

OVERVIEW OF DEEPWATER PRODUCTION HANDLING AGREEMENTS

OCSAB 2016 Summer Seminar

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NEW ORLEANS - HOUSTON

Subsea Technology

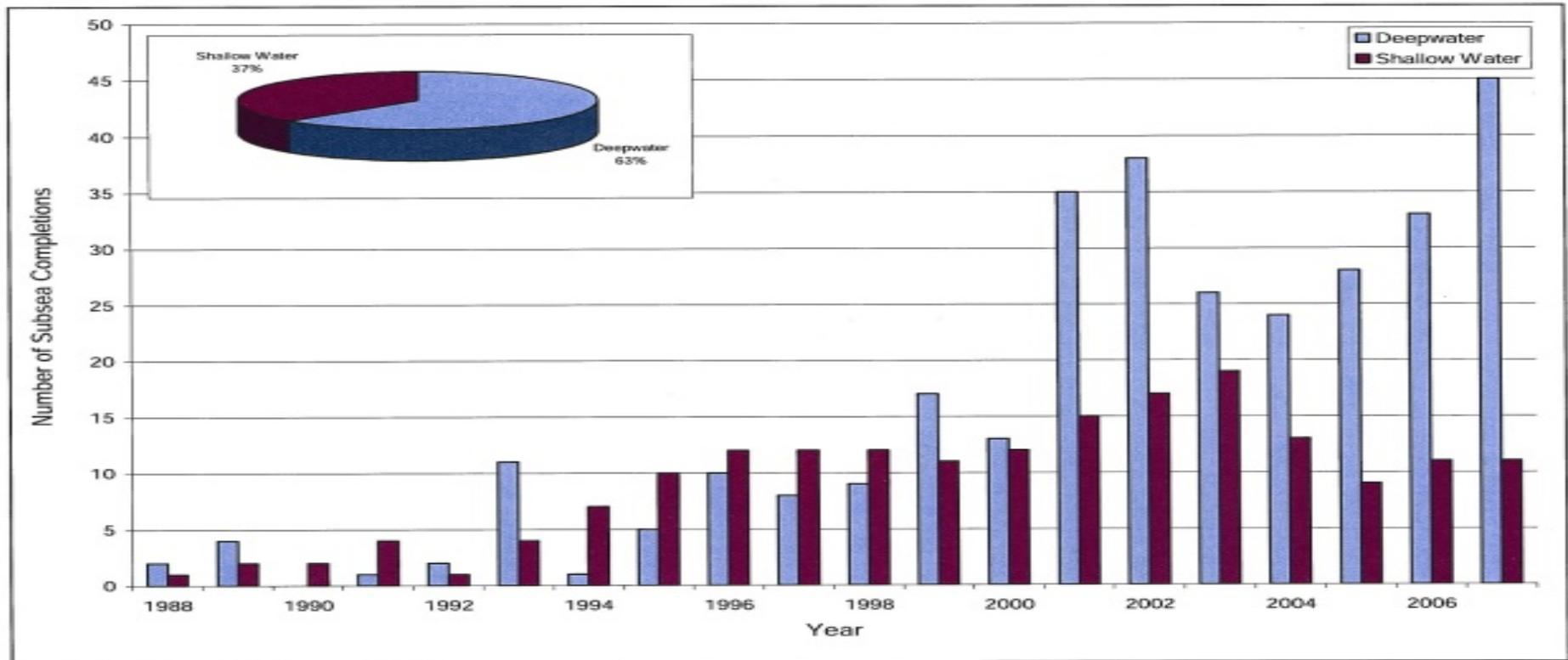


Figure 33. Number of shallow- and deepwater subsea completions each year.

Subsea Technology

DRILLING AND DEVELOPMENT

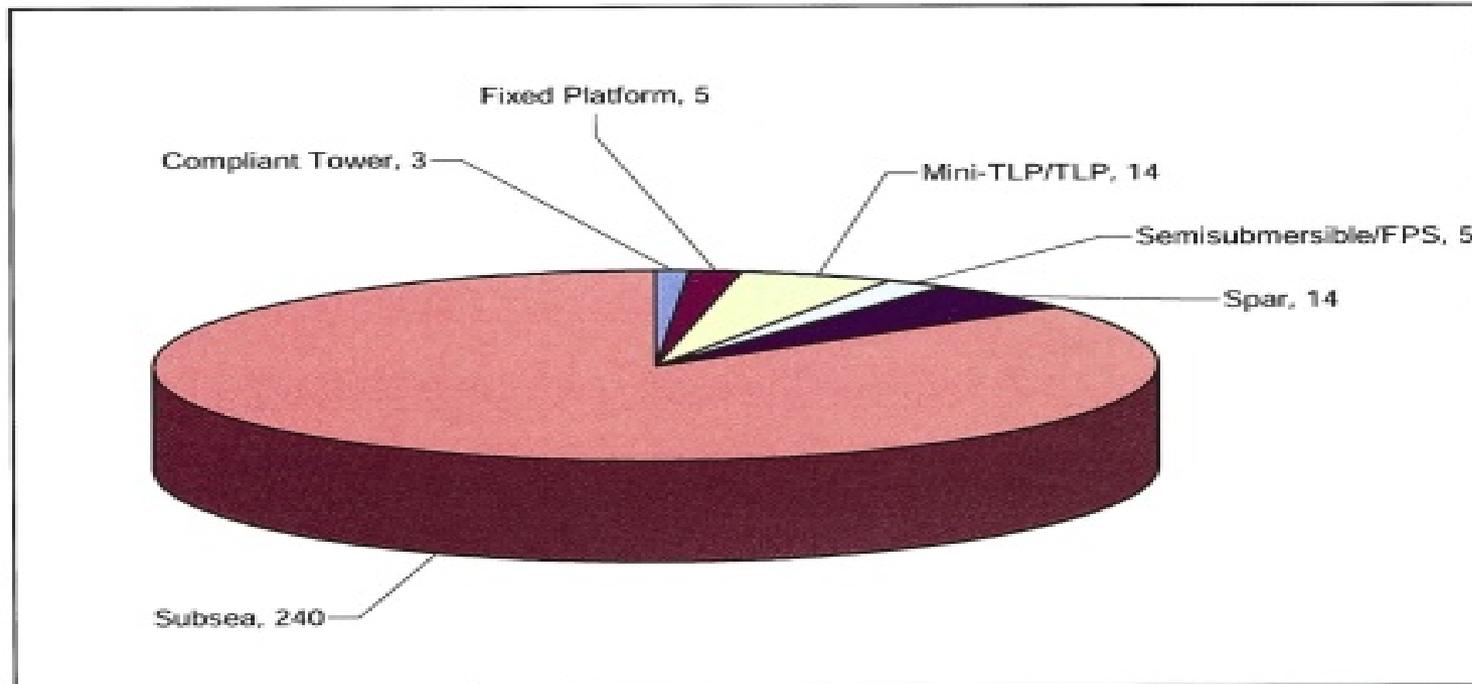


Figure 32. Production systems for currently producing fields, including subsea systems.

Term Sheet

- Term sheet allows parties to agree on key points before negotiating PHA.
- For example:
 - Gas Handling Fee: \$0.10 per Mcf
 - Oil/Condensate Handling Fee: \$1.00 per Bbl
 - Water Handling Fee: \$1.00 per Bbl
 - Compression Fee: \$0.02 per Mcf per Stage

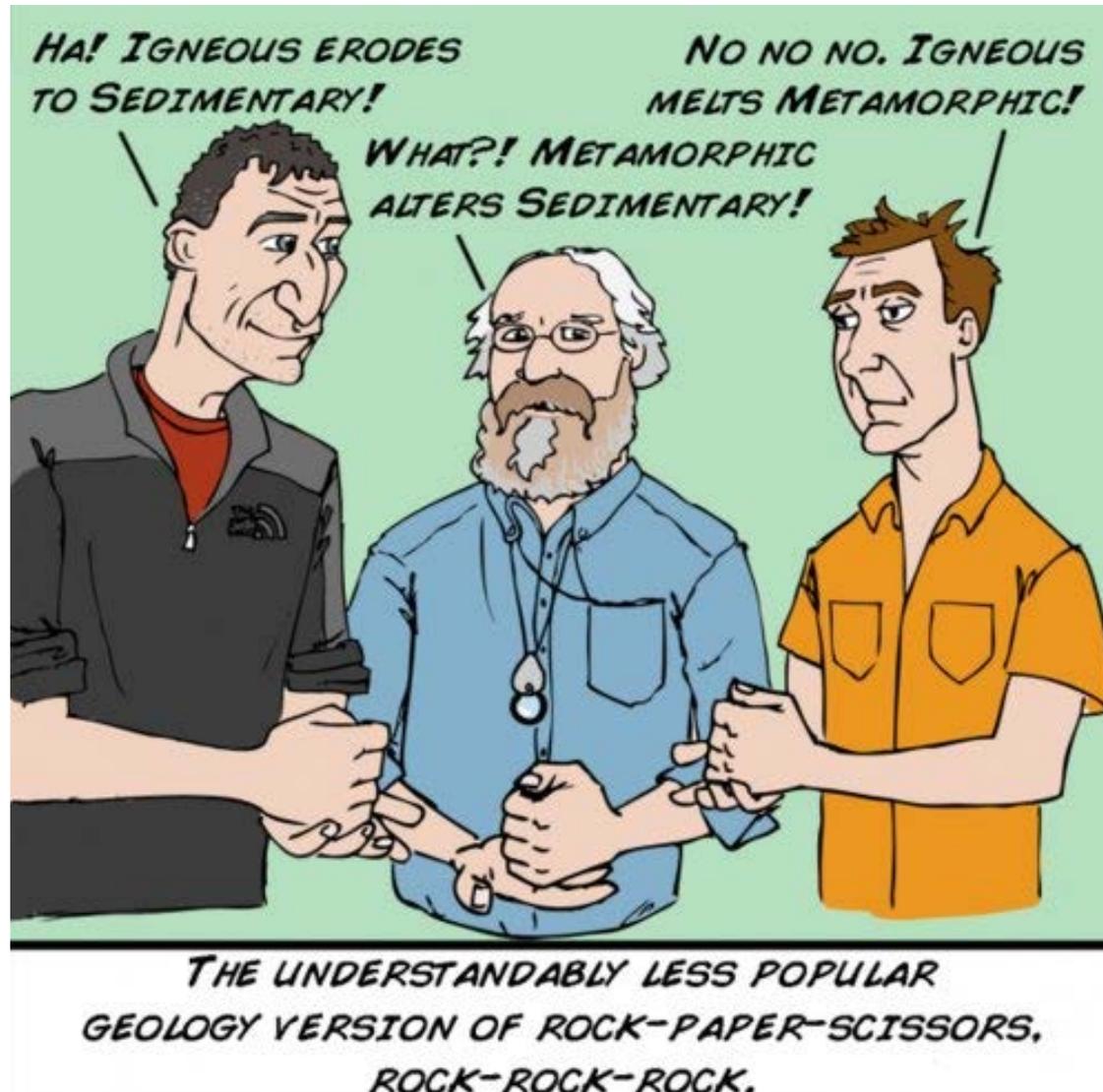
Term Sheet

- Satellite Production capacity requirements
- Fees to be paid by Satellite Producer
 - Infrastructure Access Fee
 - Processing Fees for Oil, Gas and Water
 - Minimum Monthly Processing Fee
 - Deferred Production Compensation
- Operating Expenses
- Facilities to be installed on Host

Letter of Intent

- Commercial terms and conditions of transaction are non-binding until a definitive PHA is executed.
 - Clearly state that LOI is non-binding.
- Binding provisions can include:
 - Confidentiality
 - Term of Letter of Intent
 - Exclusivity
 - Non-Disclosure
 - Choice of law

Alternative Method of Dispute Resolution



Letter of Intent

- Energy Transfer Partners, LP v. Enterprise Products Partners, 2014 WL 10120268 (Tex. Dist. Jul. 29, 2014).
- Parties signed non-binding letter of intent for possible joint venture on oil pipeline.
- Jurors found creation of statutory partnership and Enterprise did not comply with its duty of loyalty.
- Court awarded \$535 million to ETP.

Letter of Intent

- Coe v. Chesapeake Exploration, 695 F.3d 311 (5th Cir. 2012).
- Chesapeake made “Offer to Purchase” leases in the Haynesville formation.
- Chesapeake argued that parties did not intend to be bound and agreement lacked essential terms.
 - Essential terms include time of performance, price to be paid and service to be rendered.

Letter of Intent

- Chevron v. Martin Exploration Co., 447 So.2d 469 (La. 1984).
- A preliminary agreement had been reached by the parties as to operations, but contemplated finalizing terms with JOA.
- Court held that term “preliminary” does not prevent the agreement from being final until later agreements are reached.

Major Sections of Deepwater PHA

- Definitions
- Infrastructure and Facilities
- Services
- Fees and Expenses
- Capacity
- Metering and Allocation
- Suspension of Operations
- Term
- Indemnification
- Miscellaneous

Definitions

- Host – TLP, FPS, Spar, or other facility.
- Satellite Production System – Wells and subsea equipment.
- Owner – Party that own the Host.
- Producer – Party that owns the Satellite Production.
- Entry Point – Place on the Host where Satellite Production enters Host.
- Delivery Point – Place on the Host where Satellite Production leaves Host.

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Infrastructure and Facilities

Satellite Production System

- Producer owns, installs and pays for Satellite Production System.
 - All equipment upstream of the Entry Point.
- Owner usually has right to review and approve the design of Satellite Production System.
- Owner will collect costs in advance from Producer for start-up and commissioning of Satellite Production System components on Host.

Infrastructure and Facilities

Receiving Facilities

- Receiving Facilities are equipment and facilities installed on the Host for receiving Satellite Production.
- Producer pays for costs of Receiving Facilities.
- Host Operator responsible for installation and commissioning.
- Owner owns the Receiving Facilities.
- Host Buoyancy

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Services

- Host Operator will provide Production Handling Services for Satellite Production.
- Host Operator will provide Operating Services for Satellite Production System.
- Well Unloading

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Fees and Expenses

Operating and Maintenance Expenses

- Producer Sole Expenses, Owner Sole Expenses, and Host Shared Expenses.
- Host Shared Expenses: $PSopex = Hopex \times [Sprod / (\sum THprod)]$

Fees and Expenses

Infrastructure Access Fee

- May be a fixed amount per barrel of oil, per MCF of gas, and per barrel of water in lieu of, or in addition to, processing fees.
- May be an overriding royalty interest in Satellite Production.
- May be a lump sum payment.
- Adjusted for Future Governmental Regulations.

Fees and Expenses

Minimum Monthly Fee

- If sum of Infrastructure Access Fees do not exceed certain amount in a month, then Producer pays to Owner the minimum monthly fee.
- Fee may be suspended if Host incapable of handling Satellite Production.
- Fee decreased upon permanent cessation of Satellite Production.

Fees and Expenses

Deferred Production Compensation

- Owner is compensated for deferred Host Production caused by Producer.
- $DOPC = AOPR \times SDD \times (POP \times DF\%)$
- $DGPC = AGPR \times HV \times SDD \times (PGP \times DF\%)$
- Deferred production compensation for Producer.

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Capacity

- Host Capacity
- Satellite Capacity
- Interruptible Capacity
- Flow Assurance Capacity

Capacity

Production Prioritization

- Host Production has first priority.
- Satellite Production has second priority.
- Third Party Production has third priority.
- Flow Assurance priority
- Prorated Satellite Capacity = $AHC * (SP/STHP)$

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Metering and Allocation

- BSEE approved surface commingling permit.
- Metering and Allocation procedures.
- Oil Quality Bank
- Gas imbalances

Metering and Allocation

- W&T Offshore Inc. v. Apache Corp., 2014 WL 198492 (S.D. Tex. 2014), *on reconsideration in part*, 2014 WL 1600540 (S.D. Tex. 2014), *affirmed* 2016 WL 1319378 (5th Cir. 2016).
- W&T processed its oil from ST 229 at Apache's GI 116 Platform.
- W&T conducted an audit and claimed it was under allocated oil.
- First issue was applicable law under PHA.

W&T Offshore Inc. v. Apache Corp

- Claim that breach of PHA because Apache failed to use a proportional-to-flow sampler to measure BS&W in W&T's production.
- PHA required W&T to install sampler on Apache's platform.
- PHA required Apache to allocate oil in a "consistent and equitable manner."
- W&T argued that PHA implicitly incorporated MMS regulation requiring sampler.

W&T Offshore Inc. v. Apache Corp

- Claim that Apache breached PHA by failing to notify W&T of well tests.
- Under Louisiana law, elements of waiver are:
 1. An existing legal right
 2. Knowledge of the existence of that right
 3. Either:
 - a) An actual intention to relinquish the right, or
 - b) Conduct so inconsistent with the intent to enforce the right so as to induce a reasonable belief that the right has been relinquished.

W&T Offshore Inc. v. Apache Corp

- Apache conducted over 120 well tests over three year period.
 - W&T knew well tests were occurring and that Apache was not providing notice.
 - W&T did not complain about lack of notice and continued to send production.
- Court found that parties non-waiver provision in PHA was waived by conduct of W&T.

W&T Offshore Inc. v. Apache Corp

- Apache claimed that W&T's production did not meet quality specifications.
 - Apache sought costs of chemicals as damages because of W&T's breach.
- W&T claimed that PHA barred Apache from recovering because costs should have been included within invoices, and no timely written exception.
- W&T also argued that quality specifications were for Delivery Point to sales pipelines.

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Suspension of Operations

- Host Operator has right to shut down operations on Host and suspend Services if:
- Force Majeure condition
- Ensure safety of persons, property or environment
- Construction, maintenance, or repairs to Host
- Failure of Producer to pay invoices
- Failure of parties to agree on increased costs due to changes in governmental regulations

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Term

- Agreement continues in effect until terminated.
- Terminates (#) months after notice of event.
- Right to terminate by either Owner or Producer
 - BSEE doesn't approve surface commingling permit.
 - Satellite Production not delivered to Host for certain period of time.
 - Default of other party.

Term

- Right of Owner to terminate
- Major damage or total loss of Host.
- No longer economic to operate Host.
 - Producers may have option to purchase Host subject to negotiation of mutually acceptable terms.
- If first Satellite Production not delivered to Host by certain date.

Term

- Right of Producers to terminate
- Satellite Production ceases permanently.
- If delivery of Satellite Production to Host not technically or economically feasible.
- Services not available on the Host for extended period.

Term

- Producer responsible for disconnecting Satellite Production System from Host.
 - Includes removal of Satellite Production System components located on Host.
- Owner is responsible for abandonment of Host.
 - Includes the Receiving Facilities.

Term

- Shell Offshore Inc. v. Kirby Exploration, 909 F.2d 811 (5th Cir. 1990).
- Shell sold West Delta 134 Platform D and associated pipeline to Kirby.
- Pipeline went over Shell's WD 122 Platform C.
- Assignment was silent regarding removal of pipeline.

Term

- Shell claimed that predial servitude created in favor of Kirby
- Platform D and pipeline were dominant estate and Platform C was servient estate.
- Shell proposed abandoning servient estate to dominant estate.
- Court found that OCSLA applied and federal regulations on abandonment trumped civilian concept of predial servitudes.

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Indemnification

- Satellite Production System
 - Producer indemnifies Owner Group for claims arising out of construction, installation and operation.
 - Non-conforming Satellite Production.
- Receiving Facilities
 - AAPL Model Form has Owner indemnifying Producer Group for claims arising out of construction, installation and operation.
- Host
 - Owner indemnifies Producer Group.

Indemnification

- Environmental Losses
 - When source cannot be determined, then borne proportionately by all parties.
- Waiver of Consequential Damages
 - La. Civ. Code art. 2004: “any clause is null that, in advance excludes or limits the liability of one party for intentional or gross fault that causes damage to the other party.”

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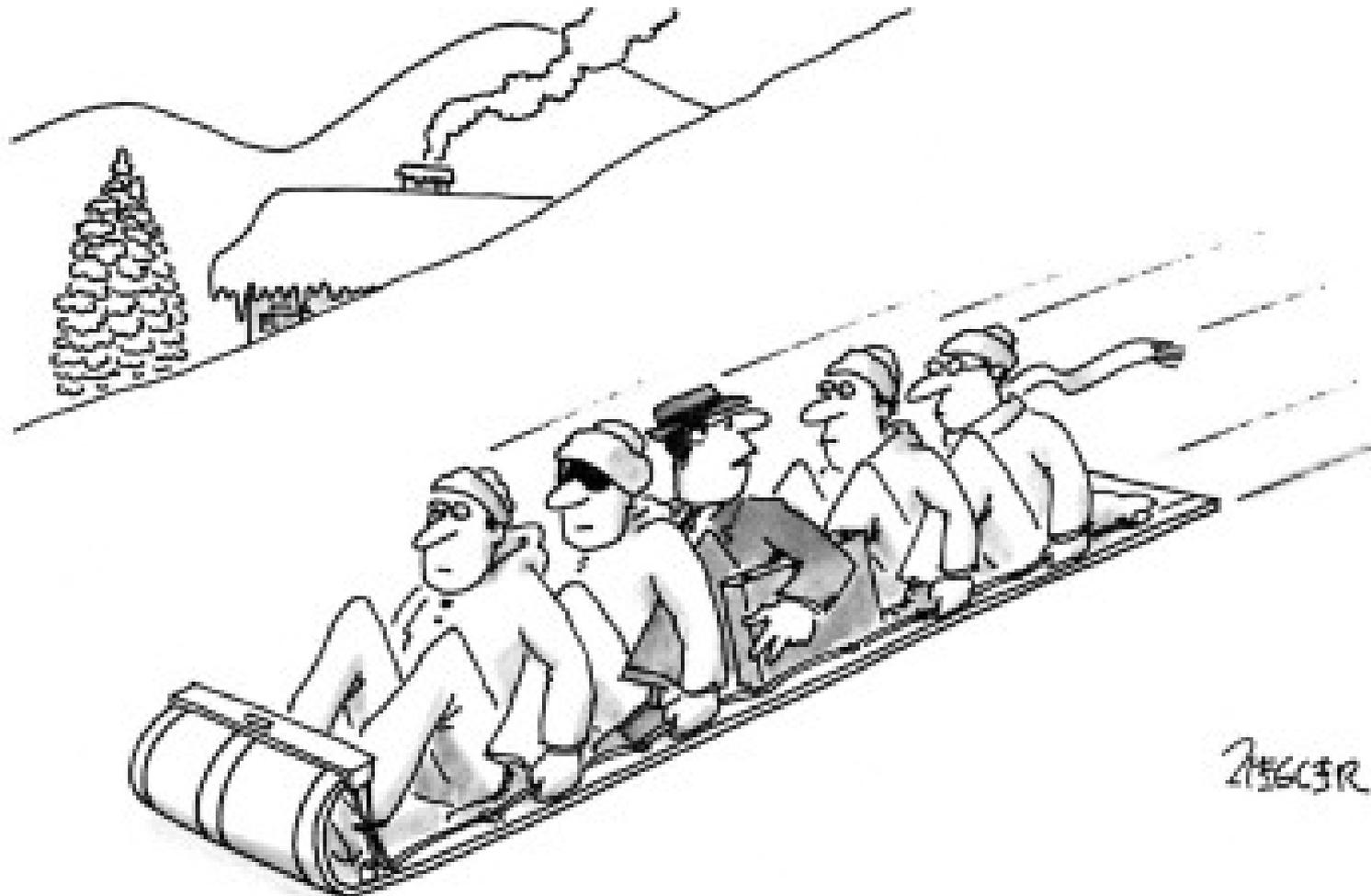
- Assignments by Producers usually require prior written consent from Owners.
 - Assign to “financially capable” party.
- Dedication of Oil and Gas reserves from Satellite Lease.
 - Deliver all Satellite Production to Host for life of Satellite Lease.

Dedication

- In re: Sabine Oil & Gas Corp., 2016 WL 2603203 (S.D. N.Y. May 3, 2016).
- Sabine filed for bankruptcy under Chapter 11.
- Debtors sought rejection of certain midstream agreements.
- Production from leases were dedicated to midstream agreements.
 - Stated that covenant running with the lands and leases.

In re: Sabine Oil & Gas Corp.

- Under Texas law, court found that dedications concern only minerals extracted from ground, thus personal property and not real property.
- Court found that covenants in midstream agreements do not run with the land as real covenants.



Look, I'm not saying its going to be today. But someday, you guys will be happy that you have taken along a lawyer.