analyzing the 24-month provision, the court held that the 24-month provision did not violate a Mississippi statute which prohibited the alteration of a statute of limitations for a cause of action by finding that the provision did not alter the statute of limitations but imposed a condition precedent to recovery.

The district court's decision that the 24-month Adjustments provision was valid under Mississippi law was affirmed on appeal by the Fifth Circuit Court of Appeals. *Exxon Corp. v. Crosby-Mississippi Res. Ltd.*, 40 F.3d 1474 (5th Cir. 1995). As discussed below, the Fifth Circuit reversed in part the district court's application of the conclusive presumption for those months where there was insufficient evidence to show that the non-operator received the joint interest billing statements required under the accounting procedure. The only evidence that existed for these two months was a statement lacking the detail required under the accounting procedure. As a result, the court held that the conclusive presumption did not apply to these two months.

c. *Anderson v. Vinson Exploration, Inc.*

In *Anderson v. Vinson Exploration, Inc.*, 832 S.W.2d 657, 665–67 (Tex. App.—El Paso 1992, writ denied), the non-operator contested the reasonableness of charges by the operator. While the court did not quote the applicable provision, the court of appeals observed that the accounting procedure attached to the joint operating agreement required the non-operator to "take written exception to any bills and statements with which they disagreed within twenty-four months after the end of the calendar year in which the disputed bills and statements were rendered." *Id.* The court found that there was no evidence that the non-operator complied with this provision.

d. *In re Antweil*

A bankruptcy court in New Mexico held that a non-operator's failure to object in writing within 24 months of the end of the calendar year waived his right to object to the amounts billed under New Mexico law. *In re Antweil*, 115 B.R. 299, 303-04 (Bankr. D. N.M. 1990). In this case, the bankruptcy trustee of the estate of a debtor operator brought suit against the non-operator seeking to recover for expenses under the terms of the joint operating agreement. Both the operator and the non-operator had

extensive experience in the oil and gas industry and had entered into a joint operating agreement with attached exhibits which were standard in the industry. *Id.* at 304. The parties attached a COPAS accounting procedure to the joint operating agreement.

Beginning in 1982, the operator began sending the non-operator joint interest billing statements. *Id.* at 304. The parties stipulated that some of the invoices issued by the operator contained over-billing. The non-operator testified that he orally objected to the accounting figures on more than one occasion as early as 1982. *Id.* at 304. However, he did not submit written exceptions to the operator until 1986, outside of the 24-month period. At that time, he wrote a letter requesting credit for the overcharges.

The court held that the non-operator waived his right to object to the amounts billed after the 24-month period expired. *Id.* at 304. Likewise, the court held that the 24-month Adjustments provision which required one party to take written exception within the 24-month period was not unconscionable, illegal, contrary to public policy, or grossly unfair. *Id.* at 304. Interestingly, the court upheld the applicability of the 24-month Adjustments provision even though the court noted that it found the result "distasteful" in light of the fact that the non-operator was liable for a debt for which he was admittedly over-billed by the operator. *Id.* at 305. However, the court reasoned that the non-operator had extensive experience in the oil and gas industry and must abide by the agreement he entered into with full knowledge. *Id.* at 305.

e. *Meridian Oil Prod., Inc. v. Universal Res. Corp.*

In *Meridian Oil Prod., Inc. v. Universal Res., Corp.,* 978 F.2d 1267 (10th Cir. 1992) (unpublished), the parties executed two joint operating agreements under which seven oil and gas wells were operated in Oklahoma. The parties attached a COPAS accounting procedure to the joint operating agreements. *Id.* From November 1981 to January 1984, the non-operators audited the operator's charges and prepared audit reports that were sent to the operator. The audit reports detailed exceptions to the joint account. Over the course of several years, the operator granted some exceptions and denied others while communications continued between the parties in an effort to resolve the open audit exceptions.

Several years later, the non-operator filed suit against the operator seeking to recover for the exceptions not granted by the operator. The operator responded by asserting Oklahoma's five year statute of limitations. The district court granted the operator's motion for summary judgment on the basis that the non-operator's claims had expired under the statute of limitations.

On appeal, the non-operator argued that the parties' participation in the audit process tolled the statute of limitations and that the operator, by having participated in the audit process, could not assert the statute of limitations as a defense. The court of appeals affirmed the district court's ruling. In doing so, the court noted that the operating agreements did not require the completion of the audit procedure prior to filing suit. Likewise, the court pointed out that the operating agreements did not provide that the statute of limitations was tolled once the audit process was invoked and underway. As a result, the court held that the parties' participation in the audit process did not toll the statute of limitations.

In addition, the court rejected the non-operator's argument that the operator was estopped from asserting the statute of limitations because the operator received an immediate, uncontested payment under the Adjustments provision. The court reasoned that the operator did not do anything to thwart the non-operator's effort to bring their

claims within the period required under the statute of limitations.

f. *Caddo Oil Co., Inc. v. O'Brien*

In *Caddo Oil Co., Inc. v. O'Brien*, 908 F.2d 13, 15 (5th Cir. 1990), the parties entered into a written operating agreement in 1975 even though the parties had operated for a number of years before based on an oral agreement. The dispute centered around whether the non-operator consented to the drilling of seven additional wells and consented to an increased monthly operating fee for other wells operated by the operator. *Id.* at 16. Although the court did not quote the applicable provision, the parties apparently had an Adjustments provision very similar to the COPAS accounting procedure.

The trial court found that the non-operator did not consent to the drilling of the additional wells and was, thus, not liable for his share of the development costs. The operator argued that the non-operator impliedly agreed to the drilling of the additional wells as the parties had spoken about the wells on numerous occasions and exchanged correspondence about the wells. The operator also showed that the non-operator had accepted production revenue from the additional wells. *Id.* at 16. However, the court found that the non-operator did not consent to the additional wells as it was the practice of the operator to obtain consent in writing and had in fact sought the non-operator's consent by a letter requesting the non-operator's signature. The non-operator did not sign the proposed letter. Instead of treating the non-operator as electing to go non-consent on these wells, the operator treated the non-operator as consenting to the additional wells.

The trial court found that operator's billings were entitled to a presumption of correctness. The court of appeal noted that the non-operator was given ample opportunity to audit the operator's records but did not do so. *Id.* at 17. The trial court also apparently considered evidence by the non-operator to determine whether the non-operator could rebut the presumption of correctness of the operator's billings by proving fraud in the execution or breach of the contract. *Id.* at 16.

D. Some Conclusions That May Be Drawn From The Caselaw For the "Conclusive Presumption"

1. To Be Entitled to the "Conclusive Presumption," The Bills and Statements Should Comply with the COPAS Accounting Procedure

In *Exxon Corp. v. Crosby-Mississippi Res., Ltd.*, 40 F.3d 1474, 1488 (5th Cir. 1995), the Fifth Circuit Court of Appeals was faced with a situation where the operator had sent out bills and statements for a number of months which were received by the non-operator. However, there were two months of bills and statements which the operator could not establish that the non-operator received. Instead, the operator was able to show that the non-operator received a "status of account statement" which reflected the unpaid balance due from the previous month and added current monthly charges reflected on the joint operations statements.

The court held that the conclusive presumption applied to the bills and statements received by the non-operator but did not apply to the two months for which the operator was only able to establish "status of account statements" were received by the non-operator. In so ruling, the court held that the operator's "status of account statements" were not detailed enough to satisfy the joint operating agreement's billing requirements. In doing so, the court noted that the agreement required the operator to prepare bills for the preceding month which "will be accompanied by statements which identify the authority for expenditure, lease or

facility, and all charges and credits, summarized by appropriate classifications of investment and expense except that items of Controllable Material and unusual charges and credits shall be separately identified and fully described in detail." *Id.* The court found that the operator's "status of account statements" was not detailed enough to satisfy the joint operating agreement's billing requirements for these two months and was thus not entitled to the conclusive presumption under the adjustments provision. *Id.*

2. The "Conclusive Presumption" May Be Rebutted for Fraud.

The district court in *Exxon v. Crosby-Mississippi Resources, Ltd.*, 775 F. Supp. 969, 975 (S.D. Miss. 1991), discussed above, held that the conclusive presumption created by the 24-month provision is rebuttable upon a showing of fraud or bad faith breach of contract. Likewise, the Fifth Circuit, in reviewing the trial court's decision in *Caddo Oil Co, Inc. v. O'Brien*, 908 F.2d 13, 15-16 (5th Cir. 1990), observed that the trial court bifurcated the trial so that during the second phase of the trial the non-operator could "rebut the presumption of correctness of [the operator's] billings by proving fraud in the execution or breach of contract." *Id.*

3. The "Conclusive Presumption" May Be Overcome If The Non-Operator's Claims Are "Fraudulently Concealed."

In *Cass v. Stephens,* 156 S.W.3d 38, 64-65 (Tex. App.—El Paso 2004, pet. denied), a non-operator was able to overcome the imposition of the conclusive presumption by showing that the operator "fraudulently concealed" the cause of action that the non-operator had against the operator. The operator had kept a very detailed accounting of expenditures for himself but sent out a very abbreviated accounting to the joint interest owners. *Id.* In addition, the non-operator was able to show that the operator tried to conceal his relationship with numerous affiliate companies and that the operator had destroyed relevant documents. *Id.*

4. The Adjustments Provision May Only Defeat Contract Claims.

Likewise, the 24-month Adjustments provision has been referred to by one court as a contract defense that is not applicable to defeat an action in tort. *Ferguson v. Coronado Oil Co.*, 884 P.2d 971, 978 (Wyo. 1994). In Ferguson, a non-operator "net profits" interest owner brought a conversion action (tort) against an operator. The court found that the non-operator's net profits interest was identical to a royalty under the instrument from which the interest was created and was capable of being converted. *Id.* Although the parties' agreement also attached to it a COPAS accounting procedure which contained a 24-month Adjustments provision and a right to audit the operator, the court held that the 24-month Adjustments provision did not apply to the conversion claim. *Id.* The court reasoned that the Adjustments provision only applied to contractual claims.

5. The Time Period That Must Elapse in Order for the Conclusive Presumption to Be Created.

The 24-month Adjustments period has been described as running from the end of the calendar year in which the bill is rendered. *Calpetco v. Marshall Exploration, Inc.*, 989 F.2d 1408, 1416 n.19 (5th Cir. 1993). For example, an objection made any time in 2007 would be effective as to charges rendered on or after January 1, 2005. *Id.* at 1416 n.19. (discussing time period under applicable facts of case).

6. In General, the Conclusive Presumption Does Not Apply to Revenues.

As one court has noted, the COPAS accounting procedures focus on accounting for the costs of a project and do not govern

revenue practices. *Armstrong Petroleum Corp. v. Tri-Valley Oil & Gas Co.*, 116 Cal. Rptr. 3d 412, 417 (Cal Ct. App. 2004). In discussing the effect of the 24-month provision, the court described the 24-month provision as having the practical effect of requiring that a non-operator challenge disputed charges sooner than otherwise required under the statute of limitations applicable to contractual disputes. *Id.* at 418.

It should be noted that, to clear up any potential confusion, the 2005 COPAS accounting procedure has been revised to expressly state that the conclusive presumption applies "with respect only to expenditures."

7. The Conclusive Presumption May Not Apply to Disputes Between Non-Operators.

In *XCO Prod. Co. v. Jamison*, 194 S.W.3d 622 (Tex. App.—Houston [14th Dist.] 2006, pet. denied), the court was faced with a dispute between two parties over a tax partnership which owned an interest in oil and gas properties located in Louisiana. Jamison brought a breach of contract claim against his partner, XCO Production, Inc. concerning the distribution of revenues from the tax partnership under the terms of this agreement. Although the partnership agreement incorporated the operating agreement which governed the operations of the oil and gas properties and had an accounting procedure attached to it, the court held that the Adjustments provision (identical to the 1984 COPAS accounting procedure) was not applicable to the dispute between the two working interest owners. The court reasoned that the Adjustments provision was applicable to statements rendered by the operator to the non-operator pursuant to the operating agreement and that Jamison's dispute was with XCO Production, a working interest owner, not with the operator.

8. The 24-month Adjustments Provision Applies To Operators As Well As Non-Operators.

In 1989, the Wyoming Supreme Court in *Woods Petroleum Corp. v. Hummel*, 784 P.2d 242 (Wyo. 1989) was faced with interpreting a COPAS accounting procedure which provided:

> Payment of any such bill shall not prejudice the right of any Non-Operator to protest or question the correctness thereof; provided however, all bills and statements rendered to Non-Operators by Operator during any calendar year shall conclusively be presumed to be true and correct after twenty-four (24) months following the end of any such calendar year, unless within the said twenty-four (24) month period a Non-Operator takes written exception thereto and makes claim on Operator for adjustment. No adjustment favorable to Operator shall be made unless it is made within the same prescribed period.

Woods Petroleum Corporation v. Hummel, 784 P.2d 242, 243 (Wyo. 1989). The operator and non-operator entered into a model form operating agreement (AAPL Form 610—1956) in 1977 which incorporated a COPAS accounting procedure. From 1978 to 1984, the operator billed the non-operator for the non-operator's expenses totaling $275,501. In December 1987, the operator claimed that it had billed the non-operator for one-fourth instead of one-third of the expenses and sent an invoice to the non-operator for an additional $91,833 which was beyond the time period set forth in the COPAS accounting procedure. The mistake was the result of a clerical error and not because of failure of loss of title.

Ultimately, the operator brought suit against the non-operator for the amount of the underbilling. The non-operator raised

as a defense that the operator was contractually barred from bringing suit under the above quoted provision in the COPAS accounting procedure. The Wyoming Supreme Court affirmed the lower court's decision to grant summary judgment in favor of the non-operator in holding that the 24-month Adjustments provision was clear and unambiguous in prohibiting any adjustment favorable to the operator unless it was made within the prescribed 24-month period.

In reaching its decision, the court discussed the operator's contention that the use of the word "adjustment" in the accounting procedure was ambiguous. The court noted that although the term "adjustment" was not defined in the accounting procedure, the plain meaning of the term was "[a] settlement of a claim or debt in a case in which the amount involved is uncertain or in which full payment is not made." As a result, the court held that the term "adjustment" was not ambiguous and that the operator could not recover the amount of the underbilling by the operator even if in error. Consequently, the court held that the Adjustments provision applied to the operator.

9. Even If The Bills and Statements Are Not Received, The "Conclusive Presumption" May Still Attach Based on Several Court Decisions.

The court in *Grynberg v. Dome Petroleum Corp.*, 599 N.W.2d 261 (N.D. 1999), was faced with a situation where the parties entered into a farmout agreement which attached both an operating agreement and a COPAS accounting procedure. Based on the language of the accounting procedure quoted by the court, it appears that the accounting procedure was probably a 1974 COPAS vintage. The farmor retained a 2.5% overriding royalty interest until payout when it could then be converted to a 50% working interest. The farmout agreement required the farmee to furnish the farmor with an itemized statement of costs and earnings for the well. The court noted that the farmor had a right to audit the operator's books and records within a 24- month period following the end of the calendar year, and all statements rendered by the farmee were conclusively presumed correct twenty-four months after the end of the calendar year unless non-operator made a written exception and claim for adjustment within that time.

The farmor failed to make a written exception to the Farmee's expenditures within the 24-month period. The farmor also claimed that the farmee failed to provide cost statements to the farmor. Despite the farmor's claim that it never received the "cost statements," the North Dakota Supreme Court concluded that the parties' agreement unambiguously required the farmor to make a written exception to the farmee's cost statements within twenty-four months after the end of the calendar year in which the statements were rendered and that the farmor had failed to do so. As a result, the court held that the farmee's expenditures were deemed true and correct. In reaching this conclusion, the court in *Grynberg*, noted that the language of the contract did not require the farmee to receive the statements to trigger the twenty-four month period. *Id.* at 267.

In *Willard Pease Oil & Gas Co. v. Pioneer Oil & Gas Co.*, 899 P.2d 766 (Utah 1995), the Utah Supreme Court faced a situation where a working interest owner who had previously farmed out its rights did not become aware of its interests in a well until approximately nine years after the well had been drilled. Upon learning of its interest, the working interest owner offered to pay its share of the cost of the well but demanded an audit of the operator's records. The operator had already destroyed the billing statements associated with the drilling of the well and the working interest owner had never received any of the billing statements. Despite not receiving the billing statements, the court held that the

original charges for the wells were conclusively presumed to be true and correct and that the operator was only required to maintain supporting documentation for the costs of drilling the well for a period of three years because that was the maximum period under the COPAS accounting procedure that the operator's records could be audited. *Id.* at 774.

It should be noted that the decisions in both *Grynberg* and *Willard Pease*, are in conflict with the Fifth Circuit Court of Appeals' decision in *Exxon Corp. v. Crosby-Mississippi Res., Ltd.*, 40 F.3d 1474, 1488 (5th Cir. 1995), where the court held that the conclusive presumption did not apply unless the non-operator actually received the billing statements from the operator. *Id.* It should also be noted that the 2005 COPAS accounting procedure Adjustments provision now expressly applies to "payout statements."

E. What Constitutes a "Written Exception" Under The 1984 COPAS Accounting Procedure?

1. A Pleading May Not Constitute a "Written Exception"

Neither the prior COPAS accounting procedures nor the 2005 COPAS accounting procedure defines "written exception." In *Calpetco v. Marshall Exploration*, 989 F.2d 1408 (5th Cir. 1993) the Fifth Circuit Court of Appeals held that counterclaims raised by a non-operator failed as a matter of law to constitute written exceptions because they did not point to specific charges or specific invoices. As the court pointed out, the allegations in the counterclaim failed to even specify which partnerships or wells were involved in the alleged overcharges. *Id.* at 1416.

The 2005 COPAS accounting procedure now expressly requires that the non-operator issue a "specific detailed written exception" instead of a "written exception." However, the accounting procedure still fails to define what constitutes a "specific detailed written exception." Nevertheless, one can surmise that this revision now requires more detail than just a statement by the non-operator that it objects to a particular joint interest billing.

2. Lengthy Negotiations Between Operator and Non-Operator Lacked Specificity to Constitute a "Written Exception."

The Fifth Circuit Court of Appeals in *Calpetco v. Marshall Exploration*, 989 F.2d 1408, (5th Cir. 1993) also dealt with the non-operator's claims that its lengthy negotiations with the operator that occurred over a two year period with written documentation going back and forth constituted "written exceptions." In this particular case, the court held that while the lengthy communications certainly conveyed discontent with the operator's billing practices, the court held that they lacked "sufficient specificity to constitute the requisite exceptions and claims for adjustment." *Id.* at 1416.

3. If It Wasn't Clear: An Oral Objection Is Not A "Written Exception."

In *In re Antweil*, 115 B.R. 299, 304 (Bankr. D. N.M. 1990), the non-operator orally objected to the operator's accounting procedures but failed to take written exception. The court held that the non-operator's oral objection was insufficient under the 24-month Adjustments provision of the accounting procedure. *Id.*

4. Handwritten Markings on the JIBs "May" Constitute a "Written Exception" in Certain Circumstances. On the Other Hand, a Written Audit Report May Be Required.

Two recent opinions are at odds as to what constitutes a sufficient written exception. The first case is *Paint Rock Operating, LLC v. Chisholm Exploration,*

Inc., 339 S.W.3d 771 (Tex. App.—Eastland 2011, no pet.). In *Paint Rock,* the court evaluated the written exception provision contained in a COPAS attachment to a JOA to determine whether marking through charges on a JIB constituted a sufficient "written exception." *Id.* at 776. Upon receiving an untimely JIB, the non-operator reviewed the invoices and disagreed with several charges. Among the problematic charges was a $400 per month overhead rate increase, the decision to hire a production supervisor, and repair operation in excess of $10,000 which were performed without the issuance of an AFE (as required under the JOA). *Id.* at 775–76. The non-operator "marked through or circled the disputed charges, marked down partially disputed charges, and returned the JIBs and a check for the balance." *Id.* at 775. Although he did not explain his markings, the non-operator believed his objections were self-explanatory. The operator sued the non-operator for the disputed charges.

The court explained that "[t]he purpose of the JOA's written exception provision is to provide the operator with notice. The JOA, however, does not define what constitutes a sufficient written exception." *Id.* at 776. The court quoted the relevant language of the COPAS provision which required that the non-operator take a "written exception." The parties JOA pre-dated the 2005 COPAS Accounting Procedure and the accounting procedure appeared to contain language from the 1984 COPAS procedure. The court of appeals found that the trial court could have found the non-operator's testimony credible and could have found the markings on the JIB sufficient to comply with COPAS requirements. The court was quick to note that it was not holding that "marking out charges on a JIB and returning it to the operator is sufficient, as a matter of law, to comply with COPAS Article I.4," but was merely reviewing the sufficiency of the evidence considered by the trial court. *Id.* At n. 4.

Furthermore, the court held that the operator could not escalate overhead rates in the manner in which it did. The increased overhead, not calculated in the manner proscribed by the JOA, was found to be excessive. *Id.* at 776. The JOA allowed for an annual adjustment of overhead expenses as of April 1, 2006, but only from the rate currently in effect. This applies even if the rate has not been adjusted for several years. *Id.* Finally, the court determined that the operator violated the JOA by undertaking repairs in excess of $10,000 without issuing an AFE as required by the JOA. *Id.* at 776.

The second recent case is *CabelTel Int'l Corp. v. Chesapeake Exploration, L.L.C.*, 2012 WL 2849289 (Tex. App.—Fort Worth, July 12, 2012). This case is at other end of the spectrum as to what constitutes a sufficient written exception. In short, the court found that the non-operator had to fulfill the written exception requirement by providing a written audit report.

In *CabelTel* the operator, Chesapeake, brought suit against the non-operator, CabelTel, for failure to pay its share of well costs for several months. Chesapeake sued to recover the outstanding balance under the JOA and, additionally, for breach of contract. *Id.* at *1. Chesapeake filed for, and the trial court granted, a motion for summary judgment on the breach of contract claim. The non-operator appealed. *Id.*

The appellate court partially affirmed and partially reversed and remanded. First, CabelTel claimed that Chesapeake failed to prove that CabelTel received the monthly billing statements; however, they did not deny receiving them and in fact had provided the bills from June 2006 through March 2007 to a third party. *Id.* at *2. The court held that summary judgment was proper as to the bills from June 2006 through March 2007 because the non-operator failed to present evidence disputing the fact that it received the billing

statements. *Id.* "Where there is actual evidence of receipts as there is here, there is no need to analyze whether [the operator] met its burden." *Id.* As to the bills received between April 2007 and December 2007, the court held that Chesapeake provided no evidence of its mailing procedures other than testimony stating that it complied with the JOA, and that such evidence was "insufficient to create a presumption of receipt." *Id.* at *3–4. The issuance of monthly billing statements was not sufficient without proof of proper address, sufficient postage and proper mailing. *Id.* at *3. The court held that fact issues remained as to whether the non-operator received these bills.

Second, CabelTel argued that a fact question existed as to whether CabelTel made timely written exceptions to the billing statements precluding summary judgment in favor of the operator. The JOA allowed 24 months, following the end of the calendar year in which the bill was issued, for a non-operator to take written exception to the bill. CabelTel attempted to argue that it never agreed to be governed by COPAS, but each page of the JOA was stamped with "COPAS 1984 ONSHORE Recommended by the Council of Petroleum Accountants Societies" and, simply, "COPAS." *Id.* at n.3. Furthermore, the non-operator's own expert stated that COPAS, particularly guideline AG-19 defining "exception," applied to the JOA. *Id.* at *4. Claiming on appeal that they made exceptions by email, affidavit, written report, and errata beginning in April of 2009, CableTel claimed that the exceptions were sufficient under the JOA. However, two problems arose for CabelTel. First, AG-19 defined an exception as a "written audit finding presented to the operator prior to or with the audit report." Second, the deposition testimony of the non-operator representative stated that he had never made a written exception and claim for adjustment as required by the JOA in order to prevent the bills from being deemed presumptively true. Therefore, the court found that no fact issue existed and the non-operator's second issue was overruled.

CabelTel attempted to argue that the holding in *Paint Rock*, affirming a trial court's decision that markings on a bill were sufficient to satisfy COPAS requirements, proved that COPAS did not apply to the JOA. *Id.* at *5. The court differentiated these cases by pointing out that in *Paint Rock*, the operator did not dispute that the non-operator made a written exception; it only argued that additional explanation was required. *Id.* The court in CabelTel stated that the question here was whether email and a nonaudit report were sufficient to constitute a written exception and claim for adjustment under a JOA governed by COPAS guidelines. *Id.*

Third, the non-operator argued that the operator would not allow an audit, therefore preventing the non-operator from performing its duties under the JOA. However, evidence showed that the non-operator never attempted to conduct an audit and therefore no fact issue existed here either. *Id.* at *5.

Finally, of particular importance, in addressing the non-operator's challenge as to the accuracy of the billing statements, the court found that the billing statements were presumed to be true and correct because CabelTel did not timely object to them by issuing written exceptions in the form of a "written audit." *Id.* at *5. This decision is at odds with *Paint Rock* and other case law. The parties in *CabelTel* have filed a petition for review with the Texas Supreme Court.

5. What Constitutes A "Specific Detailed Written Exception" Under the 2005 COPAS Accounting Procedure?

The Adjustments provision contained in the 2005 accounting procedure was revised as reflected below:

Payment of any such bills shall not prejudice the right of any Party to protest or question the correctness thereof; however, all bills and statements, including payout statements, rendered during any calendar year shall conclusively be presumed to be true and correct, with respect only to expenditures, after twenty-four (24) months following the end of any such calendar year, unless within said period a Party takes specific detailed written exception thereto making a claim for adjustment. The Operator shall provide a response to all written exceptions, whether or not contained in an audit report, within the time periods prescribed in Section I.5 (Expenditure Audits). (emphasis added)

The prior versions of the COPAS accounting procedure have not defined what constitutes a "written exception." Now that the 2005 COPAS accounting procedure requires a "specific detailed written exception" which is not defined, one must conclude that in order for the exception to preserve the non-operator's objection to the bills and statements, the non-operator must be precise in lodging its written exceptions.

As discussed above, the court in *Calpetco v. Marshall Exploration,* 989 F.2d 1408, 1416 (5th Cir. 1993) held that a parties' counterclaims did not constitute a "written exception" because the counterclaim failed to even "specify which partnerships or wells were [involved] in the alleged overcharges." *Id.* Likewise, the non-operator failed to identify the specific charges and invoices it objected to in the lawsuit. *Id.* at 1416. Obviously, a written exception must indicate the property involved, the charges and invoices, and the period at issue.

F. Participation In the Audit Process Did Not Toll the Statute of Limitations In Prior Versions But May Toll The Statute of Limitations Under The 2005 COPAS Accounting Procedure.

The 1984 COPAS accounting procedure as well as previous versions did not contain any express language tolling the applicable statute of limitations while the parties were involved in the audit process and subsequent lengthy negotiations. As a result, the statute of limitations was not tolled during the audit process absent a separate agreement between the parties. For instance, in *Meridian Oil Prod., Inc. v. Universal Res. Corp.*, 978 F.2d 1267 (10th Cir. 1992), the non-operator audited the operator's charges for seven wells located in Oklahoma. The non-operator prepared audit reports in accordance with the COPAS accounting procedure which detailed the non-operator's exceptions to the bills that had been received and paid by the non-operator. The non-operator and operator communicated over a number of years in an effort to resolve open audit exceptions.

Even though the non-operator and the operator had communicated over a number of years in an effort to resolve open audit exceptions, the court of appeals held that the non-operators claims had expired under Oklahoma's applicable five-year statute of limitations. *Id.* In doing so, the court noted that the operating agreement did not require that the audit procedures be completed as a condition precedent to filing suit to enforce a claim, and that the operating agreement did not provide that the statute of limitations was tolled once the audit process was invoked and on-going.

The 2005 COPAS accounting procedure now specifically tolls the statute of limitations if the parties abide by the strict requirements laid out in the accounting procedure. In particular, the 2005 COPAS accounting procedure provides:

> A timely filed written exception or audit report containing written exceptions (hereinafter "written exceptions") shall, with respect to the

claims made therein, preclude the Operator from asserting a statute of limitations defense against such claims, and the Operator hereby waives its right to assert any statute of limitations defense against such claims for so long as any Non-Operator continues to comply with the deadlines for resolving exceptions provided in this Accounting Procedure.

If the Non-Operators fail to comply with the additional deadlines in Section I.5.B [Operator responding to audit report within 180 days] or I.5.C [Non-Operator replying to Operator's response within 90 days], the Operator's waiver of its right to assert a statute of limitations defense against the claims brought by the Non-Operators shall lapse, and such claims shall then be subject to the applicable statute of limitations; provided that such waiver shall not lapse in the event that the Operator has failed to comply with the deadlines in Section I.5.B or I.5.C. (emphasis added).

Based on the language now in the 2005 COPAS Accounting Procedure, in the event the non-operator submits a timely "specific detailed written exception," and complies with the rules set forth in the procedure for replying to the operator's response, the statute of limitations may be tolled as to those specific written exceptions. One could envision a situation where the parties disagree as to what exactly the written exception covers and whether the operator or the non-operator have complied with the requirements placed on the parties for timely responding to their audit or exceptions lodged.

G. The Non-Operator is Responsible for the Cost of Audit Unless Otherwise Agreed.

In case there was any doubt, absent a separate agreement, the non-operator is not entitled to recover the cost of an audit under the COPAS accounting procedure. *Dime Box Petr. Corp. v. Louisiana Land & Expl. Co.*, 717 F.Supp. 717, 723 (D. Col. 1989). In this case, the non-operator was not entitled to recover the cost of a joint audit under the COPAS accounting procedure. In refusing to permit the non-operator to recover the costs of the audit, the court noted that "no evidence was submitted that [the operator] agreed to share this cost." *Id.* Consequently, unless the parties agree to the sharing of audit costs in the operating agreement or the accounting procedure (or some other agreement) the cost is borne by the non-operator.

H. The Accounting Procedures May Be Modified by The Parties' Conduct.

The COPAS accounting procedure provides formal procedures for amending and changing the accounting procedure. However, the parties should be aware that the accounting procedures might be modified by their conduct.

In *Hondo Oil & Gas Co. v. Texas Crude Operator, Inc.*, 970 F.2d 1433, 1437–38 (5th Cir. 1992), Atlantic Richfield Company ("ARCO") entered into several operating agreements in 1962 and 1965 with Texas Crude Operator, Inc. ("Texas Crude") as the operator. *Id.* at 1435–36. The PASO-T-1995-2 Accounting Procedure was attached to each of these agreements. *Id.* at 1436. In 1978, Texas Crude decided to begin charging non-operators using a COPAS accounting procedure, rather than the PASO-T-1955-2. *Id.* The conversion produced a change in the non-operators' monthly overhead charges from approximately $175 per well to over $530

per well. Texas Crude did not notify ARCO that it was changing accounting procedures. However, after making a complaint as to the new rate in October 1978, ARCO paid Texas Crude for six years in accordance with the joint interest billings. *Id.* On the other hand, Amoco another non-operator, had noticed the change in its monthly charges and complained to Texas Crude. Rather than fight with Amoco, Texas Crude agreed to bill Amoco at the lower rate using the PASO Accounting Procedure.

The issue before the Fifth Circuit Court of Appeals was whether ARCO and Texas Crude had modified their operating agreements. *Id.* at 1437. The court concluded that because ARCO knew of the change and apparently consented to it, ARCO and Texas Crude had modified the accounting procedure to be used under the operating agreements. *Id.* at 1437–38. ARCO argued that the operator could not charge different overhead rates to non-operators (ARCO and Amoco) who have signed the same operating agreement in light of the operating agreement's provisions stating that the parties will be charged their proportionate share of costs and expenses. *Id.* at 1438–49. The court of appeals disagreed. "The court held that although the non-operators signed the same operating agreements, they had no special relationship between them [that established] any fiduciary duty." *Id.* at 1439. As a result, the court held that the operator could charge using different accounting procedures for the non-operators. Consequently, the operations between Texas Crude as operator and ARCO were governed by the COPAS accounting procedure while the operations between Texas Crude and ARCO were governed by the PASO accounting procedure.

I. Miscellaneous—Cases Involving COPAS Accounting Procedures

1. *Stephenson v. Oneok Resources Co.*

This case involved over 76 oil and gas wells located in several counties in Oklahoma. *Stephenson v. Oneok Resources Co.*, 99 P.3d 717 n.1 (Okla. Civ. App. 2004). The operations for each well were governed by AAPL model form joint operating agreements with various versions of the COPAS accounting procedures (1962, 1968, and 1974). The relevant language in all of the operating agreements and accounting procedures was virtually identical. *Id.*

For a number of years, the operator's predecessor voluntarily decided to forego annual upward adjustments to the producing overhead rates which was permitted by the accounting procedure. *Id.* at 720. Approximately three years after the operator took over operations, the operator discovered that the operator's predecessor had not escalated the overhead rates in prior years. The operator then took the initial rate and adjusted it forward by the applicable index factor for each year beginning from the effective date of the joint operating agreement. Once it had calculated the overhead rate it believed it should have been charging, the operator went back two years and billed the recalculated rate for each well forward. *Id.* at 720. The non-operators refused to pay the recalculated rate. The non-operators claimed that the operator was not able to retroactively escalate the overhead charges. Instead, the non-operators claimed that the operator was required to multiply the rate in effect for the preceding year by the annual adjustment factor. *Id.* The operator took the position that the language of the operating agreement did not allow the previous operator to forego upward adjustments in prior years. *Id.* at 721.

However, the court held that the joint operating agreement did not require the operator to enforce its right to an upward adjustment in each year it was entitled to one in the prior years. *Id.* at 722. The court then determined that based on the facts of the case (where yearly adjustments had not been made) that the COPAS accounting procedure was ambiguous as to whether the "current" overhead rate under the procedure was based on the cumulative rate from the effective date of the agreement or on the rate actually being charged prior to the attempted adjustment to the overhead rate. *Id.* As a result, the court permitted the admission of industry custom and usage in affirming the jury's finding that the current rate was the rate actually being charged immediately preceding the attempted adjustment to the overhead rate. *Id.*

2. *Torch Operating Co. v. Louis Dreyfus Reserves Corp.*

In *Torch Operating Co. v. Louis Dreyfus Reserves Corp.*, 1994 WL 117786 (E.D. La. Mar. 30, 1994), this dispute involved the construction of various agreements entered into between the parties. Westdelta and Enron Gas Bank entered into an offshore operating agreement where Westdelta operated offshore leases. The offshore operating agreement had a COPAS offshore accounting procedure attached. On the same day, Westdelta entered into a operating services agreement with Torch whereby Torch agreed to fulfill Westdelta's responsibilities set forth in the offshore operating agreement. A dispute arose between the parties over whether Torch could charge Westdelta's successor for its shore base facility. The issue between the parties revolved around whether the services agreement or the operating agreement was controlling. The court found that the services agreement was controlling and, thus, the COPAS accounting procedure was not applicable to the charge at issue.

CONCLUSION

The COPAS accounting procedure has been arguably one of the most important exhibits attached to the joint operating agreement. For over 40 years, the various COPAS accounting procedures have sought to bring consistency and uniformity to accounting for joint operations. The accounting procedure has withstood the many changes in the industry brought on by changes in the business and technology. With publications in the form of Model Form Interpretations and Accounting Guidelines, COPAS has provided and continues to provide the industry with resources for operators and non-operators to resolve their differences. COPAS has been quite successful in this endeavor as evidenced by the relatively few reported cases over the years involving COPAS. With the 2005 COPAS accounting procedure, COPAS appears to have cleared up some of the "gray areas" that may have existed under the prior versions and now provides a mechanism for the speedy resolution of claims. While one might always expect there to be a struggle between the operator and the non-operator in the future, one may hope that the 2005 COPAS accounting procedure will assist the parties in focusing on resolving their issues in an efficient manner.