A farmout agreement is very simply defined as, “an agreement whereby an owner of an oil and gas lease assigns an interest in the lease to a third party in exchange for services such as drilling, rather than money.” It is important to note that many farmout agreements allow the working interest owner to retain its existing production, while allowing a “farmee” to earn an assignment of certain undeveloped acreage through the performance of certain services, or the retention of an overriding royalty interest or some other interest by the “farmor.” Despite depressed hydrocarbon prices over the recent term most operators are trying to find a way to utilize the current market conditions in order to acquire additional leasehold interests and drillable acres thereby positioning themselves better for a rebound in hydrocarbon prices. However, such hydrocarbon prices have also caused operators to deplete their liquid assets and borrowing ability in order to stay afloat. Thus, in order to balance these long-term goals with current financial constraints, crafty operators should start to think outside of the box to achieve their goals.

When distilled to their basics, farmout agreements are homage to the days of bartering for goods and services rather than a cash society. When using farmout agreements operators seek to identify what assets or services they can provide in exchange for whatever it is that they seek. Some operators have their own equipment and crews and can thus “earn” certain rights far cheaper than they could purchase them.

Farmout agreements are one of the most widely used agreements in the oil and gas industry; however there is no standard form for such agreements. Thus, there are no “standard” farmout terms that should constrain your negotiations. Some operators have services to provide, some have wells that need, pulled, plugged, or drilled; some have drillable acres with no ability to further develop it. While it is true that eventually cash must enter the picture to pay crews and maintain equipment, the cash enters the deal through a farmout arrangement in the form of additional production revenue. Stated very simply, don’t let the depressed oil prices prevent you from making the gains that you need for your business. Instead, think outside the box and beyond cash sales and seller financing transactions. The farmout agreement is certainly worth a second look in Eastern Kansas.

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