
PURCHASE AND SALE AGREEMENT

by and between

Cashing Out Resources Inc.

as Seller

and

Eager Exploration Company

as Buyer

Dated as of January 26, 2017

**The Elusive “Middle-of-the-Road” PSA
Creative and Collaborative Solutions to Current and
Recurrent Issues in Purchase and Sale Agreements**

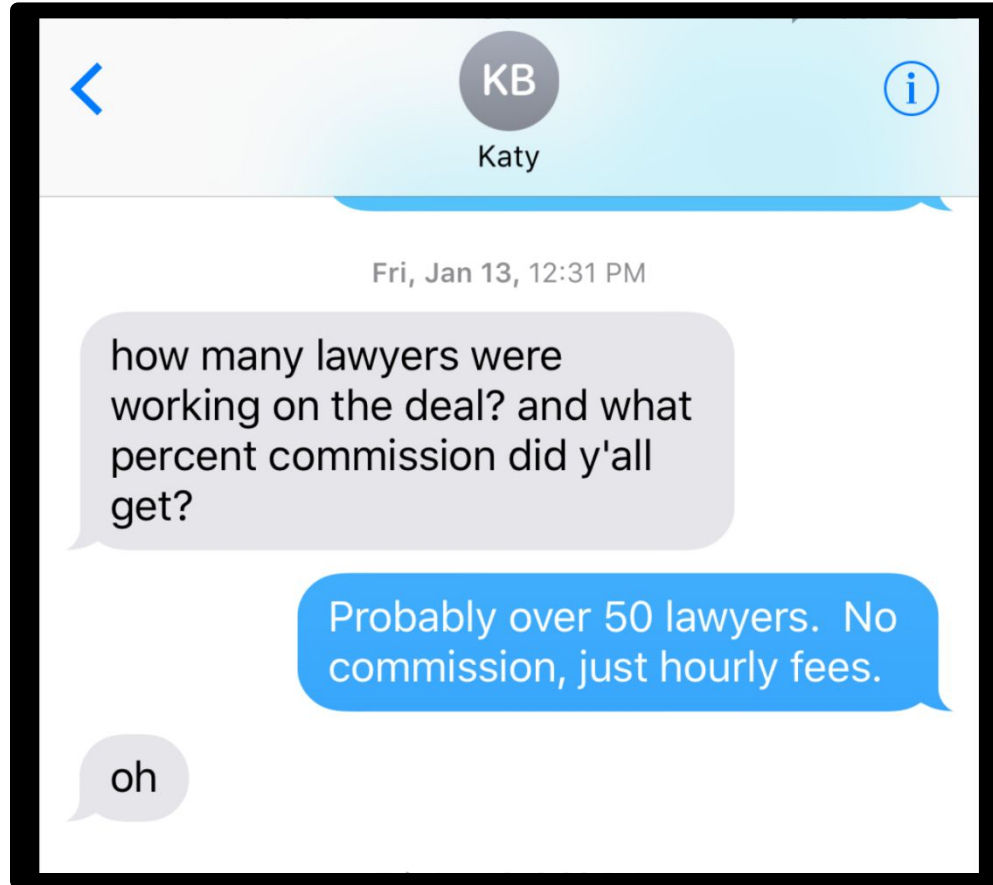
Presented by Michael J. Byrd

Houston Bar Association Oil, Gas & Mineral Law Section

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Akin Gump

STRAUSS HAUER & FELD LLP



When your kid brings you back down to earth after you tell her you finally signed up that multibillion dollar deal you worked on over her Thanksgiving and Christmas breaks

Recent Multibillion Dollar U.S. Upstream Oil & Gas M&A Deals




Acquisition from Reliance Energy
Core Midland Basin
8/15/16

\$1.6 billion



Mergers/acquisitions with Yates Petroleum Corp. and related entities.
Delaware and Powder River Basins
9/6/16
**Akin Gump worked on this deal*

\$2.5 billion



Acquisition of Silver Hill Energy
Delaware Basin
10/13/16
**Akin Gump represented the runner-up bidder*

\$2.4 billion




Acquisition from QStar LLC
Midland Basin
10/18/16

\$1.6 billion




Acquisition of acreage from private sellers
Delaware Basin
11/2/16

\$2 billion



Acquisition from Anadarko Petroleum Corp.
East Texas Haynesville Shale
11/18/16

\$1 billion




Acquisition from Brigham Resources
Delaware Basin
12/14/16
**Akin Gump worked on this deal*

\$2.45 billion



Acquisition from Vitruvian Exploration
Oklahoma SCOOP play
12/14/16
**Akin Gump worked on this deal*

\$1.85 billion




Acquisition from Anadarko Petroleum Corp.
Marcellus Shale
12/21/16
**Akin Gump worked on this deal*

\$1.24 billion



Acquisition (along with Blackstone) from Anadarko Petroleum Corp.
Eagle Ford Shale
1/12/17
**Akin Gump worked on this deal*

\$2.3 billion



Merger with Clayton Williams Energy, Inc.
Delaware Basin
1/17/17

\$3.3 billion



\$6.6 billion acquisition of Bass family-owned companies
Delaware Basin
1/17/17

\$6.6 billion

Recent Multibillion Dollar U.S. Upstream Deals Observations

- Eight of the 12 deals were in the Permian Basin.
 - 6 Delaware Basin (one of which also included Powder River Basin)
 - 2 Midland Basin
- Aside from the 8 Permian Basin deals, the others included:
 - one in the Eagle Ford Shale
 - one in the Oklahoma SCOOP
 - one in the Marcellus Shale, and
 - one in the Haynesville Shale.
- Eight deals included stock in the buyer as a part of the consideration

Recent Multibillion Dollar U.S. Upstream Deals Other observations

Five were home runs for private equity firms, including:



ENCAP INVESTMENTS L.P.

WARBURG PINCUS



Kayne Anderson

Capital Advisors, L.P.

*"loan-to-own" type investment

Recent Multibillion Dollar U.S. Upstream Deals

Other observations

- Three of the deals resulted from century wildcatters or hardhats and cashiers
 - Yates Petroleum
 - Clayton Williams
 - Bass Brothers



- The biggest one of all (ExxonMobil/Bass family companies, personally negotiated by Secretary of State nominee Rex Tillerson’s final deal before leaving XOM, which he confirms he personally negotiated with Sid Richardson. See Forbes.com, “Rex Tillerson's Last Deal? Exxon Mobil To Pay \$6B To Bass Family For Permian Oil” at <http://www.forbes.com/sites/christopherhelman/2017/01/17/rex-tillersons-last-deal-exxon-to-pay-6b-to-bass-family-for-permian-oil/#28daea646a79>

What is a “middle-of-the road PSA”?

- It does not take long for M&A lawyers to make a few observations about the so-called “middle-of-the-road PSA”:
 - Observation No. 1:
 - What the Seller and Buyer each have in mind as a “middle-of-the-road PSA” are often quite far apart; and
 - Observation No. 2:
 - Because of Observation No. 1, a promise to prepare a “middle-of-the-road PSA” is somewhat illusory.
- Obviously, the term “middle-of-the-road PSA” is a figurative term, and, consequently, any attempt to describe the components, objectives, or other attributes of such a term is inherently subjective.
- No one lawyer, judge, mediator, or legal expert has any authority to say whether a contract term is “middle-of-the-road.”
- This speaker’s opinion of what is “middle-of-the-road,” as outlined in this presentation is just that – one person’s opinion....

Common Attributes of a “Middle-of-the-Road PSA” (IMHO)

- The usual objective (at least ostensibly) of using a middle-of-the-road contract is to get a deal done fast, and minimize the time and cost of extensive negotiations for both parties.
 - Obviously, every deal has its unique features that will result in the need for changes to the form – sometimes significant changes. That is to be expected.. But if the parties have started with a middle-of-the-road PSA, it should be those kind of changes and terms that require the most time, attention, and advocacy of deal counsel – not scratching and clawing to get one-sided basic contract provisions back to the center.
- Ideally, the contract negotiations and the contract itself will foster a relationship of goodwill, trust, and cooperation between the parties between signing and Closing as well as after Closing.
 - Usually, when the business teams of the Seller and Buyer reach an agreement in principal on a sale, both sides are excited and “warm and fuzzy” toward each other. Abnormally one-sided contract terms or abnormally aggressive deal counsel can quickly sour those feelings. By contrast, reasonable, professionally handled negotiations can preserve and even solidify those feelings. In a big asset deal, each side is going to need a lot of cooperation from the other to ensure a smooth transition of the assets (and associated obligations) both between signing and closing, and often for many months after closing. Maintaining goodwill between the parties during this process benefits everyone involved including third party interest owners, lessors, purchasers of production, and vendors.

Common Attributes of a “Middle-of-the-Road PSA” (IMHO)

- It seeks to ensure that each party achieves, as closely as possible, the deal it had bargained for, without assuming greater risk than it had anticipated. It seeks to avoid moral hazard (where one party bears a disproportionate share of the risk).
 - It also accurately reflects the parties’ mutual expectations and assumptions about the assets, and provides for reasonable consequences when those expectations are not met, or when those assumptions are proven untrue.
- Ideally, it results in (a) the Buyer paying only for what the Seller actually owns in the Properties, and (b) conversely, the Seller getting paid for everything it actually owns.
 - Most PSA’s contain a process whereby the Purchase Price is adjusted down to account for Title Defects. Likewise, if it is discovered that the Seller owns more than was assumed in determining the Purchase Price, there is an upward adjustment.
 - In my view, these adjustments should generally be based on record title, not unrecorded contract rights. The burden should be on the Seller to perfect its title.*
 - To the extent that thresholds and deductibles are used to limit such adjustments, those should be business decisions. But the lawyers should ensure that they are drafted to work in a fair and equitable manner.

*Over my career, my clients have been very evenly divided among Sellers and Buyers.

Common Attributes of a “Middle-of-the-Road PSA” (IMHO)

- Usually, the Buyer assumes all environmental liability but has an inspection right coupled with the right to assert claims for environmental defects. If not remediated, the Buyer gets a downward purchase adjustment for the estimated remediation cost, or there may be a process for excluding the affected properties from the deal.
 - Generally, the Buyer has limited or no post-Closing recourse related to the environmental condition of the properties.
 - However, while it is rare for the Seller to make any direct representations about the environmental condition of the Assets, it is reasonable, and not unusual, to include certain knowledge and/or notice-based reps such as the following:
 - A Knowledge-qualified rep that the Assets and operations are in material compliance with all Environmental Laws
 - A rep that Seller has provided Buyer with all material written environmental reports or studies prepared by any Third Parties on behalf of Seller
 - A rep that Seller has not received any written notices of any release, spill, disposal, event, condition, circumstance, activity, practice or incident concerning any land, facility, asset or property included in the Assets that (i) interferes with or prevents compliance by Seller with any Environmental Law or the terms of any license or Permit issued pursuant thereto, or (ii) gives rise to or results in any common law or other liability of Seller to any Person

Common Attributes of a “Middle-of-the-Road PSA” (IMHO)

- Setting aside title and environmental matters, usually the Seller makes numerous other customary reps and warranties related to the properties, leases, contracts, etc., for which the Buyer has remedies prior to closing and for some limited time period after Closing.
- A “middle-of-the-road PSA” takes “market” terms into account – but does not hold them sacred. Rather, market terms are only one consideration among many in fairly papering a deal in accord with the circumstances and expectations of each party and the particular assets.
- It generally provides for reciprocal remedies to Seller and Buyer for the same issues, unless otherwise justified.

Common Attributes of a “Middle-of-the-Road PSA” (IMHO)

- It applies creative and collaborative solutions not only to resolve stalemates, but to avoid them in the first place.
 - “Collaborative solutions” are not the same as compromise. Rather, collaborative negotiating seeks to identify the concerns of both sides on open issues, and strives to come up with creative solutions that work for both sides, compromising only as a last resort.
 - Collaboration means “win-win.”
 - “Win/Win’ is about making sure both parties have their needs or goals met, while creating as much mutual value as time and resources allow.”
 - Calum Coburn, “*Negotiation Styles*,” at <http://www.negotiations.com/articles/negotiation-conflict-profiles/>
 - A more colorful analogy that I like to make is, if you think of compromise as “splitting the baby,” think of collaborative solutions as “cloning the baby.”
 - Example: A common issue is whether Interest Additions can result in an increase in the Purchase Price (that is, if they exceed Title Defects in value), or are only available as an offset against Title Defects.
 - As noted a few slides earlier, in my view, a middle-of-the-road PSA results in the Seller getting paid for everything it actually owns.
 - So what are the parties’ real concerns here? For the Seller, that’s obvious: it does not want to convey more than it’s getting paid for. (*con’t next slide*)

Common Attributes of a “Middle-of-the-Road PSA” (IMHO)

- What is the Buyer’s real concern here? Quite often, the real concern is either its ability, or its internal authority, to pay more than a certain price. It may have some room to go a little higher, but cannot take the risk of unlimited upward Purchase Price adjustments for Interest Additions.
- A creative solution here that often is acceptable to both sides is to agree on a specified cap on increases to the Purchase Price for Interest Additions, above which Assets may be excluded in order to avoid exceeding that cap.
 - Who gets to choose which Assets get excluded? Sample provision:
 - “The upward adjustments to the Purchase Price for Interest Additions, net of all downward adjustments to the Purchase Price under this Article 11, result in a total increase to the unadjusted Purchase Price greater than ten percent (10%) (whether at Closing or at the time of any post-Closing conveyances provided for in this Agreement), Buyer shall have the right, in its sole discretion, to notify Sellers in writing that Buyer elects to cap the net increase to the Purchase Price at an amount designated by Buyer which is not less than ten percent (10%) of the unadjusted Purchase Price (such amount elected by Buyer, the “Purchase Price Increase Limit”). If Buyer makes such an election, Sellers shall have the right to exclude Assets (to be selected by Sellers in their reasonable discretion after consulting with Buyer in good faith) from the Assets to be conveyed to Buyer, to the extent and only to the extent necessary to avoid exceeding the Purchase Price Increase Limit.”

Common Attributes of a “Middle-of-the-Road PSA” (IMHO)

- It strives to preempt disputes by providing as much clarity as possible, and by attempting to anticipate and provide for potential unforeseen events and issues as much as possible.
 - For example, consider the Title Defect process. Most PSA’s provide for the Purchase Price to be allocated among the assets, and those “Allocated Values” are used as the basis for Purchase Price adjustments for Title Defects, as well as for notices to third-parties for purposes of pref rights and tag-along rights. Most PSA’s provide very clear and detailed provisions to define things like “Defensible Title,” “Permitted Encumbrances,” and the procedures for asserting, curing, contesting, and calculating Title Defects
 - A good “middle-of-the-road PSA” accounts for numerous issues that can occur in this process, such as:
 - Variations in the Seller’s title among different Target Formations
 - Whether the Title Defect has permanent or only temporary effect (for example, title which goes up or down after the occurrence of some payout event or the recoupment of a nonconsent penalty)
 - In addition, a good “middle-of-the-road” PSA should provide for an efficient, fair, and streamlined arbitration process for resolving contested defects that the parties can’t resolve themselves after good-faith negotiations.
 - A “baseball” arbitration process incentivizes the parties to take reasonable and honest positions on these issues. (See Appendix A)

Common Attributes of a “Middle-of-the-Road” PSA (IMHO)

- Ideally, it is a contract that the Seller would sign as a Buyer and that the Buyer would sign as a Seller.
 - If one party’s counsel insists on an unusually egregious term, or, for example, one that creates a “moral hazard” situation, I believe it is a fair question to ask something like, “if you were representing my client, would you advise them to agree to that”?
 - If the answer is no, then let’s not try to pretend that we have a “middle-of-the-road PSA.”
 - For example, take the argument that the Performance Deposit should be paid directly to the Seller, rather than to a third party Escrow Agent. On some of the recent deals, we’re talking about 9-figure deposits! Would you advise your buyer client to forgo an escrow account and hand over \$100 million to any Seller, no matter how strong the Seller’s financials and reputation?
 - The point is this: It is hard to make a credible argument that you have started with a middle-of-the-road PSA when you have something egregious in your first draft.

Into the trenches: Creative and Collaborative Solutions to Current and Recurrent Issues

- Current Issues
 - Dealing with distressed counterparties
 - Dealing with commodity price uncertainty
- Recurrent Issues
 - Rights and Remedies for a Failed Deal
 - Selected Issues with Reps and Warranties
 - Title Defects
 - Environmental Inspection – Phase I or Phase II?
 - Thresholds, Deductibles and Caps
 - Selected issue with Pre-Closing Covenants – Anti-sandbagging Provisions
 - Allocation of Liabilities

Dealing with Distressed Counterparties

Bankruptcy of Seller Prior to Closing

- Prior to Closing, a PSA is almost certainly an executory contract subject to rejection by the bankrupt debtor.
 - This is because, prior to Closing, the contract remains substantially unperformed by either party.
- Advice #1: do not pay the Performance Deposit directly to the Seller.
 - If paid to Seller, the funds become part of the estate, and the Buyer has only an unsecured claim in bankruptcy.
 - A properly established third-party escrow account is by definition not a part of the Debtor's bankruptcy estate; therefore, it is protected.
- A rejection of the PSA is a breach of the contract (as opposed to a termination), so if the escrow agreement and PSA provide for return of the Deposit to Buyer in the event of Seller's breach, the Buyer is Generally, the trustee for the bankrupt seller may elect to assume the PSA.
 - Creditors may object on the ground that the Purchase Price is not reasonably equivalent value, but the standard is business judgment. This is a pretty low standard, and as long as there is an articulable business reason for proceeding, the creditors will have a difficult time preventing the Seller from proceeding to close.

Dealing with Distressed Counterparties (cont'd)

Bankruptcy of Seller After Closing

- If the Seller files for bankruptcy after Closing, creditors may seek to set aside the transaction as a fraudulent transfer.
- Virtually all of the top producing states have a 4-year statute of limitations (3 years from transfer or 1 year thereof)
- Fraudulent transfer can be actual fraud.



Dealing with Distressed Counterparties (*cont'd*)

Bankruptcy of Seller After Closing

- Elements of constructive fraud:
 - Seller received less than reasonably equivalent value.
 - Seller was either insolvent at the time of the transaction, or became insolvent as a result of the transaction.
- A broadly marketed sales process, particularly with multiple bidders, is good evidence to support “reasonably equivalent value.”
- Buyer may want to conduct its own investigation of Seller’s assets and liabilities, or obtain an independent fairness opinion on the purchase price being paid for the assets.
- A solvency rep is evidence of solvency. Such a rep may also include facts about the marketing process and the Seller’s opinion of the value.
 - See Appendix B for a sample of the terms of a fulsome, recently negotiated solvency rep on a \$116 million Bakken Shale deal from June, 2016..

Dealing with Distressed Counterparties (*cont'd*)

Distressed Seller: Security for Seller's Indemnity Obligations

- Aside from the fraudulent transfer risk, the Buyer will also want to have security for its indemnification rights.
- Best security is an “Indemnity Holdback,” whereby a negotiated portion of the Purchase Price is held back in a third-party escrow account to secure the Seller’s indemnification obligations for a negotiated survival period.
 - In combination cash/stock deals, the Seller may wish to have the holdback funded entirely with shares. (For example, this is how the Indemnity Holdback is funded in the Brigham-Diamondback transaction.)
- If negotiations stall on the amount of the Holdback and the length of the survival period, a solution that sometimes resolves such a stalemate is to have the Indemnity Holdback released in stages.
- Note, regardless of the financial strength of the Seller, having an Indemnity Holdback in an escrow account is obviously better for the Buyer than having to collect from the Seller.
- “RWI”: reps and warranties insurance is a growing industry and another option that may be available in some situations.

Dealing with Distressed Counterparties (*cont'd*)

Seller's Security for Buyer's Indemnity Obligations

- Seller may want to consider negotiating for assurances for enforcing the Buyer's indemnification obligations.
- A common rationale for not providing for such assurances is that the Buyer will own the Assets so there is something for Seller to recover (*i.e.*, the Buyer will not be judgment-proof). But what happens if the Buyer sells the Assets and then promptly distributes the proceeds to its shareholders?
 - The best option is to provide that indemnification running with the land. reflected in



Dealing with Distressed Counterparties (*cont'd*)

Seller's Security for Buyer's Indemnity Obligations (*cont'd*)

- Getting financial security for Buyer's indemnification obligations is rare, but is not uncommon in contexts where the Seller remains on the hook vis-à-vis a third party, e.g., residual liability for decommissioning obligations with BOEM and BSEE.
 - Decommissioning obligations accrue when a well is drilled or a platform, pipeline, or other facility has been installed. (30 CFR 250.1702)
 - Assignors and assignees are jointly and severally liable for all decommissioning obligations that accrue prior to transfer. (30 CFR 556.62)
 - See L. Poe Leggette and Carey R. Gagmon, "OCS Platform Abandonment Issues," Houston Bar Association Oil Gas & Mineral Law Section Presentation (September, 2015); Paul J. Goodwine, "A Few Anticipated Hot Topics for Oil and Gas Bankruptcies," Houston Bar Association Oil Gas & Mineral Law Section Presentation (March, 2016)

Dealing with Distressed Counterparties (*cont'd*)

Seller's Security for Buyer's Indemnity Obligations (*cont'd*)

- **Caution:** Sellers should not rely on waivers by BOEM of supplemental bonds based on lessee's financial wherewithal, as that evaluation is subject to re-examination / revocation by BOEM
 - Recent case in point:
 - On October 15, 2015, BOEM notified W&T Offshore that it no longer met the relevant financial strength and reliability criteria, and on February 22, 2016, BOEM ordered W&T to post \$160 million in additional security by March 29, 2016.
 - Dozens of co-lessees and predecessors were copied on the order.
- See Appendix C for an example of a sample structure for a surety bond to secure Buyer's post-Closing performance of decommissioning obligations accrued prior to the Effective Time.

Current Issue – Dealing with Price Uncertainty

- Following the 2014-2015 downturn, perhaps the single biggest obstacle to getting to an agreement was the bid-ask spread.
- Future price adjustments to deal with commodity price volatility can be used to bridge a bid-ask spread resulting from different pricing assumptions in valuing the assets.
- Generally, such provisions use published pricing data as a reference point, and provide for a purchase price adjustment based on a comparison of the prices at the Execution Date to prices at a future point in time.



Example of Future Price Adjustment Mechanism Contingent Payment

- One of the simpler such mechanisms is a contingent payment, such as the following:

If the price of West Texas Intermediate light sweet crude oil (“WTI Crude Oil”), stated in U.S. dollars per barrel, as made public by the New York Mercantile Exchange and calculated at the close of each trading day, reaches certain threshold amounts for a period of 60 consecutive calendar days in the 24-month period immediately following Closing, Sellers shall be eligible to receive a one-time contingent payment from Buyer in an aggregate amount of up to \$50,000,000 (the “Contingent Payment”) calculated in accordance with the following pricing thresholds:

<u>WTI Crude Oil price</u>	<u>Contingent Payment Amount</u>
\$60 or higher	\$10,000,000
\$65 or higher	\$10,000,000
\$70 or higher	\$15,000,000
\$75 or higher	\$15,000,000

The aggregate Contingent Payment shall be paid by Buyer at the end of such 24-month period following Closing.

Example of Future Price Adjustment Mechanism

Purchase Price of \$500 million; maximum price risk adjustment of 20%

- “Future Adjustment Price” means the weighted average of the price of WTI Crude Oil on the last day of each month from 1/31/2017 through 12/31/2018.
- “Base Price” means \$50.00.
- Effective as of 12/31/18, the Purchase Price shall be adjusted upward by the percentage by which the Future Adjustment Price is greater than the Base Price, or downward by the percentage by which the Future Adjustment Price is less than the Base Price, as applicable; provided, however, that in no event shall such adjustment, whether upward or downward, exceed \$100,000,000.00.
- Security options for Seller:
 - Buyer pays \$500 million at Closing plus \$100 million into escrow or \$100 million letter of credit.
- Security options for Buyer:
 - Buyer pays \$500 million but retains a lien in the amount of \$100 million.
 - Or Buyer pays \$400 million at Closing and \$200 million into escrow.
 - Results in \$400 million to Seller at Closing and \$200 million into escrow.

More on price volatility – Pre-Closing Hedging

- A current issue in some deals (particularly those with P/E-backed Buyers) occurs when the Buyer wants to immediately hedge against price volatility upon execution, rather than waiting until Closing.
 - Might be required by the lenders to the P/E-backed Buyer, who prefer to cap their downside exposure (*i.e.*, they would rather take the risk that they don't close the acquisition or the risk that they hedge too much than the risk that hydrocarbon prices fall further than hedged)
 - Examples:
 - Anadarko's Marcellus \$1.24 billion sale to Alta Resources, Dec. 2016
 - Anadarko's \$2.3 billion Eagle Ford sale to Sanchez/Blackstone, Jan 2017
 - Also, lenders won't agree to "SunGard" provisions limiting their rights not to fund the acquisition by the Buyer unless the hydrocarbons to be acquired are hedged, banks won't provide the hedge to a Buyer that has not yet acquired hydrocarbons, and many Sellers will require "SunGard" provisions limiting the lenders' rights not to fund.
- This requires the Seller to enter into the Hedging Transaction prior to Closing and then assign the hedge to the Buyer.

More on price volatility – Pre-Closing Hedging (*cont'd*)

- Common components:
 - Parameters for the Hedging Transaction will be agreed upon and scheduled
 - Limited to specified Counterparties for the Hedging Transaction
 - The Hedging Transaction must permit Seller to assign the hedge to Buyer, and fully release Seller upon such assignment
 - If Hedging Transaction is terminated prior to Closing, Buyer must indemnify Seller for all Hedging Losses
 - Buyer may also have to provide security or other credit support for such indemnity
 - Should Buyer bear the Hedging Losses even if Closing does not occur due to Seller's breach?
 - In a “middle-of-the-road” PSA, the answer would be no.
 - In the current market, the answer seems to be yes.

Security Deposits and Remedies for Failure to Close

- Other than “sign-and-close” agreements in which the PSA is executed contemporaneously with Closing, virtually all PSA’s require the Buyer to put up a security deposit at the time of signing the PSA.
 - Commonly, the deposit ranges from 5-10% of the Purchase Price, although there are certainly plenty of outliers on both sides of this range.
- Even in agreements that a Seller might portray as “middle-of-the-road,” it is not uncommon for the Seller’s preliminary draft of the contract to provide for the deposit to be paid directly to the Seller.
- Most Sellers and their counsel, however, fully expect the Buyer to come back with a requirement that the deposit be held by a neutral third party escrow agent, and it is rare for a Seller to push back on such a provision.
- Knowing this, a Seller who wants to add credibility to its contention that it is offering up a middle-of-the-road PSA should consider providing for an escrow account in its first draft.
 - This is consistent with the criterion that the middle-of-the-road PSA should be one that the Seller would sign if it were a Buyer.

Security Deposits and Remedies for Failure to Close

- Obviously, if the transaction closes, the Deposit is applied as a credit against the amount the Buyer is required to pay at Closing.
- But what happens to the Deposit if the PSA is terminated without a Closing? Generally, the Deposit is refunded to the Buyer if the PSA is terminated without breach by Buyer.
 - The PSA should make clear that the Deposit amount is within the parameters of genuine liquidated damages and not an unenforceable penalty.
- A frequent point of negotiation concerns whether keeping the Deposit is the Seller's sole remedy. The most common approach is to treat the Deposit as a "termination fee" – that is, retaining the Deposit as liquidated damages is Seller's sole remedy.
- Price volatility has contributed to an increase in Sellers negotiating for alternative remedies – in particular, the right to enforce specific performance.
- This negotiation often goes hand-in-hand with the size of the Deposit.
 - For example, Seller may give up specific performance in exchange for Buyer agreeing to a higher deposit.

PSA termination due to Material Breach by Seller

- Sellers' starting PSA's often provide that the only remedy the Buyer has for Seller's breach and the termination caused thereby is the return of the Deposit.
- This is not "middle-of-the-road"!!
- Getting its own money back is clearly not a satisfactory remedy for the Buyer.
- The Buyer's remedy should deter the Seller from breaching and adequately compensate Buyer if the deal does not close due to Seller's material breach.
- At a minimum, Buyer should be entitled to specific performance.
- As an alternative to specific performance, Buyer should also be entitled to a "break-up" fee that at least covers its costs.

PSA termination due to Material Breach by Seller (*cont'd*)

- If specific performance is not available, an argument can be made that Buyer should be entitled to liquidated damages comparable to those that Seller has from retaining the Deposit. See Appendix D-1 for an example.
 - Recall that one of my “common attributes” of a “middle-of-the-road” PSA is, “It generally provides for reciprocal remedies, unless otherwise justified.”
 - An even-more buyer-friendly variation is to require the Seller to deposit the liquidated damages amount into escrow, just as the Buyer must fund the Deposit into escrow.
- A more seller-friendly alternative is to allow Buyer to recover actual damages (such as transaction costs and forfeited costs of Hedges put into place based on expectations of Closing), capped at the amount of the Deposit (or some smaller cap negotiated by the Seller). See Appendix D-2 for an example.

Reps and Warranties – Selected Issues

■ Knowledge-Qualified Reps and Warranties

- Some common issues of negotiation relate to reps and warranties that the Seller is willing to make but only if they are qualified by Seller's Knowledge. One issue is agreeing on those reps and warranties for which a knowledge-qualifier is appropriate.

■ Definition of "Knowledge"

- A very common issue is how "Knowledge" is defined and to what degree does it require any level of inquiry:
- Seller-friendly definition:

Knowledge – an individual will be deemed to have "Knowledge" of a particular fact or other matter if such individual is actually aware of such fact or other matter, **without any duty of inquiry**. Seller will be deemed to have "Knowledge" of a particular fact or other matter if any of the following individuals has Knowledge of such fact or other matter: _____
_____. Buyer will be deemed to have "Knowledge" of a particular fact or other matter if any of the following individuals has Knowledge of such fact or other matter: _____.

Reps and Warranties

- Buyer-friendly definition of “Seller’s Knowledge”:
 - “**Seller’s Knowledge**” – the actual or constructive knowledge, **after due investigation and inquiry of any officer of Seller or manager or supervisor of Seller having direct or indirect responsibility over the matter in question.** Without limitation of the foregoing, Seller shall be deemed to have “Knowledge” of anything contained in the Records.
- Middle-of-the road definition of “Knowledge”:
 - “**Knowledge**” – an individual will be deemed to have “Knowledge” of a particular fact or other matter if such individual is actually aware of such fact or other matter. Seller will be deemed to have “Knowledge” of a particular fact or other matter if any of the following individuals has Knowledge of such fact or other matter (**after reasonable inquiry of the managers of Seller with direct supervisory responsibility for the matters in question**): _____.
- If the Assets are completely non-operated, you can have a duty of inquiry to the Operator only, with the right to rely on whatever the Operator says without question.

Reps and Warranties – Selected Issues

Material Contracts Rep

- This rep forces Seller to schedule certain categories of material contracts, and typically to provide such contracts for Buyer to review prior to signing.
- Theory is that certain contracts are so material that Buyer deems their review to be critical to its decision to enter into a definitive agreement.
- Examples:
 - Contracts with any Affiliate of Seller that will not be terminated on or prior to Closing
 - Marketing Contracts that (A) are not cancelable without penalty to Seller on at least 120 days prior written notice, or (B) obligate Seller by virtue of any material take or pay payment, advance payment, production payment, or other similar material payment to deliver Hydrocarbons, or proceeds from the sale thereof, at some future time without receiving payment therefor at or after the time of delivery of such Hydrocarbons.
 - Any Contract to sell, lease, farmout, exchange, or otherwise dispose of any of the Properties after Closing, but excluding rights of reassignment upon intent to abandon any such Property
 - Contracts containing any area of mutual interest agreements or similar provisions

Reps and Warranties – Selected Issues

Material Contracts Examples (*cont'd*)

- JOA's, joint venture agreements, exploration/development agreements, surface use agreements, Contracts containing express unfulfilled obligations for Seller to drill additional wells, PSA's, farmin and farmout agreements, or similar agreements for which any terms remain executory and which materially affect any interest in the Properties
- All Contracts that provide for call upon or options to purchase production
- Water rights agreement, disposal agreements, or similar agreements relating to sourcing, transportation, or disposal of water
- Any Contract under which Seller is obligated to indemnify a third party
- Any Contract containing a most-favored nation clause
- Buyer will push for Seller to further represent that (a) it is in compliance with all Contracts, and (b) it has provided complete copies of the Material Contracts, including all amendments thereto.
 - For just one eye-opening example of the importance of both having this rep and reviewing all Material Contracts, and how an AMI provision buried in a long dormant JOA can blow up an acquisition, see *Anderson Energy Corp. v. Dominion Oklahoma Texas Exploration & Prod., Inc.*, 469 S.W.3d 280 (Tex. App.—San Antonio 2015, no pet.).

Title Defects – common sticky issues

- Sellers chipping away at the “record title” component of Defensible Title
 - A common example is to provide that Defensible Title may be “record *or beneficial* title”
 - Or, the definition may simply use the single word “title” without any reference to record title.
- Common example of Seller having good title but not having record ownership: Seller is a party to a JOA where a third party has gone ‘non-consent,’ resulting in Seller’s WI and NRI being increased, but no record assignment has been made (as is common).
 - The issue is prevailing against third-party BFP’s. An actual assignment is not necessary if a Memorandum of Operating Agreement has been recorded. This would be sufficient to charge third parties with notice of Seller’s contractual rights.
 - The Model Form has a Recording Supplement. Parties should use it.

Title Defects – common sticky issues

Record title requirement (*cont'd*)

- Another example of a collaborative solution is to provide an exception for not having record title if the contractual or beneficial title is properly recorded or otherwise properly evidenced in the records:
 - “Deducible of Record” means, with respect to the Company’s title and ownership of the LLC Assets, that such title and ownership by the Company is properly filed *or otherwise properly evidenced of record in the applicable county records in a manner sufficient for the Company’s title and ownership to be successfully defended if challenged.*
- In the speaker’s view, *the burden should be on the Seller to make sure it has record title.* It is in the Seller’s own interest to do so irrespective of any anticipated divestiture of the Assets.
- For more common Title Defect issues and solutions, see Appendix E.

Environmental Defects

Common issue – access and rights to do invasive testing

- Typical Seller draft gives Seller consent rights for a Phase II:
 - “Purchaser’s investigation and review shall be conducted in a manner that minimizes interference with the ownership or operation of the Assets or the business of Seller or co-owners thereof and Purchaser’s inspection right with respect to the environmental condition of the Assets shall be limited to conducting a Phase I Environmental Site Assessment in accordance with the American Society for Testing and Materials (A.S.T.M.) Standard Practice Environmental Site Assessments: Phase I Environmental Site Assessment Process (Publication Designation: E1527-13) (“**Phase I**”) or a similar visual assessment that does not include sampling or testing of any environmental media. *Purchaser shall not be entitled to conduct any Phase II Environmental Site Assessments similar to A.S.T.M. Standard Practice Environmental Site Assessments: Phase II Environmental Site Assessment Process (Publication Designation: E1903-11) (“Phase II”), or any other invasive or intrusive testing, or sampling on, or relating to the Assets without the prior written consent of Seller, such consent to be granted, conditioned, or withheld at the sole discretion of Seller.*”

Environmental Defects

Common issue – access and rights to do invasive testing (*cont'd*)

- A ‘middle-of-the-road’ draft qualifies the Seller’s consent rights, for example:
 - “Purchaser’s inspection right with respect to the environmental condition of the Assets shall be limited to conducting a Phase I or a similar visual assessment that does not include sampling or testing of any environmental media; *provided, however, that if Purchaser conducts a Phase I, and any written report prepared by a Third Party environmental consultant in connection with the Phase I recommends a Phase II, Purchaser may submit a written request to Seller to be allowed to conduct a Phase II. Such request may be granted or denied at the sole discretion of Seller, but if Seller denies such request, Purchaser shall have the right, but not the obligation, to exclude from this transaction the Asset or Assets for which the Phase II was recommended* by providing Seller a written notice to such effect at any time before the Defect Deadline, and at the Closing (A) *the Unadjusted Purchase Price shall be decreased by the Allocated Value of such excluded Assets*, (B) all such Assets shall be deemed to be excluded from the definition of Assets and from Exhibit A, (C) such Assets shall be deemed to constitute Excluded Assets set forth on Schedule 1.1(a), and (D) Purchaser shall have no rights or obligations hereunder with respect to such Excluded Assets.”

Thresholds, Deductibles, and Caps

- Usually not deal-killers but frequently land a spot on a Top 10 List of Material Issues.
- While primarily a business issue, issues with thresholds, deductibles, and caps require careful consideration of potential pitfalls and may need significant drafting of exceptions and limitations to avoid inequitable results as applied to particular facts.
- Sidebar: for an interesting (and amusing) blog on ideas to preempt deadlocks on terms that are quantitative in nature, see *Gaille, Scott, "Game of Thrones: Resolving Negotiation Impasses,"* Gaille Energy Blog Issue 22, April 18, 2016, at <https://gaillelaw.com/2016/04/18/game-of-thrones-resolving-negotiation-impasses-gaille-energy-blog-issue-22/>

Common Rationales for Thresholds and Deductibles

- Seller does not wish to be “nitpicked” over each and every small item
- Reduce transaction costs
- It makes little sense to waste both parties’ time on small matters
- Engineering evaluations, which Buyer probably used to determine what price to pay, are not completely precise.
- BUT: from the Buyer’s perspective, the bottom line is that thresholds and deductibles result in the potential for it to pay for something that it doesn’t get (in the case of title defects) or to incur liabilities for which it is not fully reimbursed (in the case of environmental claims and indemnities).
- Assuming that the Buyer agrees to thresholds and deductibles as “going with the territory,” what are some protections it should seek to avoid unjust outcomes from these provisions?

Appropriate Limitations on Title Thresholds and Deductibles

- If acquisition includes undeveloped acreage to which value is allocated:
 - If the allocation is based on a price-per-net-acre basis for undeveloped acreage, it is arguable that there should not be a threshold on the theory that the per-net acre amount should match, to the penny, the number of net acres Seller actually owns.
 - Richardson, Steven B., “Title Aspects of Purchase and Sale Agreements: Defects, Adjustment Mechanisms, and Remedies,” Oil & Gas Agreements: Purchase and Sale Agreements Paper 7, Page No. 7-21 (Rocky Mt. Min. L. Fdn. 2016)
 - Also recall that imprecision in engineering valuations is one of the oft-cited rationales for thresholds. This does not apply on undeveloped acreage valued at a pure price-per-net-acre.

Appropriate Limitations on Title Thresholds and Deductibles (cont'd)

- If acquisition includes undeveloped acreage to which value is allocated:
 - Consider the size of the Leases and the number of Leases covering small tracts of land
 - May negotiate for different thresholds for Wells and Leases
 - Further, may negotiate for a 2-tiered threshold formula for Leases
 - *E.g.*, if the threshold for Wells is \$25,000, the threshold for Leases could be “the lower of (a) \$25,000, or (b) 5% of the Allocated Value of the Lease.”
 - Seller might negotiate for a third tier to provide a floor: “the lower of (a) \$25,000, or (b) 5% of the Allocated Value of the Lease, but in no event less than \$5,000”
- Aggregation Per Property
 - Theory: Multiple small defects can have an impact > a single large defect
 - Example: Single Lease, represented to cover 100 net mineral acres in Blackacre. Two defects in lessor’s chain of title causing title failure to 10 net mineral acres each have same impact as one defect causing title failure to 20 net mineral acres.

Appropriate Limitations on Title Thresholds and Deductibles (*cont'd*)

- Aggregation Per Defect
 - Theory: If a single Title Defect affects multiple properties, the threshold should be measured against the overall impact of the threshold on all affected properties.
 - Examples
 - Price is allocated separately to leasehold and to existing wells on such leasehold
 - Seller's title varies among formations; price allocated separately to each formation
- Defects caused by the Seller should not be subject to thresholds and deductibles
 - Possibility of “gaming”
 - Seller should bear the risk of defects that result from its own actions / omissions
 - Similar conceptually to a special warranty of title

Sample Title Defect Threshold and Deductible Clause (no limits)

Notwithstanding the foregoing, there shall be no adjustment to the Purchase Price for any Title Defect for which the Title Defect Value does not exceed \$25,000 (the “**Title Defect Threshold**”). In addition, no adjustment to the Purchase Price for Title Defects shall be made until the aggregate sum of all Title Defect Values that exceed the Title Defect Threshold (the “**Aggregate Title Defect Value**”) exceeds 2% of the unadjusted Purchase Price (the “**Title Defect Deductible**”), after which the Purchase Price shall only be adjusted downward by the amount by which the Aggregate Title Defect Value exceeds the Title Defect Deductible.

Here is the same clause with limits

Notwithstanding the foregoing, there shall be no adjustment to the Purchase Price for any Title Defect (other than a Title Defect arising by, through, or under Seller, for which no threshold shall apply) for which the Title Defect Value does not exceed \$25,000 (the “**Title Defect Threshold**”). A Title Defect Value shall be deemed to exceed the Title Defect Threshold in either of the following cases: (x) if a Title Defect affects more than one Property, the aggregate sum of the Title Defect Values for all Properties affected by such Title Defect meets or exceeds the Title Defect Threshold, or (y) if any Property is affected by more than one Title Defect, the aggregate sum of the Title Defect Values for all Title Defects affecting such Property exceeds the Title Defect Threshold. In addition, no adjustment to the Purchase Price for Title Defects (other than Title Defects arising by, through, or under Seller, for which no deductible shall apply) shall be made until the aggregate sum of all Title Defect Values (including Title Defect Values that do not exceed the Title Defect Threshold) (the “**Aggregate Title Defect Value**”) exceeds 2% of the unadjusted Purchase Price (the “**Title Defect Deductible**”), after which the Purchase Price shall only be adjusted downward by the amount by which the Aggregate Title Defect Value exceeds the Title Defect Deductible.

Aggregation of Environmental Defect Values

An Environmental Defect Value shall be deemed to exceed the Environmental Defect Threshold in any of the following cases: (a) if an Environmental Defect affects more than one Property, the aggregate sum of the Environmental Defect Values for all Properties affected by such Environmental Defect exceeds the Environmental Defect Threshold, (b) if any Property is affected by more than one Environmental Defect, the aggregate sum of the Environmental Defect Values for all Environmental Defects affecting such Property exceeds the Environmental Defect Threshold, or (c) in the case of multiple violations of the same Applicable Environmental Law, whether or not affecting the same Property (such as, by way of example, multiple instances of soil staining or multiple instances of lack of required air permits or proof of air Permit-by-Rule qualification with the Texas Commission on Environmental Quality), the aggregate sum of the Environmental Defect Values for all such common Environmental Defects exceeds the Environmental Defect Threshold.

Should Defects below the Threshold count against the Deductible?

- Example: Purchase Price \$100 million; \$50K threshold, 2% Deductible
 - Total Title Defects = \$6 million, but the aggregate Title Defect Value of those Title Defects with Title Defect Values below \$50K is \$1.8 million.
- PSA provides: “there shall be no adjustment to the Purchase Price for any Title Defect for which the Title Defect Value does not exceed \$50,000 (the “**Title Defect Threshold**”). In addition, no adjustment to the Purchase Price for Title Defects shall be made until the aggregate sum of all Title Defect Values that exceed the Title Defect Threshold (the “**Aggregate Title Defect Value**”) exceeds 2% of the unadjusted Purchase Price (the “**Title Defect Deductible**”), after which the Purchase Price shall only be adjusted downward by the amount by which the Aggregate Title Defect Value exceeds the Title Defect Deductible.”
- Total downward adjustment = \$2.2 million (\$6MM - \$1.8MM - the \$2MM Deductible)
- In its effect on total Purchase Price, the aggregate Defect Value of all Defects that are below the Threshold operates as a second Deductible.

Should Defects below the Threshold count against the Deductible?

- Example: Purchase Price \$100 million; \$50K threshold, 2% Deductible
 - Total Title Defects = \$6 million, but the aggregate Title Defect Value of those Title Defects with Title Defect Values below \$50K is \$1.8 million.
- Now suppose the second sentence instead provides: “... In addition, no adjustment to the Purchase Price for Title Defects shall be made until the aggregate sum of all Title Defect Values (including Title Defect Values that do not exceed the Title Defect Threshold) (the “**Aggregate Title Defect Value**”) exceeds 2% of the unadjusted Purchase Price (the “**Title Defect Deductible**”), after which the Purchase Price shall only be adjusted downward by the amount by which the Aggregate Title Defect Value exceeds the Title Defect Deductible.”
- Total downward adjustment = \$4 million (\$6MM minus the \$2MM Deductible)
- One final idea to lessen the burden of the Title Defect Threshold is to count the aggregate of the Title Defect Values that fall below the Title Defect Threshold toward the Buyer’s total in the “walkaway” calculation.

Defect Deductible Issue – Properties that Get Kicked Out

- Often, the mechanics for handling asserted defects give the Seller the right to exclude entirely a property affected by an asserted title or environmental defect.
- In addition, assets may be excluded due to the exercise of preferential purchase rights or the failure to obtain required consents.
- Such assets are often referred to as “Retained Assets” (as distinguished from “Excluded Assets,” which were never a part of the deal in the first place).
- Generally, the Purchase Price is reduced by the full Allocated Value of the Retained Assets (without application of the Deductible).
- Since Retained Assets result in a smaller transaction, it seems logical that the collective Allocated Value of the Retained Assets should be deducted from the Purchase Price in calculating the Deductible.
- Example: “2% of the dollar amount calculated by subtracting the collective Allocated Value of all Retained Assets from the unadjusted Purchase Price.”

Combining Deductibles

- Having an aggregate deductible for Title and Environmental Defects is fairly common.
 - An aggregate deductible can be met through Title Defects, Environmental Defects, or any combination of the two.
 - Often results from compromise during negotiations
 - Example:
 - Seller proposes 2% Title Deductible and 2% Environmental Deductible
 - Buyer counters with 1% and 1%
 - The Parties settle on a 3% aggregate Title and Environmental Deductible
- Less common: Combining the Buyer's Indemnity Deductible with the Title and Environmental Defect Deductible
 - Theory: Limits the “worst-case scenario” for the Buyer.
 - Example: on a \$1 billion deal, a 3% deductible for Title and Environmental and a 3% deductible for indemnity claims exposes Buyer to paying up to \$60 million for nothing. Combining these into, say a 4% aggregate deductible limits this exposure to \$40 million

Example of Combined Deductible for Defects and Indemnities

■ Definitions:

- “Aggregate Defect Deductible” means 3% of the unadjusted Purchase Price.
- “Indemnity Deductible” means an amount equal to the difference between four percent (4%) of the unadjusted Purchase Price and the total amount of the Aggregate Defect Deductible that was actually applied to reduce the downward adjustment to the Purchase Price for Defects.

■ Examples of How this Operates:

- If the Aggregate Defect Value is 2.5% of the unadjusted Purchase Price, then there would be no downward Purchase Price adjustment for Defects, and the Indemnity Deductible would be (4%-2.5%), or 1.5% of the unadjusted Purchase Price.
- If the Aggregate Defect Value > 3% of the unadjusted Purchase Price, then the entire Aggregate Defect Deductible would be used in adjusting the Purchase Price, and the Indemnity Deductible would be (4%-3%), or 1% of the unadjusted Purchase Price.

Using Downward Adjustments for Defects to Reduce the Seller's Indemnity Cap

- These same concepts can be used to protect the Seller.
- How it works: To the extent there are downward Purchase Price adjustments for Title Defects and Environmental Defects, the total amount of such adjustments is applied to reduce the cap on Seller's indemnity cap.
 - Example:
 - Purchase Price = \$500 million
 - Indemnity Cap = 20% of the unadjusted Purchase Price (*i.e.*, \$100 MM)
 - Total Downward Adjustments for Defects = \$20 million
 - Indemnity Cap is reduced to \$80 million
- Theory: Seller has a bottom line price, below which it would choose not to do the deal
 - Under this theory, it might be expected that the cap would be the same as the walkaway threshold
- Note: Credits should exclude downward adjustments for Properties excluded from the Closing (such as Properties that fall out due to exercise of preferential purchase price or due to an election by Seller to retain a defected Property)

Selected Issue with Pre-Closing Covenants – Anti-sandbagging

- Anti-sandbagging provisions:
 - Requires each party to promptly notify the other party of the discovery of any fact or condition that would cause a representation of either party to be inaccurate, a representation or covenant of either party to be breached, a closing condition to be affected, etc.
 - “Last minute assertions that a party is walking the deal do not help bring any party to the table for an amicable resolution.”
 - Dobbs, Jolisa Melton and Villarreal, Debra J., “*Getting What You Paid For: Representations and Warranties*,” Oil and Gas Agreements: Purchase and Sale Agreements, Paper 10, Page No. 10-34 (Rocky Mt. Min. L. Fdn. 2016).
- In the speaker’s view, anti-sandbagging provisions are “middle-of-the-road.”

Liabilities Assumed by Buyer / Retained by Seller

- The allocation of liabilities relating to the Assets is a key element of the parties' evaluation of the deal and their decision as to whether to enter into a definitive agreement to formalize the contemplated transaction.
- “Understanding the nuances of allocating liabilities under a PSA and the intricacies involved in crafting the indemnification obligations contained in a PSA are two important ways that a practitioner can add value to a transaction involving an Oil & Gas PSA and protect his or her client's interests by minimizing the client's direct and indirect risk of, and exposure to, potential post-closing liabilities under the PSA.”
 - Szalkowski, Stephen C. and Jarvis, Talia G., “*Oil and Gas Purchase Agreements: Crafting Indemnification Provisions and Allocating Liabilities*,” *Oil and Gas Agreements: Purchase and Sale Agreements*, Paper 11, Page No. 11-2 (Rocky Mt. Min. L. Fdn. 2016).

Liabilities Assumed by Buyer / Retained by Seller

- To an outsider to the M&A arena, it may seem logical that a “middle-of-the-road” approach to allocation of liabilities would be a “my watch, your watch” structure in which the Seller retains all liabilities arising prior to the Effective Time and the Buyer assumes all liabilities arising from and after the Effective Time.
- In reality, however, it is generally understood in the industry that along with the Purchase Price, the elimination or substantial reduction of the Seller’s exposure to post-Closing liabilities is a very important consideration for most Sellers in their evaluation of the contemplated transaction.
- For the Seller, the ideal approach to allocation of liabilities is the “Buyer-take-all” structure in which the Buyer assumes all liabilities related to the Assets regardless whether arising before or after the Effective Time.

The “middle-of-the-road” approach to liability allocation

- The approach found in most PSA’s lies somewhere in between the “my watch, your watch” structure and the “Buyer-take-all” structure. In general, the Buyer will assume all liabilities related to the Assets, subject to four categories of qualifications:
 - Certain pre-Effective Time liabilities that are permanently retained by the Seller, commonly defined as “Retained Liabilities”;
 - Certain pre-Effective Time liabilities that, though officially assumed by the Buyer, are effectively partly retained by the Seller through an indemnification mechanism;
 - Reps and warranties made by the Seller relating to the condition of the Assets, which are also subject to limited post-Closing indemnification obligations by the Seller; and
 - Provisions for pre-Closing (and sometimes post-Closing) title and environmental due diligence by the Buyer, coupled with the rights to obtain downward adjustments to the Purchase Price for certain conditions identified by the Buyer and not remedied by the Seller.

Retained Liabilities – “Middle-of-the-road” Definition

- All liabilities and obligations related to the Assets and constituting:
 - royalty and working interest revenue payment obligations arising, incurred, or accrued prior to the Effective Time, other than with respect to the Suspense Funds actually received by Buyer
 - claims for nonpayment or incorrect payment of royalty and working interest payment obligations relating to periods prior to the Closing
 - liabilities relating to the disposal or transportation of any Hazardous Materials from the Assets attributable to the period of time prior to the Closing Date to any location not on the Assets
 - liabilities for personal injuries or death or Casualty Loss occurring on the Assets or in the operation thereof prior to the Closing Date
 - obligations arising from joint interest audits or Contract audits to the extent covering time periods prior to the Effective Time
 - all Property Costs allocable to Seller pursuant to [the accounting adjustments provisions]

Retained Liabilities – Limitations

- Many PSA's provide for certain limitations on the Seller's Retained Obligations. While perhaps not exactly "middle-of-the-road," these are not far from the center line.
- The most common variation is to shift these items to Assumed Liabilities, but subject to limited indemnification obligations by the Seller:
 - Survival periods
 - Seller's liability terminates at end of a negotiated period of time after Closing (except as to claims asserted by Buyer during the survival period)
 - Thresholds, Deductibles, and Caps
 - In addition to the time period limitation, Seller will negotiate for thresholds, deductibles, and caps in line with those it has negotiated for all other property-related indemnification obligations (such as for breaches of Non-Fundamental Reps and operational covenants)
 - In the speaker's experience, most Buyers will be more resistant to thresholds, deductibles, and caps than they are to the survival period concept.

Thanks for your attention.....

Don't harass me, can't you tell
I'm going home, I'm tired as hell
I'm not the cat I used to be
I got a kid, I'm thirty-three
Baby, get in the road
Come on now
In the middle of the road
Yeah

- *"Middle of the Road"*

Chrissie Hynde,

The Pretenders, 1984

*Many thanks to these colleagues who assisted me with this presentation.
Stephen Boone, Niki Roberts, Sarah Schultz, and David Sweeney.*

Appendix A: “Baseball Arbitration”

- Deters the parties from taking extreme positions; assuages concerns about including language with subjective standards. (“Keeps the parties honest.”)
- Global baseball arbitration provision:
 - Each Party shall submit to the Title Expert such Party’s written description of the proposed resolution of the Disputed Title Matters, together with any relevant supporting materials. **The Title Expert’s decision with respect to the Disputed Title Matters shall be limited to the selection of the proposal for the resolution of the aggregate Disputed Title Matters proposed by a Party that best reflects the terms and provisions of this Agreement.**
- Matter-by-matter provision:
 - Each Party shall submit to the Title Expert such Party’s written description of the proposed resolution of the Disputed Title Matters, together with any relevant supporting materials. **The Title Expert’s decision with respect to each Title Defect and each Title Benefit constituting part of the Disputed Title Matters shall be limited to the selection of the proposal for the resolution of each such Title Defect or Title Benefit, as applicable, proposed by a Party that best reflects the terms and provisions of this Agreement.**

Appendix B

Sample Solvency / Fair Value Rep (from a 2016 Bakken deal)

- There are no bankruptcy, reorganization, arrangement or receivership Proceedings pending, being contemplated by or, to Seller's Knowledge, threatened against Seller.
- Seller is not now insolvent and will not be rendered insolvent by [the transaction]. As used herein, "insolvent" means that the sum of Seller's debts and other probable liabilities exceeds the present fair saleable value of Seller's assets.
- Immediately after giving effect to the [transaction], Seller will not have unreasonably small capital with which to conduct its present or proposed business and will have assets (calculated at fair market value) that exceed its liabilities.
- Buyer was selected after Seller conducted an arms-length marketing process designed to obtain the fair market value for the Assets.
- The marketing process included a competitive auction process with offers received from multiple bidders.
- Seller believes in good faith that the offer of Buyer to Seller was the best offer obtained through such marketing process.
- Based upon the marketing process, Seller believes that the Purchase Price is a fair market value for the Properties.

Appendix C

Sample Structure for Security Provision for Buyer's Indemnity Obligations

- Negotiate the term of the obligation (typically 5-10 years to allow time for depletion and complete decommissioning of wells and platforms).
- Agree on a reasonable estimate, as of Closing, of the total cost of fulfilling the decommissioning obligations ("P&A Obligations") for the Assets ("P&A Estimate").
- Subtract from the P&A Estimate the amount of supplemental bonds related to the Leases that will have been posted by Buyer at Closing ("Aggregate Bond Amount").
- At Closing, Buyer issues and delivers to Seller a surety bond, naming Seller as beneficiary, in the amount of the excess of the P&A Estimate over the Aggregate Bond Amount ("Additional P&A Security").
- The Additional P&A Security shall be payable to Seller on demand to satisfy any claim against Seller arising from the P&A Obligations.

(Cont'd...)

Appendix C (cont'd)

Sample Structure for Security Provision for Buyer's Indemnity Obligations

- On an annual basis, re-determine the amount of the Additional P&A Security to take into account such factors as:
 - (1) Buyer's then current, updated, good faith estimate of the P&A Estimate;
 - (2) Changes in the Aggregate Bond Amount; and
 - (3) Any actual expenditures made by Buyer with respect to the P&A Obligations
- Provided, however, that (a) in no event shall the P&A Estimate as to any Lease ever be less than the then-current determination by the BOEM of the costs of P&A Obligations for such Lease, and (b) nor shall deferrals or waivers of supplemental bond requirements by the BOEM (or the acceptance by the BOEM of an abandonment trust account in lieu of supplemental bonds) operate to diminish Buyer's obligations.

Appendix D-1: Provision for liquidated damages to Buyer in the event of termination due to Seller's material breach

If (i) Buyer is entitled to terminate this Agreement under Section _____ and (ii) Buyer has performed or is ready, willing, and able to perform all of its agreements and covenants contained herein which are to be performed or observed at Closing, then Buyer, at its sole option, may elect to (A) be entitled to specific performance of the terms of this Agreement (plus the recovery from Seller of all costs and expenses, including reasonable attorneys' fees, incurred by Buyer in enforcing such right of specific performance) or (B) terminate this Agreement, in which case (x) the Parties shall promptly execute and deliver Joint Instructions instructing the Bank to disburse the entirety of the Deposit to Buyer, and (y) Buyer shall be entitled to recover liquidated damages from Seller in an amount equal to the Deposit (it being understood by the Parties that such limitation is in addition to, and not in lieu of, the obligation of Seller to instruct the Bank to return the entirety of the Deposit to Buyer as required hereunder). THE PARTIES HEREBY ACKNOWLEDGE THAT THE EXTENT OF DAMAGES TO BUYER OCCASIONED BY THE FAILURE OF THIS TRANSACTION TO BE CONSUMMATED WOULD BE IMPOSSIBLE OR EXTREMELY DIFFICULT TO DETERMINE AND THAT THE AMOUNT OF THE DEPOSIT IS A FAIR AND REASONABLE ESTIMATE OF SUCH DAMAGES UNDER THE CIRCUMSTANCES AND DOES NOT CONSTITUTE A PENALTY.

Appendix D-2: Provision for actual damages to Buyer in the event of termination due to Seller's material breach

If Buyer is entitled to terminate this Agreement under Section ___ and Buyer has performed or is ready, willing and able to perform all of its agreements and covenants contained herein which are to be performed or observed at Closing, then Buyer, at its sole option, (A) shall be entitled to specific performance of the terms of this Agreement in lieu of termination (plus the recovery from Seller of all costs and expenses, including reasonable attorneys' fees, incurred by Buyer in enforcing such right of specific performance) or (B) may terminate this Agreement pursuant to Section ___, in which case (i) the Parties shall promptly execute and deliver Joint Instructions instructing the Bank to disburse the entirety of the Deposit to Buyer, and (ii) Buyer shall be entitled to all actual damages which Buyer is legally entitled at law or equity by virtue of such material breach or failure by Seller, provided that Buyer may not recover amounts in excess of an amount equal to five percent (5%) of the Base Purchase Price (it being understood by the Parties that such amount is in addition to, and not in lieu of, the obligation of Seller to instruct the Bank to return the entirety of the Deposit to Buyer as required hereunder).

Appendix E: Title Defects

Common issues (*cont'd*)

- Pushing the boundaries of the definition of “Permitted Encumbrances” and carveouts to the definition of “Title Defects”
- Onerous requirements for Defect Notices that set the Buyer up to an unwarranted waiver claim:
 - Usually, the issue is the standard for the required supporting documentation
 - In order to be a valid Defect Notice as to each alleged Defect, each such notice shall be in writing and must include:
 - a description of the alleged Defect;
 - the Oil and Gas Property subject to such Defect;
 - the Allocated Value of each Oil and Gas Property subject to the alleged Defect;
 - Purchaser’s good faith reasonable estimate of the Defect Amount attributable to such Defect and the computations and information upon which Purchaser’s estimate is based; and
 - Supporting documents reasonably necessary for Seller or its counsel *to verify the existence of* the Title Defect.

Appendix E: Title Defects

Common issues (*cont'd*)

- The waiver claim is then set up by language providing that any Defects as to which Buyer does not provide notice by the Defect Deadline using a form of Notice that meets all of the requirements set forth for a Defect Notice shall be forever waived:
 - **PURCHASER SHALL BE DEEMED TO HAVE WAIVED AND RELEASED, AND COVENANTS THAT IT SHALL WAIVE AND RELEASE, ANY AND ALL DEFECTS (AND ANY ADJUSTMENTS TO THE UNADJUSTED PURCHASE PRICE ATTRIBUTABLE THERETO) FOR WHICH SELLER HAS NOT RECEIVED ON OR BEFORE THE APPLICABLE DEFECT DEADLINE A VALID DEFECT NOTICE.**
- A well-advised Buyer might propose to modify this language as follows:
 - **PURCHASER SHALL BE DEEMED TO HAVE WAIVED AND RELEASED, AND COVENANTS THAT IT SHALL WAIVE AND RELEASE, ANY AND ALL DEFECTS (AND ANY ADJUSTMENTS TO THE UNADJUSTED PURCHASE PRICE ATTRIBUTABLE THERETO) FOR WHICH SELLER HAS NOT RECEIVED ON OR BEFORE THE APPLICABLE DEFECT DEADLINE A VALID DEFECT NOTICE; PROVIDED, HOWEVER, THAT, NOTWITHSTANDING ANYTHING HEREIN TO THE CONTRARY, AN ALLEGED FAILURE TO COMPLY WITH SUBSECTIONS [] ABOVE SHALL NOT CAUSE ANY SUCH NOTICE TO BE INVALID OR ANY DEFECT TO BE WAIVED IF THE DEFECT NOTICE IS REASONABLY SUFFICIENT TO PROVIDE NOTICE TO SELLER OF THE EXISTENCE AND GENERAL NATURE OF THE ALLEGED DEFECT.**

Appendix E: Title Defects

Common issues (*cont'd*)

- Another approach is to include a “substantial compliance” qualifier for the supporting documents component, with the right to supplement to supporting documents:
 - “To be effective, each Title Defect Notice shall be in writing and include (i) a specific description of the alleged Title Defect(s), (ii) the Leases affected, (iii) supporting documents reasonably necessary for Sellers’ counsel to verify the existence of the alleged Title Defect(s), (iv) the amount by which Buyer reasonably believes in good faith the Allocated Value(s) of the affected Lease(s) are reduced by the alleged Title Defect(s) (the “Title Defect Value”), and (v) the computations upon which Buyer’s belief is based; *provided, that substantial compliance with the obligations under clause (iii) of this section prior to the Defect Notice Date (followed by prompt delivery of all remaining supporting documents reasonably necessary for Sellers’ counsel to verify the existence of the alleged Title Defect(s)) shall satisfy the requirements thereunder.*”

Appendix E: Title Defects

Common issues (*cont'd*)

- Issues with the intricacies of the special warranty are commonly the subject of engaging negotiations between the lawyers (and often avoided by the business folks).
- Common issues include:
 - Defining just what the Seller is warranting (*i.e.*, should it be tied to the definition of “Defensible Title”?)
 - Limits on the scope of the special warranty proposed by the Seller.
- These issues have been discussed in many speeches and articles, including:
 - Gibson, Martin, *"The Perils of Quitclaims, State Bar of Texas Oil, Gas & Energy Resources Law Section, Advanced Oil & Gas Seminar, Houston, September 16–17, 2010.*
 - Richardson, Steven B., “Title Aspects of Purchase and Sale Agreements: Defects, Adjustment Mechanisms, and Remedies,” *Oil & Gas Agreements: Purchase and Sale Agreements Paper 7, Page No. 7-21 (Rocky Mt. Min. L. Fdn. 2016).*

Appendix E

Special Warranty of Title Issues

- Special Warranty of Title
 - Should it be a special warranty of “Defensible Title”?
 - Issue: If the transaction includes all (or some specified undivided percentage) of the Seller’s interest in the Assets, the Buyer must make sure that the warranty is somehow tied to specified interests.
 - **A warranty of title with respect to a conveyance of merely all or a specified portion of the Seller’s interest in an Asset is essentially meaningless.** It is impossible to breach a warranty limited to what the Seller owns.
 - Tying the special warranty to Defensible Title also benefits the Seller:
 - There are generally multiple limitations incorporated within the definition of Defensible Title such as Permitted Encumbrances, and the definition limits the interests being warranted to only those set forth on the schedules.
 - There are a handful of cases on this issue, but they have unique fact patterns and inconsistent holdings.

Appendix E

Special Warranty of Title Issues (*cont'd*)

■ Special Warranty of Title (*cont'd*)

- Many “pro-Seller” PSA’s propose various limits on the special warranty, including:
 - Inserting a survival period for the special warranty
 - The risk to which a term limit on the special warranty exposes the Buyer to risk depends in part on the applicable state “race/notice” law.
 - Texas is a “pure notice” jurisdiction, rather than a “race” or “race-notice” jurisdiction, pursuant to applicable statute and related case law. Therefore, an assignee will trump previous assignees of the same interest in the event of multiple conveyances by a particular assignor (i.e. the type of matter that would be covered under a special warranty of title covenant) to the extent the subsequent assignee paid value for such interests, in good faith and without actual or constructive knowledge of the previous conveyance, regardless of which assignee ultimately records first so long as the first assignee doesn’t record prior to the subsequent assignee’s conveyance.
 - See Tex. Prop. Code 13.001, *Stahl v. Westerman*, 250 S.W.2d 325 (Tex. App. – San Antonio 1952, no writ).

Appendix E

Special Warranty of Title Issues (*cont'd*)

- Special Warranty of Title (*cont'd*)
 - Notice may be actual or constructive, with all persons being put on constructive notice of an instrument properly recorded in the chain of title. *Westland Oil Development Corp. v. Gulf Oil Corp.*, 637 S.W.2d 903 (Tex. 1982).
- Some other states' recording statutes are as follows:
 - Race (recording is the determining factor in resolving dispute between conflicting assignees): Arkansas and Louisiana
 - Notice: Kansas, New Mexico and West Virginia
 - Race-Notice (same as Texas but subsequent assignee must ultimately record first to prevail): Colorado, Montana, North Dakota, Oklahoma, Pennsylvania, West Virginia, Wyoming, others

Appendix E

Special Warranty of Title Issues (*cont'd*)

■ Special Warranty of Title (*cont'd*)

- Another common limit that some Seller PSA's propose is to cap the Seller's liability for breach of the special warranty at the Allocated Value of the applicable property:
 - Note: in Texas and many other producing states, this is what the law is anyway. See, e.g., *Tarrant v. Schulz*, 441 S.W.2d 868 (Tex. Civ. App. – Hous. [14th Dist.] 1969, *ref. n.r.e.*), wherein the Court held that a grantor under a general warranty deed “becomes liable, if title fails, for the amount of the consideration paid to him,” citing earlier precedent holding “[i]n cases where only a part is lost, the rule is modified so as to allow a recovery of such an amount as bears the same ratio to the total consideration as the value of the land lost bore to the value of the whole tract or tracts at the date of the warranty.” *Wiggins v. Stephens*, 246 S.W. 84 (Tex. Com. App., 1922, judgment adopted). Similar holdings can be found in Oklahoma, Louisiana, Colorado and other jurisdictions.
- Notwithstanding the foregoing, in the speaker's view, in a “middle-of-the-road” PSA, there should be few, if any, limits on the special warranty. Since it is limited to matters arising by, through, and under the Seller, the risk for special warranty claims should remain with the Seller.

Appendix F :Common components of a “middle-of-the-road PSA” (usually little controversy)

There are numerous components of PSA's that I believe most practitioners would agree are “middle-of-the-road.”

- What is being bought and sold, and what is excluded
 - The PSA should describe in specific detail the Assets and the Excluded Assets
- Purchase Price and Effective Time
 - Usually (but not always) the Buyer pays a Performance Deposit
 - Accounting adjustments are made to the Purchase Price to account for costs and revenues incurred between the Effective Time and the Closing Date
- Reps and Warranties
 - Both Parties make certain fundamental reps
 - **Organization and Existence** – [Seller/Buyer] is duly formed and validly existing under the laws of the state of its organization.
 - **Power and Authority** –[Seller/Buyer] has authority under its organizational documents to execute the PSA and all other transaction documents, and that any necessary actions within the organization to approve the transaction have been taken.
 - **Valid and Binding Agreement** – the PSA and all other transaction documents will be binding and enforceable against the [Seller/Buyer]
 - **Non-Contravention** – the contemplated transactions will not violate any agreement or law to which the [Seller or any Asset][Buyer] is subject.

Appendix F: Common components (usually little controversy) (*cont'd*)

- Reps and Warranties (*cont'd*)
 - Seller makes multiple reps about the Assets
 - Common Seller reps:
 - No pending litigation (unless scheduled)
 - Consents/Pref Rights (scheduled)
 - No broker's fees
 - Taxes
 - Material Contracts (scheduled)
 - Capital Expenditure Commitments (scheduled)
 - Compliance with Leases
 - Payout Status (scheduled)
 - Suspense Funds (scheduled)
 - Status of Wells and Equipment
 - Including P&A status
 - Subject to some exceptions, these generally do not include reps regarding the sufficiency of Seller's title or the environmental condition of the Properties

Appendix F: Common components (usually little controversy) (cont'd)

- Seller's Title, Environmental Condition of the Properties
 - Generally, there is a pre-closing period for the Buyer to examine title and conduct an environmental review, with resulting Purchase Price adjustments to account for defects in either the Seller's title or for violations of environmental laws.
 - These mechanics usually provide for an opportunity for Seller to cure / remediate.
- Pre-Closing Covenants
 - Pre-closing covenants are generally included to cause the parties to:
 - take such actions as are necessary to preserve their respective expectations with respect to the transaction;
 - not take actions that would not preserve such expectations; and
 - take certain actions to facilitate the Closing of the transaction.

Appendix F: Common components (usually little controversy) (cont'd)

Seller's Operator Covenants

- **Affirmative Covenants.** Typically, Seller will covenant to do the following:
 - Make the Assets and all relevant files and records available for review by Buyer, and make Seller's relevant personnel and agents available for assistance with Buyer's due diligence inquiries;
 - Conduct its business relating to the Assets in the ordinary course;
 - Maintain the equipment in good condition;
 - Preserve in force all leases and contracts;
 - Keep Buyer reasonably informed of all current and proposed activities relating to the Assets; and/or
 - Assist with the selection of Buyer as successor Operator of the Assets.
- **Negative Covenants.** Typically, Seller will covenant NOT to do the following, without Buyer's consent:
 - Mortgage, burden, or otherwise encumber any Asset;
 - Propose or commit to any material capital expenditures; or
 - Go "nonconsent" in any operations proposed by third parties.

Appendix F: Common components (usually little controversy) (*cont'd*)

- Closing Conditions
 - Accuracy of Representations
 - The representations and warranties of the other party must have been accurate in all material respects when made, and must still be accurate in all material respects.
 - Performance
 - All of the covenants and obligations that the other party is required to perform or to comply with pursuant to the PSA at or prior to the Closing.
 - No proceedings/orders
 - There must not be any actual or threatened litigation, investigation, hearing, audit, etc., seeking to restrain, enjoin, or otherwise prohibit, or to recover material damages on account of, the transaction.
 - Likewise, there must not be any governmental order restraining, enjoining, or otherwise prohibiting the consummation of the transaction.

Appendix F: Common components (usually little controversy) (*cont'd*)

- Closing Conditions (*cont'd*)
 - Certain Downward Adjustments (“Walkaway”)
 - A “walkaway” provision allows a party to terminate the transaction if the aggregate amount of certain downward Purchase Price adjustments exceeds some specified amount, usually stated as a percentage of the unadjusted Purchase Price.
 - Generally, the following may count: the Aggregate Title Defect Value (net of Title Benefits), the Aggregate Environmental Defect Value, the aggregate value of Assets requiring consent to assign for which a consent has not been obtained by the Closing Date; the Aggregate value of Assets removed due to the exercise of pref rights (Buyer only), and the aggregate amount of casualty and condemnation losses.
 - Others
 - Other, deal-specific conditions to Closing are often included. For example, if the Assets are subject to a mortgage that is not being assumed by the Buyer, the Buyer will require the release of the mortgage as a condition to Closing.

Appendix F: Common components (usually little controversy) (cont'd)

■ Assumed and Retained Liabilities

- The Buyer almost always assumes liabilities for all matters arising after the Effective Time.
- Almost always, the Buyer assumes all liability for arising from the environmental condition of the Assets – regardless whether arising before or after the Effective Time.
- Generally, but with some exceptions and limits, the Seller retains responsibility for liabilities arising before the Effective Time (other than environmental).
 - The exceptions and limitations to the Seller's Retained Liabilities vary from deal to deal and are addressed later in this presentation.

Appendix F: Common components (usually little controversy) (*cont'd*)

■ Indemnities

- Generally, the Buyer indemnifies the Seller for the Assumed Liabilities, damages arising from Buyer's access, and damages arising from breaches of Buyer's reps and covenants.
- Generally, the Seller indemnifies the Buyer for the Retained Liabilities, and for damages arising from breaches of Seller's reps and covenants.
- However, there are many exceptions and limits on the parties' (particularly Seller's) indemnification obligations (such as thresholds, deductibles, caps, and survival periods) that are heavily negotiated in nearly every deal.