

OIL AND GAS PROPERTY MANAGEMENT FROM A BANK TRUST DEPARTMENT'S VIEWPOINT

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ABSTRACT

A major decision often confronting an individual while planning his or her estate involves the disposition of their oil and gas properties. Many people elect to place the future management responsibility of their property in the hands of an individual or corporate fiduciary. In order to provide a total management service to their clients and customers, many banking institutions, particularly in the Southwest, have assembled a staff of experienced professional personnel to oversee property held in trust. The functions of this group, including engineers, landmen, and accountants, are similar in many respects to that of an independent producer. This paper will discuss the various aspects of oil and gas property management by the corporate fiduciary.

INTRODUCTION

One of the most difficult decisions an individual must make when doing estate planning is that involving the future disposition of their oil and gas properties. The decision has been even further complicated by the dramatic increases in oil and gas prices which have occurred since late 1973 and by the more recent energy shortage. Leases which not long ago were at their economic limit have been cast into a highly profitable role from these changes.

The independent oil man must necessarily possess the knowledge and experience required to manage his properties during his active years. When approaching the retirement age, a great many owners are reluctant to sell their properties and rightfully so when you consider that a major portion of their livelihood may be derived from these assets. At the same time, they may be reluctant to pass the problems and burdens of management and operation to their spouse or children. Quite frequently, there may be no one in his immediate family qualified or willing to assume these responsibilities.

The services offered by a bank trust department afford a viable solution to property disposition by allowing the properties to remain intact and still provide income for the well-being of the surviving beneficiaries. Trust departments are called upon to act in a fiduciary capacity by serving as a trustee, agent or executor of a will. A trust arrangement will result in transfer of legal title to the trustee (bank) who, in turn, manages the property and distributes the income to one or more persons or charities designated in the agreement. In the case of an agency capacity, partial or total management responsibility is transferred to the agent while legal title remains with the owner. It is noteworthy that under neither the trust or agency does the fiduciary acquire a right to income derived from the assets other than a management fee.

STAFFING THE DEPARTMENT

A trust, agency, or estate will typically have real estate, notes and mortgages, and securities among its assets. In the Southwest, oil and gas properties are included in the assets of approximately twenty percent of the accounts handled by the corporate fiduciary. Because mineral interests constitute a high percentage of trust department assets, many of the larger banks have assembled a staff of industry trained professionals to assume management of this property. This staff is a separate entity to that involved in the making of commercial loans for financing petroleum industry ventures.

If one were to observe the operations within a bank's trust oil and gas department, he would find a close similarity to that of any other producer. Perhaps the most notable difference to be found would be that the department functions in a dual role - that of the lessor (landowner) and lessee (operator). This dual relationship results from the diverse types of ownership represented including mineral, working and royalty interests. Organization and staffing requirements of a department will vary depending on the number and size of accounts being managed. Table I depicts a typical staff and job function layout several banks have adopted.

<u>TRUST OIL & GAS DEPARTMENT STAFF</u>	
<u>AREA</u>	<u>TITLE/FUNCTION</u>
Department Manager	Petroleum Engineer, Geologist, or Petroleum Landman
Property Management Section	Petroleum Engineer Engineering Assistant
Land Section	Petroleum Landman Title Analyst Division Order Analyst Division Order Clerk
Accounting Section	Accountant Working Interest Clerk Production Clerk Oil & Gas Receipts Clerk

TABLE I

HANDLING THE NEW ACCOUNTS

Some of the most difficult administrative problems confronting the corporate fiduciary involve oil and gas interest. The handling of new accounts has been compared to that of a merger between two companies. Certain basic steps in setting up new trusts, agencies, and estates must be followed in a logical order

to assure an orderly transfer and take-over of the assets. The initial step, and sometimes the most difficult, is the identification of the assets to determine the property locations and ownership interest. This step should include examination of all legal records and correspondence in the customer's personal files by the bank's land department. Proper notification to the lease operator, if working interest is involved, and purchaser of oil and gas must be made at the earliest possible time to avoid undue delays in the payment of expenses and receipt of income.

Secondly, an evaluation of the properties must be made if an estate is being administered. This evaluation, which will serve as the basis for State and Federal taxation, may be completed by the property management group or by an outside consultant if the estate is unusually large.

Following the identification and evaluation of the assets, a review of the properties for retention or disposition is made. Properties operating at a loss with no potential for future profitable operations would be considered for sale. Sale of a profitable lease, barring extenuating circumstances, should be considered only when a cash liquidity problem exists in meeting tax obligations.

MANAGING THE ACCOUNT ASSETS

Data gathered during the inventory, evaluation and review process discussed above will be entered into the bank's internal computer system to properly record the expenses and revenue from each property. Computer generated reports including income/expense data, production volumes and product pricing are available to the property manager to aid in his review of AFE's, letter ballots, unitization agreements and gas sales contracts. The property manager also has the responsibility of approving for payment all joint interest billings along with obtaining adequate liability insurance coverage on all working interest accounts. In the case of bank operated leases, the property manager coordinates field activities including well remedial work, drilling, secondary recovery operations and routine lease operation. It follows that he often serves as a combination drilling, production, reservoir and geological engineer.

Requests for new leases on undeveloped acreage are received by the bank on a daily basis. The petroleum landman reviews recent lease trades in the area in addition to conducting an investigation of drilling activity in the vicinity of the lease. With this background of information, fair and equitable terms can be established as a basis for negotiating the lease. The immediate needs of the particular trust receiving a lease request will often dictate the type of lease trade acceptable to the trustee. For example, if the account has a high cash flow position, it may be feasible to negotiate for a lower bonus, higher royalty lease. On the other hand, if the account has a need for immediate cash, it would place the bank in a position to seek a higher bonus, lower royalty lease. In another case, an account may be in position to participate in development of the lands by participating as an unleased mineral owner.

The administration of an account may require numerous division or transfer orders to be executed to effect a change in the purchaser or to initiate payment for production on new leases. Verification of the account's ownership interest is made by the title analyst who also ascertains that all terms and conditions in the division order conform to the lease terms.

APPLICATION OF MANAGEMENT PRINCIPLES

The First National Bank of Fort Worth presently has a staff of nineteen people in the Trust Oil and Gas Department. Oil and gas sales on behalf of the accounts administered by First of Fort Worth exceeded 33 million dollars in 1979 which was derived from approximately 4,800 BOPD and 35 MMCFD.

Included in the trust assets of the First of Fort Worth is a small oil company which the bank has managed for over twenty-two years. Daily operated production of 200 BO and 500 MCFG is sufficient to justify the employment of company paid employees in lieu of contract services. About fifteen years ago, the company was operating several leases in West Texas which were approaching their economic limit under primary recovery. Waterflood operations were undertaken and the properties are still being operated at a profit for the beneficiary. More recently, the company acquired a lease in South Texas with potential gas reserves. A geological study prompted the drilling of a 6600' test which subsequently resulted in a new field discovery. The property management section had total responsibility for drilling the well including preparation of the drilling program, drilling contract and regulatory permits as well as on-site supervision of drilling and completion activity.

On another occasion, a request for an oil and gas lease on a tract of land located in Mississippi was received. The initial lease offer was \$150 per acre bonus and 3/16 royalty to the lessor. An analysis of activity in the area confirmed that a deep test being drilled in the offset section had encountered a zone with excellent gas reserves potential. The particular trust involved was in a situation where a high lease bonus was the prime consideration in our lease negotiations. Bank land personnel were ultimately able to negotiate and consummate a 1/4 royalty lease providing for \$750 per acre bonus.

Another situation involved a trust owning extensive mineral interests in an Oklahoma field where development activity was on the upswing. Since the trust was in a high cash flow position, it was decided to participate in the low risk development as an unleased mineral owner. Two wells, which initially tested 322 BOPD and 898 BOPD each, were drilled resulting in a substantial increase to the account's reserve base. The investment also proved to be a good tax shelter for the client.

CONCLUSIONS

Financial institutions have recognized the need for and are providing a service to the independent operator or individual with a desire to relieve themselves or their families of the burden of management and yet reap the future rewards of their past endeavors. A properly staffed bank trust department can effectively manage oil and gas properties in a fiduciary capacity.