

Presented:
The University of Texas School of Law
2013 Oil, Gas and Mineral Law Institute

March 22, 2013
Houston, Texas

NEGOTIATING AND DRAFTING
EXPLORATION AND
JOINT DEVELOPMENT AGREEMENTS

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Negotiating and Drafting Exploration and Joint Development Agreements

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I. INTRODUCTION

A. Introduction and Scope

Exploration agreements and joint development agreements have long been a staple in the oil and gas industry. These types of agreements can promote development, eliminate competition between parties, allow for information sharing, allocate risk, provide flexibility to the parties, and allow “at risk” parties to take advantage of development. However, notwithstanding the fact that these agreements have been utilized for decades, there are no standard exploration agreements or joint development agreements. Because deal terms vary so widely in these types of transactions, the form of the documentation varies widely as well.

Although there are no standard exploration and joint development agreements, certain provisions will almost always appear in these types of agreements. This article will focus on these provisions along with accompanying legal issues. By focusing on standard provisions in non-standard agreements, we hope to assist future draftsmen in negotiating and drafting similar transactions.

B. Exploration Agreements

An exploration agreement is a contract that provides for the joint exploration and development of a tract of land. The most common type of exploration agreement appears in the form of an operating agreement. Like other types of exploration agreements, an operating agreement typically provides for the drilling of an initial well and any subsequent wells in a tract of land, and it provides for the manner in which the revenue stream, expenses, and risks are allocated between the parties to the agreement. As discussed herein, an exploration agreement is broader in scope than a typical operating agreement, not only as to the amount of acreage included under the agreement, but also as to the types of operations that are governed by the agreement. Nevertheless, an operating agreement is almost always attached as an exhibit to this type of exploration agreement, and, therefore, many of the same issues pertaining to operating agreements pertain to the broader form exploration agreement.

C. Joint Development Agreements

Like an exploration agreement, a joint development agreement is a contract that provides for the joint exploration and development of a tract of land. However, an exploration agreement is typically utilized before the leasing phase has concluded, and a joint development agreement is typically utilized after the leasing phase has concluded. Accordingly, a joint development agreement will differ from an exploration agreement in the provisions that specify the duties and responsibilities of the parties, and in many ways a joint development agreement will resemble a farmout agreement.

II. PRE-DRAFTING ISSUES

A. Understanding the Deal

Documenting large scale agreements can be difficult, and there are many considerations and pitfalls. Many of the difficulties in the documentation can stem from a disagreement or misunderstanding of the business and legal points in the deal. Although the parties may have agreed on a general framework of the deal before it is presented to the scrivener, when the transaction is first presented it is almost certain that all of the issues have not been contemplated. Accordingly, when first presented with the business deal, it is recommended that the draftsman create a checklist to present to his client. The checklist should outline the business points of the deal that have already been agreed to, and it should point out the issues that have not been resolved or contemplated. The checklist will provide the client talking points during the initial negotiations, and the client can address the outstanding issues with the other parties. After the parties have agreed upon the outstanding issues, the checklist can be turned into a term sheet or a letter of intent that can be circulated among the parties.

A term sheet or letter of intent should include the material terms of the transaction and is ideally agreed upon by the parties before the scrivener begins drafting the controlling agreements. The term sheet or letter of intent is generally non-binding except for the following two provisions: 1) a confidentiality provision (generally referencing an independent confidentiality agreement) and 2) a standstill provision (requiring the other parties not to negotiate with third parties until closing the transaction or either party terminates further negotiations). Although the term sheet or letter of intent is non-binding, such a document will help facilitate successful documentation of the deal. By having the parties agree to the material terms of the transaction, and by procuring all of the information necessary to document the transaction prior to drafting the documents, ill will between the parties can be avoided (*i.e.*, the parties will not accuse each other, or their attorneys, of re-trading the deal), and the drafting process can be expedited while keeping time and costs down for both sides (*i.e.*, the agreement may only be red-lined 10 times instead of 25).

B. Form of the Transaction

Once the scrivener has obtained enough information to document the deal, the parties must agree upon the form that the transaction will take. Regardless of the form that is utilized to document the transaction, the documentation must clearly and accurately reflect the deal, identify and manage risks between the parties, and create a legally enforceable document. Although there are many forms to document the joint exploration and development of a tract of land, this article focuses on the exploration agreement and the joint development agreement. In an attempt to assist future draftsmen, a sample form of an exploration agreement is attached hereto as Supplement “A,” and a sample form of a joint development agreement is attached hereto as Supplement “B.” However, because of space constraints, we have not included the exhibits that are attached to the forms (*i.e.*, we have not included an operating agreement, field assignment, non-field acreage assignment, overriding royalty assignment, *etc.*).

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First appeared as part of the conference materials for the
39th Annual Ernest E. Smith Oil, Gas and Mineral Law Institute session
"Negotiating and Drafting Joint Development and Exploration Agreements"