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Joint Development Trends in Oil & Gas Transactions

BY ARTHUR WRIGHT AND REBECCA SEIDL

The development of shale plays continues to be the focus of the energy industry. According to the U.S. Energy Information Administration, almost a quarter of the estimated natural gas resources in the U.S. and approximately 24 billion barrels of technically recoverable oil resources are located in shale formations. Producers have been rapidly developing these formations; however, there is a shortage of infrastructure to gather and process the resultant production. Often, producers lack the capital to drill and/or develop the necessary infrastructure. As a result, producers are: (i) forming joint ventures (JVs) with other companies; (ii) seeking investment capital from venture capital firms; and/or (iii) forming joint ventures with midstream companies to develop midstream assets and acquire additional dedications with the intention of "flipping" to a master limited partnership (MLP).

Due to a lack of capital, producers are forming JVs to develop exploration and production (E&P) assets. The $95 million JV between the Gas Authority of India Limited and Carrizo Oil & Gas in the Eagle Ford Shale play is one example of a foreign JV that developed E&P assets. Since 2008, foreign companies have entered into 21 JVs with U.S. companies, investing more than $26 billion in shale plays. Many of these investments involved acquiring acreage through an upfront cash payment with a commitment to cover a portion of the drilling costs. Both U.S. and foreign companies benefit from these deals because the domestic companies receive financial support and the foreign companies gain experience in drilling operations while earning profits. An example of a JV between two domestic companies is that of Noble Energy and CONSOL Energy in the Marcellus Shale, which is one of the lowest cost domestic shale plays and is ideally located near major markets. Their JV agreement contained provisions that ensured both partners were economically aligned in an environment of low natural gas prices.

Midstream companies' lack of resources to construct systems large enough to support the production from the emerging shale plays has sparked the interest of private equity investors. These investors recognize the upside in development of midstream projects and then marketing a system with cash flow for sale. Such investors are generally not in the business of long term ownership and operation of oil and gas assets, but rather in building a valuable and marketable asset and making a profit as quickly and seamlessly as possible. One recent example of a privately owned and investor-funded midstream company developing large-scale infrastructure in an area of rapid growth can be found in Howard Energy Partners' acquisition of Meritage Midstream Services' and Laredo Energy's JV, Eagle Ford Escondido Gathering, LLC in the Eagle Ford shale. Meritage was formed for the purpose of acquiring assets, constructing a gathering system, and "flipping" the system. As part of that effort, Meritage entered into a JV with Laredo and formed a holding company for the gathering system built by the JV and which had, as an anchor contract, a dedication of Laredo's large acreage position in the Eagle Ford shale. This transaction is an example of a "win-win" situation: the producer benefited by participating in a JV that capitalized on its dedication, and the midstream entity acquired, for resale, a strong position in an area with growth potential.

Increasingly, midstream companies are obtaining producing acreage dedications, building infrastructure, and, once there is cash flow, "flipping" such assets to MLPs that need such cash flow to pay their dividends. Small, private-equity backed portfolio companies have the ability and incentive to develop midstream infrastructure quickly in emerging shale plays for sale to MLPs that desire assets with cash flow and growth potential. These portfolio companies recognize the need for MLPs to acquire assets with sufficient resources to pay dividends and are in the position to develop assets before there is positive cash flow. They are able to construct and develop systems that can be "flipped" quickly to an MLP, not only because they have the technical expertise to quickly design, construct, and operate the midstream assets, but also because they have experienced business development teams willing to structure transactions creatively and develop producer relationships that create a "win-win" situation.

The foregoing examples demonstrate the trend of companies entering into joint ventures that simultaneously capitalize on the strengths of each party and serve each party's needs. Furthermore, forward-looking parties and a "win-win" negotiating style are vital to the success of such joint ventures. **HN**

Arthur Wright is senior counsel and Rebecca Seidl is an associate at Thompson & Knight LLP. They can be reached at arthur.wright@tklaw.com and rebecca.seidl@tklaw.com, respectively.