Leasing for Outcomes: Benefiting from the Oil and Gas Boom

• Introduction:
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• Speaker
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Leasing for Outcomes: Benefiting From the Oil & Gas Boom

Prof. James W. Coleman • @EnergyLawProf
Today

The Third Age of Oil & Gas Law, 95 Indiana L.J. __


• The First Age:
The Lease, Born in the U.S.A., Conquers the World

• The Second Age:
Winning a Larger Share of Oil & Gas Profits

• The Third Age:
Simpler Ways to Earn a Greater Share
The First Age of Oil and Gas Law:
The Lease, Born in the U.S.A, Conquers the World
Crude Oil Production by Country

Million barrels/day • @EnergyLawProf

- OTHERS
- VENEZUELA
- IRAN
- SAUDI ARABIA
- USSR
- UNITED STATES
Where Value of Oil Barrel Goes

DIVIDING UP THE BARREL
Value Components as a Fraction of Revenue

- Royalties
- Company’s Expected Return on Investment
- Other Rents and Fees
- State/Provincial, Federal, & Municipal Taxes
- Operating Costs of Production
- Company’s Capital Investment
Laura gets a $20 million lump sum

Chart 1: Economic Rent
(dividing $66 million of oil production)

- Economic Rent, $20
- Normal Profit, $6
- Costs, $40
Laura gets a 27.3% royalty

Chart 2: Lease with Royalty
(dividing $66 million of oil production)

- Royalty Payments, $18
- Ovid's Costs, $40
- Ovid's Profit, $8
Stereotypical Texas Lease

• Lessee (oil company) gets:
  • exclusive right to produce oil & gas for five years +
  • “as long thereafter as oil or gas is produced”

• Lessor (landowner) gets:
  • Bonus up front - $
  • Royalty (fraction of production) over time - $$$$$$
  • Traditionally 1/8, now more
Laura gets a $1.5 million bonus plus a 25% royalty

Chart 3: Lease with Bonus
(dividing $66 million of oil production)

- Bonus, $1.5
- Royalty, $16.5
- Ovid's Costs, $40
- Ovid's Profit, $8
The Second Age of Oil and Gas Law: Winning a Larger Share of Oil Profits
Oil Production by Country | @EnergyLawProf

Million Barrels Per Day, 1950–2018

- **UNITED STATES**: 5.4
- **VENEZUELA**: 1.5
- **USSR**: 0.7
- **IRAN**: 0.6
- **SAUDIARABIA**: 0.5
- **VAIT**: 0.3
- **Q**: 0.1
- **I**: 0.1

1950
Net Profits Get Norland More from a Bonanza Well

Chart 4: Bonanza with Royalty
(dividing $200 million of oil production)

- Costs, $80
- Ovid's Profit, $80
- Royalty Payments, $40

Chart 5: Bonanza with Profit Split
(dividing $200 million of oil production)

- Costs, $80
- Ovid 1/2 of Profits, $60
- Norland 1/2 of Profits, $60
Net Profits Get Norland Something from Marginal Wells

Chart 6: Marginal with Royalty (dividing $120 million of oil production)

- Royalty Payments, $24
- Ovid's Profit, $6
- Costs, $90

Chart 7: Marginal with Profit Split (dividing $120 million of oil production)

- Norland ½ of Profits, $15
- Ovid ½ of Profits, $15
- Costs, $90
Approximating Net Profit

A real world sliding scale royalty
The Third Age of Oil and Gas Law: Perfecting the Lease for U.S. Landowners
Alberta’s New Royalty System

Low rate until oil company recovers cost of average well.

After “payout” higher royalty rate that depends on price.
Alberta Lessons for State Oil Revenues

- Opportunity to negotiate for a rate that bumps up once oil company has produced a fixed amount
  - Doesn’t require accounting for oil company costs
  - Bigger bump if willing to take lower rate up front
- Note: tie bumped up rates to value not volume
  - Volume particularly tricky with mix of oil & gas
- Bumped up rate could increase further as more and more value is pulled out of well
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Slides available: http://bitly.com/ThirdAgeLease