WHAT'S OLD HAS BECOME NEW AGAIN: TRADITIONAL OIL AND GAS INTERESTS FINANCING

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INTRODUCTION

Client has a large acreage position in working interests or mineral fees and wants to develop its properties but is temporarily short on cash.

- Private equity may not be available or is not acceptable.
- Bank loan may not be available or are is not acceptable.
- Equity offerings may not be practical.

Client owns no interest in a prospect but wants to get into the play ***now***.

INTRODUCTION (continued)

Service company client has rigs and equipment sitting idle or wants to provide economic assistance to its producer customers but without acting as a lender or a direct investor.

Refiner or pipeline client wants to acquire firm sources of feedstock or inventory.

Alternatives:

- Term overriding royalty interest or a production payment;
- Farmout agreement;
- Participation agreement; or
- Carried interest.

TERM OVERRIDES/ PRODUCTION PAYMENT

An **overriding royalty interest** is an interest in oil and gas, free of the expense of production, and in addition to the usual landowner's royalty reserved to the lessor in an oil and gas lease. It has no effect on the lessor's royalty; it is a new or additional royalty interest "carved out" of the working interest by the lessee and transferred to a third party, or it is "reserved" by the transferor in an assignment of the working interest to the transferee.

- May be created in exchange for goods, services, or money.
- A non-possessory non-executive interest.
- Duration is limited by the term of the underlying oil and gas lease.
- Absent a contractual provision to the contrary, override does not create a fiduciary duty between the working interest owner and the owner of the override.
- In the absence of an agreement to the contrary, the override is free of the same costs as the lessor's royalty.

TERM OVERRIDES/ PRODUCTION PAYMENT (continued)

The Transaction

In a **term override**, **production payment**, or **volumetric production payment** transaction, a producer ("**Seller**") sells its hydrocarbon production for a limited duration in exchange for a lump sum to be used for operating capital. The party making the advance payment ("**Buyer**") receives a share of oil and gas produced from selected properties for a limited time, free and clear of any of the costs of production. If structured correctly, Buyer's interest will be a real property interest of limited duration. Because Buyer owns the production, it has protection from the bankruptcy of Seller. Generally, these transactions require two documents: a purchase and sale agreement ("**PSA**"), and a conveyance (an "**Assignment**"). Sometimes there is a third document: a production and delivery agreement ("**PDA**"). The term of the transaction may be for a specified period, or it may be for the period required for Buyer to receive a stipulated sum of money or a stipulated volume of hydrocarbons.

TERM OVERRIDES/ PRODUCTION PAYMENT (continued)

When you draft
The PSA

- Statute of frauds.
- Describe the override.
  - Is the interest calculated as part of 100% (8/8ths) or the fractional working interest owned by the Seller?
  - Does it have a term either in time, volumes, or money?
- Describe the costs borne by the override, if any.
  - Sometimes, the override amount is calculated as a portion of the Seller's net profits.
- Pre-close the deal.
  - Consider attaching the form of Assignment and PDA to the PSA at the time of signing.

Title search: What's Old Has Become New Again: Traditional Oil And Gas Interests Financing

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