NEWFIELD

HBA O&G Section November Luncheon Presentation: Documenting the (non) Joint Venture in Unconventional Play Settings

OVERVIEW OF TODAY

NEWFIELD

- Suite of contracts to consider (and reconsider)
  - "JV" Agreement, OA and all the incorporated attachments
  - Remember that the dollar amounts are very large; $7-11MM *per well!*
    - So each 3 well pad costs roughly $30MM
- Method for thinking through items to consider addressing and how to approach the contractual framework.
  - Risks and outcomes to address vary depending on where the assets are in terms of assessment and development.
  - Knowing what you can't know yet (and planning for that).
- Importance of understanding that all "resource plays" are also *margin* plays and statistical plays.
  - Mistakes are very costly to returns; log normal well performance distributions.

Margin/Statistical Play Implications:

- Returns at the wellhead look somewhat impressive, but ROI may be lackluster on a total project basis. Cost control through the life of the project is critical, so think that through with your client.

- Depending on where the assets are in terms of assessment vs. development, something on the order of 60% of the wells will probably be uneconomic *on a heads-up basis*.

  - Does your client want the right to direct where wells are drilled, and when?

  - Think through how this could make alignment of the "partners" more challenging.

Think of the JV agreement as defining the courtship, marriage and honeymoon stages, and the OA as the reality of marriage.

- **First fundamental conceptual inquiry for your client (when the non-operator): are they really investing in the assets, or are they actually investing in the operator?**
  - Obviously matters which party you're representing, but it's a critical concept for deal documentation.
  - Impacts gathering/processing issues, responsibility for title problems.
- **Second fundamental conceptual inquiry: are the subject assets in assessment stage, or are they ready for development?**
  - Issues such "off ramps" and non-consent consequences greatly impacted for both parties.
  - Surface infrastructure decisions and obligations might be unclear vs. quite clear.

- **Third Fundamental Inquiry:**
  What jurisdiction(s) are the assets located within, and what is the legal landscape there?

  - This can have quite an impact when the party who already owns the assets at issue owns less than 100% WI in all leases, etc.

  - Compare Texas, North Dakota, and Oklahoma.

  - Carry/promote applies to which costs? Non-consent pick-ups? Replacement leases? Field-wide infrastructure?

  - This is the area where the client is most likely to have given inadequate consideration to important issues.

❖ The JV Agreement Framework – some thoughts

- Probably makes the most sense to use the JV agreement through the assessment phase of the assets, i.e. until they are de-risked, then rely mostly on the (heavily modified) OA.

- During assessment, probably looking at dispersed single well locations, with well costs quite high. This impacts:

  - Who can direct nature and location of wells during this period.
  - How much control/influence to allow the non-operator to determine how carry dollars are deployed (some misalignment here).
  - How much research will be subject to the carry obligation; includes all sorts of specialized logs, perhaps 3D, and microseismic.

- Query whether non-operator should be permitted to non-consent wells during the assessment phase.

❖ Assessment Phase Issues for the "JV" Agreement:

- Remember that this is where total project returns are being determined, but that this done by hurting total project returns - are the parties really aligned here (public company vs. P/E or NOC).

- Provide for communication and collaboration between the parties.

  - At least quarterly meetings, where technical information, and operational plans, and forward budget are discussed; minutes are kept and circulated for approval; no surprises.
  - Consider whether the operator should be required to keep it's "A Team" on the project - priorities change!
  - Learning curve acceleration = better well performance at lower cost faster.
  - Appropriate remedies for "soft breach"? Always remember that the carried party has a much greater margin; other party is on a thin margin.

- Think through title failures and similar problems during this stage (less likely during development phase) - which party should bear this risk? Share it?
  - Should any royalty burden increase fall to the joint account? Realize that bonus for replacing the lease will potentially hurt ROI much less than royalty burden increase depending on lease size and location in the play.
  - Good example of jurisdiction mattering a lot - different outcomes, and contractual provisions therefore needed, in TX vs. ND.
  - Consider the ***Reeder v. Wood County Energy*** case.

This is an area where the fundamental inquiry of investing in the operator vs. assets should drive the allocation of risk.

❖ Operating Agreement – The Development Phase

- ➢ For both parties to consider: is the non-operator really ready and able to operate?
  - ▪ Remember that model forms are built around this concept
  - ▪ Think about issues raised if operator has capital budget drivers which differ from the non-operator.
  - ▪ Back to fundamental inquiry about the nature of the investment.
  - ▪ Rethinking the exculpatory clause after Reeder.

❖ Operating Agreement – Suggestions

- No reason to have a single OA for both Assessment and Development Phases.
  - Issues encountered and risks will be quite different in many areas, so why not two forms?
- Development will take years of operational intensity, so plan for disagreements.
  - Consider all sorts of methods to resolve controversies, so that you avoid litigation with your partner!

❖ Operating Agreement – Suggestions (continued)

- ➢ Enhanced suite of defined terms; jurisdiction specific?
- ➢ Address long-term contracts for drilling rigs and frac fleets.
  - ▪ Cost savings and availability, but what about contractual liability for break fees
- ➢ Consider whether non-operator should have the right to use a contract operator if it needs to.
- ➢ Legal landscape in your jurisdiction matters.
  - ▪ Forced pooling, non-consents.

❖ Operating Agreement – Suggestions (continued)

- ➢ Biggest "hole" in the model forms: gathering and marketing production from the jointly owned lands.
  - ▪ Incremental cost issue again.
  - ▪ Field-wide gathering/processing/marketing will surely be a huge project.
    - ♦ Can it be addressed up front? You have limited knowledge of what is needed.
    - ♦ But think about modifying TIK regime; gas vs. oil; long term agreements.
- ➢ Consider suspension of any TIK by non-operator in default.

❖ Operating Agreement – Suggestions (continued)

- Title Losses: Joint losses probably make sense, but consider:
  - If TIK, either party could precipitate a title loss in the context of failing to pay royalties timely.
  - Should the carried operator really get Exculpatory Clause protection for this risk – that is a lot of trust by non-operator.
- On LOE, consider whether either party can really get this right prior to development phase actually commencing.
- Pad Drilling Elections; competing well proposals.