

Chapter 10

Oil and Gas Exploration and Development Agreements

Debra J. Villarreal

Thompson & Knight, LLP
Dallas, Texas

Lucas LaVoy

Thompson & Knight, LLP
Houston, Texas

Synopsis

§ 10.01.	Introduction.....	324
§ 10.02.	Joint Ventures.....	326
§ 10.03.	Participation Agreements	327
	[1] — Identifying the Exploration Area	328
	[a] — Geological Exploration Area	328
	[b] — Geographic Exploration Area	330
	[2] — Existing Interests in Exploration Area	332
	[3] — Interests of the Participants	333
	[4] — Seismic Data.....	336
	[5] — Acquiring Leases	338
	[6] — Designation of Prospect Areas	342
	[7] — Initial Well in a Prospect Area	342
	[8] — Consequences of a Failure to Participate	344
	[9] — Subsequent Operations	347
	[10] — Plan of Development	348
	[11] — Designation of Operator	348
	[12] — Financial Assurances	350
	[13] — Standard of Performance	352
	[14] — Management Committee.....	352
	[15] — Delay Rentals, Shut-In Payments and Minimum Royalties	354
	[16] — Abandoned Wells	355
	[17] — Representations.....	355
	[18] — Disclaimers	356
	[19] — Term and Termination.....	356
§ 10.04.	Joint Operating Agreement.....	357
§ 10.05.	Area of Mutual Interest	359
§ 10.06.	Assignability of a Participation Agreement.....	362

§ 10.07. Miscellaneous Provisions of a Participation

Agreement..... 364

[1] — *Force Majeure* 364

[2] — Waiver of Jury Trial and Forum Selection 366

[3] — Dispute Resolution 367

[4] — Confidentiality and Press Releases 369

[5] — Other Common Provisions 371

 [a] — Audit Rights 371

 [b] — Limitation on Special and Consequential Damages 372

 [c] — No Third-Party Beneficiaries 373

 [d] — Amendments and Waivers..... 373

 [e] — Governing Law 373

 [f] — Covenants Running with the Land 374

 [g] — Multiple Counterparts 374

 [h] — Further Assurances..... 374

§ 10.08. Conclusion..... 374

Appendix..... A-1

§ 10.01. Introduction.

Companies in the oil and gas industry form relationships with other industry players that they hope will be beneficial to all of the parties. Industry players seek out others who possess something that they lack. Some companies have acquired sizable leasehold acreage but lack the funds to timely develop the acreage. Others have cash to invest but lack the technical know-how to properly develop property. Some industry players have developed a geologic idea for a project but lack the resources necessary to acquire the acreage and develop the property.

Each of the great unconventional gas plays that have dominated the industry news over the last few years¹ — the Barnett Shale, the Marcellus, the Haynesville Shale, and the most recent of the group, the Eagle Ford² —

¹ Questar Corp. chairman Keith Rattie was quoted as stating that the Haynesville: “may be one of the biggest natural gas fields in the world[.]” *Oil and Gas Investor*, May 26, 2009.

² “In 1990, unconventional gas – from shales, coal-bed methane and so-called ‘tight’ formations – was about 10% of total U.S. production. Today it is around 40%, and growing fast, with shale gas by far the biggest part.” Daniel Yergin and Robert Ineson, “America’s

require acreage, technical know-how and substantial cash for development. Some of the major players in the unconventional gas plays, such as Chesapeake Energy, Range Resources, Cabot Oil & Gas Corporation, and Chief Oil & Gas, have amassed substantial leasehold acreage. Chesapeake Energy alone has reportedly acquired 220,000 acres in the Barnett Shale and 1.6 million net acres in the Marcellus.

Companies have always needed to allocate their capital among their various projects. To avoid spending all of their capital on one project, companies have historically formed joint ventures or entered into participation agreements with other companies who can help provide additional capital for development. In addition to the ongoing need to properly allocate funds, at a time when companies have needed substantial amounts of capital to develop their acreage, the credit crisis that started in 2008³ continues to plague the industry. Capital markets have not fully recovered. Credit remains tight. Companies without sufficient funds to finance development on their own have been actively seeking other industry players who can fulfill their need for cash. So, we have seen a surge in the number of companies that have entered into joint development programs with other companies to develop these unconventional gas plays.

The first step for companies wanting to enter into a relationship for the joint development of a project is to determine what form their relationship will take. The potential forms are numerous, but two of the most common are a joint venture and a contractual arrangement under which the parties agree to jointly explore and develop property without forming a separate legal entity.

Natural Gas Revolution,” *Wall St. J. Online*, November 2, 2009, available at <http://online.wsj.com/article/SB10001424052748703399204574507440795971268.html>.

³ The financial crisis is widely acknowledged to be the worst financial markets disruption since the Great Depression. Press Release, Cambridge Energy Research Associates, “Three Top Economists Agree 2009 Worst Financial Crisis Since Great Depression; Risks Increase if Right Steps are Not Taken” (Feb. 13, 2009), available at <http://www.cera.com/asp/cda/public1/news/pressReleases/pressReleaseDetails.aspx?CID=10119>. On December 9, 2008, the yield on three-month Treasury bills went below zero for the first time since the 1940s. David Gaffen, “Three-Month Bill Yield Goes Negative,” *Wall St. J. Marketbeat*, Dec. 9,