



“HEADS UP” IN THE GULF: A CHECKLIST FOR POTENTIAL COUNTERPARTY FINANCIAL DISTRESS

The drilling moratorium and Macondo spill litigation may result in some oil and gas companies undergoing financial distress. No company is “too big to fail.” Now is the time to make sure your documents are in order.

Perfect Your Operator’s and Non-Operator’s Liens.

The operating agreement usually grants the operator a contractual, consensual lien on the non-operator’s interest in the minerals to secure the non-operator’s obligations under the Joint Operating Agreement (“JOA”) and grants a non-operator a lien to secure the operator’s obligations. A contractual operator’s lien is generally not binding on third parties unless the JOA or a memorandum of it, with a sufficient description of the lien rights, is filed of record.

- Make sure your company has perfected its operator or non-operator’s lien by filing a memorandum of the JOA with reference to the lien.
- Also, consider filing a UCC-1 Financing Statement in the state where the contract counterparty is incorporated.

Assignments – Demand Them and Record Them.

If your company is entitled to an assignment of leases, do not allow the other party to delay giving you the assignments. Demand them. Promptly record all assignments of leases.

Make Sure Your Insurance is in Order in the Event a Contract Counterparty Goes Bankrupt.

If a company is relying on indemnification from another party for accidents or other losses, consider asking to be named as an additional insured under that party’s insurance policy; make sure you receive a copy of the endorsement to that effect.

Stay on Top of All Rights and Remedies Set Out in the JOA, and Do Not Waive Them.

- Do not inadvertently let a delinquent or defaulting party assert or enjoy rights they are not entitled to while in delinquency or default. For example, many special provisions provide that a delinquent party does not have a right to propose or participate in new operations until they pay their overdue amounts. If your company is a non-operator and receives a notice of mineral lien from a contractor, consider suspending any further payment to the operator.
- If the JOA permits, send advance billings. Do not let anyone’s unpaid invoices get too large.
- At the first sign of trouble, the non-operators should consider removing the operator.

These are just a few of the high points. Examine your contracts to determine if there are delayed obligations, particularly those concerning title to property or past-due payments that require prompt action.

CONTACTS:

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