

U.S. Upstream Joint Ventures

February 2016

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Structures - Drill-to-Earn

- Characteristics:
 - Ownership of interest in the oil and gas properties typically acquired only when a well is drilled (sometimes after the well is drilled)
 - Investor pays a portion of Producer's cost (the "Carry") of drilling wells in exchange for the right to participate and acquire designated acreage
 - For tax purposes in the context of a Carry, may be advisable to utilize a Tax Partnership
 - Parties should ensure the Carry meets the tax requirements for a Carry, as opposed to qualifying instead as deferred consideration
 - Often involves a smaller geographical area compared to other structures
 - May trigger Maintenance of Uniform Interest issues

Structures - Drill-to-Earn (cont'd)

- Characteristics:
 - May include a “Net Well Target” where Investor is required to participate in the drilling of a certain pre-determined number of “Net Wells” in order to reach the negotiated earnings trigger
 - A Net Well is often calculated using various metrics, including: Producer’s working interest in such well/applicable unit, the lateral length of such well and the number of frac stages completed in such well, etc.
 - May include a “Drilling Dollars Target” where Investor must spend a certain pre-determined amount of money on drilling wells in a certain area in order to reach the negotiated earnings trigger
 - Typically, wells drilled must meet certain criteria in order for the dollars spent by Investor on such wells to count toward the Drilling Dollars Target (e.g., certain depth, certain minimum lateral length, completion as producing well and/or plugged and abandoned after efforts to complete were unsuccessful, etc.)

Structures - Drill-to-Earn (cont'd)

- Characteristics:
 - Typically, Investors in Drill-to-Earn structures earn small portions of the joint venture acreage each time a well is “completed” and may earn the remainder of the joint venture acreage once Investor has met its Net Well Target, Drilling Dollars Target or other criteria
 - Deals are typically “sign and close”

Structures - Drill-to-Earn (cont'd)

- Typical Documents:
 - Participation Agreement (a.k.a. Joint Development Agreement, Earning Agreement, Exploration Agreement, etc.)
 - In addition to Carry mechanics, the Participation Agreement will typically cover:
 - Mechanisms for the joint venture partners to agree on potential drilling locations
 - Provisions detailing which drilling costs are/are not included in the Carry
 - Title issues
 - Representations and warranties of Producer
 - Off-Ramps that Investor may take to exit the joint venture in certain scenarios prior to reaching the trigger for earning an interest in the relevant oil and gas properties

Structures - Drill-to-Earn (cont'd)

- Typical Documents:
 - Participation Agreement
 - Transfer restrictions:
 - May contain “Lock-Up” periods restricting the joint venture partners from transferring their interests in the oil and gas properties for a period of time
 - May contain Preferential Purchase Rights in favor of the other joint venture partner in the event of a transfer of interests in the oil and gas properties

Structures - Drill-to-Earn (cont'd)

- Typical Documents:
 - Participation Agreement
 - Often contains an agreed-upon standard of care for the Operator of the joint venture properties that is more expansive than typical Joint Operating Agreement provisions
 - Removal of Operator provisions are often expanded from those contained in Joint Operating Agreements
 - Some Participation Agreements contain a development plan and budget for a defined period of time

Structures - Drill-to-Earn (cont'd)

- Typical Documents:
 - Form of Assignment
 - Joint Operating Agreement (“JOA”)
 - Typically the joint venture partners use the AAPL 1989 form with modifications for horizontal drilling
 - Security Documents (less typical)

Structures - Drill-to-Earn (cont'd)

- Example Transactions:
 - Kohlberg Kravis Roberts/EXCO Resources (*Eagle Ford Shale, Jul. 2013*)
 - With respect to core area, purchase by KKR of 50% interest in undeveloped acreage for \$131MM cash; KKR to pay 75% of drilling costs and receive 75% ownership in each well drilled, subject to EXCO quarterly obligation to repurchase a tranche of wells after such tranche of wells reaches one year of production
 - Confidential Transaction (*Woodford Shale, Jul. 2014*)
 - Investor to pay disproportionate share of drilling and completion costs in a minimum of 15 wells out of a development plan comprised of 38 wells to develop 12,160 jointly-owned acres, to earn 50% of the Producer's interest in those units in which the Investor participates

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Structures - Drill-to-Earn (cont'd)

- Example Transactions:
 - Confidential Transaction (*Permian Basin, Dec. 2013*)
 - Investor to earn, on a unit-by-unit basis, net profits interests (convertible to working interests) in 44,800 gross acres in the Bone Springs and Wolfcamp Formations in the Permian Basin for a spending commitment (drilling and completion costs) that may reach \$350MM
 - Confidential Transaction (*Barnett Shale, Sep. 2011*)
 - Investor to earn, on a unit-by-unit basis, up to 49% working interest in 26,500 net acres by paying drilling and completion costs of each well in which it participates

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Structures - Drill-to-Earn (cont'd)

- Example Transactions:
 - XTO Energy/Endeavor Energy Resources** (*Permian Basin, Feb. 2014*)
 - XTO to earn interest in acreage by drilling for and operating deep interval Wolfcamp production in Permian Basin; transaction terms undisclosed
 - Eni/Quicksilver Resources** (*Delaware Basin, Nov. 2013*)
 - Eni to earn up to 50% interest in acreage by investing up to \$52MM over three phases in form of paying 100% of drilling, completion and seismic costs; parties share costs and revenues equally thereafter

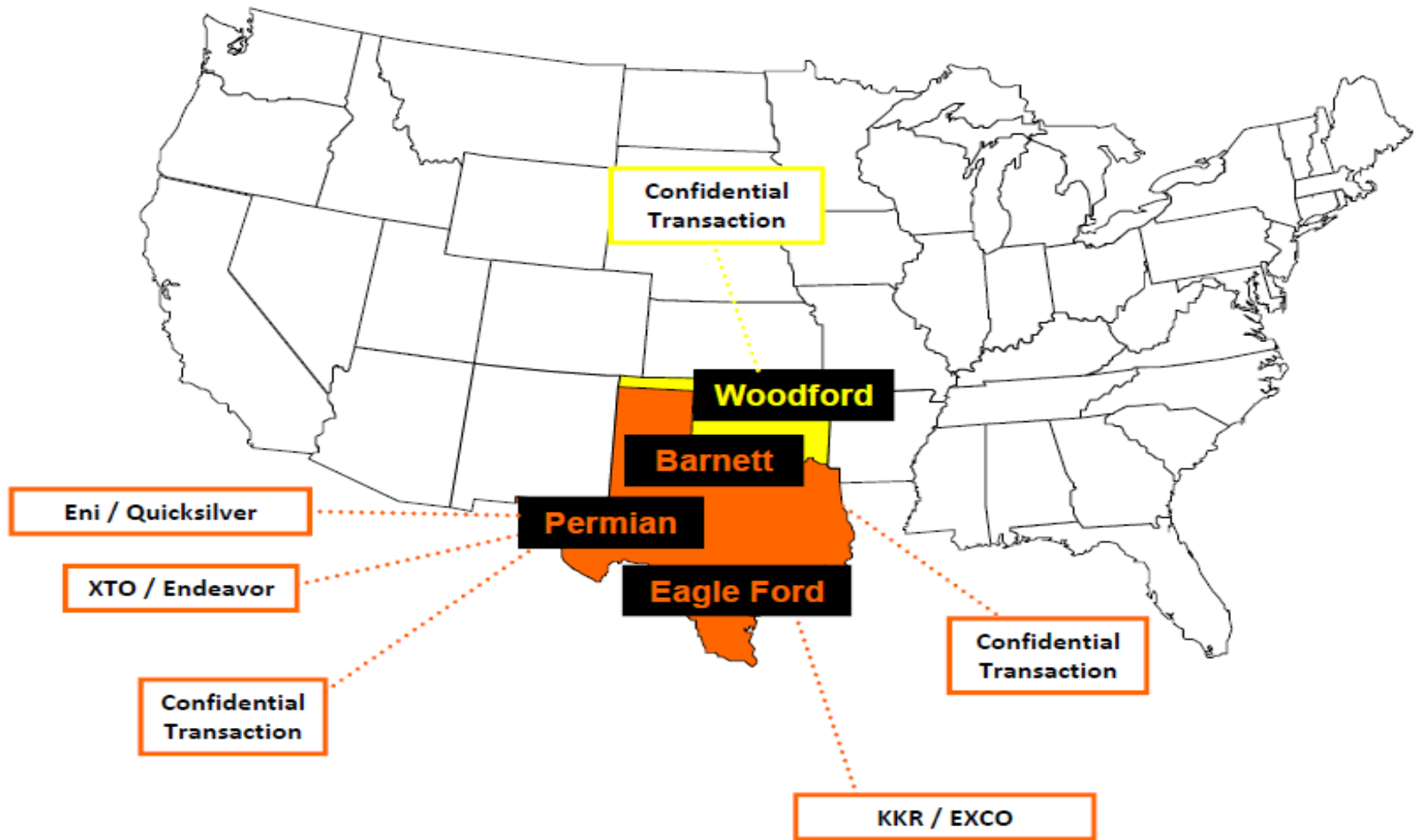
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Structures - Drill-to-Earn (cont'd)

- Example Transactions:
 - Linn Energy/GSO
 - Each year, Linn and GSO to select assets to be developed and development budget
 - GSO to fund 100% of development costs and to be assigned an 85% working interest (Linn to retain a 15% working interest) in each drilled well; upon GSO's earning 15% annualized return on development costs expended during a year, 95% of GSO's working interest in the wells drilled in such year to revert automatically to Linn, after which Linn will have a 95% working interest and GSO a 5% working interest in such wells
 - LOI contemplates a maximum term of 5 years or GSO's expenditure of \$500 million on development costs

Structures



Structures - Acquisition-and-Drill

- Characteristics:
 - Producer conveys to Investor up front an ownership interest in all relevant oil and gas properties
 - Investor typically (but not always) pays some cash up front and agrees to pay a Carry covering a portion of Producer's costs to drill wells
 - For tax purposes in the context of a Carry, may be advisable to utilize a Tax Partnership
 - Parties should ensure the Carry meets the tax requirements for a Carry, as opposed to qualifying instead as deferred consideration
 - Common for strategic plays and foreign investors
 - Often involves a large area (e.g., the entirety of a shale play)
 - Typically involves a default development plan/budget if the parties are unable to mutually agree upon an annual or quarterly plan/budget

Structures - Acquisition-and-Drill (cont'd)

- Typical Documents:
 - Acquisition Agreement
 - Covers the interest in the relevant oil and gas properties to be conveyed to, or earned by, Investor, and other typical provisions found in purchase agreements for upstream oil and gas properties (consideration adjustments, representations and warranties, title and environmental due diligence mechanisms, consent and preferential right mechanisms, indemnities and closing conditions and mechanics)

Structures - Acquisition-and-Drill (cont'd)

- Typical Documents:
 - Joint Development Agreement (“JDA”)
 - Covers the Carry component of the transaction, including:
 - Any security granted by Investor for its payment of the Carry
 - Default remedies
 - Covers the management of the joint venture, including (typically) formation of a “Management Committee” consisting of representatives of each joint venture partner
 - Management Committee’s makeup and powers are often shaped by the structure of the joint venture and each joint venture partner’s interest in the joint venture and underlying oil and gas properties

Structures - Acquisition-and-Drill (cont'd)

- Typical Documents:
 - Joint Development Agreement (“JDA”)
 - Covers a development plan and budgets for the joint venture
 - Typically a multi-year development plan and budget for the joint venture is approved up front (often designed to extend long enough to expend the Carry); typically the first year’s budget is also approved up front
 - Subsequent budgets and amendments to the development plan and/or any current budget are handled between the joint venture partner acting as Operator and the Management Committee
 - Contains a mechanism to create a default development plan and budget for the joint venture in the case of Management Committee deadlocks

Structures - Acquisition-and-Drill (cont'd)

- Typical Documents:
 - Joint Development Agreement
 - Typically contains an Area of Mutual Interest (“AMI”) provision between the joint venture partners
 - Contains any transfer restrictions that are applicable to the joint venture
 - Often contains Lock-Up periods restricting the joint venture partners from transferring
 - Also may contain Preferential Purchase Rights in favor of the other joint venture partner in the event of a transfer

Structures - Acquisition-and-Drill (cont'd)

- Typical Documents:
 - Joint Development Agreement
 - Often contains an agreed-upon standard of care for the Operator of the joint venture properties that is more expansive than the typical JOA provisions
 - Removal of Operator provisions are often expanded from those contained in JOAs
 - Often contains Off-Ramps for Investor to reduce, suspend or terminate its obligation to pay the Carry

Structures - Acquisition-and-Drill (cont'd)

- Typical Documents:
 - Form of Assignment
 - JOA
 - Typically the joint venture partners use the AAPL 1989 form with modifications for horizontal drilling
 - Security Documents
 - Secondment Agreement (depends on type of Investor)

Structures - Acquisition-and-Drill (cont'd)

- Example Transactions:
 - SK Group (South Korea)/Continental Resources (*Woodford Shale, Oct. 2014*)
 - Purchase by SK Group of 49.9% interest in Continental's Woodford Shale acreage and wells for \$90MM at closing and \$270MM carry (to fund 50% of Continental's future drilling costs over five-year carry period)
 - Sumitomo/Devon (*Permian Basin, Aug. 2012*)
 - Purchase by Sumitomo of 30% interest in Devon's Cline Shale and Midland-Wolfcamp Shale undeveloped and producing acreage for \$340MM cash and \$1.025B carry (to fund 70% of Devon's future drilling costs over undisclosed carry period)

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Structures - Acquisition-and-Drill (cont'd)

- Example Transactions:
 - Noble Energy/CONSOL Energy* (*Marcellus Shale, Aug. 2011*)
 - Purchase by Noble of 50% interest from CONSOL of (1) undeveloped acreage for \$1.07B cash (over three annual installments) and \$2.13B carry (to fund 33% of CONSOL's future drilling costs, capped at \$400MM/yr and restricted where gas prices below \$4/MMBtu) and (2) producing wells and infrastructure for \$219MM
 - Hess/CONSOL Energy* (*Utica Shale, Sep. 2011*)
 - Purchase by Hess of 50% interest in CONSOL's producing and undeveloped Utica Shale acreage for \$59MM cash and \$534MM carry (to fund 50% of CONSOL's future drilling costs over five-year carry period)

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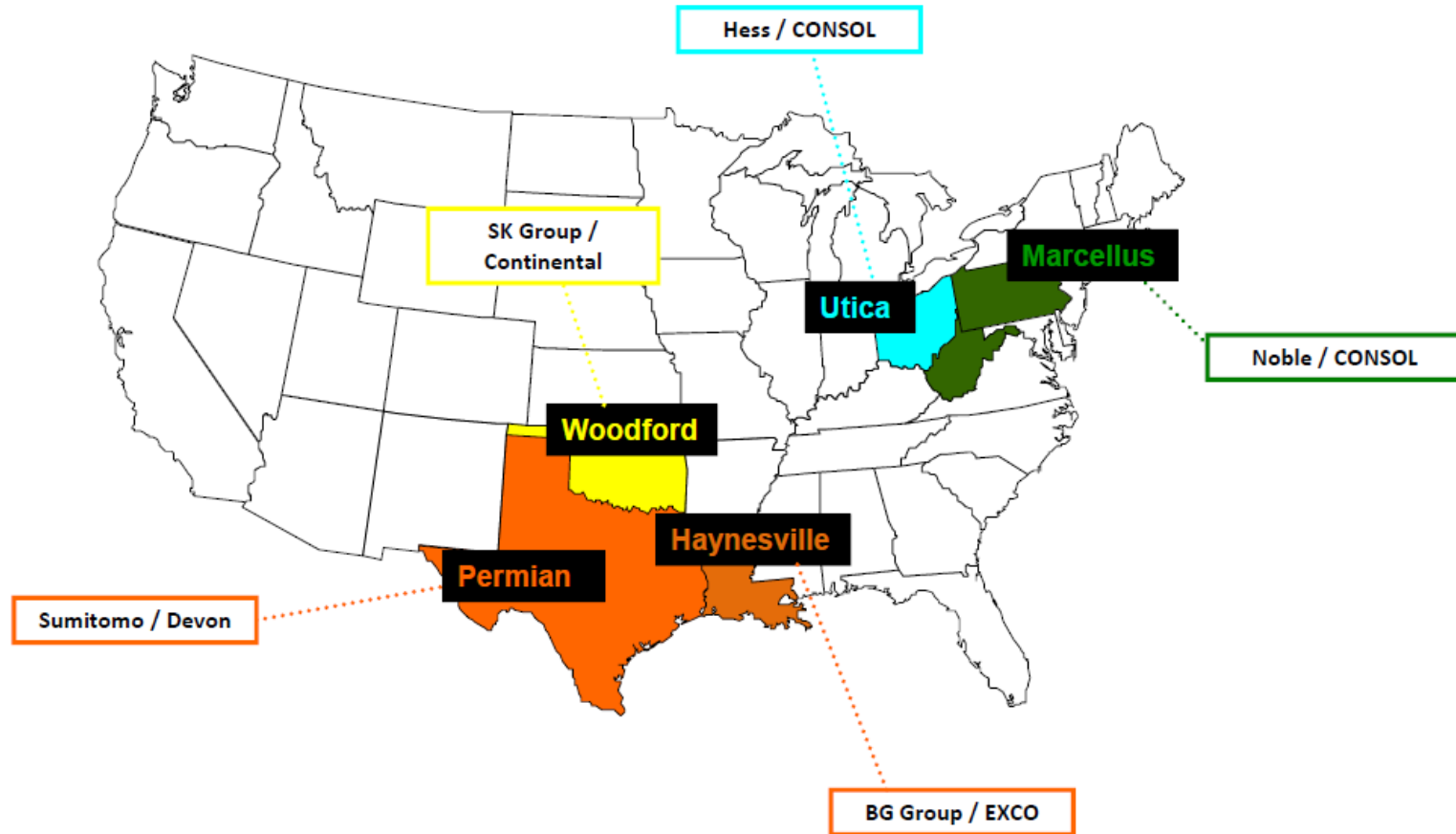
Structures - Acquisition-and-Drill (cont'd)

- Example Transactions:
 - BG Group/EXCO Resources* (*Haynesville Shale, Aug. 2009*)
 - Purchase by BG of 50% interest in EXCO's producing and undeveloped Haynesville Shale acreage for \$727MM cash and \$400MM carry (to fund 75% of EXCO's future drilling costs until carry satisfied)

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Structures



Structures - Entity Structure

- Characteristics:
 - Formation of a jointly owned entity between Producer and Investor to hold relevant oil and gas properties
 - Producer contributes oil and gas properties and Investor contributes cash equal to the agreed-upon value of such properties

Structures - Entity Structure (cont'd)

- Characteristics:
 - Jointly owned entity is typically (but not always) the Operator of the oil and gas properties
 - Sometimes a contract operating agreement exists between the jointly owned entity and Producer to conduct actual operations but the entity is named Operator of record
 - Favored by private equity
 - Exit strategy could be to sell the jointly owned entity or take it public
 - Could achieve a premium on return of capital by having the jointly owned entity designated as Operator of the relevant oil and gas properties

Structures - Entity Structure (cont'd)

- Typical Documents:
 - Contribution Agreement
 - Identifies the oil and gas properties to be contributed to the joint venture entity by Producer and the amount of funds (or commitment to fund) to be contributed to the joint venture by Investor
 - These contributions are made to the jointly owned entity in exchange for the negotiated percentage ownership interests in the jointly owned entity
 - Typically, percentage ownership interests are proportionate to the fair market value of the contributed properties, on the one hand, and the capital contribution of Investor, on the other hand (e.g., with a \$500MM valuation of contributed properties and a \$500MM capital contribution, Producer and Investor would each receive a 50% ownership interest)

Structures - Entity Structure (cont'd)

- Typical Documents:
 - Contribution Agreement
 - Also contains other typical provisions found in purchase agreements for upstream oil and gas properties (consideration adjustments, representations and warranties, title and environmental due diligence mechanisms, consent and Preferential Purchase Right mechanisms, indemnities and closing conditions and mechanics)

Structures - Entity Structure (cont'd)

- Typical Documents:
 - LLC Agreement
 - Covers the standard array of provisions that are generally found in sophisticated LLC agreements
 - *E.g.*, voting rights, default remedies, contribution mechanics, distribution mechanics, capital account mechanics, etc.

Structures - Entity Structure (cont'd)

- Typical Documents:
 - LLC Agreement
 - Typically contains provisions that are specifically tailored to the joint venture, such as:
 - Provisions outlining the jointly owned entity's duties as Operator of the joint venture properties
 - Restrictions on the joint venture partners' ability to transfer their respective ownership interest in the jointly owned entity – like the other structures, often these restrictions include a Lock-Up period during which neither joint venture partner may transfer any interest and subsequent Preferential Purchase Right
 - Typically contains provisions found in a JDA
 - *E.g.*, Management Committee/board mechanics, budget mechanics, AMI provisions, etc.

Structures - Entity Structure (cont'd)

- Typical Documents:
 - Form of Assignment
 - Security Documents
 - Contract Operating Agreement
 - Secondment Agreement
 - JOA (may not be needed)

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Structures - Entity Structure (cont'd)

- Example Transactions:
 - Harbinger Group/EXCO Resources (*Canyon Sand/Cotton Valley, Nov. 2012*)
 - Contribution to limited partnership of \$573.3MM by Harbinger for 74.5% interest; contribution of \$119.2MM in oil and gas properties and related assets by EXCO for 25.5% interest
 - BG Group/EXCO Resources* (*Appalachian Basin, May 2010*)
 - Purchase by BG of 50% interest in producing and undeveloped acreage in Appalachian Basin for \$800MM cash and \$150MM carry (to fund 75% of EXCO's future drilling costs); establishment of (a) 50/50 joint venture upstream LLC for operation of upstream assets and (b) 50/50 joint venture midstream LLC for the ownership and operation in related midstream assets, respectively

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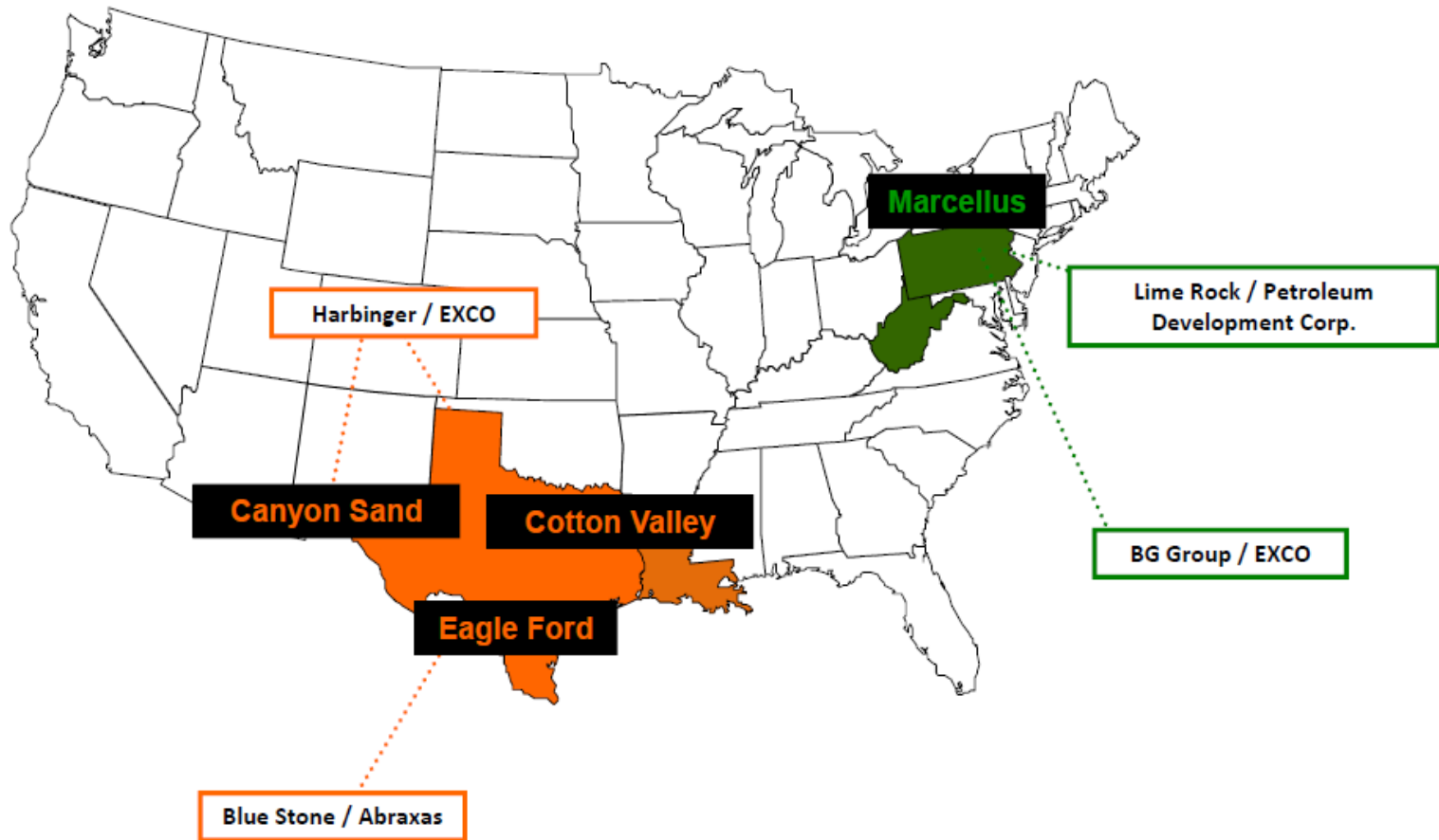
Structures - Entity Structure (cont'd)

- Example Transactions:
 - Blue Stone Oil & Gas/Abraxas Petroleum** (*Eagle Ford Shale, Aug. 2010*)
 - Initial \$25MM contribution to LLC by Blue Stone with additional \$50MM commitment to be paid at later date; contribution of Eagle ford acreage by Abraxas for \$25MM equity interest (75% Blue Stone/25% Abraxas ownership of LLC upon full funding)
 - Lime Rock/Petroleum Development Corp.** (*Appalachian Basin/Marcellus Shale, Nov. 2009*)
 - Contribution to LLC of \$158.5MM in oil and gas properties and related assets by PDC; initial contribution by Lime Rock of \$45MM with full funding due by 12/31/11 to earn 50% interest; (50% Lime Rock/50% PDC ownership of LLC upon full funding)

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Structures



Structures - Key Factors to Consider in Determining Structure

- Transferability/Encumbrance of Interests
- Financing
- Consents/Preferential Purchase Rights
 - Effects on structure
 - When to obtain
- Maintenance of Uniform Interest Provisions
- Gathering/Marketing Issues

Structures - Key Factors to Consider in Determining Structure (cont'd)

- Non-Consent Issues
- Tax Considerations
 - Common structure: foreign investor (1) places a U.S. corp. in the chain of title to prevent the foreign investor from filing U.S. tax returns and (2) forms a pass-through subsidiary (e.g., LLC) of the U.S. corp. to invest (liability shield)
 - Employees of a foreign investor working in the U.S. are typically employed by one of the foreign investor's U.S. entities in order to avoid creating a nexus for the foreign investor to be taxed under U.S. federal or state law
- Others

Rights to be Acquired/Earned - All Structures

- Certain Depths vs. Entire Leasehold Interest
 - Can a depth severance be adequately described?
 - Surface Rights/Coordination
 - If depth severance where the joint venture only gets certain depths, will there be any sharing of facilities/need for a Shared Use Agreement?
 - Which depths have priority for use of the surface?
 - Should any other surface-related rights owned by the existing owner be addressed (e.g., water rights)?

Rights to be Acquired/Earned - All Structures (cont'd)

- Certain Depths vs. Entire Leasehold Interest
 - Effect on Maintenance of Uniform Interest Provisions
 - Are JOA counterparty waivers obtainable?
 - How big are the “Contract Areas” under existing JOAs (if any)?

Rights to be Acquired/Earned - All Structures (cont'd)

- Producing vs. Non-Producing Acreage
 - Existing Wellbores
 - Excluded or included in the joint venture assets?
 - Title Issues
 - Non-producing acreage typically has greater risk of title defects/failure of title
 - Pre-Closing or Post-Closing title review?
 - Will Producer be required to deliver a title opinion to Investor prior to Investor electing to participate in a well?

Rights to be Acquired/Earned - Drill-to-Earn Structure Specific

- What rights/interest will be earned and when?
 - Acreage Earned
 - On a per-well basis? On a time-based basis (e.g., those wells drilled each calendar quarter)?
 - On a drilling-unit basis? On a larger pre-determined size?
 - Balance of Acreage
 - Will there be a right to earn remaining acreage once initial drilling plan is complete?
 - Tied to number of net wells drilled?
 - Tied to certain amount of dollars spent on drilling costs?

Consideration - Cash

- In Acquisition-and-Drill structure, upfront cash from Investor may be required, particularly if producing properties are involved
- For tax purposes, parties typically avoid (i) calling the agreement a “purchase” agreement, (ii) using the terms “Seller” or “Buyer” and (iii) denoting any upfront consideration as the “purchase price”
- Typically addressed in the Acquisition Agreement
 - Percentage of cash vs. carry split often depends on whether producing properties are involved
 - Higher number of producing properties should result in larger Closing cash payment
 - Apparent trend of decreasing percentage paid as Closing cash payment

Consideration - Carry

- What percentage of Producer's costs will be Carried?
 - Typically 50% to 100%
 - Most Investors want Producer to have some “skin in the game” and bear some portion of its own costs
- Tax considerations of the Carry
 - For tax purposes in the context of a Carry, may be advisable to utilize a Tax Partnership
 - Parties should ensure the Carry meets the tax requirements for a Carry, as opposed to qualifying instead as deferred consideration

Consideration - Carry (cont'd)

- What costs are covered by the Carry?
 - Permitting; site preparation; title opinions
 - Drilling costs
 - Completion costs
 - Gathering costs
 - Extraordinary liabilities are typically excluded
 - Personal injury and other tort claims
 - Breach of contract claims
 - Environmental liabilities not in the ordinary course
 - Others

Consideration - Carry (cont'd)

- Termination/Suspension of Carry
 - “Use it or lose it” (more typical in Acquisition-and-Drill structure)
 - Some deals structure the Carry as “use it or lose it” – if a portion of the Carry has not been expended by Investor as of a pre-determined date, Investor’s obligation to pay that portion of the Carry is terminated

Consideration - Carry (cont'd)

- Termination/Suspension of Carry
 - Off-Ramps for payment of Carry, term of joint venture and/or reduction in target number of wells or drilling dollars
 - Investors are increasingly requesting some type of Off-Ramp and/or suspension of the Carry in certain circumstances
 - Decreases in commodity prices
 - Production targets not being met
 - Increases in drilling costs, etc.

Consideration - Carry (cont'd)

- Termination/Suspension of Carry
 - Off-Ramps for payment of Carry, term of joint venture and/or reduction in target number of wells or drilling dollars
 - Consequences and duration of Off-Ramps vary:
 - Suspend obligation to pay the Carry for an agreed-upon time period
 - Automatic reduction in drilling plan
 - Reduction in the percentage of Producer's costs to be carried by Investor
 - Buy-out of remaining Carry at a pre-determined present value discount
 - Reassignment of Investor's interest

Consideration - Carry (cont'd)

- Termination/Suspension of Carry
 - Off-Ramps for payment of Carry, term of joint venture and/or reduction in target number of wells or drilling dollars
 - Limitation on use of Off-Ramps is negotiated
 - *E.g.*, once per X number of years/only once for term of joint venture

Consideration - Remedies for Carry Payment Default

- Removal of Operator
- Forfeiture of interests
 - Some Acquisition-and-Drill structure deals require a partial reassignment of interests
- Reduction in Joint Venture Entity ownership interest
 - LLC Agreement may contain automatic dilution formula or buy-out rights
- Reduction in earning potential
 - Drill-to-Earn Investor may lose ability to earn entire joint venture acreage or, in some cases, may be required to reassign joint venture acreage already earned

Consideration - Remedies for Carry Payment Default (cont'd)

- Termination or suspension of certain rights under the governing agreements
 - Rights to participate in AMI acquisitions
 - Rights to consent/withhold consents to transfers or changes-in-control by other joint venture partner, as well as rights to exercise Preferential Purchase Rights with respect to such transfer or change-in-control
 - Rights to vote, participate in Management Committee meetings, including the forfeiture of rights to approve Budgets, Budget amendments or Development Plan amendments
- Remedies under security documents (e.g., guaranty, mortgage, etc.)

Operations - Operatorship

- Removal of Operator
 - Typical JOA removal standard is common
 - Removal for breach of JDA/Participation Agreement
 - Materiality standards
 - Sometimes tied only to payment defaults

Operations - Operatorship (cont'd)

- Ability of the Investor to Operate
 - Timing (may be delayed until Investor gets experience in drilling or finds an experienced Contract Operator)
 - Right to become Operator may be split on an area-by-area basis
 - JDA/Participation Agreement may include rights to increase area operated by a given joint venture partner
 - Investor under Drill-to-Earn structure may earn Operatorship of those wells in which it carries Producer in or may earn the right to become Operator upon reaching the applicable Earning Trigger

Operations - Operatorship (cont'd)

- Reporting Requirements
 - Often Investors require the Operator to deliver additional reports to the joint venture partners (e.g., financial reports) and not just those required under a standard JOA
 - Typically contingent on the type of Investor (private equity investors/foreign investors are more likely to require expanded information than a strategic industry player)

Operations - Development/Control of Joint Venture Operations

- Common to have a Multi-Year Development Plan agreed at Closing
 - Typically, the Development Plan provides for sufficient drilling operations to expend the entire Carry
 - Can be amended through provisions of the governing agreements
 - Typically voting thresholds are designed to require mutual agreement of the joint venture partners unless one joint venture partner holds a small minority ownership percentage
 - Under a Multi-Year Development Plan structure, typically no joint venture partner can non-consent or vote against an operation included in the development plan (absent such joint venture partner's ability to amend the plan unilaterally)

Operations - Development/Control of Joint Venture Operations (cont'd)

- Alternative to Multi-Year Development Plan
 - Allow any joint venture partner to propose and/or non-consent to operations during the Carry period
 - Often, if Investor non-consents, the Carry still applies to the agreed percentage and scope of Producer's costs
 - Some Drill-to-Earn structures do not have a pre-approved Development Plan

Operations - Joint Venture Budgets

- Initial Budget is typically agreed at Closing
 - May cover a multi-year period (typically no more than two years)
 - Some Drill-to-Earn structures have no initial agreed-upon budget or plan or only a limited budget and plan approved for an initial period

Operations - Joint Venture Budgets (cont'd)

- Subsequent Budgets are subject to approval pursuant to the JDA/Participation Agreement/LLC Agreement
 - In most cases, mutual agreement of joint venture partners is required
 - Often the joint venture documents provide for a default Budget absent agreement of the joint venture partners
 - Corresponds to the then-current development plan and any operating costs for existing wells
 - Often has an adjustment component

Operations - Joint Venture Budgets (cont'd)

- Overhead
 - Handled in different ways (e.g., Operating Fee, JOA overhead provisions, included as a budget line item, etc.)
- Permitted Overages of Agreed Budget
 - Typically permitted up to 10% or 20% over the then-current budget
 - Whether this permitted overage percentage applies to each budgeted category, the budget as a whole, or both, is negotiated

Operations - Day to Day Operations

- Joint Operating Agreement
 - Typically the 1989 AAPL Form JOA is used as the starting point
 - Usually attached as an Exhibit to the JDA/Participation Agreement (with any agreed-upon modifications)
 - Governs day-to-day operations of the joint venture
 - In the event of a conflict between the JOA and the JDA/Participation Agreement/LLC Agreement, the JDA/Participation Agreement/LLC Agreement controls
 - Following the termination of the JDA in an Acquisition-and-Drill structure or the Participation Agreement in a Drill-to-Earn structure, the JOA controls the relationship of the joint venture partners with respect to the joint venture assets (in an Entity structure, the LLC Agreement will typically control, as well as the JOA, if applicable)

Operations - Day to Day Operations (cont'd)

- Joint Operating Agreement
 - In Acquisition-and-Drill and Drill-to-Earn structures, the security provisions can be expanded from those contained in the AAPL Form JOA
 - Expanded provisions provide security for more costs than what is typically covered by AAPL Form JOA (e.g., Carry costs)
 - May also contain provisions specifically tailored to horizontal drilling

Operations - Transfer/Encumbrance Restrictions

- Transfer Lock-Up during Carry period
 - Most deals have a Lock-Up period preventing transfers of interests in joint venture properties or joint venture entities, as applicable, during the Carry period
 - Other transfer restrictions vary
- Preferential Purchase Rights
 - Fairly common in all structures
 - Gives non-transferring joint venture partner the right to purchase direct interest in the joint venture properties or ownership interest in joint venture entity, as applicable

Operations - Transfer/Encumbrance Restrictions (cont'd)

- Tag-Along/Drag-Along Rights
 - Common in Entity structures and other joint ventures that are disproportionately owned
 - Often seen in structures involving private equity investors
 - Encumbrance on alienation

Operations - Transfer/Encumbrance Restrictions (cont'd)

- Maintenance of Uniform Interest provisions
 - Can be included in JDA/Participation Agreement in addition to standard JOA provision
 - Presence can create encumbrance on a joint venture partner's ability to transfer portions of the joint venture properties
 - Joint venture JOA should be negotiated with Maintenance of Uniform Interest issues in mind or multiple JOAs covering discrete sets of joint venture properties should be entered into by the joint venture partners

Operations - Transfer/Encumbrance Restrictions (cont'd)

- Existing financing/security interest issues
 - AAPL JOA “first lien” language issues
 - Liens in favor of Producer to secure Carry obligation
 - Liens in favor of third-party lender to secure financing of Closing cash payment and Carry obligation
 - Liens can be placed directly on a joint venture partner’s interest in the joint venture properties or on a joint venture partner’s ownership interest in a joint venture entity
 - Typically, restrictions on liens and other encumbrances are tighter during Carry period or prior to reaching earning trigger in a Drill-to-Earn structure, as applicable

Operations - Transfer/Encumbrance Restrictions (cont'd)

- Change-in-Control issues
 - Should negotiated transfer restrictions (e.g., Lock-Up/Preferential Purchase Rights) be triggered by a change-in-control of a joint venture partner?
 - Typically exceptions for public company takeovers, going-private transactions and changes-in-control of ultimate parent of a joint venture partner
- Standstill for acquiring Public Company stock of a joint venture partner

Operations - Remedies for Defaults Other Than Carry Defaults

- Defaults by Operator
 - Can lead to removal of Operator
 - Typically tied to JOA removal standard, but tightened JDA/Participation Agreement standard can lead to removal

Operations - Remedies for Defaults Other Than Carry Defaults (cont'd)

- Failure to pay Working Interest costs
 - If JDA/Participation Agreement is still active, can result in similar default penalties and termination/suspension of rights as a Carry payment default
 - Remedies in an LLC Agreement are typically the same for a Working Interest payment default as a Carry payment default
 - JOA remedies for failure to pay Working Interest costs are also available
- Remedies under security documents may or may not be available depending upon coverage of those security documents

Title - Title Issues

- Title
 - Key determinants of whether title is a material issue include:
 - Availability of existing title opinions
 - Amount of acreage that is held by production
 - Number of leases/average lease size
 - Producer's leasing practice

Title - Title Issues (cont'd)

- Title
 - Title Defect Period: no clear market standard
 - Title Threshold: no clear market standard
 - Title Deductible: generally 1.0% to 2.0%
 - Substitute Acreage: available as a remedy (what qualifies as “Substitute Acreage” can be an issue)
 - Consents and Preferential Purchase Rights
 - Consents required to close
 - Remedies if consents/waivers of Preferential Purchase Rights not obtained or if Preferential Purchase Rights exercised

Environmental - Environmental Issues

- Environmental Issues
 - Environmental Defect Mechanism
 - Certain foreign investors are more focused on environmental issues
 - If primarily non-producing acreage, environmental considerations may not be a material issue

Other Documents - Other Typical Transaction Documents

- Secondment Agreement
 - In Acquisition-and-Drill structures, often used by Investor to second employees into Producer's operations
 - Foreign investors (and sometimes other industry players with no shale experience) often desire Secondment Rights
 - Foreign investors want their employees to learn the business of operating and managing shale operations
 - In Entity structures, often used by both joint venture partners to second employees into the joint venture Entity for operational purposes
 - Typically operational secondees sit at a management level

Other Documents - Other Typical Transaction Documents (cont'd)

- Assignment and Bill of Sale
 - Warranty issues (special warranty vs. no warranty)
 - Joint venture partners will need to determine whether a Title Defect Mechanism should be the sole recourse for title issues
 - Recording issues
 - State requirements
 - County recording office peculiarities
 - Government-mandated forms
 - Federal/state leases

Other Documents - Other Typical Transaction Documents (cont'd)

- Security Documents
 - Typically used to secure Investor's obligation to pay the Carry
 - Sometimes also secures Investor's other obligations under the JDA/Participation Agreement and other joint venture documents (payment of Working Interest costs, agreed-upon fees, etc.)
 - Also sometimes used to secure each joint venture partner's obligations to the joint venture entity in an Entity structure (pledge of a joint venture partner's equity interest in the joint venture entity)

Other Documents - Other Typical Transaction Documents (cont'd)

- Security Documents
 - Deed of Trust/Mortgage
 - Most common in Acquisition-and-Drill structures
 - Either through a separate instrument or the expansion of the JOA lien
 - Often there are state-specific requirements to be considered
 - Mortgages can cover all properties or only undeveloped properties
 - In some joint ventures, security interests roll off of properties as they are developed (having developed properties encumbered makes it harder for Investor to sell those properties in the future)

Other Documents - Other Typical Transaction Documents (cont'd)

- Security Documents
 - Parent Guaranty
 - Scope: should the guaranty only cover the Carry or all of Investor's joint venture obligations?
 - Enforceability issues if the Guarantor entity is a foreign entity
 - Legal opinions are often used to identify any enforceability issues
 - In Entity structures, can also be used to cover a joint venture partner's obligations under the LLC Agreement

Other Documents - Other Typical Transaction Documents (cont'd)

- Security Documents
 - Letter of Credit
 - Performance Bond
 - Escrow Agreement
 - What amounts should be escrowed (*e.g.*, operating/development expenses for one month or one quarter, etc.)
 - Disbursement mechanisms

Other Documents - Other Typical Transaction Documents (cont'd)

- Other Documents that may be Applicable
 - Tax Partnership
 - Shared Use Agreement
 - Surface Use Agreement
 - Water Rights Agreement
 - Services Agreement

U.S. Upstream Joint Venture Issues in a Nutshell

Structure

- Jointly owned entity
- Individual/direct leasehold ownership
- Drill-to-Earn structures

Consideration

- Upfront cash
- Carry
 - Off-Ramps (situations where Carry may not apply – e.g., price threshold or when drilling plan is reduced)
 - Costs covered by Carry
 - percentage of costs subject to Carry
 - Term

JDA/Participation Agreement

- Governance (Management Committee)
- Development Plan
 - pre-approved for default situations
- Budgets
 - approval rights
 - default budget procedures
- Operatorship
 - removal rights
 - operatorship split between parties
 - reporting to non-operator parties
- AMI
 - scope/duration
- Transfer restrictions
- Exit strategies
 - Term limit
 - Drag/tag rights
 - if entity, IPO/sale of equity

Tax

- Foreign investors
- Employee matters
- Sale vs. other structures
- Carry/Tax Partnership

Acquisition / Contribution Agreement

- Title issues (duration of due diligence, coverage and thresholds/ deductibles)
- Applicable consents/Preferential Purchase Rights
- Environmental issues (duration of due diligence, coverage and thresholds/deductibles)
- Representations and warranties
- Indemnities
- Dispute resolution
- HSR application
- CFIUS application
- Closing conditions