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BREAKFAST SERIES *for*
Surface and Mineral Owners
Admission by Invitation Only

DATE: April 05, 2016

TOPIC: Oil & Gas and Family Law – Understanding Your Ownership Interests and Rights

LOCATION: San Antonio Petroleum Club
8620 N New Braunfels, Suite 700
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TIME: 7:30 AM Breakfast - 8:00 AM Presenters
8:50 AM Questions & Answers

INTRODUCTION: E.O. (Trey) Scott, III, Trinity Mineral Management, Ltd.

PRESENTERS: Kelly Feicht, Person, Whitworth, Borchers and Morales, LLP

Oil & Gas and Family Law – Understanding Your Ownership Interests and Rights

- 1. Introduction**
- 2. Oil & Gas Reserves as Marital Property**
- 3. Ownership Interests Related to Reserves**
 - Working Interest
 - Royalty Interest

- Other Interest Payments
 - √ *Bonus Payments*
 - √ *Delay Rentals*

4. Valuation

- Reserve Reports
- Key Classification of Reserves
 - √ *Proved Reserves*
 - √ *Probable Reserves*
 - √ *Possible Reserves*
- Methods of Valuation
 - √ *Income Approach*
 - √ *Market Approach*
 - √ *Asset Approach*

5. Other Factors

- Goodwill
- Covenant Not to Compete

6. Conclusion

UPCOMING:	May 03:	Laura Burney, “Floating” v. “Fixed” Non-Participating Royalty Problem (<i>Hysaw v. Dawkins</i> case)
	Jun 01:	Keith Franklin, Using Adverse Possession to Clean Up Your Title Mess
	Jul 05:	Trey Scott, To Be Announced

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Kelly attended St. Mary's University School of Law and received her JD in 2010. She also received a BA from the University of Texas at Austin in 2007.

Kelly joined the Law Offices of Albert M. Gutierrez, P.C. in January 2011. In January 2016, the Law Offices of Albert M. Gutierrez, P.C. merged with Person, Whitworth, Borchers & Morales, L.L.P.

As an associate attorney at Person, Whitworth, Borchers & Morales, L.L.P., her practice focuses on trials in the areas of personal injury defense, commercial litigation, oil and gas litigation and criminal law.

Kelly is a member of the American Bar Association, San Antonio Bar Association, San Antonio Young Lawyers Association, Texas Association of Defense Counsel, Federal Bar Association, the Defense Research Institute and Phi Delta Phi Legal Fraternity. She is licensed to practice in Texas (2010) and the U.S. District Courts for the Southern and Western Districts of Texas.

OIL & GAS & FAMILY LAW



UNDERSTANDING YOUR OWNERSHIP INTERESTS AND RIGHTS

OIL & GAS RESERVES AS MARITAL PROPERTY



IN TEXAS,

- INTERESTS IN O&G CATEGORIZED AS PERSONAL PROPERTY INTEREST UPON “PRODUCTION AND SEVERANCE”
 - UPON DISSOLUTION OF A MARRIAGE, COURTS LOOK AT FOLLOWING TO DETERMINE WHETHER INTERESTS IN O&G PRODUCING PROPERTY IS COMMUNITY OR SEPARATE PROPERTY:
 - DATE OF INCEPTION OF TITLE;
 - WHAT FUNDS WERE USED; AND
 - OTHER BASIC MARITAL PROPERTY FACTORS.

OIL & GAS RESERVES AS MARITAL PROPERTY



- INCOME GENERATED DURING MARRIAGE BELONGS TO COMMUNITY ESTATE
 - INCOME = ALL RENTS AND REVENUES PRODUCED FROM USE OF COMMUNITY ESTATE
- IN AN O&G LEASE, “LESSEE” WILL RENDER CONSIDERATION TO “LESSOR” FOR RIGHT TO EVALUATE AND DRILL.
 - CONSIDERATION NOT EQUIVALENT TO A RENT FOR THE TIME SPENT ON THE LAND
 - ✦ INSTEAD, A FEE PAID FOR PURCHASE OF O&G EXTRACTED FROM PROPERTY

OIL & GAS RESERVES AS MARITAL PROPERTY



- SALE OF O&G IS ACTUAL SALE OF REALTY, SO PAYMENTS RECEIVED THROUGH ROYALTIES IS SEPARATE PROPERTY OF SPOUSE WHO OWNS INTEREST IN THE LAND
 - IF MINERAL PRODUCING LAND IS CONSIDERED SEPARATE PROPERTY, PROFITS FROM SALE OF O&G WILL REMAIN A SPOUSE'S SEPARATE ESTATE
 - IF LEASE IS ACQUIRED DURING MARRIAGE, THROUGH USE OF COMMUNITY FUNDS OR THROUGH EXCHANGE OF COMMUNITY PROPERTY, NEW LEASE WILL BECOME PART OF COMMUNITY ESTATE

OWNERSHIP INTERESTS RELATED TO RESERVES



- INTERESTS IN O&G RESERVES CLASSIFIED INTO TWO PRIMARY CATEGORIES:
 - WORKING INTERESTS
 - ROYALTY INTERESTS
- TWO SUBSETS OF WORKING INTERESTS:
 - OPERATING INTERESTS
 - NON-OPERATING INTERESTS

OWNERSHIP INTERESTS RELATED TO RESERVES



- INTERESTS IN RESERVES EITHER COMMUNITY PROPERTY OR SEPARATE PROPERTY DEPENDING ON: DATE OF INCEPTION OF INTEREST AND AN EVALUATION OF OTHER FACTORS
 - **EXAMPLE:** HUSBAND OWNS A ROYALTY INTEREST IN O&G PRODUCING PROPERTY. THIS PROPERTY WILL REMAIN PART OF HIS SEPARATE ESTATE THROUGHOUT THE MARRIAGE, UNLESS:
 - ✦ HE USES COMMUNITY FUNDS TO MODIFY PROPERTY IN ANY WAY

OWNERSHIP INTERESTS RELATED TO RESERVES – WORKING INTEREST



- **WORKING INTEREST** – OPERATING INTEREST THAT PROVIDES OWNER WITH EXCLUSIVE RIGHT TO DRILL, PRODUCE, AND EXPLOIT MINERALS
 - SHARE IN PROFITS AFTER DEDUCTING:
 - ✦ ROYALTY INTEREST PAYMENTS,
 - ✦ LEASE-OPERATING EXPENSES,
 - ✦ SEVERANCE, AND
 - ✦ AD VALOREM TAXES AND CAPITAL EXPENDITURES ASSOCIATED WITH PROPERTY
- WORKING INTEREST IS INTEREST IN REAL PROPERTY
- WORKING INTEREST PRODUCES PROFITS TO HOLDER OF THIS INTEREST

OWNERSHIP INTERESTS RELATED TO RESERVES – WORKING INTEREST



- IF WORKING INTEREST ACQUIRED POST-MARRIAGE
 - PROFITS CONSTITUTE **INCOME** FROM “TOIL, TALENT, INDUSTRY OR OTHER PRODUCTIVE FACULTY” OF ONE SPOUSE
 - ✦ THEREFORE, PART OF **COMMUNITY ESTATE**
- “LESSEE” TYPICALLY HOLDS THIS INTEREST, WHICH IS ACQUIRED THROUGH EXECUTION OF MINERAL LEASE, AND BEARS BURDEN OF ALL OPERATING EXPENSES
- OPERATING/NON-OPERATING WORKING INTEREST
 - **OPERATING** – RESPONSIBLE FOR PHYSICAL OPERATION OF O&G WELLS
 - ✦ TYPICALLY REFERRED TO AS CONTROLLING OR MAJORITY INTEREST
 - EXCLUSIVE RIGHT TO CONTROL EXPLORATION AND PRODUCTION PROCESS

OWNERSHIP INTERESTS RELATED TO RESERVES – WORKING INTEREST



- **NON-OPERATING** – NOT INVOLVED IN PRODUCTION OPERATIONS
 - ✦ ACT MORE AS CONSULTANTS TO OPERATING INTEREST HOLDER IN PLANNING AND PRODUCTION DECISIONS
 - ✦ BEARS SOME PRODUCTION AND DRILLING COSTS

OWNERSHIP INTERESTS RELATED TO RESERVES – ROYALTY INTEREST



- **ROYALTY INTEREST** – RIGHT TO RECEIVE SHARE OF GROSS PRODUCTION OF MINERALS PRODUCED UNDER MINERAL LEASE, FREE OF PRODUCTION COSTS
 - LANDOWNER OR “LESSOR” WHO OWNS PROPERTY AND CONVEYS WORKING INTEREST TO “LESSEE” TYPICALLY HOLDS SUCH INTERESTS
 - PASSIVE IN NATURE – NO REQUIREMENT TO SHARE IN DRILLING OR PRODUCTION COSTS
 - RECEIVES PERIODIC PAYMENTS PURSUANT TO LEASE AGREEMENT WITHOUT BEARING BURDEN OF OPERATING EXPENSES
 - PAYMENT OF RI TAKES PREFERENCE OVER ALL OTHER PAYMENTS FROM LEASE REVENUE
 - ✦ TYPICALLY $1/4$ - $1/8$ OF GROSS REVENUE

OWNERSHIP INTERESTS RELATED TO RESERVES – ROYALTY INTEREST



- IF RI ACQUIRED PRIOR TO MARRIAGE
 - PAYMENTS RECEIVED THROUGH O&G LEASE REMAIN SEPARATE PROPERTY
- RI NOT CATEGORIZED AS INCOME OR RENTS
 - BECAUSE MEANS THROUGH WHICH ROYALTY OWNER IS COMPENSATED FOR EXTRACTION OR WASTING AWAY OF PROPERTY
- ROYALTY RECEIVED FROM PRODUCTION ON ONE SPOUSE'S SEPARATE PROPERTY WILL REMAIN SEPARATE, UNLESS:
 - CLEAR AND CONVINCING EVIDENCE THAT PRODUCTION OF O&G INVOLVED USE OF COMMUNAL TALENT OR RESOURCES

RESERVES – OTHER INTEREST PAYMENTS



- **BONUS PAYMENTS**
 - MONETARY CONSIDERATION GIVEN BY LESSEE TO LESSOR FOR EXECUTING O&G LEASE
 - ✦ AMOUNT PAID DEPENDS ON SIZE AND DURATION OF LEASE AND SUCCESS OF PRODUCTION IN SURROUNDING AREA
 - BONUS LEASE PAID FOR THE USE OF PROPERTY FOR DRILLING AND PRODUCTION OF O&G AND IS DIVISIBLE UPON DIVORCE
 - BONUS PAYMENTS WOULD REMAIN **SEPARATE PROPERTY**, SO LONG AS PRODUCED FROM SEPARATE PROPERTY
 - ✦ DIFFER FROM ROYALTY BECAUSE BONUS PAID UP FRONT, REGARDLESS IF PRODUCTION ACTUALLY OCCURS
 - ✦ BONUS PAID BY LESSEE TO SECURE RIGHT IN DEFERRING OPERATIONS UNTIL LESSEE BEGINS DRILLING OR TERMINATES LEASE

RESERVES – OTHER INTEREST PAYMENTS



- **DELAY RENTALS**

- PAYMENT ACCRUES BY LAPSE OF TIME AND ADDITIONAL TIME USED TO UTILIZE LAND IN SEARCH OF O&G
- DO NOT EXHAUST SUBSTANCE OF THE LAND SINCE SIMPLY PAYMENTS RENDERED FOR TIME SPENT ON PROPERTY
- NOT CHARACTERIZED AS A SALE OF ANY SORT
 - ✦ NOT CONTINGENT ON ACTUAL PRODUCTION OF MINERALS
- FALLS UNDER THE “RENT” CATEGORY FOR **COMMUNITY PROPERTY**
 - ✦ CONSIDERED PERSONAL PROPERTY OF THE COMMUNITY ESTATE
- NOT NECESSARILY PAID TO BEGIN PRODUCTION OR EXTRACTION BUT PAID TO ENSURE NO OPERATION WILL PROCEED WITHOUT CONSENT OF PARTY RENDERING PAYMENT

OWNERSHIP INTERESTS RELATED TO RESERVES – VALUATION



- VALUATION OF O&G RESERVES LIKELY DESIGNATED TO AN EXPERT
- REQUIRES APPRAISER TO FIRST VALUE PROPERTIES ON WHICH ENTITY IS DRILLING FOR MINERALS
 - VALUE OF PROPERTIES THEN FACTORED INTO FINAL EVALUATION OF EXPLORATION AND PRODUCTION FIRM WITH OTHER VARIABLES
 - ✦ CAN INCLUDE:
 - GOODWILL; OR
 - COVENANT NOT TO COMPLETE.
- THREE METHODS FOR VALUATION:
 - INCOME APPROACH
 - MARKET APPROACH
 - ASSET APPROACH

RESERVE REPORTS



- STARTING POINT FOR O&G INTEREST VALUATION
- COMPOSED BY PETROLEUM ENGINEERS THROUGH ESTIMATION OF CLASSIFICATION AND QUANTITY OF RESERVES THAT CAN BE RECOVERED OVER TIME
- ADDRESSES VARIETY OF ISSUES:
 - QUANTITY AND NATURE OF HYDROCARBONS IN THE GROUND;
 - HOW QUICKLY HYDROCARBONS CAN BE RECOVERED;
 - WHAT PERCENTAGE OF HYDROCARBONS CAN BE RECOVERED;
 - ESTIMATED COST OF RECOVERY; AND
 - PRESENT VALUE OF THE NET CASH FLOW USING VARIOUS

RESERVE REPORTS



- PREPARED FOR SEC, BANKING OR FINANCING, MERGER AND ACQUISITIONS OR OTHER RELATED VALUATION
- NOT A DETERMINATION OF FAIR MARKET VALUE
 - PROVIDES BASE DATA THAT QUALIFIED VALUATION EXPERT WILL USE IN CALCULATING FAIR MARKET VALUE OF O&G INTERESTS
 - **FAIR MARKET VALUE** = AMOUNT THAT WOULD BE PAID IN CASH BY WILLING BUYER WHO DESIRES TO BUY, BUT IS NOT REQUIRED TO BUY, TO WILLING SELLER WHO DESIRES TO SELL, BUT IT UNDER NO NECESSITY OF SELLING
- OPINION OF ENGINEER CREATING REPORT REGARDING PROBABLE PRODUCTION VALUE OF A

GIVEN RESERVE

KEY CLASSIFICATION OF RESERVES



- RESERVE REPORTS CLASSIFY RESERVES AS FOLLOWS:
 - PROVED RESERVES
 - PROBABLE RESERVES
 - POSSIBLE RESERVES
- **PROVED RESERVES**
 - BACKED BY GEOLOGICAL AND ENGINEERING DATA INDICATING — WITH REASONABLE CERTAINTY — THAT THEY ARE RECOVERABLE TODAY OR IN NEAR FUTURE
 - CLASSIFIED INTO THREE CATEGORIES:
 - ✦ PROVED DEVELOPED PRODUCING
 - ✦ PROVED DEVELOPED NON PRODUCING
 - ✦ PROVED UNDEVELOPED
 - **PROVED DEVELOPED PRODUCING (PDP)** = WELLS COMPLETED AND RESERVES ARE CURRENTLY BEING PRODUCED
 - ✦ REGULARLY GENERATE CASH AND PROVIDE PRESSURE AND PRODUCTION DATA THAT IS GENERALLY ACCURATE

KEY CLASSIFICATION OF RESERVES



- PROVED DEVELOPED NOT PRODUCING (PDNP) = WELLS THAT CONTAIN IDENTIFIED RESERVES, BUT WELL IS NOT PRODUCING FOR SOME EXTRINSIC REASON
 - ✦ CAUSES FOR NONPRODUCING:
 - DECREASE IN MARKET DEMAND THAT RENDERS WELLS ECONOMICALLY UNVIABLE TO PRODUCE
 - ISSUES WITH MECHANICAL DEVICES THAT MAKE PRODUCTION IMPOSSIBLE
 - ✦ LESS RISKY THAN NEW WELL BECAUSE KNOWN TO CONTAIN O&G RESERVES THAT WILL EVENTUALLY PRODUCE ONCE EXTRINSIC ISSUES ARE RESOLVED

KEY CLASSIFICATION OF RESERVES



- **PROVED UNDEVELOPED** = WELLS ARE NEW LOCATIONS THAT STILL REQUIRE DRILLING AND COMPLETION OF WELL IN ORDER TO RECOVER VALUE
 - ✦ MOST RISKY INVESTMENT OUT OF “PROVED” RESERVES
 - NOT CERTAIN TO PRODUCE SUFFICIENT VOLUME TO COVER INVESTMENT OF DRILLING AND COMPLETION
 - GENERALLY NOT COUNTED UNTIL CERTAIN TO BE FUNDED AND COMPLETED IN NEAR TERM
- **PROBABLE RESERVES** — UNPROVED, YET DATA SUGGEST MORE LIKELY THAN NOT RECOVERABLE
- **POSSIBLE RESERVES** — UNPROVED, YET DATA SUGGESTING LESS LIKELY RECOVERABLE THAN PROBABLE RESERVES
 - ALSO REFERRED TO AS “EXPLORATORY”

METHODS OF VALUATION



- **INCOME APPROACH** — CONVERTS RESERVE REPORT TO FAIR MARKET VALUE BY EVALUATION OF ANTICIPATED ECONOMIC BENEFITS STEMMING FROM PARTICULAR WELL
- **MARKET APPROACH** — APPLIES COMPARABLE TRANSACTION METRICS FROM SIMILARLY SITUATED COMPANIES TO SUBJECT EXPLORATION AND PRODUCTION FIRM'S O&G PRODUCING PROPERTIES
- **ASSET APPROACH** — FOCUSES ON CALCULATING A LIQUIDATION VALUE OF AN ENTITY'S ASSETS

OTHER FACTORS



- **GOOD WILL** — THAT INTANGIBLE ASSET ARISING AS RESULT OF NAME, REPUTATION, CUSTOMER LOYALTY, LOCATION, PRODUCTS AND SIMILAR FACTORS NOT SEPARATELY IDENTIFIED
 - TYPES : COMMERCIAL AND PERSONAL
 - ✦ **PERSONAL** — VALUE INDIVIDUAL PROFESSIONAL BRINGS TO ENTITY
 - SEPARATE PROPERTY OF PROFESSIONAL
 - ✦ **COMMERCIAL** — ATTRIBUTABLE TO SUCCESS OF ENTITY
 - ASSESSED AS PART OF COMMUNITY ESTATE
- **COVENANT NOT TO COMPETE** — PROMISE, USUALLY IN SALE-OF-BUSINESS, PARTNERSHIP, OR EMPLOYMENT CONTRACT, NOT TO ENGAGE IN SAME TYPE OF BUSINESS FOR STATED TIME IN SAME MARKET AS BUYER, PARTNER, OR EMPLOYER
 - ESSENTIAL TO VALUATION OF O&G COMPANIES BECAUSE APPRAISER MUST ACCOUNT FOR ABSENCE OF PARTY WHO WILL NO LONGER BE PART OF FIRM'S OPERATION
 - ✦ COMPANIES IMPLEMENT IN EFFORT TO PROTECT COMMERCIAL GOODWILL OF FIRM BY INSURING *CONTINUED PATRONAGE*



CONCLUSION