With recent headwinds, is the retail investment channel still a viable capital raising option for E&Ps?

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FOR 60-70 YEARS, the retail investment market has served as a reliable avenue for exploration and production[1] companies to raise capital.[2] While tax driven drilling programs have been highly sought after by advisers and retail investors for income tax planning reasons, other upstream-focused strategies have emerged over time and have come into high demand by retail advisers, including programs acquiring nonoperated[3] working interests in authority for expenditure and projects in which drilling activities are being undertaken by well-capitalized public and private E&Ps as well as programs acquiring mineral rights and royalty interests. These strategies and underlying products have come about as the result of recent market headwinds that have worked to constrain capital within the U.S. upstream sector.

HISTORICAL NARRATIVE

A pivotal feature within many retail investment drilling programs arises from their allocations of intangible drilling costs[4] and tangible equipment costs to the retail investors, the IDCs of which account for most of the drilling, completion and facilities costs set forth within an authority for expenditure. The history of taxpayers being able to expense IDCs dates back to 1913, when it was introduced as a tax deduction to incentivize the high-risk business of domestic oil and gas exploration. Initially, the option was to deduct IDCs in the year they were incurred, though this was met with challenges and was eventually codified in later tax acts. In addition to the evolution of favorable tax rules pertaining to IDCs, the 1918 Revenue Act provided for "discovery value" depletion, which evolved into the modern-day depletion deduction rules (IRC §611).[5] The development of these income tax rules within the early part of the 20th century culminated in the formation of investment partnerships by wealthy individual investors seeking income taxed-advantaged investment returns through exploration drilling.

As to E&Ps today that offer drilling investments to retail investors, private placements conducted under Rule 506 of Regulation D of the Securities Act of 1933 continue to serve as the predominate offering vehicle. However, the advent of the nontraded SEC-registered investment partnerships in oil and gas came into development in the early 1950s and eventually grew into maturity in the late 1960s and 1970s. These programs — which have tax features, program governance rules and reporting features like that of many drilling partnerships sold through private placements — are structured based upon the guidelines developed by the North American Securities Administrators Association, and they require regular SEC financial reporting. Examples of E&Ps using SEC-registered programs include Phoenix

Energy One LLC, which used registered programs to raise debt from retail investors for drilling and E&P development; Atlas Energy Resources (1990s through 2014); PDC Energy (1990s and 2000s); and Mewbourne Oil Co., which offered SEC-registered programs prior to transitioning to private placements several years ago.

Through the development of these nontraded SEC-registered programs, many sponsors stepped up their marketing efforts from a tax planning perspective by implementing flexible tax allocation programs in which the special allocation rules of the federal tax code (IRC §704(b)) were used to functionally allocate immediately deductible capital cost items, such as IDCs, to the retail investors, thereby increasing the amount of the investment that is deductible in the year of investment to 70%-85%. Coincidentally, the immediate expensing rules pertaining to IDCs (IRC §469), coupled with the ability of sponsors to functionally allocate such immediately deductible items to retail investors, continue to drive much of the marketing narrative for today's drilling programs sold through private placements.

WALL STREET/BANKS COMMAND CAPITAL DISCIPLINE (2019-PRESENT)

Around 2018-2019, the shareholders of many public E&Ps began imposing significant capital discipline mandates upon the executives and boards of their companies. This movement came about as the result of decades of aggressive leverage use by E&Ps and lax lending standards by banks, as well as treasury management practices in which the public E&Ps paid minimal distributions and retained cash to develop proven oil and gas reserves. In contrast to this philosophy that reigned supreme in E&P for years, "capital discipline" in oil and gas is a strategic shift from prioritizing production volume to focusing on financial returns. This approach includes reducing debt, returning cash to shareholders and improving profitability to make the company more resilient and attractive to investors, especially considering market volatility and uncertainty about long-term energy demand. As this movement set in, banking institutions that once had been advocates of E&P likewise began imposing tighter lending standards through semi-annual and annual borrowing redeterminations as well as a regime of strict financial covenant enforcement.

Around the time when capital discipline mandates were taking hold, private equity[6] pulled away from E&P as a favored economic sector for investments. This movement was precipitated, in significant part, by the environmental, social and governance[7] movement in which a growing number of investors began integrating ESG standards into the decision-making and investment strategies of the public

E&Ps.[8] As a result, annual investments in PE for oil and gas fell drastically from $40 billion to $50 billion in 2017-2019, to $13 billion in 2020 (COVID-19), and between $17 billion and $30 billion in 2021-23.[9] As banks and PE pulled away from E&P, we also began to observe a new market narrative for buyers and sellers of mineral rights and royalties, as cap rates for such assets moved from PV 8-12 (pre-2019) to PV 15-18 for E&P assets/interests with production.

RETAIL INVESTMENT PROGRAMS STEP IN TO FILL A VOID

Since 2005, Mick Law PC has specialized in providing due diligence legal support to a network of hundreds of broker dealers, registered investment advisers,[10] family offices and institutional clients that raise capital for nontraded real estate, oil and gas, and PE projects. From 2011-2025, we have evaluated 10-20 unique sponsor companies and 15-30 new offerings/programs per year. With the capex raised from our BD/RIA clients through Q3 2025, the E&Ps we review as a group will be pushing $1.75 billion to $2 billion for 2025. What are the program strategies and who are the players?

Sponsor operated drilling programs

Since the 1990s, sponsor operated drilling programs have been marketed to retail investors, and they have continued to attract retail capital through the capital discipline era. These programs are usually marketed through private placements and structured as Delaware limited partnerships for income tax and governance purposes. They are most often marketed on their flexible income tax structures and abilities to use functional allocations of IDCs to deliver significant investment-year deductions to retail investors and to use GP/LP elections and interest conversion features that enable the investors to direct the active/passive nature of their tax items and related exposures to operational liabilities/losses, which help to facilitate investment year tax deductions equaling 65%-80% of the investment.

In our opinion, the best opportunities within the vertically integrated programs are being syndicated by well-capitalized family-owned E&Ps with scalable leasehold positions for horizontal drilling of oil and gas liquids within the Delaware, Southern Delaware, Midland, Anadarko and Williston basins and natural gas within the Marcellus/Utica plays in western Pennsylvania. Established E&Ps operating their own programs include Mewbourne Oil Co. (No. 2 U.S. independent), Snyder Bros./MDS Development (No. 37 U.S. independent) and U.S. Energy Development Corp., which allocates 25%-35% of its annual drilling program capital to its operated horizontal drilling projects, with the remainder allocated to nonop drilling projects.[11] Additionally, Citizen Energy Ventures, an experienced owner and operator of oil and gas assets, recently announced the launch of a $20 million drilling partnership intended to fund horizontal drilling within the Oklahoma Anadarko Basin.[12] While smaller family-owned E&Ps have successfully used the retail channel to buy leaseholds and to high grade and improve their core assets — e.g., Rice Energy Inc. prior to its 2014 IPO — the timing commitment for small E&Ps to go through document drafting and the BD/RIA due diligence process can present headwinds when capital is needed very quickly, as those securities compliance processes usually take six months, or more, to get through.

Nonop drilling program

Because of the capital discipline/ESG mandates imposed upon public E&Ps and PE firms, a vibrant market came into fruition pre-COVID which now enables such well-recognized E&Ps and PE firms to monetize their nonop working interests in drilling projects. This nonop working interest deal market, which largely sprung up in 2018-2019, has grown to become a separate and distinct asset sector of E&P that involves somewhere between $10 billion and $25 billion in annual capex spending.[13]

Structurally, the nonop programs are designed like that of vertically integrated drilling programs, as they utilize flexible partnership income tax structures to generate higher investment year tax deductions through functional allocations of IDCs to investors. However, some nonop programs differ from their vertically integrated counterparts in that the nonop programs will acquire wellbore level working interests in several horizontal wells located within multiple oil and gas basins and that are operated by several established operating companies. Additionally, certain of these nonop programs use reinvestments within their program structures, which enable them to pay targeted annual distribution to the investors — often set at a 6%-10% annual rate — while at the same time reinvesting the undistributed program cash flows in additional nonop wells and interests to facilitate program returns, which gives the nonop program the flavor of an E&P-focused PE program. When the nonop program is coupled with a Qualified Opportunity Fund wrapper — i.e., due to the location of the interests being in an established qualified opportunity census tract, including counties within the Delaware Basin and Southern Delaware — the income tax deferrals of capital gains as well as the fair market value basis step-up in 10 years can render these nonop programs as highly attractive to certain investors from a tax planning perspective.

Of the retail investment dollars raised by the sponsors we reviewed in 2024, about $500 million will be deployed by sponsors that focus their acquisitions within the nonop deal market, which include Waveland Energy Partners, Trellis Energy Partners, U.S. Energy Development Corp.,[14] Purified

Resource Partners, Texakoma Resources LLC and others. In terms of the best opportunities we see, they are coming from nonop projects within core shale fields operated by well-established E&Ps at reasonable acquisition premiums.[15] The presence of the acquisition premium requires the sponsor to have an established presence within the nonop market through their prior acquisition volumes and preferred bidding status within the E&Ps and PE firms that regularly sell their nonop interests. The better situated nonop program sponsors will also have a solid engineering, geological, land and field operational presence within their staffing, sourcing and underrating groups, as well as proprietary software and/or technical evaluation tools, which enable them to source and underwrite nonoperated projects in scale and at optimal price points.

Minerals and royalty interests

Because of the capital discipline and ESG mandates imposed upon public E&Ps and PE, this resulted in fewer sophisticated buyers for mineral/royalty assets. Coincidentally this also resulted in a situation in which cap rates for producing oil and gas assets moved from PV 8-12 (pre-COVID) to PV 14-18 over the past few years. This has created an environment for mineral/royalty-focused sponsors to better source asset packages that provide opportunities for competitive returns at the retail investment level.

The retail mineral/royalty investment programs are, in many cases, structured as direct title ownership programs in which each retail investor is deeded a direct fractional interest in the assets, which enables certain of the investors to use their acquired interests as replacement properties for IRC §1031 planning purposes. The mineral/royalty assets of the direct title programs are managed by the program sponsors through an asset management agreement, in which case the program sponsors assess a fee of 75-200 basis points to manage the assets. In addition to the management fee, the sponsors receive compensation during the beginning phase of the program by retaining 5%-10% of the mineral interests, with the program investors, as a group, essentially paying 100% of the sponsor's purchase price to receive 90%-95% of the acquired minerals. In addition to being able to use the program interests as replacement properties for IRC §1031 purposes, the investors of these mineral/royalty programs receive depletion deductions under IRC §611, which can offer a significant deduction from income taxes — i.e., 15% of the production revenues from oil and gas.

In 2024, we reviewed five minerals/royalty sponsors — Montego Energy Partners, Resource Royalty LLC, U.S. Energy Development Corp., WhiteHawk Energy LLC and

Rising Phoenix Royalties — that collectively raised $120 million of retail capital through multiple retail programs. While most of the capital was raised by sponsors with direct interest programs, two of the sponsors are offering entity-structured programs through the use of partnerships and C corporations, which include Montego Energy Partners offering a diversified royalty partnership investment and WhiteHawk Energy offering a diversified royalty investment structured as a C corporation for income tax purposes and liquidity event planning.

Today the best opportunities within this retail program segment are again coming from sponsors with established technical teams that have sourced and underwritten thousands of acquisitions within their areas of geographic focus and, most importantly, understand the engineering, geology and operational developments of the fields where retail capital is being deployed to buy assets. While in prior years it was common practice for the portfolios of these royalty programs to include a high percentage of undeveloped assets — i.e., PUD locations, which in some cases could be 80%-90% of a program's P1 PV 10 — there has been a significant push within the BD/RIA selling groups for these programs to construct their portfolios with more "line-of-sight" assets that include producing wells and well locations whose drilling and completion activities are in progress. Additionally, there has been an underwriting preference in the retail community for royalty programs whose assets come with a mix of geography/geology and related oil and gas revenues and come with revenues that are being driven by well-capitalized operators with established drilling budgets.

PE RESURGENCE AND RETAIL M&A OPPORTUNITIES

Recent market data indicates that the PE sector's presence in E&P deal activity rebounded to $35 billion in 2024, representing year-over-year growth of 100%, from $17.30 billion in 2023.[16] Despite PE's resurgence into E&P, we believe that the retail investment channel continues to be a viable avenue for the independent E&Ps that want to remain family owned but are otherwise looking to either maintain or increase scale through upstream related acquisition and development activities. In recent years, the retail investment channel has also presented itself as a viable financing avenue for private E&Ps to complete and/or further scale their internal M&A activities. Here are some noteworthy examples:

- Renaissance Growth Partners LLC, a Dallas-based independently owned E&P, initiated a $125 million private offering of limited partner units in Q1 2025 for the purpose of acquiring certain family-owned leaseholds within multiple oil and gas basins in Texas, with horizontal drilling and value-add potential through redevelopment activities.
- U.S. Energy Development Corp., a Fort Worth-based independently owned E&P, acquired a significant leasehold position in the Southern Delaware from ConocoPhillips for $380 million in Q1 2025 and will use funds from its 2024 drilling and Qualified Opportunity Fund structured programs to develop the undrilled locations within this asset position.
- WhiteHawk Income Corp. acquired PHX Minerals Inc. in a deal that closed June 23, 2025. The all-cash transaction was valued at approximately $187 million and offered PHX shareholders $4.35 in cash per share. It expands WhiteHawk Energy's footprint in the Anadarko Basin and Haynesville Shale, while adding profitable mineral and royalty assets to WIC's portfolio.
- Mountain V Oil & Gas Inc. acquired the western Kentucky, Illinois and Indiana assets and Appalachian Basin projects of AXP Energy Limited for $4 million on Sept. 29, 2023. This acquisition added significant infill drilling and redevelopment scale to the sponsor's asset base, for which it is using retail capital to help fund scheduled workover and recompletion projects.

STILL VIABLE FOR SOME

While statistics are scant, there are many transactional developments and capital formation activities supporting the retail investment sector as a viable source of capital for growing and promising E&Ps. With the BDs/RIAs we represent pushing to increase their capital raises from $1.4 billion in 2024 to possibly $1.75 billion to $2 billion in 2025, the retail sector will continue to emerge as a valuable resource to smaller yet worthy E&Ps.

ABOUT THE AUTHOR

Brad Updike is an attorney and shareholder at Mick Law PC, where he manages the firm's oil and gas due diligence and tax-oriented practice. His areas of practice include securities law, oil and gas, real estate, private equity, DPP due diligence and taxation analysis relating to securitized financings. Updike's work in retail investment due diligence since 2006 is extensive and includes reviews and underwritings of 125-plus oil and gas companies and sponsors and more than 600 different offerings and programs within the oil and gas asset class. He earned his Juris Doctor from the University of South Dakota School of Law and his Master of Laws in Taxation from the University of Florida School of Law.

ENDNOTES

1. *Throughout this article, oil and gas operating companies of various sizes and ownership may be generally referred to as "E&Ps."*
2. *J. Sullivan, Oil and Gas Investment Programs: A Brief Survey, THE BUSINESS LAWYER (April 1971), providing a historical narrative of the structures and tax features of oil and gas-oriented investment programs formed in the 1950s and 1960s.*
3. *For purposes of this article, nonoperated is referred to as "nonop."*
4. *For purposes of this article, intangible drilling costs are referred to as "IDCs."*
5. *For purposes of this article, the Internal Revenue Code is referred to as "IRC."*
6. *For purposes of this article, private equity is referred to as "PE."*
7. *For purposes of this article, environmental, social and governance are referred to as "ESG."*
8. *See e.g., Private Equity Climate Risks Scorecard 2024, AMERICANS FOR FINANCIAL REFORM EDUCATION FUND (October 2024), providing a listing of 20 private equity companies with significant fossil fuels exposure and carbon footprints.*
9. *Oil & Gas in 2025: Emerging Trends & Predictions, Akin, Gump, Strauss Hauer & Feld LLP (January 2025).*
10. *For purposes of this article, broker dealers are referred to as "BDs" and registered investment advisers are referred to as "RIAs."*
11. *The top 100 independents are ranked annually by Hart Energy based upon their relative daily oil and gas production in terms of barrels of oil equivalent production. While U.S. Energy was not within the top 100 in 2025, we anticipate the operator's entry into the list in 2026 based upon its Southern Delaware acquisition from ConocoPhillips in Q1 2025.*
12. *CISTON PR Newswire (Oct. 29, 2025).*
13. *Waveland Capital Group.*
14. *For clarification purposes, U.S. Energy Development Corp.'s drilling program allocates program capital to both operated and nonop working interests.*
15. *The nonop acquisition premium is the price paid by a purchaser for the nonop interest, which can range broadly from 15%-50% of a well's AFE, or alternatively require a concession of a 15%-50% carried interest to the asset seller.*
16. *Oil & Gas in 2025: Emerging Trends & Predictions, Akin, Gump, Strauss Hauer & Feld LLP (2025).*