Issues in Oil and Gas Purchase and Sale Agreements
Initial Considerations
Letter of Intent

- Offer or Agree
- Binding or Non-Binding
- Binding Exclusive
- Confidentiality
The following numbered paragraphs of this Letter (collectively, the “Nonbinding Provisions”) reflect our mutual understanding of the matters described in them, but each party acknowledges that the Nonbinding Provisions are not intended to create or constitute any legally binding obligation between Prospective Buyer and Prospective Seller, and neither Prospective Buyer nor Prospective Seller shall have any liability to the other party with respect to the Nonbinding Provisions until a fully integrated, definitive agreement (the “Definitive Agreement”), and other related documents, are prepared, authorized, executed and delivered by and between all parties. If the Definitive Agreement is not prepared, authorized, executed or delivered for any reason, no party to this Letter shall have any liability to any other party to this Letter based upon, arising from, or relating to the Nonbinding Provisions.
Examples of Binding Provisions

- Access
- Exclusive Dealings/Non-Solicitation
- Conduct of Business
- Confidentiality
- Consents (HSR)
Initial Transaction Considerations

- **Who is the Buyer/Seller?**
  - Sophistication and experience of the parties may effect the sales process, including negotiations.

- **Asset vs. Stock**
  - Asset transaction: Buyer does not subject itself to all the corporate liabilities and obligations of the Seller as it would if it had acquired the Seller’s stock.
  - Stock transaction: Additional diligence is required.
  - Stock transaction: Asset based reps and warranties are needed in addition to more corporate reps.

- **Closing/Effective Date**
  - Effective Date establishes date on which Buyer will assume its share of liabilities and will be entitled to its share of the production and revenue.
  - Difference between Closing Date and Effective Date.

- **HSR (Hart-Scott-Rodino)**
  - Anti-trust statute applicable in oil and gas transactions with a purchase price of $500 million or more.
HSR Considerations

- Three parts: coverage, exemptions and transmittal

- Preliminary Questions
  - What is being acquired?
  - What is the amount and nature of the consideration?
  - Who are the Parties involved in the transaction?
  - When and under what conditions will the transaction take place?
Purpose of Representations

- Confirm value
  - The Seller should give reps that will identify any unknown liabilities, (i.e., well proposals, lawsuits, etc.) and confirm that Seller has properly operated the properties, including reps as to compliance with laws and operations in compliance with industry practice.

- Identify problems

- 8/8ths problem
  - Even though Buyer may be purchasing only a certain percentage interest in the properties, with respect to third party liabilities, the parties may have joint liability. Seller’s reps need to include reps regarding third party liabilities and any JOA liability arising from properties operated by third parties.

- “No matter known that gives rise to indemnity by Buyer”
  - Seller should rep that it is not aware of any matter that would give rise to Buyer having to indemnify Seller.
Reps, Warranties and Disclosures from Buyer’s Perspective

- Complement due diligence
- Identify issues that may give rise to liability
- Allow issues to be addressed in the deal
  - Defect Process
  - Indemnity
Buyer’s Form Representations and Warranties of Seller

- Seller represents to Buyer, as of the date of this Agreement and as of the date of the Closing, that:
The following documents *are in full force and effect* and constitute valid and binding obligations of the parties thereto:

- the oil, gas and/or mineral leases which are included as part of the Oil and Gas Properties;

- all contracts and agreements, licenses, permits and easements, rights-of-way and other rights-of-surface use comprising any part of or otherwise relating to the Properties; and

- all contracts and agreements (“Operational Contracts”) that are reasonably necessary to own, explore, develop, operate, maintain or use the Oil and Gas Properties:
  - in the manner in which they are currently being owned, explored, developed, operated, maintained or used, and
  - in accordance with the prudent practices of the oil and gas industry.
The leases, contracts, agreements, licenses, permits, easements, rights-of-way and other rights-of-surface use which are described in (A), (B) and (C) above are herein called the “Basic Documents”; and all contracts and agreements which are Basic Documents are disclosed on Exhibit A;

- Seller is not in breach or default (and no situation exists which with the passage of time or giving of notice would create a breach or default) of its obligations under any Basic Documents, and (ii) to Seller’s Knowledge, no breach or default by any third party (or situation which with the passage of time or giving of notice would create a breach or default) exists under any Basic Documents, to the extent such breach or default (whether by Seller or such a third party) could reasonably be expected to have a Material effect on the ownership, exploration, development, operation, maintenance, value or use of any of the Properties after the Effective Date;
All payments (including all delay rentals, royalties, shut-in royalties and valid calls for payment or prepayment under operating agreements) owing under Basic Documents have been and are being made (timely, and before the same became delinquent) by Seller in all Material respects, and (ii) such payments have been and are being made by third parties where the non-payment of same by a third party could have a Material adverse effect on the ownership, exploration, development, operation, maintenance, value or use of any of the Oil and Gas Properties after the Effective Date;
Except as set forth on Exhibit ______, no Basic Document involves an assumption by Buyer or its successors of any pre-Closing liabilities or claims; and

Except as set forth on Exhibit ______, no Basic Document includes an indemnity by Seller of any third party for their activities or matter arising prior to Seller acquiring the properties.
Area of Mutual Interest and Other Agreements

- No Oil and Gas Property is subject to (or has related to it) any area of mutual interest agreements. No Oil and Gas Property is subject to (or has related to it) any farm-out or farm-in agreement under which any party thereto is entitled to receive assignments not yet made, or could earn additional assignments after the Effective Date.
Payment of Expenses

- All expenses (including all bills for labor, materials and supplies used or furnished for use in connection with the Properties, and all severance, production, ad valorem, windfall profit and other similar Taxes) relating to the ownership or operation of the Properties, have been, and are being, paid (timely, and before the same become delinquent) by Seller.
Compliance with Laws

- The Properties are currently, and to Seller’s Knowledge, have been, owned and operated in Material compliance with all applicable Laws, including Applicable Environmental Laws;

- Without in any way limiting the foregoing representations, the Properties operated by Seller, and, to Seller’s Knowledge, the Properties operated by others, are not in any Material violation of (or subject to) (i) any existing, pending or, threatened, judicial, administrative or arbitral proceeding or any investigation or inquiry by any Governmental Authority, or (ii) any investigation, feasibility study, removal or remedial actions under any and all applicable Laws (including Applicable Environmental Laws), and (iii) to Seller’s Knowledge, there are not facts, circumstances or conditions relating to any of the Properties which could require any remediation, investigation, feasibility study, or removal or remedial actions, or which could result in any Material costs or liabilities or Material non-compliance with Applicable Environmental Laws;
Seller undertook, at the times of its respective acquisitions of the Properties, all appropriate inquiry into the previous ownership and uses of the Properties consistent with good commercial or customary practice, and Seller has taken all steps necessary to determine and has determined that no Hazardous Substances (as defined in the Applicable Environmental Laws) (i) have been disposed of or Released on or onto the Properties, (ii) or, if generated, on the Properties have been disposed of offsite in violation of Applicable Environmental Laws or at any site listed or proposed for listing on the National Priority List (as such term is defined under CERCLA) or similar lists created pursuant to any state analog to CERCLA;
Compliance with Laws cont'd

- Without limitation of the foregoing, to Seller’s Knowledge, there are no leaking underground storage tanks which are or previously were in operation, surface impoundments, disposal pits or waste ponds or lagoons, or Hazardous Materials on, in or under such Properties;

- Seller has not received written notice of any Claim that Seller is a potentially responsible party at any site included, or proposed for inclusion, on the National Priority List (as such term is defined under CERCLA) or similar lists created pursuant to any state analog to CERCLA.
Compliance with Laws cont'd

- To Seller’s Knowledge, all oil and gas wells comprising a part of the Properties have been drilled and completed within the boundaries of the applicable leases or within limits otherwise permitted by a valid and enforceable pooling, unit, or other agreement or contract or by applicable Law;

- To Seller’s Knowledge, no well comprising a part of the Properties is or was subject to any penalty on allowables after the Effective Date because of any over-production (or any other judgments, orders or decrees of any Governmental Authority) which would (or did) prevent such well from being entitled to its full legal and regular allowable (as prescribed by any Governmental Authority) from and after the Effective Date; and
Except for wells listed on Exhibit ___, there are no dry holes, or shut in or otherwise inactive wells, located on the Oil and Gas Properties or on lands pooled or unitized therewith. Except for wells listed on Exhibit ___, to Seller’s Knowledge, there are no facts, circumstances or conditions related to any plugged or abandoned wells located on the Oil and Gas Properties or on lands pooled or unitized therewith which could reasonably cause an operator of oil and gas properties to believe that Material costs, expenses or liabilities will be incurred after the Effective Date by any owner of such properties.
Governmental Permits

- Seller has all governmental licenses, filings and permits (including, without limitation, permits, licenses, approval registrations, notifications, exemptions and any other authorizations pursuant to Applicable Environmental Laws) necessary or appropriate to own and operate the Properties ("Permits") as presently being owned and operated. Such Permits are in full force and effect and final and non-appealable and (except for those Permits listed on Exhibit ___) are transferable to Buyer. The Properties have been and are being owned and operated in compliance with all Permits.
Limitations in Reps and Warranties

- Knowledge of the Seller
- “Except as Scheduled”
- Time Frame “…is in compliance and has been (limited to ownership) in compliance with all environmental laws…”
- Materiality
Defect Process

- Title

- Environmental

- Buyer has the right to reject property/Seller has the right to withdraw

- Seller’s “Double Dip” – (i) *di minimis*/threshold and (ii) aggregate deductible
  
  - Example: $25,000 per property and 1%-3% in the aggregate as a deductible

- Inflation in threshold
Environmental Diligence Considerations
Environmental Issues in Due Diligence

- Onsite conditions and releases (Phase I and II)
- Compliance
- Permits and licenses
- Potential liability for offsite conditions/disposal
- Records
- Communications with regulatory agencies
- History of prior ownership or operators
- Insurance coverage
Purpose of Environmental Reps

- Condition vs. violation of law
  - The environmental rep should address the condition of the property, the rep should not be limited to addressing only violations of environmental laws.

- “Seller’s or Buyer’s” definitions and provisions
  - Seller’s form of agreement will typically attempt to narrowly define environmental laws and potential violations.
  - Buyer would prefer a broader definition of environmental laws and defects and to have a rep from the Seller that the condition of the properties is in compliance with environmental laws.
Buyer’s Form of Environmental Diligence

- **Environmental Matters.** A Property is in violation of any Applicable Environmental Laws in any respect or there is present upon or under such property a condition which requires or *with the passage of time could require* investigation or remediation under Applicable Environmental Laws or could result in liability to third parties and such violation or condition is not such as would normally be accepted by persons engaged in the oil and gas business when purchasing producing properties.
Environmental Defect Process

- Seller will want to define a “defect” as a violation of the properties (physical condition or release of Hazardous Materials) or operations (eg, permits) under *existing* environmental laws that requires *immediate* action/remediation.

- Defect notices from a Buyer should be specific as to the condition, provide supporting documentation, and provide a reasonable estimate of the value to remediate the condition.

- From Seller’s perspective, a Seller will often want to try to exclude from the definition of “defect” the possible existence of naturally occurring radioactive material (“NORM”).
Title Diligence Considerations
Inspection and Assertion of Defects.

Seller shall make available to Buyer and its Representatives all title opinions, supplemental title opinions and other title information in the possession of the Seller and relating to the Oil and Gas Properties and access to all Properties. Buyer may, to the extent it deems appropriate, conduct, at its sole cost, such title examination or other investigation as it may choose to conduct with respect to the Properties including a Phase I Environmental Site Assessment (as such term is defined by the American Society of Testing and Materials). Should, as a result of such examination and investigation, or otherwise, matters come to Buyer’s attention which would constitute “Defects” (as below defined), and should there be one or more of such Defects which Buyer determines it is unwilling to waive and close the transaction contemplated hereby notwithstanding the fact that such Defects exist, Buyer shall or cause its Representatives to, notify Seller in writing of such Defects at least ten (10) business days prior to the Closing. Such Defects of which Buyer so provides notice are herein called “Asserted Defects” (including the furnishing of additional information). In the event that Buyer notifies Seller of Asserted Defects, Seller shall have the right (but not the obligation) to attempt to cure such Asserted Defects to the reasonable satisfaction of Buyer, and for the purpose of curing such Asserted Defects, Seller may on written notice to Buyer elect to delay Closing for a period not to exceed 14 days or may request a Closing as to the Properties not affected by any uncured Asserted Defect, and the Purchase Price for such partial Closing will be reduced by the Allocated Values for the excluded Properties affected by any Asserted Defects. As to any Properties affected by an Asserted Defect and withheld from Closing by such agreement of the parties, Seller shall have 120 days to cure such Defect to Buyer’s satisfaction. Upon acceptance of the cure, Closing shall occur as to such Property. If the Asserted Defects are not so cured within such 120 days, then the Seller shall retain the Properties which were withheld.
The term “Defect” as used in this Section shall mean the following:

- **NRI or WI Variances.** Seller’s ownership of the Properties is such that, with respect to a well, PUD location or unit listed on Exhibit [___] hereto (it is the intent of the parties that the interests and wells on Exhibit [___] are those reflected on the Reserve Report and in the event of conflict between the two, Buyer in its sole discretion, may use those reflected in the Reserve Report for all purposes of this Article VII), *it (A) entitles Seller, at any time during the production life of the Oil and Gas Property involved, to receive a percentage share of the oil, gas and other hydrocarbons produced from, or allocated to, such well, PUD location or unit which is less than the percentage share set forth on Exhibit [___] in connection with such well, PUD location or unit in the column headed “NRI” or (B) causes Seller to be obligated, at any time during the production life of the Oil and Gas Property involved, to bear a percentage share of the cost of operation of such well, PUD location or unit greater than the percentage share set forth on Exhibit [___] in connection with such well, PUD location or unit in the column headed “WI” (unless the share of production from such well, PUD location or unit to which Seller is entitled is proportionately larger than the “NRI” shown for such well on Exhibit [___]); or*
The term “Defect” as used in this Section shall mean the following:

- **Lien.** Seller’s ownership of the Properties is subject to a lien other than (A) a lien for taxes not yet delinquent, or (B) a mechanic’s or materialmen’s lien (or other similar lien), or a lien under an operating agreement or similar agreement, to the extent the same relates to expenses incurred which are not yet due; or (C) the liens to be released by Closing pursuant to Section [____]; or

- **Production Prepayments.** An Oil and Gas Property is subject to a makeup obligation to satisfy take-or-pay payments or other prepayments for production previously received by Seller; or

- **Imbalances.** Seller is in an overproduced position with respect to an Oil and Gas Property (e.g., Seller and/or its predecessors in title have taken more gas than their ownership in such Oil and Gas Property would entitle them to take), and such overproduced position is greater than that shown on Exhibit [____] as of the date or dates noted on such Exhibit.
The term “Defect” as used in this Section shall mean the following:

- **Third Party Elections.** Seller’s ownership of a Oil and Gas Property is subject to a right that could reasonably be expected to (A) cause a Defect to exist during the productive life of such Oil and Gas Property, or (B) to give rise to any third party's right to operate any Oil and Gas Property (which is currently operated by Seller) without due election by majority ownership of the working interest owners of said Oil and Gas Property; or

- **Undesirable Contracts.** An Oil and Gas Property includes, is subject to or affected by a contract or agreement that contains terms and conditions that are not customary in the oil and gas industry or that would reduce the value to Buyer of such Oil and Gas Property by more than [____]; or

- **Plugging Obligations.** Except for wells that are listed on [___] or that that been properly plugged and abandoned, there are dry holes, or shut in or otherwise inactive wells, located on the Oil and Gas Properties or on lands pooled or unitized therewith.
Certain Price Adjustments

- In the event that Asserted Defects are presented to Seller and Seller is unable (or unwilling) to cure such Asserted Defects prior to the Closing, then:
  
  o Buyer and Seller shall, with respect to each Property affected by one or more Asserted Defects, attempt to agree upon an appropriate adjustment to the Purchase Price to account for such Asserted Defects; and

  o with respect to each Property as to which Buyer and Seller are unable to agree upon an appropriate adjustment with respect to all Asserted Defects affecting such Property, such Property will be excluded from the transaction contemplated hereby and deemed an Excluded Property, and the Purchase Price will be reduced by the Allocated Values for such excluded Property.
Notwithstanding anything herein to the contrary, Buyer may elect to specify as an appropriate adjustment to the Purchase Price:

- for an Asserted Defect of the type which is specified in Sections ___ “NRI or WI Variances”, or (iii) “Imperfections in Title”, and which affects the NRI specified on Exhibit ___, for the remaining production life of the Oil and Gas Property involved, an amount equal to the Allocated Values for such Oil and Gas Property multiplied by the proportionate reduction in such NRI (e.g., the amount by which the share of production to which Seller is actually entitled is less than the NRI specified for such Oil and Gas Property on Exhibit ___, divided by such NRI specified on Exhibit ___, or...
for a Defect of the type specified in Sections ___ (b)(ii) “Lien”, (iv) “Production Payments”, or (v) “Imbalances”, the amount required to discharge such lien, or the amount represented by the loss of volumes required to discharge such make up obligation or overproduced position, which amounts shall, in the case of a make up obligation or overproduced position, be the discounted present value of the volumes required to discharge such obligation, determined by using a 10% discount rate and assuming the same would be discharged as promptly as possible (under the terms of applicable agreements) after the Closing Date assuming production occurs at the same rate as projected in projections of production furnished by Buyer as (and represented by Buyer to be) its projections used in making its decision to purchase (and valuing such production using prices for production utilized in such projections). If Buyer elects to specify an adjustment pursuant to this Section ___ (b), such adjustment will be deemed an adjustment mutually agreed to under Section ___ (a)(i) above subject to.
The Defect Amount with respect to an affected Oil and Gas Property shall be determined without duplication of any costs or losses included in another Defect Amount pertaining to such affected Oil and Gas Property hereunder.

Note, this is a Seller’s clause.
Notwithstanding anything to the contrary, as to any Asserted Defect asserted by Buyer under Section ___ (b)(vi) “Environmental Matters” for which Buyer and Seller do not reach agreement, within five (5) days after the commencement of negotiations pursuant to Section ___ (a) above, on the existence of such Asserted Defect, or the Defect Amount attributable to such Asserted Defect, Buyer may, in its sole discretion and upon written notice to the Seller, elect to exclude the affected Property, and the entire unit or JOA Contract Area which the affected Property is part of (said property so excluded shall be deemed an Excluded Property) from the transaction contemplated hereby, and the Purchase Price will be reduced by the Allocated Value of the excluded Property.

Seller will want this to be either party.
Termination Right

- It is not uncommon for there to be a termination right of the parties to the extent that the aggregate defects (title, environmental) and casualty loss adjustments exceed a certain threshold amount.

- Considerations: Greater certainty of closing vs lower price due to significant adjustments through defect process.
Indemnities

- **“Losses” vs. “Claims”**
  - For a Buyer, it is best for the indemnification to cover claims and not to be limited to losses.

- Third party claims – For a Buyer, it is best for the indemnification not to be limited to third party claims.

- Pre-Closing / Post-Closing
  - Seller should indemnify Buyer for pre-Closing operations.

- “Come Back Indemnity” – after a certain period of time liability for pre-closing activities shifts from the Seller to the Buyer.
Indemnities (cont'd)

- **Limits**
  - **Dollars**
    - Sellers typically want a cap on the maximum amount they will be liable for indemnification obligations. In some instances, the indemnification is also subject to a per claim de minimis and a threshold. Buyer obviously wants a single threshold for all claims.
  
  - **Time**
    - Buyers like to have the Seller’s indemnification last for at least 6 to 18 months.
Survival of Provisions

- All representations and warranties made herein by Buyer and Seller shall be continuing and shall be true and correct on and as of the date of Closing with the same force and effect as if made at that time and shall inure to the benefit of Buyer and Seller but not to their respective successors and assigns, and all of such representations and warranties shall not survive the Closing and the delivery of the Conveyance. The obligations of the parties under Section 3 shall (subject to any limitations set forth therein) also survive the Closing and the delivery of the Conveyance but only for a period of ____________________________.
Sole and Exclusive Remedy

- Sole and exclusive remedies
  - Sellers prefer the Purchase and Sale Agreement to provide that Buyer’s remedies are limited to those remedies specifically set forth in the agreement, such as the indemnification provisions. Exclude punitive/consequential damages.
  - Sellers prefer the agreement to expressly provide that neither party will be liable for any punitive or consequential damages. Seller’s agreements often limit such damages for them.
Remember...

Just because you are certifiably paranoid does not mean people are not...
TRYING TO SCREW YOU!
SAMPLE REPS & WARRANTIES:
Seller is a [__________/corporation] duly organized, validly existing, and in good standing under the Laws of the State of ___________. Seller is duly qualified to transact business and is in good standing in the state(s) described on Exhibit A. Seller is not a non-resident alien, foreign corporation, foreign partnership, foreign trust or foreign estate (as those terms are defined in the Code and in the regulations promulgated pursuant thereto). Seller is an experienced operator who is familiar with the operations of the Properties and familiar with the customs and practices in the oil and gas industry.
Power and Authority

- Seller has all necessary and appropriate authority to execute, deliver, and perform this Agreement and each other agreement, instrument, or document executed or to be executed by Seller in connection with the transactions contemplated hereby to which it is a party and to consummate the transactions contemplated hereby and thereby. The execution, delivery, and performance by Seller of this Agreement and each other agreement, instrument, or document executed or to be executed by Seller in connection with the transactions contemplated hereby to which it is a party, and the consummation by it of the transactions contemplated hereby and thereby, have been duly authorized by all necessary action of Seller. Except for the sale of production from the Properties in the ordinary course of business, since the effective date of the Reserve Report, Seller has not assigned, transferred or conveyed any interest in the Properties.
Valid and Binding Agreement

- This Agreement has been duly executed and delivered by Seller and constitutes, and each other agreement, instrument, or document executed or to be executed by Seller in connection with the transactions contemplated hereby to which it is a party has been, or when executed will be, duly executed and delivered by Seller and constitutes, or when executed and delivered will constitute, a valid and legally binding obligation of Seller, enforceable against it in accordance with their respective terms, except that such enforceability may be limited by (a) applicable bankruptcy, insolvency, reorganization, moratorium, and similar Laws affecting creditors’ rights generally and (b) equitable principles which may limit the availability of certain equitable remedies (such as specific performance) in certain instances.
Non-Contravention

- Other than requirements (if any) that there be obtained consents to assignment ("Consents") described on Exhibit _____ or waivers of preferential rights to purchase ("Preferential Rights") described on Exhibit _____ from third parties and Governmental Consents, neither the execution, delivery, and performance by Seller of this Agreement and each other agreement, instrument, or document executed or to be executed by Seller in connection with the transactions contemplated hereby to which it is a party nor the consummation by it of the transactions contemplated hereby and thereby do and will (a) conflict with or result in a violation of any provision of any governing instruments of Seller, (b) conflict with or result in a violation of any provision of, or constitute (with or without the giving of notice or the passage of time or both) a default under, or give rise (with or without the giving of notice or the passage of time or both) to any right of termination, cancellation, or acceleration under, any bond, debenture, note, mortgage or indenture, or any material lease, contract, agreement, or other instrument or obligation to which Seller is a party or by which Seller or any of its properties may be bound (except for liens released at Closing), (c) result in the creation or imposition of any lien or other encumbrance upon the properties of Seller, or (d) violate any applicable Law, binding upon Seller or the Properties.
Approvals

- Other than requirements (if any) that there be obtained Consents described on Exhibit __ or waivers of Preferential Rights from third parties described on Exhibit __ and Governmental Consents, no consent, approval, order, or authorization of, or declaration, filing, or registration with, any Governmental Authority or any third party is required to be obtained or made by Seller in connection with the execution, delivery, or performance by Seller of this Agreement, each other agreement, instrument, or document executed or to be executed by Seller in connection with the transactions contemplated hereby to which it is a party or the consummation by it of the transactions contemplated hereby and thereby.
Pending Litigation

- Except as set forth on Exhibit ____, there are no pending suits, investigations, actions, notices of violations, or other proceedings or claims (collectively, “Claims”) or to Seller’s Knowledge, any such threatened Claims in which (a) Seller is or may be a party which relate to the Properties (including, without limitation, Claims pursuant to Applicable Environmental Laws, and Claims challenging or pertaining to the title to Seller’s Properties), or (b) that affect the execution and delivery of this Agreement or the consummation of the transactions contemplated hereby.