O&G Joint Venture Deal Structure

Introduction

You owe it to yourself to know how joint venture deals are structured. Often the "deal promoters" who are just trying to "get you to buy" don't know what you will learn here. We at Eratz want you to understand the basics so you are confident we are built on "Wisdom and Trust". So please read on…

Ingredients of a Deal

Four ingredients comprise and O&G joint venture:

- Prospect. Geologic/geophysical evidence that there is commercially viable oil and gas in a location you know about.
- Land. The leased mineral rights to drill and produce from the prospect location.
- Dollars. Money for drilling, testing and completing the well, and for producing/maintaining the well.
- Technology. Equipment and know-how for drilling the well and producing O&G.

It requires the resources of several people to get all these ingredients. Usually one person or company has the Prospect and Land ingredients. He needs to find several "investors" who have the money so collectively than can hire a company that has the technology to drill the well. We will illustrate the process by having one person who has the Prospect and Land and three investors who will invest in the joint venture. This will illustrate the industry standard "a third for a quarter" deal structure. Here is what it means:

- The three investors put up equally the money to fund 100 percent of the costs to drill and test the well. The person with the Prospect and Land puts up no money. All four of them are each entitled to 25 percent of the revenue stream if the well is completed and produces O&G. We say that each of them has a 25 percent "Working Interest" in the well and that the three investors are "carrying the interest" of the other person.

Please note that the land owner from whom the lease was obtained gets royalties (current leases call for perhaps 25 percent royalty) on whatever is produced and incurs no costs. And sometimes there is an "overriding royalty interest" (ORRI) or a "back in after payout" (BIAPO) percentage of the revenue that goes to the person who had the Prospect and Land in the first place. It just depends on how the deal particulars are written and greed to.

The Next Step

So far, so good. We have four partners, and one of them is designated the "Managing Partner". We have just arrived at the deal structure for industry partners. Industry partners are people who actually work in the industry. They have the know-how and expertise that private investors don't. In particular, they know how to put together the "Authorization for Funds Expenditure" (AFE) that itemizes how much it will cost for the well, and they know how to hire O&G service companies to drill/produce, and they know how to sell the O&G!

However, it often takes more money than the partners have. And this is where the private investor comes in. The partners split off a designated percentage of the Working Interest and set up a separate joint venture for that amount. Say, for example they split off 50 percent. And they offer to private accredited investors a unit in the joint venture that represents a 1 percent working interest. So they must get 50 private investors to "buy in".

There are costs for setting up this separate joint venture. Among them are: organizational costs; syndication costs; sales commissions; management fees; supervisory fees, etc. These costs are passed on to the private investors as part of their purchase price. Collectively think of these costs as a percent mark-up on what the would cost to an industry partner. **Disreputable O&G companies and promoters often inflate this mark-up and will not discuss this with the private investor. Not so with Eratz! We are explaining all this to you now, and will be happy to discuss further when you are ready to buy in to one of our joint ventures.**

Wrapping Up

Congratulations for reading this far! You now know more than most investors about how deals are structured. Each joint venture and its limited partnership basically follow the above in general, but there are "refinements" that handle additional details. For example, the "carried interest" converts to a "full interest" usually "After the Casing Point" (ACP). And "BIAPO" kicks in after the partners have recovered their original investment. But don't worry about these fine points for the time being. If you want to research deals further on your own, please take a look at "Money in the Ground" by John Orban. **And please contact Eratz! We wrote this article and have built our business on "Wisdom and Trust".**